CHAPTER 4
THE ACCOUNTING CYCLE: ACCRUALS AND DEFERRALS

OVERVIEW OF BRIEF EXERCISES, EXERCISES, PROBLEMS, AND CRITICAL THINKING CASES

Brief Exercises	Topic	Learning Objectives	Skills
B. Ex. 4.1	Deferred expenses and revenue	3, 4	Analysis
B. Ex. 4.2	Deferred expenses and revenue	3, 4	Analysis
B. Ex. 4.3	Accounting for supplies	3	Analysis
B. Ex. 4.4	Accounting for depreciation	3	Analysis
B. Ex. 4.5	Accrued revenue	6	Analysis
B. Ex. 4.6	Unearned revenue	4	Analysis
B. Ex. 4.7	Accrued salaries	5	Analysis
B. Ex. 4.8	Accrued interest	5	Analysis
B. Ex. 4.9	Accrued taxes	5	Analysis
B. Ex. 4.10	Concept of materiality	8	Judgment, communication, analysis

Exercises	Topic	Learning Objectives	Skills
4.1	Accounting terminology	1–9	Analysis
4.2	Effects of adjusting entries	1–6, 9	Analysis
4.3	Deferred expenses and revenue	1-7	Analysis
4.4	Deferred expenses and revenue	1-7	Analysis
4.5	Accrued revenue	1-7	Analysis
4.6	**Real World: American Airlines** Deferred revenue	1, 2, 4	Analysis
4.7	Accruals and deferrals	1-6, 9	Analysis
4.8	Notes payable and interest	1, 2, 5	Analysis
4.9	Interpreting business transactions	1–7, 9	Analysis, judgment
4.10	Adjustments and the balance sheet	1, 3–5, 7	Communication, analysis
4.11	**Real World: Various firms** Deferred revenue	1, 4, 7	Analysis, judgment
4.12	Analyzing the adjusted trial balance	1–7, 9	Analysis
4.13	Effects of adjusting entries	1–6	Analysis
4.14	Accounting principles	1–8	Communication, analysis, judgment
4.15	**Real World: Home Depot** Using an annual report	1, 2	Communication, analysis

Problems Sets A, B	Topic	Learning Objectives	Skills
4.1 A,B	Preparing and analyzing adjusting entries	1-7	Analysis, communication
4.2 A,B	Preparing and analyzing adjusting entries	1–6, 9	Analysis, communication
4.3 A,B	Analysis of adjusted data	1–7, 9	Analysis
4.4 A,B	Preparing and analyzing adjusting entries	1–7, 9	Analysis, communication
4.5 A,B	Preparing and analyzing adjusting entries	1–7, 9	Analysis, communication
4.6 A,B	Preparing and analyzing adjusting entries	1–7, 9	Analysis, communication
4.7 A,B	Preparing and analyzing adjusting entries	1–7, 9	Analysis, communication
4.8 A,B	Analyzing the effects of errors	1–7, 9	Analysis

Critical Thinking Cases			
4.1	Determining whether adjusting entries are required	1–7	Analysis, judgment, communication
4.2	**Real World: Avis** The concept of materiality	8	Communication, judgment, analysis
4.3	Deferring expenses (Ethics, fraud & corporate governance)	3, 7, 8	Analysis, judgment, communication
4.4	**Real World: Jet Blue and Others** *(Business Week)*	1, 4, 7	Analysis, judgment, communication, research
4.5	**Real World: Hershey** Identifying accounts involved in adjusting process (Internet)	1–6	Communication, technology, judgment, research

DESCRIPTIONS OF PROBLEMS AND CRITICAL THINKING CASES

Below are brief descriptions of each problem and case. These descriptions are accompanied by the estimated time (in minutes) required for completion and by a difficulty rating. The time estimates assume use of the partially filled-in working papers.

Problems (Sets A and B)

4.1 A,B **Florida Palms Country Club/Georgia Gun Club** **20 Easy**
Requires students to prepare adjusting entries, classify them as accruals or deferrals, and discuss the difference between the book value of an asset and its fair market value.

4.2 A,B **Enchanted Forest/Big Oaks** **40 Medium**
Requires students to prepare adjusting entries, classify them as accruals or deferrals, analyze their effects on the financial statements, and report assets at book value in the balance sheet.

4.3 A,B **Gunflint Adventures/River Rat** **25 Strong**
Requires students to prepare adjusting entries and interpret financial information.

4.4 A,B **Campus Theater/Off-Campus Playhouse** **30 Medium**
Requires students to prepare adjusting entries, analyze financial information, and interpret differences between income taxes expense and income taxes payable.

4.5 A,B **Terrific Temps/Marvelous Music** **30 Medium**
Requires students to prepare adjusting entries and determine amounts reported in the financial statements.

4.6 A,B **Alpine Expeditions/Mate Ease** **30 Medium**
Requires students to prepare adjusting entries, determine amounts reported in the financial statements, and interpret certain deferrals.

Problems (continued)

4.7 A,B	**Ken Hensley Enterprises, Inc./Stillmore Investigations** Requires students to journalize adjusting entries, prepare an adjusted trial balance, and understand various relationships among financial statement elements.	**60 Strong**
4.8 A,B	**Coyne Corporation/Stephen Corporation** Requires students to analyze the effects of errors on financial statement elements.	**20 Strong**

Critical Thinking Cases

4.1	**Judgments and Year-End Adjustments** Requires students to exercise judgment regarding the need for adjusting entries.	**30 Medium**
4.2	**The Concept of Materiality** Discusses the concept of materiality. The purchase of automobiles by Avis for its rental fleet is used to illustrate how the cumulative effect of many immaterial transactions can become material.	**25 Medium**
4.3	**Expense Manipulation** **Ethics, Fraud & Corporate Governance** Students must determine whether the capitalization of advertising expenditures was in compliance with generally accepted accounting principles, and whether the decision to do so was ethical.	**10 Easy**
4.4	**Deferred Revenue** ***Business Week*** Students are required to perform an adjusting entry for JetBlue Corporation and determine from financial data the estimated number of days that passengers purchase their tickets in advance.	**15 Medium**
4.5	**Identifying Accounts** **Internet** Students are asked to identify accounts in Hershey's balance sheet that were most likely to have been involved in the company's year-end adjusting entry process.	**10 Easy**

SUGGESTED ANSWERS TO DISCUSSION QUESTIONS

1. The purpose of making adjusting entries is to recognize certain revenue and expenses that are not properly measured in the course of recording daily business transactions. These entries help achieve the goals of accrual accounting by recognizing revenue when it is earned and recognizing expenses when the related goods or services are used.

2. The only transactions that require end-of-period adjusting entries are those that affect the revenue or expenses of *more than one accounting period.* Adjusting entries then are needed to apportion the revenue or expense among the affected accounting periods.

3. All adjusting entries affect *both* an income statement account and a balance sheet account. Every adjusting entry involves the recognition of either revenue or expense. Revenue and expenses represent changes in owners' equity, which appears in the balance sheet. However, owners' equity cannot change by itself; there must also be a corresponding change in either assets or liabilities.

4. Making adjusting entries requires a better understanding of accrual accounting than does the recording of routine business transactions because there is no "external evidence" (such as bills or invoices) indicating the need for adjusting entries. Adjusting entries are necessary to reflect recorded costs that have expired and recorded revenue that has been earned or to recognize previously unrecorded business activities. Thus, the need for adjusting entries is determined by the accountant's understanding of the concepts of accrual accounting, not by external source documents.

5. Under accrual accounting, an expense is defined as the cost of goods and services used in the effort to generate revenue. Thus, an expense is incurred when the related goods and services are *used,* not when the expense is paid. A 12-month insurance policy represents insurance coverage that is used up over a 12-month period. The cost of such a policy should be debited to an asset account and gradually recognized as an expense over the 12 months that the policy is in force.

6. Accrual accounting requires that revenue be recognized in the accounting records when it is earned. If revenue has been earned, but not yet recorded in the accounts, an adjusting entry should be made to include this revenue in the income of the current period. This entry will credit a revenue account; as the revenue has not yet been collected, the debit will be to an account receivable.

7. The term, *unearned revenue,* describes amounts that have been collected from customers in advance and that have not yet been earned. As the company has an obligation to render services to these customers or to refund their advance payments, unearned revenue appears in the liability section of the balance sheet. As services are performed for these customers, the liability is reduced. Therefore, an adjusting entry is made transferring the balance of the unearned revenue account into a revenue account.

8. Salaries Expense 16,000
Salaries Payable 16,000

Salaries Expense	16,000	
Salaries Payable		16,000

To record salaries expense and related liability to employees for the last four days of the year (4/5 week x $20,000 = $16,000).

9. In the income statement, the Insurance Expense account will be understated; hence total expenses will be understated, and net income will be overstated. In the balance sheet, the asset account, Unexpired Insurance, will be overstated, as will the amount for total assets. Offsetting this overstatement of assets will be an overstatement of retained earnings; hence owners' equity will be overstated.

10. *Materiality* refers to the relative importance of an item or an event to the users of financial statements. An item is "material" if knowledge of it might reasonably influence the decisions of financial statement users.

If an item is *not material,* by definition it is *not relevant* to decision makers. Therefore, the item may be treated in the most convenient and economical manner by the preparer of the financial statements. Thus, the concept of materiality permits departures from other generally accepted accounting principles in accounting for items that are not material.

