



BACHELOR of ECONOMICS



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

AC201

Fundamental Accounting

**Semester 2/2011
(January – April, 2012)**

Course Materials

Topic:

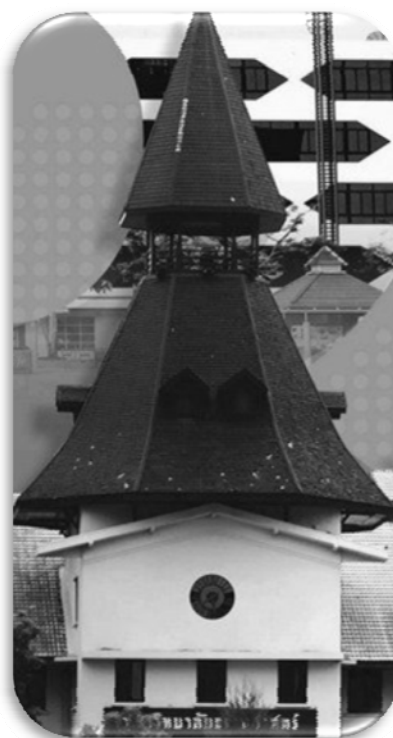
Chapter 04 Adjustments, Financial
Statements, and the Quality of Earnings

Session:

Session #4

Instructor:

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

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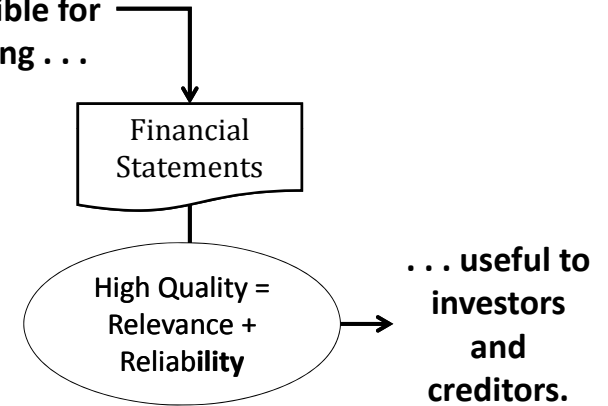
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Understanding the Business

Management is
responsible for
preparing . . .

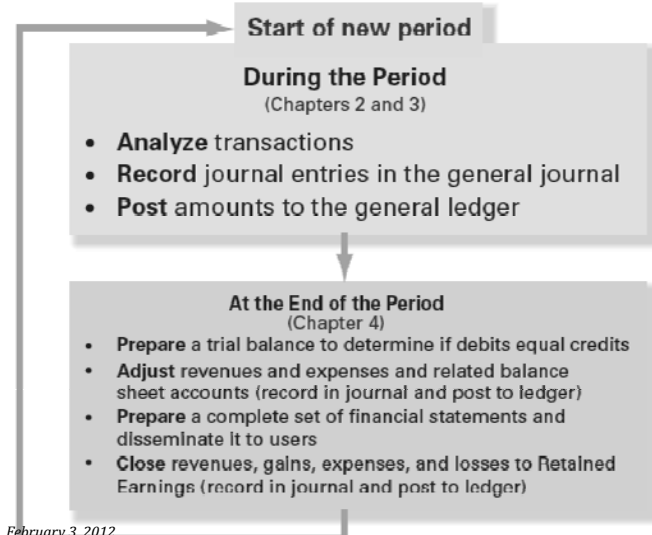


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The Accounting Cycle



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Adjusting Revenues & Expenses

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Trial Balance

- A listing of each accounts, in financial statement order, with its debit or credit balance.
- Ending debit or credit balances are listed in two separate columns.
- Total debit account balances *should* equal total credit account balances.

A **trial balance** is an internal document used to summarize all of the account balances in a company's accounting system.

