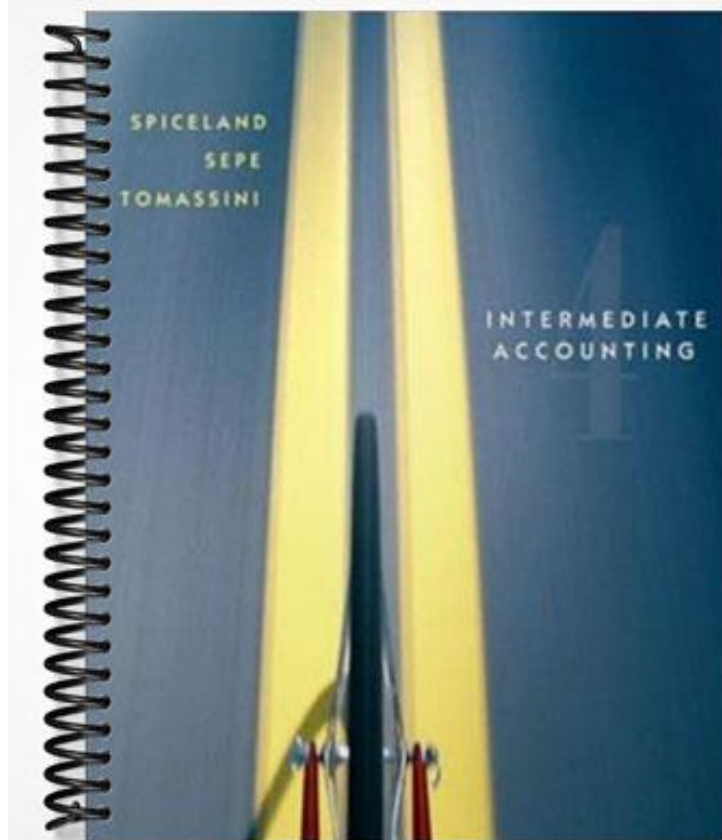


TEST BANK



Chapter 2 Review of the Accounting Process

True/False Questions

1. Owners' equity can be expressed as assets minus liabilities.

Answer: True Learning Objective: 1 Level of Learning: 1

2. Debits increase asset accounts and decrease liability accounts.

Answer: True Learning Objective: 2 Level of Learning: 1

3. Balance sheet accounts are referred to as temporary accounts because their balances are always changing.

Answer: False Learning Objective: 2 Level of Learning: 1

4. The adjusted trial balance contains only permanent accounts.

Answer: False Learning Objective: 5 Level of Learning: 1

5. The post-closing trial balance contains only permanent accounts.

Answer: True Learning Objective: 7 Level of Learning: 1

6. Adjusting journal entries are required to comply with the realization and matching principles.

Answer: True Learning Objective: 4 Level of Learning: 2

7. Accruals occur when the cash flow precedes either revenue or expense recognition.

Answer: False Learning Objective: 4 Level of Learning: 1

8. The income statement summarizes the operating activity of a firm at a particular point in time.

Answer: False Learning Objective: 6 Level of Learning: 1

9. The balance sheet can be considered a change or flow statement.

Answer: False Learning Objective: 6 Level of Learning: 1

10. The statement of cash flows summarizes transactions that caused cash and cash equivalents to change during a reporting period.

Answer: True Learning Objective: 6 Level of Learning: 1

11. The statement of shareholders' equity discloses the changes in the temporary shareholders' equity accounts.

Answer: False Learning Objective: 6 Level of Learning: 1

Chapter 2 Review of the Accounting Process

12. The closing process brings all temporary accounts to a zero balance and updates the balance in the retained earnings account.

Answer: True Learning Objective: 7 Level of Learning: 1

Matching Pair Questions

- 13-17. Listed below are ten terms followed by a list of phrases that describe or characterize five of the terms. Match each phrase with the correct term by placing the letter designating the best term in the space provided by the phrase.

Terms:

- A. Accruals
- B. Adjusted trial balance
- C. Adjusting entries
- D. Bad debt expense
- E. Balance sheet
- F. Prepayments
- G. Expenses
- H. Post-closing trial balance
- I. Statement of cash flows
- J. Unadjusted trial balance

Phrases:

- 13. ____ Assets or liabilities created when recognition precedes cash flows.
- 14. ____ Assets or liabilities created when cash flows precede recognition.
- 15. ____ A list of accounts and balances containing the source data for preparation of financial statements.
- 16. ____ A list of accounts and their balances prepared before the effects of internal transactions are recorded.
- 17. ____ A list of only permanent accounts and their balances prepared to prove that the accounting equation is in balance.

Answer: 13-A; 14-F; 15-B; 16-J; 17-H

Chapter 2 Review of the Accounting Process

18-22. Listed below are ten terms followed by a list of phrases that describe or characterize five of the terms. Match each phrase with the correct term by placing the letter designating the best term in the space provided by the phrase.

Terms:

- A. Accruals
- B. Adjusted trial balance
- C. Adjusting entries
- D. Bad debt expense
- E. Balance sheet
- F. Prepayments
- G. Expenses
- H. Post-closing trial balance
- I. Statement of cash flows
- J. Unadjusted trial balance

Phrases:

- 18. ____ Reports operating, investing, and financing activities.
- 19. ____ Records internal transactions not previously reported.
- 20. ____ Portrays financial position as of a point in time.
- 21. ____ Represents outflows of resources incurred to generate revenues.
- 22. ____ An account that reflects an estimate.

Answer: 18-I; 19-C; 20-E; 21-G; 22-D

23-27. Listed below are ten terms followed by a list of phrases that describe or characterize five of the terms. Match each phrase with the correct term by placing the letter designating the best term in the space provided by the phrase.

Terms:

- A. Closing entries
- B. Credit
- C. Debit
- D. Gains
- E. General journal
- F. General ledger
- G. Losses
- H. Periodic system
- I. Perpetual system
- J. Prepayments

Phrases:

- 23. ____ Created by dispositions of assets for consideration in excess of carrying values.
- 24. ____ Created by dispositions of assets for consideration less than carrying value.
- 25. ____ Requires adjusting entries to update the inventory account.
- 26. ____ Requires entries to cost of goods sold account when merchandise is sold.
- 27. ____ Created by funding costs prior to expense recognition.

Answer: 23-D; 24-G; 25-H; 26-I; 27-J

Chapter 2 Review of the Accounting Process

28-32. Listed below are ten terms followed by a list of phrases that describe or characterize five of the terms. Match each phrase with the correct term by placing the letter designating the best term in the space provided by the phrase.

Terms:

- A. Closing entries
- B. Credit
- C. Debit
- D. Gains
- E. General journal
- F. General ledger
- G. Losses
- H. Periodic system
- I. Perpetual system
- J. Prepayments

Phrases:

- 28. ____ Refers to the right side of an account.
- 29. ____ Asset and expense accounts normally have this type of balance.
- 30. ____ Used to record any type of transaction in chronological order.
- 31. ____ Contains all the accounts of an entity.
- 32. ____ Used to reset temporary accounts to a zero balance.

Answer: 28-B; 29-C; 30-E; 31-F; 32-A

33-37. Listed below are ten terms followed by a list of phrases that describe or characterize five of the terms. Match each phrase with the correct term by placing the letter designating the best term in the space provided by the phrase.

Terms:

- A. Control accounts
- B. Journalize
- C. Liabilities
- D. Transaction analysis
- E. Special journals
- F. Revenues
- G. Source documents
- H. Retained earnings
- I. Post
- J. Unearned revenues

Phrases:

- 33. ____ Transfer balances from journals to ledgers.
- 34. ____ Record chronologically the effects of transactions in debit/credit form.
- 35. ____ Refers to nonowners' claims against the assets of a firm.
- 36. ____ Represents the cumulative amount of net income, less distributions to shareholders.
- 37. ____ Summarize subsidiary ledgers.

