

From debits and credits to financials: a quick review of accounting

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ABSTRACT

This case facilitates a rapid understanding of the accounting process in motivated students. It explains, in simple English, the financial accounting model from start to finish without resorting to extensive explanations. This is a very practical, nuts and bolts approach, progressing rapidly from debits and credits, to the accounting model, to recording cash and accrual transactions in the accounts, to their reflection in the financial statements.

Using this case with a textbook has been successful with MBA students in a team-based program and eliminated the requirement for prerequisite coursework in accounting. The case also ensures that students have a common understanding of accounting to support more advanced subsequent coursework. For students who have completed an undergraduate accounting course, but do not use accounting in their career, the case provides a good review. It also allows students, who have extensive accounting knowledge, to help team members without an accounting background learn basic accounting concepts.

Keywords: accounting model, debits, credits, journal entries, financial statements

INTRODUCTION

It is commonly stated that accounting is the language of business (Wild, 2018), and that both managers and investors need to know accounting to read financial statements. But, what is meant by read the financial statements? What is meant by read the financial statements is the ability to analyze and interpret financial statements, within the context of business operations, in order to make sound business and investing decisions.

Accounting is the process by which business operations are tracked, recorded, accumulated, and presented in financial statements (Wild, 2018). In simple terms, financial statements present a picture of the business. They tell the story of the company: where it has been, where it is now, and where it is going. That is why accounting is the language of business. It is the method used to communicate a company's financial position (balance sheet), results of operations (income statement), and sources and uses of cash (cash flow statement).

The accounting process is computerized in most companies; however, it is critical to understand the process itself to know where the amounts and disclosures in the financial statements come from and what they mean. Without this understanding, financial information will be a black box and managers will be dependent on accounting and finance professionals to make many, if not most, management decisions.

This case is a first step in learning to effectively use financial information to make business and investing decisions. After completing this case, students will be ready to start reading, analyzing, and interpreting financial statements.

TWO THINGS TO MEMORIZE (ONLY TWO) --- EVERYTHING ELSE IS COMMON SENSE UNDERSTANDING OF BUSINESS TRANSACTIONS

The accounting language utilizes a very simple mathematical model. There is much confusion about the meaning and use of the basic components of the model: debit, credit, asset, liability, equity, revenue, and expense. Most people are familiar with these terms but are surprised to realize they are not quite sure about their meaning and use in the context of accounting. This confusion results in many finding the study of accounting to be intimidating, difficult, and/or extremely frustrating. By learning a few basic definitions, accounting becomes simple. Although many people believe that accounting requires a lot of memorization, there are two, and only two, things that must be memorized. The remainder of the accounting model, then, makes intuitive sense. Business transactions can be complex, but the basic accounting model is not. By understanding the accounting model, business transactions can be accounted for and properly reflected in the financial statements (Wild, 2018).

Start with one of the two things you need to memorize – debit. What does debit mean? Typical answers sometimes are increase, plus, or add and other times are decrease, minus, or subtract. While all those answers are correct some of the time, none are correct all the time. It is easy to see how this leads to a great deal of confusion. The first thing to memorize: debit simply means left (Wild, 2018). Put the number on the left. Debit is abbreviated DR.

DEBIT = LEFT
(Abbreviated DR) (Put it on the left side.)

A natural question is: what is the accounting term for right? Credit means right or put the number on the right (Wild, 2018). By knowing/remembering/memorizing that debit means left, it

is logical that credit must mean right. Always keep debits on the left and credits on the right. Credit is abbreviated CR.

CREDIT = RIGHT
(Abbreviated CR) (Put it on the right side.)

Accountants use phrases like double entry bookkeeping and balancing the books. These refer to the fact that every business transaction is represented by both debits and credits (double entry) and that debits must equal credits (balancing the books). This is very intuitive – when businesses or individuals transact business, they are making exchanges (transactions). In a transaction, the value of what is received is equal to the value of what is given up. Debits and credits reflect all business transactions in the financial statements.

