# Module 2

## Review of Business Activities and Financial Statements

| Learning Objectives – Coverage by question | | | | | |
|---|---|---|---|---|---|
| | True/False | Multiple Choice | Exercises | Problems | Essays |
| **LO1 –** Examine and interpret a balance sheet. | 1-7, 11 | 1-8, 13-15, 24, 26, 27, 29 | 1-7, 9-13 | 1-3, 5, 6, 9-12 | 1 |
| **LO2 –** Examine and interpret an income statement. | 7-9 | 9-12, 25, 28, 30 | 1, 2, 9, 10 | 4, 5, 9-12 | |
| **LO3 –** Examine and interpret a statement of stockholders' equity. | | | 1, 2, 10 | 9-12 | |
| **LO4-** Describe a statement of cash flows. | 10 | 20-23 | 1, 2, 10 | 9-12 | |
| **LO5** – Apply linkages among the four financial statements. | 12-14 | 16-23 | 8-10 | 7-12 | 2 |
| **LO6** – Explain the accounting cycle and apply the financial statement effects template to analyze accounting transactions. | 15-20 | 31-38, 44, 45, 53-55 | 14-17 | 13-18 | 3 |
| **LO7** – Prepare and explain accounting adjustments and their financial statement effects. | 21-25 | 39-43, 51, 52 | 17-22 | 13, 14, 17, 18 | 3, 4 |
| **LO8** – Construct financial statements from the accounting records. | 26-27 | 44, 46 | 23-25 | 18-20 | 3 |
| **LO9** – Explain and apply the closing process. | 28, 29 | 47-50 | 18, 26 | 21, 22 | 3, 5 |
| **LO10 –** Locate and use additional information from public sources. | 30, 31 | | | | |

# Module 2: Review of Business Activities and Financial Statements

## True/False

**Topic: Definition of an Asset**
**LO: 1**

**1.** In order for an asset to be reported on the balance sheet, it must be owned or controlled by the company and be expected to provide future benefits.

*Answer:* True
*Rationale:* Assets reported on the balance sheet must be owned or controlled by the company and must be expected to provide future benefits. These benefits can relate to the expected receipt of cash or another asset, or the expected decrease in a liability.

**Topic: Historical Cost**
**LO: 1**

**2.** Assets are reported on the balance sheet at their current market value.

*Answer:* False
*Rationale:* Assets are generally reported at historical costs. An exception is marketable securities.

**Topic: Book vs. Market Value**
**LO: 1**

**3.** The book value of stockholders' equity (the amount reported on the balance sheet) is most typically equal to the market value of the equity of a company.

*Answer:* False
*Rationale:* Book value and market value differ for many reasons, including reporting assets at historical costs instead of current market value, and differences between the accounting periods in which transactions are recognized in the financial statements and when the value implications of those transactions are recognized by the capital markets.

**Topic: Reporting of Assets and Liabilities**
**LO: 1**

**4.** Assets are listed on the balance sheet in order of liquidity and liabilities are listed in order of maturity.

*Answer:* True
*Rationale:* Assets are reported in the order that they are generally expected to be converted into cash. Receivables are, thus, reported before inventories, and inventories before PPE. Liabilities are reported in order of maturity, with current liabilities expected to be paid within one year and long-term liabilities expected to be paid over a longer period of time.

**Topic: Unrecorded Assets**
**LO: 1**

**5.** In addition to purchased assets like inventories and equipment, companies also may report on their balance sheets intangible assets such as the value of a brand name.

*Answer:* True
*Rationale:* Companies *may* report intangible assets if they acquired them in an arms' length transaction. But if the intangible was not purchased, if it was internally generated it may not be included on the balance sheet because its future economic benefits cannot be reliably measured. So, all internally generated intangible assets are excluded from the balance sheet under GAAP.

**Topic: Liabilities**
**LO: 1**

**6.** Liabilities and equities are both claims against the assets of a company.

*Answer:* True
*Rationale:* Both liabilities and equity are claims against the assets. In the event of default of a company, liabilities are settled first against the assets of the company. The owners, however, still have an interest in the remaining assets.

**Topic: Unearned Revenue and Revenue Recognition Principle**
**(more challenging—involves unearned revenue and recognition thereof.)**
**LO: 1, 2**

**7.** A customer's prepayment for services not yet rendered is initially recorded as unearned revenue (a liability). Then, at the end of the accounting period, the unearned revenue is moved from the balance sheet to the income statement. This is an example of the revenue recognition principle.

*Answer:* False
*Rationale:* Unearned revenue is recorded for customer prepayments. But it is only moved to the income statement when the services have been rendered and not automatically at the end of the accounting period.

**Topic: Revenue Recognition Principle and Cash**
**LO: 2**

**8.** According to the revenue recognition principle, companies are required to record revenue when cash is received as this provides the most objective evidence for the auditors.

*Answer:* False
*Rationale:* Revenue is recognized when the company has done what it is obligated to do under the sales contract, such as, when goods have been transferred or services performed for the customer. This means a sale of goods on credit would qualify for recognition of revenue although no cash was received.

**Topic: Accrual Accounting for Expenses**
**LO: 2**

**9.** Under accrual accounting principles, the cost of inventory should be reported as an expense in the income statement when it is sold, regardless of when it was purchased.

*Answer:* True
*Rationale:* Under accrual accounting, the cost of inventory is reported as expense in the period in which it is used up, typically at the point of sale. Purchased inventories that have not yet been sold are reported as assets, notwithstanding whether or not they have been paid for.

**Topic: Statement of Cash Flows**
**LO: 4**
**10.** The statement of cash flows has three main sections: cash flows from operating activities, cash flows from investing activities, and cash flows from capital activities.

*Answer:* False
*Rationale:* The statement of cash flows has three sections: cash flows from operating activities, cash flows from investing activities, and cash flows from financing activities.

**Topic: Net working Capital**
**LO: 1**
**11.** Net working capital = Current assets + Current liabilities

*Answer:* False
*Rationale:* Net working capital = Current assets less current liabilities.

**Topic: Articulation of Financial Statements**
**LO: 5**
**12.** Articulation refers to the concept that financial statements are linked to each other and linked across time.

*Answer:* True
*Rationale:* Balance sheets are linked over time because the permanent accounts' closing balance last period becomes the opening balance in the current period. The statements are linked to each other via cash (statements of cash flow and balance sheets), via retained earnings (income statements and balance sheets), and via equity accounts (statements of stockholders' equity and balance sheets).

**Topic: Articulation of Financial Statements**
**LO: 5**
**13.** The income statements of the prior and current year are linked via the balance sheet.

*Answer:* False
*Rationale:* The balance sheets of the prior and current year are linked via the income statement.

**Topic: Articulation of Retained Earnings**
**LO: 5**
**14.** Retained earnings articulate across time which means that last period's retained earnings plus current period net income (or loss) is equal to the current period's retained earnings.

*Answer:* False
*Rationale:* Last period's retained earnings plus current period net income (or loss) less any dividends paid, is equal to the current period's retained earnings.

**Topic: Financial Statement Effects Template**
**LO: 6**
**15.** The financial statement effects template captures the effects of transactions on all four financial statements.

*Answer:* True
*Rationale:* The balance sheet accounts are all on the left side of the template and the income statement accounts on the right. In addition, the cash column provides the statement of cash flows, and the two equity columns can be used to construct the statement of shareholders' equity.

**Topic: Journal Entries**
**LO: 6**
**16.** Assets, expenses and dividends increase with debits.

*Answer:* True
*Rationale:* Assets increase with debits and equity decreases with debits. Therefore, expenses and dividends decrease equity – they are debits.

**Topic: Journal Entries**
**LO: 6**
**17.** Increases are recorded on the left side of asset T-accounts and on the right side of liability T-accounts.

*Answer:* True
*Rationale:* Debits increase assets and credits increase liabilities.

**Topic: Financial Statement Effects of Transactions**
**LO: 6**
**18.** When shareholders contribute capital to a company, earned capital increases because the company has earned the shareholders' investments.

*Answer:* False
*Rationale:* When shareholders contribute capital to a company, contributed, not earned, capital increases.

**Topic: Financial Statement Effects of Transactions**
**LO: 6**
**19.** Revenues and expenses affect the income statement but not the balance sheet.

*Answer:* False
*Rationale:* Revenue and expense recognition increases retained earnings on the balance sheet.

**Topic: Financial Statement Effects of Transactions**
**LO: 6**
**20.** Revenue is typically recorded as earned when cash is received because that is when the company can measure the revenue objectively.

*Answer:* False
*Rationale:* Revenue is recorded when it is earned regardless of when cash is received.

**Topic: Financial Statement Effects of Transactions**
**LO: 7**
**21.** Expenses that are paid in advance are held on the balance sheet until the end of the accounting period when they are transferred to the income statement with accounting adjustments.

*Answer:* False
*Rationale:* Expenses paid in advance include prepaid insurance, inventory and fixed assets. All of these items end up on the income statement when they are used up, not necessarily at the end of the accounting period.

**Topic: Accrual Accounting**
**LO: 7**
**22.** Accrual accounting recognizes revenues only when cash is received and expenses only when cash is paid.

*Answer:* False
*Rationale:* Accrual accounting refers to the recognition of revenue when products and services are delivered at an amount expected to be received and the matching of expenses when incurred. The recognition of revenues and expenses does not, necessarily, relate to the receipt or payment of cash.

**Topic: Accrual Accounting**
**LO: 7**
**23.** The journal entry for recording sales revenue that has been earned is to debit accounts receivable if cash will be received later, or credit unearned revenue if cash was received in advance.

*Answer:* True
*Rationale:* If cash is received later, the debit is to accounts receivable. If the cash is received before revenue is earned then the appropriate debit is to cash and a credit to unearned revenue.

**Topic: Accounting Adjustments**
**LO: 7**
**24.** The journal entry for recording cost of sales is to debit cost of sales expense and credit the inventory account.

*Answer:* True
*Rationale:* The journal entry for recording cost of sales is to debit cost of sales expense and credit inventory. When the cash is paid for the inventory does not affect the expense.

**Topic: Accounting Adjustments**
**LO: 7**
**25.** Companies make adjustments to more accurately reflect items on the income statement and the balance sheet.

*Answer:* True
*Rationale:* Adjustments ensure that performance and position are accurately portrayed in the financial statements.

**Topic: Preparing Financial Statements**
**LO: 8**
**26.** There is a certain order in which a company prepares its financial statements. First, a company prepares its balance sheet.

*Answer:* False
*Rationale:* A company first prepares its income statement. It then uses the net income number and dividend information to update the retained earnings account.

**Topic: Preparing Financial Statements**
**LO: 8**
**27.** Two steps must be completed in order to prepare financial statements: recording transactions during the period and adjusting records to ensure all events are properly recorded.

*Answer:* True
*Rationale:* Both steps are required to prepare accrual based financial statements.

**Topic: Closing Accounts**
**LO: 9**
**28.** A company closes all of its accounts in order to zero out the balances so that next period starts with a fresh slate.

*Answer:* False
*Rationale:* A company closes its temporary accounts only. Balance sheet accounts are never closed out – they have cumulative balances.

**Topic: Closing Accounts**
**LO: 9**
**29.** To close revenue accounts, a company must debit Retained Earnings because Revenue has a credit balance and debits must equal credits.

*Answer:* False
*Rationale:* Revenue does have a credit balance. Therefore, to close Revenue, the company debits Revenue and credits Retained earnings.

**Topic: Additional Information Sources**
**LO: 10**
**30.** All companies must file with the SEC a detailed annual report and discussion of their business activities in their Form 10-K.

*Answer:* False
*Rationale:* Companies with publicly traded securities must file with the SEC, not all companies.

**Topic: Additional Information Sources**
**LO: 10**
**31.** A publicly traded company must file a Form 8-K with the SEC within four business days following a change in its certified public accounting firm.

*Answer:* True
*Rationale:* A change in a company's certified public accounting firm is one of several events in which the SEC requires a company to disclose the change by filing a Form 8-K within four business days following the event.

## Multiple Choice

**Topic: Reporting of Assets**
**LO: 1**

**1.** Assets are recorded in the balance sheet in order of:
A) Market Value
B) Historic Value
C) Liquidity
D) Maturity
E) None of the above

*Answer:* C
*Rationale:* Liquidity refers to the ease of conversation to cash. Current Assets are to be used during the current operating cycle. Non-current assets, like equipment and goodwill are reported after current assets. Market value and historic value refer not to the order but to the valuation of assets. Maturity refers to the order in which liabilities are recorded in the balance sheet.

**Topic: Current Assets**
**LO: 1**

**2.** Which of the following are included in current assets?
A) Prepaid rent
B) Taxes payable
C) Automobiles
D) Common stock
E) None of the above

*Answer:* A
*Rationale:* Taxes payable is a liability, automobiles is not a current asset but a long-term one, and common stock is an equity.

**Topic: Net Working Capital—Numerical calculations required**
**LO: 1**

**3.** In 2016, Southwest Airlines had negative net working capital of $(2,346) million and current assets of $4,498 million.

The firm's current liabilities are:
A) $2,152 million
B) $6,844 million
C) $2,346 million
D) $5,236 million
E) There is not enough information to calculate the amount.

*Answer:* B
*Rationale:* Net working capital = Current assets – Current liabilities.
Current liabilities = Current assets – Net working capital
Current liabilities = $4,498 – $(2,346)
Current liabilities = $6,844 million

**Topic: Net Working Capital—Numerical calculations required**
**LO: 1**

**4.** In 2016, Delphi Automotive PLC had current assets of $5,419 million and current liabilities of $4,148 million.

The firm's net working capital is:
A) $ 1,271 million
B) $ 5,419 million
C) $ (1,271) million
D) $ 9,567 million
E) None of the above

*Answer:* A
*Rationale:* Net working capital = Current assets – Current liabilities.
Net working capital = $5,419 – $4,148
Net working capital = $1,271 million.

**Topic: Net Working Capital—Numerical calculations required**
**LO: 1**

**5.** In 2016, Kohl's Corporation had net working capital of $2,273 million and current liabilities of $2,974 million.

The firm's current assets are:
A) $ 8,221 million
B) $ (8,221) million
C) $ 5,247 million
D) $ 2,974 million
E) None of the above

*Answer:* C
*Rationale:* Net working capital = Current assets – Current liabilities.
$2,273 = Current assets – $2,974
Current assets = $5,247

**Topic: Liabilities**
**LO: 1**

**6.** Which one of the following is *not* a current liability?
A) Taxes payable
B) Accounts payable
C) Wages payable
D) Wage expense
E) None of the above

*Answer:* D
*Rationale:* Wage expense is an income statement account, not a balance sheet account. It is not a current liability.

**Topic: Stockholders' Equity**
**LO: 1**

**7.** Which of the following is included as a component of stockholders' equity?
A) Buildings
B) Retained earnings
C) Prepaid property taxes
D) Accounts payable
E) Dividends

*Answer:* B
*Rationale:* Retained earnings is a component of stockholders' equity. Dividends affect retained earnings but they are not reported as a separate component.

**Topic: Recognition of Costs as Expense**
**LO: 1**

**8.** As inventory and property plant and equipment on the balance sheet are consumed, they are reflected:
A) As a revenue on the income statement
B) As an expense on the income statement
C) As a use of cash on the statement of cash flows
D) On the balance sheet because assets are never consumed
E) Both B and C because the financial statements articulate

*Answer:* B
*Rationale:* As assets are consumed (used up), their cost is transferred to the income statement as expenses. Cash is not involved so C and E are incorrect.

**Topic: Income Statement**
**LO: 2**

**9.** Interest expense appears in which financial statement?
A) Statement of stockholders' equity
B) Balance sheet
C) Income statement
D) Statement of cash flows
E) All of the above

*Answer:* C
*Rationale:* Expenses, including interest expense, appear in the income statement.

**Topic: Gross Profit—Numerical calculations required**
**LO: 2**

**10.** During fiscal 2016, Mattel had sales of $5,456,650, total expenses of $5,138,628 and gross profit of $2,554,391.

What was Mattel's cost of sales for 2016? ($ in thousands)

A) $2,102,065 thousand
B) $5,138,628 thousand
C) $2,902,259 thousand
D) $   903,944 thousand
E) There is not enough information to calculate the cost of sales.

*Answer:* C
*Rationale:* Sales – Cost of sales = Gross profit
$ 5,456,650 – Cost of sales = $2,554,391
Cost of sales = $2,902,259 thousand

**Topic: Net Income—Numerical calculations required**
**LO: 2**

**11.** During fiscal 2016, Kohl's had sales of $18,686 million, Cost of merchandise sold of $11,944 million, and gross profit of $6,741 million.

What was net income for 2016?

A) $  6,741 million
B) $11,944 million
C) $  5,299 million
D) $18,686 million
E) There is not enough information to calculate the amount.

*Answer:* E
*Rationale:* Sales – Total expenses = Net income. There is no information about total expenses, so we cannot compute net income.

**Topic: Net Income—Numerical calculations required**
**LO: 2**

**12.** During 2016, Skechers U.S.A., Inc. had Sales of $3,563.3 million, Gross profit of $1,634.6 million and Selling, general, and administrative expenses of $1,278.0 million.

What was Skechers' Cost of sales for 2016?

A) $1,115.7 million
B) $1,928.7 million
C) $     88.1 million
D) $1,549.5 million
E) There is not enough information to calculate the amount.

