

Chapter 02 - Understanding the Accounting Cycle

-Chapter 02 Accounting for Accruals and Deferrals Answer Key

Short Answer Questions

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

Increase = I Decrease = D No Effect = N

1. Banks Co. performed \$5,000 of services for customers on account.

Assets	Liabilities	Equity	Revenues	Expenses	Net Income	Cash

Answer: (I) (N) (I) (I) (N) (I) (N)

Learning Objective: 02-01
 Topic Area: Accounting for accounts receivable
 AACSB: Analytical Thinking
 AICPA: BB Critical Thinking
 AICPA: FN Measurement
 Blooms: Analyze
 Level of Difficulty: 1 Easy
 Feedback: Performing services on account increases assets (accounts receivable) and increases revenue, which increases net income and equity (retained earnings). It does not affect the statement of cash flows, as it does not affect cash.

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

Assets	Liabilities	Equity	Revenues	Expenses	Net Income	Cash

Answer: (N) (N) (N) (N) (N) (N) (I)

Learning Objective: 02-01

Topic Area: Accounting for accounts receivable

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Analyze

Level of Difficulty: 1 Easy

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

3. Ingstrom Co. provided \$2,600 of services for a customer who paid \$1,000 cash immediately and promised to pay an additional \$1,600 one month later.

Assets	Liabilities	Equity	Revenues	Expenses	Net Income	Cash

Answer: (I) (N) (I) (I) (N) (I) (I)

Learning Objective: 02-01

Topic Area: Accounting for accounts receivable

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Analyze

Level of Difficulty: 2 Medium

Feedback: This event increases revenue, net income and equity (retained earnings) by \$2,600. Cash increases by \$1,000 and accounts receivable increases by \$1,600, which result in an increase in assets of \$2,600. It is reported as a \$1,000 cash inflow for operating activities on the statement of cash flows.

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4. Amity Co. signed contracts for \$25,000 of services to be performed in the future.

Assets	Liabilities	Equity	Revenues	Expenses	Net Income	Cash

Answer: (N) (N) (N) (N) (N) (N) (N)

Learning Objective: 02-01

Topic Area: Accounting for accounts receivable

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Understand

Level of Difficulty: 3 Hard

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

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

Assets	Liabilities	Equity	Revenues	Expenses	Net Income	Cash

Answer: (N) (I) (D) (N) (I) (D) (N)

Learning Objective: 02-02

Topic Area: Accounting for accrued expense

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Analyze

Level of Difficulty: 1 Easy

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

Chapter 02 - Understanding the Accounting Cycle

6. Calloway Company received \$750 from a customer for services to be performed at a future date.

Assets	Liabilities	Equity	Revenues	Expenses	Net Income	Cash

Answer: (I) (I) (N) (N) (N) (N) (I)

Learning Objective: 02-07

Topic Area: Accounting for unearned revenues

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Analyze

Level of Difficulty: 1 Easy

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

7. When is revenue recognized under accrual accounting?

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

Learning Objective: 02-01

Topic Area: Accounting for accounts receivable

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Remember

Level of Difficulty: 1 Easy

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

8. What does the balance in accounts receivable represent?

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

Learning Objective: 02-01

Topic Area: Accounting for accounts receivable

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Remember

Level of Difficulty: 1 Easy

Chapter 02 - Understanding the Accounting Cycle

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

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

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

Learning Objective: 02-02

Learning Objective: 02-05

Learning Objective: 02-06

Topic Area: Accounting for accrued expense

Topic Area: Accounting for supplies purchase

Topic Area: Accounting for prepaid items

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Understand

Level of Difficulty: 2 Medium

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

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

Answer: Assets decrease; liabilities decrease

Learning Objective: 02-02

Topic Area: Accounting for accrued expense

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Understand

Level of Difficulty: 2 Medium

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

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

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

Learning Objective: 02-02

Learning Objective: 02-04

Learning Objective: 02-06

Learning Objective: 02-07

Topic Area: Accounting for accrued expense

Topic Area: The matching concept

Topic Area: Accounting for prepaid items

Topic Area: Accounting for unearned revenue

Chapter 02 - Understanding the Accounting Cycle

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Understand

Level of Difficulty: 2 Medium

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

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

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

Learning Objective: 02-01

Topic Area: Accounting for accounts receivable

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Understand

Level of Difficulty: 1 Easy

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

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

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

Learning Objective: 02-01

Topic Area: Accounting for accounts receivable

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Understand

Level of Difficulty: 2 Medium

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

14. Describe the purpose of the closing process.

Answer: The purpose of the closing process is to bring the balance of the temporary accounts to zero at the end of an accounting period and to update the retained earnings account. By closing temporary accounts, they will be ready to capture revenue, expense, and dividend information for the next period.

Learning Objective: 02-04

Topic Area: The Closing Process

Chapter 02 - Understanding the Accounting Cycle

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Understand

Level of Difficulty: 2 Medium

Feedback: Closing entries are made after the income statement is prepared. Note that retained earnings is only affected by revenues, expenses, and dividends as the result of the closing process.

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

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

Learning Objective 02-04

Topic Area: The Closing Process

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Understand

Level of Difficulty: 2 Medium

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

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

Answer: The accounting cycle is a series of steps or procedures that occur repeatedly throughout the life of a business. The stages described to this point in the course include (1) recording transactions, (2) adjusting the accounts, (3) preparing financial statements, and (4) closing the temporary accounts.

Learning Objective 02-04

Topic Area: The accounting cycle

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Understand

Level of Difficulty: 2 Medium

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

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

Answer:

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

Learning Objective 02-04

Topic Area: The Matching Concept

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Understand

Level of Difficulty: 2 Medium

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

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

Answer: Retained Earnings

Learning Objective 02-04

Topic Area: The Closing Process

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Remember

Level of Difficulty: 1 Easy

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

19. What is the "fraud triangle"?

Answer:

Auditors have identified three elements that are commonly present in instances of criminal and ethical misconduct. These three elements are often shown in the form of a triangle. The first of these elements is the availability of opportunity without which fraud could not exist. Therefore, opportunity is at the top of the triangle. The second element is the existence of some kind of pressure leading to an incentive. The third element is the capacity to rationalize the behavior.

Learning Objective: 02-10

Topic Area: Features of Criminal and Ethical Misconduct

AACSB: Reflective Thinking

AACSB: Communication

Chapter 02 - Understanding the Accounting Cycle

AACSB: Ethics

AICPA: BB Legal

AICPA: FN Risk Analysis

Blooms: Understand

Level of Difficulty: 2 Medium

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

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

Answer:

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

Learning Objective: 02-10

Topic Area: Importance of Ethics

AACSB: Communication

AACSB: Ethics

AICPA: BB Industry

AICPA: FN Decision Making

Blooms: Understand

Level of Difficulty: 2 Medium

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

Multiple Choice Questions

21. Bledsoe Company received \$17,000 cash from the issue of stock on January 1, 2016. During 2016 Bledsoe earned \$8,500 of revenue on account. The company collected \$6,000 cash from accounts receivable and paid \$5,400 cash for operating expenses. Based on this information alone, during 2016,
- A. Total assets increased by \$20,100.
 - B. Total assets increased by \$600.
 - C. Total assets increased by \$26,100.
 - D. Total assets did not change.

Answer: A

Learning Objective: 02-01

Topic Area: Accounting for accounts receivable

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Analyze

Level of Difficulty: 3 Hard

Feedback: \$17,000 (cash) + \$8,500 (accounts receivable) + \$6,000 (cash) - \$6,000 (accounts receivable) - \$5,400 (cash) = \$20,100 increase

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

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

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

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

Answer: B

Learning Objective: 02-01

Topic Area: Accounting for accounts receivable

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Analyze

Level of Difficulty: 2 Medium

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

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

	Assets	=	Liab.	+	Equity	Rev.	-	Exp.	=	Net Inc.	Cash Flow
A.	NA	=	+	+	-	-	-	+	=	NA	NA
B.	NA	=	NA	+	+ -	NA	-	NA	=	NA	NA
C.	NA	=	+	+	-	NA	-	+	=	-	NA
D.	+	=	+	+	NA	NA	-	+	=	-	-OA

Answer: C

Learning Objective: 02-02

Topic Area: Accounting for accrued expense

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Analyze

Level of Difficulty: 2 Medium

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

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

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

Answer: D

Learning Objective: 02-06

Topic Area: Accounting for prepaid items

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Understand

Level of Difficulty: 3 Hard

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

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

	Assets	=	Liab.	+	Equity	Rev.	-	Exp.	=	Net Inc.	Cash Flow
A.	+	=	+	+	NA	+	-	NA	=	+	- OA
B.	NA	=	+	+	-	NA	-	+	=	-	- IA
C.	-	=	NA	+	-	NA	-	+	=	-	NA
D.	NA	=	+	+	-	NA	-	+	=	-	NA

Answer: D

Learning Objective: 02-02

Topic Area: Accounting for accrued expense

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Analyze

Level of Difficulty: 2 Medium

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

26. Revenue on account amounted to \$5,000. Cash collections of accounts receivable amounted to \$2,300. Expenses for the period were \$2,100. The company paid dividends of \$450. Net income for the period was

- A. \$1,200.
- B. \$2,900.
- C. \$2,850.
- D. \$2,450.

Answer: B

Learning Objective: 02-01

Topic Area: Accounting for accounts receivable

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Apply

Level of Difficulty: 2 Medium

Feedback: Revenue \$5,000 – Expenses \$2,100 = \$2,900 Net Income

Chapter 02 - Understanding the Accounting Cycle

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

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

Answer: A

Learning Objective: 02-02

Topic Area: Accounting for accrued expense

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Understand

Level of Difficulty: 2 Medium

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

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

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

Answer: D

Learning Objective: 02-04

Topic Area: The matching concept

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Remember

Level of Difficulty: 2 Medium

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

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

- A. A decrease in a liability.
- B. An increase in a liability.
- C. An increase in an asset.
- D. An increase in an asset or a decrease in a liability.

Answer: D

Learning Objective: 02-01

Learning Objective: 02-07

Topic Area: Accounting for accounts receivable

Topic Area: Accounting for unearned revenue

Chapter 02 - Understanding the Accounting Cycle

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Understand

Level of Difficulty: 2 Medium

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

30. Mize Company provided \$45,500 of services on account, and collected \$38,000 from customers during the year. The company also incurred \$37,000 of expenses on account, and paid \$32,400 against its payables. As a result of these events,

- A. total assets would increase
- B. total liabilities would increase
- C. total equity would increase
- D. all of these answer choices are correct

Answer: D

Learning Objective: 02-01

Learning Objective: 02-02

Topic Area: Accounting for accounts receivable

Topic Area: Accounting for accrued expense

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Analyze

Level of Difficulty: 3 Hard

Feedback: $\$45,500 - \$32,400 = \$13,100$ increase in assets; $\$37,000 - \$32,400 = \$4,600$ increase in liabilities; $\$45,500 - \$37,000 = \$8,500$ increase in equity

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

- A. Purchasing supplies for cash
- B. Paying for one year's rent on July 1
- C. Providing services on account
- D. Each of these answer choices would require an end-of-year adjustment

Answer: C

Learning Objective: 02-01

Learning Objective: 02-05

Learning Objective: 02-06

Topic Area: Accounting for accounts receivable

Topic Area: Accounting for supplies

Topic Area: Accounting for prepaid items

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Understand

Level of Difficulty: 3 Hard

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

Chapter 02 - Understanding the Accounting Cycle

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

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

Answer: C

Learning Objective: 02-07

Topic Area: Accounting for unearned revenue

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Analyze

Level of Difficulty: 2 Medium

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

33. Jack's Snow Removal Company received a cash advance of \$6,000 on December 1, 2016 to provide services during the months of December, January, and February. The 2016 year-end adjustment to recognize the partial expiration of the contract will

- A. increase assets by \$2,000
- B. increase equity by \$2,000
- C. increase liabilities by \$2,000
- D. increase assets by \$2,000 and increase equity by \$2,000

Answer: B

Learning Objective: 02-07

Topic Area: Accounting for unearned revenue

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Apply

Level of Difficulty: 2 Medium

Feedback: The year-end adjustment to recognize one month's work on the three-month contract results in a \$2,000 decrease in liabilities (unearned revenue) and an increase in equity (retained earnings due to recognizing revenue).

