REVIEW OF THE ACCOUNTING PROCESS

The Accounting Processing Cycle

Step 1. Obtain information about transactions (events) from source documents.

Step 2. Transaction analysis is the process of reviewing source documents to determine the economic implications of a transaction (event), i.e. what financial statements elements are affected.

Step 3. Record the transaction (event) in a journal using a journal entry in which debits equal credits (dual effect or double entry). The equality is dictated by the accounting equation that must always be satisfied: Assets = Liabilities + Owners' equity.

Step 4. Post from the journal to the general ledger accounts.

Step 5. Prepare an unadjusted trial balance.

Step 6. Record adjusting entries and post to the ledger accounts.

Step 7. Prepare an adjusted trial balance.

Step 8. Prepare Financial Statements

Step 9. Close the Temporary Accounts (all income statement accounts) to income summary and close the income summary account to retained earnings.

Step 10. Prepare a post-closing trial balance.

A journal is a chronological list of transactions (events) in debit/credit form.

Assets = Liabilities + Shareholders' Equity

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Paid-in Capital	Retained Earnings

↑

Revenues (+) Gains (+)	Expenses (-) Losses (-)	Dividends (-)

Adjusting Entries (some account balances require updating)

	Prepaid Expenses		Deferred Revenues	
Prepayments	Asset	Expense	Liability	Revenues
	Credit ⇔	Debit	Debit ↑	Credit ↑

	Accrued Expenses		Accrued Receivables	
Accruals	Expense	Liability	Asset	Revenues
	Debit ↑	Credit ↑	Debit ↑	Credit ↑

1. Prepaid expenses represent assets recorded when a cash disbursement creates benefits beyond the current reporting period, i.e. Dr. Rent Expense and Cr. Prepaid Rent.

2. Deferred revenues represent liabilities recorded when cash is received from customers in advance of providing a good or service, i.e. Dr. Deferred rent revenue and Cr. Rent revenue.

Accruals involve transactions where the cash outflow or inflow takes place in a period subsequent to expense or revenue recognition.

3. Accrued liabilities represent liabilities recorded when an expense has been incurred prior to cash payment, i.e. Dr. Salaries Expense and Cr. Salaries Payable.

4. Accrued receivables involve situations when the revenue is recognized in a period prior to the cash receipt, i.e. Dr. Interest receivable and Cr. Interest Revenue.

Estimates often are made to comply with the accrual accounting model, e.g. Bad debt expense.

To close revenue accounts to income summary

Dr. Sales revenue (and other types of revenue)

Cr. Income summary

To close the expense accounts to income summary

Dr. Income summary

Cr. Cost of goods sold

Cr. Salaries expense (and other types of expenses)

To close income summary to retained earnings

Dr. Income summary

Cr. Retained earnings

Work for class discussion on E2-15 and P2-6.