*Answer:* B
*Rationale:* Sales – Cost of sales = Gross profit
$3,563.3 – Cost of sales = $1,634.6.
Cost of sales = $1,928.7 million

**Topic: Components of Financial Statements—Numerical calculations required (more challenging; total assets not given)**
**LO: 1**

**13.** In its December 31, 2016 financial statements, Harley-Davidson reported the following (in millions):

| Long-term Assets | Current Liabilities | Long-term Liabilities | Total Liabilities | Equity |
|---|---|---|---|---|
| $6,036 | $ 2,863 | $ 5,107 | $7,970 | $1,920 |

At December 31, 2016, current assets amount to:
A) $2,863 million
B) $3,854 million
C) $7,970 million
D) $5,519 million
E) None of the above

*Answer: B*
*Rationale:* Total assets = Total liabilities + Equity.
Total assets – Long-term assets = Current assets.
Current assets = $7,970 + $1,920 – $6,036.
Current assets = $3,854 million

**Topic: Components of Financial Statements—Numerical calculations required**
**LO: 1**

**14.** In 2016, Nordstrom, Inc. reported the following (in millions):

| Current Assets | Current Liabilities | Long-term Liabilities | Equity |
|---|---|---|---|
| $3,242 | $3,029 | $3,959 | $870 |

What amount did Nordstrom report as total assets?
A) $ 4,616 million
B) $ 3,950 million
C) $ 7,307 million
D) $13,170 million
E) None of the above

*Answer:* E
*Rationale:* Total assets = Total liabilities + Equity
Total assets = $3,029 + $3,959 + $870 = $7,858 million.
This amount is not given in the problem.

**Topic: Components of Financial Statements—Numerical calculations required**
**LO: 1**

**15.** In 2016, Caterpillar Inc. reported the following (in millions):

| Current Assets | Long-term Assets | Current Liabilities | Total Liabilities |
|---|---|---|---|
| $31,967 | $42,737 | $26,132 | $61,491 |

What amount did Caterpillar report as equity in 2016?

A) $36,721 million
B) $13,213 million
C) $84,896 million
D) $17,457 million
E) None of the above

*Answer:* B
*Rationale:* Total assets = Total liabilities + Equity
$31,967 + $42,737 = $61,491 + Equity
Equity = $13,213 million.

**Topic: Articulation of Statement of Retained Earnings with Income Statement—Numerical calculations required**
**LO: 5**

**16.** During fiscal year-end 2016, Kohl's Corporation reports the following (in $ millions): net income of $556, retained earnings at the end of the year of $12,522 and retained earnings at the beginning of the year of $12,329. Assume that there were no other retained earnings transactions during fiscal 2016.

What dividends did the firm pay in fiscal year ended January 28, 2017?

A) $ 683 million
B) $1,669 million
C) $ 363 million
D) $-0-
E) There is not enough information to calculate the amount.

*Answer:* C
*Rationale:* Retained earnings, 2016 = Retained earnings, 2015 + Net Income – Dividends
Dividends = Retained earnings, 2015 + Net Income – Retained earnings, 2016
Dividends = $12,329 + $556 – $12,522 = $363 million

**Topic: Articulation of Statement of Retained Earnings with Balance Sheet—Numerical calculations required**
**LO: 5**

**17.** Caterpillar Inc. reports a net loss for 2016 of $(67) million, retained earnings at the end of the year of $27,377 million, and dividends during the year of $1,802 million.

What was the company's retained earnings balance at the start of 2016?

A) $29,246 million
B) $30,361 million
C) $28,065 million
D) $26,572 million
E) There is not enough information to calculate the amount.

*Answer:* A
*Rationale:* Retained earnings, 2016 = Retained earnings, 2015 + Net Income – Dividends
$27,377 = Retained earnings, 2015 + $(67) – $1,802.
Retained earnings at the start of the year were $29,246 million.

**Topic: Articulation of Statement of Retained Earnings with Balance Sheet—Numerical calculations required**
**LO: 5**

**18.** Pfizer Inc., a pharmaceutical company, reported net income for fiscal 2016 of $7,215 million, retained earnings at the start of the year of $71,993 million and dividends of $7,448 million, and other transactions with shareholders that increased retained earnings during the year by $14 million.

If there were no additional transactions during the year that affected retained earnings, what was the balance of retained earnings at the end of the year?

A) $ 71,774 million
B) $ 38,748 million
C) $124,926 million
D) $ 47,729 million
E) There is not enough information to calculate the amount.

*Answer:* A
*Rationale:* Retained earnings, 2016 = Retained earnings, 2015 + Net Income – Dividends + Other
Retained earnings, 2016 = $71,993 + $7,215 - $7,448 +$14
Ending retained earnings = $71,774 million.

**Topic: Articulation of Statement of Retained Earnings with Income Statement—Numerical calculations required**

**LO: 5**

**19.** Intel reports retained earnings at the end of fiscal 2016 of $40,747 million and retained earnings at the end of fiscal 2015 of $37,614 million. The company reported dividends of $4,925 million and other transactions with shareholders that reduced retained earnings during the year by $2,258 million.

How much net income did the firm report in fiscal 2016?

A) $ 3,133 million net income
B) $ 3,133 million net loss
C) $10,316 million net income
D) $10,316 million net loss
E) None of the above

*Answer:* C
*Rationale:*
Retained earnings, 2016 = Retained earnings, 2015 + Net Income – Dividends +/- Other transactions
$40,747 = $37,614 + Net income – $4,925 – $2,258
Net income = $10,316 million net income.

**Topic: Articulation of Statement of Cash Flows with Balance Sheet—Numerical calculations required**

**LO: 4, 5**

**20.** In its fiscal 2016 annual report, Nike, Inc. reported cash of $3,138 million at year end. The statement of cash flows reports the following (in millions):

| | |
|---|---|
| Net cash from operating activities | $3,096 |
| Net cash from investing activities | (1,034) |
| Net cash from financing activities | (2,776) |

What was the balance in Nike's cash account at the start of fiscal 2016?

A) $3,096 million
B) $1,020 million
C) $3,852 million
D) $4,357 million
E) None of the above

*Answer:* C
*Rationale:* Cash at end of year = Cash at beginning of year + Change in cash during the year
$3,138 = Cash at beginning of year + $3,096 – $1,034 – $2,776
Cash at beginning of year = $3,852 million

**Topic: Articulation of Statement of Cash Flows with Balance Sheet—Numerical calculations required**
**LO: 4, 5**

**21.** In its fiscal 2016 balance sheet, JetBlue Airways Corporation, reported cash of $443 million at year-end. The statement of cash flows reports that cash increased by $115 million during the year and that net cash flow from operating activities was $1,632 million.

What was the cash flow from investing activities during the year?
A) $533 million cash outflow
B) $715 million cash inflow
C) $533 million cash inflow
D) $715 million cash outflow
E) There is not enough information to determine the amount.

*Answer:* E
*Rationale:* Change in cash during the year = Cash from operations + Cash from investing + Cash from financing. We are only given two of the four amounts.

**Topic: Articulation of Statement of Cash Flows with Balance Sheet—Numerical calculations required**
**LO: 4, 5**

**22.** In its fiscal year ended January 28, 2017 balance sheet, Big Lots, Inc., reported cash and cash equivalents at the start of the year of $54,144 thousand. By the end of the year, the cash and cash equivalents had decreased to $51,164 thousand. The company's statement of cash flows reported cash from operating activities of $311,925 thousand, cash from financing activities of $(230,204) thousand.

What amount did the company report for cash from investing activities?
A) $122,391 thousand cash inflow
B) $ 7,966 thousand cash outflow
C) $ 84,701 thousand cash inflow
D) $ 84,701 thousand cash outflow
E) None of the above.

*Answer:* D
*Rationale:* Cash at end of year = Cash at start of year + Cash from operations + Cash from investing + Cash from financing.
$51,164 = $54,144 + $311,925 + Cash from investing + $(230,204)
Cash from investing is an outflow of $84,701 thousand.

**Topic: Statement of Cash Flows—Numerical calculations required**
**LO: 4, 5**

**23.** On its fiscal year ended February 3, 2017 statement of cash flows, Dell Technologies Inc. reports the following (in millions):

| | |
|---|---|
| Net cash from operating activities | $2,222 |
| Net cash from investing activities | (31,256) |
| Cash at the beginning of the year | 6,576 |
| Change in cash during the year | 2,898 |

What did Dell report for “Net cash from financing activities” during fiscal year ended 2017?

A) $31,932 million cash inflow
B) $31,932 million cash outflow
C) $2,898 million cash inflow
D) $2,898 million cash outflow
E) None of the above

*Answer:* A
*Rationale:* Change in cash during the year = Cash from operations + Cash from investing + Cash from financing.
$2,898 = $2,222 + $(31,256) + Cash from financing
Cash from financing = $31,932 million

**Topic: Transaction Effects on the Balance Sheet**
**LO: 1**

**24.** How would cash collected on accounts receivable affect the balance sheet?

A) Increase liabilities and decrease equity
B) Decrease liabilities and increase equity
C) Increase assets and decrease assets
D) Increase assets and increase equity

*Answer:* C
*Rationale:* Cash collected on accounts receivable produces an increase in cash and a decrease in accounts receivable, both asset accounts. There is no impact on liabilities or on equity.

**Topic: Transaction Effects on the Income Statement (more challenging)**
**LO: 2**

**25.** How would a purchase of inventory on credit affect the income statement?

A) It would increase liabilities
B) It would decrease retained earnings
C) It would increase assets
D) Both A and C, above
E) None of the above

*Answer:* E
*Rationale:* The purchase on credit increases both accounts payable and inventory, which are balance sheet accounts. It would, therefore, have no effect on the income statement.

**Topic: Cash Conversion Cycle**
**LO: 1**

**26.** The cash conversion cycle is computed as

A) Days sales outstanding + Days inventory outstanding – Days payable outstanding
B) Days sales outstanding – Days payable outstanding
C) Days sales outstanding – Days inventory outstanding
D) Days sales outstanding – Days inventory outstanding + Days payable outstanding
E) None of the above

*Answer:* A
*Rationale:* Cash conversion cycle = Days sales outstanding + Days inventory outstanding – Days payable outstanding.

**Topic: Cash Conversion Cycle—Numerical calculations required**
**LO: 1**

**27.** Prestige Company has determined the following information for its recent fiscal year.

| | |
|---|---|
| Days inventory outstanding | 42.7 days |
| Days payable outstanding | 56.8 days |
| Days sales outstanding | 91.3 days |

Compute Prestige Company's cash conversion cycle.

A) 8.2 days
B) 77.2 days
C) 105.4 days
D) 99.5 days
E) None of the above

*Answer:* B
*Rationale:* 91.3 days + 42.7 days – 56.8 days = 77.2 days

**Topic: Gross Profit Margin—Numerical calculations required**
**LO: 2**
**28.** Following is Stanley Black & Decker's income statement for 2016 (in millions):

| STANLEY BLACK & DECKER, INC.<br>Income Statement<br>For the year ended December 31, 2016 | |
|---|---|
| ($ millions) | |
| Sales | $11,406.9 |
| Cost of goods sold | 7,139.7 |
| Gross profit | $4,267.2 |
| Selling, general and administrative expenses | 2,602.0 |
| Other operating expenses | 268.2 |
| Operating income | 1,397.0 |
| Interest and other nonoperating expenses | 171.3 |
| Income before income tax | 1,225.7 |
| Income tax expense | 261.2 |
| Net income | $964.5 |

Compute Stanley Black & Decker's gross profit margin.
A) 63.6%
B) 12.2%
C) 37.4%
D) 8.5%
E) None of the above

*Answer:* C
*Rationale:* $4,267.2 / $11,406.9 = 37.4%

**Topic: Identifying and Classifying Balance Sheet Items**
**LO: 1**
**29.** Identify which of the following items would be reported in the balance sheet.

| | | |
|---|---|---|
| a. Cash | d. Wage expense | g. Net income |
| b. Sales | e. Wages payable | h. Inventory |
| c. Long-term debt | f. Retained earnings | i. Cost of goods sold |

Items reported in the balance sheet would include:
A) a, b, c, e, and f
B) b, e, f, h, and i
C) c, d, e, h, and i
D) a, c, e, f, and h
E) c, e, f, h, and i

*Answer:* D
*Rationale:* Balance sheet items include: a. Cash, c. Long-term debt, e. Wages payable, f. Retained earnings, and h. Inventory.

**Topic: Identifying and Classifying Income Statement Items**
**LO: 2**
**30.** Identify which of the following items would be reported in the income statement.

| | | | | | |
|---|---|---|---|---|---|
| a. | Cash | d. | Wage expense | g. | Net income |
| b. | Sales | e. | Wages payable | h. | Inventory |
| c. | Long-term debt | f. | Retained earnings | i. | Cost of goods sold |

Items reported in the income statement would include:
A) b, e, g, and h
B) a, b, d, and i
C) b, e, f, and g
D) d, f, g, and h
E) b, d, g, and i

*Answer:* E
*Rationale:* Income statement items include: b. Sales, d. Wages expense, g. Net income, and i. Cost of goods sold.

**Topic: Financial Statement Effects—Sales on Account**
**LO: 6**
**31.** Sales on account would produce what effect on the balance sheet?
A) Increase the Revenue account
B) Increase noncash assets (Accounts receivable)
C) Increase cash assets
D) A and B
E) A, B and C

*Answer:* B
*Rationale:* Revenue is not on the balance sheet, therefore *Answers A, D,* and *E* are incorrect. Cash has not yet been received from the customer.

**Topic: Financial Statement Effects—Collection of a Receivable**
**LO: 6**
**32.** Cash collected on accounts receivable would produce what effect on the balance sheet?
A) Increase liabilities and decrease equity
B) Decrease liabilities and increase equity
C) Increase assets and decrease assets
D) Decrease assets and decrease liabilities
E) None of the above

*Answer:* C
*Rationale:* Cash collected on accounts receivable produces an increase in cash and a decrease in accounts receivable, both asset accounts. There is no impact on profit and on equity.

**Topic: Financial Statement Effects—Inventory Purchase**
**LO: 6**
**33.** How would a purchase $400 of inventory on credit affect the income statement?
- A) It would increase liabilities by $400.
- B) It would decrease liabilities by $400.
- C) It would increase noncash assets by $400.
- D) Both A and C
- E) None of the above

*Answer:* E
*Rationale:* There is no income statement effect of an inventory purchase.

**Topic: Financial Statement Effects—Inventory Purchase**
**LO: 6**
**34.** During fiscal 2016, Shoe Productions recorded inventory purchases on credit of $337.8 million. The financial statement effect of these purchase transactions would be to:
- A) Increase liabilities (Accounts payable) by $337.8 million
- B) Decrease cash by $337.8 million
- C) Increase expenses (Cost of goods sold) by $337.8 million
- D) Decrease noncash assets (Inventory) by $337.8 million
- E) Both A and D

*Answer:* A
*Rationale:* Credit purchases do not involve cash or expenses (B and C are incorrect). Noncash assets increase not decrease (D is incorrect).

**Topic: Financial Statement Effects—Cost of Goods Sold *(Numerical calculation required)***
**LO: 6**
**35.** During fiscal 2016, Shoe Productions recorded inventory purchases on credit of $337.8 million. Inventory at the start of the year was $38.2 million and at the end of the year was $53.0 million.

Which of the following describes how these transactions would be entered on the financial statement effects template?
- A) Increase liabilities (Accounts payable) by $323.0 million
- B) Increase expenses (Cost of goods sold) by $337.8 million
- C) Increase expenses (Cost of goods sold) by $323.0 million
- D) Increase noncash assets (Inventory) by $14.8 million
- E) Both A and C

*Answer:* C
*Rationale:* Cost of goods sold is purchases less the increase in inventory = $323.0 (C is correct) Liabilities increase by $337.8 when the inventory was purchased (not $323.0) so A is incorrect. Inventory increases during the year by $14.8 million but not because of a transaction being entered (D is incorrect).

**Topic: Financial Statement Effects—Accounts Receivable Collection**
**LO: 6**

**36.** During fiscal 2016, Plastics and Synthetic Resins Company recorded cash of $87,800 from customers for accounts receivable collections.

Which of the following financial statement effects template entries captures this transaction?

A)

| Balance Sheet | | | | | | | | | Income Statement | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Cash Asset** | **+** | **Noncash Assets** | **=** | **Liabilities** | **+** | **Contrib. Capital** | **+** | **Earned Capital** | **Revenues** | **–** | **Expenses** | **=** | **Net Income** |
| +87,800 | | | = | | | | | +87,800 (Retained Earnings) | +87,800 | – | | = | +87,800 |

B)

| Balance Sheet | | | | | | | | | Income Statement | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Cash Asset** | **+** | **Noncash Assets** | **=** | **Liabilities** | **+** | **Contrib. Capital** | **+** | **Earned Capital** | **Revenues** | **–** | **Expenses** | **=** | **Net Income** |
| +87,800 | | -87,800 (AR) | = | | | | | | | – | | = | |

C)

| Balance Sheet | | | | | | | | | Income Statement | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Cash Asset** | **+** | **Noncash Assets** | **=** | **Liabilities** | **+** | **Contrib. Capital** | **+** | **Earned Capital** | **Revenues** | **–** | **Expenses** | **=** | **Net Income** |
| | | +87,800 (AR) | = | | | | | +87,800 (Retained Earnings) | +87,800 | – | | = | +87,800 |

D)

| Balance Sheet | | | | | | | | | Income Statement | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Cash Asset** | **+** | **Noncash Assets** | **=** | **Liabilities** | **+** | **Contrib. Capital** | **+** | **Earned Capital** | **Revenues** | **–** | **Expenses** | **=** | **Net Income** |
| +87,800 | | +87,800 (AR) | = | | | | | | | – | | = | |

*Answer:* B
*Rationale:* Collecting cash from customers increases cash and decreases accounts receivable. There is no income statement effect.

