Chapter 4
Adjustments, Financial Statements, and the Quality of Earnings

ANSWERS TO QUESTIONS

1. Adjusting entries are made at the end of the accounting period to record all revenues and expenses that have not been recorded but belong in the current period. They update the balance sheet and income statement accounts at the end of the accounting period.

2. A trial balance is a list of the individual accounts, usually in financial statement order, with their debit or credit balances. It is used to provide a check on the equality of the debits and credits.

3. The four different types are adjustments for:
   (1) Unearned revenues -- previously recorded liabilities that need to be adjusted at the end of the period to reflect revenues that have been earned (e.g., Unearned Ticket Revenue must be adjusted for the portion of ticket revenues earned in the current period).
   (2) Accrued revenues -- revenues that have been earned by the end of the accounting period but which will be collected in a future accounting period (e.g., recording Interest Receivable for interest revenues not yet collected).
   (3) Prepaid expenses -- previously recorded assets that need to be adjusted at the end of the period to reflect incurred expenses (e.g., Prepaid Insurance must be adjusted for the portion of insurance expense incurred in the current period).
   (4) Accrued expenses -- expenses that have been incurred by the end of the accounting period but which will be paid in a future accounting period (e.g., recording Utilities Payable for utilities expense incurred during the period that has not yet been paid).

4. A contra-asset is an account related to an asset that is an offset or reduction to the asset's balance. Accumulated Depreciation is a contra-account to the equipment and buildings accounts.

5. The net income on the income statement is included in determining ending retained earnings on the statement of stockholders' equity and the balance sheet. The change in the cash account on the balance sheet is analyzed and categorized on the statement of cash flows into cash from operating activities, investing activities, and financing activities.

6. (a) Income statement: Revenues (and Gains) - Expenses (and Losses) = Net Income
   (b) Balance sheet: Assets = Liabilities + Stockholders' Equity
   (c) Statement of cash flows: Changes in cash for the period = Cash from Operations ± Cash from Investing Activities ± Cash from Financing Activities
   (d) Statement of stockholders' equity: Ending Stockholders' Equity = (Beginning Contributed Capital + Stock Issuances - Stock Repurchases) + (Beginning Retained Earnings + Net Income - Dividends Declared)

7. Adjusting entries have no effect on cash. For unearned revenues and prepaid expenses, cash was received or paid at some point in the past. For accruals, cash will be received or paid in a future accounting period. At the time of the adjusting entry, there is no cash being received or paid.

8. Earnings per share = Net Income ÷ average number of shares of stock outstanding during the period.

   Earnings per share measures the average amount of net income for the year attributable to one share of common stock.

9. Net profit margin = Net income ÷ net sales

   The net profit margin measures how much of every sales dollar generated during the period is profit.

10. An *unadjusted* trial balance is prepared after all current transactions have been journalized and posted to the ledger. It does not include the effects of the adjusting entries. The basic purpose of an unadjusted trial balance is to check the equalities of the accounting model (particularly, Debits = Credits) and to provide the data in a form convenient for further processing in the accounting information processing cycle.

    In contrast, an *adjusted* trial balance is prepared after the effects of all of the adjusting entries have been applied to the corresponding (prior) unadjusted trial balance amounts. The basic purpose of an adjusted trial balance is to insure that accuracy has been attained in applying the effect of the adjusting entries. The adjusted trial balance provides a second check in the model equalities (primarily Debits = Credits). It also provides data in a form convenient for further processing.

11. Closing entries are made at the end of the accounting period to transfer the balances in the temporary income statement accounts to retained earnings. The closing entries reduce the revenue, gain, expense, and loss accounts to a zero balance so that they can be used for the accumulation process during the next period. Closing entries must be entered into the system through the journal and posted to the ledger accounts to state properly the temporary and permanent account balances (i.e., zero balances in the temporary accounts).

12. (a) Permanent accounts -- balance sheet accounts; that is, the asset, liability, and stockholders' equity accounts (these are not closed at the end of each period).
    (b) Temporary accounts -- income statement accounts; that is, revenues, gains, expenses, and losses (these are closed at the end of each period).
    (c) Real accounts -- another name for permanent accounts.
    (d) Nominal accounts -- another name for temporary accounts.

13. The income statement accounts are closed at the end of the accounting period because, in effect, they are temporary subaccounts to retained earnings (i.e., a part of stockholders' equity). They are used only for accumulation during the accounting period. When the period ends, these accumulated accounts must be transferred (closed) to retained earnings. The closing process serves:

    (1) to correctly state retained earnings, and
    (2) to clear out the balances of the temporary accounts for the year just ended so that these subaccounts can be used again during the next period for accumulation and classification purposes.

    Balance sheet accounts are not closed at the end of the period because they reflect permanent accumulated balances of assets, liabilities, and stockholders' equity. Permanent accounts show the entity's financial position at the end of the period and are the beginning amounts for the next period.

14. A post-closing trial balance is a listing taken from the ledger after the adjusting and closing entries have been journalized and posted. It is not a necessary part of the accounting information processing cycle but it is useful because it demonstrates the equality of the debits and credits in the ledger after the closing entries have been journalized and posted.

ANSWERS TO MULTIPLE CHOICE

1. b
2. a
3. c
4. b
5. d
6. d
7. a
8. d
9. d
10. b

Authors' Recommended Solution Time
(Time in minutes)

Mini-exercises		*Exercises*		*Problems*		*Alternate Problems*		*Cases and Projects*	
No.	*Time*	*No.*	*Time*	*No.*	*Time*	*No.*	*Time*	*No.*	*Time*
1	5	1	10	1	15	1	15	1	25
2	5	2	10	2	20	2	20	2	25
3	3	3	10	3	25	3	20	3	25
4	5	4	15	4	20	4	20	4	25
5	5	5	10	5	20	5	20	5	25
6	5	6	20	6	25	6	25	6	40
7	5	7	20	7	30	7	30	7	45
8	5	8	20	8	30	8	30	8	35
9	5	9	15	9	60			9	50
10	5	10	20					10	25
11	5	11	10					11	*
12	3	12	20						
		13	15						
		14	15						
		15	20						
		16	20						
		17	20						
		18	20						
		19	10						
		20	15						

* Due to the nature of this project, it is very difficult to estimate the amount of time students will need to complete the assignment. As with any open-ended project, it is possible for students to devote a large amount of time to these assignments. While students often benefit from the extra effort, we find that some become frustrated by the perceived difficulty of the task. You can reduce student frustration and anxiety by making your expectations clear. For example, when our goal is to sharpen research skills, we devote class time discussing research strategies. When we want the students to focus on a real accounting issue, we offer suggestions about possible companies or industries.

MINI-EXERCISES

M4–1.

Puglisi Company
Adjusted Trial Balance
At June 30, 2010

	Debit	Credit
Cash	$ 150	
Accounts receivable	370	
Inventories	660	
Prepaid expenses	30	
Buildings and equipment	1,400	
Accumulated depreciation		$ 250
Land	300	
Accounts payable		200
Accrued expenses payable		160
Income taxes payable		50
Unearned fees		90
Long-term debt		1,360
Contributed capital		400
Retained earnings		150
Sales revenue		2,500
Interest income		60
Cost of sales	880	
Salaries expense	640	
Rent expense	460	
Depreciation expense	150	
Interest expense	70	
Income taxes expense	110	
Totals	$ 5,220	$ 5,220

M4–2. (1) A

(2) D

(3) A

(4) C

(5) D

(6) B

(7) B

(8) C

M4–3. (1) D

(2) C

(3) B

(4) A

M4–4.

(a) 1. Type – Unearned revenue

2. Amount -- $1,000 ÷ 4 months = $250 earned

3. Adjusting entry –

Unearned rent revenue (–L)	250	
Rent revenue (+R, +SE)		250

(b) 1. Type – Prepaid expense

2. Amount – $3,800 x 6/24 = $950 used

3. Adjusting entry –

Insurance expense (+E, –SE)	950	
Prepaid insurance (–A)		950

(c) 1. Type – Prepaid expense

2. Amount – $3,000 given

3. Adjusting entry –

Depreciation expense (+E, –SE)	3,000	
Accumulated depreciation (+XA, –A).....		3,000

M4–5.

	Balance Sheet			Income Statement		
Transaction	Assets	Liabilities	Stockholders' Equity	Revenues	Expenses	Net Income
a.	NE	–250	+250	+250	NE	+250
b.	–950	NE	–950	NE	+950	–950
c.	–3,000	NE	–3,000	NE	+3,000	–3,000

M4–6.

(a) 1. Type – Accrued expense

2. Amount – $360 given

3. Adjusting entry –

Utilities expense (+E, –SE)...........................	360	
Utilities payable (+L).............................		360

(b) 1. Type – Accrued expense

2. Amount – 10 employees x $150 per day x 4 days = $6,000 incurred

3. Adjusting entry –

Wages expense (+E, –SE)	6,000	
Wages payable (+L)		6,000

(c) 1. Type – Accrued revenue

2. Amount – $5,000 x .14 x 4/12 = $233 (rounded) interest earned

3. Adjusting entry –

Interest receivable (+A)	233	
Interest revenue (+R, +SE)....................		233

M4–7.

	Balance Sheet			Income Statement		
Transaction	Assets	Liabilities	Stockholders' Equity	Revenues	Expenses	Net Income
a.	NE	+360	–360	NE	+360	–360
b.	NE	+6,000	–6,000	NE	+6,000	–6,000
c.	+233	NE	+233	+233	NE	+233

M4–8.

MORGAN MARKETING COMPANY
Income Statement
For the Year Ended December 31, 2011

Operating Revenues:	
Sales revenue	$ 37,450
Total operating revenues	37,450
Operating Expenses:	
Wages expense	19,000
Depreciation expense	1,800
Utilities expense	320
Insurance expense	700
Rent expense	9,000
Total operating expenses	30,820
Operating Income	6,630
Other Items:	
Interest revenue	100
Rent revenue	750
Pretax income	7,480
Income tax expense	2,700
Net Income	$ 4,780
Earnings per share*	$8.69

* calculated as $\$4,780 \div [\underbrace{(300 + 800) \div 2}_{\text{Average number of shares}}] = \$4,780 \div 550 = \$8.69$

M4–9.

MORGAN MARKETING COMPANY
Statement of Stockholders' Equity
For the Year Ended December 31, 2011

	Contributed Capital	Retained Earnings	Total Stockholders' Equity
Balance, January 1, 2011	$ 700	$ 2,000*	$ 2,700
Share issuance	3,000		3,000
Net income		4,780	4,780
Dividends		0	0
Balance, December 31, 2011	$ 3,700	$ 6,780	$ 10,480

Work backwards

* From the trial balance.

M4–10.

Req. 1

MORGAN MARKETING COMPANY
Balance Sheet
At December 31, 2011

Assets	
Current Assets:	
Cash	$ 1,500
Accounts receivable	2,000
Interest receivable	100
Prepaid insurance	1,600
Total current assets	5,200
Notes receivable	2,800
Equipment (net of accumulated depreciation, $3,000)	12,000
Total Assets	$ 20,000
Liabilities	
Current Liabilities:	
Accounts payable	$ 2,400
Accrued expenses payable	3,920
Income taxes payable	2,700
Unearned rent revenue	500
Total current liabilities	9,520
Stockholders' Equity	
Contributed Capital	3,700
Retained Earnings	6,780
Total Stockholders' Equity	10,480
Total Liabilities and Stockholders' Equity	$ 20,000

Req. 2

The adjustments in M4–4 and M4–6 have no effect on the operating, investing, and financing activities on the statement of cash flows because no cash is paid or received at the time of the adjusting entries.

M4–11.

Revenues:	
Sales revenue	$ 37,450
Interest revenue	100
Rent revenue	750
Total revenues	38,300
Costs and expenses:	
Wages expense	19,000
Depreciation expense	1,800
Utilities expense	320
Insurance expense	700
Rent expense	9,000
Income tax expense	2,700
Total costs and expenses	33,520
Net Income	$ 4,780

Net profit margin = Net income ÷ Operating Revenues = $4,780 ÷ $37,450 = 12.76%

The operating revenue source for this company is from sales. Interest revenue and rent revenue are not included in the denominator because they are other (nonoperating) revenue sources.

M4–12.

Sales revenue (–R)	37,450	
Interest revenue (–R)	100	
Rent revenue (–R)	750	
Retained earnings (+SE)		4,780
Wages expense (–E)		19,000
Depreciation expense (–E)		1,800
Utilities expense (–E)		320
Insurance expense (–E)		700
Rent expense (–E)		9,000
Income tax expense (–E)		2,700

EXERCISES

E4–1.

