

Financial Accounting

Prepared by Dr. Mohamed Hamouda

Lecture 9

جامعة الجميع الذكية

تسعى لتكون الكيان الأول الذي يتبنى مبدأ المجتمع التعليمي
التعاوني ويقدم العلم مقابل العمل لتنمية وبناء المجتمعات.

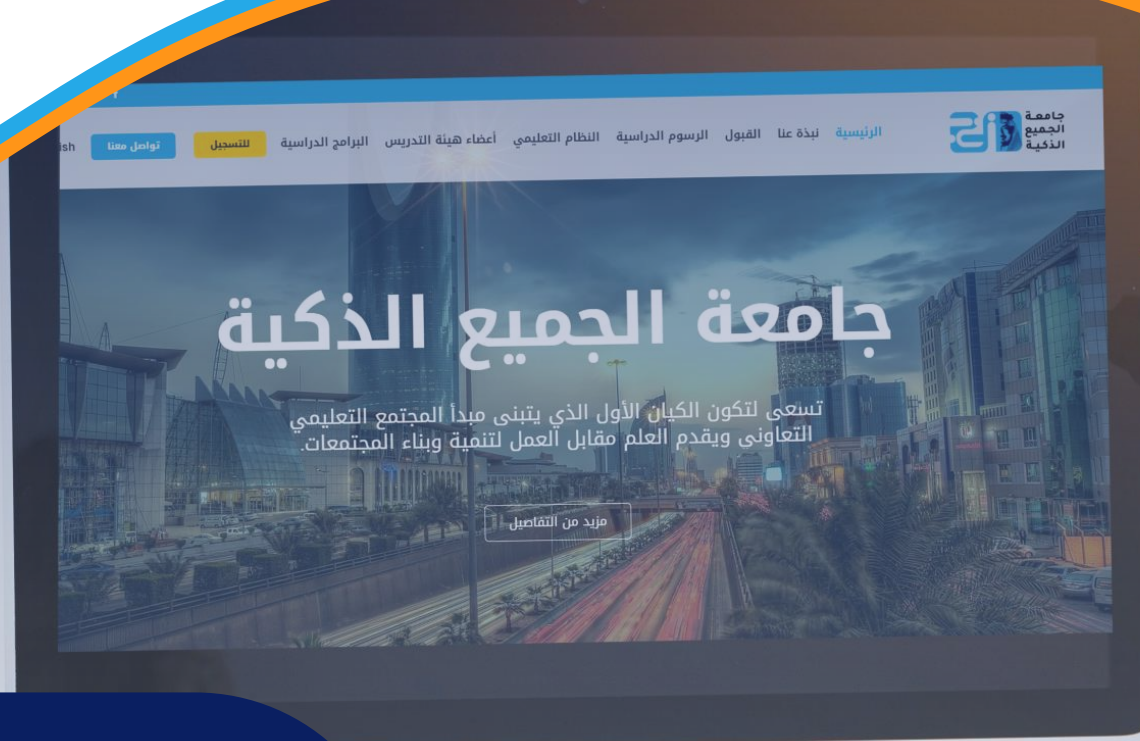
Completing the Accounting Cycle



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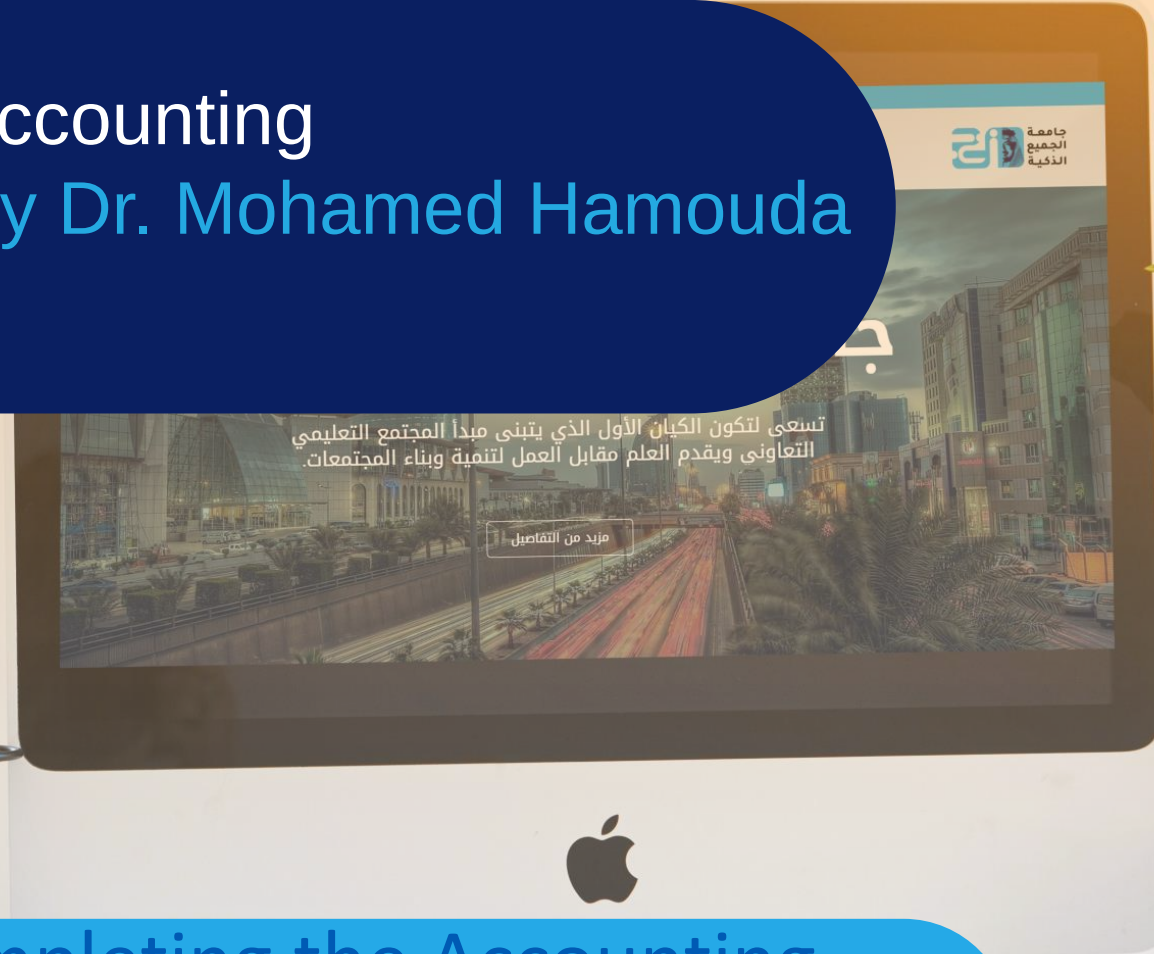
Lecture 9

