### CHAPTER 3
### ADJUSTING THE ACCOUNTS

**SUMMARY OF QUESTIONS BY STUDY OBJECTIVES AND BLOOM’S TAXONOMY**

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*sg* This question also appears in the Study Guide.

*st* This question also appears in a self-test at the student companion website.

*a* This question covers a topic in an appendix to the chapter.
### SUMMARY OF QUESTIONS BY STUDY OBJECTIVES AND BLOOM’S TAXONOMY

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### SUMMARY OF STUDY OBJECTIVES BY QUESTION TYPE

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### SUMMARY OF STUDY OBJECTIVES BY QUESTION TYPE


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

The chapter also contains one set of ten Matching questions and six Short-Answer Essay questions.
CHAPTER STUDY OBJECTIVES

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

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

3. **Explain the reasons for adjusting entries.** Companies make adjusting entries at the end of an accounting period. Such entries ensure that companies record revenues in the period in which they are earned and that they recognize expenses in the period in which they are incurred.

4. **Identify the major types of adjusting entries.** The major types of adjusting entries are deferrals (prepaid expenses and unearned revenues) and accruals (accrued revenues and accrued expenses).

5. **Prepare adjusting entries for deferrals.** Deferrals are either prepaid expenses or unearned revenues. Companies make adjusting entries for deferrals to record the portion of the prepayment that represents the expense incurred or the revenue earned in the current accounting period.

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

7. **Describe the nature and purpose of an adjusted trial balance.** An adjusted trial balance shows the balances of all accounts, including those that have been adjusted, at the end of an accounting period. Its purpose is to prove the equality of the total debit balances and total credit balances in the ledger after all adjustments.

8. **Prepare adjusting entries for the alternative treatment of deferrals.** Companies may initially debit prepayments to an expense account. Likewise they may credit unearned revenues to a revenue account. At the end of the period, these accounts may be overstated. The adjusting entries for prepaid expenses are a debit to an asset account and a credit to an expense account. Adjusting entries for unearned revenues are a debit to a revenue account and a credit to a liability account.
TRUE-FALSE STATEMENTS

1. Many business transactions affect more than one time period.

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

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

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

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

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

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

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

9. Expense recognition is tied to revenue recognition.

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

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

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

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

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

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

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

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

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

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

20. The balances of the Depreciation Expense and the Accumulated Depreciation accounts should always be the same.
21. Unearned revenue is a prepayment that requires an adjusting entry when services are performed.

22. Asset prepayments become expenses when they expire.

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

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

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

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

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

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

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

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

Additional True-False Questions

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

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

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

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

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

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

37. When a prepaid expense is initially debited to an expense account, expenses and assets are both overstated prior to adjustment.
### Answers to True-False Statements

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### MULTIPLE CHOICE QUESTIONS

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

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

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

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

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

43. The time period assumption is also referred to as the
   a. calendar assumption.
   b. cyclicity assumption.
   c. periodicity assumption.
   d. fiscal assumption.
44. In general, the shorter the time period, the difficulty of making the proper adjustments to accounts
   a. is increased.
   b. is decreased.
   c. is unaffected.
   d. depends on if there is a profit or loss.

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

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

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

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

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

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

51. The matching principle matches
   a. customers with businesses.
   b. expenses with revenues.
   c. assets with liabilities.
   d. creditors with businesses.
52. Ken’s Tune-up Shop follows the revenue recognition principle. Ken services a car on July 31. The customer picks up the vehicle on August 1 and mails the payment to Ken on August 5. Ken receives the check in the mail on August 6. When should Ken show that the revenue was earned?
   a. July 31  
   b. August 1  
   c. August 5  
   d. August 6

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

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

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

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

57. Expenses sometimes make their contribution to revenue in a different period than when the expense is paid. When wages are incurred in one period and paid in the next period, this often leads to which account appearing on the balance sheet at the end of the time period?
   a. Due from Employees  
   b. Due to Employer  
   c. Wages Payable  
   d. Wages Expense
58. Under accrual-basis accounting
   a. cash must be received before revenue is recognized.
   b. net income is calculated by matching cash outflows against cash inflows.
   c. events that change a company’s financial statements are recognized in the period they
      occur rather than in the period in which cash is paid or received.
   d. the ledger accounts must be adjusted to reflect a cash basis of accounting before
      financial statements are prepared under generally accepted accounting principles.

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

60. Which is not an application of revenue recognition?
   a. Recording revenue as an adjusting entry on the last day of the accounting period.
   b. Accepting cash from an established customer for services to be performed over the
      next three months.
   c. Billing customers on June 30 for services completed during June.
   d. Receiving cash for services performed.

61. Which statement is correct?
   a. As long as a company consistently uses the cash basis of accounting, generally
      accepted accounting principles allow its use.
   b. The use of the cash basis of accounting violates both the revenue recognition and
      matching principles.
   c. The cash basis of accounting is objective because no one can be certain of the
      amount of revenue until the cash is received.
   d. As long as management is ethical, there are no problems with using the cash basis of
      accounting.

62. The following is selected information from J Corporation for the fiscal year ending October
    31, 2008.

   Cash received from customers $300,000
   Revenue earned 350,000
   Cash paid for expenses 170,000
   Cash paid for computers on November 1, 2007 that will be used
   for 3 years (annual depreciation is $16,000) 48,000
   Expenses incurred, not including any depreciation 200,000
   Proceeds from a bank loan, part of which was used to pay for
   the computers 100,000

   Based on the accrual basis of accounting, what is J Corporation’s net income for the year
   ending October 31, 2008?
   a. $114,000
   b. $134,000
   c. $82,000
   d. $150,000
Use the following information for questions 63–64.

Sheepskin Company had the following transactions during 2008.

- Sales of $4,500 on account
- Collected $2,000 for services to be performed in 2009
- Paid $625 cash in salaries
- Purchased airline tickets for $250 in December for a trip to take place in 2009

63. What is Sheepskin’s 2008 net income using accrual accounting?
   a. $3,875
   b. $5,875
   c. $5,625
   d. $3,625

64. What is Sheepskin’s 2008 net income using cash basis accounting?
   a. $5,875
   b. $1,375
   c. $5,625
   d. $1,125

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

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

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

68. An adjusting entry
   a. affects two balance sheet accounts.
   b. affects two income statement accounts.
   c. affects a balance sheet account and an income statement account.
   d. is always a compound entry.
69. The preparation of adjusting entries is  
   a. straightforward because the accounts that need adjustment will be out of balance.  
   b. often an involved process requiring the skills of a professional.  
   c. only required for accounts that do not have a normal balance.  
   d. optional when financial statements are prepared.

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

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

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

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

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

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

76. Accrued revenues are  
   a. received and recorded as liabilities before they are earned.  
   b. earned and recorded as liabilities before they are received.  
   c. earned but not yet received or recorded.  
   d. earned and already received and recorded.
77. Prepaid expenses are
   a. paid and recorded in an asset account before they are used or consumed.
   b. paid and recorded in an asset account after they are used or consumed.
   c. incurred but not yet paid or recorded.
   d. incurred and already paid or recorded.

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

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

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

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

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

83. Quirk Company purchased office supplies costing $6,000 and debited Office Supplies for the full amount. At the end of the accounting period, a physical count of office supplies revealed $2,400 still on hand. The appropriate adjusting journal entry to be made at the end of the period would be
   a. Debit Office Supplies Expense, $2,400; Credit Office Supplies, $2,400.
   b. Debit Office Supplies, $3,600; Credit Office Supplies Expense, $3,600.
   c. Debit Office Supplies Expense, $3,600; Credit Office Supplies, $3,600.
   d. Debit Office Supplies, $2,400; Credit Office Supplies Expense, $2,400.

84. If an adjustment is needed for unearned revenues, the
   a. liability and related revenue are overstated before adjustment.
   b. liability and related revenue are understated before adjustment.
   c. liability is overstated and the related revenue is understated before adjustment.
   d. liability is understated and the related revenue is overstated before adjustment.
85. If an adjustment is needed for prepaid expenses, the
   a. asset and related expense are overstated before adjustment.
   b. asset and related expense are understated before adjustment.
   c. asset is understated and the related expense is overstated before adjustment.
   d. asset is overstated and the related expense is understated before adjustment.

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

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

88. Hardy Company purchased a computer for $4,800 on December 1. It is estimated that
    annual depreciation on the computer will be $960. If financial statements are to be
    prepared on December 31, the company should make the following adjusting entry:
    a. Debit Depreciation Expense, $960; Credit Accumulated Depreciation, $960.
    b. Debit Depreciation Expense, $80; Credit Accumulated Depreciation, $80.
    c. Debit Depreciation Expense, $3,840; Credit Accumulated Depreciation, $3,840.
    d. Debit Office Equipment, $4,800; Credit Accumulated Depreciation, $4,800.

89. Baden Realty Company received a check for $18,000 on July 1 which represents a 6
    month advance payment of rent on a building it rents to a client. Unearned Rent was
    credited for the full $18,000. Financial statements will be prepared on July 31. Baden
    Realty should make the following adjusting entry on July 31:
    a. Debit Unearned Rent, $3,000; Credit Rental Revenue, $3,000.
    b. Debit Rental Revenue, $3,000; Credit Unearned Rent, $3,000.
    c. Debit Unearned Rent, $18,000; Credit Rental Revenue, $18,000.
    d. Debit Cash, $18,000; Credit Rental Revenue, $18,000.

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

91. A company usually determines the amount of supplies used during a period by
    a. adding the supplies on hand to the balance of the Supplies account.
    b. summing the amount of supplies purchased during the period.
    c. taking the difference between the supplies purchased and the supplies paid for during
       the period.
    d. taking the difference between the balance of the Supplies account and the cost of
       supplies on hand.
92. If a company fails to make an adjusting entry to record supplies expense, then
   a. owner's equity will be understated.
   b. expense will be understated.
   c. assets will be understated.
   d. net income will be understated.

