CHAPTER 3

THE ACCOUNTING INFORMATION SYSTEM

Intermediate Accounting
IFRS Edition

Learning Objectives

1. Understand basic accounting terminology.
2. Explain double-entry rules.
3. Identify steps in the accounting cycle.
4. Record transactions in journals, post to ledger accounts, and prepare a trial balance.
5. Explain the reasons for preparing adjusting entries.
6. Prepare financial statement from the adjusted trial balance.
7. Prepare closing entries.

The Accounting Information System

Accounting Information System

- Basic terminology
- Debits and credits
- Accounting equation
- Financial statements and ownership structure

The Accounting Cycle

- Identifying and recording
- Journalizing
- Posting
- Trial balance
- Adjusting entries
- Adjusted trial balance
- Preparing financial statements
- Closing
- Post-closing trial balance
- Reversing entries
- Summary

Financial Statements For Merchandisers

- Income statement
- Statement of retained earnings
- Statement of financial position
- Closing entries

Accounting Information System

Accounting Information System (AIS)

- Collects and processes transaction data.
- Disseminates the information to interested parties.

Accounting Information System

Helps management answer such questions as:

- How much and what kind of debt is outstanding?
- Were sales higher this period than last?
- What assets do we have?
- What were our cash inflows and outflows?
- Did we make a profit last period?
- Are any of our product lines or divisions operating at a loss?
- Can we safely increase our dividends to shareholders?
- Is our rate of return on net assets increasing?

Basic Terminology

- Event
- Transaction
- Account
- Real Account
- Nominal Account
- Ledger
- Journal
- Posting
- Trial Balance
- Adjusting Entries
- Financial Statements
- Closing Entries

LO 1 Understand basic accounting terminology.

Debits and Credits

- An **Account** shows the effect of transactions on a given asset, liability, equity, revenue, or expense account.
- **Double-entry** accounting system (two-sided effect).
- Recording done by debiting at least one account and crediting another.
- **DEBITS must equal CREDITS**.

Debits and Credits

Account

- An arrangement that shows the effect of transactions on an account.
- Debit = ¯Left‖
- Credit = ¯Right‖

An Account can be illustrated in a T-Account form.

Account Name

Debit / Dr.	**Credit / Cr.**

LO 2 Explain double-entry rules.

Debits and Credits

If Debit entries are greater than Credit entries, the account will have a debit balance.

Account Name

	Debit / Dr.	**Credit / Cr.**	
Transaction #1	$10,000	$3,000	Transaction #2
Transaction #3	8,000		
Balance	$15,000		

LO 2 Explain double-entry rules.

Debits and Credits

If Credit entries are greater than Debit entries, the account will have a credit balance.

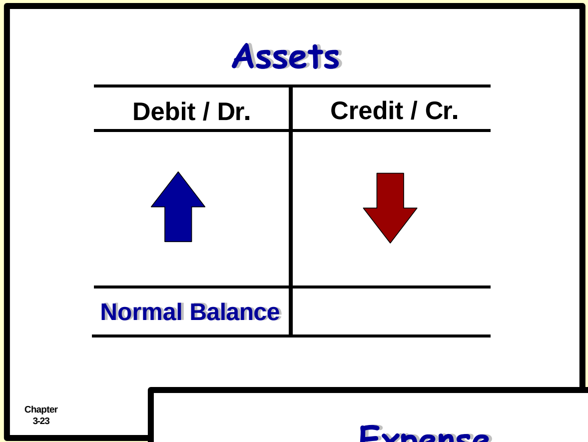
Account Name

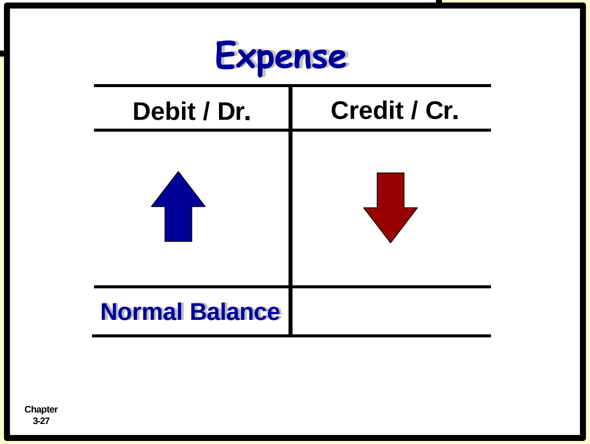
	Debit / Dr.	Credit / Cr.	
Transaction #1	$10,000	$3,000	Transaction #2
		8,000	Transaction #3
Balance		$1,000	

LO 2 Explain double-entry rules.

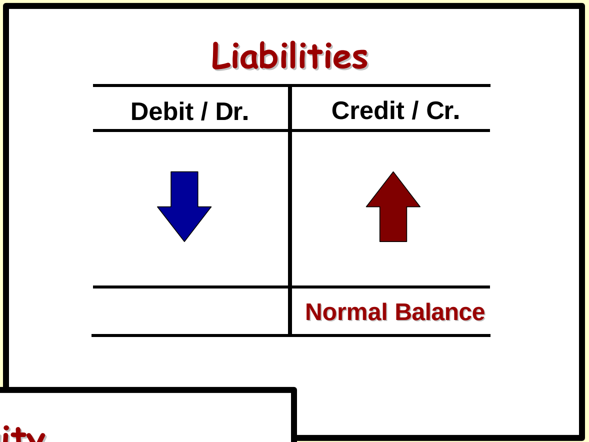
Debits and Credits Summary

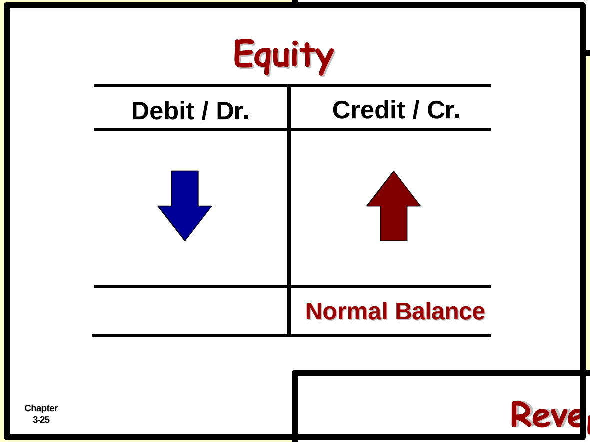
Normal Balance **Debit**

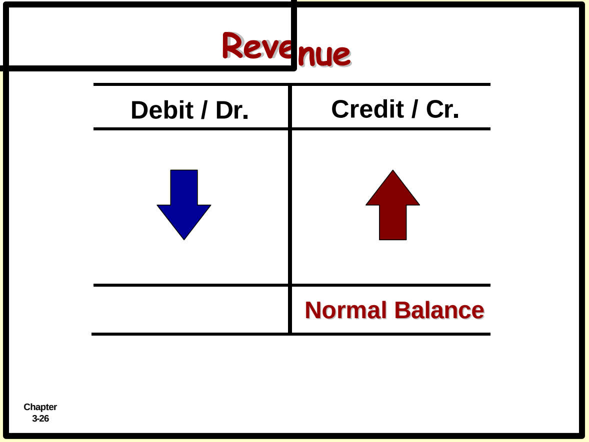




Normal Balance **Credit**







LO 2 Explain double-entry rules.

Debits and Credits Summary

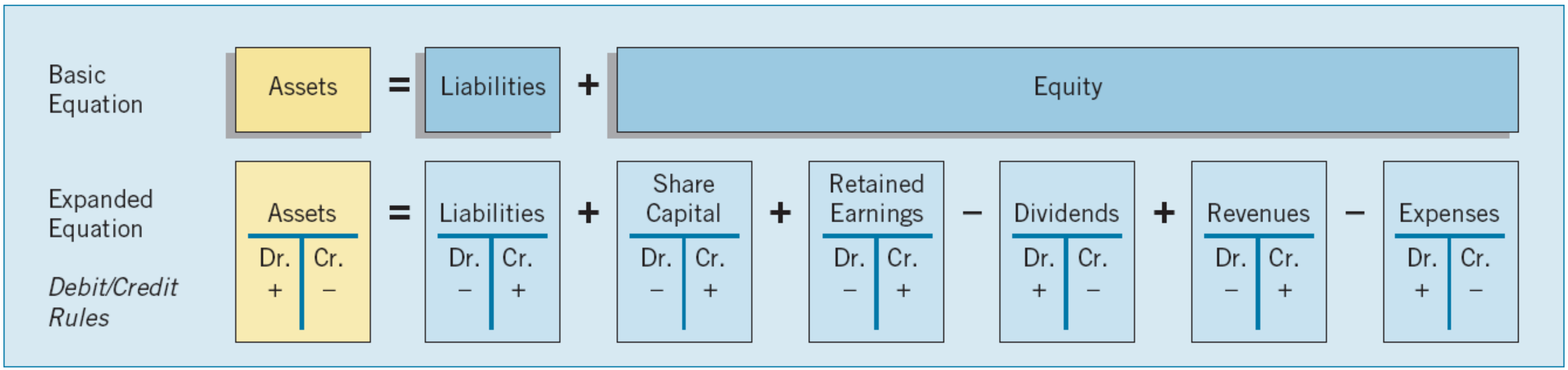
	Statement of Financial Position			Income Statement		
	Asset =	Liability +	Equity	Revenue -	Expense =	
Debit	↑	↓	↓	↓	↑	
Credit	↓	↑	↑	↑	↓	

LO 2 Explain double-entry rules.

The Accounting Equation

Relationship among the assets, liabilities and equity of a business:

Illustration 3-3



The equation must be in balance after every transaction. For every **Debit** there must be a **Credit**.

Double-Entry System Illustration

1. Owners invest $40,000 in exchange for share capital

Assets	=	Liabilities	+	Equity
+ 40,000				**+ 40,000**

LO 2 Explain double-entry rules.

Double-Entry System Illustration

2. Disburse $600 cash for secretarial wages.

Assets	=	Liabilities	+	Equity
- 600				- 600 (expense)

LO 2 Explain double-entry rules.