**Topic: Financial Statement Effects of Equity Transactions— *(Numerical calculations required)***
**LO: 6**

**37.** During fiscal 2016, Stanley Black & Decker Corporation reported Net income of $965.3 million and paid dividends of $330.9 million.

Which of the following describes how these transactions would affect Stanley Black and Decker's equity accounts? (in millions)

A) Increase contributed capital by $965.3 and decrease earned capital by $330.9
B) Decrease contributed capital by $330.9 and increase earned capital by $965.3
C) Increase contributed capital by $634.4
D) Increase earned capital by $634.4
E) None of the above

*Answer:* D
*Rationale:* Net income increases earned capital and dividends decrease earned capital. The net effect is an increase to earned capital.

**Topic: Financial Statement Effects of Equity Transactions— *(Numerical calculations required)***
**LO: 6**

**38.** Cari's Bakery, Inc., began operations in October 2017. The owner contributed cash of $18,000 and a delivery truck with fair value of $24,000 to the company.

Which of the following describes how these transactions would affect the company's equity accounts?

A) Increase contributed capital by $42,000
B) Increase earned capital by $42,000
C) Increase contributed capital by $18,000 and earned capital by $24,000
D) Increase earned capital by $18,000 and contributed capital by $24,000
E) None of the above

*Answer:* A
*Rationale:* Cash and equipment have both been contributed by the owner**—**this represents contributed capital.

**Topic: Accounting Adjustment—Accrue Wages**
**LO: 7**

**39.** An accrual of wages expense would have what effect on the balance sheet?

A) Decrease liabilities and increase equity
B) Increase assets and increase liabilities
C) Increase liabilities and decrease equity
D) Decrease assets and decrease liabilities
E) None of the above

*Answer:* C
*Rationale:* An accrual of wages expense increase wages payable (a liability) and decreases retained earnings, resulting from the decrease in net income.

**Topic: Accounting Adjustments—Cost of Goods Sold—*(Numerical calculations required)***
**LO: 7**

**40.** At the end of fiscal 2017, Nick's Greenhouse counted inventory and determined that inventories of $87,160 were on hand. The end of fiscal year the unadjusted inventory account balance is $95,000. Inventory at the start of the year was $99,880.

Which of the following accounting adjustments should Nick's Greenhouse record?

A)

| Balance Sheet | | | | | | | | | Income Statement | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Cash Asset** | **+** | **Noncash Assets** | **=** | **Liabilities** | **+** | **Contrib. Capital** | **+** | **Earned Capital** | **Revenues** | **–** | **Expenses** | **=** | **Net Income** |
| | | -7,840 (Inventory) | = | | | | | -7,840 (Retained earnings) | | – | +7,840 (COGS) | = | -7,840 |

B)

| Balance Sheet | | | | | | | | | Income Statement | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Cash Asset** | **+** | **Noncash Assets** | **=** | **Liabilities** | **+** | **Contrib. Capital** | **+** | **Earned Capital** | **Revenues** | **–** | **Expenses** | **=** | **Net Income** |
| | | -4,880 (Inventory) | = | | | | | -4,880 (Retained earnings) | | – | +4,880 (COGS) | = | -4,880 |

C)

| Balance Sheet | | | | | | | | | Income Statement | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Cash Asset** | **+** | **Noncash Assets** | **=** | **Liabilities** | **+** | **Contrib. Capital** | **+** | **Earned Capital** | **Revenues** | **–** | **Expenses** | **=** | **Net Income** |
| | | -12,720 (Inventory) | = | | | | | -12,720 (Retained earnings) | | – | +12,720 (COGS) | = | -12,720 |

D) No accounting adjustment is required.

*Answer:* A
*Rationale:* Unadjusted balance of $95,000 must be decreased to actual inventory on hand of $87,160. This requires a decrease to inventory and an increase in COGS.

**Topic: Accounting Adjustment—Supplies Inventory—*(Numerical calculations required)***
**LO: 7**

**41.** During its first three months of operations, Cari's Bakery, Inc. purchased supplies such as plates, napkins, bags, and cutlery for $9,000 and recorded this as supplies inventory. Supplies on hand at the end of the first quarter, amount to $5,600.

To prepare financial statement for the first quarter, the company must record which of the following accounting adjustments?

A) Increase Supplies expense by $5,600 and decrease Supplies inventory by $5,600
B) Increase Supplies expense by $3,400 and decrease Supplies inventory by $3,400
C) Increase Supplies inventory by $5,600 and decrease Supplies expense by $5,600
D) Increase Supplies inventory by $3,400 and decrease Supplies expense by $3,400
E) None of the above

*Answer:* B
*Rationale:* $9,000 supplies purchased less $5,600 supplies on hand equals $3,400 in supplies used for the quarter; this is recorded with an increase to supplies expense and a decrease to supplies inventory of $3,400.

**Topic: Recognition of Costs as Expense**
**LO: 7**

**42.** As inventory and PPE assets on the balance sheet are consumed, they are reflected:

A) As a revenue on the income statement
B) As an expense on the income statement
C) As a cash flow outflow on the Statement of Cash flows
D) Both B and C
E) Assets are never consumed.

*Answer:* B
*Rationale:* As assets are consumed (used up), their cost is transferred into the income statement as an expense. The cash outflow occurred when the assets were originally purchased and not when they are used up.

**Topic: Accounting Adjustment for Depreciation Expense**
**LO: 7**

**43.** A company records an adjusting journal entry to record $10,000 depreciation expense. Which of the following describes the entry?

A) Debit Property Plant and Equipment and Credit Depreciation expense
B) Debit Depreciation expense and Credit Property Plant and Equipment
C) Debit Property Plant and Equipment and Credit Cash
D) Debit Depreciation expense and Credit Cash
E) Debit Net Income and Credit Property Plant and Equipment

*Answer:* B
*Rationale:* Depreciation is an expense which decreases retained earnings—it is a debit. Property plant and equipment is being used up and thus its balance is decreasing on the balance sheet—it requires a credit.

**Topic: Calculating Net Income from Transactions—*(Numerical calculations required)***
**LO: 6, 8**

**44** During the month of March 2017, Weimar World, a tax-preparation service, had the following transactions.

- Billed $496,000 in revenues on credit
- Received $164,000 from customers' accounts receivable
- Incurred expenses of $194,000 but only paid $87,700 cash for these expenses
- Prepaid $32,220 for computer services to be used next month

What was the company's accrual basis net income for the month?

A) $302,000
B) $264,080
C) $ 41,860
D) $408,300
E) None of the above

*Answer:* A
*Rationale:*

| | |
|---|---|
| Revenues (earned) | $496,000 |
| Expenses (incurred) | 194,000 |
| Net income | $302,000 |

**Topic: Calculating Cash Balance from Transactions—*(Numerical calculations required)***
**LO: 6**

**45.** Weimar World, a tax-preparation service, had a cash balance of $122,500 as of March 1, 2017. During the month of March, Weimar World had the following transactions.

- Billed $496,000 in revenues on credit
- Received $164,000 from customers' accounts receivable
- Incurred expenses of $194,000 but only paid $87,700 cash for these expenses
- Prepaid $32,200 for computer services to be used next month

What was the company's cash balance on March 31, 2017?
A) $332,000
B) $166,600
C) $496,000
D) $198,800
E) None of the above

*Answer:* B
*Rationale:*

| | |
|---|---|
| Beginning cash balance | $122,500 |
| Revenues (cash receipts) | $164,000 |
| Expenses ($87,700 +$32,200) | 119,900 |
| Cash from operating activities | $166,600 |

**Topic: Items Involved in Preparing Income Statement**
**LO: 8**

**46.** Which of the following accounts would *not* be involved in preparing the income statement?
A) Depreciation expense
B) Accumulated depreciation
C) Taxes payable
D) Interest income
E) B and C

*Answer:* E
*Rationale:* Accumulated depreciation and taxes payable are both balance sheet accounts.

**Topic: Closing Entries**
**LO: 9**

**47.** Which of the following accounts would *not* appear in a closing entry?
A) Net income
B) Depreciation expense
C) Cost of goods sold
D) Inventory
E) Both A and D

*Answer:* E
*Rationale:* Net income (*answer A*) is not a trial balance account so it is not closed. Inventory (*answer D*) is a balance sheet (permanent) account, which is never closed. Therefore, the correct answer is E.

**Topic: Closing Entries – Dividends—*(Numerical calculations required)***
**LO: 9**

**48.** During 2016, Nike Inc., reported net income of $3,760 million. The company declared dividends of $1,022 million.

The closing entry for dividends would include which of the following?
A) Credit Cash for $1,022 million
B) Credit Dividends for $1,022 million
C) Debit Net income for $1,022 million
D) Credit Retained earnings for $1,022 million
E) Debit Dividends for $1,022 million

*Answer:* B
*Rationale:* To close out the Dividends account, the entry includes a debit to Retained Earnings and a credit to Dividends.

**Topic: Closing Entries**
**LO: 9**

**49.** Which of the following accounts would *not* appear in a closing entry?
A) Interest expense
B) Accumulated depreciation
C) Cost of goods sold
D) Dividends
E) Both B and D

*Answer:* B
*Rationale:* Accumulated depreciation is a balance sheet (permanent) account, which is never closed.

**Topic: Closing Entries—Inventory and Cost of Goods Sold**
**LO: 9**

**50.** During fiscal 2016, Caleres Inc. (formerly Brown Shoe Company), reported cost of goods sold of $1,517.4 million. Inventory at the start of the year was $546.7 million and at the end of the year was $585.8 million.

Which of the following describes the closing entry that the company will make for these accounts?
A) Debit Inventory $39.1 million
B) Credit Inventory $585.8 million
C) Credit Cost of goods sold $1,517.4 million
D) Both A and C
E) None of the above

*Answer:* C
*Rationale:* Cost of goods sold is a temporary account that must be closed. Inventory accounts are never closed—they are permanent accounts.

**Topic: Accounting Adjustment for Unearned Revenue**
**LO: 7**

**51.** On January 1, Fey Properties collected $7,200 for six months' rent in advance from a tenant renting an apartment. Fey Company prepares monthly financial statements.

Which of the following describes the required adjusting entry on January 31?
A) Debit Cash for $7,200 and Credit Rent revenue for $7,200
B) Debit Unearned rent revenue for $1,200 and Credit Rent revenue for $1,200
C) Debit Rent revenue for $1,200 and Credit Unearned rent revenue for $1,200
D) Debit Cash for $6,000 and Credit Unearned rent revenue for $6,000
E) Debit Unearned rent revenue for $6,000 and Credit Cash for $6,000

*Answer:* B
*Rationale:* The adjusting entry required consists of a debit to unearned rent revenue and a credit to revenue for $1,200 ($7,200 / 6 months).

**Topic: Accounting Adjustment for Prepaid Insurance**
**LO: 7**

**52.** On January 1, Fey Properties paid $12,600 for a three-year insurance premium, with coverage beginning immediately. Fey Company prepares monthly financial statements.

Which of the following describes the required adjusting entry on January 31?
A) Debit Cash for $4,200 and Credit Prepaid insurance for $4,200
B) Debit Prepaid insurance for $350 and Credit Insurance expense for $350
C) Debit Insurance expense for $350 and Credit Prepaid insurance for $350
D) Debit Cash for $8,400 and Credit Prepaid insurance for $8,400
E) Debit Insurance expense for $4,200 and Credit Prepaid insurance for $4,200

*Answer:* C
*Rationale:* The adjusting entry required consists of a debit to insurance expense and a credit to prepaid insurance for $350 ($12,600 / 36 months).

**Topic: Transaction Effects on the Financial Statements**
**LO: 6**

**53.** How would a sale of $400 of inventory on credit affect the balance sheet if the cost of the inventory sold was $160?
A) It would increase noncash assets by $400 and increase equity by $400
B) It would decrease noncash assets by $160 and decrease equity by 160
C) It would increase cash by $400 and increase equity by $400
D) Both A and B, above happen simultaneously
E) None of the above

*Answer:* D
*Rationale:* The sale on credit is an account receivable, a noncash asset that increases revenue and therefore increases equity (*answer A*). The sale also involves reducing inventory by $160, a noncash asset, which is an expense and therefore a decrease to equity of $160 (*answer B*). Therefore both A and B are correct so the answer is D.

**Topic: Financial Statement Effects Template**
**LO: 6**

**54.** Examine the financial statements effects template below. Then select the answer that best describes the transaction.

| | Balance Sheet | | | | | | | | | Income Statement | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Transaction** | **Cash Asset** | **+** | **Noncash Assets** | **=** | **Liabil-ities** | **+** | **Contrib. Capital** | **+** | **Earned Capital** | **Rev-enues** | **−** | **Expen-ses** | **=** | **Net Income** |
| **??** | **-300** | | **+300** | **=** | | | | | | | **−** | | **=** | |

A) Repay accounts payable of $300 with cash
B) Collect cash for accounts receivable of $300
C) Purchase inventory of $300 on account
D) Purchase inventory of $300 for cash
E) None of the above

*Answer:* D
*Rationale:* The purchase of inventory for cash decreases cash by $300 and increases inventory, a noncash asset, by $300.

**Topic: Financial Statement Effects Template**
**LO: 6**

**55.** Examine the financial statements effects template below. Then select the answer that best describes the transaction.

| | Balance Sheet | | | | | | | | | Income Statement | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Transaction** | **Cash Asset** | **+** | **Noncash Assets** | **=** | **Liabil-ities** | **+** | **Contrib. Capital** | **+** | **Earned Capital** | **Rev-enues** | **−** | **Expen-ses** | **=** | **Net Income** |
| **??** | **-120** | | **+600** | **=** | **+480** | | | | | | **−** | | **=** | |

A) Repay accounts payable of $120, net
B) Record accounts receivable of $600 and cash collected of $120
C) Purchase inventory of $600 partially on account
D) Purchase $600 of equipment on account
E) None of the above

*Answer:* C
*Rationale:* The purchase of $600 inventory partially on account implies that the rest is purchased for cash. Cash decreases by $120 and accounts payable (a liability) increase for the balance of $480.

## Exercises

**Topic: Financial Statement Accounts**
**LO: 1, 2, 3, 4**

**1.** Identify the financial statements in which you would find each of the items listed below. Some items may appear on more than one statement. Indicate all financial statements that apply to each item. The possible choices are:

| | |
|---|---|
| B : | Balance Sheet |
| SE : | Statement of Stockholders' Equity |
| I : | Income Statement |
| CF : | Statement of Cash Flows |

| | Financial Statement Item | Financial Statement |
|---|---|---|
| a. | Cost of goods sold | ______ |
| b. | Trademarks | ______ |
| c. | Inventories | ______ |
| d. | Retained earnings | ______ |
| e. | Accrued expenses | ______ |
| f. | Cash | ______ |

*Answer:*

| | Financial Statement Item | Financial Statement |
|---|---|---|
| a. | Cost of goods sold | I |
| b. | Trademarks | B |
| c. | Inventories | B |
| d. | Retained earnings | B and SE |
| e. | Accrued expenses | B |
| f. | Cash | B and CF |

**Topic: Financial Statement Accounts**
**LO: 1, 2, 3, 4**

**2.** Identify the financial statements in which you would find each of the items listed below. Some items may appear on more than one statement. Indicate all financial statements that apply to each item. The possible choices are:

| | |
|---|---|
| B : | Balance Sheet |
| SE : | Statement of Stockholders' Equity |
| I : | Income Statement |
| CF : | Statement of Cash Flows |

| Financial Statement Item | Financial Statement |
|---|---|
| a. Land | |
| b. Cash | |
| c. Prepaid insurance expense | |
| d. Insurance expense | |
| e. Revenue | |
| f. Unearned revenue | |

*Answer:*

| Financial Statement Item | Financial Statement |
|---|---|
| a. Land | B |
| b. Cash | B and CF |
| c. Prepaid insurance expense | B |
| d. Insurance expense | I |
| e. Revenue | I |
| f. Unearned revenue | B |

**Topic: Balance Sheet Relations**
**LO: 1**

**3.** Compute the missing amounts for Nike Inc. for 2016 and 2015, in the table below:

| **($ millions)** | **2016** | **2015** |
|---|---|---|
| Total assets | ? | $21,597 |
| Contributed capital | $7,789 | 6,776 |
| Earned capital | $4,469 | ? |
| Total Liabilities | $9,138 | $8,890 |
| Liabilities and equity | ? | $21,597 |

*Answer:*

| **($ millions)** | **2016** | **2015** |
|---|---|---|
| Total assets | **$21,396** | $21,597 |
| Contributed capital | $7,789 | $6,776 |
| Earned capital | $4,469 | **$5,931** |
| Total Liabilities | $9,138 | $8,890 |
| Liabilities and equity | **$21,396** | $21,597 |

**Topic: Balance Sheet Accounts**
**LO: 1**

**4.** Identify the following as a component of Assets (A), Liabilities (L), or Equity (E)

| Financial Statement Item | A / L / E |
|---|---|
| a. Common stock | |
| b. Unearned revenue | |
| c. Notes payable | |
| d. Retained earnings | |
| e. Trademark | |
| f. Prepaid rent | |
| g. Accounts payable | |

*Answer:*

| Financial Statement Item | A / L / E |
|---|---|
| a. Common stock | E |
| b. Unearned revenue | L |
| c. Notes payable | L |
| d. Retained earnings | E |
| e. Trademark | A |
| f. Prepaid rent | A |
| g. Accounts payable | L |

**Topic: Reporting of Assets**
**LO: 1**

**5.** Indicate the order of appearance on the balance sheet of the assets listed on the left.

| Asset | Balance sheet order |
|---|---|
| Equipment | |
| Accounts receivable | |
| Cash | |
| Inventory | |
| Goodwill | |

*Answer:*

| Asset | Balance sheet order |
|---|---|
| Equipment | 4 |
| Accounts receivable | 2 |
| Cash | 1 |
| Inventory | 3 |
| Goodwill | 5 |

**Topic: Reporting of Liabilities and Equity**
**LO: 1**

**6.** Indicate the order of appearance on the balance sheet of the liabilities and equity accounts listed on the left.

| Liability / Equity | Balance sheet order |
|---|---|
| Bonds payable | |
| Retained earnings | |
| Accounts payable | |
| Contributed capital | |

*Answer:*

| Liability / Equity | Balance sheet order |
|---|---|
| Bonds payable | 2 |
| Retained earnings | 4 |
| Accounts payable | 1 |
| Contributed capital | 3 |

**Topic: Balance Sheet Accounts**
**LO: 1**

**7.** For each of the following financial statement items, indicate the correct balance sheet classification, from the list below. You may use each balance sheet classification item only once.