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

94. At December 31, 2008, before any year-end adjustments, Karr Company's Insurance
   Expense account had a balance of $1,450 and its Prepaid Insurance account had a
   balance of $3,800. It was determined that $3,000 of the Prepaid Insurance had expired.
   The adjusted balance for Insurance Expense for the year would be
   a. $3,000.
   b. $1,450.
   c. $4,450.
   d. $2,250.

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

96. A new accountant working for Metcalf Company records $800 Depreciation Expense on
   store equipment as follows:
   
   Dr. Depreciation Expense ............................................. 800
   Cr. Cash ...............................................................  800

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

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

98. In computing depreciation, the number of years of useful life of the asset is
   a. known with certainty.
   b. an estimate.
   c. always fixed at 5 years.
   d. always fixed at 3 years.
99. An accumulated depreciation account  
a. is a contra-liability account.  
b. increases on the debit side.  
c. is offset against total assets on the balance sheet.  
d. has a normal credit balance.

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

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

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

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

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

105. If a business has received cash in advance of services performed and credits a liability account, the adjusting entry needed after the services are performed will be  
a. debit Unearned Revenue and credit Cash.  
b. debit Unearned Revenue and credit Service Revenue.  
c. debit Unearned Revenue and credit Prepaid Expense.  
d. debit Unearned Revenue and credit Accounts Receivable.
106. White Laundry Company purchased $6,500 worth of laundry supplies on June 2 and recorded the purchase as an asset. On June 30, an inventory of the laundry supplies indicated only $2,000 on hand. The adjusting entry that should be made by the company on June 30 is
   a. Debit Laundry Supplies Expense, $2,000; Credit Laundry Supplies, $2,000.
   b. Debit Laundry Supplies, $2,000; Credit Laundry Supplies Expense, $2,000.
   c. Debit Laundry Supplies, $4,500; Credit Laundry Supplies Expense, $4,500.
   d. Debit Laundry Supplies Expense, $4,500; Credit Laundry Supplies, $4,500.

107. On July 1, Dexter Shoe Store paid $8,000 to Ace Realty for 4 months rent beginning July 1. Prepaid Rent was debited for the full amount. If financial statements are prepared on July 31, the adjusting entry to be made by Dexter Shoe Store is
   a. Debit Rent Expense, $8,000; Credit Prepaid Rent, $2,000.
   b. Debit Prepaid Rent, $2,000; Credit Rent Expense, $2,000.
   c. Debit Rent Expense, $2,000; Credit Prepaid Rent, $2,000.
   d. Debit Rent Expense, $8,000; Credit Prepaid Rent, $8,000.

108. Southeastern Louisiana University sold season tickets for the 2008 football season for $160,000. A total of 8 games will be played during September, October and November. In September, three games were played. The adjusting journal entry at September 30
   a. is not required. No adjusting entries will be made until the end of the season in November.
   b. will include a debit to Cash and a credit to Ticket Revenue for $40,000.
   c. will include a debit to Unearned Ticket Revenue and a credit to Ticket Revenue for $60,000.
   d. will include a debit to Ticket Revenue and a credit to Unearned Ticket Revenue for $53,333.

109. Southeastern Louisiana University sold season tickets for the 2008 football season for $160,000. A total of 8 games will be played during September, October and November. In September, two games were played. In October, three games were played. The balance in Unearned Revenue at October 31 is
   a. $0.
   b. $40,000.
   c. $60,000.
   d. $100,000.

110. Southeastern Louisiana University sold season tickets for the 2008 football season for $160,000. A total of 8 games will be played during September, October and November. Assuming all the games are played, the Unearned Revenue balance that will be reported on the December 31 balance sheet will be
   a. $0.
   b. $60,000.
   c. $100,000.
   d. $160,000.

111. At March 1, 2008, Candy Inc. had supplies on hand of $500. During the month, Candy purchased supplies of $1,200 and used supplies of $1,500. The March 31 adjusting journal entry should include a
   a. debit to the supplies account for $1,500.
   b. credit to the supplies account for $500.
   c. debit to the supplies account for $1,200.
   d. credit to the supplies account for $1,500.
112. Dorting Company purchased a computer system for $3,600 on January 1, 2008. The company expects to use the computer system for 3 years. It has no salvage value. Monthly depreciation expense on the asset is
   a. $0.
   b. $100.
   c. $1,200.
   d. $3,600.

113. Maple Tree Inc. purchased a 12-month insurance policy on March 1, 2008 for $900. At March 31, 2008, the adjusting journal entry to record expiration of this asset will include a
   a. debit to Prepaid Insurance and a credit to Cash for $900.
   b. debit to Prepaid Insurance and a credit to Insurance Expense for $100.
   c. debit to Insurance Expense and a credit to Prepaid Insurance for $75
   d. debit to Insurance Expense and a credit to Cash for $75.

114. Ogletree Enterprises purchased an 18-month insurance policy on May 31, 2008 for $3,600. The December 31, 2008 balance sheet would report Prepaid Insurance of
   a. $0 because Prepaid Insurance is reported on the Income Statement.
   b. $1,400.
   c. $2,200.
   d. $3,600.

115. At March 1, J.C. Retro Inc. reported a balance in Supplies of $200. During March, the company purchased supplies for $750 and consumed supplies of $800. If no adjusting entry is made for supplies
   a. owner’s equity will be overstated by $800.
   b. expenses will be understated by $750.
   c. assets will be understated by $150.
   d. net income will be understated by $800.

116. FMI Inc. pays its rent of $120,000 annually on January 1. If the February 28 monthly adjusting entry for prepaid rent is omitted, which of the following will be true?
   a. Failure to make the adjustment does not affect the February financial statements.
   b. Expenses will be overstated by $10,000 and net income and owner’s equity will be understated by $10,000.
   c. Assets will be overstated by $20,000 and net income and owner’s equity will be understated by $20,000.
   d. Assets will be overstated by $10,000 and net income and owner’s equity will be overstated by $10,000.

117. On January 1, 2007, P.T. Oracle Company purchased a computer system for $3,240. The company expects to use the system for 3 years. The asset has no salvage value. The book value of the system at December 31, 2008 is
   a. $0.
   b. $1,080.
   c. $2,160.
   d. $3,240.
118. On January 1, 2007, E.D. Reardon Inc. purchased equipment for $30,000. The company is depreciating the equipment at the rate of $400 per month. At January 31, 2008, the balance in Accumulated Depreciation is
   a. $400.
   b. $4,800.
   c. $5,200.
   d. $24,800.

119. On January 1, 2008, M. Johnson Company purchased equipment for $30,000. The company is depreciating the equipment at the rate of $700 per month. The book value of the equipment at December 31, 2008 is
   a. $0.
   b. $8,400.
   c. $21,600.
   d. $30,000.

120. Lawton Company collected $8,400 in May of 2008 for 4 months of service which would take place from October of 2008 through January of 2009. The revenue reported from this transaction during 2008 would be
   a. 0.
   b. $6,300.
   c. $8,400.
   d. $2,010.

121. Keypress Company collected $6,500 in May of 2008 for 5 months of service which would take place from October of 2008 through February of 2009. The revenue reported from this transaction during 2008 would be
   a. 0.
   b. $3,900.
   c. $6,500.
   d. $2,600.

122. Waterfalls Corporation purchased a one-year insurance policy in January 2008 for $66,000. The insurance policy is in effect from March 2008 through February 2009. If the company neglects to make the proper year-end adjustment for the expired insurance
   a. Net income and assets will be understated by $55,000.
   b. Net income and assets will be overstated by $55,000.
   c. Net income and assets will be understated by $11,000.
   d. Net income and assets will be overstated by $11,000.

123. Younger Corporation purchased a one-year insurance policy in January 2008 for $48,000. The insurance policy is in effect from May 2008 through April 2009. If the company neglects to make the proper year-end adjustment for the expired insurance
   a. Net income and assets will be understated by $32,000.
   b. Net income and assets will be overstated by $32,000.
   c. Net income and assets will be understated by $16,000.
   d. Net income and assets will be overstated by $16,000.
124. If an adjusting entry is not made for an accrued revenue,
   a. assets will be overstated.
   b. expenses will be understated.
   c. owner's equity will be understated.
   d. revenues will be overstated.

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

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

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

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

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

130. Clark Real Estate signed a four-month note payable in the amount of $8,000 on September 1. The note requires interest at an annual rate of 9%. The amount of interest to be accrued at the end of September is
   a. $240.
   b. $60.
   c. $720.
   d. $80.
131. A gift shop signs a three-month note payable to help finance increases in inventory for the Christmas shopping season. The note is signed on November 1 in the amount of $50,000 with annual interest of 12%. What is the adjusting entry to be made on December 31 for the interest expense accrued to that date, if no entries have been made previously for the interest?
   a. Interest Expense ............................................................ 1,000
      Interest Payable......................................................... 1,000
   b. Interest Expense ............................................................ 1,500
      Interest Payable......................................................... 1,500
   c. Interest Expense ............................................................ 1,000
      Cash ................................................................................ 1,000
   d. Interest Expense ............................................................ 1,000
      Note Payable.............................................................. 1,000

132. Trent Tables paid employee wages on and through Friday, January 26, and the next payroll will be paid in February. There are three more working days in January (29–31). Employees work 5 days a week and the company pays $900 a day in wages. What will be the adjusting entry to accrue wages expense at the end of January?
   a. Wages Expense ........................................................... 900
      Wages Payable .......................................................... 900
   b. Wages Expense ........................................................... 4,500
      Wages Payable .......................................................... 4,500
   c. Wages Expense ........................................................... 2,700
      Wages Payable .......................................................... 2,700
   d. No adjusting entry is required.