Completing the Accounting Cycle

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Lecture 9



Completing the Accounting Cycle

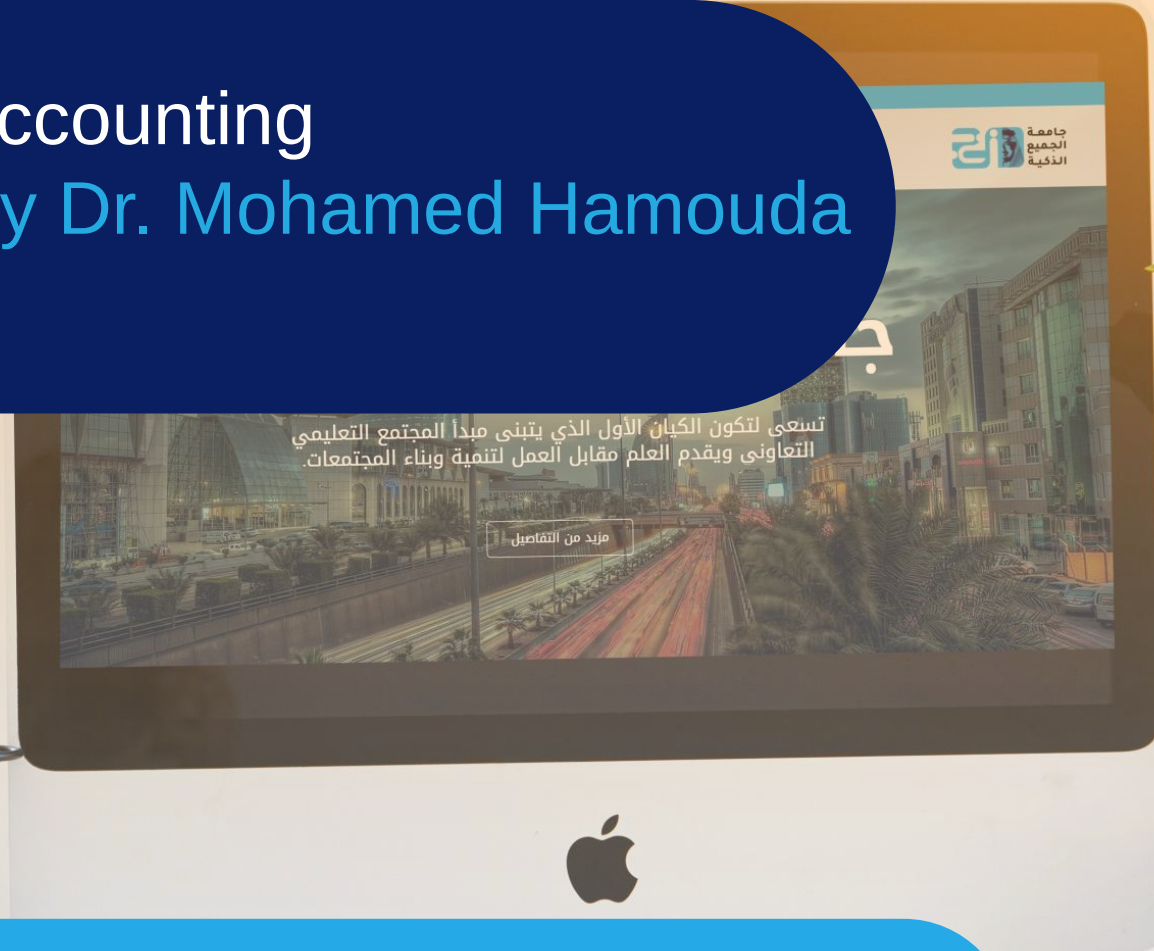


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RECAP

Building Blocks of Analysis

Ability to meet
short-term
obligations and
to efficiently
generate
revenues

**Liquidity
and
Efficiency**

Ability to
generate future
