

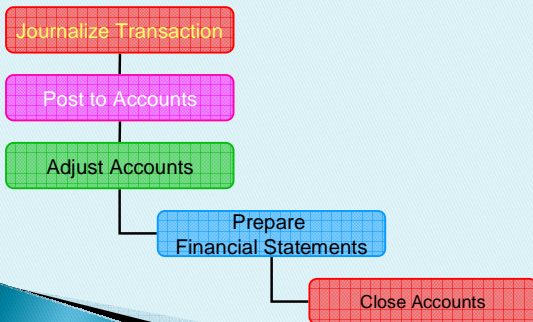
Completing the Accounting Cycle

Chapter 4

The Accounting Cycle

- ▶ Process by which companies produce their financial statements

Accounting Cycle



Learning Objective 1

Prepare an accounting work sheet

Work Sheet

- ▶ Internal summary device

COMPANY NAME									
Accounting Work Sheet									
May 31, 2010									
Accounts	Trial Balance		Adjustments		Adj. Trial Balance	Income Statement		Balance Sheet	
	Debit	Credit	Debit	Credit		Debit	Credit	Debit	Credit

Work Sheet Steps

- ▶ Enter account titles and their unadjusted balances in the Trial Balance columns
- ▶ Total the amounts

Work Sheet Steps

- Enter the adjusting entries in the Adjustments columns
- Total the amounts

Accounts	Adjustments	
	Debit	Credit
Cash		
Accounts receivable	c 300	
Supplies		a 500
Furniture		
Accum. depr.		b 1,000
Accounts payable		
Salaries payable		d 100
Unearned revenue	e 200	
Josie Smith, Capital		
Josie Smith, W/D		
Service revenue		c 300
		d 200
Salary expense	d 100	
Supplies expense	a 500	
Depreciation exp.	b 1,000	
Utilities expense		
	2,100	2,100

Copyright (c) 2009, Prentice Hall. All rights reserved.

7

Work Sheet Steps

- Compute each account's adjusted balance by combining the trial balance and adjustment figures
- Enter each account's adjusted amount in the Adjusted trial balance columns

Copyright (c) 2009, Prentice Hall. All rights reserved.

8

Work Sheet Steps

Accounts	Trial Balance		Adjustments		Adj. Trial Balance	
	Debit	Credit	Debit	Credit	Debit	Credit
Cash	4,800				4,800	
Accounts receivable	2,200		c 300		2,500	
Supplies	700			a 500	200	
Furniture	18,000				18,000	
Accum. depr.		1,000		b 1,000		2,000
Accounts payable		7,200				7,200
Salaries payable				d 100		100
Unearned revenue		600	e 200		400	
Josie Smith, Capital		13,200				13,200
Josie Smith, W/D	1,000				1,000	
Service revenue		6,000		c 300		6,500
				d 200		
Salary expense	900		d 100		1,000	
Supplies expense			a 500		500	
Depreciation exp.			b 1,000		1,000	
Utilities expense	400				400	
	28,000	28,000	2,100	2,100	29,400	29,400

Copyright (c) 2009, Prentice Hall. All rights reserved.

9

Work Sheet Steps

- Draw an imaginary line above the first revenue account
- Every account above goes to the Balance sheet columns
- Every account below goes to the Income Statement columns

Accounts	Adj. Trial Balance	
	Debit	Credit
Cash	4,800	
Accounts receivable	2,500	
Supplies	200	
Furniture	18,000	
Accum. depr.		2,000
Accounts payable		7,200
Salaries payable		100
Unearned revenue		400
Josie Smith, Capital		13,200
Josie Smith, W/D	1,000	
Service revenue		6,500
Salary expense	1,000	
Supplies expense	500	
Depreciation exp.	1,000	
Utilities expense	400	
	29,400	29,400

Copyright (c) 2009, Prentice Hall. All rights reserved.

