**Accounting 202 Review Exercise – Financial Statements, Depreciation, and Ratios**

**This exercise will be combined with a discussion opportunity. You can earn up to 20 points for this exercise, and the discussion will be part of the discussion grade.**

Based on our review exercise, students need a bit more practice with Classified Balance Sheets, and we will start working with financial analysis. The exercise will consist of 5 parts (it’s not as scary as it sounds).

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Part 1 – **Create Simple Financial Statements -** Given a set of financial data, create simple financial statements. **Since you just created a simple set of financial statements for a previous review exercise, I have completed this for you. (0 points)**

Part 2 – **Make an Initial Observation –** Based on the information presented in the financial statements from Part 1, what’s your opinion on how the company is doing? It does not need to be a thorough analysis – just your gut-level observation**. A simple couple of sentences** of your opinion (with some reasoning). (1 point)

Part 3 – **Calculate Depreciation and Create the Classified Balance Sheet –** A brief review of straight-line depreciation and the **calculation of depreciation for the items** in the Property, Plant & Equipment section of the financial statements above. (4 points)

You will make simple modifications to the Income Statement, and the Statement of Retained Earnings (they are provided for you, mostly filled in), and you will **create a new Classified Balance Sheet**. (7 points)

Part 4 – **How’s the Company Doing? Make Ratio Calculations –** In this section, you will provide **9 ratio calculations**. Most of them were from ACCT 201; however, you will find them all in our Chapter 15. Please show your work. (4 points)

Part 5 – **How’s the Company Doing? Analyze Ratio Calculations –** This will be part of our discussion. Based on the ratios you just calculated, **answer some questions** using critical thinking, backed up by your calculations. We will then have discussions about them this week. (4 points)

**Submission: You only need to submit the filled-in pages 3, 5, 6, and 8-10. You are welcome to submit the entire document if it is easier for you.**

**You should be able to recognize parts of the “Long Definition of Accounting” in this exercise!** (“…classify, record, summarize, interpret, and communicate…for decision-making purposes.”)

**Part 1 – Financial Statements Please complete, handwritten, on paper. Use correct dates, capitalization, indenting, and spelling. (I have completed this for you.)**

**Requirements**

1. Prepare the Income Statement for Executive Employment Service for the year ended December 31, 2024.
2. Prepare the Statement of Retained Earnings for the year ended December 31, 2024.
3. Prepare the Balance Sheet as of December 31, 2024.

**Data Table**

|  |  |
| --- | --- |
| Land | 109,000 |
| Notes Payable (Long-term) | 150,000 |
| Property Tax Expense | 23,300 |
| Dividends | 43,000 |
| Rent Expense | 13,000 |
| Salaries Expense | 153,000 |
| Salaries Payable | 101,400 |
| Professional Services Revenue | 375,000 |
| Office Supplies | 28,000 |
|  |  |
| Common Stock |  26,000  |
| Accounts Payable | 67,000 |
| Accounts Receivable | 124,200 |
| Advertising Expense | 14,000 |
| Building | 164,100 |
| Cash | 42,200 |
| Equipment | 18,000 |
| Insurance Expense | 32,400 |
| Interest Expense | 7,200 |
| Retained Earnings, December 31, 2023 | 52,000 |

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|  |
| **Executive Employment Services** |
| **Income Statement** |
| **Year Ended, December 31, 2024** |
| **Revenues** |  |  |
| Professional Services Revenue |  $ 375,000  |  |
| **Total Revenues** |  |  **$ 375,000**  |
|  |  |  |
| **Expenses** |  |  |
| Advertising Expense |  $ 14,000  |  |
| Insurance Expense |  32,400  |  |
| Interest Expense |  7,200  |  |
| Property Tax Expense |  23,300  |  |
| Rent Expense |  13,000  |  |
| Salaries Expense |  153,000  |  |
| **Total Expenses** |  |  **$ 242,900**  |
|  |  |  |
| **Net Income** |  |  **$ 132,100**  |
|   |   |   |

