CHAPTER 4

DISCUSSION QUESTIONS

1. Accountants prepare financial reports on a periodic basis in order to furnish decision makers with timely information. Investors, creditors, management, and others cannot wait until the results of operations are known at the termination of business. They must have periodic and timely information, even if the information must be based on estimates and the results are somewhat tentative.

2. A 12-month accounting period is known as a company's fiscal year. Only when a company closes its books on December 31 is it said to be reporting on a calendar-year basis.

3. According to IAS18, for a sale of goods to be recognized as revenue, the amount of revenue and the costs incurred or to be incurred should be reliably measurable, and it is probable that the economic benefits (in most cases, cash) from the sale will flow to the seller. In addition, the seller shout ld not continue managerial involvement in or maintain control over the goods. Finally, the rewards and significant risks associated with owning the goods should be transferred to the buyer.

4. The matching principle states that all costs and expenses incurred during a period to generate recognized revenues should be associated with those revenues in determining income (or loss) for the period.

5. Accrual-basis accounting recognizes revenues and expenses as they are earned and incurred, which is not necessarily in the same period as when cash is received or paid. For most businesses, this provides a more realistic measurement of income or loss. Accrual-basis accounting also provides a more correct financial picture of an entity's resources and obligations.

6. Accrual-based financial statements are considered somewhat tentative because the accounting measurements include amounts based on estimates and judgments. The exact results of business activity can be known only when activity has ceased and all resource flows can be accurately quantified.

7. Adjusting entries are needed for two reasons: (a) to recognize the proper amounts of revenues earned and expenses incurred during a period of time and (b) to report the appropriate balances in the asset, liability, and equity accounts at a particular date.

8. An accountant generally is not able to depend on source documents as the basis for adjusting entries. Instead, accountants must analyze the accounts at the end of the accounting period, prior to preparing the financial statements, to see which accounts need to be recorded (for unrecorded receivables and liabilities) and which accounts need to be adjusted and brought current (for prepaid expenses and unearned revenues). The amount of the adjusting entry depends on the original entry, if any, that has been made and what the updated balance in the account should be. The adjusting entries bring the accounts to their updated balances at the end of the period so proper results are reported in the financial statements.

9. The two basic steps involved in preparing adjusting entries are: (1) fix the balance sheet by making sure all assets, liability, and equity amounts are recorded correctly and (2) fix the statement of comprehensive income by making sure all revenues and expenses for the period are properly recorded.

   Both steps are necessary for the correct amounts to be reported on the balance sheet (the financial position of the entity at the end of the period) and the statement of comprehensive income (the results of operations for the period).

10. The cash account is not increased or decreased as a result of adjusting entries because, as cash is received or paid, the original entries correctly reflect increases or decreases in that account. Cash is adjusted at the end of a period only when there has been an error in recording past cash transactions.

    The primary purpose of adjusting entries, however, is not to correct errors. The main objective is to record previously unrecorded items and to adjust the balances in accounts, so the appropriate amounts of revenues and

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expenses are recognized on the statement of comprehensive income and the updated balances are reported on the balance sheet.

11. Financial statements are usually prepared after the accounts are brought current through the adjusting process. Any omission or error discovered during financial statement preparation can then be corrected, often with another adjusting entry.

12. Nominal, or temporary, accounts are reduced to a zero balance through the closing process at the end of each accounting period. Since these accounts begin each period with a zero balance, they show the results of operations for the current accounting period only. With the exception of Dividends, nominal accounts appear on the statement of comprehensive income.

    Real, or permanent, accounts appear on the balance sheet and are not closed to a zero balance at the end of an accounting period. The balances in real accounts are carried forward to the next accounting period.

13. Closing entries provide an orderly process of transferring the balances of all temporary accounts (revenues, expenses, and dividends) to equity. With zero balances, these nominal accounts are then ready for the next accounting cycle of the business.

14. The post-closing trial balance lists the balances of all real accounts after the closing process has been completed. It provides a means of testing whether total debits equal total credits for all real accounts prior to beginning a new accounting cycle.

    The information for the post-closing trial balance comes from the account balances of the general ledger, but only after the closing entries have been recorded and posted to the general ledger.

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PRACTICE EXERCISES

PE4–1 (LO1) Periodic Reporting

The correct answer is D.

a. False. There is no requirement to do so.
b. False. More frequent reporting *increases* the need for accountants to make estimates and judgments.
c. False. Most businesses, large and small, prepare periodic financial reports.
d. True. Management is free to arrange for the preparation of any useful periodic financial reports. For example, sales reports might be prepared on a daily, or even an hourly, basis.
e. False. The SEC requires all publicly traded companies in the United States to file *quarterly* financial statements.

PE 4–2 (LO1) Periodic Reporting

d

PE 4–3 (LO1) Matching Principle

c

PE 4–4 (LO1) Cash-Basis Accounting

	For 2017
Cash receipts	$92,000
Cash disbursements	73,000
Cash-basis income	$19,000

PE 4–5 (LO1) Accrual-Basis Accounting

	For 2017
Revenues earned	$135,000
Expenses incurred ($73,000 + $41,000)	114,000
Accrual-basis income (loss)	$ 21,000

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PE 4–6 (LO2) Unrecorded Receivable: Original Entry

Dec. 10	Cash	12,300	
	Delivery Revenue		12,300

PE 4–7 (LO2) Unrecorded Receivable: Adjusting Entry

1. Dec. 31	Accounts Receivable	13,700	
	Delivery Revenue		13,700
2. Jan. 10	Cash	13,700	
	Accounts Receivable		13,700

Note that no revenue is recognized on January 10. Because the revenue was earned in December, it was recognized through the adjusting entry made on December 31.

PE 4–8 (LO2) Unrecorded Liability: Original Entry

May 1	Cash	50,000	
	Loan Payable		50,000

PE 4–9 (LO2) Unrecorded Liability: Adjusting Entry

1. Dec. 31	Interest Expense	4,000	
	Interest Payable		4,000

$50,000 × 0.12 × 8/12 = $4,000; 8 months elapse from May 1 through December 31.

2. Apr. 30	Interest Expense	2,000	
	Interest Payable	4,000	
	Cash		6,000

$50,000 × 0.12 × 12/12 = $6,000; 12 months of interest from May 1 through the following April 30.
$50,000 × 0.12× 4/12 = $2,000; 4 months elapse from January 1 through April 30.

