Accounting Cycle Exercises III

Larry M. Walther; Christopher J. Skousen

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Accounting Cycle Exercises III
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Problem 1

Following are three separate transactions that pertain to prepaid items. Evaluate each item and prepare the journal entries that would be needed for the initial recording and subsequent end-of-20X3 adjusting entry. Assume the company uses the balance sheet approach, and the initial recording is to an asset account. The company has a calendar year-end and does not make any adjusting entries prior to December 31.

1) The company purchased an 18-month insurance policy for $9,000 on June 1, 20X3.
2) The company started 20X3 with $10,000 in supplies (this was previously recorded, and you do not need to make an entry for the beginning balance), purchased $15,000 in supplies during the year, and found only $6,500 in supplies on hand at the end of 20X3.
3) The company paid $1,200 to rent a truck. The rental period began on December 16, 20X3, and ends on February 14, 20X4.

Worksheet 1

GENERAL JOURNAL			
Date	**Accounts**	**Debit**	**Credit**
Jun. 1			
Dec. 30			

GENERAL JOURNAL			
Date	**Accounts**	**Debit**	**Credit**
Various			
Dec. 31			

GENERAL JOURNAL			
Date	**Accounts**	**Debit**	**Credit**
Dec. 16			
Dec. 31			

Solution 1

GENERAL JOURNAL			
Date	**Accounts**	**Debit**	**Credit**
Jun. 1	Prepaid Insurance	9,000	
	Cash		9,000
	Purchased 18-month policy		
Dec, 30	Insurance Expense	3,500	
	Prepaid Insurance		3,500
	To record expiration of 7 months of coverage (7/18 X $9,000)		

GENERAL JOURNAL			
Date	**Accounts**	**Debit**	**Credit**
Various	Supplies	15,000	
	Cash		15,000
	Purchased supplies		
Dec. 31	Supplies Expense	18,500	
	Supplies		18,500
	To record supplies used ($10,000 beginning + $15,000 purchased - $6,500 remaining)		

GENERAL JOURNAL			
Date	**Accounts**	**Debit**	**Credit**
Dec. 16	Prepaid Rent	1,200	
	Cash		1,200
	Rented a truck for 60 days		
Dec. 31	Rent Expense	300	
	Prepaid Rent		300
	To record use of truck for 15 days (15/60 X $1,200)		

Problem 2

Caritas Publishing issues the Weekly Welder. The company's primary sources of revenue are sales of subscriptions to customers and sales of advertising in the Weekly Welder. Caritas owns its building and has excess office space that it leases to others.

The following transactions involved the receipt of advance payments. Prepare the indicated journal entries for each set of transactions.

1) On September 1, 20X7, the company received a $48,000 payment from an advertising client for a 6-month advertising campaign. The campaign was to run from November, 20X7, through the end of April, 20X8. Prepare the journal entry on September 1, and the December 31 end-of-year adjusting entry.
2) The company began 20X7 with $360,000 in unearned revenue relating to sales of subscriptions for future issues. During 20X7, additional subscriptions were sold for $3,490,000. Magazines delivered during 20X7 under outstanding subscriptions totaled $3,060,000. Prepare a summary journal entry to reflect the sales of subscriptions, and the end-of-year adjusting entry to reflect magazines delivered.
3) The company received a $9,000 rental payment on December 16, 20X7, for the period running from mid-December to Mid-January. Prepare the December 16 journal entry, as well as the December 31 end-of-year adjusting entry

Worksheet 2

GENERAL JOURNAL			
Date	**Accounts**	**Debit**	**Credit**
Sep. 1			
Dec. 31			

GENERAL JOURNAL			
Date	**Accounts**	**Debit**	**Credit**
Various			
Dec. 31			

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GENERAL JOURNAL			
Date	Accounts	Debit	Credit
Dec. 16			
Dec. 31			