133. A company shows a balance in Salaries Payable of $40,000 at the end of the month. The next payroll amounting to $45,000 is to be paid in the following month. What will be the journal entry to record the payment of salaries?
   a. Salaries Expense ......................................................... 45,000
      Salaries Payable......................................................... 45,000
   b. Salaries Expense ......................................................... 45,000
      Cash ............................................................................ 45,000
   c. Salaries Expense ......................................................... 5,000
      Cash ............................................................................ 5,000
   d. Salaries Expense ......................................................... 5,000
      Salaries Payable ......................................................... 40,000
      Cash ............................................................................ 45,000

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

135. Carter Guitar Company borrowed $12,000 from the bank signing a 9%, 3-month note on September 1. Principal and interest are payable to the bank on December 1. If the company prepares monthly financial statements, the adjusting entry that the company should make for interest on September 30, would be
a. Debit Interest Expense, $1,080; Credit Interest Payable, $1,080.
b. Debit Interest Expense, $90; Credit Interest Payable, $90.
c. Debit Note Payable, $1,080; Credit Cash, $1,080.
d. Debit Cash, $270; Credit Interest Payable, $270.

136. Manning Corporation issued a one-year, 9%, $200,000 note on April 30, 2008. Interest expense for the year ended December 31, 2008 was
   a. $18,000.
   b. $13,500.
   c. $12,000.
   d. $10,500.

137. Blue Corporation issued a one-year, 12%, $200,000 note on August 31, 2008. Interest expense for the year ended December 31, 2008 was
   a. $24,000.
   b. $10,000.
   c. $8,000.
   d. $6,000.

138. Employees at B Corporation are paid $5,000 cash every Friday for working Monday through Friday. The calendar year accounting period ends on Wednesday, December 31. How much salary expense should be recorded two days later on January 2?
   a. $5,000
   b. $3,000
   c. None, matching requires the weekly salary to be accrued on December 31.
   d. $2,000

139. Can financial statements be prepared directly from the adjusted trial balance?
   a. They cannot. The general ledger must be used.
   b. Yes, adjusting entries have been recorded in the general journal and posted to the ledger accounts.
   c. No, the adjusted trial balance merely proves the equality of the total debit and total credit balances in the ledger after adjustments are posted. It has no other purpose.
   d. They can because that is the only reason that an adjusted trial balance is prepared.

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

141. An adjusted trial balance
   a. is prepared after the financial statements are completed.
   b. proves the equality of the total debit balances and total credit balances of ledger accounts after all adjustments have been made.
   c. is a required financial statement under generally accepted accounting principles.
   d. cannot be used to prepare financial statements.
142. Which of the statements below is not true?
   a. An adjusted trial balance should show ledger account balances.
   b. An adjusted trial balance can be used to prepare financial statements.
   c. An adjusted trial balance proves the mathematical equality of debits and credits in the ledger.
   d. An adjusted trial balance is prepared before all transactions have been journalized.

143. Al is a barber who does his own accounting for his shop. When he buys supplies he routinely debits Supplies Expense. Al purchased $1,500 of supplies in January and his inventory at the end of January shows $400 of supplies remaining. What adjusting entry should Al make on January 31?
   a. Supplies Expense ...................................................... 400
      Supplies .................................................................... 400
   b. Supplies Expense ...................................................... 1,500
      Cash ...................................................................... 1,500
   c. Supplies ................................................................. 400
      Supplies Expense .................................................... 400
   d. Supplies Expense ...................................................... 1,100
      Supplies .................................................................... 1,100

144. Alternative adjusting entries do not apply to
   a. accrued revenues and accrued expenses.
   b. prepaid expenses.
   c. unearned revenues.
   d. prepaid expenses and unearned revenues.

145. Jim is a lawyer who requires that his clients pay him in advance of legal services rendered. Jim routinely credits Legal Service Revenue when his clients pay him in advance. In June Jim collected $12,000 in advance fees and completed 75% of the work related to these fees. What adjusting entry is required by Jim’s firm at the end of June?
   a. Unearned Revenue ...................................................... 9,000
      Legal Service Revenue ........................................... 9,000
   b. Unearned Revenue ...................................................... 3,000
      Legal Service Revenue ........................................... 3,000
   c. Cash ........................................................................ 12,000
      Legal Service Revenue ........................................... 12,000
   d. Legal Service Revenue ................................................ 3,000
      Unearned Revenue ................................................. 3,000

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

147. If unearned revenues are initially recorded in revenue accounts and have not all been earned at the end of the accounting period, then failure to make an adjusting entry will cause
   a. liabilities to be overstated.
   b. revenues to be understated.
   c. revenues to be overstated.
   d. accounts receivable to be overstated.
On January 2, 2008, Federal Savings and Loan purchased a general liability insurance policy for $2,400 for coverage for the calendar year. The entire $2,400 was charged to Insurance Expense on January 2, 2008. If the firm prepares monthly financial statements, the proper adjusting entry on January 31, 2008, will be:

a. Insurance Expense ..............................................................  2,200
Prepaid Insurance ...........................................................  2,200

b. Prepaid Insurance ...........................................................  2,200
Insurance Expense ...........................................................  2,200

c. Insurance Expense ...........................................................  200
Prepaid Insurance ...........................................................  200

d. Prepaid Insurance ...........................................................  200
Insurance Expense ...........................................................  200

Additional Multiple Choice Questions

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

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

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

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

153. Expenses paid and recorded as assets before they are used are called
   a. accrued expenses.
   b. interim expenses.
   c. prepaid expenses.
   d. unearned expenses.
154. Demaet Cruise Lines purchased a five-year insurance policy for its ships on April 1, 2008 for $100,000. Assuming that April 1 is the effective date of the policy, the adjusting entry on December 31, 2008 is
   a. Prepaid Insurance ..................................................  15,000
      Insurance Expense .................................................. 15,000
   b. Insurance Expense .................................................. 15,000
      Prepaid Insurance .................................................. 15,000
   c. Insurance Expense .................................................. 20,000
      Prepaid Insurance .................................................. 20,000
   d. Insurance Expense ..................................................  5,000
      Prepaid Insurance ..................................................  5,000

155. Gardner Company purchased a truck from Kutner Co. by issuing a 6-month, 8% note payable for $60,000 on November 1. On December 31, the accrued expense adjusting entry is
   a. No entry is required.
   b. Interest Expense ..................................................  4,800
      Interest Payable ....................................................  4,800
   c. Interest Expense ..................................................  9,600
      Interest Payable ....................................................  9,600
   d. Interest Expense ..................................................  800
      Interest Payable ....................................................  800

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

157. Cathy Cline, an employee of Welker Company, will not receive her paycheck until April 2. Based on services performed from March 15 to March 30, her salary was $900. The adjusting entry for Welker Company on March 31 is
   a. Salaries Expense ..................................................  900
      Salaries Payable ....................................................  900
   b. No entry is required.
   c. Salaries Expense ..................................................  900
      Cash .................................................................  900
   d. Salaries Payable ....................................................  900
      Cash .................................................................  900

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

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

BE 160

State whether each situation is a prepaid expense (PE), unearned revenue (UR), accrued revenue (AR) or an accrued expense (AE).

1. Unrecorded interest on savings bonds is $245.
2. Property taxes that have been incurred but that have not yet been paid or recorded amount to $300.
3. Legal fees of $1,000 were collected in advance. By year end 60 percent were still unearned.
4. Prepaid insurance had a $500 balance prior to adjustment. By year end, 40 percent was still unexpired.

Solution 160  (3 min.)

1. AR
2. AE
3. UR
4. PE
BE 161

Prepare adjusting entries for the following transactions. Omit explanations.

1. Depreciation on equipment is $800 for the accounting period.
2. There was no beginning balance of supplies and purchased $500 of office supplies during the period. At the end of the period $80 of supplies were on hand.
3. Prepaid rent had a $1,000 normal balance prior to adjustment. By year end $600 was unexpired.

Solution 161  (6 min.)

1. Depreciation Expense................................................................. 800
   Accumulated Depreciation—Equipment................................. 800

2. Supplies Expense ................................................................. 420
   Supplies ................................................................. 420
   ($500 – $80)

3. Rent Expense................................................................. 400
   Prepaid Rent ................................................................. 400
   ($1,000 – $600)

BE 162

On June 1, during its first month of operations, Eggemeister Enterprises purchased supplies for $3,500 and debited the supplies account for that amount. At January 30, an inventory of supplies showed $1,200 of supplies on hand. What adjusting journal entry should be made for June?

Solution 162  (3 min.)

Supplies Expense ................................................................. 2,300
   Supplies ................................................................. 2,300

Be. 163

On January 1, Biddle & Biddle, CPAs received a $9,000 cash retainer for legal services to be rendered ratably over the next 3 months. The full amount was credited to the liability account Unearned Revenue. Assuming that the revenue is earned ratably over the 3-month period, what adjusting journal entry should be made at January 31?

Solution 163  (3 min.)

Unearned Revenue ................................................................. 3,000
   Fees Earned ................................................................. 3,000
BE 164

On February 1, Acts Tax Service received a $2,000 cash retainer for tax preparation services to be rendered ratably over the next 4 months. The full amount was credited to the liability account Unearned Revenue. Assuming that the revenue is earned ratably over the 4-month period, what balance would be reported on the February 28 balance sheet for Unearned Revenue?

Solution 164  (5 min.)

Revenue earned monthly = $2,000 / 4 months = $500 per month
Feb 28 balance in Unearned Revenue = $2,000 - $500 revenue earned in February = $1,500

BE 165

Hans Albert Enterprises purchased computer equipment on May 1, 2008 for $4,500. The company expects to use the equipment for 3 years. It has no salvage value.

1. What adjusting journal entry should the company make at the end of each month if monthly financials are prepared (annual depreciation is $1,500)?
2. What is the book value of the equipment at May 31, 2008?

Solution 165  (5 min.)

