

Chapter 22: End-of-Fiscal-Period Work for a Corporation: Chapter Overview

Learning Objectives

After studying Chapter 22, in addition to defining key terms, you will be able to:

- LO1 Plan and record end-of-fiscal-period adjustments for a merchandising business organized as a corporation.
- LO2 Prepare an income statement for a merchandising business organized as a corporation.
- LO3 Prepare a statement of stockholders' equity for a merchandising business organized as a corporation.
- LO4 Prepare a balance sheet for a merchandising business organized as a corporation.
- LO5 Prepare a statement of cash flows for a merchandising business organized as a corporation.
- LO6 Record closing entries for a merchandising business organized as a corporation.
- LO7 Record reversing entries for a merchandising business organized as a corporation.

Bank of America

Bank of America (BoA) is one of the largest financial services companies in the country. According to a recent annual report, BoA serves half of all U.S. households and operates in more than 40 countries. Chances are, you have a Bank of America branch office or ATM machine near you.

The recession that began in 2008 had a dramatic impact on financial institutions. One hard-hit area was the housing market. Housing prices plummeted, and many home mortgages were higher than the value of the mortgaged home. A mortgage that has a balance higher than the value of the property mortgaged is called an underwater mortgage. By the end of the first quarter of 2011, approximately 22.7% of all U.S. home mortgages were estimated to be underwater.

With a high percentage of mortgages underwater, mortgage lenders were faced with a greatly increased risk that homeowners would stop making their mortgage payments. Not making payments on a loan when they are due is called defaulting on the loan. When a mortgage is in default, the bank or finance company has the right to take possession of the property. When the bank or finance company takes possession of mortgaged property, it is called a foreclosure.

Foreclosures usually mean a loss for the mortgage holder, who must sell the property at a price less than the amount owed on the property. What is the impact of these foreclosures on the financial statements of the mortgage holder? Remember that GAAP requires a business to estimate the amount of receivables that will not be collected. Mortgages financed by BoA are listed as receivables on its balance sheet. Therefore, BoA must estimate the amount of these receivables that will not be paid in the future. This estimate is recorded in an account titled Allowance for Loans and Lease Losses.

BoA reported the following balances on its balance sheet:

2010: Loans and leases, \$940,440,000,000; Allowance for loans and lease losses, \$41,885,000,000

2009: Loans and leases, \$900,128,000,000; Allowance for loans and lease losses, \$37,200,000,000

Critical Thinking

1. For 2010 and 2009, calculate what percent the allowance account is of the Loans and Leases account.
2. For which year was the percentage higher? What does this indicate about what Bank of America thinks about the rate of foreclosures?

End-of-Fiscal-Period Work for a Corporation: Accounting in the Real World

End-of-Fiscal-Period Work for a Corporation: **Key Terms**

- cash flow
- operating activities
- financing activities
- statement of cash flows
- investing activities

Lesson 22-1: Preparing Adjusting Entries

- LO1 Plan and record end-of-fiscal-period adjustments for a merchandising business organized as a corporation.

End-of-Fiscal-Period Work LO1

The end of a fiscal period is a busy time for a corporation. It begins with preparing an unadjusted trial balance to ensure that debits equal credits in the general ledger. The unadjusted trial balance and other financial data are used to plan and record adjusting entries. Once the adjusting entries are posted, an adjusted trial balance is prepared.

The adjusted trial balance is used to prepare the financial statements. The income statement is the first statement prepared. The amount of net income, selected balance sheet accounts, and other accounting information are used to prepare the statement of stockholders' equity. Summary amounts on this statement and the adjusted trial balance are used to prepare a balance sheet.

In preparation for recording transactions during the next period, closing and reversing entries are recorded and posted. The accounts are then ready to record transactions for the next fiscal period. Sun Treasures may prepare financial statements any time they are needed. However, Sun Treasures always prepares financial statements at the end of a fiscal year. [CONCEPT: Accounting Period Cycle]

Unadjusted Trial Balance

<i>Sun Treasures, Inc.</i>				
<i>Unadjusted Trial Balance</i>				
<i>December 31, 20--</i>				
ACCOUNT TITLE	DEBIT		CREDIT	
<i>Cash</i>	43	848	68	
<i>Petty Cash</i>	4	50	00	
<i>Accounts Receivable</i>	52	481	37	
<i>Allowance for Uncollectible Accounts</i>				67556
<i>Notes Receivable</i>	15	000	00	
<i>Interest Receivable</i>				
<i>Merchandise Inventory</i>	331	235	20	
<i>Supplies—Office</i>	89	640	00	
<i>Supplies—Store</i>	158	100	00	
<i>Prepaid Insurance</i>	54	872	35	
<i>Office Equipment</i>	325	648	16	
<i>Accumulated Depreciation—Office Equipment</i>				7972700
<i>Store Equipment</i>	1099	638	43	
<i>Accumulated Depreciation—Store Equipment</i>				33790200
<i>Accounts Payable</i>				1546250
<i>Sales Tax Payable</i>				64731
<i>Notes Payable</i>				
<i>Interest Payable</i>				
<i>Line of Credit</i>				750000
<i>Unearned Rent Income</i>				450000
<i>Employee Income Tax Payable</i>				157300
<i>Social Security Tax Payable</i>				300080
<i>Medicare Tax Payable</i>				70180
<i>Medical Insurance Payable</i>				32124
<i>Retirement Benefits Payable</i>				47500
<i>Unemployment Tax Payable—State</i>				3500
<i>Unemployment Tax Payable—Federal</i>				23625
<i>Federal Income Tax Payable</i>				
<i>Dividends Payable</i>				
<i>Long-term Notes Payable</i>				10662567
<i>Bonds Payable</i>				18000000
<i>Capital Stock—Common (\$10 par, 40,000)</i>				40000000
<i>Paid-in Capital in Excess of Par—Common</i>				48000000
<i>Capital Stock—Preferred (\$50 par, 400)</i>				20000000
<i>Paid-in Capital in Excess of Par—Preferred</i>				
<i>Retained Earnings</i>				8252510
<i>Dividends</i>	21	200	00	
<i>Income Summary</i>				

Sun Treasures, Inc.				
Unadjusted Trial Balance				
December 31, 20--				
ACCOUNT TITLE	DEBIT		CREDIT	
Sales			2576	321.45
Sales Discount	15	457.93		
Sales Returns and Allowances	113	523.11		
Purchases	1307	160.50		
Purchases Discount			15	685.93
Purchases Returns and Allowances			1	150.40
Advertising Expense	58	000.00		
Cash Short and Over	2	417.25		
Credit Card Fee Expense	23	763.21		
Depreciation Expense—Office Equipment				
Depreciation Expense—Store Equipment				
Insurance Expense				
Miscellaneous Expense	38	010.66		
Payroll Taxes Expense	27	423.60		
Rent Expense	143	000.00		
Salary Expense	290	400.00		
Supplies Expense—Office				
Supplies Expense—Store				
Uncollectible Accounts Expense				
Utilities Expense	66	886.10		
Federal Income Tax Expense	23	000.00		
Interest Income			2	337.80
Rent Income				
Gain on Plant Assets			18	231.00
Interest Expense	17	636.26		
Loss on Plant Assets	16	842.00		
Totals	4335	63481	4335	63481

Adjusting Entries for Uncollectible Accounts and Merchandise Inventory

Some general ledger accounts need to be brought up to date before financial statements are prepared. An unadjusted trial balance is used to plan and record the adjusting entries. Accounts are brought up to date by recording the adjustments in the general journal and then posting them to the general ledger.

Two methods are used to determine the amount of each adjustment. For some accounts, the calculated estimate of the account is also the amount used in the adjustment. These adjustments include interest income, depreciation expense, and interest expense.

Other accounts require estimating the end-of-period balance. The current balance is typically subtracted from the estimated end-of-period account balance to determine the amount of the adjustment. These adjustments include uncollectible accounts expense, merchandise inventory, supplies, prepaid insurance, and federal income tax expense.

Examples of both types of adjustments are shown on the following pages. Other adjustments were illustrated earlier in Part 3.

Adjustments generally are made in the order that accounts are listed in the general ledger.

Uncollectible Accounts Adjustment

Sun Treasures estimates that \$2,099.25 of its accounts receivable will not be

collected. On December 31, the balance in the Allowance for Uncollectible Accounts account is \$675.56. The amount of the adjusting entry is calculated as shown.

Uncollectible Accounts Expense is debited and Allowance for Uncollectible Accounts is credited for \$1,423.69.

Desired Balance in Allowance Account	—	Current Balance in Allowance Account	=	Amount of Adjustment
\$2,099.25	—	\$675.56	=	\$1,423.69

Sun Treasures, Inc.				
Unadjusted Trial Balance				
December 31, 20--				
ACCOUNT TITLE	DEBIT		CREDIT	
Accounts Receivable	52	481.37		
Allowance for Uncollectible Accounts			6	75.56
Merchandise Inventory	331	235.20		
Income Summary				
Uncollectible Accounts Expense				

Merchandise Inventory Adjustment

If the current balance in the Merchandise Inventory account is more than the actual inventory on hand at the end of the period, Income Summary is debited and Merchandise Inventory is credited. On December 31, the balance in the Merchandise Inventory account is \$331,235.20. The actual inventory on hand on December 31 is \$307,613.20. The amount of the adjusting entry is calculated as shown.

Income Summary is debited and Merchandise Inventory is credited for \$23,622.00. If the current balance in Merchandise Inventory is less than the actual inventory on hand at the end of the period, Merchandise Inventory is debited and Income Summary is credited.

Current Balance in Merchandise Inventory Account	–	Desired Balance in Merchandise Inventory Account	=	Amount of Adjustment
\$331,235.20	–	\$307,613.20	=	\$23,622.00

1 Debit Uncollectible Accounts Expense **2 Credit Allowance for Uncollectible Accounts**

GENERAL JOURNAL										PAGE 13				
DATE	ACCOUNT TITLE	DOC. NO.	POST. REF.	DEBIT			CREDIT							
	<i>Adjusting Entries</i>										1			
20- Dec. 31	Uncollectible Accounts Expense			1	4	2	3	69			2			
	Allowance for Uncollectible Accounts								1	4	2	3	69	3
31	Income Summary			23	6	2	2	00						6
	Merchandise Inventory								23	6	2	2	00	7

3 Debit Income Summary **4 Credit Merchandise Inventory**

Journalizing Adjustments for Uncollectible Accounts and Merchandise Inventory

- 1 Debit Uncollectible Accounts Expense for \$1,423.69.
- 2 Credit Allowance for Uncollectible Accounts for \$1,423.69.
- 3 Debit Income Summary for \$23,622.00.
- 4 Credit Merchandise Inventory for \$23,622.00.

Adjusting Entries for Supplies and Insurance

Supplies-store adjustment

The balance of Supplies—Store in the trial balance, \$158,100.00, is the cost of supplies on hand at the beginning of the year plus the supplies purchased during the year. The supplies on hand on December 31 are counted and determined to be \$48,300.00. To bring the account up to date, the balance of Supplies—Store needs to be decreased by \$109,800.00 (\$158,100.00 – \$48,300.00), the cost of supplies used during the year. Supplies Expense—Store is debited and Supplies—Store is credited for the amount of the decrease.

