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

# AC 201

## Fundamental Accounting

**Semester 1/2015**

**Course Materials**

**Topics:**
Chapter 3 Operating Decisions and the Accounting System

**Session:**
Session #3

**Instructor:**
Ajarn Santana Singhasaneh

Introduction to Financial Statements

**FINANCIAL STATEMENTS**

- ✓ Statement of Financial Position
- ✓ Statement of Comprehensive Income
- ✓ Statement of Changes in Equity
- ✓ Statement of Cash Flows

**ASSETS**

- Cash
- Investments in debt and equity securities
- Accounts receivable
- Notes receivable
- Inventory
- Prepaid expenses
- Property, plant, and equipment
- Intangible assets
- Natural resources

**LIABILITIES**

- Accounts payable
- Accrued liabilities
- Unearned revenues
- Notes payable
- Bonds payable

**EQUITY**

- Share capital
  - Preferred share
  - Ordinary share
- Retained earnings
  - Appropriated R/E
  - Unappropriated R/E
- Treasury share

Accounting Cycle

Financial Statement Items

We are here

Transaction Analysis and Recording – Operating Activities

FINANCIAL STATEMENT ANALYSIS




# CHAPTER 3: OPERATING DECISIONS AND THE ACCOUNTING SYSTEM

**Ajarn Santana Singhasaneh**
**Department of Accounting**
**Thammasat Business School**
**Thammasat University**

## How do Business Activities Affect the Statement of Income ?

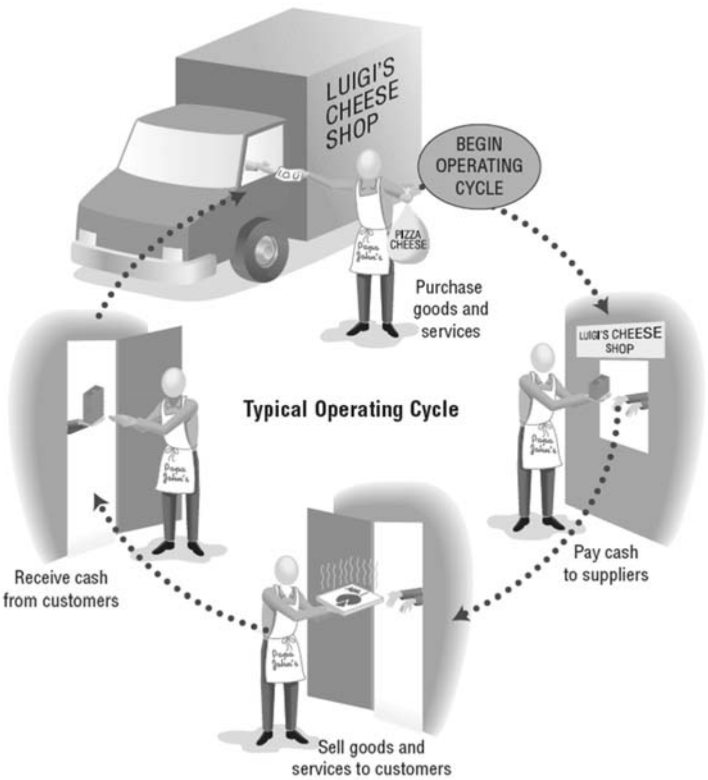




## The Operating Cycle

**Operating (Cash-to Cash) Cycle:**
is the time it takes to receives goods or services from suppliers, to pay cash to suppliers, to sell them to customers, and to collect cash from customers.

**Time-Period Assumption:**
To measure and report financial information periodically, we assume that the long life of a company can be cut into shorter periods.



## The Operating Cycle

**Issues arise in reporting periodic income to users:**

1. ***Recognition Issues***: ***When*** should the effects of operating activities be recognized (recorded)?
2. ***Measurement Issues***: ***What amounts*** should be recognized ?





## Elements of the Statement of Income

**Revenues**
Increases in assets or settlement of liabilities from ongoing operations.

**Expenses**
Decreases in assets or increases in liabilities from ongoing operations.

**Gains**
Increases in assets or settlement of liabilities from peripheral transactions.

**Losses**
Decreases in assets or increases in liabilities from peripheral transactions.

PAPA JOHN'S INTERNATIONAL, INC.
**Consolidated Statement of Income**
**For the Year Ended December 31, 2008**
**(dollars in thousands)**

| | | |
|---|---|---|
| **Operating Revenues** | | |
| Restaurant sales revenue | $ 996,000 | |
| Franchise fee revenue | 136,000 | |
| Total revenues | 1,132,000 | |
| **Operating Expenses** | | |
| Cost of sales | 483,000 | |
| Salaries expense | 193,000 | |
| Rent expense | 35,000 | *Operating activities* (central focus of the business) |
| Advertising expense | 49,000 | |
| General and administrative expenses | 100,000 | Includes insurance, repairs, utilities, and fuel expenses |
| Depreciation expense | 33,000 | |
| Other operating expenses | 172,000 | |
| Total expenses | 1,065,000 | |
| **Operating Income** | 67,000 | Subtotal of operating revenues minus operating expenses |
| **Other Items** | | |
| Investment income | 1,000 | |
| Interest expense | (8,000) | *Peripheral activities* (not the main focus of the business) |
| Loss on restaurants sold | (3,000) | |
| **Income before Income Taxes** | 57,000 | Subtotal of all revenues minus all expenses except taxes |
| Income tax expense | 20,000 | |
| **Net Income** | **$ 37,000** | |
| **Earnings per Share** | **$ 1.32** | = $37,000,000 Net Income ÷ 28,100,000 Average Number of Shares Outstanding (from Papa John's annual report) |





Papa John's
Primary Operating Expenses

Cost of sales
(used inventory)

Salaries
and benefits to
employees

Other costs
(like advertising,
insurance, and
depreciation)

