THE ABCs OF Accounting

# Lesson 4: Working with The Accounting Cycle

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# Lesson Objectives

- After studying this lesson, you will be able to:
  - Describe the first three steps in the Accounting Cycle
  - Explain what source documents are and why they are needed
  - Explain the journal and how the entries are created
  - Describe the steps in the analysis of a business transaction
  - Create compound and correcting entries in business transactions

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# Introducing the Accounting Cycle

- Accounting records produce financial information
- Records are kept for a period of time: fiscal period
- The Accounting Cycle covers one full fiscal period
- A fiscal period can be any length of time
- January 1 – December 31 (Standard)
- July 1 - June 30 (Government, Educational Institutions)

# The Accounting Cycle: Steps 1-4

- Collect source documents; verify information
- Analyze the business transactions
- Record the transactions in a journal
- Post each journal entry to the ledger accounts

# The Accounting Cycle: Steps 5-9

- Prepare the trial balance
- Prepare a worksheet
- Generate the financial statements
- Journalize and post closing entries
- Prepare the post-closing trial balance

# Who uses this information?

- Business owner
- Bookkeeper
- Banks
- Government officials
- Investors
- Employees

# Generally Accepted Accounting Principles (GAAP)

- Accounting rules used to prepare, present, and report financial statements for a wide variety of entities
- Rules are created by FASB (Financial Accounting Standards Board)

# Why use GAAP?

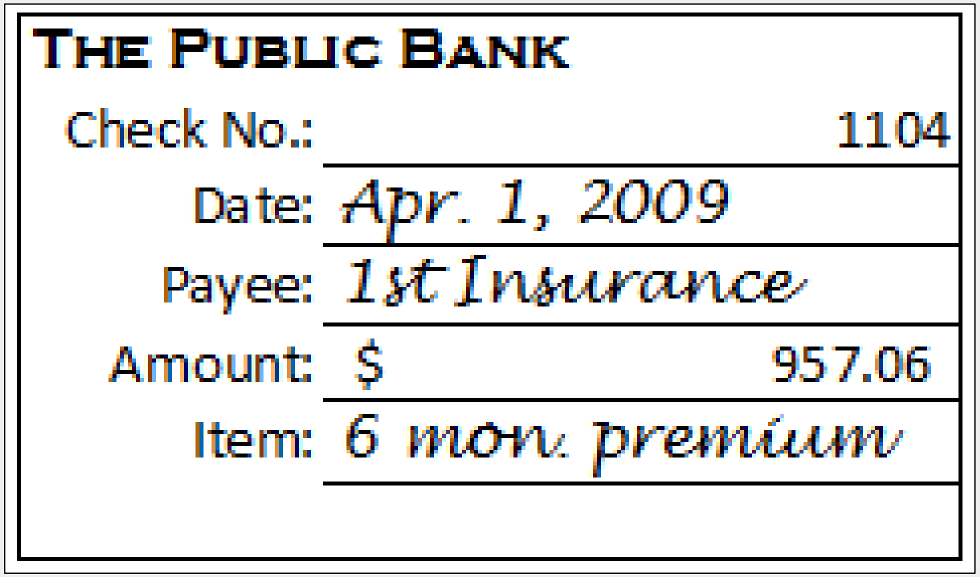
- Publicly owned companies need to follow these rules unless they can show that doing so would produce information that is misleading
- Makes taxation fair, as it affects small-business owners

# GAAP

- Business Entity Principle
- Assumption of the going concern
- Monetary unit principle
- Time-period principle
- Cost principle
- Revenue Principle
- Matching Principle
- Objectivity Principle
- Materiality Principle
- Consistency Principle
- Prudence Principle

# Step 1: Collect and Verify Source Documents

- When a business transactions occurs, the evidence is found in the source documents: Verify the accuracy
- Receipt, memorandum, check stub


THE PUBLIC BANK

Check No.: 1104

Date: Apr. 1, 2009

Payee: 1st Insurance

Amount: $ 957.06

Item: 6 mon. premium

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# Step 2: Analyze the Business Transactions

- Which accounts are involved?
- What is the classification of those accounts?
- Which account is debited?
- For what amount?
- Which account is credited?
- For what amount?

# Example

- James Rohr took $35,000 from Savings and invested in his new landscaping business – What is the completed entry in T account form?

| Cash | | J. Rohr, Capital | |
|---|---|---|---|
| + | - | - | + |
| 35,000 | | | 35,000 |