DEBITS = CREDITS
(Left side) = (Right side)

The second thing to memorize – assets go on the left side (Wild, 2018). It is important to know that debit means left and assets go on the left are definitional, not logical, which is why those facts must be memorized. But once memorized, the basic accounting model is intuitive.

ASSETS ARE ON THE LEFT

THE ACCOUNTING MODEL

The accounting model – the elements of the financial statements – can now be defined. The basic accounting model represents the Balance Sheet (remember balancing the books?). The Balance Sheet is a picture, at a particular point in time, of the financial position of the business. It shows the relationships between the asset, liability, and equity accounts. The accounting model follows the two things to be memorized: debit means left and assets go on the left.

LEFT = RIGHT
DEBIT = CREDIT
ASSETS = LIABILITIES + EQUITY

By memorizing that assets are on the left, the fact that assets = liabilities + equity should be intuitive. Consider the total of all assets, either they are still being paid for (liabilities) or they are owned by the company (equity). From that it follows that assets must equal liabilities plus equity. Also, equity is net assets (assets minus liabilities) (Wild, 2018).

Accounting is all about accounts, which are labels that identify business transactions. A company can have as many, or as few, accounts as they need. A small business may have less than one hundred and a large company may have thousands.

Each business transaction is labeled with at least one debit and one credit (double entry). Those debits and credits are summarized in the accounts. Assets (what is owned by the business), liabilities (what is owed by the business), and equities (the owners share of the business) are the accounts reported on the Balance Sheet.

However, businesses are not stagnant; they operate to earn a profit. From day to day, week to week, month to month, year to year transactions occur that must be recorded in the accounts and reflected in the financial statements. Two important types of operating transactions are revenues and expenses, which are part of the equity accounts, and the accounting model expands to include them (Wild, 2018). These five account types (assets, liabilities, equities, revenues, expense) allow accountants to record, accumulate, and present in the financial statements, all business activities.

ASSETS = LIABILITIES + EQUITY + REVENUES – EXPENSES

A major benefit of understanding the accounting model is that understanding how to account for one asset, you will know how to account for all assets. This also is true for the other types of accounts: liabilities, equities, revenues, and expenses. This knowledge is powerful. Instead of memorizing the many different business transactions, it only is necessary to determine whether assets, liabilities, equities, revenues, and/or expenses have been received or given up.

THE FIVE TYPES OF ACCOUNTS

Assets are Possessions

Assets are things owned: land, buildings, equipment, inventory, cash, etc. (Wild, 2018). Imagine how many different assets a company might possess. Similar assets typically are recorded in one account. For example, all delivery trucks might be recorded in an account called Trucks.

Assets are usually referred to as things owned, though they very often are not owned in full. For example, purchasing a car for \$20,000, with a \$5,000 down payment, requires a loan for the remaining \$15,000. This transaction is represented in the accounting model as:

$$\begin{aligned} \text{ASSETS} &= \text{LIABILITIES} + \text{EQUITY} \\ \text{Car } \$20,000 &= \text{Loan } \$15,000 + \text{Equity } \$5,000 \end{aligned}$$

Liabilities are Obligations

Liabilities are debts; they are obligations owed (Wild, 2018). Many of these debts are incurred to finance assets. Examples include mortgages payable, rent payable, salaries payable, and accounts payable. In the example above, a liability (loan payable) was created by the purchase of the car.

Equities are the Owner's Share

Equity, also called capital, is the residual value of the business that belongs to its owners. For a corporation, equity is split into contributed capital and retained earnings. Contributed capital is the owners' original investments in the company's stock. Retained earnings is the share of company income (revenues less expenses) not distributed as dividends to stockowners (Wild, 2018).

Revenues increase Equity

Revenues represent the increase in equity from delivering goods and services to customers (Wild, 2018). The most common revenue accounts are sales revenue (of goods), and service revenue. A company also may earn interest revenue from loaning money or rental revenue from renting property.

Expenses decrease Equity

Expenses are costs that a company incurs to earn revenues (Wild, 2018). Examples include salary expense, rent expense, utility expense, and interest expense. For companies that sell

products, often the largest expense is cost of goods sold. This is the cost the company paid to acquire the goods they sold to their customers.