11. The concept of *materiality* permits accountants to handle items that are unlikely to influence the decisions of users of the accounting information in the most convenient and economical manner. Charging the costs of low-priced and short-lived assets immediately to an expense is not likely to affect the decisions of users of the financial statements. On the other hand, accounting for these items as assets and recording periodic depreciation would require time, effort, and cost. Thus, low-priced and short-lived assets are routinely charged to an expense, because charging them to asset accounts simply is "not worth the bother."

12. The realization principle governs the timing of revenue recognition. The principle states that revenue should be recognized (reported in the income statement) in the period in which it is *earned*. This does not necessarily coincide with cash flow, however. Cash can be received from customers in a period *before* revenue is earned or in a period *after* revenue is earned.

13. The matching principle governs the manner in which revenue is offset by the expenses incurred in producing that revenue. Generally, expenses are matched to revenue in the periods that resources are consumed in generating revenue earned. Expense recognition does *not* necessarily coincide with the payment of cash.

14. A $1,000 expenditure is not considered material to all businesses. Most large enterprises round the dollar amounts shown in their financial statements to the nearest $1 thousand or nearest $1 million dollars.

15. Unprofitable companies recognize a "negative amount" of income tax expense. The adjusting entry to record income tax expense for a period in which a net loss is incurred requires a *debit* to Income Taxes Payable and a *credit* to Income Taxes Expense.

16. Deferred expenses are those assets reported in the balance sheet that will later become expenses reported in the income statement. They include, but are not limited to, office supplies, prepared rent, prepaid insurance, buildings, equipment, etc.

17. Deferred revenue (also referred to as unearned revenue or customer deposits) is reported in the balance sheet as a liability.

18. Accrued but unpaid expenses are reported in the balance sheet as liabilities. They include items such as salaries payable, interest payable, and taxes payable.

19. Accrued but uncollected revenue is reported in the balance sheet as accounts receivable.

20. Carnival Corporation accounts for customer deposits as deferred, or unearned, revenue. As travelers pay for their cruises in advance, Carnival debits Cash and credits Customer Deposits (a liability account). As cruises take place, Carnival debits Customer Deposits and credits Cruise Revenue Earned.

B. Ex. 4.1	a. Nov. 30	Insurance Expense ………………………………………	500	
		Unexpired Insurance …………………….		500
		To record expired portion of insurance premium ($3,000 ÷ 6 months = $500)		
	b. Nov. 30	Unearned Insurance Premiums……………………	500	
		Premium Revenue Earned…………………		500
		To convert previously unearned premiums to premium revenue earned ($3,000 ÷ 6 months = $500).		
B. Ex. 4.2	a. Feb. 28	Rent Expense …………………………………………	175	
		Prepaid Rent ………………………………		175
		To record February rent of $175.		
	b. Feb. 28	Unearned Rent Revenue……………………………	175	
		Rent Revenue Earned ……………………		175
		To convert previously unearned rent revenue to earned revenue.		
B. Ex. 4.3	Mar. 31	Office Supplies Expense ……………………………	1,100	
		Office Supplies……………………………….		1,100
		To record March office supplies expense ($900 + $600 - $400 = $1,100).		
B. Ex. 4.4	a. Dec. 31	Depreciation Expense: Equipment…………………	750	
		Accumulated Depreciation: Equipment ….		750
		To record December depreciation expense $72,000 ÷ 8 years x 1/12 = $750).		

b. The equipment's accumulated depreciation reported in the balance sheet on December 31, 2009, is $54,000 ($72,000 ÷ 8-year life x 6 years of depreciation = $54,000).

B. Ex. 4.5	Accounts Receivable …………………………………	3,340	
	Client Service Revenue ……………………		3,340
	To record earned but unbilled and unrecorded client service revenue:		

Account	Hours	Rate	Billable Amount
#4067	10	$85	$ 850
#3940	14	$75	1,050
#1852	16	$90	1,440
			$ 3,340

B. Ex. 4.6	a.		Unearned Client Revenue ……………………………	2,800	
			Client Revenue Earned …………………		2,800
			To convert previously unearned client revenue to client revenue earned.		
	b.		Client Revenue earned will be reported in the company's income statement at $31,800 ($29,000 + $2,800 = $31,800).		
B. Ex. 4.7	a.	Dec. 31	Salaries Expense ……………………………………	175,000	
			Salaries Payable ……………………………		175,000
			To record accrued but unpaid salaries.		
	b.	Jan. 15	Salaries Expense……………………………………	180,000	
			Salaries Payable……………………………………	175,000	
			Cash…………………………………………		355,000
			To record payment of salaries.		
B. Ex. 4.8	a.	Dec. 31	Interest Expense ……………………………………	160	
			Interest Payable……………..………………….		160
			To record December interest expense ($24,000 x 8% x 1/12 = $160).		
	b.	Feb. 1	Interest Expense……...…………………………….	160	
			Interest Payable…………………………………….	160	
			Notes Payable……………………………………….	24,000	
			Cash…...…………………………………….		24,320
			To record January interest expense and repay the bank the entire amount owed.		
B. Ex. 4.9	a.	Dec. 31	Income Taxes Expense ……………………………….	5,600	
			Income Taxes Payable…………………….		5,600
			To accrue December income taxes expense ($62,800 - $57,200 = $5,600).		
	b.		Income taxes payable reported in the company's balance sheet dated December 31, 2009, total $19,900 ($14,300 + $5,600 = $19,900).		

B. Ex. 4.10

a. **Materiality refers to the *relative importance* of an item. An item is *material* if knowledge of it might reasonably influence the decisions of users of financial statements. If an item is *immaterial,* by definition it is *not relevant* to decision makers.**

Accountants must account for material items in the manner required by generally accepted accounting principles. However, immaterial items may be accounted for in the most convenient and economical manner.

b. **Whether a specific dollar amount is "material" depends upon the (1) size of the amount and (2) *nature* of the item. In evaluating the size of a dollar amount, accountants consider the amount in relation to the size of the organization.**

Based solely upon dollar amount, $2,500 is *not material* in relation to the financial statements of a large, publicly owned corporation. For a small business however, this amount could be material.

In addition to considering the size of a dollar amount, accountants must also consider the *nature* of the item. The nature of an item may make the item "material" to users of the financial statements *regardless* of its dollar amount. Examples might include bribes paid to government officials, or theft of company assets or other illegal acts committed by management.

In summary, one cannot say whether $2,500 is a material amount. The answer depends upon the related circumstances.

c. **Two ways in which the concept of materiality may save time and effort for accountants are:**

1. **Adjusting entries may be based upon estimated amounts if there is little or no possibility that the use of an estimate will result in material error. For example, an adjusting entry to reflect the amount of supplies used may be based on an estimate of the cost of supplies remaining on hand.**
2. **Adjusting entries need not be made to accrue immaterial amounts of unrecorded expenses or unrecorded revenue. For example, no adjusting entries normally are made to record utility expense payable at year-end.**

SOLUTIONS TO EXERCISES

Ex 4.1

- **a.** **Book value**
- **b.** **Materiality**
- **c.** **Matching principle**
- **d.** **Unrecorded revenue**
- **e.** **Adjusting entries**
- **f.** **Unearned revenue**
- **g.** **Prepaid expenses**
- **h.** **None (This is an example of “depreciation expense.”)**

Ex. 4.2

	Income Statement			Balance Sheet		
Adjusting Entry	Revenue –	Expenses =	Net Income	Assets –	Liabilities =	Owners' Equity
a.	NE	I	D	D	NE	D
b.	NE	I	D	NE	I	D
c.	I	NE	I	I	NE	I
d.	NE	I	D	NE	I	D
e.	NE	I	D	D	NE	D
f.	I	NE	I	NE	D	I

Ex. 4.3

1.	Rent Expense …………	240,000	
	Prepaid Rent …………		240,000
	To record rent expense for May ($1,200,000 ÷ 5 months = $240,000 per month).		
2.	Unearned Ticket Revenue …………	148,800	
	Ticket Revenue Earned …………		148,800
	To record earned portion of season ticket revenue relating to May home games.		

Ex. 4.4 **a.** **Prepaid Advertising is reported in the balance sheet as an asset. Customer Deposits are reported in the balance sheet as liabilities.**

b. Advertising Expense ……………………………………	**18,000,000**	
Prepaid Advertising ……………………………………		**18,000,000**
To record the mailing of brochures costing $18 million to print.		

c. Customer Deposits ……………………………………	**90,000,000**	
Cruise Revenue ……………………………………		**90,000,000**
To record revenue earned for voyages completed.		

d. **The adjusting entry that results in the most significant expense in the company's income statement is the recording of depreciation expense on its cruise ships.**

Note to the instructor: **In a recent income statement the company reported depreciation expense of $1.1 billion.**

Ex. 4.5 **a.**

(1) Interest Expense ……………………………………	**375**	
Interest Payable ……………………………………		**375**
$50,000 x 9% annual rate x 1/12 = $375.		
(2) Accounts Receivable ……………………………………	**10,000**	
Consulting Fees Earned ……………………………		**10,000**
To record ten days of unbilled consulting fees at $1,000 per day.		

b. **$2,250 ($50,000 x 9% x 6/12 = $2,250)**

c. **$15,000 ($25,000 - $10,000 earned in December)**

Ex. 4.6 **a.** **At the time cash is collected by American Airlines for advance ticket sales, the entire amount is accounted for as *unearned* revenue. The liability created represents the *deferral* (or the postponement) of earned revenue until flight services are actually provided to passengers.**

b. **Airlines normally reduce the balance of this liability account by converting it to passenger revenue as flight services are provided. On some occasions, however, the liability may be reduced as a result of making cash refunds to customers due to cancellations.**

c. Air Traffic Liability ……………………………………	**200,000**	
Passenger Revenue Earned ……………………………		**200,000**
To record passenger revenue earned from advance ticket sales for flights completed.		

