



# BACHELOR of ECONOMICS



**Thammasat University  
Faculty of Economics  
Bachelor of Economics (International Program)**

# AC 201

## Fundamental Accounting

**Semester 2/2015**

### Course Materials

**Topics:**

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

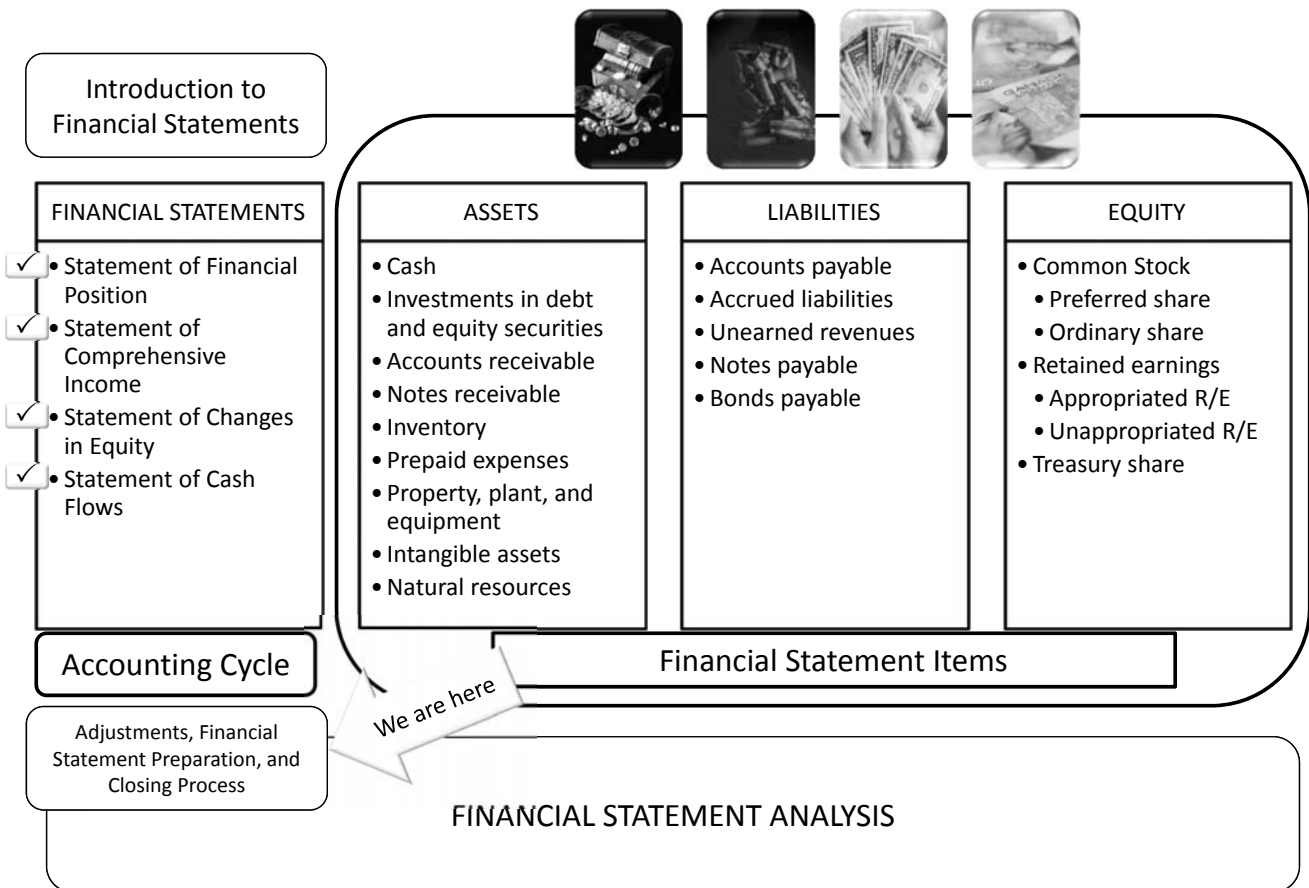
**Session:**

Sessions #4 and #5

**Instructor:**

Ajarn Santana Singhasaneh





AC201 Fundamental Accounting



BACHELOR  
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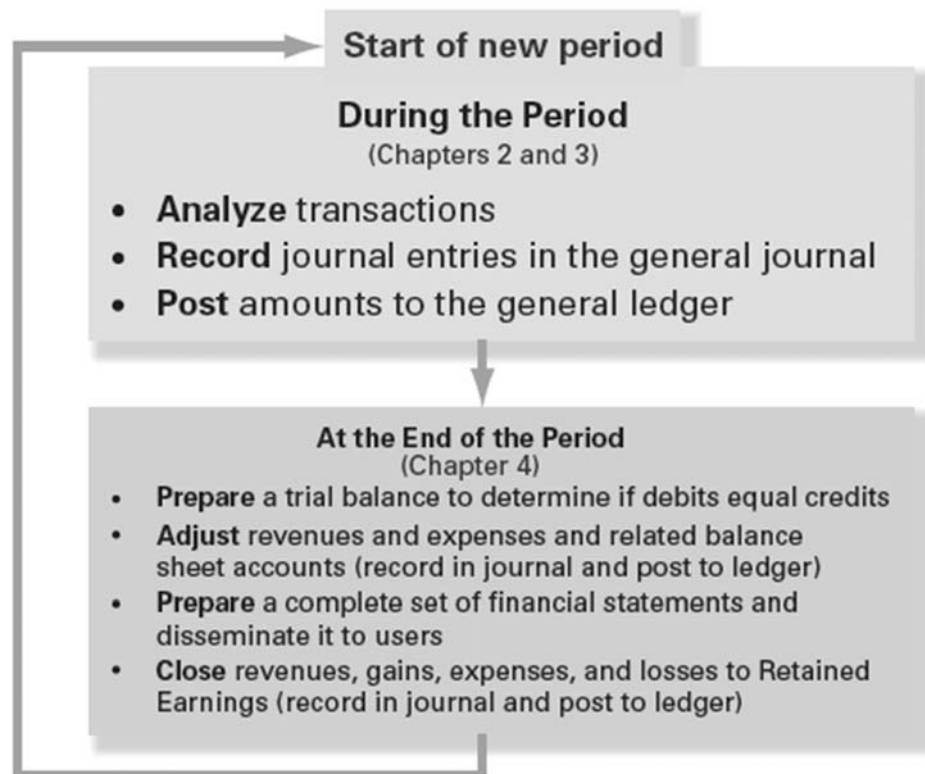