Answer: 33-I; 34-B; 35-C; 36-H; 37-A

Chapter 2 Review of the Accounting Process

38-42. Listed below are ten terms followed by a list of phrases that describe or characterize five of the terms. Match each phrase with the correct term by placing the letter designating the best term in the space provided by the phrase.

Terms:

- A. Control accounts
- B. Journalize
- C. Liabilities
- D. Transaction analysis
- E. Special journals
- F. Revenues
- G. Source documents
- H. Retained earnings
- I. Post
- J. Unearned revenues

Phrases:

- 38. ____ Refers to inflows of assets from the sale of goods and services.
- 39. ____ Used to identify external transactions.
- 40. ____ Used to record repetitive types of transactions.
- 41. ____ Liabilities created by a customer's prepayment.
- 42. ____ Determines the effects of an event in terms of the accounting equation.

Answer: 38-F; 39-G; 40-E; 41-J; 42-D

Multiple Choice Questions

43. An example of an external event would not include:
- A) Paying employees salaries.
 - B) Purchasing equipment.
 - C) Depreciating equipment.
 - D) Collecting a receivable.

Answer: C Learning Objective: 1 Level of Learning: 2

44. An example of an internal event would not include:
- A) Writing off an uncollectible account.
 - B) Recording the expiration of prepaid insurance.
 - C) Recording unpaid wages.
 - D) Paying wages to company employees.

Answer: D Learning Objective: 1 Level of Learning: 2

45. The accounting equation can be stated as:
- A) $A + L - OE = 0$.
 - B) $A - L + OE = 0$.
 - C) $-A + L - OE = 0$.
 - D) $A - L - OE = 0$.

Answer: D Learning Objective: 1 Level of Learning: 1

Chapter 2 Review of the Accounting Process

46. A sale on account would be recorded by:
- A) Debiting revenue.
 - B) Crediting assets.
 - C) Crediting liabilities.
 - D) Debiting assets.

Answer: D Learning Objective: 2 Level of Learning: 2

47. Which of the following accounts has a debit balance?
- A) Accounts payable.
 - B) Accrued taxes.
 - C) Accumulated depreciation.
 - D) Bad debt expense.

Answer: D Learning Objective: 3 Level of Learning: 2

48. The balance retained earnings at the end of the year is determined by retained earnings at the beginning of the year:
- A) Plus revenues minus liabilities.
 - B) Plus accruals minus deferrals.
 - C) Plus net income minus dividends.
 - D) Plus assets minus liabilities.

Answer: C Learning Objective: 6 Level of Learning: 2

49. Permanent accounts would not include:
- A) Interest expense.
 - B) Wages payable.
 - C) Prepaid rent.
 - D) Unearned revenues.

Answer: A Learning Objective: 6 Level of Learning: 2

50. Permanent accounts would not include:
- A) Cost of goods sold.
 - B) Inventory.
 - C) Current liabilities.
 - D) Accumulated depreciation.

Answer: A Learning Objective: 6 Level of Learning: 2

51. Temporary accounts would not include:
- A) Salaries payable.
 - B) Depreciation expense.
 - C) Supplies used.
 - D) Cost of goods sold.

Answer: A Learning Objective: 7 Level of Learning: 2

Chapter 2 Review of the Accounting Process

52. Mary Parker Co. invested \$15,000 in ABC Corporation and received capital stock in exchange. Mary Parker Co.'s journal entry to record this transaction would include a:
- A) Debit to investments.
 - B) Credit to retained earnings.
 - C) Credit to capital stock.
 - D) Debit to expense.

Answer: A Learning Objective: 2 Level of Learning: 3

53. A future economic benefit owned or controlled by an entity is:
- A) A revenue.
 - B) An asset.
 - C) A liability.
 - D) A contra asset until used.

Answer: B Learning Objective: 6 Level of Learning: 1

54. Adjusting entries are primarily needed for:
- A) Cash basis accounting.
 - B) Accrual accounting.
 - C) Current value accounting.
 - D) Manual accounting systems.

Answer: B Learning Objective: 4 Level of Learning: 2

55. Prepayments occur when:
- A) Cash flow precedes expense recognition.
 - B) Sales are delayed pending credit approval.
 - C) Customers are unable to pay the full amount due when goods are delivered.
 - D) Manufactured goods await quality control inspections.

Answer: A Learning Objective: 4 Level of Learning: 2

56. Accruals occur when cash flows:
- A) Occur before expense recognition.
 - B) Occur after revenue or expense recognition.
 - C) Are uncertain.
 - D) May be substituted for goods or services.

Answer: B Learning Objective: 4 Level of Learning: 2

57. An example of a contra account is:
- A) Depreciation expense.
 - B) Accounts receivable.
 - C) Sales revenue.
 - D) Accumulated depreciation.

Answer: D Learning Objective: 3 Level of Learning: 2

Chapter 2 Review of the Accounting Process

58. Hughes Aircraft sold a four passenger airplane for \$380,000, receiving a \$50,000 down payment and a 12% note for the balance. The journal entry to record this sale would include a:
- A) Credit to cash.
 - B) Debit to cash discount.
 - C) Debit to notes receivable.
 - D) Credit to notes receivable.

Answer: C Learning Objective: 2 Level of Learning: 3

59. The purpose of closing entries is to transfer:
- A) Accounts receivable to retained earnings when an account is fully paid.
 - B) Balances in temporary accounts to a permanent account.
 - C) Inventory to cost of goods sold when merchandise is sold.
 - D) Assets and liabilities when operations are discontinued.

Answer: B Learning Objective: 7 Level of Learning: 1

60. Which of the following would not be used typically as an adjusting entry?
- A) Prepaid Rent
Rent expense
 - B) Cash
Unearned revenue
 - C) Interest expense
Interest payable
 - D) Bad debt expense
Allowance for doubtful accounts

Answer: B Learning Objective: 5 Level of Learning: 2

61. Cost of goods sold is:
- A) An asset account.
 - B) A revenue account.
 - C) An expense account.
 - D) A permanent equity account.

Answer: C Learning Objective: 6 Level of Learning: 1

62. The adjusting entry required when amounts previously recorded as unearned revenues are earned includes:
- A) A debit to a liability.
 - B) A debit to an asset.
 - C) A credit to a liability.
 - D) A credit to an asset.

Answer: A Learning Objective: 5 Level of Learning: 2

Chapter 2 Review of the Accounting Process

63. The adjusting entry required to record accrued expenses includes:
- A) A credit to cash.
 - B) A debit to an asset.
 - C) A credit to an asset.
 - D) A credit to liability.

Answer: D Learning Objective: 5 Level of Learning: 3

64. XYZ Corporation receives \$100,000 from investors for issuing them shares of its stock. XYZ's journal entry to record this transaction would include a:
- A) Debit to investments.
 - B) Credit to retained earnings.
 - C) Credit to capital stock.
 - D) Credit to revenue.

Answer: C Learning Objective: 1 Level of Learning: 3

65. Incurring an expense for advertising on account would be recorded by:
- A) Debiting liabilities.
 - B) Crediting assets.
 - C) Debiting an expense.
 - D) Debiting assets.

Answer: C Learning Objective: 1 Level of Learning: 3

66. Which of the following accounts has a credit balance?
- A) Salary expense
 - B) Accrued income taxes.
 - C) Land.
 - D) Prepaid rent.

Answer: B Learning Objective: 5 Level of Learning: 2

67. When converting an income statement from a cash basis to an accrual basis, expenses:
- A) Exceed cash payments to suppliers.
 - B) Equal cash payments to suppliers.
 - C) Are less than cash payments to suppliers.
 - D) May exceed or be less than cash payments to suppliers.

Answer: D Learning Objective: 8 Level of Learning: 2

68. When the amount of interest receivable decreases during an accounting period,:
- A) Accrual-basis revenues exceed cash collections from borrowers.
 - B) Accrual-basis net income exceeds cash-basis net income.
 - C) Accrual-basis revenues are less than cash collections from borrowers.
 - D) Accrual-basis net income is less than cash-basis net income.