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| **Executive Employment Services** |
| **Statement of Retained Earnings** |
| **Year Ended, December 31, 2024** |
| Retained Earnings, December 31, 2023 |   | $ 52,000  |
| Net Income for Year |   | 132,100 |
|   |   | $ 184,100 |
| Less Dividends |   |  (43,000) |
| Retained Earnings, December 31, 2024 |   | **$ 141,100** |
|   |   |   |
|   |   |   |
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| **Executive Employment Services** |
| **Balance Sheet** |
| **December 31, 2024** |
| ***Assets*** |  | ***Liabilities*** |  |
| Cash | $ 42,200 |  Accounts Payable  | $ 67,000 |
| Accounts Receivable | 124,200 |  Salaries Payable  | 101,400 |
| Office Supplies | 28,000 |  Notes Payable (Long-term) | 150,000 |
| Land | 109,000 |   |  |
| Building | 164,100 |  **Total Liabilities**  | **$ 318,400** |
| Equipment | 18,000 |  |  |
|   |  |  |  |
|   |  | ***Stockholders' Equity*** |  |
|  |  |  Common Stock  | $ 26,000 |
|  |  |  Retained Earnings  | 141,100 |
|  |  |  **Total Stockholders' Equity**  | **$ 167,100** |
|  |  |  |  |
| **Total Assets** | **$ 485,500** |  **Total Liabilities and Stockholders' Equity**  | **$ 485,500** |
|  |  |  |  |

**Part 2 – Initial Observation**

Quick overall impression: Do you think that the company is doing a good job and in good shape, based on what you see on the financial statements? Give a brief (one sentence or so) reason for your answer. Write your answers here**:**

**Part 3 – Depreciation and the Classified Balance Sheet**

The above financial statements use the single-step Income Statement and the (un-Classified) Account-Form Balance Sheet. If your company sold merchandise, you would likely use the Multi-Step Income Statement.)

Regarding the Balance Sheet, it’s a good idea to use the **Classified Balance Sheet**, for two excellent reasons:

1. You can present more useful information by separating (classifying) the Assets and Liabilities into short-term and long-term.
2. You can more easily show your calculations of book values of Property, Plant, and Equipment, and some Liability accounts

The classifications for Assets are:

* Current Assets (to be “used up” within a year)
* Investments (we won’t see this yet)
* Property, Plant, & Equipment

The classifications for Liabilities are:

* Current Liabilities (to be paid within a year)
* Long-term Liabilities (due dates longer than one year)

Let’s assume that the above financial statements were created at the end of the period, *before adjusting journal entries and calculations were made for Depreciation*. These calculations are important, and should not be omitted. We must now calculate and make the adjustments for depreciation and re-create the financial statements. This is another excellent use for the Classified Balance Sheet (see reason 2 above).

**Requirements**:

1. **Calculate Depreciation Expense and Accumulated Depreciation** for eligible Property, Plant & Equipment.
2. Create/**modify the new Income Statement** to reflect the Depreciation Expense.
3. Create/**modify the new Statement of Retained Earnings** to reflect new Net Income.
4. **Create a Classified Balance Sheet** to reflect the new account totals, to separate the Assets and Liabilities based on their classifications, and to show the effects of Accumulated Depreciation on the book values of the depreciable Property, Plant & Equipment.
5. **Calculate the Depreciation Expense (and the Accumulated Depreciation) for each of the eligible Property, Plant & Equipment accounts.**
* Use straight-line depreciation.
* Use Accumulated Depreciation, (asset name) to keep track of the depreciation for the individual depreciable assets. Each is a contra-asset account named for each of the depreciable assets. Example: Accumulated Depreciation, Truck
* Use one account, Depreciation Expense, to “pool” the expense for all the depreciable assets.
* Your Equipment has an estimated residual value of $1,000, and an 8-year estimated useful life.
* Your Building has an estimated residual value of $26,000, and a 25-year estimated useful life
* Assume that these assets were purchased at the beginning of the year, and that no depreciation calculations have been made all year - neither any Accumulated Depreciation nor Depreciation Expense have been recognized (recorded).
* Not all Property, Plant & Equipment will be eligible for depreciation. (Why?) Can you name the one PP&E account that ISN’T depreciated? This is important, and you should definitely know it!

