Chapter 4

Completing the Accounting Cycle

Study Guide Solutions

Fill-in-the-Blank Equations

1. Current assets
2. Current ratio
3. Temporary
4. Owner's Capital

Exercises

1. Which financial statement (income statement, balance sheet, or statement of owner's equity) would contain each of the following accounts?
    a. Income statement
    b. Statement of owner's equity
    c. Balance sheet
2. Which financial statement (income statement, balance sheet, or statement of owner's equity) would contain each of the following accounts?
    a. Balance sheet
    b. Income statement
    c. Statement of owner's equity and balance sheet
3. Which financial statement (income statement, balance sheet, or statement of owner's equity) would contain each of the following accounts?
    a. Statement of owner's equity
    b. Balance sheet
    c. Income statement

    Strategy: *Revenue and expense items will flow into the income statement. Asset, liability, and owner's accounts flow to the balance sheet. The owner's equity and drawing accounts flow to the statement of owner's equity.*

4. Nixon Corp. had rental revenue of $40,950. Fees for the year ended December 31, 20Y5, are as follows: Utilities Expense, $7,000; Salaries Expense, $15,300; Miscellaneous Expense, $2,000; and Rent Expense, $12,450. Prepare the company's income statement for the year.

Nixon Corp.
Income Statement
For the Year Ended December 31, 20Y5

Rental revenue		$40,950
Operating expenses:		
Salaries expense	$15,300	
Rent expense	12,450	
Utilities expense	7,000	
Miscellaneous expense	2,000	
Total operating expenses		36,750
Net income		$ 4,200

5. Green Duck earned fees of $64,300 during 20Y5. Its expenses for the year are as follows: Rent Expense, $15,000; Interest Expense, $2,480; Salaries Expense, $22,560; Utilities Expense, $3,900; and Insurance Expense, $12,750. Prepare the company's income statement if the fiscal year ends on June 30.

Green Duck
Income Statement
For the Year Ended June 30, 20Y5

Fees earned		$64,300
Operating expenses:		
Salaries expense	$22,560	
Rent expense	15,000	
Insurance expense	12,750	
Utilities expense	3,900	
Interest expense	2,480	
Total operating expenses		56,690
Net income		$ 7,610

6. Nicoletti & Parks, CPAs earned fees of $82,000 during 20Y5. For the year, it had the following expenses: Salaries Expense, $40,000; Interest Expense, $1,200; Supplies Expense, $2,300; Insurance Expense, $10,000; Advertising Expense, $2,500; and Depreciation Expense, $3,750. The company has a calendar year-end.

Nicoletti & Parks, CPAs
Income Statement
For the Year Ended December 31, 20Y5

Fees earned		$82,000
Operating expenses:		
Salaries expense	$40,000	
Insurance expense	10,000	
Depreciation expense	3,750	
Advertising expense	2,500	
Supplies expense	2,300	
Interest expense	1,200	
Total operating expenses		59,750
Net income		$22,250

Strategy: *Begin with the heading, which includes the company name, Income Statement title, and time period (for the year ended). First, list the revenues and total the amounts, if multiple. List the expenses in order from smallest to largest and total the amounts. Subtract the total expenses from the total revenue to find net income.*

7. During its first year of operations, beginning August 1, 20Y5, Lazy Day Chairs had contributions of $14,700 from its owner, Mike Milton. The company's net income was $2,300, and Mike made a withdrawal of $1,750. Prepare the statement of owner's equity if the company has a calendar year-end.

Lazy Day Chairs
Statement of Owner's Equity
For the Five Months Ended December 31, 20Y5

Mike Milton, capital, August 1, 20Y5		$ 0
Investment on August 1, 20Y5	$14,700	
Net income for August through December	2,300	
Withdrawals for August through December	(1,750)	
Increase in owner's equity		15,250
Mike Milton, capital, December 31, 20Y5		$15,250

8. Oak Tree Paper Company suffered a net loss of $3,200 during 20Y5. The company had beginning capital of $7,400 from Pat Peat, who also made contributions of $5,700 during the year. Pat made a withdrawal of $900 during the year. Prepare the company's statement of owner's equity for the year ended March 31, 20Y5.