Revenues and Expenses are Annual Accounts

Revenues and expenses are a subset of equity and are temporary (nominal) accounts (Wild, 2018). All revenues and expenses are tracked annually and then the accounts are closed (cleared) to prepare for the next year. During the closing process, revenues are added and expenses are deducted from retained earnings to update the year-end balance in equity.

Note from the expanded accounting model that revenues less expenses equals net income or net loss. If revenues exceed expenses there is positive net income, which increases retained earnings. If expenses exceed revenues there is a net loss, which decreases retained earnings.

$$\text{REVENUES} - \text{EXPENSES} = \text{NET INCOME (NET LOSS)}$$

Naming Accounts

How should accounts be named. Accounting is very flexible and can use almost any name. Typically, very simple names are chosen that are recognizable to people outside and inside the company. When naming accounts, a few basic themes will be helpful:

Asset names are usually readily identifiable (a noun naming a real thing) and there are relatively few equity accounts (most include stock or capital or earning in the name). Payable in the name usually indicates a liability. Revenue in the name usually indicates a revenue. Expense in the name usually indicates an expense. It is important, however, to include enough information in account names to distinguish between accounts. For example:

1. Rent expense is rent that has been used. - Expense
2. Prepaid rent is rent paid in advance but not yet used. - Asset
3. Rent payable is rent that is owed but has not been paid. – Liability
4. Rent revenue is rent that has been earned. – Revenue
5. Unearned rent is rent that has been received in advance but not yet earned. - Liability
6. Rent receivable is rent that has been earned but has not been paid. – Asset

It is obvious that using only rent as the account name would not be enough to identify what type of account it is. Note that replacing rent with interest or salary or commissions will create up to six new account names. This could be continued for any revenue or expense category.

USING DEBITS AND CREDITS IN THE ACCOUNTING MODEL

After memorizing two basic concepts (debit means left and assets go on the left), accounting is straightforward. In addition, the five types of accounts (assets, liabilities, equity, revenues, expenses) have been defined. This knowledge is now used to describe how debits and credits either increase or decrease the five types of accounts.

Of the five types of accounts, two are increased with debits and decreased with credits and three are increased with credits and decreased with debits. It is not necessary to memorize which are which. Just remember that debit means left (credit means right) and that assets are on the left (liabilities and equity are on the right).

A useful feature of double-entry accounting is that it is not necessary to remember what to add and what to subtract to determine account balances. Simply take the difference between total

debits and total credits recorded in the account. If debits exceed credits, there is a debit balance; if credits exceed debits, there is a credit balance (Wild, 2018).

If asked how to increase an asset account, what is the response? Because assets are on the left and debit means left, it is intuitive that assets should have debit balances. Therefore, assets are increased with debits and decreased with credits. This results in a normal debit balance. Then for liability and equity accounts, because they are on the right side of the accounting equation and credit means right, these accounts are increased with credits and decreased with debits.

ASSETS = LIABILITIES + EQUITY		
Debits Increase	Credits Increase	Credits Increase
Credits Decrease	Debits Decrease	Debits Decrease

Revenues and expenses are a subset of equity (temporary equity accounts), the rules for increasing and decreasing them are consistent with equity accounts. Revenues increase equity. Equity is increased by credits. So, revenues are increased with credits and, if necessary, decreased with debits. Expenses decrease equity. Equity is decreased by debits. So, expenses are increased with debits and, if necessary, decreased with credits.

REVENUES	-	EXPENSES	=	NET INCOME (NET LOSS)
Credits Increase		Debits Increase		Net Credit = Net Income
Debits Decrease		Credits Decrease		Net Debit = Net Loss

RECORDING TRANSACTIONS WITH JOURNAL ENTRIES

The accounting model is not complex. After it is understood, it is easy to use. While many business transactions are complex, if a transaction cannot be recorded using the accounting equation, then it is not fully understood. It is, of course, important that managers fully understand the business activity of their companies. A major advantage of learning accounting is that mastering accounting requires a full understanding of the business.