Sun Treasures, Inc.		
Unadjusted Trial Balance		
December 31, 20--		
ACCOUNT TITLE	DEBIT	CREDIT
Supplies—Store	158 1 0 0 00	
Prepaid Insurance	54 8 7 2 35	
Insurance Expense		
Supplies Expense—Store		

GENERAL JOURNAL							PAGE 13
DATE	ACCOUNT TITLE	DOC. NO.	POST. REF.	DEBIT	CREDIT		
	<i>Adjusting Entries</i>						
10 31	Supplies Expense—Store			109 8 0 0 00		10	
11	Supplies—Store				109 8 0 0 00	11	
12 31	Insurance Expense			36 2 2 5 00		12	
13	Prepaid Insurance				36 2 2 5 00	13	

1 Debit Supplies Expense—Store

2 Credit Supplies—Store

3 Debit Insurance Expense

4 Credit Prepaid Insurance

Prepaid Insurance Adjustment

The balance of Prepaid Insurance in the trial balance, \$54,872.35, is the cost of prepaid insurance remaining at the beginning of the year plus the cost of insurance purchased during the period. An analysis of the account determined that \$18,647.35 of prepaid insurance premiums remain on December 31. To bring the account up to date, the balance of Prepaid Insurance needs to be decreased by \$36,225.00 (\$54,872.35 – \$18,647.35), the cost of insurance that expired during the year. Insurance Expense is debited and Prepaid Insurance is credited for the amount of the decrease.

Journalizing Adjustments for Supplies and Insurance

- 1 Debit Supplies Expense—Store for \$109,800.00.
- 2 Credit Supplies—Store for \$109,800.00.
- 3 Debit Insurance Expense for \$36,225.00.
- 4 Credit Prepaid Insurance for \$36,225.00.

Federal Income Tax Adjustment

Sun Treasures, Inc.			
Unadjusted Trial Balance			
December 31, 20--			
ACCOUNT TITLE	DEBIT	CREDIT	
Federal Income Tax Payable			
Federal Income Tax Expense	23 000 00		

GENERAL JOURNAL							PAGE 13
DATE	ACCOUNT TITLE	DOC. NO.	POST. REF.	DEBIT	CREDIT		
1	Adjusting Entries					1	
22	31 Federal Income Tax Expense			2 992 22		22	
23	Federal Income Tax Payable				2 992 22	23	

1 Debit Federal Income Tax Expense
 2 Credit Federal Income Tax Payable

Detailed instructions for preparing the federal income tax adjustment were presented in Chapter 15. The first step is to calculate the corporation's net income before federal income tax. Sun Treasures' net income before federal income tax expense is \$109,595.43.

The amount of federal income tax is calculated using tax rates provided by the Internal Revenue Service. The tax rate varies, depending on the amount of net income earned. The tax rates are given in the table below.

Tax Rate Schedule

If taxable income (line 30, Form 1120, or line 26, Form 1120-A) is:

Over—	But not over—	Tax is:	Of the amount over—
\$0	50,000	15%	-0-
50,000	75,000	\$7,500 + 25%	\$50,000
75,000	100,000	13,750 + 34%	75,000
100,000	335,000	22,250 + 39%	100,000
335,000	10,000,000	113,900 + 34%	335,000
10,000,000	15,000,000	3,400,000 + 35%	10,000,000
15,000,000	18,333,333	5,150,000 + 38%	15,000,000
18,333,333	—	35%	-0-

Calculating Federal Income Tax

The amount of taxable income is \$109,595.43.

The amount over \$100,000 is \$9,595.43.

39% of \$9,595.43 is \$3,742.22

\$22,250.00 + \$3,742.22 = \$25,992.22 Total Federal Income Tax

Sun Treasures has already paid \$23,000.00. Therefore, the amount of federal income tax still due is \$25,992.22 – \$23,000.00 = \$2,992.22. The estimated tax payments already made are subtracted from the total federal income tax expense to calculate the adjustment for federal income tax expense.

Total Federal Income Tax Expense	—	Estimated Federal Income Tax Already Paid	=	Accrued Federal Income Tax Expense
\$25,992.22	—	\$23,000.00	=	\$2,992.22

Federal Income Tax Expense is debited and Federal Income Tax Payable is credited for the amount of the accrued taxes.

Journalizing Adjustment for Federal Income Tax Expense

1 Debit Federal Income Tax Expense for \$2,992.22.

2 Credit Federal Income Tax Payable for \$2,992.22.

Adjusting Entries

Sun Treasures' adjusting entries are shown above. The entries are posted to the general ledger to bring each account up to date. An adjusted trial balance is prepared. The adjusted trial balance is used to prepare financial statements.

Adjusted Trial Balance

After all adjusting entries are journalized and posted, another trial balance is prepared to prove the general ledger. The adjusted trial balance is shown below.

GENERAL JOURNAL										PAGE 13					
DATE	ACCOUNT TITLE	DOC. NO.	POST. REF.	DEBIT				CREDIT							
1	<i>Adjusting Entries</i>										1				
2	³⁹⁻ Dec. 31	Uncollectible Accounts Expense			1	4	2	3	69			2			
3		Allowance for Uncollectible Accounts								1	4	2	3	69	3
4	31	Interest Receivable			1	7	5	00							4
5		Interest Income								1	7	5	00		5
6	31	Income Summary			23	6	2	2	00						6
7		Merchandise Inventory								23	6	2	2	00	7
8	31	Supplies Expense—Office			76	4	4	0	00						8
9		Supplies—Office								76	4	4	0	00	9
10	31	Supplies Expense—Store			109	8	0	0	00						10
11		Supplies—Store								109	8	0	0	00	11
12	31	Insurance Expense			36	2	2	5	00						12
13		Prepaid Insurance								36	2	2	5	00	13
14	31	Depreciation Exp.—Office Equip.			25	1	4	6	00						14
15		Accum. Depr.—Office Equip.								25	1	4	6	00	15
16	31	Depreciation Exp.—Store Equip.			113	4	1	8	00						16
17		Accum. Depr.—Store Equip.								113	4	1	8	00	17
18	31	Interest Expense			7	1	0	84							18
19		Interest Payable								7	1	0	84		19
20	31	Unearned Rent Income			3	0	0	0	00						20
21		Rent Income								3	0	0	0	00	21
22	31	Federal Income Tax Expense			2	9	9	2	22						22
23		Federal Income Tax Payable								2	9	9	2	22	23

Sun Treasures, Inc.
Adjusted Trial Balance
December 31, 20--

ACCOUNT TITLE	DEBIT					CREDIT				
<i>Cash</i>	43	8	4	8	68					
<i>Petty Cash</i>	4	5	0	0	00					
<i>Accounts Receivable</i>	52	4	8	1	37					
<i>Allowance for Uncollectible Accounts</i>						2	0	9	9	25
<i>Notes Receivable</i>	15	0	0	0	00					
<i>Interest Receivable</i>		1	7	5	00					
<i>Merchandise Inventory</i>	307	6	1	3	20					
<i>Supplies—Office</i>	13	2	0	0	00					
<i>Supplies—Store</i>	48	3	0	0	00					
<i>Prepaid Insurance</i>	18	6	4	7	35					
<i>Office Equipment</i>	325	6	4	8	16					
<i>Accumulated Depreciation—Office Equipment</i>						104	8	7	3	00
<i>Store Equipment</i>	1099	6	3	8	43					
<i>Accumulated Depreciation—Store Equipment</i>						451	3	2	0	00
<i>Accounts Payable</i>						15	4	6	2	50
<i>Sales Tax Payable</i>						6	4	7	31	
<i>Notes Payable</i>										
<i>Interest Payable</i>						7	1	0	84	
<i>Line of Credit</i>						7	5	0	0	00
<i>Unearned Rent Income</i>						1	5	0	0	00
<i>Employee Income Tax Payable</i>						1	5	7	3	00
<i>Social Security Tax Payable</i>						3	0	0	0	80
<i>Medicare Tax Payable</i>						7	0	1	80	
<i>Medical Insurance Payable</i>						3	2	1	24	
<i>Retirement Benefits Payable</i>						4	7	5	00	
<i>Unemployment Tax Payable—State</i>							3	5	00	
<i>Unemployment Tax Payable—Federal</i>							2	3	6	25
<i>Federal Income Tax Payable</i>						2	9	9	2	22
<i>Dividends Payable</i>										
<i>Long-term Notes Payable</i>						106	6	2	5	67
<i>Bonds Payable</i>						180	0	0	0	00

Sun Treasures, Inc.
Adjusted Trial Balance
December 31, 20--

ACCOUNT TITLE	DEBIT				CREDIT			
<i>Capital Stock—Common (\$10 par, 40,000)</i>					400	0	0	00
<i>Paid-in Capital in Excess of Par—Common</i>					480	0	0	00
<i>Capital Stock—Preferred (\$50 par, 400)</i>					20	0	0	00
<i>Paid-in Capital in Excess of Par—Preferred</i>								
<i>Retained Earnings</i>					82	5	2	50
<i>Dividends</i>	21	2	0	00				
<i>Income Summary</i>	23	6	2	00				
<i>Sales</i>					2576	3	2	10
<i>Sales Discount</i>	15	4	5	93				
<i>Sales Returns and Allowances</i>	113	5	2	11				
<i>Purchases</i>	1307	1	6	50				
<i>Purchases Discount</i>					15	6	8	93
<i>Purchases Returns and Allowances</i>					1	1	5	40
<i>Advertising Expense</i>	58	0	0	00				
<i>Cash Short and Over</i>	2	4	1	25				
<i>Credit Card Fee Expense</i>	23	7	6	21				
<i>Depreciation Expense—Office Equipment</i>	25	1	4	00				
<i>Depreciation Expense—Store Equipment</i>	113	4	1	00				
<i>Insurance Expense</i>	36	2	2	00				
<i>Miscellaneous Expense</i>	38	0	1	66				
<i>Payroll Taxes Expense</i>	27	4	2	60				
<i>Rent Expense</i>	143	0	0	00				
<i>Salary Expense</i>	290	4	0	00				
<i>Supplies Expense—Office</i>	76	4	4	00				
<i>Supplies Expense—Store</i>	109	8	0	00				
<i>Uncollectible Accounts Expense</i>	1	4	2	69				
<i>Utilities Expense</i>	66	8	8	10				
<i>Federal Income Tax Expense</i>	25	9	9	22				
<i>Interest Income</i>					2	5	1	80
<i>Rent Income</i>					3	0	0	00
<i>Gain on Plant Assets</i>					18	2	3	00
<i>Interest Expense</i>	18	3	4	10				
<i>Loss on Plant Assets</i>	16	8	4	00				
Totals	4479	5	0	56	4479	5	0	56

End of Lesson Review

LO1 Plan and record end-of-fiscal-period adjustments for a merchandising business organized as a corporation.
 Audit Your Understanding

1. Describe the two methods used to determine the amount of an adjustment.
2. Which accounts are used to adjust the Supplies account?

Work Together 22-1

Recording adjusting entries and preparing an adjusted trial balance

Travel Lite Corporation's unadjusted trial balance and accounting forms are given in the Working Papers. Your instructor will guide you through the following example.

1. Using the following information, journalize the adjusting entries for the current year ended December 31.

Estimated uncollectible accounts based on aging accounts receivable	\$ 3,697.32
Accrued interest income	137.50
Merchandise inventory	45,058.15
Supplies inventory	126.00
Value of prepaid insurance	1,535.80
Annual depreciation expense—equipment	2,250.00
Accrued interest expense	277.58
Prepaid rent income earned	1,000.00

2. Post the adjusting entries to the T accounts.
3. Using the tax table shown in this chapter, calculate federal income tax expense and journalize the income tax adjustment.
4. Post the federal income tax adjusting entry to the T accounts.
5. Using the unadjusted trial balance and the T accounts, complete the adjusted trial balance. Save your work to complete Work Together 22-2.

On Your Own 22-1

Recording adjusting entries and preparing an adjusted trial balance

Williams Corporation's unadjusted trial balance and accounting forms are given in the Working Papers. Work this problem independently.

