

Accounting Basics, Part 2

The Accounting Cycle,
T-Accounts,
Trial Balance, and
from Ledger to
Trial Closing Balance

What's Here...

- Introduction
- The Accounting Cycle
- T-Accounts
- Trial Balance
- Adjusting Entries
- Closing Entries

Introduction,

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- This *training* picks up where Part 1 left off. This one illustrates and discusses:
 - The Accounting Cycle
 - T-Accounts
 - Trial Balance
 - Adjusting Entries
 - Closing Entries
 - Trial Closing Balance

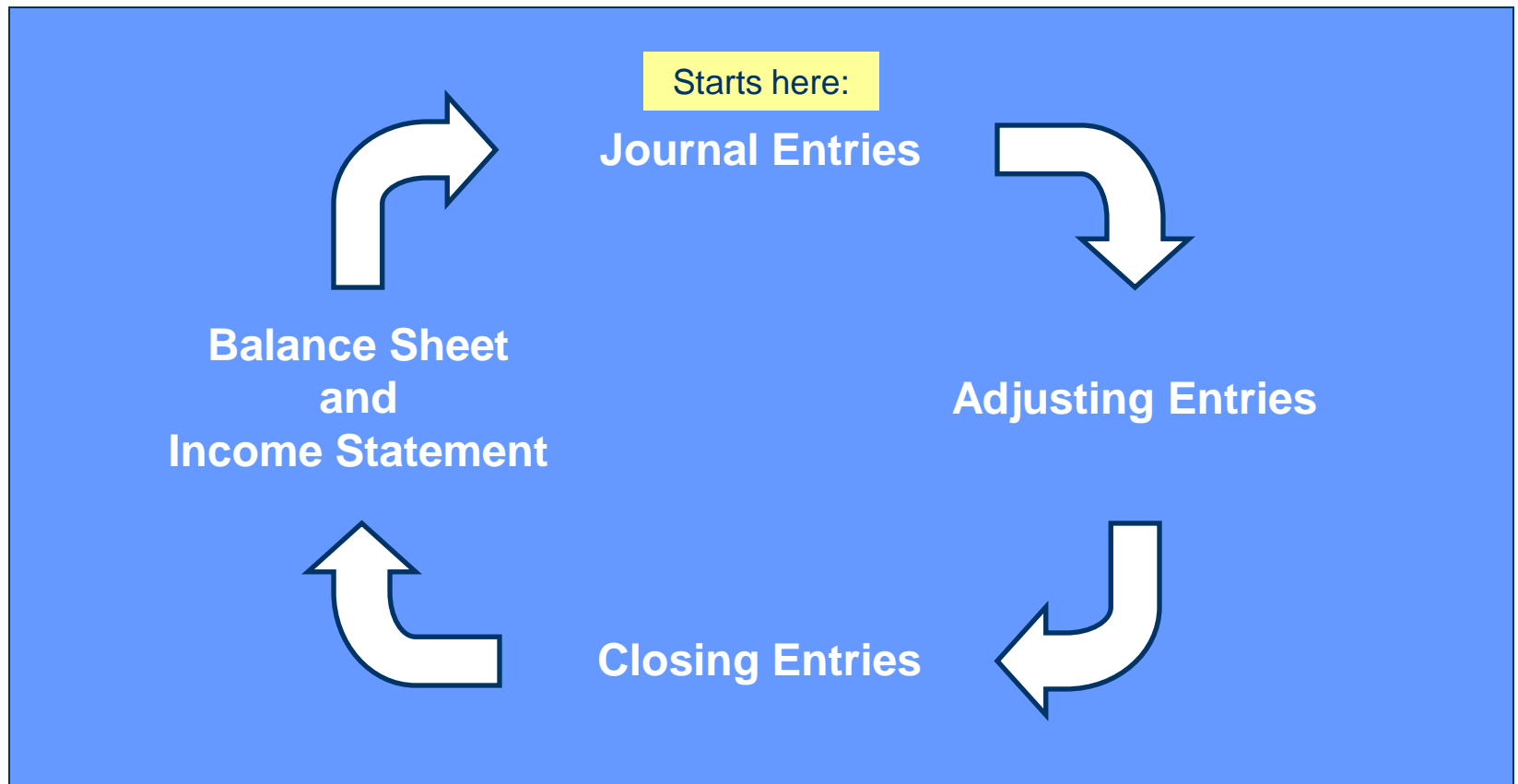
Introduction,

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- Part 1, started with the Basics by discussing:
 - Business Types
 - Business Organization
 - Professional Advice
 - Accounting and Records
 - Accrual Accounting
 - Basic Bookkeeping
 - Chart of Accounts
 - Double-Entry Accounting
 - Debits & Credits
 - The Journal
 - The Ledger
- Part 3, the next *training* in this series, illustrates and discusses the Balance Sheet, the Income Statement and analyzing financials

