

# **The Applications of Financial Statements**

قَالَ اجْعَلْنِي عَلَىٰ خَزَائِنِ الْأَرْضِ ۗ إِنِّي حَفِيظٌ عَلِيمٌ

[Joseph] said, "Appoint me over the storehouses of the land. Indeed, I will be a knowing guardian."

# Using a Worksheet

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## *Steps in Preparing a Worksheet*

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

# Steps in Preparing a Worksheet

Illustration 4-1

	A	B	C	D	E	F	G	H	I	J	K
1		Worksheet									
2		Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Balance Sheet	
3											
4	Account Titles	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
5											
6											
7											
8											
9											
10											
11											
12											
13											
14											
15											

**1**  
Prepare a trial balance on the worksheet

**2**  
Enter adjustment data

**3**  
Enter adjusted balances

**4**  
Extend adjusted balances to appropriate statement columns

**5**  
Total the statement columns, compute net income (or net loss), and complete worksheet

# Steps in Preparing a Worksheet

## 1. Prepare a Trial Balance on the Worksheet

Illustration 4-2

Account Titles	Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Balance Sheet	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	15,200									
Supplies	2,500									
Prepaid Insurance	600									
Office Equipment	5,000									
Notes Payable		5,000								
Accounts Payable		2,500								
Unearned Revenue		1,200								
Owner's Capital		10,000								
Owner's Drawing	500									
Service Revenue		10,000								
Salaries Expense	4,000									
Rent Expense	900									
<b>Totals</b>	<b>28,700</b>	<b>28,700</b>								

Include all accounts with balances.

Trial balance amounts come directly from ledger accounts.

# Steps in Preparing a Worksheet

**Illustration 3-23**  
General journal showing adjusting entries

## Adjusting Journal Entries (Chapter 3)

General Journal					J2
Date	Account Titles and Explanation	Ref.	Debit	Credit	
2012	<u>Adjusting Entries</u>				
Oct. 31	Supplies Expense	631	1,500		
	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—Equipment	158		40	
	(To record monthly depreciation)				
31	Unearned Service 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 and Wages Expense	726	1,200		
	Salaries and Wages Payable	212		1,200	
	(To record accrued salaries and wages)				

# Steps in Preparing a Worksheet

## 2. Enter the Adjustments in the Adjustments Columns

Account Titles	Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Balance Sheet	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	15,200									
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							
Owner's Capital		10,000								
Owner's Drawing	500									
Service Revenue		10,000		(d) 400						
				(e) 200						
Salaries Expense	4,000		(g) 1,200							
Rent Expense	900									
<b>Totals</b>	<b>28,700</b>	<b>28,700</b>								
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						
<b>Totals</b>			<b>3,440</b>	<b>3,440</b>						

**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		Balance Sheet	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	15,200				15,200					
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				
Owner's Capital		10,000				10,000				
Owner's Drawing	500				500					
Service Revenue		10,000		(d) 400 (e) 200		10,600				
Salaries Expense	4,000		(g) 1,200		5,200					
Rent Expense	900				900					
<b>Totals</b>	<b>28,700</b>	<b>28,700</b>								
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 (g) 1,200		50 1,200				
Salaries Payable										
<b>Totals</b>			<b>3,440</b>	<b>3,440</b>	<b>30,190</b>	<b>30,190</b>				

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		Balance Sheet	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	15,200				15,200					
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				
Owner's Capital		10,000				10,000				
Owner's Drawing	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 Expense	900				900		900			
<b>Totals</b>	<b>28,700</b>	<b>28,700</b>								
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				
<b>Totals</b>			<b>3,440</b>	<b>3,440</b>	<b>30,190</b>	<b>30,190</b>	<b>7,740</b>	<b>10,600</b>		

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

SO 1 Prepare a worksheet.

