CHAPTER 3

THE ACCOUNTING INFORMATION SYSTEM

IFRS questions are available at the end of this chapter.

TRUE/FALSE

Answer	No.	Description
F	1.	Recording transactions.
T	2.	Nominal accounts.
F	3.	Real (permanent) accounts.
F	4.	Internal event example.
F	5.	Liability and stockholders' equity accounts.
F	6.	Debits and credits.
F	7.	Steps in accounting cycle.
T	8.	Purpose of trial balance.
T	9.	General journal.
F	10.	Posting and trial balance.
T	11.	Adjusting entries for prepayments.
T	12.	Example of accrued expense.
F	13.	Book value of depreciable assets.
T	14.	Reporting ending retained earnings.
F	15.	Post-closing trial balance.
F	16.	Posting closing entries.
T	17.	Closing entries and Income Summary.
F	*18.	Accrual basis accounting.
F	*19.	Purpose of reversing entries.
F	*20.	Adjusted trial balance.

MULTIPLE CHOICE—Conceptual

Answer	No.	Description
d	21.	Purpose of an accounting system.
d	22.	Definition of posting.
d	23.	Purpose of an accounting system.
d	24.	Book of original entry.
d	25.	Purpose of trial balance.
d	26.	Identification of a real account.
b	27.	Identification of a temporary account.
a	28.	Temporary accounts.
c	29.	Double-entry accounting system.
c	30.	Double-entry system.
a	31.	Effect on stockholders' equity.
a	32.	Transaction analysis.
a	33.	Accounting equation.
b	34.	Accounting process vs. accounting cycle.

d	35.	Accounting cycle steps.
d	36.	Criteria for recording events.
d	37.	Identification of a recordable event.
c	38.	Identification of internal events.
d	39.	External events.
d	40.	Limitations of trial balance.
a	41.	General journal.
b	42.	Journal entry.
c	43.	Journal entry.
d	44.	Journal entry.
d	45.	Imbalance in a trial balance.
d	46.	Purpose of unadjusted trial balance.
b	47.	Format of adjusting entry.
b	48.	Example of accrued expense.
d	49.	Accrual-basis of accounting.
c	50.	Accrued expense adjusting entry.
a	51.	Effect of not recording accrued expense.
b	52.	Description of a deferral.
d	53.	Effect of not recording accrued revenue.
a	54.	Effect of not recording depreciation expense.
a	55.	Timing of adjustments.
a	56.	Prepaid expense.
a	57.	Expiration of prepaid expenses.
b	58.	Effect of depreciation entry.
a	59.	Unearned revenue relationships.
a	60.	Computation of interest expense for adjusting entry.
d	61.	Purpose of adjusting entries.
c	62.	Matching principle.
a	63.	Prepaid items.
d	64.	Accrued items.
c	65.	Definition of unearned revenue.
d	66.	Definition of accrued expense.
c	67.	Adjusting entry for accrued expense.
d	68.	Factors to consider in estimating depreciation.
d	69.	Adjusting entries.
d	70.	Effect of adjusting entries.
b	71.	Prepaid expense and the matching principle.
c	72.	Accrued revenue and the matching principle.
b	73.	Unearned revenue and the matching principle.
b	74.	Adjusted trial balance.
c	75.	Closing process.
c	76.	Purpose of closing entries.
d	77.	Cash collections vs. revenue recognized.
d	*78.	Cash-basis revenue.
c	*79.	Convert cash receipts to service revenue.
c	*80.	Convert cash paid for operating expenses.
c	*81.	Purpose of reversing entries.
d	*82.	Identification of reversing entries.
d	*83.	Identification of reversing entries.
b	*84.	Adjusting entries reversed.
d	*85.	Reporting inventory on a worksheet.

MULTIPLE CHOICE—Computational

Answer	No.	Description
c	86.	Effect of transactions on owners' equity.
c	87.	Effect of transactions on owners' equity.
c	88.	Unearned rent adjustment.
c	89.	Unearned rent adjustment.
d	90.	Determine adjusting entry.
c	91.	Adjusting entry for bad debts.
b	92.	Adjusting entry for bad debts.
c	93.	Adjusting entry for interest receivable.
c	94.	Subsequent period entry for interest.
d	*95.	Use of reversing entry.
d	96.	Adjusting entry for unearned rent.
b	97.	Adjusting entry for supplies.
d	98.	Effect of closing entries.
b	*99.	Calculate cash received for interest.
b	*100.	Calculate cash paid for salaries.
d	*101.	Calculate cash paid for insurance.
c	*102.	Calculate insurance expense.
c	*103.	Calculate interest revenue.
c	*104.	Calculate salary expense.
d	*105.	Adjusting entry for supplies.
c	*106.	Reversing entries.
b	*107.	Unearned rent adjustment.
a	*108.	Determine adjusting entry.
d	*109.	Determine adjusting entry.

MULTIPLE CHOICE—CPA Adapted

Answer	No.	Description
c	110.	Determine accrued interest payable.
b	111.	Determine balance of unearned revenues.
a	112.	Calculate subscriptions revenue.
c	113.	Determine interest receivable.
b	114.	Calculate balance of accrued payable.
b	115.	Calculate accrued salaries.
a	116.	Calculate royalty revenue.
d	117.	Calculate deferred revenue.
b	*118.	Difference between cash-basis and accrual method.
c	*119.	Determine cash-basis revenue.
b	*120.	Determine accrual-basis revenue.
a	*121.	Calculate cost of goods sold.

*This topic is dealt with in an Appendix to the chapter.

BRIEF EXERCISES

Item	Description
BE3-122	Definitions.
BE3-123	Terminology.
BE3-124	Accrued and deferred items.

EXERCISES

Item	Description
E3-125	Adjusting entries.
E3-126	Adjusting entries.
E3-127	Financial statements.
*E3-128	Cash-basis vs. accrual-basis accounting.
*E3-129	Accrual basis.
*E3-130	Accrual basis.
*E3-131	Accrual basis.
*E3-132	Cash basis.

PROBLEMS

Item	Description
P3-133	Adjusting entries and account classifications.
P3-134	Adjusting entries.
P3-135	Adjusting and closing entries.
*P3-136	Cash to accrual accounting.
*P3-137	Accrual accounting.
*P3-138	Accrual accounting.
*P3-139	Eight-column work sheet.

CHAPTER LEARNING OBJECTIVES

1. Understand basic accounting terminology.
2. Explain double-entry rules.
3. Identify steps in the accounting cycle.
4. Record transactions in journals, post to ledger accounts, and prepare a trial balance.
5. Explain the reasons for preparing adjusting entries and identify major types of adjusting entries.
6. Prepare financial statements from the adjusted trial balance.
7. Prepare closing entries.
8. Prepare financial statements for a merchandising company.

*9. Differentiate the cash basis of accounting from the accrual basis of accounting.

*10. Identify adjusting entries that may be reversed.

*11. Prepare a 10-column worksheet.

12. Compare the accounting information systems under GAAP and IFRS.

SUMMARY OF LEARNING OBJECTIVES BY QUESTIONS

Item	Type	Item	Type	Item	Type	Item	Type	Item	Type	Item	Type	Item	Type
Learning Objective 1													
1.	TF	3.	TF	21.	MC	23.	MC	25.	MC	27.	MC	123.	BE
2.	TF	4.	TF	22.	MC	24.	MC	26.	MC	28.	MC		
Learning Objective 2													
5.	TF	29.	MC	31.	MC	33.	MC						
6.	TF	30.	MC	32.	MC	34.	MC						
Learning Objective 3													
7.	TF	35.	MC	36.	MC	37.	MC	38.	MC	39.	MC		
Learning Objective 4													
8.	TF	10.	TF	40.	MC	42.	MC	44.	MC	46.	MC	87.	MC
9.	TF	25.	MC	41.	MC	43.	MC	45.	MC	86.	MC		
Learning Objective 5													
11.	TF	54.	MC	64.	MC	74.	MC	107.	MC	117.	MC		
12.	TF	55.	MC	65.	MC	88.	MC	108.	MC	122.	BE		
13.	TF	56.	MC	66.	MC	89.	MC	109.	MC	123.	BE		
47.	MC	57.	MC	67.	MC	90.	MC	110.	MC	124.	BE		
48.	MC	58.	MC	68.	MC	91.	MC	111.	MC	125.	E		
49.	MC	59.	MC	69.	MC	92.	MC	112.	MC	126.	E		
50.	MC	60.	MC	70.	MC	93.	MC	113.	MC	133.	P		
51.	MC	61.	MC	71.	MC	94.	MC	114.	MC	134.	P		
52.	MC	62.	MC	72.	MC	96.	MC	115.	MC	135.	P		
53.	MC	63.	MC	73.	MC	97.	MC	116.	MC				
Learning Objective 6													
14.	TF	74.	MC	127.	E								
Learning Objective 7													
15.	TF	16.	TF	75.	MC	76.	MC	98.	MC	135.	P		
Learning Objective 8													
17.	TF												
Learning Objective *9													
18.	TF	80.	MC	102.	MC	119.	MC	129.	E	136.	P		
77.	MC	99.	MC	103.	MC	120.	MC	130.	E	137.	P		
78.	MC	100.	MC	104.	MC	121.	MC	131.	E	138.	P		
79.	MC	101.	MC	118.	MC	128.	E	132.	E				
Learning Objective *10													
19.	TF	82.	MC	84.	MC	105.	MC	108.	MC	126.	E		
81.	MC	83.	MC	95.	MC	106.	MC	109.	Mc				
Learning Objective *11													
20.	TF	85.	MC	139.	P								
Learning Objective 12 – IFRS Questions													
1.	TF	2.	TF	3.	MC	4.	MC	5.	MC	6.	MC	7.	MC

8. SA	9. SA					

Note: TF = True/False E = Exercise
MC = Multiple Choice P = Problem

TRUE/FALSE

1. A ledger is where a company first records transactions and other selected events.

2. Nominal (temporary) accounts are revenue, expense, and dividend accounts and are periodically closed.

3. Real (permanent) accounts are revenue, expense, and dividend accounts and are periodically closed.

4. An example of an internal event would be a flood that destroyed a portion of a company's inventory.

5. All liability accounts and stockholders' equity accounts are increased on the credit side and decreased on the debit side.