Double-Entry System Illustration

3. Purchase office equipment priced at $5,200, giving a 10 percent promissory note in exchange.

Assets	=	Liabilities	+	Equity
+ 5,200		+ 5,200		

Double-Entry System Illustration

4. Received $4,000 cash for services rendered.

Assets	=	Liabilities	+	Equity
+ 4,000				**+ 4,000 (revenue)**

LO 2 Explain double-entry rules.

Double-Entry System Illustration

5. Pay off a short-term liability of $7,000.

Assets	=	Liabilities	+	Equity
- 7,000		**- 7,000**		

LO 2 Explain double-entry rules.

Double-Entry System Illustration

6. Declared a cash dividend of $5,000.

Assets	=	Liabilities	+	Equity
		+ 5,000		- 5,000

Double-Entry System Illustration

7. Convert a long-term liability of $80,000 into ordinary shares.

Assets	=	Liabilities	+	Equity
		- 80,000		+ 80,000

LO 2 Explain double-entry rules.

Double-Entry System Illustration

8. Pay cash of $16,000 for a delivery van.

Assets	=	Liabilities	+	Equity
- 16,000				
+ 16,000				

Note that the accounting equation equality is maintained after recording each transaction.

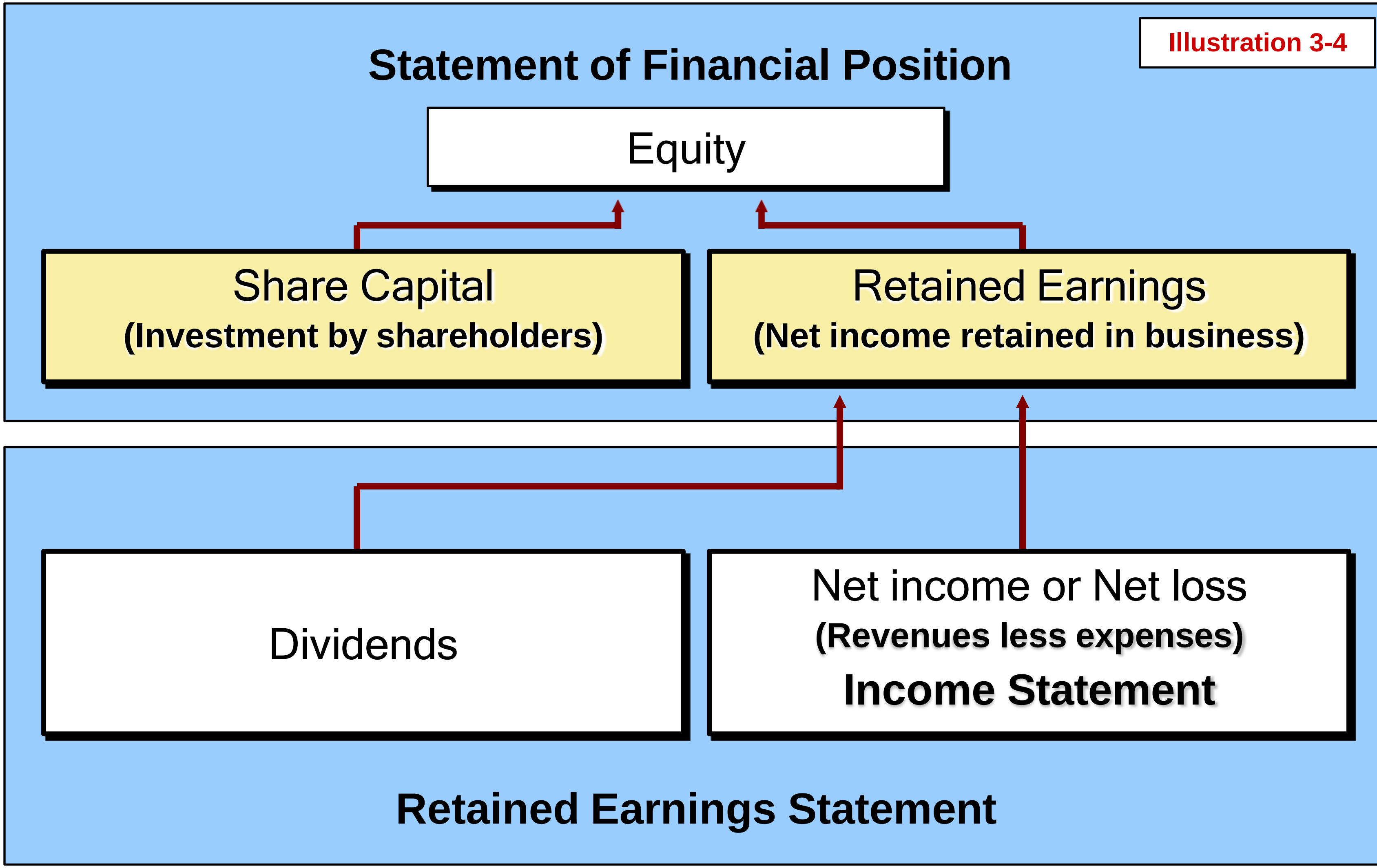
LO 2 Explain double-entry rules.

Financial Statements and Ownership Structure

Ownership structure dictates the types of accounts that are part of the equity section.

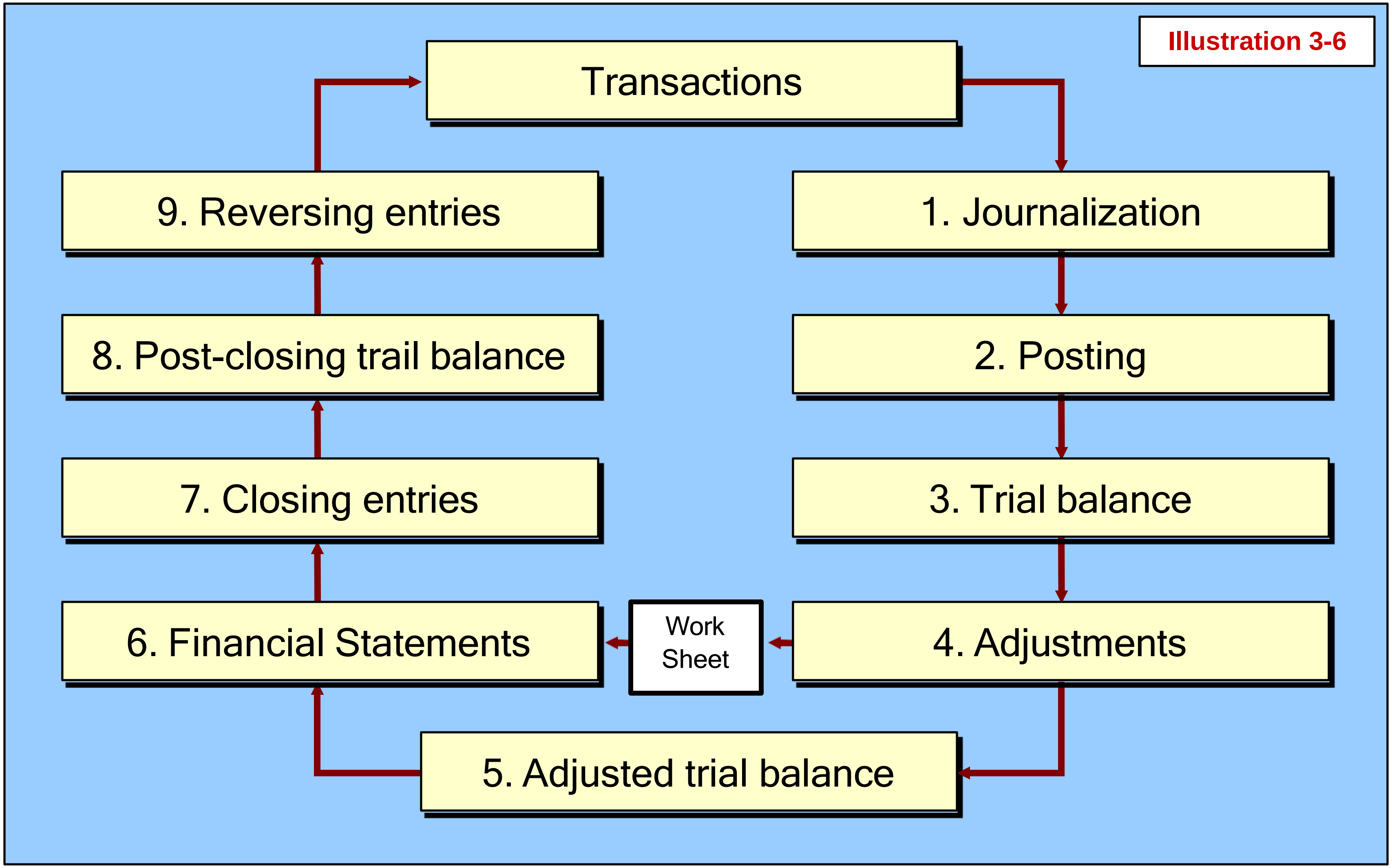
Proprietorship or Partnership	Corporation
• Capital account • Drawing account	• Share capital • Share premium • Dividends • Retained Earnings

Financial Statements and Ownership Structure



LO 2 Explain double-entry rules.

The Accounting Cycle



LO 3 Identify steps in the accounting cycle.

Identify and Recording Transactions

What to Record?

An item should be recognized in the financial statements if it is an element, is measurable, and is relevant and a faithful representation.

Underlying Concepts

Assets are probable economic benefits controlled by a particular entity as a result of a past transaction or event. Do human resources of a company meet this definition?

1. Journalizing

General Journal - a chronological record of transactions.

Journal Entries are recorded in the journal.

September 1: Shareholders invested $15,000 cash in the corporation in exchange for ordinary shares.

Illustration 3-7

GENERAL JOURNAL				J1
Date	**Account Titles and Explanation**	**Ref.**	**Debit**	**Credit**
2011				
Sept. 1	Cash		15,000	
	Share Capital—Ordinary			15,000
	(Issued ordinary shares for cash)			

LO 4 Record transactions in journals, post to ledger accounts, and prepare a trial balance.

2. Posting

Posting - the process of transferring amounts from the journal to the ledger accounts.

