DYKSTRA COMPANY

Adjusted Trial Balance

For the Year Ended December 31, 2014

	Dr.	Cr.
Retained Earnings		11,000
Dividends	12,000	
Sales Revenue		$536,800
Sales Returns and Allowances	$ 6,700	
Sales Discounts	5,000	
Cost of Goods Sold	363,400	
Freight-Out	7,600	
Advertising Expense	12,000	
Salaries and Wages Expense	56,000	
Utilities Expense	18,000	
Rent Expense	24,000	
Depreciation Expense	9,000	
Insurance Expense	4,500	
Interest Expense	3,600	

DYKSTRA COMPANY

Adjusted Trial Balance

For the Year Ended December 31, 2014

	Dr.	Cr.
Interest Revenue		2,500
	$673,900	$673,900

Instructions

Prepare a multiple-step income statement for Dykstra Company. Assume a tax rate of 30 percent.

Action Plan

- In preparing the income statement, remember that the key components are net sales, cost of goods sold, gross profit, total operating expenses, other revenues and gains, other expenses and losses, income tax expense, and net income (loss). These components are reported in the right-hand column of the income statement.
- Present nonoperating items after income from operations.

Solution to Comprehensive Do it!

DYKSTRA COMPANY

Income Statement

For the Year Ended December 31, 2014

Sales		
Sales revenue		$536,800
Less: Sales returns and allowances	$ 6,700	
Sales discounts	5,000	11,700
Net sales		525,100

DYKSTRA COMPANY

Income Statement

For the Year Ended December 31, 2014

Cost of goods sold		363,400
Gross profit		161,700
Operating expenses		
Salaries and wages expense	56,000	
Rent expense	24,000	
Utilities expense	18,000	
Advertising expense	12,000	
Depreciation expense	9,000	
Freight-out	7,600	
Insurance expense	4,500	
Total operating expenses		131,100
Income from operations		30,600
Other revenues and gains		
Interest revenue		2,500
Other expenses and losses		

DYKSTRA COMPANY

Income Statement

For the Year Ended December 31, 2014

Interest expense	3,600
Income before income taxes	29,500
Income tax expense	8,850
Net income	$ 20,650

- **Self-Test, Brief Exercises, Exercises, Problem Set A, and many more resources are available for practice in WileyPLUS.**

Note: All Questions, Exercises, and Problems marked with an asterisk relate to material in the appendix to the chapter.

Self-Test Questions

Answers are on page 279.

1.

Which of the following statements about a periodic inventory system is **true**?

(LO 1)

- (a) Companies determine cost of goods sold only at the end of the accounting period.
- (b) Companies continuously maintain detailed records of the cost of each inventory purchase and sale.
- (c) The periodic system provides better control over inventories than a perpetual system.
- (d) The increased use of computerized systems has increased the use of the periodic system.

2.

Which of the following items does **not** result in an adjustment in the Inventory account under a perpetual system?

(LO 2)

- (a) A purchase of merchandise.
- (b) A return of merchandise to the supplier.
- (c) Payment of freight costs for goods shipped to a customer.
- (d) Payment of freight costs for goods received from a supplier.

3.

Which sales accounts normally have a debit balance?

(LO 3)

- (a) Sales discounts.
- (b) Sales returns and allowances.
- (c) Both (a) and (b).
- (d) Neither (a) nor (b).

4.

A company makes a credit sale of $750 on June 13, terms 2/10, n/30, on which it grants a return of $50 on June 16. What amount is received as payment in full on June 23?

(LO 3)

- (a) $700.
- (b) $686.
- (c) $685.
- (d) $650.

5.

To record the sale of goods for cash in a perpetual inventory system:

(LO 3)

- (a) only one journal entry is necessary to record cost of goods sold and reduction of inventory.
- (b) only one journal entry is necessary to record the receipt of cash and the sales revenue.
- (c) two journal entries are necessary: one to record the receipt of cash and sales revenue, and one to record the cost of goods sold and reduction of inventory.
- (d) two journal entries are necessary: one to record the receipt of cash and reduction of inventory, and one to record the cost of goods sold and sales revenue.

6.

Gross profit will result if:

(LO 4)

- (a) operating expenses are less than net income.
- (b) sales revenues are greater than operating expenses.
- (c) sales revenues are greater than cost of goods sold.
- (d) operating expenses are greater than cost of goods sold.

7.

If sales revenues are $400,000, cost of goods sold is $310,000, and operating expenses are $60,000, what is the gross profit?

(LO 4)

- (a) $30,000.
- (b) $90,000.
- (c) $340,000.
- (d) $400,000.

8.

The multiple-step income statement for a merchandising company shows each of these features **except**:

(LO 4)

- (a) gross profit.
- (b) cost of goods sold.
- (c) a sales section.
- (d) All of these are present.

9.

If beginning inventory is $60,000, cost of goods purchased is $380,000, and ending inventory is $50,000, what is cost of goods sold under a periodic system?

(LO 5)

- (a) $390,000.
- (b) $370,000.
- (c) $330,000.
- (d) $420,000.

10.

Bufford Corporation had reported the following amounts at December 31, 2014: sales revenue $184,000; ending inventory $11,600; beginning inventory $17,200; purchases $60,400; purchase discounts $3,000; purchase returns and allowances $1,100; freight-in $600; freight-out $900. Calculate the cost of goods available for sale.

(LO 5)

- (a) $69,400.
- (b) $74,100.
- (c) $56,900.
- (d) $197,700.

11.

Which of the following would affect the gross profit rate? (Assume sales remains constant.)

(LO 6)

- (a) An increase in advertising expense.
- (b) A decrease in depreciation expense.
- (c) An increase in cost of goods sold.
- (d) A decrease in insurance expense.

12.

The gross profit rate is equal to:

(LO 6)

- (a) net income divided by sales.
- (b) cost of goods sold divided by sales.
- (c) net sales minus cost of goods sold, divided by net sales.
- (d) sales minus cost of goods sold, divided by cost of goods sold.

13.

During the year ended December 31, 2014, Bjornstad Corporation had the following results: sales revenue $267,000; cost of good sold $107,000; net income $92,400; operating expenses $55,400; net cash provided by operating activities $108,950. What was the company's profit margin?

(LO 6)

- (a) 40%.
- (b) 60%.
- (c) 20.5%.
- (d) 34.6%.

14.

A quality of earnings ratio:

(LO 7)

- (a) is computed as net income divided by net cash provided by operating activities.
- (b) that is less than 1 indicates that a company might be using aggressive accounting tactics.
- (c) that is greater than 1 indicates that a company might be using aggressive accounting tactics.
- (d) is computed as net cash provided by operating activities divided by total assets.

***15.**

When goods are purchased for resale by a company using a periodic inventory system:

(LO 8)

- (a) purchases on account are debited to Inventory.
- (b) purchases on account are debited to Purchases.
- (c) purchase returns are debited to Purchase Returns and Allowances.
- (d) freight costs are debited to Purchases.

Go to the book's companion website, www.wiley.com/college/kimmel, to access additional Self-Test Questions.

The Navigator

Questions

1.

- (a) "The steps in the accounting cycle for a merchandising company differ from the steps in the accounting cycle for a service company." Do you agree or disagree?

- (b) Is the measurement of net income in a merchandising company conceptually the same as in a service company? Explain.

2.

How do the components of revenues and expenses differ between a merchandising company and a service company?

3.

Laurie Massoth, CEO of Bargain Den Stores, is considering a recommendation made by both the company's purchasing manager and director of finance that the company should invest in a sophisticated new perpetual inventory system to replace its periodic system. Explain the primary difference between the two systems, and discuss the potential benefits of a perpetual inventory system.

4.

- (a) Explain the income measurement process in a merchandising company.
- (b) How does income measurement differ between a merchandising company and a service company?

5.

Dillard Co. has sales revenue of $100,000, cost of goods sold of $70,000, and operating expenses of $18,000. What is its gross profit?

6.

Angie Milner believes revenues from credit sales may be recorded before they are collected in cash. Do you agree? Explain.

7.

- (a) What is the primary source document for recording (1) cash sales and (2) credit sales?
- (b) Using XXs for amounts, give the journal entry for each of the transactions in part (a), assuming perpetual inventory.

8.

A credit sale is made on July 10 for $900, terms 1/15, n/30. On July 12, the purchaser returns $100 of goods for credit. Give the journal entry on July 19 to record the receipt of the balance due within the discount period.

9.

As the end of Petit Company's fiscal year approached, it became clear that the company had considerable excess inventory. Ronald Morel, the head of marketing and sales, ordered salespeople to "add 20% more units to each order that you ship. The customers can always ship the extra back next period if they decide they don't want it. We've got to do it to meet this year's sales goal." Discuss the accounting implications of Ronald's action.

10.

To encourage bookstores to buy a broader range of book titles and to discourage price discounting, the publishing industry allows bookstores to return unsold books to the publisher. This results in very significant returns each year. To ensure proper recognition of revenues, how should publishing companies account for these returns?

11.

Goods costing $1,900 are purchased on account on July 15 with credit terms of 2/10, n/30. On July 18, the purchaser receives a $300 credit from the supplier for damaged goods. Give the journal entry on July 24 to record payment of the balance due within the discount period.

12.

Scribner Company reports net sales of $800,000, gross profit of $560,000, and net income of $230,000. What are its operating expenses?

13.