Darius Consultants, Inc.
Unadjusted Trial Balance
At September 30, 2010

	Debit	Credit
Cash	$ 163,000	
Accounts receivable	225,400	
Supplies	12,200	
Prepaid expenses	10,200	
Investments	145,000	
Building and equipment	323,040	
Accumulated depreciation		$ 18,100
Land	60,000	
Accounts payable		86,830
Accrued expenses payable		25,650
Unearned consulting fees		32,500
Income taxes payable		2,030
Notes payable		160,000
Contributed capital		223,370
Retained earnings *		145,510
Consulting fees revenue		2,564,200
Investment income		10,800
Wages and benefits expense	1,590,000	
Utilities expense	25,230	
Travel expense	23,990	
Rent expense	152,080	
Professional development expense	18,600	
Interest expense	17,200	
Other operating expenses	188,000	
General and administrative expenses	320,050	
Gain on sale of land		5,000
Totals	$3,273,990	$3,273,990

* Since debits are supposed to equal credits in a trial balance, the balance in Retained Earnings is determined as the amount in the credit column necessary to make debits equal credits (a "plugged" figure).

E4–2.

Req. 1

Types	Accounts to be Adjusted
<u>Unearned Revenues:</u> Deferred Revenue may need to be adjusted for any revenue earned during the period	Deferred Revenue and Product Revenue and/or Service Revenue
<u>Accrued Revenues:</u> Interest may be earned on Short-term Investments	Interest Receivable and Interest Revenue
Any unrecorded sales or services provided will need to be recorded	Accounts Receivable and Product Revenue and/or Service Revenue
<u>Prepaid Expenses:</u> Other Current Assets may include supplies, prepaid rent, prepaid insurance, or prepaid advertising	Other Current Assets and Selling, General, and Administrative Expense
Any additional use of Property, Plant, and Equipment during the period will need to be recorded	Accumulated Depreciation and Cost of Products and/or Cost of Services
<u>Accrued Expenses:</u> Interest incurred on Short-term Note Payable and Long-term Debt will need to be recorded	Accrued Liabilities and Interest Expense
There are likely many other accrued expenses to be recorded, including wages, warranties, and utilities	Accrued Liabilities and Selling, General, and Administrative Expenses (among other expenses)
Income taxes must be computed for the period and accrued	Income Taxes Payable and Income Tax Expense

Req. 2

Temporary accounts that accumulate during the period are closed at the end of the year to the permanent account Retained Earnings. These include: Product revenue, service revenue, interest revenue, cost of products, cost of services, interest expense, research and development expense, selling, general, and administrative expense, other expenses, loss on investments, and income tax expense.

E4–3.

Req. 1

The annual reporting period for this company is January 1 through December 31, 2010.

Req. 2 (Adjusting entries)

Both transactions are accruals because revenue has been earned and expenses incurred but no cash has yet been received or paid.

(*a*) 1. Type: Accrued Expense

2. Amount: Given

3. Adjusting entry:

December 31, 2010	Wage expense (+E, –SE)	6,000	
	Wages payable (+L)		6,000

To record wages earned by employees during 2010, but not yet paid by the company. This entry records the (a) 2010 expense, and (b) 2010 liability, which is necessary to conform to accrual accounting and the matching principle.

(*b*) 1. Type: Accrued Revenue

2. Amount: Given

3. Adjusting entry:

December 31, 2010	Interest receivable (+A)	3,000	
	Interest revenue (+R, +SE)		3,000

To record interest revenue earned during 2010, but not yet collected. This entry records the (a) 2010 revenue, and (b) 2010 receivable, which is necessary to conform to accrual accounting and the revenue principle.

Req. 3

Adjusting entries are necessary at the end of the accounting period to ensure that all revenues earned and expenses incurred and the related assets and liabilities are measured properly. The entries above are accruals; entry (a) is an accrued expense (incurred but not yet recorded) and entry (b) is an accrued revenue (earned but not yet recorded). In applying the accrual basis of accounting, revenues should be recognized when earned and measurable and expenses should be recognized when incurred in generating revenues.

E4–4.

Req. 1
Prepaid Insurance is a prepaid expense that needs to be adjusted each period for the amount used during the period.

The amount of expense is computed as follows: $3,600 x 4/24 = $600 used

Adjusting entry:

	Debit	Credit
Insurance expense (+E, –SE)....................................	600	
Prepaid insurance (–A)		600

Req. 2
Shipping Supplies is a prepaid expense that needs to be adjusted at the end of the period for the amount of supplies used during the period.

The amount is computed as follows:

Beginning balance	$ 9,000
Supplies purchased	60,000
Supplies on hand at end	(20,000)
Supplies used	$49,000

Adjusting entry:

	Debit	Credit
Shipping supplies expense (+E, –SE)	49,000	
Shipping supplies (–A)....................................		49,000

Req. 3

Prepaid Insurance

Debit		Credit	
9/1	3,600		
		AJE	600
End.	3,000		

Insurance Expense

Debit		Credit
AJE	600	
End.	600	

Shipping Supplies

Debit		Credit	
Beg.	9,000		
Purch.	60,000	AJE	49,000
End.	20,000		

Shipping Supplies Expense

Debit		Credit
AJE	49,000	
End.	49,000	

2011 Income statement:
Insurance expense $600
Shipping supplies expense $49,000

Req. 4
2011 Balance sheet:
Prepaid insurance $3,000
Shipping supplies $20,000

E4–5.

	Balance Sheet			Income Statement		
Transaction	Assets	Liabilities	Stockholders' Equity	Revenues	Expenses	Net Income
E4–3 (a)	NE	+6,000	–6,000	NE	+6,000	–6,000
E4–3 (b)	+3,000	NE	+3,000	+3,000	NE	+3,000
E4–4 (a)	–600	NE	–600	NE	+600	–600
E4–4 (b)	–49,000	NE	–49,000	NE	+49,000	–49,000

E4–6.

Req. 1

a. Prepaid expense
b. Accrued expense
c. Unearned revenue
d. Accrued revenue
e. Prepaid expense
f. Prepaid expense
g. Accrued revenue

Req. 2

		Debit	Credit	Computations
a.	Office supplies expense (+E, –SE)	575		$350 + $500 - $275 = $575 used
	Office supplies (–A)		575	
b.	Wages expense (+E, –SE)	2,200		Given
	Wages payable (+L)		2,200	
c.	Unearned rent revenue (–L)	3,200		$9,600 x 2/6 = $3,200 earned
	Rent revenue (+R, +SE)		3,200	
d.	Rent receivable (+A)	960		$480 x 2 months = $960 earned
	Rent revenue (+R, +SE)		960	
e.	Depreciation expense (+E, –SE)	6,100		Given
	Accumulated depreciation (+XA, –A)		6,100	
f.	Insurance expense (+E, –SE)	550		$2,200 x 6/24 = $550 used
	Prepaid insurance (–A)		550	
g.	Repair accounts receivable (+A)	800		Given
	Repair shop revenue (+R, +SE)		800	

E4–7.

Req. 1

a.	Accrued revenue
b.	Unearned revenue
c.	Accrued expense
d.	Prepaid expense
e.	Prepaid expense
f.	Prepaid expense
g.	Accrued expense

Req. 2

				Computations
a.	Accounts receivable (+A)	2,100		Given
	Service revenue (+R, +SE).................		2,100	
b.	Unearned storage revenue (–L)	500		$3,000 x 1/6 =
	Storage revenue (+R, +SE)................		500	$500 earned
c.	Wages expense (+E, –SE)	2,800		Given
	Wages payable (+L)		2,800	
d.	Advertising expense (+E, –SE).....................	900		$1,200 x 9/12 =
	Prepaid advertising (–A).....................		900	$900 used
e.	Depreciation expense (+E, –SE)	20,000		Given
	Accumulated depreciation (+XA, –A)		20,000	
f.	Supplies expense (+E, –SE)........................	49,100		$15,500 +
	Supplies (–A)......................................		49,100	$46,000 – $12,400 = $49,100 used
g.	Interest expense (+E, –SE)	3,000		$150,000 x .12
	Interest payable (+L)		3,000	x 2/12 (since last payment) = $3,000 incurred

E4–8.

	Balance Sheet			Income Statement		
Transaction	Assets	Liabilities	Stockholders' Equity	Revenues	Expenses	Net Income
(a)	–575	NE	–575	NE	+575	–575
(b)	NE	+2,200	–2,200	NE	+2,200	–2,200
(c)	NE	–3,200	+3,200	+3,200	NE	+3,200
(d)	+960	NE	+960	+960	NE	+960
(e)	–6,100	NE	–6,100	NE	+6,100	–6,100
(f)	–550	NE	–550	NE	+550	–550
(g)	+800	NE	+800	+800	NE	+800

E4–9.

	Balance Sheet			Income Statement		
Transaction	Assets	Liabilities	Stockholders' Equity	Revenues	Expenses	Net Income
(a)	+2,100	NE	+2,100	+2,100	NE	+2,100
(b)	NE	–500	+500	+500	NE	+500
(c)	NE	+2,800	–2,800	NE	+2,800	–2,800
(d)	–900	NE	–900	NE	+900	–900
(e)	–20,000	NE	–20,000	NE	+20,000	–20,000
(f)	–49,100	NE	–49,100	NE	+49,100	–49,100
(g)	NE	+3,000	–3,000	NE	+3,000	–3,000

E4–10.

	Independent Situations	Debit		Credit	
		Code	Amount	Code	Amount
a.	Accrued wages, unrecorded and unpaid at year-end, $400 (example).	N	400	G	400
b.	Service revenue collected in advance, $800.	A	800	I	800
c.	Dividends declared and paid during the year, $900.	K	900	A	900
d.	Depreciation expense for the year, $1,000.	O	1,000	E	1,000
e.	Service revenue earned but not yet collected at year-end, $600.	C	600	L	600
f.	Office Supplies on hand during the year, $400; supplies on hand at year-end, $150.	Q	250	B	250
g.	At year-end, interest on note payable not yet recorded or paid, $220.	P	220	H	220
h.	Balance at year-end in Service Revenue account, $62,000. Give the closing entry at year-end.	L	62,000	K	62,000
i.	Balance at year-end in Interest Expense account, $420. Give the closing entry at year-end.	K	420	P	420

E4–11.

Selected Balance Sheet Amounts at December 31, 2010

Assets:	
Equipment (recorded at cost per cost principle)	$12,000
Accumulated depreciation (for one year, as given)	(1,200)
Carrying value of equipment (difference)	10,800
Office supplies (on hand, as given)	400
Prepaid insurance (remaining coverage, $400 x 18/24 months)	300

Selected Income Statement Amounts for the Year Ended December 31, 2010

Expenses:	
Depreciation expense (for one year, as given)	$ 1,200
Office supplies expense (used, $1,400 - $400 on hand)	1,000
Insurance expense (for 6 months, $400 x 6/24 months)	100

E4–12.

Date	Assets	Liabilities	Stockholders' Equity	Revenues	Expenses	Net Income
	Balance Sheet			Income Statement		
Note 1: April 1, 2011	+20,000/ –20,000	NE	NE	NE	NE	NE
December 31, 2011[a]	+ 1,500	NE	+ 1,500	+ 1,500	NE	+ 1,500
March 31, 2012[b]	+22,000/ –21,500	NE	+ 500	+500	NE	+ 500
Note 2: August 1, 2011	+ 20,000	+ 20,000	NE	NE	NE	NE
December 31, 2011[c]	NE	+ 1,000	- 1,000	NE	+ 1,000	- 1,000
January 31, 2012[d]	- 21,200	- 21,000	- 200	NE	+ 200	- 200

(a) \$20,000 principal x .10 annual interest rate x 9/12 of a year = \$1,500
(b) Additional interest revenue in 2012: \$20,000 x .10 x 3/12 = \$500. Cash received was \$22,000 (\$20,000 principal + \$2,000 interest for 12 months); receivables decreased by the \$20,000 note receivable and \$1,500 interest receivable accrued in 2011.
(c) \$20,000 principal x .12 annual interest rate x 5/12 of a year = \$1,000
(d) Additional interest expense in 2012: \$20,000 x .12 x 1/12 = \$200. Cash paid was \$21,200 (\$20,000 principal + \$1,200 interest for 6 months); payables decreased by the \$20,000 note payable and \$1,000 interest payable accrued in 2011.

E4–13.

Req. 1 *(a)* Cash paid on accrued income taxes payable.
(b) Accrual of additional income tax expense.
(c) Cash paid on dividends payable.
(d) Amount of dividends declared for the period.
(e) Cash paid on accrued interest payable.
(f) Accrual of additional interest expense.