1. Using the following information, journalize the adjusting entries for the current year ended December 31.

Estimated uncollectible accounts based on aging accounts receivable	\$ 3,796.00
Accrued interest income	80.00
Merchandise inventory	98,996.13
Supplies inventory	401.25
Value of prepaid insurance	600.00
Annual depreciation expense—equipment	7,345.00
Accrued interest expense	150.00
Prepaid rent income earned	2,000.00

2. Post the adjusting entries to the T accounts.

3. Using the tax table shown in this chapter, calculate federal income tax expense and journalize the income tax adjustment.
4. Post the federal income tax adjusting entry to the T accounts.
5. Using the unadjusted trial balance and the T accounts, complete the adjusted trial balance. Save your work to complete On Your Own 22-2.

Ethics in Action: Setting the Tone at the Top

A certain company's code of conduct prohibits employees from accepting gifts, favors, or entertainment that would influence their sound business decisions. Despite the rule, the company president is known to accept lavish gifts from suppliers. Do you think the employees will be motivated to adhere to the code of conduct?

The employees at the top of a company—managers, officers, and directors—must provide leadership in making ethical decisions. Among the many ways companies can “set the tone at the top” is to have a special code of conduct for members of the board of directors.

Instructions

Access the Board of Directors Code of Conduct for Kellogg Company. Determine whether directors can personally invest in the stock of companies that do business with Kellogg Company.

Chapter 22: End-of-Fiscal-Period Work for a Corporation: Lesson 22-2: Preparing an Income Statement, Statement of Stockholders' Equity, and Balance Sheet

Lesson 22-2: Preparing an Income Statement, Statement of Stockholders' Equity, and Balance Sheet

Income Statement LO2

Additional Items on an Income Statement

Statement of Stockholders' Equity LO3

Balance Sheet LO4

- LO2 Prepare an income statement for a merchandising business organized as a corporation.
- LO3 Prepare a statement of stockholders' equity for a merchandising business organized as a corporation.
- LO4 Prepare a balance sheet for a merchandising business organized as a corporation.
- Income Statement LO2

- (1) Rent income
- (2) Gains and losses from the sale of plant assets
- (3) Accruals for interest payable (interest expense)

These accounts are reported after income from operations. To help make decisions about current and future operations, Sun Treasures also analyzes relationships between revenue and expense items. Based on this analysis, Sun Treasures reports vertical analysis ratios for all major income statement items. Detailed procedures for preparing an income statement were presented in Chapter 16. The new items are highlighted in the illustration.

New Elements on the Income Statement for Sun Treasures

1 Income from operations, \$121,040.73, is the income earned only from normal business activities. Sun Treasures' normal business activities are selling souvenirs and tourist items. Interest earned on notes receivable, \$2,512.80, rent income, \$3,000.00, and gain from the sale of plant assets, \$18,231.00, are not normal operating activities. Therefore, these accounts are reported after income from operations in a section labeled Other Revenue. The total of these Other Revenue accounts is \$23,743.80.

2 The interest expense on notes payable and lines of credit, \$18,347.10, and the loss from the sale of plant assets, \$16,842.00, are not normal operating activities. Therefore, these accounts are reported after income from operations in a section labeled Other Expenses. The total of these two Other Expenses accounts is \$35,189.10.

3 The difference between other revenue and other expenses, \$11,445.30, is reported as a net addition or net deduction. The difference is added to or deducted from income from operations to determine the net income before federal income tax.

Statement of Stockholders' Equity LO3

The statement of stockholders' equity for Sun Treasures is similar to that for ThreeGreen in Part 2. Both companies report changes in the Capital Stock and Retained Earnings accounts. However, Sun Treasures has two additional equity accounts, so its statement of stockholders' equity has two additional sections: (1) Paid-in Capital in Excess of Par—Common and (2) Preferred Stock.

<i>Sun Treasures, Inc.</i>									
<i>Statement of Stockholders' Equity</i>									
<i>For Year Ended December 31, 20--</i>									
<i>Capital Stock—Common:</i>									
<i>\$10.00 Par Value</i>									
<i>January 1, 20--</i>									
<i>39,400 Shares Issued</i>						394	0	0	0
<i>Issued during Current Year</i>						6	0	0	0
<i>Bal., December 31, 20--</i>								400	0
<i>Paid-in Capital in Excess of Par—Common:</i>									
<i>Balance, January 1, 20--</i>						462	0	0	0
<i>Issued during Current Year</i>						18	0	0	0
<i>Balance, December 31, 20--</i>								480	0
<i>Capital Stock—Preferred:</i>									
<i>\$50.00 Par Value, 6%</i>									
<i>January 1, 20--</i>									
<i>0 Shares Issued</i>									
<i>Issued during Current Year</i>						20	0	0	0
<i>Balance, December 31, 20--</i>								20	0
<i>Retained Earnings:</i>									
<i>Balance, January 1, 20--</i>						82	5	2	5
<i>Net Income after Federal Income Tax for 20--</i>	83	6	0	3	21				
<i>Less Dividends Declared during 20--</i>	21	2	0	0	00				
<i>Net Increase during 20--</i>						62	4	0	3
<i>Balance, December 31, 20--</i>								144	9
<i>Total Stockholders' Equity, December 31, 20--</i>								1044	9

- 1 Paid-in Capital in Excess of Par—Common section
- 2 Preferred Stock section

Detailed instructions for preparing the statement of stockholders' equity were presented in Chapter 16. The new sections are highlighted in the illustration.

New Elements on the Statement of Stockholders' Equity for Sun Treasures

1 Changes in Paid-in Capital in Excess of Par—Common are listed in section 2. The ending balance, \$480,000.00, is included in total stockholders' equity.

2 Changes in Preferred Stock are listed in section 3. The ending balance, \$20,000.00, is included in total stockholders' equity.

Major corporations, especially those listed on the New York Stock Exchange (NYSE), publish lavish annual reports on their operations for the year. These annual reports are intended to summarize operations for their stockholders. They are also used to encourage investors to buy new issues of a company's stock. Most annual reports are available online as well.

Balance Sheet LO4

1 New current liability accounts

Sun Treasures, Inc.	
Balance Sheet	
December 31, 20--	
Assets	
Current Assets:	
Cash	43 8 4 8 68
Petty Cash	4 5 0 0 0
Accounts Receivable	52 4 8 1 37
Less Allowance for Uncollectible Accounts	2 0 9 9 25
Notes Receivable	50 3 8 2 12
Interest Receivable	1 7 5 0 0
Merchandise Inventory	307 6 1 3 20
Supplies—Office	13 2 0 0 0
Supplies—Store	48 3 0 0 0
Prepaid Insurance	18 6 4 7 35
Total Current Assets	497 6 1 6 35
Plant Assets:	
Office Equipment	325 6 4 8 16
Less Accumulated Depr.—Office Equipment	104 8 7 3 00
Store Equipment	1099 6 3 8 43
Less Accumulated Depr.—Store Equipment	648 3 1 8 43
Total Plant Assets	869 0 9 3 59
Total Assets	1366 7 0 9 94
Liabilities	
Current Liabilities:	
Accounts Payable	15 4 6 2 50
Sales Tax Payable	6 4 7 3 1
Interest Payable	7 1 0 8 4
Line of Credit	7 5 0 0 0
Unearned Rent Income	1 5 0 0 0
Employee Income Tax Payable	1 5 7 3 00
Social Security Tax Payable	3 0 0 0 80
Medicare Tax Payable	7 0 1 8 0
Medical Insurance Payable	3 2 1 2 4
Retirement Benefits Payable	4 7 5 0 0
Unemployment Tax Payable—State	3 5 0 0
Unemployment Tax Payable—Federal	2 3 6 2 5
Federal Income Tax Payable	2 9 9 2 22
Total Current Liabilities	35 1 5 5 96
Long-term Liabilities:	
Long-term Notes Payable	106 6 2 5 67
Bonds Payable	180 0 0 0 0
Total Long-term Liabilities	286 6 2 5 67
Total Liabilities	321 7 8 1 63
Stockholders' Equity	
Capital Stock—Common	400 0 0 0 0
Paid-in Capital in Excess of Par—Common	480 0 0 0 0
Capital Stock—Preferred	20 0 0 0 0
Retained Earnings	144 9 2 8 31
Total Stockholders' Equity	1044 9 2 8 31
Total Liabilities and Stockholders' Equity	1366 7 0 9 94

2 Long-term Liabilities section

3 Expanded Stockholders' Equity section

The balance sheet for Sun Treasures is similar to that for ThreeGreen in Part 2. Both balance sheets report assets, liabilities, and equity on a specific date. However, Sun Treasures has more current liability accounts, a new section, Long-term Liabilities, and more equity accounts. ThreeGreen only had current liabilities. Sun Treasures has both current and long-term liabilities. Each type of liability is listed separately and subtotaled. Total liabilities is also presented. Detailed procedures for preparing a balance sheet were presented in Chapter 16. The new items are highlighted in the illustration.

New Elements on the Balance Sheet for Sun Treasures

- 1 Several new current liabilities appear in the Current Liabilities section.
- 2 A new Long-term Liabilities section follows the Current Liabilities section. Each long-term liability account is listed, along with total long-term liabilities and total liabilities.
- 3 New stockholders' equity accounts are listed in the Stockholders' Equity section.

End of Lesson Review

- LO2 Prepare an income statement for a merchandising business organized as a corporation.
- LO3 Prepare a statement of stockholders' equity for a merchandising business organized as a corporation.
- LO4 Prepare a balance sheet for a merchandising business organized as a corporation.

Audit Your Understanding

2. Why are other revenue and other expenses reported separately from sales, cost of merchandise sold, and operating expenses on the income statement?
3. What is an example of a long-term liability?

Work Together 22-2

Preparing an income statement, statement of stockholders' equity, and balance sheet for a corporation

Use the adjusted trial balance from Work Together 22-1. Forms are given in the Working Papers. Your instructor will guide you through the following examples.

1. Complete the income statement for the current year. Calculate and record the following vertical analysis ratios: (a) cost of merchandise sold; (b) gross profit on operations; (c) total operating expenses; (d) income from operations; (e) net addition or deduction resulting from other revenue and expenses; and (f) net income before federal income tax. Round percentage calculations to the nearest 0.01%.
2. Complete the statement of stockholders' equity for the current year. As of January 1, Travel Lite Corporation had issued 4,500 shares of common stock with a par value of \$1.00 per share. During the fiscal year, the corporation issued 500 additional shares of common stock. The balance in Paid-in Capital in Excess of Par—Common on January 1, 20--, was \$8,000.00. As of January 1, Travel Lite had not issued any shares of preferred stock. During the fiscal year, it issued 500 shares of \$10.00 par, 5% preferred stock at par value.
3. Complete the balance sheet for the current year. Save your work to complete Work Together 22-3.

On Your Own 22-2

Preparing an income statement, statement of stockholders' equity, and balance sheet for a corporation

Use the adjusted trial balance from On Your Own 22-1. Forms are given in the Working Papers. Your instructor will guide you through the following examples.

1. Complete the income statement for the current year. Calculate and record the following vertical analysis ratios: (a) cost of merchandise sold; (b) gross profit on operations; (c) total operating expenses; (d) income from

operations; (e) net addition or deduction resulting from other revenue and expenses; and (f) net income before federal income tax. Round percentage calculations to the nearest 0.01%.

2. Complete the statement of stockholders' equity for the current year. As of January 1, Williams Corporation had issued 2,000 shares of common stock with a par value of \$5.00 per share. During the fiscal year, the corporation issued 1,000 additional shares of common stock. The balance in Paid-in Capital in Excess of Par—Common on January 1, 20--, was \$2,000. As of January 1, Williams Corporation had not issued any shares of preferred stock. During the fiscal year, it issued 1,000 shares of \$10.00 par, 5% preferred stock at par value.
3. Complete the balance sheet for the current year. Save your work to complete On Your Own 22-3.