PE 4–10 (LO2) Prepaid Expense: Original Entry

Aug. 1	Prepaid Insurance	86,400	
	Cash		86,400

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PE 4–11 (LO2) Prepaid Expense: Adjusting Entry

1. Dec.	31	Insurance Expense	9,000	
		Prepaid Insurance		9,000

$86,400 ÷ 48 months = $1,800 per month.
$1,800 × 5 months = $9,000 insurance used up;
5 months from August 1 through December 31.

2.

PREPAID INSURANCE

Debit (+)		Credit (–)		
Beg. bal.	0			
Aug. 1	86,400			
		Dec. 31	Adj.	9,000
End. bal.	77,400			

The $77,400 ending balance represents another 43 months of insurance coverage (43 × $1,800 = $77,400).

PE 4–12 (LO2) Unearned Revenue: Original Entry

Apr.	1	Cash	270,000	
		Unearned Security Revenue		270,000

PE 4–13 (LO2) Unearned Revenue: Adjusting Entry

1. Dec.	31	Unearned Security Revenue	67,500	
		Security Revenue		67,500

$270,000 ÷ 36 months = $7,500 per month.
$7,500 × 9 months = $67,500 security revenue earned;
9 months from April 1 through December 31.

2.

UNEARNED SECURITY REVENUE

Debit (–)			Credit (+)	
			Beg. bal.	0
			Mar. 1	270,000
Dec. 31	Adj.	67,500		
			End. bal.	202,500

The $202,500 ending balance represents another 27 months of revenue not yet earned (27 × $7,500 = $202,500).

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PE 4–14 (LO2) Wages Payable: Adjusting Entry and Subsequent Payment

1.	Dec.	31	Wages Expense	5,400	
			Wages Payable		5,400

$13,500 ÷ 5 days = $2,700 per day.
$2,700 × 2 days = $5,400 wages owed to employees;
2 days from Monday through Tuesday.

2.	Jan.	3	Wages Expense	8,100	
			Wages Payable	5,400	
			Cash		13,500

$2,700 × 3 days = $8,100 wages earned by employees;
3 days from Wednesday through Friday.

PE 4–15 (LO2) Supplies: Original Purchase and Adjusting Entry

1.	Mar.	23	Office Supplies	9,000	
			Cash		9,000
2.	Dec.	31	Office Supplies Expense	12,500	
			Office Supplies		12,500

OFFICE SUPPLIES

Debit (+)		Credit (–)		
Beg. bal.	6,400			
Mar. 23	9,000			
		Dec. 31	Adj.	12,500
End. bal.	2,900			

$6,400 beginning + $9,000 purchased = $15,400 supplies available.
$15,400 supplies available – $2,900 remaining = $12,500 supplies used.

PE 4–16 (LO3) Preparing an Adjusted Trial Balance

1. a.	Dec.	31	Interest Receivable	9,240	
			Interest Revenue		9,240

$144,000 × 0.11 × 7/12 = $9,240; 7 months elapse from June 1 through December 31.

b.	Dec.	31	Unearned Fee Revenue	68,750	
			Fee Revenue		68,750

$225,000 ÷ 36 months = $6,250 per month.
$6,250 × 11 months = $68,750 fee revenue earned;

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11 months from February 1 through December 31.

c. Dec. 31	Rent Expense	9,600	
	Prepaid Rent		9,600

$192,000 ÷ 60 months = $3,200 per month.
$3,200 × 3 months = $9,600 prepaid rent used up;
3 months from October 1 through December 31.

d. Dec. 31	Wages Expense	17,000	
	Wages Payable		17,000

2.

	Debits	Credits
Cash	$ 87,000	
Notes Receivable	144,000	
Interest Receivable	9,240	
Prepaid Rent ($192,000 – $9,600)	182,400	
Building	210,000	
Accounts Payable		$165,000
Wages Payable		17,000
Unearned Fee Revenue ($225,000 – $68,750)		156,250
Capital Stock		200,000
Retained Earnings		90,000
Dividends	22,000	
Fee Revenue ($257,000 + $68,750)		325,750
Interest Revenue		9,240
Wages Expense ($229,000 + $17,000)	246,000	
Utilities Expense	53,000	
Rent Expense	9,600	
Totals	$963,240	$963,240

PE 4–17 (LO3) Using an Adjusted Trial Balance to Prepare a Statement of comprehensive income

Fee revenue		$325,750
Interest revenue		9,240
Total revenue		$334,990
Expenses:		
Wages expense	$246,000	
Utilities expense	53,000	
Rent expense	9,600	308,600
Net income		$ 26,390
Other comprehensive income		0
Comprehensive income		$ 26,390

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PE 4–18 (LO3) Using an Adjusted Trial Balance to Prepare a Balance Sheet

Assets	
Cash	$ 87,000
Notes receivable	144,000
Interest receivable	9,240
Prepaid rent	182,400
Building	210,000
Total assets	$632,640
Liabilities and Equity	
Accounts payable	$165,000
Wages payable	17,000
Unearned fee revenue	156,250
Capital stock	200,000
Retained earnings	94,390*
Total liabilities and equity	$632,640

*Beginning retained earnings $90,000 + Net income $26,390 (see PE 4–17) – Dividends $22,000.

PE 4–19 (LO4) Closing Entries: Revenues

Services Revenue	6,000	
Interest Revenue	100	
Retained Earnings		6,100

PE 4–20 (LO4) Closing Entries: Expenses

Retained Earnings	3,800	
Insurance Expense		1,300
Advertising Expense		2,500

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PE 4–21 (LO4) Closing Entries: Everything

1.

Sales Revenue	9,990	
Rent Revenue	925	
Retained Earnings		10,915
Retained Earnings	8,300	
Wages Expense		5,100
Utility Expense		3,200
Retained Earnings	1,200	
Dividends		1,200

2.

RETAINED EARNINGS

Debit (–)		Credit (+)	
		Beg. bal.	1,500
		Revenues	10,915
Expenses	8,300		
Dividends	1,200		
		End. bal.	2,915

PE 4–22 (LO4) Post-Closing Trial Balance

	Debits	Credits
Cash	$ 87,000	
Notes Receivable	144,000	
Prepaid Rent	192,000	
Building	210,000	
Accounts Payable		$165,000
Unearned Fee Revenue		225,000
Capital Stock		200,000
Retained Earnings		43,000*
Totals	$633,000	$633,000

*Ending retained earnings = $90,000 (beginning) + $257,000 (revenues) – $282,000 (expenses) – $22,000 (dividends) = $43,000.

