

Chapter 02

Accounting for Accruals and Deferrals

Short Answer Questions

Indicate how each event affects the elements of financial statements. Use the following letters to record your answer in the box shown below each element. You do not need to enter amounts.

Increase = I

Decrease = D

No Effect = N

1. Jenkins Co. performed services for customers on account.

Assets	Liabilities	Equity	Revenues	Expenses	Net Income	Cash

2. George Co. collected \$1,000 cash from accounts receivable.

Assets	Liabilities	Equity	Revenues	Expenses	Net Income	Cash

3. Sparta Co. provided \$1,600 of services for a customer who paid \$1,000 cash immediately and promised to pay an additional \$600 one month later.

Assets	Liabilities	Equity	Revenues	Expenses	Net Income	Cash

4. Aztec Co. signed contracts for \$20,000 of services to be performed in the future.

Assets	Liabilities	Equity	Revenues	Expenses	Net Income	Cash

5. At the end of the accounting period, Stewart Co. recognized accrued salaries.

Assets	Liabilities	Equity	Revenues	Expenses	Net Income	Cash

6. Curtis Company received \$250 from a customer for services to be performed at a future date.

Assets	Liabilities	Equity	Revenues	Expenses	Net Income	Cash

7. When is revenue recognized under accrual accounting?

8. What does the balance in accounts receivable represent?

9. When are expenses recognized under accrual accounting in relation to the payment of cash?

10. What is the effect on the accounting equation of a cash payment to creditors?

11. Why are adjusting entries necessary in an accrual accounting system? What are some common examples?

12. What effect does the recording of revenue normally have on total assets?

13. What effect does providing services on account have on the statement of cash flows? The balance sheet?

14. Describe the purpose of the closing process.

15. Describe the difference between temporary and permanent accounts, and state which ones are closed.

16. Define the accounting cycle and list the stages of the cycle.

17. Explain the meaning of the term, "matching concept."



18. The temporary or nominal accounts are closed prior to the start of the next accounting cycle. In this closing process, the amounts in each of these accounts are transferred to what other account(s)?

19. What is meant by the "fraud triangle"?

20. Discuss the importance of ethics in the accounting profession.

### Multiple Choice Questions

21. Bledsoe Company received \$15,000 cash from the issue of stock on January 1, 2013. During 2013 Bledsoe earned \$8,500 of revenue on account. The company collected \$6,000 cash from accounts receivable and paid \$5,400 cash for operating expenses. Based on this information alone, during 2013.

- A. Total assets increased by \$24,100.
- B. Total assets increased by \$600.
- C. Total assets increased by \$18,100.
- D. Total assets did not change.

22. Adkins Company experienced an accounting event that affected its financial statements as indicated below:

Assets	=	Liab.	+	Equity	Rev.	-	Exp.	=	Net Inc.	Cash Flow
+		NA		+	+		NA		+	NA

Which of the following accounting events could have caused these effects on ABC's statements?

- A. Issued common stock.
- B. Earned cash revenue.
- C. Earned revenue on account.
- D. Collected cash from accounts receivable.

23. Which of the following choices accurately reflects how the recording of accrued salary expense affects a business's financial statements?

Assets	=	Liab.	+	Equity	Rev.	-	Exp.	=	Net Inc.	Cash Flow
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- A. 

NA	=	+	+	-	-	-	+	=	NA	NA
----	---	---	---	---	---	---	---	---	----	----
- B. 

NA	=	NA	+	+	-	NA	-	NA	=	NA	NA
----	---	----	---	---	---	----	---	----	---	----	----
- C. 

NA	=	+	+	-	NA	-	+	=	-	NA
----	---	---	---	---	----	---	---	---	---	----
- D. 

+	=	+	+	NA	NA	-	+	=	-	-OA
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24. Which of the following transactions does **not** involve an accrual?

- A. Recording interest earned that will be received in the next period.
- B. Recording operating expense incurred but not yet paid.
- C. Recording salary expense incurred but not yet paid.
- D. Recording the pre-payment of two years' worth of insurance.

25. Sandridge Company recorded salaries earned by employees but not yet paid.

Which of the following represents the effect of this transaction on the financial statements?

Assets	=	Liab.	+	Equity	Rev.	-	Exp.	=	Net Inc.	Cash Flow
--------	---	-------	---	--------	------	---	------	---	----------	-----------

A. 

+	=	+	+	NA	+	-	NA	=	+	- OA
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B. 

NA	=	+	+	-	NA	-	+	=	-	- IA
----	---	---	---	---	----	---	---	---	---	------

C. 

-	=	NA	+	-	NA	-	+	=	-	NA
---	---	----	---	---	----	---	---	---	---	----

D. 

NA	=	+	+	-	NA	-	+	=	-	NA
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26. Revenue on account amounted to \$4,000. Cash collections of accounts receivable amounted to \$2,300. Expenses for the period were \$2,100. The company paid dividends of \$450. Net income for the period was

- A. \$200.
- B. \$1,450.
- C. \$1,850.
- D. \$1,900.

27. The recognition of an expense may be accompanied by which of the following?

- A. An increase in assets
- B. A decrease in liabilities
- C. A decrease in revenue
- D. An increase in liabilities

28. Which of the following statements is true in regard to accrual accounting?

- A. Revenue is recorded only when cash is received.
- B. Expenses are recorded when they are incurred.
- C. Revenue is recorded in the period when it is earned.
- D. Both B and C.

29. Recognition of revenue **may** be accompanied by which of the following?

- A. A decrease in a liability.
- B. An increase in a liability.
- C. An increase in assets.
- D. A. and C.

30. Mackie Company provided \$25,500 of services on account, and collected \$18,000 from customers during the year. The company also incurred \$17,000 of expenses on account, and paid \$15,400 against its payables. As a result of these events.

- A. total assets would increase
- B. total liabilities would increase
- C. total equity would increase
- D. all of the above are correct

31. Which of the following events would **not** require an end-of-year adjusting entry?

- A. Purchasing supplies for cash
- B. Providing services on account
- C. Purchasing a 12-month insurance policy on July 1
- D. All of the above would require an end-of-year adjustment

32. The entry to recognize work completed on unearned revenue involves which of the following?

- A. An increase in assets and a decrease in liabilities
- B. An increase in liabilities and a decrease in equity
- C. A decrease in assets and a decrease in liabilities
- D. A decrease in liabilities and an increase in equity

33. Franklin Trash Removal Company received a cash advance of \$9,000 on December 1, 2013 to provide services during the months of December, January, and February. The year-end adjustment to recognize the partial expiration of the contract will

- A. increase equity by \$3,000
- B. increase assets by \$3,000
- C. increase liabilities by \$3,000
- D. both A and B

34. The following account balances were drawn from the 2013 financial statements of Gunn Company

Cash	\$ 4,400	Accounts payable	\$ 1,250
Accounts receivable	\$ 1,500	Common stock	?
Land	\$ 8,000	Retained earnings, Jan. 1	\$ 2,700
		Revenue	\$ 9,500
		Expenses	\$ 7,250

Based on the above information, what is the balance of Common Stock for Gunn Company?

- A. \$9,950
- B. \$7,700
- C. \$450
- D. \$10,400



35. Prior to closing, XYZ Company's accounting records showed the following balances:

Retained earnings	\$ 5,600
Service revenue	7,250
Interest revenue	600
Salaries expense	4,100
Operating expense	1,150
Interest expense	300
Dividends	900

After closing, XYZ's retained earnings balance would be

- A. \$5,600.
- B. \$7,000.
- C. \$7,900.
- D. None of the above.

36. Olaf Company began 2013 with \$600 in its supplies account. During the year, the company purchased \$1,700 of supplies on account. The company paid \$1,500 on accounts payable by year end. On December 31, 2013, Olaf counted \$700 of supplies on hand. Olaf's financial statements for 2013 would show:

- A. \$800 of supplies; \$100 of supplies expense
- B. \$700 of supplies; \$1,600 of supplies expense
- C. \$700 of supplies; \$1,000 of supplies expense
- D. \$800 of supplies; \$1,700 of supplies expense

37. James Company paid \$1,800 for one year's rent in advance beginning on October 1, 2013. James's 2013 income statement would report rent expense, and its statement of cash flows would report cash outflow for rent, respectively, of

- A. \$1,800; \$1,800
- B. \$450; \$1,800
- C. \$450; \$450
- D. \$300; \$1,800

38. In uncertain circumstances, the conservatism principle guides accountants to

- A. accelerate revenue recognition and delay expense recognition.
- B. accelerate expense recognition and delay revenue recognition.
- C. recognize expense of prepaid items when payment is made.
- D. maximize reported net income.

39. Purchasing prepaid rent is classified as a(n):

- A. asset source transaction.
- B. asset use transaction.
- C. asset exchange transaction
- D. claims exchange transaction.

40. Revenue on account amounted to \$3,000. Cash collections of accounts receivable amounted to \$2,700. Cash paid for expenses was \$2,500. The amount of employee salaries accrued at the end of the year was \$300. Cash flow from operating activities was

- A. \$200.
- B. \$300.
- C. \$500.
- D. None of these.

41. Which of the following accounts would **not** appear on a balance sheet?

- A. Unearned Revenue.
- B. Salaries Payable.
- C. Interest Revenue.
- D. Retained Earnings.

42. Woodward Enterprises had the following events during 2013:

The business issued \$20,000 of common stock to its stockholders.

The business purchased land for \$12,000 cash.

Services were provided to customers for \$16,000 cash.

Services were provided to customers for \$5,000 on account.

The company borrowed \$16,000 from the bank.

Operating expenses of \$12,000 were incurred and paid in cash.

Salary expense of \$800 was accrued.

A dividend of \$4,000 was paid to the owners of Woodward Enterprises.

Assuming the company began operations during 2013, the amount of retained earnings as of December 31, 2013 would be:

- A. \$4,200
- B. \$5,000
- C. \$8,200
- D. \$21,000

43. Which of the following would cause net income on the accrual basis to be different than (either higher or lower than) "cash provided by operating activities" on the statement of cash flows?

- A. Purchased supplies for cash.
- B. Purchased land for cash.
- C. Invested cash in an interest earning account.
- D. All of the above are correct.

44. Ruiz Company provided services for \$15,000 cash during the 2013 accounting period. Ruiz incurred \$12,000 expenses on account during 2013, and by the end of the year, \$3,000 of that amount had been paid with cash. Assuming that these are the only accounting events that affected Ruiz during 2013.

- A. The amount of net income shown on the income statement is \$3,000.
- B. The amount of net income shown on the income statement is \$9,000.
- C. The amount of net loss shown on the income statement is \$3,000.
- D. The amount of net cash flow from operating activities shown on the statement of cash flows is \$6,000.

The following accounts and balances were drawn from the records of Hoover Company on December 31, 2013:

Cash	\$1,000	Accounts Receivable	\$850
Dividends	500	Common Stock	975
Land	800	Revenue	800
Accounts Payable	450	Expense	550

45. Total assets on the December 31, 2013 balance sheet would amount to:

- A. \$3,150.
- B. \$3,450.
- C. \$1,800.
- D. \$2,650.

46. The amount of net income shown on the December 31, 2013 income statement would amount to:

- A. \$550.
- B. \$800.
- C. \$50.
- D. \$250.

47. The amount of retained earnings as of January 1, 2014 was:

- A. \$1,475.
- B. \$1,800.
- C. \$975.
- D. \$1,225.

Norris Company experienced the following transactions during 2013, its first year in operation.

1. Issued \$6,000 of common stock to stockholders.
2. Provided \$2,300 of services on account.
3. Paid \$1,600 cash for operating expenses.
4. Collected \$1,900 of cash from accounts receivable.
5. Paid a \$100 cash dividend to stockholders.

48. The amount of net income recognized on Norris Company's 2013 income statement is:

- A. \$500.
- B. \$400.
- C. \$700.
- D. \$600.

49. The amount of net cash flow from operating activities shown on Norris Company's 2013 statement of cash flows is

- A. \$200.
- B. \$300.
- C. \$700.
- D. \$600.

50. The total amount of assets shown on Norris Company's December 31, 2013 balance sheet is:

- A. \$6,200.
- B. \$6,600.
- C. \$6,700.
- D. None of these.

51. The amount of retained earnings appearing on Norris Company's December 31, 2013 balance sheet is:

- A. \$500.
- B. \$600.
- C. \$700.
- D. \$6,600.



52. On December 31, 2013, Farrell Co. owed \$1,500 in salaries to employees who had worked during December but would be paid in January. If the year-end adjustment is properly recorded on December 31, 2013, what will be the effect of the accrual on the following items for Farrell?

	Net Income	Cash Flow from Operating Activities
a.	No effect	No effect
b.	Decrease	No effect
c.	Increase	Decrease
d.	No effect	Decrease

- A. Option A
- B. Option B
- C. Option C
- D. Option D

53. Tocca Co. collected a \$5,000 cash advance from a customer on November 1, 2013 for work to be performed over a six-month period beginning on that date. If the year-end adjustment is properly recorded, what will be the effect on Tocca's 2013 financial statements?

- A. Increase assets and increase liabilities
- B. Increase assets and increase revenues
- C. Decrease liabilities and increase revenues
- D. No effect

54. Gonzales Company collected \$18,000 on September 1, 2013 from a customer for services to be provided over a one-year period beginning on that date. How much revenue would Gonzales Company report related to this contract on its income statement for the year ended December 31, 2013? How much would it report as cash flows from operating activities for 2013?

- A. \$6,000; \$6,000
- B. \$6,000; \$18,000
- C. \$18,000; \$18,000
- D. \$0; \$18,000

55. The matching concept refers to the "matching" of:

- A. expenses and liabilities
- B. expenses and revenues
- C. assets and equity
- D. assets and liabilities

56. The results of the matching process are best reported on which financial statement?

- A. Balance sheet
- B. Income statement
- C. Statement of changes in stockholders' equity
- D. Statement of cash flows

57. Expenses that are matched with the period in which they are incurred are frequently called:

- A. market expenses
- B. matching expenses
- C. period costs
- D. working costs

58. If retained earnings decreased during the year, and no dividends were paid, which of the following must be true?

- A. Expenses for the year exceeded revenues
- B. The company did not have enough cash to pay its expenses
- C. Total equity decreased
- D. Liabilities increased during the year

59. Which of the following correctly states the proper order of the accounting cycle?

- A. Record transactions, adjust accounts, prepare statements, close temporary accounts.
- B. Adjust accounts, record transactions, close temporary accounts, prepare statements.
- C. Prepare statements, record transactions, close temporary accounts, adjust accounts.
- D. Adjust accounts, prepare statements, record transactions, close temporary accounts.

60. The purpose of the accrual basis of accounting is to:

- A. Report revenue when received.
- B. Match revenues and expenses in the proper period.
- C. Report expenses when cash disbursements are made.
- D. Improve the company's earnings per share.

61. Which of the following financial statement elements is closed at the end of an accounting cycle?

- A. Liabilities
- B. Common stock
- C. Assets
- D. Revenues

62. Which of the following accounts is **not** closed at the end of an accounting cycle?

- A. Liabilities
- B. Revenues
- C. Dividends
- D. Expenses

63. The balance in a revenue account at the beginning of an accounting period will always be

- A. equal to the amount of retained earnings for the previous period.
- B. last period's ending balance.
- C. higher than the previous periods beginning balance.
- D. zero.

64. The accounting principle that guides accountants, when faced with a recognition dilemma, to choose the alternative that produces the lowest net income is referred to as

- A. the matching principle.
- B. internal control.
- C. conservatism.
- D. materiality.

65. Which of the following is **not** a component of the fraud triangle?

- A. Opportunity
- B. Rationalization
- C. Trust
- D. Pressure

66. Which of the following is **not** an article of the AICPA Code of Professional Conduct?

- A. Conservatism
- B. Objectivity and Independence
- C. Integrity
- D. Due Care

67. Which of the following is **not** a common feature of ethical misconduct?

- A. The capacity to rationalize.
- B. The existence of pressure leading to an incentive.
- C. The assistance of others.
- D. The presence of an opportunity.

68. Policies and procedures designed to reduce the opportunities for fraud are often called:

- A. accounting principles
- B. asset source transactions
- C. internal controls
- D. financial systems

69. What action did the U. S. Congress take because of the audit failures at Enron, WorldCom and other companies?

- A. Required publicly-traded companies to be audited by a government agency
- B. Required companies to begin preparing an additional financial statement
- C. Passed the Sarbanes-Oxley Act
- D. Passed an amendment to the Securities and Exchange Act

70. Which of the following describes the effects of a claims exchange transaction on a company's financial statements?

Assets	=	Liab.	+	Equity	Rev.	-	Exp.	=	Net Inc.	Cash Flow
--------	---	-------	---	--------	------	---	------	---	----------	-----------

- A. 

NA	=	NA	+	NA	NA	-	NA	=	NA	+ OA
----	---	----	---	----	----	---	----	---	----	------
- B. 

+	=	+	+	NA	NA	-	NA	=	NA	+ OA
---	---	---	---	----	----	---	----	---	----	------
- C. 

NA	=	+	+	-	NA	-	+	=	-	NA
----	---	---	---	---	----	---	---	---	---	----
- D. 

All of these could represent the effects of a claims exchange transaction.										
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71. Which of the following is an asset source transaction?

- A. Issued common stock.
- B. Paid a cash dividend to stockholders.
- C. Received a payment on accounts receivable.
- D. Accrued salary expense.



72. Which of the following is an asset use transaction?

- A. Purchased machine for cash.
- B. Recorded supplies expense at the end of the period.
- C. Invested cash in an interest earning account.
- D. Accrued salary expense.

73. Which of the following is a claims exchange transaction?

- A. Purchased machine for cash.
- B. Issued common stock.
- C. Invested cash in an interest earning account.
- D. Recognized revenue earned on a contract where the cash had been collected at an earlier date.

74. Which of the following is an asset exchange transaction?

- A. Issued common stock.
- B. Accrued salary expense at the end of the accounting period.
- C. Recognized revenue earned on a contract where the cash had been collected at an earlier date.
- D. Collected cash on accounts receivable

75. Earning revenue on account would be classified as a/an?

- A. claims exchange transaction.
- B. asset source transaction.
- C. asset use transaction.
- D. asset exchange transaction.

### Essay Questions

76. Kenyon Company uses accrual accounting. Indicate whether each of the following statements regarding Kenyon's accounting system is true or false.

\_\_\_\_ a) The recognition of accounting events and the realization of cash consequences may occur in different accounting periods.

\_\_\_\_ b) The cash consequence of a transaction always precedes its accounting recognition.

\_\_\_\_ c) Expenses may either be matched to revenues they produce or to periods in which they are incurred.

\_\_\_\_ d) Kenyon may record accrual transactions, but may not record deferral transactions.

\_\_\_\_ e) Kenyon is not permitted to make cash sales.

77. Whetstone Co. performed services for a customer on account. Indicate whether each of the following statements about this transaction is true or false.

- \_\_\_\_ a) Assets and equity both increase when the revenue is recognized.
- \_\_\_\_ b) This transaction did not affect cash flows.
- \_\_\_\_ c) The company recorded an increase in revenue and a decrease in accounts receivable.
- \_\_\_\_ d) Recognition of revenue would be delayed until cash was received.
- \_\_\_\_ e) This transaction is an example of an asset source transaction.

78. Dandridge Company collected cash in 2012 from a customer for services to be performed beginning January 2013. Indicate whether each of the following statements about this transaction is true or false.

\_\_\_\_ a) Dandridge's 2012 income statement would not be affected by this transaction.

\_\_\_\_ b) Dandridge's 2012 statement of cash flows would be affected by this transaction.

\_\_\_\_ c) This transaction is an asset exchange transaction.

\_\_\_\_ d) The revenue for the services provided will be recorded in 2013.

\_\_\_\_ e) This transaction is considered an accrual transaction.

79. Regarding the relationships of revenues and expenses to assets and liabilities, state whether each of the following statements is true or false.

\_\_\_\_ a) Recording an increase in a revenue account may be associated with an increase in assets.

\_\_\_\_ b) Recording an increase in a revenue account may be associated with a decrease in liabilities.

\_\_\_\_ c) An increase in Salaries Expense may be accompanied by a decrease in Salaries Payable.

\_\_\_\_ d) Recording a decrease in assets may be associated with an increase in an expense account.

\_\_\_\_ e) An increase in Supplies may be accompanied by an increase in Supplies Expense.

80. Wyatt Company paid \$57,000 in January 2013 for salaries that had been earned by employees in December 2012. Indicate whether each of the following statements about financial statement effects of the January 2013 event is true or false.

\_\_\_\_ a) The income statement for 2013 is not affected because the salaries expense had been recognized at the end of December.

\_\_\_\_ b) On the 2013 statement of cash flows, cash flows from operating activities decreased.

\_\_\_\_ c) Payment of the salaries in 2013 decreased a liability.

\_\_\_\_ d) The 2013 statement of changes in stockholders' equity would not be affected because the salaries expense had been recognized at the end of December.

