CHAPTER 18

REVENUE RECOGNITION

IFRS questions are available at the end of this chapter.

TRUE-FALSE—Conceptual

Answer	No.	Description
F	1.	Recognition of revenue.
T	2.	Realization of revenue.
T	3.	Delayed recognition of revenue.
F	4.	Recognizing revenue when right of return exists.
T	5.	Recognizing revenue prior to product completion.
F	6.	Use of percentage-of-completion method.
T	7.	Input measure for contract progress.
T	8.	Reporting Construction in Process and Billings on Construction in Process.
F	9.	Construction in Process account balance.
F	10.	Recognition of revenue under completed-contract method.
T	11.	Principal advantage of completed-contract method.
F	12.	Recognizing loss on an unprofitable contract.
F	13.	Recognizing current period loss on a profitable contract.
T	14.	Recognizing revenue under completion-of-production basis.
F	15.	Recording a loss on an unprofitable contract.
F	16.	Deferring revenue under installment-sales method.
T	17.	Deferring gross profit under installment-sales method.
T	18.	Classification of deferred gross profit.
F	19.	Recognizing revenue under cost-recovery method.
T	20.	Recognizing profit under cost-recovery method.

MULTIPLE CHOICE—Conceptual

Answer	No.	Description
c	21.	Revenue recognition principle.
b	22.	Definition of "realized."
a	23.	Definition of "earned."
b	[S]24.	Revenue recognition representations.
d	[P]25.	Definition of recognition.
b	[P]26.	Revenue recognition principle.
d	27.	Recognizing revenue at point of sale.
d	28.	Recording sales when right of return exists.
c	29.	Revenue recognition when right of return exists.
d	30.	Revenue recognition when right of return exists.
b	31.	Appropriate accounting method for long-term contracts.
c	32.	Percentage-of-completion method.
b	33.	Percentage-of-completion method.
c	34.	Classification of progress billings and construction in process.
b	35.	Calculation of gross profit using percentage-of-completion.
a	36.	Disclosure of earned but unbilled revenues.
b	37.	Disadvantage of using percentage-of-completion.
d	[S]38.	Percentage-of-completion input measures.

MULTIPLE CHOICE—Conceptual (cont.)

Answer	No.	Description
a	S39.	Advantage of completed-contract method
c	40.	Revenue, cost, and gross profit under the completed-contract method.
a	41.	Loss recognition on a long-term contract.
c	42.	Accounting for long-term contract losses.
d	43.	Criteria for revenue recognition of completion of production.
a	44.	Completion-of-production basis.
d	S45.	Revenue recognition of completion of production.
b	S46.	Treatment of estimated contract cost increase.
c	47.	Presentation of deferred gross profit.
c	48.	Appropriate use of the installment-sales method.
b	49.	Valuing repossessed assets.
b	50.	Gross profit deferred under the installment-sales method.
c	S51.	Income realization on installment sales.
d	P52.	Conservative revenue recognition method.
b	53.	Income recognition under the cost-recovery method.
b	54.	Income recognition under the cost-recovery method.
d	55.	Cost recovery basis of revenue recognition.
b	56.	Deposit method of revenue recognition.
d	57.	Cost recovery method.
b	*58.	Types of franchising arrangements.
d	*59.	Accounting for consignment sales.
d	*60.	Allocation of initial franchise fee.
a	*61.	Recognition of continuing franchise fees.
b	*62.	Future bargain purchase option.
a	*63.	Option to purchase franchisee's business agreement.
d	*64.	Revenue recognition by the consignor.

P These questions also appear in the Problem-Solving Survival Guide.
S These questions also appear in the Study Guide.
*This topic is dealt with in an Appendix to the chapter.

MULTIPLE CHOICE—Computational

Answer	No.	Description
c	65.	Computation of total revenue and accounts receivable.
d	66.	Computation of total construction expenses.
b	67.	Computation of costs and profits in excess of billings balance.
c	68.	Computation of total revenue and construction expenses.
b	69.	Gross profit recognized under percentage-of-completion.
c	70.	Computation of construction in process amount.
c	71.	Percentage-of-completion method.
c	72.	Percentage-of-completion method.
b	73.	Determine cash collected on long-term construction contract.
d	74.	Determine gross profit using percentage-of-completion.
c	75.	Gross profit to be recognized using percentage-of-completion.
b	76.	Gross profit to be recognized using percentage-of-completion.
c	77.	Profit to be recognized using completed-contract method.
a	78.	Gross profit to be recognized using percentage-of-completion.

MULTIPLE CHOICE—Computational (cont.)

Answer	No.	Description
b	79.	Profit to be recognized using completed-contract method.
a	80.	Gross profit to be recognized using percentage-of-completion.
c	81.	Gross profit to be recognized using completed-contract method.
b	82.	Computation of construction costs incurred.
c	83.	Gross profit recognized under percentage-of-completion.
a	84.	Computation of construction in process amount.
b	85.	Loss recognized using completed-contract method.
c	86.	Revenue recognition using completed-contract method.
c	87.	Reporting a current liability with completed-contract-method.
a	88.	Reporting inventory under completed-contract method.
d	89.	Gain recognized on repossession—installment sale.
b	90.	Calculate loss on repossessed merchandise.
a	91.	Calculate loss on repossessed merchandise.
b	92.	Interest recognized on installment sales.
b	93.	Calculation of deferred gross profit amount.
b	94.	Computation of realized gross profit amount.
d	95.	Computation of loss on repossession.
d	96.	Calculation of gross profit rate.
a	97.	Computation of net income from installment sales.
d	98.	Computation of realized and deferred gross profit.
a	99.	Calculation of gross profit rate.
d	100.	Computation of net income from installment sales.
a	101.	Computation of realized and deferred gross profit.
c	102.	Computation of realized gross profit amount.
b	103.	Computation of realized gross profit-cost recovery method.
a	104.	Revenue recognized under the cost-recovery method.
d	*105.	Cancellation of franchise agreement.
c	*106.	Accounting for initial and annual continuing franchise fees.
b	*107.	Franchise fee with a bargain purchase option.
d	*108.	Sales on consignment.
a	*109.	Reporting inventory on consignment.

MULTIPLE CHOICE—CPA Adapted

Answer	No.	Description
a	110.	FASB's definition of "recognition."
b	111.	Determine contract costs incurred during year.
d	112.	Gross profit to be recognized using percentage-of-completion.
d	113.	Profit to be recognized using completed-contract method.
c	114.	Revenue recognized under completed-production method.
b	115.	Determine balance of installment accounts receivable.
c	116.	Calculate deferred gross profit—installment sales.
c	117.	Calculate deferred gross profit—installment sales.
c	118.	Balance of deferred gross profit—installment sales.
c	119.	Reporting deferred gross profit—installment sales.
a	120.	Effect of collections received on service contracts.

EXERCISES

Item	Description
E18-121	Revenue recognition (essay).
E18-122	Revenue recognition (essay).
E18-123	Long-term contracts (essay).
E18-124	Journal entries—percentage-of-completion.
E18-125	Percentage-of-completion method.
E18-126	Percentage-of-completion method.
E18-127	Percentage-of-completion and completed-contract methods.
E18-128	Installment sales.
E18-129	Installment sales.
E18-130	Installment sales.
*E18-131	Franchises.

PROBLEMS

Item	Description
P18-132	Long-term construction project accounting.
P18-133	Accounting for long-term construction contracts.
P18-134	Long-term contract accounting—completed-contract.
P18-135	Installment sales.

CHAPTER LEARNING OBJECTIVES

1. Apply the revenue recognition principle.

2. Describe accounting issues for revenue recognition at point of sale.

3. Apply the percentage-of-completion method for long-term contracts.

4. Apply the completed-contract method for long-term contracts.

5. Identify the proper accounting for losses on long-term contracts.

6. Describe the installment-sales method of accounting.

7. Explain the cost-recovery method of accounting.

*8. Explain revenue recognition for franchises and consignment sales.

SUMMARY OF LEARNING OBJECTIVES BY QUESTIONS

Item	Type	Item	Type	Item	Type	Item	Type	Item	Type	Item	Type	Item	Type
Learning Objective 1													
1.	TF	3.	TF	22.	MC	[S]24.	MC	[P]26.	MC	121.	E		
2.	TF	21.	MC	23.	MC	[P]25.	MC	110.	MC	122.	E		
Learning Objective 2													
4.	TF	6.	TF	28.	MC	30.	MC						
5.	TF	27.	MC	29.	MC	122.	E						
Learning Objective 3													
7.	TF	34.	MC	66.	MC	72.	MC	80.	MC	123.	E	133.	P
8.	TF	35.	MC	67.	MC	73.	MC	82.	MC	124.	E		
9.	TF	36.	MC	68.	MC	74.	MC	83.	MC	125.	E		
31.	MC	37.	MC	69.	MC	75.	MC	84.	MC	126.	E		
32.	MC	[S]38.	MC	70.	MC	76.	MC	111.	MC	127.	E		
33.	MC	65.	MC	71.	MC	78.	MC	112.	MC	132.	P		
Learning Objective 4													
10.	TF	40.	MC	81.	MC	87.	MC	123.	E	134.	P		
11.	TF	77.	MC	85.	MC	88.	MC	127.	E				
[S]39.	MC	79.	MC	86.	MC	113.	MC	133.	P				
Learning Objective 5													
12.	TF	14.	TF	41.	MC	43.	MC	[S]45.	MC	114.	MC	133.	P
13.	TF	15.	TF	42.	MC	44.	MC	[S]46.	MC	132.	P		
Learning Objective 6													
16.	TF	49.	MC	91.	MC	96.	MC	101.	MC	118.	MC	130.	E
17.	TF	50.	MC	92.	MC	97.	MC	102.	MC	119.	MC	135.	P
18.	TF	[S]51.	MC	93.	MC	98.	MC	115.	MC	120.	MC		
47.	MC	89.	MC	94.	MC	99.	MC	116.	MC	128.	E		
48.	MC	90.	MC	95.	MC	100.	MC	117.	MC	129.	E		
Learning Objective 7													
19.	TF	[P]52.	MC	54.	MC	56.	MC	103.	MC				
20.	TF	53.	MC	55.	MC	57.	MC	104.	MC				
Learning Objective 8*													
58.	MC	60.	MC	62.	MC	64.	MC	106.	MC	108.	MC	131.	E
59.	MC	61.	MC	63.	MC	105.	MC	107.	MC	109.	MC		

Note: TF = True-False
MC = Multiple Choice
E = Exercise
P = Problem

TRUE-FALSE—Conceptual

1. Companies should recognize revenue when it is realized and when cash is received.

2. Revenues are realized when a company exchanges goods and services for cash or claims to cash.

3. Delayed recognition of revenue is appropriate if the sale does not represent substantial completion of the earnings process.

4. If a company sells its product but gives the buyer the right to return it, the company should not recognize revenue until the sale is collected.

5. Companies can recognize revenue prior to completion and delivery of the product under certain circumstances.

6. Companies must use the percentage-of-completion method when estimates of progress toward completion are reasonably dependable.

