

Completing the Accounting Cycle

Chapter 4

Wild, Kwok, Venkatesh and Shaw
Fundamental Accounting Principles
3rd Edition

Accrual Basis versus Cash Basis Definitions

Accrual Basis

Revenues are recorded when products or services are delivered (Revenue recognition principle), and records expenses when incurred (matching principle).

Cash Basis

Revenues are recorded when cash is received and expenses are recorded when cash is paid. Cash Basis is not allowed under *GAAP*.

Types of Adjusting Entries

Deferrals

- (A) **Prepaid Expenses**—Assets paid for in advance of receiving their benefits. When these assets are used, those advance payments become expenses.
E.g. prepaid rent/supplies /depreciation for equipment
- (L) **Unearned Revenues**—Receive cash in advance of providing products and services.

Accruals

- Accrued Expenses**—Costs that are incurred in a period that are both unpaid and unrecorded.
- Accrued Revenues**—Revenues earned in a period that are both unrecorded and not yet received in cash (or other assets).

Dr. Prepaid Expense
Cr. Cash

Dr. XX Expense
Cr. Prepaid Expense

Dr. Cash
Cr. Unearned Revenue
Dr. Unearned Revenue
Cr. XX Revenue

Dr. XX Expense
Cr. XX Payable

Dr. XX Receivable
Cr. XX Revenue

Preparing Financial Statements from an Adjusted Trial Balance

- Step 1— Prepare income statement using revenue and expense accounts from adjusted trial balance.**
- Step 2—Prepare statement of changes in equity using capital and withdrawals from adjusted trial balance; and pull net profit from step 1.**
- Step 3—Prepare balance sheet using asset and liability account from adjusted trial balance; and pull updated capital balance from step 2.**
- Step 4—Prepare statement of cash flows from changes in cash flows for the period (illustrated later in the book).**

