

Chapter 03

The Income Statement

True / False Questions

1. All revenues come from selling the company's goods or services.

True False

2. Expenses are the same as expenditures.

True False

3. In any given industry, companies are entirely consistent in the account titles they use on financial statements.

True False

4. Costs that benefit future periods are reported as assets.

True False

5. A net profit margin of 15.4% means that the company used 84.6 cents of each sales dollar to cover costs and expenses.

True False

6. To evaluate a company's net profit margin, it is best to compare it to another company in the same industry.

True False

7. If debits equal credits on the trial balance, it means that the accounting records do not contain any errors.

True False

8. Prepaid expenses would be reported on the Balance Sheet.

True False

9. Net income is based on estimates.

True False

10. If a company decides to record an expenditure made this period as an expense, when it should have been recorded as an asset, net income will be overstated in the current period as a result.

True False

11. Net Income on the Income Statement is equal to the amount of cash generated by the business.

True False

12. A company does not need to record the receipt of a bill for utilities used during this year if they will not pay for it until next year.

True False

13. The period of time from buying goods and services to collecting cash from customers is called the accounting cycle.

True False

14. Dividing up the continuing life of a company into shorter periods is called the time period assumption.

True False

15. GAAP does not allow cash basis accounting to be used in external financial reports.

True False

16. It is possible for a company to be profitable, yet not have enough cash to pay its bills.

True False

17. If revenues are not growing faster than expenses, then Net income will decrease.

True False

18. Net Income would be understated by a failure to record collection of accounts receivable.

True False

19. Unearned Revenue is reported on the Balance Sheet as a liability.

True False

20. When expenses exceed revenues in a period, stockholders' equity will increase.

True False

Multiple Choice Questions

21. Which one of the following statements regarding the accrual and cash basis of accounting is true?

- A. Using the accrual basis of accounting, if payment is received before delivery of a good or service, a revenue is recorded at the time the payment is received.
- B. Using the accrual basis of accounting, if payment is received after delivery of a good or service, an asset is recorded at the time the good or service was delivered.
- C. Using the cash basis of accounting, if payment is received before delivery of a good or service, net income is affected when goods or services are delivered.
- D. Using the cash basis, if payment is received after delivery of a good or service, unearned revenue is recorded.

22. Which one of the following statements regarding the debit/credit processing of revenues and expenses is true?

- A. Debits reduce expenses.
- B. The total credits recorded in revenue accounts must equal the total debits recorded in expense accounts.
- C. Across all revenue accounts, the total value of all debits must equal the total value of all credits.
- D. Credits increase revenues.

23. Which one of the following statements regarding the trial balance is true?

- A. A trial balance is included in the full set of external financial statements, just like an income statement.
- B. If debits equal credits in the unadjusted trial balance, you have made no errors in preparing and posting journal entries.
- C. The balances for each account reported on an unadjusted trial balance are determined by adding the amounts on the "+" side and subtracting the amounts on the "-" side of each ledger or T-account.
- D. GAAP allows companies to choose between the cash basis or the accrual basis of accounting.

24. Which one of the following statements regarding the Revenue Recognition Principle and Expense Recognition (Matching) Principle is true?

- A. According to the revenue principle, a company should not record the revenue from a transaction until it is actually received in cash.
- B. Expenses are recorded when the company uses goods or services.
- C. The Expense Recognition (Matching) principle requires that expenses be determined first and then revenues be "matched" to those expenses.
- D. The revenue and expense accounts on the income statement continue to have an impact beyond the current period, whereas balance sheet items report the financial impact in just the current period.

25. Which of the following statements regarding revenues and expenses is true?

- A. Both revenues and expenses typically have credit balances.
- B. Revenues and expenses are considered assets and liabilities, respectively.
- C. Revenue is the same as cash.
- D. Expenses decrease the amount of stockholders' equity.

26. Which of the following statements regarding cash and accrual accounting is true?

- A. If payment is received at the same time a service is produced and sold, there is no difference between how cash and accrual accounting record the transaction.
- B. The cash basis of accounting works best when a lengthy delay exists between the timing of cash flows and the underlying business activities to which they relate.
- C. If a company receives a bill for rent for the period and decides to delay payment, the rent will not be recorded as an expense according to the accrual model of accounting.
- D. The cash basis of accounting would record unearned revenue if a company received a deposit in advance of services to be rendered by the company.

Melody's Piano School operations for the month of May are summarized in the following three transactions:

- Provided \$500 of instruction to students.
- Of the \$500 of instruction provided in May, \$400 is collected in cash, and an additional \$300 is collected for lessons provided in April.
- Paid April's piano rental bill of \$100. Received May's bill of \$150 but did not pay.

27. What is Melody's Net Income for May using the cash basis of accounting?

- A. \$800
- B. \$300
- C. \$350
- D. \$600

28. What is Melody's Net Income for May using the accrual basis of accounting?

- A. \$400
- B. \$300
- C. \$350
- D. \$600

29. Which of the following would not be associated with an expense?

- A. Using supplies.
- B. Paying off an account payable.
- C. Paying for electricity used by production equipment during the current period.
- D. Paying daily wages for production workers.

30. Which of the following represents a subtotal rather than an account?

- A. Advertising Expense.
- B. Service Revenue.
- C. Supplies Expense.
- D. Total Revenues.

31. Which of the following is an expense of this period?

- A. Costs of items used up this period but paid for next period.
- B. Costs of items paid for in this period but used up next period.
- C. Cost of land purchased and paid for this period.
- D. Repayment of debt from a loan in a prior period.

32. Net Income refers to:

- A. The difference between what was earned and the costs incurred during a period.
- B. The difference between the cash received and the cash paid out during a period.
- C. The difference between what is owned and what is owed at a point in time.
- D. The change in the value of the company during a period.

33. Time Warner is a publishing and communications company, specializing in magazines, cable television operation, television program development, and other telecommunication services. Its financial statements show \$37,666 in an account called "Unearned Subscriber Revenue," which represents amounts that customers have paid in advance of receiving magazines, cable television, and internet services. What type of account is this and on what statement is it reported?

	<u>Type of Account</u>	<u>Financial Statement</u>
A)	Asset	Balance Sheet
B)	Liability	Balance Sheet
C)	Revenue	Balance Sheet
D)	Revenue	Income Statement

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

34. Which of the following items is not a specific account in a company's chart of accounts?
- A. Income Tax Expense.
 - B. Sales Revenue.
 - C. Unearned Revenue.
 - D. Net Income.
35. During November 2013, Asler Inc. performs consulting services. The client does not pay Asler until January, 2014.
- A. Using the accrual basis of accounting, the revenue is reported in January 2014.
 - B. Using the cash basis of accounting, the revenue is reported in November 2013.
 - C. Using the accrual basis of accounting, the revenue is reported in November 2013.
 - D. Using the accrual basis of accounting, the revenue is reported when Asler's expenses are paid.
36. The Fastbank Motorcycle Service Company (FMSC) wins a \$10 million bid to provide the repair service for a recall on a popular brand of motorcycles. No money is exchanged. The repairs are expected to take place next quarter. How will these events affect the balance sheet?
- A. Accounts Receivable will increase by \$10 million this quarter and Inventories will decrease next quarter.
 - B. Both Accounts Receivable and Accounts Payable will increase by \$10 million this quarter.
 - C. Both Accounts Receivable and Stockholders' Equity will increase by \$10 million this quarter.
 - D. These events will not impact the balance sheet this quarter.

37. During June, the Grass is Greener Company mows 100 lawns a week and is paid in July by those customers. The company uses the accrual basis of accounting. How will these events affect the company's financial statements?

- A. The income statement shows the effects of the transactions in June.
- B. The income statement shows the effects of the transactions in July.
- C. The balance sheet shows no effect from the transactions in June.
- D. The transactions have no effect on the balance sheet.

38. During June, the Grass is Greener Company mows 100 lawns a week; the company was paid in advance during May by those customers. The company uses the accrual basis of accounting. How will these events affect the company's financial statements?

- A. The income statement shows the effects of the transactions in May.
- B. The income statement shows the effects of the transactions in June.
- C. The balance sheet shows no effect from the transactions in May.
- D. The transactions have no effect on the balance sheet.

39. During April, the Grass is Greener Company buys and pays for a six-month supply of fertilizer in order to receive a bulk discount. The cost of fertilizer is recorded:

- A. immediately as an expense.
- B. as a liability, which will later be reduced as the fertilizer used.
- C. partially as an expense and partially as a liability.
- D. as an asset, which will later be reduced as the fertilizer is used.

40. Which of the following practices would not be considered ethical?
- A. Failing to record an expense even though cash has been paid.
 - B. Recording 31 days of sales in April.
 - C. Using the cash basis of accounting.
 - D. Adjusting the accounts after a trial balance has been prepared.
41. Your company bought a 30-second advertisement that aired during the Super Bowl at a cost of \$1.2 million. It is legally obligated to pay for the ad but has not yet done so. How does the purchase and use of the ad time affect your company's balance sheet?
- A. It increases both assets and liabilities by \$1.2 million.
 - B. It increases assets and decreases stockholders' equity by \$1.2 million each.
 - C. It does not affect the balance sheet.
 - D. It increases liabilities and decreases stockholders' equity by \$1.2 million each.
42. Your company receives advance payment in October for services that are provided during November. Which of the following is true?
- A. A liability is recorded in October; in November the liability is reduced and revenue is recorded.
 - B. Revenue is recorded in October and expenses are recorded in November.
 - C. An asset is recorded in October; in November, the asset is reduced and revenue is recorded.
 - D. Revenue and expenses are recorded in October.

43. Your company orders and receives supplies in January, pays for them in February, provides services that use those goods up in March and is paid by customers in April. Using the accrual basis of accounting:
- A. expenses are recorded in February and revenues are recorded in April.
 - B. expenses are recorded in February and revenues are recorded in March.
 - C. expenses and revenues are recorded in March.
 - D. expenses are recorded in January and revenues are recorded in April.
44. If accounts receivable has a beginning balance of \$4,210 and an ending balance of \$3,495, and collections on account were \$9,600, how much were credit sales?
- A. \$8,885
 - B. \$17,305
 - C. \$10,315
 - D. \$1,895
45. Which of the following is not true concerning requirements of when a company should recognize revenue?
- A. When delivery has occurred or services have been provided (rendered).
 - B. When the price is fixed or determinable.
 - C. When there is persuasive evidence of an arrangement for customer payment and collection is reasonably assured.
 - D. When cash has been received for services rendered.

46. Which one of the following would not be considered an operating activity?

- A. pay employees for work completed
- B. buy supplies on account
- C. purchase equipment for cash
- D. sell goods to customers

47. Which of the following statements is true about the cash basis of accounting?

- A. It can distort reported profits.
- B. It is the only acceptable method for external reporting.
- C. It reports revenues when earned and expenses when incurred.
- D. It is used when cash is paid at the same time as the cost is incurred, but is not used when cash is paid before the expense is incurred.

48. Company A receives \$10,000 in advance this month for work to be performed next month. This month, the company should:

- A. Debit Cash \$10,000 and credit Service Revenue \$10,000.
- B. Debit Cash \$10,000 and credit Unearned Revenue \$10,000.
- C. Debit Cash \$10,000 and credit Accounts Receivable \$10,000.
- D. Debit Prepaid Expense \$10,000 and credit Cash \$10,000.

49. A customer purchased \$1,500 of services on credit two months ago and has just paid the bill. The receipt of the payment from the customer is recorded as a

- A. debit to Cash and a credit to Accounts Receivable.
- B. debit to Cash and a credit to Accounts Payable.
- C. debit to Cash and a credit to Revenue.
- D. debit to Purchases and a credit to Cash.

50. When a customer buys services on account, it should be recorded by the company as:

- A. a debit to Cash and a credit to Accounts Receivable.
- B. a debit to Accounts Receivable and a credit to Revenue.
- C. a debit to Services and a credit to Unearned Revenue.
- D. a debit to Cash and a credit to Accounts Payable.

51. Which of the following is a true statement?

- A. Revenue accounts are a subset of assets, and expense accounts are a subset of liabilities.
- B. Both revenue accounts and expense accounts are subsets of contributed capital.
- C. Both revenue accounts and expense accounts are subsets of retained earnings.
- D. Revenue accounts are a subset of cash, and expense accounts are a subset of accounts payable.

52. Which of the following is true?

- A. Credits increase both revenues and expenses.
- B. Credits increase expenses and decrease revenues.
- C. Credits increase revenues and decrease expenses.
- D. Credits decrease both revenues and expenses.

53. If a company provides a service and receives payment at the same time,:

- A. more than one journal entry is needed.
- B. cash will be credited.
- C. a revenue account will be increased with a debit.
- D. stockholders' equity will increase.

54. During March, the Long Life Consulting Company provides \$23,000 in consulting services of which \$12,000 is immediately paid for and \$11,000 is on account.

- A. Cash increases \$12,000, revenue increases \$11,000, and accounts receivable increases \$23,000.
- B. Cash increases \$12,000, Accounts Receivable increases \$11,000, and revenues increase \$23,000.
- C. Accounts Receivable increases \$11,000, liabilities decrease \$12,000, and stockholders' equity increases \$1,000.
- D. Revenues increase \$12,000, liabilities decrease \$12,000, and stockholders' equity is unchanged.

55. In October, your company prepays rent of \$7,000 for November and December. Which of the following describes the effects of this transaction on your company in October?

- A. Assets decrease \$7,000 and liabilities decrease \$7,000.
- B. Assets increase \$7,000 and stockholders' equity increases \$7,000.
- C. There is no change to total assets, liabilities or stockholders' equity.
- D. Liabilities decrease \$7,000 and stockholders' equity increases \$7,000.

56. Cansing Company collected \$5,000 from a customer on account. What journal entry will Cansing record?

- A. Debit Cash, credit Accounts Receivable.
- B. Debit Cash, credit Revenue.
- C. Debit Accounts Receivable, credit Revenue.
- D. Debit Accounts Receivable, credit Cash.

57. West Corporation issued a \$1,000 gift certificate. What journal entry will West Corporation record?

- A. Debit Cash, credit Sales Revenue.
- B. Debit Cash, credit Unearned Revenue.
- C. Debit Unearned Revenue, credit Cash.
- D. Debit Accounts Receivable, credit Cash.

58. If a company is paid in full for services provided this month, how will the basic accounting equation be affected?
- A. Liabilities will decrease.
 - B. Stockholders' equity will increase as revenue is recorded.
 - C. Liabilities will increase.
 - D. Assets will decrease.
59. Your company received payment last month for a service that you provided this month. How will the business activity of the current month affect the basic accounting equation?
- A. Assets will not change; liabilities (Unearned Revenue) will decrease; and stockholders' equity (Service Revenue) will increase.
 - B. Assets (Cash) will increase, liabilities (Unearned Revenue) will increase, and stockholders' equity will not change.
 - C. Assets (Cash) will increase, liabilities will not change, and stockholders' equity (Service Revenue) will increase.
 - D. Assets (Prepaid Expenses) will decrease, liabilities will not change, and stockholders' equity (Service Revenue) will increase.
60. Which of the following would eventually cause a reduction in retained earnings?
- A. Receiving contributions from investors.
 - B. Earning unearned revenue.
 - C. Billing customers for services provided.
 - D. Using up supplies.

61. Customers paid \$8,000 on their accounts. Which accounts are affected by this transaction?
- A. Revenue and Retained Earnings increase \$8,000.
 - B. Cash and Revenue increase \$8,000. Liabilities and Expense increase \$8,000.
 - C. Cash increases \$8,000 and Accounts Receivable decreases \$8,000. Revenue and Retained Earnings are unchanged.
 - D. Cash and liabilities decrease \$8,000.
62. Sparkling Pools provides \$1,000 of pool maintenance services during July and collects payment in August. The company performs \$1,600 of pool maintenance services during July that were paid for in June. The company accepts an order to perform \$500 of pool maintenance services in August and will be paid in the same month. Revenue should be credited for:
- A. \$1,600 in June, \$1,000 in July, and \$500 in August.
 - B. \$1,600 in June, \$0 in July, and \$1,500 in August.
 - C. \$0 in June, \$1,600 in July, and \$1,500 in August.
 - D. \$0 in June, \$2,600 in July, and \$500 in August.
63. Sparkling Pools received a bill for \$1,200 for running newspaper ads during the last two weeks of July; the bill will be paid on August 1. Advertising expense should be:
- A. credited for \$1,200 in July.
 - B. credited for \$1,200 in August.
 - C. debited for \$1,200 in July.
 - D. debited for \$1,200 in August.

64. This month, a company performed \$517,000 of services and incurred total expenses of \$438,000. If the company was paid in cash for all its services and paid cash for all its expenses, these transactions would cause:

- A. revenues to increase \$517,000, expenses to increase \$438,000, and retained earnings to decrease \$79,000.
- B. cash to increase \$517,000, expenses to increase \$438,000, and contributed capital to increase \$79,000.
- C. revenues to increase \$517,000, expenses to increase \$438,000, and cash to increase \$79,000.
- D. revenues to increase \$79,000, expenses to increase \$438,000, and cash to increase \$517,000.

65. This month, Grass is Greener Lawn Service pays cash for \$4,000 of grass fertilizer to be used two months from now. What journal entry will Grass is Greener record this month?

- A. Debit cash for \$4,000 and credit supplies expense for \$4,000.
- B. Debit supplies expense for \$4,000 and credit accounts payable for \$4,000.
- C. Debit supplies for \$4,000 and credit cash for \$4,000.
- D. Debit retained earnings for \$4,000 and credit accounts payable for \$4,000.

66. On October 10, a company paid \$12,000 to its suppliers, of which \$2,000 was for supplies received on October 10 and \$10,000 was for supplies received and recorded during September. The \$12,000 payment would be recorded as a:

- A. \$10,000 debit to Supplies, a \$2,000 debit to Accounts Payable, and a \$12,000 credit to Cash.
- B. \$12,000 debit to Supplies and a \$12,000 credit to Cash.
- C. \$12,000 debit to Supplies Expense and a \$12,000 credit to Cash.
- D. \$2,000 debit to Supplies, a \$10,000 debit to Accounts Payable, and a \$12,000 credit to Cash.

