

Financial Accounting

Prepared by Dr. Sara Ahmed

MGM611

Lecture 4





مجموعة جامعة
الجميع الذكية
للتعليم القابضة

MIDOCEAN
UNIVERSITY
BY EVERYONE'S SMART UNIVERSITY

Completing the Accounting Cycle

Lecture 4

MGM 611

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TOPIC
04

LEARNING OBJECTIVES

Explain why temporary accounts are closed each period.
Identify steps in the accounting cycle.
Explain and prepare a classified balance sheet.
Compute the current ratio and describe what it reveals about a company's financial condition.
Prepare a work sheet and explain its usefulness.
Describe and prepare closing entries.
Explain and prepare a post-closing trial balance.

Learning Objective

Prepare a work sheet and explain its usefulness.

Benefits of a Work Sheet

Aids the preparation of financial statements.

Reduces risk of errors.

Links accounts and their adjustments.

Not a required report.

Helps in preparing interim financial statements.

Shows the effects of proposed transactions.

Use of a Work Sheet

Five important 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
Income or Loss, and Balance Columns

Use of a Work Sheet

FastForward Work Sheet For Month Ended December 31, 2017											
1		2		3		4		5			
Unadjusted Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Balance Sheet & Statement of Owner's Equity			
No.	Account	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
101	Cash	4,275				4,275				4,275	
106	Accounts receivable	0		(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 income							3,785			3,785
	Totals							8,150	8,150	43,245	43,245

1a List all accounts from the ledger; include those accounts (shaded in dark green) necessary to make accounting adjustments.

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 income or loss. (2) Totals.

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

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

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

The following 10-column work sheet contains the year-end unadjusted trial balance for Magic Company as of December 31. Complete the work sheet by entering the necessary adjustments, computing the adjusted account balances, extending the adjusted balances into the appropriate financial statement columns, and entering the amount of net income for the period. Note: The Magic, Capital account balance was \$75,000 at December 31, 2016.

No.	Unadjusted Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Balance Sheet and Statement of Owner's Equity	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
101 Cash	13,000									
106 Accounts receivable	8,000									
183 Land	85,000									
201 Accounts payable		10,000								
251 Long-term notes payable		33,000								
301 Magic, Capital		75,000								
302 Magic, Withdrawals	20,000									
401 Fees earned		70,000								
622 Salaries expense	54,000									
650 Office supplies expense	8,000									
Totals	188,000	188,000								

1. Prepare and complete the work sheet, starting with the unadjusted trial balance and including adjustments based on the following.

- The company has earned \$9,000 in fees that were not yet recorded at year-end.
- The company incurred \$2,000 in salary expense that was not yet recorded at year-end.
(Hint: For simplicity, assume it records any salary not yet paid as part of accounts payable.)
- The long-term note payable was issued on December 31 this year. Thus, no interest has yet accrued on this loan.

	Unadjusted Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Balance Sheet and Statement of Owner's Equity	
No.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
101 Cash	13,000				13,000				13,000	
106 Accounts receivable	8,000		(a) 9,000		17,000				17,000	
183 Land	85,000				85,000				85,000	
201 Accounts payable		10,000		(b) 2,000		12,000				12,000
251 Long-term notes payable		33,000				33,000				33,000
301 Magic, Capital		75,000				75,000				75,000
302 Magic, Withdrawals	20,000				20,000				20,000	
401 Fees earned		70,000		(a) 9,000		79,000		79,000		
622 Salaries expense	54,000		(b) 2,000		56,000		56,000			
650 Office supplies expense	8,000				8,000		8,000			
Totals	188,000	188,000	11,000	11,000	199,000	199,000	64,000	79,000	135,000	120,000
Net income							15,000			15,000
Totals							79,000	79,000	135,000	135,000

- The company has earned \$9,000 in fees that were not yet recorded at year-end.
- The company incurred \$2,000 in salary expense that was not yet recorded at year-end.
(Hint: For simplicity, assume it records any salary not yet paid as part of accounts payable.)
- The long-term note payable was issued on December 31 this year. Thus, no interest has yet accrued on this loan.

