CHAPTER 5

THE ACCOUNTING CYCLE: REPORTING FINANCIAL RESULTS

OVERVIEW OF BRIEF EXERCISES, EXERCISES, PROBLEMS AND CRITICAL THINKING CASES

Brief Exercises	Topic	Learning Objectives	Skills
B. Ex. 5.1	Balancing the accounting equation	1, 2	Analysis
B. Ex. 5.2	Financial statement relationships	1, 2	Analysis
B. Ex. 5.3	Classifying balance sheet accounts	1, 2	Analysis
B. Ex. 5.4	Closing temporary accounts	4	Analysis
B. Ex. 5.5	Closing entries of profitable firms	4	Analysis
B. Ex. 5.6	Closing entries of unprofitable firms	4	Analysis
B. Ex. 5.7	After-closing trial balance	5	Analysis
B. Ex. 5.8	Profitability and liquidity	6	Analysis
B. Ex. 5.9	Measuring interim revenue	7	Analysis
B. Ex. *5.10	The worksheet	8	Judgment, communication, analysis

Exercises	Topic	Learning Objectives	Skills
5.1	Accounting terminology	1-7	Analysis
5.2	Financial statement preparation	1, 2, 6	Analysis
5.3	Financial statement preparation	1, 2, 6	Analysis
5.4	Closing and after-closing trial balance	2, 4, 5	Analysis, communication
5.5	Closing and after-closing trial balance	2, 4, 5	Analysis, communication
5.6	**Real World: Circuit City** Adequate Disclosure	3	Analysis, communication
5.7	Closing entries of profitable firms	2, 4	Analysis
5.8	Closing entries of unprofitable firms	2, 4	Analysis
5.9	Adjusting versus closing entries	2, 4	Analysis, communication
5.10	Profitability and liquidity measures	6	Analysis
5.11	Profitability and liquidity measures	6	Analysis
5.12	Interim results	1, 2, 7	Analysis
5.13	Interim results	1, 2, 7	Analysis
5.14	Effects of accounting errors	2, 3	Analysis
5.15	**Real World: Home Depot, Inc.** Using an annual report	3, 6	Communication, analysis

Supplemental Topic, "The Worksheet."

Problems Sets A, B	Topic	Learning Objectives	Skills
5.1 A,B	Correcting classification errors	1, 2, 4, 6	Analysis, communication
5.2 A,B	Statement preparation and closing process of a profitable firm	1, 2, 4-6	Analysis, communication
5.3 A,B	Statement preparation and closing process of an unprofitable firm	1-4, 6	Analysis, communication
5.4 A,B	Interim financial statements	1, 2, 7	Analysis, communication
5.5 A,B	Comprehensive problem combining Chapter 4 and Chapter 5	1–4, 6	Analysis, communication
5.6 A,B	Comprehensive problem combining Chapter 4 and Chapter 5	1–4, 6	Analysis, communication
*5.7 A,B	Comprehensive problem combining Chapter 4 and Chapter 5	8	Analysis, communication
5.8 A,B	**Real World: Best Buy/The Gap** Evaluating profitability and liquidity	6	Analysis, communication

Critical Thinking Cases			
5.1	Adequate disclosure	3	Analysis, communication
5.2	Conflicts of interest (Ethics, fraud & corporate governance)	1	Communication, judgment, analysis, research
5.3	Sarbanes-Oxley Act: CEO and CFO personal certifications	3	Analysis, judgment, communication
5.4	Sarbanes-Oxley Act: CEO and CFO *(Business Week)*	3	Analysis, judgment, communication, research
5.5	**Real World: Ford Motor Company** Annual report disclosures (Internet)	3	Communication, technology, research

***Supplemental Topic*, "The Worksheet."**

DESCRIPTIONS OF PROBLEMS AND CRITICAL THINKING CASES

Below are brief descriptions of each problem and case. These descriptions are accompanied by the estimated time (in minutes) required for completion and by a difficulty rating. The time estimates assume use of the partially filled-in working papers.

Problems (Sets A and B)

5.1 A,B **Party Wagon, Inc./Strong Knot, Inc.** **20 Easy**
Students are required to correct errors in a set of financial statements. Upon completion of the corrected financial statements, closing entries and a brief financial analysis are required.

5.2 A,B **Lawn Pride, Inc./Garden Wizards** **30 Medium**
Students are required to prepare a set of financial statements for a profitable company from an adjusted trial balance. Closing entries, an after-closing trial balance, and a brief financial analysis are also required.

5.3 A,B **Mystic Masters, Inc./Debit Doctors, Inc.** **45 Strong**
Students are required to prepare a set of financial statements for an unprofitable company from an adjusted trial balance. Closing entries, an after-closing trial balance, and a brief financial analysis are also required.

5.4 A,B **Guardian Insurance Agency/Silver Real Estate** **25 Easy**
Interim financial statements are required for a company that adjusts monthly, but closes at year-end. This problem generates good class discussion.

5.5 A,B **Silver Lining, Inc./Next Job, Inc.** **70 Strong**
This is a comprehensive problem that requires students to combine Chapter 4 material with that of Chapter 5. An unadjusted trial balance is presented. Students are required to prepare adjusting entries and an adjusted trial balance. From their adjusted trial balance they are asked to prepare a set of financial statements, closing entries, an after-closing trial balance, and a brief financial analysis.

5.6 A,B **Brushstroke Art Studio/Touchtone Talent Agency** **70 Strong**
This is a comprehensive problem combining elements of Chapter 4 and Chapter 5. It is similar in format to Problem 5.5 A,B.

***5.7 A,B** **Internet Consulting Service, Inc./Campus Theater** **50 Strong**
This is a comprehensive problem that requires students to combine Chapter 4 material with that of Chapter 5. From an unadjusted trial balance, students are asked to complete a 10-column worksheet.

5.8 A,B **Best Buy/The Gap, Inc.** **15 Medium**
Information from an actual annual report is used to evaluate profitability and solvency.

****Supplemental Topic, "*The Worksheet*."***

Critical Thinking Cases

5.1	**Adequate Disclosure** Students are asked to analyze five items that may (or may not) require disclosure in the notes accompanying the financial statements. Students must defend their position.	**25 Strong**
5.2	**Working for the Competition** **Ethics, Fraud & Corporate Governance** This is a group assignment focusing on the following issues: "Is it ethical for a CPA to provide accounting services to companies that compete with each other?" Interviews are required.	**No time estimate**
5.3	**Sarbanes-Oxley Act and CEO/CFO Certifications** Working in groups, students are required to discuss the meaning, purpose, and impact of CEO/CFO personal certifications required under the Sarbanes-Oxley Act.	**5 Easy**
5.4	**Sarbanes-Oxley Act** ***Business Week*** Students are asked to discuss whether it is ethical for a CFO to transfer personal assets out of his or her name due to being held personally liable for financial irregularities reported by the company for which he or she works.	**10 Medium**
5.5	**Annual Report Disclosures** **Internet** Students must identify and discuss topics disclosed in the company's financial statements. This is a good problem to assign in conjunction with Case 5.1.	**15 Easy**

SUGGESTED ANSWERS TO DISCUSSION QUESTIONS

1. An annual report generally includes comparative financial statements, supporting information about the company's financial position, its business operations, and a discussion by management concerning the company's future prospects. Before the annual report is issued, the financial statements must be audited by a firm of Certified Public Accountants (CPAs). Publicly owned companies must file their financial statements and detailed supporting schedules with the Securities and Exchange Commission (SEC).

2. The income statement's measurement of net income is not absolutely accurate or precise due to various assumptions and estimates involved in the accounting process. For instance, the amounts shown for depreciation expense are based upon estimates of the useful lives of the company's depreciable assets. Also, the income statement includes only those events that have been evidenced by actual business transactions. For instance, a strong customer base is an important step toward profitable operations; however the development of a customer base is not reflected in the income statement because its value cannot be measured *objectively* until actual sales transactions take place.

3. Retained earnings is that portion of stockholders' equity created by earning income and retaining all or part of the resources created in the business. Income is a function of revenue less expenses. We have learned that cash is not always *received* at the exact time that revenue is earned, nor is cash necessarily *disbursed* at the exact time that an expense is incurred. Thus, the income retained by a company is not in the form of *cash.* Even if a company's income *did* equal its net cash inflow, the amount retained would not be kept in the form of cash. As the company grew, the cash would be converted into property, plant, equipment, and other assets.

4. Dividends are not *part* of income. As such, the dividends paid to stockholders are never reported in the income statement as an expense. Dividends represent a policy decision by a corporation's directors to distribute a portion of income to stockholders.

5. The income statement, statement of retained earnings, and balance sheet are prepared directly from the amounts shown in the adjusted trial balance. The income statement reports revenue earned during the period less expenses incurred in generating that revenue. When revenue exceeds expenses, net income is reported, and an increase in stockholders' equity results. When expenses exceed revenue, a net loss is reported, and a decrease in stockholders' equity results. The net income (or net loss) from the income statement is *added* to the beginning Retained Earnings balance in the statement of retained earnings. Any dividends declared during the period are subtracted in arriving at the ending Retained Earnings balance to be reported in the balance sheet at the end of the period.

6. Items that may require disclosure include, but are not limited to: pending lawsuits, scheduled plant closings, certain governmental investigations, significant events occurring after the balance sheet date but before the statements are issued, specific customers that account for a large portion of the company's business, names of stockholders that own large amounts of the company's stock, any changes in accounting principles having a significant impact on the company's financial position, and any unusual conflicts between the company and its officers.

7. Temporary (or nominal) accounts include revenue, expenses, and dividend accounts. These are the accounts involved in the closing process at the end of the year. Generally speaking, all *income statement* accounts (and dividends reported in the statement of retained earnings) are considered temporary.

8. Permanent (or real) accounts include assets, liability, and stockholders' equity accounts. These accounts are *not* involved in the closing process at the end of the year. Generally speaking, all accounts reported in the *balance sheet* (and in the after-closing trial balance) are considered permanent.

9. Dividends paid to stockholders are *not* considered an expense of the business and, therefore, are not taken into account in determining net income for the period. Since dividends are not an expense, the Dividends account is not closed to the Income Summary account. Instead, it is closed directly to the Retained Earnings account.

10. After all revenue, expense, and dividend accounts have been closed, the only accounts that remain are the permanent (or real) accounts appearing in the balance sheet. In comparison to the adjusted trial balance, the after-closing trial balance contains *only* balance sheet accounts. Also, the Retained Earnings account is no longer reported at its *beginning* balance.

11. A company *can* be both profitable and insolvent. For instance, the company's sales might be made only on account. If customers delay in paying what they owe, the average number of days that accounts receivable remain outstanding could be very high (say, 120 days). At the same time, the company's creditors may require payment at a much faster rate, say, 30 days. Thus even though this business might be *profitable* (i.e., its revenue exceed its expenses), it may not be able to remain *solvent* if its accounts receivable fail to convert to cash in time to settle its accounts payable.

12. A company may close its accounts annually, but prepare financial reports monthly or quarterly. These monthly (or quarterly) statements are referred to as *interim* financial statements. General ledger accounts to be reported in the interim *income statement* require certain computations in order to determine their correct monthly or quarterly amounts. Computations are *not* required to ascertain interim balance sheet amounts because the balance is always based on the account balances *at the balance sheet date.*

13. *Adequate disclosure* means that financial statements should include whatever supplemental information is necessary for an intelligent user to interpret the statements properly.

14. The *notes* accompanying financial statements include whatever disclosures are necessary for users to interpret the statements properly. Among the facts disclosed in notes are the accounting methods in use, due dates of major liabilities, significant events occurring after the balance sheet date, and litigation pending against the company. The notes *do not* include disclosure of items that are *immaterial,* or which do not directly affect the financial position of the business.

15. Unlike most other operating expenses, depreciation does not require regular periodic outlays of cash. Depreciation is merely an estimate of that portion of a depreciable asset's cost which is to be matched against revenue earned during the current accounting period.

16. Revenue, expense, and dividend accounts are called temporary accounts, or nominal accounts, because they accumulate the transactions of only one accounting period. At the end of the period, the changes in owners' equity accumulated in these temporary accounts need to be transferred to the Retained Earnings account, and the temporary accounts need to have *zero balances* in order to be ready to measure the revenue, expenses, and dividends of the next accounting period. The closing process serves these purposes. Revenue and expense accounts are first closed to the Income Summary account which, in turn, is closed to the Retained Earnings account. Any dividends declared during the period are then closed directly to the Retained Earnings account.

17. Virtually every accounting software package performs the year-end closing process automatically without having to perform manually the series of journal entries illustrated in the text. When a business first purchases a software package accountants prepare a chart of accounts specifically tailored for the reporting needs of the company. During this process, revenue and expense accounts are identified as candidates for closing at year-end. The software is written such that those accounts identified as revenues are closed with debits, and those identified as expenses are closed with credits.

18. Income statements report business activity for a *period* of time (e.g., a month, quarter, year, etc.). Balance sheets report financial position at a specific *point* in time. Thus, the balance sheet always is based on account balances at the balance sheet date. A March 31 balance sheet, for example, looks exactly the same regardless of the time period covered by the other financial statements (i.e., the income statement, statement of retained earnings, and statement of cash flows).

19. Return on equity is a measure of net income relative to a company's average stockholders' equity throughout the year. Thus, it conveys the amount of income generated for every dollar of equity capital. A high return on equity indicates that management efficiently used resources provided through owners' equity to generate income. A low return on equity indicates that management was not efficient in using resources provided through owners' equity to generate income.

***20.** A worksheet (or spreadsheet software):

- Provides a "scratch pad" for working out adjusting entries prior to actually entering these items in the accounts.
- Enables accountants to prepare interim financial statements without formally adjusting and closing the accounts.
- Without affecting the account balances, provides both accountants and management with a "preview" of the effects of proposed entries upon the financial statements.