PAPA JOHN'S INTERNATIONAL, INC.
**Consolidated Statement of Income**
**For the Year Ended December 31, 2008**
**(dollars in thousands)**

| | |
|---|---|
| **Operating Revenues** | |
| Restaurant sales revenue | $ 996,000 |
| Franchise fee revenue | 136,000 |
| Total revenues | 1,132,000 |
| **Operating Expenses** | |
| Cost of sales | 483,000 |
| Salaries expense | 193,000 |
| Rent expense | 35,000 |
| Advertising expense | 49,000 |
| General and administrative expenses | 100,000 |
| Depreciation expense | 33,000 |
| Other operating expenses | 172,000 |
| Total expenses | 1,065,000 |
| **Operating Income** | 67,000 |
| **Other Items** | |
| Investment income | 1,000 |
| Interest expense | (8,000) |
| Loss on restaurants sold | (3,000) |
| **Income before Income Taxes** | 57,000 |
| Income tax expense | 20,000 |
| **Net Income** | **$ 37,000** |
| **Earnings per Share** | **$ 1.32** |

## International Perspective: Statement of Income Differences

As indicated in Chapter 2, under IFRS, the income statement is usually titled the Statement of Operations. There is also a difference in how expenses may be reported:

| | GAAP | IFRS |
|---|---|---|
| **Presentation of Expenses**<br>• Similar expenses are reported, but may be grouped in different ways | Public companies categorize expenses by business **function** (e.g., production, research, marketing, general operations). | Companies can categorize expenses by either **function or nature** (e.g., salaries, rent, supplies, electricity). |

In addition, foreign companies often use account titles that differ from U.S. companies. For example, GlaxoSmithKline (a U.K. pharmaceutical company), Parmalat (an Italian food producer of milk, dairy products, and fruit-based beverages), and Unilever (a U.K. and Netherlands-based company supplying food, home, and personal care products such as Hellman's mayonnaise, Dove soap, and Popsicle treats) use the term *turnover* to refer to sales revenue, *finance income* for income from investments, and *finance cost* for interest expense. BMW Group, on the other hand, reports *revenues* and uses *financial result* for the difference between income from investments and interest expense. All four companies follow IFRS.





## How are Operating Activities Recognized and Measured ?

## How Are Operating Activities Recognized and Measured?

**Cash Basis Accounting:**

records only **CASH** transactions. Cash receipts are treated as revenues, and cash payments are treated as expenses.

**Accrual Basis Accounting:**

records the impact of business transactions on the entity's assets and liabilities **in the period in which those transactions occur**, even if the resulting cash receipts or payments occur in a prior or future period.





## How Are Operating Activities Recognized and Measured?

### Cash Basis Accounting

***Revenues*** are recorded when cash is received and ***Expenses*** are recorded when cash is paid.

**Income Measurement**

Revenues [= cash receipts]
- Expenses [= cash payments]

Net income [cash basis]

Earn = to receive as return for effort and especially for work done or services rendered

### Accrual Basis Accounting

***Revenues*** are recorded when earned and ***Expenses*** are recorded when incurred, regardless of the timing of cash receipts or payments.

**Income Measurement**

Revenues [= when earned]
- Expenses [= when incurred]

Net income [accrual basis]

## Example: Cash Basis v/s Accrual Basis Accounting

- During 2014, Canine Consulting billed its client for $55,000 for its services. On December 31, 2014, it had received $2,500, with the remaining $52,500 to be received in 2015. Total expenses during 2014 were $34,000 with $33,000 of these costs not yet paid at December 31, 2014. Determine net income for the year 2014 under both method.

**Cash Basis: Income Measurement**

| | | |
|---|---|---|
| Revenues | 2,500 | [= cash receipts] |
| - Expenses | (1,000) | [= cash payments] |
| Net income | 1,500 | [cash basis] |

**Accrual Basis: Income Measurement**

| | | |
|---|---|---|
| Revenues | 55,000 | [= when earned] |
| - Expenses | (34,000) | [= when incurred] |
| Net income | 21,000 | [accrual basis] |

Accrual basis accounting allows for a **BETTER** measure of a company's economic measurement





## How Are Operating Activities Recognized and Measured?

# Accrual Basis Accounting

In accrual basis accounting,
revenues and expenses are recognized (recorded)
when the transaction that causes them occurs,
**NOT** necessarily when cash is received or paid.

***Revenues*** are recorded when earned,
***Expenses*** are recorded when incurred,
regardless of the timing of cash receipts or payments.

Two basic accounting principles that determine
***when*** *revenues and expenses are recorded*:
1. *Revenue realization principle*
2. *Expense matching principle*

## Accrual Basis: Revenue Realization Principle





## Revenue Realization Principle

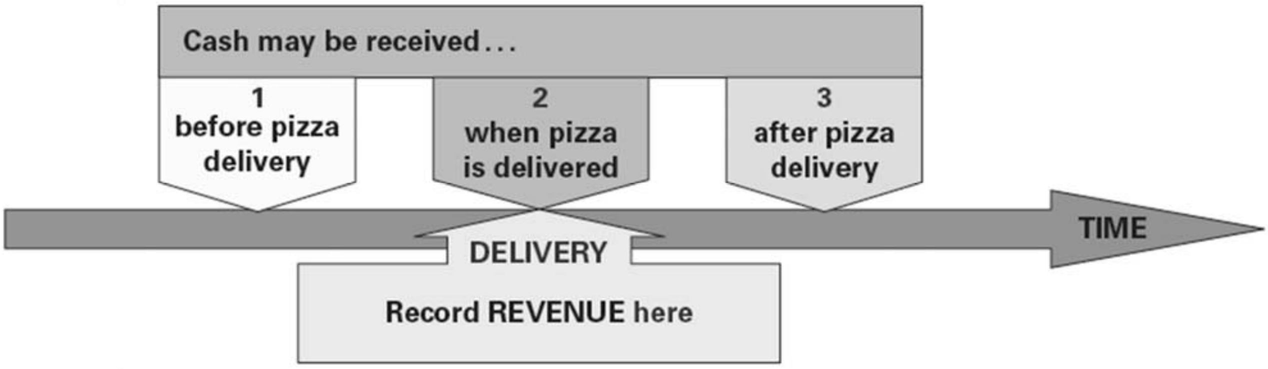
Under the Revenue Realization Principle,
**ALL 4 criteria** must be met for ***REVENUE*** to be ***RECOGNIZED***.

1. Delivery has occurred or services have been rendered;
2. There is persuasive evidence of an arrangement for customer payment;
3. The price is fixed or determinable; and
4. Collection is reasonably assured.