Ex. 4.7

a.

		Debit	Credit
1.	Interest Expense …………………………………	1,200	
	Interest Payable …………………………………		1,200
	To record interest accrued on bank loan during December.		
2.	Depreciation Expense: Office Building ………………	1,100	
	Accumulated Depreciation: Office Building …………		1,100
	To record depreciation on office building ($330,000/25 years) x 1/12 = $1,100).		
3.	Accounts Receivable …………………………………	64,000	
	Marketing Revenue Earned …………………………		64,000
	To record accrued marketing revenue earned in December.		
4.	Insurance Expense …………………………………	150	
	Prepaid Insurance …………………………………		150
	To record insurance expense ($1,800/12 months = $150).		
5.	Unearned Revenue …………………………………	3,500	
	Marketing Revenue Earned …………………………		3,500
	To record portion of unearned revenue that had become earned in December.		
6.	Salaries Expense …………………………………	2,400	
	Salaries Payable …………………………………		2,400
	To record accrued salaries in December.		

b. **$62,650** Increase ($64,000 + $3,500 – $1,200 – $1,100 – $150 – $2,400).

Ex. 4.8

a. The total interest expense over the life of the note is $5,400 ($120,000 x .09 x 6/12 = $5,400).

The monthly interest expense is $900 ($5,400/6 = $900).

b. The liability to the bank at December 31, 2009, is $121,800 (Principal, $120,000 + $1,800 accrued interest).

c. 2009

				Debit	Credit
c.	Oct.	31	Cash …………………………………………	120,000	
			Notes Payable …………………………………		120,000
			Obtain from bank six-month loan with interest at 9% a year.		
d.	Dec.	31	Interest Expense …………………………………	900	
			Interest Payable ………………………………		900
			To accrue interest expense for December on note payable ($120,000 x 9% x 1/12).		

e. The liability to the bank at March 31, 2010, is $124,500, consisting of $120,000 principal plus $4,500 accrued interest for five months.

Ex. 4.9	**a. May**	**1**	**Cash ……………………………………………………**	**300,000**	
			Notes Payable …………………………….		**300,000**
			Obtained a three-month loan from National Bank at 12% interest per year.		
	May	**31**	**Interest Expense ……………………………………**	**3,000**	
			Interest Payable ……………………………		**3,000**
			To record interest expense for May on note payable to National Bank ($300,000 x 12% x 1/12 = $3,000).		
	b. May	**1**	**Prepaid Rent …………………………………………**	**180,000**	
			Cash …………………………………………		**180,000**
			Paid rent for six months at $30,000 per month.		
	May	**31**	**Rent Expense …………………………………………**	**30,000**	
			Prepaid Rent ………………………………		**30,000**
			To record rent expense for the month of May.		
	c. May	**2**	**Cash ……………………………………………………**	**910,000**	
			Unearned Admissions Revenue ……………		**910,000**
			Sold season tickets to the 70-day racing season.		
	May	**31**	**Unearned Admissions Revenue ……………………**	**260,000**	
			Admissions Revenue ………………………		**260,000**
			To record admissions revenue from the 20 racing days in May ($910,000 x 20/70 = $260,000).		
	d. May	**4**	**No entry required.**		

Ex. 4.10 a. $8.37 billion ($3.35 book value + $5.02 accumulated depreciation)

b. Type III (Accrued compensation is a liability arising from the accrual of unpaid salaries and wages expense)

c. When the company receives cash from its customer prior to earning any revenue it *debits* Cash and *credits* either Short-Term Unearned Revenue or Long-Term Unearned Revenue. As goods are delivered to customers, the company *debits* the appropriate unearned revenue account and *credits* Sales (revenue earned). If the unearned revenue is expected to convert to earned revenue in the near future

Ex. 4.11 a. America West Corporation: Air Traffic Liability
The New York Times Company: Unexpired Subscriptions
Carnival Corporation: Customer Deposits
Devry, Inc.: Deferred Tuition Revenue
Clear Channel Communications, Inc.: Deferred Advertising Income
AFLAC Incorporated: Unearned Premiums
Bally Total Fitness Corporation: Deferred Membership Dues

b. America West Corporation: As passengers complete their flights.
The New York Times Company: As newspapers are delivered.
Carnival Corporation: As passengers complete their cruises.
Devry, Inc.: As students complete their courses.
Clear Channel Communications, Inc.: As advertisements are aired.
AFLAC Incorporated: As policies expire.
Bally Total Fitness Corporation: As members use the facilities.

Ex. 4.12	**Accounts Receivable……………………………………**	**5,000**	
	Fees Earned………………………………		**5,000**
	To record accrued but uncollected revenue.		
	Insurance Expense…………………………………	**600**	
	Unexpired Insurance……………………..		**600**
	To record expired portion of insurance policies.		
	Rent Expense …………………………………………	**1,800**	
	Prepaid Rent ………………………………		**1,800**
	To record rent expense for December.		
	Office Supplies Expense……………………………	**300**	
	Office Supplies……………………………..		**300**
	To record December office supplies expense.		
	Depreciation Expense: Equip……………………..	**1,000**	
	Accumulated Depreciation: Equip………..		**1,000**
	To record depreciation of equipment.		
	Salaries Expense…………………………………….	**2,100**	
	Salaries Payable…………………………..		**2,100**
	To record accrued but unpaid salaries.		
	Interest Expense……………………………………	**50**	
	Interest Payable…………………………..		**50**
	To record accrued but unpaid interest expense.		
	Income Taxes Expense…………………………….	**600**	
	Income Taxes Payable…………………….		**600**
	To record accrued but unpaid income taxes.		
	Unearned Revenue……………………………………	**3,000**	
	Fees Earned………..…………………….		**3,000**
	To convert previously unearned revenue to earned revenue.		

Ex. 4.13

Adjustment Type	Revenue	Expenses	Net Income	Assets	Liabilities	Owners' Equity
Type I	**NE**	**I**	**D**	**D**	**NE**	**D**
Type II	**I**	**NE**	**I**	**NE**	**D**	**I**
Type III	**NE**	**I**	**D**	**NE**	**I**	**D**
Type IV	**I**	**NE**	**I**	**I**	**NE**	**I**

Ex. 4.14 **a. None (or Materiality). Accounting for immaterial items is not "wrong" or a "violation" of generally accepted accounting principles; it is merely a waste of time. The bookkeeper is failing to take advantage of the concept of materiality, which permits charging immaterial costs directly to expense, thus eliminating the need to record depreciation in the later periods.**

b. Matching.

c. Realization.

Ex. 4.15 **Accounts requiring adjusting entries may include:**

- **Short-term investments**
- **Receivables**
- **Merchandise inventories**
- **Other current assets**
- **Buildings**
- **Furniture, fixtures and equipment**
- **Leasehold improvements**
- **Construction in progress**
- **Capital leases**
- **Accrued salaries and related expenses**
- **Sales taxes payable**
- **Deferred revenue**
- **Income taxes payable**
- **Current installments of long-term debt**
- **Other accrued expenses**
- **Deferred income taxes**

Note to the instructor: **The adjustments required for many of the accounts listed above are discussed in subsequent chapters. Some are beyond the scope of an introductory text.**

SOLUTIONS TO PROBLEMS SET A

20 Minutes, Easy

PROBLEM 4.1A
FLORIDA PALMS COUNTRY CLUB

a.

FLORIDA PALMS COUNTRY CLUB				
General Journal				
(Adjusting Entries)				
20__		(1)		
Dec.	31	Salaries Expense	9,600	
		Salaries Payable		9,600
		To record accrued salaries at December 31.		
		(2)		
	31	Accounts Receivable	1,800	
		Green Fee Revenue		1,800
		To record green fees owed by the Tampa Univ. golf		
		golf team.		
		(3)		
	31	Unearned Membership Dues	106,000	
		Membership Dues Earned		106,000
		To record the portion of annual membership dues		
		earned in December.		
		(4)		
	31	Depreciation Expense: Carts	1,000	
		Accumulated Depreciation: Carts		1,000
		To record December depreciation expense		
		($180,000 ÷ 15 years x 1/12).		
		(5)		
	31	Interest Expense	300	
		Interest Payable		300
		To record accrued interest expense in December		
		($45,000 x 8% x 1/12).		
		(6)		
	31	Insurance Expense	650	
		Unexpired Insurance		650
		To record December insurance expense		
		($7,800 x 1/12).		
		(7)		
	31	No adjusting entry required. Revenue is recognized		
		when it is earned. Entering into a contract does not		
		constitute the earning of revenue.		
		(8)		
	31	Income Taxes Expense	19,000	
		Income Taxes Payable		19,000
		To record income taxes accrued in December.		