Supplemental Topic, "**The Worksheet*****."***

SOLUTIONS TO BRIEF EXERCISES

B. Ex. 5.1

Decrease in assets during the year…………………..	**$**	**(60,000)**
Decrease in liabilities during the year……………….		**(300,000)**
Increase in stockholders' equity during the year……	**$**	**240,000**
Less: New stock issued during the year……………		**(100,000)**
Income for the year……………………………..		**(250,000)**
Decrease to equity attributed to dividends…………	**$**	**(110,000)**

B. Ex. 5.2

Capital stock (January 1, 2009)…………………….	**$**	**200,000**
Capital stock issued during the year………………		**60,000**
Capital stock (December 31, 2009)………………..	**$**	**260,000**
Add: Retained earnings (December 31, 2009)……		**90,000**
Total stockholders' equity (December 31, 2009)….	**$**	**350,000**

Note: The depreciation of the truck is included in the net income which is included in the ending retained earnings given. Likewise, the dividend is also included in the ending retained earnings figure given.

B. Ex. 5.3

a. **CA**
b. **CL**
c. **CL**
d. **NCA***
e. **SHE**
f. **LTL**
g. **CL**
h. **CA**
i. **NCA**
j. **CA**

*** Accumulated depreciation is a *contra asset* classified in the non current asset section of the balance sheet.**

B. Ex. 5.4

a. **C**
b. **N**
c. **D**
d. **C**
e. **C**
f. **N**
g. **D**
h. **N**
i. **C**
j. **N**
k. **D**
l. **C**

B. Ex. 5.5	**Service Revenue ………………………………………………**	**19,800**	
	Income Summary …………………………		**19,800**
	To close revenue to income summary.		
	Income Summary……………………….…………………..	**18,700**	
	Supplies Expense……………………………		**525**
	Rent Expense………………………………		**3,660**
	Depreciation Expense: Equipment………		**1,200**
	Salaries Expense…………………………..		**12,700**
	Income Taxes Expense…………………..		**615**
	To close expense accounts to income summary.		
	Income Summary…………………………………………….	**1,100**	
	Retained Earnings…………………………		**1,100**
	To transfer net income to retained earnings.		
	Retained Earnings……………………………………………	**600**	
	Dividends…………………………………..		**600**
	To close dividends to retained earnings.		
B. Ex. 5.6	**Consulting Fees Earned…………………………………….**	**26,000**	
	Interest Revenue……………………………………………	**300**	
	Income Summary…………………………..		**26,300**
	To close revenue to income summary.		
	Income Summary……………………………………………..	**34,700**	
	Insurance Expense………………………..		**1,900**
	Rent Expense……………………………..		**10,800**
	Depreciation Expense: Office Equip. …..		**5,600**
	Salaries Expense…………………………..		**16,400**
	To close expense accounts to income summary.		
	Retained Earnings…………………………………………….	**8,400**	
	Income Summary…………………………..		**8,400**
	To transfer net loss to income summary.		
	Retained Earnings…………………………………………..	**400**	
	Dividends…………………………………..		**400**
	To close dividends to retained earnings.		

B. Ex. 5.7

a.	C
b.	C
c.	D
d.	N
e.	C
f.	N
g.	N
h.	C
i.	D
j.	N
k.	C
l.	C

B. Ex. 5.8

a.	Net Income ($15,000) ÷ Total Revenue ($60,000)….		25%
b.	Net Income ($15,000) ÷ Average Equity ($37,500)….		40%
c.	Current Assets ($16,000) ÷ Current Liab. ($4,000)		4-to-1
	Computations:		
	Total revenue…………………………………		60,000
	Total expenses……………………………….	$	(45,000)
	Net income……………………………………		15,000
	Stockholders' equity (January 1, 2009)……………	$	37,000
	Stockholders' equity (December 31, 2009)……….		38,000
			75,000
			÷ 2
	Average stockholders' equity in 2009		37,500

B. Ex. 5.9

a.	April through September ($450,000 - $140,000)….	$	310,000
b.	October through December ($680,000 - $450,000)..	$	230,000
c.	April through December ($680,000 - $140,000)……	$	540,000

***B. Ex.5.10**

a.	Net income ($540,000 - $410,000)…………………	$	130,000 [1]
b.	Income statement debits ($380,000 - $130,000)….	$	250,000 [2]

[1] The amount needed to make the columns of the balance sheet equal is net income for the period.

[2] The credit column of the income statement represents total revenue whereas the debit column amount represents total expenses. Thus, total revenue ($380,000 credit column amount) minus net income ($130,000 computed in part a.), equals total expenses (i.e., the income statement debit column total).

**Supplemental Topic, "The Worksheet."*

SOLUTIONS TO EXERCISES

Ex 5.1

- **a.** **Adequate disclosure**
- **b.** **Liquidity**
- **c.** **Nominal accounts**
- **d.** **Real accounts**
- **e.** **After-closing trial balance**
- **f.** **Dividends**
- **g.** **Closing entries**
- **h.** **None (This is an example of a "correcting entry.")**

Ex. 5.2
a.

TUTORS FOR RENT, INC.		
Income Statement		
For the Year Ended December 31, 2009		
Revenues:		
Tutoring revenue earned		**$ 96,000**
Expenses:		
Salary expense	**$ 52,000**	
Supply expense	**1,200**	
Advertising expense	**300**	
Depreciation expense: equipment	**1,000**	**54,500**
Income before taxes		**$ 41,500**
Income taxes expense		**11,600**
Net income		**$ 29,900**

TUTORS FOR RENT, INC.		
Statement of Retained Earnings		
For the Year Ended December 31, 2009		
Retained earnings (1/1/09)		**$ 45,000**
Add: Net Income		**29,900**
Less: Dividends		**2,000**
Retained earnings (12/31/09)		**$ 72,900**

Ex. 5.2 (concluded)

TUTORS FOR RENT, INC.		
Balance Sheet		
December 31, 2009		
Assets		
Cash		$ 91,100
Accounts receivable		4,500
Supplies		300
Equipment	$ 12,000	
Less: Accumulated depreciation: equipment	5,000	7,000
TOTAL ASSETS		$ 102,900
Liabilities		
Accounts payable		$ 1,500
Income taxes payable		3,500
TOTAL LIABILITIES		$ 5,000
Stockholders' Equity		
Capital stock		$ 25,000
Retained earnings		72,900
TOTAL STOCKHOLDERS' EQUITY		$ 97,900
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY		$ 102,900

b. **The company appears to be extremely liquid. Cash and accounts receivable comprise 93% of total assets. Together, these highly liquid assets total $95,600, compared to only $5,000 in liabilities coming due. In other words, the combined total of cash and accounts receivable are 19 times the obligations coming due in the near future.**

c. **The $45,000 credit Retained Earnings balance reported in the company's adjusted trial balance is its *beginning* balance. In order to have retained $45,000 in earnings, the company must have been profitable in the past.**

Ex. 5.3

a.

WILDERNESS GUIDE SERVICES, INC.		
Income Statement		
For the Year Ended December 31, 2009		
Revenues:		
Guide revenue earned		**$ 102,000**
Expenses:		
Salary expense	**$ 87,500**	
Camping supply expense	**1,200**	
Insurance expense	**9,600**	
Depreciation expense: equipment	**5,000**	
Interest expense	**1,700**	**105,000**
Net Loss		**$ (3,000)**

WILDERNESS GUIDE SERVICES, INC.		
Statement of Retained Earnings		
For the Year Ended December 31, 2009		
Retained earnings (1/1/09)		**$ 15,000**
Less: Net loss		**3,000**
Less: Dividends		**1,000**
Retained earnings (12/31/09)		**$ 11,000**

Ex. 5.3 (Concluded)

		WILDERNESS GUIDE SERVICES, INC.		
		Balance Sheet		
		December 31, 2009		
		Assets		
		Cash		**$ 12,200**
		Accounts receivable		**31,000**
		Camping supplies		**7,900**
		Unexpired insurance policies		**2,400**
		Equipment	**$ 70,000**	
		Less: Accumulated depreciation: equipment	**60,000**	**10,000**
		TOTAL ASSETS		**$ 63,500**
		Liabilities		
		Notes payable (due 4/1/10)		**$ 18,000**
		Accounts payable		**9,500**
		TOTAL LIABILITIES		**$ 27,500**
		Stockholders' Equity		
		Capital stock		**$ 25,000**
		Retained earnings		**11,000**
		TOTAL STOCKHOLDERS' EQUITY		**$ 36,000**
		TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY		**$ 63,500**

b. **The company appears to be liquid. Cash and accounts receivable comprise 68% of the company's total assets. These highly liquid assets total $43,200, in comparison to $27,500 in liabilities coming due in the near future. However, given that its equipment is nearly *fully depreciated*, it *may* have to invest in new equipment shortly.**

c. **The company was *not* profitable in the current period as evidenced by the $3,000 *net loss* reported in the income statement. However, the $15,000 credit Retained Earnings balance reported in the company's adjusted trial balance is the balance *carried forward* from prior years. In order to have retained $15,000 in earnings, the company must have been profitable in the past.**

Ex. 5.4

a.

		TUTORS FOR RENT		
		General Journal		
		December 31, 2009		
		(1)		
Dec.	**31**	**Tutoring Revenue earned**	**96,000**	
		Income Summary		**96,000**
		To close Tutoring Revenue Earned		
		(2)		
	31	**Income Summary**	**66,100**	
		Salary Expense		**52,000**
		Supply Expense		**1,200**
		Advertising Expense		**300**
		Depreciation Expense: Equipment		**1,000**
		Income Taxes Expense		**11,600**
		To close all expense accounts.		
		(3)		
	31	**Income Summary**	**29,900**	
		Retained Earnings		**29,900**
		To transfer net income earned in 2009 to the		
		Retained Earnings account ($96,000-$66,100 =		
		$29,900).		
		(4)		
	31	**Retained Earnings**	**2,000**	
		Dividends		**2,000**
		To transfer dividends declared in 2009 to the		
		Retained Earnings account.		

Ex. 5.4 (Concluded)

b.

		TUTORS FOR RENT, INC.		
		After-Closing Trial Balance		
		December 31, 2009		
		Cash	**$ 91,100**	
		Accounts receivable	**4,500**	
		Supplies	**300**	
		Equipment	**12,000**	
		Less: Accumulated depreciation: equipment		**$ 5,000**
		Accounts payable		**1,500**
		Income taxes payable		**3,500**
		Capital stock		**25,000**
		Retained earnings		**$ 72,900**
		Totals	**$ 107,900**	**$ 107,900**

c. **The $72,900 Retained Earnings balance reported in the after-closing trial balance is $27,900 *more* than the $45,000 balance reported in the unadjusted trial balance. By *adding* net income to the Retained Earnings balance in the unadjusted trial balance, and *subtracting* dividends, one arrives at the $72,900 reported in the after-closing trial balance ($45,000 + $29,900 - $2,000 = $72,900).**

Ex. 5.5

a.

WILDERNESS GUIDE SERVICES, INC.				
General Journal				
December 31, 2009				
		(1)		
Dec.	**31**	**Guide Revenue Earned**	**102,000**	
		Income Summary		**102,000**
		To close Guide Revenue Earned.		
		(2)		
	31	**Income Summary**	**105,000**	
		Salary Expense		**87,500**
		Camping Supply Expense		**1,200**
		Insurance Expense		**9,600**
		Depreciation Expense: Equipment		**5,000**
		Interest Expense		**1,700**
		To close all expense accounts.		
		(3)		
	31	**Retained Earnings**	**3,000**	
		Income Summary		**3,000**
		To transfer net loss incurred in 2009 to the		
		Retained Earnings account ($102,000 - $105,000 =		
		$3,000 loss).		
		(4)		
	31	**Retained Earnings**	**1,000**	
		Dividends		**1,000**
		To transfer dividends declared in 2009 to the		
		Retained Earnings account.		

Ex. 5.5 (Concluded)

b.

		WILDERNESS GUIDE SERVICES, INC.		
		After-Closing Trial Balance		
		December 31, 2009		
		Cash	$ 12,200	
		Accounts receivable	31,000	
		Camping supplies	7,900	
		Unexpired insurance policies	2,400	
		Equipment	70,000	
		Accumulated depreciation: equipment		$ 60,000
		Notes payable (due 4/1/10)		18,000
		Accounts payable		9,500
		Capital stock		25,000
		Retained earnings		11,000
		Totals	$ 123,500	$ 123,500

c. **The $11,000 Retained Earnings balance reported in the after-closing trial balance is $4,000 *less* than the $15,000 balance reported in the unadjusted trial balance. By *subtracting* both the net loss and dividends from the Retained Earnings balance in the unadjusted trial balance, one arrives at the $11,000 reported in the after-closing trial balance ($15,000 - $3,000 - $1,000 = $11,000).**

Ex. 5.6 a. 1. Circuit City recognizes revenue when the earnings process is complete. This means that revenue is recorded at the time customers receive their products.

2. The earnings process is not complete when the company first receives cash for gift cards. This is because no products have been delivered. Thus, as gift cards are sold, the company debits Cash and credits Unearned Revenue. As gift card recipients use their cards to purchase products, the company debits Unearned Revenue and credits Revenue Earned (Sales).

3. The company records advertising expense in the period that it purchases advertisements in various media (e.g., radio, newspaper, etc.). Thus, when it pays for advertising it debits Advertising Expense and credits Cash.

4. The company matches the cost of property and equipment to the periods in which it contributes to generating revenue. It does so by dividing the cost of property and equipment by its estimated life and charging the result to depreciation expense each period.

b.

