

Solutions Manual to Accompany
Introduction to
Financial Accounting

Based on International
Financial Reporting Standards

Third Edition (v. 3.1)

Prepared by David Annand

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**Based on International Financial Reporting
Standards**

David Annand

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Latest version available at <http://business.athabascau.ca/faculty/david-annand-edd/>

Please forward suggested changes to davida@athabascau.ca.

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CHAPTER ONE

Introduction to Financial Accounting

Concept Self-check

1. Managerial accounting serves the decision-making needs of internal users. Financial accounting focuses on external reporting and meeting the needs of users like creditors and shareholders.
2. Business organizations sell products and services for profit. A non-business organization exists to meet various societal needs and does not have profit as a goal. Examples of non-business organizations are churches, mosques, and hospitals.
3. There are three common forms of business organizations—a proprietorship, a partnership, and a corporation. A proprietorship is a business owned by one person. A partnership is a business owned by two or more individuals. A corporation is a business owned by one or more shareholders.
4. A corporation that sells its shares publicly, typically on a stock exchange, is called a publicly accountable enterprise (PAE). A corporation that holds its shares privately is known as a private enterprise (PE). Its shares are generally held by only one or a few individuals who are often related.
5. Limited liability means that the shareholders of a corporation are not responsible for the corporation's debts. The most that shareholders can lose is what they invested in the corporation.
6. Generally accepted accounting principles (GAAP) refer to the guidelines for financial accounting used in any given jurisdiction. They include the standards and common, agreed practices that accountants follow in recording and summarizing financial information, and in the preparation of financial statements.

Concept Self-check continued

7. The six qualitative characteristics of GAAP are relevance, faithful representation, comparability, verifiability, timeliness, and understandability.
 - relevant information has the ability to make a difference in the decision-making process;
 - faithful representation means that information is complete, neutral, and free from error;
 - comparability tells users of the information that businesses utilize similar accounting practices;
 - verifiability means that others are able to confirm that the information accurately represents the economic activities of the business;
 - timely information is available to decision makers while it is still useful; and
 - understandable information is clear and concise.
8. Financial statements evaluate the performance of an entity and measure its progress. Financial information is collected, then summarised and reported in the financial statements (statement of financial position, income statement, statement of cash flows, and statement of changes in equity).
9. The purpose of the income statement is to communicate the inflow of assets, in the form of revenues, and the outflow or consumption of assets, in the form of expenses, *over a period of time*. Total inflows greater than total outflows creates net income or profit, which is reported on the income statement and in retained earnings in the shareholders' equity section of the statement of financial position. The purpose of the statement of financial position is to communicate what the entity owns (its *assets*), what the entity owes (its *liabilities*), and the difference between assets and liabilities (its *equity*) *at a point in time*.
10. Revenue is an increase in an entity's assets or a decrease in liabilities in return for services performed or goods sold, expressed in monetary units like dollars. An expense is an asset that is used up or obligations incurred in selling goods or performing services.
11. Net income is the difference between revenues and expenses. It is one measure of the success of the entity.
12. The statement of changes in equity shows why share capital and retained earnings have changed over a specified period of time – for instance, when shares are issued or net income is earned.
13. Shareholders' equity consists of share capital and retained earnings. Share capital represents how much shareholders have invested. Retained earnings is the sum of all net incomes earned (net of losses incurred) by a corporation over its life, less any distributions of these net incomes to shareholders.
14. Dividends are distributions of retained earnings to shareholders.

Concept Self-check continued

15. The statement of financial position consists of assets, liabilities, and shareholders' equity. Liabilities plus shareholders' equity always equal assets.
16. An asset is anything of value that is owned by the entity. Assets are economic resources controlled by an entity. They have some future value to the entity, usually for used generating revenue.
17. A liability is an obligation to pay an asset or to provide services or goods in the future. Until the obligations are paid, creditors have claims against the assets of the entity.

Shareholders' equity represents the amount of assets owing to the owners of the entity. The total assets of an entity belong either to the shareholders or to the creditors.

18. The statement of cash flows (SCF) explains how the cash reported on the statement of financial position changed over a period of time by detailing its sources and uses of cash. The income statement does not disclose all important activities of the entity involving cash that is shown on the SCF, like investment in long-lived assets or repayment of debt.
19. Notes to the financial statements provide greater detail about various amounts shown in the financial statements, or provide non-quantitative information that is useful to users, like loan repayment terms.
20. The double entry accounting system is used to record financial transactions. Each transaction affects at least two items in the accounting equation, in order to maintain its equality. For example,
 - a. Revenue is earned in cash: The asset Cash increases and Shareholders' Equity increases by the same amount. (Net income increases. This increases Retained Earnings, which is part of Shareholders' Equity.)
 - b. An obligation is paid: The liability Accounts Payable decreases and the asset Cash decreases by the same amount.
 - c. An amount owing from a customer is collected: The asset Cash increases and the asset Accounts Receivable decreases equally.

In this way, the accounting equation always remains in balance after each transaction is recorded.

21. Financial statements are prepared at regular intervals to keep a number of interested groups informed about the financial performance of a corporation. The timing is determined in response to the needs of management in running the entity or of outside parties, such as bankers and shareholders. These external users make lending or investing decision in part based on the financial statements.

Concept Self-check continued

22. The accounting equation takes the following form:

ASSETS	=	LIABILITIES	+	SHAREHOLDERS' EQUITY
(Economic resources owned by an entity)		(Creditors' claims to assets)		(Owners' claims to assets, or residual claims)

The entity has assets, which are the resources it owns. The total assets owned by an entity must always equal the total claims of creditors and owners, who have the residual claims.

23. The exchange of assets or obligations by a business entity, expressed in monetary terms like dollars, is called a financial transaction. The exchange of cash for land or a building is an example of such a transaction.

CP 1-1

A	=	L	+	+E	
<u>(+)</u>				<u>(+)</u>	Issued share capital for cash
<u>(+)(-)</u>					Purchased a truck for cash
<u>(+)</u>		<u>(+)</u>			Received a bank loan to pay for equipment
<u>(+)(-)</u>					Purchased the equipment for cash
<u>(+)(-)</u>					Made a deposit for electricity service to be provided in the future
<u>(-)</u>				<u>(-)</u>	Paid rent for the month just ended
	No Effect				Signed a new union contract that provides for increased wages in the future
	No Effect				Hired a messenger service to deliver letters during a mail strike
<u>(-)</u>				<u>(-)</u>	Received a parcel; paid the delivery service
<u>(+)</u>				<u>(+)</u>	Billed customers for services performed
<u>(-)</u>		<u>(-)</u>			Made a cash payment to satisfy an outstanding obligation
<u>(+)(-)</u>					Received a payment of cash in satisfaction of an amount owed by a customer
<u>(+)</u>				<u>(+)</u>	Collected cash from a customer for services rendered the same day
<u>(-)</u>				<u>(-)</u>	Paid cash for truck expenses (gas, oil, etc.)
<u>(-)</u>		<u>(-)</u>		<u>(-)</u>	Made a monthly payment on the bank loan; this payment included a payment on part of the loan and also an amount of interest expense. Shareholders' equity is affected because interest expense is incurred
		<u>(-)</u>		<u>(+)</u>	Issued shares in the company to pay off a loan
<u>(-)</u>				<u>(-)</u>	Paid a dividend with cash.

CP 1–2

- 1 Issued share capital for cash (+) Cash (+) Share Capital
- 5 Paid an account payable (-) Cash (-) Accounts Payable
- 2 Borrowed money from a bank (+) Cash (+) Bank Loan
- 3 Collected an account receivable (+) Cash (-) Accounts Receivable
- 1 Collected a commission on a sale made today (+) Cash (+) Revenue [or (+) Accounts Receivable (+) Revenue, then (+) Cash (-) Accounts Receivable if the sale is first recorded as an account receivable]
- 4 Paid for this month's advertising in a newspaper (-) Cash (-) Expense [or (+) Accounts Payable (-) Expense, then (-) Cash (-) Accounts Payable if the bill is first set up as an Accounts Payable]
- 2 Repaid money borrowed from a bank (-) Cash (-) Bank Loan
- X Signed a contract to purchase a computer NO EFFECT
- 6 Received a bill for supplies used during the month (+) Accounts Payable (-) Expense
- 3 Received a cash payment in satisfaction of an amount owed by a customer (+) Cash (-) Accounts Receivable
- 1 Sent a bill to a customer for repairs made today (+) Accounts Receivable (+) Revenue
- 3 Sold equipment for cash (+) Cash (-) Equipment
- 2 Purchased a truck on credit, to be paid in six months (+) Truck (+) Accounts Payable (or Loan)
- X Requested payment from a customer of an account receivable that is overdue NO EFFECT
- X Increased vacations for employees from four weeks to six weeks NO EFFECT
- 6 Recorded the amount due to the landlord as rent (+) Accounts Payable (-) Expense
- 6 Received the monthly telephone answering service bill (+) Accounts Payable (-) Expense

CP 1–3

ASSETS		=	LIABILITIES	+	SHAREHOLDERS' EQUITY	
Cash	+ Equipment	=	Accounts Payable	+	Share Capital	+ Retained Earnings
A. Retained earnings			= \$5,000 (3,000 + 8,000 - 4,000 - 2,000)			
B. Accounts payable			= \$3,000 (1,000 + 6,000 - 3,000 - 1,000)			
C. Cash			= \$1,000 (4,000 - 1,500 - 3,000 - 500)			
D. Retained earnings			= \$6,000 (6,000 + 7,000 - 3,000 - 4,000)			
E. Equipment			= \$3,500 (2,500-4,500-500-1,000)			

CP 1–4

ASSETS = LIABILITIES + SHAREHOLDERS' EQUITY

Shareholders' equity at Jan. 1 = \$10,000 (\$50,000 – 40,000)

Shareholders' equity at Dec. 31 = \$15,000 (\$35,000 – 20,000)

The increase in shareholders' equity during the year was \$5,000 (\$15,000-10,000). This must be the net income amount.

CP 1–5

- | | |
|------|-------|
| 1. L | 8. A |
| 2. A | 9. E |
| 3. L | 10. E |
| 4. A | 11. E |
| 5. A | 12. E |
| 6. E | 13. A |
| 7. L | 14. E |

CP 1–6

1.	ASSETS	=	Cash + Accounts receivable + Unused supplies + Land + Building + Equipment
		=	\$33,000 + \$82,000 + \$2,000 + \$25,000 + \$70,000 + \$30,000
		=	\$242,000
2.	LIABILITIES	=	Bank loan + Accounts payable
		=	\$15,000 + \$27,000
		=	\$42,000
3.	ASSETS	=	LIABILITIES + SHAREHOLDERS' EQUITY
	S/H EQUITY	=	\$242,000 - \$42,000
		=	\$200,000
		=	
	RET. EARN.	=	\$40,000 – 1,000
		=	\$39,000

Since shareholders' equity is \$200,000 and retained earnings is \$39,000, share capital must be \$161,000.

Income Statement
For the Month Ended January 31, 2019

<i>Revenue</i>		
Service fees		\$20,000
<i>Expenses</i>		
Insurance	\$1,500	
Miscellaneous	2,500	
Office Supplies	1,000	
Wages	<u>9,000</u>	
Total expenses		<u>14,000</u>
Net income		<u>\$ 6,000</u>

Statement of Changes in Equity
For the Month Ended January 31, 2019

	<i>Share capital</i>	<i>Retained earnings</i>	<i>Total equity</i>
Opening balance	\$-0-	\$ -0-	\$ -0-
Shares issued	4,000		4,000
Net income		6,000	6,000
Dividends	<u>-</u>	<u>(2,000)</u>	<u>(2,000)</u>
Ending balance	<u>\$4,000</u>	<u>\$4,000</u>	<u>\$8,000</u>

Statement of Financial Position
At January 31, 2019

<i>Assets</i>		
Cash		\$ 1,000
Accounts receivable		4,000
Merchandise inventory		<u>8,000</u>
Total assets		<u>\$13,000</u>
<i>Liabilities</i>		
Accounts payable		\$ 5,000
<i>Shareholders' Equity</i>		
Share capital	\$ 4,000	
Retained earnings	<u>4,000</u>	<u>8,000</u>
Total liabilities and shareholders' equity		<u>\$13,000</u>

Adams Ltd.
Income Statement
For the Month Ended January 31, 2019

<i>Revenue</i>		
Services		\$3,335
<i>Expenses</i>		
Rent	\$ 300	
Repairs	500	
Salaries	1,000	
Miscellaneous	<u>335</u>	
Total expenses		<u>2,135</u>
Net income		<u>\$1,200</u>

Adams Ltd.
Statement of Changes in Equity
For the Month Ended January 31, 2019

	<i>Share capital</i>	<i>Retained earnings</i>	<i>Total equity</i>
Opening balance	\$ -0-	\$ -0-	\$ -0-
Shares issued	3,000	-0-	3,000
Net income	-0-	1,200	1,200
Dividends	<u>-0-</u>	<u>(500)</u>	<u>(500)</u>
Ending balance	<u>\$3,000</u>	<u>\$ 700</u>	<u>\$3,700</u>

Adams Ltd.
Statement of Financial Position
At January 31, 2019

<i>Assets</i>		
Cash	\$1,000	
Land	1,000	
Building	<u>2,000</u>	
Total assets		<u>\$4,000</u>
<i>Liabilities</i>		
Accounts payable		\$ 300
<i>Shareholders' Equity</i>		
Share capital	\$3,000	
Retained earnings	<u>700</u>	
Total shareholders' equity		<u>3,700</u>
Total liabilities and shareholders' equity		<u>\$4,000</u>

CP 1-9

- a. Caldwell employs the principle of *materiality*. Even though the stapler is theoretically an asset, it would be expensed. Its small cost is not large or important enough to affect the judgement of a reasonably knowledgeable user about the financial results of the company.
- b. Fred Rozak follows the *business entity* principle, which states that each entity is an individual unit of accountability separate from its owners and from other entities.
- c. In accordance with the *historical cost* principle, the machine is recorded at cost even though its value may increase.
- d. Dollar amounts used to establish cost are assumed to be constant over time in accordance with the stable *monetary unit* principle.
- e. Hull Corporation accountants follow the *going concern* principle. Because the corporation is assumed to continue indefinitely, assets are not revalued at estimated disposal amounts.
- f. Investors of Spellman Corporation have benefitted from the application of the *consistency* principle.
- g. Senior managers of Looten Corporation are using the *full disclosure* principle in the company's financial statements.

P 1-1

Hill Chairs Inc.
Transactions Worksheet
At April 30, 2019

	ASSETS				=	LIABILITY	+	S/H EQUITY	
	Cash	+ Accounts Receivable	+ Prepaid Expense	+ Unused Supplies	=	Accounts Payable	+	Share Capital	+ Retained Earnings
Opening	1,400	3,600	1,000	350		2,000		4,350	
a.	+2,000	-2,000							
b.		+3,000							+3,000 Revenue
c.	-2,400								-300 Advertising expense
									-2,000 Salaries expense
									-100 Telephone expense
d.	-1,000					-1,000			
e.						+500			-500 Truck operating expense
f.	+2,500	-2,500							
g.		+1,500							+1,500 Revenue
h.			-500						-500 Rent expense
i.				-150					-150 Supplies expense
J.	+1,000							+1,000	
k.	-200								-200 Dividend
	<u>\$3,300</u>	<u>+ \$3,600</u>	<u>+ \$ 500</u>	<u>+ \$200</u>	=	<u>\$1,500</u>	<u>+ \$5,350</u>	<u>+ \$ 750</u>	
	<u>\$7,600</u>				=	<u>\$7,600</u>			
	ASSETS				=	LIABILITIES + S/H EQUITY			

P 1-2

1.

Larson Services Inc.
Transactions Worksheet
At August 31, 2019

		ASSETS					=	LIABILITIES			+	S/H EQUITY									
		Cash	+	Acct. Rec.	+	Ppd. Exp.	+	Unused Supplies	+	Truck	=	Bank Loan	+	Acct. Pay	+	Unearn. Revenue	+	Share Capital	+	Retained Earnings	
Aug.	1	+3,000																+3,000			
	1	+10,000										+10,000									
	1	-8,000								+8,000											
	4	-600				+\$600															
	5	+2,000														+2,000					
	7			+ 5,000															+5,000	Fees revenue	
	9	-250																	-250	Supplies	
	12							+500						+500							
	15	+1,000		-1,000																	
	16	-200																	-200	Advertising	
	20	-250												-250							
	25	-2,800																	-350	Rent expense	
																			-2,150	Supplies	
																			-50	Telephone	
																			-250	Truck operating	
28	No Effect																				
29				+4,500												-1,500			+6,000	Fees revenue	
31						-50													-50	Insurance	
31								-400											-400	Supplies	
		<u>\$3,900</u>	+	<u>\$8,500</u>	+	<u>\$550</u>	+	<u>\$100</u>	+	<u>\$8,000</u>	=	<u>\$10,000</u>	+	<u>\$250</u>		<u>\$500</u>		<u>\$3,000</u>	+	<u>\$7,300</u>	

P 1–2 continued

2.

Larson Services Inc. Income Statement For the Month Ended August 31, 2019			Larson Services Inc. Statement of Financial Position At August 31, 2019		
			<i>Assets</i>		
<i>Revenue</i>			Cash	\$3,900	
Fees		\$11,000	Accounts receivable	8,500	
			Prepaid expenses	550	
			Unused supplies	100	
			Truck	<u>8,000</u>	
			Total assets		<u>\$21,050</u>
<i>Expenses</i>			<i>Liabilities</i>		
Advertising	\$ 200		Bank loan	\$10,000	
Insurance	50		Accounts payable	250	
Rent	350		Unearned revenue	<u>500</u>	10,750
Salaries	2,150				
Supplies	650				
Telephone	50				
Truck operating	<u>250</u>				
Total expenses		<u>3,700</u>	<i>Shareholders' Equity</i>		
Net income		<u>\$7,300</u>	Share capital	3,000	
			Retained earnings	<u>7,300</u>	<u>10,300</u>
			Total liabilities and shareholders' equity		<u>\$21,050</u>

Larson Services Inc.
Statement of Changes in Equity
For the Month Ended August 31, 2019

	<i>Share capital</i>	<i>Retained earnings</i>	<i>Total equity</i>
Opening balance	\$ -0-	\$ -0-	\$ -0-
Shares issued	3,000	-0-	3,000
Net income	<u>-0-</u>	<u>7,300</u>	<u>7,300</u>
Ending balance	<u>\$3,000</u>	<u>\$7,300</u>	<u>\$10,300</u>

Dumont Inc. Income Statement For the Month Ended January 31, 2019			Dumont Inc. Statement of Financial Position At January 31, 2019		
			<i>Assets</i>		
<i>Revenue</i>			Cash	\$ 1,300	
Services		\$7,500	Accounts receivable	2,400	
			Prepaid expenses	550	
<i>Expenses</i>			Unused supplies	750	
Advertising	\$ 500		Truck	<u>9,000</u>	
Commissions	720		Total assets		<u>\$14,000</u>
Insurance	50				
Interest	80		<i>Liabilities</i>		
Rent	400		Bank loan	\$ 8,000	
Supplies	100		Accounts payable	<u>1,000</u>	9,000
Telephone	150				
Wages	<u>2,300</u>		<i>Shareholders' Equity</i>		
Total expenses		<u>4,300</u>	Share capital	2,000	
Net income		<u>\$3,200</u>	Retained earnings	<u>3,000</u>	<u>5,000</u>
			Total liabilities and shareholders' equity		<u>\$14,000</u>

Dumont Inc.
Statement of Changes in Equity
For the Month Ended January 31, 2019

	<i>Share capital</i>	<i>Retained earnings</i>	<i>Total equity</i>
Opening balance	\$ -0-	\$ -0-	\$ -0-
Shares issued	2,000	-0-	2,000
Net income	-0-	3,200	3,200
Dividends	<u>-0-</u>	<u>(200)</u>	<u>(200)</u>
Ending balance	<u>\$2,000</u>	<u>\$3,000</u>	<u>\$5,000</u>

P 1-4

Kenyon Services Corporation
Income Statement
For the Month Ended March 31, 2019

<i>Revenue</i>		
Fees		\$4,500
<i>Expenses</i>		
Advertising	\$ 300	
Equipment rental	500	
Insurance	400	
Interest	100	
Truck operating	700	
Wages	<u>1,500</u>	
Total expenses		<u>3,500</u>
Net income		<u>\$1,000</u>

Kenyon Services Corporation
Statement of Financial Position
At March 31, 2019

<i>Assets</i>		
Cash		\$3,100
Accounts receivable		3,900
Equipment		<u>5,000</u>
Total assets		<u>\$12,000</u>
<i>Liabilities</i>		
Accounts payable		\$ 9,000
<i>Shareholders' Equity</i>		
Share capital		2,000
Retained earnings		<u>1,000</u>
Total liabilities and shareholders' equity		<u>\$12,000</u>

Kenyon Services Corporation
Statement of Changes in Equity
For the Month Ended January 31, 2019

	<i>Share capital</i>	<i>Retained earnings</i>	<i>Total equity</i>
Opening balance	\$2,000	\$ -0-	\$2,000
Net income	<u>-0-</u>	<u>1,000</u>	<u>1,000</u>
Ending balance	<u>\$2,000</u>	<u>\$1,000</u>	<u>\$3,000</u>

P 1-5

1. It's hard to tell. The corporation's fiscal year-end is likely December 31. It started business on January 1. These are interim financial statements. Any year-end date is possible between September 1 and December 31 without knowing more information.
2. and 3.

Laberge Sheathing Inc. Income Statement For the Eighth Month Period Ended August 31, 2019			Laberge Sheathing Inc. Statement of Financial Position At August 31, 2019		
<i>Revenue</i>			<i>Assets</i>		
Services		\$6,000	Cash	\$	400
			Accounts receivable		3,800
			Unused supplies		100
			Equipment		<u>8,700</u>
			Total assets		<u>\$13,000</u>
<i>Expenses</i>			<i>Liabilities</i>		
Advertising	\$	300	Accounts payable		\$ 7,800
Interest		500	<i>Shareholders' Equity</i>		
Maintenance		475	Share capital		3,200
Supplies		125	Retained earnings		<u>2,000</u>
Wages		<u>2,000</u>	Total liabilities and shareholders' equity		<u>\$13,000</u>
Total expenses		<u>3,400</u>			
Net income		<u>\$2,600</u>			

Laberge Sheathing Inc.
Statement of Changes in Equity
For the Eighth Month Period Ended August 31, 2019

	<i>Share capital</i>	<i>Retained earnings</i>	<i>Total equity</i>
Opening balance	\$3,200	\$ -0-	\$3,200
Net income	-0-	2,600	2,600
Dividends	<u>-0-</u>	<u>(600)</u>	<u>(600)</u>
Ending balance	<u>\$3,200</u>	<u>\$2,000</u>	<u>\$5,200</u>

P 1-6

1.

McIntyre Builders Corporation
Transactions Worksheet
At March 31, 2019

ASSETS						=	LIABILITIES		+	EQUITY								
		Cash	+	Accts. Rec.	+	Ppd. Exp.	+	Unused Supplies	+	Equipment	=	Accounts Payable	+	Loan Payable	+	Share Capital	+	Ret. Earn.
Jun.	1	+8,000														+8,000		
	1									+5,000		+5,000						
	2	+600																+ 600 Reno rev
	3	-20																-20 Supplies
	4							+1,000				+1,000						
	5			+2,500													+2,500	Reno rev
	8	+500		-500														
	10	-2,500										-2,500						
	15			+1,000						-1,000								
	18	-1,000												-1,000				
	20											+100					-100	Util. exp.
	22	-600				+600												
	23	No Effect																
	25	+1,000		-1,000														
	27	-3,700																-150 Adv. exp. -50 Tel. exp. -1,000 Truck op. -2,500 Wages +2,000 Reno rev -300 Rent -850 Supplies -30 Dividend
	30			+2,000														
	30					-300												
	30							-850										
	30	-30																
		<u>\$2,250</u>	+	<u>\$4,000</u>	+	<u>\$300</u>	+	<u>\$ 150</u>	+	<u>\$4,000</u>	=	<u>\$1,600</u>		<u>\$1,000</u>	+	<u>\$8,000</u>	+	<u>\$100</u>
ASSETS											LIABILITIES + EQUITY =							
<u>=<u>\$10,700</u></u>											<u>\$10,700</u>							

P 1–6 continued

2.

McIntyre Builders Corporation Income Statement For the Month Ended June 30, 2019		McIntyre Builders Corporation Statement of Financial Position At June 30, 2019	
		<i>Assets</i>	
<i>Revenue</i>		Cash	\$ 2,250
Renovations	\$5,100	Accounts receivable	4,000
		Prepaid expenses	300
		Unused supplies	150
<i>Expenses</i>		Equipment	<u>4,000</u>
Advertising	\$ 150	Total assets	<u>\$10,700</u>
Rent	300		
Supplies	870		
Telephone	50		
Truck operating	1,000	<i>Liabilities</i>	
Utilities	100	Accounts payable	\$1,600
Wages	<u>2,500</u>	Loan payable	<u>1,000</u> 2,600
Total expenses	<u>4,970</u>		
		<i>Shareholders' Equity</i>	
Net income	<u>\$ 130</u>	Share capital	\$8,000
		Retained earnings	<u>100</u> <u>8,100</u>
		Total liabilities and shareholders' equity	<u>\$10,700</u>

McIntyre Builders Corporation
Statement of Changes in Equity
For the Month Ended June 30, 2019

	<i>Share capital</i>	<i>Retained earnings</i>	<i>Total equity</i>
Opening balance	\$ -0-	\$ -0-	\$ -0-
Shares issued	8,000	-0-	8,000
Net income	-0-	130	130
Dividends	<u>-0-</u>	<u>(30)</u>	<u>(30)</u>
Ending balance	<u>\$8,000</u>	<u>\$ 100</u>	<u>\$8,100</u>

P 1–7

- The land and the building cost \$30,000 in total. If one-third of the total cost is applied to land, then land is \$10,000 and building is \$20,000. Total assets then equal \$128,430. Since assets = liabilities, total shareholders' equity must equal \$100,577 (\$128,430 - 27,853). Since retained earnings equals \$1,000, share capital equals \$99,577 (\$100,577 - 1,000).

P 1-7 continued

2.

Clarke Limited
Transactions Worksheet
At October 31, 2019

		ASSETS										LIABILITIES		S/H EQUITY								
		Cash	+	Acct. Rec.	+	Un. Supp.	+	Land	+	Bldg.	+	Furn.	+	Equip.	+	Truck	=	Acct. Pay.	+	Loans Payable	+	Share Capital
Sep	30	14,215		+11,785		+1,220		+10,000		+20,000		+8,000		+60,000		+3,210	=	3,853		+25,000		+99,577
Oct	2	-110																-110				
	3	+670		-670																		
	4					+400												+400				
	8	+16,000																				+16,000
	10	+1,000		-1,000																		
	11	-2,000												+22,000				+20,000				
	15	-400																-400				
	20a.	-10,000																-10,000				
	20b.																	-10,000		+10,000		
	31	+300		-300																		
		<u>\$19,675</u>	+	<u>\$ 9,815</u>	+	<u>\$1,620</u>	+	<u>\$10,000</u>	+	<u>\$20,000</u>	+	<u>\$8,000</u>	+	<u>\$82,000</u>	+	<u>\$3,210</u>	=	<u>\$ 3,743</u>	+	<u>\$35,000</u>	+	<u>\$115,577</u>

CHAPTER TWO

The Accounting Process

Concept Self-check

1. An *account* is an accounting record designed to classify and accumulate the dollar effect of financial transactions. In a simplified account called a T-account, the term “debit” is used to describe the left side of the account, while the term “credit” refers to the right side.
2. A T-account shows increases and decreases in an account. It graphically illustrates how a general ledger account functions.
3. The left side of a T-account records debit entries and the right side records credit entries.
4. A chart of accounts is a list of all general ledger accounts used in a business, showing each account’s name and number. A common practice is to have the accounts arranged in a manner that is compatible with the order of their use in financial statements.
5. Increases in shareholders’ equity are recorded as a credit – for example, issuing share capital, or recording revenue.
6. Decreases in shareholders’ equity are recorded as a debit – for example, dividends or expenses are debits.
7.

<i>Assets, Expenses, Dividends</i>	<i>Liabilities, Share Capital, Revenues</i>
Increases are debited.	Increases are credited.
Decreases are credited.	Decreases are debited.
8. A trial balance is a list of each account contained in the general ledger of an entity, together with its individual debit or credit balance. It is prepared in order to establish the equality of debits with credits before the preparation of the financial statements
9. A trial balance shows the totals of each revenue and expense account that will appear on the income statement and the asset, liability, and shareholders’ equity balances that will appear on the statement of financial position, usually in the order these accounts appear in the statement of financial position and income statement.
10. A general journal is a chronological record of an entity’s financial transactions. It is often called a book of original entry because each transaction is recorded in the general journal first before it is posted to the entity’s accounts in the general ledger.

Concept Self-check continued

11. A general ledger is a book that contains the separate asset, liability, shareholders' equity, revenue, and expense accounts of an entity. It is often referred to as a *book of final entry* and it is prepared so that the balance of each account can be found easily at any time.
12. *Posting* consists of transferring debits and credits from the general journal to the appropriate general ledger accounts.
13. The steps in the accounting cycle are
 - a. Transactions are analysed and recorded.
 - b. Transactions are summarized by account.
 - c. The equality of debits with credits is established to ensure accuracy.
 - d. The summarized transactions are used to prepare the income statement, statement of financial position, and statement of changes in equity

CP 2–1

Transaction	Any Asset		Any Liability		Share Capital		Any Revenue		Any Expense	
	<i>Debit</i> <u>(increase)</u>	<i>Credit</i> <u>(decrease)</u>	<i>Debit</i> <u>(decrease)</u>	<i>Credit</i> <u>(increase)</u>	<i>Debit</i> <u>(decrease)</u>	<i>Credit</i> <u>(increase)</u>	<i>Debit</i> <u>(decrease)</u>	<i>Credit</i> <u>(increase)</u>	<i>Debit</i> <u>(increase)</u>	<i>Credit</i> <u>(decrease)</u>
(1)	X					X				
(2)	X	X								
(3)	X	X								
(4)	X			X						
(5)				X					X	
(6)	X							X		
(7)	X							X		
(8)		X	X							
(9)	X	X								
(10)		X	X							
(11)				X					X	
(12)		X	X							
(13)	X	X								

CP 2–2

$$\underline{\text{ASSETS}} = \underline{\text{LIABILITIES}} + \underline{\text{SHAREHOLDERS' EQUITY}}$$

Cash + Truck = Accounts Payable + Bank Loan + Share Capital + Net Income

- A. \$0 (100+200-50-75-175)
- B. \$122 (72+130-10-50-20)
- C. \$65 (71-5-25-100-6)
- D. \$139 (20+200-10-61-10)

CP 2–3

	Assets		=	Liabilities		+	S/H Equity	
	<i>Debit</i> (increase)	<i>Credit</i> (decrease)		<i>Debit</i> (decrease)	<i>Credit</i> (increase)		<i>Debit</i> (decrease)	<i>Credit</i> (increase)
2. Borrowed \$5,000 from the bank	5,000				5,000			
3. Paid \$2,000 of the bank loan		2,000		2,000				
4. Paid \$600 in advance for a one-year insurance policy	600	600						
5. Received \$500 in advance for next month's rental of office space.	500				500			

CP 2–4

	<i>Debit</i>	<i>Credit</i>
2. Purchased equipment on credit	Equipment	Accounts Payable
3. Paid for a one-year insurance policy	Prepaid Insurance	Cash
4. Billed a customer for repairs completed today	Accounts Receivable	Repair Revenue
5. Paid for this month's rent	Rent Expense	Cash
6. Collected the amount billed in transaction 4 above	Cash	Accounts Receivable
7. Collected cash for repairs completed today	Cash	Repair Revenue
8. Paid for the equipment purchased in transaction 2 above	Accounts Payable	Cash
9. Signed a union contract	n/a	
10. Collected cash for repairs to be made for customers next month	Cash	Unearned Revenue
11. Transferred this month's portion of prepaid insurance to expenses	Insurance Expense	Prepaid Rent

CP 2-5

Cash			
(1)	5,000	(2)	900
(5)	7,500	(8)	2,500
(6)	500	(10)	2,000

Bank Loan			
(8)	2,500	(5)	7,500

Share Capital			
		(1)	5,000

Repair Revenue			
		(3)	1,500

Accounts Receivable			
(3)	1,500	(6)	500

Accounts Payable			
(10)	2,000	(4)	2,000
		(7)	200

Electricity Expense			
(7)	200		

Prepaid Rent			
(2)	900	(11)	300

Rent Expense			
(11)	300		

Unused Supplies			
(4)	2,000	(9)	800

Supplies Expense			
(9)	800		

	<i>Debit</i>	<i>Credit</i>
1. Cash	3,000	
Share Capital		3,000
To record the issuance of share capital.		
2. Equipment	2,000	
Accounts Payable		2,000
To record the purchase of equipment on account.		
3.* Rent Expense	400	
Cash		400
To record the payment of rent for the month.		
4. Supplies	4,000	
Accounts Payable		4,000
To record the purchase of supplies.		
5. Accounts Receivable	2,500	
Repair Revenue		2,500
To record repair revenue.		
6. Accounts Payable	2,000	
Cash		2,000
To record the payment on account.		
7. Cash	500	
Accounts Receivable		500
To record collection of an amount owed.		
8. Cash	1,000	
Equipment		1,000
To record the sale of equipment.		
*Alternately, two entries could be made		
3. Prepaid Rent	400	
Cash		400
To record payment in advance of rent for the month.		
9. Rent Expense	400	
Prepaid Rent		400
To record rent expense for the month.		

CP 2-7

1. Cash
 Share Capital
 To record issuance of share capital.
2. Unused Supplies
 Cash
 Accounts Payable
 To record purchase of supplies not used immediately.
3. Cash
 Repair Revenue
 To record revenue earned.
4. Accounts Receivable
 Repair Revenue
 To record revenue earned.
5. Prepaid Expense
 Cash
 To record expense paid in advance.
6. Supplies Expense
 Accounts Payable
 To record bill received for supplies used immediately.
7. Electricity Expense
 Accounts Payable
 To record bill received for electricity used.
8. Supplies Expense
 Prepaid Expense
 To record use of supplies on hand.
9. Rent Expense
 Prepaid Rent
 To record rent for period.
10. Accounts Payable
 Cash
 To record payment of account payable.
11. Cash
 Bank Loan
 To record the receipt of a bank loan.

Cross Corporation
Trial Balance
At December 31, 2019

<i>Acct.</i> <i>No.</i> <i>Account Title</i>		<u><i>Account Balances</i></u>	
		<i>Debit</i>	<i>Credit</i>
101	Cash	\$120,400	
110	Accounts receivable	26,000	
173	Unused supplies	6,000	
180	Land	8,000	
181	Building	120,000	
201	Bank loan		\$80,000
210	Accounts payable		30,000
320	Share capital		170,000
420	Commissions earned		5,000
631	Insurance expense	100	
654	Rent expense	1,000	
656	Salaries expense	3,000	
668	Supplies expense	300	
669	Telephone expense	200	
		<u>\$285,000</u>	<u>\$285,000</u>
		Total Debits = Total Credits	

CP 2–9

1. March 2019	Schulte Corporation GENERAL JOURNAL			Page 1
	Description	PR	Debit	Credit
1	Cash	101	5	
	Share Capital	320		5
	To record issuance of share capital.			
2	Equipment	183	6	
	Cash	101		3
	Accounts Payable	210		3
	To record purchase of equipment for cash and on account.			
3	Prepaid Rent	162	2	
	Cash	101		2
	To record payment of rent in advance.			
15	Cash	101	4	
	Accounts Receivable	110	2	
	Service Revenue	470		6
	To record receipt of payments and billing of customers for work done.			
17	Cash	101	1	
	Equipment	183		1
	To record sale of equipment for cash.			
18	Supplies Expense	668	3	
	Accounts Payable	210		3
	To record purchase of supplies on account.			
24	Accounts Receivable	110	1	
	Service Revenue	470		1
	To record billing of client for work done.			
31	Rent Expense	654	1	
	Prepaid Rent	162		1
	To record write-off of rent expired for the month.			
31	Truck Operating Expense	670	2	
	Accounts Payable	210		2
	To record receipt of bill with respect to truck expenses incurred.			
31	Accounts Payable	210	1	
	Cash	101		1
	To record payment of account payable.			

CP 2-9 continued

2. Schulte Corporation

Cash		No. 101	
Mar. 1	5	Mar.2	3
15	4	3	2
17	<u>1</u>	31	<u>1</u>
	10		6
Bal.	4		

Accounts Receivable		No. 110	
Mar.15	2		
24	1		
Bal.	3		

Prepaid Rent		No. 162	
Mar. 3	2	Mar.31	1
Bal.	1		

Equipment		No. 183	
Mar. 2	6	Mar.17	1
Bal.	5		

Accounts Payable		No. 210	
Mar.31	1	Mar. 2	3
		18	3
		31	<u>2</u>
	<u>1</u>		8
		Bal.	7

Share Capital		No. 320	
		Mar.1	5

Service Revenue		No. 470	
		Mar.15	6
		24	1
		Bal.	7

Rent Expense		No. 654	
Mar.31	1		

Supplies Expense		No. 668	
Mar.18	3		

Truck Operating Expense		No. 670	
Mar.31	2		

CP 2–9 continued

3.

Schulte Corporation
Trial Balance
At March 31, 2019

	<u>Account Balances</u>	
	<i>Debit</i>	<i>Credit</i>
Cash	\$ 4	
Accounts receivable	3	
Prepaid rent	1	
Equipment	5	
Accounts payable		\$ 7
Share capital		5
Service revenue		7
Rent expense	1	
Supplies expense	3	
Truck operating expense	<u>2</u>	
	<u>\$19</u>	<u>\$19</u>

Total Debits = Total Credits

4.

Schulte Corporation
Income Statement
For the Month Ended March 31, 2019

<i>Revenue</i>		
Services		\$7
<i>Expenses</i>		
Rent	\$1	
Supplies	3	
Truck operating	<u>2</u>	
Total expenses		<u>6</u>
Net income		<u>\$1</u>

Schulte Corporation
Statement of Changes in Equity
For the Month Ended March 31, 2019

	<i>Share capital</i>	<i>Retained earnings</i>	<i>Total equity</i>
Opening balance	\$ -0-	\$ -0-	\$ -0-
Shares issued	5	-0-	5
Net income	<u>--0-</u>	<u>1</u>	<u>1</u>
Ending balance	<u>\$ 5</u>	<u>\$ 1</u>	<u>\$ 6</u>

CP 2–9 continued

Schulte Corporation
Statement of Financial Position
At March 31, 2019

Assets

Cash	\$ 4
Accounts receivable	3
Prepaid rent	1
Equipment	<u>5</u>
Total assets	<u>\$13</u>

Liabilities

Accounts payable	\$7
------------------	-----

Shareholders' Equity

Share capital	\$5	
Retained earnings	<u>1</u>	<u>6</u>
Total liabilities and shareholders' equity		<u>\$13</u>

CP 2–10

McQueen Corp.
Trial Balance
At December 31, 2019

<i>Acct.</i>		<u><i>Account Balances</i></u>	
<i>No.</i>	<i>Account Title</i>	<i>Debit</i>	<i>Credit</i>
101	Cash	\$ 15,500	
110	Accounts receivable	10,000	
161	Prepaid insurance	9,600	
162	Prepaid rent	8,000	
173	Unused supplies	2,800	
180	Land	12,000	
181	Building	50,000	
182	Furniture	6,000	
201	Bank loan		\$ 28,000
210	Accounts payable		13,250
320	Share capital		75,000
350	Dividends	<u>2,350</u>	<u>-</u>
		<u>\$116,250</u>	<u>\$116,250</u>

1.			<i>Debit</i>	<i>Credit</i>
Jun. 1	Cash		25,000	
	Share Capital			25,000
	To record the issuance of share capital.			
1	Rent Expense		500	
	Cash			500
	To record rent paid for the month.			
1	Prepaid Insurance		2,000	
	Cash			2,000
	To record payment of insurance, policy effective one year.			
15	Salaries Expense		1,000	
	Cash			1,000
	To record payment of salaries.			
20	Cash		5,000	
	Repair Revenue			5,000
	To record repair revenue earned.			
23	Unused Supplies		4,000	
	Cash			4,000
	To record the purchase of office supplies.			
27	Telephone Expense		100	
	Accounts Payable			100
	To record telephone expense.			
30	Salaries Expense		1,000	
	Cash			1,000
	To record the payment of salaries.			
30	Land		5,000	
	Building		15,000	
	Bank Loan			4,000
	Cash			16,000
	To record the purchase of land and building.			
30	Insurance Expense		200	
	Prepaid Insurance			200
	To record June insurance expense			
30	Accounts Receivable		3,000	
	Repair Revenue			3,000
	To record repair revenue earned.			
30	Supplies Expense		200	
	Unused Supplies			200
	To record office supplies used.			

2.

Collins Corporation
Trial Balance
June 30, 2019

<i>Account Title</i>	<u><i>Account Balances</i></u>	
	<i>Debit</i>	<i>Credit</i>
Cash	\$ 5,500	
Accounts receivable	3,000	
Prepaid insurance	1,800	
Unused supplies	3,800	
Land	5,000	
Building	15,000	
Bank loan		\$ 4,000
Accounts payable		100
Share capital		25,000
Repair revenue		8,000
Insurance expense	200	
Rent expense	500	
Salaries expense	2,000	
Supplies expense	200	
Telephone expense	100	
	<u>\$37,100</u>	<u>\$37,100</u>

3.

Collins Corporation
Income Statement
For the Month Ended June 30, 2019

<i>Revenue</i>		
Repairs		\$8,000
<i>Expenses</i>		
Insurance	\$ 200	
Rent	500	
Salaries	2,000	
Supplies	200	
Telephone	100	
Total Expenses		<u>3,000</u>
Net Income		<u>\$5,000</u>

Collins Corporation
Statement of Changes in Equity
For the Month Ended January 31, 2019

	<i>Share capital</i>	<i>Retained earnings</i>	<i>Total equity</i>
Opening balance	\$ -0-	\$ -0-	\$ -0-
Shares issued	25,000	0	25,000
Net income	<u>-0-</u>	<u>5,000</u>	<u>5,000</u>
Ending balance	<u>\$25,000</u>	<u>\$5,000</u>	<u>\$30,000</u>

Collins Corporation
Statement of Financial Position
At June 30, 2019

<i>Assets</i>		
Cash		\$5,500
Account receivable		3,000
Prepaid insurance		1,800
Unused supplies		3,800
Land		5,000
Building		<u>15,000</u>
Total assets		<u>\$34,100</u>
<i>Liabilities</i>		
Accounts payable	\$ 100	
Bank loan	<u>4,000</u>	4,100
<i>Shareholders' Equity</i>		
Share capital	25,000	
Retained earnings	<u>5,000</u>	<u>30,000</u>
Total liabilities and shareholders' equity		<u>\$34,100</u>

1.

Sabre Travels Inc.
Trial Balance
January 31, 2019

	<u>Account Balances</u>	
	<i>Debit</i>	<i>Credit</i>
Cash	\$ 60	
Accounts receivable	140	
Unused supplies	10	
Equipment	300	
Building	700	
Land	300	
Accounts payable		\$ 20
Bank loan		100
Share capital		250
Fees earned		1,875
Advertising expense	200	
Repairs expense	100	
Supplies expense	20	
Telephone expense	10	
Utilities expense	5	
Wages expense	<u>400</u>	
	<u>\$2,245</u>	<u>\$2,245</u>

2.

Sabre Travels Inc.
Income Statement
For the Year Ended January 31, 2019

Sabre Travels Inc.
Statement of Financial Position
At January 31, 2019

Revenue		Assets	
Fees earned	1,875	Cash	\$ 60
		Accounts receivable	140
		Unused supplies	10
		Equipment	300
		Building	700
		Land	<u>300</u>
		Total assets	<u>\$1,510</u>
Expenses		Liabilities	
Advertising	\$200	Accounts payable	\$ 20
Repairs	100	Bank loan	<u>100</u>
Supplies	20		
Telephone	10		
Utilities	5		
Wages	<u>400</u>		
Total expenses	<u>735</u>		120
		Shareholders' Equity	
		Share capital	250
Net income	<u>\$1,140</u>	Retained earnings	<u>1,140</u> <u>1,390</u>
		Total liabilities and shareholders' equity	<u>\$1,510</u>

Sabre Travels Inc.
Statement of Changes in Equity
For the Year Ended January 31, 2019

	<i>Share capital</i>	<i>Retained earnings</i>	<i>Total equity</i>
Opening balance	\$ 250	\$ -0-	\$ 250
Net income	<u>-0-</u>	<u>1,140</u>	<u>1,140</u>
Ending balance	<u>\$ 250</u>	<u>\$1,140</u>	<u>\$1,390</u>

CP 2-13

1. Elgert Corporation

Cash			
Jan. 1	10,000	Jan. 5	200
11	1,300	4	4,000
		30	1,800
		31	50
	<u>11,300</u>		<u>6,050</u>
Bal.	5,250		

Accounts Payable	
Jan. 28	450

Share Capital	
Jan. 1	10,000

Service Revenue		
Jan. 11	1,300	
31	<u>1,600</u>	
Bal.	2,900	

Accounts Receivable	
Jan. 31	1,600

Dividends	
Jan. 31	50

Rent Expense	
Jan. 5	200

Unused Supplies		
Jan. 9	4,000	Jan.31 200
Bal.	3,800	

Truck Operating Expense	
Jan. 28	450

Salaries Expense	
Jan. 30	1,800

Supplies Expense	
Jan. 31	200

CP 2–13 continued

2.

Elgert Corporation
Trial Balance
January 31, 2019

<i>Account Title</i>	<u><i>Accounts Balances</i></u>	
	<i>Debit</i>	<i>Credit</i>
Cash	\$ 5,250	
Accounts receivable	1,600	
Unused supplies	3,800	
Accounts payable		\$ 450
Share capital		10,000
Dividends	50	
Service revenue		2,900
Rent expense	200	
Truck operating expense	450	
Salaries expense	1,800	
Supplies expense	<u>200</u>	
	<u>\$13,350</u>	<u>\$13,350</u>

3.

Elgert Corporation
Income Statement
For the Month Ended January 31, 2019

<i>Revenue</i>		
Services		\$2,900
<i>Expenses</i>		
Rent	\$200	
Truck operating	450	
Salaries	1,800	
Supplies	<u>200</u>	
Total expenses		<u>2,650</u>
Net income		<u>\$ 250</u>

CP 2–13 continued

3. (continued)

Elgert Corporation
Statement of Changes in Equity
For the Month Ended January 31, 2019

	<i>Share capital</i>	<i>Retained earnings</i>	<i>Total equity</i>
Opening balance	\$ 0	\$ 0	\$ 0
Shares issued	10,000	0	10,000
Net income		250	250
Dividends	<u>0</u>	<u>(50)</u>	<u>(50)</u>
Ending balance	<u>\$10,000</u>	<u>\$ 200</u>	<u>\$10,200</u>

Elgert Corporation
Statement of Financial Position
At January 31, 2019

<i>Assets</i>	
Cash	\$ 5,250
Accounts receivable	1,600
Unused supplies	<u>3,800</u>
Total assets	<u>\$10,650</u>
<i>Liabilities</i>	
Accounts payable	\$450
<i>Shareholders' Equity</i>	
Share capital	\$10,000
Retained earnings	<u>200</u>
Total liabilities and shareholders' equity	<u>\$10,650</u>

1.

Fox Creek Service Limited
Trial Balance
At October 31, 2019

	<u>Account Balances</u>	
	<i>Debit</i>	<i>Credit</i>
Cash	\$ 1,000	
Accounts receivable	6,000	
Equipment	7,000	
Truck	9,000	
Bank loan		\$ 5,000
Accounts payable		9,000
Wages payable		1,500
Share capital		2,000
Repair revenue		19,000
Advertising expense	2,200	
Commissions expense	4,500	
Insurance expense	500	
Supplies expense	800	
Telephone expense	250	
Truck operating expense	1,250	
Wages expense	4,000	
	<u>\$36,500</u>	<u>\$36,500</u>

P 2–1 continued

2.

Fox Creek Service Limited
Statement of Changes in Equity
For the Year Ended October 31, 2019

	<i>Share capital</i>	<i>Retained earnings</i>	<i>Total equity</i>
Opening balance	\$ -0-	\$ -0-	\$ -0-
Shares issued	2,000	-0-	2,000
Net income	<u>-0-</u>	<u>5,500</u>	<u>5,500</u>
Ending balance	<u>\$2,000</u>	<u>\$5,500</u>	<u>\$7,500</u>

3.

Fox Creek Service Limited
Income Statement
For the Year Ended October 31, 2019

<i>Revenue</i>		
Repairs		\$19,000
<i>Expenses</i>		
Advertising	\$2,200	
Commissions	4,500	
Insurance	500	
Supplies	800	
Telephone	250	
Truck operating	1,250	
Wages	<u>4,000</u>	
Total expenses		<u>13,500</u>
Net income		<u>\$ 5,500</u>

Fox Creek Service Limited
Statement of Financial Position
At October 31, 2019

<i>Assets</i>	
Cash	\$ 1,000
Accounts receivable	6,000
Equipment	7,000
Truck	<u>9,000</u>
Total assets	<u>\$23,000</u>
<i>Liabilities</i>	
Bank loan	\$5,000
Accounts payable	9,000
Wages payable	<u>1,500</u>
	<u>15,500</u>
<i>Shareholders' Equity</i>	
Share capital	2,000
Retained earnings	<u>5,500</u>
	<u>7,500</u>
Total liabilities and shareholders' equity	<u>\$23,000</u>

P 2-2

1.

Davidson Tool Rentals Corporation
GENERAL JOURNAL

Page 1

Date	Description	PR	Debit	Credit
May 1	Cash Share Capital To record issuance of share capital.	101 320	5,000	5,000
5	Accounts Receivable Service Revenue To record billings to customers.	110 470	3,000	3,000
6	Cash Service Revenue To record cash payment by customers for work completed.	101 470	2,000	2,000
10	Cash Accounts Receivable To record collections on account.	101 110	1,500	1,500
11	Equipment Cash Accounts Payable To record purchase of equipment partially paid by cash, remainder on account.	183 101 210	2,000	1,000 1,000
15	Cash Accounts Receivable To record payment received on account.	101 110	1,200	1,200
16	Prepaid Advertising Cash To record payment of advertising in advance.	160 101	500	500
18	Accounts Receivable Service Revenue To record billings to customers.	110 470	2,500	2,500
20	Unused Supplies Cash To record purchase of supplies for inventory.	173 101	300	300
21	Cash Equipment To record sale of equipment at cost.	101 183	800	800

P 2-2 continued

Davidson Tool Rentals Corporation
GENERAL JOURNAL

Page 2

Date	Description	PR	Debit	Credit
May 22	Accounts Payable	210	600	
	Cash	101		600
	To record payment of amounts owing.			
23	Telephone Expense	669	150	
	Accounts Payable	210		150
	To record receipt of telephone bill.			
24	Commissions Expense	615	1,100	
	Accounts Payable	210		1,100
	To record receipt of commissions bill.			
28	Rent Expense	654	400	
	Cash	101		400
	To record payment of rent for May.			
29	Salaries Expense	656	3,500	
	Cash	101		3,500
	To record payment of wages incurred.			
30	Supplies Expense	668	100	
	Unused Supplies	173		100
	To record supplies used during the month.			
31	Advertising Expense	610	250	
	Prepaid Advertising	160		250
	To record expiry of prepaid advertising.			

P 2-2 continued

Davidson Tools Rentals Corporation

Cash	No. 101	Accounts Payable	No. 210	Share Capital	No. 320	Service Revenue	No. 460
5,000	1,000	600	1,000		5,000		3,000
2,000	500		150				2,000
1,500	300						2,500
1,200	600		<u>1,100</u>				Bal. 7,500
800	400	600	2,250				
-	3,500		Bal. 1,650				
10,500	6,300						
Bal. 4,200							
Accounts Receivable	No. 110					Advertising Expense	No. 610
3,000	1,500					250	
<u>2,500</u>	<u>1,200</u>						
5,500	2,700						
Bal. 2,800							
Prepaid Advertising	No. 160					Commissions Expense	No. 615
500	250					1,100	
Bal. 250							
Unused Supplies	No. 173					Rent Expense	No. 654
300	100					400	
Bal. 200							
Equipment	No. 183					Salaries Expense	No. 656
2,000	800					3,500	
Bal. 1,200							
						Supplies Expense	No. 668
						100	
						Telephone Expense	No. 669
						150	

P 2-2 continued

2.

Davidson Tools Rentals Corporation
Trial Balance
May 31, 2019

<i>Acct.</i>		<u><i>Account Balances</i></u>	
<i>No.</i>	<i>Account Title</i>	<i>Debit</i>	<i>Credit</i>
101	Cash	\$ 4,200	
110	Accounts receivable	2,800	
160	Prepaid advertising	250	
173	Unused supplies	200	
183	Equipment	1,200	
210	Accounts payable		\$ 1,650
320	Share capital		5,000
460	Service revenue		7,500
610	Advertising expense	250	
615	Commissions expense	1,100	
654	Rent expense	400	
656	Salaries expense	3,500	
668	Supplies expense	100	
669	Telephone expense	150	
		<u>\$14,150</u>	<u>\$14,150</u>

1. Findlay Consultants Corp.
 Trial Balance
 At January 31, 2019

<i>Acct.</i>		<u><i>Account Balances</i></u>	
<i>No.</i>	<i>Account Title</i>	<i>Debit</i>	<i>Credit</i>
101	Cash	\$ 2,000	
110	Accounts receivable	8,000	
160	Prepaid advertising	300	
182	Furniture	1,000	
183	Equipment	4,000	
184	Truck	9,000	
210	Accounts payable		\$9,000
226	Salaries payable		1,500
236	Utilities payable		3,625
320	Share capital		7,000
420	Fees earned		9,500
610	Advertising expense	150	
631	Insurance expense	200	
641	Maintenance expense	250	
654	Rent expense	400	
656	Salaries expense	2,600	
668	Supplies expense	350	
669	Telephone expense	125	
670	Truck operating expense	750	
677	Wages expense	<u>1,500</u>	
		<u>\$30,625</u>	<u>\$30,625</u>

2. Findlay Consultants Corp.
 Income Statement
 For the Month Ended January 31, 2019

<i>Revenue</i>		
Fees		\$9,500
<i>Expenses</i>		
Advertising	\$ 150	
Insurance	200	
Maintenance	250	
Rent	400	
Salaries	2,600	
Supplies	350	
Telephone	125	
Truck operating	750	
Wages	<u>1,500</u>	
Total expenses		<u>6,325</u>
Net income		<u>\$3,175</u>

P 2-3 continued

Findlay Consultants Corp.
Statement of Changes in Equity
For the Month Ended January 31, 2019

	<i>Share capital</i>	<i>Retained earnings</i>	<i>Total equity</i>
Opening balance	\$ -0-	\$ -0-	\$ -0-
Shares issued	7,000	-0-	7,000
Net income	<u>-0-</u>	<u>3,175</u>	<u>3,175</u>
Ending balance	<u>\$7,000</u>	<u>\$3,175</u>	<u>\$10,175</u>

3.

Findlay Consultants Corp.
Statement of Financial Position
At January 31, 2019

<i>Assets</i>		
Cash		\$2,000
Accounts receivable		8,000
Prepaid advertising		300
Equipment		4,000
Furniture		1,000
Truck		<u>9,000</u>
Total assets		<u>\$24,300</u>
<i>Liabilities</i>		
Accounts payable	\$9,000	
Salaries payable	1,500	
Utilities payable	<u>3,625</u>	14,125
<i>Shareholders' Equity</i>		
Share capital	7,000	
Retained earnings	<u>3,175</u>	<u>10,175</u>
Total liabilities and shareholders' equity		<u>\$24,300</u>

P 2-4

1. and 3.

Fenton Table Rentals Corporation

Cash		No. 101	
Apr.1	1,400	c.	2,400
a.	2,000	d.	1,000
f.	2,500	j.	100
	5,900		3,500
Bal.	2,400		

Accounts Payable		No. 210	
d.	1,000	Apr.1	2,000
		e.	500
	1,000		2,500
		Bal.	1,500

Share Capital		No. 320	
		Apr.1	4,350

Service Revenue		No. 470	
		b.	3,000
		g.	1,500
		Bal.	4,500

Accounts Receivable		No. 110	
Apr.1	3,600	a.	2,000
b.	3,000	f.	2,500
g.	1,500		
	8,100		4,500
Bal.	3,600		

Dividends		No. 350	
j.	100		

Advertising Expense		No. 610	
c.	300		

Rent Expense		No. 654	
h.	500		

Prepaid Rent		No. 162	
Apr.1	1,000	h.	500
Bal.	500		

Salaries Expense		No. 656	
c.	2,000		

Unused Supplies		No. 173	
Apr.1	350	i.	150
Bal.	200		

Supplies Expense		No. 668	
i.	150		

Telephone Expense		No. 669	
c.	100		

Truck Operating Expense		No. 670	
e.	500		

P 2-4 continued

2.

Fenton Table Rentals Corporation
GENERAL JOURNAL

page 1

April 2019	Description	PR	Debit	Credit
a.	Cash	101	2,000	
	Accounts receivable	110		2,000
	To record a collection on account.			
b.	Accounts Receivable	110	3,000	
	Service Revenue	170		3,000
	To record billings to customers.			
c.	Advertising Expense	610	300	
	Salaries Expense	656	2,000	
	Telephone Expense	669	100	
	Cash	101		2,400
	To record payment of expenses incurred.			
d.	Accounts Payable	210	1,000	
	Cash	101		1,000
	To record payment made on account.			
e.	Truck Operating Expense	670	500	
	Accounts Payable	210		500
	To record bill received for truck repair expense.			
f.	Cash	101	2,500	
	Accounts Receivable	110		2,500
	To record payment received on account.			
g.	Accounts Receivable	110	1,500	
	Service revenue	470		1,500
	To record billings to customers.			
h.	Rent Expense	654	500	
	Prepaid Rent	162		500
	To record expiry of a portion of prepaid rent.			
i.	Supplies Expense	668	150	
	Unused Supplies	173		150
	To record supplies used, based on count of unused supplies at end of month.			
j.	Dividends	350	100	
	Cash	101		100
	To record dividends paid in cash.			

P 2-4 continued

4.

Fenton Table Rentals Corporation
Trial Balance
At April 30, 2019

<i>Acct. No. Account Title</i>		<u><i>Account Balances</i></u>	
		<i>Debit</i>	<i>Credit</i>
101	Cash	\$ 2,400	
110	Accounts receivable	3,600	
162	Prepaid rent	500	
173	Unused supplies	200	
210	Accounts payable		\$ 1,500
320	Share capital		4,350
350	Dividends	100	
470	Service revenue		4,500
610	Advertising expense	300	
654	Rent expense	500	
656	Salaries expense	2,000	
668	Supplies expense	150	
669	Telephone expense	100	
670	Truck operating expense	500	
		<u>\$10,350</u>	<u>\$10,350</u>

P 2-4 continued

5.

Fenton Table Rentals Corporation Income Statement For the Month Ended April 30, 2019		Fenton Table Rentals Corporation Statement of Financial Position At April 30, 2019	
<i>Revenue</i>		<i>Assets</i>	
Services	\$4,500	Cash	\$2,400
<i>Expenses</i>		Accounts receivable	3,600
Advertising	\$ 300	Prepaid rent	500
Rent	500	Unused supplies	<u>200</u>
Salaries	2,000	Total assets	<u>\$6,700</u>
Supplies	150	<i>Liabilities</i>	
Telephone	100	Accounts payable	\$1,500
Truck operating	<u>500</u>	<i>Shareholders' Equity</i>	
Total expenses	<u>3,550</u>	Share capital	\$4,350
Net income	<u>\$ 950</u>	Retained earnings	<u>850</u> <u>5,200</u>
		Total liabilities and shareholders' equity	<u>\$6,700</u>

Fenton Table Rentals Corporation
Statement of Changes in Equity
For the Month Ended April 30, 2019

	<i>Share capital</i>	<i>Retained earnings</i>	<i>Total equity</i>
Opening balance	\$ 4,350	\$ -0-	\$ 4,350
Net income		950	950
Dividends	<u>0</u>	<u>(100)</u>	<u>(100)</u>
Ending balance	<u>\$4,350</u>	<u>\$ 850</u>	<u>\$5,200</u>

P 2-5

1. and 3.

Thorn Accounting Services Inc.

<u>Cash</u>		<u>No. 101</u>	
Aug.1	3,000	Aug.1	8,000
1	10,000	4	600
5	2,000	9	250
15	1,000	16	200
		20	250
		25	<u>2,800</u>
	<u>16,000</u>		<u>12,100</u>
Bal.	3,900		

<u>Accounts Receivable</u>		<u>No. 110</u>	
Aug.7	5,000	Aug.15	1,000
29	<u>6,000</u>		
	<u>11,000</u>		<u>1,000</u>
Bal.	10,000		

<u>Prepaid Insurance</u>		<u>No. 161</u>	
Aug.4	600	Aug.31	50
Bal.	550		

<u>Unused Supplies</u>		<u>No. 173</u>	
Aug.12	500	Aug.31	400
Bal.	100		

<u>Truck</u>		<u>No. 184</u>	
Aug.18,000			

<u>Bank Loan</u>		<u>No. 201</u>	
		Aug.1	10,000
<u>Accounts Payable</u>		<u>No. 210</u>	
Aug.20	250	Aug.12	500
		Bal.	250

<u>Share Capital</u>		<u>No. 320</u>	
		Aug.1	3,000

<u>Fees Earned</u>		<u>No. 420</u>	
		Aug.5	2,000
		7	5,000
		29	<u>6,000</u>
		Bal.	13,000
<u>Advertising Expense</u>		<u>No. 610</u>	
Aug.16	200		

<u>Insurance Expense</u>		<u>No. 631</u>	
Aug.31	50		

<u>Rent Expense</u>		<u>No. 654</u>	
Aug.25	350		

<u>Salaries Expense</u>		<u>No. 656</u>	
Aug.25	2,150		
<u>Supplies Expense</u>		<u>No. 668</u>	
Aug.9	250		
31	<u>400</u>		
Bal.	650		

<u>Telephone Expense</u>		<u>No. 669</u>	
Aug.25	50		

<u>Truck Operating Expense</u>		<u>No. 670</u>	
Aug.25	250		

P 2–5 continued

2.

Thorn Accounting Services Inc.
General Journal

Page 1

Date 2019	Description	PR	Debit	Credit
Aug. 1	Cash Share Capital To record issuance of share capital.	101 320	3,000	3,000
1	Cash Bank Loan To record amount borrowed from bank.	101 201	10,000	10,000
1	Truck Cash To record purchase of a used truck.	184 101	8,000	8,000
4	Prepaid Insurance Cash To record payment of a one-year insurance policy.	161 101	600	600
5	Cash Fees Earned To record collection of cash fees from a customer.	101 420	2,000	2,000
7	Accounts Receivable Fees Earned To record billings to customers.	110 420	5,000	5,000
9	Supplies Expense Cash To record payment of supplies used.	668 101	250	250
12	Unused Supplies Accounts Payable To record purchase of supplies on account.	173 210	500	500
15	Cash Accounts Receivable To record collection of customer accounts.	101 110	1,000	1,000
16	Advertising Expense Cash To record payment of advertising expense.	610 101	200	200

P 2–5 continued

Thorn Accounting Services Inc.
General Journal

Page 2

Aug. 2019	Description	PR	Debit	Credit
Aug. 20	Accounts Payable	210	250	
	Cash	101		250
	To record payment made on account.			
25	Rent Expense	654	350	
	Salaries Expense	656	2,150	
	Telephone Expense	669	50	
	Truck Operating Expense	670	250	
	Cash	101		2,800
	To record cash payment of expenses.			
29	Accounts Receivable	110	6,000	
	Fees Earned	420		6,000
	To record billings to customers.			
31	Insurance Expense	631	50	
	Prepaid Insurance	161		50
	To record insurance expired for August (\$600/12 months)			
31	Supplies Expense	668	400	
	Unused Supplies	173		400
	To record supplies used for August.			

P 2–5 continued

4.

Thorn Accounting Services Inc.
Trial Balance
At August 31, 2019

<i>Acct.</i>		<i>Account Balances</i>	
		<i>Debit</i>	<i>Credit</i>
<i>No.</i>	<i>Account Title</i>		
101	Cash	\$ 3,900	
110	Accounts receivable	10,000	
161	Prepaid insurance	550	
173	Unused supplies	100	
184	Truck	8,000	
201	Bank loan		\$10,000
210	Accounts payable		250
320	Share capital		3,000
420	Fees earned		13,000
610	Advertising expense	200	
631	Insurance expense	50	
654	Rent expense	350	
656	Salaries expense	2,150	
668	Supplies expense	650	
669	Telephone expense	50	
670	Truck operating expense	250	
		<u>\$26,250</u>	<u>\$26,250</u>

P 2-5 continued

5.