1. Depreciation Expense ................................................................. 125
   Accumulated Depreciation.................................................. 125

2. Cost $4,500
   Accumulated Depreciation – 125
   Book value $4,375

BE 166

Hampton International purchased software on October 1, 2008 for $10,800. The company expects to use the software for 3 years. It has no salvage value.

1. What adjusting journal entry should the company make at the end of each month if monthly financials are prepared? (annual depreciation is $3,600)
2. What balance will be reported on the December 31, 2008 balance sheet for Accumulated Depreciation?

Solution 166  (5 min.)

1. Depreciation Expense ................................................................. 300
   Accumulated Depreciation.................................................. 300

2. Balance in Accumulated Depreciation at December 31, 2008:
   3 months × $300 per month = $900
Better Publications sold annual subscriptions to their magazine for $24,000 in December, 2007. The magazine is published monthly. The new subscribers received their first magazine in January, 2008.

1. What adjusting entry should be made in January if the subscriptions were originally recorded as a liability?
2. What amount will be reported on the January 2008 balance sheet for Unearned Revenue?

Solution 167 (5 min.)
1. Unearned Revenue ................................................................. 2,000
   Subscription Revenue ...................................................... 2,000

2. Unearned Revenue at January 31:
   $24,000 – $2,000 = $22,000

On January 1, 2008, J.C. Cohen Company purchased a general liability insurance policy for $3,600 to provide coverage for the calendar year.

1. If the company recorded the policy as an asset when purchased, what is the monthly adjusting journal entry that should be recorded at January 31, 2008?
2. If the company expensed the cost of the policy on January 1, 2008, what is the monthly adjusting entry that should be recorded at January 31, 2008?

Solution 168 (5 min.)
1. Insurance Expense .............................................................. 300
   Prepaid Insurance ............................................................. 300

*2. Prepaid Insurance ............................................................. 3,300
   Insurance Expense .......................................................... 3,300

Identify the impact on the balance sheet if the following information is not used to adjust the accounts.

1. Supplies consumed totalled $3,000.
2. Interest accrues on notes payable at the rate of $200 per month.
3. Insurance of $450 expired during the month.
4. Plant and equipment are depreciated at the rate of $1,200 per month.
Solution 169  (5 min.)
1. Assets overstated and Owner’s Equity overstated by $3,000.
2. Liabilities understated and Owner’s Equity overstated by $200.
3. Assets overstated and Owner’s Equity overstated by $450.
4. Assets overstated and Owner’s Equity overstated by $1,200.

BE 170
Determine the impact on the balance sheet accounts if the following information is not used to adjust the accounts of Lake Castle Company for the month of January, 2008. Round answers to the nearest dollar.
1. The company rents extra office space to Franz, CPAs. Franz pays the $12,000 rent annually on January 1.
2. The company has an outstanding loan to its President in the amount of $100,000. The loan accrues interest at the annual rate of 4%. Principal and interest are due January 1, 2012.
3. The company completed work on a project during January that was not yet billed to the client. The client will be charged $2,500.

Solution 170  (5 min.)
1. Liabilities overstated and Owner’s Equity understated by $1,000.
2. Assets understated and Owner’s Equity understated by $333.
3. Assets understated and Owner’s Equity understated by $2,500.

BE 171
For each of the following oversights, state whether total assets will be understated (U), overstated (O), or no affect (NA).

_____  1. Failure to record revenue earned but not yet received.
_____  2. Failure to record expired prepaid rent.
_____  3. Failure to record accrued interest on the bank savings account.
_____  4. Failure to record depreciation.
_____  5. Failure to record accrued wages.
_____  6. Failure to recognize the earned portion of unearned revenues.

Solution 171  (5 min.)
1. U
2. O
3. U
4. O
5. NA
6. NA
BE 172

River Ridge Music School borrowed $20,000 from the bank signing a 10%, 6-month note on November 1. Principal and interest are payable to the bank on May 1. If the company prepares monthly financial statements, what adjusting entry should the company make at November 30 with regard to the note (round answer to the nearest dollar)?

Solution 172 (3 min.)

Interest Expense ($20,000 × 10% × 1/12) ....................................... 167
Interest Payable ..................................................................... 167

BE 173

The adjusted trial balance of Ninety-Six Inc. on December 31, 2008 includes the following accounts: Accumulated Depreciation, $6,000; Depreciation Expense, $2,000; Note Payable $7,500; Interest Expense $150; Utilities Expense, $300; Rent Expense, $500; Service Revenue, $19,600; Salaries Expense, $4,000; Supplies, $200; Supplies Expense, $1,200; Wages Payable, $600. Prepare an income statement for the month of December.

Solution 173 (10 min.)

Ninety-Six Inc.
Income Statement
For the Month Ended December 31, 2008

Service Revenue  $19,600
Expenses:
  Depreciation expense $2,000
  Interest expense  150
  Utilities expense  300
  Rent expense  500
  Salaries expense  4,000
  Supplies expense  1,200  8,150
Net Income  $11,450

BE 174

The adjusted trial balance of Jesper Company at December 31, 2008 includes the following accounts: L. Jesper, Capital $12,600; L. Jesper, Drawing $6,000; Service Revenue $35,000; Salaries Expense $13,000; Insurance Expense $2,000; Rent Expense $3,500; Supplies Expense $500; and Depreciation Expense $1,000. Prepare an owner’s equity statement for the year.
JESPER CORPORATION
Owner’s Equity Statement
For the Year Ended December 31, 2008

<table>
<thead>
<tr>
<th></th>
<th>12/31/08</th>
<th>12/31/07</th>
</tr>
</thead>
<tbody>
<tr>
<td>L. Jesper, Capital, January 1</td>
<td>12,600</td>
<td></td>
</tr>
<tr>
<td>Plus: Net Income</td>
<td>15,000</td>
<td></td>
</tr>
<tr>
<td>Less: Drawings</td>
<td>6,000</td>
<td></td>
</tr>
<tr>
<td>L. Jesper, Capital, December 31</td>
<td>21,600</td>
<td></td>
</tr>
</tbody>
</table>

EXERCISES

Ex. 175

The balance sheets of Cole Company include the following:

<table>
<thead>
<tr>
<th></th>
<th>12/31/08</th>
<th>12/31/07</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest Receivable</td>
<td>$6,300</td>
<td>-0-</td>
</tr>
<tr>
<td>Supplies</td>
<td>5,000</td>
<td>3,000</td>
</tr>
<tr>
<td>Wages Payable</td>
<td>3,600</td>
<td>3,800</td>
</tr>
<tr>
<td>Unearned Revenue</td>
<td>-0-</td>
<td>4,000</td>
</tr>
</tbody>
</table>

The income statement for 2008 shows the following:

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest Revenue</td>
<td>$18,400</td>
</tr>
<tr>
<td>Service Revenue</td>
<td>72,700</td>
</tr>
<tr>
<td>Supplies Expense</td>
<td>8,700</td>
</tr>
<tr>
<td>Wages Expense</td>
<td>39,000</td>
</tr>
</tbody>
</table>

Instructions

Calculate the following for 2008:

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

Solution 175 (15 min.)

1. Cash received for interest = $12,100
   - Interest Revenue $18,400
   - Less: Interest Receivable 6,300
   - Cash Received $12,100

2. Cash paid for supplies = $10,700
   - Supplies Expense $8,700
   - Less: Supplies (2007) 3,000
   - Add: Supplies (2008) 5,000
   - Cash Paid $10,700
Solution 175  (cont.)

3. Cash paid for wages = $39,200
   Wages Expense $39,000
   Add: Wages Payable (2007) 3,800
   42,800
   Less: Wages Payable (2008) 3,600
   Cash Paid $39,200

4. Cash received for revenue = $68,700
   Service Revenue $72,700
   Less: Unearned Revenue (2007) 4,000
   Cash Received $68,700

Ex. 176

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

LINDER COMPANY
Income Statement, Cash Basis
For the Year Ended December 31, 2008

Service revenue (does not include $20,000 of services rendered on account because the collection will not be until 2009).................................................... $370,000
Expenses (does not include $20,000 of expenses on account because payment will not be made until 2009)................................................................. 220,000
Net income................................................................................................ $150,000

Additional data:
1. Depreciation on a company automobile for the year amounted to $6,000. This amount is not included in the expenses above.
2. On January 1, 2008, paid for a two-year insurance policy on the automobile amounting to $1,800. This amount is included in the expenses above.

Instructions
(a) Recast the above income statement on the accrual basis in conformity with generally accepted accounting principles. Show computations and explain each change.
(b) Explain which basis (cash or accrual) provides a better measure of income.

Solution 176  (15 min.)

(a)
LINDER COMPANY
Income Statement
For the Year Ended December 31, 2008

Service revenue................................................................. $390,000
Expenses............................................................................. 245,100
Net income ........................................................................ $144,900
Solution 176 (cont.)

Service revenue should include the $20,000 for services performed on account. The accrual basis states that revenue is reflected in the period when the service is performed. ($370,000 + $20,000 = $390,000). Expenses should include the $20,000 for expenses incurred but not yet paid. The accrual basis states that expenses should be reflected in the period when incurred. Expenses also should only include half of the $1,800 insurance premium since $900 applies to 2008. The other $900 is an asset and should be reflected on the balance sheet as prepaid insurance. The $6,000 of depreciation for the automobile is included as an expense in 2008. ($220,000 + $20,000 – $900 + $6,000 = $245,100).

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

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

Ex. 177

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

- Depreciation for February is $1,800.
- Revenue earned but not yet billed is $2,300.
- Accrued interest expense is $700.
- Revenue collected in advance that is now earned is $3,500.
- Portion of prepaid insurance expired during February is $400.

Instructions

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

Solution 177 (5 min.)