1.	Cash……………………………………………	500	
	Unearned Revenue……………………		500
	To record the sale of a $500 gift card.		
2.	Unearned Revenue…………………………	500	
	Sales (Revenue)………………………		500
	To record the redemption of a $500 gift card.		

c. Circuit City matches advertising expense to revenue in the period that it pays for advertising. The alternative would be to debit Prepaid Advertising when payment is made, and later debit Advertising Expense and credit Prepaid Advertising when the ads are aired or appear in print. Differences in these two alternatives are not considered material, so Circuit City takes the simpler approach of expensing advertising costs immediately.

Ex. 5.7	**a.**	**Counseling Revenue……**	**225,000**	
		Income Summary……		**225,000**
		To close counseling revenue earned.		
		Close all expenses to the Income summary account:		
		Income Summary……	**170,400**	
		Advertising Expense……		**1,800**
		Salaries Expense……		**94,000**
		Office Supplies Expense……		**1,200**
		Utilities Expense……		**850**
		Malpractice Insurance Expense……		**6,000**
		Office Rent Expense……		**24,000**
		Continuing Education Expense……		**2,650**
		Depreciation Expense: Fixtures……		**4,500**
		Miscellaneous Expense……		**6,000**
		Income Taxes Expense……		**29,400**
		To close all expense accounts.		
		Income Summary……	**54,600**	
		Retained Earnings……		**54,600**
		To transfer net income earned in 2009 ($225,000 - $170,400) to Retained Earnings.		
		Retained Earnings……	**6,000**	
		Dividends……		**6,000**
		To close dividends declared in 2009 to Retained Earnings.		

b.	**Retained Earnings, January 1, 2009**	**$ 92,000**
	Plus: Net Income	**54,600**
		$ 146,600
	Less: Dividends Declared in 2009	**(6,000)**
	Retained Earnings, December 31, 2009	**$ 140,600**

Ex. 5.8	**a.**	**Consulting Revenue - Individual Clients……………..**	**40,000**	
		Consulting Revenue - Corporate Clients……………..	**160,000**	
		Income Summary……………………………………		**200,000**
		To close revenue accounts to income summary.		
		Income Summary……………………………………………	**275,000**	
		Advertising Expense…………………………………		**16,000**
		Depreciation Expense: Computers...…………..		**24,000**
		Rent Expense………………………………….		**9,600**
		Office Supplies Expense…………………………		**4,400**
		Travel Expense………………………………..		**57,800**
		Utilities Expense…………………………………		**3,300**
		Telephone and Internet Expense………………		**1,900**
		Salaries Expense……………………………..		**155,500**
		Interest Expense……………………………..		**2,500**
		To close expense accounts to income summary.		
		Retained Earnings…………………………………….	**75,000**	
		Income Summary…………………………………		**75,000**
		To transfer a net loss for the period to retained earnings.		
		Retained Earnings…………………………………………	**25,000**	
		Dividends………………………………………….		**25,000**
		To close dividends to retained earnings.		

b.	**Retained Earnings, (January 1, 2009)………...……**		**$ 300,000**
	Less:	**Net loss in 2009……………………………….**	**(75,000)**
		Dividends in 2009……………………………….	**(25,000)**
	Retained Earnings, December 31, 2009		**$ 200,000**

Ex. 5.9	**a.**	**Insurance Expense……………………………………………**	**600**	
		Unexpired Insurance…………………………………		**600**
		To record insurance expense for December.		
	b.	**Income Summary………………………………………………**	**3,000**	
		Insurance Expense……………………………………		**3,000**
		To close Insurance Expense (5 months) to Income Summary.		

c. **No, the dollar amounts are not the same in the adjusting and closing entries. The accounts are adjusted *monthly;* therefore the adjusting entry reflects insurance expense for one month ($600). The books are closed *annually.* By December 31, five months' insurance expense ($3,000) has been recognized for the period August through December.**

Ex. 5.10 a. Net Income ($5,100) ÷ Total Revenue ($25,500) **20%**

Significance: **All companies must consume resources (incur costs) in order to generate revenue. The net income percentage is a measure of management's ability to control these costs and use resources efficiently to generate revenue.**

b. Net Income ($5,100) ÷ Average Equity ($17,000) **30%**

Significance: **Return on equity is a measure of net income relative to a company's stockholders' equity throughout the year. Thus, it reports how much income is generated for every dollar of equity capital.**

c. Current Assets ($16,000) - Current Liabilities ($4,000) **$ 12,000**

Significance: **Current assets often convert to cash in the near future, whereas current liabilities often consume cash in the near future. Thus, working capital is a measure of a company's short-term liquidity.**

d. Current Assets ($16,000) ÷ Current Liabilities ($4,000) **4-to-1**

Significance: **The current ratio is simply working capital expressed as a proportion. Thus, it is also a measure of short-term liquidity.**

Based on the above measures, this company appears to be profitable and potentially liquid.

Computations:

Total revenue…………………………………	$	25,500
Total expenses……………………………….		(20,400)
Net income……………………………………	$	5,100
Stockholders' equity (January 1, 2009)…	$	14,800
Stockholders' equity (December 31, 2009)..		19,200
	$	34,000
		÷ 2
Average stockholders' equity in 2009	$	17,000
Total assets…………………………….……	$	23,200
Less: Equipment (net of depreciation)…		(7,200)
Current assets………………………………	$	16,000

Ex. 5.11 **a.** **Net Income ($3,040) ÷ Total Revenue ($152,000)** **2%**

Significance: **All companies must consume resources (incur costs) in order to generate revenue. The net income percentage is a measure of management's ability to control these costs and use resources efficiently to generate revenue.**

b. **Net Income ($3,040) ÷ Average Equity ($80,000)** **3.8%**

Significance: **Return on equity is a measure of net income relative to a company's stockholders' equity throughout the year. Thus, it reports how much income is generated for every dollar of equity capital.**

c. **Current Assets ($94,000) - Current Liabilities ($235,000)** **$ (141,000)**

Significance: **Current assets often convert to cash in the near future, whereas current liabilities often consume cash in the near future. Thus, working capital is a measure of a company's short-term liquidity.**

d. **Current Assets ($94,000) ÷ Current Liabilities ($235,000)** **0.4-to-1**

Significance: **The current ratio is simply working capital expressed as a proportion. Thus, it is also a measure of short-term liquidity.**

Based on the above measures, this company appears to be marginally profitable but heading for liquidity problems.

Computations:

Total revenue……………………………………	**$**	**152,000**
Total expenses………………………………		**(148,960)**
Net income…………………………………..	**$**	**3,040**
Stockholders' equity (January 1, 2009)…	**$**	**79,000**
Stockholders' equity (December 31, 2009)…		**81,000**
		160,000
		÷ 2
Average stockholders' equity in 2009	**$**	**80,000**
Total assets………………………………..…	**$**	**316,000**
Less: Equipment (net of depreciation)…		**(222,000)**
Current assets………………………………..	**$**	**94,000**

Ex. 5.12 **a.** **(1)** **Lift Ticket Revenue, $210,000 ($850,000 – $640,000)**

(2) **Cash, $116,000**

b. **(1)** **Lift Ticket Revenue, $960,000 ($990,000 – $30,000)**

(2) **Cash, $138,000**

c. **January was the best month with respect to lift ticket revenue ($640,000 – $200,000 = $440,000). December, however, was the best month with respect to net cash flow ($59,000 – $9,000 = $50,000).**

Ex. 5.13 **a.** **Ranking of profitability by quarter (revenue minus expenses):**

4th quarter ($90,000 - $45,000)……………………………….	$	45,000
1st quarter (69,000 - $48,000)…………………………………		21,000
2nd quarter ($60,000 - $42,000)……………………………….		18,000
3rd quarter ($30,000 - $40,000)……………………………….		(10,000)
Profit for the year ending December 31 ($249,000 - $175,000)	$	74,000

Computations:

Revenue by Quarter		
January - March	$	69,000
April - June ($129,000 - $69,000)		60,000
July - Sept. ($159,000 - $129,000)		30,000
Oct. - Dec. ($249,000 - $159,000)		90,000
Total revenue for the year	$	249,000

Expenses by Quarter		
January - March	$	48,000
April - June ($90,000 - $48,000)		42,000
July - Sept. ($130,000 - 90,000)		40,000
Oct. - Dec. ($175,000 - $130,000)		45,000
Total expenses for the year	$	175,000

b.

September revenue ($159,000 - $134,000)	$	25,000
September expenses ($130,000 - $115,000)		(15,000)
September income	$	10,000

c.

Third quarter loss (part a.)	$	(10,000)
Less: September income (part b.)		(10,000)
Loss in July and August	$	(20,000)

Given that this business provides janitorial services to schools, the poor performance in July and August is probably attributable to schools not being in session.

Ex. 5.14

	Error	Net Income	Total Assets	Total Liabilities	Retained Earnings
a.	**Recorded a dividend as an *expense* in the income statement**	**U**	**NE**	**NE**	**NE**
b.	**Recorded unearned revenue as earned revenue in the income statement.**	**O**	**NE**	**U**	**O**
c.	**Failed to record accrued wages payable at the end of the period.**	**O**	**NE**	**U**	**O**
d.	**Recorded a declared but unpaid dividend by debiting Dividends and crediting Cash.**	**NE**	**U**	**U**	**NE**
e.	**Failed to disclose a pending lawsuit in the notes accompanying the financial statements.**	**NE**	**NE**	**NE**	**NE**

Ex. 5.15 a. The company uses straight-line depreciation as discussed in the Summary of Significant Accounting Policies section of the notes accompanying the financial statements.

b. Revenue is recognized at the time customers take possession of merchandise or receive services. Cash received prior to this point is reported as Deferred Revenue in the liability section of the balance sheet.

c. Profitability:

Net income for the year ended February 3, 2008, was $4.395 billion, which was $1.366 billion less than the year ended January 28, 2007, and $1.443 billion less than the year ended January 29, 2006. Gross profit as a percentage of sales for the year ended February 3, 2008 was 34%, virtually unchanged from the previous two years reported. Net income as a percentage of stockholder investment for the year ended February 3, 2008, was an impressive 25%.

Liquidity:

The current ratio at February 3, 2008, was approximately 1.15-to-1, down from 1.39-to-1 reported at the end of the previous year. Cash flows from operating activities for the year ended February 3, 2008, were $5.727 billion, down from $7.661 billion reported in the previous year.

SOLUTIONS TO PROBLEMS SET A

20 Minutes, Easy

PROBLEM 5.1A
PARTY WAGON, INC.

a.

		PARTY WAGON, INC.		
		Income Statement		
		For the Year Ended December 31, 2009		
		Revenues:		
		Party revenue earned		**$ 130,000**
		Expenses:		
		Insurance expense	**$ 1,800**	
		Office rent expense	**12,000**	
		Supplies expense	**1,200**	
		Salary expense	**75,000**	
		Depreciation expense: van	**8,000**	
		Depreciation expense: equipment & music	**7,000**	
		Repair & maintenance expense	**2,000**	
		Travel expense	**6,000**	
		Miscellaneous expense	**3,600**	
		Interest expense	**4,400**	**121,000**
		Income before taxes		**$ 9,000**
		Income taxes expense		**2,000**
		Net income		**$ 7,000**

		PARTY WAGON, INC.		
		Statement of Retained Earnings		
		For the Year Ended December 31, 2009		
		Retained earnings (1/1/09)		**$ 15,000**
		Add: Net Income		**7,000**
		Less: Dividends		**1,000**
		Retained earnings (12/31/09)		**$ 21,000**

PROBLEM 5.1A
PARTY WAGON, INC. (continued)

a. (cont'd)

		PARTY WAGON, INC.		
		Balance Sheet		
		December 31, 2009		
		Assets		
		Cash		$ 15,000
		Accounts receivable		9,000
		Unexpired insurance		4,500
		Prepaid rent		2,000
		Supplies		500
		Van	$ 40,000	
		Less: Accumulated depreciation: van	16,000	24,000
		Equipment & music	35,000	
		Less: Accumulated depreciation: equipment & music	14,000	21,000
		TOTAL ASSETS		$ 76,000
		Liabilities		
		Accounts payable		$ 7,000
		Notes payable		39,000
		Salaries payable		1,600
		Interest payable		200
		Income taxes payable		400
		Unearned party revenue		1,800
		TOTAL LIABILITIES		$ 50,000
		Stockholders' Equity		
		Capital stock		$ 5,000
		Retained earnings		21,000
		TOTAL STOCKHOLDERS' EQUITY		$ 26,000
		TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY		$ 76,000

b.

		PARTY WAGON, INC.		
		General Journal		
		December 31, 2009		
		(1)		
Dec.	31	Party Revenue Earned	130,000	
		Income Summary		130,000
		To close Party Revenue Earned.		
		(2)		
	31	Income Summary	123,000	
		Insurance Expense		1,800
		Office Rent Expense		12,000
		Supplies Expense		1,200
		Salaries Expense		75,000
		Depreciation Expense: Van		8,000
		Depreciation Expense: Equip. & Music		7,000
		Repair & Maintenance Expense		2,000
		Travel Expense		6,000
		Miscellaneous Expense		3,600
		Interest Expense		4,400
		Income Taxes Expense		2,000
		To close all expense accounts.		
		(3)		
	31	Income Summary	7,000	
		Retained Earnings		7,000
		To transfer net income earned in 2009 to the		
		Retained Earnings account ($130,000 - $123,000 =		
		$7,000).		
		(4)		
	31	Retained Earnings	1,000	
		Dividends		1,000
		To transfer dividends declared in 2009 to the		
		Retained Earnings account.		

c. For the year ended December 31, 2009, the company generated net income of $7,000 on $130,000 sales. Thus, net income as a percentage of sales was approximately 5.4%. Moreover, the $7,000 profit represented a 27% return on stockholders' equity, which is a fairly strong return on investment. The company's balance sheet at December 31, 2009, reports cash and accounts receivable totaling $24,000. It also reports various payables (liabilities) totaling $48,200. Thus, the company may or *may not* currently be liquid depending on when the $39,000 note payable reported in the balance sheet is due. If this obligation is *not* due in the near future, then the company appears to be solvent. If, however, this note is due shortly, the company may experience some cash flow difficulty.