6. In general, debits refer to increases in account balances, and credits refer to decreases.

7. The first step in the accounting cycle is the journalizing of transactions and selected other events.

8. One purpose of a trial balance is to prove that debits and credits are equal in the general ledger.

9. A general journal chronologically lists transactions and other events, expressed in terms of debits and credits to accounts.

10. If a company fails to post one of its journal entries to its general ledger, the trial balance will not show an equal amount of debit and credit balance accounts.

11. Adjusting entries for prepayments record the portion of the prepayment that represents the expense incurred or the revenue recognized in the current accounting period.

12. An adjustment for wages expense, earned but unpaid at year end, is an example of an accrued expense.

13. The book value of any depreciable asset is the difference between its cost and its salvage value.

14. The ending retained earnings balance is reported on both the retained earnings statement and the balance sheet.

15. The post-closing trial balance consists of asset, liability, owners' equity, revenue and expense accounts.

16. It is not necessary to post the closing entries to the ledger accounts because new revenue and expense accounts will be opened in the subsequent accounting period.

17. Total stockholders' equity consists of common stock and the earnings retained in the business.

*18. The accrual-basis of accounting recognizes revenue when the performance obligation is satisfied and expenses when cash is paid.

*19. Reversing entries are made at the end of the accounting cycle to correct errors in the original recording of transactions.

*20. An adjusted trial balance that shows equal debit and credit columnar totals proves the accuracy of the adjusting entries.

True / False Answers — Conceptual

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
1.	F	5.	F	9.	T	13.	F	17.	T
2.	T	6.	F	10.	F	14.	T	*18.	F
3.	F	7.	F	11.	T	15.	F	*19.	F
4.	F	8.	T	12.	T	16.	F	*20.	F

MULTIPLE CHOICE—Conceptual

21. Factors that shape an accounting information system include the
    a. nature of the business.
    b. size of the firm.
    c. volume of data to be handled.
    d. All of these answer choices are correct.

22. The process of transferring figures from the book of original entry to the ledger accounts is called
    a. adjusting.
    b. balancing.
    c. ledgering.
    d. posting.

23. Debit **always** means
    a. the right side of an account.
    b. an increase.
    c. a decrease.
    d. None of these answer choices are correct.

24. An accounting record into which the essential facts and figures in connection with all transactions are first recorded is called the
    a. ledger.

b. account.
c. trial balance.
d. None of these answer choices are correct.

25. A trial balance
    a. proves that debits and credits are equal in the ledger.
    b. supplies a listing of open accounts and their balances that are used in preparing financial statements.
    c. is normally prepared three times in the accounting cycle.
    d. All of these answer choices are correct.

26. Which of the following is a real (permanent) account?
    a. Goodwill
    b. Service Revenue
    c. Accounts Receivable
    d. Both Goodwill and Accounts Receivable

27. Which of the following is a nominal (temporary) account?
    a. Unearned Service Revenue
    b. Salaries and Wages Expense
    c. Inventory
    d. Retained Earnings

28. Nominal accounts are also called
    a. temporary accounts.
    b. permanent accounts.
    c. real accounts.
    d. None of these answer choices are correct.

29. The double-entry accounting system means
    a. Each transaction is recorded with two journal entries.
    b. Each item is recorded in a journal entry, then in a general ledger account.
    c. The dual effect of each transaction is recorded with a debit and a credit.
    d. None of these answer choices are correct.

30. When a corporation pays a note payable and interest,
    a. the account notes payable will be increased.
    b. the account interest expense will be decreased.
    c. they will debit notes payable and interest expense.
    d. they will debit cash.

31. Stockholders' equity is not affected by all
    a. cash receipts.
    b. dividends.
    c. revenues.
    d. expenses.

32. The debit and credit analysis of a transaction normally takes place
    a. before an entry is recorded in a journal.
    b. when the entry is posted to the ledger.
    c. when the trial balance is prepared.
    d. at the end of the accounting cycle.

33. The accounting equation must remain in balance
    a. throughout each step in the accounting cycle.
    b. only when journal entries are recorded.
    c. only at the time the trial balance is prepared.
    d. only when formal financial statements are prepared.

34. The difference between the accounting process and the accounting cycle is
    a. the accounting process results in the preparation of financial statements, whereas the accounting cycle is concerned with recording business transactions.
    b. the accounting cycle represents the steps taken to accomplish the accounting process.
    c. the accounting process represents the steps taken to accomplish the accounting cycle.
    d. merely semantic, because both concepts refer to the same thing.

35. An optional step in the accounting cycle is the preparation of
    a. adjusting entries.
    b. closing entries.
    c. a statement of cash flows.
    d. a post-closing trial balance.

36. Which of the following criteria must be met before an event or item should be recorded for accounting purposes?
    a. The event or item can be measured objectively in financial terms.
    b. The event or item is relevant and reliable.
    c. The event or item is an element.
    d. All of these must be met.

37. Which of the following is a recordable event or item?
    a. Changes in managerial policy
    b. The value of human resources
    c. Changes in personnel
    d. None of these answer choices are correct.

38. Which of the following is **not** an internal event?
    a. Depreciation
    b. Using raw materials in the production process
    c. Dividend declaration and subsequent payment
    d. All of these are internal transactions.

39. External events do **not** include
    a. interaction between an entity and its environment.
    b. a change in the price of a good or service that an entity buys or sells.
    c. improvement in technology by a competitor.
    d. using buildings and machinery in operations.

40. A trial balance may prove that debits and credits are equal, but
    a. an amount could be entered in the wrong account.
    b. a transaction could have been entered twice.
    c. a transaction could have been omitted.
    d. All of these answer choices are correct.

41. A general journal
    a. chronologically lists transactions and other events, expressed in terms of debits and credits.
    b. contains one record for each of the asset, liability, stockholders' equity, revenue, and expense accounts.
    c. lists all the increases and decreases in each account in one place.
    d. contains only adjusting entries.

42. A journal entry to record the sale of inventory on account will include a
    a. debit to Inventory.
    b. debit to Accounts Receivable.
    c. debit to Sales Revenue.
    d. credit to Cost of Goods Sold.

43. A journal entry to record a payment on account will include a
    a. debit to Accounts Receivable.
    b. credit to Accounts Receivable.
    c. debit to Accounts Payable.
    d. credit to Accounts Payable.

44. A journal entry to record a receipt of rent in advance will include a
    a. debit to Rent Revenue.
    b. credit to Rent Revenue.
    c. credit to Cash.
    d. credit to Unearned Revenue.

45. Which of the following errors will cause an imbalance in the trial balance?
    a. Omission of a transaction in the journal.
    b. Posting an entire journal entry twice to the ledger.
    c. Posting a credit of $720 to Accounts Payable as a credit of $720 to Accounts Receivable.
    d. Listing the balance of an account with a debit balance in the credit column of the trial balance.

[S]46. Which of the following is not a principal purpose of an unadjusted trial balance?
    a. It proves that debits and credits of equal amounts are in the ledger.
    b. It is the basis for any adjustments to the account balances.
    c. It supplies a listing of open accounts and their balances.
    d. It proves that debits and credits were properly entered in the ledger accounts.

[S]47. An adjusting entry should never include
    a. a debit to an expense account and a credit to a liability account.
    b. a debit to an expense account and a credit to a revenue account.
    c. a debit to a liability account and a credit to revenue account.
    d. a debit to a revenue account and a credit to a liability account.

48. Which of the following is an example of an accrued expense?
    a. Office supplies purchased at the beginning of the year and debited to an expense account.
    b. Property taxes incurred during the year, to be paid in the first quarter of the subsequent year.
    c. Depreciation expense
    d. Rent recognized during the period, to be received at the end of the year

[P]49. Which of the following statements is true about the accrual basis of accounting?
a. The timing of cash receipts and disbursements is emphasized.
b. A minimal amount of record keeping is required in accrual basis accounting compared to cash basis.
c. This method is used less frequently by businesses than the cash method of accounting.
d. Revenues are recognized in the period the performance obligation is satisfied, regardless of the time period the cash is received.

[P]50. An adjusting entry to record an accrued expense involves a debit to a(an)
a. expense account and a credit to a prepaid account.
b. expense account and a credit to Cash.
c. expense account and a credit to a liability account.
d. liability account and a credit to an expense account.

[P]51. The failure to properly record an adjusting entry to accrue an expense will result in an
a. understatement of expenses and an understatement of liabilities.
b. understatement of expenses and an overstatement of liabilities.
c. understatement of expenses and an overstatement of assets.
d. overstatement of expenses and an understatement of assets.

[P]52. Which of the following properly describes a deferral?
a. Cash is received after revenue is recognized.
b. Cash is received before revenue is recognized.
c. Cash is paid after expense is incurred.
d. Cash is paid in the same time period that an expense is incurred.

[P]53. The failure to properly record an adjusting entry to accrue a revenue item will result in an
a. understatement of revenues and an understatement of liabilities.
b. overstatement of revenues and an overstatement of liabilities.
c. overstatement of revenues and an overstatement of assets.
d. understatement of revenues and an understatement of assets.