67. On the 15th of the month, a company receives \$8,000 in payments from customers. \$1,000 is for services performed on that day and the remaining is payment for services performed in the previous month. The \$8,000 cash receipt would be recorded as a:

- A. debit of \$7,000 to Accounts Receivable, debit of \$1,000 to Service Revenue, and a credit of \$8,000 to Cash.
- B. debit of \$8,000 to Cash, a credit of \$7,000 to Accounts Receivable, and a credit of \$1,000 to Service Revenue.
- C. debit of \$7,000 to Accounts Receivable, a debit of \$1,000 to Unearned Revenue, and a credit of \$8,000 to Cash.
- D. debit of \$8,000 to Cash, debit of \$1,000 to Service Revenue, and a credit of \$7,000 to Accounts Receivable.

68. In January, the Caribbean Dream Resort books and accepts a cash payment for \$32,000 for vacation services to be provided during spring break in March. The \$32,000 would be recorded during January as a:
- A. debit to Cash and a credit to Unearned Revenue.
 - B. debit to Accounts Payable and a credit to Service Revenue.
 - C. debit to Accounts Receivable and a credit to Service Revenue.
 - D. debit to Prepaid Expenses and a credit to Service Revenue.
69. In January, the Huntington Beach Resort (HBR) accepts your reservation and receives your \$2,000 payment for a week of sun and fun in California during spring break. The \$2,000 would be recorded by HBR during January as a:
- A. debit to Cash and a credit to Unearned Revenue.
 - B. debit to Accounts Payable and a credit to Service Revenue.
 - C. debit to Cash and a credit to Service Revenue.
 - D. debit to Service Revenue and a credit to Cash.
70. Which of the following groups of accounts contains only those that normally have credit balances?
- A. Accounts Payable; Retained Earnings; Service Revenue.
 - B. Equipment; Cash; Contributed Capital.
 - C. Notes Payable; Wages Payable; Rent Expense.
 - D. Accounts Receivable, Retained Earnings, Cash.

71. An increase in revenue will always:

- A. increase stockholders' equity.
- B. increase assets.
- C. decrease stockholders' equity.
- D. decrease assets.

72. Which of the following journal entries would decrease stockholders' equity?

- A. Debiting Prepaid Insurance and crediting Cash.
- B. Debiting Unearned Revenue and crediting Revenue.
- C. Debiting Supplies and crediting Accounts Payable.
- D. Debiting Insurance Expense and crediting Cash.

73. In January, a company pays for advertising space in the local paper for ads to be run during the months of January, February, and March at \$1,500 a month. The payment would be recorded in January as a:

- A. debit of \$4,500 to Cash, a credit of \$1,500 to Advertising Expense, and a credit of \$3,000 to Prepaid Advertising.
- B. debit of \$4,500 to Accounts Payable and a credit of \$4,500 to Cash.
- C. debit of \$4,500 to Accounts Payable and a credit of \$4,500 to Stockholders' Equity.
- D. debit of \$1,500 to Advertising Expense, a debit of \$3,000 to Prepaid Advertising, and a credit of \$4,500 to Cash.

74. An increase in operating expenses would have which of the following effects on a company's profit margin?
- A. Net profit margin would increase.
 - B. Net profit margin would decrease.
 - C. Net profit margin would remain unchanged.
 - D. There is not enough information given to determine the effect.
75. Trudy's Café paid employees \$50,000 in September for work done that month. What journal entry will Trudy's record in September, assuming Trudy's did not owe any amounts to employees at the end of August?
- A. Debit Cash, credit Wages Revenue.
 - B. Debit Cash, credit Wages Payable.
 - C. Debit Wages Revenue, credit Cash.
 - D. Debit Wages Expense, credit Cash.
76. Which account is least likely to be credited when an expense is recorded?
- A. Cash.
 - B. Accounts Payable.
 - C. Prepaid Expenses.
 - D. Accounts Receivable.

77. Which of the following is not true about the unadjusted trial balance?

- A. An unadjusted trial balance may only include a preliminary amount for income tax expense.
- B. An unadjusted trial balance might balance even if there is a mistake.
- C. An unadjusted trial balance does not yet include end-of-the-accounting period adjustments.
- D. An unadjusted trial balance is part of the financial statements issued to external decision makers.

78. The unadjusted trial balance:

- A. is a preliminary financial statement for external and internal users.
- B. generally lists account names in alphabetical order.
- C. is created to determine that total debits equal total credits.
- D. indicates whether or not errors were made in recording transactions.

79. Which of the following is an example of an error that would cause the trial balance to be out of balance?

- A. A journal entry was posted as a debit to Cash for \$525 and a credit to Accounts Receivable for \$552.
- B. A journal entry was posted as a debit to Cash and a credit to Sales Revenue when the company received a \$400 payment from a customer on account.
- C. A purchase of supplies on account for \$100 was posted as a debit to supplies for \$10 and a credit to accounts payable for \$10.
- D. A \$350 transaction was not recorded at all.

80. A company's revenue recognition policy:
- A. affects the income statement but not the balance sheet.
 - B. defines when its revenue should be collected.
 - C. is usually described in the notes to a company's financial statements.
 - D. states that revenues should not be recorded until payments are received from customers.
81. In September, a customer signed a contract to have his house painted and paid for the job in October. The painting company bought the paint in August on account and paid for it in September. The painting company painted the house in November. According to the Revenue and Expense Recognition (Matching) Principles, the painting company should record:
- A. the revenues in November and the expenses in September.
 - B. the revenues and the expenses in September.
 - C. the revenues and the expenses in November.
 - D. the revenues in September and the expenses in August.
82. The Rainbow House Painting Company has been contracted to strip, repair, prime and paint a house for \$3,600 to be paid in installments as phases of the work are completed. Rainbow should recognize the revenue when
- A. the work begins.
 - B. the first payment is received.
 - C. half of the work is complete and half of the payments have been received.
 - D. the work is complete.

83. Which of the following is not a condition for reporting revenue?

- A. The goods or services have been delivered.
- B. The customer has already paid for the good or service.
- C. The price is fixed or determinable.
- D. Collection is reasonably assured.

84. A dance studio accepts \$1,500 to provide a series of dance lessons to a youth group during the month of July. The studio decides to record the revenue in July. The studio also decides to record the July expenses of rent, utilities and salaries in August, when it pays for them. One or both of these decisions:

- A. violate the Expense Recognition (Matching) principle.
- B. are an example of accrual accounting.
- C. violate the revenue principle.
- D. violate the accounting equation.

85. Which of the following is the correct sequence of steps in the accounting cycle?

- A. Journal entries, T-accounts, financial statements, unadjusted trial balance.
- B. T-account, journal entries, unadjusted trial balance, financial statements.
- C. Journal entries, T-accounts, unadjusted trial balance, financial statements.
- D. Financial statements, journal entries, T-accounts, unadjusted trial balance.

86. The Expense Recognition (Matching) principle indicates
- A. where expenses should be presented on the income statement.
 - B. how expenses should be split between the income statement and the balance sheet
 - C. the ordering of current assets and current liabilities on the balance sheet.
 - D. when costs are recognized as expenses on the income statement.
87. Which of the following errors would most likely lead to an overstatement of net income in the current year?
- A. Recording revenue when the cash is collected next year although it is earned in the current year.
 - B. Recording an expense when paid next year although it is incurred this year.
 - C. Failing to adjust the Unearned Rent Revenue account for the portion of rent earned this year.
 - D. Recording revenue earned in the current year when cash is collected this year.
88. If a company receives the rent for January 2014 from a tenant in December 2013, this will be reported as:
- A. revenue in 2013.
 - B. an expense in 2013.
 - C. a liability in 2013.
 - D. stockholders' equity in 2013.

89. Which of the following accounts has a normal credit balance?

- A. Cash
- B. Notes receivable
- C. Wage expense
- D. Unearned revenue

90. A company has total revenue of \$560,000 and total expenses of \$330,000. If the company overstates sales by \$10,000, how would the net profit margin be affected?

- A. Net profit margin would be overstated.
- B. Net profit margin would be understated.
- C. Net profit margin would be unaffected.
- D. Net profit margin cannot be computed because overstating sales is unethical.

91. On June 30, a company purchased 1 year of insurance coverage which started immediately, paying cash of \$2,400. Choose the true statement.

- A. On June 30, cash would be debited for \$2,400.
- B. On the Income Statement for the year, insurance expense will be \$1,200.
- C. On the Balance Sheet at the end of the year, prepaid insurance will be \$2,400.
- D. On the Balance Sheet at the end of the year, prepaid insurance will be a non-current asset.

92. On December 31, 2013, a company paid \$10,000 to rent a storage facility from July 1, 2014 to July 1, 2015. Choose the true statement.

- A. The Balance Sheet at December 31, 2013 should report prepaid rent of \$10,000 as a non-current asset.
- B. The income statement at December 31, 2013 should report rent expense of \$10,000.
- C. The Income Statement for the year ended December 31, 2013 is unaffected by this transaction.
- D. The Balance Sheet at December 31, 2014 will not report any of this rent as an asset.

The following activities occurred during the current year, 2013, for the Maverick Law Firm.

- On February 1, 2013, received cash of \$5,000 from clients in payment of their accounts from 2012.
- In 2013, received cash of \$13,000 for law services rendered in 2013.
- At the end of 2013, billed customers \$4,000 for services rendered in 2013. This amount was unpaid as of the end of the year.
- In November of 2013, received cash of \$2,000 from clients as a deposit on law services to be performed in 2014.

93. What is the amount of Law Services Revenue to be reported on the Income Statement for the year 2013?

- A. \$19,000
- B. \$22,000
- C. \$24,000
- D. \$17,000

94. Which of the following statements is TRUE about the activities for Maverick Law Firm for 2013?
- A. If Accounts receivable prior to February 1, 2013 was \$25,000, the amount of Accounts Receivable to be reported on the Balance Sheet at December 31, 2013 will be \$24,000.
 - B. The \$2,000 received from clients for law services to be performed next year will be reported as revenue on the Income Statement this year since cash was received.
 - C. The \$4,000 billed to clients for services rendered this year and unpaid as of December 31 will be reported on the Balance Sheet at December 31 as Accounts Payable.
 - D. The \$5,000 received this year from clients in payment of their accounts will be reported on the Income Statement of 2013 as Revenue.
95. Based on the activities above, stockholders' equity of the Maverick Law Firm in 2013 will be
- A. increased by \$20,000.
 - B. decreased by \$5,000.
 - C. increased by \$17,000.
 - D. decreased by \$2,000.
96. Which of the following is not true of the Income Statement of a company that was formed 10 years ago?
- A. Reports a Net Loss for the year if expenses are more than revenues.
 - B. Reports the financial effects of activities that have occurred since the company's inception.
 - C. Reports the amount of the increase in stockholders' equity this year as a result of the company's operations.
 - D. Reports Net Income which is not an account in the ledger.

97. Which of the following accounts does not have a normal debit balance?

- A. Wages Expense
- B. Service Revenue
- C. Accounts Receivable
- D. Cash

98. Which of the following accounts does not have a normal credit balance?

- A. Contributed capital
- B. Accounts Payable
- C. Service Revenue
- D. Rent Expense

99. Which of the following is not true about accrual basis accounting?

- A. The revenue principle is applied.
- B. The Expense Recognition (Matching) principle is applied.
- C. It is required for external accounting reports.
- D. It requires the timing of cash receipts be in the same period as revenues are recognized.

100. Which of the following is not true of the unadjusted trial balance?

- A. A trial balance is an internal report used to determine whether total debits equal total credits.
- B. A trial balance lists every account name in one column, usually in the order of assets, liabilities, stockholders' equity, revenues and expenses.
- C. A trial balance shows the ending balances obtained from the ledger listed in either the debit or credit column.
- D. If debits equal credits in the unadjusted trial balance, it means that no errors were made in the recording of transactions.

101. BD One Company entered into the following transactions. Choose the one which represents an accounting error.

- A. A shareholder of BD One Company purchases a new car, but this was not recorded by the company.
- B. Revenue was recognized when a customer received services from BD One Company.
- C. Cash received from a customer in payment of his account was debited to Cash and credited to Accounts Receivable.
- D. BD One Company ordered inventory and the order was recorded by a debit to Inventory and a credit to Accounts Payable.

The following accounts are taken from the December 31, 2013, financial statements of A to Z Advertising Company:

Advertising Revenue	46,482
Cash	1,516
Accounts receivable	7,296
Interest expense	2,299
Accounts payable	5,000
Operating expenses	37,460
Unearned revenue	1,178
Equipment	18,048
Income Tax Expense	2,326

The following activities occurred in 2014:

1. Billed customers for advertising services rendered, \$55,000.
2. Received cash from customers in payment of their accounts, \$10,400.
3. Incurred \$45,000 of operating expenses of which \$39,000 was paid in cash and \$6,000 was on account and unpaid as of the end of the year.
4. Paid suppliers \$5,000 on the accounts payable.
5. Received deposits from customers of \$2,500 for advertising services to be performed in 2015.

102. What is the balance in the Cash account at December 31, 2014?

- A. \$46,116
- B. \$41,516
- C. \$1,416
- D. \$46,916

103. What is the amount of Accounts receivable at the end of 2014?

- A. \$51,896
- B. \$55,000
- C. \$44,600
- D. \$54,396

104. The income statement for the year ended December 31, 2014 will show

- A. Total Revenue of \$57,500.
- B. Total Expenses of \$39,000.
- C. Total Revenue of \$55,000.
- D. Total Expenses of \$50,000.

105. Which of the following is the journal entry to record activity #5?

- | | | |
|----------------------------|-------|-------|
| A. Cash | 2,500 | |
| Unearned Revenue | | 2,500 |
| | | |
| B. Unearned Revenue | 2,500 | |
| Advertising Revenue | | 2,500 |
| | | |
| C. Cash | 2,500 | |
| Accounts Receivable | | 2,500 |
| | | |
| D. Unearned Revenue | 2,500 | |
| Accounts Receivable | | 2,500 |

106. Which of the following is the journal entry to record activity #4?

- | | | |
|----------------------|-------|-------|
| A. Operating Expense | 5,000 | |
| Cash | | 5,000 |
| | | |
| B. Accounts payable | 5,000 | |
| Cash | | 5,000 |
| | | |
| C. Accounts payable | 5,000 | |
| Operating expense | | 5,000 |
| | | |
| D. Cash | 5,000 | |
| Accounts payable | | 5,000 |

107. Which of the following is the journal entry to record activity #1?

- | | | |
|------------------------|--------|--------|
| A. Advertising Revenue | 55,000 | |
| Accounts receivable | | 55,000 |
| | | |
| B. Accounts receivable | 55,000 | |
| Cash | | 55,000 |
| | | |
| C. Accounts receivable | 55,000 | |
| Advertising revenue | | 55,000 |
| | | |
| D. Accounts receivable | 55,000 | |
| Unearned revenue | | 55,000 |

108. Which of the following is not an operating activity?

- A. Paying off a loan to the bank.
- B. Receiving cash from customers for services rendered.
- C. Paying employees for work completed.
- D. Billing customers for services rendered but not yet paid for.

The following transactions occurred during July:

1. Received \$800 cash for services rendered during July.
2. Received \$5,000 from issuance of stock to investors.
3. Received \$400 from a customer in payment of accounts receivable from the prior month.
4. Billed customers for services performed in July, \$3,500.
5. Borrowed \$2,500 from the bank, giving a promissory note in exchange.
6. Received \$1,000 from a customer for services to be performed next year.

109. What is the amount of Revenue for July?

- A. \$5,300
- B. \$5,700
- C. \$4,300
- D. \$7,200

110. As a result of these transactions, the cash account will increase by:

- A. \$9,700.
- B. \$13,200.
- C. \$2,200.
- D. \$7,200.

111. Recording the above transactions would include which of the following?

- A. Transaction #1 would include a debit to Revenue.
- B. Transaction #3 would include a debit to Accounts Receivable.
- C. Transaction #4 would include a debit to Accounts Receivable.
- D. Transaction #6 would include a debit to Unearned Revenue.

112. A credit of \$500 to Equipment was mistakenly credited to Revenue. What is the effect of this error?

- A. Equipment is understated and Revenue is understated.
- B. Equipment is overstated and Revenue is overstated.
- C. Equipment is overstated and Revenue is understated.
- D. Equipment is understated and Revenue is overstated.

In January 2013, a new consulting firm recorded the following transactions:

1. Issued stock to investors for \$20,000 cash.
2. Purchased \$5,000 of equipment, paying 20% in cash and giving a promissory note for the balance.
3. Received \$9,000 in cash for consulting services performed in January.
4. Bought \$1,500 of supplies on account; all of the supplies were used in January.
5. Provided consulting services for clients and billed them \$16,000.
6. Paid \$750 toward the supplies purchased in #4.
7. Paid \$3,000 to employees for work performed in January.
8. Received a bill for rent and utilities for January of \$3,400.

113. What the amount of total expense to be reported on the Income Statement for the month of January?

- A. \$3,750
- B. \$7,900
- C. \$8,150
- D. \$4,500

114. What is the amount of total revenue to be reported on the Income Statement for the month of January?

- A. \$45,000
- B. \$9,000
- C. \$29,000
- D. \$25,000

115. What is the amount to be reported as total liabilities on the balance sheet at the end of January?

- A. \$4,750
- B. \$4,150
- C. \$8,150
- D. \$8,500

116. What is the amount of Current Assets on the classified balance sheet at the end of January?

- A. \$25,750
- B. \$26,500
- C. \$41,750
- D. \$40,250

117. Which of the following is not true about the Income Statement?

- A. Amounts received from customers for services performed in the current month would be revenues on the income statement.
- B. Costs incurred in the current month but not paid as of the end of the month would be expenses on the income statement for the current month.
- C. Amounts received from customers in payment of their accounts arising from service in the prior period would be revenues in the income statement for the current period.
- D. Amounts received from customer as deposits for services to be rendered next month will not be recorded as revenues on the income statement for the current month.

Accounts receivable	\$ 4,500
Accounts payable	650
Cash	1,700
Consulting Revenue	5,500
Contributed capital	4,000
Equipment	4,900
Insurance expense	400
Land	3,800
Notes payable, due 2005	4,000
Notes receivable, matures 2002	1,200
Prepaid insurance	400
Rent Expense	1,400
Retained earnings, January 1, 2000	7,850
Wage expense	3,700

All accounts have normal balances.