10

COMPANY NAME Accounting Work Sheet May 31, 2010

Accounts	Adj. Trial Balance		Income statement		Balance sheet	
	Debit	Credit	Debit	Credit	Debit	Credit
Cash	4,800				4,800	
Accounts receivable	2,500				2,500	
Supplies	200				200	
Furniture	18,000				18,000	
Accum. depr.		2,000				2,000
Accounts payable		7,200				7,200
Salaries payable		100				100
Unearned revenue		400				400
Josie Smith, Capital		13,200				13,200
Josie Smith, W/D	1,000				1,000	
Service revenue		6,500		6,500		
Salary expense	1,000		1,000			
Supplies expense	500		500			
Depreciation exp.	1,000		1,000			
Utilities expense	400		400			
	29,400	29,400	2,900	6,500	26,500	22,900

Copyright (c) 2009, Prentice Hall. All rights reserved.

11

Work Sheet Steps

- On the income statement, compute net income
- Enter net income as the balancing amount

Accounting Work Sheet May 31, 2010		
Accounts	Income Statement	
	Debit	Credit
Cash		
Accounts receivable		
Supplies		
Furniture		
Accum. depr.		
Accounts payable		
Salaries payable		
Unearned revenue		
Josie Smith, Capital		
Josie Smith, W/D		
Service revenue		6,500
Salary expense	1,000	
Supplies expense	500	
Depreciation exp.	1,000	
Utilities expense	400	
	2,900	6,500
	3,600	

Copyright (c) 2009, Prentice Hall. All rights reserved.

12

Work Sheet Steps

- Also enter net income as a balancing amount on the balance sheet

COMPANY NAME Accounting Work Sheet May 31, 2010		
Accounts	Balance Sheet	
	Debit	Credit
Cash	4,800	
Accounts receivable	2,500	
Supplies	200	
Furniture	18,000	
Accum. depr.		2,000
Accounts payable		7,200
Salaries payable		100
Unearned revenue		400
Josie Smith, Capital		13,200
Josie Smith, W/D	1,000	
Service revenue		
Salary expense		
Supplies expense		
Depreciation exp.		
Utilities expense		
Net Income		22,900
		3,600
	26,500	26,500

Copyright (c) 2009, Prentice Hall. All rights reserved.

13

COMPANY NAME Accounting Work Sheet May 31, 2010										
Accounts	Trial Balance		Adjustments		Adj. Trial Balance		Income Statement		Balance Sheet	
	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit
Cash	4,800				4,800				4,800	
Accounts receivable	2,200		c 300		2,500				2,500	
Supplies	700			a 500	200				200	
Furniture	18,000				18,000				18,000	
Accum. depr.		1,000		b 1,000		2,000				2,000
Accounts payable		7,200				7,200				7,200
Salaries payable				d 100		100				100
Unearned revenue		400				400				400
Josie Smith, Capital		13,200				13,200				13,200
Josie Smith, W/D	1,000				1,000					1,000
Service revenue			c 300			6,500				
Salary expense			d 100			1,000				
Supplies expense			a 500			500				
Depreciation exp.			b 1,000			1,000				
Utilities expense						400				
	28,000	28,000	2,100	2,100	29,400	29,400	2,900	6,500	26,500	22,900
							3,600	6,500	26,500	26,500
							6,500	6,500	26,500	26,500

Copyright (c) 2009, Prentice Hall. All rights reserved.

14

Learning Objective 2

Use the work sheet to prepare financial statements

Copyright (c) 2009, Prentice Hall. All rights reserved.

15

Preparing Financial Statements from a Work Sheet

- Both work sheet and financial statements have the same account balances and the same net income(or loss)
- Work sheet is an **internal** document
- Financial statements are for **external** users

Copyright (c) 2009, Prentice Hall. All rights reserved.

16

Work Sheet

Accounts	Income Statement	
	Debit	Credit
Cash		
Accounts receivable		
Supplies		
Furniture		
Accum. depr.		
Accounts payable		
Salaries payable		
Unearned revenue		
Josie Smith, Capital		
Josie Smith, W/D		
Service revenue		6,500
Salary expense	1,000	
Supplies expense	500	
Depreciation exp.	1,000	
Utilities expense	400	
	2,900	6,500
Net Income	3,600	
	6,500	6,500

Financial Statement

Any Company Income Statement Month ended May 31, 2010	
Revenue:	
Service revenue	\$ 6,500
Expenses:	
Salary expense	\$1,000
Depreciation expense	1,000
Supplies expense	500
Utilities expense	400
Total expenses	2,900
Net Income	\$ 3,600

Copyright (c) 2009, Prentice Hall. All rights reserved.