For most businesses, these conditions are met
**at the point of delivery of goods or services**,
regardless of when cash is received.

# Revenue Realization Principle

## Recording Revenues v/s Cash Receipts




Revenue is earned
when the business delivers goods or services.

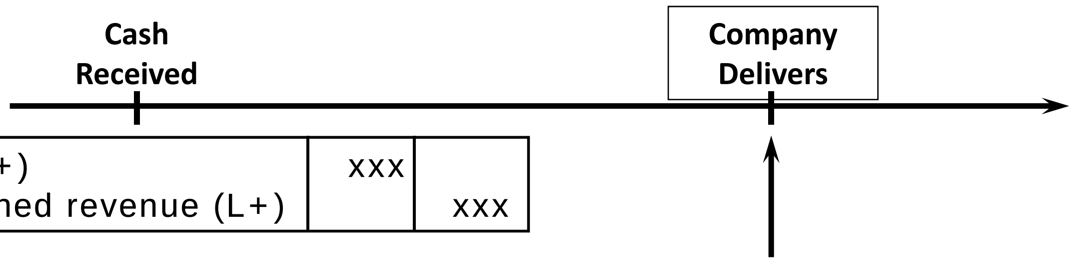




# 1. Cash Received BEFORE Revenue is Earned (1)

If cash is received ***BEFORE*** the company delivers goods or services, a liability account ***UNEARNED REVENUE*** is recorded.

When the company delivers the goods or services, ***UNEARNED REVENUE*** is reduced and ***REVENUE*** is recorded.




| | | |
|---|---|---|
| Cash (A+) | xxx | |
| Unearned revenue (L+) | | xxx |

***Unearned revenue***:
A liability representing a company's obligation to provide goods or services to customers in the future.

**Revenue will be recorded when earned.**

| | | |
|---|---|---|
| Unearned revenue (L-) | xxx | |
| Service revenue (REV+) | | xxx |

# 1. Cash Received BEFORE Revenue is Earned (2)

***UNEARNED REVENUE:***

Some businesses collect cash from customers before earning of revenue. This create a liability called "unearned revenue."

**Example:** On August 1, ABC Company received $16,000 cash for its services to be provided to a customer during the following 3 months. The company noted that it had provided $10,000 worth of services in the month of August.

**When cash is received**

| Date | Account Title & Explanation | Debit | Credit |
|---|---|---|---|
| Aug 1 | Cash (A+) | 16,000 | |
| | Unearned revenue (L+) | | 16,000 |

**When revenue is earned**

| Date | Account Title & Explanation | Debit | Credit |
|---|---|---|---|
| Aug 31 | Unearned revenue (L-) | 10,000 | |
| | Service revenue (REV+) | | 10,000 |





# 2. Cash Received WHEN Revenue is Earned

When cash is received
***ON*** the date
the ***REVENUE*** is earned,
the following entry is made:

**Cash Received** ***AND*** **Company Delivers**

| | | |
|---|---|---|
| Cash (A+) | xxx | |
| Revenue (REV+) | | xxx |

# 3. Cash Received AFTER Revenue is Earned (1)

If cash is received ***AFTER*** the company delivers goods or services, an asset account ***ACCOUNTS RECEIVABLE*** is recorded.

When the cash is received the ***ACCOUNTS RECEIVABLE*** is reduced.

**Company Delivers**

| | | |
|---|---|---|
| Accounts receivable (A+) | xxx | |
| Revenue (REV+) | | xxx |

**Cash Received**

**Cash will be collected**.

| | | |
|---|---|---|
| Cash (A+) | xxx | |
| Accounts receivable (A-) | | xxx |





# 3. Cash Received AFTER Revenue is Earned (2)

***ACCOUNTS RECEIVABLE:***

Businesses may earn revenue before they receive the cash. A revenue that has been earned but not yet collected is called accounts receivable.

**Example:** On August 4, ABC Company delivered merchandise of $7,100 to a customer on account. On September 3, the customer paid the amount in full.

**When revenue is earned**

| Date | Account Title & Explanation | Debit | Credit |
|---|---|---|---|
| Aug 4 | Accounts receivable (A+) | 7,100 | |
| | Sales revenue (REV+) | | 7,100 |

**When cash is received**

| Date | Account Title & Explanation | Debit | Credit |
|---|---|---|---|
| Sep 3 | Cash (A+) | 7,100 | |
| | Accounts receivable (A-) | | 7,100 |

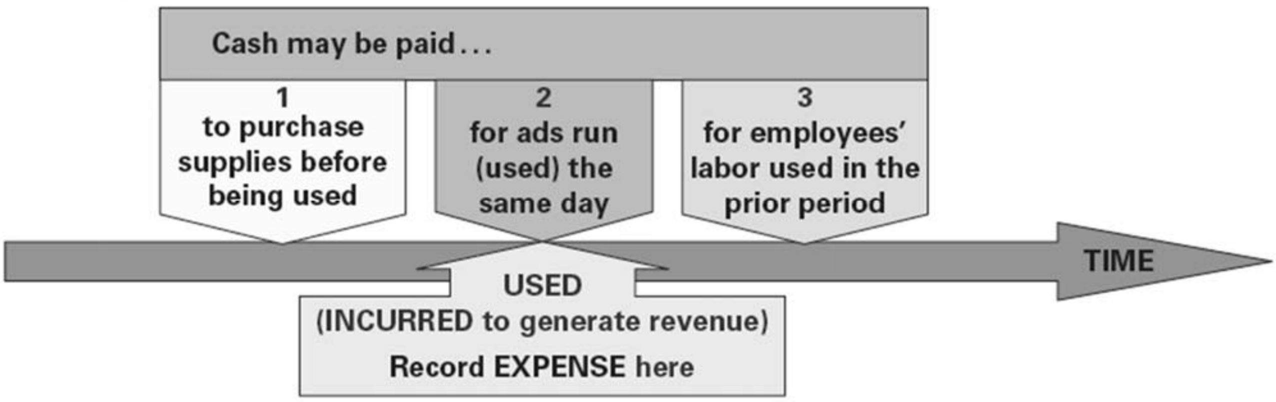
## Accrual Basis:
## Expense Matching Principle






