

THE OPERATING CYCLE and REVENUE RECOGNITION

I. Review of Key Concepts and Terms:

- A. The **operating cycle** of a merchandising (retail) business is the average period of time, normally measured in months, that a business takes to:
1. spend cash for assets (purchase inventory);
 2. sell the inventory for cash or receivables and;
 3. convert the receivables back into cash.
 4. pay for inventory

Recall that the **accounting cycle** is the longer of the accounting cycle or one year. The operating cycle of a service business (Doctor, lawyer, CPA etc) is the average period of time to take on a client/case and receive payment for services rendered.

- B. The issue of **revenue recognition** deals with how the business should recognize (record) revenue for reporting purposes. Revenue should be recognized when:
1. the earnings process is complete and
 2. an exchange has taken place or services have been completed

C. The matching principle and revenue recognition

1. Recall from Chapter Two that the matching principle states that revenues and expenses should be recognized (recorded) in the periods in which they are earned/incurred. This means that payments received in the current accounting period for goods or services that will not be rendered until subsequent periods cannot be recorded as revenues in the current accounting period. Likewise, only those payments for assets that will be consumed in the current accounting period can be considered expenses. (**Review the definitions of revenues and expenses in Handout 1A.** To illustrate these points consider the following examples. Each example differs in terms of when the payment is made.

Note: The key issue in each of the following examples is the timing of revenue recognition. Cash received as payment for goods or services must be earned before revenue can be recognized. The following examples illustrate the revenue recognition process and the timing of revenue recognition.

a. Services rendered and payment received in the current period:

Bill Teague, an attorney, takes a case and settles the matter in the current period. The client is billed \$1,000 and pays \$400 on account. The earnings process is complete and an exchange has taken place (Teague has provided legal services and been paid for them)

(asset)	Cash.....	400	
(asset)	Accounts receivable.....	600	
(revenue)	Legal service revenue.....	1,000	

b. Service is prepaid:

On December 15, 19x1 Bill Teague, an attorney, takes a case that he estimates will require 40 hours of legal work to be billed at \$200 per hour. Teague request and receives a retainer (prepayment of legal fees) of \$2,000. Teague uses a calendar year accounting cycle and performs no work on the case in the present year.

(asset)	Cash	2,000	
(liability)	Retainer revenue.....	2,000	

Note: The earnings process is not complete, and no exchange has taken place. The fees have been prepaid, but Teague has performed no services for which compensation has been earned, so a liability (debt) is recorded on Teague's books. **Note that Retainer revenue is unearned income.** Because it is unearned, it is a liability (debt) to the client until services are rendered. The process of Teague rendering services to the client converts the liability from a debt (owed the client for prepayment of fees) to revenue from services rendered.

c. Service is prepaid and partially earned in the current period.

Assume the facts described in case (b) above except that Teague performed 5 hours of legal work prior to December 31, 19x1 (the end of the accounting cycle):

(asset)	Cash.....	2,000	
(liability)	Retainer Revenue (2,000 - 1,000).....	1,000	
(revenue)	Legal Service Revenue (5 @ \$200).....	1,000	

To the extent that the revenue as been earned it should be recognized in the current period, to the extent that it has not been earned it's recognition as revenue must be put off until the earnings process is complete and recorded as a liability in the meantime.

d. Expenses incurred and paid for in current period.

Assume the same facts as in case (c) above except that Teague also pays \$500 for investigative services and receives the completed report prior to the end of the period.

(asset)	Cash.....	2,000	
(expense)	Investigation expenses ...	500	
(liability)	Retainer revenue (2,000 - 1,000)...		1,000
(revenue)	Legal service revenue.....	1,000	
(asset)	Cash (pay for investigation).....	500	

The cost of the investigation is expensed (charged against revenues) in the current period because the utility it rendered (the report) was utilized in the present period. That is to say that the knowledge rendered by the investigation was made available in the present period.

e. Prepaid expenses

Assume the same facts described in case (d) above except that Teague also contracts for computerized legal research to be conducted January 2, 19x2. The estimated charge is \$300.

(asset)	Cash.....	2,000	
(expense)	Investigation expenses	500	
(asset)	Research expenses.....	300	
(liability)	Retainer revenue (2,000 - 1,000)..		1,000
(revenue)	Legal service revenue.....	1,000	
(asset)	Cash.....	500	
(liability)	Accounts payable.....		300

To the extent that research expenses are **prepaid** they represent an asset. Recall that expenses are only charged against revenues in the current period if the benefits they create are utilized in that period.

D. Differentiating between Costs, Assets, Expenses and Mixed Accounts.

1. For financial accounting purposes (as opposed to economic purposes) the **Cost** of anything is the historical cost amount, expressed in dollars that must be given up in order to attain its use. Historical cost is used because it is objective (verifiable). It should be noted that *only at the time of purchase (because the transaction is assumed to be at "arms-length) does historical cost bare any relationship to market value.*

- a. If the item attained for a certain cost is going to benefit the business in the current period only, the item attained is considered an **expense**.
- b. If the item attained for a certain cost is going to benefit the business both in the current and future periods, the item attained is considered an **asset**. As the asset is utilized by the business its utility is diminished and it is expensed, in increments to the periods over which it will provide benefit. The process of assigning the utility of assets to different accounting periods is called **depreciation**.

2. A **Mixed Account** is an account that contains both a real (balance sheet) and nominal (income statement) component. During the adjusting process, these two components (real and nominal) are separated and placed on the appropriate statement (balance sheet or income statement). For example, prior to adjusting the accounts inventory has a real component (that portion on hand at the end of the period) and a nominal component (that portion that has been sold during the period and must be charged against revenues). In the adjusting process inventory will be reduced (credited) on the balance sheet and expensed (debited) on the income statement.