7. The most popular input measure used to determine the progress toward completion is the cost-to-cost basis.

8. If the difference between the Construction in Process and the Billings on Construction in Process account balances is a debit, the difference is reported as a current asset.

9. The Construction in Process account includes only construction costs under the percentage-of-completion method.

10. Under the completed-contract method, companies recognize revenue and costs only when the contract is completed.

11. The principal advantage of the completed-contract method is that reported revenue reflects final results rather than estimates.

12. Companies must recognize a loss on an unprofitable contract under the percentage-of-completion method but not the completed-contract method.

13. A loss in the current period on a profitable contract must be recognized under both the percentage-of-completion and completed-contract method.

14. Under the completion-of-production basis, companies recognize revenue when agricultural crops are harvested since the sales price is reasonably assured and no significant costs are involved in product distribution.

15. The provision for a loss on an unprofitable contract may be combined with the Construction in Process account balance under percentage-of-completion but not completed-contract.

16. Under the installment-sales method, companies defer revenue and income recognition until the period of cash collection.

17. The installment-sales method defers only the gross profit instead of both the sales price and cost of goods sold.

18. Deferred gross profit is generally treated as an unearned revenue and classified as a current liability.

19. Under the cost-recovery method, a company recognizes no revenue or profit until cash payments by the buyer exceed the cost of the merchandise sold.

20. Companies recognize profit under the cost-recovery method only when cash collections exceed the total cost of the goods sold.

True-False Answers—Conceptual

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
1.	F	6.	F	11.	T	16.	F
2.	T	7.	T	12.	F	17.	T
3.	T	8.	T	13.	F	18.	T
4.	F	9.	F	14.	T	19.	F
5.	T	10.	F	15.	F	20.	T

MULTIPLE CHOICE—Conceptual

21. The revenue recognition principle provides that revenue is recognized when
    a. it is realized.
    b. it is realizable.
    c. it is realized or realizable and it is earned.
    d. none of these.

22. When goods or services are exchanged for cash or claims to cash (receivables), revenues are
    a. earned.
    b. realized.
    c. recognized.
    d. all of these.

23. When the entity has substantially accomplished what it must do to be entitled to the benefits represented by the revenues, revenues are
    a. earned.
    b. realized.
    c. recognized.
    d. all of these.

S24. Which of the following is *not* an accurate representation concerning revenue recognition?
a. Revenue from selling products is recognized at the date of sale, usually interpreted to mean the date of delivery to customers.
b. Revenue from services rendered is recognized when cash is received or when services have been performed.
c. Revenue from permitting others to use enterprise assets is recognized as time passes or as the assets are used.
d. Revenue from disposing of assets other than products is recognized at the date of sale.

P25. The process of formally recording or incorporating an item in the financial statements of an entity is
a. allocation.
b. articulation.
c. realization.
d. recognition.

P26. Dot Point, Inc. is a retailer of washers and dryers and offers a three-year service contract on each appliance sold. Although Dot Point sells the appliances on an installment basis, all service contracts are cash sales at the time of purchase by the buyer. Collections received for service contracts should be recorded as
a. service revenue.
b. deferred service revenue.
c. a reduction in installment accounts receivable.
d. a direct addition to retained earnings.

27. Which of the following is *not* a reason why revenue is recognized at time of sale?
a. Realization has occurred.
b. The sale is the critical event.
c. Title legally passes from seller to buyer.
d. All of these are reasons to recognize revenue at time of sale.

28. An alternative available when the seller is exposed to continued risks of ownership through return of the product is
a. recording the sale, and accounting for returns as they occur in future periods.
b. not recording a sale until all return privileges have expired.
c. recording the sale, but reducing sales by an estimate of future returns.
d. all of these.

29. A sale should *not* be recognized as revenue by the seller at the time of sale if
a. payment was made by check.
b. the selling price is less than the normal selling price.
c. the buyer has a right to return the product and the amount of future returns cannot be reasonably estimated.
d. none of these.

30. The FASB concluded that if a company sells its product but gives the buyer the right to return the product, revenue from the sales transaction shall be recognized at the time of sale only if *all* of six conditions have been met. Which of the following is *not* one of these six conditions?
    a. The amount of future returns can be reasonably estimated.
    b. The seller's price is substantially fixed or determinable at time of sale.
    c. The buyer's obligation to the seller would not be changed in the event of theft or damage of the product.
    d. The buyer is obligated to pay the seller upon resale of the product.

31. In selecting an accounting method for a newly contracted long-term construction project, the principal factor to be considered should be
    a. the terms of payment in the contract.
    b. the degree to which a reliable estimate of the costs to complete and extent of progress toward completion is practicable.
    c. the method commonly used by the contractor to account for other long-term construction contracts.
    d. the inherent nature of the contractor's technical facilities used in construction.

32. The percentage-of-completion method must be used when certain conditions exist. Which of the following is *not* one of those necessary conditions?
    a. Estimates of progress toward completion, revenues, and costs are reasonably dependable.
    b. The contractor can be expected to perform the contractual obligation.
    c. The buyer can be expected to satisfy some of the obligations under the contract.
    d. The contract clearly specifies the enforceable rights of the parties, the consideration to be exchanged, and the manner and terms of settlement.

33. When work to be done and costs to be incurred on a long-term contract can be estimated dependably, which of the following methods of revenue recognition is preferable?
    a. Installment-sales method
    b. Percentage-of-completion method
    c. Completed-contract method
    d. None of these

34. How should the balances of progress billings and construction in process be shown at reporting dates prior to the completion of a long-term contract?
    a. Progress billings as deferred income, construction in progress as a deferred expense.
    b. Progress billings as income, construction in process as inventory.
    c. Net, as a current asset if debit balance, and current liability if credit balance.
    d. Net, as income from construction if credit balance, and loss from construction if debit balance.

35. In accounting for a long-term construction-type contract using the percentage-of-completion method, the gross profit recognized during the first year would be the estimated total gross profit from the contract, multiplied by the percentage of the costs incurred during the year to the
    a. total costs incurred to date.
    b. total estimated cost.
    c. unbilled portion of the contract price.
    d. total contract price.

36. How should earned but unbilled revenues at the balance sheet date on a long-term construction contract be disclosed if the percentage-of-completion method of revenue recognition is used?
    a. As construction in process in the current asset section of the balance sheet.
    b. As construction in process in the noncurrent asset section of the balance sheet.
    c. As a receivable in the noncurrent asset section of the balance sheet.
    d. In a note to the financial statements until the customer is formally billed for the portion of work completed.

37. The principal disadvantage of using the percentage-of-completion method of recognizing revenue from long-term contracts is that it
    a. is unacceptable for income tax purposes.
    b. gives results based upon estimates which may be subject to considerable uncertainty.
    c. is likely to assign a small amount of revenue to a period during which much revenue was actually earned.
    d. none of these.

S38. One of the more popular input measures used to determine the progress toward completion in the percentage-of-completion method is
    a. revenue-percentage basis.
    b. cost-percentage basis.
    c. progress completion basis.
    d. cost-to-cost basis.

S39. The principal advantage of the completed-contract method is that
    a. reported revenue is based on final results rather than estimates of unperformed work.
    b. it reflects current performance when the period of a contract extends into more than one accounting period.
    c. it is not necessary to recognize revenue at the point of sale.
    d. a greater amount of gross profit and net income is reported than is the case when the percentage-of-completion method is used.

40. Under the completed-contract method
    a. revenue, cost, and gross profit are recognized during the production cycle.
    b. revenue and cost are recognized during the production cycle, but gross profit recognition is deferred until the contract is completed.
    c. revenue, cost, and gross profit are recognized at the time the contract is completed.
    d. none of these.

41. Cost estimates on a long-term contract may indicate that a loss will result on completion of the entire contract. In this case, the entire expected loss should be
    a. recognized in the current period, regardless of whether the percentage-of-completion or completed-contract method is employed.
    b. recognized in the current period under the percentage-of-completion method, but the completed-contract method should defer recognition of the loss to the time when the contract is completed.
    c. recognized in the current period under the completed-contract method, but the percentage-of-completion method should defer the loss until the contract is completed.
    d. deferred and recognized when the contract is completed, regardless of whether the percentage-of-completion or completed-contract method is employed.

42. Cost estimates at the end of the second year indicate a loss will result on completion of the entire contract. Which of the following statements is correct?
   a. Under the completed-contract method, the loss is not recognized until the year the construction is completed.
   b. Under the percentage-of-completion method, the gross profit recognized in the first year must not be changed.
   c. Under the completed-contract method, when the billings exceed the accumulated costs, the amount of the estimated loss is reported as a current liability.
   d. Under the completed-contract method, when the Construction in Process balance exceeds the billings, the estimated loss is added to the accumulated costs.

43. The criteria for recognition of revenue at the completion of production of precious metals and farm products include
   a. an established market with quoted prices.
   b. low additional costs of completion and selling.
   c. units are interchangeable.
   d. all of these.

44. In certain cases, revenue is recognized at the completion of production even though no sale has been made. Which of the following statements is *not* true?
   a. Examples involve precious metals or farm equipment.
   b. The products possess immediate marketability at quoted prices.
   c. No significant costs are involved in selling the product.
   d. All of these statements are true.

S45. For which of the following products is it appropriate to recognize revenue at the completion of production even though no sale has been made?
   a. Automobiles
   b. Large appliances
   c. Single family residential units
   d. Precious metals

S46. When there is a significant increase in the estimated total contract costs but the increase does not eliminate all profit on the contract, which of the following is correct?
   a. Under both the percentage-of-completion and the completed-contract methods, the estimated cost increase requires a current period adjustment of excess gross profit recognized on the project in prior periods.
   b. Under the percentage-of-completion method only, the estimated cost increase requires a current period adjustment of excess gross profit recognized on the project in prior periods.
   c. Under the completed-contract method only, the estimated cost increase requires a current period adjustment of excess gross profit recognized on the project in prior periods.
   d. No current period adjustment is required.

47. Deferred gross profit on installment sales is generally treated as a(n)
   a. deduction from installment accounts receivable.
   b. deduction from installment sales.
   c. unearned revenue and classified as a current liability.
   d. deduction from gross profit on sales.

48. The installment-sales method of recognizing profit for accounting purposes is acceptable if
 a. collections in the year of sale do not exceed 30% of the total sales price.
 b. an unrealized profit account is credited.
 c. collection of the sales price is not reasonably assured.
 d. the method is consistently used for all sales of similar merchandise.

49. The method most commonly used to report defaults and repossessions is
 a. provide no basis for the repossessed asset thereby recognizing a loss.
 b. record the repossessed merchandise at fair value, recording a gain or loss if appropriate.
 c. record the repossessed merchandise at book value, recording no gain or loss.
 d. none of these.

50. Under the installment-sales method,
 a. revenue, costs, and gross profit are recognized proportionate to the cash that is received from the sale of the product.
 b. gross profit is deferred proportionate to cash uncollected from sale of the product, but total revenues and costs are recognized at the point of sale.
 c. gross profit is not recognized until the amount of cash received exceeds the cost of the item sold.
 d. revenues and costs are recognized proportionate to the cash received from the sale of the product, but gross profit is deferred until all cash is received.