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Income before Adjustments ($9,000 – 4,400)</td>
<td>$ 4,600</td>
</tr>
<tr>
<td>Add: Unearned Revenues</td>
<td>$3,500</td>
</tr>
<tr>
<td>Accrued Revenues</td>
<td>2,300</td>
</tr>
<tr>
<td></td>
<td>5,800</td>
</tr>
<tr>
<td>Subtract: Depreciation Expense</td>
<td>1,800</td>
</tr>
<tr>
<td>Interest Expense</td>
<td>700</td>
</tr>
<tr>
<td>Insurance Expense</td>
<td>400</td>
</tr>
<tr>
<td></td>
<td>2,900</td>
</tr>
<tr>
<td>Net Income after Adjustments</td>
<td>$ 7,500</td>
</tr>
</tbody>
</table>
Ex. 178

On December 31, 2008, Gomez Company prepared an income statement and balance sheet and failed to take into account three adjusting entries. The incorrect income statement showed net income of $40,000. The balance sheet showed total assets, $120,000; total liabilities, $45,000; and owner's equity, $75,000.

The data for the three adjusting entries were:
1. Depreciation of $9,000 was not recorded on equipment.
2. Wages amounting to $8,000 for the last two days in December were not paid and not recorded. The next payroll will be in January.
3. Rent of $14,000 was paid for two months in advance on December 1. The entire amount was debited to Rent Expense when paid.

Instructions

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

<table>
<thead>
<tr>
<th>Item</th>
<th>Net Income</th>
<th>Total Assets</th>
<th>Total Liabilities</th>
<th>Owner's Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Incorrect balances</td>
<td>$40,000</td>
<td>$120,000</td>
<td>$45,000</td>
<td>$75,000</td>
</tr>
<tr>
<td>Effects of:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation</td>
<td>(9,000)</td>
<td>(9,000)</td>
<td></td>
<td>(9,000)</td>
</tr>
<tr>
<td>Wages</td>
<td>(8,000)</td>
<td></td>
<td></td>
<td>(8,000)</td>
</tr>
<tr>
<td>Rent</td>
<td>7,000</td>
<td>7,000</td>
<td></td>
<td>7,000</td>
</tr>
<tr>
<td>Correct Balances</td>
<td>$30,000</td>
<td>$118,000</td>
<td>$53,000</td>
<td>$65,000</td>
</tr>
</tbody>
</table>

Solution 178 (5 min.)

Ex. 179

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

1. Supplies of $200 have been used.
2. Salaries of $600 are unpaid.
3. Rent received in advance totaling $300 has been earned.
4. Services provided but not recorded total $500.
Solution 179  (7 min.)

(a) Type of Adjustment  
(b) Accounts before Adjustment

1. Prepaid Expense  
   Assets Overstated  
   Expenses Understated

2. Accrued Expense  
   Expenses Understated  
   Liabilities Understated

3. Unearned Revenue  
   Liabilities Overstated  
   Revenues Understated

4. Accrued Revenue  
   Assets Understated  
   Revenues Understated

Ex. 180

Ellis Company accumulates the following adjustment data at December 31.
1. Revenue of $900 collected in advance has been earned.
2. Salaries of $600 are unpaid.
3. Prepaid rent totaling $450 has expired.
4. Supplies of $550 have been used.
5. Revenue earned but unbilled total $750.
6. Utility expenses of $200 are unpaid.
7. Interest of $250 has accrued on a note payable.

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

(b) Assume net income before the adjustments listed above was $14,500. What is the adjusted net income?

Prepare your answer in the tabular form presented below.

<table>
<thead>
<tr>
<th>Type of Adjustment</th>
<th>Account Relationship</th>
<th>Account Balances Before Adjustment (Understatement or Overstatement)</th>
<th>Adjusting Entry</th>
</tr>
</thead>
</table>
Solution 180  (20 min.)

(a)  

<table>
<thead>
<tr>
<th>Type of Adjustment</th>
<th>Account Balance Before Adjustment (Understatement or Overstatement)</th>
<th>Adjusting Entry</th>
<th>Income Effect Increase (Decrease)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Unearned revenue.</td>
<td>L/R Liab. O Exp. U</td>
<td>Unearned Revenue</td>
<td>Service Revenue</td>
</tr>
<tr>
<td>3. Prepaid expense.</td>
<td>E/A Exp. U Asset O</td>
<td>Rent Expense</td>
<td>Prepaid Rent</td>
</tr>
<tr>
<td>4. Prepaid expense.</td>
<td>E/A Exp. U Asset O</td>
<td>Supplies Expense</td>
<td>Supplies</td>
</tr>
<tr>
<td>5. Accrued revenue.</td>
<td>A/R Asset O Exp. U</td>
<td>Accounts Receivable</td>
<td>Service Revenue</td>
</tr>
</tbody>
</table>

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

(b)  

Net income before adjustments .................................................... $14,500  
Add:  
Unearned revenue (1) ....................................................... $900  
Accrued revenue (5).......................................................... 750  
1,650  
16,150

Less:  
Accrued salaries (2) ....................................................... 600  
Prepaid rent expired (3) .................................................... 450  
Supplies used (4) ............................................................. 550  
Accrued utilities (6) ......................................................... 200  
Accrued interest (7) .......................................................... 250  
2,050  
Adjusted net income.............................................................. $14,100
Ex. 181
The adjusted trial balance of the Nance Company includes the following balance sheet accounts that frequently require adjustment. For each account, indicate (a) the type of adjusting entry (prepaid expenses, unearned revenues, accrued revenues, or accrued expenses) and (b) the related account in the adjusting entry.

<table>
<thead>
<tr>
<th>Balance Sheet Account</th>
<th>Type of Adjusting Entry</th>
<th>Related Account</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Supplies</td>
<td>Prepaid Expense</td>
<td>Supplies Expense</td>
</tr>
<tr>
<td>2. Accounts Receivable</td>
<td>Accrued Revenue</td>
<td>Service Revenue</td>
</tr>
<tr>
<td>3. Prepaid Insurance</td>
<td>Prepaid Expense</td>
<td>Insurance Expense</td>
</tr>
<tr>
<td>4. Accumulated Depreciation— Equipment</td>
<td>Prepaid Expense</td>
<td>Depreciation Expense</td>
</tr>
<tr>
<td>5. Interest Payable</td>
<td>Accrued Expense</td>
<td>Interest Expense</td>
</tr>
<tr>
<td>6. Salaries Payable</td>
<td>Accrued Expense</td>
<td>Salaries Expense</td>
</tr>
<tr>
<td>7. Unearned Revenue</td>
<td>Unearned Revenues</td>
<td>Service Revenue</td>
</tr>
</tbody>
</table>

Solution 181  (15 min.)

Ex. 182
Match the statements below with the appropriate terms by entering the appropriate letter code in the spaces provided.

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

STATEMENTS:

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

_____ 2. Office supplies on hand that will be used in the next period.
Ex. 182  (cont.)

- 3. Interest revenue collected; not yet earned.
- 4. Rent not yet collected; already earned.
- 5. An expense incurred; not yet paid or recorded.
- 6. A revenue earned; not yet collected or recorded.
- 7. An expense not yet incurred; paid in advance.
- 8. Interest expense incurred; not yet paid.

Solution 182  (5 min.)

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

Ex. 183

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

(a)  Paid $120,000 to Wichita City as advance rent for use of Wichita City Stadium for the six month period April 1 through September 30.

(b)  Collected $250,000 cash from sales of season tickets for the team’s 20 home games. This amount was credited to Unearned Ticket Revenue.

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

Instructions

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

Solution 183  (5 min.)

(a)  Rent Expense ................................................................. 20,000
    Prepaid Rent ............................................................... 20,000
    \(\frac{120,000}{6} = 20,000\)

(b)  Unearned Ticket Revenue ............................................. 50,000
    Ticket Revenue ............................................................ 50,000
    \(\frac{250,000}{20} = 12,500; 12,500 \times 4 = 50,000\)
Ex. 184
On July 1, 2008, Sheeley Company pays $8,000 to its insurance company for a 2-year insurance policy.

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

Solution 184  (5 min.)
July 1  Prepaid Insurance................................................................  8,000
        Cash.........................................................................   8,000
Dec. 31 Insurance Expense..............................................................  2,000
        Prepaid Insurance ($8,000 × 6/24)..........................   2,000

Ex. 185
On July 1, 2008, Anderson Insurance Company received $10,000 from a client for a 2-year insurance policy.

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

Solution 185  (5 min.)
July 1  Cash ....................................................................................  10,000
        Unearned Insurance Revenue....................................   10,000
Dec. 31 Unearned Insurance Revenue.............................................  2,500
        Insurance Revenue ($10,000 × 6/24) .........................   2,500

Ex. 186
Dane Coat Company purchased equipment on June 1 for $81,000, paying $18,000 cash and signing a 12%, 2-month note for the remaining balance. The equipment is expected to depreciate $18,000 each year. Dane Coat Company prepares monthly financial statements.

Instructions
(a) Prepare the general journal entry to record the acquisition of the equipment on June 1st.
(b) Prepare any adjusting journal entries that should be made on June 30th.
(c) Show how the equipment will be reflected on Dane Coat Company's balance sheet on June 30th.
Solution 186 (10 min.)