## CHAPTER 4: ADJUSTMENTS, FINANCIAL STATEMENTS, AND THE QUALITY OF EARNINGS

Ajarn Santana Singhasaneh  
Department of Accounting  
Thammasat Business School  
Thammasat University



## The Accounting Cycle



## Preparing a Trial Balance





# Unadjusted Trial Balance

Revenue from selling pizza and ingredients plus equipment to franchisees  
 Revenue from selling franchises during the period  
 Revenue on investments earned during the period

Expense for wages incurred during the period

Summary for many operating expenses  
 Expense for supplies used during period  
 Expense for rent used during period  
 Expense for insurance used during period  
 Expense for utilities used during period  
 Expense for property and equipment used during period  
 Expense for interest incurred on debt during period  
 Expense for income taxes incurred during period

Restaurant sales revenue		66,000	} Revenues and Gains <b>REV</b>
Franchise fee revenue		2,800	
Investment income		1,000	
Gain on sale of land		3,000	
Cost of sales	30,000		} Expenses and Losses <b>EXP</b>
Salaries expense	14,000		
General and administrative expenses	7,000		
Supplies expense	0	51,000	
Rent expense	0		
Insurance expense	0		
Utilities expense	0		
Depreciation expense	0		
Interest expense	0		
Income tax expense	0		
Debits = Credits → Total	\$675,100	\$675,100	

By adding all the debit balances and all the credit balances, we can see whether total debits equal total credits. Thus, **the accounting equation is in balance.**



# Adjusting Revenue & Expenses



## Purpose of Adjustments

### Accrual Accounting

A better measure of performance than cash-basis accounting.

Revenues are recorded when earned.

Expenses are recorded when incurred.

### Matching Principle

All costs and expenses incurred in generating revenues must be recognized in the same reporting period as the related revenues.



## Purpose of Adjustments

Certain transactions affect the revenue or expenses of 2 or more accounting periods. The purpose of adjusting entries is *to assign appropriate amounts of revenue and expense to each accounting period.*

	<b>Record shows</b>				
	<b>\$1,100 earned @ Jan 31</b>				
<b>Unearned Revenue</b> = \$6,300 @ Jan 1	\$1,100	?	?	?	
	Jan1	Jan31	Feb28	Mar31	Apr30
	↓				
	<b>\$500 insurance expense</b> <b>incurred @ Jan 31</b>				
<b>Prepaid Insurance</b> = \$2,000 @ Jan 1 covering 4 months	\$500	\$500	\$500	\$500	
	Jan1	Jan31	Feb28	Mar31	Apr30
	↓				
	<b>\$2,000 rent expense</b> <b>incurred @ Jan 31</b>				
<b>Prepaid Rent</b> = \$6,000 @ Jan 1 covering 3 months	\$2,000	\$2,000	\$2,000		
	Jan1	Jan31	Feb28	Mar31	
	↓				
	<b>Need adjusting entries</b> <b>at end of accounting period</b>				



# Adjusting Entries

- **ADJUSTING ENTRIES** are the journal entries that bring the accounts up to date at the end of the accounting period.
- Each adjusting entry always involves at least one statement of income account and one statement of financial position account.
- Adjusting entries never involve cash

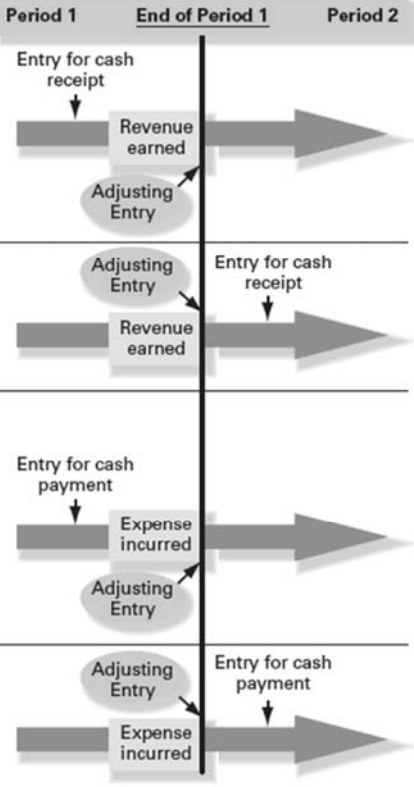
Because transactions occur over time, **ADJUSTING ENTRIES** are required **at the end of each accounting period** to get the revenues and expenses into the “right” period.

- Most adjusting entries fall into one of four categories:
- |   |                                       |
|---|---------------------------------------|
| <b>Adjusting entries that increase REVENUES</b> | 1. Converting liabilities to revenue. |
| .....   | 2. Accruing uncollected revenue.      |
| <b>Adjusting entries that increase EXPENSES</b> | 3. Converting assets to expenses.     |
|   | 4. Accruing unpaid expenses.          |



# Types of Adjusting Entries

- Adjusting Entries that Increase Revenues:**
- **Deferred Revenues** – Previously recorded liabilities that were created when cash was received in advance, and that must be reduced for the amount of revenue actually earned during the period.
    - Unearned Revenue
  - **Accrued Revenues** – Revenues that have been earned but not yet recorded because cash will be received after the services are performed or goods are delivered.
    - Accounts Receivable, Interest Receivable
- Adjusting Entries that Increase Expenses:**
- **Deferred Expenses** – Previously recorded assets, such as Prepaid Rent, Supplies, and Equipment, that were created when cash was paid in advance and that must be reduced for the amount of expense actually incurred during the period through use of the asset.
    - Prepaid Expenses, Supplies, Accum. Depreciation
  - **Accrued Expenses** – Expenses that have been incurred but not yet recorded because cash will be paid after the goods or services are used.
    - Accrued Expenses, Income Tax Payable





