

# INFO 7225

## M1. Financial Accounting

### 4. Analyzing & Recording Transactions

Professor Shaoxing Shi

College of Engineering

Northeastern University

1,000

Q3

Q4



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# LEARNING OBJECTIVES

**After completing this class, you should be able to**

- Analyze transactions using the accounting equation;
- Record transactions in a general journal using the double-entry system;
- Post journal information in a general ledger;
- Prepare an unadjusted trial balance.



# Analyze Transactions Using the Accounting Equation

# THE ACCOUNTING EQUATION

**Cash + Accounts + Prepaid + Equipment + Truck = Accounts + Unearned + Notes + Common + Retained  
Receivable Insurance Payable Revenue Payable Stock Earnings**

## Effects on the Accounting Equation

### Transactions summary

1. Issued share capital for \$10,000 cash.
2. Received a bank loan for \$3,000.
3. Purchased equipment for \$3,000 cash.
4. Purchased a truck for \$8,000; paid \$3,000 cash and incurred a bank loan for the balance.
5. Paid \$2,400 for a comprehensive one-year insurance policy effective January 1.
6. Paid \$2,000 cash to reduce the bank loan.
7. Received \$400 as an advance payment for repair services to be provided over the next two months as follows: \$300 for February, \$100 for March.
8. Performed repairs for \$8,000 cash and \$2,000 on credit.
9. Paid a total of \$7,100 for operating expenses incurred during the month; also incurred an expense on account for \$700.
10. Dividends of \$200 were paid in cash to the only shareholder, Bob Baldwin.

Transaction #	Assets	=	Liabilities	+	Equity
1					
2					
3					
4					
5					
6					
7					
8					
9					
10					

	ASSETS				=	LIABILITIES			=	EQUITY									
Trans.	Cash	+	Acc. Rec.	+	Prepaid Insur.	+	Equip.	+	Truck	=	Acc. Pay.	+	Unearned Revenue	+	Notes Pay.	+	Common Stock	+	Retained Earnings
1.	+10,000																+10,000		
2.	+3,000																+3,000		
3.	-3,000												+3,000						
4.	-3,000												+8,000				+5,000		
5.	-2,400												+2,400						
6.	-2,000																-2,000		
7.	+400																+400		
8.	+8,000												+2,000						+10,000
9.	-7,100																+700	-1,600	-3,500
10.	-200																	-2,000	-700
	3,700	+	2,000	+	2,400	+	3,000	+	8,000	=	700	+	400	+	6,000	+	10,000	+	2,000

**Figure 1.3: Transactions Worksheet for January 31, 2015**

Transactions in these columns are used to prepare the Statement of Shareholders' Equity.

Column totals are used to prepare the Balance Sheet.

ASSETS = \$19,100

**LIABILITIES + EQUITY = \$19,100**

## In-class Exercise 1. Calculating Financial Statement Components

The following information is taken from the records of Jasper Inc. at January 31, 2015, after its first month of operations. Assume no dividends were declared in January.

Cash	\$33,000	Equipment	\$30,000
Accounts receivable	82,000	Notes payable	15,000
Unused supplies	2,000	Accounts payable	27,000
Land	25,000	Common stock	?
Building	70,000	Net income	40,000

**Required:**

- a. Calculate total assets.
- b. Calculate total liabilities.
- c. Calculate common stock.
- d. Calculate retained earnings.
- e. Calculate total equity.

## In-class Exercise 2. Determining Missing Financial Information

**Required:** Complete the following calculations for each individual company:

- a. If ColorMePink Ltd. has a retained earnings opening balance of \$50,000 at the beginning of the year, and an ending balance of \$40,000 at the end of the year, what would be the net income/loss, if dividends paid were \$20,000?
- b. If ForksAndSpoons Ltd. has net income of \$150,000, dividends paid of \$40,000 and a retained earnings ending balance of \$130,000, what would be the retained earnings opening balance?
- c. If CupsAndSaucers Ltd. has a retained earnings opening balance of \$75,000 at the beginning of the year, and an ending balance of \$40,000 at the end of the year, what would be the dividends paid, if the net loss was \$35,000?

## In-class Exercise 3. Equity – What Causes It to Change

	Assets	=	Liabilities	+	Equity	
Balances at April 1, 2015	\$100,000		\$60,000		\$40,000	
			?		Shares issued in April	
			?		April net income(loss)	
			?		Dividends paid in April	
Balances at April 30, 2015	<u>\$180,000</u>	=	<u>\$130,000</u>	+ <u>                ?</u>		

**Required:** Using the information provided above, calculate the net income or net loss realized during April under each of the following independent assumptions.

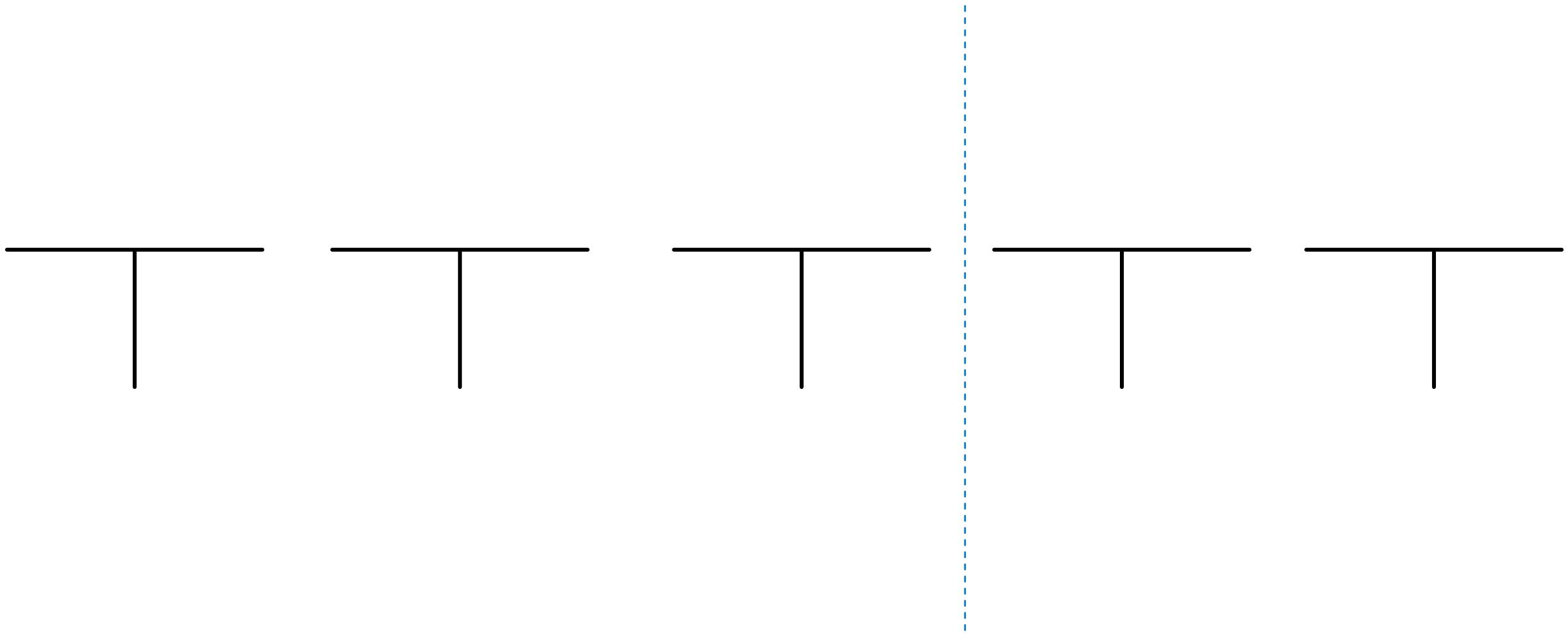
- a. No shares were issued in April and no dividends were paid.
- b. \$50,000 of shares were issued in April and no dividends were paid.
- c. No shares were issued in April and \$4,000 of dividends were paid in April.



# **Analyzing and Recording Business Transactions**

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# REVIEW: NORMAL BALANCE OF MAJOR ACCOUNTS



What impact the following transactions would have on the accounting equation? Record the debit and credit in the appropriate account.

#	Transaction Description	Impact 1	Impact 2	Debit	Credit
1	Issued common stock for cash.				
2	Received a bank loan.				
3	Purchased equipment with cash.				
4	Purchased a truck with cash and bank loan.				
5	Paid for a one-year insurance policy.				
6	Paid cash to reduce the bank loan in transaction 2.				
7	Received payment for services to be provided for customers next month.				
8	Performed repair services for customers on credit.				
9	Incurred expenses on account during the month.				
10	Cash dividends were paid to shareholders.				
11	Signed a union contract.				

# IN-CLASS EXERCISE

- Indicate the net effect ( $\uparrow$  for increase;  $\downarrow$  for decrease; 0 for no effect) of each of the following transactions on each part of the accounting equation, Assets = Liabilities + Equity.
- For example, for payment of an accounts payable balance,  $A(\downarrow) = L(\downarrow) + E(0)$

A. Payment of principal balance of note payable  $A(\ ) = L(\ ) + E(\ )$

B. Purchase of supplies for cash  $A(\ ) = L(\ ) + E(\ )$

C. Payment of dividends to stockholders  $A(\ ) = L(\ ) + E(\ )$

D. Issuance of stock for cash  $A(\ ) = L(\ ) + E(\ )$

E. Billing customer for physician services provided  $A(\ ) = L(\ ) + E(\ )$



# **Recording Transactions**

## **in the Journal: *Journal Entry***

# THE ACCOUNTING EQUATION

Transaction: a small business borrowed \$2,000 from a local bank.

GENERAL JOURNAL			
Date	Account Title	Debit	Credit

**Transactions summary:**

1. Issued share capital for \$10,000 cash.
2. Received a bank loan for \$3,000.
3. Purchased equipment for \$3,000 cash.
4. Purchased a truck for \$8,000; paid \$3,000 cash and incurred a bank loan for the balance.
5. Paid \$2,400 for a comprehensive one-year insurance policy effective January 1.
6. Paid \$2,000 cash to reduce the bank loan.
7. Received \$400 as an advance payment for repair services to be provided over the next two months as follows: \$300 for February, \$100 for March.
8. Performed repairs for \$8,000 cash and \$2,000 on credit.
9. Paid a total of \$7,100 for operating expenses incurred during the month; also incurred an expense on account for \$700.
10. Dividends of \$200 were paid in cash to the only shareholder, Bob Baldwin.