Req. 2 Computations:

(a)

Beg. Bal.	+	accrued income taxes	-	cash paid	=	End. bal.
$71	+	332	-	?	=	$80
				?	=	$323 paid

(c)

Beg. Bal.	+	dividends declared	-	cash paid	=	End. bal.
$43	+	176	-	?	=	$48
				?	=	$171 paid

(f)

Beg. Bal.	+	accrued interest expense	-	cash paid	=	End. bal.
$45	+	?	-	297	=	$51
		?			=	$303 accrued

E4–14.

Req. 1 Adjusting entries that were or should have been made at December 31:

(a) Should have been made.

Depreciation expense (+E, –SE)	15,000	
Accumulated depreciation (+XA, –A) …………		15,000

(b) Should have been made.

Unearned revenue (–L)	1,500	
Fee revenue (+R, +SE)...................................		1,500

(c) Entry already made.

Interest expense (+E, –SE)	1,710	
Interest payable (+L)		1,710
($19,000 x 9% x 12/12 months)		

Should have been made.

Interest expense (+E, –SE)	285	
Interest payable (+L).......................................		285
($19,000 x 9% x 2/12 months)		

(d) Should have been made.

Insurance expense (+E, –SE)....................................	650	
Prepaid insurance (–A)		650

(e) Should have been made.

Rent receivable (+A)..	1,400	
Rent revenue (+R, +SE)		1,400

Req. 2

	Balance Sheet			Income Statement		
Transaction	Assets	Liabilities	Stockholders' Equity	Revenues	Expenses	Net Income
(a)	O 15,000	NE	O 15,000	NE	U 15,000	O 15,000
(b)	NE	O 1,500	U 1,500	U 1,500	NE	U 1,500
(c)	NE	O 1,425	U 1,425	NE	O 1,425	U 1,425
(d)	O 650	NE	O 650	NE	U 650	O 650
(e)	U 1,400	NE	U 1,400	U 1,400	NE	U 1,400

E4–15.

Items	Net Income	Total Assets	Total Liabilities	Stockholders' Equity
Balances reported	$60,000	$180,000	$80,000	$100,000
Additional adjustments:				
a. Depreciation	(16,000)	(16,000)		(16,000)
b. Wages	(34,000)		34,000	(34,000)
c. Rent revenue	3,200		(3,200)	3,200
Adjusted balances	13,200	164,000	110,800	53,200
d. Income taxes	(3,960)		3,960	(3,960)
Correct balances	$ 9,240	$164,000	$114,760	$49,240

Computations:

a. Given, $16,000 depreciation expense.

b. Given, $34,000 accrued and unpaid.

c. $9,600 x 1/3 = $3,200 rent revenue earned. The remaining $6,400 in unearned revenue is a liability for two months of occupancy "owed" to the renter.

d. $13,200 income before taxes x 30% = $3,960.

E4–16.

Req. 1

		Debit	Credit
a.	Expenses (depreciation) (+E, –SE)	4,500	
	Accumulated depreciation (+XA, –A)...		4,500
b.	Rent receivable (+A)...................................	1,500	
	Revenues (rent) (+R, +SE).................		1,500
c.	Income tax expense (+E, –SE)..................	5,100	
	Income taxes payable (+L)		5,100

Req. 2

	As Prepared		***Effects of Adjusting Entries***	***Corrected Amounts***
Income statement:				
Revenues	$98,000	*b*	$1,500	$99,500
Expenses	(72,000)	*a*	(4,500)	(76,500)
Income tax expense		*c*	(5,100)	(5,100)
Net income	$26,000		(8,100)	$17,900
Balance Sheet:				
Assets				
Cash	$20,000			$20,000
Accounts receivable	22,000			22,000
Rent receivable		*b*	1,500	1,500
Equipment	50,000			50,000
Accumulated depreciation	(10,000)	*a*	(4,500)	(14,500)
	$82,000		(3,000)	$79,000
Liabilities				
Accounts payable	$10,000			$10,000
Income taxes payable		*c*	5,100	5,100
Stockholders' Equity				
Contributed capital	40,000			40,000
Retained earnings	32,000		(8,100)	23,900
	$82,000		(3,000)	$79,000

E4–17.

Req. 1

		Debit	Credit
a.	Salaries and wages expense (+E, –SE)	560	
	Salaries and wages payable (+L)		560
b.	Utilities expense (+E, –SE)...................................	440	
	Utilities payable (+L)......................................		440
c.	Depreciation expense (+E, –SE)	24,000	
	Accumulated depreciation (+XA, –A)..............		24,000
d.	Interest expense (+E, –SE)	300	
	Interest payable (+L)		300
	($15,000 x .08 x 3/12)		
e.	No adjustment is needed because the revenue will not be earned until January (next year).		
f.	Maintenance expense (+E, –SE)...........................	1,100	
	Maintenance supplies (–A)		1,100
g.	Income tax expense (+E, –SE).............................	5,800	
	Income tax payable (+L).................................		5,800

E4–17. (continued)

Req. 2

DEREK, INC.
Income Statement
For the Year Ended December 31, 2011

Operating Revenue:	
Rental revenue	$109,000
Operating Expenses:	
Salaries and wages ($26,500 + $560)	$27,060
Maintenance expense ($12,000 + $1,100)	13,100
Rent expense	8,800
Utilities expense ($4,300 + $440)	4,740
Gas and oil expense	3,000
Depreciation expense	24,000
Miscellaneous expenses	1,000
Total expenses	81,700
Operating Income	27,300
Other Item:	
Interest expense ($15,000 x 8% x 3/12)	300
Pretax income	27,000
Income tax expense	5,800
Net income	**$ 21,200**
Earnings per share: $21,200 ÷ 8,000 shares	$2.65

Req. 3

Net profit margin = Net income ÷ Net Sales = $21,200 ÷ $109,000 = 19.4%

The net profit margin indicates that, for every $1 of rental revenues, Derek earns $0.194 (19.4%) in net income. This ratio is higher than the industry average net profit margin of 18%, implying that Derek is more profitable and better able to manage its business (in terms of sales price or costs) than the average company in the industry.

E4–18.

Req. 1

(a)	Insurance expense (+E, –SE)	5	
	Prepaid insurance (–A)		5
(b)	Depreciation expense (+E, –SE)	7	
	Accumulated depreciation (+XA, –A)		7
(c)	Wages expense (+E, –SE)	5	
	Wages payable (+L).......................................		5
(d)	Income tax expense (+E, –SE).................................	9	
	Income tax payable (+L)		9

Req. 2

SENECA COMPANY
Trial Balance
December 31, 2010
(in thousands of dollars)

	Unadjusted		Adjustments		Adjusted	
	Debit	Credit	Debit	Credit	Debit	Credit
Cash	38				38	
Accounts receivable	9				9	
Prepaid insurance	6			*a* 5	1	
Machinery	80				80	
Accumulated depreciation				*b* 7		7
Accounts payable		9				9
Wages payable				*c* 5		5
Income taxes payable				*d* 9		9
Contributed capital		76				76
Retained earnings	4				4	
Revenues (not detailed)		84				84
Expenses (not detailed)	32		*a* 5 *b* 7 *c* 5 *d* 9		58	
Totals	<u>169</u>	<u>169</u>	<u>26</u>	<u>26</u>	<u>190</u>	<u>190</u>

E4–19.

SENECA COMPANY
Income Statement
For the Year Ended December 31, 2010
(in thousands of dollars)

Revenues (not detailed)	$84
Expenses ($32 + $5 + $7 + $5)	49
Pretax income	35
Income tax expense	9
Net income	$26
EPS ($26,000 ÷ 4,000 shares)	$6.50

SENECA COMPANY
Statement of Stockholders' Equity
For the Year Ended December 31, 2010
(in thousands of dollars)

	Contributed Capital	Retained Earnings	Total Stockholders' Equity
Beginning balances, 1/1/2010	$ 0	$ 0	$ 0
Stock issuance	76		76
Net income		26	26
Dividends declared		(4) *	(4)
Ending balances, 12/31/2010	$ 76	$ 22	$ 98

* The amount of dividends declared can be inferred because the unadjusted trial balance amount for retained earnings is a negative $4. Since this is the first year of operations, we can assume the entire amount is due to a dividend declaration.

SENECA COMPANY
Balance Sheet
At December 31, 2010
(in thousands of dollars)

Assets		**Liabilities and Stockholders' Equity**	
Current Assets:		***Current Liabilities:***	
Cash	$ 38	Accounts payable	$ 9
Accounts receivable	9	Wages payable	5
Prepaid insurance ($6 - $5)	1	Income taxes payable	9
Total current assets	48	Total current liabilities	23
Machinery	80	**Stockholders' Equity:**	
Accumulated depreciation	(7)	Contributed capital	76
		Retained earnings	22
Total assets	$121	Total liabilities and stockholders' equity	$121

E4–20.

Req. 1
The purpose of “closing the books” at the end of the accounting period is to transfer the balance in the temporary accounts to a permanent account (Retained Earnings). This also creates a zero balance in each of the temporary accounts for accumulation of activities in the next accounting period.

Req. 2

Revenues (–R)	84	
Expenses ($32 + $5 + $7 + $5 + $9) (–E)........		58
Retained earnings (+SE)		26

Req. 3

SENECA COMPANY
Post-closing Trial Balance
December 31, 2010
(in thousands of dollars)

	Debit	Credit
Cash	38	
Accounts receivable	9	
Prepaid insurance	1	
Machinery	80	
Accumulated depreciation		7
Accounts payable		9
Wages payable		5
Income taxes payable		9
Contributed capital		76
Retained earnings		22
Revenues (not detailed)		0
Expenses (not detailed)	0	
Totals	128	128

PROBLEMS

P4–1.

Req. 1

Dell Inc.
Adjusted Trial Balance
At January 31, 2012
(in millions of dollars)

	Debit	Credit
Cash	$ 520	
Marketable securities	2,661	
Accounts receivable	2,094	
Inventories	273	
Property, plant, and equipment	775	
Accumulated depreciation		$ 252
Other assets	806	
Accounts payable		2,397
Accrued expenses payable		1,298
Long-term debt		512
Other liabilities		349
Contributed capital		1,781
Retained earnings (deficit)	844	
Sales revenue		18,243
Cost of sales	14,137	
Selling, general, and administrative expenses	1,788	
Research and development expense	272	
Other expenses	38	
Income tax expense	624	
Totals	$ 24,832	$ 24,832

Req. 2

Since debits are supposed to equal credits in a trial balance, the balance in Retained Earnings is determined as the amount in the debit column necessary to make debits equal credits (a "plugged" figure).

P4–2.

Req. 1

a.	Unearned revenue	*e.*	Prepaid expense
b.	Accrued expense	*f.*	Prepaid expense
c.	Accrued revenue	*g.*	Unearned revenue
d.	Accrued expense	*h.*	Accrued expense

Req. 2

		Debit	Credit
a.	Unearned rent revenue (–L)..	4,800	
	Rent revenue (+R, +SE)		4,800
	($7,200 ÷ 6 months = $1,200 per month x 4 months)		
b.	Wage expense (+E, –SE)	14,000	
	Wages payable (+L)..		14,000
c.	Accounts receivable (+A)..	3,000	
	Service revenue (+R, +SE)...............................		3,000
d.	Interest expense (+E, –SE)	540	
	Interest payable (+L)		540
	($18,000 x 12% x 3/12 = $540)		
e.	Insurance expense (+E, –SE).....................................	1,167	
	Prepaid insurance (–A)		1,167
	($7,000 ÷ 12 months = $583 per month x 2 months of coverage)		
f.	Depreciation expense (+E, –SE).................................	2,000	
	Accumulated depreciation, service truck (+XA, –A)		2,000
g.	Unearned service revenue (–L)...................................	500	
	Service revenue (+R, +SE).................................		500
	($3,000 x 2/12)		
h.	Property tax expense (+E, –SE)..................................	500	
	Property tax payable (+L)....................................		500

P4–3.

Req. 1

a.	Prepaid expense	*e.*	Accrued revenue
b.	Prepaid expense	*f.*	Prepaid expense
c.	Accrued expense	*g.*	Accrued expense
d.	Accrued expense	*h.*	Accrued expense

Req. 2

		Debit	Credit
a.	Insurance expense (+E, –SE)	200	
	Prepaid insurance (–A)		200
	($1,200 ÷ 36 months x 6 months of coverage)		
b.	Supplies expense (+E, –SE)	1,000	
	Supplies (–A)		1,000
	(Beg. Inventory of $400 + Purchases $1,000 – Ending Inventory $400)		
c.	Repairs expense (+E, –SE)	800	
	Accounts payable (+L)		800
d.	Property tax expense (+E, –SE)	1,500	
	Property tax payable (+L)		1,500
e.	Accounts receivable (+A)	6,000	
	Service revenue (+R, +SE)		6,000
f.	Depreciation expense (+E, –SE)	1,000	
	Accumulated depreciation, van (+XA, –A)		1,000
g.	Interest expense (+E, –SE)	385	
	Interest payable (+L)		385
	($11,000 x 14% x 3/12 = $385)		
h.	Income tax expense (+E, –SE)	9,335	
	Income tax payable (+L)		9,335

To accrue income tax expense incurred but not paid:

Income before adjustments (given)	$30,000	
Effect of adjustments (a) through (g)	+ 1,115	(–$200–$1,000–$800–$1,500 +$6,000–$1,000–$385)
Income before income taxes	31,115	
Income tax rate	x 30%	
Income tax expense	$ 9,335	

P4–4.

