

# COMPREHENSIVE PROBLEM 1

## SUSQUEHANNA EQUIPMENT RENTALS

### **Susquehanna Equipment Rentals**

A mini-practice set illustrating the complete accounting cycle for a service-type business. Includes computation of income taxes expense (as a percentage of income before taxes) and an evaluation of solvency. Can be done as a group assignment.

**5 to 6 hours**

**Strong**

5 to 6 hours, Strong

## COMPREHENSIVE PROBLEM 1 SUSQUEHANNA EQUIPMENT RENTALS

a.				
General Journal				
December Daily Transactions				
2015				
Dec	1	Cash	200,000	
		Capital Stock		200,000
		Owner invested cash in the business.		
	1	Rental Equipment	240,000	
		Cash		140,000
		Notes Payable		100,000
		Purchased equipment from Rent-it. Note payable is due in one year.		
	1	Prepaid Rent	12,000	
		Cash		12,000
		Paid three months' rent in advance to Shapiro Realty.		
	4	Office Supplies	1,000	
		Accounts Payable		1,000
		Purchased supplies on account; payment due in 30 days.		
	8	Cash	8,000	
		Unearned Rental Fees		8,000
		Received advance payment for equipment rental by McNamer Construction Company.		
	12	Salaries Expense	5,200	
		Cash		5,200
		Paid salaries for first two weeks in December.		
	15	Cash	12,000	
		Accounts Receivable	6,000	
		Rental Fees Earned		18,000
		To record rental fees earned in first 15 days of December.		
	17	Maintenance Expense	600	
		Accounts Payable		600
		To record purchase of repair parts on account from Earth Movers, Inc.; payment due in 10 days.		
	23	Cash	2,000	
		Accounts Receivable		2,000
		Collection of an accounts receivable.		
	26	(No entry required to record rental of backhoe.)		

# COMPREHENSIVE PROBLEM 1

## SUSQUEHANNA EQUIPMENT RENTALS

(continued)

<b>a.</b>				
<b>General Journal</b>				
<b>December Daily Transactions</b>				
<b>2015</b>				
<b>Dec</b>	<b>26</b>	<b>Salaries Expense</b>	<b>5,200</b>	
		<b>Cash</b>		<b>5,200</b>
		<b>Paid biweekly payroll.</b>		
	<b>27</b>	<b>Accounts Payable</b>	<b>600</b>	
		<b>Cash</b>		<b>600</b>
		<b>Paid account payable to Earth Movers, Inc.</b>		
	<b>28</b>	<b>Dividends</b>	<b>2,000</b>	
		<b>Dividends Payable</b>		<b>2,000</b>
		<b>Declared a dividend of 10 cents per share payable on January 15, 2016.</b>		
	<b>29</b>	<b>(No journal entry required to record lawsuit.)</b>		
	<b>29</b>	<b>Unexpired Insurance</b>	<b>9,600</b>	
		<b>Cash</b>		<b>9,600</b>
		<b>Purchased 12-month liability policy, effective January 1, 2016.</b>		
	<b>31</b>	<b>Utilities Expense</b>	<b>700</b>	
		<b>Accounts Payable</b>		<b>700</b>
		<b>Utilities for December; payment due in 30 days.</b>		
	<b>31</b>	<b>Cash</b>	<b>15,600</b>	
		<b>Accounts Receivable</b>	<b>4,400</b>	
		<b>Rental Fees Earned</b>		<b>20,000</b>
		<b>To record rental fees earned in the second half of December.</b>		

# COMPREHENSIVE PROBLEM 1

## SUSQUEHANNA EQUIPMENT RENTALS

(continued)

a.				
General Journal				
(Adjusting Entries)				
2015				
Dec	31	Rent Expense	4,000	
		Prepaid Rent		4,000
		To recognize rent expense for December.		
	31	Interest Expense	500	
		Interest Payable		500
		Interest on note payable to Rent-It (\$100,000 x 6% x 1/12).		
	31	Depreciation Expense	2,500	
		Accumulated Depreciation: Rental Equip.		2,500
		Depreciation for December ( $\$240,000 \div 8 \text{ years} \times 1/12 = \$2,500$ ).		
	31	Office Supplies Expense	400	
		Office Supplies		400
		To record office supplies used during the month. (\$1,000 - \$600 = \$400)		
	31	Unearned Rental Fees	3,700	
		Rental Fees Earned		3,700
		To record portion of advance payment by McNamer Construction Co. earned during December.		
	31	Accounts Receivable	1,500	
		Rental Fees Earned		1,500
		To record fees earned from Mission Landscaping on backhoe rental (6 days x \$250 per day).		
	31	Salaries Expense	1,400	
		Salaries Payable		1,400
		To record accrued salaries payable at month-end.		
	31	Income Taxes Expense	9,080	
		Income Taxes Payable		9,080
		To record income taxes for December [(\$43,200 - \$11,800 - \$600 - \$700 - \$4,000 - \$400 - \$2,500 - \$500) x 40%].		