Accounting Cycle

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Accounting Cycle,

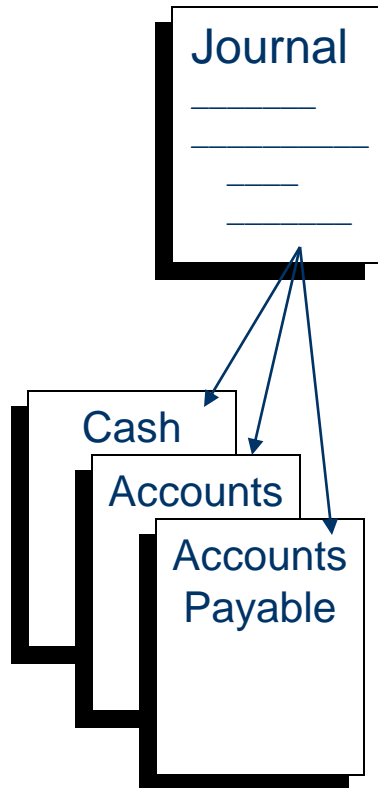
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- Step 1 Business transactions occur that result in source documents such as receipts, bills, checks, etc.
- Step 2 Business transactions are recorded in the Journal chronologically by account name
- Step 3 Information is posted (copied) from the Journal to the General Ledger (book in which *accounts* are recorded)

Steps are illustrated on next slide

Accounting Cycle,

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Steps 1 and 2 – Transactions occur resulting in business revenue and expense details that are recorded in the Journal

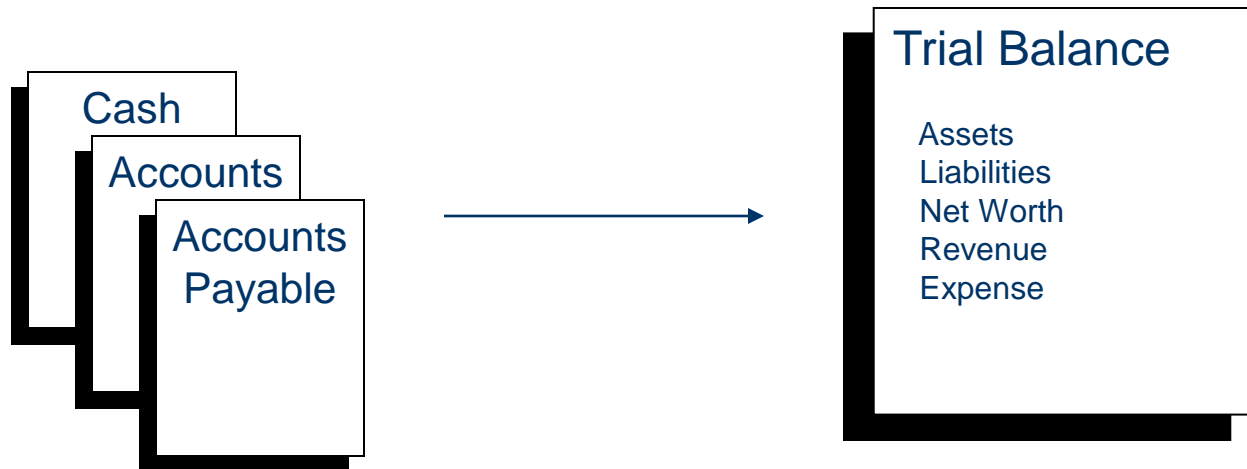
Step 3 – Information from Journal is posted to applicable ledgers

Recurring transactions are grouped together into like accounts (categories) such as cash, receivables, payables, equipment, etc.