Preparing Financial Statements from an Adjusted Trial Balance

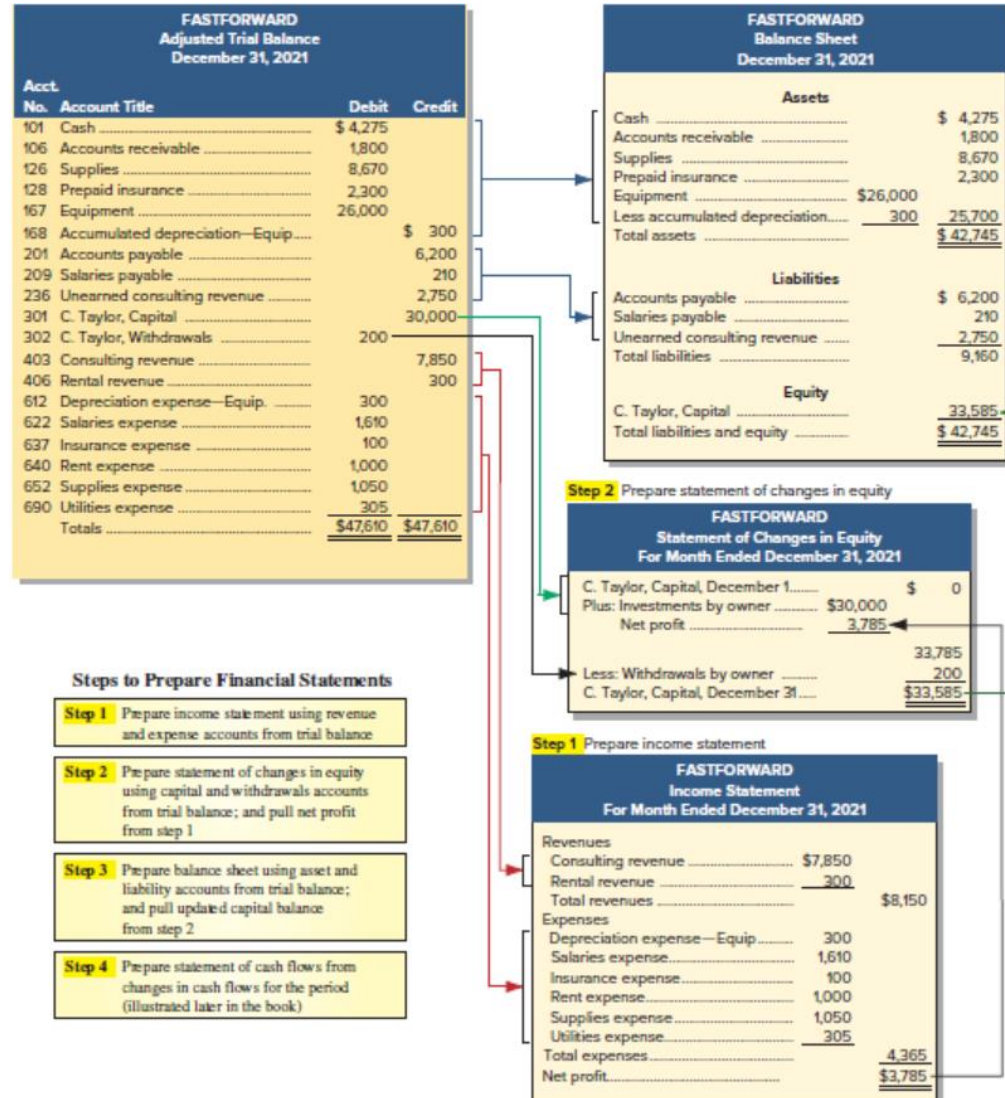


Exhibit
3.14

Steps to Prepare Financial Statements

- Step 1** Prepare income statement using revenue and expense accounts from trial balance
- Step 2** Prepare statement of changes in equity using capital and withdrawals accounts from trial balance; and pull net profit from step 1
- Step 3** Prepare balance sheet using asset and liability accounts from trial balance; and pull updated capital balance from step 2
- Step 4** Prepare statement of cash flows from changes in cash flows for the period (illustrated later in the book)

Benefits of a Work Sheet

Reduces risk of errors.

Helps in preparing financial statements.

Links accounts and their adjustments.

Shows the effects of proposed transactions.

Use of a Work Sheet

Five steps:

Step 1: Enter Unadjusted Trial Balance

Step 2: Enter Adjustments

Step 3: Prepare Adjusted Trial Balance

Step 4: Sort Adjusted Trial Balance Amounts
to Financial Statements

Step 5: Total Statement Columns, Compute
Profit or Loss, and Balance Columns

Use of a Work Sheet (continued)

Exhibit 4.1

FastForward
Work Sheet
For Month Ended December 31, 2021

No.	Account	Unadjusted Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Balance Sheet & Statement of Changes in Equity	
		Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
101	Cash	4,275				4,275				4,275	
106	Accounts receivable			(f) 1,800		1,800				1,800	
126	Supplies	9,720		(b) 1,050		8,670				8,670	
128	Prepaid insurance	2,400		(a) 100		2,300				2,300	
167	Equipment	26,000				26,000				26,000	
168	Accumulated depreciation—Equip.			(c) 300			300				300
201	Accounts payable		6,200				6,200				6,200
209	Salaries payable			(e) 210			210				210
236	Unearned consulting revenue		3,000	(d) 250			2,750				2,750
301	C. Taylor, Capital		30,000				30,000				30,000
302	C. Taylor, Withdrawals	200				200				200	
403	Consulting revenue		5,800	(d) 250			7,850		7,850		
				(f) 1,800							
406	Rental revenue		300				300		300		
612	Depreciation expense—Equip.			(c) 300		300		300			
622	Salaries expense	1,400		(e) 210		1,610		1,610			
637	Insurance expense			(a) 100		100		100			
640	Rent expense	1,000				1,000		1,000			
652	Supplies expense			(b) 1,050		1,050		1,050			
690	Utilities expense	305				305		305			
	Totals	45,300	45,300	3,710	3,710	47,610	47,610	4,365	8,150	43,245	39,460
	Net profit							3,785			3,785
	Totals							8,150	8,150	43,245	43,245

1a List all accounts from the ledger; accounts necessary to make accounting adjustments are shaded in dark green.