Answer: C Learning Objective: 8 Level of Learning: 3

Chapter 2 Review of the Accounting Process

69. When converting an income statement from a cash basis to an accrual basis, cash received for services:
- A) Exceed service revenue.
 - B) May exceed or be less than service revenue.
 - C) Is less than service revenue.
 - D) Equals service revenue.

Answer: B Learning Objective: 8 Level of Learning: 3

70. When the amount of revenue collected in advance decreases during an accounting period,:
- A) Accrual-basis revenues exceed cash collections from customers.
 - B) Accrual-basis net income exceeds cash-basis net income.
 - C) Accrual-basis revenues are less than cash collections from customers.
 - D) Accrual-basis net income is less than cash-basis net income.

Answer: A Learning Objective: 8 Level of Learning: 2

71. When converting an income statement from a cash basis to an accrual basis, which of the following is incorrect?
- A) An adjustment for depreciation reduces the net income.
 - B) An adjustment for bad debts increases the net income.
 - C) A reduction in prepaid expenses decreases net income.
 - D) An increase in accrued payables decreases net income.

Answer: B Learning Objective: 8 Level of Learning: 2

72. Making insurance payments in advance is an example of:
- A) An accrued revenue transaction.
 - B) An accrued expense transaction.
 - C) A deferred revenue transaction.
 - D) A deferred expense transaction.

Answer: D Learning Objective: 4 Level of Learning: 1

73. Recording revenue earned, but not yet collected, from a customer is an example of:
- A) A deferred expense transaction.
 - B) A deferred revenue transaction.
 - C) An accrued expense transaction.
 - D) An accrued revenue transaction.

Answer: D Learning Objective: 4 Level of Learning: 1

74. When a magazine sells subscriptions to customers, it is an example of:
- A) An accrued expense transaction.
 - B) An accrued revenue transaction.
 - C) A deferred expense transaction.
 - D) A deferred revenue transaction.

Answer: D Learning Objective: 4 Level of Learning: 1

Chapter 2 Review of the Accounting Process

75. When a tenant makes an end-of-period adjusting entry credit to the “Prepaid rent” account:
- A) (S)he usually debits cash.
 - B) (S)he usually debits an expense account.
 - C) (S)he debits a liability account.
 - D) (S)he does none of the above.

Answer: B Learning Objective: 5 Level of Learning: 2

76. When an employer makes an end-of-period adjusting entry with a debit to supplies expense, the usual credit entry is made to:
- A) Accounts payable.
 - B) Supplies.
 - C) Cash.
 - D) Retained earnings.

Answer: B Learning Objective: 5 Level of Learning: 2

77. Carolina Mills purchased \$270,000 in supplies this year. The supplies account increased by \$10,000 during the year to an ending balance of \$66,000. What was supplies expense for Carolina Mills during the year?
- A) \$300,000.
 - B) \$280,000.
 - C) \$260,000.
 - D) \$240,000.

Answer: C Learning Objective: 5 Level of Learning: 3

Rationale:

		Supplies
Bal.	56,000	
	270,000	?
Bal.	66,000	

78. Somerset Leasing received \$12,000 for 24 months rent in advance. How should Somerset record this transaction?
- A) Prepaid Rent 12,000
Rent expense 12,000
 - B) Cash 12,000
Unearned revenue 12,000
 - C) Interest expense 12,000
Interest payable 12,000
 - D) Bad debt expense 12,000
Allowance for doubtful accounts 12,000

Answer: B Learning Objective: 2 Level of Learning: 3

Chapter 2 Review of the Accounting Process

79. Davis Hardware Company uses a perpetual inventory system. How should Davis record the sale of merchandise costing \$620 for \$960 on account?

- | | | | |
|----|---------------------|-----|-----|
| A) | Inventory | 620 | |
| | Accounts receivable | | 620 |
| | Sales | 960 | |
| | Revenue from sales | | 960 |
| B) | Accounts receivable | 960 | |
| | Sales revenue | | 960 |
| | Cost of goods sold | 620 | |
| | Inventory | | 620 |
| C) | Inventory | 620 | |
| | Gain on sale | 340 | |
| | Sales revenue | | 960 |
| D) | Accounts receivable | 960 | |
| | Sales revenues | | 620 |
| | Gain on sale | | 340 |

Answer: B Learning Objective: 2 Level of Learning: 3

80. Ace Bonding Company purchased merchandise inventory on account. The inventory costs \$2,000 and is expected to sell for \$3,000. How should Ace record the purchase?

- | | | | |
|----|--------------------|-------|-------|
| A) | Inventory | 2,000 | |
| | Accounts payable | | 2,000 |
| B) | Cost of goods sold | 2,000 | |
| | Deferred revenue | 1,000 | |
| | Sales in advance | | 3,000 |
| C) | Cost of goods sold | 2,000 | |
| | Inventory payable | | 2,000 |
| D) | Cost of goods sold | 2,000 | |
| | Profit | 1,000 | |
| | Sales payable | | 3,000 |

Answer: A Learning Objective: 2 Level of Learning: 3

Chapter 2 Review of the Accounting Process

81. Yummy Foods purchased a two-year fire and extended coverage insurance policy on August 1, 2006, and charged the \$4,200 premium to Insurance expense. At its December 31, 2006, year-end, Yummy Foods would record which of the following adjusting entries?

- | | | | |
|----|-------------------|-------|-------|
| A) | Insurance expense | 875 | |
| | Prepaid insurance | | 875 |
| B) | Prepaid insurance | 875 | |
| | Insurance expense | | 875 |
| C) | Insurance expense | 875 | |
| | Prepaid insurance | 3,325 | |
| | Insurance payable | | 4,200 |
| D) | Prepaid insurance | 3,325 | |
| | Insurance expense | | 3,325 |

Answer: D Learning Objective: 5 Level of Learning: 3

Rationale:

Entry on 8/1:	Insurance expense	4,200	
	Cash		4,200

Unused at 12/31: $\$4,200 \times 19/24 = \$3,325$

82. The employees of Neat Clothes work Monday through Friday. Every other Friday the company issues payroll checks totaling \$32,000. The current pay period ends on Friday, July 3. Neat Clothes is now preparing quarterly financial statements for the three months ended June 30. What is the adjusting entry to record accrued salaries at the end of June?

- | | | | |
|----|------------------|--------|--------|
| A) | Salaries expense | 22,400 | |
| | Prepaid salaries | 9,600 | |
| | Salaries payable | | 32,000 |
| B) | Salaries expense | 6,400 | |
| | Salaries payable | | 6,400 |
| C) | Prepaid salaries | 9,600 | |
| | Salaries payable | | 9,600 |
| D) | Salaries expense | 22,400 | |
| | Salaries payable | | 22,400 |

Answer: D Learning Objective: 5 Level of Learning: 3

Rationale: Amount accrued: $\$32,000 \times 7/10 = \$22,400$

Chapter 2 Review of the Accounting Process

83. On September 1, 2006, Fortune Magazine sold 600 one-year subscriptions for \$81 each. The total amount received was credited to unearned subscriptions revenue. What would be the required adjusting entry at December 31, 2006?

A)	Unearned subscriptions revenue	48,600	
	Subscriptions revenue		16,200
	Prepaid subscriptions		32,400
B)	Unearned subscriptions revenue	16,200	
	Subscriptions revenue		16,200
C)	Unearned subscriptions revenue	16,200	
	Subscriptions payable		16,200
D)	Unearned subscriptions revenue	32,400	
	Subscriptions revenue		32,400

Answer: B Learning Objective: 5 Level of Learning: 3

Rationale:

Entry on 9/1:	Cash	48,600	
	Unearned subscriptions revenue		48,600
Amount earned: $\$48,600 \times 4/12 = \$16,200$			

84. Mama's Pizza Shoppe borrowed \$8,000 at 9% interest on May 1, 2006, with principal and interest due on October 31, 2007. The company's fiscal year ends June 30, 2006. What adjusting entry would the company record on June 30, 2006?

