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FINANCIAL ACCOUNTING

NINTH EDITION

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WILEY

4

Completing the Accounting Cycle

Learning Objectives

After studying this chapter, you should be able to:

- [1] Prepare a worksheet.**
- [2] Explain the process of closing the books.**
- [3] Describe the content and purpose of a post-closing trial balance.**
- [4] State the required steps in the accounting cycle.**
- [5] Explain the approaches to preparing correcting entries.**
- [6] Identify the sections of a classified balance sheet.**

Preview of Chapter 4

COMPLETING THE ACCOUNTING CYCLE			
Using a Worksheet	Closing the Books	Summary of the Accounting Cycle	Classified Balance Sheet
<ul style="list-style-type: none">• Steps in preparation• Preparing financial statements• Preparing adjusting entries	<ul style="list-style-type: none">• Preparing closing entries• Posting closing entries• Preparing a post-closing trial balance	<ul style="list-style-type: none">• Reversing entries—An optional step• Correcting entries—An avoidable step	<ul style="list-style-type: none">• Current assets• Long-term investments• Property, plant, and equipment• Intangible assets• Current liabilities• Long-term liabilities• Stockholders' equity

Financial Accounting
Ninth Edition
Weygandt • Kimmel • Kieso

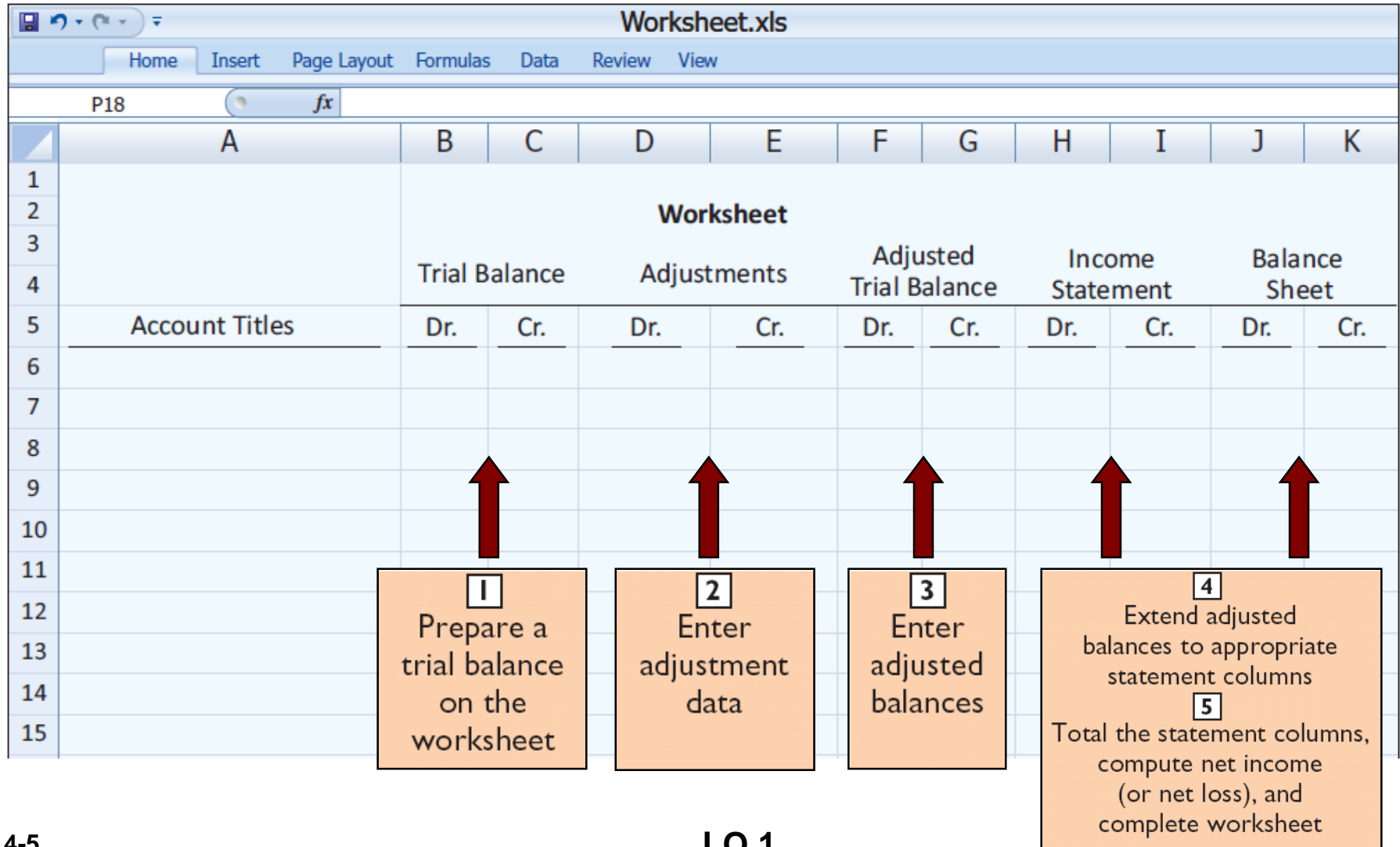
Using a Worksheet

Worksheet

- ◆ Multiple-column form used in preparing financial statements.
- ◆ Not a permanent accounting record.
- ◆ May be a computerized worksheet using an electronic spreadsheet program such as Excel.
- ◆ Prepared using a five step process.
- ◆ Use of worksheet is optional.

Steps in Preparing a Worksheet

Illustration 4-1



Steps in Preparing a Worksheet

Illustration 4-2

1. Prepare a Trial Balance on the Worksheet

Account Titles	Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Balance Sheet	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	15,200									
Supplies	2,500									
Prepaid Insurance	600									
Equipment	5,000									
Notes Payable		5,000								
Accounts Payable		2,500								
Unearned Revenue		1,200								
Common Stock		10,000								
Dividends	500									
Service Revenue		10,000								
Salaries and Wages Exp.	4,000									
Rent Exp.	900									
Totals	28,700	28,700								

Trial balance amounts come directly from ledger accounts.

Include all accounts with balances.