	Unadjusted Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Balance Sheet and Statement of Owner's Equity	
No.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
101 Cash	13,000				13,000				13,000	
106 Accounts receivable	8,000		(a) 9,000		17,000				17,000	
183 Land	85,000				85,000				85,000	
201 Accounts payable		10,000		(b) 2,000		12,000				12,000
251 Long-term notes payable		33,000				33,000				33,000
301 Magic, Capital		75,000				75,000				75,000
302 Magic, Withdrawals	20,000				20,000				20,000	
401 Fees earned		70,000		(a) 9,000		79,000		79,000		
622 Salaries expense	54,000		(b) 2,000		56,000		56,000			
650 Office supplies expense	8,000				8,000		8,000			
Totals	188,000	188,000	11,000	11,000	199,000	199,000	64,000	79,000	135,000	120,000
Net income							15,000			15,000
Totals							79,000	79,000	135,000	135,000

2. Use information from the completed work sheet in part 1 to prepare adjusting entries.

Date	General Journal	Debit	Credit
Dec. 31	Accounts Receivable	9,000	
	Fees earned		9,000
Dec. 31	Salaries expense	2,000	
	Accounts payable		2,000
Dec. 31	No journal entry required		

3. Prepare the income statement and the statement of owner's equity for the year ended December 31 and the unclassified balance sheet at December 31.

	Debit	Credit
Cash	\$13,000	
Accounts receivable	17,000	
Land	85,000	
Accounts payable		\$12,000
Long-term notes payable		33,000
Magic, Capital		75,000
Magic, Withdrawals	20,000	
Fees earned		79,000
Salaries expense	56,000	
Office supplies expense	8,000	
Totals	<u>\$199,000</u>	<u>\$199,000</u>

Magic Company	
Income Statement	
For Year Ended December 31, 2017	
Fees earned	\$79,000
Expenses	
Salaries expense	\$56,000
Office supplies expense	<u>8,000</u>
	64,000
Net income	<u>\$15,000</u>

Magic Company	
Statement of Owner's Equity	
For Year Ended December 31, 2017	
Magic, Capital, Dec. 31 2016	\$75,000
Plus: Net income	15,000
Less: Magic, Withdrawals	<u>(20,000)</u>
Magic, Capital, Dec. 31 2017	<u>\$70,000</u>