Thorn Accounting Services Inc. Income Statement For the Month Ended August 31, 2019		Thorn Accounting Services Inc. Statement of Financial Position At August 31, 2019	
		<i>Assets</i>	
<i>Revenue</i>		Cash	\$ 3,900
Fees earned	\$13,000	Accounts receivable	10,000
		Prepaid insurance	550
		Unused supplies	100
<i>Expenses</i>		Truck	<u>8,000</u>
Advertising	\$ 200	Total assets	<u>\$22,550</u>
Insurance	50		
Rent	350		
Salaries	2,150	<i>Liabilities</i>	
Supplies	650	Bank loan	\$10,000
Telephone	50	Accounts payable	<u>250</u> <u>10,250</u>
Truck operating	<u>250</u>		
Total expenses	<u>3,700</u>	<i>Shareholders' Equity</i>	
		Share capital	3,000
Net income	<u>\$ 9,300</u>	Retained earnings	<u>9,300</u> <u>12,300</u>
		Total liabilities and shareholders' equity	<u>\$22,550</u>

Thorn Accounting Service Inc.
Statement of Changes in Equity
For the Month Ended August 31, 2019

	<i>Share capital</i>	<i>Retained earnings</i>	<i>Total equity</i>
Opening balance	\$ -0-	\$ -0-	\$ 0
Shares issued	3,000	-0-	3,000
Net income	<u>-0-</u>	<u>9,300</u>	<u>9,300</u>
Ending balance	<u>\$3,000</u>	<u>\$9,300</u>	<u>\$12,300</u>

P 2-6

1. and 3.

Chan Renovations Corporation

Cash				No. 101			
Jun. 1	8,000	Jun. 3	20				
2	600	10	2,500				
8	500	18	1,000				
25	1,000	22	600				
		25	<u>3,700</u>				
	<u>10,100</u>		<u>7,820</u>				
Bal.	2,280						

Accounts Payable				No. 210			
Jun. 10	2,500	Jun. 1	5,000				
18	1,000	4	1,000				
		20	<u>100</u>				
	<u>3,500</u>		<u>6,100</u>				
		Bal.	2,600				

Share Capital				No. 320			
		Jun.1	8,000				

Repair Revenue				No. 450			
		Jun. 2	600				
		5	2,500				
		30	2,000				
		Bal.	5,100				

Telephone Expense				No. 669			
Jun. 25	50						

Advertising Expense				No. 610			
Jun. 25	150						

Truck Operating Expense				No. 670			
Jun. 25	1,000						

Accounts Receivable				No. 110			
Jun. 5	2,500	Jun. 8	500				
15	1,000	25	1,000				
30	<u>2,000</u>						
	5,500		<u>1,500</u>				
Bal.	4,000						

Prepaid Rent				No. 162			
Jun. 22	600	Jun. 30	300				
Bal.	300						

Utilities Expense				No. 676			
Jun. 20	100						

Unused Supplies				No. 173			
Jun. 4	1,000	Jun. 30	850				
Bal.	150						

Wages Expenses				No. 677			
Jun. 25	2,500						

Equipment				No. 183			
Jun. 1	5,000	Jun. 15	1,000				
Bal.	4,000						

Supplies Expense				No. 668			
Jun. 3	20						
	30	850					
Bal.	870						

P 2-6 continued

2.

Chan Renovations Corporation
General Journal

Page 1

2019	Description	PR	Debit	Credit
Jun. 1	Cash	101	8,000	
	Share Capital	320		8,000
	To record issuance of share capital.			
1	Equipment	183	5,000	
	Accounts Payable	210		5,000
	To record purchase of equipment on account.			
2	Cash	101	600	
	Repair Revenue	450		600
	To record collection of cash from customer.			
3	Supplies Expense	668	20	
	Cash	101		20
	To record payment of supplies used.			
4	Unused Supplies	173	1,000	
	Accounts Payable	210		1,000
	To record purchase of unused supplies on account.			
5	Accounts Receivable	110	2,500	
	Repair Revenue	450		2,500
	To record billings to customers.			
8	Cash	101	500	
	Accounts Receivable	110		500
	To record collection on account.			
10	Accounts Payable	210	2,500	
	Cash	101		2,500
	To record payment on account.			
15	Accounts Receivable	110	1,000	
	Equipment	183		1,000
	To record sale of equipment on account.			
18	Accounts Payable	210	1,000	
	Cash	101		1,000
	To record payment made on account.			

P 2-6 continued

Chan Renovations Corporation
General Journal

Page 2

2019	Description	PR	Debit	Credit
Jun. 20	Utilities Expense	676	100	
	Share Capital	210		100
	To record bill received for utilities.			
22	Prepaid Rent	162	600	
	Cash	101		600
	To record June and July rent payments made in advance.			
25	Cash	101	1,000	
	Accounts Receivable	110		1,000
	To record payment received on account.			
27	Advertising Expense	610	150	
	Telephone Expense	669	50	
	Truck Operating Expense	670	1,000	
	Wages Expense	677	2,500	
	Cash	101		3,700
	To record payment of expenses in cash.			
30	Accounts Receivable	110	2,000	
	Repair Revenue	450		2,000
	To record customer billings.			
30	Rent Expense	654	300	
	Prepaid Rent	162		300
	To record expiry of June rent.			
30	Supplies Expense	668	850	
	Unused Supplies	173		850
	To record supplies used in June.			

P 2-6 continued

4.

Chan Renovations Corporation
Trial Balance
At June 30, 2019

<i>Acct.</i>		<u><i>Account Balances</i></u>	
<i>No.</i>	<i>Account Title</i>	<i>Debit</i>	<i>Credit</i>
101	Cash	\$ 2,280	
110	Accounts receivable	4,000	
162	Prepaid rent	300	
172	Unused supplies	150	
183	Equipment	4,000	
210	Accounts payable		\$ 2,600
320	Share capital		8,000
450	Repair revenue		5,100
610	Advertising expense	150	
654	Rent expense	300	
668	Supplies expense	870	
669	Telephone expense	50	
670	Truck operating expense	1,000	
676	Utilities expense	100	
677	Wages expense	<u>2,500</u>	
		<u>\$15,700</u>	<u>\$ 15,700</u>

P 2-6 continued

5.

Chan Renovations Corporation Income Statement For the Month Ended June 30, 2019			Chan Renovations Corporation Statement of Financial Position At June 30, 2019	
<i>Revenue</i>			<i>Assets</i>	
Repairs		\$5,100	Cash	\$ 2,280
<i>Expenses</i>			Accounts receivable	4,000
Advertising	\$ 150		Prepaid rent	300
Rent	300		Unused supplies	150
Supplies	870		Equipment	<u>4,000</u>
Telephone	50		Total assets	<u>\$10,730</u>
Truck operating	1,000		<i>Liabilities</i>	
Utilities	100		Accounts payable	\$ 2,600
Wages	<u>2,500</u>		<i>Shareholders' Equity</i>	
Total expenses		<u>4,970</u>	Share capital	8,000
Net income		<u>\$ 130</u>	Retained earnings	<u>130</u> <u>8,130</u>
			Total liabilities and shareholders' equity	<u>\$10,730</u>

Chan Renovations Corporation
Statement of Changes in Equity
For the Month Ended June 30, 2019

	<i>Share capital</i>	<i>Retained earnings</i>	<i>Total equity</i>
Opening balance	\$ -0-	\$ -0-	\$ -0-
Shares issued	8,000	-0-	8,000
Net income	<u>-0-</u>	<u>130</u>	<u>130</u>
Ending balance	<u>\$8,000</u>	<u>\$ 130</u>	<u>\$8,130</u>

CHAPTER THREE

Financial Accounting and the Use of Adjusting Entries

Concept Self-check

1. The sequence of financial transactions that occurs continuously during an accounting time period is called the *operating cycle*. Operations begin with some cash on hand. The cash is used to purchase supplies and pay expenses while revenue is being generated. Often when revenue is earned, an account receivable is created, which is later collected in cash. This begins the cycle over again. There are many operating cycles occurring simultaneously. While some transactions are being completed, others are only beginning.
2. The operating cycle does not have to be complete before income can be measured. Accrual accounting is the means to accomplish this. Revenue can be recorded as earned when the product is sold or the service performed regardless of when cash is collected. To measure income, expenses must be matched to revenues or the relevant time period. This usually can be done whether or not the operating cycle is complete.
3. Accrual accounting matches expenses to revenues for a particular time period. The accrual method is the basis on which accounts are adjusted to reach this objective. Under this method, expenses are matched to the revenues during the period that the revenues are generated. The revenue recognition assumption helps determine when revenues are earned, thus allowing expenses to be matched to these revenues. Revenues are not generally matched to expenses by convention. The rationale is that generating revenue is the principal objective of a business. Therefore, these are recognized and then expenses are matched to revenues.
4. Adjusting entries are changes made at the end of an operating cycle to more accurately reflect economic activity during the period. For instance, depreciation is calculated on plant and equipment and charged to the income statement as depreciation expense.

Concept Self-check continued

5. The five types of adjusting entries are:

(1)			
Dec. 31	Expense	XX	
	Prepaid Expense		XX
	<i>To adjust prepaid expense for the amount of benefit used.</i>		
(2)			
Dec. 31	Account Recievable	XX	
	Revenue		XX
	<i>To record reveue earned on credit.</i>		
(3)			
Dec. 31	Depreciation Expense	XX	
	Accumulated Depreciation		XX
	<i>To allocate the cost of plant and equipment over their useful lives.</i>		
(4)			
Dec. 31	Unearned Revenue	XX	
	Revenue		XX
	<i>To adjust unearned amounts now earned.</i>		
(5)			
Dec. 31	Expense	XX	
	Payable		XX
	<i>To adjust for accrued expenses.</i>		

6. At the end of the accounting period, an accountant must determine the amount of future benefits (assets like Prepaid Insurance) that belong on the statement of financial position and how much should be recorded in the income statement (as Insurance Expense, in this example). The appropriate amounts must be transferred by means of adjusting entries.
7. Long-lived asset accounts like Equipment and are handled differently than other asset accounts. The expired portion of the cost of such an asset is estimated based on its useful life and recorded as depreciation expense. This requires no cash outlay, despite being an expense. Capital asset accounts themselves are not reduced by the depreciation expense; rather, a contra asset account is set up in order to show the asset at its carrying value on the statement of financial position.

Concept Self-check continued

8. A contra account is used to reduce the value of a related statement of financial position item. For instance, the account Accumulated Depreciation—Equipment is credited by the amount of depreciation expense recorded each year. The balance in this account is netted against the related account (Equipment, in this example) so that the asset is shown at carrying amount on the statement of financial position.
9. At the end of the accounting period, the amount of services that still remain to be performed is determined. The related revenue and liability account balances are adjusted through the use of an adjusting entry (in this case, Unearned Repair Revenue, a liability account and Repair Revenue, a revenue account).
10. Accrued revenues and accrued expenses are items that are not recognized in the normal course of recording financial transactions.. They are not captured by source documents like sales and purchase invoices. They are recorded through the use of accrual adjusting entries at the end of the accounting period. Examples of revenues and expenses that accrue are rent revenue and expenses, interest revenue and expense, salaries and wages expenses, and income taxes expense.

Related asset or liability accounts record the offsetting debits and credits. These statement of financial position accounts are eventually reduced when cash is received or paid, as applicable.

11. An adjusted trial balance is prepared after posting the adjusting entries in order to establish the equality of debits and credits, and before preparing the financial statements.
12. The adjusted trial balance conveniently summarises the general ledger accounts in order of their appearance in the financial statements. This facilitates preparation of the financial statements.
13. The eight steps in the accounting cycle are:
 1. Transactions are analyzed and recorded in the general journal.
 2. The journal entries in the general journal are posted to accounts in the general ledger.
 3. An unadjusted trial balance is prepared to ensure total debits equal total credits.
 4. The unadjusted account balances are analyzed, and adjusting entries are journalized in the general journal and posted to the general ledger.
 5. An adjusted trial balance is prepared to prove the equality of debits and credits.
 6. The adjusted trial balance is used to prepare financial statements.
 7. Closing entries are journalized and posted.
 8. A post-closing trial balance is prepared.

Concept Self-check continued

14. The first two steps in the accounting cycle occur continuously throughout the accounting period:
1. Transactions are analyzed and recorded in the general journal.
 2. The journal entries in the general journal are posted to accounts in the general ledger.

15. The last two steps in the accounting cycle occur only at the end of the accounting period:
7. Closing entries are journalized and posted.
 8. A post-closing trial balance is prepared.

These steps differ from the others because they are only used to zero out temporary accounts and adjust retained earnings to the amount shown on the fiscal year-end statement of financial position.

16. The need for regular financial information requires that revenue and expense accounts of a business be accumulated for usually no more than one year by convention, and that financial statements be prepared for that period. Using a consistent time period allows revenue and expenses for one period to be compared to a preceding period. A one-year cycle reduces effects of seasonal variations in business activity, for instance, but also allows for business performance to be evaluated by owners and creditors regularly and predictably.
17. Temporary accounts include all revenues and expense categories that are reduced to zero at the end of the fiscal year when they are closed to the Retained Earnings account. Permanent accounts have a continuing balance from one fiscal year to the next. All statement of financial position accounts are permanent accounts.
18. An Income Summary account is an general ledger record used only at year-end to accumulate all revenue and expense balances, and to reduce their general ledger accounts to zero at the end of the fiscal year. This account summarises the net income (or net loss) for the year. It is closed to the Retained Earnings account at year-end.

Concept Self-check continued

19. The general forms of the four closing entries are:

	(1)		
Dec. 31	Revenue	XX	
	Income Summary		XX
	To close revenue account balances to the Income Summary account.		
	(2)		
Dec. 31	Income Summary	YY	
	Expense		YY
	To close expense account balances to the Income Summary account.		
	(3)		
Dec. 31	Income Summary	ZZ	
	Retained Earnings		ZZ
	To close the Income Summary account balance to Retained Earnings (ZZ = XX – YY; ZZ must equal net income).		
	(4)		
Dec. 31	Retained Earnings	AA	
	Dividends		AA
	To close the Dividend account to Retained Earnings.		

The purpose of the Income Summary is to accumulate the debits and credits to revenue and expense accounts respectively at the end of the fiscal year to ensure that these are equal to net income shown on the income statement. This balance is then closed to retained earnings.

20. The Dividends account is not closed to the Income Summary account because it is not an income statement item. It is closed directly to the Retained Earnings account at the end of the fiscal year as it is considered a distribution of retained earnings to shareholders.
21. A post-closing trial balance is a listing of permanent (statement of financial position) accounts and their balances after all temporary accounts have been closed. It proves the equality of general ledger debit and credit balances before the next accounting period commences.

CP 3-1

- | | |
|---------------------------------|-----------------------------|
| a. Insurance Expense | 7. Prepaid Insurance |
| b. Rent Earned | 10. Unearned Rent |
| c. Prepaid Rent | 6. Rent Expense |
| d. Interest Payable | 9. Interest Expense |
| e. Interest Receivable | 8. Interest Earned |
| f. Fees Earned | 4. Unearned Fees |
| g. Unused Supplies | 2. Supplies Expense |
| h. Unearned Commissions Revenue | 1. Commissions Earned |
| i. Salaries Payable | 3. Salaries Expense |
| j. Depreciation Expense | 5. Accumulated Depreciation |

CP 3-2

2019			
Dec. 31	Depreciation Expense—Truck	624	1,200
	Accumulated Depreciation—Truck	194	1,200
	To record additional truck depreciation		
	for the year (\$2,500 – 1,300)		
	<u>\$10,000</u> = \$2,500/year		
	4 years		

CP 3-3

2019				
Dec. 31	Interest Expense	632	100	
	Interest Payable	222		100
	To adjust accrued interest (\$1,200 – 1,100).			

CP 3-4

Armstrong Corp.
General Journal

Date 2019		Description	PR	Debit	Credit
a.	Jun. 30	Office Supplies Expense Unused Office Supplies To adjust of office supplies on hand to the remaining amount.		135	135
b.	30	Depreciation Expense-Truck Accumulated Depreciation-Truck To record truck depreciation for the period.		400	400
c.	30	Insurance Expense Prepaid Insurance To adjust the portion of insurance expired for the period.		240	240
d.	30	Interest Expense Interest Payable To adjust interest payable for the period.		100	100
e.	30	Unearned Rent Revenue Rent Earned To adjust the portion of unearned rent at the end of the period.		500	500

1. and 3.

ASSETS		=	LIABILITIES		+	SHAREHOLDERS' EQUITY		
Rent Receivable			Interest Payable			Rent Earned		
(a)	110			(c)	90		(a)	110
Prepaid Insurance						Insurance Expense		
	1,800							
	(b)	1,200				Interest Expense		
Bal.	600							

2.

Page 1

Date	Description	PR	Debit	Credit
	<u>Adjusting Entries</u>			
a.	Rent Receivable Rent Earned		110	110
b.	Insurance Expense Prepaid Insurance		1,200	1,200
c.	Interest Expense Interest Payable		90	90

- 70

CP 3-6

1. General Journal

	Date 2019	Description	PR	Debit	Credit
a.	Dec. 31	Rent Expense Prepaid Rent To adjust prepaid rent account to the proper balance.		200	200
b.	31	Office Supplies Expense Unused Office Supplies To adjust the ending balance of supplies on hand.		400	400
c.	31	Income Taxes Expense Income Taxes Payable To record income taxes for the period.		5,000	5,000
d.	31	Unearned Commissions Revenue Commissions Earned To record the proper balance in the Unearned Commissions account.		1,000	1,000
e.	31	Salaries Expense Salaries Payable To accrue salaries for the period.		300	300

2. Assets would be overstated by \$600 (a: 200+b: 400)
 Liabilities would be understated by \$4,300 (c: 5,000 – d: 1,000 + e: 300)
 Revenue would be understated by \$1,000 (d)
 Expenses would be understated by \$5,900 (a: 200 + b: 400 + c: 5,000 + e: 300)
 Shareholders' equity would be overstated by \$4,900 (asset overstatement: \$600 + liabilities understatement: \$4,300), while net income would be overstated by \$4,900 (revenue understatement: \$1,000 – expense understatement: \$5,900).

CP 3-7

Bernard Inc.
General Journal

	Date 2019	Description	PR	Debit	Credit
a.	Dec.31	Advertising Expense Prepaid Advertising To record the expired portion of advertising expense for the period.	610 160	500	500
b.	31	Supplies Expense Unused Supplies To adjust supplies on hand to the remaining amount.	668 173	400	400
c.	31	Depreciation Expense—Equipment Accumulated Depreciation—Equipment To record depreciation for the period.	623 193	250	250
d.	31	Maintenance Expense Telephone Expense Utilities Expense Commissions Expense Accounts Payable To record expenses incurred but not yet paid for the period.	641 669 676 615 210	200 100 400 800	1,500
e.	31	Salaries Expense Salaries Payable To record salaries accrued for the period.	656 226	700	700
f.	31	Unearned Subscription Revenue Subscription Revenue To record subscription revenue earned for the period.	250 480	5,000	5,000

CP 3-8

1.

Cash	101	Accounts Payable	210	Share Capital	320
750	50	70	145		400
950	150	Unearned Repair Revenue	247	Ret. Earn.	340
90	50		500		350
	24	(e) 400		Repair Rev.	450
	20				950
	70				228
Accounts Receivable	110	Interest Payable	222		400 (e)
228	90		12 (g)	Rent Earned	440
Rent Receivable	125				40 (f)
(f) 40		Income Taxes Pay.	260	Dep'n Exp. - Furniture	621
Prepaid Insurance	161		400 (h)	(b) 2	
24	2 (a)	Interest Expense	632	Insurance Exp.	631
Unused Office Supplies	170	(g) 12		(a) 2	
50	25 (c)	Income Taxes Expense	830	Office Supplies Exp.	650
Unused Repair Supplies	171	(h) 400		(c) 25	
145	80 (d)			Rent Expense	654
Furniture	182			50	
150				Repair Supplies Expense	655
Acc. Dep'n - Furniture	191			(d) 80	
	2 (b)			Telephone Expense	669
				20	

CP 3-8 continued

2.

Hynes Corporation
General Journal

Page 1

	Date	Description	PR	Debit	Credit
		<u>Adjusting Entries</u>			
a.	Dec. 31	Insurance Expense	631	2	
		Prepaid Insurance	161		2
		To record expiry of prepaid insurance.			
b.	31	Depreciation Expense—Furniture	621	2	
		Accumulated Depreciation—Furniture	191		2
		To record depreciation.			
c.	31	Office Supplies Expense	650	25	
		Unused Office Supplies	170		25
		To record use of office supplies.			
d.	31	Repair Supplies Expense	655	80	
		Unused Repair Supplies	171		80
		To record use of supplies.			
e.	31	Unearned Repair Revenue	247	400	
		Repair Revenue	450		400
		To adjust unearned repair revenue to actual.			
f.	31	Rent Receivable	125	40	
		Rent Earned	440		40
		To adjust for rent receivable.			
g.	31	Interest Expense	632	12	
		Interest Payable	222		12
h.	31	Income Taxes Expense	669	400	
		Income Taxes Payable	260		400
		To adjust for income taxes.			

CP 3-9

1.

Acct. No.	Account	Trial Balance		Adjustments		Adjusted Trial Balance	
		Debit	Credit	Debit	Credit	Debit	Credit
101	Cash	\$ 4,000				\$ 4,000	
110	Accounts receivable	5,000				5,000	
161	Prepaid insurance	3,600			(a) 300	3,300	
162	Prepaid rent	1,000			(b) 500	500	
184	Truck	6,000				6,000	
194	Acc. dep. – truck				(c) 1,500		\$1,500
210	Accounts payable		\$7,000				7,000
222	Interest payable				(d) 400		400
226	Salaries payable				(e) 1,000		1,000
248	Unearned rent revenue		1,200	(f) 600			600
320	Share capital		2,700				2,700
440	Rent earned		25,000		(f) 600		25,600
610	Advertising expense	700				700	
615	Commissions expense	2,000				2,000	
624	Dep. expense – truck			(c) 1,500		1,500	
631	Insurance expense			(a) 300		300	
632	Interest expense	100		(d) 400		500	
654	Rent expense	5,500		(b) 500		6,000	
656	Salaries expense	8,000		(e) 1,000		9,000	
	Totals	<u>\$35,900</u>	<u>\$35,900</u>	<u>\$4,300</u>	<u>\$4,300</u>	<u>\$38,800</u>	<u>\$38,800</u>

CP 3-9 continued

2. Lauer Corporation
General Journal

	2019	Description	PR	Debit	Credit
		<u>Adjusting Entries</u>			
a.	Dec.31	Insurance Expense	631	300	
		Prepaid Insurance	131		300
		To record expiry of prepaid insurance.			
b.	31	Rent Expense	654	500	
		Prepaid Rent	162		500
		To record expiry of prepaid rent.			
c.	31	Depreciation Expense	624	1,500	
		Accumulated Depreciation—Truck	194		1,500
		To record truck depreciation.			
d.	31	Interest Expense	632	400	
		Interest Payable	222		400
		To accrue interest.			
e.	31	Salaries Expense	656	1,000	
		Salaries Payable	226		1,000
		To accrue unpaid salaries.			
f.	31	Unearned Rent	248	600	
		Rent Earned	440		600
		To record rent earned.			

CP 3-10

1.

Wolfe Corporation
General Journal

Page 1

Date 2019		Description	PR	Debit	Credit
		<u>Adjusting Entries</u>			
a.	Dec. 31	Insurance Expense	631	600	
		Prepaid Insurance	161		600
		To adjust for expiry of 6 months insurance (\$1,200 x ½).			
b.	31	Supplies Expense	668	200	
		Unused Supplies	173		200
		To adjust supplies on hand to physical count.			
c.	31	Rent Expense	654	50	
		Accounts Payable	210		50
		To adjust for unpaid rent.			

CP 3-10 continued

2. and 4.

Wolfe Corporation

Cash	101	Accounts Payable	210	Share Capital	320	Repair Revenue	450
Bal. 2,700		(c) 50		Bal. 3,800		(d) 7,750	Op. Bal. 7,750
Accounts Receivable	110			Retained Earnings	340		Bal. 0
Bal. 2,000				(f) 1,950		Advertising Expense	610
Prepaid Insurance	161			Bal. 1,950		Op. Bal. 200	(e) 200
Op. Bal. 1,200	(a) 600			Income Summary	360	Bal. 0	
Bal. 600				(e) 5,800	(d) 7,750	Insurance Expense	631
Unused Supplies	173			(f) 1,950		(a) 600	(e) 600
Op. Bal. 700	(b) 200			Bal. 0		Bal. 0	
Bal. 500						Rent Expense	654
						Op. Bal. 250	
						(c) 50	
						Bal. 300	(e) 300
						Bal. 0	
						Salaries Expense	656
						Op. Bal. 4,500	(e) 4,500
						Bal. 0	
						Supplies Expense	668
						(b) 200	(e) 200
						Bal. 0	

CP 3–10 continued

3.

Wolfe Corporation
General Journal

Page 2

Date 2019		Description	PR	Debit	Credit
		<u>Closing Entries</u>			
d.	Dec. 31	Repair Revenue	450	7,750	
		Income Summary	360		7,750
e.	31	Income Summary	360	5,800	
		Advertising Expense	610		200
		Insurance Expense	631		600
		Rent Expense	654		300
		Salaries Expense	656		4,500
		Supplies Expense	668		200
f.	31	Income Summary	360	1,950	
		Retained Earnings	340		1,950

Meekins Limited
General Journal

	Date	Description	PR	Debit	Credit
		<u>Adjusting Entries</u>			
a.	Dec.31	Prepaid Rent Rent Expense To record prepaid rent at year-end.		300	300
b.	31	Wages Expense Wages Payable To record accrued wages at year-end.		200	200
c.	31	Income Taxes Expense Income Taxes Payable To record income taxes.		1,000	1,000
d.	31	Commissions Earned Unearned Commissions Revenue To record unearned commissions at year-end.		1,000	1,000
e.	31	Other Unearned Revenue Revenue To adjust unearned revenue to actual at year-end.		5,000	5,000
f.	31	Prepaid Advertising Advertising Expense To record prepaid advertising at year-end.		1,500	1,500
g.	31	Depreciation Expense—Equipment Accumulated Depreciation—Equipment To record depreciation expense.		500	500
h.	31	Unused Supplies Supplies Expense To adjust for unused supplies.		225	225
i.	31	Truck Expense Accounts Payable To record accounts payable at year-end.		500	500

Lukas Films Corporation
General Journal

	Date 2019	Description	PR	Debit	Credit
		<u>Adjusting Entries</u>			
a.	Dec. 31	Supplies Expense Unused Supplies		400	400
b.	31	Telephone Expense Accounts Payable		75	75
c.	31	Wages Expense Wages Payable		125	125
d.	31	Depreciation Expense—Equipment Accumulated Depreciation—Equipment		100	100
e.	31	Rent Expense Prepaid Rent		500	500
f.	31	Unearned Advertising Revenue Advertising Revenue		300	300
g.	31	Insurance Expense Prepaid Insurance		450	450

Mighty Fine Services Inc.
General Journal

Date		Description	PR	Debit	Credit
		<u>Adjusting Entries</u>			
a.	Dec. 31	Insurance Expense Prepaid Insurance		200	200
b.	31	Supplies Expense Unused Supplies		200	200
c.	31	Interest Expense Interest Payable		25	25
d.	31	Subscription Revenue Unearned Subscription Revenue (\$9,000 x 5/6 mos. = \$7,500)		7,500	7,500
e.	31	Salaries Expense Salaries Payable		300	300
f.	31	Prepaid Rent Rent Expense		300	300
g.	31	Truck Operating Expense Accounts Payable		400	400

Bill Pitt Corp.
General Journal

	Date 2019	Description	PR	Debit	Credit
		<u>Adjusting Entries</u>			
a.	Dec. 31	Depreciation Expense—Truck Accumulated Depreciation—Truck (\$6,000 x 6/48 mos. = \$750 – 600 = \$150)		150	150
b.		No Entry Required			
c.	31	Unused Supplies Supplies Expense		300	300
d.	31	Rent Expense Prepaid Rent		400	400
e.	31	Wages Expense Wages Payable		250	250
f.	31	Interest Expense Interest Payable (\$8,000 x 10% = \$800 – 600 = \$200)		200	200
g.	31	Utilities Expense Utilities Payable		150	150
h.	31	Insurance Expense Prepaid Insurance (\$1,200 x 1/12 mos. = \$100 prepaid; \$600 – 100 = \$500)		500	500
i.	31	Unearned Rent Revenue Rent Earned		600	600
j.	31	Commissions Earned Other Unearned Revenue		2,000	2,000

P 3-5

1.

Pape Pens Corporation
General Journal

Page 1

	Dec. 2019	Description	PR	Debit	Credit
		<u>Adjusting Entries</u>			
a.	Dec.31	Insurance Expense	631	600	
		Prepaid Insurance	161		600
b.	31	Supplies Expense	668	200	
		Unused Supplies	173		200
c.	31	Depreciation Expense-Truck	624	1,000	
		Accumulated Depreciation- Truck	194		1,000
		(\$8,000 x 6/48 mos. = \$1,000)			
d.	31	Salaries Expense	656	200	
		Salaries Payable	226		200
e.	31	Unearned Rent Revenue	248	1,200	
		Rent Earned	440		1,200
f.	31	Telephone Expense	669	100	
		Accounts Payable	210		100
g.	31	Income Taxes Expense	830	300	
		Income Taxes Payable	260		300

P 3–5 continued

2.

Pape Pens Corporation Adjusted Trial Balance December 31, 2019			
Acct. No.	Account	Balance	
		Debit	Credit
101	Cash	\$ 3,300	
110	Accounts receivable	4,000	
161	Prepaid insurance	600	
173	Unused supplies	300	
184	Truck	8,000	
194	Acc. dep. – truck		\$ 1,000
210	Accounts payable		5,100
226	Salaries payable		200
248	Unearned rent revenue		1,200
260	Income taxes payable		300
320	Share capital		7,000
350	Dividends	1,000	
410	Commissions earned		16,100
440	Rent earned		1,200
610	Advertising expense	200	
615	Commissions expense	1,000	
624	Dep. expense – truck	1,000	
631	Insurance expense	600	
632	Interest expense	400	
654	Rent expense	3,600	
656	Salaries expense	7,200	
668	Supplies expense	200	
669	Telephone expense	400	
830	Income taxes expense	300	
		<u>\$32,100</u>	<u>\$32,100</u>

P 3–5 continued

3.

Pape Pens Corporation
Income Statement
For the Year Ended December 31, 2019

<i>Revenue</i>		
Commissions	\$16,100	
Rent	<u>1,200</u>	
Total revenue		\$17,300
<i>Expenses</i>		
Advertising	200	
Commissions	1,000	
Depreciation—truck	1,000	
Insurance	600	
Interest	400	
Rent	3,600	
Salaries	7,200	
Supplies	200	
Telephone	400	
Income taxes	<u>300</u>	
Total expenses		<u>14,900</u>
Net income		<u>\$ 2,400</u>

Pape Pens Corporation
Statement of Changes in Equity
For the Year Ended December 31, 2019

	<i>Share capital</i>	<i>Retained earnings</i>	<i>Total equity</i>
Balance, beginning of year	\$ -0-	\$ -0-	\$ -0-
Shares issued	7,000	-0-	7,000
Net income		2,400	2,400
Dividends	<u>-0-</u>	<u>(1,000)</u>	<u>(1,000)</u>
Balance, end of year	<u>\$7,000</u>	<u>\$1,400</u>	<u>\$8,400</u>

P 3–5 continued

3. continued

Pape Pens Corporation
Statement of Financial Position
At December 31, 2019

<i>Assets</i>		
Cash		\$ 3,300
Accounts receivable		4,000
Prepaid insurance		600
Unused supplies		300
Truck	\$8,000	
Less: Accum. dep.	<u>1,000</u>	<u>7,000</u>
Total assets		<u>\$15,200</u>
<i>Liabilities</i>		
Accounts payable		\$5,100
Salaries payable		200
Unearned rent revenue		1,200
Income taxes payable		<u>300</u>
Total liabilities		6,800
<i>Shareholders' Equity</i>		
Share capital	\$7,000	
Retained earnings	<u>1,400</u>	
Total shareholders' equity		<u>8,400</u>
Total liabilities and shareholders' equity		<u>\$15,200</u>

P 3–5 continued

4.

Pape Pens Corporation
General Journal

Page 2

Dec. 2019		Description	PR	Debit	Credit
		<u>Closing Entries</u>			
1.	Dec. 31	Commissions Earned	410	16,100	
		Rent Earned	440	1,200	
		Income Summary	360		17,300
		To close the revenue account balances.			
2.	31	Income Summary	360	14,900	
		Advertising Expense	610		200
		Commissions Expense	615		1,000
		Depreciation Expense—Truck	624		1,000
		Insurance Expense	631		600
		Interest Expense	632		400
		Rent Expense	654		3,600
		Salaries Expense	656		7,200
		Supplies Expense	668		200
		Telephone Expense	669		400
		Income Taxes Expense	830		300
		To close the expense account balances.			
3.	31	Income Summary	360	2,400	
		Retained Earnings	340		2,400
		To close the income summary balances to retained earnings.			
4.	31	Retained Earnings	340	1,000	
		Dividends	350		1,000
		To close dividends to retained earnings.			

P 3–5 continued

5.

Pape Pens Corporation
Post-closing Trial Balance
December 31, 2019

<i>Acct. No.</i>	<i>Account</i>	<i>Balance</i>	
		<i>Debit</i>	<i>Credit</i>
101	Cash	\$ 3,300	
110	Accounts receivable	4,000	
161	Prepaid insurance	600	
173	Unused supplies	300	
184	Truck	8,000	
194	Acc. dep. – truck		\$ 1,000
210	Accounts payable		5,100
226	Salaries payable		200
248	Unearned rent revenue		1,200
260	Income taxes payable		300
320	Share capital		7,000
340	Retained earnings		1,400
		<u>\$16,200</u>	<u>\$16,200</u>

P 3-6 1., 3., 4., and 6.

Roth Contractors Corporation

Cash (a) 5,000 (b) 1,200 (g) 800 (e) 1,800 (i) 2,000 (h) 3,450 (m) 2,000 (l) 3,225 <u>9,800</u> <u>9,675</u> Bal. 125	Accounts Payable (c) 10,000 (d) 1,000 (n) 100 <u>Bal. 11,100</u>	Share Capital (a) 5,000	Repair Revenue (r) 2,000 (f) 4,500 (g) 800 (j) 6,500 (m) 2,000 <u>2,000</u> <u>13,800</u> Bal. 11,800	Rent Expense (p) 400
Accounts Receivable (f) 4,500 (i) 2,000 (j) 6,500 <u>11,000</u> <u>2,000</u> Bal. 9,000	Wages Payable (s) 1,500		Advertising Expense (h) 350 (l) 200 Bal. 550	Supplies Expense (d) 1,000 (q) 350 Bal. 650
Prepaid Insurance (e) 1,800 (o) 150 Bal. 1,650	Unearned Repair Revenue (r) 2,000		Telephone Expense (h) 75	Truck Operating Expense (h) 425 (l) 375 Bal. 800
Prepaid Rent (b) 1,200 (p) 400 Bal. 800	Income Taxes Payable (u) 500		Depreciation Expense-Truck (t) 208	Utilities Expense (n) 100
Unused Supplies (q) 350			Insurance Expense (o) 150	Wages Expense (h) 2,500 (l) 2,500 (s) 1,500 Bal. 6,500
Truck (c) 10,000	Accum. Dep'n Truck (t) 208		Interest Expense (h) 100 (l) 150 Bal. 250 Income Taxes Expense (u) 500	

P 3–6 continued

2.

Roth Contractors Corporation
General Journal

Page 1

Dec. 2019	Description	PR	Debit	Credit
a.	Cash Share Capital		5,000	5,000
b.	Prepaid Rent Cash		1,200	1,200
c.	Truck Accounts Payable		10,000	10,000
d.	Supplies Expense Accounts Payable		1,000	1,000
e.	Prepaid Insurance Cash		1,800	1,800
f.	Accounts Receivable Repair Revenue		4,500	4,500
g.	Cash Repair Revenue		800	800
h.	Advertising Expense Interest Expense Telephone Expense Truck Operating Expense Wages Expense Cash		350 100 75 425 2,500	3,450
i.	Cash Accounts Receivable		2,000	2,000
j.	Accounts Receivable Repair Revenue		6,500	6,500
k.	No effect			
l.	Advertising Expense Interest Expense Truck Operating Expense Wages Expense Cash		200 150 375 2,500	3,225

P 3–6 continued

Roth Contractors Corporation
General Journal continued

Dec. 2019	Description	PR	Debit	Credit
m.	Cash Repair Revenue		2,000	2,000
n.	Utilities Expense Accounts Payable		100	100

5.

Roth Contractors Corporation
General Journal

Page 2

Dec. 31 2019	Description	PR	Debit	Credit
	<u>Adjusting Entries</u>			
o.	Insurance Expense Prepaid Insurance		150	150
p.	Rent Expense Prepaid Rent		400	400
q.	Unused Supplies Supplies Expense		350	350
r.	Repair Revenue Unearned Repair Revenue		2,000	2,000
s.	Wages Expense Wages Payable		1,500	1,500
t.	Depreciation Expense—Truck Accumulated Depreciation—Truck \$10,000/48 mos. = \$208 per month (rounded)		208	208
u.	Income Taxes Expense Income Taxes Payable		500	500

P 3-6 continued

7.		Roth Contractors Corporation	
		Adjusted Trial Balance	
		At December 31, 2019	
		<u>Account Balances</u>	
		<i>Debit</i>	<i>Credit</i>
Cash	\$	125	
Accounts Receivable		9,000	
Prepaid Insurance		1,650	
Prepaid Rent		800	
Unused Supplies		350	
Truck		10,000	
Accumulated Depreciation—Truck			\$ 208
Accounts Payable			11,100
Wages Payable			1,500
Income Taxes Payable			500
Unearned Revenue			2,000
Share Capital			5,000
Repair Revenue			11,800
Advertising Expense		550	
Depreciation Expense—Truck		208	
Insurance Expense		150	
Interest Expense		250	
Rent Expense		400	
Supplies Expense		650	
Telephone Expense		75	
Truck Operating Expense		800	
Utilities Expense		100	
Wages Expense		6,500	
Income Taxes Expense		500	
		<u>\$32,108</u>	<u>\$32,108</u>

8. Roth Contractors Corporation
Income Statement
For the Year Ended December 31, 2019

<i>Revenue</i>		
Repairs		\$11,800
<i>Expenses</i>		
Advertising	\$ 550	
Depreciation—truck	208	
Insurance	150	
Interest	250	
Rent	400	
Supplies	650	
Telephone	75	
Truck operating	800	
Utilities	100	
Wages	6,500	
Income taxes	<u>500</u>	
Total expenses		<u>10,183</u>
Net income		<u>\$ 1,617</u>

Roth Contractors Corporation
Statement of Changes in Equity
For the Year Ended December 31, 2019

	<i>Share capital</i>	<i>Retained earnings</i>	<i>Total equity</i>
Balance, beginning of year	\$ -0-	\$ -0-	\$ -0-
Shares issued	5,000	-0-	5,000
Net income		<u>1,617</u>	<u>1,617</u>
Balance, end of year	<u>\$5,000</u>	<u>\$1,617</u>	<u>\$6,617</u>

P 3–6 continued

3. continued

Roth Contractors Corporation
Statement of Financial Position
At December 31, 2019

<i>Assets</i>	
Cash	\$ 125
Accounts receivable	9,000
Prepaid insurance	1,650
Prepaid rent	800
Unused supplies	350
Truck	\$10,000
Less: Accum. dep.	<u>208</u>
Total assets	<u>\$21,717</u>
<i>Liabilities</i>	
Accounts payable	\$11,100
Wages payable	1,500
Unearned repair revenue	2,000
Income taxes payable	<u>500</u>
Total liabilities	15,100
<i>Shareholders' Equity</i>	
Share capital	\$5,000
Retained earnings	<u>1,617</u>
Total shareholders' equity	<u>6,617</u>
Total liabilities and shareholders' equity	<u>\$21,717</u>

P 3–6 continued

9.

Roth Contractors Corporation
General Journal

Page 2

Dec. 2019		Description	PR	Debit	Credit
		<u>Closing Entries</u>			
1.	Dec. 31	Repair Revenue Income Summary To close the revenue account balances.		11,800	11,800
2.	31	Income Summary Advertising Expense Depreciation Expense—Truck Insurance Expense Interest Expense Rent Expense Supplies Expense Telephone Expense Truck Operating Expense Utilities Expense Wages Expense Income Taxes Expense To close the expense account balances.		10,183	550 208 150 250 400 650 75 800 100 6,500 500
3.	31	Income Summary Retained Earnings To close the income summary balances to retained earnings.		1,617	1,617

P 3–6 continued

9. continued

Roth Contractors Corporation
Post-closing Trial Balance
December 31, 2019

<i>Account</i>	<i>Balance</i>	
	<i>Debit</i>	<i>Credit</i>
Cash	\$ 125	
Accounts receivable	9,000	
Prepaid insurance	1,650	
Prepaid rent	800	
Unused supplies	350	
Truck	10,000	
Acc. dep. – truck		\$ 208
Accounts payable		11,100
Wages payable		1,500
Unearned repair revenue		2,000
Income taxes payable		500
Share capital		5,000
Retained earnings		1,617
	<u>\$21,925</u>	<u>\$21,925</u>

P 3-7

1., 3., 4., and 6.

Snow Services Corporation

<u>Cash</u>	
Bal.	30,000
(b)	12,000
(f)	900
(g)	150
(i)	<u>1,200</u>
	44,250
Bal.	15,650
<u>Short-term Investments</u>	
(d)	5,000
<u>Interest Receivable</u>	
(q)	50
<u>Prepaid Insurance</u>	
(c)	600
Bal.	550
<u>Unused Supplies</u>	
(o)	200
<u>Equipment</u>	
(h)	5,000
<u>Truck</u>	
(a)	15,000
<u>Accumulated Depreciation-Equipment</u>	
	(r) 104
<u>Accumulated Depreciation-Truck</u>	
	No.194
	(k) 250

<u>Accounts Payable</u>	
	(e) 500
<u>Wages Payable</u>	
	(t) 150
<u>Unearned Advertising Revenue</u>	
	(p) 600
<u>Unearned Fees Revenue</u>	
	(l) 8,000
<u>Unearned Interest Revenue</u>	
	(n) 75
<u>Unearned Rent Revenue</u>	
	(s) 800

<u>Share Capital</u>	
Bal.	30,000

<u>Other Revenue</u>	
(p)	600
	(f) 900
	Bal. 300
<u>Interest Earned</u>	
(n)	75
	(g) 150
	(q) 50
	75
	200
	Bal. 125

<u>Rent Earned</u>	
(s)	800
	(i) 1,200
	Bal. 400

<u>Service Revenue</u>	
(l)	8,000
	(b) 12,000
	Bal. 4,000

<u>Depreciation Expense-Equipment</u>	
(r)	104
<u>Depreciation Expense-Truck</u>	
(k)	250
<u>Insurance Expense</u>	
(m)	50
<u>Supplies Expense</u>	
(e)	500
	(o) 200
Bal.	300
<u>Wages Expense</u>	
(j)	3,000
(t)	150
Bal.	3,150

P 3–7 continued

2.

Snow Services Corporation
General Journal

Page 1

	Jan. 2019	Description	PR	Debit	Credit
a.	Jan. 31	Truck Cash		15,000	15,000
b.	31	Cash Service Revenue		12,000	12,000
c.	31	Prepaid Insurance Cash		600	600
d.	31	Short-term investments Cash		5,000	5,000
e.	31	Supplies Expense Accounts Payable		500	500
f.	31	Cash Other Revenue		900	900
g.	31	Cash Interest Earned		150	150
h.	31	Equipment Cash		5,000	5,000
i.	31	Cash Rent Earned		1,200	1,200
j.	31	Wages Expense Cash		3,000	3,000

P 3–7 continued

5. Snow Services Corporation
General Journal

Page 2

Jan 2019		Description	PR	Debit	Credit
		<u>Adjusting Entries</u>			
k.	Jan. 31	Depreciation Expense—Truck Accumulated Depreciation—Truck (\$15,000 x 1/60 mos. = \$250)		250	250
l.	31	Service Revenue Unearned Fees Revenue		8,000	8,000
m.	31	Insurance Expense Prepaid Insurance		50	50
n.	31	Interest Earned Unearned Interest Revenue		75	75
o.	31	Unused Supplies Supplies Expense		200	200
p.	31	Other Revenue Unearned Advertising Revenue		600	600
q.	31	Interest Receivable Interest Earned		50	50
r.	31	Depreciation Expense—Equipment Accumulated Depreciation—Equipment (\$5,000 x 1/48 mos. = \$104 rounded)		104	104
s.	31	Rent Earned Unearned Rent Revenue		800	800
t.	31	Wages Expense Wages Payable		150	150

7. Snow Services Corporation
Adjusted Trial Balance
January 31, 2019

	<u>Account Balances</u>	
	<i>Debit</i>	<i>Credit</i>
Cash	\$15,650	
Short-term investments	5,000	
Interest receivable	50	
Prepaid insurance	550	
Unused supplies	200	
Equipment	5,000	
Truck	15,000	
Accumulated depreciation—equipment		\$ 104
Accumulated depreciation—truck		250
Accounts payable		500
Wages payable		150
Unearned advertising revenue		600
Unearned fees revenue		8,000
Unearned interest revenue		75
Unearned rent revenue		800
Share capital		30,000
Other revenue		300
Interest earned		125
Rent earned		400
Service revenue		4,000
Depreciation expense—equipment	104	
Depreciation expense—truck	250	
Insurance expense	50	
Supplies expense	300	
Wages expense	<u>3,150</u>	
	<u>\$45,304</u>	<u>\$45,304</u>

CHAPTER FOUR

The Classified Statement of Financial Position and Related Disclosures

Concept Self-check

1. Economists define wealth as an increase or decrease in the entity's ability to purchase goods and services. Accountants use a more specific measurement—they consider only increases and decreases resulting from actual transactions. If a transaction has not taken place, they do not record a change in wealth.
2. Financial statements are primarily intended for external users.
3. Assets and liabilities are classified as either *current* or *non-current*. The current asset category includes accounts whose future benefits are expected to expire within one fiscal year. Non-current assets consist of PPE, long-term investments like shares of another corporation, and intangible assets like patents. Current liabilities consist of amounts due within one-year on borrowings, accounts payable, and accruals like income taxes payable. Non-current liabilities include items like long-term borrowings. Shareholder's equity is divided into share capital and retained earnings.
4. Current assets are those resources that the entity expects to convert to cash or consume in the upcoming fiscal year or operating cycle, whichever is longer.
5. Non-current assets are assets that will be useful for more than one year or more than one operating cycle, whichever is longer.
6. Current liabilities are obligations that must be paid within the next fiscal year, or normal operating cycle, if this is longer than the fiscal year.
7. Non-current liabilities are borrowings that do not require repayment for more than one year or for more than one operating cycle, whichever is longer.
8. Notes to the financial statements provide relevant details that are not included in the body of the financial statements, like repayment terms of borrowings and depreciation rates of plant and equipment. Notes usually also disclose items like significant accounting policies and assumptions used to prepare the financial statements.
9. The auditor's report is a structured statement issued by an independent examiner, usually a professional accountant, who is contracted by the company to report the audit's findings to the company's board of directors. An audit report provides some assurance to present and potential investors and creditors that the company's financial statements are trustworthy. Therefore, it is a useful means to reduce the risk of their financial decisions.

Concept Self-check continued

10. The report describes management's responsibility for the accurate preparation and presentation of financial statements. This statement underscores the division of duties involved with the publication of financial statements. It clearly states that management is responsible for preparing the financial statements, including estimates that underlie the accounting numbers.
11. The economic resources of Big Dog Carworks Corp. are its assets: cash, accounts receivable, inventories, prepaid expenses and property, plant and equipment.
12. The financial statements are the statement of financial position, the income statement, the statement of changes in equity, and the statement of cash flows. Notes to the financial statements are also included. The statements report the financial position of the company at year-end, the results of operations for the year, changes in share capital and retained earnings, sources and uses of cash during the year, and information in the notes that is not quantifiable or that provides additional supporting information to the financial statements.
13. Fundamentally, accounting measures the financial progress of an entity. The purpose of financial statements is to communicate information about this progress to external users, chiefly investors and creditors.
14. $\text{ASSETS} = \text{LIABILITIES} + \text{SHAREHOLDERS' EQUITY}$
 $\$284,645 = 241,145 + 43,500.$
15. Net assets equal \$43,500 ($\$284,645 - 241,145$). Net assets is synonymous with shareholder's equity. They represent the amount of total assets attributable to the shareholders after taking into account the claims of creditors.
16. The individual assets of Big Dog Carworks Corp. as shown on the statement of financial position are cash, accounts receivable, merchandise inventories, prepaid expenses, and property, plant, and equipment. Its liabilities are borrowings, accounts payable, and income taxes payable.
17. GAAP permit the accountant to report financial information more fairly, objectively, comparably, and relevantly to outside parties who rely on this information. For instance, the use of accrual accounting allows the activities of the company to be divided into meaningful time periods that facilitate the timely analysis of financial performance.
18. Note 3(g) refers to materiality as a consideration in the estimates and assumptions used to recognise assets, liabilities, income, and expenses. The fact that all figures are rounded to the nearest dollar is an application of materiality.
19. Big Dog Carworks Corp. uses the accrual basis of accounting because it records items such as accounts receivable, inventory, and accounts payable.
20. Per Note 3(d), property, plant, and equipment are depreciated on a straight-line basis over their estimated useful lives. Land is not depreciated.

Concept Self-check continued

21. The president's salary is payment for work already done, not for work that will be done. It is likely true that some work the president has done will benefit future periods, but this benefit is too difficult to quantify and involves too much uncertainty to record it as an asset.
22.
 - a. Current asset accounts: Per Note 3(a), revenue and expenses are accrued. This will give rise to current assets like accounts receivable, prepaid expenses, accounts payable, income taxes payable, and accrued liabilities.
 - b. Non-current asset accounts: Per Note 3(d), PPE are depreciated at various rate. This would require yearly adjustments to the accounts.
 - c. Current liability accounts: income taxes payable are adjusted at the end of the period to reflect the estimated amount of taxes incurred for the period. All expenses that are incurred but not yet paid are added to the unrecorded accrual accounts. Examples are salaries payable for partial periods and interest owed but not yet paid.
 - d. Non-current liability accounts: borrowings must be analyzed to determine current and non-current amounts, as shown in Note 5.
23. The accounting process is generally as follows and likely applies to BDCC:
 - a. Transactions are analyzed and recorded in the general journal.
 - b. The general journal entries are posted to the general ledger accounts.
 - c. The equality of debits and credits is established by the trial balance.
 - d. The account balances are analyzed, and adjusting entries are prepared.
 - e. The adjusting entries are posted to the general ledger accounts.
 - f. An adjusted trial balance is prepared to prove the equality of debits and credits.
 - g. Closing entries are prepared from the worksheet.
 - h. Closing entries are posted to the general ledger.
 - i. A post-closing trial balance is prepared.
24. The statement of financial position is classified in order to facilitate the analysis of its information. For instance, comparing amounts that will be needed to be satisfied within the upcoming year (current liabilities) with resources available to satisfy these claims (current assets) allows readers to assess the relative ability of the corporation to meet its short-term obligations as they become due.
25. Big Dog Carworks Corp. makes it easier to compare financial information from period to period by presenting comparative annual financial data for two years.
26. The auditor is H. K. Walker, Chartered Professional Accountant. The audit report states that the financial statements of BDCC have been examined in accordance with generally accepted auditing standards. It also states that, in the auditor's opinion, the statements present fairly the financial position of BDCC and the results of its operations and changes in financial position for the year ended December 31, 2020. There are no concerns raised in the report.

Concept Self-check continued

27. The auditor's report indicates that GAAP have been consistently applied in BDCC's financial statements (see last sentence of the report).
28. Management's responsibilities for financial statements are to:
 - a. Ensure that they are prepared in accordance with GAAP, in this case International Financial Reporting Standards.
 - b. Ensure their integrity and objectivity.
 - c. Establish a system of internal controls to safeguard assets and produce reliable accounting records.

Though the financial statements are produced under the direction of management, they belong to the shareholders. Shareholders are the beneficial owners of the company.

Viking Company Ltd.
Statement of Financial Position
At December 31, 2019

<i>Assets</i>		
<i>Current</i>		
Cash	\$20	
Accounts receivable	100	
Notes receivable	40	
Prepaid insurance	30	
Unused supplies	<u>10</u>	
Total current assets		\$ 200
<i>Property, plant, and equipment</i>		
Land	2,000	
Building	1,000	
Equipment	<u>500</u>	
Net property, plant, and equipment		<u>3,500</u>
Total assets		<u>\$3,700</u>
<i>Liabilities</i>		
<i>Current</i>		
Accounts payable	\$200	
Bank loan	500	
Salaries payable	<u>60</u>	
Total current liabilities		\$ 760
<i>Non-current</i>		
Mortgage payable		<u>1,500</u>
Total liabilities		2,260
<i>Shareholders' Equity</i>		
Share capital	1,200	
Retained earnings	<u>220</u>	
Total shareholders' equity		<u>1,440</u>
Total liabilities and shareholders' equity		<u>\$3,700</u>

Oregon Corporation
Statement of Financial Position
At October 31, 2019

<i>Assets</i>		
<i>Current</i>		
Cash	\$2	
Accounts receivable	5	
Inventories	<u>3</u>	
Total current assets		\$ 10
<i>Non-current investments</i>		4
<i>Property, plant, and equipment</i>		
Land	200	
Buildings	10	
Equipment	<u>5</u>	
Net property, plant, and equipment		<u>215</u>
Total assets		<u>\$229</u>
<i>Liabilities</i>		
<i>Current</i>		
Accounts payable	\$30	
Current portion of mortgage payable	<u>4</u>	
Total current liabilities		\$34
<i>Non-current</i>		
Mortgage payable		<u>6</u>
Total liabilities		40
<i>Shareholders' Equity</i>		
Share capital	100	
Retained earnings (balancing figure)	<u>89</u>	
Total shareholders' equity		<u>189</u>
Total liabilities and shareholders' equity		<u>\$229</u>

1. Equipment is always an asset and in this case non-current asset, as its useful life is likely greater than one fiscal year. Cash is almost always a current asset. Short-term investments are current assets because they are readily marketable, by definition. Notes receivable should be divided into current and non-current portions. Unused supplies are likely current assets, as they are generally used in the next fiscal year. The bank loan is a liability divided into current and non-current portions as indicated. Salaries payable is likely a current liability, as these will be paid in the next fiscal year in all likelihood. The last line on the statement of financial position should read "Total Liabilities and Shareholders' Equity". The statement of financial position lists a building account but not a land account. Sometimes a company owns a building without owning land, but it is more likely that these two assets should have been separated when they were acquired. The building (or land and building) is correctly shown as a current asset as it was sold within one fiscal year of the statement of financial position date. A note to the financial statements would be needed to explain why this item is treated in such an unusual manner. Retained earnings should be shown in the shareholders' equity section.
3. Additional disclosure should be considered for (see BDCC notes in text):
 - treatment of capitalised borrowing costs, if any
 - valuation bases for non-current assets, share capital, and inventory
 - depreciation rates for plant and equipment
 - details about cost and accumulated depreciation amounts for property, plant, and equipment
 - details about debt, including basis of valuation, interest rates, due dates, any assets securing the debt, repayment amounts and intervals, and when terms will be re-negotiated
 - details about share capital.

2.

Abbey Limited
Statement of Financial Position
At November 30, 2019

<i>Assets</i>	
<i>Current</i>	
Cash	\$ 1,000
Short-term investments	2,500
Notes receivable	5,000
Merchandise inventory	3,000
Unused supplies	100
Building*	<u>12,000</u>
Total current assets	\$23,600
<i>Non-current notes receivable</i>	1,000
<i>Property, plant, and equipment</i>	
Equipment	2,000
Truck	<u>1,350</u>
Net property, plant, and equipment	<u>3,350</u>
Total assets	<u>\$27,950</u>
<i>Liabilities</i>	
<i>Current</i>	
Bank loan	\$ 400
Accounts payable	5,600
Notes payable	500
Salaries payable	250
Current portion of mortgage payable	<u>2,000</u>
Total current liabilities	\$ 8,750
<i>Non-current</i>	
Bank loan	600
Notes payable	1,500
Mortgage payable	<u>4,000</u>
Total non-current liabilities	<u>6,100</u>
Total liabilities	14,850
<i>Shareholders' Equity</i>	
Share capital	11,100
Retained earnings	<u>2,000</u>
Total shareholders' equity	<u>13,100</u>
Total liabilities and shareholders' equity	<u>\$27,950</u>

*Land may need to be separated out

P 4-2

1. a. 2019 net income is \$1,000, the balancing figure in the adjusted trial balance to produce a zero column total for that year, assuming normal debit/credit balances:

<i>Account</i>	<i>2019 Dr(Cr)</i>
Accounts payable	\$(4,000)
Accounts receivable	3,000
Notes receivable	2,000
Bank loan	(5,000)
Building	20,000
Cash	1,000
Dividends	-0-
Equipment	12,000
Income taxes payable	(2,500)
Land	5,000
Merchandise inventory	24,500
Mortgage payable	(7,000)
Prepaid insurance	1,000
Share capital	(48,000)
Retained earnings, start of year	(1,000)
Net income	<u>(1,000)</u>
Total	<u>\$ -0-</u>

- b. Opening 2020 retained earnings must be the same as 2019 ending retained earnings:

	<i>2019</i>
2019 opening retained earnings (given)	\$ 1,000
Net income (per above)	1,000
Dividends (given)	<u>(-0-)</u>
2019 ending retained earnings	<u>\$2,000</u>

- c. 2020 net income is \$6,000, the balancing figure in the 2020 adjusted trial balance column to produce a zero total for that year, assuming opening retained earnings of \$2,000 and normal debit/credit balances:

<i>Account</i>	<i>2020 Dr(Cr)</i>
Accounts payable	\$(7,000)
Accounts receivable	5,000
Notes receivable	3,000
Bank loan	(5,000)
Building	24,000
Cash	2,000
Dividends	1,000
Equipment	16,000
Income taxes payable	(3,000)
Land	5,000
Merchandise inventory	19,000
Mortgage payable	(5,000)
Prepaid insurance	1,000
Share capital	(48,000)
Retained earnings, start of year (1.b)	(2,000)
Net income	(6,000)
Total	<u><u>\$ -0-</u></u>

2. Joyes Enterprises Ltd.
Statement of Financial Position
At December 31, 2020
(\$000)

<i>Assets</i>		
<i>Current</i>	<i>2020</i>	<i>2019</i>
Cash	\$ 2,000	\$ 1,000
Accounts receivable	5,000	3,000
Merchandise inventory	19,000	24,500
Prepaid insurance	1,000	1,000
Notes receivable	<u>1,500</u>	<u>2,000</u>
Total current assets	<u>28,500</u>	<u>31,500</u>
<i>Non-current notes receivable</i>	<u>1,500</u>	<u>-0-</u>
<i>Property, plant, and equipment</i>		
Land	5,000	5,000
Buildings	24,000	20,000
Equipment	<u>16,000</u>	<u>12,000</u>
Net property, plant, and equipment	<u>45,000</u>	<u>37,000</u>
Total assets	<u>\$75,000</u>	<u>\$68,500</u>
<i>Liabilities</i>		
<i>Current</i>		
Bank loan*	\$ 1,000	\$ -0-
Mortgage payable*	2,000	2,000
Accounts payable	7,000	4,000
Income taxes payable	<u>3,000</u>	<u>2,500</u>
Total current liabilities	<u>13,000</u>	<u>8,500</u>
<i>Non-current</i>		
Bank loan	4,000	5,000
Mortgage payable	<u>3,000</u>	<u>5,000</u>
Total non-current liabilities	<u>7,000</u>	<u>10,000</u>
Total liabilities	<u>20,000</u>	<u>18,500</u>
<i>Shareholders' Equity</i>		
Share capital	48,000	48,000
Retained earnings (per 1. above)	<u>7,000</u>	<u>2,000</u>
Total shareholders' equity	<u>55,000</u>	<u>50,000</u>
Total liabilities and shareholders' equity	<u>\$75,000</u>	<u>\$68,500</u>

*The mortgage payable declined from \$7,000 to \$5,000 during 2020. Therefore, the current portion at December 31, 2019 must be \$2,000. The bank loan balance did not change during 2020. Therefore, the current portion at December 31, 2019 must be \$-0-.

P 4-2 continued

3. Current assets total \$28,500. Current liabilities total \$13,000. The company appears to have sufficient resources to meet its obligations in 2021.

4. The statement of financial position would show:

	2020	2019
<i>Property, plant, and equipment</i> (Note X)	\$45,000	\$37,000

Note X might show:

X. Property, plant, and equipment

Details of the company's property, plant, and equipment and their carrying amounts at December 31 are as follows:

	2020				2019
	<i>Land</i>	<i>Building</i>	<i>Equip.</i>	<i>Total</i>	<i>Total</i>
Carrying Amount, Jan. 1	\$ 5,000	\$ 20,000	\$ 12,000	\$37,000	\$ 37,000
Additions	-0-	4,000	4,000	8,000	-0-
Carrying Amount, Dec. 31	<u>\$ 5,000</u>	<u>\$ 24,000</u>	<u>\$ 16,000</u>	<u>\$45,000</u>	<u>\$ 37,000</u>

(Other presentation formats are acceptable if reasonable and informative.)

P 4-3

- b 1. The significant accounting policies, which management believes are appropriate for the company, are described in Note X to the financial statements.
- c 2. The financial statements of Acme Supplies Ltd. have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued the International Accounting Standards Boards (IASB).
- b 3. Management has established systems of internal control that are designed to provide reasonable assurance that assets are safeguarded from loss or unauthorized use [. . .]
- b 4. The board of directors is responsible for ensuring that management fulfils its responsibilities for financial reporting and internal control.
- c 5. When preparing the financial statements, management undertakes a number of judgments, estimates, and assumptions about the recognition and measurement of assets, liabilities, income, and expenses. Information about estimates and assumptions that have the most significant effect on recognition and measurement of assets, liabilities, income, and expenses is provided below. Actual results may be substantially different.
- c 6. The mortgage is payable to Last Chance Bank. It bears interest at 5% per year and is amortized over 20 years.

P 4-3 continued

- a 7. [...] the accompanying financial statements of Acme Supplies Ltd., which comprise the statement of financial position as at December 31, 2019, the income statement, statement of changes in equity, and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.
- a 8. An [...] involves performing procedures to obtain [...] evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the [...] judgment, including assessment of the risks of material misstatement of the financial statements, whether due to fraud or error.
- b 9. The accompanying financial statements of the company are the responsibility of management.
- c 10. Revenue arises from the rendering of service. It is measured by reference to the fair value of consideration received or receivable.
- c 11. The bank loan is due on demand and bears interest at 4% per year. It is secured by real estate of the company.
- b 12. The audit committee reviews the annual financial statements and reporting to the board, and makes recommendations with respect to their acceptance.
- b 13. Management recognizes its responsibility for conducting the company's affairs in compliance with established financial standards and applicable laws, and maintains proper standards of conduct for its activities.
- a 14. My responsibility is to express an opinion on the financial statements based on my audit.
- b 15. Estimates are necessary in the preparation of these statements and, based on careful judgments, have been properly reflected.
- a 16. I believe that the [...] evidence I have obtained is sufficient and appropriate to provide a basis for my [...].
- c 17. Land held for use in production or administration is stated at cost. Other property, plant, and equipment are initially recognized at acquisition cost plus any costs directly attributable to bringing the assets to the locations and conditions necessary to be employed in operations. They are subsequently measured using the cost model: cost less subsequent depreciation.
- b 18. In making those risk assessments, [...] considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design [...] procedures that are appropriate in the circumstances
- c 19. The share capital of Acme Supplies Ltd. consists of fully-paid common shares with a stated value of \$1 each.
- c 20. The principal activity of Acme Supplies Ltd. is the retail sale of merchandise.

CHAPTER FIVE

Accounting for the Sale of Goods

Concept Self-check

1. A company providing a service holds no inventory for resale. A company that sells goods must match the cost of the goods sold with the revenue the sales generate. The income statement will show this. This includes the calculation of gross profit—the difference between sales and cost of goods sold. A service business income statement would not show these items.
2. Gross profit results from deducting cost of goods sold from sales. For example, if a vehicle is sold for \$16,000 but cost \$12,000, the gross profit calculation would be

Sales	\$16,000
Cost of Goods Sold	<u>12,000</u>
Gross Profit	<u>4,000</u>

The gross profit on the sale is \$4,000. The gross profit percentage is $\$4,000/\$16,000$ or 25 per cent. That is for every \$1 of sales, the business earns \$.25 on average to cover other expenses.