revenues and
meet long-term
obligations

Solvency

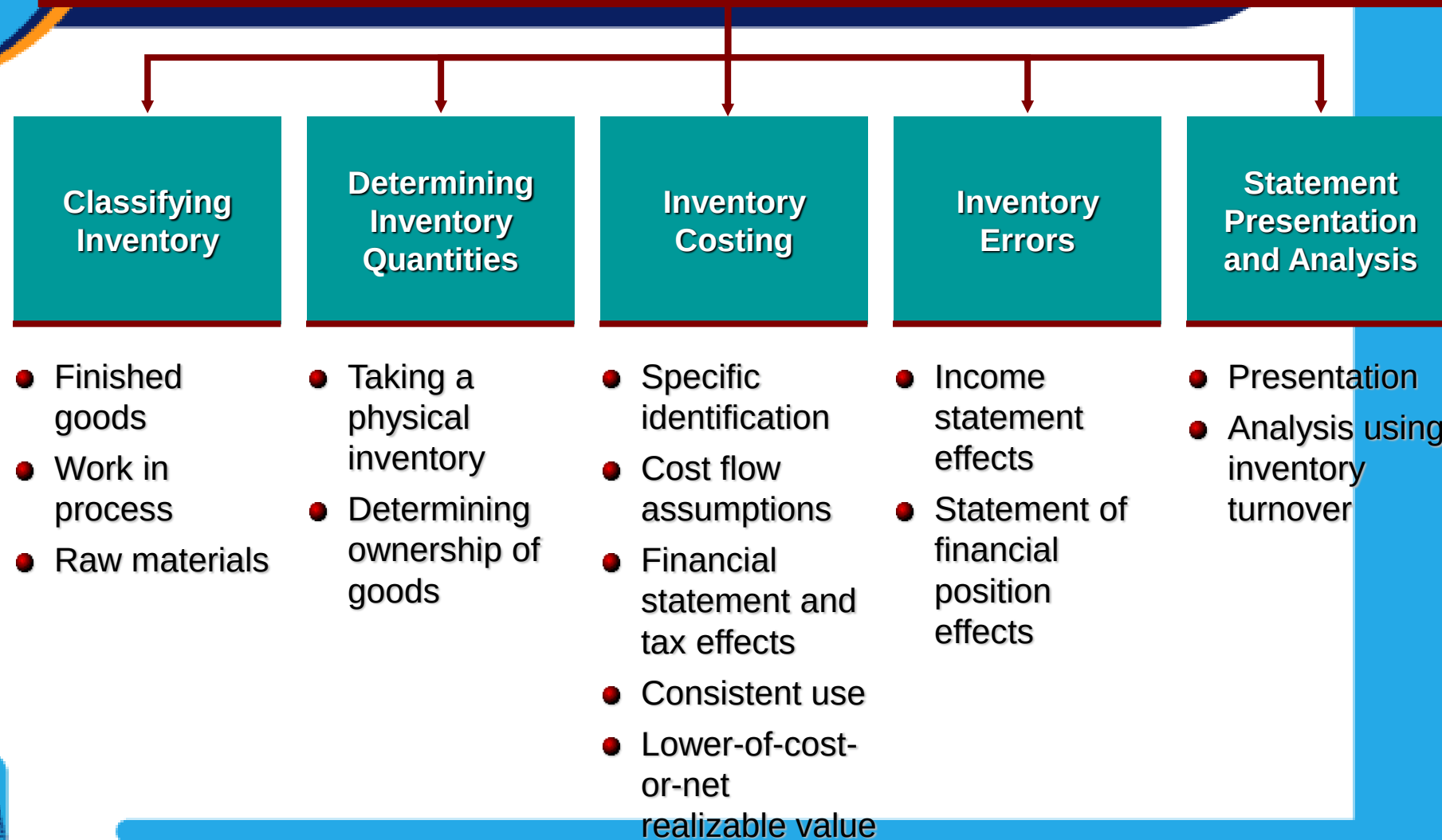
Ability to provide
financial rewards
sufficient to
attract and retain
financing

Profitability

Market

Ability to
generate
positive
market
expectations

Inventories



Allowance Method

At the end of each period, **estimate** total bad debts expected to be realized from that period's sales.