E. Depreciation

1. Depreciation is a method of **allocating** the historical cost (less the salvage value) of an asset to the periods that asset provides benefit.

- a. **Salvage value** is the residual or scrap value an asset will have at the end of its useful (economic) life. The salvage value is not depreciated.
- b. **Straight line depreciation** allocates an equal portion of historical cost to each period the asset will benefit. The amount of straight line depreciation allocated in a given period is computed as follows:

$$\text{Depreciation Expense} = \text{Cost} - \text{Salvage} / \text{Life}$$

c. The journal entry to record depreciation is:

(expense)	Depreciation expense.....	xxxx
(contra asset)*	Accumulated depreciation.....	xxxx

* a **contra** (offset) account is any account whose balance is deducted (offset) from the account to which it relates. Contra accounts can only exist in relationship with a **control account**. Contra accounts are utilized to allow the control account to remain at historical cost in the ledger for reporting purposes while the net value of the control account offset by the contra account reflects the historical cost of the asset after allocation of depreciation expense to the present and past periods.

2. A common misconception is that depreciation sets funds aside for asset replacement; **depreciation does not set any funds aside to replace the asset in the future; it is an allocation scheme only. It has no relationship with the market value of the asset.**

F. The accounting process revisited:

1. The accounting process as described in Chapter Two of the Study guide is presented below:

a. transactions are **recorded in the general journal**;

The purpose of the journal is to provide a complete historical record of the transaction in a single location;

b. the amounts recorded in the journal are **posted to (recorded in) the appropriate ledger account**;

The purpose of the ledger is to provide a complete historical record of each account.

c. a **pre-closing trial balance** is taken to assure that the accounting equation is in balance;

d. **the nominal (temporary or income statement accounts) are closed** to the expense and revenue summary and any other adjustments necessary to correct the accounts to the end of year balances are made to the ledger;

1. This procedure is known as the **adjusting and closing process**.

2. The **purpose of the adjusting process** is to allow an accurate measurement of net income (revenues less expenses) and financial position on the **accrual** basis in order to conform to the matching principle.

3. Adjusting entries always affect at least one real and at least one nominal account.

4. The **closing process** involves closing all the nominal accounts to the expense and revenue summary. The balance in the expense and revenue summary is net income and is closed to retained earnings.

e. **Adjustments are posted to the ledger**

f. a **post-closing trial balance** is taken to assure that the accounts remain in balance after all adjustments to real and nominal accounts and closing of nominal accounts;

g. the **financial statements are produced** using the numbers in the post closing trial balance; the balance sheet (real) accounts are reported on the balance sheet and the income statement (nominal or expense and revenue) accounts are reported on the income statement. The statement of cash flows reconciles the changes that have occurred in each of the ledger accounts and explains the sources and uses of cash for the accounting period.

Key Concept Comprehension

1. The amount of the use of each fixed asset is accumulated in a separate account which is called a _____ account.
2. The recognition of an accrued expense results in credit entry to a _____.
3. _____ is a system of allocating the cost of fixed assets to operations over their useful life.
4. Under a _____ based system of accounting, revenues are only recognized when cash is received.
5. _____ are entries required at the end of an accounting period to correct certain account balances.
6. The estimated scrap value of a fixed asset is referred to as the _____.
7. The process of identifying all expenses related to the earning of revenue for a particular accounting period is called the _____ principle.
8. When insurance premiums are paid on a two-year policy, a debit is made to _____ for the unexpired portion.
9. Cash received for services to be performed in the next accounting period is credited to _____.
10. _____ costs, such as prepaid insurance are expenses paid in the current period for the benefit of future accounting periods.
11. A _____ account is an account that contains both balance sheet and income statement components.
12. After the adjusting entries are posted to the general ledger, the account balances are checked for equality with the _____.
13. _____ is a contra-account that shows the cumulative amount of the cost of depreciable fixed assets written off as expenses since the assets were acquired.
14. List the seven steps in the accounting cycle.
 - a.
 - b.
 - c.
 - d.
 - e.
 - f.
 - g.

TRUE OR FALSE

1. All cash received in a month does not represent revenues for that month.
2. Adjusting entries are not recorded in the general journal.
3. All adjusted balances in the expense accounts represent costs incurred to earn the revenue for the period.
4. Depreciation expense represents a cost allocation of the purchase price of fixed assets, such as buildings, over one or more accounting periods that benefit from the use of these assets.
5. Cash received for services to be performed in a future period is recorded as service revenue earned.
6. A mixed balance sheet account contains both asset and liability entries.
7. Prepaid rent is a payment of rent for the receipt of rental service during the current period.
8. Journal entries are always prepared after the posting to the ledger accounts.
9. An adjusted trial balance is taken to prove the equality of debits and credits after the posting of the adjusting entries.
10. Supplies used in the operation of the business are shown as an expense on the income statement.
11. Services performed for customers who have not paid by the balance sheet date are referred to as accounts payable.
12. To accrue means to increase over time.
13. Expenses decrease net income.
14. Salvage value represents an estimate of the amount that will be received for fixed assets at the end of their useful life.

Problem 1 (Preparation of adjusting entries)

The following information for adjustments was available on December 31, 19X3, at the end of the annual accounting period of a firm that adjusts its accounts each December 31.

Required: 1. Prepare an adjusting journal entry for each unit of information that follows:

a. An examination of the insurance policies showed the following:

<u>Policy No.</u>	<u>Date of Purchase</u>	<u>Life of Policy</u>	<u>Cost</u>
A-143567	Jun. 1 of previous year	1 year	\$144
B-586849	Sep. 1 of current year	3 years	288
C-4D85	7 May 1 of current year	2 years	360

All payments were debited to Prepaid Insurance.