1b Enter all amounts available from ledger accounts. Column totals must be equal.

2 Enter adjustment amounts and use letters to cross-reference debit and credit adjustments. Column totals must be equal.

3 Combine unadjusted trial balance amounts with the adjustments to get the adjusted trial balance amounts. Column totals must be equal.

4a Extend all revenue and expense amounts to the income statement columns.

4b Extend all asset, liability, capital, and withdrawals amounts to these columns.

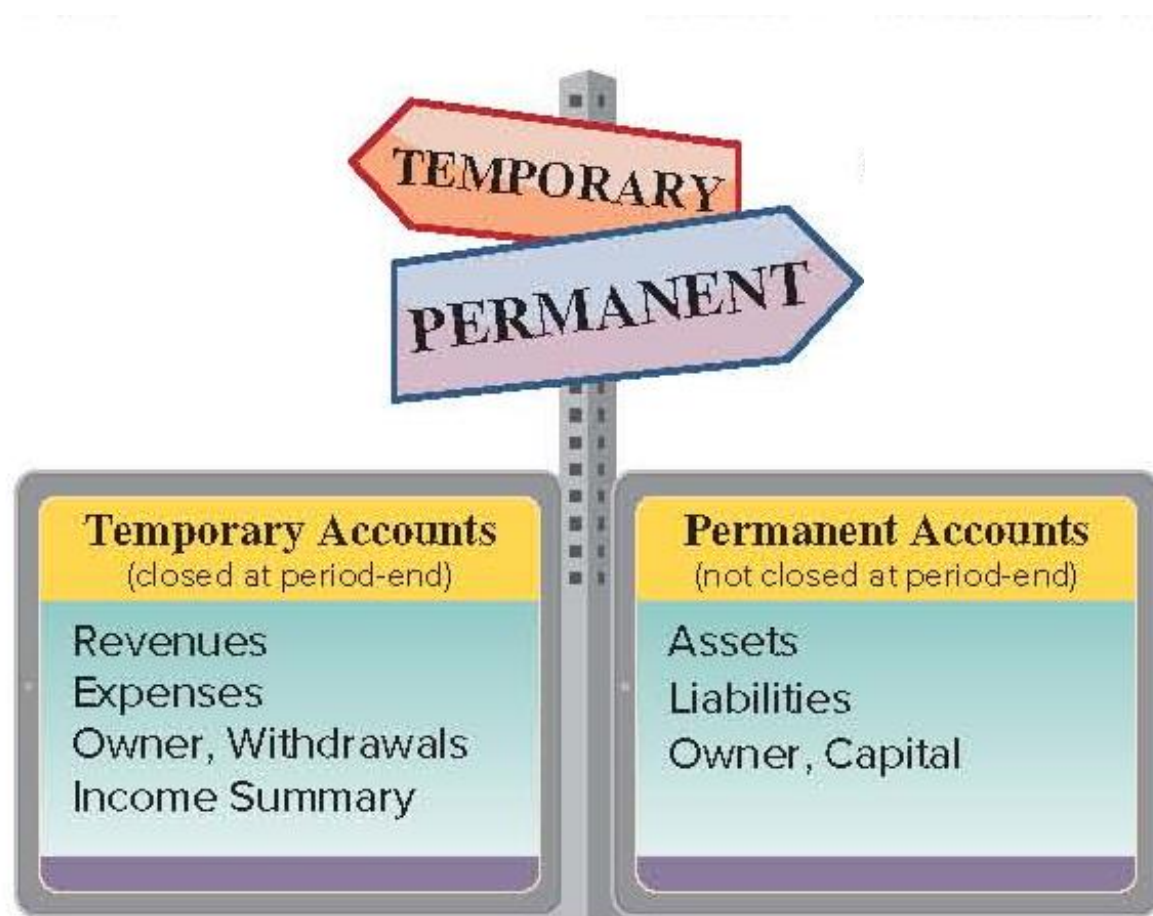
5a Enter two new lines for the (1) Net profit or loss. (2) Totals.

