2013 UIL Capital Conference

Accounting
Accruals & Deferrals. . .
Don't be Afraid; It's Just Timing!

by:

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General Review
(Paragraph Numbers Refer to Table 1)

¶1 Real Life Review of Property Taxes

1. Summer—appraisal district informs owner of appraised value and owner is given opportunity to question or protest
2. The "bill" comes in the fall. Owner may pay in the fall or through January 31 of the following year without penalty.
3. So in this problem, in 2012 when we receive the "bill" we "book it." We hold our cash until the final month to pay without penalty.

¶2 "What is a mortgage? That is not in our book!" says the student.

1. It is briefly mentioned in SW GJ page 672
2. It is a long-term liability
3. Everything you need to know about a mortgage is given
4. You do not have to calculate the amount of interest (don't need terms of note)
5. You do have to understand accruals and how those appear in the general ledger (T-accounts). (Page 8 will give you some insight for December 31, 20**<u>11</u>** Balance Sheet accounts.)

¶3 Accrual Basis of Accounting

1. Record income when it is earned regardless of when cash received
2. Record expense when it is incurred regardless of when cash is paid
3. Follows Matching Principle
4. Review: Time Sheet for Accruals and Deferrals
5. Accrual & Deferral <u>ADJUSTING ENTRIES</u> will include at least one balance sheet account and at least one income statement account. An <u>adjusting entry</u> for an accrual or deferral NEVER affects Cash in Bank. (Remember, cash action creates the deferral. The adjusting entry occurs in a later period.)

¶4 What is Unearned Rent?

1. It is a type of unearned revenue
2. We received the cash BEFORE we earned the revenue
3. If we don't perform (earn it), we must "repay" it
4. What type of account do we typically "repay" ?? Answer: a liability
5. Therefore Unearned Rent is a current liability account
6. It is an amount, sitting on the Balance Sheet, waiting to grow up to be income and move to the Income Statement. (It has a credit balance just like revenue! But it must first be earned.)

<u>T-Accounts</u>

1. When I draw a line making a "double T" this line means "at the end of the fiscal period," and the amount I write under this line is the ending balance. (If this is a temporary capital account, it is the balance before closing.)
2. I will often make notations of dates within my T-accounts
3. Do not get hung up on Account Titles
   Example: Mortgage Interest Payable could be called Interest Payable

Time Sheet for Accruals & Deferrals

PAST			NOW			FUTURE		
			Accrued Revenue:					
			Accts. Receivable	DR		Cash in Bank	DR	
			Fees Income		CR	Accts. Receivable		CR
			Accrued Expense:					
			Salary Expense	DR		Salary Payable	DR	
			Salary Payable		CR	Cash in Bank		CR
			Deferred Revenue:					
Cash in Bank	DR		Unearned Revenue	DR				
Unearned Revenue		CR	Fees Income		CR			
			Deferred Expense: (or Prepaid Expense)					
Supplies	DR		Supplies Expense	DR				
Cash in Bank		CR	Supplies		CR			

<u>Creation of Deferral</u> (<u>PAST</u> column) (when cash action takes place before earning/incurring):

- **If the someday "revenue" (normal credit balance) is not yet earned (but cash has been received), it does not yet belong on the Income Statement. So where can we "park this credit" until it is earned? What type of account on the Balance Sheet has a normal credit balance? (Liabilities and Owner's Equity) If we don't ever earn it, what do we have to do with the cash we already received? (refund it; so we "owe" it; Liability)**
- **If the someday "expense" (normal debit balance) is not yet incurred (but cash has been paid), it does not yet belong on the Income Statement. So where can we "park this debit" until the expense is incurred and until we can match it to the revenue it helped to create? What type of account on the Balance Sheet has a normal debit balance? (asset)**

Note: It is possible for a deferred revenue or a deferred expense to require more than one accounting reporting period in the future to finally be disposed or eliminated. For example: when an attorney receives a deposit on a long-term engagement that spans several accounting reporting periods. So things could "sit on the Balance Sheet" for a short time or for a long time.

2013 State Test

Group 9

Refer to Table 1. For questions 54 through 59, write the identifying letter of the best response on your answer sheet. Each question refers to the financial statements that are prepared at the end of 2012.