\_\_\_\_ e) Both assets and equity decreased as a result of this transaction.

81. Indicate whether each of the following statements about the closing process and the accounting cycle is true or false.

\_\_\_\_ a) The closing process transfers certain account balances to retained earnings at the end of the accounting cycle.

\_\_\_\_ b) Only accounts that appear on the income statement are closed at the end of each accounting cycle.

\_\_\_\_ c) Another name for permanent accounts is "nominal accounts."

\_\_\_\_ d) The permanent accounts contain information that is cumulative in nature.

\_\_\_\_ e) The retained earnings balance at the end of any given year is equal to that year's net income.



82. Regarding the effects of end-of-period adjustments, state whether each of the following statements is true or false.

\_\_\_\_ a) Recording the usage of supplies involves a decrease in assets and a decrease in equity.

\_\_\_\_ b) The accrual of salaries is considered a claims exchange transaction.

\_\_\_\_ c) Recording services performed on a prepaid contract involves a decrease in liabilities and an increase in assets.

\_\_\_\_ d) End of period adjustments never affect cash flows.

\_\_\_\_ e) Failure to record accrued salaries at the end of the year will cause reported income to be higher than it should have been.

83. Indicate whether each of the following statements regarding the four types of accounting events is true or false.

\_\_\_\_ a) Asset use transactions involve an increase in one asset and a decrease in another asset.

\_\_\_\_ b) An asset source transaction involves an increase in assets and an increase in a corresponding claims account.

\_\_\_\_ c) An asset exchange transaction involves an increase in an asset and a decrease in a claims account.

\_\_\_\_ d) Asset exchange transactions involve an increase in one asset and a decrease in another asset.

\_\_\_\_ e) Some claims exchange transactions involve an increase in a liability account and a decrease in an equity account.

84. Indicate whether each of the following statements about corporate governance is true or false.

\_\_\_\_\_ a) The Financial Accounting Standards Board issues a code of ethical behavior by which public accountants must abide.

\_\_\_\_\_ b) The Sarbanes Oxley Act created the Public Company Accounting Oversight Board (PCAOB).

\_\_\_\_\_ c) Because of the Sarbanes Oxley Act, many audit firms now provide nonaudit services to audit clients.

\_\_\_\_\_ d) The fraud triangle identifies opportunity, pressure, and rationalization as the three elements that are typically present when fraud is committed.

\_\_\_\_\_ e) An executive found guilty of falsely certifying a company's financial statements faces up to a \$5 million fine and 20 years in prison.

**True / False Questions**

85. The term "recognition" means to report an economic event in the financial statements.

True False

86. Companies that use accrual accounting recognize revenues and expenses at the time that cash is paid or received.

True False

87. The term "accrual" describes an earnings event that is recognized after cash is paid or received.

True False

88. A company may recognize a revenue or expense without a corresponding cash collection or payment in the same accounting period.

True False

89. A payment to an employee in settlement of salaries payable decreases an asset and decreases a liability.

True False

90. An increase in an expense may be accompanied by an increase in a liability.

True   False

91. Revenues and liabilities are temporary accounts.

True   False

92. In the closing process, the amounts in temporary accounts are moved to retained earnings, a permanent account.

True   False

93. Accounts that are closed include expenses, dividends, and unearned revenues.

True   False

94. After closing, only balance sheet accounts have non-zero balances.

True   False

95. Two of the steps in the accounting cycle are adjusting the accounts and closing the accounts.

True   False

96. Cash-basis accounting often fails to match expenses with revenues.

True   False

97. The matching concept leads accountants to select the recognition alternative that produces the lowest amount of net income.

True   False

98. Adjusting entries never affect a business's cash account.

True   False

99. Asset use transactions always involve the payment of cash.

True   False

100. The governance of a corporation includes the roles and responsibilities of the board of directors, managers, shareholders, and auditor.

True   False

101. The ethical standards for certified public accountants simply require that such accountants comply with applicable laws and regulations.

True   False

102.Certified public accountants are obligated to act in a way that serves the public interest.

True   False

103.The bankruptcies of Enron and WorldCom both indicated the occurrence of major audit failures.

True   False

104.The Sarbanes-Oxley Act includes several significant reforms that affect the auditing profession, but it did not reduce an audit firm's ability to provide non-audit services to its audit clients.

True   False

105.A business's internal controls are designed to reduce the probability of occurrence of fraud.

True   False

106.Providing services to customers on account is an asset source transaction.

True   False

107. An adjusting entry that decreases unearned revenue and increases service revenue is a claims exchange transaction.

True   False

108. Sometimes the recognition of revenue is accompanied by an increase in liabilities.

True   False

109. The collection of an account receivable is a claims exchange transaction.

True   False

## Essay Questions



110. Houston Company began business operations and experienced the following transactions during 2013:

- 1) Issued common stock for \$20,000 cash.
- 2) Provided services to customers for \$50,000 on account.
- 3) Purchased \$1,000 of supplies on account.
- 4) Paid \$12,000 cash to rent office space for a 12-month period beginning July 1.
- 5) Collected \$46,000 cash from customers.
- 6) Paid cash for \$36,000 of operating expenses.
- 7) Adjusted the accounting records to reflect that there was \$300 of supplies remaining on hand at year-end.
- 8) Recorded an end-of-year adjustment to recognize rent expense.

Required:

- a) Record the above transactions on a horizontal statements model, reflecting their effect on the different financial statements.
- b) Prepare Houston Company's income statement, balance sheet and statement of cash flows for the year ended December 31, 2013.

111. The following transactions apply to Brunswick Corporation.

- a) Issued common stock for \$35,000 cash.
- b) Provided services to customers for \$18,000 on account.
- c) Purchased land for \$18,000 cash.
- d) Purchased \$500 of supplies on account.
- e) Paid \$9,000 for operating expenses.
- f) Paid \$450 on accounts payable.
- g) Collected \$15,000 cash from customers.
- h) Accrued \$400 of salary expense at year end.
- i) Paid \$2,500 dividends to stockholders.

Required:

- a) Identify the effect on the statement of cash flows for each of the above transactions.
- b) Classify the above accounting events into one of four types of transactions (asset source, asset use, asset exchange, claims exchange).

112. Record each of the following events in the horizontal statements model. After each event, record the corresponding **end-of-year adjustment** that would be necessary.

- a) Paid \$18,000 for a 1-year lease beginning April 1.
- b) Paid \$1,500 to purchase supplies. At year end, \$540 of supplies remained.
- c) Received a \$24,000 cash advance for a 6-month contract beginning on Sept. 1.

113. The following data were taken from the accounting records of Lorenzo Company.

Except where indicated, the balances are as of December 31, 2013 before closing entries have been made.

Service revenue	\$ 83,000
Retained earnings	47,500
Accounts receivable	13,250
Salaries expense	44,000
Operating expense	7,700
Accounts payable	11,400
Supplies expense	380
Prepaid rent	2,000
Common stock	45,000
Supplies	200
Dividends	1,200
Insurance expense	800
Rent expense	10,000
Unearned revenue	765

Required:

- List the accounts that should be closed at the end of 2013.
- Prepare an income statement for Lorenzo Company for 2013.
- What is the balance in retained earnings after closing entries have been made?

114. For each of the following transactions, indicate the type by entering AS for asset source transactions, AU for asset use transactions, AE for asset exchange transactions, and CE for claims exchange transactions.

- 1) \_\_\_ Purchased supplies on account.
- 2) \_\_\_ Recorded the accrual of \$1,000 in salaries to be paid later.
- 3) \_\_\_ Issued common stock for \$20,000 in cash.
- 4) \_\_\_ Earned revenue to be collected next year.
- 5) \_\_\_ Paid \$2,000 in dividends to its stockholders.
- 6) \_\_\_ Received cash from customers in #4 above.
- 7) \_\_\_ Paid the salaries accrued in #2 above.
- 8) \_\_\_ Received \$500 from a customer for services to be provided later.

115. Classify each of the following transactions for the purpose of the statement of cash flow as operating activities (OA), investing activities (IA), financing activities (FA), or not reported on the statement of cash flows (NA).

- 1) \_\_\_\_ Made adjusting entry to recognize interest revenue on investments.
- 2) \_\_\_\_ Borrowed funds from the bank.
- 3) \_\_\_\_ Paid rent in advance for the next six months.
- 4) \_\_\_\_ Paid cash to settle accrued salary expense.
- 5) \_\_\_\_ Purchased supplies on account.
- 6) \_\_\_\_ Collected accounts receivable.
- 7) \_\_\_\_ Sold land.

116. Jack Grimes started a consulting business, Grimes Consulting, on January 1, 2013 by issuing \$7,000 of common stock. In addition, the following events occurred in 2013.

Provided services on account, \$25,500.

Paid cash for \$11,500 in operating expenses.

Collected \$9,000 of the revenue that was previously recorded on account.

Paid a cash dividend of \$4,000 to the stockholders.

Required:

a) Show the effects of the above transactions on the accounting equation.

<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Common Stock</u>	+	<u>Retained Earnings</u>
1)						
2)						
3)						
4)						
5)						

b) Prepare an income statement and statement of cash flows for 2013.

117. Thiessen Company started its business by issuing \$7,000 of common stock on January 1, 2013. The company performed \$18,000 of service for customers on account in 2013. It collected \$12,500 of this amount in 2013, recorded expenses on account of \$14,500, paid \$11,000 of the payables owed, and paid a \$300 dividend to the stockholders.

Required:

- a) What is the amount of total assets at the end of 2013?
- b) What is the amount of cash on hand at the end of 2013?
- c) What is the net income for 2013?
- d) Prepare a balance sheet for 2013.



118. The Ping Corporation was started on January 1, 2013, with the issuance of \$20,000 of stock. During 2013, the company provided \$30,000 of services on account and collected \$18,000 of that amount. Ping incurred \$23,000 of expenses, and paid \$20,000 of that amount during 2013. On December 31, 2013, Ping paid investors a \$800 cash dividend and accrued \$2,000 of salary expense.

Required:

- 1) What is the net income for year ending December 31, 2013?
- 2) Prepare Ping Corporation's Statement of Cash Flows for the year ended December 31, 2013.
- 3) What is the balance in Ping's retained earnings account after closing entries are made on December 31, 2013?

119. Consider the following independent scenarios:

a) At January 1, 2013, accounts receivable was \$22,000. Cash collected on accounts receivable during 2011 was \$15,000. At December 31, 2011, accounts receivable was \$30,000.

What were the revenues earned on account during 2011?

b) At January 1, 2013, accounts payable was \$19,000. During 2013, expenses on account were \$28,000. At December 31, 2013, accounts payable was \$15,000.

What was the amount of cash paid on accounts payable during 2013?

c) At January 1, 2013, the balance in the prepaid insurance account was \$480. On March 1, 2013, the company paid \$2,940 for insurance coverage for the next 12 months. What was the amount of insurance expense for 2013?

d) At January 1, 2013, the balance in the supplies account was \$550. At December 31, 2013, the company counted \$600 of supplies on hand. The company reported supplies expense in 2013 of \$2,300. What was the total of supplies purchases during 2013?

120. Washington Co. began operations on January 1, 2013, by issuing \$10,000 in common stock to the stockholders. On March 1, 2013, Washington accepted an advance of \$18,000 to provide services for a one-year period beginning April 1. During 2013, services in the amount of \$16,000 were provided to customers on account, and 80% of this amount was collected by year-end. During 2013, operating expenses incurred on account were \$12,000, and 60% of this amount was paid by year-end. During the year, Washington paid \$600 to purchase supplies. By year-end, \$540 of the supplies had been used. Dividends to stockholders were \$1,000 during the year. During 2013, Washington paid salaries of \$14,000, and on December 31, 2013, the company accrued salaries of \$1,400. Washington recorded all appropriate adjusting entries at year end.

- 1) What would Washington report for service revenue for 2013?
- 2) What would Washington report for salaries expense for 2013?
- 3) What would Washington report for supplies expense for 2013?
- 4) What would the amount be for net cash flows from operating activities for 2013?
- 5) What is the net income for 2013?
- 6) What would the balance in the retained earnings account be at December 31, 2013?

121. In a company's annual report, the reader will find a company's income statement, statement of changes in stockholder's equity, balance sheet, and statement of cash flows. These financial statements can help the reader to answer specific questions. Identify which financial statement would be most useful in answering the following questions. If more than one financial statement can answer the question, please identify all applicable statements.

- 1) What was the amount of cash dividends paid to the stockholders during the most recent year?
- 2) What was the total amount of land owned by the company?
- 3) What was the total amount of cash borrowed by the company during the most recent year?
- 4) What were the types of claims that the company has against its assets?
- 5) What was the total amount of cash received by the issuance of common stock?
- 6) Was the company profitable during the most recent year?
- 7) How much cash was collected from accounts receivable during the current year?
- 8) What was the total revenue earned by the company during the most recent year?
- 9) What was the ending balance of retained earnings?
- 10) What was the amount of change in the cash balance during the current year?

122. The following events apply to Bowen's Cleaning Service for 2013.

- 1). Issued stock for \$14,000 cash.
- 2). On May 1, paid \$9,000 for one year's rent in advance.
- 3). Purchased on account \$2,500 of supplies to be used in the business.
- 4). Performed services of \$18,400 and received cash.
- 5). At December 31, an inventory of supplies showed that \$360 of supplies were still unused.
- 6). At December 31, adjusted the records for the expired rent.

Required:

Draw an accounting equation and record the effects of the above events under the appropriate account headings. Show the year-end total for each account.

123. Using the form below, record each of the following 2013 transactions for Morris Corporation:

- Nov. 1. Received cash from clients for services to be performed over the next six months, \$6,000.
- Nov. 1. Paid \$600 for a 12-month insurance policy.
- Dec. 31. Recorded expiration of two months of the insurance.
- Dec. 31. Earned \$2,000 of the amount received from clients in November.

[illegible]

124. In a company's annual report, the reader will find a company's income statement, statement of changes in stockholders' equity, balance sheet, and statement of cash flows. These financial statements can help the reader to answer specific questions. Identify which financial statement would be most useful in answering the following questions. If more than one financial statement can answer the question, please identify all applicable statements.

- 1) What was the amount of cash dividends paid to the stockholders during the most recent year?
- 2) What was the total amount of land owned by the company?
- 3) What was the total amount of cash borrowed by the company during the most recent year?
- 4) What were the types of claims that the company had against its assets?
- 5) What was the total amount of cash received by the issuance of common stock in the current year?
- 6) Was the company profitable during the most recent year?
- 7) How much cash was collected from accounts receivable during the current year?
- 8) What was the total revenue earned by the company during the most recent year?
- 9) What was the ending balance of retained earnings?
- 10) What was the amount of change in the cash balance during the current year?

125. The following transactions apply to Kent Company.

- 1) Issued common stock for \$21,000 cash
- 2) Provided services to customers for \$28,000 on account
- 3) Purchased land for \$18,000 cash
- 4) Incurred \$9,000 of operating expenses on account
- 5) Collected \$15,000 cash from customers for services provided in event #2
- 6) Paid \$7,000 on accounts payable
- 7) Paid \$2,500 dividends to stockholders

Required:

- a) Identify the effect on the Statement of Cash Flows, if any, for each of the above transactions. Indicate whether each transaction involves operating, investing, or financing activities and the amount of increase or decrease.
- b) Classify the above accounting events into one of four types of transactions (asset source, asset use, asset exchange, claims exchange).

Event	(a) Effect on Statement of Cash Flows	(b) Transaction Type
1		
2		
3		
4		
5		
6		
7		



126. Danielle McLynn started a consulting business, McLynn Consulting, on January 1, 2013, and the business engaged in the following transactions during the year:

1. Issued \$8,000 of common stock for cash
2. Provided services on account, \$26,500
3. Incurred \$17,500 of operating expense, but only paid \$12,000 of this amount
4. Collected \$19,000 of the revenue that was previously recorded on account
5. Paid a cash dividend of \$4,500 to the stockholders

Required:

- a) Show the effects of the above transactions on the accounting equation.

Event	Assets	=	Liabilities	+	Common Stock	+	Retained Earnings
1							
2							
3							
4							
5							
Totals							

- b) Prepare an income statement and statement of cash flows for 2013.

127. Patterson Company was founded in 2013 and engaged in the following transactions:

1. issued common stock for cash
2. purchased supplies on account
3. collected cash from a customer for services to be provided over a period of 1 year
4. paid a cash dividend to stockholders
5. purchased a 2-year fire insurance policy
6. provided services to customers on account
7. collected cash from accounts receivable
8. paid cash for various operating expenses
9. paid rent in advance for 3 months at a time

Required:

- a) Which of the above transactions would require adjusting entries at year end?
- b) Why are adjusting entries required before financial statements can be prepared.

128. Jerry Mathers started his business by issuing \$4,000 of common stock on January 1, 2013. Jerry performed \$8,500 of service on account in 2013, and he collected \$6,200 of this amount by year end. He paid operating expenses of \$6,900 and paid a \$900 dividend to the stockholders.

Required:

- a) What is the amount of total assets at the end of 2013?
- b) What is the amount of cash on hand at the end of 2013?
- c) What is net income for 2013?
- d) Prepare a balance sheet for 2013.

129. The effects of transactions occurring during 2013 and their related end-of-year adjustments have been recorded below using the accounting equation.

	Assets				=	Liab		+	Stockholders' Equity		
	Cash	AR	Ppd. Ins.	Land		AP	Unearn. Rev.		CS	+	RE
1	40,000								40,000		
2	(10,000)			10,000							
3		24,000									24,000
4	16,000						16,000				
5	16,000	(16,000)									
6	(2,400)		2,400								
7						12,000					(12,000)
8	10,000			(10,000)							
9			(2,000)								(2,000)
10							(10,000)				10,000
Totals	\$ 69,600	\$ 8,000	\$ 400	\$ -		\$ 12,000	\$ 6,000		\$ 40,000		\$ 20,000

Required:

With your knowledge of transaction analysis using an accounting equation,

- Prepare an income statement for 2013, and
- Prepare a statement of cash flows for 2013.

130.Kramer Corporation began business operations and experienced the following transactions during 2013:

- 1) Issued common stock for \$10,000 cash.
- 2) Provided services to customers for \$40,000 on account.
- 3) Incurred \$18,000 of operating expenses on account.
- 4) Collected \$23,000 cash from customers.
- 5) Paid \$15,000 on accounts payable.

Required:

Record the above transactions on a horizontal statements model to reflect their effect on Kramer's financial statements.

[illegible]

131. Indicate for each of the following items if the item would be reported on the income statement (IS), statement of changes in equity (CE), balance sheet (BS), or statement of cash flows (CF). Some items may appear on more than one statement, if so, identify all applicable statements.

- 1) Prepaid insurance
- 2) Dividends paid to stockholders
- 3) Interest revenue
- 4) Accounts payable
- 5) Salaries expense
- 6) Retained earnings
- 7) Unearned subscription revenue
- 8) Cash flows from operating activities
- 9) Beginning common stock
- 10) Issued stock to investors for cash
- 11) Salaries payable
- 12) Accounts receivable

132. Classify each of the following transactions for the purpose of the statement of cash flows as operating activities (OA), investing activities (IA), financing activities (FA), or not reported on the statement of cash flows (NA).

- 1) \_\_\_\_ Made adjusting entry to accrue salary expense at the end of the year
- 2) \_\_\_\_ Borrowed funds from the bank
- 3) \_\_\_\_ Paid rent for the month
- 4) \_\_\_\_ Paid cash to settle accounts payable
- 5) \_\_\_\_ Issued common stock for \$30,000 cash
- 6) \_\_\_\_ Collected accounts receivable
- 7) \_\_\_\_ Paid cash to acquire land

133. Tuttle Company shows the following transactions for the accounting period ending December 31, 2013:

- 1) Sold books to customers for \$34,000 on account
- 2) Collected \$28,000 from customers
- 3) Issued common stock for \$8,000 cash
- 4) Prepaid four months' rent for \$4,400 on October 1, 2013
- 5) Purchase supplies for \$10,500 cash
- 6) Physical count shows \$3,250 of supplies left over on December 31, 2013
- 7) Recorded adjustment for prepaid rent used

Show how the above transactions and year end adjustments affect the financial statements on the accounting equation:

	Accts.	Ppd.		=	Common	Retained
Cash +	Rec. +	Rent +	Supplies		Stock +	Earnings
1)						
2)						
3)						
4)						
5)						
6)						
7)						



134. For each of the following transactions, indicate the type by entering "AS" for asset source transaction, "AU" for asset use transaction, "AE" for asset exchange transaction, and "CE" for claims exchange transaction.