## Expense Matching Principle

### Recording expenses v/s cash payments

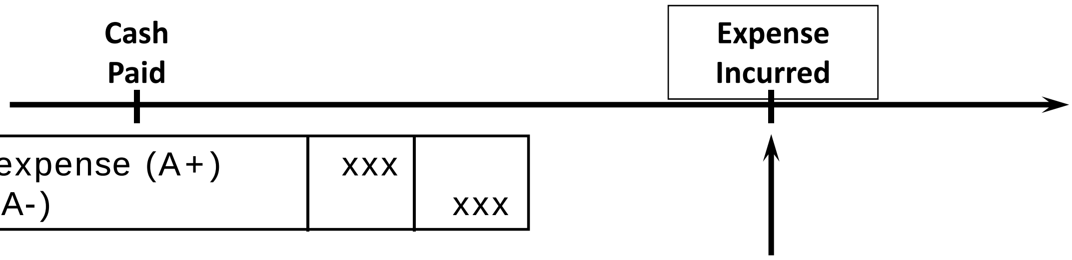



***EXPENSES*** are ***RECOGNIZED***
when they are incurred in generating revenue,
regardless of when cash is paid.

# 1. Cash is Paid BEFORE Expense is Incurred (1)

If cash is paid ***BEFORE*** the company receives goods or services,
an asset account,
***PREPAID EXPENSE*** is recorded.

When the expense is incurred ***PREPAID EXPENSE*** is reduced and an ***EXPENSE*** is recorded.




| | | |
|---|---|---|
| Prepaid expense (A+)<br>Cash (A-) | xxx | <br>xxx |

***Prepaid expenses***:
***(or prepayment)*** is an expense paid in advance. Prepaid expenses are assets because they provide a future economic benefit for the owner.

**Expense will be recorded when incurred.**

| | | |
|---|---|---|
| Expense (EXP+)<br>Prepaid expense (A-) | xxx | <br>xxx |





# 1. Cash is Paid BEFORE Expense is Incurred (2)

Typical assets and their related expense accounts include. . .

| CASH PAID FOR (ASSETS) | As USED over time becomes | EXPENSE |
|---|---|---|
| Prepaid rent | → | Rent expense |
| Prepaid insurance | → | Insurance expense |
| Supplies | → | Supplies expense |
| Building & equipment | → | Depreciation expense |

# 1. Cash is Paid BEFORE Expense is Incurred (3)

***PREPAID EXPENSES:***

Companies pay rent (or insurance) in advance. This prepayment creates an asset for the renter (or insurer), who can use the rented item (or be covered by the insurance policy) in the future.

**Example:** On August 1, ABC Company paid $3,000 cash for 3 months' store rent.

$1,000 per month

**When cash is paid**

| Date | Account Title & Explanation | Debit | Credit |
|---|---|---|---|
| Aug 1 | Prepaid rent (A+) | 3,000 | |
| | Cash (A-) | | 3,000 |

**When expense Incurred**

| Date | Account Title & Explanation | Debit | Credit |
|---|---|---|---|
| Aug 31 | Rent expense (EXP+) | 1,000 | |
| | Prepaid rent (A-) | | 1,000 |





**Prepaid rent & Rent expense**

| | August x1 | Septeber x1 | October x1 |
|---|---|---|---|
| Prepaid rent at beginning of month | 3,000 | 2,000 | 1,000 |
| Add increase during month | - | - | - |
| Less used up during month | (1,000) | (1,000) | (1,000) |
| Prepaid rent at end of month | 2,000 | 1,000 | - |
| Supply expense (EXP) | 1,000 | 1,000 | 1,000 |

# 1. Cash is Paid BEFORE Expense is Incurred (4)

***SUPPLIES:***

Supplies are another type of prepaid expense. Companies purchase supplies for use in their operations. During the period, some supplies (assets) are used up and become expenses.

**Example:** On August 1, ABC Company paid $900 cash for office supplies. On August 31, records showed that $250 of office supplies was used up during the month.

**When cash is paid**

| Date | Account Title & Explanation | Debit | Credit |
|---|---|---|---|
| Aug 1 | Supplies (A+) | 900 | |
| | Cash (A-) | | 900 |

**When expense Incurred**

| Date | Account Title & Explanation | Debit | Credit |
|---|---|---|---|
| Aug 31 | Supplies expense (EXP+) | 250 | |
| | Supplies (A-) | | 250 |





**Supplies & Supply expense**

| | August x1 | Septeber x1 | October x1 |
|---|---|---|---|
| Supplies at beginning of month | 900 | 650 | 850 |
| Add purchase during month | - | 100 | - |
| Less used up during month | (250) | (300) | 400 |
| Supplies at end of month | 650 | 850 | 450 |
| Supply expense (EXP) | 250 | 300 | 400 |

# 1. Cash is Paid BEFORE Expense is Incurred (5)

***BUILDING & EQUIPMENT:***

Building & equipment are long-lived tangible assets. They have finite useful lives and the passage of time reduces their usefulness. This decline is an expense. Depreciation is the process of allocating cost of building equipment to expense over their useful lives.

**Example:** On August 1, ABC Company paid $14,400 cash for office equipment. The equipment is estimated to last 6 years.

**When cash is paid**

| Date | Account Title & Explanation | Debit | Credit |
|---|---|---|---|
| Aug 1 | Office equipment (A+) | 14,400 | |
| | Cash (A-) | | 14,400 |

**When expense Incurred**

| Date | Account Title & Explanation | Debit | Credit |
|---|---|---|---|
| Aug 31 | Depreciation expense (EXP+) | 200 | |
| | Accumulated depreciation (XA-) | | 200 |

Contra asset account





**If Accumulated Depreciation account is NOT used**
[Depreciation expense is directly charged to the asset account.]

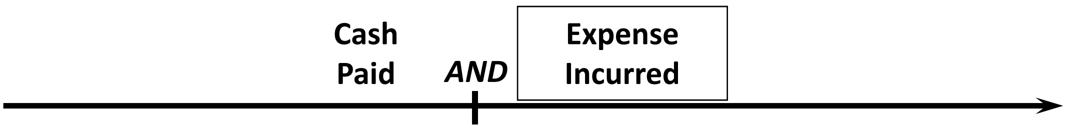
| | Aug 1, x1 | Dec 31, x1 | Dec 31, x2 | Dec 31, x3 | Dec 31, x4 | Dec 31, x5 | Dec 31, x6 | Aug 1, x7 |
|---|---|---|---|---|---|---|---|---|
| Office equipment (A) | 14,400 | 13,400 | 11,000 | 8,600 | 6,200 | 3,800 | 1,400 | - |
| Depreciation expense (EXP) | - | 1,000 | 2,400 | 2,400 | 2,400 | 2,400 | 2,400 | 1,400 |