Magic Company
Balance Sheet
December 31, 2017

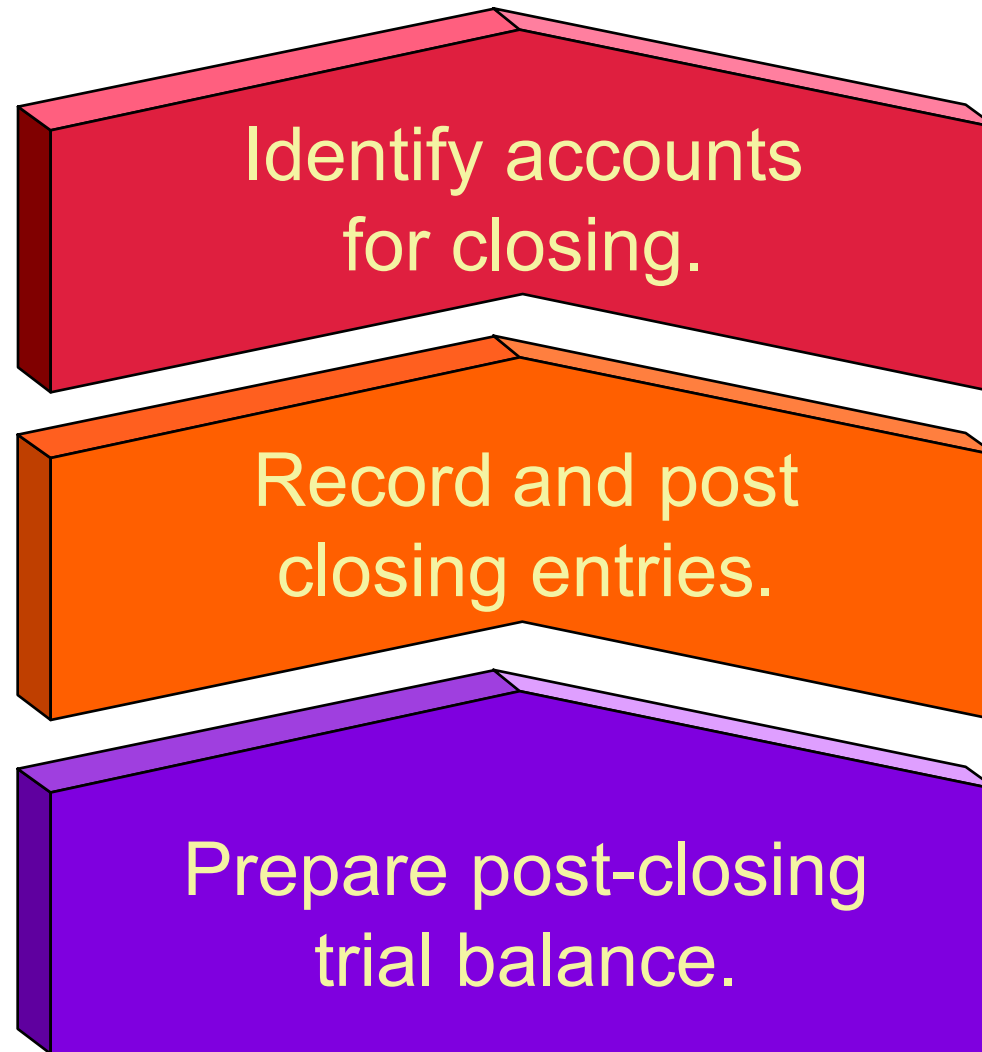
Assets		Liabilities	
Cash	\$13,000	Accounts payable	\$12,000
Accounts receivable	17,000	Long-term notes payable	<u>33,000</u>
Land	85,000	Total liabilities	45,000
		Equity	
		Magic, Capital	<u>70,000</u>
Total assets	<u>\$115,000</u>	Total liabilities and equity	<u>115,000</u>