Accounting Cycle,

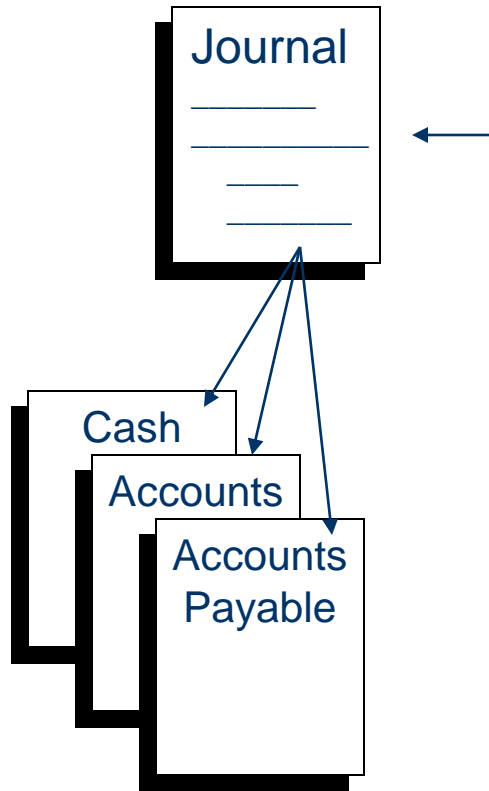
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Step 4 A trial balance is prepared which lists, in order, the ending monthly balances of all general ledger accounts



Accounting Cycle,

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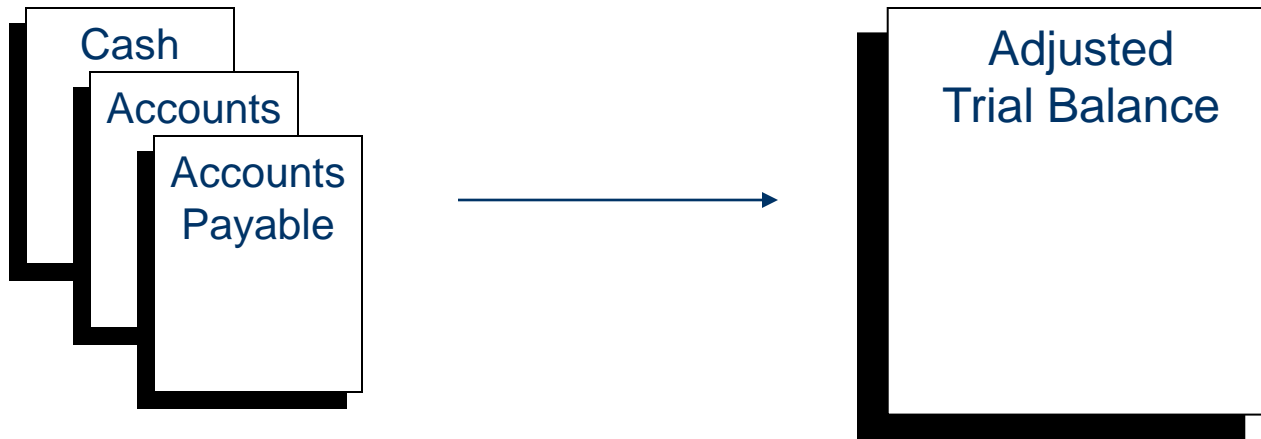
Step 5 Adjusting entries are completed at the end of the accounting period (e.g., monthly) to match proper revenue with expenses in that period

Step 6 Adjusting entries from the Journal are posted into the General Ledger

Accounting Cycle,

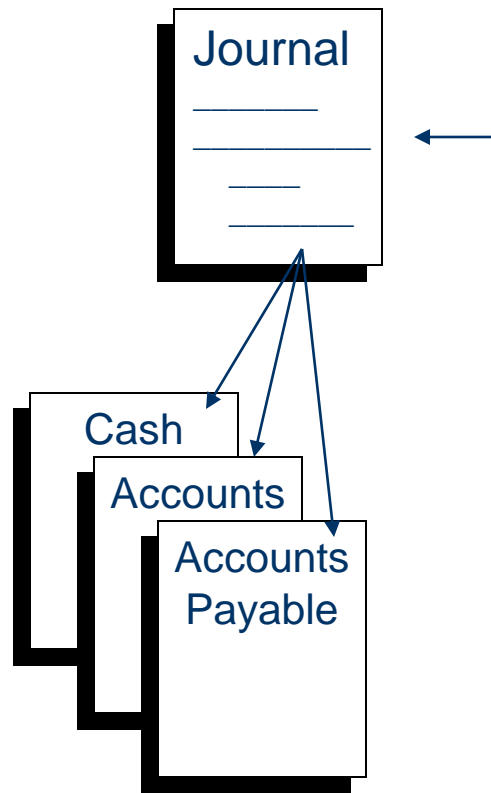
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Step 7 An adjusted trial balance is prepared that reflects only the adjusting entries. (If an error has occurred, it was made in posting.)