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EXERCISES

E 4–1 (LO1) Reporting Income: Cash versus Accrual Accounting

1. a. Cash-basis:

Collections from customers	$150,560
Interest received	3,500
Wages paid to employees	(78,000)
Rent paid for 1.5 years	(36,000)
Net income	$ 40,060

b. Accrual-basis:

Sales to customers	$ 329,000
Interest earned	3,500
Wages earned and paid to employees	(78,000)
Wages earned and owed to employees at year-end	(3,500)
Utility bill owed	(1,750)
Interest due at 12/31	(2,400)
Amount paid for rent for 1 year	(24,000)
Income taxes owed at year-end	(7,000)
Net income	$ 215,850

2. Accrual-basis accounting provides Ryan with the better measure of his company's operating results. It matches earned revenues with the expenses incurred to generate those revenues during the reporting period. Because it is a better measure of net income, accrual-basis accounting is required by generally accepted accounting principles (GAAP).

E 4–2 (LO1) Reporting Income: Cash versus Accrual Accounting

1. a. Cash-basis:

Cash receipts:		
From customers	$185,000	
From interest	1,100	$186,100
Cash disbursements:		
For rent	$ 18,000	
For wages	71,000	89,000
Net income for the year		$ 97,100

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E 4–2 (LO1) (Continued)

b. Accrual-basis:

Revenues:		
Services	$265,000	
Interest	1,100	$266,100
Expenses:		
Rent	12,000	
Utilities	1,350	
Wages ($71,000 + $3,500)	74,500	
Interest	950	88,800
Net income for the year		$177,300

2. Accrual-basis accounting provides a better measure of operating results. It reflects the sales that have been earned, not just the cash collected, and it reports the expenses incurred, not just the cash paid. Note that cash flows are important for assessing liquidity. Daniel would have to be careful not to spend more money than he is bringing in, especially as a new business. However, as a measure of ongoing profitability, the accrual-basis net income amount ($177,300 in this case) is the better measure of operating results.

E 4-3 (LO1, 2) Identifying Accounting Concepts

1. (b) 2.(c) 3. (f) 4. (a),(d),(e)

E 4–4 (LO2) Adjusting Entries: Prepaid Expenses and Unearned Revenues

1. *Original entry*

Prepaid Insurance	5,400	
Cash		5,400

Adjusting entry

Insurance Expense	900	
Prepaid Insurance		900

($5,400/3 years = $1,800 per year; $1,800 year × 1/2 year = $900)

E 4–4 (LO2) (Continued)

2. *Original entry*

Prepaid Property Taxes	2,400	
Cash		2,400

Adjusting entry

Property Tax Expense	2,200	
Prepaid Property Taxes		2,200

($2,400/12 months = $200 per month; $200 × 11 months = $2,200)

3. *Original entry*

Prepaid Subscriptions	360	
Cash		360

Adjusting entry

Subscription Expense	80	
Prepaid Subscriptions		80

($360/36 months = $10 per month; $10 × 8 months = $80)

4. *Original entry*

Cash	3,600	
Unearned Consulting Fees Revenue		3,600

Adjusting entry

Unearned Consulting Fees Revenue	700	
Consulting Fees Revenue		700

($3,600/18 months = $200 per month; $200 per month × 3.5 months = $700)

5. *Original entry*

Cash	900	
Unearned Rent Revenue		900

Adjusting entry

Unearned Rent Revenue	300	
Rent Revenue		300

($900/6 months = $150 per month; $150 × 2 months = $300)

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E 4–4 (LO2) (Continued)

6. ***Original entry***

	Cash	14,400	
	Unearned Interest Revenue		14,400

Adjusting entry

	Unearned Interest Revenue	1,200	
	Interest Revenue		1,200
	($14,400/24 months = $600 per month; $600 × 2 months = $1,200)		

E 4–5 (LO2) Adjusting Entries: Prepaid Expenses and Unearned Revenues

1. ***Original entry***

Mar. 15	Cash	54,000	
	Unearned Consulting Fees		54,000

Adjusting entry

Dec. 31	Unearned Consulting Fees	28,500	
	Consulting Fees Revenue		28,500
	($54,000/18 months = $3,000 per month; $3,000 × 9.5 months = $28,500)		

2. ***Original entry***

Apr. 1	Prepaid Subscriptions	285	
	Cash		285

Adjusting entry

Dec. 31	Subscription Expense	107	
	Prepaid Subscriptions		107
	($285/24 months = $11.88 pr month; $11.88 × 9 months = $107)		

3. ***Original entry***

May 1	Prepaid Property Taxes	7,500	
	Cash		7,500

Adjusting entry

Dec. 31	Property Tax Expense	5,000	
	Prepaid Property Taxes		5,000
	($7,500/12 months = $625.00 per month; $625 × 8 months = $5,000)		

E 4–5 (LO2) (Continued)

4.	*Original entry*		
	Aug. 1 Cash	3,350	
	Unearned Rent		3,350
	Adjusting entry		
	Dec. 31 Unearned Rent	2,792	
	Rent Revenue		2,792
	($3,350/6 months = $558.33 per month; $558.33 × 5 months = $2,792)		
5.	*Original entry*		
	Sept. 1 Prepaid Insurance	30,000	
	Cash		30,000
	Adjusting entry		
	Dec. 31 Insurance Expense	5,000	
	Prepaid Insurance		5,000
	($30,000/24 months = $1,250 per month; $1,250 × 4 months = $5,000)		
6.	*Original entry*		
	Oct. 1 Cash	13,300	
	Unearned Interest Revenue		13,300
	Adjusting entry		
	Dec. 31 Unearned Interest Revenue	3,325	
	Interest Revenue		3,325
	($13,300/12 months = $1,108.33 per month; $1,108.33 × 3 months = $3,325)		

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E 4–6 (LO2) Adjusting Entries

			Debit	Credit
1.	June 1	Cash	4,800	
		Unearned Subscription Revenue		4,800
		To record receipt of two-year subscription.		
	Dec. 31	Unearned Subscription Revenue	1,400	
		Subscription Revenue		1,400
		To record seven months of revenue earned. ($4,800/24 months = $200 per month × 7 months = $1,400)		
2.	a. Dec. 31	Salaries Expense	72,000	
		Salaries Payable		72,000
		To record salaries payable for two days. ($180,000 × 2/5 = $72,000)		
	b. Jan. 3	Salaries Payable	72,000	
		Salaries Expense	108,000	
		Cash		180,000
		To record payment of salaries for the week. ($180,000× 3/5 = $108,000)		