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Unadjusted Trial Balance

Balance taken from each ledger account

This is retained earnings at Jan 1, 2009, an accumulation of earnings from previous periods

May need an accrual for any amount earned from franchisees but not yet recorded
May need an accrual for any investment income earned but not yet received
May need an adjustment for the amount of supplies used during the period
May need an adjustment for the amount of rent and insurance used during period

Represents the historical cost of property and equipment
Represents the total amount of the cost of property and equipment used in the past

For reporting purposes:
Property and Equipment (cost) \$388,000
- Accumulated Depreciation (used cost) 189,000
Net book value (unused cost) \$199,000

May need an accrual for any wages, utilities, and interest incurred
Needs an accrual for the amount of income tax expense incurred during period
May need an adjustment for the amount earned during period

Represents the beginning balance of retained earnings minus dividends declared during the month (\$123,000 - \$3,000)

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

	Unadjusted Trial Balance	
	Debit	Credit
Cash	41,900	
Accounts receivable	20,200	
Interest receivable	0	
Supplies	16,000	
Prepaid expenses	19,000	
Other current assets	13,000	
Investments (long-term)	2,000	
Property and equipment	388,000	
Accumulated depreciation		189,000
Notes receivable (long-term)	11,000	
Intangibles	77,000	
Other assets	36,000	
Accounts payable		39,000
Dividends payable		3,000
Accrued expenses payable		71,000
Income tax payable		0
Unearned franchise fees		6,300
Notes payable (long-term)		138,000
Other long-term liabilities		27,000
Contributed capital		9,000
Retained earnings		120,000

Assets

Liabilities

Stockholders' Equity



Unadjusted Trial Balance

Revenue from selling pizzas 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

	Debit	Credit
Restaurant sales revenue		66,000
Franchise fee revenue		2,800
Investment income		1,000
Gain on sale of land		3,000
Cost of sales	30,000	
Salaries expense	14,000	
General and administrative expenses	7,000	
Supplies expense	0	
Rent expense	0	
Insurance expense	0	
Utilities expense	0	
Depreciation expense	0	
Interest expense	0	
Income tax expense	0	
Total	\$675,100	\$675,100

Revenues and Gains

Expenses and Losses

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.**

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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.

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Adjusting Entries

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

Adjusting entries are entries required at the end of each accounting period:

- to recognize, on an accrual basis, **revenues** and **expenses** for the period, and
- to report proper amounts for **asset**, **liability** and **owners' equity accounts**.

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Types of Adjustments

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

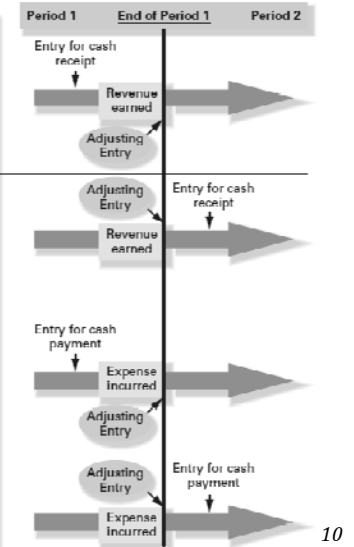
Adjusting Entries that Increase Expenses:

- 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



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Adjustments – When Revenue is Earned

When revenue is earned, the adjusting entry is:

DEFERRED REVENUE

if cash was received and previously recorded

Cash (+A)	xx	
Deferred (unearned) revenue (+L)		xx

Deferred (unearned) revenue (-L)	xx	
Revenue (+R, +SE)		xx

OR

ACCRUED REVENUE

if cash will be received

Receivable (+A)	xx	
Revenue (+R, +SE)		xx

Increase revenues

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Adjustments – When Expense is Incurred

When expense is incurred, the adjusting entry is:

DEFERRED EXPENSE

if cash was paid and previously recorded

Deferred (prepaid) expense (+A)	xx	
Cash (-A)		xx

Expense (+E, -SE)	xx	
Deferred (prepaid) expense (-A)		xx

OR

ACCRUED EXPENSE

if cash will be paid

Expense (+E, -SE)	xx	
Payable (+L)		xx

Increase expenses

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Deferred Revenue (or Unearned Revenue)

Papa John's received cash last period 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, Papa John's performed \$1,100 in services for franchisees who had previously paid fees.