118. What is the total of the debit side of the unadjusted trial balance?

- A. \$22,000
- B. \$17,350
- C. \$16,500
- D. \$13,500

119. What is the amount of Total Assets at December 31?

- A. \$16,500
- B. \$22,000
- C. \$17,350
- D. \$13,500

120. What is the amount of the total liabilities at December 31?

- A. \$4,650
- B. \$8,650
- C. \$5,700
- D. \$9,700

121. Revenues

- A. decrease assets.
- B. increase stockholders' equity.
- C. increase liabilities.
- D. decrease expenses.

A company had the following assets and liabilities at the beginning and end of the current year:

	Assets	Liabilities
Beginning of year	\$214,000	\$ 88,000
End of the year	245,000	75,000

Stock was issued for \$15,000 cash and dividends of \$5,000 were paid during the year.

122. What is the amount of net income for the year?

- A. \$44,000
- B. \$34,000
- C. \$24,000
- D. \$54,000

123.If contributed capital was \$100,000 at the beginning of the year, what was the amount at the end of the year?

- A. \$100,000
- B. \$110,000
- C. \$115,000
- D. \$170,000

The balances for the accounts of Dudley Do-Right Repair Shop for the year ended December 31, 2013, are shown below and each account has a normal balance:

Accounts payable	\$ 6,500
Accounts receivable	7,000
Cash	?
Repair supplies	1,200
Building	125,000
Repair supplies expense	21,500
Contributed capital	50,000
Repair service revenue	175,000
Wages expense	36,000
Rent expense	6,000
Retained earnings, January 1, 2013	68,700
Land	50,000
Unearned repair revenue	4,000
Dividends	48,000

124.What will be the trial balance total?

- A. \$439,200
- B. \$367,700
- C. \$608,400
- D. \$304,200

125. Which of the following is not true about the financial statements of Dudley Do-Right Repair Shop?

- A. The balance sheet at December 31, 2013 will show Total Liabilities of \$10,500.
- B. The balance sheet at December 31, 2013 will show Retained earnings of \$68,700.
- C. The Income Statement for the year will not include the dividends of \$48,000.
- D. The Income Statement for the year will show Total Revenue of \$175,000.

126. Which of the following would not be reported on the Income Statement?

- A. Utilities expense in the amount of a bill received for utilities used during the current period but unpaid as of the end of the period.
- B. Rent expense in the amount of rent paid during the period for use of a storage facility in the current period.
- C. Revenue in the amount of services provided to customers who promise to pay in the next period.
- D. Cost of land, paid in cash, and purchased for future use.

127. Seconds Best Retail Store receives and immediately pays a \$3,500 utility bill from the City Gas & Electric Company. The entry by the City Gas & Electric Company to record receipt of this payment would include a:

- A. credit to accounts payable.
- B. credit to utilities expense.
- C. debit to utilities revenue.
- D. debit to cash.

128. A company received a bill of \$3,500 for utilities used in the current month. The journal entry to record this would include:

- A. a debit to Accounts receivable for \$3,500.
- B. a credit to Accounts payable for \$3,500.
- C. a credit to Utilities expense.
- D. No entry would be made until the utilities are paid.

In the previous month, Seconds Best Company sold goods to a customer for \$10,000 cash and \$60,000 on credit. In the current month, the customer paid \$50,000 to Seconds Best toward the amount owed.

129. The correct entry by Seconds Best to record the sale in the previous month is:

- | | | | |
|----|------------------------|--------|--------|
| A. | Cash | 10,000 | |
| | Accounts receivable | 60,000 | |
| | Sales Revenue | | 70,000 |
| | | | |
| B. | Cash | 10,000 | |
| | Unearned Sales revenue | 60,000 | |
| | Sales Revenue | | 70,000 |
| | | | |
| C. | Cash | 10,000 | |
| | Accounts payable | 60,000 | |
| | Sales Revenue | | 70,000 |
| | | | |
| D. | Cash | 10,000 | |
| | Sales Revenue | | 10,000 |

130. The correct entry by Seconds Best Company to record the receipt of payment in the current month is:

- | | | |
|------------------------|--------|--------|
| A. Cash | 60,000 | |
| Unearned Sales Revenue | | 60,000 |
| B. Cash | 60,000 | |
| Sales Revenue | | 60,000 |
| C. Cash | 60,000 | |
| Accounts receivable | | 60,000 |
| D. Cash | 60,000 | |
| Accounts payable | | 60,000 |

131. An expense:

- A. will decrease the amount of net income on the income statement.
- B. will decrease the amount of contributed capital on the balance sheet.
- C. will be increased with a credit to the account.
- D. normally has a credit balance.

132. Which of the following is true about accrual basis accounting and cash basis accounting?

- A. Net Income is generally larger under accrual basis accounting than cash basis accounting.
- B. GAAP does not require accrual basis accounting be used for external reports.
- C. Accrual basis accounting and cash basis accounting will always produce the same amount of net income.
- D. Accrual basis accounting provides a better measure of operating performance than does cash basis accounting

133. During 2014, a company provided services for cash of \$21,000 and services on credit of \$15,000. The company collected accounts receivable of \$8,000 and incurred operating expenses of \$22,700, \$14,000 of which were paid during the year. The amount of net income (loss) for the year is:

- A. \$13,300.
- B. (\$1,700).
- C. \$22,700.
- D. \$6,300.

134. A company reported Sales revenue, all from credit sales, of \$40,000 on the Income Statement for the current year. The balance sheet includes the following:

Unearned Sales revenue, beginning of current year	\$ 0
Unearned Sales revenue, end of current year	\$7,750
Accounts receivable, beginning of current year	\$4,500
Accounts receivable, end of current year	\$ 800

What is the amount of cash that was collected during the year?

- A. \$11,450
- B. \$51,450
- C. \$43,700
- D. \$38,200

135. Which of the following is an operating activity?

- A. Repaying a bank loan.
- B. Paying a dividend to owners.
- C. Purchasing a new building.
- D. Paying for inventory to be offered for sale.

136. Which of the following is true of income statement accounts?

- A. Costs incurred to help generate revenue are only reported as expenses on the income statement if they are paid in cash in the same period as the revenue received.
- B. Revenue accounts are shown after the amount of expense accounts on the income statement.
- C. Revenue accounts include accounts receivable, unearned revenue and cash accounts.
- D. There is no net income account.

137. A company incurred \$5,000 in wages for employees for the year. \$4,500 of these wages were paid by the end of the year. Choose the TRUE statement.

- A. Wages payable on the income statement will be \$4,500.
- B. Wages expense on the income statement will be \$500.
- C. Wages expense on the balance sheet will be \$5,000.
- D. Wages payable on the balance sheet will be \$500.

138. This month, a company recorded sales revenue of \$50,000 from sales of goods to customers who agreed to pay later. Next month, the company received payment from customers of \$45,000. Choose the TRUE statement.

- A. Revenue for this month is \$45,000.
- B. Accounts receivable at the end of next month is \$5,000.
- C. Accounts Payable at the end of this month is \$5,000.
- D. Revenue for next month will be \$45,000.

139. A company has sales revenues of \$200,000 and expenses of \$50,000. What is its net profit margin?

- A. 4
- B. 25%
- C. 75%
- D. \$150,000

140. Which of the following statements is not true regarding net profit margin?

- A. If a company's net profit margin increases from 15% to 20% this would be considered an improvement in profitability.
- B. A company with a net profit margin of 10% may be evaluated differently depending upon which industry it is in.
- C. A company with a net profit margin of 10% is using 90% of each dollar of revenue to cover costs and expenses.
- D. Net profit margin indicates how much revenue is earned for every dollar of net income.

Essay Questions

Jim's Gymnastics Training's operations for the month of October are summarized as follows:

- Provided \$5,000 of training to students.
- Received \$8,000 cash from students—of which \$4,000 is for training provided in October (as billed above), \$1,000 is for training to be provided in November, and \$3,000 is for training provided in September.
- Paid September's gym rental bill of \$1,000. Received October's bill of \$1,500 but did not pay.

141. Calculate the following:

- a) Net Income for October using the cash basis of accounting.
- b) Net Income for October using the accrual basis of accounting.

142. Prepare appropriate journal entries using the accrual basis of accounting.

143. Analyze the events listed below by indicating the accounts and amounts involved in the table below. In the column labeled "+/-", select the sign that describes how the category is affected. If the event should not to be recorded as a transaction, state so.

- A. Borrowed \$7,000,000 cash, signing a promissory note.
- B. Bought a factory for \$800,000, paying \$200,000 in cash and signing a promissory note for \$600,000.
- C. Rented equipment and issued a check for 6 months at \$10,000 a month.
- D. Provided \$104,000 of services and billed customers.
- E. Purchased \$30,000 of supplies on account.
- F. Received a utility bill for the current period in the amount of \$1,200.
- G. Raised sales prices on 200 units from \$400 per unit to \$440 per unit.
- H. Received a 50% deposit from a customer on a \$20,000 order to be filled next month.

	Assets			Liabilities			Stockholders' Equity		
	Account(s)	+ /-	Amount	Account(s)	+/ -	Amount	Account(s)	+/ -	Amount
A									
B									
C									
D									
E									
F									
G									
H									

144. The Pet Sitters, Inc., had the following transactions during the month of January. For each of the transactions, prepare journal entries.

- A. Paid \$5,000 cash for cat litter.
- B. Paid \$4,480 for wages for the month of January.
- C. Paid \$480 in advance for February rent.
- D. Provided \$12,000 in services on account.
- E. Paid \$800 on accounts payable.
- F. Received \$210 from customers as deposits for future pet sitting services.
- G. Obtained \$390 in vet services during the month, but will not pay the bill until February.
- H. Paid \$780 for equipment.

145. The following is a series of accounts for the Sprinkler Blowout Company, listed alphabetically and numbered for identification. Following the accounts is a series of transactions. For each transaction, indicate the account(s) that should be debited and credited by entering the appropriate account number(s) to the right of each transaction. If no journal entry is needed, write *none* after the transaction. The first transaction is given as an example.

Acct. #	Account Title	Acct. #	Account Title
1	Accounts payable	9	Land
2	Accounts receivable	10	Note payable
3	Rent expense	11	Prepaid insurance
4	Building	12	Service revenue
5	Cash	13	Unearned revenue
6	Contributed capital	14	Supplies
7	Insurance expense	15	Wages expense
8	Income taxes payable	16	Wages payable

Transactions	Debit	Credit
Example: Collected cash from customers paying off their accounts.	5	2
A. Performed services for customers this month for cash.		
B. Purchased supplies on credit.		
C. Purchased a building, paying part cash and signing a note for the rest.		
D. Paid insurance premium for coverage beginning next month.		
E. Booked blowouts to be done next month; didn't collect cash.		
F. Made payment to suppliers on account.		
G. Collected from customers for work to be performed next month.		
H. Hired an employee.		
I. Pay this month's rent.		

146. Show journal entries for each of the following January activities, and post results to the relevant T-accounts. Compute the ending balance of each T-account. Beginning balances have been entered.

- A. Paid \$689 on account for December's utilities.
- B. Bought \$423 of supplies for cash.
- C. Paid \$3,500 legal fees in advance for legal services to be received over the next six months.
- D. Bought \$15,000 of new equipment, signing a promissory note.
- E. Provided \$26,000 of services. \$17,000 was received in cash and \$9,000 was provided on credit.
- F. Paid workers \$8,300 for work done in January.

147. At September 30, Balance Corporation reported the following unadjusted amounts for its accounts, each of which is considered to be a "normal" balance. That is, an account that normally has a debit balance actually does have a debit balance. Prepare an unadjusted trial balance.

Accounts Payable	\$12,000
Accounts Receivable	1,000
Advertising Expense	400
Cash	85,000
Contributed Capital	64,000
Equipment	60,000
Note Payable	36,000
Rent Revenue	42,000
Retained Earnings	24,800
Supplies	1,400
Supplies Expense	600
Utilities Expense	2,000
Wages Expense	28,400

148. Match the term and the explanation. There are more definitions than terms.

_____ cash basis

_____ net profit margin

_____ unadjusted trial balance

_____ prepaid expense

_____ unearned revenue

_____ revenue recognition policy

_____ Expense Recognition (Matching) principle

A. Reported when a company sells goods or services in the ordinary course of business for more than it costs to produce.

B. Reporting expenses and revenue according to the time the underlying activities occur.

C. A list of account balances when the accounts do not yet include all revenues and expenses.

D. The concept that expenses should be reported at the same time as the related revenue.

E. The principle that changes in assets must be matched by changes in liabilities and equity.

F. Also known as net assets, this is the value of assets minus liabilities.

G. An asset account indicating a company has already paid a cost not yet incurred.

H. A company's policy on when to report revenue in the financial statements.

I. Reporting expenses and revenues according to the time the money is paid or received.

J. A liability account indicating customers have already paid for services not yet rendered.

K. A ratio that indicates the percent of each revenue dollar that is left over after covering costs and expenses.

149. Match the term and the definition. There are more definitions than terms.

- _____ unearned revenue
- _____ expenditure
- _____ revenue recognition principle
- _____ accrual basis
- _____ time period assumption
- _____ expense
- _____ net income

- A. To reduce the recorded value of an asset to better reflect its true market value.
- B. Any outlay of money by a company for any purpose.
- C. The practice of dividing the life of the business into months and years.
- D. The concept that revenue and expenses should be recorded at the time received or paid.
- E. The concept that revenue should be recorded when earned, not necessarily when payment is received.
- F. Revenues should be recorded when they are earned and expenses when they are incurred.
- G. Total revenue minus total expenses.
- H. Any use or sacrifice of a company's resources to generate revenue.
- I. The increase in value of financial assets held by a company.
- J. Payments received for goods that have not yet been delivered or services that have not yet been performed.
- K. The concept that a company should record revenue during the same period as expenses.

150. For each of the following, indicate the effect the situation would have on net income in the current period.

O overstate net income

U understate net income

N/A not applicable; no effect on net income

_____ recording prepaid costs as current expenses.

_____ recording an expense at more than the actual cost.

_____ failing to record the receipt of a payment by a customer on account.

_____ failing to record some supplies received.

_____ recording unearned revenue as revenue.

_____ recording an expense as revenue.

_____ failing to record the company issuing additional shares of its own common stock.

151. Indicate whether a debit (dr) or credit (cr) would be used to increase each of the following accounts.

_____ prepaid expenses.

_____ rental revenue.

_____ salaries and wages expense.

_____ service revenue.

_____ property and equipment.

_____ wages expense.

_____ retained earnings.

_____ supplies expense.

152. Match the letter and the blank in each transaction description to complete the analysis. All letters will not be used and some letters may be used more than once.

- A. debit
- B. cash
- C. revenue
- D. supplies
- E. credit
- F. expense
- G. accrued liabilities
- H. unearned revenue
- I. accounts receivable
- J. notes payable

1. A company pays wages. This is posted as a(n) ____ to cash and a(n) ____ to wages expense.
2. A company is paid for a job completed last month. This is posted as a debit to ____ and a credit to ____.
3. A restaurant buys and immediately uses ingredients. This is posted as a(n) ____ to an expense and a(n) ____ to cash.
4. A company pays the original amount owed on a promissory note. This is posted as a debit to ____ and a credit to ____.
5. A company receives money for a job to be done next month. This is posted as a debit to ____ and a credit to ____.

Chapter 03 The Income Statement **Answer Key**

True / False Questions

1. All revenues come from selling the company's goods or services.

FALSE

Revenues can be generated by peripheral activities, such as interest revenue earned on financial investments.

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Reporting

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 03-01 Describe common operating transactions and select appropriate income statement account titles.

Topic: Operating Transactions

2. Expenses are the same as expenditures.

FALSE

Expenditures include any spending by the company while expenses are costs incurred (not just cash spent) to generate revenue.

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Reporting

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 03-01 Describe common operating transactions and select appropriate income statement account titles.

Topic: Income Statement

3. In any given industry, companies are entirely consistent in the account titles they use on financial statements.

FALSE

There is a great deal of variability in how individual companies name accounts.

AACSB: Analytic

AICPA BB: Industry

AICPA FN: Reporting

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 03-01 Describe common operating transactions and select appropriate income statement account titles.

Topic: Income Statement

4. Costs that benefit future periods are reported as assets.

TRUE

Expenses are costs incurred in generating revenue in the period. Costs incurred to benefit future periods are not expenses of the current period.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Expense Recognition (Matching) Principle

5. A net profit margin of 15.4% means that the company used 84.6 cents of each sales dollar to cover costs and expenses.

TRUE

A net profit margin of 15.4% means that the company earned 15.4 cents of net income for each dollar of sales revenue, so 84.6 cents ($\$1.00 - \$.154$) went to cover costs and expenses.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Blooms: Evaluate

Difficulty: 3 Hard

Learning Objective: 03-05 Evaluate net profit margin; but beware of income statement limitations.

Topic: Net Profit Margin

6. To evaluate a company's net profit margin, it is best to compare it to another company in the same industry.

TRUE

Different industries have different cost structures which can affect financial ratios.

AACSB: Analytic

AICPA BB: Industry

AICPA FN: Decision Making

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-05 Evaluate net profit margin; but beware of income statement limitations.

Topic: Net Profit Margin

7. If debits equal credits on the trial balance, it means that the accounting records do not contain any errors.

FALSE

Even if debits equal credits on the trial balance, it is still possible that the wrong account was used, or an entry was omitted or recorded twice, or the wrong amount was entered as both a debit and a credit.

AACSB: Reflective Thinking

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 03-04 Prepare an unadjusted trial balance.

Topic: Unadjusted Trial Balance

8. Prepaid expenses would be reported on the Balance Sheet.

TRUE

Prepaid expense is an asset account and would be reported on the balance sheet.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Expense Recognition (Matching) Principle

9. Net income is based on estimates.

TRUE

Accounting involves estimating certain values. For example, depreciation requires an estimate of the asset's useful life.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 03-05 Evaluate net profit margin; but beware of income statement limitations.

Topic: Income Statement Limitations

10. If a company decides to record an expenditure made this period as an expense, when it should have been recorded as an asset, net income will be overstated in the current period as a result.

FALSE

Erroneously recording an asset as an expense would overstate total expenses, which would understate net income.

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Reporting

Blooms: Understand

Difficulty: 3 Hard

Learning Objective: 03-04 Prepare an unadjusted trial balance.

Topic: Income Statement

11. Net Income on the Income Statement is equal to the amount of cash generated by the business.

FALSE

Net Income under the accrual basis is equal to revenues as measured using the revenue principle minus expenses as measured using the matching principle and results in revenues that do not necessarily equal cash receipts and expenses that do not necessarily equal cash disbursements.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Income Statement

12. A company does not need to record the receipt of a bill for utilities used during this year if they will not pay for it until next year.

