

Handout 5

Mega keeps its accounting records on a cash basis during the year. At year end, it converts its books to the accrual basis for preparing its financial statements. At the end of **2005**, Mega reported the following balance sheet items after adjusting to accrual basis. [Hint: These will also be the **beginning** balances for **2006**.]

	<u>December 31, 2005 (accrual)</u>	
	<u>Debit</u>	<u>Credit</u>
Cash	\$ 2,700	
Accounts receivable	4,200	
Inventory	5,600	
Equipment	12,000	
Accumulated depreciation		\$ 4,800
Accounts payable (for inventory)		6,100
Common stock		5,000
Retained earnings		8,600

At the end of **2006**, you are asked to convert Mega's books from **cash** basis to **accrual** basis and prepare a balance sheet and income statement on an **accrual** basis. To do so, you are provided with the following information:

Mega's checkbook shows the following **year-end** information for **2006**:

Year-end cash balance	\$ 4,700
Cash receipts from customers	51,300
Cash payments:	
To suppliers (for inventory)	30,600
Prepaid rent (2 years starting 1/1/06)	7,200
For other operating expenses (OE)	5,500
Dividends	6,000
On December 31, 2006:	
Customers owed Mega	5,900
Mega owed suppliers (for inventory)	7,000
Mega owed employees	900
Ending inventory	6,300

Mega depreciates its equipment using the straight-line method over 10 years with no salvage value. You can ignore income taxes in this problem. Assume that the balance given for other operating expenses (OE) is the same for both cash and accrual.

Required: Using accrual basis accounting, prepare a 2006 income statement and a 2006 balance sheet.