- 1) \_\_\_\_ The company paid \$10,000 for a plot of land.
- 2) \_\_\_\_ Recorded the accrual of \$1,000 in salaries to be paid later.
- 3) \_\_\_\_ The company issued common stock for \$20,000 in cash.
- 4) \_\_\_\_ The business incurred operating expense on account.
- 5) \_\_\_\_ The business paid off its accounts payable.
- 6) \_\_\_\_ The business earned revenue to be collected next year.
- 7) \_\_\_\_ The company paid \$2,000 in dividends to its stockholders.
- 8) \_\_\_\_ The business received cash from customers in #6 above.
- 9) \_\_\_\_ Paid the salaries accrued in #2 above.
- 10) \_\_\_\_ Borrowed money from a local bank.

135. Tell whether each of the following events are asset source (AS), asset use (AU), asset exchange (AE), or claims exchange (CE) transactions.

- \_\_\_\_ 1) Issued common stock to investors for \$8,000 cash
- \_\_\_\_ 2) Paid one year's rent in advance
- \_\_\_\_ 3) Provided services to customers and received \$35,000 cash
- \_\_\_\_ 4) Paid creditors \$10,000
- \_\_\_\_ 5) Received \$3,000 of revenue in advance
- \_\_\_\_ 6) Provided services to customers on account, \$12,000
- \_\_\_\_ 7) Collected \$2,000 from accounts receivable
- \_\_\_\_ 8) Recognized accrued salary expense of \$2,000
- \_\_\_\_ 9) Borrowed \$6,000 from creditors
- \_\_\_\_ 10) Adjusted the records for supplies used of \$800

136.Creighton Company accrued \$120 of interest expense.

Assets	Liabilities	Equity	Revenues	Expenses	Net Income	Cash

137.Via Company paid \$40 of accrued interest expense.

Assets	Liabilities	Equity	Revenues	Expenses	Net Income	Cash

138.Crosby Company recorded \$3,000 of depreciation expense on a delivery van.

Assets	Liabilities	Equity	Revenues	Expenses	Net Income	Cash

### Multiple Choice Questions

139.Garrison Company purchased a delivery van on January 1, 2013 for \$20,000. The van is estimated to have a 5-year useful life and a \$4,000 salvage value. How much expense should Garrison recognize in 2013 related to the use of the van?

- A. \$16,000
- B. \$3,200
- C. \$20,000
- D. \$4,000

140. Which of the following events involves a deferral?

- A. Recording interest that has been earned but not received.
- B. Recording supplies that have been purchased with cash but not yet used.
- C. Recording revenue that has been earned but not yet collected in cash.
- D. Recording salaries owed to employees at the end of the year that will be paid during the following year.

141. The entry to recognize depreciation expense incurred on equipment involves which of the following?

- A. An increase in assets
- B. An increase in liabilities
- C. A decrease in assets
- D. A decrease in liabilities

142.The following accounts and balances were drawn from the records of Ji Company:

Cash	\$ 4,500
Accounts receivable	\$ 2,700
Equipment	\$10,000
Accumulated depreciation	\$ 3,200
Accounts payable	\$ 2,800
Common stock	\$ 6,000

Based on this information alone the amount of Ji's retained earnings is

- A. \$11,600.
- B. \$5,200.
- C. \$17,200.
- D. None of the above.

143.Which of the following would be included in the "cash flow from operating activities" section of the statement of cash flows?

- A. Accrual of salary expense at year-end.
- B. Cash paid for interest on a note payable.
- C. Payments of cash dividends to the owners of the business.
- D. Purchase of equipment for cash.

144. Collins Company began 2013 with a note payable of \$10,000 and interest payable of \$400. During the year, the company accrued an additional \$200 of interest expense, and paid off the note with interest. On the company's 2013 income statement, cash flows for financing activities related to the note would be:

- A. \$600 outflow
- B. \$10,000 outflow
- C. \$10,200 outflow
- D. \$10,600 outflow

145. Which of the following would cause net income on the accrual basis to be different (either higher or lower) than "cash provided by operating activities" on the statement of cash flows?

- A. Recognized depreciation expense on equipment.
- B. Incurred operating expenses on account.
- C. Paying interest on a note that was accrued in a prior year.
- D. All of the above are correct.

146. Grant Company purchased a machine on January 1, 2013 for \$13,000 cash. The machine has an estimated useful life of 4 years and a \$3,000 salvage value. What would be the book value of the machine reported on Grant's December 31, 2013 balance sheet?

- A. \$13,000
- B. \$9,750
- C. \$10,500
- D. \$7,500

#### True / False Questions

147. Recognition of depreciation expense is a claims exchange transaction.

True   False

148. Recognition of depreciation expense on equipment decreases the equipment account.

True   False



149. When a company purchases a depreciable asset, it must estimate the asset's useful life and salvage value.

True   False

150. Payment of interest is classified as a financing activity on the statement of cash flows.

True   False

### Essay Questions

151. Thornrose Company started its business on January 1, 2013 by issuing \$5,000 of common stock. On January 1, the company purchased a computer for \$3,500. The computer is estimated to have a 3-year useful life and a \$500 salvage value. On March 1, Thornrose issued a \$9,000, 6% 5-year note to Community Bank. Customers paid Thornrose \$18,000 for service performed in 2013. The company paid \$11,000 for operating expenses, and paid a \$300 dividend to the stockholders. At year-end, Thornrose recognized interest expense on the note and depreciation expense on the computer.

Required:

- a) What is the amount of interest expense Thornrose will recognize in 2013?
- b) What is the book value of the computer at the end of 2013?
- c) What is the net income for 2013?
- d) Prepare a balance sheet for 2013.

152. The following events apply to John's Lawn Service for 2013.

- 1). Issued stock for \$14,000 cash.
- 2). On January 1, purchased equipment for \$12,000. The equipment has an estimated 5-year useful life and a \$2,000 salvage value.
- 3). On May 1, issued a \$3,000, 5% 3-year note to a local bank.
- 4). Performed services of \$18,400 and received cash.
- 5). Paid \$15,000 of operating expenses.
- 6). At December 31, adjusted the records to recognize expense associated with use of the equipment and accrued interest.

Required:

Record the effects of the above events under the appropriate account headings in the accounting formula below.

	Assets		=	Liab		+	Stockholders' Equity	
	Cash	Book Value of Equip.		Notes Payable	Interest Payable		CS	RE
1								
2								
3								
4								
5								
6a								
6b								
Totals								

153. Giambrone Corporation began business operations and experienced the following transactions during 2013:

- 1) Issued common stock for \$15,000 cash.
- 2) Issued a \$10,000, 6% 4-year note to the bank on February 1.
- 3) Provided services to customers for \$40,000 cash.
- 4) Paid \$19,000 for operating expenses.
- 5) Accrued interest expense on the note.
- 6) Paid a \$2,000 dividend to shareholders.

Required:

Record the above transactions on a horizontal statements model to reflect their effect on Giambrone's financial statements.

[illegible]

## Chapter 02 Accounting for Accruals and Deferrals **Answer Key**

### Short Answer Questions

Indicate how each event affects the elements of financial statements. Use the following letters to record your answer in the box shown below each element. You do not need to enter amounts.

Increase = I

Decrease = D

No Effect = N

1. Jenkins Co. performed services for customers on account.

Assets	Liabilities	Equity	Revenues	Expenses	Net Income	Cash

(I) (N) (I) (I) (N) (I) (N)

Feedback: Performing services on account increases assets (accounts receivable) and increases revenue, which increases net income and equity (retained earnings). It does not affect the statement of cash flows, as it does not affect cash.

AICPA FN: Measurement

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 02-01: Show how receivables affect financial statements

Topic: Accounting for accounts receivable

2. George Co. collected \$1,000 cash from accounts receivable.

Assets	Liabilities	Equity	Revenues	Expenses	Net Income	Cash

(N) (N) (N) (N) (N) (N) (I)

Feedback: Collecting on accounts receivable increases one asset (cash) and decreases another asset (accounts receivable). It does not affect the income statement, but is reported as a cash inflow for operating activities on the statement of cash flows.

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 02-01: Show how receivables affect financial statements

Topic: Accounting for accounts receivable

3. Sparta Co. provided \$1,600 of services for a customer who paid \$1,000 cash immediately and promised to pay an additional \$600 one month later.

Assets	Liabilities	Equity	Revenues	Expenses	Net Income	Cash

(I) (N) (I) (I) (N) (I) (I)

Feedback: This event increases revenue, net income and equity (retained earnings) by \$1,600. Cash increases by \$1,000 and accounts receivable increases by \$600, which result in an increase in assets of \$1,600. It is reported as a \$1,000 cash inflow for operating activities on the statement of cash flows.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-01: Show how receivables affect financial statements*

*Topic: Accounting for accounts receivable*

4. Aztec Co. signed contracts for \$20,000 of services to be performed in the future.

Assets	Liabilities	Equity	Revenues	Expenses	Net Income	Cash

(N) (N) (N) (N) (N) (N) (N)

Feedback: This event does not affect the financial statements at all. Revenue is recorded when services are performed, not when the contract is signed.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 3 Hard*

*Learning Objective: 02-01: Show how receivables affect financial statements*

*Topic: Other events*



5. At the end of the accounting period, Stewart Co. recognized accrued salaries.

Assets	Liabilities	Equity	Revenues	Expenses	Net Income	Cash

(N) (I) (D) (N) (I) (D) (N)

Feedback: Accruing salaries expense increases liabilities (salaries payable) and it increases expenses, which decreases net income and equity (retained earnings). It does not affect the statement of cash flows.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 1 Easy*

*Learning Objective: 02-02: Show how payables affect financial statements*

*Topic: Accounting for salary expense*

6. Curtis Company received \$250 from a customer for services to be performed at a future date.

Assets	Liabilities	Equity	Revenues	Expenses	Net Income	Cash

(I) (I) (N) (N) (N) (N) (I)

Feedback: Collecting a payment in advance from a customer increases assets (cash) and increases liabilities (unearned revenue). It does not affect the income statement. Revenue will not be recognized until the services are provided. It will be reported as a cash inflow from operating activities on the statement of cash flows.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 1 Easy*

*Learning Objective: 02-05: Show how unearned revenues affect financial statements*

*Topic: Accounting for unearned revenues*

7. When is revenue recognized under accrual accounting?

Revenue is recognized when it is earned; i.e. when the services are performed.

Feedback: Accrual accounting requires that companies recognize revenue when work is done regardless of when cash is collected.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Blooms: Understand*

*Difficulty: 1 Easy*

*Learning Objective: 02-01: Show how receivables affect financial statements*

*Topic: Accounting for accounts receivable*

8. What does the balance in accounts receivable represent?

The balance in accounts receivable represents the amount of future cash receipts that is due from customers. In other words, it is the amount to be collected from customers who previously received goods or services on account.

Feedback: Accounts receivable is an asset account because it represents something that is owed to the company.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-01: Show how receivables affect financial statements*

*Topic: Accounting for accounts receivable*

9. When are expenses recognized under accrual accounting in relation to the payment of cash?

Expenses are recognized when they are incurred, regardless of when cash is paid. In accrual transactions, that means that expenses are recorded before cash payments, and in deferral transactions they are recorded after cash payments.

Feedback: Expenses are recognized when incurred, regardless of when payment is made.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-02: Show how payables affect financial statements*

*Learning Objective: 02-05: Show how unearned revenues affect financial statements*

*Topic: Accounting for accounts payable*

*Topic: Accounting for unearned revenues*

10. What is the effect on the accounting equation of a cash payment to creditors?

Assets decrease; liabilities decrease

Feedback: Making a cash payment to creditors decreases assets (cash) and decreases liabilities (accounts payable).

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-02: Show how payables affect financial statements*

*Topic: Accounting for salary expense*

11. Why are adjusting entries necessary in an accrual accounting system? What are some common examples?

Adjusting entries are necessary in order to recognize revenues and expenses that should be recognized in the current year, but have not yet been recorded. Some common adjusting entries include recognizing accrued salaries expense, accrued interest revenue, and deferred expenses, such as prepaid rent, as well as recognizing revenue that had been previously unearned.

Feedback: The Matching Principle requires adjusting entries in certain transactions in order to recognize revenues and expenses in the proper accounting period. These adjusting entries are made at the end of the period.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-06: Explain the accounting cycle including adjustments and the closing process*

*Topic: Adjusting Entries*

12. What effect does the recording of revenue normally have on total assets?

The recording of revenue normally has the effect of increasing total assets (usually cash or accounts receivable).

Feedback: If revenue is earned at the same time cash is collected, cash is increased. If revenue is earned on account, and a customer is billed, accounts receivable is increased. A less common situation involves earning revenue after cash was received in advance, in which case assets are unaffected (liabilities decrease and equity increases).

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 1 Easy*

*Learning Objective: 02-01: Show how receivables affect financial statements*

*Topic: Accounting for accounts receivable*

13. What effect does providing services on account have on the statement of cash flows? The balance sheet?

There is no effect on the statement of cash flows when services are performed on account. Assets and equity will increase on the balance sheet.

Feedback: Providing services on account does not affect the cash account; therefore the statement of cash flows is unaffected. The asset accounts receivable increases as does equity (revenue increases retained earnings).

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-01: Show how receivables affect financial statements*

*Topic: Accounting for accounts receivable*



14. Describe the purpose of the closing process.

The purpose of the closing process is to bring the balance of the nominal (temporary) accounts to zero at the end of an accounting period and to update the retained earnings account.

Feedback: Closing entries are made after the income statement is prepared.

Note that retained earnings is only affected by revenues, expenses, and dividends as the result of the closing process.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-06: Explain the accounting cycle including adjustments and the closing process*

*Topic: The Closing Process*

15. Describe the difference between temporary and permanent accounts, and state which ones are closed.

Temporary (nominal) accounts (revenues, expenses and dividends) collect information about a single period only; they are closed at the end of that period. Permanent accounts include the balance sheet accounts (assets, liabilities, common stock and retained earnings), and their balances roll forward each year rather than being closed out.

Feedback: Revenue and expense accounts appear on the income statement. Dividends is also a temporary account, but is not reported on the income statement. It is reported only on the statement of changes in equity. All permanent accounts appear on the balance sheet.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-06: Explain the accounting cycle including adjustments and the closing process*

*Topic: The Closing Process*

16. Define the accounting cycle and list the stages of the cycle.

The accounting cycle is a series of steps or procedures that occur repeatedly throughout the life of a business. The three stages described to this point in the course include

- (1) recording transactions
- (2) preparing statements and
- (3) closing temporary accounts.

Feedback: The accounting cycle repeats every accounting period. This is usually annually.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-06: Explain the accounting cycle including adjustments and the closing process*

*Topic: The accounting cycle*

17. Explain the meaning of the term, "matching concept."

The "matching concept" refers to the process of "matching" the expenses with the revenues that they produce in the appropriate time period. This matching is largely done through the adjusting process. For example, the accrual of salary expense has the effect of matching the correct portion of salary expense to the accounting period in which the employees contributed to producing revenue. Matching means that expenses should be recognized in the same accounting period as the revenues that they helped a business to earn.

Feedback: The matching concept is the foundation of accrual accounting - the recognition of revenues as they are earned and expenses as they are incurred, regardless of when cash is exchanged.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-06: Explain the accounting cycle including adjustments and the closing process*

*Topic: The Matching Concept*

18. The temporary or nominal accounts are closed prior to the start of the next accounting cycle. In this closing process, the amounts in each of these accounts are transferred to what other account(s)?

### Retained Earnings

Feedback: Closing revenues increases retained earnings. Closing expenses and dividends decreases retained earnings. Note that closing entries are the only transactions that directly involve the retained earnings account.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-06: Explain the accounting cycle including adjustments and the closing process*

*Topic: The Closing Process*

19. What is meant by the "fraud triangle"?

Auditors have identified three elements that are commonly present in instances of criminal and ethical misconduct. The first of these elements is the availability of opportunity. The second is the existence of some kind of pressure leading to an incentive. The third is the capacity to rationalize the behavior. These three elements are often shown in the form of a triangle.

Feedback: When working with ethical dilemmas, it is helpful to identify the opportunity, pressure and rationalization associated with that particular situation.

*AACSB: Analytic*

*AACSB: Communications*

*AACSB: Ethics*

*AICPA BB: Legal*

*AICPA FN: Risk Analysis*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-09: Discuss the primary components of corporate governance*

*Topic: The Fraud Triangle*

20. Discuss the importance of ethics in the accounting profession.

Because the users of accounting information depend on that information for making decisions, auditors must be trustworthy and credible. The management of a business is ultimately responsible for the financial statements; therefore, the accounting personnel of the business must also conduct themselves in a highly ethical manner.

Feedback: The high ethical standards required by the accounting profession state "a certified public accountant assumes an obligation of self-discipline above and beyond requirements of laws and regulations." The AICPA Code of Professional Conduct and the IMA Standards of Ethical Conduct are among ethics regulations governing the accounting profession.

*AACSB: Analytic*

*AACSB: Communications*

*AACSB: Ethics*

*AICPA BB: Industry*

*AICPA FN: Decision Making*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-09: Discuss the primary components of corporate governance*

*Topic: Importance of Ethics*

## Multiple Choice Questions

21. Bledsoe Company received \$15,000 cash from the issue of stock on January 1, 2013. During 2013 Bledsoe earned \$8,500 of revenue on account. The company collected \$6,000 cash from accounts receivable and paid \$5,400 cash for operating expenses. Based on this information alone, during 2013.

- A. Total assets increased by \$24,100.
- B. Total assets increased by \$600.
- C. Total assets increased by \$18,100.
- D. Total assets did not change.

$\$15,000 \text{ (cash)} + \$8,500 \text{ (accounts receivable)} + \$6,000 \text{ (cash)} - \$6,000$   
 $\text{(accounts receivable)} - \$5,400 \text{ (cash)} = \$18,100 \text{ increase}$

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-01: Show how receivables affect financial statements*

*Topic: Accounting for accounts receivable*



22. Adkins Company experienced an accounting event that affected its financial statements as indicated below:

Assets	=	Liab.	+	Equity	Rev.	-	Exp.	=	Net Inc.	Cash Flow
+		NA		+	+		NA		+	NA

Which of the following accounting events could have caused these effects on ABC's statements?

- A. Issued common stock.
- B. Earned cash revenue.
- C. Earned revenue on account.
- D. Collected cash from accounts receivable.

Earning revenue on account increases assets (accounts receivable) and increases revenue, which increases net income and equity (retained earnings). It does not affect cash flows.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-01: Show how receivables affect financial statements*

*Topic: Accounting for accounts receivable*

23. Which of the following choices accurately reflects how the recording of accrued salary expense affects a business's financial statements?

Assets	=	Liab.	+	Equity	Rev.	-	Exp.	=	Net Inc.	Cash Flow
--------	---	-------	---	--------	------	---	------	---	----------	-----------

- A. 

NA	=	+	+	-	-	-	+	=	NA	NA
----	---	---	---	---	---	---	---	---	----	----
- B. 

NA	=	NA	+	+	-	NA	-	NA	=	NA	NA
----	---	----	---	---	---	----	---	----	---	----	----
- C.

NA	=	+	+	-	NA	-	+	=	-	NA
----	---	---	---	---	----	---	---	---	---	----
- D. 

+	=	+	+	NA	NA	-	+	=	-	-OA
---	---	---	---	----	----	---	---	---	---	-----

Accruing salary expense increases liabilities (salaries payable) and increases expenses, which decreases net income and equity (retained earnings). It does not affect cash flows.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-02: Show how payables affect financial statements*

*Topic: Accounting for salary expense*

24. Which of the following transactions does **not** involve an accrual?

- A. Recording interest earned that will be received in the next period.
- B. Recording operating expense incurred but not yet paid.
- C. Recording salary expense incurred but not yet paid.
- D. Recording the pre-payment of two years' worth of insurance.

Recording the pre-payment of two years' worth on insurance involves a deferral, not an accrual. A deferral occurs when cash changes hands before revenue or expense is recognized. All other choices are accruals: interest receivable, accounts payable, and salaries payable.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 3 Hard*

*Learning Objective: 02-04: Show how prepaid items affect financial statements.*

*Topic: Prepaid items*

25. Sandridge Company recorded salaries earned by employees but not yet paid. Which of the following represents the effect of this transaction on the financial statements?

Assets	=	Liab.	+	Equity	Rev.	-	Exp.	=	Net Inc.	Cash Flow
--------	---	-------	---	--------	------	---	------	---	----------	-----------

A. 

+	=	+	+	NA	+	-	NA	=	+	- OA
---	---	---	---	----	---	---	----	---	---	------

B. 

NA	=	+	+	-	NA	-	+	=	-	- IA
----	---	---	---	---	----	---	---	---	---	------

C. 

-	=	NA	+	-	NA	-	+	=	-	NA
---	---	----	---	---	----	---	---	---	---	----

D.

NA	=	+	+	-	NA	-	+	=	-	NA
----	---	---	---	---	----	---	---	---	---	----

Accruing salaries expense increases liabilities (salaries payable) and increases expenses, which decreases net income and equity (retained earnings). It does not affect cash flows.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-02: Show how payables affect financial statements*

*Topic: Accounting for salary expense*

26. Revenue on account amounted to \$4,000. Cash collections of accounts receivable amounted to \$2,300. Expenses for the period were \$2,100. The company paid dividends of \$450. Net income for the period was
- A. \$200.
  - B. \$1,450.
  - C. \$1,850.
  - D. \$1,900.