3. In a perpetual inventory system, the Merchandise Inventory and Cost Of Goods Sold accounts in the general ledger are updated immediately when a purchase or sale of goods occurs.
4. When merchandise inventory is purchased, the cost is recorded in a Merchandise Inventory general ledger account.
5. The amount of a purchase allowance is recorded as a credit to the Merchandise Inventory account and a debit to Accounts Payable (or Cash if the account has been paid and a cheque received.)
6. The term “1/15, n30” means that the amount owing must be paid within 30 days (‘n’ = net). However, if cash payment is made within 15 days, the purchase price will be reduced by 1%.
7. A purchase discount is recorded at the time of payment. Accounts Payable is debited for the full amount. Cash is credited for the net payment (full amount owing minus the purchase discount). Merchandise inventory is credited for the amount of the purchase discount.
8. The sale of merchandise inventory is recorded with two entries:
 - a. recording the sale by debiting Cash or Accounts Receivable and crediting Sales, and
 - b. recording the cost of the sale by debiting Cost of Goods Sold and crediting Merchandise Inventory.

Concept Self-check continued

9. When a sales return occurs, the sales and related cost of goods sold recorded in the general ledger are reversed, since the goods are returned to inventory.
10. A sales discount is a reduction in sales amounts when a customer pays within a certain time period. Cash is debited for the net amount (amount receivable less sales discount). Accounts Receivable is credited for the full amount. Sales Discounts is debited for the amount of the discount. This account is netted against Sales on the income statement.
11. Usually, a physical count of inventory is conducted at the fiscal year-end and valued. This amount is then compared to the Merchandise Inventory account balance in the general ledger. These should agree, unless inventory has been lost for some reason. This discrepancy is called shrinkage. To adjust for shrinkage, Merchandise Inventory is credited and Cost of Goods Sold is debited.
12. Purchases, purchase discounts and allowances, transportation expenses to deliver goods to the merchandiser, and shrinkage are recorded in the Merchandise Inventory general ledger account under the perpetual inventory system.
13. All items with credit balances are still closed to the Income Summary for a merchandising company. In a service company, usually this closing entry only includes the Revenue general ledger account. In a merchandising company, Purchase Returns and Allowances and Purchase Discounts, as well as Sales, will also be closed to the Income Summary, as these all have normal credit balances. Additional accounts with normal debit balances also need to be closed to the Income Summary in a merchandising company. These include Sales Discounts and Sales Returns and Allowances under a perpetual inventory system.
14. The classified multiple-step income statement shows expenses by both function and nature. The broad categories that show expenses by function include operating expenses, selling expenses, general and administrative expenses, and income taxes. Within each of these categories, the nature of expenses is disclosed such as sales salaries, advertising, depreciation, supplies, and insurance.
15. Rent revenue, interest and dividends earned, and gains on the sale of property, plant, and equipment are reported under Other Revenues and Expenses because these types of revenue are usually not part of normal operations. Interest expense can also be listed under Other Revenues and Expenses because it does not result from operating activities; it is a financing activity because it is associated with the borrowing of money. Other examples of non-operating expenses include losses on the sale of property, plant, and equipment.

Concept Self-check continued

16. The perpetual inventory system records all transactions affecting the statement of financial position item Merchandise Inventory at the point that these are incurred. These expenditures' include purchases, import duties, discounts and allowances for damage and returns, transportation and handling costs necessary to prepare goods for sale, and subsequent sales of merchandise to customers. The periodic inventory system records all these types of transactions as income statement items. The Merchandise Inventory account is adjusted only at the end of the accounting year. A physical count of goods on hand is conducted, the goods are valued and the Merchandise Inventory account is adjusted accordingly. The advantage of the perpetual inventory system is its relative simplicity and lower administrative costs. The advantage of the perpetual inventory system is that it provides a more accurate inventory valuation at all times. It can be used to compare recorded and actual inventory items on hand at year-end to determine if there are discrepancies due to theft, for instance.
17. The contra accounts associated with Purchases are
 - a. Purchase returns and Allowances, which accumulates goods returned to suppliers because of some defect or error; and
 - b. Purchase discounts, which accumulates discounts taken when payment is made within a specified discount period.
18. Cost of goods available for sale is calculated by taking opening inventory (counted and valued at the prior period-end), adding the balance from the Purchases account in the, deducting Purchase Returns and Allowances and Purchase Discounts balances, and adding the Transportation-In balance from their general ledger accounts.
19. Cost of goods sold is calculated by taking cost of goods available for sale (see #18 above), and deducting ending inventory (counted and valued at the period-end).
20. Ending inventory is recorded in the accounts of a merchandiser through closing entries. The opening balance in the Merchandising Inventory (statement of financial position) account is credited and the Income Summary account debited. The ending inventory is counted and valued. This amount is then recorded by debiting the Merchandise Inventory account in the general ledger and crediting the Income Summary account.

CP 5–1

1.

	2022	2021	2020	2019
Sales	\$10,000	\$9,000	\$8,000	\$7,000
Cost of Goods Sold	<u>7,500</u>	<u>6,840</u>	<u>6,160</u>	<u>^b 5,460</u>
Gross Profit	<u>2,500</u>	<u>2,160</u>	<u>1,840</u>	<u>^a \$1,540</u>
Gross Profit Percentage	<u>25%</u>	<u>24%</u>	<u>23%</u>	<u>22%</u>

^a \$7,000 x .22 = \$1,540
^b \$7,000 – 1,540 = \$5,460

2. Gross profit percentages are increasing steadily each year, as are sales. These are healthy trends.

CP 5–2

Reber Corp.
General Journal

Date 2019	Description	PR	Debit	Credit
Jul. 6	Merchandise Inventory Accounts Payable To record purchase of inventory on account.	150 210	600	600
9	Accounts Payable Merchandise Inventory To record returns made on goods purchased.	210 150	200	200
15	Accounts Payable Cash Purchase Discounts To record payment made within discount period [((\$600 – 200) x 1% = \$4].	210 101 559	400	396 4

Boucher Ltd.
General Journal

Date 2019	Description	PR	Debit	Credit
Jun. 1	Merchandise Inventory	150	1,200	
	Accounts Payable	210		1,200
	To record inventory purchase.			
3	Accounts Receivable	110	1,500	
	Sales	500		1,500
	Cost of Goods Sold	570	1,200	
	Merchandise Inventory	150		1,200
	To record sale to Wright Inc.: terms 2/10, net 30.			
8	Sales Returns and Allowances	508	800	
	Accounts Receivable	110		800
	Merchandise Inventory	150	600	
	Cost of Goods Sold	570		600
	To record merchandise returned.			
13	Sales Discounts	509	14	
	Cash	101	686	
	Accounts Receivable	110		700
	To record payment received and discount taken [$(\$1,500 - 800) \times 2\% = \14].			

1. Horne Inc.:

May 5	Accounts Receivable	4,000	
	Sales		4,000
	Cost of Goods Sold	2,500	
	Merchandise Inventory		2,500
	To record sale on account to Sperling.		
May 7	Sales Returns and Allowances	500	
	Accounts Receivable		500
	Merchandise Inventory	300	
	Cost of Goods Sold		300
	To record return of items from Sperling.		
May 15	Cash	3,430	
	Sales Discounts	70	
	Accounts Receivable		3,500
	To record payment by Sperling: discount applied.		
Dec. 31	Cost of Goods Sold	100	
	Merchandise Inventory		100
	To adjust the Merchandise Inventory account at year-end to physical count ($\$3,000 - 2,500 + 300 = \800 per records - $\$700$ per count = $\$100$ adjustment needed for shrinkage.)		

2. Sperling Renovations Ltd:

May 5	Merchandise Inventory	4,000	
	Accounts Payable		4,000
	To record purchase on account from Horne.		
May 7	Accounts Payable	500	
	Merchandise Inventory		500
	To record return of merchandise to Horne.		
May 15	Accounts Payable	3,500	
	Merchandise Inventory	70	
	Cash		3,430
	To record payment to Horne: discount taken.		

CP 5–5

1.

Smith Corp.
Income Statement
For the Year Ended June 30, 2019

Sales		\$72,000
Less: Sales returns and allowances		<u>(2,000)</u>
Net sales		70,000
Cost of goods sold		<u>50,000</u>
Gross profit		20,000
<i>Selling expenses</i>		
Advertising	\$1,500	
Commissions	4,000	
Delivery	1,000	
Insurance	1,000	
Rent	2,500	
Salaries	<u>5,000</u>	<u>15,000</u>
Net income		<u>\$ 5,000</u>

2. Gross profit percentage = $\$20,000 / 70,000 = 28.6\%$

CP 5–6

(a)

Dec. 31	Sales	500	72,000	
	Income Summary	360		72,000

To close all income statement accounts with credit balances to the Income Summary account.

(b)

Dec. 31	Income Summary	360	67,000	
	Advertising Expense	610		1,500
	Commissions Expense	615		4,000
	Cost of Goods Sold	570		50,000
	Delivery Expense	620		1,000
	Insurance Expense	631		1,000
	Rent Expense	654		2,500
	Salaries Expense	656		5,000
	Sales Returns and Allowances	508		2,000

To close all income statement accounts with debit balances to the Income Summary and remove opening inventory from the Merchandise Inventory account.

(c)

Dec. 31	Income Summary	360	5,000	
	Retained Earnings	340		5,000

To close the Income Summary account to the Retained Earnings account.

CP 5-7

Opening Inventory + Purchases + Transportation-In = Cost of Goods Available
 Cost of Goods Available - Ending Inventory = Cost of Goods Sold

- A. $? + \$1,415 + \$25 = \$1,940$
 Opening Inventory = \$500

 $\$1,940 - \$340 = ?$
 Cost of Goods Sold = \$1,600
- B. $\$184 + ? + \$6 = \$534$
 Purchases = \$344

 $\$534 - \$200 = ?$
 Cost of Goods Sold = \$334
- C. $\$112 + \$840 + \$15 = ?$
 Cost of Goods Available = \$967

 $\$967 - \$135 = ?$
 Cost of Goods Sold = \$832
- D. $\$750 + \$5,860 + ? = \$6,620$
 Transportation-In = \$10

 $\$6,620 - ? = \$5,740$
 Ending Inventory = \$880

CP 5-8

Opening inventory		\$ 375
Purchases	\$2,930	
Purchase discounts	(5)	
Purchase returns and allowances	(20)	
Transportation-in	105	
Goods available for sale		3,010
Less: Ending inventory		(440)
Cost of goods sold		<u>\$2,945</u>

CP 5–9

1.

	A	B	C	D
Sales (a)	<u>\$300</u>	<u>\$150</u>	<u>\$300⁸</u>	<u>\$ 90</u>
Opening Inventory	80 ¹	40	40	12
Purchases	<u>240</u>	<u>120⁶</u>	<u>220⁷</u>	<u>63</u>
Cost of Goods Available	320	160 ⁵	260	75 ⁹
Less: Ending Inventory	<u>(120)³</u>	<u>(60)</u>	<u>(60)</u>	<u>(15)</u>
Cost of Goods Sold	<u>200²</u>	<u>100</u>	<u>200</u>	<u>60</u>
Gross Profit (b)	<u>\$100</u>	<u>\$ 50⁴</u>	<u>\$100</u>	<u>\$ 30¹⁰</u>
Gross Profit percentage (a/b)	<u>33%</u>	<u>33%</u>	<u>33%</u>	<u>33%</u>

$$^1 \$320 - 240 = \$80$$

$$^2 \$300 - 100 = \$200$$

$$^3 \$320 - 200 = \$120$$

$$^4 \$150 - 100 = \$50$$

$$^5 \$100 + 60 = \$160$$

$$^6 \$160 - 40 = \$120$$

$$^7 \$260 - 40 = \$220$$

$$^8 \$100 + 200 = \$300$$

$$^9 \$12 + 63 = \$75$$

$$^{10} \$90 - 60 = \$30$$

2. All the companies have the same gross profit percentage. It is difficult to differentiate performance on this basis alone.

CP 5–10

1.

Mohan Corp.
Income Statement
For the Year Ended December 31, 2019

Sales	\$25,000
Less: Sales discounts	(400)
Sales returns and allowances	<u>(2,000)</u>
Net sales	22,600
<i>Cost of goods sold</i>	
Purchases	\$20,000
Purchase returns and allowances	(1,000)
Purchase discounts	(300)
Transportation-in	<u>500</u>
Cost of goods available for sale	19,200
Less: Ending inventory	<u>(7,900)</u>
Cost of goods sold	<u>11,300</u>
Gross profit	<u>\$11,300</u>

2. Gross profit percentage = $\$11,300 / \$22,600 = 50\%$

1.

O'Donnell Corp. Income Statement For the Year Ended June 30, 2019		
Sales		\$72,000
Less: Sales returns and allowances		<u>(2,000)</u>
Net sales		<u>70,000</u>
<i>Cost of goods sold</i>		
Opening inventory	\$ 6,000	
Purchases	35,000	
Purchase returns and allowances	(2,000)	
Transportation-in	<u>1,000</u>	
Cost of goods available for sale	40,000	
Less: Ending inventory	<u>(10,000)</u>	
Cost of goods sold		<u>30,000</u>
Gross profit		40,000
<i>Selling expenses</i>		
Advertising	1,500	
Commissions	4,000	
Delivery	1,000	
Insurance	1,000	
Rent	2,500	
Salaries	<u>5,000</u>	<u>15,000</u>
Net income		<u><u>\$25,000</u></u>

2. Gross profit percentage = $\$40,000 / 70,000 = 57.1\%$

(a)			
Dec. 31	Merchandise Inventory (ending)	150	10,000
	Sales	500	72,000
	Purchase Returns and Allowances	558	2,000
	Income Summary	360	84,000
To close all income statement accounts with credit balances to the Income Summary account and record ending inventory balance.			

(b)			
Dec. 31	Income Summary	360	59,000
	Merchandise Inventory (opening)	150	6,000
	Advertising Expense	610	1,500
	Commissions Expense	615	4,000
	Delivery Expense	620	1,000
	Insurance Expense	631	1,000
	Purchases	550	35,000
	Rent Expense	654	2,500
	Salaries Expense	656	5,000
	Sales Returns and Allowances	508	2,000
	Transportation-In	560	1,000
To close all income statement accounts with debit balances to the Income Summary and remove opening inventory from the Merchandise Inventory account.			

(c)			
Dec. 31	Income Summary	360	15,000
	Retained Earnings	340	15,000
To close the Income Summary account to the Retained Earnings account.			

1. Sherman Stores Ltd:

Oct. 8	Purchases	2,800	
	Accounts Payable		2,800
12	Accounts Payable	800	
	Purchase Returns and Allowances		800
a.	Paid on Oct. 8:		
Oct. 8	Accounts Payable	2,800	
	Purchase Discounts		28
	Cash		2,772
b.	Paid on Oct. 25:		
Oct. 25	Accounts Payable	2,000	
	Cash		2,000

2. Morris Wholesalers Corp.:

Oct. 8	Accounts Receivable	2,800	
	Sales		2,800
12	Sales Returns and Allowances	800	
	Accounts Receivable		800
a.	Received payment on Oct. 18:		
Oct. 18	Cash	2,772	
	Sales Discounts	28	
	Accounts Receivable		2,800
b.	Received payment on Oct. 25:		
Oct. 25	Cash	2,000	
	Accounts Receivable		2,000

P 5-1

1.

Salem Corp. General Journal					Page 1
Date 2019	Description	PR	Debit	Credit	
Jul. 2	Cash Share Capital To record the issue of shares to George Salem.	101 320	5,000	5,000	
2	Merchandise Inventory Accounts Payable To record purchases on credit 2/10, n/30, from Blic Pens, Ltd.	150 210	3,500	3,500	
2	Accounts Receivable Sales Cost of Goods Sold Merchandise Inventory To record sale to Spellman Chair Rentals, Inc. 2/10, n/30.	110 500 570 150	2,000 1,200	2,000 1,200	
3	Rent Expense Cash To record July rent payment.	654 101	500	500	
5	Equipment Cash To record purchase of equipment from Easton Furniture Ltd.	183 101	1,000	1,000	
8	Cash Sales Cost of Goods Sold Merchandise Inventory To record sale and receipt of cash from Ethan Matthews Furniture Ltd.	101 500 570 150	200 120	200 120	
8	Merchandise Inventory Accounts Payable To record purchases on credit 2/15, n/30, from Shaw Distributors, Inc.	150 210	2,000	2,000	
9	Cash Sales Discount Accounts Receivable To record receipt of amount due from Spellman Chair Rentals, Inc.	101 509 110	1,960 40	2,000	
10	Accounts Payable Cash Merchandise Inventory To record payment to Blic Pens Ltd.	210 101 150	3,500	3,430 70	
10	Merchandise Inventory Accounts Payable To record purchases on credit n/30, from Peel Products, Inc.	150 210	200	200	

P 5–1 continued

Salem Corp.
General Journal

Page 2

Date 2019	Description	PR	Debit	Credit
July 15	Accounts Receivable Sales Cost of Goods Sold Merchandise Inventory To record sale to Eagle Products Corp. 2/10, n/30.	110 500 570 150	2,000 1,300	 2,000 1,300
15	Merchandise Inventory Accounts Payable To record purchases on credit 2/10, n/30, from Bevan Door, Inc.	150 210	1,500	1,500
15	Accounts Payable Merchandise Inventory To record credit note from Shaw Distributors Inc.	210 150	100	100
16	Sales Returns and Allowances Accounts Receivable Merchandise Inventory Cost of Goods Sold To record credit note issued to Eagle Products Corp.	508 110 150 570	200	200 150
20	Accounts Receivable Sales Cost of Goods Sold Merchandise Inventory To record sale to Aspen Promotions, Ltd. 2/10, n/30.	110 500 570 150	3,500 2,700	3,500 2,700
20	Accounts Payable Cash Merchandise Inventory To record payment of half of the amount due to Shaw Distributors Inc.	210 101 150	950	931 19
24	Cash Sales Discounts Accounts Receivable To record receipt of half of the amount due from Eagle Products Corp.	101 509 110	882 18	900
24	Accounts Payable Cash Merchandise Inventory To record payment made to Bevan Door, Inc.	210 101 150	1,500	1,470 30
26	Accounts Receivable Sales Cost of Goods Sold Merchandise Inventory To record sale to Longbeach Sales, Ltd. for terms 2/10, n/30.	110 500 570 150	600 400	600 400

P 5–1 continued

Salem Corp.
General Journal

Page 3

Date 2019	Description	PR	Debit	Credit
26	Merchandise Inventory Accounts Payable To record purchase from Silverman Co. for terms 2/10, n/30.	150 210	800	800
31	Merchandise Inventory Cash To record payment to Speedy Transport Co. for July.	150 101	350	350

2. The unadjusted ending inventory balance at July 31 is \$2,561, calculated as follows:

Merchandise Inventory			
July 2	3,500	1,200	July 2
8	2,000	120	8
10	200	70	10
15	1,500	1,300	15
16	150	100	15
26	800	2,700	20
31	350	19	24
		30	24
		400	26
	8,500	5,939	
Unadj. Bal.	2,561		
		161	Adj. needed
Adj. Bal.	2,400		

Salem Corp.
General Journal

Page 3

Date 2019	<u>Adjusting Entry</u>	PR	Debit	Credit
July 31	Cost of Goods Sold Merchandise Inventory To record shrinkage and adjust ending inventory to July 31 count.	570 150	161	161

P 5-2

1.

Randall Sales Corp.
General Journal

Page 1

Date 2019	Description	PR	Debit	Credit
May 1	Cash Share Capital To record the issue of shares to Harry Randall.	101 320	2,000	2,000
1	Cash Bank Loan To record receipt of a demand loan from First Chance Bank.	101 201	10,000	10,000
1	Prepaid Rent Cash To record payment of rent for May, June, and July to Viva Corp.	162 101	1,500	1,500
1	Equipment Cash To record payment to Avanti Equipment, Ltd.	183 101	5,000	5,000
1	Merchandise Inventory Accounts Payable To record purchases from Renaud Wholesalers, Ltd. for terms 2/10, n/30.	150 210	5,000	5,000
1	Accounts Receivable Sales Cost of Goods Sold Merchandise Inventory To record sale to North Vancouver Distributors for terms 2/10, n/30.	110 500 570 150	2,500 1,700	2,500 1,700
2	Merchandise Inventory Accounts Payable To record purchase from Lilydale Products, Ltd. for terms n/30.	150 210	1,800	1,800
2	Accounts Receivable Sales Cost of Goods Sold Merchandise Inventory To record sale to Tarrabain Sales, Inc. for terms 2/10, n/30.	110 500 570 150	2,000 1,400	2,000 1,400
3	Cash Sales To record sale to Smith Weston Ltd.	101 500	500	500
5	Prepaid Insurance Cash To record payment to All West Insurance, Inc. for a one-year policy.	161 101	1,200	1,200
5	Accounts Receivable Sales Cost of Goods Sold Merchandise Inventory To record sale to Trent Stores Corporation for terms 2/10, n/30.	110 500 570 150	1,000 700	1,000 700

P 5–2 continued

Randall Sales Corp.
General Journal

Page 2

Date 2019	Description	PR	Debit	Credit
May 6	Sales Returns and Allowances	508	500	
	Accounts Receivable	110		500
	Merchandise Inventory	150	300	
	Cost of Goods Sold			300
	To record the issue of a credit note to Tarrabain Sales Inc..			
8	Accounts Payable	210	300	
	Merchandise Inventory	150		300
	To record credit memo received from Renaud Wholesalers Ltd. for defective merchandise returned.			
8	Merchandise Inventory	150	2,800	
	Accounts Payable	210		2,800
	To record purchases from Pinegrove Novelties, Ltd. for terms 2/15, n/30.			
9	Cash		101	2,450
	Sales Discounts	509	50	
	Accounts Receivable	110		2,500
	To record amount received from North Vancouver Distributors.			
9	Accounts Payable	210	1,700	
	Cash	101		1,666
	Merchandise Inventory	150		34
	To record payment to Renaud Wholesaler Corp. (2,000 - 300 = 1,700)			
10	Accounts Receivable	110	400	
	Sales	500		400
	Cost of Goods Sold	570	250	
	Merchandise Inventory	150		250
	To record sale to Eastern Warehouse for terms 2/10, n/30.			
11	Cash		101	1,470
	Sales Discounts	509	30	
	Accounts Receivable	110		1,500
	To record receipt from Tarrabain Sales Inc. after 2% discount taken.			
13	Merchandise Inventory	150	100	
	Cash	101		100
	To record payment to Fast Delivery Corporation.			
15	Merchandise Inventory	150	1,500	
	Accounts Payable	210		1,500
	To record purchase from James Bay Distributors Inc. for terms 2/10, n/30.			

P 5–2 continued

Randall Sales Corp.
General Journal

Page 3

Date 2019	Description	PR	Debit	Credit
May 15	Accounts Receivable	110	1,500	
	Sales	500		1,500
	Cost of Goods Sold	570	1,100	
	Merchandise Inventory	150		1,100
	To record sale to Ransom Outlets Inc. for terms 2/10, n/30.			
15	Commissions Expense	615	500	
	Cash	101		500
	To record payment to Yvonne Smith for sales invoices 1, 2, and 3.			
19	Accounts Payable	210	1,800	
	Cash	101		1,800
	To record payment to Lilydale Products Inc.			
19	Merchandise Inventory	150	1,200	
	Accounts Payable	210		1,200
	To record purchase from Midlife Stores Corp. for terms 1/10, n/30.			
22	Merchandise Inventory	150	600	
	Accounts Payable	210		600
	To record purchase from Speedy Sales Co. for terms n/30.			
22	Accounts Payable	210	2,800	
	Cash	101		2,744
	Merchandise Inventory	150		56
	To record payment to Pinegrove Novelties Inc.			
24	Merchandise Inventory	150	150	
	Cash	101		150
	To record payment to In Transit Corporation.			
25	Accounts Receivable	110	900	
	Sales	500		900
	Cost of Goods Sold	570	650	
	Merchandise Inventory	150		650
	To record sale to Timmins Centres Ltd. for terms 2/10, n/30.			
26	Cash		101	1,000
	Accounts Receivable	110		1,000
	To record receipt from Trent Stores Corporation.			
27	Delivery Expense	620	200	
	Cash	101		200
	To record payment to Intown Deliveries Ltd.			

P 5–2 continued

Randall Sales Corp.
General Journal

Page 4

Date 2019	Description	PR	Debit	Credit
May 28	Cash	101	300	
	Sales	500		300
	Cost of Goods Sold	570	250	
	Merchandise Inventory	150		250
	To record sale to Betty Regal.			
28	Purchases	500	200	
	Cash	101		200
	To record purchase from Joe Balla Sales Inc.			
28	Accounts Receivable	110	900	
	Sales	500		900
	Cost of Goods Sold	570	700	
	Merchandise Inventory	150		700
	To record sale to Sault Rapids Corp. for terms 2/10, n/30.			
29	Merchandise Inventory	150	100	
	Accounts Payable	210		100
	To record purchase from Amigos Inc.			
29	Delivery Expense	620	300	
	Cash	101		300
	To record payment to Intown Deliveries Ltd.			
29	Advertising Expense	610	400	
	Cash	101		400
	To record payment for May to Main Force Advertising Agency.			
29	Utilities Expense	676	100	
	Cash	101		100
	To record payment to State Hydro for electricity.			
29	Commissions Expense	615	350	
	Cash	101		350
	To record payment to Yvonne Smith for sales invoices 4, 5, 6, and 7.			
30	Cash	101	1,000	
	Accounts Receivable	110		1,000
	To record payment received from Ransom Outlets Inc.			
31	Accounts Payable	210	700	
	Cash	101		700
	To record payment to Midlife Stores Corp.			

P 5-2 continued

Randall Sales Corp.
General Journal

Page 5

2019	Adjusting Entries			Debit	Credit
May 31	Rent Expense		165	500	
	Prepaid Rent		162		500
	To record expiration of May prepaid rent.				
31	Insurance Expense		631	100	
	Prepaid Insurance		161		100
	To record expiration of May prepaid insurance.				
31	Cost of Goods Sold		570	110	
	Merchandise Inventory		150		110*
	To record shrinkage and ending inventory at May 31 per physical count as follows:				
	Merchandise Inventory				
	May 1	5,000	1,700	May 1	
	2	1,800	1,400	2	
	6	300	700	5	
	8	2,800	300	8	
	13	100	34	9	
	15	1,500	250	10	
	19	1,200	1,100	15	
	22	600	56	22	
	24	150	650	25	
	28	200	250	28	
	29	100	700	28	
	13,750		7,140		
	Unadj. Bal.	6,610			
			110	*Adj. needed	
	Adj. Bal.	6,500			

P 5-3

1.

Whirlybird Products Inc.
General Ledger

Retained Earnings	<i>No. 340</i>
	(c) 5,000

Income Summary	<i>No. 360</i>
(b) 32,800	(a) 37,800
(c) 5,000	
Bal. -0-	

Sales	<i>No. 510</i>
(a) 37,800	37,800
Bal. -0-	

Sales Returns & Allowances	<i>No. 508</i>
690	(b) 690
Bal. -0-	

Sales Discounts	<i>No. 509</i>
310	(b) 310
Bal. -0-	

Cost of Goods Sold	<i>No. 570</i>
26,800	(b) 26,800
Bal. -0-	

Salaries Expense	<i>No. 656</i>
5,000	(b) 5,000
Bal. -0-	

2. Gross profit = \$37,800 – 690 – 310 – 26,800 = \$10,000.

P 5-4

1.

Southern Cross Corporation
Income Statement
For the Year Ended December 31, 2019

Sales	\$100,000
Less: Sales returns and allowances	<u>10,000</u>
Net sales	90,000
Cost of goods sold	<u>70,000</u>
Gross profit	20,000
Other expenses	
Delivery	\$2,000
Office supplies	7,000
Salaries	<u>4,000</u>
Net income	<u>\$ 7,000</u>

2.

Southern Cross Corporation
General Journal

Date 2019	<u>Closing Entries</u>	PR	Debit	Credit
	(a)			
Dec. 31	Sales	500	100,000	
	Income Summary	360		100,000
	To close accounts with credit balances to the Income Summary.			
	(b)			
Dec 31	Income Summary	360	93,000	
	Sales Returns and Allowances	508		10,000
	Cost of Goods Sold	570		70,000
	Delivery Expense	620		2,000
	Office Supplies Expense	650		7,000
	Salaries Expense	656		4,000
	To close accounts with debit balances to the Income Summary.			
	(c)			
Dec. 31	Income Summary	360	7,000	
	Retained Earnings	340		7,000
	To close Income Summary account to the Retained Earnings account.			

P 5-5

1.

Acme Automotive Inc.
General Journal

	Date 2019	Description	PR	Debit	Credit
a.	Dec. 31	Accounts Receivable	110	1,000	
		Sales	500		1,000
		Cost of Goods Sold	570	700	
		Merchandise Inventory	150		700
		To accrue amounts receivable at year-end.			
b.	31	Unused Office Supplies	170	100	
		Office Supplies Expense	650		100
		To adjust supplies still on hand at year-end to count.			
c.	31	Telephone Expense	669	460	
		Accounts Payable	210		460
		To accrue amount owing at year-end.			
d.	31	Cost of Goods Sold	570	2,300	
		Merchandise Inventory	150		2,300
		To record shrinkage and adjust ending inventory balance to physical count as follows:			
		Merchandise Inventory			
		Unadj. Bal. 56,000 700 (a)			
		55,300			
		2,300 Adj. needed			
		Adj. Bal. 53,000			

P 5–5 continued

2.

Acme Automotive Inc.
Income Statement
For the Year Ended December 31, 2019

Sales		\$101,000
Less: Sales returns and allowances		(1,500)
Sales discounts		(500)
Net sales		<u>99,000</u>
Cost of goods sold		<u>37,000</u>
Gross profit		62,000
Operating expenses		
Selling		
Advertising	\$1,700	
Commissions	4,800	
Delivery	650	
Rent	1,950	
Total selling	<u>9,100</u>	
General and administrative		
Insurance	450	
Office supplies	150	
Telephone	760	
Utilities	290	
Total general and administrative	<u>1,650</u>	
Total operating expenses		<u>10,750</u>
Income from operations		51,250
Interest		<u>600</u>
Income before income taxes		50,650
Income taxes		<u>2,400</u>
Net income		<u><u>\$48,250</u></u>

Acme Automotive Inc.
Statement of Changes in Equity
For the Year Ended December 31, 2019

	<i>Share capital</i>	<i>Retained earnings</i>	<i>Total equity</i>
Balance, Jan. 1	\$2,000	\$ 600	\$ 2,600
Net income		48,250	48,250
Balance, Dec. 31	<u><u>\$2,000</u></u>	<u><u>\$48,850</u></u>	<u><u>\$50,850</u></u>

P 5–5 continued

Acme Automotive Inc.
Statement of Financial Position
At December 31, 2019

<i>Assets</i>		
Current		
Cash		\$ 750
Accounts receivable		13,000
Merchandise inventory		53,000
Unused supplies		<u>100</u>
Total current		66,850
Equipment		<u>4,400</u>
Total assets		<u>\$71,250</u>
<i>Liabilities</i>		
Current		
Bank loan		\$ 5,000
Accounts payable		13,000
Income taxes payable		<u>2,400</u>
Total liabilities		20,400
<i>Shareholders' Equity</i>		
Share capital	2,000	
Retained earnings	<u>48,850</u>	<u>50,850</u>
Total liabilities and share. equity		<u>\$71,250</u>

P 5–5 continued

3.

Acme Automotive Inc.
General Journal

Date 2019		Description	PR	Debit	Credit
		<u>Closing Entries</u>			
e.	Dec. 31	Sales	500	101,000	
		Income Summary	360		101,000
		To close all credit balance accounts to the Income Summary account.			
f.	31	Income Summary	360	52,750	
		Sales Returns and Allowances	508		1,500
		Sales Discounts	509		500
		Cost of Goods Sold	570		37,000
		Advertising Expense	610		1,700
		Commissions Expense	615		4,800
		Delivery Expense	620		650
		Insurance Expense	631		450
		Interest Expense	632		600
		Office Supplies Expense	650		150
		Rent Expense	654		1,950
		Telephone Expense	669		760
		Utilities Expense	676		290
		Income Taxes Expense	830		2,400
		To close all debit balance accounts to the Income Summary account.			
g.	31	Income Summary	360	48,250	
		Retained Earnings	340		48,250
		To close the Income Summary account to the Retained Earnings account.			

Providence Corp.
General Journal

Page 1

Date 2019	Description	PR	Debit	Credit
Jul. 2	Cash Share Capital To record the issue of shares to Pam Providence.	101 320	5,000	5,000
2	Purchases Accounts Payable To record Purchases on credit 2/10, n/30, from Blic Pens Ltd.	550 210	3,500	3,500
2	Accounts Receivable Sales To record sale to Spellman Chair Rentals Inc. 2/10, n/30.	110 500	2,000	2,000
3	Rent Expense Cash To record July rent payment.	654 101	500	500
5	Equipment Cash To record purchase of equipment.	183 101	1,000	1,000
8	Cash Sales To record receipt of cash from Ethan Matthews Furniture Ltd.	101 500	200	200
8	Purchases Accounts Payable To record Purchases on credit 2/15, n/30, from Shaw Distributors Inc.	550 210	2,000	2,000
9	Cash Sales Discount Accounts Receivable To record receipt of amount due from Spellman Chair Rentals Inc.	101 509 110	1,960 40	2,000
10	Accounts Payable Cash Purchase Discounts To record payment to Blic Pens Ltd.	210 101 559	3,500	3,430 70
10	Purchases Accounts Payable To record Purchases on credit n/30, from Peel Products Inc.	550 210	200	200
15	Accounts Receivable Sales To record sale to Eagle Products Corp. 2/10, n/30.	110 500	2,000	2,000

Providence Corp.
General Journal

Date 2019	Description	PR	Debit	Credit
July 15	Purchases Accounts Payable To record purchases on credit 2/10, n/30, from Bevan Door Inc.	550 210	1,500	1,500
15	Accounts Payable Purchase Returns and Allowances To record credit note from Shaw Distributors Inc.	210 558	100	100
16	Sales Returns and Allowances Accounts Receivable To record credit note issued to Eagle Products Corp.	508 110	200	200
20	Accounts Receivable Sales To record sale to Aspen Promotions Ltd. 2/10, n/30.	110 500	3,500	3,500
20	Accounts Payable Cash Purchase Discounts To record payment of half of the amount due to Shaw Distributors Inc.	210 101 559	950	931 19
24	Cash Sales Discounts Accounts Receivable To record receipt of half of the amount due from Eagle Products Corp.	509 110	101 18	882 900
24	Accounts Payable Cash Purchase Discounts To record payment made to Bevan Door Inc.	210 101 559	1,500	1,470 30
26	Accounts Receivable Sales To record sale to Longbeach Sales Ltd. for terms 2/10, n/30.	110 500	600	600
26	Purchases Accounts Payable To record purchase from Silverman Co. for terms 2/10, n/30.	550 210	800	800
31	Transportation-In Cash To record payment to Speedy Transport Co. for July.	560 101	350	350
31	No entry is made to record inventory on hand until closing entries are made.			

Robert Sales Corp.
General Journal

Date 2019	Description	PR	Debit	Credit
May 1	Cash Share Capital To record the issue of shares to Rob Robert.	101 320	2,000	2,000
1	Cash Bank Loan To record receipt of a demand loan from First Chance Bank.	101 201	10,000	10,000
1	Prepaid Rent Cash To record payment of rent for May, June, and July.	162 101	1,500	1,500
1	Equipment Cash To record payment to Avanti Equipment Ltd.	183 101	5,000	5,000
1	Purchases Accounts Payable To record purchases from Renaud Wholesalers Ltd. for terms 2/10, n/30.	550 210	5,000	5,000
1	Accounts Receivable Sales To record sale to North Vancouver Distributors for terms 2/10, n/30.	110 500	2,500	2,500
2	Purchases Accounts Payable To record purchase from Lilydale Products Ltd. for terms n/30.	550 210	1,800	1,800
2	Accounts Receivable Sales To record sale to Tarrabain Sales Inc. for terms 2/10, n/30.	110 500	2,000	2,000
3	Cash Sales To record sale to Smith Weston Ltd.	101 500	500	500
5	Prepaid Insurance Cash To record payment to All West Insurance Inc. for a one-year policy.	161 101	1,200	1,200
5	Accounts Receivable Sales To record sale to Trent Stores Corporation for terms 2/10, n/30.	110 500	1,000	1,000

Robert Sales Corp.
General Journal

Page 2

Date 2019	Description	PR	Debit	Credit
May 6	Sales Returns and Allowances	508	500	
	Accounts Receivable	110		500
	To record the issue of a credit note to Tarrabain Sales Inc. for merchandise returned.			
8	Accounts Payable	210	300	
	Purchase Returns and Allowances	558		300
	To record credit memo received from Renaud Wholesalers Corp. for defective merchandise returned.			
8	Purchases	550	2,800	
	Accounts Payable	210		2,800
	To record purchases from Pinegrove Novelties Ltd. for terms 2/15, n/30.			
9	Cash	101	2,450	
	Sales Discounts	509	50	
	Accounts Receivable	110		2,500
	To record amount received from North Vancouver Distributors.			
9	Accounts Payable	210	1,700	
	Cash	101		1,666
	Purchase Discounts	559		34
	To record payment to Renaud Wholesalers Ltd. (2,000 - 300 = 1,700)			
10	Accounts Receivable	110	400	
	Sales	500		400
	To record sale to Eastern Warehouse for terms 2/10, n/30.			
11	Cash	101	1,470	
	Sales Discounts	509	30	
	Accounts Receivable	110		1,500
	To record receipt from Tarrabain Sales Inc. after 2% discount taken.			
13	Transportation-In	560	100	
	Cash	101		100
	To record payment to Fast Delivery Corporation.			
15	Purchases	550	1,500	
	Accounts Payable	210		1,500
	To record purchase from James Bay Distributors Inc. for terms 2/10, n/30.			
15	Accounts Receivable	110	1,500	
	Sales	500		1,500
	To record sale to Ransom Outlets Inc. for terms 2/10, n/30.			

P 5–7 continued

Robert Sales Corp.
General Journal

Page 3

Date 2019	Description	PR	Debit	Credit
May 15	Commissions Expense Cash To record payment to Yvonne Smith for sales invoices 1, 2, and 3.	615 101	500	500
19	Accounts Payable Cash To record payment to Lilydale Products Inc.	210 101	1,800	1,800
19	Purchases Accounts Payable To record purchase from Midlife Stores Corp. for terms 1/10, n/30.	550 210	1,200	1,200
22	Purchases Accounts Payable To record purchase from Speedy Sales Co. for terms n/30.	550 210	600	600
22	Accounts Payable Cash Purchase Discounts To record payment to Pinegrove Novelties Inc.	210 101 559	2,800	2,744 56
24	Transportation-In Cash To record payment to In Transit Corporation.	560 101	150	150
25	Accounts Receivable Sales To record sale to Timmins Centres Ltd. for terms 2/10, n/30.	110 500	900	900
26	Cash Accounts Receivable To record receipt from Trent Stores Corporation.	101 110	1,000	1,000
27	Delivery Expense Cash To record payment to Intown Deliveries Ltd.	620 101	200	200
28	Cash Sales To record sale to Betty Regal.	101 500	300	300
28	Purchases Cash To record purchase from Joe Balla Sales Inc.	500 101	200 200	

Robert Sales Corp.
General Journal

Date 2019	Description	PR	Debit	Credit
May 28	Accounts Receivable Sales To record sale to Sault Rapids Corp. for terms 2/10, n/30.	110 500	900	900
29	Purchases Accounts Payable To record purchase from Amigos Inc.	550 210	100	100
29	Delivery Expense Cash To record payment to Intown Deliveries Ltd.	620 101	300	300
29	Advertising Expense Cash To record payment for May to Main Force Advertising Agency.	610 101	400	400
29	Utilities Expense Cash To record payment to State Hydro for electricity.	676 101	100	100
29	Commissions Expense Cash To record payment to Yvonne Smith for sales invoices 4, 5, 6, and 7.	615 101	350	350
30	Cash Accounts Receivable To record payment received from Ransom Outlets Inc.	101 110	1,000	1,000
31	Accounts Payable Cash To record payment to Midlife Stores Corp.	210 101	700	700
31	No entry is made to record inventory on hand until closing entries are made.			
	<u>Adjusting Entries</u>			
31	Rent Expense Prepaid Rent To record expiration of May prepaid rent.	165 162	500	500
31	Insurance Expense Prepaid Insurance To record expiration of May prepaid insurance.	631 161	100	100

Zenith Products Inc.
General Ledger

Merchandise Inventory		No. 150	
Op. Bal.	4,000	(b)	4,000
(a)	6,000		
End. Bal.	6,000		

Retained Earnings		No. 340	
		(c)	5,000

Purchases		No. 550	
	22,500	(b)	22,500
Bal.	-0-		

Income Summary		No. 360	
(b)	32,800	(a)	37,800
(c)	5,000		
Bal.	-0-		

Purchase Returns & Allowances		No. 558	
(a)	575		575
Bal.	-0-		

Sales		No. 510	
(a)	31,000		31,000
Bal.	-0-		

Purchase Discounts		No. 559	
(a)	225		225
Bal.	-0-		

Sales Returns & Allowances		No. 508	
	690	(b)	690
Bal.	-0-		

Transportation – In		No. 560	
	300	(b)	300
Bal.	-0-		

Sales Discounts		No. 509	
	310	(b)	310
Bal.	-0-		

Salaries Expense		No. 656	
	5,000	(b)	5,000
Bal.	-0-		

P 5–8 continued

2.

Zenith Products Inc.
Partial Income Statement
For the Year Ended December 31, 2019

Sales		\$31,000
Less: Sales returns and allowances		(690)
Sales discounts		<u>(310)</u>
Net sales		30,000
Cost of goods sold		
Opening inventory	\$ 4,000	
Purchases	22,500	
Less: Purchase returns and allowances	(575)	
Purchase discounts	(225)	
Add: Transportation-in	<u>300</u>	
Cost of goods available for sale	26,000	
Less: Ending inventory	<u>(6,000)</u>	
Cost of goods sold		<u>20,000</u>
Gross profit		<u>\$10,000</u>

P 5–9

1.

Northern Lights Corporation
Partial Income Statement
For the Year Ended December 31, 2019

Sales		\$100,000
Less: Sales returns and allowances		<u>(10,000)</u>
Net sales		90,000
Cost of goods sold		
Opening inventory	\$ 12,000	
Purchases	70,000	
Less: Purchase returns and allowances	(6,000)	
Purchase discounts	(4,000)	
Add: Transportation-in	<u>3,000</u>	
Cost of goods available for sale	75,000	
Less: Ending inventory	<u>(15,000)</u>	
Cost of goods sold		<u>60,000</u>
Gross profit		<u>\$ 30,000</u>

P 5–9 continued

2. Northern Lights Corporation
General Journal

Date 2019	<u>Closing Entries</u>	PR	Debit	Credit
a. Dec. 31	Merchandise Inventory Sales Purchase Returns and Allowances Purchase Discounts Income Summary To close all income statement accounts with credit balances to Income Summary and record ending inventory balance in the Merchandise Inventory account.	150 500 558 559 360	15,000 100,000 6,000 4,000	125,000
b. Dec. 31	Income Summary Merchandise Inventory Sales Returns and Allowances Purchases Transportation-In Delivery Expense Office Supplies Expense To close all income statement accounts with debit balances to Income Summary and eliminate opening inventory balance in the Merchandise Inventory account.	360 150 508 550 560 620 650	104,000	12,000 10,000 70,000 3,000 2,000 7,000
c. Dec. 31	Income Summary Retained Earnings To close the Income Summary account to Retained Earnings.	360 340	21,000	21,000

3. Net income is \$21,000, the amount credited to retained earnings in closing entry c.

P 5-10

1.

Tom's Trucks Inc.
General Journal

	Date 2019	Description	PR	Debit	Credit
a.	Dec. 31	Telephone Expense Accounts Payable To accrue amount owing at year-end.	669 210	60	60
b.	31	Accounts Receivable Sales To accrue amounts receivable at year-end.	110 500	600	600
c.	31	Unused Office Supplies Office Supplies Expense To adjust supplies still on hand at year-end to count.	170 650	100	100
d.		No entry is made. The correct merchandise inventory balance at year-end is recorded when the closing entries are posted.			

P 5–10 continued

2.

Tom's Trucks Inc.
Income Statement
For the Year Ended December 31, 2019

Sales		\$100,600
Less: Sales returns and allowances		(1,500)
Sales discounts		(500)
Net sales		<u>98,600</u>
<i>Cost of goods sold</i>		
Opening inventory	\$56,000	
Purchases	35,000	
Less: Purchase returns and allows.	(1,700)	
Purchase discounts	(300)	
Transportation-in	1,000	
Cost of goods available for sale	<u>90,000</u>	
Less: Ending inventory	(58,000)	
Cost of goods sold		<u>32,000</u>
Gross profit		66,600
<i>Operating expenses</i>		
<i>Selling</i>		
Advertising	1,700	
Commissions	4,800	
Delivery	650	
Insurance	450	
Rent	1,950	
Total selling	<u>9,550</u>	
<i>General and administrative</i>		
Supplies	150	
Telephone	360	
Utilities	290	
Total general and administrative	<u>800</u>	
Total operating expenses		<u>10,350</u>
Income from operations		56,250
Interest		600
Income before income taxes		<u>55,650</u>
Income taxes		2,400
Net income		<u><u>\$53,250</u></u>

Tom's Trucks Inc.
Statement of Changes in Equity
For the Year Ended December 31, 2019

	<i>Share capital</i>	<i>Retained earnings</i>	<i>Total equity</i>
Balance, Jan. 1	\$2,000	\$600	\$ 2,600
Net income		53,250	53,250
Balance, Dec. 31	<u><u>\$2,000</u></u>	<u><u>\$53,850</u></u>	<u><u>\$55,850</u></u>

Tom's Trucks Inc.
Statement of Financial Position
At December 31, 2019

<i>Assets</i>		
Current		
Cash		\$ 750
Accounts receivable		13,000
Merchandise inventory		58,000
Unused supplies		<u>100</u>
Total current		71,450
Equipment		<u>4,400</u>
Total assets		<u>\$75,850</u>
<i>Liabilities</i>		
Current		
Accounts payable		\$12,600
Income taxes payable		<u>2,400</u>
Total current		15,000
Bank loan		<u>5,000</u>
Total liabilities		20,000
<i>Shareholders' Equity</i>		
Share capital	2,000	
Retained earnings	<u>53,850</u>	<u>55,850</u>
Total liabilities and share. equity		<u>\$75,850</u>

P 5–10 continued

3. Tom's Trucks Inc.
General Journal

Date 2019		<u>Closing Entries</u>	PR	Debit	Credit
f.	Dec. 31	Merchandise Inventory	150	58,000	
		Sales	500	100,600	
		Purchase Returns and Allowances	558	1,700	
		Purchase Discounts	559	300	
		Income Summary	360		160,600
		To close all credit balance accounts to the Income Summary account and record ending inventory.			
g.	31	Income Summary	360	107,350	
		Merchandise Inventory	150		56,000
		Sales Returns and Allowances	508		1,500
		Sales Discounts	509		500
		Purchases	550		35,000
		Transportation-In	560		1,000
		Advertising Expense	610		1,700
		Commissions Expense	615		4,800
		Delivery Expense	620		650
		Insurance Expense	631		350
		Interest Expense	632		600
		Office Supplies Expense	650		250
		Rent Expense	654		1,950
		Telephone Expense	669		360
		Utilities Expense	676		290
		Income Taxes Expense	830		2,400
		To close all debit balance accounts to Income Summary account and expense opening inventory.			
h.	31	Income Summary	360	53,250	
		Retained Earnings	340		53,250
		To close the Income Summary account to the Retained Earnings account.			

CHAPTER SIX

Assigning Costs to Merchandise

Concept Self-check

1. The three inventory cost flow assumptions that are allowed under GAEB are first-in, first out (FIFO), weighted average, and specific identification.
2. There is no effect on financial statements of using different inventory cost flow assumptions, unless purchase prices are changing.
3. When prices are rising, FIFO costing yields the highest ending inventory and the highest net income, while weighted average costing produces the lowest ending inventory and the lowest net income.
4. In a period of rising prices, the FIFO inventory cost flow assumption would maximize net income and thus management's year-end bonus. Assume a gadget is acquired on January 1 for \$10 and one on July 1 for \$16. On December 1, one gadget is sold for \$20. Gross profit calculations under each cost flow assumption would be:

	<u>FIFO</u>	<u>Wtd. avg.</u>
Sales	\$20	\$20
Cost of Goods Sold	<u>10</u>	<u>12</u> *
Gross Profit	<u>\$10</u>	<u>\$ 8</u>

$$*(\$10 + 16)/2 = \$12$$

If prices were falling, the choice would be the opposite. The weighted average inventory cost flow assumption yields the higher net income.

5. If the ending inventory is overstated at the end of 2019, then cost of goods sold is understated; therefore, the 2019 net income is overstated by \$5,000. In 2020, the opening inventory would be overstated and cost of goods sold would be overstated; therefore, the net income would be understated by \$5,000.
6. The laid-down cost of inventory is the invoice price of the goods less purchase discounts, plus transportation-in, insurance while in transit, and any other expenditure made by the purchaser to get the merchandise to the place of business and ready for sale.
7. Inventory must be evaluated at each fiscal year-end to determine whether the net realizable value (NRV) is lower than cost. Net realizable value is the expected selling cost of inventory, less any applicable costs related to the sale.
8. The primary reason for the use of the LCNRV method of inventory valuation is prudence. If the likely value of inventory has declined below cost, it is prudent to recognize the loss immediately, rather than when the goods are eventually sold to better inform investors and creditors of estimated future cash flows.

Concept Self-check continued

9. Estimating inventory is useful for two reasons:
 - a. It is useful for inventory control. When a total inventory amount is calculated under a periodic inventory system through physical count and valuation, an estimate can help check the accuracy.
 - b. It is useful for the preparation of interim financial statements. Under a periodic inventory system, inventory on hand at any point in time is not readily available. To take a physical count often would be costly and inconvenient. An estimate offers a way of determining a company's inventory at any point in time in a cost-effective manner.
10. Under the gross profit method, the percentage of profit remaining after accounting for cost of goods sold (the gross profit percentage) is assumed to remain the same from year to year. By applying the rate to sales, gross profit and then cost of goods sold can be estimated. Opening inventory and purchases will be known from the accounting records, so cost of goods available for sale can be determined. The difference between the cost of goods sold and cost of goods available for sale is the ending inventory amount.

Under the retail inventory method, mark-up on goods purchased then sold is considered to be constant. Both cost and selling prices of goods acquired are then valued at retail by using the mark-up amount. From this, the ending inventory at retail is calculated. By applying the cost percentage (cost of goods available for sale divided by retail cost of goods available for sale) to the retail ending inventory, its value at cost can be calculated.

i. Example — gross profit method:

Sales		\$100
<i>Cost of Goods Sold:</i>		
Opening Inventory (from records)	80	
Purchases (from records)	<u>70</u>	
Cost of Goods Available for Sale	150	
Ending Inventory	<u>(a)?</u>	<u>(b)?</u>
Gross Profit		<u>\$ (c)?</u>

If the gross profit percentage average is 25%, the following can be estimated:

(c) Gross profit	= 25% x \$100	= \$25
(b) Cost of goods sold	= \$100 – \$25 (c)	= \$75
(a) Ending inventory	= \$150 – \$75 (b)	= \$75

Ending inventory (a) would be \$75.

Concept Self-check continued

ii. Example — retail inventory method; assumed mark-up = 200%:

	<u>At Retail</u>	<u>At Cost</u>
Sales	\$500	\$500
<i>Cost of Goods Sold:</i>		
Opening Inventory (records)	\$(b)	\$ 80
Purchases (records)	<u>(b)</u>	<u>300</u>
Cost of Goods Available for Sale	(c)	380
Ending Inventory	<u>(d)?</u>	<u>(e)?</u>
Cost of Goods Sold	<u>(a)?</u>	<u>(f)?</u>
Gross Profit (same as Sales)	<u>\$-0-</u>	<u>(g)?</u>

(a) Cost of Goods restated at retail to equal sales = \$500

(b) Opening Inventory and Purchases re-stated at retail
 $= \$300 \times 200\% = \600 ; $80 \times 200\%$
 $= \$160$

(c) Cost of Goods Available at retail = $\$600$ (b) + 160 (b)
 $= \$760$

(d) Ending Inventory at retail
 $= \text{Cost of Goods Available at retail} - \text{Cost of Goods Sold at retail}$
 $= \$760$ (c) – 500 (a)
 $= \$260$

(e) Inventory at cost = $\text{Inventory at retail} / 200\%$
 $= \$260$ (c) / 200%
 $= \$130$

(f) Cost of Goods Sold at cost = $\$380 - 130$ (e) = $\$250$

(g) Gross Profit at cost = $\$500 - \250 (e) = $\$250$

11. The gross profit method is particularly useful in cases where goods have been stolen or lost in a fire; in such cases it is not possible to determine the balance in the ending inventory by a physical count when the periodic inventory system is used.
12. The retail inventory method assumes an average inventory cost flow assumption because the cost percentage used to calculate ending inventory and cost of goods sold is based on a constant mark-up.

Concept Self-check continued

13. Under the periodic inventory system, purchased inventory is recorded in the general ledger Purchases account; under a perpetual inventory system, it is recorded under Merchandise Inventory.

When inventory is sold under the periodic inventory system, there is no entry to cost of goods sold; this is determined at the end of the period. Under the perpetual inventory system, an entry is recorded in the Cost of Goods Sold account and an offsetting decrease is recorded under Merchandise Inventory when each sale transaction occurs.

CP 6–1

1. FIFO

Date	Purchased			Sold			Balance in Inventory		
	Units	Unit Cost	Total \$	Units	Unit Cost	Total \$	Units	Unit Cost	Total \$
Jan. 1							100	\$1	\$100
7	10	\$2	\$20				100 10	\$1 \$2	\$120
9				80	\$1	\$80	20 10	\$1 \$2	\$40
21	20	\$3	\$60				20 10 20	\$1 \$2 \$3	\$100
24				20 10 10	\$1 \$2 \$3	\$70	10	\$3	\$30

2. Weighted average (answers may differ depending on rounding assumptions)

Date	Purchased			Sold			Balance in Inventory		
	Units	Unit Cost	Total \$	Units	Unit Cost	Total \$	Units	Unit Cost	Total \$
Jan. 1							100	\$1.00	\$100.00
7	10	\$2	\$20				110	\$1.09 ¹	\$120.00
9				80	\$1.09	\$87.20	30	\$1.09 ³	\$32.80 ²
21	20	\$3	\$60				50	\$1.86 ⁴	\$92.80
24				40	\$1.86	\$74.40	10	\$1.84 ⁶	\$18.40 ⁵

¹ $(\$100 + 20)/(100+10) = \1.09 (rounded)

² $\$120.00 - 87.20 = \32.80 (This eliminates rounding errors. Remember, cost of goods available – cost of goods sold = ending inventory.)

³ $\$32.80/30$ units = \$1.09 per unit (rounded)

⁴ $(\$32.80 + 60.00)/(30 + 20) = \1.86 per unit (rounded)

⁵ $\$92.80 - 74.40 = \18.40

⁶ $\$18.40/10 = \1.84 per unit

1. FIFO

Date	Purchased			Sold			Balance in Inventory		
	Units	Unit Cost	Total \$	Units	Unit Cost	Total \$	Units	Unit Cost	Total \$
Jan. 1							2,000	\$.50	\$1,000
5				1,200	\$.50	\$600	800	\$.50	\$400
6	1,000	\$2	\$2,000				800	\$.50	\$2,400
							1,000	\$2.00	
10	500	\$1	\$500				800	\$.50	\$2,900
							1,000	\$2.00	
							500	\$1.00	
16				800	\$.50	\$2,600	300	\$1.00	\$300
				1,000	\$2.00				
				200	\$1.00				
21	1,000	\$2.50	\$2,500				300	\$1.00	\$2,800
							1,000	\$2.50	

- a. Jan. 5 Accounts Receivable 110 6,000
 Sales 550 6,000
 Cost of Goods Sold 570 600
 Merchandise Inventory 150 600
 To record Jan. 5 sales; COGS at FIFO.
- b. Jan. 16 Accounts Receivable 110 12,000
 Sales 550 12,000
 Cost of Goods Sold 570 2,600
 Merchandise Inventory 150 2,600
 To record Jan. 16 sales; COGS at FIFO.
- c. Per the above table, there are 1,300 units on hand: 300 @ \$1; 1,000 @ \$2.50, for a total ending inventory cost of \$2,800.

2. Weighted average (answers may differ depending on rounding assumptions)

Date	Purchased			Sold			Balance in Inventory		
	Units	Unit Cost	Total \$	Units	Unit Cost	Total \$	Units	Unit Cost	Total \$
Jan. 1							2,000	\$.50	\$1,000
5				1,200	\$.50	\$600	800	\$.50	\$400
6	1,000	\$2	\$2,000				1,800	\$1.33 ¹	\$2,400
10	500	\$1	\$500				2,300	\$1.26 ²	\$2,900
16				2,000	\$1.26	\$2,520	300	\$1.27 ⁴	\$380 ³
21	1,000	\$2.50	\$2,500				1,300	\$2.22 ⁵	\$2,880

¹ $(\$400 + \$2,000)/(800 + 1,000) = \$1.33$ per unit (rounded)² $(\$2,400 + \$500)/(1,800 + 500) = \$1.26$ per unit (rounded)³ $\$2,900 - 2,520 = \380 (This eliminates rounding errors. Remember, cost of goods available – cost of goods sold = ending inventory.)⁴ $\$380/300 = \1.27 per unit (rounded)⁵ $\$2,880/1,300 = \2.22 per unit (rounded)

CP 6–2 continued

- a. Jan. 5 Accounts Receivable 110 6,000
 Sales 550 6,000
 Cost of Goods Sold 570 600
 Merchandise Inventory 150 600
 To record Jan. 5 sales; COGS at weighted average.
- b. Jan. 16 Accounts Receivable 110 12,000
 Sales 550 12,000
 Cost of Goods Sold 570 2,520
 Merchandise Inventory 150 2,520
 To record Jan. 16 sales; COGS at weighted average.
- c. Per the above table, there are 1,300 units on hand @ \$2.22 (rounded), for a total ending inventory cost of \$2,880. This should be calculated as the inventory balance of \$380 on January 16 plus the January 21 purchase of \$2,500, *not* 1,300 units x wtd. avg. cost of \$2.22.

CP 6–3

1. a. FIFO

Date	Purchased			Sold			Balance in Inventory		
	Units	Unit Cost	Total \$	Units	Unit Cost	Total \$	Units	Unit Cost	Total \$
May 1							100	\$1	\$100
5				80	\$1	\$80	20	\$1	\$20
6	200	\$2	\$400				20	\$1	\$420
							200	\$2	
12	125	\$3	\$375				20	\$1	\$795
							200	\$2	
							125	\$3	
13				20	\$1	\$660			\$135
				200	\$2				
				80	\$3		45	\$3	
19	350	\$2	\$700				45	\$3	\$835
							350	\$2	
29	150	\$1	\$150				45	\$3	\$985
							350	\$2	
							150	\$1	
30				45	\$3	\$840			\$145
				350	\$2				
				5	\$1		145	\$1	
	Total COGS					\$1,580			

CP 6–3 continued

1. b. Specific identification

<i>Date</i>	<i>Purchased</i>			<i>Sold</i>			<i>Balance in Inventory</i>		
	<i>Units</i>	<i>Unit Cost</i>	<i>Total \$</i>	<i>Units</i>	<i>Unit Cost</i>	<i>Total \$</i>	<i>Units</i>	<i>Unit Cost</i>	<i>Total \$</i>
May 1							100	\$1	\$100
5				80	\$1	\$80	20	\$1	\$20
6	200	\$2	\$400				20	\$1	\$420
							200	\$2	
12	125	\$3	\$375				20	\$1	\$795
							200	\$2	
							125	\$3	
13				125	\$3	\$725	20	\$1	\$70
				175	\$2		25	\$2	
19	350	\$2	\$700				20	\$1	\$770
							25	\$2	
							350	\$2	
29	150	\$1	\$150				20	\$1	\$920
							25	\$2	
							350	\$2	
							150	\$1	
30				20	\$1	\$700	25 ¹	\$2	\$220
				300	\$2		50 ²	\$2	
				80	\$1		70 ³	\$1	
	Total COGS					\$1,505			

¹ May 6 purchase

² May 19 purchase

³ May 29 purchase

CP 6–3 continued

1. c. Weighted average

Date	Purchased			Sold			Balance in Inventory		
	Units	Unit Cost	Total \$	Units	Unit Cost	Total \$	Units	Unit Cost	Total \$
May 1							100	\$1.00	\$100
5				80	\$1	\$80	20	\$1.00	\$20
6	200	\$2	\$400				220	\$1.91 ¹	\$420
12	125	\$3	\$375				345	\$2.30 ²	\$795
13				300	\$2.30	\$690	45	\$2.30	\$105 ³
19	350	\$2	\$700				395	\$2.04 ⁴	\$805
29	150	\$1	\$150				545	\$1.75 ⁵	\$955
30				400	\$1.75	\$700	145	\$1.76 ⁷	\$255 ⁶
	Total COGS					\$1,470			

¹ \$420/220 units = \$1.91 per unit (rounded)

² \$795/345 units = \$2.30 per unit (rounded)

³ \$795 – 690 = \$105 (This eliminates rounding errors. Remember, cost of goods available – cost of goods sold = ending inventory.)

⁴ \$805/395 units = \$2.04 per unit (rounded)

⁵ \$955/545 units = \$1.75 per unit (rounded)

⁶ \$955 – 700 = \$255

⁷ \$255/145 units = \$1.76 per unit (rounded)

2.

	<i>FIFO</i>	<i>Spec. ident.</i>	<i>Wtd. avg.</i>
Sales	\$3,900	\$3,900	\$3,900
Cost of goods sold	<u>(1,580)</u>	<u>(1,505)</u>	<u>(1,470)</u>
Gross profit	<u>\$2,320</u>	<u>\$2,395</u>	<u>\$2,430</u>

3. The weighted average inventory cost flow assumption maximizes net income (\$2,430) and ending inventory (\$253.75).

CP 6-4

- 3 Matches actual flow of goods with actual flow of costs in all cases
- 1 Matches old costs with new sales prices
- 1 Results in the lowest net income in periods of falling prices
- 2,3 Does not assume any particular flow of goods
- 1 Best suited for situations in which inventory consists of perishable goods
- 1 Values inventory at approximate replacement cost

CP 6-5

<i>Errors</i>	2019 Statements				2020 Statements			
	<i>Open. invent.</i>	<i>End. invent.</i>	<i>2019 Total assets</i>	<i>2019 Net income</i>	<i>Open. invent.</i>	<i>End. invent.</i>	<i>2020 Total assets</i>	<i>2020 Net income</i>
1. Goods purchased in 2019 were included in December 31 inventory, but the transaction was not recorded until early 2020.	0	0	0	+	0	0	0	-
2. Goods purchased in 2020 were included in December 31, 2019 inventory, and the transaction was recorded in 2019.	0	+	+	0*	+	0	0	0
3. Goods were purchased in 2019 and the transaction recorded in that year; however, the goods were not included in the December 31 inventory as they should have been.	0	-	-	-	-	0	0	+
4. Goods purchased in 2019 were excluded from December 31 inventory, and the transaction was recorded early in 2020.	0	-	-	0	-	0	0	0

* The effects of this error cancel each other out, so net income is not affected in either 2019 or 2020.

CP 6–6

1. a. Ending inventory for 2019 was understated by \$2,000. Instead of being \$5,000, it should have been \$7,000. Thus, cost of goods sold should have been \$18,000 and gross profit, \$12,000. Because of this mistake, the 2020 opening inventory was also understated by \$2,000, causing cost of goods sold to be understated by \$2,000 and gross profit overstated by \$2,000. It should have been \$15,000.
- b. The 2021 ending inventory was overstated by \$5,000. It should have been \$10,000. Thus, cost of goods sold should have been \$30,000 and gross profit, \$20,000.
2. For 2019, the merchandise inventory on the statement of financial position was understated by \$2,000. Thus, the total assets were \$2,000 less than they should have been. For 2020, there is no effect on the statement of financial position, as the error is in opening inventory. For 2021, the ending inventory in the statement of financial position is overstated by \$5,000, which means that total assets were overstated by \$5,000.

CP 6–7

1. LCNRV on a unit-by-unit basis:
 $(2 \times \$50) + (3 \times \$75) + (4 \times \$20) = \405
2. LCNRV on a group inventory basis:
 $(2 \times \$50) + (3 \times \$150) + (4 \times \$25) = \650
 $(2 \times \$60) + (3 \times \$75) + (4 \times \$20) = \425

Therefore, LCNRV = \$425

CP 6–8

1. Sales		\$300,000	100%
<i>Cost of goods sold</i>			
Opening inventory	\$ 80,000		
Purchases	<u>150,000</u>		
Cost of goods available	230,000		
Ending inventory (estimated)	<u> (c) </u>		
Cost of goods sold		<u> (b) </u>	<u>66 2/3%</u>
Gross profit		<u> (a) </u>	<u>33 1/3%</u>
(a) Gross profit = 33 1/3% of Sales			
= 33 1/3% x \$300,000			
= \$100,000			
(b) Cost of goods sold = Sales – gross profit			
= \$300,000 – 100,000			
= \$200,000			
(c) Estimated ending inventory			
= Cost of goods available – cost of goods sold			
= \$230,000 – \$200,000			
= \$30,000			
2. Balton lost about \$30,000 of inventory in the fire and is claiming \$45,000. This does not seem reasonable.			