54. What was the total amount of the debits to the Rent Receivable controlling account?
A. $171,600 D. $180,000
B. $179,100 E. $187,500
C. $179,550

*55. What amount will be reported on the income statement as Rental Income Earned?
A. $179,400 D. $181,800
B. $179,550 E. $182,250
C. $180,000 F. $182,400

*56. What amount will be reported on the income statement as Insurance Expense?
A. $ 7,650 D. $10,875
B. $ 8,325 E. $11,100
C. $10,200 F. $13,650

*57. What amount will be reported on the balance sheet as Prepaid Insurance?
A. zero D. $ 5,325
B. $2,550 E. $11,100
C. $2,775 F. $13,650

58. What amount will be reported on the income statement as Property Tax Expense?
A. zero B. $21,200 C. $22,500 D. $43,700

59. When the next annual mortgage payment of $90,860 is made on January 1, 20<u>13</u>, what is the amount of principal?
A. zero D. $62,710
B. $24,950 E. $64,310
C. $26,550 F. $65,910

Refer to Table 1. For questions 60 through 63, write the correct amount on your answer sheet.

*60. After the mortgage payment is made next year on January 1, 20<u>13</u>, what will be the balance of Mortgage Payable?

61. On December 31, 2012 what is the balance in the Cash in Bank account?

*62. Using the accrual basis of accounting, what is the amount of net income (before depreciation is calculated) for 2012?

*63. What was the amount of the insurance premium paid on April 1, 20<u>11</u>?

Table 1

(for questions 54 through 63)

¶1 Gulf Rentals, Inc. owns several condominiums on the coast that it leases to vacationing families year round. Gulf Rentals carries adequate insurance and pays property taxes on the real and personal property. Property taxes for a given year are assessed in October of that year, but are payable in January of the following year.

¶2 All of the condos were financed through a single long term note (mortgage) payable. The interest (calculated on the principal balance) for twelve months is accrued on December 31 of each year. Gulf Rentals makes a payment of $90,860 each year on January 1, consisting of interest accrued for the previous year plus an amount of principal. (As the principal balance declines each year, the calculated interest expense will decrease.) Regardless of the breakdown between interest and principal, the annual payment is set at $90,860.

¶3 The company uses the accrual basis of accounting and prepares adjusting and closing entries only at the end of the fiscal year, which is December 31. Financial statements are prepared annually; therefore the income statement is for twelve months.

¶4 Every rental arrangement is made by written contract and first entered into the accounting records as a rental receivable. Occasionally, customers prepay an amount in order to give a condo rental as a gift to a family member. The gift prepayment is not recorded by Gulf Rentals as income earned until the gift recipient signs a contract to use the condo. At contract signing, the prepayment is applied and any balance due is receivable from the gift recipient.

¶5 All other operating expenses (such as salaries, utilities, office supplies etc.) in the amount of $47,869 were paid by check. Regarding this group of expenses, no accrual or deferral entries are necessary at the end of the fiscal year 2012. They are grouped together for simplicity. Disregard payroll tax liabilities and expenses.

¶6 The following is a portion of the comparative balance sheet for Gulf Rentals, Inc. (All accounts have normal balances.)

	December 31	
	2011	**2012**
Cash in Bank	16,240	??
Rent Receivable	3,750	4,200
Prepaid Insurance	2,550	??
Mortgage Interest Payable	26,550	24,950
Property Tax Payable	21,200	22,500
Unearned Rent	2,250	2,850
Mortgage Payable (principal)	1,062,260	??

¶7 Gulf's accounting records provided the following details for the year 2012:

- The total debits to the Cash in Bank account for the year were $182,400 (consisting of $179,550 for condo rental receivables collected and $2,850 for rental gifts).
- Cash disbursed to pay the only insurance premium was on April 1, 2012 for $11,100. (In 2011 there was only one premium paid on April 1, 2011.)
- Cash disbursed to pay the mortgage payment on January 1, 2012
- Cash disbursed to pay property taxes $21,200.
- Cash disbursed to pay operating expenses $47,869