FALSE

Costs incurred in generating revenue for the period are expenses according to the matching principle. Utilities expense is recorded this year and a liability, accounts payable or utilities payable, is recorded.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Expense Recognition (Matching) Principle

13. The period of time from buying goods and services to collecting cash from customers is called the accounting cycle.

FALSE

The time between buying assets to be sold to customers and collecting cash from customers is the operating cycle of the business.

AACSB: Analytic

AICPA BB: Industry

AICPA FN: Measurement

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 03-01 Describe common operating transactions and select appropriate income statement account titles.

Topic: Operating Transactions

14. Dividing up the continuing life of a company into shorter periods is called the time period assumption.

TRUE

The ongoing life of a company is divided up into shorter periods according to the time period assumption so that financial reports can be issued for specific periods of time and at a specific point in time.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 03-01 Describe common operating transactions and select appropriate income statement account titles.

Topic: Operating Transactions

15. GAAP does not allow cash basis accounting to be used in external financial reports.

TRUE

GAAP requires accrual accounting to be used in external financial reports.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Expense Recognition (Matching) Principle

Topic: Revenue Recognition Principle

16. It is possible for a company to be profitable, yet not have enough cash to pay its bills.

TRUE

Under the accrual basis, revenues are recorded when earned and expenses when incurred, whereas cash may be received at a different time. A profitable company may not be able to pay its bills if it does not collect cash from customers quickly enough.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Blooms: Remember

Difficulty: 3 Hard

Learning Objective: 03-01 Describe common operating transactions and select appropriate income statement account titles.

Topic: Accrual Basis of Accounting

17. If revenues are not growing faster than expenses, then Net income will decrease.

TRUE

If revenues are increasing, but expenses are increasing even faster, then the amount of Net Income (Revenues - Expenses) will decrease.

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Reporting

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Income Statement

18. Net Income would be understated by a failure to record collection of accounts receivable.

FALSE

Recording the collection of accounts receivable would increase Cash and decrease Accounts Receivable. This would have no effect on Net Income.

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Reporting

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

19. Unearned Revenue is reported on the Balance Sheet as a liability.

TRUE

Unearned Revenue is a liability account. Revenue is recorded when it is earned, that is when services or goods have been provided. Prior to that, amounts received in advance are reported as Unearned Revenue, a liability, on the Balance Sheet.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

20. When expenses exceed revenues in a period, stockholders' equity will increase.

FALSE

Revenue - Expense = Net Income, and if expenses are greater than revenues, the amount of Net Income will be negative. This amount will be subtracted from retained earnings, which is a component of stockholders' equity, and therefore, this will decrease stockholders' equity.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

Multiple Choice Questions

21. Which one of the following statements regarding the accrual and cash basis of accounting is true?
- A. Using the accrual basis of accounting, if payment is received before delivery of a good or service, a revenue is recorded at the time the payment is received.
 - B. Using the accrual basis of accounting, if payment is received after delivery of a good or service, an asset is recorded at the time the good or service was delivered.**
 - C. Using the cash basis of accounting, if payment is received before delivery of a good or service, net income is affected when goods or services are delivered.
 - D. Using the cash basis, if payment is received after delivery of a good or service, unearned revenue is recorded.

Under the accrual basis, the Revenue Recognition Principle states that revenue is recorded when it is earned which may not be the time when cash is received. If cash is received prior to revenue being earned, the balance sheet will report a liability for unearned revenue. If revenue is earned prior to cash being received, the balance sheet will report an asset called Accounts Receivable.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Accrual Basis of Accounting

Topic: Cash Basis of Accounting

Topic: Revenue Recognition Principle

22. Which one of the following statements regarding the debit/credit processing of revenues and expenses is true?

- A. Debits reduce expenses.
- B. The total credits recorded in revenue accounts must equal the total debits recorded in expense accounts.
- C. Across all revenue accounts, the total value of all debits must equal the total value of all credits.
- D. Credits increase revenues.

Debits increase expenses and credits increase revenues. Across all accounts, the total debits must equal the total credits so that the unadjusted trial balance is in balance.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Debit/Credit Framework

23. Which one of the following statements regarding the trial balance is true?
- A. A trial balance is included in the full set of external financial statements, just like an income statement.
 - B. If debits equal credits in the unadjusted trial balance, you have made no errors in preparing and posting journal entries.
 - C.** The balances for each account reported on an unadjusted trial balance are determined by adding the amounts on the "+" side and subtracting the amounts on the "-" side of each ledger or T-account.
 - D. GAAP allows companies to choose between the cash basis or the accrual basis of accounting.

The trial balance is an internal accounting report only. Debits equal credits means only that you have recorded transactions with equal debits and credits. Errors could still exist if incorrect accounts were used or if transactions were not recorded at all. The balance in an account is determined by adding the increases and subtracting the decreases to the account. GAAP requires the accrual basis of accounting.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Unadjusted Trial Balance

24. Which one of the following statements regarding the Revenue Recognition Principle and Expense Recognition (Matching) Principle is true?
- A. According to the revenue principle, a company should not record the revenue from a transaction until it is actually received in cash.
 - B. Expenses are recorded when the company uses goods or services.**
 - C. The Expense Recognition (Matching) principle requires that expenses be determined first and then revenues be "matched" to those expenses.
 - D. The revenue and expense accounts on the income statement continue to have an impact beyond the current period, whereas balance sheet items report the financial impact in just the current period.

Revenue is recognized (reported on the Income Statement) when it is earned which may not be the same time as cash is received. Expenses are recorded when goods or services are used. Expenses are matched to the revenues. Revenues and expenses have an impact on the current period only, while balance sheet items continue to have an impact beyond the current period.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Expense Recognition (Matching) Principle

Topic: Revenue Recognition Principle

25. Which of the following statements regarding revenues and expenses is true?

- A. Both revenues and expenses typically have credit balances.
- B. Revenues and expenses are considered assets and liabilities, respectively.
- C. Revenue is the same as cash.
- D. Expenses decrease the amount of stockholders' equity.

Revenues have credit balances and expenses have debit balances. Revenues are not assets and expenses are not liabilities. Expenses decrease net income which decreases retained earnings, a component of stockholders' equity.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

26. Which of the following statements regarding cash and accrual accounting is true?

- A. If payment is received at the same time a service is produced and sold, there is no difference between how cash and accrual accounting record the transaction.
- B. The cash basis of accounting works best when a lengthy delay exists between the timing of cash flows and the underlying business activities to which they relate.
- C. If a company receives a bill for rent for the period and decides to delay payment, the rent will not be recorded as an expense according to the accrual model of accounting.
- D. The cash basis of accounting would record unearned revenue if a company received a deposit in advance of services to be rendered by the company.

Cash basis accounting records revenue when cash is received and expenses when cash is paid. Accrual accounting records revenue when it is earned and expenses for costs incurred in generating the revenue whether or not they have been paid.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Accrual Basis of Accounting

Topic: Cash Basis of Accounting

Topic: Expense Recognition (Matching) Principle

Topic: Revenue Recognition Principle

Melody's Piano School operations for the month of May are summarized in the following three transactions:

- Provided \$500 of instruction to students.
- Of the \$500 of instruction provided in May, \$400 is collected in cash, and an additional \$300 is collected for lessons provided in April.
- Paid April's piano rental bill of \$100. Received May's bill of \$150 but did not pay.

27. What is Melody's Net Income for May using the cash basis of accounting?

- A. \$800
- B. \$300
- C. \$350
- D. \$600

Using the cash basis, revenues equal the cash received and expenses equal the cash paid.

$$\$700 - \$100 = \$600$$

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Apply

Difficulty: 2 Medium

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Cash Basis of Accounting

28. What is Melody's Net Income for May using the accrual basis of accounting?

- A. \$400
- B. \$300
- C. \$350**
- D. \$600

Under accrual accounting, revenues are reported when they are earned (\$500) and expenses are reported when incurred to generate the revenue (\$150).

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Apply

Difficulty: 2 Medium

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Accrual Basis of Accounting

29. Which of the following would not be associated with an expense?

- A. Using supplies.
- B. Paying off an account payable.**
- C. Paying for electricity used by production equipment during the current period.
- D. Paying daily wages for production workers.

Using supplies, paying for electricity used in production activities and paying wages of production workers are expenses which reduce assets. Paying off an accounts payable reduces cash and liabilities.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 03-01 Describe common operating transactions and select appropriate income statement account titles.

Topic: Transaction Analysis

30. Which of the following represents a subtotal rather than an account?

- A. Advertising Expense.
- B. Service Revenue.
- C. Supplies Expense.
- D.** Total Revenues.

The revenue accounts are added together and a subtotal of Total Revenues is reported on the Income Statement.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 03-01 Describe common operating transactions and select appropriate income statement account titles.

Topic: Income Statement

31. Which of the following is an expense of this period?

- A. Costs of items used up this period but paid for next period.
- B. Costs of items paid for in this period but used up next period.
- C. Cost of land purchased and paid for this period.
- D. Repayment of debt from a loan in a prior period.

Expenses are costs incurred in generating revenue. If an item is not used up this period it is not an expense of this period. Expenses are not land acquisition (an investing activity) or repayment of debt (a financing activity) which both affect the balance sheet.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Expense Recognition (Matching) Principle

32. Net Income refers to:

- A. The difference between what was earned and the costs incurred during a period.
- B. The difference between the cash received and the cash paid out during a period.
- C. The difference between what is owned and what is owed at a point in time.
- D. The change in the value of the company during a period.

The Income Statement reports revenues earned minus expenses incurred during a period. Net income does not refer to the difference in cash inflows and outflows which are reported on the Statement of Cash Flows or to the difference between what is owned (assets) and what is owed (liabilities) which are reported on the Balance Sheet. The Income Statement does not measure the change in value of a company during a period. There are many factors involved in determining the value of the company and the income statement only reports the results of operating activities that have resulted in recordable transactions.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 03-05 Evaluate net profit margin; but beware of income statement limitations.

Topic: Limitations of Income Statement

33. Time Warner is a publishing and communications company, specializing in magazines, cable television operation, television program development, and other telecommunication services. Its financial statements show \$37,666 in an account called "Unearned Subscriber Revenue," which represents amounts that customers have paid in advance of receiving magazines, cable television, and internet services. What type of account is this and on what statement is it reported?

	<u>Type of Account</u>	<u>Financial Statement</u>
A)	Asset	Balance Sheet
B)	Liability	Balance Sheet
C)	Revenue	Balance Sheet
D)	Revenue	Income Statement

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

Unearned revenue is a liability, not an asset, on the balance sheet. Amounts received in advance (unearned revenue) are not yet earned, and are not yet revenue to be reported on the income statement.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Revenue Recognition Principle

34. Which of the following items is not a specific account in a company's chart of accounts?

- A. Income Tax Expense.
- B. Sales Revenue.
- C. Unearned Revenue.
- D. Net Income.

Net Income is not an account. It is the final amount shown on the Income Statement which is the amount of Revenues - Expenses.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 03-01 Describe common operating transactions and select appropriate income statement account titles.

Topic: Income Statement

35. During November 2013, Asler Inc. performs consulting services. The client does not pay Asler until January, 2014.
- A. Using the accrual basis of accounting, the revenue is reported in January 2014.
 - B. Using the cash basis of accounting, the revenue is reported in November 2013.
 - C. Using the accrual basis of accounting, the revenue is reported in November 2013.
 - D. Using the accrual basis of accounting, the revenue is reported when Asler's expenses are paid.

Using the accrual basis of accounting, revenue is reported on the income statement in the period that it is earned which in this example is November 2013. Using the cash basis of accounting, revenue would be reported in the month cash is received which in this example is January 2014.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Accrual Basis of Accounting

Topic: Cash Basis of Accounting

Topic: Revenue Recognition Principle

36. The Fastbank Motorcycle Service Company (FMSC) wins a \$10 million bid to provide the repair service for a recall on a popular brand of motorcycles. No money is exchanged. The repairs are expected to take place next quarter. How will these events affect the balance sheet?

- A. Accounts Receivable will increase by \$10 million this quarter and Inventories will decrease next quarter.
- B. Both Accounts Receivable and Accounts Payable will increase by \$10 million this quarter.
- C. Both Accounts Receivable and Stockholders' Equity will increase by \$10 million this quarter.
- D. These events will not impact the balance sheet this quarter.

This is not a recordable transaction this quarter.

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Reporting

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Transaction Analysis

37. During June, the Grass is Greener Company mows 100 lawns a week and is paid in July by those customers. The company uses the accrual basis of accounting. How will these events affect the company's financial statements?

- A.** The income statement shows the effects of the transactions in June.
- B. The income statement shows the effects of the transactions in July.
- C. The balance sheet shows no effect from the transactions in June.
- D. The transactions have no effect on the balance sheet.

The Income Statement for June will report the revenue from the lawn mowing done in June. The Balance Sheet at the end of June will report the asset, accounts receivable, which is the amount receivable from the customers.

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Reporting

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Accrual Basis of Accounting

Topic: Expense Recognition (Matching) Principle

Topic: Revenue Recognition Principle

38. During June, the Grass is Greener Company mows 100 lawns a week; the company was paid in advance during May by those customers. The company uses the accrual basis of accounting. How will these events affect the company's financial statements?

- A. The income statement shows the effects of the transactions in May.
- B.** The income statement shows the effects of the transactions in June.
- C. The balance sheet shows no effect from the transactions in May.
- D. The transactions have no effect on the balance sheet.

Using accrual basis of accounting, revenue is reported on the Income Statement in the period in which it is earned, that is when services are performed. In this example the revenue will be recorded in June. In May the balance sheet will show a liability, unearned revenue, for the amounts received in advance.

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Accrual Basis of Accounting

Topic: Expense Recognition (Matching) Principle

Topic: Revenue Recognition Principle

39. During April, the Grass is Greener Company buys and pays for a six-month supply of fertilizer in order to receive a bulk discount. The cost of fertilizer is recorded:
- A. immediately as an expense.
 - B. as a liability, which will later be reduced as the fertilizer used.
 - C. partially as an expense and partially as a liability.
 - D. as an asset, which will later be reduced as the fertilizer is used.

Before the fertilizer is used it is an asset. As it is used it will become an expense, a cost incurred in order to generate revenue.

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Transaction Analysis

40. Which of the following practices would not be considered ethical?

- A. Failing to record an expense even though cash has been paid.
- B. Recording 31 days of sales in April.**
- C. Using the cash basis of accounting.
- D. Adjusting the accounts after a trial balance has been prepared.

Expenses are recorded when goods/services are used, not necessarily when cash is paid. Since April only has 30 days, recording 31 days of sales would overstate revenue. GAAP requires companies to use the accrual basis of accounting for external reporting, but small companies may use the cash basis, and the cash basis may be used for internal reporting. After a trial balance is prepared, the accounts need to be adjusted to update the accounts.

AACSB: Ethics

AICPA BB: Critical Thinking

AICPA FN: Decision Making

Blooms: Evaluate

Difficulty: 2 Medium

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Learning Objective: 03-04 Prepare an unadjusted trial balance.

Topic: Accounting Cycle

Topic: Accrual Basis of Accounting

Topic: Cash Basis of Accounting

Topic: Income Statement

41. Your company bought a 30-second advertisement that aired during the Super Bowl at a cost of \$1.2 million. It is legally obligated to pay for the ad but has not yet done so. How does the purchase and use of the ad time affect your company's balance sheet?

- A. It increases both assets and liabilities by \$1.2 million.
- B. It increases assets and decreases stockholders' equity by \$1.2 million each.
- C. It does not affect the balance sheet.
- D. It increases liabilities and decreases stockholders' equity by \$1.2 million each.

Use of the ad time does not increase assets. It is an expense of the period which will decrease stockholders' equity. Since it is unpaid it will be recorded as a liability.

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Transaction Analysis

42. Your company receives advance payment in October for services that are provided during November. Which of the following is true?

- A. A liability is recorded in October; in November the liability is reduced and revenue is recorded.
- B. Revenue is recorded in October and expenses are recorded in November.
- C. An asset is recorded in October; in November, the asset is reduced and revenue is recorded.
- D. Revenue and expenses are recorded in October.

In October the amount received is recorded as unearned revenue, a liability, because it has not yet been earned. In November, it is earned. The amount is then recorded as revenue and the liability is decreased.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Transaction Analysis

43. Your company orders and receives supplies in January, pays for them in February, provides services that use those goods up in March and is paid by customers in April. Using the accrual basis of accounting:

- A. expenses are recorded in February and revenues are recorded in April.
- B. expenses are recorded in February and revenues are recorded in March.
- C. expenses and revenues are recorded in March.
- D. expenses are recorded in January and revenues are recorded in April.

Supplies are initially recorded as assets. When they are used up in March in helping to generate revenue in March, they are then recorded as expenses. Revenues are recorded in March when services are provided.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 3 Hard

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Transaction Analysis

44. If accounts receivable has a beginning balance of \$4,210 and an ending balance of \$3,495, and collections on account were \$9,600, how much were credit sales?

- A. \$8,885
- B. \$17,305
- C. \$10,315
- D. \$1,895

Assets are not service revenue, which is reported on the income statement. Beginning accounts receivable (\$4,210) plus credit sales (\$8,885), less collections on account (\$9,600) is equal to the ending balance (\$3,495).

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Analyze

Difficulty: 2 Medium

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Transaction Analysis

45. Which of the following is not true concerning requirements of when a company should recognize revenue?

- A. When delivery has occurred or services have been provided (rendered).
- B. When the price is fixed or determinable.
- C. When there is persuasive evidence of an arrangement for customer payment and collection is reasonably assured.
- D. When cash has been received for services rendered.

Revenue is recorded when it is earned, the price is determined, and there is persuasive evidence that collection is reasonably assured.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Remember

Difficulty: 3 Hard

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Revenue Principle

46. Which one of the following would not be considered an operating activity?

- A. pay employees for work completed
- B. buy supplies on account
- C. purchase equipment for cash
- D. sell goods to customers

Paying employees, buying supplies, and selling goods to customers are all operating activities.

Purchasing equipment is an investing activity.

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Reporting

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 03-01 Describe common operating transactions and select appropriate income statement account titles.

Topic: Operating Activities

47. Which of the following statements is true about the cash basis of accounting?

- A.** It can distort reported profits.
- B. It is the only acceptable method for external reporting.
- C. It reports revenues when earned and expenses when incurred.
- D. It is used when cash is paid at the same time as the cost is incurred, but is not used when cash is paid before the expense is incurred.