Luo Company has always provided its customers with payment terms of 1/10, n/30. Members of its sale force have commented that competitors are offering customers 2/10, n/45. Explain what these terms mean, and discuss the implications to Luo of switching its payment terms to those of its competitors.

14.

In its year-end earnings announcement press release, Brantley Corp. announced that its earnings increased by $15 million relative to the previous year. This represented a 20% increase. Inspection of its income statement reveals that the company reported a $20 million gain under “Other revenues and gains” from the sale of one of its factories. Discuss the implications of this gain from the perspective of a potential investor.

15.

Identify the distinguishing features of an income statement for a merchandising company.

16.

Why is the normal operating cycle for a merchandising company likely to be longer than for a service company?

17.

What title does Tootsie Roll use for gross profit? How did it present gross profit? By how much did its total gross profit change, and in what direction, in 2011?

18.

What merchandising account(s) will appear in the post-closing trial balance?

19.

What types of businesses are most likely to use a perpetual inventory system?

20.

Identify the accounts that are added to or deducted from purchases to determine the cost of goods purchased under a periodic system. For each account, indicate (a) whether it is added or deducted, and (b) its normal balance.

21.

In the following cases, use a periodic inventory system to identify the item(s) designated by the letters X and Y.

- (a) Purchases − X − Y = Net purchases.
- (b) Cost of goods purchased − Net purchases = X.
- (c) Beginning inventory + X = Cost of goods available for sale.
- (d) Cost of goods available for sale − Cost of goods sold = X.

22.

What two ratios measure factors that affect profitability?

23.

What factors affect a company's gross profit rate—that is, what can cause the gross profit rate to increase and what can cause it to decrease?

24.

Mark Elarton, director of marketing, wants to reduce the selling price of his company's products by 15% to increase market share. He says, "I know this will reduce our gross profit rate, but the increased number of units sold will make up for the lost margin." Before this action is taken, what other factors does the company need to consider?

25.

George Mallein is considering investing in Wigginton Pet Food Company. Wigginton's net income increased considerably during the most recent year even though many other companies in the same industry reported disappointing earnings. George wants to know whether the company's earnings provide a reasonable depiction of its results. What initial step can George take to help determine whether he needs to investigate further?

* 26.

On July 15, a company purchases on account goods costing $1,900, with credit terms of 2/10, n/30. On July 18, the company receives a $400 credit memo from the supplier for damaged goods. Give the journal entry on July 24 to record payment of the balance due within the discount period assuming a periodic inventory system.

Brief Exercises

BE5-1

Presented here are the components in Casilla Company's income statement. Determine the missing amounts.

Compute missing amounts in determining net income.

(LO 1, 4), **AP**

Sales Revenue	Cost of Goods Sold	Gross Profit	Operating Expenses	Net Income
$ 71,200	(b)	$ 30,000	(d)	$12,100
$108,000	$70,000	(c)	(e)	$29,500
(a)	$71,900	$109,600	$46,200	(f)

BE5-2

Gerish Company buys merchandise on account from Mangus Company. The selling price of the goods is $900 and the cost of the goods sold is $590. Both companies use perpetual inventory systems. Journalize the transactions on the books of both companies.

Journalize perpetual inventory entries.

(LO 2, 3), **AP**

BE5-3

Prepare the journal entries to record the following transactions on Horst Company's books using a perpetual inventory system.

Journalize sales transactions.

(LO 3), **AP**

- (a) On March 2, Horst Company sold $800,000 of merchandise to Bernadina Company, terms 2/10, n/30. The cost of the merchandise sold was $540,000.
- (b) On March 6, Bernadina Company returned $140,000 of the merchandise purchased on March 2. The cost of the merchandise returned was $94,000.
- (c) On March 12, Horst Company received the balance due from Bernadina Company.

BE5-4

From the information in **BE5-3**, prepare the journal entries to record these transactions on Bernadina Company's books under a perpetual inventory system.

Journalize purchase transactions.

(LO 2), **AP**

BE5-5

Alvarado Company provides this information for the month ended October 31, 2014: sales on credit $300,000; cash sales $150,000; sales discounts $5,000; and sales returns and allowances $19,000. Prepare the sales section of the income statement based on this information.

Prepare sales section of income statement.

(LO 4), **AP**

BE5-6

Explain where each of these items would appear on a multiple-step income statement: gain on disposal of plant assets; cost of goods sold; depreciation expense; and sales returns and allowances.

Identify placement of items on a multiple-step income statement.

(LO 4), **AP**

BE5-7

Sands Company sold goods with a total selling price of $800,000 during the year. It purchased goods for $380,000 and had beginning inventory of $67,000. A count of its ending inventory determined that goods on hand was $50,000. What was its cost of goods sold?

Determine cost of goods sold using basic periodic formula.

(LO 5), **AP**

BE5-8

Assume that Tracy Company uses a periodic inventory system and has these account balances: Purchases $404,000; Purchase Returns and Allowances $13,000; Purchase Discounts $9,000; and Freight-In $16,000. Determine net purchases and cost of goods purchased.

Compute net purchases and cost of goods purchased.

(LO 5), **AP**

BE5-9

Assume the same information as in **BE5-8** and also that Tracy Company has beginning inventory of $60,000, ending inventory of $90,000, and net sales of $612,000. Determine the amounts to be reported for cost of goods sold and gross profit.

Compute cost of goods sold and gross profit.

(LO 5), **C**

BE5-10

Durbin Corporation reported net sales of $250,000, cost of goods sold of $150,000, operating expenses of $50,000, net income of $32,500, beginning total assets of $520,000, and ending total assets of $600,000. Calculate each of the following values and explain what they mean: (a) profit margin and (b) gross profit rate.

Calculate profitability ratios.

(LO 6), **AP**

BE5-11

Barten Corporation reported net sales $800,000; cost of goods sold $520,000; operating expenses $210,000; and net income $68,000. Calculate the following values and explain what they mean: (a) profit margin and (b) gross profit rate.

Calculate profitability ratios.

(LO 6), AP

BE5-12

Moritz Corporation reported net income of $346,000, cash of $67,800, and net cash provided by operating activities of $221,200. What does this suggest about the quality of the company's earnings? What further steps should be taken?

Evaluate quality of earnings.

(LO 7), **C**

*** BE5-13**

Prepare the journal entries to record these transactions on Kimbrel Company's books using a periodic inventory system.

Journalize purchase transactions.

(LO 8), **AP**

- (a) On March 2, Kimbrel Company purchased $800,000 of merchandise from Pineda Company, terms 2/10, n/30.
- (b) On March 6, Kimbrel Company returned $95,000 of the merchandise purchased on March 2.
- (c) On March 12, Kimbrel Company paid the balance due to Pineda Company.

Do it! Review

Do it! 5-1

On October 5, Narveson Company buys merchandise on account from Rossi Company. The selling price of the goods is $5,000, and the cost to Rossi Company is $3,000. On October 8, Narveson returns defective goods with a selling price of $640 and a scrap value of $240. Record the transactions of Narveson Company, assuming a perpetual approach.

Record transactions of purchasing company.

(LO 2), **AP**

Do it! 5-2

Assume information similar to that in 5-1. That is: On October 5, Narveson Company buys merchandise on account from Rossi Company. The selling price of the goods is $5,000, and the cost to Rossi Company is $3,000. On October 8, Narveson returns defective goods with a selling price of $640 and a scrap value of $240. Record the transactions on the books of Rossi Company, assuming a perpetual approach.

Record transactions of selling company.

(LO 3), **AP**

Do it! 5-3

The following information is available for Vogt Corp. for the year ended December 31, 2014:

Prepare multiple-step income statement.

(LO 4), **AP**

Other revenues and gains	$ 12,700	Sales revenue	$592,000
Other expenses and losses	13,300	Operating expenses	186,000
Cost of goods sold	156,000	Sales returns and allowances	40,000

Prepare a multiple-step income statement for Vogt Corp. The company has a tax rate of 30%.

Do it! 5-4

Mountain Lake Corporation's accounting records show the following at year-end December 31, 2014:

Determine cost of goods sold using periodic system.

(LO 5), **AP**

Purchase Discounts	$ 5,900	Beginning Inventory	$31,720
Freight-In	8,400	Ending Inventory	27,950
Freight-Out	11,100	Purchase Returns and Allowances	3,600
Purchases	162,500		

Assuming that Mountain Lake Corporation uses the periodic system, compute (a) cost of goods purchased and (b) cost of goods sold.

Exercises

E5-1

This information relates to Crisp Co.

Journalize purchase transactions.

(LO 2), **AP**

- 1. On April 5, purchased merchandise from Frost Company for $28,000, terms 2/10, n/30.
- 2. On April 6, paid freight costs of $700 on merchandise purchased from Frost.
- 3. On April 7, purchased equipment on account for $30,000.

- 4. On April 8, returned $3,600 of April 5 merchandise to Frost Company.
- 5. On April 15, paid the amount due to Frost Company in full.

Instructions

- (a) Prepare the journal entries to record the transactions listed above on Crisp Co.'s books. Crisp Co. uses a perpetual inventory system.
- (b) Assume that Crisp Co. paid the balance due to Frost Company on May 4 instead of April 15. Prepare the journal entry to record this payment.

E5-2

Assume that on September 1, Office Depot had an inventory that included a variety of calculators. The company uses a perpetual inventory system. During September, these transactions occurred.

Journalize perpetual inventory entries.