Two advantages to the allowance method:

1. It records estimated bad debts expense in the period when the related sales are recorded.
2. It reports accounts receivable on the balance sheet at the estimated amount of cash to be collected.

Estimating Bad Debts Expense

Two Methods

1. Percent of Sales Method
2. Accounts Receivable Methods
 - Percent of Accounts Receivable
 - Aging of Accounts Receivable



Plant Assets

Tangible in Nature



Actively Used in Operations



Expected to Benefit Future Periods



Called Property, Plant, & Equipment

Statement of Cash Flows

The Statement of Cash Flows: Usefulness and Format

- Usefulness
- Classifications
- Significant noncash activities
- Format
- Corporate life cycle
- Preparation
- Indirect and direct methods

Preparing the Statement of Cash Flows—Indirect Method

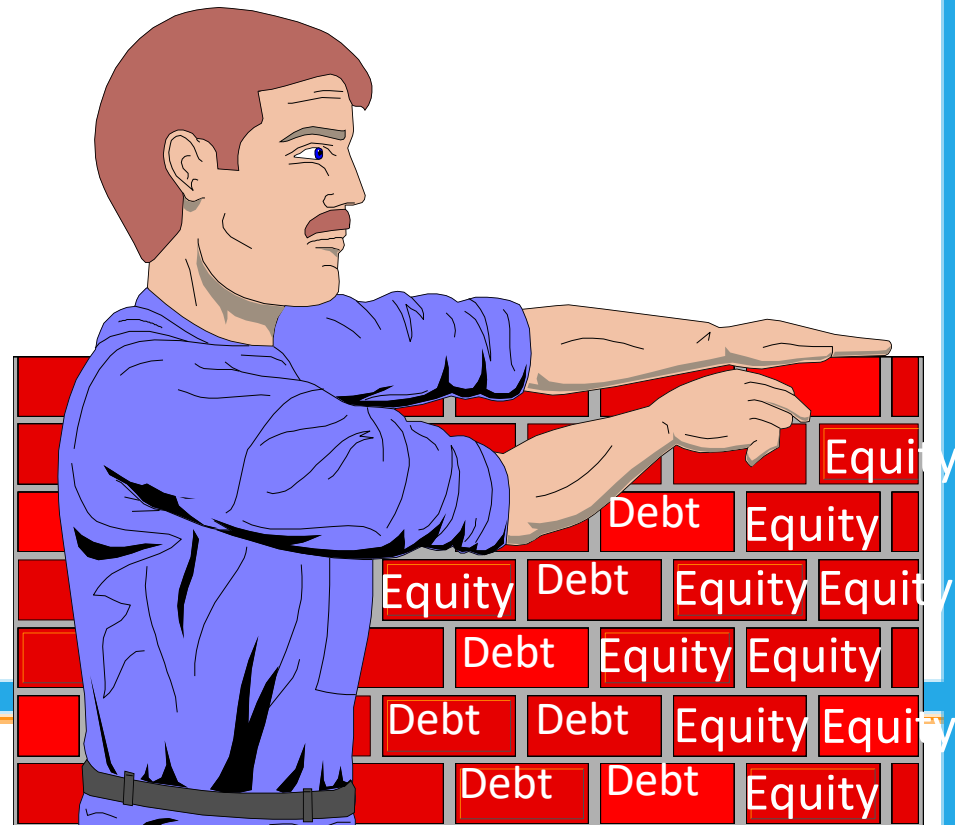
- Step 1: Operating activities
- Step 2: Investing and financing activities
- Step 3: Net change in cash