Balance sheet classification

a. Current asset
b. Long term asset
c. Current liability
d. Long term liability
e. Equity
f. None of the above

| Financial statement item | Balance sheet classification |
|---|---|
| Interest payable | |
| Treasury stock | |
| Insurance expense | |
| Goodwill | |
| Note payable, due in 2025 | |
| Prepaid insurance expense | |

*Answer:*

| Financial statement item | Balance sheet classification |
|---|---|
| Interest payable | c. Current liability |
| Treasury stock | e. Equity |
| Insurance expense | f. None of the above |
| Goodwill | b. Long term asset |
| Note payable, due in 2025 | d. Long term liability |
| Prepaid insurance expense | a. Current asset |

**Topic: Articulation of Retained Earnings Account**
**LO: 5**

**8.** Caterpillar Inc.'s statement of stockholders' equity for 2016 and 2015 shows the following amounts. Fill in the missing items to show how retained earnings articulate across the years.

| ($ millions) | 2016 | 2015 |
|---|---|---|
| Retained earnings, beginning of year | ? | $28,515 |
| Net income(loss) for the year | (67) | ? |
| Dividends | ? | (1,781) |
| Retained earnings, end of year | $27,377 | $29,246 |

*Answer:*

| ($ millions) | 2016 | 2015 |
|---|---|---|
| Retained earnings, beginning of year | **$29,246** | $28,515 |
| Net income (loss) for the year | (67) | **2,512** |
| Dividends | **(1,802)** | (1,781) |
| Retained earnings, end of year | $27,377 | $29,246 |

**Topic: Preparation of Financial Statements and Income Statement / Balance Sheet Articulation (more challenging—requires preparation of two financial statements)**
**LO: 1, 2**

**9.** Super Style Clothing begins operations in November. During the month the company receives $46,000 from a shareholder for common stock and gets a $6,000 loan from a bank. The company buys $38,000 of inventory for cash and sells half of the inventory for $30,000 on credit. The company had no other transactions in November. Fill in the missing amounts below.

| SUPER STYLE CLOTHING<br>Income Statement<br>For the Month of November | |
|---|---|
| Sales | ______ |
| Cost of sales | ______ |
| Net income | ______ |

| SUPER STYLE CLOTHING<br>Balance Sheet<br>At the End of November | |
|---|---|
| Cash | ______ |
| Accounts receivable | ______ |
| Inventory | ______ |
| Total assets | ______ |
| Accounts payable | ______ |
| Bank loan | ______ |
| Total liabilities | ______ |
| Contributed capital | ______ |
| Retained earnings | ______ |
| Total equity | ______ |
| Total liabilities and equity | ______ |

*Answer:*

| SUPER STYLE CLOTHING<br>Income Statement<br>For the Month of November | |
|---|---|
| Sales | $30,000 |
| Cost of sales | 19,000 |
| Net income | $11,000 |

| SUPER STYLE CLOTHING<br>Balance Sheet<br>At the End of November | |
|---|---|
| Cash | $14,000 |
| Accounts receivable | 30,000 |
| Inventory | 19,000 |
| Total assets | $63,000 |
| | |
| Accounts payable | $ 0 |
| Bank loan | 6,000 |
| Total liabilities | 6,000 |
| | |
| Contributed capital | 46,000 |
| Retained earnings | 11,000 |
| Total equity | 57,000 |
| Total liabilities and equity | $63,000 |

**Topic: Applying Financial Statement Linkages to Understand Transactions**
**LO: 1, 2, 3, 4, 5**

**10.** Consider the effects of the independent transactions, a through d, on a company's balance sheet, income statement, statement of cash flows, and statement of stockholders' equity.

*a.* Services were performed for cash.
*b.* Inventory was purchased for cash.
*c.* Wages were accrued at the end of the period.
*d.* Rent was paid in cash.

Complete the table below to explain the effects and financial statement linkages. Use "+" to indicate the account increases and "–" to indicate the account decreases.

| | *a.* | *b.* | *c.* | *d.* |
|---|---|---|---|---|
| **Balance sheet** | | | | |
| Cash | | | | |
| Noncash assets | | | | |
| Total liabilities | | | | |
| Contributed capital | | | | |
| Retained earnings | | | | |
| Other equity | | | | |
| **Statement of cash flows** | | | | |
| Operating cash flow | | | | |
| Investing cash flow | | | | |
| Financing cash flow | | | | |
| **Income statement** | | | | |
| Revenues | | | | |
| Expenses | | | | |
| Net earnings | | | | |
| **Statement of stockholders' equity** | | | | |
| Contributed capital | | | | |
| Retained earnings | | | | |

*Answer:*

| | *a.* | *b.* | *c.* | *d.* |
|---|---|---|---|---|
| **Balance sheet** | | | | |
| Cash | **+** | **−** | | **−** |
| Noncash assets | | **+** | | |
| Total liabilities | | | **+** | |
| Contributed capital | | | | |
| Retained earnings | **+** | | **−** | **−** |
| Other equity | | | | |
| **Statement of cash flows** | | | | |
| Operating cash flow | **+** | **−** | | **−** |
| Investing cash flow | | | | |
| Financing cash flow | | | | |
| **Income statement** | | | | |
| Revenues | **+** | | | |
| Expenses | | | **+** | **+** |
| Net earnings | **+** | | **−** | **−** |
| **Statement of stockholders' equity** | | | | |
| Contributed capital | | | | |
| Retained earnings | **+** | | **−** | **−** |

**Topic: Effects of Transactions on Balance Sheet Accounts**
**LO: 1**

**11.** Miguel decided to open a lemonade stand on Saturdays. Match Miguel's business activities to the following balance sheet items. (*Note:* each balance sheet item can only be used once).

| | | | |
|---|---|---|---|
| a. | Borrowed cash from Dad to be repaid in two years. | 1) | Long-term liability |
| b. | Purchased tent from neighbor, at a garage sale. | 2) | Accounts payable |
| c. | Bought lemons, sugar and (secret ingredient) grapefruit. | 3) | Accounts receivable |
| d. | The items in (c) will not be paid for until next month. | 4) | Long-term asset |
| e. | At the end of the day, Miguel has cash in his pocket from sales. | 5) | Inventory |
| f. | Mr. Wisner, a potential customer had no cash with him. Miguel agrees to let Mr. Wisner pay for his lemonade next Monday. | 6) | Cash |

*Answer:*
a. 1) Long-term liability
b. 4) Long-term asset
c. 5) Inventory
d. 2) Accounts payable
e. 6) Cash
f. 3) Accounts receivable

**Topic: Effects of Transactions on Balance Sheet**
**LO: 1**

**12.** Consider the transactions listed on the left. Match them to the financial statement effects listed on the right.

| | Transaction | | | Financial Statement Effect |
|---|---|---|---|---|
| a. | Sell common stock for cash | ______ | 1. | Decrease assets and decrease equity |
| b. | Pay accounts payable | ______ | 2. | Decrease liabilities and decrease assets |
| c. | Repurchase common stock | ______ | 3. | Increase assets and decrease assets |
| d. | Purchase inventory for cash | ______ | 4. | Increase assets and increase equity |

*Answer:*

| | Transaction | |
|---|---|---|
| a. | Sell common stock for cash | 4 |
| b. | Pay accounts payable | 2 |
| c. | Repurchase common stock | 1 |
| d. | Purchase inventory for cash | 3 |

**Topic: Effects of Transactions on Balance Sheet**
**LO: 1**

**13.** Consider the transactions listed on the left. Match them to the financial statement effects listed on the right.

| | Transaction | | | Financial Statement Effect |
|---|---|---|---|---|
| a. | Pay wages with cash | ______ | 1. | Increase assets and increase liabilities |
| b. | Repay bank loan | ______ | 2. | Decrease liabilities and decrease assets |
| c. | Prepay insurance expense | ______ | 3. | Decrease assets and decrease equity |
| d. | Receive prepayment from customer | ______ | 4. | Decrease assets and increase assets |

*Answer:*

| | Transaction | |
|---|---|---|
| a. | Pay wages with cash | 3 |
| b. | Repay bank loan | 2 |
| c. | Prepay insurance expense | 4 |
| d. | Receive prepayment from customer | 1 |

**Topic: Using the Financial Statements Effects Template—Balance Sheet and Income Statement**
**LO: 6**

**14.** Record the following transactions in the financial statements effects template below.

| | Balance Sheet | | | | | | | | | Income Statement | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Transaction** | **Cash Asset** | **+** | **Noncash Assets** | **=** | **Liabil-ities** | **+** | **Contrib. Capital** | **+** | **Earned Capital** | **Rev-enues** | **–** | **Expen-ses** | **=** | **Net Income** |
| Purchase $30,000 of inventory on credit | | | | = | | | | | | | – | | = | |
| Sell all inventory for $56,000 on account | | | | = | | | | | | | – | | = | |
| Collect $18,000 cash for accounts receivable | | | | = | | | | | | | – | | = | |
| Pay $16,000 cash toward accounts payable | | | | = | | | | | | | – | | = | |

*Answer:*

| | Balance Sheet | | | | | | | | | Income Statement | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Transaction** | **Cash Asset** | **+** | **Noncash Assets** | **=** | **Liabil-ities** | **+** | **Contrib. Capital** | **+** | **Earned Capital** | **Rev-enues** | **–** | **Expen-ses** | **=** | **Net Income** |
| Purchase $30,000 of inventory on credit | | | +30,000 (Inventory) | = | +30,000 (AP) | | | | | | – | | = | |
| Sell all inventory for $56,000 on account | | | +56,000 (AR) -30,000 (Inventory) | = | | | | | +26,000 (Retained Earnings) | +56,000 (Sales) | – | +30,000 (COGS) | = | +26,000 |
| Collect $18,000 cash for accounts receivable | +18,000 | | –18,000 (AR) | = | | | | | | | – | | = | |
| Pay $16,000 cash toward accounts payable | –16,000 | | | = | –16,000 (AP) | | | | | | – | | = | |

**Topic: Using the Financial Statements Effects Template – Balance Sheet Only**
**LO: 6**

**15.** Record the following transactions in the financial statements effects template below.

a) Founder contributes $44,000 in cash in exchange for common stock.

b) Obtain $26,000 short-term bank loan.

c) Purchase equipment costing $24,000 for cash.

d) Purchase inventory costing $14,000 on account.

| | Balance Sheet | | | | | | | | | Income Statement | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Transaction** | **Cash Asset** | **+** | **Noncash Assets** | **=** | **Liabil-ities** | **+** | **Contrib. Capital** | **+** | **Earned Capital** | **Rev-enues** | **–** | **Expen-ses** | **=** | **Net Income** |
| a) | | | | = | | | | | | | – | | = | |
| b) | | | | = | | | | | | | – | | = | |
| c) | | | | = | | | | | | | – | | = | |
| d) | | | | = | | | | | | | – | | = | |

*Answer:*

| | Balance Sheet | | | | | | | | | Income Statement | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Transaction** | **Cash Asset** | **+** | **Noncash Assets** | **=** | **Liabil-ities** | **+** | **Contrib. Capital** | **+** | **Earned Capital** | **Rev-enues** | **–** | **Expen-ses** | **=** | **Net Income** |
| a) | +44,000 | | | = | | | +44,000 (Common Stock) | | | | – | | = | |
| b) | +26,000 | | | = | +26,000 (Note Payable) | | | | | | – | | = | |
| c) | -24,000 | | +24,000 (Equipment) | = | | | | | | | – | | = | |
| d) | | | +14,000 (Inventory) | = | +14,000 (AP) | | | | | | – | | = | |

**Topic: Inferring Transactions from Reported Financial Statements**
**LO: 6**

**16.** The January 28, 2017 income statement and balance sheet for Kohl's Corporation shows the following items (in millions):

| | |
|---|---|
| Net sales | $18,686 |
| Cost of merchandise sold | 11,944 |
| Merchandise inventories | 3,795 |

*Required:* Prepare the journal entries to record Net sales and Cost of goods sold for Kohl's for the fiscal year ended January 28, 2017. Assume all sales are for cash.

*Answer:*

| | | |
|---|---|---|
| Debit Cash | 18,686 | |
| Credit Net sales | | 18,686 |
| *To record sales for the year.* | | |
| Debit Cost of merchandise sold | 11,944 | |
| Credit Merchandise inventories | | 11,944 |
| *To record cost of merchandise sold expense for the year.* | | |

**Topic: Using the Financial Statements Effects Template *(Numerical calculations required)***
**LO: 6, 7**

**17.** Record the following transactions in the financial statements effects template below.

a) Company receives $6,000 from the sale of gift certificates.
b) Customers used $5,700 gift certificates. The cost of the inventory sold is $3,900.
c) The balance of the gift certificates expire unused.

| | Balance Sheet | | | | | | | | | Income Statement | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Transaction | Cash Asset | + | Noncash Assets | = | Liabil-ities | + | Contrib. Capital | + | Earned Capital | Rev-enues | – | Expen-ses | = | Net Income |
| a) | | | | = | | | | | | | – | | = | |
| b) | | | | = | | | | | | | – | | = | |
| c) | | | | = | | | | | | | – | | = | |

*Answer:*

| | Balance Sheet | | | | | | | | | Income Statement | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Transaction | Cash Asset | + | Noncash Assets | = | Liabil-ities | + | Contrib. Capital | + | Earned Capital | Rev-enues | – | Expen-ses | = | Net Income |
| a) | +6,000 | | | = | +6,000 (Unearned Revenue) | | | | | | – | | = | |
| b) | | | -3,900 (Inventory) | = | -5,700 (Unearned Revenue) | | | | +1,800 (Retained Earnings) | +5,700 (Sales) | – | +3,900 (Cost of Goods Sold) | = | +1,800 |
| c) | | | | = | -300 (Unearned Revenue) | | | | +300 (Retained Earnings) | +300 (Sales) | – | | = | +300 |

**Topic: Preparing Accounting Adjustments and Closing Entries *(Numerical calculations required)***
**LO: 7, 9**

**18.** The balance sheet of Taos Promotion includes the amounts shown below. Analysis of the company's records reveals the following transactions during 2017, the company's first year of operations:

| | |
|---|---|
| Cash received from customers, recorded as service revenue | $311,475 |
| Purchase of supplies for cash, expensed | $ 43,500 |
| Cash paid for salaries, expensed | $ 28,100 |

Analysis of the company's balance sheet accounts reveals that at year-end, supplies on hand total $7,950, employees have earned $12,000 but have not yet been paid, and on the last day of the fiscal year, customers paid deposits of $22,050 for future promotions (this is included in total cash received from customers, above).

*Required:* Prepare journal entries to adjust the account balances for revenue, supplies expense and salary expense for the year-end. Prepare closing entries.

*Answer:*

| | | |
|---|---|---|
| Debit Service revenue | 22,050 | |
| Credit Unearned revenue | | 22,050 |
| *To record unearned revenue for deposits received from customers.* | | |
| | | |
| Debit Supplies inventory | 7,950 | |
| Credit Supplies expense | | 7,950 |
| *To record supplies on hand at year-end.* | | |
| | | |
| Debit Salaries expense | 12,000 | |
| Credit Salaries payable | | 12,000 |
| *To record unpaid wages at year-end.* | | |
| | | |
| Debit Service revenue | 289,425 | |
| Credit Retained earnings | | 289,425 |
| *To close revenues at year-end.* | | |
| | | |
| Debit Retained earnings | 35,550 | |
| Credit Supplies expense | | 35,550 |
| *To close supplies expense at year-end.* | | |
| | | |
| Debit Retained earnings | 40,100 | |
| Credit Salaries expense | | 40,100 |
| *To close salaries expense at year-end.* | | |

**Topic: Adjusting Accounts**
**(*Numerical calculations required*—More challenging, requires decrease to expense account)**
**LO: 7**

**19.** Select accounts of Pete's Pizza are shown below as of the end fiscal 2017, before any accounts have been adjusted for the current fiscal year.

| | Debit | Credit |
|---|---|---|
| Inventory | $143,400 | |
| Wages payable | | $2,400 |
| Prepaid insurance | 18,400 | |
| Taxes payable | | 0 |

Your analysis reveals additional information as follows:

- The cost of inventory items on hand is $69,600.
- Employee wages earned prior to year-end were $23,400. These will not be paid until the 2018 fiscal year.
- The unexpired portion of the company's insurance policy at year end was $13,800.
- The company's tax accountant reports that the company will owe $162,000 for income taxes for fiscal 2017.