Accounting Cycle,

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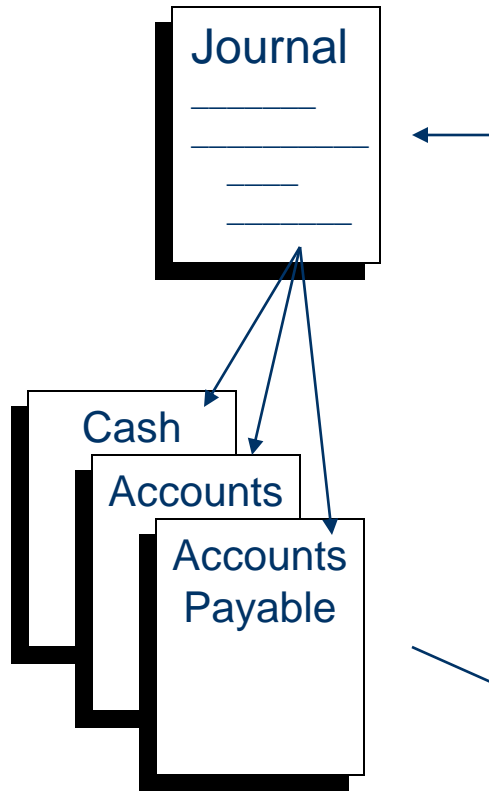
Step 8

All temporary (nominal) accounts are closed and have a zero balance at the beginning of the next accounting period (month)

All closing entries at the end of the accounting period are recorded in the Journal

Accounting Cycle,

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Step 9 Closing entries from the Journal are posted to the General Ledger

Step 10 A post-closing trial balance is prepared which only shows permanent accounts

Accounting Cycle,

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Step 11 Monthly (or periodic) financial statements are prepared:

➤ Income Statement

$$\text{Revenue} - \text{Expenses} = \text{Net Profit/Loss}$$

➤ Balance Sheet

$$\text{Assets} = \text{Liabilities} + \text{Net Worth}$$

The Balance Sheet equation cannot balance until net income (or loss) is added to the Balance Sheet from the Income Statement.

T- Accounts,

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Cash

Account No. 101

Date 20XX		Item	PR	Debit	Date 20XX		Item	PR	Credit
Jan	1		J1	2500	Jan	2		J1	250
					Jan	3		J1	175
				2500					452
Jan	xx	Balance 2048							

Standard Ledger Account ... the "T" Account

Footings (adding) helps balance the account.

Ending balance is difference between the footings.

T- Accounts,

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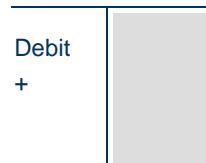


Balances are the differences between debits and credits in the accounts.

Normal balance for all asset accounts are debits.

Normal balance for liability accounts are credits.

Withdrawals



T- Accounts,

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On Jan 1, 20XX, the business owner invested \$5000 cash and \$100 office equipment in the business.

Cash		Equipment		Capital	
Debit	Credit	Debit	Credit	Debit	Credit
5000		100			5100

On Jan 15, 20XX, the business bought a used truck for \$1000 cash and a note payable for \$4000.

Cash		Truck		Note Payable	
Debit	Credit	Debit	Credit	Debit	Credit
5000	1000	5000			4000

T- Accounts,

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On Jan 17, 20XX, the business earned \$2000 for services.

Cash		Revenue	
Debit	Credit	Debit	Credit
5000	1000		2000
2000			

On Jan 20, 20XX, the business paid utilities on the building for \$200.

Cash		Utilities Expense	
Debit	Credit	Debit	Credit
5000	1000	200	
2000	200		

T- Accounts,

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On Jan 21, 20XX, the business paid its monthly building/office rent of \$500.