CP 6–9

1.			
	<u>At retail</u>	<u>At cost</u>	
Sales	\$ 276,000	\$ 276,000	
<i>Cost of goods sold</i>			
Opening inventory	\$ 78,000	\$ 26,000	
Purchases	282,000	90,000	
Transportation-in	—	4,000	
Cost of goods available for sale	360,000 (a)	120,000	
Less: Ending inventory	<u>(84,000) (c)</u>	<u>(28,000) (d)</u>	
Cost of goods sold	276,000 (b)	92,000 (e)	
Gross Profit	<u>\$ 0</u>	<u>\$ 184,000 (f)</u>	
2. Mark-up = \$276,000/92,000 = 300%.			

CP 6–10

The estimated ending inventory at cost is \$25,000, calculated as follows:

	<u>At retail</u>	<u>At cost</u>
Sales (given)	\$ 250,000	\$ 250,000
<i>Cost of goods sold</i>		
Opening inventory	\$ 20,000	\$ 10,000
Purchases	<u>280,000</u>	<u>140,000</u>
Cost of goods available for sale	300,000 (a)	150,000
Less: Ending inventory	<u>(50,000) (c)</u>	<u>(25,000) (d)</u>
Cost of goods sold	250,000 (b)	125,000
Gross profit	<u>\$ 0</u>	<u>\$ 125,000</u>

CP 6–11

	1	2	3	4
Opening inventory	\$ 0	\$3,000	\$1,000	\$2,000
Purchases	5,000	5,000	5,000	5,000
Ending inventory	<u>(2,000)</u>	<u>(4,000)</u>	<u>(1,500)</u>	<u>(0)</u>
Cost of goods sold	<u>\$3,000</u>	<u>\$4,000</u>	<u>\$4,500</u>	<u>\$7,000</u>

CP 6–12

	<i>FIFO</i>	<i>Spec. ident.</i>	<i>Wtd. Avg.</i>
Sales	\$1,200	\$1,200	\$1,200
<i>Cost of goods sold</i>			
Opening inventory	\$100	\$100	\$100
Purchases	<u>550¹</u>	<u>550</u>	<u>550</u>
Goods avail. for sale ²	650	650	650
Less: Ending inv.	<u>(250)³</u>	<u>(140)⁴</u>	<u>(130)⁵</u>
Cost of goods sold	400	510	520
Gross profit	<u>\$800</u>	<u>\$690</u>	<u>\$680</u>

$$^1 (\$10 + \$40 + \$90 + \$160 + \$250) = \$550$$

$$^2 \text{Total units available} \\ (100 + 10 + 20 + 30 + 40 + 50) \quad 250 \text{ units} \\ \text{Total units sold (given)} \quad \underline{(200)} \text{ units} \\ \text{Ending inventory} \quad \underline{50} \text{ units}$$

$$^3 50 \text{ units @ } \$5 = \$250$$

$$^4 \begin{array}{rcl} \text{Purchase} & \# & \text{units @ price} & \text{cost} \\ & \#1 & 10 @ \$1 & \$10 \\ & \#2 & 20 @ \$2 & 40 \\ & \#4 & 10 @ \$4 & 40 \\ & \#5 & 10 @ \$5 & 50 \\ & & \underline{50} & \underline{\$140} \end{array}$$

$$^5 \$650 / 250 \text{ units} = \$2.60 \text{ per unit} \times 50 \text{ units} = \$130$$

1. Specific identification ending Inventory:

1,200 units @ \$0.50 =	\$ 600
1,000 units @ \$2.00 =	2,000
<u>300 units @ \$1.00 =</u>	<u>300</u>
<u>2,500 units</u>	<u>\$2,900</u>

2. FIFO ending inventory:

1,000 units @ \$2.00 =	\$2,000
500 units @ \$1.00 =	500
<u>1,000 units @ \$2.50 =</u>	<u>2,500</u>
<u>2,500</u>	<u>\$5,000</u>

3. Weighted average ending inventory:

2,000 units @ \$0.50 =	\$1,000
1,000 units @ \$2.00 =	2,000
500 units @ \$1.00 =	500
<u>1,000 units @ \$2.50 =</u>	<u>2,500</u>
<u>4,500</u>	<u>\$6,000</u>

Weighted average cost = $\$6,000 / 4,500 \text{ units} = \$1.33/\text{unit} \times 2,500 \text{ units} = \$3,333$
(rounded)

4. Specific identification cost of goods sold:

800 units @ \$.50 =	\$ 400
200 units @ \$1.00 =	200
<u>1,000 units @ \$2.50 =</u>	<u>2,500</u>
<u>2,000</u>	<u>\$3,100</u>

5. FIFO cost of goods sold: 2,000 units @ \$0.50 = \$1,000

6. Weighted average cost of goods sold:

2,000 units @ \$0.50 =	\$1,000
1,000 units @ \$2.00 =	2,000
500 units @ \$1.00 =	500
<u>1,000 units @ \$2.50 =</u>	<u>2,500</u>
<u>4,500</u>	<u>\$6,000</u>

Weighted average cost = $\$6,000 / 4,500 \text{ units} = \$1.33/\text{unit} \times 2,000 \text{ units} = \$2,667$
(rounded)

CP 6–14

1. a. FIFO ending inventory = $(150 \times \$3) + (50 \times \$2) = \underline{\$550}$
 b. Specific identification ending inventory = $(100 \times \$1) + (100 \times \$3) = \underline{\$400}$
 c. Weighted average = $(100 \times \$1) + (200 \times \$1) + (125 \times \$2) + (350 \times \$2) + (150 \times \$3)$
 $= \$1,700/925 = \$1.84/\text{unit (rounded)}$
 Weighted average ending inventory = $\$1.84 \times 200 = \underline{\$368}$
2. Units sold = $925 - 200 = 725$ units $\times \$2 = \$3,625$ total sales.

	<i>FIFO</i>	<i>Spec. ident</i>	<i>Wtd. avg.</i>
Sales	\$3,625	\$3,625	\$3,625
<i>Cost of goods sold</i>			
Opening inventory	\$ 100	\$ 100	\$ 100
Purchases	<u>1,600</u>	<u>1,600</u>	<u>1,600</u>
Cost of goods available for sale	1,700	1,700	1,700
Less: Ending inventory	<u>(550)</u>	<u>(400)</u>	<u>(368)</u>
Cost of goods sold	<u>1,150</u>	<u>1,300</u>	<u>1,332</u>
Gross profit	<u>\$2,475</u>	<u>\$2,325</u>	<u>\$ 2,293</u>

P 6-1

1. The COGS calculation is the same for all three methods:

Date	Purchased			Sold			Balance in Inventory		
	Units	Unit Cost	Total \$	Units	Unit Cost	Total \$	Units	Unit Cost	Total \$
Jan. 1							50	\$1	\$50
Apr. 15	200	\$2	\$400				50 200	\$1 \$2	\$450
Apr. 25				50 200	\$1 \$2	\$450	-0-	\$-0-	\$-0-
Oct. 15	600	\$5	\$3,000				600	\$5	\$3,000
Oct. 25				500	\$5	\$2,500	100	\$5	\$500
	Total COGS					\$2,950			

2. Cost of goods sold is \$2,950 under all three alternatives. Therefore gross profit and net income will also be the same.
3. You should advise the president that all of the alternatives have the same effect. However, once an inventory cost flow assumption is adopted, it must be used consistently in future years. This minimizes the ability to manipulate net income through accounting policy changes, if that is the president's plan.

P 6-2

1. a. FIFO

Date	Purchased			Sold			Balance in Inventory		
	Units	Unit Cost	Total \$	Units	Unit Cost	Total \$	Units	Unit Cost	Total \$
Jan. 1							25	\$1	\$25
Feb. 15	15	\$2	\$30				25 15	\$1 \$2	\$55
Feb. 28				25 5	\$1 \$2	\$35	10	\$2	\$20
Mar. 14	10	\$3	\$30				10 10	\$2 \$3	\$50
Apr. 9				10 5	\$2 \$3	\$35	5	\$3	\$15
Oct. 28	35	\$4	\$140				5 35	\$3 \$4	\$155
Dec. 4	40	\$5	\$200				5 35 40	\$3 \$4 \$5	\$355
Dec. 21				5 35 10	\$3 \$4 \$5	\$205	30	\$5	\$150
	Total COGS					\$275			

P 6–2 continued

The journal entry would be:

Dec. 21	Accounts Receivable	110	300	
	Sales	550		300
	Cost of Goods Sold	570	205	
	Merchandise Inventory	150		205
To record Dec. 21 sales; COGS at FIFO.				

1. b. Weighted average

Date	Purchased			Sold			Balance in Inventory		
	Units	Unit Cost	Total \$	Units	Unit Cost	Total \$	Units	Unit Cost	Total \$
Jan. 1							25	\$1.00	\$25.00
Feb. 15	15	\$2	\$30				40	\$1.38 ¹	\$55.00
Feb. 28				30	\$1.38	\$41.40	10	\$1.36 ³	\$13.60 ²
Mar. 14	10	\$3	\$30				20	\$2.18 ⁴	\$43.60
Apr. 9				15	\$2.18	\$32.70	5	\$2.18	\$10.90
Oct. 28	35	\$4	\$140				40	\$3.77 ⁵	\$150.90
Dec. 4	40	\$5	\$200				80	\$4.39 ⁶	\$350.90
Dec. 21				50	\$4.39	\$219.50	30	\$4.38 ⁸	\$131.40⁷
	Total COGS					\$293.60			

¹ \$55/40 units = \$1.38 per unit (rounded)

² \$55.00 – 41.40 = \$13.60 (This eliminates rounding errors. Remember, cost of goods available – cost of goods sold = ending inventory.)

³ \$13.60/10 units = \$1.36 per unit (rounded)

⁴ \$43.60/20 units = \$2.18 per unit (rounded)

⁵ \$150.90/40 units = \$3.77 per unit (rounded)

⁶ \$350.90/80 units = \$4.39 per unit (rounded)

⁷ \$350.90 – 219.50 = \$131.40

⁸ \$131.40/30 units = \$4.38 per unit (rounded)

The journal entry would be:

Dec. 21	Accounts Receivable	110	300.00	
	Sales	550		300.00
	Cost of Goods Sold	570	219.50	
	Merchandise Inventory	150		219.50
To record Dec. 21 sales; COGS at weighted average.				

2.

	FIFO	Wtd. avg.
Sales	\$420 ¹	\$420.00
COGS	275	293.60
Gross Profit	<u>\$145</u>	<u>\$126.40</u>

¹ (30 x \$2) + (15 x \$4) + (50 x \$6) = \$420

P 6–2 continued

Weighted average more closely matches cost of goods sold with sales because it uses more recent purchase prices to calculate cost of goods sold.

3. More income taxes would be paid under FIFO because gross profit is higher using FIFO in a period of rising prices. Weighted average minimizes income taxes in a period of rising prices so that accounting policy should be adopted.

P 6–3

1.

<i>Product A</i>									
<i>Date</i>	<i>Purchased</i>			<i>Sold</i>			<i>Balance in Inventory</i>		
	<i>Units</i>	<i>Unit Cost</i>	<i>Total \$</i>	<i>Units</i>	<i>Unit Cost</i>	<i>Total \$</i>	<i>Units</i>	<i>Unit Cost</i>	<i>Total \$</i>
Jan. 1							4,000	\$11.90	\$47,600
Jan. 7	8,000	\$12.00	\$96,000				12,000	\$11.97 ¹	\$143,600
Mar. 30				9,000	\$11.97	\$107,730	3,000	\$11.96 ³	\$35,870 ²
May 10	12,000	\$12.10	\$145,200				15,000	\$12.07 ⁴	\$181,070
Jul. 4				14,000	\$12.07	\$169,000	1,000	\$12.07	\$12,070

¹ $(\$47,600 + 96,000)/12,000 \text{ units} = \$11.97 \text{ per unit (rounded)}$

² $\$143,600 - 107,730 = 35,870$ (This eliminates rounding errors. Remember, cost of goods available – cost of goods sold = ending inventory.)

³ $\$35,870/3,000 \text{ units} = 11.96 \text{ per unit (rounded)}$

⁴ $(\$35,870 + 145,200)/15,000 \text{ units} = \$12.07 \text{ per unit (rounded)}$

<i>Product B</i>									
<i>Date</i>	<i>Purchased</i>			<i>Sold</i>			<i>Balance in Inventory</i>		
	<i>Units</i>	<i>Unit Cost</i>	<i>Total \$</i>	<i>Units</i>	<i>Unit Cost</i>	<i>Total \$</i>	<i>Units</i>	<i>Unit Cost</i>	<i>Total \$</i>
Jan. 1							2,000	\$13.26	\$26,520
Jan. 13	5,000	\$13.81	\$69,050				7,000	\$13.65 ¹	\$95,570
Jul. 15				1,000	\$13.65	\$13,650	6,000	\$13.65 ³	\$81,920 ²
Oct. 13	7,000	\$14.21	\$99,470				13,000	\$13.95 ⁴	\$181,390
Dec. 14				8,000	\$13.95		5,000	\$13.99 ⁵	\$69,970

¹ $(\$26,520 + 69,050)/7,000 \text{ units} = \$13.65 \text{ per unit (rounded)}$

² $\$95,570 - 13,650 = 81,920$ (This eliminates rounding errors. Remember, cost of goods available – cost of goods sold = ending inventory.)

³ $\$81,920/6,000 \text{ units} = 13.65 \text{ per unit (rounded)}$

⁴ $(\$81,920 + 99,470)/13,000 \text{ units} = \$13.95 \text{ per unit (rounded)}$

⁵ $\$69,970/5,000 \text{ units} = 13.99 \text{ per unit (rounded)}$

2. Total ending inventory at December 31, 2019:

Product A	\$12,070
Product B	<u>69,970</u>
Total	<u>\$82,040</u>

P 6–3 continued

3. Computerized accounting software would do most of the calculations otherwise done manually. Even calculating only two products' transactions by hand is tedious and time-consuming.
4. If only two products are sold by Southern Cross and there are only a handful of inventory sales and purchases, the company should consider using the simpler periodic inventory system.

P 6–4

1. a. FIFO

<i>Date</i>	<i>Purchased</i>			<i>Sold</i>			<i>Balance in Inventory</i>		
	<i>Units</i>	<i>Unit Cost</i>	<i>Total \$</i>	<i>Units</i>	<i>Unit Cost</i>	<i>Total \$</i>	<i>Units</i>	<i>Unit Cost</i>	<i>Total \$</i>
Jan. 1							100	\$1	\$100
3	100	\$1	\$100				100	\$1	\$200
							100	\$1	
8	200	\$2	\$400				200	\$1	\$600
							200	\$2	
10				200	\$1	\$200	200	\$2	\$400
15	300	\$3	\$900				200	\$2	\$1,300
							300	\$3	
20				200	\$2	\$1,000	100	\$3	\$300
				200	\$3				
27	400	\$1	\$400				100	\$3	\$700
							400	\$1	
	Total COGS					\$1,200			

P 6–4 continued

1. b. Specific identification

Date	Purchased			Sold			Balance in Inventory		
	Units	Unit Cost	Total \$	Units	Unit Cost	Total \$	Units	Unit Cost	Total \$
Jan. 1							100	\$1	\$100
3	100	\$1	\$100				100	\$1	\$200
							100	\$1	
8	200	\$2	\$400				100	\$1	\$600
							100	\$1	
							200	\$2	
10				50	\$1	\$350	50	\$1	\$250
				150	\$2		100	\$1	
							50	\$2	
15	300	\$3	\$900				50	\$1	\$1,150
							100	\$1	
							50	\$2	
							300	\$3	
20				100	\$1	\$1,000	50	\$1	\$150
				300	\$3		50	\$2	
27	400	\$1	\$400				50	\$1	\$550
							50	\$2	
							400	\$1	
	Total COGS					\$1,350			

1. c. Weighted Average

Date	Purchased			Sold			Balance in Inventory		
	Units	Unit Cost	Total \$	Units	Unit Cost	Total \$	Units	Unit Cost	Total \$
Jan. 1							100	\$1.00	\$100
3	100	\$1	\$100				200	\$1.00	\$200
8	200	\$2	\$400				400	\$1.50 ¹	\$600
10				200	\$1.50	\$300	200	\$1.50	\$300
15	300	\$3	\$900				500	\$2.40 ²	\$1,200
20				400	\$2.40	\$960	100	\$2.40	\$240
27	400	\$1	\$400				500	\$1.28 ³	\$640
	Total COGS					\$1,260			

$$^1(\$200 + 400)/400 \text{ units} = \$1.50 \text{ per unit}$$

$$^2(\$300 + 900)/500 \text{ units} = \$2.40 \text{ per unit}$$

$$^3(\$240 + 400)/500 \text{ units} = \$1.28 \text{ per unit}$$

P 6–4 continued

2. FIFO journal entries

Jan. 3	Merchandise Inventory	100	
	Accounts Payable		100
8	Merchandise Inventory	400	
	Accounts Payable		400
10	Accounts Receivable	600	
	Sales		600
	Cost of Goods Sold	200	
	Merchandise Inventory (200 units X \$1)		200
15	Merchandise Inventory	900	
	Accounts Payable		900
20	Accounts Receivable	2,000	
	Sales		2,000
	Cost of Goods Sold	1,000	
	Merchandise Inventory [(200 units X \$2) + (200 units X \$3)]		1,000
27	Merchandise Inventory	400	
	Accounts Payable		400

3.

	<i>FIFO</i>	<i>Spec. ident.</i>	<i>Wtd. Avg.</i>
COGS	\$1,200	\$1,350	\$1,260
Ending Inv.	700	550	640
Total	<u>\$1,900</u>	<u>\$1,900</u>	<u>\$1,900</u>

All the totals are the same. Different inventory cost flow assumptions merely change the allocation of cost of goods available for sale between cost of goods sold and ending inventory.

P 6–5

1. Ending inventory for 2019 was overstated by \$2,000. Thus, cost of goods sold should have been \$2,000 higher, or \$22,000 and gross profit \$2,000 lower, or \$28,000. Because of this mistake, the 2020 opening inventory was also overstated by \$2,000, causing cost of goods sold to be overstated by \$2,000 and gross profit to be understated by \$2,000. Gross profit should have been \$29,000.
2. 2019 total and net assets were overstated by \$2,000. 2020 total assets and net assets were correct.

P 6-6

<u>Item</u>	<u>Cost</u>	<u>Market</u>	<u>Unit LCNRV</u>	<u>Group LCNRV</u>
A	\$ 60	\$ 63	\$ 60	
B	40	40	40	
C	80	78	78	
D	<u>50</u>	<u>42</u>	<u>42</u>	
	<u>\$230</u>	<u>\$223</u>	<u>\$220</u>	<u>\$223*</u>

*Lower of total cost or total market value is used; in this case, total market

P 6-7

1.							
2019				2020			
		<i>Net</i>	<i>Unit basis</i>		<i>Nets</i>	<i>Unit basis</i>	
<i>Item</i>	<i>Cost</i>	<i>realizable</i>	<i>(LCNRV)</i>	<i>Cost</i>	<i>realizable</i>	<i>(LCNRV)</i>	
		<i>value</i>			<i>value</i>		
Product X	\$14,000	\$15,000	\$14,000	\$15,000	\$16,000	\$15,000	
Product Y	12,500	12,000	12,000	12,000	11,500	11,500	
Product Z	<u>11,000</u>	<u>11,500</u>	<u>11,000</u>	<u>10,500</u>	<u>10,000</u>	<u>10,000</u>	
Total	<u>\$37,500</u> (3)	<u>\$38,500</u>	<u>\$37,000</u> (1)	<u>\$37,500</u> (4)	<u>\$37,500</u>	<u>\$36,500</u> (2)	

		2.					
		2019					
		<u>Unit basis (LCNRV)</u>		<u>Group basis (LCNRV)</u>		<u>Cost basis</u>	
Sales		\$240,000		\$240,000		\$240,000	
Cost of goods sold							
Opening inventory	\$ 20,000			\$20,000		\$20,000	
Purchases	<u>240,000</u>			<u>240,000</u>		<u>240,000</u>	
Cost of goods available	260,000			260,000		260,000	
Ending inventory	<u>37,000</u> (1)			<u>37,500</u> (3)		<u>37,500</u> (3)	
Total cost of goods sold		<u>223,000</u>		<u>222,500</u>		<u>222,500</u>	
Gross profit		<u>\$17,000</u>		<u>\$17,500</u>		<u>\$17,500</u>	

P 6–7 continued

	3.			
2020		<i>Unit basis</i>	<i>Group basis</i>	
		<i>(LCNRV)</i>	<i>(LCNRV)</i>	<i>Cost basis</i>
Sales		<u>\$ 280,000</u>	<u>\$ 280,000</u>	<u>\$ 280,000</u>
<i>Cost of goods sold</i>				
Opening inventory		\$ 37,000	\$37,500	\$37,500
Purchases		<u>260,000</u>	<u>260,000</u>	<u>260,000</u>
Cost of goods available		297,000	297,500	297,500
Ending inventory		<u>36,500</u> (2)	<u>37,500</u> (4)	<u>37,500</u> (4)
Cost of goods sold		<u>260,500</u>	<u>260,000</u>	<u>260,000</u>
Gross profit		<u>\$ 19,500</u>	<u>\$ 20,000</u>	<u>\$ 20,000</u>

4. b. (2019:\$17,500; 2020:\$20,000)

5. Using LCNRV/group basis and using the cost basis yield the same maximum profit (\$20,000).

P 6–8

1. Sales	\$305
Less: Sales returns	<u>5</u>
Net sales	300
<i>Cost of goods sold:</i>	
Opening inventory	\$ 25
Purchases	175
Less: Purchases returns	(5)
Transportation-in	<u>3</u>
Cost of goods available	198
Ending inventory	<u>15</u> (c)
Cost of goods sold	<u>183</u> (b)
Gross profit	<u>\$117</u> (a)

(a) Net sales = 39% x \$300 = \$117

(b) Cost of goods sold = Net sales – gross profit = \$300 – \$117 = \$183

(c) Ending inventory = Goods available for sale – cost of goods sold
= \$198 – \$183 = \$15

1. Retail inventory method

	<i>At retail</i>	<i>At cost, should be</i>
Sales	\$ 160,000	\$ 160,000
Less: Sales returns	10,000	10,000
Net sales	<u>\$150,000</u>	<u>150,000</u>
<i>Cost of goods sold</i>		
Opening inventory	\$ 20,000	\$ 11,000
Purchases	164,000	80,000
Less: Purchases returns	(4,000)	(2,000)
Transportation-in		1,000
Cost of goods available for sale	<u>180,000</u>	<u>90,000</u>
Ending inventory	<u>(30,000) (b)</u>	<u>(15,000) (c)</u>
Cost of goods sold	150,000 (a)	75,000
Gross profit	<u>\$ 0</u>	<u>\$ 75,000</u>

(a) Cost of goods sold = Net sales

(b) Estimated ending inventory at retail
 = Cost of goods available for sale – cost of goods sold
 = \$180,000 – \$150,000
 = \$30,000

(c) Estimated ending inventory at cost = \$30,000/200% = \$15,000

2. Inventory lost = Estimated ending inventory – actual inventory on hand
 = \$15,000 – 5,000
 = \$10,000

3. Some of the inventory may have been stolen or sold for less than the assumed mark-up.

4. Adopting a perpetual inventory system might be cost-effective, given the amount of the discrepancy (\$10,000 out of \$180,000 of goods available for sale). A perpetual inventory system would enable staff to compare actual amounts of goods in ending inventory to the accountings records to determine where the discrepancies arose, as well as possible solutions (for example, more physical safeguards for high-value goods).

P 6-10

a.	<i>Specific identification</i>	2019	2020	2021
	Sales	<u>\$1,000</u>	<u>\$1,200</u>	<u>\$1,150</u>
	COGS			
	Op. inv.	0	360	400
	Purchases	1,280	1,100	1,010
	End. inv.	<u>(360)</u>	<u>(400)</u>	<u>(320)</u>
	Cost of goods sold	<u>920</u>	<u>1,060</u>	<u>1,090</u>
	Gross profit/net income	<u>\$ 80</u>	<u>\$ 140</u>	<u>\$ 60</u>
b.	<i>FIFO</i>	2019	2020	2021
	Sales	<u>1,000</u>	<u>1,200</u>	<u>1,150</u>
	COGS			
	Op. inv.	0	300	320
	Purchases	1,280	1,100	1,010
	End. inv.	<u>(300)</u>	<u>(320)</u>	<u>(280)</u>
	Cost of goods sold	<u>980</u>	<u>1,080</u>	<u>1,050</u>
	Gross profit/net income	<u>\$ 20</u>	<u>\$ 120</u>	<u>\$ 100</u>
c.	<i>Weighted average</i>	2019	2020	2021
	Sales	<u>\$1,000</u>	<u>\$1,200</u>	<u>\$1,150</u>
	COGS			
	Op. inv.	0	340	420
	Purchases	1,280	1,100	1,010
	End. inv.	<u>(340)</u>	<u>(420)</u>	<u>(300)</u>
	Cost of goods sold	<u>940</u>	<u>1,020</u>	<u>1,130</u>
	Gross profit/net income	<u>\$ 60</u>	<u>\$ 180</u>	<u>\$ 20</u>

P 6-11

1.

	<u>Units</u>	<u>FIFO</u>	<u>Spec. ident.</u>	<u>Weighted average</u>
Opening inventory	50	\$ 50	\$ 50	\$ 50
Purchases	<u>800</u>	<u>2,800</u>	<u>2,800</u>	<u>2,800</u>
Cost of goods available	<u>850</u>	<u>\$2,850</u>	<u>\$2,850</u>	<u>\$2,850</u>

2.

FIFO: 200 @ \$5	=	<u>\$1,000</u>	
Sp. ident: (50 @ \$1) + (150 @ \$2)	=		<u>\$ 350</u>
Wtd. avg.: \$2,850/850 =			
\$3.35/unit (rounded) x 200 units			<u>\$670</u>

3.

	<u>Units</u>	<u>FIFO</u>	<u>Spec. ident.</u>	<u>Wtd. avg.</u>
Cost of goods available	850	\$2,850	\$2,850	\$2,850
Ending inventory	<u>200</u>	<u>1,000</u>	<u>350</u>	<u>670</u>
Cost of goods sold	<u>650</u>	<u>\$1,850</u>	<u>\$2,500</u>	<u>\$2,180</u>

P 6–11 continued

4. Based on response 3 above:
 - a. Weighted average income is less than specific identification by \$320 (\$2,180 - 2,500)
 - b. Specific identification income is greater than FIFO income by \$650 (\$2,500 - 1,850)
5. Cost of purchases are rising. Specific identification costing is more realistic with respect to income measurement in a period of rising prices (in this case) as it more closely matches current costs with current revenue.

P 6–12

1. Ending inventory (FIFO) = \$1 x 25 = \$25
2. Ending inventory (wtd. avg.) = \$5 x 25 = 65 *
- Difference \$ 40
- * (25 x \$5) + (15 x \$4) + (10 x \$3) + (35 x \$2) + (40 x \$1) = \$325/125 units = \$2.60/unit x 25 units = \$65.

3.

	<u>FIFO</u>	<u>Wtd. avg.</u>
Sales	\$360 ¹	\$360
<i>Cost of goods sold</i>		
Opening inventory	\$125	\$125
Purchases	<u>200</u>	<u>200</u>
Cost of goods available	325	325
Less: Ending inventory	<u>(25)</u>	<u>(65)</u>
Gross profit	<u>\$ 60</u>	<u>\$100</u>

$$^1 (30 \times \$6) + (20 \times \$4) + (50 \times \$2) = \underline{\underline{\$360}}$$

In a period of decreasing prices (as in this example), weighted average produces a higher net income than FIFO because more-recent costs are matched against recent sales, thus producing a better matching of costs with revenues.

4. Under FIFO in a period of decreasing prices, less income taxes would be payable, since income would be lower than under weighted average.

Therefore in a period of rising prices, more taxes would be payable using FIFO, since income would be higher than under weighted average. Over the life of the company, though, the same amount of taxes would be paid. The chosen inventory valuation method affects only the timing of cost of goods sold recognition.

1. Total purchases

Jan.	7	8,000 units @ \$12.00 = \$ 96,000
Mar.	30	9,000 units @ \$12.40 = \$111,600
May	10	12,000 units @ \$12.00 = \$144,000
Jul.	4	16,000 units @ \$12.60 = \$201,600
Sept.	2	6,000 units @ \$12.80 = \$ 76,800
Dec.	14	7,000 units @ \$12.70 = \$ 88,900
Total purchases		\$718,900

Ending inventory

FIFO				Spec. ident			
	<u>Quantity</u>	<u>Unit cost</u>	<u>Total cost</u>		<u>Quantity</u>	<u>Unit cost</u>	<u>Total cost</u>
Dec. 14	7,000	\$12.70	\$88,900	Jan. 1	4,000	\$11.90	\$ 47,600
Sept. 2	6,000	12.80	76,800	Jan. 7	8,000	12.00	96,000
Jul. 4	<u>2,000</u>	12.60	<u>25,200</u>	Mar. 30	<u>3,000</u>	12.40	<u>37,200</u>
	<u>15,000</u>		<u>\$190,900</u> (1)		<u>15,000</u>		<u>\$180,800</u> (2)

Weighted average			
	<u>Quantity</u>	<u>Unit cost</u>	<u>Total cost</u>
Jan. 1	4,000	\$11.90	\$ 47,600
Jan. 7	8,000	12.00	96,000
May 30	9,000	12.40	111,600
May 10	12,000	12.00	144,000
Jul. 4	16,000	12.60	201,600
Sept. 2	6,000	12.80	76,800
Dec. 14	<u>7,000</u>	12.70	<u>88,900</u>
	<u>62,000</u>		<u>\$766,500</u>

Average cost per unit: $\frac{\$766,500}{62,000 \text{ units}} = \12.36 (rounded)

Ending inventory: 15,000 units x 12.36 = **\$185,400** (3)

P 6–13 continued

2.

	Income Statement		
	<i>FIFO</i>	<i>Sp. Ident</i>	<i>Wtd. Avg.</i>
Sales	\$752,000	\$752,000	\$752,000
(47,000 @ \$16)			
<i>Cost of goods sold</i>			
Opening inventory	\$47,600	\$47,600	\$47,600
Purchases	718,900	718,900	718,900
Cost of goods available	766,500	766,500	766,500
Ending inventory	190,900 ⁽¹⁾	180,800 ⁽³⁾	185,400 ⁽⁴⁾
Cost of goods sold	575,600	585,700	581,100
Gross profit	<u>\$176,400</u>	<u>\$166,300</u>	<u>\$170,900</u>

3. Specific identification inventory valuation best matches revenue with costs in this case, because recent higher prices are matched against relatively recent selling prices.

P 6–14

1. to 3.

	Rising prices		Falling prices	
	<i>FIFO</i>	<i>Wtd. avg.</i>	<i>FIFO</i>	<i>Wtd. avg.</i>
Sales	\$5,000	\$5,000	\$5,000	\$5,000
<i>Cost of goods sold</i>				
Opening inventory	\$1,000	\$1,000	\$1,000	\$1,000
Purchases	6,000	6,000	4,000	4,000
Cost of goods available	7,000	7,000	5,000	5,000
Less: Ending inventory	3,000	2,917 ¹	2,000 ²	2,083 ³
Cost of goods sold	4,000	4,083	3,000	2,917
Gross profit	<u>\$1,000</u>	<u>\$ 917</u>	<u>\$2,000</u>	<u>\$2,083</u>

¹ Weighted average/rising: $(\$1,000 + 6,000)/600 \text{ units} \times 250 \text{ units} = \$2,917$ (rounded)

² FIFO/falling: $250 \text{ units} \times \$8 = \$2,000$

³ Weighted average/falling: $[\$1,000 + (500 \times \$8)]/600 \text{ units} \times 250 \text{ units} = \$2,083$ (rounded)

4. Less taxes would be payable under weighted average in a period of rising prices (gross profit is lower). More taxes would be payable under weighted average in a period of falling prices. However, there would be no difference in total over the life of the company.

CHAPTER SEVEN

Cash and Receivables

Concept Self-check

1. Internal control is the system, plan, or organization established to ensure, as far as practical, the orderly and efficient conduct of business. In part, it is used to ensure accurate record-keeping and the timely preparation of financial statements, safeguard the assets of the business, and promote efficiency.
2. An imprest petty cash system reimburses petty cash for an amount equal to the amounts disbursed when the fund has been depleted.
3. When a petty cash fund is established, a regular cheque is written for the amount to be held in the petty cash fund. The general ledger account Petty Cash is debited and Cash is credited. The cheque is cashed and the funds are held by the petty cash fund custodian.

When the balance of cash in the funds held by the custodian is low, a cheque is written to reimburse the fund for the amount of all receipts held. The cheque is recorded as a debit to the applicable expense accounts and a credit to the Petty Cash account in the general ledger.

4. A bank reconciliation is a comparison of the items shown on the bank statement with the entries made in the records of the entity. A reconciliation leads to the update of the accounting records and the correction of errors, if any. Thus, control over cash is enhanced.
5. Different reconciling items that may appear in a bank reconciliation are as follows:

Book Reconciling Items

Book errors
NSF cheques
Bank charges

Bank Reconciling Items

Outstanding deposits
Outstanding cheques
Bank errors

6. The steps in preparing a bank reconciliation are:

Step 1

List the ending general ledger cash balance on the bank reconciliation as the unreconciled general ledger Cash balance.

Step 2

List the ending cash balance on the bank statement on the bank reconciliation as the unreconciled bank statement balance.

Step 3

Compare clearing cheques shown on the bank statement with cheques recorded as cash disbursements in the company's records, including outstanding cheques shown on the prior month's bank reconciliation.

Concept Self-check continued

Step 4

Identify other disbursements made by the bank but not recorded in the company records.

Step 5

Compare the deposits shown on the bank statement with the amounts recorded in the company general ledger Cash account.

Step 6

Review the prior month's bank reconciliation for outstanding deposits.

Step 7

Rectify any errors in the company records or in the bank statement that become apparent during the reconciliation process.

Step 8

Total both sides of the bank reconciliation. The result should be that the reconciled general ledger Cash balance and the bank statement balances are equal.

Step 9

The adjusted balance calculated in the bank reconciliation must be reflected in the company's general ledger Cash account by means of adjusting entries.

7. A cheque received from trade customers that has been deposited but cannot be cleared by the bank because the customer's own bank balance is less than the amount of the cheque is an NSF (not sufficient funds) cheque.
8. Allowance for doubtful accounts is a contra accounts receivable account showing the estimated amount that will not be collected. To set it up, bad debt expense is debited and the allowance is credited for the estimated amount. In this way, the bad debt expenses for the period are matched with revenues for that period.
9. The income statement method for calculating the estimated amount of doubtful accounts assumes that a certain percentage of sales made on account will become uncollectible. The percentage is applied to credit sales and is chosen on the basis of bad debt experience of previous years. The estimated bad debt expense is calculated independently of any current balance in the Allowance for Doubtful Accounts general ledger account.
10. Ageing of accounts receivable is the detailed analysis of trade accounts receivable based on time that has elapsed since the creation of the receivable. An estimated loss percentage is applied to each time category to estimate an uncollectible amount. The estimated bad debt expense consists of the difference between the current balance in the Allowance for Doubtful Accounts general ledger account and the amount required to be set up based on this analysis.

Concept Self-check continued

11. The usual balance in the Accounts Receivable general ledger account is a debit. Occasionally, as a result of double payments, merchandise returns, or allowances granted for example, a credit balance occurs in some accounts. Theoretically, the credit balance should be transferred to liabilities. In practice, the net amount of accounts receivable is reported on the statement of financial position unless the credits would materially distort the numbers reported.
12. An example entry would be:
- | | | |
|---------------------------------------|--------|-------|
| Dr. Notes Receivable – Customer A | \$xxxx | |
| Cr. Sales (or, e.g., Service Revenue) | | \$xxx |

If the note is created as a result of an outstanding account receivable, the entry would be:

Dr. Notes Receivable – Customer A	\$xxxx	
Cr. Accounts Receivable – Customer A		\$xxx

CP 7-1

2019

Mar. 1	Petty Cash	200	
	Cash		200
	To establish petty cash fund.		
12	Office Supplies Expense	60	
	Maintenance Expense	35	
	Miscellaneous Selling Expense	25	
	Cash		120
	To reimburse petty cash.		
18	Petty Cash	200	
	Cash		200
	To increase petty cash balance to \$400.		
25	Office Supplies Expense	75	
	Delivery Expense	30	
	Cash		105
	To reimburse petty cash.		
28	Cash	50	
	Petty Cash		50
	To reduce petty cash fund balance to \$350.		

CP 7-2

Ferguson Corp.
Bank Reconciliation
At December 31, 2019

Cash per general ledger, Dec. 31	\$5,005	Cash per bank statement, Dec. 31	\$7,000
<i>Add:</i> Note collected by bank	1,300	<i>Add:</i> Error Fluet Inc. cheque	200
Interest on note	25	Outstanding deposit	700
<i>Less:</i> Bank service charges	<u>(30)</u>	<i>Less:</i> Outstanding cheques	<u>(1,600)</u>
Adjusted Cash balance, Dec. 31	<u>\$6,300</u>	Adjusted Cash balance, Dec. 31	<u>\$6,300</u>

2019 adjusting entries:

Dec. 31	Cash	1,325	
	Note Receivable		1,300
	Interest Earned		25
	To record the note collected by the bank.		
31	Bank Charges Expense	30	
	Cash		30
	To record service charges from the bank.		

CP 7–3

Gladstone Ltd.
Bank Reconciliation
At March 31, 2019

Cash per general ledger, Mar. 31	\$2,531	Cash per bank statement, Mar. 31	\$1,500
<i>Add:</i> Error cheque No. 4302	27	<i>Add:</i> Outstanding deposit	1,000
Note receivable	250	Error re. Global	250
Interest on note	50		
<i>Less:</i> Service charges—March	(20)	<i>Less:</i> Outstanding cheques	(622)
Service charges—note	(10)		
NSF cheque	<u>(700)</u>		
Adjusted cash balance, Mar. 31	<u>\$2,128</u>	Adjusted cash balance, Mar. 31	<u>\$2,128</u>

2019 adjusting entries:

Mar. 31	Cash	27	
	Office Supplies Expense		27
	To correct ck. no. 4302		
	Cash	290	
	Note Receivable		250
	Interest Earned		50
	Bank Charges Expense	10	
	To record note collected by the bank.		
	Bank Charges Expense	20	
	Cash		20
	To record service charges for March.		
	Accounts Receivable	700	
	Cash		700
	To record NSF cheque returned.		

CP 7-4

1.

2019			
Dec.	31	Bad Debt Expense	5,000
		Allowance for Doubtful Accounts	5,000
2020			
Apr.	15	Allowance for Doubtful Accounts	700
		Accounts Receivable	700
Aug.	8	Allowance for Doubtful Accounts	3,000
		Accounts Receivable	3,000
Dec.	31	Bad Debt Expense	4,000
		Allowance for Doubtful Accounts	4,000
2021			
Mar.	6	Accounts Receivable	200
		Allowance for Doubtful Accounts	200
Sept.	4	Allowance for Doubtful Accounts	4,000
		Accounts Receivable	4,000
Dec.	31	Bad Debt Expense	4,500
		Allowance for Doubtful Accounts	4,500
2. Both methods are estimates and attempt to match expenses with revenues. Over time, the allowance for doubtful accounts under either method should be approximately the same. If not, management should review the percentage estimates under each method to ensure that they are reasonable.

CP 7-5

1. Allowance for doubtful accounts = $5\% \times \$125,000 = \$6,250$
2. The Allowance for Doubtful Accounts general ledger account has a balance of \$3,000 but the balance should be \$6,250. The difference is the amount of the bad debt expense.

$$\text{Bad debt expense} = (\$6,250 - \$3,000) = \$3,250$$

3.

Impulse Inc.			
Partial Statement of Financial Position			
At December 31, 2019			
<i>Assets</i>			
	Accounts receivable	\$125,000	
	Less: Allowance for doubtful accounts	<u>6,250</u>	\$118,750
OR	Accounts receivable (net of \$6,250 AFDA)		\$118,750

CP 7-6

1.	Allowance for doubtful accounts, Dec. 31, 2018	\$8,000
	Written off in 2019	<u>(2,400)</u>
		5,600
	Allowance for doubtful accounts, Dec. 31, 2019	<u>(9,000)</u>
	Bad debt expense for 2019	<u>\$3,400</u>
2.	Allowance for doubtful accounts, Dec. 31, 2019	\$ 9,000
	Written off in 2020	(1,000)
	Recovered in 2020	<u>300</u>
		8,300
	Allowance for doubtful accounts, Dec. 31, 2020	<u>(10,000)</u>
	Bad debt expense for 2020	<u>\$ 1,700</u>

CP 7-7

- | | | |
|---------------------------------|--------|--------|
| Bad Debt Expense | 15,000 | |
| Allowance for Doubtful Accounts | | 15,000 |
| (2% x \$750,000 = \$15,000) | | |
 - Allowance for Doubtful Accounts = \$3,000 + \$15,000 = \$18,000
- | | | |
|---|--------|--------|
| Bad Debt Expense | 11,700 | |
| Allowance for Doubtful Accounts | | 11,700 |
| [10% x (\$150,000 - 3,000)] = 14,700 - 3,000 = \$11,700 | | |
 - Allowance for Doubtful Accounts = \$3,000 + \$11,700 = \$14,700
(or 10% x (\$150,000-3,000))
- There is a difference in the estimates because different methods are used. The first method is based on a percentage of sales; the second on aging of accounts receivable.

CP 7-8

- Bad debt expense = 2% x \$200,000 = \$4,000
 - Allowance for doubtful accounts = \$1,000 debit - \$4,000 credit = \$3,000 credit
- Bad debt expense = (5% x \$50,000) + \$1,000 debit = \$3,500
 - Allowance for doubtful accounts = (5% x \$50,000) = \$2,500
- The calculation made in question 1 above better matches revenue and expenses. The revenue (sales) is directly related to the amount that is written off as bad debt expense.

The calculation made in question 2 above better matches accounts receivable to allowance for doubtful accounts and thus produces a better statement of financial position valuation.

CP 7-9

1. 2019
 Nov. 1 Note Receivable – Smith Co. 12,000
 Account Receivable – Smith Co. 12,000
 To record conversion of account receivable to 3-month, 6% note receivable.

2. 2019
 Dec. 31 Interest Receivable 120
 Interest Earned 120
 To record accrued interest on note receivable – Smith Co.
 (\$12,000 x 6% x 2/12 mos. = \$120)

3. 2020
 Feb. 1 Cash 12,180
 Note Receivable – Smith Co. 12,000
 Interest Receivable 120
 Interest Earned 60
 To record collection of Smith Co. note receivable
 (\$12,000 x 6% x 1/12 mos. = \$60)

P 7-1

1. 2019
 Dec. 1 Petty Cash 200
 Cash 200
 To establish petty cash fund.

 14 Office Supplies Expense 30
 Maintenance Expense 20
 Cash Over/short Expense 4
 Cash 54
 To reimburse petty cash and record shortage.

 29 Office Supplies Expense 10
 Delivery Expense 20
 Cash Over/short Expense 2
 Cash 28
 To reimburse petty cash and record overage.

 31 Cash 50
 Petty Cash 50
 To reduce petty cash fund balance to \$50.

2. The fund is small but adequate. Overage/shortages are not large. These are good indicators. The manager could consider reviewing the reimbursed receipts occasionally to ensure they are reasonable and petty cash disbursements are adequately supported.

1.
 - a The company has received a \$3,000 loan from the bank, that was deposited into its bank account but was not recorded in the books of the company.
 - e A \$250 cheque was not returned with the bank statement though it was paid by the bank.
 - d Cheques amounting to \$4,290 shown as outstanding on the November reconciliation still have not been returned by the bank.
 - a A collection of a note receivable for \$1,000 made by the bank has not been previously reported to Goertzen. This includes interest earned of \$50.
 - c The bank has erroneously charged Goertzen with an \$1,100 cheque which should have been charged to Gagetown Ltd.
 - b A \$350 cheque made out by Fynn Company and deposited by Goertzen has been returned by the bank marked NSF; this is the first knowledge Goertzen has of this action.
 - a A cheque for \$840 was erroneously recorded as \$730 in the company records.
 - c A \$600 bank deposit of December 31 does not appear on the bank statement.
 - b Bank service charges amounting to \$75 were deducted from the bank statement but not yet from the company records.

2. Goertzen Ltd.
Bank Reconciliation
At December 31, 2019

Cash per general ledger, Dec. 31	\$84,293	Cash per bank statement, Dec. 31	\$90,568
<i>Add:</i> Bank loan not recorded	\$3,000	<i>Add:</i> Cheque charged to	
Bank collection not		wrong account	\$1,100
recorded on books	950	Outstanding deposit	<u>600</u>
Interest earned on note	50		<u>1,700</u>
Error in recording cheque	<u>110</u>		92,268
	<u>4,110</u>		
	88,403		
<i>Less:</i> NSF cheque	350	<i>Less:</i> Outstanding cheques	<u>4,290</u>
Bank charge	<u>75</u>		
	<u>425</u>		
Adjusted Cash balance, Dec. 31	<u>\$87,978</u>	Adjusted Cash balance, Dec. 31	<u>\$87,978</u>

P 7–2 continued

3.				
	Dec.31	Cash	3,000	
		Bank Loan		3,000
		To record proceeds of bank loan.		
	31	Cash	1,000	
		Notes Receivable		950
		Interest Earned		50
		To record collection of notes receivable by bank.		
	31	Cash	110	
		Accounts Receivable		110
		To record correction of cheque deposited as \$730, should have been \$840.		
	31	Bank Charges Expense	75	
		Cash		75
		To record monthly bank charges.		
	31	Accounts Receivable	350	
		Cash		350
		To record NSF cheque from Fynn Company returned by the bank.		

P 7–3

1.

Gibson Energy Ltd.			
Bank Reconciliation			
At November 30, 2019			
Cash per general ledger, Nov. 30	\$4,213	Cash per bank statement, Nov. 30	\$4,440
Add: Error on cheque No. 1042	\$ 54	Add: Outstanding deposit	<u>611</u>
Note collected	<u>500</u> <u>554</u>		
	4,767		5,051
Less: NSF cheque	130	Less: Outstanding cheques	
Service charge	10	No. 1014	\$152
Note collection fee	<u>6</u> <u>146</u>	1054	32
		1192	54
		1193	83
		1194	<u>109</u> <u>430</u>
Adjusted cash balance, Nov. 30	<u>\$4,621</u>	Adjusted cash balance, Nov. 30	<u>\$4,621</u>

P 7–3 continued

2.	Oct. 31	Cash	54	
		Office Supplies Expense		54
		To adjust for error in recording cheque no. 1042.		
	31	Accounts Receivable	130	
		Cash		130
		To record NSF cheque.		
	31	Bank Charges Expense	10	
		Cash		10
		To record bank charges for the month.		
	31	Cash	494	
		Bank Charges Expense	6	
		Notes Receivable		500
		To record a collection made by the bank.		

P 7–4

1. Accounts receivable = balance + credits = \$74,460 + 3,200 + 1,800 = \$79,460
2. The \$5,000 credit balance could be shown as a current liability on the statement of financial position, unless it is considered immaterial. In that case, it would be netted against accounts receivable with debit balances and \$74,460 would be shown in the asset section of the statement of financial position.

P 7–5

1.	2019			
	Dec.31	Allowance for Doubtful Accounts	2,000	
		Bad Debt Expense		2,000
		To adjust balance to 3% of \$100,000 A/R.		
	2020			
	a.	Allowance for Doubtful Accounts	9,000	
		Accounts Receivable		9,000
	b.	Accounts Receivable	800,000	
		Sales		800,000
	c.	Cash	700,000	
		Accounts Receivable		700,000
	d.	Accounts Receivable	2,000	
		Allowance for Doubtful Accounts		2,000
		Cash	2,000	
		Accounts Receivable		2,000

P 7–5 continued

e.	Bad Debt Expense	14,000	
	Allowance for Doubtful Accounts		14,000 ←
<u>Allowance for Doubtful Accounts</u>			
	2,000	5,000	}
	9,000	2,000	
	4,000		
		14,000	
		10,000	

Balance at Dec. 31, 2019
Write-offs and recovery
Balance before adjustment
Adjustment needed ←
Balance at Dec. 31, 2020

2.	<u>Allowance for Doubtful Accounts</u>		
		5,000	Balance at Dec. 31, 2019
		6,000	1% of \$600,000 sales
		11,000	Adjusted bal. Dec. 31, 2019
	9,000		Transaction (a)
		8,000	1% of \$800,000 sales
		2,000	Transaction (d)
		12,000	Balance at Dec. 31, 2020

P 7–6

Part A: 2019

1.	Dec. 31	Allowance for Doubtful Accounts	1,000	
		Accounts Receivable		1,000

2. Calculation of uncollectible amount at December 31, 2019

<u>Age (days)</u>	<u>Accounts receivable</u>	<u>Estimated loss percentage</u>	<u>Estimated uncollectible amount</u>
1-30	\$ 50,000	2%	\$1,000
31-60	27,000	4%	1,080
61-90	40,000	5%	2,000
91-120	30,000	10%	3,000
Over 120	2,000 *	50%	1,000
	<u>\$149,000</u>		<u>\$8,080</u>

* net of R. Laws' balance

AFDA adjusting entry = (starting balance – accounts written off) – ending balance
= (\$1,500 Cr – 1,000 Dr) – 8,080 Cr.
= \$7,580 Cr. needed

2019			
Dec. 31	Bad Debt Expense	7,580	
	Allowance for Doubtful Accounts		7,580

P 7–6 continued

Part B: 2020

Accounts Receivable	700,000	
Sales		700,000
Cash	599,000	
Accounts Receivable		599,000
Allowance for Doubtful Accounts	10,000	
Accounts Receivable		10,000

Calculation of uncollectible amount at December 31, 2020

<u>Age (days)</u>	<u>Accounts receivable</u>	<u>Estimated loss percentage</u>	<u>Estimated uncollectible amount</u>
1-30	\$170,000	2%	\$ 3,400
31-60	35,000	3%	1,050
91-120	27,000	25%	6,750
Over 120	<u>8,000</u>	50%	<u>4,000</u>
	<u>\$240,000</u>		<u>\$15,200</u>

AFDA adjusting entry = (starting balance- accounts written off) – ending balance required
 = (\$8,080 Cr. – 10,000 Dr.) - \$15,200 Cr.
 = \$17,120 Cr. needed

2020

Dec. 31	Bad Debt Expense	17,120	
	Allowance for Doubtful Accounts		17,120

P 7–7

- Allowance for Doubtful Accounts 25,000
Accounts Receivable 25,000
 - Accounts Receivable 15,000
Allowance for Doubtful Accounts 15,000
 - Cash 15,000
Accounts Receivable 15,000
- Allowance for doubtful accounts = (\$15,000 Cr. - \$25,000 Dr.) (1a) + \$15,000 Cr. (1b)
= \$5,000 Cr. balance
- Balance required = 3% of credit sales
= 3% x 70% x \$1,000,000
= \$21,000

Bad Debt Expense	16,000	
Allowance for Doubtful Accounts		16,000

To record the proper balance: \$21,000 Cr. required; \$5,000 Cr. is already in the account.

 - | | | |
|---------------------------------|-------|-------|
| Bad Debt Expense | 7,500 | |
| Allowance for Doubtful Accounts | | 7,500 |

To record the proper balance: \$12,500 Cr. required, \$5,000 Cr. is already in the account.

P 7-7 continued

c. Calculation of uncollectible amount at December 31, 2020

<u>Age (days)</u>	<u>Accounts receivable</u>	<u>Estimated loss percentage</u>	<u>Estimated uncollectible amount</u>
1-30	\$100,000	2%	\$ 2,000
31-60	50,000	4%	2,000
61-90	25,000	5%	1,250
91-120	60,000	10%	6,000
Over 120	<u>15,000</u>	50%	<u>7,500</u>
	<u>\$250,000</u>		<u>\$18,750</u>
Bad Debt Expense			13,750
Allowance for Doubtful Accounts			13,750
To record the proper balance: \$18,750 Cr. required, \$5,000 Cr. already in the account.			

P 7-8

1. 2019

AFDA adjusting entry = (starting balance-accounts written off)-ending balance required

$$= (\$1,500 \text{ Cr.} - \$600 \text{ Dr.}) - \$3,900 \text{ Cr.}$$

$$= \$3,000 \text{ Cr. needed}$$

Bad Debt Expense	3,000	
Allowance for Doubtful Accounts		3,000
To record adjustment needed (\$3,900 - [\$1,500 - \$600])		

2. 2020

AFDA adjusting entry = (starting balance – accounts written off + accounts recovered) – ending balance required

$$= (\$3,900 \text{ Cr.} - \$300 \text{ Dr.} + \$400 \text{ Cr.})$$

Bad Debt Expense	3,200	
Allowance for Doubtful Accounts		3,200
To record adjustment needed (\$7,200 - [\$3,900 - \$300 + \$400])		

3. 2020

Jun. 5	Accounts Receivable	400	
	Allowance for Doubtful Accounts		400
5	Cash	400	
	Accounts Receivable		400

1.	2019			
		Accounts Receivable	8,540,000	
		Sales		8,540,000
		To record sales for 2019.		
		Accounts Receivable (Huron Supplies)	15,600	
		Allowance for Doubtful Accounts		15,600
		To reinstate account of Huron Supplies previously written off as uncollectible.		
		Cash	8,262,560	
		Accounts Receivable		8,262,560
		To account for collections during year.		
		Allowance for Doubtful Accounts	33,660	
		Accounts Receivable		33,660
		To write off bad debts.		
		Notes Receivable (12%, 6 months)	520,000	
		Accounts Receivable		520,000
		To record receipt of note (assumes cash is included in the \$8,262,560 above).		
2.	a. Dec. 31	Bad Debt Expense	21,870	
		Allowance for Doubtful Accounts		21,870(2)
		To record bad debt expense provision:		
		10% on \$200,580	\$20,058	
		2% on \$807,600 (1)	<u>16,152</u>	
		Required allowance	<u>\$36,210</u>	
	b. Dec. 31	Interest Receivable	10,400	
		Interest Earned		10,400
		To record accrued interest on note receivable (\$520,000 x 12% x 2/12 mos. = \$10,400)		
		(1) Accounts receivable not past due		
		= \$1,268,800 + 8,540,000 - 8,262,560 + 15,600 - 33,660 - 200,580 - 520,000		
		= \$807,600 x 2% = \$16,152		
		(2) AFDA adjusting entry		
		= (starting balance – accounts written off + accounts recovered) - ending balance required)		
		= (\$32,400 Cr. - \$33,660 Dr + \$15,600 Cr.) - \$36,210 Cr.		
		= \$21,870 Cr. needed		
3.	Amount of bad debt expense on income statement	=	<u>\$21,870</u>	
4.	Allowance for doubtful accounts	=	<u>\$36,210</u>	

1.

Ageing of Accounts Receivable
December 31, 2019
Age (days)

	<u>1-30</u>	<u>31-60</u>	<u>61-90</u>	<u>91-120</u>	<u>121-150</u>	<u>+150</u>
Greenwood						600
Granville					335	
Kutcher	275	720				
Lamb						445
Grimm			822			
Fehr		250		465		922
Golden	500					
	<u>\$775</u>	<u>\$970</u>	<u>\$822</u>	<u>\$465</u>	<u>\$335</u>	<u>\$1,967</u>

2.

Calculation of Uncollectible Amount
December 31, 2019

<u>Age (days)</u>	<u>Accounts receivable</u>	<u>Estimated loss percentage</u>	<u>Uncollectible amount</u>
1-30	\$775	0.5%	\$ 3.90
31-60	970	1.0%	9.70
61-90	822	3.0%	24.66
91-120	465	10.0%	46.50
121-150	335	25.0%	83.75
Over 150	<u>1,967</u>	50.0%	<u>983.50</u>
Totals	<u>\$5,334</u>		<u>\$1,152.01</u>

3. Dec. 31

Bad Debt Expense 952.01
 Allowance for Doubtful Accounts 952.01
 To record the proper balance: \$1,152.01 Cr. required, \$200.00 Cr.
 already in the account.

P 7-11

1.	Feb. 15	Allowance for Doubtful Accounts	200	
		Accounts Receivable		200
	Apr. 30	Accounts Receivable	100	
		Allowance for Doubtful Accounts		100
		Cash	100	
		Accounts Receivable		100
	Jun. 26	Cash	300	
		Allowance for Doubtful Accounts	400	
		Accounts Receivable		700
	Sep. 7	Allowance for Doubtful Accounts	350	
		Accounts Receivable		350
	Dec. 31	Allowance for Doubtful Accounts	800	
		Accounts Receivable		800

2. Calculation of Uncollectible Amount
December 31, 2019

	<i>Accounts receivable</i>	<i>Estimated Loss percentage</i>	<i>Estimated uncollectible amount</i>
<u>Age (days)</u>			
1-30	\$20,000	2%	\$ 400
31-60	12,000	4%	480
61-90	5,000	5%	250
91-120	3,000	10%	300
Over 120	<u>10,000</u>	50%	<u>5,000</u>
Totals	<u>\$50,000</u>		<u>\$6,430</u>

Allowance for
Doubtful Accounts

	1,735	Balance at Dec. 31, 2018	
200	100	} Write-offs and recovery	
400			
350			
800			
	85	Balance before adjustment	
	6,345	Adjustment needed ←	
	6,430	Balance needed at Dec. 31, 2019	
Dec. 31	Bad Debt Expense	6,345	↓
	Allowance for Doubtful Accounts		6,345

P 7-12

- | | | | |
|----|---|--------|--------|
| 1. | Note Receivable – Baron Cabinet Ltd. | 12,000 | |
| | Account Receivable – Baron Cabinet Ltd. | | 12,000 |
| | To record conversion of account receivable to 12-month,
12% note receivable. | | |
2. No entry is required. Accrued interest was paid in cash on December 31.
- | | | | |
|----|---|--------|--------|
| 3. | Cash | 10,600 | |
| | Note Receivable – Baron Cabinet Ltd. | | 10,000 |
| | Interest Earned | | 600 |
| | To record collection of the February portion of Baron
Cabinet Ltd. note receivable and interest for one month
(\$60,000 x 12% x 1/12 mo. = \$600) | | |

CHAPTER EIGHT

Long-lived Assets

Concept Self-check

1. To capitalize a cost means to record an expenditure as a long-lived asset.
2. An expenditure is a cash disbursement. A capital expenditure is one that
 - a. benefits more than the current accounting period, and these benefits are reasonably assured;
 - b. enhances service potential or makes an asset more valuable, and
 - c. is significant in amount.

A revenue expenditure does not have these characteristics.

3. The purchase of a computer for business use qualifies as a capital expenditure when it benefits more than one accounting period. However, its purchase price may be immaterial, depending on the company's capitalization policy. The annual maintenance or repairs made to the computer to keep it running are revenue expenditures if the cash disbursements are frequent, small, and do not extend the life of the computer. Purchase of a part that significantly enhances performance or extends the useful life of the computer might be capitalized, again depending on materiality.
4. Purchasing land and buildings for a lump sum means that no distinction is made between the two items at the time the purchase price is negotiated. The purchase price must be apportioned between the Land and Building accounts because buildings are subject to depreciation. The purchase price, therefore, is allocated on the basis of relative fair values of the land and the buildings.
5. As a matter of expediency, companies usually set a dollar limit to help determine whether a disbursement is to be treated as a revenue or a capital expenditure because efforts required to capitalize and amortize an inexpensive item are so much greater than the benefits to be derived. The concept of materiality is used to determine the amount at which an expenditure is considered capital in nature.
6. The three criteria to capitalize a replacement part are:
 - a. whether it is a material amount;
 - b. whether the cost can be reliably measured; and
 - c. whether it will enhance the future economic benefit of the asset.

Concept Self-check continued

7. When one asset is exchanged for another, the cost of the asset acquired is determined by the fair value of the asset given up.
8. Depreciation is the process of allocating the cost of a tangible, long-lived asset to each accounting period that will benefit from its use. The amount to be allocated depends on the estimate of the asset's useful life and residual value, and method of depreciation to be used.
9. As time elapses, the economic benefits provided by an asset may decrease, so that the efficiency of the asset is greater during its initial years and less later on. If a car is free from initial defect, it should not require any repairs in its first year of use, but it will need regular maintenance (e.g., oil changes). Eventually, it will likely require repairs, such as a replacement battery or new valves. The annual maintenance costs will increase, costing the user more to use the car. Therefore, the value of the car or the value of its services each year will decrease, so depreciation should likely be lower in subsequent years.
10. A usage method of depreciation is useful when the use of an asset varies from period to period and when wear and tear is the major cause of depreciation. A time-based method, such as straight-line depreciation, assumes that each period receives services of equal value from the use of the asset; time-based methods ignore asset usage. The preferable method is a matter of judgement.

The sports car may wear out in two ways. The distance travelled has a large bearing on the value of the car; however, the passage of time also does, as an older model generally sells for less than its original cost. In terms of the useful life of the car, it will only last for a certain number of kilometres and it only renders services if it is driven. A usage method is likely best to measure depreciation, since the car is not necessarily driven for equal times during each period; the less it is driven, the more periods it will last.

11. Under the declining balance method, a constant depreciation rate is applied in each accounting period to the remaining carrying amount (cost less accumulated depreciation). Carrying amount declines more quickly in earlier years. Under the straight-line method, the carrying amount declines by the same amount over the useful life of the asset.
12. If an asset is expected to have a 10-year life, then 10 per cent of its usefulness expires each year ($100\%/10 \text{ years} = 10\%$). The double-declining balance is double this rate or 20% per year. The rate is applied to the carrying amount of the asset at the end of the previous year.
13. Partial year depreciation is calculated in the year in which a long-lived asset is purchased or disposed. It can be calculated by several means – for example, using the half-year rule or by pro-rating depreciation expense over the number of months that the asset was in use.

Concept Self-check continued

14. Either changes in estimated residual value or useful life may affect the calculation of depreciation expense. In both cases, no change is made to depreciation expense already recorded. The effects of the changes are spread over the remaining future periods.
15. Subsequent capital expenditures affect depreciation calculations in the same manner as changes in accounting estimates. The effects are accounted for prospectively (over the remaining future periods).
16. At the end of each reporting period, the recoverable amount (fair value less estimated costs of disposal) of an asset must be compared to its carrying value. If the recoverable amount is lower, the carrying value must be adjusted downward (a credit to the asset account) and an impairment loss must be recorded (a debit to an expense account). Subsequent years' depreciation expense calculations must also be adjusted.
17. Estimates of future events are commonplace in accounting, and are deemed necessary to provide more meaningful information to financial statement users, within reason. Depreciation is one example. The benefits of matching the use of a capital asset to the revenue of future periods that it helps to produce is considered useful information under GAAP. To facilitate this, depreciation methods rely on estimates of future events, and these are subject to error. Accounting is intended to produce financial information that is not precise but rather a fair representation of the activities of the entity. If the estimates used subsequently prove to be incorrect, they are adjusted.
18. Significant parts may have different estimated usage patterns, useful lives, and residual values. They may be replaced at different points in the useful life of the long-lived asset. Separate accounting for significant parts allows for these differences to be reflected in the financial statements.
19. A gain or loss on disposal does not occur if the carrying amount of an asset is the same as the proceeds of disposition. This rarely occurs.
20. A trade-in involves acquiring a long-lived asset by giving up a similar asset to the one being acquired (i.e., exchanging it) as part of the purchase price. It is not quite the same as an outright sale, which involves giving up a long-lived asset and receiving another type of asset like cash for it.
21. The trade-in allowance may be higher or lower than the fair value of the used asset on the open market. Dealers often give more trade-in allowance on a used car than it is actually worth to make purchasers think that they are getting a better deal on the new car.
22. The cost of the new asset is calculated as the sum of cash paid plus the fair value of the trade-in.

Concept Self-check continued

23. Intangible assets, unlike property, plant, and equipment, cannot be touched or otherwise sensed. They are the same as PPE in that they represent future economic benefits to an entity over more than one accounting period, and so are similarly capitalized.
24. A patent is an exclusive right granted by the state to an inventor to produce and sell an invention for a specified period of time. A patent's useful life may be affected by economic factors based on demand and competition. The 20-year life may be excessive; a shorter life may be more realistic. For example, if a company develops a unique computer and patents it, even though it cannot be reproduced by other firms for 20 years, nothing stops a competitor from studying it, improving it, and patenting this improved computer. Although the "unique" computer may be useful for many years, it may be technologically obsolete before the patent expires.
25. A copyright is the exclusive right granted by the state to publish a literary or artistic work. It exists for the lifetime of the author and for a specific period of time after death. Similarly, a trademark is a legal right granted by the state, in this case for an entity to use a symbol or a word as a trademark to identify one of its products or services. A copyright would be granted for a piece of music or a novel. Examples of trademarks are the word "Coke"® on soft drink bottles and the stylized 'M'® of the McDonald's® logo.
26. Intangible assets are generally measured and recorded at cost. The measurement basis should be disclosed, along with
 - a. the type of amortization method for each class of intangible asset;
 - b. opening and ending balances for cost, accumulated amortization, and carrying value, and disclosure of any changes;
 - c. whether they are internally generated; and
 - d. whether they have finite or indefinite lives.
27. Goodwill is a long-lived asset that represents the capitalized value of superior earnings obtained by purchasing the net assets of another company. Such factors as favourable customer relations, loyal and competent employees, possession of valuable patents or copyrights, high-quality products, or effective management help create goodwill. Goodwill differs from an intangible asset. It cannot be separately identified. It relates to the totality of the future benefits acquired. The useful life of goodwill is considered indefinite. Goodwill can only be purchased in an arms-length transaction because it is otherwise difficult to attach a value to it.