Revenue \$4,000 - Expenses \$2,100 = \$1,900 Net Income

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-01: Show how receivables affect financial statements*

*Topic: Accounting for accounts receivable*

27. The recognition of an expense may be accompanied by which of the following?

- A. An increase in assets
- B. A decrease in liabilities
- C. A decrease in revenue
- D. An increase in liabilities

Recognizing an expense may be accompanied by an increase in liabilities (i.e. accounts payable, salaries payable) or a decrease in assets (i.e. cash, prepaid rent or insurance).

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-02: Show how payables affect financial statements*

*Topic: Accounting for payables*

28. Which of the following statements is true in regard to accrual accounting?

- A. Revenue is recorded only when cash is received.
- B. Expenses are recorded when they are incurred.
- C. Revenue is recorded in the period when it is earned.
- D. Both B and C.

Revenue is recognized when earned and expenses are recognized when incurred, regardless of when cash is exchanged.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-01: Show how receivables affect financial statements*

*Learning Objective: 02-02: Show how payables affect financial statements*

*Topic: Accounting for Accruals*

29. Recognition of revenue **may** be accompanied by which of the following?

- A. A decrease in a liability.
- B. An increase in a liability.
- C. An increase in assets.
- D. A. and C.

Recognizing revenue may be accompanied by either an increase in assets (cash or accounts receivable) or a decrease in liabilities (unearned revenue).

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 3 Hard*

*Learning Objective: 02-02: Show how payables affect financial statements*

*Learning Objective: 02-05: Show how unearned revenues affect financial statements*

*Topic: Accounting for payables*

*Topic: Accounting for unearned revenues*



30. Mackie Company provided \$25,500 of services on account, and collected \$18,000 from customers during the year. The company also incurred \$17,000 of expenses on account, and paid \$15,400 against its payables. As a result of these events.

- A. total assets would increase
- B. total liabilities would increase
- C. total equity would increase
- D. all of the above are correct

$\$25,500 - \$15,400 = \$10,100$  increase in assets;  $\$17,000 - \$15,400 = \$1,600$   
increase in liabilities;  $\$25,500 - \$17,000 = \$8,500$  increase in equity

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 3 Hard*

*Learning Objective: 02-01: Show how receivables affect financial statements*

*Learning Objective: 02-02: Show how payables affect financial statements*

*Topic: Accounting for accounts receivable*

*Topic: Accounting for payables*

31. Which of the following events would **not** require an end-of-year adjusting entry?

- A. Purchasing supplies for cash
- B. Providing services on account
- C. Purchasing a 12-month insurance policy on July 1
- D. All of the above would require an end-of-year adjustment

Providing services on account does not require an end-of-year adjusting entry. Accounts receivable is increased when services are provided on account and is decreased when payment is received from customers. Supplies and prepaid insurance both require end-of-year adjusting entries to recognize expense.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 3 Hard*

*Learning Objective: 02-01: Show how receivables affect financial statements*

*Topic: Accounting for accounts receivable*

32. The entry to recognize work completed on unearned revenue involves which of the following?

- A. An increase in assets and a decrease in liabilities
- B. An increase in liabilities and a decrease in equity
- C. A decrease in assets and a decrease in liabilities
- D. A decrease in liabilities and an increase in equity

Recognizing work completed on unearned revenue involves a decrease in liabilities (unearned revenue) and an increase in equity (retained earnings as a result of revenue).

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-05: Show how unearned revenues affect financial statements*

*Topic: Accounting for unearned revenues*

33. Franklin Trash Removal Company received a cash advance of \$9,000 on December 1, 2013 to provide services during the months of December, January, and February. The year-end adjustment to recognize the partial expiration of the contract will

- A. increase equity by \$3,000
- B. increase assets by \$3,000
- C. increase liabilities by \$3,000
- D. both A and B

The year-end adjustment to recognize one month's work on the three-month contract results in a \$3,000 decrease in liabilities (unearned revenue) and an increase in equity (retained earnings due to recognizing revenue).

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Apply*

*Difficulty: 2 Medium*

*Learning Objective: 02-05: Show how unearned revenues affect financial statements*

*Topic: Accounting for unearned revenues*

34. The following account balances were drawn from the 2013 financial statements of Gunn Company

Cash	\$ 4,400	Accounts payable	\$ 1,250
Accounts receivable	\$ 1,500	Common stock	?
Land	\$ 8,000	Retained earnings, Jan. 1	\$ 2,700
		Revenue	\$ 9,500
		Expenses	\$ 7,250

Based on the above information, what is the balance of Common Stock for Gunn Company?

- A. \$9,950
- B. \$7,700**
- C. \$450
- D. \$10,400

Assets (\$4,400 + \$1,500 + \$8,000) = Liabilities (\$1,250) + Equity; Equity = \$12,650; \$12,650 = Common Stock + Retained Earnings (\$2,700 + \$9,500 - \$7,250); \$12,650 = Common Stock + \$4,950; Common Stock = \$7,700

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Analyze*

*Difficulty: 2 Medium*

*Learning Objective: 02-07: Prepare financial statements based on accrual accounting*

*Topic: The Balance Sheet*

35. Prior to closing, XYZ Company's accounting records showed the following balances:

Retained earnings	\$ 5,600
Service revenue	7,250
Interest revenue	600
Salaries expense	4,100
Operating expense	1,150
Interest expense	300
Dividends	900

After closing, XYZ's retained earnings balance would be

- A. \$5,600.
- B.** \$7,000.
- C. \$7,900.
- D. None of the above.

$$\$5,600 + \$7,250 + \$600 - \$4,100 - \$1,150 - \$300 - \$900 = \$7,000$$

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Analyze*

*Difficulty: 2 Medium*

*Learning Objective: 02-06: Explain the accounting cycle including adjustments and the closing process*

*Topic: Adjusting Entries*

36. Olaf Company began 2013 with \$600 in its supplies account. During the year, the company purchased \$1,700 of supplies on account. The company paid \$1,500 on accounts payable by year end. On December 31, 2013, Olaf counted \$700 of supplies on hand. Olaf's financial statements for 2013 would show:

- A. \$800 of supplies; \$100 of supplies expense
- B. \$700 of supplies; \$1,600 of supplies expense
- C. \$700 of supplies; \$1,000 of supplies expense
- D. \$800 of supplies; \$1,700 of supplies expense

\$700 of supplies on hand is the supplies asset on the balance sheet; \$600 beginning balance + \$1,700 of supplies purchased - \$700 ending balance = \$1,600 supplies expense

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Analyze*

*Difficulty: 2 Medium*

*Learning Objective: 02-03: Show how supplies affect financial statements*

*Topic: Accounting for supplies*

37. James Company paid \$1,800 for one year's rent in advance beginning on October 1, 2013. James's 2013 income statement would report rent expense, and its statement of cash flows would report cash outflow for rent, respectively, of

- A. \$1,800; \$1,800
- B. \$450; \$1,800
- C. \$450; \$450
- D. \$300; \$1,800

$\$1,800 \times 3/12 = \$450$  rent expense; \$1,800 payment on 10/1/13 is a cash outflow for rent

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*AICPA FN: Reporting*

*Blooms: Analyze*

*Difficulty: 2 Medium*

*Learning Objective: 02-04: Show how prepaid items affect financial statements.*

*Topic: Prepaid items*



38. In uncertain circumstances, the conservatism principle guides accountants to

- A. accelerate revenue recognition and delay expense recognition.
- B. accelerate expense recognition and delay revenue recognition.
- C. recognize expense of prepaid items when payment is made.
- D. maximize reported net income.

The conservatism principle guides accountants to choose the alternative that produces the lowest net income, which causes them to accelerate expense recognition and delay revenue recognition.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Decision Making*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-06: Explain the accounting cycle including adjustments and the closing process*

*Topic: The Conservatism Principle*

39. Purchasing prepaid rent is classified as a(n):

- A. asset source transaction.
- B. asset use transaction.
- C. asset exchange transaction
- D. claims exchange transaction.

Purchasing prepaid rent increases one asset (prepaid rent) and decreases another asset (cash). Therefore, it is classified as an asset exchange transaction.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Analyze*

*Difficulty: 1 Easy*

*Learning Objective: 02-08: Classify accounting events into asset source; asset use; asset exchange; and claims exchange transactions.*

*Topic: Asset Source Transactions*

40. Revenue on account amounted to \$3,000. Cash collections of accounts receivable amounted to \$2,700. Cash paid for expenses was \$2,500. The amount of employee salaries accrued at the end of the year was \$300. Cash flow from operating activities was

- A. \$200.
- B. \$300.
- C. \$500.
- D. None of these.

\$2,700 collected from customers - \$2,500 paid for expenses = \$200. Revenue earned on account and accrued salaries are not cash flow activities.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Analyze*

*Difficulty: 2 Medium*

*Learning Objective: 02-02: Show how payables affect financial statements*

*Topic: Accounting for salary expense*

41. Which of the following accounts would **not** appear on a balance sheet?

- A. Unearned Revenue.
- B. Salaries Payable.
- C. Interest Revenue.
- D. Retained Earnings.

Interest revenue is an income statement account. Unearned revenue, despite having the word "revenue" in its title, is a liability account that appears on the balance sheet.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-07: Prepare financial statements based on accrual accounting*

*Topic: The Balance Sheet*

42. Woodward Enterprises had the following events during 2013:

The business issued \$20,000 of common stock to its stockholders.

The business purchased land for \$12,000 cash.

Services were provided to customers for \$16,000 cash.

Services were provided to customers for \$5,000 on account.

The company borrowed \$16,000 from the bank.

Operating expenses of \$12,000 were incurred and paid in cash.

Salary expense of \$800 was accrued.

A dividend of \$4,000 was paid to the owners of Woodward Enterprises.

Assuming the company began operations during 2013, the amount of retained earnings as of December 31, 2013 would be:

A. \$4,200

B. \$5,000

C. \$8,200

D. \$21,000

$\$0 \text{ beginning balance} + \$21,000 \text{ revenue} - \$12,800 \text{ expenses} - \$4,000 \text{ dividends}$   
 $= \$4,200 \text{ ending balance}$

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Analyze*

*Difficulty: 2 Medium*

*Learning Objective: 02-07: Prepare financial statements based on accrual accounting*

*Topic: The Balance Sheet*

43. Which of the following would cause net income on the accrual basis to be different than (either higher or lower than) "cash provided by operating activities" on the statement of cash flows?

- A. Purchased supplies for cash.
- B. Purchased land for cash.
- C. Invested cash in an interest earning account.
- D. All of the above are correct.

Purchasing supplies for cash is a cash outflow for operating activities, but will not be reported as an expense until the supplies are used. Purchasing land is a cash flow for investing activities and does not affect net income. Investing cash in an interest earning account is a cash flow for investing activities and the investment itself does not affect net income.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*AICPA FN: Reporting*

*Blooms: Analyze*

*Difficulty: 2 Medium*

*Learning Objective: 02-03: Show how supplies affect financial statements*

*Topic: Accounting for supplies*

44. Ruiz Company provided services for \$15,000 cash during the 2013 accounting period. Ruiz incurred \$12,000 expenses on account during 2013, and by the end of the year, \$3,000 of that amount had been paid with cash. Assuming that these are the only accounting events that affected Ruiz during 2013.

- A. The amount of net income shown on the income statement is \$3,000.  
B. The amount of net income shown on the income statement is \$9,000.  
C. The amount of net loss shown on the income statement is \$3,000.  
D. The amount of net cash flow from operating activities shown on the statement of cash flows is \$6,000.

$\$15,000 \text{ revenue} - \$12,000 \text{ expenses} = \$3,000 \text{ net income}$

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*AICPA FN: Reporting*

*Blooms: Analyze*

*Difficulty: 1 Easy*

*Learning Objective: 02-02: Show how payables affect financial statements*

*Topic: Accounting for accounts payable*

The following accounts and balances were drawn from the records of Hoover Company on December 31, 2013:

Cash	\$1,000	Accounts Receivable	\$850
Dividends	500	Common Stock	975
Land	800	Revenue	800
Accounts Payable	450	Expense	550

45. Total assets on the December 31, 2013 balance sheet would amount to:

- A. \$3,150.
- B. \$3,450.
- C. \$1,800.
- D. \$2,650.

\$1,000 cash + \$800 land + \$850 accounts receivable = \$2,650 total assets

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*AICPA FN: Reporting*

*Blooms: Apply*

*Difficulty: 2 Medium*

*Learning Objective: 02-07: Prepare financial statements based on accrual accounting*

*Topic: The Balance Sheet*



46. The amount of net income shown on the December 31, 2013 income statement would amount to:

A. \$550.

B. \$800.

C. \$50.

D. \$250.

\$800 revenue - \$550 expenses = \$250

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*AICPA FN: Reporting*

*Blooms: Apply*

*Difficulty: 1 Easy*

*Learning Objective: 02-07: Prepare financial statements based on accrual accounting*

*Topic: The Income Statement*

47. The amount of retained earnings as of January 1, 2014 was:

- A. \$1,475.
- B. \$1,800.
- C. \$975.
- D. \$1,225.

Assets (\$1,000 + \$850 + \$800) = Liabilities (\$450) + Common Stock (\$975) +  
Pre-closing Retained Earnings

Pre-closing Retained Earnings = \$2,650 - \$1,425 = \$1,225

\$1,225 + \$250 Net Income - \$500 Dividends = \$975 Retained Earnings on  
1/1/14

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*AICPA FN: Reporting*

*Blooms: Analyze*

*Difficulty: 3 Hard*

*Learning Objective: 02-07: Prepare financial statements based on accrual accounting*

*Topic: The Statement of Changes in Equity*

Norris Company experienced the following transactions during 2013, its first year in operation.

1. Issued \$6,000 of common stock to stockholders.
  2. Provided \$2,300 of services on account.
  3. Paid \$1,600 cash for operating expenses.
  4. Collected \$1,900 of cash from accounts receivable.
  5. Paid a \$100 cash dividend to stockholders.
48. The amount of net income recognized on Norris Company's 2013 income statement is:
- A. \$500.
  - B. \$400.
  - C. \$700.
  - D. \$600.

$\$2,300 \text{ revenue} - \$1,600 \text{ expenses} = \$700 \text{ net income}$

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*AICPA FN: Reporting*

*Blooms: Apply*

*Difficulty: 2 Medium*

*Learning Objective: 02-07: Prepare financial statements based on accrual accounting*

*Topic: The Income Statement*

49. The amount of net cash flow from operating activities shown on Norris Company's 2013 statement of cash flows is

- A. \$200.
- B. \$300.
- C. \$700.
- D. \$600.

\$1,900 cash collected from revenue - \$1,600 cash paid for expenses = \$300  
cash flow from operating activities

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*AICPA FN: Reporting*

*Blooms: Apply*

*Difficulty: 2 Medium*

*Learning Objective: 02-07: Prepare financial statements based on accrual accounting*

*Topic: The Statement of Cash Flows*

50. The total amount of assets shown on Norris Company's December 31, 2013 balance sheet is:

- A. \$6,200.
- B. \$6,600.
- C. \$6,700.
- D. None of these.

Cash (\$6,000 + \$1,900 - \$1,600 - \$100) + Accounts Receivable (\$2,300 - \$1,900)  
= \$6,600 Total Assets

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*AICPA FN: Reporting*

*Blooms: Apply*

*Difficulty: 2 Medium*

*Learning Objective: 02-07: Prepare financial statements based on accrual accounting*

*Topic: The Balance Sheet*

51. The amount of retained earnings appearing on Norris Company's December 31, 2013 balance sheet is:

- A. \$500.
- B. \$600.
- C. \$700.
- D. \$6,600.

$\$6,600 \text{ Assets} - \$6,000 \text{ Common Stock} = \$600 \text{ Retained Earnings}$

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*AICPA FN: Reporting*

*Blooms: Apply*

*Difficulty: 2 Medium*

*Learning Objective: 02-07: Prepare financial statements based on accrual accounting*

*Topic: The Balance Sheet*

52. On December 31, 2013, Farrell Co. owed \$1,500 in salaries to employees who had worked during December but would be paid in January. If the year-end adjustment is properly recorded on December 31, 2013, what will be the effect of the accrual on the following items for Farrell?

	Net Income	Cash Flow from Operating Activities
a.	No effect	No effect
b.	Decrease	No effect
c.	Increase	Decrease
d.	No effect	Decrease

- A. Option A  
B. Option B  
C. Option C  
D. Option D

Recording the adjusting entry will increase salaries expense, which will reduce net income and it will increase salaries payable, a liability. It will not affect cash flows.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-02: Show how payables affect financial statements*

*Learning Objective: 02-06: Explain the accounting cycle including adjustments and the closing process*

*Topic: Accounting for salary expense*

*Topic: The Closing Process*

53. Tocca Co. collected a \$5,000 cash advance from a customer on November 1, 2013 for work to be performed over a six-month period beginning on that date. If the year-end adjustment is properly recorded, what will be the effect on Tocca's 2013 financial statements?

- A. Increase assets and increase liabilities
- B. Increase assets and increase revenues
- C. Decrease liabilities and increase revenues
- D. No effect

The adjusting entry to recognize revenue earned on the contract will increase revenues and decrease liabilities (unearned revenue).

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*AICPA FN: Reporting*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-05: Show how unearned revenues affect financial statements*

*Learning Objective: 02-06: Explain the accounting cycle including adjustments and the closing process*

*Topic: Accounting for unearned revenues*

*Topic: The Closing Process*



54. Gonzales Company collected \$18,000 on September 1, 2013 from a customer for services to be provided over a one-year period beginning on that date. How much revenue would Gonzales Company report related to this contract on its income statement for the year ended December 31, 2013? How much would it report as cash flows from operating activities for 2013?

- A. \$6,000; \$6,000
- B. \$6,000; \$18,000**
- C. \$18,000; \$18,000
- D. \$0; \$18,000

Gonzales will recognize revenue earned for the 4 months between September 1 and December 31 ( $\$18,000 \times 4/12 = \$6,000$ ). However, the company will recognize the entire \$18,000 received as a cash inflow for operating activities in 2013.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*AICPA FN: Reporting*

*Blooms: Analyze*

*Difficulty: 2 Medium*

*Learning Objective: 02-05: Show how unearned revenues affect financial statements*

*Learning Objective: 02-06: Explain the accounting cycle including adjustments and the closing process*

*Topic: Accounting for unearned revenues*

*Topic: The Closing Process*

55. The matching concept refers to the "matching" of:

- A. expenses and liabilities
- B. expenses and revenues
- C. assets and equity
- D. assets and liabilities

The matching concept refers to the matching of expenses to the revenues that those expenses produce.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 1 Easy*

*Learning Objective: 02-06: Explain the accounting cycle including adjustments and the closing process*

*Topic: The Matching Concept*

56. The results of the matching process are best reported on which financial statement?

- A. Balance sheet
- B. Income statement
- C. Statement of changes in stockholders' equity
- D. Statement of cash flows

The matching process matches expenses to the revenues that they produce. Revenues and expenses are reported on the income statement.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-06: Explain the accounting cycle including adjustments and the closing process*

*Topic: The Matching Concept*

57. Expenses that are matched with the period in which they are incurred are frequently called:

- A. market expenses
- B. matching expenses
- C. period costs
- D. working costs

When the connection between an expense and the corresponding revenue is vague, accountants commonly match the expense with the period in which it is incurred. Those expenses are called period costs.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-06: Explain the accounting cycle including adjustments and the closing process*

*Topic: The Matching Concept*

58. If retained earnings decreased during the year, and no dividends were paid, which of the following must be true?

- A. Expenses for the year exceeded revenues
- B. The company did not have enough cash to pay its expenses
- C. Total equity decreased
- D. Liabilities increased during the year

If retained earnings decreased and no dividends were paid, the company must have reported a net loss. A net loss would have been the result if expenses for the year exceeded revenues.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Analyze*

*Difficulty: 2 Medium*

*Learning Objective: 02-06: Explain the accounting cycle including adjustments and the closing process*

*Topic: The Closing Process*

59. Which of the following correctly states the proper order of the accounting cycle?

- A. Record transactions, adjust accounts, prepare statements, close temporary accounts.
- B. Adjust accounts, record transactions, close temporary accounts, prepare statements.
- C. Prepare statements, record transactions, close temporary accounts, adjust accounts.
- D. Adjust accounts, prepare statements, record transactions, close temporary accounts.

In the accounting cycle, a company records transactions throughout the accounting period, then adjusted accounts at the end of the period. Next, the company prepares financial statements, and finally, it closes temporary accounts in order to begin the next accounting period.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-06: Explain the accounting cycle including adjustments and the closing process*

*Topic: The accounting cycle*

60. The purpose of the accrual basis of accounting is to:

- A. Report revenue when received.
- B. Match revenues and expenses in the proper period.
- C. Report expenses when cash disbursements are made.
- D. Improve the company's earnings per share.