30 Minutes, Medium

PROBLEM 5.2A
LAWN PRIDE, INC.

a.

LAWN PRIDE, INC.		
Income Statement		
For the Year Ended December 31, 2009		
Revenues:		
Mowing revenue earned		$ 170,000
Expenses:		
Insurance expense	$ 2,400	
Office rent expense	36,000	
Supplies expense	5,200	
Salary expense	60,000	
Depreciation expense: trucks	30,000	
Depreciation expense: mowing equipment	4,000	
Repair & maintenance expense	3,000	
Fuel expense	1,500	
Miscellaneous expense	5,000	
Interest expense	3,000	150,100
Income before taxes		$ 19,900
Income taxes expense		6,000
Net income		$ 13,900

LAWN PRIDE, INC.		
Statement of Retained Earnings		
For the Year Ended December 31, 2009		
Retained earnings (1/1/09)		$ 30,000
Add: Net Income		13,900
Less: Dividends		5,000
Retained earnings (12/31/09)		$ 38,900

PROBLEM 5.2A
LAWN PRIDE, INC. (continued)

a. (cont'd)

		LAWN PRIDE, INC.		
		Balance Sheet		
		December 31, 2009		
		Assets		
		Cash		$ 58,525
		Accounts receivable		4,800
		Unexpired insurance		8,000
		Prepaid rent		3,000
		Supplies		1,075
		Trucks	$ 150,000	
		Less: Accumulated depreciation: trucks	120,000	30,000
		Mowing equipment	20,000	
		Less: Accumulated depreciation: mowing equipment	12,000	8,000
		TOTAL ASSETS		$ 113,400
		Liabilities		
		Accounts payable		$ 1,500
		Notes payable		50,000
		Salaries payable		900
		Interest payable		150
		Income taxes payable		1,050
		Unearned mowing revenue		900
		TOTAL LIABILITIES		$ 54,500
		Stockholders' Equity		
		Capital stock		$ 20,000
		Retained earnings		38,900
		TOTAL STOCKHOLDERS' EQUITY		$ 58,900
		TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY		$ 113,400

PROBLEM 5.2A
LAWN PRIDE, INC. (continued)

b.

		LAWN PRIDE, INC.		
		General Journal		
		December 31, 2009		
		(1)		
Dec.	31	Mowing Revenue Earned	170,000	
		Income Summary		170,000
		To close Mowing Revenue Earned.		
		(2)		
	31	Income Summary	156,100	
		Insurance Expense		2,400
		Office Rent Expense		36,000
		Supplies Expense		5,200
		Salary Expense		60,000
		Depreciation Expense: Trucks		30,000
		Depreciation Expense: Mowing Equip.		4,000
		Repair & Maintenance Expense		3,000
		Fuel Expense		1,500
		Miscellaneous Expense		5,000
		Interest Expense		3,000
		Income Taxes Expense		6,000
		To close all expense accounts.		
		(3)		
	31	Income Summary	13,900	
		Retained Earnings		13,900
		To transfer net income earned in 2009 to the		
		Retained Earnings account ($170,000 - $156,100 =		
		$13,900).		
		(4)		
	31	Retained Earnings	5,000	
		Dividends		5,000
		To transfer dividends declared in 2009 to the		
		Retained Earnings account.		

PROBLEM 5.2A
LAWN PRIDE, INC. (concluded)

c.

LAWN PRIDE, INC.		
After-Closing Trial Balance		
December 31, 2009		
Cash	$ 58,525	
Accounts receivable	4,800	
Unexpired insurance	8,000	
Prepaid rent	3,000	
Supplies	1,075	
Trucks	150,000	
Accumulated depreciation: trucks		$ 120,000
Mowing equipment	20,000	
Accumulated depreciation: mowing equipment		12,000
Accounts payable		1,500
Notes payable		50,000
Salaries payable		900
Interest payable		150
Income taxes payable		1,050
Unearned mowing revenue		900
Capital stock		20,000
Retained earnings		38,900
Totals	$ 245,400	$ 245,400

d. **For the year ended December 31, 2009, the company generated net income of $13,900 on $170,000 sales. Thus, net income as a percentage of sales was approximately 8.2%. Moreover, the $13,900 profit represented a return on stockholders' equity of approximately 25.5%, which is a fairly strong return on investment. The company's balance sheet at December 31, 2009, reports cash and accounts receivable totaling $63,325. It also reports various payables (liabilities) totaling $53,600. Depending on when the $50,000 note payable reported in the balance sheet is due, the company may be *extremely liquid*. If this obligation is *not* due in the near future, the company has $63,325 in cash and accounts receivable to cover obligations of only $3,600. Even if this note *is* due shortly, the company still appears to be liquid.**

45 Minutes, Strong

PROBLEM 5.3A
MYSTIC MASTERS, INC.

a.

MYSTIC MASTERS, INC.		
Income Statement		
For the Year Ended December 31, 2009		
Revenues:		
Client revenue earned		$ 52,000
Expenses:		
Insurance expense	$ 6,000	
Office rent expense	9,000	
Supplies expense	440	
Salary expense	48,000	
Depreciation expense: furniture & fixtures	1,400	
Office and telephone expense	3,000	
Internet service expense	4,900	
Legal expense	1,500	
Interest expense	4,000	
Miscellaneous expense	5,000	83,240
Net loss		$ (31,240)

MYSTIC MASTERS, INC.		
Statement of Retained Earnings		
For the Year Ended December 31, 2009		
Retained earnings (1/1/09)		$ 2,600
Less: Net loss		31,240
Retained earnings (12/31/09)		$ (28,640)

PROBLEM 5.3A
MYSTIC MASTERS, INC. (continued)

a. (cont'd)

MYSTIC MASTERS, INC.		
Balance Sheet		
December 31, 2009		
Assets		
Cash		$ 960
Accounts receivable		300
Unexpired insurance		2,000
Prepaid rent		1,500
Supplies		200
Furniture & fixtures	$ 8,400	
Less: Accumulated depreciation: furniture & fixtures	5,200	3,200
TOTAL ASSETS		$ 8,160
Liabilities		
Accounts payable		$ 6,540
Notes payable		24,000
Salaries payable		1,700
Interest payable		360
Unearned client revenue		200
TOTAL LIABILITIES		$ 32,800
Stockholders' Equity		
Capital stock		$ 4,000
Retained earnings (deficit)		(28,640)
TOTAL STOCKHOLDERS' EQUITY (DEFICIT)		$ (24,640)
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY		$ 8,160

b.

MYSTIC MASTERS, INC.				
General Journal				
December 31, 2009				
		(1)		
Dec.	31	Client Revenue Earned	52,000	
		Income Summary		52,000
		To close Client Revenue Earned.		
		(2)		
	31	Income Summary	83,240	
		Insurance Expense		6,000
		Office Rent Expense		9,000
		Supplies Expense		440
		Salary Expense		48,000
		Depreciation Expense: Furn. & Fixt.		1,400
		Office & Telephone Expense		3,000
		Internet Service Expense		4,900
		Legal Expense		1,500
		Interest Expense		4,000
		Miscellaneous Expense		5,000
		To close all expense accounts.		
		(3)		
	31	Retained Earnings	31,240	
		Income Summary		31,240
		To transfer net loss in 2009 to the Retained		
		Earnings account ($52,000 - $83,240 = $31,240 loss)		
		Note: No dividends were declared in 2009.		

PROBLEM 5.3A
MYSTIC MASTERS, INC. (concluded)

c.

MYSTIC MASTERS, INC. After-Closing Trial Balance December 31, 2009		
Cash	$ 960	
Accounts receivable	300	
Unexpired insurance	2,000	
Prepaid rent	1,500	
Supplies	200	
Furniture & fixtures	8,400	
Accumulated depreciation: furniture & fixtures		$ 5,200
Accounts payable		6,540
Notes payable		24,000
Salaries payable		1,700
Interest payable		360
Unearned client revenue		200
Capital stock		4,000
Retained earnings	28,640	
Totals	$ 42,000	$ 42,000

d. **For the year ended December 31, 2009, the company suffered a *net loss* of $31,240 on $52,000 sales. Thus, the net *loss* as a percentage of sales was approximately 60%. The net loss, in combination with the *deficit balance* in stockholders' equity, makes meaningful interpretations of return on equity impossible. It will suffice to say that the company is extremely *unprofitable.* The company's balance sheet at December 31, 2009, reports cash and accounts receivable totaling only $1,260. It reports various payables (liabilities) totaling $32,600, for a shortfall of $31,340. Thus, in addition to being unprofitable, the company also is not liquid. Even if the note payable reported in the balance sheet is *not* due in the near future, the company still faces a significant shortfall with respect to its ability to make good on its current obligations.**

e. **The primary issue to be addressed in the notes to the financial statements is the company's ability, or lack thereof, to remain a *going concern.* In other words, just how much longer can this business stay afloat given its desperate financial condition? Information about the $24,000 note payable should also be disclosed. Who is the maker of this note? When is it due? Is it secured with company assets? Etc. The company may also have to disclose information concerning any legal problems it faces. The legal expenses reported in the income statement may suggest that one or more lawsuits are currently pending.**

25 Minutes, Easy

PROBLEM 5.4A
GUARDIAN INSURANCE AGENCY

a.

GUARDIAN INSURANCE AGENCY			
Income Statement			
For the Following Time Periods in 2007			
	Month Ended Sept. 30	Quarter Ended Sept. 30	9 Months Ended Sept. 30
Revenue:			
Commissions earned	$ 16,000	$ 54,000	$ 144,000
Expenses:			
Advertising	$ 5,000	$ 13,000	$ 28,000
Salaries expense	4,000	12,000	36,000
Rent expense	2,500	7,500	22,500
Depreciation expense	300	900	2,700
Total expenses	$ 11,800	$ 33,400	$ 89,200
Net Income	$ 4,200	$ 20,600	$ 54,800
Supporting computations			
September Commissions:			
$144,000 - $128,000 = $16,000			
	`		
Third Quarter Commissions:			
$144,000 - $90,000 = $54,000			

b. **The balances in the revenue and expense accounts at September 30 represent the year to date. To determine revenue or expense for the *month* of September, the balance as of August 31 is *subtracted* from the September 30 balance. To determine the revenue or expense for the *quarter* ended September 30, the *June 30* balance is subtracted from the September 30 balance.**

Revenue and expenses for the *nine-month* period ended September 30 are represented by the current balances in the accounts.

No such computations are required for balance sheet accounts, because their balances describe financial position at a *point* in time, rather than for a *period* of time.

c. **If Guardian closed its accounts *monthly,* the current adjusted balances could be used in preparing financial statements for the *month* ended September 30. However, to prepare an income statement for the *quarter* ended September 30, it would be necessary to combine for each revenue and expense account the balances as of July 31, August 31, and September 30. To determine revenue and expenses for the *nine months* ended September 30, it would be necessary to combine the monthly amounts for each of the nine months.**

70 Minutes, Strong

PROBLEM 5.5A
SILVER LINING, INC.

a.

SILVER LINING, INC. General Journal December 31, 2009				
		(1)		
Dec.	31	Accounts Receivable	1,500	
		Consulting Services Revenue		1,500
		To record revenue accrued at the end of Dec.		
		(2)		
	31	Unearned Consulting Services Revenue	2,500	
		Consulting Services Revenue		2,500
		To convert unearned revenue to earned revenue in Dec.		
		(3)		
	31	Office Supplies Expense	95	
		Office Supplies		95
		To record offices supplies used in December.		
		(4)		
	31	Depreciation Expense: Office Equipment	750	
		Accumulated Depreciation: Office Equip.		750
		To record depreciation expense in December.		
		(5)		
	31	Rent Expense	300	
		Prepaid Rent		300
		To record December rent expense.		
		(6)		
	31	Insurance Expense	90	
		Unexpired Insurance		90
		To record portion of insurance policies expired		
		in December.		
		(7)		
	31	Salaries Expense	1,900	
		Salaries Payable		1,900
		To record accrued but unpaid salaries in Dec.		
		(8)		
	31	Interest Expense	60	
		Interest Payable		60
		To record interest expense accrued in December.		
		(9)		
		Income Taxes Expense	600	
		Income Taxes Payable		600
		To record income taxes expense accrued in Dec.		

PROBLEM 5.5A
SILVER LINING, INC. (continued)

a. (cont'd)

Computations for each of the adjusting journal entries:

1. Accounts receivable increased by the $1,500 of accrued revenue in December.

2. Unearned revenue is reduced by the $2,500 amount earned in December.

3. $205 (supplies per trial balance) - $110 at 12/31 = $95 used in December.

4. $54,000 (office equipment per trial balance) ÷ 72 months = $750 per month.

5. $1,200 (prepaid rent per trial balance) ÷ 4 mo. Remaining at 11/30 = $300 per month.

6. $270 (unexpired insurance per trial balance) ÷ 3 mo. Remaining at 11/30 = $90 per month.

7. Salaries payable increased by the $1,900 of accrued salaries in December.

8. $9,000 (note payable per trial balance) x 8% x 1/12 = $60 interest expense per month.

9. $7,500 total income taxes expense - $6,900 (per trial balance) = $600 accrued in December.

The company's *adjusted trial balance* dated December 31, 2009, appears on the following page.

PROBLEM 5.5A
SILVER LINING, INC. (continued)

a. (cont'd.)