- b. The Office Supplies account had a \$44 balance at the beginning of the year; \$520-worth of office supplies were purchased during the year; and an inventory of unused supplies on hand at the year-end totalled \$76.
- c. The company owns a building that it completed and occupied for the first time on May 1 of the current year. The building cost \$154,000, has an estimated 40-year life, and a \$10,000 salvage value at the end of that time.
- d. The company occupies most of the space in its building but it also rents space to a tenant. The tenant agreed beginning on May 1 to rent a small amount of space at \$150 per month, and on that date he paid six months rent in advance. The amount paid was credited to the Unearned Rent account.
- e. The tenant of (d), above has not paid since the payment in May.
- f. The company borrowed \$10,000 on September 1, 19X3, at 12 percent. Interest is payable when the loan is repaid on January 31, 19X4.

This next problem is included to show the importance of adjusting entries. Note how the net income figure changes with the recording of the adjusting entries.

Problem 2 (The effect of adjusting entries on net income)

Murray Inc.'s income statement showed a net income of \$2,640 for the year ended December 31, 19X2. However, the following adjusting entries were not recorded:

- a. Supplies of \$140 were on hand on January 2, 19X2; \$415 of supplies were purchased during the year; and \$185 of supplies were on hand on December 31, 19X2. All purchases were posted to the Supplies account.
- b. Insurance Expense account had a balance of \$1,280 on December 31, 19X2. Data revealed that \$470 of this insurance was unexpired on the balance sheet date. All insurance policies are posted to the Insurance Expense account.
- c. Depreciation expense for the year on the office equipment was \$740 and was not recorded.
- d. Customer advances of \$1,100 had been posted to the Revenue Earned account in error. The work will be done in March 19X3.

Required: Prepare the adjusting entries and then compute the adjusted net income or loss of Murray Inc. for the year ended December 31, 19X2.

The third problem is an example of the recording of the business transactions in the general journal to the adjusted trial balance.

Mayfair Moving Co. Inc. was incorporated February 1, 19X1 and the following transactions occurred during February.

- a. Issued common shares for \$30,000. b. Paid CRKO Radio Station for two months of radio advertising, \$1,800.
- c. Paid the first three months rent, \$1,350, which was posted to the Prepaid Rent account.
- d. Paid cash for office supplies, \$1,240 to be used over the next several months.
- e. Paid February salaries, \$7,200.
- f. Purchased office equipment costing \$2,700 for \$700 cash and the balance on account. This equipment is expected to have a 5-year useful life and a salvage value of \$300.
- g. Purchased a moving van for \$18,500, paying \$3,000 in cash and the balance with the proceeds of a bank loan. This moving van is expected to have a 3-year useful life and a salvage value of \$4,100.
- h. Paid \$2,880 premium for a two-year insurance policy on the trucks.
- i. Paid gas and oil bills for February, \$800.
- j. Paid \$1,000 toward the accounts owed.
- k. Billed customers \$21,500 for moving services, of which \$9,000 was collected during the month.
- l. Received \$800 from customers for work to be done in the future
- m. Paid the February utility bill \$300.

Required:

1. Journalize the February transactions.
2. Post to the general ledger using T-accounts.
3. Prepare a trial balance of the general ledger at February 28, 19X1.
4. Prepare the adjusting entries for the month of February for the following:
 - a. Depreciation on the office equipment.
 - b. Depreciation on the moving van.
 - c. Office supplies on hand at the end of the month totalled \$120.
 - d. Recognize \$200 of unearned revenue, which was earned in February.
 - e. Recognize insurance expense for the month.
 - f. Recognize the rent expense for the month.
 - g. Recognize the advertising expense for the month.
5. Post adjusting entries to the general ledger T-accounts.
6. Prepare adjusted trial balance as at February 28, 19X1.

Problem 4 (Preparing the financial statements)

The following trial balance is from the general ledger of Goodman Paving Co. Inc. at May 31, 19X2 before the year-end adjusting entries have been prepared.

Goodman Paving Co. Inc.			
TRIAL BALANCE			
May 31, 19X2			
Account Title	Debit	Credit	
Cash	\$ 9,140		
Accounts Receivable	2,600		
Prepaid Insurance	1,280		
Supplies	1,400		
Equipment	2,700		
Truck	17,900		
Accounts Payable		\$ 1,470	
Loans Payable		4,000	
Unearned Revenue		1,600	
Common Stock		15,000	
Paving Revenue		56,000	
Advertising Expense	2,500		
Interest Expense	1,300		
Miscellaneous Expense	2,750		
Rent Expense	4,400		
Salaries Expense	32,100		
Totals	<u>\$ 78,070</u>	<u>\$ 78,070</u>	

Supplementary information concerning the adjustments to be made are included below:

- a. Prepaid insurance consists of a premium for a comprehensive two-year insurance policy on the company's truck and equipment effective June 1, 19X1.
- b. The company's monthly rent is \$400 and has not been paid for May.
- c. A physical inventory taken May 31, 19X2 showed \$280-worth of unused supplies.
- d. The truck was purchased on June 1, 19X1; the company estimates it to have a useful life of 5 years and a salvage value of \$900. It is the company's policy to depreciate all assets in the year of purchase for the period that benefits from its use.
- e. The equipment was purchased on July 2, 19X1 and has an estimated useful life of 3 years and no salvage value.
- f. During the year the company completed work worth \$750, for which payment was received in March 19X2. The payment for this work was credited to Unearned Revenue.
- g. The company collected \$2,000 from customers for work to be completed in July 19X2. The bookkeeper incorrectly credited this payment to Paving Revenue.