The cash basis of accounting is not acceptable for external reports. It reports revenues when cash is received and expenses when cash is paid which can distort reported profits since the exchange of cash may not correspond to when the activities occur.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Cash Basis of Accounting

48. Company A receives \$10,000 in advance this month for work to be performed next month. This month, the company should:

- A. Debit Cash \$10,000 and credit Service Revenue \$10,000.
- B.** Debit Cash \$10,000 and credit Unearned Revenue \$10,000.
- C. Debit Cash \$10,000 and credit Accounts Receivable \$10,000.
- D. Debit Prepaid Expense \$10,000 and credit Cash \$10,000.

Receiving cash in advance of performing work means that revenue has not been earned. The company has an obligation to carry out this work before revenue is recognized. This transaction would be recorded as an increase, debit, to Cash \$10,000 and an increase, credit, to Unearned Revenue \$10,000.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

49. A customer purchased \$1,500 of services on credit two months ago and has just paid the bill. The receipt of the payment from the customer is recorded as a

- A. debit to Cash and a credit to Accounts Receivable.
- B. debit to Cash and a credit to Accounts Payable.
- C. debit to Cash and a credit to Revenue.
- D. debit to Purchases and a credit to Cash.

Revenue was recognized when the customer was billed on his/her account two months ago. Now the company is receiving payment on this account. This transaction would be recorded as an increase to cash, debit, and a decrease to Accounts receivable, credit.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

50. When a customer buys services on account, it should be recorded by the company as:

- A. a debit to Cash and a credit to Accounts Receivable.
- B.** a debit to Accounts Receivable and a credit to Revenue.
- C. a debit to Services and a credit to Unearned Revenue.
- D. a debit to Cash and a credit to Accounts Payable.

Services are recorded with a credit to Revenue and when rendered on account, a debit to Accounts Receivable.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

51. Which of the following is a true statement?

- A. Revenue accounts are a subset of assets, and expense accounts are a subset of liabilities.
- B. Both revenue accounts and expense accounts are subsets of contributed capital.
- C.** Both revenue accounts and expense accounts are subsets of retained earnings.
- D. Revenue accounts are a subset of cash, and expense accounts are a subset of accounts payable.

Revenue and expense accounts are subsets of retained earnings. Revenues increase retained earnings and Expenses decrease retained earnings.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Accounting Equation

52. Which of the following is true?

- A. Credits increase both revenues and expenses.
- B. Credits increase expenses and decrease revenues.
- C. Credits increase revenues and decrease expenses.**
- D. Credits decrease both revenues and expenses.

Revenues increase with credits and expenses increase with debits.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Debit/Credit Framework

53. If a company provides a service and receives payment at the same time,:

- A. more than one journal entry is needed.
- B. cash will be credited.
- C. a revenue account will be increased with a debit.
- D. stockholders' equity will increase.

One journal entry is needed that will debit Cash and credit Revenue. Revenue is a subset of Retained earnings and a credit will increase stockholders' equity.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

54. During March, the Long Life Consulting Company provides \$23,000 in consulting services of which \$12,000 is immediately paid for and \$11,000 is on account.

- A. Cash increases \$12,000, revenue increases \$11,000, and accounts receivable increases \$23,000.
- B.** Cash increases \$12,000, Accounts Receivable increases \$11,000, and revenues increase \$23,000.
- C. Accounts Receivable increases \$11,000, liabilities decrease \$12,000, and stockholders' equity increases \$1,000.
- D. Revenues increase \$12,000, liabilities decrease \$12,000, and stockholders' equity is unchanged.

Revenue is recorded (credit to Consulting Services, \$23,000) and assets of Cash (\$12,000) and Accounts receivable (\$11,000) are recorded by debits. There are no liabilities to record in this transaction. Stockholders' equity increases by \$23,000 as a result of the revenue recorded.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

55. In October, your company prepays rent of \$7,000 for November and December. Which of the following describes the effects of this transaction on your company in October?

- A. Assets decrease \$7,000 and liabilities decrease \$7,000.
- B. Assets increase \$7,000 and stockholders' equity increases \$7,000.
- C.** There is no change to total assets, liabilities or stockholders' equity.
- D. Liabilities decrease \$7,000 and stockholders' equity increases \$7,000.

Prepaid rent (an asset) increases, and Cash (an asset) decreases. The net effect on total assets is no change. There are no liabilities involved in this transaction. With no change in total assets and no change in liabilities, there can be no change in stockholders' equity.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

56. Cansing Company collected \$5,000 from a customer on account. What journal entry will Cansing record?

- A. Debit Cash, credit Accounts Receivable.
- B. Debit Cash, credit Revenue.
- C. Debit Accounts Receivable, credit Revenue.
- D. Debit Accounts Receivable, credit Cash.

This transaction is an increase to cash, debit, and a decrease to accounts receivable, credit. Revenue was recognized when this account was recorded. Now only the collection is recorded.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

57. West Corporation issued a \$1,000 gift certificate. What journal entry will West Corporation record?

- A. Debit Cash, credit Sales Revenue.
- B. Debit Cash, credit Unearned Revenue.**
- C. Debit Unearned Revenue, credit Cash.
- D. Debit Accounts Receivable, credit Cash.

This is not revenue because it is not earned yet. Increase cash with a debit, and increase unearned revenue with a credit.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 3 Hard

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

58. If a company is paid in full for services provided this month, how will the basic accounting equation be affected?

- A. Liabilities will decrease.
- B.** Stockholders' equity will increase as revenue is recorded.
- C. Liabilities will increase.
- D. Assets will decrease.

Cash received will result in an increase to assets and services provided will result in an increase to stockholders' equity as revenue is recorded. Liabilities are not involved in this transaction.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

59. Your company received payment last month for a service that you provided this month. How will the business activity of the current month affect the basic accounting equation?

- A. Assets will not change; liabilities (Unearned Revenue) will decrease; and stockholders' equity (Service Revenue) will increase.
- B. Assets (Cash) will increase, liabilities (Unearned Revenue) will increase, and stockholders' equity will not change.
- C. Assets (Cash) will increase, liabilities will not change, and stockholders' equity (Service Revenue) will increase.
- D. Assets (Prepaid Expenses) will decrease, liabilities will not change, and stockholders' equity (Service Revenue) will increase.

Last month assets (cash) increased and liabilities (unearned revenue) increased. This month, liabilities (unearned revenue) will decrease and revenue (service revenue) will increase as a result of the revenue being earned this month. An increase in revenue will increase stockholders' equity.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 3 Hard

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

60. Which of the following would eventually cause a reduction in retained earnings?

- A. Receiving contributions from investors.
- B. Earning unearned revenue.
- C. Billing customers for services provided.
- D. Using up supplies.

Contributions from investors increase contributed capital and have no effect on retained earnings. Earning previously recorded unearned revenue increases retained earnings as a result of revenue being recognized. Using up supplies increases expenses, which decreases retained earnings.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

61. Customers paid \$8,000 on their accounts. Which accounts are affected by this transaction?

- A. Revenue and Retained Earnings increase \$8,000.
- B. Cash and Revenue increase \$8,000. Liabilities and Expense increase \$8,000.
- C. Cash increases \$8,000 and Accounts Receivable decreases \$8,000. Revenue and Retained Earnings are unchanged.
- D. Cash and liabilities decrease \$8,000.

Cash is increased and accounts receivable is decreased. There is no effect on retained earnings because there is no revenue recorded. There are no liabilities or expenses in this transaction.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

62. Sparkling Pools provides \$1,000 of pool maintenance services during July and collects payment in August. The company performs \$1,600 of pool maintenance services during July that were paid for in June. The company accepts an order to perform \$500 of pool maintenance services in August and will be paid in the same month. Revenue should be credited for:

- A. \$1,600 in June, \$1,000 in July, and \$500 in August.
- B. \$1,600 in June, \$0 in July, and \$1,500 in August.
- C. \$0 in June, \$1,600 in July, and \$1,500 in August.
- D. \$0 in June, \$2,600 in July, and \$500 in August.

There is no revenue to record in June since services are not rendered until July (\$1,000 + \$1,600) and August (\$500).

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 3 Hard

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Revenue Recognition Principle

63. Sparkling Pools received a bill for \$1,200 for running newspaper ads during the last two weeks of July; the bill will be paid on August 1. Advertising expense should be:

- A. credited for \$1,200 in July.
- B. credited for \$1,200 in August.
- C. debited for \$1,200 in July.
- D. debited for \$1,200 in August.

An expense is recorded, debited, in July, the month that costs were incurred in generating revenue.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

64. This month, a company performed \$517,000 of services and incurred total expenses of \$438,000. If the company was paid in cash for all its services and paid cash for all its expenses, these transactions would cause:
- A. revenues to increase \$517,000, expenses to increase \$438,000, and retained earnings to decrease \$79,000.
 - B. cash to increase \$517,000, expenses to increase \$438,000, and contributed capital to increase \$79,000.
 - C. revenues to increase \$517,000, expenses to increase \$438,000, and cash to increase \$79,000.
 - D. revenues to increase \$79,000, expenses to increase \$438,000, and cash to increase \$517,000.

Revenues \$517,000 - expenses \$438,000 = Net Income \$79,000 which would increase retained earnings. In this case, revenues are equal to cash receipts and expenses are all paid, so net income is equal to the increase in cash.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

65. This month, Grass is Greener Lawn Service pays cash for \$4,000 of grass fertilizer to be used two months from now. What journal entry will Grass is Greener record this month?
- A. Debit cash for \$4,000 and credit supplies expense for \$4,000.
 - B. Debit supplies expense for \$4,000 and credit accounts payable for \$4,000.
 - C. Debit supplies for \$4,000 and credit cash for \$4,000.
 - D. Debit retained earnings for \$4,000 and credit accounts payable for \$4,000.

The purchase is recorded as an asset, Supplies (debited), and the asset cash is credited since payment is made immediately. The purchase is an asset, not an expense, because the fertilizer has not been used, so retained earnings is not decreased by a debit.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

66. On October 10, a company paid \$12,000 to its suppliers, of which \$2,000 was for supplies received on October 10 and \$10,000 was for supplies received and recorded during September. The \$12,000 payment would be recorded as a:

- A. \$10,000 debit to Supplies, a \$2,000 debit to Accounts Payable, and a \$12,000 credit to Cash.
- B. \$12,000 debit to Supplies and a \$12,000 credit to Cash.
- C. \$12,000 debit to Supplies Expense and a \$12,000 credit to Cash.
- D. \$2,000 debit to Supplies, a \$10,000 debit to Accounts Payable, and a \$12,000 credit to Cash.

The \$2,000 paid immediately for the supplies purchased should be debited to Supplies while the \$10,000 payment on last month's purchases should be debited to Accounts Payable; the \$12,000 paid should be credited to Cash.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 3 Hard

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

67. On the 15th of the month, a company receives \$8,000 in payments from customers. \$1,000 is for services performed on that day and the remaining is payment for services performed in the previous month. The \$8,000 cash receipt would be recorded as a:
- A. debit of \$7,000 to Accounts Receivable, debit of \$1,000 to Service Revenue, and a credit of \$8,000 to Cash.
 - B.** debit of \$8,000 to Cash, a credit of \$7,000 to Accounts Receivable, and a credit of \$1,000 to Service Revenue.
 - C. debit of \$7,000 to Accounts Receivable, a debit of \$1,000 to Unearned Revenue, and a credit of \$8,000 to Cash.
 - D. debit of \$8,000 to Cash, debit of \$1,000 to Service Revenue, and a credit of \$7,000 to Accounts Receivable.

Cash of \$8,000 is received, so Cash should be debited. If \$7,000 of the receipt is payment for accounts receivable which was the result of previously recorded revenue, this is a credit to accounts receivable. The remaining \$1,000 is the current month's revenue which is a credit to Service Revenue.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 3 Hard

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

68. In January, the Caribbean Dream Resort books and accepts a cash payment for \$32,000 for vacation services to be provided during spring break in March. The \$32,000 would be recorded during January as a:

- A. debit to Cash and a credit to Unearned Revenue.
- B. debit to Accounts Payable and a credit to Service Revenue.
- C. debit to Accounts Receivable and a credit to Service Revenue.
- D. debit to Prepaid Expenses and a credit to Service Revenue.

The cash receipt is a debit to cash of \$32,000. Since this is payment in advance of services provided, it is unearned so a credit is needed to Unearned Revenue of \$32,000.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

69. In January, the Huntington Beach Resort (HBR) accepts your reservation and receives your \$2,000 payment for a week of sun and fun in California during spring break. The \$2,000 would be recorded by HBR during January as a:

- A. debit to Cash and a credit to Unearned Revenue.
- B. debit to Accounts Payable and a credit to Service Revenue.
- C. debit to Cash and a credit to Service Revenue.
- D. debit to Service Revenue and a credit to Cash.

Cash received will be recorded as a debit to cash. Since this is payment in advance of services rendered, the amount is unearned revenue and would be recorded as a credit to Unearned Revenue.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

70. Which of the following groups of accounts contains only those that normally have credit balances?

- A. Accounts Payable; Retained Earnings; Service Revenue.
- B. Equipment; Cash; Contributed Capital.
- C. Notes Payable; Wages Payable; Rent Expense.
- D. Accounts Receivable, Retained Earnings, Cash.

Assets (cash, equipment, accounts receivable) and expenses (rent expense) normally have debit balances. Liabilities (accounts payable, notes payable, and wages payable), Revenues (Service Revenue) and Stockholders' Equity (contributed capital and retained earnings) normally have credit balances.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Debit/Credit Framework

71. An increase in revenue will always:

- A. increase stockholders' equity.
- B. increase assets.
- C. decrease stockholders' equity.
- D. decrease assets.

An increase in revenue may increase assets (e.g., services provided for cash) or it may decrease liabilities (e.g., unearned revenue is earned), but it will always increase stockholders' equity.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

72. Which of the following journal entries would decrease stockholders' equity?

- A. Debiting Prepaid Insurance and crediting Cash.
- B. Debiting Unearned Revenue and crediting Revenue.
- C. Debiting Supplies and crediting Accounts Payable.
- D. Debiting Insurance Expense and crediting Cash.

Stockholders' equity would decrease if expenses increase.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

73. In January, a company pays for advertising space in the local paper for ads to be run during the months of January, February, and March at \$1,500 a month. The payment would be recorded in January as a:

- A. debit of \$4,500 to Cash, a credit of \$1,500 to Advertising Expense, and a credit of \$3,000 to Prepaid Advertising.
- B. debit of \$4,500 to Accounts Payable and a credit of \$4,500 to Cash.
- C. debit of \$4,500 to Accounts Payable and a credit of \$4,500 to Stockholders' Equity.
- D. debit of \$1,500 to Advertising Expense, a debit of \$3,000 to Prepaid Advertising, and a credit of \$4,500 to Cash.

Payment of \$4,500 cash would be recorded as a credit to cash. In January, only \$1,500 of this amount is an expense and would be recorded as a debit to Advertising Expense. The remaining \$3,000 (February and March) is paid in advance and would be recorded as a debit to Prepaid Advertising.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

74. An increase in operating expenses would have which of the following effects on a company's profit margin?

- A. Net profit margin would increase.
- B.** Net profit margin would decrease.
- C. Net profit margin would remain unchanged.
- D. There is not enough information given to determine the effect.

An increase in operating expenses would decrease net income which would, in turn decrease net profit margin.

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement

Blooms: Analyze

Difficulty: 2 Medium

Learning Objective: 03-05 Evaluate net profit margin; but beware of income statement limitations.

Topic: Net Profit Margin

75. Trudy's Café paid employees \$50,000 in September for work done that month. What journal entry will Trudy's record in September, assuming Trudy's did not owe any amounts to employees at the end of August?

- A. Debit Cash, credit Wages Revenue.
- B. Debit Cash, credit Wages Payable.
- C. Debit Wages Revenue, credit Cash.
- D. Debit Wages Expense, credit Cash.

Payment is recorded as a credit to cash. If the wages are all for the current period, they are recorded as a debit to Wages Expense.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

76. Which account is least likely to be credited when an expense is recorded?

- A. Cash.
- B. Accounts Payable.
- C. Prepaid Expenses.
- D. Accounts Receivable.

An expense paid in cash would be recorded as a debit to expense and a credit to cash. An expense which is unpaid would be recorded as a debit to expense and a credit to accounts payable. A prepaid expense which is used up during the period would be recorded as a debit to expense and a credit to prepaid expenses. Accounts receivable would be credited when customers pay amounts owed to the company, not when recording an expense.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

77. Which of the following is not true about the unadjusted trial balance?

- A. An unadjusted trial balance may only include a preliminary amount for income tax expense.
- B. An unadjusted trial balance might balance even if there is a mistake.
- C. An unadjusted trial balance does not yet include end-of-the-accounting period adjustments.
- D.** An unadjusted trial balance is part of the financial statements issued to external decision makers.

The unadjusted trial balance is an internal accounting report. It shows the balances of all the ledger accounts used by the company. An unadjusted trial balance may include a preliminary amount for income tax expense but it does not include end-of-period adjustments necessary before financial statements can be prepared. It indicates only whether or not debits equal credits in recorded transactions and does not guarantee that the correct accounts were debited or credited or that everything that should be recorded has been recorded.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 03-04 Prepare an unadjusted trial balance.

Topic: Unadjusted Trial Balance

78. The unadjusted trial balance:

- A. is a preliminary financial statement for external and internal users.
- B. generally lists account names in alphabetical order.
- C. is created to determine that total debits equal total credits.
- D. indicates whether or not errors were made in recording transactions.

The unadjusted trial balance is an internal accounting report. The order of accounts is generally, assets, liabilities, stockholders' equity, revenues, expenses. The unadjusted trial balance indicates whether the balances in the ledger accounts used by the company are in balance in that debit balance accounts equal credit balance accounts. The unadjusted trial balance does not indicate whether or not errors were made. Incorrect accounts or amounts could have been recorded even if debits equal credits in the recording process.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 03-04 Prepare an unadjusted trial balance.

Topic: Unadjusted Trial Balance

79. Which of the following is an example of an error that would cause the trial balance to be out of balance?

- A. A journal entry was posted as a debit to Cash for \$525 and a credit to Accounts Receivable for \$552.
- B. A journal entry was posted as a debit to Cash and a credit to Sales Revenue when the company received a \$400 payment from a customer on account.
- C. A purchase of supplies on account for \$100 was posted as a debit to supplies for \$10 and a credit to accounts payable for \$10.
- D. A \$350 transaction was not recorded at all.