SILVER LINING, INC.	
Adjusted Trial Balance	
December 31, 2009	

Cash	$ 42,835	
Accounts receivable	3,500	
Office supplies	110	
Prepaid rent	900	
Unexpired insurance	180	
Office equipment	54,000	
Accumulated depreciation: office equipment		$ 36,000
Accounts payable		1,400
Notes payable (Due 3/1/10)		9,000
Income taxes payable		2,350
Unearned consulting services revenue		1,000
Salaries payable		1,900
Interest payable		420
Capital stock		30,000
Retaining earnings		8,000
Dividends	1,000	
Consulting services revenue		64,000
Office supplies expense	700	
Depreciation expense: office equipment	9,000	
Rent expense	3,825	
Insurance expense	1,100	
Salaries expense	29,000	
Interest expense	420	
Income taxes expense	7,500	
Totals	$ 154,070	$ 154,070

PROBLEM 5.5A
SILVER LINING, INC. (continued)

b.

		SILVER LINING, INC.		
		Income Statement		
		For the Year Ended December 31, 2009		
		Revenues:		
		Consulting services revenue		$ 64,000
		Expenses:		
		Office supplies expense	$ 700	
		Depreciation expense: office equipment	9,000	
		Rent expense	3,825	
		Insurance expense	1,100	
		Salaries expense	29,000	
		Interest expense	420	44,045
		Income before taxes		$ 19,955
		Income taxes expense		7,500
		Net Income		$ 12,455

		SILVER LINING, INC.		
		Statement of Retained Earnings		
		For the Year Ended December 31, 2009		
		Retained earnings (1/1/09)		$ 8,000
		Add: Net income		12,455
		Less: Dividends		(1,000)
		Retained earnings (12/31/09)		$ 19,455

b. (cont'd)

		SILVER LINING, INC.		
		Balance Sheet		
		December 31, 2009		
		Assets		
		Cash		$ 42,835
		Accounts receivable		3,500
		Office supplies		110
		Prepaid rent		900
		Unexpired insurance		180
		Office equipment	$ 54,000	
		Less: Accumulated Depreciation: Office equipment	36,000	18,000
		TOTAL ASSETS		$ 65,525
		Liabilities		
		Accounts payable		$ 1,400
		Note payable (Due 3/1/10)		9,000
		Income taxes payable		2,350
		Unearned consulting services revenue		1,000
		Salaries payable		1,900
		Interest payable		420
		TOTAL LIABILITIES		$ 16,070
		Stockholders' Equity		
		Capital stock		$ 30,000
		Retained earnings		19,455
		TOTAL STOCKHOLDERS' EQUITY		$ 49,455
		TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY		$ 65,525

PROBLEM 5.5A
SILVER LINING, INC. (continued)

c.

SILVER LINING, INC. General Journal December 31, 2009				
		(1)		
Dec.	31	Consulting Services Revenue	64,000	
		Income Summary		64,000
		To close revenue earned.		
		(2)		
	31	Income Summary	51,545	
		Office Supply Expense		700
		Depreciation Expense: Office Equipment		9,000
		Rent Expense		3,825
		Insurance Expense		1,100
		Salaries Expense		29,000
		Interest Expense		420
		Income Taxes Expense		7,500
		To close all expense accounts.		
		(3)		
	31	Income Summary	12,455	
		Retained Earnings		12,455
		To transfer net income earned in 2009 to the		
		Retained Earnings account ($64,000 - $51,545 =		
		$12,455).		
		(4)		
	31	Retained Earnings	1,000	
		Dividends		1,000
		To close dividends declared in 2009 to Retained		
		Earnings.		

PROBLEM 5.5A
SILVER LINING, INC. (continued)

d.

		SILVER LINING, INC.		
		After-Closing Trial Balance		
		December 31, 2009		
		Cash	$ 42,835	
		Accounts receivable	3,500	
		Office supplies	110	
		Prepaid rent	900	
		Unexpired insurance	180	
		Office equipment	54,000	
		Accumulated depreciation: office equipment		$ 36,000
		Accounts payable		1,400
		Notes payable (Due 3/1/10)		9,000
		Income taxes payable		2,350
		Unearned consulting services revenue		1,000
		Salaries payable		1,900
		Interest payable		420
		Capital stock		30,000
		Retained earnings		19,455
		Totals	$ 101,525	$ 101,525

e.

		Insurance expense incurred in 2009	$ 1,100	
		Less: Total insurance expense for March		
		through December (at $90 per month)	900	
		Total expense incurred in January and February	$ 200	
			÷ 2	months
		Monthly insurance expense January and February	$ 100	monthly
		Monthly decrease starting in March ($100 - $90)	$ 10	monthly

f.

		Rent expense incurred in 2009	$ 3,825	
		Less: Total rent expense October through		
		December (at $300 per month)	900	
		Total rent expense for January through September	$ 2,925	
			÷ 9	months
		Monthly rent expense January through September	$ 325	monthly
		Monthly decrease starting in October ($325-$300)	$ 25	monthly

g.

		Accum. depreciation: office equipment (12/31/09)	$ 36,000	
		Divided by monthly depreciation expense	750	monthly
		Total months company has been in operation	48	months

70 Minutes, Strong

PROBLEM 5.6A
BRUSHSTROKE ART STUDIO

a.

BRUSHSTROKE ART STUDIO				
General Journal				
December 31, 2009				
		(1)		
Dec.	31	Supply Expense	5,000	
		Supplies		5,000
		To record supplies used in December.		
		(2)		
	31	Studio Rent Expense	1,250	
		Prepaid Studio Rent		1,250
		To record portion of prepaid rent expired in December.		
		(3)		
	31	Depreciation Expense: Equipment	800	
		Accumulated Depreciation: Equipment		800
		To record depreciation of equipment in December.		
		(4)		
	31	Interest Expense	240	
		Interest Payable		240
		To record interest expense accrued in December.		
		(5)		
	31	Unearned Client Fees	3,000	
		Client Fees Earned		3,000
		To convert unearned revenue to earned revenue		
		in December.		
		(6)		
	31	Client Fees Receivable	690	
		Client Fees Earned		690
		To record additional revenues accrued in December.		
		(7)		
	31	Salary Expense	750	
		Salaries Payable		750
		To record salary expense accrued at the end of		
		December.		
		(8)		
	31	Income Taxes Expense	2,000	
		Income Taxes Payable		2,000
		To record income taxes expense accrued in		
		December.		

PROBLEM 5.6A
BRUSHSTROKE ART STUDIO (continued)

a. (cont'd)

Computations for each of the adjusting journal entries:

1. **$6,000 (supplies per trial balance) - $1,000 (at 12/31) = $5,000 used in December.**
2. **$2,500 (prepaid rent per trial balance)/2 months remaining at 11/30/09 = $1,250 per month.**
3. **$96,000 (studio equipment per trial balance)/120 months = $800 per month.**
4. **$24,000 (note payable per trial balance) x 12% x 1/12 = $240 interest expense per month.**
5. **Unearned client fees need to be reduced by the $3,000 amount earned in December.**
6. **Accounts receivable needs to be increased by the $690 of accrued revenue in December.**
7. **Salaries payable of $750 needs to be reported for salaries accrued at the end of December.**
8. **$7,000 total income taxes expense -$5,000 (per trial balance) = $2,000 accrued in December.**

The company's *adjusted trial balance* dated December 31, 2009, appears on the following page.

PROBLEM 5.6A
BRUSHSTROKE ART STUDIO (continued)

a. (cont'd.)

		BRUSHSTROKE ART STUDIO		
		Adjusted Trial Balance		
		December 31, 2009		
		Cash	$ 22,380	
		Client fees receivable	71,940	
		Supplies	1,000	
		Prepaid studio rent	1,250	
		Studio equipment	96,000	
		Accumulated depreciation: studio equipment		$ 52,800
		Accounts payable		6,420
		Salaries payable		750
		Notes payable		24,000
		Interest payable		720
		Unearned client fees		5,000
		Income taxes payable		7,000
		Capital stock		50,000
		Retained earnings		20,000
		Client fees earned		86,000
		Supply expense	9,000	
		Salary expense	18,000	
		Interest expense	720	
		Studio rent expense	12,500	
		Utilities expense	3,300	
		Depreciation expense: studio equipment	9,600	
		Income taxes expense	7,000	
		Totals	$ 252,690	$ 252,690

PROBLEM 5.6A
BRUSHSTROKE ART STUDIO (continued)

b.

		BRUSHSTROKE ART STUDIO, INC.		
		Income Statement		
		For the Year Ended December 31, 2009		
		Revenues:		
		Client fees earned		**$ 86,000**
		Expenses:		
		Supply expense	**$ 9,000**	
		Salary expense	**18,000**	
		Studio rent expense	**12,500**	
		Utilities expense	**3,300**	
		Depreciation expense: studio equipment	**9,600**	
		Interest expense	**720**	**53,120**
		Income before taxes		**$ 32,880**
		Income taxes expense		**7,000**
		Net Income		**$ 25,880**

		BRUSHSTROKE ART STUDIO, INC.		
		Statement of Retained Earnings		
		For the Year Ended December 31, 2009		
		Retained earnings (1/1/09)		**$ 20,000**
		Add: Net income		**25,880**
		Retained earnings (12/31/09)		**$ 45,880**

PROBLEM 5.6A
BRUSHSTROKE ART STUDIO (continued)

b. (cont'd)

BRUSHSTROKE ART STUDIO, INC.		
Balance Sheet		
December 31, 2009		
Assets		
Cash		$ 22,380
Client fees receivable		71,940
Supplies		1,000
Prepaid studio rent		1,250
Studio equipment	$ 96,000	
Less: Accumulated Depreciation: Studio equipment	52,800	43,200
TOTAL ASSETS		$ 139,770
Liabilities		
Accounts payable		$ 6,420
Salaries payable		750
Notes payable		24,000
Interest payable		720
Unearned client fees		5,000
Income taxes payable		7,000
TOTAL LIABILITIES		$ 43,890
Stockholders' Equity		
Capital stock		$ 50,000
Retained earnings		45,880
TOTAL STOCKHOLDERS' EQUITY		$ 95,880
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY		$ 139,770

PROBLEM 5.6A
BRUSHSTROKE ART STUDIO (continued)

c.

BRUSHSTROKE ART STUDIO				
General Journal				
December 31, 2009				
		(1)		
Dec.	31	Client Fees Earned	86,000	
		Income Summary		86,000
		To close Client Fees Earned.		
		(2)		
	31	Income Summary	60,120	
		Supply Expense		9,000
		Salary Expense		18,000
		Interest Expense		720
		Studio Rent Expense		12,500
		Utilities Expense		3,300
		Depreciation Expense: Studio Equipment		9,600
		Income Taxes Expense		7,000
		To close all expense accounts.		
		(3)		
	31	Income Summary	25,880	
		Retained Earnings		25,880
		To transfer net income earned in 2009 to the		
		Retained Earnings account ($86,000 - $60,120 =		
		$25,880).		
		Note: No dividends were declared in 2009.		

PROBLEM 5.6A
BRUSHSTROKE ART STUDIO (concluded)

d.

		BRUSHSTROKE ART STUDIO		
		After-Closing Trial Balance		
		December 31, 2009		
		Cash	$ 22,380	
		Client fees receivable	71,940	
		Supplies	1,000	
		Prepaid studio rent	1,250	
		Studio equipment	96,000	
		Less: Accumulated depreciation: studio equip.		$ 52,800
		Accounts payable		6,420
		Salaries payable		750
		Notes payable		24,000
		Interest payable		720
		Unearned client fees		5,000
		Income taxes payable		7,000
		Capital stock		50,000
		Retained earnings		45,880
		Totals	$ 192,570	$ 192,570

e. **The studio's rent expense has increased by $250 per month as shown below:**

Total rent expense through November 30, 2009 (per unadjusted trial balance……………………………………………………………………………	**$**	**11,250**
Less: Rent expense in November (see computation 2., part a.) ………………		**1,250**
Total rent expense through October 31, 2009 …………………………………	**$**	**10,000**
Rent expense per month through October 31, 2009 ($10,000/10 months………………………………………………………………………………		**$1,000/mo.**
Increase in monthly rent expense ($1,250 - $1,000) ………………………….		**$250/mo.**

50 Minutes, Strong

PROBLEM 5.7A
INTERNET CONSULTING SERVICE, INC.

INTERNET CONSULTING SERVICE, INC.
Worksheet
For the Month Ended December 31, 2009

	Trial Balance		Adjustments *		Adjusted Trial Balance		Income Statement		Balance Sheet	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Balance sheet accounts:										
Cash	49,100				49,100				49,100	
Consulting fees receivable	23,400		(7) 11,000		34,400				34,400	
Prepaid office rent	6,300			(1) 2,100	4,200				4,200	
Prepaid dues and subscriptions	300			(2) 50	250				250	
Supplies	600			(3) 150	450				450	
Equipment	36,000				36,000				36,000	
Accumulated Depr.: Equipment		10,200		(4) 600		10,800				10,800
Notes payable		5,000				5,000				5,000
Income taxes payable		12,000		(9) 5,000		17,000				17,000
Unearned consulting fees		5,950	(6) 2,850			3,100				3,100
Capital stock		30,000				30,000				30,000
Retained earnings		32,700				32,700				32,700
Dividends	60,000				60,000				60,000	
Salaries payable				(8) 1,700		1,700				1,700
Interest payable				(5) 100		100				100
Income statement accounts:										
Consulting fees earned		257,180		(6) 2,850		271,030		271,030		
				(7) 11,000						
Salaries expense	88,820		(8) 1,700		90,520		90,520			
Telephone expense	2,550				2,550		2,550			
Rent expense	22,000		(1) 2,100		24,100		24,100			
Income taxes expense	51,000		(9) 5,000		56,000		56,000			
Dues and subscriptions expense	560		(2) 50		610		610			
Supplies expense	1,600		(3) 150		1,750		1,750			
Depreciation expense: equip.	6,600		(4) 600		7,200		7,200			
Miscellaneous expense	4,200				4,200		4,200			
	353,030	353,030								
Interest expense			(5) 100		100		100			
			23,550	23,550	371,430	371,430	187,030	271,030	184,400	100,400
Net income							84,000			84,000
Totals							271,030	271,030	184,400	184,400

Adjustments:
(1) Rent expense for December.
(2) Dues and subscriptions expense for December.
(3) Supplies used in December ($600-$450).
(4) Depreciation expense ($36,000 ÷ 60 mos.).
(5) Accrued interest on notes payable.
(6) Consulting services performed for clients who paid in advance.
(7) Services rendered but not billed.
(8) Salaries earned but not paid.
(9) Estimated income taxes expense.