# Steps in Preparing a Worksheet

## 5. Total Columns, Compute Net Income (Loss)

Account Titles	Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Balance Sheet	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	15,200				15,200				15,200	
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
Owner's Capital		10,000				10,000				10,000
Owner's Drawing	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 Expense	900				900		900			
<b>Totals</b>	<b>28,700</b>	<b>28,700</b>								
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
<b>Totals</b>			<b>3,440</b>	<b>3,440</b>	<b>30,190</b>	<b>30,190</b>	<b>7,740</b>	<b>10,600</b>	<b>22,450</b>	<b>19,590</b>
Net Income							<b>2,860</b>			<b>2,860</b>
<b>Totals</b>							<b>10,600</b>	<b>10,600</b>	<b>22,450</b>	<b>22,450</b>

Compute Net Income or Net Loss.

SO 1 Prepare a worksheet.

# Using a Worksheet

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## *Preparing Statements from a Worksheet*

- ◆ Income statement is prepared from the income statement columns.
- ◆ Balance sheet and owner's equity statement are prepared from the balance sheet columns.
- ◆ Companies journalize and post adjusting entries.

# Preparing Statements from a Worksheet

Illustration 4-4

Pioneer Advertising Agency		
Income Statement		
For the Month Ended October 31, 2012		
Revenues		
Service revenue		\$10,600
Expenses		
Salaries and wages expense	\$5,200	
Supplies expense	1,500	
Rent expense	900	
Insurance expense	50	
Interest expense	50	
Depreciation expense	40	
Total expenses	<u>7,740</u>	<u>7,740</u>
Net income		<u><u>\$ 2,860</u></u>

# Preparing Statements from a Worksheet

Illustration 4-4

<b>Pioneer Advertising Agency</b> Owner's Equity Statement For the Month Ended October 31, 2012		
Owner's capital, October 1		\$ -0-
Add: Investments	\$10,000	
Net income	<u>2,860</u>	<u>12,860</u>
		12,860
Less: Drawings		<u>500</u>
Owner's capital, October 31		<u><u>\$12,360</u></u>

# Preparing Statements from a Worksheet

Illustration  
4-4

Pioneer Advertising Agency		
Balance Sheet		
October 31, 2012		
<u>Assets</u>		
Cash		\$15,200
Accounts receivable		200
Supplies		1,000
Prepaid insurance		550
Office equipment	\$5,000	
Less: Accumulated depreciation—equipment	40	4,960
Total assets		<u><u>\$21,910</u></u>
<u>Liabilities and Owner's Equity</u>		
Liabilities		
Notes payable	\$5,000	
Accounts payable	2,500	
Interest payable	50	
Unearned service revenue	800	
Salaries and wages payable	1,200	
Total liabilities		\$ 9,550
Owner's equity		
Owner's capital		<u>12,360</u>
Total liabilities and owner's equity		<u><u>\$21,910</u></u>

# Using a Worksheet

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## *Preparing Adjusting Entries from a Worksheet*

- ◆ 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.

# Closing the Books

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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

Owner's drawing account

## PERMANENT

These accounts are not closed

All asset accounts

All liability accounts

Owner's capital account



# Closing the Books

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## *Preparing Closing Entries*

**Closing entries** formally recognize, in the general ledger, the transfer of

- ◆ net income (or net loss) and
  - ◆ owner's drawing
- to owner's capital.

Closing entries are only made at the end of the annual accounting period.