Use of T-Accounts Demonstrated

Cash in Bank

1-1-12	16,240	11,100	4-1-12
	182,400	90,860	1-1-12
		21,200	
		47,869	
27,611			

Rent Receivable

1-1-12	3,750	
	180,000	179,550
4,200		

Prepaid Insurance

1-1-12	2,550	
4-1-12	11,100	10,875 (exp)
2,775		

Mort. Interest Payable

	26,550	1-1-12
26,550	24,950	
	24,950	

Property Tax Payable

	21,200	1-1-12
21,200	22,500	
	22,500	

Unearned Rent

	2,250	1-1-12
2,250	2,850	
	2,850	

Mortgage Payable

		1,062,260 1-1-12
Pmt 1-1-12	64,310	
		997,950

Rent Income

	180,000
	2,250
	182,250

Operating Expenses

47,869	
47,869	

Insurance Expense

10,875	
10,875	

Interest Expense

24,950	
24,950	

Property Tax Expense

22,500	
22,500	

Cash in Bank

Rent Receivable

Prepaid Insurance

Mort. Interest Payable

Property Tax Payable

Unearned Rent

Mortgage Payable

Rent Income

Operating Expenses

Insurance Expense

Interest Expense

Property Tax Expense

How Did These Numbers Get Here?

An Analysis of January 1, 2012 Balances

Ref.		12/31/2011
	Cash in Bank	16,240
1	Rent Receivable	3,750
2	Prepaid Insurance	2,550
3	Mortgage Interest Payable	26,550
4	Property Tax Payable	21,200
5	Unearned Rent	2,250
	Mortgage Payable (principal)	1,062,260

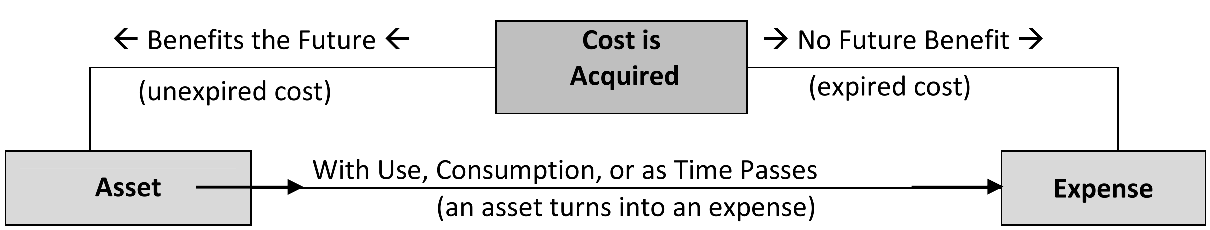
1. Rent Receivable $3,750 represents 2011 accrued revenue. The revenue was earned in 2011 but the cash had not yet been received as of 12-31-11.

2. Prepaid Insurance $2,550. The given info (See Table 1, ¶7, Bullet #2) states "In 2011 there was only one premium paid on April 1, 2011." So 9/12 (April thru Dec) of the premium was expensed in 2011 leaving the balance of $2,550 (or 3/12) to sit on the Balance Sheet until it could grow up to be an expense and move to the Income Statement. So this $2,550 is a deferred expense.

3. Mortgage Interest Payable $26,550. This accrued interest was "booked" on 12-31-11 as an accrued expense for 2011. It will be paid when the annual payment of $90,860 is made on 1-1-12.

4. Property Tax Payable $21,200. This is a 2011 accrued expense. It was "booked" in October of 2011 when the statement was received. It will be paid in January 2012.

5. Unearned Rent $2,250. Gulf Rentals, Inc. received the cash in 2011 but had not yet earned the revenue. So this is a deferred revenue for the year 2011. This $2,250 is sitting on the Balance sheet waiting to grow up to be revenue and move to the Income Statement.



This is ONE possible way to solve 2013 State Group 9. I have provided journal entries ONLY for clarity. Contestants do not have time to write JE's and then "post."