(LO 2, 3), **AP**

Sept. 6	Purchased calculators from Dragoo Co. at a total cost of $1,650, terms n/30.
9	Paid freight of $50 on calculators purchased from Dragoo Co.
10	Returned calculators to Dragoo Co. for $66 credit because they did not meet specifications.
12	Sold calculators costing $520 for $690 to Fryer Book Store, terms n/30.
14	Granted credit of $45 to Fryer Book Store for the return of one calculator that was not ordered. The calculator cost $34.
20	Sold calculators costing $570 for $760 to Heasley Card Shop, terms n/30.

Instructions

Journalize the September transactions.

E5-3

The following transactions are for Solarte Company.

Journalize sales transactions.

(LO 3), **AP**

- 1. On December 3, Solarte Company sold $500,000 of merchandise to Rooney Co., terms 1/10, n/30. The cost of the merchandise sold was $330,000.
- 2. On December 8, Rooney Co. was granted an allowance of $25,000 for merchandise purchased on December 3.
- 3. On December 13, Solarte Company received the balance due from Rooney Co.

Instructions

- (a) Prepare the journal entries to record these transactions on the books of Solarte Company. Solarte uses a perpetual inventory system.
- (b) Assume that Solarte Company received the balance due from Rooney Co. on January 2 of the following year instead of December 13. Prepare the journal entry to record the receipt of payment on January 2.

E5-4

On June 10, Purcey Company purchased $9,000 of merchandise from Guyer Company, terms 3/10, n/30. Purcey pays the freight costs of $400 on June 11. Goods totaling $600 are returned to Guyer for credit on June 12. On June 19, Purcey Company pays Guyer Company in full, less the purchase discount. Both companies use a perpetual inventory system.

Journalize perpetual inventory entries.

(LO 2, 3), **AP**

Instructions

- (a) Prepare separate entries for each transaction on the books of Purcey Company.
- (b) Prepare separate entries for each transaction for Guyer Company. The merchandise purchased by Purcey on June 10 cost Guyer $5,000, and the goods returned cost Guyer $310.

E5-5

The adjusted trial balance of Hodges Company shows these data pertaining to sales at the end of its fiscal year, October 31, 2014: Sales Revenue $900,000; Freight-Out $14,000; Sales Returns and Allowances $22,000; and Sales Discounts $13,500.

Prepare sales section of income statement.

(LO 4), **AP**

Instructions

Prepare the sales section of the income statement.

E5-6

Presented below is information for Zhou Co. for the month of January 2014.

Prepare an income statement and calculate profitability ratios.

(LO 4, 6), **AP**

Cost of goods sold	$212,000	Rent expense	$ 32,000
Freight-out	7,000	Sales discounts	8,000
Insurance expense	12,000	Sales returns and allowances	20,000

Salaries and wages expense	60,000	Sales revenue	370,000

Instructions

- (a) Prepare an income statement using the format presented on page 245. Assume a 25% tax rate.
- (b) Calculate the profit margin and the gross profit rate.

E5-7

Financial information is presented here for two companies.

Compute missing amounts and calculate profitability ratios.

(LO 4, 6), **AP**

	Yanik Company	**Nunez Company**
Sales revenue	$90,000	?
Sales returns and allowances	?	$ 5,000
Net sales	84,000	100,000
Cost of goods sold	58,000	?
Gross profit	?	40,000
Operating expenses	14,380	?
Net income	?	17,000

Instructions

Yanik Company **Nunez Company**

- (a) Fill in the missing amounts. Show all computations.
- (b) Calculate the profit margin and the gross profit rate for each company.
- (c) Discuss your findings in part (b).

E5-8

In its income statement for the year ended December 31, 2014, Gavin Company reported the following condensed data.

Prepare multiple-step income statement and calculate profitability ratios.

(LO 4, 6), **AP**

Salaries and wages expense	$465,000	Loss on disposal of plant assets	$ 83,500
Cost of goods sold	987,000	Sales revenue	2,210,000
Interest expense	71,000	Income tax expense	25,000
Interest revenue	65,000	Sales discounts	160,000
Depreciation expense	310,000	Utilities expense	110,000

Instructions

- (a) Prepare a multiple-step income statement.
- (b) Calculate the profit margin and gross profit rate.
- (c) In 2013, Gavin had a profit margin of 5%. Is the decline in 2014 a cause for concern? (Ignore income tax effects.)

E5-9

Suppose in its income statement for the year ended June 30, 2014, The Clorox Company reported the following condensed data (dollars in millions).

Prepare multiple-step income statement and calculate profitability ratios.

(LO 4, 6), **C**

Salaries and wages expense	$ 460	Research and development expense	$ 114
Depreciation expense	90	Income tax expense	276
Sales revenue	5,730	Loss on disposal of plant assets	46
Interest expense	161	Cost of goods sold	3,104

Advertising expense	499	Rent expense	105
Sales returns and allowances	280	Utilities expense	60

Instructions

- (a) Prepare a multiple-step income statement.
- (b) Calculate the gross profit rate and the profit margin and explain what each means.
- (c) Assume the marketing department has presented a plan to increase advertising expenses by $340 million. It expects this plan to result in an increase in both net sales and cost of goods sold of 25%. (*Hint:* Increase both sales revenue and sales returns and allowances by 25%.) Redo parts (a) and (b) and discuss whether this plan has merit. (Assume a tax rate of 34%, and round all amounts to whole dollars.)

E5-10

The trial balance of Sanchez Company at the end of its fiscal year, August 31, 2014, includes these accounts: Beginning Inventory $18,700; Purchases $154,000; Sales Revenue $190,000; Freight-In $8,000; Sales Returns and Allowances $3,000; Freight-Out $1,000; and Purchase Returns and Allowances $5,000. The ending inventory is $21,000.

Prepare cost of goods sold section using periodic system.

(LO 5), **AP**

Instructions

Prepare a cost of goods sold section (periodic system) for the year ending August 31, 2014.

E5-11

Below is a series of cost of goods sold sections for companies A, L, N, and R.

Prepare cost of goods sold section using periodic system.

(LO 5), **AP**

	A	L	N	R
Beginning inventory	$ 250	$ 120	$ 700	$ (j)
Purchases	1,500	1,080	(g)	43,590
Purchase returns and allowances	80	(d)	290	(k)
Net purchases	(a)	1,040	7,410	42,290

	A	L	N	R
Freight-in	130	(e)	(h)	2,240
Cost of goods purchased	(b)	1,230	8,050	(l)
Cost of goods available for sale	1,800	1,350	(i)	49,530
Ending inventory	310	(f)	1,150	6,230
Cost of goods sold	(c)	1,230	7,600	43,300

Instructions

Fill in the lettered blanks to complete the cost of goods sold sections.

E5-12

Dorcas Corporation reported sales revenue of $257,000, net income of $45,300, cash of $9,300, and net cash provided by operating activities of $23,200. Accounts receivable have increased at three times the rate of sales during the last 3 years.

Evaluate quality of earnings.

(LO 7), **C**

Instructions

- (a) Explain what is meant by high quality of earnings.
- (b) Evaluate the quality of the company's earnings. Discuss your findings.
- (c) What factors might have contributed to the company's quality of earnings?

*** E5-13**

This information relates to Woodward Co.

Journalize purchase transactions.

(LO 8), **AP**

- 1. On April 5, purchased merchandise from Cozart Company for $27,000, terms 2/10, n/30.
- 2. On April 6, paid freight costs of $1,200 on merchandise purchased from Cozart Company.
- 3. On April 7, purchased equipment on account for $30,000.
- 4. On April 8, returned some of the April 5 merchandise to Cozart Company, which cost $3,600.
- 5. On April 15, paid the amount due to Cozart Company in full.

Instructions

- (a) Prepare the journal entries to record these transactions on the books of Woodward Co. using a periodic inventory system.
- (b) Assume that Woodward Co. paid the balance due to Cozart Company on May 4 instead of April 15. Prepare the journal entry to record this payment.

Exercises: Set B and Challenge Exercises

Visit the book's companion website, at www.wiley.com/college/kimmel, and choose the Student Companion site to access Exercise Set B and Challenge Exercises.

Problems: Set A

P5-1A

Waters Hardware Store completed the following merchandising transactions in the month of May. At the beginning of May, Waters' ledger showed Cash of $8,000 and Common Stock of $8,000.

Journalize, post, prepare partial income statement, and calculate ratios.

(LO 2, 3, 4, 6), **AP**

May	1	Purchased merchandise on account from Hauke Wholesale Supply for $8,000, terms 1/10, n/30.
	2	Sold merchandise on account for $4,400, terms 2/10, n/30. The cost of the merchandise sold was $3,300.
	5	Received credit from Hauke Wholesale Supply for merchandise returned $200.
	9	Received collections in full, less discounts, from customers billed on May 2.
	10	Paid Hauke Wholesale Supply in full, less discount.
	11	Purchased supplies for cash $900.
	12	Purchased merchandise for cash $3,100.
	15	Received $230 refund for return of poor-quality merchandise from supplier on cash purchase.
	17	Purchased merchandise from Friedrich Distributors for $2,500, terms 2/10, n/30.