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Solution 2

GENERAL JOURNAL			
Date	**Accounts**	**Debit**	**Credit**
Sep. 1	Cash	48,000	
	Unearned Advertising Revenue		48,000
	Sold 6-month ad campaign		
Dec. 31	Unearned Advertising Revenue	16,000	
	Advertising Revenue		16,000
	To record delivery of ad services for 2 months (2/6 X $48,000)		

GENERAL JOURNAL			
Date	**Accounts**	**Debit**	**Credit**
Various	Cash	3,490,000	
	Unearned Subscription Revenue		3,490,000
	Sold advance subscriptions		
Dec. 31	Unearned Subscription Revenue	3,060,000	
	Subscription Revenue		3,060,000
	To record subscriptions delivered		

GENERAL JOURNAL			
Date	**Accounts**	**Debit**	**Credit**
Dec. 16	Cash	9,000	
	Unearned Rental Revenue		9,000
	Rented office space to tenant		
Dec. 31	Unearned Rental Revenue	4,500	
	Rental Revenue		4,500
	To record rents earned for last half of December		

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Problem 3

EarCreations Technologies of Manchester recently introduced a blue-tooth enabled hearing aid that allows hearing-disabled users to not only hear better, but also interface with their cell phones and digital music players.

The company reports the following four transactions and events related to December of 20X7, and is seeking your help to prepare the end-of-year adjusting entries needed at December 31.

1) On December 1, the company borrowed £20,000,000 at an 8% per annum interest rate. The loan, and all accrued interest, is due in 3 months.
2) Early in December, the company licensed their new technology to Quick Computer, Inc., for use in Quick's existing product lines. The agreement provides for a royalty payment from Quick to EarCreations based on Quick's sales of products using the licensed technology. As of December 31, £90,000 is due under the agreement for actual sales made by Quick to date.
3) EarCreations pays many employee's on an hourly basis. As of December 31, there are 10,640 unpaid labor hours already worked, at an average hourly rate of £34.
4) The company estimates that utilities used during December, for which bills will be received in January, amount to £40,000.

Worksheet 3

GENERAL JOURNAL			
Date	**Accounts**	**Debit**	**Credit**
Dec. 31			
Dec. 31			
Dec. 31			
Dec. 31			

Solution 3

GENERAL JOURNAL			
Date	**Accounts**	**Debit**	**Credit**
Dec. 31	Interest Expense	133,333	
	Interest Payable		133,333
	Accrued interest for 1 month (£20,000,000 X 8% X 1/12)		
Dec. 31	Accounts Receivable	90,000	
	Royalty Revenue		90,000
	To record accrued revenue for December licensing agreement		
Dec. 31	Wages Expense	361,760	
	Wages Payable		361,760
	To record accrued wages (10,640 X £34 per hour)		
Dec. 31	Utilities Expense	40,000	
	Utilities Payable		40,000
	To record accrued utilities payable		

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Problem 4

Nathan Goldstien's administrative assistant maintains a very simple computerized general ledger system. This system includes intuitive routines for recording receipts, payments, and sales on account. However, the system is not sufficiently robust to automate end-of-period adjustments. Below is the trial balance for the month ending January 31, 20X8. This trial balance has not been adjusted for the various items that are described on the following page. Review the trial balance and narratives, and prepare the necessary adjusting entries.

NATHAN CORPORATION Trial Balance January 31, 20X8		
	Debits	**Credits**
Cash	$ 112,500	$ -
Accounts Receivable	37,230	-
Prepaid Insurance	7,200	-
Supplies	21,339	-
Equipment	105,000	-
Accumulated Depreciation	-	30,000
Accounts Payable	-	22,707
Unearned Revenue	-	25,500
Loan Payable	-	45,000
Capital Stock	-	72,000
Retained Earnings, Jan. 1	-	46,371
Revenues	-	131,985
Salary Expense	36,294	-
Rent Expense	39,000	-
Office Expense	7,500	-
Dividends	7,500	-
	$ 373,563	$ 373,563

Nathan Corporation's equipment had an original life of 140 months, and the straight-line depreciation method is used. As of January 1, the equipment was 40 months old. The equipment will be worthless at the end of its useful life.

