

## 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)		

<b>Prepaid Insurance</b>			
06/01/X1	4,500	2,625	12/31/X1
	<u>1,875</u>		

<b>Insurance Expense</b>			
12/31/X1	<u>2,625</u>		

**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)		

<b>Prepaid Insurance</b>			
12/31/X1	<u>1,875</u>		

<b>Insurance Expense</b>			
06/01/X1	4,500	1,875	12/31/X1
	<u>2,625</u>		

**Scenario 2: Balance Sheet Approach**

08/01/X1			

12/31/X1			

<b>Unearned Revenue</b>	

<b>Revenue</b>	

**Scenario 2: Income Statement Approach**

08/01/X1			

12/31/X1			

<b>Unearned Revenue</b>	

<b>Revenue</b>	

**Scenario 3: Balance Sheet Approach**

12/01/X1			

12/31/X1			

<b>Prepaid Rent</b>	<b>Rent Expense</b>
<div style="border: 1px solid black; width: 100%; height: 100%; position: relative;"> <div style="position: absolute; top: 50%; left: 50%; transform: translate(-50%, -50%); border: 1px solid black; width: 50%; height: 50%;"></div> </div>	<div style="border: 1px solid black; width: 100%; height: 100%; position: relative;"> <div style="position: absolute; top: 50%; left: 50%; transform: translate(-50%, -50%); border: 1px solid black; width: 50%; height: 50%;"></div> </div>

**Scenario 3: Income Statement Approach**

12/01/X1			

12/31/X1			

<b>Prepaid Rent</b>	<b>Rent Expense</b>
<div style="border: 1px solid black; width: 100%; height: 100%; position: relative;"> <div style="position: absolute; top: 50%; left: 50%; transform: translate(-50%, -50%); border: 1px solid black; width: 50%; height: 50%;"></div> </div>	<div style="border: 1px solid black; width: 100%; height: 100%; position: relative;"> <div style="position: absolute; top: 50%; left: 50%; transform: translate(-50%, -50%); border: 1px solid black; width: 50%; height: 50%;"></div> </div>

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## 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
	<u>1,875</u>		

Insurance Expense			
		2,625	
		<u>2,625</u>	

## 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	<u>1,875</u>		

Insurance Expense			
06/01/X1	4,500	1,875	12/31/X1
	<u>2,625</u>		

**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
		<u>36,000</u>	

Revenue		
	<u>24,000</u>	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		Revenue	
	<u>36,000</u>		<u>24,000</u>
	12/31/X1	12/31/X1	08/01/X1

**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		Rent Expense	
12/01/X1	9,000		<u>0</u>
	<u>9,000</u>		



**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	<u>9,000</u>
	<u>0</u>

Rent Expense			
12/01/X1	9,000	9,000	12/31/X1
		<u>0</u>	

**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
		<u>0</u>	

Revenue	
	<u>0</u>

**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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