19 Paid freight on May 17 purchase $250.

24 Sold merchandise for cash $5,500. The cost of the merchandise sold was $4,100.

25 Purchased merchandise from Fasteners Inc. for $800, terms 3/10, n/30.

27 Paid Friedrich Distributors in full, less discount.

29 Made refunds to cash customers for returned merchandise $124. The returned merchandise had cost $90.

31 Sold merchandise on account for $1,280, terms n/30. The cost of the merchandise sold was $830.

Waters Hardware's chart of accounts includes Cash, Accounts Receivable, Inventory, Supplies, Accounts Payable, Common Stock, Sales Revenue, Sales Returns and Allowances, Sales Discounts, and Cost of Goods Sold.

Instructions

- (a) Journalize the transactions using a perpetual inventory system.
- (b) Post the transactions to T-accounts. Be sure to enter the beginning cash and common stock balances.
- (c) Prepare an income statement through gross profit for the month of May 2014.

(c) Gross profit $2,828

- (d) Calculate the profit margin and the gross profit rate. (Assume operating expenses were $1,400.)

P5-2A

McCoy Warehouse distributes hardback books to retail stores and extends credit terms of 2/10, n/30 to all of its customers. During the month of June, the following merchandising transactions occurred.

Journalize purchase and sale transactions under a perpetual system.

(LO 2, 3), **AP**

June	1	Purchased books on account for $1,040 (including freight) from Carlin Publishers, terms 2/10, n/30.
	3	Sold books on account to the Goldschmidt bookstore for $1,200. The cost of the merchandise sold was $720.
	6	Received $40 credit for books returned to Carlin Publishers.
	9	Paid Carlin Publishers in full.
	15	Received payment in full from the Goldschmidt bookstore.

17 Sold books on account to Town Crier for $1,200. The cost of the merchandise sold was $730.

20 Purchased books on account for $720 from Good Book Publishers, terms 1/15, n/30.

24 Received payment in full from Town Crier.

26 Paid Good Book Publishers in full.

28 Sold books on account to Emporia Bookstore for $1,300. The cost of the merchandise sold was $780.

30 Granted Emporia Bookstore $130 credit for books returned costing $80.

Instructions

Journalize the transactions for the month of June for McCoy Warehouse, using a perpetual inventory system.

P5-3A

At the beginning of the current season on April 1, the ledger of Flint Hills Pro Shop showed Cash $2,500; Inventory $3,500; and Common Stock $6,000. The following transactions were completed during April 2014.

Journalize, post, and prepare trial balance and partial income statement.

(LO 2, 3, 4), **AP**

GLS

Apr. 5 Purchased golf bags, clubs, and balls on account from Akers Co. $1,500, terms 3/10, n/60.

7 Paid freight on Akers purchase $80.

9 Received credit from Akers Co. for merchandise returned $200.

10 Sold merchandise on account to members $1,340, terms n/30. The merchandise sold had a cost of $820.

12 Purchased golf shoes, sweaters, and other accessories on account from Palmer Sportswear $830, terms 1/10, n/30.

14 Paid Akers Co. in full.

17 Received credit from Palmer Sportswear for merchandise returned $30.

20 Made sales on account to members $810, terms n/30. The cost of the merchandise sold was $550.

21 Paid Palmer Sportswear in full.

27 Granted an allowance to members for clothing that did not fit properly $80.

30 Received payments on account from members $1,220.

The chart of accounts for the pro shop includes Cash, Accounts Receivable, Inventory, Accounts Payable, Common Stock, Sales Revenue, Sales Returns and Allowances, and Cost of Goods Sold.

Instructions

- (a) Journalize the April transactions using a perpetual inventory system.
- (b) Using T-accounts, enter the beginning balances in the ledger accounts and post the April transactions.
- (c) Prepare a trial balance on April 30, 2014.

(c) Tot. trial balance $8,150

- (d) Prepare an income statement through gross profit for the month of April 2014.

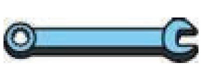
(d) Gross profit $ 700

P5-4A

Lambert Department Store is located in midtown Metropolis. During the past several years, net income has been declining because suburban shopping centers have been attracting business away from city areas. At the end of the company's fiscal year on November 30, 2014, these accounts appeared in its adjusted trial balance.

Prepare financial statements and calculate profitability ratios.

(LO 4, 6), **AP**



Accounts Payable	$ 26,800
Accounts Receivable	17,200
Accumulated Depreciation—Equipment	68,000
Cash	8,000

Common Stock	35,000
Cost of Goods Sold	614,300
Freight-Out	6,200
Equipment	157,000
Depreciation Expense	13,500
Dividends	12,000
Gain on Disposal of Plant Assets	2,000
Income Tax Expense	10,000
Insurance Expense	9,000
Interest Expense	5,000
Inventory	26,200
Notes Payable	43,500
Prepaid Insurance	6,000
Advertising Expense	33,500
Rent Expense	34,000
Retained Earnings	14,200
Salaries and Wages Expense	117,000
Sales Revenue	904,000
Salaries and Wages Payable	6,000

Sales Returns and Allowances	20,000

Utilities Expense	10,600

Additional data: Notes payable are due in 2018.

Instructions

- (a) Prepare a multiple-step income statement, a retained earnings statement, and a classified balance sheet.

(a) Net income	**$ 32,900**
Tot. assets	**$146,400**

- (b) Calculate the profit margin and the gross profit rate.
- (c) The vice president of marketing and the director of human resources have developed a proposal whereby the company would compensate the sales force on a strictly commission basis. Given the increased incentive, they expect net sales to increase by 15%. As a result, they estimate that gross profit will increase by $40,443 and expenses by $58,600. Compute the expected new net income. (*Hint:* You do not need to prepare an income statement.) Then, compute the revised profit margin and gross profit rate. Comment on the effect that this plan would have on net income and on the ratios, and evaluate the merit of this proposal. (Ignore income tax effects.)

P5-5A

An inexperienced accountant prepared this condensed income statement for Sundberg Company, a retail firm that has been in business for a number of years.

Prepare a correct multiple-step income statement.

(LO 4), **AP**

SUNDBERG COMPANY

Income Statement

For the Year Ended December 31, 2014

Revenues	
Net sales	$850,000
Other revenues	22,000
	872,000
Cost of goods sold	555,000

SUNDBERG COMPANY	
Income Statement	
For the Year Ended December 31, 2014	
Gross profit	317,000
Operating expenses	
Selling expenses	109,000
Administrative expenses	103,000
	212,000
Net earnings	$105,000

As an experienced, knowledgeable accountant, you review the statement and determine the following facts.

- 1. Net sales consist of sales $911,000, less freight-out on merchandise sold $33,000, and sales returns and allowances $28,000.
- 2. Other revenues consist of sales discounts $18,000 and rent revenue $4,000.
- 3. Selling expenses consist of salespersons' salaries $80,000; depreciation on equipment $10,000; advertising $13,000; and sales commissions $6,000. The commissions represent commissions paid. At December 31, $3,000 of commissions have been earned by salespersons but have not been paid. All compensation should be recorded as Salaries and Wages Expense.
- 4. Administrative expenses consist of office salaries $47,000; dividends $18,000; utilities $12,000; interest expense $2,000; and rent expense $24,000, which includes prepayments totaling $6,000 for the first quarter of 2015.

Instructions

Prepare a correct detailed multiple-step income statement. Assume a 25% tax rate.

Net income	**$67,500**

P5-6A

The trial balance of Customer Choice Wholesale Company contained the accounts shown at December 31, the end of the company's fiscal year.

Journalize, post, and prepare adjusted trial balance and financial statements.

(LO 4), **AP**

CUSTOMER CHOICE WHOLESALE COMPANY

Trial Balance

December 31, 2014

	Debit	Credit
Cash	$ 31,400	
Accounts Receivable	37,600	
Inventory	70,000	
Land	92,000	
Buildings	200,000	
Accumulated Depreciation—Buildings		$ 60,000
Equipment	83,500	
Accumulated Depreciation—Equipment		40,500
Notes Payable		54,700
Accounts Payable		17,500
Common Stock		160,000
Retained Earnings		67,200
Dividends	10,000	
Sales Revenue		$ 922,100
Sales Discounts	$ 6,000	

CUSTOMER CHOICE WHOLESALE COMPANY

Trial Balance

December 31, 2014

	Debit	Credit
Cost of Goods Sold	709,900	
Salaries and Wages Expense	51,300	
Utilities Expense	11,400	
Maintenance and Repairs Expense	8,900	
Advertising Expense	5,200	
Insurance Expense	4,800	
	$1,322,000	$1,322,000

Adjustment data:

- 1. Depreciation is $8,000 on buildings and $7,000 on equipment. (Both are operating expenses.)
- 2. Interest of $4,500 is due and unpaid on notes payable at December 31.
- 3. Income tax due and unpaid at December 31 is $24,000.

Other data: $15,000 of the notes payable are payable next year.

Instructions

- (a) Journalize the adjusting entries.
- (b) Create T-accounts for all accounts used in part (a). Enter the trial balance amounts into the T-accounts and post the adjusting entries.
- (c) Prepare an adjusted trial balance.

(c) Tot. trial balance $1,365,500

- (d) Prepare a multiple-step income statement and a retained earnings statement for the year, and a classified balance sheet at December 31, 2014.

(d) Net income $ 81,100

Tot. assets $ 399,000

P5-7A

At the end of Ermler Department Store's fiscal year on November 30, 2014, these accounts appeared in its adjusted trial balance.

Determine cost of goods sold and gross profit under a periodic system.