## Adjusting Entries - Increase Revenues (1)

### I. Converting liability to revenue

If cash was received and previously recorded:

Journal entry at the time cash was received

Cash (A+)	90	
Unearned revenue (L+)		90



At the end of accounting period, revenue has been earned, the **ADJUSTING ENTRY** is:

Adjusting entry at end of period

Unearned revenue (L-)	30	
Revenue (REV+, SE+)		30 ← Revenue increases



## Adjusting Entries - Increase Revenues (2)

### II. Accruing uncollected revenue

If cash has NEVER been received:

----- No transaction -----



At the end of accounting period, revenue has been earned, cash will be received in the future, the **ADJUSTING ENTRY** is:

Adjusting entry at end of period

Accounts receivable (A+)	30	
Revenue (REV+, SE+)		30 ← Revenue increases



## Adjusting Entries - Increase Expenses (1)

### III. Converting assets to expenses

If cash was paid and previously recorded:

Journal entry at the time cash was paid

Prepaid expense (A+)	80	
Cash (A-)		80



At the end of accounting period, expense has been incurred, the **ADJUSTING ENTRY** is:

Adjusting entry at end of period

<b>Expense (EXP+, SE-)</b>	<b>20</b>	← Expense increases
<b>Prepaid expense (A-)</b>		<b>20</b>



## Adjusting Entries - Increase Expenses (2)

### IV. Accruing unpaid expenses

If cash has NEVER been paid:

----- No transaction -----



At the end of accounting period, expense has been incurred, cash will be paid in the future, the **ADJUSTING ENTRY** is:

Adjusting entry at end of period

<b>Expense (EXP+, SE-)</b>	<b>20</b>	← Expense increases
<b>Accrued expense (L+)</b> <b>(or Accounts payable )</b>		<b>20</b>



## Adjusting Entries: An Illustration



## Unearned Revenue

**Last period**, Papa John's received cash and recorded an increase in Cash and increase in Unearned Franchise Fees, a liability, to recognize the business's obligation to provide future services to franchisees.

**During January 2009**, Papa John's performed \$1,100 in services for franchisees who had previously paid fees.

This adjusting entry is made on Jan 31, 2009

### I. Converting liability to revenue

		Step 2	Debit	Credit
<i>AJE 1:</i>				
Unearned Franchise Fees (-L)	.....	↓	1,100	
Franchise Fee Revenue (+R, +SE)	.....	↑		1,100
		Step 1		Step 3

Assets	=	Liabilities	+	Stockholders' Equity	
		-1,100		+1,100	Franchise Fee Revenue (+R)





## Interest Receivable (2)

This adjusting entry is made on Jan 31, 2009

### II. Accruing uncollected revenue

		Debit	Credit
<i>AJE 3:</i>			
Step 2	Interest Receivable (+A) .....	70	
	Investment Income (+R, +SE) .....		70
Step 1			Step 3

Assets	=	Liabilities	+	Stockholders' Equity
+70				+70    Investment Income (+R)



## Prepaid Expense (1)

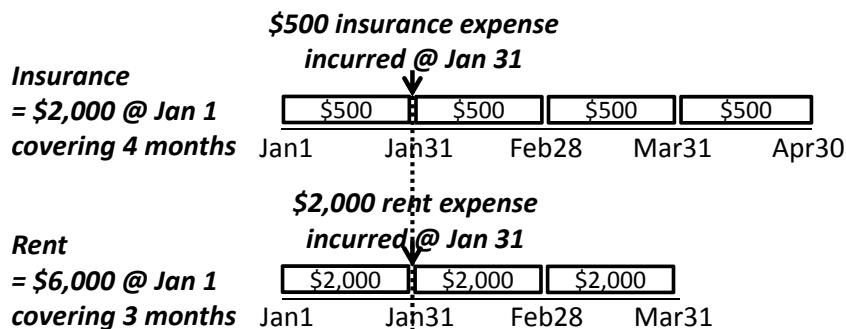
**Prepaid Expenses** includes:

- \$2,000 paid on January 1 for insurance coverage for 4 months, and
- \$6,000 paid on January 1 for rental of space over 3 months

**Compute the amount of expense incurred.**

One month has expired for each of the prepaid amounts:

- Insurance:  $\$2,000 \times 1 \text{ month} / 4 \text{ months} = \$ 500$  used in January.
- Rent:  $\$6,000 \times 1 \text{ month} / 3 \text{ months} = \$ 2,000$  used in January.



**Need adjusting entries at end of accounting period [See Slide #24]**



## Prepaid Expense (2)

This adjusting entry is made on Jan 31, 2009

Step 1

III. Converting assets to expenses

<i>AJE 4:</i>	Debit	Credit
Insurance Expense (+E, -SE) .....	500	
Rent Expense (+E, -SE) .....	2,000	
Prepaid Expenses (-A) .....		2,500

Step 2

Step 3

Assets	=	Liabilities	+	Stockholders' Equity
-2,500				-500 -2,000
				Insurance Expense (+E) Rent Expense (+E)



## Prepaid Expense (3)

Followings are **adjusting journal entries** at the end of each month:

III. Converting assets to expenses

Date	Account Title & Explanation	Debit	Credit
Jan 31	Insurance expense (EXP+, SE-)	500	
	Rent expense (EXP+, SE-)	2,000	
	Prepaid expenses (A-)		2,500
Feb 28	Insurance expense (EXP+, SE-)	500	
	Rent expense (EXP+, SE-)	2,000	
	Prepaid expenses (A-)		2,500
Mar 31	Insurance expense (EXP+, SE-)	500	
	Rent expense (EXP+, SE-)	2,000	
	Prepaid expenses (A-)		2,500
Apr 30	Insurance expense (EXP+, SE-)	500	
	Prepaid expenses (A-)		500



## Supplies (1)

Supplies include food and paper products.  
 At the end of the month, Papa John's counted \$12,000 in supplies on hand,  
 but the Supplies account indicated a balance of \$16,000.  
 We need to determine the **supplies used** during the current accounting period.



