

EXAM REVIEW

ACCOUNTING 101 - UNIT 1 - CHAPTERS 1, 2 & 3

STUDY SUGGESTIONS

Review your class notes, homework exercises and problems.

Be sure to review any chapter appendices assigned on the General Course Outline.

Review **Demonstration Problem, Summary and Key Terms** at the end of each chapter.

Answer the **Multiple Choice Quiz** at the end of each chapter.

Answer **Multiple Choice Quiz A and B** on the textbook website www.mhhe.com/wild .

Know accounting terms and concepts by answering the **Discussion Questions** at the end of each chapter.

Know the account classification (i.e. asset, liability, or owner's equity) and normal balance of all accounts.

Know the what the financial ratios mean and how to calculate them.

Other online help is available ay a variety of sites such as:

<http://www.cliffsnotes.com/WileyCDA/Section/id-305261.html>

<http://www.simplestudies.com/>

Chapter 1 – Accounting in Business

Understand the **accounting equation** and its three basic elements.

Know how business transactions affect the three basic elements in the **accounting equation**.

Know which accounts are **income statement** accounts, how to prepare an income statement and how to calculate net income without preparing an income statement.

Know how to prepare a **retained earnings statement**.

Understand which accounts are **balance sheet** accounts and be able to prepare a balance sheet.

Chapter 2 – Accounting for Transactions

Know what a **journal** is and what it is used for.

Know what a **ledger** is and what it is used for.

Know what a **chart of accounts** is and what it is used for.

Know the rules of **Debit and Credit** and the **normal balances** of accounts:

Debit is the **left side** of an account and **Credit** is the **right side** of an account

	<u>Normal Balance</u>			<u>Normal Balance</u>	
	<u>Increase</u>	<u>Decrease</u>		<u>Increase</u>	<u>Decrease</u>
<u>Balance Sheet Accounts</u>			<u>Income Statement Accounts</u>		
Asset	Debit	Credit	Revenue	Credit	Debit
Liability	Credit	Debit	Expense	Debit	Credit
Owner's Equity					
Capital Stock	Credit	Debit			
Retained Earnings	Credit	Debit			
Dividends	Debit	Credit			

Know how to **journalize transactions**, including which accounts to debit and credit, for the various types of transactions.

Know how to prepare a **trial balance** and correct any errors.

Chapter 3 – Preparing Financial Statements

Understand the matching concept and how it relates to accrual accounting.

Know how to classify items as:

deferred expenses (prepaid expenses)

deferred revenues (unearned revenues)

accrued expenses (accrued liabilities)

accrued revenues (accrued assets)

Know how to journalize **adjusting entries** and understand their characteristics.

Know what the effects on the financial statements will be if adjusting entries are omitted.

Know how to journalize **closing entries**.

Understand the basic steps in the accounting cycle.

Know how to prepare a post-closing trial balance, which accounts should and should not appear on it and why it is a necessary step in the accounting cycle.

SAMPLE PROBLEMS

Problem 1 - Accounting Equation

James Morley is the sole stockholder and operator of Dynamic Business Solutions, Inc. a management consulting firm organized as a professional corporation. At the end of its accounting period, December 31, 1997, Dynamic Business Solutions has assets of \$100,000 and liabilities of \$75,000.

- a. What is owner's equity at December 31, 1997?
- b. What is owner's equity as of December 31, 1998, assuming that assets increased by \$25,000 and liabilities increased by \$15,000 during 1998?
- c. What is the increase or (decrease) in owner's equity for the year 1998?
- d. What is the net income (or net loss) for the year 1998 assuming that there were no additional investments in 1998 and that dividends of \$15,000 were paid in 1998.

Problem 2 - Changes in owner's equity

On the basis of the following information, determine the net income (or net loss) for the year, assuming that additional capital stock of \$25,000 was issued, and that no dividends were paid.

	Total Assets	Total Liabilities
Beginning of the year	\$500,000	\$200,000
End of the year	\$625,000	\$250,000

Problem 3 - Changes in owner's equity

On the basis of the following information, determine the net income (or net loss) for the year, assuming that capital stock of \$70,000 was issued, and dividends of \$45,000 were paid.

