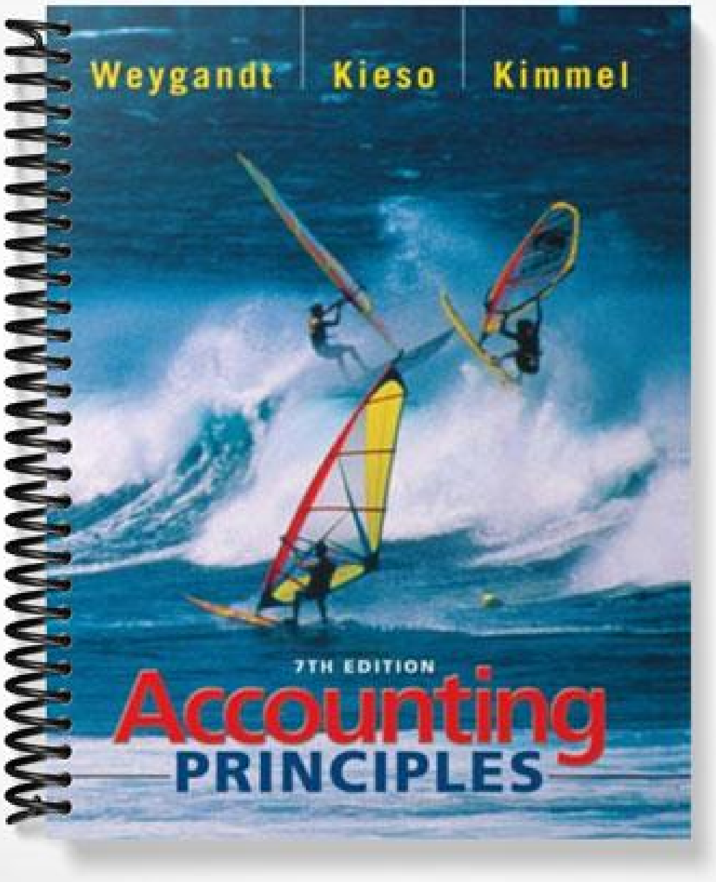
TEST BANK



CHAPTER 3

ADJUSTING THE ACCOUNTS

SUMMARY OF QUESTIONS BY OBJECTIVES AND BLOOM'S TAXONOMY

Item	SO	BT	Item	SO	BT	Item	SO	BT	Item	SO	BT	Item	SO	BT
True-False Statements														
1.	1	C	9.	2	C	17.	5	C	25.	5	K	33.	3	
2.	1	K	10.	2	K	18.	5	K	26.	6	K	34.	5	
3.	1	K	11.	3	C	19.	5	C	27.	7	K	35.	6	
4.	1	C	12.	3	K	20.	5	C	[a]28.	8	C	36.	7	
5.	1	K	13.	3	K	21.	5	C	[a]29.	8	C	[a]37.	8	
6.	2	C	14.	3	K	22.	5	K	[a]30.	8	C			
7.	2	K	15.	4	C	23.	5	K	31.	2				
8.	2	K	16.	4	K	24.	5	C	32.	3				
Multiple Choice Questions														
38.	1	K	58.	2	K	78.	4	AN	98.	5	C	[a]118.	8	C
39.	1	K	59.	2	C	79.	5	C	99.	5	K	[a]119.	8	C
40.	1	K	60.	3	K	80.	5	C	100.	5	C	[a]120.	8	AN
41.	1	C	61.	3	C	81.	5	K	101.	5	AN	[a]121.	8	AN
42.	1	K	62.	3	C	82.	5	K	102.	5	AN	[a]122.	8	AN
43.	1	K	63.	3	K	83.	5	AN	103.	6	C	[a]123.	8	AN
44.	1	C	64.	3	C	84.	5	AN	104.	6	C	124.	2	
45.	1	C	65.	3	C	85.	5	K	105.	6	AN	125.	2	
46.	1	C	66.	3	C	86.	5	K	106.	6	AN	126.	2	
47.	1	K	67.	3	C	87.	5	C	107.	6	AN	127.	4	
48.	2	K	68.	4	K	88.	5	C	108.	6	C	128.	4	
49.	2	K	69.	4	C	89.	5	AN	109.	6	AN	129.	5	
50.	2	K	70.	4	K	90.	5	K	110.	6	AN	130.	6	
51.	2	K	71.	4	K	91.	5	AN	111.	6	AN	131.	6	
52.	2	C	72.	4	K	92.	5	C	112.	6	AP	132.	6	
53.	2	C	73.	4	K	93.	5	K	113.	6	C	133.	7	
54.	2	C	74.	4	K	94.	5	K	114.	6	AN	134.	7	
55.	2	C	75.	4	K	95.	5	K	115.	7	K			
56.	2	C	76.	4	C	96.	5	K	116.	7	K			
57.	2	C	77.	4	K	97.	5	C	117.	7	C			
Exercises														
135.	2	AN	141.	4	C	147.	5,6	AN	153.	6	AN	159.	7	AP
136.	2	AN	142.	4	C	148.	5,6	AN	154.	6	AN	[a]160.	8	AN
137.	3	AN	143.	4,5	AN	149.	5,6	AN	155.	6	AN			
138.	3	AN	144.	5	AN	150.	5,6	AN	156.	5-7	AN			
139.	4	C	145.	5	AN	151.	5,6	AN	157.	5-7	AN			
140.	4	AN	146.	5,6	AN	152.	5,6	C	158.	7	AN			
Completion Statements														
161.	1	K	164.	2	K	167.	5	K	170.	6	K			
162.	1	K	165.	2	K	168.	5	K	171.	7	K			
163.	2	K	166.	5	K	169.	5	K						

[a] This topic is dealt with in an Appendix to the chapter

SUMMARY OF STUDY OBJECTIVES BY QUESTION TYPE

Item	Type	Item	Type	Item	Type	Item	Type	Item	Type	Item	Type	Item	Type
Study Objective 1													
1.	TF	4.	TF	39.	MC	42.	MC	45.	MC	161.	C		
2.	TF	5.	TF	40.	MC	43.	MC	46.	MC	162.	C		
3.	TF	38.	MC	41.	MC	44.	MC	47.	MC				
Study Objective 2													
6.	TF	10.	TF	50.	MC	54.	MC	58.	MC	126.	MC	164.	C
7.	TF	31.	TF	51.	MC	55.	MC	59.	MC	135.	Ex	165.	C
8.	TF	48.	MC	52.	MC	56.	MC	124.	MC	136.	Ex		
9.	TF	49.	MC	53.	MC	57.	MC	125.	MC	163.	C		
Study Objective 3													
11.	TF	14.	TF	60.	MC	63.	MC	66.	MC	138.	Ex		
12.	TF	[s]32.	TF	61.	MC	64.	MC	67.	MC				
13.	TF	[s]33.	TF	62.	MC	65.	MC	137.	Ex				
Study Objective 4													
15.	TF	69.	MC	72.	MC	75.	MC	78.	MC	139.	Ex	142.	Ex
16.	TF	70.	MC	73.	MC	76.	MC	127.	MC	140.	Ex	143.	Ex
68.	MC	71.	MC	74.	MC	77.	MC	128.	MC	141.	Ex		
Study Objective 5													
17.	TF	25.	TF	85.	MC	93.	MC	101.	MC	148.	Ex	167.	C
18.	TF	34.	TF	86.	MC	94.	MC	102.	MC	149.	Ex	168.	C
19.	TF	79.	MC	87.	MC	95.	MC	129.	MC	150.	Ex	169.	C
20.	TF	80.	MC	88.	MC	96.	MC	143.	Ex	151.	Ex		
21.	TF	81.	MC	89.	MC	97.	MC	144.	Ex	152.	Ex		
22.	TF	82.	MC	90.	MC	98.	MC	145.	Ex	156.	Ex		
23.	TF	83.	MC	91.	MC	99.	MC	146.	Ex	157.	Ex		
24.	TF	84.	MC	92.	MC	100.	MC	147.	Ex	166.	C		
Study Objective 6													
26.	TF	107.	MC	112.	MC	132.	MC	150.	Ex	155.	Ex		
35.	TF	108.	MC	113.	MC	146.	Ex	151.	Ex	156.	Ex		
104.	MC	109.	MC	114.	MC	147.	Ex	152.	Ex	157.	Ex		
105.	MC	110.	MC	130.	MC	148.	Ex	153.	Ex	170.	C		
106.	MC	111.	MC	131.	MC	149.	Ex	154.	Ex				
Study Objective 7													
27.	TF	115.	MC	117.	MC	134.	MC	157.	Ex	159.	Ex		
36.	TF	116.	MC	133.	MC	156.	Ex	158.	Ex	171.	C		
Study Objective [a]8													
[a]28.	TF	[a]30.	TF	[a]118.	MC	[a]120.	MC	[a]122.	MC	[a]160.	Ex		
[a]29.	TF	[a]37.	TF	[a]119.	MC	[a]121.	MC	[a]123.	MC				

Note: TF = True-False C = Completion
MC = Multiple Choice Ex = Exercise

The chapter also contains one set of ten Matching questions and four Short-Answer Essay questions.

CHAPTER STUDY OBJECTIVES

1. ***Explain the time period assumption.*** The time period assumption assumes that the economic life of a business can be divided into artificial time periods.

2. ***Explain the accrual basis of accounting.*** Accrual-basis accounting means that events that change a company's financial statements are recorded in the periods in which the events occur, rather than in the periods in which the company receives or pays cash.

3. ***Explain why adjusting entries are needed.*** Adjusting entries are made at the end of an accounting period. They ensure that revenues are recorded in the period in which they are earned and that expenses are recognized in the period in which they are incurred.

4. ***Identify the major types of adjusting entries.*** The major types of adjusting entries are prepaid expenses, unearned revenues, accrued revenues, and accrued expenses.

5. ***Prepare adjusting entries for prepayments.*** Prepayments are either prepaid expenses or unearned revenues. Adjusting entries for prepayments are required at the statement date to record the portion of the prepayment that represents the expense incurred or the revenue earned in the current accounting period.