Learning Objective

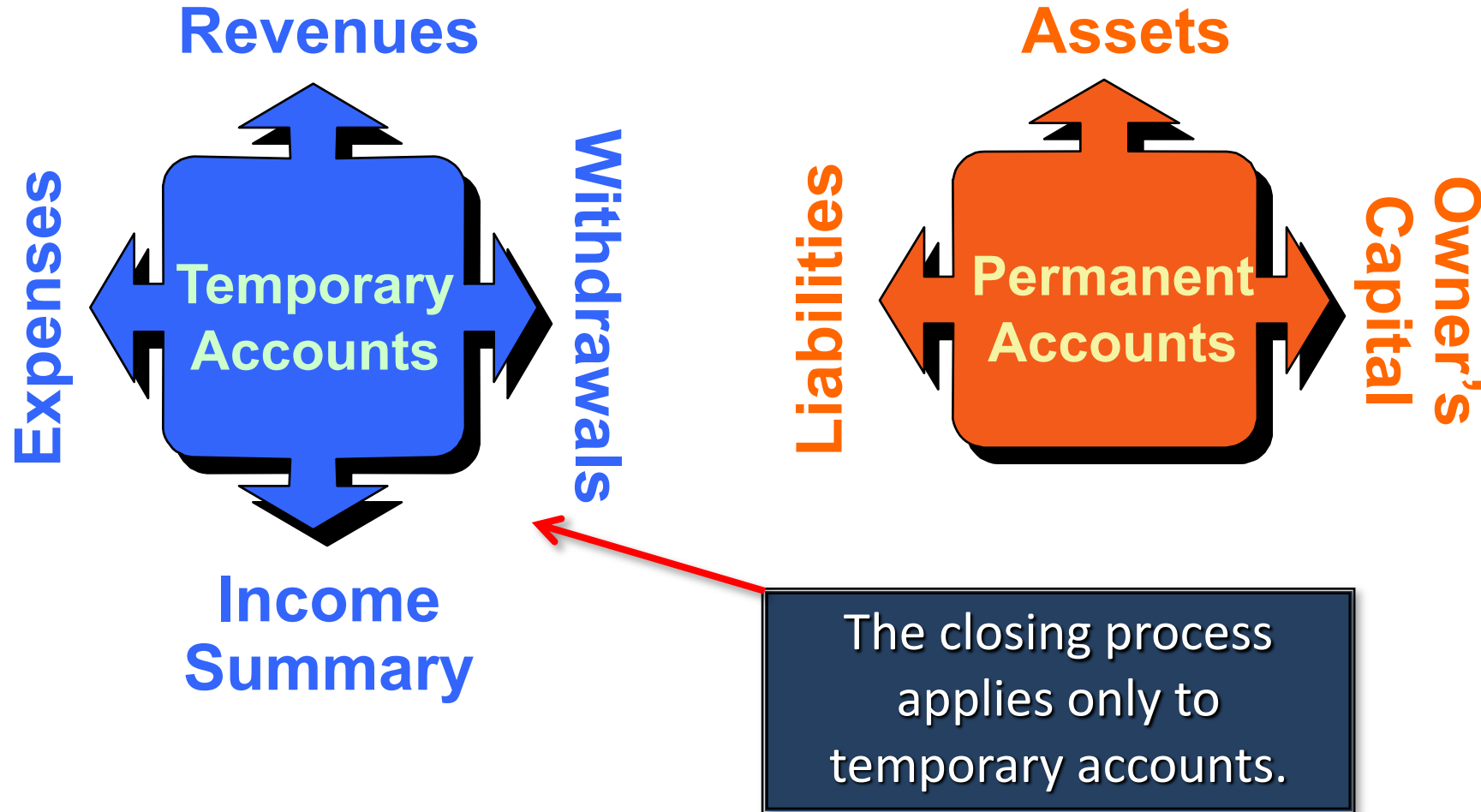
Explain why temporary accounts are closed each period.

Closing Process

1. Resets revenue, expense, and withdrawal account balances to zero at the end of the period.
2. Helps summarize a period's revenues and expenses in the **Income Summary** account.