[S]51. The realization of income on installment sales transactions involves
 a. recognition of the difference between the cash collected on installment sales and the cash expenses incurred.
 b. deferring the net income related to installment sales and recognizing the income as cash is collected.
 c. deferring gross profit while recognizing operating or financial expenses in the period incurred.
 d. deferring gross profit and all additional expenses related to installment sales until cash is ultimately collected.

[P]52. A manufacturer of large equipment sells on an installment basis to customers with questionable credit ratings. Which of the following methods of revenue recognition is *least* likely to overstate the amount of gross profit reported?
 a. At the time of completion of the equipment (completion of production method)
 b. At the date of delivery (sales method)
 c. The installment-sales method
 d. The cost–recovery method

53. A seller is properly using the cost-recovery method for a sale. Interest will be earned on the future payments. Which of the following statements is *not* correct?
 a. After all costs have been recovered, any additional cash collections are included in income.
 b. Interest revenue may be recognized before all costs have been recovered.
 c. The deferred gross profit is offset against the related receivable on the balance sheet.
 d. Subsequent income statements report the gross profit as a separate item of revenue when it is recognized as earned.

54. Under the cost-recovery method of revenue recognition,
    a. income is recognized on a proportionate basis as the cash is received on the sale of the product.
    b. income is recognized when the cash received from the sale of the product is greater than the cost of the product.
    c. income is recognized immediately.
    d. none of these.

55. Winser, Inc. is engaged in extensive exploration for water in Utah. If, upon discovery of water, Winser does not recognize any revenue from water sales until the sales exceed the costs of exploration, the basis of revenue recognition being employed is the
    a. production basis.
    b. cash (or collection) basis.
    c. sales (or accrual) basis.
    d. cost recovery basis.

56. The deposit method of revenue recognition is used when
    a. the product can be marketed at quoted prices and units are interchangeable.
    b. cash is received before the sales transaction is complete.
    c. the contract is short-term or the percentage-of-completion method can't be used.
    d. there are no significant costs of distribution.

57. The cost-recovery method
    a. is prohibited under current GAAP due to its conservative nature.
    b. requires a company to defer profit recognition until all cash payments are received from the buyer.
    c. is used by sellers when there is a reasonable basis for estimating collectibility.
    d. recognizes total revenue and total cost of goods sold in the period of sale.

*58. Types of franchising arrangements include all of the following except
    a. service sponsor-retailer.
    b. wholesaler-service sponsor.
    c. manufacturer-wholesaler.
    d. wholesaler-retailer.

*59. In consignment sales, the consignee
    a. records the merchandise as an asset on its books.
    b. records a liability for the merchandise held on consignment.
    c. recognizes revenue when it ships merchandise to the consignor.
    d. prepares an "account report" for the consignor which shows sales, expenses, and cash receipts.

*60. Some of the initial franchise fee may be allocated to
    a. continuing franchise fees.
    b. interest revenue on the future installments.
    c. options to purchase the franchisee's business.
    d. All of these may reduce the amount of the initial franchise fee that is recognized as revenue.

*61. Continuing franchise fees should be recorded by the franchisor
a. as revenue when earned and receivable from the franchisee.
b. as revenue when received.
c. in accordance with the accounting procedures specified in the franchise agreement.
d. as revenue only after the balance of the initial franchise fee has been collected.

*62. Occasionally a franchise agreement grants the franchisee the right to make future bargain purchases of equipment or supplies. When recording the initial franchise fee, the franchisor should
a. increase revenue recognized from the initial franchise fee by the amount of the expected future purchases.
b. record a portion of the initial franchise fee as unearned revenue which will increase the selling price when the franchisee subsequently makes the bargain purchases.
c. defer recognition of any revenue from the initial franchise fee until the bargain purchases are made.
d. None of these.

*63. A franchise agreement grants the franchisor an option to purchase the franchisee's business. It is probable that the option will be exercised. When recording the initial franchise fee, the franchisor should
a. record the entire initial franchise fee as a deferred credit which will reduce the franchisor's investment in the purchased outlet when the option is exercised.
b. record the entire initial franchise fee as unearned revenue which will reduce the amount of cash paid when the option is exercised.
c. record the portion of the initial franchise fee which is attributable to the bargain purchase option as a reduction of the future amounts receivable from the franchisee.
d. None of these.

*64. Revenue is recognized by the consignor when the
a. goods are shipped to the consignee.
b. consignee receives the goods.
c. consignor receives an advance from the consignee.
d. consignor receives an account sales from the consignee.

Multiple Choice Answers—Conceptual

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
21.	c	28.	d	35.	b	42.	c	49.	b	56.	b	*63.	a
22.	b	29.	c	36.	a	43.	d	50.	b	57.	d	*64.	d
23.	a	30.	d	37.	b	44.	a	51.	c	*58.	b		
24.	b	31.	b	38.	d	45.	d	52.	d	*59.	d		
25.	d	32.	c	39.	a	46.	b	53.	b	*60.	d		
26.	b	33.	b	40.	c	47.	c	54.	b	*61.	a		
27.	d	34.	c	41.	a	48.	c	55.	d	*62.	b		

MULTIPLE CHOICE—Computational

Use the following information for questions 65-68:

Seasons Construction is constructing an office building under contract for Cannon Company. The contract calls for progress billings and payments of $930,000 each quarter. The total contract price is $11,160,000 and Seasons estimates total costs of $10,650,000. Seasons estimates that the building will take 3 years to complete, and commences construction on January 2, 2012.

65. At December 31, 2012, Seasons estimates that it is 30% complete with the construction, based on costs incurred. What is the total amount of Revenue from Long-Term Contracts recognized for 2012 and what is the balance in the Accounts Receivable account assuming Cannon Cafe has not yet made its last quarterly payment?

	Revenue	Accounts Receivable
a.	$3,720,000	$3,720,000
b.	$3,195,000	$ 930,000
c.	$3,348,000	$ 930,000
d.	$3,195,000	$3,720,000

66. At December 31, 2013, Seasons Construction estimates that it is 75% complete with the building; however, the estimate of total costs to be incurred has risen to $10,800,000 due to unanticipated price increases. What is the total amount of Construction Expenses that Seasons will recognize for the year ended December 31, 2013?
    a. $8,100,000
    b. $4,725,000
    c. $4,792,500
    d. $4,905,000

67. At December 31, 2013, Seasons Construction estimates that it is 75% complete with the building; however, the estimate of total costs to be incurred has risen to $10,800,000 due to unanticipated price increases. What is reported in the balance sheet at December 31, 2013 for Seasons as the difference between the Construction in Process and the Billings on Construction in Process accounts, and is it a debit or a credit?

	Difference between the accounts	Debit/Credit
a.	$2,535,000	Credit
b.	$930,000	Debit
c.	$660,000	Debit
d.	$930,000	Credit

68. Seasons Construction completes the remaining 25% of the building construction on December 31, 2014, as scheduled. At that time the total costs of construction are $11,250,000. What is the total amount of Revenue from Long-Term Contracts and Construction Expenses that Seasons will recognize for the year ended December 31, 2014?

	Revenue	Expenses
a.	$11,160,000	$11,250,000
b.	$2,790,000	$ 2,812,000
c.	$2,790,000	$ 3,150,000
d.	$2,812,500	$ 2,812,500

The following information relates to questions 69 and 70.

Cooper Construction Company had a contract starting April 2013, to construct a $12,000,000 building that is expected to be completed in September 2015, at an estimated cost of $11,000,000. At the end of 2013, the costs to date were $5,060,000 and the estimated total costs to complete had not changed. The progress billings during 2013 were $2,400,000 and the cash collected during 2013 was 1,600,000.

69. For the year ended December 31, 2013, Cooper would recognize gross profit on the building of:
    a. $421,667
    b. $460,000
    c. $540,000
    d. $0

70. At December 31, 2013 Cooper would report Construction in Process in the amount of:
    a. $460,000
    b. $5,060,000
    c. $5,520,000
    d. $4,720,000

71. Hayes Construction Corporation contracted to construct a building for $3,000,000. Construction began in 2012 and was completed in 2013. Data relating to the contract are summarized below:

	Year ended December 31,	
	2012	2013
Costs incurred	$1,200,000	$900,000
Estimated costs to complete	800,000	—

Hayes uses the percentage-of-completion method as the basis for income recognition. For the years ended December 31, 2012, and 2013, respectively, Hayes should report gross profit of
    a. $540,000 and $360,000.
    b. $1,800,000 and $1,200,000.
    c. $600,000 and $300,000.
    d. $0 and $900,000.

72. Monroe Construction Company uses the percentage-of-completion method of accounting. In 2013, Monroe began work on a contract it had received which provided for a contract price of $20,000,000. Other details follow:

	2013
Costs incurred during the year	$9,600,000
Estimated costs to complete as of December 31	6,400,000
Billings during the year	8,800,000
Collections during the year	5,200,000

What should be the gross profit recognized in 2013?
    a. $800,000
    b. $10,400,000
    c. $2,400,000
    d. $4,000,000

Use the following information for questions 73 and 74.

In 2013, Fargo Corporation began construction work under a three-year contract. The contract price is $3,600,000. Fargo uses the percentage-of-completion method for financial accounting purposes. The income to be recognized each year is based on the proportion of costs incurred to total estimated costs for completing the contract. The financial statement presentations relating to this contract at December 31, 2013, follow:

Balance Sheet		
Accounts receivable—construction contract billings		$150,000
Construction in progress	$450,000	
Less contract billings	360,000	
Costs and recognized profit in excess of billings		90,000
Income Statement		
Income (before tax) on the contract recognized in 2013		$90,000

73. How much cash was collected in 2013 on this contract?
   a. $150,000
   b. $210,000
   c. $30,000
   d. $360,000

74. What was the initial estimated total income before tax on this contract?
   a. $450,000
   b. $480,000
   c. $600,000
   d. $720,000

75. Adler Construction Co. uses the percentage-of-completion method. In 2012, Adler began work on a contract for $5,500,000 and it was completed in 2013. Data on the costs are:

	Year Ended December 31	
	2012	2013
Costs incurred	$1,950,000	$1,400,000
Estimated costs to complete	1,300,000	—

For the years 2012 and 2013, Adler should recognize gross profit of

	2012	2013
a.	$0	$2,150,000
b.	$1,290,000	$860,000
c.	$1,350,000	$800,000
d.	$1,350,000	$2,150,000

Use the following information for questions 76 and 77.

Gomez, Inc. began work in 2012 on contract #3814, which provided for a contract price of $9,600,000. Other details follow:

	2012	2013
Costs incurred during the year	$1,600,000	$4,900,000
Estimated costs to complete, as of December 31	4,800,000	0
Billings during the year	1,800,000	7,200,000
Collections during the year	1,200,000	7,800,000

76. Assume that Gomez uses the percentage-of-completion method of accounting. The portion of the total gross profit to be recognized as income in 2012 is
    a. $600,000.
    b. $800,000.
    c. $2,400,000.
    d. $3,200,000.