**General Journal**

Page #

Date	Description	R	Debit	Credit
2015				
Jan. 1	To record			
2	To record			
2	To record the purchase of equipment for cash.			

**Transactions summary:**

1. Issued share capital for \$10,000 cash.
2. Received a bank loan for \$3,000.
3. Purchased equipment for \$3,000 cash.
4. Purchased a truck for \$8,000; paid \$3,000 cash and incurred a bank loan for the balance.
5. Paid \$2,400 for a comprehensive one-year insurance policy effective January 1.
6. Paid \$2,000 cash to reduce the bank loan.
7. Received \$400 as an advance payment for repair services to be provided over the next two months as follows: \$300 for February, \$100 for March.
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9. Paid a total of \$7,100 for operating expenses incurred during the month; also incurred an expense on account for \$700.
10. Dividends of \$200 were paid in cash to the only shareholder, Bob Baldwin.

**General Journal**

Page #

Date	Description	R	Debit	Credit
3				
	To record the purchase of a truck for cash and bank loan.			
5				
	To record payment of a one-year insurance policy.			
10				
	To record payment on bank loan.			
15				
	To record receipt of payment for service not yet performed: \$300 for February, \$100 for March.			

**Transactions summary:**

1. Issued share capital for \$10,000 cash.
2. Received a bank loan for \$3,000.
3. Purchased equipment for \$3,000 cash.
4. Purchased a truck for \$8,000; paid \$3,000 cash and incurred a bank loan for the balance.
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10. Dividends of \$200 were paid in cash to the only shareholder, Bob Baldwin.

**General Journal**

Page #

Date	Description	R	Debit	Credit
31				
	To record repair revenue eared in January.			
31				
	To record expenses incurred and cash payment of exp. in Jan.			
31				
	To record distribution of dividends.			

# RECORDING TRANSACTIONS IN THE GENERAL JOURNAL

This entry tells us to:

- Post \$10,000 to the debit side of the Cash account (increasing Cash by \$10,000), and
- Post \$10,000 to the credit side of the Common stock account (increasing this account by \$10,000).

GENERAL JOURNAL							Page 1
	Date 2015	Description	R	Debit	Credit		
1	Jan. 1	Cash Common Stock To record the issuance of common stock.	101 320	1 0 0 0 0 -	1 0 0 0 0 -		
2		Cash Notes Payable To record receipt of a bank loan.	101 201	3 0 0 0 -	3 0 0 0 -		
3		Equipment Cash To record the purchase of equipment for cash.	183 101	3 0 0 0 -	3 0 0 0 -		

3	Truck	184	8 000	-	
	Notes Payable	201		5 000	-
	Cash	101		3 000	-
	To record the purchase of a tow truck; paid cash and incurred additional bank loan.				
5	Prepaid Insurance	161	2 400	-	
	Cash	101		2 400	-
	To record payment for a one-year insurance policy.				
10	Notes Payable	201	2 000	-	
	Cash	101		2 000	-
	To record payment on bank loan.				
15	Cash	101	4 00	-	
	Unearned Repair Revenue	247		4 00	-
	To record receipt of payment for services not performed: \$300 for February, \$100 for March.				

31	Cash	101	8 000	-	
	Accounts Receivable	110	2 000	-	
	Repair Revenue	450			1 000 00 -
	To record repaid revenue earned in January.				
31	Rent Expense	654	1 600	-	
	Salaries Expense	656	3 500	-	
	Supplies Expense	668	2 000	-	
	Truck Operation Expense	670	700	-	
	Cash	101			7 100 -
	Accounts Payable	210			700 -
	To record cash payment of expenses for the month.				
31	Dividends	330	2 00	-	
	Cash	101			2 00 -
	To record distribution of dividends.				

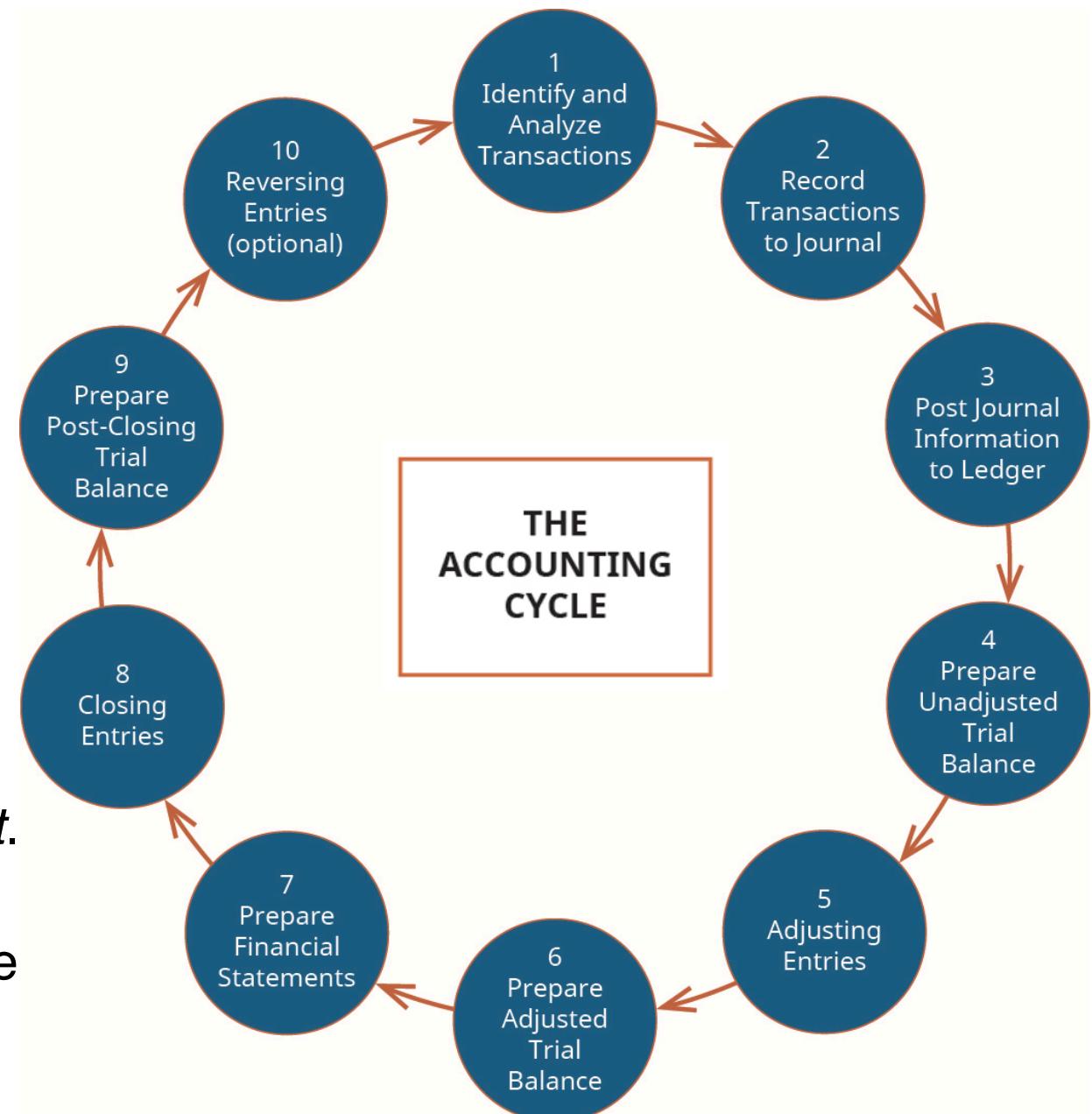
# THE ACCOUNTING CYCLE

## Steps 1 & 2:

- Transactions are analyzed and journalized.
- **Journalizing** consists of analyzing transactions as they occur to see how they affect the accounting equation.
- Then, the transactions are recorded *chronologically* in the **general journal**.

## Step 3:

- Transactions are summarized *by account*.
- **Posting** consists of transferring debits and credits from the general journal to the appropriate **general ledger** accounts.