Req. 1

a.	Unearned revenue	*e.*	Prepaid expense
b.	Accrued expense	*f.*	Prepaid expense
c.	Accrued revenue	*g.*	Unearned revenue
d.	Accrued expense	*h.*	Accrued expense

Req. 2

	Balance Sheet			Income Statement		
Transaction	Assets	Liabilities	Stockholders' Equity	Revenues	Expenses	Net Income
a.	NE	–4,800	+4,800	+4,800	NE	+4,800
b.	NE	+14,000	–14,000	NE	+14,000	–14,000
c.	+3,000	NE	+3,000	+3,000	NE	+3,000
d.	NE	+540	–540	NE	+540	–540
e.	–1,167	NE	–1,167	NE	+1,167	–1,167
f.	–2,000	NE	–2,000	NE	+2,000	–2,000
g.	NE	–500	+500	+500	NE	+500
h.	NE	+500	–500	NE	+500	–500

Computations:

a. $7,200 ÷ 6 months = $1,200 per month x 4 months = $4,800 earned

b. Amount is given.

c. Amount is given.

d. $18,000 principal x 12% x 3/12 = $540 interest incurred

e. $7,000 ÷ 12 months = $583 per month x 2 months of coverage = $1,167 incurred

f. Amount is given.

g. $3,000 unearned x 2/12 = $500 earned

h. Amount is given.

P4–5.

Req. 1

a.	Prepaid expense	*e.*	Accrued revenue
b.	Prepaid expense	*f.*	Prepaid expense
c.	Accrued expense	*g.*	Accrued expense
d.	Accrued expense	*h.*	Accrued expense

Req. 2

	Balance Sheet			Income Statement		
Transaction	Assets	Liabilities	Stockholders' Equity	Revenues	Expenses	Net Income
a.	– 200	NE	– 200	NE	+ 200	– 200
b.	– 1,000	NE	– 1,000	NE	+ 1,000	– 1,000
c.	NE	+ 800	– 800	NE	+ 800	– 800
d.	NE	+ 1,500	– 1,500	NE	+ 1,500	– 1,500
e.	+ 6,000	NE	+ 6,000	+ 6,000	NE	+ 6,000
f.	– 1,000	NE	– 1,000	NE	+ 1,000	– 1,000
g.	NE	+ 385	– 385	NE	+ 385	– 385
h.	NE	+ 9,335	– 9,335	NE	+ 9,335	– 9,335

Computations:

a. $1,200 x 6/36 = $200 used

b. Beg. inventory, $400 + Purchases, $1,000 - Ending inventory, $400 = $1,000 used

c. Amount is given.

d. Amount is given.

e. Amount is given.

f. Amount is given.

g. $11,000 x 14% x 3/12 = $385 interest expense for the period

h. Adjusted income = $30,000 - 200 - 1,000 - 800 -1,500 + 6,000 -1,000 - 385 = $31,115 x 30% tax rate = $9,335 income tax expense.

P4–6.

Account	2010 Balance	Financial Statement	Effect on Cash Flows
1. Rent revenue	$528,000	Income statement	+ $524,000
2. Salary expense	65,000	Income statement	– 67,500
3. Maintenance supplies expense	9,300	Income statement	No effect
4. Rent receivable	16,000	Balance sheet	No effect
5. Receivables from employees	1,500	Balance sheet	– 1,500
6. Maintenance supplies	1,700	Balance sheet	– 8,000
7. Unearned rent revenue	12,000	Balance sheet	+12,000
8. Salaries payable	3,000	Balance sheet	– 4,000

(1) Rent Revenue

	512,000 *(a)*
	16,000 *(b)*
	528,000

(2) Salary Expense

(e) 62,000	
(f) 3,000	
65,000	

(3) Maintenance Supplies Expense

Used 9,300	
9,300	

(4) Rent Receivable

(b) 16,000	
16,000	

(5) Receivables from Employees

(g) 1,500	
1,500	

(6) Maintenance Supplies

(h) 3,000	
(i) 8,000	9,300 used
(j) 1,700	

(7) Unearned Rent Revenue

	12,000 *(c)*
	12,000

(8) Salaries Payable

(d) 4,000	4,000 Bal. ← Inferred
	3,000 *(f)*
	3,000

Cash

(a) from renters	512,000	4,000	*(d)* to employees
(c) from renters	12,000	62,000	*(e)* to employees
		1,500	*(g)* to employees
		8,000	*(i)* to suppliers

P4–7.

Req. 1

December 31, 2010, Adjusting Entries

(1)	Accounts receivable (+A)..	560		(*b*)
	Service revenue (+R, +SE)		560	*(i)*
	To record service fees earned, but not collected.			
(2)	Insurance expense (+E, –SE)	280		(*l*)
	Prepaid insurance (–A)		280	(*c*)
	To record insurance expired as an expense.			
(3)	Depreciation expense (+E, –SE).............................	11,900		(*k*)
	Accumulated depreciation, equipment (+XA, –A)		11,900	*(e)*
	To record depreciation expense.			
(4)	Income tax expense (+E, –SE)	6,580		(*m*)
	Income taxes payable (+L)		6,580	*(f)*
	To record income taxes for 2010.			

Req. 2

	Amounts before Adjusting Entries	***Amounts after Adjusting Entries***
Revenues:		
Service revenue	$64,400	$64,960
Expenses:		
Salary expense	58,380	58,380
Depreciation expense		11,900
Insurance expense		280
Income tax expense		6,580
Total expense	58,380	77,140
Net income (loss)	$ 6,020	$(12,180)

Net loss is $12,180 because this amount includes all revenues and all expenses (after the adjusting entries). This amount is correct because it incorporates the effects of the revenue and matching principles applied to all transactions whose effects extend beyond the period in which the transactions occurred. Net income of $6,020 was not correct because expenses of $18,760 and revenues of $560 were excluded that should have been recorded in 2010.

Req. 3

Earnings (loss) per share = $(12,180) net loss ÷ 3,000 shares = $(4.06) per share

P4–7. (continued)

Req. 4

Net profit margin = Net income ÷ Net Sales = $(12,180) net loss ÷ $64,960 = (18.8)%

The net profit margin indicates that, for every $1 of service revenues, Wagonblatt actually lost $0.188 of net income. This ratio implies that Wagonblatt destroys shareholder value in generating its sales and suggests that better management of its business (in terms of sales price or costs) is required.

Req. 5

Service revenue (–R)	64,960	
Retained earnings (–SE)	12,180	
Salary expense (–E)		58,380
Depreciation expense (–E)		11,900
Insurance expense (–E)		280
Income tax expense (–E)		6,580

Req. 6

Wagonblatt Company
Post-closing Trial Balance
December 31, 2010

	Debit	**Credit**
Cash	12,600	
Accounts receivable	560	
Prepaid insurance	560	
Equipment	168,280	
Accumulated depreciation, equipment		56,000
Income taxes payable		6,580
Contributed capital		112,000
Retained earnings		7,420
Service revenue		0
Salary expense	0	
Depreciation expense	0	
Insurance expense	0	
Income tax expense	0	
Totals	182,000	182,000

P4–8.

Req. 1

December 31, 2011, Adjusting Entries:

(*a*)	Supplies expense (+E, –SE)	400	
	Supplies (–A)		400
(*b*)	Insurance expense (+E, –SE)	400	
	Prepaid insurance (–A)		400
(*c*)	Depreciation expense (+E, –SE)	3,200	
	Accumulated depreciation, service trucks (+XA, –A)		3,200
(*d*)	Wages expense (+E, –SE)	720	
	Wages payable (+L)		720
(*e*)	Income tax expense (+E, –SE)	5,880	
	Income taxes payable (+L)		5,880

Req. 2

ST. DENIS, INC.
Income Statement
For the Year Ended December 31, 2011

Operating Revenue:	
Service revenue	$61,600
Operating Expenses:	
Supplies expense ($640 - $240)	400
Insurance expense ($800 - $400)	400
Depreciation expense	3,200
Wages expense	720
Remaining expenses (not detailed)	33,360
Total expenses	38,080
Operating Income	23,520
Income tax expense	5,880
Net income	**$17,640**
Earnings per share ($17,640 ÷ 5,000 shares)	$3.53

P4–8. (continued)

Req. 2 (continued)

ST. DENIS, INC.
Balance Sheet
At December 31, 2011

Assets		**Liabilities and Stockholders' Equity**	
Current Assets:		Current Liabilities:	
Cash	$48,000	Accounts payable	$ 2,400
Accounts receivable	10,400	Wages payable	720
Supplies	240	Income taxes payable	5,880
Prepaid insurance	400	Total current liabilities	9,000
Total current assets	59,040	Note payable, long term	16,000
Service trucks	16,000	Total liabilities	25,000
Accumulated depreciation	(12,800)		
		Stockholders' Equity	
Other assets (not detailed)	8,960	Contributed capital	22,560
		Retained earnings*	23,640
		Total stockholders' equity	46,200
Total assets	**$71,200**	**Total liabilities and stockholders' equity**	**$71,200**

*Unadjusted balance, $6,000 + Net income, $17,640 = Ending balance, $23,640.

Req. 3

December 31, 2011, Closing Entry:

Service revenue (–R)	61,600	
Retained earnings (+SE)		17,640
Supplies expense (–E)		400
Insurance expense (–E)		400
Depreciation expense (–E)		3,200
Wages expense (–E)		720
Remaining expenses (not detailed) (–E)		33,360
Income tax expense (–E)		5,880

P4–9.

Req. 1, 2, 3, and 5 T-accounts **(in thousands)**

Cash

Bal.	4	*b*	12
a	12	*e*	91
c	156	*g*	13
d	4	*h*	17
f	31	*k*	22
Bal.	52		

Accounts Receivable

Bal.	7		
c	52	*f*	31
Bal.	28		

Supplies

Bal.	16		
i	23	*l*	21
Bal.	18		

Land

Bal.	0		
b	12		
Bal.	12		

Equipment

Bal.	78		
Bal.	78		

Accumulated Depreciation

		Bal.	8
		m	8
		Bal.	16

Other Assets

Bal.	5		
g	13		
Bal.	18		

Accounts Payable

		Bal.	0
h	17	*e*	20
		i	23
		Bal.	26

Notes Payable

		Bal.	7
		a	12
		Bal.	19

Wages Payable

		Bal.	0
		o	16
		Bal.	16

Interest Payable

		Bal.	0
		n	1
		Bal.	1

Income Taxes Payable

		Bal.	0
		p	10
		Bal.	10

Contributed Capital

		Bal.	85
		d	4
		Bal.	89

Retained Earnings

		Bal.	10
k	22		
		CE	41
		Bal.	29

Service Revenue

		Bal.	0
		c	208
CE	208		
		Bal.	0

Depreciation Expense

Bal.	0		
m	8	CE	8
Bal.	0		

Income Tax Expense

Bal.	0		
p	10	CE	10
Bal.	0		

Interest Expense

Bal.	0		
*n**	1	CE	1
Bal.	0		

* $12,000 x .10 x 10/12

Supplies Expense

l	21	CE	21
Bal.	0		

Wages Expense

o	16	CE	16
Bal.	0		

Remaining Expenses

e	111	CE	111
Bal.	0		

P4–9. (continued)

Req. 2

		Debit	Credit
a.	Cash (+A)	12,000	
	Notes payable (+L)		12,000
b.	Land (+A)	12,000	
	Cash (–A)		12,000
c.	Cash (+A)	156,000	
	Accounts receivable (+A)	52,000	
	Service revenue (+R, +SE)		208,000
d.	Cash (+A)	4,000	
	Contributed capital (+SE)		4,000
e.	Remaining expenses (+E, –SE)	111,000	
	Accounts payable (+L)		20,000
	Cash (–A)		91,000
f.	Cash (+A)	31,000	
	Accounts receivable (–A)		31,000
g.	Other assets (+A)	13,000	
	Cash (–A)		13,000
h.	Accounts payable (–L)	17,000	
	Cash (–A)		17,000
i.	Supplies (+A)	23,000	
	Accounts payable (+L)		23,000
j.	No entry required; no revenue earned in 2011.		
k.	Retained earnings (–SE)	22,000	
	Cash (–A)		22,000