Using Cash Flows to Evaluate a Company

- Free cash flow
- Assessing liquidity and solvency

Capital Structure and Dividend Policy Decisions

- The combination of debt and equity used to finance a firm



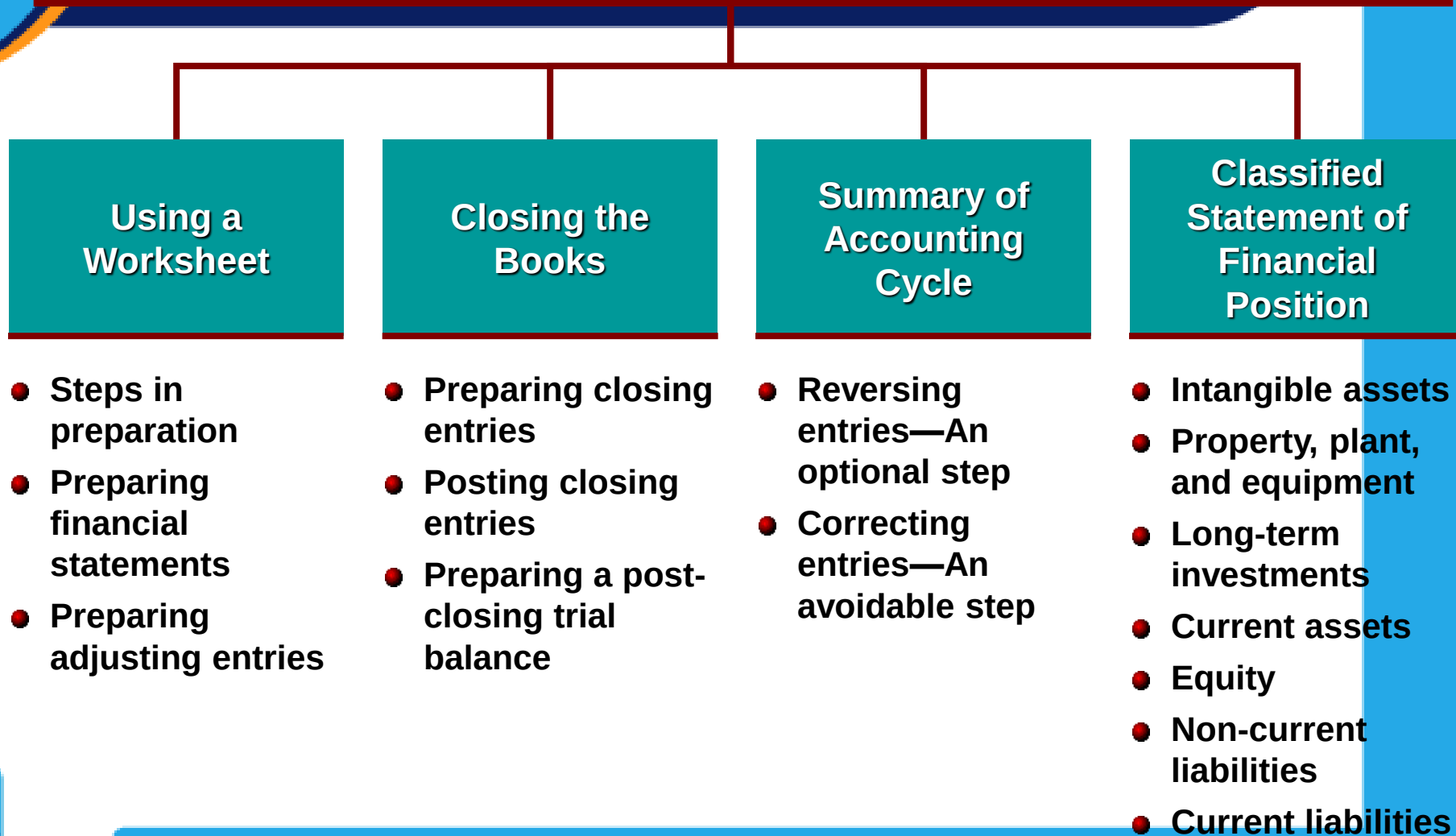
- The optimal mix of debt, preferred stock, and common equity with which the firm plans to finance its investments May change over time
- Trade-off between risk and return to achieve goal of maximizing the price of the stock



- 1. Firm's business risk
- 2. Firm's tax position
- 3. Financial flexibility
- 4. Managerial attitude