# COMPREHENSIVE PROBLEM 1

## SUSQUEHANNA EQUIPMENT RENTALS

(continued)

a.		Cash			
Date		Explanation	Debit	Credit	Balance
Dec	1		200,000		200,000
	1			140,000	60,000
	1			12,000	48,000
	8		8,000		56,000
	12			5,200	50,800
	15		12,000		62,800
	23		2,000		64,800
	26			5,200	59,600
	27			600	59,000
	29			9,600	49,400
	31		15,600		65,000

		Accounts Receivable			
Date		Explanation	Debit	Credit	Balance
Dec	15		6,000		6,000
	23			2,000	4,000
	31		4,400		8,400
	31		1,500		9,900

		Prepaid Rent			
Date		Explanation	Debit	Credit	Balance
Dec	1		12,000		12,000
	31			4,000	8,000

		Unexpired Insurance			
Date		Explanation	Debit	Credit	Balance
Dec	29		9,600		9,600

		Office Supplies			
Date		Explanation	Debit	Credit	Balance
Dec	4		1,000		1,000
	31			400	600

# COMPREHENSIVE PROBLEM 1

## SUSQUEHANNA EQUIPMENT RENTALS

(continued)

a.		Rental Equipment			
Date		Explanation	Debit	Credit	Balance
Dec	1		240,000		240,000

		Accumulated Depreciation: Rental Equipment			
Date		Explanation	Debit	Credit	Balance
Dec	31			2,500	2,500

		Notes Payable			
Date		Explanation	Debit	Credit	Balance
Dec	1			100,000	100,000

		Accounts Payable			
Date		Explanation	Debit	Credit	Balance
Dec	4			1,000	1,000
	17			600	1,600
	27		600		1,000
	31			700	1,700

		Interest Payable			
Date		Explanation	Debit	Credit	Balance
Dec	31			500	500

# COMPREHENSIVE PROBLEM 1

## SUSQUEHANNA EQUIPMENT RENTALS

(continued)

a.		Salaries Payable			
Date		Explanation	Debit	Credit	Balance
Dec	31			1,400	1,400

		Dividends Payable			
Date		Explanation	Debit	Credit	Balance
Dec	28			2,000	2,000

		Unearned Rental Fees			
Date		Explanation	Debit	Credit	Balance
Dec	8			8,000	8,000
	31		3,700		4,300

		Income Taxes Payable			
Date		Explanation	Debit	Credit	Balance
Dec	31			9,080	9,080

		Capital Stock			
Date		Explanation	Debit	Credit	Balance
Dec	1			200,000	200,000

# COMPREHENSIVE PROBLEM 1

## SUSQUEHANNA EQUIPMENT RENTALS

(continued)

a. & d.		Retained Earnings			
Date		Explanation	Debit	Credit	Balance
Dec	31	Income, 2015		13,620	13,620
	31	Dividends	2,000		11,620

		Dividends			
Date		Explanation	Debit	Credit	Balance
Dec	28		2,000		2,000
	31	To close		2,000	0

		Income Summary			
Date		Explanation	Debit	Credit	Balance
Dec	31	To close revenue accounts		43,200	43,200
	31	To close expense accounts	29,580		13,620
	31	To close	13,620		0

		Rental Fees Earned			
Date		Explanation	Debit	Credit	Balance
Dec	15			18,000	18,000
	31			20,000	38,000
	31			3,700	41,700
	31			1,500	43,200
	31	To close	43,200		0

		Salaries Expense			
Date		Explanation	Debit	Credit	Balance
Dec	12		5,200		5,200
	26		5,200		10,400
	31		1,400		11,800
	31	To close		11,800	0



# COMPREHENSIVE PROBLEM 1

## SUSQUEHANNA EQUIPMENT RENTALS

(continued)

a. & d.		Maintenance Expense			
Date		Explanation	Debit	Credit	Balance
Dec	17		600		600
	30	To close		600	0

		Utilities Expense			
Date		Explanation	Debit	Credit	Balance
Dec	31		700		700
	31	To close		700	0