A)	No entry.		
B)	Interest expense	240	
	Interest payable		240
C)	Interest expense	120	
	Interest payable		120
D)	Prepaid interest	120	
	Interest payable		120

Answer: C Learning Objective: 5 Level of Learning: 3

Rationale: Accrued interest expense: $\$8,000 \times 9\% \times 2/12 = \120

Chapter 2 Review of the Accounting Process

85. On September 15, 2006, Oliver's Mortuary received a \$6,000, nine-month note bearing interest at an annual rate of 10% from the estate of Jay Hendrix for services rendered. Oliver's has a December 31 year-end. What adjusting entry would the company record on December 31, 2006?

A)	Interest receivable	175	
	Interest revenue		175
B)	Interest receivable	230	
	Interest revenue		230
C)	Interest receivable	175	
	Notes receivable		175
D)	Interest receivable	600	
	Interest revenue		175
	Cash		425

Answer: A Learning Objective: 5 Level of Learning: 3

Rationale: Accrued interest revenue: $\$6,000 \times 10\% \times 3.5/12 = \175

86. On December 31, 2005, Coolwear Inc. had balances in its Accounts receivable and Allowance for uncollectible accounts of \$48,400 and \$940, respectively. During 2006, Coolwear wrote off \$820 in Accounts receivable and determined that there should be an Allowance for uncollectible accounts of \$1,140 at December 31, 2006. Bad debt expense for 2006 would be:
- A) \$ 320.
 B) \$1,140.
 C) \$ 820.
 D) \$1,020.

Answer: D Learning Objective: 4 Level of Learning: 3

Rationale:

		Allowance for Uncollectibles	
		940	12/31/05 Bal.,
Write-Offs	820	?	record Bad Debt Exp.
		1140	12/31/06 Bal.

Bad debt expense = $\$1,140 + 820 - 940 = \underline{\underline{\$1,020}}$

Chapter 2 Review of the Accounting Process

87. On December 31, 2005, Larry's Used Cars had balances in its accounts receivable and allowance for uncollectible accounts of \$53,600 and \$1,325 respectively. During 2006, Larry's wrote off \$1,465 in accounts receivable and determined that there should be an allowance for uncollectible accounts of \$1,280 at December 31, 2006. Bad debt expense for 2006 would be:
- A) \$1,280.
 B) \$1,465.
 C) \$1,420.
 D) \$1,140.

Answer: C Learning Objective: 4 Level of Learning: 3

Rationale:

Allowance for Uncollectibles	
Write-offs	1,465
	1,325 12/31/02 Bal., ? record Bad Debt Exp.
	1,280 12/31/03 Bal.

$$\text{Bad debt expense} = \$1,280 + 1,465 - 1,325 = \underline{\$1,420}$$

88. Molly's Auto Detailers maintains its records on the cash basis. During 2006, Molly's collected \$72,000 from customers and paid \$21,000 in expenses. Depreciation expense of \$5,000 would have been recorded on the accrual basis. Over the course of the year, accounts receivable increased \$4,000, prepaid expenses decreased \$2,000, and accrued liabilities decreased \$1,000. Molly's accrual basis net income would be:
- A) \$38,000.
 B) \$54,000.
 C) \$49,000.
 D) \$42,000.

Answer: C Learning Objective: 6 Level of Learning: 3

Rationale:

Cash receipts	\$72,000
Cash disbursements	<u>21,000</u>
Cash basis net income	51,000
Deduct depreciation expense	(5,000)
Add increase in accounts receivable	4,000
Deduct decrease in prepaid expenses	(2,000)
Add decrease in prepaid expenses	<u>1,000</u>
Accrual basis net income	<u>\$49,000</u>

Chapter 2 Review of the Accounting Process

89. Pat's Custom Tuxedo Shop maintains its records on the cash basis. During this past year Pat's collected \$42,000 in tailoring fees, and paid \$14,000 in expenses. Depreciation expense totaled \$2,000. Accounts receivable increased \$1,500, supplies increased \$4,000, and accrued liabilities increased \$2,500. Pat's accrual basis net income would be:
- A) \$18,000.
 B) \$34,000.
 C) \$23,000.
 D) \$29,000.

Answer: D Learning Objective: 6 Level of Learning: 3

Rationale:

Cash receipts	\$42,000
Cash disbursements	<u>14,000</u>
Cash basis net income	28,000
Deduct depreciation expense	(2,000)
Add increase in accounts receivable	1,500
Add increase in supplies	4,000
Deduct increase in accrued liabilities	<u>(2,500)</u>
	<u>\$29,000</u>

90. The Hamada Company sales for 2006 totaled \$150,000 and purchases totaled \$95,000. Selected January 1, 2006, balances were: accounts receivable, \$18,000; inventory, \$14,000; and accounts payable, \$12,000. December 31, 2006, balances were: accounts receivable, \$16,000; inventory, \$15,000; and accounts payable, \$13,000. Net cash flows from these activities were
- A) \$45,000.
 B) \$55,000.
 C) \$58,000.
 D) \$74,000.

Answer: C Learning Objective: 6 Level of Learning: 3

Rationale:

Sales	\$150,000	Purchases	\$95,000
Add decrease in A/R	<u>2,000</u>	Deduct increase in A/P	<u>(1,000)</u>
Cash collections	\$152,000	Cash disbursements	\$94,000

Net cash flows = \$152,000 - \$94,000 = \$58,000

(Purchases includes increase in inventory.)

Chapter 2 Review of the Accounting Process

91. In its first year of operations Acme Corp. had income before tax of \$400,000. Acme made income tax payments totaling \$150,000 during the year and has an income tax rate of 40%. What would be the balance in income tax payable at the end of the year?
- A) \$160,000 credit.
 B) \$150,000 credit.
 C) \$ 10,000 credit.
 D) \$ 10,000 debit.

Answer: C Learning Objective: 5 Level of Learning: 3

Rationale:

Income tax expense = \$400,000 x 40% = \$160,000

Income Tax Payable	
<u>150,000</u>	<u>160,000</u>
	10,000

92. In its first year of operations Best Corp. had income before tax of \$500,000. Best made income tax payments totaling \$210,000 during the year and has an income tax rate of 40%. What was Best's net income for the year?
- A) \$290,000.
 B) \$294,000.
 C) \$300,000.
 D) \$306,000.

Answer: C Learning Objective: 6 Level of Learning: 3

Rationale:

Income before tax	\$500,000
Income tax (\$500,000 x 40%)	<u>(200,000)</u>
Net income	<u>\$300,000</u>

93. Cal Farms reported supplies expense of \$2,000,000 this year. The supplies account decreased by \$200,000 during the year to an ending balance of \$400,000. What was the cost of supplies the Cal Farms purchased during the year?
- A) \$1,600,000.
 B) \$1,800,000.
 C) \$2,200,000.
 D) \$2,400,000.

Answer: B Learning Objective: 4 Level of Learning: 3

Rationale:

Supplies	
Bal. 600,000	
?	2,000,000
Bal. 400,000	

Supplies purchases: \$400,000 + 2,000,000 – 600,000 = \$1,800,000

Chapter 2 Review of the Accounting Process

94. Dave's Duds reported cost of goods sold of \$2,000,000 this year. The inventory account increased by \$200,000 during the year to an ending balance of \$400,000. What was the cost of merchandise that Dave purchased during the year?
- A) \$1,600,000.
 B) \$1,800,000.
 C) \$2,200,000.
 D) \$2,400,000.

Answer: C Learning Objective: 6 Level of Learning: 3

Rationale:

Cost of goods sold	\$2,000,000
Add increase in inventories	<u>200,000</u>
Purchases	<u>\$2,200,000</u>

95. Eve's Apples opened business on January 1, 2006, and paid for two insurance policies effective that date. The liability policy was \$36,000 for eighteen-months, and the crop damage policy was \$12,000 for a two-year term. What was the balance in Eve's prepaid insurance as of December 31, 2006?
- A) \$ 9,000.
 B) \$18,000.
 C) \$30,000.
 D) \$48,000.