**Computation of Supplies Expense:**

Beginning balance of supplies	}	\$ 16,000 unadjusted balance
+ Supply purchases during period		
- Ending amount of supplies on hand		-12,000
<u>= Supplies used during the period</u>		<u>\$ 4,000</u>

This needs to be adjusted as Supplies Expense



## Supplies (2)

This adjusting entry is made on Jan 31, 2009

III. Converting assets to expenses

**AJE 5:**

	Debit	Credit
Supplies Expense (+E, -SE) .....	4,000	
Supplies (-A) .....		4,000

Step 1 points to the entry. Step 2 points to the debit side. Step 3 points to the credit side.

<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Stockholders' Equity</u>	
-4,000				-4,000	Supplies Expense (+E)



## Property and Equipment (1)

Property and equipment include building and all types of equipment, fixtures, furnishings. They are **physical objects** that retain their size and shape but that eventually wear out or become obsolete. They are **NOT physically consumed**, as are supplies, but nonetheless their economic usefulness diminished over time.

Each period, a portion of these assets' usefulness expires. Therefore, a corresponding portion of their costs are recognized as **"depreciation expense."**

Property and equipment are assets that have a normal debit balance.

**Depreciation is the systematic allocation of the cost of an asset to expense over the asset's estimated useful life.** Depreciation is an expense with a normal debit balance.



## Property and Equipment (2)

When we record depreciation we credit a "contra asset account" called **"Accumulated Depreciation."** Contra-accounts are accounts that are directly linked to another account, but with an opposite balance. Therefore, accumulated depreciation has a normal credit balance. We subtract accumulated depreciation from the cost of our property and equipment to arrive at net book value.

	Year 1	Year 2	Year 5
Building	\$35,000	\$35,000	\$35,000
Less: Accumulated depreciation	<u>(7,000)</u>	<u>(14,000)</u>	<u>(35,000)</u>
Building - net	<u>\$28,000</u>	<u>\$21,000</u>	<u>\$ 0</u>

**asset account**      **A**

+ Property and Equipment (A) -	
Beginning bal.	Sell
Buy	
Ending bal.	

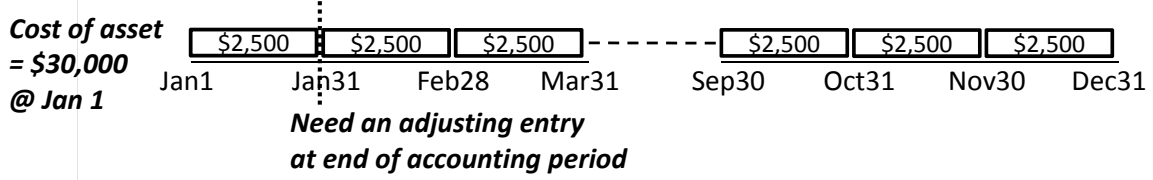
**contra-asset account**      **XA**

- Accumulated Depreciation (XA) +	
	Beginning bal.
	Used
Ending bal.	



## Property and Equipment (3)

Papa John's estimates depreciation to be \$30,000 per year.  
 $\$30,000 \div 12 \text{ months} = \$2,500$  per month depreciation expense



This adjusting entry is made on Jan 31, 2009

Step 1
III. Converting assets to expenses

<b>AJE 6:</b>	<u>Debit</u>	<u>Credit</u>
Depreciation Expense (+E, -SE) .....	2,500	
Accumulated Depreciation (+XA, -A) .....		2,500

Step 2

Step 3

Assets	=	Liabilities	+	Stockholders' Equity	
-2,500				-2,500	Depreciation Expense (+E)



## Accrued Expenses /Accounts Payable (1)

Papa John's owed:

- (1) its employees salaries for working four days at the end of January at \$500 per day
 

Accrued salaries expense =  $\$500 \text{ per day} \times 4 \text{ days}$   
= **\$2,000**
- (2) \$610 for utilities used in January
 

Accrued utilities expense = **\$610**
- (3) interest on its \$138,000 long-term notes payable borrowed at a 6 percent annual rate.
 

Accrued interest expense =  $\$138,000 \times 0.06 \times 1/12$   
= **\$690**

.....

Total Accrued expenses = **\$3,300**



## Accrued Expenses /Accounts Payable (2)

This adjusting entry is made on Jan 31, 2009

IV. Accruing unpaid expenses

Step 1			Step 2	Step 3
<b>AJE 7:</b>				
	Debit	Credit		
Salaries Expense (+E, -SE).....	2,000			
Utilities Expense (+E, -SE).....	610			
Interest Expense (+E, -SE).....	690			
Accrued Expenses Payable (+L) .....		3,300		

Assets	=	Liabilities	+	Stockholders' Equity	
		+3,300		-2,000	Salaries Expense (+E)
				-610	Utilities Expense (+E)
				-690	Interest Expense (+E)



## Income Tax Payable (1)

The final adjusting journal entry is to record the accrual of **income taxes** that will be paid in the next quarter. This requires computing adjusted pretax income (that is, balances from the unadjusted trial balance plus the effects of all of the other adjustments):

	Revenues and Gains	Expenses and Losses	
Unadjusted totals	\$72,800	\$51,000	<div style="border: 1px solid black; padding: 5px; display: inline-block;">From our unadjusted trial balance shown earlier</div>
AJE 1	1,100		
AJE 2	830		<div style="border: 1px solid black; padding: 5px; display: inline-block;">From all the adjusting journal entries in slides #18-30</div>
AJE 3	70		
AJE 4		2,500	
AJE 5		4,000	
AJE 6		2,500	
AJE 7		3,300	
	\$74,800	\$63,300	= <u>\$11,500</u> Pretax income



## Income Tax Payable (2)

Papa John's average income tax rate is 34 percent.  
So, the estimated amount of the taxes on this income  
that will be at the end of the quarter is  $\$11,500 \times 0.34 = \$3,910$ .