		Rent Expense			
Date		Explanation	Debit	Credit	Balance
Dec	31		4,000		4,000
	31	To close		4,000	0

		Office Supplies Expense			
Date		Explanation	Debit	Credit	Balance
Dec	31		400		400
	31	To close		400	0

# COMPREHENSIVE PROBLEM 1

## SUSQUEHANNA EQUIPMENT RENTALS

(continued)

a. & d.		Depreciation Expense			
Date		Explanation	Debit	Credit	Balance
Dec	31		2,500		2,500
	31	To close		2,500	0

		Interest Expense			
Date		Explanation	Debit	Credit	Balance
Dec	31		500		500
	31	To close		500	0

		Income Taxes Expense			
Date		Explanation	Debit	Credit	Balance
Dec	31		9,080		9,080
	31	To close		9,080	0

**SUSQUEHANNA EQUIPMENT RENTALS**

**Worksheet**

**December 31, 2015**

**COMPREHENSIVE PROBLEM 1**

**SUSQUEHANNA EQUIPMENT**

**RENTALS (continued)**

a.	Trial Balance		Adjustments*		Adjusted Trial Balance		Income Statement		Balance Sheet	
	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit
<b>Balance sheet accounts :</b>										
Cash	\$ 65,000				\$ 65,000				\$ 65,000	
Accounts receivable	8,400		(f) \$ 1,500		9,900				9,900	
Prepaid rent	12,000			(a) \$ 4,000	8,000				8,000	
Unexpired insurance	9,600				9,600				9,600	
Office supplies	1,000			(d) 400	600				600	
Rental equipment	240,000				240,000				240,000	
Notes payable		\$ 100,000				\$ 100,000				\$ 100,000
Accounts payable		1,700				1,700				1,700
Unearned rental fees		8,000	(e) 3,700			4,300				4,300
Dividends payable		2,000				2,000				2,000
Capital stock		200,000				200,000				200,000
Retained earnings		-								
Dividends	2,000				2,000				2,000	
Interest payable				(b) 500		500				500
Accum. Dep.: rental equip.				(c) 2,500		2,500				2,500
Salaries payable				(g) 1,400		1,400				1,400
Income taxes payable				(h) 9,080		9,080				9,080
<b>Income statement accounts:</b>										
Rental fees earned		38,000		(e) 3,700		43,200		\$ 43,200		
				(f) 1,500						
Salaries expense	10,400		(g) 1,400		11,800		\$ 11,800			
Maintenance expense	600				600		600			
Utilities expense	700				700		700			
	\$ 349,700	\$ 349,700								
Rent expense			(a) 4,000		4,000		4,000			
Interest expense			(b) 500		500		500			
Depreciation expense			(c) 2,500		2,500		2,500			
Office supplies expense			(d) 400		400		400			
Income taxes expense			(h) 9,080		9,080		9,080			
			\$ 23,080	\$ 23,080	\$ 364,680	\$ 364,680	29,580	43,200	335,100	321,480
<b>Net income</b>							13,620			13,620
<b>Totals</b>							\$ 43,200	\$ 43,200	\$ 335,100	\$ 335,100

\* Adjustments

(a) December rent expense (\$12,000 ÷ 3).

(b) December interest expense (\$100,000 x 6% x 1/12).

(c) December depreciation expense (\$240,000 ÷ 96 months).

(d) Office supplies used in December (\$1,000 - \$600).

(e) Portion of unearned revenue earned in December.

(f) Accrued revenue earned in December.

(g) Accrued salaries at month-end.

(h) Accrued income taxes expense at month-end.

# COMPREHENSIVE PROBLEM 1

## SUSQUEHANNA EQUIPMENT RENTALS

(continued)

b.

SUSQUEHANNA EQUIPMENT RENTALS		
Income Statement		
For the Year Ended December 31, 2015		
Revenue:		
Rental fees earned		\$ 43,200
Expenses		
Salaries expense	\$ 11,800	
Maintenance expense	600	
Utilities expense	700	
Rent expense	4,000	
Office supplies expense	400	
Depreciation expense	2,500	
Interest expense	500	20,500
Income before income taxes expense		\$ 22,700
Income taxes expense @ 40%		9,080
Net income		\$ 13,620

SUSQUEHANNA EQUIPMENT RENTALS		
Statement of Retained Earnings		
For the Year Ended December 31, 2015		
Retained earnings, December 1, 2015		\$0
Net income		13,620
Subtotal		13,620
Less: Dividends		2,000
Retained earnings, December 31, 2015		\$ 11,620

# COMPREHENSIVE PROBLEM 1

## SUSQUEHANNA EQUIPMENT RENTALS

(continued)

b.