Completing the Accounting Cycle

Completing the Accounting Cycle



Using A Worksheet

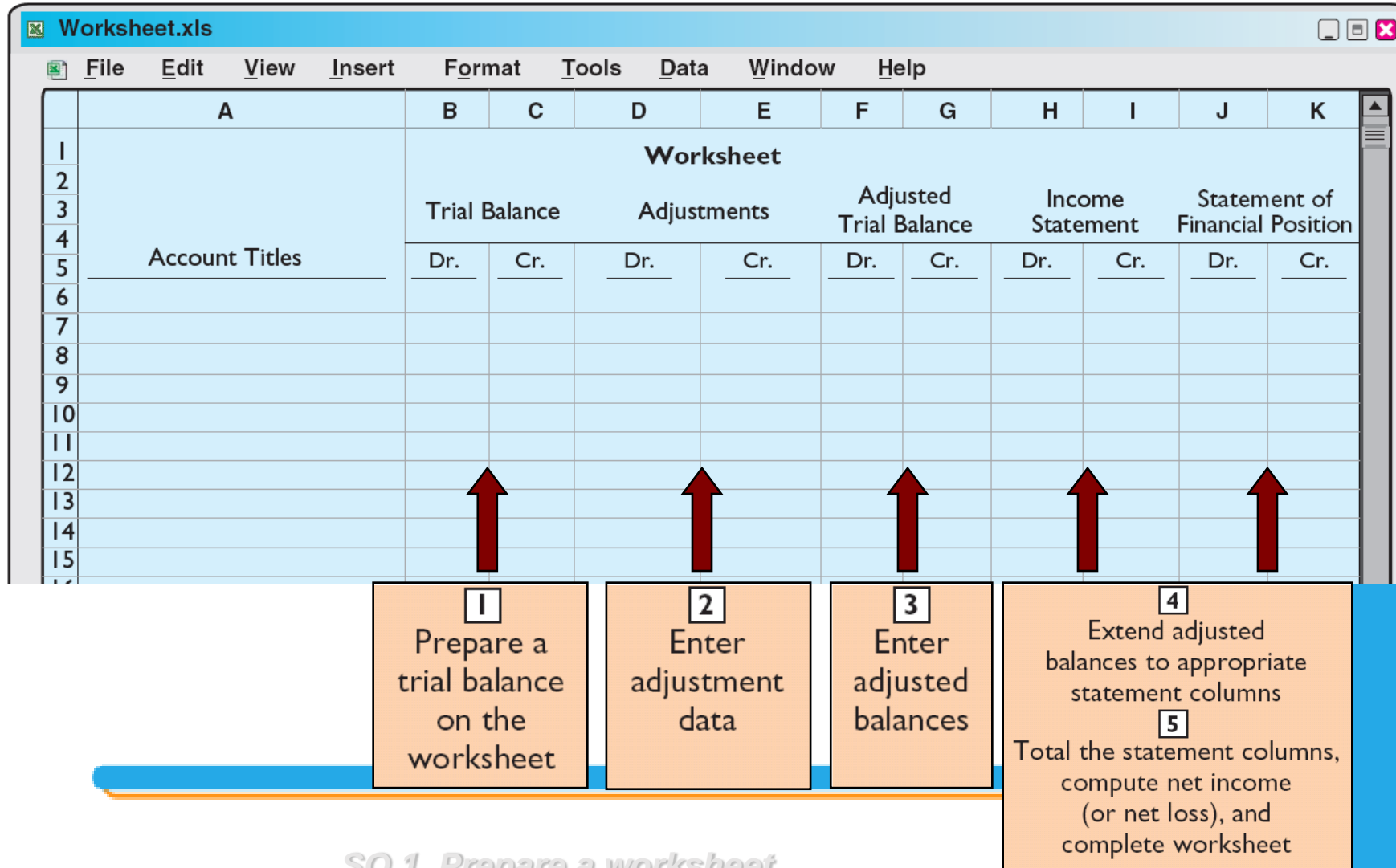
Worksheet

- A multiple-column form used in preparing financial statements.
- Not a permanent accounting record.
- Five step process.
- Use of worksheet is optional.

Chapter 9

Steps in Preparing a Worksheet

Illustration 4-1



Steps in Preparing a Worksheet

Illustration:

Illustration 4-2
Preparing a trial balance

PIONEER ADVERTISING AGENCY INC. Worksheet For the Month Ended October 31, 2011										
Account Titles	Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Statement of Financial Position	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	15,200									
Advertising Supplies	2,500									
Prepaid Insurance	600									
Office Equipment	5,000									
Notes Payable		5,000								
Accounts Payable		2,500								
Unearned Revenue		1,200								
Share Capital		10,000								
Dividends	500									
Service Revenue		10,000								
Salaries Expense	4,000									
Rent Expense	900									
Totals	28,700	28,700								

Steps in Preparing a Worksheet

1. Prepare a Trial Balance on the Worksheet

Account Titles	Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Statement of Financial Position	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	15,200									
Advertising Supplies	2,500									
Prepaid Insurance	600									
Office Equipment	5,000									
Notes Payable		5,000								
Accounts Payable		2,500								
Unearned Revenue		1,200								
Share Capital		10,000								
Dividends	500									
Service Revenue		10,000								
Salaries Expense	4,000									
Rent	900									
Totals	<u>28,700</u>	<u>28,700</u>								

Include all accounts with balances.

Trial balance amounts come directly from ledger accounts.

Steps in Preparing a Worksheet

Illustration 3-22

General journal showing adjusting entries

Adjusting Journal Entries (Chapter 3)

GENERAL JOURNAL					J2
Date	Account Titles and Explanation	Ref.	Debit	Credit	
2011	<u>Adjusting Entries</u>				
Oct. 31	Advertising Supplies Expense	631	1,500		
	Advertising Supplies	126		1,500	
	(To record supplies used)				
31	Insurance Expense	722	50		
	Prepaid Insurance	130		50	
	(To record insurance expired)				
31	Depreciation Expense	711	40		
	Accumulated Depreciation—Office Equipment	158		40	
	(To record monthly depreciation)				
31	Unearned Revenue	209	400		
	Service Revenue	400		400	
	(To record revenue for services provided)				
31	Accounts Receivable	112	200		
	Service Revenue	400		200	
	(To record revenue for services provided)				
31	Interest Expense	905	50		
	Interest Payable	230		50	
	(To record interest on notes payable)				
31	Salaries Expense	726	1,200		
	Salaries Payable	212		1,200	
	(To record accrued salaries)				