(LO 4, 5), **AP**

Freight-In	$ 5,060
Inventory (beginning)	41,300
Purchases	613,000
Purchase Discounts	7,000
Purchase Returns and Allowances	6,760
Sales Revenue	902,000
Sales Returns and Allowances	20,000

Additional facts:

- 1. Inventory on November 30, 2014, is $36,200.
- 2. Note that Ermler Department Store uses a periodic system.

Instructions

Prepare an income statement through gross profit for the year ended November 30, 2014.

Gross profit $272,600

P5-8A

Yang Inc. operates a retail operation that purchases and sells snowmobiles, among other outdoor products. The company purchases all inventory on credit and uses a periodic inventory system. The Accounts Payable account is used for recording inventory purchases only; all other current liabilities are accrued in separate accounts. You are provided with the following selected information for the fiscal years 2012 through 2015, inclusive.

Calculate missing amounts and assess profitability.

(LO 4, 5, 6), AN

	2012	2013	2014	2015
Income Statement Data				
Sales revenue		$96,890	$ (e)	$82,220
Cost of goods sold		(a)	28,060	26,490
Gross profit		67,800	59,620	(i)
Operating expenses		63,640	(f)	52,870
Net income		$ (b)	$ 3,510	$ (j)
Balance Sheet Data				
Inventory	$13,000	$ (c)	$14,700	$ (k)
Accounts payable	5,800	6,500	4,600	(l)
Additional Information				
Purchases of inventory on account		$25,890	$ (g)	$24,050
Cash payments to suppliers		(d)	(h)	24,650

Instructions

- (a) Calculate the missing amounts.
- (b) The vice presidents of sales, marketing, production, and finance are discussing the company’s results with the CEO. They note that sales declined over the 3-year fiscal period, 2013–2015. Does that mean that profitability necessarily also declined? Explain, computing the gross profit rate and the profit margin for each fiscal year to help support your answer.

* P5-9A

At the beginning of the current season on April 1, the ledger of Flint Hills Pro Shop showed Cash $2,500; Inventory $3,500; and Common Stock $6,000. The following transactions occurred during April 2014.

Journalize, post, and prepare trial balance and partial income statement under a periodic system.

(LO 5, 8), **AP**

GLS

Apr. 5	Purchased golf bags, clubs, and balls on account from Akers Co. $1,500, terms 3/10, n/60.
7	Paid freight on Akers Co. purchases $80.
9	Received credit from Akers Co. for merchandise returned $200.
10	Sold merchandise on account to members $1,340, terms n/30.
12	Purchased golf shoes, sweaters, and other accessories on account from Palmer Sportswear $830, terms 1/10, n/30.
14	Paid Akers Co. in full.
17	Received credit from Palmer Sportswear for merchandise returned $30.
20	Made sales on account to members $810, terms n/30.
21	Paid Palmer Sportswear in full.
27	Granted credit to members for clothing that did not fit properly $80.
30	Received payments on account from members $1,220.

The chart of accounts for the pro shop includes Cash, Accounts Receivable, Inventory, Accounts Payable, Common Stock, Sales Revenue, Sales Returns and Allowances, Purchases, Purchase Returns and Allowances, Purchase Discounts, and Freight-In.

Instructions

- (a) Journalize the April transactions using a periodic inventory system.
- (b) Using T-accounts, enter the beginning balances in the ledger accounts and post the April transactions.
- (c) Prepare a trial balance on April 30, 2014.

(c) Tot. trial balance $8,427

- (d) Prepare an income statement through gross profit, assuming inventory on hand at April 30 is $4,263.

(d) Gross profit $ 700

Problems: Set B

P5-1B

Krey Distributing Company completed these merchandising transactions in the month of April. At the beginning of April, the ledger of Krey showed Cash of $10,000 and Common Stock of $10,000.

Journalize, post, prepare partial income statement, and calculate ratios.

(LO 2, 3, 4, 6), **AP**

Apr. 2	Purchased merchandise on account from Am-Bev Co. $8,700, terms 2/10, n/30.
4	Sold merchandise on account $6,000, terms 2/10, n/30. The cost of the merchandise sold was $3,700.
5	Paid $200 freight on April 4 sale.
6	Received credit from Am-Bev Co. for merchandise returned $400.
11	Paid Am-Bev Co. in full, less discount.
13	Received collections in full, less discounts, from customers billed on April 4.
14	Purchased merchandise for cash $4,700.
16	Received refund from supplier for returned merchandise on cash purchase of April 14, $500.
18	Purchased merchandise from Lohr Distributors $5,500, terms 2/10, n/30.
20	Paid freight on April 18 purchase $180.

23 Sold merchandise for cash $8,300. The cost of the merchandise sold was $5,580.

26 Purchased merchandise for cash $2,300.

27 Paid Lohr Distributors in full, less discount.

29 Made refunds to cash customers for returned merchandise $180. The returned merchandise had a cost of $120.

30 Sold merchandise on account $3,980, terms n/30. The cost of the merchandise sold was $2,500.

Krey Distributing Company's chart of accounts includes Cash, Accounts Receivable, Inventory, Accounts Payable, Common Stock, Sales Revenue, Sales Returns and Allowances, Sales Discounts, Cost of Goods Sold, and Freight-Out.

Instructions

- (a) Journalize the transactions.
- (b) Post the transactions to T-accounts. Be sure to enter the beginning cash and common stock balances.
- (c) Prepare the income statement through gross profit for the month of April 2014.

(c) Gross profit $6,320

- (d) Calculate the profit margin and the gross profit rate. (Assume operating expenses were $3,000.)

P5-2B

Cosmotologist Warehouse distributes commercial hair care products in one-gallon bottles to hair salons and extends credit terms of 3/10, n/30 to all of its customers. During the month of April, the following merchandising transactions occurred.

Journalize purchase and sale transactions under a perpetual inventory system.

(LO 2, 3), **AP**

Apr. 1 Purchased 190 bottles on account for $6 each (including freight) from Luminous Hair, terms 2/10, n/30.

3 Sold 40 bottles on account to the Jane's Hair Salon for $10 each.

6 Received $90 credit for 15 bottles returned to Luminous Hair.

9 Paid Luminous Hair in full.

12 Received payment in full from the Jane's Hair Salon.

13 Sold 25 bottles on account to Luxury Salon for $12 each.

20 Purchased 200 bottles on account for $6 each from Blond Beauty, terms 1/15, n/30.

24 Received payment in full from Luxury Salon.

26 Paid Blond Beauty in full.

28 Sold 160 bottles on account to Beautiful Cuts salons for $10 each.

30 Granted Beautiful Cuts $120 credit for 12 bottles returned costing $72.

Instructions

Journalize the transactions for the month of April for Cosmotologist Warehouse, using a perpetual inventory system. Assume the cost of each bottle sold was $6.

P5-3B

At the beginning of the current season, the ledger of Connors' Tennis Shop showed Cash $3,500; Inventory $1,700; and Common Stock $5,200. The following transactions were completed during April 2014.

Journalize, post, and prepare trial balance and partial income statement.

(LO 2, 3, 4), **AP**

Apr. 4 Purchased racquets and balls from Rawlings Co. $980, terms 2/10, n/30.

6 Paid freight on Rawlings Co. purchase $60.

8 Sold merchandise to members $750, terms n/30. The merchandise sold cost $480.

10 Received credit of $130 from Rawlings Co. for damaged racquets that were returned.

11 Purchased tennis shoes from Fast Feet for cash $300.

13 Paid Rawlings Co. in full.

14 Purchased tennis shirts and shorts from Armour Sportswear $1,300, terms 3/10, n/60.

15 Received cash refund of $50 from Fast Feet for damaged merchandise that was returned.

17 Paid freight on Armour Sportswear purchase $60.

18 Sold merchandise to members $660, terms n/30. The cost of the merchandise sold was $440.

20 Received $500 in cash from members in partial settlement of their accounts.

21 Paid Armour Sportswear in full.

27 Granted an allowance of $30 to members for tennis clothing that did not fit properly.

30 Received cash payments on account from members $550.

The chart of accounts for the tennis shop includes Cash, Accounts Receivable, Inventory, Accounts Payable, Common Stock, Sales Revenue, Sales Returns and Allowances, and Cost of Goods Sold.

Instructions

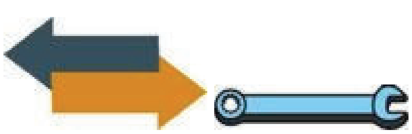
- (a) Journalize the April transactions using a perpetual inventory system.
- (b) Using T-accounts, enter the beginning balances in the ledger accounts and post the April transactions.
- (c) Prepare a trial balance on April 30, 2014.
- (d) Prepare an income statement through gross profit for the month of April 2014.

P5-4B

Parker Department Store is located near the Mark Twain Shopping Mall. At the end of the company's fiscal year on December 31, 2014, the following accounts appeared in its adjusted trial balance.

Prepare financial statements and calculate profitability ratios.

(LO 4, 6), **AP**



Accounts Payable	$ 73,300
Accounts Receivable	43,500
Accumulated Depreciation—Buildings	52,500
Accumulated Depreciation—Equipment	42,600

Buildings	140,000
Cash	30,000
Common Stock	140,000
Cost of Goods Sold	412,000
Depreciation Expense	23,400
Dividends	15,000
Equipment	100,000
Gain on Disposal of Plant Assets	4,300
Income Tax Expense	15,000
Insurance Expense	8,400
Interest Expense	7,000
Interest Payable	2,000
Inventory	43,000
Land	50,000
Mortgage Payable	62,500
Prepaid Insurance	2,400
Maintenance and Repairs Expense	6,200
Retained Earnings	19,200
Salaries and Wages Expense	111,000

Sales Revenue	626,000
Salaries and Wages Payable	3,500
Sales Returns and Allowances	8,000
Utilities Expense	11,000

Additional data: $20,000 of the mortgage payable is due for payment next year.