Steps in Preparing a Worksheet

Illustration 3-23
General journal
showing adjusting
entries

Adjusting Journal Entries (Chapter 3)

GENERAL JOURNAL				J2
Date	Account Titles and Explanation	Ref.	Debit	Credit
2015	<u>Adjusting Entries</u>			
Oct. 31	Supplies Expense	631	1,500	
	Supplies	126		1,500
	(To record supplies used)			
31	Insurance Expense	722	50	
	Prepaid Insurance	130		50
	(To record insurance expired)			
31	Depreciation Expense	711	40	
	Accumulated Depreciation—Equipment	158		40
	(To record monthly depreciation)			
31	Unearned Service Revenue	209	400	
	Service Revenue	400		400
	(To record revenue for services performed)			
31	Accounts Receivable	112	200	
	Service Revenue	400		200
	(To record revenue for services performed)			
31	Interest Expense	905	50	
	Interest Payable	230		50
	(To record interest on notes payable)			
31	Salaries and Wages Expense	726	1,200	
	Salaries and Wages Payable	212		1,200
	(To record accrued salaries and wages)			

Steps in Preparing a Worksheet

Illustration 4-2

2. Enter the Adjustments in the Adjustments Columns

Account Titles	Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Balance Sheet	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	15,200									
Supplies	2,500			(a) 1,500						
Prepaid Insurance	600			(b) 50						
Equipment	5,000									
Notes Payable		5,000								
Accounts Payable		2,500								
Unearned Revenue		1,200	(d) 400							
Common Stock		10,000								
Dividends	500									
Service Revenue		10,000		(d) 400 (e) 200						
Salaries and Wages Exp.	4,000		(g) 1,200							
Rent Exp.	900									
Totals	28,700	28,700								
Supplies Expense			(a) 1,500							
Insurance Expense			(b) 50							
Accumulated Depreciation				(c) 40						
Depreciation Expense			(c) 40							
Accounts Receivable			(e) 200							
Interest Expense			(f) 50							
Interest Payable				(f) 50						
Salaries and Wages Payable				(g) 1,200						
Totals			3,440	3,440						

Adjustments Key:

- (a) Supplies Used.
- (b) Insurance Expired.
- (c) Depreciation Expensed.
- (d) Service Revenue Recognized.
- (e) Service Revenue Accrued.
- (f) Interest Accrued.
- (g) Salaries Accrued.

Enter adjustment amounts, total adjustments columns, and check for equality.

Add additional accounts as needed.

Steps in Preparing a Worksheet

Illustration 4-2

3. Complete the Adjusted Trial Balance Columns

Account Titles	Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Balance Sheet	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	15,200				15,200					
Supplies	2,500			(a) 1,500	1,000					
Prepaid Insurance	600			(b) 50	550					
Equipment	5,000				5,000					
Notes Payable		5,000								5,000
Accounts Payable		2,500								2,500
Unearned Revenue		1,200	(d) 400							800
Common Stock		10,000								10,000
Dividends	500				500					
Service Revenue		10,000		(d) 400 (e) 200						10,600
Salaries and Wages Exp.	4,000		(g) 1,200		5,200					
Rent Exp.	900				900					
Totals	28,700	28,700								
Supplies Expense			(a) 1,500		1,500					
Insurance Expense			(b) 50		50					
Accumulated Depreciation				(c) 40						40
Depreciation Expense			(c) 40		40					
Accounts Receivable			(e) 200		200					
Interest Expense			(f) 50		50					
Interest Payable				(f) 50						50
Salaries and Wages Payable				(g) 1,200						1,200
Totals			3,440	3,440	30,190	30,190				
Net Income										
Totals										

Total the adjusted trial balance columns and check for equality.

Steps in Preparing a Worksheet

Illustration 4-2

4. Extend Amounts to Financial Statement Columns

Account Titles	Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Balance Sheet	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	15,200				15,200				15,200	
Supplies	2,500			(a) 1,500	1,000				1,000	
Prepaid Insurance	600			(b) 50	550				550	
Equipment	5,000				5,000				5,000	
Notes Payable		5,000				5,000				5,000
Accounts Payable		2,500				2,500				2,500
Unearned Revenue		1,200	(d) 400			800				800
Common Stock		10,000				10,000				10,000
Dividends	500				500				500	
Service Revenue		10,000		(d) 400 (e) 200		10,600		10,600		
Salaries and Wages Exp.	4,000		(g) 1,200		5,200		5,200			
Rent Exp.	900				900		900			
Totals	28,700	28,700								
Supplies Expense			(a) 1,500		1,500		1,500			
Insurance Expense			(b) 50		50		50			
Accumulated Depreciation				(c) 40		40				40
Depreciation Expense			(c) 40		40		40			
Accounts Receivable			(e) 200		200				200	
Interest Expense			(f) 50		50		50			
Interest Payable				(f) 50		50				50
Salaries and Wages Payable				(g) 1,200		1,200				1,200
Totals			3,440	3,440	30,190	30,190	7,740	10,600	22,450	19,590
Net Income										
Totals										

Extend adjusted trial balance amounts to appropriate financial statement columns.

Steps in Preparing a Worksheet

Illustration 4-2

5. Total Columns, Compute Net Income (Loss)

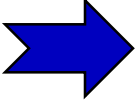
Account Titles	Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Balance Sheet	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	15,200				15,200				15,200	
Supplies	2,500			(a) 1,500	1,000				1,000	
Prepaid Insurance	600			(b) 50	550				550	
Equipment	5,000				5,000				5,000	
Notes Payable		5,000				5,000				5,000
Accounts Payable		2,500				2,500				2,500
Unearned Revenue		1,200	(d) 400			800				800
Common Stock		10,000				10,000				10,000
Dividends	500				500				500	
Service Revenue		10,000		(d) 400 (e) 200		10,600		10,600		
Salaries and Wages Exp.	4,000		(g) 1,200		5,200		5,200			
Rent Exp.	900				900		900			
Totals	28,700	28,700								
Supplies Expense			(a) 1,500		1,500		1,500			
Insurance Expense			(b) 50		50		50			
Accumulated Depreciation				(c) 40		40				40
Depreciation Expense			(c) 40		40		40			
Accounts Receivable			(e) 200		200				200	
Interest Expense			(f) 50		50		50			
Interest Payable				(f) 50		50				50
Salaries and Wages Payable				(g) 1,200		1,200				1,200
Totals			3,440	3,440	30,190	30,190	7,740	10,600	22,450	19,590
Net Income							2,860			2,860
Totals							10,600	10,600	22,450	22,450

Compute Net Income or Net Loss.