		Step 2			
AJE 1:		Debit	Credit		
Unearned Franchise Fees (-L)		1,100			
Franchise Fee Revenue (+R, +SE)			1,100		
				Step 1	Step 3
		Step 2			
Assets	=	Liabilities	+	Stockholders' Equity	
		-1,100		+1,100	Franchise Fee Revenue (+R) 13



Accrued Revenue

Papa John's franchisees owe Papa John's \$830 in royalties for sales the franchisees made in the last week of January. The cash will be received in the future.

		Step 2			
AJE 2:		Debit	Credit		
Accounts Receivable (+A)		830			
Franchise Fee Revenue (+R, +SE)			830		
				Step 1	Step 3
		Step 2			
Assets	=	Liabilities	+	Stockholders' Equity	
+830				+830	Franchise Fee Revenue (+R) 14



Accrued Revenue

Papa John's loaned \$3,000 to franchisees on December 31 (one month ago) at 6 percent interest per year with interest to be paid at the end of each year.

There was also \$8,000 in notes receivable outstanding all month from prior loans.

There are two components when lending or borrowing money: **principal** (the amount loaned or borrowed) and **interest** (the cost of borrowing).

Notes Receivable (the principal) was recorded properly when the money was loaned.

Accrued Revenue

Principal	×	Rate per Year	×	Number of Months (since last computation)/12	=	Interest for the Period
\$3,000	×	.06	×	1 month / 12 months	=	\$15
Assume interest on the other \$8,000 in notes receivable						= 55
Total interest earned						<u>\$70</u>
Add this \$70 amount to the adjusting journal entry.						

		Step 2			
AJE 3:		Debit	Credit		
Interest Receivable (+A)		70			
Investment Income (+R, +SE)			70		
				Step 1	Step 3
		Step 2			
Assets	=	Liabilities	+	Stockholders' Equity	
+70				+70	Investment Income (+R) 16

**Deferred Expense (or Prepaid Expense)**

Prepaid Expenses includes \$2,000 paid on January 1 for insurance coverage for four months (January through April) and \$6,000 paid on January 1 for rental of space at shopping centers over three months (January through March).

Compute the amount of expense incurred.

One month has expired for each of the prepaid amounts:

Insurance: \$2,000 x 1 month/4 months = \$ 500 used in January.

Rent: \$6,000 x 1 month/3 months = \$ 2,000 used in January.

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**Deferred Expense (or Prepaid Expense)**

		Step 1			
		↓			
AJE 4:				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	Insurance Expense (+E)
				-2,000	Rent Expense (+E)

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**Deferred Expense (or Prepaid Expense)**

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	
= Supplies used during the period		<u>\$ 4,000</u>	

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**Deferred Expense (or Prepaid Expense)**

		Step 1			
		↓			
AJE 5:				Debit	Credit
Supplies Expense (+E, -SE)				4,000	
Supplies (-A)					4,000
		Step 2		Step 3	
Assets	=	Liabilities	+	Stockholders' Equity	
-4,000				-4,000	Supplies Expense (+E)

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Deferred Expense (or Prepaid Expense)

Property and equipment are assets that have a normal debit balance. Depreciation is the allocation of the cost of an asset over its estimated useful life to the company. Depreciation is an expense with a normal debit balance. 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. We subtract accumulated depreciation from the cost of our property and equipment to arrive at net book value.

+ Property and Equipment (A) –		– Accumulated Depreciation (XA) +	
Beginning bal.	Buy	Beginning bal.	Used
Ending bal.	Sell	Ending bal.	