Illustration 3-7

GENERAL JOURNAL				J1
Date	Account Titles and Explanation	Ref.	Debit	Credit
2011				
Sept. 1	Cash		15,000	
	Share Capital—Ordinary			15,000
	(Issued ordinary shares for cash)			

GENERAL LEDGER

Illustration 3-8

Cash					No. 101
Date	Explanation	Ref.	Debit	Credit	Balance

LO 4 Record transactions in journals, post to ledger accounts, and prepare a trial balance.

2. Posting

Posting - Transferring amounts from journal to ledger.

Illustration 3-8

GENERAL JOURNAL J1

Date	Account Titles and Explanation	Ref.	Debit	Credit
2011 Sept. 1	Cash	101	15,000	
	Share Capital—Ordinary	311		15,000
	(Issued ordinary shares for cash)			

GENERAL LEDGER

Cash No. 101

Date	Explanation	Ref.	Debit	Credit	Balance
2011 Sept. 1		J1	15,000		15,000

Share Capital—Ordinary No. 311

Date	Explanation	Ref.	Debit	Credit	Balance
2011 Sept. 1		J1		15,000	15,000

2. Posting

Expanded Example

The purpose of transaction analysis is

(1) to identify the type of account involved, and

(2) to determine whether a debit or a credit is required.

Keep in mind that every journal entry affects one or more of the following items: assets, liabilities, equity, revenues, or expense.

LO 4 Record transactions in journals, post to ledger accounts, and prepare a trial balance.

2. Posting

1. October 1: Shareholders invest $100,000 cash in an advertising venture to be known as Pioneer Advertising Agency Inc.

Illustration 3-9

Oct. 1	Cash	100,000	
	Share capital - ordinary		100,000

Cash

Debit	Credit
100,000	

Share Capital - Ordinary

Debit	Credit
	100,000

LO 4 Record transactions in journals, post to ledger accounts, and prepare a trial balance.

2. Posting

2. October 1: Pioneer Advertising purchases office equipment costing $50,000 by signing a 3-month, 12%, $50,000 note payable.

Illustration 3-10

Oct. 1	Office equipment	50,000	
	Notes payable		50,000

Office Equipment	
Debit	Credit
50,000	

Notes Payable	
Debit	Credit
	50,000

LO 4 Record transactions in journals, post to ledger accounts, and prepare a trial balance.

2. Posting

3. October 2: Pioneer Advertising receives a $12,000 cash advance from KC, a client, for advertising services that are expected to be completed by December 31.

Illustration 3-11

Oct. 2	Cash	12,000	
	Unearned service revenue		12,000

Cash

Debit	Credit
100,000	
12,000	

Unearned Service Revenue

Debit	Credit
	12,000

LO 4 Record transactions in journals, post to ledger accounts, and prepare a trial balance.

2. Posting

4. October 3: Pioneer Advertising pays $9,000 office rent, in cash, for October.

Illustration 3-12

Oct. 3	Rent expense	9,000	
	Cash		9,000

Cash

Debit	Credit
100,000	9,000
12,000	

Rent Expense

Debit	Credit
9,000	

LO 4 Record transactions in journals, post to ledger accounts, and prepare a trial balance.

2. Posting

5. October 4: Pioneer Advertising pays $6,000 for a one-year insurance policy that will expire next year on September 30.

Illustration 3-13

Oct. 4	Prepaid insurance	6,000	
	Cash		6,000

Cash

Debit	Credit
100,000	9,000
12,000	6,000

Prepaid Insurance

Debit	Credit
6,000	

LO 4 Record transactions in journals, post to ledger accounts, and prepare a trial balance.

2. Posting

6. October 5: Pioneer Advertising purchases, for $25,000 on account, an estimated 3-month supply of advertising materials from Aero Supply.

Illustration 3-14

Oct. 5	Advertising supplies	25,000	
	Accounts payable		25,000

Advertising Supplies

Debit	Credit
25,000	

Accounts Payable

Debit	Credit
	25,000

LO 4 Record transactions in journals, post to ledger accounts, and prepare a trial balance.

2. Posting

7. October 9: Pioneer Advertising signs a contract with a local newspaper for advertising inserts (flyers) to be distributed starting the last Sunday in November. Pioneer will start work on the content of the flyers in November. Payment of $7,000 is due following delivery of the Sunday papers containing the flyers.

Illustration 3-15

A business transaction has not occurred. There is only an agreement between Pioneer Advertising and the newspaper for the services to be provided in November. Therefore, no journal entry is necessary in October.

2. Posting

8. October 20: Pioneer Advertising's board of directors declares and pays a $5,000 cash dividend to shareholders.

Illustration 3-16

Oct. 20	Dividends	5,000	
	Cash		5,000

Cash

Debit	Credit
100,000	9,000
12,000	6,000
	5,000

Dividends

Debit	Credit
5,000	

LO 4 Record transactions in journals, post to ledger accounts, and prepare a trial balance.

2. Posting

9. October 26: Employees are paid every four weeks. The total payroll is $2,000 per day. The pay period ended on Friday, October 26, with salaries of $40,000 being paid.

Illustration 3-17

Oct. 26	Salaries expense	40,000	
	Cash		40,000

Cash

Debit	Credit
100,000	9,000
12,000	6,000
	5,000
	40,000

Salaries Expense

Debit	Credit
40,000	

LO 4 Record transactions in journals, post to ledger accounts, and prepare a trial balance.

2. Posting

10. October 31: Pioneer Advertising receives $28,000 in cash and bills Copa Company $72,000 for advertising services of $100,000 provided in October.

Illustration 3-18

Oct. 31	Cash	28,000	
	Accounts receivable	72,000	
	Service revenue		100,000

Cash		Accounts Receivable		Service Revenue	
Debit	Credit	Debit	Credit	Debit	Credit
100,000	9,000	72,000			100,000
12,000	6,000				
28,000	5,000				
	40,000				
80,000					

3. Trial Balance

Illustration 3-19

Trial Balance – A list of each account and its balance; used to prove equality of debit and credit balances.

PIONEER ADVERTISING AGENCY INC.
TRIAL BALANCE
OCTOBER 31, 2011

	Debit	Credit
Cash	$ 80,000	
Accounts Receivable	72,000	
Advertising Supplies	25,000	
Prepaid Insurance	6,000	
Office Equipment	50,000	
Notes Payable		$ 50,000
Accounts Payable		25,000
Unearned Service Revenue		12,000
Share Capital—Ordinary		100,000
Dividends	5,000	
Service Revenue		100,000
Salaries Expense	40,000	
Rent Expense	9,000	
	$287,000	$287,000

LO 4 Record transactions in journals, post to ledger accounts, and prepare a trial balance.

4. Adjusting Entries

Makes it possible to:

- Report on the statement of financial position the appropriate assets, liabilities, and equity at the statement date.
- Report on the income statement the proper revenues and expenses for the period.
  - **Revenues** are recorded in the period in which they are earned.
  - **Expenses** are recognized in the period in which they are incurred.

Types of Adjusting Entries

Illustration 3-20

Deferrals	Accruals
1. **Prepaid Expenses.** Expenses paid in cash and recorded as assets **before** they are used or consumed.	3. **Accrued Revenues.** Revenues earned but **not yet received** in cash or recorded.
2. **Unearned Revenues.** Revenues received in cash and recorded as liabilities **before** they are earned.	4. **Accrued Expenses.** Expenses incurred but **not yet paid** in cash or recorded.

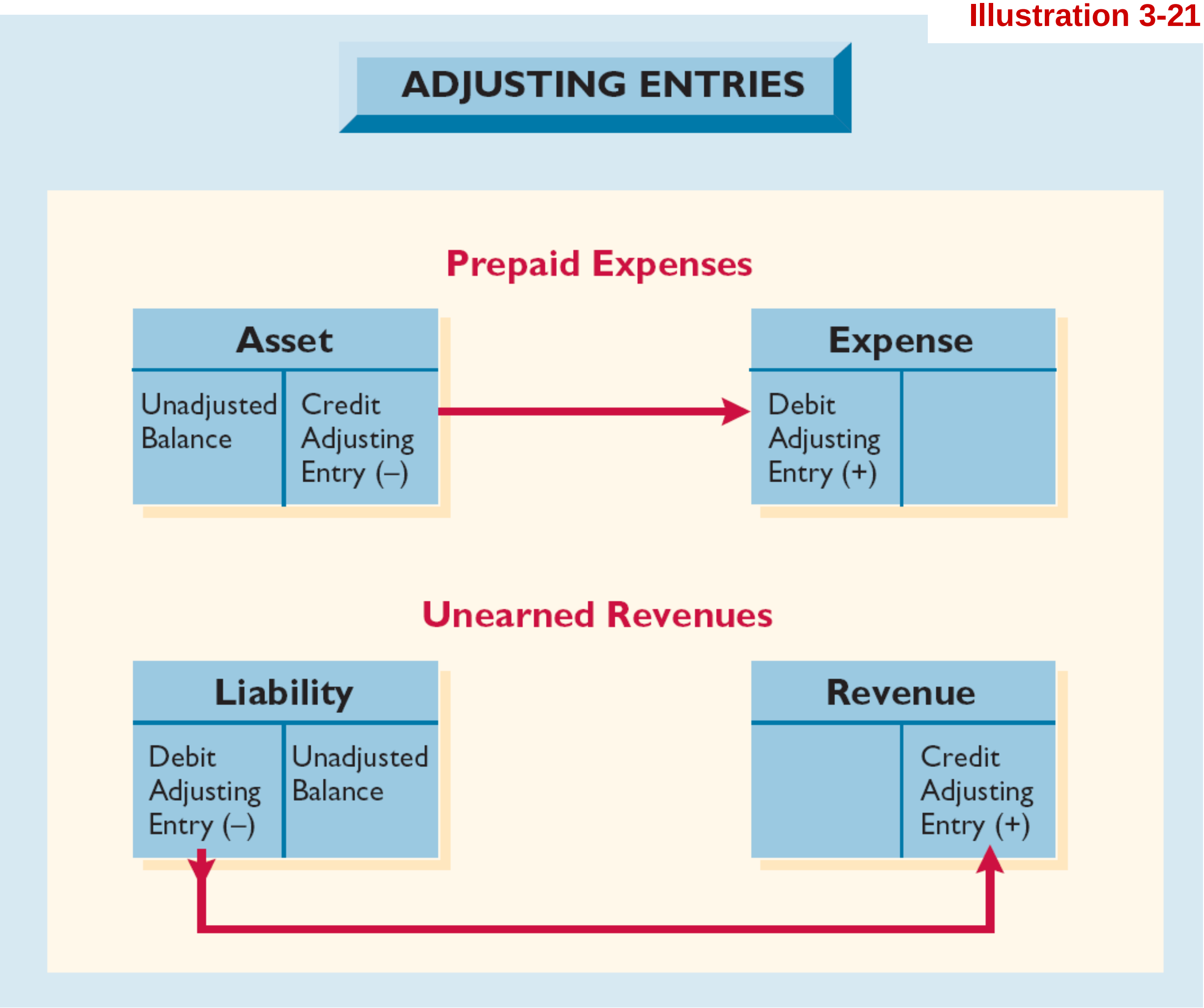
LO 5 Explain the reasons for preparing adjusting entries.