Oak Tree Paper Company
Statement of Owner's Equity
For the Year Ended March 31, 20Y5

Pat Peat, capital, April 1, 20Y4		$7,400
Contributions for the year	$ 5,700	
Net loss for the year	(3,200)	
Withdrawals for the year	(900)	
Increase in owner's equity		1,600
Mike Milton, capital, March 31, 20Y5		$9,000

9. Mark Kinney made a contribution during 20Y5 to his proprietorship, Kinney Kare, of $1,250. The business suffered a net loss of $2,850 for the year. Mark did not make any withdrawals, but had a balance in his capital account of $9,300 at the beginning of the fiscal year on October 1, 20Y4. Prepare the statement of owner's equity for the year.

Kinney Kare
Statement of Owner's Equity
For the Year Ended September 30, 20Y5

Mark Kinney, capital, October 1, 20Y4		$ 9,300
Contributions for the year	$ 1,250	
Net loss for the year	(2,850)	
Withdrawals for the year	0	
Decrease in owner's equity		(1,600)
Mark Kinney, capital, September 30, 20Y5		$ 7,700

Strategy: *Begin with the title, which should include the company name, Statement of Owner's Equity title, and time period (for the year ended). First, show the beginning capital. Next, sum the contributions and net income (or subtract the net loss) and subtract the amount of withdrawals. Add or subtract this amount to the beginning capital to find the ending capital amount.*

10. Determine if each of the following accounts is a current asset, fixed asset, current liability, or long-term liability.

- **a.** Current liability
- **b.** Fixed asset
- **c.** Fixed asset

11. Determine if each of the following accounts is a current asset, fixed asset, current liability, or long-term liability.

- **a.** Current asset
- **b.** Current liability
- **c.** Current asset

12. Determine if each of the following accounts is a current asset, fixed asset, current liability, or long-term liability.

- **a.** Current liability
- **b.** Long-term liability
- **c.** Fixed asset

Strategy: *Current assets are short-term assets, while fixed assets are assets the company intends to hold for longer periods of time to generate income. Current liabilities are used for short-term financing, while long-term liabilities will not be repaid within the upcoming year.*

13. Red Boat Co. had the following assets: Machinery, $7,450; Cash, $1,300; Land, $11,500; Prepaid Expenses, $3,150; Accounts Receivable, $2,750; Inventory, $5,500; and a building, $13,000. At year-end, on June 30, 20Y5, Lara Middleton's capital account had a balance of $8,750. The company's only liabilities are: Long-Term Debt, $22,500; Accounts Payable, $5,950; and Accrued Expenses, $7,450. Prepare the company's balance sheet, distinguishing between current and long-term assets and liabilities.

Red Boat Co.
Balance Sheet
June 30, 20Y5

Assets		
Current assets:		
Cash	$ 1,300	
Accounts receivable	2,750	
Inventory	5,500	
Prepaid expenses	3,150	
Total current assets		$12,700
Property, plant, and equipment:		
Land	$11,500	
Building	13,000	
Machinery	7,450	
Total property, plant, and equipment		31,950
Total assets		$44,650
Liabilities		
Current liabilities:		
Accounts payable	$ 5,950	
Accrued expenses	7,450	
Total current liabilities		$13,400
Long-term debt		22,500
Total liabilities		$35,900
Owner's Equity		
Lara Middleton, capital		8,750
Total liabilities and owner's equity		$44,650

14. Melissa Burns had a capital account in Burns & Company totaling $ 12,280 by year-end. The company's only liabilities for the 20Y5 calendar year included Notes Payable, $18,750; Accounts Payable, $2,300; and Interest Payable, $1,500. The company's asset balances were as follows: Building, $12,000 with $900 in accumulated depreciation; Accounts Receivable, $1,300; Short-Term Investments, $1,980; Land, $18,700; and Cash, $1,750. Prepare the company's balance sheet.