**When Accumulated Depreciation account is used**
[Depreciation expense is charged to the **contra-asset account**.]

| | Aug 1, x1 | Dec 31, x1 | Dec 31, x2 | Dec 31, x3 | Dec 31, x4 | Dec 31, x5 | Dec 31, x6 | Aug 1, x7 |
|---|---|---|---|---|---|---|---|---|
| Office equipment | 14,400 | 14,400 | 14,400 | 14,400 | 14,400 | 14,400 | 14,400 | 14,400 |
| Less Accumulated depreciation | - | 1,000 | 3,400 | 5,800 | 8,200 | 10,600 | 13,000 | 14,400 |
| Office equipment-net | 14,400 | 13,400 | 11,000 | 8,600 | 6,200 | 3,800 | 1,400 | - |
| Depreciation expense | - | 1,000 | 2,400 | 2,400 | 2,400 | 2,400 | 2,400 | 1,400 |

## 2. Cash is Paid WHEN Expense is Incurred

When cash is paid
***ON*** the date
the ***EXPENSE*** is incurred,
the following entry is made:




| | | |
|---|---|---|
| Expense (EXP+) | xxx | |
| Cash (A-) | | xxx |

# 3. Cash is Paid AFTER Expense is Incurred (1)

If cash is paid ***AFTER*** the company delivers goods or services, a liability account, ***PAYABLE*** is recorded.

When the cash is paid the ***PAYABLE*** is reduced.

**Expense Incurred**

**Cash Paid**

| | | |
|---|---|---|
| Expense (EXP+) | xxx | |
| Accrual/Payable (L+) | | xxx |

**Cash will be paid.**

| | | |
|---|---|---|
| Accrual/Payable (L-) | xxx | |
| Cash (A-) | | xxx |





# 3. Cash is Paid AFTER Expense is Incurred (2)

***ACCRUED EXPENSES/ACCOUNTS PAYABLE:***

Businesses incur expenses before they pay cash. Examples include salary expense where the company's payable grows as the employees work. In effect, a liability is accrued.

**Example:** The payday of the month falls on Sunday, August 31. The salary of $2,600 will be paid on Monday, September 1.

**When expense Incurred**

| Date | Account Title & Explanation | Debit | Credit |
|---|---|---|---|
| Aug 31 | Salary expense (EXP+) | 2,600 | |
| | Accrued salary expense (L+) | | 2,600 |

**When cash is paid**

| Date | Account Title & Explanation | Debit | Credit |
|---|---|---|---|
| Sep 1 | Accrued salary expense (L-) | 2,600 | |
| | Cash (A-) | | 2,600 |

# A Question of Ethics

## Management's Incentives to Violate Accounting Rules

Investors in the stock market base their decisions on their expectations of a company's future earnings. When companies announce quarterly and annual earnings information, investors evaluate how well the companies have met expectations and adjust their investing decisions accordingly. Companies that fail to meet expectations often experience a decline in stock price. Thus, managers are motivated to produce earnings results that meet or exceed investors' expectations to bolster stock prices. Greed may lead some managers to make unethical accounting and reporting decisions, often involving falsifying revenues and expenses. While this sometimes fools people for a short time, it rarely works in the long run and often leads to very bad consequences.

Fraud is a criminal offense for which managers may be sentenced to jail. Samples of fraud cases, a few involving faulty revenue and expense accounting, are shown below. Just imagine what it must have been like to be 65-year-old Bernie Ebbers or 21-year-old Barry Minkow, both sentenced to 25 years in prison for accounting fraud.

| The CEO | The Fraud | Conviction/Plea | The Outcome |
|---|---|---|---|
| **Bernard Madoff,** 71 Madoff Investment Securities | Scammed $50 billion from investors in a Ponzi scheme in which investors receive "returns" from money paid by subsequent investors. | Confessed, December 2008 | Sentenced to 150 years |
| **Bernie Ebbers,** 65 Worldcom | Recorded $11 billion in operating expenses as if they were assets. | Convicted, July 2005 | Sentenced to 25 years |
| **Sanjay Kumar,** 44 Computer Associates | Recorded sales in the wrong accounting period. | Pleaded guilty, April 2006 | Sentenced to 12 years |
| **Martin Grass,** 49 Rite Aid Corporation | Recorded rebates from drug companies before they were earned. | Pleaded guilty, June 2003 | Sentenced to 8 years |
| **Barry Minkow,** 21 ZZZZ Best | Made up customers and sales to show profits when, in reality, the company was a sham. | Convicted, December 1988 | Sentenced to 25 years |