5b First "Totals" row for income statement columns differ by the amount of net profit or net loss.

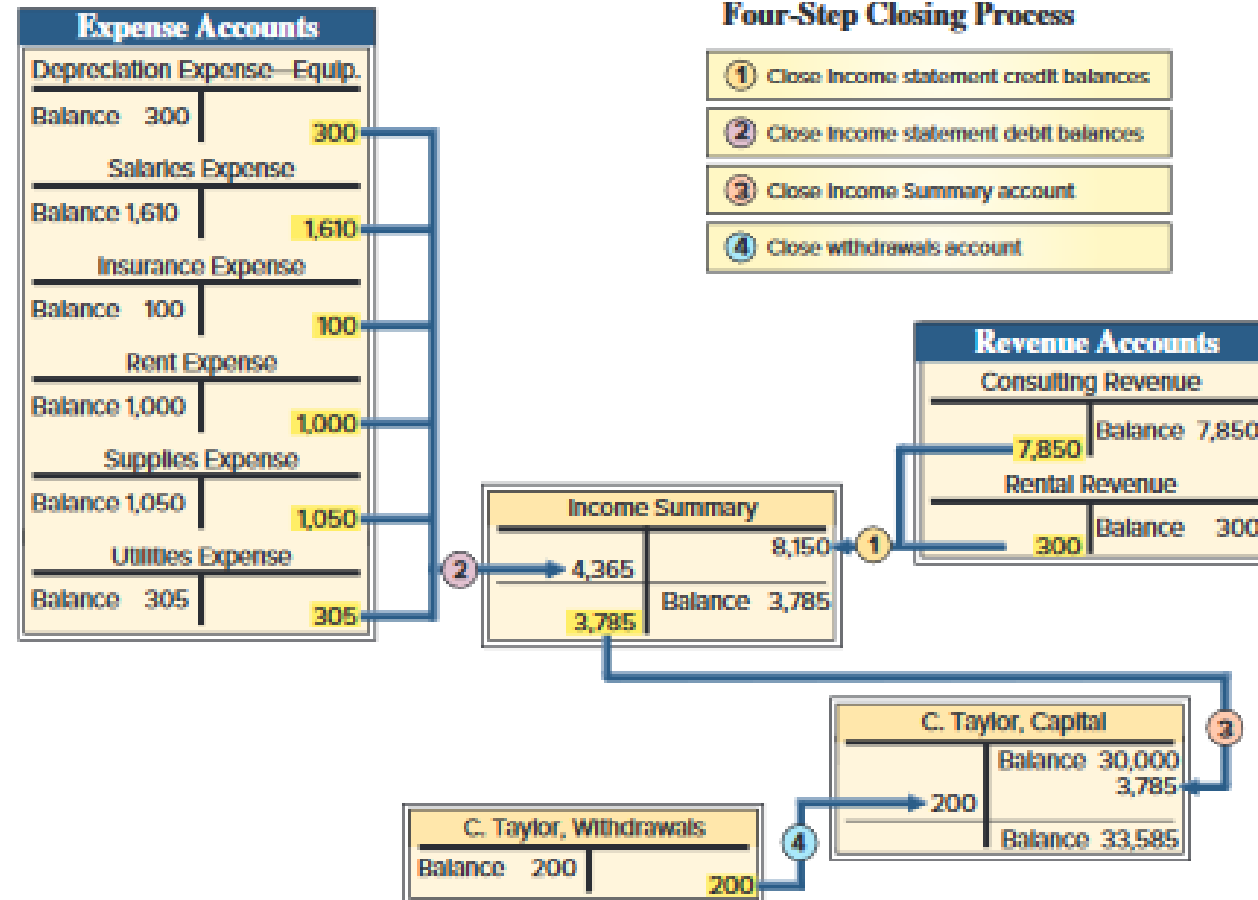
5c Net profit (loss) is extended to the credit (debit) column.