17

Any Company Statement of Owner's Equity Month ended May 31, 2010

Josie Smith, Capital May 1, 2010	\$13,200
Add: Net Income	3,600
	16,800
Less: Withdrawals	(1,000)
Josie Smith, Capital, May 31, 2010	\$15,800

Copyright (c) 2009, Prentice Hall. All rights reserved.

18

COMPANY NAME Accounting Work Sheet May 31, 2010		
Accounts	Balance Sheet	
	Debit	Credit
Cash	4,800	
Accounts receivable	2,500	
Supplies	200	
Furniture	18,000	
Accum. depr.		2,000
Accounts payable		7,200
Salaries payable		100
Unearned revenue		400
Josie Smith, Capital		13,200
Josie Smith, W/D	1,000	
Service revenue		
Salary expense		
Supplies expense		
Depreciation exp.		
Utilities expense		
	26,500	22,900
	26,500	26,500

Any Company Balance Sheet May 31, 2010	
Assets	
Cash	\$ 4,800
Accounts receivable	2,500
Supplies	200
Furniture	18,000
Less: Accumulated depreciation	(2,000)
Total assets	\$ 23,500
Liabilities	
Accounts payable	7,200
Salaries payable	100
Unearned revenue	400
Total liabilities	7,700
Owner's Equity	
Josie Smith, Capital	15,800
Total liabilities & owner's equity	23,500

Copyright (c) 2009, Prentice Hall. All rights reserved. 19

Learning Objective 3

Close the revenue, expense, and withdrawal accounts

Copyright (c) 2009, Prentice Hall. All rights reserved. 20

Closing the Accounts

- ▶ Occurs at the end of the period
- ▶ Zeroes out revenue and expense accounts

Copyright (c) 2009, Prentice Hall. All rights reserved. 21

Temporary and Permanent Accounts

<p>Temporary</p> <ul style="list-style-type: none"> ▶ Closed at the end of the period ▶ Start next period with a zero balance 	<p>Permanent</p> <ul style="list-style-type: none"> ▶ Not closed at the end of the period ▶ Ending balance carries forward to next period
--	--

Copyright (c) 2009, Prentice Hall. All rights reserved. 22

Closing Entries

- ▶ Transfer temporary accounts to Capital
- ▶ Income summary account used in closing process

Copyright (c) 2009, Prentice Hall. All rights reserved. 23

Four Closing Entries

- ▶ 1. Close revenues

GENERAL JOURNAL				
Date	Accounts	Post Ref	Debit	Credit
	Service revenue		6,500	
	Income summary			6,500
- ▶ 2. Close expenses

GENERAL JOURNAL				
Date	Accounts	Post Ref	Debit	Credit
	Income summary		2,900	
	Salaries expense			1,000
	Supplies expense			500
	Depreciation exp.			1,000
	Utilities expense			400

Copyright (c) 2009, Prentice Hall. All rights reserved. 24

Income Summary

Service Revenue		Expenses	
#1	6,500	2,900	#2
	6,500	2,900	

Income summary	
2,900	6,500
	Bal. 3,600

Copyright (c) 2009, Prentice Hall. All rights reserved.

25

Four Closing Entries

- 3. Close Income summary

GENERAL JOURNAL				
Date	Accounts	Post Ref	Debit	Credit
	Income summary		3,600	
	Josie Smith, Capital			3,600

- 4. Close Withdrawals

GENERAL JOURNAL				
Date	Accounts	Post Ref	Debit	Credit
	Josie Smith, Capital		1,000	
	Josie Smith, W/D			1,000

Copyright (c) 2009, Prentice Hall. All rights reserved.

26

Four Closing Entries

Income summary		Josie Smith, W/D	
2,900	6,500	1,000	#4
#3	3,600		
	Bal. 3,600		

Josie Smith, Capital	
1,000	13,200
	3,600
	15,800
	Beginning balance
	Ending balance

Copyright (c) 2009, Prentice Hall. All rights reserved.