6. ***Prepare adjusting entries for accruals.*** Accruals are either accrued revenues or accrued expenses. Adjusting entries for accruals are required to record revenues earned and expenses incurred in the current accounting period that have not been recognized through daily entries.

7. ***Describe the nature and purpose of an adjusted trial balance.*** An adjusted trial balance shows the balances of all accounts, including those that have been adjusted, at the end of an accounting period. Its purpose is to show the effects of all financial events that have occurred during the accounting period.

[a]8. ***Prepare adjusting entries for the alternative treatment of prepayments.*** Prepayments may be initially debited to an expense account. Unearned revenues may be credited to a revenue account. At the end of the period, these accounts may be overstated. The adjusting entries for prepaid expenses are a debit to an asset account and a credit to an expense account. Adjusting entries for unearned revenues are a debit to a revenue account and a credit to a liability account.

TRUE-FALSE STATEMENTS

1. Because accounting often requires estimates to be made to assess the effect of a transaction, the shorter the time period, the easier it becomes to determine the proper adjustments.

2. The time period assumption states that the economic life of a business entity can be divided into artificial time periods.

3. The time period assumption is often referred to as the matching principle.

4. A company's calendar year and fiscal year are always the same.

5. Accounting time periods that are one year in length are referred to as interim periods.

6. Income will always be greater under the cash basis of accounting than under the accrual basis of accounting.

7. The cash basis of accounting is not in accordance with generally accepted accounting principles.

8. The matching principle requires that efforts be matched with accomplishments.

9. Expense recognition is tied to revenue recognition.

10. The revenue recognition principle dictates that revenue be recognized in the accounting period in which cash is received.

11. Adjusting entries are not necessary if the trial balance debit and credit columns balances are equal.

12. An adjusting entry always involves two balance sheet accounts.

13. Adjusting entries are often made because some business events are not recorded as they occur.

14. Adjusting entries are recorded in the general journal but are not posted to the accounts in the general ledger.

15. Revenue received before it is earned and expenses paid before being used or consumed are both initially recorded as liabilities.

16. Accrued revenues are revenues which have been received but not yet earned.

17. The book value of a depreciable asset is always equal to its market value because depreciation is a valuation technique.

18. Accumulated Depreciation is a liability account and has a credit normal account balance.

19. A liability—revenue account relationship exists with an unearned rent revenue adjusting entry.

20. The balances of the Depreciation Expense and the Accumulated Depreciation accounts should always be the same.

21. Unearned revenue is a prepayment that requires an adjusting entry when services are performed.

22. Asset prepayments become expenses when they expire.

23. A contra asset account is subtracted from a related account in the balance sheet.

24. If prepaid costs are initially recorded as an asset, no adjusting entries will be required in the future.

25. The cost of a depreciable asset less accumulated depreciation reflects the book value of the asset.

26. Accrued revenues are revenues that have been earned and received before financial statements have been prepared.

27. Financial statements can be prepared from the information provided by an adjusted trial balance.

[a]28. The adjusting entry at the end of the period to record an expired cost may be different depending on whether the cost was initially recorded as an asset or an expense.

[a]29. Rent received in advance and credited to a rent revenue account which is still unearned at the end of the period, will require an adjusting entry crediting a liability account for the amount still unearned.

[a]30. An adjusting entry requiring a credit to Insurance Expense indicates that the initial transaction was charged to an asset account.

<u>Additional True/False Questions</u>

31. The matching principle requires that expenses be matched with revenues.

32. In general, adjusting entries are required each time financial statements are prepared.

33. Every adjusting entry affects one balance sheet account and one income statement account.

34. The Accumulated Depreciation account is a contra asset account that is reported on the balance sheet.

35. Accrued revenues are amounts recorded and received but not yet earned.

36. An adjusted trial balance should be prepared before the adjusting entries are made.

[a]37. When a prepaid expense is initially debited to an expense account, expenses and assets are both overstated prior to adjustment.

Answers to True-False Statements

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
1.	F	7.	T	13.	T	19.	T	25.	T	31.	T	[a]37.	F
2.	T	8.	T	14.	F	20.	F	26.	F	32.	T		
3.	F	9.	T	15.	F	21.	T	27.	T	33.	T		
4.	F	10.	F	16.	F	22.	T	[a]28.	T	34.	T		
5.	F	11.	F	17.	F	23.	T	[a]29.	T	35.	F		
6.	F	12.	F	18.	F	24.	F	[a]30.	F	36.	F		

MULTIPLE CHOICE QUESTIONS

38. Monthly and quarterly time periods are called
    a. calender periods.
    b. fiscal periods.
    c. interim periods.
    d. quarterly periods.

39. The time period assumption states that
    a. a transaction can only affect one period of time.
    b. estimates should not be made if a transaction affects more than one time period.
    c. adjustments to the enterprise's accounts can only be made in the time period when the business terminates its operations.
    d. the economic life of a business can be divided into artificial time periods.

40. An accounting time period that is one year in length, but does *not* begin on January 1, is referred to as
    a. a fiscal year.
    b. an interim period.
    c. the time period assumption.
    d. a reporting period.

41. Adjustments would *not* be necessary if financial statements were prepared to reflect net income from
    a. monthly operations.
    b. fiscal year operations.
    c. interim operations.
    d. lifetime operations.

42. Management usually desires ________ financial statements and the IRS requires all businesses to file _________ tax returns.
    a. annual, annual
    b. monthly, annual
    c. quarterly, monthly
    d. monthly, monthly

43. The time period assumption is also referred to as the
    a. calendar assumption.
    b. cyclicity assumption.
    c. periodicity assumption.
    d. fiscal assumption.

44. In general, the shorter the time period, the difficulty of making the proper adjustments to accounts
    a. is increased.
    b. is decreased.
    c. is unaffected.
    d. depends on if there is a profit or loss.

45. Which of the following is *not* a common time period chosen by businesses as their accounting period?
    a. Daily
    b. Monthly
    c. Quarterly
    d. Annually

46. Which of the following time periods would *not* be referred to as an interim period?
    a. Monthly
    b. Quarterly
    c. Semi-annually
    d. Annually

47. The fiscal year of a business is usually determined by
    a. the IRS.
    b. a lottery.
    c. the business.
    d. the SEC.

48. Which of the following are in accordance with generally accepted accounting principles?
    a. Accrual basis accounting
    b. Cash basis accounting
    c. Both accrual basis and cash basis accounting
    d. Neither accrual basis nor cash basis accounting

49. The revenue recognition principle dictates that revenue should be recognized in the accounting records
    a. when cash is received.
    b. when it is earned.
    c. at the end of the month.
    d. in the period that income taxes are paid.

50. In a service-type business, revenue is considered earned
    a. at the end of the month.
    b. at the end of the year.
    c. when the service is performed.
    d. when cash is received.

51. The matching principle matches
    a. customers with businesses.
    b. expenses with revenues.
    c. assets with liabilities.
    d. creditors with businesses.

52. Jim's Tune-up Shop follows the revenue recognition principle. Jim services a car on July 31. The customer picks up the vehicle on August 1 and mails the payment to Jim on August 5. Jim receives the check in the mail on August 6. When should Jim show that the revenue was earned?
    a. July 31
    b. August 1
    c. August 5
    d. August 6

53. A company spends $10 million dollars for an office building. Over what period should the cost be written off?
    a. When the $10 million is expended in cash
    b. All in the first year
    c. Over the useful life of the building
    d. After $10 million in revenue is earned

54. The matching principle states that expenses should be matched with revenues. Another way of stating the principle is to say that
    a. assets should be matched with liabilities.
    b. efforts should be matched with accomplishments.
    c. owner withdrawals should be matched with owner contributions.
    d. cash payments should be matched with cash receipts.

55. A dress shop makes a large sale for $1,000 on November 30. The customer is sent a statement on December 5 and a check is received on December 10. The dress shop follows GAAP and applies the revenue recognition principle. When is the $1,000 considered to be earned?
    a. December 5
    b. December 10
    c. November 30
    d. December 1

56. A furniture factory's employees work overtime to finish an order that is sold on February 28. The office sends a statement to the customer in early March and payment is received by mid-March. The overtime wages should be expensed in
    a. February.
    b. March.
    c. the period when the workers receive their checks.
    d. either in February or March depending on when the pay period ends.

57. Expenses sometimes make their contribution to revenue in a different period than when the expense is paid. When wages are incurred in one period and paid in the next period, this often leads to which account appearing on the balance sheet at the end of the time period?
    a. Due from Employees
    b. Due to Employer
    c. Wages Payable
    d. Wages Expense

58. Under accrual-basis accounting
    a. cash must be received before revenue is recognized.
    b. net income is calculated by matching cash outflows against cash inflows.
    c. events that change a company's financial statements are recognized in the period they occur rather than in the period in which cash is paid or received.
    d. the ledger accounts must be adjusted to reflect a cash basis of accounting before financial statements are prepared under generally accepted accounting principles.

59. Adjusting entries are required
    a. yearly.
    b. quarterly.
    c. monthly.
    d. every time financial statements are prepared.

60. Adjusting entries are required
    a. because some costs expire with the passage of time and have not yet been journalized.
    b. when the company's profits are below the budget.
    c. when expenses are recorded in the period in which they are incurred.
    d. when revenues are recorded in the period in which they are earned.

61. A small company may be able to justify using a cash basis of accounting if they have
    a. sales under $1,000,000.
    b. no accountants on staff.
    c. few receivables and payables.
    d. all sales and purchases on account.

62. Which one of the following is *not* a justification for adjusting entries?
    a. Adjusting entries are necessary to ensure that revenue recognition principles are followed.
    b. Adjusting entries are necessary to ensure that the matching principle is followed.
    c. Adjusting entries are necessary to enable financial statements to be in conformity with GAAP.
    d. Adjusting entries are necessary to bring the general ledger accounts in line with the budget.

63. An adjusting entry
    a. affects two balance sheet accounts.
    b. affects two income statement accounts.
    c. affects a balance sheet account and an income statement account.
    d. is always a compound entry.