Use this section to show your depreciation calculations.

**Equipment:** Annual Depreciation Expense and amount to be added to Accumulated Depreciation, if applicable. Show your formula in words, and in numbers. Round to the nearest dollar.

**Calculation:**

**(Cost – Residual Value) / Estimated Useful Life**

**(18,000 - 1,000) / 8 =**

**17,000 / 8 = $2,125**

**Land**: AnnualDepreciation Expense and amount to be added to Accumulated Depreciation, if applicable. Show your formula in words, and in numbers. Round to the nearest dollar.

**Calculation**:

**Land is not depreciable.**

**Building:** Annual Depreciation Expense and amount to be added to Accumulated Depreciation, if applicable. Show your formula in words, and in numbers. Round to the nearest dollar.

**Calculation:**

**(Cost – Residual Value) / Estimated Useful Life**

**(164,100 - 26,000) / 25 =**

**138,100 / 25 = $5,524**

**Total Depreciation Expense:**

**Calculation: Equipment Depreciation: $2,125**

 **Land Depreciation: 0**

 **Building Depreciation : $5,524**

 **$7,649**

1. **Complete the new Income Statement** for year ended, Dec. 31, 2024, to reflect the updated Net Income. Fill in only the shaded areas.

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| **Executive Employment Services** |
| **Income Statement** |
| **Year Ended, December 31, 2024** |
| **Revenues** |  |  |
| Professional Services Revenue |  $ 375,000  |  |
| **Total Revenues** |  |  **$ 375,000**  |
|  |  |  |
| **Expenses** |  |  |
| Advertising Expense |  $ 14,000  |  |
| Depreciation Expense | **7,649** |  |
| Insurance Expense |  32,400  |  |
| Interest Expense |  7,200  |  |
| Property Tax Expense |  23,300  |  |
| Rent Expense |  13,000  |  |
| Salaries Expense |  153,000  |  |
| **Total Expenses** |  |  **$ 250,549** |
|  |  |  |
| **Net Income** |  | **$ 124,451** |
|   |   |   |

1. **Complete the new Statement of Retained Earnings** for year ended, Dec. 31, 2024, to reflect the updated Net Income.

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| **Executive Employment Services** |
| **Statement of Retained Earnings** |
| **Year Ended, December 31, 2024** |
| Retained Earnings, December 31, 2023 |   | $ 52,000  |
| Net Income for Year |   | **124,451** |
|   |   | **176,451** |
| Less Dividends |   |  (43,000) |
| Retained Earnings, December 31, 2024 |   | **$ 133,451** |
|   |   |   |
|   |   |   |
|   |   |   |

On the next page(s), you will create the new Classified Balance Sheet. *So many of you had trouble with this in a previous exercise, so I am presenting another, this time with color-coded guides for where you are to place the data.* It is important that you complete ACCT 201 and 202 with this knowledge.

1. **Create the new Classified Balance Sheet**. (Blank sheet on next page.) Rather than using the side-by-side “Account-Form” Balance sheet form, we’ll use the vertical, “Report-Form” Balance Sheet so that we can show interior calculations more easily. Here are some tips:
	1. Assets:
	* See the textbook for “Classified Balance Sheet” for examples. You will likely find one at the end of the chapter where Depreciation is explained.
	* Classify the Asset categories into the following: (1) Current Assets, and (2) Property, Plant & Equipment (sometimes referred to as “Fixed Assets”).
	* Total the Current Assets and place the total in the 3rd column.
	* For each PP&E account eligible for depreciation, list its cost in the 1st numeric column.
	* List each Property, Plant & Equipment (we call it “PP&E”) account on its own line. If a PP&E Asset is not depreciable, enter its cost in the 2nd numeric column.
	* Under each PP&E account eligible for depreciation, list its adjoining valuation account, “Accumulated Depreciation, (asset name)”, and list its amount in the 1st numeric column. You’ll often see “Less” to show that Accumulated Depreciation will be subtracted from the cost to determine the book value, but not necessarily. In either case, you will subtract.
	* After listing the “Accumulated Depreciation, (asset name)” amount, show the **book value** of the asset in the 2nd numeric column (to the right of the Accumulated Depreciation amount). In the example below.