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Deferred Expense (or Prepaid Expense)

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

Step 1		Debit	Credit
AJE 6:			
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)

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Accrued Expenses

Papa John’s owed (1) its employees salaries for working four days at the end of January at \$500 per day, (2) \$610 for utilities used in January, and (3) interest on its long-term notes payable borrowed at a 6 percent annual rate.

Amounts for Accrued Expenses:

- Salaries = $\$500 \text{ per day} \times 4 \text{ days} = \$2,000$
- Utilities = \$610
- Interest = $\$138,000 \times .06 \times 1/12 = \690

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Accrued Expenses

Step 1		Debit	Credit
AJE 7:			
Salaries Expense (+E, –SE)	2,000		
Utilities Expense (+E, –SE)	610		
Interest Expense (+E, –SE)	690		
Accrued Expenses Payable (+L)		3,300	
Step 2		Step 3	
Assets	=	Liabilities	+ Stockholders' Equity
		+3,300	–2,000 Salaries Expense (+E)
			–610 Utilities Expense (+E)
			–690 Interest Expense (+E)

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Accrued Expenses – Income Tax Payable

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	From our unadjusted trial balance shown earlier
AJE 1	1,100		
AJE 2	830		
AJE 3	70		
AJE 4		2,500	
AJE 5		4,000	
AJE 6		2,500	
AJE 7		3,300	
	<u>\$74,800</u>	<u>\$63,300</u>	
			= \$11,500 Pretax income

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Accrued Expenses – Income Tax Payable

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 $\$11,500 \times .34 = \$3,910$.

AJE 8:

	Debit	Credit
Income Tax Expense (+E, -SE)	3,910	
Income Tax Payable (+L)		3,910

Step 1 points to the first row, Step 2 points to the second row, and Step 3 points to the second row.

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

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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.

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Preparing Financial Statements

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Preparing 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. Income statement,
2. Statement of stockholders' equity,
3. Balance sheet, 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
Contributed capital		9,000				9,000
Retained earnings		120,000				120,000

To prepare
Balance
Sheet

Fe

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Adjusted Trial Balance

Restaurant sales revenue		66,000				66,000
Franchise fee revenue		2,800		AJE 1 1,100		4,730
Investment income		1,000		AJE 2 830		1,070
Gain on sale of land		3,000		AJE 3 70		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

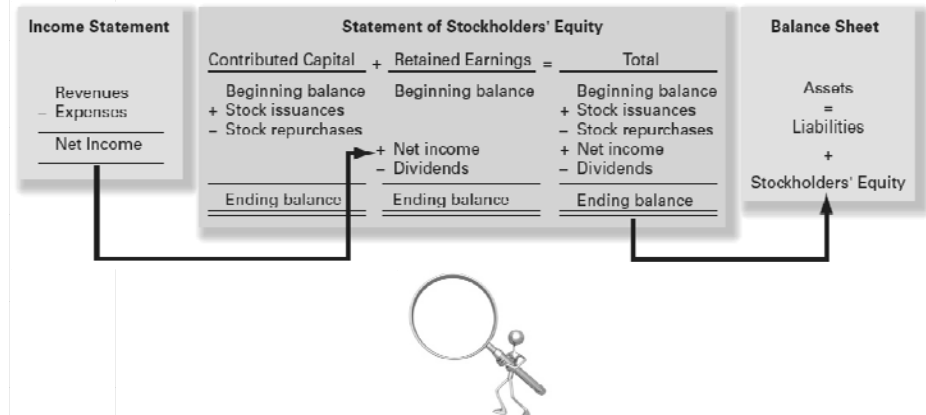
To prepare
Income
Statement

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Financial Statement Relationships



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Income Statement

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

Operating Revenues	
Restaurant sales revenue	\$66,000
Franchise fee revenue	4,730
Total revenues	70,730
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

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

To Statement of Stockholders' Equity

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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.