This adjusting entry is made on Jan 31, 2009

**AJE 8:** IV. Accruing unpaid expenses

	Step 1				
Income Tax Expense (+E, -SE) .....	↓	Debit	Credit	3,910	
Income Tax Payable (+L) .....	↑				3,910
	Step 2			↑	Step 3

Assets	=	Liabilities	+	Stockholders' Equity	
		+3,910		-3,910	Income Tax Expense (+E)



## Ethics and Adjusting Entries

### Adjustments and Incentives

Owners and managers of companies are most directly affected by the information presented in financial statements. If the financial performance and condition of the company appear strong, the company's stock price rises. Shareholders usually receive dividends and increase their investment value. Managers often receive bonuses based on the strength of a company's financial performance, and many in top management are compensated with options to buy their company's stock at prices below market value. The higher the market value, the more compensation they earn. When actual performance lags behind expectations, managers and owners may be tempted to manipulate accruals and deferrals to make up part of the difference. For example, managers may record cash received in advance of being earned as revenue in the current period or may fail to accrue certain expenses at year-end.

Evidence from studies of large samples of companies indicates that some managers do engage in such behavior. This research is borne out by enforcement actions of the Securities and Exchange Commission against U.S. companies and sometimes against their auditors. In January 2003, an SEC study reported that, in a five-year period, there were 227 enforcement investigations. Of these, "126 involved improper revenue recognition and 101 involved improper expense recognition. . . . Of the 227 enforcement matters during the Study period, 157 resulted in charges against at least one senior manager. . . . Furthermore, the Study found that 57 enforcement matters resulted in charges for auditing violations. . . ." (p. 47).\*

In many of these cases, the firms involved, their managers, and their auditors are penalized for such actions. Furthermore, owners suffer because news of an SEC investigation negatively affects the company's stock price.

\*These statistics are reported in the Securities and Exchange Commission's study, "Report Pursuant to Section 704 of the Sarbanes-Oxley Act of 2002," January 27, 2003.



## Preparing the Financial Statements

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## Praparing the Financial Statements

Before we prepare a complete set of financial statements, let's **update the trial balance** to reflect the adjustments and provide us with adjusted balances for the statements.

1. Statement of Income,
2. Statement of stockholders' equity,
3. Statement of financial position, and
4. Statement of cash flows.



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## Adjusted Trial Balance

Effects of the adjusting entries

PAPA JOHN'S INTERNATIONAL, INC.  
Trial Balance at January 31, 2009  
(dollars in thousands)

	Unadjusted Trial Balance		Adjustments		Adjusted Trial Balance	
	Debit	Credit	Debit	Credit	Debit	Credit
Cash	41,900				41,900	
Accounts receivable	20,200		AJE 2 830		21,030	
Interest receivable	0		AJE 3 70		70	
Supplies	16,000			AJE 5 4,000	12,000	
Prepaid expenses	19,000			AJE 4 2,500	16,500	
Other current assets	13,000				13,000	
Investments (long-term)	2,000				2,000	
Property and equipment	388,000				388,000	
Accumulated depreciation		189,000		AJE 6 2,500		191,500
Notes receivable (long-term)	11,000				11,000	
Intangibles	77,000				77,000	
Other assets	36,000				36,000	
Accounts payable		39,000				39,000
Dividends payable		3,000				3,000
Accrued expenses payable		71,000		AJE 7 3,300		74,300
Income tax payable		0		AJE 8 3,910		3,910
Unearned franchise fees		6,300	AJE 1 1,100			5,200
Notes payable (long-term)		138,000				138,000
Other long-term liabilities		27,000				27,000
Common stock		9,000				9,000
Retained earnings		120,000				120,000

To prepare Statement of Financial Position

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## Adjusted Trial Balance

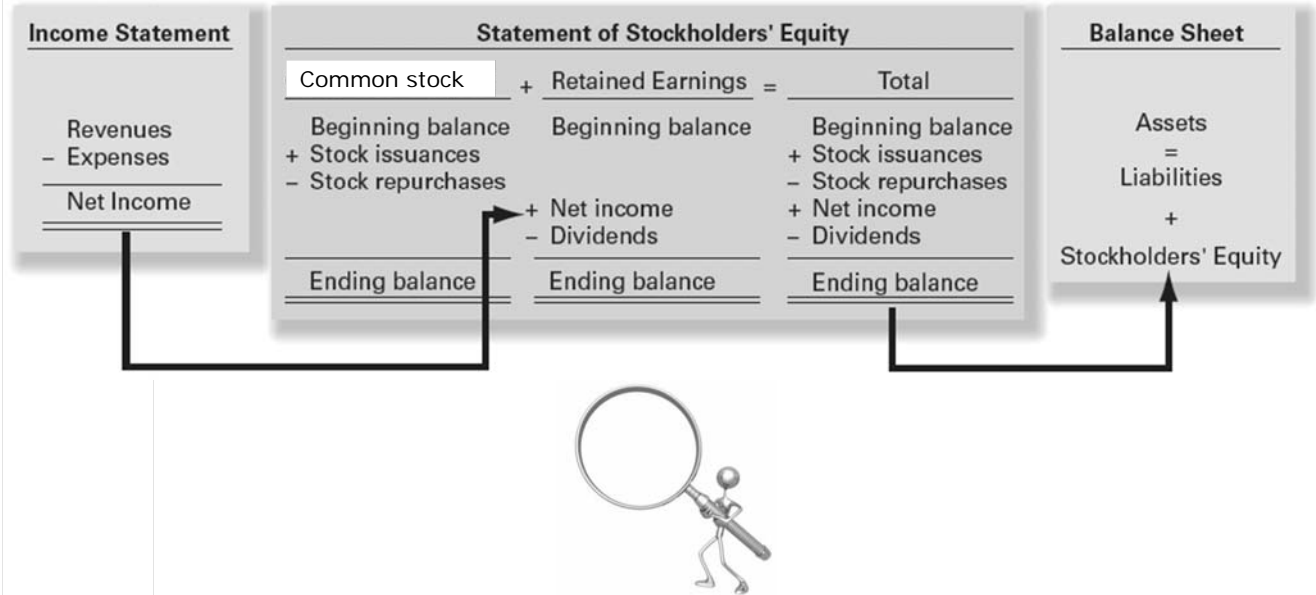
Restaurant sales revenue		66,000				66,000
Franchise fee revenue		2,800		AJE 1 1,100 AJE 2 830		4,730
Investment income		1,000		AJE 3 70		1,070
Gain on sale of land		3,000				3,000
Cost of sales	30,000				30,000	
Salaries expense	14,000		AJE 7 2,000		16,000	
General and administrative expenses	7,000				7,000	
Supplies expense	0		AJE 5 4,000		4,000	
Rent expense	0		AJE 4 2,000		2,000	
Insurance expense	0		AJE 4 500		500	
Utilities expense	0		AJE 7 610		610	
Depreciation expense	0		AJE 6 2,500		2,500	
Interest expense	0		AJE 7 690		690	
Income tax expense	0		AJE 8 3,910		3,910	
Total	\$675,100	\$675,100	\$18,210	\$18,210	\$685,710	\$685,710