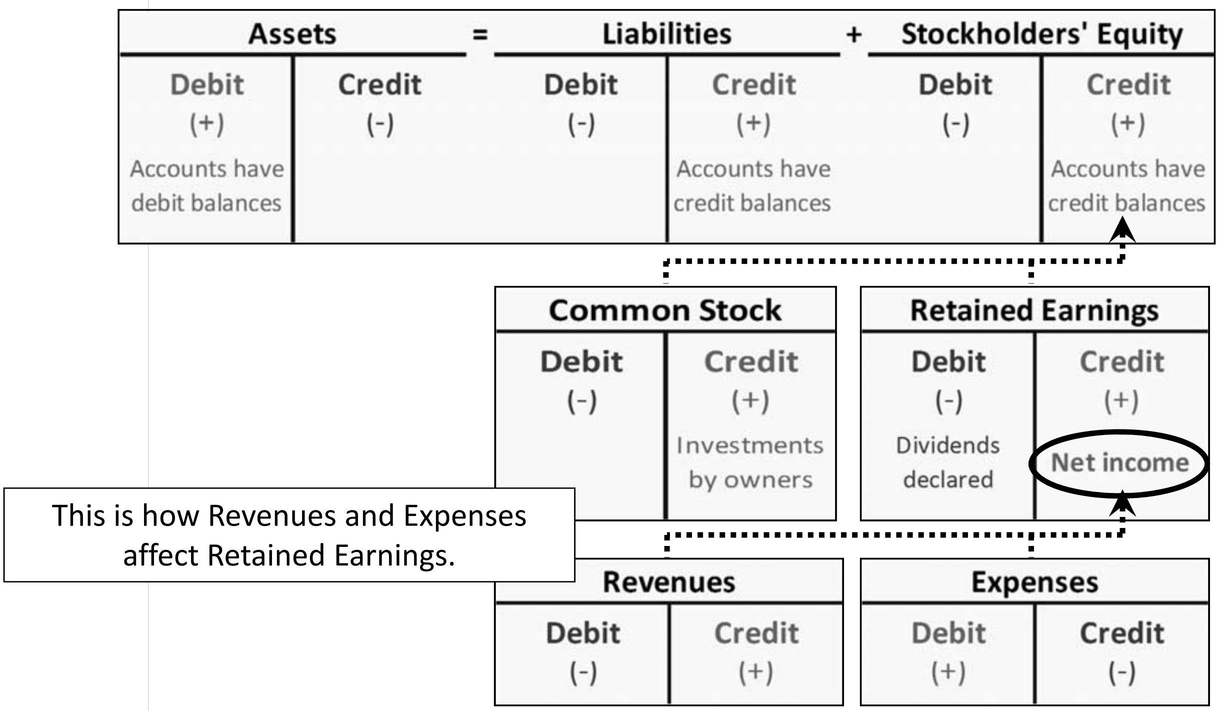
Many others are affected by fraud. Shareholders lose stock value, employees may lose their jobs (and pension funds, as in the case of Enron), and customers and suppliers may become wary of dealing with a company operating under the cloud of fraud. As a manager, you may face an ethical dilemma in the workplace. The ethical decision is the one you will be proud of 20 years later.





# The Expanded Transaction Analysis Model

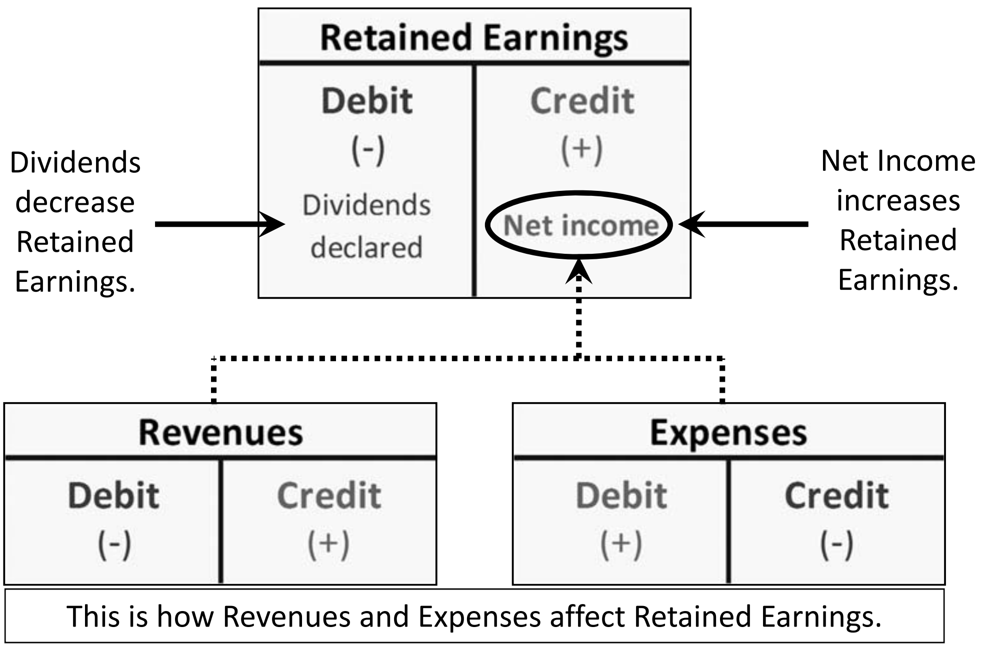
# A = L + SE








## Expanded Transaction Analysis Model



## Analyzing Some of Papa John's Transactions

(a) Papa John's restaurants sold pizza to customers for $36,000 cash and sold $30,000 in supplies to franchised restaurants, receiving $21,000 cash with the rest due on account.

| | | Debit | Credit |
|---|---|---|---|
| *(a)* | Cash (+A) [$36,000 + $21,000] | 57,000 | |
| | Accounts Receivable (+A) | 9,000 | |
| | Restaurant Sales Revenue (+R, +SE) | | 66,000 |

| Assets | | = | Liabilities | + | Stockholders' Equity | |
|---|---|---|---|---|---|---|
| Cash | +57,000 | | | | Restaurant Sales Revenue (+R) | +66,000 |
| Accounts Receivable | + 9,000 | | | | | |

Equality checks:
1. Debits $66,000 equal Credits $66,000,
2. The accounting equation is in balance.





## Analyzing Some of Papa John's Transactions

(b) The cost of the dough, sauce, cheese, and other supplies for the restaurant sales in (a) on the previous screen was $30,000.

| | | Debit | Credit |
|---|---|---|---|
| *(b)* | Cost of Sales (+E, −SE) | 30,000 | |
| | Supplies (−A) | | 30,000 |

| Assets | | = | Liabilities | + | Stockholders' Equity | |
|---|---|---|---|---|---|---|
| Supplies | −30,000 | | | | Cost of Sales (+E) | −30,000 |

Equality checks:
1. Debits $30,000 equal Credits $30,000,
2. The accounting equation is in balance.

## Analyzing Some of Papa John's Transactions

(c) Papa John's sold new franchises for $400 cash, earning $100 immediately by performing services for franchisees; the rest will be earned over the next several months.

for services performed

| | | Debit | Credit |
|---|---|---|---|
| *(c)* | Cash (+A) | 400 | |
| | Franchise Fee Revenue (+R, +SE) | | 100 |
| | Unearned Franchise Fees (+L) | | 300 |

| Assets | | = | Liabilities | | + | Stockholders' Equity | |
|---|---|---|---|---|---|---|---|
| Cash | +400 | | Unearned Franchise Fees | +300 | | Franchise Fee Revenue (+R) | +100 |

for services NOT yet performed

Equality checks:
1. Debits $400 equal Credits $400,
2. The accounting equation is in balance.