[P]54. The omission of the adjusting entry to record depreciation expense will result in an
a. overstatement of assets and an overstatement of owners' equity.
b. understatement of assets and an understatement of owner's equity.
c. overstatement of assets and an overstatement of liabilities.
d. overstatement of liabilities and an understatement of owners' equity.

55. Adjustments are often prepared
a. after the balance sheet date, but dated as of the balance sheet date.
b. after the balance sheet date, and dated after the balance sheet date.
c. before the balance sheet date, and dated before the balance sheet date.
d. before the balance sheet date, and dated after the balance sheet date.

56. At the time a company prepays a cost
a. it debits an asset account to show the service or benefit it will receive in the future.
b. it debits an expense account to match the expense against revenues recognized.
c. its credits a liability account to show the obligation to pay for the service in the future.
d. it credits an asset account and debits an expense account.

57. How do these prepaid expenses expire?

	Rent	***Supplies***
a.	With the passage of time	Through use and consumption
b.	With the passage of time	With the passage of time
c.	Through use and consumption	Through use and consumption
d.	Through use and consumption	With the passage of time

58. Recording the adjusting entry for depreciation has the same effect as recording the adjusting entry for
    a. an unearned revenue.
    b. a prepaid expense.
    c. an accrued revenue.
    d. an accrued expense.

59. Unearned revenue on the books of one company is likely to be
    a. a prepaid expense on the books of the company that made the advance payment.
    b. an unearned revenue on the books of the company that made the advance payment.
    c. an accrued expense on the books of the company that made the advance payment.
    d. an accrued revenue on the books of the company that made the advance payment.

60. To compute interest expense on a note for an adjusting entry, the formula is (principal × annual rate × a fraction). The numerator and denominator of the fraction are:

	Numerator	***Denominator***
a.	Length of time note has been outstanding	12 months
b.	Total length of note	12 months
c.	Length of time until note matures	Total length of note
d.	Length of time note has been outstanding	Total length of note

61. Adjusting entries are necessary to
    1. obtain a proper matching of revenue and expense.
    2. achieve an accurate statement of assets and equities.
    3. adjust assets and liabilities to their fair market value.

    a. 1
    b. 2
    c. 3
    d. 1 and 2

62. Why are certain costs of doing business capitalized when incurred and then depreciated or amortized over subsequent accounting cycles?
    a. To reduce the federal income tax liability
    b. To aid management in cash-flow analysis
    c. To match the costs of production with revenues as recognized
    d. To adhere to the accounting constraint of conservatism

63. When an expense is paid in cash before it is used, it is called a(n)
    a. prepaid expense.
    b. accrued expense.
    c. estimated expense.
    d. cash expense.

64. When revenue or expense has been recognized or incurred but not yet collected or paid, it is normally called a(n) ____________ revenue or expense.
    a. deferred
    b. adjusted
    c. estimated
    d. None of these answer choices are correct.

65. When a revenue is collected and recorded in advance, it is normally accounted for as a(n) ___________ revenue.
    a. accrued
    b. prepaid
    c. unearned
    d. cash

66. An accrued expense can best be described as an amount
    a. paid and currently matched with earnings.
    b. paid and not currently matched with earnings.
    c. not paid and not currently matched with earnings.
    d. not paid and currently matched with earnings.

67. During an accounting period, if an expense has been incurred and consumed but not yet paid for or recorded, then the end-of-period adjusting entry would involve
    a. a liability account and an asset account.
    b. an asset or contra asset account and an expense account.
    c. a liability account and an expense account.
    d. a receivable account and a revenue account.

68. Which of the following must be considered in estimating depreciation on an asset for an accounting period?
    a. The original cost of the asset
    b. Its useful life
    c. The decline of its fair value
    d. Both the original cost of the asset and its useful life.

69. Which of the following would **not** be a correct form for an adjusting entry?
    a. A debit to a revenue and a credit to a liability
    b. A debit to an expense and a credit to a liability
    c. A debit to a liability and a credit to a revenue
    d. A debit to an asset and a credit to a liability

70. Year-end net assets would be overstated and current expenses would be understated as a result of failure to record which of the following adjusting entries?
    a. Expiration of prepaid insurance
    b. Depreciation of fixed assets
    c. Use of supplies
    d. All of these answer choices are correct.

71. A prepaid expense can best be described as an amount
    a. paid and currently matched with revenues.
    b. paid and not currently matched with revenues.
    c. not paid and currently matched with revenues.
    d. not paid and not currently matched with revenues.

72. An accrued revenue can best be described as an amount
    a. collected and currently matched with expenses.
    b. collected and not currently matched with expenses.
    c. not collected and currently matched with expenses.
    d. not collected and not currently matched with expenses.

73. An unearned revenue can best be described as an amount
    a. collected and currently matched with expenses.
    b. collected and not currently matched with expenses.
    c. not collected and currently matched with expenses.
    d. not collected and not currently matched with expenses.

74. An adjusted trial balance
    a. is prepared after the financial statements are completed.
    b. proves the equality of the debit balances and credit balances of ledger accounts after all adjustments have been made.
    c. is a required financial statement under generally accepted accounting principles.
    d. cannot be used to prepare financial statements.

75. Which type of account is always debited during the closing process?
    a. Dividends
    b. Expense
    c. Revenue
    d. Retained earnings

S76. Which of the following statements best describes the purpose of closing entries?
    a. To faciliate posting and taking a trial balance.
    b. To determine the amount of net income or net loss for the following period.
    c. To reduce the balances of revenue and expense accounts to zero so that they may be used to accumulate the revenues and expenses of the next period.
    d. To complete the record of various transactions that were started in a prior period.

P77. If ending accounts receivable exceeds the beginning accounts receivable
    a. cash collections during the period exceed the amount of revenue recognized.
    b. net income for the period is less than the amount of cash-basis income.
    c. no cash was collected during the period.
    d. cash collections during the year are less than the amount of revenue recognized.

*78. Under the cash-basis of accounting, revenues are recorded
    a. when they are recognized and realized.
    b. when they are recognized and realizable.
    c. when they are recognized.
    d. when they are realized.

*79. When converting from cash-basis to accrual-basis accounting, which of the following adjustments should be made to cash receipts from customers to determine accrual-basis service revenue?
    a. Subtract ending accounts receivable.
    b. Subtract beginning unearned service revenue.
    c. Add ending accounts receivable.
    d. Add cash sales.

*80. When converting from cash-basis to accrual-basis accounting, which of the following adjustments should be made to cash paid for operating expenses to determine accrual-basis operating expenses?
a. Add beginning accrued liabilities.
b. Subtract beginning prepaid expense.
c. Subtract ending prepaid expense.
d. Subtract interest expense.

*81. Reversing entries are
1. normally prepared for prepaid, accrued, and estimated items.
2. necessary to achieve a proper matching of revenue and expense.
3. useful in simplifying the recording of transactions in the next accounting period.

a. 1
b. 2
c. 3
d. 1 and 2

*82. Adjusting entries that should be reversed include those for prepaid or unearned items that
a. create an asset or a liability account.
b. were originally entered in a revenue or expense account.
c. were originally entered in an asset or liability account.
d. create an asset or a liability account and were originally entered in a revenue or expense account.

*83. Adjusting entries that should be reversed include
a. all accrued revenues.
b. all accrued expenses.
c. those that debit an asset or credit a liability.
d. All of these answer choices are correct.

S*84. A reversing entry should never be made for an adjusting entry that
a. accrues unrecorded revenue.
b. adjusts expired costs from an asset account to an expense account.
c. accrues unrecorded expenses.
d. adjusts unexpired costs from an expense account to an asset account.

S*85. The worksheet for Sharko Co. consisted of five pairs of debit and credit columns. The dollar amount of one item appeared in both the credit column of the income statement section and the debit column of the balance sheet section. That item is
a. net income for the period.
b. beginning inventory.
c. cost of goods sold.
d. net loss for the period.

Multiple Choice Answers—Conceptual

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
21.	d	32.	a	43.	c	54.	a	65.	c	76.	c
22.	d	33.	a	44.	d	55.	a	66.	d	77.	d
23.	d	34.	b	45.	d	56.	a	67.	c	*78.	d
24.	d	35.	d	46.	d	57.	a	68.	d	*79.	c
25.	d	36.	d	47.	b	58.	b	69.	d	*80.	c
26.	d	37.	d	48.	b	59.	a	70.	d	*81.	c
27.	b	38.	c	49.	d	60.	a	71.	b	*82.	d
28.	a	39.	d	50.	c	61.	d	72.	c	*83.	d
29.	c	40.	d	51.	a	62.	c	73.	b	*84.	b
30.	c	41.	a	52.	b	63.	a	74.	b	*85.	d
31.	a	42.	b	53.	d	64.	d	75.	c		

Solutions to those Multiple Choice questions for which the answer is “none of these.”

23. left or left-side.
24. journal.
37. Many answers are possible.
64. accrued.

MULTIPLE CHOICE—Computational

86. Maso Company recorded journal entries for the issuance of common stock for $160,000, the payment of $52,000 on accounts payable, and the payment of salaries expense of $84,000. What net effect do these entries have on owners’ equity?
    a. Increase of $160,000.
    b. Increase of $108,000.
    c. Increase of $76,000.
    d. Increase of $24,000.

87. Mune Company recorded journal entries for the declaration of $150,000 of dividends, the $96,000 increase in accounts receivable for services rendered, and the purchase of equipment for $63,000. What net effect do these entries have on owners’ equity?
    a. Decrease of $213,000.
    b. Decrease of $117,000.
    c. Decrease of $54,000.
    d. Increase of $33,000.