E 4–7 (LO2) Adjusting Entries

		Debit	Credit
1.	Interest Expense	9,000	
	Interest Payable		9,000
	To record interest expense for six months. ($225,000 × 0.08 × 6/12 = $9,000)		
2.	Unearned Rent Revenue	14,000	
	Rent Revenue		14,000
	To record rental revenue for four months. ($21,000 × 4/6 = $14,000)		
3.	Office Supplies Expense	3,985	
	Office Supplies		3,985
	To record office supplies expense. ($1,005 + $4,300 – $1,320 = $3,985)		
4.	Interest Receivable	5,775	
	Interest Revenue		5,775
	To record interest revenue for 11 months. ($90,000 × 0.07 × 11/12 = $5,775)		

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E 4–8 (LO2) **Adjusting Entries**

1.	Feb. 1	Prepaid Rent	24,000	
		Cash		24,000
		To record prepayment of rent for one year.		
	Dec. 31	Rent Expense	22,000	
		Prepaid Rent		22,000
		To record rent expense for 11 months.		
		($24,000 × 11/12 = $22,000)		
2.	Mar. 31	Cash	50,000	
		Bank Loan Payable		50,000
		To record $50,000, 15%, one-year loan.		
	Dec. 31	Interest Expense	5,625	
		Interest Payable		5,625
		To record interest expense for nine months.		
		($50,000 × 0.15 × 9/12 = $5,625)		
3.	Recorded upon receipt			
		Cash	60,000	
		Unearned Design Revenue		60,000
		To record receipt of design fees in advance.		
	Dec. 31	Unearned Design Revenue	36,000	
		Design Revenue		36,000
		To record design revenue earned.		
		[$60,000 × (1 – 0.40) = $36,000]		
4.	June 15	Supplies	1,400	
		Cash		1,400
		To record purchase of supplies.		
	Sept. 14	Supplies	1,100	
		Cash		1,100
		To record purchase of supplies.		
	Dec. 31	Supplies Expense	1,700	
		Supplies		1,700
		To record supplies used during the period.		
5.	Dec. 31	Programming Expense	800	
		Accounts Payable		800
		To record programming expense.		

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E 4–9 (LO2) Adjusting Entries

		Debit	Credit
1.	Insurance Expense	18,000	
	Prepaid Insurance		18,000
	To recognize six months of insurance expense. ($54,000 × 6/18 = $18,000)		
2.	Unearned Rent Revenue	4,000	
	Rent Revenue		4,000
	To recognize two months of rent revenue. ($12,000 × 2/6 = $4,000)		
3.	Interest Expense	4,583	
	Interest Payable		4,583
	To record 11 months of interest expense to be paid next year. ($50,000 × 0.10 × 11/12 = $4,583)		
4.	Interest Receivable	450	
	Interest Revenue		450
	To record three months of interest revenue. ($15,000 × 0.12 × 3/12 = $450)		

E 4–10 (LO2) Adjusting Entries

		Debit	Credit
1.	Supplies Expense	1,435	
	Supplies		1,435
	Beginning supplies on hand ($245) + Supplies purchased ($1,950) – Ending supplies on hand ($760) = Supplies used during the year ($1,435).		
2.	Salaries Expense	19,000	
	Salaries Payable	19,000	
	Cash		38,000
	To recognize one-half month of salaries expense. ($38,000/2 = $19,000)		
3.	Unearned Revenue	10,500	
	Service Revenue		10,500
	One-fourth of the $42,000 has been earned. ($42,000/4 = $10,500)		

4. No adjusting entry
(This payment relates only to January's rent. As such, the company does not recognize any expense until January of the next year.)

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E 4–11 (LO2) Analysis of Accounts

1. **Amount of office supplies on hand = $3,725, as follows:**

	SUPPLIES ON HAND		CASH		SUPPLIES EXPENSE	
Beginning balance	2,750					
Purchases	14,200			14,200		
Adjusting entry (12/31)		13,225			13,225	
Updated balance (12/31)	3,725				13,225	

2. **Cash collected from customers = $168,000, as follows:**

	ACCOUNTS RECEIVABLE		CASH		SALES	
Beginning balance	76,000					
Sales for period	174,000					174,000
Cash collections		168,000	168,000			
Updated balance (12/31)	82,000					174,000

3. **Rent collected in advance = $24,500, as follows:**

	UNEARNED RENT		CASH		RENT REVENUE	
Beginning balance		8,000				
Collections in advance		24,500	24,500			
Revenue for period	23,000					23,000
Updated balance (12/31)		9,500				23,000

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SOUTH-WESTERN
CENGAGE Learning

Chapter 4

E4- 12 (LO2) Identifying Types of Adjustments and Account Relationships

Item	(a) Type of Adjustment	(b) Accounts before Adjustment
1.	**Accrued Revenues**	**Assets Understated** Revenues Understated
2.	**Prepaid Expenses**	**Assets Overstated** Expenses Understated
3.	**Accrued Expenses**	**Expenses Understated** Liabilities Understated
4.	**Unearned Revenues**	**Liabilities Overstated** Revenues Understated
5.	**Accrued Expenses**	**Expenses Understated** Liabilities Understated
6.	**Prepaid Expenses**	**Assets Overstated** Expenses Understated

E 4–13 (LO3) Classifying Account Balances

1. BS
2. S/CI
3. BS
4. BS
5. S/CI
6. BS
7. S/CI
8. BS
9. BS
10. BS
11. BS
12. BS
13. S/CI
14. BS
15. BS
16. BS
17. S/CI
18. S/CI
19. BS
20. BS
21. BS
22. BS
23. BS
24. N*

*Note that Dividends would be closed to Retained Earnings and is not shown on the balance sheet or the statement of comprehensive income..