# **Posting Journal Information to General Ledger**

# ACCOUNTING RECORDS

## ■ Documents

- Source documents
- Product documents
- Turnaround documents

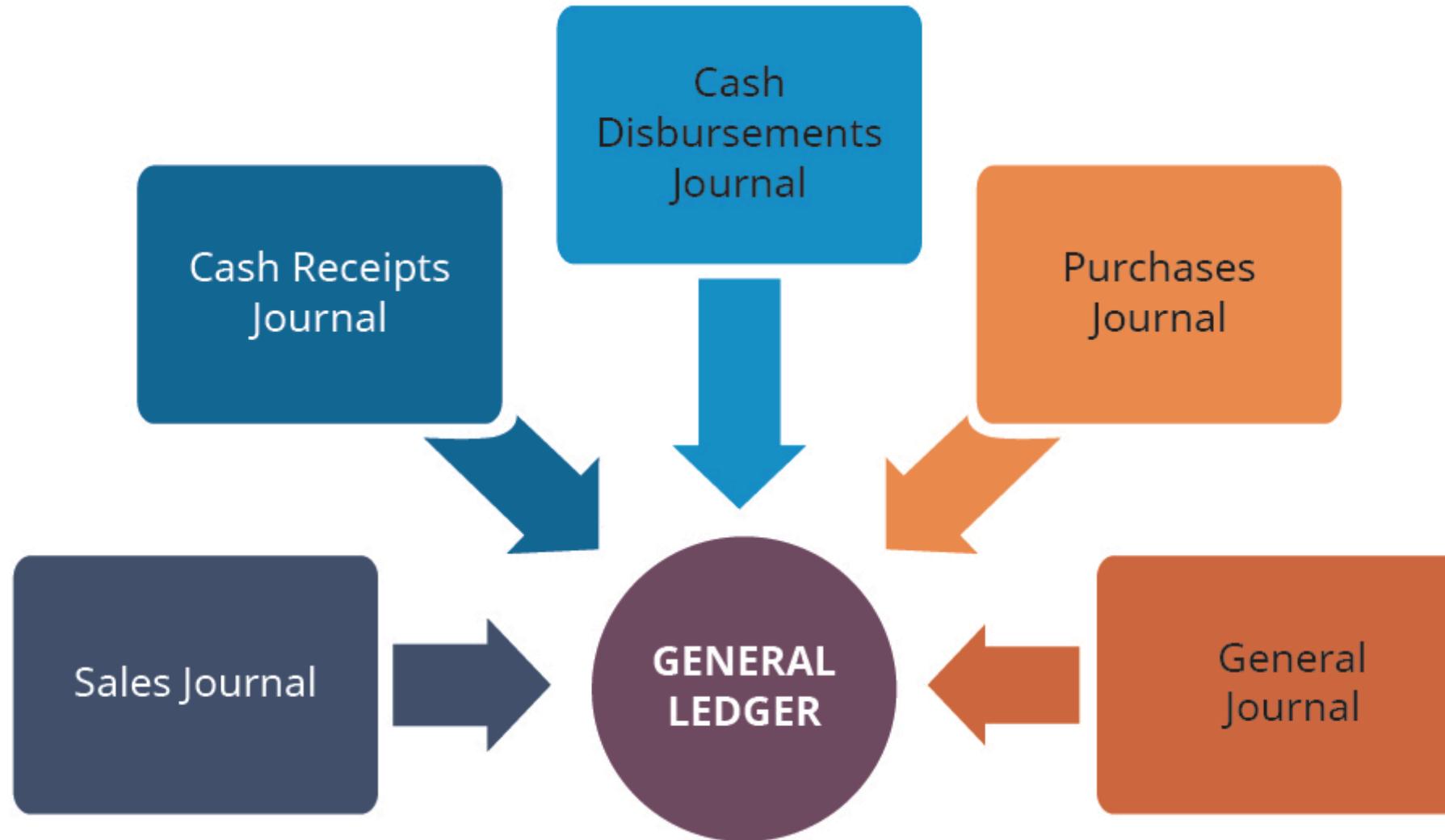
## ■ Journal (chronological records)

- General journal
- Special journal

## ■ Ledger (organized by accounts)

- General ledger
  - A ledger that contains summary-level data for every asset, liability, equity, revenue, and expense account of the organization.
  - Examples: AR, AP
- Subsidiary ledger
  - A ledger used to record detailed data for a general ledger account with many individual subaccounts
  - Breaks down certain general ledger accounts to provide more detailed information to users

Transaction summaries from the special journals, and all transactions in the general journal are posted to the general ledger



# General Ledger in T-account Form

# EXAMPLE 1

## Record Transaction and Post Information to T-accounts

- Prepare journal entries to record the following transactions. Create a T-account for Cash, post any entries that affect the account, and calculate the ending balance for the account. Assume a Cash beginning balance of \$37,400.
  - A. May 12, collected balance due from customers on account, \$16,000
  - B. June 10, purchased supplies for cash, \$4,400

Date	Description	Debit	Credit

Cash	

## **EXAMPLE 2**

### **RECORD TRANSACTION AND POST INFORMATION TO T-ACCOUNTS**

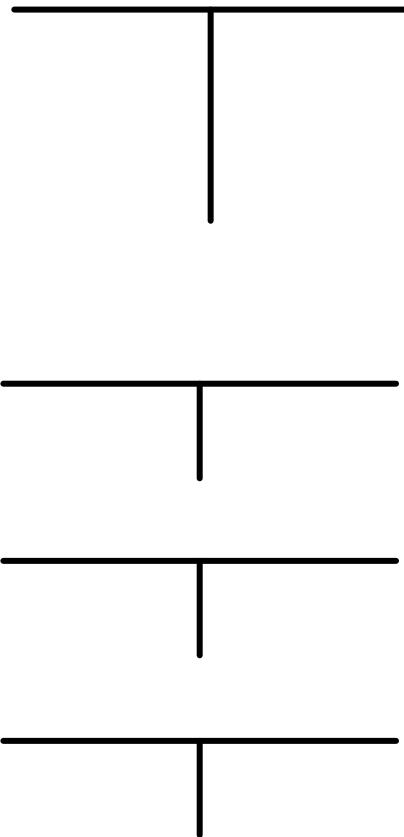
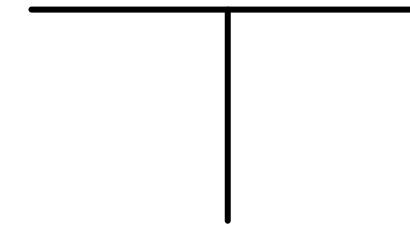
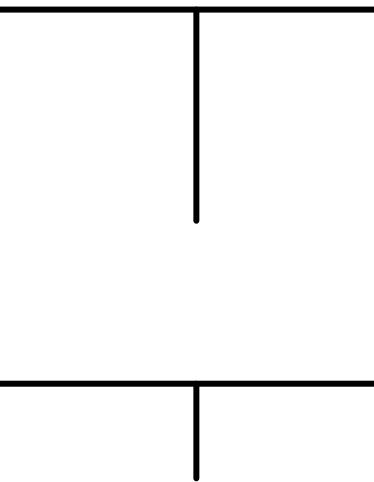
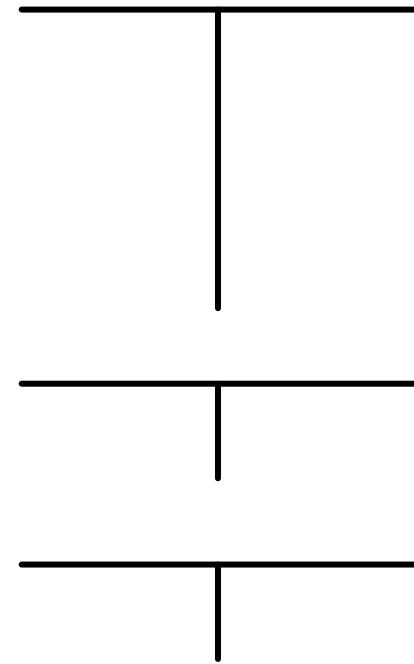
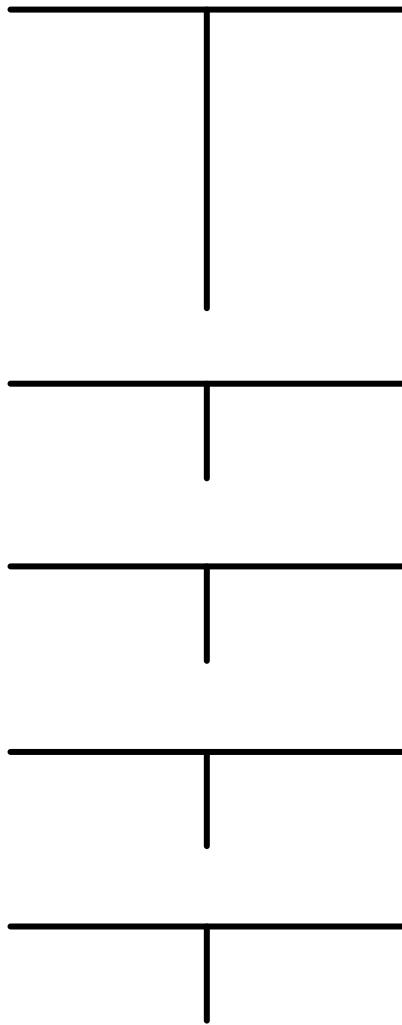
- Prepare journal entries to record the following transactions. Create a T-account for Accounts Receivable and Cash, post any entries that affect the account, and calculate the ending balance for the account (assume no beginning balance).
    - A. Provided legal services to customers for cash, \$5,600
    - B. Provided legal services to customers on account, \$4,700
    - C. Collected cash from customer accounts, \$3,500

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## **Transactions summary:**

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2. Received a bank loan for \$3,000.
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4. Purchased a truck for \$8,000; paid \$3,000 cash and incurred a bank loan for the balance.
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10. Dividends of \$200 were paid in cash to the only shareholder, Bob Baldwin.

**ASSETS****LIABILITIES****EQUITY****REVENUE****EXPENSES**

# RECORDING TRANSACTIONS IN THE GENERAL JOURNAL

This entry tells us to:

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- Post \$10,000 to the credit side of the Common stock account (increasing this account by \$10,000).

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5	Prepaid Insurance	161	2 400	-	
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31	Cash	101	8 000	-		
	Accounts Receivable	110	2 000	-		
	Repair Revenue	450			1 000	-
	To record repaid revenue earned in January.					
31	Rent Expense	654	1 600	-		
	Salaries Expense	656	3 500	-		
	Supplies Expense	668	2 000	-		
	Truck Operation Expense	670	700	-		
	Cash	101			7 100	-
	Accounts Payable	210			700	-
	To record cash payment of expenses for the month.					
31	Dividends	330	2 00	-		
	Cash	101			2 00	-
	To record distribution of dividends.					

# Cash

## Bank Loan (Notes Payable)

## **TRANSACTIONS POSTED TO TWO ACCOUNTS IN THE GENERAL LEDGER (FORMAL VARIATION OF THE T-ACCOUNT)**

The journal records each financial transaction in double-entry form. Each side of the entry is transferred to a separate ledger account.

The ledger stores transactions according to account and keeps a running total of each account balance.

GENERAL JOURNAL							Page 1
Date	Description			R	Debit	Credit	
2015							
Jan. 1	Cash Common Stock To record the issuance of common stock.			3 101 320	1 000 00 -	1 000 00 -	
GENERAL LEDGER							
Date	Description		R	Debit	Credit	DR/CR	Balance
2015							
Jan. 1	1	2 GJ1		1 000 00 -		DR	1 000 00 - 4
Common Stock							
Date	Description		R	Debit	Credit	DR/CR	Balance
2015							
Jan. 1	1	GJ1			1 000 00 -	CR	1 000 00 - 4

# THE ACCOUNTING CYCLE

## Steps 1 & 2:

- Transactions are analyzed and journalized.
- **Journalizing** consists of analyzing transactions as they occur to see how they affect the accounting equation.
- Then, the transactions are recorded *chronologically* in the **general journal**.