The accrual basis of accounting allows a company to recognize expenses in the same accounting period as the revenues those expenses produce.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-06: Explain the accounting cycle including adjustments and the closing process*

*Topic: The Closing Process*

61. Which of the following financial statement elements is closed at the end of an accounting cycle?

- A. Liabilities
- B. Common stock
- C. Assets
- D. Revenues

Revenues, expenses and dividends are closed to retained earnings at the end of an accounting cycle.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 1 Easy*

*Learning Objective: 02-06: Explain the accounting cycle including adjustments and the closing process*

*Topic: The Closing Process*



62. Which of the following accounts is **not** closed at the end of an accounting cycle?

A. Liabilities

B. Revenues

C. Dividends

D. Expenses

Revenues, expenses and dividends are closed to retained earnings at the end of an accounting cycle. Liabilities is a permanent account that is reported on the balance sheet.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-06: Explain the accounting cycle including adjustments and the closing process*

*Topic: The Closing Process*

63. The balance in a revenue account at the beginning of an accounting period will always be

- A. equal to the amount of retained earnings for the previous period.
- B. last period's ending balance.
- C. higher than the previous periods beginning balance.
- D. zero.

The closing process at the end of an accounting period closes all temporary accounts, including revenue, to zero to start off the next accounting period.

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-06: Explain the accounting cycle including adjustments and the closing process*

*Topic: The Closing Process*

64. The accounting principle that guides accountants, when faced with a recognition dilemma, to choose the alternative that produces the lowest net income is referred to as

- A. the matching principle.
- B. internal control.
- C. conservatism.
- D. materiality.

Conservatism guides companies to choose accounting methods that avoid overstating revenues and understating expenses.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-06: Explain the accounting cycle including adjustments and the closing process*

*Topic: Accrual Accounting*

65. Which of the following is **not** a component of the fraud triangle?

- A. Opportunity
- B. Rationalization
- C. Trust
- D. Pressure

The fraud triangle includes opportunity, rationalization, and pressure.

*AACSB: Ethics*

*AICPA BB: Critical Thinking*

*AICPA BB: Legal*

*AICPA FN: Risk Analysis*

*Blooms: Remember*

*Difficulty: 2 Medium*

*Learning Objective: 02-09: Discuss the primary components of corporate governance*

*Topic: The Fraud Triangle*

66. Which of the following is **not** an article of the AICPA Code of Professional Conduct?

- A. Conservatism
- B. Objectivity and Independence
- C. Integrity
- D. Due Care

Conservatism is not an article of the AICPA Code of Professional Conduct. It is an accounting principle.

*AACSB: Ethics*

*AICPA BB: Critical Thinking*

*AICPA FN: Decision Making*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-09: Discuss the primary components of corporate governance*

*Topic: Importance of Ethics*

67. Which of the following is **not** a common feature of ethical misconduct?

- A. The capacity to rationalize.
- B. The existence of pressure leading to an incentive.
- C. The assistance of others.
- D. The presence of an opportunity.

The capacity to rationalize, the existence of pressure, and the presence of an opportunity are the three common features of ethical misconduct that make up what is known as the Fraud Triangle.

*AACSB: Ethics*

*AICPA BB: Critical Thinking*

*AICPA FN: Decision Making*

*AICPA FN: Risk Analysis*

*Blooms: Understand*

*Difficulty: 1 Easy*

*Learning Objective: 02-09: Discuss the primary components of corporate governance*

*Topic: The Fraud Triangle*

68. Policies and procedures designed to reduce the opportunities for fraud are often called:

- A. accounting principles
- B. asset source transactions
- C. internal controls
- D. financial systems

Internal controls are policies and procedures designed to reduce the opportunities for fraud.

*AACSB: Ethics*

*AICPA BB: Critical Thinking*

*AICPA FN: Risk Analysis*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-09: Discuss the primary components of corporate governance*

*Topic: Internal Controls*

69. What action did the U. S. Congress take because of the audit failures at Enron, WorldCom and other companies?

- A. Required publicly-traded companies to be audited by a government agency
- B. Required companies to begin preparing an additional financial statement
- C. Passed the Sarbanes-Oxley Act
- D. Passed an amendment to the Securities and Exchange Act

Congress passed the Sarbanes-Oxley Act in 2002 in response to audit failures at Enron and WorldCom, among others.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA BB: Legal*

*AICPA FN: Risk Analysis*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-09: Discuss the primary components of corporate governance*

*Topic: The Sarbanes-Oxley Act*



70. Which of the following describes the effects of a claims exchange transaction on a company's financial statements?

Assets	=	Liab.	+	Equity	Rev.	-	Exp.	=	Net Inc.	Cash Flow
--------	---	-------	---	--------	------	---	------	---	----------	-----------

- A. 

NA	=	NA	+	NA	NA	-	NA	=	NA	+ OA
----	---	----	---	----	----	---	----	---	----	------
- B. 

+	=	+	+	NA	NA	-	NA	=	NA	+ OA
---	---	---	---	----	----	---	----	---	----	------
- C.

NA	=	+	+	-	NA	-	+	=	-	NA
----	---	---	---	---	----	---	---	---	---	----
- D. 

All of these could represent the effects of a claims exchange transaction.										
--	--	--	--	--	--	--	--	--	--	--

A claims exchange transaction will result in either an increase in liabilities and a decrease in equity or a decrease in liabilities and an increase in equity. It may or may not affect the income statement, but it will never affect the statement of cash flows, as it does not affect any asset, including cash.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Analyze*

*Difficulty: 2 Medium*

*Learning Objective: 02-08: Classify accounting events into asset source; asset use; asset exchange; and claims exchange transactions.*

*Topic: Claims Exchange Transactions*

71. Which of the following is an asset source transaction?

- A. Issued common stock.
- B. Paid a cash dividend to stockholders.
- C. Received a payment on accounts receivable.
- D. Accrued salary expense.

Issuing common stock is an asset source transaction that increases assets (cash) and increases equity (common stock). Paying a cash dividend is an asset use transaction, receiving a payment on accounts receivable is an asset exchange transaction, and accruing salary expense is a claims exchange transaction.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-08: Classify accounting events into asset source; asset use; asset exchange; and claims exchange transactions.*

*Topic: Asset Source Transactions*

72. Which of the following is an asset use transaction?

- A. Purchased machine for cash.
- B. Recorded supplies expense at the end of the period.
- C. Invested cash in an interest earning account.
- D. Accrued salary expense.

Recording supplies expense at the end of the period is an asset use transaction that decreases assets (supplies) and decreases equity (supplies expense decreases retained earnings). Purchasing a machine for cash and investing cash in an interest earning account are asset exchange transactions. Accruing salary expense is a claims exchange transaction.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-08: Classify accounting events into asset source; asset use; asset exchange; and claims exchange transactions.*

*Topic: Asset Use Transactions*

73. Which of the following is a claims exchange transaction?

- A. Purchased machine for cash.
- B. Issued common stock.
- C. Invested cash in an interest earning account.
- D. Recognized revenue earned on a contract where the cash had been collected at an earlier date.

Recognizing revenue earned on a contract where the cash had been collected at an earlier date is a claims exchange transaction that decreases liabilities (unearned revenue) and increases equity (revenue increases retained earnings). Purchasing a machine for cash and investing in an interest earning account are asset exchange transactions. Issuing common stock is an asset source transaction.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-08: Classify accounting events into asset source; asset use; asset exchange; and claims exchange transactions.*

*Topic: Claims Exchange Transactions*

74. Which of the following is an asset exchange transaction?

- A. Issued common stock.
- B. Accrued salary expense at the end of the accounting period.
- C. Recognized revenue earned on a contract where the cash had been collected at an earlier date.
- D. Collected cash on accounts receivable

Collecting cash on accounts receivable is an asset exchange transaction that increases one asset (cash) and decreases another asset (accounts receivable). Issuing common stock is an asset source transaction. Accruing salary expense and recognizing revenue earned on a contract where the cash had been collected at an earlier date are both claims exchange transactions.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-08: Classify accounting events into asset source; asset use; asset exchange; and claims exchange transactions.*

*Topic: Asset Exchange Transactions*

75. Earning revenue on account would be classified as a/an?

- A. claims exchange transaction.
- B. asset source transaction.
- C. asset use transaction.
- D. asset exchange transaction.

This transaction increases assets (accounts receivable) and increases equity (revenue increases retained earnings), and is therefore classified as an asset source transaction.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-08: Classify accounting events into asset source; asset use; asset exchange; and claims exchange transactions.*

*Topic: Asset Source Transactions*

## Essay Questions

76. Kenyon Company uses accrual accounting. Indicate whether each of the following statements regarding Kenyon's accounting system is true or false.

\_\_\_\_\_ a) The recognition of accounting events and the realization of cash consequences may occur in different accounting periods.

\_\_\_\_\_ b) The cash consequence of a transaction always precedes its accounting recognition.

\_\_\_\_\_ c) Expenses may either be matched to revenues they produce or to periods in which they are incurred.

\_\_\_\_\_ d) Kenyon may record accrual transactions, but may not record deferral transactions.

\_\_\_\_\_ e) Kenyon is not permitted to make cash sales.

a) T b) F c) T d) F e) F

Feedback: a) This is true. Recognizing accounting events (reporting them on the financial statements) and realizing cash consequences may occur in different accounting periods.

b) This is false. Sometimes the cash consequence of a transaction occurs after its accounting recognition. An example is prepaid rent.

c) This is true. The matching concept allows companies that use accrual accounting to match expenses with either revenues or accounting periods.

d) This is false. A company that uses accrual accounting records both accrual and deferral transactions.

e) This is false. Accrual basis companies may make cash sales and may pay cash

expenses.

*AACSB: Analytic*

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-06: Explain the accounting cycle including adjustments and the closing process*

*Topic: Accrual Accounting*



77. Whetstone Co. performed services for a customer on account. Indicate whether each of the following statements about this transaction is true or false.

- \_\_\_\_\_ a) Assets and equity both increase when the revenue is recognized.
- \_\_\_\_\_ b) This transaction did not affect cash flows.
- \_\_\_\_\_ c) The company recorded an increase in revenue and a decrease in accounts receivable.
- \_\_\_\_\_ d) Recognition of revenue would be delayed until cash was received.
- \_\_\_\_\_ e) This transaction is an example of an asset source transaction.

a) T b) T c) F d) F e) T

Feedback: a) This is true. Assets (accounts receivable) and equity (revenue increases retained earnings) both increase.

b) This is true. Because cash is not affected, cash flows are not affected.

c) This is false. The event resulted in an increase in revenue and an increase in accounts receivable.

d) This is false. Kenyon would recognize revenue when the services are performed, not when cash is received.

e) This is true. Because assets (accounts receivable) increase, it is an asset source transaction.

*AACSB: Analytic*

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-01: Show how receivables affect financial statements*

*Learning Objective: 02-08: Classify accounting events into asset source; asset use; asset exchange; and claims exchange transactions.*

*Topic: Accounting for accounts receivable*

*Topic: Asset Source Transactions*

78. Dandridge Company collected cash in 2012 from a customer for services to be performed beginning January 2013. Indicate whether each of the following statements about this transaction is true or false.

\_\_\_\_\_ a) Dandridge's 2012 income statement would not be affected by this transaction.

\_\_\_\_\_ b) Dandridge's 2012 statement of cash flows would be affected by this transaction.

\_\_\_\_\_ c) This transaction is an asset exchange transaction.

\_\_\_\_\_ d) The revenue for the services provided will be recorded in 2013.

\_\_\_\_\_ e) This transaction is considered an accrual transaction.

a) T b) T c) F d) T e) F

Feedback: a) This is true. Because work will not begin until 2013, no revenue is recognized in 2012.

b) This is true. Only the 2012 statement of cash flows is affected because no cash is received in 2013.

c) This is false. Collecting a cash advance is an asset source transaction that increases assets (cash) and increases liabilities (unearned revenue).

d) This is true. Revenue will be recognized only when services are performed, beginning in 2013.

e) This is false. This transaction is considered a deferral transaction because cash is exchanged before revenue or expense is recognized.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*AICPA FN: Reporting*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-05: Show how unearned revenues affect financial statements*

*Learning Objective: 02-08: Classify accounting events into asset source; asset use; asset exchange; and claims exchange transactions.*

*Topic: Accounting for unearned revenues*

*Topic: Asset Source Transactions*

79. Regarding the relationships of revenues and expenses to assets and liabilities, state whether each of the following statements is true or false.

\_\_\_\_\_ a) Recording an increase in a revenue account may be associated with an increase in assets.

\_\_\_\_\_ b) Recording an increase in a revenue account may be associated with a decrease in liabilities.

\_\_\_\_\_ c) An increase in Salaries Expense may be accompanied by a decrease in Salaries Payable.

\_\_\_\_\_ d) Recording a decrease in assets may be associated with an increase in an expense account.

\_\_\_\_\_ e) An increase in Supplies may be accompanied by an increase in Supplies Expense.

a) T b) T c) F d) T e) F

Feedback: a) This is true. An increase in a revenue account is usually associated with an increase in assets, such as cash or accounts receivable.

b) This is true. Recording an increase in revenue may be associated with a decrease in liabilities, as in the case of earning revenue from a prepaid contract (unearned revenue).

c) This is false. An increase in salaries expense could be accompanied by an increase in salaries payable, as in the case of accruing salaries expense, but not a decrease.

d) This is true. Recording a decrease in assets (such as prepaid rent or insurance, or supplies) may be associated with an increase in expenses.

e: This is false. Supplies expense is increased when supplies are used, or decreased.

*AACSB: Analytic*

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-01: Show how receivables affect financial statements*

*Learning Objective: 02-02: Show how payables affect financial statements*

*Learning Objective: 02-05: Show how unearned revenues affect financial statements*

*Topic: Accounting for payables*

*Topic: Accounting for receivables*

*Topic: Accounting for unearned revenues*

80. Wyatt Company paid \$57,000 in January 2013 for salaries that had been earned by employees in December 2012. Indicate whether each of the following statements about financial statement effects of the January 2013 event is true or false.

\_\_\_\_\_ a) The income statement for 2013 is not affected because the salaries expense had been recognized at the end of December.

\_\_\_\_\_ b) On the 2013 statement of cash flows, cash flows from operating activities decreased.

\_\_\_\_\_ c) Payment of the salaries in 2013 decreased a liability.

\_\_\_\_\_ d) The 2013 statement of changes in stockholders' equity would not be affected because the salaries expense had been recognized at the end of December.

\_\_\_\_\_ e) Both assets and equity decreased as a result of this transaction.

a) T b) T c) T d) T e) F

Feedback: a) This is true. The expense is recognized in the period in which the salaries were earned, 2012.

b) This is true. The January, 2013 payment decreases cash flows from operating activities in 2013.

c) This is true. When the payment is made, salaries payable, a liability, is decreased.

d) This is true. Because the expense was recognized in 2012, the 2013 statement of changes in equity is unaffected.

e) This is false. The January, 2013 payment decreases assets (cash) and liabilities

(salaries payable), but not equity.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*AICPA FN: Reporting*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-02: Show how payables affect financial statements*

*Topic: Accounting for salary expense*



81. Indicate whether each of the following statements about the closing process and the accounting cycle is true or false.

\_\_\_\_\_ a) The closing process transfers certain account balances to retained earnings at the end of the accounting cycle.

\_\_\_\_\_ b) Only accounts that appear on the income statement are closed at the end of each accounting cycle.

\_\_\_\_\_ c) Another name for permanent accounts is "nominal accounts."

\_\_\_\_\_ d) The permanent accounts contain information that is cumulative in nature.

\_\_\_\_\_ e) The retained earnings balance at the end of any given year is equal to that year's net income.

a) T b) F c) F d) T e) F

Feedback: a) This is true. The closing process transfers the balances in revenue, expense, and dividend accounts to retained earnings at the end of the period.

b) This is false. Dividends are closed, but do not appear on the income statement.

c) This is false. Temporary accounts are also called nominal accounts.

d) This is true. All balance sheet, or permanent, accounts contain cumulative information.

e) This is false. Because the retained earnings account accumulates earnings from year to year, its balance is not equal to net income in any particular year.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-06: Explain the accounting cycle including adjustments and the closing process*

*Topic: The Closing Process*

82. Regarding the effects of end-of-period adjustments, state whether each of the following statements is true or false.

\_\_\_\_\_ a) Recording the usage of supplies involves a decrease in assets and a decrease in equity.

\_\_\_\_\_ b) The accrual of salaries is considered a claims exchange transaction.

\_\_\_\_\_ c) Recording services performed on a prepaid contract involves a decrease in liabilities and an increase in assets.

\_\_\_\_\_ d) End of period adjustments never affect cash flows.

\_\_\_\_\_ e) Failure to record accrued salaries at the end of the year will cause reported income to be higher than it should have been.

a) T b) T c) F d) T e) T

Feedback: a) This is true. Recording usage of supplies decreases assets (supplies) and increases expense, which decreases equity.

b) This is true. Accruing salaries increases a liability (salaries payable) and decreases equity (salaries expense decreases retained earnings).

c) This is false. Recording service performed on a prepaid contract involves a decrease in liabilities (unearned revenue) and an increase in revenue, which increases equity. Assets are not affected.

d) This is true. End of period adjustments never affect the cash account, therefore never affect cash flows.

e) This is true. Failure to record accrued salaries would understate salaries expense, causing reported income to be higher than it should have been.

*AACSB: Analytic*

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Analyze*

*Difficulty: 2 Medium*

*Learning Objective: 02-06: Explain the accounting cycle including adjustments and the closing process*

*Learning Objective: 02-08: Classify accounting events into asset source; asset use; asset exchange; and claims exchange transactions.*

*Topic: Adjusting Entries*

83. Indicate whether each of the following statements regarding the four types of accounting events is true or false.

\_\_\_\_\_ a) Asset use transactions involve an increase in one asset and a decrease in another asset.

\_\_\_\_\_ b) An asset source transaction involves an increase in assets and an increase in a corresponding claims account.

\_\_\_\_\_ c) An asset exchange transaction involves an increase in an asset and a decrease in a claims account.

\_\_\_\_\_ d) Asset exchange transactions involve an increase in one asset and a decrease in another asset.

\_\_\_\_\_ e) Some claims exchange transactions involve an increase in a liability account and a decrease in an equity account.

a) F b) T c) F d) T e) T

Feedback: a) This is false. An asset use transaction does not involve an increase in an asset.

b) This is true. An asset source transaction involves an increase in assets and an increase in liabilities or equity.

c) This is false. An asset exchange transaction involves an increase in one asset and a decrease in another.

d) This is true. An asset exchange transaction involves an increase in one asset and a decrease in another.

e) This is true. Some claims exchange transactions, including accruing salaries,

involve an increase in a liability and a decrease in equity.

*AACSB: Analytic*

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 1 Easy*

*Learning Objective: 02-08: Classify accounting events into asset source; asset use; asset exchange; and claims exchange transactions.*

*Topic: Claims Exchange Transactions*

84. Indicate whether each of the following statements about corporate governance is true or false.

\_\_\_\_\_ a) The Financial Accounting Standards Board issues a code of ethical behavior by which public accountants must abide.

\_\_\_\_\_ b) The Sarbanes Oxley Act created the Public Company Accounting Oversight Board (PCAOB).

\_\_\_\_\_ c) Because of the Sarbanes Oxley Act, many audit firms now provide nonaudit services to audit clients.

\_\_\_\_\_ d) The fraud triangle identifies opportunity, pressure, and rationalization as the three elements that are typically present when fraud is committed.

\_\_\_\_\_ e) An executive found guilty of falsely certifying a company's financial statements faces up to a \$5 million fine and 20 years in prison.

a) F b) T c) F d) T e) T

Feedback: a) This is false. The AICPA, not FASB, issues a code of professional behavior for CPAs.

b) This is true. The PCAOB is a result of the Sarbanes-Oxley Act.

c) This is false. The Sarbanes-Oxley Act restricts nonaudit services that audit firms can provide to audit clients.

d) This is true. Opportunity, pressure, and rationalization make up the fraud triangle.

e) This is true. A \$5 million fine and 20 year prison sentence are possible penalties for executives who falsely certify a company's financial statements.

*AACSB: Reflective Thinking*

*AICPA BB: Legal*

*AICPA FN: Risk Analysis*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-09: Discuss the primary components of corporate governance*

*Topic: The Fraud Triangle*

## True / False Questions

85. The term "recognition" means to report an economic event in the financial statements.

**TRUE**

Recognition means recording revenue or expense, which results in reporting the event in the financial statements.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Remember*

*Difficulty: 1 Easy*

*Learning Objective: 02-01: Show how receivables affect financial statements*

*Topic: Revenue recognition*



86. Companies that use accrual accounting recognize revenues and expenses at the time that cash is paid or received.

**FALSE**

Accrual basis companies recognize revenue when earned and expense when incurred, regardless of when cash is received or paid.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 1 Easy*

*Learning Objective: 02-01: Show how receivables affect financial statements*

*Learning Objective: 02-02: Show how payables affect financial statements*

*Topic: Expense Recognition*

*Topic: Revenue recognition*

87. The term "accrual" describes an earnings event that is recognized after cash is paid or received.

**FALSE**

This describes a deferral event, not an accrual event.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 1 Easy*

*Learning Objective: 02-01: Show how receivables affect financial statements*

*Topic: Accrual Accounting*

88. A company may recognize a revenue or expense without a corresponding cash collection or payment in the same accounting period.