27

Any Company	
Statement of Owner's Equity	
Month ended May 31, 2010	
Josie Smith, Capital, May 1, 2010	\$13,200
Add: Net income	3,600
	16,800
Less: Withdrawals	(1,000)
Josie Smith, Capital, May 31, 2010	\$15,800

Josie Smith, Capital	
1,000	13,200
	3,600
	15,800
	Beginning balance
	Ending balance

Copyright (c) 2009, Prentice Hall. All rights reserved.

28

Exercise 4-20

GENERAL JOURNAL				
DATE	DESCRIPTION	REF	DEBIT	CREDIT
	Service revenue		110,90	
	Income summary			110,90
	<i>To close revenues</i>			

Copyright (c) 2009, Prentice Hall. All rights reserved.

29

Exercise 4-20

GENERAL JOURNAL				
DATE	DESCRIPTION	REF	DEBIT	CREDIT
	Income Summary		35,000	
	Salary expense			26,100
	Supplies expense			2,500
	Depreciation exp. – furniture			900
	Depreciation exp. - building			5,500
	<i>To close expenses</i>			

Copyright (c) 2009, Prentice Hall. All rights reserved.

30

Exercise 4-20

<table style="width: 100%; border-collapse: collapse;"> <tr> <td colspan="2" style="text-align: center; border-bottom: 1px solid black;"><u>Service Revenue</u></td> </tr> <tr> <td style="width: 50%; border-right: 1px solid black;">#1 110,900</td> <td style="width: 50%;">110,900</td> </tr> </table>	<u>Service Revenue</u>		#1 110,900	110,900	<table style="width: 100%; border-collapse: collapse;"> <tr> <td colspan="2" style="text-align: center; border-bottom: 1px solid black;"><u>Expenses</u></td> </tr> <tr> <td style="width: 50%; border-right: 1px solid black;">35,000</td> <td style="width: 50%;">35,000 #2</td> </tr> </table>	<u>Expenses</u>		35,000	35,000 #2
<u>Service Revenue</u>									
#1 110,900	110,900								
<u>Expenses</u>									
35,000	35,000 #2								
<table style="width: 100%; border-collapse: collapse;"> <tr> <td colspan="2" style="text-align: center; border-bottom: 1px solid black;"><u>Income summary</u></td> </tr> <tr> <td style="width: 50%; border-right: 1px solid black;">35,000</td> <td style="width: 50%;">110,900</td> </tr> <tr> <td colspan="2" style="text-align: center; border-top: 1px solid black;">Bal. 75,900</td> </tr> </table>		<u>Income summary</u>		35,000	110,900	Bal. 75,900			
<u>Income summary</u>									
35,000	110,900								
Bal. 75,900									

Exercise 4-20

GENERAL JOURNAL				
DATE	DESCRIPTION	REF	DEBIT	CREDIT
	Income summary		75,900	
	C. Pipeline, Capital			75,900
	<i>To close Income summary</i>			

Exercise 4-20

GENERAL JOURNAL				
DATE	DESCRIPTION	REF	DEBIT	CREDIT
	C. Pipeline, Capital		59,000	
	C. Pipeline, W/D			59,000
	<i>To close withdrawals</i>			

Exercise 4-20

<table style="width: 100%; border-collapse: collapse;"> <tr> <td colspan="2" style="text-align: center; border-bottom: 1px solid black;"><u>Income summary</u></td> </tr> <tr> <td style="width: 50%; border-right: 1px solid black;">35,000</td> <td style="width: 50%;">100,900</td> </tr> <tr> <td colspan="2" style="text-align: center; border-top: 1px solid black;">#3 75,900 Bal. 75,900</td> </tr> </table>	<u>Income summary</u>		35,000	100,900	#3 75,900 Bal. 75,900		<table style="width: 100%; border-collapse: collapse;"> <tr> <td colspan="2" style="text-align: center; border-bottom: 1px solid black;"><u>C. Pipeline, W/D</u></td> </tr> <tr> <td style="width: 50%; border-right: 1px solid black;">59,000</td> <td style="width: 50%;">59,000 #4</td> </tr> </table>	<u>C. Pipeline, W/D</u>		59,000	59,000 #4
<u>Income summary</u>											
35,000	100,900										
#3 75,900 Bal. 75,900											
<u>C. Pipeline, W/D</u>											
59,000	59,000 #4										
<table style="width: 100%; border-collapse: collapse;"> <tr> <td colspan="2" style="text-align: center; border-bottom: 1px solid black;"><u>C. Pipeline, Capital</u></td> </tr> <tr> <td style="width: 50%; border-right: 1px solid black;">59,000</td> <td style="width: 50%;">46,000 Beginning balance</td> </tr> <tr> <td colspan="2" style="text-align: center; border-top: 1px solid black;">75,900</td> </tr> <tr> <td colspan="2" style="text-align: center; border-top: 1px solid black;">62,900 Ending balance</td> </tr> </table>		<u>C. Pipeline, Capital</u>		59,000	46,000 Beginning balance	75,900		62,900 Ending balance			
<u>C. Pipeline, Capital</u>											
59,000	46,000 Beginning balance										
75,900											
62,900 Ending balance											