Instructions

- (a) Prepare a multiple-step income statement, a retained earnings statement, and a classified balance sheet.

(a) Net income	**$28,300**
Tot. assets	**$313,800**

- (b) Calculate the profit margin and the gross profit rate.
- (c) The vice president of marketing and the director of human resources have developed a proposal whereby the company would compensate the sales force on a strictly commission basis. Given the increased incentive, they expect net sales to increase by 25%. As a result, they estimate that gross profit will increase by $50,500 and expenses by $27,800. Compute the expected new net income. (*Hint:* You do not need to prepare an income statement.) Then, compute the revised profit margin and gross profit rate. Comment on the effect that this plan would have on net income and the ratios, and evaluate the merit of this proposal.

P5-5B

An inexperienced accountant prepared this condensed income statement for Wright Company, a retail firm that has been in business for a number of years.

Prepare a correct multiple-step income statement.

(LO 4), **AP**

WRIGHT COMPANY

Income Statement

For the Year Ended December 31, 2014

Revenues		
Net sales	$952,000	
Other revenues	16,000	

WRIGHT COMPANY

Income Statement

For the Year Ended December 31, 2014

	968,000
Cost of goods sold	548,000
Gross profit	420,000
Operating expenses	
Selling expenses	160,000
Administrative expenses	104,000
	264,000
Net earnings	$156,000

As an experienced, knowledgeable accountant, you review the statement and determine the following facts.

- 1. Net sales consist of sales $972,000, less freight-out on merchandise sold $20,000.
- 2. Other revenues consist of sales discounts $12,000 and interest revenue $4,000.
- 3. Selling expenses consist of salespersons' salaries $88,000; depreciation on equipment $4,000; sales returns and allowances $46,000; advertising $12,000; and sales commissions $10,000. All compensation should be recorded as Salaries and Wages Expense.
- 4. Administrative expenses consist of office salaries $54,000; dividends $14,000; utilities $13,000; interest expense $3,000; and rent expense $20,000, which includes prepayments totaling $2,000 for the first month of 2015. The utilities represent utilities paid. At December 31, utility expense of $3,000 has been incurred but not paid.

Instructions

Prepare a correct detailed multiple-step income statement.

Net income **$145,000**

P5-6B

The trial balance of Buse's Fashion Center contained the accounts below at November 30, the end of the company's fiscal year.

Journalize, post, and prepare adjusted trial balance and financial statements.

(LO 4), **AP**

BUSE'S FASHION CENTER

Trial Balance

November 30, 2014

	Debit	Credit
Cash	$ 37,700	
Accounts Receivable	33,700	
Inventory	43,000	
Supplies	8,800	
Equipment	143,000	
Accumulated Depreciation—Equipment		$ 41,000
Notes Payable		62,000
Accounts Payable		17,800
Common Stock		80,000
Retained Earnings		30,000
Dividends	12,000	
Sales Revenue		757,200
Sales Returns and Allowances	6,200	

BUSE'S FASHION CENTER

Trial Balance

November 30, 2014

	Debit	Credit
Cost of Goods Sold	505,400	
Salaries and Wages Expense	110,000	
Advertising Expense	26,400	
Utilities Expense	14,000	
Maintenance and Repairs Expense	12,100	
Freight-Out	11,700	
Rent Expense	24,000	___
	$988,000	$988,000

Adjustment data:

- 1. Store supplies on hand total $4,000.
- 2. Depreciation is $14,000 on the store equipment and $6,000 on the delivery equipment.
- 3. Interest of $4,400 is accrued on notes payable at November 30.
- 4. Income tax due and unpaid at November 30 is $3,000.

Other data: $24,000 of notes payable are due for payment next year.

Instructions

- (a) Journalize the adjusting entries.
- (b) Prepare T-accounts for all accounts used in part (a). Enter the trial balance amounts into the T-accounts and post the adjusting entries.
- (c) Prepare an adjusted trial balance.

(c) Tot. trial balance $1,015,400

- (d) Prepare a multiple-step income statement and a retained earnings statement for the year, and a classified balance sheet at November 30, 2014.

(d) Net income $15,200

Tot. assets $200,400

P5-7B

At the end of Alma's Department Store's fiscal year on December 31, 2014, these accounts appeared in its adjusted trial balance.

Determine cost of goods sold and gross profit under a periodic system.

(LO 4, 5), **AP**

Freight-In	$ 7,200
Inventory (beginning)	40,500
Purchases	456,000
Purchase Discounts	12,000
Purchase Returns and Allowances	6,400
Sales Revenue	702,000
Sales Returns and Allowances	8,000

Additional facts:

- 1. Inventory on December 31, 2014, is $48,300.
- 2. Note that Alma's Department Store uses a periodic system.

Instructions

Prepare an income statement through gross profit for the year ended December 31, 2014.

Gross profit $257,000

P5-8B

Sandy Melon operates a clothing retail operation. She purchases all inventory on credit and uses a periodic inventory system. The Accounts Payable account is used for recording inventory purchases only; all other current liabilities are accrued in separate accounts. You are provided with the following selected information for the fiscal years 2012, 2013, 2014, and 2015.

Calculate missing amounts and assess profitability.

(LO 4, 5, 6), **AN**

	2012	**2013**	**2014**	**2015**
Inventory (ending)	$16,000	$ 11,300	$ 16,400	$ 14,200
Accounts payable (ending)	17,000			
Sales revenue		229,700	227,600	220,000
Purchases of inventory on account		146,900	155,700	139,200
Cash payments to suppliers		135,900	159,000	127,000

Instructions

- (a) Calculate cost of goods sold for each of the 2013, 2014, and 2015 fiscal years.

2012 **2013** **2014** **2015**

(a) 2014 $150,600

- (b) Calculate the gross profit for each of the 2013, 2014, and 2015 fiscal years.
- (c) Calculate the ending balance of accounts payable for each of the 2013, 2014, and 2015 fiscal years.

(c) 2014 $24,700

- (d) The vice presidents of sales, marketing, production, and finance are discussing the company's results with the CEO. They note that sales declined in fiscal 2015. They wonder whether that means that profitability, as measured by the gross profit rate, necessarily also declined. Explain, calculating the gross profit rate for each fiscal year to help support your answer.

*** P5-9B**

At the beginning of the current season on November 1, the ledger of Winona Sports showed Cash $3,300, Inventory $4,700, and Common Stock $8,000. The following transactions occurred during November 2014.

Journalize, post, and prepare trial balance and partial income statement under a periodic system.

(LO 5, 8), **AP**

Nov.	5	Purchased hockey sticks and pucks on account from Hi-Stick Co. $1,600, terms 2/10, n/60.
	7	Paid freight on Hi-Stick Co. purchases $90.
	9	Received credit from Hi-Stick Co. for merchandise returned $350.
	10	Sold merchandise on account for $1,000, terms n/30.
	12	Purchased gloves, socks, and other accessories on account from Twin City Sportswear $945, terms 1/10, n/30.
	14	Paid Hi-Stick Co. in full.
	17	Received credit from Twin City Sportswear for merchandise returned $45.
	20	Made sales on account for $1,330, terms n/30.
	21	Paid Twin City Sportswear in full.
	27	Granted credit to customers for clothing that did not fit properly $150.
	30	Received payments on account for $1,900.

The chart of accounts for Winona Sports includes Cash, Accounts Receivable, Inventory, Accounts Payable, Common Stock, Sales Revenue, Sales Returns and Allowances, Purchases, Purchase Returns and Allowances, Purchase Discounts, and Freight-In.

Instructions

- (a) Journalize the November transactions using a periodic inventory system.
- (b) Using T-accounts, enter the beginning balances in the ledger accounts and post the November transactions.
- (c) Prepare a trial balance on November 30, 2014.

(c) Tot. trial balance $10,759

- (d) Prepare an income statement through Gross profit, assuming inventory on hand at November 30 is $5,196.

(d) Net income $470

Problems: Set C

Visit the book's companion website, at www.wiley.com/college/kimmel, and choose the Student Companion site to access Problem Set C.

Comprehensive Problem

CP5

On December 1, 2014, Boline Distributing Company had the following account balances.

	Debit		Credit
Cash	$ 7,200	Accumulated Depreciation—Equipment	$ 2,200
Accounts Receivable	4,600		
Inventory	12,000	Accounts Payable	4,500
Supplies	1,200	Salaries and Wages Payable	1,000
Equipment	22,000	Common Stock	15,000
	$47,000	Retained Earnings	24,300
			$47,000

Debit Credit

During December, the company completed the following summary transactions.

Dec.	6	Paid $1,600 for salaries due employees, of which $600 is for December and $1,000 is for November salaries payable.
	8	Received $1,900 cash from customers in payment of account (no discount allowed).
	10	Sold merchandise for cash $6,300. The cost of the merchandise sold was $4,100.
	13	Purchased merchandise on account from Gong Co. $9,000, terms 2/10, n/30.
	15	Purchased supplies for cash $2,000.