E4-14 (LO3) Preparing Financial Statements from Adjusted Trial Balance

BUNNY COMPANY
Statement of Comprehensive Income
For the Year Ended June 30, 2017

Revenues		
Service revenue		$35,200
Rent revenue		11,700
Total revenues		46,900
Expenses		
Salaries and wages expense	$18,100	
Rent expense	15,000	
Supplies expense	1,600	
Insurance expense	1,500	
Depreciation expense	1,300	
Total expenses		37,500
Net income		$ 9,400

BUNNY COMPANY
Statement of Retained Earnings
For the Year Ended June 30, 2017

Retained earnings, July 1, 2015	$ 3,600
Add: Net income	9,400
Retained earnings, June 30, 2017	$13,000

BUNNY COMPANY
Balance Sheet
June 30, 2017

Assets

Current assets:		
Cash		$ 10,400
Accounts receivable		10,000
Supplies		700
Prepaid insurance		2,500
Long-term assets:		
Equipment	$14,000	
Less: Accum. depreciation—equipment	(4,900)	9,100
Total assets		$32,700

Equity and Liabilities

Current liabilities:

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Unearned rent revenues	$ 800	
Salaries and wages payable	1,100	
Accounts payable	5,800	
Total Liabilities		$ 7,700
Equity		
Capital stock	$12,000	
Retained earnings	13,000	
Total Equity		25,000
Total equity and liabilities		$32,700

E 4–15 (LO4) Real and Nominal Accounts

1.	R	6.	R	11.	N	16.	N	21.	R
2.	N	7.	N	12.	R	17.	N	22.	R
3.	R	8.	R	13.	R	18.	R	23.	N
4.	R	9.	N	14.	N	19.	R		
5.	R	10.	R	15.	R	20.	N		

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E 4–16 (LO4) Closing Entry

1.

Sales Revenue	867,650	
Operating Expenses		650,000
Income Tax Expense		76,178
Retained Earnings		141,472

2. The statement of comprehensive income may combine or condense several accounts and report them in summary form. If closing entries are prepared from these summarized data, the individual revenue and expense accounts might not be reduced to a zero balance. For example, if Basket Weavers Inc. has several operating expense accounts, it would not be sufficient to close the combined total of $650,000. Each individual expense account in the ledger, the total of which is $650,000, must be closed.

E 4–17 (LO4) Closing Entries

Services Revenue	215,890	
Retained Earnings		215,890
Retained Earnings	3,000	
Insurance Expense		3,000
Retained Earnings	100,000	
Administrative Expenses		100,000
Retained Earnings	30,100	
Income Tax Expense		30,100

Note: Alternatively, the above journal entries may be combined into the following compound journal entry:

Services Revenue	215,890	
Insurance Expense		3,000
Administrative Expenses		100,000
Income Tax Expense		30,100
Retained Earnings		82,790

The net result on Retained Earnings is the same under both journal entries.

E 4–18 (LO4) Closing Entries

Services Revenue	906,000	
Retained Earnings		906,000
Interest Revenue	23,000	
Retained Earnings		23,000

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Retained Earnings	450,000	
Salaries Expense		450,000
Retained Earnings	140,000	
Utilities Expenses		140,000
Retained Earnings	135,600	
Income Tax Expense		135,600

Note: **Alternatively, the above journal entries may be combined into the following compound journal entry:**

Services Revenue	906,000	
Interest Revenue	23,000	
Salaries Expense		450,000
Utilities Expenses		140,000
Income Tax Expense		135,600
Retained Earnings		203,400

The net result on Retained Earnings is the same under both journal entries.

E 4–19 (LO4) Closing Dividends and Preparing a Post-Closing Trial Balance

1.

Retained Earnings	55,000	
Dividends		55,000

2.

Contemporary Literature Enterprises
Post-Closing Trial Balance
December 31, 2017

	Debits	Credits
Cash	$ 63,710	
Accounts Receivable	154,230	
Prepaid Insurance	10,070	
Land	430,800	
Accounts Payable		$ 68,540
Notes Payable		92,000
Salaries Payable		27,100
Taxes Payable		36,990
Unearned Rent		18,400
Mortgage Payable		190,500
Capital Stock		130,000
Retained Earnings		95,280*
Totals	$658,810	$658,810

*$150,280 – $55,000 = $95,280

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E 4–20 (LO4) Closing Dividends and Preparing a Post-Closing Trial Balance

1.

Retained Earnings	14,800	
Dividends		14,800

2.

Jolley Manufacturing Corporation
Post-Closing Trial Balance
December 31, 2017

	Debits	Credits
Cash	$ 16,400	
Accounts Receivable	23,500	
Prepaid Advertising	4,000	
Building	181,000	
Land	45,000	
Accounts Payable		$ 24,000
Wages Payable		8,000
Income Taxes Payable		7,000
Mortgage Payable		82,500
Notes Payable		23,000
Unearned Rent		4,200
Capital Stock		80,000
Retained Earnings		41,200*
Totals	$269,900	$269,900

*$56,000 – $14,800 = $41,200

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PROBLEMS

P 4–1 (LO1) Cash- and Accrual-Basis Accounting

1. Cash-basis:

Cash collected from providing services		$352,000
Expenses:		
Salaries paid in 2017	$53,000	
Utility bills paid in 2017	6,300	
Taxes paid in 2017	5,930	
Rent paid in 2017	41,000	106,230
Net income		$245,770

2. Accrual-basis:

Services revenue		$327,000
Expenses:		
Salaries expense for 2017	$61,000	
Utilities expense for 2017	7,500	
Tax assessment for 2017	6,210	
Rent expense for 2017	36,000	110,710
Net income		$216,290

3. Accrual-basis accounting recognizes revenues when they are earned by a firm and recognizes expenses as they are incurred, not necessarily when cash is received or paid. In determining income on an accrual basis, only revenues that have actually been earned during a period are reported. Similarly, the expenses incurred to generate those revenues are associated with the same period.

   Under cash-basis accounting, ample opportunity exists to manipulate income. A firm could delay or prepay expenses in order to affect the amount of income reported for the period.

P 4–2 (LO2) Adjusting Entries

a.	Salaries Expense	17,840	
	Salaries Payable		17,840
b.	Interest Expense	5,225	
	Interest Payable		5,225
	($190,000 × 0.11 × 3/12 year = $5,225)		

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P 4–2 (LO2) (Continued)

c.	Rent Expense	6,000	
	Prepaid Rent		6,000
	($36,000/6 months = $6,000; $6,000 × 1 month = $6,000)		
d.	Unearned Rent Revenue	33,900	
	Rent Revenue		33,900
	($76,000 – $42,100 = $33,900)		
e.	Insurance Expense	2,400	
	Prepaid Insurance		2,400
f.	Interest Receivable	400	
	Interest Revenue		400

P 4–3 (LO2) Adjusting Entries

a.	Interest Expense	9,600	
	Interest Payable		9,600
	($320,000 × 0.09 × 4/12 = $9,600)		
b.	Unearned Rent Revenue	51,250	
	Rent Revenue		51,250
	($93,500 – $42,250 = $51,250)		
c.	Interest Receivable	9,450	
	Interest Revenue		9,450
d.	Insurance Expense	4,960	
	Prepaid Insurance		4,960
e.	Rent Expense	7,500	
	Prepaid Rent		7,500
	($30,000/6 months = $5,000 per month; $5,000 × 1 1/2 months = $7,500)		
f.	Salaries Expense	15,300	
	Salaries Payable		15,300