# Closing the Books

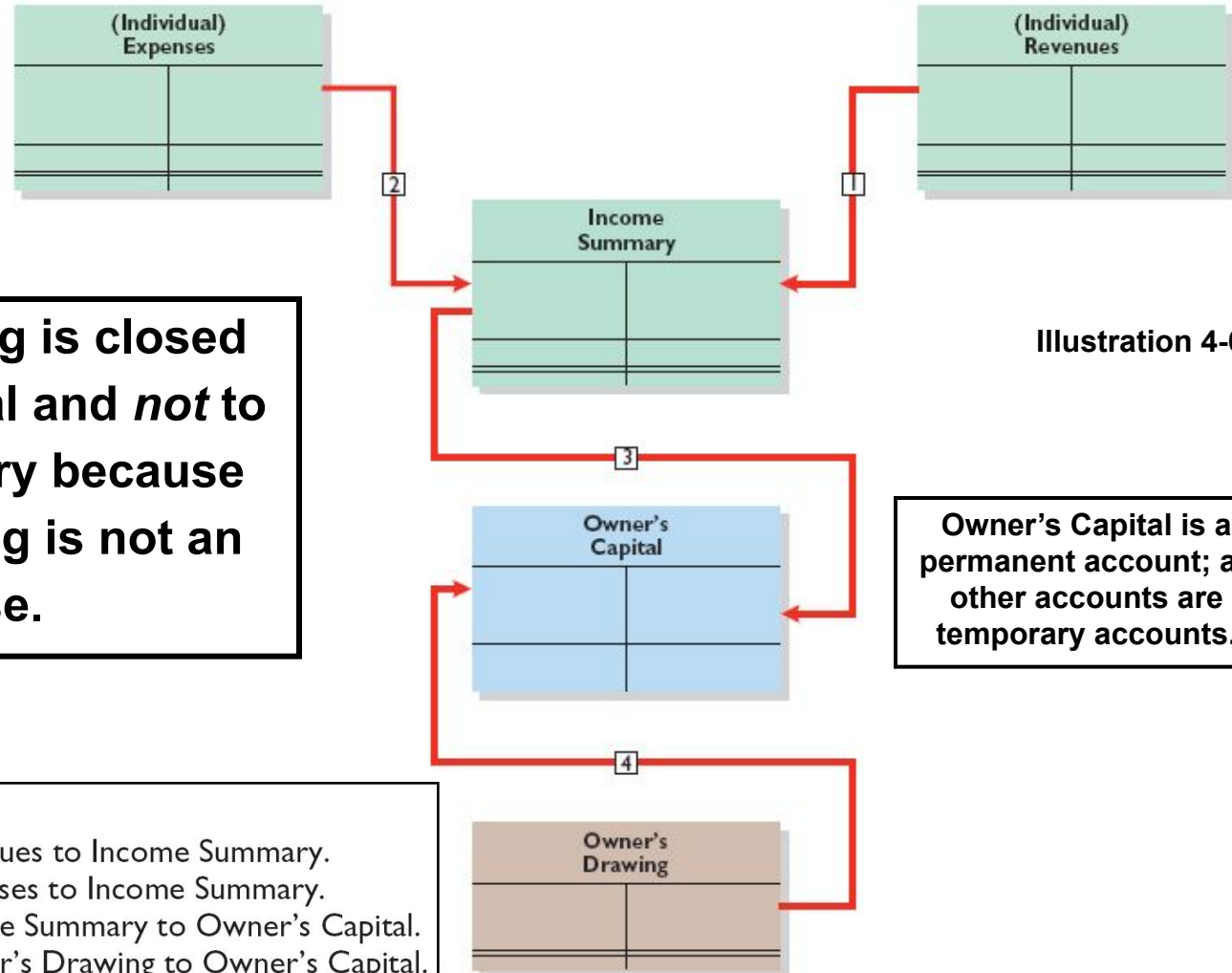


Illustration 4-6

## Note:

**Owner's Drawing is closed directly to Capital and *not* to Income Summary because Owner's Drawing is not an expense.**

**Owner's Capital is a permanent account; all other accounts are temporary accounts.**

### Key:

- 1 Close Revenues to Income Summary.
- 2 Close Expenses to Income Summary.
- 3 Close Income Summary to Owner's Capital.
- 4 Close Owner's Drawing to Owner's Capital.

# Closing the Books

## Closing Entries Illustrated

General Journal					J3
Date	Account Titles and Explanation	Ref.	Debit	Credit	
	<u>Closing Entries</u>				
2012	(1)				
Oct. 31	Service Revenue	400	10,600		
	Income Summary	350		10,600	
	(To close revenue account)				
	(2)				
31	Income Summary	350	7,740		
	Supplies Expense	631		1,500	
	Depreciation Expense	711		40	
	Insurance Expense	722		50	
	Salaries and Wages Expense	726		5,200	
	Rent Expense	729		900	
	Interest Expense	905		50	
	(To close expense accounts)				
	(3)				
31	Income Summary	350	2,860		
	Owner's Capital	301		2,860	
	(To close net income to capital)				
	(4)				
31	Owner's Capital	301	500		
	Owner's Drawings	306		500	
	(To close drawings to capital)				