Steps in Preparing a Worksheet

Review Question

Net income is shown on a worksheet in the:

- a. income statement debit column only.
- b. balance sheet debit column only.
- c. income statement credit column and balance sheet debit column.
-  d. income statement debit column and balance sheet credit column.

Using a Worksheet

Preparing Financial Statements from a Worksheet

- ◆ Income statement is prepared from the income statement columns.
- ◆ Balance sheet and retained earnings statement are prepared from the balance sheet columns.
- ◆ Companies can prepare financial statements before they journalize and post adjusting entries.

Preparing Statements from a Worksheet



PIONEER ADVERTISING AGENCY INC.

Illustration 4-3

Income Statement

For the Month Ended October 31, 2015

Revenues		
Service revenue		<u>\$10,600</u>
Expenses		
Salaries and wages expense	\$5,200	
Supplies expense	1,500	
Rent expense	900	
Insurance expense	50	
Interest expense	50	
Depreciation expense	40	
Total expenses	<u>7,740</u>	<u>7,740</u>
Net income		<u><u>\$ 2,860</u></u>

Preparing Statements from a Worksheet



PIONEER ADVERTISING AGENCY INC. Retained Earnings Statement For the Month Ended October 31, 2015

Illustration 4-3

Retained earnings, October 1	\$ -0-
Add: Net income	<u>2,860</u>
	2,860
Less: Dividends	<u>500</u>
Retained earnings, October 31	<u><u>\$2,360</u></u>

Preparing Statements from a Worksheet



PIONEER ADVERTISING AGENCY INC.

Illustration 4-3

Balance Sheet
October 31, 2015

Assets

Cash		\$15,200
Accounts receivable		200
Supplies		1,000
Prepaid insurance		550
Equipment	\$5,000	
Less: Accumulated depreciation—equipment	<u>40</u>	<u>4,960</u>
Total assets		<u><u>\$21,910</u></u>

Liabilities and Stockholders' Equity

Liabilities		
Notes payable	\$5,000	
Accounts payable	2,500	
Interest payable	50	
Unearned service revenue	800	
Salaries and wages payable	<u>1,200</u>	
Total liabilities		\$ 9,550
Stockholders' equity		
Common stock	10,000	
Retained earnings	<u>2,360</u>	
Total stockholders' equity		<u>12,360</u>
Total liabilities and stockholders' equity		<u><u>\$21,910</u></u>

Using a Worksheet

Preparing Adjusting Entries from a Worksheet

- ◆ Adjusting entries are prepared from the adjustments columns of the worksheet.
- ◆ Journalizing and posting of adjusting entries **follows** the preparation of financial statements when a worksheet is used.



DO IT!

Susan Elbe is preparing a worksheet. Explain to Susan how she should extend the following adjusted trial balance accounts to the financial statement columns of the worksheet.

Cash	Balance sheet (debit column)
Accumulated Depreciation	Balance Sheet (credit column)
Accounts Payable	Balance Sheet (credit column)
Dividends	Balance sheet (debit column)
Service Revenue	Income statement (credit column)
Salaries and Wages Expense	Income statement (debit column)

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Completing the Accounting Cycle

Learning Objectives

After studying this chapter, you should be able to:

- [1] Prepare a worksheet.
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- [3] Describe the content and purpose of a post-closing trial balance.
- [4] State the required steps in the accounting cycle.
- [5] Explain the approaches to preparing correcting entries.
- [6] Identify the sections of a classified balance sheet.

Closing the Books

At the end of the accounting period, the company makes the accounts ready for the next period.

Illustration 4-4

TEMPORARY

These accounts are closed

All revenue accounts

All expense accounts

Dividends

PERMANENT

These accounts are not closed

All asset accounts

All liability accounts

Stockholders' equity

Closing the Books

Preparing Closing Entries

Closing entries formally recognize in the ledger the transfer of

- ◆ net income (or net loss) and
- ◆ Dividends

to Retained Earnings.

Companies generally journalize and post closing entries only at the end of the annual accounting period.

Closing entries produce a zero balance in each temporary account.