Think Like an Accountant: Formatting Amounts in Financial Statements

The board of directors of Blanc Corporation is reviewing its financial statements. The president begins her presentation to the board by discussing sales trends. Which of these statements would the board members better understand?

1. Our sales for May were \$542,349.31, an increase of \$23,136.89 over April.
2. Our sales for May were \$542 thousand, an increase of \$23 thousand over April.

Does the board need to know the exact amount of sales? Will knowing about that extra \$349.31 of sales cause the board to make any different decisions? Most people will better understand the second statement.

Amounts rounded to two, three, or four digits can provide an adequate level of information. This level of accuracy is common in other areas of our daily living. Consider these examples. Speed limit signs have only two digits. Baseball batting averages are stated in three digits, such as .325. College grade point averages are also presented with three digits, such as 3.68.

Most corporations present their financial statements in thousands or millions. Notations such as in thousands of dollars or \$000s are included in the statement headings. These notations inform the reader that the amounts are stated in thousands of dollars. A corporation can also replace digits with zeros. For example, the statement could round \$12,345 to \$12,000.

Open the Spreadsheet TLA_CH22

Follow the steps on the Instructions worksheet. Each worksheet contains a financial statement. Format each financial statement assuming it will be presented to a board of directors.

Chapter 22: End-of-Fiscal-Period Work for a Corporation: Lesson 22-3: Preparing a Statement of Cash Flows

Lesson 22-3: Preparing a Statement of Cash Flows

- LO5 Prepare a statement of cash flows for a merchandising business organized as a corporation.

Statement of Cash Flows LO5

ThreeGreen, the company in Part 2, prepared three financial statements: income statement, statement of stockholders' equity, and balance sheet. Corporations are required to prepare one additional statement which addresses the changes in the business's cash for the period. The cash receipts and cash payments of a company are called cash flow. A financial

statement that summarizes cash receipts and cash payments resulting from business activities during a fiscal period is called a statement of cash flows .

The statement of cash flows is different than the other financial statements in one major way—the basis it uses. The income statement, the statement of stockholders' equity, and the balance sheet are prepared using the accrual basis of accounting. This means that revenues are recorded when earned, not when cash is received and expenses are included when incurred, not when cash is paid. The statement of cash flows is prepared using the cash basis of accounting. This means that the statement of cash flows only reports inflows and outflows of cash and excludes business transactions that do not affect cash. For example, interest accrued on a note receivable would not affect cash. Similarly, wages accrued but not paid during the period would not affect cash.

The purpose of the statement of cash flows is to provide important information to external parties such as stockholders and creditors. A business may have impressive profits, but may experience a cash shortage and have difficulty paying its bills. The statement of cash flows allows the reader to more fully understand how cash is acquired and how it is used by a company.

Cash Flows from Operating, Investing, and Financing Activities

The statement of cash flows is divided into three sections. The cash flows for each of these sections are calculated by analyzing the information presented in the ledger accounts and the other financial statements of the company.

Cash Flows from Operating Activities

The cash receipts and payments necessary to operate a business on a day-to-day basis are called operating activities . Creditors, owners, and potential investors examine the operating activities to determine if the company generates sufficient cash to support future investments and long-term profitability.

Cash Flows from Investing Activities

Cash receipts and cash payments involving the sale or purchase of assets used to earn revenue over a period of time are called investing activities . Financial analysts examine the investing activities to assess the future financial strength and profitability of a business. If a company is forced to sell buildings and equipment to raise cash for operations, there would soon be no more assets to use in operations.

Cash Flows from Financing Activities

Cash receipts and payments involving debt or equity transactions are called financing activities . These activities usually involve borrowing money from creditors and repaying the principal or selling stock and paying dividends. Financing activities are often used to ensure that an adequate balance exists in the Cash account. If a business uses more cash than it receives, it must obtain additional financing. This often happens as a business expands operations, as Sun Treasures is doing. Extra cash is required to obtain inventory and assets for the new stores. If a business has excess cash, it can use it to repay loans, notes, and bonds.

A list of Sun Treasures' common inflows and outflows from operating, investing, and financing activities is presented.

Activity	Cash Inflows	Cash Outflows
Operating	Sale of merchandise	Payment for daily operations (advertising, insurance, interest, inventory, rent, salaries, taxes, utilities)
	Receipt of interest income	
	Receipt of rent income	
Investing	Sale of office equipment	Purchase of office equipment
	Sale of store equipment	Purchase of store equipment
	Sale of other investments	Purchase of other investments
Financing	Issuance of stock	Payment of dividends
	Issuance of long-term notes payable	Payment of principal from long-term notes payable
	Issuance of bonds	Payment of bond principal
	Borrowing cash against line of credit	Making principal payments on line of credit

Companies often establish a line of credit with a bank. This credit can be used to pay invoices or make cash purchases, especially for urgent business needs that require an immediate cash payment. A line of credit is a short-term loan to the company, and interest must be paid on the loan. The advantage of having a line of credit is that the company will not need to take out a new loan every time cash is needed to operate the business.

Operating Activities Section of a Statement of Cash Flows

Sun Treasures' statement of cash flows is shown on the next page.

The operating activities section of the statement of cash flows can be prepared using one of two methods: the direct method or the indirect method. Sun Treasures uses the direct method to prepare the operating activities section of the statement of cash flows. The indirect method begins with net income and makes adjustments for noncash expenditures and other cash differences. Regardless of the method used, the net cash provided or used by operating activities is the same amount.

Sun Treasures has three sources of cash from operating activities: sales, interest, and rent. The amount of cash received for each of these items is not the same as the amount of sales, interest income, and rent income listed on Sun Treasures' income statement. Since the statement of cash flows is prepared on a cash basis, the amount listed is the total amount of cash received this period for each item. For example, Sun Treasures received \$4,500.00 for three months' rent on November 1. The amount listed on the statement of cash flows for rent received is \$4,500.00. By December 31, Sun Treasures only earned \$3,000.00 of rent income. Only the amount of rent income earned, \$3,000.00, is reported on Sun Treasures' income statement. Likewise, other amounts on the statement of cash flows may not be the same as related amounts on the income statement or the statement of stockholders' equity.

The amount listed for sales and interest income is the actual amount of cash received for each item during this fiscal period. The amount is determined by examining the general ledger accounts and the financial statements.

The payments section is prepared in a similar manner. The actual amount of cash paid for each item must be determined. Sun Treasures lists the major operating items separately and adds smaller operating items together in a category called Other operating expenses.

Completed Statement of Cash Flows

1 Complete the heading

Sun Treasures, Inc.
Statement of Cash Flows
For Year Ended December 31, 20--

2 Cash flows from operating activities

3 Cash receipts from:

Cash flows from operating activities:									
Cash receipts from:									
Sales	2420	741	35						
Interest	2450	75							
Rent	4500	00							
Total cash receipts						2427	692	10	
Cash payments for:									
Inventory purchases	(1455)	210	88						
Salaries and wages	(319)	245	36						
Insurance	(54)	368	00						
Interest	(22)	154	31						
Taxes	(27)	465	29						
Rent	(143)	000	00						
Other operating expenses	(304)	986	92						
Total cash payments						2326	430	76	
Net cash provided/(used) by operating activities									101 261 34

4 Record source and amount for each type of cash received for operating activities.

5 Calculate and enter total cash receipts.

6 Cash payments for:

7 Records use and amount for each type of cash paid for operating activities.

8 Calculate and enter total cash payments.

9 Net cash provided/(used) by operating activities

10 Calculate and enter net cash provided by operating activities.

Preparing the Operating Activities Section of a Statement of Cash Flows

1 Prepare the heading of the statement. The statement is prepared for the same period of time as the income statement.

2 Write the name of the first section, Cash flows from operating activities, on the first line.

3 Write the words Cash receipts from: on the next line.

4 Write the name and amount of each type of cash receipt for operating activities.

5 Calculate and enter total cash receipts.

6 Write the words Cash payments for: on the next line.

7 Write the name and amount of each type of cash payment for operating activities.

8 Calculate and enter total cash payments.

9 Write the words Net cash provided/(used) by operating activities on the next line.

10 Calculate and enter the net cash provided by operating activities, \$101,261.34 (\$2,427,692.10 – \$2,326,430.76).

Investing Activities Section of a Statement of Cash Flows

Sun Treasures, Inc. Statement of Cash Flows For Year Ended December 31, 20--	
Cash flows from investing activities:	
Sale of equipment	5 2 0 0 00
Purchase of equipment	(405 2 0 0 71)
Net cash provided/(used) by investing activities	(400 0 0 0 71)

1 Cash flows from investing activities

2 Record source and amount for each type of cash received and paid for investing activities.

3 Calculate and enter net cash used by investing activities.

The remaining two sections of the statement of cash flows are prepared the same, regardless of the method used to prepare the operating activities section. The accountant for Sun Treasures examines the ledger accounts and other financial data to determine the actual cash received by investing activities and the actual cash paid for investing activities.

Preparing the Investing Activities Section of a Statement of Cash Flows

- 1 Leaving one line blank, write the name of the second section, Cash flows from investing activities.
- 2 Write the name and amount of each type of cash receipt and cash payment for investing activities.
- 3 Calculate and enter the net cash used by investing activities, \$(400,000.71) (\$5,200.00 – \$405,200.71).

Financing Activities Section of a Statement of Cash Flows

Sun Treasures, Inc. Statement of Cash Flows For Year Ended December 31, 20--	
Cash flows from financing activities:	
Issuance of stock	44 0 0 0 00
Issuance of long-term notes payable	120 0 0 0 00
Issuance of bonds	180 0 0 0 00
Proceeds from line of credit	15 8 0 0 00
Payment of notes payable	(12 5 4 7 10)
Payment on line of credit	(1 5 1 2 00)
Payment of cash dividends	(21 2 0 0 00)
Net cash provided/(used) by financing activities	324 5 4 0 90

1 Cash flows from financing activities

2 Record source and amount for each type of cash received and paid for financing activities.

3 Calculate and enter net cash used by financing activities.

The financing activities section is prepared in a manner similar to the investing activities section. Actual cash received by financing activities and actual cash paid for financing activities is determined and recorded on the statement of cash flows.

Preparing the Financing Activities Section of a Statement of Cash Flows

- 1 Leaving one line blank, write the name of the third section, Cash flows from financing activities.
- 2 Write the name and amount of each type of cash receipt and cash payment for financing activities.
- 3 Calculate and enter the net cash provided by financing activities, \$324,540.90 (\$44,000.00 + \$120,000.00 + \$180,000.00 + \$15,800.00 – \$12,547.10 – \$1,512.00 – \$21,200.00).

Completing the Statement of Cash Flows

The last three lines of the statement of cash flows show and verify the amount of increase or decrease in cash during the fiscal period. The net change in cash is calculated by netting out the totals of the three activities: Net cash provided by operating activities, \$101,261.34, minus net cash used by investing activities, \$400,000.71, plus net cash provided by financing activities, \$324,540.90, equals net change in cash, \$25,801.53.