Adjusting Entries for Deferrals

Deferrals are either

- **prepaid expenses** or
- **unearned revenues.**

Illustration 3-21



LO 5 Explain the reasons for preparing adjusting entries.

Adjusting Entries for "Prepaid Expenses"

Payment of cash that is recorded as an asset because service or benefit will be received in the future.

Cash Payment **BEFORE** **Expense Recorded**

Prepayments often occur in regard to:

- insurance
- supplies
- advertising
- rent
- purchasing buildings and equipment

LO 5 Explain the reasons for preparing adjusting entries.

Adjusting Entries for "Prepaid Expenses"

Supplies. Pioneer purchased advertising supplies costing $25,000 on October 5. Prepare the journal entry to record the purchase of the supplies.

Oct. 5	Advertising supplies	25,000	
	Cash		25,000

Advertising Supplies

Debit	Credit
25,000	

Cash

Debit	Credit
	25,000

Adjusting Entries for "Prepaid Expenses"

Supplies. An inventory count at the close of business on October 31 reveals that $10,000 of the advertising supplies are still on hand.

Oct. 31	Advertising supplies expense	15,000	
	Advertising supplies		15,000

Advertising Supplies

Debit	Credit
25,000	15,000
10,000	

Advertising Supplies Expense

Debit	Credit
15,000	

LO 5 Explain the reasons for preparing adjusting entries.

Adjusting Entries for "Prepaid Expenses"

Illustration 3-35

Statement Presentation:

Advertising supplies identifies that portion of the asset's cost that will provide future economic benefit.

PIONEER ADVERTISING AGENCY INC.
Statement of Financial Position
October 31, 2011

Assets

Office equipment	$50,000	
Less: Accumulated depreciation	400	$49,600
Advertising supplies		10,000
Prepaid insurance		5,500
Accounts receivable	74,000	
Less: Allowance	1,600	72,400
Cash		80,000
Total assets		$217,500

LO 5 Explain the reasons for preparing adjusting entries.

Adjusting Entries for "Prepaid Expenses"

Illustration 3-34

Statement Presentation:

Advertising expense identifies that portion of the asset's cost that expired in October.

PIONEER ADVERTISING AGENCY INC.
Income Statement
For the Month Ended October 31, 2011

Revenues		
Service Revenue		$106,000
Expenses		
Salaries expense	$46,000	
Advertising supplies expense	15,000	
Rent expense	9,000	
Insurance expense	500	
Interest expense	500	
Depreciation expense	400	
Bad debt expense	1,600	
Total expenses		73,000
Net income		$ 33,000

LO 5 Explain the reasons for preparing adjusting entries.

Adjusting Entries for "Prepaid Expenses"

Insurance. On Oct. 4th, Pioneer paid $6,000 for a one-year fire insurance policy, beginning October 1. Show the entry to record the purchase of the insurance.

Oct. 4	Prepaid insurance	6,000	
	Cash		6,000

Prepaid Insurance

Debit	Credit
6,000	

Cash

Debit	Credit
	6,000

LO 5 Explain the reasons for preparing adjusting entries.

Adjusting Entries for "Prepaid Expenses"

Insurance. An analysis of the policy reveals that $500 ($6,000 / 12) of insurance expires each month. Thus, Pioneer makes the following adjusting entry.

Oct. 31	Insurance expense	500	
	Prepaid insurance		500

Prepaid Insurance

Debit	Credit
6,000	500
5,500	

Insurance Expense

Debit	Credit
500	

LO 5 Explain the reasons for preparing adjusting entries.

Adjusting Entries for "Prepaid Expenses"

Illustration 3-35

Statement Presentation:

Prepaid Insurance identifies that portion of the asset's cost that will provide future economic benefit.

PIONEER ADVERTISING AGENCY INC.
Statement of Financial Position
October 31, 2011

Assets

Office equipment	$50,000	
Less: Accumulated depreciation	400	$49,600
Advertising supplies		10,000
Prepaid insurance		5,500
Accounts receivable	74,000	
Less: Allowance	1,600	72,400
Cash		80,000
Total assets		$217,500

LO 5 Explain the reasons for preparing adjusting entries.

Adjusting Entries for "Prepaid Expenses"

Illustration 3-34

Statement Presentation:

Insurance expense identifies that portion of the asset's cost that expired in October.

PIONEER ADVERTISING AGENCY INC.
Income Statement
For the Month Ended October 31, 2011

Revenues		
Service Revenue		$106,000
Expenses		
Salaries expense	$46,000	
Advertising supplies expense	15,000	
Rent expense	9,000	
Insurance expense	500	
Interest expense	500	
Depreciation expense	400	
Bad debt expense	1,600	
Total expenses		73,000
Net income		$ 33,000

LO 5 Explain the reasons for preparing adjusting entries.

Adjusting Entries for "Prepaid Expenses"

Depreciation. Pioneer Advertising estimates depreciation on its office equipment to be $400 per month. Accordingly, Pioneer recognizes depreciation for October by the following adjusting entry.

Oct. 31	Depreciation expense	400	
	Accumulated depreciation		400

Depreciation Expense	
Debit	Credit
400	

Accumulated Depreciation	
Debit	Credit
	400

Adjusting Entries for "Prepaid Expenses"

Illustration 3-35

Statement Presentation:

Accumulated Depreciation–is a contra asset account.

PIONEER ADVERTISING AGENCY INC.
Statement of Financial Position
October 31, 2011

Assets

Office equipment	$50,000	
Less: Accumulated depreciation	400	$49,600
Advertising supplies		10,000
Prepaid insurance		5,500
Accounts receivable	74,000	
Less: Allowance	1,600	72,400
Cash		80,000
Total assets		$217,500

Adjusting Entries for "Prepaid Expenses"

Illustration 3-34

Statement Presentation:

Depreciation expense identifies that portion of the asset's cost that expired in October.

PIONEER ADVERTISING AGENCY INC.
Income Statement
For the Month Ended October 31, 2011

Revenues		
Service Revenue		$106,000
Expenses		
Salaries expense	$46,000	
Advertising supplies expense	15,000	
Rent expense	9,000	
Insurance expense	500	
Interest expense	500	
Depreciation expense	400	
Bad debt expense	1,600	
Total expenses		73,000
Net income		$ 33,000

LO 5 Explain the reasons for preparing adjusting entries.

Adjusting Entries for "Unearned Revenues"

Receipt of cash that is recorded as a liability because the revenue has not been earned.

Cash Receipt **BEFORE** **Revenue Recorded**

Unearned revenues often occur in regard to:

- rent
- airline tickets
- school tuition
- magazine subscriptions
- customer deposits

LO 5 Explain the reasons for preparing adjusting entries.

Adjusting Entries for "Unearned Revenues"

Unearned Revenue. Pioneer Advertising received $12,000 on October 2 from KC for advertising services expected to be completed by December 31. Show the journal entry to record the receipt on Oct. 2nd.

Oct. 2	Cash	12,000	
	Unearned service revenue		12,000

Cash

Debit	Credit
12,000	

Unearned Service Revenue

Debit	Credit
	12,000

Adjusting Entries for "Unearned Revenues"

Unearned Revenues. Analysis reveals that Pioneer earned $4,000 of the advertising services in October. Thus, Pioneer makes the following adjusting entry.

Oct. 31	Unearned service revenue	4,000	
	Service revenue		4,000

Service Revenue

Debit	Credit
	100,000
	4,000

Unearned Service Revenue

Debit	Credit
4,000	12,000
	8,000

Adjusting Entries for "Unearned Revenues"

Illustration 3-35

Statement Presentation:

Unearned service revenue identifies that portion of the liability that has not been earned.

Equity and Liabilities

Equity		
Share capital—ordinary	$100,000	
Retained earnings	28,000	
Total equity		$128,000
Liabilities		
Notes payable	50,000	
Accounts payable	25,000	
Unearned service revenue	8,000	
Salaries payable	6,000	
Interest payable	500	
Total liabilities		89,500
Total equity and liabilities		$217,500

LO 5 Explain the reasons for preparing adjusting entries.

Adjusting Entries for "Unearned Revenues"

Illustration 3-34

Statement Presentation:

Service revenue represents that portion of the liability that was earned in October.