PROBLEM 4.1A
FLORIDA PALMS COUNTRY CLUB (concluded)

b.

1. **Accruing unpaid expenses.**
2. **Accruing uncollected revenue.**
3. **Converting liabilities to revenue.**
4. **Converting assets to expenses.**
5. **Accruing unpaid expenses.**
6. **Converting assets to expenses.**
7. **No adjusting entry required.**
8. **Accruing unpaid expenses.**

c. **The clubhouse was built in 1925 and has been fully depreciated for financial accounting purposes. The net book value of an asset reported in the balance sheet does *not* reflect the asset's fair market value. Likewise, depreciation expense reported in the income statement does not reflect a decline in fair market value, physical obsolescence, or wear-and-tear.**

40 Minutes, Medium

PROBLEM 4.2A
ENCHANTED FOREST

a.

General Journal				
(Adjusting Entries)				
		(1)		
Dec.	31	Interest Receivable	400	
		Interest Revenue		400
		To record accrued interest revenue on CDs at December 31.		
		(2)		
	31	Interest Expense	85	
		Interest Payable		85
		To record accrued interest expense in December ($12,000 x 8.5% x 1/12)		
		(3)		
	31	Depreciation Expense: Buildings	2,000	
		Accumulated Depreciation: Buildings		2,000
		To record December depreciation expense ($600,000 ÷ 25 years x 1/12).		
		(4)		
	31	No adjusting entry required. Revenue is recognized when it is earned. Entering into a contract does not constitute the earning of revenue.		
		(5)		
	31	Salaries Expense	1,250	
		Salaries Payable		1,250
		To record accrued salary expense in December.		
		(6)		
	31	Camper Revenue Receivable	2,400	
		Camper Revenue		2,400
		To record camper revenue earned in December.		
		(7)		
	31	Unearned Camper Revenue	900	
		Camper Revenue		900
		To record revenue earned from campers that paid in advance ($5,400 ÷ 6 months).		
		(8)		
	31	Bus Rental Expense	1,000	
		Accounts Payable		1,000
		To record accrued bus rental expense in December ($40 per day x 25 days).		
		(9)		
	31	Income Taxes Expense	8,400	
		Income Taxes Payable		8,400
		To record income taxes accrued in December.		

PROBLEM 4.2A
ENCHANTED FOREST (concluded)

b.

1. **Accruing uncollected revenue.**
2. **Accruing unpaid expenses.**
3. **Converting assets to expenses.**
4. **No adjusting entry required.**
5. **Accruing unpaid expenses.**
6. **Accruing uncollected revenue.**
7. **Converting liabilities to revenue.**
8. **Accruing unpaid expenses.**
9. **Accruing unpaid expenses.**

c.

	Income Statement			Balance Sheet		
Adjustment	Revenue –	Expenses =	Net Income	Assets =	Liabilities +	Owners' Equity
1.	I	NE	I	I	NE	I
2.	NE	I	D	NE	I	D
3.	NE	I	D	D	NE	D
4.	NE	NE	NE	NE	NE	NE
5.	NE	I	D	NE	I	D
6.	I	NE	I	I	NE	I
7.	I	NE	I	NE	D	I
8.	NE	I	D	NE	I	D
9.	NE	I	D	NE	I	D

d. **$340 ($12,000 x 8.5% x 4/12)**

e.

Original cost of buildings …………………………………………		$ 600,000
Accumulated depreciation: buildings (prior to adjusting entry 3 in part a)…………………………………………………	$ 310,000	
December depreciation expense from part a ……………………	2,000	
Accumulated depreciation, buildings, 12/31 ……………………		(312,000)
Net book value at December 31 …………………………………		$ 288,000

25 Minutes, Strong

PROBLEM 4.3A
GUNFLINT ADVENTURES

a. **(1)** **Age of airplane in months = accumulated depreciation/monthly depreciation. Useful life is given as 20 years, or 240 months.**
Cost $240,000/240 months = $1,000 monthly depreciation expense
Accumulated depreciation $36,000/$1,000 monthly depreciation = 36 months.

(2) **At June 30, two months of prepaid airport rent have been converted to expense (May and June). Thus, four months of prepaid airport rent remain at June 30. Remaining prepaid amount $7,200/4 months remaining = $1,800 per month.**

(3) **At June 30, five months of the original insurance policy have expired (February through June). Thus, seven months of coverage remains unexpired at June 30. Remaining unexpired amount $3,500/7 months remaining = $500 per month. $500 monthly cost x 12 months coverage = $6,000 paid on February 1.**

b.

		General Journal		
		(Adjusting Entries)		
20___		(1)		
June	30	Depreciation Expense	1,000	
		Accumulated Depreciation: Airplane		1,000
		To record June depreciation expense on airplane.		
		(2)		
	30	Airport Rent Expense	1,800	
		Prepaid Airport Rent		1,800
		Recognizing rent expense for June.		
		(3)		
	30	Insurance Expense	500	
		Unexpired Insurance		500
		Recognizing insurance expense for June.		
		(4)		
	30	Unearned Passenger Revenue	75,000	
		Passenger Revenue Earned		75,000
		Recording portion of unearned revenue earned in June.		

30 Minutes, Medium

PROBLEM 4.4A
CAMPUS THEATER

a.

General Journal
(Adjusting Entries)

2009				
		(1)		
Aug.	31	Film Rental Expense	15,200	
		Prepaid Film Rental		15,200
		Film rental expense incurred in August.		
		(2)		
	31	Depreciation Expense: Buildings	700	
		Accumulated Depreciation: Buildings		700
		To record August depreciation expense		
		($168,000 ÷ 240 months).		
		(3)		
	31	Depreciation Expense: Fixtures and Equipment	600	
		Accumulated Depreciation: Fixtures and Equip.		600
		To record August depreciation ($36,000 ÷ 60 months).		
		(4)		
	31	Interest Expense	1,500	
		Interest Payable		1,500
		Interest expense accrued in August.		
		(5)		
	31	Unearned Admissions Revenue (YMCA)	500	
		Admissions Revenue		500
		To record advance payment from YMCA earned in		
		August ($1,500 x 1/3).		
		(6)		
	31	Concessions Revenue Receivable	2,250	
		Concessions Revenue		2,250
		To record accrued concessions revenue in August.		
		(7)		
	31	Salaries Expense	1,700	
		Salaries Payable		1,700
		To record accrued salary expense in August.		
		(8)		
	31	Income Taxes Expense	4,200	
		Income Taxes Payable		4,200
		To record income taxes accrued in August.		
		(9)		
	31	No adjusting entry required.		

PROBLEM 4.4A
CAMPUS THEATER (concluded)

b. (1) Eight months (bills received January through August). Utilities bills are recorded as monthly bills are received. As of August 31, eight monthly bills should have been received.

(2) Seven months (January through July). Depreciation expense is recorded only in month-end adjusting entries. Thus, depreciation for August is not included in the August *unadjusted* trial balance.

(3) Twenty months ($14,000/$700 per month).

c. Corporations must pay income taxes in several *installments* throughout the year. The balance in the Income Taxes Expense account represents the total amount of income taxes expense recognized since the beginning of the year. But Income Taxes *Payable* represents only the portion of this expense that has not yet been paid. In the example at hand, the $4,740 in income taxes payable probably represents only the income taxes expense accrued in July, as Campus Theater should have paid taxes accrued in the first two quarters by June 15.

30 Minutes, Medium

PROBLEM 4.5A
TERRIFIC TEMPS

a.

General Journal
(Adjusting Entries)

2009				
		(1)		
Dec.	31	Accounts Receivable	1,500	
		Fees Earned		1,500
		To record accrued but uncollected fees earned.		
		(2)		
	31	Unearned Revenue	2,500	
		Fees Earned		2,500
		To convert previously unearned revenue to		
		earned revenue.		
		(3)		
	31	Insurance Expense	300	
		Unexpired Insurance		300
		To record Dec. insurance exp. ($1,800 ÷ 6 mo.).		
		(4)		
	31	Rent Expense	1,000	
		Prepaid Rent		1,000
		To record Dec. rent expense ($3,000 ÷ 3 mo.).		
		(5)		
	31	Office Supplies Expense	200	
		Office Supplies		200
		To record offices supplies used in December		
		($600 - $400).		
		(6)		
	31	Depreciation Expense: Equipment	500	
		Accumulated Depreciation: Equipment		500
		To record December depreciation expense		
		($60,000 ÷ 120 mo.).		
		(7)		
	31	Interest Expense	80	
		Interest Payable		80
		To record interest accrued in December		
		($12,000 x 8% x 1/12).		
		(8)		
	31	Salaries Expense	2,700	
		Salaries Payable		2,700
		To record income taxes accrued in December.		
		(9)		
	31	Income Taxes Expense	3,000	
		Income Taxes Payable		3,000
		To record income taxes accrued in December.		

PROBLEM 4.5A
TERRIFIC TEMPS (concluded)

b.