SUSQUEHANNA EQUIPMENT RENTALS		
Balance Sheet		
December 31, 2015		
Assets		
Cash		\$ 65,000
Accounts Receivable		9,900
Prepaid rent		8,000
Unexpired insurance		9,600
Office supplies		600
Rental equipment	240,000	
Less: Accumulated depreciation	2,500	237,500
<b>Total assets</b>		<b>\$ 330,600</b>
Liabilities & Stockholders' Equity		
<b>Liabilities:</b>		
Notes payable		\$ 100,000
Accounts payable		1,700
Interest payable		500
Salaries payable		1,400
Dividends payable		2,000
Unearned rental fees		4,300
Income taxes payable		9,080
<b>Total liabilities</b>		<b>\$ 118,980</b>
<b>Stockholders' equity:</b>		
Capital stock		\$ 200,000
Retained earnings		11,620
<b>Total Stockholders' Equity</b>		<b>\$ 211,620</b>
<b>Total liabilities and stockholders' equity</b>		<b>\$ 330,600</b>

c. Notes to the financial statements:

*Note 1—Depreciation policies*

Depreciation expense in the financial statements is computed by the straight-line method. The estimated useful life of the rental equipment is 8 years.

*Note 2—Maturity dates of liabilities*

The Company's notes payable consist of a single obligation which matures on November 30, 2016. The maturity value of this note, including interest, will amount to \$106,000.

*Note 3—Pending litigation*

The Company has been named as a co-defendant in a \$25,000 personal injury lawsuit. The extent of legal and financial responsibility, if any, cannot be determined at this time.

# COMPREHENSIVE PROBLEM 1

## SUSQUEHANNA EQUIPMENT RENTALS

(continued)

**d.**

General Journal (Closing Entries)				
2015				
Dec	31	Rent Fees Earned	43,200	
		Income Summary		43,200
		To close the revenue account.		
	31	Income Summary	29,580	
		Salaries Expense		11,800
		Maintenance Expense		600
		Utilities Expense		700
		Rent Expense		4,000
		Office Supplies Expense		400
		Depreciation Expense		2,500
		Interest Expense		500
		Income Taxes Expense		9,080
		To close the expense accounts.		
	31	Income Summary	13,620	
		Retained Earnings		13,620
		To close the Income Summary account.		
	31	Retained Earnings	2,000	
		Dividends		2,000
		To close the Dividends account.		

**e.**

SUSQUEHANNA EQUIPMENT RENTALS		
After-Closing Trial Balance		
December 31, 2015		
Cash	\$ 65,000	
Accounts receivable	9,900	
Prepaid rent	8,000	
Unexpired insurance	9,600	
Office supplies	600	
Rental equipment	240,000	
Accumulated depreciation: rental equipment		\$ 2,500
Notes payable		100,000
Accounts payable		1,700
Interest payable		500
Salaries payable		1,400
Dividends payable		2,000
Unearned rental fees		4,300
Income taxes payable		9,080
Capital stock		200,000
Retained earnings		11,620
Totals	\$ 333,100	\$ 333,100

## **COMPREHENSIVE PROBLEM 1**

### **SUSQUEHANNA EQUIPMENT RENTALS**

#### **(concluded)**

**f.**

It does not appear that the company faces any immediate solvency problems. It did start with \$200,000 cash, but in its first transaction the company spent \$140,000 on equipment, leaving only \$60,000 cash to begin operations. This amount had increased to \$65,000 by the end of December. Thus, during its first month of operations, the business was able to generate \$5,000 of positive cash flow from operations.

The \$100,000 note payable due on November 30, 2016, does raise a potential concern about the company's solvency, however. Currently, the business does not have sufficient liquid assets to satisfy this obligation. In fact, the company's working capital position is actually negative by \$25,880 (\$93,100 of current assets minus \$118,980 of current liabilities). Likewise, its current ratio is only 0.78:1 (\$93,100 of current assets divided by \$118,980 of current liabilities). However, if the business can continue to generate at least \$5,000 of positive operating cash flows each month, remaining solvent should not pose a serious issue.

**g.** There is nothing at all unethical about Patty Driver (a founding stockholder) maintaining the accounting records for Susquehanna Equipment Rentals. In most businesses, the accounting records are maintained either by owners or employees, none of whom are “independent” of the organization.

The concept of independence refers to auditing financial statements, where the auditor has to make an independent evaluation of the statements’ “fairness.” Independence does not apply to the routine maintenance of accounting records.