The net change in cash is verified by adding it to the cash balance at the beginning of the period. The total

<i>Sun Treasures, Inc.</i>											
<i>Statement of Cash Flows</i>											
<i>For Year Ended December 31, 20--</i>											
<i>Cash flows from operating activities:</i>											
<i>Cash receipts from:</i>											
<i>Sales</i>	2420	741	35								
<i>Interest</i>	2450	75									
<i>Rent</i>	4500	00									
<i>Total cash receipts</i>				2427	692	10					
<i>Cash payments for:</i>											
<i>Inventory purchases</i>	(1455)	210	88								
<i>Salaries and wages</i>	(319)	245	36								
<i>Insurance</i>	(54)	368	00								
<i>Interest</i>	(22)	154	31								
<i>Taxes</i>	(27)	465	29								
<i>Rent</i>	(143)	000	00								
<i>Other operating expenses</i>	(304)	986	92								
<i>Total cash payments</i>				(2326)	430	76					
<i>Net cash provided/(used) by operating activities</i>									101	261	34
<i>Cash flows from investing activities:</i>											
<i>Sale of equipment</i>				5200	00						
<i>Purchase of equipment</i>	(405)	200	71								
<i>Net cash provided/(used) by investing activities</i>									(400)	000	71
<i>Cash flows from financing activities:</i>											
<i>Issuance of stock</i>				44000	00						
<i>Issuance of long-term notes payable</i>				120000	00						
<i>Issuance of bonds</i>				180000	00						
<i>Proceeds from line of credit</i>				15800	00						
<i>Payment of notes payable</i>	(12)	547	10								
<i>Payment on line of credit</i>	(1)	512	00								
<i>Payment of cash dividends</i>	(21)	200	00								
<i>Net cash provided/(used) by financing activities</i>									324	540	90
<i>Net change in cash</i>									25	801	53
<i>Cash balance, January 1, 20--</i>									18	047	15
<i>Cash balance, December 31, 20--</i>									43	848	68

1 Calculate net change in cash.

2 Record cash balance on January 1.

3 Record cash balance on December 31. Verify change in cash balance.

should equal the ending balance in the Cash account.

Completing the Statement of Cash Flows

- 1 Calculate and record the net change in cash, \$25,801.53.
- 2 Record the beginning cash balance, \$18,047.15.
- 3 Record the ending cash balance, \$43,848.68, and verify the net change in cash ($\$25,801.53 + \$18,047.15 = \$43,848.68$).

End of Lesson Review

LO5 Prepare a statement of cash flows for a merchandising business organized as a corporation.

Terms Review

- cash flow
- statement of cash flows
- operating activities
- investing activities
- financing activities

Audit Your Understanding

1. What basis is used to prepare the statement of cash flows?
2. List the three categories of activities used on the statement of cash flows.

Work Together 22-3

Preparing a statement of cash flows for a corporation

Use the balance sheet from Work Together 22-2 and the information below. A form is given in the Working Papers. Your instructor will guide you through the following example.

Prepare a statement of cash flows for the current year.

Cash balance at the beginning of the period	\$ 39,522.51
Cash receipts during the year:	
Cash from sales	\$598,236.31
Cash from interest	635.21
Cash from rent	4,000.00
Cash from sale of equipment	1,200.00
Cash from issuance of stock	17,500.00
Cash from issuance of bonds	10,000.00
Cash payments during the year:	
Cash for inventory	\$375,623.54
Cash for salaries and wages	85,807.14
Cash for insurance	4,254.35
Cash for interest	1,587.35
Cash for taxes	12,885.00
Cash for rent	16,248.65
Cash for other operating expenses	95,412.88

Cash for purchase of equipment	10,549.00
Cash for payment of notes payable	2,500.00
Cash for payment of dividends	21,200.00

On Your Own 22-3

Preparing a statement of cash flows for a corporation

Use the balance sheet from On Your Own 22-2 and the information below. A form is given in the Working Papers. Work the following problem independently.

Prepare a statement of cash flows for the current year.

Cash receipts during the year:

Cash from sales	\$1,226,425.41
Cash from interest	377.00
Cash from rent	13,000.00
Cash from sale of equipment	13,200.00
Cash from issuance of stock	18,000.00
Cash from issuance of bonds	10,000.00

Cash payments during the year:

Cash for inventory	\$ 805,412.20
Cash for salaries and wages	220,147.25
Cash for insurance	8,200.00
Cash for interest	915.00
Cash for taxes	28,000.00
Cash for rent	28,210.00
Cash for other operating expenses	95,214.20
Cash for purchase of equipment	75,000.00
Cash for payment of notes payable	7,500.00
Cash for payment of dividends	10,000.00
Cash balance at the beginning of the period	\$ 6,023.29

Chapter 22: End-of-Fiscal-Period Work for a Corporation: Global Awareness: Working in a Foreign Country

Global Awareness: Working in a Foreign Country

Critical Thinking

Global Awareness: Working in a Foreign Country

Does working in a foreign country appeal to you? Are you willing to pack your clothes and a few personal belongings and fly off for new adventures? Before you go, you will need to do some advance planning.

Many countries do not allow foreign workers. Those that do allow foreign workers may require a work permit. In some countries, you can only get a work permit if it can be proven that the position cannot be filled by a citizen of that country because of lack of skills or other reasons.

If you go to a country that does not require a work permit, you may be required to apply for and be granted a visa before you can enter the country. In addition, you may be required to provide proof of specific immunizations. Visas are often issued for a limited time span, after which you must leave the country.

Perhaps the most important thing to consider is the culture and customs of the country, which may be very different than those to which you are accustomed. Understanding and tolerating these customs may be the ultimate test of your ability to live happily and successfully abroad.

Critical Thinking

Choose a country in which you are interested. Search the Internet for suggestions on what is needed to work in that country, including work permits and visas. Also include what language is spoken in this country and what kind of climate you can tolerate. Summarize your findings in a one-paragraph written report.

Chapter 22: End-of-Fiscal-Period Work for a Corporation: Forensic Accounting: The Enron Legacy

Forensic Accounting: The Enron Legacy

There was a time when Enron Corporation was an iconic symbol of American capitalism. The company was a leader in the production and trading of energy. Enron owned pipelines, power plants, natural gas distributors, and paper mills all over the world. Enron occupied a stunning office complex in Houston. For a short time, its famous crooked E logo adorned the home of Major League Baseball's Houston Astros.

Enron's growth and political power were headline news. Enron's revenue grew an astonishing 750% from 1996 to 2000. Its revenue of \$101 billion in 2000 ranked it as one of the world's largest companies. Fortune magazine named Enron its "most innovative" company for six years. Enron was also well connected in national politics. Chief executive officer Ken Lay was a personal friend of President George W. Bush.

But underneath its pristine image was a corporate culture that motivated employees to take advantage of any situation to increase revenue and earnings. Enron's role in the 2000–2001 California energy crisis brought this culture to light. Legislation in California designed to control the energy prices charged to consumers had an unintended effect. California power companies had to pay market prices for extra energy while being limited to what they could charge the public. Enron schemed to inflate energy costs, causing wholesale electricity prices to skyrocket from \$30 to \$1,500 per megawatt hour. Enron was making huge profits while Californians were dealing with rolling blackouts. It certainly didn't help when president and chief operating officer Jeffrey Skilling was quoted as saying "What's the difference between California and the Titanic? At least when the Titanic went down ... the lights were on."

A victim of accounting fraud and high debt, Enron filed for bankruptcy just over a year after its stock reached an all-time high of \$90 per share. The accounting fraud included the abuse of revenue recognition rules, mark-to-market accounting, and special-purpose entities. These topics are well beyond the scope of this textbook. In fact, the complexity of these topics may have been beyond the ability or willingness of the financial community to understand.

Neither Enron nor its auditor, Arthur Andersen, survived the fraud. Numerous Enron officers were convicted of federal charges and sentenced to substantial jail terms. In a scene out of a Hollywood movie, Arthur Andersen staff shredded thousands of documents and e-mails related to its Enron audit. The accounting firm was convicted of obstruction of justice, an action that resulted in the firm's demise.

The Enron story has been told by numerous books and the documentary *The Smartest Guys in the Room*. The combined size and spectacular nature of the Enron and WorldCom frauds led to the passage of the Sarbanes-Oxley Act. The Act requires corporations to exert a higher level of internal control and executive responsibility over the fair presentation of financial information.

Activity

BelCorp Furniture has hired you to examine its purchases of materials. The company has reason to believe that its purchasing employees are favoring certain vendors.

Instructions

Open the spreadsheet FA_CH22 and complete the steps on the Instructions tab.

Chapter 22: End-of-Fiscal-Period Work for a Corporation: Lesson 22-4: Preparing Closing and Reversing Entries

Lesson 22-4: Preparing Closing and Reversing Entries

- LO6 Record closing entries for a merchandising business organized as a corporation.
- LO7 Record reversing entries for a merchandising business organized as a corporation.

Closing Entry for Accounts with Credit Balances LO6

GENERAL JOURNAL										PAGE 14				
DATE	ACCOUNT TITLE	DOC. NO.	POST. REF.	DEBIT				CREDIT						
	<i>Closing Entries</i>										1			
Dec. 31	Sales			2576	3	2	1	45				2		
	Purchases Discount			15	6	8	5	93				3		
	Purchases Returns and Allowances			1	1	5	0	40				4		
	Interest Income			2	5	1	2	80				5		
	Rent Income			3	0	0	0	00				6		
	Gain on Plant Assets			18	2	3	1	00				7		
	Income Summary								2616	9	0	1	58	8

- 1 Debit the balance of every income statement account with a credit balance. 2 Enter the total of the debit entries as a credit to Income Summary.

After financial statements are prepared, the adjusted trial balance is used to journalize the closing entries for a corporation. The income statement accounts with credit balances consist of the revenue accounts (Sales, Interest Income, Rent Income, and Gain on Plant Assets) and the contra cost accounts (Purchases Discount and Purchases Returns and Allowances). Closing entries are recorded on a new page of the general journal.

Journalizing a Closing Entry for Income Statement Accounts with Credit Balances

- 1 Debit the balance of every income statement account with a credit balance.
- 2 Enter the total of the debit entries, \$2,616,901.58, as a credit to Income Summary.

In most commercial computerized accounting systems, year-end closing is performed by the software. The accountant selects a menu item to close the accounting records for the year, and the software automatically updates its database. In some systems, year-end closing cannot be undone.

Closing Entry for Accounts with Debit Balances

1 Enter Income Summary

Enter the total of the credit entries as a debit to Income Summary.

3

GENERAL JOURNAL						PAGE 14
DATE	ACCOUNT TITLE	DOC. NO.	POST. REF.	DEBIT	CREDIT	
	Closing Entries					
31	Income Summary			2509 676 37		9
	Sales Discount				15 457 93	10
	Sales Returns and Allowances				113 523 11	11
	Purchases				1307 160 50	12
	Advertising Expense				58 000 00	13
	Cash Short and Over				2 417 25	14
	Credit Card Fee Expense				23 763 21	15
	Depreciation Expense—Office Equipment				25 146 00	16
	Depreciation Expense—Store Equipment				113 418 00	17
	Insurance Expense				36 225 00	18
	Miscellaneous Expense				38 010 66	19
	Payroll Taxes Expense				27 423 60	20
	Rent Expense				143 000 00	21
	Salary Expense				290 400 00	22
	Supplies Expense—Office				76 440 00	23
	Supplies Expense—Store				109 800 00	24
	Uncollectible Accounts Expense				1 423 69	25
	Utilities Expense				66 886 10	26
	Federal Income Tax Expense				25 992 22	27
	Interest Expense				18 347 10	28
	Loss on Plant Assets				16 842 00	29

2 Credit the balance of every income statement account with a debit balance.

The income statement accounts with debit balances consist of the contra revenue accounts (Sales Discount and Sales Returns and Allowances), the cost (Purchases), and all expense accounts. Information needed for closing income statement debit balance accounts is obtained from the adjusted trial balance Debit column.

Because Cash Short and Over has a debit balance in this fiscal period, the account balance amount is closed to Income Summary with the debit balance accounts.

Journalizing a Closing Entry—for Income Statement Accounts with Debit Balances

- 1 Enter the account title Income Summary.
- 2 Credit the balance of every income statement account with a debit balance.
- 3 Enter the total of the credit entries, \$2,509,676.37, as a debit to Income Summary.