Required:

1. Prepare general ledger accounts for all the accounts in the trial balance using the T-account form.
2. Prepare adjusting entries for the year ended May 31, 19X2.
3. Post adjusting entries to the general ledger.
4. Prepare an adjusted trial balance.
5. Prepare financial statements for the year ended May 31, 19X2 from the data listed in the adjusted trial balance.

Problem 5 Adjusting entries

Brown Financial Services Inc. was incorporated February 1, 19X1. The following selected accounts and balances have been taken from the general ledger trial balance at September 30, 19X1 before the monthly adjusting entries have been prepared. All adjusting entries were made to the end of August.

Prepaid Advertising	\$	1,000
Prepaid Insurance		1,500
Prepaid Rent		3,150
Office Supplies		510
Postage Supplies		1,150
Office Furniture		3,820
Office Equipment		6,700
Accumulated Depreciation-Office Furniture		(156)
Accumulated Depreciation-Office Equipment		(475)
Unearned Revenue		(2,800)

Additional information:

- a. The premium on the 2-year insurance policy was \$1,800.
- b. Annual rent for the business is \$5,400.
- c. Office furniture has an estimated useful life of 10 years and a salvage value of \$700.
- d. Annual advertising costs are \$1,500.
- e. The company received \$1,400 from customers for work to be completed in November. The bookkeeper incorrectly credited this payment to Revenue.
- f. Work paid for in August and completed in September was \$2,300; credit for the payment was to Unearned Revenue.
- g. A physical inventory on September 30, 19X1 showed \$280 unused office supplies and \$900 unused postage supplies.
- h. Office equipment has an estimated useful life of 5 years and a salvage value of \$1,000.

Required: Answer each of the following questions.

1. In what month was the premium on the insurance policy set up as prepaid insurance?
2. What was the original entry made by the bookkeeper in (e), above?
3. In what month was the payment for advertising set up as prepaid advertising?
4. In what month was the payment for the rent set up as prepaid rent?
5. In what month did the company start charging depreciation expense for office equipment? for office furniture?
6. Prepare and journalize adjusting entries for September from the information given.

Problem 6 Adjusting entries; Preparation of Financial Statements

The following accounts and balances have been taken from the general ledger trial balance of Neufeld Repairs Inc. as at December 31, 19X1 after its first year of operation but before adjusting entries have been made.

	Debit	(Credit)
Accounts Payable		(3,100)
Accounts Receivable	4,650	
Advertising Expense	1,560	
Bank Loan		(7,000)
Cash	1,435	
Common Stock		(23,000)
Equipment	8,400	
Furniture and Fixtures	2,750	
Insurance Expense	840	
Miscellaneous Expense	930	
Office Supplies Used	1,395	
Prepaid Rent	7,200	
Repair Revenue		(84,065)
Repair Supplies Used	32,500	
Salaries Expense	35,005	
Truck	18,100	
Utilities Expense	2,400	

Additional information:

- a. The company billed and included in Revenue \$2,800 for work to be completed in January 19X2.
- b. On January 2, 19X1 Neufeld Repairs Inc. was required to pay the first year's rent in advance and debited the amount to Prepaid Rent when the payment was made.
- c. A physical inventory taken December 31 showed: unused office supplies on hand of \$215, and unused repair supplies on hand of \$1,950. Purchases were posted to the expense account.
- d. The insurance premium paid May 1, 19X1 is for a one-year policy.
- e. Summary of Assets:

Asset	Estimated Useful Life	Salvage Value	Date Acquired
Furniture and Fixtures	10 years	\$ 350	Mar. 1, 19X1
Equipment	5 years	600	Jan. 2, 19X1
Trucks	3 years	820	Feb. 1, 19X1

- f. The advertising expense includes \$600 paid in October for television and radio ads to begin in January 19X2.
- g. Income tax expense for the year ended December 31, 19X1 is \$4,300.

Required:

1. Prepare general ledger accounts (using T-accounts) for each account listed in the alphabetical list in the problem.
2. Prepare and journalize the December adjusting entries.
3. Post adjusting entries to the general ledger accounts.
4. Prepare an adjusted trial balance.

SOLUTIONS

Key Concept Comprehension

1. contra
2. liability account
3. Depreciation
4. cash
5. Adjusting entries
6. salvage value
7. matching
8. prepaid insurance
9. unearned revenue
10. Deferred
11. mixed balance sheet
12. adjusted trial balance
13. accumulated depreciation
14.
 - a. Transactions are first analyzed and entered in the general journal.
 - b. The entries are then posted in the general ledger.
 - c. The equality of the debits and credits is then established by a pre-closing trial balance.
 - d. The account balances are analyzed and adjusting entries prepared.
 - e. The adjusting entries are posted in the general ledger.
 - f. The equality of debits and credits is then established by the adjusted trial balance.
 - g. The summarized financial information is communicated to interested parties through the financial statements.

True or False Questions

1. T.
2. F Adjusting entries are always entered first in the general journal and then posted in the general ledger.
3. T
4. T
5. F Cash received for services to be performed in a future period is recorded in a liability account, i.e., Unearned Revenue.
6. F A mixed account contains both real (balance sheet) and nominal (income statement) amounts.
7. F Prepaid rent is a payment of rent before receipt of the rental service.
8. F Journal entries are always prepared before the posting to ledger account.
9. T
10. T
11. F Services performed for customers who have not paid are referred to on the balance sheet as accounts receivable.
12. T
13. T
14. T

Solution Problem 1 (Preparing adjusting entries)