As of the end of the month, Asher Corporation has provided services to customers for which the earnings process is complete. Formal billings are normally sent out on the first day of each month for the prior month's work. January's unbilled work is $75,000.

Utilities used during January, for which bills will soon be forthcoming from providers, are estimated at $4,500.

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A review of supplies on hand at the end of the month revealed items costing $10,500.

The $7,200 balance in prepaid insurance was for a 6-month policy running from January 1 to June 30.

The unearned revenue was collected in December of 20X7. 60% of that amount was actually earned in January, with the remainder to be earned in February.

The loan accrues interest at 1% per month. No interest was paid in January.

Worksheet 4

GENERAL JOURNAL			
Date	**Accounts**	**Debit**	**Credit**
Jan. 31			
Jan. 31			
Jan. 31			
Jan. 31			
Jan. 31			
Jan. 31			
Jan. 31			

Solution 4

GENERAL JOURNAL			
Date	**Accounts**	**Debit**	**Credit**
Jan. 31	Depreciation Expense	750	
	Accumulated Depreciation		750
	To record depreciation expense ($105,000 /140 months)		
Jan. 31	Accounts Receivable	75,000	
	Revenues		75,000
	To record accrued revenues		
Jan. 31	Utilities Expense	4,500	
	Utilities Payable		4,500
	To record accrued utilities		
Jan. 31	Supplies Expense	10,839	
	Supplies		10,839
	To record supplies used ($7,113 - $3,500 = $3,613)		
Jan. 31	Insurance Expense	1,200	
	Prepaid Insurance		1,200
	To record expired insurance ($7,200/6 months = $400)		
Jan. 31	Unearned Revenue	15,300	
	Revenues		15,300
	To record revenues earned ($8,500 X 60% = $5,100)		
Jan. 31	Interest Expense	450	
	Interest Payable		450
	To record accrued interest ($45,000 X 1% = $450)		

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Problem 5

Evaluate the following items, and determine the correct amount to report on the income statement for each, using the accrual basis of accounting for the referenced period of time.

Revenues	A Company had beginning accounts receivable of $16,000. The company reported cash basis revenues of $200,000. The ending accounts receivable amounted to $36,000.
Supplies	B Company purchased $50,000 of supplies. Supplies on hand decreased by $10,000 during the period.
Rent	C Company started the year with no prepaid rent, and ended the year with $2,000 in prepaid rent. Rent expense on a cash basis was $26,000.
Equipment	A the beginning of the year, D Company purchased and expensed an item of equipment for $40,000. The equipment has a 4-year life, and will be worthless after four years.
Wages	There were no wages payable at the beginning of the year. E Company paid $290,000 in wages during the year, and owed an additional $24,000 at year's end.