5d Ending balance of owner's capital is computed in the statement of changes in equity.

Temporary and Permanent Accounts



Recording Closing Entries



**Exhibit
4.3**

Preparing Closing Entries

Exhibit 4.3

FASTFORWARD Adjusted Trial Balance December 31, 2021		
	Debit	Credit
Cash	\$ 4,275	
Accounts receivable	1,800	
Supplies	8,670	
Prepaid insurance	2,300	
Equipment	26,000	
Accumulated depreciation—Equip. ..		\$ 300
Accounts payable		6,200
Salaries payable		210
Unearned consulting revenue		2,750
C. Taylor, Capital		30,000
C. Taylor, Withdrawals	200	
Consulting revenue		7,850
Rental revenue		300
Depreciation expense—Equip.	300	
Salaries expense	1,610	
Insurance expense	100	
Rent expense	1,000	
Supplies expense	1,050	
Utilities expense	305	
Totals	<u>\$47,610</u>	<u>\$47,610</u>

General Journal		
Step 1: Dec. 31	Consulting Revenue	7,850
	Rental Revenue	300
	Income Summary	8,150
	<i>Close revenue accounts.</i>	
Step 2: Dec. 31	Income Summary	4,365
	Depreciation Expense—Equip.	300
	Salaries Expense	1,610
	Insurance Expense	100
	Rent Expense	1,000
	Supplies Expense	1,050
	Utilities Expense	305
	<i>Close expense accounts.</i>	
Step 3: Dec. 31	Income Summary	3,785
	C. Taylor, Capital	3,785
	<i>Close Income Summary account.</i>	
Step 4: Dec. 31	C. Taylor, Capital	200
	C. Taylor, Withdrawals	200
	<i>Close withdrawals account.</i>	

Discussion Question

Q: What are the steps in recording closing entries?

Post-Closing Trial Balance

- Total debits equal total credits for permanent accounts.
- All temporary accounts have zero balances.

Post-Closing Trial Balance (continued)

Exhibit
4.6

FASTFORWARD Post-Closing Trial Balance December 31, 2021			Debit	Credit
Cash		\$ 4,275		
Accounts receivable		1,800		
Supplies		8,670		
Prepaid insurance		2,300		
Equipment		26,000		
Accumulated depreciation—Equipment				\$ 300
Accounts payable				6,200
Salaries payable				210
Unearned consulting revenue				2,750
C. Taylor, Capital				33,585
Totals		<u>\$43,045</u>	<u>\$43,045</u>	

Discussion Question

Q: What two purposes are accomplished by recording closing entries?

E 4–9: The following adjusted trial balance contains the accounts and year-end balances of Cruz Company as of December 31.

No.	Account Title	Debit	Credit
101	Cash	\$19,000	
126	Supplies	13,000	
128	Prepaid insurance	3,000	
167	Equipment	24,000	
168	Accumulated depreciation—Equipment		\$ 7,500
301	A. Cruz, Capital		47,600
302	A. Cruz, Withdrawals	7,000	
404	Services revenue		44,000
612	Depreciation expense—Equipment	3,000	
622	Salaries expense	22,000	
637	Insurance expense	2,500	
640	Rent expense	3,400	
652	Supplies expense	2,200	
	Totals	<u>\$99,100</u>	<u>\$99,100</u>

(1) Prepare the December 31 closing entries for Cruz Company. Assume the account number for Income Summary is 901.

(2) Prepare the December 31 post-closing trail balance for Cruz Company. Note: The *A. Cruz, Capital* account balance was \$47,600 on December 31 of the *prior year*.

(1) Prepare the December 31 closing entries for Cruz Company. Assume the account number for Income Summary is 901.