## Step 3:

- Transactions are summarized *by account*.
- **Posting** consists of transferring debits and credits from the general journal to the appropriate **general ledger** accounts.

## Step 4:

- Prepare unadjusted trial balance



# PREPARE UNADJUSTED TRIAL BALANCE

- Purpose: start of financial statements preparation
- Purpose: help prove the accounting equation is in balance
- The account balances in the \_\_\_\_\_ are used to prepare the trial balance.
- The trial balance is an internal report that lists all the account balances \_\_\_\_\_.
- The total debits must equal total credits on the trial balance.
- The (adjusted) trial balance is used in the preparation of financial statements.



## EXAMPLE 3

### PREPARE AN UNADJUSTED TRIAL BALANCE

- Prepare an unadjusted trial balance, in correct format, from the alphabetized account information from the ledger accounts summarized as follows. Assume all accounts have normal balances.

Accounts payable	\$ 8,005
Accounts receivable	12,500
Cash	56,015
Common stock	28,000
Fees earned revenue	75,510
Operating expense	43,000

Account	Debit	Credit
Total		

## Transactions summary:

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2. Received a bank loan for \$3,000.
3. Purchased equipment for \$3,000 cash.
4. Purchased a truck for \$8,000; paid \$3,000 cash and incurred a bank loan for the balance.
5. Paid \$2,400 for a comprehensive one-year insurance policy effective January 1.
6. Paid \$2,000 cash to reduce the bank loan.
7. Received \$400 as an advance payment for repair services to be provided over the next two months as follows: \$300 for February, \$100 for March.
8. Performed repairs for \$8,000 cash and \$2,000 on credit.
9. Paid a total of \$7,100 for operating expenses incurred during the month; also incurred an expense on account for \$700.
10. Dividends of \$200 were paid in cash to the only shareholder, Bob Baldwin.

Big Dog Carworks Corp.  
Unadjusted Trial Balance  
At January 31, 2015

<i>Acct.</i>	<i>Account</i>	<i>Debit</i>	<i>Credit</i>
101	Cash	\$3,700	
110.	Accounts receivable	2,000	
161	Prepaid insurance	2,400	
183	Equipment	3,000	
184.	Truck	8,000	
201	Bank loan		\$6,000
210	Accounts payable		700
247	Unearned revenue		400
320	Share capital		10,000
330	Dividends	200	
450	Repair revenue		10,000
654	Rent expense	1,600	
656	Salaries expense	3,500	
668	Supplies expense	2,000	
670	Truck operation expense	700	
		\$27,100	\$27,100

# SUMMARY

- Companies record transactions in a \_\_\_\_\_, a document which *chronologically* lists each debit and credit journal entry.
- To summarize the debit and credit entries *by account*, the entries in the general journal are posted (or transferred) to \_\_\_\_\_.
- To help prove the accounting equation is in balance, a trial balance is prepared.
  - The account balances in the *general ledger* are used to prepare the trial balance.
  - The trial balance is an internal report that lists all the account balances *at a point in time*.
  - The total debits must **equal** total credits on the trial balance.



# SUMMARY

- ✓ GAAP
- ✓ Accounting records
- ✓ Five classes of accounts

- ✓ Accounting equation
- ✓ Normal balance of each account
- ✓ Four financial statements

# INFO 7225

## M1. Financial Accounting

### 5. Cash-basis vs. Accrual-basis Accounting

Professor Shaoxing Shi  
College of Engineering  
Northeastern University

1,000





# **Cash Basis Accounting**

**vs.**

# **Accrual Basis Accounting**

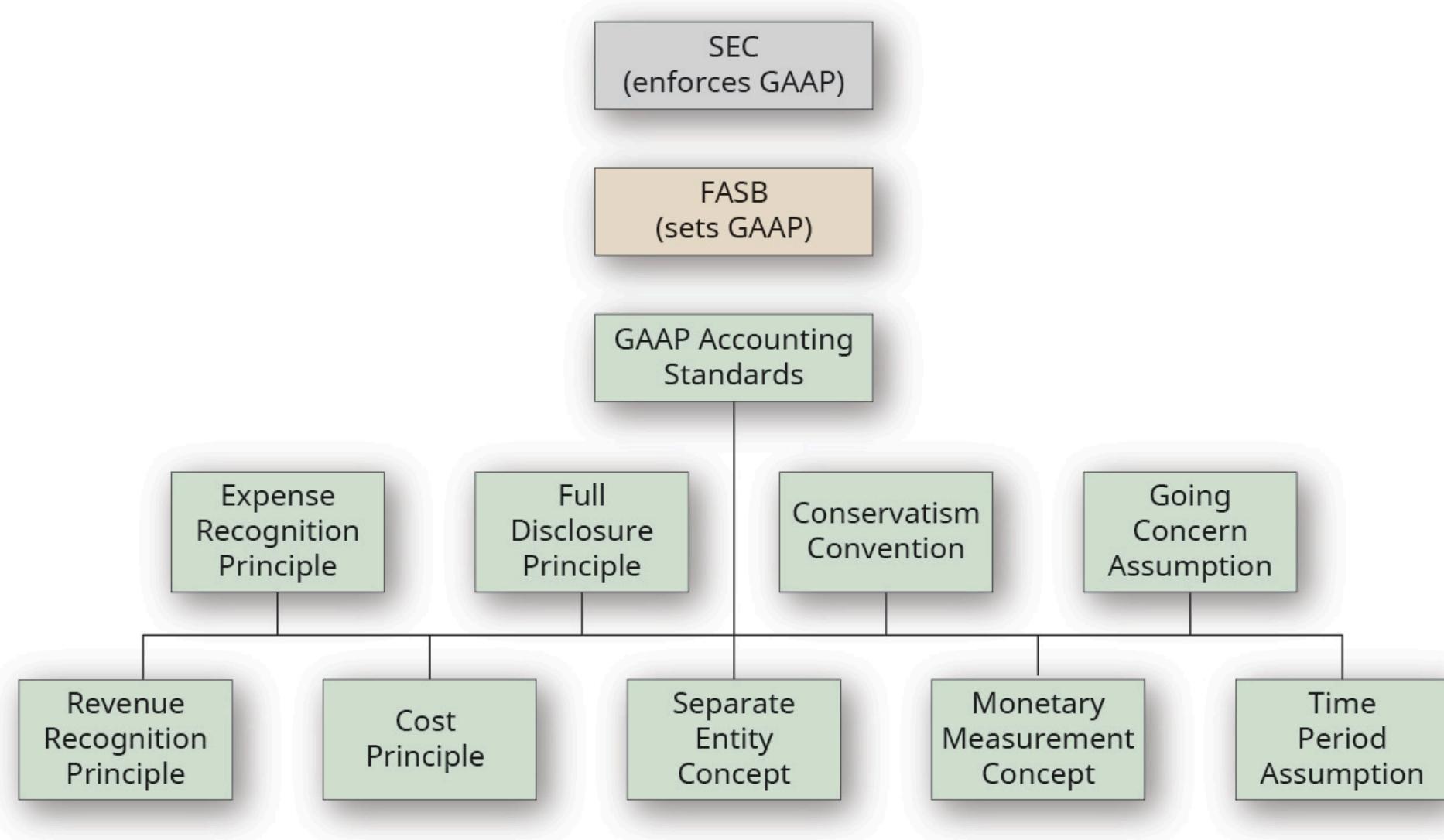
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# LEARNING OBJECTIVES

**After completing this session, you should be able to**

- Explain the difference between cash basis and accrual basis of accounting;
- Apply revenue recognition principle and expense matching principle in accrual basis accounting.

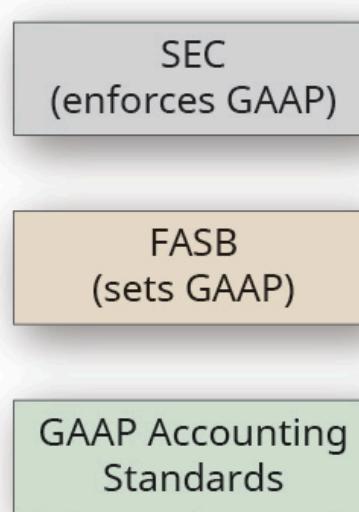
# GAAP Accounting Standards Connection Tree



# GAAP Accounting Standards Connection Tree

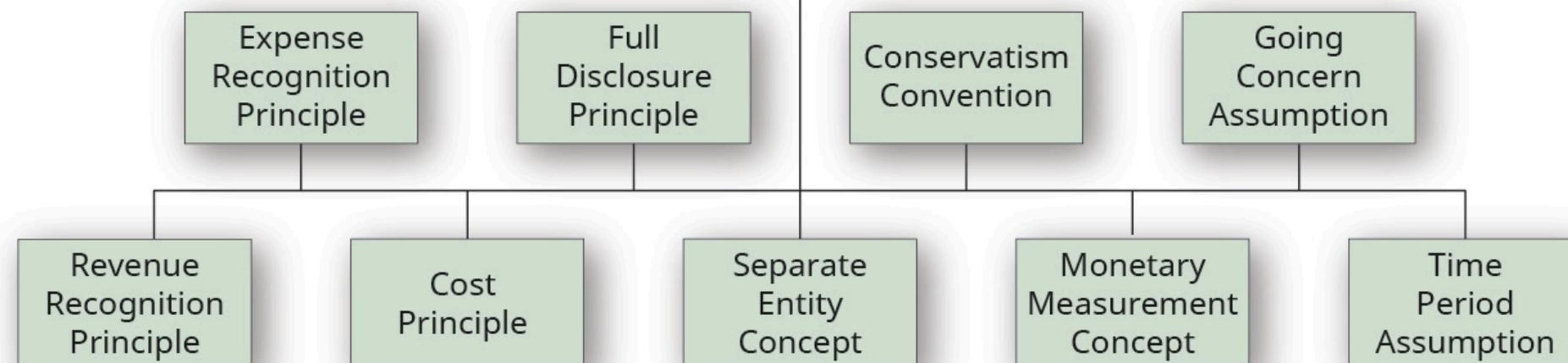
## What is “expense matching principle”?