1.	Fees earned (unadjusted)	$ 75,000
	Add: Adjusting entry #1	1,500
	Adjusting entry #2	2,500
	Fees Earned in 2009	$ 79,000
2.	Travel expense (no adjustment required)	$ 5,000
3.	Insurance expense (unadjusted)	$ 2,980
	Add: Adjusting entry #3	300
	Insurance expense incurred in 2009	$ 3,280
4.	Rent expense (unadjusted)	$ 9,900
	Add: Adjusting entry #4	1,000
	Rent expense incurred in 2009	$ 10,900
5.	Office supplies expense (unadjusted)	$ 780
	Add: Adjusting entry #5	200
	Office supplies expense incurred in 2009	$ 980
6.	Utilities expense (no adjustment required)	$ 4,800
7.	Depreciation expense: equipment (unadjusted)	$ 5,500
	Add: Adjusting entry #6	500
	Equipment depreciation expense in 2009	$ 6,000
8.	Interest expense (unadjusted)	$ 320
	Add: Adjusting entry #7	80
	Interest expense incurred in 2009	$ 400
9.	Salaries expense (unadjusted)	$ 30,000
	Add: Adjusting entry #8	2,700
	Salaries expense incurred in 2009	$ 32,700
10.	Income taxes expense (unadjusted)	$ 12,000
	Add: Adjusting entry #9	3,000
	Income taxes expense incurred in 2009	$15,000

c. The unadjusted trial balance reports no dividends payable. Thus, the entire $3,000 dividend has been paid

30 Minutes, Medium

PROBLEM 4.6A
ALPINE EXPEDITIONS

a.

General Journal
(Adjusting Entries)

2009		(1)		
Dec.	31	Accounts Receivable	6,400	
		Client Revenue Earned		6,400
		To record accrued but uncollected revenue.		
		(2)		
	31	Unearned Client Revenue	6,600	
		Client Revenue Earned		6,600
		To convert previously unearned revenue to		
		earned revenue.		
		(3)		
	31	Insurance Expense	3,000	
		Unexpired Insurance		3,000
		To record Dec. insurance expense ($36,000 ÷ 12 mo.).		
		(4)		
	31	Advertising Expense	1,100	
		Prepaid Advertising		1,100
		To record Dec. advertising expense.		
		(5)		
	31	Climbing Supplies Expense	2,900	
		Climbing Supplies		2,900
		To record climbing supplies used in December		
		($4,900 - $2,000).		
		(6)		
	31	Depreciation Expense: Climbing Equip.	1,200	
		Accumulated Dep.: Climbing Equipment		1,200
		To recorded December depreciation expense		
		($57,600 ÷ 48 mo.)		
		(7)		
	31	Interest Expense	75	
		Interest Payable		75
		To record interest accrued in December.		
		($10,000 x 9% x 1/12).		
		(8)		
	31	Salaries Expense	3,100	
		Salaries Payable		3,100
		To record salaries accrued in December.		
		(9)		
	31	Income Taxes Expense	1,250	
		Income Taxes Payable		1,250
		To record income taxes accrued in December.		

PROBLEM 4.6A
ALPINE EXPEDITIONS (continued)

b.

1.	Cash (no adjustment required)	$	13,900
2.	Accounts receivable (unadjusted)		78,000
	Add: Adjusting entry #1		6,400
	Accounts receivable at December 31, 2009	$	84,400
3.	Unexpired insurance (unadjusted)	$	18,000
	Less: Adjusting entry #3		(3,000)
	Unexpired insurance at December 31, 2009	$	15,000
4.	Prepaid advertising (unadjusted)	$	2,200
	Less: Adjusting entry #4		(1,100)
	Prepaid advertising at December 31, 2009	$	1,100
5.	Climbing supplies (unadjusted)	$	4,900
	Less: Adjusting entry #5		(2,900)
	Climbing supplies at December 31, 2009	$	2,000
6.	Climbing equipment (no adjustment necessary)	$	57,600
7.	Acc. Depreciation: climbing equip. (unadjusted)	$	38,400
	Add: Adjusting entry #6		1,200
	Salaries payable at December 31, 2009	$	39,600
8.	Salaries payable (unadjusted)	$	-
	Add: Adjusting entry #8		3,100
	Salaries payable at December 31, 2009	$	3,100
9.	Notes payable (no adjustment required)	$	10,000
10.	Interest payable (unadjusted)	$	150
	Add: Adjusting entry #7		75
	Income taxes payable at December 31, 2009	$	225
11.	Income taxes payable (unadjusted)	$	1,200
	Add: Adjusting entry #9		1,250
	Income taxes payable at December 31, 2009	$	2,450
12.	Unearned client revenue (unadjusted)	$	9,600
	Less: Adjusting entry #2		(6,600)
	Unearned client revenue at December 31, 2009	$	3,000

PROBLEM 4.6A
ALPINE EXPEDITIONS (concluded)

c. **Deferred expenses are assets that eventually convert into expenses. For Alpine Expeditions, these accounts include Unexpired Insurance, Prepaid Advertising, Climbing Supplies, and Climbing Equipment.**

60 Minutes, Strong

PROBLEM 4.7A
KEN HENSLEY ENTERPRISES, INC.

a.

General Journal
(Adjusting Entries)

2009		(1)		
Dec.	31	Accounts Receivable	4,400	
		Studio Revenue Earned		4,400
		To record accrued studio revenue earned in		
		December.		
		(2)		
	31	Supplies Expense	700	
		Studio Supplies		700
		To record studio supplies used in December		
		($7,600 - $6,900).		
		(3)		
	31	Insurance Expense	250	
		Unexpired Insurance		250
		To record December insurance expense ($1,500 x1/6).		
		(4)		
	31	Studio Rent Expense	2,000	
		Prepaid Studio Rent		2,000
		To record studio rent in December ($6,000 x 1/3).		
		(5)		
	31	Depreciation Expense: Recording Equipment	1,500	
		Accumulated Depreciation: Rec. Eq.		1,500
		To record depreciation expense in December		
		($90,000 x 1/60).		
		(6)		
	31	Interest Expense	120	
		Interest Payable		120
		To record accrued interest expense in		
		December. ($16,000 x 9% x 1/12).		
		(7)		
	31	Unearned Studio Revenue	3,600	
		Studio Revenue Earned		3,600
		To record advance collections earned in Dec.		
		(8)		
	31	Salaries Expense	540	
		Salaries Payable		540
		To record salaries accrued in December.		
		(9)		
	31	Income Taxes Expense	1,700	
		Income Taxes Payable		1,700
		To record income taxes accrued in December.		
		($19,600 - $17,900).		

PROBLEM 4.7A
KEN HENSLEY ENTERPRISES, INC. (continued)

b.

		Ken Hensley Enterprises, Inc.		
		Income Statement		
		For the Year Ended December 31, 2009		
		Studio Revenue Earned		$ 115,000
		Salaries Expense	$ 18,540	
		Supplies Expense	1,900	
		Insurance Expense	2,930	
		Depreciation Expense: Recording Equipment	18,000	
		Studio Rent Expense	23,000	
		Utilities Expense	2,350	
		Interest Expense	960	
		Income Tax Expense	19,600	
		Total Expenses		87,280
		Net Income		$ 27,720

c. **Monthly rent expense for the last two months of 2009 was $2,000 ($6,000/3 months). The $21,000 rent expense shown in the trial balance includes a $2,000 rent expense for November, which means that total rent expense for January through October was $19,000 ($21,000 - $2,000). The monthly rent expense in these months must have been $1,900 ($19,000/10 months). Thus, it appears that monthly rent increased by $100 (from $1,900 to $2,000) in November and December.**

PROBLEM 4.7A
KEN HENSLEY ENTERPRISES, INC. (concluded)

d. **Insurance expense of $250 per month in the last 5 months of the year was $10 per month more than the average monthly cost in the first 7 months of the year ($250 - $240).**

		Insurance expense for 12 months ended		
		December 31, 2009	$ 2,930	
		Less: Insurance expense for August through December		
		@ $250/month	1,250	
		Insurance expense for January through July	$ 1,680	
			÷ 7	months
		Average monthly insurance expense for Jan.-July	$ 240	

e.

		Accumulated depreciation per trial balance	$ 52,500	
		Add: December depreciation expense (adj. entry 5)	1,500	
		Accumulated depreciation at December 31, 2009	$ 54,000	
			÷ 1,500	per month
		Age of equipment at December 31, 2009	36	months

f.

	Income Statement				Balance Sheet		
Adjustment	Revenue	- Expenses	= Net Income	Assets	= Liabilities	+	Owners' Equity
1.	I	NE	I	I	NE		I
2.	NE	I	D	D	NE		D
3.	NE	I	D	D	NE		D
4.	NE	I	D	D	NE		D
5.	NE	I	D	D	NE		D
6.	NE	I	D	NE	I		D
7.	I	NE	I	NE	D		I
8.	NE	I	D	NE	I		D
9.	NE	I	D	NE	I		D

20 Minutes, Strong

PROBLEM 4.8A
COYNE CORPORATION

	Error	Total Revenue	Total Expenses	Net Income	Total Assets	Total Liabilities	Owners' Equity
a.	**Recorded a dividend as an expense reported in the income statement.**	NE	O	U	NE	NE	NE
b.	**Recorded the payment of an account payable as a debit to accounts payable and a credit to an expense account.**	NE	U	O	O	NE	O
c.	**Failed to record depreciation expense.**	NE	U	O	O	NE	O
d.	**Recorded the sale of capital stock as a debit to cash and a credit to retained earnings.**	NE	NE	NE	NE	NE	NE
e.	**Recorded the receipt of a customer deposit as a debit to cash and a credit to fees earned.**	O	NE	O	NE	U	O
f.	**Failed to record expired portion of an insurance policy.**	NE	U	O	O	NE	O
g.	**Failed to record accrued interest earned on an outstanding note receivable.**	U	NE	U	U	NE	U

SOLUTIONS TO PROBLEMS SET B

20 Minutes, Easy

PROBLEM 4.1B
GEORGIA GUN CLUB

a.