64. The preparation of adjusting entries is
    a. straight forward because the accounts that need adjustment will be out of balance.
    b. often an involved process requiring the skills of a professional.
    c. only required for accounts that do not have a normal balance.
    d. optional when financial statements are prepared.

65. If a resource has been consumed but a bill has *not* been received at the end of the accounting period, then
    a. an expense should be recorded when the bill is received.
    b. an expense should be recorded when the cash is paid out.
    c. an adjusting entry should be made recognizing the expense.
    d. it is optional whether to record the expense before the bill is received.

66. Accounts often need to be adjusted because
    a. there are never enough accounts to record all the transactions.
    b. many transactions affect more than one time period.
    c. there are always errors made in recording transactions.
    d. management can't decide what they want to report.

67. Adjusting entries are
    a. not necessary if the accounting system is operating properly.
    b. usually required before financial statements are prepared.
    c. made whenever management desires to change an account balance.
    d. made to balance sheet accounts only.

68. Expenses incurred but not yet paid or recorded are called
    a. prepaid expenses.
    b. accrued expenses.
    c. interim expenses.
    d. unearned expenses.

69. A law firm received $2,000 cash for legal services to be rendered in the future. The full amount was credited to the liability account Unearned Legal Fees. If the legal services have been rendered at the end of the accounting period and no adjusting entry is made, this would cause
    a. expenses to be overstated.
    b. net income to be overstated.
    c. liabilities to be understated.
    d. revenues to be understated.

70. Adjusting entries can be classified as
    a. postponements and advances.
    b. accruals and prepayments.
    c. prepayments and postponements.
    d. accruals and advances.

71. Accrued revenues are
    a. received and recorded as liabilities before they are earned.
    b. earned and recorded as liabilities before they are received.
    c. earned but not yet received or recorded.
    d. earned and already received and recorded.

72. Prepaid expenses are
    a. paid and recorded in an asset account before they are used or consumed.
    b. paid and recorded in an asset account after they are used or consumed.
    c. incurred but not yet paid or recorded.
    d. incurred and already paid or recorded.

73. Accrued expenses are
    a. paid and recorded in an asset account before they are used or consumed.
    b. paid and recorded in an asset account after they are used or consumed.
    c. incurred but not yet paid or recorded.
    d. incurred and already paid or recorded.

74. Unearned revenues are
    a. received and recorded as liabilities before they are earned.
    b. earned and recorded as liabilities before they are received.
    c. earned but not yet received or recorded.
    d. earned and already received and recorded.

75. A liability—revenue relationship exists with
    a. prepaid expense adjusting entries.
    b. accrued expense adjusting entries.
    c. unearned revenue adjusting entries.
    d. accrued revenue adjusting entries.

76. Which of the following reflect the balances of prepayment accounts prior to adjustment?
    a. Balance sheet accounts are understated and income statement accounts are understated.
    b. Balance sheet accounts are overstated and income statement accounts are overstated.
    c. Balance sheet accounts are overstated and income statement accounts are understated.
    d. Balance sheet accounts are understated and income statement accounts are overstated.

77. An asset—expense relationship exists with
    a. liability accounts.
    b. revenue accounts.
    c. prepaid expense adjusting entries.
    d. accrued expense adjusting entries.

78. Quirk Company purchased office supplies costing $4,000 and debited Office Supplies for the full amount. At the end of the accounting period, a physical count of office supplies revealed $1,600 still on hand. The appropriate adjusting journal entry to be made at the end of the period would be
    a. Debit Office Supplies Expense, $1,600; Credit Office Supplies, $1,600.
    b. Debit Office Supplies, $2,400; Credit Office Supplies Expense, $2,400.
    c. Debit Office Supplies Expense, $2,400; Credit Office Supplies, $2,400.
    d. Debit Office Supplies, $1,600; Credit Office Supplies Expense, $1,600.

79. If an adjustment is needed for unearned revenues, the
    a. liability and related revenue are overstated before adjustment.
    b. liability and related revenue are understated before adjustment.
    c. liability is overstated and the related revenue is understated before adjustment.
    d. liability is understated and the related revenue is overstated before adjustment.

80. If an adjustment is needed for prepaid expenses, the
    a. asset and related expense are overstated before adjustment.
    b. asset and related expense are understated before adjustment.
    c. asset is understated and the related expense is overstated before adjustment.
    d. asset is overstated and the related expense is understated before adjustment.

81. Depreciation expense for a period is computed by taking the
    a. original cost of an asset – accumulated depreciation.
    b. depreciable cost ÷ depreciation rate.
    c. cost of the asset ÷ useful life.
    d. market value of the asset ÷ useful life.

82. Accumulated Depreciation is
    a. an expense account.
    b. an owner's equity account.
    c. a liability account.
    d. a contra asset account.

83. Hardy Company purchased a computer for $2,400 on December 1. It is estimated that annual depreciation on the computer will be $480. If financial statements are to be prepared on December 31, the company should make the following adjusting entry:
    a. Debit Depreciation Expense, $480; Credit Accumulated Depreciation, $480.
    b. Debit Depreciation Expense, $40; Credit Accumulated Depreciation, $40.
    c. Debit Depreciation Expense, $1,920; Credit Accumulated Depreciation, $1,920.
    d. Debit Office Equipment, $2,400; Credit Accumulated Depreciation, $2,400.

84. Meyer Realty Company received a check for $21,000 on July 1 which represents a 6 month advance payment of rent on a building it rents to a client. Unearned Rent was credited for the full $21,000. Financial statements will be prepared on July 31. Meyer Realty should make the following adjusting entry on July 31:
    a. Debit Unearned Rent, $3,500; Credit Rental Revenue, $3,500.
    b. Debit Rental Revenue, $3,500; Credit Unearned Rent, $3,500.
    c. Debit Unearned Rent, $21,000; Credit Rental Revenue, $21,000.
    d. Debit Cash, $21,000; Credit Rental Revenue, $21,000.

85. As prepaid expenses expire with the passage of time, the correct adjusting entry will be a
    a. debit to an asset account and a credit to an expense account.
    b. debit to an expense account and a credit to an asset account.
    c. debit to an asset account and a credit to an asset account.
    d. debit to an expense account and a credit to an expense account.

86. A company usually determines the amount of supplies used during a period by
    a. adding the supplies on hand to the balance of the Supplies account.
    b. summing the amount of supplies purchased during the period.
    c. taking the difference between the supplies purchased and the supplies paid for during the period.
    d. taking the difference between the balance of the Supplies account and the cost of supplies on hand.

87. If a company fails to make an adjusting entry to record supplies expense, then
    a. owner's equity will be understated.
    b. expense will be understated.
    c. assets will be understated.
    d. net income will be understated.

88. If a company fails to adjust a Prepaid Rent account for rent that has expired, what effect will this have on that month's financial statements?
    a. Failure to make an adjustment does not affect the financial statements.
    b. Expenses will be overstated and net income and owner's equity will be understated.
    c. Assets will be overstated and net income and owner's equity will be understated.
    d. Assets will be overstated and net income and owner's equity will be overstated.

89. At December 31, 2005, before any year-end adjustments, Karr Company's Insurance Expense account had a balance of $725 and its Prepaid Insurance account had a balance of $1,900. It was determined that $1,500 of the Prepaid Insurance had expired. The adjusted balance for Insurance Expense for the year would be
    a. $1,500.
    b. $725.
    c. $2,225.
    d. $1,125.

90. Depreciation is the process of
    a. valuing an asset at its fair market value.
    b. increasing the value of an asset over its useful life in a rational and systematic manner.
    c. allocating the cost of an asset to expense over its useful life in a rational and systematic manner.
    d. writing down an asset to its real value each accounting period.

91. A new accountant working for Metcalf Company records $800 Depreciation Expense on store equipment as follows:

Dr.	Depreciation Expense	800	
Cr.	Cash		800

    The effect of this entry is to
    a. adjust the accounts to their proper amounts on December 31.
    b. understate total assets on the balance sheet as of December 31.
    c. overstate the book value of the depreciable assets at December 31.
    d. understate the book value of the depreciable assets as of December 31.

92. From an accounting standpoint, the acquisition of productive facilities can be thought of as a long-term
    a. accrual of expense.
    b. accrual of revenue.
    c. accrual of unearned revenue.
    d. prepayment for services.

93. In computing depreciation, the number of years of useful life of the asset is
    a. known with certainty.
    b. an estimate.
    c. always fixed at 5 years.
    d. always fixed at 3 years.

94. An accumulated depreciation account
    a. is a contra-liability account.
    b. increases on the debit side.
    c. is offset against total assets on the balance sheet.
    d. has a normal credit balance.

95. The difference between the cost of a depreciable asset and its related accumulated depreciation is referred to as the
    a. market value of the asset.
    b. blue book value of the asset.
    c. book value of the asset.
    d. depreciated difference of the asset.

96. If a business has several types of long-term assets such as equipment, buildings, and trucks,
    a. there should be only one accumulated depreciation account.
    b. there should be separate accumulated depreciation accounts for each type of asset.
    c. all the long-term asset accounts will be recorded in one general ledger account.
    d. there won't be a need for an accumulated depreciation account.

97. Which of the following would *not* result in unearned revenue?
    a. Rent collected in advance from tenants
    b. Services performed on account
    c. Sale of season tickets to football games
    d. Sale of two-year magazine subscriptions

98. If business pays rent in advance and debits a Prepaid Rent account, the company receiving the rent payment will credit
    a. cash.
    b. prepaid rent.
    c. unearned rent revenue.
    d. accrued rent revenue.

99. Unearned revenue is classified as
    a. an asset account.
    b. a revenue account.
    c. a contra-revenue account.
    d. a liability.

100. If a business has received cash in advance of services performed and credits a liability account, the adjusting entry needed after the services are performed will be
    a. debit Unearned Revenue and credit Cash.
    b. debit Unearned Revenue and credit Service Revenue.
    c. debit Unearned Revenue and credit Prepaid Expense.
    d. debit Unearned Revenue and credit Accounts Receivable.