CP 8–1

i	Battery purchased for truck ¹
c	Cash discount received on payment for equipment
a	Commission paid to real estate agent to purchase land
d	Cost of equipment test runs
b	Cost to remodel building
b	Cost to replace manual elevator with automatic elevator
a	Cost of sewage system
d	Equipment assembly expenditure
d	Expenditures for debugging equipment
f	Installation of air-conditioner in automobile
b	Insurance paid during construction of building
a	Legal fees associated with court case to defend title to land purchased
i	Oil change for truck ¹
c	Payment for paving parking lot
a	Proceeds from sale of old building on purchased land
a	Expenditures for removal of derelict structures
i	Repair made to building after moving in ¹
i	Repair of collision damage to truck ¹
i	Repair of torn seats in automobile ¹
i	Replacement of rusted fender on automobile ¹
f	Replacement of transmission on automobile
c	Special reinforced floor foundations for installed equipment
h	Tires purchased for truck ¹
d	Transportation expenditures to bring equipment to plant.

¹Assumed to be immaterial in amount. All others assumed to be material, estimable, and to benefit future periods, and therefore capitalized.

Alternate answers are acceptable if plausible.

CP 8–2

1. Cost = \$3,250 + \$100 + \$300 + \$50 + (10% x \$3,250) = \$4,025. Answers may vary. The table may be recorded as a separate asset. Also, all or some of the expenditures may be considered immaterial.

2. Straight-Line Method:

		<i>Straight-line</i>	<i>Double-declining balance</i>
Year	1	\$378*	\$4,025 x 40%** = \$1,610
	2	\$755	2,415 x 40% = 966
	3	\$755	1,449 x 40% = 580
	4	\$755	869 x 40% = 348
	5	\$755	521 x 40% = 208

$$\frac{*(\$4,025 - 250) \times \frac{1}{2}}{5 \text{ years}} = \$378 \text{ (rounded)}$$

$$**(100\%/5\text{yrs.} = 20\% \times 2 = 40\%)$$

Under the straight-line method, each period is assumed to receive equal benefits from the use of the asset. Under the double-declining balance method, each period is charged a diminishing amount. The straight-line method would be more appropriate if the economic benefits would be used about equally over the years. The double-declining balance method would be better to use if the economic benefits were used up more in the first few years. The DDB method is likely the better choice, given the probability of technological obsolescence of this type of asset.

CP 8–3

1. Journal entries to record the sale on the books of:

- a. Freeman:

April 30, 2019		
Equipment	200,000	
Land		125,000
Gain on Disposal		75,000

The equipment is valued at the fair value of the asset given up.

- b. The developer:

April 30, 2019		
Land	240,000	
Equipment		325,000
Accumulated Depreciation – Equipment	80,000	
Loss on Disposal	5,000	
Calculated as:		
Cost		\$325,000
Accumulated depreciation		<u>(80,000)</u>
Carrying amount		245,000
Proceeds (fair value of equipment)		<u>240,000</u>
Loss on disposal		<u>\$ 5,000</u>

CP 8–3 continued

2. The land may have been zoned as agricultural land. The appraiser may have valued the land assuming no change in use would occur. The developer may anticipate that the land could be rezoned to commercial land, which should increase its value.

CP 8–4

1. Straight–line method:

$$\frac{(\$110,000 - 10,000)}{10 \text{ years}} = \$10,000 \text{ per year}$$

$$2019 \text{ depreciation} = \$10,000 \times \frac{1}{2} = \$5,000$$

$$2020 \text{ depreciation} = \$10,000$$

2. Double–declining balance method:

$$\frac{100\%}{10 \text{ years}} \times 2 = 20\%$$

$$2019 \text{ depreciation} = \$110,000 \times 20\% \times \frac{1}{2} = \$11,000$$

$$2020 \text{ depreciation} = (\$110,000 - 11,000) \times 20\% = \$19,800$$

CP 8–5

1. Straight–line method:

$$\frac{(\$25,000 - 5,000)}{5 \text{ years}} = \$4,000 \text{ per year}$$

$$2019 \text{ depreciation} = \$4,000 \times \frac{1}{2} = \$2,000$$

$$2020 \text{ depreciation} = \$4,000$$

2. Usage method:

$$\frac{(\$25,000 - 5,000)}{500,000 \text{ km.}} = \$0.04/\text{km.}$$

$$2019 \text{ depreciation} = 120,000 \text{ km.} \times \$0.04 = \$4,800$$

$$2020 \text{ depreciation} = 150,000 \text{ km.} \times \$0.04 = \$6,000$$

The $\frac{1}{2}$ year rule does not apply under usage methods of calculating depreciation.

3. Double–declining balance method:

$$\frac{100\%}{5 \text{ years}} \times 2 = 40\% \text{ per year}$$

$$2019 \text{ depreciation} = \$25,000 \times 40\% = \$10,000 \times \frac{1}{2} \text{ yr.} = \$5,000$$

$$2020 \text{ depreciation} = (\$25,000 - 5,000) \times 40\% = \$8,000$$

CP 8–6

1. Jan. 31, 2019		
Computer	3,000	
Cash		3,000
March 1, 2019		
Computer	1,000	
Cash		1,000
Apr. 1, 2020		
Computer	2,000	
Cash		2,000

Alternate interpretations are acceptable, with adequate explanation.

2. Double-declining balance rate = 66.7% (100%/3 yrs. = 33.3% x 2).

Dec. 31, 2019

Depreciation Expense	1,334	
Accumulated Depreciation – Equipment		1,334
To record 2019 depreciation: (\$3,000 + 1,000) x 66.7%. X ½ yr.		

Dec. 31, 2020

Depreciation Expense	2,445	
Accumulated Depreciation – Equipment		2,445
To record 2020 depreciation:		
2019 additions (\$3,000 + 1,000 – 1,334) x 66.7%	\$1,778	
2020 additions (\$2,000 x 66.7% x ½ yr.)	<u>667</u>	
Total depreciation		<u>\$2,445</u>

CP 8–7

1. Straight-line method:

$$\text{Balance at end of 2020} = (\$110,000 - 10,000) - 5,000 - 10,000 = \$85,000$$

$$\frac{\$85,000}{4 \text{ years}} = \$21,250 \text{ per year}$$

$$2021 \text{ depreciation} = \$21,250$$

2. Double-declining balance method:

$$\text{Balance at end of 2020} = \$110,000 - 11,000 - 19,800 = \$79,200$$

$$\frac{100\%}{4 \text{ years}} \times 2 = 50\% \text{ per year}$$

$$2021 \text{ depreciation} = \$79,200 \times 50\% = \$39,600$$

1. Equipment sold for \$50,000:

Cash	50,000	
Accumulated Depreciation	46,875	
Loss on Disposal	13,125	
Equipment		110,000
To record loss on disposal		
Cost	\$110,000	
Acc. dep'n.		
(\$5,000 + 10,000 + 21,250 + 10,625*)	(46,875)	
Carrying amount	63,125	
Proceeds of disposal	(50,000)	
Loss on disposal	<u>\$13,125</u>	

*2021 depreciation expense = \$21,250 x 1/2 = \$10,625.

2. Equipment sold for \$85,000:

Cash	85,000	
Accumulated Depreciation	46,875	
Equipment		110,000
Gain on Disposal		21,875
To record gain on disposal		
Cost of old asset	\$110,000	
Acc. dep'n.		
(\$5,000 + 10,000 + 21,250 + 10,625*)	(46,875)	
Carrying amount	63,125	
Proceeds of disposal (fair value)	(85,000)	
Gain on disposal	<u>\$(21,875)</u>	

3. Equipment sold for \$63,125:

Cash	63,125	
Accumulated Depreciation	46,875	
Equipment		110,000
To record disposal. No gain or loss resulted.		
Cost of old asset	\$110,000	
Acc. dep'n.		
(\$5,000 + 10,000 + 21,250 + 10,625*)	(46,875)	
Carrying amount	63,125	
Proceeds of disposal (fair value)	(63,125)	
Gain on disposal	<u>\$ -0-</u>	

CP 8–9

Equipment*	145,000 ³	
Accumulated Depreciation	46,875	
Equipment		110,000
Cash		50,000 ²
Gain on Disposal		31,875
To record gain on disposal		
Cost of old asset	\$110,000	
Acc. dep'n.		
(\$5,000 + 10,000 + 21,250 + 10,625*)	(46,875)	
Carrying amount	63,125	
Proceeds of disposal (fair value)	(95,000)	
Gain on disposal	<u>\$(31,875)</u>	

*2021 depreciation expense = \$21,250 x 1/2 = \$10,625.

List price	150,000
Trade-in allowance	<u>(100,000)</u>
Cash paid	<u>\$50,000²</u>

Cost of new asset = Cash paid² + fair value of asset traded in
= \$50,000 + 95,000
= \$145,000³

CP 8–10

1. Depreciation Method	Calculation	Year 1	Year 2	Year 3
A: Straight-Line	\$30,000/5 = \$6,000	<u>\$3,000¹</u>	<u>\$6,000</u>	<u>\$6,000</u>
B: Declining Balance	40% ² x \$30,000	<u>\$6,000³</u>		
	40% x \$24,000		<u>\$9,600</u>	
	40% x \$14,400			<u>\$5,760</u>

¹\$6,000 x ½ year rule

²(100%/5 yrs.) = 20% x 2 = 40%

³12,000 x ½ year rule

- The chief financial officer may be correct in asserting that depreciation is an arbitrary allocation method based on unreliable estimates. On the other hand, some general methods of a) recognising future benefits, and b) allocating these benefits over future periods in which they are used to earn revenue seems necessary to present the financial position and results of operations of an entity. Capitalizing certain non-current assets and depreciating them over their estimated useful lives is likely the best option. Although there are many specific techniques for calculating and allocating depreciation over future periods, the need for consistency and reliability within financial statements under GAEB requires that the technique, once chosen, should be applied in a similar manner from year to year unless circumstances change, and disclosed in the notes.
- The method of depreciation chosen should be the one that best allocates the cost of the asset over its estimated useful life and over the accounting periods expected to receive benefits from its use (to best match costs with revenues earned).

1. 2020

Jan. 1	Accumulated Depreciation — Machine 1	7,500	
	Cash	500	
	Gain on Disposal		500
	Machine 1		7,500
	To record gain on disposal		
	Cost — machine 1	\$7,500	
	Acc. dep'n.		
	(\$750* + 1,500 + 1,500 + 1,500 + 1,500 + 750*)	(7,500)	
	Carrying amount	-0-	
	Proceeds of disposal	(500)	
	Gain on disposal	\$ (500)	
	* ½ year rules applies		

2. 2020

Dec. 31	Depreciation Expense — Machine 2	788	
	Accumulated Depreciation — Machine 2		788
	Revised depreciation = $\frac{\text{Remaining carrying amount} - \text{residual value}}{\text{Revised remaining useful life}}$		
		$= \frac{(\$2,775^1 - 1,200)}{2 \text{ years}}$	
		$= \$788 \text{ (rounded)}$	
	Cost machine 2		\$7,500
	Acc. dep'n.		
	2015: $[(\$7,500 - 1,200) \times 1/6 \text{ yrs.} = 1,050 \times 1/2 \text{ yr.}]$	\$ 525	
	2016 through 2019: $(\$1,050/\text{yr.} \times 4 \text{ yrs.})$	4,200	(4,725)
	Carrying amount at December 31, 2019		<u>\$2,775¹</u>

3. 2020

Dec. 31	Depreciation Expense — Machine 3	690	
	Accumulated Depreciation — Machine 3		690
	Revised depreciation = $\frac{\text{Remaining carrying amount} - \text{residual value}}{\text{Revised remaining useful life}}$		
		$= \frac{(\$3,450^* - 0)}{5 \text{ years}}$	
		$= \$690$	
	Cost machine 3		\$7,500
	Acc. dep'n.		
	2015: $[(\$7,500 - 300) \times 1/8 \text{ yrs.} = 900 \times 1/2 \text{ yrs.}]$	\$ 450	
	2016 through 2019: $(\$900/\text{yr.} \times 4 \text{ yrs.})$	3,600	(4,050)
	Carrying amount at December 31, 2019		<u>\$3,450*</u>

1. Equipment cost \$15,000
 Less: Acc. depreciation to Dec. 31, 2018 3,750
 Carrying amount (Jan. 1, 2019) \$11,250
 ($\$11,250 - 0$)/4 yrs. = \$2,813 (rounded) depreciation expense each year of remaining useful life

2. 2019
 Dec. 31 Depreciation Expense—Equipment 2,813
 Accumulated Depreciation—Equipment 2,813

3. Accumulated Depreciation—Equipment No. 193

Date	Description	PR	Debit	Credit	DR or CR	Balance
2018						
Dec. 31	Bal. Fwd.				Cr	2,250
	Depreciation for 2018			1,500	Cr	3,750
2019						
Dec. 31	Depreciation for 2019			2,813	Cr	6,563

4. If the estimated useful life of five years was known at the time of purchase, depreciation expense would have been \$1,500 in 2016 ($\$15,000/5$ yrs. $\times \frac{1}{2}$ yr.) and \$3,000 each subsequent year until the equipment was fully depreciated or disposed.
5. Depreciation was calculated correctly in all years based on reasonable information available at the time. The estimates were updated when more accurate information was available. As such, the financial statement information would be deemed to be reasonable even though the depreciation expense varies between 2018 and subsequent years. The amounts also may be immaterial. If so, differences would not affect the usefulness of the financial statements.

1. a. Jan. 1, 2018
 Truck 10,500
 Cash 10,500
 To record the purchase of the truck.
- b. Dec. 31, 2018
 Depreciation Expense 2,100
 Accumulated Depreciation—Truck 2,100
 To record 2018 depreciation expense as follows:
 (100%/5yrs. = 20% x 2 = 40% DDB; \$10,500 x 40% x 1/2 = \$2,100)
- c. March 1, 2019
 Truck 4,000
 Truck Operating Expense 3,500
 Cash 7,500
 To record truck expenditures. (Items in truck operating expense are for regular maintenance, and are also not material. They are therefore expensed).
- d. Dec. 31, 2019
 Depreciation Expense 4,160
 Accumulated Depreciation—Truck 4,160
 To record 2019 depreciation expense as:
 Original truck (\$10,500 – 2,100) x 40% \$3,360
 Lift (\$4,000 x 40% x ½ yr.) 800
 Total depreciation \$4,160
- 2.a. March 3, 2020
 Depreciation Expense — Truck 1,648
 Accumulated Depreciation — Truck 1,648
 To record depreciation to date of disposal [(\$10,500 + 4,000 – 2,100 – 4,160) x 40% x ½ yr.] = \$1,648.
- b. March 3, 2020
 Accumulated Depreciation — Truck 7,908
 Cash 8,000
 Gain on Disposal 1,408
 Truck 14,500
 To record gain on disposal, as follows:
 Cost (10,500 + 4,000) \$14,500
 Acc. dep'n. (\$2,100 + 4,160 + 1,648) (7,908)
 Carrying amount 6,592
 Proceeds of disposal (8,000)
 Gain on disposal (1,408)

1. Jan. 1, 2019
- | | | |
|-----------|---------|---------|
| Land | 300,000 | |
| Buildings | 200,000 | |
| Patents | 100,000 | |
| Machinery | 250,000 | |
| Goodwill | 50,000 | |
| Cash | | 900,000 |
- To record purchase of Coffee Company assets.
2. Dec. 31, 2019
- | | | |
|--------------------------------------|---------------------|--------|
| Depreciation Expense – Building | 20,000 ¹ | |
| Depreciation Expense – Machinery | 37,500 ² | |
| Amortization Expense – Patents | 2,500 ³ | |
| Accumulated Depreciation – Building | | 20,000 |
| Accumulated Depreciation – Machinery | | 37,500 |
| Patents | | 2,500 |
- To record 2019 depreciation and amortization expense on assets acquired from Coffee Company as follows:
1. DDB rate: $\frac{100\%}{10 \text{ yrs.}} \times 2 = 20\%$
 2019 building depreciation = $\$200,000 \times 20\% \times \frac{1}{2} \text{ yr.} = \$20,000$
2. 2019 machinery depreciation
 = $(\$250,000 - 25,000) \times \frac{10,000}{60,000}$
 = $\$37,500$
3. 2019 patent amortization = $\frac{\$100,000}{20 \text{ yrs.}} \times \frac{1}{2} \text{ yr.} = \$2,500$
3. Dec. 31, 2020
- | | | |
|-----------------|--------|--------|
| Impairment Loss | 12,500 | |
| Patents | | 12,500 |
- To write-down patents to estimated value at December 31, 2020 as follows:
- | | |
|--------------------------|-----------------|
| Cost | 100,000 |
| Accumulated amortization | <u>(7,500)*</u> |
| Carrying amount | 92,500 |
| Fair value | <u>(80,000)</u> |
| Impairment loss | <u>\$12,500</u> |
- *2019: $(\$100,000/20 \text{ yrs.} \times \frac{1}{2} \text{ yr}) = \$2,500$
 2020: $(\$100,000/20 \text{ yrs.}) = \underline{5,000}$
 Total \$7,500

4.

a. Dec. 2, 2021

Depreciation Expense – Machinery	75,000	
Accumulated Dep'n. – Machinery		75,000

To record depreciation in year of disposal as:
 $(250,000 - 25,000) \times 20,000/60,000 \text{ units} = \$75,000$

b. Dec. 2, 2021

Cash	100,000	
Accumulated Depreciation – Machinery	168,750	
Gain on Disposal		18,750
Machinery		250,000

To record sale of machinery as follows:

Cost	\$250,000	
Accumulated depreciation		
2019	37,500 ¹	
2020	56,250 ²	
2021	75,000 ³	(168,750)
Carrying amount		81,250
Proceeds of disposal		(100,000)
Gain on disposal		(<u>\$18,750</u>)

¹ $(\$250,000 - 25,000) \times \frac{20,000}{60,000} \times \frac{1}{2} \text{ yr.} = \$37,500$
² $(\$250,000 - 25,000) \times \frac{15,000}{60,000} = \$56,250$
³ $(\$250,000 - 25,000) \times \frac{15,000}{60,000} = \$75,000$

P 8–1*Cost of lots:*

Cheque to Jones		\$140,000
Bank loan assumed by Arrow		100,000
Razing of barns		6,000
Legal, accounting, and brokerage fees		20,000
Clearing and levelling costs		<u>10,000</u>
Total outlays		\$276,000
Less: Contra items:		
Proceeds from crops	\$6,000	
Proceeds from house	1,600	
Proceeds from lumber	<u>4,400</u>	<u>12,000</u>
Net cost of 500 lots		<u>\$264,000</u>
Net cost per lot (\$264,000/500)		<u>\$528</u>

P 8–2

1	Invoice price of new machine, net of cash discount offered
1	Cash discount on the above, which has not yet been taken (assumes the company follows this treatment)
5 ¹	Anticipated first year's savings in operating costs from use of new machine
3 ²	Two-year service contract on operations of new machine paid in full
1	Cost of materials used while testing new machine
1	Cost of installing sound insulation in wall near machine so that nearby office employees will not be disturbed by it
1 ³	Cost of removing machine that new machine replaces.

¹ No need to record; will be reflected as lower operating costs in the first year.

² Will be recorded as prepaid expense and written off over the two years in question.

³ Will increase carrying amount of old machine, which in effect will decrease gain on disposal when calculated.

P 8-3

- | | | | | |
|----|--|---|--------|--------|
| 1. | Jul. 1 | Amusement Ride | 20,000 | |
| | | Accounts Payable | | 20,000 |
| | | To record acquisition of new amusement ride. | | |
| | 4 | Amusement Ride | 4,000 | |
| | | Cash | | 4,000 |
| | | To record cost of base for new ride. | | |
| | 5 | Amusement Ride | 520 | |
| | | Cash | | 520 |
| | | To record cost of transporting ride to park. | | |
| | 5 | Prepaid Insurance | 90 | |
| | | Cash | | 90 |
| | | To record three years prepayment of insurance. | | |
| | 5 | Amusement Ride | 675 | |
| | | Accounts Receivable | 225 | |
| | | Cash | | 900 |
| | | To record payment for ride alterations and set up receivable from vendor. | | |
| | 6 | Amusement Ride | 188 | |
| | | Cash | | 188 |
| | | To record cost of installation. | | |
| | 15 | Accounts Payable | 20,000 | |
| | | Amusement Ride | | 200 |
| | | Cash | | 19,575 |
| | | Accounts Receivable | | 225 |
| | | To record payment of ride invoice less 1% discount and less account receivable re. alterations. | | |
| 2. | The carrying value of the asset is \$25,183 (\$20,000 + 4,000 + 520 + 675 + 188 – 200) | | | |

1. Depreciation per unit = $\frac{\text{Cost}}{\text{Expected production}} = \frac{\$90,000}{9,000 \text{ units}} = \10 per unit

Depreciation Based on Usage		
<i>Year</i>	<i>Units</i>	<i>Depreciation</i>
2017	2,000	\$20,000
2018	3,000	\$30,000

2. Accumulated depreciation at the end of 2019 is \$50,000.
3. Carrying amount of the machine at the end of 2019 is \$40,000 (\$90,000 – 50,000).

4.

Janz Corporation Partial Statement of Financial Position At December 31			
		2019	2018
	<i>Assets</i>		
Machinery		\$90,000	\$90,000
Less: Accumulated depreciation		<u>50,000</u>	<u>20,000</u>
Carrying amount		<u>\$40,000</u>	<u>\$70,000</u>

1. Depreciation Expense:

Year	Straight-line ¹	Double-declining balance ²	Usage ³
2019	\$ 500	\$1,250	\$ 800
2020	1,000	1,875	1,200
2021	1,000	875 ²	1,600
2022	<u>1,500</u>	<u>-0-</u>	<u>400³</u>
Totals	<u>\$4,000</u>	<u>\$4,000</u>	<u>\$4,000</u>

¹ 2019: $(\$5,000 - 1,000) \times \frac{1}{4} \text{ yrs.} \times \frac{1}{2} \text{ yr.} = \500

2020: $(\$5,000 - 1,000) \times \frac{1}{4} \text{ yrs.} = \$1,000$

2021: $(\$5,000 - 1,000) \times \frac{1}{4} \text{ yrs.} = \$1,000$

2022: \$1,500*

*Since the printer has reached the end of its estimated useful life, the carrying amount should be reduced to the estimated residual value of \$1,000.

² DDB rate: $\frac{100\%}{4 \text{ yrs.}} \times 2 = 50\%$

Year	Carrying Amount	DDB Rate	Depreciation Expense
2019	\$5,000	50% x $\frac{1}{2}$ yr.	\$1,250
2020	3,750	50%.	\$1,875
2021	1,875	50%	875*

*Limited to the amount that reduces carrying amount to estimated residual value.

³ 2019: $[(\$5,000 - 1,000) \times 10,000/50,000 \text{ units}] = \800

2020: $[(\$5,000 - 1,000) \times 15,000/50,000 \text{ units}] = \$1,200$

2021: $[(\$5,000 - 1,000) \times 20,000/50,000 \text{ units}] = \$1,600$

2022: \$400*

*Limited to the amount that reduces carrying amount to estimated residual value.

- Technological obsolescence is the most likely factor affecting estimated residual value and useful life of the printer. Deprecation rates and residual value estimates need to be reviewed annually. Any effects on depreciation expense that result from these changes are accounted for prospectively. Prior fiscal years' amounts are not changed.
- When choosing between alternatives, management must take several factors into account. In this case, since significant changes are likely in printer technology, the double-declining balance method may be more suitable since it produces greater depreciation expense in the first few years. On the other hand, depreciation based on usage may more accurately represent the decline in value of the machine.

1.
 - a. Usage $\frac{(\$11,000 - 2,000)}{75,000 \text{ units}} \times 20,000 \text{ units} = \$2,400$
 The ½ year rule does not apply to usage-based depreciation methods.
 - b. Straight-line $\frac{(\$11,000 - 2,000)}{4 \text{ yrs.}} \times \frac{1}{2} \text{ yr.} = \$1,125$
 - c. Double-declining balance $50\% * \$11,000 \times \frac{1}{2} \text{ yr} = \$2,750$
 *100%/4 yrs. X 2 = 50% DDB rate
2.

	<i>Depreciation expense</i>	<i>Carrying amount</i>
a. Usage	\$2,400	\$8,600
b. Straight-line	\$1,125	\$9,875
c. Double-declining balance	\$2,750	\$8,250
3. The straight-line method should be adopted, since it produces the least depreciation expense and hence the highest 2018 net income.

1. a. Straight-line method

Purchase of machinery	\$23,000
Transportation charges	600
Installation charge	<u>1,400</u>
	25,000
Less: Residual value	<u>2,000</u>
Depreciable cost of machinery	<u>\$23,000</u>

b. Double-declining balance method

Purchase of machinery	\$23,000
Transportation charges	600
Installation charge	<u>1,400</u>
	<u>25,000</u>

2. a. Straight-line depreciation for:

2019: (\$23,000 x 1/3 yrs. x ½ yr.)	<u>\$3,833</u> (rounded)
2020: (\$23,000 x 1/3 yrs.)	<u>\$7,667</u>
2021:	<u>\$7,667</u>

b. Double-declining balance rate: $(100\%/3 \text{ yrs.}) = 33.3\% \times 2 = 66.7\%$

2019: \$25,000 x 66.7% x ½ yr.	<u>\$8,375</u>
2020: (\$25,000 – 8,375) x 66.7%	<u>\$11,139</u> (rounded)
2021: (\$25,000 – 8,375 – 11,139) x 66.7%	<u>\$3,676</u> (rounded),
but limited to <u>\$3,486</u> to reduce carrying amount to estimated residual value of \$2,000.	

3. Depreciable cost of machine	\$23,000
Depreciation recorded in 2019	<u>(3,833)</u>
Depreciable amount for remaining four years	<u>\$19,167</u>

Annual depreciation for the remaining four years of life: $[(\$19,167 - 2,000)/4 \text{ yrs.}]$
 = \$4,292 per year (rounded).

1.	Cost (Jan. 1, 2013)	\$30,000	
	Less: Estimated residual value (10%)	<u>3,000</u>	
	Depreciable amount	<u>\$27,000</u>	
	Annual depreciation = \$27,000/20 yrs. =	<u>\$1,350</u>	
	2013 depreciation (\$1,350 x ½)	\$ 675	
	2014 – 2019 depreciation (\$1,350 x 6 yrs.)	<u>8,100</u>	
	Total depreciation to Dec. 31, 2019	<u>\$8,775</u>	
	Cost	\$30,000	
	Less: Accumulated depreciation	<u>(8,775)</u>	
	Carrying amount (Dec. 31, 2019)	<u>\$21,225</u>	
2.	Carrying amount (above)	\$21,225	
	Less: New estimated residual value	<u>(6,000)</u>	
	Undepreciated cost (Jan. 1, 2020)	<u>\$15,225</u>	
3.	Annual depreciation = \$15,225/8 years = \$1,903 (rounded)		
	Dec. 31, 2020		
	Depreciation Expense	1,903	
	Accumulated Depreciation		1,903
	To record depreciation for year.		
4.	March 31, 2021		
	Depreciation Expense	952	
	Accumulated Depreciation		952
	To record depreciation to date of disposal (\$1,903 x ½).		
	March 31, 2021		
	Cash	22,000	
	Accumulated Depreciation – Machine	11,630	
	Gain on Disposal		3,630
	Machine		30,000
	To record gain on disposal as follows:		
	Cost	\$30,000	
	Accumulated depreciation		
	2013	\$ 675	
	2014–2019	8,100	
	2020	1,903	
	2021	<u>952</u>	
		<u>(11,630)</u>	
	Carrying amount	18,370	
	Proceeds of disposal	<u>(22,000)</u>	
	Gain on disposal	<u>\$ (3,630)</u>	

Part A

1.	2018			
	May 1	Equipment	130,000	
		Cash		130,000
		To record the purchase of equipment.		
2.	2021			
	Jan. 1	Equipment—New	200,000 ²	
		Accumulated Depreciation—Old Equipment	74,400 ¹	
		Equipment—Old		130,000
		Cash		140,000
		Gain on Disposal		4,400
		To record the trade-in of equipment as follows:		
		Cost		\$ 130,000
		Accum. dep'n: 2018- 20		<u>(74,400)¹</u>
		Carrying amount		55,600
		Proceeds of disposal		<u>(60,000)</u>
		Gain on disposal		<u>\$ (4,400)</u>
		*\$300,000/50 yrs. = \$6,000 per year		

¹ Accumulated depreciation = $\frac{\$130,000 - 10,000}{100,000 \text{ units}} \times 62,000 \text{ units} = \$74,400$

² Cost of new asset = \$140,000 + 60,000 = \$200,000

Part B

1.	2019			
	Jan. 1	Land	50,000	
		Building	300,000	
		Bank Loan		320,000
		Cash		30,000
		To record the purchase of a warehouse.		
2.	2023			
	Jul. 31	Account Receivable – Insurance Proceeds	270,000	
		Accumulated Depreciation—Building	24,000 ¹	
		Loss on disposal	6,000 ²	
		Building		300,000
		To record settlement of fire loss by insurance company as follows:		
		Cost		\$ 300,000
		Accum. dep'n: 2019 (\$6,000* x 1/2 yr.)	\$ 3,000	
		2020-20 (\$6,000* x 3 yrs.)	18,000	
		2023 (\$6,000* x 1/2 yr.)	<u>3,000</u>	<u>(24,000)¹</u>
		Carrying amount at June 28		276,000
		Proceeds of disposal		<u>(270,000)</u>
		Loss on disposal		<u>\$ 6,000²</u>
		*\$300,000/50 yrs. = \$6,000 per year		

1. a. 2019

Sept. 30	Land	300,000	
	Buildings	100,000	
	Computer Software	75,000	
	Goodwill	25,000	
	Cash		500,000
	To record purchase of assets from Marine Company.		

b. 2019

Dec. 31	Depreciation Expense – Building	1,125 ¹	
	Amortization Expense – Computer Software	25,000 ²	
	Accumulated Depreciation – Building		1,125
	Accumulated Amortization – Computer Software		25,000

To record 2019 depreciation and amortization expense on assets acquired from Marine Company

¹ $(\$100,000 - 10,000)/40 \text{ yrs.} \times \frac{1}{2} = \$1,125$

² $\frac{100\%}{3 \text{ yrs.}} \times 2 = 67\% \times \$75,000 \times \frac{1}{2} = \$25,000 \text{ (rounded)}$

c. No journal entry is required. Only impairment losses are recorded.

d. 2020

Sept. 15	Amortization Expense – Computer Software	5,583 ¹	
	Computer Software		5,583

To record amortization expense on computer software to date of sale.

¹ 2019 amortization:

$(\$75,000 - 25,000) \times 67\% \text{ (rounded)} = \$33,333$

2020 amortization to date of disposal:

$(\$75,000 - 25,000 - 33,333) \times 67\% \times \frac{1}{2} \text{ yr.} = \$5,583$

Sept. 15	Cash	65,000	
	Gain on Disposal		53,916
	Computer Software		11,084 ¹

To record sale of computer software as follows:

Cost	\$ 75,000	
Accumulated amortization		
2018	\$25,000	
2019	33,333	
2020	<u>5,583</u>	<u>(63,916)</u>
Carrying amount		11,084 ¹
Proceeds of disposal		<u>(65,000)</u>
Gain on disposal		<u><u>\$ (53,916)</u></u>

P 8–10 continued

2.	Land		\$300,000
	Building	\$100,000	
	Accum. dep'n		
	(\$1,125 + 2,250 + 2,250)	<u>(5,625)</u>	94,375
	Goodwill		<u>25,000</u>
	Total carrying amount		<u>\$419,375</u>

P 8–11

1.	2019 depreciation expense:		
	Wheel assemblies (\$1,200,000 – 30,000)/30 yrs.	\$39,000	
	Diesel engine	315,000*	
	Electric motors (4) (\$600,000 – 60,000)/6 yrs.	90,000	
	Other (\$200,000 – 0)/10 yrs.	<u>20,000</u>	
	Total 2019 depreciation expense		<u>\$464,000</u>
	*Cost		\$1,000,000
	Less: Acc. Dep'n to Dec. 31, 2018		
	2017 (\$1,000,000 – 100,000)/5 yrs. x ½ yr.	90,000	
	2018 (\$1,000,000 – 100,000)/5 yrs.	<u>180,000</u>	<u>(270,000)</u>
	Carrying amount at Jan. 1, 2019		<u>\$730,000</u>
	2019 depreciation expense (\$730,000 – 100,000)/2 yrs.		<u>\$315,000</u>
2.	Cost of replaced electric motor (\$600,000/4)		\$150,000
	Acc. dep'n		
	2017 (\$150,000 – 15,000)/6 yrs. x ½ yr.	\$11,250	
	2018 (\$150,000 – 15,000)/6 yrs.	22,500	
	2019	22,500	
	2020 (\$150,000 – 15,000)/6 yrs. x ½ yr.	<u>11,250</u>	<u>(67,500)</u>
	Carrying amount at August 31, 2020		82,500
	Proceeds on disposal		<u>(10,000)</u>
	Loss on disposal		<u>\$72,500</u>
3.	2020 depreciation expense:		
	Wheel assemblies (same as 2019)	\$ 39,000	
	Diesel engine (same as 2019)	315,000	
	Electric motors [(3@\$150,000) – (3@\$15,000)]/6 yrs.	67,500	
	New electric motor (\$180,000 x 20,000)/4 yrs. x ½ yr.	20,000	
	Other (same)	<u>20,000</u>	
	Total 2020 depreciation expense		<u>\$461,500</u>

4. Carrying amount of locomotive at December 31, 2020 is \$1,588,500, calculated as:

Component	Cost	Accumulated Depreciation					Carrying amount
		2017 (½ yr.)	2018	2019	2020	Total	
Wheel assemblies	\$1,200,000	\$19,500	39,000	39,000	39,000	\$136,500	\$1,063,500
Diesel engine	1,000,000	90,000	180,000	315,000	315,000	900,000	100,000
Electric motors							
Original (3)	450,000	45,000	90,000	90,000	90,000	315,000	135,000
New motor (½ yr.)	180,000				20,000	20,000	160,000
Other	200,000	10,000	20,000	20,000	20,000	70,000	130,000
Totals	<u>\$3,030,000</u>	<u>\$164,500</u>	<u>\$329,000</u>	<u>\$464,000</u>	<u>\$484,000</u>	<u>\$1,441,500</u>	<u>\$1,588,500</u>

5. Gain on sale of locomotive in 2021 is \$6,000, calculated as:

Component	Cost	Accumulated Depreciation			Carrying amount
		To 2020 per above	2021 (½ yr.)	Total	
Wheel assemblies	\$1,200,000	\$136,500	\$19,500	\$156,00	\$1,044,000
Diesel engine	1,000,000	900,000		900,000	100,000*
Electric motors					
Original (3)	450,000	315,000	45,000	360,000	90,000
New motor	180,000	20,000	20,000	40,000	140,000
Other	200,000	70,000	10,000	80,000	120,000
Totals	<u>\$3,030,000</u>	<u>\$1,441,500</u>	<u>\$94,500</u>	<u>\$1,536,000</u>	<u>\$1,494,000</u>
Proceeds on disposal					<u>(1,500,000)</u>
Gain on disposal					<u>(\$6,000)</u>

*carrying amount equal to residual value at December 31, 2020. No depreciation claimed in 2021.

CHAPTER NINE

Debt Financing: Current and Non-current Liabilities

Concept Self-check

1. A current liability is a debt that is expected to be paid within one year of the statement of financial position date or the next operating cycle, whichever is longer. A non-current liability is expected to be paid beyond one year of the statement of financial position date or the next operating cycle, whichever is longer.
2. Examples of known current liabilities include accounts payable, salaries and wages payable, income taxes payable, unearned revenues, sales taxes payable, short-term bank loans, and the portion of long-term debt that will be paid within one year of the statement of financial position date.
3. An estimated current liability is a liability that is certain to exist, though the amount is somewhat uncertain and therefore can only be reasonably estimated. This usually occurs when a supplier invoice has not been received by the time the financial statements are prepared.
4. Two common examples of estimated current liabilities are warranty reserves and professional fees related to preparation or audit of year-end financial statements.
5. A contingent liability's existence is uncertain and improbable. Alternately, it is probable but its amount is unknown at the date financial statements are issued.
6. A loan, like a bond issue, is a means for an entity to raise investment capital through creditors. Both can be secured, and generally have fixed rates of interest and specified terms of repayment. However, loans are usually repaid with blended payments of interest and principal over the life of the liability. While the total payment on a loan is constant, the relative portion of interest decreases with each payment because loan principal is being reduced with each preceding payment. The portion of principal repayment increases. Bonds usually pay interest only to investors at regular intervals over the life of the issue plus a payment for the face value of the bond when it matures. They are usually issued to many investors as public offerings.

Concept Self-check continued

7. A loan and a finance lease are both long-term debt instruments. They are repaid with blended principal and interest payments over a specified period of time. However, proceeds from a long-term loan are usually obtained from a financial institution like a bank, and then used to purchase a long-lived asset from a third party like an equipment manufacturer. Title passes to the purchaser from the seller.

Under a finance lease, the leasing company is usually the same as or closely associated with the company that owns the specific asset that is subject to the lease agreement. Title may not pass from the leasing company to the lessee. However, the rights and responsibilities of ownership are transferred to the lessee as well as beneficial ownership. As a result, a finance lease is essentially a purchase. The related assets is reported as an item of property, plant, and equipment, and the finance lease is reported as a liability on the statement of financial position.

CP 9–1

2019				
Dec. 31	Interest Expense	632	340	
	Interest Payable	222		340
	To adjust interest payable $[(\$12,000 \times 6\% \times 9/12 \text{ mos.}) - 200]$.			

CP 9–2

Selby Corp. General Journal

Date 2019		Description	PR	Debit	Credit
		<u>Adjusting Entries</u>			
a.	Dec. 31	Supplies Expense Unused Office Supplies To record additional accounts payable at year-end.		40	40
b.	31	Interest Expense Interest Payable To adjust interest payable for the year.		100	100
c.	31	Unearned Rent Revenue Rent Earned To adjust rent revenue at year-end.		500	500

CP 9–3

1. 2019

Dec. 31	Salaries Expense	2,000	
	Employee Income Taxes Payable		500
	Employment Insurance Payable		40 ¹
	Government Pension Payable		80 ²
	Salaries Payable		1,380
	To record unpaid salary and benefits re. J. Smith at December 31.		
	¹ \$2,000 x 2% = \$40		
	² \$2,000 x 4% = \$80		

2019			
Dec. 31	Employment Insurance Expense	56 ¹	
	Government Pension Expense	80 ²	
	Employment Insurance Payable		56
	Government Pension Payable		80
	To record unpaid company benefits re. J. Smith at December 31.		
	¹ \$2,000 x 2% = 40 x 1.4 times = \$56		
	² \$2,000 x 4% = \$80		

 2. 2020

			(1)
Jan. 5	Salaries Payable	1,380	
	Cash		1,380
	To record payment of Dec. 31 salary payable to J. Smith.		

			(2)
Jan. 5	Employee Income Taxes Payable	500	
	Employment Insurance Payable	96	
	Government Pension Payable	160	
	Cash		756
	To record payment of amounts owing at Dec. 31 to Government of Canada re. J. Smith.		

CP 9–4

1. 2019

Jun. 20	Merchandise Inventory	4,000	
	GST Payable	200	
	Accounts Payable		4,200
	(\$4,000 x 5% = \$200)		

2. 2019

Jul. 5	Accounts Receivable	5,250	
	Sales		5,000
	GST Payable		250
	Cost of Goods Sold	4,000	
	Merchandise Inventory		4,000
	(\$5,000 x 5% = \$250)		

No GST is recorded when inventory is transferred to cost of goods sold. GST has been recorded when the merchandise was originally purchased.

CP 9–4 continued

3. 2019
 Jul. 31 GST Payable (\$250 – 200) 50
 Cash 50
4. No expense is recorded on the income statement. The company merely passes on to the government the net amount of GST paid on purchases and GST collected from the final consumer.

CP 9–5

1. 2019
 Feb. 15 Corporate Income Taxes Payable 400
 Cash 400
2. 2019
 Dec. 31 Corporate Income Taxes Expense 6,000
 Corporate Income Taxes Payable 6,000
 (\$15,000 x 40% = \$6,000)
3. 2020
 Jan. 31 Corporate Income Taxes Payable 1,600
 Cash 1,600
 To record payment of 2019 corporate income taxes owing:
 2019 expense \$ 6,000
 Instalments paid (11 x \$400) (4,400)
 Owing \$ 1,600

CP 9–6

1. 2019
 Nov. 1 Accounts Payable 10,000
 Note Payable 10,000
 To record conversion of account payable owing to Tree Corp. to a 10% note payable due January 31, 2019.
2. 2019
 Dec. 31 Interest Expense 167
 Interest Payable 167
 To record interest on note payable to Dec. 31 [\$10,000 x 10% x 2/12 mos.] = \$167 (rounded)
3. 2020
 Jan. 31 Interest Expense 83
 Interest Payable 167
 Note Payable 10,000
 Cash 10,250
 To record payment of note payable and interest Jan. 1-31 [\$10,000 x 10% x 1/12 mos.] = \$83 (rounded).

CP 9–6 continued

4. a. 2019			
Nov. 1	Note Receivable	10,000	
	Accounts Receivable		10,000
To record conversion of account receivable due from Branch Corporation to a 10% note receivable due January 31, 2019.			
b. 2019			
Dec. 31	Interest Receivable	167	
	Interest Earned		167
To record interest earned to December 31 (see 2 above).			
c. 2020			
Jan. 31	Cash	10,250	
	Interest Earned		83
	Interest Receivable		167
	Note Receivable		10,000
To record collection of Branch note receivable and interest (see calculations above).			

CP 9–7

1. 2019			
June 30	Estimated Warranty Liability	2,500	
	Parts Inventory		2,000
	Cash		500
2. 2019			
Dec. 31	Warranty Expense	20,000	
	Estimated Warranty Liability		20,000
(\$2M x 1% = \$20,000)			
3. Estimated warranty expense			
		\$20,000	
	2019 warranty claims	<u>(22,000)</u>	
	Balance in Estimated Warr. Liab. account at Dec. 31	\$ <u>(2,000)</u>	Debit

Claims have exceeded the estimated provision. Zebra management should monitor this to determine if the 1% estimate should be increased in the future. It is difficult to determine if a change is needed immediately, as this is only the first year of operation.

CP 9–8

Claim 1 would be neither recorded nor disclosed.

Claim 2 requires note disclosure.

Claim 3 needs to be recorded in the accounting records (Dr. Lawsuit Damages Expense; Cr. Estimated Current Liabilities)

CP 9-9

- | | | | |
|------------|--|--------|--------|
| 1. a. 2019 | | | |
| Jan. 1 | Cash | 50,000 | |
| | Loan Payable | | 50,000 |
| | To record loan from Second Capital Bank. | | |
| b. Jan. 1 | Equipment | 48,000 | |
| | Cash | | 48,000 |
| | To record purchase of equipment. | | |

- 2.

Rosedale Corp.
Loan Repayment Schedule

	<u>A</u>	<u>B</u>	<u>C</u>	<u>D</u>	<u>E</u>
			<i>(D – B)</i>		<i>(A – C)</i>
<i>Year ended</i>	<i>Beginning loan balance</i>	<i>(A x 6%) Interest expense</i>	<i>Reduction of loan payable</i>	<i>Total loan payment</i>	<i>Ending loan balance</i>
<i>Dec. 31</i>					
2019	\$50,000	\$3,000	\$15,705	\$18,705	\$34,295
2020	34,295	2,058	16,647	18,705	17,648
2021	17,648	1,057	17,648	18,705	-0-

3. 2019
Dec. 31 Interest Expense 3,000
Loan Payable 15,705
Cash 18,705
To record loan payment to Second Capital Bank.
4. The current portion of the loan at December 31, 2019 is \$16,647 (see bolded amount in 2 above).

CP 9–10

- | | | | | |
|----|--------|---|--------|--------|
| 1. | 2019 | | | |
| | Jan. 1 | Vehicle | 80,000 | |
| | | Finance Lease | | 80,000 |
| | | To record assumption of lease with Night Leasing Ltd. | | |

- 2.

Day Corp.
Lease Repayment Schedule

	<u>A</u>	<u>B</u>	<u>C</u>	<u>D</u>	<u>E</u>
			$(D - B)$		$(A - C)$
<i>Year ended</i>	<i>Beginning lease balance</i>	<i>(A x 8%) Interest expense</i>	<i>Reduction of finance lease</i>	<i>Total lease payment</i>	<i>Ending lease balance</i>
<i>Dec. 31</i>					
2019	\$80,000	\$6,400	\$17,754	\$24,154	\$62,246
2020	62,246	4,980	19,174	24,154	43,072
2021	43,072	3,446	20,708	24,154	22,364
2022	22,364	1,790	22,364	24,154	-0-

CP 9–10 continued

3. Day Corp.
Partial Statement of Financial Position
At December 31, 2019

Liabilities

Current	
Current portion of finance lease	\$19,174
Non-current	
Finance lease (Note X)	43,072

Note X would disclose pertinent information including details of the lease repayment agreement (for example, interest rate, repayment terms, security).

P 9–1

1.a. 2019			
Jan. 1	Cash	20,000	
	Share Capital		20,000
b. Jan. 1	Cash	30,000	
	Bank Loan		30,000
c. Jan. 2	Merchandise Inventory	20,000	
	GST Payable	1,000	
	Accounts Payable		21,000
d. Jan. 8	Accounts Receivable	8,400	
	Sales		8,000
	GST Payable		400
	Cost of Goods Sold	3,000	
	Merchandise Inventory		3,000
e. (i) Jan. 15	Salaries Expense	2,000	
	Employee Income Taxes Payable		300
	Employment Insurance Payable		40
	Government Pension Payable		100
	Cash		1,560
	(ii) Jan. 15	Employment Insurance Expense	56 ¹
		Government Pension Expense	100
		Employment Insurance Payable	56
		Government Pension Payable	100
		¹ (\$40 x 1.4) = \$56	
2.f. 2019			
Jan. 31	Interest Expense	100	
	Interest Payable		100
	(\$30,000 x 4% x 1/12 mos.) = \$100		

P 9–1 continued

g. Jan. 31	Salaries Expense	2,000	
	Employee Income Taxes Payable		300
	Employment Insurance Payable		40
	Government Pension Payable		100
	Salaries Payable		1,560
Jan. 31	Employment Insurance Expense	56 ¹	
	Government Pension Expense	100	
	Employment Insurance Payable		56
	Government Pension Payable		100
	¹ (\$40 x 1.4) = \$56		
h. Jan. 31	Corporate Income Taxes Expense	118	
	Corporate Income Taxes Payable		118
	Sales	\$8,000	
	COGS	\$3,000	
	Salaries	4,000	
	Emp. Ins.	112	
	Pension	200	
	Interest	<u>100</u>	
	Income before inc. taxes	<u>7,412</u>	
		<u>\$ 588</u>	x 20% = \$118 (rounded)

3. Current liabilities at January 31:

Bank loan	\$30,000
Accounts payable	21,000
Interest payable	100
Salaries payable	1,560
Employee income taxes payable	600
Employment insurance payable	192
Government pension payable	400
Corporate income taxes payable	<u>118</u>
	<u>\$53,970</u>

GST refundable is \$600 (\$1,000 – 400). This would be reported as a current asset.

P 9-2

1.

ASSETS		LIABILITIES		SHAREHOLDERS' EQUITY	
Cash		Bank Loan	Corp. Inc. Tax. Pay.	Share Capital	
a.	20,000	30,000 b.	118 h.	20,000	a.
b.	30,000				
Bal.	48,440				
Accounts Receivable		Accounts Payable	Interest Payable	Cost of Goods Sold	
d.	8,400	21,000 c.	100 f.	d.	3,000
Merchandise Inventory		Salaries Payable	Emp'ee Inc. Tax Pay.	Salaries Expense	
c.	20,000	1,560 g(i)	300 e(i)	e(i)	2,000
	3,000 d.		300 g(i)	g(i)	2,000
Bal.	17,000		600 Bal.	Bal.	4,000
		Employ. Ins. Pay.	Gov't Pension Pay.	Employ. Ins. Exp.	
		40 e(i)	200 e(i)	e(ii)	56
		56 e(ii)	200 e(ii)	g(ii)	56
		40 g(i)	200 g(i)		
		56 g(ii)	200 g(ii)		
		192 Bal.	400 Bal.	Bal.	112
		GST Payable		Gov't Pension Exp.	
c.	1,000	400 d.		e(ii)	100
Bal.	600			g(ii)	100
				Bal.	200
				Interest Expense	
				f.	100
				Corp. Inc. Taxes Exp.	
				h.	118

2.

Latex Paint Corporation
Income Statement
For the Month Ended January 31, 2019

<i>Sales</i>	\$8,000
Cost of goods sold	<u>3,000</u>
Gross profit	5,000
<i>Operating Expenses</i>	
Selling expenses	
Salaries and benefits	<u>4,312¹</u>
Income before interest and income taxes expense	688
Interest expense	<u>100</u>
Income before income taxes	588
Income taxes	<u>118</u>
Net income	<u><u>\$ 470</u></u>

¹\$4,000 + 112 + 200 = \$4,312

Other reasonable presentation formats are acceptable.

Latex Paint Corporation
Statement of Changes in Equity
For the Month Ended January 31, 2019

	<i>Share capital</i>	<i>Retained earnings</i>	<i>Total equity</i>
Balance at Jan. 1, 2019	\$ -0-	\$ -0-	\$ -0-
Shares issued	20,000		20,000
Net income		470	470
Balance at Jan. 31, 2019	<u><u>\$20,000</u></u>	<u><u>\$ 470</u></u>	<u><u>\$20,470</u></u>

P 9–2 continued

Latex Paint Corporation
Statement of Financial Position
At January 31, 2019

<i>Assets</i>	
<i>Current</i>	
Cash	\$48,440
Accounts receivable	8,400
GST receivable	600
Merchandise inventory	<u>17,000</u>
Total assets	<u>\$74,440</u>
 <i>Liabilities</i>	
<i>Current</i>	
Borrowings (or Bank loan)	\$30,000
Accounts payable	21,000
Interest payable	100
Salary and benefits payable	2,752 ¹
Corporate income taxes payable	<u>118</u>
Total liabilities	<u>53,970</u>
 <i>Shareholders' Equity</i>	
Share capital	20,000
Retained earnings	<u>470</u>
Total equity	<u>20,470</u>
Total liabilities and shareholders' equity	<u>\$74,440</u>

¹\$1,560 + 192 + 600 + 400 = \$2,752

Other reasonable presentation formats are acceptable.

P 9–3

1.a. 2019				
Dec. 31	Rent Earned	440	1,000	
	Unearned Rent Revenue	248		1,000
	To adjust rent earned to yearly amount (\$12,000).			
b. Dec. 31	Estimated Warranty Liability	213	600	
	Cost of Goods Sold	570		500
	Salaries Expense	65		100
	To reallocate warranty claim expenditures recorded in wrong accounts.			
c. Dec. 31	Parts Inventory	151	4,000	
	GST Payable	238	200	
	Accounts Payable	210		4,200
	To record additional parts inventory.			

P 9-3 continued

d. Dec. 31	Warranty Expense	678	7,919	4,000
	Estimated Warranty Liability	213	4,000	7,919
	To record estimated warranty expense (\$791,900 x 1% = \$7,919)			
	(Alternately, two entries could be made or just the net adjustment of \$3,919.)			

e. The summary of deductions is as follows:

Employee	Gross pay	Payroll Deductions					Net pay
		Income taxes (15%)	Employ. insur. (2%)	Gov't pension (5%)	Comp. health (3%)	Total. deduct.	
J. Smith	5,000	750	100	250	150	1,250	3,750
Employer contrib.		-0-	100	250	150		
Total remittances		750	200	500	300		

i. The journal entry to record the amount owing to Smith and related deductions would be:

Dec. 31	Salaries Expense	656	5,000	
	Employee Inc. Tax Pay.	227		750
	Employment Ins. Pay.	228		100
	Gov't Pension Pay.	229		250
	Company Health Plan Pay.	230		150
	Salaries Payable	226		3,750

ii. The journal entry to record the company's matching contributions would be:

Dec. 31	Gov't Emp. Ins. Exp.	658	100	
	Gov't Pension Exp.	659	250	
	Co. Health Plan Exp.	660	150	
	Employment Ins. Pay.	228		100
	Gov't Pension Pay.	229		250
	Company Health Plan Pay.	230		150

f. Dec. 31	Professional Fees	653	8,000	
	Estimated Liabilities	212		8,000
	To record estimated audit fees.			

g. Dec. 31	Corporate Income Taxes Expense	830	19,895	16,500
	Corporate Income Taxes Payable	260	16,500	19,895
	To reallocate 2018 income tax instalments and record corporate income tax expense (\$79,581 x 25% = \$19,895).			

P 9–3 continued

2.

No.	Account	Unadjusted TB		Adjustments		Adjusted TB	
		Debit	Credit	Debit	Credit	Debit	Credit
101	Cash	12,000				12,000	
110	Accounts receivable	30,000				30,000	
150	Merch. inventory	70,000				70,000	
151	Parts inventory	10,000		c 4,000		14,000	
210	Accounts payable		40,000		4,200 c		44,200
212	Est. current liab.				8,000 f		8,000
213	Est. warranty liab.	3,000		d 4,000 b 600	7,919 d		319
226	Salaries payable				3,750 e(i)		3,750
227	Emp'ee inc. tax pay.				750 e(i)		750
228	Emp. insur. pay.				100 e(i) 100 e(ii)		200
229	Gov't pension pay.				250 e(i) 250 e(ii)		500
230	Co. health ins. pay.				150 e(i) 150 e(ii)		300
238	GST payable		1,000	c 200			800
248	Unearn. rent rev.				1,000 a		1,000
260	Corp. inc. tax pay.			g 16,500	19,895 g		3,395
320	Share capital		100				100
340	Retained earnings		3,000				3,000
440	Rent earned		13,000	a 1,000			12,000
500	Sales		791,900				791,900
570	Cost of goods sold	263,500			500 b	263,000	
653	Professional fees			f 8,000		8,000	
656	Salaries expense	400,000		e(i) 5,000	100 b	404,900	
658	Gov't emp. insur. ex.	8,000		e(ii) 100		8,100	
659	Gov't pension exp.	20,000		e(ii) 250		20,250	
660	Co. health insur. exp.	12,000		e(ii) 150		12,150	
678	Warranty exp.	4,000		d 7,919	4,000 d	7,919	
830	Corp. inc. tax exp.	16,500		g 19,895		19,895	
		849,000	849,000	67,614	67,614	870,214	870,214

Mudryk Wholesalers Corporation
Income Statement
For the Year Ended December 31, 2019

<i>Sales</i>		\$791,900
Cost of goods sold		<u>263,000</u>
Gross profit		528,900
<i>Operating expenses</i>		
Selling expenses		
Salaries	\$404,900	
Employment insurance	8,100	
Government pension	20,250	
Company health insurance	12,150	
Warranty	<u>7,919</u>	
Total selling expenses	453,319	
General and administrative expenses		
Professional fees	<u>8,000</u>	
<i>Total operating expenses</i>		<u>461,319</u>
Income from operations		67,581
Other income		
Rent earned		<u>12,000</u>
Income before income taxes		79,581
Income taxes		<u>19,895</u>
Net income		<u>\$59,686</u>

Mudryk Wholesalers Corporation
Statement of Changes in Equity
For the Year Ended December 31, 2019

	<i>Share capital</i>	<i>Retained earnings</i>	<i>Total equity</i>
Balance, Jan. 1, 2019	\$ 100	\$ 3,000	\$ 3,100
Net income		59,686	59,686
Balance, Dec. 31, 2019	<u>\$ 100</u>	<u>\$ 62,686</u>	<u>\$ 62,786</u>

P 9–3 continued

Mudryk Wholesalers Corporation
Statement of Financial Position
At December 31, 2019

<i>Assets</i>	
<i>Current</i>	
Cash	\$ 12,000
Accounts receivable	30,000
Merchandise inventory	70,000
Parts inventory	<u>14,000</u>
Total assets	<u>\$126,000</u>
<i>Liabilities</i>	
<i>Current</i>	
Accounts payable	\$ 44,200
Estimated liabilities	8,000
Estimated warranty liabilities	319
Salaries payable	3,750
Employee income taxes payable	750
Employment insurance payable	200
Government pension payable	500
Company health insurance payable	300
GST payable	800
Unearned rent revenue	1,000
Corporate income taxes payable	<u>3,395</u>
Total liabilities	<u>63,214</u>
<i>Shareholders' Equity</i>	
Share capital	100
Retained earnings	<u>62,686</u>
Total equity	<u>62,786</u>
Total liabilities and shareholders' equity	<u>\$126,000</u>

Other reasonable presentation formats are acceptable.

2.

Zinc Corp.
Loan Repayment Schedule

<i>A</i>	<i>B</i>	<i>C</i>	<i>D</i>	<i>E</i>
		<i>(D – B)</i>		<i>(A – C)</i>
<i>Beginning</i>	<i>(A x 8%)</i>	<i>Reduction</i>	<i>Total</i>	<i>Ending</i>
<i>loan</i>	<i>Interest</i>	<i>of loan</i>	<i>loan</i>	<i>loan</i>
<i>balance</i>	<i>expense</i>	<i>payable</i>	<i>payment</i>	<i>balance</i>
\$100,000	\$8,000	\$22,192	\$30,192	\$77,808
77,808	6,225	23,967	30,192	53,841
53,841	4,307	25,885	30,192	27,956
27,956	2,236	27,956	30,192	-0-

3. 2023

Dec. 31	Interest Expense	2,236	
	Loan Payable	27,956	
	Cash		30,192

To record final loan payment to First National Bank.

<i>Liabilities</i>	
Current	
Current Portion of First National Bank Loan (Note X)	\$25,885
Non-current	
First National Bank Loan (Note X)	27,956

CHAPTER NINE / Debt Financing: Current and Non-current Liabilities Version 3.1

- | | | | |
|----|--------|---|---------|
| 1. | 2020 | | |
| | Apr. 1 | Equipment | 200,000 |
| | | Finance Lease | 190,000 |
| | | Cash | 10,000 |
| | | To record purchase of equipment from West Leasing Ltd. via lease and cash payment | |

- 2.

East Corp. Lease Repayment Schedule

	<u>A</u>	<u>B</u>	<u>C</u>	<u>D</u>	<u>E</u>
			<u>(D – B)</u>		<u>(A – C)</u>
<i>Year</i>	<i>Beginning</i>	<i>(A x 6%)</i>	<i>Reduction</i>	<i>Total</i>	<i>Ending</i>
<i>Ended</i>	<i>lease</i>	<i>Interest</i>	<i>of finance</i>	<i>lease</i>	<i>lease</i>
<i>March 31</i>	<i>balance</i>	<i>expense</i>	<i>lease</i>	<i>payment</i>	<i>balance</i>
2021	\$190,000	\$11,400	\$59,681	\$71,081	\$130,319
2022	130,319	7,819	63,262	71,081	67,057
2023	67,057	4,024	67,057	71,081	-0-

- 3.

East Corp.
Partial Statement of Financial Position
At December 31, 2022

Liabilities

Current	
Lease Interest Payable	\$3,018 ¹
Finance Lease (Note X)	67,057

¹ Estimated accrued interest = \$4,024 x 9/12 mos. = \$3,018

Note X would disclose pertinent information including details of the lease repayment agreement (for example, interest rate, repayment terms, security).

CHAPTER TEN

Debt Financing: Bonds

Concept Self-check

1. A bond is a debt security that requires periodic interest payments during its life as well as a future repayment of the borrowed amount. A bond indenture is the contract that binds the corporation to the bondholders; it specifies the terms with which the corporation must comply and may restrict further borrowing by the corporation. A trustee may be used to serve as an impartial intermediary between the corporation and the bondholders, and so better balance the rights and needs of these two groups.
2. A bondholder has the following rights:
 - a. The right to receive the face value of the bond at a specified maturity date in the future, that is, the right to receive the amount of money that was invested;
 - b. The right to receive periodic interest payments at a specified per cent of the bond's face value; this interest represents the bondholder's return on investment; and
 - c. In some cases, the right to have the corporation pledge some assets to protect the bondholder's investment; this safeguard restricts excess borrowing and, in the event that interest or the face amount of the bonds cannot be paid, allows for the sale of these assets to generate the funds necessary for repayment.
3. Since bondholders' claims on the net assets of a corporation take precedence over those of shareholders if liquidation occurs, shareholders must approve bond issues. Also, interest payments must be made to bondholders; these may affect cash flow, so that future dividends may be impaired during the life of the bond.
4. Bond issues with different characteristics are disclosed separately in the financial statements, or more usually, in a note. The interest rate, maturity date, and any restrictions imposed on the corporation in the bond indenture, together with any assets pledged, also must be disclosed.
5. Three main types of bond terminology can be identified:
 - a. Terms relating to different types of bonds (secured, unsecured, registered, bearer).

Concept Self-check continued

- b. Terms relating to other special features of corporate bonds (serial, callable, convertible, sinking).
 - c. The amount printed on the bond certificate (face or par value).
6. The different possibilities in the redemption of bonds before their maturity follow:
- a. The bonds can be repurchased on the open market if this option is financially advantageous to the issuer.
 - b. The issuer may exercise a call provision if it is financially advantageous. A call provision, sometimes included in a bond indenture, permits early redemption at a specified price, usually higher than the face value.
 - c. The bondholder or issuer may exercise a conversion feature if provided for in the bond indenture, whereby the bonds can be converted into corporate shares.
7. If the bond contract interest rate is the same as the prevailing market interest rate, the bond will sell “at par”. If the bond contract interest rate is higher than the prevailing market interest rate, the bond will sell at a premium. Prospective bondholders will bid up the price of the bonds because the bonds pay a rate of interest higher than other securities with similar features and risks. This creates a premium over the face value of the bonds. If the bond contract interest rate is lower than the prevailing market interest rate, the bond will sell at a discount because prospective bondholders will not be willing to pay the face value of the bonds. The issuer will have to accept a lower price so the effective interest rate will equal that of other securities with similar features and risks.
8. Under GAAP, an unamortized premium (discount) is added to (deducted from) the face value of the bond so that the liability is recorded at its carrying amount on the statement of financial position.
9. If the bond contract interest rate is greater than that required in the market, then the bonds are sold at a premium. If the investment market operates efficiently, investor should earn only the market rate of interest. By paying a premium over the face value, the overall return to the investor is reduced from the bond contract rate to the market rate in effect at the issue date.

Concept Self-check continued

10. There are two different methods to amortize a premium or a discount. The *straight-line method* allocates an equal amount of amortization to each interest period. The *effective interest method* of amortization calculates different amounts of amortization from one period to another. This method uses an amortization table, in which the interest expense on the carrying amount of the bond is calculated using the market rate of interest at the date of bond issue. The difference between this amount and the actual bond contract interest paid is the amortization amount applicable to the current period. Under this method, interest expense recorded in the accounts varies, but the effective interest rate is constant.
11. Interest accumulates from the previous interest payment date and is paid semi-annually, regardless of when the bond is actually sold. Interest paid is always calculated on the face value of the bond, regardless of premium or discount. Whenever a bond is issued, a six-month interest payment is made to the bondholder. Therefore, if a bond is sold between interest payment dates, it is sold for a price that includes accrued interest. The purchaser pays the seller for the interest from the previous interest payment date to the date of sale. When the purchaser receives the six-month interest payment, the net amount is what is earned while the bond was held by the investor.
12. The amortization of a bond premium is achieved through credits to the Interest Expense general ledger account and offsetting debits to the Bond Premium account, a statement of financial position contra account. A discount is amortized by periodic debits to the Interest Expense account and credits to the Bond Discount account.
13. If money is borrowed today for one year, at the end of that year the money to be repaid is increased by the amount of interest charged. The future value is therefore the principal plus interest. If a certain sum must be repaid in one year, the value in today's money would exclude the interest to be earned in the future. This is its present value. The time value of money is represented by interest. Interest is added to the principal to obtain the future value, and it is removed from a future sum to arrive at the present value.
14. The price of a bond is determined by combining the present value of the following future cash flows associated with the bond: (a) a single amount, the face value, to be paid at maturity, and (b) semi-annual interest payments made during the bond's life.

Assume a \$50,000 12 per cent bond is issued when the prevailing market interest rate is 8 per cent. Interest is payable semi-annually on June 30 and December 31 and the bond matures in three years. We need to compute

Concept Self-check continued

- a. The present value of the face value of \$50,000 in 3 years at 8 per cent. The present value factor is based on 6, six-month interest payment periods or 4 per cent. The PV factor is 0.79032 (see Table A in Appendix 1 of text).
- b. The present value of 6 interest payments of $\frac{1}{2}$ of 12% = 6% x \$50,000 = \$3,000. The present value factor is based on 6 interest payment periods using 4 per cent, that is 5.242137 (see Table B in Appendix 1).