77. Assume that Gomez uses the completed-contract method of accounting. The portion of the total gross profit to be recognized as income in 2013 is
    a. $1,200,000.
    b. $1,800,000.
    c. $3,100,000.
    d. $9,600,000.

Use the following information for questions 78 and 79.

Kiner, Inc. began work in 2012 on a contract for $12,600,000. Other data are as follows:

	2012	2013
Costs incurred to date	$5,400,000	$8,400,000
Estimated costs to complete	3,600,000	—
Billings to date	4,200,000	12,600,000
Collections to date	3,000,000	10,800,000

78. If Kiner uses the percentage-of-completion method, the gross profit to be recognized in 2012 is
    a. $2,160,000.
    b. $2,400,000.
    c. $3,240,000.
    d. $3,600,000.

79. If Kiner uses the completed-contract method, the gross profit to be recognized in 2013 is
    a. $2,040,000.
    b. $4,200,000.
    c. $2,100,000.
    d. $8,400,000.

Use the following information for questions 80 and 81.

80. Horner Construction Co. uses the percentage-of-completion method. In 2012, Horner began work on a contract for $11,000,000; it was completed in 2013. The following cost data pertain to this contract:

	Year Ended December 31	
	2012	2013
Cost incurred during the year	$3,900,000	$2,800,000
Estimated costs to complete at the end of year	2,600,000	—

    The amount of gross profit to be recognized on the income statement for the year ended December 31, 2013 is
    a. $1,600,000.
    b. $1,720,000.
    c. $1,800,000.
    d. $4,300,000.

81. If the completed-contract method of accounting was used, the amount of gross profit to be recognized for years 2012 and 2013 would be

	2012	2013
a.	$4,500,000.	$0.
b.	$4,300,000.	$(200,000).
c.	$0.	$4,300,000.
d.	$0.	$4,500,000.

82. Remington Construction Company uses the percentage-of-completion method. During 2012, the company entered into a fixed-price contract to construct a building for Sherman Company for $18,000,000. The following details pertain to the contract:

	At December 31, 2012	At December 31, 2013
Percentage of completion	25%	60%
Estimated total cost of contract	$13,500,000	$15,000,000
Gross profit recognized to date	1,125,000	1,800,000

The amount of construction costs incurred during 2013 was
a. $9,000,000.
b. $5,625,000.
c. $3,375,000.
d. $1,500,000.

Use the following information for questions 83 and 84.

Eilert Construction Company had a contract starting April 2013, to construct an $18,000,000 building that is expected to be completed in September 2014, at an estimated cost of $16,500,000. At the end of 2013, the costs to date were $7,590,000 and the estimated total costs to complete had not changed. The progress billings during 2013 were $3,600,000 and the cash collected during 2013 was $2,400,000. Eilert uses the percentage-of-completion method.

83. For the year ended December 31, 2013, Eilert would recognize gross profit on the building of
a. $0.
b. $632,500.
c. $690,000.
d. $810,000.

84. At December 31, 2013, Eilert would report Construction in Process in the amount of
a. $8,280,000.
b. $7,590,000.
c. $7,080,000.
d. $690,000.

85. Hiser Builders, Inc. is using the completed-contract method for an $8,400,000 contract that will take two years to complete. Data at December 31, 2013, the end of the first year, are as follows:

Costs incurred to date	$3,840,000
Estimated costs to complete	4,920,000
Billings to date	3,600,000
Collections to date	3,000,000

The gross profit or loss that should be recognized for 2013 is
a. $0.
b. a $360,000 loss.
c. a $180,000 loss.
d. a $158,400 loss.

Use the following information for questions 86 through 88.

Gorman Construction Co. began operations in 2013. Construction activity for 2013 is shown below. Gorman uses the completed-contract method.

Contract	Contract Price	Billings Through 12/31/13	Collections Through 12/31/13	Costs to 12/31/13	Estimated Costs to Complete
1	$3,200,000	$3,150,000	$2,600,000	$2,150,000	—
2	3,600,000	1,500,000	1,000,000	820,000	$1,880,000
3	3,300,000	1,900,000	1,800,000	2,250,000	1,200,000

86. Which of the following should be shown on the income statement for 2013 related to Contract 1?
a. Gross profit, $450,000
b. Gross profit, $1,000,000
c. Gross profit, $1,050,000
d. Gross profit, $600,000

87. Which of the following should be shown on the balance sheet at December 31, 2013 related to Contract 2?
a. Inventory, $680,000
b. Inventory, $820,000
c. Current liability, $680,000
d. Current liability, $1,500,000

88. Which of the following should be shown on the balance sheet at December 31, 2013 related to Contract 3?
a. Inventory, $200,000
b. Inventory, $350,000
c. Inventory, $2,100,000
d. Inventory, $2,250,000

89. Oliver Co. uses the installment-sales method. When an account had a balance of $11,200, no further collections could be made and the dining room set was repossessed. At that time, it was estimated that the dining room set could be sold for $3,200 as repossessed, or for $4,000 if the company spent $400 reconditioning it. The gross profit rate on this sale was 70%. The gain or loss on repossession was a
    a. $7,840 loss.
    b. $8,000 loss.
    c. $800 gain.
    d. $240 gain.

90. Spicer Corporation has a normal gross profit on installment sales of 30%. A 2011 sale resulted in a default early in 2013. At the date of default, the balance of the installment receivable was $40,000, and the repossessed merchandise had a fair value of $22,500. Assuming the repossessed merchandise is to be recorded at fair value, the gain or loss on repossession should be
    a. $0.
    b. a $5,500 loss.
    c. a $5,500 gain.
    d. a $12,500 loss.

91. Fryman Furniture uses the installment-sales method. No further collections could be made on an account with a balance of $36,000. It was estimated that the repossessed furniture could be sold as is for $10,800, or for $12,600 if $600 were spent reconditioning it. The gross profit rate on the original sale was 40%. The loss on repossession was
    a. $9,600.
    b. $9,000.
    c. $24,000.
    d. $25,200.

92. Melton Company sold some machinery to Addison Company on January 1, 2012. The cash selling price would have been $758,160. Addison entered into an installment sales contract which required annual payments of $200,000, including interest at 10%, over five years. The first payment was due on December 31, 2012. What amount of interest income should be included in Melton's 2013 income statement (the second year of the contract)?
    a. $20,000
    b. $63,398
    c. $40,000
    d. $55,816

93. Carperter Company has used the installment method of accounting since it began operations at the beginning of 2013. The following information pertains to its operations for 2013:

Installment sales	$ 2,100,000
Cost of installment sales	1,470,000
Collections of installment sales	840,000
General and administrative expenses	210,000

The amount to be reported on the December 31, 2013 balance sheet as Deferred Gross Profit should be
a. $ 252,000.
b. $ 378,000.
c. $ 504,000.
d. $1,260,000.

94. Daily, Inc. appropriately used the installment method of accounting to recognize income in its financial statement. Some pertinent data relating to this method of accounting include:

	2012	2013
Installment sales	$750,000	$900,000
Cost of sales	450,000	630,000
Gross profit	$300,000	$270,000
Collections during year:		
On 2012 sales	150,000	150,000
On 2013 sales		180,000

What amount to be realized gross profit should be reported on Daily's income statement for 2013?
a. $99,000
b. $114,000
c. $132,000
d. $162,000

95. Sutton Company sells plasma-screen televisions on an installment basis and appropriately uses the installment-sales method of accounting. A customer with an account balance of $2,800 refuses to make any more payments and the merchandise is repossessed. The gross profit rate on the original sale is 40%. Sutton estimates that the television can be sold as is for $875, or for $1,050 if $70 is spent to refurbish it. The loss on repossession is
a. $1,925.
b. $1,120.
c. $ 805.
d. $ 700.

Use the following information for questions 96-98.

During 2012, Vaughn Corporation sold merchandise costing $3,000,000 on an installment basis for $4,000,000. The cash receipts related to these sales were collected as follows: 2012, $1,600,000; 2013, $1,400,000; 2014, $1,000,000.

96. What is the rate of gross profit on the installment sales made by Vaughn Corporation during 2012?
    a. 75%
    b. 60%
    c. 40%
    d. 25%

97. If expenses, other than the cost of the merchandise sold, related to the 2012 installment sales amounted to $180,000, by what amount would Vaughn's net income for 2012 increase as a result of installment sales?
    a. $ 220,000
    b. $ 355,000
    c. $ 400,000
    d. $1,420,000

98. What amount would be shown in the December 31, 2013 financial statement for realized gross profit on 2012 installment sales, and deferred gross profit on 2012 installment sales, respectively?
    a. $350,000 and $750,000
    b. $650,000 and $350,000
    c. $750,000 and $250,000
    d. $350,000 and $250,000

Use the following information for questions 99 – 101.
During 2012, Martin Corporation sold merchandise costing $2,800,000 on an installment basis for $4,000,000. The cash receipts related to these sales were collected as follows: 2012, $1,600,000; 2013, $1,400,000; 2014, $1,000,000.

99. What is the rate of gross profit on the installment sales made by Martin Corporation during 2012?
    a. 30%
    b. 40%
    c. 60%
    d. 70%

100. If expenses, other than the cost of the merchandise sold, related to the 2012 installment sales amounted to $160,000, by what amount would Martin's net income for 2012 increase as a result of installment sales?
    a. $1,440,000
    b. $ 480,000
    c. $ 360,000
    d. $ 320,000

101. What amount would be shown in the December 31, 2013 financial statements for realized gross profit on 2012 installment sales, and deferred gross profit on 2012 installment sales, respectively?
    a. $420,000 and $300,000
    b. $780,000 and $420,000
    c. $300,000 and $900,000
    d. $420,000 and $900,000

Use the following information for questions 102 and 103.
Coaster manufactures and sells logging equipment. Due to the nature of its business, Coaster is unable to reliably predict bad debts. During 2012, Coaster sold equipment costing $3,600,000 for $5,400,000. The terms of the sale were 20% down, with equal payments due quarterly over the next 3 years. All payments for 2012 were made on schedule. Round answers to two places.