To prepare Statement of Income

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## Financial Statement Relationships



## Statement of Income

This is the statement of income drawn from the **adjusted trial balance**. Refer back to the adjusted trial balance and trace the statement of income numbers forward. Notice that gains and losses are reported in the "Other Items" section of the statement.

PAPA JOHN'S INTERNATIONAL, INC., AND SUBSIDIARIES  
**Consolidated Statement of Income**  
 For the Month Ended January 31, 2009  
 (dollars in thousands)

<b>Operating Revenues</b>	
Restaurant sales revenue	\$66,000
Franchise fee revenue	4,730
Total revenues	70,730
<b>Operating Expenses</b>	
Cost of sales	30,000
Salaries expense	16,000
General and administrative expenses	7,000
Supplies expense	4,000
Rent expense	2,000
Insurance expense	500
Utilities expense	610
Depreciation expense	2,500
Total expenses	62,610
<b>Operating Income</b>	8,120
<b>Other Items</b>	
Investment income	1,070
Interest expense	(690)
Gain on sale of land	3,000
Income before Income Taxes	11,500
Income tax expense	3,910
<b>Net Income</b>	<b>\$ 7,590</b>
Earnings per Share (EPS)	\$ .27

To Statement of Stockholders' Equity



## Earnings Per Share

You will note that the earnings (EPS) ratio is reported on the income statement. It is widely used in evaluating the operating performance and profitability of a company.

$$\text{Earnings per Share} = \frac{\text{Net Income}}{\text{Average No. of Shares of Common Stock Outstanding during the Period}}$$

$$\frac{\$7,590,000 \text{ Net Income}}{28,100,000 \text{ shares}} = \$0.27 \text{ earnings per share for the month}$$



## Statement of Stockholders' Equity

Net income appears on the statement of stockholders' equity as an increase in Retained Earnings.

PAPA JOHN'S INTERNATIONAL, INC., AND SUBSIDIARIES Consolidated Statement of Stockholders' Equity Month Ended January 31, 2009 (dollars in thousands)			
	Common Stock	Retained Earnings	Total Stockholders' Equity
Beginning balance, December 31, 2008	\$7,000	\$123,000	\$130,000
Additional stock issuances	2,000		2,000
Net income		7,590	7,590
Dividends declared		(3,000)	(3,000)
Ending balance, January 31, 2009	\$9,000	\$127,590	\$136,590

**From Statement of Income**

From Event (a) in Chapter 2 →

From the income statement →

From Event (f) in Chapter 2 →

Included on the balance sheet →

**To Statement of Financial Position**



## Statement of Financial Position

This is the statement of financial position drawn from the **adjusted trial balance**..

From  
Statement of  
Stockholders'  
Equity →

<b>Current Assets</b>	
Cash	\$ 41,900
Accounts receivable	21,030
Interest receivable	70
Supplies	12,000
Prepaid expenses	16,500
Other current assets	13,000
<b>Total current assets</b>	<b>104,500</b>
Investments	2,000
Property and equipment (net of accumulated depreciation of \$191,500)	196,500
Notes receivable	11,000
Intangibles	77,000
Other assets	36,000
<b>Total assets</b>	<b>\$427,000</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>	
<b>Current Liabilities</b>	
Accounts payable	\$ 39,000
Dividends payable	3,000
Accrued expenses payable	74,300
Income tax payable	3,910
<b>Total current liabilities</b>	<b>120,210</b>
Unearned franchise fees	5,200
Notes payable	138,000
Other long-term liabilities	27,000
<b>Total liabilities</b>	<b>290,410</b>
<b>Stockholders' Equity</b>	
Common stock	9,000
Retained earnings	127,590
<b>Total stockholders' equity</b>	<b>136,590</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$427,000</b>



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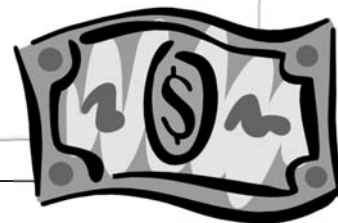


## Statement of Cash Flows

**Statement of Cash Flows** is a categorized list of all transactions of the period that affected the Cash account.

The three categories are . . .

1. Operating activities,
2. Investing activities, and
3. Financing activities.



### SUPPLEMENTAL INFORMATION

1. Cash interest paid.
2. Cash income taxes paid.
3. A schedule of significant noncash investing and financing transactions.

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## Net Profit Margin

Net Profit Margin indicates how effective management is at generating profit on every dollar of sales.

$$\text{Net Profit Margin} = \frac{\text{Net Income}}{\text{Net Sales}}$$

Net profit margin for Papa John's for 2008 is:

$$\frac{\$36,796,000}{\$1,132,087,000} = 0.0325 = 3.25\%$$



## Closing the Books



## End of Accounting Cycle

- The ending balance in each of the **asset, liability, and stockholders' equity** accounts becomes the beginning account balance for the next period. These accounts are "**Permanent Accounts**" or "**Real Accounts.**"
- **Revenue, expense, gain, and loss** accounts are used to accumulate data for current accounting period only. These accounts are "**Temporary Accounts**" or "**Nominal Accounts.**"

Closing entries:

1. Transfer net income (or loss) to Retained Earnings.
2. Establish a zero balance in each of the **temporary accounts** to start the next accounting period.