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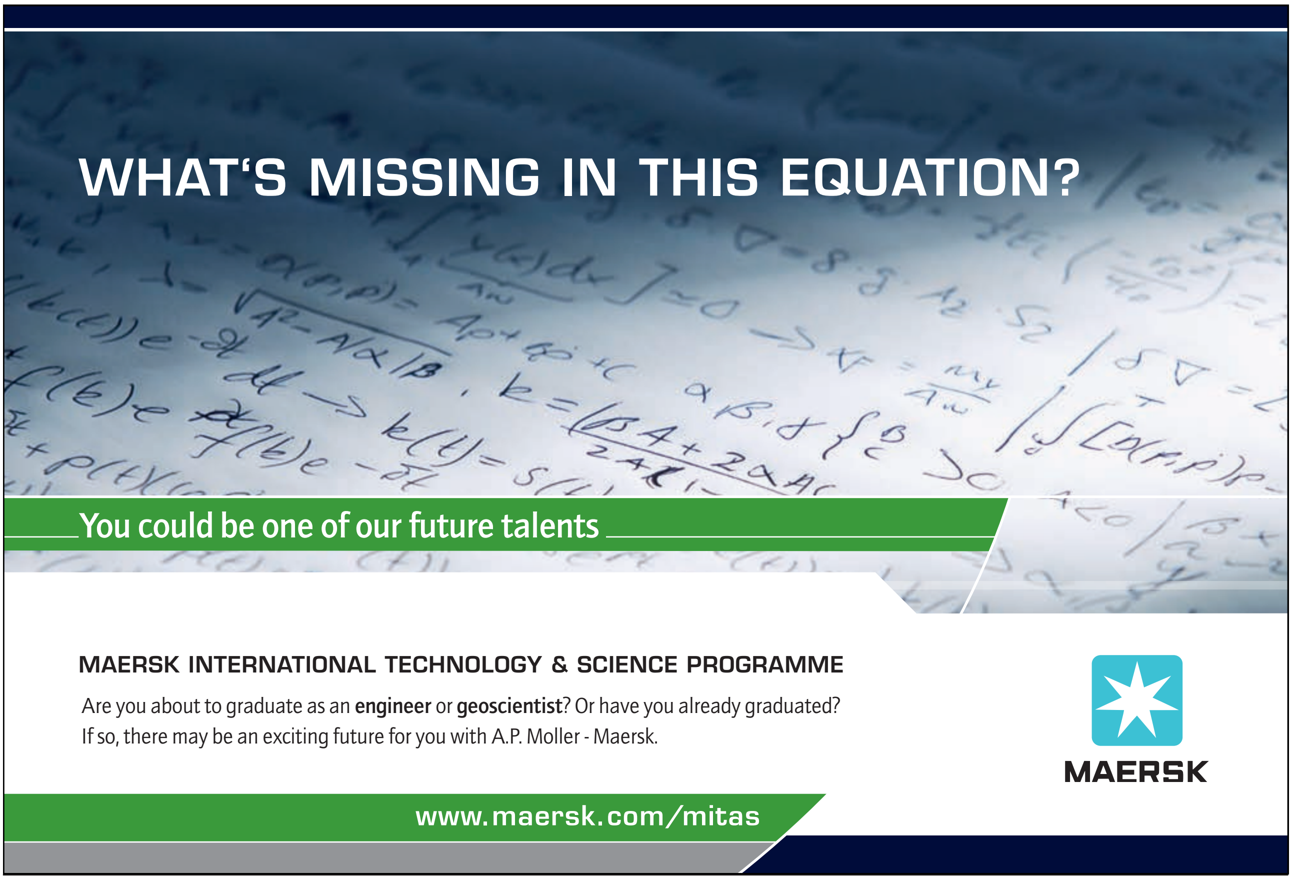

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Worksheet 5

Revenues	
Supplies	
Rent	
Equipment	
Wages	

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Solution 5

Revenues	$220,000. The increase in Accounts Receivable corresponds to services rendered but not yet collected. Therefore, accrual basis revenues exceed cash basis revenues by $20,000.
Supplies	$60,000. The decrease in supplies means that $10,000 more was used than purchased. The accrual basis will measure supplies used as the amount of expense for the period.
Rent	$24,000. The increase in Prepaid Rent signifies that payments exceeded consumption.
Equipment	$10,000. The accrual basis would result in depreciating 25% of the asset cost ($40,000/4 years).
Wages	$314,000. Accrual basis Wage Expense would include the amount owed at the end of the year.

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Problem 6

Toto Motors is an automobile service center offering a full range of repair services for high performance cars. The following information is pertinent to adjusting entries that are needed for Toto, as of March 31, 20X5. Toto has a fiscal year ending on March 31, and only records adjusting entries at year end.

Toto has a large investment in repair equipment, and maintains detailed asset records. These records show that depreciation for fiscal "X5" is $61,700.

As of March 31, 20X5, accrued interest on loans owed by Toto is $10,839.

Auto dealerships outsource work to Toto. This work is done on account, and billed monthly. As of March 31, 20X5, $27,400 of unbilled services have been provided.

Toto maintains a general business liability insurance policy. The prepaid annual premium is $12,000. The policy was purchased on October 1, 20X4. Another policy is a 6-month property and casualty policy, and it was obtained on December 1, 20X4, at a cost of $6,000. Both policies were initially recorded as prepaid insurance.