101. White Laundry Company purchased $6,500 worth of laundry supplies on June 2 and recorded the purchase as an asset. On June 30, an inventory of the laundry supplies indicated only $3,000 on hand. The adjusting entry that should be made by the company on June 30 is
    a. Debit Laundry Supplies Expense, $3,000; Credit Laundry Supplies, $3,000.
    b. Debit Laundry Supplies Expense, $3,500; Credit Laundry Supplies, $3,000.
    c. Debit Laundry Supplies, $3,500; Credit Laundry Supplies Expense, $3,500.
    d. Debit Laundry Supplies Expense, $3,500; Credit Laundry Supplies, $3,500.

102. On July 1 the Watson Shoe Store paid $6,000 to Ace Realty for 4 months rent beginning July 1. Prepaid Rent was debited for the full amount. If financial statements are prepared on July 31, the adjusting entry to be made by Watson Shoe Store is
    a. Debit Rent Expense, $6,000; Credit Prepaid Rent, $1,500.
    b. Debit Prepaid Rent, $1,500; Credit Rent Expense, $1,500.
    c. Debit Rent Expense, $1,500; Credit Prepaid Rent, $1,500.
    d. Debit Rent Expense, $6,000; Credit Prepaid Rent, $6,000.

103. If an adjusting entry is *not* made for an accrued revenue,
    a. assets will be overstated.
    b. expenses will be understated.
    c. owner's equity will be understated.
    d. revenues will be overstated.

104. If an adjusting entry is *not* made for an accrued expense,
    a. expenses will be overstated.
    b. liabilities will be understated.
    c. net income will be understated.
    d. owner's equity will be understated.

105. Failure to prepare an adjusting entry at the end of the period to record an accrued expense would cause
    a. net income to be understated.
    b. an overstatement of assets and an overstatement of liabilities.
    c. an understatement of expenses and an understatement of liabilities.
    d. an overstatement of expenses and an overstatement of liabilities.

106. Failure to prepare an adjusting entry at the end of a period to record an accrued revenue would cause
    a. net income to be overstated.
    b. an understatement of assets and an understatement of revenues.
    c. an understatement of revenues and an understatement of liabilities.
    d. an understatement of revenues and an overstatement of liabilities.

107. Deb Smiley has performed $500 of CPA services for a client but has not billed the client as of the end of the accounting period. What adjusting entry must Deb make?
    a. Debit Cash and credit Unearned Revenue
    b. Debit Accounts Receivable and credit Unearned Revenue
    c. Debit Accounts Receivable and credit Service Revenue
    d. Debit Unearned Revenue and credit Service Revenue

108. Deb Smiley, CPA, has billed her clients for services performed. She subsequently receives payments from her clients. What entry will she make upon receipt of the payments?
a. Debit Unearned Revenue and credit Service Revenue
b. Debit Cash and credit Accounts Receivable
c. Debit Accounts Receivable and credit Service Revenue
d. Debit Cash and credit Service Revenue

109. Clark Real Estate signed a four-month note payable in the amount of $8,000 on September 1. The note requires interest at an annual rate of 12%. The amount of interest to be accrued at the end of September is
a. $320.
b. $80.
c. $960.
d. $107.

110. A gift shop signs a three-month note payable to help finance increases in inventory for the Christmas shopping season. The note is signed on November 1 in the amount of $40,000 with annual interest of 12%. What is the adjusting entry to be made on December 31 for the interest expense accrued to that date, if no entries have been made previously for the interest?

a.	Interest Expense	800	
	Interest Payable		800
b.	Interest Expense	1,200	
	Interest Payable		1,200
c.	Interest Expense	800	
	Cash		800
d.	Interest Expense	800	
	Note Payable		800

111. Trent Tables paid employee wages on and through Friday, January 26, and the next payroll will be paid in February. There are three more working days in January (29–31). Employees work 5 days a week and the company pays $800 a day in wages. What will be the adjusting entry to accrue wages expense at the end of January?

a.	Wages Expense	800	
	Wages Payable		800
b.	Wages Expense	4,000	
	Wages Payable		4,000
c.	Wages Expense	2,400	
	Wages Payable		2,400

d. No adjusting entry is required.

112. A company shows a balance in Salaries Payable of $40,000 at the end of the month. The next payroll amounting to $50,000 is to be paid in the following month. What will be the journal entry to record the payment of salaries?

a. Salaries Expense	50,000	
Salaries Payable		50,000
b. Salaries Expense	50,000	
Cash		50,000
c. Salaries Expense	10,000	
Cash		10,000
d. Salaries Expense	10,000	
Salaries Payable	40,000	
Cash		50,000

113. The accounts of a business before an adjusting entry is made to record an accrued revenue reflect an
   a. understated liability and an overstated owner's capital.
   b. overstated asset and an understated revenue.
   c. understated expense and an overstated revenue.
   d. understated asset and an understated revenue.

114. Carter Guitar Company borrowed $10,000 from the bank signing a 9%, 3-month note on September 1. Principal and interest are payable to the bank on December 1. If the company prepares monthly financial statements, the adjusting entry that the company should make for interest on September 30, would be
   a. Debit Interest Expense, $900; Credit Interest Payable, $900.
   b. Debit Interest Expense, $75; Credit Interest Payable, $75.
   c. Debit Note Payable, $900; Credit Cash, $900.
   d. Debit Cash, $225; Credit Interest Payable, $225.

115. The adjusted trial balance is prepared
   a. after financial statements are prepared.
   b. before the trial balance.
   c. to prove the equality of total assets and total liabilities.
   d. after adjusting entries have been journalized and posted.

116. An adjusted trial balance
   a. is prepared after the financial statements are completed.
   b. proves the equality of the total debit balances and total credit balances of ledger accounts after all adjustments have been made.
   c. is a required financial statement under generally accepted accounting principles.
   d. cannot be used to prepare financial statements.

117. Which of the statements below is *not* true?
   a. An adjusted trial balance should show ledger account balances.
   b. An adjusted trial balance can be used to prepare financial statements.
   c. An adjusted trial balance proves the mathematical equality of debits and credits in the ledger.
   d. An adjusted trial balance is prepared before all transactions have been journalized.

[a]118. Al is a barber who does his own accounting for his shop. When he buys supplies he routinely debits Supplies Expense. Al purchased $1,500 of supplies in January and his inventory at the end of January shows $600 of supplies remaining. What adjusting entry should Al make on January 31?

a. Supplies Expense	600	
Supplies		600
b. Supplies Expense	1,500	
Cash		1,500
c. Supplies	600	
Supplies Expense		600
d. Supplies Expense	900	
Supplies		900

[a]119. Alternative adjusting entries do *not* apply to
a. accrued revenues and accrued expenses.
b. prepaid expenses.
c. unearned revenues.
d. prepaid expenses and unearned revenues.

[a]120. Joe is a lawyer who requires that his clients pay him in advance of legal services rendered. Joe routinely credits Legal Service Revenue when his clients pay him in advance. In June Joe collected $8,000 in advance fees and completed 75% of the work related to these fees. What adjusting entry is required by Joe's firm at the end of June?

a. Unearned Revenue	6,000	
Legal Service Revenue		6,000
b. Unearned Revenue	2,000	
Legal Service Revenue		2,000
c. Cash	8,000	
Legal Service Revenue		8,000
d. Legal Service Revenue	2,000	
Unearned Revenue		2,000

[a]121. If prepaid expenses are initially recorded in expense accounts and have not all been used at the end of the accounting period, then failure to make an adjusting entry will cause
a. assets to be understated.
b. assets to be overstated.
c. expenses to be understated.
d. contra-expenses to be overstated.

[a]122. If unearned revenues are initially recorded in revenue accounts and have not all been earned at the end of the accounting period, then failure to make an adjusting entry will cause
a. liabilities to be overstated.
b. revenues to be understated.
c. revenues to be overstated.
d. accounts receivable to be overstated.

[a]123. On January 2, 2005, Federal Savings and Loan purchased a general liability insurance policy for $1,800 for coverage for the calendar year. The entire $1,800 was charged to Insurance Expense on January 2, 2005. If the firm prepares monthly financial statements, the proper adjusting entry on January 31, 2005, will be:

a. Insurance Expense	1,650	
Prepaid Insurance		1,650
b. Prepaid Insurance	1,650	
Insurance Expense		1,650
c. Insurance Expense	150	
Prepaid Insurance		150
d. Prepaid Insurance	150	
Insurance Expense		150

<u>Additional Multiple-Choice Questions</u>

124. Which of the following statements concerning accrual-basis accounting is *incorrect?*
   a. Accrual-basis accounting follows the revenue recognition principle.
   b. Accrual-basis accounting is the method required by generally accepted accounting principles.
   c. Accrual-basis accounting recognizes expenses when they are paid.
   d. Accrual-basis accounting follows the matching principle.

125. The revenue recognition principle dictates that revenue be recognized in the accounting period
   a. before it is earned.
   b. after it is earned.
   c. in which it is earned.
   d. in which it is collected.

126. An expense is recorded under the cash basis only when
   a. services are performed.
   b. it is earned.
   c. cash is paid.
   d. it is incurred.

127. For prepaid expense adjusting entries
   a. an expense—liability account relationship exists.
   b. prior to adjustment, expenses are overstated and assets are understated.
   c. the adjusting entry results in a debit to an expense account and a credit to an asset account.
   d. none of these.

128. Expenses paid and recorded as assets before they are used are called
   a. accrued expenses.
   b. interim expenses.
   c. prepaid expenses.
   d. unearned expenses.

129. Demaet Cruise Lines purchased a five-year insurance policy for its ships on April 1, 2005 for $120,000. Assuming that April 1 is the effective date of the policy, the adjusting entry on December 31, 2005 is

a. Prepaid Insurance	18,000	
Insurance Expense		18,000
b. Insurance Expense	18,000	
Prepaid Insurance		18,000
c. Insurance Expense	24,000	
Prepaid Insurance		24,000
d. Insurance Expense	6,000	
Prepaid Insurance		6,000

130. Gardner Company purchased a truck from Kutner Co. by issuing a 6-month, 10% note payable for $60,000 on November 1. On December 31, the accrued expense adjusting entry is

a. No entry is required.

b. Interest Expense	6,000	
Interest Payable		6,000
c. Interest Expense	12,000	
Interest Payable		12,000
d. Interest Expense	1,000	
Interest Payable		1,000

131. If the adjusting entry for depreciation is *not* made,
a. assets will be understated.
b. owner's equity will be understated.
c. net income will be understated.
d. expenses will be understated.

