
Chapter 4: Completing the Accounting Cycle

Learning Objective 1 → Describe the financial statements of a proprietorship and explain how they interrelate.

Financial Statements → After transactions have been recorded and summarized, reports are prepared for users. The accounting reports providing this information are called financial statements.

Order Prepared	Financial Statement	Description of Statements
1	Income Statement	A summary of the revenue and expenses for a specific period of time, such as a month or a year.
2	Statement of Owner's Equity	A summary of the changes in the owner's equity that have occurred during a specific period of time, such as a month or a year.
3	Balance Sheet	A list of the assets, liabilities, and owner's equity as of a specific date, usually at the close of the last day of a month or a year.
4	Statement of Cash flows	A summary of cash receipts and cash payments for a specific period of time, such as a month or a year.

Learning Objective 2 Prepare financial statements from adjusted account balances.

From chapter 3

Net Solutions Adjusted Trial Balance December 31, 2011		
	Debit Balances	Credit Balances
Cash	2,065	
Account receivable	2,720	
Supplies	760	
Prepaid insurance	2,200	
Land	20,000	
Office equipment	1,800	
Accumulated depreciation - office equipment ...		50
Account payable		900
Wages Payable		250
Unearned rent		240
Chris Clark, Capital		25,000
Chris Clark, Drawing	4,000	
Fees earned		16,840
Rent Revenue		120
Wages expense	4,525	
Rent expense	1,600	
Depreciation Expenses	50	
Utilities expense	985	
Supplies expense	2,040	
Insurance expense	200	
Miscellaneous expense	455	
	<u>43,400</u>	<u>43,400</u>

Income Statement

- **Income Statement** → Revenue and expense balances in the Adjusted Trial Balance column are extended to the Income Statement column. (Beginning with fees earned of \$16,840).

Company Name Income Statement For The Period Ended (Date)		
Revenues	xxx	
Total Revenues	<u> </u>	xxx
Expenses	xxx	
Total expenses	<u> </u>	(xxx)
Net income (or net loss)		<u> </u> xxx

Net solutions Income Statement For The Year Ended December 31, 2011		
Fees earned	16,840	
Rent revenue	<u> </u> 120	
Total revenues		16,960
Expenses:		
Wages expense	4,525	
Supplies expense	2,040	
Rent expense	1,600	
Utilities expense	985	
Insurance expense	200	
Depreciation expense	50	
Miscellaneous expense	<u> </u> 455	
Total expenses		9,855
Net income		7,105

Statement of Owner's Equity

→ The first item presented on the statement of owner's equity is the balance of the owner's capital account at the beginning of the period.

Company Name Statement of Owner's Equity For The Period Ended (Date)		
Capital, at the beginning of the period		xxx
Investment during the period	xxx	
Net income (or net loss)	xxx	
	xxx	
Less withdrawals	(xxx)	
Increase or decrease in owner's equity		xxx
Capital, at the end of the period		xxx

NetSolutions Statement of Owner's Equity For The Year Ended December 31, 2011		
Chris Clark, Capital, November 1, 2011		25,000
Investment on November 1, 2011	0	
Net income for November and December	7,105	
	32,105	
Less withdrawals	4,000	
Increase in owner's equity		28,105
Chris Clark, Capital, December 31, 2011		28,105

Balance Sheet

→ **Balance Sheet** → Asset, liability, owner's equity, and drawing balances in the Adjusted Trial Balance column are extended to the Balance Sheet column.

Classified Balance Sheet

→ A classified balance sheet is a balance sheet that was expanded by adding subsections for current assets; property, plant, and equipment; current liabilities ;and long-term liabilities.

Company Name			
Balance Sheet			
Date			
Assets		Liabilities	
Current Assets		Current Liabilities	
Cash	xx	Accounts payable	xx
Accounts Receivable	xx	Note payable	xx
Notes Receivable	xx	Wages payable	xx
Supplies	xx	Interest payable	xx
Prepaid Expenses	xx	Unearned fees	xx
Total current Assets.....	xx	Total current Liabilities	xx
Fixed Assets		Long-Term Liabilities	
Land	xx	Long -term notes payable	xx
Equipment	xx	Mortgages payable	xx
Accum. Dep. - equipment	xx	Bonds payable	xx
Machinery	xx	Loans	xx
Accum. Dep. - machinery	xx	total Long-Term Liabilities	xx
Buildings	xx		
Accum. Dep. - Buildings	xx		
Cars (automobile)	xx		
Accum. Dep. - cars	xx		
Total fixed assets	xx		
Total assets	xx		
		Owner's Equity	
		Owner's capital	xx
		Total Liabilities and Owner's equity	xx