Closing Entry to Record Net Income

GENERAL JOURNAL							PAGE 14
DATE	ACCOUNT TITLE	DOC. NO.	POST. REF.	DEBIT	CREDIT		
1	<i>Closing Entries</i>					1	
30	31 <i>Income Summary</i>			83 603 21		30	
31	<i>Retained Earnings</i>				83 603 21	31	

1 Debit Income Summary
 2 Credit Retained Earnings

After closing entries for the income statement accounts are posted, Income Summary has a credit balance of \$83,603.21. This credit balance equals the net income for the period.

As reported on the statement of stockholders' equity, the net income of a corporation increases Retained Earnings. Closing the balance of Income Summary actually increases the Retained Earnings account by the amount of net income. After the closing entry is posted, Income Summary has a zero balance.

A corporation having a net loss will have a debit balance in Income Summary. Retained Earnings would then be debited and Income Summary credited for the net loss amount. The entry would reduce the balance of Retained Earnings.

Journalizing a Closing Entry to Record Net Income in Retained Earnings

- 1 Record a debit to Income Summary for the amount of net income, \$83,603.21.
- 2 Record a credit to Retained Earnings for the same amount, \$83,603.21.

Closing Entry for Dividends

GENERAL JOURNAL							PAGE 14
DATE	ACCOUNT TITLE	DOC. NO.	POST. REF.	DEBIT	CREDIT		
1	<i>Closing Entries</i>					1	
33	31 <i>Retained Earnings</i>			21 200 00		33	
34	<i>Dividends</i>				21 200 00	34	

1 Debit Retained Earnings
 2 Credit Dividends

Dividends reduce the earnings retained by a corporation, as reported on the statement of stockholders' equity. The closing entry reduces the balance in the Retained Earnings account by the amount of the dividends.

Journalizing a Closing Entry for Dividends

1 Record a debit to Retained Earnings for the amount of dividends, \$21,200.00.

2 Record a credit to Dividends for the same amount, \$21,200.00.

Reversing Entries LO7

GENERAL JOURNAL							PAGE 13
DATE	ACCOUNT TITLE	DOC. NO.	POST. REF.	DEBIT	CREDIT		
1	<i>Adjusting Entries</i>						1
31	Interest Receivable			1 7 5 0 0		4	
	Interest Income				1 7 5 0 0	5	
31	Interest Expense			7 1 0 8 4		18	
	Interest Payable				7 1 0 8 4	19	
31	Federal Income Tax Expense			2 9 9 2 2 2		22	
	Federal Income Tax Payable				2 9 9 2 2 2	23	

Reverse the entry that created a balance in Interest Receivable.

1

GENERAL JOURNAL							PAGE 1
DATE	ACCOUNT TITLE	DOC. NO.	POST. REF.	DEBIT	CREDIT		
1	<i>Reversing Entries</i>						1
20-Jan. 1	Interest Income			1 7 5 0 0		2	
	Interest Receivable				1 7 5 0 0	3	
1	Interest Payable			7 1 0 8 4		4	
	Interest Expense				7 1 0 8 4	5	
1	Federal Income Tax Payable			2 9 9 2 2 2		6	
	Federal Income Tax Expense				2 9 9 2 2 2	7	

Reverse the entry that created a balance in Interest Payable.

2

Reverse the entry that created a balance in Federal Income Tax Payable.

3

If an adjusting entry creates a balance in an asset or a liability account, the adjusting entry should be reversed. A review of Sun Treasures' adjusting entries shows that three adjusting entries created a balance in an asset or a liability account.

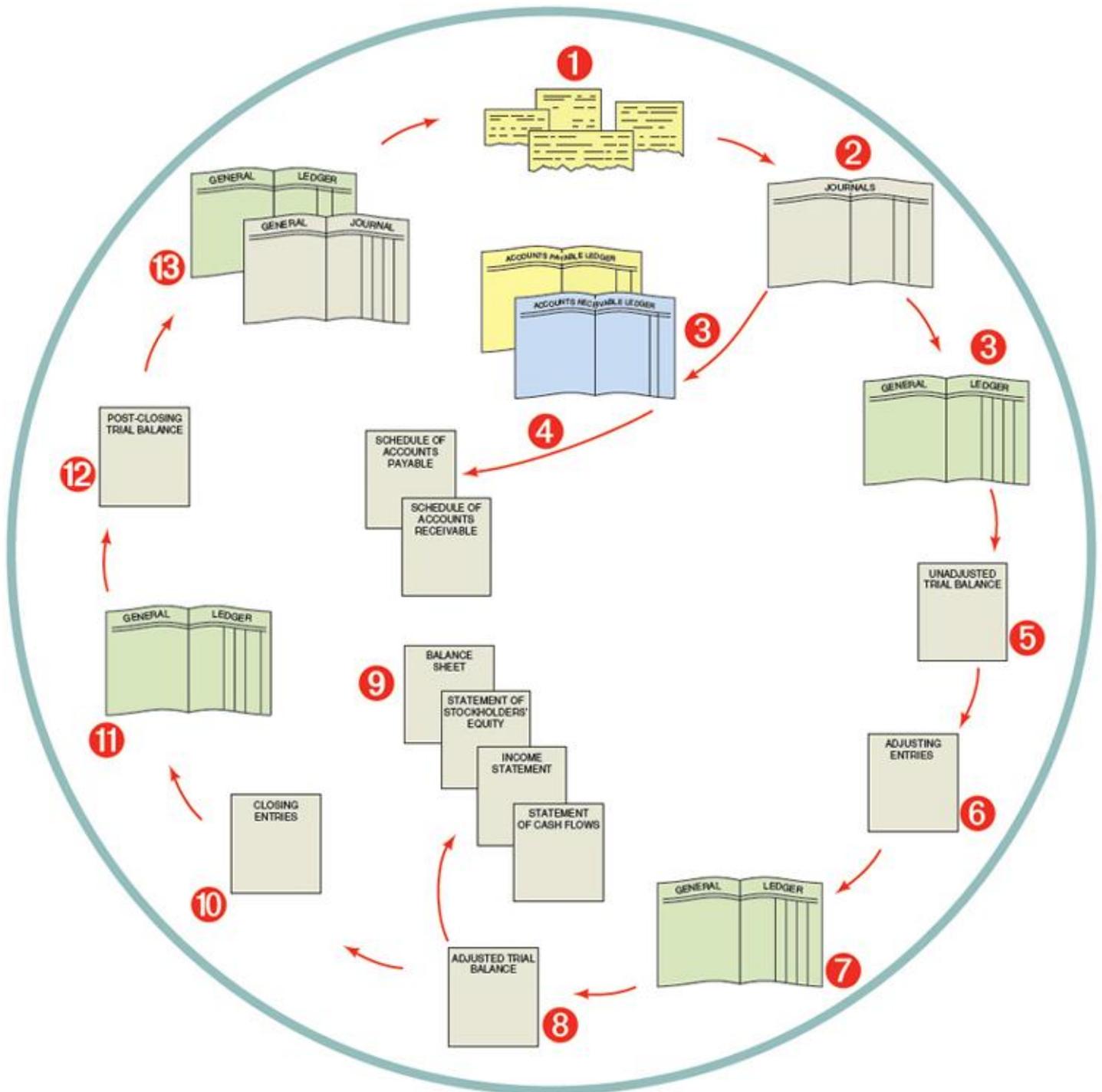
1. The adjusting entry for accrued interest income created a balance in the Interest Receivable account.

2. The adjusting entry for accrued interest expense created a balance in the Interest Payable account.
3. The adjusting entry for federal income tax expense created a balance in the Federal Income Tax Payable account.

Journalizing Reversing Entries

- 1 Reverse the entry that created a balance in Interest Receivable.
- 2 Reverse the entry that created a balance in Interest Payable.
- 3 Reverse the entry that created a balance in Federal Income Tax Payable.

Accounting Cycle for a Merchandising Business Organized as a Corporation



The accounting cycles are similar for merchandising businesses, regardless of how the businesses are organized. Variations occur in preparing financial statements. Variations also occur when reversing entries are recorded.

Accounting Cycle for a Merchandising Business Organized as a Corporation

- 1 Source documents are checked for accuracy, and transactions are analyzed into debit and credit parts.
- 2 Transactions, from information on source documents, are recorded in journals.
- 3 Journal entries are posted to the accounts payable, accounts receivable, and general ledgers.
- 4 Schedules of accounts payable and accounts receivable are prepared from the subsidiary ledgers.

- 5 An unadjusted trial balance is prepared from the general ledger.
- 6 Adjusting entries are journalized.
- 7 Adjusting entries are posted to the general ledger.
- 8 An adjusted trial balance is prepared from the general ledger.
- 9 Financial statements are prepared from the adjusted trial balance.
- 10 Closing entries are journalized.
- 11 Closing entries are posted to the general ledger.
- 12 A post-closing trial balance is prepared from the general ledger.
- 13 Reversing entries are journalized and posted to the general ledger.

End of Lesson Review

- LO6 Record closing entries for a merchandising business organized as a corporation.
- LO7 Record reversing entries for a merchandising business organized as a corporation.

Audit Your Understanding

1. What is used to prove the equality of debits and credits in the general ledger after closing entries are posted?
2. What are the four closing entries for a corporation?
3. Which accounts are closed to Retained Earnings?

Work Together 22-4

Journalizing closing and reversing entries for a corporation

Use the accounting forms and financial statements from Work Together 22-1. General journal pages are given in the Working Papers. Your instructor will guide you through the following examples.

1. For the current year, journalize the closing entries using page 13 of a general journal.
2. For the following year, journalize the reversing entries using page 14 of a general journal.

On Your Own 22-4

Journalizing closing and reversing entries for a corporation

Use the accounting forms and financial statements from On Your Own 22-1. General journal pages are given in the Working Papers. Work this problem independently.

1. For the current year, journalize the closing entries using page 13 of a general journal.
2. For the following year, journalize the reversing entries using page 14 of a general journal.

Why Accounting?: Information Technology Departments

Most companies use some form of automated accounting software to record transactions, generate reports, and analyze financial results. For a small business, this software is usually a generic system that can easily be used by thousands of other businesses. These “one-size-fits-all” packages allow the user a few choices, but not great flexibility.

Larger companies, with information technology (IT) departments, may either develop their own accounting software programs internally or make major revisions in purchased programs to meet the company's needs. In addition to standard financial statements, company management may need unique reports for decision-making purposes. A standard accounting program assists in preparing the financial statements but is not programmed to gather data for the special reports. In this case, the IT department may attempt to revise the program. These reports will only be helpful if they are accurate.

The IT personnel must have at least a basic understanding of accounting. They will have to work closely with accounting department personnel to ensure that the revised accounting software is measuring and reporting the data accurately. The more accounting knowledge the IT workers have, the easier it will be to communicate the needs of the accounting department and company management.

Critical Thinking

1. As a class, identify a local business or government agency that has an information technology department. Choose a student to contact that organization to arrange an interview with a member of that department and two or three class representatives.
2. As a class, develop a list of questions that the class representatives should ask the IT representative.
3. After the interview, have the class representatives share their findings with the class.

Chapter 22:End-of-Fiscal-Period Work for a Corporation: End of Chapter Review

End-of-Fiscal-Period Work for a Corporation: A Look at Accounting Software Recurring Reversing Entries

A Look at Accounting Software in Chapter 15 showed the procedure for fully or partially automating transactions. This feature shows what happens when a recurring entry is set up for adjustments.

In this chapter, you learned about the need to accrue some types of revenue and expenses. You learned that accountants often prefer to reverse some adjusting entries. It was explained that reversing entries are not required, but doing so makes the accounting easier and less prone to error.