The company prepared a detailed count of shop supplies at March 31, 20X4. $18,952 was on hand at that date. Management believed this level was greater than necessary and undertook a strategy to reduce these levels over the next year. During the fiscal year 20X5, Toto purchased an additional $62,500 of supplies, and debited the Supplies account. By March 31, 20X5, the effort to reduce inventory was successful, as the count revealed an ending balance of only $6,800.

During the fiscal year, Toto began offering a service contract to retail customers entitling them regular tire rotations, car washing, and other routine maintenance items. Customers prepay for this service agreement, and Toto records the proceeds in the Unearned Revenue account. The service plan is a flat fee of $189, and Toto sold the plan to 678 customers. At March 31, 20X5, it is estimated that 25% of the necessary work has been provided under these agreements.

Toto's primary advertising is on billboards. Big and Wide Outdoor Advertising sold Toto a plan for multiple sign locations around the city. Because Toto agreed to prepay the full price of $13,000, Big and Wide agreed to leave the signs up for 13 months. Toto paid on June 1, 20X4, and recorded the full amount as a prepaid. However, the advertising campaign was not begun until July 1, 20X4. It will conclude on July 31, 20X5.

Toto leases shop space. Monthly rent is due and payable on the first day of each month. Toto paid March's rent on March 1, and expects to pay April's rent on April 1.

Prepare adjusting entries (hint: when necessary) for Toto, as of March 31, 20X5.

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Worksheet 6

GENERAL JOURNAL			
Date	**Accounts**	**Debit**	**Credit**
Mar. 31			
Mar. 31			
Mar. 31			
Mar. 31			
Mar. 31			
Mar. 31			
Mar. 31			

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Solution 6

GENERAL JOURNAL			
Date	**Accounts**	**Debit**	**Credit**
Mar. 31	Depreciation Expense	61,700	
	Accumulated Depreciation		61,700
	To record depreciation expense		
Mar. 31	Interest Expense	10,839	
	Interest Payable		10,839
	To record accrued interest		
Mar. 31	Accounts Receivable	27,400	
	Revenues		27,400
	To record unbilled services		
Mar. 31	Insurance Expense	10,000	
	Prepaid Insurance		10,000
	To record insurance expense ($12,000 X 6/12) + ($6000 X 4/6)		
Mar. 31	Supplies Expense	74,652	
	Supplies		74,652
	To record supplies expense ($18,952 + $62,500 - $6,800)		
Mar. 31	Unearned Revenues	32,461	
	Revenues		32,461
	To record services provided ($189 X 687 X 25%)		
Mar. 31	Advertising Expense	9,750	
	Prepaid Advertising		9,750
	To record advertising expense ($13,000 X 9/13)		

Problem 7

Examine each of the following fact scenarios, then prepare initial and end-of-year adjusting entries (when needed) assuming (a) use of a "balance sheet" approach versus (b) use of an "income statement" approach. You may assume a calendar year end for each scenario. Use T-accounts to show how the same financial statement results occur under either approach. The preprinted worksheet includes an illustrative solution for the first scenario.

Scenario 1	A $4,500, one-year insurance policy was purchased on June 1, 20X1.
Scenario 2	$60,000 of unearned revenue was collected on August 1, 20X1. 40% of this amount was earned by the end of the year.
Scenario 3	On December 1, 20X1, $9,000 was prepaid for space in a trade-show booth. The trade show is in February of 20X2.
Scenario 4	A $3,000 customer deposit for future services was received on April 1, 20X1. On June 20, 20X1, the customer canceled the agreement and received a full refund.