18 Sold merchandise on account $12,000, terms 3/10, n/30. The cost of the merchandise sold was $8,000.

20 Paid salaries $1,800.

23 Paid Gong Co. in full, less discount.

27 Received collections in full, less discounts, from customers billed on December 18.

Adjustment data:

- 1. Accrued salaries payable $800.
- 2. Depreciation $200 per month.
- 3. Supplies on hand $1,500.
- 4. Income tax due and unpaid at December 31 is $200.

Instructions

- (a) Journalize the December transactions using a perpetual inventory system.
- (b) Enter the December 1 balances in the ledger T-accounts and post the December transactions. Use Cost of Goods Sold, Depreciation Expense, Salaries and Wages Expense, Sales Revenue, Sales Discounts, Supplies Expense, Income Tax Expense, and Income Taxes Payable.
- (c) Journalize and post adjusting entries.
- (d) Prepare an adjusted trial balance.

(d) Totals $65,500

- (e) Prepare an income statement and a retained earnings statement for December and a classified balance sheet at December 31.

(e) Net income $540

Continuing Cookie Chronicle

(*Note:* This is a continuation of the Cookie Chronicle from Chapters 1 through 4.)

CCC5

Because Natalie has had such a successful first few months, she is considering other opportunities to develop her business. One opportunity is to become the exclusive distributor of a line of fine European mixers. Natalie comes to you for advice on how to account for these mixers.

Go to the book's companion website, at **www.wiley.com/college/kimmel**, to see the completion of this problem.

Broadening Your Perspective

Financial Reporting and Analysis

FINANCIAL REPORTING PROBLEM: *Tootsie Roll Industries, Inc.*

BYP5-1

The financial statements for Tootsie Roll Industries appear in Appendix A at the end of this textbook.

Instructions

Answer these questions using the Consolidated Income Statement.

- (a) What was the percentage change in total revenue and in net income from 2010 to 2011?
- (b) What was the profit margin in each of the 3 years? (Use "Total Revenue.") Comment on the trend.
- (c) What was Tootsie Roll's gross profit rate in each of the 3 years? (Use "Net Product Sales" amounts.) Comment on the trend.

COMPARATIVE ANALYSIS PROBLEM: *Tootsie Roll vs. Hershey*

BYP5-2

The financial statements of The Hershey Company appear in Appendix B, following the financial statements for Tootsie Roll in Appendix A.

Instructions

- (a) Based on the information contained in these financial statements, determine the following values for each company.
  - (1) Profit margin for 2011. (For Tootsie Roll, use “Total Revenue.”)
  - (2) Gross profit for 2011. (For Tootsie Roll, use “Product” amounts.)
  - (3) Gross profit rate for 2011. (For Tootsie Roll, use “Product” amounts.)
  - (4) Operating income for 2011.
  - (5) Percentage change in operating income from 2011 to 2010.
- (b) What conclusions concerning the relative profitability of the two companies can be drawn from these data?

RESEARCH CASE

BYP5-3

The February 21, 2012, edition of the *New York Times* contains an article by Stephanie Clifford entitled “High-End Retailers Report Strong Profits, but Wal-Mart Still Struggles.”

Instructions

Read the article and answer the following questions.

- (a) Explain why Wal-Mart’s gross profit margin fell even though its total sales revenue increased.
- (b) Saks Fifth Avenue experienced an increase in its gross profit rate for the year. What factors contributed to this increase?
- (c) Macy’s experienced a decline in its gross profit rate. The article said that the decline could be attributed to two factors: a free-shipping promotion and markdowns on cold-weather gear. Discuss whether this explanation is consistent with what you learned in this chapter about the financial presentation of these items in the income statement.
- (d) The article mentions that Home Depot experienced increases in “same store sales.” What does “increase in same store sales” mean? What implications does an increase in same store sales have for the profit margin?

INTERPRETING FINANCIAL STATEMENTS

BYP5-4

Recently, it was announced that two giant French retailers, Carrefour SA and Promodes SA, would merge. A headline in the *Wall Street Journal* blared, “French Retailers Create New Wal-Mart Rival.” While Wal-Mart’s total sales would still exceed those of the combined company, Wal-Mart’s international sales are far less than those of the combined company. This is a serious concern for Wal-Mart, since its primary opportunity for future growth lies outside of the United States.

Below are basic financial data for the combined corporation (in euros) and Wal-Mart (in U.S. dollars). Even though their results are presented in different currencies, by employing ratios we can make some basic comparisons.

	Carrefour (in millions)	**Wal-Mart (in millions)**
Sales revenue	€70,486	$256,329
Cost of goods sold	54,630	198,747
Net income	1,738	9,054
Total assets	39,063	104,912
Current assets	14,521	34,421
Current liabilities	13,660	37,418
Total liabilities	29,434	61,289

Instructions

Compare the two companies by answering the following.

- (a) Calculate the gross profit rate for each of the companies, and discuss their relative abilities to control cost of goods sold.
- (b) Calculate the profit margin, and discuss the companies' relative profitability.
- (c) Calculate the current ratio and debt to assets ratios for the two companies, and discuss their relative liquidity and solvency.
- (d) What concerns might you have in relying on this comparison?

REAL-WORLD FOCUS

BYP5-5

Purpose: No financial decision-maker should ever rely solely on the financial information reported in the annual report to make decisions. It is important to keep abreast of financial news. This activity demonstrates how to search for financial news on the Internet.

Address: **http://biz.yahoo.com/i**, or go to www.wiley.com/college/kimmel

Steps

- 1. Type in either Wal-Mart, Target Corp., or Kmart.
- 2. Choose **News**.
- 3. Select an article that sounds interesting to you and that would be relevant to an investor in these companies.

Instructions

- (a) What was the source of the article (e.g., Reuters, Businesswire, Prnewswire)?
- (b) Assume that you are a personal financial planner and that one of your clients owns stock in the company. Write a brief memo to your client summarizing the article and explaining the implications of the article for their investment.

Critical Thinking

DECISION-MAKING ACROSS THE ORGANIZATION

BYP5-6

Three years ago, Sue Kienholz and her brother-in-law Jeremy Reyes opened Megamart Department Store. For the first 2 years, business was good, but the following condensed income statement results for 2014 were disappointing.

MEGAMART DEPARTMENT STORE

Income Statement

For the Year Ended December 31, 2014

Net sales		$700,000
Cost of goods sold		560,000
Gross profit		140,000
Operating expenses		
Selling expenses	$100,000	
Administrative expenses	20,000	
		120,000
Net income		$ 20,000

MEGAMART DEPARTMENT STORE

Income Statement

For the Year Ended December 31, 2014

Sue believes the problem lies in the relatively low gross profit rate of 20%. Jeremy believes the problem is that operating expenses are too high. Sue thinks the gross profit rate can be improved by making two changes. (1) Increase average selling prices by 15%; this increase is expected to lower sales volume so that total sales dollars will increase only 4%. (2) Buy merchandise in larger quantities and take all purchase discounts; these changes are expected to increase the gross profit rate from 20% to 25%. Sue does not anticipate that these changes will have any effect on operating expenses.

Jeremy thinks expenses can be cut by making these two changes. (1) Cut 2014 sales salaries of $60,000 in half and give sales personnel a commission of 2% of net sales. (2) Reduce store deliveries to one day per week rather than twice a week; this change will reduce 2014 delivery expenses of $40,000 by 40%. Jeremy feels that these changes will not have any effect on net sales.

Sue and Jeremy come to you for help in deciding the best way to improve net income.

Instructions

With the class divided into groups, answer the following.

- (a) Prepare a condensed income statement for 2015 assuming (1) Sue's changes are implemented and (2) Jeremy's ideas are adopted.
- (b) What is your recommendation to Sue and Jeremy?
- (c) Prepare a condensed income statement for 2015 assuming both sets of proposed changes are made.
- (d) Discuss the impact that other factors might have. For example, would increasing the quantity of inventory increase costs? Would a salary cut affect employee morale? Would decreased morale affect sales? Would decreased store deliveries decrease customer satisfaction? What other suggestions might be considered?

COMMUNICATION ACTIVITY

BYP5-7

The following situation is presented in chronological order.

- 1. Shafer decides to buy a surfboard.
- 2. He calls Surfing USA Co. to inquire about their surfboards.
- 3. Two days later, he requests Surfing USA Co. to make him a surfboard.
- 4. Three days later, Surfing USA Co. sends him a purchase order to fill out.
- 5. He sends back the purchase order.
- 6. Surfing USA Co. receives the completed purchase order.
- 7. Surfing USA Co. completes the surfboard.
- 8. Shafer picks up the surfboard.
- 9. Surfing USA Co. bills Shafer.
- 10. Surfing USA Co. receives payment from Shafer.

Instructions

In a memo to the president of Surfing USA Co., answer the following questions.

- (a) When should Surfing USA Co. record the sale?
- (b) Suppose that with his purchase order, Shafer is required to make a down payment. Would that change your answer to part (a)?

ETHICS CASE

BYP5-8

Andrea Tabares was just hired as the assistant treasurer of Northshore Stores, a specialty chain store company that has nine retail stores concentrated in one metropolitan area. Among other things, the payment of all invoices is centralized in one of the departments Andrea will manage. Her primary responsibility is to maintain the company's high credit rating by paying all bills when due and to take advantage of all cash discounts.