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P 4–4 (LO2) Year-End Analysis of Accounts

1.	Wages Payable balance at December 31, 2017	$ 3,400
	Add cash wages paid in 2017	30,000
	Total	$33,400
	Less balance of Wages Payable at January 1, 2017	2,600
	Wages Expense for 2017	$30,800
2.	Unearned Rent at January 1, 2017	$ 4,500
	Add cash rent received in 2017	15,000
	Total	$19,500
	Less Unearned Rent balance at December 31, 2017	5,000
	Rent Revenue for 2017	$14,500
3.	Prepaid Insurance balance at January 1, 2017	$ 200
	Add cash insurance paid in 2017	720
	Total	$ 920
	Less Prepaid Insurance balance at December 31, 2017	120
	Insurance Expense for 2017	$ 800

Alternative solution using T-accounts:

1.

Wages Payable

Cash paid	30,000	Bal. (1/1/17)	2,600
			30,800
		Bal. (12/31/17)	3,400

Wages Expense

	30,800		
Bal. (12/31/17)	30,800		

2.

Unearned Rent

		Bal. (1/1/17)	4,500
		Cash rec'd.	15,000
	14,500		
		Bal. (12/31/17)	5,000

Rent Revenue

			14,500
		Bal. (12/31/17)	14,500

3.

Prepaid Insurance

Bal. (1/1/17)	200		
Cash paid	720		
			800
Bal. (12/31/17)	120		

Insurance Expense

	800		
Bal. (12/31/17)	800		

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P 4-5(LO2, 3) Preparing Adjusting Entries, Posting, and Preparing Adjusted Trial Balance, and Financial Statements

(a).	Aug 31	Insurance Expense	1,200	
		Prepaid Insurance		1,200
	Aug 31	Supplies Expense	2,400	
		Supplies		2,400
	Aug 31	Depreciation Expense	1,725	
		Accumulated Depreciation-Buildings		1,125
		Accumulated Depreciation-Equipment		600
	Aug 31	Unearned Rent Revenue	4,100	
		Rent Revenue		4,100
	Aug 31	Salaries and Wages Expense	400	
		Salaries and Wages Payable		400
	Aug 31	Accounts Receivable	3,700	
		Rent Revenue		3,700
	Aug 31	Interest Expense	600	
		Interest Payable		600

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(b)

SKYLINE Inc.
Adjusted Trial Balance
August 31, 2017

	Debit	Credit
Cash	$ 19,600	
Accounts Receivable	3,700	
Supplies	900	
Prepaid Insurance	4,800	
Land	25,000	
Buildings	125,000	
Accumulated Depreciation—Buildings		$ 1,125
Equipment	26,000	
Accumulated Depreciation—Equipment		600
Accounts Payable		6,500
Unearned Rent Revenue		3,300
Salaries and Wages Payable		400
Interest Payable		600
Mortgage Payable		80,000
Capital Stock		100,000
Dividends	5,000	
Rent Revenue		87,800
Maintenance and Repairs Expense	3,600	
Supplies Expense	2,400	
Depreciation Expense	1,725	
Interest Expense	600	
Insurance Expense	1,200	
Salaries and Wages Expense	51,400	
Utilities Expense	9,400	
	$280,325	$280,325

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(c)

SKYLINE Inc.
Statement of Comprehensive Income
For the Three Months Ended August 31, 2017

Revenues		
Rent revenue		$87,800
Expenses		
Salaries and wages expense	$51,400	
Utilities expense	9,400	
Maintenance and repairs expense	3,600	
Supplies expense	2,400	
Depreciation expense	1,725	
Insurance expense	1,200	
Interest expense	600	
Total expenses		70,325
Net income		$17,475

SKYLINE Inc.
Statement of Retained Earnings
For the Three Months Ended August 31, 2017

Retained Earnings, June 1	$ 0
Add: Net income	17,475
	17,475
Less: Dividends	5,000
Retained Earnings, August 31	$12,475

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SKYLINE Inc.
Balance Sheet
August 31, 2017

Assets		
Current assets		
Cash		$19,600
Accounts receivable		3,700
Supplies		900
Prepaid insurance		4,800
Total Current assets		$29,000
Long-term assets		
Equipment	$ 26,000	
Less: Accum. depreciation—equipment	600	$25,400
Buildings	125,000	
Less: Accum. depreciation—buildings	1,125	123,875
Land		25,000
Total Long-term assets		$174,275
Total assets		$203,275
Equity and Liabilities		
Liabilities		
Salaries and wages payable	$ 400	
Interest payable	600	
Unearned rent revenue	3,300	
Accounts payable	6,500	
Mortgage payable	80,000	
Total Liabilities		$ 90,800
Equity		
Capital Stock	$100,000	
Retained earnings	12,475	
Total Equity		112,475
Total equity and liabilities		$203,275

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P 4–6 (LO4) Account Classifications and Debit-Credit Relationships

	Account Title	(1) B/S or S/CI	(2) A, L, OE, R, E	(3) Real or Nominal	(4) Closed or Open	(5) Debit/ Credit
	Example: Cash	B/S	A	Real	Open	Debit
1.	Accounts Receivable	B/S	A	Real	Open	Debit
2.	Accounts Payable	B/S	L	Real	Open	Credit
3.	Prepaid Insurance	B/S	A	Real	Open	Debit
4.	Mortgage Payable	B/S	L	Real	Open	Credit
5.	Rent Expense	S/CI	E	Nominal	Closed	Debit
6.	Services Revenue	S/CI	R	Nominal	Closed	Credit
7.	Dividends	Neither*	OE*	Nominal	Closed	Debit
8.	Capital Stock	B/S	OE	Real	Open	Credit
9.	Retained Earnings	B/S	OE	Real	Open	Credit
10.	Prepaid Rent	B/S	A	Real	Open	Debit
11.	Supplies on Hand	B/S	A	Real	Open	Debit
12.	Utilities Expense	S/CI	E	Nominal	Closed	Debit
13.	Income Taxes Payable	B/S	L	Real	Open	Credit
14.	Interest Revenue	S/CI	R	Nominal	Closed	Credit
15.	Notes Payable	B/S	L	Real	Open	Credit
16.	Income Tax Expense	S/CI	E	Nominal	Closed	Debit
17.	Wages Payable	B/S	L	Real	Open	Credit
18.	Unearned Rent Revenue	B/S	L	Real	Open	Credit
19.	Land	B/S	A	Real	Open	Debit
20.	Unearned Consulting Fees	B/S	L	Real	Open	Credit
21.	Interest Receivable	B/S	A	Real	Open	Debit
22.	Consulting Fees	S/CI	R	Nominal	Closed	Credit

*Temporary account that does not appear on either the balance sheet or statement of comprehensive income, but that reduces the permanent equity account—Retained Earnings.