Reversing entries in a computerized accounting system are very easy to do. It is as simple as clicking a button on the Make Journal Entries window. The system does all the work.

When recurring entries and reversing entries work together, much of the work is reduced for the accounting staff and the chances for error are greatly reduced. It is important to remember, however, that accountants still need to determine which accounts to adjust and by what amounts.

Recurring Journal Entry

Date: Dec. 31, 20X1 **TOTALS**

Transaction Date: Dec. 31, 20X1 **Debit** **Credit**

Reference No.: G1407 \$2,778.31 \$2,778.31

Out of balance \$0.00

Reverse Transaction

Acct. No.	Account Title	Debit	Credit	Description
1145	Interest Receivable	118.00		Adjusting entry
7105	Interest Income		118.00	Adjusting entry
8105	Interest Expense	506.34		Adjusting entry
2140	Interest Payable		506.34	Adjusting entry
6205	Federal Income Tax Expense	2,153.97		Adjusting entry
2185	Federal Income Tax Payable		2,153.97	Adjusting entry

Recurring entries are ready to be reviewed and posted.

Close

Save Recurring Cancel Post

Entered by user Entered automatically

1 At the end of 20X0, Sun Treasures made the adjusting entries shown in the window and saved them as a recurring entry (Chapter 15). The posting option of "Edit before posting" was selected. Now, on December 31, 20X1, the system presents the recurring entries for review.

2 The system automatically enters the system date, the transaction date, and the transaction reference number.

3 When these adjustments were entered in 20X0, the accountant chose to reverse the entries and clicked the reverse transaction button. The system automatically posted a reversing entry on January 1, 20X1.

4 These amounts were used for the adjustments on December 31, 20X0. The user will change them to the 20X1 amounts: Interest Receivable, \$175.00; Interest Expense, \$710.84; and Federal Income Tax Expense, \$2,992.22.

5 Other recurring transactions will have been presented by the system as well, including the adjusting entries that will not be reversed. The user can use the forward and back arrows to view those transactions.

6 After the entries have been edited, the user can elect to save the edited recurring entry. That would be very helpful if adjusting entries were added or deleted with this year's adjustments.

7 The user clicks Post to post the adjustments. The system will automatically post a reversing entry on January 1, 20X2.

End-of-Fiscal-Period Work for a Corporation: Chapter Summary

Each adjusting entry affects an income statement account and a balance sheet account. Therefore, all adjusting entries must be accurately calculated and recorded. Any errors will affect the accuracy of both the income statement and the balance sheet.

Once the adjusting entries are journalized and posted, financial statements are prepared. The income statement is prepared first. The amount of net income is used in the statement of stockholders' equity, which is prepared second. The totals from the statement of stockholders' equity are used to prepare the balance sheet.

The statement of cash flows is also prepared. It contains three main sections: operating activities, investing activities, and financing activities. The statement of cash flows is prepared on a cash basis, meaning that it shows actual cash inflows and outflows.

Next, the closing entries are prepared and posted. The closing entries close all temporary accounts and transfer the balances through Income Summary to the Retained Earnings account. Only assets, liabilities, and equity accounts will have a balance going into the next fiscal period. A post-closing trial balance is completed to ensure that debits equal credits.

If a company chooses to use reversing entries, these entries are recorded as the first entries of the new fiscal period. Every adjusting entry that established a balance in a receivable or payable account is reversed.

End-of-Fiscal-Period Work for a Corporation: Explore Accounting

End-of-Fiscal-Period Work for a Corporation: Explore Accounting

Audits Provide Stockholders with Positive Assurance

The financial statements are the responsibility of the company management. Stockholders want assurance that the financial statements of their corporation accurately present its financial condition and results of operations. To provide this assurance, corporations hire independent public accountants to audit the financial statements. Public accountants referred to as auditors provide the assurance of the accuracy of the financial statements. They also provide a written opinion that informs stockholders whether the financial statements can be relied upon for making informed business decisions.

Auditors examine accounting records to collect evidence that supports amounts in the financial statements. The auditors then form an opinion, which is the basis for a letter to the stockholders and directors. There are four types of audit opinions that the letter can communicate: unqualified, qualified, adverse, and disclaimer.

An unqualified opinion means the auditors feel that the financial statements fairly represent the financial position of the company without any exceptions (qualifications). This is the best opinion that an auditor can issue. It means that the auditor believes the company followed GAAP to prepare its financial statements—without exceptions.

A qualified opinion means the auditors feel that the financial statements fairly represent the financial position of the company, except for one or more minor issues (or qualifications).

An adverse opinion means the auditors feel the financial statements do not fairly represent the financial position of the company or that the financial statements do not follow GAAP.

A disclaimer means the auditors could not form an opinion as to whether the financial statements fairly represent the financial position of the company. This may happen because the company did not provide enough information to the auditors. It can also happen when the information needed to support the financial statements is not available because it has been destroyed by fire or natural disaster.

Instructions

Access an annual report using a library or the Internet. Read the opinion letter written by the company auditors. In a written report, list the name of the company, the date of the opinion, and which type of audit opinion the auditors gave the company. Include a copy of the auditors' letter with your report.

End-of-Fiscal-Period Work for a Corporation: Apply Your Understanding: Application Problem

INSTRUCTIONS: Download problem instructions for Excel, QuickBooks, and Peachtree from the textbook companion website at www.C21accounting.com .

22-1 Application Problem: Recording Adjusting Entries and Preparing an Adjusted Trial Balance LO1

Handy Hardware Corporation's unadjusted trial balance and accounting forms are given in the Working Papers.

Instructions:

1. Using the following information, journalize the adjusting entries for the current year ended December 31.

Adjustment Information, December 31

Estimated uncollectible accounts based on aging accounts receivable	\$ 13,832.96
Accrued interest income	630.00
Merchandise inventory	162,569.00
Supplies inventory	3,695.00
Value of prepaid insurance	8,360.00
Annual depreciation expense—equipment	13,034.00
Accrued interest expense	600.00
Prepaid rent income earned	4,000.00

2. Post the adjusting entries to the T accounts.
3. Using the tax table shown in this chapter, calculate federal income tax expense and journalize the income tax adjustment.
4. Post the federal income tax adjusting entry to the T accounts.
5. Using the unadjusted trial balance and the T accounts, complete the adjusted trial balance. Save your work to complete Problem 22-2.

22-2 Application Problem: Preparing an Income Statement, Statement of Stockholders' Equity, and Balance Sheet for a Corporation LO2, 3, 4

Use the adjusted trial balance from Problem 22-1. Forms are given in the Working Papers.

Instructions:

1. Complete the income statement for the current year. Calculate and record the following vertical analysis ratios: (a) cost of merchandise sold; (b) gross profit on operations; (c) total operating expenses; (d) income from operations; (e) net addition or deduction from other revenue and expenses; and (f) net income before federal income tax. Round percentage calculations to the nearest 0.01%.

- Complete the statement of stockholders' equity for the current year. As of January 1, Handy Hardware Corporation had issued 15,000 shares of common stock with a par value of \$1.00 per share. During the fiscal year, the corporation issued 5,000 additional shares of common stock. The balance in Paid-in Capital in Excess of Par—Common on January 1, 20--, was \$20,000.00. As of January 1, Handy Hardware had not issued any shares of preferred stock. During the fiscal year, it issued 1,000 shares of \$30.00 par, 5% preferred stock at par value.
- Complete the balance sheet for Handy Hardware Corporation for the current year. Save your work to complete Problem 22-3.

22-3 Application Problem: Preparing a Statement of Cash Flows for a Corporation LO5

Use the balance sheet from Problem 22-2 and the information below. A form is given in the Working Papers.

Instructions:

Prepare a statement of cash flows for the current year.

Cash receipts during the year:

Cash from sales	\$1,925,342.80
Cash from interest	754.14

Cash from rent	\$ 12,000.00
Cash from sale of equipment	2,500.00
Cash from issuance of stock	65,000.00
Cash from issuance of bonds	8,000.00
Cash payments during the year:	
Cash for inventory	\$1,371,254.10
Cash for salaries and wages	262,954.25
Cash for insurance	18,500.00
Cash for interest	7,050.50
Cash for taxes	25,650.00
Cash for rent 30,000.00	
Cash for other operating expenses	171,501.54
Cash for purchase of equipment	40,000.00
Cash for payment of notes payable	20,000.00
Cash for payment of dividends	40,000.00
Cash balance at the beginning of the period	\$ 11,010.61

22-4 Application Problem: Journalizing Closing and Reversing Entries for a Corporation LO6, 7

Use the accounting forms and financial statements from Problem 22-1 to complete this problem. General journal pages are given in the Working Papers.

Instructions:

- For the current year, journalize the closing entries using page 13 of a general journal.
 For the following year, journalize the reversing entries using page 14 of a general journal.

Peachtree

1. Journalize and post closing entries to the general journal.
2. Print the general journal and trial balance.
3. Journalize and post reversing entries to the general journal.

Quickbooks

1. Journalize and post closing entries to the journal.
2. Print the journal and trial balance.
3. Journalize and post reversing entries to the journal.

Excel

1. Journalize and post closing and reversing entries to the general journal.
2. Print the worksheets.

End-of-Fiscal-Period Work for a Corporation: Apply Your Understanding: Mastery Problem

22-M Mastery Problem: Journalizing Adjustments, Preparing Financial Statements, and Journalizing End-of-Fiscal-Period Entries for a Corporation LO1, 2, 3, 4, 5, 6, 7

Ramel Corporation's unadjusted trial balance and accounting forms are given in the Working Papers.

Instructions:

1. Using the following information, journalize the adjusting entries for the current year ended December 31.

Adjustment Information, December 31

Estimated uncollectible accounts based on aging accounts receivable	\$ 11,020.00
Accrued interest income	160.00
Merchandise inventory	581,489.16
Supplies inventory	620.01
Value of prepaid insurance	4,000.00
Annual depreciation expense—office equipment	10,960.00
Annual depreciation expense—store equipment	10,120.00
Accrued interest expense	625.00
Prepaid rent income earned	6,000.00

2. Post the adjusting entries to the T accounts.
3. Using the tax table presented in this chapter, calculate the federal income tax expense and journalize the income tax adjustment.
4. Post the federal income tax adjusting entry to the T accounts.
5. Using the unadjusted trial balance and the T accounts, complete the adjusted trial balance.
6. Complete the income statement for the current year. Calculate and record the following vertical analysis ratios: (a) cost of merchandise sold; (b) gross profit on operations; (c) total operating expenses; (d) income from operations; (e)

net addition or deduction from other revenue and expenses; and (f) net income before federal income tax. Round percentage calculations to the nearest 0.01%.

7. Analyze the corporation's income statement by determining if vertical analysis ratios are within acceptable levels. If any vertical analysis ratio is not within an acceptable level, suggest steps that the company should take. The corporation considers the following ratios acceptable.

Cost of merchandise sold	Not more than 65.00%
Gross profit on operations	Not less than 35.00%
Total operating expenses	Not more than 30.00%
Income from operations	Not less than 5.00%
Net deduction from other revenue and expenses	Not more than 0.10%
Net income before federal income tax	Not less than 4.90%

8. Complete the statement of stockholders' equity for the current year. As of January 1, Ramel Corporation had issued 10,000 shares of common stock with a par value of \$5.00 per share. During the fiscal year, the corporation issued 6,000 additional shares of common stock. The balance in Paid-in Capital in Excess of Par—Common on January 1, 20--, was \$130,000.00. As of January 1, Ramel Corporation issued 1,500 shares of \$20.00 par, 5% preferred stock. During the year, it issued 500 additional shares of preferred stock at par value.

9. Complete the balance sheet for Ramel Corporation for the current year.

10. Calculate the corporation's (a) working capital and (b) current ratio. Determine if these items are within acceptable levels. The corporation considers the following levels acceptable.