Example:

|  |  |  |
| --- | --- | --- |
| **Property, Plant & Equipment** |   |   |
|  Equipment | $ 100,000  |   |
|  Accumulated Depreciation, Equipment | 21,533  | 78,467  |

* + - * 1. 100,000 is the cost
				2. 21,533 is the Accumulated Depreciation
				3. 78,467 is the book value
	+ Total the PP&E amounts from the 2nd column and place in the 3rd column.
	+ Total the Current Assets *and* the PP&E placing the total in the 3rd column.
	1. Liabilities:
	+ You’ll also classify your Liabilities into Current Liabilities and Long-Term Liabilities, with subtotals for each, and then a “Total Liabilities” line.
	+ Assume that the Notes Payable amount is due several years from now.
	1. Stockholders’ Equity:
	+ The Stockholders’ Equity section remains the same with both the (unclassified) Balance Sheet and the Classified Balance Sheet.
	+ Be sure to total both the Stockholders’ Equity section and then display and calculate “Total Liabilities and Stockholders’ Equity. This total should be the same as “Total Assets.” If these are not equal, you must locate the error and correct it before moving on.

(Classified Balance Sheet - Be sure to complete the depreciation calculations and update the Income Statement and the Statement of Retained Earnings first.)

Fill in correct heading, and complete all the rest.

Place each PP&E asset’s cost and Accum. Depr. In the FIRST col., and its book value in the SECOND col. (If no depr, place cost in the SECOND col.) Place PP&E TOTAL in the THIRD column.

Fill in shaded areas only

Totals are in yellow highlighting

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| **Problem\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ Name\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_** |
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| **Assets** |   |   |   |
| **Current Assets** |   |   |   |
| Cash |  | $ 42,200 |  |
| Accounts Receivable |   | 124,200  |   |
| Office Supplies |   | 28,000  |   |
|   |   |   |   |
| Total Current Assets |   |   | $ 194,400  |
|   |   |   |   |
| **Property, Plant & Equipment** |   |   |   |
| Land |  | $ 109,000 |  |
| Building | $ 164,100  |   |   |
| Accumulated Depreciation, Building | 5,524  | 158,576  |   |
| Equipment | 18,000  |   |   |
| Accumulated Depreciation, Equipment | 2,125  | 15,875  |   |
| Total Property, Plant & Equipment |   |   | 283,451  |
|   |   |   |   |
| **Total Assets** |   |   | **$ 477,851** |
|   |   |   |  |
| **Liabilities** |   |   |   |
| **Current Liabilities** |   |   |   |
| Accounts Payable |   | $ 67,000 |   |
| Salaries Payable |   | 101,400 |   |
|   |   |   |   |
|   |   |   |   |
| Total Current Liabilities |   |   | $ 168,400  |
|   |   |   |   |
| **Long-term Liabilities** |   |   |   |
| Notes Payable |   | 150,000  |   |
|   |   |   |   |
|   |   |   |   |
|   |   |   |   |
|   |   |   |   |
| Total Long-term Liabilities |   |   | $ 150,000  |
|   |   |   |   |
| **Total Liabilities** |   |   | $ 318,400  |
|   |   |   |  |
| **Stockholders' Equity** |   |   |  |
| Common Stock |   | $ 26,000 |  |
| Retained Earnings |   | 133,451 |  |
| **Total Stockholders' Equity** |   |   | $ 159,451  |
| **Total Liabilities and Stockholders' Equity** |   |   | **$ 477,851** |
|   |   |   |   |
|  |  |  |  |

**Part 4 – How’s the Company Doing? Ratio Calculations**

While just a few simple ratio calculations will not give the full picture of the company’s financial health, it is a good beginning. Calculating the answers below will help you answer some important questions: ***Be sure to complete Part 3 first.***  (Most of the ratios are from ACCT 201, and all can be found in Ch. 15).