(a) June 1

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equipment</td>
<td>81,000</td>
</tr>
<tr>
<td>Cash</td>
<td>18,000</td>
</tr>
<tr>
<td>Notes Payable</td>
<td>63,000</td>
</tr>
</tbody>
</table>

(To record acquisition of equipment and signing of a 2-month, 12% note)

(b) June 30

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Depreciation Expense</td>
<td>1,500</td>
</tr>
<tr>
<td>Accumulated Depreciation—Equipment</td>
<td>1,500</td>
</tr>
</tbody>
</table>

(To record monthly depreciation)

$18,000 ÷ 12 = $1,500/month

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest Expense</td>
<td>630</td>
</tr>
<tr>
<td>Interest Payable</td>
<td>630</td>
</tr>
</tbody>
</table>

(To accrue interest on notes payable)

$63,000 × 12% × 1/12 = $630

(c) Assets

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equipment</td>
<td>$81,000</td>
</tr>
<tr>
<td>Less: Accumulated Depreciation—Equipment</td>
<td>1,500</td>
</tr>
<tr>
<td></td>
<td>$79,500</td>
</tr>
</tbody>
</table>

Ex. 187

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

WELCH COMPANY
Trial Balance (Selected Accounts)
September 30, 2008

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Office Supplies</td>
<td>$2,700</td>
</tr>
<tr>
<td>Prepaid Insurance</td>
<td>4,200</td>
</tr>
<tr>
<td>Office Equipment</td>
<td>16,200</td>
</tr>
<tr>
<td>Accumulated Depreciation—Office Equipment</td>
<td>$1,000</td>
</tr>
<tr>
<td>Unearned Rent Revenue</td>
<td>1,200</td>
</tr>
</tbody>
</table>

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

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

1. A physical count of office supplies revealed $1,000 on hand on September 30.
2. A two-year life insurance policy was purchased on June 1 for $4,800.
3. Office equipment depreciated $6,000 per year.
4. The amount of rent received in advance that remains unearned at September 30 is $500.

Instructions

Using the above additional information, prepare the adjusting entries that should be made by Welch Company on September 30.
Solution 187  (10 min.)

1. Office Supplies Expense ................................................................. 1,700
   Office Supplies ................................................................. 1,700
   (To record the amount of office supplies used)

2. Insurance Expense .......................................................................... 200
   Prepaid Insurance .................................................................. 200
   (To record insurance expired $4,800 ÷ 24)

3. Depreciation Expense ..................................................................... 500
   Accumulated Depreciation—Office Equipment ....................... 500
   (To record monthly depreciation $6,000 ÷ 12)

4. Unearned Rent Revenue ................................................................ 700
   Rent Revenue ........................................................................ 700
   (To record rent revenue earned)

Ex. 188

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

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

Case 2
Eaton Company has a calendar year-end accounting period. On July 1, the company purchased office equipment for $30,000. It is estimated that the office equipment will depreciate $500 each month. No adjusting entry has been made until year end.

Case 3
Ward Realty is in the business of renting several apartment buildings and prepares monthly financial statements. It has been determined that 3 tenants in $700 per month apartments and one tenant in the $1,000 per month apartment had not paid their August rent as of August 31st.

Solution 188  (10 min.)

Case 1—December 31
Office Supplies Expense ................................................................. 6,400
   Office Supplies ................................................................. 6,400
   (To record office supplies used during the year)

Case 2—December 31
Depreciation Expense ..................................................................... 3,000
   Accumulated Depreciation—Office Equipment ...... 3,000
   (To record depreciation expense for six months)
   $500 × 6 months = $3,000 Depreciation
Solution 188  (cont.)

Case 3—August 31

Rent Receivable ................................................................. 3,100
Rent Revenue ......................................................... 3,100
(To accrue rent earned but not yet received)

Ex. 189

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

MORAN INSURANCE AGENCY
Income Statement
For the Month Ended June 30

<table>
<thead>
<tr>
<th>Revenues</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Premium Commission Revenue</td>
<td>$35,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Expenses</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Salary expense</td>
<td>$6,000</td>
</tr>
<tr>
<td>Advertising expense</td>
<td>800</td>
</tr>
<tr>
<td>Rent expense</td>
<td>4,200</td>
</tr>
<tr>
<td>Depreciation expense</td>
<td>2,800</td>
</tr>
<tr>
<td>Total expenses</td>
<td>13,800</td>
</tr>
<tr>
<td>Net income</td>
<td>$21,200</td>
</tr>
</tbody>
</table>

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

1. A utility bill for $2,000 was received on the last day of the month for electric and gas service for the month of June.
2. A company insurance salesman sold a life insurance policy to a client for a premium of $35,000. The agency billed the client for the policy and is entitled to a commission of 20%.
3. Supplies on hand at the beginning of the month were $3,000. The agency purchased additional supplies during the month for $3,500 in cash and $2,200 of supplies were on hand at June 30.
4. The agency purchased a new car at the beginning of the month for $19,200 cash. The car will depreciate $4,800 per year.
5. Salaries owed to employees at the end of the month total $5,300. The salaries will be paid on July 5.

Instructions
Prepare a correct income statement.
Solution 189  (15 min.)

MORAN INSURANCE AGENCY
Income Statement
For the Month Ended June 30

<table>
<thead>
<tr>
<th>Revenues</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Premium Commission Revenue</td>
<td>($35,000 + $7,000)</td>
</tr>
<tr>
<td></td>
<td>$42,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Expenses</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Salary expense</td>
<td>($6,000 + $5,300)</td>
</tr>
<tr>
<td></td>
<td>$11,300</td>
</tr>
<tr>
<td>Supplies expense</td>
<td>($0 + $4,300)</td>
</tr>
<tr>
<td></td>
<td>4,300</td>
</tr>
<tr>
<td>Rent expense</td>
<td></td>
</tr>
<tr>
<td></td>
<td>4,200</td>
</tr>
<tr>
<td>Depreciation expense</td>
<td>($2,800 + $400)</td>
</tr>
<tr>
<td></td>
<td>3,200</td>
</tr>
<tr>
<td>Utilities expense</td>
<td>($0 + $2,000)</td>
</tr>
<tr>
<td></td>
<td>2,000</td>
</tr>
<tr>
<td>Advertising expense</td>
<td></td>
</tr>
<tr>
<td></td>
<td>800</td>
</tr>
<tr>
<td>Total expenses</td>
<td></td>
</tr>
<tr>
<td></td>
<td>25,800</td>
</tr>
<tr>
<td>Net income</td>
<td></td>
</tr>
<tr>
<td></td>
<td>$16,200</td>
</tr>
</tbody>
</table>

Ex. 190

One part of eight adjusting entries is given below.

Instructions
Indicate the account title for the other part of each entry.
1. Unearned Revenue is debited.
2. Prepaid Rent is credited.
3. Accounts Receivable is debited.
4. Depreciation Expense is debited.
5. Utilities Expense is debited.
6. Interest Payable is credited.
7. Service Revenue is credited (give two possible debit accounts).
8. Interest Receivable is debited.

Solution 190  (5 min.)

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

Ex. 191

For each of the following accounts, indicate (a) the type of adjusting entry (prepaid expense, accrued revenue, etc.) and (b) the related account in the adjusting entry.
1. Depreciation Expense
2. Salaries Payable
3. Service Revenue
4. Supplies
5. Unearned Revenue
Solution 191  (5 min.)

<table>
<thead>
<tr>
<th>Account</th>
<th>Type of Entry</th>
<th>Related Account</th>
</tr>
</thead>
<tbody>
<tr>
<td>Depreciation Expense</td>
<td>Prepaid expense</td>
<td>Accum. Depreciation</td>
</tr>
<tr>
<td>Salaries Payable</td>
<td>Accrued expense</td>
<td>Salaries Expense</td>
</tr>
<tr>
<td>Service Revenue</td>
<td>Accrued revenue</td>
<td>Accounts Receivable</td>
</tr>
<tr>
<td>Supplies</td>
<td>Prepaid expense</td>
<td>Supplies Expense</td>
</tr>
<tr>
<td>Unearned Revenue</td>
<td>Unearned revenue</td>
<td>Service Revenue</td>
</tr>
</tbody>
</table>

Ex. 192

Prepare the necessary adjusting entry for each of the following:
1. Services provided but unrecorded totaled $900.
2. Accrued salaries at year-end are $1,000.
3. Depreciation for the year is $600.

Solution 192  (5 min.)

1. Accounts Receivable................................................................. 900  
   Service Revenue.................................................................  900  
2. Salaries Expense ................................................................. 1,000  
   Salaries Payable ................................................................. 1,000  
3. Depreciation Expense............................................................. 600  
   Accumulated Depreciation ......................................................  600  

Ex. 193

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

- Accounts Receivable
- Prepaid Printing
- Prepaid Rent
- Unearned Admissions Revenue
- Printing Expense
- Rent Expense
- Admissions Revenue
- Concessions Revenue

Instructions
For each of the following transactions below, prepare the journal entry (if one is required) to record the initial transaction and then prepare the adjusting entry, if any, required on September 30, the end of the fiscal year.
(a) On September 1, paid rent on the track facility for three months, $180,000.
Ex. 193 (cont.)

(b) On September 1, sold season tickets for admission to the racetrack. The racing season is year-round with 25 racing days each month. Season ticket sales totaled $840,000.

(c) On September 1, borrowed $300,000 from First National Bank by issuing a 9% note payable due in three months.

(d) On September 5, schedules for 20 racing days in September, 25 racing days in October, and 15 racing days in November were printed for $2,400.

(e) The accountant for the concessions company reported that gross receipts for September were $140,000. Ten percent is due to Ottawa and will be remitted by October 10.

Solution 193 (15 min.)

(a) Journal Entry

Prepaid Rent ................................................................. 180,000
Cash ................................................................. 180,000

Adjusting Entry
Rent Expense ............................................................... 60,000
Prepaid Rent ............................................................... 60,000

(b) Journal Entry

Cash ................................................................. 840,000
Unearned Admissions Revenue ........................................ 840,000

Adjusting Entry
Unearned Admissions Revenue ........................................ 70,000
Admissions Revenue ........................................................... 70,000
($840,000 ÷ 12 = $70,000)

(c) Journal Entry

Cash ................................................................. 300,000
Note Payable ............................................................... 300,000

Adjusting Entry
Interest Expense ............................................................. 2,250
Interest Payable ............................................................ 2,250
($300,000 × .09 × 1 ÷ 12 = $2,250)

(d) Journal Entry

Prepaid Printing .............................................................. 2,400
Cash ................................................................. 2,400

Adjusting Entry
Printing Expense ............................................................ 800
Prepaid Printing .............................................................. 800
($2,400 × 20 ÷ 60 = $800)

(e) Journal Entry

None

Adjusting Entry
Accounts Receivable .................................................. 14,000
Concessions Revenue ...................................................... 14,000
Ex. 194

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

<table>
<thead>
<tr>
<th>Date</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Monday</td>
<td>$3,000</td>
</tr>
<tr>
<td>Tuesday</td>
<td>3,800</td>
</tr>
<tr>
<td>Wednesday</td>
<td>2,800</td>
</tr>
<tr>
<td>Thursday</td>
<td>3,000</td>
</tr>
<tr>
<td>Friday</td>
<td>2,400</td>
</tr>
</tbody>
</table>

Instructions
(a) Prepare any necessary adjusting journal entries that should be made at year end on June 30.
(b) Prepare the journal entry to record the payment of the weekly payroll on July 2.