15 Minutes, Medium

PROBLEM 5.8A
BEST BUY

a.	**Net income percentage: Net Income/Total Revenue**	
	$1.4 billion/$33.3 billion =	**4.2%**
	Return on equity: Net Income/Average Stockholders' Equity	
	$1.4 billion/$5.35 billion* =	**26.2%**
	***Average Stockholders' Equity = ($4.5 billion + $6.2 billion)/2**	
b.	**Working capital: Current Assets – Current Liabilities**	
	Beginning of year: $9.1 billion - $6.3 Bllion	**$2.8 billion**
	End of year: $7.3 billion - $6.8 billion	**$0.5 billion**
	Current ratio: Current Assets ÷ Current Liabilities	
	Beginning of year: $9.1 billion/$6.3 billion	**1.44:1**
	End of year: $7.3 billion/$6.8 billion	**1.07:1**

c. **The company was profitable, given its reported net income of $1.4 billion. Its net income percentage reveals that management earned income in excess of 4 cents for every dollar of revenue generated. The company also appears liquid, based upon its working capital and its current ratios. However, if it is not able to convert a sufficient portion of its current assets into cash in a timely manner, it may have difficulty paying its current liabilities as they come due.**

SOLUTIONS TO PROBLEMS SET B

20 Minutes, Easy

PROBLEM 5.1B
STRONG KNOT, INC.

a.

STRONG KNOT, INC.		
Income Statement		
For the Year Ended December 31, 2009		
Revenues:		
Service revenue earned		$ 160,000
Expenses:		
Insurance expense	$ 1,800	
Office rent expense	18,000	
Supplies expense	1,200	
Salary expense	96,000	
Depreciation expense: automobile	4,000	
Depreciation expense: equipment	3,000	
Repair and maintenance expense	1,700	
Travel expense	6,600	
Miscellaneous expense	2,100	
Interest expense	2,800	137,200
Income before taxes		$ 22,800
Income taxes expense		4,000
Net income		$ 18,800

STRONG KNOT, INC.		
Statement of Retained Earnings		
For the Year Ended December 31, 2009		
Retained earnings (1/1/09)		$ 17,500
Add: Net Income		18,800
Less: Dividends		3,000
Retained earnings (12/31/09)		$ 33,300

PROBLEM 5.1B
STRONG KNOT, INC. (continued)

a. (cont'd)

		STRONG KNOT, INC.		
		Balance Sheet		
		December 31, 2009		
		Assets		
		Cash		$ 15,400
		Accounts receivable		8,200
		Unexpired insurance		3,000
		Prepaid rent		800
		Supplies		900
		Automobile	$ 37,000	
		Less: Accumulated depreciation: automobile	12,000	25,000
		Equipment	39,000	
		Less: Accumulated depreciation: equipment	13,000	26,000
		TOTAL ASSETS		$ 79,300
		Liabilities		
		Accounts payable		$ 5,200
		Notes payable*		33,000
		Salaries payable		900
		Income taxes payable		400
		Unearned revenue		3,500
		TOTAL LIABILITIES		$ 43,000
		Stockholders' Equity		
		Capital stock		$ 3,000
		Retained earnings		33,300
		TOTAL STOCKHOLDERS' EQUITY		$ 36,300
		TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY		$ 79,300

*** Notes payable of $33,000 is the plug figure required to make the balance sheet balance.**

PROBLEM 5.1B
STRONG KNOT, INC. (concluded)

b.

STRONG KNOT, INC.				
General Journal				
December 31, 2009				
		(1)		
Dec.	31	Service Revenue Earned	160,000	
		Income Summary		160,000
		To close revenue account.		
		(2)		
	31	Income Summary	141,200	
		Insurance Expense		1,800
		Office Rent Expense		18,000
		Supplies Expense		1,200
		Salaries Expense		96,000
		Depreciation Expense: Automobile		4,000
		Depreciation Expense: Equipment		3,000
		Repair and Maintenance Expense		1,700
		Travel Expense		6,600
		Miscellaneous Expense		2,100
		Interest Expense		2,800
		Income Taxes Expense		4,000
		To close all expense accounts.		
		(3)		
	31	Income Summary	18,800	
		Retained Earnings		18,800
		To transfer net income earned in 2009 to the		
		Retained Earnings account ($160,000 - $141,200 =		
		$18,800).		
		(4)		
	31	Retained Earnings	3,000	
		Dividends		3,000
		To transfer dividends declared in 2009 to the		
		Retained Earnings account.		

c. For the year ended December 31, 2009, the company generated net income of $18,800 on $160,000 sales. Thus, net income as a percentage of sales was 11.75%. Moreover, the $18,800 profit represented a 66% return on average stockholders' equity, which is a very impressive performance. The company's balance sheet at December 31, 2009 reports cash and accounts receivable totaling $23,600. It also reports various payables (liabilities) totaling $43,000. Thus, the company may or *may not* currently be liquid depending on when the $33,000 note payable reported in the balance sheet is due. If this obligation is *not* due in the near future, then the company appears to be liquid. If however, this note is due shortly, the company may experience some cash flow difficulty.

PROBLEM 5.2B
GARDEN WIZARDS

a.

GARDEN WIZARDS		
Income Statement		
For the Year Ended December 31, 2009		
Revenues:		
Service revenue earned		**$ 194,000**
Expenses:		
Insurance expense	**$ 1,800**	
Office rent expense	**28,000**	
Supplies expense	**5,600**	
Salary expense	**72,000**	
Depreciation expense: trucks	**16,000**	
Depreciation expense: equipment	**4,000**	
Repair & maintenance expense	**5,300**	
Fuel expense	**2,200**	
Miscellaneous expense	**2,700**	
Interest expense	**3,800**	**141,400**
Income before taxes		**$ 52,600**
Income taxes expense		**9,000**
Net income		**$ 43,600**

GARDEN WIZARDS		
Statement of Retained Earnings		
For the Year Ended December 31, 2009		
Retained earnings (1/1/09)		**$ 21,000**
Add: Net income		**43,600**
Less: Dividends		**3,300**
Retained earnings (12/31/09)		**$ 61,300**

PROBLEM 5.2B
GARDEN WIZARDS (continued)

a. (cont'd)

		GARDEN WIZARDS		
		Balance Sheet		
		December 31, 2009		
		Assets		
		Cash		$ 27,800
		Accounts receivable		4,300
		Unexpired insurance		8,700
		Prepaid rent		3,200
		Supplies		1,400
		Trucks	$ 140,000	
		Less: Accumulated depreciation: trucks	75,000	65,000
		Equipment	28,000	
		Less: Accumulated depreciation: equipment	14,000	14,000
		TOTAL ASSETS		$ 124,400
		Liabilities		
		Accounts payable		$ 2,200
		Notes payable		38,000
		Salaries payable		900
		Interest payable		300
		Income taxes payable		1,700
		Unearned service revenue		2,000
		TOTAL LIABILITIES		$ 45,100
		Stockholders' Equity		
		Capital stock		$ 18,000
		Retained earnings		61,300
		TOTAL STOCKHOLDERS' EQUITY		$ 79,300
		TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY		$ 124,400

PROBLEM 5.2B
GARDEN WIZARDS (continued)

b.

GARDEN WIZARDS				
General Journal				
December 31, 2009				
		(1)		
Dec.	31	Service Revenue Earned	194,000	
		Income Summary		194,000
		To close revenue account.		
		(2)		
	31	Income Summary	150,400	
		Insurance Expense		1,800
		Office Rent Expense		28,000
		Supplies Expense		5,600
		Salary Expense		72,000
		Depreciation Expense: Trucks		16,000
		Depreciation Expense: Equipment		4,000
		Repair & Maintenance Expense		5,300
		Fuel Expense		2,200
		Miscellaneous Expense		2,700
		Interest Expense		3,800
		Income Taxes Expense		9,000
		To close all expense accounts.		
		(3)		
	31	Income Summary	43,600	
		Retained Earnings		43,600
		To transfer net income earned in 2009 to the		
		Retained Earnings account ($194,000 -$150,400 =		
		$43,600).		
		(4)		
	31	Retained Earnings	3,300	
		Dividends		3,300
		To transfer dividends declared in 2009 to the		
		Retained Earnings account.		

PROBLEM 5.2B
GARDEN WIZARDS (concluded)

c.

		GARDEN WIZARDS		
		After-Closing Trial Balance		
		December 31, 2009		
		Cash	$ 27,800	
		Accounts receivable	4,300	
		Unexpired insurance	8,700	
		Prepaid rent	3,200	
		Supplies	1,400	
		Trucks	140,000	
		Accumulated depreciation: trucks		$ 75,000
		Equipment	28,000	
		Accumulated depreciation: equipment		14,000
		Accounts payable		2,200
		Notes payable		38,000
		Salaries payable		900
		Interest payable		300
		Income taxes payable		1,700
		Unearned service revenue		2,000
		Capital stock		18,000
		Retained earnings		61,300
		Totals	$ 213,400	$ 213,400

d. **For the year ended December 31, 2009, the company generated net income of $43,600 on $194,000 sales. Thus, net income as a percentage of sales was approximately 22.5 %. Moreover, the $43,600 profit represented a return on average stockholders' equity of approximately 74%, which is impressive. The company's balance sheet at December 31, 2009, reports cash and accounts receivable totaling $32,100. It also reports liabilities totaling $45,100. Depending on when the $38,000 note payable reported in the balance sheet is due, the company may be *extremely liquid* . If this obligation is not *due* in the near future, the company has $32,100 in cash and accounts receivable to cover obligations of only $7,100.**

PROBLEM 5.3B
DEBIT DOCTORS, INC.

a.

		DEBIT DOCTORS, INC.		
		Income Statement		
		For the Year Ended December 31, 2009		
		Revenues:		
		Client revenue earned		$ 56,700
		Expenses:		
		Insurance expense	$ 6,200	
		Office rent expense	12,000	
		Supplies expense	300	
		Salary expense	48,000	
		Depreciation expense: furniture & fixtures	1,200	
		Office and telephone expense	4,600	
		Internet service expense	7,200	
		Legal expense	1,800	
		Interest expense	2,700	
		Miscellaneous expense	4,300	88,300
		Net loss		$ (31,600)

		DEBIT DOCTORS, INC.		
		Statement of Retained Earnings		
		For the Year Ended December 31, 2009		
		Retained earnings (1/1/09)		$ 2,000
		Less: Net loss		(31,600)
		Retained earnings (12/31/09)		$ (29,600)

PROBLEM 5.3B
DEBIT DOCTORS, INC. (continued)

a. (cont'd)

DEBIT DOCTORS, INC.		
Balance Sheet		
December 31, 2009		
Assets		
Cash		$ 450
Accounts receivable		220
Unexpired insurance		1,600
Prepaid rent		1,800
Supplies		900
Furniture & fixtures	$ 10,000	
Accumulated depreciation: furniture & fixtures	6,600	3,400
TOTAL ASSETS		$ 8,370
Liabilities		
Accounts payable		$ 7,100
Notes payable		24,000
Salaries payable		2,100
Interest payable		170
Unearned client revenue		600
TOTAL LIABILITIES		$ 33,970
Stockholders' Equity		
Capital Stock		$ 4,000
Retained earnings (deficit)		(29,600)
TOTAL STOCKHOLDERS' EQUITY (DEFICIT)		$ (25,600)
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY		$ 8,370

PROBLEM 5.3B
DEBIT DOCTORS, INC. (continued)

b.

DEBIT DOCTORS, INC. General Journal December 31, 2009				
		(1)		
Dec.	31	Client revenue earned	56,700	
		Income Summary		56,700
		To close revenue account.		
		(2)		
	31	Income Summary	88,300	
		Insurance Expense		6,200
		Office Rent Expense		12,000
		Supplies Expense		300
		Salary Expense		48,000
		Depreciation Expense: Furniture & fixtures		1,200
		Office & Telephone Expense		4,600
		Internet Service Expense		7,200
		Legal Expense		1,800
		Interest Expense		2,700
		Miscellaneous Expense		4,300
		To close all expense accounts.		
		(3)		
	31	Retained Earnings	31,600	
		Income Summary		31,600
		To transfer net loss to the Retained Earnings		
		account ($56,700 - $88,300 = $31,600 loss.)		
		Note: No dividends were declared in 2009.		

PROBLEM 5.3B
DEBIT DOCTORS, INC. (concluded)

c.

		DEBIT DOCTORS, INC.		
		After-Closing Trial Balance		
		December 31, 2009		
		Cash	$ 450	
		Accounts receivable	220	
		Unexpired insurance	1,600	
		Prepaid rent	1,800	
		Supplies	900	
		Furniture & fixtures	10,000	
		Accumulated depreciation: furniture & fixtures		$ 6,600
		Accounts payable		7,100
		Notes payable		24,000
		Salaries payable		2,100
		Interest payable		170
		Unearned client revenue		600
		Capital stock		4,000
		Retained earnings	29,600	
		Totals	$ 44,570	$ 44,570

d.

