

**SOLUTIONS****Learning Goal 2****Multiple Choice**

1. d Business income (or loss) is more properly measured using accrual basis accounting because accrual basis accounting recognizes (records) noncash revenues as well as cash revenues, and noncash expenses as well as cash expenses.
2. c    3. d    4. b    5. d    6. b    7. c    8. a
9. a Expenses must be matched with revenues. Also, concerning (d) remember that a cash basis balance sheet will never show receivables or payables, because revenues and expenses cannot be accrued—they must always be received or paid in cash.

**Reinforcement Problems**

**LG 2-1.** The periodicity (time-period) assumption is the assumption that the life of a business can be divided into regular, fixed time intervals. The revenue recognition principle tells accountants how to determine the amount of revenue that should be recorded in any particular time period. The matching principle tells accountants how to determine the amount of expense that should be recorded in any particular time period.

**LG 2-2.**

- a. When cash basis is used, accounts receivable and accounts payable do not appear on the balance sheet. An account receivable results from noncash revenue. Noncash revenue transactions are not recorded on a cash basis. Accounts payable result from noncash expenses or purchases not paid for. Because there are no cash payments, these transactions would not be recorded.
- b. Unlike cash basis, accrual basis accounting records all revenues (cash and noncash), so it is not necessary for cash to be received in order to record revenue. However, all receipts of cash are not revenue. *Examples:* Loans and owner investments are not revenue.
- c. Unlike cash basis, accrual basis accounting records all expenses (cash and noncash), so it is not necessary for cash to be paid in order to record an expense. However, all payments of cash are not expenses. *Examples:* Buying assets for cash and paying back loans.
- d. The manager is incorrect because it is not yet earned. The order is not yet finished and delivered to the customer, so no revenue can be recorded. Intentionally recording the revenue on December 31 would be a violation of the revenue recognition principle, would overstate the year's revenue, and would be a fraudulent transaction.

**LG 2-3.**

Situation	Which principle?	Period to record: Revenue / Expense
a. Cape Fear Company performed \$500 of repair services in January and was paid in March.	revenue recognition	\$500 January revenue
b. Wilkes Delivery Company used \$250 of automotive supplies in August.	matching	\$250 August expense. This expense cannot be traced to any particular revenue.

## SOLUTIONS

## Learning Goal 2, continued

## LG 2-3, continued

Situation	Which principle?	Period to record: Revenue / Expense
c. Guilford, Inc. paid \$500 each for two airline tickets in June. One ticket was used in July.	matching	\$500 in July—a ticket was used in July and is not traced to any particular revenue.
d. In 2017, Orangeburg Enterprises received payment of \$2,750 on account from customers who purchased merchandise in 2016.	revenue recognition	\$2,750 of revenue in 2007 because that is when it was sold. Collection from the customer in 2008 is not revenue.
e. In February, Trident Consulting Services used up \$200 of office supplies specifically for a report for a client. The report was finished and delivered to the client in March, who paid in April.	matching	\$200 expense in March. This expense can be traced to a particular revenue in March when the report was delivered.
f. On December 30, 2016, a frequent and reliable customer of Greenville Company calls and says it will purchase \$50,000 of merchandise in the first week of January 2017.	revenue recognition	No revenue is recognized yet. This is because there has only been a promise—and no sale has been made.
g. Midlands Corporation pays a \$1,000 account payable on July 3 for June utility services.	matching	\$1,000 of utility expense in June. This expense cannot be identified with any particular revenue.
h. York Company receives a \$1,500 advance payment from a client in April for accounting services, which are provided in May.	revenue recognition	\$1,500 of revenue is recognized in May, when the services are provided.
i. In June, Williamsburg Company prepays rent for July, August, and September in the amount of \$9,000.	matching	\$3,000 per month for July, August, and September—the periods that benefited.

## LG 2-4.

Revenues	November	December	January
Daisy Industries job		\$3,500	
Satisfied Cat Company job			\$2,000
Rocky Mountain Learning Company	\$500	500	500
<b>Expenses</b>			
Computer services—Satisfied Cat Company job			700
Office rent	900	900	900
Office supplies		450	
Telephone	100	180	
<b>Net Income (Loss)</b>	<u>\$ (500)</u>	<u>\$2,470</u>	<u>\$900</u>

**SOLUTIONS****Learning Goal 2, continued****LG 2-4, continued***Revenue notes:*

- The Ecology Industries job is *not finished*, so *no revenue* can be recognized, even though a cash advance was received.
- The Daisy Industries job was finished and delivered in December. That is when revenue is earned.
- The Satisfied Cat Company job was finished and delivered in January. That is when revenue is earned.
- The teaching contract is different because it is not a single job to be delivered. Revenue on the teaching contract is earned each month as services are performed.