The following account balances were drawn from the 2016 financial statements of Grayson Company:

Cash	\$ 8,800	Accounts payable	\$ 2,500
Accounts receivable	\$ 3,000	Common stock	?
Land	\$ 16,000	Retained earnings, Jan. 1	\$ 5,400
		Revenue	\$ 19,000
		Expenses	\$ 14,500

Chapter 02 - Understanding the Accounting Cycle

34. Based on the above information, what is the balance of Common Stock for Grayson Company?

- A. \$15,400
- B. \$19,900
- C. \$900
- D. \$20,800

Answer: A

Learning Objective: 02-03

Topic Area: Prepare financial statements

Topic Area: Balance Sheet

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Apply

Level of Difficulty: 2 Medium

Feedback: Assets (\$8,800 + \$3,000 + \$16,000) = Liabilities (\$2,500) + Equity; Equity = \$25,300; \$25,300 = Common Stock + Retained Earnings (\$5,400 + \$19,000 - \$15,500); \$25,300 = Common Stock + \$9,900; Common Stock = \$15,400

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

Retained earnings	\$ 16,800
Service revenue	21,750
Interest revenue	1,800
Salaries expense	12,300
Operating expense	3,450
Interest expense	900
Dividends	2,700

After closing, Syracuse's retained earnings balance would be

- A. \$16,800.
- B. \$23,700.
- C. \$21,000.
- D. \$26,400.

Answer: C

Learning Objective: 02-04

Topic Area: The closing process

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Apply

Level of Difficulty: 2 Medium

Feedback: \$16,800 + \$21,750 + \$1,800 - \$12,300 - \$3,450 - \$900 - \$2,700 = \$21,000

36. Sheldon Company began 2016 with \$1,200 in its supplies account. During the year, the company purchased \$3,400 of supplies on account. The company paid \$3,000 on accounts payable by year end. On December 31, 2016, Sheldon counted \$1,400 of supplies on hand. Sheldon's financial statements for 2016 would show:

- A. \$1,600 of supplies; \$200 of supplies expense
- B. \$1,400 of supplies; \$2,000 of supplies expense
- C. \$1,400 of supplies; \$3,200 of supplies expense
- D. \$1,600 of supplies; \$3,400 of supplies expense

Answer: A

Learning Objective 02-05

Topic Area: Accounting for supplies

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Apply

Level of Difficulty: 2 Medium

Feedback: \$1,400 of supplies on hand is the supplies asset on the balance sheet; \$1,200 beginning balance + \$3,400 of supplies purchased - \$1,400 ending balance = \$3,200 supplies expense

37. Jason Company paid \$7,200 for one year's rent in advance beginning on October 1, 2015. Jason's 2015 income statement would report rent expense, and its statement of cash flows would report cash outflow for rent, respectively, of

- A. \$7,200; \$7,200
- B. \$1,800; \$1,800
- C. \$1,800; \$7,200
- D. \$1,200; \$7,200

Answer: C

Learning Objective: 02-06

Topic Area: Accounting for prepaid items

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Apply

Level of Difficulty: 2 Medium

Feedback: $\$7,200 \times 3/12 = \$1,800$ rent expense; \$7,200 payment on 10/1/15 is a cash outflow for rent

38. In uncertain circumstances, the conservatism principle guides accountants to
- A. accelerate revenue recognition and delay expense recognition.
 - B. accelerate expense recognition and delay revenue recognition.
 - C. recognize expense of prepaid items when payment is made.
 - D. delay both expense recognition and revenue recognition.

Answer: B

Learning Objective: 02-04

Topic Area: Prepare financial statements

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Decision Making

Blooms: Understand

Level of Difficulty: 2 Medium

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

39. Purchasing prepaid rent is classified as a(n):
- A. asset source transaction.
 - B. asset use transaction.
 - C. asset exchange transaction
 - D. claims exchange transaction.

Answer: C

Learning Objective: 02-06

Learning Objective: 02-09

Topic Area: Accounting for prepaid items

Topic Area: Transaction classification

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Understand

Level of Difficulty: 1 Easy

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

40. Revenue on account amounted to \$9,000. Cash collections of accounts receivable amounted to \$8,100. Cash paid for expenses was \$7,500. The amount of employee salaries accrued at the end of the year was \$900. Cash flow from operating activities was
- A. \$900.
 - B. \$600.
 - C. \$1,500.
 - D. \$8,700.

Answer: B

Learning Objective: 02-01

Learning Objective: 02-02

Topic Area: Accounting for accounts receivable

Topic Area: Accounting for accrued expense

Chapter 02 - Understanding the Accounting Cycle

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Apply

Level of Difficulty: 2 Medium

Feedback: \$8,100 collected from customers - \$7,500 paid for expenses = \$600. Revenue earned on account and accrued salaries are not cash flow activities.

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

A. Service Revenue.

B. Salaries Payable.

C. Unearned Revenue.

D. Neither Service Revenue nor Unearned Revenue would appear on a balance sheet.

Answer: A

Learning Objective: 02-03

Topic Area: Prepare financial statements

Topic Area: Balance Sheet

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Understand

Level of Difficulty: 2 Medium

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

42. Warren Enterprises had the following events during 2016:

The business issued \$40,000 of common stock to its stockholders.

The business purchased land for \$24,000 cash.

Services were provided to customers for \$32,000 cash.

Services were provided to customers for \$10,000 on account.

The company borrowed \$32,000 from the bank.

Operating expenses of \$24,000 were incurred and paid in cash.

Salary expense of \$1,600 was accrued.

A dividend of \$8,000 was paid to the stockholders of Warren Enterprises.

Assuming the company began operations during 2016, the amount of retained earnings as of December 31, 2016 would be:

A. \$10,000

B. \$8,400

C. \$16,400

D. \$42,000

Answer: B

Learning Objective: 02-01

Learning Objective: 02-02

Learning Objective: 02-03

Topic Area: Accounting for accounts receivable

Topic Area: Accounting for accrued expense

Topic Area: Prepare financial statements

Chapter 02 - Understanding the Accounting Cycle

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Apply

Level of Difficulty: 2 Medium

Feedback: $\$0$ beginning balance + $\$42,000$ revenue - $\$25,600$ expenses - $\$8,000$ dividends = $\$8,400$ ending balance

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

- A. Purchased land for cash.
- B. Purchased supplies for cash.
- C. Paid advertising expense.
- D. Paid dividends to stockholders.

Answer: B

Learning Objective: 02-05

Topic Area: Accounting for Supplies

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Analyze

Level of Difficulty: 2 Medium

Feedback: Purchasing supplies for cash is a cash outflow for operating activities, but will not be reported as an expense until the supplies are used. Purchasing land is a cash flow for investing activities and does not affect net income. Paying utilities expense causes equal decreases in net income and cash flows from operating activities.

44. Rushmore Company provided services for $\$45,000$ cash during the 2016 accounting period. Rushmore incurred $\$36,000$ expenses on account during 2016, and by the end of the year, $\$9,000$ of that amount had been paid with cash. Assuming that these are the only accounting events that affected Rushmore during 2016,

- A. The amount of net loss shown on the income statement is $\$9,000$.
- B. The amount of net income shown on the income statement is $\$27,000$.
- C. The amount of net income shown on the income statement is $\$9,000$.
- D. The amount of net cash flow from operating activities shown on the statement of cash flows is $\$18,000$.

Answer: C

Learning Objective: 02-02

Learning Objective: 02-03

Topic Area: Accounting for accrued expense

Topic Area: Prepare financial statements

Topic Area: Income statement

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Apply

Level of Difficulty: 2 Medium

Feedback: $\$45,000$ revenue - $\$36,000$ expenses = $\$9,000$ net income

Chapter 02 - Understanding the Accounting Cycle

Use the following information for questions 45-47:

The following accounts and balances were drawn from the records of Carolina Company on December 31, 2016:

Cash	\$ 4,000	Accounts receivable	\$ 3,400
Dividends	2,000	Common stock	3,900
Land	3,200	Revenue	3,200
Accounts payable	1,800	Expense	2,200

45. Total assets on Carolina's December 31, 2016 balance sheet would amount to:

- A. \$12,600.
- B. \$13,800.
- C. \$7,200.
- D. \$10,600.

Answer: D

Learning Objective: 02-03

Topic Area: Prepare financial statements

Topic Area: Balance Sheet

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Apply

Level of Difficulty: 1 Easy

Feedback: \$4,000 cash + \$3,200 land + \$3,400 accounts receivable = \$10,600 total assets

46. The amount of net income shown on Carolina's 2016 income statement would amount to:

- A. \$2,200.
- B. \$3,200.
- C. \$1,000.
- D. \$200.

Answer: C

Learning Objective: 02-03

Topic Area: Prepare financial statements

Topic Area: Income Statement

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Apply

Level of Difficulty: 1 Easy

Feedback: \$3,200 revenue - \$2,200 expenses = \$1,000

Chapter 02 - Understanding the Accounting Cycle

47. The amount of Carolina's retained earnings after closing on December 31, 2016 was:

- A. \$5,900.
- B. \$7,200.
- C. \$3,900.
- D. \$4,900.

Answer: D

Learning Objective: 02-03

Topic Area: Prepare financial statements

Topic Area: Statement of changes in stockholders' equity

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Apply

Level of Difficulty: 2 Medium

Feedback: Assets (\$4,000 + \$3,400 + \$3,200) = Liabilities (\$1,800) + Common Stock (\$3,900) + Retained Earnings

Retained Earnings = \$10,600 - \$5,700 = \$4,900

Use the following information for questions 48-51:

Nelson Company experienced the following transactions during 2016, its first year in operation.

1. Issued \$12,000 of common stock to stockholders.
2. Provided \$4,600 of services on account.
3. Paid \$3,200 cash for operating expenses.
4. Collected \$3,800 of cash from accounts receivable.
5. Paid a \$200 cash dividend to stockholders.

48. The amount of net income recognized on Nelson Company's 2016 income statement is:

- A. \$1,400.
- B. \$800.
- C. \$1,000.
- D. \$1,200.

Answer: A

Learning Objective: 02-03

Topic Area: Prepare financial statements

Topic Area: Income Statement

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Apply

Level of Difficulty: 2 Medium

Feedback: \$4,600 revenue - \$3,200 expenses = \$1,400 net income

Chapter 02 - Understanding the Accounting Cycle

49. The amount of net cash flow from operating activities shown on Nelson Company's 2016 statement of cash flows is

- A. \$400.
- B. \$600.
- C. \$1,400.
- D. \$1,200.

Answer: B

Learning Objective: 02-03

Topic Area: Prepare financial statements

Topic Area: Statement of Cash Flows

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Apply

Level of Difficulty: 2 Medium

Feedback: \$3,800 cash collected from revenue - \$3,200 cash paid for expenses = \$600 cash flow from operating activities

50. The total amount of assets shown on Nelson Company's December 31, 2016 balance sheet is:

- A. \$12,400.
- B. \$12,600.
- C. \$13,400.
- D. \$13,200.

Answer: D

Learning Objective: 02-03

Topic Area: Prepare financial statements

Topic Area: Balance Sheet

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Apply

Level of Difficulty: 2 Medium

Feedback: Cash (\$12,000 + \$3,800 - \$3,200 - \$200) + Accounts Receivable (\$4,600 - \$3,800) = \$13,200 Total Assets

51. The amount of retained earnings appearing on Nelson Company's December 31, 2016 balance sheet is:

- A. \$1,200.
- B. \$1,000.
- C. \$1,400.
- D. \$13,200.

Answer: A

Learning Objective: 02-03

Topic Area: Prepare financial statements

Topic Area: Balance sheet

Topic Area: Statement of changes in stockholders' equity

Chapter 02 - Understanding the Accounting Cycle

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Apply

Level of Difficulty: 2 Medium

Feedback: $\$13,200 \text{ Assets} - \$12,000 \text{ Common Stock} = \$1,200 \text{ Retained Earnings}$ or $\$1,400 \text{ Net income} - \$200 \text{ Dividends} = \$1,200 \text{ Retained Earnings}$

52. On December 31, 2016, Gaskins Co. owed \$4,500 in salaries to employees who had worked during December but would be paid in January. If the year-end adjustment is properly recorded on December 31, 2016, what will be the effect of this accrual on the following items for Gaskins?

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

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

Answer: B

Learning Objective: 02-02

Topic Area: Accounting for accrued expense

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Analyze

Level of Difficulty: 2 Medium

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

53. Duluth Co. collected a \$6,000 cash advance from a customer on November 1, 2016 for work to be performed over a six-month period beginning on that date. If the year-end adjustment is properly recorded, what will be the effect of the adjusting entry on Duluth's 2016 financial statements?

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

Answer: C

Learning Objective: 02-07

Topic Area: Accounting for unearned revenue

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Chapter 02 - Understanding the Accounting Cycle

AICPA: FN Measurement

Blooms: Analyze

Level of Difficulty: 2 Medium

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

54. Gomez Company collected \$9,000 on September 1, 2016 from a customer for services to be provided over a one-year period beginning on that date. How much revenue would Gomez Company report related to this contract on its income statement for the year ended December 31, 2016? How much would it report as cash flows from operating activities for 2016?