88. Pappy Corporation received cash of $24,000 on September 1, 2014 for one year’s rent in advance and recorded the transaction with a credit to Unearned Rent Revenue. The December 31, 2014 adjusting entry is
    a. debit Rent Revenue and credit Unearned Rent Revenue, $8,000.
    b. debit Rent Revenue and credit Unearned Rent Revenue, $16,000.
    c. debit Unearned Rent Revenue and credit Rent Revenue, $8,000.
    d. debit Cash and credit Unearned Rent Revenue, $16,000.

89. Panda Corporation paid cash of $60,000 on June 1, 2014 for one year's rent in advance and recorded the transaction with a debit to Prepaid Rent. The December 31, 2014 adjusting entry is
    a. debit Prepaid Rent and credit Rent Expense, $25,000.
    b. debit Prepaid Rent and credit Rent Expense, $35,000.
    c. debit Rent Expense and credit Prepaid Rent, $35,000.
    d. debit Prepaid Rent and credit Cash, $25,000.

90. Tate Company purchased equipment on November 1, 2014 and gave a 3-month, 9% note with a face value of $60,000. The December 31, 2014 adjusting entry is
    a. debit Interest Expense and credit Interest Payable, $5,400.
    b. debit Interest Expense and credit Interest Payable, $1,350.
    c. debit Interest Expense and credit Cash, $900.
    d. debit Interest Expense and credit Interest Payable, $900.

91. Brown Company's account balances at December 31, 2014 for Accounts Receivable and the related Allowance for Doubtful Accounts are $920,000 debit and $1,400 credit, respectively. From an aging of accounts receivable, it is estimated that $23,000 of the December 31 receivables will be uncollectible. The necessary adjusting entry would include a credit to the allowance account for
    a. $23,000.
    b. $24,400.
    c. $21,600.
    d. $1,400.

92. Chen Company's account balances at December 31, 2014 for Accounts Receivable and the Allowance for Doubtful Accounts are $480,000 debit and $900 credit. Sales during 2014 were $1,650,000. It is estimated that 1% of sales will be uncollectible. The adjusting entry would include a credit to the allowance account for
    a. $17,400.
    b. $16,500.
    c. $15,600.
    d. $4,800.

93. Starr Corporation loaned $450,000 to another corporation on December 1, 2014 and received a 3-month, 8% interest-bearing note with a face value of $450,000. What adjusting entry should Starr make on December 31, 2014?
    a. Debit Interest Receivable and credit Interest Revenue, $9,000.
    b. Debit Cash and credit Interest Revenue, $3,000.
    c. Debit Interest Receivable and credit Interest Revenue, $3,000.
    d. Debit Cash and credit Interest Receivable, $9,000.

94. A company receives interest on a $70,000, 8%, 5-year note receivable each April 1. At December 31, 2014, the following adjusting entry was made to accrue interest receivable:

Interest Receivable	4,200	
Interest Revenue		4,200

Assuming that the company does **not** use reversing entries, what entry should be made on April 1, 2015 when the annual interest payment is received?

a.	Cash	1,400	
	Interest Revenue		1,400
b.	Cash	4,200	
	Interest Receivable		4,200
c.	Cash	5,600	
	Interest Receivable		4,200
	Interest Revenue		1,400
d.	Cash	5,600	
	Interest Revenue		5,600

*95. A company receives interest on a $70,000, 8%, 5-year note receivable each April 1. At December 31, 2014, the following adjusting entry was made to accrue interest receivable:

Interest Receivable	4,200	
Interest Revenue		4,200

Assuming that the company **does** use reversing entries, what entry should be made on April 1, 2015 when the annual interest payment is received?

a.	Cash	1,400	
	Interest Revenue		1,400
b.	Cash	4,200	
	Interest Receivable		4,200
c.	Cash	5,600	
	Interest Receivable		4,200
	Interest Revenue		1,400
d.	Cash	5,600	
	Interest Revenue		5,600

96. Murphy Company sublet a portion of its warehouse for five years at an annual rental of $60,000, beginning on May 1, 2014. The tenant, Sheri Charter, paid one year's rent in advance, which Murphy recorded as a credit to Unearned Rent Revenue. Murphy reports on a calendar-year basis. The adjustment on December 31, 2014 for Murphy should be

a.	No entry		
b.	Unearned Rent Revenue	20,000	
	Rent Revenue		20,000
c.	Rent Revenue	20,000	
	Unearned Rent Revenue		20,000
d.	Unearned Rent Revenue	40,000	
	Revenue Revenue		40,000

97. During the first year of Wilkinson Co.'s operations, all purchases were recorded as assets. Supplies in the amount of $25,800 were purchased. Actual year-end supplies amounted to $5,600. The adjusting entry for store supplies will

a. increase net income by $20,200.
b. increase expenses by $20,200.
c. decrease supplies by $5,600.
d. debit Accounts Payable for $5,600.

98. Big-Mouth Frog Corporation had revenues of $300,000, expenses of $200,000, and dividends of $45,000. When Income Summary is closed to Retained Earnings, the amount of the debit or credit to Retained Earnings is a
a. debit of $55,000.
b. debit of $100,000.
c. credit of $55,000.
d. credit of $100,000.

*99. The income statement of Dolan Corporation for 2014 included the following items:

Interest revenue	$121,000
Salaries and wages expense	180,000
Insurance expense	18,200

The following balances have been excerpted from Dolan Corporation's balance sheets:

	December 31, 2014	December 31, 2013
Interest receivable	$18,200	$15,000
Salaries and wages payable	17,800	8,400
Prepaid insurance	2,200	3,000

The cash received for interest during 2014 was
a. $102,800.
b. $117,800.
c. $121,000.
d. $124,200.

*100. The income statement of Dolan Corporation for 2014 included the following items:

Interest revenue	$121,000
Salaries and wages expense	180,000
Insurance expense	18,200

The following balances have been excerpted from Dolan Corporation's balance sheets:

	December 31, 2014	December 31, 2013
Interest receivable	$18,200	$15,000
Salaries and wages payable	17,800	8,400
Prepaid insurance	2,200	3,000

The cash paid for salaries and wages during 2014 was
a. $189,400.
b. $170,600.
c. $171,600.
d. $197,800.

*101. The income statement of Dolan Corporation for 2014 included the following items:

Interest revenue	$121,000
Salaries and wages expense	180,000
Insurance expense	18,200

The following balances have been excerpted from Dolan Corporation's balance sheets:

	December 31, 2014	December 31, 2013
Interest receivable	$18,200	$15,000
Salaries and wages payable	17,800	8,400
Prepaid insurance	2,200	3,000

The cash paid for insurance premiums during 2014 was
a. $16,000.
b. $15,200.
c. $19,000.
d. $17,400.

*102. Olsen Company paid or collected during 2014 the following items:

Insurance premiums paid	$ 25,800
Interest collected	62,800
Salaries paid	260,400

The following balances have been excerpted from Olsen's balance sheets:

	December 31, 2014	December 31, 2013
Prepaid insurance	$ 2,400	$ 3,000
Interest receivable	7,400	5,800
Salaries and wages payable	24,600	21,200

The insurance expense on the income statement for 2014 was
a. $20,400.
b. $25,200.
c. $26,400.
d. $31,200.

*103. Olsen Company paid or collected during 2014 the following items:

Insurance premiums paid	$ 25,800
Interest collected	62,800
Salaries paid	260,400

The following balances have been excerpted from Olsen's balance sheets:

	December 31, 2014	December 31, 2013
Prepaid insurance	$ 2,400	$ 3,000
Interest receivable	7,400	5,800
Salaries and wages payable	24,600	21,200

The interest revenue on the income statement for 2014 was
a. $49,600.
b. $61,200.
c. $64,400.
d. $76,000.

*104. Olsen Company paid or collected during 2014 the following items:

Insurance premiums paid	$ 25,800
Interest collected	62,800
Salaries and wages paid	260,400

The following balances have been excerpted from Olsen's balance sheets:

	December 31, 2014	December 31, 2013
Prepaid insurance	$ 2,400	$ 3,000
Interest receivable	7,400	5,800
Salaries and wages payable	24,600	21,200

Salaries and wages expense on the income statement for 2014 was
a. $214,600.
b. $257,000.
c. $263,800.
d. $306,200.

*105. The Supplies account had a balance at the beginning of year 3 of $8,000 (before the reversing entry). Payments for purchases of supplies during year 3 amounted to $50,000 and were recorded as expense. A physical count at the end of year 3 revealed supplies costing $11,500 were on hand. Reversing entries are used by this company. The required adjusting entry at the end of year 3 will include a debit to:
a. Supplies Expense for $3,500.
b. Supplies for $3,500.
c. Supplies Expense for $46,500.
d. Supplies for $11,500.

*106. At the end of 2014, Drew Company made four adjusting entries for the following items:
1. Depreciation expense, $25,000.
2. Expired insurance, $2,200 (originally recorded as prepaid insurance.)
3. Interest payable, $6,000.
4. Rent receivable, $10,000.

In the normal situation, to facilitate subsequent entries, the adjusting entry or entries that may be reversed is (are)
a. Entry No. 3 only.
b. Entry No. 4 only.
c. Entry No. 3 and No. 4.
d. Entry No. 2, No. 3 and No. 4.

*107. Garcia Corporation received cash of $36,000 on August 1, 2014 for one year's rent in advance and recorded the transaction with a credit to Rent Revenue. The December 31, 2014 adjusting entry is
a. debit Rent Revenue and credit Unearned Rent Revenue, $15,000.
b. debit Rent Revenue and credit Unearned Rent Revenue, $21,000.
c. debit Unearned Rent Revenue and credit Rent Revenue, $15,000.
d. debit Cash and credit Unearned Rent Revenue, $21,000.