Answer: B Learning Objective: 5 Level of Learning: 3

Rationale:

Prepaid liability insurance: \$36,000 x 6/18	\$12,000
Prepaid hazard insurance: \$12,000 x 12/24	<u>6,000</u>
Total prepaid insurance at 12/31/03	<u>\$18,000</u>

96. Fink Insurance collected premiums of \$18,000,000 from its customers during the current year. The adjusted balance in the Unearned premiums account increased from \$6 million to \$8 million dollars during the year. What was Fink's revenues from earned insurance premiums for the current year?
- A) \$10,000,000.
 B) \$16,000,000.
 C) \$18,000,000.
 D) \$20,000,000.

Answer: B Learning Objective: 5 Level of Learning: 3

Rationale:

Cash collections	\$18,000,000
Deduct increase in unearned premiums	<u>2,000,000</u>
Premiums earned	<u>\$16,000,000</u>

Chapter 2 Review of the Accounting Process

97. On November 1, 2006, Tim's Toys borrows \$30,000,000 at 9% to finance the holiday sales season. The note is for a six-month term and both principal and interest are payable at maturity. What should be the balance of interest payable for the loan as of December 31, 2006?
- A) \$ 112,500.
 B) \$ 225,000.
 C) \$ 450,000.
 D) \$1,350,000.

Answer: C Learning Objective: 5 Level of Learning: 3

Rationale: Accrued interest payable = \$30,000,000 x 9% x 2/12 = \$450,000

Problems

Use the following to answer questions 98-101:

The December 31, 2006 (pre-closing) adjusted trial balance for Kline Enterprises was as follows:

<u>Account Title</u>	<u>Debits</u>	<u>Credits</u>
Accounts payable		80,000
Accounts receivable.....	170,000	
Accumulated depreciation – equipment		260,000
Allowance for uncollectible accounts.....		10,000
Capital stock		490,000
Cash	26,000	
Cost of goods sold	480,000	
Depreciation expense	60,000	
Equipment	700,000	
Interest expense	4,000	
Inventory	150,000	
Note payable (due in six months)		60,000
Rent expense	30,000	
Retained earnings		62,000
Salaries payable		8,000
Sales revenue		<u>770,000</u>
Salaries expense	<u>120,000</u>	
TOTALS	<u>1,740,000</u>	<u>1,740,000</u>

REQUIRED: Assuming no taxes, compute the following, and place answer in the space provided:

98. Kline's 2006 net income (or loss)

Answer:

Kline's 2006 net income (or loss) \$76,000

Computation: 770,000 – 480,000 – 60,000 – 4,000 – 30,000 – 120,000

Learning Objective: 6 Level of Learning: 3

Chapter 2 Review of the Accounting Process

99. Kline's 12/31/2006 total current assets

Answer:

Kline's 12/31/2006 total current assets \$336,000

Computation: 26,000 + 170,000 – 10,000 + 150,000

Learning Objective: 6 Level of Learning: 3

100. Kline's 12/31/2006 total current liabilities

Answer:

Kline's 12/31/2006 total current liabilities \$148,000

Computation: 80,000 + 60,000 + 8,000

Learning Objective: 6 Level of Learning: 3

101. Kline's 12/31/2006 total owners' equity

Answer:

Kline's 12/31/2006 total owners' equity \$628,000

Computation: 490,000 + 62,000 + Net Income (or Total Assets - Total Liabilities)

Learning Objective: 6 Level of Learning: 3

Use the following to answer questions 102-106:

Suppose that Laramie Ltd.'s adjusted trial balance (above) ignored the following information. For each item of information, indicate what effects, if any, these omissions would have on the stated components of Laramie Ltd.'s 2006 Income Statement and 12/31/2006 Balance Sheet. Again, assume no taxes.

Use the following code for your answers and be sure to include the dollar amounts of the effects:

0 = No Effect

+ = Overstated

- = Understated

102.

Additional Information	12/31/06 Assets	12/31/06 Liabilities	12/31/06 Owners' Equity	2006 Net Income
\$2,000 interest on a loan was not yet paid or recorded				

Answer:

Additional Information	12/31/06 Assets	12/31/06 Liabilities	12/31/06 Owners' Equity	2006 Net Income
\$2,000 interest on a loan was not yet paid or recorded	0	- 2,000	+ 2,000	+2,000

Learning Objective: 5 Level of Learning: 2

Chapter 2 Review of the Accounting Process

103.

Additional Information	12/31/06 Assets	12/31/06 Liabilities	12/31/06 Owners' Equity	2006 Net Income
The total estimated uncollectible accounts receivable should be \$25,000.				

Answer:

Additional Information	12/31/06 Assets	12/31/06 Liabilities	12/31/06 Owners' Equity	2006 Net Income
The total estimated uncollectible accounts receivable should be \$25,000.	+25,000	0	+25,000	+25,000

Learning Objective: 5 Level of Learning: 2

104.

Additional Information	12/31/06 Assets	12/31/06 Liabilities	12/31/06 Owners' Equity	2006 Net Income
\$10,000 of the paid and recorded rent expense pertains to the year 2007.				

Answer:

Additional Information	12/31/06 Assets	12/31/06 Liabilities	12/31/06 Owners' Equity	2006 Net Income
\$10,000 of the paid and recorded rent expense pertains to the year 2007.	-10,000	0	-10,000	-10,000

Learning Objective: 5 Level of Learning: 2

105.

Additional Information	12/31/06 Assets	12/31/06 Liabilities	12/31/06 Owners' Equity	2006 Net Income
\$20,000 in depreciation on some equipment was still unrecorded.				

Answer:

Additional Information	12/31/06 Assets	12/31/06 Liabilities	12/31/06 Owners' Equity	2006 Net Income
\$20,000 in depreciation on some equipment was still unrecorded.	+20,000	0	+20,000	+20,000

Learning Objective: 5 Level of Learning: 2

Chapter 2 Review of the Accounting Process

106.

Additional Information	12/31/06 Assets	12/31/06 Liabilities	12/31/06 Owners' Equity	2006 Net Income
\$4,000 in cash dividends declared and paid in December 2006 were unrecorded.				

Answer:

Additional Information	12/31/06 Assets	12/31/06 Liabilities	12/31/06 Owners' Equity	2006 Net Income
\$4,000 in cash dividends declared and paid in December 2006 were unrecorded.	+4,000	0	+4,000	0

Learning Objective: 5 Level of Learning: 2

Use the following to answer questions 107-112:

You are reviewing O'Brian Co.'s adjusted trial balance for the year ended 12/31/06. You notice several omissions and incorrect items during your review, some of which are noted below. For each one, you are to determine what effect, if any, these items would have on the stated components of O'Brian Co.'s 2006 Income Statement and 12/31/2006 Balance Sheet if they are not corrected or updated. Assume, no income taxes.

Use the following code for your answers. You need not include any dollar amounts.

N = No Effect

O = Overstated

U = Understated

107.

Additional Information	12/31/06 Assets	12/31/06 Liabilities	12/31/06 Owners' Equity	2006 Net Income
Estimated uncollectible accounts of \$7,000 are estimated at the end of the year and recorded as a debit to Bad Debts Expense and a credit to Accounts Receivable.				

Answer:

Additional Information	12/31/06 Assets	12/31/06 Liabilities	12/31/06 Owners' Equity	2006 Net Income
Estimated uncollectible accounts of \$7,000 are estimated at the end of the year and recorded as a debit to Bad Debts Expense and a credit to Accounts Receivable.	N	N	N	N

Learning Objective: 5 Level of Learning: 2

Chapter 2 Review of the Accounting Process

108.

Additional Information	12/31/06 Assets	12/31/06 Liabilities	12/31/06 Owners' Equity	2006 Net Income
The journal entry for depreciation on equipment for 2006 was recorded for \$48,000. It should have been \$66,000.				

Answer:

Additional Information	12/31/06 Assets	12/31/06 Liabilities	12/31/06 Owners' Equity	2006 Net Income
The journal entry for depreciation on equipment for 2006 was recorded for \$48,000. It should have been \$66,000.	O	N	O	O

Learning Objective: 5 Level of Learning: 2

109.