Prepare journal entries for any required accounting adjustments.

*Answer:*

| | | |
|---|---|---|
| Debit Cost of goods sold | 73,800 | |
| Credit Inventory | | 73,800 |
| *To adjust inventory to amount on hand at year-end.* | | |
| Debit Wages expense | 21,000 | |
| Credit Wages payable | | 21,000 |
| *To adjust unpaid wages at year-end.* | | |
| Debit Insurance expense | 4,600 | |
| Credit Prepaid insurance | | 4,600 |
| *To adjust prepaid insurance to amount available at year-end.* | | |
| Debit Tax expense | 162,000 | |
| Credit Taxes payable | | 162,000 |
| *To record taxes owing for the year.* | | |

**Topic: Adjusting Accounts**
**(*Numerical calculations required* – More challenging, requires decrease to expense account)**
**LO: 7**

**20.** Select accounts of Burger Express are shown below as of December 31, 2017, before any accounts have been adjusted for the current fiscal year.

| | Debit | Credit |
|---|---|---|
| Prepaid rent | 103,680 | |
| Accumulated depreciation - Van | | 16,500 |
| Accumulated depreciation - Stoves | | 29,250 |
| Gift certificates – unearned revenue | | 4,680 |

Your analysis reveals additional information as follows:

- On June 1, 2017, the company prepaid rent of $8,640 per month for a 12-month lease on its building.
- The company bought the van on January 1, 2015 for the cost of $132,000. The van is expected to last eight years. The company's policy is to record depreciation evenly over the asset's useful life. No depreciation has been recorded during fiscal year 2017.
- When purchased on January 1, 2014, the stoves had expected lives of 10 years. The company's policy is to record depreciation evenly over the asset's useful life. No depreciation has been recorded on the stoves during fiscal 2017.
- The company sells numbered gift certificates in $60 denominations. At year-end there were 30 unredeemed gift certificates.

Prepare journal entries for any required accounting adjustments.

*Answer:*

| | | |
|---|---|---|
| Debit Rent expense | 60,480 | |
| Credit Prepaid rent | | 60,480 |

*To record rent expense for seven months @ $8,640 per month.*

| | | |
|---|---|---|
| Debit Depreciation expense | 16,500 | |
| Credit Accumulated depreciation - Van | | 16,500 |

*To record depreciation for the year on the van ($132,000 / 8 years = $16,500 per year).*

| | | |
|---|---|---|
| Debit Depreciation expense | 9,750 | |
| Credit Accumulated depreciation - Stoves | | 9,750 |

*To record depreciation for the year on the stoves ($29,250/ 3 years to date = $9,750 per year).*

| | | |
|---|---|---|
| Debit Gift certificates – unearned revenue | 2,880 | |
| Credit Revenue | | 2,880 |

*To adjust for gift certificates still outstanding = $60 × 30 = $1,800. ($4,680 - $1,800 = $2,880)*

**Topic: Adjusting Accounts**
***(Numerical calculations required—More challenging, using T-account to infer adjustments)***
**LO: 7**

**21.** During the year ended December 31, 2016, Cabela's, Inc., a retailer of outdoor equipment and apparel, purchased merchandise inventory at a cost of $2,413,850 (in thousands). The following T-account reflects information contained in the company's 2015 and 2016 balance sheets (in thousands).

Calculate Cabela's cost of sales for 2016 and complete the T-account.

**Inventory**

| | | | |
|---|---|---|---|
| 2015 Balance | 819,271 | | |
| 2016 Balance | 860,360 | | |

*Answer:*
COGS = Beginning inventory $819,271 + Purchases $2,413,850 - Ending inventory $860,360 = $2,372,761

**Inventory**

| | | | |
|---|---|---|---|
| 2015 Balance | 819,271 | | |
| Purchases | 2,413,850 | 2,372,761 | Cost of sales |
| 2016 Balance | 860,360 | | |

**Topic: Adjusting Accounts**
***(Numerical calculations required—More challenging, using T-account to infer adjustments)***
**LO: 7**

**22.** During the year ended December 31, 2016, Cabela's, Inc., a retailer of outdoor equipment and apparel, purchased merchandise inventory at a cost of $2,413,850 (in thousands). Assume that all inventory purchases were on account (on credit) and that accounts payable is only used for inventory purchases. The following T-account reflects information contained in the company's 2015 and 2016 balance sheets (in thousands).

Calculate the amount Cabela's paid in cash to its suppliers during 2016 and complete the T-account.

**Accounts Payable**

| | | | |
|---|---|---|---|
| | | 281,985 | 2015 Balance |
| | | 347,784 | 2016 Balance |

*Answer:*
Payments on account =
Beginning balance $281,985 + Purchases $2,413,850 – Ending balance $347,784
= $2,348,051

**Accounts Payable**

| | | | |
|---|---|---|---|
| | | 281,985 | 2015 Balance |
| Payments | 2,348,051 | 2,413,850 | Purchases |
| | | 347,784 | 2016 Balance |

**Topic: Constructing Financial Statements from Transaction Data *(Numerical calculations required)***
**LO: 8**

**23.** Organic Floral is an organic flower shop. After its first quarter of operations, the company's accountant prepared the following list of account balances, in alphabetical order. The accountant also tells you that net income for the quarter was $52,500.

Use the information below along with the net income information to prepare a balance sheet for Organic Floral.

| | Debit | Credit |
|---|---|---|
| Accounts payable | | $6,900 |
| Accounts receivable | $600 | |
| Bank loan for van | | 39,600 |
| Cash | 39,000 | |
| Common stock | | 3,000 |
| Cost of goods sold | 36,000 | |
| Delivery van | 54,000 | |
| Gas for van | 1,500 | |
| Tax expense | 6,000 | |
| Insurance expense | 3,000 | |
| Inventory | 11,400 | |
| Prepaid insurance | 3,000 | |
| Rent expense | 4,500 | |
| Salaries expense | 24,000 | |
| Sales | | 127,500 |
| Taxes payable | | 6,000 |

*Answer:*

| ORGANIC FLORAL<br>Balance Sheet | | | |
|---|---|---|---|
| Cash | $39,000 | Accounts payable | $ 6,900 |
| Accounts receivable | 600 | Taxes payable | 6,000 |
| Inventory | 11,400 | Total current liabilities | 12,900 |
| Prepaid insurance | 3,000 | Bank loan for van | 39,600 |
| Total current assets | 54,000 | Total liabilities | 52,500 |
| | | | |
| Delivery van | 54,000 | Common stock | 3,000 |
| | | Retained earnings | 52,500 |
| | | Total equity | 55,500 |
| Total assets | $108,000 | Total liabilities and equity | $108,000 |

**Topic: Constructing Financial Statements from Transaction Data *(Numerical calculations required)***
**LO: 8**

**24.** Green Garden Company made $192,000 in net income during September 2017, its first month of business. It sold its services on credit and billed its customers $360,000 for September sales. The company collected $24,000 of these receivables in September. Company employees earned September wages (the company's only expense), but those are not paid until the first of October.

Complete the following financial statements for the end of September 2017.

| Income Statement | |
|---|---|
| Sales | $ |
| Wages expense | |
| Net Income | $ |

| Balance Sheet | |
|---|---|
| Cash | $ |
| Accounts receivable | |
| Total assets | $ |
| | |
| Wages payable | $ |
| Retained earnings | |
| Total liabilities and equity | $ |

*Answer:*

| Income Statement | |
|---|---|
| Sales | $360,000 |
| Wages expense | 168,000 |
| Net income | $192,000 |

| Balance Sheet | |
|---|---|
| Cash | $ 24,000 |
| Accounts receivable | 336,000 |
| Total assets | $360,000 |
| | |
| Wages payable | $168,000 |
| Retained earnings | 192,000 |
| Total liabilities and equity | $360,000 |

**Topic: Constructing Financial Statements from Transaction Data *(Numerical calculations required)***
**LO: 8**

**25.** Craft Corner began operations in March with cash and common stock of $36,000. The company made $582,000 in net income its first month. It performed print jobs for customers and billed these customers $900,000. The company collected half of its receivables by the end of the month. The company had cost of goods sold of $162,000 paid for in cash and $6,000 inventory left over at the end of the month. Craft Corner employees earned wages but those are not paid until the first of April. This was the company's only liability.

Complete the following statements for the end of March.

| Income Statement | |
|---|---|
| Sales | $ |
| Cost of sales | |
| Wages expense | |
| Net income | $ |

| Balance Sheet | |
|---|---|
| Cash | $ |
| Accounts receivable | |
| Inventory | |
| Total assets | $ |
| | |
| Wages payable | $ |
| Common Stock | |
| Retained earnings | |
| Total liabilities and equity | $ |

*Answer:*

| Income Statement | |
|---|---|
| Sales | $900,000 |
| Cost of sales | 162,000 |
| Wages expense | 156,000 |
| Net income | $582,000 |

| Balance Sheet | |
|---|---|
| Cash | $318,000 |
| Accounts receivable | 450,000 |
| Inventory | 6,000 |
| Total assets | $774,000 |
| | |
| Wages payable | $156,000 |
| Common stock | 36,000 |
| Retained earnings | 582,000 |
| Total liabilities and equity | $774,000 |

**Topic: Preparing Closing Entries from Income Statement**
**LO: 9**

**26.** The December 28, 2016 income statement of Snap-On Incorporated includes the amounts shown below. The company paid dividends of $147.5 (in millions).

Prepare the closing entries for the company for 2016.

| (in millions) | |
|---|---|
| Net sales | $3,430.4 |
| Cost of goods sold | 1,720.8 |
| Other operating expenses | 1,054.1 |
| Interest & other expense, net | 52.8 |
| Operating income from financial services | 198.7 |
| Income tax expense | 244.3 |

*Answer:*

| | | |
|---|---|---|
| Debit Net sales | 3,430.4 | |
| Debit Operating income from financial services | 198.7 | |
| Credit Retained earnings | | 3,629.1 |

*To close revenue accounts for the year.*

| | | |
|---|---|---|
| Debit Retained earnings | 3,072.0 | |
| Credit Cost of goods sold | | 1,720.8 |
| Credit Other operating expenses | | 1,054.1 |
| Credit Interest & other expense, net | | 52.8 |
| Credit Income tax expense | | 244.3 |

*To close expense accounts for the year.*

| | | |
|---|---|---|
| Debit Retained earnings | 147.5 | |
| Credit Dividends | | 147.5 |

*To close dividends for the year.*

## Problems

**Topic: Analyzing Balance Sheet Accounts**
**LO: 1**
**1.** Selected balance sheet amounts for Harley Davidson Inc. for five recent years follow.

| ($ millions) | Current Assets | Long-term Assets | Total Assets | Current Liabilities | Long-term Liabilities | Total Liabilities | Equity |
|---|---|---|---|---|---|---|---|
| 2012 | 4,050.9 | | 9,170.8 | | 5,110.0 | 6,613.1 | 2,557.7 |
| 2013 | 3,988.8 | 5,416.2 | | 2,509.5 | 3,886.0 | 6,395.5 | |
| 2014 | | 5,580.0 | 9,528.1 | 2,389.3 | 4,229.5 | | 2,909.3 |
| 2015 | 3,977.9 | 5,995.1 | | 2,747.3 | 5,386.0 | 8,133.3 | |
| 2016 | | 6,036.4 | 9,890.2 | 2,862.5 | 5,107.5 | | 1,920.2 |

Compute the missing balance sheet amounts for each of the five years.

*Answer:*

| ($ millions) | Current Assets | Long-term Assets | Total Assets | Current Liabilities | Long-term Liabilities | Total Liabilities | Equity |
|---|---|---|---|---|---|---|---|
| 2012 | 4,050.9 | **5,119.9** | 9,170.8 | **1,503.1** | 5,110.0 | 6,613.1 | 2,557.7 |
| 2013 | 3,988.8 | 5,416.2 | **9,405.0** | 2,509.5 | 3,886.0 | 6,395.5 | **3,009.5** |
| 2014 | **3,948.1** | 5,580.0 | 9,528.1 | 2,389.3 | 4,229.5 | **6,618.8** | 2,909.3 |
| 2015 | 3,977.9 | 5,995.1 | **9,973.0** | 2,747.3 | 5,386.0 | 8,133.3 | **1,839.7** |
| 2016 | **3,853.8** | 6,036.4 | 9,890.2 | 2,862.5 | 5,107.5 | **7,970.0** | 1,920.2 |

**Topic: Analyzing Balance Sheet Accounts**
**LO: 1**
**2.** Selected balance sheet amounts for Nordstrom Inc. for four recent years follow.

| ($ millions) | Current Assets | Long-term Assets | Total Assets | Current Liabilities | Long-term Liabilities | Total Liabilities | Equity |
|---|---|---|---|---|---|---|---|
| 2013 | 5,228 | 3,346 | | 2,541 | 3,953 | | 2,080 |
| 2014 | 5,224 | 4,021 | | | 4,005 | 6,805 | |
| 2015 | 3,014 | | 7,698 | 2,911 | | 6,827 | 871 |
| 2016 | 3,242 | 4,616 | | 3,029 | 3,959 | | 870 |

Compute the missing balance sheet amounts for each of the four years.

*Answer:*

| ($ millions) | Current Assets | Long-term Assets | Total Assets | Current Liabilities | Long-term Liabilities | Total Liabilities | Equity |
|---|---|---|---|---|---|---|---|
| 2013 | 5,228 | 3,346 | **8,574** | 2,541 | 3,953 | **6,494** | 2,080 |
| 2014 | 5,224 | 4,021 | **9,245** | **2,800** | 4,005 | 6,805 | **2,440** |
| 2015 | 3,014 | **4,684** | 7,698 | 2,911 | **3,916** | 6,827 | 871 |
| 2016 | 3,242 | 4,616 | **7,858** | 3,029 | 3,959 | **6,988** | 870 |

**Topic: Preparing a Balance Sheet from a List of Accounts**
**LO: 1**
**3.** Use the accounts below for Stanley Black & Decker, Inc. to prepare a balance sheet at December 31, 2016.

| ($ millions) | |
|---|---|
| Contributed capital | $3,186.8 |
| Cash | 1,131.8 |
| Long-term debt | 3,815.3 |
| Accounts receivable | 1,302.8 |
| Other current assets | 875.9 |
| Other long-term assets | 9,395.2 |
| Current liabilities | 2,807.5 |
| Inventory | 1,478.0 |
| Other long-term liabilities | 2,638.5 |
| Property plant and equipment | 1,451.2 |
| Retained earnings | 5,127.3 |
| Other equity | (1,940.5) |

*Answer:*

| STANLEY BLACK & DECKER, INC.<br>Balance Sheet<br>At December 31, 2016<br>($ millions) | |
|---|---|
| Cash | $1,131.8 |
| Accounts receivable | 1,302.8 |
| Inventory | 1,478.0 |
| Other current assets | 875.9 |
| Current assets | 4,788.5 |
| | |
| Property plant and equipment | 1,451.2 |
| Other long-term assets | 9,395.2 |
| Total assets | $15,634.9 |
| | |
| Current liabilities | $2,807.5 |
| | |
| Long-term debt | 3,815.3 |
| Other long-term liabilities | 2,638.5 |
| Total liabilities | 9,261.3 |
| | |
| Contributed capital | 3,186.8 |
| Retained earnings | 5,127.3 |
| Other equity | (1,940.5) |
| Total equity | 6,373.6 |
| Total liabilities and equity | $15,634.9 |

**Topic: Preparing an Income Statement from a List of Accounts**
**LO: 2**

**4.** Use the accounts below for Stanley Black & Decker, Inc. to prepare an income statement for the year ended December 31, 2016.

| ($ millions) | |
|---|---|
| Cost of goods sold | $7,139.7 |
| Sales | 11,406.9 |
| Other operating expenses | 268.2 |
| Selling, general and administrative expenses | 2,602.0 |
| Income tax expense | 261.2 |
| Interest and other nonoperating expenses, net | 171.3 |

*Answer:*

| STANLEY BLACK & DECKER, INC.<br>Income Statement<br>For the year ended December 31, 2016 | |
|---|---|
| ($ millions) | |
| Sales | $11,406.9 |
| Cost of goods sold | 7,139.7 |
| Gross profit | $4,267.2 |
| Selling, general and administrative expenses | 2,602.0 |
| Other operating expenses | 268.2 |
| Operating income | 1,397.0 |
| Interest and other nonoperating expenses | 171.3 |
| Income before income tax | 1,225.7 |
| Income tax expense | 261.2 |
| Net income | $964.5 |

**Topic: Preparing a Balance Sheet and Income Statement from a List of Accounts**
**LO: 1, 2**

**5.** Use the accounts below for Delphi Automotive PLC for December 31, 2016 to prepare an income statement and a balance sheet.

| ($ millions) | |
|---|---|
| Contributed capital | $1,636 |
| Cost of sales | 13,107 |
| Cash | 839 |
| Long-term liabilities | 5,381 |
| Accounts receivable | 2,938 |
| Other current assets | 410 |
| Other long-term assets | 3,358 |
| Other current liabilities | 1,585 |
| Other operating expenses | 1,572 |
| Other nonoperating expenses | 414 |
| Inventory | 1,232 |
| Accounts payable | 2,563 |
| Property, net | 3,515 |
| Retained earnings | 1,980 |
| Sales | 16,661 |
| Tax expense | 242 |
| Other equity | (853) |

*Answer:*

| DELPHI AUTOMOTIVE PLC<br>Income Statement<br>For the Year Ended December 31, 2016<br><br>($ millions) | |
|---|---|
| Sales | $16,661 |
| Cost of sales | 13,107 |
| Gross profit | 3,554 |
| Other operating expenses | 1,572 |
| Operating income | 1,982 |
| Other nonoperating expenses | 414 |
| Income before taxes | 1,568 |
| Tax expense | 242 |
| Net income | $1,326 |

*Continued next page*

*Continued*

| Delphi Automotive PLC<br>Balance Sheet<br>At December 31, 2016<br>($ millions) | |
|---|---|
| Cash | $839 |
| Accounts receivable | 2,938 |
| Inventory | 1,232 |
| Other current assets | 410 |
| Current assets | 5,419 |
| | |
| Property, net | 3,515 |
| Other long-term assets | 3,358 |
| Total assets | $12,292 |
| | |
| Accounts payable | $2,563 |
| Other current liabilities | 1,585 |
| Current liabilities | 4,148 |
| | |
| Long-term liabilities | 5,381 |
| Total liabilities | 9,529 |
| | |
| Contributed capital | 1,636 |
| Retained earnings | 1,980 |
| Other equity | (853) |
| Total equity | 2,763 |
| Total liabilities and equity | $12,292 |

**Topic: Market to Book Value and Unrecorded Intangible Assets**
**LO: 1**
**6.** Below are selected balance sheet and market data for three shoe companies. ($ millions)

| Company | Company Year End | Assets | Liabilities | Number of shares outstanding (in millions) | End of year stock price (per share) |
|---|---|---|---|---|---|
| Nike, Inc. | May 31, 2016 | 21,396 | 9,138 | 1,682 | $55.22 |
| Skechers, USA, Inc. | Dec. 31, 2016 | 2,394 | 708 | 155 | $24.58 |
| Caleres, Inc. | Jan. 28, 2017 | 1,475 | 861 | 43 | $32.82 |

a. Calculate the market capitalization of each company.
b. Calculate the market to book ratio for each company.
c. Comment on differences you observe.