*108. Lopez Company received $14,400 on April 1, 2014 for one year's rent in advance and recorded the transaction with a credit to a nominal account. The December 31, 2014 adjusting entry is
a. debit Rent Revenue and credit Unearned Rent Revenue, $3,600.
b. debit Rent Revenue and credit Unearned Rent Revenue, $10,800.
c. debit Unearned Rent Revenue and credit Rent Revenue, $3,600.
d. debit Unearned Rent Revenue and credit Rent Revenue, $10,800.

*109. Gibson Company paid $12,000 on June 1, 2014 for a two-year insurance policy and recorded the entire amount as Insurance Expense. The December 31, 2014 adjusting entry is
a. debit Insurance Expense and credit Prepaid Insurance, $3,500.
b. debit Insurance Expense and credit Prepaid Insurance, $8,500.
c. debit Prepaid Insurance and credit Insurance Expense, $3,500
d. debit Prepaid Insurance and credit Insurance Expense, $8,500.

Multiple Choice Answers—Computational

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans	Item	Ans	Item	Ans.
86.	c	90.	d	94.	c	98.	d	*102.	c	*106.	c
87.	c	91.	c	95.	d	*99.	b	*103.	c	*107.	b
88.	c	92.	b	96.	d	*100.	b	*104.	c	*108.	a
89.	c	93.	c	97.	b	*101.	d	*105.	d	*109.	d

MULTIPLE CHOICE—CPA Adapted

110. On September 1, 2014, Lowe Co. issued a note payable to National Bank in the amount of $900,000, bearing interest at 9%, and payable in three equal annual principal payments of $300,000. On this date, the bank's prime rate was 8%. The first payment for interest and principal was made on September 1, 2015. At December 31, 2015, Lowe should record accrued interest payable of
a. $27,000.
b. $24,000.
c. $18,000.
d. $16,000.

111. Eaton Co. sells major household appliance service contracts for cash. The service contracts are for a one-year, two-year, or three-year period. Cash receipts from contracts are credited to Unearned Service Revenue. This account had a balance of $3,800,000 at December 31, 2014 before year-end adjustment. Service contract costs are charged as incurred to the Service Contract Expense account, which had a balance of $900,000 at December 31, 2014.

Service contracts still outstanding at December 31, 2014 expire as follows:

During 2015	$960,000
During 2016	1,140,000
During 2017	700,000

What amount should be reported as Unearned Service Revenue in Eaton's December 31, 2014 balance sheet?

a. $2,900,000.
b. $2,800,000.
c. $1,900,000.
d. $1,000,000.

112. In November and December 2014, Lane Co., a newly organized magazine publisher, received $60,000 for 1,000 three-year subscriptions at $20 per year, starting with the January 2015 issue. Lane included the entire $60,000 in its 2014 income tax return. What amount should Lane report in its 2014 income statement for subscriptions revenue?

a. $0.
b. $3,333.
c. $20,000.
d. $60,000.

113. On June 1, 2014, Nott Corp. loaned Horn $800,000 on a 12% note, payable in five annual installments of $160,000 beginning January 2, 2015. In connection with this loan, Horn was required to deposit $5,000 in a noninterest-bearing escrow account. The amount held in escrow is to be returned to Horn after all principal and interest payments have been made. Interest on the note is payable on the first day of each month beginning July 1, 2014. Horn made timely payments through November 1, 2014. On January 2, 2015, Nott received payment of the first principal installment plus all interest due. At December 31, 2014, Nott's interest receivable on the loan to Horn should be

a. $0.
b. $8,000.
c. $16,000.
d. $24,000.

114. Included in Allen Corp.'s balance sheet at June 30, 2015 is a 10%, $3,000,000 note payable. The note is dated October 1, 2013 and is payable in three equal annual payments of $1,500,000 plus interest. The first interest and principal payment was made on October 1, 2014. In Allen's June 30, 2015 balance sheet, what amount should be reported as accrued interest payable for this note?

a. $337,500.
b. $225,000.
c. $112,500.
d. $75,000.

115. Colaw Co. pays all salaried employees on a biweekly basis. Overtime pay, however, is paid in the next biweekly period. Colaw accrues salaries expense only at its December 31 year end. Data relating to salaries earned in December 2014 are as follows:

Last payroll was paid on 12/26/14, for the 2-week period ended 12/26/14.
Overtime pay earned in the 2-week period ended 12/26/14 was $20,000.
Remaining work days in 2014 were December 29, 30, 31, on which days there was no overtime.
The recurring biweekly salaries total $360,000.

Assuming a five-day workweek, Colaw should record a liability at December 31, 2014 for accrued salaries of

a. $108,000.
b. $128,000.
c. $216,000.
d. $236,000.

116. Tolan Corp.'s trademark was licensed to Eddy Co. for royalties of 15% of sales of the trademarked items. Royalties are payable semiannually on March 15 for sales in July through December of the prior year, and on September 15 for sales in January through June of the same year. Tolan received the following royalties from Eddy:

	March 15	September 15
2013	$5,000	$7,500
2014	6,000	9,500

Eddy estimated that sales of the trademarked items would total $30,000 for July through December 2014. In Tolan's 2014 income statement, the royalty revenue should be

a. $14,000.
b. $15,500.
c. $20,000.
d. $20,500.

117. At December 31, 2014, Sue's Boutique had 1,000 gift certificates outstanding, which had been sold to customers during 2014 for $60 each. Sue's operates on a gross profit of 60% of its sales. What amount of revenue pertaining to the 1,000 outstanding gift certificates should be deferred at December 31, 2014?

a. $0.
b. $24,000.
c. $36,000.
d. $60,000.

*118. Compared to the accrual basis of accounting, the cash basis of accounting overstates income by the net increase during the accounting period of the

	Accounts Receivable	Accrued Expenses Payable
a.	No	No
b.	No	Yes
c.	Yes	No
d.	Yes	Yes

*119. Gregg Corp. reported revenue of $1,450,000 in its accrual basis income statement for the year ended June 30, 2015. Additional information was as follows:

Accounts receivable June 30, 2014	$400,000
Accounts receivable June 30, 2015	530,000
Uncollectible accounts written off during the fiscal year	15,000

Under the cash basis, Gregg should report revenue of

a. $1,035,000.
b. $1,050,000.
c. $1,305,000.
d. $1,335,000.

*120. Jim Yount, M.D., keeps his accounting records on the cash basis. During 2015, Dr. Yount collected $350,000 from his patients. At December 31, 2014, Dr. Yount had accounts receivable of $40,000. At December 31, 2015, Dr. Yount had accounts receivable of $70,000 and unearned revenue of $10,000. On the accrual basis, how much was Dr. Yount's patient service revenue for 2015?

a. $310,000.
b. $370,000.
c. $380,000.
d. $390,000.

*121. The following information is available for Ace Company for 2014:

Disbursements for purchases	$1,360,000
Increase in trade accounts payable	100,000
Decrease in merchandise inventory	40,000

Cost of goods sold for 2014 was

a. $1,500,000.
b. $1,420,000.
c. $1,300,000.
d. $1,220,000.

Multiple Choice Answers—CPA Adapted

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans	Item	Ans.
110.	c	112.	a	114.	b	116.	a	*118.	b	*120.	b
111.	b	113.	c	115.	b	117.	d	*119.	c	*121.	a

DERIVATIONS — Computational

No.	Answer	Derivation
86.	c	\$160,000 - \$84,000 = \$76,000.
87.	c	\$150,000 - \$96,000 = \$54,000.
88.	c	\$24,000 x 4/12 = \$8,000.
89.	c	\$60,000 x 7/12 = \$35,000.
90.	d	2/12 x 9% x \$60,000 = \$900.
91.	c	\$23,000 – \$1,400 = \$21,600.
92.	b	\$1,650,000 x 1% = \$16,500.
93.	c	1/12 x 8% x \$450,000 = \$3,000.
94.	c	\$70,000 x 8% = \$5,600; \$5,600 - \$4,200 = \$1,400 int. rev.
*95.	d	\$70,000 x 8% = \$5,600
96.	d	\$60,000 x 8/12 = \$40,000.
97.	b	\$25,800 – \$5,600 = \$20,200.
98.	d	\$300,000 - \$200,000 = \$100,000.
*99.	b	\$15,000 + \$121,000 - \$18,200 = \$117,800.
*100.	b	\$8,400 + \$180,000 - \$17,800 = \$170,600.
*101.	d	\$18,200 – \$3,000 + \$2,200 = \$17,400.
*102.	c	\$25,800 + \$600 = \$26,400.
*103.	c	\$62,800 – \$5,800 + \$7,400 = \$64,400.
*104.	c	\$260,400 – \$21,200 + \$24,600 = \$263,800.
*105.	d	\$11,500 + \$8,000 – \$8,000 = \$11,500.
*106.	c	
*107.	b	7/12 x \$36,000 = \$21,000.
*108.	a	3/12 x \$14,400 = \$3,600.
*109.	d	17/24 x \$12,000 = \$8,500.

DERIVATIONS — CPA Adapted

No.	Answer	Derivation
110.	c	(\$900,000 – \$300,000) × 9% × 4/12 = \$18,000.
111.	b	\$960,000 + \$1,140,000 + \$700,000 = \$2,800,000.
112.	a	\$0, none of the \$60,000 is recognized.
113.	c	\$800,000 × 12% × 2/12 = \$16,000.
114.	b	\$3,000,000 × 9/12 × 10% = \$225,000.
115.	b	\$20,000 + (\$360,000 ÷ 10 × 3) = \$128,000.
116.	a	\$9,500 + (\$30,000 × 15%) = \$14,000.
117.	d	1,000 × \$60 = \$60,000.
*118.	b	Conceptual.
*119.	c	\$1,450,000 + \$400,000 – \$530,000 – \$15,000 = \$1,305,000.
*120.	b	\$350,000 – \$40,000 + \$70,000 – \$10,000 = \$370,000.
*121.	a	\$1,360,000 + \$100,000 + \$40,000 = \$1,500,000.