102. Assuming that Coaster uses the installment method of accounting for its installment sales, what amount of realized gross profit will Coaster report in its income statement for the year ended December 31, 2012?
   a. $2,520,000
   b. $1,680,000
   c. $ 840,000
   d. $ 554,400

103. Assuming that Coaster uses the cost-recovery method of accounting for its installment sales, what amount of realized gross profit will Coaster report in its income statement for the year ended December 31, 2013?
   a. $0
   b. $ 360,000
   c. $ 475,200
   d. $1,440,000

104. On January 1, 2013, Shaw Co. sold land that cost $420,000 for $560,000, receiving a note bearing interest at 10%. The note will be paid in three annual installments of $225,190 starting on December 31, 2013. Because collection of the note is very uncertain, Shaw will use the cost-recovery method. How much revenue from this sale should Shaw recognize in 2013?
   a. $0
   b. $42,000
   c. $56,000
   d. $140,000

*105. On April 1, 2013 Weston, Inc. entered into a franchise agreement with a local business-man. The franchisee paid $300,000 and gave a $200,000, 8%, 3-year note payable with interest due annually on March 31. Weston recorded the $500,000 initial franchise fee as revenue on April 1, 2013. On December 30, 2013, the franchisee decided not to open an outlet under Weston's name. Weston canceled the franchisee's note and refunded $160,000, less accrued interest on the note, of the $300,000 paid on April 1. What entry should Weston make on December 30, 2013?

a.	Loss on Repossessed Franchise	160,000	
	Cash		160,000
b.	Loss on Repossessed Franchise	148,000	
	Cash		148,000
c.	Loss on Repossessed Franchise	348,000	
	Cash		148,000
	Notes Receivable		200,000
d.	Revenue from Franchise Fees	500,000	
	Interest Income		12,000
	Cash		148,000
	Notes Receivable		200,000
	Revenue from Repossessed Franchise		140,000

*106. On January 1, 2013 Dairy Treats, Inc. entered into a franchise agreement with a company allowing the company to do business under Dairy Treats's name. Dairy Treats had performed substantially all required services by January 1, 2013, and the franchisee paid the initial franchise fee of $700,000 in full on that date. The franchise agreement specifies that the franchisee must pay a continuing franchise fee of $60,000 annually, of which 20% must be spent on advertising by Dairy Treats. What entry should Dairy Treats make on January 1, 2013 to record receipt of the initial franchise fee and the continuing franchise fee for 2013?

a.	Cash	760,000	
	Franchise Fee Revenue		700,000
	Revenue from Franchise Fees		60,000
b.	Cash	760,000	
	Unearned Franchise Fees		760,000
c.	Cash	760,000	
	Franchise Fee Revenue		700,000
	Revenue from Franchise Fees		48,000
	Unearned Franchise Fees		12,000
d.	Prepaid Advertising	12,000	
	Cash	760,000	
	Franchise Fee Revenue		700,000
	Revenue from Franchise Fees		60,000
	Unearned Franchise Fees		12,000

*107. Wynne Inc. charges an initial franchise fee of $1,380,000, with $300,000 paid when the agreement is signed and the balance in five annual payments. The present value of the future payments, discounted at 10%, is $818,808. The franchisee has the option to purchase $180,000 of equipment for $144,000. Wynne has substantially provided all initial services required and collectibility of the payments is reasonably assured. The amount of revenue from franchise fees is

a. $ 300,000.
b. $1,082,808.
c. $1,118,808.
d. $1,380,000.

Use the following information for questions 108 and 109.

On May 1, 2013, TV Inc. consigned 80 TVs to Ed's TV. The TVs cost $360. Freight on the shipment paid by Ed's TV was $800. On July 10, TV Inc. received an account sales and $17,200 from Ed's TV. Thirty TVs had been sold and the following expenses were deducted:

Freight	$800
Commission (20% of sales price)	?
Advertising	520
Delivery	280

*108. The total sales price of the TVs sold by Ed's TV was

a. $20,500.
b. $21,500.
c. $21,850.
d. $23,500.

*109. The inventory of TVs will be reported on whose balance sheet and at what amount?

	Balance Sheet of	Amount of Inventory
a.	TV Inc.	$18,500
b.	TV Inc.	$18,000
c.	Ed's TV	$18,500
d.	Ed's TV	$18,000

Multiple Choice Answers—Computational

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
65.	c	72.	c	79.	b	86.	c	93.	b	100.	d	*107.	b
66.	d	73.	b	80.	a	87.	c	94.	b	101.	a	*108.	d
67.	b	74.	d	81.	c	88.	a	95.	d	102.	c	*109.	a
68.	c	75.	c	82.	b	89.	d	96.	d	103.	b		
69.	b	76.	b	83.	c	90.	b	97.	a	104.	a		
70.	c	77.	c	84.	a	91.	a	98.	d	*105.	d		
71.	c	78.	a	85.	b	92.	b	99.	a	*106.	c		

MULTIPLE CHOICE—CPA Adapted

110. According to the FASB's conceptual framework, the process of reporting an item in the financial statements of an entity is
a. recognition.
b. realization.
c. allocation.
d. matching.

111. Green Construction Co. has consistently used the percentage-of-completion method of recognizing revenue. During 2012, Green entered into a fixed-price contract to construct an office building for $16,000,000. Information relating to the contract is as follows:

	At December 31	
	2012	2013
Percentage of completion	15%	45%
Estimated total cost at completion	$12,000,000	$12,800,000
Gross profit recognized (cumulative)	800,000	1,920,000

Contract costs incurred during 2013 were
a. $3,840,000.
b. $3,960,000.
c. $4,200,000.
d. $5,760,000.

112. Bruner Constructors, Inc. has consistently used the percentage-of-completion method of recognizing income. In 2012, Bruner started work on a $28,000,000 construction contract that was completed in 2013. The following information was taken from Bruner's 2012 accounting records:

Progress billings	$8,800,000
Costs incurred	8,400,000
Collections	5,600,000
Estimated costs to complete	16,800,000

What amount of gross profit should Bruner have recognized in 2012 on this contract?
a. $2,800,000
b. $1,866,667
c. $1,400,000
d. $933,333

113. During 2012, Gates Corp. started a construction job with a total contract price of $7,000,000. The job was completed on December 15, 2013. Additional data are as follows:

	2012	2013
Actual costs incurred	$2,700,000	$3,050,000
Estimated remaining costs	2,700,000	—
Billed to customer	2,400,000	4,600,000
Received from customer	2,000,000	4,800,000

Under the completed-contract method, what amount should Gates recognize as gross profit for 2013?
a. $450,000
b. $625,000
c. $950,000
d. $1,250,000

114. Hogan Farms produced 1,200,000 pounds of cotton during the 2013 season. Hogan sells all of its cotton to Ott Co., which has agreed to purchase Hogan's entire production at the prevailing market price. Recent legislation assures that the market price will not fall below $.70 per pound during the next two years. Hogan's costs of selling and distributing the cotton are immaterial and can be reasonably estimated. Hogan reports its inventory at expected exit value. During 2013, Hogan sold and delivered to Ott 900,000 pounds at the market price of $.70. Hogan sold the remaining 300,000 pounds during 2014 at the market price of $.72. What amount of revenue should Hogan recognize in 2013?
a. $630,000
b. $648,000
c. $840,000
d. $864,000

115. Braun, Inc. appropriately uses the installment-sales method of accounting to recognize income in its financial statements. Some pertinent data relating to this method of accounting include:

	2012	2013
Installment sales	$750,000	$720,000
Cost of installment sales	570,000	504,000
Gross profit	$180,000	$216,000
Rate of gross profit	24%	30%
Balance of deferred gross profit at year end:		
2012	$108,000	$ 36,000
2013		198,000
Total	$108,000	$234,000

What amount of installment accounts receivable should be presented in Braun's December 31, 2013 balance sheet?

a. $720,000
b. $810,000
c. $780,000
d. $866,666

116. Hartz Co., which began operations on January 1, 2013, appropriately uses the installment-sales method of accounting. The following information pertains to Hartz's operations for the year 2013:

Installment sales	$2,000,000
Regular sales	800,000
Cost of installment sales	1,200,000
Cost of regular sales	480,000
General and administrative expenses	160,000
Collections on installment sales	480,000

The deferred gross profit account in Hartz's December 31, 2013 balance sheet should be

a. $192,000.
b. $320,000.
c. $608,000.
d. $800,000.

117. On January 1, 2012, Orton Co. sold a used machine to King, Inc. for $700,000. On this date, the machine had a depreciated cost of $490,000. King paid $100,000 cash on January 1, 2012 and signed a $600,000 note bearing interest at 10%. The note was payable in three annual installments of $150,000 beginning January 1, 2013. Orton appropriately accounted for the sale under the installment method. King made a timely payment of the first installment on January 1, 2013 of $260,000, which included interest of $60,000 to date of payment. At December 31, 2013, Orton has deferred gross profit of

a. $140,000.
b. $132,000.
c. $120,000.
d. $102,000.

118. Piper Co. began operations on January 1, 2013 and appropriately uses the installment method of accounting. The following information pertains to Piper's operations for 2013:

Installment sales	2,400,000
Cost of installment sales	1,440,000
General and administrative expenses	240,000
Collections on installment sales	1,100,000

The balance in the deferred gross profit account at December 31, 2013 should be
a. $440,000.
b. $660,000.
c. $520,000.
d. $960,000.

119. Moon Co. records all sales using the installment method of accounting. Installment sales contracts call for 36 equal monthly cash payments. According to the FASB's conceptual framework, the amount of deferred gross profit relating to collections 12 months beyond the balance sheet date should be reported in the
a. current liabilities section as a deferred revenue.
b. noncurrent liabilities section as a deferred revenue.
c. current assets section as a contra account.
d. noncurrent assets section as a contra account.

120. Crane, Inc. is a retailer of home appliances and offers a service contract on each appliance sold. Crane sells appliances on installment contracts, but all service contracts must be paid in full at the time of sale. Collections received for service contracts should be recorded as an increase in a
a. deferred revenue account.
b. sales contracts receivable valuation account.
c. stockholders' valuation account.
d. service revenue account.

Multiple Choice Answers—CPA Adapted

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
110.	a	112.	d	114.	c	116.	c	118.	c	120.	a
111.	b	113.	d	115.	b	117.	c	119.	c		

DERIVATIONS — Computational

No.	Answer	Derivation
65.	c	$11,160,000 × .30 = $3,348,000.
66.	d	($10,800,000 × .75) – ($10,650,000 × .30) = $4,905,000.
67.	b	($11,160,000 × .75) – ($930,000 × 8) = $930,000 debit.
68.	c	$11,160,000 × .25 = $2,790,000 $11,250,000 – ($10,800,000 × .75) = $3,150,000.

DERIVATIONS — Computational (cont.)

No.	Answer	Derivation
69.	b	($12,000,000 – $11,000,000) × ($5,060,000 ÷ $11,000,000) = $460,000.
70.	c	$5,060,000 + $460,000 = $5,520,000.
71.	c	$\frac{\$1,200,000}{\$1,200,000 + \$800,000}$ × ($3,000,000 – $2,000,000) = $600,000 ($3,000,000 – $2,100,000) – $600,000 = $300,000.
72.	c	$\frac{\$9,600,000}{\$9,600,000 + \$6,400,000}$ × ($20,000,000 – $16,000,000) = $2,400,000.
73.	b	$360,000 – $150,000 = $210,000.
74.	d	$450,000 – $90,000 = $360,000 $\frac{\$360,000}{\text{Total estimated cost}}$ × ($3,600,000 – Total estimated cost) = $90,000 Total estimated cost = $2,880,000 $3,600,000 – $2,880,000 = $720,000.
75.	c	$\frac{\$1,950,000}{\$3,250,000}$ × ($5,500,000 – $3,250,000) = $1,350,000 ($5,500,000 – $3,350,000) – $1,350,000 = $800,000.
76.	b	$\frac{\$1,600,000}{\$6,400,000}$ × ($9,600,000 – $6,400,000) = $800,000.
77.	c	$9,600,000 – $6,500,000 = $3,100,000.
78.	a	$\frac{\$5,400,000}{\$9,000,000}$ × ($12,600,000 – $9,000,000) = $2,160,000.
79.	b	$12,600,000 – $8,400,000 = $4,200,000.
80.	a	[$3,900,000 ÷ ($3,900,000 + $2,600,000)] × $4,500,000 = $2,700,000 ($11,000,000 – $6,700,000) – $2,700,00 = $1,600,000.
81.	c	$11,000,000 – $6,700,000 = $4,300,000.