PIONEER ADVERTISING AGENCY INC.
Income Statement
For the Month Ended October 31, 2011

Revenues		
Service Revenue		$106,000
Expenses		
Salaries expense	$46,000	
Advertising supplies expense	15,000	
Rent expense	9,000	
Insurance expense	500	
Interest expense	500	
Depreciation expense	400	
Bad debt expense	1,600	
Total expenses		73,000
Net income		$ 33,000

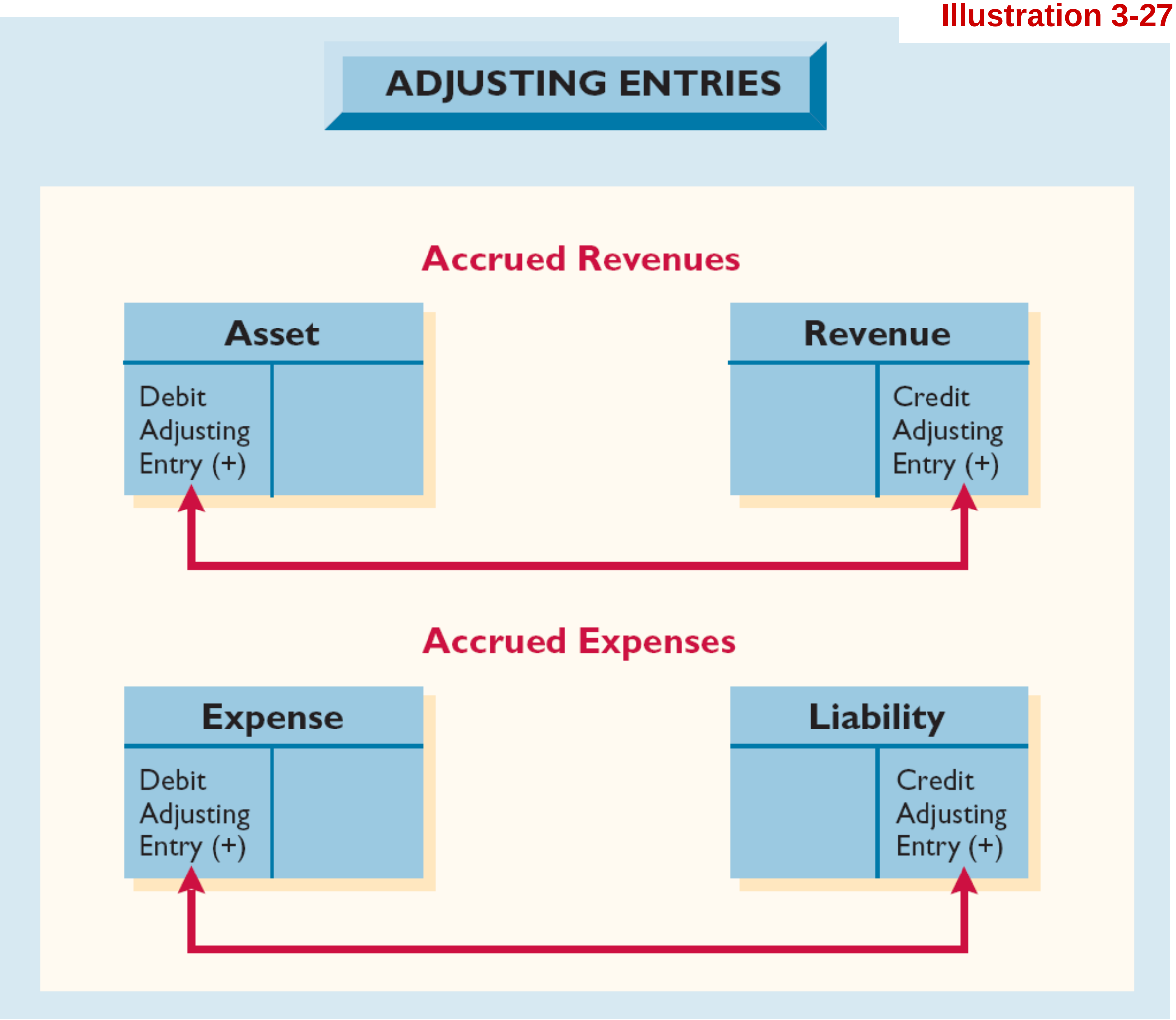
LO 5 Explain the reasons for preparing adjusting entries.

Adjusting Entries for Accruals

Accruals are either

- **accrued revenues** or
- **accrued expenses.**

Illustration 3-27



LO 5 Explain the reasons for preparing adjusting entries.

Adjusting Entries for "Accrued Revenues"

Revenues earned but not yet received in cash or recorded.

Adjusting entry results in:

Revenue Recorded **BEFORE** **Cash Receipt**

Accrued revenues often occur in regard to:

- rent
- interest
- services performed

Adjusting Entries for "Accrued Revenues"

Accrued Revenues. In October Pioneer earned $2,000 for advertising services that it did not bill to clients before October 31. Thus, Pioneer makes the following adjusting entry.

Oct. 31	Accounts receivable	2,000	
	Service revenue		2,000

Accounts Receivable		Service Revenue	
Debit	Credit	Debit	Credit
72,000			100,000
2,000			4,000
			2,000
74,000			106,000

Adjusting Entries for "Accrued Revenues"

PIONEER ADVERTISING AGENCY INC.
Statement of Financial Position
October 31, 2011

Assets		
Office equipment	$50,000	
Less: Accumulated depreciation	400	$49,600
Advertising supplies		10,000
Prepaid insurance		5,500
Accounts receivable	74,000	
Less: Allowance	1,600	72,400
Cash		80,000
Total assets		$217,500
Equity and Liabilities		
Equity		
Share capital—ordinary	$100,000	
Retained earnings	28,000	
Total equity		$128,000
Liabilities		
Notes payable	50,000	
Accounts payable	25,000	
Unearned service revenue	8,000	
Salaries payable	6,000	
Interest payable	500	
Total liabilities		89,500
Total equity and liabilities		$217,500

Illustration 3-35

PIONEER ADVERTISING AGENCY INC.
Income Statement
For the Month Ended October 31, 2011

Revenues		
Service Revenue		$106,000
Expenses		
Salaries expense	$46,000	
Advertising supplies expense	15,000	
Rent expense	9,000	
Insurance expense	500	
Interest expense	500	
Depreciation expense	400	
Bad debt expense	1,600	
Total expenses		73,000
Net income		$ 33,000

Illustration 3-34

Statement Presentation

Adjusting Entries for "Accrued Expenses"

Expenses incurred but not yet paid in cash or recorded.

Adjusting entry results in:

Expense Recorded **BEFORE** **Cash Payment**

Accrued expenses often occur in regard to:

- rent
- interest
- salaries
- taxes

Adjusting Entries for "Accrued Expenses"

Accrued Interest. Pioneer signed a three-month, 12%, note payable in the amount of $50,000 on October 1. The note requires interest at an annual rate of 12 percent. Three factors determine the amount of the interest accumulation:

Illustration 3-29

1		2		3		
Face Value of Note	x	Annual Interest Rate	x	Time in Terms of One Year	=	Interest
$50,000	x	12%	x	1/12	=	**$500**

Adjusting Entries for "Accrued Expenses"

Accrued Interest. Pioneer signed a three-month, 12%, note payable in the amount of $50,000 on October 1. Prepare the adjusting entry on Oct. 31 to record the accrual of interest.

Oct. 31	Interest expense	500	
	Interest payable		500

Interest Expense

Debit	Credit
500	

Interest Payable

Debit	Credit
	500

LO 5 Explain the reasons for preparing adjusting entries.

Adjusting Entries for "Accrued Expenses"

PIONEER ADVERTISING AGENCY INC.
Statement of Financial Position
October 31, 2011

Assets		
Office equipment	$50,000	
Less: Accumulated depreciation	400	$49,600
Advertising supplies		10,000
Prepaid insurance		5,500
Accounts receivable	74,000	
Less: Allowance	1,600	72,400
Cash		80,000
Total assets		$217,500
Equity and Liabilities		
Equity		
Share capital—ordinary	$100,000	
Retained earnings	28,000	
Total equity		$128,000
Liabilities		
Notes payable	50,000	
Accounts payable	25,000	
Unearned service revenue	8,000	
Salaries payable	6,000	
Interest payable	500	
Total liabilities		89,500
Total equity and liabilities		$217,500

Illustration 3-35

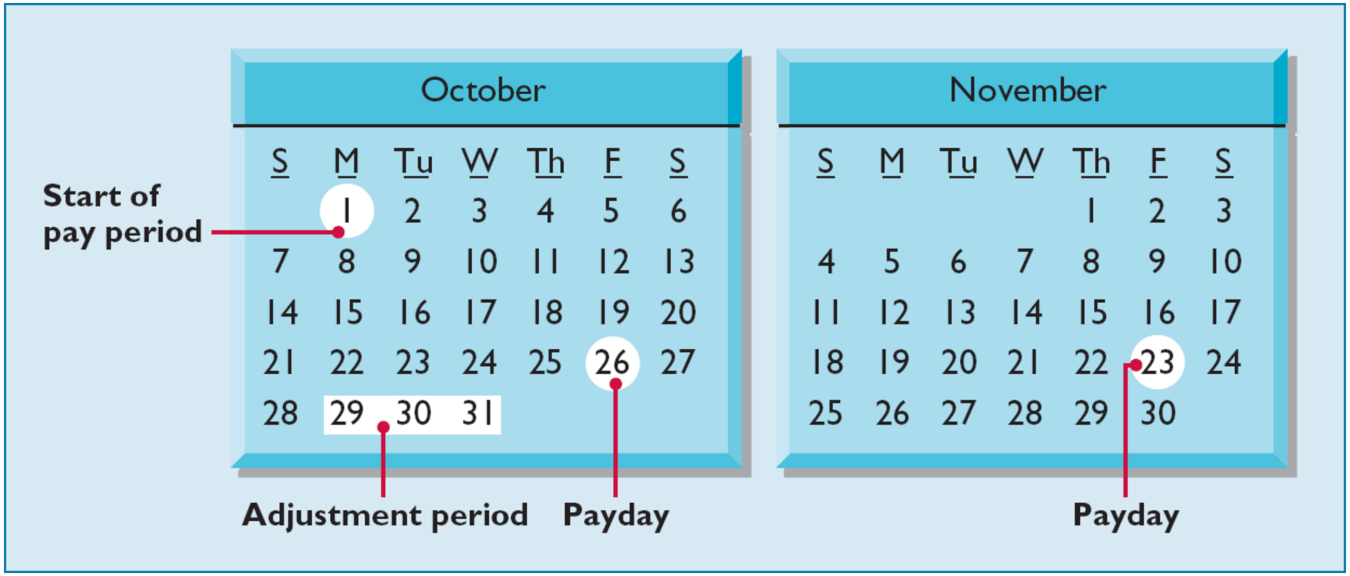
PIONEER ADVERTISING AGENCY INC.
Income Statement
For the Month Ended October 31, 2011

Revenues		
Service Revenue		$106,000
Expenses		
Salaries expense	$46,000	
Advertising supplies expense	15,000	
Rent expense	9,000	
Insurance expense	500	
Interest expense	500	
Depreciation expense	400	
Bad debt expense	1,600	
Total expenses		73,000
Net income		$ 33,000

Illustration 3-34

Statement Presentation

Adjusting Entries for "Accrued Expenses"



Accrued Salaries. At October 31, the salaries for these days represent an accrued expense and a related liability to Pioneer. The employees receive total salaries of $10,000 for a five-day work week, or $2,000 per day.