132. Cathy Cline, an employee of Merlin Company, will not receive her paycheck until April 2. Based on services performed from March 15 to March 30 her salary was $900. The adjusting entry for Merlin Company on March 31 is

a. Salaries Expense	900	
Salaries Payable		900
b. No entry is required.		
c. Salaries Expense	900	
Cash		900
d. Salaries Payable	900	
Cash		900

133. Which of the following statements related to the adjusted trial balance is *incorrect?*
a. It shows the balances of all accounts at the end of the accounting period.
b. It is prepared before adjusting entries have been made.
c. It proves the equality of the total debit balances and the total credit balances in the ledger.
d. Financial statements can be prepared directly from the adjusted trial balance.

134. Financial statements are prepared directly from the
a. general journal.
b. ledger.
c. trial balance.
d. adjusted trial balance.

Answers to Multiple Choice Questions

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
38.	c	52.	a	66.	b	80.	d	94.	d	108.	b	[a]122.	c
39.	d	53.	c	67.	b	81.	c	95.	c	109.	b	[a]123.	b
40.	a	54.	b	68.	b	82.	d	96.	b	110.	a	124.	c
41.	d	55.	c	69.	d	83.	b	97.	b	111.	c	125.	c
42.	b	56.	a	70.	b	84.	a	98.	c	112.	d	126.	c
43.	c	57.	c	71.	c	85.	b	99.	d	113.	d	127.	c
44.	a	58.	c	72.	a	86.	d	100.	b	114.	b	128.	c
45.	a	59.	d	73.	c	87.	b	101.	d	115.	d	129.	b
46.	d	60.	a	74.	a	88.	d	102.	c	116.	b	130.	d
47.	c	61.	c	75.	c	89.	c	103.	c	117.	d	131.	d
48.	a	62.	d	76.	c	90.	c	104.	b	[a]118.	c	132.	a
49.	b	63.	c	77.	c	91.	c	105.	c	[a]119.	a	133.	b
50.	c	64.	b	78.	c	92.	d	106.	b	[a]120.	d	134.	d
51.	b	65.	c	79.	c	93.	b	107.	c	[a]121.	a		

EXERCISES

Ex. 135

The balance sheets of Cole Company include the following:

	12/31/05	12/31/04
Interest Receivable	$6,300	$ -0-
Supplies	5,000	3,500
Wages Payable	3,600	3,800
Unearned Revenue	-0-	4,000

The income statement for 2005 shows the following:

Interest Revenue	$15,400
Service Revenue	72,700
Supplies Expense	8,700
Wages Expense	37,000

Instructions

Calculate the following for 2005:

1. Cash received for interest.
2. Cash paid for supplies.
3. Cash paid for wages.
4. Cash received for revenue.

Solution 135 (15 min.)

1. Cash received for interest =		$9,100
Interest Revenue	$15,400	
Less: Interest Receivable	6,300	
Cash Received	$ 9,100	
2. Cash paid for supplies =		$10,200
Supplies Expense	$8,700	
Less: Supplies (2004)	3,500	
	5,200	
Add: Supplies (2005)	5,000	
Cash Paid	$10,200	
3. Cash paid for wages =		$37,200
Wages Expense	$37,000	
Add: Wages Payable (2004)	3,800	
	40,800	
Less: Wages Payable (2005)	3,600	
Cash Paid	$37,200	
4. Cash received for revenue =		$68,700
Service Revenue	$72,700	
Less: Unearned Revenue (2004)	4,000	
Cash Received	$68,700	

Ex. 136

Reiley Company prepared the following income statement using the cash basis of accounting:

REILEY COMPANY
Income Statement, Cash Basis
For the Year Ended December 31, 2005

Service revenue (does not include $40,000 of services rendered on account because the collection will not be until 2006)........	$370,000
Expenses (does not include $25,000 of expenses on account because payment will not be made until 2006)........	220,000
Net income........	$150,000

Additional data:
1. Depreciation on a company automobile for the year amounted to $6,000. This amount is not included in the expenses above.
2. On January 1, 2005, paid for a two-year insurance policy on the automobile amounting to $1,800. This amount is included in the expenses above.

Instructions
(a) Recast the above income statement on the accrual basis in conformity with generally accepted accounting principles. Show computations and explain each change.

(b) Explain which basis (cash or accrual) provides a better measure of income.

Solution 136 (15 min.)

(a)

REILEY COMPANY
Income Statement
For the Year Ended December 31, 2005

Service revenue........	$410,000
Expenses........	250,100
Net income	$159,900

Service revenue should include the $40,000 for services performed on account. The accrual basis states that revenue is reflected in the period when the service is performed. ($370,000 + $40,000 = $410,000). Expenses should include the $25,000 for expenses incurred but not yet paid. The accrual basis states that expenses should be reflected in the period when incurred. Expenses also should only include half of the $1,800 insurance premium since $900 applies to 2005. The other $900 is an asset and should be reflected on the balance sheet as prepaid insurance. The $6,000 of depreciation for the automobile is included as an expense in 2005. ($220,000 + $25,000 – $900 + $6,000 = $250,100).

(b) The accrual basis of accounting provides a better measure of income than the cash basis. The accrual basis is required under generally accepted accounting principles and recognizes revenues when earned and expenses when incurred. Revenues and expenses recognized under the accrual basis are related to the economic environment in which they occur and thus allow trends to be more meaningfully interpreted.

The cash basis often fails to recognize revenue in the period when earned and expenses when incurred. Additionally, expenses are not matched with revenues when earned; therefore, the matching principle is violated.

Ex. 137

Before month-end adjustments are made, the February 28 trial balance of Ed's Enterprise contains revenue of $9,000 and expenses of $4,400. Adjustments are necessary for the following items:

- Depreciation for February is $1,300.
- Revenue earned but not yet billed is $3,300.
- Accrued interest expense is $700.
- Revenue collected in advance that is now earned is $3,500.
- Portion of prepaid insurance expired during February is $400.

Instructions
Calculate the correct net income for Ed's Income Statement for February.

Solution 137 (5 min.)

Net Income before Adjustments ($9,000 – 4,400)			$ 4,600
Add:	Unearned Revenues	$3,500	
	Accrued Revenues	3,300	6,800
			11,400
Subtract:	Depreciation Expense	1,300	
	Interest Expense	700	
	Insurance Expense	400	2,400
Net Income after Adjustments			$ 9,000

Ex. 138

On December 31, 2005, Gomez Company prepared an income statement and balance sheet and failed to take into account three adjusting entries. The incorrect income statement showed net income of $40,000. The balance sheet showed total assets, $120,000; total liabilities, $45,000; and owner's equity, $75,000.

The data for the three adjusting entries were:
(1) Depreciation of $7,000 was not recorded on equipment.
(2) Wages amounting to $8,000 for the last two days in December were not paid and not recorded. The next payroll will be in January.
(3) Rent of $12,000 was paid for two months in advance on December 1. The entire amount was debited to Rent Expense when paid.

Instructions
Complete the following tabulation to correct the financial statement amounts shown (indicate deductions with parentheses):

Item	Net Income	Total Assets	Total Liabilities	Owner's Equity
Incorrect balances	$ 40,000	$120,000	$ 45,000	$ 75,000
Effects of:				
Depreciation	________	________	________	________
Wages	________	________	________	________
Rent	________	________	________	________
Correct Balances	________	________	________	________

Solution 138 (5 min.)

Item	Net Income	Total Assets	Total Liabilities	Owner's Equity
Incorrect balances	$40,000	$120,000	$45,000	$75,000
Effects of:				
Depreciation	(7,000)	(7,000)		(7,000)
Wages	(8,000)		8,000	(8,000)
Rent	6,000	6,000		6,000
Correct Balances	$31,000	$119,000	$53,000	$66,000

Ex. 139

Indicate (a) the type of adjustment (prepaid expense, unearned revenue, accrued revenue, or accrued expense), and (b) the accounts before adjustment (overstated or understated) for each of the following:

1. Supplies of $200 have been used.
2. Salaries of $600 are unpaid.
3. Rent received in advance totaling $300 has been earned.
4. Services provided but not recorded total $500.

Solution 139 (7 min.)

	(a) Type of Adjustment	(b) Accounts before Adjustment
1.	Prepaid Expense	Assets Overstated Expenses Understated
2.	Accrued Expense	Expenses Understated Liabilities Understated
3.	Unearned Revenue	Liabilities Overstated Revenues Understated
4.	Accrued Revenue	Assets Understated Revenues Understated

Ex. 140

Ellis Company accumulates the following adjustment data at December 31.

1. Revenue of $800 collected in advance has been earned.
2. Salaries of $600 are unpaid.
3. Prepaid rent totaling $450 has expired.
4. Supplies of $550 have been used.
5. Revenue earned but unbilled total $750.
6. Utility expenses of $200 are unpaid.
7. Interest of $250 has accrued on a note payable.

Ex. 140 (cont.)

Instructions

(a) For each of the above items indicate:
1. The type of adjustment (prepaid expense, unearned revenue, accrued revenue, or accrued expense).
2. The account relationship (asset/liability, liability/revenue, etc.).
3. The status of account balances before adjustment (understatement or overstatement).
4. The adjusting entry.

(b) Assume net income before the adjustments listed above was $16,500. What is the adjusted net income?

Prepare your answer in the tabular form presented below.

Type of Adjustment	Account Relationship	Account Balances Before Adjustment (Understatement or Overstatement)	Adjusting Entry

Solution 140 (20 min.)