P4–9. (continued)

Req. 3

l.	Supplies expense (+E, –SE).............................	21,000	
	Supplies (–A)...		21,000
	($39,000 in account – $18,000 at year end)		
m.	Depreciation expense (+E, –SE)	8,000	
	Accumulated depreciation (+XA, –A)........		8,000
n.	Interest expense (+E, –SE)	1,000	
	Interest payable (+L)		1,000
	($12,000 x 10% x 10/12)		
o.	Wages expense (+E, –SE)	16,000	
	Wages payable (+L)		16,000
p.	Income tax expense (+E, –SE)..........................	10,000	
	Income taxes payable (+L)		10,000

Req. 4

H & H TOOL, INC.
Income Statement
For the Year Ended December 31, 2011

Operating Revenues:	
Service revenue	$208,000
Operating Expenses:	
Depreciation expense	8,000
Supplies expense	21,000
Wages expenses	16,000
Remaining expenses	111,000
Total operating expenses	156,000
Operating Income	52,000
Other Item:	
Interest expense	1,000
Pretax income	51,000
Income tax expense	10,000
Net income	$41,000
Earnings per share	$0.46
[$41,000 ÷ 89,000 shares all year]	

P4–9. (continued)

H & H TOOL, INC.
Statement of Stockholders' Equity
For the Year Ended December 31, 2011

	Contributed Capital	Retained Earnings	Total Stockholders' Equity
Balance, January 1, 2011	$85,000	$ 10,000	$95,000
Additional stock issuance	4,000		4,000
Net income		41,000	41,000
Dividends declared		(22,000)	(22,000)
Balance, December 31, 2011	$89,000	$29,000	$118,000

H & H TOOL, INC.
Balance Sheet
At December 31, 2011

Assets		***Liabilities and Stockholders' Equity***	
Current Assets:		Current Liabilities:	
Cash	$ 52,000	Accounts payable	$ 26,000
Accounts receivable	28,000	Interest payable	1,000
Supplies	18,000	Wages payable	16,000
Total current assets	98,000	Income taxes payable	10,000
Land	12,000	Total current liabilities	53,000
Equipment	78,000	Notes payable	19,000
Less: Accumulated deprec.	(16,000)	Total liabilities	72,000
Other assets	18,000	Stockholders' Equity:	
		Contributed capital	89,000
		Retained earnings	29,000
		Total stockholders' equity	118,000
Total assets	**$190,000**	**Total liabilities and stockholders' equity**	**$190,000**

P4–9. (continued)

H & H TOOL, INC.
Statement of Cash Flows
For the Year Ended December 31, 2011

Cash from Operating Activities:	
Cash collected from customers (*c* + *f*)	$187,000
Cash paid to suppliers and employees (*e* +*h*)	(108,000)
Cash provided by operations	**79,000**
Cash from Investing Activities:	
Purchase of land (*b*)	(12,000)
Purchase of other assets (*g*)	(13,000)
Cash used for investing activities	**(25,000)**
Cash from Financing Activities:	
Borrowing from bank (*a*)	12,000
Issuance of stock (*d*)	4,000
Payment of dividends (*k*)	(22,000)
Cash used for financing activities	**(6,000)**
Change in cash	48,000
Beginning cash balance, January 1, 2011	4,000
Ending cash balance, December 31, 2011	$ 52,000

Req. 5

December 31, 2011, Closing Entry

Service revenue (–R)..	208,000	
Retained earnings (+SE)		41,000
Depreciation expense (–E)		8,000
Interest expense (–E)		1,000
Supplies expense (–E)		21,000
Wages expense (–E)		16,000
Remaining expenses (–E)		111,000
Income tax expense (–E)		10,000

P4–9. (continued)

Req. 6

Post-closing trial balance:

H & H TOOL, INC.
Post-Closing Trial Balance
At December 31, 2011

	Debit	Credit
Cash	$ 52,000	
Accounts receivable	28,000	
Supplies	18,000	
Land	12,000	
Equipment	78,000	
Accumulated depreciation (equipment)		$ 16,000
Other assets (not detailed)	18,000	
Accounts payable		26,000
Wages payable		16,000
Interest payable		1,000
Income taxes payable		10,000
Notes payable (long-term)		19,000
Contributed capital (89,000 shares)		89,000
Retained earnings		29,000
Service revenue		0
Depreciation expense	0	
Income tax expense	0	
Interest expense	0	
Supplies expense	0	
Wages expense	0	
Remaining expenses (not detailed)	0	
Total	$206,000	$206,000

P4–9. (continued)

Req. 7

(a) Financial leverage = Average total assets ÷ Average stockholders' equity
= [($102,000+$190,000)÷2]÷ [($95,000+$118,000)÷2]
= $146,000 ÷ $106,500
= 1.37

This suggests that H & H Tool, Inc., finances its assets primarily with stockholders' equity. Approximately one-third of the assets are financed with debt and the rest with stockholders' equity.

(b) Total asset turnover = Sales ÷ Average total assets
= $208,000 ÷ $146,000
= 1.42

This suggests that H & H Tool, Inc., generates $1.42 for every dollar of assets.

(c) Net profit margin = Net income ÷ Sales
= $41,000 ÷ $208,000
= 0.197 or 19.7%

This suggests that H & H Tool, Inc., earns $0.197 for every dollar in sales that it generates.

For all of the ratios, a comparison across time and a comparison against an industry average or competitors will need to be analyzed to determine how risky (financial leverage ratio), how efficient (total asset turnover) and how effective (net profit margin) H & H Tool's management is.

ALTERNATE PROBLEMS

AP4–1.

Req. 1

Starbucks Corporation
Adjusted Trial Balance
At September 30, 2009
(in millions)

	Debit	Credit
Cash	$ 66	
Short-term investments	51	
Accounts receivable	48	
Inventories	181	
Prepaid expenses	19	
Other current assets	21	
Long-term investments	68	
Property, plant, and equipment	1,081	
Accumulated depreciation		$ 321
Other long-lived assets	38	
Accounts payable		56
Accrued liabilities		131
Short-term bank debt		64
Long-term liabilities		40
Contributed capital		647
Retained earnings		212
Net revenues		1,680
Interest income		9
Cost of sales	741	
Store operating expenses	544	
Other operating expenses	51	
Depreciation expense	98	
General and admin. expenses	90	
Interest expense	1	
Income tax expense	62	
Totals	$ 3,160	$ 3,160

Req. 2

Since debits are supposed to equal credits in a trial balance, the balance in Retained Earnings is determined as the amount in the credit column necessary to make debits equal credits (a “plugged” figure).

AP4–2.

Req. 1

a.	Prepaid expense	*e.*	Unearned revenue
b.	Accrued expense	*f.*	Accrued expense
c.	Unearned revenue	*g.*	Accrued expense
d.	Prepaid expense	*h.*	Accrued revenue

Req. 2

a.	Insurance expense (+E, –SE)	1,600	
	Prepaid insurance (–A)		1,600
	($3,200 ÷ 6 months x 3 months of coverage)		
b.	Wage expense (+E, –SE)	900	
	Wages payable (+L)		900
c.	Unearned maintenance revenue (–L)	225	
	Maintenance revenue (+R, +SE)		225
	($450 ÷ 2 months x 1 month)		
d.	Depreciation expense (+E, –SE)	3,000	
	Accumulated depreciation, service truck (+XA, –A)		3,000
e.	Unearned service revenue (–L)	700	
	Service revenue (+R, +SE)		700
	($4,200 ÷ 12 months x 2 months)		
f.	Interest expense (+E, –SE)	600	
	Interest payable (+L)		600
	($16,000 x 9% ÷ 12 months x 5 months = $600)		
g.	Property tax expense (+E, –SE)	500	
	Property tax payable (+L)		500
h.	Accounts receivable (+A)	2,000	
	Service revenue (+R, +SE)		2,000

AP4–3.

Req. 1

a.	Prepaid expense	*e.*	Prepaid expense
b.	Accrued revenue	*f.*	Prepaid expense
c.	Accrued expense	*g.*	Accrued revenue
d.	Prepaid expense	*h.*	Accrued expense

Req. 2

a.	Supplies expense (+E, –SE)	1,150	
	Supplies (–A)		1,150
	(Beg. Inventory of $350 + Purchases $1,200 – Ending Inventory $400)		
b.	Accounts receivable (+A)	7,500	
	Catering revenue (+R, +SE)		7,500
c.	Repairs expense (+E, –SE)	600	
	Accounts payable (+L)		600
d.	Insurance expense (+E, –SE)	200	
	Prepaid insurance (–A)		200
	($1,200 ÷ 12 months x 2 months of coverage)		
e.	Rent expense (+E, –SE)	700	
	Prepaid rent (–A)		700
	($2,100 ÷ 3 months x 1 month of rent used)		
f.	Depreciation expense (+E, –SE)	1,600	
	Accumulated depreciation, display counters (+XA, –A)		1,600
g.	Interest receivable (+A)	80	
	Interest income (+R, +SE)		80
	($4,000 x 12% x 2/12 = $80)		
h.	Income tax expense (+E, –SE)	7,719	
	Income tax payable (+L)		7,719

To accrue income tax expense incurred but not paid:

Income before adjustments (given)	$22,400	
Effect of adjustments (a) through (g)	+ 3,330	(-$1,150+$7,500-$600
Income before income taxes	25,730	-$200-$700-$1,600+$80)
Income tax rate	x 30%	
Income tax expense	$ 7,719	

AP4–4.

Req. 1

a.	Prepaid expense	*e.*	Unearned revenue
b.	Accrued expense	*f.*	Accrued expense
c.	Unearned revenue	*g.*	Accrued expense
d.	Prepaid expense	*h.*	Accrued revenue

Req. 2

	Balance Sheet			Income Statement		
Transaction	Assets	Liabilities	Stockholders' Equity	Revenues	Expenses	Net Income
a.	–1,600	NE	–1,600	NE	+1,600	–1,600
b.	NE	+900	–900	NE	+900	–900
c.	NE	–225	+225	+225	NE	+225
d.	–3,000	NE	–3,000	NE	+3,000	–3,000
e.	NE	–700	+700	+700	NE	+700
f.	NE	+600	–600	NE	+600	–600
g.	NE	+500	–500	NE	+500	–500
h.	+2,000	NE	+2,000	+2,000	NE	+2,000

Computations:

a. $3,200 prepaid insurance ÷ 6 months x 3 months of coverage = $1,600 used

b. Amount is given.

c. $450 unearned revenue ÷ 2 months x 1 month = $225 earned

d. Amount is given.

e. $4,200 unearned revenue ÷ 12 months x 2 months = $700 earned

f. $16,000 principal x 9% x 5/12 months = $600 interest expense

g. Amount is given.

h. Amount is given.

AP4–5.

Req. 1

a.	Prepaid expense	*e.*	Prepaid expense
b.	Accrued revenue	*f.*	Prepaid expense
c.	Accrued expense	*g.*	Accrued revenue
d.	Prepaid expense	*h.*	Accrued expense

Req. 2

	Balance Sheet			Income Statement		
Transaction	Assets	Liabilities	Stockholders' Equity	Revenues	Expenses	Net Income
a.	–1,150	NE	–1,150	NE	+1,150	–1,150
b.	+7,500	NE	+7,500	+7,500	NE	+7,500
c.	NE	+600	–600	NE	+600	–600
d.	–200	NE	–200	NE	+200	–200
e.	–700	NE	–700	NE	+700	–700
f.	–1,600	NE	–1,600	NE	+1,600	–1,600
g.	+80	NE	+80	+80	NE	+80
h.	NE	+7,719	–7,719	NE	+7,719	–7,719

Computations:

a. Beg. Inventory of $350 + Purchases $1,200 – Ending Inventory $400 = $1,150 used for the period.

b. Amount is given.

c. Amount is given.

d. $1,200 prepaid expense x 2/12 = $200 insurance used

e. $2,100 x 1/3 = $700 rent used

f. Amount is given.

g. $4,000 principal x 12% x 2/12 months = $80 interest earned

h. Adjusted income = $22,400 - $1,150 + $7,500 - $600 - $200 - $700 - $1,600 + $80 = $25,730 x 30% tax rate = $7,719 income tax expense

AP4–6.