GENERAL JOURNAL

Journal	Description	Debit	Credit
a.	Insurance Expense	212	
	Prepaid Insurance		212
	To record insurance expense for the year ended December 31, 19X3.		
	A-143567 \$144/12 months = \$12 per month. During the current year the policy will be in effect from January 1 to June 1, which is 5 months or \$60		
	B-586849 \$288/36 months = \$8 per month. During the current year the policy will be in effect from September 1 to December 31, which is 4 months or \$32		
	C-4D857 \$360/24 months = \$15 per month. During the current year the policy will be in effect from May 1 to December 31, which is 8 months or \$ 120		
	Expense for the year \$60 + \$32 + \$120 = \$212		
* b.	Office Supplies Used	488	
	Office Supplies		488
	To record office supplies used during the year		
c.	Depreciation Expense-Building	2,400	
	Accumulated Depreciation-Building		2,400
	To record depreciation expense on the building for the period in which the company occupied it.		
	Building cost \$154,000 less salvage value \$10,000 = \$144,000 to be depreciated over the 40 years expected life = \$3,600 per year, or \$3,600/12 months = \$300. The company occupied the building from May 1 to December 31 or 8 months x \$300 = \$2,400		
d.	Unearned Rent	900	
	Rental Revenue		900
	To recognize rental revenue earned during the year ended December 31.		
	\$150/month x 6 months = \$900		
e.	Rent Receivable	300	
	Rental Revenue		300
	To record rent receivable for the months of November and December.		
	\$150 x 2 months = \$300		
f.	Interest Expense	400	
	Interest Payable		400
	To record interest expense on the \$10,000 loan for the period from September 1 to December 31.		
	Loan \$10,000 x 12% = \$1,200/12 months = \$100 per month \$100 x 4 months = \$400		

* Office Supplies		No. 170	
Bal.	44	Purchases	520
Adjustment	488		
Ending Bal.	76		

Solution Problem 2 (Part 1)

Journal	Description	Debit	Credit
a.	Supplies Used	370	
	Supplies		370*
b.	Prepaid Insurance	470	
	Insurance Expense		470*
c.	Depreciation Expense-Office Equipment	740	
	Accumulated Depreciation-Office Equip.		740
d.	Revenue Earned	1,100	
	Unearned Revenue		1,100

Supplies		No. 173	
Bal.	\ 140		
Purchases	415		Used 370*
Bal.	185		
Insurance Expense		No. 631	
Bal.	1,280		Unexpired
			Portion 470*
Adj. Bal.	810		

Adjusted net income or loss of Murray Inc. is \$900 net income computed as follows:

Net Income Reported	\$	2,640
Supplies Used		(370)
Insurance Unexpired		470
Depreciation Expense-Office Equipment		(740)
Unearned Revenue		<u>(1,100)</u>
Revised Net Income	\$	900

SOLUTION TO PROBLEM 3

Journal	Description	Debit	Credit
a.	Cash	30,000	
	Common Stock		30,000
	To record investment in business.		
b.	Prepaid Advertising	1,800	
	Cash		1,800
	To record the payment for two months		
c.	Prepaid Rent	1,350	
	Cash		1,350
	To record payment of three months rent.		
d.	Office Supplies	1,240	
	Cash		1,240
	To record purchase of office supplies.		
e.	Salaries Expense	7,200	
	Cash		7,200
	To record payment of February salaries.		
f.	Office Equipment	2,700	
	Cash	700	
	Accounts Payable		2,000
	To record purchases of office equipment \$700 cash and \$2,000 on account.		
g.	Moving Vans	18,500	
	Cash		3,000
	Bank Loan		15,500
	To record purchase of a moving van with \$3,000 cash and the proceeds of a bank loan.		
h.	Prepaid Insurance	2,880	
	Cash		2,880
	To record purchase of a two-year insurance policy on moving van.		
i.	Maintenance-Gas and Oil Expense	800	
	Cash		800
	To record February payment.		
j.	Accounts Payable	1,000	
	Cash		1,000
	To record payment on accounts owed.		
k.	Cash	9,000	
	Accounts Receivable	12,500	
	Moving Revenue		21,500
	To record revenue on account and for cash		
l.	Cash	800	
	Unearned moving revenue		800
	To record prepayment for March		
m.	Utilities Expense	300	

Cash
Sollution Problem 3 continued: (Parts 2 and 5)

300

Cash	No. 101
(a) 30,000	(b) 1,800
(k) 9,000	(c) 1,350
(l) 800	(d) 1,240
	(e) 7,200
	(f) 700
	(g) 3,000
	(h) 2,880
	(i) 800
	(j) 1,000
	(m) 300
Bal. 19,530	

Accounts Receivable	No. 110
(k) 12,500	
Bal. 12,500	

Prepaid Advertising	No. 160
(b) 1,800	(4g) 900
Bal. 900	

Prepaid Insurance	No. 161
(g) 2,880	(4e) 120
Bal. 2,760	

Prepaid Rent	No. 162
(c) 1,350	(4f) 450
Bal. 900	

Office Supplies	No. 170
(d) 1,240	(4c) 1,120
Bal. 120	

Office Equipment	No. 183
(f) 2,700	
Bal. 2,700	

Moving Vans	No. 184
(g) 18,500	
Bal. 18,500	

Accumulated Depreciation-Office Equipment	No. 193
	(4a) 40
	Bal. 40

Maintenance-Gas and Oil Expense	No. 641
(i) 800	
Bal. 800	

Office Supplies Used	No. 650
(4c) 1,120	
Bal. 1,120	

Rent Expense	No. 654
(4f) 450	
Bal. 450	

Mayfair Moving Co. Inc. GENERAL LEDGER	
Accumulated Depreciation- Moving Vans	No. 194
	(4b) 400
	Bal. 400