BRIEF EXERCISES

BE. 3-122—Definitions.

Provide clear, concise answers for the following.

1. What is the accrual-basis of accounting?
2. What is an accrued expense?
3. What is accrued revenue?
4. What is a prepaid expense?
5. What is unearned revenue?

*6. State the rule that indicates which adjusting entries for prepaid and unearned items should be reversed.

Solution 3-122

1. The accrual basis of accounting recognizes revenue when the performance obligation is satisfied and recognizes expenses in the period incurred.
2. An accrued expense is an expense which is incurred but not paid in cash or recorded.
3. An accrued revenue is a revenue which is recognized but not yet received in cash or recorded.
4. A prepaid expense is an expense paid in cash and recorded as an asset before it is used.
5. Unearned revenues are the revenues received in cash and recorded as liabilities before they are recognized.

*6. Adjusting entries that create an asset or a liability account should be reversed. This would include prepaid and unearned items originally recorded in a revenue or expense account.

BE. 3-123—Terminology.

In the space provided at the right, write the word or phrase that is defined or indicated.

1. Revenue and expense accounts.	1.	________________
2. An optional step in the accounting cycle.	2.	________________
3. A revenue collected, but not recognized.	3.	________________
4. A revenue recognized, but not collected.	4.	________________
5. Asset, liability, and equity accounts.	5.	________________
6. An expense paid, but not incurred.	6.	________________
7. An expense incurred, but not paid.	7.	________________

Solution 3-123

1. Nominal (temporary) accounts.
2. Reversing entries.
3. Unearned revenue.
4. Accrued revenue.
5. Real (permanent) accounts.
6. Prepaid expense.
7. Accrued expense.

BE. 3-124—Accrued items and deferred (unearned or prepaid) items.

Generally accepted accounting principles require the use of accruals and deferrals in the determination of income. How is income determined under the accrual-basis of accounting? Include in your answer what constitutes an accrued item and a deferred (prepaid) item, and give appropriate examples of each.

Solution 3-124

Accrual accounting recognizes and reports the effects of transactions and other events in the time periods to which they relate rather than only when cash is received or paid. Accrual accounting attempts to match revenues and the expenses associated with those revenues in order to determine net income for an accounting period.

An accrued item is an item of revenue or expense that has been recognized or incurred during the period, but has not yet been collected or paid in cash. An example of an accrued revenue is rent for the last month of an accounting period that has been recognized by a landlord but not yet paid by the tenant. An example of an accrued expense is salaries incurred for the last week of an accounting period that are not payable until the subsequent accounting period.

A deferred (unearned or prepaid) item is an item of revenue or expense that has been received or paid in cash, but has not yet been recognized or consumed. An example of a deferred revenue is unearned subscription revenue collected in advance of being recognized. An example of a deferred expense is an insurance premium paid at the end of an accounting period which will provide insurance coverage for the first six months of the subsequent period.

EXERCISES

Ex. 3-125—Adjusting entries.

Present, in journal form, the adjustments that would be made on July 31, 2015, the end of the fiscal year, for each of the following.

1. The supplies inventory on August 1, 2014 was $9,350. Supplies costing $22,150 were acquired during the year and charged to the supplies inventory. A count on July 31, 2015 indicated supplies on hand of $8,810.
2. On April 30, a ten-month, 6% note for $30,000 was received from a customer.

*3. On May 1, $12,000 was collected as rent for one year and a nominal account was credited.

Solution 3-125

1. Supplies Expense	22,690	
Supplies		22,690
2. Interest Receivable	450	
Interest Revenue		450
*3. Rent Revenue	9,000	
Unearned Rent Revenue		9,000

Ex. 3-126—Adjusting entries.

Reed Co. wishes to enter receipts and payments in such a manner that adjustments at the end of the period will not require reversing entries at the beginning of the next period. Record the following transactions in the indicated manner and give the adjusting entry on December 31, 2014. (Two entries for each part.)

1. An insurance policy for two years was acquired on April 1, 2014 for $18,000.
2. Rent of $12,000 for six months for a portion of the building was received on November 1, 2014.

Solution 3-126

1. Prepaid Insurance	18,000	
Cash		18,000
Insurance Expense	6,750	
Prepaid Insurance		6,750
2. Cash	12,000	
Unearned Rent Revenue		12,000
Unearned Rent Revenue	4,000	
Rent Revenue		4,000

Ex. 3-127

The adjusted trial balance of Ryan Financial Planners appears below. Using the information from the adjusted trial balance, you are to prepare for the month ending December 31:

1. an income statement.
2. a retained earnings statement.
3. a balance sheet.

RYAN FINANCIAL PLANNERS
Adjusted Trial Balance
December 31, 2014

	Debit	Credit
Cash	$ 2,900	
Accounts Receivable	2,200	
Supplies	1,800	
Equipment	16,000	
Accumulated Depreciation—Equipment		$ 4,000
Accounts Payable		3,300
Unearned Service Revenue		5,000
Common Stock		10,000
Retained Earnings		4,400
Dividends	2,000	
Service Revenue		4,200
Supplies Expense	600	
Depreciation Expense	2,500	
Rent Expense	2,900	
	$30,900	$30,900

Solution 3-127 (20 min)

1.

RYAN FINANCIAL PLANNERS
Income Statement
For the Month Ended December 31, 2014

Revenues		
Service revenue		$ 4,200
Expenses		
Rent expense	$2,900	
Depreciation expense	2,500	
Supplies expense	600	
Total expenses		6,000
Net loss		$(1,800)

2.

RYAN FINANCIAL PLANNERS
Retained Earnings Statement
For the Month Ended December 31, 2014

Retained earnings, December 1		$ 4,400
Less: Net loss	$1,800	
Dividends	2,000	3,800
Retained earnings, December 31		$ 600

3.

RYAN FINANCIAL PLANNERS
Balance Sheet
December 31, 2014

Assets

Cash		$ 2,900
Accounts receivable		2,200
Supplies		1,800
Equipment	$16,000	
Less: Accumulated depreciation—equipment	4,000	12,000
Total assets		$18,900

Liabilities and Stockholders' Equity

Liabilities		
Accounts payable	$ 3,300	
Unearned service revenue	5,000	
Total liabilities		$ 8,300
Stockholders' Equity		
Common stock	10,000	
Retained earnings	600	10,600
Total liabilities and stockholders' equity		$18,900

***Ex. 3-128**—Cash basis vs. accrual basis of accounting.

Contrast the cash basis of accounting with the accrual basis of accounting.

***Solution 3-128**

The essential difference between the cash basis and the accrual basis of accounting relates to the timing of the recognition of revenues and expenses. Under the cash basis of accounting, the effects of transactions and other events are recognized and reported only when cash is received or paid. Under the accrual basis of accounting, these effects are recognized and reported in the time periods to which they relate, regardless of the time of the receipt or payment of cash. Because no attempt is made under the cash basis of accounting to match revenues and the expenses associated with those revenues, cash basis financial statements are not in accordance with generally accepted accounting principles.

***Ex. 3-129**—Accrual basis.

Sales salaries paid during 2014 were $85,000. Advances to salesmen were $1,100 on January 1, 2014, and $800 on December 31, 2014. Sales salaries accrued were $1,360 on January 1, 2014, and $1,880 on December 31, 2014. Show the computation of sales salaries on an accrual basis for 2014.

***Solution 3-129**

$85,000 + $1,100 – $800 – $1,360 + $1,880 = $85,820.

***Ex. 3-130**—Accrual basis.

The records for Todd Inc. showed the following for 2014:

	Jan. 1	Dec. 31
Accrued expenses	$1,300	$2,150
Prepaid expenses	720	870
Cash paid during the year for expenses, $42,500		

Show the computation of the amount of expense that should be reported on the income statement.

***Solution 3-130**

$42,500 – $1,300 + $2,150 + $720 – $870 = $43,200.

***Ex. 3-131**—Accrual basis.
The records for Kiley Company showed the following for 2014:

	Jan. 1	Dec. 31
Unearned revenue	$1,100	$2,160
Accrued revenue	1,260	920
Cash collected during the year for revenue, $65,000		

Show the computation of the amount of revenue that should be reported on the income statement.

***Solution 3-131**

$65,000 + $1,100 – $2,160 – $1,260 + $920 = $63,600.

***Ex. 3-132**—Cash basis.

Revenue on the income statement was $125,800. Accounts receivable were $3,500 on January 1 and $3,540 on December 31. Unearned revenue was $1,050 on January 1 and $1,670 on December 31.

Show the computation of revenue for the year on a cash basis.

***Solution 3-132**
$125,800 + $3,500 – $3,540 – $1,050 + $1,670 = $126,380.

PROBLEMS

Pr. 3-133—Adjusting entries and account classification.

Selected amounts from Trent Company's trial balance of 12/31/14 appear below:

1.	Accounts Payable	$ 160,000
2.	Accounts Receivable	150,000
3.	Accumulated Depreciation—Equipment	200,000
4.	Allowance for Doubtful Accounts	20,000
5.	Bonds Payable	500,000
6.	Cash	150,000
7.	Common Stock	60,000
8.	Equipment	960,000
9.	Prepaid Insurance	30,000
10.	Interest Expense	10,000
11.	Inventory	300,000
12.	Notes Payable (due 6/1/15)	200,000
13.	Prepaid Rent	210,000
14.	Retained Earnings	818,000
15.	Salaries and Wages Expense	328,000

(All of the above accounts have their standard or normal debit or credit balance.)