The unadjusted trial balance would balance as long as debits = credits in the transactions that were recorded. Omitting a transaction, or using incorrect accounts or amounts would not cause the trial balance to be out of balance.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-04 Prepare an unadjusted trial balance.

Topic: Unadjusted Trial Balance

80. A company's revenue recognition policy:

- A. affects the income statement but not the balance sheet.
- B. defines when its revenue should be collected.
- C. is usually described in the notes to a company's financial statements.
- D. states that revenues should not be recorded until payments are received from customers.

The notes to the financial statements contain information about the accounting rules used to record revenues. The accrual basis of accounting reports revenue when it is earned which may be in a different period than when it is collected in cash.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Revenue Recognition Principle

81. In September, a customer signed a contract to have his house painted and paid for the job in October. The painting company bought the paint in August on account and paid for it in September. The painting company painted the house in November. According to the Revenue and Expense Recognition (Matching) Principles, the painting company should record:
- A. the revenues in November and the expenses in September.
 - B. the revenues and the expenses in September.
 - C. the revenues and the expenses in November.
 - D. the revenues in September and the expenses in August.

The revenue principle states that revenue is recorded when it is earned and the Expense Recognition (Matching) principle says expenses are reported in the same period as the revenues they helped to generate.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Expense Recognition (Matching) Principle

Topic: Revenue Recognition Principle

82. The Rainbow House Painting Company has been contracted to strip, repair, prime and paint a house for \$3,600 to be paid in installments as phases of the work are completed. Rainbow should recognize the revenue when

- A. the work begins.
- B. the first payment is received.
- C. half of the work is complete and half of the payments have been received.
- D. the work is complete.

Revenue is recognized when it is earned, that is, when the work is complete, which may not be the same time as when cash is received.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Blooms: Remember

Difficulty: 3 Hard

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Revenue Recognition Principle

83. Which of the following is not a condition for reporting revenue?

- A. The goods or services have been delivered.
- B.** The customer has already paid for the good or service.
- C. The price is fixed or determinable.
- D. Collection is reasonably assured.

The revenue principle states that revenue is reported when it is earned, which is when goods or services have been delivered, the price is determinable, and, if the customer has not yet paid, the collection is reasonably assured.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Revenue Principle

84. A dance studio accepts \$1,500 to provide a series of dance lessons to a youth group during the month of July. The studio decides to record the revenue in July. The studio also decides to record the July expenses of rent, utilities and salaries in August, when it pays for them. One or both of these decisions:

- A. violate the Expense Recognition (Matching) principle.
- B. are an example of accrual accounting.
- C. violate the revenue principle.
- D. violate the accounting equation.

The Expense Recognition (Matching) principle states that expenses are to be matched to the revenues they helped to generate. The revenues are recorded in July, therefore, the expenses should be recorded in the same time period, so this is a violation of the Expense Recognition (Matching) principle.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Expense Recognition (Matching) Principle

Topic: Revenue Recognition Principle

85. Which of the following is the correct sequence of steps in the accounting cycle?

- A. Journal entries, T-accounts, financial statements, unadjusted trial balance.
- B. T-account, journal entries, unadjusted trial balance, financial statements.
- C. Journal entries, T-accounts, unadjusted trial balance, financial statements.
- D. Financial statements, journal entries, T-accounts, unadjusted trial balance.

After transactions are journalized, they are posted to T-accounts. Next an unadjusted trial balance is prepared, followed by the financial statements.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Learning Objective: 03-04 Prepare an unadjusted trial balance.

Topic: Accounting Cycle

86. The Expense Recognition (Matching) principle indicates

- A. where expenses should be presented on the income statement.
- B. how expenses should be split between the income statement and the balance sheet
- C. the ordering of current assets and current liabilities on the balance sheet.
- D. when costs are recognized as expenses on the income statement.

The Expense Recognition (Matching) principle states *when* costs are to be recorded as expenses on the income statement and not where or how they should be presented on the income statement.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Expense Recognition (Matching) Principle

87. Which of the following errors would most likely lead to an overstatement of net income in the current year?
- A. Recording revenue when the cash is collected next year although it is earned in the current year.
 - B.** Recording an expense when paid next year although it is incurred this year.
 - C. Failing to adjust the Unearned Rent Revenue account for the portion of rent earned this year.
 - D. Recording revenue earned in the current year when cash is collected this year.

Not recording revenue this year that was earned this year would understate net income in the current year. Not recording an expense this year that was incurred this year would understate expenses and overstate net income for the current year. Recording revenue earned in the current year would correctly state net income.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 3 Hard

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Expense Recognition (Matching) Principle

Topic: Revenue Recognition Principle

88. If a company receives the rent for January 2014 from a tenant in December 2013, this will be reported as:

- A. revenue in 2013.
- B. an expense in 2013.
- C.** a liability in 2013.
- D. stockholders' equity in 2013.

In order for the rent to be stockholders' equity in 2013 it would have to be recognized as revenue in 2013. Since it is unearned, it would be a liability in 2013, not a revenue. This is not an expense of the company

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

89. Which of the following accounts has a normal credit balance?

- A. Cash
- B. Notes receivable
- C. Wage expense
- D. Unearned revenue

Assets, such as cash and notes receivable, and expenses such as wage expense have a normal debit balance. Liabilities such as unearned revenue have a normal credit balance.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Debit/Credit Framework

90. A company has total revenue of \$560,000 and total expenses of \$330,000. If the company overstates sales by \$10,000, how would the net profit margin be affected?

- A. Net profit margin would be overstated.
- B. Net profit margin would be understated.
- C. Net profit margin would be unaffected.
- D. Net profit margin cannot be computed because overstating sales is unethical.

An overstatement of sales would increase total revenues and net income by the same dollar amount. The effect on net income is more significant than the effect on revenues because net income is a smaller number than total revenue. Therefore net profit margin would be overstated.

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement

Blooms: Analyze

Difficulty: 3 Hard

Learning Objective: 03-05 Evaluate net profit margin; but beware of income statement limitations.

Topic: Net Profit Margin

91. On June 30, a company purchased 1 year of insurance coverage which started immediately, paying cash of \$2,400. Choose the true statement.
- A. On June 30, cash would be debited for \$2,400.
 - B.** On the Income Statement for the year, insurance expense will be \$1,200.
 - C. On the Balance Sheet at the end of the year, prepaid insurance will be \$2,400.
 - D. On the Balance Sheet at the end of the year, prepaid insurance will be a non-current asset.

On June 30, an asset, Prepaid Insurance, should be debited and Cash should be credited. As of December 31, half of this asset has been used up and should be reported as an expense on the income statement and half of this asset would be reported as Prepaid Insurance, a current asset, on the balance sheet.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Blooms: Understand

Difficulty: 3 Hard

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

92. On December 31, 2013, a company paid \$10,000 to rent a storage facility from July 1, 2014 to July 1, 2015. Choose the true statement.

- A. The Balance Sheet at December 31, 2013 should report prepaid rent of \$10,000 as a non-current asset.
- B. The income statement at December 31, 2013 should report rent expense of \$10,000.
- C.** The Income Statement for the year ended December 31, 2013 is unaffected by this transaction.
- D. The Balance Sheet at December 31, 2014 will not report any of this rent as an asset.

On December 31, 2013, \$10,000 of prepaid rent would be recorded and reported as an asset on the Balance Sheet. \$5,000 is current and \$5,000 is non-current. The journal entry to record this payment will include a credit to cash. The income statement for 2013 is not affected by this since none of the rent is an expense for 2013. The Balance Sheet at December 31, 2014 would include the remaining Prepaid Rent as a current asset, \$5,000.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Blooms: Understand

Difficulty: 3 Hard

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

The following activities occurred during the current year, 2013, for the Maverick Law Firm.

- On February 1, 2013, received cash of \$5,000 from clients in payment of their accounts from 2012.
- In 2013, received cash of \$13,000 for law services rendered in 2013.
- At the end of 2013, billed customers \$4,000 for services rendered in 2013. This amount was unpaid as of the end of the year.
- In November of 2013, received cash of \$2,000 from clients as a deposit on law services to be performed in 2014.

93. What is the amount of Law Services Revenue to be reported on the Income Statement for the year 2013?

- A. \$19,000
- B. \$22,000
- C. \$24,000
- D. \$17,000

Revenue principle states that revenue is recorded when it is earned. $\$13,000 + \$4,000 = \$17,000$ revenue for 2013. The \$5,000 collected from clients in payment of their accounts is not revenue in this year (it was revenue in 2012). The \$2,000 received in advance will be revenue next year, 2014, when it is earned.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Apply

Difficulty: 2 Medium

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

94. Which of the following statements is TRUE about the activities for Maverick Law Firm for 2013?
- A. If Accounts receivable prior to February 1, 2013 was \$25,000, the amount of Accounts Receivable to be reported on the Balance Sheet at December 31, 2013 will be \$24,000.
 - B. The \$2,000 received from clients for law services to be performed next year will be reported as revenue on the Income Statement this year since cash was received.
 - C. The \$4,000 billed to clients for services rendered this year and unpaid as of December 31 will be reported on the Balance Sheet at December 31 as Accounts Payable.
 - D. The \$5,000 received this year from clients in payment of their accounts will be reported on the Income Statement of 2013 as Revenue.

The \$2,000 is unearned in 2013 and will not be reported on the Income Statement for 2013. The \$5,000 received in 2013 from clients in payment of their accounts from 2012 was revenue in 2012. The \$4,000 billed to clients will be included in accounts receivable on the Balance Sheet. Beginning Accounts receivable of \$25,000 - \$5,000 + \$4,000 = \$24,000 Ending Accounts receivable.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 3 Hard

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

95. Based on the activities above, stockholders' equity of the Maverick Law Firm in 2013 will be

- A. increased by \$20,000.
- B. decreased by \$5,000.
- C. increased by \$17,000.
- D. decreased by \$2,000.

Stockholders' equity will be increased by the amount of revenue for 2013 (\$13,000 + \$4,000).

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

96. Which of the following is not true of the Income Statement of a company that was formed 10 years ago?

- A. Reports a Net Loss for the year if expenses are more than revenues.
- B.** Reports the financial effects of activities that have occurred since the company's inception.
- C. Reports the amount of the increase in stockholders' equity this year as a result of the company's operations.
- D. Reports Net Income which is not an account in the ledger.

The Income Statement reports the results of operations for a period of time, not since the inception of the company. If revenues are less than expenses then the net income is a negative amount and is called *net loss*. Stockholders' equity increases by the amount of net income or decreases by the amount of net loss for a period.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-01 Describe common operating transactions and select appropriate income statement account titles.

Topic: Income Statement

97. Which of the following accounts does not have a normal debit balance?

- A. Wages Expense
- B. Service Revenue**
- C. Accounts Receivable
- D. Cash

All asset accounts (Cash, Accounts Receivable) and expense accounts (Wages expense) have a normal debit balance. All revenue accounts (Service revenue) have a normal credit balance.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Debit/Credit Framework

98. Which of the following accounts does not have a normal credit balance?

- A. Contributed capital
- B. Accounts Payable
- C. Service Revenue
- D. Rent Expense

All liability accounts (Accounts Payable), Stockholders' Equity accounts (contributed capital), and revenue accounts (Service Revenue) have a normal credit balance. Expense accounts (Rent Expense) have a normal debit balance.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Debit/Credit Framework

99. Which of the following is not true about accrual basis accounting?

- A. The revenue principle is applied.
- B. The Expense Recognition (Matching) principle is applied.
- C. It is required for external accounting reports.
- D.** It requires the timing of cash receipts be in the same period as revenues are recognized.

Accrual basis accounting reports revenues when they are earned and expenses when they are incurred, regardless of the timing of cash receipts or payments. GAAP requires the use of accrual basis accounting in external accounting reports.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Accrual Basis of Accounting

Topic: Expense Recognition (Matching) Principle

Topic: Revenue Recognition Principle

100. Which of the following is not true of the unadjusted trial balance?

- A. A trial balance is an internal report used to determine whether total debits equal total credits.
- B. A trial balance lists every account name in one column, usually in the order of assets, liabilities, stockholders' equity, revenues and expenses.
- C. A trial balance shows the ending balances obtained from the ledger listed in either the debit or credit column.
- D. If debits equal credits in the unadjusted trial balance, it means that no errors were made in the recording of transactions.

The unadjusted trial balance is an internal report which shows the amounts of debit and credit ledger balances for assets, liabilities, stockholders' equity, revenue and expense accounts listed in that order. The unadjusted trial balance only indicates whether or not debits equal credits and does not assure that the correct accounts were debited or credited or that every transaction was recorded.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 03-04 Prepare an unadjusted trial balance.

Topic: Unadjusted Trial Balance

101. BD One Company entered into the following transactions. Choose the one which represents an accounting error.

- A. A shareholder of BD One Company purchases a new car, but this was not recorded by the company.
- B. Revenue was recognized when a customer received services from BD One Company.
- C. Cash received from a customer in payment of his account was debited to Cash and credited to Accounts Receivable.
- D.** BD One Company ordered inventory and the order was recorded by a debit to Inventory and a credit to Accounts Payable.

The separate entity principle requires only transactions of the company be recorded. Revenue recognition states that revenue is recorded when it is earned. When a customer pays on his account, the company debits cash and credits accounts receivable. An order is not a recordable accounting transaction.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Transaction Analysis

The following accounts are taken from the December 31, 2013, financial statements of A to Z Advertising Company:

Advertising Revenue	46,482
Cash	1,516
Accounts receivable	7,296
Interest expense	2,299
Accounts payable	5,000
Operating expenses	37,460
Unearned revenue	1,178
Equipment	18,048
Income Tax Expense	2,326

The following activities occurred in 2014:

1. Billed customers for advertising services rendered, \$55,000.
2. Received cash from customers in payment of their accounts, \$10,400.
3. Incurred \$45,000 of operating expenses of which \$39,000 was paid in cash and \$6,000 was on account and unpaid as of the end of the year.
4. Paid suppliers \$5,000 on the accounts payable.
5. Received deposits from customers of \$2,500 for advertising services to be performed in 2015.

102. What is the balance in the Cash account at December 31, 2014?

- A. \$46,116
- B. \$41,516
- C. \$1,416
- D. \$46,916

Cash Balance at 12/31/14 = Cash balance at 12/31/13 + receipts from customers on account + deposits received - operating expenses paid on account - payments on account. $\$1,416 = \$41,516 + \$10,400 + \$2,500 - \$39,000 - \$5,000$.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Apply

Difficulty: 2 Medium

Learning Objective: 03-01 Describe common operating transactions and select appropriate income statement account titles.

Topic: Cash Basis of Accounting

103. What is the amount of Accounts receivable at the end of 2014?

- A. \$51,896
- B. \$55,000
- C. \$44,600
- D. \$54,396

Accounts receivable at December 31, 2013 is \$7,296 and was increased by \$55,000 of billings in 2014 and decreased by \$10,400 of payments received.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Apply

Difficulty: 3 Hard

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

104. The income statement for the year ended December 31, 2014 will show

- A. Total Revenue of \$57,500.
- B. Total Expenses of \$39,000.
- C. Total Revenue of \$55,000.
- D. Total Expenses of \$50,000.

The Income Statement would include revenue according to the revenue principle which states that revenue is reported when it is earned. For the year ended December 31, 2014 this would be \$55,000. Expenses are costs incurred to generate revenue. For the year ended December 31, 2014 this would be \$45,000.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Apply

Difficulty: 2 Medium

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Expense Recognition (Matching) Principle

Topic: Revenue Recognition Principle

106. Which of the following is the journal entry to record activity #4?

- | | | | |
|-----------|-------------------|-------|-------|
| A. | Operating Expense | 5,000 | |
| | Cash | | 5,000 |
| <u>B.</u> | Accounts payable | 5,000 | |
| | Cash | | 5,000 |
| C. | Accounts payable | 5,000 | |
| | Operating expense | | 5,000 |
| D. | Cash | 5,000 | |
| | Accounts payable | | 5,000 |

This is not an expense for 2014. Paying cash is recorded with a credit to Cash and reducing the amount owed to suppliers is recorded with a debit to Accounts Payable.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

107. Which of the following is the journal entry to record activity #1?

- | | | | |
|-----------|---------------------|--------|--------|
| A. | Advertising Revenue | 55,000 | |
| | Accounts receivable | | 55,000 |
| B. | Accounts receivable | 55,000 | |
| | Cash | | 55,000 |
| <u>C.</u> | Accounts receivable | 55,000 | |
| | Advertising revenue | | 55,000 |
| D. | Accounts receivable | 55,000 | |
| | Unearned revenue | | 55,000 |

Billing customers is recorded by a debit to accounts receivable and since services were rendered revenue should be credited for this activity.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

108. Which of the following is not an operating activity?

- A. Paying off a loan to the bank.
- B. Receiving cash from customers for services rendered.
- C. Paying employees for work completed.
- D. Billing customers for services rendered but not yet paid for.

Paying off loans is a financing activity. Receiving cash from customers for services rendered, paying employees for work and billing customers are all operating activities.

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Reporting

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 03-01 Describe common operating transactions and select appropriate income statement account titles.

Topic: Operating Activities

The following transactions occurred during July:

1. Received \$800 cash for services rendered during July.
2. Received \$5,000 from issuance of stock to investors.
3. Received \$400 from a customer in payment of accounts receivable from the prior month.
4. Billed customers for services performed in July, \$3,500.
5. Borrowed \$2,500 from the bank, giving a promissory note in exchange.
6. Received \$1,000 from a customer for services to be performed next year.

109. What is the amount of Revenue for July?

- A. \$5,300
- B. \$5,700
- C. \$4,300
- D. \$7,200

Revenue is recognized in the period that it is earned. Revenue for July = \$3,500 + \$800.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Apply

Difficulty: 2 Medium

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Revenue Recognition Principle

110. As a result of these transactions, the cash account will increase by:

- A. \$9,700.
- B. \$13,200.
- C. \$2,200.
- D. \$7,200.

Cash will increase by \$9,700. Cash increases for amounts received for services rendered + issuance of stock + collection of accounts receivable + proceeds of bank loan + amounts collected in advance. $\$800 + \$5,000 + \$400 + \$2,500 + \$1,000 = \$9,700$.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

111. Recording the above transactions would include which of the following?

- A. Transaction #1 would include a debit to Revenue.
- B. Transaction #3 would include a debit to Accounts Receivable.
- C. Transaction #4 would include a debit to Accounts Receivable.
- D. Transaction #6 would include a debit to Unearned Revenue.