The present value of the bond is \$55,242, the total of (a) and (b):

i.	\$50,000 x 0.79032	= \$39,516
ii.	\$3,000 x 5.242137	= <u>15,726</u>
		<u>\$55,242</u>

15. Amortization under the effective interest method is calculated by applying the market rate of interest to the carrying amount of the bonds. The difference between this interest and the actual bond contract interest paid is the amortization applicable to the current period.

For example, assume a \$50,000 bond with a contract rate of 12 per cent is issued on January 1, 2019 at \$55,242 (see above) when the market rate of interest is 8 per cent. The bond earns interest semi-annually on June 30 and December 31 and will mature in 3 years.

Issue of \$50,000 Bonds Payable for \$55,242
Amortization Table
Using Market Interest Rate of 8 Per Cent

		A	B	C	D	E
		<i>Beginning bond carrying amount</i>	<i>($\frac{1}{2}$ x 8%) = 4% x A Using 8% market rate to calculate 6-month interest expense</i>	<i>Actual cash interest paid</i>	<i>(B – C) Periodic premium amort.</i>	<i>(A – D) Ending bond carrying amount</i>
<i>Year</i>	<i>Six month period ending</i>					
2019	Jun. 30	\$55,242	4% x \$55,242 = \$2,210	\$3,000	\$790	\$54,452
	Dec. 31	54,452	4% x 54,452 = 2,178	3,000	822	53,630
2020	Jun. 30	53,360	4% x 53,360 = 2,145	3,000	855	52,775
	Dec. 31	52,775	4% x 52,775 = 2,111	3,000	889	51,886
2021	Jun. 30	51,886	4% x 51,886 = 2,075	3,000	925	50,961
	Dec. 31	50,961	4% x 50,961 = 2,039	3,000	961	50,000

16. The effective interest method produces a constant interest rate equal to the market rate of interest on the date the bonds were issued. From a theoretical perspective, this is more appropriate, since it reflects market reality. The simpler straight-line amortization method may be preferred when the amounts of premiums or discounts are immaterial, due to cost/benefit considerations.

CP 10-1

1. discount
2. premium
3. discount
4. premium
5. premium
6. discount

CP 10-2

1. a. The issuance of bonds:

$$\text{Cash} = \$100,000 \times 94\% = \$94,000$$

$$\text{Discount} = \$100,000 - \$94,000 = \$6,000$$

2019

Jan. 1	Cash	94,000	
	Discount on Bonds	6,000	
	Bonds Payable		100,000

- b. The interest payment:

Jun. 30	Interest Expense	6,000	
	Cash		6,000

- c. The amortization of the discount:

$$\text{Discount} = \$6,000 / 3 \text{ years} \times 6/12 = \$1,000$$

Jun. 30	Interest Expense	1,000	
	Discount on Bonds		1,000

2. Interest paid in cash = $\$100,000 \times 12\% = \$12,000$

$$\begin{aligned} \text{Interest expense for 2019} &= \text{Interest} + \text{amortization for the year} \\ &= \$12,000 + \$2,000 = \$14,000 \end{aligned}$$

- 3.

Nevada Inc.
Partial Statement of Financial Position
At December 31, 2019

Liabilities

*Non-current**

Bonds payable (Note X)	\$100,000
Discount on bonds	<u>(4,000)</u>
Carrying amount	<u>\$ 96,000</u>

Note X would disclose pertinent information of the bond indenture including details of the face value and unamortized bond discount if (as here) just the carry amount is shown on the statement of financial position.

* If it was likely that the bonds would be called on January 1, 2020, they would be classified as current liabilities. If so, details of the redemption should be disclosed in a note to the December 31, 2019 financial statements.

CP 10–2 continued

4.	Retirement of the bonds:			
	2021			
	Dec. 31	Bonds Payable	100,000	
		Cash		100,000
5.	Calling of the bonds:			
	2021			
	Jan. 1	Bonds Payable	100,000	
		Discount on Bonds		4,000
		Cash		102,000
		Loss on Bond Retirement	6,000	
	To record retirement of bonds at 102 as follows:			
		Face value	\$100,000	
		Unamortized discount	<u>(4,000)</u>	
		Carrying amount	96,000	
		Cash paid	<u>102,000</u>	
		Loss on retirement	<u>(\$6,000)</u>	

CP 10–3

1.	a.	The issuance of the bonds:		
		Cash = \$200,000 x 112% = \$224,000		
		2019		
		Jan. 1	Cash	224,000
			Premium on Bonds	24,000
			Bonds Payable	200,000
	b.	The interest payment:		
		Interest = \$200,000 x 12% x 6/12 = \$12,000		
		Jun. 30	Interest Expense	12,000
			Cash	12,000
	c.	The amortization of the premium:		
		Premium = (\$24,000/3 years) x 6/12 = \$4,000		
		Jun. 30	Premium on Bonds	4,000
			Interest Expense	4,000
2.	Interest paid in cash = \$200,000 x 12% = \$24,000			
	Interest expense for 2019 = Interest – amortization for the year			
	= \$24,000 – (\$24,000/3 years)			
	= \$24,000 – \$8,000			
	= \$16,000			

These amounts are different because the amortization of the premium, which reduces Interest Expense, does not require cash.

CP 10–3 continued

3. Sydney Corp.
Partial Statement of Financial Position
At December 31, 2019

Liabilities

Non-current

Bonds payable	\$200,000
Premium on bonds	<u>16,000</u>
Carrying amount	\$216,000

4. Calling of the bonds:
Cash paid = \$200,000 x 106% = \$212,000

2022

Jan. 1	Bonds Payable	200,000	
	Premium on Bonds	8,000	
	Cash		212,000
	Loss on Bond Retirement	4,000	
	To record retirement of bonds at 106 as follows:		
	Face value	\$200,000	
	Unamortized premium	<u>(8,000)</u>	
	Carrying amount	208,000	
	Cash paid	<u>212,000</u>	
	Loss on retirement	<u>(\$4,000)</u>	

CP 10–4

Discount = \$500 x 12/6 x 3 years = \$3,000
Bonds payable = (\$16,500 x 12/6 months)/12% = \$275,000

2019

Jan. 1	Discount on Bonds	3,000	
	Cash	272,000	
	Bonds Payable		275,000

CP 10–5

Premium = \$100 x 12/6 x 3 years = \$600
Bonds payable = (\$18,000 x 12/6 months)/12% = \$300,000

2019

Jan. 1	Cash	300,600	
	Premium on Bonds		600
	Bonds Payable		300,000

CP 10–6

	CASE A	CASE B	CASE C
	A. <i>Investors purchase the bonds at par</i>	B. <i>Investors purchase the bonds at a premium</i>	C. <i>Investors purchase the bonds at a discount</i>
1.	The corporation receives \$100,000 cash for the bonds.	The corporation receives \$112,000 cash for the bonds.	The corporation receives \$88,000 cash for the bonds.
2.	The corporation pays \$12,000 annual interest on the \$100,000 face value of the bonds.	The corporation pays \$12,000 annual interest on the \$100,000 face value of the bonds.	The corporation pays \$12,000 annual interest on the \$100,000 face value of the bonds.
3.	The following journal entry records the sale of the bonds. Cash 100,000 Bonds Payable 100,000	The following journal entry records the sale of the bonds. Cash 112,000 Premium on Bonds 12,000 Bonds Payable 100,000	The following journal entry records the sale of the bonds. Cash 88,000 Discount on Bonds 12,000 Bonds Payable 100,000
4.	June 30, 2019 The interest payment is recorded as follows: Interest Expense 6,000 Cash 6,000	June 30, 2019 The interest payment is recorded as follows: Interest Expense 6,000 Cash 6,000 Amortization is recorded as follows: Premium on Bonds 2,000 Interest Expense 2,000	June 30, 2019 The interest payment is recorded as follows: Interest Expense 6,000 Cash 6,000 Amortization is recorded as follows: Interest Expense 2,000 Discount on Bonds 2,000
	December 31, 2019 The interest payment is recorded as follows: Interest Expense 6,000 Cash 6,000	December 31, 2019 The interest payment is recorded as follows: Interest Expense 6,000 Cash 6,000 Amortization is recorded as follows: Premium on Bonds 2,000 Interest Expense 2,000	December 31, 2019 The interest payment is recorded as follows: Interest Expense 6,000 Cash 6,000 Amortization is recorded as follows: Interest Expense 2,000 Discount on Bonds 2,000

CP 10–7

1. The amount of cash interest paid to investors each period is constant, and based on the face value of the bond and the stated interest rate in the bond indenture. When the bond is issued at a premium, the premium must be amortized so that the carrying amount of the bond at maturity is equal to its face value. The amortization of the premium reduces this interest expense of the corporation. When the bond is issued at a discount, the amortization of the discount increases the interest expense recorded on the corporation's income statement.
2. The diagram shows a bond for which the straight-line method of amortization is used, since the premium and discount are amortized by same amount as time passes (hence the term "straight-line").

CP 10–8 (Appendix)

1. Interest payment every 6 months = $\$200,000 \times 12\% \times 1/2 = \$12,000$

2. Issue of \$200,000 Bonds Payable for \$210,152

Amortization Table

Using Market Interest Rate of 10 Per Cent

		<u>A</u>	<u>B</u>	<u>C</u>	<u>D</u>	<u>E</u>
		<i>Beginning bond carrying amount</i>	<i>($\frac{1}{2} \times 10\%$) = 5% x A Using 10% market rate to calculate 6-month interest expense</i>	<i>Actual cash interest paid</i>	<i>(B – C) Periodic premium amort.</i>	<i>(A – D) Ending bond carrying amount</i>
<i>Year</i>	<i>Six month period ending</i>					
2019	Jun. 30	\$210,152	$5\% \times \$210,152 = \$10,507$	\$12,000	\$(1,493)	\$208,659
	Dec. 31	208,659	$5\% \times 208,659 = 10,433$	12,000	(1,567)	207,092
2020	Jun. 30	207,092	$5\% \times 207,092 = 10,355$	12,000	(1,645)	205,447
	Dec. 31	205,447	$5\% \times 205,447 = 10,272$	12,000	(1,728)	203,719
2021	Jun. 30	203,719	$5\% \times 203,719 = 10,186$	12,000	(1,814)	201,905
	Dec. 31	201,905	$5\% \times 201,905 = 10,095$	12,000	(1,905)	200,000

3.

Calculation of Effective Interest Rate

		<u>A</u>	<u>B</u>	
			<i>($\frac{1}{2} \times 10\%$) = 5% x A Using 10% market rate to calculate periodic interest expense</i>	
<i>Year</i>	<i>Six month period ending</i>	<i>Bond carrying amount</i>		<i>(B/A)</i>
2019	Jun. 30	\$210,152	$5\% \times \$210,152 = \$10,507$	5%
	Dec. 31	208,659	$5\% \times 208,659 = 10,433$	5%
2020	Jun. 30	207,092	$5\% \times 207,092 = 10,355$	5%
	Dec. 31	205,447	$5\% \times 205,447 = 10,272$	5%
2021	Jun. 30	203,719	$5\% \times 203,719 = 10,186$	5%
	Dec. 31	201,905	$5\% \times 201,905 = 10,095$	5%

4. The financing charge remains constant from period to period under the market interest method. It would vary slightly under the straight-line method. Some may argue that the interest rate should remain constant to be theoretically correct. From a practical point of view, there may be no material difference from period to period when using the straight-line method, and the effective interest method may not be worth the calculation effort. The straight-line method is simpler to use.

P 10-2

- Amortization every 6 months = \$3,000 over 6 periods = \$500

- | | | | | |
|----|---------|--|-------|-------|
| 3. | 2019 | | | |
| | June 30 | Interest Expense | 9,000 | |
| | | Cash | | 9,000 |
| | | To record payment of interest. | | |
| | June 30 | Interest Expense | 500 | |
| | | Bond Discount | | 500 |
| | | To record amortization of bond discount. | | |

- | | 2020 | 2019 |
|------------------------|----------------|----------------|
| <i>Liabilities</i> | | |
| <i>Current</i> | | |
| Bonds payable (Note X) | \$150,000 | \$ -0- |
| Discount on bonds | <u>(1,000)</u> | <u>-0-</u> |
| Carrying amount | <u>149,000</u> | <u>-0-</u> |
| <i>Non-current</i> | | |
| Bonds payable (Note X) | -0- | 150,000 |
| Discount on bonds | <u>-0-</u> | <u>(2,000)</u> |
| Carrying amount | <u>-0-</u> | <u>148,000</u> |

P 10-2

- CHAPTER TEN / Debt Financing: Bonds Version 3.1

P 10-2 continued

- | | | | | |
|------|------------|--|-----------|-----------|
| 2. | 2019 | | | |
| | Dec. 1 | Interest Expense | 216,200 | |
| | | Premium on Bonds | 23,800 | |
| | | Cash | | 240,000 |
| | | To record interest payment and premium amortization as follows: | | |
| | | Premium = $\$142,800/3 \text{ years} \times 6/12 = \$23,800$ | | |
| | | Cash = $\$4,000,000 \times 12\% \times 6/12 = \$240,000$ | | |
| 3. | 2019 | | | |
| | Dec. 31 | Interest Expense | 36,033 | |
| | | Premium on Bonds | 3,967 | |
| | | Bond Interest Payable | | 40,000 |
| | | To accrue interest expense and premium amortization at year-end as follows: | | |
| | | Premium = $\$142,800/3 \text{ years} \times 1/12 = \$3,967$ | | |
| | | Interest payable = $\$4,000,000 \times 12\% \times 1/12 = \$40,000$ | | |
| | | If no bond premium was amortized on December 1 (see entry 2), the entry would be: | | |
| | Dec. 31 | Interest Expense | 12,233 | |
| | | Premium on Bonds | 27,767 | |
| | | Bond Interest Payable | | 40,000 |
| | | To accrue interest expense and premium amortization at year-end ($\$142,800/3 \text{ years} \times 7/12 = \$27,767$) | | |
| 4. | 2020 | | | |
| | Jun. 1 | Interest Expense | 180,167 | |
| | | Premium on Bonds | 19,833 | |
| | | Bond Interest Payable | 40,000 | |
| | | Cash | | 240,000 |
| | | To record interest payment and premium amortization. | | |
| | | Premium = $\$142,800/3 \text{ years} \times 5/12 = \$19,833$ (rounded) | | |
| 5.a. | 2020 | | | |
| | Sept. 1 | Cash | 3,910,400 | |
| | | Discount on Bonds | 89,600 | |
| | | Bonds Payable | | 4,000,000 |
| | | To record issue of bonds at 97.76. | | |
| | | ($\$4,000,000 \times .9776 = \$3,910,400$) | | |
| | b. Sept. 1 | Cash | 120,000 | |
| | | Bond Interest Payable | | 120,000 |
| | | To record accrued interest paid by purchaser. | | |
| | | ($\$4,000,000 \times 12\% \times 3/12 \text{ mos.}$) | | |

P 10–2 continued

6.a. 2022			
Jun.1	Interest Expense	180,167	
	Bond Interest Payable	40,000	
	Premium on Bonds	19,833	
	Cash		240,000
	To record final interest payment and premium amortization on first bond issue.		
b. Jun.1	Interest Expense	221,333	
	Bond Interest Payable	40,000	
	Discount on Bonds		21,333
	Cash		240,000
	To record final interest payment and discount amortization on second bond issue.		
c. Jun. 1	Bonds Payable	8,000,000	
	Cash		8,000,000
	To record repayment of bonds at maturity.		

P 10-3

1.a. Amount of interest paid every 6 months:

	<i>Case A</i>	<i>Case B</i>	<i>Case C</i>
Face value (\$100,000 at 12% x 1/2)	<u>\$6,000</u>	<u>\$6,000</u>	<u>\$6,000</u>

b. Amount of amortization every 6 months:

Issue price	\$100,000	\$103,000	\$ 94,000
Face value	<u>100,000</u>	<u>100,000</u>	<u>100,000</u>
Premium (discount)	<u>\$ -0-</u>	<u>\$ 3,000</u>	<u>\$(6,000)</u>
Amortization semi-annually over 3 years		<u>\$ 500</u>	<u>\$(1,000)</u>

2.

		<i>Case A</i>	<i>Case B</i>	<i>Case C</i>
a. Issue of the bonds:				
2019				
Jan.1	Cash	100,000	103,000	94,000
	Bond Discount	—	—	6,000
	Bond Payable	100,000	100,000	100,000
	Bond Premium	—	3,000	—
b. Payment of interest:				
2019				
Jun. 30	Interest Expense	6,000	6,000	6,000
	Cash	6,000	6,000	6,000
c. Amortization:				
2019				
Jun. 30	Interest Expense	—	—	1,000
	Bond Discount	—	—	1,000
	Bond Premium	—	500	—
	Interest Expense	—	500	—

P 10–3 continued

		<i>Case A</i>		<i>Case B</i>		<i>Case C</i>
d.	Payment of interest:					
	2019					
	Dec. 31	Interest Expense	6,000	6,000	6,000	
		Cash		6,000	6,000	6,000
e.	Amortization:					
	2019					
	Dec. 31	Interest Expense	—	—	1,000	
		Bond Discount	—	—		1,000
		Bond Premium	—	500	—	
		Interest Expense	—	500		—
f.	Payment of interest:					
	2021					
	Dec. 31	Interest Expense	6,000	6,000	6,000	
		Cash		6,000	6,000	6,000
g.	Amortization:					
	2021					
	Dec. 31	Interest Expense	—	—	1,000	
		Bond Discount	—	—		1,000
		Bond Premium	—	500	—	
		Interest Expense	—	500		—
h.	Redemption of bonds:					
	2022					
	Jan. 1	Bonds Payable	100,000	100,000	100,000	
		Cash		100,000	100,000	100,000

3. Calculation of interest expense:

	<i>Case A</i>	<i>Case B</i>	<i>Case C</i>
Cash interest paid	\$12,000	\$12,000	\$12,000
Amortization of discount (premium)	<u>-0-</u>	<u>(1,000)</u>	<u>2,000</u>
Interest in income statement	<u>\$12,000</u>	<u>\$11,000</u>	<u>\$14,000</u>

The amount of cash interest paid by Esther differs from the amount shown on the income statement where a premium or a discount exists because the amortization of a premium is credited to interest expense, while the amortization of a discount is debited to interest expense.

P 10–3 continued

4. Exercise of a call option at Dec. 31, 2020:

	Case A	Case B	Case C
Bond Payable	50,000	50,000	50,000
Bond Premium	—	2,000	—
Loss on Bond Redemption	1,500	—	5,500
Bond Discount	—	—	4,000
Gain on Bond Redemption	—	500	—
Cash	51,500	51,500	51,500

To record retirement of \$50,000 of 12% bonds at 102 as follows:

	Case A	Case B	Case C
Face value	\$50,000	\$50,000	\$50,000
Unamortized premium (discount)	—	<u>2,000</u>	<u>(4,000)</u>
Carrying amount	50,000	52,000	46,000
Cash paid (\$50,000 @ 102)	<u>51,500</u>	<u>51,500</u>	<u>51,500</u>
Gain (loss) on retirement	<u>\$ 1,500</u>	<u>\$ 500</u>	<u>(\$5,500)</u>

P 10–4

1. a. Amount of interest paid in cash every 6 months
= \$300,000 x 12% x 1/2 = \$18,000

- b. Face value \$300,000
Issue price 272,263
Discount \$ 27,737

Amortization every 6 months
= \$27,737 over 3 years x 1/2
= \$4,623 (rounded)

2.

Issue of \$300,000 Bonds Payable for \$272,263

Amortization Table
(straight-line)

		A	B	C	D	E
		Beginning bond carrying amount	(C + D) Periodic interest expense	Actual cash interest paid	Periodic discount amort.	(A + D) Ending bond carrying amount
Year	Six month period ending					
2019	Jun. 30	\$272,263	\$22,623	\$18,000	\$4,623	\$276,886
	Dec. 31	276,886	22,623	18,000	4,623	281,509
2020	Jun. 30	281,509	22,623	18,000	4,623	286,132
	Dec. 31	286,132	22,623	18,000	4,623	290,755
2021	Jun. 30	290,755	22,623	18,000	4,623	295,378
	Dec. 31	295,378	22,622	18,000	4,622	300,000

3.

Calculation of Effective Interest Rate

<i>Year</i>	<i>Six month period ending</i>	<i>A</i>	<i>B</i>	<i>% (B/A)</i>
		<i>Bond carrying amount</i>	<i>Six-month interest expense</i>	
2019	Jun. 30	\$272,263	\$22,623	8.3%
	Dec. 31	276,886	22,623	8.2%
2020	Jun. 30	281,509	22,623	8.0%
	Dec. 31	286,132	22,623	7.9%
2021	Jun. 30	290,755	22,623	7.8%
	Dec. 31	295,378	22,622	7.7%

4. The bonds were issued at a discount. Actual cash received was lower than the face value of the bonds. This indicates that the market rate of interest at the date of bond issue was higher than the stated interest rate of the bonds. The difference represents unamortized discount, which is amortized over the life of the bonds and acts to increase interest expense. As a result, the average interest expense is significantly higher than the interest rate on the face of the bonds each year (more than 15% per year actual vs. 12% per year stated). The interest expense also varies from period to period under the straight-line amortization method. Some may argue that such variation is not theoretically correct and therefore prefer the effective interest method, which provides a constant, market-based interest expense. From a practical point of view, there may be no material difference from period to period. The effective interest method may not be worth the calculation effort. The straight-line method is usually simpler to use.

P 10–4 continued

5. Otter Products Inc.		
Partial Statement of Financial Position		
At December 31, 2020		
	2020	2019
	<i>Liabilities</i>	
<i>Current</i>		
Bonds payable (Note X)	\$300,000	\$ -0-
Discount on bonds	<u>(9,245)</u>	<u>-0-</u>
Carrying amount	<u>290,755</u>	<u>-0-</u>
<i>Non-current</i>		
Bonds payable (Note X)	-0-	300,000
Discount on bonds	<u>-0-</u>	<u>(18,491)</u>
Carrying amount	<u>-0-</u>	<u>281,509</u>

Note X would disclose relevant details about the bonds, including interest rate, maturity date, and fair value of the bonds at December 31 each year. Alternately, just carrying amounts could be shown on the statement of financial position. Face value and unamortized discount amounts could be disclosed in a note to the financial statements.

P 10–5

1. a. Difference between the premiums from 2019 to 2020: $(\$23,600 - 21,200) = \$2,400$
Amortization per month = $\$2,400/12 = \200
Premium at date of issue, Nov. 1, 2019 = $(2 \times \$200) + \$23,600 = \$24,000$
Original issue price = $\$500,000 + \$24,000 = \$524,000$
- b. Total premium/yearly amortization = $\$24,000/2,400 = 10$ years.
The maturity date is 10 years after Nov. 1, 2019, or 10 years and four months after date of authorization on July 1, 2019.

2.

2019		
Nov. 1	Cash	539,000
	Bonds Payable	500,000
	Premium on Bonds	24,000
	Bond Interest Payable	15,000
	To record the bond issue and accrued interest payable $(\$500,000 \times 9\% \times 4/12 \text{ mos.} = \$15,000)$	

P 10–5 continued

3. 2021 unadjusted interest expense = \$43,800

Comprised of:

Cash interest paid (\$500,000 x 9%)	\$45,000
Amortization of premium from January 1 to June 30	<u>(1,200)</u>
	<u>\$43,800</u>

The following journal entry is needed:

2021

Dec. 31	Premium on Bonds	1,200	
	Interest Expense		1,200
	To record amortization of bond premium from July 1 to December 31 (\$200 x 6 mos.)		

4. Carrying value at December 31, 2021
 = \$500,000 + 20,000 – 1,200
 = \$518,800

P 10–6

1. 2019
- | | | | |
|--------|---------------------------------|---------|-----------|
| Apr. 1 | Discount on Bonds | 30,000 | |
| | Cash | 970,000 | |
| | Bonds Payable | | 1,000,000 |
| | To record issue of bonds at 97. | | |
-
- | | | | |
|----------|--|--------|--------|
| Sept. 30 | Interest Expense | 55,000 | |
| | Discount on Bonds | | 5,000 |
| | Cash | | 50,000 |
| | To record payment of interest and amortization of bond discount. | | |
| | Amortization = \$30,000/3 x 6/12 = \$5,000 | | |
| | Interest = \$1,000,000 x 10% x 6/12 = \$50,000 | | |
-
- | | | | |
|---------|--|--------|--------|
| Dec. 31 | Interest Expense | 27,500 | |
| | Discount on Bonds | | 2,500 |
| | Bond Interest Payable | | 25,000 |
| | To record accrual of bond interest and amortization of bond discount to year-end | | |
| | Interest = \$1,000,000 x 10% x 3/12 = \$25,000 | | |
| | Amortization = \$30,000/3 x 3/12 mos. = \$2,500 | | |

P 10–6 continued

2.	2019			
	Apr. 1	Cash	1,060,000	
		Premium on Bonds		60,000
		Bonds Payable		1,000,000
		To record bonds issued at 106.		
	Sept. 30	Premium on Bonds	10,000	
		Interest Expense	40,000	
		Cash		50,000
		To record payment of interest and amortization of bond premium.		
		Interest = \$1,000,000 x 10% x 6/12 = \$50,000		
		Amortization = \$60,000/3 x 6/12 = \$10,000		
	Dec. 31	Premium on Bonds	5,000	
		Interest Expense	20,000	
		Bond Interest Payable		25,000
		To record accrual of bond interest and amortization of bond premium to year-end		
		Interest = \$1,000,000 x 10% x 3/12 = \$25,000		
		Amortization = \$60,000/3 x 3/12 mos. = \$5,000		
3.	2020			
	Dec.1	Cash	1,030,000	
		Premium on Bonds		30,000
		Bonds Payable		1,000,000
		To record bonds issued at 103.		
	Dec. 1	Cash	16,667	
		Bond Interest Payable		16,667
		To record accrued interest on bonds issued November 30.		
		(\$1,000,000 x 10% x 2/12 mos. = \$16,667)		
	2020			
	Dec. 31	Interest Expense	8,333	
		Bond Interest Payable		8,333
		To record additional accrued interest from December 1 to December 31 (\$1,000,000 x 10% x 1/12 mos. = \$8,333).		
	Dec. 31	Premium on Bonds	1,875	
		Interest Expense		1,875
		To record amortization of bond premium to December 31. Bonds will be outstanding 16 months, Dec. 1, 2020 to April 1, 2022 (\$30,000 x 1/16 mos. = \$1,875)		

P 10–7 (Appendices)

	CASE A	CASE B	CASE C
1. a. Interest payment every 6 months: \$500,000 x 12% x ½ yrs.	<u>\$30,000</u>	<u>\$30,000</u>	<u>\$30,000</u>
b. Issue price computation: Present value \$500,000 at the end of 10 periods at 6% use 0.558395	\$279,197		
8% use 0.463193		\$231,597	
4% use 0.675564			\$337,782
Present value \$30,000, payments for 10 periods at 6% use 7.360087	\$220,803		
8% use 6.710081		\$201,302	
4% use 8.110896			\$243,327
Issue price	<u>\$500,000</u>	<u>\$432,899</u>	<u>\$581,109</u>

c. i. Bonds issued when market rate is 12%: no amortization needed

ii. Bonds issued when market rate is 16%: the amortization table is as follows:

		<u>A</u>	<u>B</u>	<u>C</u>	<u>D</u>	<u>E</u>
		<i>Beginning bond carrying amount</i>	<i>1/2 x 16% = 8% x A</i>	<i>Actual cash interest paid</i>	<i>(B – C) Periodic premium amort.</i>	<i>(A + D) Ending bond carrying amount</i>
Year	<i>Six month period ending</i>					
2019	Jun. 30	432,899	34,632	30,000	4,632	437,531
	Dec. 31	437,531	35,002	30,000	5,002	442,533
2020	Jun. 30	442,533	35,403	30,000	5,403	447,936
	Dec. 31	447,936	35,835	30,000	5,835	453,771
2021	Jun. 30	453,771	36,302	30,000	6,302	460,073
	Dec. 31	460,073	36,806	30,000	6,806	466,878

iii. Bonds issued when market rate is 8%: the amortization table is as follows:

		<u>A</u>	<u>B</u>	<u>C</u>	<u>D</u>	<u>E</u>
		<i>Beginning bond carrying amount</i>	<i>1/2 x 8% = 4% x A</i>	<i>Actual cash interest paid</i>	<i>(B – C) Periodic premium amort.</i>	<i>(A + D) Ending bond carrying amount</i>
Year	<i>Six month period ending</i>					
2019	Jun. 30	581,109	232,44	30,000	6,756	574,353
	Dec. 31	574,353	229,74	30,000	7,026	567,327
2020	Jun. 30	567,327	226,93	30,000	7,307	560,021
	Dec. 31	560,021	224,01	30,000	7,599	552,421
2021	Jun. 30	552,421	220,97	30,000	7,903	544,518
	Dec. 31	544,518	217,81	30,000	8,219	536,299

P 10–7 continued

d. The carrying value of the bonds at December 31, 2021:

Case A: \$500,000

Case B: \$466,878

Case C: \$536,299

2.		<u>CASE A</u>		<u>CASE B</u>		<u>CASE C</u>	
2021							
Jan. 1	Cash	500,000		432,899		581,109	
	Bond Discount	—		67,101		—	
	Bond Payable		500,000		500,000		500,000
	Bond Premium		—		—		81,109
Jun. 30	Interest Expense	30,000		30,000		30,000	
	Cash		30,000		30,000		30,000
30	Interest Expense	—		6,302		—	
	Bond Discount		—		6,302		—
30	Bond Premium	—		—		7,903	
	Interest Expense		—		—		7,903
Dec. 31	Interest Expense	30,000		30,000		30,000	
	Cash		30,000		30,000		30,000
31	Interest Expense	—		6,806		—	
	Bond Discount		—		6,806		—
31	Bond Premium	—		—		8,219	
	Bond Interest Expense		—		—		8,219

P 10–8 (Appendices)

1. Issue price computation:

Present value of \$300,000 at the end of 6 periods at 8%: use 0.630170	\$189,051
Present value of \$18,000 payments for 6 periods at 8%: use 4.622880	<u>83,212</u>
Issue price	<u>\$272,263</u>

2.

Issue of \$300,000 Bonds Payable for \$272,263
Amortization Table
Using Market Interest Rate of 16 Per Cent

		<u>A</u>	<u>B</u>	<u>C</u>	<u>D</u>	<u>E</u>
		<i>Beginning bond carrying amount</i>	<i>(1/2 x 16% = 8% x A) Using 16% market rate to calculate periodic interest expense</i>	<i>Actual cash interest paid</i>	<i>(B – C) Periodic premium amort.</i>	<i>(A + D) Ending bond carrying amount</i>
<i>Year</i>	<i>Six month period ending</i>					
2019	Jun. 30	\$272,263	(8% x \$272,263) = \$21,781	\$18,000	\$3,781	\$276,044
	Dec. 31	276,044	(8% x 276,044) = 22,084	18,000	4,084	280,128
2020	Jun. 30	280,128	(8% x 280,128) = 22,410	18,000	4,410	284,538
	Dec. 31	284,538	(8% x 284,538) = 22,763	18,000	4,763	289,301
2021	Jun. 30	289,301	(8% x 289,301) = 23,144	18,000	3,144	294,445
	Dec. 31	294,445	(8% x 294,445) = 23,555	18,000	5,555	300,000

3. Calculation of financing percentage

		<u>A</u>	<u>B</u>	
		<i>Six month period ending</i>	<i>Bond carrying amount</i>	<i>Six-month interest expense</i>
<i>Year</i>				<i>(B/A)</i>
2019	Jun. 30	\$272,263	\$21,781	8.0%
	Dec. 31	276,044	22,084	8.0%
2020	Jun. 30	280,128	22,410	8.0%
	Dec. 31	284,538	22,763	8.0%
2021	Jun. 30	289,301	23,144	8.0%
	Dec. 31	294,445	23,555	8.0%

4. The interest rate expense remains constant from period to period under the effective interest amortization method, though the amortization amount varies each period. The effective interest rate would vary slightly under the straight-line method. The former method is theoretically superior. From a practical point of view, there is often no material difference from period to period when using the straight-line method; therefore, the effective interest method may not be worth the effort.

CHAPTER ELEVEN

Equity Financing

Concept Self-check

1. The corporate form of organization offers the following advantages:
 - a. It is a legal entity with unlimited life; its existence is separate from its owners; and it has many of the rights and responsibilities of an individual.
 - b. It has limited liability; the owners are liable only for the amount they invest in the corporation.
 - c. Acquiring capital is facilitated by being able to issue shares (ownership units) with different risk and reward structures to many owners.
 - d. Corporations may pay income taxes at rates that may be lower than rates for individuals.
2. The owners of the corporation are liable for only the amount they have each invested. If the corporation fails, its assets are used to pay the creditors. If assets are not sufficient to pay all creditors, the shareholders have no further liability. Creditors are protected to some degree by disclosure of the corporation's limited liability.
3. Some of the rights of common shareholders are as follows:
 - a. The right to participate in the management of the corporation by voting at shareholders' meetings (1 share generally equals 1 vote)
 - b. The right to participate in dividends when they are declared by the corporation's board of directors
 - c. The right to participate in a distribution of assets on liquidation
 - d. The right to appoint auditors.

The rights may be printed on the share certificate itself; they are detailed in the articles of incorporation.

Concept Self-check continued

4. One or more interested parties prepare and file an application for incorporation with the appropriate governmental agency. The forms describe the name, head office address, classes and maximum number of shares that the corporation requesting to issue, and the number of directors, among other information. A certificate of incorporation or similar document is issued by the state on approval of the application. The incorporators hold the initial shareholders' meeting to issue share certificates, and the shareholders elect a board of directors and approve the by-laws (set of corporate rules and regulations). The directors hold a directors' meeting to appoint the officers to execute the policies approved by the board of directors.
5. The shareholders elect a board of directors, which appoints the officers of the corporation. The officers execute the policies approved by the board of directors. The directors are not involved in the daily management of the corporation.
6. a. The two main classes of shares are:
 - i. *Preferred Shares*—a class of shares that has a preference over common shares. Holders of preferred shares are entitled to payment of dividends before common shareholders and usually have prior claims on a corporation's assets on liquidation. A fixed dividend rate may be attached to the shares. Some preferred shares may have voting privileges.
 - ii. *Common Shares*—the class of shares that are the basic ownership units in a corporation. Ownership of common shares carries the right to vote, to share in dividends, and to share in the assets of the corporation if it is liquidated; however, all other claims to the assets of a corporation rank ahead of the common shareholders' claims.
- b. Terms relating to the present status of a corporation's shares:
 - i. *Authorized Shares*—the designated number of shares within each class of shares that a corporation may issue.
 - ii. *Unissued Shares*—the shares of share capital in each class that a corporation is authorized to issue but has not yet issued.
 - iii. *Issued Shares*—the total number of authorized shares that have been issued in the name of shareholders; issued shares may not actually be in the hands of shareholders (e.g., treasury shares).
 - iv. *Outstanding Shares*—authorized shares that have been issued and are actually in the hands of shareholders.
 - v. *Reacquired Shares*—shares that have been re-purchased from shareholders, have not been cancelled, and have not been reissued (also called treasury shares).

Concept Self-check continued

7. Shares are preferred in that their owners
- Generally assume less risk than common shareholders. When a corporation is dissolved, preferred shareholders have first claim on the remaining assets after the creditors have been paid; and
 - Have a prior claim to the earnings of the corporation. Preferred shareholders must be paid specified dividends before any payments are made to common shareholders.

Preferred shareholders are similar to common shareholders in that both

- Own share certificates, evidence of corporate ownership;
- Have the legal guarantee that all shares of the same class will be treated equally with respect to rights and privileges attached to them;
- Have the right to dividends declared by the board of directors; and
- Have the right to participate in distribution of assets on liquidation of the corporation.

Preferred shareholders differ from common shareholders in that

- Common shareholders can participate in the management of the corporation by voting at shareholders' meetings (though some preferred shares may have voting privileges);
 - Common shareholders can appoint auditors;
 - Common shareholders assume more risk than preferred shareholders. However, common shareholders have more potential for receiving substantial dividends and increases in the value of their shares if the corporation is successful; and
 - Common shareholders receive the balance of assets after other claims have been satisfied—in the case of a bankruptcy or liquidation, there are usually few or no other assets to distribute to common shareholders; preferred shareholders have prior claims.
8. The shares are restored to the status of authorized but unissued. The appropriate contributed capital account must be reduced by the payment. Assuming that common shares are repurchased for cash, the entry would be:
- | | | | |
|-----|---------------|-----|------|
| Dr. | Common Shares | XXX | |
| Cr. | Cash | | XXXX |
- To record repurchase of outstanding shares to be held in treasury.
- These shares can subsequently be resold.
9. When the shares of a corporation are selling at a high price on the stock market, management may opt for a share split in order to put them more easily within the reach of more investors. This appeals to the psychology of some investors.

Concept Self-check continued

10.
 - a. The number of authorized and issued shares doubles.
 - b. Stated value per share halves.
11. The major components of the shareholders' equity section of the statement of financial position are share capital (preferred shares and common shares) and retained earnings. These two major components are distinguished because share capital represents contributed capital not available for distribution to owners, while retained earnings are available for distribution as dividends.
12. Some of the main considerations involving the declaration of dividends are
 - a. Whether or not there is enough cash, or whether the dividends can be paid by distribution of some other assets;
 - b. Whether the policy of the corporation precludes dividend payments; and
 - c. Whether there is a legal requirement that dividends must be declared.
13. A corporation may decide not to pay cash dividends even though it has a substantial net income because financial conditions may make it impractical or impossible.
 - a. There may be insufficient cash, due to a significant investment in capital assets or reduction of debt, for instance. In a growth-oriented corporation, shareholders benefit from this strategy through increased earnings, which increase market prices for the shares.
 - b. The policy of the corporation may preclude dividend payments.
 - c. There is no legal requirement that dividends must be paid, unless otherwise specified by the various classes of shares.
 - d. Dividends may be issued in shares of the corporation rather than in cash. A share dividend helps to preserve cash or to increase the number of shares traded on the stock market.
14. *The date of dividend declaration:* the corporation is legally required to pay the dividend; a liability is established.
The date of record: shareholders who own shares on this date will receive the dividend.
The date of payment: the dividend is actually paid on this date.

Concept Self-check continued

15. Dividend preferences that may be attached to preferred shares are
 - a. Preferred shareholders are entitled to dividends before any dividends are distributed to common shareholders;
 - b. Preferred shares may be cumulative; undeclared dividends can accumulate from one year to the next; and
 - c. Preferred shareholders may participate with common shareholders in dividend distributions beyond their usual preferred dividends.

Preferred shares have returns that are more predictable and thus attract investors with a lower tolerance for risk. These advantages do not mean that purchasing preferred shares are necessarily better than purchasing common shares. Holding common shares has its own advantages. Common shareholders generally have legal control of the corporation. Ownership of common shares carries the right to vote, to earn potentially unlimited dividends, and to have share values increase on stock markets.

16. If preferred shares are cumulative, undeclared dividends from previous years are tracked and must be paid along with the current dividend. The unpaid dividends are called dividends in arrears. They are not a liability of the corporation unless dividends have been declared by the board of directors.
17. Book value is the amount of net assets that can be claimed by each class of shareholders. The dollar amounts may be obtained from the statement of changes in equity, statement of financial position, or notes to the financial statements. With respect to common shares, book value represents the amount of net assets not claimed by creditors and preferred shareholders. With respect to preferred shares, book value represents the amount that preferred shareholders would receive if the corporation were liquidated. This would include any dividends in arrears.
18. When only one class of shares exists, book value is calculated by dividing shareholders' equity by the number of shares outstanding. If both preferred and common shares exist, preferred shares are allocated the amount they would receive if the corporation were liquidated. The common shares receive any remaining balance. The liquidating value of preferred shares is printed on the share certificate. Some preferred shares have a cumulative dividend feature — they are entitled to dividends that are in arrears. This is included when calculating the book value of preferred shares.

Concept Self-check continued

19. The balance in shareholders' equity changes from period to period; thus the book value changes also, since it is based on the shareholders' equity balance. The reader of the financial statements can compare book value with market value to get an insight into the perceived value of the corporation by investors. Since the market price of shares are related to factors such as company earnings, dividend payments, and perceived future potential to generate earnings, a book value higher than a market price may be interpreted by an investor as indicating that the corporation's shares are a more risky investment. Comparing the ratio of market value per share to book value per share among different corporations can indicate the stock market's expectations of relative profitability for each company.
20. Since the market price of shares are related to such factors as company earnings, dividend payments, and future earnings potential, a book value higher than a market price could be interpreted by an investor as indicating that the corporation's shares are a risky investment rather than a bargain.
21. A cash dividend reduces both the asset Cash and the shareholders' equity account Retained Earnings. A share dividend does not affect Cash; the Retained Earnings account is still reduced, but the account Common (or Preferred, if applicable) Shares is increased. A share dividend has no net effect on shareholders' equity. Example journal entries for each kind of dividend are as follows:

	<i>Declaration Date</i>		<i>Payment/Distribution Date</i>	
<i>Cash Dividend</i>	Dividends	X	Dividends Payable	X
	Dividends Payable	X	Cash	X
<i>Share Dividend</i>	Share Dividend	X	Share Dividend to be Issued	X
	Share Dividend		Common Shares	X
	to be issued	X		

22. A share dividend is a dividend in the form of shares of the corporation. Retained earnings decrease and share capital increases. A share split is an action taken by the corporation to increase the number of shares outstanding and reduce the per-share market value. No journal entry is required to record a share split, and there is no effect on the accounting records.

Concept Self-check continued

23. A share dividend increases the number of shares held by each shareholder but the ownership percentage remains the same. If a 10 per cent share dividend is distributed, each shareholder holds more shares but the percentage of ownership remains the same, illustrated as follows:

<i>Shareholders</i>	<i>Ownership</i>			
	<i>Before Share Dividend</i>		<i>After Share Dividend</i>	
	<i>Shares</i>	<i>%</i>	<i>Shares</i>	<i>%</i>
W	250	25%	275	25%
X	250	25%	275	25%
Y	250	25%	275	25%
Z	<u>250</u>	<u>25%</u>	<u>275</u>	<u>25%</u>
	<u>1,000</u>	<u>100%</u>	<u>1,100</u>	<u>100%</u>

24. Unrestricted retained earnings are those that are available for the payment of dividends. The board of directors passes a resolution for a specific purpose to restrict retained earnings: for example, to accommodate a plant expansion. The journal entry required to place a restriction on retained earnings would be

Dr.	Retained Earnings	XXX	
Cr.		Retained Earnings—Restricted for . . .	XXX
	To place a restriction on retained earnings for plant expansion.		

25. Retained earnings represent net assets that are earned by a corporation over its life that have not been distributed as dividends to shareholders. These net assets (e.g., excess cash) can be used to invest in productive activities of the business.

CP 11–1

	<i>Total share capital</i>	<i>Retained earnings</i>
1. Company is incorporated	x	x
2. Issued common shares with a stated value of \$1	↑	x
3. Split the common shares 2 for 1	x	x
4. Recorded net income for the year	x	↑
5. Reacquired common shares previously outstanding	↓	x
6. Declared a cash dividend	x	↓
7. Paid a cash dividend (retained earnings effect recorded when dividend declared)	x	x
8. Declared a share dividend	↑	↓
9. Created a restriction on retained earnings	x	x

CP 11–2

1.

	<i>12% bonds</i>	<i>Preferred shares</i>	<i>Common shares</i>
Income before interest and income taxes	\$12,000,000	\$12,000,000	\$12,000,000
Less: Interest expense	4,800,000 ¹	-0-	-0-
Income before income taxes	7,200,000	12,000,000	12,000,000
Less: Income taxes at 50%	3,600,000	6,000,000	6,000,000
	3,600,000	6,000,000	6,000,000
Less: Preferred dividends	-0-	4,000,000 ²	-0-
Net available to common shareholders (a)	\$3,600,000	\$2,000,000	\$6,000,000
Number of common shares outstanding (b)	200,000	200,000	400,000
Earnings per common share (a/b)	\$18	\$10	\$15

¹ \$40,000,000 x 12% = \$4,800,000

² 400,000 x \$100 x 10% = \$4,000,000

- Issuing bonds is the financing option that is most advantageous to the common shareholders, all other factors being considered equal. It results in higher earnings per common share. A second advantage is that bondholders normally do not have any control over the company. Issuing shares will distribute control over a larger number of shareholders and the present shareholders' control would be diluted. A third advantage is that interest expense is deductible for tax purposes, while dividends are paid out of after-tax dollars. One disadvantage, which may make one of the other options more advantageous, is that interest expense is fixed. The company may not earn enough income to cover the interest expense in any given year if bonds are issued.

CP 11-3

1. Authorization of share issue:
Memorandum
The company is authorized under the [name of legislation] to issue an unlimited number of no-par value, voting common shares and 10,000, no-par value, 4% preferred shares.

2. Issue of 10,000 common shares:

2019

Jan. 2	Intangible Assets	10,000	
	Common Shares		10,000

3. Issue of 1,000 preferred shares:

2019

Jan. 2	Cash	3,000	
	Preferred Shares		3,000

CP 11-4

1. 2019

Jan. 2	Land	500,000	
	Preferred Shares		500,000

To record the purchase of a tract of land in exchange for preferred shares for stated value of \$50 each.

2. The credit part of the transaction would be classified on the statement of financial position in the shareholders' equity section as part of share capital. The debit part of the transaction would be recorded as an asset in the property, plant, and equipment section.

CP 11-5

1. The stated value received for each issued preferred share is \$54 ($\$3,456/64$).
2. The stated value received for each issued common share is \$2.10 ($\$1,680/800$).
3. The total stated capital is \$5,136 ($\$3,456 + 1,680$).

CP 11-6

2019			
Dec.	Cash	30,000	
	Common Shares		30,000
	To record issue of common shares for cash.		
	Common Shares	5,000	
	Cash		5,000
	To record repurchase of common shares.		
	Cash	15,000	
	Preferred Shares		15,000
	To record issue of preferred shares for cash.		
	Building	8,000	
	Cash		8,000
	To record purchase of a building for cash.		
	Land	10,000	
	Building	12,000	
	Common Shares		22,000
	To record purchase of land and building through issue of common shares.		
	Cash	7,000	
	Common Shares		7,000
	To record issue of common shares for cash.		
	Cash	4,000	
	Land		4,000
	To record sale of land for cash.		
	Preferred Shares	6,000	
	Cash		6,000
	To record redemption of preferred shares for cash.		
	Incorporation Costs	14,000	
	Preferred Shares		14,000
	To record issue of preferred shares in exchange for incorporation costs.		
	(If incorporation costs amounts are judged material, this would be recorded as an asset; otherwise, it would be expensed.)		

CP 11-7

1. 2019
 May 25 Dividends Declared 100,000
 Dividends Payable 100,000
 To record the declaration of the dividend.
2. No entry is required on the date of record.
3. 2019
 June 26 Dividends Payable 100,000
 Cash 100,000
 To record payment of the dividend.

CP 11-8

1. Since the preferred shareholders have cumulative shares, they must receive all dividends in arrears and the current dividend before the common shareholders receive any dividends.

Dividends received by preferred shareholders
 = Dividends in arrears for one year + Dividends for current year
 = \$5,000 + 5,000 = \$10,000

2. Common shareholders receive the balance, or \$4,000.

Dividends received by common shareholders
 = Total dividends – Dividends received by preferred shareholders
 = \$14,000 – \$10,000 = \$4,000

CP 11-9

Dividends in arrears	\$ 2,000
Liquidation value	<u>25,000</u>
Preferred shares	<u>\$27,000</u>

Book value of preferred shares = Preferred shares/Number of preferred shares
 = \$27,000/5,000
 = \$5.40 per preferred share

Book value of
 common shares =
$$\frac{(\text{Total shareholders' equity} - \text{Book value of preferred shares})}{\text{Number of common shares}}$$

 = (\$210,000 – 27,000)/20,000
 = \$9.15 per common share

CP 11–10

1. a. Book value per preferred share = $(\$300 + 30)/300$ shares = \$1.10 per share
 b. Book value per common share = $(\$992 - 330)/20$ shares = \$33.10 per share
2. Book value per common share after split = $\$662/40$ shares = \$16.55 per share

CP 11–11

1. The amount of cumulative preferred dividends in arrears at December 31, 2019 does not appear as a liability. Although the dividends pertain to cumulative shares, no liability exists until such time as the board of directors *declares* a dividend. Disclosure of dividends in arrears would be made in a note to the financial statements as shown here, however.
2. The company may have sufficient retained earnings but may not have sufficient cash to pay the dividends, taking into consideration other needs of the company. Perhaps working capital is being conserved for an important investment project, for instance. The retained earnings balance may be restricted and consequently not available at present for shareholder dividends.

3. Amount available for all dividends ($1/2 \times \$35,000$)	\$17,500
Priority given to cumulative preferred shareholders	
Arrears to December, 2019	(15,000)
Preferred dividends for 2020	<u>(5,000)</u>
Deficiency	<u><u>\$(2,500)</u></u>

The \$2,500 deficiency in 2020 preferred dividends has to be paid in the future before any dividends are paid to common shareholders. There will be no dividends available for common shareholders at December 31, 2020 based on the projections.

CP 11–12

Common share dividend to be issued = $(5,000 \text{ shares} \times 10\%) \times \10
 = \$5,000

2019

Jan. 15	Retained Earnings	5,000	
	Common Share Dividend to be Issued		5,000
Feb. 15	Common Share Dividend to be Issued	5,000	
	Common Shares		5,000

CP 11–13

2019			
Apr. 1	Share Dividend Declared	15,000	
	Common Share Dividend To Be Issued		15,000
	To record the declaration of the share dividend. (10,000 x 10% x \$15)		
Apr. 15	Common Share Dividend To Be Issued	15,000	
	Common Shares		15,000
	To record the distribution of the dividend.		
Jun. 1	Cash Dividends Declared	22,000	
	Dividends Payable		22,000
	To record the declaration of the cash dividend. [(10,000 + 1,000) x \$2]		
Jun. 30	Dividends Payable	22,000	
	Cash		22,000
	To record the cash dividend payment.		
Dec. 31	Retained Earnings	37,000	
	Share Dividend Declared		15,000
	Cash Dividend Declared		22,000
	To close the Dividends Declared general ledger account to the Retained Earnings account.		

CP 11–14

1. 2019			
Jan. 5	Cash	150	
	Common Shares		150
	To record issue of 30 common shares, stated value \$5, for cash.		
12	Land	50	
	Buildings	100	
	Machinery	100	
	Common Shares		250
	To record issue of 50 common shares, stated value \$5, in exchange for assets.		
Feb. 28	Share Dividend Declared	56	
	Common Share Dividend to be Issued		56
	To record the share dividend [(30 + 50) x 10% = 8 shares x \$7]. (An entry to record net income to date could be made, but is not necessary here.)		
Mar. 15	Common Share Dividend to be Issued	56	
	Common Shares		56
	To record issue of dividend on common shares.		

CP 11–14 continued

Dec. 31	Income Summary	200	
	Retained Earnings		200
	To close the income summary account.		
Dec. 31	Cash Dividend Declared	88	
	Dividends Payable		88
	To record the cash dividend declared $[(30 + 50 + 8) \times \$1]$		
Dec. 31	Retained Earnings	144	
	Share Dividend Declared		56
	Cash Dividend Declared		88
	To close 2019 dividends to retained earnings.		

2. a. Blitz Power Tongs Inc.
Partial Statement of Financial Position
At January 31, 2019

Shareholders' Equity

Common shares, stated value \$5 per share	
Authorized—unlimited shares	
Issued and outstanding—80 shares	<u>\$400</u>

- b. Blitz Power Tongs Inc.
Partial Statement of Financial Position
At February 28, 2019

*Shareholders' Equity**

Share capital

Common shares, stated value \$5.18 ¹ per share	
Authorized—unlimited shares	
Issued and outstanding—88 shares	\$400
Common share dividend to be issued – 8 shares	<u>56</u>
Total contributed capital	\$456

Retained earnings

Net income	60	
Common share dividend declared	<u>(56)</u>	<u>4</u>
Total shareholders' equity		<u>\$460</u>

¹ $\$456/88 \text{ shares} = \$5.18 \text{ per share (rounded)}$

Other reasonable presentation formats are acceptable. For instance, these amounts could be shown in a note to the financial statements and on the statement of changes in equity. Just the total share capital and retained earnings amounts, could be shown on the statement of financial position.

CP 11–14 continued

- c. Blitz Power Tongs Inc.
Partial Statement of Financial Position
At December 31, 2019

Shareholders' Equity

Share capital

Common shares, stated value \$5.18 per share	
Authorized—unlimited shares	
Issued and outstanding—88 shares	
Total contributed capital	\$456

Retained earnings

Net income	\$200	
Cash dividends declared	(88)	
Common share dividend declared	<u>(56)</u>	<u>56</u>
Total shareholders' equity		<u>\$512</u>

* Other reasonable presentation formats are acceptable. For instance, these amounts could be shown in a note to the financial statements and on the statement of changes in equity. Just the total share capital and retained earnings amounts, could be shown on the statement of financial position.

CP 11–15

- 2019
Dec. 31 Retained Earnings 80,000
Retained Earnings – Restriction
for Plant Expansion 80,000
To record restriction per board of directors' resolution.

2.

Shareholders' Equity

	2019
Share capital	\$ 100,000
Retained earnings (Note X)	<u>200,000</u>
Total shareholders' equity	<u>\$300,000</u>

Note X: On December 31, 2019 the board of directors authorized a \$80,000 restriction on the retained earnings for plant expansion.

- 2020
Jun. 30 Plant 90,000
Cash 90,000
To record construction of building.
- 2020
Jul. 31 Retained Earnings – Restriction
for Plant Expansion 80,000
Retained Earnings 80,000
To record removal of restriction.

Stetson Auto Inc.
Partial Statement of Financial Position
As at December 31, 2019

Share Capital		
Common shares, stated value \$1		
Issued and outstanding — 10,000 shares		\$ 10,000
Retained Earnings		
Restricted for plant addition	\$150,000	
Unrestricted	<u>400,000</u>	
Total retained earnings		<u>550,000</u>
Total shareholders' equity		<u>\$560,000</u>

Alternately, some of these amounts could be disclosed in a note to the financial statements. The partial statement of financial position would just show:

Share capital (Note X)	\$ 10,000
Retained earnings (Note Y)	<u>550,000</u>
Total shareholders' equity	<u>\$560,000</u>

Stetson Auto Inc.
Statement of Changes in Equity
For the Year Ended December 31, 2019

	<i>Share capital</i>	<i>Retained earnings</i>		<i>Total equity</i>
		<i>Unrestricted</i>	<i>Restricted</i>	
Balance at Jan. 1, 2019	\$ -0-	\$ -0-	\$ -0-	\$ -0-
Common shares issued (Note X)	8,000			8,000
Net income		575,000		575,000
Cash dividends declared		(23,000)		(23,000)
Common share dividend declared	2,000	(2,000)		
Restriction for plant addition (Note Y)		<u>(150,000)</u>	<u>150,000</u>	
Balance at Dec. 31, 2019	<u>\$10,000</u>	<u>\$400,000</u>	<u>\$150,000</u>	<u>\$560,000</u>

P 11-1

1.

	<i>12% bonds</i>	<i>Preferred shares</i>	<i>Common shares</i>
Income before interest and income taxes	\$1,000,000	\$1,000,000	\$1,000,000
Less: Interest expense	240,000 ¹	-0-	-0-
Income before income taxes	760,000	1,000,000	1,000,000
Less: Income taxes at 50%	380,000	500,000	500,000
	380,000	500,000	500,000
Less: Preferred dividends	-0-	160,000 ²	-0-
Net Available to common shareholders (a)	\$380,000	\$340,000	\$500,000
Number of common shares outstanding (b)	40,000	40,000	90,000
Earnings per common share (a/b)	\$9.50	\$8.50	\$5.56

¹ \$2,000,000 x 12% = \$240,000

² 20,000 x \$8 = \$160,000

2. As representatives of common shareholders results based on earnings per share are important. On this basis, issuing bonds is the best option, since it results in higher earnings per share.
3. Other factors to be considered by board of directors:
 - a. Bondholders do not normally have control over managerial decisions. By issuing shares, the present shareholders' control would be spread over a larger number of shareholders.
 - b. The company may not be profitable enough to be able to cover a fixed annual interest charge.

- | | | | | | |
|----|----|---------|---|--------|--------|
| 1. | a. | 2019 | | | |
| | | Jan. 2 | Cash | 15,000 | |
| | | | Preferred Shares | | 15,000 |
| | | | To record issue of 3,000 preferred shares for cash. | | |
| | b. | Jan. 2 | Incorporation Costs* | 2,000 | |
| | | | Common Shares | | 2,000 |
| | | | To record issue of 2,000 common shares for cash. | | |
| | | | *these would be capitalized if material. | | |
| | c. | Jan. 12 | Cash | 25,000 | |
| | | | Preferred Shares | | 25,000 |
| | | | To record issue of 5,000 preferred shares for cash. | | |
| | d. | Aug. 1 | Cash | 1,000 | |
| | | | Common Shares | | 1,000 |
| | | | To record issue of 1,000 common shares for cash. | | |
| | e. | Dec. 15 | Land | 25,000 | |
| | | | Preferred Shares | | 25,000 |
| | | | To record issue of 500 preferred shares for land. | | |

2. Crystal Clear Electronics Inc.
Partial Statement of Financial Position
At December 31, 2019

Shareholders' Equity

Share capital (Note X)			
Preferred shares, 13,000 outstanding	\$65,000		
Common shares, 3,000 outstanding	3,000		
Total contributed capital			\$68,000
Retained earnings			
Net income	10,000		
Preferred dividends declared ¹	<u>(3,000)</u>		<u>7,000</u>
Total shareholders' equity			<u>\$75,000</u>

Note X

The share capital of Crystal Clear Electronics Inc. consists of an unlimited number of no-par value common shares and 20,000, 5%, no-par value, cumulative, non-voting preferred shares. Preferred shares take precedence when dividends are declared and upon repayment of capital.

¹ All the dividend was used to pay preferred shareholders.
 Pref. dividends in arrears = (3,000 + 5,000 + 5,000) shares x \$5 x 5%
 = \$3,250 – 3,000
 = \$250

Common shares represent one vote each at shareholders' meetings of Crystal Clear Electronics Inc.

During the year, 3,000 common shares with a stated value of \$1 per share were issued. This represented 100% of total common shares issued. 8,000 preferred shares with a stated value of \$5 per share were issued for cash. This represented 62%² of total preferred shares issued. 5,000 preferred shares with a stated value of \$5 per share were issued to acquire land for future operations. This represented 38% of total preferred shares issued.

At December 31, 2019 dividends on preferred shares were in arrears by \$250.

Reasonable alternate wording and information placement is acceptable. For instance, shares outstanding could be shown on the statement of changes in equity or disclosed in a note.

² $(8,000 + 5,000)/13,000 = 62\%$ (rounded)

P 11–2 continued

3.

Crystal Clear Electronics Inc.
Statement of Changes in Equity
For the Years Ended December 31, 2019 and 2020

	<i>Share capital</i>			<i>Ret. earn.</i>	<i>Total equity</i>
	<i>Preferred</i>	<i>Common</i>	<i>Total</i>		
Balance at January 1, 2019	\$ -0-	\$ -0-	\$ -0-	\$ -0-	\$ -0-
Shares issued during 2019					
Preferred – 13,000 shares	65,000		65,000		65,000
Common – 3,000 shares		3,000	3,000		3,000
Net income				10,000	10,000
Pref. share dividends declared				(3,000)	(3,000)
Balance at December 31, 2019	65,000	3,000	68,000	7,000	75,000
Net income				20,000	20,000
Pref. share dividends declared				(3,500)	(3,500)
Common share dividends declared				(500)	(500)
Balance at December 31, 2020					
Preferred – 13,000 shares	<u>\$65,000</u>				
Common – 6,000 shares		<u>\$3,000</u>			
Total			<u>\$68,000</u>	<u>\$23,000</u>	<u>\$91,000</u>

Alternate presentation formats are acceptable. For example, the ending shares issued and outstanding could be disclosed in a note. Information about the share split would also be disclosed in a note.

P 11–3

1.

Before Split		After Split
<i>Shareholders' Equity</i>		<i>Shareholders' Equity</i>
Common Shares		Common Shares
Authorized—5,000 Shares		Authorized—5,000 Shares
Issued and Outstanding — 1,000 shares	\$100,000	Issued and Outstanding — 5,000 shares
		\$100,000

2.

Common Shares		No. XXX		
<i>Date</i>	<i>Description</i>	<i>PR</i>	<i>Debit</i>	<i>Credit</i>
2019 April 15	Memorandum The issued shares were increased from 1,000 to 5,000 by a 5-for-1 share split.			

3. The market price per share would be \$8 (\$40/5). The share split should not have any effect on the overall value of the firm to investors. Therefore, if five times as many shares are now outstanding, each share should be worth 1/5 as much.

Gearing Gravel Limited
Statement of Changes in Equity
For the Year Ended December 31, 2019

	<i>Share capital</i>			<i>Ret. earn.</i>	<i>Other Treas. shares</i>	<i>Total equity</i>
	<i>Preferred</i>	<i>Common</i>	<i>Total</i>			
Balance at January 1, 2019	\$50,000	\$10,000	\$60,000	\$100,000		\$160,000
Shares issued		5,000	5,000			5,000
Net income				20,000		20,000
Shares reacquired and held in treasury					(1,000)	(1,000)
Cash dividends declared						
Preferred shares (\$50,000 x 5%)				(2,500)		(2,500)
Common shares				(500)		(500)
Balance at December 31, 2019	<u>\$50,000</u>	<u>\$15,000</u>	<u>\$65,000</u>	<u>\$117,000</u>	<u>\$(1,000)</u>	<u>\$181,000</u>

Note X

The authorized share capital of Gearing Gravel Limited consists of an unlimited number of common shares with a stated value of \$50 per share, and 1,000 5%, non-voting, non-cumulative preferred shares with a stated value of \$50 per share. Preferred shares take precedence when dividends are declared and upon repayment of capital. Common shares represent one vote at shareholders' meetings of Gearing Gravel Limited.

During the year, 100 common shares were issued for a stated value of \$50 per share. This represents 33%¹ of total common shares issued as of December 31, 2019. 20 common shares were reacquired during the year and held as treasury shares. This represents 7%² of total common shares issued as of December 31, 2019.

¹ 100/300 = 33% (rounded)

² 20/300 = 7% (rounded)

(Alternate presentation and disclosure formats are acceptable, providing that information contained in the note and statement of changes in equity shown here are disclosed in some fashion.)

P 11–5

	<i>Assets</i>	<i>Liabilities</i>	<i>Shareholders' Equity</i>
1. Common shares issued for cash	↑	x	↑
2. Declared a cash dividend	x	↑	↓
3. Common shares split 3:1	x	x	x
4. Calculated book value of common shares	x	x	x
5. Paid cash dividend related to item 2 above	↓	↑	x
6. Recorded restriction of retained earnings	x	x	x

P 11–6

1. a. Common Shares 4,000
Cash 4,000
To record reacquisition of 400 common shares at \$10.
- b. Memorandum
Split common shares 2–for–1; issued shares increased from 4,400 to 8,800 shares.
- c. Cash 600
Common Shares 600
To record issue of 200 common shares for cash.
- d. Income Summary 19,500
Retained Earnings 19,500
To close income summary.
- e. Retained Earnings 5,000
Retained Earnings—Restricted for Plant Expansion 5,000
To record restriction of retained earnings for plant expansion. (Complete only if Appendix 2 is covered.)

P 11–6 continued

2.

River Valley Produce Limited
Statement of Changes in Equity
For the Year Ended December 31, 2020

	<u>Share capital</u>		<u>Retained earnings</u>			<u>Other</u>	<u>Total equity</u>
	<i>Preferred shares</i>	<i>Common shares</i>	<i>Restricted for plant expansion</i>	<i>Un-restricted</i>	<i>Total</i>	<i>Treas. shares</i>	
Balance at Jan. 1, 2020	\$15,000	\$24,000	\$ -0-	\$40,000	\$40,000	\$ -0-	\$79,000
Shares reacquired and held in treasury						(4,000)	(4,000)
Common shares issued		600					600
Restriction for plant expansion			5,000	(5,000)			
Net income				19,500	19,500		19,500
Balance at Dec. 31, 2020	<u>\$15,000</u>	<u>\$24,600</u>	<u>\$5,000</u>	<u>\$54,500</u>	<u>\$59,500*</u>	<u>(4,000)</u>	<u>\$95,100</u>

*If appendix 2 is not covered, only the “Total” column of retained earnings applies. Also, there would be no row entitled, “Restriction for plant expansion”.

3. \$54,500 is available for distribution, the amount of unrestricted retained earnings at December 31, 2020 (see bolded amount above). If Appendix 2 is not covered, \$59,500 is available.