Cash		Rent Expense	
Debit	Credit	Debit	Credit
5000	1000	500	
2000	200		
	500		

On Jan 22, 20XX, the business bought office supplies for \$250.

Cash		Office Supplies	
Debit	Credit	Debit	Credit
5000	1000	250	
2000	200		
	500		
	250		

T- Accounts,

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On Jan 24, 20XX, the business owner withdrew \$100 cash to pay personal expenses.

Cash	
Debit	Credit
5000	1000
2000	200
	500
	250
	100

Withdrawals	
Debit	Credit
100	

T- Accounts,

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At the end of the month the business transactions were summarized.

Cash		Office Equipment		Business Capital		Utilities	
Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit
5000	1000	100			5100	200	
2000	200						
	500						
	250	Truck		Withdrawals		Rent	
	100	Debit	Credit	Debit	Credit	Debit	Credit
Balance		5000		100		500	
4950							
Office Supplies		Note Payable		Revenue			
Debit	Credit	Debit	Credit	Debit	Credit		
250			4000		2000		

...to Trial Balance



Trial Balance,

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Business Name Trial Balance Date		
	Debit	Credit
Cash	\$4,950	
Supplies	250	
Equipment	100	
Vehicle	5,000	
Note Payable		4,000
Capital		5,100
Withdrawal	100	
Revenue		2,000
Utilities	200	
Rent	500	
TOTALS	\$11,100	\$11,100

Debits = Credits

When the Trial Balance matches (equals), everything is fine.

But, when it doesn't the bookkeeper must backtrack and verify all entries against the business transaction documentation until the discrepancy is discovered.

Corrections are entered and annotated in the Journal, posted to the applicable ledger, and the Trial Balance.

Trial Balance,

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- Prepared at the end of the accounting period
- Prepared from the general ledger
- Each account balance is recorded in order starting with assets, liabilities, net worth, revenue and expenses
- Totals for debits and credits are compared and should equal
- Journals, ledgers and business transaction documentation are reconciled

Adjusting Entries,

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- Made at the end of the month or accounting period
- Made to:
 - Current Assets
 - Long-Term Assets
 - Liabilities
 - Revenue
 - Expense

Adjusting Entries,

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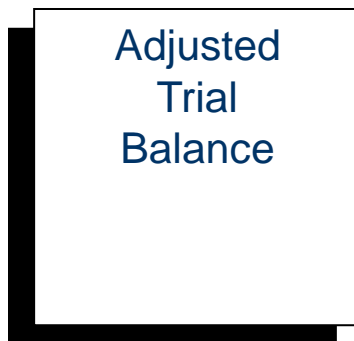
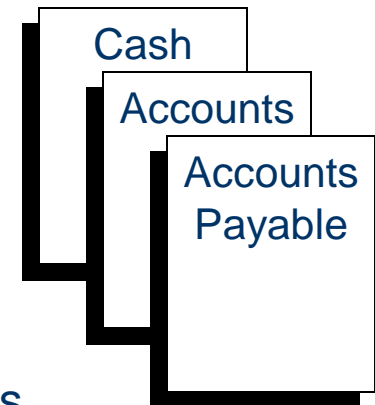
- Cash is never used in an adjusting entry
- An expense or revenue account is used in every transaction
- Expenses will normally be debits and revenue accounts will be credits
- Revenue and Expense Accounts that have been earned, but remain unrecorded, must be adjusted

Adjusting Entries,

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Date	Description of Entry	PR	Debit	Credit
20XX				
10	Cash		50000	
	Capital			50000
	Invested in the business			
10	Supplies		3500	
	Cash			3500
	Shirts for resale			

1. Adjustments are recorded in the Journal .. Then posted to ledgers



2. An adjusted trial balance is prepared to guard against errors.

Adjusting Entries,

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- Asset
 - Accounts such as prepaid insurance, office supplies, prepaid rent have been paid in advance and recorded as assets. These should be expensed as used.
- Liabilities
 - A unique liability may be created when services are paid in advance for something the business has not yet done. This receipt of cash increased the cash account and a liability called *Unearned Revenue* which remains in this account until “earned”. As it is “earned” it is transferred out of this account and into Revenue.

Adjusting Entries,

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- Accrued Expense
 - These are expenses that have been *incurred*, but *not yet paid*.
- Accrued Revenue
 - A job will not be completed for several months and the business won't get paid until the end of the job. At the end of the first month, an adjusting entry is needed for the amount of earnings in the current month, even though the job is not yet completed and no bill has been sent.