For the year ended December 31, 2009, the company suffered a net loss of $31,600 on $56,700 sales. Thus, net loss as a percentage of sales was approximately 56%. The net loss in combination with the deficit balance in stockholders' equity, makes meaningful interpretations of return on equity impossible. It will suffice to say that the company is extremely unprofitable. The company's balance sheet at December 31, 2009, reports cash and accounts receivable totaling only $670. It reports various payables (liabilities) totaling $33,970, for a shortfall of $33,300. Thus, in addition to being unprofitable, the company also is not liquid. Even if the note payable reported in the balance sheet is not due in the near future, the company still faces a significant shortfall with respect to its ability to make good on its current obligations.

e.

The primary issue to be addressed in the notes to the financial statements is the company's ability, or lack thereof, to remain a going concern. In other words, just how much longer can this business stay afloat given its desperate financial condition. Information about the $24,000 note payable should also be disclosed. Who is the maker? When is it due? Is it secured with company assets? Etc. The company may also have to disclose information concerning any legal problems it faces. The legal expenses reported in the income statement may suggest that one or more lawsuits are currently pending.

PROBLEM 5.4B
SILVER REAL ESTATE

a.

SILVER REAL ESTATE			
Income Statement			
For the Following Time Periods			
	Month Ended	Quarter Ended	9 Months Ended
	Sept. 30	Sept. 30	Sept. 30
Revenue:			
Commissions earned	$ 15,000	$ 60,000	$ 160,000
Expenses:			
Advertising expense	5,000	15,000	33,000
Salaries expense	3,000	10,000	38,000
Rent expense	2,000	6,000	20,000
Depreciation expense	100	700	2,200
Total expenses	$ 10,100	$ 31,700	$ 93,200
Net Income	$ 4,900	$ 28,300	$ 66,800
Supporting computations			
September Commissions:			
$160,000 - $145,000 = $15,000			
Third Quarter Commissions:			
$160,000 - $100,000 = $60,000			

b. **The balances in the revenue and expense accounts at September 30 represent the year-to-date. To determine revenue or expense for the *month* of September, the balance as of August 31 is *subtracted* from the September 30 balance. To determine the revenue or expense for the *quarter* ended September 30, the *June 30* balance is subtracted from the September 30 balance.**

Revenue and expenses for the *nine-month* period ended September 30 are represented by the current balances in the accounts.

No computations are required for the balance sheet accounts, because their balances describe financial position at a *point* in time, rather than a *period* of time.

c.

If Silver closed its accounts *monthly*, the current adjusted balances could be used in preparing financial statements for the *month* ended September 30. However, to prepare an income statement for the *quarter* ended September 30, it would be necessary to combine for each revenue and expense account the balances as of July 31, August 31, and September 30. To determine revenue and expenses for the *nine* months ended September 30, it would be necessary to combine the monthly amounts for each of the nine months.

70 Minutes, Strong

PROBLEM 5.5B
NEXT JOB, INC.

a.

NEXT JOB, INC.				
General Journal				
December 31, 2009				
		(1)		
Dec.	31	Accounts Receivable	25,000	
		Consulting Services Revenue		25,000
		To record revenue accrued at the end of Dec.		
		(2)		
	31	Unearned Consulting Services Revenue	15,000	
		Consulting Services Revenue		15,000
		To convert unearned revenue to earned revenue in Dec.		
		(3)		
	31	Office Supplies Expense	500	
		Office Supplies		500
		To record offices supplies used in December.		
		(4)		
	31	Depreciation Expense: Office Equipment	1,000	
		Accumulated Depreciation: Office Equip.		1,000
		To record depreciation expense in December.		
		(5)		
	31	Rent Expense	1,200	
		Prepaid Rent		1,200
		To record December rent expense.		
		(6)		
	31	Insurance Expense	250	
		Unexpired Insurance		250
		To record portion of insurance policies expired		
		in December.		
		(7)		
	31	Salaries Expense	12,000	
		Salaries Payable		12,000
		To record accrued but unpaid salaries in Dec.		
		(8)		
	31	Interest Expense	200	
		Interest Payable		200
		To record interest expense accrued in December.		
		(9)		
		Income Taxes Expense	5,000	
		Income Taxes Payable		5,000
		To record income taxes expense accrued in Dec.		

PROBLEM 5.5B
NEXT JOB, INC. (continued)

a. (continued)

Computations for each of the adjusting journal entries:

1. Accounts receivable increased by the $25,000 of accrued revenue in December.

2. Unearned revenue is reduced by the $15,000 amount earned in December.

3. $800 (supplies per trial balance) - $300 at 12/31 = $500 used in December.

4. $72,000 (office equipment per trial balance ÷ 72 months = $1,000 per month.

5. $3,600 (prepaid rent per trial balance) ÷ 3 mo. remaining at 11/30 = $1,200 per month.

6. $1,500 (unexpired insurance per trial balance) ÷ 6 mo. remaining at 12/1 = $250 per month.

7. Salaries payable increased by the $12,000 of accrued salaries in December.

8. $60,000 (note payable per trial balance) x 4% x 1/12 = $200 interest expense per month.

9. $50,000 total income taxes expense - $45,000 (per trial balance) = $5,000 accrued in December.

PROBLEM 5.5B
NEXT JOB, INC. (continued)

a. (cont'd.)

		NEXT JOB, INC.		
		Adjusted Trial Balance		
		December 31, 2009		
		Cash	$ 276,500	
		Accounts receivable	115,000	
		Office supplies	300	
		Prepaid rent	2,400	
		Unexpired insurance	1,250	
		Office equipment	72,000	
		Accumulated depreciation: office equipment		$ 25,000
		Accounts payable		4,000
		Notes payable (8-month)		60,000
		Interest payable		800
		Income taxes payable		14,000
		Dividends payable		3,000
		Salaries payable		12,000
		Unearned consulting fees		7,000
		Capital stock		200,000
		Retaining earnings		40,000
		Dividends	3,000	
		Consulting fees earned		540,000
		Rent expense	15,900	
		Insurance expense	2,450	
		Office supplies expense	5,000	
		Depreciation expense: office equipment	12,000	
		Salaries expense	342,000	
		Utilities expense	4,800	
		Interest expense	3,200	
		Income taxes expense	50,000	
		Totals	$ 905,800	$ 905,800

PROBLEM 5.5B
NEXT JOB, INC. (continued)

b.

NEXT JOB, INC.		
Income Statement		
For the Year Ended December 31, 2009		
Revenues:		
Consulting fees earned		**$ 540,000**
Expenses:		
Rent expense	**$ 15,900**	
Insurance expense	**2,450**	
Office supplies expense	**5,000**	
Depreciation expense: office equipment	**12,000**	
Salaries expense	**342,000**	
Utilities expense	**4,800**	
Interest expense	**3,200**	**385,350**
Income before taxes		**$ 154,650**
Income taxes expense		**50,000**
Net Income		**$ 104,650**

NEXT JOB, INC.		
Statement of Retained Earnings		
For the Year Ended December 31, 2009		
Retained earnings (1/1/09)		**$ 40,000**
Add: Net income		**104,650**
Less: Dividends		**(3,000)**
Retained earnings (12/31/09)		**$ 141,650**

PROBLEM 5.5B
NEXT JOB, INC. (continued)

b. (cont'd)

		NEXT JOB, INC.		
		Balance Sheet		
		December 31, 2009		
		Assets		
		Cash		$ 276,500
		Accounts receivable		115,000
		Office supplies		300
		Prepaid rent		2,400
		Unexpired insurance		1,250
		Office equipment	$ 72,000	
		Less: Accumulated Depreciation: office equipment	25,000	47,000
		TOTAL ASSETS		$ 442,450
		Liabilities		
		Accounts payable		$ 4,000
		Note payable (Due 3/1/10)		60,000
		Income taxes payable		800
		Income taxes payable		14,000
		Dividends payable		3,000
		Salaries payable		12,000
		Unearned consulting fees		7,000
		TOTAL LIABILITIES		$ 100,800
		Stockholders' Equity		
		Capital stock		$ 200,000
		Retained earnings		141,650
		TOTAL STOCKHOLDERS' EQUITY		$ 341,650
		TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY		$ 442,450

PROBLEM 5.5B
NEXT JOB, INC. (continued)

c.

NEXT JOB, INC.				
General Journal				
December 31, 2009				
		(1)		
Dec.	31	Consulting Services Revenue	540,000	
		Income Summary		540,000
		To close Agency Fees Earned.		
		(2)		
	31	Income Summary	435,350	
		Rent expense		15,900
		Insurance expense		2,450
		Office supplies expense		5,000
		Depreciation expense: office equipment		12,000
		Salaries expense		342,000
		Utilities expense		4,800
		Interest expense		3,200
		Income Taxes Expense		50,000
		To close all expense accounts.		
		(3)		
	31	Income Summary	104,650	
		Retained Earnings		104,650
		To transfer net income earned in 2009 to the		
		Retained Earnings account ($540,000 - $435,350 =		
		$104,650).		
		(4)		
	31	Retained Earnings	3,000	
		Dividends		3,000
		To close dividends declared in 2009 to Retained		
		Earnings.		

PROBLEM 5.5B
NEXT JOB, INC. (continued)

d.

		NEXT JOB, INC.		
		After-Closing Trial Balance		
		December 31, 2009		
		Cash	$ 276,500	
		Accounts receivable	115,000	
		Office supplies	300	
		Prepaid rent	2,400	
		Unexpired insurance	1,250	
		Office equipment	72,000	
		Accumulated depreciation: office equipment		$ 25,000
		Accounts payable		4,000
		Notes payable (Due 3/1/10)		60,000
		Interest payable		800
		Income taxes payable		14,000
		Dividends payable		3,000
		Salaries payable		12,000
		Unearned consulting fees		7,000
		Capital stock		200,000
		Retained earnings		141,650
		Totals	$ 467,450	$ 467,450

e.

		Insurance expense incurred in 2009	$ 2,450	
		Less: Total insurance expense for December.	250	
		Total expense incurred in Jan. through Nov.	$ 2,200	
			÷ 11	months
		Monthly insurance expense Jan. and Nov.	$ 200	monthly
		Monthly increase starting in Dec. ($250 - $200)	$ 50	monthly

PROBLEM 5.5B
NEXT JOB, INC. (concluded)

f.

		Rent expense incurred in 2009	$ 15,900	
		Less: Total rent expense June through December	8,400	(at $1,200/mo.)
		Total rent expense incurred in Jan. through May	$ 7,500	
			÷ 5	months
		Monthly rent expense in January through May	$ 1,500	monthly
		Monthly decrease starting in June ($1,500 - $1,200)	$ 300	monthly

g.

		Accumulated depreciation: office equip. (12/31/09)	$ 25,000	
		Divided by monthly depreciation expense	1,000	monthly
		Total months company has been in operation	25	months

h.

		Interest expense incurred in 2009	$ 3,200	
		Less: Total interest expense in Sept. through Dec.	800	
		Total interest on prior note in Jan. through Mar.	$ 2,400	
			÷ 3	months
		Monthly interest expense in January through March	$ 800	monthly

70 Minutes, Strong

PROBLEM 5.6B
TOUCHTONE TALENT AGENCY

TOUCHTONE TALENT AGENCY				
General Journal				
December 31, 2009				
		(1)		
Dec.	31	Depreciation Expense: Office Equipment	250	
		Accumulated Depreciation: Office Equip.		250
		To record depreciation of office equipment in December.		
		(2)		
	31	Unearned Agency Fees	2,500	
		Agency Fees Earned		2,500
		To convert unearned revenue to earned revenue		
		in December.		
		(3)		
	31	Salaries Expense	1,360	
		Salaries Payable		1,360
		To record salary expense accrued at the end of		
		December.		
		(4)		
	31	Rent Expense	600	
		Prepaid Rent		600
		To record prepaid rent expired in December.		
		(5)		
	31	Fees Receivable	3,000	
		Agency Fees Earned		3,000
		To record revenue accrued at the end of		
		December.		
		(6)		
	31	Office Supply Expense	370	
		Office Supplies		370
		To record office supplies used in December.		
		(7)		
	31	Insurance Expense	125	
		Unexpired Insurance Policies		125
		To record portion of insurance policies expired in		
		December.		
		(8)		
	31	Interest Expense	45	
		Interest Payable		45
		To record interest expense accrued in December.		
		(9)		
	31	Income Taxes Expense	700	
		Income Taxes Payable		700
		To record income taxes expense accrued in December.		

a. (continued)

Computations for each of the adjusting journal entries:

1. **$15,000 (office equipment per trial balance)/60 months = $250 per month.**
2. **Unearned agency fees reduced by the $2,500 amount earned in December.**
3. **Salaries payable of $1,360 for salaries accrued at the end of December.**
4. **$1,800 initial prepayment/3 mo. = $600 rent expense incurred in December.**
5. **Fees receivable increased by the $3,000 of accrued revenue in December.**
6. **$900 (supplies per trial balance) - $530 (at 12/31) = $370 used in December.**
7. **$750 initial prepayment/6 mo. = $125 ins. expense incurred in December.**
8. **$6,000 (note payable per trial balance) x 9% x 1/12 = $45 int. expense per mo.**
9. **$3,900 total expense - $3,200 (per trial balance) = $700 accrued in December.**

The company's *adjusted trial balance* dated December 31, 2009, appears on the following page.

PROBLEM 5.6B
TOUCHTONE TALENT AGENCY (continued)

a. (cont'd.)

TOUCHTONE TALENT AGENCY Adjusted Trial Balance December 31, 2009		
Cash	$ 14,950	
Fees receivable	38,300	
Prepaid rent	600	
Unexpired insurance policies	250	
Office supplies	530	
Office equipment	15,000	
Accumulated depreciation: office equipment		$ 12,250
Accounts payable		1,500
Notes payable (Due 3/1/10)		6,000
Income taxes payable		3,900
Unearned agency fees		5,500
Salaries payable		1,360
Interest payable		45
Capital stock		20,000
Retained earnings		10,800
Dividends	800	
Agency fees earned		52,000
Telephone expense	480	
Office supply expense	1,500	
Depreciation expense: office equipment	3,000	
Rent expense	6,700	
Insurance expense	1,300	
Salaries expense	26,000	
Income taxes expense	3,900	
Interest expense	45	
Totals	$ 113,355	$ 113,355

PROBLEM 5.6B
TOUCHTONE TALENT AGENCY (continued)

b.