Transaction #1 would include a credit to Revenue.

Transaction #3 would include a credit to Accounts Receivable.

Transaction #6 would include a credit to Unearned revenue.

Transaction #4 would be recorded as a debit to Accounts Receivable and a credit to Revenue.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

112. A credit of \$500 to Equipment was mistakenly credited to Revenue. What is the effect of this error?

- A. Equipment is understated and Revenue is understated.
- B. Equipment is overstated and Revenue is overstated.**
- C. Equipment is overstated and Revenue is understated.
- D. Equipment is understated and Revenue is overstated.

A credit decreases assets and increases revenue. If revenue has been mistakenly credited it will be overstated. If equipment was not credited it will be understated.

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

In January 2013, a new consulting firm recorded the following transactions:

1. Issued stock to investors for \$20,000 cash.
2. Purchased \$5,000 of equipment, paying 20% in cash and giving a promissory note for the balance.
3. Received \$9,000 in cash for consulting services performed in January.
4. Bought \$1,500 of supplies on account; all of the supplies were used in January.
5. Provided consulting services for clients and billed them \$16,000.
6. Paid \$750 toward the supplies purchased in #4.
7. Paid \$3,000 to employees for work performed in January.
8. Received a bill for rent and utilities for January of \$3,400.

113. What the amount of total expense to be reported on the Income Statement for the month of January?

- A. \$3,750
- B. \$7,900**
- C. \$8,150
- D. \$4,500

Total expenses for the period are the costs incurred to help generate revenue for the period.

Supplies expense + Wages expense + Rent & utilities expense = \$1,500 + \$3,000 + \$3,400 = \$7,900.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Apply

Difficulty: 2 Medium

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Expense Recognition (Matching) Principle

114. What is the amount of total revenue to be reported on the Income Statement for the month of January?

- A. \$45,000
- B. \$9,000
- C. \$29,000
- D. \$25,000

Revenues are sales of goods of services to customers in a period and are recorded when they are earned which may not be the same period as cash is received for them. Total revenue = \$9,000 + \$16,000.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Apply

Difficulty: 2 Medium

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Revenue Principle

115. What is the amount to be reported as total liabilities on the balance sheet at the end of January?

- A. \$4,750
- B. \$4,150
- C. \$8,150
- D. \$8,500

Liabilities are obligations or debts of the business.

Notes payable + Purchases on account - payments on account + Accounts payable for rent & utilities. $\$4,000 + \$1,500 - \$750 + \$3,400$

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Apply

Difficulty: 2 Medium

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

116. What is the amount of Current Assets on the classified balance sheet at the end of January?

- A. \$25,750
- B. \$26,500
- C. \$41,750
- D. \$40,250

Current assets are cash plus assets expected to be used up or turned into cash within the year. Cash + Accounts receivable + Supplies.

Cash: $\$20,000 - \$1,000 + \$9,000 - \$750 - \$3,000 = \$24,250$

Accounts receivable: \$16,000

Supplies: \$0 (1,500 - 1,500)

$\$24,250 + \$16,000 + 0 = \$40,250$

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Apply

Difficulty: 3 Hard

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

117. Which of the following is not true about the Income Statement?

- A. Amounts received from customers for services performed in the current month would be revenues on the income statement.
- B. Costs incurred in the current month but not paid as of the end of the month would be expenses on the income statement for the current month.
- C.** Amounts received from customers in payment of their accounts arising from service in the prior period would be revenues in the income statement for the current period.
- D. Amounts received from customer as deposits for services to be rendered next month will not be recorded as revenues on the income statement for the current month.

Revenue is recognized when it is earned and expenses are recorded when they are incurred in helping to generate revenue.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Expense Recognition (Matching) Principle

Topic: Revenue Recognition Principle

Accounts receivable	\$ 4,500
Accounts payable	650
Cash	1,700
Consulting Revenue	5,500
Contributed capital	4,000
Equipment	4,900
Insurance expense	400
Land	3,800
Notes payable, due 2005	4,000
Notes receivable, matures 2002	1,200
Prepaid insurance	400
Rent Expense	1,400
Retained earnings, January 1, 2000	7,850
Wage expense	3,700

All accounts have normal balances.

118. What is the total of the debit side of the unadjusted trial balance?

- A. \$22,000
- B. \$17,350
- C. \$16,500
- D. \$13,500

The debit balances = the credit balances. The debit balances are: Accounts receivable + Cash + Equipment + Insurance expense + Land + Notes receivable + Prepaid Insurance + Rent expense + Wage expense = \$22,000

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Apply

Difficulty: 1 Easy

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Unadjusted Trial Balance

119. What is the amount of Total Assets at December 31?

- A. \$16,500
- B. \$22,000
- C. \$17,350
- D. \$13,500

Assets are the economic resources of the company that have future benefits. Accounts receivable + Cash + Equipment + Land + Notes receivable + Prepaid Insurance = \$16,500

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Apply

Difficulty: 2 Medium

Learning Objective: 03-04 Prepare an unadjusted trial balance.

Topic: Unadjusted Trial Balance

120. What is the amount of the total liabilities at December 31?

- A. \$4,650
- B. \$8,650
- C. \$5,700
- D. \$9,700

Liabilities are debts or obligations of the business. Accounts payable + Notes payable

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Apply

Difficulty: 2 Medium

Learning Objective: 03-04 Prepare an unadjusted trial balance.

Topic: Unadjusted Trial Balance

121. Revenues

- A. decrease assets.
- B. increase stockholders' equity.**
- C. increase liabilities.
- D. decrease expenses.

Revenue is increased with a credit and credits increase stockholders' equity. Revenues increase net income which in turn increases retained earnings, a component of stockholders' equity.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Transaction Analysis

A company had the following assets and liabilities at the beginning and end of the current year:

	Assets	Liabilities
Beginning of year	\$214,000	\$ 88,000
End of the year	245,000	75,000

Stock was issued for \$15,000 cash and dividends of \$5,000 were paid during the year.

122. What is the amount of net income for the year?

- A. \$44,000
- B. \$34,000**
- C. \$24,000
- D. \$54,000

Assets = Liabilities + Stockholders' equity

Beginning: $\$214,000 = \$88,000 + \text{stockholders' equity}$; stockholders' equity = $\$126,000$

Ending: $\$245,000 = \$75,000 + \text{stockholders' equity}$; stockholders' equity = $\$170,000$

Change in stockholders' equity = $\$170,000 - \$126,000 = \$44,000$ increase

$\$44,000 = \$15,000$ (contributed capital increase) + net income - $\$5,000$ dividends

Net income = $\$34,000$

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Analyze

Difficulty: 3 Hard

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Accounting Equation

123. If contributed capital was \$100,000 at the beginning of the year, what was the amount at the end of the year?

- A. \$100,000
- B. \$110,000
- C. \$115,000**
- D. \$170,000

Beginning contributed capital of \$100,000 + issuance of stock \$15,000 = \$115,000

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Apply

Difficulty: 2 Medium

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Accounting Equation

The balances for the accounts of Dudley Do-Right Repair Shop for the year ended December 31, 2013, are shown below and each account has a normal balance:

Accounts payable	\$ 6,500
Accounts receivable	7,000
Cash	?
Repair supplies	1,200
Building	125,000
Repair supplies expense	21,500
Contributed capital	50,000
Repair service revenue	175,000
Wages expense	36,000
Rent expense	6,000
Retained earnings, January 1, 2013	68,700
Land	50,000
Unearned repair revenue	4,000
Dividends	48,000

124. What will be the trial balance total?

- A. \$439,200
- B. \$367,700
- C. \$608,400
- D. \$304,200

Debits = Credits.

The credit balances are: Accounts payable + Contributed Capital + Repair service revenue + Retained earnings + Unearned repair revenue. Total credits equal \$304,200.

The debit balances are: Accounts receivable + Cash + Repair supplies + Building + Repair supplies expense + Wages expense + Rent expense + Land + Dividends. Total debits equal \$304,200.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Apply

Difficulty: 2 Medium

Learning Objective: 03-04 Prepare an unadjusted trial balance.

Topic: Unadjusted Trial Balance

125. Which of the following is not true about the financial statements of Dudley Do-Right Repair Shop?

- A. The balance sheet at December 31, 2013 will show Total Liabilities of \$10,500.
- B.** The balance sheet at December 31, 2013 will show Retained earnings of \$68,700.
- C. The Income Statement for the year will not include the dividends of \$48,000.
- D. The Income Statement for the year will show Total Revenue of \$175,000.

Liabilities = Accounts payable \$6,500 + Unearned Repair Revenue \$4,000.

The amount of retained earnings on the balance sheet for the year will be the amount taken from the statement of retained earnings for the year and will not be the amount shown on the unadjusted trial balance. Dividends are reported on the statement of retained earnings, not an expense on the income statement. The amount of revenue on the income statement is the amount of the Repair Service Revenue account.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-04 Prepare an unadjusted trial balance.

Topic: Transaction Analysis

126. Which of the following would not be reported on the Income Statement?

- A. Utilities expense in the amount of a bill received for utilities used during the current period but unpaid as of the end of the period.
- B. Rent expense in the amount of rent paid during the period for use of a storage facility in the current period.
- C. Revenue in the amount of services provided to customers who promise to pay in the next period.
- D. Cost of land, paid in cash, and purchased for future use.

Investing in land for future use is not an operating activity and would not be reported on the income statement.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 03-01 Describe common operating transactions and select appropriate income statement account titles.

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Expense Recognition (Matching) Principle

Topic: Operating Activities

Topic: Revenue Recognition Principle

127. Seconds Best Retail Store receives and immediately pays a \$3,500 utility bill from the City Gas & Electric Company. The entry by the City Gas & Electric Company to record receipt of this payment would include a:

- A. credit to accounts payable.
- B. credit to utilities expense.
- C. debit to utilities revenue.
- D. debit to cash.

No liability account would be increased; this is not an expense to City Gas & Electric. City Gas & Electric receives cash which would be increased with a debit.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

128. A company received a bill of \$3,500 for utilities used in the current month. The journal entry to record this would include:

- A. a debit to Accounts receivable for \$3,500.
- B.** a credit to Accounts payable for \$3,500.
- C. a credit to Utilities expense.
- D. No entry would be made until the utilities are paid.

Expenses are recorded when they are incurred. The unpaid utility cost should be recorded by an entry which includes a credit to increase the liability accounts payable. Utilities expense is increased by this utility cost and that requires a debit to utilities expense.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

In the previous month, Seconds Best Company sold goods to a customer for \$10,000 cash and \$60,000 on credit. In the current month, the customer paid \$50,000 to Seconds Best toward the amount owed.

129. The correct entry by Seconds Best to record the sale in the previous month is:

A.	Cash	10,000	
	Accounts receivable	60,000	
	Sales Revenue		70,000
B.	Cash	10,000	
	Unearned Sales revenue	60,000	
	Sales Revenue		70,000
C.	Cash	10,000	
	Accounts payable	60,000	
	Sales Revenue		70,000
D.	Cash	10,000	
	Sales Revenue		10,000

The cash and credit sale is recorded with a credit to revenue. The amount of cash received is recorded with a debit to Cash and the amount still owed to the company is recorded with a debit to accounts receivable.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

130. The correct entry by Seconds Best Company to record the receipt of payment in the current month is:

- | | | | |
|-----------|------------------------|--------|--------|
| A. | Cash | 60,000 | |
| | Unearned Sales Revenue | | 60,000 |
| B. | Cash | 60,000 | |
| | Sales Revenue | | 60,000 |
| <u>C.</u> | Cash | 60,000 | |
| | Accounts receivable | | 60,000 |
| D. | Cash | 60,000 | |
| | Accounts payable | | 60,000 |

The entry reflects the collection of cash (debit to cash) from customers in settlement of their accounts (accounts receivable).

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

131. An expense:

- A. will decrease the amount of net income on the income statement.
- B. will decrease the amount of contributed capital on the balance sheet.
- C. will be increased with a credit to the account.
- D. normally has a credit balance.

Net income = Revenues (recorded with credits) - Expenses (recorded with debits). Contributed capital is not affected by the amount of expenses reported.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

132. Which of the following is true about accrual basis accounting and cash basis accounting?

- A. Net Income is generally larger under accrual basis accounting than cash basis accounting.
- B. GAAP does not require accrual basis accounting be used for external reports.
- C. Accrual basis accounting and cash basis accounting will always produce the same amount of net income.
- D.** Accrual basis accounting provides a better measure of operating performance than does cash basis accounting

Net income using accrual basis accounting can be higher or lower than cash basis accounting. GAAP does require the use of accrual basis accounting for external reports because it provides a better measure of operating performance.

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Accrual Basis of Accounting

Topic: Cash Basis of Accounting

133. During 2014, a company provided services for cash of \$21,000 and services on credit of \$15,000. The company collected accounts receivable of \$8,000 and incurred operating expenses of \$22,700, \$14,000 of which were paid during the year. The amount of net income (loss) for the year is:

- A. \$13,300.
- B. (\$1,700).
- C. \$22,700.
- D. \$6,300.

Revenue is the total amount of cash and credit services provided for the period: $\$21,000 + \$15,000 = \$36,000$. Expenses equal the total operating expenses incurred of $\$22,700$. Net income = $\$36,000 - \$22,700 = \$13,300$.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Apply

Difficulty: 2 Medium

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Income Statement

134. A company reported Sales revenue, all from credit sales, of \$40,000 on the Income Statement for the current year. The balance sheet includes the following:

Unearned Sales revenue, beginning of current year	\$ 0
Unearned Sales revenue, end of current year	\$7,750
Accounts receivable, beginning of current year	\$4,500
Accounts receivable, end of current year	\$ 800

What is the amount of cash that was collected during the year?

- A. \$11,450
- B. \$51,450**
- C. \$43,700
- D. \$38,200

Cash received from sales is $\$40,000 + \$4,500 - \$800 = \$43,700$ and cash received in advance, unearned sales revenue, is \$7,750; total cash received is $\$43,700 + \$7,750 = \$51,450$

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Analyze

Difficulty: 3 Hard

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

135. Which of the following is an operating activity?

- A. Repaying a bank loan.
- B. Paying a dividend to owners.
- C. Purchasing a new building.
- D. Paying for inventory to be offered for sale.

Operating transactions include buying goods to be sold to customers. Repaying a bank loan and paying dividends are financing activities. Purchasing a new building is an investing activity.

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Reporting

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 03-01 Describe common operating transactions and select appropriate income statement account titles.

Topic: Operating Activities

136. Which of the following is true of income statement accounts?

- A. Costs incurred to help generate revenue are only reported as expenses on the income statement if they are paid in cash in the same period as the revenue received.
- B. Revenue accounts are shown after the amount of expense accounts on the income statement.
- C. Revenue accounts include accounts receivable, unearned revenue and cash accounts.
- D. There is no net income account.

Net income is the amount of revenue earned minus the amount of expenses incurred on the income statement.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 03-01 Describe common operating transactions and select appropriate income statement account titles.

Topic: Income Statement

137. A company incurred \$5,000 in wages for employees for the year. \$4,500 of these wages were paid by the end of the year. Choose the TRUE statement.

- A. Wages payable on the income statement will be \$4,500.
- B. Wages expense on the income statement will be \$500.
- C. Wages expense on the balance sheet will be \$5,000.
- D. Wages payable on the balance sheet will be \$500.

The unpaid wages of \$500 are reported as a wages payable liability on the balance sheet.

Wages expense of \$5,000 is reported on the income statement.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Expense Recognition (Matching) Principle

138. This month, a company recorded sales revenue of \$50,000 from sales of goods to customers who agreed to pay later. Next month, the company received payment from customers of \$45,000. Choose the TRUE statement.

- A. Revenue for this month is \$45,000.
- B. Accounts receivable at the end of next month is \$5,000.**
- C. Accounts Payable at the end of this month is \$5,000.
- D. Revenue for next month will be \$45,000.

All \$50,000 of revenue is recorded this month. Accounts Receivable next month is \$50,000 - \$45,000 = \$5,000. Accounts Payable is a liability account.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Revenue Recognition Principle

Topic: Transaction Analysis

139. A company has sales revenues of \$200,000 and expenses of \$50,000. What is its net profit margin?

- A. 4
- B. 25%
- C. 75%**
- D. \$150,000

Net profit margin = net income (\$200,000 - 50,000)/sales revenue (\$200,000) = 75%.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Apply

Difficulty: 1 Easy

Learning Objective: 03-05 Evaluate net profit margin; but beware of income statement limitations.

Topic: Net Profit Margin

140. Which of the following statements is not true regarding net profit margin?

- A. If a company's net profit margin increases from 15% to 20% this would be considered an improvement in profitability.
- B. A company with a net profit margin of 10% may be evaluated differently depending upon which industry it is in.
- C. A company with a net profit margin of 10% is using 90% of each dollar of revenue to cover costs and expenses.
- D. Net profit margin indicates how much revenue is earned for every dollar of net income.**

Net profit margin indicates how much net income is earned for every dollar of revenue.

AACSB: Reflective Thinking

AICPA BB: Critical Thinking

AICPA FN: Measurement

Blooms: Evaluate

Difficulty: 2 Medium

Learning Objective: 03-05 Evaluate net profit margin; but beware of income statement limitations.

Topic: Net Profit Margin

Essay Questions

Jim's Gymnastics Training's operations for the month of October are summarized as follows:

- Provided \$5,000 of training to students.
- Received \$8,000 cash from students—of which \$4,000 is for training provided in October (as billed above), \$1,000 is for training to be provided in November, and \$3,000 is for training provided in September.
- Paid September's gym rental bill of \$1,000. Received October's bill of \$1,500 but did not pay.

