

Chapter 03

Special Activities

SA 3-1
Ethics and
professional
conduct in business



Cliff Hall opened Meridian Co. on January 1, 2009. At the end of the first year, the business needed additional capital. On behalf of Meridian, Cliff applied to Federal National Bank for a loan of \$300,000. Based on Meridian financial statements, which had been prepared on a cash basis, the Federal National Bank loan officer rejected the loan as too risky. After receiving the rejection notice, Cliff instructed his accountant to prepare the financial statements on an accrual basis. These statements included \$48,500 in accounts

receivable and \$15,650 in accounts payable. Cliff then instructed his accountant to record an additional \$20,000 of accounts receivable for commissions on property for which a contract had been signed on December 28, 2009, but which would not be formally “closed” and the title transferred until January 5, 2010.

Cliff then applied for a \$300,000 loan from First City Bank, using the revised financial statements. On this application, Cliff indicated that he had not previously been rejected for credit.

Discuss the ethical and professional conduct of Cliff Hall in applying for the loan from First City Bank.

SA 3-2
Accrued expense



On December 30, 2010, you buy a Ford Expedition. It comes with a three-year, 36,000-mile warranty. On March 5, 2011, you return the Expedition to the dealership for some basic repairs covered under the warranty. The cost of the repairs to the dealership is \$1,645. In what year, 2010 or 2011, should **Ford Motor Company** recognize the cost of the warranty repairs as an expense?

SA 3-3
Accrued revenue



The following is an excerpt from a conversation between Joel Loomis and Krista Truitt just before they boarded a flight to Paris on **Delta Air Lines**. They are going to Paris to attend their company’s annual sales conference.

Joel: Krista, aren’t you taking an introductory accounting course at college?

Krista: Yes, I decided it’s about time I learned something about accounting. You know, our annual bonuses are based on the sales figures that come from the accounting department.

Joel: I guess I never really thought about it.

Krista: You should think about it! Last year, I placed a \$750,000 order on December 28. But when I got my bonus, the \$750,000 sale wasn’t included. They said it hadn’t been shipped until January 3, so it would have to count in next year’s bonus.

Joel: A real bummer!

Krista: Right! I was counting on that bonus including the \$750,000 sale.

Joel: Did you complain?

Krista: Yes, but it didn’t do any good. Ashley, the head accountant, said something about matching revenues and expenses. Also, something about not recording revenues until the sale is final. I figure I’d take the accounting course and find out whether she’s just jerking me around.

Joel: I never really thought about it. When do you think Delta Air Lines will record its revenues from this flight?

Krista: Hmmm . . . I guess it could record the revenue when it sells the ticket . . . or . . . when the boarding passes are taken at the door . . . or . . . when we get off the plane . . . or when our company pays for the tickets . . . or . . . I don’t know. I’ll ask my accounting instructor.

Discuss when Delta Air Lines should recognize the revenue from ticket sales to properly match revenues and expenses.

SA 3-4
Adjustments and financial statements

Several years ago, your brother opened Niagara Appliance Repairs. He made a small initial investment and added money from his personal bank account as needed. He withdrew money for living expenses at irregular intervals. As the business grew, he hired an assistant. He is now considering adding more employees, purchasing additional service trucks, and purchasing the building he now rents. To secure funds for the expansion, your brother submitted a loan application to the bank and included the most recent financial statements (shown below) prepared from accounts maintained by a part-time bookkeeper.

Niagara Appliance Repairs Income Statement For the Year Ended October 31, 2010		
Service revenue		\$112,500
Less: Rent paid	\$31,200	
Wages paid	24,750	
Supplies paid	7,000	
Utilities paid	6,500	
Insurance paid	3,600	
Miscellaneous payments	9,100	82,150
Net income		<u>\$ 30,350</u>

(continued)

**Niagara Appliance Repairs
Balance Sheet
October 31, 2010**

Assets	
Cash	\$15,900
Amounts due from customers	18,750
Truck	<u>55,350</u>
Total assets	<u>\$90,000</u>
Equities	
Owner's capital	<u>\$90,000</u>

After reviewing the financial statements, the loan officer at the bank asked your brother if he used the accrual basis of accounting for revenues and expenses. Your brother responded that he did and that is why he included an account for “Amounts Due from Customers.” The loan officer then asked whether or not the accounts were adjusted prior to the preparation of the statements. Your brother answered that they had not been adjusted.

- a. Why do you think the loan officer suspected that the accounts had not been adjusted prior to the preparation of the statements?
- b. Indicate possible accounts that might need to be adjusted before an accurate set of financial statements could be prepared.

SA 3-5
Codes of ethics

Group Project



Obtain a copy of your college or university’s student code of conduct. In groups of three or four, answer the following question:

- 1. Compare this code of conduct with the accountant’s Codes of Professional Conduct, which is linked to the text Web site at academic.cengage.com/accounting/warren.
- 2. One of your classmates asks you for permission to copy your homework, which your instructor will be collecting and grading for part of your overall term grade. Although your instructor has not stated whether one student may or may not copy another student’s homework, is it ethical for you to allow your classmate to copy your homework? Is it ethical for your classmate to copy your homework?