No.	Account Title	Debit	Credit
101	Cash	\$19,000	
126	Supplies	13,000	
128	Prepaid insurance	3,000	
167	Equipment	24,000	
168	Accumulated depreciation—Equipment		\$ 7,500
301	A. Cruz, Capital		47,600
302	A. Cruz, Withdrawals	7,000	
404	Services revenue		44,000
612	Depreciation expense—Equipment	3,000	
622	Salaries expense	22,000	
637	Insurance expense	2,500	
640	Rent expense	3,400	
652	Supplies expense	2,200	
	Totals	<u>\$99,100</u>	<u>\$99,100</u>

Step 1-Close Revenue Accounts

(1) Prepare the December 31 closing entries for Cruz Company. Assume the account number for Income Summary is 901.

No.	Account Title	Debit	Credit
101	Cash	\$19,000	
126	Supplies	13,000	
128	Prepaid insurance	3,000	
167	Equipment	24,000	
168	Accumulated depreciation—Equipment		\$ 7,500
301	A. Cruz, Capital		47,600
302	A. Cruz, Withdrawals	7,000	
404	Services revenue		44,000
612	Depreciation expense—Equipment	3,000	
622	Salaries expense	22,000	
637	Insurance expense	2,500	
640	Rent expense	3,400	
652	Supplies expense	2,200	
	Totals	<u>\$99,100</u>	<u>\$99,100</u>

Step 2-Close Expense Accounts

(1) Prepare the December 31 closing entries for Cruz Company. Assume the account number for Income Summary is 901.

No.	Account Title	Debit	Credit
101	Cash	\$19,000	
126	Supplies	13,000	
128	Prepaid insurance	3,000	
167	Equipment	24,000	
168	Accumulated depreciation—Equipment		\$ 7,500
301	A. Cruz, Capital		47,600
302	A. Cruz, Withdrawals	7,000	
404	Services revenue		44,000
612	Depreciation expense—Equipment	3,000	
622	Salaries expense	22,000	
637	Insurance expense	2,500	
640	Rent expense	3,400	
652	Supplies expense	2,200	
	Totals	<u>\$99,100</u>	<u>\$99,100</u>

Step 3-Close Income Summary Account

(1) Prepare the December 31 closing entries for Cruz Company. Assume the account number for Income Summary is 901.

No.	Account Title	Debit	Credit
101	Cash	\$19,000	
126	Supplies	13,000	
128	Prepaid insurance	3,000	
167	Equipment	24,000	
168	Accumulated depreciation—Equipment		\$ 7,500
301	A. Cruz, Capital		47,600
302	A. Cruz, Withdrawals	7,000	
404	Services revenue		44,000
612	Depreciation expense—Equipment	3,000	
622	Salaries expense	22,000	
637	Insurance expense	2,500	
640	Rent expense	3,400	
652	Supplies expense	2,200	
	Totals	<u>\$99,100</u>	<u>\$99,100</u>

Step 4-Close Withdrawal Account

(2) Prepare the December 31 post-closing trial balance for Cruz Company. Note: The *A. Cruz, Capital* account balance was \$47,600 on December 31 of the *prior year*.

Classified Balance Sheet

Assets	Liabilities and Equity
Current assets	Current liabilities
Noncurrent assets	Noncurrent liabilities
Long-term investments	Equity
Property, plant and equipment	
Intangible assets	

**Exhibit
4.8**

Current items are expected to come due (collected or owed) within the longer of one year or the company's normal operating cycle.

Most operating cycles are less than one year, so most companies use a one-year period in deciding what assets and liabilities are current.