Even though the statement of financial position account balances carry forward from period to period, the statement of income accounts **DO NOT**.



## Closing the Books

Here is an example of the closing process using an illustration with just a few accounts.

Revenues have credit balances. Close them with debits.	Sales Revenue (-R).....	100		
	Gain on Sale of Assets (-R).....	30		
	Wages Expense (-E).....		40	
	Loss on Sale of Assets (-E).....		10	
	Retained Earnings (+SE).....			80

Expenses have debit balances. Close them with credits. = Net income

To transfer Net Income of \$80 to Retained Earnings

CE is short for closing entry.

Wages Expense			
Bal.	40	40	CE
Closed	0		

Retained Earnings			
	6,000	Bal.	
	80	CE	
	<u>6,080</u>	Bal.	

Sales Revenue			
CE	100	100	Bal.
		<u>0</u>	Closed

Loss on Sale of Assets			
Bal.	10	10	CE
Closed	0		

Gain on Sale of Assets			
CE	30	30	Bal.
		<u>0</u>	Closed

$130 \text{ revenues} - 50 \text{ expenses} = 80$   
Net income



# Closing Entries for Papa John's

## PAPA JOHN'S INTERNATIONAL, INC., AND SUBSIDIARIES Consolidated Statement of Income For the Month Ended January 31, 2009 (dollars in thousands)

<b>Revenues have credit balances. →</b>	
Operating Revenues	
Restaurant sales revenue	\$66,000
Franchise fee revenue	4,730
Total revenues	70,730
<b>Expenses have debit balances. →</b>	
Operating Expenses	
Cost of sales	30,000
Salaries expense	16,000
General and administrative expenses	7,000
Supplies expense	4,000
Rent expense	2,000
Insurance expense	500
Utilities expense	610
Depreciation expense	2,500
Total expenses	62,610
Operating Income	8,120
Other Items	
Investment income	1,070
Interest expense	(690)
Gain on sale of land	3,000
Income before Income Taxes	11,500
Income tax expense	3,910
Net Income	\$ 7,590
Earnings per Share (EPS)	\$ .27

## Closing Entries

Restaurant Sales Revenue (-R)	66,000	
Franchise Fee Revenue (-R)	4,730	
Investment Income (-R)	1,070	
Gain on Sale of Land (-R)	3,000	
Cost of Sales (-E)		30,000
Salaries Expense (-E)		16,000
General and Administrative Expenses (-E)		7,000
Supplies Expense (-E)		4,000
Rent Expense (-E)		2,000
Insurance Expense (-E)		500
Utilities Expense (-E)		610
Depreciation Expense (-E)		2,500
Interest Expense (-E)		690
Income Tax Expense (-E)		3,910
Retained Earnings (+SE)		7,590

After the book is closed, all revenue, expense, gain and loss accounts will have a zero balance.

↑  
"Net income" is transferred to Retained Earnings



# Post-Closing Trial Balance

## PAPA JOHN'S INTERNATIONAL, INC. Trial Balance at January 31, 2009 (dollars in thousands)

	Post-Closing Trial Balance	
	Debit	Credit
Cash	41,900	
Accounts receivable	21,030	
Interest receivable	70	
Supplies	12,000	
Prepaid expenses	16,500	
Other current assets	13,000	
Investments (long-term)	2,000	
Property and equipment	388,000	
Accumulated depreciation		191,500
Notes receivable (long-term)	11,000	
Intangibles	77,000	
Other assets	36,000	
Accounts payable		39,000
Dividends payable		3,000
Accrued expenses payable		74,300
Income tax payable		3,910
Unearned franchise fees		5,200
Notes payable (long-term)		138,000
Other long-term liabilities		27,000
Common stock		9,000
Retained earnings		7,590

All temporary accounts have been CLOSED. Only balances of permanent accounts (assets, liabilities, stockholders' equity) will become the beginning account balances for the next period.

← After closing, this is retained earnings at Jan 31, 2009

## CHAPTER 4: ADJUSTMENTS, FINANCIAL STATEMENTS, AND THE QUALITY OF EARNINGS

An unadjusted trial balance of Deana's Decorators dated December 31, 2014 is as follows.

DEANA'S DECORATORS  
Unadjusted Trial Balance  
December 31, 2014

Accounts	Debit	Credit
Cash	43,450	
Supplies	1,800	
Accounts Receivable	4,000	
Prepaid Rent	12,000	
Prepaid Insurance	6,000	
Certificate of Deposit	20,000	
Interest Receivable	0	
Property, Plant & Equipment	40,000	
Accumulated Depreciation		0
Accounts Payable		250
Dividend Payable		0
Unearned Revenue		500
Notes Payable		30,000
Interest Payable		0
Income Tax Payable		0
Common Stock		10,000
Retained Earnings		0
Decorating Revenue		120,000
Investment Income		0
Wage Expense	32,000	
Utilities Expense	1,000	
Telephone Expense	500	
Supplies Expense	0	
Rent Expense	0	
Insurance Expense	0	
Depreciation Expense	0	
Interest Expense	0	
Income Tax Expense	0	
Totals	160,750	160,750

Prepare the required adjusting journal entry for each situation as of December 31, 2014.