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

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

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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)

	Contributed Capital	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 Income Statement

From Event (a) in Chapter 2

From the income statement

From Event (f) in Chapter 2

Included on the balance sheet

To Balance Sheet

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PAPA JOHN'S INTERNATIONAL, INC., AND SUBSIDIARIES
Consolidated Balance Sheet

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Balance Sheet

Current Assets	
Cash	\$ 41,900
Accounts receivable	21,050
Interest receivable	70
Supplies	12,000
Prepaid expenses	16,500
Other current assets	13,000
Total current assets	104,500
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
Total assets	\$427,000
LIABILITIES AND STOCKHOLDERS' EQUITY	
Current Liabilities	
Accounts payable	\$ 39,000
Dividends payable	3,000
Accrued expenses payable	74,300
Income tax payable	3,910
Total current liabilities	120,210
Unearned franchise fees	5,200
Notes payable	138,000
Other long-term liabilities	27,000
Total liabilities	290,410
Stockholders' Equity	
Contributed capital	9,000
Retained earnings	127,590
Total stockholders' equity	136,590
Total liabilities and stockholders' equity	\$427,000

From Statement of Stockholders' Equity

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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.



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Focus on Cash Flow

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:

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

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Closing the Books

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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**."

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Closing the Books



Even though the balance sheet account balances carry forward from period to period, the income statement accounts *do not*.

Closing entries:

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

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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			Retained Earnings			Sales Revenue		
Bal.	40	40	CE			CE	100	100
Closed	0			6,000	Bal.			
				80	CE		0	Closed
Loss on Sale of Assets						Gain on Sale of Assets		
Bal.	10	10	CE			CE	30	30
Closed	0			6,080	Bal.			
					CE		0	Closed

130 revenues - 50 expenses = 80
Net income

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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)

Operating Revenues	
Restaurant sales revenue	\$66,000
Franchise fee revenue	4,730
Total revenues	70,730
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 Entry

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

All revenue, expense, gain and loss accounts will have a zero balance.

Transfer net income to Retained Earnings

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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
Contributed capital		9,000
Retained earnings		122,630

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

This is now retained earnings at Jan 31, 2009

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End of Chapter 4



February 3, 2012

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EXERCISE 4 – 1

ADJUSTING ENTRIES AND POSTING TO T-ACCOUNTS

Prepare the required adjusting journal entry for each situation as of December 31, 2010. *See page 4 for the unadjusted account balances shown in T-accounts.*

(a) Suppose Deana's had received a \$1,800 shipment of supplies in September 2010. When counting the supplies on December 31, 2010, Deana's found only \$800 worth of supplies on hand.

Debit and credit the accounts affected.

Dec. 31, 10			

Ensure the equation still balances and debits = credits.

Assets	=	Liabilities	+	Stockholders' Equity

(b) Suppose Deana's had paid \$12,000 for six months' rent on November 1, 2010. As of December, 31, 2010, two months' (November & December) prepaid rent has expired.

Debit and credit the accounts affected.

Dec. 31, 10			

Ensure the equation still balances and debits = credits.

Assets	=	Liabilities	+	Stockholders' Equity

(c) Suppose Deana's had paid \$6,000 for one year's insurance on June 1, 2010.

Debit and credit the accounts affected.

Dec. 31, 10			

Ensure the equation still balances and debits = credits.

Assets	=	Liabilities	+	Stockholders' Equity

EXERCISE 4 – 1, continued

(d) The company had acquired Property, Plant & Equipment costing \$40,000 on January 1, 2010. Suppose that the depreciation on this Equipment was calculated to be \$2,000 for 2010.

Debit and credit the accounts affected.

Dec. 31, 10			

Ensure the equation still balances and debits = credits.

Assets	=	Liabilities	+	Stockholders' Equity	

(e) On December 1, 2010, the company had sold \$500 in gift certificates for decorating services to a customer. On December 31, 2010, the accountant received an envelope containing \$400 worth of redeemed gift certificates, not yet recorded in the company's books.

Debit and credit the accounts affected.

Dec. 31, 10			

Ensure the equation still balances and debits = credits.