TOUCHTONE TALENT AGENCY		
Income Statement		
For the Year Ended December 31, 2009		
Revenues:		
Agency fees earned		**$ 52,000**
Expenses:		
Telephone expense	**$ 480**	
Office supply expense	**1,500**	
Depreciation expense: office equipment	**3,000**	
Rent expense	**6,700**	
Insurance expense	**1,300**	
Salaries expense	**26,000**	
Interest expense	**45**	**39,025**
Income before taxes		**12,975**
Income taxes expense		**3,900**
Net income		**$ 9,075**

TOUCHTONE TALENT AGENCY		
Statement of Retained Earnings		
For the Year Ended December 31, 2009		
Retained earnings (1/1/09)		**$ 10,800**
Add: Net income		**9,075**
Less: Dividends		**(800)**
Retained earnings (12/31/09)		**$ 19,075**

b. (cont'd.)

TOUCHTONE TALENT AGENCY		
Balance Sheet		
December 31, 2009		
Assets		
Cash		$ 14,950
Fees receivable		38,300
Prepaid rent		600
Unexpired insurance policies		250
Office supplies		530
Office equipment	$ 15,000	
Less: Accumulated depreciation: office equipment	12,250	2,750
TOTAL ASSETS		$ 57,380
Liabilities		
Accounts payable		$ 1,500
Note payable (Due 3/1/10)		6,000
Income taxes payable		3,900
Unearned agency fees		5,500
Salaries payable		1,360
Interest payable		45
TOTAL LIABILITIES		$ 18,305
Stockholders' Equity		
Capital stock		$ 20,000
Retained earnings		19,075
TOTAL STOCKHOLDERS' EQUITY		$ 39,075
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY		$ 57,380

PROBLEM 5.6B
TOUCHTONE TALENT AGENCY (continued)

c.

		TOUCHTONE TALENT AGENCY		
		General Journal		
		December 31, 2009		
		(1)		
Dec.	31	Agency Fees Earned	52,000	
		Income Summary		52,000
		To close Agency Fees Earned.		
		(2)		
	31	Income Summary	42,925	
		Telephone Expense		480
		Office Supply Expense		1,500
		Depreciation Expense: Office Equipment		3,000
		Rent Expense		6,700
		Insurance Expense		1,300
		Salaries Expense		26,000
		Interest Expense		45
		Income Taxes Expense		3,900
		To close all expense accounts.		
		(3)		
	31	Income Summary	9,075	
		Retained Earnings		9,075
		To transfer net income earned in 2009 to the		
		Retained Earnings account ($52,000 -$42,925 =		
		$9,075).		
		(4)		
	31	Retained Earnings	800	
		Dividends		800
		To close dividends declared in 2009 to Retained Earnings.		

PROBLEM 5.6B
TOUCHTONE TALENT AGENCY (continued)

d.

		TOUCHTONE TALENT AGENCY		
		After-Closing Trial Balance		
		December 31, 2010		
		Cash	$ 14,950	
		Fees receivable	38,300	
		Prepaid rent	600	
		Unexpired insurance policies	250	
		Office supplies	530	
		Office equipment	15,000	
		Accumulated depreciation: office equipment		$ 12,250
		Accounts payable		1,500
		Note payable (Due 3/1/10)		6,000
		Income taxes payable		3,900
		Unearned agency payable		5,500
		Salaries payable		1,360
		Interest payable		45
		Capital stock		20,000
		Retained earnings		19,075
		Totals	$ 69,630	$ 69,630

e.

		Accumulated depreciation: office equipment (12/31/09)	$ 12,250	
		Divided by monthly depreciation expense	÷ 250	monthly
		Total months agency has been in operation	49	months

PROBLEM 5.6B
TOUCHTONE TALENT AGENCY (concluded)

f.

		Rent expense incurred in 2009	$ 6,700	
		Less: Total rent expense for November and December	1,200	(at $600/mo.)
		Total rent expense incurred in January through October	$ 5,500	
			÷ 10	months
		Monthly rent expense in January through October	$ 550	monthly
		Monthly increase starting in November ($600-$550)	$ 50	monthly

g.

		Insurance expense incurred in 2009	$ 1,300	
		Less: Total insurance expense for September		
		through December (at $125 per month)	500	
		Total expense incurred in January through August	$ 800	
			÷ 8	months
		Monthly insurance expense January through August	$ 100	monthly
		Monthly increase starting in September ($125-$100)	$ 25	monthly

50 Minutes, Strong

PROBLEM 5.7B
CAMPUS THEATER

CAMPUS THEATER
WORKSHEET
For the Month Ended August 31, 2009

	Trial Balance		Adjustments *		Adjusted Trial Balance		Income Statement		Balance Sheet	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Balance sheet accounts:										
Cash	20,000				20,000				20,000	
Prepaid film rental	31,200			(1) 15,200	16,000				16,000	
Land	120,000				120,000				120,000	
Building	168,000				168,000				168,000	
Accum. Depreciation: building		14,000		(2) 700		14,700				14,700
Fixtures and equipment	36,000				36,000				36,000	
Accumulated depreciation:										
fixtures & equipment		12,000		(3) 600		12,600				12,600
Notes payable		180,000				180,000				180,000
Accounts payable		4,400				4,400				4,400
Unearned admission revenue										
(YMCA)		1,000	(5) 500			500				500
Income taxes payable		4,740		(8) 4,200		8,940				8,940
Capital stock		40,000				40,000				40,000
Retained earnings		46,610				46,610				46,610
Dividends	15,000				15,000				15,000	
Interest payable				(4) 1,500		1,500				1,500
Concessions revenue receivable			(6) 2,250		2,250				2,250	
Salaries payable				(7) 1,700		1,700				1,700
Income statement accounts:										
Admissions revenue		305,200		(5) 500		305,700		305,700		
Concessions revenue		14,350		(6) 2,250		16,600		16,600		
Salaries expense	68,500		(7) 1,700		70,200		70,200			
Film rental expense	94,500		(1) 15,200		109,700		109,700			
Utilities expense	9,500				9,500		9,500			
Depreciation expense: building	4,900		(2) 700		5,600		5,600			
Depreciation expense: fixtures										
and equipment	4,200		(3) 600		4,800		4,800			
Interest expense	10,500		(4) 1,500		12,000		12,000			
Income taxes expense	40,000		(8) 4,200		44,200		44,200			
	622,300	622,300	26,650	26,650	633,250	633,250	256,000	322,300	377,250	310,950
Net income							66,300			66,300
Totals							322,300	322,300	377,250	377,250

*Adjustments:

(1) Film rental expense for August.
(2) Depreciation expense for August ($168,000 ÷ 240 =$700).
(3) Depreciation expense for August ($36,000 ÷ 60 =$600).
(4) Accrued interest on notes payable.
(5) Advance payment from YMCA earned during August ($1,500 x 1/3 = $500 per month).
(6) Revenue from concessions for August.
(7) Salaries owed to employees but not yet paid.
(8) Accrued income taxes on August income.

15 Minutes, Medium

PROBLEM 5.8B
THE GAP, INC.

a.	**Net income percentage: Net Income/Total Revenue**	
	\$833 million ÷ \$15.8 billion =	**<u>5.3%</u>**
	Return on equity: Net Income/Average Stockholders' Equity	
	\$833 million ÷ \$4.75 billion*	**<u>17.5%</u>**
	***Average Stockholders' Equity = (\$4.3 billion + \$5.2 billion)/2**	
b.	**Working capital: Current Assets – Current Liabilities**	
	Beginning of year: \$5.0 billion - \$2.3 billion	**<u>\$2.7 billion</u>**
	End of year: \$4.1 billion - \$2.4 billion	**<u>\$1.7 billion</u>**
	Current ratio: Current Assets/Current Liabilities	
	Beginning of year: \$5.0 billion ÷ \$2.3 billion	**<u>2.17:1</u>**
	End of year: \$4.1 billion ÷ \$2.4 billion	**<u>1.71:1</u>**

c. **The company was profitable, given its net income of \$833 million. Its net income percentage and its return on equity are both reasonable, indicating that the company is fairly profitable. The company also appears to be liquid, given its working capital position and its current ratio. Yet, both of these liquidity measures have declined significantly during the year. To remain liquid, the company must be able to convert a sufficient portion of its current assets to cash in a timely manner in order to pay its current liabilities as they come due.**

SOLUTIONS TO CRITICAL THINKING CASES

25 Minutes, Strong

CASE 5.1
ADEQUATE DISCLOSURE

a. **Mandella Construction Co. should disclose the accounting method that it is using in the notes accompanying its financial statements. When different accounting methods are acceptable, users of financial statements need to know the methods in use if they are to properly interpret the statements.**

b. **Generally accepted accounting principles *do not* require disclosure of changes in personnel. Personnel changes normally do not have a direct (or at least measurable) effect upon financial position. Thus, disclosure of personnel changes would be more likely to confuse the users of financial statements than to provide them with useful information.**

c. **The fact that one of the company's two processing plants will be out of service for at least three months *is relevant* to the interpretation of the financial statements. Obviously, the company's ability to generate revenue in the coming year has been impaired. Thus, the damage to the plant and the estimated period of its closure should be disclosed in notes accompanying the financial statements.**

d. **No disclosure is required under generally accepted accounting principles, because any statements about the financial impact of this new product would amount to sheer speculation. Management may voluntarily disclose that it has developed new products, but it should avoid speculations as to financial impact.**

e. **Normally, pending litigation should be disclosed in notes to the financial statements. But a $500 dispute over a security deposit is clearly a routine and immaterial matter to any property management company large enough to have financial reporting obligations. Therefore, disclosure can be omitted on the basis of *immateriality.***

Group assignment:

No time estimate

CASE 5.2
WORKING FOR THE COMPETITION
ETHICS, FRAUD & CORPORATE GOVERNANCE

We do not provide comprehensive solutions for group problems. It is the nature of these problems that solutions should reflect the collective experiences of the group. But the following observations may be useful in stimulating class discussion:

a. The principal argument against an accountant serving clients who are direct competitors is:

- **An accountant has access to much information about a company's business strategies. Thus, an accountant who also worked for a company's competitors might inadvertently reveal the company's strategies, secrets, and areas of vulnerability. This would, of course, violate the accounting profession's code of ethics regarding confidentiality. At the very least, knowledge of competitive information could affect a CPA's objectivity.**

b. Arguments for an accountant serving clients who are direct competitors include:

- **Accountants, like doctors, develop greater proficiency through specialization. By serving numerous clients in the same industry, accountants develop greater expertise in industry problems and accounting practices.**
- **In many cases, it is impractical to define "direct competitors." Is a video rental business a direct competitor of a movie theater? A television station? A miniature golf course?**
- **It would be impractical for accountants not to serve competing businesses. If accounting firms were limited to one client per industry, they could not develop a viable "client base." If each company in an industry had to hire a different accountant, there often would not be enough accountants to "go around."**

c. During the interview (part b), the accountant probably described the ethical concept of confidentiality. In general, accountants are ethically prohibited from divulging information about clients without the client's permission. The concept of confidentiality is, in large part, the accounting profession's response to the primary objection that might be raised about working with competing clients.

5 Minutes, Easy

CASE 5.3
CERTIFICATIONS BY CEOs AND CFOs

The purpose of the personal certification process is to make CEOs and CFOs more accountable and personally responsible for the contents in the annual reports issued by their companies.

One would hope that the process will help to improve investor confidence in much the same way as unqualified audit opinions contribute to investor confidence. In fact, the language used in the personal certifications is very similar to the language used by independent auditors in the attestation process. CEOs and CFOs must acknowledge that they have reviewed the annual reports and attest to the fact that they believe the information is both factual and fairly presented. Moreover, the CEO and CFO must hold themselves personally responsible for establishing controls, pointing out deficiencies in control systems, and for disclosing fraudulent activities.

10 Minutes, Medium

CASE 5.4
SARBANES-OXLEY ACT
BUSINESS WEEK

If a CFO (or other high-ranking corporate officer) knowingly misrepresents financial disclosures about their companies prior to transferring personal assets to spouses or other family members, these actions would clearly be unethical.

If, however, a CFO transfers personal assets to a spouse or other family members as a precautionary measure, this is an entirely different situation. Taking steps to protect one's wealth against frivolous lawsuits and/or inadvertent mistakes is no more unethical than purchasing an insurance policy for malpractice.

Regardless of its ethical implications, this practice might certainly be viewed with an element of scrutiny by investors and creditors. The transfer of personal assets to others may convey a signal that the CFO has something to hide.

15 Minutes, Easy

CASE 5.5
ANNUAL REPORT DISCLOSURES
INTERNET

Listed below are the headings of the major disclosure items presented in Ford's most recent financial statement footnotes. Students are to discuss the general nature and content of the various topics. The advanced nature of some of these topics goes beyond the scope of an introductory course.

Accounting Policies
Income Taxes
Discontinued Operations
Marketable and Other Securities
Inventories
Net Property
Goodwill and Other Intangibles
Finance Receivables
Net Investment in Operating Leases
Allowance for Credit Losses
Liabilities
Debt and Commitments
Capital Stock
Stock Options
Derivative Financial Instruments
Operating Cash Flows
Acquisitions, Dispositions, and Restructuring
Retirement Benefits
Segment Information
Geographic Information
Summary of Quarterly Financial Data
Commitments and Contingencies