TRUE

Accrual basis companies recognize revenue when earned and expense when incurred, regardless of when cash is received or paid.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 1 Easy*

*Learning Objective: 02-01: Show how receivables affect financial statements*

*Topic: Accrual Accounting*

89. A payment to an employee in settlement of salaries payable decreases an asset and decreases a liability.

TRUE

The event decreases assets (cash) and decreases liabilities (salaries payable).

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 1 Easy*

*Learning Objective: 02-02: Show how payables affect financial statements*

*Topic: Accounting for salary expense*

90. An increase in an expense may be accompanied by an increase in a liability.

**TRUE**

An increase in an expense, such as salaries expense, may be accompanied by an increase in a liability, such as salaries payable.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 1 Easy*

*Learning Objective: 02-02: Show how payables affect financial statements*

*Topic: Accounting for payables*

91. Revenues and liabilities are temporary accounts.

**FALSE**

Revenues and expenses, not liabilities, are temporary accounts.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 1 Easy*

*Learning Objective: 02-06: Explain the accounting cycle including adjustments and the closing process*

*Topic: The Closing Process*

92. In the closing process, the amounts in temporary accounts are moved to retained earnings, a permanent account.

TRUE

All temporary account balances are moved to retained earnings in the closing process.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 1 Easy*

*Learning Objective: 02-06: Explain the accounting cycle including adjustments and the closing process*

*Topic: The Closing Process*

93. Accounts that are closed include expenses, dividends, and unearned revenues.

FALSE

Revenues, not unearned revenues, are closed.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-06: Explain the accounting cycle including adjustments and the closing process*

*Topic: The Closing Process*

94. After closing, only balance sheet accounts have non-zero balances.

TRUE

All temporary accounts have zero balances after closing.

*AACSB: Analytic*

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-06: Explain the accounting cycle including adjustments and the closing process*

*Topic: The Closing Process*

95. Two of the steps in the accounting cycle are adjusting the accounts and closing the accounts.

TRUE

The accounting cycle includes recording transactions, adjusting the accounts, preparing statements, and closing the accounts.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 1 Easy*

*Learning Objective: 02-06: Explain the accounting cycle including adjustments and the closing process*

*Topic: The accounting cycle*

96. Cash-basis accounting often fails to match expenses with revenues.

**TRUE**

Accrual-basis, not cash-basis, accounting matches expenses with revenues.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 1 Easy*

*Learning Objective: 02-06: Explain the accounting cycle including adjustments and the closing process*

*Topic: The Matching Concept*

97. The matching concept leads accountants to select the recognition alternative that produces the lowest amount of net income.

**FALSE**

This is a definition of conservatism, not the matching concept.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-06: Explain the accounting cycle including adjustments and the closing process*

*Topic: The Matching Concept*

98. Adjusting entries never affect a business's cash account.

**TRUE**

Adjusting entries involve either revenue or expense and a non-cash balance sheet account.

*AACSB: Analytic*

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-06: Explain the accounting cycle including adjustments and the closing process*

*Topic: Adjusting Entries*

99. Asset use transactions always involve the payment of cash.

**FALSE**

Asset use transactions can involve a decrease in another asset account, such as supplies or prepaid rent.

*AACSB: Analytic*

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-08: Classify accounting events into asset source; asset use; asset exchange; and claims exchange transactions.*

*Topic: Asset Use Transactions*

100. The governance of a corporation includes the roles and responsibilities of the board of directors, managers, shareholders, and auditor.

**TRUE**

All of these stakeholders determine how a company is operated.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Risk Analysis*

*Blooms: Understand*

*Difficulty: 1 Easy*

*Learning Objective: 02-09: Discuss the primary components of corporate governance*

*Topic: Corporate Governance*

101. The ethical standards for certified public accountants simply require that such accountants comply with applicable laws and regulations.

**FALSE**

According to the AICPA, "A certified public accountant assumes an obligation of self-discipline above and beyond requirements of laws and regulations."

*AACSB: Ethics*

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Decision Making*

*Blooms: Understand*

*Difficulty: 1 Easy*

*Learning Objective: 02-09: Discuss the primary components of corporate governance*

*Topic: Standards of Ethical Conduct*



102. Certified public accountants are obligated to act in a way that serves the public interest.

TRUE

This is Article II of the AICPA Code of Professional Conduct.

*AACSB: Ethics*

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Decision Making*

*Blooms: Understand*

*Difficulty: 1 Easy*

*Learning Objective: 02-09: Discuss the primary components of corporate governance*

*Topic: Standards of Ethical Conduct*

103. The bankruptcies of Enron and WorldCom both indicated the occurrence of major audit failures.

TRUE

These audit failures led to the Sarbanes-Oxley Act of 2002.

*AACSB: Ethics*

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA BB: Legal*

*AICPA FN: Risk Analysis*

*Blooms: Understand*

*Difficulty: 1 Easy*

*Learning Objective: 02-09: Discuss the primary components of corporate governance*

*Topic: The Sarbanes-Oxley Act*

104. The Sarbanes-Oxley Act includes several significant reforms that affect the auditing profession, but it did not reduce an audit firm's ability to provide non-audit services to its audit clients.

**FALSE**

The Sarbanes-Oxley Act restricts an audit firm's ability to provide non-audit service to its clients.

*AACSB: Analytic*

*AACSB: Ethics*

*AICPA BB: Critical Thinking*

*AICPA BB: Legal*

*AICPA FN: Risk Analysis*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-09: Discuss the primary components of corporate governance*

*Topic: The Sarbanes-Oxley Act*

105. A business's internal controls are designed to reduce the probability of occurrence of fraud.

**TRUE**

Internal controls are policies and procedures that a company uses to reduce the probability of occurrence of fraud.

*AACSB: Ethics*

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Risk Analysis*

*Blooms: Understand*

*Difficulty: 1 Easy*

*Learning Objective: 02-09: Discuss the primary components of corporate governance*

*Topic: Internal Controls*

106. Providing services to customers on account is an asset source transaction.

TRUE

Providing services to customers on account increases the asset accounts receivable.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Apply*

*Difficulty: 1 Easy*

*Learning Objective: 02-08: Classify accounting events into asset source; asset use; asset exchange; and claims exchange transactions.*

*Topic: Asset Source Transactions*

107. An adjusting entry that decreases unearned revenue and increases service revenue is a claims exchange transaction.

TRUE

Unearned revenue, a liability, decreases and service revenue increases the equity account retained earnings, making this a claims exchange transaction.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Apply*

*Difficulty: 2 Medium*

*Learning Objective: 02-08: Classify accounting events into asset source; asset use; asset exchange; and claims exchange transactions.*

*Topic: Claims Exchange Transactions*

108. Sometimes the recognition of revenue is accompanied by an increase in liabilities.

**FALSE**

Recognition of revenue increases equity, which cannot be accompanied by an increase in liabilities. It could, however, be accompanied by a decrease in liabilities as in a claims exchange transaction.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Apply*

*Difficulty: 2 Medium*

*Learning Objective: 02-08: Classify accounting events into asset source; asset use; asset exchange; and claims exchange transactions.*

*Topic: Claims Exchange Transactions*

109. The collection of an account receivable is a claims exchange transaction.

**FALSE**

The collection of an account receivable is an asset exchange transaction.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Apply*

*Difficulty: 2 Medium*

*Learning Objective: 02-08: Classify accounting events into asset source; asset use; asset exchange; and claims exchange transactions.*

*Topic: Assets Exchange Transactions*

## Essay Questions

1 Houston Company began business operations and experienced the following  
1 transactions during 2013:

0

- 1) Issued common stock for \$20,000 cash.
- 2) Provided services to customers for \$50,000 on account.
- 3) Purchased \$1,000 of supplies on account.
- 4) Paid \$12,000 cash to rent office space for a 12-month period beginning July 1.
- 5) Collected \$46,000 cash from customers.
- 6) Paid cash for \$36,000 of operating expenses.
- 7) Adjusted the accounting records to reflect that there was \$300 of supplies remaining on hand at year-end.
- 8) Recorded an end-of-year adjustment to recognize rent expense.

Required:

- a) Record the above transactions on a horizontal statements model, reflecting their effect on the different financial statements.
- b) Prepare Houston Company's income statement, balance sheet and statement of cash flows for the year ended December 31, 2013.

a)

	Assets				=	Liab	+
	Cash	AR	Supp.	Ppd. Rent		AP	
1	20,000						
2		50,000					
3			1,000			1,000	
4	(12,000)			12,000			
5	46,000	(46,000)					
6	(36,000)						
7			(700)				
8				(6,000)			
Totals	\$ 18,000	\$ 4,000	\$ 300	\$ 6,000		\$ 1,000	

b)

Houston Company	
Income Statement	
For the Year Ended December 31, 2013	
Revenue	\$50,000
Operating expense	(36,000)
Rent expense	(6,000)
Supplies expense	(700)
Net Income	<u>\$7,300</u>

Houston Company		
Balance Sheet		
As of December 31, 2013		
Assets		
Cash	\$ 18,000	
Accounts receivable	4,000	
Supplies	300	
Prepaid rent	<u>6,000</u>	<u>\$ 28,300</u>
Liabilities		
Accounts payable		\$ 1,000
Stockholders' equity		
Common stock	20,000	
Retained earnings	<u>7,300</u>	<u>27,300</u>
Total liabilities and stockholders' equity		<u>\$ 28,300</u>

Houston Company		
Statement of Cash Flows		
For the Year Ended December 31, 2013		
Cash flows from operating activities		
Cash receipts from revenue	\$ 46,000	
Cash payments for rent	(12,000)	
Cash payments for operating expenses	<u>(36,000)</u>	
Net cash flow from operating activities		\$ (2,000)
Cash flows for investing activities		\$ -
Cash flows from financing activities		<u>\$ 20,000</u>
Net increase in cash		18,000
Plus: Beginning cash balance		<u>-</u>
Ending cash balance		<u>\$ 18,000</u>



*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Blooms: Apply*

*Difficulty: 3 Hard*

*Learning Objective: 02-07: Prepare financial statements based on accrual accounting*

*Topic: The Income Statement, The Balance Sheet, The Statement of Cash Flows*

111. The following transactions apply to Brunswick Corporation.

- a) Issued common stock for \$35,000 cash.
- b) Provided services to customers for \$18,000 on account.
- c) Purchased land for \$18,000 cash.
- d) Purchased \$500 of supplies on account.
- e) Paid \$9,000 for operating expenses.
- f) Paid \$450 on accounts payable.
- g) Collected \$15,000 cash from customers.
- h) Accrued \$400 of salary expense at year end.
- i) Paid \$2,500 dividends to stockholders.

Required:

- a) Identify the effect on the statement of cash flows for each of the above transactions.
- b) Classify the above accounting events into one of four types of transactions (asset source, asset use, asset exchange, claims exchange).

	a)		b)
Event	Cash Flow		Transaction Type
a)	\$ 35,000	FA	Asset Source
b)	NA		Asset Source
c)	\$(18,000)	IA	Asset Exchange
d)	NA		Asset Source
e)	\$ (9,000)	OA	Asset Use
f)	\$ (450)	OA	Asset Use
g)	\$ 15,000	OA	Asset Source
h)	NA		Claims Exchange
i)	\$ (2,500)	FA	Asset Use

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Blooms: Apply*

*Difficulty: 2 Medium*

*Learning Objective: 02-01: Show how receivables affect financial statements*

*Learning Objective: 02-02: Show how payables affect financial statements*

*Learning Objective: 02-03: Show how supplies affect financial statements*

*Learning Objective: 02-08: Classify accounting events into asset source; asset use; asset exchange; and claims exchange transactions.*

*Topic: Accounting for accounts receivable*

*Topic: Accounting for salary expense*

*Topic: Accounting for supplies*

*Topic: Asset Source, Asset Use, and Claims Exchange Transactions*

112. Record each of the following events in the horizontal statements model. After each event, record the corresponding **end-of-year adjustment** that would be necessary.

- a) Paid \$18,000 for a 1-year lease beginning April 1.
- b) Paid \$1,500 to purchase supplies. At year end, \$540 of supplies remained.
- c) Received a \$24,000 cash advance for a 6-month contract beginning on Sept. 1.

Event	Assets			=	Liab.	+	Equity		Rev.	-	Exp.	=	NI		CF
	Cash	Supplies	Ppd. Rent		Unearned Rev.		Ret. Earn.								
a)	(18,000)		18,000											(18,000)	O A
			(13,500)				(13,500)				13,500		(13,500)		
b)	(1,500)	1,500												(1,500)	O A
		(960)					(960)				960		(960)		
c)	24,000				24,000									24,000	O A
					(16,000)		16,000		16,000				16,000		

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Blooms: Apply*

*Difficulty: 3 Hard*

*Learning Objective: 02-03: Show how supplies affect financial statements*

*Learning Objective: 02-04: Show how prepaid items affect financial statements.*

*Learning Objective: 02-05: Show how unearned revenues affect financial statements*

*Topic: Accounting for supplies*

*Topic: Accounting for unearned revenues*

*Topic: Prepaid items*

113. The following data were taken from the accounting records of Lorenzo Company. Except where indicated, the balances are as of December 31, 2013 before closing entries have been made.

Service revenue	\$ 83,000
Retained earnings	47,500
Accounts receivable	13,250
Salaries expense	44,000
Operating expense	7,700
Accounts payable	11,400
Supplies expense	380
Prepaid rent	2,000
Common stock	45,000
Supplies	200
Dividends	1,200
Insurance expense	800
Rent expense	10,000
Unearned revenue	765

Required:

- List the accounts that should be closed at the end of 2013.
- Prepare an income statement for Lorenzo Company for 2013.
- What is the balance in retained earnings after closing entries have been made?

a) The accounts that should be closed are:

- Service revenue
- Salaries expense

- Operating expense
- Supplies expense
- Insurance expense
- Rent expense
- Dividends

b)

Lorenzo Company		
Income Statement		
For the Year Ended December 31, 2013		
Service revenue		\$ 83,000
Salaries expense	44,000	
Operating expense	7,700	
Rent expense	380	
Supplies expense	10,000	62,080
Net Income		\$ 20,920

c)

Beginning Retained earnings	\$47,500
Add: Net income	20,920
Less: Dividends	(1,200)
Ending Retained earnings	\$67,220

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Reporting

Blooms: Apply

Difficulty: 2 Medium

Learning Objective: 02-06: Explain the accounting cycle including adjustments and the closing process

Learning Objective: 02-07: Prepare financial statements based on accrual accounting

Topic: The Closing Process

Topic: The Income Statement, The Statement of Changes in Equity

114. For each of the following transactions, indicate the type by entering AS for asset source transactions, AU for asset use transactions, AE for asset exchange transactions, and CE for claims exchange transactions.

- 1) \_\_\_ Purchased supplies on account.
- 2) \_\_\_ Recorded the accrual of \$1,000 in salaries to be paid later.
- 3) \_\_\_ Issued common stock for \$20,000 in cash.
- 4) \_\_\_ Earned revenue to be collected next year.
- 5) \_\_\_ Paid \$2,000 in dividends to its stockholders.
- 6) \_\_\_ Received cash from customers in #4 above.
- 7) \_\_\_ Paid the salaries accrued in #2 above.
- 8) \_\_\_ Received \$500 from a customer for services to be provided later.

1) AS 2) CE 3) AS 4) AS 5) AU 6) AE 7) AU 8) AS

Feedback:

- 1) Assets (supplies) increased, Liabilities (accounts payable) increased
- 2) Liabilities (salaries payable) increased, Equity (retained earnings from salaries expense) decreased
- 3) Assets (cash) increased, Equity (common stock) increased
- 4) Assets (accounts receivable), Equity (retained earnings from revenue) increased
- 5) Assets (cash) decreased, Equity (retained earnings from dividends) decreased
- 6) Assets (cash) increased, Assets (accounts receivable) decreased
- 7) Assets (cash) decreased, Liabilities (salaries payable) decreased

8) Assets (cash) increased, Liabilities (unearned revenue) increased

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Apply*

*Difficulty: 1 Easy*

*Learning Objective: 02-08: Classify accounting events into asset source; asset use; asset exchange; and claims exchange transactions.*

*Topic: Asset Source, Asset Use, Asset Exchange, Claims Exchange Transactions*



115. Classify each of the following transactions for the purpose of the statement of cash flow as operating activities (OA), investing activities (IA), financing activities (FA), or not reported on the statement of cash flows (NA).

- 1) \_\_\_\_ Made adjusting entry to recognize interest revenue on investments.
- 2) \_\_\_\_ Borrowed funds from the bank.
- 3) \_\_\_\_ Paid rent in advance for the next six months.
- 4) \_\_\_\_ Paid cash to settle accrued salary expense.
- 5) \_\_\_\_ Purchased supplies on account.
- 6) \_\_\_\_ Collected accounts receivable.
- 7) \_\_\_\_ Sold land.

1) NA 2) FA 3) OA 4) OA 5) NA 6) OA 7) IA

Feedback:

- 1) Adjusting entries never affect cash flows
- 2) Borrowing cash is a financing activity
- 3) Paying rent, including paying in advance, is an operating activity
- 4) Paying salaries is an operating activity
- 5) Making purchase on account does not affect cash flows
- 6) Collecting cash from customers is an operating activity
- 7) Purchasing and selling long-lived assets is an investing activity

*Blooms: Apply*

*Difficulty: 2 Medium*

*Learning Objective: 02-07: Prepare financial statements based on accrual accounting*

*Topic: The Statement of Cash Flows*

116. Jack Grimes started a consulting business, Grimes Consulting, on January 1, 2013 by issuing \$7,000 of common stock. In addition, the following events occurred in 2013.

Provided services on account, \$25,500.

Paid cash for \$11,500 in operating expenses.

Collected \$9,000 of the revenue that was previously recorded on account.

Paid a cash dividend of \$4,000 to the stockholders.

Required:

- a) Show the effects of the above transactions on the accounting equation.

	<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Common Stock</u>	+	<u>Retained Earnings</u>
1)							
2)							
3)							
4)							
5)							

- b) Prepare an income statement and statement of cash flows for 2013.

a)

	ASSETS	=	LIABILITIES	+	EQUITY
1)	+\$ 7,000				+\$7,000
2)	+\$25,500				+25,500
3)	-11,500				-11,500
4)	+ 9,000				
	- 9,000				
5)	- 4,000				- 4,000
Total	<u>\$17,000</u>	=	<u>0</u>	+	<u>\$17,000</u>

b)

Grimes Consulting	
Income Statement	
For the Year Ended December 31, 2013	
Service Revenue	\$ 25,500
Operating expense	<u>11,500</u>
Net Income	<u>\$ 14,000</u>

Grimes Consulting		
Statement of Cash Flows		
For the Year Ended December 31, 2013		
Cash flows from operating activities		
Cash receipts from customers	\$ 9,000	
Cash payment for expenses	<u>(11,500)</u>	
Net cash flow from operating activities		\$ (2,500)
Cash flows for investing activities		\$ -
Cash flows from financing activities		
Cash receipt from issuance of stock	\$ 7,000	
Cash payment for dividends	<u>(4,000)</u>	
Net cash flow from financing activities		<u>\$ 3,000</u>
Net increase in cash		500
Plus: Beginning cash balance		<u>-</u>
Ending cash balance		<u>\$ 500</u>

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Reporting

Blooms: Apply

Difficulty: 2 Medium

Learning Objective: 02-01: Show how receivables affect financial statements

Learning Objective: 02-07: Prepare financial statements based on accrual accounting

Topic: Accounting for accounts receivable

Topic: The Income Statement, The Statement of Cash Flows

117. Thiessen Company started its business by issuing \$7,000 of common stock on January 1, 2013. The company performed \$18,000 of service for customers on account in 2013. It collected \$12,500 of this amount in 2013, recorded expenses on account of \$14,500, paid \$11,000 of the payables owed, and paid a \$300 dividend to the stockholders.