	Total Assets	Total Liabilities
Beginning of the year	\$425,000	\$165,000
End of the year	\$440,000	\$185,000

Problem 4 - Business transactions

Indicate the effect of each of the below transactions on the accounting equation and determine whether the transaction is:

1. an increase in an asset and an increase in a liability
2. an increase in a asset and an increase in owner's equity
3. an increase in an asset and a decrease in another asset
4. a decrease in an asset and a decrease in a liability
5. a decrease in an asset and a decrease in owner's equity

Transactions:

- a. Received cash for common stock
- b. Purchased supplies for cash
- c. Purchased equipment on account
- d. Billed customers for services on account
- e. Paid creditor on account
- f. Received cash from customers billed on account
- g. Paid rent for the month
- h. Received payment for services from cash customers
- i. Paid cash dividends

Problem 5 - Debits and Credits

Fill in the blanks with the word Debit or Credit

- a. The right side of an account is the _____ side.
- b. Asset accounts are increased by a _____.
- c. Liability accounts are decreased by a _____.
- d. Expense accounts are increased by a _____.
- e. The left side of an account is the _____ side.
- f. Revenue accounts are increased by a _____.
- g. Owner's equity is increased by a _____.
- h. The normal balance of an asset account is a _____.
- i. The normal balance of a liability account is a _____.
- j. The normal balance of the common stock account is a _____.
- k. The normal balance of the retained earnings account is a _____.
- l. The normal balance of revenue account is a _____.
- m. The normal balance of an expense account is a _____.
- n. The cash account is increased by a _____.

- o. The accounts payable account is increased by a _____.
- p. The dividend account is increased by a _____.
- q. The accounts receivable account is decreased by a _____.
- r. The common stock account is increased by a _____.
- s. The retained earnings account is decreased by a _____.
- t. The equipment account is increased by a _____.
- u. The sum of the debits must be _____ to the sum of the credits.

Problem 6 - Financial statements

Complete the following financial statements from the account balances of the Oakley Corporation for the month ended September 30, 1998, the first month of business. All account balances are normal balances.

Accounts Payable	\$ 500
Retained Earnings	-----
Rent Expense	1,000
Cash	10,025
Fees earned	16,500
Auto expense	1,350
Accounts receivable	5,350
Salaries expense	2,500
Supplies	1,275
Capital stock	10,000
Miscellaneous expense	150
Dividends	5,000
Supplies expense	350

Oakley Corporation
Income Statement

For the Month Ended September 30, 1998

Fees earned	\$
Operating Expenses:	
Rent expense	\$
Salaries expense	
Auto expense	
Supplies expense	
Miscellaneous expense	_____
Total operating expenses	_____
Net Income.....	\$ _____

Oakley Corporation
Retained Earnings Statement
For the Month Ended September 30, 1998

Net income for September .	\$
Less: Dividends	_____
Retained earnings, September 30, 1998	\$ <u>_____</u>

Oakley Corporation
Balance Sheet
September 30, 1998

<u>Assets</u>		<u>Liabilities</u>
Cash	\$	Accounts payable
Accounts receivable		
Supplies		<u>Stockholders' Equity</u>
		Capital stock
		Retained earnings
		Total liabilities and
Total assets.....	\$ <u>_____</u>	stockholders' equity
		\$ <u>_____</u>

Problem 7 - Journal Entries

In recording the following transactions, what account is debited, what account is credited?

- a. Issuance of common stock to a shareholder for cash.
- b. Payment of rent for the current month.
- c. Purchase of supplies on account.
- d. Payment to a creditor on account.
- e. Fees earned and billed to customers.
- f. Receipt of cash from customers previously billed on account.
- g. Payment of cash dividends to stockholders.
- h. Payment for a 3-year insurance policy.
- i. Incurred utilities expenses.
- j. Receipt of cash for services to be provided in the future.

Problem 8 - Retained Earnings

As of January 1, 1998 the retained earnings account had a credit balance of \$100,500. During the year, the Corporation had net income of \$58,500 and paid dividends of \$32,000. What is the balance of the retained earnings account at December 31, 1998?

Problem 9 - Classify accruals and deferrals

Classify the following items as **deferred expenses** (prepaid expenses), **deferred revenues** (unearned revenues), **accrued expenses** (accrued liabilities) or **accrued revenues** (accrued assets):

- a. The supplies account is an example of a _____.
- b. Tuition received by a college is an example of _____.
- c. Wages earned by employees but not yet paid are an example of an _____.
- d. A two year premium paid on a fire insurance policy is a _____.
- e. Fees earned but not yet recorded are an example of an _____.
- f. Property taxes for 1998 that are not due until February, 1999 are _____.
- g. Subscription payments received in advance by a newspaper are _____.
- h. An electric bill for July that is not due until August 7 is an _____.