Journal entries are used to record business transactions (Wild, 2018). A journal entry is prepared listing the account(s) to debit on the left and the account(s) to credit on the right. Under double entry bookkeeping, total debits must equal total credits. The debits and credits are then posted (copied) to the accounts (Wild, 2018).

Example 1 – Exchange Asset for Asset – Purchase delivery truck for \$40,000 cash.

Dr Delivery Truck	\$40,000	
Cr Cash		\$40,000

Example 2 – Exchange Asset and Liability for Asset – Purchase building for \$100,000 cash and \$400,000 mortgage payable.

Dr Building	\$500,000	
Cr Cash		\$100,000
Cr Mortgage payable		\$400,000

Example 3 – Exchange Equity for Asset – Issue stock for land valued at \$500,000.

Dr Land	\$500,000	
Dr Capital stock		\$500,000

Example 4 – Exchange Asset for Revenue – Receive customer promise to pay (account receivable) for \$20,000 services delivered.

Dr Accounts receivable	\$20,000	
Cr Service revenue		\$20,000

Example 5 – Exchange Asset for Expense – Paid \$5,000 cash for the use of a rented warehouse.

Dr Rent expense	\$5,000	
Cr Cash		\$5,000

Example 6 – Exchange Asset for Expense and Liability – Paid \$9,000 principle and \$1,000 interest on a note payable.

Dr Note payable	\$9,000	
Dr Interest expense	\$1,000	
Cr Cash		\$10,000

Cash, Deferral, and Accrual Journal Entries

With knowledge of the five types of accounts, how each is increased or decreased with debits and credits, and how journal entries record business transactions, it is time to add an additional level of complexity – deferrals and accruals (Wild, 2018). Many find this topic confusing.

The accounting model is fully equipped to handle these transactions. There are six types of revenue and expense transactions: cash revenue, deferred (unearned) revenue, accrued revenue (account receivable), cash expense, deferred (prepaid) expense, and accrued expense (account payable). Two of those types are uncomplicated: cash revenue and cash expense. The key is that cash is received or paid at the time of the transaction. The other four represent deferrals and accruals: cash is received or paid either before or after the transaction. The problem created by deferrals and accruals is knowing how to split it into two parts: the time period when the transaction occurs and the time period when cash is received or paid.

A critical point for understanding deferrals and accruals is that revenues are not necessarily earned at the same time that cash is received, and expenses are not necessarily incurred at the same time that cash is paid out (Wild, 2018). A customer may pay for goods or services when they are received, in advance, or later. Revenue is not earned because cash is received – it is earned because the goods or services are delivered. The same is true for expenses. A company may pay costs when they are incurred, in advance, or later. Expense is not incurred because cash is paid out – it is incurred when the goods or services are consumed.

Business transactions for a lawn mowing service (Mowing Company) will illustrate cash, deferral, and accrual transactions. Related business activity for a medical service firm (Medical Company) also will be recorded. Medical Company hires Mowing Company to maintain the lawns around its offices. Medical Company agrees to pay Mowing Company \$500 for mowing services for the month of April.

- 1) First, assume the mowing is done on April 15th and the \$500 is paid on April 15th.

Mowing Company would record the cash revenue as:

April 15	Dr Cash	\$500	
	Cr Mowing revenue		\$500

Medical Company would record the cash expense as:

April 15	Dr Mowing expense	\$500	
	Cr Cash		\$500

- 2) Next, assume that the mowing will be done on April 15, but \$500 is paid in advance on March 31. This is an example of deferring revenue and deferring expense.
 - a) Mowing Company would record the receipt of the cash on March 31 as:

March 31 Dr Cash \$500
 Cr Unearned mowing revenue \$500
 After the mowing is done in April, Mowing Company would record:

April 15 Dr Unearned mowing revenue \$500
 Cr Mowing revenue \$500

b) Medical Company would record payment of the cash as:

March 31 Dr Prepaid mowing \$500
 Cr Cash \$500

After the mowing is done, Medical Company would record:

April 15 Dr Mowing expense \$500
 Cr Prepaid mowing \$500

3) Finally, assume that the mowing is done on April 15, but \$500 is paid later on May 15. This is an example of accruing revenue and accruing expense.

a) After the mowing is done, Mowing Company would record:

April 15 Dr Accounts receivable \$500
 Cr Mowing revenue \$500

Mowing Company would record the receipt of the cash later as:

May 15 Dr Cash \$500
 Cr Accounts receivable \$500

b) After the mowing is done, Medical Company would record:

April 15 Dr Mowing expense \$500
 Cr Accounts payable \$500

Medical Company would record payment of the cash later as:

May 15 Dr Accounts payable \$500
 Cr Cash \$500

Note that in 2a), above, the March 31 credit to Unearned mowing revenue is reversed by the April 15 debit to Unearned mowing revenue. Combining the March 31 and the April 15 entries results in the same entry as in 1a). In 3a), above, the March 31 debit to Accounts receivable is reversed by the April 15 credit to Accounts receivable. Combining the March 31 and the April 15 entries also results in the same entry as in 1a).

Note that in 2b), above, the March 31 debit to Prepaid mowing is reversed by the April 15 credit to Prepaid mowing. Combining the March 31 and the April 15 entries results in the same entry as in 1b). In 3b), above, the March 31 credit to Accounts payable is reversed by the April 15 debit to Accounts payable. Combining the March 31 and the April 15 entries also results in the same entry as in 1b).

The question could be asked: why bother recording deferrals and accruals of revenues and expenses, given that they will be reversed later. The answer is that it is necessary to show all revenues and expenses, and related effects on assets, liabilities, and equity, in the appropriate time period. Companies prepare monthly financial statements for internal use and quarterly and annual statements for external users. Without accruals and deferrals, the accounts would not accurately reflect the economic events that took place during those time periods (Wild, 2018).

Note that revenues and expenses are deferred/accrued – not cash flows (Wild, 2018). This causes confusion for many. Revenues are recorded when earned; when goods are delivered or services performed, not just because cash is received. Expenses are recorded when incurred, not just because cash is paid. Cash flows are recorded when they happen, even if the related revenue or expenses occurred before or after the cash flow.

Adjusting Journal Entries

The journal entries that record business transactions are source entries. After recording all the business transactions for an accounting period, it is important to determine whether all of the accounts reflect a correct balance. Adjusting entries are made to correct the account balances for the financial statements (Wild, 2018). It is not surprising that the accounts may need adjustment. Errors may occur and transactions may not all be recorded in the normal course of business. In addition, there are adjustments for previously unrecorded deferrals and accruals.

To show examples of adjusting entries assume a December 31 year end and that financial statements are prepared at year end only:

- 1) A bank reconciliation indicates that cash should be stated at \$10,800. The cash account reflects \$10,900. Your investigation shows that \$100 of bank service charges have not been recorded. The adjusting journal entry is:

December 31	Dr Bank service charge expense	\$100	
	Cr Cash		\$100
- 2) On March 1st the company paid \$24,000 building rent for twelve months. Prepaid rent was debited. This entry expenses an assets (a deferred expense). The adjusting journal entry is:

December 31	Dr Rent expense	\$20,000	
	Cr Prepaid rent		\$20,000
- 3) On July 1st the company borrowed \$50,000 cash and signed a 10% note payable for twelve months. Interest has not been accrued. Note this entry reflects accruing an expense. The adjusting journal entry is:

December 31	Dr Interest expense	\$2,500	
	Cr Interest payable		\$2,500
- 4) At December 31, the company realizes that it failed to record an invoice for \$2,000 in services delivered to a customer in December. Payment is due January 10th. Note that this entry reflects accruing a revenue. The adjusting journal entry is:

December 31	Dr Accounts receivable	\$2,000	
	Cr Service revenue		\$2,000

FINANCIAL STATEMENTS

Recording transactions with journal entries and posting them to accounts reflects the business activity during the year (or quarter or month) and adjusting entries correct account balances for the final step, preparing the financial statements (Wild, 2018). The basic financial statements are balance sheet, income statement, statement of equity, and statement of cash flows. A formal presentation of the financial statements also includes notes. The notes are detailed descriptions of the company's choices of accounting principles, of changes in important account balances, and other accounting issues required to be disclosed by the company.