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P 4–7 (LO4) Closing Entries

1.	Retained Earnings	16,400	
	Services Revenue	178,000	
	Salaries Expense		144,000
	Interest Expense		10,500
	Office Supplies Expense		7,640
	Insurance Expense		9,860
	Property Tax Expense		22,400
2.	Retained Earnings	36,000	
	Dividends		36,000

P 4–8 (LO4) Closing Entries

1.	Services Revenue	276,100	
	Wages Expense		102,750
	Utilities Expense		4,890
	Insurance Expense		6,930
	Property Tax Expense		10,510
	Rent Expense		49,000
	Advertising Expense		15,640
	Interest Expense		9,800
	Retained Earnings		76,580
2.	Retained Earnings	18,600	
	Dividends		18,600

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P4–9(LO4) Preparing Closing Entries, and Preparing a Post-Closing Trial Balance

(a)

Service Revenue	4,300	
Retained Earnings		4,300
Retained Earnings	2,724	
Salaries and Wages Expense		1,344
Miscellaneous Expense		180
Supplies Expense		1,200
Retained Earnings	300	
Dividends		300

(b)

SORA COMPANY
Post-Closing Trial Balance
For the Month Ended June 30, 2017

Account Titles	Debit	Credit
Cash	$3,712	
Accounts Receivable	2,904	
Supplies	480	
Accounts Payable		$1,056
Salaries and Wages Payable		244
Unearned Service Revenue		160
Capital Stock		3,000
Retained Earnings		2,636
	$7,096	$7,096

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P 4–10 (LO2, LO4) Unifying Concepts: Adjusting and Closing Entries

1.	Supplies Expense	1,300	
	Supplies on Hand		1,300
	Rent Expense	10,000	
	Prepaid Rent		10,000
	Insurance Expense	885	
	Prepaid Insurance		885
	Wages Expense	5,700	
	Wages Payable		5,700
	Income Tax Expense	580	
	Income Taxes Payable		580
	Interest Expense	600	
	Interest Payable		600
2.	Consulting Fees Earned	142,380	
	Wages Expense		98,035
	Rent Expense		10,000
	Interest Expense		4,100
	Insurance Expense		1,470
	Supplies Expenses		5,665
	Income Tax Expense		3,350
	Retained Earnings		19,760

P 4–11 (LO3, LO4) Unifying Concepts: Analysis of Accounts

1.	Cash	$ 61,000
	Accounts Receivable	49,000
	Furniture (net)	40,000
	Inventory	160,000
	Land	260,000
	Supplies on Hand	10,000
	Buildings (net)	240,000
	Total assets	$ 820,000
2.	Services revenues	$ 195,000
	Salaries expense	(50,000)
	Net income	$ 145,000

Note: Dividends are not an expense; they are a distribution of net income.

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3. Since a beginning Retained Earnings balance is not known, the amount of ending Retained Earnings must be computed by using the basic accounting equation:
Assets = Liabilities + Equity
Total assets ($820,000) = Total liabilities ($120,000 + $250,000) + equity
Therefore, Equity at 12/31/17 = $450,000
Equity ($450,000) = Capital stock ($300,000) + Retained earnings(?)
Therefore, Retained Earnings at 12/31/17 = $(150,000)

4. If ending Retained Earnings is $(150,000) and net income for the period was $145,000, with $20,000 of Dividends, then beginning Retained Earnings must be $(25,000).

Retained Earnings

		Beg. bal	X=25,000
Dividends	20,000	Net income	145,000
		End. bal	150,000

P 4–12 (LO5) Unifying Concepts: Analysis and Correction of Errors

	Assets	=	Liabilities	+	Equity
Reported balances	$103,070	≠	$ 53,300	+	$76,300
(a)					(9,000)
(b)	14,800		14,800		
(c)			4,000		(4,000)
(d)			(25,000)		25,000
(e)	17,530				
Correct balances	$135,400	=	$ 47,100	+	$88,300

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P 4–13 (LO5) Unifying Concepts: The Accounting Cycle

1.

		Debit	Credit
(a)	Equipment	80,000	
	Accounts Payable		80,000
(b)	Cash	10,000	
	Capital Stock		10,000
(c)	Cash	80,000	
	Accounts Receivable	100,000	
	Services Revenue		180,000
(d)	Notes Payable	35,000	
	Interest Expense	7,000	
	Cash		42,000
(e)	Cash	105,000	
	Accounts Receivable		105,000
(f)	Accounts Payable	95,000	
	Cash		95,000
(g)	Salaries Expense	30,000	
	Cash		30,000
(h)	Dividends	10,000	
	Cash		10,000

2. Entries (a) through (h) are derived from the solution to item 1. Closing entries (i) and (j) are derived from item 4.

Cash

Beg. bal.	15,000	(d)	42,000
(b)	10,000	(f)	95,000
(c)	80,000	(g)	30,000
(e)	105,000	(h)	10,000
Updated bal.	33,000		

Accounts Receivable

Beg. bal.	20,000	(e)	105,000
(c)	100,000		
Updated bal.	15,000		

Equipment

Beg. bal.	0		
(a)	80,000		
Updated bal.	80,000		

Land

Bal.	180,000		

Accounts Payable

(f)	95,000	Beg. bal.	25,000
		(a)	80,000
		Updated bal.	10,000

Notes Payable

(d)	35,000	Beg. bal.	35,000
		Updated bal.	0

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Capital Stock

		Beg. bal.	125,000
		(b)	10,000
		Updated bal.	135,000

Retained Earnings

(j)	10,000	Beg. bal.	30,000
		(i)	143,000
		Updated bal.	163,000

Dividends

(h)	10,000	(j)	10,000
Updated bal.	0		

Services Revenue

(i)	180,000	(c)	180,000
		Updated bal.	0

Interest Expense

(d)	7,000	(i)	7,000
Updated bal.	0		

Salaries Expense

(g)	30,000	(i)	30,000
Updated bal.	0		

3.