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Worksheet 7

Scenario 1: Balance Sheet Approach

06/01/X1	Prepaid Insurance	4,500	
	Cash		4,500
	To record payment for 1-year policy		

12/31/X1	Insurance Expense	2,625	
	Prepaid Insurance		2,625
	To record insurance “used” ($4,500 X 7/12)		

Prepaid Insurance

06/01/X1	4,500	2,625	12/31/X1
	1,875		

Insurance Expense

12/31/X1	2,625		

Scenario 1: Income Statement Approach

06/01/X1	Insurance Expense	4,500	
	Cash		4,500
	To record payment for 1-year policy		

12/31/X1	Prepaid Insurance	1,875	
	Insurance Expense		1,875
	To record insurance “unused” ($4,500 X 5/12)		

Prepaid Insurance

12/31/X1	1,875		

Insurance Expense

06/01/X1	4,500	1,875	12/31/X1
	2,625		

Scenario 2: Balance Sheet Approach

08/01/X1			

12/31/X1			

Unearned Revenue	Revenue

Scenario 2: Income Statement Approach

08/01/X1			

12/31/X1			

Unearned Revenue	Revenue

Scenario 3: Balance Sheet Approach

12/01/X1			

12/31/X1			

Prepaid Rent	

Rent Expense	

Scenario 3: Income Statement Approach

12/01/X1			

12/31/X1			

Prepaid Rent	

Rent Expense	

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Scenario 4: Balance Sheet Approach

04/01/X1			

06/20/X1			

Unearned Revenue

Revenue

Scenario 4: Income Statement Approach

04/01/X1			

06/20/X1			

Unearned Revenue

Revenue

Solution 7

Scenario 1: Balance Sheet Approach

06/01/X1	Prepaid Insurance	4,500	
	Cash		4,500
	To record payment for 1-year policy		

12/31/X1	Insurance Expense	2,625	
	Prepaid Insurance		2,625
	To record insurance "used" ($4,500 X 7/12)		

Prepaid Insurance

06/01/X1	4,500	2,625	12/31/X1
	1,875		

Insurance Expense

12/31/X1	2,625		

Scenario 1: Income Statement Approach

06/01/X1	Insurance Expense	4,500	
	Cash		4,500
	To record payment for 1-year policy		

12/31/X1	Prepaid Insurance	1,875	
	Insurance Expense		1,875
	To record insurance "unused" ($4,500 X 5/12)		

Prepaid Insurance

12/31/X1	1,875		

Insurance Expense

06/01/X1	4,500	1,875	12/31/X1
	2,625		

Scenario 2: Balance Sheet Approach

08/01/X1	Cash	60,000	
	Unearned Revenue		60,000
	To record receipt of payment for future service		

12/31/X1	Unearned Revenue	24,000	
	Revenue		24,000
	To record revenue earned ($60,000 X 40%)		

Unearned Revenue			
12/31/X1	24,000	60,000	08/01/X1
		36,000	

Revenue			
		24,000	12/31/X1

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Scenario 2: Income Statement Approach

08/01/X1	Cash	60,000	
	Revenue		60,000
	To record receipt of payment for future service		

12/31/X1	Revenue	36,000	
	Unearned Revenue		36,000
	To record revenue not earned ($60,000 X 60%)		

Unearned Revenue

		36,000	12/31/X1

Revenue

12/31/X1	36,000	60,000	08/01/X1
		24,000	

Scenario 3: Balance Sheet Approach

12/01/X1	Prepaid Rent	9,000	
	Cash		9,000
	To record payment for future booth space		

12/31/X1	No Entry		

Prepaid Rent

12/01/X1	9,000		
	9,000		

Rent Expense

	0		

Scenario 3: Income Statement Approach

12/01/X1	Rent Expense	9,000	
	Cash		9,000
	To record payment for future booth space		

12/31/X1	Prepaid Rent	9,000	
	Rent Expense		9,000
	To record future booth space		

Prepaid Rent

12/31/X1	9,000		

Rent Expense

12/01/X1	9,000	9,000	12/31/X1
	0		

Scenario 4: Balance Sheet Approach

04/01/X1	Cash	3,000	
	Unearned Revenue		3,000
	To record receipt of payment for future service		

06/20/X1	Unearned Revenue	3,000	
	Cash		3,000
	To record fund		

Unearned Revenue

06/20/X1	3,000	3,000	04/01/X1
		0	

Revenue

		0	

Scenario 4: Income Statement Approach

04/01/X1	Cash	3,000	
	Revenue		3,000
	To record receipt of payment for future service		