- A. \$3,000; \$3,000
- B. \$9,000; \$9,000
- C. \$3,000; \$9,000
- D. \$0; \$9,000

Answer: C

Learning Objective: 02-07

Topic Area: Accounting for unearned revenue

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Analyze

Level of Difficulty: 2 Medium

Feedback: Gomez will recognize revenue earned for the 4 months between September 1 and December 31 ($\$9,000 \times 4/12 = \$3,000$). However, the company will recognize the entire \$9,000 received as a cash inflow for operating activities in 2016.

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

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

Answer: A

Learning Objective: 02-04

Topic Area: The Matching Concept

AACSB: A Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Remember

Level of Difficulty: 1 Easy

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

Chapter 02 - Understanding the Accounting Cycle

56. The matching concept most significantly influences which financial statement?

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

Answer: B

Learning Objective: 02-04

Topic Area: The Matching Concept

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Understand

Level of Difficulty: 2 Medium

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

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

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

Answer: C

Learning Objective: 02-04

Topic Area: The Matching Concept

AACSB Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Remember

Level of Difficulty: 1 Easy

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

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

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

Answer: A

Learning Objective: 02-03

Topic Area: Prepare financial statements

Chapter 02 - Understanding the Accounting Cycle

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Analyze

Level of Difficulty: 2 Medium

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

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

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

Answer: C

Learning Objective: 02-04

Topic Area: The Accounting Cycle

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Remember

Level of Difficulty: 2 Medium

Feedback: In the accounting cycle, a company records transactions throughout the accounting period, then adjusted accounts at the end of the period. Next, the company prepares financial statements, and finally, it closes temporary accounts in order to begin the next accounting period. If accounts were closed prior to preparing statements, the income statement accounts would have zero balances on the income statement.

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

- A. Report revenue when received.
- B. Match assets and liabilities in the proper period.
- C. Report expenses when cash disbursements are made.
- D. Match revenues and expenses in the proper period.

Answer: D

Learning Objective: 02-04

Topic Area: The Matching Concept

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Understand

Level of Difficulty: 2 Medium

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

Chapter 02 - Understanding the Accounting Cycle

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

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

Answer: A

Learning Objective: 02-04

Topic Area: The Closing Process

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Remember

Level of Difficulty: 1 Easy

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

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

- A. Revenues
- B. Retained earnings
- C. Dividends
- D. Expenses

Answer: B

Learning Objective: 02-04

Topic Area: The Closing Process

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Remember

Level of Difficulty: 2 Medium

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

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

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

Answer: A

Learning Objective: 02-04

Topic Area: The Closing Process

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Remember

Level of Difficulty: 2 Medium

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

Chapter 02 - Understanding the Accounting Cycle

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

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

Answer: C

Learning Objective: 02-04

Topic Area: Prepare financial statements

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Remember

Level of Difficulty: 2 Medium

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

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

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

Answer: A

Learning Objective: 02-10

Topic Area: Features of criminal and ethical misconduct

AACSB: Ethics

AICPA: BB Critical Thinking

AICPA: FN Decision Making

AICPA: FN Risk Analysis

Blooms: Remember

Level of Difficulty: 2 Medium

Feedback: The fraud triangle includes opportunity, rationalization, and pressure.

66. Which of the following is **not** a principle of the AICPA Code of Professional Conduct?

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

Answer: D

Learning Objective: 02-10

Topic Area: Importance of Ethics

AACSB: Ethics

AICPA: BB Critical Thinking

AICPA: FN Decision Making

Blooms: Remember

Level of Difficulty: 2 Medium

Feedback: Conservatism is not a principle of the AICPA Code of Professional Conduct. Conservatism is an accounting principle.

Chapter 02 - Understanding the Accounting Cycle

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

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

Answer: C

Learning Objective: 02-10

Topic Area: Features of criminal and ethical misconduct

AACSB: Ethics

AICPA: BB Critical Thinking

AICPA: FN Decision Making

AICPA: FN Risk Analysis

Blooms: Understand

Level of Difficulty: 1 Easy

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

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

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

Answer: A

Learning Objective: 02-10

Topic Area: Corporate Governance

AACSB: Ethics

AICPA: BB Critical Thinking

AICPA: FN Risk Analysis

Blooms: Remember

Level of Difficulty: 1 Easy

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

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

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

Answer: B

Learning Objective: 02-10

Topic Area: Corporate Governance

AACSB: Reflective Thinking

AICPA: BB Legal

AICPA: FN Risk Analysis

Blooms: Remember

Level of Difficulty: 1 Easy

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

Chapter 02 - Understanding the Accounting Cycle

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

	Assets	=	Liab.	+	Equity	Rev.	-	Exp.	=	Net Inc.	Cash Flow
A.	NA	=	NA	+	NA	NA	-	NA	=	NA	+ OA
B.	+	=	+	+	NA	NA	-	NA	=	NA	+ OA
C.	NA	=	+	+	-	NA	-	+	=	-	NA
D.	All of these could represent the effects of a claims exchange transaction.										

Answer: C

Learning Objective: 02-09

Topic Area: Transaction classification

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Analyze

Level of Difficulty: 2 Medium

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

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

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

Answer: A

Learning Objective: 02-09

Topic Area: Transaction classification

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Understand

Level of Difficulty: 2 Medium

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

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

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

Answer: B

Learning Objective: 02-09

Chapter 02 - Understanding the Accounting Cycle

Topic Area: Transaction classification

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Understand

Level of Difficulty: 2 Medium

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

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

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

Answer: A

Learning Objective: 02-09

Topic Area: Transaction classification

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Understand

Level of Difficulty: 2 Medium

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

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

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

Answer: C

Learning Objective: 02-09

Topic Area: Transaction classification

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Understand

Level of Difficulty: 2 Medium

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

Chapter 02 - Understanding the Accounting Cycle

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

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

Answer: C

Learning Objective: 02-09

Topic Area: Transaction classification

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Understand

Level of Difficulty: 2 Medium

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

Chapter 02 - Understanding the Accounting Cycle

Essay Questions

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

- _____ a) The recognition of accounting events and the realization of cash consequences must occur in different accounting periods.
- _____ b) The cash consequence of a transaction sometimes precedes its accounting recognition.
- _____ c) Expenses may either be matched to revenues they produce or to periods in which they are incurred.
- _____ d) Vanguard may record accrual transactions, but may not record deferral transactions.
- _____ e) Vanguard is not permitted to make cash sales.

Answer:

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

Learning Objective: 02-04

Topic Area: The Matching Concept

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Understand

Level of Difficulty: 2 Medium

Feedback:

a) This is false. Recognizing accounting events (reporting them on the financial statements) and realizing cash consequences may, but not must, occur in different accounting periods.

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

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

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

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

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

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

Answer:

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

Learning Objective: 02-01

Learning Objective: 02-09

Topic Area: Accounting for accounts receivable

Topic Area: Transaction classification

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Analyze

Level of Difficulty: 2 Medium

Feedback:

- a) This is true. Assets (accounts receivable) and equity (revenue increases retained earnings) both increase.
- b) This is true. Because cash is not affected, cash flows are not affected.
- c) This is false. The event resulted in an increase in revenue and an increase in accounts receivable.
- d) This is false. Kenyon would recognize revenue when the services are performed, not when cash is received.
- e) This is false. Because assets (accounts receivable) increase, it is an asset source transaction.

78. Dixon Company collected cash in 2015 from a customer for services to be performed beginning January 2016. Indicate whether each of the following statements about this transaction is true or false.

- a) Dixon's 2016 income statement would not be affected by this transaction.
- b) Dixon's 2015 statement of cash flows would be affected by this transaction.
- c) This transaction is an asset exchange transaction.
- d) The revenue for the services provided will be recorded in 2016.
- e) The transaction increases Dixon's liabilities.

Answer:

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

Learning Objective: 02-07

Learning Objective: 02-09

Topic Area: Accounting for unearned revenue

Topic Area: Transaction classification

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Analyze

Level of Difficulty: 2 Medium

Feedback:

Chapter 02 - Understanding the Accounting Cycle

- a) This is false. Because work will not begin until 2016, the revenue is recognized in 2016.
- b) This is true. Only the 2015 statement of cash flows is affected because no cash is received in 2016.
- c) This is false. Collecting a cash advance is an asset source transaction that increases assets (cash) and increases liabilities (unearned revenue).
- d) This is true. Revenue will be recognized only when services are performed, beginning in 2016.
- e) This is true. The transaction increases unearned revenue, a liability.

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

- _____ a) Recording an increase in a revenue account may be associated with a decrease in assets.
- _____ b) Recording an increase in a revenue account may be associated with a decrease in liabilities.
- _____ c) An increase in Salaries Expense may be accompanied by a decrease in Salaries Payable.
- _____ d) Recording a decrease in assets may be associated with an increase in an expense account.
- _____ e) A decrease in Supplies will be accompanied by an increase in Supplies Expense.

Answer:

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

Learning Objective: 02-01

Learning Objective: 02-02

Learning Objective: 02-05

Learning Objective: 02-06

Learning Objective: 02-07

Topic Area: Accounting for receivables

Topic Area: Accounting for accrued expense

Topic Area: Accounting for supplies

Topic Area: Accounting for prepaid items

Topic Area: Accounting for unearned revenue

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Analyze

Level of Difficulty: 3 Hard

Feedback:

- a) This is false. An increase in a revenue account is usually associated with an increase in assets, such as cash or accounts receivable.
- b) This is true. Recording an increase in revenue may be associated with a decrease in liabilities, as in the case of earning revenue from a prepaid contract (unearned revenue).
- c) This is false. An increase in salaries expense could be accompanied by an increase in salaries payable, as in the case of accruing salaries expense, but not a decrease.
- d) This is true. Recording a decrease in assets (such as prepaid rent or insurance, or supplies) may be associated with an increase in expenses.
- e) This is true. Supplies expense is increased when supplies are used, or decreased.

80. Wyatt Company paid \$57,000 in January 2016 for salaries that had been earned by employees in December 2015. Indicate whether each of the following statements about financial statement effects of the January 2016 event is true or false.

- _____ a) The income statement for 2016 is not affected because the salaries expense had been recognized at the end of December in 2015.
- _____ b) On the 2016 statement of cash flows, cash flows from operating activities decreased.
- _____ c) Payment of the salaries in 2016 increased a liability.
- _____ d) The 2016 statement of changes in stockholders' equity would not be affected because the salaries expense had been recognized at the end of December in 2015.
- _____ e) Both assets and equity decreased in 2016 as a result of this transaction.

Answer:

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

Learning Objective: 02-02

Topic Area: Accounting for accrued expense

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Analyze

Level of Difficulty: 3 Hard

Feedback:

- a) This is true. The expense is recognized in the period in which the salaries were earned, in 2015.
- b) This is true. The January, 2016 payment decreases cash flows from operating activities in 2016.
- c) This is false. When the payment is made, salaries payable, a liability, is decreased, not increased.
- d) This is true. Because the expense was recognized in 2015, the 2016 statement of changes in stockholders' equity is unaffected.
- e) This is false. The January, 2016 payment decreases assets (cash) and liabilities (salaries payable), but not equity.

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

- _____ a) The closing process transfers certain account balances to retained earnings at the end of the accounting cycle.
- _____ b) Only accounts that appear on the income statement are closed at the end of each accounting cycle.
- _____ c) Another name for temporary accounts is "nominal accounts."
- _____ d) The permanent accounts contain information that is cumulative in nature.
- _____ e) The retained earnings balance at the end of any given year is equal to that year's net income.

Answer:

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

Learning Objective: 02-04

Topic Area: The Accounting Cycle

Chapter 02 - Understanding the Accounting Cycle

Topic Area: The Closing Process

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Understand

Level of Difficulty: 2 Medium

Feedback:

- a) This is true. The closing process transfers the balances in revenue, expense, and dividend accounts to retained earnings at the end of the period.
- b) This is false. Dividends are closed, but do not appear on the income statement.
- c) This is true. Temporary accounts are also called nominal accounts.
- d) This is true. All balance sheet, or permanent, accounts contain cumulative information.
- e) This is false. Because the retained earnings account accumulates earnings from year to year, its balance is not equal to net income in any particular year.

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

- _____ a) Recording the usage of supplies involves an increase in liabilities and a decrease in equity.
- _____ b) The accrual of salaries is considered a claims exchange transaction.
- _____ c) Recording services performed on a prepaid contract involves a decrease in liabilities and an increase in assets.
- _____ d) End-of-period adjustments often affect cash flows.
- _____ e) Failure to record accrued salaries at the end of the year will cause reported net income to be higher than it should have been.