- States that we must match expenses with associated revenues in the period in which the revenues were earned.
- Also referred to as the **matching principle**



## What is “revenue recognition principle”?

- Directs a company to recognize revenue in the period in which it is earned; revenue is not considered earned until a product or service has been provided.
- This means the period of time in which you performed the service or gave the customer the product is the period in which revenue is recognized.
- No correlation between when cash is collected and when revenue is recognized.



# CASH ACCOUNTING VS. ACCRUAL ACCOUNTING

- Cash basis of accounting
  - Revenue and expenses are recorded only based on if there is an exchange of cash.
- Accrual basis of accounting
  - **Revenues** are recognized as soon as a product has been sold or a service has been performed, regardless of when the money is actually received.
  - All costs that match revenues reported in the present period are recorded as **expenses**, regardless of when the money is actually paid.



# **REVENUE RECOGNITION**

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# REVENUE RECOGNITION: INTRODUCTION

- Revenue recognition is the process of recording revenue in the accounting period in which it was \_\_\_\_\_.
  - This is not necessarily when cash is \_\_\_\_\_.
- Most corporations assume that revenue has been earned when:
  - a sales invoice has been sent to a customer and the related goods have been received by a customer or services performed.

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# GAAP GUIDANCE ON REVENUE RECOGNITION

- GAAP provide guidance about when an economic activity should be recognized in financial accounting and reporting.
- An economic activity is recognized when it meets two criteria (whether payment has been received is **not** one of them):
  1. It is probable that any future economic benefit associated with the item will flow to the business; and
  2. It has a value that can be measured with reliability.

# ACCRUAL BASIS OF ACCOUNTING: INTRODUCTION

- Under the accrual accounting principle, a company could earn and report \$1,000 of revenue in its first month of operation but receive \$0 in actual cash in that month.
- Example
  - ABC Consulting completes its service at an agreed price of \$1,000.
  - ABC should recognize \$\_\_\_\_\_ of revenue as soon as its work is done.
  - It does \_\_\_\_\_ matter whether the client pays the \$1,000 immediately or in 30 days.
- Do not confuse revenue with a cash receipt.

# CASH ACCOUNTING VERSUS ACCRUAL ACCOUNTING

## ACE Corp.'s transactions in October

- Service performed in October totaled \$20,000. \$18,000 cash payment was received in October; \$2,000 will be received in November.

## BEE Corp.'s transactions in October

- Cash payment received in October totaled \$20,000; \$15,000 was for services that had been performed in October; \$5,000 payment was for services that would be performed in November.

	ACE Corp.	BEE Corp.
Revenue for October (Cash Basis)		
Revenue for October (Accrual Basis)		

---

# REVENUE RECOGNITION ILLUSTRATED:

## THREE POSSIBLE SCENARIOS

- 1) Revenue was earned \_\_\_\_\_ cash was received.
- 2) Revenue was earned \_\_\_\_\_ cash was received.
- 3) Revenue was earned \_\_\_\_\_ cash was received.

# REVENUE RECOGNITION ILLUSTRATED (SCENARIO 1)

**When revenue is earned and recognized *before* the receipt of cash payment from a customer.**

Date	Account/Explanation	R	Debit	Credit
	To recognize revenue earned on (date).			

**When cash payment is later received from the above customer:**

Date	Account/Explanation	R	Debit	Credit
	To record payment received from customer #			

- Revenue is recognized in the \_\_\_\_\_ journal entry (the credit to revenue), prior to the receipt of cash.
- The second journal entry has \_\_\_\_\_ effect on revenue.

# REVENUE RECOGNITION ILLUSTRATED (SCENARIO 2)

**When cash is received at the same time when revenue is earned and recognized.**

Date	Account/Explanation	R	Debit	Credit
	To recognize revenue earned and cash receipt			

# REVENUE RECOGNITION ILLUSTRATED (SCENARIO 3)

**When a cash deposit or advance payment is received *before* revenue is earned.**

Date	Account/Explanation	R	Debit	Credit
To recognize cash receipt and deferred revenue incurred on (date).				

**Revenue is recognized only after the services have been performed:**

Date	Account/Explanation	R	Debit	Credit
To record revenue earned on (date)				

- Revenue is recognized in the \_\_\_\_\_ journal entry (the credit to revenue), after the receipt of cash.
- The \_\_\_\_\_ journal entry has no effect on revenue.

# REVENUE RECOGNITION: SUMMARY

	<b>Revenues have been earned</b>	<b>Revenues not yet earned</b>
Cash payments have been received from customers.	Revenues should be recognized (debit _____ / credit _____)	Revenue should <b>not</b> be recognized; A _____ is created (called unearned revenue or deferred revenue)
Cash payments have <b>not</b> been received from customers.	Revenues should be recognized (debit _____ / credit _____)	No transaction and no journal entry



# **EXPENSE MATCHING**

# EXPENSE MATCHING PRINCIPLE

- The matching principle requires that expenses be matched with revenues.
- Examples:

## Example 1

Wages to employees are reported as an expense in the week when the employees worked and *not* in the week when the employees are paid.

## Example 2

If a company agrees to give its employees 1% of its 2019 revenues as a bonus on January 15, 2020, the company should report the bonus as an expense in \_\_\_\_\_.

# Cost Outlays

Incurred to produce revenue in the ***present*** accounting period

Record as \_\_\_\_\_

Examples:

- Rent expense
- Insurance expense
- Office supplies expense

Incurred to produce revenue in ***future*** accounting period

Record as \_\_\_\_\_

Examples:

- Prepaid rent
- Prepaid insurance
- Unused office supplies

# EXPENSE RECOGNITION ILLUSTRATED

An example of when expenses are incurred **before** cash is paid occurs when the utilities expense for January is not paid until February.

In this case, an account payable is created in January as follows:

Description	Debit	Credit

On which financial statement and which month this utilities expense is reported?

---

When the January utilities are paid in February, the following is recorded:

Description	Debit	Credit

Does this entry have any effect on expenses reported on the February income statement?

---

# EXPENSE RECOGNITION ILLUSTRATED (CONT'D)

Expenses can also be recorded *at the same time* when cash is paid.

For example, if salaries for January are paid on January 31, the entry on January 31 is:

Description	Debit	Credit

As a result of this entry, salaries expense is reported on the \_\_\_\_\_ income statement when cash is paid.

When a cash payment is made before the expense is incurred, such as insurance paid in advance:

Description	Debit	Credit

As the prepaid insurance is used, an expense should be reported on the income statement by recording the following entry:

Description	Debit	Credit

# EXPENSE RECOGNITION SUMMARY

- The preceding examples illustrate how to match expenses to the appropriate accounting period.
- The matching principle requires that expenses be reported ***in the same period*** as the revenues they helped generate. That is, expenses are reported on the income statement:
  - When related revenue is recognized, or
  - During the appropriate time period when it is consumed, regardless of when cash is paid.
- To ensure the recognition and matching of revenues and expenses to the correct accounting period, account balances must be reviewed and **adjusted** prior to the preparation of financial statements.

# REVENUE RECOGNITION & EXPENSE MATCHING SUMMARY

	Revenues has been earned	Revenues <u>not</u> yet earned
Cash payments have been received from customers.	Revenues should be recognized (debit _____/credit _____)	Revenue should not be recognized; A _____ is created (unearned revenue/deferred revenue); debit _____/credit _____
Cash payments have <u>not</u> been received from customers.	Revenues should be recognized (debit _____/credit _____)	No transaction and no journal entry

	Costs Recorded as Expense	Costs Recorded as Assets
Cash payments have been made	Paid for <i>present</i> period revenue Expenses are recognized (debit _____/credit _____)	Paid for <i>future</i> period revenue No expense is recognized; An _____ is created (prepaid expense or deferred expense); debit _____/credit _____
Cash payments have yet to be made	Expense are recognized (debit _____/credit _____)	N/A

# INFO 7225

## M1. Financial Accounting

### 6. Preparation of Financial Statements

Professor Shaoxing Shi

College of Engineering

Northeastern University

1,000

Q3

Q4



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# LEARNING OBJECTIVES

**After completing this session, you should be able to**

- Record and post adjusting entries;
- Prepare adjusted trial balance;
- Use adjusted trial balance to prepare the following financial statements
  - ✓ The Income Statement
  - ✓ The Statement of Shareholders' Equity, and
  - ✓ The Balance Sheet