Adjusting Entries, Page 6 of 11

Business Name: _____		Date _____
Trial Balance		
	Debit	Credit
Cash	1000.00	
Accounts Receivable	5000.00	
Prepaid Insurance	600.00	
Office Supplies	400.00	
Equipment	10000.00	
Automobiles	24000.00	
Buildings	80000.00	
Land	25000.00	
Accounts Payable		25000.00
Notes Payable		15000.00
Unearned Revenue		1500.00
Mortgage Payable		80000.00
Capital		27500.00
Withdrawals	12000.00	
Revenue (earnings)		90000.00
Wage Expense	48000.00	
Utilities Expense	12000.00	
Advertising Expense	6000.00	
Repair Expense	15000.00	
TOTAL	239000.00	239000.00

This sample trial balance will be used to demonstrate end-of-month/period adjusting entries for:

- Current Assets
- Long-Term Assets
- Current Liabilities
- Accrued Expense
- Accrued Revenue

While each of the examples are separate, all of these that are applicable would be made and an Adjusted Trial Balance prepared.

Adjustments will appear in blue.

Adjusting Entries, Page 7 of 11

Adjusting Current Assets:

Business Name: Adjusted Trial Balance	Date _____	
	Debit	Credit
Cash	1000.00	
Accounts Receivable	5000.00	
Prepaid Insurance	600.00	
Office Supplies	400.00 300.00	
Equipment	10000.00	
Automobiles	24000.00	
Buildings	80000.00	
Land	25000.00	
Accounts Payable		25000.00
Notes Payable		15000.00
Unearned Revenue		1500.00
Mortgage Payable		80000.00
Capital		27500.00
Withdrawals	12000.00	
Revenue (earnings)		90000.00
Wage Expense	48000.00	
Office Supplies Expense	100.00	
Utilities Expense	12000.00	
Advertising Expense	6000.00	
Repair Expense	15000.00	
TOTAL	239000.00	239000.00

Date			P.R.	Debit	Credit
Dec	31	Office Supplies Exp		100	
		Office Supplies			100

Current assets are adjusted by removing the used amount from the asset account and transferring it to the expense account.

Adjusting Entries, Page 8 of 11

Adjusting Long-Term Assets:

Date			P.R.	Debit	Credit
Dec	31	Depreciation Expense, Equip	J16	2000	
		Accumulated Depreciation	J17		2000
Dec	31	Depreciation Expense, Auto	J18	5000	
		Accumulated Depreciation	J19		5000
Dec	31	Depreciation Expense, Bldg	J20	4000	
		Accumulated Depreciation	J21		4000

Long-term assets need to be adjusted for the amount of depreciation (use) for the accounting period. AN account called Accumulated Depreciation is used. This account is a contra-asset account (credit balance) instead of a the normal debit balance of an asset.

The difference between cost and depreciation is known as *book value*. (e.g., equip cost 10000 – 2000 depreciation = 8000 book value.)

Business Name: _____		Date _____
Adjusted Trial Balance		
	Debit	Credit
Cash	1000.00	
Accounts Receivable	5000.00	
Prepaid Insurance	600.00	
Office Supplies	400.00	
Equipment	10000.00	
Accumulated Depreciation		2000.00
Automobiles	24000.00	
Accumulated Depreciation		5000.00
Buildings	80000.00	
Accumulated Depreciation		4000.00
Land	25000.00	
Accounts Payable		25000.00
Notes Payable		15000.00
Unearned Revenue		1500.00
Mortgage Payable		80000.00
Capital		27500.00
Withdrawals	12000.00	
Revenue (earnings)		90000.00
Wage Expense	48000.00	
Utilities Expense	12000.00	
Advertising Expense	6000.00	
Repair Expense	15000.00	
Depreciation Expense	2000.00	
Depreciation Expense	5000.00	
Depreciation Expense	4000.00	
TOTAL	239000.00	239000.00

Adjusting Entries, Page 9 of 11

Adjusting Current Liabilities:

Business Name: Adjusted Trial Balance	Date _____	
	Debit	Credit
Cash	1000.00	
Accounts Receivable	5000.00	
Prepaid Insurance	600.00	
Office Supplies	400.00	
Equipment	10000.00	
Automobiles	24000.00	
Buildings	80000.00	
Land	25000.00	
Accounts Payable		25000.00
Notes Payable		15000.00
Unearned Revenue		1500.00
		1000.00
Mortgage Payable		80000.00
Capital		27500.00
Withdrawals	12000.00	
Revenue (earnings)		90000.00
		90500.00
Wage Expense	48000.00	
Utilities Expense	12000.00	
Advertising Expense	6000.00	
Repair Expense	15000.00	
TOTAL	239000.00	239000.00

Date			P.R.	Debit	Credit
Dec	31	Unearned Revenue		500	
		Revenue			500

Earnings of \$500 are recorded as revenue from the liability account. The liability account was created when the company received cash in advance, but had not earned the amount. When the amount is earned, it is transferred to the revenue account.

Adjusting Entries, Page 10 of 11

Adjusting Accrued Expense:

Business Name: Adjusted Trial Balance	Date _____	
	Debit	Credit
Cash	1000.00	
Accounts Receivable	5000.00	
Prepaid Insurance	600.00	
Office Supplies	400.00	
Equipment	10000.00	
Automobiles	24000.00	
Buildings	80000.00	
Land	25000.00	
Accounts Payable		25000.00
Wage Payable		1500.00
Notes Payable		15000.00
Unearned Revenue		1500.00
Mortgage Payable		80000.00
Capital		27500.00
Withdrawals	12000.00	
Revenue (earnings)		90000.00
Wage Expense	48000.00	
	49500.00	
Utilities Expense	12000.00	
Advertising Expense	6000.00	
Repair Expense	15000.00	
TOTAL	239000.00	239000.00

Date			P.R.	Debit	Credit
Dec	31	Wage Expense		1500	
		Wage Payable			1500

This entry would be made by a company that pays payroll on the 5th and 20th of the month. The last days of the month would be recorded as a payable, because the expense had been incurred, but the company will not make a payment until the 5th.

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Adjusting Accrued Revenue:

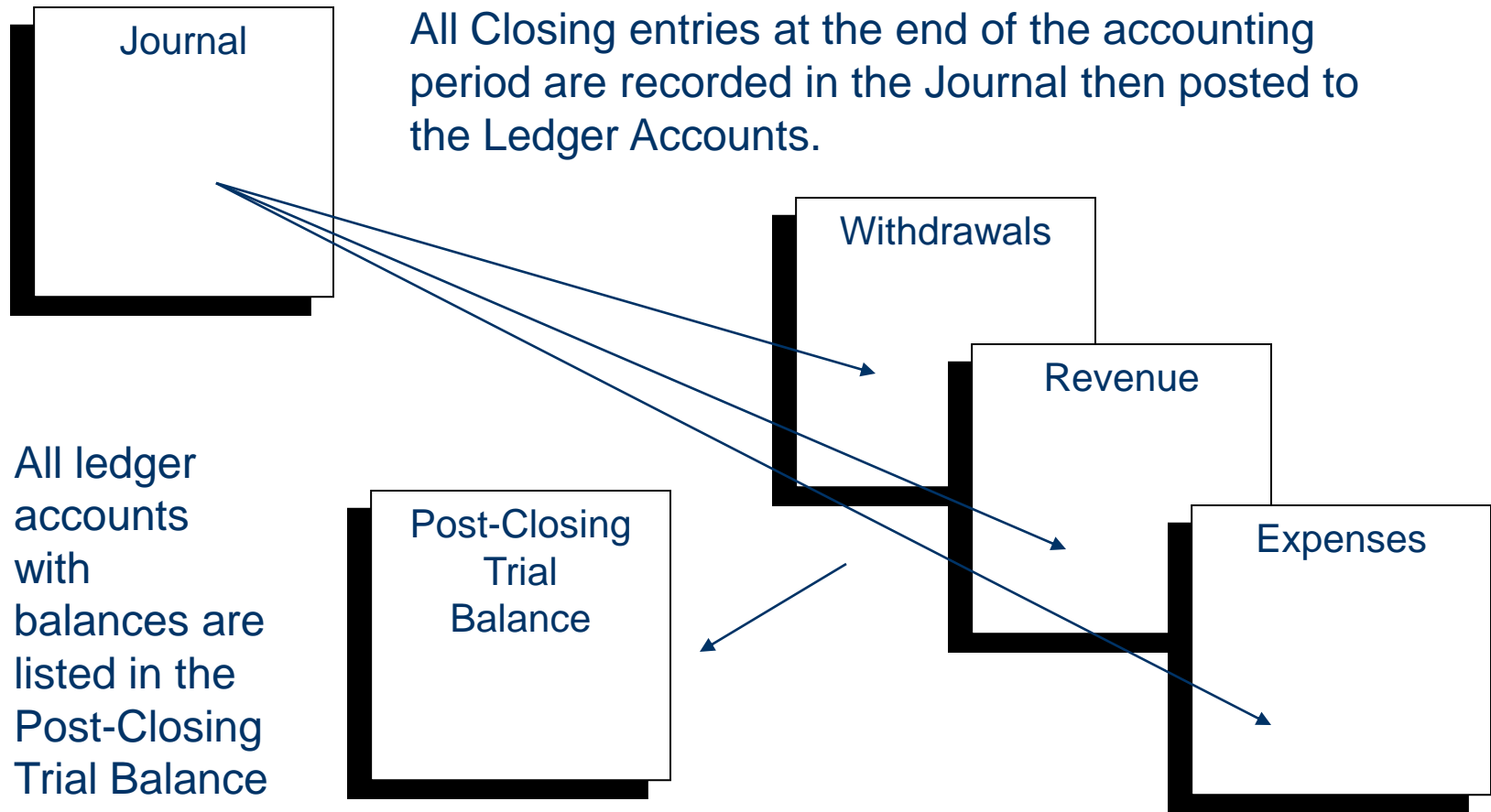
Business Name: Adjusted Trial Balance	Date _____	
	Debit	Credit
Cash	1000.00	
Accounts Receivable	5000.00	
	6000.00	
Prepaid Insurance	600.00	
Office Supplies	400.00	
Equipment	10000.00	
Automobiles	24000.00	
Buildings	80000.00	
Land	25000.00	
Accounts Payable		25000.00
Notes Payable		15000.00
Unearned Revenue		1500.00
Mortgage Payable		80000.00
Capital		27500.00
Withdrawals	12000.00	
Revenue (earnings)		90000.00
		91000.00
Wage Expense	48000.00	
Utilities Expense	12000.00	
Advertising Expense	6000.00	
Repair Expense	15000.00	
TOTAL	239000.00	239000.00