06/20/X1	Revenue	3,000	
	Cash		3,000
	To record fund		

Unearned Revenue			
		0	

Revenue			
06/20/X1	3,000	3,000	04/01/X1
		0	

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Problem 8

Jonathan Wilde is a CPA. He has numerous clients, one of which is Wonderful Weekend Events (WWE). WWE is a full service weekend event consulting firm, and is interested in buying Weekend Wonders Photography Studio (WWPS). WWPS uses the cash basis of accounting. Jonathan has been retained to help WWE acquire WWPS, and you are a staff accountant working for Jonathan. Begin by evaluating the following facts for June.

Revenues	WWPS provides a complete wedding-day package for $3,950. The package requires a $2,000 down payment at the time the contract is signed, a $1,000 payment on the date of the event, and a final $950 payment 30 days after the wedding. The company uses a mobile digital processing lab, and is able to deliver a complete wedding portfolio at the close of the reception on the wedding day itself!
	75 weddings were photographed during June. All of these events were booked in earlier months. During June, an additional 92 weddings were booked for future months. Final payments were received during June for 47 weddings performed in May. None of the June weddings resulted in receipt of the final payment before July 1, but full payment is expected.
Expenses	During June $124,000 was actually paid for wages. Accrued wages at the beginning of the month totaled $24,000. At the end of the month, $46,000 was owed to employees.
	At the close of June, the WWPS bought new photography equipment for $26,000. Coming into June, WWPS owned equipment with a total cost of $900,000. This equipment has an average life of 50 months.
	Supplies on hand at the beginning of the month totaled $225,300. $152,000 was expended for supplies during the month. At the end of the month, supplies on hand were $282,400.

a) Prepare a cash basis income statement for June. Preliminarily, WWE is willing to pay a price equal to 75 X June's monthly income.
b) On further review of the facts relating to WWPS, Roger suggested that a fair offer should be based on accrual basis income. Calculate accrual basis income.
c) What is the proposed purchase price? What is the value of utlizing a CPA to assist in the business decision process.

Worksheet 8

a)

WWPS Cash Basis Income Statement For the Month Ending June 30, 20XX		
Revenues		
Services to customers		$ -
Expenses		
Wages	$ -	
Equipment	-	
Supplies	-	-
Cash basis income		$ -

Cash basis revenues: ____

b)

WWPS Income Statement For the Month Ending June 30, 20XX		
Revenues		
Services to customers		$ -
Expenses		
Wages	$ -	
Depreciation	-	
Supplies	-	-
Net income		$ -

Accrual basis revenues: ____

Expenses: ____

c)

Solution 8

a)

WWPS Cash Basis Income Statement For the Month Ending June 30, 20XX		
Revenues		
Services to customers		$ 303,650
Expenses		
Wages	$ 124,000	
Equipment	26,000	
Supplies	152,000	302,000
Cash basis income		$ 1,650

Cash basis revenues:	
92 weddings booked @ $2,000 payment	$ 184,000
75 weddings photographed @ $1,000 payment	75,000
47 weddings final payment @ $950 payment	44,650
	$ 303,650