Classified Balance Sheet Example

Exhibit 4.9

SNOWBOARDING COMPONENTS			
Balance Sheet			
January 31, 2021			
Assets		Liabilities	
Current assets		Current liabilities	
Cash	\$ 6,500	Accounts payable	\$15,300
Short-term investments	2,100	Wages payable	3,200
Accounts receivable, net	4,400	Notes payable (due within one year)	3,000
Merchandise inventory	27,500	Current portion of long-term liabilities	<u>7,500</u>
Prepaid expenses	<u>2,400</u>	Total current liabilities	\$ 29,000
Total current assets	\$ 42,900	Long-term liabilities (net of current portion)	<u>150,000</u>
Long-term investments		Total liabilities	179,000
Notes receivable (due in three years)	1,500		
Investments in stocks and bonds	18,000		
Land held for future expansion	<u>48,000</u>		
Total long-term investments	67,500		
Property, plant and equipment		Equity	
Equipment and buildings	203,200	T. Hawk, Capital	164,800
Less accumulated depreciation	<u>53,000</u>		
Equipment and buildings, net	150,200		
Land	<u>73,200</u>		
Total property, plant and equipment	223,400		
Intangible assets	<u>10,000</u>		
Total assets	<u>\$343,800</u>	Total liabilities and equity	<u>\$343,800</u>

Current Assets

Current assets are cash and other resources that are expected to be sold, collected, or used within one year or the company's operating cycle, whichever is longer.

Long-Term Investments

Long-term investments are expected to be held for more than the longer of one year or the operating cycle.

Property, plant and equipment

Property, plant and equipment are tangible long-term assets used to produce or sell products and services.

Intangible Assets

Intangible assets are long-term assets that benefit business operations but lack physical form.

Current Liabilities

Current liabilities are liabilities due to be paid or settled within one year or the operating cycle, whichever is longer.

Long-Term Liabilities

Long-term liabilities are liabilities not due within one year or the operating cycle, whichever is longer.

Equity

Equity is the owner's claim on the assets.

P 4–6A: The following six-column table for Hawkeye Ranges includes the unadjusted balance as of December 31.

Account Title	Unadjusted Trial Balance		Adjustments		Adjusted Trial Balance	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	\$ 14,000					
Accounts receivable	0					
Supplies	6,500					
Equipment	135,000					
Accumulated depreciation—Equipment		\$ 30,000				
Interest payable		0				
Salaries payable		0				
Unearned member fees		15,000				
Notes payable		75,000				
P. Hawkeye, Capital		50,250				
P. Hawkeye, Withdrawals	21,125					
Member fees earned		42,000				
Depreciation expense—Equipment	0					
Salaries expense	30,000					
Interest expense	5,625					
Supplies expense	0					
Totals	\$212,250	\$212,250				

1. Prepare the adjusting entries.
2. Complete the six-column table.

a. As of December 31, employees had earned \$1,200 of unpaid and unrecorded salaries. The next payday is January 4, at which time \$1,500 of salaries will be paid.

Account Title	Unadjusted Trial Balance		Adjustments		Adjusted Trial Balance	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	\$ 14,000					
Accounts receivable	0					
Supplies	6,500					
Equipment	135,000					
Accumulated depreciation—Equipment		\$ 30,000				
Interest payable		0				
Salaries payable		0				
Unearned member fees		15,000				
Notes payable		75,000				
P. Hawkeye, Capital		50,250				
P. Hawkeye, Withdrawals	21,125					
Member fees earned		42,000				
Depreciation expense—Equipment	0					
Salaries expense	30,000					
Interest expense	5,625					
Supplies expense	0					
Totals	\$212,250	\$212,250				

b. The cost of supplies still available at December 31 is \$3,000.

Account Title	Unadjusted Trial Balance		Adjustments		Adjusted Trial Balance	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	\$ 14,000					
Accounts receivable	0					
Supplies	6,500					
Equipment	135,000					
Accumulated depreciation—Equipment		\$ 30,000				
Interest payable		0				
Salaries payable		0				
Unearned member fees		15,000				
Notes payable		75,000				
P. Hawkeye, Capital		50,250				
P. Hawkeye, Withdrawals	21,125					
Member fees earned		42,000				
Depreciation expense—Equipment	0					
Salaries expense	30,000					
Interest expense	5,625					
Supplies expense	0					
Totals	\$212,250	\$212,250				

c. The notes payable required an interest payment to be made every three months. The amount of unrecorded accrued interest at December 31 is \$1,875. The next interest payment, at an amount of \$2,250, is due on January 15.