William Parks, the former assistant treasurer, who has been promoted to treasurer, is training Andrea in her new duties. He instructs Andrea that she is to continue the practice of preparing all checks "net of discount" and dating the checks the last day of the discount period. "But," William continues, "we always hold the checks at least 4 days beyond the discount period before mailing them. That way we get another 4 days of interest on our money. Most of our creditors need our business and don't complain. And, if they scream about our missing the discount period, we blame it on the mail room or the post office. We've only lost one discount out of every hundred we take that way. I think everybody does it. By the way, welcome to our team!"

Instructions

- (a) What are the ethical considerations in this case?
- (b) What stakeholders are harmed or benefited?
- (c) Should Andrea continue the practice started by William? Does she have any choice?

ALL ABOUT YOU

BYP5-9

There are many situations in business where it is difficult to determine the proper period in which to record revenue. Suppose that after graduation with a degree in finance, you take a job as a manager at a consumer electronics store called Midwest Electronics. The company has expanded rapidly in order to compete with Best Buy.

Midwest has also begun selling gift cards. The cards are available in any dollar amount and allow the holder of the card to purchase an item for up to 2 years from the time the card is purchased. If the card is not used during those 2 years, it expires.

Instructions

Answer the following questions.

At what point should the revenue from the gift cards be recognized? Should the revenue be recognized at the time the card is sold, or should it be recorded when the card is redeemed? Explain the reasoning to support your answers.

FASB CODIFICATION ACTIVITY

BYP5-10

If your school has a subscription to the FASB Codification, go to **http://aaahq.org/ascLogin.cfm** to log in and prepare responses to the following.

- (a) Access the glossary ("Master Glossary") to answer the following.
  - (1) What is the definition provided for inventory?
  - (2) What is a customer?
- (b) What guidance does the Codification provide concerning reporting inventories above cost?

Answers to Insight and Accounting Across the Organization Questions

p. 233 Morrow Snowboards Improves Its Stock Appeal Q: If a perpetual system keeps track of inventory on a daily basis, why do companies ever need to do a physical count? **A:** A perpetual system keeps track of all sales and purchases on a continuous basis. This provides a constant record of the number of units in the inventory. However, if employees make errors in recording sales or purchases, or if there is theft, the inventory value will not be correct. As a consequence, all companies do a physical count of inventory at least once a year.

p. 240 Should Costco Change Its Return Policy? Q: If a company expects significant returns, what are the implications for revenue recognition? **A:** If a company expects significant returns, it should make an adjusting entry at the end of the year to increase Sales Returns and Allowances by the estimated amount of sales returns. This is necessary so as not to overstate the amount of revenue recognized in the period.

p. 244 Disclosing More Details Q: Why have investors and analysts demanded more accuracy in isolating "Other gains and losses" from operating items? **A:** Greater accuracy in the classification of operating versus nonoperating

(“Other gains and losses”) items permits investors and analysts to judge the real operating margin, the results of continuing operations, and management's ability to control operating expenses.

p. 250 Selling Green Q: What is meant by “monetize environmental sustainability” for shareholders? **A:** By marketing green, not only does PepsiCo help the environment in the long run, but it also leads to long-term profitability as well. In other words, sound sustainability practices are good business and lead to sound financial results.

Answers to Self-Test Questions

1. a **2.** c **3.** c **4.** b (($750 – $ 50) × .98) **5.** c **6.** c **7.** b ($400,000 – $310,000) **8.** d **9.** a ($60,000 + $380,000 – $50,000) **10.** b ($17,200 + ($60,400 – $3,000 – $1,100 + $600)) **11.** c **12.** c **13.** d ($92,400 ÷ $267,000) **14.** b ***15.** b

A Look at IFRS

The basic accounting entries for merchandising are the same under both GAAP and IFRS. The income statement is a required statement under both sets of standards. The basic format is similar although some differences do exist.

LEARNING OBJECTIVE 9

Compare the accounting procedures for merchandising under GAAP and IFRS.

KEY POINTS

- • Under both GAAP and IFRS, a company can choose to use either a perpetual or a periodic system.
- • Inventories are defined by IFRS as held-for-sale in the ordinary course of business, in the process of production for such sale, or in the form of materials or supplies to be consumed in the production process or in the providing of services.
- • Under GAAP, companies generally classify income statement items by function. Classification by function leads to descriptions like administration, distribution, and manufacturing. Under IFRS, companies must classify expenses by either nature or function. Classification by nature leads to descriptions such as the following:

salaries, depreciation expense, and utilities expense. If a company uses the functional-expense method on the income statement, disclosure by nature is required in the notes to the financial statements.

- • Presentation of the income statement under GAAP follows either a single-step or multiple-step format. IFRS does not mention a single-step or multiple-step approach.
- • Under IFRS, revaluation of land, buildings, and intangible assets is permitted. The initial gains and losses resulting from this revaluation are reported as adjustments to equity, often referred to as **other comprehensive income**. The effect of this difference is that the use of IFRS results in more transactions affecting equity (other comprehensive income) but not net income.
- • *IAS 1*, "Presentation of Financial Statements," provides general guidelines for the reporting of income statement information. Subsequently, a number of international standards have been issued that provide additional guidance to issues related to income statement presentation.
- • Similar to GAAP, comprehensive income under IFRS includes unrealized gains and losses (such as those on certain types of investment securities) that are not included in the calculation of net income.
- • IFRS requires that two years of income statement information be presented, whereas GAAP requires three years.

LOOKING TO THE FUTURE

The IASB and FASB are working on a project that would rework the structure of financial statements. Specifically, this project will address the issue of how to classify various items in the income statement. A main goal of this new approach is to provide information that better represents how businesses are run. In addition, this approach draws attention away from just one number—net income. It will adopt major groupings similar to those currently used by the statement of cash flows (operating, investing, and financing), so that numbers can be more readily traced across statements. For example, the amount of income that is generated by operations would be traceable to the assets and liabilities used to generate the income. Finally, this approach would also provide detail, beyond that currently seen in most statements (either GAAP or IFRS), by requiring that line items be presented both by function and by nature. The new financial statement format was heavily influenced by suggestions from financial statement analysts.

IFRS PRACTICE

IFRS SELF-TEST QUESTIONS

1.

Which of the following would **not** be included in the definition of inventory under IFRS?

- (a) Photocopy paper held for sale by an office-supply store.
- (b) Stereo equipment held for sale by an electronics store.
- (c) Used office equipment held for sale by the human relations department of a plastics company.
- (d) All of the above would meet the definition.

2.

Which of the following would **not** be a line item of a company reporting costs by nature?

- (a) Depreciation expense.
- (b) Salaries expense.
- (c) Interest expense.
- (d) Manufacturing expense.

3.

Which of the following would **not** be a line item of a company reporting costs by function?

- (a) Administration.

- (b) Manufacturing
- (c) Utilities expense
- (d) Distribution.

4.

Which of the following statements is **false**?

- (a) IFRS specifically requires use of a multiple-step income statement.
- (b) Under IFRS, companies can use either a perpetual or periodic system.
- (c) The proposed new format for financial statements was heavily influenced by the suggestions of financial statement analysts.
- (d) The new income statement format will try to de-emphasize the focus on the "net income" line item.

5.

Under the new format for financial statements being proposed under a joint IASB/FASB project:

- (a) all financial statements would adopt headings similar to the current format of the balance sheet.
- (b) financial statements would be presented consistent with the way management usually run companies.
- (c) companies would be required to report income statement line items by function only.
- (d) the amount of detail shown in the income statement would decrease compared to current presentations.

IFRS CONCEPTS AND APPLICATION

IFRS5-1

Explain the difference between the "nature-of-expense" and "function-of-expense" classifications.

IFRS5-2

For each of the following income statement line items, state whether the item is a "by nature" expense item or a "by function" expense item.

- _____________ Cost of goods sold
- _____________ Depreciation expense
- _____________ Salaries and wages expense
- _____________ Selling expenses
- _____________ Utilities expense
- _____________ Delivery expense
- _____________ General and administrative expenses

IFRS5-3

Reinsch Company reported the following amounts (in euros) in 2014: Net income, €150,000; Unrealized gain related to revaluation of buildings, €10,000; and Unrealized loss on nontrading securities, €(35,000). Determine Reinsch's total comprehensive income for 2014.

INTERNATIONAL FINANCIAL REPORTING PROBLEM: *Zetar plc*

IFRS5-4

The financial statements of Zetar plc are presented in Appendix C. The company's complete annual report, including the notes to its financial statements, is available in the Investors section at **www.zetarplc.com**.

Instructions

Visit Zetar's corporate website and answer the following questions from Zetar's 2011 annual report.

- (a) Does Zetar use a multiple-step or a single-step income statement format? Explain how you made your determination.
- (b) Instead of "interest expense," what label does Zetar use for interest costs that it incurs?
- (c) What is the approximate tax rate of Zetar's "Tax on profit from continuing activities"?
- (d) Using the notes to the company's financial statements, explain what each of the following are:
  - (1) Adjusted results.
  - (2) One-off items.

Answers to IFRS Self-Test Questions

1. c **2.** d **3.** c **4.** a **5.** b

Remember

Remember to go back to The Navigator box on the chapter opening page and check off your completed work.

1

The "Anatomy of a Fraud" stories in this textbook are adapted from *Fraud Casebook: Lessons from the Bad Side of Business*, edited by Joseph T. Wells (Hoboken, NJ: John Wiley & Sons, Inc., 2007). Used by permission. The names of some of the people and organizations in the stories are fictitious, but the facts in the stories are true.