(a)

	Type of Adjustment	Account Relationship	Account Balances Before Adjustment (Understatement or Overstatement)	Adjusting Entry	Income Effect Increase (Decrease)
1.	Unearned revenue.	L/R	Liab. O	Unearned Revenue	
			Rev. U	Service Revenue	800
2.	Accrued expense.	E/L	Exp. U	Salary Expense	
			Liab. U	Salaries Payable	(600)
3.	Prepaid expense.	E/A	Exp. U	Rent Expense	
			Asset O	Prepaid Rent	(450)
4.	Prepaid expense.	E/A	Exp. U	Supplies Expense	
			Asset O	Supplies	(550)
5.	Accrued revenue.	A/R	Asset U	Accounts Receivable	
			Rev. U	Service Revenue	750

Solution 140 (cont.)

	Type of Adjustment	Account Relationship	Account Balances Before Adjustment (Understatement or Overstatement)	Adjusting Entry	Income Effect Increase (Decrease)
6.	Accrued expense.	E/L	Exp. U Liab. U	Utilities Expense Accounts Payable	(200)
7.	Accrued expense.	E/L	Exp. U Liab. U	Interest Expense Interest Payable	(250)

Codes:

A	=	Asset	R	=	Revenue
L	=	Liability	O	=	Overstatement
E	=	Expense	U	=	Understatement

(b)

Net income before adjustments			$16,500
Add:	Unearned revenue (1)	$800	
	Accrued revenue (5)	750	1,550
			18,050
Less:	Accrued salaries (2)	600	
	Prepaid rent expired (3)	450	
	Supplies used (4)	550	
	Accrued utilities (6)	200	
	Accrued interest (7)	250	2,050
Adjusted net income			$16,000

Ex. 141

The adjusted trial balance of the Nance Company includes the following balance sheet accounts that frequently require adjustment. For each account, indicate (a) the type of adjusting entry (prepaid expenses, unearned revenues, accrued revenues, or accrued expenses) and (b) the related account in the adjusting entry.

Balance Sheet Account	(a) Type of Adjusting Entry	(b) Related Account
1. Supplies		
2. Accounts Receivable		
3. Prepaid Insurance		
4. Accumulated Depreciation—Equipment		
5. Interest Payable		
6. Salaries Payable		
7. Unearned Revenue		

Solution 141 (15 min.)

Balance Sheet Account	(a) Type of Adjusting Entry	(b) Related Account
1. Supplies	Prepaid Expense	Supplies Expense
2. Accounts Receivable	Accrued Revenue	Service Revenue
3. Prepaid Insurance	Prepaid Expense	Insurance Expense
4. Accumulated Depreciation— Equipment	Prepaid Expense	Depreciation Expense
5. Interest Payable	Accrued Expense	Interest Expense
6. Salaries Payable	Accrued Expense	Salaries Expense
7. Unearned Revenue	Unearned Revenues	Service Revenue

Ex. 142

Match the statements below with the appropriate terms by entering the appropriate letter code in the spaces provided.

TERMS:

A. Prepaid Expenses
B. Unearned Revenues
C. Accrued Revenues
D. Accrued Expenses

STATEMENTS:

____ 1. A revenue not yet earned; collected in advance.

____ 2. Office supplies on hand that will be used in the next period.

____ 3. Interest revenue collected; not yet earned.

____ 4. Rent not yet collected; already earned.

____ 5. An expense incurred; not yet paid or recorded.

____ 6. A revenue earned; not yet collected or recorded.

____ 7. An expense not yet incurred; paid in advance.

____ 8. Interest expense incurred; not yet paid.

Solution 142 (5 min.)

1. B
2. A
3. B
4. C
5. D
6. C
7. A
8. D

Ex. 143

The Royals, a semi-professional baseball team, prepare financial statements on a monthly basis. Their season begins in April, but in March the team engaged in the following transactions:

(a) Paid $150,000 to Wichita City as advance rent for use of Wichita City Stadium for the six month period April 1 through September 30.

(b) Collected $300,000 cash from sales of season tickets for the team's 20 home games. This amount was credited to Unearned Ticket Revenue.

During the month of April, the Royals played four home games and five road games.

Instructions
Prepare the adjusting entries required at April 30 for the transactions above.

Solution 143 (5 min.)

(a)	Rent Expense	25,000	
	Prepaid Rent		25,000
	($150,000 ÷ 6 = $25,000)		
(b)	Unearned Ticket Revenue	60,000	
	Ticket Revenue		60,000
	($300,000 ÷ 20 = $15,000; $15,000 × 4 = $60,000)		

Ex. 144

On July 1, 2005, Edwards Company pays $6,000 to its insurance company for a 2-year insurance policy.

Instructions
Prepare the necessary journal entries for Edwards on July 1 and December 31.

Solution 144 (5 min.)

July 1	Prepaid Insurance	6,000	
	Cash		6,000
Dec. 31	Insurance Expense	1,500	
	Prepaid Insurance ($6,000 × 6/24)		1,500

Ex. 145

On July 1, 2005, Bluestem Insurance Company received $12,000 from a client for a 2-year insurance policy.

Instructions
Prepare the necessary journal entries for Bluestem on July 1 and December 31.

Solution 145 (5 min.)

July 1	Cash	12,000	
	Unearned Insurance Revenue		12,000
Dec. 31	Unearned Insurance Revenue	3,000	
	Insurance Revenue ($12,000 × 6/24)		3,000

Ex. 146

Baer Coat Company purchased equipment on June 1 for $54,000, paying $12,000 cash and signing a 12%, 2-month note for the remaining balance. The equipment is expected to depreciate $12,000 each year. Baer Coat Company prepares monthly financial statements.

Instructions
(a) Prepare the general journal entry to record the acquisition of the equipment on June lst.
(b) Prepare any adjusting journal entries that should be made on June 30th.
(c) Show how the equipment will be reflected on Baer Coat Company's balance sheet on June 30th.

Solution 146 (10 min.)

(a)	June 1	Equipment	54,000	
		Cash		12,000
		Notes Payable		42,000
		(To record acquisition of equipment and signing of a 2-month, 12% note)		
(b)	June 30	Depreciation Expense	1,000	
		Accumulated Depreciation—Equipment		1,000
		(To record monthly depreciation) $12,000 ÷ 12 = $1,000/month		
	30	Interest Expense	420	
		Interest Payable		420
		(To accrue interest on notes payable) $42,000 × 12% × 1/12 = $420		

(c) Assets

Equipment	$54,000	
Less: Accumulated Depreciation—Equipment	1,000	$53,000

Ex. 147

Unruh Company prepares monthly financial statements. Below are listed some selected accounts and their balances in the September 30 trial balance before any adjustments have been made for the month of September.

UNRUH COMPANY
Trial Balance (Selected Accounts)
September 30, 2005

	Debit	Credit
Office Supplies	$ 2,700	
Prepaid Insurance	4,200	
Office Equipment	16,200	
Accumulated Depreciation—Office Equipment		$ 900
Unearned Rent Revenue		1,200

(**Note:** Debit column does not equal credit column because this is a *partial* listing of selected account balances)

An analysis of the account balances by the company's accountant provided the following additional information:

1. A physical count of office supplies revealed $1,200 on hand on September 30.
2. A two-year life insurance policy was purchased on June 1 for $4,800.
3. Office equipment depreciated $5,400 per year.
4. The amount of rent received in advance that remains unearned at September 30 is $500.

Instructions
Using the above additional information, prepare the adjusting entries that should be made by Unruh Company on September 30.

Solution 147 (10 min.)

	Debit	Credit
1. Office Supplies Expense	1,500	
Office Supplies		1,500
(To record the amount of office supplies used)		
2. Insurance Expense	200	
Prepaid Insurance		200
(To record insurance expired $4,800 ÷ 24)		
3. Depreciation Expense	450	
Accumulated Depreciation—Office Equipment		450
(To record monthly depreciation $5,400 ÷ 12)		
4. Unearned Rent Revenue	700	
Rent Revenue		700
(To record rent revenue earned)		

Ex. 148

Prepare the required end-of-period adjusting entries for each independent case listed below.

Case 1
Starr Company began the year with a $3,000 balance in the Office Supplies account. During the year, $8,500 worth of additional office supplies were purchased. A physical count of office supplies on hand at the end of the year revealed that $6,400 worth of office supplies had been used during the year. No adjusting entry has been made until year end.

Case 2
Eaton Company has a calendar year-end accounting period. On July 1, the company purchased office equipment for $30,000. It is estimated that the office equipment will depreciate $400 each month. No adjusting entry has been made until year end.

Case 3
Ward Realty is in the business of renting several apartment buildings and prepares monthly financial statements. It has been determined that 3 tenants in $600 per month apartments and one tenant in the $1,000 per month apartment had not paid their August rent as of August 31st.

Solution 148 (10 min.)

Case 1—December 31		
Office Supplies Expense	6,400	
Office Supplies		6,400
(To record office supplies used during the year)		
Case 2—December 31		
Depreciation Expense	2,400	
Accumulated Depreciation—Office Equipment		2,400
(To record depreciation expense for six months)		
$400 × 6 months = $2,400 Depreciation		
Case 3—August 31		
Rent Receivable	2,800	
Rent Revenue		2,800
(To accrue rent earned but not yet received)		

Ex. 149

Logan Insurance Agency prepares monthly financial statements. Presented below is an income statement for the month of June that is correct on the basis of information considered.

LOGAN INSURANCE AGENCY
Income Statement
For the Month Ended June 30

Revenues		
Premium Commission Revenue		$35,000
Expenses		
Salary expense	$6,000	
Advertising expense	800	
Rent expense	4,200	
Depreciation expense	2,800	
Total expenses		13,800
Net income		$21,200

Additional Data: When the income statement was prepared, the company accountant neglected to take into consideration the following information:

1. A utility bill for $2,000 was received on the last day of the month for electric and gas service for the month of June.
2. A company insurance salesman sold a life insurance policy to a client for a premium of $28,000. The agency billed the client for the policy and is entitled to a commission of 20%.
3. Supplies on hand at the beginning of the month were $3,000. The agency purchased additional supplies during the month for $2,500 in cash and $2,200 of supplies were on hand at June 30.
4. The agency purchased a new car at the beginning of the month for $16,800 cash. The car will depreciate $4,200 per year.
5. Salaries owed to employees at the end of the month total $5,300. The salaries will be paid on July 5.