Req. 1

December 31, 2009, Adjusting Entries

(1)	Accounts receivable (+A)	1,500		(*b*)
	Service revenue (+R, +SE)		1,500	(*j*)
	To record service fees earned, but not collected.			
(2)	Rent expense (+E, –SE)	400		(*m*)
	Prepaid rent (–A)..		400	(*c*)
	To record rent expired as an expense.			
(3)	Depreciation expense (+E, –SE)	17,500		(*l*)
	Accumulated depreciation (+XA, –A)		17,500	(*e*)
	To record depreciation expense.			
(4)	Unearned revenue (–L)	8,000		(*g*)
	Service revenue (+R, +SE)		8,000	(*j*)
	To record service fees earned.			
(5)	Income tax expense (+E, –SE)	6,500		(*n*)
	Income taxes payable (+L)		6,500	(*f*)
	To record income taxes for 2009.			

Req. 2

	Amounts before Adjusting Entries	***Amounts after Adjusting Entries***
Revenues:		
Service revenue	$83,000	$92,500
Expenses:		
Salary expense	54,000	54,000
Depreciation expense		17,500
Rent expense		400
Income tax expense		6,500
Total expense	54,000	78,400
Net income	$ 29,000	$ 14,100

Net income is $14,100 because this amount includes all revenues and all expenses (after the adjusting entries). This amount is correct because it incorporates the effects of the revenue and matching principles applied to all transactions whose effects extend beyond the period in which the transactions occurred. Net income of $29,000 was not correct because expenses of $24,400 and revenues of $9,500 were excluded that should have been recorded in 2009.

AP4–6. (continued)

Req. 3

Earnings per share = $14,100 net income ÷ 5,000 shares = $2.82 per share

Req. 4

Net profit margin = Net income ÷ Net Sales = $14,100 ÷ $92,500 = 15.2%

The net profit margin indicates that, for every $1 of service revenues, Abraham made $0.152 (15.2%) of net income. This ratio suggests that Abraham is generally profitable.

Req. 5

Service revenue (–R)	92,500	
Retained earnings (+SE)		14,100
Salary expense (–E)		54,000
Depreciation expense (–E)		17,500
Rent expense (–E)		400
Income tax expense (–E)		6,500

Req. 6

Abraham Company
Post-closing Trial Balance
December 31, 2009

	Debit	**Credit**
Cash	18,000	
Accounts receivable	1,500	
Prepaid rent	800	
Property, plant, and equipment	210,000	
Accumulated depreciation		70,000
Income taxes payable		6,500
Unearned revenue		8,000
Contributed capital		110,000
Retained earnings		35,800
Service revenue		0
Salary expense	0	
Depreciation expense	0	
Rent expense	0	
Income tax expense	0	
Totals	230,300	230,300

AP4–7.

Req. 1

December 31, 2010, Adjusting Entries:

		Debit	Credit
(*a*)	Depreciation expense (+E, –SE)	3,000	
	Accumulated depreciation (+XA, –A)		3,000
(*b*)	Insurance expense (+E, –SE)	450	
	Prepaid insurance (–A)		450
(*c*)	Wages expense (+E, –SE)	1,100	
	Wages payable (+L)		1,100
(*d*)	Supplies expense (+E, –SE)	700	
	Supplies (–A)		700
(*e*)	Income tax expense (+E, –SE)	2,950	
	Income tax payable (+L)		2,950

Req. 2

AUSTIN CO.
Income Statement
For the Year Ended December 31, 2010

Operating Revenue:	
Service revenue	$48,000
Operating Expenses:	
Supplies expense ($1,300 balance - $600 on hand)	700
Insurance expense	450
Depreciation expense	3,000
Wages expense	1,100
Remaining expenses (not detailed)	32,900
Total expenses	38,150
Operating Income	9,850
Income tax expense	2,950
Net income	**$6,900**
Earnings per share ($6,900 ÷ 4,000 shares)	$1.73

AP4–7. (continued)

AUSTIN CO.
Balance Sheet
At December 31, 2010

Assets		**Liabilities and Stockholders' Equity**	
Current Assets:		Current Liabilities:	
Cash	$19,600	Accounts payable	$ 2,500
Accounts receivable	7,000	Wages payable	1,100
Supplies	600	Income tax payable	2,950
Prepaid insurance	450	Total current liabilities	6,550
Total current assets	27,650	Note payable, long term	5,000
Equipment	27,000	Total liabilities	11,550
Accumulated depreciation	(15,000)	Stockholders' Equity	
Other assets (not detailed)	5,100	Contributed capital	16,000
		Retained earnings*	17,200
		Total stockholders' equity	33,200
Total assets	**$44,750**	**Total liabilities and stockholders' equity**	**$44,750**

*Unadjusted balance, $10,300 + Net income, $6,900 = Ending balance, $17,200.

Req. 3

December 31, 2010, Closing Entry:

Service revenue (–R)	48,000	
Retained earnings (+SE)		6,900
Supplies expense (–E)		700
Insurance expense (–E)		450
Depreciation expense (–E)		3,000
Wages expense (–E)		1,100
Remaining expenses (not detailed) (–E)		32,900
Income tax expense (–E)		2,950

AP4–8.

Req. 1, 2, 3, and 5 T-accounts (in thousands)

Cash

Bal.	5		
a	20	*b*	18
c	5	*e*	28
d	56	*f*	3
g	8	*h*	11
j	3	*k*	10
Bal.	27		

Accounts Receivable

Bal.	4		
d	9	*g*	8
Bal.	5		

Supplies

Bal.	2		
i	10	*l*	8
Bal.	4		

Small Tools

Bal.	6		
f	3	*l*	1
Bal.	8		

Equipment

Bal.	0		
b	18		
Bal.	18		

Accumulated Depreciation

		Bal.	0
		m	2
		Bal.	2

Other Assets

Bal.	9		
Bal.	9		

Accounts Payable

		Bal.	7
h	11	*e*	7
		i	10
		Bal.	13

Notes Payable

		Bal.	0
		a	20
		Bal.	20

Wages Payable

		Bal.	0
		o	3
		Bal.	3

Interest Payable

		Bal.	0
		n	1
		Bal.	1

Income Taxes Payable

		Bal.	0
		p	4
		Bal.	4

Unearned Revenue

		Bal.	0
		j	3
		Bal.	3

Contributed Capital

		Bal.	15
		c	5
		Bal.	20

Retained Earnings

k	10	Bal.	4
		CE	11
		Bal.	5

Service Revenue

		Bal.	0
		d	65
CE	65		
		Bal.	0

Income Tax Expense

Bal.	0		
p	4		
		CE	4
Bal.	0		

Interest Expense

Bal.	0		
n	1		
		CE	1
Bal.	0		

Depreciation Expense

Bal.	0		
m	2		
		CE	2
Bal.	0		

Wages Expense

Bal.	0		
o	3		
		CE	3
Bal.	0		

Remaining Expenses

Bal.	0		
e	35		
l	9	CE	44
Bal.	0		

AP4–8. (continued)

Req. 2

		Debit	Credit
a.	Cash (+A)	20,000	
	Notes payable (+L)		20,000
b.	Equipment (+A)	18,000	
	Cash (–A)		18,000
c.	Cash (+A)	5,000	
	Contributed capital (+SE)		5,000
d.	Cash (+A)	56,000	
	Accounts receivable (+A)	9,000	
	Service revenue (+R, +SE)		65,000
e.	Remaining expenses (+E, –SE)	35,000	
	Accounts payable (+L)		7,000
	Cash (–A)		28,000
f.	Small tools (+A)	3,000	
	Cash (–A)		3,000
g.	Cash (+A)	8,000	
	Accounts receivable (–A)		8,000
h.	Accounts payable (–L)	11,000	
	Cash (–A)		11,000
i.	Supplies (+A)	10,000	
	Accounts payable (+L)		10,000
j.	Cash (+A)	3,000	
	Unearned revenue (+L)		3,000
k.	Retained earnings (–SE)	10,000	
	Cash (–A)		10,000

AP4–8. (continued)

Req. 3

l.	Remaining expenses (+E, –SE)	9,000	
	Supplies (–A)		8,000
	Small tools (–A)		1,000
	[Supplies used ($12 – 4) and small tools used ($9 – 8)]		
m.	Depreciation expense (+E, –SE)	2,000	
	Accumulated depreciation (+XA, –A)		2,000
n.	Interest expense (+E, –SE)	1,000	
	Interest payable (+L)		1,000
	($20,000 principal x 10% x 6/12)		
o.	Wages expense (+E, –SE)	3,000	
	Wages payable (+L)		3,000
p.	Income tax expense (+E, –SE)	4,000	
	Income taxes payable (+L)		4,000

Req. 4

NEW AGAIN FURNITURE, INC.
Income Statement
For the Year Ended December 31, 2011

Operating Revenues:	
Service revenue	$65 000
Operating Expenses:	
Depreciation expense	2,000
Wages expense	3,000
Remaining expenses	44,000
Operating Income	16,000
Other Item:	
Interest expense	1,000
Pretax income	15,000
Income tax expense	4,000
Net income	**$11,000**
Earnings per share [$11,000 ÷ [(15,000+20,000)÷2]	$0.63

AP4–8. (continued)

NEW AGAIN FURNITURE, INC.
Statement of Stockholders' Equity
For the Year Ended December 31, 2011

	Contributed Capital	Retained Earnings	Total Stockholders' Equity
Balance, January 1, 2011	$15,000	$ 4,000	$19,000
Additional stock issuance	5,000		5,000
Net income		11,000	11,000
Dividends declared		(10,000)	(10,000)
Balance, December 31, 2011	$20,000	$ 5,000	$25,000

NEW AGAIN FURNITURE, INC.
Balance Sheet
At December 31, 2011

Assets		*Liabilities and Stockholders' Equity*	
Current Assets:		Current Liabilities:	
Cash	$27,000	Accounts payable	$13,000
Accounts receivable	5,000	Notes payable	20,000
Supplies	4,000	Wages payable	3,000
Small tools	8,000	Interest payable	1,000
Total current assets	44,000	Income taxes payable	4,000
Equipment	18,000	Unearned revenue	3,000
Less: Accum. deprec.	(2,000)	Total current liabilities	44,000
Other assets	9,000	*Stockholders' Equity:*	
		Contributed capital	20,000
		Retained earnings	5,000
		Total stockholders' equity	25,000
Total assets	**$69,000**	**Total liabilities and stockholders' equity**	**$69,000**

AP4–8. (continued)

NEW AGAIN FURNITURE, INC.
Statement of Cash Flows
For the Period Ended December 31, 2011

Cash from Operating Activities:	
Cash collected from customers (*d* + *g* + *j*)	$ 67,000
Cash paid to suppliers and employees (*e* + *h*)	(39,000)
Cash provided by operations	**28,000**
Cash from Investing Activities:	
Purchase of equipment (*b*)	(18,000)
Purchase of small tools (*f*)	(3,000)
Cash used in investing activities	**(21,000)**
Cash from Financing Activities:	
Borrowing from bank (*a*)	20,000
Issuance of stock (*c*)	5,000
Payment of dividends (*k*)	(10,000)
Cash provided by financing activities	**15,000**
Change in cash	22,000
Beginning cash balance, January 1, 2011	5,000
Ending cash balance, December 31, 2011	$ 27,000

Req. 5

December 31, 2011, Closing Entry

	Debit	Credit
Service revenue (–R)..	65,000	
Retained earnings (+SE)		11,000
Depreciation expense (–E)		2,000
Interest expense (–E)		1,000
Wages expense (–E)		3,000
Remaining expenses (–E)		44,000
Income tax expense (–E)		4,000

AP4–8. (continued)

Req. 6

NEW AGAIN FURNITURE, INC.
Post-Closing Trial Balance
At December 31, 2011

Account Titles	*Debit*	*Credit*
Cash	$27,000	
Accounts receivable	5,000	
Supplies	4,000	
Small tools	8,000	
Equipment	18,000	
Accumulated depreciation		$ 2,000
Other assets (not detailed)	9,000	
Accounts payable		13,000
Notes payable		20,000
Wages payable		3,000
Interest payable		1,000
Income taxes payable		4,000
Unearned revenue		3,000
Contributed capital (20,000 shares)		20,000
Retained earnings		5,000
Service revenue		0
Depreciation expense	0	
Wages expense	0	
Income tax expense	0	
Interest expense	0	
Remaining expenses (not detailed)	0	
Totals	$71,000	$71,000

AP4–8. (continued)

Req. 7

(a) Financial leverage = Average total assets ÷ Average stockholders' equity
= [($26,000+$69,000)÷2]÷ [($19,000+$25,000)÷2]
= $47,500 ÷ $22,000
= 2.16

This result suggests that New Again Furniture, Inc., finances its assets more with debt than stockholders' equity. The company borrowed $1.16 and utilized $1 of stockholders' equity to acquire every dollar of assets.

(b) Total asset turnover = Sales ÷ Average total assets
= $65,000 ÷ $47,500
= 1.37

This suggests that New Again Furniture, Inc., generates $1.37 for every dollar of assets.