Date			P.R.	Debit	Credit
Dec	31	Accounts Receivable		1000	
		Revenue			1000

This entry is made for a job that is not completed by the end of the accounting period, but needs to be recorded since the service was performed in the accounting period.

Closing Entries,

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Closing Entries,

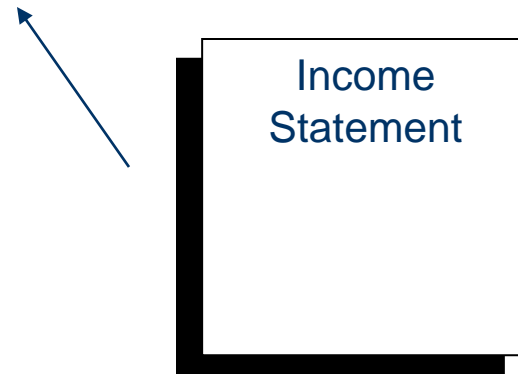
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- At the end of each month, the revenue, expense and withdrawal accounts are closed to zero balance
- Closing entries move the difference between revenue and expense from the income statement to net worth (owner's equity)

Closing Entries,

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- Assets = Liabilities + Net Worth



The Balance Sheet equation can not balance without the amount of profit or loss from the Income Statement

Closing Entries,

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- All revenue accounts start over at the end of each month. The revenue accounts are closed to the Expense and Income Summary
- All expense accounts are closed into the Expense and Income Summary
- The Expense and Income Summary account is closed to equity
- The Withdrawal Account is closed to equity

Additional Information,

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- Basic Accounting *Training* Part 1, covers:

- Business Types
- Business Organization
- Professional Advice
- Accounting and Records
- Accrual Accounting
- Basic Bookkeeping
- Chart of Accounts
- Double-Entry Accounting
- Debits & Credits
- The Journal
- The Ledger

Additional Information,

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- Basic Accounting *Training* Part 3, covers:
 - Balance Sheet
 - Income Statement
 - Analyzing financial reports