**Illustration 4-7**  
Closing entries  
journalized

# Closing the Books

## Posting Closing Entries

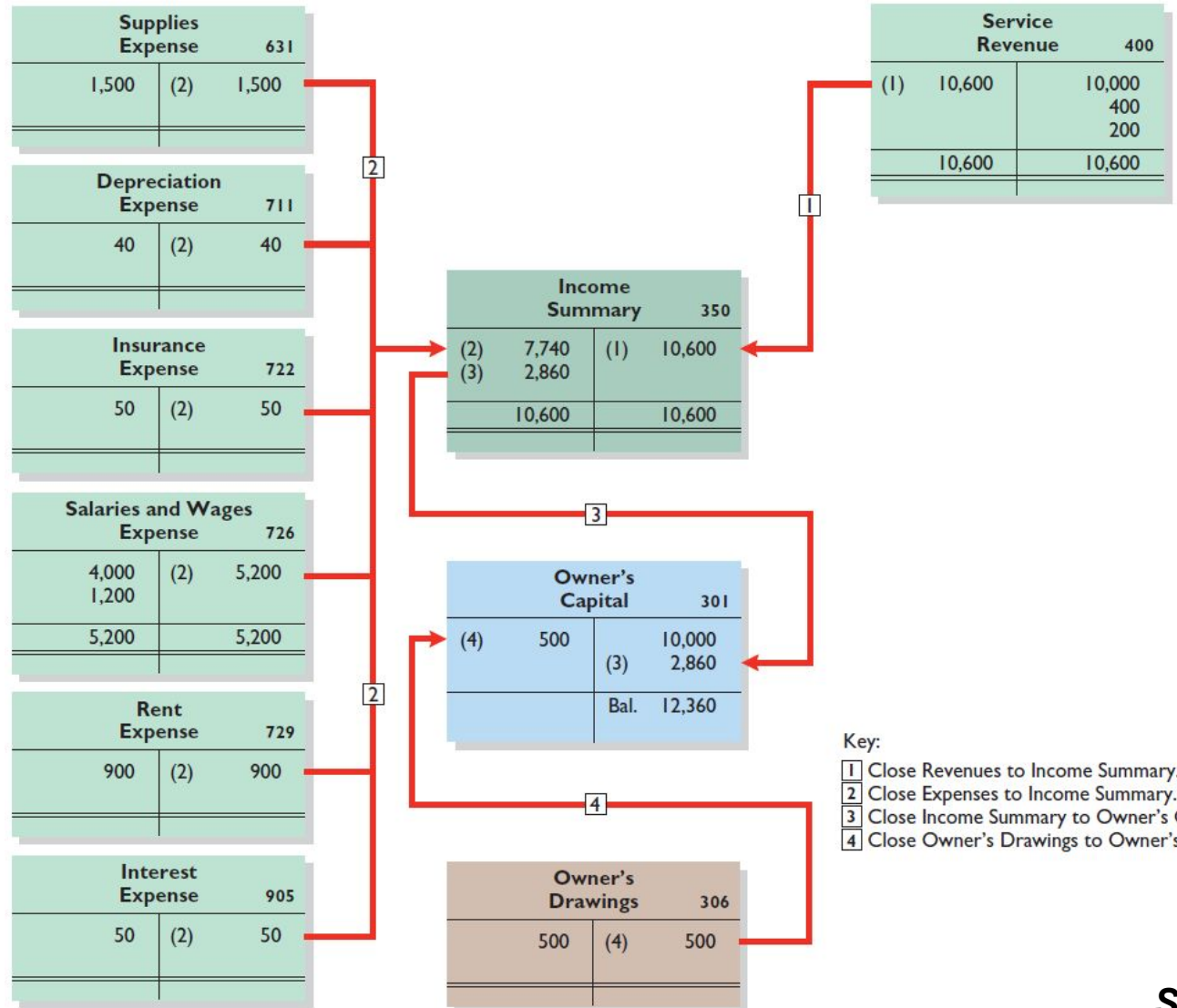


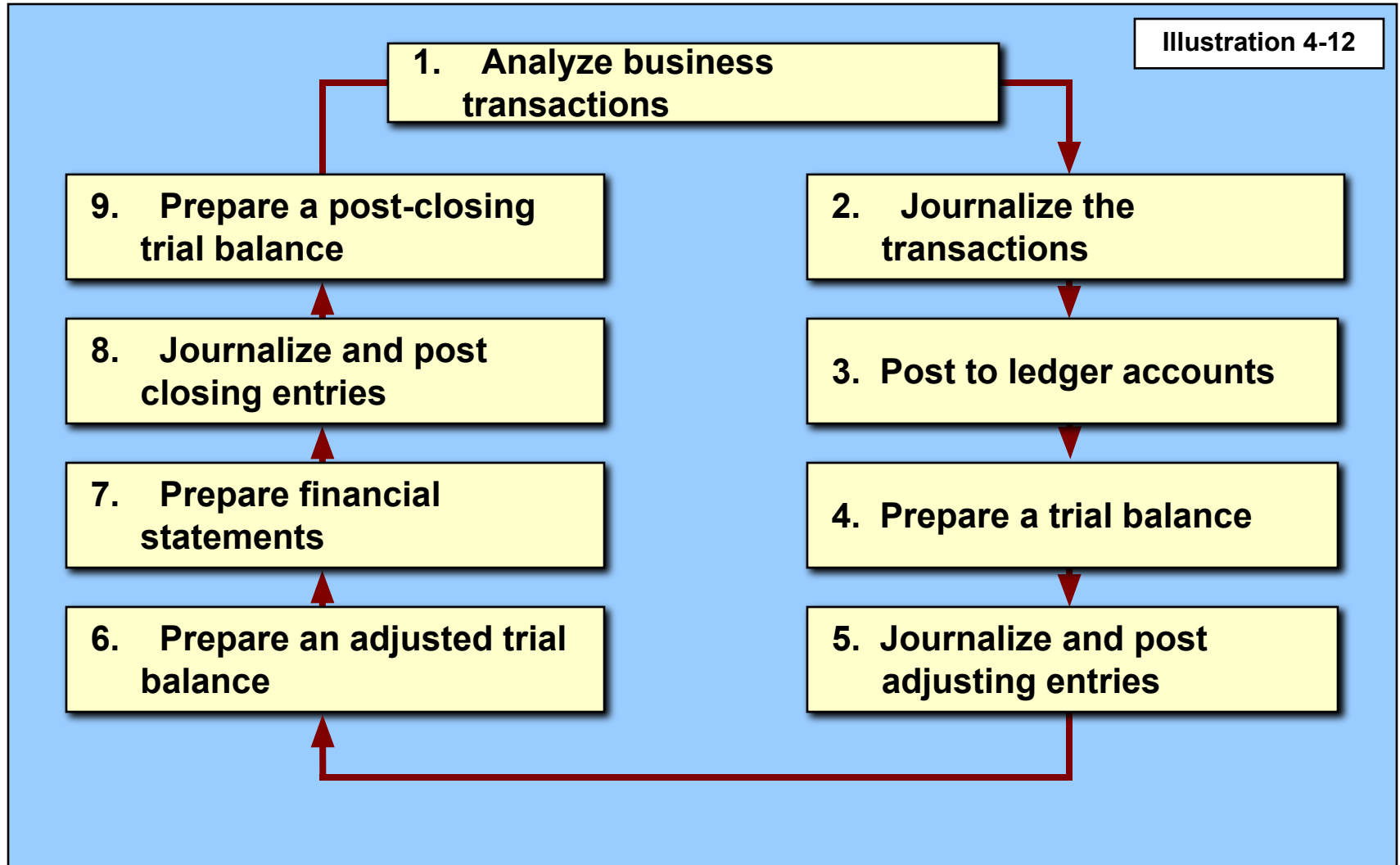
Illustration 4-8

# Preparing a Post-Closing Trial Balance

**Purpose** is to prove the equality of the permanent account balances after journalizing and posting of closing entries.