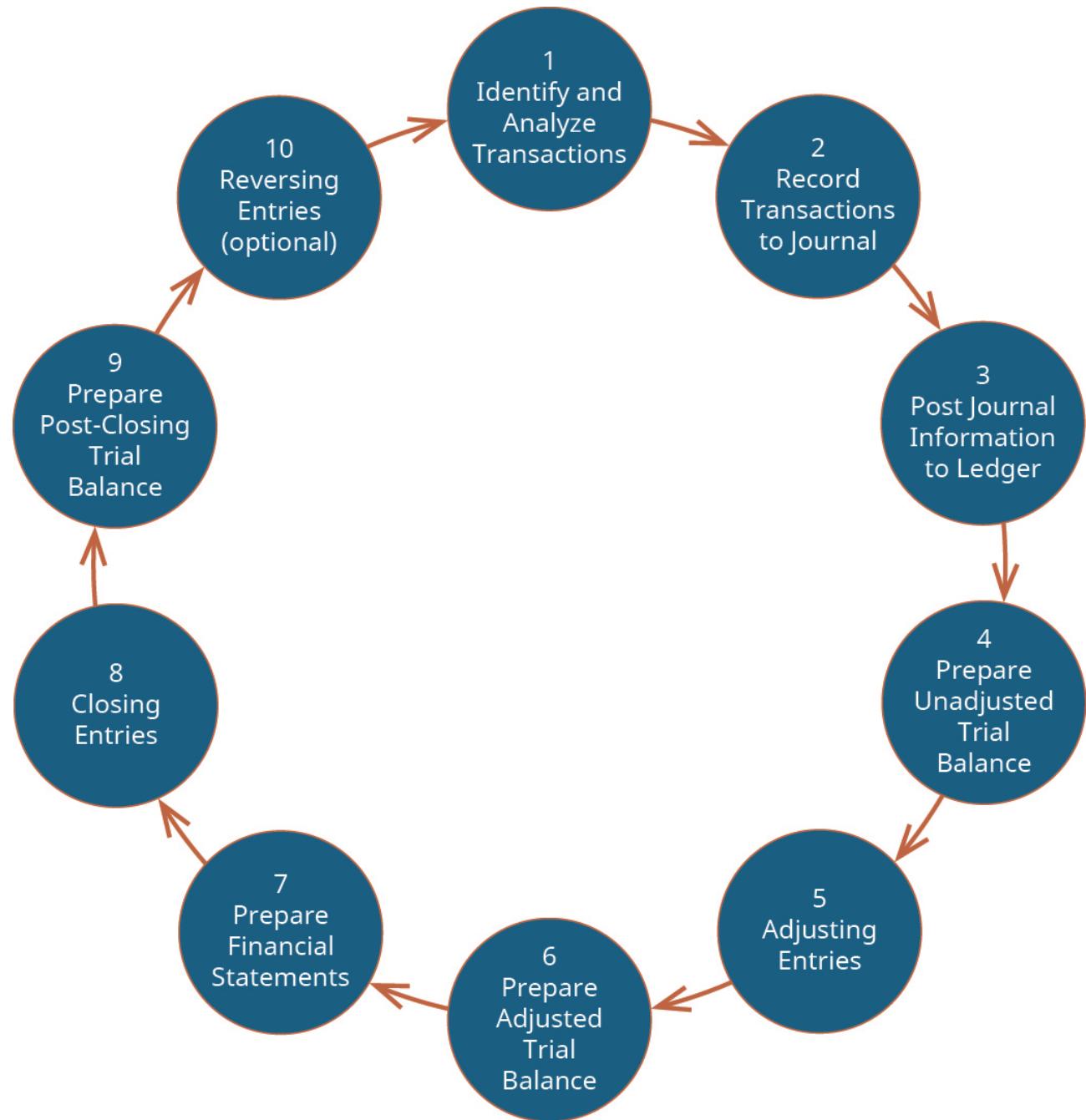
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# **Record and Post Adjusting Entries and Prepare Adjusted Trial Balance**

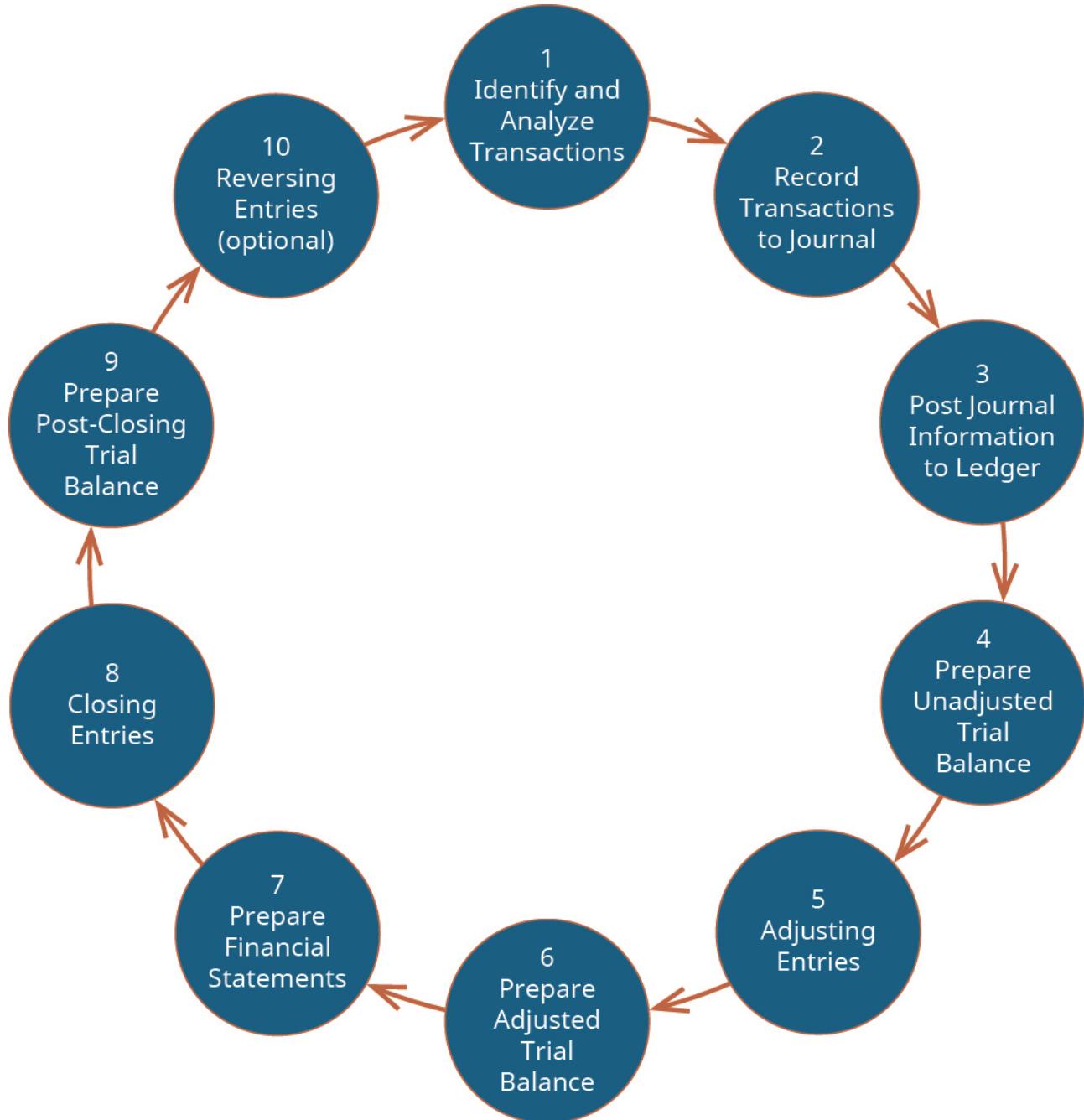
# The Accounting Cycle: Review



# The Accounting Cycle: Review

Big Dog Carworks Corp.  
Unadjusted Trial Balance  
At January 31, 2015

<u>Acct.</u>	<u>Account</u>	<u>Debit</u>	<u>Credit</u>
101	Cash	\$3,700	
110	Accounts receivable	2,000	
161	Prepaid insurance	2,400	
183	Equipment	3,000	
184	Truck	8,000	
201	Bank loan		
210	Accounts payable		
247	Unearned revenue		
320	Share capital		
330	Dividends	200	
450	Repair revenue		
654	Rent expense	1,600	
656	Salaries expense	3,500	
668	Supplies expense	2,000	
670	Truck operation expense	700	
		<u>\$27,100</u>	<u>\$27,100</u>



Big Dog Carworks Corp.  
**Unadjusted Trial Balance**  
At January 31, 2015

Big Dog Carworks Corp.  
**Adjusted Trial Balance**  
At January 31, 2015

<u>Acct.</u>	<u>Account</u>	<u>Debit</u>	<u>Credit</u>
101	Cash	\$3,700	
110.	Accounts receivable	2,000	
161	Prepaid insurance	2,400	→
183	Equipment	3,000	
184.	Truck	8,000	
201	Bank loan		\$6,000
210	Accounts payable		700
247	Unearned revenue		400
320	Share capital		10,000
330	Dividends	200	
450	Repair revenue		10,000
654	Rent expense	1,600	
656	Salaries expense	3,500	
668	Supplies expense	2,000	
670	Truck operation expense	700	
		<u>\$27,100</u>	<u>\$27,100</u>

Big Dog Carworks Corp.  
**Unadjusted Trial Balance**  
At January 31, 2015

Big Dog Carworks Corp.  
**Adjusted Trial Balance**  
At January 31, 2015

<u>Acct.</u>	<u>Account</u>	<u>Debit</u>	<u>Credit</u>
101	Cash	\$3,700	
110.	Accounts receivable	2,000	
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668	Supplies expense	2,000	
670	Truck operation expense	700	
		<u>\$27,100</u>	<u>\$27,100</u>

Big Dog Carworks Corp.  
**Unadjusted Trial Balance**  
At January 31, 2015

Big Dog Carworks Corp.  
**Adjusted Trial Balance**  
At January 31, 2015

<u>Acct.</u>	<u>Account</u>	<u>Debit</u>	<u>Credit</u>
101	Cash	\$3,700	
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161	Prepaid insurance	2,400	
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450	Repair revenue		10,000
654	Rent expense	1,600	
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670	Truck operation expense	700	
		<u>\$27,100</u>	<u>\$27,100</u>

Big Dog Carworks Corp.  
**Unadjusted Trial Balance**  
At January 31, 2015

Big Dog Carworks Corp.  
**Adjusted Trial Balance**  
At January 31, 2015

<u>Acct.</u>	<u>Account</u>	<u>Debit</u>	<u>Credit</u>
101	Cash	\$3,700	
110.	Accounts receivable	2,000	
161	Prepaid insurance	2,400	
183	Equipment	3,000	
184.	Truck	8,000	
201	Bank loan		\$6,000
210	Accounts payable		700
247	Unearned revenue		400
320	Share capital		10,000
330	Dividends	200	
450	Repair revenue		10,000
654	Rent expense	1,600	
656	Salaries expense	3,500	
668	Supplies expense	2,000	
670	Truck operation expense	700	
		<u>\$27,100</u>	<u>\$27,100</u>



# The Accounting Cycle: Review

Big Dog Carworks Corp.  
Unadjusted Trial Balance  
At January 31, 2015

<u>Acct.</u>	<u>Account</u>	<u>Debit</u>	<u>Credit</u>
101	Cash	\$3,700	
110	Accounts receivable	2,000	
161	Prepaid insurance	2,400	
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320	Share capital		10,000
330	Dividends	200	
450	Repair revenue		10,000
654	Rent expense	1,600	
656	Salaries expense	3,500	
668	Supplies expense	2,000	
670	Truck operation expense	700	
		<u>\$27,100</u>	<u>\$27,100</u>