Answer:

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

Learning Objective: 02-02

Learning Objective: 02-05

Learning Objective: 02-07

Topic Area: Accounting for accrued expense

Topic Area: Accounting for supplies

Topic Area: Accounting for unearned revenue

AACSB: Reflective Thinking

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Analyze

Blooms: Understand

Level of Difficulty: 2 Medium

Feedback:

- a) This is false. Recording usage of supplies decreases assets (supplies) and increases expense, which decreases equity.
- b) This is true. Accruing salaries increases a liability (salaries payable) and decreases equity (salaries expense decreases retained earnings).
- c) This is false. Recording service performed on a prepaid contract involves a decrease in liabilities (unearned revenue) and an increase in revenue, which increases equity. Assets are not affected.
- d) This is false. End of period adjustments never affect the cash account, therefore never affect cash flows.
- e) This is true. Failure to record accrued salaries would understate salaries expense, causing reported income to be higher than it should have been.

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

- _____ a) Asset exchange transactions involve an increase in one asset and a decrease in another asset.
- _____ b) An asset source transaction involves an increase in assets and an increase in a corresponding claims account.
- _____ c) An asset use transaction cannot result in an increase in equity.
- _____ d) Asset exchange transactions cannot affect cash flows.
- _____ e) Some claims exchange transactions involve an increase in a liability account and a decrease in an equity account.

Answer:

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

Learning Objective: 02-09

Topic Area: Transaction classification

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Remember

Level of Difficulty: 2 Medium

Feedback:

- a) This is true. An asset exchange transaction involves an increase in one asset and a decrease in another.
- b) This is true. An asset source transaction involves an increase in assets and an increase in liabilities or equity.
- c) This is true. An asset use transaction involves a decrease in assets and either a decrease in liabilities or equity. Therefore, it cannot result in an increase in equity.
- d) This is false. Because an asset exchange transaction involves an increase in one asset and a decrease in another, it often affects cash.
- e) This is true. Some claims exchange transactions, including accruing salaries, involve an increase in a liability and a decrease in equity.

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

- _____ a) The Financial Accounting Standards Board issues a code of ethical behavior by which public accountants must abide.
- _____ b) The Sarbanes Oxley Act created the Public Company Accounting Oversight Board (PCAOB).
- _____ c) Because of the Sarbanes Oxley Act, audit firms are not permitted to provide many nonaudit services to audit clients.
- _____ d) The fraud triangle identifies opportunity, pressure, and rationalization as the three elements that are typically present when fraud is committed.
- _____ e) An executive found guilty of falsely certifying a company's financial statements faces up to a \$100,000 fine and 5 years in prison.

Chapter 02 - Understanding the Accounting Cycle

Answer:

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

Learning Objective: 02-10

Topic Area: Corporate Governance

Topic Area: Features of criminal and ethical misconduct

Topic Area: Importance of Ethics

AACSB: Reflective Thinking

AICPA: BB Legal

AICPA: FN Risk Analysis

Blooms: Remember

Level of Difficulty: 2 Medium

Feedback:

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

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

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

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

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

Chapter 02 - Understanding the Accounting Cycle

True / False Questions

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

Answer: True

Learning Objective: 02-01

Topic Area: Accounting for accounts receivable

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Remember

Level of Difficulty: 1 Easy

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

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

Answer: False

Learning Objective: 02-01

Learning Objective: 02-02

Learning Objective: 02-04

Topic Area: Accounting for accounts receivable

Topic Area: Accounting for accrued expense

Topic Area: The matching concept

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Remember

Level of Difficulty: 1 Easy

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

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

Answer: True

Learning Objective: 02-01

Learning Objective: 02-02

Learning Objective: 02-04

Topic Area: Accounting for accounts receivable

Topic Area: Accounting for accrued expense

Topic Area: The matching concept

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Remember

Level of Difficulty: 1 Easy

Feedback: Accruals involve events such as earning revenue on account and incurring expense on account, in which earnings is affected before cash is paid or received.

Chapter 02 - Understanding the Accounting Cycle

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

Answer: True

Learning Objective: 02-01

Learning Objective: 02-02

Learning Objective: 02-04

Topic Area: Accounting for accounts receivable

Topic Area: Accounting for accrued expense

Topic Area: The matching concept

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Remember

Level of Difficulty: 1 Easy

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

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

Answer: False

Learning Objective: 02-02

Topic Area: Accounting for accrued expense

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Analyze

Level of Difficulty: 2 Medium

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

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

Answer: False

Learning Objective: 02-02

Topic Area: Accounting for accrued expense

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Analyze

Level of Difficulty: 1 Easy

Feedback: An increase in an expense, such as salaries expense, may be accompanied by an increase in a liability, such as salaries payable, but it may not be accompanied by a decrease in a liability.

91. Revenues and expenses are temporary accounts.

Answer: True

Learning Objective: 02-04

Topic Area: The Closing Process

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Remember

Level of Difficulty: 1 Easy

Feedback: Revenues and expenses, along with dividends, are temporary accounts.

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

Answer: False

Learning Objective: 02-04

Topic Area: The Closing Process

Chapter 02 - Understanding the Accounting Cycle

AACSB: Reflective Thinking
AICPA: BB Critical Thinking
AICPA: FN Measurement
Blooms: Remember
Level of Difficulty: 1 Easy
Feedback: All temporary account balances are moved to retained earnings, not net income, in the closing process.

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

Answer: False
Learning Objective: 02-04
Topic Area: The Closing Process
AACSB: Reflective Thinking
AICPA: BB Critical Thinking
AICPA: FN Measurement
Blooms: Understand
Level of Difficulty: 2 Medium
Feedback: Revenues, not unearned revenues, are closed.

94. After closing, all income statement accounts have non-zero balances.

Answer: False
Learning Objective: 02-04
Topic Area: The Closing Process
AACSB: Reflective Thinking
AICPA: BB Critical Thinking
AICPA: FN Measurement
Blooms: Remember
Level of Difficulty: 1 Easy
Feedback: All income statement accounts have zero balances after closing.

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

Answer: True
Learning Objective: 02-04
Topic Area: The Accounting Cycle
AACSB: Reflective Thinking
AICPA: BB Critical Thinking
AICPA: FN Measurement
Blooms: Remember
Level of Difficulty: 1 Easy
Feedback: The accounting cycle includes recording transactions, adjusting the accounts, preparing statements, and closing the accounts.

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

Answer: False
Learning Objective: 02-04
Topic Area: The Matching Concept
AACSB: Reflective Thinking
AICPA: BB Critical Thinking
AICPA: FN Measurement
Blooms: Understand
Level of Difficulty: 1 Easy
Feedback: Accrual-basis accounting matches expenses with revenues.

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

Answer: False
Learning Objective: 02-04
Topic Area: The Matching Concept

Chapter 02 - Understanding the Accounting Cycle

AACSB: Reflective Thinking
AICPA: BB Critical Thinking
AICPA: FN Measurement
Blooms: Understand
Level of Difficulty: 2 Medium
Feedback: This is a definition of conservatism, not the matching concept.

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

Answer: True
Learning Objective: 02-04
Topic Area: The accounting cycle
AACSB: Reflective Thinking
AICPA: BB Critical Thinking
AICPA: FN Measurement
Blooms: Understand
Level of Difficulty: 2 Medium
Feedback: Adjusting entries involve either revenue or expense and a non-cash balance sheet account.

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

Answer: False
Learning Objective: 02-09
Topic Area: Transaction classification
AACSB: Reflective Thinking
AICPA: BB Critical Thinking
AICPA: FN Measurement
Blooms: Understand
Level of Difficulty: 2 Medium
Feedback: Asset use transactions can involve a decrease in another asset account, such as supplies or prepaid rent.

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

Answer: True
Learning Objective: 02-10
Topic Area: Corporate Governance
AACSB: Reflective Thinking
AICPA: BB Critical Thinking
AICPA: FN Risk Analysis
Blooms: Understand
Level of Difficulty: 1 Easy
Feedback: All of these stakeholders determine how a company is operated.

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

Answer: False
Learning Objective: 02-10
Topic Area: Importance of Ethics
AACSB: Reflective Thinking
AACSB: Ethics
AICPA: BB Critical Thinking
AICPA: BB Legal
AICPA: FN Decision Making
Blooms: Understand
Level of Difficulty: 1 Easy
Feedback: According to the AICPA, "A certified public accountant assumes an obligation of self-discipline above and beyond requirements of laws and regulations."

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

Answer: True
Learning Objective: 02-10

Chapter 02 - Understanding the Accounting Cycle

Topic Area: Importance of Ethics
AACSB: Reflective Thinking
AACSB: Ethics
AICPA: BB Critical Thinking
AICPA: FN Decision Making
Blooms: Remember
Level of Difficulty: 1 Easy
Feedback: This is Article II of the AICPA Code of Professional Conduct.

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

Answer: True
Learning Objective: 02-10
Topic Area: Importance of Ethics
AACSB: Reflective Thinking
AACSB: Ethics
AICPA: BB Critical Thinking
AICPA: BB Legal
AICPA: FN Risk Analysis
Blooms: Understand
Level of Difficulty: 1 Easy
Feedback: These audit failures led to the Sarbanes-Oxley Act of 2002.

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

Answer: False
Learning Objective: 02-10
Topic Area: Importance of Ethics
AACSB: Ethics
AICPA: BB Legal
AICPA: BB Critical Thinking
AICPA: FN Risk Analysis
Blooms: Understand
Level of Difficulty: 2 Medium
Feedback: The Sarbanes-Oxley Act restricts an audit firm's ability to provide non-audit service to its clients.

105. The internal controls of a business are designed to reduce the probability of occurrence of fraud.

Answer: True
Learning Objective: 02-10
Topic Area: Corporate Governance
AACSB: Reflective Thinking
AACSB: Ethics
AICPA: BB Critical Thinking
AICPA: FN Risk Analysis
Blooms: Understand
Level of Difficulty: 1 Easy
Feedback: Internal controls are policies and procedures that a company uses to reduce the probability of occurrence of fraud.

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

Answer: False
Learning Objective: 02-01
Learning Objective: 02-09
Topic Area: Accounting for accounts receivable
Topic Area: Transaction classification

Chapter 02 - Understanding the Accounting Cycle

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Analyze

Level of Difficulty: 1 Easy

Feedback: Providing services to customers on account is an asset source transaction that increases the asset accounts receivable.

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

Answer: True

Learning Objective: 02-07

Learning Objective: 02-09

Topic Area: Accounting for unearned revenue

Topic Area: Transaction classification

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Analyze

Level of Difficulty: 2 Medium

Feedback: Unearned revenue, a liability, decreases and service revenue increases the equity account retained earnings, making this a claims exchange transaction.

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

Answer: False

Topic Area: Accounting for unearned revenue

Learning Objective: 02-09

Topic Area: Transaction classification

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Analyze

Level of Difficulty: 2 Medium

Feedback: Recognition of revenue increases equity, which cannot be accompanied by an increase in liabilities. It could, however, be accompanied by a decrease in liabilities as in a claims exchange transaction.

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

Answer: False

Learning Objective: 02-01

Learning Objective: 02-09

Topic Area: Accounting for accounts receivable

Topic Area: Transaction classification

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Analyze

Level of Difficulty: 2 Medium

Feedback: The collection of an account receivable is an asset exchange transaction.

Essay Questions and Problems

110. Hernandez Company began business operations and experienced the following transactions during 2016:

- 1) Issued common stock for \$50,000 cash.
- 2) Provided services to customers for \$125,000 on account.
- 3) Purchased \$2,500 of supplies on account.
- 4) Paid \$30,000 cash to rent office space for a 12-month period beginning July 1.
- 5) Collected \$115,000 cash from customers.
- 6) Paid cash for \$90,000 of operating expenses.
- 7) Adjusted the accounting records to reflect that there was \$750 of supplies remaining on hand at year-end.
- 8) Recorded an end-of-year adjustment to recognize rent expense.

Required:

- a) Record the above transactions on a horizontal statements model, reflecting their effect on the different financial statements. Precede the amount with a minus sign if the transaction reduces that section of the equation. Precede a cash outflow amount with a minus sign. Enter 0 for items not affected.
- b) Prepare Hernandez Company's income statement, balance sheet and statement of cash flows for the year ended December 31, 2016.