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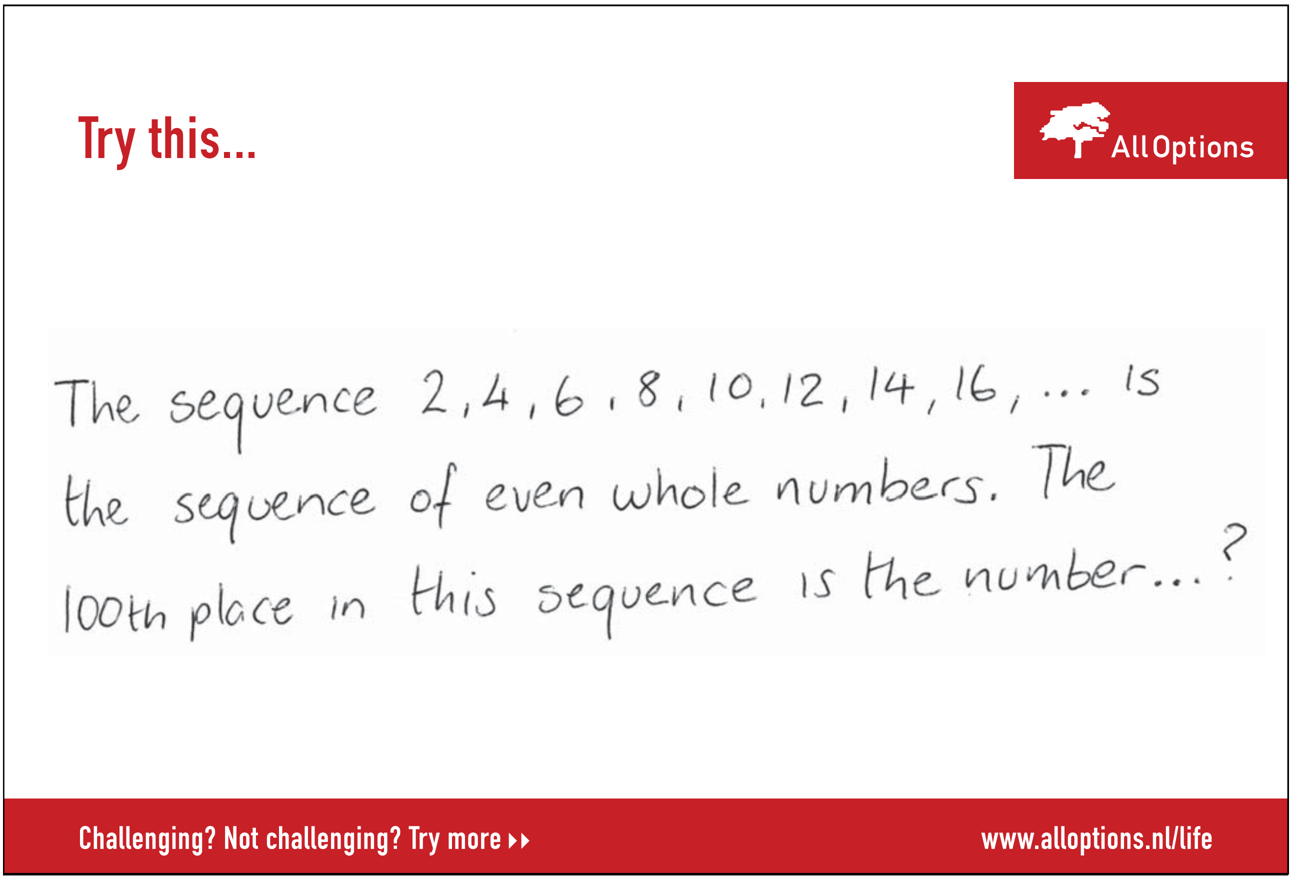

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b)

WWPS Income Statement For the Month Ending June 30, 20XX		
Revenues		
Services to customers		$ 296,250
Expenses		
Wages	$ 146,000	
Depreciation	18,000	
Supplies	124,900	288,900
Net income		$ 7,350

Accrual basis revenues:	
75 weddings photographed @ $3,950	$ 296,250

Expenses:	
Wages paid	$ 124,000
Less: Beginning accrued wages	(24,000)
Plus: Ending accrued wages	46,000
Accrual basis wages	$ 146,000
Depreciation ($900,000/50 months)	$ 18,000
Supplies purchased	$ 152,000
Plus: Beginning supplies	225,300
Less: Ending supplies	(252,400)
Accrual basis supplies:	$ 124,900

c) The proposed purchase price is $551,250 ($7,350 X 75). This is a far cry from the price that would result based on the cash basis income ($123,750 = $1,650 X 75). CPAs are well trained in financial decision making, and can offer valuable services to structure "smart" and "fair" business deals.

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