DERIVATIONS — Computational (cont.)

No.	Answer	Derivation
82.	b	($15,000,000 × .60) – ($13,500,000 × .25) = $5,625,000.
83.	c	($7,590,000 ÷ $16,500,000) × $1,500,000 = $690,000.
84.	a	($7,590,000 ÷ $16,500,000) × $1,500,000 = $690,000. $7,590,000 + $690,000 = $8,280,000.
85.	b	$8,400,000 – ($3,840,000 + $4,920,000) = ($360,000).
86.	c	$3,200,000 – $2,150,000 = $1,050,000.
87.	c	$1,500,000 – $820,000 = $680,000.
88.	a	($2,250,000 – $150,000) – $1,900,000 = $200,000.
89.	d	$11,200 – $7,840 = $3,360 ($4,000 – $400) – $3,360 = $240 gain.
90.	b	$40,000 – $12,000 = $28,000 $28,000 – $22,500 = $5,500 loss.
91.	a	$36,000 – $14,400 = $21,600 ($12,600 – $600) – $21,600 = $9,600 loss.
92.	b	2012: $200,000 – ($758,160 × 10%) = $124,184. 2013: ($758,160 – $124,184) × 10% = $63,398.
93.	b	[($2,100,000 – $1,470,000) ÷ $2,100,000] × $1,260,000 = $378,000.
94.	b	($300,000 ÷ $750,000) × $150,000 = $60,000 [($270,000 ÷ $900,000) × $180,000] + $60,000 = $114,000.
95.	d	[$2,800 × (1 – .40)] – ($1,050 – $70) = $700.
96.	d	($4,000,000 – $3,000,000) ÷ $4,000,000 = 25%
97.	a	($1,600,000 × .25) – $180,000 = $220,000,
98.	d	$1,400,000 × .25 = $350,000; $1,000,000 × .25 = $250,000.
99.	a	($4,000,000 – $2,800,000) ÷ $4,000,000 = 30%.
100.	d	($1,600,000 × .30) – $160,000 = $320,000.
101.	a	$1,400,000 × .30 = $420,000 $1,200,000 – [($1,600,000 + $1,400,000) × .30] = $300,000.

DERIVATIONS — Computational (cont.)

No.	Answer	Derivation
102.	c	(\$5,400,000 – \$3,600,000) ÷ \$5,400,000 = 33 1/3% (\$5,400,000 × .20) + [(5,400,000 × .80) × 4/12)] = \$2,520,000 \$2,520,000 × 33 1/3% = \$840,000.
103.	b	[(\$5,400,000 × .20) + (\$5,400,000 × .80 × 8/12] – \$3,600,000 = \$360,000.
104.	a	\$0.
*105.	d	Revenue = \$500,000 Interest income = \$200,000 × 8% × 9/12 = \$12,000 Cash = \$160,000 – \$12,000 = \$148,000 Repossession revenue: \$300,000 – \$160,000 = \$140,000.
*106.	c	Cash = \$700,000 + \$60,000 = \$760,000 Franchise Fee Revenue = \$700,000 Unearned Franchise Fees = \$60,000 × 20% = \$12,000 Revenue from Franchise Fees = \$60,000 – \$12,000 = \$48,000.
*107	b	\$300,000 + \$818,808 – \$36,000 = \$1,082,808.
*108.	d	Sales – (Sales × 20%) – \$800 – \$520 – \$280 = \$17,200 .8 Sales = \$18,800 Sales = \$23,500.
*109.	a	(\$360 × 50) + [(\$800 ÷ 80) × 50] = \$18,500.

DERIVATIONS — CPA Adapted

No.	Answer	Derivation
110.	a	Conceptual.
111.	b	(\$12,800,000 × 45%) – (\$12,000,000 × 15%) = \$3,960,000.
112.	d	$\frac{\$8,400,000}{\$25,200,000}$ × (\$28,000,000 – \$25,200,000) = \$933,333.
113.	d	\$7,000,000 – \$2,700,000 – \$3,050,000 = \$1,250,000.
114.	c	1,200,000 lbs. × \$.70 = \$840,000.
115.	b	(\$36,000 ÷ 24%) + (\$198,000 ÷ 30%) = \$810,000.
116.	c	\$2,000,000 – \$1,200,000 = \$800,000 gross profit (40% gross profit rate) \$800,000 – (\$480,000 × .4) = \$608,000.

DERIVATIONS — CPA Adapted (cont.)

No.	Answer	Derivation
117.	c	$600,000 + $100,000 = $700,000 $700,000 – $490,000 = $210,000 gross profit (30% gross profit rate) ($600,000 – $200,000) × 30% = $120,000.
118.	c	$2,400,000 – $1,440,000 = $960,000 (40% gross profit rate) $960,000 – ($1,100,000 × 40%) = $520,000.
119.	c	Conceptual.
120.	a	Conceptual.

EXERCISES

Ex. 18-121— Revenue recognition (essay).

The revenue recognition principle provides that revenue is recognized when (1) it is realized or realizable and (2) it is earned.

Instructions
Explain when revenues are (a) realized, (b) realizable, and (c) earned.

Solution 18-121

(a) Revenues are *realized* when goods or services are exchanged for cash or claims to cash (receivables).
(b) Revenues are *realizable* when assets received in exchange are readily convertible to known amounts of cash or claims to cash.
(c) Revenues are *earned* when the earnings process is complete or virtually complete.

Ex. 18-122—Revenue recognition (essay).

The earning of revenue by a business is recognized for accounting purposes when the transaction is recorded. Revenue is often recognized at time of sale.

Instructions
At what times, other than at time of sale, may it be appropriate to recognize revenue? Explain and justify each of these times.

Solution 18-122

Revenue is also recognized (1) during production, (2) at completion, and (3) at collection.

(1) During production. The most common situation is the use of the percentage-of-completion method for long-term construction contracts. The point of sale is much less significant than production activity. If the contractor can expect to perform the contractual obligation, the revenue is assured by the contract. To defer recognition until completion of the entire contract misrepresents the efforts (costs) and accomplishments (revenues) of the interim periods. If progress toward completion can be estimated with reasonable accuracy, the percentage-of-completion method should be used.

(2) At completion. Examples of revenue recognition at completion of production involve precious metals and agricultural products with quoted prices. These sales prices are reasonably assured, there are low additional costs of distribution, and unit costs cannot be determined because of joint costs.

(3) At collection. When collection is highly uncertain and there is no reasonably objective basis for estimating the degree of collectibility, revenue should not be recognized until cash is received. In addition, if collection costs and bad debts are expected to be high and their amount cannot be reasonably estimated, revenue recognition should be deferred.

Ex. 18-123—Long-term construction contracts (essay).

In accounting for long-term construction contracts (those taking longer than one year to complete), the two methods commonly followed are percentage-of-completion and completed-contract.

Instructions

(a) Discuss how earnings on long-term construction contracts are recognized and computed under these two methods.

(b) Under what circumstances should one method be used over the other?

(c) How are job costs and interim billings reflected on the balance sheet under the percentage-of-completion method and the completed-contract method?

Solution 18-123

(a) The revenue recognized on a long-term construction contract under the percentage-of-completion method is determined by applying a percentage representing the degree of completion to the total contract price at the end of the accounting period. The percentage may be derived by dividing the costs incurred to date by the total estimated costs of the entire contract based on the most recent information. The revenue so derived is then reduced by the direct contract costs to determine the gross profit recognized in the initial period.

In subsequent periods, since the percentage-of-completion method described produces cumulative results, revenue and gross profit recognized in prior periods must be subtracted to obtain current revenue and gross profit to be recognized.

Solution 18-123 (cont.)

Under the completed-contract method, no earnings are recognized until the contract is substantially completed. For the period in which completion occurs, gross revenues include the total contract price. Total job costs incurred are deducted from gross revenues, resulting in recognition of the entire amount of gross profit in the completion period. If it is expected that a loss will occur on the contract, a provision for loss should be recognized immediately under both the completed-contract method and the percentage-of-completion method.

(b) The percentage-of-completion method should be used when estimates of the bases upon which progress is measured are reasonably dependable and all the following conditions exist:

1. The contract clearly specifies the enforceable rights regarding goods or services to be provided and received by the parties, the consideration to be exchanged, and the manner and terms of settlement.
2. The buyer can be expected to satisfy all obligations under the contract.
3. The contractor can be expected to perform the contractual obligation.

The completed-contract method should be used when inherent hazards or lack of dependable estimates cause the forecasts to be of doubtful value.

(c) Under the percentage-of-completion method, a schedule is made of the contracts in process, showing the total costs incurred as of the end of a given period, the estimated gross profit recognized based on the degree of completion, and the total billings rendered on each individual contract. If costs incurred plus recognized profits exceed the related billings on a contract, this net figure is shown as a current asset. This treatment shows that the contractor has not fully billed the customer for work performed to date and has a claim against the customer for that portion of work completed but not yet billed. If billings on a contract exceed costs incurred plus estimated profits, this net figure is shown as a current liability, which means that the contractor has overbilled the customer for work done to date and must complete the work represented by the excess billings.

Under the completed-contract method, the treatment of excess costs and billings is the same as under the percentage-of-completion method except that estimated profits are not computed because profit recognition is deferred until a contract is completed. The excess of costs over related billings on a contract is a current asset while the excess of billings over related costs on a contract is a current liability.

Ex. 18-124—Journal entries—percentage-of-completion.

Dixon Construction Company was awarded a contract to construct an interchange at the junction of U.S. 94 and Highway 30 at a total contract price of $10,000,000. The estimated total costs to complete the project were $7,500,000.

Instructions

(a) Make the entry to record construction costs of $4,500,000, on construction in process to date.

(b) Make the entry to record progress billings of $2,500,000.

(c) Make the entry to recognize the profit that can be recognized to date, on a percentage-of-completion basis.

Solution 18-124

(a)	Construction in Process	4,500,000	
	Materials, Cash, Payables.		4,500,000
(b)	Accounts Receivable	2,500,000	
	Billings on Construction in Process		2,500,000
(c)	Construction Expenses	4,500,000	
	Construction in Process (60% complete)	1,500,000	
	Revenue from Long-Term Contracts		6,000,000

Ex. 18-125—Percentage-of-completion method.

Dalton Construction Co. contracted to build a bridge for $10,000,000. Construction began in 2012 and was completed in 2013. Data relating to the construction are:

	2012	2013
Costs incurred	$3,300,000	$2,750,000
Estimated costs to complete	2,700,000	—

Dalton uses the percentage-of-completion method.

Instructions

(a) How much revenue should be reported for 2012? Show your computation.
(b) Make the entry to record progress billings of $3,300,000 during 2012.
(c) Make the entry to record the revenue and gross profit for 2012.
(d) How much gross profit should be reported for 2013? Show your computation.

