

CHAPTER 4

Accrual Accounting Concepts

ANSWERS TO QUESTIONS

1. (a) Under the periodicity assumption, an accountant is required to determine the effect of each accounting transaction on a specific accounting period.
(b) An accounting time period that is one year in length is referred to as a fiscal year.
2. The two generally accepted accounting principles that pertain to adjusting the accounts are:
The revenue recognition principle, which states that revenue should be recognized in the time period in which the performance obligation is satisfied.
The expense recognition principle, which states that expenses be matched with revenues in the period when the company makes efforts to generate those revenues.
3. The law firm should recognize the revenue in April. The revenue recognition principle states that revenue should be recognized in the accounting period in which the performance obligation is satisfied.
4. Expenses of \$4,700 should be deducted from the revenues in April. Under the expense recognition principle efforts (expenses) should be matched with results (revenues).
5. No, adjusting entries are required by the revenue and expense recognition principles.
6. The financial information in a trial balance may not be up-to-date because:
 - (1) Some events are not journalized daily because it is not useful or efficient to do so.
 - (2) The expiration of some costs occurs with the passage of time rather than as a result of recurring daily transactions.
 - (3) Some items may be unrecorded because the transaction data are not known.
7. The two categories of adjusting entries are deferrals and accruals. Deferrals consist of revenues collected before services are provided and expenses paid before they are incurred. Accruals consist of revenues for services performed prior to collection and expenses incurred prior to payment.
8. In a prepaid expense adjusting entry, expenses are debited and assets are credited.
9. No. Depreciation is the process of allocating the cost of an asset to expense over its useful life. Depreciation results in the presentation of the book value of the asset, not its fair value.
10. Depreciation expense is an expense account whose normal balance is a debit. This account shows the cost that has expired during the current accounting period. Accumulated depreciation is a contra asset account whose normal balance is a credit. The balance in this account is the depreciation that has been recognized from the date of acquisition to the balance sheet date.
11.

Equipment.....	\$15,000	
Less: Accumulated depreciation—equipment.....	7,000	\$8,000
12. In an unearned revenue adjusting entry, liabilities are debited and revenues are credited.
13. The sale of a three-year maintenance contract on December 29, 2013 will have no effect on the 2013 income statement but receipt of \$100,000 on December 29, 2013, 2014, and 2015 will increase an asset, Cash, and a liability, Unearned Service Revenue. As Ace

Technologies provides service to its customer during 2014, 2015, and 2016, the liability will decrease and revenue will be recognized. Accrual accounting rules require that revenue be recognized as the performance obligation is satisfied rather than when cash is received.

Questions Chapter 4 (Continued)

- 14.** This promotion plan sounds like a bad idea for two reasons:
- (1) GAAP requires that the sale of a gift card be recorded as Unearned Sales Revenue (a liability) rather than Sales Revenue. Revenue recognition is delayed until the gift card is used or expires. Steve's plan will not help the company meet its target revenue unless customers use the cards by year-end.
 - (2) Selling a \$50 card for \$45 will probably not help the company meet its target net income. Although this promotion may result in additional sales revenue as the cards are used, the income resulting from the cards will be much less than usual since they eliminate \$5 of normal gross profit.
- 15.** An asset is debited and a revenue is credited.
- 16.** An expense is debited and a liability is credited.
- 17.** Net income was understated \$270 because prior to adjustment revenues are understated by \$780 and expenses are understated by \$510. The difference in this case is \$270 (\$780 – \$510).
- 18.** The entry is:
- | | | | |
|--------|----------------------------------|-------|-------|
| Jan. 9 | Salaries and Wages Expense | 5,100 | |
| | Salaries and Wages Payable | 1,100 | |
| | Cash | | 6,200 |
- 19.** (a) Accrued revenues. (d) Accrued expenses or prepaid expenses.
 (b) Unearned revenues. (e) Prepaid expenses.
 (c) Accrued expenses. (f) Accrued revenues or unearned revenues.
- 20.** (a) Salaries and Wages Payable. (d) Supplies Expense.
 (b) Accumulated Depreciation. (e) Service Revenue.
 (c) Interest Expense. (f) Service Revenue.
- 21.** Disagree. An adjusting entry affects only one balance sheet account and one income statement account.
- 22.** Tootsie Roll reports Accounts Receivable. This suggests that it records revenue when it has delivered goods, even though it hasn't received payment. If it used a cash basis it wouldn't record revenue until cash was received, and it would therefore not establish receivables.
- 23.** Financial statements can be prepared from an adjusted trial balance because the balances of all accounts have been adjusted to show the effects of all financial events that have occurred during the accounting period.
- 24.** (a) Information presented on an accrual basis is useful because it reveals important information about the relationship between efforts and results. This information is useful in predicting future results. Trends in revenues and expenses are thus more meaningful.
 (b) Information presented on a cash basis is useful for predicting the future availability of cash. Cash basis financial statements provide useful information about a company's sources and uses of cash.
- 25.** The amount shown in the adjusted trial balance column for an account equals the account balance in the ledger after adjusting entries have been journalized and posted.