Big Dog Carworks Corp.  
Adjusted Trial Balance  
At January 31, 2015

<u>Account</u>	<u>Debit</u>	<u>Credit</u>
Cash	\$3,700	
Accounts receivable	2,400	
Prepaid insurance	2,200	
Equipment	3,000	
Accumulated depreciation – equipment		\$25
Truck	8,000	
Accumulated depreciation – truck		100
Bank loan		6,000
Accounts payable		700
Interest payable		18
Unearned repair revenue		100
Income tax payable		500
Share capital		10,000
Dividends		200
Repair revenue		10,700
Depreciation expense – equipment	25	
Depreciation expense – truck	100	
Rent expense		1,600
Insurance expense		200
Interest expense		18
Salaries expense		3,500
Supplies expense		2,000
Truck operation expense		700
Income tax expense		500
Total debits and credits	<u>\$28,143</u>	<u>\$28,143</u>

# REVIEW: FIVE TYPES OF ADJUSTING ENTRIES

**Adjust for  
prepaid  
assets<sup>1</sup>**

**Adjust for  
unearned  
revenues<sup>2</sup>**

**Adjust for plant  
& equipment  
assets<sup>3</sup>**

**Adjust for  
accrued  
revenues<sup>4</sup>**

**Adjust for  
accrued  
expenses<sup>5</sup>**

**1. Deferred expenses (Prepaid ~; = \_\_\_\_\_)**

Expenses paid for before their use. Some examples include supplies, insurance, and rent. When they are used, this asset's value is reduced and an expense is recognized (debit \_\_\_\_\_ /credit \_\_\_\_\_).

**2. Deferred revenues (unearned ~; = \_\_\_\_\_)**

Customer advanced payments for product or services yet to be provided. When the company provides the product or service, revenue is then recognized (debit \_\_\_\_\_ /credit \_\_\_\_\_).

**3. Depreciation of fixed assets:** debit \_\_\_\_\_ / credit \_\_\_\_\_

**4. Accrued revenues**

Revenues earned in a period but have yet to be recorded and no money has been collected. Accrued revenues are updated at the end of the period to recognize revenue and money owed to the company (debit \_\_\_\_\_ / credit \_\_\_\_\_).

**5. Accrued expenses** (examples: interest on loans; taxes)

Accrued expenses are incurred in a period but have yet to be recorded and no money has been paid. Accrued expenses are updated to reflect the expense and the company's liability (debit \_\_\_\_\_ /credit \_\_\_\_\_).

**de·fer·ral** | də'fərəl |

noun

a postponement of an action or event:

*they agreed to a deferral of industrial action | they can offer deferrals on loan repayments | it is unclear whether deferral of feeding is beneficial.*

**ac·cru·al** | ə'krōōəl |

noun

- the accumulation or increase of something over time, especially payments or benefits: *all debts must be frozen with no further accrual of interest*
- **a charge for work that has been done but not yet invoiced, for which provision is made at the end of a financial period:** *before closing off an accounting period it is essential that provision is made for accruals.*



# **PREPARING FINANCIAL STATEMENTS**

Adjusted Trial Balance at the End of a Reporting Period		Account Balance	
	Account	Debit	Credit
Cash		\$ 3,700	
Accounts receivable		2,400	
Prepaid insurance		2,200	
Equipment		3,000	
Accumulated depreciation – equipment			\$ 25
Truck		8,000	
Accumulated depreciation – truck			100
Accounts payable			700
Unearned revenue			100
Interest payable			19
Income tax payable			500
Notes payable			6,000
Common stock			10,000
Dividends		200	
Repair revenue			10,700
Depreciation expense – equipment		25	
Depreciation expense – truck		100	
Rent expense		1,600	
Insurance expense		200	
Interest expense		19	
Salaries expense		3,500	
Supplies expense		2,000	
Truck operation expense		700	
Income tax expense		500	
Total debits and credits		<u>\$28,144</u>	<u>\$28,144</u>

<u>Account</u>	<u>Debit</u>	<u>Credit</u>
Cash	\$ 3,700	
Accounts receivable	2,400	
Prepaid insurance	2,200	
Equipment	3,000	
Accum. dep. – equipment		\$ 25
Truck	8,000	
Accum. dep. – truck		100
Accounts payable		700
Unearned revenue		100
Interest payable		19
Income tax payable		500
Notes payable		6,000
Common stock		10,000
Dividends	200	
<b>Repair revenue</b>		<b>10,700</b>
Dep. expense – equipment	25	
Dep. expense – truck	100	
Rent expense	1,600	
Insurance expense	200	
Interest expense	19	
Salaries expense	3,500	
Supplies expense	2,000	
Truck operation expense	700	
Income tax expense	500	
	<b>\$28,144</b>	<b>\$28,144</b>

Big Dog Carworks Corp.

---

For the Month Ended January 31, 2015

<b>Revenues</b>	
Repair revenue	\$10,700
<b>Expenses</b>	
Salaries expense	\$ 3,500
Supplies expense	2,000
Rent expense	1,600
Truck operation expense	700
Insurance expense	200
Dep. expense – truck	100
Dep. expense – equipment	25
Interest expense	19
Income tax expense	500
	<hr/>
Total expenses	8,644
<b>Net income</b>	<b>\$2,056</b>

<u>Account</u>	<u>Debit</u>	<u>Credit</u>
Cash	\$ 3,700	
Accounts receivable	2,400	
Prepaid insurance	2,200	
Equipment	3,000	
Accum. dep. – equipment		\$ 25
Truck	8,000	
Accum. dep. – truck		100
Accounts payable		700
Unearned revenue		100
Interest payable		19
Income tax payable		500
Notes payable		6,000
Common stock		10,000
Dividends	200	
<b>Repair revenue</b>		<b>10,700</b>
Dep. expense – equipment	25	
Dep. expense – truck	100	
Rent expense	1,600	
Insurance expense	200	
Interest expense	19	
Salaries expense	3,500	
Supplies expense	2,000	
Truck operation expense	700	
Income tax expense	500	
	<b>\$28,144</b>	<b>\$28,144</b>

Common Stock and Dividends are transferred to the Statement of Stockholders' Equity. Dividends is part of Retained Earnings because it is a distribution of Net Income.

Big Dog Carworks Corp. Income Statement For the Month Ended January 31, 2015	
<b>1</b>	
<b>Revenues</b>	
Repair revenue	\$10,700
<b>Expenses</b>	
Salaries expense	\$ 3,500
Supplies expense	2,000
Rent expense	1,600
Truck operation expense	700
Insurance expense	200
Dep. expense – truck	100
Dep. expense – equipment	25
Interest expense	19
Income tax expense	500
Total expenses	
	<b>8,644</b>
<b>Net income</b>	<b>\$2,056</b>

Big Dog Carworks Corp.  
Statement of Stockholders' Equity  
For the Month Ended January 31, 2015

Net Income is transferred to the Statement of Stockholders' Equity as part of Retained Earnings.

Common	Retained	Total
stock	earnings	equity
\$ -0-	\$ -0-	\$ -0-

Balance at beginning of period

Stock issued

Dividends

Net income

Balance at end of period

These accounts are used to prepare \_\_\_\_\_

**Big Dog Carworks Corp.**  
Trial Balance  
At January 31, 2015

Account	Debit	Credit
Cash	\$ 3,700	
Accounts receivable	2,400	
Prepaid insurance	2,200	
Equipment	3,000	
Accum. dep. – equipment		\$ 25
Truck	8,000	
Accum. dep. – truck		100
Accounts payable		700
Unearned revenue		100
Interest payable		19
Income tax payable		500
Notes payable		6,000
Common stock		10,000
Dividends	200	
Repair revenue		10,700
Dep. expense – equipment	25	
Dep. expense – truck	100	
Rent expense	1,600	
Insurance expense	200	
Interest expense	19	
Salaries expense	3,500	
Supplies expense	2,000	
Truck operation expense	700	
Income tax expense	500	
	<b>\$28,144</b>	<b>\$28,144</b>

**Big Dog Carworks Corp.**

At January 31, 2015

<i>Assets</i>	
Cash	\$ 3,700
Accounts receivable	2,400
Prepaid insurance	2,200
Equipment	\$3,000
Less: Accum. dep.	25
Truck	\$8,000
Less: Accum. dep.	100
Total assets	<b>\$19,175</b>
<i>Liabilities</i>	
Accounts payable	\$ 700
Unearned revenue	100
Interest payable	19
Income tax payable	500
Notes payable	6,000
Total liabilities	<b>\$7,319</b>
<i>Equity</i>	
Common stock	
Retained earnings	
Total equity	11,856
Total liabilities and equity	<b>\$19,175</b>

The Common Stock and Retained Earnings balances are transferred to the balance sheet from the statement of stockholders' equity.

## Adjusted Trial Balance at the End of a Reporting Period

Account	Account Balance	
	Debit	Credit
Cash	\$ 3,700	
Accounts receivable	2,400	
Prepaid insurance	2,200	
Equipment	3,000	
Accumulated depreciation – equipment		\$ 25
Truck	8,000	
Accumulated depreciation – truck		100
Accounts payable		700
Unearned revenue		100
Interest payable		19
Income tax payable		500
Notes payable		6,000
Common stock		10,000
Dividends	200	
Repair revenue		10,700
Depreciation expense – equipment	25	
Depreciation expense – truck	100	
Rent expense	1,600	
Insurance expense	200	
Interest expense	19	
Salaries expense	3,500	
Supplies expense	2,000	
Truck operation expense	700	
Income tax expense	500	
Total debits and credits	<u>\$28,144</u>	<u>\$28,144</u>

Asset accounts, liability accounts, and the \_\_\_\_\_ are used to prepare the balance sheet.