Bank	
Loan	No. 201
	(h) 15,500
	Bal. 15,500

Accounts Payable		No. 210
(j) 1,000		(f) 2,000
		Bal. 1,000

Unearned Moving Revenue		No. 249
(4d) 200		(l) 800
		Bal. 600

Common Stock		No. 320
		(a) 30,000
		Bal. 30,000

Moving Revenue		No. 470
(k) 21,500		
	200	
	Bal. 21,700	

Advertising Expense		No. 610
(4g) 900		
Bal. 900		

Depreciation Expense-Office Equipment		No. 623
(4a) 40		
Bal. 40		

Depreciation Expense-Moving Vans		No. 624
(4b) 400		
Bal. 400		

Insurance Expense		No. 631
(4e) 120		
Bal. 120		

Salaries Expense		No. 656
(e) 7,200		
Bal. 7,200		

Utilities Expense		No. 676
(m) 300		
Bal. 300		

Solution Problem 3 (Part 3)

Mayfair Moving Co. Inc.
TRIAL BALANCE
February 28, 19X1

Account Title	Debit	Credit
Cash	\$ 19,530	
Accounts Receivable	12,500	
Prepaid Advertising	1,800	
Prepaid Insurance	2,880	
Prepaid Rent	1,350	
Office Supplies	1,240	
Office Equipment	2,700	
Moving Vans	8,500	
Bank Loan		\$ 15,500
Accounts Payable		1,000
Unearned Moving Revenue		800
Common Stock		30,000
Moving Revenue		21,500
Maintenance-Gas and Oil Expense	800	
Salaries Expense	7,200	
Utilities Expense	300	
Totals	\$ 68,800	\$ 68,800

Mayfair Moving Co. Inc.
GENERAL JOURNAL

Journal	Description	Debit	Credit
4a.	Depreciation Expense-Office Equipment Accumulated Deprec.-Office Equip. To record depreciation expense on office equipment for February. Cost \$2,700 less \$300 salvage value = \$2,400/5 years = \$480 per year/ 12 months = \$40 per month	40	40
4b.	Depreciation Expense-Moving Vans Accumulated Depreciation-Moving Vans To record depreciation expense on moving vans for month of February. Cost \$18,500 less \$4,100 salvage value = \$14,400/3 \$4,800 per year/12 months = \$400/month.	400	400
4c.	Office Supplies Used Office Supplies To record office supplies used during February. Purchased and available for use \$1,240 less \$120 on hand at the end of the month = \$1,120 used.	1,120	1,120
4d.	Unearned Moving Revenue Moving Revenue To recognize \$200 moving revenue earned. Payment was credited to unearned revenue when received.	200	200
4e.	Insurance Expense Prepaid Insurance To record insurance expense for the month of February. \$2,880/2 years = \$1,440 per year, \$1,440/12 months = \$120 per month.	120	120
4f.	Rent Expense Prepaid Rent To record rent expense for the month of February. \$1,350 payment/3 months = 450 per month.	450	450
4g.	Advertising Expense Prepaid Advertising To record advertising expense for the month of February. \$1,800 payment/2 months = \$900	900	900

Solution Problem 3 (Part 6)

Mayfair Moving Co. Inc.
ADJUSTED TRIAL BALANCE
February 28, 19X1

Account Title	Debit	Credit
Cash	\$ 19,530	
Accounts Receivable	12,500	
Prepaid Advertising	900	
Prepaid Insurance	2,760	
Prepaid Rent	900	
Office Supplies	120	
Office Equipment	2,700	
Moving Vans	18,500	
Accumulated Depreciation-Office Equipment		\$ 40
Accumulated Depreciation-Moving Vans		400
Bank Loan		15,500
Accounts Payable		1,000
Unearned Moving Revenue		600
Common Stock		30,000
Moving Revenue		21,700
Advertising Expense	900	
Depreciation Expense-Office Equipment	40	
Depreciation Expense-Moving Vans	400	
Insurance Expense	120	
Maintenance_Gas and Oil Expense	800	
Office Supplies Used	1,120	
Rent Expense	450	
Salaries Expense	7,200	
Utilities Expense	300	
Totals	<u>\$ 69,240</u>	<u>\$ 69,240</u>

SOLUTION TO PROBLEM 4 (Parts 1 and 3)

Goodman Paving Co. Inc.
GENERAL LEDGER

Cash	No. 101
Bal. 9,140	(g) 2,000
Accounts Receivable	No. 110
Bal. 2,600	
Prepaid Insurance	No. 161
Bal. 1,280	(a) 640
Bal. 640	
Supplies	No. 173
Bal. 1,400	(c) 1,120
Bal. 280	
Equipment	No. 183
Bal. 2,700	
Truck	No. 184
Bal. 17,900	
Accumulated Depreciation-Equipment	No. 193
	(e) 825
	Bal. 825
Accumulated Depreciation-Truck	No. 194
	(d) 3,400
	Bal. 3,400
Accounts Payable	No. 210
	Bal. 1,470

Paving Revenue	No. 460
	Bal. 56,000
	(f) 750
	Bal. 54,750
Advertising Expense	No. 610
Bal. 2,500	
Depreciation Expense-Equipment	No. 62
(e) 825	
Bal. 825	
Depreciation Expense-Truck	No. 624
(d) 3,400	
Bal. 3,400	
Insurance Expense	No. 631
(a) 640	
Bal. 640	
Interest Expense	No. 632
Bal. 1,300	
Miscellaneous Expense	No. 642
Bal. 2,750	
Rent Expense	No. 654
Bal. 4,400	
(b) 400	
Bal. 4,800	

Loans Payable	No. 214
Bal. 4,000	
Salaries Expense	No. 656
Bal. 32,100	
Rent Payable	No. 225
	(b) 400
	Bal. 400
Supplies Used	No. 668
(c) 1,120	
Bal. 1,120	
Unearned Revenue	No. 249
(f) 750	
	Bal. 1,600
	(g) 2,000
	Bal 2,850
Common Stock	No. 230
	Bal 15,000