Account Title	Unadjusted Trial Balance		Adjustments		Adjusted Trial Balance	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	\$ 14,000					
Accounts receivable	0					
Supplies	6,500					
Equipment	135,000					
Accumulated depreciation—Equipment		\$ 30,000				
Interest payable		0				
Salaries payable		0				
Unearned member fees		15,000				
Notes payable		75,000				
P. Hawkeye, Capital		50,250				
P. Hawkeye, Withdrawals	21,125					
Member fees earned		42,000				
Depreciation expense—Equipment	0					
Salaries expense	30,000					
Interest expense	5,625					
Supplies expense	0					
Totals	\$212,250	\$212,250				

d. Analysis of the Unearned Member Fees account shows \$5,800 remaining unearned at December 31.

Account Title	Unadjusted Trial Balance		Adjustments		Adjusted Trial Balance	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	\$ 14,000					
Accounts receivable	0					
Supplies	6,500					
Equipment	135,000					
Accumulated depreciation—Equipment		\$ 30,000				
Interest payable		0				
Salaries payable		0				
Unearned member fees		15,000				
Notes payable		75,000				
P. Hawkeye, Capital		50,250				
P. Hawkeye, Withdrawals	21,125					
Member fees earned		42,000				
Depreciation expense—Equipment	0					
Salaries expense	30,000					
Interest expense	5,625					
Supplies expense	0					
Totals	\$212,250	\$212,250				

e. In addition to the member fees included in the revenue account balance, the company has earned another \$9,300 in unrecorded fees that will be collected on January 31. The company is also expected to collect \$10,000 on that same day for new fees earned in January.

Account Title	Unadjusted Trial Balance		Adjustments		Adjusted Trial Balance	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	\$ 14,000					
Accounts receivable	0					
Supplies	6,500					
Equipment	135,000					
Accumulated depreciation—Equipment		\$ 30,000				
Interest payable		0				
Salaries payable		0				
Unearned member fees		15,000				
Notes payable		75,000				
P. Hawkeye, Capital		50,250				
P. Hawkeye, Withdrawals	21,125					
Member fees earned		42,000				
Depreciation expense—Equipment	0					
Salaries expense	30,000					
Interest expense	5,625					
Supplies expense	0					
Totals	\$212,250	\$212,250				

f. Depreciation expense for the year is \$15,000.

Account Title	Unadjusted Trial Balance		Adjustments		Adjusted Trial Balance	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	\$ 14,000					
Accounts receivable	0					
Supplies	6,500					
Equipment	135,000					
Accumulated depreciation—Equipment		\$ 30,000				
Interest payable		0				
Salaries payable		0				
Unearned member fees		15,000				
Notes payable		75,000				
P. Hawkeye, Capital		50,250				
P. Hawkeye, Withdrawals	21,125					
Member fees earned		42,000				
Depreciation expense—Equipment	0					
Salaries expense	30,000					
Interest expense	5,625					
Supplies expense	0					
Totals	\$212,250	\$212,250				

2. Complete the six-column table.

Account Title	Unadjusted Trial Balance		Adjustments		Adjusted Trial Balance	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	\$ 14,000					
Accounts receivable	0					
Supplies	6,500					
Equipment	135,000					
Accumulated depreciation—Equipment		\$ 30,000				
Interest payable		0				
Salaries payable		0				
Unearned member fees		15,000				
Notes payable		75,000				
P. Hawkeye, Capital		50,250				
P. Hawkeye, Withdrawals	21,125					
Member fees earned		42,000				
Depreciation expense—Equipment	0					
Salaries expense	30,000					
Interest expense	5,625					
Supplies expense	0					
Totals	\$212,250	\$212,250				

End of Chapter 4