AC201 Fundamental Accounting

## Analyzing Some of Papa John's Transactions

(d) In January, Papa John's paid $7,000 for utilities, repairs, and fuel for delivery vehicles, all considered general and administrative expenses incurred during the month.

| | | Debit | Credit |
|---|---|---|---|
| *(d)* | General and Administrative Expenses (+E, −SE) | 7,000 | |
| | Cash (−A) | | 7,000 |

| Assets | | = | Liabilities | + | Stockholders' Equity | |
|---|---|---|---|---|---|---|
| Cash | −7,000 | | | | General and Administrative Expenses (+E) | −7,000 |

Equality checks:
1. Debits $7,000 equal Credits $7,000,
2. The accounting equation is in balance.

# Papa John's Statement of Financial Position Accounts

**+ Cash (A) –**

| | | | |
|---|---|---|---|
| Bal. | 13,000 | | |
| (a) | 57,000 | 7,000 | (d) |
| (c) | 400 | 9,000 | (e) |
| (h) | 4,000 | 14,000 | (f) |
| (i) | 15,500 | 9,000 | (g) |
| (k) | 1,000 | 10,000 | (j) |
| Bal. | 41,900 | | |

**+ Accounts Receivable (A) –**

| | | | |
|---|---|---|---|
| Bal. | 24,000 | | |
| (a) | 9,000 | 12,800 | (i) |
| Bal. | 20,200 | | |

**+ Supplies (A) –**

| | | | |
|---|---|---|---|
| Bal. | 17,000 | | |
| (e) | 29,000 | 30,000 | (b) |
| Bal. | 16,000 | | |

**+ Prepaid Expenses (A) –**

| | | | |
|---|---|---|---|
| Bal. | 10,000 | | |
| (g) | 9,000 | | |
| Bal. | 19,000 | | |

**+ Property and Equipment (A) –**

| | | | |
|---|---|---|---|
| Bal. | 200,000 | | |
| | | 1,000 | (h) |
| Bal. | 199,000 | | |

**– Accounts Payable (L) +**

| | | | |
|---|---|---|---|
| | | 29,000 | Bal. |
| (j) | 10,000 | 20,000 | (e) |
| | | 39,000 | Bal. |

**– Unearned Franchise Fees (L) +**

| | | | |
|---|---|---|---|
| | | 6,000 | Bal. |
| | | 300 | (c) |
| | | 6,300 | Bal. |





# Papa John's Statement of Income Accounts

**Beginning balances start at zero.**

**– Restaurant Sales Revenue (R) +**

| | | | |
|---|---|---|---|
| | | 0 | Bal. |
| | | 66,000 | (a) |
| | | 66,000 | Bal. |

**– Franchise Fee Revenue (R) +**

| | | | |
|---|---|---|---|
| | | 0 | Bal. |
| | | 100 | (c) |
| | | 2,700 | (i) |
| | | 2,800 | Bal. |

**– Gain on Sale of Land (R) +**

| | | | |
|---|---|---|---|
| | | 0 | Bal. |
| | | 3,000 | (h) |
| | | 3,000 | Bal. |

**– Investment Income (R) +**

| | | | |
|---|---|---|---|
| | | 0 | Bal. |
| | | 1,000 | (k) |
| | | 1,000 | Bal. |

**+ Cost of Sales (E) –**

| | | | |
|---|---|---|---|
| Bal. | 0 | | |
| (b) | 30,000 | | |
| Bal. | 30,000 | | |

**+ Salaries Expense (E) –**

| | | | |
|---|---|---|---|
| Bal. | 0 | | |
| (f) | 14,000 | | |
| Bal. | 14,000 | | |

**+ General and Administrative Expenses (E) –**

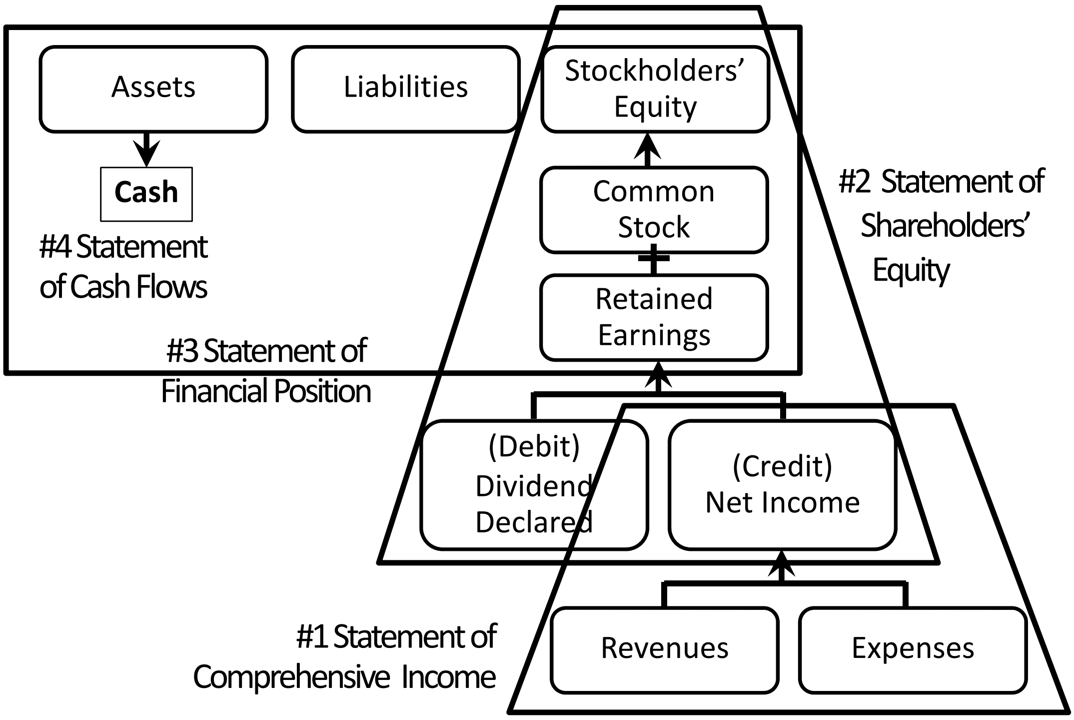
| | | | |
|---|---|---|---|
| Bal. | 0 | | |
| (d) | 7,000 | | |
| Bal. | 7,000 | | |