Additional Information	12/31/06 Assets	12/31/06 Liabilities	12/31/06 Owners' Equity	2006 Net Income
Cash dividends declared and paid in December 2006 were unrecorded.				

Answer:

Additional Information	12/31/06 Assets	12/31/06 Liabilities	12/31/06 Owners' Equity	2006 Net Income
Cash dividends declared and paid in December 2006 were unrecorded.	O	N	O	N

Learning Objective: 5 Level of Learning: 2

110.

Additional Information	12/31/06 Assets	12/31/06 Liabilities	12/31/06 Owners' Equity	2006 Net Income
\$10,000 of the rent revenue collected and recorded as earned this year pertains to 2007.				

Answer:

Additional Information	12/31/06 Assets	12/31/06 Liabilities	12/31/06 Owners' Equity	2006 Net Income
\$10,000 of the rent revenue collected and recorded as earned this year pertains to 2007.	N	U	O	O

Learning Objective: 5 Level of Learning: 2

Chapter 2 Review of the Accounting Process

111.

Additional Information	12/31/06 Assets	12/31/06 Liabilities	12/31/06 Owners' Equity	2006 Net Income
Interest earned during the year on a note receivable was not yet collected or recorded				

Answer:

Additional Information	12/31/06 Assets	12/31/06 Liabilities	12/31/06 Owners' Equity	2006 Net Income
Interest earned during the year on a note receivable was not yet collected or recorded	U	N	U	U

Learning Objective: 5 Level of Learning: 2

112.

Additional Information	12/31/06 Assets	12/31/06 Liabilities	12/31/06 Owners' Equity	2006 Net Income
Supplies purchased during the year for \$1,000 cash were recorded by a debit to Supplies Expense and a credit to Cash. Only \$200 of supplies remain at the end of the year, but no further entries have been made.				

Answer:

Additional Information	12/31/06 Assets	12/31/06 Liabilities	12/31/06 Owners' Equity	2006 Net Income
Supplies purchased during the year for \$1,000 cash were recorded by a debit to Supplies Expense and a credit to Cash. Only \$200 of supplies remain at the end of the year, but no further entries have been made.	U	N	U	U

Learning Objective: 5 Level of Learning: 2

Chapter 2 Review of the Accounting Process

Use the following to answer questions 113-127:

1111	Cash	2152	Property taxes payable
1121	Short-term investments	2161	Rent payable
1131	Notes receivable	2211	Long-term notes payable
1132	Accounts receivable	3121	Capital stock
1133	Allowance for uncollectible accounts	3211	Retained earnings
1136	Interest receivable	5211	Sales revenue
1137	Other accrued receivables	5311	Interest revenue
1141	Inventory	6111	Cost of goods sold
1151	Supplies	6201	Advertising expense
1152	Prepaid expenses	6205	Bad debt expense
1321	Buildings and equipment (B&E)	6208	Depreciation expense
1322	Accumulated depreciation-B&E	6215	Insurance expense
2111	Short-term notes payable	6223	Property tax expense
2113	Interest payable	6224	Rent expense
2121	Accounts payable	6226	Supplies expense
2131	Unearned revenues	6230	Wages and salaries expense
2141	Salaries & wages payable	6411	Interest expense
2145	Dividends payable	6999	Income summary account

Using the chart of accounts provided, indicate by account number the account or accounts that would be debited and credited in the following transactions and indicate the type of transaction as: 1) An external transaction, or 2) An internal transaction recorded as an adjusting journal entry, or 3) a closing entry. The company uses a perpetual inventory system. All prepayments are initially recorded in permanent accounts.

TRANSACTION	Account(s) debited	Account(s) credited	Transaction type
EXAMPLE: Sold \$110,000,000 in capital stock for cash.	1111	3121	1

113. Purchased building and equipment for \$10,000,000, paying 20% cash and issuing a 30-year note for the balance.

Answer:

TRANSACTION	Account(s) debited	Account(s) credited	Transaction type
Purchased building and equipment for \$10,000,000, paying 20% cash and issuing a 30-year note for the Balance.	1321	1111, 2211	1

Learning Objective: 2 Level of Learning: 3

114. Invested idle cash in short-term money market funds.

Answer:

TRANSACTION	Account(s) debited	Account(s) credited	Transaction type
Invested idle cash in short-term money market funds.	1121	1111	1

Learning Objective: 2 Level of Learning: 3

Chapter 2 Review of the Accounting Process

115. Purchased inventory on account.

Answer:

TRANSACTION	Account(s) debited	Account(s) credited	Transaction type
Purchased inventory on account.	1141	2121	1

Learning Objective: 2 Level of Learning: 3

116. Sold inventory on account.

Answer:

TRANSACTION	Account(s) debited	Account(s) credited	Transaction type
Sold inventory on account	1132, 6111	5211, 1141	1

Learning Objective: 2 Level of Learning: 3

117. Sold merchandise to a customer in exchange for a promissory note.

Answer:

TRANSACTION	Account(s) debited	Account(s) credited	Transaction type
Sold merchandise to a customer in exchange for a promissory note.	1131, 6111	5211, 1141	1

Learning Objective: 2 Level of Learning: 3

118. Accrued the interest earned but not collected on notes receivable.

Answer:

TRANSACTION	Account(s) debited	Account(s) credited	Transaction type
Accrued the interest earned but not collected on notes receivable.	1136	5311	2

Learning Objective: 5 Level of Learning: 3

119. Collected a note receivable at maturity, including the interest that had already been accrued.

Answer:

TRANSACTION	Account(s) debited	Account(s) credited	Transaction type
Collected a note receivable at maturity, including the interest that had already been accrued	1111	1131, 1136	1

Learning Objective: 2 Level of Learning: 3

Chapter 2 Review of the Accounting Process

120. Collected cash on account from customers.

Answer:

TRANSACTION	Account(s) debited	Account(s) credited	Transaction type
Collected cash on account from customers.	1111	1132	1

Learning Objective: 2 Level of Learning: 3

121. Sold inventory for cash.

Answer:

TRANSACTION	Account(s) debited	Account(s) credited	Transaction type
Sold inventory for cash.	1111, 6111	5211, 1141	1

Learning Objective: 2 Level of Learning: 3

122. Received payment for services to be performed next year.

Answer:

TRANSACTION	Account(s) debited	Account(s) credited	Transaction type
Received payment for services to be performed next year.	1111	2131	1

Learning Objective: 2 Level of Learning: 3

123. Accrued wages due but unpaid at the end of an accounting period.

Answer:

TRANSACTION	Account(s) debited	Account(s) credited	Transaction type
Accrued wages due but unpaid at the end of an accounting period.	6230	2141	2

Learning Objective: 5 Level of Learning: 3

124. Closed the income summary account, assuming there was a net income for the period.

Answer:

TRANSACTION	Account(s) debited	Account(s) credited	Transaction type
Closed the income summary account, assuming there was a net income for the period.	6999	3211	3

Learning Objective: 7 Level of Learning: 3

Chapter 2 Review of the Accounting Process

125. Paid property taxes that have already been accrued.

Answer:

TRANSACTION	Account(s) debited	Account(s) credited	Transaction type
Paid property taxes that have already been accrued.	2152	1111	1

Learning Objective: 2 Level of Learning: 3

126. Declared cash dividends on common stock.

Answer:

TRANSACTION	Account(s) debited	Account(s) credited	Transaction type
Declared cash dividends on common stock.	3211	2145	1

Learning Objective: 2 Level of Learning: 3

127. Paid rent for the next three months.

Answer:

TRANSACTION	Account(s) debited	Account(s) credited	Transaction type
Paid rent for the next three months.	1152	1111	1

Learning Objective: 2 Level of Learning: 3

Chapter 2 Review of the Accounting Process

Use the following to answer questions 128-139:

Below is a list of accounts in no particular order. Assume that all accounts have normal balances.