The balance sheet and income statements are prepared by presenting the balances in the accounts in financial statement form. That is, each account balance appears either on the balance sheet or on the income statement. All the financial statements, but particularly the balance sheet and income statement, are articulated (interrelated). Because of double-entry accounting, changes in income statement accounts (revenues or expense) require changes in balance sheet accounts (assets or liabilities) (Wild, 2018). Also, net income from the income statement (revenues –

expenses) must be added to equity (retained earnings) on the balance sheet for the balance sheet to balance.

The equity statement and cash flow statement represent changes in account balances over time and are prepared by analyzing the activity in the equity and cash accounts respectively. The equity statement shows changes in contributed capital (when shares of stock are issued) and changes in retained earnings (net income is added, dividends are subtracted). The cash flow statement shows the change in the cash account for the time period shown (Wild, 2018). The change in cash is divided into three sections. Operating activities convert accrual-based net income to cash flows from operations (cash income). Investing activities show cash used (received) from purchasing (selling) long-term assets (land, buildings, equipment) or investments (marketable securities). Financing activities show cash received (used) from issuing (paying) debt, issuing (buying) stock or paying dividends. Examples of simple financial statements for the Mowing Company are:

Mowing Company	
Balance Sheet	
December 31, 2020	
Current Assets	
Cash	\$ 5,000
Accounts Receivable	20,000
Inventory	15,000
Total Current Assets	40,000
Non-current Assets	
Equipment	30,000
Building	50,000
Total Assets	\$ 120,000
Current Liabilities	
Accounts Payable	\$ 9,000
Salaries Payable	4,000
Total Current Liabilities	13,000
Non-Current Liabilities:	
Notes payable – due in 2 years	20,000
Mortgage Payable	40,000
Total Liabilities	73,000
Equity	
Contributed Capital	20,000
Retained Earnings	27,000
Total Equity	47,000
Total Liabilities and Equity	\$ 120,000

Mowing Company			
Statement of Equity			
For the Year Ended December 31, 2020			
	Contributed Capital	Retained Earnings	Total Capital
Balance – January 1, 2020	\$ 15,000	\$ 20,000	\$ 35,000
Additional Stock Issued	5,000		5,000

Net Income		12,000	12,000
Dividends		(5,000)	(5,000)
Balance – December 31, 2020	\$ 20,000	\$ 27,000	\$ 47,000

Mowing Company
Income Statement
For the Year Ended December 31, 2020

Revenues		\$ 92,000
Expenses		
Rent Expense	20,000	
Interest Expense	2,500	
Bank Charges	100	
Gas and Oil	50,000	
Depreciation	7,400	
Total Expenses		<u>80,000</u>
Net Income		<u>\$ 12,000</u>

Mowing Company
Statement of Cash Flows
For the Year Ended December 31, 2020

Operating Activities		
Net Income		\$ 12,000
+ Depreciation		7,400
- Increase in Accounts Receivable		(8,000)
Cash from Operating Activities		<u>11,400</u>
Investing Activities		
- Increase in Buildings		(9,400)
Financing Activities		
+ Increase in Stock Issued		5,000
- Dividend Paid		(5,000)
Cash from Financing Activities		<u>-0-</u>
Increase in Cash		2,000
Cash Balance, 1/1/20		<u>3,000</u>
Cash Balance, 12/31/20		<u>\$ 5,000</u>

INDIVIDUAL CASE ASSIGNMENT

Margie Company is a wholesale distributor of merchandise inventory to many independent stores throughout the local area. Like many small to medium size companies, Margie Company relies on a CPA to record and summarize its accounting transactions each year and to prepare its balance sheet, income statement, and statement of equity for its December 31 year end. Margie Company provided the following unclassified Balance Sheet at December 31, 2019. The company also provided a list of transactions for 2020 and a list of year-end adjustments to the accounts.