* Do they have enough cash to pay their current liabilities?
* What percentage of their assets are funded by liabilities?
* How long does It take the company, on average, to collect their Accounts Receivable?
* What percentage of their Net Income has the company paid in Dividends? You may have to look up this ratio in the index of the book (it’s in Chapter 15) or on the Internet.
* What, on the average, would investors expect to receive as a return on their investment in assets?

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **1. Cash Ratio** | (words) | **Cash + Cash Equivalents** | **/** | **Current Liabilities** |  |  |
|  | (calculations) | **42,200** | **/** | **168,400** | **=** | **.25** |
|  |  |  |  |  |  |  |
| **2. Debt Ratio** | (words) | **Total Liabilities** | **/** | **Total Assets** |  |  |
| (aka Debt-to-Assets) | (calculations) | **318,400** | **/** | **477,851** | **=** | **66.63 %** |
|  |  |  |  |  |  |  |
| **3. Current Ratio** | (words) | **Current Assets** | **/** | **Current Liabilities** |  |  |
|  | (calculations) | **194,400** | **/** | **168,400** | **=** | **1.15** |
|  |  |  |  |  |  |  |
| **4. Quick (Acid Test) Ratio** | (words) | **(Cash + Cash Eq + AR + Marketable Securities)** | **/** | **Current Liabilities** | **OR: (Curr Assets – Inventory – Prepaids) / Current Liabiiities** |
|  | (calculations) | **(42,200 + 124,200) = 166,400** | **/** | **168,400** | **=** | **0.99** |
|  |  |  |  |  |  |  |
| **5. Accounts Receivable Turnover Ratio** | (words) | **Net Credit Sales** | **/** | **Average Accounts Receivable** |  |  |
|  | (calculations) | **Use Revenues here****375,000** | **/** | **(1,200 + 124,200) / 2 =** **125,400 / 2 = 62,700** | **=** | **6** |
|  |  |  |  |  |  |  |
| **6. Days’ Sales in Receivables** | (words) | **365** | **/** | **Accounts Receivable Turnover Ratio** |  |  |
| *Always* round UP! No partial days. | (calculations) | **365** | **/** | **6** | **=** |  **61 days** |
|  |  |  |  |  |  |  |
| **7. Dividend Payout Ratio** | (words) | **Dividends (or** **Dividends per Share)** | **/** | **Net Income (or Earnings Per Share)** |  |  |
|  | (calculations) | **43,000** | **/** | **124,451** | **=** | **34.6 %** |
|  |  |  |  |  |  |  |
| **8. Average Total Assets** | (words) | **Beginning Assets + Ending Assets** | **/** | **2** |  |  |
|  | (calculations) | **(100,700 + 477,851) =****578,551** | **/** | **2** | **=** | **$ 289,276** |
|  |  |  |  |  |  |  |
| **9. Return on Assets** | (words) | **Net Income** | **/** | **Average Total Assets** |  |  |
|  | (calculations) | **124,451** | **/** | **289,276** | **=** |  **43 %** |

Keep in mind that a *thorough* analysis of the company’s financial health always includes comparisons with other companies in their same industry.

**Note: Last year’s Account’s Receivable was $1,200, and Total Assets were $100,700**

Example for the Cash Ratio shown below.

**Part 5 – How’s the Company Doing? Analysis of Ratio Calculations**

Questions:

1. **What is your opinion of the Cash position of the company – Do they have enough cash to cover their current liabilities?** Refer to the calculations above and provide an opinion.
2. **Would you loan money to this company? Do you think that the company is in a good position to keep up with their *current* debt obligations**? Refer to the calculations above and provide a opinion. Support your opinion.
3. **Let’s assume that the industry standard for collections on Accounts Receivable is 30 days. How is *this* company doing?** Refer to the calculations above and provide an opinion.
4. **What is your opinion of the percentage of Assets that are funded by Debt?** Refer to the calculations above and provide an opinion.
5. **In your opinion, will investors be happy with the return on assets?** Refer to the calculations above and provide an opinion. What is your basis for comparison**?**
6. **How do you think investors will feel about the percentage of net income that the company paid in dividends, and why**? Refer to the calculations above and provide an opinion.
7. **Have you changed your mind about the health of the company compared to your initial observation?** Explain why, based on the calculations and observations that you have made.