Burns & Company
Balance Sheet
December 31, 20Y5

Assets			
Current assets:			
Cash		$ 1,750	
Accounts receivable		1,300	
Short-term investments		1,980	
Total current assets			$ 5,030
Property, plant, and equipment:			
Land		$18,700	
Building	$12,000		
Less accum. depr.	900	11,100	
Total property, plant, and equipment			29,800
Total assets			$34,830
Liabilities			
Current liabilities:			
Accounts payable		$ 2,300	
Interest payable		1,500	
Total current liabilities			$ 3,800
Notes payable			18,750
Total liabilities			$22,550
Owner's Equity			
Melissa Burns, capital			12,280
Total liabilities and owner's equity			$34,830

15. Brick Master has a September 30 year-end. At the end of 20Y5, the company's assets are as follows: Machinery, $15,700 with $1,600 accumulated depreciation; Prepaid Rent, $1,200; a building bought on September 30 for $16,500; Cash, $2,250; and Accounts Receivable, $3,150. The owner, Kathleen Dills, has a capital account balance of $6,150. The liabilities include Notes Payable, $22,700, which includes $3,200 due within the following year; Accounts Payable, $6,600; and Taxes Payable, $1,750. Prepare the company's balance sheet for the year-end.

Brick Master
Balance Sheet
September 30, 20Y5

Assets			
Current assets:			
Cash		$ 2,250	
Accounts receivable		3,150	
Prepaid rent		1,200	
Total current assets			$ 6,600
Property, plant, and equipment:			
Building		$16,500	
Machinery	$15,700		
Less accum. depr.	1,600	14,100	
Total property, plant, and equipment			30,600
Total assets			$37,200
Liabilities			
Current liabilities:			
Accounts payable		$ 6,600	
Current portion of long-term debt		3,200	
Taxes payable		1,750	
Total current liabilities			$11,550
Notes payable			19,500
Total liabilities			$31,050
Owner's Equity			
Kathleen Dills, capital			6,150
Total liabilities and owner's equity			$37,200

Strategy: *Begin with the heading, which includes the company name, Balance Sheet title, and the date of the balance sheet (you don't measure the changes in the account balances on the balance sheet). Separate the current assets and fixed assets, with current assets in order highest to lowest liquidity and total the amounts. Next, classify the liabilities as either current or long-term and total the amounts. Lastly, add the owner's equity to total liabilities and ensure the sum equals the total assets.*

16. Determine if the following accounts are considered temporary or permanent.

- **a.** Permanent
- **b.** Temporary
- **c.** Permanent

17. Determine if the following accounts are considered temporary or permanent.

- **a.** Temporary
- **b.** Temporary
- **c.** Permanent

18. Determine if the following accounts are considered temporary or permanent.

- **a.** Permanent
- **b.** Temporary
- **c.** Permanent

Strategy: *Temporary accounts are found on the income statement, while permanent accounts are on the balance sheet. A company finds its net income for each year, so the revenue and expense accounts must be closed each year in order to do so. Balance sheet amounts carry over into later years, for example a note payable, because it will still be held (owed) by the company until it is disposed (paid).*

19. Prepare the closing entry for Happy Smiles Corp. that had Sales Revenue of $55,200 and Interest Revenue of $4,200.

Sales Revenue	55,200	
Interest Revenue	4,200	
Owner's Capital		59,400

20. Happy Smiles Corp. incurred rent expense of $17,500, salaries expense of $18,950, utilities expense of $7,800, and interest expense of $750. Prepare the closing entries for these expenses.