*Answer:*
a. and b.

| Company | Book Value of Equity (Assets – Liabilities) | Market Capitalization (Shares outstanding × stock price) | Market to book ratio |
|---|---|---|---|
| Nike, Inc. | 12,258 | 92,880 | 7.58 |
| Skechers, USA, Inc. | 1,686 | 3,810 | 2.26 |
| Caleres, Inc. | 614 | 1,411 | 2.30 |

c. Nike has a market to book ratio of 7.56, the highest among the three companies. This means that Nike's economic value exceeds its GAAP book value by a factor of over 7.5. This is due to the fact that significant, valuable intangible assets are omitted from Nike's GAAP balance sheet. GAAP does not allow firms to capitalize (add to their balance sheets) the value of self-generated intangible assets. Nike's brand name and the "swoosh" symbol will bring future economic benefits—assets that the market clearly values. At the other end, Caleres and Skechers both have a market to book of about 2.30. This means that their brand names, while still valuable, are not significant enough to boost their stock price. Note that it would also be possible for a company to have a book value of equity that exceeds its market value. This would mean that the market undervalues this company, relative to GAAP, perhaps because the company's earning power is low.

**Topic: Articulation of Retained Earnings**
**LO: 5**

**7.** Following is information for Snap-On, Inc., for three recent years. Reconcile the retained earnings account for the three-year period.

| (in millions) | |
|---|---|
| Retained earnings, December 31, 2016 | 3,384.9 |
| Net income, 2016 | 546.4 |
| Net income, 2015 | 478.7 |
| Net income, 2014 | 421.9 |
| Dividends*, 2016 | 148.4 |
| Dividends*, 2015 | 129.0 |
| Dividends*, 2014 | 108.8 |

*Dividends include "dividend reinvestment plan and other" amounts of: 1.2 (2014), 1.1 (2015) and 0.9 (2016).

*Answer:*

SNAP-ON, INC.
Retained Earnings Reconciliation
For Years Ending December 31

| (in millions) | 2016 | 2015 | 2014 |
|---|---|---|---|
| Retained earnings, beginning of year | $2,986.9 | $2,637.2 | $2,324.1 |
| Net income (loss) for the year | 546.4 | 478.7 | 421.9 |
| Dividends declared | (148.4) | (129.0) | (108.8) |
| Retained earnings, end of year | $3,384.9 | $2,986.9 | $2,637.2 |

**Topic: Articulation of Retained Earnings**
**LO: 5**

**8.** Following is information for Goodyear Tire & Rubber Company for three recent years. Reconcile the retained earnings account for the three-year period.

| (in millions) | |
|---|---|
| Retained earnings, December 31, 2016 | 5,808 |
| Net income, 2016 | 1,264 |
| Net income, 2015 | 307 |
| Net income, 2014 | 2,452 |
| Other, 2016 | 56 |
| Dividends, 2016 | 82 |
| Dividends, 2015 | 68 |
| Dividends, 2014 | 67 |

*Answer:*

GOODYEAR TIRE & RUBBER COMPANY
Retained Earnings Reconciliation
For Years Ending December 31

| (in millions) | 2016 | 2015 | 2014 |
|---|---|---|---|
| Retained earnings, beginning of year | $4,570 | $4,331 | $1,946 |
| Net income (loss) for the year | 1,264 | 307 | 2,452 |
| Other | 56 | — | — |
| Dividends | (82) | (68) | (67) |
| Retained earnings, end of year | $5,808 | $4,570 | $4,331 |

**Topic: Applying Financial Statement Linkages to Understand Transactions**
**LO: 1, 2, 3, 4, 5**

**9.** Consider the effects of the independent transactions, a through f, on a company's balance sheet, income statement, statement of cash flows, and statement of stockholders' equity.

*a.* Owner invests cash into the business in exchange for stock.
*b.* Recognizes account receivable for services provided.
*c.* Pays account payable with cash.
*d.* Buys land with cash.
*e.* Buys plant equipment on credit.
a. Borrows money by taking out loan at bank.

Complete the table below to explain the effects and financial statement linkages. Use "+" to indicate the account increases and "–" to indicate the account decreases.

| | *a.* | *b.* | *c.* | *d.* | *e.* | *f.* |
|---|---|---|---|---|---|---|
| **Balance sheet** | | | | | | |
| Cash | | | | | | |
| Noncash assets | | | | | | |
| Total liabilities | | | | | | |
| Contributed capital | | | | | | |
| Retained earnings | | | | | | |
| Other equity | | | | | | |
| **Statement of cash flows** | | | | | | |
| Operating cash flow | | | | | | |
| Investing cash flow | | | | | | |
| Financing cash flow | | | | | | |
| **Income statement** | | | | | | |
| Revenues | | | | | | |
| Expenses | | | | | | |
| Net earnings | | | | | | |
| **Statement of stockholders' equity** | | | | | | |
| Contributed capital | | | | | | |
| Retained earnings | | | | | | |

*Answer:*

| | *a.* | *b.* | *c.* | *d.* | *e.* | *f.* |
|---|---|---|---|---|---|---|
| **Balance sheet** | | | | | | |
| Cash | + | + | – | – | | + |
| Noncash assets | | – | | + | + | |
| Total liabilities | | | – | | + | + |
| Contributed capital | + | | | | | |
| Retained earnings | | | | | | |
| Other equity | | | | | | |
| **Statement of cash flows** | | | | | | |
| Operating cash flow | | + | – | | | |
| Investing cash flow | | | | – | | |
| Financing cash flow | + | | | | | + |
| **Income statement** | | | | | | |
| Revenues | | | | | | |
| Expenses | | | | | | |
| Net earnings | | | | | | |
| **Statement of stockholders' equity** | | | | | | |
| Contributed capital | + | | | | | |
| Retained earnings | | | | | | |

**Topic: Applying Financial Statement Linkages to Understand Transactions**
**LO: 1, 2, 3, 4, 5**

**10.** Consider the effects of the independent transactions, a through d, on a company's balance sheet, income statement, statement of cash flows, and statement of stockholders' equity.

*a.* The company purchased inventory on credit.
*b.* The company paid cash for rent expense.
*c.* The company collected cash from clients previously billed for goods sold.
*d.* The company paid cash for inventory purchased in Transaction *a*.

Complete the table below to explain the effects and financial statement linkages. Use "+" to indicate the account increases and "-" to indicate the account decreases.

| | *a.* | *b.* | *c.* | *d.* |
|---|---|---|---|---|
| **Balance sheet** | | | | |
| Cash | | | | |
| Noncash assets | | | | |
| Total liabilities | | | | |
| Contributed capital | | | | |
| Retained earnings | | | | |
| Other equity | | | | |
| **Statement of cash flows** | | | | |
| Operating cash flow | | | | |
| Investing cash flow | | | | |
| Financing cash flow | | | | |
| **Income statement** | | | | |
| Revenues | | | | |
| Expenses | | | | |
| Net earnings | | | | |
| **Statement of stockholders' equity** | | | | |
| Contributed capital | | | | |
| Retained earnings | | | | |

*Answer:*

| **Balance sheet** | *a.* | *b.* | *c.* | *d.* |
|---|---|---|---|---|
| Cash | | – | + | – |
| Noncash assets | + | | – | |
| Total liabilities | + | | | – |
| Contributed capital | | | | |
| Retained earnings | | – | | |
| Other equity | | | | |

| **Statement of cash flows** | | | | |
|---|---|---|---|---|
| Operating cash flow | | – | + | – |
| Investing cash flow | | | | |
| Financing cash flow | | | | |

| **Income statement** | | | | |
|---|---|---|---|---|
| Revenues | | | | |
| Expenses | | + | | |
| Net earnings | | – | | |

| **Statement of stockholders' equity** | | | | |
|---|---|---|---|---|
| Contributed capital | | | | |
| Retained earnings | | – | | |

**Topic: Applying Financial Statement Linkages to Understand Transactions**
**LO: 1, 2, 3, 4, 5**

**11.** Consider the effects of the independent transactions, a through h, on a company's balance sheet, income statement, statement of cash flows, and statement of stockholders' equity.

*a.* The company purchased inventory on credit.
*b.* The company sold all inventory purchased in transaction *a)* on credit (and for more than its cost).
*c.* The company collected cash from customers from transaction *b)*.
*d.* The company purchased equipment with cash.
*e.* The company paid cash for a note payable that came due.
*f.* The company paid cash for interest on borrowings.
*g.* Wages were earned by company employees but not yet paid.
*h.* The company paid cash in dividends.

Complete the table below to explain the effects and financial statement linkages. Use "+" to indicate the account increases and "–" to indicate the account decreases.

| | *a.* | *b.* | *c.* | *d.* | *e.* | *f.* | *g.* | *h.* |
|---|---|---|---|---|---|---|---|---|
| **Balance sheet** | | | | | | | | |
| Cash | | | | | | | | |
| Noncash assets | | | | | | | | |
| Total liabilities | | | | | | | | |
| Contributed capital | | | | | | | | |
| Retained earnings | | | | | | | | |
| Other equity | | | | | | | | |
| **Statement of cash flows** | | | | | | | | |
| Operating cash flow | | | | | | | | |
| Investing cash flow | | | | | | | | |
| Financing cash flow | | | | | | | | |
| **Income statement** | | | | | | | | |
| Revenues | | | | | | | | |
| Expenses | | | | | | | | |
| Net earnings | | | | | | | | |
| **Statement of stockholders' equity** | | | | | | | | |
| Contributed capital | | | | | | | | |
| Retained earnings | | | | | | | | |

*Answer:*

| | a. | b. | c. | d. | e. | f. | g. | h. |
|---|---|---|---|---|---|---|---|---|
| **Balance sheet** | | | | | | | | |
| Cash | | | + | – | – | – | | – |
| Noncash assets | + | + | – | + | | | | |
| Total liabilities | + | | | | – | | + | |
| Contributed capital | | | | | | | | |
| Retained earnings | | + | | | | – | – | – |
| Other equity | | | | | | | | |
| **Statement of cash flows** | | | | | | | | |
| Operating cash flow | | | + | | | – | | |
| Investing cash flow | | | | – | | | | |
| Financing cash flow | | | | | – | | | – |
| **Income statement** | | | | | | | | |
| Revenues | | + | | | | | | |
| Expenses | | + | | | | + | + | |
| Net earnings | | + | | | | – | – | |
| **Statement of stockholders' equity** | | | | | | | | |
| Contributed capital | | | | | | | | |
| Retained earnings | | + | | | | – | – | – |

**Topic: Applying Financial Statement Linkages to Understand Transactions**
**LO: 1, 2, 3, 4, 5**

**12.** Consider the effects of the independent transactions, a through g, on a company's balance sheet, income statement, statement of cash flows, and statement of stockholders' equity.

*a.* The company issued stock in exchange for cash.
*b.* The company paid cash for rent.
*c.* The company performed services for clients and immediately received cash.
*d.* The company performed services for clients and sent a bill with payment due in 30 days.
*e.* The company compensated its employees with cash for wages.
*f.* The company received cash as payment on the amount owed from clients.
*g.* The company paid cash in dividends.

Complete the table below to explain the effects and financial statement linkages. Use "+" to indicate the account increases and "–" to indicate the account decreases.

| | *a.* | *b.* | *c.* | *d.* | *e.* | *f.* | *g.* |
|---|---|---|---|---|---|---|---|
| **Balance sheet** | | | | | | | |
| Cash | | | | | | | |
| Noncash assets | | | | | | | |
| Total liabilities | | | | | | | |
| Contributed capital | | | | | | | |
| Retained earnings | | | | | | | |
| Other equity | | | | | | | |
| **Statement of cash flows** | | | | | | | |
| Operating cash flow | | | | | | | |
| Investing cash flow | | | | | | | |
| Financing cash flow | | | | | | | |
| **Income statement** | | | | | | | |
| Revenues | | | | | | | |
| Expenses | | | | | | | |
| Net earnings | | | | | | | |
| **Statement of stockholders' equity** | | | | | | | |
| Contributed capital | | | | | | | |
| Retained earnings | | | | | | | |

*Answer:*

| | *a.* | *b.* | *c.* | *d.* | *e.* | *f.* | *g.* |
|---|---|---|---|---|---|---|---|
| **Balance sheet** | | | | | | | |
| Cash | **+** | **–** | **+** | | **–** | **+** | **–** |
| Noncash assets | | | | **+** | | **–** | |
| Total liabilities | | | | | | | |
| Contributed capital | **+** | | | | | | |
| Retained earnings | | **–** | **+** | **+** | **–** | | **–** |
| Other equity | | | | | | | |
| **Statement of cash flows** | | | | | | | |
| Operating cash flow | | **–** | **+** | | **–** | **+** | |
| Investing cash flow | | | | | | | |
| Financing cash flow | **+** | | | | | | **–** |
| **Income statement** | | | | | | | |
| Revenues | | | **+** | **+** | | | |
| Expenses | | **+** | | | **+** | | |
| Net earnings | | **–** | **+** | **+** | **–** | | |
| **Statement of stockholders' equity** | | | | | | | |
| Contributed capital | **+** | | | | | | |
| Retained earnings | | **–** | **+** | **+** | **–** | | **–** |

**Topic: Use Template to Record Transactions and Accounting Adjustments**
***(Numerical calculations required)***
**LO: 6, 7**

**13.** Maibrit's Bike's began operations in April 2017 and had the following transactions.

a) Owner invested $120,000 cash and a truck worth $36,000 in exchange for stock.
b) Paid $84,000 cash for 6 months' rent.
c) Purchased $300,000 of bicycle inventory on credit.
d) Sold bicycles for cash of $507,000. The cost of the bikes sold was $180,000.
e) Sold and invoiced bicycles to a client for $95,400. The cost of the bikes sold was $48,000.
f) Paid $90,000 cash for an advertising campaign in connection with Tour de France. The campaign will run over the next two of months.
g) Paid $24,000 in cash for supplies to have on hand for bike repairs.
h) Collected $60,000 from accounts receivable.
i) Paid for bikes purchased on credit in *Transaction c* above.
j) Paid cash dividends of $3,000.
k) Received $6,000 cash from a customer as a deposit for a custom bicycle to be built.

*Required:* Record each transaction a) through k) in the financial statements effects template, below.

| | Balance Sheet | | | | | | | | | Income Statement | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Transaction** | **Cash Asset** | **+** | **Noncash Assets** | **=** | **Liabil-ities** | **+** | **Contrib. Capital** | **+** | **Earned Capital** | **Rev-enues** | **−** | **Expen-ses** | **=** | **Net Income** |
| a) | | | | = | | | | | | | − | | = | |
| b) | | | | = | | | | | | | − | | = | |
| c) | | | | = | | | | | | | − | | = | |
| d) | | | | = | | | | | | | − | | = | |
| e) | | | | = | | | | | | | − | | = | |
| f) | | | | = | | | | | | | − | | = | |
| g) | | | | = | | | | | | | − | | = | |
| h) | | | | = | | | | | | | − | | = | |
| i) | | | | = | | | | | | | − | | = | |
| j) | | | | = | | | | | | | − | | = | |
| k) | | | | = | | | | | | | − | | = | |

*Continued next page*

At the end of April, the following information is available:

i. At the end of April, $19,200 supplies remained on hand.
ii. Rent paid in *Transaction b* is for a lease that began on April 1.
iii. At the end of April, one-third of the advertising campaign in *Transaction f* was completed.
iv. The truck is expected to be used for five years (60 months).
v. The custom bicycle in *Transaction k* was built and delivered to the customer on April 30.