Closing the Books

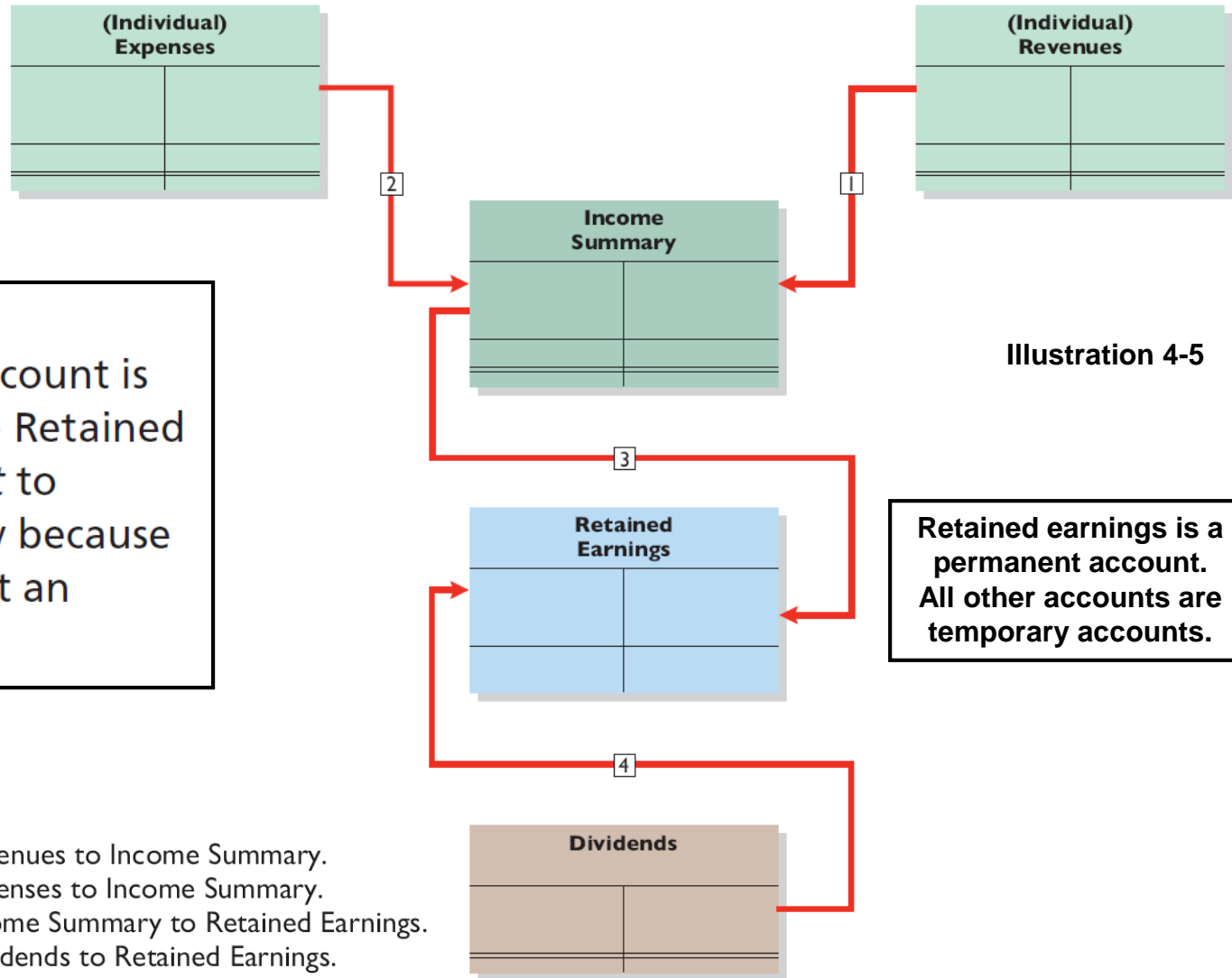


Illustration 4-5

Helpful Hint

The Dividends account is closed directly to Retained Earnings and *not* to Income Summary because dividends are not an expense.

Retained earnings is a permanent account. All other accounts are temporary accounts.

Key:

- 1 Close Revenues to Income Summary.
- 2 Close Expenses to Income Summary.
- 3 Close Income Summary to Retained Earnings.
- 4 Close Dividends to Retained Earnings.

Closing the Books

Closing Entries Illustrated

GENERAL JOURNAL				
Date	Account Titles and Explanation	Ref.	Debit	Credit
	Closing Entries			
2015	(1)			
Oct. 31	Service Revenue	400	10,600	
	Income Summary	350		10,600
	(To close revenue account)			
	(2)			
31	Income Summary	350	7,740	
	Supplies Expense	631		1,500
	Depreciation Expense	711		40
	Insurance Expense	722		50
	Salaries and Wages Expense	726		5,200
	Rent Expense	729		900
	Interest Expense	905		50
	(To close expense accounts)			
	(3)			
31	Income Summary	350	2,860	
	Retained Earnings	320		2,860
	(To close net income to retained earnings)			
	(4)			
31	Retained Earnings	320	500	
	Dividends	332		500
	(To close dividends to retained earnings)			