Anderson Company
Statement of Comprehensive Income
For the Year Ended December 31, 2017

Services revenue		$180,000
Expenses:		
Salaries expense	$30,000	
Interest expense	7,000	37,000
Net income		$143,000
Other comprehensive income		0
Comprehensive income		$143,000

Anderson Company
Balance Sheet
December 31, 2017

Assets

Cash	$ 33,000
Accounts receivable	15,000
Equipment	80,000
Land	180,000
Total assets	$308,000

Liabilities and Equity

Liabilities:	
Accounts payable	$ 10,000
Equity:	
Capital stock	$135,000
Retained earnings	163,000*
Total equity	$298,000

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Total liabilities and equity	$308,000

*See statement of retained earnings.

Anderson Company
Statement of Retained Earnings
December 31, 2017

Retained earnings (January 1)	$30,000
Add: Net income for 2017	143,000
	$173,000
Less: Dividends for 2017	10,000
Retained earnings (December 31)	$163,000

4.

(i) Services Revenue	180,000	
Salaries Expense		30,000
Interest Expense		7,000
Retained Earnings		143,000
(j) Retained Earnings	10,000	
Dividends		10,000

5.

Anderson Company
Post-Closing Trial Balance
December 31, 2017

	Debits	Credits
Cash	$ 33,000	
Accounts Receivable	15,000	
Equipment	80,000	
Land	180,000	
Accounts Payable		$ 10,000
Capital Stock		135,000
Retained Earnings		163,000
Totals	$308,000	$308,000

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ANALYTICAL ASSIGNMENTS

AA 4–1 Using Financial Statements for Investment Decisions

Discussion

In completing this analysis, accounts may be set up, journal entries made and posted to the accounts, and the financial statements drawn from the adjusted year-end account balances, as follows:

Real Estate Business
Balance Sheet
At Year-End

Assets		
Cash in bank	$30,700	
Commissions receivable	1,000	
Notes receivable	10,000	
Supplies on hand	300	
Prepaid office rent	1,500	
Total assets		$43,500
Liabilities and Equity		
Accounts payable	$ 300	
Equity	43,200*	
Total liabilities and equity		$43,500

*The balance in the equity account results from the beginning balance $22,600 plus the net income for the year $20,600, as shown in the following T-account:

EQUITY

	Beg. bal.	22,600
	Net income	20,600
	Updated bal.	43,200

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AA 4–1 (Continued)

Real Estate Business
Statement of Comprehensive Income
For the Current Year

Revenues:		
Commissions revenue	$45,500	
Interest revenue	1,200	$46,700
Expenses:		
Supplies expense	$ 950	
Office rent expense	3,000	
Utilities expense	1,500	
Miscellaneous office expense	250	
Salaries and wages expense	20,400	26,100
Net income		$20,600
Other comprehensive income		0
Comprehensive income		$20,600

The business appears profitable since the net income is positive. The balance sheet also presents a positive financial picture. The business has significant cash relative to total assets, and its relationship of current assets to current liabilities (current ratio) is very positive. One potential concern is the collectibility of the note receivable, which is almost one-fourth of total assets. The doctors would want to look at the cash flows of the business (i.e., cash flow statement) as well as compare the current year results with other years to see if the financial trends are as positive as the current results. The doctors would also want to consider alternative investments to see if this venture would be the best use of their investment dollars.

AA 4–2 Accounting and Ethical Issues Involving the Closing Process

Discussion

The main accounting issue is proper cutoff of the accounting period.In this case, Year-Round Landscape, Inc., has a December 31 year-end. Only transactions for the current accounting period should be included. The major contract to be signed on January 3 is a transaction properly accounted for in the next fiscal period.

Revenues are to be recognized (recorded) when the earnings process is completed and when objective evidence exists as to the amounts involved, e.g., when an arm's-length transaction has occurred. In this case, as mentioned above, the transaction occurs in the next period (e.g., when the contract is signed). The earnings process is likely to occur during the next fiscal period as well—when the services for the contract are provided.

The primary ethical issue involved in this case is the proposed deliberate misrepresentation of operating results for Year-Round Landscape, Inc., if the books are not properly closed on December 31.

Also, even if the books are held open for a week, as Silva suggests, it would not be appropriate to increase this year's earnings by 20% unless all services for the major contract were performed in that one-week period, which is unlikely. Revenue should not be reported until it is earned, as indicated before. Silva should resist the temptation to make Year-Round Landscape's results look better than they actually are.

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AA 4–3 Home Depot

Real Company Analysis
(in millions)

1. | | |
|---|---|
| Retained earnings, 2/3/2013 | $20,038 |
| Add: Net income for the year | 5,385 |
| Less: Dividends for the year | (2,243) |
| Retained earnings, 2/2/2014 | $23,180 |
| Add: Net income for the year | 6,345 |
| Less: Dividends for the year | (2,530) |
| Retained earnings, 2/1/2015 | $26,995 |
| Add: Net income for the year | 7,009 |
| Less: Dividends for the year | (3,031) |
| Retained earnings, 1/31/2016 | $30,973 |

2. Dividend Payout Ratio

2014 41.65% ($2,243/$5,385)
2015 39.87% ($2,530/$6,345)
2016 43.24% ($3,031/$7,009)

Comparing with 2014, Home Depot's dividend payout ratio decreased in 2015 and increased in 2016.

AA 4–4 Do Two Wrongs Make a Right?

Ethics

This ethics case illustrates that in many cases accountants are not dealing with someone who is lying, cheating, or stealing. In this instance, Jex has elected to account for certain items a little differently. There is no criminal intent on his part. In fact, Jex's argument for comparability is quite compelling. One of the major uses of financial statement information is to compare the performance of a company across time and across other firms in the same industry.

But the fact remains that the unearned revenue is just that—unearned. It should not be reported as revenue in this year. In addition, the $350,000 of revenue that was earned in January of this year, yet reported last year, should be corrected. The fact that the same error was made twice does not justify the error.

The adjusting entry required at year-end to account for the $400,000 of unearned revenue would be:

Revenue	400,000	
Unearned Revenue		400,000

In addition, a journal entry should be made to correct for the error made last year. That is, $350,000 of revenue recognized last year should be recognized this year. The journal entry to accomplish this would be:

Retained Earnings	350,000	
Revenue		350,000

Why the debit to Retained Earnings? If you think about it, it makes sense. The revenue was erroneously recorded last year and then closed to Retained Earnings. We need to get it out of Retained Earnings, which is accomplished with a debit.

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