Steps in Preparing a Worksheet

2. Enter the Adjustments in the Adjustments Columns

Account Titles	Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Statement of Financial Position	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	15,200									
Advertising Supplies	2,500			(a) 1,500						
Prepaid Insurance	600			(b) 50						
Office Equipment	5,000									
Notes Payable		5,000								
Accounts Payable		2,500								
Unearned Revenue		1,200	(d) 400							
Share Capital		10,000								
Dividends	500									
Service Revenue		10,000		(d) 400						
				(e) 200						
Salaries Expense	4,000		(g) 1,200							
Rent	900									
Totals	28,700	28,700								
Advertising Supplies Expense			(a) 1,500							
Insurance Expense			(b) 50							
Accumulated Depreciation				(c) 40						
Depreciation Expense			(c) 40							
Accounts Receivable			(e) 200							
Interest Expense			(f) 50							
Interest Payable				(f) 50						
Salaries Payable				(g) 1,200						
Totals			3,440	3,440						

Adjustments Key:

- (a) Supplies Used.
- (b) Insurance Expired.
- (c) Depreciation Expensed.
- (d) Service Revenue Earned.
- (e) Service Revenue Accrued.
- (f) Interest Accrued.
- (g) Salaries Accrued.

Enter adjustment amounts, total adjustments columns, and check for equality.

Add additional accounts as needed.

Steps in Preparing a Worksheet

3. Complete the Adjusted Trial Balance Columns

Account Titles	Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Statement of Financial Position	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	15,200				15,200					
Advertising Supplies	2,500			(a) 1,500	1,000					
Prepaid Insurance	600			(b) 50	550					
Office Equipment	5,000				5,000					
Notes Payable		5,000				5,000				
Accounts Payable		2,500				2,500				
Unearned Revenue		1,200	(d) 400			800				
Share Capital		10,000				10,000				
Dividends	500				500					
Service Revenue		10,000		(d) 400 (e) 200		10,600				
Salaries Expense	4,000		(g) 1,200		5,200					
Rent	900				900					
Totals	28,700	28,700								
Advertising Supplies Expense			(a) 1,500		1,500					
Insurance Expense			(b) 50		50					
Accumulated Depreciation				(c) 40		40				
Depreciation Expense			(c) 40		40					
Accounts Receivable			(e) 200		200					
Interest Expense			(f) 50		50					
Interest Payable				(f) 50		50				
Salaries Payable				(g) 1,200		1,200				
Totals			3,440	3,440	30,190	30,190				

Total the adjusted trial balance columns and check for equality.

Steps in Preparing a Worksheet

4. Extend Amounts to Financial Statement Columns

Account Titles	Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Statement of Financial Position	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	15,200				15,200					
Advertising Supplies	2,500			(a) 1,500	1,000					
Prepaid Insurance	600			(b) 50	550					
Office Equipment	5,000				5,000					
Notes Payable		5,000				5,000				
Accounts Payable		2,500				2,500				
Unearned Revenue		1,200	(d) 400			800				
Share Capital		10,000				10,000				
Dividends	500				500					
Service Revenue		10,000		(d) 400 (e) 200		10,600		10,600		
Salaries Expense	4,000		(g) 1,200		5,200		5,200			
Rent	900				900		900			
Totals	28,700	28,700								
Advertising Supplies Expense			(a) 1,500		1,500		1,500			
Insurance Expense			(b) 50		50		50			
Accumulated Depreciation				(c) 40		40				
Depreciation Expense			(c) 40		40		40			
Accounts Receivable			(e) 200		200					
Interest Expense			(f) 50		50		50			
Interest Payable				(f) 50		50				
Salaries Payable				(g) 1,200		1,200				
Totals			3,440	3,440	30,190	30,190	7,740	10,600		

Extend all revenue and expense account balances to the income statement columns.

Steps in Preparing a Worksheet

4. Extend Amounts to Financial Statement Columns

Account Titles	Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Statement of Financial Position	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	15,200				15,200				15,200	
Advertising Supplies	2,500			(a) 1,500	1,000				1,000	
Prepaid Insurance	600			(b) 50	550				550	
Office Equipment	5,000				5,000				5,000	
Notes Payable		5,000				5,000				5,000
Accounts Payable		2,500				2,500				2,500
Unearned Revenue		1,200	(d) 400			800				800
Share Capital		10,000				10,000				10,000
Dividends	500				500				500	
Service Revenue		10,000		(d) 400 (e) 200		10,600		10,600		
Salaries Expense	4,000		(g) 1,200		5,200		5,200			
Rent	900				900		900			
Totals	28,700	28,700								
Advertising Supplies Expense			(a) 1,500		1,500		1,500			
Insurance Expense			(b) 50		50		50			
Accumulated Depreciation				(c) 40		40				40
Depreciation Expense			(c) 40		40		40			
Accounts Receivable			(e) 200		200				200	
Interest Expense			(f) 50		50		50			
Interest Payable				(f) 50		50				50
Salaries Payable				(g) 1,200		1,200				1,200
Totals			3,440	3,440	30,190	30,190	7,740	10,600	22,450	19,590

Extend all asset, liability, and equity account balances to the statement of financial position columns.

SO 1 Prepare a worksheet.