*Expense notes:*

- The computer services are directly traceable to jobs, so this expense has to be recognized in the same periods the revenue is recognized from each job. Because no revenue has been recognized from the Ecology Industries job, none of the directly traceable expenses to that job are recognized.
- The office rent is not identifiable with any particular job, so the \$900 is assigned to the period that receives the benefit.
- Office supplies expense: \$350 is not yet recognized because it belongs with the Ecology Industries job. \$200 is recognized in December with the Daisy Industries job. Because no supplies are left, that leaves \$250 not accounted for ( $\$800 - \$550$ ). The remaining \$250 is not traceable to any particular job, so the \$250 is assigned to the period in which it was consumed and provided benefits—December.
- A telephone bill is not traceable to any particular revenue, so the telephone expense is assigned to the period in which benefits were received.

**LG 2-5.**

<b>Revenues</b>	<b>November</b>	<b>December</b>	<b>January</b>
Ecology Industries		\$5,000	
Satisfied Cat Company job		500	\$1,500
Rocky Mountain Learning Company	\$ 500	500	500
<b>Expenses</b>			
Computer services		1,900	
Office rent	900	900	900
Supplies purchase			800
Telephone expense		100	180
<b>Net Income (Loss)</b>	<b><u>\$(400)</u></b>	<b><u>\$3,100</u></b>	<b><u>\$ 120</u></b>

The cash basis method gives very different results, doesn't it? This is because it ignores when the revenues were actually earned and when the expenses should be matched against revenues.

**SOLUTIONS**

**Learning Goal 2, continued**

**LG 2-6.**

Method	Date	(A) Before Revenue Is Recorded	(B) Revenue Is Recorded	(C) After Revenue Is Recorded
a.	Cash Basis		Cash 900 Service Revenue 900	
	Accrual Basis			Cash 900 Accounts Receivable 900
b.	Cash Basis	Cash 5,000 Common Stock 5,000	<i>Note:</i> Investing in a business is never revenue under either a cash basis or an accrual basis method.	
	Accrual Basis	Cash 5,000 Common Stock 5,000		
c.	Cash Basis		Cash 750 Service Revenue 750	
	Accrual Basis		Cash 750 Service Revenue 750	
d.	Cash Basis	Cash 10,000 Notes Payable 10,000	<i>Note:</i> Borrowing money is not revenue for cash basis and is not revenue for accrual basis.	
	Accrual Basis	Cash 10,000 Notes Payable 10,000		
e.	Cash Basis	— No transaction on a cash basis because cash is not received.		
	Accrual Basis		Accounts Receivable 500 Service Revenue 500	
f.	Cash Basis		Cash 1,000 Service Revenue 1,000	
	Accrual Basis	Cash 1,000 Unearned Revenue 1,000		

Notice that on a cash basis, cash receipts are always recorded as revenue whenever the cash is received (except for investments and loans); however, on an accrual basis, the receipt of cash does not necessarily correspond to when revenue is recorded.

## SOLUTIONS

## Learning Goal 2, continued

## LG 2-7.

	Method	Date	(A) Before Expense Is Recorded	(B) Expense Is Recorded	(C) After Expense Is Recorded
a.	Cash Basis	9/5		Telephone Expense 450 Cash 450	
	Accrual Basis	9/5			Accounts Payable 450 Cash 450
b.	Cash Basis	1/30	Dividends 4,000 Cash 4,000	<i>Note:</i> Withdrawing an asset from a business is never an expense on either the cash or the accrual basis.	
	Accrual Basis	1/30	Dividends 4,000 Cash 4,000		
c.	Cash Basis	2/11		Repairs Expense 825 Cash 825	
	Accrual Basis	2/11		Repairs Expense 825 Cash 825	
d.	Cash Basis	4/9	Notes Payable 15,000 Cash 15,000	Repayment of money is not normally an expense for cash basis and is never an expense for accrual basis.	
	Accrual Basis	4/9	Notes Payable 15,000 Cash 15,000		
e.	Cash Basis	—	No transaction on a cash basis because cash is not paid.		
	Accrual Basis	9/20		Advertising Expense 300 Accounts Payable 300	
f.	Cash Basis	6/28		Insurance Expense 1,200 Cash 1,200	
	Accrual Basis	6/28	Prepaid Insurance 1,200 Cash 1,200		
g.	Cash Basis	5/2		Supplies Expense 800 Cash 800	
	Accrual Basis			No expense is incurred until some supplies are used up.	
h.	Cash Basis		No transaction on a cash basis because cash is not paid.		
	Accrual Basis	5/31		Supplies Expense 300 Supplies 300	

Notice that on a cash basis, cash payments are always recorded as expense whenever the cash is paid (except for dividends and loan repayment); however, on an accrual basis, the payment of cash does not necessarily correspond to when expense is recorded.