Problem 10 - Adjusting entry for Supplies

The balance of the Supplies account before adjustment at the end of the year, is \$2,730. Journalize the adjusting entry required if the amount of supplies on hand at the end of the year is \$260.

Problem 11 - Adjusting entry for Unearned Fees

The balance of the Unearned Fees account before adjustment is \$7,300.

- a. Journalize the adjusting entry required if the amount of unearned fees at the end of the year is \$1,700.
- b. If the adjusting entry for unearned fees was not made, which items on the income statement and/or the balance sheet will be overstated or understated?

Problem 12 - Adjusting entry for Accrued Wages

Doctor Smith pays his staff weekly every Friday. The weekly wages average \$3,000. Journal the adjusting entry required if the accounting period ends on Wednesday.

Problem 13 - Effect of Omitting Adjusting entry for Accrued Wages

Doctor Jones, a professional corporation, owed his staff \$3,500 for wages earned but not yet paid on December 31. Which items on the income statement and/or the balance sheet will be overstated or understated?

Problem 14 - Adjusting entry for Depreciation

Bill Jorgenson, a landscape contractor, purchased a new truck on January 1, 1998 for \$25,000. The depreciation for 1998 is \$5,000.

- a. Journalize the adjusting entry to record the depreciation for 1998.
- b. What is the book value of the truck on December 31, 1998?
- c. If the adjusting entry for depreciation was not made, which items on the income statement and/or the balance sheet will be overstated or understated?

Problem 15 - Adjusting entries

Selected account balances at December 31, before year-end adjustments, were:

	<u>Debits</u>	<u>Credits</u>
Cash	12,780	
Accounts Receivable	11,250	
Supplies	4,750	
Prepaid Insurance	2,700	
Office Equipment	42,500	
Accumulated Depreciation		8,250
Salaries and Wages Payable		-----
Unearned Fees		6,250
Fees Earned		89,750
Salaries And Wages Expense	29,420	
Depreciation Expense.....	-----	
Supplies Expense.....	-----	
Insurance Expense.....	-----	

Data needed for year-end adjustments are as follows:

- a. Unbilled fees at December 31, \$3,650
- b. Supplies on hand at December 31, 1,275
- c. Insurance expired during the year, \$2,400
- d. Depreciation of office equipment for the year, \$2,750
- e. Unearned fees at December 31, \$1,250
- f. Salaries and wages earned but not paid at December 31, \$1,150

Journalize the adjusting entries required.

Problem 16 - Closing entries

The following is the trial balance of Arnold Corporation at December 31, 1997 after the year-end adjustments were made. Journalize the necessary closing entries

	<u>Debits</u>	<u>Credits</u>
Cash	13,750	
Accounts Receivable	10,250	
Supplies	1,250	
Prepaid Insurance	700	
Office Equipment	42,500	
Accumulated Depreciation		8,250
Accounts Payable		3,250
Salaries and Wages Payable		1,150
Unearned Fees		1,250
Capital Stock		25,000
Retained Earnings		27,050
Dividends	20,000	
Fees Earned		92,250
Salaries And Wages Expense	31,420	
Rent Expense	24,000	
Depreciation Expense	2,750	
Supplies Expense	3,475	
Insurance Expense	2,400	
Telephone Expense	2,700	
Utilities Expense	2,600	
Miscellaneous Expense	405	

Problem 17 - Permanent and Temporary Accounts

Circle the accounts below that are temporary and would be closed at the end of the accounting period.

- | | |
|-----------------------------------|-------------------|
| Accounts Payable | Fees Earned |
| Accumulated Depreciation-Building | Land |
| Capital Stock | Retained Earnings |
| Depreciation Expense-Building | Salaries Expense |
| Dividends | Salaries Payable |
| Equipment | Unearned Fees |
| Supplies Expense | Supplies |
| Interest Receivable | Prepaid Insurance |

SOLUTIONS TO SAMPLE PROBLEMS

Problem 1 - Accounting Equation

$$\text{Assets} - \text{liabilities} = \text{Owner's Equity}$$

- a. Owner's equity as of December 31, 1997 is \$25,000 (100,000 - 75,000 = 25,000)
- b. Owner's equity as of December 31, 1998 is \$35,000
 December 31, 1997: 100,000 - 75,000 = 25,000
 Change during 1998: $\frac{+25,000 - 15,000}{=} 10,000$
 December 31, 1998: 125,000 - 90,000 = 35,000
- c. The increase in owner's equity is \$10,000 (35,000 - 25,000 = 10,000)
- d. Net income for 1998 was \$25,000.
 Net Income - Dividends = Increase in Owner's Equity
 Net Income - \$15,000 = \$10,000
 Net Income = \$25,000