Solution 18-125

(a) $$\frac{\$3,300,000}{\$6,000,000} \times \$10,000,000 = \underline{\underline{\$5,500,000}}$$

(b)	Accounts Receivable	3,300,000	
	Billings on Construction in Process		3,300,000
(c)	Construction Expenses	3,300,000	
	Construction in Process	2,200,000	
	Revenue from Long-Term Contracts		5,500,000

Solution 18-125 (cont.)

(d)

Revenue	$10,000,000
Costs	6,050,000
Total gross profit	3,950,000
Recognized in 2012	(2,200,000)
Recognized in 2013	$ 1,750,000

Or

Total revenue	$10,000,000
Recognized in 2012	(5,500,000)
Recognized in 2013	4,500,000
Costs in 2013	(2,750,000)
Gross profit in 2013	$ 1,750,000

Ex. 18-126—Percentage-of-completion method.

Penner Builders contracted to build a high-rise for $21,000,000. Construction began in 2012 and is expected to be completed in 2015. Data for 2012 and 2013 are:

	2012	2013
Costs incurred to date	$2,700,000	$7,800,000
Estimated costs to complete	10,800,000	7,200,000

Penner uses the percentage-of-completion method.

Instructions

(a) How much gross profit should be reported for 2012? Show your computation.
(b) How much gross profit should be reported for 2013?
(c) Make the journal entry to record the revenue and gross profit for 2013.

Solution 18-126

(a) $$\frac{\$2{,}700{,}000}{\$13{,}500{,}000} \times \$7{,}500{,}000 = \underline{\underline{\$1{,}500{,}000}}$$

(b) $$\frac{\$7{,}800{,}000}{\$15{,}000{,}000} \times \$6{,}000{,}000 = \$3{,}120{,}000$$

Less 2012 gross profit	1,500,000
Gross profit in 2013	$1,620,000

(c)

Construction in Process	1,620,000	
Construction Expenses	5,100,000	
Revenue from Long-Term Contracts		6,720,000

Ex. 18-127—Percentage-of-completion and completed-contract methods.

On February 1, 2012, Marsh Contractors agreed to construct a building at a contract price of $5,400,000. Marsh estimated total construction costs would be $4,000,000 and the project would be finished in 2014. Information relating to the costs and billings for this contract is as follows:

	2012	2013	2014
Total costs incurred to date	$1,500,000	$2,640,000	$4,600,000
Estimated costs to complete	2,500,000	1,760,000	-0-
Customer billings to date	2,200,000	4,000,000	5,600,000
Collections to date	2,000,000	3,500,000	5,500,000

Instructions

Fill in the correct amounts on the following schedule. For percentage-of-completion accounting and for completed-contract accounting, show the gross profit that should be recorded for 2012, 2013, and 2014.

	Percentage-of-Completion Gross Profit		Completed-Contract Gross Profit
2012	__________	2012	__________
2013	__________	2013	__________
2014	__________	2014	__________

Solution 18-127

	Percentage-of-Completion Gross Profit		Completed-Contract Gross Profit
2012	$525,000[a]	2012	—
2013	$ 75,000[b]	2013	—
2014	$200,000[c]	2014	$800,000[d]

[a] $\frac{\$1,500,000}{\$4,000,000} \times \$1,400,000 = \underline{\$525,000}$

[b] $\frac{\$2,640,000}{\$4,400,000} \times \$1,000,000 = \$600,000$

Less 2012 gross profit	(525,000)
2013 gross profit	$75,000

[c] Total revenue	$5,400,000
Total costs	4,600,000
Total gross profit	800,000
Recognized to date	(600,000)
2014 gross profit	$ 200,000

[d] Total revenue	$5,400,000
Total costs	4,600,000
Total gross profit	$800,000

Ex. 18-128—Installment sales.

Newton Co. had installment sales of $1,000,000 and cost of installment sales of $650,000 in 2012. A 2012 sale resulted in a default in 2014, at which time the balance of the installment receivable was $40,000. The repossessed merchandise had a fair value of $21,000.

Instructions
(a) Calculate the rate of gross profit on 2012 installment sales.
(b) Make the entry to record the repossession.

Solution 18-128

(a) $350,000 ÷ $1,000,000 = 35%

(b)	Repossessed Merchandise	21,000	
	Deferred Gross Profit, 2012 (.35 × $40,000)	14,000	
	Loss on Repossession	5,000	
	Installment Accounts Receivable, 2012		40,000

Ex. 18-129—Installment sales.

Sawyer Furniture Company concluded its *first* year of operations in which it made sales of $900,000, *all* on installment. Collections during the year from down payments and installments totaled $300,000. Purchases for the year totaled $620,000; the cost of merchandise on hand at the end of the year was $80,000.

Instructions
Using the installment-sales method, make summary entries to record:
(a) the installment sales and cash collections;
(b) the cost of installment sales;
(c) the unrealized gross profit;
(d) the realized gross profit.

Solution 18-129

(a)	Installment Accounts Receivable	900,000	
	Installment Sales		900,000
	Cash	300,000	
	Installment Accounts Receivable		300,000
(b)	Cost of Installment Sales ($620,000 – $80,000)	540,000	
	Inventory		540,000
(c)	Installment Sales	900,000	
	Cost of Installment Sales		540,000
	Deferred Gross Profit (40%)		360,000
(d)	Deferred Gross Profit (40% × $300,000)	120,000	
	Realized Gross Profit		120,000

Ex. 18-130—Installment sales.

Finley Company sells office equipment. On January 1, 2013, Finley entered into an installment sale contract with Miller Company for a six-year period expiring January 1, 2019. Equal annual payments under the installment sale are $894,000 and are due on January 1. The first payment was made on January 1, 2013.

Additional information is as follows:

The cash selling price of the equipment, i.e., the amount that would be realized on an outright sale, is $4,584,000.

The cost of sales relating to the equipment is $3,438,000.

The finance charges relating to the installment period are $780,000 based on a stated interest rate of 7% which is appropriate. For tax purposes, Finley appropriately uses the accrual basis for recording finance charges.

Circumstances are such that the collection of the installment sale is reasonably assured.

The installment sale qualified for the installment method of reporting for tax purposes.

Assume that the income tax rate is 30%.

Instructions

What income (loss) before income taxes should Finley appropriately record as a result of this transaction for the year ended December 31, 2013? Show supporting computations in good form.

Solution 18-130

(Note: For financial accounting purposes, the installment-sales method is not used, and the full gross profit is recognized in the year of sale, because collection of the receivable is reasonably assured.)

Finley Company
Computation of Income Before Income Taxes
On Installment Sale Contract
For the Year Ended December 31, 2013

Sales	$4,584,000
Cost of Sales	3,438,000
Gross Profit	1,146,000
Interest Revenue (Schedule I)	258,300
Income before Income Taxes	$1,404,300

Schedule I

Computation of Interest Revenue on
Installment Sale Contract

Cash selling price (sales)	$4,584,000
Payment made on January 1, 2013	894,000
Balance outstanding at 12/31/13	3,690,000
Interest rate	7%
Interest Revenue	$ 258,300

***Ex. 18-131**—Franchises.

Pasta Inn charges an initial fee of $900,000 for a franchise, with $180,000 paid when the agreement is signed and the balance in four annual payments. The present value of the annual payments, discounted at 10%, is $570,600. The franchisee has the right to purchase $60,000 of kitchen equipment and supplies for $50,000. An additional part of the initial fee is for advertising to be provided by Pasta Inn during the next five years. The value of the advertising is $1,000 a month. Collectibility of the payments is reasonably assured and Pasta Inn has performed all the initial services required by the contract.

Instructions
Prepare the entry to record the initial franchise fee. Show supporting computations in good form.

***Solution 18-131**

Total fee		$900,000
Discount	$ 720,000	
	(570,600)	(149,400)
Bargain purchase		(10,000)
Advertising ($1,000 × 60)		(60,000)
		$680,600

Cash	180,000	
Notes Receivable	720,000	
Discount on Notes Receivable		149,400
Revenue from Franchise Fees		680,600
Unearned Franchise Fees		70,000

PROBLEMS

Pr. 18-132—Long-term construction project accounting.

Dobson Construction specializes in the construction of commercial and industrial buildings. The contractor is experienced in bidding long-term construction projects of this type, with the typical project lasting fifteen to twenty-four months. The contractor uses the percentage-of-completion method of revenue recognition since, given the characteristics of the contractor's business and contracts, it is the most appropriate method. Progress toward completion is measured on a cost to cost basis. Dobson began work on a lump-sum contract at the beginning of 2013. As bid, the statistics were as follows:

Lump-sum price (contract price)		$4,000,000
Estimated costs		
Labor	$ 850,000	
Materials and subcontractor	1,750,000	
Indirect costs	400,000	3,000,000
		$1,000,000

Pr. 18-132 (cont.)

At the end of the first year, the following was the status of the contract:

Billings to date		$2,250,000
Costs incurred to date		
Labor	$ 464,000	
Materials and subcontractor	798,000	
Indirect costs	193,000	1,455,000
Latest forecast total cost		3,000,000

It should be noted that included in the above costs incurred to date were standard electrical and mechanical materials stored on the job site, but not yet installed, costing $105,000. These costs should not be considered in the costs incurred to date.

Instructions

(a) Compute the percentage of completion on the contract at the end of 2013.

(b) Indicate the amount of gross profit that would be reported on this contract at the end of 2013.

(c) Make the journal entry to record the income (loss) for 2013 on Dobson's books.

(d) Indicate the account(s) and the amount(s) that would be shown on the balance sheet of Dobson Construction at the end of 2013 related to its construction accounts. Also indicate where these items would be classified on the balance sheet. Billings collected during the year amounted to $1,980,000.

(e) Assume the latest forecast on total costs at the end of 2013 was $4,080,000. How much income (loss) would Dobson report for the year 2013?

Solution 18-132

(a)

Costs to date	$1,455,000
Less materials on job site	(105,000)
	$1,350,000

$$\frac{\text{Costs Incurred to Date}}{\text{Total Estimated Costs}} = \text{Percentage of Completion}$$

$$\frac{\$1,350,000}{\$3,000,000} = 45\%$$

(b)

45% × $4,000,000 =	$1,800,000
Costs incurred	1,350,000
Gross profit	$ 450,000

(c)

Construction Expenses	1,350,000	
Construction in Process	450,000	
Revenue from Long-Term Contracts		1,800,000

Solution 18-132 (cont.)

(d) Current Assets

Accounts receivable	$270,000	($2,250,000 – $1,980,000)

Current Liability

Billings in excess of contract costs and recognized profit	$50,000	($2,250,000 – $2,200,000)

(e) Total loss reported in 2013

Contract price	$4,000,000
Estimated cost to complete	4,080,000
Amount of loss to be reported	$ (80,000)

Pr. 18-133—Accounting for long-term construction contracts.