Required: In column A, indicate whether a debit will:

- 1.) Increase the account balance, or
- 2.) Decrease the account balance.

In column B, classify each account according to the following scheme. For contra accounts, indicate the classification of the account to which it relates.

- 1.) A current asset in the balance sheet.
- 2.) A noncurrent asset in the balance sheet.
- 3.) A current liability in the balance sheet.
- 4.) A long-term liability in the balance sheet.
- 5.) A permanent equity account in the balance sheet.
- 6.) A revenue account in the income statement.
- 7.) An expense account shown in the income statement.
- 8.) Account does not appear in either the balance sheet or the income statement.

	A Effect of a debit on account	B Classification
EXAMPLE: Advertising expense	1	7

128. Buildings and equipment (B&E)

Answer:

	Effect	Classification
Buildings and equipment (B&E)	1	2

Learning Objective: 2 Level of Learning: 2

129. Short-term notes payable

Answer:

	Effect	Classification
Short-term notes payable	2	3

Learning Objective: 2 Level of Learning: 2

130. Cost of goods sold

Answer:

	Effect	Classification
Cost of goods sold	1	7

Learning Objective: 2 Level of Learning: 2

Chapter 2 Review of the Accounting Process

131. Accounts receivable

Answer:

	Effect	Classification
Accounts receivable	1	1

Learning Objective: 2 Level of Learning: 2

132. Inventory

Answer:

	Effect	Classification
Inventory	1	1

Learning Objective: 2 Level of Learning: 2

133. Unearned revenues

Answer:

	Effect	Classification
Unearned revenues	2	3

Learning Objective: 2 Level of Learning: 2

134. Property taxes payable

Answer:

	Effect	Classification
Property taxes payable	2	3

Learning Objective: 2 Level of Learning: 2

135. Retained earnings

Answer:

	Effect	Classification
Retained earnings	2	5

Learning Objective: 2 Level of Learning: 2

136. Interest revenue

Answer:

	Effect	Classification
Interest revenue	2	6

Learning Objective: 2 Level of Learning: 2

Chapter 2 Review of the Accounting Process

137. Supplies expense

Answer:

	Effect	Classification
Supplies expense	1	7

Learning Objective: 2 Level of Learning: 2

138. Allowance for uncollectible accounts

Answer:

	Effect	Classification
Allowance for uncollectible accounts	2	1

Learning Objective: 2 Level of Learning: 2

139. Capital stock

Answer:

	Effect	Classification
Capital stock	2	5

Learning Objective: 2 Level of Learning: 2

140. The following is selected financial information for Osmond Dental Laboratories for 2005 and 2006:

	<u>2005</u>	<u>2006</u>
Retained earnings, January 1	\$53,000	?
Net income	37,000	42,000
Dividends declared and paid	15,000	18,000
Capital stock	70,000	?

Osmond issued 2,000 shares of additional capital stock in 2006 for \$20,000. There were no other capital transactions.

Required: Prepare a statement of shareholders' equity for Osmond Dental Laboratories for the year ended December 31, 2006.

Answer:

Osmond Dental Laboratories
Statement of Shareholders' Equity
For the Year Ended December 31, 2006

	Capital <u>Stock</u>	Retained <u>Earnings</u>	Total Shareholders' <u>Equity</u>
Balance, January 1, 2006	\$70,000	\$75,000*	\$145,000
Issue of capital stock	20,000		20,000
Net income for 2006		42,000	42,000
Less: Dividends		- 18,000	- 18,000
Balance, December 31, 2006	<u>\$ 90,000</u>	<u>\$ 99,000</u>	<u>\$189,000</u>

*\$53,000 + 37,000 - 15,000 = \$75,000

Learning Objective: 6 Level of Learning: 3

Chapter 2 Review of the Accounting Process

141. Rite Shoes was involved in the transactions described below.

Required: Prepare the appropriate journal entry for each transaction. If an entry is not required, state "No Entry."

- (a.) Purchased \$8,200 of inventory on account.
- (b.) Paid weekly salaries, \$920.
- (c.) Recorded sales for the first week: Cash: \$7,100; On account: \$5,300.
- (d.) Paid for inventory purchased in event (a).
- (e.) Placed an order for \$6,200 of inventory.

Answer:

(a.)	Inventory	8,200	
	Accounts payable		8,200
(b.)	Salaries expense	920	
	Cash		920
(c.)	Cash	7,100	
	Accounts receivable	5,300	
	Sales revenue		12,400
(d.)	Accounts payable	8,200	
	Cash		8,200
(e.)	No Entry.		

Learning Objective: 2 Level of Learning: 3

Chapter 2 Review of the Accounting Process

142. Prepare journal entries to record the following transactions of Daisy King Ice Cream Company. If an entry is not required, state "No Entry."

- (a.) Started business by issuing 10,000 shares of capital stock for \$20,000.
- (b.) Signed a franchise agreement to pay royalties of 5% of sales.
- (c.) Leased a building for three years at \$500 per month and paid six months' rent in advance.
- (d.) Purchased equipment for \$5,400, paying \$1,000 down and signing a two-year, 10% note for the balance.
- (e.) Purchased \$1,800 of supplies on account.
- (f.) Recorded cash sales of \$800 for the first week.
- (g.) Paid weekly wages, \$320.
- (h.) Paid for supplies purchased in item (e).
- (i.) Paid royalties due on first week's sales.
- (j.) Recorded depreciation on equipment, \$50.

Answer:

(a.)	Cash	20,000	
	Capital stock		20,000
(b.)	No Entry.		
(c.)	Prepaid rent	3,000	
	Cash		3,000
(d.)	Equipment	5,400	
	Cash		1,000
	Notes payable		4,400
(e.)	Supplies inventory	1,800	
	Accounts payable		1,800
(f.)	Cash	800	
	Sales revenue		800
(g.)	Wages expense	320	
	Cash		320
(h.)	Accounts payable	1,800	
	Cash		1,800
(i.)	Royalty expense	40	
	Cash		40
(j.)	Depreciation expense	50	
	Accumulated depreciation		50

Learning Objective: 2 Level of Learning: 3

Chapter 2 Review of the Accounting Process

143. Flint Hills, Inc. has prepared a year-end 2006 trial balance. Certain accounts in the trial balance do not reflect all activities that have occurred.

Required: Prepare adjusting journal entries, as needed, for the following items.

- (a.) The Supplies account shows a balance of \$540, but a count of supplies reveals only \$210 on hand.
- (b.) Flint Hills initially records the payments of all insurance premiums as expenses. The trial balance shows a balance of \$420 in Insurance expense. A review of insurance policies reveals that \$125 of insurance is unexpired.
- (c.) Flint Hills' employees work Monday through Friday, and salaries of \$2,400 per week are paid each Friday. Flint Hills' year-end falls on Tuesday.
- (d.) On December 31, 2006, Flint Hills received a utility bill for December electricity usage of \$190 that will be paid in early January.