Part A. Prepare adjusting journal entries at year end, December 31, 2014, based on the following supplemental information.

a. The equipment has a useful life of 15 years with no salvage value. (Straight-line method being used.)
b. Interest accrued on the bonds payable is $15,000 as of 12/31/14.
c. Prepaid insurance at 12/31/14 is $25,000.
d. The rent payment of $180,000 covered the six months from November 30, 2014 through May 31, 2015.
e. Salaries and wages earned but unpaid at 12/31/14, $22,000.

Part B. Indicate the proper balance sheet classification of each of the 15 numbered accounts in the 12/31/14 trial balance *before adjustments* by placing appropriate numbers after each of the following classifications. If the account title would appear on the income statement, do not put the number in any of the classifications.

a. Current assets
b. Property, plant, and equipment
c. Current liabilities
d. Long-term liabilities
e. Stockholders' equity

Solution 3-133

Part A.

a. Depreciation Expense ($960,000 – 0) ÷ 15	64,000	
Accumulated Depreciation—Equipment		64,000
b. Interest Expense	15,000	
Interest Payable		15,000
c. Insurance Expense	5,000	
Prepaid Insurance ($30,000 - $25,000)		5,000
d. Rent Expense ($210,000 ÷ 6)	35,000	
Prepaid Rent		35,000
e. Salaries and Wages Expense	22,000	
Salaries and Wages Payable		22,000

Part B.

a. Current assets—2, 4, 6, 9, 11, 13
b. Property, plant, and equipment—3, 8
c. Current liabilities—1, 12
d. Long-term liabilities—5
e. Stockholders' equity—7, 14

Pr. 3-134—Adjusting entries.

Data relating to the balances of various accounts affected by adjusting or closing entries appear below. (The entries which caused the changes in the balances are not given.) You are asked to supply the missing journal entries which would logically account for the changes in the account balances.

1. Interest receivable at 1/1/14 was $1,000. During 2014 cash received from debtors for interest on outstanding notes receivable amounted to $5,000. The 2014 income statement showed interest revenue in the amount of $6,400. You are to provide the missing adjusting entry that must have been made, assuming reversing entries are not made.

2. Unearned rent at 1/1/14 was $5,300 and at 12/31/14 was $8,000. The records indicate cash receipts from rental sources during 2014 amounted to $55,000, all of which was credited to the Unearned Rent Revenue account. You are to prepare the missing adjusting entry.

3. Accumulated depreciation—equipment at 1/1/14 was $230,000. At 12/31/14 the balance of the account was $280,000. During 2014, one piece of equipment was sold. The equipment had an original cost of $40,000 and was 3/4 depreciated when sold. You are to prepare the missing adjusting entry.

4. Allowance for doubtful accounts on 1/1/14 was $50,000. The balance in the allowance account on 12/31/14 after making the annual adjusting entry was $65,000 and during 2014 bad debts written off amounted to $30,000. You are to provide the missing adjusting entry.

5. Prepaid rent at 1/1/14 was $29,000. During 2014 rent payments of $120,000 were made and charged to "rent expense." The 2014 income statement shows as a general expense the item "rent expense" in the amount of $145,000. You are to prepare the missing adjusting entry that must have been made, assuming reversing entries are not made.

6. Retained earnings at 1/1/14 was $130,000 and at 12/31/14 it was $210,000. During 2014, cash dividends of $50,000 were paid and a stock dividend of $40,000 was issued. Both dividends were properly charged to retained earnings. You are to provide the missing closing entry.

Solution 3-134

1. Interest Receivable		2,400	
Interest Revenue			2,400
Interest revenue per books	$6,400		
Interest revenue received related to 2014 ($5,000 – $1,000)	4,000		
Interest accrued	$2,400		
2. Unearned Rent Revenue		52,300	
Rent Revenue			52,300
Cash receipts	$55,000		
Beginning balance	5,300		
Ending balance	(8,000)		
Rent revenue	$52,300		

Solution 3-134 (cont.)

			Debit	Credit
3. Depreciation Expense			80,000	
Accumulated Depreciation—Equipment				80,000
Ending balance		$280,000		
Beginning balance		230,000		
Difference		50,000		
Write-off at time of sale 3/4 × $40,000		30,000		
		$ 80,000		
4. Bad Debt Expense			45,000	
Allowance for Doubtful Accounts				45,000
Ending balance		$65,000		
Beginning balance		50,000		
Difference		15,000		
Written off		30,000		
		$45,000		
5. Rent Expense			25,000	
Prepaid Rent				25,000
Rent expense		$145,000		
Less cash paid		120,000		
Reduction in prepaid rent account		$ 25,000		
6. Income Summary			170,000	
Retained Earnings				170,000
Ending balance		$210,000		
Beginning balance		(130,000)		
Difference		80,000		
Cash dividends	$50,000			
Stock dividends	40,000	90,000		
		$170,000		

Pr. 3-135—Adjusting and closing entries.

The following trial balance was taken from the books of Fisk Corporation on December 31, 2014.

Account	Debit	Credit
Cash	$ 9,000	
Accounts Receivable	40,000	
Notes Receivable	10,000	
Allowance for Doubtful Accounts		$ 1,800
Inventory	44,000	
Prepaid Insurance	4,800	
Equipment	110,000	
Accumulated Depreciation--Equip.		15,000
Accounts Payable		10,800
Common Stock		44,000
Retained Earnings		55,000
Sales Revenue		280,000
Cost of Goods Sold	126,000	
Salaries and Wages Expense	50,000	
Rent Expense	12,800	
Totals	$406,600	$406,600

Pr. 3-135 (cont.)

At year end, the following items have not yet been recorded.
a. Insurance expired during the year, $2,000.
b. Estimated bad debts, 1% of gross sales.
c. Depreciation on equipment, 10% per year on original cost.
d. Interest at 5% is receivable on the note for one full year.
*e. Rent paid in advance at December 31, $5,400 (originally charged to expense).
f. Accrued salaries and wages at December 31, $5,800.

Instructions
(a) Prepare the necessary adjusting entries.
(b) Prepare the necessary closing entries.

Solution 3-135

(a) Adjusting Entries

a.	Insurance Expense	2,000	
	Prepaid Insurance		2,000
b.	Bad Debt Expense	2,800	
	Allowance for Doubtful Accounts		2,800
c.	Depreciation Expense	11,000	
	Accumulated Depreciation--Equip.		11,000
d.	Interest Receivable	500	
	Interest Revenue		500
*e.	Prepaid Rent	5,400	
	Rent Expense		5,400
f.	Salaries and Wages Expense	5,800	
	Salaries and Wages Payable		5,800

(b) Closing Entries

Sales	280,000	
Interest Revenue	500	
Income Summary		280,500
Income Summary	205,000	
Salaries and Wages Expense		55,800
Rent Expense		7,400
Depreciation Expense		11,000
Bad Debt Expense		2,800
Insurance Expense		2,000
Cost of Goods Sold		126,000
Income Summary	75,500	
Retained Earnings		75,500

***Pr. 3-136**—Cash to accrual accounting.
The following information is available for Renn Corporation's first year of operations:

Payment for merchandise purchases	$335,000
Ending merchandise inventory	135,000
Accounts payable (balance at end of year)	60,000
Collections from customers	280,000

The balance in accounts payable relates only to merchandise purchases. All merchandise items were marked to sell at 35% above cost. What should be the ending balance in accounts receivable, assuming all accounts are deemed collectible?

***Solution 3-136**

Since this is the first year of operations and there were $280,000 of accounts receivable collected, one must compute total sales to determine the ending balance in accounts receivable. Cost of goods sold is $260,000 assuming the accounts payable are for inventory (the $335,000 constitutes only payments made for purchases). Since the markup is 35% on cost, the sales are $351,000 ($260,000 × 135%). Sales of $351,000 less collections of $280,000 results in an ending accounts receivable balance of $71,000 as calculated below.

Cash purchases	$335,000
A/P balance	60,000
Total purchases	395,000
Ending inventory	135,000
Cost of goods sold	260,000
	× 135%
Sales	351,000
Less collections	280,000
Ending A/R	$71,000

***Pr. 3-137**—Accrual accounting.

Yates Company's records provide the following information concerning certain account balances and changes in these account balances during the current year. Transaction information is missing from each item below.

Instructions
Prepare the *entry* to record the missing information for each account. (Consider each independently.)

1. Accounts Receivable: Jan. 1, balance $41,000, Dec. 31, balance $55,000, uncollectible accounts written off during the year, $6,000; accounts receivable collected during the year, $139,000. Prepare the entry to record sales revenue.
2. Allowance for Doubtful Accounts: Jan. 1, balance $4,000, Dec. 31, balance $7,500, uncollectible accounts written off during the year, $20,000. Prepare the entry to record bad debt expense.
3. Accounts Payable: Jan. 1, balance $25,000, Dec. 31, balance $54,000, purchases on account for the year, $120,000. Prepare the entry to record payments on account.
4. Interest Receivable: Jan. 1 accrued, $3,000, Dec. 31 accrued, $2,100, recognized for the year, $35,000. Prepare the entry to record cash interest received.

***Solution 3-137**

1.

Ending balance	$ 55,000		Ending balance	$ 55,000
Less: Beginning balance	41,000		Plus: Rec. collected	139,000
Difference	14,000		Write-offs	6,000
Uncollectible accounts	6,000	OR		200,000
Receivables collected	139,000		Less: Beginning balance	41,000
Sales revenue for period	$159,000		Sales revenue for period	$159,000

Accounts Receivable	159,000	
Sales Revenue		159,000

2.