Solution Problem 4 (Part 2)

Goodman Paving Co. Inc.
GENERAL JOURNAL

Journal	Description	Debit	Credit
a.	Insurance Expense	640	
	Prepaid Insurance		640
	To record insurance expense for the year. \$1,280/2 years = \$640 /year		
b.	Rent Expense	400	
	Rent Payable		400
	To record rent expense for the month of May.		
c.	Supplies Used	1,120	
	Supplies		1,120
	To record supplies used during the year. \$ 1,400 - \$280 = \$ 1,120		
d.	Depreciation Expense-Truck	3,400	
	Accumulated Depreciation-Truck		3,400
	To record depreciation expense for the year. Truck cost \$17,900 - \$900 salvage value = \$17,000 over 5 years = \$3,400 per year.		
e.	Depreciation Expense-Equipment	825	
	Accumulated Depreciation-Equipment		825
	To record depreciation expense for eleven months. Cost \$2,700/3 years = \$900 per year /12 months = \$75/month x 11 months = \$825.		
f.	Unearned Revenue	750	
	Paving Revenue		750
	To record recognition of revenue on completion of services.		
g.	Paving Revenue	2,000	
	Unearned Revenue		2,000
	To correct the entry for cash received in advance of services rendered, originally credited to Revenue in error.		

Solution Problem 4 (Part 4)

Goodman Paving Co. Inc.
ADJUSTED TRIAL BALANCE
May 31, 19X2

Account Title	Debit	Credit
Cash	\$ 9,140	
Accounts Receivable	2,600	
Prepaid Insurance	640	
Supplies	280	
Equipment	2,700	
Truck	17,900	
Accumulated Depreciation-Equipment		\$ 825
Accumulated Depreciation-Truck		3,400
Accounts Payable		1,470
Loans Payable		4,000
Rent Payable		400
Unearned Revenue		2,850
Common Stock		15,000
Paving Revenue		54,750
Advertising Expense	2,500	
Depreciation Expense-Equipment	825	
Depreciation Expense-Truck	3,400	
Insurance Expense	640	
Interest Expense	1,300	
Miscellaneous Expense	2,750	
Rent Expense	4,800	
Salaries Expense	32,100	
Supplies Used	1,120	
Totals	\$ 82,695	\$ 82,695

Solution Problem 4 (Part 5)

Goodman Paving Co. Inc.
INCOME STATEMENT
For the Year Ended May 31, 19X2

Paving Revenue		\$	54,750
EXPENSES			
Advertising Expense	\$	2,500	
Depreciation Expense-Equipment		825	
Depreciation Expense-Truck		3,400	
Insurance Expense		640	
Interest Expense		1,300	
Miscellaneous Expense		2,750	
Rent Expense		4,800	
Salaries Expense		32,100	
Supplies Used		1,120	
Total Expenses		<u>49,435</u>	
Net Income		<u>\$ 5,315</u>	

Solution Problem 4 (Part 6)

Goodman Paving Co. Inc.
BALANCE SHEET
May 31, 19X2

Assets			
Cash		\$	9,140
Accounts Receivable			2,600
Prepaid Insurance			640
Supplies			280
Equipment	\$	2,700	
Less: Accumulated Depreciation-Equipment		(825)	1,875
Truck	\$	17,900	
Less: Accumulated Depreciation-Truck		(3,400)	<u>14,500</u>
Total Assets			<u>\$ 29,035</u>
Liabilities and Shareholders' Equity			
Accounts Payable	\$		1,470
Loans Payable			4,000
Rent Payable			400
Unearned Revenue			<u>2,850</u>
Total Liabilities	\$		8,720
Common Stock			15,000
Retained Earnings			<u>5,315</u>
Total Shareholders' Equity			<u>20,315</u>
Total Liabilities and Shareholders' Equity			<u>\$ 29,035</u>

Solution Problem 5

1. **May**
Insurance expense per month = \$1,800 premium/24 months = \$75/month
Number of months expired = $(\$1,800 - \$1,500)/\$75 = 4$ months
2. Cash..... 1,400
 Revenue 1,400
3. **May**
Advertising expense per month = \$1,500 annual/12 months = \$125
Number of months charged = $(\$1,500 - \$1,000)/\$125 = 4$ months
4. **April**
Rent expense per month = \$5,400/12 months = \$450
Number of months charged = $(\$5,400 - \$3,150)/\$450 = 5$ months
5. **Office Equipment: April**
Depreciation expense per month = $(\$6,700 - \$1,000)/60$ months = \$95
Number of months charged = $\$475/\$95 = 5$ months

Office Furniture: March Depreciation expense per month = $(\$3,820 - \$700)/120$ months = \$26 Number of months charged = $\$156/\$26 = 6$ months.