Chapter 9

Steps in Preparing a Worksheet

5. Total Columns, Compute Net Income (Loss)

Account Titles	Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Statement of Financial Position	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	15,200				15,200				15,200	
Advertising Supplies	2,500		(a)	1,500	1,000				1,000	
Prepaid Insurance	600		(b)	50	550				550	
Office Equipment	5,000				5,000				5,000	
Notes Payable		5,000				5,000				5,000
Accounts Payable		2,500				2,500				2,500
Unearned Revenue		1,200	(d)	400		800				800
Share Capital		10,000				10,000				10,000
Dividends	500				500				500	
Service Revenue		10,000	(d)	400		10,600		10,600		
			(e)	200						
Salaries Expense	4,000		(g)	1,200	5,200		5,200			
Rent	900				900		900			
Totals	28,700	28,700								
Advertising Supplies Expense			(a)	1,500	1,500		1,500			
Insurance Expense			(b)	50	50		50			
Accumulated Depreciation			(c)	40		40				40
Depreciation Expense			(c)	40	40		40			
Accounts Receivable			(e)	200	200				200	
Interest Expense			(f)	50	50		50			
Interest Payable			(f)	50		50				50
Salaries Payable			(g)	1,200		1,200				1,200
Totals			3,440	3,440	30,190	30,190	7,740	10,600	22,450	19,590
Net income							2,860			2,860
Totals							10,600	10,600	22,450	22,450

Compute Net Income or Net Loss.

SO 1 Prepare a worksheet.

Steps in Preparing a Worksheet

Review Question

Net income is shown on a worksheet in the:

- a. income statement debit column only.
- b. statement of financial position debit column only.
- c. income statement credit column and statement of financial position debit column.
- ☒ d. income statement debit column and statement of financial position credit column.

Worksheet

- Income statement is prepared from the income statement columns.
- Statement of financial position and retained earnings statement are prepared from the statement of financial position columns.

Companies journalize and post adjusting entries.

Illustration 4-4

PIONEER ADVERTISING AGENCY

Income Statement
For the Month Ended October 31, 2011

Revenues		
Service revenue		\$10,600
Expenses		
Salaries expense	\$5,200	
Advertising supplies expense	1,500	
Rent expense	900	
Insurance expense	50	
Interest expense	50	
Depreciation expense	40	
Total expenses	<u>7,740</u>	
Net income		<u><u>\$ 2,860</u></u>



Illustration 4-4

PIONEER ADVERTISING AGENCY INC.

Retained Earnings Statement For the Month Ended October 31, 2011

Retained earnings, October 1	\$ -0-
Add: Net income	<u>2,860</u>
	2,860
Less: Dividends	<u>500</u>
Retained earnings, October 31	<u><u>\$2,360</u></u>

Illustration 4-4

PIONEER ADVERTISING AGENCY INC.

Statement of Financial Position
October 31, 2011

<u>Assets</u>		
Office equipment	\$5,000	
Less: Accumulated depreciation	<u>40</u>	\$ 4,960
Prepaid insurance		550
Advertising supplies		1,000
Accounts receivable		200
Cash		<u>15,200</u>
Total assets		<u>\$21,910</u>
<u>Equity and Liabilities</u>		
Equity		
Share capital		\$10,000
Retained earnings		<u>2,360</u>
Liabilities		
Notes payable		5,000
Accounts payable		2,500
Interest payable		50
Unearned revenue		800
Salaries payable		<u>1,200</u>
Total liabilities		<u>9,550</u>
Total equity and liabilities		<u>\$21,910</u>

Adjusting Entries

- The adjusting entries are prepared from the adjustments columns of the worksheet.
- Journalizing and posting of adjusting entries follows the preparation of financial statements when a worksheet is used.

Chapter 9

Preparing Adjusting Entries from a Worksheet

Illustration 3-22

General journal showing adjusting entries

Adjusting Journal Entries (Chapter 3)

GENERAL JOURNAL					J2
Date	Account Titles and Explanation	Ref.	Debit	Credit	
2011	<u>Adjusting Entries</u>				
Oct. 31	Advertising Supplies Expense	631	1,500		
	Advertising Supplies	126		1,500	
	(To record supplies used)				
31	Insurance Expense	722	50		
	Prepaid Insurance	130		50	
	(To record insurance expired)				
31	Depreciation Expense	711	40		
	Accumulated Depreciation—Office Equipment	158		40	
	(To record monthly depreciation)				
31	Unearned Revenue	209	400		
	Service Revenue	400		400	
	(To record revenue for services provided)				
31	Accounts Receivable	112	200		
	Service Revenue	400		200	
	(To record revenue for services provided)				
31	Interest Expense	905	50		
	Interest Payable	230		50	
	(To record interest on notes payable)				
31	Salaries Expense	726	1,200		
	Salaries Payable	212		1,200	
	(To record accrued salaries)				

Closing the Books

At the end of the accounting period, the company makes the accounts ready for the next period.

Illustration 4-5

TEMPORARY

These accounts are closed

All revenue accounts

All expense accounts

Dividends

PERMANENT

These accounts are not closed

All asset accounts

All liability accounts

Equity