Owner's Capital	45,000	
Rent Expense		17,500
Salaries Expense		18,950
Utilities Expense		7,800
Interest Expense		750

21. Prepare the closing entry for Christian Coco's drawing account, which had a balance of $8,900.

Christian Coco, Capital	8,900	
Christian Coco, Drawing		8,900

Strategy: *Closing entries include closing the revenue and expense accounts to Owner's Capital. To close the accounts, debit or credit for the account balance, whichever is opposite the normal balance and record the difference in the owner's capital account (net income will increase the amount by crediting the capital account and a net loss will decrease the amount by debiting the account). The drawing account is closed by decreasing (debiting) the capital account. Remembering normal balances is helpful when deciding to debit or credit an account in the closing process.*

22. Identify which items are steps in the accounting cycle.

a. Yes

b. Yes

c. No

d. Yes

23. Which steps in the accounting cycle are missing from the following list: Prepare financial statements, analyze transactions and record in the journal, journalize and post adjusting entries, prepare an adjusted trial balance, post transactions to the ledger, and assemble and analyze adjustment data?

Missing steps include: Prepare an unadjusted trial balance, prepare an optional end-of-period spreadsheet, journalize and post closing entries, and prepare a post-closing trial balance.

24. Put the following steps from the accounting cycle in order, including any missing steps and omitting any that are not a step in the accounting cycle. Prepare an end-of-period spreadsheet, post transactions to the ledger, prepare financial statements, prepare a post-closing trial balance, calculate ratios to analyze the financial statements, and journalize and post the closing entries.

In order: Analyze and record transactions in the journal, post transactions to the ledger, prepare an unadjusted trial balance, assemble and analyze adjustment data, prepare an end-of-period spreadsheet, journalize and post adjusting entries to the ledger, prepare an adjusted trial balance, prepare financial statements, journalize and post the closing entries to the ledger, and prepare a post-closing trial balance.

Strategy: *Thinking about the process of running a business is helpful when considering the steps in the accounting cycle. A company has activities for the year and must show those in transactions and ledgers. The unadjusted trial balance is a way to ensure amounts are in balance prior to adjusting entries. The adjusting entries must be calculated and recorded. The adjusted trial balance ensures amounts are in balance and no errors occurred when making the adjusting entries. The company must make financial statements from the balances. Closing entries should prepare the company for the next year, and the post-closing trial balance ensures that debits equal credits in the closing entries.*

25. Prepare the adjusting entries for each situation for Sibley Co., which began operations on September 1, 20Y5.

a.

Depreciation Expense	1,750	
Accumulated Depreciation—Machinery		1,750

b.

Unearned Membership Revenue	7,000	
Membership Revenue		7,000

c.

Legal Expense	1,890	
Legal Fees Payable		1,890

26. Prepare the closing entry for Sibley Co. when it earned membership revenues of $5,200 and rent revenue of $6,200, and it incurred startup expenses of $1,550, wages expense of $3,400, utilities expense of $1,900, and miscellaneous expense of $600.

Membership Revenue	5,200	
Rent Revenue	6,200	
Owner's Capital		11,400

Owner's Capital	7,450	
Organizational Expense		1,550
Wages Expense		3,400
Utilities Expense		1,900
Miscellaneous Expense		600

27. Prepare Sibley Co.'s post-closing trial balance. The company's accounts on December 31, 20Y5, include Cash, $900; Notes Payable, $965; Accounts Receivable, $1,500; Accounts Payable, $2,900; Janice Sibley, Capital, $2,185; Accrued Expenses, $2,400; Prepaid Expenses, $1,275; Machinery, $4,000, with $890 accumulated depreciation; and Land, $1,665.