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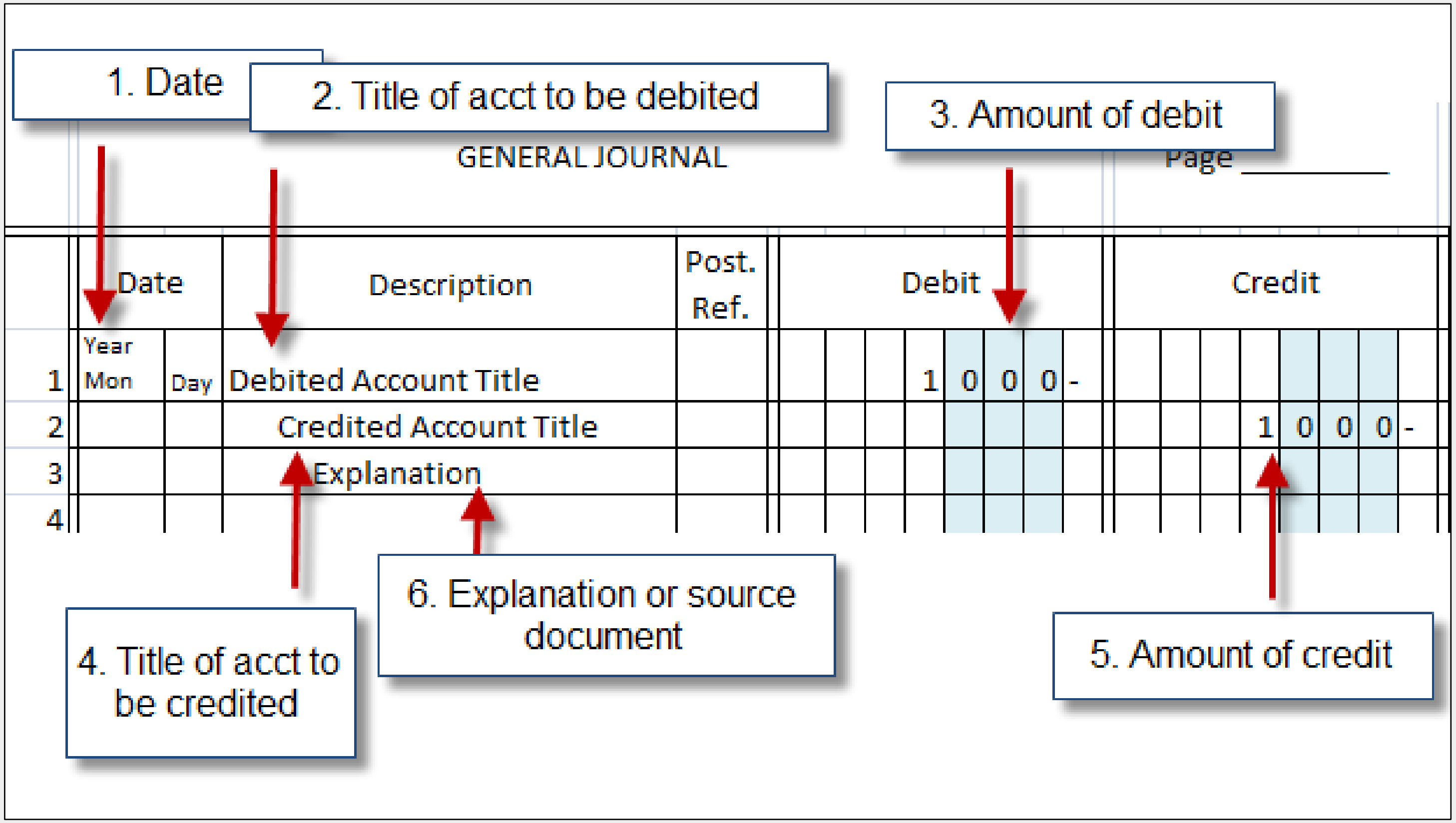
# Step 3: Record the transactions in a Journal

- Each entry includes the following information:
  - The date of the transaction
  - The title of the account to be debited
  - The amount of the debit
  - The title of the account to be credited
  - The amount of the credit
  - A reference to the source document or a brief explanation

# Journal entry format



# Example: J. Rohr, Business Investment

- James Rohr invested $35,000 in his new business

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| | Date | | Description | Post. Ref. | Debit | Credit |
|---|---|---|---|---|---|---|
| | 2009 | | | | | |
| 1 | April | 1 | Cash | | 3 5 0 0 0 - | |
| 2 | | | James Rohr, Capital | | | 3 5 0 0 0 - |

# Compound Entry

- He has more than one debit and one credit entry

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|---|---|---|---|---|---|
| | Date | | Description | Post. Ref. | Debit | Credit |
| | 2009 | | | | | |
| 1 | Apr. | 3 | Landscaping Equipment | | 15000 - | |
| 2 | | | Cash | | | 3500 - |
| 3 | | | Accounts Payable | | | 11500 - |
| 4 | | | Purchase of Chipper | | | |

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# Correcting Entry

- An error is made:
  - Wrong account number
  - Wrong account name
  - Wrong amount

# How to correct the error:

- If discovered before posting, cross out incorrect item and write the correct data above it. DO NOT ERASE.

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| | Date | | Description | Post. Ref. | Debit | Credit |
|---|---|---|---|---|---|---|
| | 2009 | | | | | |
| 1 | Apr | 3 | Shop ~~Office~~ Equipment | 140 ~~135~~ | 7500 - | |
| 2 | | | Cash | 103 | | 7500 - |
| 3 | | | Purchased Equipment | | | |
| 4 | | | Check #147. | | | |
| 5 | | | | | | |

# If an error was posted . . .

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| | Date | | Description | Post. Ref. | Debit | Credit |
|---|---|---|---|---|---|---|
| 1 | 2009 | | | | | |
| 2 | Apr | 3 | Office Equipment | 135 | 7 5 0 0 -- | |
| 3 | | | Cash | 103 | | 7 5 0 0 -- |
| 4 | | | Purchased equipment | | | |
| 5 | | | Check #1475 | | | |
| 6 | | | | | | |

**The equipment was purchased for the shop. It was posted to the wrong account.**

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# A correcting entry must be made

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| | Date | | Description | Post. Ref. | Debit | Credit |
|---|---|---|---|---|---|---|
| 1 | 2009 | | | | | |
| 2 | Apr | 4 | Shop Equipment | 140 | 7 5 0 0 -- | |
| 3 | | | Office Equipment | 135 | | 7 5 0 0 -- |
| | | | To Correct error made on | | | |
| 5 | | | Apr. 4 when a purchase of | | | |
| 6 | | | Shop Equipment was recorded | | | |
| 7 | | | as Office Equipment | | | |

**The equipment is posted to Shop Equipment and credited to Office Equipment. This corrects the incorrect entry posted previously.**

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# Summary

- The accounting cycle tracks the financial information of a business
- Source documents, verifying information, analyzing business transactions, and entering the information in the journal
- Compound entries and correcting entries



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