The board of directors of Ogle Construction Company is meeting to choose between the completed-contract method and the percentage-of-completion method of accounting for long-term contracts in the company's financial statements. You have been engaged to assist Ogle's controller in the preparation of a presentation to be given at the board meeting. The controller provides you with the following information:

1. Ogle commenced doing business on January 1, 2013.
2. Construction activities for the year ended December 31, 2013, were as follows:

Project	Total Contract Price	Billings Through 12/31/13	Cash Collections Through 12/31/13
A	$ 510,000	$ 340,000	$ 310,000
B	700,000	210,000	210,000
C	475,000	475,000	390,000
D	200,000	100,000	65,000
E	460,000	400,000	400,000
	$2,345,000	$1,525,000	$1,375,000

Project	Contract Costs Incurred Through 12/31/13	Estimated Additional Costs to Complete Contracts
A	$ 424,000	$101,000
B	195,000	455,000
C	350,000	-0-
D	123,000	97,000
E	320,000	80,000
	$1,412,000	$733,000

3. Each contract is with a different customer.
4. Any work remaining to be done on the contracts is expected to be completed in 2014.

Instructions

(a) Prepare a schedule by project, computing the amount of income (or loss) before selling, general, and administrative expenses for the year ended December 31, 2013, which would be reported under:
  (1) The completed-contract method.
  (2) The percentage-of-completion method (based on estimated costs).

(b) Prepare the general journal entry(ies) to record revenue and gross profit on project B (second project) for 2013, assuming that the percentage-of-completion method is used.

(c) Indicate the balances that would appear in the balance sheet at December 31, 2013 for the following accounts for Project D (fourth project), assuming that the percentage-of-completion method is used.
  Accounts Receivable
  Billings on Construction in Process
  Construction in Process

(d) How would the balances in the accounts discussed in part (c) change (if at all) for Project D (fourth project), if the completed-contract method is used?

Solution 18-133

(a) (1) and (2)

Projects	A	B	C	D	E
Contract price	$510,000	$700,000	$475,000	$200,000	$460,000
Contract costs incurred	424,000	195,000	350,000	123,000	320,000
Additional costs to complete	101,000	455,000	-0-	97,000	80,000
Total cost	525,000	650,000	350,000	220,000	400,000
Total gross profit or (loss)	$ (15,000)	$ 50,000	$125,000	$ (20,000)	$ 60,000

The amount reported as income (loss) under the completed-contract method for 2013 is:

Project	A	$(15,000)
	B	-0-
	C	125,000
	D	(20,000)
	E	-0-
		$ 90,000

The amount reported as income (loss) under the percentage-of-completion method for 2013 is:

Project	A	$(15,000)	
	B	15,000	$50,000 × ($195,000 ÷ $650,000)
	C	125,000	
	D	(20,000)	
	E	48,000	$60,000 × ($320,000 ÷ $400,000)
		$153,000	

Solution 18-133 (cont.)

(b)	Construction in Process	15,000	
	Construction Expenses	195,000	
	Revenue from Long-term Contracts		210,000

(c)	Billings	$100,000
	Cash collections	65,000
	Accounts receivable	$ 35,000
	Billings on Construction in Process	100,000
	Costs incurred	$123,000
	Loss reported	(20,000)
	Construction in process	$103,000

(d) The account balances would be the same.

Pr. 18-134—Long-term contract accounting (completed-contract).

Evans Construction, Inc. experienced the following construction activity in 2013, the first year of operations.

Contract	Total Contract Price	Billings through 12/31/13	Cash Collections through 12/31/13	Cost Incurred through 12/31/13	Estimated Additional Costs to Complete
X	$260,000	$175,000	$155,000	$182,000	$ 63,000
Y	330,000	115,000	115,000	100,000	242,000
Z	233,000	233,000	198,000	158,000	-0-
	$823,000	$523,000	$468,000	$440,000	$305,000

Each of the above contracts is with a different customer, and any work remaining at December 31, 2013 is expected to be completed in 2014.

Instructions

Prepare a partial income statement and a partial balance sheet to indicate how the above contract information would be reported. Evans uses the completed-contract method.

Solution 18-134

Evans Construction, Inc.
Income Statement
For the Year 2013

Revenue from long-term contracts (contract Z)	$233,000
Cost of construction (contract Z)	158,000
Gross profit	$ 75,000
Provision for loss (contract Y)*	12,000

*Contract costs through 12/31/13	$100,000
Estimated costs to complete	242,000
Total estimated costs	342,000
Total contract price	330,000
Loss recognized in 2013	$ 12,000

Solution 18-134 (cont.)

Evans Construction, Inc.
Balance Sheet
As of 12/31/13

Current assets:		
Accounts receivable ($523,000 – $468,000)		$ 55,000
Inventories		
Construction in process (contract X)	$182,000	
Less: Billings	175,000	
Unbilled contract costs		7,000
Current liabilities:		
Billings ($115,000) in excess of contract costs ($100,000)		15,000
Estimated loss from long-term contracts		12,000

Pr. 18-135—Installment sales.

Houser Appliances accounts for *all* sales of its merchandise on the installment basis. Following is the *unadjusted* trial balance at 12/31/14.

Cash	$38,000	
Installment accounts receivable—2012	20,000	
Installment accounts receivable—2013	50,000	
Installment accounts receivable—2014	90,000	
Inventory	27,800	
Repossessed merchandise	4,600	
Accounts payable		$ 37,400
Deferred gross profit—2012		15,000
Deferred gross profit—2013		26,600
Common stock		117,000
Retained earnings		10,000
Installment sales		125,000
Cost of installment sales	85,000	
Loss on repossessions	2,600	
Operating expenses	13,000	
	$331,000	$331,000

Additional information:

2012 gross profit rate: 30%

Total cash receipts during 2014: $110,000

Merchandise sold in 2013 was repossessed in 2014 and the following entry was prepared:

Deferred Gross Profit—2013	2,800	
Repossessed Merchandise	4,600	
Loss on Repossessions	2,600	
Installment Accounts Receivable—2013		10,000

Pr. 18-135 (cont.)

Instructions

(a) What is the gross profit rate for 2013? Show supporting computations.

(b) What is the gross profit rate for 2014? Show supporting computations.

(c) Of the total cash receipts in 2014, how much represents collections from installment sales of: (Show supporting computations.)
  (1) 2012?
  (2) 2013?
  (3) 2014?

(d) What is the total realized gross profit in 2014? Show supporting computations.

Solution 18-135

(a) Determined from the repossession entry:

$$\frac{\text{Deferred gross profit}}{\text{Installment accounts receivable}} = \frac{\$2{,}800}{\$10{,}000} = \underline{28\%}$$

b)

Installment sales	$125,000
Cost of sales	85,000
Gross profit	$ 40,000

$$\frac{\text{Gross profit}}{\text{Installment sales}} = \frac{\$40{,}000}{\$125{,}000} = \underline{32\%} \text{ gross profit rate}$$

(c)

2012	Deferred gross profit balance	$ 15,000
	Gross profit rate	÷ 30%
	Beginning accounts receivable	$ 50,000
	Beginning accounts receivable	$ 50,000
	Ending accounts receivable	(20,000)
	Cash collected	$ 30,000
2013	Deferred gross profit balance	$ 26,600
	Gross profit rate	÷ 28%
	Beginning accounts receivable*	$95,000
	Beginning accounts receivable*	$95,000
	Ending accounts receivable*	(50,000)
	Cash collected	$ 45,000
2014	Installment sales—2014	$125,000
	Accounts receivable—2014	(90,000)
	Cash collected	$ 35,000

(d) Total realized gross profit in 2014

From	2012	$30,000 × 30% =	$ 9,000
	2013	$45,000 × 28% =	12,600
	2014	$35,000 × 32% =	11,200
			$32,800

*Excluding accounts receivable for repossessed merchandise.

IFRS QUESTIONS

True/False

1. The International Accounting Standards Board (IASB) defines revenue to include both revenues and gains.

2. IFRS bases revenue recognition on the concepts of "earned" and "realized or realizable."

3. IFRS prohibits use of the percentage-of-completion method of accounting for long-term construction contracts.

4. IFRS requires immediate recognition of a loss if the overall contract is going to be unprofitable.

5. Terry Company is unable to reliably estimate revenues and costs associated with its only long-term construction contract. Under IFRS, Terry Company must use the completed-contract method to account for this contract.

Answers to True/False:

1. True
2. False
3. False
4. True
5. False

Multiple Choice

1. The joint project of the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) related to revenue recognition includes
   I. Evaluating a "customer-consideration" model
   II. Eliminating inconsistencies in the existing conceptual guidance
   III. Establishing a single, comprehensive standard
   a. II and III only.
   b. I and II only.
   c. I, II, and III.
   d. Neither I, II, nor III are currently included in the joint project of the FASB and IASB.

2. Belgium Co. is constructing a tunnel for $800 million. Construction began in 2011 and is estimated to be completed in 2016. At December 31, 2013, Belgium has incurred costs totaling $356 million with $85 million of that incurred in 2013, $143 million in 2012, and the remainder during 2011. Belgium believes that it completed 30% of the tunnel during 2013, although that may change based on future activity. Belgium Co. uses iGAAP for its accounting and regards its cost numbers as very uncertain. What amount of revenue should Belgium Co. recognize for the year ended December 31, 2013?
   a. No revenue should be recognized until the contract is completed in 2016.
   b. $356 million
   c. $240 million
   d. $85 million

3. Portugal, Inc. has the following amounts related to its activities for the year ended December 31, 2013:

Sales to customers	$5,000,000
Gain on sale of equipment	$ 360,000
Gain on sale of investments	$ 760,000
Loss on sale of land	$ 240,000

Portugal, Inc. uses IFRS for its external financial reporting. How much revenue should Portugal, Inc. report on its income statement for the year ended December 31, 2013?
a. $5,000,000
b. $5,760,000
c. $6,120,000
d. $5,880,000

4. Under IFRS, the standard for revenue recognition states that the
I. Revenue is realized or realizable.
II. Economic benefits associated with the transaction will flow to the company selling the goods.
III. Costs must be capable of being reliably measured.
a. I, II, and III.
b. I and III only.
c. II only.
d. II and III only.

5. IFRS for revenue recognition
a. is enforced by an international enforcement body, the IASB, which is comparable to the U.S. SEC.
b. bases revenue recognition on the concepts of “earned” and “realized or realizable.”
c. permits use of the completed-contract method when costs are difficult to estimate.
d. contains limited industry-specific guidance.

Answers to Multiple Choice:
1. c
2. d
3. c
4. d
5. d

Short Answer:

1. What is a major difference between IFRS and U.S. GAAP as regards revenue recognition practices?

    1. The general concepts and principles used for revenue recognition are similar between U.S. GAAP and IFRS. When they differ is in the detail. U.S. GAAP provides specific guidance related to revenue recognition in many different industries. That is not the case for IFRS. Also, the SEC has issued broad and specific guidance for public companies in the United States related to revenue recognition. Again the IASB does not have a regulatory body that provides additional guidance.

2. IFRS prohibits the use of the completed-contract method in accounting for long-term contracts. If revenues and costs are difficult to estimate, how must companies account for long-term contracts?

    2. If revenues and costs are difficult to estimate, then companies recognize revenue only to the extent of the cost incurred – a zero-profit approach.