*Required:* Record any accounting adjustments required for items i. through v., in the financial statement effects template, that follows.

| | | | | | Balance Sheet | | | | | Income Statement | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Transaction** | **Cash Asset** | **+** | **Noncash Assets** | **=** | **Liabil-ities** | **+** | **Contrib. Capital** | **+** | **Earned Capital** | **Rev-enues** | **–** | **Expen-ses** | **=** | **Net Income** |
| i. | | | | = | | | | | | | – | | = | |
| ii. | | | | = | | | | | | | – | | = | |
| iii. | | | | = | | | | | | | – | | = | |
| iv. | | | | = | | | | | | | – | | = | |
| v. | | | | = | | | | | | | – | | = | |

*Answer:*

| | | | | | Balance Sheet | | | | | Income Statement | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Transaction** | **Cash Asset** | **+** | **Noncash Assets** | **=** | **Liabil-ities** | **+** | **Contrib. Capital** | **+** | **Earned Capital** | **Rev-enues** | **–** | **Expen-ses** | **=** | **Net Income** |
| a) | +120,000 | | +36,000 (Truck, net) | = | | | +156,000 (Common Stock) | | | | – | | = | |
| b) | -84,000 (Cash) | | +84,000 (Prepaid Rent) | = | | | | | | | – | | = | |
| c) | | | +300,000 (Inventory) | = | +300,000 (AP) | | | | | | – | | = | |
| d) | +507,000 | | -180,000 (Inventory) | = | | | | | +327,000 (Retained Earnings) | +507,000 (Sales) | – | +180,000 (COGS) | = | +327,000 |
| e) | | | +95,400 (AR) -48,000 (Inventory) | = | | | | | +47,400 (Retained Earnings) | +95,400 (Sales) | – | +48,000 (COGS) | = | +47,400 |
| f) | -90,000 | | +90,000 (Prepaid Advertising) | = | | | | | | | – | | = | |

*Continued next page*

*(table continued):*

| | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | Balance Sheet | | | | | | Income Statement | | | | |
| **Transaction** | **Cash Asset** | **+** | **Noncash Assets** | **=** | **Liabil-ities** | **+** | **Contrib. Capital** | **+** | **Earned Capital** | **Rev-enues** | **–** | **Expen-ses** | **=** | **Net Income** |
| g) | -24,000 | | +24,000 (Supplies) | = | | | | | | | – | | = | |
| h) | +60,000 | | -60,000 (AR) | = | | | | | | | – | | = | |
| i) | -300,000 | | | = | -300,000 (AP) | | | | | | – | | = | |
| j) | -3,000 | | | = | | | | | -3,000 (Dividends) | | – | | = | |
| k) | +6,000 | | | = | +6,000 (Unearned Revenue) | | | | | | – | | = | |

| | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | Balance Sheet | | | | | | Income Statement | | | | |
| **Transaction** | **Cash Asset** | **+** | **Noncash Assets** | **=** | **Liabil-ities** | **+** | **Contrib. Capital** | **+** | **Earned Capital** | **Rev-enues** | **–** | **Expen-ses** | **=** | **Net Income** |
| i. | | | -4,800 (Supplies) | = | | | | | -4,800 (Retained Earnings) | | – | +4,800 (Supplies Exp.) | = | -4,800 |
| ii. | | | -14,000 (Prepaid Rent) | = | | | | | -14,000 (Retained Earnings) | | – | +14,000 (Rent Exp.) | = | -14,000 |
| iii. | | | -30,000 (Prepaid Advert.) | = | | | | | -30,000 (Retained Earnings) | | – | +30,000 (Advert. Exp.) | = | -30,000 |
| iv. | | | -600 (Truck, net) | = | | | | | -600 (Retained Earnings) | | – | +600 (Dep'n. Exp.) | = | -600 |
| v. | | | | = | -6,000 (Unearned Revenue) | | | | +6,000 (Retained Earnings) | +6,000 (Sales) | – | | = | +6,000 |

**Topic: Use Journal Entries to Record Transactions *(Numerical calculations required)***
**LO: 6, 7**
**14.** Maibrit's Bike's began operations in April 2017 and had the following transactions.

a) Owner invested $120,000 cash and a truck worth $36,000 in exchange for stock.
b) Paid $84,000 cash for 6 months' rent.
c) Purchased $300,000 of bicycle inventory on credit.
d) Sold bicycles for cash of $507,000. The cost of the bikes sold was $180,000.
e) Sold and invoiced bicycles to a client for $95,400. The cost of the bikes sold was $48,000.
f) Paid $90,000 cash for an advertising campaign in connection with Tour de France. The campaign will run over the next two of months.
g) Paid $24,000 in cash for supplies to have on hand for bike repairs.
h) Collected $60,000 from accounts receivable.
i) Paid for bikes purchased on credit in *Transaction c* above.
j) Paid cash dividends of $3,000.
k) Received $6,000 cash from a customer as a deposit for a custom bicycle to be built.

At the end of April, the following information is available:

i. At the end of April, $19,200 supplies remained on hand.
ii. Rent paid in *Transaction b* is for a lease that began on April 1.
iii. At the end of April, one-third of the advertising campaign in *Transaction f* was completed.
iv. The truck is expected to be used for five years (60 months).
v. The custom bicycle in *Transaction k* was built and delivered to the customer on April 30.

*Required:* Prepare journal entries for any accounting adjustments required for items i. through v.

*Answer:*
Transaction journal entries:

a)

| | | |
|---|---|---|
| Debit Cash | 120,000 | |
| Debit Truck (PPE) | 36,000 | |
| Credit Common stock | | 156,000 |
| *To record initial investment by owner.* | | |

b)

| | | |
|---|---|---|
| Debit Prepaid rent | 84,000 | |
| Credit Cash | | 84,000 |
| *To record prepaid rent.* | | |

c)

| | | |
|---|---|---|
| Debit Inventory | 300,000 | |
| Credit Accounts payable | | 300,000 |
| *To record inventory purchased on account* | | |

*Continued next page*

d)

| | | |
|---|---|---|
| Debit Cash | 507,000 | |
| Credit Sales | | 507,000 |
| Debit Cost of goods sold | 180,000 | |
| Credit Inventory | | 180,000 |

*To record cash sale and cost of sale.*

e)

| | | |
|---|---|---|
| Debit Accounts receivable | 95,400 | |
| Credit Sales | | 95,400 |
| Debit Cost of goods sold | 48,000 | |
| Credit Inventory | | 48,000 |

*To record sale on account.*

f)

| | | |
|---|---|---|
| Debit Prepaid advertising | 90,000 | |
| Credit Cash | | 90,000 |

*To record prepaid advertising.*

g)

| | | |
|---|---|---|
| Debit Supplies inventory | 24,000 | |
| Credit Cash | | 24,000 |

*To record supplies purchased.*

h)

| | | |
|---|---|---|
| Debit Cash | 60,000 | |
| Credit Accounts receivable | | 60,000 |

*To record cash collected from customers.*

i)

| | | |
|---|---|---|
| Debit Accounts payable | 300,000 | |
| Credit Cash | | 300,000 |

*To pay suppliers for bikes purchased earlier on account.*

j)

| | | |
|---|---|---|
| Debit Dividends | 3,000 | |
| Credit Cash | | 3,000 |

*To record dividends paid to owner.*

k)

| | | |
|---|---|---|
| Debit Cash | 6,000 | |
| Credit unearned revenue | | 6,000 |

*To record cash deposit received from customer.*

*Continued next page*

Accounting adjustments:

i.

| | | |
|---|---|---|
| Debit Supplies expense | 4,800 | |
| Credit Supplies inventory | | 4,800 |
| *To record supplies used.* | | |

ii.

| | | |
|---|---|---|
| Debit Rent expense | 14,000 | |
| Credit Prepaid rent | | 14,000 |
| *To record April rent expense.* | | |

iii.

| | | |
|---|---|---|
| Debit Advertising expense | 30,000 | |
| Credit Prepaid advertising | | 30,000 |
| *To record advertising expense.* | | |

iv.

| | | |
|---|---|---|
| Debit Depreciation expense | 600 | |
| Credit Truck (Accum. Depreciation) | | 600 |
| *To record depreciation expense on truck.* | | |

v.

| | | |
|---|---|---|
| Debit Unearned revenue | 6,000 | |
| Credit Sales | | 6,000 |
| *To record revenue earned on custom bicycle.* | | |

**Topic: Using the Financial Statements Effects Template *(Numerical calculations required)***
**LO: 6**

**15.** Record the following transactions for Mouser Pet Foods, Inc., in the financial statements effects template below (in thousands).

a) Sell stock in company for $78,000
b) Obtain long-term bank loan of $30,000.
c) Purchase manufacturing equipment for $20,400 cash.
d) Rent manufacturing and warehousing space and pay $34,800 in advance for the year.
e) Purchase $30,000 of inventory, paying $6,000 in cash and the remaining amount on credit.
f) Sell half of the inventory purchased in *Transaction e* for $33,900 on account.
g) Pay $24,000 to creditors.
h) Make loan payment of $4,800 of which interest is $480 and the rest is principal.

| ($ thousands) | Balance Sheet | | | | | | | | | Income Statement | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Transaction | Cash Asset | + | Noncash Assets | = | Liabil-ities | + | Contrib. Capital | + | Earned Capital | Rev-enues | – | Expen-ses | = | Net Income |
| a) | | | | = | | | | | | | – | | = | |
| b) | | | | = | | | | | | | – | | = | |
| c) | | | | = | | | | | | | – | | = | |
| d) | | | | = | | | | | | | – | | = | |
| e) | | | | = | | | | | | | – | | = | |
| f) | | | | = | | | | | | | – | | = | |
| g) | | | | = | | | | | | | – | | = | |
| h) | | | | = | | | | | | | – | | = | |

*Answer:*

| ($ thousands) | Balance Sheet | | | | | | | | | | Income Statement | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Transaction** | **Cash Asset** | **+** | **Noncash Assets** | **=** | **Liabil-ities** | **+** | **Contrib. Capital** | **+** | **Earned Capital** | **Rev-enues** | **–** | **Expen-ses** | **=** | **Net Income** |
| a) | +78,000 | | | = | | | +78,000 (Common Stock) | | | | – | | = | |
| b) | +30,000 | | | = | +30,000 (Loan) | | | | | | – | | = | |
| c) | -20,400 | | +20,400 (Equipment) | = | | | | | | | – | | = | |
| d) | -34,800 | | +34,800 (Prepaid Rent) | = | | | | | | | – | | = | |
| e) | -6,000 | | +30,000 (Inventory) | = | +24,000 (AP) | | | | | | – | | = | |
| f) | | | +33,900 (AR) -15,000 (Inventory) | = | | | | | +18,900 (Retained Earnings) | +33,900 (Sales) | – | +15,000 (Cost of Goods Sold) | = | +18,900 |
| g) | -24,000 | | | = | -24,000 (AP) | | | | | | – | | = | |
| h) | -4,800 | | | = | -4,320 (Loan) | | | | -480 (Retained Earnings) | | – | +480 (Interest Expense) | = | -480 |

**Topic: Preparing Journal Entries to Record Transactions *(Numerical calculations required)***
**LO: 6**

**16.** Prepare journal entries to record the following transactions for Mouser Pet Foods, Inc. (in thousands).

a) Sell stock in company for $78,000
b) Obtain long-term bank loan of $30,000.
c) Purchase manufacturing equipment for $20,400 cash.
d) Rent manufacturing and warehousing space and pay $34,800 in advance for the year.
e) Purchase $30,000 of inventory, paying $6,000 in cash and the remaining amount on credit.
f) Sell half of the inventory purchased in transaction e., for $33,900 on account.
g) Pay $24,000 to creditors.
h) Make loan payment of $4,800 of which interest is $480 and the rest is principal.

*Answer:*
*(in thousands)*

a.

| | | |
|---|---|---|
| Debit Cash | 78,000 | |
| Credit Common stock | | 78,000 |
| *To record owner's contribution.* | | |

b.

| | | |
|---|---|---|
| Debit Cash | 30,000 | |
| Credit Bank loan | | 30,000 |
| *To record cash received from bank.* | | |

c.

| | | |
|---|---|---|
| Debit Equipment (PPE) | 20,400 | |
| Credit Cash | | 20,400 |
| *To record purchase of equipment.* | | |

d.

| | | |
|---|---|---|
| Debit Prepaid rent | 34,800 | |
| Credit Cash | | 34,800 |
| *To record rent paid in advance for the year.* | | |

e.

| | | |
|---|---|---|
| Debit Inventory | 30,000 | |
| Credit Accounts payable | | 24,000 |
| Credit Cash | | 6,000 |
| *To record inventory purchased with both cash and credit.* | | |

f.

| | | |
|---|---|---|
| Debit Accounts receivable | 33,900 | |
| Credit Sales | | 33,900 |
| Debit Cost of goods sold | 15,000 | |
| Credit Inventory | | 15,000 |
| *To record sale on account and cost of sales.* | | |

g.

| | | |
|---|---|---|
| Debit Accounts payable | 24,000 | |
| Credit Cash | | 24,000 |
| *To record payment on account.* | | |

h.

| | | |
|---|---|---|
| Debit Interest expense | 480 | |
| Debit Bank loan | 4,320 | |
| Credit Cash | | 4,800 |
| *To record payment of loan: interest and principal*. | | |

**Topic: Assessing Financial Statement Effects of Transactions and Adjustments**
***(Numerical calculations required)***

**LO: 6, 7**

**17.** You have been hired by Peters CAD, a small engineering and drafting firm, to help prepare a set of financial statements for the bank for the fiscal year ending October 31. You have reviewed all the transactions for the year and find the following information that has not been recorded in the company's books.

1) During October, Peters CAD provided $11,400 of CAD services to clients who will be billed in early November. The firm uses the account Fees Receivable to reflect amounts due but not yet billed.
2) The firm paid $14,400 cash on October 15 for a series of radio commercials to run during October and November. One-third of the commercials have aired by October 31st. The $14,400 payment was recorded in the Prepaid advertising account.
3) Starting October 1, all maintenance work on Peters CAD's computer and printing equipment is handled by PC Guru under an agreement whereby Peters CAD pays a fixed monthly charge of $4,800. Peters CAD paid six months' service charges of $28,800 cash in advance on October 1, and increased its Prepaid expenses account by $28,800.
4) Starting October 16, Peters CAD rented 800 square feet of storage space from a neighboring business. The monthly rent of $4.80 per square foot is due in advance on the first of each month. Nothing was paid in October, as the neighbor agreed that Peters CAD could pay the rent for October with the November 1 rent payment.
5) Peters CAD invested $60,000 cash in securities on October 1 (this part of the transaction was already properly recorded) and earned interest of $1,200 on these securities by October 31. No interest will be received until January.
6) Monthly depreciation on the equipment is $870. No depreciation has been recorded yet for the year.
7) Weekly salaries for a five-day week total $37,500, payable on Fridays. October 31 of the current year is a Tuesday.
8) A bill for work done during August and September has not yet been sent because the client is out of the country. The bill totals $12,450.
9) Peters CAD has $240,000 of notes payable outstanding at October 31(already recorded on the books). Interest of $2,400 has accrued on these notes by October 31, and will be paid when the notes mature in 2020.
10) Peters CAD received a $12,000 deposit in June from a client for a job to be completed by the end of the fiscal year (this part of the transaction was already properly recorded). Peters CAD completed the job on October 31.

*Required:* Prepare accounting adjustments required at October 31 using the financial statement effects template that follows.

| | Balance Sheet | | | | | | | | | | Income Statement | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Transaction | Cash Asset | + | Noncash Assets | = | Liabil-ities | + | Contrib. Capital | + | Earned Capital | Rev-enues | – | Expen-ses | = | Net Income |
| 1) | | | | = | | | | | | | – | | = | |
| 2) | | | | = | | | | | | | – | | = | |
| 3) | | | | = | | | | | | | – | | = | |
| 4) | | | | = | | | | | | | – | | = | |
| 5) | | | | = | | | | | | | – | | = | |
| 6) | | | | = | | | | | | | – | | = | |
| 7) | | | | = | | | | | | | – | | = | |
| 8) | | | | = | | | | | | | – | | = | |
| 9) | | | | = | | | | | | | – | | = | |
| 10) | | | | = | | | | | | | – | | = | |

*Answer:*

| | Balance Sheet | | | | | | | | | | Income Statement | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Transaction | Cash Asset | + | Noncash Assets | = | Liabil-ities | + | Contrib Capital | + | Earned Capital | Rev-enues | – | Expen-ses | = | Net Income |
| 1) | | | 11,400 (Fees Rec.) | = | | | | | +11,400 (Retained Earnings) | +11,400 (Sales) | – | | = | +11,400 |
| 2) | | | -4,800 (Prepaid Advertising ) | = | | | | | -4,800 (Retained Earnings) | | – | +4,800 (Advert . Exp.) | = | -4,800 |
| 3) | | | -4,800 (Prepaid Expenses) | = | | | | | -4,800 (Retained Earnings) | | – | +4,800 (Maint-enance Exp) | = | -4,800 |

Continued next page

*Table continued*

| | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | **Balance Sheet** | | | | | | | | | **Income Statement** | | | | |
| **Transaction** | **Cash Asset** | **+** | **Noncash Assets** | **=** | **Liabil-ities** | **+** | **Contrib Capital** | **+** | **Earned Capital** | **Rev-enues** | **–** | **Expen-ses** | **=** | **Net Income** |
| 4) | | | | = | +1,920 (Rent Payable) | | | | -1,920 (Retained Earnings) | | – | +1,920 (Rent Exp.) | = | -1,920 |
| 5) | | | +1,200 (Interest Receivable) | = | | | | | +1,200 (Retained Earnings) | +1,200 (Interest Income) | – | | = | +1,200 |
| 6) | | | -10,440 (PPE, net) | = | | | | | -10,440 (Retained Earnings) | | – | +10,440 (Dep'n Exp.) | = | -10,440 |
| 7) | | | | = | +15,000 (Wages Payable) | | | | -15,000 (Retained Earnings) | | – | +15,000 (Wages Exp.) | = | -15,000 |
| 8) | | | +12,450 (AR) | = | | | | | +12,450 (Retained Earnings) | +12,450 (Sales) | – | | = | +12,450 |
| 9) | | | | = | +2,400 (Interest Payable) | | | | -2,400 (Retained Earnings) | | – | +2,400 (Interest Exp.) | = | -2,400 |
| 10) | | | | = | -12,000 (Unearned Revenue) | | | | +12,000 (Retained Earnings) | +12,000 (Sales) | – | | = | +12,000 |

**Topic:Preparing Financial Statements from Financial Statement Effects Template *(Numerical calculations required)***
**LO: 6, 7, 8**

**18.** In December 2017, Beth Gilligan opened dry-cleaning store. The financial statement effects template below shows transactions for the month (a through i) and accounting adjustments (i through iv).