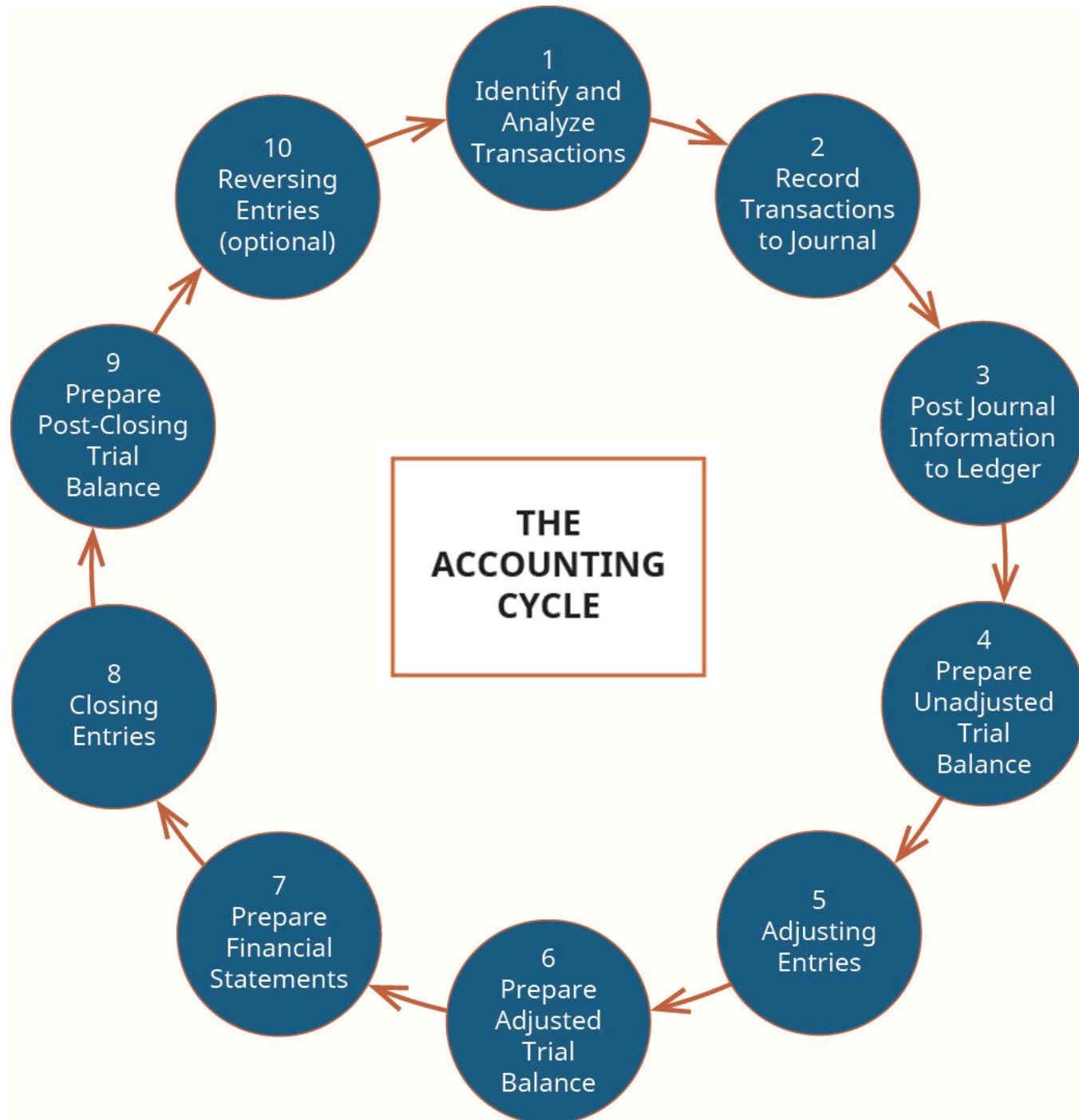
3

Common stock, dividends, and the \_\_\_\_\_ are used to prepare the statement of stockholders' equity.

2

Revenue and expense accounts are used to prepare the \_\_\_\_\_.

1



## THE ACCOUNTING CYCLE

## **5.1 Describe and Prepare Closing Entries for a Business**

- Closing entries: Closing entries prepare a company for the next period and zero out balance in temporary accounts.
- Purpose of closing entries: Closing entries are necessary because they help a company review income accumulation during a period, and verify data figures found on the adjusted trial balance.
- Permanent accounts: Permanent accounts do not close and are accounts that transfer balances to the next period. They include balance sheet accounts, such as assets, liabilities, and stockholder's equity
- Temporary accounts: Temporary accounts are closed at the end of each accounting period and include income statement, dividends, and income summary accounts.
- Income Summary: The Income Summary account is an intermediary between revenues and expenses, and the Retained Earnings account. It stores all the closing information for revenues and expenses, resulting in a “summary” of income or loss for the period.
- Recording closing entries: There are four closing entries; closing revenues to income summary, closing expenses to income summary, closing income summary to retained earnings, and close dividends to retained earnings.
- Posting closing entries: Once all closing entries are complete, the information is transferred to the general ledger T-accounts. Balances in temporary accounts will show a zero balance.

## Step 8a. Record Closing Entries

Closing entry 1:

DR      CR

Close revenue accounts to \_\_\_\_\_ account.

Closing entry 2:

DR      CR

Close expense accounts to \_\_\_\_\_ account.

Closing entry 3:

DR      CR

Close \_\_\_\_\_ to \_\_\_\_\_ account.

Closing entry 4:

DR      CR

Close \_\_\_\_\_ to \_\_\_\_\_ account.

**PRINTING PLUS**  
Adjusted Trial Balance  
For the Month Ended January 31, 2019

Account Title	Debit	Credit
Cash	\$24,800	
Accounts Receivable	1,200	
Interest Receivable	140	
Supplies	400	
Equipment	3,500	
Accumulated Depreciation: Equipment		\$ 75
Accounts Payable		500
Salaries Payable		1,500
Unearned Revenue		3,400
Common Stock		20,000
Dividends	100	
Interest Revenue		140
Service Revenue		10,100
Supplies Expense	100	
Depreciation Expense: Equipment	75	
Salaries Expense	5,100	
Utility Expense	300	
Total	\$35,715	\$35,715

## Step 8b. Post Closing Entries to Ledger

**PRINTING PLUS**  
**Adjusted Trial Balance**  
**For the Month Ended January 31, 2019**

Account Title	Debit	Credit
Cash	\$24,800	
Accounts Receivable	1,200	
Interest Receivable	140	
Supplies	400	
Equipment	3,500	
Accumulated Depreciation: Equipment		\$ 75
Accounts Payable		500
Salaries Payable		1,500
Unearned Revenue		3,400
Common Stock		20,000
Dividends	100	
Interest Revenue		140
Service Revenue		10,100
Supplies Expense	100	
Depreciation Expense: Equipment	75	
Salaries Expense	5,100	
Utility Expense	300	
Total	<u><u>\$35,715</u></u>	<u><u>\$35,715</u></u>

# Step 9: Prepare Post-Closing Trial Balance

**PRINTING PLUS**  
Adjusted Trial Balance  
For the Month Ended January 31, 2019

Account Title	Debit	Credit
Cash	\$24,800	
Accounts Receivable	1,200	
Interest Receivable	140	
Supplies	400	
Equipment	3,500	
Accumulated Depreciation: Equipment		\$ 75
Accounts Payable		500
Salaries Payable		1,500
Unearned Revenue		3,400
Common Stock		20,000
Dividends	100	
Interest Revenue		140
Service Revenue		10,100
Supplies Expense	100	
Depreciation Expense: Equipment	75	
Salaries Expense	5,100	
Utility Expense	300	
Total	<u>\$35,715</u>	<u>\$35,715</u>

**PRINTING PLUS**  
Post-Closing Trial Balance  
January 31, 2019

Account	Debit	Credit
Cash	\$24,800	
Accounts Receivable	1,200	
Interest Receivable	140	
Supplies	400	
Equipment	3,500	
Accumulated Depreciation: Equipment		\$ 75
Accounts Payable		500
Salaries Payable		1,500
Unearned Revenue		3,400
Common Stock		20,000
Retained Earnings		4,565
Total	<u>\$30,040</u>	<u>\$30,040</u>

# Change of Retained Earnings

**PRINTING PLUS**  
 Adjusted Trial Balance  
 For the Month Ended [REDACTED], 2019

Account Title	Debit	Credit
Cash	\$24,800	
Accounts Receivable	1,200	
Interest Receivable	140	
Supplies	400	
Equipment	3,500	
Accumulated Depreciation: Equipment		\$ 75
Accounts Payable		500
Salaries Payable		1,500
Unearned Revenue		3,400
Common Stock		20,000
Dividends	100	
Interest Revenue		
Service Revenue		
Supplies Expense		
Depreciation Expense: Equipment		
Salaries Expense		
Utility Expense		
Total	<u><u>\$35,715</u></u>	<u><u>\$35,715</u></u>

**PRINTING PLUS**  
 Post-Closing Trial Balance  
 [REDACTED], 2019

Account	Debit	Credit
Cash	\$24,800	
Accounts Receivable	1,200	
Interest Receivable	140	
Supplies	400	
Equipment	3,500	
Accumulated Depreciation: Equipment		\$ 75
Accounts Payable		500
Salaries Payable		1,500
Unearned Revenue		3,400
Common Stock		20,000
Retained Earnings		
Total	<u><u>\$30,040</u></u>	<u><u>\$30,040</u></u>

# SUMMARY

- The \_\_\_\_\_ trial balance is used to prepare financial statements.
  - 1) \_\_\_\_\_ is first prepared: shows the net income or loss as a result of revenue and expense activities occurring in a period.
  - 2) Net income (or loss) from the \_\_\_\_\_ statement is used to prepare the \_\_\_\_\_ part of the Statement of Owners' Equity (SOE): shows the effects of net income (loss) and dividends on the earnings the the company maintains.
  - 3) Once the equity accounts are updated, together with the ledger balances of \_\_\_\_\_ and \_\_\_\_\_ from the \_\_\_\_\_ trial balance, the \_\_\_\_\_ is prepared.
    - ✓ This financial statement visually represents the accounting equation, showing that assets balance with liabilities and equity.
- To prepare a company for the next period and zero out balance in \_\_\_\_\_ account, closing entries are made and then posted to the ledger. \_\_\_\_\_ trial balance is prepared and only includes \_\_\_\_\_ accounts.



**Thank you!  
Questions?**