P 11–7

1. Stated value per common share = $\frac{\text{Dollar amount of shares issued}}{\text{Number of shares outstanding}}$
= $\$3,070/300 = \10.23 (rounded)

$$\text{Book value per common share} = \frac{\text{Total equity}}{\text{Number of shares outstanding}} \\ = \$3,570/300 = \$11.90$$

2. There is little relationship between market price and the book value of a share. Book value provides only a basis on which to compare two or more companies, or to compare a company’s market price per share. Market value is affected by investors’ perceptions of future earnings expectations of the company. Also some assets recorded at historical cost, such as land, may have appreciated in value. This appreciation would be reflected in the market value of the common shares, but not in the book value.

1.	2020			
	Feb. 15	Cash Dividends Declared	112	
		Dividends Payable—Preferred Shares		12
		Dividends Payable—Common Shares		100
	Apr. 1	Dividends Payable—Preferred Shares	12	
		Dividends Payable—Common Shares	100	
		Cash		112
	May 1	Share Dividends Declared	400	
		Share Dividends to be Issued		400
		(2,000 x 10% = 200 shares @ \$2 FMV)		
	Jun. 15	Share Dividends to be Issued	400	
		Common Shares		400
	Aug. 15	Cash Dividends Declared	122	
		Dividends Payable—Preferred Shares		12
		Dividends Payable—Common Shares		
		(2,200 x \$.05)		110
	Oct. 1	Dividends Payable—Preferred Shares	12	
		Dividends Payable—Common Shares	110	
		Cash		122
	Dec. 15	Share Dividends Declared	660	
		Share Dividends to be Issued		660
		(2,200 x 10% x \$3 = \$660)		
	31	Income Summary	1,400	
		Retained Earnings		1,400
	31	Retained Earnings	1,294	
		Share Dividends Declared		1,060
		Cash Dividends Declared		234

2.

TWR Contracting Inc.
Statement of Changes in Equity
For the Year Ended December 31, 2020

	<i>Share capital</i>			<i>Retained earnings</i>	<i>Total equity</i>
	<i>Preferred shares</i>	<i>Common shares</i>	<i>Total</i>		
Balance at Jan. 1, 2020	\$2,000	\$ 400	\$2,400	\$ 900	\$ 3,300
Net income				1,400	1,400
Dividends declared					
Cash				(234)	(234)
Common shares		1,060	1,060	(1,060)	
Balance at Dec. 31, 2020	<u>\$2,000</u>	<u>\$1,460</u>	<u>\$3,460</u>	<u>\$ 1,006</u>	<u>\$ 4,466</u>

1.	Cash dividends paid on December 31, 2020		\$25,000
	Cumulative and unpaid balance of dividends on preferred shares that was not declared per March 20 entry (50,000 x \$.20)		<u>(10,000)</u>
	Cash dividends paid on common shares		<u>\$15,000</u>
2.	2020		
Mar. 20	Cash Dividends Declared	10,000	
	Dividends Payable—Preferred Shares		10,000
Apr. 1	Dividends Payable—Preferred Shares	10,000	
	Cash		10,000
Jun. 15	Cash Dividends Declared	20,000	
	Dividends Payable—Common Shares		20,000
Jul. 10	Dividends Payable—Common Shares	20,000	
	Cash		20,000
Aug. 1	Cash	200,000	
	Common Shares		200,000
Dec. 15	Retained Earnings	20,000	
	Dividends Payable—Common Shares		20,000
Dec. 31	Cash Dividends Declared ¹	10,000	
	Dividends Payable – Common Shares	15,000	
	Cash		25,000
	Remaining cumulative dividends on preferred shares = 50,000 x \$.20 = \$10,000		

¹ No preferred share dividends were declared, but these are cumulative. \$10,000 remains to be paid per part 1 above. Therefore, the debit to record the preferred shares dividend goes directly against the Cash Dividends Declared general ledger account.

P 11–9 continued

3.

Apex Auto Corporation
Statement of Changes in Equity
For the Year Ended December 31, 2020
(‘000s)

	<i>Retained earnings</i>					
	<i>Common shares</i>	<i>Preferred shares</i>	<i>Restricted for plant expansion</i>	<i>Un- restricted</i>	<i>Total</i>	<i>Total equity</i>
Balance at Jan. 1, 2020	\$ 750	\$ 500	\$ 150	\$ 600	\$ 750	\$2,000
Common shares issued	200					200
Restriction for plant extension			75	(75)		
Net income				165	165	165
Dividends						
Preferred ¹				(20) ¹	(20)	(20)
Common ²				(40) ²	(40)	(40)
Balance at Dec. 31, 2020	<u>\$ 950</u>	<u>\$ 500</u>	<u>\$ 225</u>	<u>\$ 630</u>	<u>\$ 855*</u>	<u>\$2,305</u>

¹ March 20 dividends \$10,000
Dec. 31 cumulative dividends deemed paid 10,000
Total \$20,000

² June 15 dividends \$20,000
Dec. 15 dividends 20,000
Total \$40,000

*If appendix 2 is not covered, only the “Total” column of retained earnings applies. Also, there would be no row entitled, “Restriction for plant extension”.

CHAPTER TWELVE

Proprietorships and Partnerships

Concept Self-check

1. A proprietorship differs from a corporation because:
 - a. it is not a separate legal entity from the owner;
 - b. it is not taxed separately on its earnings; proprietorship earnings are included in income reported on a proprietor's personal income tax return.; and
 - c. it does not have limited liability; if an unincorporated business cannot pay its debts, creditors have claims on the personal assets of the owner.
2.

Dr.	Cash	XXX	
Cr.	Proprietor's Capital		XXX
3. The closing entries of a proprietorship do not require net income to be closed to Retained Earnings general ledger account. Rather, net income is closed to the Proprietor's Capital general ledger account. . There are no dividend payments in a proprietorship. Withdrawals by the proprietor are closed to the Proprietor's Capital account. All profits are credited to the Proprietor's Capital account.
4. A corporation's statement of financial position distinguishes between investments in the corporation (shares) and net income generated by the company less its dividends distributions (retained earnings). A proprietorship makes no such distinction. Since there is only one owner and no separate legal entity, there is no distinction made between contributions, earnings, and distributions of profit in a proprietorship.
5. A partnership is an unincorporated form of business organization in which the entity is owned by two or more persons. Five characteristics of a partnership are:
 - a. Limited life — if a partner is admitted, withdraws, or dies, the existing partnership is dissolved and the business continues under a new partnership agreement.
 - b. Unlimited liability — in general, each partner is personally liable for the debts that the partnership cannot pay. In the event that a partner cannot pay their share of partnership debts, the other partners can be called on to personally pay for such debts.
 - c. Mutual agency — each partner can make binding agreements not only on the partnership, but also on the other partners.

Concept Self-check continued

- d. Co-ownership of assets — all assets contributed to the partnership by individual partners are jointly owned by all partners.
 - e. Sharing of profits and losses — if the partnership agreement does not stipulate how profits and losses will be shared, all profits and losses are shared equally.
6. The advantages of a partnership are:
- a. The knowledge, skills, and financial resources of two or more persons can be combined.
 - b. Partnerships can be formed relatively easily and quickly.
 - c. A partnership can act promptly as a business enterprise in all matters. A corporation may be restricted in its actions on certain matters by its charter, by laws, or by statute.
 - d. Many of the formal government reports required of a corporation are not required of the partnership.
 - e. Income taxes are not levied against partnerships. The partners, however, report on their individual tax returns their share of partnership income.

The disadvantages of partnerships are:

- a. Liability is usually unlimited. Partners are liable for all debts of the partnership.
 - b. The life of the partnership is limited. Death, withdrawal, or admission of a partner; agreement to terminate; bankruptcy; and incapacity of a partner are all terminate a partnership.
 - c. The partnership is a mutual agency; that is, each partner may act in business matters as the agent of the partnership.
 - d. The ability of a partnership to raise funds may be limited.
7. To account for a partnership, two types of accounts are used. One is the capital account, where contributions and withdrawals by each partner are recorded, along with the share of profits and losses. The withdrawals account records distributions and is closed to the capital account at the end of each fiscal period. Each partner has their own capital and withdrawals account.

In a corporation, a general ledger account called Share Capital or Common Shares is used to record the amount of shares issued. A separate account called Retained Earnings records all net income, losses and distributions to shareholders.

Concept Self-check continued

8. Profits and losses are divided equally among partners if no agreement exists. Otherwise, several methods may be followed to allocate profits or losses. Formulas often consider three factors — a return to each partner based on relative levels of services rendered, a return on capital invested, and a further division of remaining profits and losses according to a fixed ratio.
9. Salary and interest allocations are included in the division of profits and losses because the time and effort contributed by individual partners to the business and the amount of contributed capital may differ among partners.
10. The statement of financial position of a partnership merely shows the ending capital balance of each partner. If many partners exist, a total capital amount is shown and the details of each partner's capital account appear in a statement of partners' capital.
11. A partner may be admitted to replace an existing partner. In this case, there is no change in the capital account balances. A new partner may be admitted by new contributions to the partnership. If the amount invested exceeds the amount of credit that the partner receives in the partnership, the excess is credited to the other partners as a bonus on the basis of the profit sharing agreement. The bonus may be paid in order to gain admission to the partnership.
12. An existing partner may withdraw by either selling their interest to a new partner or selling to the remaining partners. If the partner sells to a new partner, there is no change in the assets or capital of the partnership. Payment is a private transaction. If the partner sells to existing partners, the assets and equity of the partnership may change if the value of the partnership interest as agreed is different from the partnership interest as recorded in the accounting records. Also, an entry must be made to record the change and transfer the capital of the withdrawing partner to the remaining partners.
13. A deficiency is allocated to the other partners on the basis of the profit sharing agreement.

1. An adjusting entry is needed to reallocate personal income taxes:

Proprietor's Withdrawals	5,000	
Income Taxes Expense		5,000

The income statement would then appear as follows:

R. Black Proprietorship Income Statement For the Year Ended December 31, 2019	
Sales	\$166,000
Cost of goods sold	<u>100,000</u>
Gross profit	66,000
<i>Operating expenses</i>	
Rent	<u>24,000</u>
Net income	<u>\$42,000</u>

- 2.

R. Black Proprietorship Statement of Proprietor's Capital For the Year Ended December 31, 2019	
Balance at Jan. 1, 2019 (derived)	\$ -0-
Contributions	5,000
Net income	42,000
Withdrawals	<u>(12,000)</u>
Balance at Dec. 31, 2019	<u>\$ 35,000</u>

CP 12–1 continued

3.	<p style="text-align: center;">R. Black Proprietorship Statement of Financial Position At December 31, 2019</p>		
	<i>Assets</i>		
	<i>Current</i>		
	Cash		\$10,000
	Accounts receivable		20,000
	Inventory		30,000
	Total assets		<u>\$60,000</u>
	<i>Liabilities</i>		
	<i>Current</i>		
	Accounts payable		\$25,000
	<i>Proprietor's Capital</i>		
	R. Black, capital		<u>35,000</u>
	Total liabilities and proprietor's capital		<u>\$60,000</u>
4.	Sales	166,000	
	Cost of Goods Sold		100,000
	Rent Expense		24,000
	Income Summary		42,000
	Income Summary	42,000	
	R. Black, Capital		42,000
	R. Black, Capital	12,000	
	R. Black, Withdrawals		12,000

1.

R. Black Ltd.
Income Statement
For the Year Ended December 31, 2019

Sales	\$166,000
Cost of goods sold	<u>100,000</u>
Gross profit	66,000
<i>Operating expenses</i>	
Rent	<u>24,000</u>
Income before income taxes	42,000
Income taxes	<u>5,000</u>
Net income	<u><u>\$37,000</u></u>

2.

R. Black Ltd.
Statement of Changes in Equity
For the Year Ended December 31, 2019

	<i>Share capital</i>	<i>Retained earnings</i>	<i>Total</i>
Balance at Jan. 1, 2019	\$5,000	\$ -0-	\$ 5,000
Net income		37,000	37,000
Dividends		<u>(7,000)</u>	<u>(7,000)</u>
Balance at Dec. 31, 2019	<u>\$5,000</u>	<u>\$30,000</u>	<u>\$35,000</u>

3.

R. Black Ltd.
Statement of Financial Position
At December 31, 2019

		<i>Assets</i>
<i>Current</i>		
Cash		\$10,000
Accounts receivable		20,000
Inventory		<u>30,000</u>
Total assets		<u>\$60,000</u>
		<i>Liabilities</i>
<i>Current</i>		
Accounts payable		\$25,000
		<i>Shareholders' Equity</i>
Share capital		\$ 5,000
Retained earnings		<u>30,000</u>
Total liabilities and shareholders' equity		<u>\$60,000</u>

CP 12–2 continued

4.	Sales	166,000	
	Cost of Goods Sold		100,000
	Rent Expense		24,000
	Income Taxes Expense		5,000
	Income Summary		37,000
	Income Summary	37,000	
	Retained Earnings		37,000
	Income Summary	7,000	
	Dividends		7,000

CP 12–3

1.	G, Capital	30,000	
	I, Capital		30,000
	To record transfer of G's partnership interest to new partner I.		
2.	G, Capital (\$30,000 – 17,100)	12,900	
	H, Capital (\$10,000 – 17,100)		7,100
	I, Capital		3,800
	Cash		2,000
	To record payment of bonus to new partner I and reallocation of partnership interest as follows:		
	G, Capital	\$30,000	
	H, Capital	10,000	
	Bonus payment	<u>(2,000)</u>	
	Capital of new partnership	<u>\$38,000</u>	
	Allocated as:		
	G (45%)	\$17,100	
	H (45%)	17,100	
	I (10%)	<u>3,800</u>	
		<u>\$38,000</u>	

CP 12–3 continued

3.	Land	100,000	
	G, Capital (\$30,000 – 28,000)	2,000	
	H, Capital (\$10,000 – 7,000)	3,000	
	I, Capital		105,000

To record contribution of assets by new partner I and reallocation of partnership interest as follows:

G, Capital	\$30,000
H, Capital	10,000
I, Investment	<u>100,000</u>
Capital of new partnership	<u>\$140,000</u>

Allocated as:

G (20%)	\$28,000
H (5%)	7,000
I (75%)	<u>105,000</u>
	<u>\$140,000</u>

CP 12–4

1.	X, Capital	10,000	
	T, Capital		10,000

To record transfer of X's partnership interest to new partner T.

2.	X, Capital	10,000	
	Y, Capital		10,000

To record transfer of X's partnership interest to existing partner Y.

3.	X, Capital	10,000	
	Accounts Payable	2,000	
	Y, Capital		1,200
	Z, Capital		800
	Cash		5,000
	Inventory		5,000

To record dispersal of partnership net assets to withdrawing partner X and transfer of X's partnership interest to existing partners Y and Z.

CP 12-5

1.

Able, Brown, and Crown
Statement of Partnership Liquidation
For the Month Ending November 30, 2019

	<i>Cash</i>	<i>Other assets</i>	<i>Liabilities</i>	<i>Partners' capital</i>		
				<i>Able</i>	<i>Brown</i>	<i>Crown</i>
Balance, November 1, 2019	\$ 20,000	\$180,000	\$50,000	\$37,000	\$65,000	\$48,000
Sale of other assets and allocation of loss (\$80,000)	100,000	(180,000)		(32,000)	(32,000)	(16,000)
	<u>120,000</u>	<u>\$ -0-</u>	<u>50,000</u>	<u>5,000</u>	<u>33,000</u>	<u>32,000</u>
Payment of liabilities	(50,000)		(50,000)			
	<u>70,000</u>		<u>\$ -0-</u>			
Distribution of cash	(70,000)			(5,000)	(33,000)	(32,000)
Balance, November 30, 2019	\$ -0-			\$ -0-	\$ -0-	\$ -0-

2. a. Loss on Sale of Other Assets	80,000	
Cash	100,000	
Other Assets		180,000
To record sale of other assets for cash.		
b. Able, Capital	32,000	
Brown, Capital	32,000	
Crown, Capital	16,000	
Loss on Sale of Other Assets		80,000
To allocate loss on sale of other assets.		
c. Accounts Payable	50,000	
Cash		50,000
To record the payment of liabilities.		
d. Able, Capital	5,000	
Brown, Capital	33,000	
Crown, Capital	32,000	
Cash		70,000
To record payment of capital accounts.		

1.

B. White and C. Green Partnership
Income Statement
For the Year Ended December 31, 2019

Sales		\$322,000
Cost of goods sold		160,500
		<u>161,500</u>
Gross profit		161,500
<i>Operating expenses</i>		
Rent	36,000	
Advertising	27,200	
Delivery	9,600	
Office	12,800	
Utilities	23,300	108,900
	<u>23,300</u>	<u>108,900</u>
Net income		<u>\$ 52,600</u>

2.

B. White and C. Green Partnership
Statement of Partners' Capital
For the Year Ended December 31, 2019

	<i>White</i>	<i>Green</i>	<i>Total</i>
Balance at Jan. 1, 2019	\$20,000	\$10,000	\$ 30,000
Contributions	10,000	10,000	20,000
Net income	26,300	26,300	52,600
Withdrawals	(7,000)	(5,000)	(12,000)
Balance at Dec. 31, 2019	<u>\$49,300</u>	<u>\$41,300</u>	<u>\$ 90,600</u>

P 12–1 continued

3. B. White and C. Green Partnership
Statement of Financial Position
At December 31, 2019

<i>Assets</i>	
<i>Current</i>	
Cash	\$41,000
Accounts receivable	68,400
Inventory	27,000
Total assets	<u>\$136,400</u>
<i>Liabilities</i>	
<i>Current</i>	
Accounts payable	\$45,800
<i>Partners' Capital</i>	
B. White, capital	\$49,300
C. Green, capital	<u>41,300</u>
Total liabilities and partners' capital	<u>\$136,400</u>

4. Sales	322,000	
Cost of Goods Sold		160,500
Rent		36,000
Advertising		27,200
Delivery		9,600
Office		12,800
Utilities		23,300
Income Summary		52,600
Income Summary	52,600	
B. White, Capital		26,300
C. Green, Capital		26,300
B. White, Capital	7,000	
B. White, Withdrawals		7,000
C. Green, Capital	5,000	
C. Green, Withdrawals		5,000

P 12-2

1.

B. White Proprietorship	
Statement of Proprietor's Capital	
For the Year Ended December 31, 2019	
Balance at Jan. 1, 2019	\$ 30,000
Contributions	20,000
Net income	52,600
Withdrawals	(12,000)
Balance at Dec. 31, 2019	<u>\$ 90,600</u>

2.

BW and CG Ltd.			
Statement of Changes in Equity			
For the Year Ended December 31, 2019			
	<i>Share capital</i>	<i>Retained earnings</i>	<i>Total</i>
Balance at Jan. 1, 2019	\$200	\$29,800	\$ 30,000
Common shares issued	20,000		20,000
Net income		52,600	52,600
Dividends declared		(12,000)	(12,000)
Balance at Dec. 31, 2019	<u>\$20,200</u>	<u>\$70,400</u>	<u>\$ 90,600</u>

P 12-3

1.	Income Summary	52,600	
	B. White, Capital		32,875
	C. Green, Capital		19,725
	To allocate 2019 net income as follows:		
	White (\$52,600 x 5/8)	\$32,875	
	Green (\$52,600 x 3/8)	<u>19,725</u>	
		<u>\$52,600</u>	

P 12–3 continued

2.	Income Summary	52,600		
	B. White, Capital			37,760
	C. Green, Capital			14,840
	To allocate 2019 net income as follows:			
		<i>White</i>	<i>Green</i>	<i>Total</i>
	Profit to be allocated			\$52,600
	<i>Interest allocation:</i>			
	White: \$20,000 x 10%	\$ 2,000		
	Green: \$10,000x 10%		\$ 1,000	(3,000)
	Balance			<u>49,600</u>
	<i>Salary allocation:</i>	30,000	10,000	(40,000)
	Balance			<u>9,600</u>
	<i>Balance allocated in profit and loss sharing ratio:</i>			
	White: \$9,600 x 3/5	5,760		
	Green: \$9,600 x 2/5		3,840	(9,600)
	Balance			<u>\$ -0-</u>
	Total allocated to partners	<u>\$37,760</u>	<u>\$14,840</u>	

P 12–4

1.		<i>Bog</i>	<i>Cog</i>	<i>Fog</i>	<i>Total</i>
	Profit to be allocated				\$40,000
	<i>Interest allocation:</i>				
	Bog: \$60,000 x 10%	\$ 6,000			
	Cog: \$100,000x 10%		\$ 10,000		
	Fog: \$20,000 x 10%			\$ 2,000	
	Balance				<u>22,000</u>
	<i>Salary allocation:</i>	24,000	30,000	48,000	(102,000)
	Balance (deficit)				<u>(80,000)</u>
	<i>Balance allocated in profit and loss sharing ratio:</i>				
	Bog: (\$80,000) x 5/10	(40,000)			
	Cog: (\$80,000) x 3/10		(24,000)		
	Fog: (\$80,000 x 2/10			(16,000)	
	Balance				<u>\$ -0-</u>
	Total allocated to partners	<u>(\$10,000)</u>	<u>\$16,000</u>	<u>\$34,000</u>	

P 12–4 continued

2.	Income Summary	40,000	
	Bog, Capital	10,000	
	Cog, Capital		16,000
	Fog, Capital		34,000
	To record net income allocation to partners.		

P 12–5

1.		Profit and loss sharing plan		(a) Division with profit \$60,000		(b) Division with loss \$30,000	
				<i>Bo</i>	<i>Diddley</i>	<i>Bo</i>	<i>Diddley</i>
Plan A	Salary			\$15,000	\$ -0-	\$ 15,000	\$ -0-
	Balance			15,000 ¹	30,000 ²	(15,000)	(30,000)
	Totals			<u>\$30,000</u>	<u>\$30,000</u>	<u>\$ -0-</u>	<u>\$(30,000)</u>
Plan B	Salary			\$12,000	\$ -0-	\$ 12,000	\$ -0-
	Interest			4,000	8,000	4,000	8,000
	Balance			18,000	18,000	(27,000)	(27,000)
	Totals			<u>\$34,000</u>	<u>\$26,000</u>	<u>\$(11,000)</u>	<u>\$(19,000)</u>

¹ (\$60,000 – 15,000) x (\$50,000/150,000) = \$15,000

² (\$60,000 – 15,000) x (\$100,000/150,000) = \$30,000

2. Plan A produces less income variability for Bo compared to plan B and more variability for Diddley. If the allocation based on salary is reasonable (for example, Bo actually works more hours than Diddley), plan B is likely more equitable.

1.

Good, capital	\$30,000
Hood, capital	26,000
Food, capital	<u>19,000</u>
Existing capital	75,000
Investment by Mood	<u>15,000</u>
Capital of new partnership (a)	<u>\$90,000</u>
Mood's capital (a x 1/4)	<u>\$22,500</u>

The new partner's bonus is recorded as:

Cash	15,000	
Good, Capital	2,500	
Hood, Capital	2,500	
Food, Capital	2,500	
Mood, Capital		22,500

2.

Good, capital	\$ 30,000
Hood, capital	26,000
Food, capital	<u>19,000</u>
Existing capital	75,000
Investment by Mood	<u>45,000</u>
Capital of new partnership (a)	<u>\$120,000</u>
Mood's capital (a x 1/4)	<u>\$ 30,000</u>

The bonus to existing partners is recorded as:

Cash	45,000	
Good, Capital		5,000
Hood, Capital		5,000
Food, Capital		5,000
Mood, Capital		30,000

P 12-7

1.

A, B, and C
Statement of Partnership Liquidation
For the Month Ending March 31, 2019

	Cash	Other assets	Accounts payable	Partners' capital		
				A	B	C
Balance, March 1, 2019	\$ 10,000	\$125,000	\$ 10,000	\$ 25,000	\$ 37,500	\$ 62,500
Sale of other assets and	42,500	(125,000)	}			
Allocation of loss (\$82,500)				(27,500)	(27,500)	(27,500)
	<u>52,500</u>	<u>\$ -0-</u>	<u>10,000</u>	<u>(2,500)</u>	<u>10,000</u>	<u>35,000</u>
Payment of liabilities	<u>(10,000)</u>		<u>(10,000)</u>			
	42,500		<u><u>\$ -0-</u></u>			
Allocation of A's debit balance				2,500	(1,250)	(1,250)
				<u>-0-</u>	<u>8,750</u>	<u>33,750</u>
Distribution of cash	<u>(42,500)</u>				<u>(8,750)</u>	<u>(33,750)</u>
	\$ -0-			\$ -0-	\$ -0-	\$ -0-

- | | | |
|---|--------|---------|
| 2. a. Loss on Sale of Other Assets | 82,500 | |
| Cash | 42,500 | |
| Other Assets | | 125,000 |
| To record sale of other assets. | | |
| b. A, Capital | 27,500 | |
| B, Capital | 27,500 | |
| C, Capital | 27,500 | |
| Loss on Sale of Other Assets | | 82,500 |
| To record allocation of the loss on sale of other assets. | | |
| c. Accounts Payable | 10,000 | |
| Cash | | 10,000 |
| To record payment of liabilities. | | |
| d. B, Capital | 1,250 | |
| C, Capital | 1,250 | |
| A, Capital | | 2,500 |
| To record allocation of A's debit balance. | | |
| e. B, Capital | 8,750 | |
| C, Capital | 33,750 | |
| Cash | | 42,500 |
| To record payment of capital accounts. | | |

CHAPTER THIRTEEN

Financial Statement Analysis

Concept Self-check

1. Comparisons can be made using published industry statistics, statistics of previous years, statistics of leading competitors, trade magazines, or internally-developed ratios.
2. Liquidity is a corporation's ability to pay current liabilities as they become due. Being less liquid means creditors that have provided the corporation with goods and services on account, or with other forms of short-term borrowing, cannot be paid. Implications of being less liquid:

Creditors:

- a. Can refuse to provide further goods or services on account
- b. Can sue for payment
- c. Can put the corporation into receivership or bankruptcy
- d. Can refuse to lend additional cash
- e. Can demand repayment of all debts, including long-term debt.

Shareholders:

- a. May be unwilling to invest in additional share capital of the corporation
 - b. Risk the loss of their investments if the company becomes bankrupt
3. A corporation is becoming less liquid if it cannot pay current liabilities as they become due. The corporation may have large sums of capital tied up in inventory and therefore not enough cash available to pay liabilities as needed, for instance.
 4. Current ratio: Indicates how many current asset dollars exist to pay current liabilities

Acid-test ratio: Indicates whether or not the corporation is able to meet the immediate demands of creditors, without considering current assets tied up in inventory or prepaid expenses.

Accounts receivable collection period: Indicates the average time needed to collect receivables

Number of days of sales in inventory: Indicates how many days of sales can be made with inventory on hand

Revenue operating cycle: Indicates how long it is between the purchase of inventory and the subsequent collection of cash from sales of inventory.

Concept Self-check continued

5. a. Working capital is the difference between current assets and current liabilities.

The current ratio is computed by dividing current assets by current liabilities. It is one measure of whether or not the corporation is able to repay short-term creditors. The acid-test ratio, on the other hand, is a more severe test of liquidity. It is computed by dividing quick assets (cash, short-term investments, accounts receivable) by current liabilities.

- b. The current ratio is only a rough indication of how able an entity is to pay its current liabilities as they become due. The relative liquidity of components of current assets is not considered in the calculation of this ratio. The acid-test ratio is often used as a more severe test of liquidity.
6. The ability to pay short-term creditors as amounts become due depends on the liquidity of the current assets. If, for example, company X's current assets consist of cash and company Y's current assets consist of inventory, company Y will not be able to pay its creditors easily because of a lack of cash.
7. Taking too long to collect accounts receivable will reduce the amount of cash available to pay liabilities as they become due. The same is true if there is an over-investment in inventory.
8. An acceptable number of days to collect accounts receivable and to convert inventory to sales depends on several factors, including the industry in which the corporation does business and the state of the economy. Management judgement and experience are crucial. If accounts receivable are collected too slowly, or if credit is extended too liberally, debts may not be collected in a timely manner, or at all. If accounts receivable collections are too short, potential credit sales may be lost. Similarly, higher number of days of sales in inventory indicates that more cash is tied up in inventory. On the other hand, a lower number of days of sales in inventory may indicate that inventory levels are too low. Potential sales may be lost.
9. Advantages of decreasing number of days of sales in inventory might be that
- The amount of assets tied up in inventory is reduced
 - The dangers of obsolescence or deterioration are reduced
 - Less storage space is used for inventory, so that warehousing expenses are reduced.
 - Borrowings to purchase inventory and related interest expense can be reduced.

A disadvantage of decreasing number of days of sales in inventory is that merchandise can be reduced to the point where sales are lost.

Concept Self-check continued

10. The revenue operating cycle indicates the number of days that elapse between the purchase of inventory and the subsequent collection of cash after a sale is made. It is computed by adding the average number of days needed to turn over inventory and the average number of days needed to collect receivables. It is useful in evaluating liquidity because a comparison can be made of the number of days needed to complete the cycle and the number of days within which the payables are due. Management can determine how long it will take the corporation to reinvest in inventory with cash generated by the revenue operating cycle.
11.
 - a. Ratios that measure margins on sales:
 - i. Gross profit ratio: indicates the amount of revenue left to cover other expenses after deducting cost of goods sold. It is calculated by dividing gross profit by net sales.
 - ii. Operating profit ratio: indicates the amount of revenue left to cover interest and income taxes expenses after deducting cost of goods sold and operating expenses. It is calculated by dividing income from operations by net sales.
 - iii. Net profit ratio: Indicates the percentage of sales revenue left in the business after payment of operating expenses, interest, and income taxes. It is calculated by dividing net income by net sales.
 - b. Ratios that measure returns on statement of financial position items:
 - i. Sales to total assets ratio: Indicates the adequacy of sales in relation to the investment in capital assets. It is calculated by dividing net sales by average capital assets.
 - ii. Return on total assets ratio: Indicates how efficiently a company uses all of its statement of financial position assets to earn income from operations. It is calculated by dividing income from operations by average total assets.
 - iii. Return on shareholders' equity ratio: Indicates the amount of income that is generated by shareholders' proportion of total assets. It is calculated by dividing net income by average shareholders' equity.
12. Analysts and investors are concerned with the financial structure of a corporation because the higher the reliance on debt, the more substantial claim the creditors have against the assets of the corporation. The corporation is also more vulnerable to rises in interest rates and economic downturns, which in turn affects future earnings expectations.

Concept Self-check continued

13. Reliance on creditor financing can be positive, since financing a corporation by issuing additional shares results in a dilution of existing shareholders' control of the corporation. Also, creditor financing is beneficial to shareholders when the return is greater than the interest paid on the debt. However, interest has to be paid on the debt and, ultimately, the debt itself has to be repaid. Interest reduces the income of the corporation. If interest rates paid on debt are higher than the returns generated from the borrowed funds, net income is reduced. The corporation is more susceptible to economic downturns and interest rate increases as its reliance on debt grows.

14. *Short-term financing*

Advantages:

- a. Usually does not require interest payment to the creditors
- b. Easily obtained

Disadvantages:

- a. Payment is required within a short time
- b. More risky, because it has to be renewed more frequently

Long-term financing

Advantages:

- a. More secure, because renewal is infrequent
- b. Principal repayment not required for a long time

Disadvantages:

- a. Must pay interest, and legal documents are often signed to enforce this.
- b. More work to acquire (must present financial statements, may have to be audited)

15. a. Earnings per share: Indicates the amount of net income that has been earned on each common share. It is calculated by dividing (net income less preferred share dividends) by number of common shares outstanding.
- b. Price-earnings ratio: Indicates the reasonableness of the market price in relation to per-share earnings. It is calculated by dividing market price per share by earnings per share.
- c. Dividend yield: Indicates the short-term cash return that could be expected from an investment in a company's shares. It is calculated by dividing dividends declared by outstanding common shares.

Concept Self-check continued

16. Horizontal analysis is the comparison of the change in one item on financial statements (such as merchandise inventory) during two or more accounting periods. Vertical analysis is the analysis of the composition of a financial statement by restating all items in that statement as percentages of a total. Generally sales is used as the income statement base and total assets (or total liabilities and shareholders' equity) is used as the statement of financial position base. Comparing the percentages of a particular item between two or more years shows the change in composition of the statement components.

17. The Scott formula is calculated as follows:

$$\begin{array}{c}
 \text{Return on operating capital} \\
 \left[\frac{\text{(1) Income from operations (after tax)}}{\text{Net sales}} \times \frac{\text{(2) Net sales}}{\text{Operating capital}} \right] + \left[\frac{\text{(3) (ROC - Interest rate)}}{\text{Shareholders' equity}} \times \frac{\text{(4) Net financial debt}}{\text{Shareholders' equity}} \right] = \frac{\text{Return on shareholders' equity}}{\text{(5) Net income}}
 \end{array}$$

The formula separates ROSE into two components: return on operating capital (ROC) and return on leveraging (ROL). ROC can be further analysed as the product of the after-tax return on operating income x sales to operating capital ratio. ROL can be further analysed as (ROC – after-tax interest rate) x debt to shareholders' equity ratio. The after-tax interest rate is calculated as [interest expense x (1- income tax rate)]/net financial debt.

CP 13–1

<u>l</u>	Acid–test ratio
<u>f</u>	Current ratio
<u>k</u>	Return on shareholders' equity
<u>a</u>	Times interest earned
<u>c</u>	Earnings per share
<u>m</u>	Accounts receivable collection period
<u>d</u>	Sales to total assets
<u>j</u>	Dividend yield
<u>e</u>	Price–to–earnings ratio
<u>g</u>	Number of days of sales in inventory
<u>b</u>	Debt to shareholders' equity ratio
<u>h</u>	Net profit ratio
<u>m</u>	Accounts receivable collection period
<u>i</u>	Return on total assets

1. Current ratio = $\frac{\text{Current assets}}{\text{Current liabilities}}$

The current ratio indicates how many dollars of current assets exist to pay a dollar of current liabilities. A ratio of 2 to 1 is often appropriate but this depends on the type of industry.

2019: $(\$10 + 35 + 200 + 600)/745 = \1.13 to 1

2018: $(\$15 + 35 + 150 + 400)/580 = \1.03 to 1

2. Acid–test ratio = $\frac{\text{Quick assets}}{\text{Current liabilities}}$

The acid–test ratio indicates how many dollars of current assets excluding inventory and prepaid expenses exist to pay a dollar of current liabilities. A ratio of at least 1 to 1 is often appropriate but this depends on the type of industry.

2019: $(\$10 + 35 + 200)/745 = \$.33$ to 1

2018: $(\$15 + 35 + 150)/580 = \$.34$ to 1

3. Both the current and acid-test ratios are below the suggested guidelines. The company's continuing low acid-test ratio in particular suggests that it will likely have problems meeting its liabilities as they become due, and that the company may be at risk of bankruptcy.

4.

	2019	2018
<i>Working capital from operations</i>		
Accounts receivable	\$200	\$150
Inventory	600	400
Less: Accounts payable	(500)	(400)
	<u>\$300</u>	<u>\$150</u>
<i>Net financial debt</i>		
Borrowings	\$245	\$180
Less: Cash	(10)	(15)
Short-term investments	(35)	(35)
	<u>\$200</u>	<u>\$130</u>

CP 13–3

$$\text{Gross profit ratio} = \frac{\text{Gross profit}}{\text{Net sales}}$$

$$2019: \$63/252 = 25\%$$

$$2018: \$48/141 = 34\%$$

$$2017: \$54/120 = 45\%$$

$$\text{Net profit ratio} = \frac{\text{Net income}}{\text{Net sales}}$$

$$2019: \$12/252 = 4.7\%$$

$$2018: \$5/141 = 3.6\%$$

$$2017: \$15/120 = 12.5\%$$

This company has a decreasing gross profit ratio. This significantly affects net income and the net profit ratio. Net income and the net profit ratio dipped significantly in 2018, but both have rebounded somewhat in 2019. The company may be facing significant competition in recent years; hence the overall decline in the gross profit and net profit ratios.

CP 13–4

$$\text{Price-earnings ratio} = \frac{\text{Market price per share}}{\text{Earnings per share}}$$

This ratio indicates the stock market's expectations of profitability for the company. A higher P/E ratio indicates that the market expects the company to be profitable despite relatively lower net income at present. On this basis, company C is preferred.

$$\text{A: } \$35/11 = 3.2$$

$$\text{B: } \$40/5 = 8$$

$$\text{C: } \$90/10 = 9$$

$$\text{Dividend yield} = \frac{\text{Dividends per share}}{\text{Market price per share}}$$

This ratio indicates what short-term cash return shareholders might expect on their investment in common shares of the company.

$$\text{A: } 0$$

$$\text{B: } \$4/40 = 10$$

$$\text{C: } \$6/90 = 6.7$$

The stock market indicates that company C is expected to be relatively more profitable than A or B in the future. However, if dividend yield is important to the shareholder, then company B should be chosen. On either basis, company A does not appear to be a good investment.

CP 13–5

	2019 (a)	2018 (b)	Change	
			Amount (a – b)	Percentage (a – b)/b
Sales	\$2,520	\$1,440	\$ +1,080	+75%
Cost of goods sold	<u>1,890</u>	<u>960</u>	+930	+96.9%
Gross profit	\$630	\$480	+150	+31.3%
Operating expenses	<u>510</u>	<u>430</u>	+80	+18.6%
Net income	<u>\$ 120</u>	<u>\$ 50</u>	+70	+140%

Although sales have increased, cost of goods sold has increased at a faster pace. However, operating expenses have increased at a slower pace, resulting in a substantially higher net income.

CP 13–6

Transaction	Ratio	Effect on ratio		
		Inc.	Dec.	No change
Declared a cash dividend	Current ratio		X	
Wrote-off an uncollectible account receivable	Accounts receivable collection period	X		
Purchased inventory on account	Acid–test ratio		X	
Issued 10–year bonds to acquire capital assets	Return on total assets		X	
Issued additional shares for cash	Debt to shareholders’ equity ratio		X	
Declared a share dividend on common shares	Earnings per share			X
Restricted part of retained earnings	Return on shareholders’ equity			X
Purchased supplies on account	Current ratio		X	
Paid a short–term creditor in full	Acid–test ratio	X		
Paid an account payable, taking the cash discount	Number of days sales in inventory			X

- 1.a. Return on total assets

$$= \frac{\text{Income from operations}}{\text{Average total assets}}$$

$$= (\$36/220)$$

$$= 16.4\%$$
- b. Return on shareholders' equity

$$= \frac{\text{Net income}}{\text{Average shareholders' equity}}$$

$$= \$20/(80 + 60)$$

$$= 14.3\%$$
- c. Times interest earned ratio

$$= \frac{\text{Income from operations}}{\text{Interest expense}}$$

$$= \$36/6$$

$$= 6 \text{ times}$$
- d. Earnings per share

$$= \frac{\text{Net income}}{\text{Number of common shares outstanding}}$$

$$= \$20/8 \text{ shares}$$

$$= \$2.50$$
- e. Number of days of sales in inventory

$$= \frac{\text{Average inventory}}{\text{Cost of goods sold}} \times 365 \text{ days}$$

$$= \$40/50 \times 365 \text{ days}$$

$$= 292 \text{ days}$$
- f. Accounts receivable collection period

$$= \frac{\text{Accounts receivable}}{\text{Net credit sales}} \times 365 \text{ days}$$

$$= \$20/100 \times 365 \text{ days}$$

$$= 73 \text{ days}$$
- g. Sales to total assets ratio

$$= \frac{\text{Net sales}}{\text{Average total assets}}$$

$$= \$100/220$$

$$= 45\%$$
- h. Current ratio

$$= \frac{\text{Current assets}}{\text{Current liabilities}}$$

$$= (\$20 + 20 + 40)/20$$

$$= 4:1$$

CP 13–7 continued

i. Acid-test ratio

$$= \frac{\text{Quick assets}}{\text{Current liabilities}}$$

$$= (\$20 + 20)/20$$

$$= 2:1$$

j. Debt to shareholders' equity ratio

$$= \frac{\text{Total liabilities}}{\text{Shareholders' equity}}$$

$$= \$ (20 + 60)/140$$

$$= .57:1$$

2. The following ratios are measures of liquidity:

- e. Number of days of sales in inventory
- f. Accounts receivable collection period
- h. Current ratio
- i. Acid–test ratio

3.

Statement of Financial Position			
<i>Operating Capital</i>			
<i>Working capital from operations</i>			
Accounts receivable		\$ 20	
Merchandise inventory		40	
Less: Accounts payable		<u>(20)</u>	
		40	
Plant, at carrying amount		<u>140</u>	
Operating capital		<u>\$180</u>	
<i>Net Financial Debt</i>			
Borrowings	\$ 60		
Less: Cash	<u>(20)</u>	40	
<i>Shareholders' Equity</i>			
Common shares	80		
Retained earnings	<u>60</u>	<u>140</u>	
Financial capital		<u>\$180</u>	

CP 13–7 continued

Income Statement	
Sales	\$100
Cost of goods sold	50
Gross profit	50
Operating expenses	14
Income from operations	36
Less: Income taxes	(12)
Income from operations, after-tax	24
Interest	6
Less: Income tax savings	(2)
Net interest expense	4
Net income	<u>\$20</u>

4. Scott formula

$$\begin{array}{rcccl}
 \text{Return on operating capital} & + & \text{Return on leveraging} & = & \text{Return on shareholders' equity} \\
 (1) & & (2) & & (3) & (4) & (5) \\
 \left[\frac{\$24}{100} \times \frac{\$100}{180} \right] + \left[\left(\frac{\$24}{180} - \frac{\$4}{40} \right) \times \frac{\$40}{140} \right] & = & \frac{\$20}{140} \\
 = [24\% \times .6] + [3.3\% \times .3] & = & 14.3\% \\
 = \mathbf{13.3\%} + \mathbf{1.0\%} & = & \mathbf{14.3\%}
 \end{array}$$

1. Current ratio

$$= \frac{\text{Current assets}}{\text{Current liabilities}}$$

$$= \frac{\text{Cash} + \text{accounts receivable} + \text{inventory} + \text{prepaid expenses}}{\text{Current liabilities}}$$

$$= (\$72 + 88 + 100 + 40)/60$$

$$= \$300/60$$

$$= 5:1$$
2. Return on total assets

$$= \frac{\text{Income from operations}}{\text{Average total assets}}$$

$$= \$46/620$$

$$= 7.4\%$$
1. Sales to total assets ratio

$$= \frac{\text{Net sales}}{\text{Average total assets}}$$

$$= \$240/620$$

$$= 38.7\%$$
4. Acid-test ratio

$$= \frac{\text{Quick assets}}{\text{Current liabilities}}$$

$$= \frac{\text{Cash} + \text{accounts receivable}}{\text{Current liabilities}}$$

$$= (\$72 + 88)/60$$

$$= 2.7:1$$
5. Times interest earned ratio

$$= \frac{\text{Income from operations}}{\text{Interest expense}}$$

$$= \$46/8$$

$$= 5.75:1$$
6. Earnings per common share

$$= \frac{\text{Net income} - \text{preferred share dividends}}{\text{Number of common shares outstanding}}$$

$$= [\$20 - (\$60 \times 10\%)]/10 \text{ shares}$$

$$= \$1.40 \text{ per share}$$

CP 13–8 continued

$$\begin{aligned}
 7. \quad & \text{Accounts receivable collection period} \\
 &= \frac{\text{Average accounts receivable} \times 365 \text{ days}}{\text{Net credit sales}} \\
 &= \$88 / (80\% \times \$240) \times 365 \text{ days} \\
 &= 167 \text{ days}
 \end{aligned}$$

$$\begin{aligned}
 8. \quad & \text{Return on shareholders' equity} \\
 &= \frac{\text{Net income}}{\text{Shareholders' equity}} \\
 &= \frac{\text{Net income}}{\text{Preferred shares} + \text{common shares} + \text{retained earnings}} \\
 &= \$20 / (60 + 250 + 100) \\
 &= 4.9\%
 \end{aligned}$$

9. Scott formula

<i>Return on operating capital</i>	+	<i>Return on leveraging</i>	=	<i>Return on shareholders' equity</i>
(1)		(2)		(3)
$\left[\frac{24^1}{240} \right]$	x	$\frac{\$240}{488^2}$	+	$\left[\left[\frac{\$24}{488} - \frac{\$4^3}{78^4} \right] \times \frac{\$78}{410^5} \right]$
=	[10%	x	.49
]	+	[(0%)
]	x	.2]
=		4.9%	+	0%
				=
				4.9%

$$^1 \$46 \times (1 - .473^*) = \$24$$

$$^2 \$620 - 72 - 60 = \$488$$

$$^3 \$8 \times (1 - .473) = \$4$$

$$^4 \$150 - 72 = \$78$$

$$^5 \$60 + 250 + 100 = \$410$$

$$^* \text{income tax rate: } \$18 / \$38 = 47.3\%$$

1. Current assets + capital assets = Total liabilities + shareholders' equity
 Current assets + \$90 = \$40 + 140
 Current assets = \$90
 Current ratio = $\frac{\text{Current assets}}{\text{Current liabilities}}$
 2.5 = \$90 / Current liabilities
 Current liabilities = \$36

2. Per above: Current assets = \$90; current liabilities = \$36
 Acid-test Ratio = $\frac{\text{Quick current assets}}{\text{Current liabilities}}$
 Since the Acid-test Ratio is 1:1,

$$\text{Inventory} = \frac{\$90 - \text{inventory} + 0}{\$36}$$
 Inventory = \$90 – 36
 Inventory = \$54

3. Accounts receivable = Quick current assets – (cash + short-term investments)
 \$36 – 6 = 30
 Accounts rec. collection period = $\frac{\text{Average accounts receivable} \times 365 \text{ days}}{\text{Net credit sales}}$
 = \$30 / 300 x 365 days
 = 37 days

4. If gross profit is 30 per cent of sales, the cost of goods sold is 70 per cent of sales (70% x \$420 = \$294). Per above, inventory = \$54
 Number of days of sales in inventory = $\frac{\text{Average inventory} \times 365 \text{ days}}{\text{Net credit sales}}$
 = \$54 / 294 x 365 days
 = 12 days

5. Revenue operating cycle = Accounts receivable collection period + number of days of sales in inventory
 = 37 + 12 = 49 days

6. Net financial debt = Bank loan (current liabilities) – (cash and short-term investments)
 = \$36 (see above) – 6
 = \$30

1.

		<i>Effect on current ratio</i>		
<i>Transaction</i>		<i>Inc.</i>	<i>Dec.</i>	<i>No change</i>
a.	Bought \$20,000 of merchandise on account (the company uses a perpetual inventory system)		X	
b.	Sold for \$10,000 cash, merchandise that cost \$5,000	X		
c.	Collected a \$2,500 account receivable			X
d.	Paid a \$10,000 account payable	X		
e.	Wrote off a \$1,500 bad debt against the allowance for doubtful accounts			X*
f.	Declared a \$1 per-share cash dividend on the 10,000 outstanding common shares		X	
g.	Paid the dividend declared above	X		
h.	Borrowed \$10,000 from a bank by assuming a 60-day, 10 per cent loan		X	
i.	Borrowed \$25,000 from a bank by placing a 10-year mortgage on the plant	X		
j.	Used the \$25,000 proceeds of the mortgage to buy additional machinery		X	

* the journal entry is Dr. Allowance for Doubtful Accounts; Cr. Accounts Receivable

2. At the end of May,

a. The current ratio was 2.15 to 1, calculated as follows:

		<i>May 1 Bal.</i>	<i>(a)</i>	<i>(b)</i>	<i>(c)</i>	<i>(d)</i>	<i>(e)</i>	<i>(f)</i>	<i>(g)</i>	<i>(h)</i>	<i>(i)</i>	<i>(j)</i>	<i>May 31 Bal.</i>
Current assets (given)	x	\$200	+20	+10	+2.5	−10	+1.5	−	−10	+10	+25	−25	215
				−5	−2.5		−1.5						
Current liabilities (derived)	y	\$80	+20	−	−	−10	−	+10	−10	+10	−	−	100
Current ratio	x/y	<u>2.5</u>											<u>2.15</u>

CP 13–10 continued

b. The acid–test ratio was 1 to 1 calculated as follows:

		<i>May 1 Bal.</i>	<i>(a)</i>	<i>(b)</i>	<i>(c)</i>	<i>(d)</i>	<i>(e)</i>	<i>(f)</i>	<i>(g)</i>	<i>(h)</i>	<i>(i)</i>	<i>(j)</i>	<i>May 31 Bal.</i>
Quick assets (derived)	x	\$100	–	+10	+2.5 –2.5	–10	+1.5 –1.5	–	–10	+10	+25	–25	100
Current liabilities (see above)	y	\$80	+20	–	–	–10	–	+10	–10	+10	–	–	100
Acid-test ratio	x/y	<u>1.25</u>											<u>1.0</u>

P 13–1

1. a. Current ratio

$$= \frac{\text{Current assets}}{\text{Current liabilities}}$$

$$= \$850/400$$

$$= 2.13:1$$

b. Acid-test ratio

$$= \frac{\text{Quick assets}}{\text{Current liabilities}}$$

$$= \$300/400$$

$$= .75:1$$

c. Debt to shareholders' equity ratio

$$= \frac{\text{Total liabilities}}{\text{Shareholders' equity}}$$

$$= \$1,200/(500 + 50)$$

$$= 1.85:1$$
2. Mammoth Corporation could be considered a poor risk for a potential lender. While the current ratio is acceptable, the acid–test ratio is less than 1. There do not appear to be enough liquid assets (\$100) to cover short–term liabilities (\$400).

The total debt is high in relation to total shareholders' equity, which means that outside creditors are providing most of the financing of Mammoth; it may be difficult to obtain further debt financing.
3. A full set of financial statements including notes would help, as well as past years' ratios and industry averages. Stock market information and investors' analyses would also be useful, as well as other qualitative information like management discussion and analysis often contained in the companies' annual reports.

1. a. Current ratio

$$= \frac{\text{Current assets}}{\text{Current liabilities}}$$

$$= \frac{\text{Cash} + \text{accounts receivable} + \text{inventory} + \text{prepaid expenses}}{\text{Accounts payable} + \text{notes payable} + \text{current portion of borrowings}}$$

$$= (\$60 + 140 + 250 + 10) / (100 + 20 + 60)$$

$$= \$460 / 180$$

$$= 2.6:1$$
- b. Acid-test ratio

$$= \frac{\text{Quick assets}}{\text{Current liabilities}}$$

$$= \frac{\text{Cash} + \text{accounts receivable}}{\text{Accounts payable} + \text{notes payable} + \text{current portion of borrowings}}$$

$$= (\$60 + 140) / 180$$

$$= \$200 / 180$$

$$= 1.1:1$$
- c. Accounts receivable collection period

$$= \frac{\text{Average accounts receivable} \times 365 \text{ days}}{\text{Net credit sales}}$$

Average accounts receivable

$$= (\$140 + 180) / 2$$

$$= \$160$$

Accounts receivable collection period

$$= \$160 / 800 \times 365 \text{ days}$$

$$= 73 \text{ days}$$
- d. Number of days of sales in inventory

$$= \frac{\text{Average inventory} \times 365 \text{ days}}{\text{Cost of goods sold}}$$

$$= [(\$200 + 250) / 2] / 600 \times 365 \text{ days}$$

$$= \$24 \text{ days}$$
- e. Debt to shareholders' equity ratio

$$= \frac{\text{Total liabilities}}{\text{Shareholders' equity}}$$

$$= \frac{\text{Current liabilities} + \text{borrowings}}{\text{Common shares} + \text{preferred shares} + \text{retained earnings}}$$

$$= (\$180 + 140) / (250 + 120 + 100)$$

$$= \$320 / 470$$

$$= .68:1$$

P 13–2 continued

f. Return on shareholders' equity

$$= \frac{\text{Net income}}{\text{Average shareholders' equity}}$$

Average shareholders' equity

$$= [(\$120 + 250 + 100) + (120 + 250 + 80)]/2$$

$$= \$460$$

Return on shareholders' equity

$$= \$50/460$$

$$= 10.9\%$$

g. Earnings per share

$$= \frac{\text{Net income} - \text{preferred share dividends}}{\text{Number of common shares outstanding}}$$

Preferred share dividends

$$= \$120 \times 10\%$$

$$= \$12$$

Earnings per share

$$= (\$50 - 12)/50$$

$$= \$0.76 \text{ per share}$$

2. Dividends paid on common shares = \$18, calculated as follows:

Retained Earnings

	80	Opening balance (Jan. 1, 2019, given)
	50	Net income 2019
12		Preferred share dividend (1g above)
18		Common share dividend (to balance)
	<u>100</u>	Closing balance (Dec. 31, 2019, given)

3. The debt to shareholders' equity ratio shows that Epicentre has \$.68 of debt financing for each \$1 of shareholders' equity. Creditors may prefer this greater emphasis on shareholders' equity financing. Both the current ratio and the acid-test ratio tell us that Epicentre is not threatened with insolvency, given the high ratios. Again, creditors may like this. Epicentre takes 73 days to collect the average account receivable. This rate seems a little slow, but it depends on the credit terms offered to customers. The number of days sales in inventory is 24, which seems very low. However, the company may operate in an unusual industry. Epicentre's return on shareholders' equity seems adequate at 10.9 per cent. Earnings per share and dividends need to be evaluated in conjunction with the market price of common shares, but overall Epicentre seems to be a good investment for creditors and shareholders. As always, more information would be useful, particularly prior years' ratios and industry averages.

4.

Epicentre Corporation
Statement of Financial Position
At December 31, 2019

<i>Operating Capital</i>		
<i>Working capital from operations</i>		
Accounts receivable		\$140
Merchandise inventory		250
Prepaid expenses		10
Less: Accounts payable		<u>(100)</u>
		300
Capital Assets, net		<u>330</u>
Operating capital		<u><u>\$630</u></u>
<i>Net Financial Debt</i>		
Notes payable	\$ 20	
Borrowings (\$140 + 60)	200	
Less: Cash	<u>(60)</u>	160
<i>Shareholders' Equity</i>		
Preferred shares	120	
Common shares	250	
Retained earnings	<u>100</u>	<u>470</u>
Financial capital		<u><u>\$630</u></u>

Epicentre Corporation
Income Statement
For the Year Ended December 31, 2019

Sales		\$800
Cost of goods sold		<u>600</u>
Gross profit		200
Selling and administrative expenses		<u>100</u>
Income from operations		100
Less: Income taxes*		<u>(38)</u>
Income from operations, after-tax		62
Interest	\$20	
Less: Income tax savings	<u>(8)</u>	
Net interest expense		<u>12</u>
Net income		<u><u>\$50</u></u>

*\$30/80 = 37.5%; \$100 x 37.5% = \$38 (rounded)

P 13–2 continued

5. Scott Formula

$$\begin{array}{rcccl}
 \text{Return on operating capital} & + & \text{Return on leveraging} & = & \text{Return on} \\
 \text{(1)} & & \text{(3)} & & \text{shareholders'} \\
 & & & & \text{equity} \\
 & & & & \text{(5)} \\
 \left[\frac{\$62}{800} \times \frac{\$800}{630} \right] + \left[\left[\frac{\$62}{630} - \frac{\$12}{160} \right] \times \frac{\$160}{470} \right] & = & \frac{\$50}{470} \\
 = [7.8\% \times 1.3] + [2.3\% \times .34] & = & 10.6\% \\
 = 9.8\% + .8\% & = & 10.6\%
 \end{array}$$

Epicentre earns almost its entire ROSE from ROC (9.8/10.6). ROL is only .8%. Since the difference between ROC and the cost of borrowing is relatively healthy (2.3%), the company could consider borrowing more funds and paying off preferred shares if their dividend rate is higher than the after-tax interest rate (\$12/160 or 7.5%). As always, prior years' information and other indicators (e.g., P/E ratio) would help the analysis.

P 13–3

Belafonte Corporation
Statement of Financial Position
At April 30, 2019

<i>Assets</i>		<i>Liabilities and Shareholders' Equity</i>	
Cash	\$ 2,000 (c)	Accounts payable	\$ 8,000 (f)
Accounts receivable	8,000 (a)	Bonds payable	20,000 (b)
Merchandise inventories	<u>20,000</u> (b)	Common shares	15,000 (g)
Total current assets	30,000 (d)	Retained earnings	7,000 (i)
Capital assets, net	20,000 (b)		
		Total liabilities and	
Total assets	<u>\$50,000</u> (e)	shareholders' equity	<u>\$50,000</u> (h)

Information:

- (1) Current assets = 3.75 x Current liabilities (accounts payable)
- (2) Sales for year = \$73,000
- (3) Merchandise inventories = \$20,000 = Capital assets = bonds payable
- (4) Accounts receivable collection period = 40 days
Average accounts receivable x 365 days
Net credit sales
- (5) Bonds payable = 10 x cash
- (6) Total current assets = 2 x common shares.

P 13–3 continued

Calculations:

- (a) $\frac{\text{Average accounts receivable} \times 365 \text{ days}}{\$73,000} = 40 \text{ days}$
Average accounts receivable = \$8,000
- (b) Merchandise inventory, capital assets (net), and bonds payable each equal \$20,000
- (c) Cash = bonds payable/10 = \$20,000/10 = \$2,000
- (d) Total current assets = \$2,000 + 8,000 + 20,000 = \$30,000
- (e) Total assets = \$20,000 + 30,000 = \$50,000
- (f) Accounts payable = Current assets/3.75 = \$30,000/3.75 = \$8,000
- (g) Common shares = Current assets/2 = \$30,000/2 = \$15,000
- (h) Total liabilities and shareholders' equity must equal total assets
- (i) Retained earnings = Total liabilities and shareholders' equity – accounts payable – bonds payable – common shares
= \$50,000 – 8,000 – 20,000 – \$15,000 = \$7,000

P 13–4

1.

Escalade Corporation
Vertical Analysis of the Income Statement
For the Years Ending December 31, 2018–2020

	<i>Common-size percentages</i>		
	<i>2020</i>	<i>2019</i>	<i>2018</i>
Sales	100.0	100.0	100.0
Cost of goods sold	<u>76.0</u>	<u>66.7</u>	<u>50.0</u>
Gross profit	24.0	33.3	50.0
Other expenses	<u>14.0</u>	<u>22.7</u>	<u>29.2</u>
Net income	<u>10.0</u>	<u>10.6</u>	<u>20.8</u>

2. Escalade's gross profit ratio has significantly declined over the past three years. This could be owing to the initial inefficiency of a larger plant or because of selling an increased number of units at a greatly reduced price to obtain a larger share of the market. At any rate, the reasons for this decline should be investigated further. Since other expenses have not increased proportionately, perhaps more money could be put into sales promotion to increase the number of units sold.

Hook Limited
Statement of Financial Position
At December 31, 2019

Assets

Current			
Cash		\$ 30,000	
Accounts receivable		150,000	(3)
Merchandise inventories		<u>90,000</u>	(4)
Total current assets		270,000	(2)
Property, plant, and equipment	442,500	(10)	
Less: Accumulated depreciation	<u>100,000</u>	<u>342,500</u>	(9)
Total assets		<u>\$612,500</u>	(8)

Liabilities

Current			
Accounts payable	\$ 50,000		
Accrued liabilities	<u>70,000</u>	(1)	
Total current liabilities		120,000	
Non-current			
8% Bonds payable		<u>125,000</u>	(6)
		245,000	

Shareholders' Equity

Common shares	80,000	(5)	
Retained earnings	<u>287,500</u>	(12)	<u>367,500</u>
Total liabilities and shareholders' equity			<u>\$612,500</u> (11)

Calculations:

- (1) Accrued liabilities = \$120,000 – 50,000 = \$70,000
(Total current liabilities – accounts payable)
- (2) Total current assets = \$120,000 + 150,000 = \$270,000
(Total current liabilities + working capital)
- (3) Accounts receivable = (\$120,000 x 1.5) – 30,000 = \$150,000
[(Total current liabilities x acid-test ratio) – cash]
- (4) Inventories = \$270,000 – 150,000 – 30,000 = \$90,000
(Total current assets – accounts receivable – cash)
- (5) Net income = [\$80,000 – (80,000/8)] – \$30,000 = \$40,000
[Income before interest and income taxes – (income before interest and income taxes/Times interest earned) – income taxes]

Therefore, common shares = \$40,000/5 x \$10 = \$80,000
(Net income/Earnings per share) x issued value

P 13–5 continued

- (6) Bonds payable = $\$80,000/8$ divided by $0.08\% = \$125,000$
[Income before interest and income taxes/Times interest earned]/Interest rate]
- (7) If the ratio of shareholders' equity to total assets is 0.60 to 1, then the ratio of liabilities to total assets is 0.40 to 1.
- (8) Total assets = $(\$120,000 + 125,000)/0.4 = \$612,500$
[(Total current liabilities + total non-current liabilities)/Total debt to total assets ratio]
- (9) Net PPE = $\$612,500 - 270,000 = \$342,500$
(Total assets – current assets)
- (10) PPE = $\$342,500 + 100,000 = \$442,500$
(Net PPE + accumulated depreciation)
- (11) Total liabilities and shareholders' equity = Total assets = $\$612,500$.
- (12) Retained earnings = $\$612,500 - 245,000 - 80,000 = \$287,500$
(Total liabilities and shareholders' equity – total liabilities – common shares)

CHAPTER FOURTEEN

The Statement of Cash Flows

Concept Self-check

1. A statement of cash flows (SCF) provides external readers of a corporation's financial statements with a summary of the cash transactions that took place in the company in a particular period. For example, a reader could determine the amount of proceeds from the sale of capital assets, or whether capital assets were acquired. It communicates how the company is financing its activities (internally from operations or externally from other sources), and why cash increased or decreased.

Its advantage over the statement of financial position is that the statement of financial position reports the financial position of the company at a particular point in time, while the SCF reports the changes in cash that occurred from one statement of financial position date to another.

An income statement reports earnings on an accrual basis, which is important. However, investors and creditors are also interested in determining how a corporation has generated and used cash during a fiscal period, because cash is an important determinant of liquidity. The SCF provides this information succinctly to readers.

2. These activities are important to readers who wish to evaluate the financial position and the results of operations of a particular company in order to make certain decisions, such as whether or not to invest in it. The extent of cash flows resulting from financing and investing decisions can help readers identify the underlying, longer-range activities of the firm that may affect future earnings, such as whether capital assets are being acquired, or debt is being retired. The SCF makes these activities explicit.
3. An increase in accounts receivable during a fiscal year is recorded by a debit. The offsetting credit to the Cash account denotes a use of cash. In effect, cash has been diminished because amounts owing by customers has increased, instead of being collected at the same rate as the prior year.
4. This is basically correct if the direct method is used. However, the SCF also classifies these as operating, investing, and financing activities. Under the indirect method, cash receipts and disbursements are not separately disclosed in the operating section of the SCF.

Concept Self-check continued

5. The declaration of cash dividends has no effect on cash flow, since it does not involve the use of cash; it merely sets up a dividend payable in the books of the company. The payment of a dividend declared decreases cash flow, since it involves the outlay of cash. Whether the dividend was declared in prior years or in the current year has no effect; only the payment reduces cash. Changes in dividends payable amounts from one year to the next also affect cash flows. A net reduction in dividends payable (a debit) increases cash outflow from financing activities (a credit). A net increase in dividends payable decreases cash outflow.
6. Buying or selling short-term investments may decrease or increase the amount of cash available to the company if they are not considered part of cash and cash equivalents. For instance, they may be intended to be held for longer than 90 days. If they are considered part of C&CE, transactions involving short-term investments have no effect on cash flow from operating activities, since they are considered the same as cash.
7. Net income for a period may consist of sales or other types of revenue, cost of goods sold, operating expenses, and other expenses like interest and income taxes. If there are a large number of credit sales and the amount of accounts receivable over the last year has increased, then there is less cash inflow compared to sales revenue recorded on the income statement. If many expenses are prepaid, then cash has been used but the expenses have not decreased net income. Similarly, if inventory levels have increased from one year-end to the next, cash has decreased but cost of goods sold is unaffected on the income statement.

Depreciation of PPE decreases net income but not cash. Losses and gains on sale of long-lived assets affect net income, but do not affect cash flows. Cash may also be used to purchase PPE, pay off borrowings, pay dividends, and repurchase outstanding shares, as examples. These investing and financing activities affect cash, but are not reflected on the income statement.

8. Main statement of financial position account transactions that use cash are (a) operations of the company (net cash outflow from operating activities during the period), (b) purchase of capital assets, (c) retirement of debt and common shares, and (d) payment of dividends. The statement of financial position accounts are analysed by looking at the opening and ending balances of the account, determining the reasons for the change in the account, and recording the effects as a cash inflow or outflow from operating, financing, or investing activities.

Concept Self-check continued

9. A model format of the SCF lists separate sections for operating, investing, and financing activities involving cash flows, as follows (this format differs slightly if the appendix is used):

Operating activities

Net income

Items not affecting cash flow

Depreciation

Net gains (losses) on disposal

Net changes in non-cash working capital

Cash flow from (used by) operating activities

Investing activities

Proceeds from disposal of capital assets

Purchase of capital assets

Cash flow from (used by) investing activities

Financing activities

Loan proceeds (repayments)

Shares issued (redeemed)

Payment of dividends

Cash flow from (used by) financing activities

Net increase (decrease) in cash

Cash at beginning of year

Cash at end of year

10. (Appendix) Steps in using the cash flow table method to prepare the SCF:

Step 1 Set up a cash flow table

Step 2 Calculate the change in every account on the statement of financial position.