Chapter 02 - Understanding the Accounting Cycle

Answer:

a)

	Assets				=	Liab	+	Stockholders' Equity		Rev.	-	Exp.	=	NI	CF	
	Cash	AR	Supp.	Ppd. Rent	=	AP	+	CS	+	RE			=			
1.	50,000							50,000							50,000	FA
2.		125,000								125,000	125,000			125,000		
3.			2,500			2,500										
4.	(30,000)			30,000											(30,000)	OA
5.	115,000	(115,000)													115,000	OA
6.	(90,000)							(90,000)			90,000			(90,000)	(90,000)	OA
7.			(1,750)					(1,750)			1,750			(1,750)		
8.				(15,000)				(15,000)			15,000			(15,000)		
Totals	45,000	10,000	750	15,000		2,500		50,000		18,250	125,000			106,750	18,250	45,000

b)

Hernandez Company	
Income Statement	
For the Year Ended December 31, 2016	
Service revenue	\$ 125,000
Operating expenses	(90,000)
Rent expense	(15,000)
Salaries expense	(1,750)
Net income	<u>\$ 18,250</u>

Hernandez Company		
Balance Sheet		
As of December 31, 2016		
Assets		
Cash	\$ 45,000	
Accounts receivable	10,000	
Supplies	750	
Prepaid rent	<u>15,000</u>	<u>\$ 70,750</u>
Liabilities		
Accounts payable	\$ 2,500	2,500
Stockholders' equity		
Common stock	50,000	
Retained earnings	<u>18,250</u>	<u>68,250</u>
Total liabilities and stockholders' equity		<u>\$ 70,750</u>

Chapter 02 - Understanding the Accounting Cycle

Hernandez Company		
Statement of Cash Flows		
For the Year Ended December 31, 2016		
Cash flows from operating activities		
Cash receipts from revenue	\$ 115,000	
Cash payments for rent	(30,000)	
Cash payments for operating expenses	<u>(90,000)</u>	
Net cash flow from operating activities		\$ (5,000)
Cash flows for investing activities		-
Cash flows from financing activities		
Cash receipts from issuing common stock		<u>50,000</u>
Net increase in cash		45,000
Plus: Beginning cash balance		<u>-</u>
Ending cash balance		<u>\$45,000</u>

Learning Objective: 02-01

Learning Objective: 02-05

Learning Objective: 02-06

Learning Objective: 02-08

Topic Area: Accounting for accounts receivable

Topic Area: Accounting for supplies

Topic Area: Accounting for prepaid items

Topic Area: Prepare financial statements

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Apply

Level of Difficulty: 3 Hard

Chapter 02 - Understanding the Accounting Cycle

111. The following transactions apply to Einstein Corporation.

- a) Issued common stock for \$50,000 cash.
- b) Provided services to customers for \$28,000 on account.
- c) Purchased land for \$16,000 cash.
- d) Purchased \$1,500 of supplies on account.
- e) Paid \$12,000 for operating expenses.
- f) Paid \$550 on accounts payable.
- g) Collected \$25,000 cash from customers.
- h) Accrued \$600 of salary expense at year end.
- i) Paid \$2,000 dividends to stockholders.

Required:

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

Answer:

	a)		b)	
<u>Event</u>	<u>Cash Flow</u>		<u>Transaction</u>	
a)	50,000	FA	Asset source	
b)	NA		Asset source	
c)	(16,000)	IA	Asset exchange	
d)	NA		Asset source	
e)	(12,000)	OA	Asset use	
f)	(550)	OA	Asset use	
g)	25,000	OA	Asset source	
h)	NA		Claims exchange	
i)	(2,000)	FA	Asset use	

Learning Objective: 02-01

Learning Objective: 02-02

Learning Objective: 02-05

Learning Objective: 02-09

Topic Area: Accounting for accounts receivable

Topic Area: Accounting for accrued expense

Topic Area: Accounting for Supplies

Topic Area: Transaction classification

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Apply

Level of Difficulty: 2 Medium

Chapter 02 - Understanding the Accounting Cycle

112. Record each of the following events in the horizontal statements model. After each event, record the corresponding December 31 **end-of-year adjustment** that would be necessary. Precede the amount with a minus sign if the transaction reduces that section of the equation. Precede a cash outflow amount with a minus sign. Enter 0 for items not affected.

- a) Paid \$36,000 for a 1-year lease beginning April 1.
- b) Paid \$3,000 to purchase supplies. At year end, \$1,080 of supplies remained.
- c) Received a \$48,000 cash advance for a 6-month contract beginning on Sept. 1.

Answer:

	Assets			=	Liab	+	Stockholders' Equity			Rev.	-	Exp.	=	NI		CF	
	Cash	Supp.	Ppd. Rent	=	Unearn. Rev.	+	CS	+	RE				=				
a)	(36,000)		36,000													(36,000)	OA
			(27,000)						(27,000)			27,000		(27,000)			
b)	(3,000)	3,000														(3,000)	OA
		(1,920)							(1,920)			1,920		(1,920)			
c)	48,000				48,000											48,000	OA
					(24,000)				24,000	24,000				24,000			

Learning Objective: 02-05

Learning Objective: 02-06

Learning Objective: 02-07

Topic Area: Accounting for supplies

Topic Area Accounting for prepaid items

Topic Area: Accounting for unearned revenue

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Apply

Level of Difficulty: 2 Medium

Feedback:

(a) $\$36,000 \div 12 = \$3,000/\text{month}$. April through December = 9 months.

$\$3,000 \times 9 = \$27,000$

(b) Purchase \$3,000 less ending balance \$1,080 = \$1,920 used

(c) $\$48,000 \div 6 = \$8,000/\text{month}$. September through December = 4 months.

$\$8,000 \times 4 = \$32,000$

113. The following data were taken from the accounting records of Li Company at December 31, 2016 after adjusting entries have been entered. The December 31, 2016 closing entries have not been made.

Service revenue	166,000
Retained earnings	95,000
Accounts receivable	26,500
Salaries expense	88,000
Operating expense	15,400
Accounts payable	22,800
Supplies expense	760
Prepaid rent	4,000
Common stock	90,000
Supplies	400
Dividends	2,400
Insurance expense	1,600
Rent expense	20,000
Unearned revenue	1,530

Required:

- a) List the accounts that should be closed at the end of 2016.
- b) Prepare an income statement for Li Company for 2016.
- c) What is the balance in retained earnings after closing entries have been made?

Answer:

a) The accounts that should be closed are:

- Service revenue
- Salaries expense
- Operating expense
- Supplies expense
- Insurance expense
- Rent expense
- Dividends

b)

Chapter 02 - Understanding the Accounting Cycle

Li Company		
Income Statement		
For the Year Ended December 31, 2016		
Service revenue		\$ 166,000
Salaries expense	88,000	
Operating expense	15,400	
Insurance expense	1,600	
Rent expense	20,000	
Supplies expense	<u>760</u>	<u>125,760</u>
Net Income		<u>\$ 40,240</u>

c)

Beginning retained earnings	\$ 95,000
Add: Net income	40,240
Less: Dividends	<u>(2,400)</u>
Ending retained earnings	<u>\$ 132,840</u>

Learning Objective: 02-04

Learning Objective: 02-08

Topic Area: The Closing Process

Topic Area: Prepare financial statements

Topic Area: Income statement

Topic Area: Statement of changes in stockholders' equity

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Apply

Level of Difficulty: 2 Medium

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

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

Answer :

- 1) AU 2) CE 3) AS 4) AS 5) AU 6) AE 7) AS 8) AS

Learning Objective: 02-09

Topic Area: Transaction classification

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Analyze

Level of Difficulty: 2 Medium

Feedback:

- 1) Assets (cash) decreased, Equity (retained earnings from dividends) decreased
- 2) Liabilities (salaries payable) increased, Equity (retained earnings from salaries expense) decreased
- 3) Assets (cash) increased, Equity (common stock) increased
- 4) Assets (accounts receivable), Equity (retained earnings from revenue) increased
- 5) Assets (cash) decreased, Liabilities (salaries payable) decreased
- 6) Assets (cash) increased, Assets (accounts receivable) decreased
- 7) Assets (supplies) increased, Liabilities (accounts payable) increased
- 8) Assets (cash) increased, Liabilities (unearned revenue) increased

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

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

Answer:

- 1) IA 2) NA 3) FA 4) OA 5) OA 6) NA 7) OA

Learning Objective: 02-08

Chapter 02 - Understanding the Accounting Cycle

Topic Area: Prepare financial statements

Topic Area: Statement of Cash Flows

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Analyze

Level of Difficulty: 2 Medium

Feedback:

- 1) Purchasing and selling long-lived assets is an investing activity
- 2) Adjusting entries never affect cash flows
- 3) Borrowing cash is a financing activity
- 4) Paying rent, including paying in advance, is an operating activity
- 5) Paying salaries is an operating activity
- 6) Making purchase on account does not affect cash flows
- 7) Collecting cash from customers is an operating activity

116. Maggie Stern started a consulting business, Stern Consulting, on January 1, 2016 by issuing \$9,000 of common stock. In addition, the following events occurred in 2016.

Provided services on account, \$27,500.

Paid cash for \$13,500 in operating expenses.

Collected \$11,000 of the revenue that was previously recorded on account.

Paid a cash dividend of \$5,000 to the stockholders.

Required:

a) Show the effects of the above transactions on the accounting equation. Precede the amount with a minus sign if the transaction reduces that section of the equation. Enter 0 for items not affected.

Chapter 02 - Understanding the Accounting Cycle

		<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Equity</u>
	1)					
	2)					
	3)					
	4)					
	5)					
Total						

b) Prepare an income statement and statement of cash flows for 2016. Precede a cash outflow amount with a minus sign.

Answer:

a)						
		<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Equity</u>
	1)	9,000				9,000
	2)	27,500				27,500
	3)	(13,500)				(13,500)
	4)	11,000				
		(11,000)				
	5)	(5,000)				(5,000)
Total						

b)

Stern Consulting	
Income Statement	
For the Year Ended December 31, 2016	
Service revenue	\$ 27,500
Operating expense	<u>(13,500)</u>
Net income	<u>\$ 14,000</u>

Chapter 02 - Understanding the Accounting Cycle

Stern Consulting		
Statement of Cash Flows		
For the Year Ended December 31, 2016		
Cash flows from operating activities		
Cash receipts from revenue	\$ 11,000	
Cash payments for operating expenses	<u>(13,500)</u>	
Net cash flow for operating activities		\$ (2,500)
Cash flows for investing activities		
		-
Cash flows from financing activities		
Cash receipt stock issuance	9,000	
Cash payment for dividends	<u>(5,000)</u>	
Net cash flow from financing activities		<u>4,000</u>
Net increase in cash		1,500
Plus: Beginning cash balance		<u>-</u>
Ending cash balance		<u>\$ 1,500</u>

Learning Objective: 02-01
 Learning Objective: 02-03
 Topic Area: Accounting for accounts receivable
 Topic Area: Prepare financial statements
 Topic Area: Income statement
 Topic Area: Statement of cash flows
 AACSB: Knowledge Application
 AICPA: BB Critical Thinking
 AICPA: FN Measurement
 Blooms: Apply
 Level of Difficulty: 2 Medium

117. Turner Company started its business by issuing \$10,000 of common stock on January 1, 2016. The company performed \$38,000 of service for customers on account in 2016. It collected \$32,500 of this amount in 2016, recorded expenses on account of \$29,500, paid \$21,000 of the payables owed, and paid a \$500 dividend to the stockholders.

Required:

- a) What is the amount of total assets at the end of 2016?
- b) What is the amount of cash on hand at the end of 2016?
- c) What is the net income for 2016?
- d) Prepare a balance sheet for 2016.

Answer:

- a) $\$10,000 + 38,000 - 21,000 - 500 = \$26,500$ Total assets
- b) $\$10,000 + 32,500 - 21,000 - 500 = \$21,000$ Cash on hand
- c) $\$38,000 - 29,500 = \$8,500$ Net income

d)

Turner Company		
Balance Sheet		
As of December 31, 2016		
Assets		
Cash	\$ 21,000	
Accounts receivable	<u>5,500</u>	<u>\$ 26,500</u>
Liabilities		
Accounts payable		8,500
Stockholders' equity		
Common stock	10,000	
Retained earnings	<u>8,000</u>	<u>18,000</u>
Total liabilities and stockholders' equity		<u>\$ 26,500</u>

Learning Objective: 02-01

Learning Objective: 02-02

Learning Objective: 02-03

Topic Area: Accounting for accounts receivable

Topic Area: Accounting for accrued expense

Topic Area: Prepare financial statements

Topic Area: Income statement

Topic Area: Balance sheet

Chapter 02 - Understanding the Accounting Cycle

AACSB: Knowledge Application
 AICPA: BB Critical Thinking
 AICPA: FN Measurement
 Blooms: Apply
 Level of Difficulty: 3 Hard

118. The Maryland Corporation was started on January 1, 2016, with the issuance of \$50,000 of stock. During 2016, the company provided \$75,000 of services on account and collected \$68,000 of that amount. Maryland incurred \$63,000 of expenses, and paid \$50,000 of that amount during 2016. On December 31, 2016, Maryland paid investors a \$2,000 cash dividend and accrued \$4,000 of salary expense.