Solution 194 (10 min.)
(a) June 30
Salaries Expense ........................................................... 9,600
Salaries Payable ............................................................  9,600
(To accrue salaries incurred but not yet paid)
(b) July 2
Salaries Payable ............................................................ 9,600
Salaries Expense ............................................................. 5,400
Cash ......................................................................  15,000
(To record payment of July 2 payroll)

Ex. 195

On Friday of each week, Noble Company pays its factory personnel weekly wages amounting to $40,000 for a five-day work week.

Instructions
(a) Prepare the necessary adjusting entry at year end, assuming December 31 falls on Wednesday.
(b) Prepare the journal entry for payment of the week’s wages on the payday which is Friday, January 2 of the next year.

Solution 195 (5 min.)
(a) Dec. 31
Wages Expense ............................................................... 24,000
Wages Payable ...............................................................  24,000
(b) Jan. 2
Wages Payable ............................................................... 24,000
Wages Expense ............................................................... 16,000
Cash ......................................................................  40,000
Presented below is the Trial Balance and Adjusted Trial Balance for Kimberly Company on December 31.

**KIMBERLY COMPANY**  
**Trial Balance**  
**December 31**

<table>
<thead>
<tr>
<th>Account</th>
<th>Before Adjustment</th>
<th>After Adjustment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$2,000</td>
<td>$2,000</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>2,800</td>
<td>3,700</td>
</tr>
<tr>
<td>Prepaid Rent</td>
<td>2,100</td>
<td>1,500</td>
</tr>
<tr>
<td>Supplies</td>
<td>1,200</td>
<td>700</td>
</tr>
<tr>
<td>Automobile equipment</td>
<td>18,000</td>
<td>18,000</td>
</tr>
<tr>
<td>Accumulated depreciation—</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Automobile equipment</td>
<td>$1,300</td>
<td>$1,500</td>
</tr>
<tr>
<td>Accounts Payable</td>
<td>2,700</td>
<td>3,000</td>
</tr>
<tr>
<td>Notes Payable</td>
<td>10,000</td>
<td>10,000</td>
</tr>
<tr>
<td>Interest Payable</td>
<td></td>
<td>120</td>
</tr>
<tr>
<td>Salaries Payable</td>
<td></td>
<td>800</td>
</tr>
<tr>
<td>Unearned Revenue</td>
<td></td>
<td>4,460</td>
</tr>
<tr>
<td>Kimberly, Capital</td>
<td>7,200</td>
<td>7,200</td>
</tr>
<tr>
<td>Kimberly, Drawings</td>
<td>3,200</td>
<td>3,200</td>
</tr>
<tr>
<td>Service Revenue</td>
<td>8,000</td>
<td>9,300</td>
</tr>
<tr>
<td>Salaries Expense</td>
<td>2,060</td>
<td>2,860</td>
</tr>
<tr>
<td>Utilities Expense</td>
<td>1,800</td>
<td>2,100</td>
</tr>
<tr>
<td>Rent Expense</td>
<td>500</td>
<td>1,100</td>
</tr>
<tr>
<td>Supplies Expense</td>
<td></td>
<td>500</td>
</tr>
<tr>
<td>Depreciation Expense—</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Automobile Equipment</td>
<td></td>
<td>200</td>
</tr>
<tr>
<td>Interest Expense</td>
<td></td>
<td>120</td>
</tr>
<tr>
<td>Totals</td>
<td>$33,660</td>
<td>$35,980</td>
</tr>
</tbody>
</table>

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

**Solution 196**  
(15 min.)

Accounts Receivable............................................................... 900

Service Revenue ................................................................. 900

(To record revenue earned but not yet received)

Rent Expense................................................................. 600

Prepaid Rent................................................................. 600

(To record expiration of prepaid rent)

Supplies Expense............................................................ 500

Supplies................................................................. 500

(To record supplies used)
Solution 196  (cont.)

Depreciation Expense—Automobile Equipment ........................................ 200
Accumulated Depreciation—Automobile Equipment .......................... 200
(To record depreciation expense)

Salaries Expense .................................................................................. 800
Salaries Payable ............................................................................... 800
(To record salaries owed, not yet paid)

Interest Expense .................................................................................... 120
Interest Payable .................................................................................. 120
(To record accrued interest payable)

Unearned Revenue ................................................................................ 400
Service Revenue .................................................................................. 400
(To record revenue earned)

Utilities Expense .................................................................................... 300
Accounts Payable ................................................................................ 300
(To record receipt of utility bill)

Ex. 197

Compute the net income for 2008 based on the following amounts presented on the adjusted trial balance of Pryor Company.

<table>
<thead>
<tr>
<th>Account</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accumulated Depreciation</td>
<td>$20,000</td>
</tr>
<tr>
<td>Depreciation Expense</td>
<td>10,000</td>
</tr>
<tr>
<td>Salaries Expense</td>
<td>15,000</td>
</tr>
<tr>
<td>Service Revenue</td>
<td>40,000</td>
</tr>
<tr>
<td>Unearned Revenue</td>
<td>8,000</td>
</tr>
</tbody>
</table>

Solution 197  (5 min.)

<table>
<thead>
<tr>
<th>Account</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Service Revenue</td>
<td>$40,000</td>
</tr>
<tr>
<td>Depreciation Expense</td>
<td>$10,000</td>
</tr>
<tr>
<td>Salaries Expense</td>
<td>15,000</td>
</tr>
<tr>
<td>Net Income</td>
<td>$15,000</td>
</tr>
</tbody>
</table>
Ex. 198

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

- Prepaid Rent $10,000
- Fencing 30,000
- Accumulated Depreciation—Fencing 5,500
- Unearned Ticket Revenue 400

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

Instructions
(a) Calculate the following:
   1. Monthly rent expense.
   2. The age of the fencing in months.
   3. The number of tickets sold on April 1.
(b) Prepare the adjusting entries that were made by the Boulder Petting Zoo on April 30.

Solution 198  (15 min.)

(a) 1. $5,000. The $10,000 balance on the adjusted trial balance reflects two months remaining on the prepaid lease. This indicates that the monthly lease is $5,000.
2. The fencing is 11 months old. By dividing annual depreciation ($6,000) by 12, the monthly depreciation expense is $500. The accumulated depreciation account shows $5,500 which means that depreciation has been taken for 11 months.
3. 120 tickets were originally sold. Twenty tickets were used in April at $4.00 each. The adjusted trial balance shows a balance of $400 indicating that 100 tickets are still outstanding. By adding the 20 used in April to the 100 still remaining to be used, 120 tickets must have been sold on April 1.

(b) 1. Rent Expense ................................................................. 5,000
    Prepaid Rent ............................................................... 5,000
2. Depreciation Expense ..................................................... 500
    Accumulated Depreciation—Fencing ............................ 500
3. Unearned Ticket Revenue .................................................. 80
    Ticket Revenue ............................................................ 80
    (20 × $4 = $80)
Ex. 199

The adjusted trial balance of Pool Financial Planners appears below. Using the information from the adjusted trial balance, you are to prepare for the month ending December 31:
1. an income statement.
2. an owner's equity statement.
3. a balance sheet.

### POOL FINANCIAL PLANNERS

#### Adjusted Trial Balance
December 31, 2008

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$ 5,400</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>2,200</td>
</tr>
<tr>
<td>Office Supplies</td>
<td>1,800</td>
</tr>
<tr>
<td>Office Equipment</td>
<td>15,000</td>
</tr>
<tr>
<td>Accumulated Depreciation—Office Equipment</td>
<td>$ 4,000</td>
</tr>
<tr>
<td>Accounts Payable</td>
<td>3,300</td>
</tr>
<tr>
<td>Unearned Revenue</td>
<td>6,000</td>
</tr>
<tr>
<td>Pool, Capital</td>
<td>14,400</td>
</tr>
<tr>
<td>Pool, Drawing</td>
<td>2,500</td>
</tr>
<tr>
<td>Service Revenue</td>
<td>4,200</td>
</tr>
<tr>
<td>Office Supplies Expense</td>
<td>600</td>
</tr>
<tr>
<td>Depreciation Expense</td>
<td>2,500</td>
</tr>
<tr>
<td>Rent Expense</td>
<td>1,900</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$31,900</strong></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$31,900</strong></td>
</tr>
</tbody>
</table>

### Solution 199  (20 min.)

1. **POOL FINANCIAL PLANNERS**
   **Income Statement**
   For the Month Ended December 31, 2008

<table>
<thead>
<tr>
<th>Revenues</th>
<th>$ 4,200</th>
</tr>
</thead>
<tbody>
<tr>
<td>Service Revenue</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Expenses</th>
<th>$2,500</th>
</tr>
</thead>
<tbody>
<tr>
<td>Depreciation expense</td>
<td></td>
</tr>
<tr>
<td>Rent expense</td>
<td>1,900</td>
</tr>
<tr>
<td>Office supplies expense</td>
<td>600</td>
</tr>
<tr>
<td><strong>Total expenses</strong></td>
<td>$ 5,000</td>
</tr>
</tbody>
</table>

   | Net loss       | $(800)  |

2. **POOL FINANCIAL PLANNERS**
   **Owner's Equity Statement**
   For the Month Ended December 31, 2008

<table>
<thead>
<tr>
<th>Pool, Capital, December 1</th>
<th>$14,400</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less: Net loss</td>
<td>$ 800</td>
</tr>
<tr>
<td>Drawings</td>
<td>2,500</td>
</tr>
<tr>
<td>Pool, Capital, December 31</td>
<td>$11,100</td>
</tr>
</tbody>
</table>
### Solution 199 (cont.)