Adjusting Entries for "Accrued Expenses"

Accrued Salaries. Employees receive total salaries of $10,000 for a five-day work week, or $2,000 per day. Prepare the adjusting entry on Oct. 31 to record accrual for salaries.

Oct. 31	Salaries expense	6,000	
	Salaries payable		6,000

Salaries Expense

Debit	Credit
40,000	
6,000	
46,000	

Salaries Payable

Debit	Credit
	6,000

LO 5 Explain the reasons for preparing adjusting entries.

Adjusting Entries for "Accrued Expenses"

PIONEER ADVERTISING AGENCY INC.
Statement of Financial Position
October 31, 2011

Assets		
Office equipment	$50,000	
Less: Accumulated depreciation	400	$49,600
Advertising supplies		10,000
Prepaid insurance		5,500
Accounts receivable	74,000	
Less: Allowance	1,600	72,400
Cash		80,000
Total assets		$217,500
Equity and Liabilities		
Equity		
Share capital—ordinary	$100,000	
Retained earnings	28,000	
Total equity		$128,000
Liabilities		
Notes payable	50,000	
Accounts payable	25,000	
Unearned service revenue	8,000	
Salaries payable	6,000	
Interest payable	500	
Total liabilities		89,500
Total equity and liabilities		$217,500

Illustration 3-35

PIONEER ADVERTISING AGENCY INC.
Income Statement
For the Month Ended October 31, 2011

Revenues		
Service Revenue		$106,000
Expenses		
Salaries expense	$46,000	
Advertising supplies expense	15,000	
Rent expense	9,000	
Insurance expense	500	
Interest expense	500	
Depreciation expense	400	
Bad debt expense	1,600	
Total expenses		73,000
Net income		$ 33,000

Illustration 3-34

Statement Presentation

LO 5

Adjusting Entries for "Accrued Expenses"

Accrued Salaries. On November 23, Pioneer will again pay total salaries of $40,000. Prepare the entry to record the payment of salaries on November 23.

Nov. 23	Salaries payable	6,000	
	Salaries expense	34,000	
	Cash		40,000

Salaries Expense

Debit	Credit
34,000	

Salaries Payable

Debit	Credit
6,000	6,000

Adjusting Entries for "Accrued Expenses"

Bad Debts. Assume Pioneer reasonably estimates a bad debt expense for the month of $1,600. It makes the adjusting entry for bad debts as follows.

Oct. 31

Bad Debt Expense	1,600	
Allowance for Doubtful Accounts		1,600
(To record monthly bad debt expense)		

After Pioneer posts the adjusting entry, the accounts show the following.

Illustration 3-32

Accounts Receivable

10/ 1		72,000	
31	Adj.	2,000	

Allowance for Doubtful Accounts

	10/31	Adj.	1,600

Bad Debt Expense

10/31	Adj.	1,600	

LO 5 Explain the reasons for preparing adjusting entries.

5. Adjusted Trial Balance

Shows the balance of all accounts, after adjusting entries, at the end of the accounting period.

PIONEER ADVERTISING AGENCY INC.
ADJUSTED TRIAL BALANCE
OCTOBER 31, 2011

Illustration 3-33

	Debit	Credit
Cash	$ 80,000	
Accounts Receivable	74,000	
Allowance for Doubtful Accounts		$ 1,600
Advertising Supplies	10,000	
Prepaid Insurance	5,500	
Office Equipment	50,000	
Accumulated Depreciation— Office Equipment		400
Notes Payable		50,000
Accounts Payable		25,000
Interest Payable		500
Unearned Service Revenue		8,000
Salaries Payable		6,000
Share Capital—Ordinary		100,000
Dividends	5,000	
Service Revenue		106,000
Salaries Expense	46,000	
Advertising Supplies Expense	15,000	
Rent Expense	9,000	
Insurance Expense	500	
Interest Expense	500	
Depreciation Expense	400	
Bad Debt Expense	1,600	
	$297,500	$297,500

6. Preparing Financial Statements

Financial Statements are prepared directly from the Adjusted Trial Balance.

- Income Statement
- Retained Earnings Statement
- Statement of Financial Position

LO 6 Prepare financial statement from the adjusted trial balance.

6. Preparing Financial Statements

Illustration 3-34

PIONEER ADVERTISING AGENCY INC.
Adjusted Trial Balance
October 31, 2011

Account	Debit	Credit
Cash	$80,000	
Accounts Receivable	74,000	
Allowance for Doubtful Accounts		$ 1,600
Advertising Supplies	10,000	
Prepaid Insurance	5,500	
Office Equipment	50,000	
Accumulated Depreciation—Office Equipment		400
Notes Payable		50,000
Accounts Payable		25,000
Unearned Service Revenue		8,000
Salaries Payable		6,000
Interest Payable		500
Share Capital—Ordinary		100,000
Retained Earnings		–0–
Dividends	5,000	
Service Revenue		106,000
Salaries Expense	46,000	
Advertising Supplies Expense	15,000	
Rent Expense	9,000	
Insurance Expense	500	
Interest Expense	500	
Depreciation Expense	400	
Bad Debt Expense	1,600	
	$297,500	$297,500

PIONEER ADVERTISING AGENCY INC.
Income Statement
For the Month Ended October 31, 2011

Revenues		
Service Revenue		$106,000
Expenses		
Salaries expense	$46,000	
Advertising supplies expense	15,000	
Rent expense	9,000	
Insurance expense	500	
Interest expense	500	
Depreciation expense	400	
Bad debt expense	1,600	
Total expenses		73,000
Net income		$ 33,000

PIONEER ADVERTISING AGENCY INC.
Retained Earnings Statement
For the Month Ended October 31, 2011

Retained earnings, October 1	$ –0–
Add: Net income	33,000
	33,000
Less: Dividends	5,000
Retained earnings, October 31	$28,000

To the statement of financial position

LO 6

6. Preparing Financial Statements

Illustration 3-35

PIONEER ADVERTISING AGENCY INC.
Adjusted Trial Balance
October 31, 2011

Account	Debit	Credit
Cash	$80,000	
Accounts Receivable	74,000	
Allowance for Doubtful Accounts		$ 1,600
Advertising Supplies	10,000	
Prepaid Insurance	5,500	
Office Equipment	50,000	
Accumulated Depreciation— Office Equipment		400
Notes Payable		50,000
Accounts Payable		25,000
Unearned Service Revenue		8,000
Salaries Payable		6,000
Interest Payable		500
Share Capital—Ordinary		100,000
Retained Earnings		–0–
Dividends	5,000	
Service Revenue		106,000
Salaries Expense	46,000	
Advertising Supplies Expense	15,000	
Rent Expense	9,000	
Insurance Expense	500	
Interest Expense	500	
Depreciation Expense	400	
Bad Debt Expense	1,600	
	$297,500	$297,500

PIONEER ADVERTISING AGENCY INC.
Statement of Financial Position
October 31, 2011

Assets		
Office equipment	$50,000	
Less: Accumulated depreciation	400	$49,600
Advertising supplies		10,000
Prepaid insurance		5,500
Accounts receivable	74,000	
Less: Allowance	1,600	72,400
Cash		80,000
Total assets		$217,500
Equity and Liabilities		
Equity		
Share capital—ordinary	$100,000	
Retained earnings	28,000	
Total equity		$128,000
Liabilities		
Notes payable	50,000	
Accounts payable	25,000	
Unearned service revenue	8,000	
Salaries payable	6,000	
Interest payable	500	
Total liabilities		89,500
Total equity and liabilities		$217,500

Balance at Oct. 31 from retained earnings statement in Illustration 3-34

7. Closing Entries

- To reduce the balance of the income statement (**revenue** and **expense**) accounts to zero.
- To transfer net income or net loss to equity.
- Statement of financial position (**asset**, **liability**, and **equity**) accounts are not closed.
- Dividends are closed directly to the Retained Earnings account.

LO 7 Prepare closing entries.