Answer:

(a.)	Supplies expense	330	
	Supplies		330
(b.)	Prepaid insurance	125	
	Insurance expense		125
(c.)	Salaries expense	960	
	Salaries payable		960
(d.)	Utilities expense	190	
	Accounts payable		190

Learning Objective: 5 Level of Learning: 3

Chapter 2 Review of the Accounting Process

Use the following to answer questions 144-146:

The adjusted trial balance for China Tea Company at December 31, 2006 is presented below:

	<u>Debit</u>	<u>Credit</u>
Cash	10,500	
Accounts receivable	150,000	
Allowance for uncollectible accounts		10,000
Prepaid rent	5,000	
Inventory	25,000	
Equipment	300,000	
Accumulated depreciation - equipment		125,000
Accounts payable		20,000
Notes payable - due in three months		30,000
Salaries payable		4,000
Interest payable		1,000
Capital stock		200,000
Retained earnings		50,000
Sales revenue		400,000
Costs of goods sold	180,000	
Salaries expense	120,000	
Rent expense	15,000	
Depreciation expense	30,000	
Interest expense	2,000	
Bad debt expense	2,500	
Totals	<u>840,000</u>	<u>840,000</u>

144. Prepare the closing entries for China Tea Company for the year ended December 31, 2006.

Answer:

(a.)	Sales revenue	400,000	
	Income summary		400,000
(b.)	Income summary	349,500	
	Cost of goods sold		180,000
	Salaries expense		120,000
	Rent expense		15,000
	Depreciation expense		30,000
	Interest expense		2,000
	Bad debt expense		2,500
(c.)	Income summary	50,500	
	Retained earnings		50,500

Learning Objective: 6 Level of Learning: 3

Chapter 2 Review of the Accounting Process

145. Prepare an income statement for China Tea Company for the year ended December 31, 2006.

Answer:

China Tea Company		
Income Statement		
For the Year Ended December 31, 2006		
Sales revenue		\$400,000
Cost of goods sold		<u>180,000</u>
Gross profit		220,000
Other expenses:		
Salaries expense	\$120,000	
Rent expense	15,000	
Depreciation expense	30,000	
Interest expense	2,000	
Bad debt expense	<u>2,500</u>	
Total other expenses		<u>169,500</u>
Net income		<u>\$ 50,500</u>

Learning Objective: 6 Level of Learning: 3

146. Prepare a classified balance sheet for China Tea Company as of December 31, 2006.

Answer:

China Tea Company		
Balance Sheet		
As of December 31, 2006		
Assets		
Current assets:		
Cash		\$ 10,500
Accounts receivable	\$150,000	
Less: allowance for uncollectible accounts	<u>10,000</u>	140,000
Inventory		25,000
Prepaid rent		<u>5,000</u>
Total current assets		180,500
Property and equipment:		
Equipment	300,000	
Less: Accumulated depreciation	<u>125,000</u>	<u>175,000</u>
Total assets		<u>\$355,500</u>
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable		\$ 20,000
Notes payable		30,000
Salaries payable		4,000
Interest payable		<u>1,000</u>
Total current liabilities		55,000
Shareholders' equity:		
Capital stock	\$200,000	
Retained earnings	<u>100,500</u>	
Total shareholders' equity		<u>300,500</u>
Total liabilities and shareholders' equity		<u>\$355,500</u>

Learning Objective: 6 Level of Learning: 3

Chapter 2 Review of the Accounting Process

Use the following to answer questions 147-148:

The following information, based on the 2005 Annual Report to Shareholders of Krafty Foods (all in \$ millions),

Accounts payable	1,897
Accounts receivables (net)	3,131
Accrued liabilities and taxes	4,105
Cash and cash equivalents	162
Cost of sales	17,531
Current payables to parent and affiliates	1,652
Current portion of long-term debt	540
Deferred income taxes and other liabilities	10,311
Earnings retained in the business	2,391
Goodwill and other intangible assets (net)	35,957
Income tax expense	1,565
Interest and other debt expense, net	1,437
Inventories	3,026
Long-term debt	8,134
Long-term notes payable to parent and affiliates	5,000
Marketing, general and administration expenses	11,460
Operating revenues	33,875
Other current assets	687
Other noncurrent assets	3,726
Other stockholders' equity	(2,568)
Paid-in capital for common and preferred stock	23,655
Property, plant and equipment (net)	9,109
Short-term borrowings	681

147. Based on the information presented above, prepare the 2005 Income Statement for Krafty Foods.

Answer:

	Krafty Foods	
	Income Statement	
	For the Year 2005	
(in \$ millions)		
Operating revenues	33,875	
Cost of sales	<u>17,531</u>	
Gross profit		16,344
Marketing, general and administration expenses		<u>11,460</u>
Operating income		4,884
Interest and other debt expense, net		<u>1,437</u>
Income before taxes		3,447
Income tax expense		<u>1,565</u>
Net income		<u><u>1,882</u></u>

Learning Objective: 6 Level of Learning: 3

Chapter 2 Review of the Accounting Process

148. Based on the information presented above, prepare the 12/31/2005 Balance Sheet for Krafty Foods.

Answer:

Krafty Foods
Balance Sheet
At December 31, 2005

(in \$ millions)

ASSETS

Cash and cash equivalents	162	
Accounts Receivables (net)	3,131	
Inventories	3,026	
Other current assets	<u>687</u>	
Total current assets		7,006
Property, plant and equipment (net)		9,109
Goodwill and other intangible assets (net)		35,957
Other noncurrent assets		<u>3,726</u>
Total assets		<u>55,798</u>

LIABILITIES AND STOCKHOLDERS'

EQUITY

Accounts payable	1,897	
Accrued liabilities and taxes	4,105	
Short-term borrowings	681	
Current payables to parent and affiliates	1,652	
Current portion of long-term debt	<u>540</u>	
Total current liabilities		8,875
Long-term debt		8,134
Deferred income taxes and other liabilities		10,311
Long-term notes payable to parent and affiliates		<u>5,000</u>
Total liabilities		32,320
Paid-in capital for common and preferred stock		23,655
Earnings retained in the business		2,391
Other stockholders' equity		<u>-2,568</u>
Total stockholders' equity		<u>23,478</u>
Total liabilities and stockholders' equity		<u>55,798</u>

Learning Objective: 6 Level of Learning: 3

Chapter 2 Review of the Accounting Process

Essay

The following answers point out the key phrases that should appear in students' answers. They are not intended to be examples of complete student responses. It might be helpful to provide detailed instructions to students on how brief or in-depth you want their answers to be.

149. Describe what is meant by unearned revenues and give two examples.

Answer:

Unearned revenues are inflows of resources before the earnings process is complete. Examples include magazine subscriptions received in advance by a publishing firm or rent received in advance by a property leasing firm. A liability exists because of the obligation to provide the service.

Learning Objective: 4 Level of Learning: 2

150. Describe what is meant by prepaid expenses and give two examples.

Answer:

Prepaid expenses are outflows of resources that create benefits that will last beyond the current reporting period. Examples include insurance or rent paid in advance of use.

Learning Objective: 4 Level of Learning: 2

151. What is the difference between permanent accounts and temporary accounts and why does an accounting system have both types of accounts?

Answer:

Permanent accounts represent assets, liabilities, and shareholders' equity at a point in time. Temporary accounts represent changes in retained earnings caused by dividend, revenue, expense, gain and loss accounts. The temporary accounts are closed out annually to facilitate measuring income on an annual basis.

Learning Objective: 6 Level of Learning: 2

152. What is the purpose of the closing process?

Answer:

The closing process serves a dual purpose: (1) the temporary accounts are reduced to a zero balance, ready to measure activity in the next accounting period, and (2) the balances of these temporary accounts are transferred to retained earnings to reflect the changes that have occurred in that account during the period. Revenue and expense accounts are first transferred to income summary. The net balance in income summary is then transferred to retained earnings.

Learning Objective: 7 Level of Learning: 2

Chapter 2 Review of the Accounting Process

153. Describe the difference between external events and internal events and give two examples of each.

Answer:

External events involve an exchange between the company and a separate economic entity. Examples include purchasing inventory on account or borrowing money from a bank. Internal events directly affect the financial position of the company but do not involve exchange transactions with another entity. Examples include depreciation of equipment or use of supplies.

Learning Objective: 1 Level of Learning: 3

154. What is the purpose of the statement of cash flows? List the three major categories of cash flows and give an example of a cash transaction for each category.

Answer:

The purpose of the statement of cash flows is to summarize the transactions that caused cash to change during the reporting period. The statement of cash flows summarizes cash flows in three categories: operating, investing, and financing. Operating activities include cash flows related to transactions entering into the determination of net income, such as cash collections from customers, payments for purchases, and other receipts such as interest and dividends. Investing activities include purchasing and selling equipment or certain investment securities. Financing activities include borrowing or repaying loans, issuing stock, and payment of dividends.

Learning Objective: 6 Level of Learning: 3

155. What is an accrued liability?

Answer:

An accrued liability results from an expense being incurred prior to cash payment. Examples include interest and wages payable.

Learning Objective: 4 Level of Learning: 3