Problem 2 - Changes in owner's equity

	<u>Assets</u>	-	<u>Liabilities</u>	=	<u>Owner's Equity</u>
Beginning of the year	\$500,000		\$200,000		\$300,000
End of the year	\$625,000		\$250,000		\$375,000
Increase in Owner' Equity					\$ 75,000

$$\begin{aligned} \text{Net Income} + \text{Capital Stock Issued} - \text{Dividends} &= \text{Increase in Owner's equity} \\ \text{Net Income} + \quad \$25,000 \quad - \quad 0 &= \$75,000 \\ \text{Net Income} &= \$50,000 \end{aligned}$$

Problem 3 - Changes in owner's equity

	<u>Assets</u>	-	<u>Liabilities</u>	=	<u>Owner's Equity</u>
Beginning of the year	\$425,000		\$165,000		\$260,000
End of the year	\$440,000		\$185,000		\$255,000
Decrease in Owner' Equity					\$ (5,000)

$$\begin{aligned} \text{Net Income}(\text{net loss}) + \text{Additional Investment} - \text{Dividends} &= \text{Change in Owner's Equity} \\ \text{Net Income or (net loss)} + \$70,000 - \$45,000 &= (\$5,000) \\ \text{Net Loss} &= \$30,000 \end{aligned}$$

Problem 4 - Business transactions

- a. Received cash for common stock
 - 2. an increase in an asset and an increase in owner's equity
- b. Purchased supplies for cash
 - 3. an increase in an asset and a decrease in another asset
- c. Purchased equipment on account
 - 1. an increase in an asset and an increase in a liability
- d. Billed customers for services on account
 - 2. an increase in a asset and a increase in owner's equity
- e. Paid creditor on account
 - 4. a decrease in an asset and a decrease in a liability
- f. Received cash from customers on account
 - 3. an increase in an asset and a decrease in another asset
- g. Paid rent for the month
 - 5. a decrease in an asset and a decrease in owner's equity
- h. Received payment for services from cash customers
 - 2. an increase in an asset and an increase in owner's equity
- i. Paid cash dividends
 - 5. a decrease in an asset and a decrease in owner's equity

Problem 5 - Debits and Credits

- a. The right side of an account is the **credit** side.
- b. Asset accounts are increased by a **debit**.
- c. Liability accounts are decreased by a **debit**.
- d. Expense accounts are increased by a **debit**.
- e. The left side of an account is the **debit** side.
- f. Revenue accounts are increased by a **credit**.
- g. Owner's equity is increased by a **credit**.
- h. The normal balance of an asset account is a **debit**.
- i. The normal balance of a liability account is a **credit**.
- j. The normal balance of the common stock account is a **credit**.
- k. The normal balance of the retained earnings account is a **credit**.
- l. The normal balance of revenue account is a **credit**.
- m. The normal balance of an expense account is a **debit**.
- n. The cash account is increased by a **debit**.
- o. The accounts payable account is increased by a **credit**.
- p. The dividend account is increased by a **debit**.
- q. The accounts receivable account is decreased by a **credit**.
- r. The common stock account is increased by a **credit**.
- s. The retained earnings account is decreased by a **debit**.
- t. The equipment account is increased by a **debit**.
- u. The sum of the debits must be **equal** to the sum of the credits.

Problem 6 - Financial statements

Oakley Corporation
Income Statement

For the Month Ended September 30, 1998

Fees earned		\$16,500
Operating Expenses:		
Rent expense	1,000	
Salaries expense	2,500	
Auto expense	1,350	
Supplies expense	350	
Miscellaneous expense	<u>150</u>	
Total operating expenses		<u>5,350</u>
Net Income.....		<u>\$11,150</u>

Oakley Corporation

Retained Earnings Statement

For the Month Ended September 30, 1998

Net income for September .	\$11,150	
Less: Dividends	<u>5,000</u>	
Retained earnings, September 30, 1998		<u>\$ 6,150</u>

Oakley Corporation

Balance Sheet

September 30, 1998

<u>Assets</u>	<u>Liabilities</u>
Cash	Accounts payable
10,025	\$ 500
Accounts receivable .	
5,350	
Supplies	
1,275	
	<u>Stockholders' Equity</u>
	Capital stock
	\$10,000
	Retained earnings
	<u>6,150</u> <u>16,150</u>
	Total liabilities and
	stockholders' equity
	<u>\$16,650</u>
Total assets.....	
<u>\$16,650</u>	

Problem 7 - Journal Entries

In recording the following transactions, what account is debited, what account is credited?