NetSolutions			
Balance Sheet			
December 31, 2011			
Assets		Liabilities	
Current Assets		Current Liabilities	
Cash	2,065	Accounts payable	900
Accounts Receivable	2,720	Wages payable	250
Supplies	760	Unearned rent	240
Prepaid insurance	2,200		
	<u>2,200</u>	Total current Liabilities	<u>1,390</u>
Total current assets	7,745		
Fixed Assets		Owner's Equity	
Land	20,000	Chris clark, capital	28,105
Equipment	1,800		
Accum. Dep. - equipment	(50)		
Total fixed assets	<u>21,750</u>		
Total assets	<u>29,495</u>	Total Liabilities and Owner's equity	<u>29,495</u>

Current Assets → Cash and other assets that are expected to be converted into cash, sold, or used up usually within a year or less, through the normal operations of the business, are called current assets.

- Cash
- Accounts Receivable
- Notes Receivable → are written promises by the customer to pay the amount of the note and possibly interest at an agreed rate.
- Supplies

Fixed Assets → Property, plant, and equipment (also called fixed assets or plant assets) include assets that depreciate over a period of time. Land is an exception, as it is not subject to depreciation.

- Equipment
- Machinery
- Buildings
- Land

Current Liabilities → Liabilities that will be due within a short time (usually one year or less) and that are to be paid out of current assets are called current liabilities.

- Accounts payable
- Wages payable
- Interest payable
- Unearned fees

Long-Term Liabilities → Liabilities not due for a long time (usually more than one year) are called long-term liabilities.

- Short-term notes payable
- Mortgages payable
- Bonds payable

Owner's Equity → Owner's equity is the owner's right to the assets of the business. Owner's equity is added to the total liabilities, and this total must be equal to the total assets.

Learning Objective 3 Prepare closing entries.

Closing Entries

- Accounts that are relatively permanent from year to year are called **permanent accounts or real accounts**. These accounts are carried forward from year to year.
- Accounts that report amounts for only one period are called **temporary accounts or nominal accounts**. Temporary accounts are not carried forward because they relate to only one period.
- To report amounts for only one period, temporary accounts should have zero balances at the beginning of the next period.
- To achieve this, the revenue and expense account balances are transferred to Income Summary at the end of the period.
- The balance of Income Summary (net income or net loss) is then transferred to the owner's capital account.
- The balance of the owner's drawing account is also transferred to the owner's capital account.
- The entries that transfer these balances are called **closing entries**.
- Income Summary is a temporary account that is only used during the closing process.
- At the end of the closing process, the Income Summary account will have a zero balance.
- Income Summary is sometimes called a **clearing account**.

Date	Description	Debit	Credit
Dec. 31	Fees earned Rent revenue Income summary	16,840 120	16,960
Dec. 31	Income summary Wages expense Rent expense Depreciation expense Utilities expense Supplies expense Insurance expense Miscellaneous expense	9,855	4,525 1,600 50 985 2,040 200 455
Dec. 31	Income summary Chris Clark, Capital	7,105	7,105
Dec. 31	Chris Clark, Capital Chris Clark, Drawing	4,000	4,000

Temporary Account Balances

- After the closing entries are posted, all of the temporary accounts have zero balances.

Learning Objective 4 Describe the accounting cycle.

Accounting Cycle

- The accounting process that begins with analyzing and journalizing transactions and ends with preparing the accounting records for the next period's transactions is called the accounting cycle. There are ten steps in the accounting cycle.
 1. Transactions are analyzed and recorded in the journal.
 2. Transactions are posted to the ledger.
 3. An unadjusted trial balance is prepared.
 4. Adjustment data are assembled and analyzed.
 5. An optional end-of-period spreadsheet (work sheet) is prepared.
 6. Adjusting entries are journalized and posted to the ledger.
 7. An adjusted trial balance is prepared.
 8. Financial statements are prepared.
 9. Closing entries are journalized and posted to the ledger.
 10. A post-closing trial balance is prepared.

Homework

Continuing problem (page 201)