7. Closing Entries

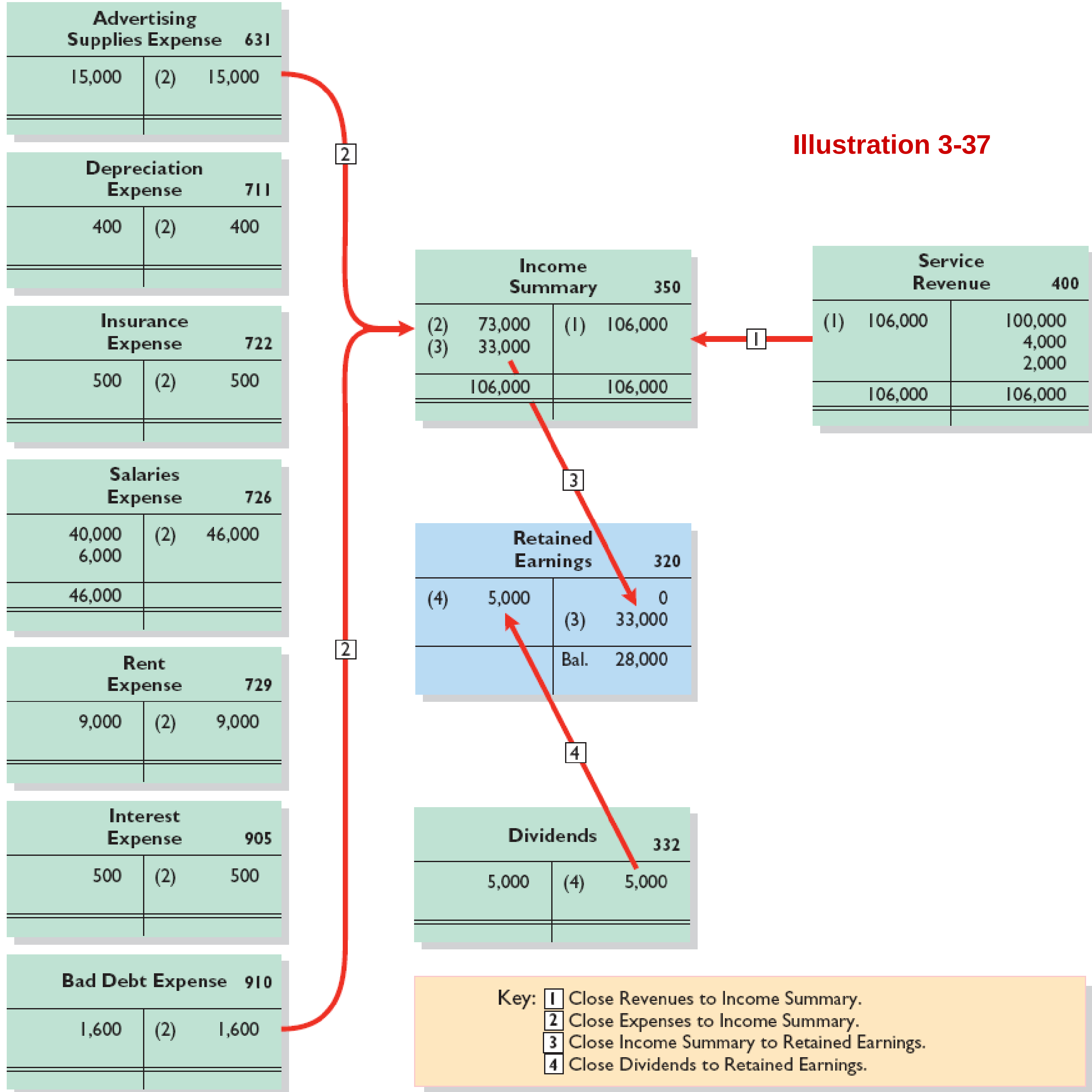
Illustration 3-36

GENERAL JOURNAL J3

Date	Account Titles and Explanation	Debit	Credit
	Closing Entries		
	(1)		
Oct. 31	Service Revenue	106,000	
	Income Summary		106,000
	(To close revenue account)		
	(2)		
31	Income Summary	73,000	
	Advertising Supplies Expense		15,000
	Depreciation Expense		400
	Insurance Expense		500
	Salaries Expense		46,000
	Rent Expense		9,000
	Interest Expense		500
	Bad Debt Expense		1,600
	(To close expense accounts)		
	(3)		
31	Income Summary	33,000	
	Retained Earnings		33,000
	(To close net income to retained earnings)		
	(4)		
31	Retained Earnings	5,000	
	Dividends		5,000
	(To close dividends to retained earnings)		

7. Closing Entries

Illustration 3-37



LO 7

8. Post-Closing Trial Balance

Illustration 3-38

PIONEER ADVERTISING AGENCY INC.
POST-CLOSING TRIAL BALANCE
OCTOBER 31, 2011

Account	Debit	Credit
Cash	$ 80,000	
Accounts Receivable	74,000	
Allowance for Doubtful Accounts		$ 1,600
Advertising Supplies	10,000	
Prepaid Insurance	5,500	
Office Equipment	50,000	
Accumulated Depreciation—Office Equipment		400
Notes Payable		50,000
Accounts Payable		25,000
Unearned Service Revenue		8,000
Salaries Payable		6,000
Interest Payable		500
Share Capital—Ordinary		100,000
Retained Earnings		28,000
	$219,500	$219,500

LO 7 Prepare closing entries.

9. Reversing Entries

After preparing the financial statements and closing the books, a company may reverse some of the adjusting entries before recording the regular transactions of the next period.

Accounting Cycle Summarized

1. Enter the transactions of the period in appropriate journals.
2. Post from the journals to the ledger (or ledgers).
3. Take an unadjusted trial balance (trial balance).
4. Prepare adjusting journal entries and post to the ledger(s).
5. Take a trial balance after adjusting (adjusted trial balance).
6. Prepare the financial statements from the second trial balance.
7. Prepare closing journal entries and post to the ledger(s).
8. Take a trial balance after closing (post-closing trial balance).
9. Prepare reversing entries **(optional)** and post to the ledger(s).

Financial Statements for a Merchandising Company

Illustration 3-39

UPTOWN CABINET CORP.
INCOME STATEMENT
FOR THE YEAR ENDED DECEMBER 31, 2011

Net sales		$400,000
Cost of goods sold		316,000
Gross profit on sales		84,000
Selling expenses		
Sales salaries expense	$20,000	
Traveling expense	8,000	
Advertising expense	2,200	30,200
Administrative expenses		
Salaries, office and general	19,000	
Depreciation expense—furniture and equipment	6,700	
Property tax expense	5,300	
Rent expense	4,300	
Bad debt expense	1,000	
Telephone and Internet expense	600	
Insurance expense	360	37,260
Other income and expense		
Interest revenue		800
Income from operations		17,340
Interest expense		1,700
Income before income tax		15,640
Income tax		3,440
Net income		$ 12,200

Financial Statements of a Merchandising Company

Illustration 3-40

UPTOWN CABINET CORP.
RETAINED EARNINGS STATEMENT
FOR THE YEAR ENDED DECEMBER 31, 2011

Retained earnings, January 1	$16,200
Add: Net income	12,200
	28,400
Less: Dividends	2,000
Retained earnings, December 31	$26,400

Financial Statements of a Merchandising Company

Illustration 3-41

UPTOWN CABINET CORP.
STATEMENT OF FINANCIAL POSITION
AS OF DECEMBER 31, 2011

Assets			
Non-current assets			
Property, plant, and equipment			
Furniture and equipment		$67,000	
Less: Accumulated depreciation		18,700	
Total property, plant, and equipment			$ 48,300
Current assets			
Merchandise inventory		40,000	
Prepaid insurance		540	
Prepaid rent expense		500	
Notes receivable	$16,000		
Accounts receivable	41,000		
Interest receivable	800		
Less: Allowance for doubtful accounts	3,000	54,800	
Cash		1,200	
Total current assets			97,040
Total assets			$145,340
Equity and Liabilities			
Equity			
Share capital—ordinary, $5.00 par value, issued and outstanding, 10,000 shares		$50,000	
Retained earnings		26,400	
Total equity			$ 76,400
Non-current liabilities			
Bonds payable, due June 30, 2018		30,000	
Current liabilities			
Notes payable	$20,000		
Accounts payable	13,500		
Property tax payable	2,000		
Income tax payable	3,440		
Total current liabilities		38,940	
Total liabilities			68,940
Total equity and liabilities			$145,340

CONVERGENCE CORNER

ACCOUNTING INFORMATION SYSTEMS

RELEVANT FACTS

- Internal controls are a system of checks and balances designed to prevent and detect fraud and errors. Both of these actions are required under SOX.
- Companies find that internal control review is a costly process. One study estimates the cost for U.S. companies at over $35 billion, with audit fees doubling in the first year of compliance.
- The enhanced internal control standards apply only to large public companies listed on U.S. exchanges. There is continuing debate over whether foreign issuers should have to comply.

APPENDIX 3A CASH-BASIS ACCOUNTING VERSUS ACCRUAL-BASIS ACCOUNTING

Most companies use **accrual-basis accounting**

- recognize revenue when it is earned and
- expenses in the period incurred,

without regard to the time of receipt or payment of cash.

Under the strict cash basis, companies

- record revenue only when they receive cash, and
- record expenses only when they disperse cash.

Cash basis financial statements are not in conformity with IFRS.

APPENDIX 3A CASH-BASIS ACCOUNTING VERSUS ACCRUAL-BASIS ACCOUNTING

Illustration: Quality Contractor signs an agreement to construct a garage for $22,000. In January, Quality begins construction, incurs costs of $18,000 on credit, and by the end of January delivers a finished garage to the buyer. In February, Quality collects $22,000 cash from the customer. In March, Quality pays the $18,000 due the creditors.

Illustration 3A-1

QUALITY CONTRACTOR
INCOME STATEMENT—CASH BASIS
For the Month of

	January	February	March	Total
Cash receipts				
Cash payments				
Net income (loss)				

LO 8 Differentiate the cash basis of accounting from the accrual basis of accounting.

APPENDIX 3A CASH-BASIS ACCOUNTING VERSUS ACCRUAL-BASIS ACCOUNTING

Illustration: Quality Contractor signs an agreement to construct a garage for $22,000. In January, Quality begins construction, incurs costs of $18,000 on credit, and by the end of January delivers a finished garage to the buyer. In February, Quality collects $22,000 cash from the customer. In March, Quality pays the $18,000 due the creditors.

Illustration 3A-2

QUALITY CONTRACTOR
INCOME STATEMENT—ACCRUAL BASIS
For the Month of

	January	February	March	Total
Revenues				
Expenses				
Net income (loss)				

LO 8 Differentiate the cash basis of accounting from the accrual basis of accounting.

Conversion From Cash Basis To Accrual Basis

Illustration: Dr. Diane Windsor, like many small business owners, keeps her accounting records on a cash basis. In the year 2010, Dr. Windsor received $300,000 from her patients and paid $170,000 for operating expenses, resulting in an excess of cash receipts over disbursements of $130,000 ($300,000 - $170,000). At January 1 and December 31, 2010, she has accounts receivable, unearned service revenue, accrued liabilities, and prepaid expenses as shown in Illustration 3A-5.

Illustration 3A-5

	January 1, 2011	December 31, 2011
Accounts receivable	$12,000	$9,000
Unearned service revenue	–0–	4,000
Accrued liabilities	2,000	5,500
Prepaid expenses	1,800	2,700

APPENDIX 3A CASH-BASIS ACCOUNTING VERSUS ACCRUAL-BASIS ACCOUNTING

Conversion From Cash Basis To Accrual Basis

Illustration: Calculate service revenue on an accrual basis.