Illustration 4-6
Closing entries
journalized

Closing the Books

Posting Closing Entries

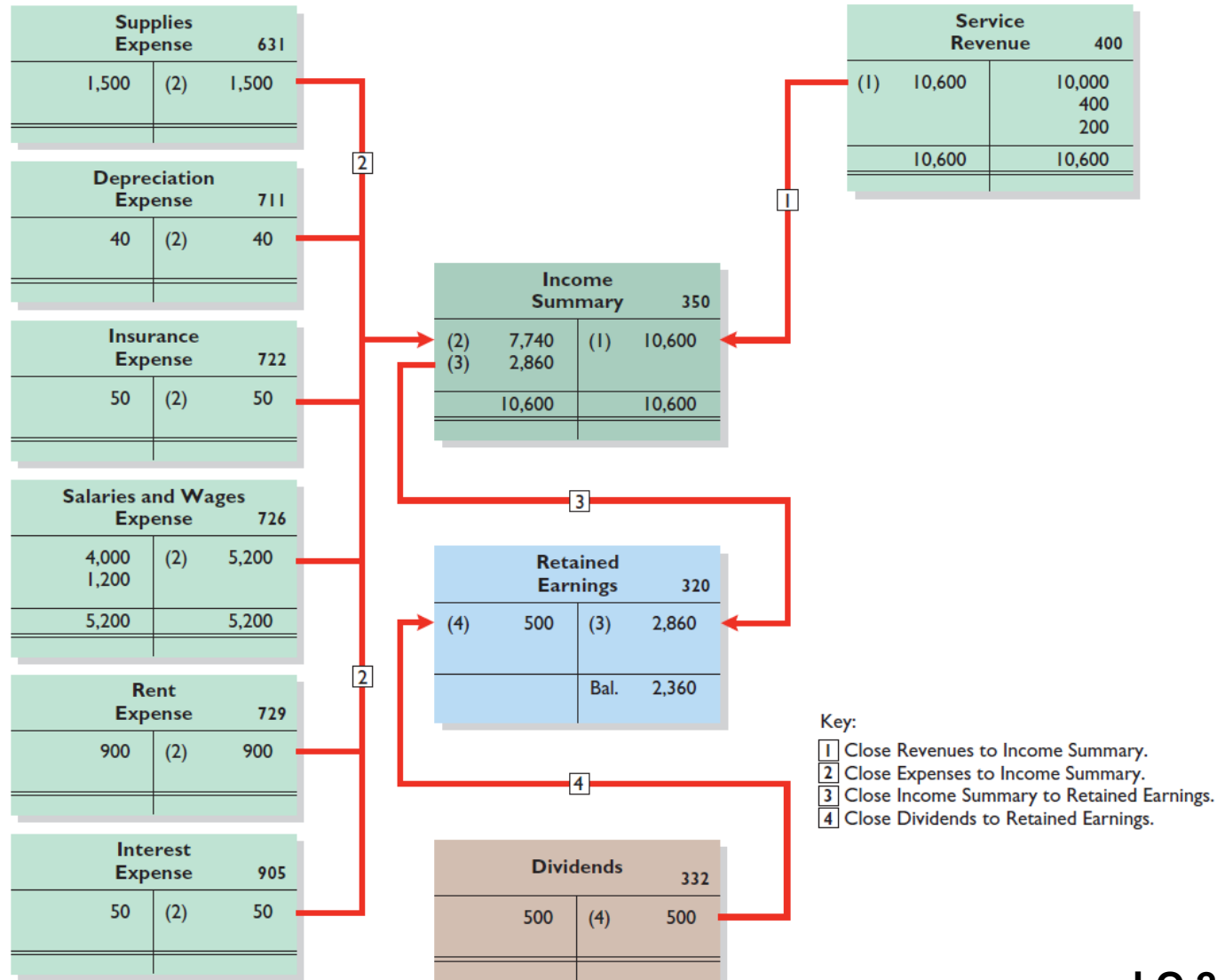


Illustration 4-7

ACCOUNTING ACROSS THE ORGANIZATION



Cisco Performs the Virtual Close

Technology has dramatically shortened the closing process. Recent surveys have reported that the average company now takes only six to seven days to close, rather than 20 days. But a few companies do much better. **Cisco Systems** can perform a “virtual close”—closing within 24 hours on any day in the quarter. The same is true at **Lockheed Martin Corp.**, which improved its closing time by 85% in just the last few years. Not very long ago, it took 14 to 16 days. Managers at these companies emphasize that this increased speed has not reduced the accuracy and completeness of the data.

This is not just showing off. Knowing exactly where you are financially all of the time allows the company to respond faster than competitors. It also means that the hundreds of people who used to spend 10 to 20 days a quarter tracking transactions can now be more usefully employed on things such as mining data for business intelligence to find new business opportunities.

Source: “Reporting Practices: Few Do It All,” Financial Executive (November 2003), p. 11.



Who else benefits from a shorter closing process? (See page 215.)



DO IT!

The worksheet for Hancock Company shows the following in the financial statement columns:

Dividends	\$15,000
Common stock	\$42,000
Net income	\$18,000

Prepare the closing entries at December 31 that affect stockholders' equity.

Income summary	18,000	
Retained earnings		18,000
Retained earnings	15,000	
Dividends		15,000

4

Completing the Accounting Cycle

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- [4] State the required steps in the accounting cycle.
- [5] Explain the approaches to preparing correcting entries.
- [6] Identify the sections of a classified balance sheet.

Preparing a Post-Closing Trial Balance

Purpose is to prove the equality of the permanent account balances carried forward into the next accounting period.

Illustration 4-8
Post-closing trial balance

 PIONEER ADVERTISING AGENCY INC. Post-Closing Trial Balance October 31, 2015		
	<u>Debit</u>	<u>Credit</u>
Cash	\$ 15,200	
Accounts Receivable	200	
Supplies	1,000	
Prepaid Insurance	550	
Equipment	5,000	
Accumulated Depreciation—Equipment		\$ 40
Notes Payable		5,000
Accounts Payable		2,500
Unearned Service Revenue		800
Salaries and Wages Payable		1,200
Interest Payable		50
Common Stock		10,000
Retained Earnings		2,360
	<u><u>\$21,950</u></u>	<u><u>\$21,950</u></u>

4

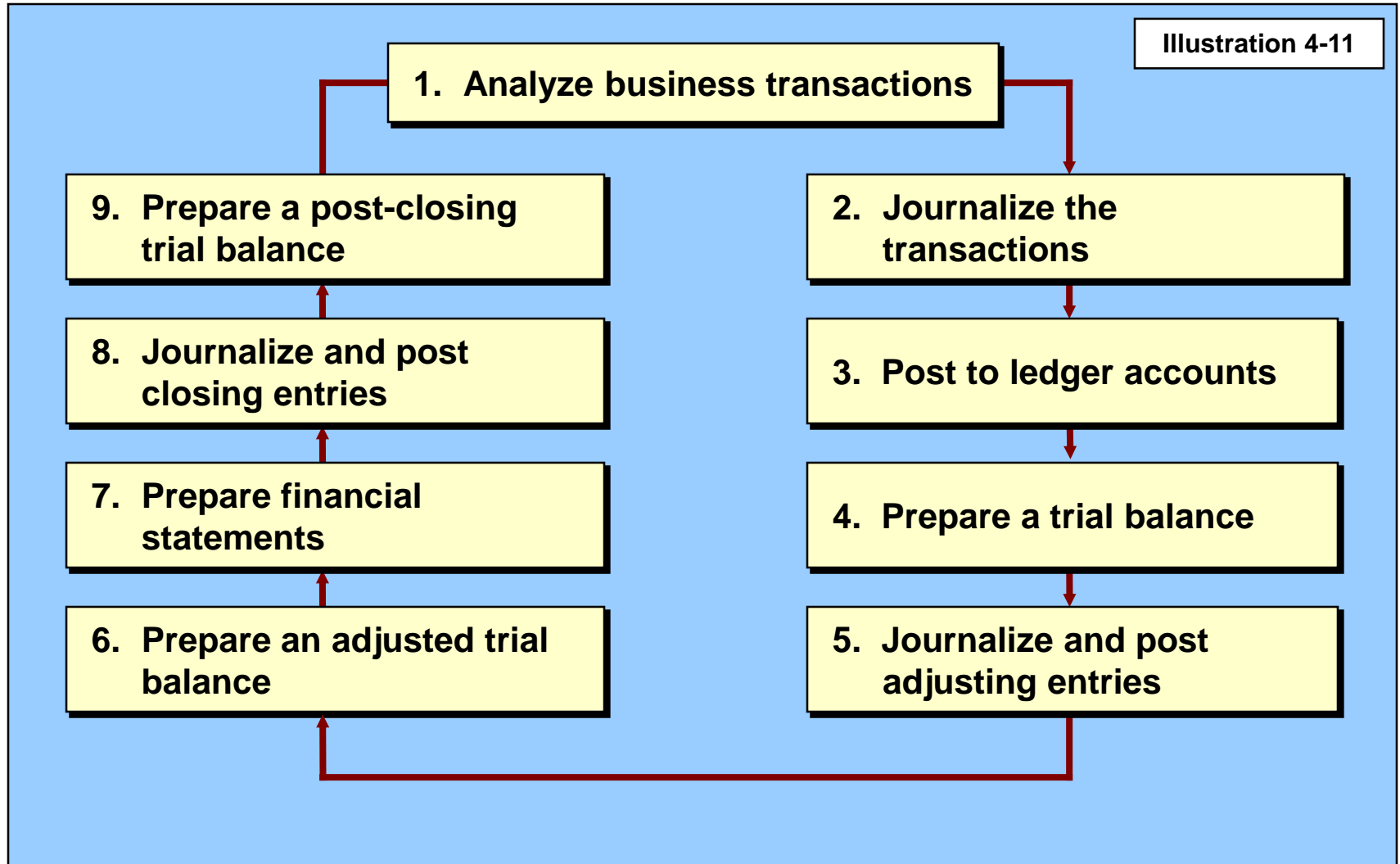
Completing the Accounting Cycle

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Summary of the Accounting Cycle



