Identify or define the following terms:

- a. economic entity
- b. going concern

Economic entity - All economic events can be identified with a particular economic entity.

Going concern - In the absence of information to the contrary, it is anticipated that a business entity will continue to operate indefinitely.

List and describe the basic financial statements.

- Balance sheet or statement of financial position - presents the assets, liabilities and owners' equity as of a given point in time.
- Income statement - presents the revenues, expenses, gains and losses for a period of time.
- Statement of cash flows - presents the cash flows for a period of time.
- Statement of shareholders' equity - shows the changes in shareholders' equity for a period of time.

Define assets, liabilities, and equity.

- Assets - Probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.
- Liabilities - Probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions.
- Equity - Residual interest in the assets of an entity that remains after deducting liabilities.
Feel-Good Custom Clothing started business April 1, 1997. Required:
Prepare journal entries for the transactions listed below:

a. Issued 4,000 shares of capital stock for $15,000 cash.
b. Leased building space, paying six months rent of $4,000 in advance.
c. Rented equipment at a cost of $100 per month, paying $100 upon
   signing the rental agreement.
d. Purchased supplies, on account $800.
e. Recorded cash sales, $800.
f. Paid wages, $500.
g. Paid two-year insurance premium, $900.
h. Recorded cash sales $1,100.
i. Paid wages, $500.
j. Paid for half of supplies purchased in (d).

\[ 2 \text{ cash} = 20 \]

<table>
<thead>
<tr>
<th></th>
<th>a. Cash</th>
<th>15,000</th>
<th>b. Prepaid rent</th>
<th>4,000</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Capital stock</td>
<td>15,000</td>
<td>Cash</td>
<td>4,000</td>
</tr>
<tr>
<td></td>
<td>Rent expense</td>
<td>100</td>
<td>Cash</td>
<td>100</td>
</tr>
<tr>
<td></td>
<td>Supplies inventory</td>
<td>600</td>
<td>Accounts payable</td>
<td>600</td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td>800</td>
<td>Sales revenue</td>
<td>800</td>
</tr>
<tr>
<td></td>
<td>Wages expense</td>
<td>500</td>
<td>Cash</td>
<td>500</td>
</tr>
<tr>
<td></td>
<td>Prepaid insurance</td>
<td>900</td>
<td>Cash</td>
<td>900</td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td>1,100</td>
<td>Sales revenue</td>
<td>1,100</td>
</tr>
<tr>
<td></td>
<td>Wages expense</td>
<td>500</td>
<td>Cash</td>
<td>500</td>
</tr>
<tr>
<td></td>
<td>Accounts payable</td>
<td>300</td>
<td>Cash</td>
<td>300</td>
</tr>
</tbody>
</table>

E3-5 Journalize the entries for the following adjustments at December 31, the end of the accounting period:

a. Employees salaries owed for Monday and Tuesday of a five-day workweek; weekly payroll, $15,000.
b. Prepaid insurance expired, $300.
c. Interest revenue earned, $1,100.
d. Unearned service revenue earned, $800.
e. Depreciation, $3,200.

\[ 3 \text{ cash} = 15 \]
## Journal

<table>
<thead>
<tr>
<th>DATE</th>
<th>DESCRIPTION</th>
<th>POST REF</th>
<th>DEBIT</th>
<th>CREDIT</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td><strong>Salary Expense ($10,000 X 2/5)</strong></td>
<td></td>
<td>4,000</td>
<td>4,000</td>
</tr>
<tr>
<td>a.</td>
<td>Salary Payable</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Insurance Expense</strong></td>
<td></td>
<td>300</td>
<td>300</td>
</tr>
<tr>
<td>b.</td>
<td>Prepaid Insurance</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Interest Receivable</strong></td>
<td></td>
<td>4,400</td>
<td>4,400</td>
</tr>
<tr>
<td>c.</td>
<td>Interest Revenue</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Unearned Service Revenue</strong></td>
<td></td>
<td>800</td>
<td>800</td>
</tr>
<tr>
<td>d.</td>
<td>Service Revenue</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Depreciation Expense</strong></td>
<td></td>
<td>3,200</td>
<td>3,200</td>
</tr>
<tr>
<td>c.</td>
<td>Accumulated Depreciation</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

## Net income:

- **Overstated by omission of:**
  - Salary expense $4,000
  - Insurance expense 300
  - Depreciation expense 3,200
  - Total overstatement $7,500

- **Understated by omission of:**
  - Interest revenue $4,400
  - Service revenue 800
  - Total understatement 5,200

- Overall effect—net income overstated by $2,300
Moondoo Tea Company
Balance Sheet
at December 31, 1999

Assets

Current assets:
Cash $10,500
Accounts receivable $150,000
Less: allowance for doubtful accounts (19,000)
Inventory 140,000
Prepaid rent 25,000
Total current assets $180,500

Property and equipment:
Equipment $300,000
Less: accumulated depreciation 125,000 (175,000)
Total assets $355,500

Liabilities and Shareholders' Equity

Current liabilities:
Accounts payable $20,000
Notes payable 30,000
Salaries payable 4,000
Interest payable 1,000
Total current liabilities $55,000

Shareholders' equity:
Capital stock $200,000
Retained earnings 100,500
Total shareholders' equity $300,500

Total liabilities and shareholders' equity $355,500

Moondoo Tea Company
Income Statement
For the Year Ended December 31, 1999

Sales revenue $400,000
Cost of goods sold 180,000
Gross profit $220,000

Other expenses:
Salary expense $120,000
Rent expense 15,000
Depreciation expense 30,000
Interest expense 2,000
Bad debts expense 2,600
Total other expenses $169,600

Net income $30,400

Intermediate Accounting, 1/e
a. Sales revenue: 400,000
   Income summary: 400,000

b. Income summary: 349,500
   Cost of goods sold: 180,000
   Salaries expense: 120,000
   Rent expense: 10,000
   Depreciation expense: 30,000
   Interest expense: 2,000
   Bad debts expense: 2,500

c. Income summary: 50,500
   Retained earnings: 50,500

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McDougles Company
Balance Sheet
at December 31, 1999

Assets

<table>
<thead>
<tr>
<th>Current assets:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$ 5,250</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>$75,000</td>
</tr>
<tr>
<td>Less: allowance for doubtful accounts</td>
<td>5,000</td>
</tr>
<tr>
<td>Inventory</td>
<td>12,500</td>
</tr>
<tr>
<td>Prepaid rent</td>
<td>2,500</td>
</tr>
<tr>
<td>Total current assets</td>
<td>$90,250</td>
</tr>
</tbody>
</table>

Property and equipment:

| Equipment          | $150,000|
|                   | 62,500  |
| Total assets       | $177,250|

Liabilities and Shareholders' Equity

<table>
<thead>
<tr>
<th>Current liabilities:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts payable</td>
<td>$10,000</td>
</tr>
<tr>
<td>Notes payable</td>
<td>15,000</td>
</tr>
<tr>
<td>Salaries payable</td>
<td>2,000</td>
</tr>
<tr>
<td>Interest payable</td>
<td>500</td>
</tr>
<tr>
<td>Total current liabilities</td>
<td>$27,500</td>
</tr>
</tbody>
</table>

Shareholders' equity:

| Capital stock        | $100,000 |
| Retained earnings    | 50,250   |
| Total shareholders' equity | $150,250 |
| Total liabilities and shareholders' equity | $177,250 |