Step 3 Analyze the changes in non-cash accounts. Record the opposite change from step 2 as a cash inflow or outflow in the appropriate cash effect column. A debit change in a non-cash statement of financial position account creates a credit change in the Cash account. A credit change corresponds to a cash outflow. A credit change in a non-cash statement of financial position account creates a debit change in the Cash account. A debit change corresponds to a cash inflow. Each change is labelled as a change resulting from an operating, investing, or financing activity depending on the underlying nature of the transaction.

Step 4 Prepare the cash flow from operating activities section of the SCF. Adjust this section to disclose income taxes paid in cash.

Step 5 Prepare the investing, financing, and net changes to cash sections of the statement of cash flows.

<u> F </u>	A payment of \$5,000 was made on a non-current bank loan.
<u> O </u>	Depreciation expense for equipment was \$1,000.
<u> F </u>	\$10,000 of common shares were issued for cash.
<u> F </u>	Cash dividends of \$2,500 were declared and paid to shareholders.
<u> N/E* </u>	A non-current bank loan was assumed in exchange for equipment costing \$7,000.
<u> I </u>	Land was purchased for \$25,000 cash.
<u> O </u>	\$750 of accrued salaries was paid.
<u> N/E** </u>	A \$5,000 operating loan was obtained. The loan is due on demand and is an integral part of the company's cash management strategy.
<u> O </u>	\$10,000 of accounts receivable was collected.
<u> I & F </u>	A building was purchased for \$80,000. \$30,000 was paid in cash and the rest was borrowed.
<u> I </u>	Land was sold for \$50,000 cash.
<u> O & I </u>	Equipment was sold for \$6,000. The original cost was \$10,000. The accumulated depreciation was \$3,000.
<u> O </u>	\$1,200 cash was paid for a 14-month insurance policy to take effect next year.
<u> O </u>	A patent was amortized for \$500.
<u> F </u>	Shares were redeemed for \$50,000 cash, their original issue price.

* No effect. Investing and financing transactions that do not require the use of cash should be excluded from the statement of cash flows and disclosed in a note to the financial statements.

** No effect. The short-term loan would be considered "negative" cash, so the transaction has no cash effect and would not be reported on the statement of cash flows.

CP 14–2

	<i>Operating activities In (out)</i>	<i>Financing activities In (out)</i>	<i>Investing activities In (out)</i>
1. Retired \$100 of non-current debt with cash		(100)	
2. Purchased a building for \$90; \$60 was financed by non-current debt and the rest was paid in cash		60	(90)
3. Declared and paid cash dividends of \$12 during the year		(12)	
4. Purchased equipment by issuing \$20 of common shares		20	(20)
5. Paid \$50 in cash to pay off a non-current bank loan		(50)	
6. Sold land for \$30 cash			30
7. Earned net income of \$75	75		
8. Purchased equipment costing \$15; of this, \$5 was paid in cash and the rest with a 90-day note payable		10 ¹	(15)
9. Amortized a patent by \$2	2 ²		
10. Assumed \$100 of non-current debt and repurchased common shares		100 (100) ³	
11. Purchased short-term investments for \$5 cash			(5) ⁴
12. Sold a machine that cost \$20 for \$7 cash; the accumulated depreciation on it was \$10	3 ⁵		7 ⁵
13. Depreciation expense for building and equipment amounted to \$8	8 ²		
14. Paid in cash the note payable from transaction 8 above.		(10)	
15. Issued \$20 of preferred shares for cash		20	
16. Purchased a patent for \$25 cash			(25)
17. Prepaid \$20 for the next two months of advertising	(2)		
18. Purchased land for \$60 cash.			(60)

¹ Though due on demand, the note payable is likely not part of cash management. Rather, it is a means to facilitate the sale of the equipment. As such, it is reported as a financing activity. This alternate interpretation is acceptable, with explanation.

² This would be added back to net income to arrive at cash flow from operating activities.

³ Only offsetting investing and financing transactions are excluded from the statement of cash flows. Since this transaction involves two financing activities, the cash inflow and offsetting outflow would be reported on the SCF.

⁴ If the short-term investments are low-risk and will be cashed with three months of the date of acquisition, they would be considered cash equivalents. This transaction would then have no effect on the statement of cash flows.

CP 14–2 continued

⁵ The loss on sale would be \$3, calculated as:

Cost of machine	\$ 20
Accumulated depreciation	<u>(10)</u>
Carrying amount	10
Cash proceeds	<u>(7)</u>
Loss on sale	<u>\$ 3</u>

The journal entry to record the sale would be:

Dr.	Cash	7	
Dr.	Acc. Dep'n – Mach.	10	
Dr.	Loss on Sale	3	
Cr.	Machine		20

On the SCF, a \$7 debit would be recorded as an inflow when calculating cash flow from investing activities. The \$3 loss (also a debit) would be added back to net income to arrive at cash flow from operating activities.

CP 14–3

<i>Cash Flow</i>		
↑	↓	No Effect
X		
	X	
	X	
X		X
X		
		X
X		
	X	
	X	
X		
		X
	X	
		X
		X

- Earning net income for the year
- Redemption of preferred shares at face value
- Purchase of inventory
- Issuing common shares for equipment (offsetting, so not reported)
- Assuming non-current debt
- Declaring a cash dividend (only payment creates a cash outflow)
- Collection of an account receivable
- Payment of an account payable
- Purchase of land for cash
- Issuing common shares for cash
- Reclassifying non-current liabilities as current liabilities equal to the amount to be repaid in cash next year
- Payment of a cash dividend declared last year
- Decrease in market value of short-term investments due in 90 days.
- Calculation of amount owing for income taxes.

CP 14-4

The answer depends on your definition of cash equivalents. If the short-term investments will be converted into a known amount of cash within three months of acquisition and are not subject to significant risk of changes in value, cash and cash equivalents are the same at the beginning and end of the year: \$100.

If the short-term investments are not considered to be cash equivalents, cash has decreased by \$100 during the year. More information is needed about the nature of the short-term investments.

CP 14-5

There has been no change in cash and cash equivalents during the year. The bank loan would be considered “negative cash” since it is due on demand by the creditor and an integral part of cash management.

Opening cash and cash equivalents (\$50 – 50)	\$ -0-
Change in cash and cash equivalents during the year	<u>-0-</u>
Ending cash and cash equivalents (\$100 – 100)	<u>\$ -0-</u>

CP 14-6

1. Cash flow from operating activities:

	2020 Dr. (Cr.)	2019 Dr. (Cr.)	Change Debit (Credit)
<i>Non-cash current assets</i>			
Accounts receivable	60	40	20
Inventory	36	30	6
Prepaid rent	10		10

The journal entries used to construct the SCF would be:

Dr.	Accounts Receivable	60	
Cr.	Cash		60
Dr.	Inventory	6	
Cr.	Cash		6
Dr.	Prepaid Rent	10	
Cr.	Cash		10

A debit to the Cash account denotes a cash inflow; a credit denotes a cash outflow. Cash flow from operating activities would be calculated as:

Net income		\$ 50
Changes in non-cash working capital		
Increase in accounts receivable	(20)	
Increase in inventory	(6)	
Increase in prepaid rent	(10)	(36)
Cash flow from operating activities		<u>\$ 14</u>

CP 14–6 continued

2. (Appendix) Cash flow table

	<i>Balance</i>		<i>Change</i>		<i>Cash effect</i>		<i>Activity</i>
	<i>2020</i>	<i>2019</i>					
	<i>Dr. (Cr.)</i>	<i>Dr. (Cr.)</i>	<i>Dr.</i>	<i>Cr.</i>	<i>Inflow</i>	<i>Outflow</i>	
Cash	100	86	14		To be explained		C&CE
Accounts receivable	60	40	20			20	Operating
Inventory	36	30	6			6	Operating
Prepaid rent	10	-0-	10			10	Operating
Retained earnings	(206)	(156)		50	50		Operating
	<u>-0-</u>	<u>-0-</u>	<u>50</u>	<u>50</u>	<u>50</u>	<u>36</u>	
					</		

CP 14–7

1. The equipment therefore must have sold for \$900 cash:

Cost (given)	\$1,000
Accum. dep'n (given)	<u>(600)</u>
Carrying amount	400
Cash proceeds (derived)	<u>900</u>
Gain on sale (given)	<u><u>\$ (500)</u></u>

2. The journal entry to record the sale of the equipment would have been:

Dr. Cash	900	
Dr. Accumulated Depreciation	600	
Cr. Equipment		1,000
Cr. Gain on Sale of Equipment		500

The only cash effect of this transaction is the receipt of \$900 from the sale of the equipment. The gain on sale needs to be deducted from net income to arrive at cash flow from operating activities (which will be \$0), since it (a) is not related to an operating activity, and (b) does not represent actual cash flow.

CP 14–7 continued

3.

<i>Operating activities</i>	
Net income	\$ 500
Item not affecting cash flow	
Gain on sale of equipment	(500)
	<u>\$ -0-</u>
<i>Investing activities</i>	
Proceeds from sale of equipment	<u>\$ 900</u>

CP 14–8

1. There are no adjustments to net income. All revenue was received in cash and all expenses were paid in cash, and there were no changes to any other statement of financial position accounts that affect cash flow from operating activities. Cash flow from operating activities equals net income of \$90.

2. The statement of changes in equity would show:

	<i>Common shares</i>	<i>Retained earnings</i>	<i>Total equity</i>
Balance at January 1, 2020 (given)	\$300	\$500	\$800
Common shares redeemed	(100)		(100)
Add: Net income (given)		90	90
Less: Dividends paid (derived)		(40)	(40)
Balance at December 31, 2020 (given)	<u>\$200</u>	<u>\$550</u>	<u>\$750</u>

3. Borrowings have decreased by \$400. Cash must have been used to repay these. Common shares decreased by \$100, also requiring cash. Dividends of \$40 were declared. These must have been paid in cash, as there is no Dividends Payable account.

The journal entries to construct the SCF would be:

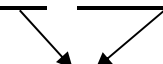
Dr.	Borrowings	400	
Cr.	Cash		400
Dr.	Common Shares	100	
Cr.	Cash		100
Dr.	Retained Earnings	40	
Cr.	Cash		40

Cash used by financing activities:

Repayment of borrowings	(\$400)
Redemption of common shares	(100)
Payment of dividends	(40)
	<u>(\$540)</u>

CP 14–8 continued

4. (Appendix) Cash flow table

	<i>Balance</i>		<i>Change</i>		<i>Cash effect</i>		<i>Activity</i>
	<i>2019</i>	<i>2018</i>					
	<i>Dr. (Cr.)</i>	<i>Dr. (Cr.)</i>	<i>Dr.</i>	<i>Cr.</i>	<i>Inflow</i>	<i>Outflow</i>	
Cash	1,250	1,600		*350	To be explained		C&CE
S/T investments	100	200		*100	To be explained		C&CE
Borrowings	(600)	(1,000)	400			400	Financing
Common shares	(200)	(300)	100			100	Financing
Ret. earnings	(550)	(500)		50	{ 90	40	Operating Financing
	<u>-0-</u>	<u>-0-</u>	<u>500</u>	<u>500</u>	<u>90</u>	<u>540</u>	
							
							<u>*\$450</u> net cash outflow

1. Dividends paid:

Retained earnings at January 1, 2020 (given)	\$ (18)
Add: Net income (given)	(14)
Less: Dividends declared (derived)	<u>6</u>
Retained earnings at December 31, 2020 (given)	<u>\$ (26)</u>

Dividends of \$6 were declared. These must have been all paid in cash, as there is no Dividends Payable account.

The journal entry to construct the SCF would be:

Dr. Retained Earnings	6	
Cr. Cash		6

2. Statement of cash flows:

Step 1: Convert net income to cash flow from operations

a. Net income to be added on SCF	<u>14</u>
b. Depreciation to be added back	<u>6</u>
c. Losses to be added back	<u>4</u>
Gains to be deducted	<u>(1)</u>

d. Analysis of changes in non-cash working capital accounts:

	2020 Dr. (Cr.)	2019 Dr. (Cr.)	Change Debit (Credit)
<i>Non-cash current assets</i>			
Accounts receivable	\$18	\$10	8
Inventory	24	20	4
<i>Non-cash current liabilities</i>			
Accounts payable	(16)	(12)	(4)

The journal entries to construct the SCF would be:

Dr. Accounts Receivable	8	
Cr. Cash		8
Dr. Inventory	4	
Cr. Cash		4
Dr. Cash 4		
Cr. Accounts Payable		4

CP 14–9 continued

Step 2: Record investing activities

Analysis of changes in long-term assets accounts:

	2020 Dr. (Cr.)	2019 Dr. (Cr.)	Change Debit (Credit)
<i>Long-term assets</i>			
Land	10	24	(14)
Plant and equipment	94	60	34
Accum. dep'n	(14)	(10)	(4)

The journal entry to record the sale of the land would be:

Dr. Cash	10	
Dr. Loss on Disposal	4	
Cr. Land		14

The \$10 is a cash inflow from investing activities. The \$4 loss has already been added back to net income to arrive at cash flow from operating activities.

Calculation of cash from equipment sale:

Cost of equipment sold (given)	\$7
Accumulated depreciation (derived)	<u>(2)</u>
Carrying amount (given)	5
Cash proceeds (derived)	<u>(6)</u>
Gain on sale (per income statement)	<u>\$1</u>

The journal entry to record the disposal of machinery would be:

Dr. Cash	6	
Dr. Accumulated Dep'n.	2	
Cr. Equipment		7
Cr. Gain on Disposal		1

The \$6 is a cash inflow from investing activities. The \$1 gain is shown on the income statement and has been deducted from net income to arrive at cash from operating activities on the SCF.

Step 3: Record non-current liabilities and shareholders' equity account activities

	2020 Dr. (Cr.)	2019 Dr. (Cr.)	Change Debit (Credit)
<i>Non-current liabilities</i>			
Borrowings	(40)	(32)	(8)
<i>Shareholders' equity</i>			
Common shares	(60)	(50)	(10)

CP 14–9 continued

The journal entry to record cash from additional borrowings would be:

Dr. Cash	8	
Cr.	Borrowings	8

The \$6 is a cash inflow from financing activities.

The journal entry to record cash from issuing shares would be:

Dr. Cash	10	
Cr.	Common Shares	10

The \$10 is a cash inflow from financing activities.

2.

Glacier Corporation
Statement of Cash Flows
For the Year Ended December 31, 2020

<i>Operating activities</i>	
Net income	\$ 14
Items not affecting cash flow	
Depreciation	6
Gain on sale of equipment	(1)
Loss on sale of land	4
Net changes in non-cash working capital	
Increase in accounts receivable	(8)
Increase in inventory	(4)
Increase in accounts payable	4
Cash flow from operating activities	<u>15</u>
<i>Investing activities</i>	
Proceeds from sale of equipment	\$ 6
Proceeds from sale of land	10
Purchase of PPE	<u>(41)</u>
Cash flow used by investing activities	(25)
<i>Financing activities</i>	
Proceeds from borrowings	8
Common shares issued	10
Payment of dividends	<u>(6)</u>
Cash flow from financing activities	<u>12</u>
Net increase in cash	2
Cash at beginning of year	8
Cash at end of year	<u>\$ 10</u>

3. Cash flow from operating activities is almost identical to net income (\$15 vs. \$14). The company appears to be embarking on a re-capitalization project, selling equipment and investing in new PPE. Most of this (\$8 + 10) has been financed by issuing debt and common shares. Opening and ending cash balances are almost identical. (\$8 vs. \$10).

CP 14–9 continued

4. (Appendix) Cash flow table:

	<i>Balance</i>		<i>Change</i>		<i>Cash effect</i>		<i>Activity</i>
	2020	2019	Dr.	Cr.	Inflow	Outflow	
Cash	10	8	2		To be explained		C&CE
Accounts receivable	18	10	8			8	Operating
Merchandise inventory	24	20	4			4	Operating
Land	10	24		14	(a) 10		Investing
					(a) 4		Operating
Plant and equipment	94	60	41			41	Investing
			34	(b) 7	(b) 6		Investing
Accum. dep'n	(14)	(10)	(b) 2	4		(b) 1	Operating
				6	6		Operating
Accounts payable	(16)	(12)		4	4		Operating
Non-current borrowings	(40)	(32)		8	8		Financing
Common shares	(60)	(50)		10	10		Financing
Retained earnings	(26)	(18)		8	14		Operating
						6	Financing
	<u>-0-</u>	<u>-0-</u>	<u>57</u>	<u>57</u>	<u>62</u>	<u>60</u>	

\$2 net cash inflow

(a) The journal entry to record the sale of the land would be:

Dr. Cash	10	
Dr. Loss on Disposal	4	
Cr. Land		14

The \$10 is a cash inflow from investing activities. The \$4 loss is added back to net income to arrive at cash flow from operating activities.

(b) Cost of equipment sold (given)	\$7
Accumulated depreciation (derived)	<u>(2)</u>
Carrying amount (given)	5
Cash proceeds (derived)	<u>(6)</u>
Gain on sale (per income statement)	<u>\$1</u>

The journal entry to record the disposal of machinery would be:

Dr. Cash	6	
Dr. Accumulated Dep'n.	2	
Cr. Equipment		7
Cr. Gain on Disposal		1

1. Journal entry to record disposal of equipment:

Dr. Cash	12	
Dr. Accumulated Dep'n.	16	
Cr. Equipment		20
Cr. Gain on Sale of Equipment		8

Cost (given)	20
Acc. dep'n (derived)	<u>(16)</u>
Carrying amount (given)	4
Cash proceeds (given)	<u>12</u>
Gain on sale (given)	<u>(\$8)</u>

Cash is increased by \$12, the amount of the sale proceeds, but this does not represent cash flow from an operating activity. The sale of capital assets is an investing activity, and so will not be shown in the calculation of cash flow from operating activities. It will be shown as a cash inflow in the Investing Activities section of the SCF.

However, the \$8 gain on sale is included in the calculation of net income on the income statement. Since it does not represent cash inflow (the \$12 is the actual cash inflow) and it is not an operating activity, the gain is deducted from net income on the SCF to derive cash flow from operating activities.

2. a. Cash flow from operating activities:

Net income	\$ 33
Items not affecting cash flow	
Depreciation	10
Gain on sale of equipment	<u>(8)</u>
Cash flow from operating activities	<u>\$ 35</u>

b. Cash flow from investing activities:

Proceeds from sale of equipment	<u>\$12</u>
---------------------------------	-------------

1. Cash flow from operating activities:

Step 1: Convert net income to cash flow from operations

a. Net income to be added on SCF	<u>80</u>
b. Depreciation to be added back	<u>0</u>
c. Losses to be added back	<u>0</u>
Gains to be deducted	<u>(0)</u>

d. Analysis of changes in non-cash working capital accounts:

	2020 Dr. (Cr.)	2019 Dr. (Cr.)	Change Debit (Credit)
<i>Non-cash current liabilities</i>			
Accounts payable	\$(15)	\$ (6)	(9)
Income taxes payable	(20)	(12)	(8)

Journal entries to record effects on SCF:

Dr. Cash	9	
Cr. Accounts Payable		9
Dr. Cash	8	
Cr. Income Taxes Payable		8

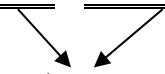
Operating activities:

Net income	\$80
Changes in non-cash working capital	
Increase in accounts payable	9
Increase in income taxes payable	8
Cash flow from operating activities	<u>\$97</u>

P 14–2 continued

2. (Appendix) Cash flow table:

	<i>Balance</i>		<i>Change</i>		<i>Cash effect</i>	
	<i>2020</i>	<i>2019</i>	<i>Dr.</i>	<i>Cr.</i>	<i>Inflow</i>	<i>Outflow</i>
	<i>Dr. (Cr.)</i>	<i>Dr. (Cr.)</i>			<i>To be explained</i>	
Cash	135	38	97			
Accounts payable	(15)	(6)		9	9	
Income taxes payable	(20)	(12)		8	8	
Retained earnings	(100)	(20)		80	80	
	<u>-0-</u>	<u>-0-</u>	<u>97</u>	<u>97</u>	<u>97</u>	<u>-0-</u>



\$97 net cash inflow

Revised cash flow from operating activities would be shown as:

Income before income taxes	\$100
Income taxes paid (\$20 – 8)	(12)
Add changes in non-cash working capital	
Increase in accounts payable	9
Cash flow from operating activities	<u>\$ 97</u>

- | | | | |
|----|--|-----|-----|
| 1. | Dr. Depreciation Expense | 100 | |
| | Cr. Accumulated Depreciation—Machinery | | 100 |

There is no cash effect. However, the depreciation expense should be added back to the net loss figure when deriving cash flow from operating activities. Note, as well, that the credit to Accumulated Depreciation explains all the changes to this account during the year.

- | | | | |
|----|---------------|-----|-----|
| 2. | Dr. Machinery | 300 | |
| | Cr. Cash | | 300 |

Since (a) the Machinery account increased \$300 (500 — 200) during the year, (b) no disposals occurred, and (c) all purchases of machinery were paid in cash, \$300 of cash must have been spent on machinery purchases.

The \$300 cash outflow is an investing activity since it affects a non-current asset account and should be shown as such when preparing the SCF.

3.

Statement of Cash Flows
For the Year Ended December 31, 2020

Operating activities

Net loss	\$(100)
Item not affecting cash flow	
Depreciation	<u>100</u>
Cash flow from operating activities	-0-

Investing activities

Purchase of machinery	<u>(300)</u>
Net decrease in cash	(300)
Cash at beginning of year	<u>650</u>
Cash at end of year	<u>\$ 350</u>

4. (Appendix) Cash flow table:

	<i>Balance</i>		<i>Change</i>		<i>Cash effect</i>		<i>Activity</i>
	<i>2020</i>	<i>2019</i>			<i>Inflow</i>	<i>Outflow</i>	
	<i>Dr. (Cr.)</i>	<i>Dr. (Cr.)</i>	<i>Dr.</i>	<i>Cr.</i>	<i>To be explained</i>		
Cash	350	650		300			C&CE
Machinery	500	200	300			300	Investing
Acc. depn.	(250)	(150)		100	100		Operating
Ret. earn.	(600)	(700)	100			100	Operating
	<u>-0-</u>	<u>-0-</u>	<u>400</u>	<u>400</u>	<u>100</u>	<u>400</u>	
<div style="text-align: center;"> </div>							
<u>\$300</u> net cash outflow							

1.

Hubris Corporation
Statement of Cash Flows
For the Year Ended December 31, 2020

Operating activities

Net income	\$ 800
Items not affecting cash flow	
Depreciation and amortization (\$120 + 5)	125
Changes in non-cash working capital	
Increase in accounts receivable	(40)
Decrease in inventory	50
Increase in wages payable	20
Cash flow from operating activities	<u>955</u>

Financing activities

Repayment of borrowings	\$(250)
Common shares issued	500
Payment of dividends	<u>(30)</u>
Cash flow from financing activities	<u>220</u>
Net increase in cash	1,175
Cash at beginning of year**	25
Cash at end of year	<u><u>\$1,200</u></u>

**If the company had \$1,200 cash on hand at the end of the year and cash increased by \$1,175 during the year, cash on hand at the beginning of the year must be \$25.

2. (Appendix) Partial cash flow table:

	<i>Balance</i>		<i>Change</i>		<i>Cash effect</i>		<i>Activity</i>
	<i>2020</i>	<i>2019</i>					
	<i>Dr. (Cr.)</i>	<i>Dr. (Cr.)</i>	<i>Dr.</i>	<i>Cr.</i>	<i>Inflow</i>	<i>Outflow</i>	
Cash			*1,175		To be explained		C&CE
Accum. dep'n.				120(b)	120		Operating
Acc. rec.			(d)40			40	Operating
Merch. inventory				50(e)	50		Operating
Acc. am. – patents				5(f)	5		Operating
Wages payable				20(c)	20		Operating
Borrowings			(g)250			250	Financing
Common shares				500(h)	500		Financing
Retained earnings				800(a)	800		Operating
			(i)30			30	Financing
			<u>1,495</u>	<u>1,495</u>	<u>1,495</u>	<u>320</u>	

*\$1,175 net cash inflow

* balancing figure for Change columns

1.

Wheaton Co. Ltd.
Statement of Cash Flows
For the Year Ended December 31, 2020

Operating activities

Net income	\$20,000
Items not affecting cash flow	
Depreciation and amortization (\$3,000 + 100)	3,100
Loss on disposal of machinery ^b	1,500
Net changes in non-cash working capital	
Increase in accounts receivable	(900)
Decrease in merchandise inventory	1,200
Decrease in accounts payable	(1,000)
Increase in wages payable	500
Cash flow from operating activities	<u>24,400</u>

Investing activities^a

Proceeds from sale of machinery ^b	6,000
--	-------

Financing activities

Repayment of borrowings	(5,000)
Common shares issued	<u>12,500</u>
Cash flow from financing activities	<u>7,500</u>
Net increase in cash	37,900
Cash at beginning of year (given)	<u>1,000</u>
Cash at end of year (derived)	<u>\$ 38,900</u>

^a Offsetting investing and financing transactions that do not require the use of cash should be excluded from the statement of cash flows, but separately disclosed elsewhere in a note to the financial statements.

^b Cost of machinery	\$15,000
Accumulated depreciation (1/2)	<u>(7,500)</u>
Carrying amount	7,500
Cash proceeds	<u>(6,000)</u>
Loss on disposal	<u>\$1,500</u>

The journal entry to record the sale would be:

Dr. Cash	6,000	
Dr. Accumulated Dep'n.	7,500	
Dr. Loss on Disposal	1,500	
Cr. Machinery		15,000

The \$6,000 is a cash inflow from investing activities. The \$1,500 loss is added back to net income to arrive at cash flow from operating activities.

P 14–5 continued

2. The statement of cash flows shows that the company has financed its activities internally from operations and by issuing common shares. The sale of machinery also generated cash. It has repaid some borrowings and acquired some capital assets. Wheaton Co. Ltd. has generated substantially more cash than it has used in 2020.

3. (Appendix) Partial cash flow table:

	<i>Balance</i>		<i>Change</i>		<i>Cash effect</i>		<i>Activity</i>
	<u>2020</u>	<u>2019</u>	<u>Dr.</u>	<u>Cr.</u>	<u>Inflow</u>	<u>Outflow</u>	
Cash			37,900 ¹		To be explained		C&CE
Accounts receivable			(c) 900			900	Operating
Merchandise inventory				(d) 1,200	1,200		Operating
Equipment			(h) 10,000 ²	(j) 15,000		-0-	Investing
					(j) 6,000 ³	(j) 1,500 ³	Investing
					(j) 1,500 ³		Operating
Accum. dep'n. – equip.			(j) 7,500	(a) 3,000	3,000		Operating
Accum. amort – patents				(e) 100	100		Operating
Accounts payable			(k) 1,000			1,000	Operating
Wages payable				(b) 500	500		Operating
Dividends payable				(i) 5,000	5,000		Financing
Borrowings			(f) 5,000			5,000	Financing
Common shares				(g) 12,500	12,500		Financing
				(h) 10,000 ²			
Retained earnings				20,000 ¹	20,000		Operating
			(i) 5,000			5,000	Financing
			<u>57,300</u>	<u>57,300</u>	<u>49,800</u>	<u>11,900</u>	
					<u>\$37,900</u> ¹ net cash inflow		

¹ Given

² Offsetting investing and financing transactions that do not require the use of cash should be excluded from the statement of cash flows, but separately disclosed elsewhere in a note to the financial statements.

³

Cost of machinery	\$15,000
Accumulated depreciation (1/2)	<u>(7,500)</u>
Carrying amount	7,500
Cash proceeds	<u>(6,000)</u>
Loss on disposal	<u>\$1,500</u>

P 14–5 continued

The journal entry to record the sale would be:

Dr.	Cash	6,000	
Dr.	Accumulated Dep'n.	7,500	
Dr.	Loss on Disposal	1,500	
Cr.	Machinery		15,000

The \$6,000 is a cash inflow from investing activities. The \$1,500 loss is added back to net income to arrive at cash flow from operating activities.

The revised operating activities section would show:

<i>Operating activities</i>	
Income before income taxes (\$95,000 – 70,000)	\$ 25,000
Income taxes paid	(5,000)
Items not affecting cash flow	
Depreciation and amortization (\$3,000 + 100)	3,100
Loss on disposal of machinery	1,500
Net changes in non-cash working capital (\$500 – 900 + 1,200 – 1,000)	(200)
Cash flow from operating activities	<u>24,400</u>

P 14–6

1. Cash flow from operating activities:

Step 1: Convert net income to cash flow from operations

- a. Net income to be added on SCF 77
- b. Depreciation to be added back 44
- c. Gains to be deducted (20)
- d. Analysis of changes in non-cash working capital accounts:

	2020 Dr. (Cr.)	2019 Dr. (Cr.)	Change Debit (Credit)
<i>Non-cash current assets</i>			
Accounts receivable	\$100		100
Inventory	60		60
Prepaid rent	10		10
<i>Non-cash current liabilities*</i>			
Accounts payable	(50)		(50)
Income taxes payable	(8)		(8)

*excluding Dividends Payable account

P 14–6 continued

Journal entries to record SCF effects:

Dr.	Accounts Receivable	100	
Cr.	Cash		100
Dr.	Inventory	60	
Cr.	Cash		60
Dr.	Prepaid Rent	10	
Cr.	Cash		10
Dr.	Cash	50	
Cr.	Accounts Payable		50
Dr.	Cash	8	
Cr.	Income Taxes Payable		8

Step 2: Record investing activities

Analysis of changes in long-term assets accounts:

	2020 Dr. (Cr.)	2019 Dr. (Cr.)	Change Debit (Credit)
<i>Long-term assets</i>			
Land	-0-		
Equipment	160		160
Acc. dep'n	(44)		(44)

The journal entry to record the purchase of land would be:

Dr.	Land	30	
Cr.	Cash		30

The journal entry to record the sale of land would be:

Dr.	Cash	50	
Cr.	Land		30
Cr.	Gain on Sale		20

The \$50 would be a cash inflow from investing activities. The \$20 credit to gain on sale has already been deducted to arrive at cash flow from operating activities in step 1(c).

Changes in Equipment account:

Balance at Jan. 1 (given)	-0-
Addition for cash (given)	120
Addition for shares (given)	<u>40</u>
Balance at Dec. 31 (given)	<u>160</u>

\$40 of equipment was purchased by issuing \$40 of common shares. Offsetting investing and financing transactions that do not require the use of cash should be excluded from the statement of cash flows, but separately disclosed elsewhere in a note to the financial statements.

P 14–6 continued

The journal entry to record the purchase of equipment for cash would be:

Dr. Equipment	120	
Cr. Cash		120

The journal entry to record the purchase of equipment for shares would be:

Dr. Equipment	40	
Cr. Cash		40

Step 3: Record non-current liabilities and shareholders' equity account activities

Analysis of changes in non-current liabilities and shareholders' equity accounts:

	2020 Dr. (Cr.)	2019 Dr. (Cr.)	Change Debit (Credit)
<i>Long-term liabilities and dividends payable</i>			
Borrowings	(80)		(80)
Dividends payable	(5)		(5)
<i>Shareholders' equity</i>			
Common shares	(140)		(140)
Retained earnings	(48)		(48)

The journal entry to record the proceeds from borrowings:

Dr. Cash	100	
Cr. Non-current Borrowings		100

The journal entry to record the repayment of some of the borrowings would be:

Dr. Non-current Borrowings	20	
Cr. Cash		20

The cash effects from these two transactions could be netted on the SCF.

Changes in Common Shares account:

Balance at Jan. 1 (given)	(-0-)	
Shares issued for building (given)	(40)	
Additional shares issued (derived)	(100)	
Balance at Dec. 31 (given)	(140)	(140) net change

\$40 of equipment was purchased by issuing \$40 of common shares. The journal entry to record this would be:

P 14–6 continued

The journal entry to record the common shares issued would be:

Dr.	Equipment	40	
Cr.	Common Shares		40

There is no cash effect. Offsetting investing and financing transactions that do not require the use of cash should be excluded from the statement of cash flows, but separately disclosed elsewhere in a note to the financial statements.

The journal entry to record the common shares issued would be:

Dr.	Cash	100	
Cr.	Common Shares		100

Changes in Retained Earnings account:

Balance at Jan. 1 (given)	(-0-)	
Net income (given)	(70)	→ (48) net change per above
Dividends declared (given)	<u>22</u>	
Balance at Dec. 31 (given)	<u>(48)</u>	

Net income has already been inserted in the SCF as the first step. The journal entry to record the dividends paid would be:

Dr.	Retained Earnings	22	
Cr.	Cash		17
Cr.	Dividends Payable		5

P 14–6 continued

Step 4 Calculate the net change in cash and ending cash balance, and prepare the statement of cash flows

Obelisk Corporation
Statement of Cash Flows
For the Year Ended December 31, 2020

<i>Operating activities</i>		
Net income		\$ 70
Items not affecting cash flow		
Depreciation		44
Gain on sale of land		(20)
Changes in non-cash working capital		
Increase in accounts receivable		(100)
Increase in inventory		(60)
Increase in prepaid rent		(10)
Increase in accounts payable		50
Increase in income taxes payable		8
Cash flow used by operating activities		<u>(18)</u>
<i>Investing activities</i>		
Proceeds from sale of land	\$ 50	
Purchase of equipment	(120)	
Purchase of land	<u>(30)</u>	
Cash flow used by investing activities		(100)
<i>Financing activities</i>		
Proceeds from borrowings	100 *	
Common shares issued	100	
Repayment of borrowings	(20) *	
Payment of dividends (\$22 – 5)	<u>(17)</u>	
Cash flow from financing activities		163
Net increase in cash and cash at end of year		<u>\$ 45</u>

* \$100 of non-current debt was assumed; \$20 of non-current debt was redeemed. These amounts could also be netted.

- The statement of cash flows shows that the company used cash to finance its operations, purchase land and equipment, and pay dividends. It generated cash by assuming long-term debt (net), issuing common shares, and selling land. The company generated more cash than it used (\$45), but chiefly from financing activities. The cash flow used by operating activities (\$18) is a concern, but on the other hand, this may be acceptable in the first year of operations.

P 14–6 continued

3. a. (Appendix) Cash flow table:

	<i>Balance</i>		<i>Change</i>		<i>Cash effect</i>		<i>Activity</i>
	<i>2020</i>	<i>2019</i>	<i>Dr.</i>	<i>Cr.</i>	<i>Inflow</i>	<i>Outflow</i>	
Cash	45	-0-	45		To be explained		C&CE
Accounts receivable	100	-0-	100			100	Operating
Merchandise inventory	60	-0-	60			60	Operating
Prepaid rent	10	-0-	10			10	Operating
Equipment	160	-0-	160	(a) 40		(c) 120	Investing
Accum. dep'n	(44)	-0-		44	44		Operating
Land	-0-	-0-	30			30	Investing
				(b) 30	{ (b) 50	(b) 20	Operating Investing
Accounts payable	(50)	-0-		50	50		Operating
Dividends payable	(5)	-0-		5	5		Financing
Income taxes payable	(8)	-0-		8	8		Operating
Non-current borrowings	(80)	-0-		80	{ (d) 100	20	Financing Financing
Common shares	(140)	-0-	(a) 40	140	(e) 100		Financing
Retained earnings	(48)	-0-		48	{ 70		Operating
						22	Financing
	<u>-0-</u>	<u>-0-</u>	<u>445</u>	<u>445</u>	<u>427</u>	<u>382</u>	
					<u>\$45 net cash inflow</u>		

- (a) \$40 of equipment was purchased by issuing \$40 of common shares. Offsetting investing and financing transactions that do not require the use of cash should be excluded from the statement of cash flows, but separately disclosed elsewhere in a note to the financial statements.
- (b) The journal entry to record the sale of land would be:
- | | | | |
|-----|--------------|----|----|
| Dr. | Cash | 50 | |
| Cr. | Land | | 30 |
| Cr. | Gain on Sale | | 20 |
- (c) Given
- (d) \$100 of non-current debt was assumed; \$20 of non-current debt was redeemed.

P 14–6 continued

b. Revised operating activities section of SCF:

Income from operations	\$ 60
Income taxes paid (\$10 – 8)	(2)
Items not affecting cash flow	
Depreciation	44
Net changes in non-cash working capital (\$50 – 100 – 60 – 10)	<u>(120)</u>
Cash flow used by operating activities	(18)

P 14–7

1. Cash flow from operating activities:

Step 1: Convert net income to cash flow from operations

a. Net income to be added on SCF	<u>56</u>
b. Depreciation to be added back	<u>14</u>
Amortization to be added back	<u>2</u>
c. Gains to be deducted	<u>(4)</u>
Losses to be added back	<u>2</u>

d. Analysis of changes in non-cash working capital accounts:

	2020	2019	Change Debit (Credit)
<i>Non-cash current assets</i>			
Accounts receivable	38	28	10
Inventory	102	106	(4)
Prepaid expenses	8	6	2
<i>Non-cash current liabilities*</i>			
Accounts payable	40	44	4
Income taxes payable	8	6	(2)

P 14–7 continued

Journal entries to record SCF effects:

Dr.	Accounts Receivable	10	
Cr.	Cash		10
Dr.	Cash	4	
Cr.	Inventory		4
Dr.	Prepaid Expenses	2	
Cr.	Cash		2
Dr.	Cash	4	
Cr.	Accounts Payable		4
Dr.	Income Taxes Payable	2	
Cr.	Cash		2

Step 2: Record investing activities

Analysis of changes in long-term assets accounts:

	2020 Dr. (Cr.)	2019 Dr. (Cr.)	Change Debit (Credit)
<i>Long-term assets</i>			
Land		20	(20)
Buildings	240	180	60
Machinery	134	80	54
Acc. dep'n	(76)	(80)	4
Patents, at carrying amount	8	10	(2)

Analysis of Land sale:

Cost of land	\$20
Cash proceeds	<u>(24)</u>
Gain on disposal	<u>\$ (4)</u>

The journal entry to record the land sale would be:

Dr.	Cash	24(a)	
Cr.	Land		20
Cr.	Gain on disposal of land		4(b)

The first item (a) is a cash inflow from investing activities. The second item (b) should already have been added back to net income to arrive at cash flow from operating activities.

The journal entry to record the building purchase would be:

Dr.	Buildings	60	
Cr.	Cash		60

P 14–7 continued

The cash effect is a \$60 outflow for investing activities.

Analysis of Machinery account:

Balance at Jan. 1	80
Purchase for part loan	30
Purchase for shares	60
Disposal	<u>(36)</u>
Balance at Dec. 31	<u>134</u>

The investing activity journal entry to record the machinery purchase for cash and a loan would be:

Dr. Machinery	30	
Cr. Cash		30

A separate entry would be recorded in the financing activity section of the SCF for the assumption of the loan.

The journal entry to record the machinery purchase for shares would be:

Dr. Machinery	60	
Cr. Common Shares		60

There is no cash effect. Since this is an offsetting investing and financing activity, it would not be shown on the SCF. It would be disclosed in a note to the financial statements.

Analysis of machinery sale:

Cost of machinery	\$36
Accumulated depreciation (1/2)	<u>(18)</u>
Carrying amount	18
Cash proceeds	<u>(16)</u>
Loss on disposal	<u>\$2</u>

The journal entry to record the sale would be:

Dr. Cash	16(a)	
Dr. Accumulated Dep'n.	18	
Dr. Loss on Disposal	2(b)	
Cr. Machinery		36

The first item (a) is a cash inflow from investing activities. The second item (b) should have already been added back to net income to arrive at cash flow from operating activities.

The journal entry to record the patent amortization would be:

Dr. Amortization Expense	2	
Cr. Patents, net		2

Analysis of Accumulated Depreciation account:

Balance at Jan. 1	(80)
Credit for depreciation expense	(14)
Debit re. loss on disposal	<u>18</u>
Balance at Dec. 31	<u>(76)</u>

P 14–7 continued

The journal entry to record PPE depreciation would be:

Dr. Depreciation Expense	14	
Cr. Acc. Dep'n		14

The operating activity effect of this entry has been noted in step 1(c) above. The \$18 debit to Accumulated Depreciation from the disposal of machinery (see above) would be netted against the \$14 credit resulting from recording depreciation expense. These two effects account for the net change.

Step 3: Record non-current liabilities and shareholders' equity account activities

Analysis of changes in non-current liabilities and shareholders' equity accounts:

	2020 Dr. (Cr.)	2019 Dr. (Cr.)	Change Debit (Credit)
<i>Long-term liabilities</i>			
Borrowings	(70)	(60)	(10)
<i>Shareholders' equity</i>			
Common shares	(310)	(240)	(70)
Retained earnings	(66)	(30)	(36)

Changes in Borrowings account:

Balance at Jan. 1 (given)	(60)	
Proceeds from mach. finance (given)	(20)	→ (10) net change
Repayments (derived)	<u>10</u>	
Balance at Dec. 31 (given)	<u>(70)</u>	

The journal entry to record the loan to finance the machinery purchase would be:

Dr. Cash	20	
Cr. Non-current Borrowings		20

From the analysis, \$10 of borrowings must have been repaid during the year.

The journal entry to record repayment would be:

Dr. Non-current Borrowings	20	
Cr. Cash		20

Changes in Common Shares account:

Balance at Jan. 1 (given)	(240)	
Shares issued for mach. (given)	(60)	→ (70) net change
Additional shares issued (derived)	<u>(10)</u>	
Balance at Dec. 31 (given)	<u>(300)</u>	

P 14–7 continued

As noted above, the journal entry to record the machinery purchase for shares would be:

Dr.	Machinery	60	
Cr.	Common Shares		60

Since this is an offsetting investing and financing activity, it would not be shown on the SCF. It would be disclosed in a note to the financial statements.

An additional \$10 of common shares must have been issued. The journal entry to record this would be:

Dr.	Cash	10	
Cr.	Common shares		10

The \$10 cash inflow effect would be reported in the financing activities section of the SCF.

Changes in Retained Earnings account:

Balance at Jan. 1 (given)	(30)	
Net income (given)	(56)	
Dividends declared (given)	<u>20</u>	
Balance at Dec. 31 (given)	<u>(66)</u>	

(36) net change per above

The net income is shown as the first entry on the SCF in the operating activities section.

The journal entry to record the dividends declared and paid would be:

Dr.	Retained Earnings	20	
Cr.	Cash		20

The \$20 cash outflow effect would be reported in the financing activities section of the SCF.

P 14–7 continued

Step 4 Calculate the net change in cash and ending cash balance, and prepare the statement of cash flows

Operating activities

Net income	\$	56
Items not affecting cash flow		
Depreciation and amortization expense (\$14 + 2)		16
Loss on disposal of machinery		2
Gain on disposal of land		(4)
Changes in non-cash working capital		
Increase in accounts receivable		(10)
Decrease in inventory		4
Increase in prepaid expenses		(2)
Decrease in accounts payable		(4)
Increase in income taxes payable		2
Cash flow from operating activities		<u>60</u>

Investing activities

Proceeds from sale of land	\$	24
Proceeds from sale of machinery		16
Purchase of building		(60)
Purchase of machinery		<u>(30)</u>
Cash flow used by investing activities		(50)

Financing activities

Proceeds from borrowings*		20
Repayment of borrowings*		(10)
Common shares issued		10
Payment of dividends		<u>(20)</u>
Cash flow from financing activities		-0-
Net increase in cash		<u>10</u>
Cash at beginning of year		<u>30</u>
Cash at end of year	\$	<u><u>40</u></u>

*The cash effects from borrowings and repayment could be netted.

2. Cormier has generated slightly more cash flow from operating activities than net income (\$60 vs. \$56), It has sold land and machinery, but overall there has been a cash outflow from investing activities because of the purchase of new machinery and the building, largely paid by cash flow from operations. There is no net financing activity. Net proceeds from borrowings and issuing common shares have been offset by dividends paid. Overall, the company has \$10,000 more cash on hand at the end of the year.

P 14-7 continued

3. (Appendix) Cash flow table:

	<i>Balance</i>		<i>Change</i>		<i>Cash effect</i>		<i>Activity</i>
	<i>2020</i>	<i>2019</i>	<i>Dr.</i>	<i>Cr.</i>	<i>Inflow</i>	<i>Outflow</i>	
Cash	40	30	10		To be explained		C&CE
Accounts receivable	38	28	10			10	Operating
Merchandise inventory	102	106		4	4		Operating
Prepaid expenses	8	6	2			2	Operating
Land	-0-	20		20	{ 24		Investing
						4	Operating
Building	240	180	60			60	Investing
Machinery	134	80	90	60 ²	{ (a) 16 ¹ (b) 2 ¹	30	Investing
				36 ¹			Operating
Accum. dep'n	(76)	(80)	18 ¹			-0-	Operating
			4	14			
Patents	8	10		2	2		Operating
Accounts payable	(40)	(44)	4			4	Operating
Income taxes payable	(8)	(6)		2	2		Operating
Borrowings	(70)	(60)		10	10		Financing
Common shares	(310)	(240)	60 ²	70	10		Financing
Retained earnings	(66)	(30)		36	56		Operating
						20	Financing
	<u>-0-</u>	<u>-0-</u>	<u>254</u>	<u>254</u>	<u>140</u>	<u>130</u>	

\$10 net cash inflow

¹ Cost of machinery	\$36
Accumulated depreciation (1/2)	(18)
Carrying amount	18
Cash proceeds	(16)
Loss on disposal	<u>\$2</u>

The journal entry to record the sale would be:

Dr. Cash	16(a)
Dr. Accumulated Dep'n.	18
Dr. Loss on Disposal	2(b)
Cr. Machinery	36

The first item (a) is a cash inflow from investing activities. The second item (b) is added back to net income to arrive at cash flow from operating activities.

² Offsetting investing and financing transactions that do not require the use of cash should be excluded from the statement of cash flows, but separately disclosed elsewhere in a note to the financial statements.

P 14–7 continued

The revised operating activities section of the SCF would show:

<i>Operating activities</i>	
Income before income taxes (\$56 + 20)	\$ 76
Income taxes paid (\$20 – 2)	(18)
Items not affecting cash flow	
Depreciation and amortization (\$14 + 2)	16
Net gains on disposal (\$2 – 4)	(2)
Net changes in non-cash working capital (\$4 – 10 – 2 – 4)	<u>(12)</u>
Cash flow from operating activities	<u>\$ 60</u>

1a. Construct the 2022 SCF:

Step 1: Convert net income to cash flow from operations

a. Net income to be added on SCF 117b. Depreciation to be added back 84c. Gains to be deducted (3)

d. Analysis of changes in non-cash working capital accounts:

	2022	2021	Change
	Dr. (Cr.)	Dr. (Cr.)	Debit (Credit)
<i>Non-cash current assets</i>			
Marketable investments*	31	37	(6)
Accounts receivable – trade**	370	257	113
Inventory	503	361	142
<i>Non-cash current liabilities</i>			
Accounts payable	(295)	(219)	(76)
Income taxes payable	(52)	(50)	(2)

* The marketable investments are not considered cash equivalents because they will not be converted into cash within three months of purchase. They are considered part of operating activities on the SCF like other current assets.

** Insurance proceeds receivable will be analyzed as part of long-term assets.

Journal entries to record SCF effects:

Dr. Cash	6	
Cr. Short-term Investments		6
Dr. Accounts Receivable	113	
Cr. Cash		113
Dr. Inventory	142	
Cr. Cash		142
Dr. Cash	76	
Cr. Accounts Payable		76
Dr. Cash	2	
Cr. Income Taxes Payable		2

P 14–8 continued

Step 2: Record investing activities

Analysis of changes in long-term assets accounts:

	2022	2021	Change
	Dr. (Cr.)	Dr. (Cr.)	Debit (Credit)
<i>Long-term assets</i>			
A/R – insurance proceeds	50		50
PPE, net	1,128	712	416

The PPE (net) account had the following transactions:

Balance at Jan. 1 (given)	712	
Addition (derived)	547	
Disposal of warehouse at carrying amount (given)	(47)	} 416 net change
Depreciation expense (given)	<u>(84)</u>	
Balance at Dec. 31 (given)	<u>1,128</u>	

PPE additions must have amounted to \$547 in 2022, per the above analysis.

The journal entry to record the transaction would be:

Dr. PPE	547	
Cr. Cash		547

The 2022 gain on the disposal of the warehouse is calculated as follows:

Cost (given)	100
Accumulated dep'n. (derived)	<u>(53)</u>
Carrying amount (given)	47
Insurance proceeds (given)	<u>(50)</u>
Gain on disposal (derived)	<u>(3)</u>

The journal entry to record the transaction would be:

Dr. Accounts Receivable	50	
Dr. Accumulated Depreciation	53	
Cr. Building		100
Cr. Gain on Disposal		3

There is no cash inflow effect from investing activities related to the receipt of insurance proceeds until 2023. However, the gain on sale will be added back to net income to arrive at cash flow from operating activities on the 2022 SCF.

The depreciation effect (\$84) has been recorded in step 1a above. This is a credit to the Accumulated Depreciation – Equipment account.

P 14–8 continued

Step 3: Record non-current liabilities and shareholders' equity account activities

Analysis of changes in non-current, shareholders' equity, and related accounts:

	2022 <i>Dr. (Cr.)</i>	2021 <i>Dr. (Cr.)</i>	<i>Change Debit (Credit)</i>
<i>Other liabilities*</i>			
<i>Shareholders' equity</i>			
Common shares	(1,063)	(963)	(100)
Retained earnings	(132)	(85)	(47)

* Shareholder loan transactions are relevant for financing activities analysis.
There were no shareholder loans outstanding at the end of 2021 and 2022.

Analysis of common shares transactions:

Balance at Jan. 1 (given)	(963)
Shares issued (derived)	<u>(100)</u>
Balance at Dec. 31 (given)	<u>(1,063)</u>

The journal entry to record the shares issue is:

Dr. Cash	100	
Cr. Common Shares		100

Analysis of the 2022 statement of changes in equity indicates that \$70 of dividends were declared. There are no amounts in Dividends Payable account at the end of 2022 and 2021. Dividends declared must have all been paid in cash.

The journal entry to record the dividends would be:

Dr. Retained Earnings	70	
Cr. Cash		70

P 14–8 continued

Step 4 Calculate the net change in cash and ending cash balance, and prepare the statement of cash flows

<i>Operating activities</i>	
Net income	\$ 117
Items not affecting cash flow	
Depreciation	84
Gain on disposal of warehouse	(3)
Changes in non-cash working capital	
Decrease in marketable securities	6
Increase in accounts receivable	(113)
Increase in inventory	(142)
Increase in accounts payable	76
Increase in income taxes payable	2
Cash flow from operating activities	<u>27</u>
<i>Investing activities</i>	
Purchase of PPE	<u>(547)</u>
Cash flow used by investing activities	<u>(547)</u>
<i>Financing activities</i>	
Payment of dividends	(70)
Common shares issued	<u>100</u>
Cash flow used by financing activities	<u>30</u>
Net decrease in cash and cash equivalents	(490)
Cash and cash equivalents deficiency at beginning of year	<u>(50)</u>
Cash and cash equivalents deficiency at end of year	<u><u>\$ (540)</u></u>
Represented by:	
Cash	\$ 30
Operating bank loan	<u>(570)</u>
	<u><u>\$ (540)</u></u>

P 14–8 continued

1b. Construct the 2023 SCF:

Step 1: Convert net income to cash flow from operations

a. Net income to be added on SCF	<u>116</u>
b. Depreciation to be added back	<u>75</u>
c. Gains to be deducted	<u>(0)</u>

d. Analysis of changes in non-cash working capital accounts:

	2023 Dr. (Cr.)	2022 Dr. (Cr.)	Change Debit (Credit)
<i>Non-cash current assets</i>			
Marketable investments*	36	31	5
Accounts receivable – trade**	544	370	174
Inventory***	833	503	330
<i>Non-cash current liabilities</i>			
Accounts payable****	(302)	(295)	(7)
Income taxes payable	(48)	(52)	4

* The marketable investments are not considered cash equivalents because they will not be converted into cash within three months of purchase. They are considered part of operating activities on the SCF like other current assets.

** Insurance proceeds receivable will be analyzed as part of long-term assets.

*** Just the net change to inventory can be calculated without regard to the write-down. All changes in the inventory account are netted and shown as net changes to non-cash working capital accounts in the operating activities section of the SCF.

**** Excluding dividends payable. These are analyzed as part of financing activities.

P 14–8 continued

Journal entries to record SCF effects:

Dr. Marketable Investments	5	
Cr. Cash		5
Dr. Accounts Receivable	174	
Cr. Cash		174
Dr. Inventory	330	
Cr. Cash		330
Dr. Cash	7	
Cr. Accounts Payable		7
Dr. Income Taxes Payable	4	
Cr. Cash		4

Step 2: Record investing activities

Analysis of changes in long-term asset and related accounts:

	2023 Dr. (Cr.)	2022 Dr. (Cr.)	Change Debit (Credit)
<i>Current asset</i>			
A/R – insurance proceeds		80	(80)
<i>Long-term assets</i>			
PPE, net	1,053	1,128	(75)

The PPE (net) account had the following transactions:

Balance at Jan. 1 (given)	1,128
Depreciation expense (given)	<u>(75)</u>
Balance at Dec. 31 (given)	<u>1,053</u>

Journal entries to record SCF effects:

Dr. Cash	50	
Cr. A/R – Insurance Proceeds		50

The \$50 would be recorded as a cash inflow from investing activities since it relates to the disposal of a long-term asset. The depreciation effect (\$84) has been recorded in step 1a above. There are no other adjustments needed.

P 14–8 continued

Step 3: Record non-current liabilities and shareholders' equity account activities

Analysis of changes in non-current, shareholders' equity, and related accounts:

	2023 Dr. (Cr.)	2022 Dr. (Cr.)	Change Debit (Credit)
<i>Other liabilities</i>			
Shareholder loans	(225)		(225)
Dividends payable	(80)		(80)
<i>Shareholders' equity</i>			
Common shares	(1,063)	(1,063)	
Retained earnings	(168)	(132)	(36)

* Shareholder loan transactions are relevant for financing activities analysis. There were no such loans outstanding at the end of 2021 and 2022.

The journal entry to record the shareholder loan SCF effect would be:

Dr.	Cash	225	
Cr.	Shareholder Loan		225

Analysis of the 2023 statement of changes in equity indicates that besides net income of \$116, dividends of \$80 were declared. There are no amounts in Dividends Payable account at the end of 2022. At the end of 2023, the balance was \$80. In effect, none of the 2023 dividends declared were paid in cash. The journal entry to record the dividend transactions would be:

Dr.	Retained Earnings	80	
Cr.	Dividends Payable		80

P 14–8 continued

Step 4 Calculate the net change in cash and ending cash balance, and prepare the statement of cash flows (comparative figures are optional):

Big Dog Carworks Corp.
Statement of Cash Flows
For the Year Ended December 31, 2023
(000s)

	2023	2022
<i>Operating activities</i>		
Net income	\$ 116	\$ 117
Items not affecting cash flow		
Depreciation	75	84
Gain on disposal of warehouse		(3)
Changes in non-cash working capital		
Decrease (increase) in marketable investments	(5)	6
Increase in accounts receivable	(174)	(113)
Increase in inventory	(330)	(142)
Increase in accounts payable	7	76
Increase (decrease) in income taxes payable	(4)	2
Cash flow from (used by) operating activities	<u>(315)</u>	<u>27</u>
<i>Investing activities</i>		
Insurance proceeds	50	
Purchase of PPE		(547)
Cash flow from (used by) investing activities	<u>50</u>	<u>(547)</u>
<i>Financing activities</i>		
Proceeds from shareholder loan	225	
Payment of dividends		(70)
Issuance of common shares		100
Cash flow from financing activities	<u>225</u>	<u>30</u>
Net decrease in cash and cash equivalents	(40)	(490)
Cash and cash equivalents deficiency at beginning of year	(540)	(50)
Cash and cash equivalents deficiency at end of year	<u>\$ (580)</u>	<u>\$ (540)</u>
Represented by:		
Cash	\$ 20	\$ 30
Operating bank loan	<u>(600)</u>	<u>(570)</u>
	<u>\$ (580)</u>	<u>\$ (540)</u>

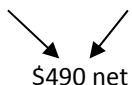
P 14–8 continued

2. The SCF reveals that there is a large net cash outflow in 2022 totalling \$590 due mainly to the purchase of PPE (\$547) and payment of dividends (\$70). Despite a relatively healthy net income in 2022 (\$117), cash flow from operating activities (CFOA) is significantly lower (\$21). In 2023, the effect is even more pronounced (net income: \$116; CFOA: \$310 outflow) due to large increases in inventory and accounts receivable levels. The relatively large increases in non-cash current assets (accounts receivable and inventory) are concerning. Because there was no investment in PPE, no dividends paid, and a large loan advance from a shareholder (\$225) in 2023, cash did not decrease as precipitously as in 2022 (\$40 net cash outflow vs. \$490 net cash outflow, respectively). The SCF indicates that BDCC has become overly-dependent on short-term debt. The company is growing and producing net income but needs to re-balance its financial structure by issuing more common shares and assuming more long-term debt. At the same time, it needs to reduce current liabilities. Likely, the shareholder loan should be converted to long-term debt by agreement with the shareholder. BDCC also needs to address the rapid growth in accounts receivable and inventory levels.

P 14–8 continued

3.a. Cash flow table for the year ended December 31, 2022 (000s):

	<i>Balance</i>		<i>Change</i>		<i>Cash effect</i>	
	<i>2022</i>	<i>2021</i>	<i>Dr.</i>	<i>Cr.</i>	<i>Inflow</i>	<i>Outflow</i>
Cash	30	50		20	} To be explained	
Operating loan	(570)	(100)		470		To be explained
S/T invest.	31	37		6	(a) 6	
Inventory	503	361	142			142
A/R – Trade (net)	370	257	113			113
A/R – Ins. proc.	50	-0-	(b) 50		} {	
PPE, net	1,128	712	(b) 53	(b) 100		(b) 3
				84	84	
			(c) 547			547
Acc. payable	(295)	(219)		76	76	
Inc. taxes pay.	(52)	(50)		2	2	
Common shares	(1,063)	(963)		100	100	
Ret. earnings	(132)	(85)		47	{ 117	
						70
	<u>-0-</u>	<u>-0-</u>	<u>914</u>	<u>914</u>	<u>385</u>	<u>875</u>



\$490 net cash outflow

(a) The marketable investments are not considered cash equivalents because they will not be converted into cash within three months of acquisition. They are considered part of operating activities on the SCF like other current assets.

(b) The 2022 gain on the disposal of the warehouse is calculated as follows:

Cost (given)	\$100
Accumulated dep'n. (derived)	<u>(53)</u>
Carrying amount (given)	47
Insurance proceeds (given)	<u>(50)</u>
Gain on disposal (derived)	<u>\$ (3)</u>

P 14–8 continued

The journal entry to record the transaction would be:

Dr. Accounts Receivable	50	
Dr. Accumulated Depreciation	53	
Cr. Building		100
Cr. Gain on Disposal		3

There is no cash inflow effect from investing activities related to the receipt of insurance proceeds until 2023. However, the gain on sale will be added back to net income to arrive at cash flow from operating activities on the 2022 SCF.

- (c) Balancing figure. Since there were no other disposals, this amount would be the additions to PPE.

The 2022 operating activities of the SCF would be restated as:

	2022
<i>Operating activities</i>	
Income before income taxes	\$ 219
Income taxes paid (102 – 2)	(100)
Items not affecting cash flow	
Depreciation	84
Gain on disposal of warehouse	(3)
Net changes in non-cash working capital	
(\$6 + 76 – 113 – 142)	(176)
Cash flow from operating activities	<u>27</u>

P 14–8 continued

3.b. Cash flow table for the year ended December 31, 2023 (000s):

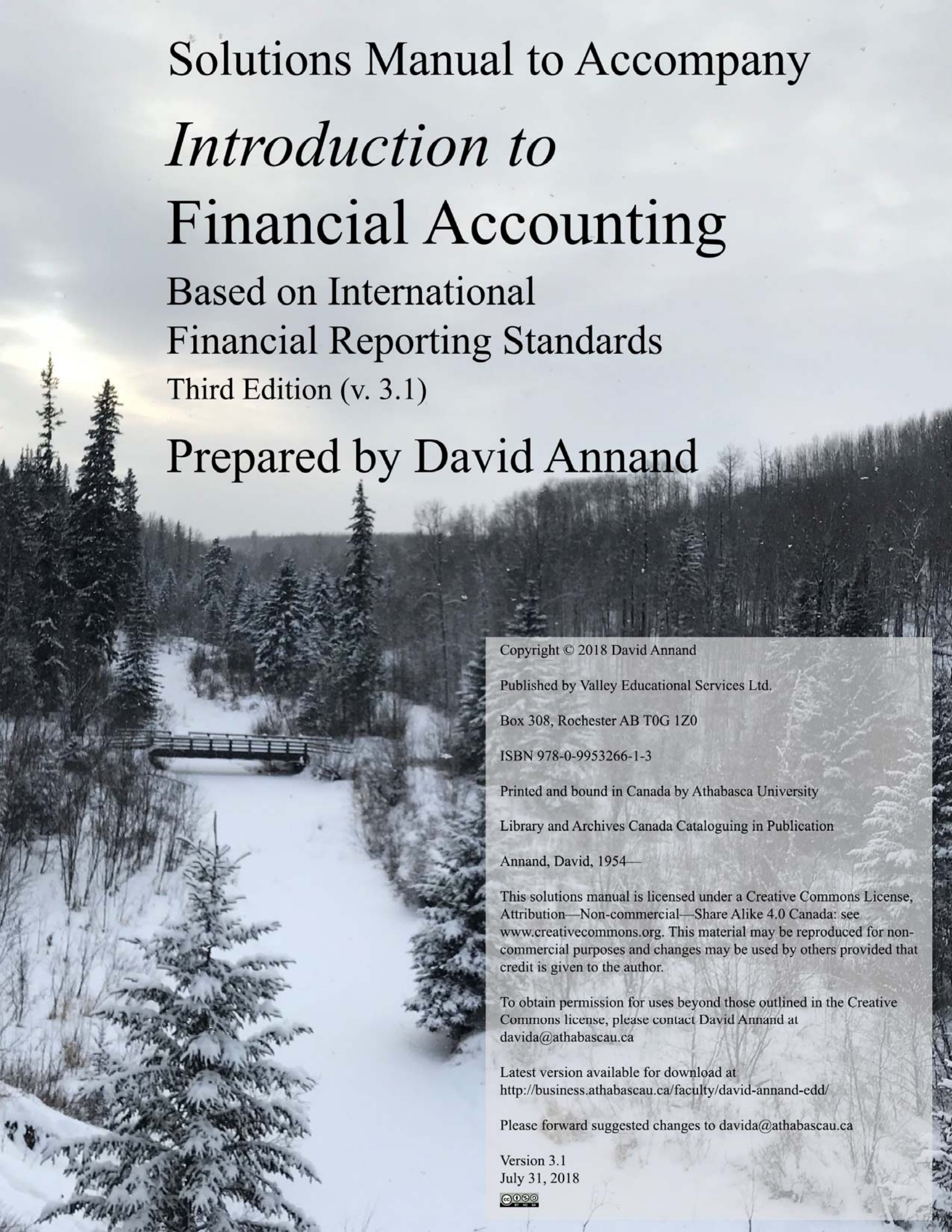
	<i>Balance</i>		<i>Change</i>		<i>Cash effect</i>		<i>Activity</i>
	<i>2023</i>	<i>2022</i>	<i>Dr.</i>	<i>Cr.</i>	<i>Inflow</i>	<i>Outflow</i>	
Cash	20	30		10	To be explained		C&CE
Operating loan	(600)	(570)		30			C&CE
S/T invest.	36	31	5			5	Operating
Inventory	833	503	330			(a) 330	Operating
A/R – Trade (net)	544	370	174			174	Operating
A/R – Ins. proc.	-0-	50		50	(b) 50		Investing
PPE, net	1,053	1,128		75	75		Operating
S/H loan	(225)	-0-		225	225		Financing
Acc. payable	(302)	(295)		7	7		Operating
Div. payable	(80)	-0-		80	(c) 80		Financing
Inc. taxes pay.	(48)	(52)	4			4	Operating
Common shares	(1,063)	(1,063)					
Ret. earnings	(168)	(132)		36	116	(c) 80	Operating Financing
	<u>-0-</u>	<u>-0-</u>	<u>513</u>	<u>513</u>	<u>553</u>	<u>593</u>	

\$40 net cash outflow

- (a) Just the net change to inventory can be calculated without regard to the write-down. All changes in the inventory account are netted and shown as net changes to non-cash working capital accounts in the operating activities section of the SCF.
- (b) Since this relates to the 2022 disposal of the warehouse, it would be recorded as an investing activity.
- (c) There is no cash effect when the dividends are declared.

The 2023 operating activities of the SCF would be restated as:

<i>Operating activities</i>	
Income before income taxes	\$ 211
Income taxes paid (\$95 + 4)	(99)
Items not affecting cash flow	
Depreciation	75
Net changes in non-cash working capital	
(\$7 – 174 – 330 – 5)	(502)
Cash flow used by operating activities	<u>(315)</u>



Solutions Manual to Accompany *Introduction to* Financial Accounting

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