<b>Pioneer Advertising Agency</b>		Illustration 4-9
Post-Closing Trial Balance		
October 31, 2012		
	<u>Debit</u>	<u>Credit</u>
Cash	\$15,200	
Accounts Receivable	200	
Supplies	1,000	
Prepaid Insurance	550	
Office Equipment	5,000	
Accumulated Depreciation – Equipment		\$ 40
Notes Payable		5,000
Accounts Payable		2,500
Unearned Service Revenue		800
Salaries and Wages Payable		1,200
Interest Payable		50
Owner's Capital		12,360
	<u><b>\$21,950</b></u>	<u><b>\$21,950</b></u>

# Summary of the Accounting Cycle



# Summary of the Accounting Cycle

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## *Correcting Entries—An Avoidable Step*

- ◆ Unnecessary if the records are error-free.
- ◆ Made whenever an error is discovered.
- ◆ Must be posted before closing entries.

Instead of preparing a correcting entry, it is possible to reverse the incorrect entry and then prepare the correct entry.

# Correcting Entries—An Avoidable Step

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**Illustration (Case 1):** On May 10, Mercato Co. journalized and posted a \$50 cash collection on account from a customer as a debit to Cash \$50 and a credit to Service Revenue \$50. The company discovered the error on May 20, when the customer paid the remaining balance in full.

Incorrect entry	Cash	50	
	Service revenue		50
Correct entry	Cash	50	
	Accounts receivable		50
Correcting entry	Service revenue	50	
	Accounts receivable		50



# Correcting Entries—An Avoidable Step

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**Illustration (Case 2):** On May 18, Mercato purchased on account equipment costing \$450. The transaction was journalized and posted as a debit to Equipment \$45 and a credit to Accounts Payable \$45. The error was discovered on June 3,

Incorrect entry	Equipment 45	
	Accounts payable	45
Correct entry	Equipment 450	
	Accounts payable	450
Correcting entry	Equipment 405	
	Accounts payable	405

# The Classified Balance Sheet

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- ◆ Presents a snapshot at a point in time.
- ◆ To improve understanding, companies group similar assets and similar liabilities together.

## Standard Classifications

Illustration 4-17

### Assets Liabilities and Owner's Equity

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Current assets    Current liabilities

Long-term investments    Long-term liabilities

Property, plant, and equipment    Owner's (Stockholders') equity

Intangible assets

# The Classified Balance Sheet

Illustration 4-18

Franklin Company			
Balance Sheet			
October 31, 2012			
<u>Assets</u>			
<b>Current assets</b>			
Cash		\$ 6,600	
Short-term investments		2,000	
Accounts receivable		7,000	
Notes receivable		1,000	
Inventory		3,000	
Supplies		2,100	
Prepaid insurance		400	
Total current assets			\$22,100
<b>Long-term investments</b>			
Investment in stock of Walters Corp.		5,200	
Investment in real estate		2,000	7,200
<b>Property, plant, and equipment</b>			
Land		10,000	
Equipment	\$24,000		
Less: Accumulated depreciation— equipment	5,000	19,000	29,000
<b>Intangible assets</b>			
Patents			3,100
Total assets			\$61,400

# The Classified Balance Sheet

Franklin Company Balance Sheet October 31, 2012		
<u>Liabilities and Owner's Equity</u>		
<b>Current liabilities</b>		
Notes payable	\$11,000	
Accounts payable	2,100	
Salaries and wages payable	1,600	
Unearned service revenue	900	
Interest payable	450	
Total current liabilities		\$16,050
<b>Long-term liabilities</b>		
Mortgage payable	10,000	
Notes payable	1,300	
Total long-term liabilities		11,300
Total liabilities		27,350
<b>Owner's equity</b>		
Owner's capital		34,050
Total liabilities and owner's equity		<u>\$61,400</u>

Illustration 4-18