Solution Problem 5 (Part 6)

Brown Financial Services Inc.
GENERAL JOURNAL

Journal	Description	Debit	Credit
a.	Insurance Expense	75	
	Prepaid Insurance		75
	To record insurance expense for August. \$1,800/24 months = \$75		
b.	Rent Expense	450	
	Prepaid Rent		450
	To record rent expense. \$5,400/12 months		
c.	Depreciation Expense-Office Furniture	26	
	Accumulated Depreciation-Office Furn.		26
	To record depreciation expense. $(\$3,820 - \$700)/120$ months = \$26		
d.	Advertising Expense	125	
	Prepaid Advertising		125
	To record advertising exp. $\$1,500/12 = \125		
e.	Revenue	1,400	
	Unearned Revenue		1,400
	To correct entry: cash received in adv. of services rendered credited to Revenue in err		
f.	Unearned Revenue	2,300	
	Revenue		2,300
	To record recognition of revenue.		
g.	Office Supplies Used	230	
	Supplies Used-Postage	250	
	Office Supplies		230
	Postage Supplies		250
	To record office supplies and postage supplies used. \$ 510 - \$280 = \$230 \$1,150- \$900= \$250		
h.	Depreciation Expense-Office Equipment	95	
	Accumulated Deprec.-Office Equip.		95
	To record depreciation expense. $\$6,700 - \$1,000/60$ months		

SOLUTION TO PROBLEM 6 (Parts 1 and 3)

Neufeld Repairs Inc.
GENERAL LEDGER

Cash	No. 101
Bal. 1,435	
Accounts Receivable	No. 110
Bal. 4,650	
Prepaid Advertising	No. 160
Bal. 600	
Prepaid Insurance	No. 161
Bal. 280	
Prepaid Rent	Repair No. 162
Bal. 7,200	(b) 7,200
Office Supplies	No. 170
(c) 215	
Repair Supplies	No. 171
(c) 1,950	
Furniture and Fixtures	No. 182
Bal. 2,750	
Equipment	No. 183
Bal. 8,400	
Truck	No. 184
Bal. 18,100	(e) 5,280
Accumulated Depreciation-Furniture and Fixtures	No. 192
(e) 200	
Accumulated Depreciation-Equipment	No. 193
(e) 1,560	
Accumulated Depreciation-Truck	No. 194
(e) 5,280	
Bank Loan	No. 201
	Bal. 7,000
Rent Expense	No. 654
(b) 7,200	Bal. 35,005
Repair Supplies Used	No. 655
Bal. 32,500	(c) 1,950
Bal. 30,550	

Accounts Payable	No. 210
	Bal. 3,100
Unearned Revenue	No. 249
	(a) 2,800
Income Tax Payable	No. 260
	(g) 4,300
Common Stock	No. 320
	Bal. 23,000
Revenue	No. 450
(e) 2,800	Bal. 84,065
	Bal. 81,265
Advertising Expense	No. 610
Bal. 1,560	(f) 600
Bal. 960	
Depreciation Expense-Furniture and Fixtures	No. 622
(e) 200	
Depreciation Expense-Equipment	No. 623
(e) 1,560	
Depreciation Expense-Truck	No. 624
Insurance Expense	No. 631
Bal. 840	(d) 280
Bal. 560	
Miscellaneous Expense	No. 642
Bal. 930	
Office Supplies Used	No. 650
Bal. 1,395	(c) 215
Bal. 1,180	
Salaries Expense	No. 656
Utilities Expense	No. 676
Bal. 2,400	
Income Tax Expense	No. 830
(g) 4,300	

SOLUTION TO PROBLEM 6 continues (Part 2)

Neufeld Repairs Inc.
GENERAL JOURNAL

Journal	Description	Debit	Credit
a.	Repair Revenue	2,800	
	Unearned Revenue		2,800
	To record unearned portion of revenue as a liability.		
b.	Rent Expense	7,200	
	Prepaid Rent		7,200
	To record expense for the year.		
c.	Office Supplies	215	
	Repair Supplies	1,950	
	Office Supplies Used		215
	Repair Supplies Used		1,950
	To record unused supplies as an asset.		
d.	Prepaid Insurance	280	
	Insurance Expense		280
	To record prepaid portion of insurance exp. \$840/12 months= \$70/month \$70/month x 4 (Prepaid Jan. - Apr.) = \$280		
e.	Depreciation Expense-Furniture and Fixtures	200	
	Depreciation Expense-Equipment	1,560	
	Depreciation Expense-Truck	5,280	
	Accumulated Depreciation-Furn.and Fixt	200	
	Accumulated Depreciation-Equipment		1,560
	Accumulated Depreciation-Truck		5,280
	To record depreciation expense for the year. F & F (\$2,750 - \$350)/120 months = \$20 x 10 months = \$200 Equip. (\$8,400 - \$600)/5 years = \$1,560 Truck (\$18,100 - \$820)/36 months = \$480/month x 1 months= \$5,280		
f.	Prepaid Advertising	600	
	Advertising Expense		600
	To record prepaid portion of advertising exp		
g.	Income Tax Expense	4,300	
	Income Tax Payable		4,300
	To record the income tax expense for the yr.		

Solution to Problem 6 (Part 4)

Neufeld Repairs Inc.
ADJUSTED TRIAL BALANCE
December 31, 19X1

Account Title	Debit	Credit
Cash	\$ 1,435	
Accounts Receivable	4,650	
Prepaid Advertising	600	
Prepaid Insurance	280	
Office Supplies	215	
Repair Supplies	1,950	
Furniture and Fixtures	2,750	
Equipment	8,400	
Truck	18,100	
Accumulated Depreciation-Furn. and Fixt.		\$ 200
Accumulated Depreciation-Equipment		1,560
Accumulated Depreciation-Truck		5,280
Bank Loan		7,000
Accounts Payable		3,100
Unearned Revenue		2,800
Income Tax Payable		4,300
Common Stock		23,000
Repair Revenue		81,265
Advertising Expense	960	
Depreciation Expense-Furniture and Fixt	200	
Depreciation Expense-Equipment	1,560	
Depreciation Expense-Truck	5,280	
Insurance Expense	560	
Miscellaneous Expense	930	
Office Supplies Used	1,180	
Rent Expense	7,200	
Repair Supplies Used	30,550	
Salaries Expense	35,005	
Utilities Expense	2,400	
Income Tax Expense	4,300	
Totals	\$ 128,505	\$ 128,505