4

Completing the Accounting Cycle

Learning Objectives

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- [3] Describe the content and purpose of a post-closing trial balance.
- [4] State the required steps in the accounting cycle.
- [5] **Explain the approaches to preparing correcting entries.**
- [6] Identify the sections of a classified balance sheet.

Summary of the Accounting Cycle

Correcting Entries—An Avoidable Step

- ◆ Unnecessary if accounting records are free of errors.
- ◆ Made whenever an error is discovered.
- ◆ Must be posted before closing entries.

Instead of preparing a correcting entry, **it is possible to reverse the incorrect entry and then prepare the correct entry.**

Correcting Entries—An Avoidable Step

Case 1: On May 10, Mercato Co. journalized and posted a \$50 cash collection on account from a customer as a debit to Cash \$50 and a credit to Service Revenue \$50. The company discovered the error on May 20, when the customer paid the remaining balance in full.

Incorrect entry	Cash	50	
	Service Revenue		50
Correct entry	Cash	50	
	Accounts Receivable		50
Correcting entry	Service Revenue	50	
	Accounts Receivable		50

Correcting Entries—An Avoidable Step

Case 2: On May 18, Mercato purchased on account equipment costing \$450. The transaction was journalized and posted as a debit to Equipment \$45 and a credit to Accounts Payable \$45. The error was discovered on June 3.

Incorrect entry	Equipment	45	
	Accounts Payable		45
Correct entry	Equipment	450	
	Accounts Payable		450
Correcting entry	Equipment	405	
	Accounts Payable		405

ACCOUNTING ACROSS THE ORGANIZATION



Yale Express Loses Some Transportation Bills

Yale Express, a short-haul trucking firm, turned over much of its cargo to local truckers to complete deliveries. Yale collected the entire delivery charge. When billed by the local trucker, Yale sent payment for the final phase to the local trucker. Yale used a cutoff period of 20 days into the next accounting period in making its adjusting entries for accrued liabilities. That is, it waited 20 days to receive the local truckers' bills to determine the amount of the unpaid but incurred delivery charges as of the balance sheet date.

On the other hand, **Republic Carloading**, a nationwide, long-distance freight forwarder, frequently did not receive transportation bills from truckers to whom it passed on cargo until months after the year-end. In making its year-end adjusting entries, Republic waited for months in order to include all of these outstanding transportation bills.

When Yale Express merged with Republic Carloading, Yale's vice president employed the 20-day cutoff procedure for both firms. As a result, millions of dollars of Republic's accrued transportation bills went unrecorded. When the company detected the error and made correcting entries, these and other errors changed a reported profit of \$1.14 million into a loss of \$1.88 million!



What might Yale Express's vice president have done to produce more accurate financial statements without waiting months for Republic's outstanding transportation bills?
(See page 215.)

4

Completing the Accounting Cycle

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- [4] State the required steps in the accounting cycle.
- [5] Explain the approaches to preparing correcting entries.
- [6] **Identify the sections of a classified balance sheet.**

The Classified Balance Sheet

- ◆ Presents a snapshot at a point in time.
- ◆ To improve understanding, companies group similar assets and similar liabilities together.

Standard Classifications

Illustration 4-16

Assets

Current assets
Long-term investments
Property, plant, and equipment
Intangible assets

Liabilities and Owner's Equity

Current liabilities
Long-term liabilities
Stockholders' equity

The Classified Balance Sheet

FRANKLIN CORPORATION
Balance Sheet
October 31, 2015

Illustration 4-17

<u>Assets</u>			
Current assets			
Cash		\$ 6,600	
Debt investments		2,000	
Accounts receivable		7,000	
Notes receivable		1,000	
Inventory		3,000	
Supplies		2,100	
Prepaid insurance		400	
Total current assets			\$22,100
Long-term investments			
Stock investments		5,200	
Investment in real estate		2,000	7,200
Property, plant, and equipment			
Land		10,000	
Equipment	\$24,000		
Less: Accumulated depreciation— equipment	5,000	19,000	29,000
Intangible assets			
Patents			3,100
Total assets			\$61,400

The Classified Balance Sheet

FRANKLIN CORPORATION
Balance Sheet
October 31, 2015

Illustration 4-17

Liabilities and Stockholders' Equity

Current liabilities

Notes payable	\$11,000	
Accounts payable	2,100	
Unearned service revenue	900	
Salaries and wages payable	1,600	
Interest payable	450	
Total current liabilities		\$16,050

Long-term liabilities

Mortgage payable	10,000	
Notes payable	1,300	
Total long-term liabilities		11,300
Total liabilities		27,350

Stockholders' equity

Common stock	20,000	
Retained earnings	14,050	
Total stockholders' equity		34,050
Total liabilities and stockholders' equity		\$61,400

The Classified Balance Sheet

Current Assets

- ◆ Assets that a company expects to **convert to cash** or **use up** within one year or the operating cycle, whichever is longer.
- ◆ **Operating cycle** is the average time that it takes to purchase inventory, sell it on account, and then collect cash from customers.

The Classified Balance Sheet

Current Assets

Illustration 4-18

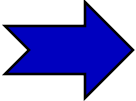
Real World		SOUTHWEST AIRLINES CO.	
		Balance Sheet (partial)	
		(in millions)	
Current assets			
Cash and cash equivalents			\$1,390
Short-term investments			369
Accounts receivable			241
Inventories			181
Prepaid expenses and other current assets			420
Total current assets			<u>\$2,601</u>

Usually listed in the order they expect to convert them into cash.