Temporary and Permanent Accounts



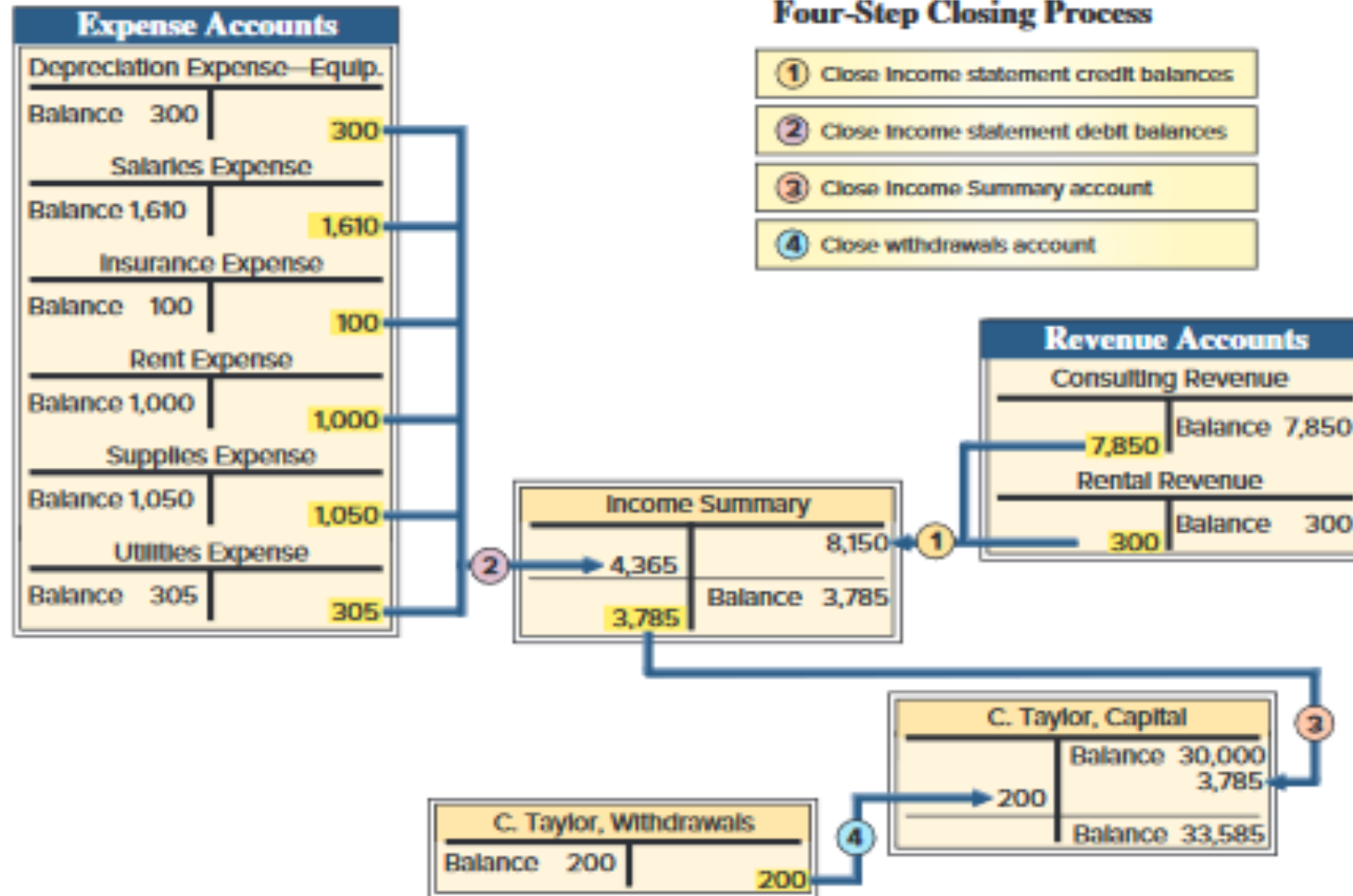
Learning Objective

Describe and prepare closing entries.

Recording Closing Entries

1. Close Credit Balances in Revenue Accounts to Income Summary.
2. Close Debit Balances in Expense accounts to Income Summary.
3. Close Income Summary account to Owner's Capital.
4. Close Withdrawals to Owner's Capital.

Recording Closing Entries



Learning Objective

Explain and prepare a post-closing trial balance.

Post-Closing Trial Balance

- List of permanent accounts and their balances after posting closing entries.
- Total debits and credits must be equal.