Assets	=	Liabilities	+	Stockholders' Equity	

(f) On June 30, 2010, the company invested \$20,000 in a certificate of deposit that will yield 12% interest at the end of one year.

Debit and credit the accounts affected.

Dec. 31, 10			

Ensure the equation still balances and debits = credits.

Assets	=	Liabilities	+	Stockholders' Equity	

EXERCISE 4 – 1, continued

(g) The company borrowed a note payable from the bank for \$30,000 on January 1, 2010, due with all interest on June 30, 2011. The note payable requires 10% interest.

Debit and credit the accounts affected.							
Dec. 31, 10							
Ensure the equation still balances and debits = credits.							
Assets		=	Liabilities		+	Stockholders' Equity	

(h) The company calculated its income taxes as \$26,110 for the year ended December 31, 2010.

Debit and credit the accounts affected.							
Dec. 31, 10							
Ensure the equation still balances and debits = credits.							
Assets		=	Liabilities		+	Stockholders' Equity	

(i) On December 15, 2010, the company declared a \$750 dividend, payable January 15, 2011.

Debit and credit the accounts affected.							
Dec. 31, 10							
Ensure the equation still balances and debits = credits.							
Assets		=	Liabilities		+	Stockholders' Equity	

Post the adjusting entries above to the T-accounts on the following page.

EXERCISE 4 – 1, continued

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

EXERCISE 4 – 2

Deana's Decorators
Adjusted Trial Balance
December 31, 2010

Accounts	Debit	Credit
Cash		
Supplies		
Accounts Receivable		
Prepaid Rent		
Prepaid Insurance		
Certificate of Deposit		
Interest Receivable		
Property, Plant & Equipment		
Accumulated Depreciation		
Accounts Payable		
Dividend Payable		
Unearned Revenue		
Notes Payable		
Interest Payable		
Income Tax Payable		
Contributed Capital		
Retained Earnings		
Decorating Revenue		
Investment Income		
Wage Expense		
Utilities Expense		
Telephone Expense		
Supplies Expense		
Rent Expense		
Insurance Expense		
Depreciation Expense		
Interest Expense		
Income Tax Expense		
Totals		

[illegible][illegible]

EXERCISE 4 – 3, continued

Deana's Decorators
Balance Sheet
December 31, 2010

Assets

1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26	27	28	29	30	31	32	33	34	35	36	37	38	39	40	41	42	43	44	45	46	47	48	49	50	51	52	53	54	55	56	57	58	59	60	61	62	63	64	65	66	67	68	69	70	71	72	73	74	75	76	77	78	79	80	81	82	83	84	85	86	87	88	89	90	91	92	93	94	95	96	97	98	99	100
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26	27	28	29	30	31	32	33	34	35	36	37	38	39	40	41	42	43	44	45	46	47	48	49	50	51	52	53	54	55	56	57	58	59	60	61	62	63	64	65	66	67	68	69	70	71	72	73	74	75	76	77	78	79	80	81	82	83	84	85	86	87	88	89	90	91	92	93	94	95	96	97	98	99	100
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26	27	28	29	30	31	32	33	34	35	36	37	38	39	40	41	42	43	44	45	46	47	48	49	50	51	52	53	54	55	56	57	58	59	60	61	62	63	64	65	66	67	68	69	70	71	72	73	74	75	76	77	78	79	80	81	82	83	84	85	86	87	88	89	90	91	92	93	94	95	96	97	98	99	100
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26	27	28	29	30	31	32	33	34	35	36	37	38	39	40	41	42	43	44	45	46	47	48	49	50	51	52	53	54	55	56	57	58	59	60	61	62	63	64	65	66	67	68	69	70	71	72	73	74	75	76	77	78	79	80	81	82	83	84	85	86	87	88	89	90	91	92	93	94	95	96	97	98	99	100
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26	27	28	29	30	31	32	33	34	35	36	37	38	39	40	41	42	43	44	45	46	47	48	49	50	51	52	53	54	55	56	57	58	59	60	61	62	63	64	65	66	67	68	69	70	71	72	73	74	75	76	77	78	79	80	81	82	83	84	85	86	87	88	89	90	91	92	93	94	95	96	97	98	99	100
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26	27	28	29	30	31	32	33	34	35	36	37	38	39	40	41	42	43	44	45	46	47	48	49	50	51	52	53	54	55	56	57	58	59	60	61	62	63	64	65	66	67	68	69	70	71	72	73	74	75	76	77	78	79	80	81	82	83	84	85															