(Adjusting Entries)

20__		(1)		
Dec.	31	Salaries Expense	13,600	
		Salaries Payable		13,600
		To record accrued salaries at December 31.		
		(2)		
	31	Accounts Receivable	3,200	
		Guest Fee Revenue		3,200
		To record guest fees owed by the Georgia State		
		Police.		
		(3)		
	31	Unearned Membership Dues	140,000	
		Membership Dues Earned		140,000
		To record the portion of annual membership dues		
		earned in December.		
		(4)		
	31	Depreciation Expense: Furniture and Fixtures	1,250	
		Accumulated Depreciation: Furn. & fixtures		1,250
		To record December depreciation expense		
		($120,000 ÷ 8 years x 1/12).		
		(5)		
	31	Interest Expense	400	
		Interest Payable		400
		To record accrued interest expense in December		
		($60,000 x 8% x 1/12).		
		(6)		
	31	Insurance Expense	900	
		Unexpired Insurance		900
		To record December insurance expense		
		($10,800 x 1/12).		
		(7)		
	31	No adjusting entry required. Revenue is recognized		
		when it is earned. Entering into a contract does not		
		constitute the earning of revenue.		
		(8)		
	31	Income Taxes Expense	12,600	
		Income Taxes Payable		12,600
		To record income taxes accrued in December.		

PROBLEM 4.1B
GEORGIA GUN CLUB (concluded)

b.

1. **Accruing unpaid expenses.**
2. **Accruing uncollected revenue.**
3. **Converting liabilities to revenue.**
4. **Converting assets to expenses.**
5. **Accruing unpaid expenses.**
6. **Converting assets to expenses.**
7. **No adjusting entry required.**
8. **Accruing unpaid expenses.**

c. The clubhouse was built in 1776 and has been fully depreciated for financial accounting purposes. The net book value of an asset reported in the balance sheet does *not* reflect the asset's fair market value. Likewise, depreciation expense reported in the income statement does not reflect a decline in fair market value, physical obsolescence, or wear-and-tear.

40 Minutes, Medium

PROBLEM 4.2B
BIG OAKS

a.

		General Journal		
		(Adjusting Entries)		
		(1)		
Dec.	31	Interest Receivable	425	
		Interest Revenue		425
		To record accrued interest revenue.		
		(2)		
	31	Interest Expense	80	
		Interest Payable		80
		To record accrued interest expense in December		
		($12,000 x 8% x 1/12).		
		(3)		
	31	Depreciation Expense: Buildings	3,000	
		Accumulated Depreciation: Buildings		3,000
		To record December depreciation expense		
		($720,000 ÷ 20 years x 1/12).		
		(4)		
	31	No adjusting entry required. Revenue is recognized		
		when it is earned. Entering into a contract does not		
		constitute the earning of revenue.		
		(5)		
	31	Salaries Expense	1,515	
		Salaries Payable		1,515
		To record accrued salary expense in December.		
		(6)		
	31	Camper Revenue Receivable	2,700	
		Camper Revenue		2,700
		To record accrued camper revenue earned in		
		December.		
		(7)		
	31	Unearned Camper Revenue	1,500	
		Camper Revenue		1,500
		To record revenue earned from campers that paid		
		in advance ($7,500 ÷ 5 months).		
		(8)		
	31	Bus Rental Expense	810	
		Accounts Payable		810
		To record accrued bus rental expense in December		
		($45 per day x 18 days).		
		(9)		
	31	Income Taxes Expense	6,600	
		Income Taxes Payable		6,600
		To record income taxes accrued in December.		

PROBLEM 4.2B
BIG OAKS (concluded)

b.

1. **Accruing uncollected revenue.**
2. **Accruing unpaid expenses.**
3. **Converting assets to expenses.**
4. **No adjusting entry required.**
5. **Accruing unpaid expenses.**
6. **Accruing uncollected revenue.**
7. **Converting liabilities to revenue.**
8. **Accruing unpaid expenses.**
9. **Accruing unpaid expenses.**

c.

	Income Statement					Balance Sheet				
Adjustment	Revenue	–	Expenses	=	Net Income	Assets	=	Liabilities	+	Owners' Equity
1.	I		NE		I	I		NE		I
2.	NE		I		D	NE		I		D
3.	NE		I		D	D		NE		D
4.	NE		NE		NE	NE		NE		NE
5.	NE		I		D	NE		I		D
6.	I		NE		I	I		NE		I
7.	I		NE		I	NE		D		I
8.	NE		I		D	NE		I		D
9.	NE		I		D	NE		I		D

d. **$240 ($12,000 x 8% x 3/12)**

e.

Original cost of buildings ……………………………………………		**$ 720,000**
Accumulated depreciation: buildings (prior to adjusting entry 3 in part a) ……………………………………………………	**$ 160,000**	
December depreciation expense from part a ……………………	**3,000**	
Accumulated depreciation, buildings, 12/31 ……………………		**(163,000)**
Net book value at December 31 ……………………………………		**$ 557,000**

25 Minutes, Strong

PROBLEM 4.3B
RIVER RAT

a. (1) Age of the ferry in months = accumulated depreciation/monthly depreciation. Useful life is given as 8 years, or 96 months.

Cost $96,000/96 months = $1,000 monthly depreciation expense.
Accumulated depreciation $20,000/$1,000 monthly depreciation = 20 months.

(2)

Tickets used in April………………………………..	160
Tickets outstanding on April 30 ($1,040 ÷ $2)…….	520
Tickets sold to resort hotel on April 1……………..	680

(3) Prepaid rent of $12,000 ÷ 4 months remaining = $3,000 monthly rental expense.

(4) Since 2 months of the 12-month life of the policy have expired, the $2,400 of unexpired insurance applies to the remaining 10 months. This indicates a monthly cost of $240, computed as $2,400 ÷ 10. Therefore, the 12-month policy originally cost $2,880, or 12 x $240.

b.

General Journal
(Adjusting Entries)

20___		(1)		
Apr.	30	Depreciation Expense: Ferry	1,000	
		Accumulated Depreciation: Ferry		1,000
		To record April depreciation expense on ferry.		
		(2)		
	30	Unearned Passenger Revenue	320	
		Passenger Revenue Earned		320
		To record earning of revenue from 160 future ride		
		tickets used in April (160 tickets x $2 = $320).		
		(3)		
	30	Rent Expense	3,000	
		Prepaid Rent		3,000
		To recognize rent expense for April.		
		(4)		
	30	Insurance Expense	240	
		Unexpired Insurance		240
		To record expiration of insurance in April.		

30 Minutes, Medium

PROBLEM 4.4B
OFF-CAMPUS PLAYHOUSE

a.				
General Journal (Adjusting Entries)				
2009		(1)		
Sept.	30	Costume Rental Expense	600	
		Prepaid Costume Rental		600
		Costume rental expense incurred in September.		
		(2)		
	30	Depreciation Expense: Buildings	500	
		Accumulated Depreciation: Buildings		500
		To record September depreciation expense		
		($150,000 ÷ 300 months).		
		(3)		
	30	Depreciation Expense: Fixtures and Equipment	300	
		Accumulated Depreciation: Fixtures and Equip.		300
		To record September depreciation ($18,000 ÷ 60		
		months).		
		(4)		
	30	Interest Expense	1,062	
		Interest Payable		1,062
		Interest expense accrued in September.		
		(5)		
	30	Unearned Admissions Revenue	500	
		Admissions Revenue		500
		To record earned revenue from nursing homes.		
		(6)		
	30	Concessions Revenue Receivable	4,600	
		Concessions Revenue		4,600
		To record accrued concessions revenue in		
		September.		
		(7)		
	30	Salaries Expense	2,200	
		Salaries Payable		2,200
		To record accrued salary expense in September.		
		(8)		
	30	Income Taxes Expense	3,600	
		Income Taxes Payable		3,600
		To record income taxes accrued in September.		
		(9)		
	30	No adjusting entry required.		

PROBLEM 4.4B
OFF-CAMPUS PLAYHOUSE (concluded)

b.

(1) Nine months (bills received January through September). Utility bills are recorded as monthly bills are received. As of September 30, nine monthly bills should have been received.

(2) Eight months (January through August). Depreciation expense is recorded only in month-end adjusting entries. Thus, depreciation for September is not included in the September unadjusted trial balance.

(3) Thirty-seven months ($18,500 ÷ $500 per month).

c. **Corporations must pay income taxes in several *installments* throughout the year. The balance in the Income Taxes Expense account represents the total amount of income taxes expense recognized since the beginning of the year. But Income Taxes Payable represents only the portion of this expense that has not yet been paid.**

30 Minutes, Medium

PROBLEM 4.5B
MARVELOUS MUSIC

a.