Post-Closing Trial Balance

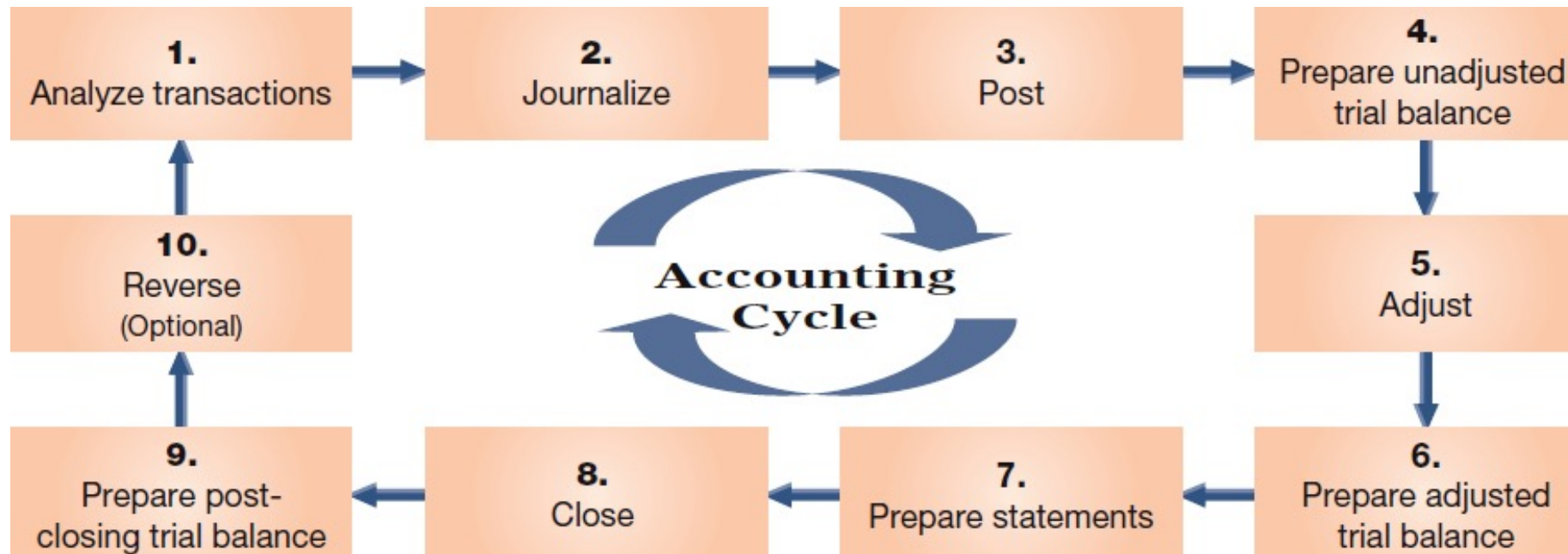
FASTFORWARD Post-Closing Trial Balance December 31, 2017		
	Debit	Credit
Cash	\$ 4,275	
Accounts receivable	1,800	
Supplies	8,670	
Prepaid Insurance	2,300	
Equipment	26,000	
Accumulated depreciation—Equipment		\$ 300
Accounts payable		6,200
Salaries payable		210
Unearned consulting revenue		2,750
C. Taylor, Capital*		33,585
Totals	<u>\$43,045</u>	<u>\$43,045</u>

* Computed as \$30,000 + \$3,785 – \$200.

Learning Objective

Identify steps in the accounting cycle.

Accounting Cycle



Use the adjusted trial balance of Magic Company to prepare its closing entries.

Magic Company		
Trial Balance		
December 31, 2017		
	Debit	Credit
Cash	\$13,000	
Accounts receivable	17,000	
Land	85,000	
Accounts payable		\$12,000
Long-term notes payable		33,000
Magic, Capital		75,000
Magic, Withdrawals	20,000	
Fees earned		79,000
Salaries expense	56,000	
Office supplies expense	8,000	
Totals	<u>\$199,000</u>	<u>\$199,000</u>

	Debit	Credit
Cash	\$13,000	
Accounts receivable	17,000	
Land	85,000	
Accounts payable		\$12,000
Long-term notes payable		33,000
Magic, Capital		75,000
Magic, Withdrawals	20,000	
Fees Earned		79,000
Salaries expense	56,000	
Office supplies expense	8,000	
Totals	<u>\$199,000</u>	<u>\$199,000</u>