(c) Net profit margin = Net income ÷ Sales
= $11,000 ÷ $65,000
= 0.17 or 17%

This suggests that New Again Furniture, Inc., earns $0.17 for every dollar in sales that it generates.

For all of the ratios, a comparison across time and a comparison against an industry average or competitors will need to be analyzed to determine how risky (financial leverage ratio), how efficient (total asset turnover) and how effective (net profit margin) New Again Furniture's management is.

CASES AND PROJECTS

FINANCIAL REPORTING AND ANALYSIS CASES

CP4–1.

1. American Eagle paid $204,179 thousand in income taxes in its 2006 fiscal year, as disclosed in note 2 under "Supplemental Disclosures of Cash Flow Information."

2. The quarter ended February 3, 2007, was its best quarter in terms of sales at $973,365,000 (this quarter covered Christmas, the biggest part of the year for retailers). The worst quarter ended April 29, 2006 (the quarter following Christmas), and most likely this is because most people have very little money to spend on extra clothing in that period. Note 14 discloses quarterly information.

3. Other income (net) is an aggregate of many accounts, but a summary entry for them all would be:

Other income (net)	42,277	
Retained Earnings		42,277

4. As disclosed in Note 4, Accounts and Note Receivable consists of (in thousands):

Construction allowances	9,345
Merchandise sell-offs	2,488
Taxes	1,012
Interest income	7,251
Property insurance claims	2,530
Other	3,419
Total	$26,045

5. Fiscal year (dollars are in thousands)

2004: Net Profit Margin $= \dfrac{\text{Net Income}}{\text{Sales}} = \dfrac{\$213,343}{\$1,889,647} = 0.113$

2005: Net Profit Margin $= \dfrac{\text{Net Income}}{\text{Sales}} = \dfrac{\$294,153}{\$2,321,962} = 0.127$

2006: Net Profit Margin $= \dfrac{\text{Net Income}}{\text{Sales}} = \dfrac{\$387,359}{\$2,794,409} = 0.139$

Over the past three years, the company's net profit margin has improved each year. Management appears to be more effective over time at controlling costs, generating greater sales, or both.

CP4–2

1. At the end of the most recent year, Prepaid Expenses were $27,286 thousand. This information is disclosed on the balance sheet.

2. The company reported $88,650 thousand in deferred rent. This information is disclosed on the balance sheet.

3. Prepaid rent represents rent that Urban Outfitters has paid in advance to its landlords. It is an asset. Urban Outfitters also rents property to tenants. Deferred rent represents rent that it has collected in advance for which Urban Outfitters has an obligation to allow a tenant to use Urban Outfitters' property.

4. Accrued Liabilities would consist of costs that have been incurred by the end of the accounting period but which have not yet been paid.

5. Interest Income is related to the company's short-term investments.

6. The company's income statement accounts (revenues, expense, gains, and losses) would not have balances on a post-closing trial balance. These accounts are temporary accounts that have been closed to Retained Earnings.

7. Prepaid Expenses is an asset account. As such, it is a permanent account that carries its ending balance into the next accounting period. It is not closed at the end of the period.

8. The company reported basic earnings per share of $0.71 for the year ended January 31, 2007, $0.80 for the year ended January 31, 2006, and $0.56 for the year ended January 31, 2005.

9. Year Ended (dollars in thousands)

1/31/05: Net Profit Margin $= \dfrac{\text{Net Income}}{\text{Sales}} = \dfrac{\$90{,}489}{\$827{,}750} = 0.109$

1/31/06: Net Profit Margin $= \dfrac{\text{Net Income}}{\text{Sales}} = \dfrac{\$130{,}796}{\$1{,}092{,}107} = 0.120$

1/31/07: Net Profit Margin $= \dfrac{\text{Net Income}}{\text{Sales}} = \dfrac{\$116{,}206}{\$1{,}224{,}717} = 0.095$

Over the past three years, the company's net profit margin at first increased and then the most recent year's profit margin was lower than during the years ended January 31, 2005 and 2006. For the year ended January 31, 2007, management appears to be having a harder time controlling costs, generating greater sales, or both.

CP4–3.

1. American Eagle Outfitters reported an advertising expense of $64.3 million for the most recent year (Note 2 under Advertising Costs). Urban Outfitters reported $35.9 million of advertising costs for the year. (See Note 2 under Advertising).

2.	American Eagle Outfitters		Urban Outfitters	
Year	Advertising Expense / Net Sales		Advertising Expense / Net Sales	
2006	64,300 / 2,794,409	2.3%	35,882 / 1,224,717	2.9%
2005	53,300 / 2,321,962	2.3%	30,033 / 1,092,107	2.8%
2004	41,400 /1,889,647	2.2%	22,455 / 827,750	2.7%

Urban Outfitters incurred the higher percentage in 2006 (and in each year). Both firms had a slightly increasing balance of advertising costs as a percentage of net sales over the three years.

3.	Industry Average	American Eagle Outfitters	Urban Outfitters
Advertising/Sales =	2.39%	2.3%	2.9%

American Eagle Outfitters is spending less on advertising as a percentage of sales than the average company in the industry, while Urban Outfitters is spending more. This might imply that American Eagle is more effective, as they are generating more sales per dollar spent on advertising. Another interpretation is that they are not supporting their brand, and sales will eventually decline as their brands lose value.

4. Both accounting policies are similar indicating that advertising costs are expensed when the marketing campaigns become publicly available. American Eagle allocates advertising costs for television campaigns over the life of the campaign. Urban Outfitters capitalizes expenses associated with direct-to-consumer advertising (catalogs) and amortizes these expenses over the expected period of future benefits. (The policies are disclosed in note 2 in both annual reports).

CP4–3. (continued)

5.

	American Eagle Outfitters	Urban Outfitters
2004: Net Profit Margin = Net Income / Sales	$\frac{\$213,343}{\$1,889,647} = 0.113$	$\frac{\$90,489}{\$827,750} = 0.109$
2005: Net Profit Margin = Net Income / Sales	$\frac{\$294,153}{\$2,321,962} = 0.127$	$\frac{\$130,796}{\$1,092,107} = 0.120$
2006: Net Profit Margin = Net Income / Sales	$\frac{\$387,359}{\$2,794,409} = 0.139$	$\frac{\$116,206}{\$1,224,717} = 0.095$

American Eagle Outfitters shows steadily increasing profit margins over time; whereas Urban Outfitters showed a dip in its profit margin in 2006. Over the previous three years, American Eagle has been able to attain a greater profit margin than that for Urban Outfitters, suggesting a better overall performance.

6.

	Industry Average	American Eagle Outfitters	Urban Outfitters
Net Profit Margin =	7.69%	13.9%	9.5%

Both companies, American Eagle Outfitters and Urban Outfitters have higher Net Profit Margins than the average company in their industry. This is likely due to the strategy that these two companies have pursued, which is to differentiate their clothing in terms of style and quality and appeal to a particular niche market, therefore being able to charge a higher price.

CP4–4

Req. 1

The author suggests that the root cause of accounting scandals is "a widespread obsession with earnings that drives companies to push accounting standards to the limit and, in extreme cases, to engage in outright fraud." This causes managers to make decisions to meet short-term earnings expectations, often at the expense of long-term shareholder value.

Req. 2

The uncertainties that the author believes are problems in current financial reporting are related to the subjective assumptions about the future (accruals) – revenue recognition and expense matching. Examples include uncertainties as to how much revenue a company will generate from current-period expenditures for research and development, employee training, brand building, or additions to production capacity. There is also subjectivity in matching expenses with revenues. Examples include the various depreciation methods available to managers and expensing research and development.

According to the author, these uncertainties about the future combined with historical information produce financial statements, and net income in particular, that do not tell users what they need to know to make investing and lending decisions.

CP4–5.

Req. 1

Account	Unadjusted Trial Balance Debit	Unadjusted Trial Balance Credit	Adjusted Trial Balance Debit	Adjusted Trial Balance Credit	Post-Closing Trial Balance Debit	Post-Closing Trial Balance Credit
Cash	20,000		20,000		20,000	
Maintenance supplies	500		200		200	
Service equipment	90,000		90,000		90,000	
Accumulated depreciation, service equipment		18,000		27,000		27,000
Remaining assets	42,500		42,500		42,500	
Note payable, 8%		10,000		10,000		10,000
Interest payable				800		800
Income taxes payable				13,020		13,020
Wages payable				500		500
Unearned revenue				6,000		6,000
Contributed capital		56,000		56,000		56,000
Retained earnings		9,000		9,000		39,380
Service revenue		220,000		214,000		0
Expenses	160,000		183,620		0	
	313,000	313,000	336,320	336,320	152,700	152,700

Ending Retained Earnings = Beg., $9,000 + Net income, ($214,000 - $183,620)

Req. 2

(*a*) To record the amount of supplies used during 2010, $300, and to reduce the supplies account to the amount remaining on hand at the end of 2010.

(*b*) To accrue interest expense for 2010 (the interest is payable in 2011, computed as $10,000 x 8% = $800) and to record interest payable.

(*c*) To reduce service revenue for cash collected in advance of being earned and to record the liability for those services yet to be performed, $6,000.

(*d*) To record depreciation expense for 2010, $9,000.

(*e*) To record 2010 wages of $500 that will be paid in 2008.

(*f*) To record 2010 income tax and the related liability, $13,020.

CP4–5. (continued)

Req. 3

Closing Entry on December 31, 2010:

Service revenue (from the adjusted trial balance) (–R)	214,000	
Retained earnings (+SE)		30,380
Expenses (from the adjusted trial balance) (–E).........		183,620

Req. 4

Pretax income	x	Average income tax rate	=	Income tax expense
($214,000 - 170,600)	x	?	=	$13,020
$43,400	x	?	=	$13,020
		?	=	30%

Req. 5

Number of shares issued	x	Average issue price	=	Total issue amount
8,000	x	?	=	$56,000
		?	=	$7.00 per share

CP4–6.

Transaction (a):

1. This transaction will affect Shirley's financial statements for 10 years (from 2009 to 2018) in conformity with the matching principle.

2. Income statement:

Depreciation expense, as given	$1,400 each year

3. Balance sheet at December 31, 2011:

Assets:	
Office equipment	$14,000
Less: Accumulated depreciation*	4,200
Net book (carrying) value	$ 9,800

*$1,400 x 3 years = $4,200.

4. An adjusting entry each year over the life of the asset would be recorded to reflect the allocation of the cost of the asset when used to generate revenues:

Depreciation expense (+E, –SE)	1,400	
Accumulated depreciation (+XA, –A)		1,400

Transaction (b):

1. This transaction will affect Shirley's financial statements for 2 years--2011 and 2012--because four month's rent revenue was earned in 2011, and two months' rent revenue will be earned in 2012.

2. The 2011 income statement should report rent revenue earned of $16,000 ($24,000 x 4/6). Occupancy was provided for only 4 months in 2011. This is in conformity with the revenue principle.

3. This transaction created an $8,000 liability ($24,000 - $16,000 = $8,000) as of December 31, 2011, because at that date Shirley "owes" the renter two more months' occupancy for which it has already collected the cash.

4. Yes, an adjusting entry must be made to (a) increase the rent revenue account by $16,000, and (b) to decrease the liability to $8,000 representing the future occupancy owed (in conformity with the revenue principle).

December 31, 2011--Adjusting entry:

Unearned rent revenue (–L)	16,000	
Rent revenue (+R, +SE)		16,000

CP4–6. (continued)

Transaction (c):

1. This transaction will directly affect Shirley's financial statements for two years, with the expense incurred in 2011 and the cash payment in 2012.

2. The $7,500 should be reported as wage expense in the 2011 income statement and as a liability on the 2011 balance sheet. On January 5, 2012, the liability will be paid. Therefore, the 2012 balance sheet will reflect a reduced cash balance and reduced liability balance. The transaction will not directly affect the 2012 income statement (unless the adjusting entry was not made).

3. Yes, an adjusting entry must be made to (a) record the $7,500 as an expense in 2011 (matching principle) and (b) to record the liability which will be paid in 2012.

December 31, 2011--Adjusting entry:

Wage expense (+E, –SE)	7,500	
Wages payable (+L)		7,500

Note: On January 5, 2012, the liability, Wages Payable, $7,500, will be paid. Wage expense for 2012 will not include this $7,500. The 2012 related entry will debit (decrease) wages payable, and credit (decrease) cash, $7,500.

Transaction (d):

1. Yes, service revenue of $45,000 (i.e., $60,000 x 3/4) should be recorded as earned by Shirley in conformity with the revenue principle. Service revenue is recognized as the service is performed.