1. Read the Table paragraphs 1 thru 5 to understand the set up.
2. As you read paragraph 6, WRITE DOWN WHAT YOU KNOW into the T-accounts.
3. If it is helpful, make a circle for anything that is unknown (not provided in the given information), so later on, you don't search for it again in the given info.
4. Paragraph 7 walks us through selected transactions, and here are the JE's:

Account Title	Debit	Credit
Cash in Bank	182,400	
Rent Receivable		179,550
Unearned Rent		2,850

Account Title	Debit	Credit
Prepaid Insurance	11,100	
Cash in Bank		11,100

Account Title	Debit	Credit
Mortgage Interest Payable	26,550	
Mortgage Payable	64,310	
Cash in Bank		90,860

Account Title	Debit	Credit
Property Tax Payable	21,200	
Cash in Bank		21,200

Account Title	Debit	Credit
Various Operating Expenses	47,869	
Cash in Bank		47,869

5. Calculate the missing debit to Rent Receivable: 3,750-179,550-4,200=180,000 Q#54

Account Title	Debit	Credit
Rent Receivable	180,000	
Rent Income		180,000

6. Calculate the missing debit to Unearned Rent:

Account Title	Debit	Credit
Unearned Rent	2,250	
Rent Income		2,250

7. Calculate the ending balance of Rent Income: Q#55
   180,000+2,250=182,250

8. Calculate the insurance premium paid on April 1, 2011:

Beginning balance Prepaid Insurance 1-1-12	2,550	
	÷ 3 mo	
Remember, a Balance Sheet account balance on 12-31-11	850	monthly
(after adjusting entries) will have this same balance on	x 12	
1-1-12 (before any 2012 transactions).	10,200	Q#63

9. Calculate Insurance Expense for 2012: (I LOVE THIS TABLE!!!)

		2011	2012	2013	
Pmt 4-1-11	$10,200	7,650	2,550		
Pmt 4-1-12	$11,100		8,325	2,775	Q#57
			10,875		
			Q#56		

Pmt 4-1-11 $10,200 = (9mo in 2011 or 7,650; and 3mo in 2012 or 2,550)
Pmt 4-1-12 $11,100 = (9mo in 2012 or 8,325; and 3mo in 2013 or 2,775)

Account Title	Debit	Credit
Insurance Expense	10,875	
Prepaid Insurance		10,875

10. Calculate the missing credit to Property Tax Payable: Q#58

Account Title	Debit	Credit
Property Tax Expense	22,500	
Property Tax Payable		22,500

11. Calculate the missing credit to Mortgage Interest Payable:

Account Title	Debit	Credit
Mortgage Interest Expense	24,950	
Mortgage Interest Payable		24,950

12. Calculate the principal portion of the payment to be made NEXT year (Jan 1, 2013):

Standard Annual Payment	90,860	
Less 2012 Accrued Interest Expense	<24,950>	
	65,910	Q#59

13. Calculate new balance of Mortgage Payable after 1-1-13 payment:

Balance in Mortgage Payable on 12-31-11	1,062,260	
Less Principal Paid on 1-1-12 (90,860-26,550)	<64,310>	
Balance in Mortgage Payable on 12-31-12	997,950	
Less Principal Paid on 1-1-13 (90,860-24,950)	<65,910>	
	932,040	Q#60

14. Calculate the ending balance of Cash in Bank:
16,240+182,400-11,100-90,860-21,200-47,869=27,611 Q#61

15. Calculate Net Income (before depreciation):

Revenue		182,250
Expenses:		
Insurance Expense	10,875	
Property Tax Expense	22,500	
Mortgage Interest Expense	24,950	
Various Operating Expenses	47,869	
Total Expenses		106,194
Net Income (before depreciation)		76,056

Q#62

Mortgage Loan Amortization

Loan Payment Date	Amount of Payment	Acctg Year for Accrued Expense	Accrued Interest Expense	Principal Paid (Pmt – Int = Prin	Note Principal Balance	Note Balance As of Date
					1,062,260	12-31-11
1-1-12	90,860	2011	26,550	64,310	997,950	12-31-12
1-1-13	90,860	2012	24,950	65,910	932,040	12-31-13

If we knew the terms of the mortgage note (interest rate, time, etc.) we could have actually calculated the accrued interest.

AJE Account Relationships
(Time Sheet, NOW column)

Write the two types of accounts in relationship for each item at the left

1.	Accrued Revenue	→		
2.	Accrued Expense	→		
3.	Deferred Revenue	→		
4.	Deferred Expense	→		

KEY

54	D	57	C	60	$932,040
55	E	58	C	61	$ 27,611
56	D	59	F	62	$ 76,056
				63	$ 10,200

AJE Account Relationships	
1	asset, revenue
2	expense, liability
3	liability, revenue
4	expense, asset