

CHAPTER 4

COMPLETING THE ACCOUNTING CYCLE

Chapter Outline

Notes

I. Work Sheet as a Tool

- A. The work sheet is an internal document that serves as a useful tool for organizing accounting information. It is *not* a required report.
- B. Benefits include: aids the preparation of financial statements, reduces possibility of errors, links accounts and adjustments to their impacts in financial statements, assists in planning and organizing an audit of financial statements, helps in preparing interim (monthly and quarterly) financial statements, and shows the effect of proposed or “what if” transactions.
- C. Steps to prepare a work sheet:
 - 1. Enter the unadjusted trial balance in the first two columns.
 - 2. Enter the adjustments in the third and fourth columns. Total columns to verify debit adjustments equal credit adjustments.
 - 3. Prepare the Adjusted Trial Balance. This is done by combining the unadjusted trial balance and adjustment columns. Total Adjusted Trial Balance columns to verify debits equal credits.
 - 4. Sort the adjusted trial balance amounts to the appropriate financial statement columns.
 - 5. Total statement columns, compute net income or loss and balance the columns by adding net income or loss.
- D. Work Sheet Applications and Analysis—it does not substitute for financial statements. The financial statement columns yield pro forma financial statements because they show the statements *as if* the proposed transactions occurred.

II. Closing Process—The closing process is an important step at end of the accounting period *after* financial statements have been completed.

- A. Steps in closing process:
 - 1. Identify accounts for closing.
 - 2. Record and post closing entries.
 - 3. Prepare a post-closing trial balance.
- B. Purpose of closing process:
 - 1. To reset revenues, expenses, and withdrawals account balances to zero at the end of every period to prepare these accounts for proper measurement in the next period.
 - 2. To make owner’s capital account reflect prior periods’ revenues, expenses and withdrawals.

- C. Temporary and Permanent Accounts
1. Temporary (or nominal) accounts accumulate data related to one accounting period. (All income statement accounts, withdrawals accounts, and the Income Summary.)
 2. Permanent (or real) accounts report on activities related to one or more future accounting periods. They are all balance sheet accounts that are not closed.
- D. Recording Closing Entries—the purpose is to transfer the end-of-period balances in revenues, expense, and withdrawals accounts to the permanent capital account.
1. Use a new temporary account called Income Summary. The four closing entries are:
 - a. Close credit balances in revenue (and gain) accounts by debiting the accounts and crediting Income Summary. This transfers revenue balances to the credit side Income Summary.
 - b. Close debit balances in expense (and loss) accounts by crediting the accounts and debiting Income Summary. This transfers the expense balances to the debit side of Income Summary.
 - c. Close the Income Summary account to the owner's capital account.

Note: The Income Summary account, prior to closing, will have a credit balance equal to net income or a debit balance equal to net loss. Therefore this entry will credit capital for the amount of net income (or debit capital for a net loss).

 - d. Close withdrawals account by crediting the account and debiting the owner's capital account.
 2. After all closing entries are posted, all temporary accounts have a zero balance and capital is up to date.
- E. Post-Closing Trial Balance—a list of permanent accounts and their balances taken from the ledger.
1. Prepared after closing entries are journalized and posted.
 2. Verifies that total debits equal total credits for permanent accounts and all temporary accounts have zero ending balances.
- F. The Accounting Cycle--steps can vary if a worksheet is used (see Visual 7)
The ten steps repeated each accounting cycle are as follows:
1. Analyze transactions
 2. Journalize
 3. Post
 4. Prepare unadjusted trial balance
 5. Adjust
 6. Prepare an adjusted trial balance

7. Prepare statements
8. Close
9. Prepare a post-closing trial balance.
10. Reverse (optional)

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