2. Recognition of revenue earned but not collected by the end of 2011 requires an adjusting entry. This adjusting entry is necessary to (a) record the revenue earned (to be reported on the 2011 income statement) and (b) record the related account receivable (an asset to be reported on the 2011 balance sheet). The adjusting entry on December 31, 2011 is:

Accounts receivable (+A)..	45,000	
Service revenue (+R, +SE).............................		45,000

($60,000 total price x 3/4 completed)

3. February 15, 2012--Completion of the last phase of the service contract and cash collected in full:

Cash (+A)	60,000	
Accounts receivable (–A)................................		45,000
Service revenue (+R, +SE).............................		15,000

CP4–7.

Req. 1

Adjusting entries:

		Debit	Credit
(a)	Expenses (insurance) (+E, –SE)	1	
	Prepaid insurance (–A)		1
	To adjust for expired insurance.		
(b)	Rent receivable (+A)	2	
	Revenues (rent) (+R, +SE)		2
	To adjust for rent revenue earned but not yet collected.		
(c)	Expenses (depreciation) (+E, –SE)	11	
	Accumulated depreciation, long-lived assets (+XA, –A)		11
	To adjust for annual depreciation.		
(d)	Expenses (wages) (+E, –SE)	3	
	Wages payable (+L)		3
	To adjust for wages earned but not recorded or paid.		
(e)	Income tax expense (+E, –SE)	5	
	Income taxes payable (+L)		5
	To adjust for income tax expense.		
(f)	Unearned rent revenue (–L)	3	
	Revenues (rent) (+R, +SE)		3
	To adjust for rent revenue collected but unearned.		

Req. 2

Closing entry (from the adjusted trial balance):

Revenues (–R)	103	
Retained earnings (+SE)		15
Expenses (–E)		83
Income tax expense (–E)		5
To close the temporary accounts to Retained Earnings for 2009.		

CP4–7. (continued)

Req. 3

(a) Shares outstanding: 1,000 shares (given) – no change all year.

(b) Interest expense: $20,000 x 10% = $2,000.

(c) Ending balance in retained earnings:
Unadjusted balance, $(3,000) + Net income, $15,000 = $12,000.

(d) Average income tax rate: $5,000 income tax expense ÷ ($103,000 revenues - $83,000 total expenses) = 25%.

(e) Rent receivable -- report on the balance sheet as an asset.
Unearned rent revenue -- report on the balance sheet as a liability (for future occupancy "owed").

(f) Net income of $15,000 was computed on the basis of **accrual** accounting concepts. Revenue is recognized when earned and expenses recorded when incurred regardless of the timing of the respective cash flows. Cash inflows, in addition to certain revenues, were from numerous sources such as the issuance of capital stock, borrowing, and revenue collected in advance. Similarly, cash outflows were, in addition to certain expenses, due to numerous transactions such as the purchase of operational and other assets, prepaid insurance, and dividends to stockholders.

(g) EPS: $15,000 ÷ 1,000 shares (per (a) above) =$15.00 per share.

(h) Selling price per share: $30,000 contributed capital ÷ 1,000 shares = $30 per share.

(i) The prepaid insurance account reflected a $2,000 balance before the adjustment (decrease) of $1,000. Therefore, it appears that the policy premium was paid on January 1, 2009, and it was prepaid for two years (2009 and 2010). Other possibilities might be (a) a 12-month policy purchased on July 1, 2009, or (b) a 2-month policy purchased on December 1, 2009. In any case, one-half of the premium has expired.

(j) Net profit margin: $15,000 net income ÷ $103,000 revenues = 0.146 (14.6%).

CP4–8.

Req. 1

CRYSTAL'S DAY SPA AND SALON, INC.
Income Statement
For the Year Ended December 31, 2011

Items	***Cash Basis Per Crystal's Statement***	***Explanation of Changes***	***Corrected Basis***
Revenues:			
Spa fees	$1,115,000	See * below.	$1,012,000
Expenses:			
Office rent	130,000	Exclude rent for Jan. 2012 ($130,000 ÷ 13) (g)	120,000
Utilities	43,600	No change	43,600
Telephone	12,200	See ** below.	11,800
Salaries	522,000	Add December 2011 salary ($18,000 ÷ 12) (e)	523,500
Supplies	31,900	See *** below.	29,825
Miscellaneous	12,400	No change	12,400
Depreciation	0	Given for 2011 (c)	20,500
Total expenses	752,100		761,625
Net income	$ 362,900		$ 250,375

* Cash collected for spa fees	$1,115,000
Fees earned in prior years (a)	-132,000
Fees earned in 2011 but not yet collected (b)	+ 29,000
Fees earned in 2011	$1,012,000

** Add December 2011 bill of $1,400 (f) and subtract the December 2010 bill of $1,800 paid in 2011 ($12,200 + $1,400 - $1,800 = $11,800).

*** Supplies (d)

Beg.	3,125		
Purchases	31,900	29,825	Used
End.	5,200		

CP4–8. (continued)

Req. 2

Memo to Crystal Mullinex should include the following:

(1) Net income was overstated by $112,525 because of inappropriate recognition of revenue (overstated by $103,000) and expenses (understated by $9,525). Revenue should be recognized when earned, not when the cash is collected. Similarly, expenses should be matched against revenue in the period when the services or materials were used (including depreciation expense).

(2) Some other items the parties should consider in the pricing decision:
  (a) A correct balance sheet at December 31, 2011.
  (b) Collectibility of any receivables (if they are to be sold with the business).
  (c) Any liabilities of the spa to be assumed by the purchaser.
  (d) Current employees -- how will they be affected?
  (e) Adequacy of the rented space -- is there a long-term noncancellable lease?
  (f) Characteristics of Crystal's spa practices.
  (g) Expected future cash flows of the business. What is the present value of those expectations?

CRITICAL THINKING CASES

CP4–9.

Req. 1

2010	**Adjusting Entries**	**Debit**	**Credit**
12/31			
(a)	Supplies expense (+E, –SE)…………………	4,200	
	Supplies (–A)………………………………		4,200
	($6,000 - $1,800 = $4,200)		
(b)	Insurance expense (+E, –SE)…………………….	2,000	
	Prepaid insurance (–A)……………………		2,000
	($4,000 ÷ 2 years)		
(c)	Depreciation expense (+E, –SE)…………………	8,000	
	Accumulated depreciation (+XA, –A)…….		8,000
(d)	Salaries expense (+E, –SE)………………………..	2,200	
	Salaries payable (+L)…………………….		2,200
(e)	Transportation revenue (–R, +SE) ………	7,000	
	Unearned transportation revenue (+L)……		7,000
	Transportation revenue is too high and needs to be reduced and an Unearned revenue account created for the appropriate amount.		
(f)	Income tax expense (+E, –SE)…………………...	3,650	
	Income tax payable (+L)……………………		3,650

To record 2010 income tax computation:

Transportation revenue:	$85,000 – $7,000 =	$78,000
Expenses:	$47,000 + $4,200 + $2,000 + $8,000 + $2,200 =	63,400
Pretax income		$14,600
Income tax expense:	$14,600 x 25% =	$ 3,650

CP4–9. (continued)

Req. 2

MAGLIOCHETTI MOVING CORPORATION
Corrections to 2010 Financial Statements

	Amounts Reported		***Changes Debit***	***Credit***	***Corrected Amounts***
2010 Income Statement:					
Revenue:					
Transportation revenue	$ 85,000	*e*	7,000		$ 78,000
Expenses:					
Salaries expense	17,000	*d*	2,200		19,200
Supplies expense	12,000	*a*	4,200		16,200
Other expenses	18,000				18,000
Insurance expense	0	*b*	2,000		2,000
Depreciation expense	0	*c*	8,000		8,000
Income tax expense	0	*f*	3,650		3,650
Total expenses	47,000				67,050
Net income	$ 38,000				$ 10,950
December 31, 2010, Balance Sheet					
Assets:					
Current Assets:					
Cash	$ 2,000				$ 2,000
Receivables	3,000				3,000
Supplies	6,000	*a*		4,200	1,800
Prepaid insurance	4,000	*b*		2,000	2,000
Total current assets	15,000				8,800
Equipment	40,000				40,000
Less: Accumulated deprec.	0	*c*		8,000	(8,000)
Remaining assets	27,000				27,000
Total assets	$82,000				$67,800
Liabilities:					
Current Liabilities:					
Accounts payable	$ 9,000				$ 9,000
Salaries payable	0	*d*		2,200	2,200
Unearned transportation revenue	0	*e*		7,000	7,000
Income tax payable	0	*f*		3,650	3,650
Total current liabilities	9,000				21,850
Stockholders' Equity					
Contributed capital	35,000				35,000
Retained earnings	38,000				10,950
Total stockholders' equity	73,000				45,950
Total liabilities and stockholders' equity	$82,000				$67,800

CP4–9. (continued)

Req. 3

Omission of the adjusting entries caused:

(a) Net income to be overstated by $27,050.
(b) Total assets to be overstated by $14,200.

Req. 4

(a) Earnings per share:

Unadjusted -- $38,000 net income ÷ 10,000 shares = $3.80 per share
Adjusted -- $10,950 net income ÷ 10,000 shares = $1.095 per share

(b) Net profit margin:

Unadjusted -- $38,000 net income ÷ $85,000 sales = 44.7%
Adjusted -- $10,950 net income ÷ $78,000 sales = 14.0%

Each of the ratios was affected by inclusion of the adjustments with revenues decreasing and expenses increasing resulting in a lower net income. For earnings per share, the numerator net income decreased while the denominator did not, resulting in a significantly lower figure. For the net profit margin, the denominator sales was lower but did not decrease more than the reduction in the numerator net income causing a significantly lower percentage.

CP4–9. (continued)

Req. 5

(today's date)

To the Stockholders of Magliochetti Moving Corporation:

We regret to inform you that your request for a $20,000 loan has been denied.

Our review showed that various adjustments were required to the original set of financial statements provided to us. The original (unadjusted) financial statements overstated net income for 2010 by $27,050 (i.e., $38,000 - $10,950). This overstatement was caused by incorrectly including $7,000 of revenue collected in advance that had not been earned in 2010. Further, all of the expenses were understated and income tax expense had been incorrectly excluded.

Total assets were overstated by $14,200 (i.e., $82,000 - $67,800). Supplies was overstated by $4,200, prepaid insurance was overstated by $2,000, and the net book value of the equipment was overstated by $8,000 because annual depreciation was not properly recognized.

A review of key financial ratios indicates that the adjustments caused earnings per share and net profit margin to decline. Net profit margin declined from 44.7% to 14.0%. The adjusted ratios, however, would be compared to those of other start-up companies in the same industry.

We require that there be sufficient collateral pledged against the loan before we can consider it. The current market value of the equipment may be able to provide additional collateral against which the loan could be secured. Your personal investments may also be considered viable collateral if you are willing to sign an agreement pledging these assets as collateral for the loan. This is a common requirement for small start-up businesses.

If you would like us to reconsider your application, please provide us the current market values of any assets you would pledge as collateral.

Regards,
(your name)

Loan Application Department,
Your Bank

CP4–10.

Req. 1 Cash from Operations: $18,000

Req. 2 Subscriptions Revenue for fiscal year ended March 31, 2011
($18,000 x 7/36): $3,500

Req. 3 March 31, 2011, Unearned Subscriptions Revenue
($18,000 x 29/36) = $14,500 or $18,000 - $3,500 = $14,500.

Req. 4

Adjusting entry (cash receipt credited to Unearned Subscriptions Revenue):

Unearned Subscriptions Revenue (L)			
		9/1	18,000
AJE	3,500		
		End.	14,500

Subscriptions Revenue (R)			
		AJE	3,500
		End.	3,500

Unearned subscriptions revenue (–L).........................	3,500	
Subscriptions revenue (+R, +SE)		3,500

Req. 5

a. $4,000 revenue target based on cash sales:
This target is not clearly defined. Does management mean any cash subscriptions received during the period? Your region generated $18,000 in cash subscriptions. By this assumption, your region far exceeded the company's target. You may be entitled to a generous bonus due to your strong performance.

On the other hand, management may mean any sales revenue earned that has also been received in cash during the period. Under this assumption, sales revenue earned and received in cash is $3,500 (the accrual accounting basis amount). If this is the company's intention of its target, then your region did not meet the goal, only generating 87.5% of the target. You may need to provide an analysis to management regarding this below par performance.

This example demonstrates the need for clear communication of expectations by management.

b. $4,000 revenue target based on accrual accounting:
This situation is the same as the second assumption under *a.* Your region earned $500 less than expected by the company.

FINANCIAL REPORTING AND ANLYSIS PROJECT

CP4–11.

The solutions to this project will depend on the company and/or accounting period selected for analysis.