## How is the Statement of Income Prepared and Analyzed ?





## How is the Statement of Income Prepared and Analyzed ?



# How is the Statement of Income Prepared and Analyzed ?

| Statement | Formula |
|---|---|
| #1 Income Statement | Revenues − Expenses = Net Income |
| #2 Statement of Stockholders' Equity | Beginning Retained Earnings + Net Income − Dividends Declared = Ending Retained Earnings<br>Beginning Common Stock + Stock Issuances − Stock Repurchases = Ending Common Stock<br>Ending Stockholders' Equity |
| #3 Balance Sheet | Assets = Liabilities + Stockholders' Equity<br>(includes Cash) |
| #4 Statement of Cash Flows | Cash provided by (or used in) Operating Activities<br>+/− Cash provided by (or used in) Investing Activities<br>+/− Cash provided by (or used in) Financing Activities<br>Change in Cash<br>+ Beginning Cash<br>Ending Cash |





# 1. Statement of Comprehensive Income

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

| | |
|---|---|
| **Operating Revenues** | |
| Restaurant sales revenue | $66,000 |
| Franchise fee revenue | 2,800 |
| Total revenues | 68,800 |
| **Operating Expenses** | |
| 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 |
| Other operating expenses | 0 |
| Total expenses | 51,000 |
| **Operating Income** | 17,800 |
| **Other Items** | |
| Investment income | 1,000 |
| Interest expense | (0) |
| Gain on sale of land | 3,000 |
| Income before Income Taxes | 21,800 |
| Income tax expense | 0 |
| **Net Income** | **$21,800** |
| **Earnings per Share** (for the month) | $ 0.78 |

Note:
*Normally, accounts with zero balances are not included on formal statements. However, we include them here to indicate that there are numerous expenses and revenues to be determined and recorded in the adjustment process described in Chapter 4.*

*$21,800,000 unadjusted net income divided by approximately 28,100,000 shares (from Papa John's annual report)*

# 2. Statement of Shareholders' Equity

PAPA JOHN'S INTERNATIONAL, INC.
**Consolidated Statement of Stockholders' Equity (before adjustments)**
**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 (prior to adjustments) | | 21,800 | 21,800 |
| Dividends declared | | (3,000) | (3,000) |
| Ending balance, January 31, 2009 | $9,000 | $141,800 | $150,800 |

The net income ($21,800) comes from
Statement of Comprehensive Income we just prepared.



AC201 Fundamental Accounting

# 3. Statement of Financial Position

PAPA JOHN'S INTERNATIONAL, INC.
**Consolidated Balance Sheet (before adjustments)**
**January 31, 2009**
**(dollars in thousands)**

| | |
|---|---|
| **ASSETS** | |
| **Current Assets** | |
| Cash | $ 41,900 |
| Accounts receivable | 20,200 |
| Supplies | 16,000 |
| Prepaid expenses | 19,000 |
| Other current assets | 13,000 |
| **Total current assets** | 110,100 |
| Investments | 2,000 |
| Property and equipment (net) | 199,000 |
| Notes receivable | 11,000 |
| Intangibles | 77,000 |
| Other assets | 36,000 |
| **Total Assets** | $435,100 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | |
| **Current Liabilities** | |
| Accounts payable | $ 39,000 |
| Dividends payable | 3,000 |
| Accrued expenses payable | 71,000 |
| **Total current liabilities** | 113,000 |
| Unearned franchise fees | 6,300 |
| Notes payable | 138,000 |
| Other long-term liabilities | 27,000 |
| **Total liabilities** | 284,300 |
| **Stockholders' Equity** | |
| Common Stock | 9,000 |
| Retained earnings | 141,800 |
| **Total stockholders' equity** | 150,800 |
| **Total liabilities and stockholders' equity** | $435,100 |

*From the Statement of Stockholders' Equity*

# 4. Statement of Cash Flows

| Operating activities | | Effect on Cash Flows |
|---|---|---|
| Cash received: | Customers | + |
| | Interest and dividends on investments | + |
| Cash paid: | Suppliers | - |
| | Employees | - |
| | Interest on debt obligations | - |
| | Income taxes | - |
| **Cash Flows from Operating Activities** | | Total |





4. Statement of Cash Flows

Direct approach to preparing operating cash flows.

| | | Effect on Cash Flows |
|---|---|---|
| **Operating activities** | | |
| Cash received: | Customers | + |
| | Interest and dividends on investments | + |
| Cash paid: | Suppliers | - |
| | Employees | - |
| | Interest on debt obligations | - |
| | Income taxes | - |
| **Cash Flows from Operating Activities** | | Total |
| **Investing Activities** | | |
| Purchase of property, plant or equipment | | - |
| Purchase of other long-term assets | | - |
| Sale of property, plant or equipment | | + |
| Sale of other long-term assets | | + |
| **Cash Flows from Investing Activities** | | Total |
| **Financing Activities** | | |
| Issuance of long-term debt | | + |
| Issuance of common stock | | + |
| Dividends paid | | - |
| Repurchase of long-term debt | | - |
| Repurchase of contributed capital | | - |
| **Cash Flows from Financing Activities** | | Total |
| Net increase or (decrease) in cash | | |
| Beginning balance in cash account | | |
| Ending balance in cash account | | |

## Total Asset Turnover Ratio

$$\text{Total Asset Turnover Ratio} = \frac{\text{Sales (or Operating) Revenues}}{\text{Average Total Assets}}$$

(Beginning total assets + ending total assets) ÷ 2

Papa John's Total Asset Turnover Ratio for 2008 (dollars in thousands):

$$\frac{\$1{,}132{,}000}{(\$402{,}000 + \$386{,}000) \div 2} = 2.87$$





## End of Chapter 3