Required:

- 1) What is the net income for year ended December 31, 2016?
- 2) Prepare Maryland Corporation's Statement of Cash Flows for the year ended December 31, 2016. Precede a cash outflow amount with a minus sign.
- 3) What is the balance in Maryland's retained earnings account after closing entries are made on December 31, 2016?

Answer:

- 1) Net income: \$8,000 (\$75,000 – 63,000 - 4,000)
- 2)

Maryland Corporation		
Statement of Cash Flows		
For the Year Ended December 31, 2016		
Cash flows from operating activities		
Cash receipts from revenue	\$ 68,000	
Cash payments for operating expenses	<u>(50,000)</u>	
Net cash flow from operating activities		\$ 18,000
Cash flows from investing activities		-
Cash flows from financing activities		
Cash receipt stock issuance	50,000	
Cash payment for dividends	<u>(2,000)</u>	
Net cash flow from financing activities		<u>48,000</u>
Net increase in cash		66,000
Plus: Beginning cash balance		<u>-</u>
Ending cash balance		<u>\$ 66,000</u>

- 3) Retained earnings: \$6,000 (\$0 beg. + 8,000 net income – 2,000 dividends)

Chapter 02 - Understanding the Accounting Cycle

Learning Objective: 02-01
Learning Objective: 02-02
Learning Objective: 02-03
Topic Area: Accounting for accounts receivable
Topic Area: Accounting for accrued expense
Topic Area: Prepare financial statements
AACSB: Knowledge Application
AICPA: BB Critical Thinking
AICPA: FN Measurement
Blooms: Apply
Level of Difficulty: 3 Hard

119. Consider the following independent scenarios:

a) At January 1, 2016, accounts receivable was \$24,000. Cash collected on accounts receivable during 2016 was \$55,000. At December 31, 2016, accounts receivable was \$30,000. What were the revenues earned on account during 2016?

b) At January 1, 2016, accounts payable was \$19,000. During 2016, expenses on account were \$68,000. At December 31, 2016, accounts payable was \$15,000. What was the amount of cash paid on accounts payable during 2016?

c) At January 1, 2016, the balance in the prepaid insurance account was \$480. On March 1, 2016, the company paid \$3,000 for insurance coverage for the next 12 months. What was the amount of insurance expense for 2016?

d) At January 1, 2016, the balance in the supplies account was \$550. At December 31, 2016, the company counted \$400 of supplies on hand. The company reported supplies expense in 2016 of \$3,300. What was the total of supplies purchases during 2016?

Answer:

a) $\$24,000 \text{ beg. AR} + X \text{ rev. on acct.} - \$55,000 \text{ cash coll. on AR} = \$30,000 \text{ end. AR}$
 $X = \$61,000 \text{ revenue on account}$

b) $\$19,000 \text{ beg. AP} + \$68,000 \text{ exp. on acct.} - X \text{ cash paid on AP} = \$15,000 \text{ end. AP}$
 $X = \$72,000 \text{ cash paid on accounts payable}$

c) $\$480 \text{ insurance expense for Jan. and Feb.} + \$2,500 \text{ for March-December } (\$3,000/12 \text{ months} \times 10 \text{ months}) = \$2,980 \text{ insurance expense}$

d) $\$550 \text{ beg. supplies} + X \text{ supplies purchased} - \$400 \text{ end. supplies} = \$3,300 \text{ supplies exp.}$
 $X = \$3,150 \text{ supplies purchased}$

Learning Objective: 02-01
Learning Objective: 02-02
Learning Objective: 02-05
Learning Objective: 02-06
Topic Area: Accounting for accounts receivable

Chapter 02 - Understanding the Accounting Cycle

Topic Area: Accounting for accrued expense

Topic Area: Accounting for supplies

Topic Area: Accounting for prepaid items

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Apply

Level of Difficulty: 3 Hard

120. Oregon Co. began operations on January 1, 2016, by issuing \$10,000 in common stock to the stockholders. On March 1, 2016, Oregon accepted an advance of \$36,000 to provide services for a one-year period beginning April 1. During 2016, services in the amount of \$32,000 were provided to customers on account, and 80% of this amount was collected by year-end. During 2016, operating expenses incurred on account were \$24,000, and 60% of this amount was paid by year-end. During the year, Oregon paid \$1,200 to purchase supplies. By year-end, \$1,080 of the supplies had been used. Dividends to stockholders were \$2,000 during the year. During 2016, Oregon paid salaries of \$28,000, and on December 31, 2016, the company accrued salaries of \$2,800.

Oregon recorded all appropriate adjusting entries at year end.

- 1) What would Oregon report for service revenue for 2016?
- 2) What would Oregon report for salaries expense for 2016?
- 3) What would Oregon report for supplies expense for 2016?
- 4) What would the amount be for net cash flows from operating activities for 2016?
- 5) What is the net income for 2016?
- 6) What would the balance in the retained earnings account be at December 31, 2016?

Answer:

1) $\$32,000 \text{ rev. on account} + (\$36,000 \times 9/12) \text{ rev. earned on contract} = \$59,000 \text{ Rev.}$

2) $\$28,000 \text{ salaries expense paid} + \$2,800 \text{ accrued salaries at year end} = \$30,800 \text{ Sal. Exp.}$

3) $\$1,080 \text{ Supplies Exp.}$

4) $\$36,000 + \$25,600 (\$32,000 \times .80) - \$14,400 (\$24,000 \times .60) - \$1,200 - \$28,000 = \$18,000$
CF from OA

5) $\$59,000 \text{ revenue} - \$24,000 \text{ oper. exp.} - \$30,800 \text{ sal. exp.} - \$1,080 \text{ supp. exp.} = \$3,120 \text{ NI}$

6) $\$0 \text{ beg.} + \$3,120 \text{ NI} - \$2,000 \text{ Div.} = \$1,120 \text{ RE bal.}$

Learning Objective: 02-01

Learning Objective: 02-02

Learning Objective: 02-05

Learning Objective: 02-06

Learning Objective: 02-07

Learning Objective: 02-08

Topic Area: Accounting for accounts receivable

Topic Area: Accounting for accrued expense

Topic Area: Accounting for supplies

Topic Area: Accounting for prepaid items

Topic Area: Accounting for unearned revenue

Topic Area: Prepare financial statements

Chapter 02 - Understanding the Accounting Cycle

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Apply

Level of Difficulty: 3 Hard

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

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

Answer:

- 1) Statement of cash flows.
- 2) Balance sheet.
- 3) Income statement.
- 4) Balance sheet.
- 5) Statement of cash flows and statement of changes in stockholder's equity.
- 6) Income statement and statement of changes in stockholder's equity.
- 7) Statement of cash flows and statement of changes in stockholder's equity.
- 8) Statement of cash flows.
- 9) Balance sheet & statement of changes in stockholder's equity.
- 10) Statement of cash flows.

Learning Objective: 02-03
Topic Area: Prepare financial statements
AACSB: Reflective Thinking
AICPA: BB Critical Thinking
AICPA: FN Measurement
Blooms: Understand
Level of Difficulty: 2 Medium

122. The following events apply to Bowman's Cleaning Service for 2016.

- 1). Issued stock for \$44,000 cash.
- 2). On May 1, paid \$27,000 for one year's rent in advance.
- 3). Purchased on account \$4,500 of supplies to be used in the business.
- 4). Performed services of \$68,400 and received cash.
- 5). At December 31, adjusted the records for the expired rent.
- 6). At December 31, an inventory of supplies showed that \$660 of supplies were still unused.

Required: Draw an accounting equation and record the effects of the above events under the appropriate account headings. Show the year-end total for each account. Precede the amount with a minus sign if the transaction reduces that section of the equation. Enter 0 for items not affected.

Answer:

	Assets			=	Liab	+	Stockholders' Equity	
	Cash	Supplies	Ppd. Rent		AP		CS	+
1)	44,000						44,000	
2)	(27,000)		27,000					
3)		4,500			4,500			
4)	68,400							68,400
5)			(18,000)					(18,000)
6)		(3,840)						(3,840)

Learning Objective: 02-05

Learning Objective: 02-06

Topic Area: Accounting for Supplies

Topic Area: Accounting for prepaid items

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Apply

Level of Difficulty: 2 Medium

Chapter 02 - Understanding the Accounting Cycle

123. Using the form below, record each of the following 2016 transactions for Mayer Corporation. Precede the amount with a minus sign if the transaction reduces that section of the equation. Enter 0 for items not affected.

- a) Nov. 1. Received cash from clients for services to be performed over the next six months, \$12,000.
- b) Nov. 1. Paid \$1,200 for a 12-month insurance policy.
- c) Dec. 31. Recorded expiration of two months of the insurance.
- d) Dec. 31. Earned \$4,000 of the amount received from clients in November.

	Assets			=	Liabilities		+	Stockholders' Equity		
	Cash	Supplies	Ppd. Ins.		AP	Unearned Rev.		CS	+	RE
a.										
b.										
c.										
d.										

	Assets			=	Liabilities		+	Stockholders' Equity		
	Cash	Supplies	Ppd. Ins.		AP	Unearned Rev.		CS	+	RE
a.	12,000					12,000				
b.	(1,200)		1,200							
c.			(200)							(200)
d.						(4,000)				4,000

Learning Objective: 02-06
 Learning Objective: 02-07
 Topic Area: Accounting for prepaid items
 Topic Area: Accounting for unearned revenue
 AACSB: Knowledge Application
 AICPA: BB Critical Thinking
 AICPA: FN Measurement
 Blooms: Apply
 Level of Difficulty: 1 Easy

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

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

Answer:

- 1) Balance sheet & statement of changes in stockholders' equity.
- 2) Statement of cash flows and statement of changes in stockholders' equity.
- 3) Balance sheet.
- 4) Statement of cash flows.
- 5) Balance sheet.
- 6) Statement of cash flows and statement of changes in stockholders' equity.
- 7) Income statement and statement of changes in stockholders' equity.
- 8) Statement of cash flows.
- 9) Income statement.
- 10) Statement of cash flows.

Learning Objective: 02-08

Topic Area: Prepare financial statements

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Understand

Level of Difficulty: 2 Medium

Chapter 02 - Understanding the Accounting Cycle

125. The following transactions apply to Kellogg Company.

- 1) Issued common stock for \$20,000 cash
- 2) Provided services to customers for \$38,000 on account
- 3) Purchased land for \$15,000 cash
- 4) Incurred \$29,000 of operating expenses on account
- 5) Collected \$35,000 cash from customers for services provided in event #2
- 6) Paid \$27,000 on accounts payable
- 7) Paid \$2,000 dividends to stockholders

Required:

- a) Identify the dollar amount effect on the Statement of Cash Flows, if any, for each of the above transactions. Precede a cash outflow amount with a minus sign. Enter NA for items not affected.
- b) Indicate whether each transaction involves operating, investing, or financing activities. Enter NA for items not affected.
- c) Classify the above accounting events into one of four types of transactions (asset source, asset use, asset exchange, claims exchange).

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

Answer:

Event	(a) Effect on Statement of Cash Flows	(b) Transaction Type
1)	20,000	FA
2)	NA	
3)	(15,000)	IA
4)	NA	
5)	35,000	OA
6)	(27,000)	OA
7)	(2,000)	FA

Chapter 02 - Understanding the Accounting Cycle

Learning Objective: 02-01

Learning Objective: 02-02

Learning Objective: 02-09

Topic Area: Accounting for accounts receivable

Topic Area: Accounting for accrued expense

Topic Area: Transaction classification

AACSB: Analytical Thinking

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Analyze

Blooms: Apply

Level of Difficulty: 2 Medium

126. Grant Hylton started a consulting business, Grant Consulting, on January 1, 2016, and the business engaged in the following transactions during the year:

1. Issued \$40,000 of common stock for cash
2. Provided services on account, \$46,500
3. Incurred \$37,500 of operating expense, but only paid \$32,000 of this amount
4. Collected \$39,000 of the revenue that was previously recorded on account
5. Paid a cash dividend of \$4,000 to the stockholders

Required:

a) Show the effects of the above transactions on the accounting equation. Precede the amount with a minus sign if the transaction reduces that section of the equation. Enter 0 for items not affected.