Sibley Co.
Post-Closing Trial Balance
December 31, 20Y5

	Debit Balances	Credit Balances
Cash	900	
Accounts Receivable	1,500	
Prepaid Expenses	1,275	
Land	1,665	
Machinery	4,000	
Accumulated Depreciation		890
Accounts Payable		2,900
Accrued Expenses		2,400
Notes Payable		965
Janice Sibley, Capital		2,185
	9,340	9,340

Strategy: *The accounting cycle is used to ensure accuracy and efficiency of the information needed in a business. All steps are important to guarantee that the information is accurate.*

28. Franco Corporation began operations on August 1, 20Y5. The company adopts a fiscal year that begins September 1.

- **a.** August 1, 20Y5, to August 31, 20Y5
- **b.** September 1, 20Y5, to August 31, 20Y6

29. Ripa Co. adopts a fiscal year that ends March 31. It begins operations on August 1, 20Y5.

- **a.** August 1, 20Y5, to March 31, 20Y6
- **b.** April 1, 20Y6, to March 31, 20Y7

30. Dillman Pickle incorporates on July 2, 20Y5, and adopts a calendar year-end.

- **a.** July 2, 20Y5, to December 31, 20Y5
- **b.** January 1, 20Y6, to December 31, 20Y6

Strategy: *A fiscal year is 12 months that ends on the last day of the twelfth month. During the first year, the fiscal year may be a short year, starting with the date of incorporation and ending on the fiscal year-end.*

31. Given the following amounts, calculate the working capital.

- **a.** $195; ($480 – $285)
- **b.** $840; [($5,090 – $2,050) – $2,200]
- **c.** $1,100; [($8,450 – $2,600) – ($8,450 – $1,500 – $2,200)]

32. Calculate working capital for the companies in each situation.

	Company A	Company B	Company C
Current assets	$16,080	$12,000	$17,850
Fixed assets	13,300	10,900	5,400
Current liabilities	15,000	14,500	19,800
Long-term liabilities	9,500	4,900	2,200
Working capital	1,080	(2,500)	(1,950)

33. Using the balance sheet below, calculate working capital.

Current assets ($1,800 + $1,750 + $5,400 + $2,450) – Current liabilities ($4,500 + $3,400 + $1,600 + $1,300) = $600

Sharp Sharks
Balance Sheet
June 30, 20Y5

Assets	
Cash	$ 1,800
Marketable securities	1,750
Accounts receivable	5,400
Prepaid expenses	2,450
Property, plant, and equipment	18,050
Total assets	$29,450
Liabilities	
Accounts payable	$ 4,500
Unearned revenue	3,400
Accrued expenses	1,600
Current portion of long-term debt	1,300
Long-term debt	8,900
Owner's Equity	
Owner's equity	9,750
Total liabilities and owner's equity	$29,450

Strategy: *First, calculate current assets and current liabilities, if not directly given. Next, find the working capital by subtracting the current liabilities from current assets.*

34. With the following amounts, calculate the company's current ratio, rounding to two decimal places. Compare the ratios in each situation to determine which has the strongest position.

a. 1.34; ($17,500/$13,050)

b. 1.01; [($22,780 – $5,760)/$16,900]

c. 1.43; [$10,980/($17,900 – $10,200)]

The company in situation c. has the strongest position.

35. Calculate Bixby Corporation's current ratio with the following information, rounding to two decimal places. Determine if the company is in a stronger position in Year 1 or Year 2.

	Year 2	**Year 1**
Current assets	$ 6,500	$ 6,550
Fixed assets	11,000	15,000
Current liabilities	7,250	9,000
Long-term liabilities	9,500	12,000
Current ratio	0.90	0.73

The company is in a stronger position during Year 2.

36. Calculate the current ratio for each situation, rounding to two decimal places. Determine which company has the strongest position to pay current liabilities.

a. 0.64; ($1,780/$2,800)

b. 1.06; {$2,200/[($2,200 + $8,670) – $1,700 – $7,100]}

c. 0.37; [($3,500 + $2,700 + $1,900 – $6,800)/$3,500]

The company in situation b. has the strongest position.

Strategy: *First, calculate current assets and current liabilities if not directly given. Next, compute the current ratio by dividing current assets by current liabilities. The higher the current ratio, the better a position a company is in to pay its current liabilities with current assets.*