Assets		
Cash		\$ 57,000
Accounts Receivable		83,000
Merchandise Inventory		167,000
Prepaid Rent - Warehouse		3,500
Supplies Inventory		3,300
Prepaid Insurance		6,000
Land		55,000
Building	150,000	
Accumulated Depreciation – Bldg	-20,000	130,000
Equipment	100,000	
Accumulated Depreciation – Equip	-29,000	71,000
Total Assets:		<u>\$ 575,800</u>
Liabilities & Stockholders' Equity		
Accounts Payable (all for merchandise)		\$ 88,000
Salaries Payable		11,000
Income Taxes Payable		6,800
Notes Payable, 7% (due in 6 months)		45,000
Bonds Payable, 8% (Matures 2030)		80,000
Common Stock –No Par		305,000
Retained Earnings		40,000
Total Liabilities & Stockholders' Equity:		<u><u>\$ 575,800</u></u>

The following transactions occurred in 2020:

- a. Cash sales totaled \$140,000.
- b. Credit sales totaled \$420,000.
- c. Credit card sales totaled \$280,000. (The credit card company charges Margie Company 4% on sales and transfers the net amount directly to Margie's bank account.)
- d. Purchases of merchandise inventory on account totaled \$470,000, terms 2/10, N/30. Margie records all purchases at net and takes advantages of all discounts.
- e. Cost of merchandise sold totaled \$502,000.
- f. Salaries paid to employees totaled \$96,000, including the salaries payable at 12/31/19.
- g. Utilities paid during the year totaled \$59,000
- h. Rent for 2020 paid for special equipment totaled \$ 60,000.
- i. Supplies purchased for cash during the year totaled \$12,400.
- j. Paid the note payable from last year, plus six months interest.
- k. Equipment (cost \$15,000 and accumulated depreciation \$6,000) was sold for \$7,300.
- l. Issued an additional 10,000 shares of common stock for a total of \$57,000 cash.
- m. New equipment costing \$24,000 was purchased on August 1. Maggie paid \$4,000 down and issued a 1 year, 7.5% note for the balance
- n. New equipment costing \$ 120,000 was purchased on Nov. 12 for \$ 120,000, \$ 90,000 was paid in cash and 4,800 shares of common stock was issued for the equipment.
- o. Payment to vendors on account for merchandise totaled \$483,000.
- p. Collections of accounts receivable totaled \$ 411,000
- q. Declared and paid dividends of \$11,800 during the year
- r. The income taxes due at the beginning of the year were paid.

- s. The prepaid insurance at 12/31/19 expired on 3/31/20 and a new one-year policy costing \$26,000 was purchased.
- t. Annual interest was paid on the bond payable.
- u. Prepaid rent on the warehouse at 12/31/19 expired on 2/28/20, at which time rent of \$24,000 was paid.

Additional end of year information (for adjusting journal entries):

- 1. Salaries earned by employees but unpaid as of year-end totaled \$7,500.
- 2. Supplies inventory on hand at year-end totaled \$3,950.
- 3. Depreciation expense on the equipment for the year was determined to be \$7,500
 - 4. Depreciation expense on the building for the year was determined to be \$ 15,800
 - 5. Prepaid rent as of year-end totaled \$4,000.
 - 6. Interest needs to be accrued on the note issued at m, above.
 - 7. Need to record expired insurance.
 - 8. The marginal income tax rate is 30%. The taxes are to be paid on 3/15/21.
(Need to calculate and accrue tax.)

Required:

- 1. Prepare journal entries for the year, based on the transactions a thru u data provided.
- 2. Prepare year-end adjusting entries based on the additional information (1 thru 8).
- 3. Prepare in good form for 2020:
 - a. Income Statement
 - b. Statement of Equity
 - c. Classified Balance Sheet

Prepare the financial statements in good form using Excel. Use an Excel spreadsheet with separate tabs for journal entries, T accounts, and each of the statements. Data (numbers) should be entered only for the journal entries and opening balances in the accounts. Excel formulas should be used to post the entries, total the balances, and prepare the statements.

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