Ending balance	$ 7,500		Ending balance	$ 7,500
Less: Beginning balance	4,000		Plus: Write-off	20,000
Difference	3,500	OR		27,500
Write-off	20,000		Less: Beginning balance	4,000
Adjusting entry	$23,500		Adjusting entry	$23,500

Bad Debt Expense	23,500	
Allowance for Doubtful Accounts		23,500

3.

Ending balance	$ 54,000		Beginning balance	$ 25,000
Less: Beginning balance	25,000		Plus: Purchases	120,000
Difference	29,000	OR		145,000
Purchases	120,000		Less: Ending balance	54,000
Payments	$ 91,000		Payments	$ 91,000

Accounts Payable	91,000	
Cash		91,000

4.

Revenue Recognized	$35,000		Beginning balance	$ 3,000
Less: Dec. 31 accrual	(2,100)		Plus: Revenue recognized	35,000
Plus: Jan. 1 accrual	3,000	OR		38,000
Cash received	$35,900		Less: Ending balance	2,100
			Cash received	$35,900

Cash	35,900	
Interest Receivable		35,900

(This entry assumes that the $35,000 interest recognized was first recorded as a receivable.)

***Pr. 3-138**—Accrual basis.
Grier & Associates maintains its records on the cash basis. You have been engaged to convert its cash basis income statement to the accrual basis. The cash basis income statement, along with additional information, follows:

Grier & Associates
Income Statement (Cash Basis)
For the Year Ended December 31, 2014

Cash receipts from customers		$450,000
Cash payments:		
Salaries and wages	$170,000	
Income taxes	65,000	
Insurance	40,000	
Interest	25,000	300,000
Net income		$150,000

Additional information:

	Balances at 12/31	
	2014	2013
Accounts receivable	$50,000	$30,000
Salaries and wages payable	10,000	20,000
Income taxes payable	24,000	19,000
Prepaid insurance	8,000	4,000
Accumulated depreciation	95,000	75,000
Interest payable	3,000	9,000

No plant assets were sold during 2014.

***Solution 3-138**

Grier & Associates
Income Statement (Accrual Basis)
For the Year Ended December 31, 2014

Revenue ($450,000 + $50,000 – $30,000)		$470,000
Expenses		
Salaries and wages ($170,000 + $10,000 – $20,000)	$160,000	
Income taxes ($65,000 + $24,000 – $19,000)	70,000	
Insurance ($40,000 + $4,000 – $8,000)	36,000	
Depreciation ($95,000 – $75,000)	20,000	
Interest ($25,000 + $3,000 – $9,000)	19,000	
Total expenses		305,000
Net Income		$165,000

***Pr. 3-139**—Eight-column work sheet.

The trial balance of Winsor Corporation is reproduced on the following page. The information below is relevant to the preparation of adjusting entries needed to both properly match revenues and expenses for the period and reflect the proper balances in the real and nominal accounts.

Instructions

As the accountant for Winsor Corporation, you are to prepare adjusting entries based on the following data, entering the adjustments on the work sheet and completing the additional columns with respect to the income statement and balance sheet. Carefully key your adjustments and label all items. (Due to time constraints, an adjusted trial balance is not required.) Round all computations to the nearest dollar.

(a) Winsor determined that one percent of sales will become uncollectible.

(b) Depreciation is computed using the straight-line method, with an eight-year life and $1,000 salvage value.

(c) Salesmen are paid commissions of 15% of sales. Commissions on sales for December have not been paid.

(d) The note was issued on October 1, bearing interest at 8%, due Feb. 1, 2015.

(e) A physical inventory of supplies indicated $340 of supplies currently in stock.

(f) Provisions of a lease contract specify payments must be made one month in advance, with monthly payments at $800/mo. This provision has been complied with as of Dec. 31, 2014.

Winsor Corporation
Work Sheet
For the Year Ended December 31, 2014

	Trial Balance		Adjustments		Income Statement		Balance Sheet	
Accounts	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	12,400							
Equity Invest.	4,050							
Accounts Rec.	30,000							
Allow. for D. A.		420						
Inventory	16,800							
Supplies	1,040							
Equipment	65,000							
Accum. Depr.-Equip.		9,500						
Accounts Payable		4,400						
Notes Payable		10,000						
Common Stock		40,000						
Ret. Earnings		29,690						
Sales Revenue		340,000						
Cost of Goods Sold	235,520							
Salaries and Wages Exp.	20,800							
Sales Comm. Exp.	39,000							
Rent Expense	7,200							
Misc. Expense	2,200							
Totals	434,010	434,010						

Solution 3-139

Winsor Corporation
Work Sheet
For the Year Ended December 31, 2014

	Trial Balance		Adjustments		Income Statement		Balance Sheet	
Accounts	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	12,400						12,400	
Equity Invest.	4,050						4,050	
Accounts Rec.	30,000						30,000	
Allow. for D. A.		420		(a) 3,400				3,820
Inventory	16,800						16,800	
Supplies	1,040			(e) 700			340	
Equipment	65,000						65,000	
Accum. Depr.-Eq.		9,500		(b) 8,000				17,500
Accounts Payable		4,400						4,400
Notes Payable		10,000						10,000
Common Stock		40,000						40,000
Ret. Earnings		29,690						29,690
Sales Revenue		340,000				340,000		
Cost of Goods Sold	235,520				235,520			
Salaries and Wages Exp.	20,800				20,800			
Sales Comm. Exp.	39,000		(c) 12,000		51,000			
Rent Expense	7,200			(f) 800	6,400			
Misc. Expense	2,200				2,200			
Totals	434,010	434,010						
Bad Debt Exp.			(a) 3,400		3,400			
Depr. Exp.			(b) 8,000		8,000			
Sales Com. Exp Pay.				(c) 12,000				12,000
Interest Expense			(d) 200		200			
Interest Payable				(d) 200				200
Supplies Expense			(e) 700		700			
Prepaid Rent			(f) 800				800	
Totals			25,100	25,100	328,220	340,000	129,390	117,610
Net Income					11,780			11,780
Totals					340,000	340,000	129,390	129,390

Adjusting entries and explanations

(a) Bad Debt Expense ($340,000 x 1%)	3,400	
Allowance for Doubtful Accounts		3,400
(b) Depreciation Expense	8,000	
Accumulated Depreciation—Equipment		8,000

($65,000 – $1,000 is $64,000. One-eighth of $64,000 is $8,000.)

Solution 3-139 (cont.)

(c)	Sales Commission Expense	12,000	
	Sales Commission Expense Payable		12,000
	(15% of sales is 15% × $340,000, which is $51,000. The balance in the Sales Commission Expense account is $39,000 before adjustment, indicating that $12,000 of commissions are accrued but unpaid.)		
(d)	Interest Expense	200	
	Interest Payable		200
	($10,000 × .08 × 3/12 = $200)		
(e)	Supplies Expense	700	
	Supplies		700
	(The balance of $1,040 in the Supplies account before adjustment less the correct ending balance of $340 is $700.)		
(f)	Prepaid Rent	800	
	Rent Expense		800
	(Since the trial balance contains no account for prepaid rent, the $800 lease payment has apparently been debited to Rent Expense. An account must be set up for the Prepaid Rent.)		

IFRS QUESTIONS

True / False

1. As rules for accounting for specific events sometimes differ across countries, the double-entry accounting system is difficult to implement as the basis of worldwide accounting system.
2. IASB is working to establish high-quality auditing and assurance quality standards throughout the world.

Answers to True / False questions:

1. False
2. False

Multiple Choice:

3. Icon International, a software company, incorporated on January 1, 2013 is planning to convert to IFRS. The company decided to present its first IFRS statements for the year ended December 31, 2015. What is the transition date of Icon International?
   a. January 1, 2013
   b. January 1, 2015
   c. December 31, 2015
   d. December 31, 2013

4. Icon International, a software company, incorporated on January 1, 2013 is planning to convert to IFRS. The company decided to present its first IFRS statements for the year ended December 31, 2015. What is the reporting date of Icon International?
   a. January 1, 2013
   b. January 1, 2015
   c. December 31, 2015
   d. December 31, 2013

5. Which of the following is a reason for recasting prior financial statements based on IFRS?
   a. To increase the market value of a company's shares
   b. To report a high income for attracting investors
   c. To report a low taxable income reducing the tax liability
   d. To provide financial statement users with comparable information

6. IFRS 1 requires information in a company's first IFRS statement to:
   a. be same as in GAAP statement.
   b. be transparent.
   c. be as lengthy as possible.
   d. provide a suitable ending point.

7. Which of the following is the first step to be taken by a company deciding to convert to IFRS?
   a. Preparing an opening balance sheet at the date of transition
   b. Identifying the timing of first IFRS statement
   c. Selecting accounting principles that comply with IFRS
   d. Implementing accounting principles retrospectively

Answers to Multiple Choice:
3. b
4. c
5. d
6. b
7. b

Short Answer:

8. Are all international companies subject to the same internal control standards? Explain.

    1. No, all international companies are not subject to the same internal control standards. All public companies that list their securitites on U.S. stock exchanges are subject to the internal control testing and assurance provisions of the Sarbanes-Oxley Act. International companies that list their securities on non-U.S. exchanges are not subject to these rules and there is debate as to whether they should have to comply.

9. What are some of the consequences of international differences in internal control standards?

    2. There is concern that the cost of complying with higher internal control provisions is making U.S. markets fewer competitive as a place to list securities. This in turn could give U.S. investors less investment opportunties. On the other hand, some argue that the enhanced internal control requirements in the U.S. increase the perceived reliability of companies' financial statements and helps reduce their cost of capital. Furthermore, the decline in public listings in the U.S. is more likely due to other factors, such as growth in non-U.S. markets and general globalization. Thus, the jury is still out on the net cost/benefit of Sarbanes-Oxley and its impact on international competitiveness.