

SURVEY OF ACCOUNTING · CHAPTER 1 · LO 1-9

Interactive Assessment — LO 1-9

Work these on your own, then we'll go through them together on the screen.

Name _____ Date _____ Section _____

LO 1-9 Distinguish between permanent and temporary accounts.

1 Permanent or temporary?

Classify each account. Write the letter. A letter may be used more than once or not at all.

A Permanent account (balance carries forward) · **B** Temporary account (closed to Retained Earnings) · **C** Closed to Cash at year end

ITEM	ANSWER
Cash	A — Permanent account (balance carries forward)
Revenue	B — Temporary account (closed to Retained Earnings)
Dividends	B — Temporary account (closed to Retained Earnings)
Retained Earnings	A — Permanent account (balance carries forward)
Notes Payable	A — Permanent account (balance carries forward)
Expense	B — Temporary account (closed to Retained Earnings)

FOR THE INSTRUCTOR

Revenue, Expense, and Dividends hold one period's information and are closed to Retained Earnings. Nothing is ever closed to Cash; that option is a trap for students who think closing means 'settling up'.

2 Retained earnings through the year

After closing on December 31, Year 1, Cahaba Kayaks had retained earnings of \$5,200. During Year 2 it earned \$9,400 of revenue, incurred \$6,100 of expenses, and paid \$800 of dividends, all in cash. It closes its books each December 31.

Retained Earnings balance after closing on December 31, Year 2

\$7,700

SHOW YOUR WORK

FOR THE INSTRUCTOR

Closing adds $9,400 - 6,100 - 800 = 2,500$ to the 5,200 opening balance, giving 7,700 after closing on December 31. The usual miss is leaving out the dividends and reporting 8,500. Same structure as Check Yourself 1.6.

3 Retained earnings before closing

Cahaba Kayaks had retained earnings of \$5,200 after closing its books on December 31, Year 1. By June 30, Year 2 it has earned \$9,400 of revenue and incurred \$6,100 of expenses, and it has not closed its books for Year 2. What is the balance in the Retained Earnings account on June 30, Year 2? Circle one.

- ☒ A \$5,200
- ☐ B \$8,500
- ☐ C \$3,300
- ☐ D \$14,600

FOR THE INSTRUCTOR

Retained earnings changes only when the books are closed. Until then revenue and expenses sit in their own temporary accounts and retained earnings still shows the \$5,200 from the last closing. Option b adds the year's net income early; option c is net income alone; option d adds revenue and ignores expenses.

4 Revenue account at the start of the new year

Cahaba Kayaks earned \$9,400 of revenue during Year 2 and closes its books each December 31. What is the balance in the Revenue account on January 1, Year 3? Circle one.

- ☐ A \$9,400, because revenue accumulates until the business stops operating
- ☒ B \$0, because closing moves the year's revenue into retained earnings and the account starts the new year empty
- ☐ C \$9,400, because revenue is a permanent account that carries forward
- ☐ D \$0, because revenue is paid out to owners as dividends at year end

FOR THE INSTRUCTOR

Revenue is a temporary account: closing transfers its balance to retained earnings so the new year starts at zero. Options a and c treat revenue as permanent; option d confuses closing with paying dividends.

5 Why bother with temporary accounts?

Why does the chapter say revenues, expenses, and dividends are recorded in separate accounts instead of directly in Retained Earnings? Circle one.

- ☒ **A To capture information about a specific accounting period, which is needed to prepare the income statement and statement of changes in stockholders' equity**
- ☐ B Because GAAP forbids changing Retained Earnings during the year
- ☐ C Because Retained Earnings is a cash account and revenue is not
- ☐ D So that dividends can be treated as expenses

FOR THE INSTRUCTOR

The separate accounts isolate one period's activity. Option c repeats the LO 1-5 misconception that retained earnings is cash; option d contradicts LO 1-7.

6 Before closing

Cahaba Kayaks was formed on January 1, Year 1. By December 31, Year 1 it had recorded \$12,000 of revenue, \$7,000 of expenses, and \$1,000 of dividends, but had not yet closed its books. What is the balance in the Retained Earnings account at that moment? Circle one.

- ☐ A \$4,000
- ☐ B \$5,000
- ☐ C \$12,000
- ☒ D \$0

FOR THE INSTRUCTOR

Until closing, the three amounts sit in the temporary Revenue, Expense, and Dividends accounts. Retained Earnings is still zero; after closing it will be 4,000. The text repeats 'the current balance in the Retained Earnings account is zero' three times in the RCS example for exactly this reason.