The Classified Balance Sheet

Review Question

The correct order of presentation in a classified balance sheet for the following current assets is:

- a. accounts receivable, cash, prepaid insurance, inventory.
- b. cash, inventory, accounts receivable, prepaid insurance.
-  c. cash, accounts receivable, inventory, prepaid insurance.
- d. inventory, cash, accounts receivable, prepaid insurance.

The Classified Balance Sheet

Long-Term Investments

- ◆ Investments in stocks and bonds of other companies.
- ◆ Investments in long-term assets such as land or buildings that is not currently being used in operating activities.
- ◆ Long-term notes receivable.

Illustration 4-19

YAHOO! INC.	
Balance Sheet (partial)	
(in thousands)	
Long-term investments	
Investments in securities	\$90,266

The Classified Balance Sheet

Property, Plant, and Equipment

- ◆ Long useful lives.
- ◆ Currently used in operations.
- ◆ **Depreciation** - allocating the cost of assets to a number of years.
- ◆ **Accumulated depreciation** - total amount of depreciation expensed thus far in the asset's life.

Alternative Terminology

Property, plant, and equipment is sometimes called *fixed assets* or *plant assets*.

The Classified Balance Sheet

Property, Plant, and Equipment


Illustration 4-20

COOPER TIRE & RUBBER COMPANY			
Balance Sheet (partial)			
(in thousands)			
Property, plant, and equipment			
Land and land improvements	\$ 41,553		
Buildings	298,706		
Machinery and equipment	1,636,091		
Molds, cores, and rings	<u>268,158</u>		\$2,244,508
Less: Accumulated depreciation			<u>1,252,692</u>
			\$ 991,816

The Classified Balance Sheet

Intangible Assets

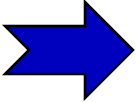
- ◆ Long-lived assets that do not have physical substance.

		TIME WARNER, INC.	Illustration 4-21
		Balance Sheet (partial)	
		(in millions)	
Intangible assets			
Goodwill			\$40,953
Film library			2,690
Customer lists			2,540
Cable television franchises			38,048
Sports franchises			262
Brands, trademarks, and other intangible assets			8,313
			<u> </u>
			\$92,806

The Classified Balance Sheet

Question

Patents and copyrights are

- a. Current assets.
-  b. Intangible assets.
- c. Long-term investments.
- d. Property, plant, and equipment.

PEOPLE, PLANET, AND PROFIT INSIGHT



Regaining Goodwill

After falling to unforeseen lows amidst scandals, recalls, and economic crises, the American public's positive perception of the reputation of corporate America is on the rise. Overall corporate reputation is experiencing rehabilitation as the American public gives high marks overall to corporate America, specific industries, and the largest number of individual companies in a dozen years. This is according to the findings of the *2011 Harris Interactive RQ Study*, which measures the reputations of the 60 most visible companies in the United States.

The survey focuses on six reputational dimensions that influence reputation and consumer behavior. Four of these dimensions, along with the five corporations that ranked highest within each, are as follows.

- **Social Responsibility:** (1) Whole Foods Market, (2) Johnson & Johnson, (3) Google, (4) The Walt Disney Company, (5) Procter & Gamble Co.
- **Emotional Appeal:** (1) Johnson & Johnson, (2) Amazon.com, (3) UPS, (4) General Mills, (5) Kraft Foods
- **Financial Performance:** (1) Google, (2) Berkshire Hathaway, (3) Apple, (4) Intel, (5) The Walt Disney Company
- **Products and Services:** (1) Intel Corporation, (2) 3M Company, (3) Johnson & Johnson, (4) Google, (5) Procter & Gamble Co.

Source: www.harrisinteractive.com.



Name two industries today which are probably rated low on the reputational characteristics of "being trusted" and "having high ethical standards." (See page 215.)



DO IT!

Advance slide in presentation mode to reveal answer.

Baxter Hoffman recently received the following information related to Hoffman Company's December 31, 2015, balance sheet.

Prepaid insurance	\$ 2,300	Inventory	\$3,400
Cash	800	Accumulated depreciation—	
Equipment	10,700	equipment	2,700
		Accounts receivable	1,100

Prepare the asset section of Hoffman Company's classified balance sheet.

Assets

Current assets

Total current assets

Property, plant, and equipment

Total assets

The Classified Balance Sheet

Current Liabilities

- ◆ Obligations the company is to pay within the coming year or its operating cycle, whichever is longer.
- ◆ Usually list notes payable first, followed by accounts payable. Other items follow in order of magnitude.
- ◆ Common examples are accounts payable, salaries and wages payable, notes payable, interest payable, income taxes payable current maturities of long-term obligations.
- ◆ **Liquidity** - ability to pay obligations expected to be due within the next year.

The Classified Balance Sheet

Current Liabilities

Illustration 4-22

Real World		MARCUS CORPORATION	
		Balance Sheet (partial)	
		(in thousands)	
Current liabilities			
Notes payable		\$	239
Accounts payable			24,242
Current maturities of long-term debt			57,250
Other current liabilities			27,477
Income taxes payable			11,215
Salaries and wages payable			6,720
Total current liabilities			<u>\$127,143</u>

ACCOUNTING ACROSS THE ORGANIZATION



Can a Company Be Too Liquid?

There actually is a point where a company can be too liquid—that is, it can have too much working capital (current assets less current liabilities). While it is important to be liquid enough to be able to pay short-term bills as they come due, a company does not want to tie up its cash in extra inventory or receivables that are not earning the company money.

By one estimate from the **REL Consultancy Group**, the thousand largest U.S. companies have on their books cumulative excess working capital of \$764 billion. Based on this figure, companies could have reduced debt by 36% or increased net income by 9%. Given that managers throughout a company are interested in improving profitability, it is clear that they should have an eye toward managing working capital. They need to aim for a “Goldilocks solution”—not too much, not too little, but just right.

Source: K. Richardson, “Companies Fall Behind in Cash Management,” Wall Street Journal (June 19, 2007).



What can various company managers do to ensure that working capital is managed efficiently to maximize net income? (See page 215.)

The Classified Balance Sheet

Long-Term Liabilities

- ◆ Obligations a company expects to pay **after** one year.

