1. **B** A decrease in the items on the left is not balanced by an increase in the items on the right. For a., an increase on the left and right will balance out. For c., a decrease on the left and right will balance out just like an increase and a decrease on the left for d.

2. **C** Expenses (product costs) are recognized when they match revenue, NOT when the expenses are actually paid. Also, expenses (period costs) are recognized in the period in which the service is consumed.

3. **B** Revenue and expense accounts are temporary accounts. The reason why these are temporary accounts is because revenue and expense amounts reside only for a short while before being transferred to retained earnings (which is a permanent balance sheet account).

4. **B** Interest must be accrued even if it is not paid or received. The 10% interest rate is for the whole entire year. We need the interest rate for only three months (120 days). Three months is equivalent to a quarter of the year, so take 1/4 of the 10% interest rate (2.5%). Now multiply the $10,000 by the 2.5% which equals $250.

5. **D** The important thing to remember here is that inventory is considered a current asset. In a typical business, it is reasonable to take one year as the dividing line between current and noncurrent assets. Inventory is always being purchased throughout the year for most businesses. Also, shareholders’ equity falls under the equity section on the balance sheet, not under the asset section. All other items are long term.

6. **B** Magazine subscriptions collected in advance are reported as deferred revenue in the liability section of the balance sheet. The reason why it is reported in the liability section is because the magazine company still has to carry out its obligation of providing the magazines before recording the subscriptions as actual revenue.

7. **D** Revenues measure two important things. Revenues measure the inflows of assets from selling goods and providing services to customers. In other words, it measures the amount of money that the company will be making. Also, revenues measure the reduction of liabilities from selling goods and providing services to customers. This was seen in question 6. As the company starts providing the magazine service to the customers, deferred revenue (which is the liability) decrease. As the deferred revenue decrease, the actual revenue increased.

8. **B** Financial reporting does not provide any information on competitors’ performance. When you look at the financials of a company, you are not given any information about its competitors. All the objectives are on pages 17-18 of your text.

9. Working capital is the excess of a firm’s current assets over its current liabilities.

| Cash | Income | Working Capital | Debt/Equity |
a. -- 0 w 0
b. -- 0 w 0 or --
c. -- 0 -- +
d. -- 0 0 0

10. a. There is NO entry. An entry would not be needed until the company starts paying the CFO which, at that time, would be a salary expense.

   b. dr. Prepaid Insurance 800
      cr. Cash 800

   c. dr. Cash 1500
      cr. Deferred revenue 1500
      (The deferred revenue account is a liability. It is NOT considered a revenue account.)

   d. dr. Inventory 980
      cr. Accounts Payable 980

   e. NO entry. An entry would not be needed until the firm actually purchases (or orders) the inventory.

11. a. Cash 20,000
    Paid in Capital 10,000
    Stock 10,000

   b. Cash 10,000
      Notes Payable 10,000

   c. Rent 2,000
      Cash 2,000

   d. Equipment 1,000
      Cash 1,000

   e. Maintenance Expense 800
      Cash 800

   f. Income Summary 2,000
      Rent Expense 2,000

* Check the T-Account sheet for answers.
12. (a) Income summary 11,000
    Cost of Sales 11,000
(b) Income summary 3,000
    Expense 3,000
(c) Revenue 17,000
    Income summary 17,000
(d) Income summary 3,000
    R.E. 3,000

* Check the T-account sheet for answers.

Goodblue Company
Balance Sheet
As of June 30, 1996

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>14,600</td>
</tr>
<tr>
<td>Accounts Rec.</td>
<td>6,600</td>
</tr>
<tr>
<td>Inventory</td>
<td>7,500</td>
</tr>
<tr>
<td>Current Assets</td>
<td>28,700</td>
</tr>
<tr>
<td><strong>Equipment (net)</strong></td>
<td>20,000</td>
</tr>
<tr>
<td><strong>TOTAL ASSETS</strong></td>
<td>48,700</td>
</tr>
<tr>
<td>Accounts Payable</td>
<td>4,700</td>
</tr>
<tr>
<td>Current Liabilities</td>
<td>4,700</td>
</tr>
<tr>
<td>Bank Loan</td>
<td>25,000</td>
</tr>
<tr>
<td>Capital</td>
<td>15,000</td>
</tr>
<tr>
<td>Retained Earnings</td>
<td>4,000</td>
</tr>
<tr>
<td><strong>TOTAL EQUITIES</strong></td>
<td>48,700</td>
</tr>
</tbody>
</table>

Goodblue Company
Income Statement
For the year ended June 30, 1996

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>17,000</td>
</tr>
<tr>
<td>Cost of Sales</td>
<td>11,000</td>
</tr>
<tr>
<td>Gross Margin</td>
<td>6,000</td>
</tr>
<tr>
<td>Expenses</td>
<td>3,000</td>
</tr>
<tr>
<td><strong>Net Income</strong></td>
<td>$3,000</td>
</tr>
</tbody>
</table>
QUESTION 12

REVENUE
(c) 17,000

INCOME SUMMARY
(a) 17,000
(b) 14,000
(c) 17,000
(d) 3,000

COST OF SALES
11,000
(a) 11,000

EXPENSES
3,000
(b) 3,000

RE
1,000
(d) 3,000
4,000