General Journal				
(Adjusting Entries)				
2009		(1)		
Dec.	31	Accounts Receivable	3,200	
		Lesson Revenue Earned		3,200
		To record accrued but uncollected revenue.		
		(2)		
	31	Unearned Lesson Revenue	800	
		Lesson Revenue Earned		800
		To convert previously unearned revenue to		
		earned revenue.		
		(3)		
	31	Insurance Expense	400	
		Unexpired Insurance		400
		To record Dec. insur. expense ($4,800 ÷ 12 mo.).		
		(4)		
	31	Rent Expense	1,500	
		Prepaid Rent		1,500
		To record Dec. rent expense ($9,000 ÷ 6 mo.).		
		(5)		
	31	Sheet Music Supplies Expense	250	
		Sheet Music Supplies		250
		To record offices supplies used in December		
		($450 - $200).		
		(6)		
	31	Depreciation Expense: Music Equipment	3,000	
		Accum. Depreciation: Music Equipment		3,000
		To record December depreciation expense		
		($180,000 ÷ 60 mo.).		
		(7)		
	31	Interest Expense	25	
		Interest Payable		25
		To record interest accrued in December		
		($5,000 x 6% x 1/12).		
		(8)		
	31	Salaries Expense	3,500	
		Salaries Payable		3,500
		To record accrued salaries expense in December.		
		(9)		
	31	Income Taxes Expense	8,155	
		Income Taxes Payable		8,155
		To record income taxes accrued in December.		

b.

1.	Lesson revenue earned (unadjusted)	$ 154,375
	Add: Adjusting entry #1	3,200
	Adjusting entry #2	800
	Fees Earned in 2009	$ 158,375
2.	Advertising expense (no adjustment required)	$ 7,400
3.	Insurance expense (unadjusted)	$ 4,400
	Add: Adjusting entry #3	400
	Insurance expense incurred in 2009	$ 4,800
4.	Rent expense (unadjusted)	$ 16,500
	Add: Adjusting entry #4	1,500
	Rent expense incurred in 2009	$ 18,000
5.	Sheet music supplies expense (unadjusted)	$ 780
	Add: Adjusting entry #5	250
	Sheet music expense incurred in 2009	$ 1,030
6.	Utilities expense (no adjustment required)	$ 5,000
7.	Depreciation expense: music equipment	$ 33,000
	Add: Adjusting entry #6	3,000
	Equipment depreciation expense in 2009	$ 36,000
8.	Interest expense (unadjusted)	$ 25
	Add: Adjusting entry #7	25
	Interest expense incurred in 2009	$ 50
9.	Salaries expense (unadjusted)	$ 27,500
	Add: Adjusting entry #8	3,500
	Salaries expense incurred in 2009	$ 31,000
10.	Income taxes expense (unadjusted)	$ 13,845
	Add: Adjusting entry #9	8,155
	Income taxes expense incurred in 2009	$22,000

c. **The unadjusted trial balance reports dividends payable of $1,000. Thus, none of the $1,000 dividend has been paid.**

30 Minutes, Medium

PROBLEM 4.6B
MATE EASE

a.

General Journal (Adjusting Entries)				
2009		(1)		
Dec.	31	Unearned Member Dues	21,000	
		Client Fees Earned		21,000
		To convert previously unearned revenue to		
		earned revenue.		
		(2)		
	31	Insurance Expense	3,200	
		Unexpired Insurance		3,200
		To record Dec. insur. Exp. ($19,200 ÷ 6 mo.).		
		(3)		
	31	Rent Expense	7,300	
		Prepaid Rent		7,300
		To record Dec. rent expense ($21,900 ÷ 3 mo.).		
		(4)		
	31	Office Supplies Expense	1,720	
		Office Supplies		1,720
		To record office supplies used in December		
		($2,160 - 440).		
		(5)		
	31	Depreciation Expense: Computer Equip.	3,000	
		Accumulated Dep.: Computer Equip.		3,000
		To record December depreciation expense		
		($108,000 ÷ 36 mo.).		
		(6)		
	31	Interest Expense	750	
		Interest Payable		750
		To record interest accrued in December		
		($90,000 x 10% x 1/12).		
		(7)		
	31	Salaries Expense	10,500	
		Salaries Payable		10,500
		To record salaries accrued in December.		
		(8)		
	31	Income Taxes Expense	2,000	
		Income Taxes Payable		2,000
		To record incomes taxes accrued in December.		

PROBLEM 4.6B
MATE EASE (continued)

b.

1.	Cash (no adjustment required)	$ 169,500
2.	Unexpired insurance (unadjusted)	12,800
	Less: Adjusting entry #2	(3,200)
	Unexpired insurance at December 31, 2009	$ 9,600
3.	Prepaid rent (unadjusted rent)	$ 14,600
	Less: Adjusting entry #3	(7,300)
	Prepaid rent at December 31, 2009	$ 7,300
4.	Office supplies (unadjusted)	$ 2,160
	Less: Adjusting entry #4	(1,720)
	Office supplies at December 31, 2009	$ 440
5.	Computer equip. (no adjustment necessary)	$ 108,000
6.	Acc. Deprec.: computer equip. (unadjusted)	$ 54,000
	Add: Adjusting entry #5	3,000
	Accum. Depreciation at December 31, 2009	$ 57,000
7.	Accounts payable (no adjustment necessary)	$ 4,300
8.	Notes payable (no adjustment necessary)	$ 90,000
9.	Salaries payable (unadjusted)	$ -
	Add: Adjusting entry #7	10,500
	Salaries payable at December 31, 2009	$ 10,500
10.	Interest payable (unadjusted)	$ 6,750
	Add: Adjusting entry #6	750
	Interest payable at December 31, 2009	$ 7,500
11.	Income taxes payable (unadjusted)	$ 7,500
	Add: Adjusting entry #8	2,000
	Income taxes payable at December 31, 2009	$ 9,500
12.	Unearned member dues (unadjusted)	$ 36,000
	Less: Adjusting entry #1	(21,000)
	Unearned client revenue at December 31, 2009	$ 15,000

PROBLEM 4.6A
MATE EASE (concluded)

c. **The company is following the realization principle requiring that revenue not be recognized until it is earned. Clients pay the company in advance for services to be provided in the future. As members are provided services, the company converts the unearned member dues into client fees earned.**

60 Minutes, Strong

PROBLEM 4.7B
STILLMORE INVESTIGATIONS

a.

General Journal (Adjusting Entries)				
2009		(1)		
Dec.	31	Accounts Receivable	1,500	
		Client Fees Earned		1,500
		To record accrued revenue in December.		
		(2)		
	31	Unearned Retainer Fees	2,500	
		Client Fees Earned		2,500
		To record advance collections earned in December.		
		(3)		
	31	Office Supplies Expense	95	
		Office Supplies		95
		To record supplies used in Dec. ($205 - $110).		
		(4)		
	31	Depreciation Expense: Office Equipment	750	
		Accumulated Depreciation: Office Equipment		750
		To record depreciation expense in December		
		($54,000 x 1/72).		
		(5)		
	31	Rent Expense	300	
		Prepaid Rent		300
		To record office rent in December ($1,800 x 1/6).		
		(6)		
	31	Insurance Expense	90	
		Unexpired Insurance		90
		To record December insurance expense		
		($1,080 x 1/12).		
		(7)		
	31	Salaries Expense	1,900	
		Salaries Payable		1,900
		To record salaries expense accrued in December.		
		(8)		
	31	Interest Expense	60	
		Interest Payable		60
		To record accrued interest expense in December.		
		($9,000 x 8% x 1/12).		
		(9)		
	31	Income Taxes Expense	600	
		Income Taxes Payable		600
		To record income taxes accrued in December		
		($7,500 - $6,900).		

PROBLEM 4.7B
STILLMORE INVESTIGATIONS (continued)

b.

		STILLMORE INVESTIGATIONS		
		Adjusted Trial Balance		
		December 31, 2009		
		Cash	$ 40,585	
		Accounts receivable	3,500	
		Office supplies	110	
		Prepaid rent	900	
		Unexpired insurance	180	
		Office Equipment	54,000	
		Accumulated depreciation: Office equipment		$ 36,000
		Accounts payable		1,400
		Interest payable		420
		Income taxes payable		2,350
		Note payable		9,000
		Unearned retainer fees		1,000
		Salaries payable		1,900
		Capital stock		30,000
		Retained earnings		8,000
		Dividends	1,000	
		Client fees earned		64,000
		Office supplies expense	700	
		Depreciation expense: Office equipment	9,000	
		Rent expense	6,075	
		Insurance expense	1,100	
		Salaries expense	29,000	
		Interest expense	420	
		Income tax expense	7,500	
		Totals	$ 154,070	$ 154,070

PROBLEM 4.7B
STILLMORE INVESTIGATIONS (continued)

c.