Required:

- a) What is the amount of total assets at the end of 2013?
- b) What is the amount of cash on hand at the end of 2013?
- c) What is the net income for 2013?
- d) Prepare a balance sheet for 2013.

a)  $\$7,000 + 18,000 - 11,000 - 300 = \$13,700$  Total assets

b)  $\$7,000 + 12,500 - 11,000 - 300 = \$8,200$  Cash on hand

c)  $\$18,000 - 14,500 = \$3,500$  Net income

d)

Thiessen Company		
Balance Sheet		
As of December 31, 2013		
Assets		
Cash	\$ 8,200	
Accounts receivable	<u>5,500</u>	<u>\$ 13,700</u>
Liabilities		
Accounts payable		\$ 3,500
Stockholders' equity		
Common stock	7,000	
Retained earnings	<u>3,200</u>	<u>10,200</u>
Total liabilities and stockholders' equity		<u>\$ 13,700</u>

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Reporting

Blooms: Apply

Difficulty: 3 Hard

Learning Objective: 02-01: Show how receivables affect financial statements

Learning Objective: 02-02: Show how payables affect financial statements

Learning Objective: 02-07: Prepare financial statements based on accrual accounting

Topic: Accounting for accounts payable

Topic: Accounting for accounts receivable

Topic: The Balance Sheet

118. The Ping Corporation was started on January 1, 2013, with the issuance of \$20,000 of stock. During 2013, the company provided \$30,000 of services on account and collected \$18,000 of that amount. Ping incurred \$23,000 of expenses, and paid \$20,000 of that amount during 2013. On December 31, 2013, Ping paid investors a \$800 cash dividend and accrued \$2,000 of salary expense.

Required:

- 1) What is the net income for year ending December 31, 2013?
- 2) Prepare Ping Corporation's Statement of Cash Flows for the year ended December 31, 2013.
- 3) What is the balance in Ping's retained earnings account after closing entries are made on December 31, 2013?

1) Net income: \$5,000 (\$30,000 - 23,000 - 2,000)

2)

Ping Corporation		
Statement of Cash Flows		
For the Year Ended December 31, 2013		
Cash flows from operating activities		
Cash receipts from customers	\$ 18,000	
Cash payment for expenses	<u>(20,000)</u>	
Net cash flow from operating activities		\$ (2,000)
Cash flows for investing activities		\$ -
Cash flows from financing activities		
Cash receipt from issuance of stock	\$ 20,000	
Cash payment for dividends	<u>(800)</u>	
Net cash flow from financing activities		<u>\$ 19,200</u>
Net increase in cash		17,200
Plus: Beginning cash balance		<u>-</u>
Ending cash balance		<u><u>\$ 17,200</u></u>

3) Retained earnings: \$4,200 (\$5,000 - 800)

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Blooms: Apply*

*Difficulty: 3 Hard*

*Learning Objective: 02-07: Prepare financial statements based on accrual accounting*

*Topic: The Balance Sheet, Income Statement, Statement of Changes in Equity*



119. Consider the following independent scenarios:

a) At January 1, 2013, accounts receivable was \$22,000. Cash collected on accounts receivable during 2011 was \$15,000. At December 31, 2011, accounts receivable was \$30,000.

What were the revenues earned on account during 2011?

b) At January 1, 2013, accounts payable was \$19,000. During 2013, expenses on account were \$28,000. At December 31, 2013, accounts payable was \$15,000.

What was the amount of cash paid on accounts payable during 2013?

c) At January 1, 2013, the balance in the prepaid insurance account was \$480. On March 1, 2013, the company paid \$2,940 for insurance coverage for the next 12 months. What was the amount of insurance expense for 2013?

d) At January 1, 2013, the balance in the supplies account was \$550. At December 31, 2013, the company counted \$600 of supplies on hand. The company reported supplies expense in 2013 of \$2,300. What was the total of supplies purchases during 2013?

a)  $\$22,000 \text{ beg. AR} + X \text{ rev. on acct.} - \$15,000 \text{ cash coll. on AR} = \$30,000 \text{ end.}$

AR

$X = \$23,000$

b)  $\$19,000 \text{ beg. AP} + \$28,000 \text{ exp. on acct.} - X \text{ cash paid on AP} = \$15,000 \text{ end.}$

AP

$X = \$32,000$

c)  $\$480 \text{ insurance expense for Jan. and Feb.} + \$2,450 \text{ for March-December}$   
 $(\$2,940/12 \text{ months} \times 10 \text{ months}) = \$2,930 \text{ insurance expense}$

d)  $\$550 \text{ beg. supplies} + X \text{ supplies purchased} - \$600 \text{ end. supplies} = \$2,300$

supplies exp.

X = \$2,350

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Analyze*

*Difficulty: 3 Hard*

*Learning Objective: 02-01: Show how receivables affect financial statements*

*Learning Objective: 02-02: Show how payables affect financial statements*

*Learning Objective: 02-03: Show how supplies affect financial statements*

*Learning Objective: 02-04: Show how prepaid items affect financial statements.*

*Topic: Accounting for accounts payable*

*Topic: Accounting for accounts receivable*

*Topic: Accounting for supplies*

*Topic: Prepaid items*

120. Washington Co. began operations on January 1, 2013, by issuing \$10,000 in common stock to the stockholders. On March 1, 2013, Washington accepted an advance of \$18,000 to provide services for a one-year period beginning April 1. During 2013, services in the amount of \$16,000 were provided to customers on account, and 80% of this amount was collected by year-end. During 2013, operating expenses incurred on account were \$12,000, and 60% of this amount was paid by year-end. During the year, Washington paid \$600 to purchase supplies. By year-end, \$540 of the supplies had been used. Dividends to stockholders were \$1,000 during the year. During 2013, Washington paid salaries of \$14,000, and on December 31, 2013, the company accrued salaries of \$1,400.

Washington recorded all appropriate adjusting entries at year end.

- 1) What would Washington report for service revenue for 2013?
- 2) What would Washington report for salaries expense for 2013?
- 3) What would Washington report for supplies expense for 2013?
- 4) What would the amount be for net cash flows from operating activities for 2013?
- 5) What is the net income for 2013?
- 6) What would the balance in the retained earnings account be at December 31, 2013?

1)  $\$16,000 \text{ rev. on account} + (\$18,000 \times 9/12) \text{ rev. earned on contract} = \$29,500$   
Rev.

2)  $\$14,000 \text{ salaries expense paid} + \$1,400 \text{ accrued salaries at year end} =$   
 $\$15,400 \text{ Sal. Exp.}$

3) \$540 Supplies Exp.

4)  $\$18,000 + \$12,800(\$16,000 \times .80) - \$7,200(\$12,000 \times .60) - \$600 - \$14,000 =$   
\$9,000 CF from OA

5)  $\$29,500 \text{ revenue} - \$12,000 \text{ oper. exp.} - \$15,400 \text{ sal. exp.} - \$540 \text{ supp. exp.} =$   
\$1,560 NI

6)  $\$1,560 \text{ NI} - \$1,000 \text{ Div.} = \$560 \text{ RE bal.}$

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*AICPA FN: Reporting*

*Blooms: Analyze*

*Difficulty: 3 Hard*

*Learning Objective: 02-01: Show how receivables affect financial statements*

*Learning Objective: 02-02: Show how payables affect financial statements*

*Learning Objective: 02-03: Show how supplies affect financial statements*

*Learning Objective: 02-04: Show how prepaid items affect financial statements.*

*Learning Objective: 02-05: Show how unearned revenues affect financial statements*

*Topic: Accounting for accounts receivable*

*Topic: Accounting for prepaid items*

*Topic: Accounting for salary expense*

*Topic: Accounting for supplies*

*Topic: Accounting for unearned revenues*

121. In a company's annual report, the reader will find a company's income statement, statement of changes in stockholder's equity, balance sheet, and statement of cash flows. These financial statements can help the reader to answer specific questions. Identify which financial statement would be most useful in answering the following questions. If more than one financial statement can answer the question, please identify all applicable statements.

- 1) What was the amount of cash dividends paid to the stockholders during the most recent year?
- 2) What was the total amount of land owned by the company?
- 3) What was the total amount of cash borrowed by the company during the most recent year?
- 4) What were the types of claims that the company has against its assets?
- 5) What was the total amount of cash received by the issuance of common stock?
- 6) Was the company profitable during the most recent year?
- 7) How much cash was collected from accounts receivable during the current year?
- 8) What was the total revenue earned by the company during the most recent year?
- 9) What was the ending balance of retained earnings?
- 10) What was the amount of change in the cash balance during the current year?

- 1) Statement of cash flows and statement of changes in stockholder's equity.
- 2) Balance sheet.

- 3) Statement of cash flows.
- 4) Balance sheet.
- 5) Statement of cash flows and statement of changes in stockholder's equity.
- 6) Income statement and statement of changes in stockholder's equity.
- 7) Statement of cash flows. (Direct method)
- 8) Income statement.
- 9) Balance sheet & statement of changes in stockholder's equity.
- 10) Statement of cash flows.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-07: Prepare financial statements based on accrual accounting*

*Topic: The Income Statement, The Balance Sheet, The Statement of Changes in Equity, The Statement of Cash Flows*

122. The following events apply to Bowen's Cleaning Service for 2013.

- 1). Issued stock for \$14,000 cash.
- 2). On May 1, paid \$9,000 for one year's rent in advance.
- 3). Purchased on account \$2,500 of supplies to be used in the business.
- 4). Performed services of \$18,400 and received cash.
- 5). At December 31, an inventory of supplies showed that \$360 of supplies were still unused.
- 6). At December 31, adjusted the records for the expired rent.

Required:

Draw an accounting equation and record the effects of the above events under the appropriate account headings. Show the year-end total for each account.

	Assets				=	Liab	+	Stockholders' Equity	
	Cash	AR	Supp.	Ppd. Rent		AP		CS	+ RE
1	14,000							14,000	
2	(9,000)			9,000					
3			2,500			2,500			
4	18,400								18,400
5			(2,140)						(2,140)
6				(6,000)					(6,000)
Totals	\$ 23,400	\$ 0	\$ 360	\$ 3,000		\$ 2,500		\$ 14,000	\$10,260

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement

Blooms: Apply

Difficulty: 2 Medium

Learning Objective: 02-03: Show how supplies affect financial statements

Learning Objective: 02-04: Show how prepaid items affect financial statements.

Topic: Accounting for supplies

Topic: Prepaid items

123. Using the form below, record each of the following 2013 transactions for Morris Corporation:

- a) Nov. 1. Received cash from clients for services to be performed over the next six months, \$6,000.
- b) Nov. 1. Paid \$600 for a 12-month insurance policy.
- c) Dec. 31. Recorded expiration of two months of the insurance.
- d) Dec. 31. Earned \$2,000 of the amount received from clients in November.

	Cash	+	Accts Rec.	+	Assets Ppd. Ins.	+	Equip	=	Accts Pay	+	Liabilities Unearned Rev	+	Common Stock	+	Equity Retained Earnings
a.															
b.															
c.															
d.															

	Cash	+	Accts Rec.	+	Assets Ppd. Ins.	+	Equip	=	Accts Pay	+	Liabilities Unearned Rev	+	Common Stock	+	Equity Retained Earnings
a.	+6,000										+6,000				
b.	(600 )				+600										
c.					(100 )										(100)
d.											(2,000 )				+2,000

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement

Blooms: Apply

Difficulty: 2 Medium

Learning Objective: 02-01: Show how receivables affect financial statements

Learning Objective: 02-02: Show how payables affect financial statements



*Learning Objective: 02-04: Show how prepaid items affect financial statements.*

*Learning Objective: 02-05: Show how unearned revenues affect financial statements*

*Topic: Accounting for unearned revenues*

*Topic: Prepaid items*

124. In a company's annual report, the reader will find a company's income statement, statement of changes in stockholders' equity, balance sheet, and statement of cash flows. These financial statements can help the reader to answer specific questions. Identify which financial statement would be most useful in answering the following questions. If more than one financial statement can answer the question, please identify all applicable statements.

- 1) What was the amount of cash dividends paid to the stockholders during the most recent year?
- 2) What was the total amount of land owned by the company?
- 3) What was the total amount of cash borrowed by the company during the most recent year?
- 4) What were the types of claims that the company had against its assets?
- 5) What was the total amount of cash received by the issuance of common stock in the current year?
- 6) Was the company profitable during the most recent year?
- 7) How much cash was collected from accounts receivable during the current year?
- 8) What was the total revenue earned by the company during the most recent year?
- 9) What was the ending balance of retained earnings?
- 10) What was the amount of change in the cash balance during the current year?

- 1) Statement of cash flows and statement of changes in stockholders' equity.
- 2) Balance sheet.

- 3) Statement of cash flows.
- 4) Balance sheet.
- 5) Statement of cash flows and statement of changes in stockholders' equity.
- 6) Income statement and statement of changes in stockholders' equity.
- 7) Statement of cash flows. (Direct method)
- 8) Income statement.
- 9) Balance sheet & statement of changes in stockholders' equity.
- 10) Statement of cash flows.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-07: Prepare financial statements based on accrual accounting*

*Topic: The Balance Sheet, The Income Statement, The Statement of Changes in Equity, The Statement of Cash Flows*

125. The following transactions apply to Kent Company.

- 1) Issued common stock for \$21,000 cash
- 2) Provided services to customers for \$28,000 on account
- 3) Purchased land for \$18,000 cash
- 4) Incurred \$9,000 of operating expenses on account
- 5) Collected \$15,000 cash from customers for services provided in event #2
- 6) Paid \$7,000 on accounts payable
- 7) Paid \$2,500 dividends to stockholders

Required:

- a) Identify the effect on the Statement of Cash Flows, if any, for each of the above transactions. Indicate whether each transaction involves operating, investing, or financing activities and the amount of increase or decrease.
- b) Classify the above accounting events into one of four types of transactions (asset source, asset use, asset exchange, claims exchange).

Event	(a) Effect on Statement of Cash Flows	(b) Transaction Type
1		
2		
3		
4		
5		
6		
7		

a)		b)
Event	Cash Flow	Transaction Type
1	21,000 FA	Asset Source
2	NA	Asset Source
3	(18,000) IA	Asset Exchange
4	NA	Claims Exchange
5	15,000 OA	Asset Exchange
6	(7,000) OA	Asset Use
7	(2,500) FA	Asset Use

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*AICPA FN: Reporting*

*Blooms: Apply*

*Difficulty: 2 Medium*

*Learning Objective: 02-01: Show how receivables affect financial statements*

*Learning Objective: 02-02: Show how payables affect financial statements*

*Learning Objective: 02-08: Classify accounting events into asset source; asset use; asset exchange; and claims exchange transactions.*

*Topic: Accounting for accounts payable*

*Topic: Accounting for accounts receivable*

*Topic: Asset Source, Asset Use, Asset Exchange, Claims Exchange Transactions*

126. Danielle McLynn started a consulting business, McLynn Consulting, on January 1, 2013, and the business engaged in the following transactions during the year:

1. Issued \$8,000 of common stock for cash
2. Provided services on account, \$26,500
3. Incurred \$17,500 of operating expense, but only paid \$12,000 of this amount
4. Collected \$19,000 of the revenue that was previously recorded on account
5. Paid a cash dividend of \$4,500 to the stockholders

Required:

a) Show the effects of the above transactions on the accounting equation.

Event	Assets	=	Liabilities	+	Common Stock	+	Retained Earnings
1							
2							
3							
4							
5							
Totals							

b) Prepare an income statement and statement of cash flows for 2013.

a)

Event	Assets	=	Liabilities	+	Common Stock	+	Retained Earnings
1	8,000				8,000		
2	26,500						26,500
3	(12,000)		5,500				(17,500)
4	19,000						
	(19,000)						
5	(4,500)						(4,500)
Totals	18,000		5,500		8,000		4,500

b)

McLynn Consulting	
Income Statement	
For the Year Ended December 31, 2013	
Service Revenue	\$ 26,500
Operating expense	<u>17,500</u>
Net Income	<u>\$ 9,000</u>

McLynn Consulting		
Statement of Cash Flows		
For the Year Ended December 31, 2013		
Cash flows from operating activities		
Cash receipts from customers	\$ 19,000	
Cash payment for expenses	<u>(12,000)</u>	
Net cash flow from operating activities		\$ 7,000
Cash flows for investing activities		\$ -
Cash flows from financing activities		
Cash receipt from issuance of stock	\$ 8,000	
Cash payment for dividends	<u>(4,500)</u>	
Net cash flow from financing activities		<u>\$ 3,500</u>
Net increase in cash		10,500
Plus: Beginning cash balance		<u>-</u>
Ending cash balance		<u><u>\$10,500</u></u>

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Reporting

Blooms: Apply

Difficulty: 3 Hard

Learning Objective: 02-01: Show how receivables affect financial statements

Learning Objective: 02-02: Show how payables affect financial statements

Learning Objective: 02-07: Prepare financial statements based on accrual accounting

Topic: Accounting for accounts payable

Topic: Accounting for accounts receivable

Topic: The Income Statement, The Statement of Cash Flows



127. Patterson Company was founded in 2013 and engaged in the following transactions:

1. issued common stock for cash
2. purchased supplies on account
3. collected cash from a customer for services to be provided over a period of 1 year
4. paid a cash dividend to stockholders
5. purchased a 2-year fire insurance policy
6. provided services to customers on account
7. collected cash from accounts receivable
8. paid cash for various operating expenses
9. paid rent in advance for 3 months at a time

Required:

- a) Which of the above transactions would require adjusting entries at year end?
- b) Why are adjusting entries required before financial statements can be prepared.

- a) Adjusting entries are required for transactions 2, 3, 5, and 9
- b) Adjusting entries are required at the end of an accounting period to properly match expenses with revenues. Transactions that involve deferrals and accruals require adjusting entries to bring account balances up to date.

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-06: Explain the accounting cycle including adjustments and the closing process*

*Topic: Adjusting Entries*

128. Jerry Mathers started his business by issuing \$4,000 of common stock on January 1, 2013. Jerry performed \$8,500 of service on account in 2013, and he collected \$6,200 of this amount by year end. He paid operating expenses of \$6,900 and paid a \$900 dividend to the stockholders.

Required:

- a) What is the amount of total assets at the end of 2013?
- b) What is the amount of cash on hand at the end of 2013?
- c) What is net income for 2013?
- d) Prepare a balance sheet for 2013.

a)  $\$4,000 + \$8,500 - \$6,900 - \$900 = \$4,700$  Total assets

b)  $\$4,000 + \$6,200 - \$6,900 - \$900 = \$2,400$  Cash balance

c)  $\$8,500 - \$6,900 = \$1,600$  Net Income

d)

Balance Sheet		
As of December 31, 2013		
Assets		
Cash	\$ 2,400	
Accounts receivable	<u>2,300</u>	<u>\$ 4,700</u>
Liabilities		
Stockholders' equity		
Common stock	4,000	
Retained earnings	<u>700</u>	<u>4,700</u>
Total liabilities and stockholders' equity		<u>\$ 4,700</u>

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*AICPA FN: Reporting*

*Blooms: Apply*

*Difficulty: 2 Medium*

*Learning Objective: 02-01: Show how receivables affect financial statements*

*Learning Objective: 02-07: Prepare financial statements based on accrual accounting*

*Topic: Accounting for accounts receivable*

*Topic: The Income Statement, The Balance Sheet*

129. The effects of transactions occurring during 2013 and their related end-of-year adjustments have been recorded below using the accounting equation.

	Assets				=	Liab		+	Stockholders' Equity		
	Cash	AR	Ppd. Ins.	Land		AP	Unearn. Rev.		CS	+	RE
1	40,000								40,000		
2	(10,000)			10,000							
3		24,000									24,000
4	16,000						16,000				
5	16,000	(16,000)									
6	(2,400)		2,400								
7						12,000					(12,000)
8	10,000			(10,000)							
9			(2,000)								(2,000)
10							(10,000)				10,000
Totals	\$ 69,600	\$ 8,000	\$ 400	\$ -		\$ 12,000	\$ 6,000		\$ 40,000		\$ 20,000

Required:

With your knowledge of transaction analysis using an accounting equation,

- Prepare an income statement for 2013, and
- Prepare a statement of cash flows for 2013.

a)

Income Statement	
For the Year Ended December 31, 2013	
Revenue	\$ 34,000
Operating expense	\$ (12,000)
Insurance expense	(2,000)
Net Income	<u>\$ 20,000</u>

b)

Statement of Cash Flows		
For the Year Ended December 31, 2013		
Cash flows from operating activities		
Cash receipts from revenue	\$ 32,000	
Cash payment for insurance	<u>(2,400)</u>	
Net cash flow from operating activities		\$ 29,600
Cash flows for investing activities		
Cash receipt from sale of land	\$ 10,000	
Cash payment for land	<u>(10,000)</u>	
Net cash flow from investing activities		\$ -
Cash flows from financing activities		
Cash receipt from issuance of stock	\$ 40,000	
Net cash flow from financing activities		<u>\$ 40,000</u>
Net increase in cash		69,600
Plus: Beginning cash balance		<u>-</u>
Ending cash balance		<u><u>\$ 69,600</u></u>

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Blooms: Analyze*

*Difficulty: 3 Hard*

*Learning Objective: 02-07: Prepare financial statements based on accrual accounting*

*Topic: The Income Statement, The Statement of Cash Flows*

130. Kramer Corporation began business operations and experienced the following transactions during 2013:

- 1) Issued common stock for \$10,000 cash.
- 2) Provided services to customers for \$40,000 on account.
- 3) Incurred \$18,000 of operating expenses on account.
- 4) Collected \$23,000 cash from customers.
- 5) Paid \$15,000 on accounts payable.