*Required:*
Determine the ending balances for the accounts as of December 31, 2017 and prepare an income statement for Beth Gilligan's first month of operations and a balance sheet for December 31, 2017.

| | Balance Sheet | | | | | | | | | | Income Statement | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Transaction** | **Cash Asset** | **+** | **Noncash Assets** | **=** | **Liabil-ities** | **+** | **Contrib. Capital** | **+** | **Earned Capital** | | **Rev-enues** | **–** | **Expen-ses** | **=** | **Net Income** |
| a) | +38,000 | | +48,000 (Equipment) | = | | | +86,000 (Common Stock) | | | | | – | | = | |
| b) | -4,140 | | +3,600 (Supplies) | = | | | | | -540 Retained Earnings) | | | – | +540 (Phone Expense) | = | -540 |
| c) | | | +6,900 (Equipment) | = | +6,900 (AP) | | | | | | | – | | = | |
| d) | +8,400 | | | = | | | | | +8,400 (Retained Earnings) | | +8,400 (Sales) | – | | = | +8,400 |
| e) | +795 | | | = | +795 (Unearned Revenue) | | | | | | | – | | = | |
| f) | -12,000 | | +12,000 (Equipment) | = | | | | | | | | – | | = | |
| g) | -4,500 | | | = | | | | | -4,500 (Retained Earnings) | | | – | +4,500 (Wages Exp.) | = | -4,500 |
| h) | +15,900 | | | = | | | | | +15,900 (Retained Earnings) | | +15,900 (Sales) | – | | = | +15,900 |
| i) | -6,900 | | | = | -6,900 (AP) | | | | | | | – | | = | |
| Adjustments: | | | | | | | | | | | | | | | |
| i. | | | -2,400 (Supplies) | = | | | | | -2,400 (Retained Earnings) | | | – | +2,400 (Supplies Exp.) | = | -2,400 |
| ii. | | | -3,000 (Equipment) | = | | | | | -3,000 (Retained Earnings) | | | – | +3,000 (Depr'n Exp.) | = | -3,000 |
| iii. | | | | = | +150 (Wages Payable) | | | | -150 (Retained Earnings) | | | – | +150 (Wages Exp.) | = | -150 |
| iv. | | | | = | +3,600 (Rent Payable) | | | | -3,600 (Retained Earnings) | | | – | +3,600 (Rent Exp.) | = | -3,600 |

*Answer:*

| | Balance Sheet | | | | | | | | | Income Statement | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Cash Asset | + | Noncash Assets | = | Liabil-Ities | + | Contrib. Capital | + | Earned Capital | Rev-enues | – | Expen-ses | = | Net Income |
| Balance Dec. 31, 2017 | 35,555 | | 65,100[a] | = | 4,545[b] | | 86,000 | | 10,110 | 24,300 | – | 14,190[c] | = | 10,110 |

| | | |
|---|---|---|
| a | Noncash assets | |
| | Equipment, net | 63,900 |
| | Supplies | 1,200 |
| b | Liabilities | |
| | Unearned revenue | 795 |
| | Wages payable | 150 |
| | Rent payable | 3,600 |
| c | Expenses | |
| | Phone expense | 540 |
| | Wages expense | 4,650 |
| | Supplies expense | 2,400 |
| | Depreciation expense | 3,000 |
| | Rent expense | 3,600 |

BETH GILLIGAN CLEANERS
Income Statement
For the Month of December 2017

| | |
|---|---|
| Sales | $24,300 |
| Wages expense | 4,650 |
| Rent expense | 3,600 |
| Depreciation | 3,000 |
| Supplies expense | 2,400 |
| Phone expense | 540 |
| Net income | $10,110 |

BETH GILLIGAN CLEANERS
Balance Sheet
At December 31, 2017

| | | | |
|---|---|---|---|
| Cash | $ 35,555 | Rent payable | $ 3,600 |
| Supplies | 1,200 | Wages payable | 150 |
| Total current assets | 36,755 | Unearned revenue | 795 |
| | | Total current liabilities | 4,545 |
| Equipment, net | 63,900 | | |
| | | Common stock | 86,000 |
| | | Retained earnings | 10,110 |
| | | Total equity | 96,110 |
| Total assets | $100,655 | Total liabilities & equity | $100,655 |

**Topic: Preparing Financial Statements *(Numerical calculations required)***
**LO: 8**

**19.** Cabela's Incorporated has the following account balances as of December 31, 2016, the end of its fiscal year.

| ($ thousands) | Debit | Credit |
|---|---|---|
| Accounts payable | | 347,784 |
| Accounts receivable | 76,140 | |
| Gift instruments and rewards programs | | 387,865 |
| Income tax expense | 100,653 | |
| Inventories | 860,360 | |
| Merchandise costs | 2,426,985 | |
| Other current assets | 207,981 | |
| Cash and cash equivalents | 312,522 | |
| Credit card loans, net | 5,579,575 | |
| Contributed capital | | 258,712 |
| Interest expense, net | 26,340 | |
| Long-term liabilities | | 4,269,455 |
| Other current liabilities | | 1,954,121 |
| Long-term assets | 1,934,246 | |
| Retained earnings | | 1,605,940 |
| Selling, distribution, and administrative expenses | 1,428,434 | |
| Total revenue | | 4,129,359 |

Prepare the company's income statement and balance sheet for December 31, 2016. The company paid no dividends during the year.

*Answer:*

| CABELA'S INCORPORATED<br>Income Statement<br>For the Year Ended December 31, 2016<br>(in $ thousands) | |
|---|---|
| Total revenue | $4,129,359 |
| Merchandise costs | 2,426,985 |
| Selling, distribution, and administrative expenses | 1,428,434 |
| Operating income | 273,940 |
| Interest expense, net | 26,340 |
| Income before tax | 247,600 |
| Income tax expense | 100,653 |
| Net income | $ 146,947 |

| CABELA'S INCORPORATED<br>Balance Sheet<br>December 31, 2016<br>($ thousands) | | | |
|---|---|---|---|
| Cash and cash equivalents | $312,522 | Accounts payable | $347,784 |
| Accounts receivable | 76,140 | Other current liabilities | 1,954,121 |
| Inventories | 860,360 | Gift instruments and rewards programs | 387,865 |
| Other current assets | 207,981 | Current liabilities | 2,689,770 |
| Credit card loans, net | 5,579,575 | Long-term liabilities | 4,269,455 |
| Current assets | 7,036,578 | Total liabilities | 6,959,225 |
| Long-term assets | 1,934,246 | Contributed capital | 258,712 |
| | | Retained earnings | 1,752,887 |
| | | Total equity | 2,011,599 |
| Total assets | $8,970,824 | Total liabilities and equity | $8,970,824 |

**Topic: Preparing Financial Statements *(Numerical calculations required)***
**LO: 8**

**20.** Graham Holdings Company (formerly The Washington Post Company) has the following account balances as of December 31, 2016, the end of its fiscal year.

| (in thousands) | Debit | Credit |
|---|---|---|
| Accounts payable | | 500,726 |
| Advertising revenue | | 311,078 |
| Cash | 670,816 | |
| Contributed capital | | 364,413 |
| Deferred revenue | | 312,107 |
| Depreciation and amortization expense | 92,894 | |
| Dividends | 27,325 | |
| Education revenue | | 1,598,347 |
| Long-term assets | 2,561,324 | |
| Operating expenses | 2,085,462 | |
| Other current assets | 1,200,530 | |
| Other current liabilities | | 6,128 |
| Other equity | | 236,486 |
| Other expenses, net | 52,876 | |
| Common stock | | 20,000 |
| Other liabilities | | 1,160,718 |
| Other revenue | | 572,465 |
| Retained earnings | | 5,446,809 |
| Tax expense | 81,200 | |
| Treasury stock | 3,756,850 | |

Prepare the company's income statement and balance sheet for 2016.

*Answer:*

| GRAHAM HOLDINGS COMPANY<br>Income Statement<br>For the Year Ended December 31, 2016<br>(in thousands) | |
|---|---|
| Education revenue | $1,598,347 |
| Advertising revenue | 311,078 |
| Other revenue | 572,465 |
| Total revenue | 2,481,890 |
| Operating expenses | (2,085,462) |
| Depreciation and amortization expense | (92,894) |
| Operating profit | 303,534 |
| Other expenses, net | (52,876) |
| Income before tax | 250,658 |
| Tax expense | (81,200) |
| Net income | $ 169,458 |

| GRAHAM HOLDINGS COMPANY<br>Balance Sheet<br>December 31, 2016<br>(in thousands) | | | |
|---|---|---|---|
| Cash | $ 670,816 | Accounts payable | $ 500,726 |
| Other current assets | 1,200,530 | Deferred revenue | 312,107 |
| Current assets | 1,871,346 | Other current liabilities | 6,128 |
| | | Total current liabilities | 818,961 |
| Long-term assets | 2,561,324 | Other liabilities | 1,160,718 |
| | | Total liabilities | 1,979,679 |
| | | Common stock | 20,000 |
| | | Contributed capital | 364,413 |
| | | Retained earnings | 5,588,942 |
| | | Treasury stock | (3,756,850) |
| | | Other equity | 236,486 |
| | | Total equity | 2,452,991 |
| Total assets | $4,432,670 | Total liabilities and equity | $4,432,670 |

**Topic: Preparing Closing Entries from Account Balances** ***(Numerical calculations required)***
**LO: 9**

**21.** Graham Holdings Company (formerly The Washington Post Company) has the following account balances as of December 31, 2016, the end of its fiscal year.

| (in thousands) | Debit | Credit |
|---|---|---|
| Accounts payable | | 500,726 |
| Advertising revenue | | 311,078 |
| Cash | 670,816 | |
| Contributed capital | | 364,413 |
| Deferred revenue | | 312,107 |
| Depreciation and amortization expense | 92,894 | |
| Dividends | 27,325 | |
| Education revenue | | 1,598,347 |
| Long-term assets | 2,561,324 | |
| Operating expenses | 2,085,462 | |
| Other current assets | 1,200,530 | |
| Other current liabilities | | 6,128 |
| Other equity | | 236,486 |
| Other expenses, net | 52,876 | |
| Common stock | | 20,000 |
| Other liabilities | | 1,160,718 |
| Other revenue | | 572,465 |
| Retained earnings | | 5,446,809 |
| Tax expense | 81,200 | |
| Treasury stock | 3,756,850 | |

Prepare the closing entries for the fiscal year.

*Answer:*

(in thousands)

| | | |
|---|---|---|
| Debit Education revenue | 1,598,347 | |
| Debit Advertising revenue | 311,078 | |
| Debit Other revenue | 572,465 | |
| Credit Retained earnings | | 2,481,890 |
| *To close revenue accounts for the fiscal year.* | | |
| | | |
| Debit Retained earnings | 2,312,432 | |
| Credit Operating expenses | | 2,085,462 |
| Credit Depreciation and amortization expense | | 92,894 |
| Credit Other expenses, net | | 52,876 |
| Credit Tax expense | | 81,200 |
| *To close expense accounts for the fiscal year.* | | |
| | | |
| Debit Retained earnings | 27,325 | |
| Credit Dividends | | 27,325 |
| *To close dividends account for the year.* | | |

**Topic: Preparing Closing Entries from Income Statement**
***(Numerical calculations required—More challenging, requires determining debits and credits for certain items and requires students to ignore subtotals)***
**LO: 9**

**22.** The 2016 income statement of The Coca-Cola Company is as follows.

| The Coca-Cola Company<br>Income Statement<br>For the Year Ended December 31, 2016 | |
|---|---|
| (In millions) | |
| Net revenues | $41,863 |
| Cost of goods sold | 16,465 |
| GROSS PROFIT | 25,398 |
| Selling, general and administrative | 15,262 |
| Other operating charges | 1,510 |
| OPERATING INCOME | 8,626 |
| Interest expense, net | 91 |
| Other nonoperating expenses | 399 |
| INCOME BEFORE INCOME TAXES | 8,136 |
| Income taxes | 1,586 |
| CONSOLIDATED NET INCOME | $6,550 |

Prepare the closing entries for 2016 for the income statement temporary accounts.

*Answer:*
(in millions)

| | | |
|---|---|---|
| Debit Net revenues | 41,863 | |
| Credit Retained earnings | | 41,863 |

*To close revenue accounts for the fiscal year.*

| | | |
|---|---|---|
| Debit Retained earnings | 35,313 | |
| Credit Cost of goods sold | | 16,465 |
| Credit Selling, general and administrative | | 15,262 |
| Credit Other operating charges | | 1,510 |
| Credit Interest expense | | 91 |
| Credit Other nonoperating expense | | 399 |
| Credit Income taxes | | 1,586 |

*To close expense accounts for the fiscal year.*

## Essay Questions

**Topic: Book Value vs. Market Value**
**LO: 1**

**1.** Book value of stockholders' equity usually differs from company market value. Explain some reasons why a company's book value of stockholders' equity can differ from a company's market value.

*Answer:*

1. GAAP generally reports assets and liabilities at historical costs; whereas the market attempts to estimate fair values for assets.
2. GAAP excludes resources that cannot be reliably measured such as talented management, employee morale, recent innovations and successful marketing; whereas the market attempts to value these with some recognition of uncertainty.
3. GAAP does not consider market differences in which companies operate such as competitive conditions and expected changes; where as the market attempts to factor in these differences in determining value.
4. GAAP does not usually report expected future performance; whereas the market does attempt to predict future performance.

**Topic: Articulation of the Financial Statements**
**LO: 5**

**2.** Explain the concept of articulation among the four financial statements.

*Answer:*
Articulation refers to the fact that the four financial statements are linked to each other and that changes in one statement affect the other three. For example, net income reported on the income statement is linked to the statement of stockholders' equity, which in turn is linked to the balance sheet. Also, the statement of cash flows explains how the cash reported on the balance sheet changes from one period to the next. Understanding how the financial statements articulate, helps us to analyze transactions and events and to understand how events affect each financial statement separately and all four together.

**Topic: Accounting Cycle**
**LO: 6, 7, 8, 9, 10**

**3.** Describe and explain the accounting cycle.

*Answer:*
Financial statements report on the financial performance and condition of a business. Those statements are tied to a period or point in time. The period of time is referred to as the accounting cycle, and each cycle consists of four activities.

Step 1: Record transactions in the accounting records. Each transaction is the result of an external or internal transaction or event, such as a sale to a customer or the payment of wages to employees. Once details of each transaction are known to a company's accounting department, entries are made in the company's accounting system.

Step 2: Prepare accounting adjustments, which recognize a number of events that have occurred but that have not yet been recorded. These might include the recognition of wage expense and the related wages payable for those employees who have earned wages but have not yet been paid or of depreciation expense for buildings and equipment. The preparation of accounting adjustments is done at the end of an accounting period.

Step 3: Prepare financial statements. Once all of the transactions and adjustments are entered into the accounting system, the ending account balances are used to prepare the four financial statements: income statement, balance sheet, statement of stockholders' equity, and the statement of cash flows.

Step 4: Close the books in anticipation of the start of a new accounting cycle. The closing process (or closing the books) refers to "zeroing out" the temporary accounts by transferring their ending balances to retained earnings. Income statement accounts—revenues and expenses—and the dividend account are temporary accounts because their balances are zero at the start of each accounting period so that only the current period's activities are included. The closing process is typically carried out via a series of journal entries. The balance sheet accounts do not need to be similarly adjusted because their balances carry over from period to period.

**Topic: Need for Accounting Adjustments**
**LO: 7**

**4.** Explain what accounting adjustments are and why firms use them.

*Answer:*
Companies make adjustments to more accurately report their financial performance and condition.

For example, employees might not have been paid for wages earned at the end of an accounting period. Failure to recognize this labor cost would understate the company's total liabilities (because wages payable would be too low), and would overstate net income for the period (because wages expense would be too low). Thus, neither the balance sheet nor the income statement would be accurate.

**Topic: Closing Temporary Accounts**
**LO: 9**

**5.** Describe the closing process and explain why firms engage in this process.

*Answer:*
The closing process refers to the 'zeroing out' of revenue, expense, and dividend accounts (the temporary accounts) by transferring their ending balances to retained earnings. The closing process is typically carried out via a series of journal entries that successively zero out each revenue and expense account, transferring those balances to retained earnings. The result is that all income statement accounts begin the next period with zero balances. The balance sheet accounts do not need to be similarly adjusted because their balances carry over from period to period.