Illustration 3A-8

Cash receipts from customers	$300,000
Service revenue (accrual)	

Illustration 3A-5

	January 1, 2011	December 31, 2011
Accounts receivable	$12,000	$9,000
Unearned service revenue	–0–	4,000
Accrued liabilities	2,000	5,500
Prepaid expenses	1,800	2,700

LO 8 Differentiate the cash basis of accounting from the accrual basis of accounting.

Conversion From Cash Basis To Accrual Basis

Illustration: Calculate operating expenses on an accrual basis.

Illustration 3A-11

Cash paid for operating expenses	$170,000
Operating expenses (accrual)	

Illustration 3A-5

	January 1, 2011	December 31, 2011
Accounts receivable	$12,000	$9,000
Unearned service revenue	–0–	4,000
Accrued liabilities	2,000	5,500
Prepaid expenses	1,800	2,700

Conversion From Cash Basis To Accrual Basis

Illustration 3A-12

DIANE WINDSOR, D.D.S.
Conversion of Income Statement Data from Cash Basis to Accrual Basis
For the Year 2011

	A	B	C	D	E
1		Cash Basis	Adjustments Add	Adjustments Deduct	Accrual Basis
2	Collections from customers	$300,000			
3	− Accounts receivable, Jan. 1			$12,000	
4	+ Accounts receivable, Dec. 31		$9,000		
5	+ Unearned service revenue, Jan. 1		—	—	
6	− Unearned service revenue, Dec. 31			4,000	
7	Service revenue				$293,000
8	Disbursement for expenses	170,000			
9	+ Prepaid expenses, Jan. 1		1,800		
10	− Prepaid expenses, Dec. 31			2,700	
11	− Accrued liabilities, Jan. 1			2,000	
12	+ Accrued liabilities, Dec. 31		5,500		
13	Operating expenses				172,600
14	Excess of cash collections over disbursements—cash basis	$130,000			
15	Net income—accrual basis				$120,400

Sheet1 Sheet2 Sheet3

LO 8 Differentiate the cash basis of accounting from the accrual basis of accounting.

Theoretical Weaknesses of the Cash Basis

Today's economy is considerably more lubricated by credit than by cash.

The accrual basis, not the cash basis, recognizes all aspects of the credit phenomenon.

Investors, creditors, and other decision makers seek timely information about an enterprise's *future* cash flows.

Illustration of Reversing Entries—Accruals

Illustration 3B-1

Reversing Entries Not Used				Reversing Entries Used			
Initial Salary Entry							
Oct. 24	Salaries Expense	4,000		Oct. 24	Salaries Expense	4,000	
	Cash		4,000		Cash		4,000
Adjusting Entry							
Oct. 31	Salaries Expense	1,200		Oct. 31	Salaries Expense	1,200	
	Salaries Payable		1,200		Salaries Payable		1,200
Closing Entry							
Oct. 31	Income Summary	5,200		Oct. 31	Income Summary	5,200	
	Salaries Expense		5,200		Salaries Expense		5,200
Reversing Entry							
Nov. 1	No entry is made.			Nov. 1	Salaries Payable	1,200	
					Salaries Expense		1,200
Subsequent Salary Entry							
Nov. 8	Salaries Payable	1,200		Nov. 8	Salaries Expense	2,500	
	Salaries Expense	1,300			Cash		2,500
	Cash		2,500				

LO 9 Identifying adjusting entries that may be reversed.

Illustration of Reversing Entries—Deferrals

Illustration 3B-2

Reversing Entries Not Used				Reversing Entries Used			
Initial Purchase of Supplies Entry							
Dec. 10	Office Supplies	20,000		Dec. 10	Office Supplies Expense	20,000	
	Cash		20,000		Cash		20,000
Adjusting Entry							
Dec. 31	Office Supplies Expense	15,000		Dec. 31	Office Supplies	5,000	
	Office Supplies		15,000		Office Supplies Expense		5,000
Closing Entry							
Dec. 31	Income Summary	15,000		Dec. 31	Income Summary	15,000	
	Office Supplies Expense		15,000		Office Supplies Expense		15,000
Reversing Entry							
Jan. 1	No entry			Jan. 1	Office Supplies Expense	5,000	
					Office Supplies		5,000

LO 9 Identifying adjusting entries that may be reversed.

Summary of Reversing Entries

1. All accruals should be reversed.
2. All deferrals for which a company debited or credited the original cash transaction to an expense or revenue account should be reversed.
3. Adjusting entries for depreciation and bad debts are not reversed.

Recognize that reversing entries do not have to be used. Therefore, some accountants avoid them entirely.

A company prepares a worksheet either on

- columnar paper or
- within an electronic spreadsheet.

A company uses the worksheet to adjust

- account balances and
- to prepare financial statements.

Worksheet Columns

A company prepares a worksheet either on

- columnar paper or
- within an electronic spreadsheet.

Adjusted Trial Balance

UPTOWN CABINET CORP.
Ten-Column Worksheet for The Year Ended December 31, 2011

	A	B	C	D	E	F	G	H	I	J	K
1	Accounts	Trial Balance Dr.	Trial Balance Cr.	Adjustments Dr.	Adjustments Cr.	Adjusted Trial Balance Dr.	Adjusted Trial Balance Cr.	Income Statement Dr.	Income Statement Cr.	Statement of Financial Position Dr.	Statement of Financial Position Cr.
2	Cash	1,200				1,200				1,200	
3	Notes receivable	16,000				16,000				16,000	
4	Accounts receivable	41,000				41,000				41,000	
5	Allowance for doubtful accounts		2,000		(b) 1,000		3,000				3,000
6	Merchandise inventory	40,000				40,000				40,000	
7	Prepaid insurance	900			(c) 360	540				540	
8	Furniture and equipment	67,000				67,000				67,000	
9	Accumulated depreciation–furniture and equipment		12,000		(a) 6,700		18,700				18,700
10	Notes payable		20,000				20,000				20,000
11	Accounts payable		13,500				13,500				13,500
12	Bonds payable		30,000				30,000				30,000
13	Share capital—ordinary		50,000				50,000				50,000
14	Retained earnings, Jan. 1, 2010		16,200				16,200				16,200
15	Dividends	2,000				2,000				2,000	
16	Sales		400,000				400,000		400,000		
17	Cost of goods sold	316,000				316,000		316,000			
18	Sales salaries expense	20,000				20,000		20,000			
19	Advertising expense	2,200				2,200		2,200			
20	Traveling expense	8,000				8,000		8,000			
21	Salaries, office and general	19,000				19,000		19,000			
22	Telephone and Internet expense	600				600		600			
23	Rent expense	4,800			(e) 500	4,300		4,300			
24	Property tax expense	3,300		(f) 2,000		5,300		5,300			
25	Interest expense	1,700				1,700		1,700			
26	Totals	543,700	543,700								
27	Depreciation expense–furniture and equipment			(a) 6,700		6,700		6,700			
28	Bad debt expense			(b) 1,000		1,000		1,000			
29	Insurance expense			(c) 360		360		360			
30	Interest receivable			(d) 800		800				800	
31	Interest revenue				(d) 800		800		800		
32	Prepaid rent expense			(e) 500		500				500	
33	Property tax payable				(f) 2,000		2,000				2,000
34	Income tax expense			(g) 3,440		3,440		3,440			
35	Income tax payable				(g) 3,440		3,440				3,440
36	Totals			14,800	14,800	557,640	557,640	388,600	400,800		
37	Net income							12,200			12,200
38	Totals							400,800	400,800	169,040	169,040

Illustration 3C-1

LO 10 Prepare a 10-column worksheet.

Preparing Financial Statements from a Worksheet

The Worksheet:

- Provides information needed for preparation of the financial statements.
- Sorts data into appropriate columns, which facilitates the preparation of the statements.

Illustration 3-39

UPTOWN CABINET CORP.
INCOME STATEMENT
FOR THE YEAR ENDED DECEMBER 31, 2011

Net sales		$400,000
Cost of goods sold		316,000
Gross profit on sales		84,000
Selling expenses		
Sales salaries expense	$20,000	
Traveling expense	8,000	
Advertising expense	2,200	30,200
Administrative expenses		
Salaries, office and general	19,000	
Depreciation expense—furniture and equipment	6,700	
Property tax expense	5,300	
Rent expense	4,300	
Bad debt expense	1,000	
Telephone and Internet expense	600	
Insurance expense	360	37,260
Other income and expense		
Interest revenue		800
Income from operations		17,340
Interest expense		1,700
Income before income tax		15,640
Income tax		3,440
Net income		$ 12,200

Illustration 3-40

UPTOWN CABINET CORP.
Retained Earnings Statement
For the Year Ended December 31, 2011

Retained earnings, January 1	$16,200
Add: Net income	12,200
	28,400
Less: Dividends	2,000
Retained earnings, December 31	$26,400

LO 10 Prepare a 10-column worksheet.

Illustration 3-41

UPTOWN CABINET CORP.
STATEMENT OF FINANCIAL POSITION
AS OF DECEMBER 31, 2011

Assets			
Non-current assets			
Property, plant, and equipment			
Furniture and equipment		$67,000	
Less: Accumulated depreciation		18,700	
Total property, plant, and equipment			$ 48,300
Current assets			
Merchandise inventory		40,000	
Prepaid insurance		540	
Prepaid rent expense		500	
Notes receivable	$16,000		
Accounts receivable	41,000		
Interest receivable	800		
Less: Allowance for doubtful accounts	3,000	54,800	
Cash		1,200	
Total current assets			97,040
Total assets			$145,340
Equity and Liabilities			
Equity			
Share capital—ordinary, $5.00 par value, issued and outstanding, 10,000 shares		$50,000	
Retained earnings		26,400	
Total equity			$ 76,400
Non-current liabilities			
Bonds payable, due June 30, 2018		30,000	
Current liabilities			
Notes payable	$20,000		
Accounts payable	13,500		
Property tax payable	2,000		
Income tax payable	3,440		
Total current liabilities		38,940	
Total liabilities			68,940
Total equity and liabilities			$145,340

Copyright