Learning Objective 4

Prepare postclosing trial balance

Post-Closing Trial Balance

- ▶ List of permanent accounts and their balances after posting closing entries
- ▶ Total debits and credits must be equal
- ▶ Same accounts as on the Balance Sheet

ANY COMPANY		
Postclosing Trial Balance		
May 31, 2010		
	Balance Sheet	
Accounts	Debit	Credit
Cash	4,800	
Accounts receivable	2,500	
Supplies	200	
Furniture	18,000	
Accum. depr.		2,000
Accounts payable		7,200
Salaries payable		100
Unearned revenue		400
Josie Smith, Capital		15,800
Totals	25,500	25,500

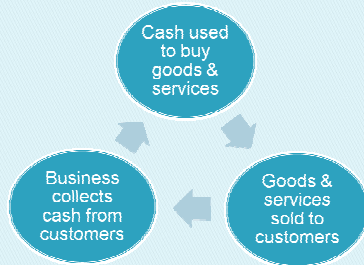
Learning Objective 5

Classify assets and liabilities as current or long-term

Liquidity

- ▶ Measure of how quickly an item can be converted into cash
- ▶ A classified balance sheet lists assets in order of their liquidity

Operating Cycle



Current Assets

- ▶ Will be converted to cash, sold or used up during the next year or **operating cycle**, whichever is longer

Long-Term Assets

- ▶ Not converted to cash within the current year or operating cycle
- ▶ Categories
 - Plant assets
 - Long-term investments
 - Other assets

Current Liabilities

- ▶ Must be paid either with cash or goods & services within one year or operating cycle

Long-Term Liabilities

- ▶ Are not due within the current year or operating cycle

Any Company Classified Balance Sheet May 31, 2010	
Assets	
Current assets:	
Cash	\$ 4,800
Accounts receivable	2,500
Supplies	200
Total current assets	7,500
Plant assets:	
Furniture	18,000
Less: Accumulated depreciation	(2,000) 16,000
Total assets	\$ 23,500
Liabilities	
Current liabilities:	
Accounts payable	7,200
Salaries payable	100
Unearned revenue	400
Total liabilities	7,700
Owner's Equity	
Josie Smith, Capital	15,800
Total liabilities & owner's equity	23,500

Balance Sheet Forms

- | | |
|---|--|
| <p>Account Format</p> <ul style="list-style-type: none"> ▶ Side-by-side <ul style="list-style-type: none"> ◦ Assets on left ◦ Liabilities & Equity on right | <p>Report Format</p> <ul style="list-style-type: none"> ▶ Top and bottom <ul style="list-style-type: none"> ◦ Assets on top ◦ Liabilities & Equity on bottom |
|---|--|

Learning Objective 6

Use the current ratio and the debt ratio to evaluate a company

Current Ratio

- ▶ Measures a company's ability to pay its current liabilities
- ▶ Rule of thumb
 - Strong current ratio is 1.5

$$\frac{\text{Current assets}}{\text{Current liabilities}}$$

Debt Ratio

- ▶ Indicates the proportion of a business's assets that are financed with debt
- ▶ Measures business's ability to pay its debts
- ▶ Rule of thumb:
 - Below 60% is considered safe

$$\frac{\text{Total liabilities}}{\text{Total assets}}$$

A rectangular graphic with a light blue background and a dark blue gradient at the bottom. The text "End of Chapter 4" is centered in the light blue area.

End of Chapter 4