Instructions
Prepare a correct income statement.

Solution 149 (15 min.)

LOGAN INSURANCE AGENCY
Income Statement
For the Month Ended June 30

Revenues		
Premium Commission Revenue ($35,000 + $5,600)		$40,600
Expenses		
Salary expense ($6,000 + $5,300)	$11,300	
Advertising expense	800	
Rent expense	4,200	
Depreciation expense ($2,800 + $350)	3,150	
Utilities expense ($0 + $2,000)	2,000	
Supplies expense ($0 + $3,300)	3,300	
Total expenses		24,750
Net income		$15,850

Ex. 150

One part of eight adjusting entries is given below.

Instructions

Indicate the account title for the other part of each entry.

1. Unearned Revenue is debited.
2. Prepaid Rent is credited.
3. Accounts Receivable is debited.
4. Depreciation Expense is debited.
5. Utilities Expense is debited.
6. Interest Payable is credited.
7. Service Revenue is credited (give two possible debit accounts).
8. Interest Receivable is debited.

Solution 150 (5 min.)

1. Service Revenue
2. Rent Expense
3. Service Revenue
4. Accumulated Depreciation
5. Utilities Payable
6. Interest Expense
7. Accounts Receivable or Unearned Revenue
8. Interest Revenue

Ex. 151

For each of the following accounts, indicate (a) the type of adjusting entry (prepaid expense, accrued revenue, etc.) and (b) the related account in the adjusting entry.

1. Depreciation Expense
2. Salaries Payable
3. Service Revenue
4. Supplies
5. Unearned Revenue

Solution 151 (5 min.)

	Account	Type of Entry	Related Account
1.	Depreciation Expense	Prepaid expense	Accum. Depreciation
2.	Salaries Payable	Accrued expense	Salaries Expense
3.	Service Revenue	Accrued revenue	Accounts Receivable
4.	Supplies	Prepaid expense	Supplies Expense
5.	Unearned Revenue	Unearned revenue	Service Revenue

Ex. 152

Prepare the necessary adjusting entry for each of the following:

1. Services provided but unrecorded totaled $700.
2. Accrued salaries at year-end are $1,000.
3. Depreciation for the year is $600.

Solution 152 (5 min.)

1. Accounts Receivable	700	
Service Revenue		700
2. Salaries Expense	1,000	
Salaries Payable		1,000
3. Depreciation Expense	600	
Accumulated Depreciation		600

Ex. 153

The following ledger accounts are used by the Ottawa Greyhound Park:

Accounts Receivable
Prepaid Printing
Prepaid Rent

Unearned Admissions Revenue

Printing Expense
Rent Expense

Admissions Revenue
Concessions Revenue

Instructions
For each of the following transactions below, prepare the journal entry (if one is required) to record the initial transaction and then prepare the adjusting entry, if any, required on September 30, the end of the fiscal year.

(a) On September 1, paid rent on the track facility for three months, $180,000.
(b) On September 1, sold season tickets for admission to the racetrack. The racing season is year-round with 25 racing days each month. Season ticket sales totaled $900,000.
(c) On September 1, borrowed $200,000 from First National Bank by issuing a 9% note payable due in three months.
(d) On September 5, schedules for 20 racing days in September, 25 racing days in October, and 15 racing days in November were printed for $3,000.
(e) The accountant for the concessions company reported that gross receipts for September were $140,000. Ten percent is due to Ottawa and will be remitted by October 10.

Solution 153 (15 min.)

(a) Journal Entry

Prepaid Rent	180,000	
Cash		180,000

Adjusting Entry

Rent Expense	60,000	
Prepaid Rent		60,000

(b) Journal Entry

Cash	900,000	
Unearned Admissions Revenue		900,000

Adjusting Entry

Unearned Admissions Revenue	75,000	
Admissions Revenue		75,000
($900,000 ÷ 12 = $75,000)		

(c) Journal Entry

Cash	200,000	
Note Payable		200,000

Adjusting Entry

Interest Expense	1,500	
Interest Payable		1,500
($200,000 × .09 × 1 ÷ 12 = $1,500)		

(d) Journal Entry

Prepaid Printing	3,000	
Cash		3,000

Adjusting Entry

Printing Expense	1,000	
Prepaid Printing		1,000
($3,000 × 20 ÷ 60 = $1,000)		

(e) Journal Entry

None

Adjusting Entry

Accounts Receivable	14,000	
Concessions Revenue		14,000

Ex. 154

Fielder Company has an accounting fiscal year which ends on June 30. The company also has a policy of paying the weekly payroll on Friday. Payroll records indicate the following salary costs were incurred.

	Date	Amount
Monday	June 28	$3,000
Tuesday	June 29	3,800
Wednesday	June 30	2,400
Thursday	July 1	3,000
Friday	July 2	2,400

Instructions

(a) Prepare any necessary adjusting journal entries that should be made at year end on June 30.

(b) Prepare the journal entry to record the payment of the weekly payroll on July 2.

Solution 154 (10 min.)

(a)	June 30	Salaries Expense	9,200	
		Salaries Payable..		9,200
		(To accrue salaries incurred but not yet paid)		
(b)	July 2	Salaries Payable	9,200	
		Salaries Expense	5,400	
		Cash		14,600
		(To record payment of July 2 payroll)		

Ex. 155

On Friday of each week, Noble Company pays its factory personnel weekly wages amounting to $35,000 for a five-day work week.

Instructions

(a) Prepare the necessary adjusting entry at year end, assuming December 31 falls on Wednesday.

(b) Prepare the journal entry for payment of the week's wages on the payday which is Friday, January 2 of the next year.

Solution 155 (5 min.)

(a)	Dec. 31	Wages Expense	21,000	
		Wages Payable		21,000
(b)	Jan. 2	Wages Payable	21,000	
		Wages Expense	14,000	
		Cash		35,000

Ex. 156

Presented below is the Trial Balance and Adjusted Trial Balance for Jennings Company on December 31.

JENNINGS COMPANY
Trial Balance
December 31

	Before Adjustment Dr.	Before Adjustment Cr.	After Adjustment Dr.	After Adjustment Cr.
Cash	$ 2,000		$ 2,000	
Accounts Receivable	2,800		3,900	
Prepaid Rent	2,100		1,500	
Supplies	1,200		800	
Automobile equipment	18,000		18,000	
Accumulated depreciation— Automobile equipment		$ 1,300		$ 1,500
Accounts Payable		2,700		3,000
Notes Payable		10,000		10,000
Interest Payable				120
Salaries Payable				600
Unearned Revenue		4,460		4,360
Jennings, Capital		7,200		7,200
Jennings, Drawings	3,200		3,200	
Service Revenue		8,000		9,200
Salaries Expense	2,060		2,660	
Utilities Expense	1,800		2,100	
Rent Expense	500		1,100	
Supplies Expense			400	
Depreciation Expense— Automobile Equipment			200	
Interest Expense			120	
Totals	$33,660	$33,660	$35,980	$35,980

Instructions
Prepare in journal form, with explanations, the adjusting entries that explain the changes in the balances from the trial balance to the adjusted trial balance.

Solution 156 (15 min.)

	Dr.	Cr.
Accounts Receivable	1,100	
Service Revenue		1,100
(To record revenue earned but not yet received)		
Rent Expense	600	
Prepaid Rent		600
(To record expiration of prepaid rent)		
Supplies Expense	400	
Supplies		400
(To record supplies used)		

Solution 156 (cont.)

Depreciation Expense—Automobile Equipment	200	
Accumulated Depreciation—Automobile Equipment		200
(To record depreciation expense)		
Salaries Expense	600	
Salaries Payable		600
(To record salaries owed, not yet paid)		
Interest Expense	120	
Interest Payable		120
(To record accrued interest payable)		
Unearned Revenue	100	
Service Revenue		100
(To record revenue earned)		
Utilities Expense	300	
Accounts Payable		300
(To record receipt of utility bill)		

Ex. 157

Compute the net income for 2005 based on the following amounts presented on the adjusted trial balance of Pryor Company.

Accumulated Depreciation	$20,000
Depreciation Expense	10,000
Salaries Expense	15,000
Service Revenue	45,000
Unearned Revenue	8,000

Solution 157 (5 min.)

Service Revenue		$45,000
Depreciation Expense	$10,000	
Salaries Expense	15,000	25,000
Net Income		$20,000

Ex. 158

The Boulder Petting Zoo operates a drive through tourist attraction in Colorado. The company adjusts its accounts at the end of each month. The selected accounts appearing below reflect balances after adjusting entries were prepared on April 30. The adjusted trial balance shows the following:

Prepaid Rent	$ 8,000
Fencing	30,000
Accumulated Depreciation—Fencing	5,500
Unearned Ticket Revenue	500

Other data:

1. Three months' rent had been prepaid on April 1.
2. The fencing is being depreciated at $6,000 per year.
3. The unearned ticket revenue represents tickets sold for future zoo visits. The tickets were sold at $4.00 each on April 1. During April, twenty-five of the tickets were used by customers.

Instructions

(a) Calculate the following:
   1. Monthly rent expense.
   2. The age of the fencing in months.
   3. The number of tickets sold on April 1.

(b) Prepare the adjusting entries that were made by the Boulder Petting Zoo on April 30.

Solution 158 (15 min.)

(a) 1. $4,000. The $8,000 balance on the adjusted trial balance reflects two months remaining on the prepaid lease. This indicates that the monthly lease is $4,000.

2. The fencing is 11 months old. By dividing annual depreciation ($6,000) by 12, the monthly depreciation expense is $500. The accumulated depreciation account shows $5,500 which means that depreciation has been taken for 11 months.

3. 150 tickets were originally sold. Twenty-five tickets were used in April at $4.00 each. The adjusted trial balance shows a balance of $500 indicating that 125 tickets are still outstanding. By adding the 25 used in April to the 125 still remaining to be used, 150 tickets must have been sold on April 1.