**Step 1:** Analyze the information available for preparing journal entries at the end of the accounting period.

**Step 2:** Journalize the adjusting entries.

- a. Suppose Deana's had received a \$1,800 shipment of supplies in September 2014. When counting the supplies on December 31, 2014, Deana's found only \$800 worth of supplies on hand.
- b. Suppose Deana's had paid \$12,000 for six months' rent on November 1, 2014. As of December 31, 2014, two months' (November & December) prepaid rent has expired.
- c. Suppose Deana's had paid \$6,000 for one year's insurance on June 1, 2014.
- d. The company had acquired Property, Plant & Equipment costing \$40,000 on January 1, 2014. Suppose that the depreciation on this Equipment was calculated to be \$2,000 for 2014.
- e. On December 1, 2014, the company had sold \$500 in gift certificates for decorating services to a customer. On December 31, 2014, the accountant received an envelope containing \$400 worth of redeemed gift certificates, not yet recorded in the company's books.
- f. On June 30, 2014, the company invested \$20,000 in a certificate of deposit that will yield 12% interest at the end of one year.
- g. The company borrowed a note payable from the bank for \$30,000 on January 1, 2014, due with all interest on June 30, 2015. The note payable requires 10% interest.
- h. The company calculated its income taxes as \$26,110 for the year ended December 31, 2014.
- i. On December 15, 2014, the company declared a \$750 dividend, payable January 15, 2015.

GENERAL JOURNAL					
	Date		Account Titles and Explanation	Debit	Credit
a.					
b.					
c.					
d.					
e.					
f.					
g.					
h.					
i.					

**Step 3:** Post the adjusting entries to T-accounts to bring the accounts up to date at the end of the accounting period.

Shown in the T-accounts below are the unadjusted account balances from page 1. Post the adjusting journal entries on previous page to the T-accounts below.

Assets				Liabilities				Stockholders' Equity					
+ Cash –				- Accounts Payable +				- Common Stock +					
Unadj.	43,450					Unadj.	250			Unadj.	10,000		
+ Supplies –				- Dividend Payable +				- Retained Earnings +					
Unadj.	1,800					Unadj.	0			Unadj.	0		
+ Accounts Receivable –				- Unearned Revenue +				- Decorating Revenue +					
Unadj.	4,000					Unadj.	500			Unadj.	120,000		
+ Prepaid Rent –				- Notes Payable +				- Investment Income +					
Unadj.	12,000					Unadj.	30,000						
+ Prepaid Insurance –				- Interest Payable +				+ Wage Expense –					
Unadj.	6,000					Unadj.	0	Unadj.	32,000				
+ Certificate of Deposit –				- Income Tax Payable +				+ Utilities Expense –					
Unadj.	20,000					Unadj.	0	Unadj.	1,000				
+ Interest Receivable –								+ Telephone Expense –					
Unadj.	0							Unadj.	500				
+ Property, Plant & Equipment –								+ Supplies Expense –					
Unadj.	40,000												
- Accumulated Depr. +								+ Rent Expense –					
						Unadj.	0						
								+ Insurance Expense –					
								+ Depreciation Expense –					
								+ Interest Expense –					
								+ Income Tax Expense –					

**Step 4:** Prepare an adjusted trial balance as of December 31, 2014

DEANA'S DECORATORS  
Trial Balance  
As at December 31, 2014

[Balances from Page 1]

[Closing Entry from Page 8]

Accounts	Unadjusted Trial Balance		Adjustments		Adjusted Trial Balance		Closing Entry		Post-Closing Trial Balance	
	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit
Cash	43,450				43,450				43,450	
Supplies	1,800									
Accounts Receivable	4,000				4,000				4,000	
Prepaid Rent	12,000									
Prepaid Insurance	6,000									
Certificate of Deposit	20,000				20,000				20,000	
Interest Receivable	0									
Property, Plant & Equipment	40,000				40,000				40,000	
Accumulated Depreciation		0								
Accounts Payable		250				250				250
Dividend Payable		0								
Unearned Revenue		500								
Notes Payable		30,000				30,000				30,000
Interest Payable		0								
Income Tax Payable		0								
Common Stock		10,000				10,000				10,000
Retained Earnings		0								
Decorating Revenue		120,000								
Investment Income		0								
Wage Expense	32,000									
Utilities Expense	1,000									
Telephone Expense	500									
Supplies Expense	0									
Rent Expense	0									
Insurance Expense	0									
Depreciation Expense	0									
Interest Expense	0									
Income Tax Expense	0									
Totals	160,750	160,750								

**Step 5:** Prepare the Statement of Comprehensive Income, Statement of Stockholders' Equity, and Statement of Financial Position

Use balances from the adjusted trial balance on the previous page to prepare (1) Statement of Income; (2) Statement of Stockholders' Equity; and (3) Statement of Financial Position for Deana's Decorators as of and for the year ended December 31, 2014.

**DEANA'S DECORATORS**  
**Statement of Income**  
**For the year ended December 31, 2014**

Revenues:		
Decorating revenue		_____
Investment income		_____
Total revenues		_____
Expenses:		
Wages expense		_____
Utilities expense		_____
Telephone expense		_____
Supplies expense		_____
Rent expense		_____
Insurance expense		_____
Depreciation expense		_____
Interest expense		_____
Total expenses		_____
Pretax income		_____
Less: Income tax expense		_____
Net income		_____

**DEANA'S DECORATORS**  
**Statement of Stockholders' Equity**  
**For the year ended December 31, 2014**

	Common Stock	Retained Earnings	Total Stockholders' Equity
Balance, January 1, 2014	_____	_____	_____
Net income	_____	_____	_____
Dividend	_____	_____	_____
Balance, December 31, 2014	_____	_____	_____

DEANA'S DECORATORS  
**Statement of Financial Position**  
**As of December 31, 2014**

**Assets**

Current assets		
Cash		_____
Certificate of deposit		_____
Supplies		_____
Accounts receivable		_____
Interest receivable		_____
Prepaid rent		_____
Prepaid insurance		_____
Total current assets		_____
Property, plant and equipment – net of accumulated depreciation		_____
Total assets		_____

**Liabilities & Stockholders' Equity**

Current liabilities		
Accounts payable		_____
Dividends payable		_____
Unearned revenue		_____
Notes payable		_____
Interest payable		_____
Income tax payable		_____
Total current liabilities		_____
Stockholders' Equity		
Common stock		_____
Retained earnings		_____
Total stockholders' equity		_____
Total liabilities & stockholders' equity		_____