Required:

Record the above transactions on a horizontal statements model to reflect their effect on Kramer's financial statements.

Event	Cash	+	Accounts Rec.	=	Accounts Pay	+	Common Stock	+	Retained Earnings	Cash Flows
1										
2										
3										
4										
5										
Totals										

	Cash	+	Acc Rec	=	Acc Pay	+	C Stk	+	Ret Earn	Cash Flows
1	10,000						10,000			10,000 FA
2			40,000						40,000	
3					18,000				(18,000)	
4	23,000		(23,000)							23,000 OA
5	(15,000)				(15,000)					(15,000) OA
Totals	18,000		17,000		3,000		10,000		22,000	18,000

*AICPA FN: Measurement*

*AICPA FN: Reporting*

*Blooms: Apply*

*Difficulty: 1 Easy*

*Learning Objective: 02-01: Show how receivables affect financial statements*

*Learning Objective: 02-02: Show how payables affect financial statements*

*Topic: Accounting for accounts payable*

*Topic: Accounting for accounts receivable*



131. Indicate for each of the following items if the item would be reported on the income statement (IS), statement of changes in equity (CE), balance sheet (BS), or statement of cash flows (CF). Some items may appear on more than one statement, if so, identify all applicable statements.

- 1) Prepaid insurance
- 2) Dividends paid to stockholders
- 3) Interest revenue
- 4) Accounts payable
- 5) Salaries expense
- 6) Retained earnings
- 7) Unearned subscription revenue
- 8) Cash flows from operating activities
- 9) Beginning common stock
- 10) Issued stock to investors for cash
- 11) Salaries payable
- 12) Accounts receivable

- 1) BS 2) CE and CF 3) IS 4) BS 5) IS 6) BS and CE 7) BS 8) CF 9) CE 10) CE and CF  
11) BS 12) BS

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-07: Prepare financial statements based on accrual accounting*

*Topic: The Balance Sheet, The Income Statement, The Statement of Changes in Equity, The Statement of Cash Flows*

132. Classify each of the following transactions for the purpose of the statement of cash flows as operating activities (OA), investing activities (IA), financing activities (FA), or not reported on the statement of cash flows (NA).

- 1) \_\_\_\_ Made adjusting entry to accrue salary expense at the end of the year
- 2) \_\_\_\_ Borrowed funds from the bank
- 3) \_\_\_\_ Paid rent for the month
- 4) \_\_\_\_ Paid cash to settle accounts payable
- 5) \_\_\_\_ Issued common stock for \$30,000 cash
- 6) \_\_\_\_ Collected accounts receivable
- 7) \_\_\_\_ Paid cash to acquire land

1) NA 2) FA 3) OA 4) OA 5) FA 6) OA 7) IA

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-07: Prepare financial statements based on accrual accounting*

*Topic: The Statement of Cash Flows*

133. Tuttle Company shows the following transactions for the accounting period ending December 31, 2013:

- 1) Sold books to customers for \$34,000 on account
- 2) Collected \$28,000 from customers
- 3) Issued common stock for \$8,000 cash
- 4) Prepaid four months' rent for \$4,400 on October 1, 2013
- 5) Purchase supplies for \$10,500 cash
- 6) Physical count shows \$3,250 of supplies left over on December 31, 2013
- 7) Recorded adjustment for prepaid rent used

Show how the above transactions and year end adjustments affect the financial statements on the accounting equation:

	Accts.	Ppd.		=	Common	Retained
	Rec. +	Rent +	Supplies		Stock +	Earnings
1)						
2)						
3)						
4)						
5)						
6)						
7)						

	Accts.	Ppd.		=	Common	Retained
Cash +	Rec. +	Rent +	Supplies		Stock +	Earnings
1)	34,000					34,000
2)	28,000	(28,000)				
3)	8,000				8,000	
4)	(4,400)	4,400				
5)	(10,500)		10,500			
6)			(7,250)			(7,250)
7)		(3,300)				(3,300)
	21,100	6,000	1,100	3,250	8,000	23,450

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Reporting

Blooms: Apply

Difficulty: 2 Medium

Learning Objective: 02-01: Show how receivables affect financial statements

Learning Objective: 02-03: Show how supplies affect financial statements

Learning Objective: 02-04: Show how prepaid items affect financial statements.

Topic: Accounting for accounts receivable

Topic: Accounting for supplies

Topic: Prepaid items

134. For each of the following transactions, indicate the type by entering "AS" for asset source transaction, "AU" for asset use transaction, "AE" for asset exchange transaction, and "CE" for claims exchange transaction.

- 1) \_\_\_\_ The company paid \$10,000 for a plot of land.
- 2) \_\_\_\_ Recorded the accrual of \$1,000 in salaries to be paid later.
- 3) \_\_\_\_ The company issued common stock for \$20,000 in cash.
- 4) \_\_\_\_ The business incurred operating expense on account.
- 5) \_\_\_\_ The business paid off its accounts payable.
- 6) \_\_\_\_ The business earned revenue to be collected next year.
- 7) \_\_\_\_ The company paid \$2,000 in dividends to its stockholders.
- 8) \_\_\_\_ The business received cash from customers in #6 above.
- 9) \_\_\_\_ Paid the salaries accrued in #2 above.
- 10) \_\_\_\_ Borrowed money from a local bank.

1) AE 2) CE 3) AS 4) CE 5) AU 6) AS 7) AU 8) AE 9) AU 10) AS

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-08: Classify accounting events into asset source; asset use; asset exchange; and claims exchange transactions.*

*Topic: Asset Source, Asset Use, Asset Exchange, Claims Exchange Transactions*

135. Tell whether each of the following events are asset source (AS), asset use (AU), asset exchange (AE), or claims exchange (CE) transactions.

- \_\_\_\_1) Issued common stock to investors for \$8,000 cash
- \_\_\_\_2) Paid one year's rent in advance
- \_\_\_\_3) Provided services to customers and received \$35,000 cash
- \_\_\_\_4) Paid creditors \$10,000
- \_\_\_\_5) Received \$3,000 of revenue in advance
- \_\_\_\_6) Provided services to customers on account, \$12,000
- \_\_\_\_7) Collected \$2,000 from accounts receivable
- \_\_\_\_8) Recognized accrued salary expense of \$2,000
- \_\_\_\_9) Borrowed \$6,000 from creditors
- \_\_\_\_10) Adjusted the records for supplies used of \$800

1) AS 2) AE 3) AS 4) AU 5) AS 6) AS 7) AE 8) CE 9) AS 10) AU

Feedback: 1) Issuing common stock is an asset source transaction that increases cash

2 )Paying rent in advance is an asset exchange transaction that increases prepaid rent and decreases cash

3) Providing services for cash is an asset source transaction that increases cash

4) Paying creditors is an asset use transaction that decreases cash

5) Receiving an advance payment is an asset source transaction that increases cash

6) Providing services on account is an asset source transaction that increases accounts receivable

- 7) Collecting on accounts receivable is an asset exchange transaction that increases cash and decreases accounts receivable
- 8) Accruing salary expense is a claims exchange transaction that increases accounts payable and decreases retained earnings
- 9) Borrowing cash is an asset source transaction that increases cash
- 10) Recognizing supplies expense is an asset use transaction that decreases supplies

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-08: Classify accounting events into asset source; asset use; asset exchange; and claims exchange transactions.*

*Topic: Asset Source, Asset Use, Asset Exchange, and Claims Exchange Transactions*

136. Creighton Company accrued \$120 of interest expense.

Assets	Liabilities	Equity	Revenues	Expenses	Net Income	Cash

(N) (I) (D) (N) (I) (D) (N)

Feedback: Accruing interest expense increases liabilities (interest payable) and decreases equity (interest expense decreases retained earnings). It increases expenses and decreases net income. It does not affect cash flows.

*AACSB: Analytic*

AICPA BB: Critical Thinking

AICPA FN: Measurement

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 02-11: Compute interest expense and show how it affects financial statements.

Topic: Accounting for Interest Expense

137. Via Company paid \$40 of accrued interest expense.

Assets	Liabilities	Equity	Revenues	Expenses	Net Income	Cash

(D) (D) (N) (N) (N) (N) (D)

Feedback: Paying accrued interest expense decreases assets (cash) and decreases liabilities (interest payable). It does not affect the income statement, but is reported as a cash outflow for operating activities on the statement of cash flows.

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 02-11: Compute interest expense and show how it affects financial statements.

Topic: Accounting for Interest Expense



138. Crosby Company recorded \$3,000 of depreciation expense on a delivery van.

Assets	Liabilities	Equity	Revenues	Expenses	Net Income	Cash

(D) (N) (D) (N) (I) (D) (N)

Feedback: Recording depreciation expense decreases assets (increases the contra-asset accumulated depreciation) and decreases equity (depreciation expense decreases retained earnings). It increases expenses and decreases net income. It does not affect cash flows.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 1 Easy*

*Learning Objective: 02-10: Compute depreciation expense and show how it affects financial statements*

*Topic: Accounting for Depreciation Expense*

## Multiple Choice Questions

139. Garrison Company purchased a delivery van on January 1, 2013 for \$20,000. The van is estimated to have a 5-year useful life and a \$4,000 salvage value. How much expense should Garrison recognize in 2013 related to the use of the van?

A. \$16,000

B. \$3,200

C. \$20,000

D. \$4,000

( \$20,000 cost - \$4,000 salvage value)/5 year useful life = \$3,200 depreciation expense

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 1 Easy*

*Learning Objective: 02-10: Compute depreciation expense and show how it affects financial statements*

*Topic: Accounting for Depreciation Expense*

140. Which of the following events involves a deferral?

- A. Recording interest that has been earned but not received.
- B. Recording supplies that have been purchased with cash but not yet used.
- C. Recording revenue that has been earned but not yet collected in cash.
- D. Recording salaries owed to employees at the end of the year that will be paid during the following year.

Recording the purchase of supplies constitutes a deferral because it involves the payment of cash before an expense (in this case, supplies expense) is recognized.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-11: Compute interest expense and show how it affects financial statements.*

*Topic: Accounting for Interest Expense*

141. The entry to recognize depreciation expense incurred on equipment involves which of the following?

- A. An increase in assets
- B. An increase in liabilities
- C. A decrease in assets
- D. A decrease in liabilities

Recognizing depreciation expense involves a decrease in assets due to an increase in the contra-asset accumulated depreciation and a decrease in equity due to recognizing depreciation expense.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-10: Compute depreciation expense and show how it affects financial statements*

*Topic: Accounting for Depreciation Expense*

142. The following accounts and balances were drawn from the records of Ji Company:

Cash	\$ 4,500
Accounts receivable	\$ 2,700
Equipment	\$10,000
Accumulated depreciation	\$ 3,200
Accounts payable	\$ 2,800
Common stock	\$ 6,000

Based on this information alone the amount of Ji's retained earnings is

- A. \$11,600.
- B. \$5,200.
- C. \$17,200.
- D. None of the above.

Assets (\$4,500 + \$2,700 + \$10,000 - \$3,200) = Liabilities (\$2,800) + Equity (\$6,000 + Retained Earnings); Retained Earnings = \$5,200

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Analyze*

*Difficulty: 2 Medium*

*Learning Objective: 02-10: Compute depreciation expense and show how it affects financial statements*

*Topic: Accounting for Depreciation Expense*

143. Which of the following would be included in the "cash flow from operating activities" section of the statement of cash flows?

- A. Accrual of salary expense at year-end.
- B. Cash paid for interest on a note payable.
- C. Payments of cash dividends to the owners of the business.
- D. Purchase of equipment for cash.

Paying or receiving interest is considered an operating activity. Accruing salary expense is not a cash flow. Paying dividends is a financing activity, and purchasing equipment is an investing activity.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-11: Compute interest expense and show how it affects financial statements.*

*Topic: Accounting for Interest Expense*

144. Collins Company began 2013 with a note payable of \$10,000 and interest payable of \$400. During the year, the company accrued an additional \$200 of interest expense, and paid off the note with interest. On the company's 2013 income statement, cash flows for financing activities related to the note would be:

- A. \$600 outflow
- B. \$10,000 outflow
- C. \$10,200 outflow
- D. \$10,600 outflow

Only the \$10,000 principle would be considered an outflow for financing activities. The \$600 interest paid is considered an operating activity.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Blooms: Analyze*

*Difficulty: 2 Medium*

*Learning Objective: 02-11: Compute interest expense and show how it affects financial statements.*

*Topic: Accounting for Interest Expense*

145. Which of the following would cause net income on the accrual basis to be different (either higher or lower) than "cash provided by operating activities" on the statement of cash flows?

- A. Recognized depreciation expense on equipment.
- B. Incurred operating expenses on account.
- C. Paying interest on a note that was accrued in a prior year.
- D. All of the above are correct.

Recognizing depreciation expense reduces net income, but does not affect cash flows for operating activities. Incurring operating expenses on account also reduces net income, but does not affect cash flows for operating activities. Paying interest that was accrued in a prior year will reduce cash flows for operating activities, but will not affect net income.

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*AICPA FN: Reporting*

*Blooms: Analyze*

*Difficulty: 2 Medium*

*Learning Objective: 02-11: Compute interest expense and show how it affects financial statements.*

*Topic: Accounting for Interest Expense*



146. Grant Company purchased a machine on January 1, 2013 for \$13,000 cash. The machine has an estimated useful life of 4 years and a \$3,000 salvage value. What would be the book value of the machine reported on Grant's December 31, 2013 balance sheet?

- A. \$13,000
- B. \$9,750
- C. \$10,500
- D. \$7,500

The amount of assets related to the machine on December 31 would be the machine's book value (cost minus accumulated depreciation). ( $\$13,000 \text{ cost} - \$3,000 \text{ salvage value}$ )/4 year useful life = \$2,500 annual depreciation expense. Book value =  $\$13,000 - \$2,500 = \$10,500$ .

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Apply*

*Difficulty: 2 Medium*

*Learning Objective: 02-10: Compute depreciation expense and show how it affects financial statements*

*Topic: Accounting for Depreciation Expense*

**True / False Questions**

147. Recognition of depreciation expense is a claims exchange transaction.

**FALSE**

Recognition of depreciation expense is an asset use transaction that decreases the book value of the depreciated asset and decreases equity.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-10: Compute depreciation expense and show how it affects financial statements*

*Topic: Accounting for Depreciation Expense*

148. Recognition of depreciation expense on equipment decreases the equipment account.

**FALSE**

Recognition of depreciation expense increases the contra-asset accumulated depreciation which decreases the book value of the asset on the balance sheet. It does not decrease the equipment account itself.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Understand*

*Difficulty: 2 Medium*

*Learning Objective: 02-10: Compute depreciation expense and show how it affects financial statements*

*Topic: Accounting for Depreciation Expense*

149. When a company purchases a depreciable asset, it must estimate the asset's useful life and salvage value.

TRUE

It is necessary to estimate an asset's useful life and salvage value in order to calculate depreciation expense associated with the use of that asset.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Apply*

*Difficulty: 1 Easy*

*Learning Objective: 02-10: Compute depreciation expense and show how it affects financial statements*

*Topic: Accounting for Depreciation Expense*

150. Payment of interest is classified as a financing activity on the statement of cash flows.

FALSE

Payment of interest is classified as an operating activity on the statement of cash flows.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Blooms: Apply*

*Difficulty: 2 Medium*

*Learning Objective: 02-11: Compute interest expense and show how it affects financial statements.*

*Topic: Accounting for Interest Expense*

## Essay Questions

151. Thornrose Company started its business on January 1, 2013 by issuing \$5,000 of common stock. On January 1, the company purchased a computer for \$3,500. The computer is estimated to have a 3-year useful life and a \$500 salvage value. On March 1, Thornrose issued a \$9,000, 6% 5-year note to Community Bank. Customers paid Thornrose \$18,000 for service performed in 2013. The company paid \$11,000 for operating expenses, and paid a \$300 dividend to the stockholders. At year-end, Thornrose recognized interest expense on the note and depreciation expense on the computer.

Required:

- a) What is the amount of interest expense Thornrose will recognize in 2013?
- b) What is the book value of the computer at the end of 2013?
- c) What is the net income for 2013?
- d) Prepare a balance sheet for 2013.

a)  $\$9,000 \times 6\% \times 10/12 = \$450$  interest expense

b) Depreciation expense =  $(\$3,500 - \$500)/3 = \$1,000$ ; Book value =  $\$3,500 - \$1,000 = \$2,500$

c)  $\$18,000 - \$11,000 - \$1,000 - \$450 = \$5,550$  Net income

d)

Thornrose Corporation		
Balance Sheet		
As of December 31, 2013		
Assets		
Cash	\$ 17,200	
Computer	\$ 3,500	
Less: Accumulated Depreciation	<u>(1,000)</u>	<u>\$ 19,700</u>
Liabilities		
Interest payable	\$ 450	
Note payable	<u>9,000</u>	<u>\$ 9,450</u>
Stockholders' equity		
Common stock	5,000	
Retained earnings	<u>5,250</u>	<u>10,250</u>
Total liabilities and stockholders' equity		<u>\$ 19,700</u>

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Reporting

Blooms: Apply

Difficulty: 3 Hard

Learning Objective: 02-10: Compute depreciation expense and show how it affects financial statements

Learning Objective: 02-11: Compute interest expense and show how it affects financial statements.

Topic: Accounting for Depreciation Expense

Topic: Accounting for Interest Expense

152. The following events apply to John's Lawn Service for 2013.

- 1). Issued stock for \$14,000 cash.
- 2). On January 1, purchased equipment for \$12,000. The equipment has an estimated 5-year useful life and a \$2,000 salvage value.
- 3). On May 1, issued a \$3,000, 5% 3-year note to a local bank.
- 4). Performed services of \$18,400 and received cash.
- 5). Paid \$15,000 of operating expenses.
- 6). At December 31, adjusted the records to recognize expense associated with use of the equipment and accrued interest.

Required:

Record the effects of the above events under the appropriate account headings in the accounting formula below.

	Assets		=	Liab		+	Stockholders' Equity	
	Cash	Book Value of Equip.		Notes Payable	Interest Payable		CS	RE
1								
2								
3								
4								
5								
6a								
6b								
Totals								

	Assets		=	Liab		+	Stockholders' Equity	
	Cash	Book Value of Equip.		Notes Payable	Interest Payable		CS	RE
1	14,000						14,000	
2	(12,000)	12,000						
3	3,000			3,000				
4	18,400							18,400
5	(15,000)							(15,000)
6a		(2,000)						(2,000)
6b					100			(100)
Totals	\$ 8,400	\$ 10,000		\$ 3,000	\$ 100		\$ 14,000	\$ 1,300

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*AICPA FN: Reporting*

*Blooms: Apply*

*Difficulty: 3 Hard*

*Learning Objective: 02-10: Compute depreciation expense and show how it affects financial statements*

*Learning Objective: 02-11: Compute interest expense and show how it affects financial statements.*

*Topic: Accounting for Depreciation Expense*

*Topic: Accounting for Interest Expense*

153. Giambrone Corporation began business operations and experienced the following transactions during 2013:

- 1) Issued common stock for \$15,000 cash.
- 2) Issued a \$10,000, 6% 4-year note to the bank on February 1.
- 3) Provided services to customers for \$40,000 cash.
- 4) Paid \$19,000 for operating expenses.
- 5) Accrued interest expense on the note.
- 6) Paid a \$2,000 dividend to shareholders.

Required:

Record the above transactions on a horizontal statements model to reflect their effect on Giambrone's financial statements.

	Assets	=	Liabilities		+	Stockholders' Equity		Revenue	-	Expense	=	NI	Cash Flow	
	Cash		Notes Payable	Interest Payable		Common Stock	Retained Earnings							
1														
2														
3														
4														
5														
6														
Totals														

	Assets	=	Liabilities		+	Stockholders' Equity		Revenue	-	Expense	=	NI	Cash Flow	
	Cash		Notes Payable	Interest Payable		Common Stock	Retained Earnings							
1	15,000					15,000							15,000	FA
2	10,000		10,000										10,000	FA
3	40,000						40,000	40,000				40,000	40,000	OA
4	(19,000)						(19,000)			19,000		(19,000)	(19,000)	OA
5				550			(550)			550		(550)		
6	(2,000)						(2,000)						(2,000)	FA
Totals	44,000		10,000	550		15,000	18,450	40,000		19,550		20,450	44,000	



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*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*AICPA FN: Reporting*

*Blooms: Apply*

*Difficulty: 1 Easy*

*Learning Objective: 02-01: Show how receivables affect financial statements*

*Learning Objective: 02-02: Show how payables affect financial statements*

*Topic: Accounting for accounts payable*

*Topic: Accounting for accounts receivable*