Liabilities and Shareholders' Equity

[illegible]

EXERCISE 4 – 4**CLOSING ENTRIES, POSTING TO T-ACCOUNTS,
PREPARATION OF POST-CLOSING TRIAL BALANCE**

For Deana's Decorators, prepare the required closing entries. Post the entries to the T-accounts shown on the next page. Then, prepare a post-closing trial balance.

Date	Entries	Debit	Credit

EXERCISE 4 – 4, continued

Assets				Liabilities				Stockholders' Equity			
+ Cash –				- Accounts Payable +				+ Contributed Capital –			
Unadj.	43,450				250	Unadj.			10,000	Unadj.	
Adj.	43,450				250	Adj.					
+ Supplies –				- Dividend Payable +				- Retained Earnings +			
Unadj.	1,800				0	Unadj.			0	Unadj.	
		1,000	(a)		750	(i)		(i)	750		
Adj.	800				750	Adj.		Adj.	750		
+ Accounts Receivable –				- Unearned Revenue +				- Revenue +			
Unadj.	4,000				500	Unadj.			120,000	Unadj.	
				(e)	400				400	(e)	
Adj.	4,000			Adj.	100				120,400	Adj.	
+ Prepaid Rent –				- Notes Payable +				+ Investment Income –			
Unadj.	12,000				30,000	Unadj.				1,200	(f)
		4,000	(b)		30,000	Adj.					
Adj.	8,000			- Interest Payable +				+ Wage Expense –			
+ Prepaid Insurance –					0	Unadj.		Unadj.	32,000		
Unadj.	6,000				3,000	(g)					
		3,500	(c)		3,000	Adj.		+ Utilities Expense –			
Adj.	2,500			- Income Tax Payable +				Unadj.	1,000		
+ Certificate of Deposit –					0	Unadj.					
Unadj.	20,000				26,110	(h)		+ Telephone Expense –			
					26,110	Adj.		Unadj.	500		
Adj.	20,000			Stockholders' Equity							
+ Interest Receivable –				+ Depreciation Expense –				+ Supplies Expense –			
Unadj.	0			(d)	2,000			(a)	1,000		
(f)	1,200										
Adj.	1,200			+ Interest Expense –				+ Rent Expense –			
+ Property, Plant & Equipment –				(g)	3,000			(b)	4,000		
Unadj.	40,000										
				+ Income Tax Expense –				+ Insurance Expense –			
Adj.	40,000			(h)	26,110			(c)	3,500		
- Accumulated Depr. +											
		0	Unadj.								
		2,000	(d)								
		2,000									

EXERCISE 4 – 4, continued

Deana's Decorators
Post-Closing Trial Balance
December 31, 2010

Accounts	Debit	Credit
Cash		
Supplies		
Accounts Receivable		
Prepaid Rent		
Prepaid Insurance		
Certificate of Deposit		
Interest Receivable		
Property, Plant & Equipment		
Accumulated Depreciation		
Accounts Payable		
Dividend Payable		
Unearned Revenue		
Notes Payable		
Interest Payable		
Income Tax Payable		
Contributed Capital		
Retained Earnings		
Decorating Revenue		
Investment Income		
Wage Expense		
Utilities Expense		
Telephone Expense		
Supplies Expense		
Rent Expense		
Insurance Expense		
Depreciation Expense		
Interest Expense		
Income Tax Expense		
Totals		