Event	Assets	=	Liabilities	+	Equity
1)					
2)					
3)					
4)					
5)					
Totals					

b) Prepare an income statement and statement of cash flows for 2016. Precede a cash outflow amount with a minus sign.

Answer:

a)

Event	Assets	=	Liabilities	+	Equity
1)	40,000				40,000
2)	46,500				46,500
3)			37,500		(37,500)
	(32,000)		(32,000)		
4)	39,000				
	(39,000)				
5)	(4,000)				(4,000)
Totals	50,500		5,500		45,000

Chapter 02 - Understanding the Accounting Cycle

b)

Hylton Consulting	
Income Statement	
For the Year Ended December 31, 2016	
Service revenue	\$ 46,500
Operating expense	<u>(37,500)</u>
Net income	<u>\$ 9,000</u>

Hylton Consulting		
Statement of Cash Flows		
For the Year Ended December 31, 2016		
Cash flows from operating activities		
Cash receipts from customers	\$ 39,000	
Cash payments for operating expenses	<u>(32,000)</u>	
Net cash flow from operating activities		\$ 7,000
Cash flows from investing activities		-
Cash flows from financing activities		
Cash receipt stock issuance	40,000	
Cash payment for dividends	<u>(4,000)</u>	
Net cash flow from financing activities		<u>36,000</u>
Net increase in cash		43,000
Plus: Beginning cash balance		<u>-</u>
Ending cash balance		<u>\$43,000</u>

Learning Objective: 02-01
 Learning Objective: 02-02
 Learning Objective: 02-03
 Topic Area: Accounting for accounts receivable
 Topic Area: Accounting for accrued expense
 Topic Area: Prepare financial statements
 Topic Area: Income statement
 Topic Area: Statement of cash flows
 AACSB: Knowledge Application
 AICPA: BB Critical Thinking
 AICPA: FN Measurement
 Blooms: Apply
 Level of Difficulty: 3 Hard

127. Pierce Company was founded in 2016 and engaged in the following transactions:

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

Required:

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

Answer:

- a) Adjusting entries are required for transactions 2, 3, 4, and 6
- b) Adjusting entries are required at the end of an accounting period to properly match expenses with revenues. Transactions that involve deferrals and accruals often require adjusting entries to bring account balances up to date.

Learning Objective: 02-01

Learning Objective: 02-04

Learning Objective: 02-05

Learning Objective: 02-06

Topic Area: Accounting for accounts receivable

Topic Area: The matching concept

Topic Area: Accounting for supplies

Topic Area: Accounting for prepaid items

AACSB: Reflective Thinking

AICPA: BB Communication

AICPA: FN Measurement

Blooms: Understand

Level of Difficulty: 2 Medium

128. Jenna Fisk started her business by issuing \$8,000 of common stock on January 1, 2016. Jenna performed \$18,500 of service on account in 2016, and she collected \$16,200 of this amount by year end. She paid operating expenses of \$14,900 and paid a \$600 dividend to the stockholders.

Required:

- What is the amount of total assets at the end of 2016?
- What is the amount of cash on hand at the end of 2016?
- What is net income for 2016?
- Prepare a balance sheet for December 31, 2016.

Answer:

- $\$8,000 + \$18,500 - \$14,900 - \$600 = \$11,000$ Total assets
- $\$8,000 + \$16,200 - \$14,900 - \$600 = \$8,700$ Cash balance
- $\$18,500 - \$14,900 = \$3,600$ Net Income

d)

Balance Sheet		
As of December 31, 2016		
Assets		
Cash	\$ 8,700	
Accounts receivable	<u>2,300</u>	<u>\$ 11,000</u>
Liabilities		-
Stockholders' equity		
Common stock	8,000	
Retained earnings	<u>3,000</u>	<u>11,000</u>
Total liabilities and stockholders' equity		<u>\$ 11,000</u>

Learning Objective: 02-01

Learning Objective: 02-03

Topic Area: Accounting for accounts receivable

Topic Area: Prepare financial statements

Topic Area: Balance sheet

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Apply

Level of Difficulty: 2 Medium

129. The effects of transactions occurring during 2016 and their related end-of-year adjustments have been recorded below using the accounting equation.

	Assets				=	Liabilities		+	Stockholders' Equity	
	Cash	AR	Ppd Ins.	Land		AP	Unearned Rev.		CS	RE
1)	80,000								80,000	
2)	(20,000)			20,000						
3)		48,000								48,000
4)	32,000						32,000			
5)	32,000	(32,000)								
6)	(4,800)		4,800							
7)						24,000				(24,000)
8)	20,000			(20,000)						
9)			(4,000)							(4,000)
10)							(20,000)			20,000
Totals	139,200	16,000	800	-		24,000	12,000		80,000	40,000

Required:

With your knowledge of transaction analysis using an accounting equation,

- Prepare an income statement for 2016, and
- Prepare a statement of cash flows for 2016. Precede a cash outflow amount with a minus sign.

Answer:

a)

Income Statement	
For the Year Ended December 31, 2016	
Service revenue	\$ 68,000
Operating expense	(24,000)
Insurance expense	<u>(4,000)</u>
Net income	<u>\$ 40,000</u>

b)

Chapter 02 - Understanding the Accounting Cycle

Statement of Cash Flows		
For the Year Ended December 31, 2016		
Cash flows from operating activities		
Cash receipts from revenue	\$ 64,000	
Cash payment for insurance	<u>(4,800)</u>	
Net cash flow from operating activities		\$ 59,200
Cash flows from investing activities		
Cash receipt from sale of land	20,000	
Cash payment for land	<u>(20,000)</u>	
Net cash flow from investing activities		-
Cash flows from financing activities		
Cash receipt stock issuance	<u>80,000</u>	
Net cash flow from financing activities		<u>80,000</u>
Net increase in cash		139,200
Plus: Beginning cash balance		<u>-</u>
Ending cash balance		<u>\$ 139,200</u>

Learning Objective: 02-01

Learning Objective: 02-02

Learning Objective: 02-06

Learning Objective: 02-07

Learning Objective: 02-08

Topic Area: Accounting for accounts receivable

Topic Area: Accounting for accrued expense

Topic Area: Accounting prepaid items

Topic Area: Topic Area: Accounting for unearned revenue

Topic Area: Prepare financial statements

Topic Area: Income statement

Topic Area: Statement of cash flows

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Apply

Level of Difficulty: 3 Hard

Chapter 02 - Understanding the Accounting Cycle

130. Kiscaden Corporation began business operations and experienced the following transactions during 2016:

- 1) Issued common stock for \$20,000 cash.
- 2) Provided services to customers for \$80,000 on account.
- 3) Incurred \$36,000 of operating expenses on account.
- 4) Collected \$46,000 cash from customers.
- 5) Paid \$30,000 on accounts payable.

Required:

Record the above transactions on a horizontal statements model to reflect their effect on Kiscaden's financial statements. Precede the amount with a minus sign if the transaction reduces that section of the equation. Enter 0 for items not affected. In the last column, enter OA, IA, FA for the type of cash flow activity, or NA if there is no activity.

	Assets		=	Liabilities	+	Stockholders' Equity		Cash Flows
	Cash	Accounts Receivable		Accounts Payable		Common Stock	Retained Earnings	
1)								
2)								
3)								
4)								
5)								
Totals								

Answer:

	Assets		=	Liabilities	+	Stockholders' Equity		Cash Flows
	Cash	Accounts Receivable		Accounts Payable		Common Stock	Retained Earnings	
1)	20,000					20,000		20,000 FA
2)		80,000					80,000	
3)				36,000			(36,000)	
4)	46,000	(46,000)						46,000 OA
5)	(30,000)			(30,000)				(30,000) OA
Totals	36,000	34,000		6,000		20,000	44,000	36,000

Learning Objective: 02-01

Learning Objective: 02-02

Topic Area: Accounting for accounts receivable

Topic Area: Accounting for accrued expense

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Apply

Level of Difficulty: 2 Medium

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

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

Answer:

- 1) BS, 2) BS, 3) SE and CF, 4) IS, 5) BS, 6) IS, 7) BS and SE, 8) BS, 9) CF, 10) SE, 11) SE and CF, 12) BS

Learning Objective: 02-08

Topic Area: Prepare financial statements

AACSB Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Understand

Level of Difficulty: 2 Medium

Chapter 02 - Understanding the Accounting Cycle

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

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

Answer:

- 1) OA, 2) NA, 3) FA, 4) OA, 5) OA, 6) FA, 7) IA

Learning Objective: 02-08

Topic Area: Prepare financial statements

Topic Area: Statement of Cash Flows

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Understand

Level of Difficulty: 2 Medium

Chapter 02 - Understanding the Accounting Cycle

133. Tucker Company shows the following transactions for the accounting period ending December 31, 2016:

- 1) Sold books to customers for \$68,000 on account
- 2) Collected \$56,000 from customers
- 3) Issued common stock for \$16,000 cash
- 4) Prepaid four months' rent for \$8,800 on October 1, 2016
- 5) Purchased supplies for \$21,000 cash
- 6) Physical count shows \$6,500 of supplies remained on December 31, 2016
- 7) Recorded adjustment for prepaid rent used

Show how the above transactions and year-end adjustments affect the accounting equation. Precede the amount with a minus sign if the transaction reduces that section of the equation. Enter 0 for items not affected.

	Assets				=	Liabilities	+	Stockholders' Equity	
	Cash	Accounts Receivable	Prepaid Rent	Supplies				Common Stock	Retained Earnings
1)									
2)									
3)									
4)									
5)									
6)									
7)									
Totals									

Answer:

	Assets				=	Liabilities	+	Stockholders' Equity	
	Cash	Accounts Receivable	Prepaid Rent	Supplies				Common Stock	Retained Earnings
1)		68,000							68,000
2)	56,000	(56,000)							
3)	16,000						16,000		
4)	(8,800)		8,800						
5)	(21,000)			21,000					
6)				(14,500)					(14,500)
7)			(6,600)						(6,600)
Totals	42,200	12,000	2,200	6,500		-	16,000		46,900

Chapter 02 - Understanding the Accounting Cycle

Learning Objective: 02-05

Learning Objective: 02-06

Topic Area: Accounting for accounts receivable

Topic Area: Accounting for Supplies

Topic Area: Accounting for prepaid items

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Apply

Level of Difficulty: 2 Medium

Chapter 02 - Understanding the Accounting Cycle

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

- 1) ___ Paid \$10,000 for a plot of land.
- 2) ___ Recorded the accrual of \$1,000 in salaries to be paid the following week.
- 3) ___ Issued common stock for \$20,000 in cash.
- 4) ___ Incurred operating expense on account.
- 5) ___ Paid off its accounts payable.
- 6) ___ Earned revenue to be collected at a future date.
- 7) ___ Paid \$2,000 in dividends to its stockholders.
- 8) ___ Received cash from customers in #6 above.
- 9) ___ Paid the salaries accrued in #2 above.
- 10) ___ Borrowed money from a local bank.

Answer:

- 1) AE 2) CE 3) AS 4) CE 5) AU 6) AS 7) AU 8) AE 9) AU 10) AS

Learning Objective: 02-09
Topic Area: Transaction classification
AACSB: Analytical Thinking
AICPA: BB Critical Thinking
AICPA: FN Measurement
Blooms: Analyze
Level of Difficulty: 2 Medium

Chapter 02 - Understanding the Accounting Cycle

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

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

Answer:

- 1) AS 2) AS 3) AE 4) AS 5) AU 6) AS 7) AS 8) AE 9) CE 10) AU

Learning Objective: 02-09

Topic Area: Transaction classification

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Analyze

Level of Difficulty: 2 Medium

Feedback:

- 1) Borrowing cash is an asset source transaction that increases cash
- 2) Issuing common stock is an asset source transaction that increases cash
- 3) Paying rent in advance is an asset exchange transaction that increases prepaid rent and decreases cash
- 4) Providing services for cash is an asset source transaction that increases cash
- 5) Paying creditors is an asset use transaction that decreases cash
- 6) Receiving an advance payment is an asset source transaction that increases cash
- 7) Providing services on account is an asset source transaction that increases accounts receivable
- 8) Collecting on accounts receivable is an asset exchange transaction that increases cash and decreases accounts receivable
- 9) Accruing salary expense is a claims exchange transaction that increases accounts payable and decreases retained earnings
- 10) Recognizing supplies expense is an asset use transaction that decreases supplies

Chapter Appendix

For questions 136-138:

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

Increase = I

Decrease = D

No Effect = N

Chapter 02 - Understanding the Accounting Cycle

136. Carson Company accrued \$100 of interest expense.

Assets	Liabilities	Equity	Revenues	Expenses	Net Income	Cash

Answer: (N) (I) (D) (N) (I) (D) (N)

Learning Objective: 02-12

Topic Area: Accounting for Interest Expense

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Analyze

Level of Difficulty: 1 Easy

Feedback: Accruing interest expense increases liabilities (interest payable) and decreases equity (interest expense decreases retained earnings). It increases expenses and decreases net income. It does not affect cash flows.