- a. Issuance of common stock to a shareholder for cash is:

Cash	Debit	
Common Stock		Credit

- b. Payment of rent for the current month:

Rent Expense	Debit	
Cash		Credit

- c. Purchase of supplies on account:

Supplies	Debit	
Accounts Payable		Credit

- d. Payment to a creditor on account:

Accounts Payable	Debit	
Cash		Credit

- e. Fees earned and billed to customers:

Accounts Receivable	Debit	
Fees Earned		Credit

- f. Receipt of cash from customers previously billed on account:

Cash	Debit	
Accounts Receivable		Credit

- g. Payment of cash dividends to stockholders:

Dividends	Debit	
Cash		Credit

- h. Payment of a 3-year insurance policy.

Prepaid Insurance	Debit	
Cash		Credit

- i. Incurred utilities expenses.

Utilities Expense	Debit	
A/P		Credit

- j. Receipt of cash for services to be provided in the future.

Cash	Debit	
Unearned Fees		Credit

Problem 8 - Retained Earnings

The balance of the retained earnings account at December 31, 1998 is \$127,000.

$$(\$100,500 + \$58,500 - \$32,000 = \$127,000)$$

Problem 9 - Classify accruals and deferrals

- a. The supplies account is an example of a **deferred expense**.
- b. Tuition received by a college is an example of a **deferred revenue**.
- c. Wages earned by employees but not yet paid are an example of an **accrued expense**.
- d. A two year premium paid on a fire insurance policy is a **deferred expense or prepaid expense**.
- e. Fees earned but not yet recorded are an example of an **accrued revenue**.
- f. Property taxes for 1998 that are not due until February, 1999 are an **accrued expense**.
- g. Subscription payments received in advance by a newspaper are **deferred revenue or unearned revenue**.
- h. The electric bill for July that is not due for payment until August 7 is an **accrued expense**.

Problem 10 - Adjusting entry for Supplies

Supplies Expense	2,470	
Supplies		2,470

Problem 11 - Adjusting entry for Unearned Fees

- a. Adjusting entry required:

Unearned Fees	5,600	
Fees Earned		5,600

- b. If the above adjusting entry was not made
- revenue and net income on the income statement will be understated
 - on the balance sheet, liabilities will be overstated and both retained earnings and owner's equity will be understated.

Problem 12 - Adjusting entry for Accrued Wages

Wages Expense (3 days x \$600)	1,800	
Wages Payable		1,800

Problem 13 - Effect of Omitting Adjusting entry for Accrued Wages

If the adjusting entry for accrued wages was not made:

- wages expense will be understated and net income on the income statement will be overstated
- on the balance sheet, liabilities will be understated and both retained earnings and owner's equity will be overstated.

Problem 14 - Adjusting entry for Depreciation

a. The adjusting entry to record the depreciation for 1998:

Depreciation Expense	5,000	
Accumulated Depreciation		5,000

b. The book value of the truck on December 31, 1998 is \$20,000 (25,000 - 5,000)

c. If the adjusting entry for depreciation was not made:

- on the income statement, depreciation expense will be understated and net income will be overstated
- on the balance sheet, assets will be overstated and owner's equity will be overstated.

Problem 15 - Adjusting entries

Adjusting entries required:

a. Accounts Receivable	3,650	
Fees Earned		3,650
b. Supplies Expense	3,475	
Supplies		3,475
c. Insurance Expense	2,400	
Prepaid Insurance		2,400
d. Depreciation Expense	2,750	
Accumulated Depreciation		2,750
e. Unearned Fees	5,000	
Fees earned		5,000
f. Salaries and Wages Expense	1,150	
Salaries and Wages Payable		1,150

Problem 16 - Closing entries

Fees Earned	92,250	
Income Summary		92,250
Income Summary	69,750	
Salaries And Wages Expense		31,420
Rent Expense		24,000
Depreciation Expense		2,750
Supplies Expense		3,475
Insurance Expense		2,400
Telephone Expense		2,700
Utilities Expense		2,600
Miscellaneous Expense		405
Income Summary	22,500	
Retained Earnings		22,500
Retained Earnings	20,000	
Dividends		20,000

Problem 17 - Permanent and Temporary Accounts

The following accounts are temporary and would be closed:

- Depreciation Expense-Building
- Dividends
- Supplies Expense
- Fees Earned
- Salaries Expense