Working capital Not less than \$600,000.00
 Current ratio Between 5.0 to 1 and 6.0 to 1

11. Using the balance sheet and the following information, prepare a statement of cash flows for the current year.

Cash receipts during the year:

Cash from sales	\$4,211,326.34
Cash from interest	1,510.00
Cash from rent	9,000.00
Cash from sale of store equipment	3,500.00
Cash from issuance of stock	90,000.00

Cash payments during the year:

Cash for inventory	\$2,645,507.48
Cash for salaries and wages	844,521.30
Cash for insurance	30,000.00
Cash for interest	8,000.00
Cash for taxes	50,000.00
Cash for rent	90,000.00
Cash for other operating expenses	312,884.13
Cash for purchase of office equipment	48,651.87
Cash for purchase of store equipment	15,500.00
Cash for payment of notes payable	68,000.00
Cash for payment of bonds payable	150,000.00
Cash for payment of dividends	70,000.00

Cash balance at the beginning of the period \$ 72,764.94

12. Journalize the closing entries using page 16 of a general journal.

13. Journalize the reversing entries using page 17 of a general journal.

Peachtree

1. Journalize and post adjusting and closing entries to the general journal.
2. Print the general journal and trial balance.
3. Journalize and post reversing entries to the general journal.

Quick books

1. Journalize and post adjusting and closing entries to the journal.
2. Print the journal and trial balance.
3. Journalize and post reversing entries to the journal.

Excel

Journalize and post adjusting, closing, and reversing entries to the general journal.
Print the worksheets.

AAOnline

Go to www.cengage.com/login
Click on AA Online to access.
Go to the online assignment and follow the instructions.

End-of-Fiscal-Period Work for a Corporation: Apply Your Understanding: Challenge Problem

22-C Challenge Problem: Reversing Entries LO7

Ekert Company's blank journals and T accounts are given in the Working Papers. On December 31, 20X1, Ekert Company has one note receivable on its records. It is a \$10,000.00, 90-day, 9% note. The accountant recorded the following adjusting entry related to this note:

GENERAL JOURNAL							PAGE 24
DATE	ACCOUNT TITLE	DOC. NO.	POST. REF.	DEBIT	CREDIT		
1	<i>Adjusting Entries</i>					1	
4	31 <i>Interest Receivable</i>			75 00		4	
5	<i>Interest Income</i>				75 00	5	

After closing entries were posted, the related accounts had the balances reflected in the following T accounts.

Notes Receivable	
Dec. 31 Bal.	10,000.00

Interest Income			
Dec. 31 Closing	75.00	Dec. 31 Adj.	75.00

Interest Receivable	
Dec. 31 Adj.	75.00

Instructions:

1. Assume that Elert Company uses reversing entries.
 - a. Journalize the reversing entry and post the entry to the T accounts.
 - b. Journalize the receipt of the note and interest on its due date, March 1, 20X2, using Check No. 441 as the source document. Post the entry to the T accounts.
 - c. Complete the statements regarding how much interest income was recognized in 20X1 and 20X2.
2. Assume that Elert Company does not use reversing entries.
 - a. Journalize the receipt of the note and interest on its due date, March 1, 20X2, using Check No. 441 as the source document. Post the entry to the T accounts.
 - b. Complete the statements regarding how much interest income was recognized in 20X1 and 20X2.
3. Why would Elert choose to use reversing entries?

End-of-Fiscal-Period Work for a Corporation: 21st Century Skills

The Ins and Outs of Cash Flow

Theme: Financial, Economic, Business, and Entrepreneurial Literacy

Skills: Critical Thinking and Problem Solving, ICT Literacy

One of the first things to do in managing personal finances is to understand the inflow and outflow of cash for a period of time. While a budget provides a plan for spending, a cash flow statement actually shows where the money came from and how it was spent. Learning to manage cash flow will prevent overspending and allow personal wealth-building.

A cash flow statement for personal use contains three parts: sources of income (inflows of cash), expenditures (outflows of cash), and the difference between the two amounts, the net cash flow.

Sources of income are more than just your salary. Income can be gifts, scholarships, and investment income. Basically, anything that brings in money is considered income.

Outflows of cash consist of all of your expenditures, both fixed and variable. Fixed expenditures are those costs that remain unchanged from one period to the next. These include rent, car payments, savings, and investments. Variable expenditures might include food, charitable contributions, gas, and clothing.

The last component of the cash flow statement is calculating the net cash flow. This is the cash inflow minus cash outflow. A positive number is good and means you have extra cash to invest toward financial goals and build personal wealth or even pay down debt. A negative balance is bad and means outflow is greater than inflow. A plan must be created to spend less or generate more income. One cannot become a millionaire if there is a deficit of cash.

Managing your cash flow allows you to direct the cash. Understanding money flow keeps you in control!

Application

1. Julia, a recent college graduate, just prepared a cash flow statement after her first month of employment at Hickman's Hometown Cuisine. Her cash flow statement showed the following for the month of August: cash inflow, \$3,269.27 and cash outflow, \$2,975.00. Julia also has student loan debt totaling \$12,425.00. Julia would like to purchase a new computer. She does not have a savings plan or a retirement plan. Determine the amount of net cash at the end of August. What suggestions would you make for Julia to help her achieve her financial goals? Explain.

2. Elias works at Harmon's Historical Village, a living history museum. He received \$4,971.65 during May for tips and wages earned by providing tours at the museum. His cash outflow for May was \$5,325.19. Explain how Elias could have a negative cash flow, yet be able to make his payments.

3. Create an Excel spreadsheet with the following headings down the side (rows): Cash Inflow, Cash Outflow, and Net Cash Flow. The following headings should be placed at the top (columns): Recent College Graduate, Newly Married, Married with 3 Kids.

a. Assume that you are a recent college graduate, newly married, and married with three children. Anticipate your sources of cash inflow and a list of expenditures (cash outflow) for the different stages in your life. Record your sources and estimations. Calculate your net cash flow.

b. Explain how the various stages of your life might affect your cash flow statement.

[Back to Top \[View PDF\] P. 713](#)

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End-of-Fiscal-Period Work for a Corporation: Analyzing Nike's Financial Statements

As stated in this chapter, the Operating Activities section of the statement of cash flows can be prepared using the direct method or the indirect method. Sun Treasures used the direct method to prepare its statement of cash flows. Nike uses the indirect method. The only difference is in the operating activities section. Look at Nike's Consolidated Statements of Cash Flows on page B-7 in Appendix B. The "Cash provided by operations" section begins with net income and then makes adjustments not affecting cash and changes in certain other accounts. The Operating Activities section of Sun Treasures' statement of cash flows lists cash receipts and cash payments. Both companies arrive at an amount of cash flow from operating activities.

Instructions

List the cash provided by operations for Nike for the fiscal year 2011.

Did Nike's cash increase or decrease during the fiscal year ended 2011? By what amount?

What was the largest use of cash for financing activities for the fiscal year ended 2011?

End-of-Fiscal-Period Work for a Corporation: Reinforcement Activity 3—Part B

End-of-Fiscal-Period Work for a Corporation: Reinforcement Activity 3Part B

End-of-Fiscal-Period Work for a Corporation: Reinforcement Activity 3Part B

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The plant asset records and ledgers used in Reinforcement Activity 3—Part A are needed to complete Reinforcement Activity 3—Part B.

Reinforcement Activity 3—Part B includes those accounting activities needed to complete the accounting cycle of Restaurant Warehouse, Inc.

Instructions

9. Record the 20X4 depreciation on the plant asset record of plant asset no. 422. (Plant assets 452 and 453 will not have depreciation in 20X4 because they were purchased at the end of the year.)
10. Prepare an unadjusted trial balance.
11. Use the information below, collected on December 31, to journalize the adjusting entries.
 - a. Estimated uncollectible accounts based on aging accounts receivable, \$1,261.20.
 - b. Outstanding notes receivable consist of NR30, a 60-day, 11% note accepted from Northside Catering on December 7, 20X4, for an extension of time on its account, \$7,200.00.
 - c. Merchandise inventory, \$150,983.90.
 - d. Supplies inventory, \$850.00.
 - e. Value of prepaid insurance, \$9,200.00.
 - f. Estimate of office equipment depreciation, \$15,040.00.
 - g. Estimate of warehouse equipment depreciation, \$28,420.00.
 - h. Outstanding notes payable consist of (1) NP19, a 100-day, 9% note for \$20,000.00 signed on October 31, 20X4, and (2) NP22, a 90-day, 10% note for \$12,000.00 signed on December 28, 20X4.
 - i. Rent earned, \$3,000.00.
12. Post the adjusting entries in the general ledger.
13. Prepare an adjusted trial balance and total the columns.
14. Using the tax table shown in Chapter 22, calculate the federal income tax owed for the fiscal year.

15. Journalize and post the adjusting entry for federal income tax payable.
16. Complete the adjusted trial balance.
17. Prepare an income statement for the current year. Prepare a vertical analysis of each amount in the fourth column. Round calculations to the nearest 0.1%.
18. Prepare a statement of stockholders' equity. The company had 6,000 shares of \$10.00 par value common stock and no shares of \$50.00, 5% preferred stock outstanding on January 1. The company issued 500 shares of common stock and 300 shares of preferred stock during the year.
19. Prepare a balance sheet for the current year.
20. Use the Cash account and the information below to prepare a statement of cash flows for the current year.
- | | |
|--|----------------|
| Cash balance at the beginning of the period: | \$ 15,250.25 |
| Cash receipts during the year: | |
| Cash from sales | \$1,534,072.65 |
| Cash from interest | 875.00 |
| Cash from rent | 10,000.00 |
| Cash from sale of equipment | 33,000.00 |
| Cash from issuance of stock | 40,000.00 |
| Cash payments during the year: | |
| Cash payments during the year: | |
| Cash for inventory | \$1,024,273.20 |
| Cash for salaries and wages | 210,573.25 |
| Cash for insurance | 15,000.00 |
| Cash for interest | 6,851.23 |
| Cash for taxes | 16,412.88 |
| Cash for rent | 48,000.00 |
| Cash for other operating expenses | 174,585.94 |
| Cash for purchase of equipment | 25,500.00 |
| Cash for payment of bonds | 40,000.00 |
| Cash for payment of notes payable | 17,000.00 |
| Cash for payment of dividends | 30,000.00 |
21. Journalize and post the closing entries.
22. Prepare a post-closing trial balance.
23. Journalize and post the reversing entries.

End-of-Fiscal-Period Work for a Corporation: Century 21 Accounting

This company covers an online merchandising business organized as a corporation with its company offices in Bradenton, Florida. Digital Diversions sells televisions, cell phones, MP3 players, computers, video games, and other electronics goods.

The business sells merchandise for cash and also subscribes to a national credit card service. In addition, some sales are made on account to certain customers. In this simulation, you will do accounting work for Digital Diversions.

This real-life business simulation comes with source documents. It is available in manual and automated versions. The automated version is used with Automated Accounting Online software.

The following activities are included in this simulation:

- 1 Recording transactions in special journals from source documents.
- 2 Posting items to be posted individually to a general ledger and subsidiary ledger.
- 3 Posting column totals to a general ledger.
- 4 Preparing schedules of accounts receivable and accounts payable from subsidiary ledgers.
- 5 Preparing a trial balance on a work sheet.
- 6 Planning adjustments and completing a work sheet.
- 7 Preparing financial statements.
- 8 Journalizing and posting adjusting entries.
- 9 Journalizing and posting closing entries.
- 10 Preparing a post-closing trial balance.
- 11 Journalizing and posting reversing entries.
- 12 Completing the Think Like an Accountant Financial Analysis activities.