137. Venture Company paid \$50 of accrued interest expense.

Assets	Liabilities	Equity	Revenues	Expenses	Net Income	Cash

Answer: (D) (D) (N) (N) (N) (N) (D)

Learning Objective: 02-12

Topic Area: Accounting for Interest Expense

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Analyze

Level of Difficulty: 1 Easy

Feedback: Paying accrued interest expense decreases assets (cash) and decreases liabilities (interest payable). It does not affect the income statement, but is reported as a cash outflow for operating activities on the statement of cash flows.

Chapter 02 - Understanding the Accounting Cycle

Assets	Liabilities	Equity	Revenues	Expenses	Net Income	Cash

Answer: (D) (N) (D) (N) (I) (D) (N)

Learning Objective: 02-11

Topic Area: Accounting for Depreciation Expense

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Analyze

Level of Difficulty: 1 Easy

Feedback: Recording depreciation expense decreases assets (increases the contra-asset accumulated depreciation) and decreases equity (depreciation expense decreases retained earnings). It increases expenses and decreases net income. It does not affect cash flows.

Multiple Choice Questions - Appendix

139. Joseph Company purchased a delivery van on January 1, 2016 for \$35,000. The van is estimated to have a 5-year useful life and a \$5,000 salvage value. How much expense should Joseph recognize in 2016 related to the use of the van?

- A. \$6,000
- B. \$7,000
- C. \$30,000
- D. \$5,000

Answer: A

Learning Objective: 02-11

Topic Area: Accounting for Depreciation Expense

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Apply

Level of Difficulty: 1 Easy

Feedback: $(\$35,000 \text{ cost} - \$5,000 \text{ salvage value}) / 5 \text{ year useful life} = \$6,000 \text{ depreciation expense}$

140. Which of the following events involves a deferral?

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

Answer: C

Learning Objective: 02-12

Topic Area: Accounting for Interest Expense

Chapter 02 - Understanding the Accounting Cycle

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Understand

Level of Difficulty: 2 Medium

Feedback: Recording the purchase of supplies constitutes a deferral because it involves the payment of cash before an expense (in this case, supplies expense) is recognized.

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

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

Answer: A

Learning Objective: 02-11

Topic Area: Accounting for Depreciation Expense

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Understand

Level of Difficulty: 2 Medium

Feedback: Recognizing depreciation expense involves a decrease in assets due to an increase in the contra-asset accumulated depreciation and a decrease in equity due to recognizing depreciation expense.

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

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

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

- A. \$11,600.
- B. \$17,200.
- C. \$5,200.
- D. None of these answers is correct.

Answer: C

Learning Objective: 02-11

Topic Area: Accounting for Depreciation Expense

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Apply

Level of Difficulty: 2 Medium

Feedback: Assets (\$4,500 + \$2,700 + \$10,000 - \$3,200) = Liabilities (\$2,800) + Equity (\$6,000 + Retained Earnings); Retained Earnings = \$5,200

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

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

Answer: D

Learning Objective: 02-12

Topic Area: Accounting for Interest Expense

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Understand

Level of Difficulty: 2 Medium

Feedback: Paying or receiving interest is considered an operating activity. Accruing salary expense is not a cash flow. Paying dividends is a financing activity, and purchasing equipment is an investing activity.

144. Chester Company began 2016 with a note payable of \$20,000 and interest payable of \$800. During the year, the company accrued an additional \$400 of interest expense, and paid off the note with interest. On the company's 2016 income statement, cash flows for financing activities related to the note would be:

- A. \$1,200 outflow
- B. \$20,000 outflow
- C. \$20,400 outflow
- D. \$21,200 outflow

Answer: B

Learning Objective: 02-12

Topic Area: Accounting for Interest Expense

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Apply

Level of Difficulty: 2 Medium

Feedback: Only the \$20,000 principle would be considered an outflow for financing activities. The \$1,200 interest paid is considered an operating activity.

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

- A. Recognized depreciation expense on equipment.
- B. Incurred operating expenses on account.
- C. Paid interest that was accrued in a prior year.
- D. All of these answer choices would affect the income statement in a different period from the statement of cash flows.

Answer: D

Learning Objective: 02-11

Learning Objective: 02-12

Topic Area: Accounting for Depreciation Expense

Topic Area: Accounting for Interest Expense

Chapter 02 - Understanding the Accounting Cycle

AACSB: Analytical Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

AICPA: FN Measurement

Blooms: Analyze

Level of Difficulty: 2 Medium

Feedback: Recognizing depreciation expense reduces net income, but does not affect cash flows for operating activities. Incurring operating expenses on account also reduces net income, but does not affect cash flows for operating activities. Paying interest that was accrued in a prior year will reduce cash flows for operating activities, but will not affect net income.

146. Alabama Company purchased a machine on January 1, 2016 for \$26,000 cash. The machine has an estimated useful life of 4 years and a \$6,000 salvage value. What would be the book (carrying) value of the machine reported on Alabama's December 31, 2016 balance sheet?

A. \$26,000

B. \$19,500

C. \$21,000

D. \$15,000

Answer: C

Learning Objective: 02-11

Topic Area: Accounting for Depreciation Expense

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Apply

Level of Difficulty: 2 Medium

Feedback: The amount of assets related to the machine on December 31 would be the machine's book (carrying) value (cost minus accumulated depreciation). $(\$26,000 \text{ cost} - \$6,000 \text{ salvage value}) / 4 \text{ year useful life} = \$5,000 \text{ annual depreciation expense}$. Book value = $\$26,000 - \$5,000 = \$21,000$.

True / False Questions - Appendix

147. Recognition of depreciation expense is an asset use transaction.

Answer: True

Learning Objective: 02-11

Topic Area: Accounting for Depreciation Expense

AACSB: Reflective Thinking

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Understand

Level of Difficulty: 2 Medium

Feedback: Recognition of depreciation expense is an asset use transaction that decreases the book (carrying) value of the depreciated asset and decreases equity.

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

Answer: False

Learning Objective: 02-11

Topic Area: Accounting for Depreciation Expense

Chapter 02 - Understanding the Accounting Cycle

AACSB: Reflective Thinking
AICPA: BB Critical Thinking
AICPA: FN Measurement
Blooms: Understand
Level of Difficulty: 2 Medium

Feedback: Recognition of depreciation expense increases the contra-asset accumulated depreciation which decreases the book (carrying) value of the asset on the balance sheet. It does not decrease the equipment account itself.

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

Answer: True
Learning Objective: 02-11
Topic Area: Accounting for Depreciation Expense
AACSB: Reflective Thinking
AICPA: BB Critical Thinking
AICPA: FN Measurement
Blooms: Remember
Level of Difficulty: 1 Easy
Feedback: It is necessary to estimate an asset's useful life and salvage value in order to calculate depreciation expense associated with the use of that asset.

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

Answer: False
Learning Objective: 02-12
Topic Area: Accounting for Interest Expense
AACSB: Reflective Thinking
AICPA: BB Critical Thinking
AICPA: FN Measurement
Blooms: Remember
Level of Difficulty: 2 Medium
Feedback: Payment of interest is classified as an operating activity on the statement of cash flows.

Essay Questions - Appendix

151. Thurston Company started its business on January 1, 2016 by issuing \$15,000 of common stock. On January 1, the company purchased equipment for \$10,500. The equipment is estimated to have a 3-year useful life and a \$1,500 salvage value. On March 1, Thurston issued a \$27,000, 6% 5-year note to Community Bank. Customers paid Thurston \$54,000 for services performed in 2016. The company paid \$33,000 for operating expenses, and paid a \$900 dividend to the stockholders. At year-end, Thurston recognized interest expense on the note and depreciation expense on the computer.

Required:

- What is the amount of interest expense Thurston will recognize in 2016?
- What is the book (carrying) value of the computer at the end of 2016?
- What is the net income for 2016?
- Prepare a balance sheet for 2016.

Answer:

- $\$27,000 \times 6\% \times 10/12 = \$1,350$ interest expense
- Depreciation expense = $(\$10,500 - \$1,500)/3 = \$3,000$; Book value = $\$10,500 - \$3,000 = \$7,500$
- $\$54,000 - \$33,000 - \$3,000 - \$1,350 = \$16,650$ Net income
-

Thurston Corporation		
Balance Sheet		
As of December 31, 2016		
Assets		
Cash	\$51,600	
Equipment	10,500	
Less: Accumulated depreciation	<u>(3,000)</u>	
Total assets		<u>\$59,100</u>
Liabilities		
Interest payable	\$ 1,350	
Notes payable	<u>27,000</u>	28,350
Stockholders' equity		
Common stock	15,000	
Retained earnings	<u>15,750</u>	<u>30,750</u>
Total liabilities and stockholders' equity		<u>\$59,100</u>

Chapter 02 - Understanding the Accounting Cycle

Learning Objective: 02-08
Learning Objective: 02-11
Learning Objective: 02-12
Topic Area: Prepare financial statements
Topic Area: Balance Sheet
Topic Area: Accounting for Depreciation Expense
Topic Area: Accounting for Interest Expense
AACSB: Knowledge Application
AICPA: BB Critical Thinking
AICPA: FN Measurement
Blooms: Apply
Level of Difficulty: 3 Hard

152. The following events apply to Jason's Lawn Service for 2016.

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

Required: Record the effects of the above events under the appropriate account headings in the accounting formula below. Precede the amount with a minus sign if the transaction reduces that section of the equation. Enter 0 for items not affected.

Chapter 02 - Understanding the Accounting Cycle

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

Answer:

	Assets		=	Liab		+	Stockholders' Equity	
	Cash	Book Value of Equip.		Notes Payable	Interest Payable		CS	RE
1	14,000						14,000	
2	(12,000)	12,000						
3	3,000			3,000				
4	18,400							18,400
5	(15,000)							(15,000)
6a		(2,000)						(2,000)
6b					100			(100)
Totals	\$ 8,400	\$ 10,000		\$ 3,000	\$ 100		\$ 14,000	\$ 1,300

Learning Objective: 02-11
 Learning Objective: 02-12
 Topic Area: Accounting for Depreciation Expense
 Topic Area: Accounting for Interest Expense
 AACSB: Knowledge Application
 AICPA: BB Critical Thinking
 AICPA: FN Measurement
 Blooms: Apply
 Level of Difficulty: 3 Hard

Chapter 02 - Understanding the Accounting Cycle

153. Osage Corporation began business operations and experienced the following transactions during 2016:

- 1) Issued common stock for \$25,000 cash.
- 2) Issued a \$20,000, 6% 4-year note to the bank on February 1.
- 3) Provided services to customers for \$80,000 cash.
- 4) Paid \$38,000 for operating expenses.
- 5) Accrued interest expense on the note.
- 6) Paid a \$4,000 dividend to shareholders.

Required:

Record the above transactions on a horizontal statements model to reflect their effect on Osage's financial statements. Precede the amount with a minus sign if the transaction reduces that section of the equation. Enter 0 for items not affected. Precede a cash outflow amount with a minus sign. In the last column, enter OA, IA, FA for the type of cash flow activity, or NA if there is no activity.

	Assets		Liabilities			Equity		Revenue	-	Expense	=	NI		Cash Flow	
	Cash	=	Notes Pay.	Int. Pay.	+	Comm. Stock	Ret. Earn.								
1)															
2)															
3)															
4)															
5)															
6)															
Totals															

Answer:

	Assets		Liabilities			Equity		Revenue	-	Expense	=	NI		Cash Flow	
	Cash	=	Notes Pay.	Int. Pay.	+	Comm. Stock	Ret. Earn.								
1)	25,000					25,000								25,000	FA
2)	20,000		20,000											20,000	FA
3)	80,000						80,000	80,000				80,000		80,000	OA
4)	(38,000)						(38,000)		38,000			(38,000)		(38,000)	OA
5)				1,100			(1,100)		1,100			(1,100)			
6)	(4,000)						(4,000)							(4,000)	FA
Totals	83,000		20,000	1,100		25,000	36,900	80,000	39,100			40,900		83,000	

Learning Objective: 02-12

Topic Area: Accounting for interest expense

AACSB: Knowledge Application

AICPA: BB Critical Thinking

AICPA: FN Measurement

Blooms: Apply

Level of Difficulty: 2 Medium

Chapter 02 - Understanding the Accounting Cycle