

Study Notes
Financial Accounting: An Introduction to
Concepts, Methods, and Uses, 14e
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1 Example 4

Accrual basis of accounting. Under the accrual basis of accounting, *Adam-Art Supply* recognizes, for January 2013, the entire €140,000.00 of sales during January as revenue, even though it has received only €114,000.00 in cash by the end of January. The firm reasonably expects to collect the remaining accounts receivable of €26,000.00 in February or soon thereafter. The sale of the goods, rather than the collection of cash from customers, triggers the recognition of revenue. The merchandise sold during January cost €42,000.00. Recognizing this amount as an expense (cost of goods sold) matches the cost of the merchandise sold with revenue from sales of those goods. Of the advance rental payment of €14,000.00, only €7,000.00 applies to the cost of benefits consumed during January. The remaining rental of €7,000.00 purchases benefits for the month of February and will therefore appear on the January 31 balance sheet as an asset. Unlike the cost of merchandise sold, January's salaries and rent expenses do not match January revenues. These costs become expenses of January to the extent that the firm consumed salary and rent services during the month. Using the accrual basis of accounting, Adam-Art would report January net income of €66,000.00:

Sales Revenue	€ 140,000.00
Cost of Goods Sold	(42,000.00)
Rent Expense	(7,000.00)
Salaries Expense	(25,000.00)
Net Income	€ 66,000.00

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