

Questions 3–9 of the Self-Study Questions are based on the following data:

HYDRO COMPANY Balance Sheet December 31			
Cash	\$ 40,000	Current liabilities	\$ 80,000
Accounts receivable (net)	80,000	10% Bonds payable	120,000
Inventory	130,000	Common stock	200,000
Plant and equipment (net)	250,000	Retained earnings	100,000
Total Assets	<u>\$500,000</u>	Total Liabilities and Stockholders' Equity ...	<u>\$500,000</u>

Sales revenues for the year were \$800,000, gross profit was \$320,000, and net income was \$36,000. The income tax rate was 40 percent. One year ago, accounts receivable (net) were \$76,000, inventory was \$110,000, total assets were \$460,000, and stockholders' equity was \$260,000. The bonds payable were outstanding all year and the interest expense for the year was **\$12,000**.

LO4



3. The current ratio of Hydro Company at December 31, calculated using the above data, was 3.13, and the company's working capital was \$170,000. Which of the following would happen if the firm paid off \$20,000 of its current liabilities on January 1 of the following year?

- Both the current ratio and working capital would decrease.
- Both the current ratio and working capital would increase.
- The current ratio would increase, but working capital would remain the same.
- The current ratio would increase, but working capital would decrease.

LO4



4. What was the firm's inventory turnover for the year?

- 6.67
- 4
- 6
- 3.69

LO4



5. What was the firm's return on common stockholders' equity for the year?

- 25.7 percent
- 12.9 percent**
- 17.1 percent
- 21.4 percent

LO4



6. What was the firm's average collection period for the year?

- 36.5 days
- 37.4 days
- 35.6 days
- 18.3 days

LO4



7. What was the firm's times-interest-earned ratio for the year?

- 4
- 3
- 5
- 6

LO4



8. What was the firm's profit margin for the year?

- 4.0 percent
- 4.5 percent
- 5.0 percent
- 5.5 percent

LO4



9. What was the firm's return on assets for the year?

- 6.0 percent
- 7.0 percent
- 7.5 percent
- 8.0 percent

LO2



10. When performing trend analysis, each line item is expressed as a percentage of:

- net income.
- the base year amount.
- the prior year amount.
- total assets.

LO5



11. Recognized limitations of financial statement analysis include each of the following except:

- companies in the same industry using different accounting methods.
- inflation.
- different levels of profitability between companies.
- difficulty of classifying by industry conglomerates.

LO6

(Appendix 11A)



12. Financial statement disclosures include each of the following except:

- notes to the financial statements.
- parenthetical disclosures.
- supplementary information.
- promotional giveaways.

Recognizing Accrued Revenue

Accrued Revenues

Transaction: *Accrue fee revenue earned in December.*

Trans	Balance Sheet					Income Statement		
	Assets	=	Liabilities	+ Stockholders' Equity		Revenues	- Expenses	= Net Income
				Contrib. Capital	+ Retained Earnings			
(e)	+150 Accounts receivable	=		+	+150	+150 Fee revenue	-	= +150

Dec. 31	Accounts receivable	150	
	Fee revenue		150
	<i>To record accrued fee revenue earned in December.</i>		

Accounts Receivable			Fee Revenue		
Unadjusted	1,340		18,250	Unadjusted	
(e)	150		750	(a)	
Adjusted	1,490		150	(e)	
			19,150	Adjusted	

Recognizing Accrued Expenses

Accrued Expenses

Transaction: *Accrue wages for the last two days of December.*

Trans	Balance Sheet					Income Statement		
	Assets	=	Liabilities	+ Stockholders' Equity		Revenues	- Expenses	= Net Income
				Contrib. Capital	+ Retained Earnings			
(f)		=	+324 Wages payable	+	-324		+324 Wage expense	= -324

Dec. 31	Wage expense	324	
	Wages payable		324
	<i>To record accrued wages for the final two days of December.</i>		

Wage Expense			Wages Payable		
Unadjusted	1,620		0	Unadjusted	
(f)	324		324	(f)	
Adjusted	1,944		324	Adjusted	

Transaction: <i>Accrue interest expense for</i> December.									
Balance Sheet						Income Statement			
Trans	Assets	=	Liabilities	+ Stockholders' Equity		Revenues	− Expenses	= Net Income	
				Contrib. Capital + Retained Earnings					
(g)		=	+300 Interest payable	+ −300			− +300 Interest expense	= −300	
Dec. 31 Interest expense 300 Interest payable 300 To record accrued interest expense for December.									
Interest Expense					Interest Payable				
Unadjusted	0					0	Unadjusted		
(g)	300					300	(g)		
Adjusted	300					300	Adjusted		

Summary of Accounting Adjustments

Exhibit C-6 summarizes the adjusting entries for DataForce as recorded in its general journal. These adjustments would be posted to the company’s general ledger.

Exhibit C-7 lists the four types of accounting adjustments and also shows (1) examples of how each type of adjustment arises, (2) the generic adjusting entry for each type of adjustment, and (3) what accounts are overstated or understated *prior to* any adjustment. As we explained, each adjustment affects at least one balance sheet (asset or liability) account and at least one income statement account (expense or revenue).