141. Calculate the following:

- a) Net Income for October using the cash basis of accounting.
- b) Net Income for October using the accrual basis of accounting.

a) Cash Received - Cash Paid = Net Income

$$\$8,000 - \$1,000 = \$7,000$$

b) Revenues - Expenses = Net Income

$$\$5,000 - \$1,500 = \$3,500$$

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Apply

Difficulty: 2 Medium

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Accrual Basis of Accounting

Topic: Cash Basis of Accounting

142. Prepare appropriate journal entries using the accrual basis of accounting.

<i>dr</i>	Accounts receivable (+A)	5,000	
	<i>cr</i> Service revenue (+Rev)		5,000
<i>dr</i>	Cash (+A)	8,000	
	<i>cr</i> Accounts receivable (-A)		7,000
	<i>cr</i> Unearned Revenue (+L)		1,000
<i>dr</i>	Accounts payable (-L)	1,000	
	<i>cr</i> Cash (-A)		1,000
<i>dr</i>	Rent Expense (+Exp)	1,500	
	<i>cr</i> Accounts Payable (+L)		1,500

Alternative Ans:

<i>dr</i>	Accounts receivable (+A)	1,000	
<i>dr</i>	Cash (+A)	4,000	
	<i>cr</i> Service revenue (+Rev)		5,000
<i>dr</i>	Cash (+A)	4,000	
	<i>cr</i> Accounts receivable (-A)		3,000
	<i>cr</i> Unearned Revenue (+L)		1,000
<i>dr</i>	Accounts payable (-L)	1,000	
	<i>cr</i> Cash (-A)		1,000
<i>dr</i>	Rent Expense (+Exp)	1,500	
	<i>cr</i> Accounts Payable (+L)		1,500

Alternative Ans:

<i>dr</i>	Cash (+A)	8,000	
	<i>cr</i>	Service revenue (+Rev)	5,000
	<i>cr</i>	Accounts receivable (-A)	2,000
	<i>cr</i>	Unearned Revenue (+L)	1,000
<i>dr</i>	Accounts payable (-L)	1,000	
	<i>cr</i>	Cash (-A)	1,000
<i>dr</i>	Rent Expense (+Exp)	1,500	
	<i>cr</i>	Accounts Payable (+L)	1,500

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Apply

Difficulty: 3 Hard

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

143. Analyze the events listed below by indicating the accounts and amounts involved in the table below. In the column labeled "+/-", select the sign that describes how the category is affected. If the event should not to be recorded as a transaction, state so.

- A. Borrowed \$7,000,000 cash, signing a promissory note.
- B. Bought a factory for \$800,000, paying \$200,000 in cash and signing a promissory note for \$600,000.
- C. Rented equipment and issued a check for 6 months at \$10,000 a month.
- D. Provided \$104,000 of services and billed customers.
- E. Purchased \$30,000 of supplies on account.
- F. Received a utility bill for the current period in the amount of \$1,200.
- G. Raised sales prices on 200 units from \$400 per unit to \$440 per unit.
- H. Received a 50% deposit from a customer on a \$20,000 order to be filled next month.

	Assets			Liabilities			Stockholders' Equity		
	Account(s)	+ /-	Amount	Account(s)	+/ -	Amount	Account(s)	+/ -	Amount
A									
B									
C									
D									
E									
F									
G									
H									

	Assets			Liabilities			Stockholders' Equity		
	Account(s)	+ /-	Amount	Account(s)	+/ -	Amount	Account(s)	+/ -	Amount
A	Cash	+	7,000,000	Notes Payable	+	7,000,000			
B	Factory	+	800,000	Notes Payable	+	600,000			
	Cash	-	200,000						
C	Cash	-	60,000						
	Prepaid Rent	+	60,000						
D	Accounts Receivable	+	104,000				Service Revenue	+	104,000
E	Supplies	+	30,000	Accounts Payable	+	30,000			
F				Accounts Payable	+	1,200	Utility Expense	-	1,200
G	No transaction								
H	Cash	+	10,000	Unearned Revenue	+	10,000			

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Analyze

Difficulty: 2 Medium

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

144. The Pet Sitters, Inc., had the following transactions during the month of January. For each of the transactions, prepare journal entries.

- A. Paid \$5,000 cash for cat litter.
- B. Paid \$4,480 for wages for the month of January.
- C. Paid \$480 in advance for February rent.
- D. Provided \$12,000 in services on account.
- E. Paid \$800 on accounts payable.
- F. Received \$210 from customers as deposits for future pet sitting services.
- G. Obtained \$390 in vet services during the month, but will not pay the bill until February.
- H. Paid \$780 for equipment.

A.	<i>dr</i> Supplies (+A).....	5,000	
	<i>cr</i> Cash (-A)		5,000
B	<i>dr</i> Wages Expense (+E, -SE).....	4,480	
	<i>cr</i> Cash (-A)		4,480
C.	<i>dr</i> Prepaid Rent (+A).....	480	
	<i>cr</i> Cash (-A)		480
D.	<i>dr</i> Accounts Receivable (+A).....	12,000	
	<i>cr</i> Service Revenue (+R, +SE) ...		12,000
E.	<i>dr</i> Accounts Payable (-L).....	800	
	<i>cr</i> Cash (-A)		800
F.	<i>dr</i> Cash (+A).....	210	
	<i>cr</i> Unearned Revenue (+L).....		210
G.	<i>dr</i> Vet Expenses (+E, -SE).....	390	
	<i>cr</i> Accounts Payable (+L).....		390
H.	<i>dr</i> Equipment (+A)	780	
	<i>cr</i> Cash (-A)		780

AACSB: Analytic

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

145. The following is a series of accounts for the Sprinkler Blowout Company, listed alphabetically and numbered for identification. Following the accounts is a series of transactions. For each transaction, indicate the account(s) that should be debited and credited by entering the appropriate account number(s) to the right of each transaction. If no journal entry is needed, write *none* after the transaction. The first transaction is given as an example.

Acct. #	Account Title	Acct. #	Account Title
1	Accounts payable	9	Land
2	Accounts receivable	10	Note payable
3	Rent expense	11	Prepaid insurance
4	Building	12	Service revenue
5	Cash	13	Unearned revenue
6	Contributed capital	14	Supplies
7	Insurance expense	15	Wages expense
8	Income taxes payable	16	Wages payable

Transactions	Debit	Credit
Example: Collected cash from customers paying off their accounts.	5	2
A. Performed services for customers this month for cash.		
B. Purchased supplies on credit.		
C. Purchased a building, paying part cash and signing a note for the rest.		
D. Paid insurance premium for coverage beginning next month.		
E. Booked blowouts to be done next month; didn't collect cash.		
F. Made payment to suppliers on account.		
G. Collected from customers for work to be performed next month.		
H. Hired an employee.		
I. Pay this month's rent.		

A: 5, 12; B: 14, 1; C: 4, 5/10; D: 11, 5; E: none; F: 1, 5; G: 5, 13; H: none; I: 3, 5.

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

146. Show journal entries for each of the following January activities, and post results to the relevant T-accounts. Compute the ending balance of each T-account. Beginning balances have been entered.

- A. Paid \$689 on account for December's utilities.
- B. Bought \$423 of supplies for cash.
- C. Paid \$3,500 legal fees in advance for legal services to be received over the next six months.
- D. Bought \$15,000 of new equipment, signing a promissory note.
- E. Provided \$26,000 of services. \$17,000 was received in cash and \$9,000 was provided on credit.
- F. Paid workers \$8,300 for work done in January.

A.	<table border="0"> <tr> <td style="padding-right: 10px;"><i>dr</i></td> <td>Accounts Payable (-L).....</td> <td style="text-align: right;">689</td> <td></td> </tr> <tr> <td></td> <td style="padding-left: 20px;"><i>cr</i> Cash (-A)</td> <td></td> <td style="text-align: right;">689</td> </tr> </table>	<i>dr</i>	Accounts Payable (-L).....	689			<i>cr</i> Cash (-A)		689				
<i>dr</i>	Accounts Payable (-L).....	689											
	<i>cr</i> Cash (-A)		689										
B.	<table border="0"> <tr> <td style="padding-right: 10px;"><i>dr</i></td> <td>Supplies (+A).....</td> <td style="text-align: right;">423</td> <td></td> </tr> <tr> <td></td> <td style="padding-left: 20px;"><i>cr</i> Cash (-A)</td> <td></td> <td style="text-align: right;">423</td> </tr> </table>	<i>dr</i>	Supplies (+A).....	423			<i>cr</i> Cash (-A)		423				
<i>dr</i>	Supplies (+A).....	423											
	<i>cr</i> Cash (-A)		423										
C.	<table border="0"> <tr> <td style="padding-right: 10px;"><i>dr</i></td> <td>Prepaid Legal Fees (+A).....</td> <td style="text-align: right;">3,500</td> <td></td> </tr> <tr> <td></td> <td style="padding-left: 20px;"><i>cr</i> Cash (-A)</td> <td></td> <td style="text-align: right;">3,500</td> </tr> </table>	<i>dr</i>	Prepaid Legal Fees (+A).....	3,500			<i>cr</i> Cash (-A)		3,500				
<i>dr</i>	Prepaid Legal Fees (+A).....	3,500											
	<i>cr</i> Cash (-A)		3,500										
D.	<table border="0"> <tr> <td style="padding-right: 10px;"><i>dr</i></td> <td>Property and Equipment (+A).....</td> <td style="text-align: right;">15,000</td> <td></td> </tr> <tr> <td></td> <td style="padding-left: 20px;"><i>cr</i> Notes Payable (+L).....</td> <td></td> <td style="text-align: right;">15,000</td> </tr> </table>	<i>dr</i>	Property and Equipment (+A).....	15,000			<i>cr</i> Notes Payable (+L).....		15,000				
<i>dr</i>	Property and Equipment (+A).....	15,000											
	<i>cr</i> Notes Payable (+L).....		15,000										
E.	<table border="0"> <tr> <td style="padding-right: 10px;"><i>dr</i></td> <td>Cash (+A).....</td> <td style="text-align: right;">17,000</td> <td></td> </tr> <tr> <td style="padding-right: 10px;"><i>dr</i></td> <td>Accounts Receivable (+A).....</td> <td style="text-align: right;">9,000</td> <td></td> </tr> <tr> <td></td> <td style="padding-left: 20px;"><i>cr</i> Revenue (+R, +SE)</td> <td></td> <td style="text-align: right;">26,000</td> </tr> </table>	<i>dr</i>	Cash (+A).....	17,000		<i>dr</i>	Accounts Receivable (+A).....	9,000			<i>cr</i> Revenue (+R, +SE)		26,000
<i>dr</i>	Cash (+A).....	17,000											
<i>dr</i>	Accounts Receivable (+A).....	9,000											
	<i>cr</i> Revenue (+R, +SE)		26,000										
F.	<table border="0"> <tr> <td style="padding-right: 10px;"><i>dr</i></td> <td>Wage Expense (+E, -SE).....</td> <td style="text-align: right;">8,300</td> <td></td> </tr> <tr> <td></td> <td style="padding-left: 20px;"><i>cr</i> Cash (-A)</td> <td></td> <td style="text-align: right;">8,300</td> </tr> </table>	<i>dr</i>	Wage Expense (+E, -SE).....	8,300			<i>cr</i> Cash (-A)		8,300				
<i>dr</i>	Wage Expense (+E, -SE).....	8,300											
	<i>cr</i> Cash (-A)		8,300										

Cash	
1,000	
	689 (A)
	423 (B)
	3,500 (C)
(E) 17,000	
	8,300 (F)
<u>5,088</u>	

Accounts Receivable	
1,000	
(E) 9,000	
<u>10,000</u>	

Supplies	
100	
(B) 423	
<u>523</u>	

Prepaid Legal Fees	
0	
(C) 3,500	
<u>3,500</u>	

Property and Equipment	
500	
(D) 15,000	
<u>15,500</u>	

Accounts Payable	
	689
(A) 689	
<u>0</u>	

Notes Payable	
	3,000
	15,000 (D)
	<u>18,000</u>

Contributed Capital	
	10,000
	<u>10,000</u>

Retained Earnings	
	2,911
	<u>2,911</u>

Service Revenue	
	0
	26,000 (E)
	<u>26,000</u>

Wages Expense	
3,500	
(F) 8,300	
<u>11,800</u>	

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Apply

Difficulty: 2 Medium

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

147. At September 30, Balance Corporation reported the following unadjusted amounts for its accounts, each of which is considered to be a "normal" balance. That is, an account that normally has a debit balance actually does have a debit balance. Prepare an unadjusted trial balance.

Accounts Payable	\$12,000
Accounts Receivable	1,000
Advertising Expense	400
Cash	85,000
Contributed Capital	64,000
Equipment	60,000
Note Payable	36,000
Rent Revenue	42,000
Retained Earnings	24,800
Supplies	1,400
Supplies Expense	600
Utilities Expense	2,000
Wages Expense	28,400

Balance Corporation
Unadjusted Trial Balance
 September 30

	<u>Debit</u>	<u>Credit</u>
Cash	\$85,000	
Accounts Receivable	1,000	
Supplies	1,400	
Equipment	60,000	
Accounts Payable		\$12,000
Note Payable		36,000
Contributed Capital		64,000
Retained Earnings		24,800
Rent Revenue		42,000
Advertising Expense	400	
Supplies Expense	600	
Utilities Expense	2,000	
Wages Expense	28,400	
TOTALS	<u>\$178,800</u>	<u>\$178,800</u>

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Create

Difficulty: 1 Easy

Learning Objective: 03-04 Prepare an unadjusted trial balance.

Topic: Unadjusted Trial Balance

148. Match the term and the explanation. There are more definitions than terms.

- _____ cash basis
- _____ net profit margin
- _____ unadjusted trial balance
- _____ prepaid expense
- _____ unearned revenue
- _____ revenue recognition policy
- _____ Expense Recognition (Matching) principle

- A. Reported when a company sells goods or services in the ordinary course of business for more than it costs to produce.
- B. Reporting expenses and revenue according to the time the underlying activities occur.
- C. A list of account balances when the accounts do not yet include all revenues and expenses.
- D. The concept that expenses should be reported at the same time as the related revenue.
- E. The principle that changes in assets must be matched by changes in liabilities and equity.
- F. Also known as net assets, this is the value of assets minus liabilities.
- G. An asset account indicating a company has already paid a cost not yet incurred.
- H. A company's policy on when to report revenue in the financial statements.
- I. Reporting expenses and revenues according to the time the money is paid or received.
- J. A liability account indicating customers have already paid for services not yet rendered.
- K. A ratio that indicates the percent of each revenue dollar that is left over after covering costs and expenses.

I, K, C, G, J, H, D

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Learning Objective: 03-04 Prepare an unadjusted trial balance.

Learning Objective: 03-05 Evaluate net profit margin; but beware of income statement limitations.

Topic: Accrual Basis of Accounting

Topic: Cash Basis of Accounting

Topic: Expense Recognition (Matching) Principle

Topic: Revenue Recognition Principle

Topic: Unadjusted Trial Balance

149. Match the term and the definition. There are more definitions than terms.

- _____ unearned revenue
- _____ expenditure
- _____ revenue recognition principle
- _____ accrual basis
- _____ time period assumption
- _____ expense
- _____ net income

- A. To reduce the recorded value of an asset to better reflect its true market value.
- B. Any outlay of money by a company for any purpose.
- C. The practice of dividing the life of the business into months and years.
- D. The concept that revenue and expenses should be recorded at the time received or paid.
- E. The concept that revenue should be recorded when earned, not necessarily when payment is received.
- F. Revenues should be recorded when they are earned and expenses when they are incurred.
- G. Total revenue minus total expenses.
- H. Any use or sacrifice of a company's resources to generate revenue.
- I. The increase in value of financial assets held by a company.
- J. Payments received for goods that have not yet been delivered or services that have not yet been performed.
- K. The concept that a company should record revenue during the same period as expenses.

J, B, E, F, C, H, and G

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Reporting

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 03-01 Describe common operating transactions and select appropriate income statement account titles.

Learning Objective: 03-02 Explain and apply the revenue and expense recognition principles.

Topic: Accrual Basis of Accounting

Topic: Expense Recognition (Matching) Principle

Topic: Income Statement

Topic: Revenue Recognition Principle

150. For each of the following, indicate the effect the situation would have on net income in the current period.

O overstate net income

U understate net income

N/A not applicable; no effect on net income

_____ recording prepaid costs as current expenses.

_____ recording an expense at more than the actual cost.

_____ failing to record the receipt of a payment by a customer on account.

_____ failing to record some supplies received.

_____ recording unearned revenue as revenue.

_____ recording an expense as revenue.

_____ failing to record the company issuing additional shares of its own common stock.

U, U, N/A, N/A, O, O, N/A

Feedback: Recording prepaid costs as expenses overstates expenses which in turn understates net income. Recording an expense at more than cost overstates expenses which understates net income. Failing to record receipt of a payment by a customer on account affects accounts receivable and cash, but has no effect on revenues or expenses. Failing to record supplies received affects supplies and cash or accounts payable, but has no effect on revenues or expenses. Recording unearned revenue as revenue overstates revenue which in turn overstates net income. Recording an expense as revenue overstates revenue which in turn overstates net income. Failing to record the issuance of common stock affects cash and contributed capital, but does not affect revenues or expenses.

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Reporting

Blooms: Analyze

Difficulty: 2 Medium

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis

151. Indicate whether a debit (dr) or credit (cr) would be used to increase each of the following accounts.

- _____ prepaid expenses.
- _____ rental revenue.
- _____ salaries and wages expense.
- _____ service revenue.
- _____ property and equipment.
- _____ wages expense.
- _____ retained earnings.
- _____ supplies expense.

dr, cr, dr, cr, dr, dr, cr, dr

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Debit/Credit Framework

152. Match the letter and the blank in each transaction description to complete the analysis. All letters will not be used and some letters may be used more than once.

- A. debit
- B. cash
- C. revenue
- D. supplies
- E. credit
- F. expense
- G. accrued liabilities
- H. unearned revenue
- I. accounts receivable
- J. notes payable

1. A company pays wages. This is posted as a(n) ____ to cash and a(n) ____ to wages expense.
2. A company is paid for a job completed last month. This is posted as a debit to ____ and a credit to ____.
3. A restaurant buys and immediately uses ingredients. This is posted as a(n) ____ to an expense and a(n) ____ to cash.
4. A company pays the original amount owed on a promissory note. This is posted as a debit to ____ and a credit to ____.
5. A company receives money for a job to be done next month. This is posted as a debit to ____ and a credit to ____.

1:E, A; 2:B, I; 3:A, E; 4: J, B; 5:B, H

AACSB: Analytic

AICPA BB: Resource Management

AICPA FN: Measurement

Blooms: Apply

Difficulty: 2 Medium

Learning Objective: 03-03 Analyze; record; and summarize the effects of operating transactions using the accounting equation; journal entries; and T-accounts.

Topic: Transaction Analysis