(b)

1. Rent Expense	4,000	
Prepaid Rent		4,000
2. Depreciation Expense	500	
Accumulated Depreciation—Fencing		500
3. Unearned Ticket Revenue	100	
Ticket Revenue		100
(25 × $4 = $100)		

Ex. 159

The adjusted trial balance of Ryan Financial Planners appears below. Using the information from the adjusted trial balance, you are to prepare for the month ending December 31:

1. an income statement.
2. an owner's equity statement.
3. a balance sheet.

RYAN FINANCIAL PLANNERS
Adjusted Trial Balance
December 31, 2005

	Debit	Credit
Cash	$ 4,400	
Accounts Receivable	2,200	
Office Supplies	1,800	
Office Equipment	15,000	
Accumulated Depreciation—Office Equipment		$ 4,000
Accounts Payable		3,800
Unearned Revenue		5,000
Ryan, Capital		14,400
Ryan, Drawing	2,500	
Service Revenue		3,700
Office Supplies Expense	600	
Depreciation Expense	2,500	
Rent Expense	1,900	
	$30,900	$30,900

Solution 159 (20 min.)

1.

RYAN FINANCIAL PLANNERS
Income Statement
For the Month Ended December 31, 2005

Revenues		
Service Revenue		$ 3,700
Expenses		
Depreciation expense	$2,500	
Rent expense	1,900	
Office supplies expense	600	
Total expenses		5,000
Net loss		$(1,300)

2.

RYAN FINANCIAL PLANNERS
Owner's Equity Statement
For the Month Ended December 31, 2005

Ryan, Capital, December 1		$14,400
Less: Net loss	$1,300	
Drawings	2,500	3,800
Ryan, Capital, December 31		$10,600

Solution 159 (cont.)

3.

RYAN FINANCIAL PLANNERS
Balance Sheet
December 31, 2005

Assets		
Cash		$ 4,400
Accounts receivable		2,200
Office supplies		1,800
Office equipment	$15,000	
Less: Accumulated depreciation—office equipment	4,000	11,000
Total assets		$19,400
Liabilities and Owner's Equity		
Liabilities		
Accounts payable	$3,800	
Unearned revenue	5,000	
Total liabilities		$ 8,800
Owner's Equity		
Ryan, Capital		10,600
Total liabilities and owner's equity		$19,400

[a]Ex. 160

1. Flynn Company prepares monthly financial statements. On July 1, the Office Supplies account had a balance of $3,000. During July, additional office supplies were purchased for $3,800 and that amount was debited to Office Supplies Expense. On July 31, a physical count of office supplies revealed that there was $2,700 on hand. Prepare the adjusting journal entry that Flynn Company should make on July 31.

2. Reese Rental Agency prepares monthly financial statements. On September 1, a check for $9,600 was received from a tenant for six months' rent. The full amount was credited to Rent Revenue. Prepare the adjusting entry the company should make on September 30.

[a]Solution 160 (5 min.)

1.	July 31	Office Supplies Expense	300	
		Office Supplies		300
		(To record supplies used)		
2.	Sept. 30	Rent Revenue	8,000	
		Unearned Rent		8,000
		(To record unearned rent)		

COMPLETION STATEMENTS

161. The ______________ assumption divides the economic life of a business into artificial time periods.

162. An accounting period that is one year in length is referred to as a ______________ year.

163. The ______________ principle gives accountants guidance as to when revenue is to be recorded.

164. In a service company, revenue is earned when the service is ______________.

165. The matching principle attempts to match ______________ with ______________.

166. Expenses paid and recorded in an asset account before they are used or consumed are called ______________. Revenue received and recorded as a liability before it is earned is referred to as ______________.

167. Failure to adjust a prepaid expense account for the amount expired will cause ______________ to be understated and ________________ to be overstated.

168. Depreciation is a ______________ allocation process rather than a process of ______________.

169. Depreciation expense for a period is an ______________ rather than a factual measurement of cost that has expired.

170. An adjusting entry recording accrued salaries for a period indicates that Salaries Expense has been ________________ but has not yet been ________________ or recorded.

171. An adjusted trial balance proves the ______________ of the total debit and credit balances after all ______________ entries have been made.

Answers to Completion Statements

161. time period
162. fiscal
163. revenue recognition
164. performed
165. expenses, revenues
166. prepaid expenses, unearned revenue
167. expenses, assets
168. cost, valuation
169. estimate
170. incurred, paid
171. equality, adjusting

MATCHING

172. Match the items below by entering the appropriate code letter in the space provided.

A.	Time period assumption	F.	Accrued revenues
B.	Fiscal year	G.	Depreciation
C.	Revenue recognition principle	H.	Accumulated depreciation
D.	Prepaid expenses	I.	Accrued expenses
E.	Matching principle	J.	Book value

_____ 1. A twelve month accounting period

_____ 2. Expenses paid before they are incurred

_____ 3. Cost less accumulated depreciation

_____ 4. Divides the economic life of a business into artificial time periods

_____ 5. Efforts are related to accomplishments

_____ 6. A contra asset account

_____ 7. Recognition of revenue when it is recorded when earned

_____ 8. Revenues earned but not yet received

_____ 9. Expenses incurred but not yet paid

_____ 10. A cost allocation process

Answers to Matching

1.	B	6.	H
2.	D	7.	C
3.	J	8.	F
4.	A	9.	I
5.	E	10.	G

SHORT-ANSWER ESSAY QUESTIONS

S-A E 173

The income statement is an important financial statement used by individuals who are interested in the operations of a business enterprise. Explain how the time period assumption and the revenue recognition and matching principles provide guidance to accountants in preparing an income statement.

Solution 173

The time period assumption divides the economic life of an accounting entity, such as a business enterprise, into arbitrary time periods. The revenue recognition and matching principles are the basic rules for allocating revenues and expenses to these arbitrary time periods under accrual-basis accounting. The revenue recognition principle dictates the time period to which revenue is to be allocated and recognized; that is, on which income statement the revenue is to be reported. The matching principle dictates the time period to which costs are allocated and recognized as expenses; that is, on which income statement the expenses are to be reported and matched against revenues in the determination of net income.

S-A E 174

In developing an accounting information system, it is important to establish procedures whereby all transactions that affect the components of the accounting equation are recorded. Why then, is it often necessary to adjust the accounts before financial statements are prepared even in a properly designed accounting system? Identify the major types of adjustments that are frequently made and give a specific example of each.

Solution 174

Account balances must be adjusted before financial statements are prepared, even in a properly designed accounting system, because (1) some of the recorded transactions have been recognized prematurely and (2) some effects on components of the accounting equation have not been recorded. Prepayments and deferrals are types of adjustments of recorded transactions that must be allocated to future periods as well as the current period. Examples of deferral-type adjustments are: prepaid rent, prepaid insurance, and unearned revenue. Accruals are adjustments of unrecorded transactions that must be recognized in the current period. Examples of accrual-type adjustments are: salaries and wages payable, interest payable, and interest receivable.

S-A E 175 (Ethics)

Marsh and Linton is a manufacturing company that specializes in writing instruments. The past year was a difficult one for the company, as it sought to retain its share in a market in which the largest competitors were also rapid innovators. Marsh and Linton introduced a new product late in the year, even though testing was not complete. It was a pen designed with two cartridges: one supplying ink and the other correction fluid. A person could then switch easily between writing and correcting errors. It was priced fairly high, and was never heavily advertised. Even so, the Correct-O-Pen, as the product was named, was an overwhelming success.

S-A E 175 (cont.)

The success of the product has Fran Henley, the manager of the New Products division, worried, however. She was concerned that quality problems would begin occurring, since the longevity of the pen and stability of the correction fluid formulation had not been tested. She did not want sales personnel to get the bonuses that appeared to be indicated, since they might aggressively promote a product that would fail in use. She preferred to complete testing of the pen first, so that more confidence could be placed in the results.

Top management, however, declined the tests. Ms. Henley then instructed you, the accountant, not to prorate payroll taxes or rent expense for the rest of the year, but to show them as current expenses in total. In this way, the new product would appear to be only slightly profitable.

Required:

1. Describe the alternatives that you as an accountant would have in this situation.
2. Indicate which alternative is best.

Solution 175

The choices include:

1. Follow the manager's instructions.
2. Explain to the manager why you cannot follow her instructions.
3. Report the manager's actions to her superior.
4. Resign.

There are probably other alternatives as well. Students should be able to come up with at least #1 and #2.

Of the choices, #1 is unethical because it will cause the financial statements to be misleading. #3 and #4 are rather drastic measures that do not seem to be indicated, at least not yet. #2, therefore, is the best choice.

S-A E 176 (Communication)

A new sales representative, Mark Yount, has just received his copy of the month-end financial reports. He is puzzled by the term "unearned revenue." He left the following e-mail message for you on the company's bulletin board system:

> What is this??? Creative Accounting, or what??? Line item 12 on year-to-date financials shows over $25Gs in Unearned Revenue!!! Come on, guys! Either we earned it, or we didn't . . . Right??! Is this how you guys lower our commissions?
> Reply to m.yount@sbd

Required:

Write a response to send to Mark.

Solution 176

Since the answer is being prepared for a "bulletin board" type system, it can be in informal language and can respond in kind to the humor. However, proper grammar and spelling are essential, as is the message about what unearned revenue really is. A proposed message follows:

> Mark—What a pleasant surprise to hear from you! Maybe you can teach those other guys in your department something about living in the present! Do you know some of them still write me notes on paper??? Unbelievable, right??!
>
> Now to your question. Your unearned revenue is the sales you made that us smart guys in accounting didn't figure you had earned, so we just took it away from you! Might as well save the company some dough for our own bonuses, right??
>
> Seriously, Mark—unearned revenue is the result of your getting customers of the kind we like—they pay in advance! When they pay before we can even get their products made or shipped, we can't count the money they pay us as revenue. What we actually have is a liability—an obligation to make and ship products. So that's how we (smart guys) in accounting count it—as a liability. You happened to have about 25% of your sales that fit in that category. When production can catch up with orders, you'll get credit for the sales. You will receive your commissions the same month the company records the revenue as "earned." (Take heart—It'll seem like Christmas all over again.)
>
> Thanks again for actually using the system. Talk to me again sometime. . . Reply to mking@sbd