Income summary			
Expenses	64,000	Revenues	79,000
		Net income	15,000
Closing	15,000		
			0

Magic, Capital			
		12/31/2016	75,000
Magic, Withdrawals	20,000	Net income	15,000
		12/31/2017	70,000

Date	General Journal	Debit	Credit
Dec. 31	Fees Earned	79,000	
	Income summary		79,000
Dec. 31	Income summary	64,000	
	Salaries expense		56,000
	Office supplies expense		8,000
Dec. 31	Income summary	15,000	
	Magic, Capital		15,000
Dec. 31	Magic, Capital	20,000	
	Magic, Withdrawals		20,000

Learning Objective

Explain and prepare a classified balance sheet.

Classified Balance Sheet

Assets	Liabilities and Equity
Current assets	Current liabilities
Noncurrent assets	Noncurrent liabilities
Long-term investments	Equity
Plant assets	
Intangible assets	

Current items are expected to come due (collected and 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.

Current Assets

Current assets are expected to be sold, collected, or used within one year or the company's operating cycle.

Long-Term Investments

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

Plant Assets

Plant assets are tangible long-lived assets used to produce or sell products and services.

Intangible Assets

Intangible assets are long-term resources used to produce or sell products and services and that lack physical form.

Current Liabilities

Current liabilities are obligations due within the longer of one year or the company's operating cycle.

Long-Term Liabilities

Long-term liabilities are obligations not due within the longer of one year or the company's operating cycle.

Equity

Equity is the owner's claim on the assets.

Use the adjusted trial balance of Magic Company to prepare its classified balance sheet as of December 31, 2017.

Magic Company		
Adjusted Trial Balance		
December 31, 2017		
	Debit	Credit
Cash	\$13,000	
Accounts receivable	17,000	
Land	85,000	
Accounts payable		\$12,000
Long-term notes payable		33,000
Magic, Capital		75,000
Magic, Withdrawals	20,000	
Fees earned		79,000
Salaries expense	56,000	
Office supplies expense	8,000	
Totals	<u>\$199,000</u>	<u>\$199,000</u>

Use the adjusted trial balance of Magic Company to prepare its classified balance sheet as of December 31, 2017.

Magic Company Adjusted Trial Balance December 31, 2017		
	Debit	Credit
Cash	\$13,000	
Accounts receivable	17,000	
Land	85,000	
Accounts payable		\$12,000
Long-term notes payable		33,000
Magic, Capital		75,000
Magic, Withdrawals	20,000	
Fees earned		79,000
Salaries expense	56,000	
Office supplies expense	8,000	
Totals	<u>\$199,000</u>	<u>\$199,000</u>

Magic Company Balance Sheet December 31, 2017	
Assets	
Current assets	
Cash	\$13,000
Accounts receivable	<u>17,000</u>
Total current assets	30,000
Plant assets	
Land	<u>85,000</u>
Total plant assets	<u>85,000</u>
Total assets	<u><u>\$115,000</u></u>
Liabilities	
Current liabilities	
Accounts payable	<u>\$12,000</u>
Total current liabilities	12,000
Long-term liabilities	
Long-term notes payable	<u>33,000</u>
Total liabilities	\$45,000
Equity	
Magic, Capital	<u>70,000</u>
Total liabilities and equity	<u><u>\$115,000</u></u>

Learning Objective

Compute the current ratio and describe what it reveals about a company's financial condition.

Current Ratio

Helps assess the company's ability to pay its debts in the near future

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

Limited Brands, Inc.

\$ millions	2015	2014	2013	2012	2011	2010
Current assets	\$3,232	\$3,150	\$2,205	\$2,368	\$2,592	\$3,250
Current liabilities	\$1,679	\$1,826	\$1,538	\$1,526	\$1,504	\$1,322
Current ratio	1.9	1.7	1.4	1.6	1.7	2.5
Industry current ratio	1.8	1.7	1.5	1.6	1.7	1.9



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