STILLMORE INVESTIGATIONS				
Income Statement				
For the Year Ended December 31, 2009				
		Client fees earned		$ 64,000
		Office supplies expense	$ 700	
		Depreciation expense: office equipment	9,000	
		Rent expense	6,075	
		Insurance expense	1,100	
		Salaries expense	29,000	
		Interest expense	420	
		Income taxes expense	7,500	
		Total Expenses		53,795
		Net Income		$ 10,205

d. **Rent expense of $300/month in the last 3 months of the year was $275/month less than the average monthly cost in the first 9 months of the year ($575 - $300).**

		Rent expense for 12 months ended December 31, 2009	$ 6,075	
		Less: Rent expense in October through December		
		@ $300 per month	900	
		Rent expense for January through September	$ 5,175	
			÷ 9	months
		Average monthly rent expense for Jan. - Sept.	$ 575	

e.

Insurance expense of $90/month in the last 10 months of the year was $10/month less than the average monthly cost in the first 2 months of the year ($100 - $90).

		Insurance expense for 12 months ended Dec. 31, 2009	$ 1,100	
		Less: Insurance expense from March through		
		December @ $90/month	900	
		Insurance expense for January through February	200	
			÷ 2	months
		Average insurance expense for Jan. and Feb.	$ 100	

PROBLEM 4.7B
STILLMORE INVESTIGATIONS (concluded)

f.

		Accumulated depreciation per unadjusted trial balance	$ 35,250	
		Add: December depreciation expense (adjusting entry 4)	750	
		Accumulated depreciation at December 31, 2009	$ 36,000	
			÷ 750	per month
		Age of equipment at December 31, 2009	48	months

g.

	Income Statement			Balance Sheet		
Adjustment	Revenue	- Expenses	= Net Income	Assets	= Liabilities	+ Owners' Equity
1.	I	NE	I	I	NE	I
2.	I	NE	I	NE	D	I
3.	NE	I	D	D	NE	D
4.	NE	I	D	D	NE	D
5.	NE	I	D	D	NE	D
6.	NE	I	D	D	NE	D
7.	NE	I	D	NE	I	D
8.	NE	I	D	NE	I	D
9.	NE	I	D	NE	I	D

20 Minutes, Strong

PROBLEM 4.8B
STEPHEN CORPORATION

	Error	Total Revenue	Total Expenses	Net Income	Total Assets	Total Liabilities	Owners' Equity
a.	Recorded a declared but unpaid dividend by debiting dividends and crediting Cash.	NE	NE	NE	U	U	NE
b.	Recorded a receipt of an account receivable as a debit to cash and a credit to fees earned.	O	NE	O	O	NE	O
c.	Recorded depreciation expense twice.	NE	O	U	U	NE	U
d.	Recorded the sale of capital stock as a debit to cash and a credit to revenue.	O	NE	O	NE	NE	NE
e.	Purchased equipment and debited supplies expense and credited cash.	NE	O	U	U	NE	U
f.	Failed to record expired portion of prepaid advertising.	NE	U	O	O	NE	O
g.	Failed to record accrued and unpaid interest expense.	NE	U	O	NE	U	O

SOLUTIONS TO CRITICAL THINKING CASES

30 Minutes, Medium

CASE 4.1
YEAR-END ADJUSTMENTS

a. **No adjusting entry is needed, because although the revenue was collected in advance on September 1, it has all been earned prior to year-end. Thus, inclusion of the entire amount in revenue of the period is correct.**

b. **Three months' revenue was collected in advance on December 1 and was credited to an unearned revenue account. At December 31, an adjusting entry is needed to recognize that one-third of this advance payment has now been earned. The effects of this adjusting entry will be to reduce a liability (unearned revenue) and increase revenue recognized as earned in the period. Of course, recognizing revenue also increases owners' equity.**

c. **Management services rendered in December, but which are not billed to customers until the following month, represent *unrecorded revenue* at year-end. An adjusting entry should be made to record this revenue, debiting Accounts Receivable and crediting appropriate revenue accounts. This entry will increase assets, revenue, and owners' equity.**

d. **No adjusting entry is required, as none of the cost of this insurance policy expires in the current year.**

e. **An adjusting entry should be made to record *depreciation expense* on all equipment owned. The entry to record depreciation expense reduces assets, increases expenses, and reduces owners' equity.**

f. **Not recording salaries and wages expense until payroll dates is a common practice. However, salaries and wages actually represent expenses of the period in which employees render services, not the period in which they are paid. Thus, if the payroll date falls in another accounting period, an adjusting entry is needed to recognize an expense the cost of employees' services during the current period. The effects of this entry are to recognize an expense, which in turn decreases owners' equity, and also to recognize a liability for salaries (or wages) payable.**

25 Minutes, Medium

CASE 4.2
THE CONCEPT OF MATERIALITY: AVIS RENT-A-CAR

a. (1) An event or transaction is "material" when knowledge of the item reasonably may be expected to influence the decisions of users of financial statements. One consideration is simply the size of the dollar amounts involved: what is "material" in relation to the operations of a small business may *not be material* in relation to the operations of a large corporation. In addition, the *nature* of the event plays a key role in determining whether or not knowledge of the event would influence decision makers.

There are no official rules determining what is—or is not—material. Thus, the "materiality" of specific events is a matter of professional judgment, left to the accountants preparing financial statements and also to the company's auditors.

(2) In evaluating the "materiality" of an event or transaction, accountants should consider: (1) the dollar amounts involved, relative to the size of the business entity, and (2) the nature of the transaction or event. The nature of an event, such as fraud by management, may be of interest to investors even though the dollar amounts are relatively small in relation to the company's overall earnings and resources.

(3) The concept of materiality *does* mean that financial statements are *not precise "down to the last dollar."* Such precision would be impossible to achieve in most large business organizations; further, such precision is not necessary. A "material" event is one that may influence the decisions of informed users of financial statements. Thus, by definition, *immaterial* events do not influence decisions and, therefore, are irrelevant to the decision makers. The treatment accorded to immaterial events should not make financial statements less useful.

b. The concept of materiality would *not* permit Avis to charge the purchase of new automobiles for its rental fleet directly to expense. Although the cost of each *individual car* is immaterial to Avis, the *cumulative* cost of all cars purchased during the year is quite material.

***Note to instructor:* It is interesting to note that the effect of charging annual purchases of new rental cars directly to expense might not have a material effect upon Avis's income statement, as the cost of new cars purchased might be reasonably close to the depreciation expense that would be recognized annually had the cars been charged to an asset account. Thus, the overall effect on income might not be "material."**

However, charging the purchases of new cars directly to expense would definitely cause a material distortion in the company's balance sheet. One of its largest assets—its rental fleet—would simply not appear. Thus, both assets and owners' equity would be understated by a material amount (the cost of the entire rental fleet).

10 Minutes, Easy

CASE 4.3
EXPENSE MANIPULATION
ETHICS, FRAUD & CORPORATE GOVERNANCE

a. **The decision by management to wait three years before converting the $40,000 capitalized advertising expenditure to advertising expense clearly violates generally accepted accounting principles. The matching principle requires that revenue earned during a particular period be offset with the expenses incurred in generating that revenue. Thus, the $40,000 preseason advertising expenditure should have been converted to advertising expense as the brochures were distributed, as the broadcast media ads were aired, and as the magazine and newspaper ads appeared. Advertising prepayments such as these are normally deferred in the balance sheet for only a few months and are classified as current assets prior to being converted to expenses. Management's decision to capitalize these expenditures for three years would require that they be reported in the balance sheet as long-term assets.**

b. **The decision to capitalize the $40,000 advertising expenditure for three years certainly has ethical implications if management's intent was to purposely inflate profitability, and thereby improve Slippery Slope's chances of receiving a loan from the bank to expand snowmaking capabilities. Whether the $40,000 amount is material or immaterial does not make management's decision any more or any less of an ethical breach if the underlying intent was to inflate the income figures given to the bank.**

Note to instructor: **It is likely that the bank would insist upon receiving a set of audited financial statements prior to approving this loan. As such, the auditors would not provide an unqualified audit opinion unless Slippery Slope reported the $40,000 advertising expenditure as advertising expense.**

15 Minutes, Medium

CASE 4.4
ACCOUNTING FOR DEFERRED REVENUE
BUSINESS WEEK

a.	**Air Traffic Liability……………………………………………**	**180,000,000**	
	Passenger Revenue…………………………….		**180,000,000**
	To record conversion of unearned revenue to earned revenue as transportation services were provided or tickets expired.		

b. **Passenger revenue divided by the average air traffic liability provides an estimate of the "turnover" of the unearned revenue account.**

Liability turnover rate: $2,840,000,000 ÷ $400,000,000 = 7.1 times

Dividing the number of days in a year by the liability turnover rate computed above provides an estimate of the number of days in advance, on average, that passengers purchase their tickets.

365 days ÷ 7.1 times turnover = 51 days

10 Minutes, Easy

CASE 4.5
IDENTIFYING ACCOUNTS
INTERNET

Accounts from Hershey's balance sheet likely to have required an adjusting entry are:

1. **Accounts Receivable–Trade**
2. **Inventories**
3. **Deferred Income Taxes**
4. **Prepaid Expenses**
5. **Accounts Payable**
6. **Accrued Liabilities**
7. **Accrued Income Taxes**
8. **Current portion of Long-Term Debt**
9. **Property, Plant, and Equipment**
10. **Other Intangibles**

Note to the instructor: **The adjustments required for several of the accounts listed above are discussed in subsequent chapters. Some are beyond the scope of an introductory course.**