3. **POOL FINANCIAL PLANNERS**  
   **Balance Sheet**  
   **December 31, 2008**

<table>
<thead>
<tr>
<th>Assets</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$  5,400</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>2,200</td>
</tr>
<tr>
<td>Office supplies</td>
<td>1,800</td>
</tr>
<tr>
<td>Office equipment</td>
<td>$15,000</td>
</tr>
<tr>
<td>Less: Accumulated depreciation—office equipment</td>
<td>4,000</td>
</tr>
<tr>
<td>Total assets</td>
<td>$20,400</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Liabilities and Owner's Equity</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Liabilities</td>
<td></td>
</tr>
<tr>
<td>Accounts payable</td>
<td>$3,300</td>
</tr>
<tr>
<td>Unearned revenue</td>
<td>6,000</td>
</tr>
<tr>
<td>Total liabilities</td>
<td>$  9,300</td>
</tr>
<tr>
<td>Owner's Equity</td>
<td></td>
</tr>
<tr>
<td>Pool, Capital</td>
<td>11,100</td>
</tr>
<tr>
<td>Total liabilities and owner's equity</td>
<td>$20,400</td>
</tr>
</tbody>
</table>

---

### Ex. 200

1. Flynn Company prepares monthly financial statements. On July 1, the Office Supplies account had a balance of $3,000. During July, additional office supplies were purchased for $3,800 and that amount was debited to Office Supplies Expense. On July 31, a physical count of office supplies revealed that there was $2,400 on hand. Prepare the adjusting journal entry that Flynn Company should make on July 31.

2. Reese Rental Agency prepares monthly financial statements. On September 1, a check for $7,200 was received from a tenant for six months’ rent. The full amount was credited to Rent Revenue. Prepare the adjusting entry the company should make on September 30.

---

### Solution 200 (5 min.)

1. **July 31**  
   Office Supplies Expense .................................................  600  
   Office Supplies ..........................................................  600  
   (To record supplies used)

2. **Sept. 30**  
   Rent Revenue ..............................................................  6,000  
   Unearned Rent .............................................................  6,000  
   (To record unearned rent)
COMPLETION STATEMENTS

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

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

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

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

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

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

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

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

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

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

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

Answers to Completion Statements

201. time period 207. expenses, assets 202. fiscal 208. cost, valuation 203. revenue recognition 209. estimate 204. performed 210. incurred, paid 205. expenses, revenues 211. equality, adjusting 206. prepaid expenses, unearned revenue
MATCHING

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

A. Time period assumption
B. Fiscal year
C. Revenue recognition principle
D. Prepaid expenses
E. Matching principle

F. Accrued revenues
G. Depreciation
H. Accumulated depreciation
I. Accrued expenses
J. Book value

___ 1. A twelve month accounting period
___ 2. Expenses paid before they are incurred
___ 3. Cost less accumulated depreciation
___ 4. Divides the economic life of a business into artificial time periods
___ 5. Efforts are related to accomplishments
___ 6. A contra asset account
___ 7. Recognition of revenue when it is recorded when earned
___ 8. Revenues earned but not yet received
___ 9. Expenses incurred but not yet paid
___ 10. A cost allocation process

Answers to Matching

1. B  6. H
2. D  7. C
3. J  8. F
5. E  10. G
SHORT-ANSWER ESSAY QUESTIONS

S-A E 213
The income statement is an important financial statement used by individuals who are interested in the operations of a business enterprise. Explain how the time period assumption and the revenue recognition and matching principles provide guidance to accountants in preparing an income statement.

Solution 213
The time period assumption divides the economic life of an accounting entity, such as a business enterprise, into arbitrary time periods. The revenue recognition and matching principles are the basic rules for allocating revenues and expenses to these arbitrary time periods under accrual-basis accounting. The revenue recognition principle dictates the time period to which revenue is to be allocated and recognized; that is, on which income statement the revenue is to be reported. The matching principle dictates the time period to which costs are allocated and recognized as expenses; that is, on which income statement the expenses are to be reported and matched against revenues in the determination of net income.

S-A E 214
In developing an accounting information system, it is important to establish procedures whereby all transactions that affect the components of the accounting equation are recorded. Why then, is it often necessary to adjust the accounts before financial statements are prepared even in a properly designed accounting system? Identify the major types of adjustments that are frequently made and give a specific example of each.

Solution 214
Account balances must be adjusted before financial statements are prepared, even in a properly designed accounting system, because (1) some of the recorded transactions have been recognized prematurely and (2) some effects on components of the accounting equation have not been recorded. Prepayments and deferrals are types of adjustments of recorded transactions that must be allocated to future periods as well as the current period. Examples of deferral-type adjustments are: prepaid rent, prepaid insurance, and unearned revenue. Accruals are adjustments of unrecorded transactions that must be recognized in the current period. Examples of accrual-type adjustments are: salaries and wages payable, interest payable, and interest receivable.

S-A E 215
You are visiting with a friend, Mark Adams, who wants to start a new business. During discussions on forming the business, Mark makes this statement:

Our business will have accounts receivable and accounts payable. It will also acquire a substantial amount of computers and equipment. Will it be acceptable to use the cash basis of accounting?

Prepare a response for Mark.
Solution 215

Considering the proper basis of accounting to use is an important decision that should be addressed before the business is started. Thus, this is an excellent time to look at the differences between the cash and accrual basis of accounting.

When the cash basis is used, revenue is recorded when cash is received and expenses are recorded when cash is paid. This is not an objective approach in determining net income because the receipt and payment of cash does not reflect the efforts and accomplishments of the business. Also, accounts receivable, accounts payable and depreciation are not recognized in the accounting records.

The use of the accrual basis of accounting overcomes these problems. Revenue is recorded when it is earned and expenses are recorded when they are incurred. This represents an objective way of matching efforts and accomplishments of the accounting period. In addition, accounts receivable and accounts payable are recorded and their balances are shown on the balance sheet. The business has access to these balances during the accounting period and can make important decisions about them.

Since the business has computers, it is important to record a portion of their costs each accounting period. This process is called depreciation. Instead of showing the cost as an expense when the computers are purchased (cash basis), the cost is allocated to the accounting periods in which the computers are used (accrual basis). This makes net income more meaningful because it reflects a matching of the expense to the period in which revenues were earned. The cost of the computers, less the accumulation of depreciation that has been taken, is shown as an asset on the balance sheet. Thus, the user can see that these assets are available for future use.

Also, generally accepted accounting principles require the use of the accrual basis of accounting. It will be better to use the accrual basis of accounting.

S-A E 216

The long-term liability section of A Company’s Balance Sheet includes the following accounts:

<table>
<thead>
<tr>
<th>Account</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Notes Payable</td>
<td>$100,000</td>
</tr>
<tr>
<td>Mortgage Payable</td>
<td>250,000</td>
</tr>
<tr>
<td>Salaries Payable</td>
<td>75,000</td>
</tr>
<tr>
<td>Accumulated Depreciation</td>
<td>125,000</td>
</tr>
<tr>
<td>Total Long-Term Liabilities</td>
<td>$550,000</td>
</tr>
</tbody>
</table>

A Company is an established company and does not experience any financial difficulties or have any cash flow problems. Discuss at least two items that are questionable as long-term liabilities.

Solution 216

Salaries Payable should not be reported as a long-term liability. This represents the amounts owed to employees. If the company does not have any financial difficulties or cash flow problems, the salaries should be paid within one year.

Accumulated Depreciation is a contra asset account. The balance is subtracted from the cost of the related asset in the Property, Plant, and Equipment section of the balance sheet.
Solution 216  (cont.)

Are all of the notes payable actually long-term (due after one year)? If not, the portion due within one year should be reported as a current liability instead.

S-A E 217  (Ethics)

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

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

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

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

Solution 217

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

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

Of the choices, #1 is unethical because it will cause the financial statements to be misleading. #3 and #4 are rather drastic measures that do not seem to be indicated, at least not yet. #2, therefore, is the best choice.
A new sales representative, Joel Goode, has just received his copy of the month-end financial reports. He is puzzled by the term "unearned revenue." He left the following e-mail message for you on the company's bulletin board system:

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

Reply to j.goode@sbd

Required:
Write a response to send to Joel.

Solution 218
Since the answer is being prepared for a "bulletin board" type system, it can be in informal language and can respond in kind to the humor. However, proper grammar and spelling are essential, as is the message about what unearned revenue really is. A proposed message follows:

Joel—What a pleasant surprise to hear from you! Maybe you can teach those other guys in your department something about living in the present! Do you know some of them still write me notes on paper??? Unbelievable, right??!

Now to your question. Your unearned revenue is the sales you made that us smart guys in accounting didn't figure you had earned, so we just took it away from you! Might as well save the company some dough for our own bonuses, right??

Seriously, Joel—unearned revenue is the result of your getting customers of the kind we like—they pay in advance! When they pay before we can even get their products made or shipped, we can't count the money they pay us as revenue. What we actually have is a liability—an obligation to make and ship products. So that's how we (smart guys) in accounting count it—as a liability. You happened to have about 25% of your sales that fit in that category. When production can catch up with orders, you'll get credit for the sales. You will receive your commissions the same month the company records the revenue as “earned.” (Take heart—it'll seem like Christmas all over again.)

Thanks again for actually using the system. Talk to me again sometime. . . Reply to mking@sbd