Illustration 4-23

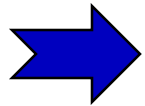
THE PROCTER & GAMBLE COMPANY	
Balance Sheet (partial)	
(in millions)	
Long-term liabilities	
Long-term debt	\$23,375
Deferred income taxes	12,015
Other noncurrent liabilities	5,147
Total long-term liabilities	<u>\$40,537</u>

The Classified Balance Sheet

Question

Which of the following is not a long-term liability?

a. Bonds payable



b. Current maturities of long-term obligations

c. Long-term notes payable

d. Mortgages payable

The Classified Balance Sheet

Stockholders' (Owner's) Equity

Alternative Terminology
Common stock is sometimes called *capital stock*.

- ◆ Proprietorship - one capital account.
- ◆ Partnership - capital account for each partner.
- ◆ Corporation - Common Stock and Retained Earnings.

Real World		NORDSTROM, INC. Balance Sheet (partial) (\$ in thousands)		Illustration 4-24
Stockholders' equity				
Common stock, 271,331 shares			\$ 685,934	
Retained earnings			<u>1,406,747</u>	
Total stockholders' equity			\$2,092,681	

Reversing Entries

- ◆ It is often helpful to reverse some of the adjusting entries before recording the regular transactions of the next period.
- ◆ Companies make a reversing entry at the **beginning** of the next accounting period.
- ◆ Each reversing entry is the **exact opposite** of the adjusting entry made in the previous period.
- ◆ The use of reversing entries **does not change** the amounts reported in the financial statements.

APPENDIX 4A Reversing Entries

Illustration: To illustrate the optional use of reversing entries for accrued expenses, we will use the salaries expense transactions for Pioneer Advertising Agency.

1. October 26 (initial salary entry): Pioneer pays \$4,000 of salaries and wages earned between October 15 and October 26.
2. October 31 (adjusting entry): Salaries and wages earned between October 29 and October 31 are \$1,200. The company will pay these in the November 9 payroll.
3. November 9 (subsequent salary entry): Salaries and wages paid are \$4,000. Of this amount, \$1,200 applied to accrued salaries and wages payable and \$2,800 was earned between November 1 and November 9.

APPENDIX 4A Reversing Entries

Illustration 4A-1

Without Reversing Entries (per chapter)

Initial Salary Entry

Oct. 26	Salaries and Wages Expense	4,000	
	Cash		4,000

Adjusting Entry

Oct. 31	Salaries and Wages Expense	1,200	
	Salaries and Wages Payable		1,200

Closing Entry

Oct. 31	Income Summary	5,200	
	Salaries and Wages Expense		5,200

Reversing Entry

Nov. 1 | No reversing entry is made.

Subsequent Salary Entry

Nov. 9	Salaries and Wages Payable	1,200	
	Salaries and Wages Expense	2,800	
	Cash		4,000

With Reversing Entries (per appendix)

Initial Salary Entry

Oct. 26 | **Same entry**

Adjusting Entry

Oct. 31 | **Same entry**

Closing Entry

Oct. 31 | **Same entry**

Reversing Entry

Nov. 1 | **Salaries and Wages Payable 1,200**
Salaries and Wages Expense 1,200

Subsequent Salary Entry

Nov. 9 | **Salaries and Wages Expense 4,000**
Cash 4,000

APPENDIX 4A Reversing Entries

Illustration 4A-2
Postings with reversing entries

Salaries and Wages Expense					
10/26	Paid	4,000	10/31	Closing	5,200
	31	Adjusting	1,200		
		5,200			5,200
11/9	Paid	4,000	11/1	Reversing	1,200

Salaries and Wages Payable					
11/1	Reversing	1,200	10/31	Adjusting	1,200



Compare the procedures for the closing process under GAAP and IFRS.

Key Points

- ◆ The procedures of the closing process are applicable to all companies, whether they are using IFRS or GAAP.
- ◆ IFRS recommends but does not require the use of the title “statement of financial position” rather than balance sheet.
- ◆ The format of statement of financial position information is often presented differently under IFRS. Most companies that follow IFRS present statement of financial position information in this order:
 - ▶ Non-current assets
 - ▶ Current assets
 - ▶ Equity
 - ▶ Non-current liabilities
 - ▶ Current liabilities



A Look at IFRS

Key Points

- ◆ IFRS requires a classified statement of financial position except in very limited situations. IFRS follows the same guidelines as this textbook for distinguishing between current and noncurrent assets and liabilities.
- ◆ Under IFRS, current assets are usually listed in the reverse order of liquidity.
- ◆ Some companies report the subtotal **net assets**, which equals total assets minus total liabilities.
- ◆ IFRS has many differences in terminology that you will notice in this textbook.



A Look at IFRS

Key Points

- ◆ Both IFRS and GAAP require disclosures about (1) accounting policies followed, (2) judgments that management has made in the process of applying the entity's accounting policies, and (3) the key assumptions and estimation uncertainty that could result in a material adjustment to the carrying amounts of assets and liabilities within the next financial year.
- ◆ Comparative prior-period information must be presented and financial statements must be prepared annually.
- ◆ Both GAAP and IFRS are increasing the use of fair value to report assets. Under IFRS companies can apply fair value to property, plant, and equipment; natural resources; and in some cases intangible assets.



A Look at IFRS

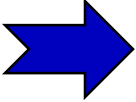
Looking to the Future

The IASB and the FASB are working on a project to converge their standards related to financial statement presentation. A key feature of the proposed framework is that each of the statements will be organized in the same format, to separate an entity's financing activities from its operating and investing activities and, further, to separate financing activities into transactions with owners and creditors.



IFRS Self-Test Questions

Which of the following statements is false?

- a) Assets equals liabilities plus equity.
-  b) Under IFRS, companies sometimes net liabilities against assets to report "net assets."
- c) The FASB and IASB are working on a joint conceptual framework project.
- d) Under IFRS, the statement of financial position is usually referred to as the statement of assets and equity.



IFRS Self-Test Questions

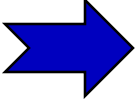
A company has purchased a tract of land and expects to build a production plant on the land in approximately 5 years. During the 5 years before construction, the land will be idle. Under IFRS, the land should be reported as:

- a) land expense.
- b) property, plant, and equipment.
- c) an intangible asset.
- ➔ d) a long-term investment.



IFRS Self-Test Questions

Current assets under IFRS are listed generally:

- a) by importance.
-  b) in the reverse order of their expected conversion to cash.
- c) by longevity.
- d) alphabetically.

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