

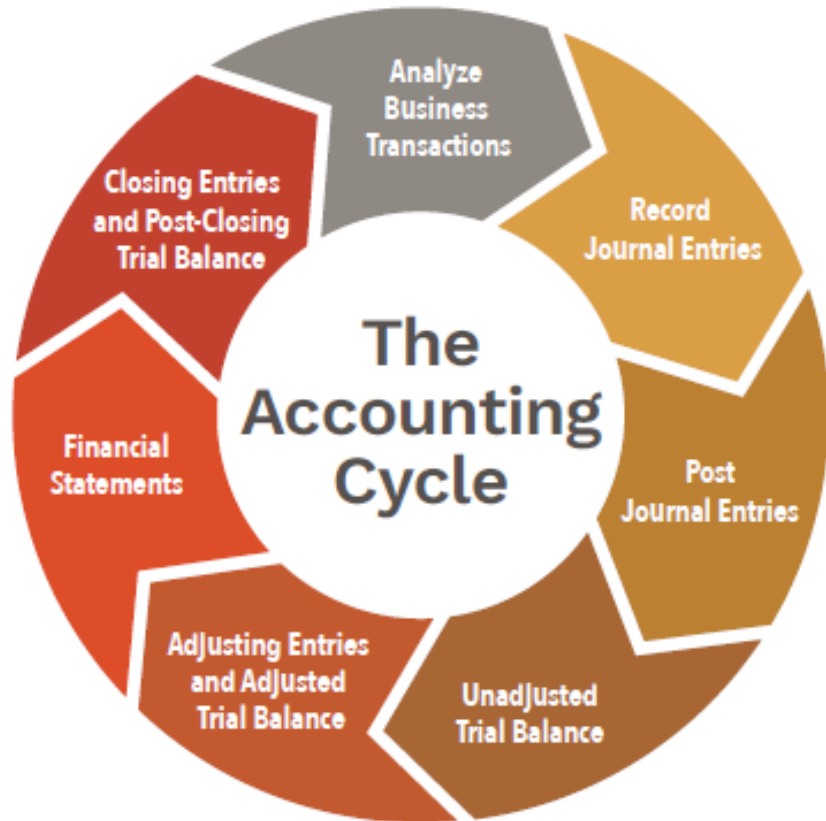
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The Accounting Cycle

LEARNING OBJECTIVES

- Explain the concept of posting journal entries
- Identify the purpose of a trial balance
- Distinguish between adjusting entries and closing entries
- Discuss the four primary financial statements

The Accounting Cycle



- **Step 1:** Analyze business transactions
- **Step 2:** Record journal entries
- **Step 3:** Post journal entries
- **Step 4:** Unadjusted trial balance
- **Step 5:** Adjusting entries and adjusted trial balance
- **Step 6:** Financial statements
- **Step 7:** Closing entries and post-closing trial balance

Source Documents

- **Invoice:** A bill for goods or services
- **Cheque:** Provides information regarding payment from a customer or to a supplier
- **Bank statement:** Outlines monthly bank activity
- **Purchase order:** Sent to the seller to indicate a desire to purchase items
- **Sales order:** Prepared by the seller upon receipt of a purchase order

Generally Accepted Accounting Principles

- **Cost principle:** Every asset must be recorded at the amount paid for the item.
- **Time-period principle:** Accounting activity may be expressed over a specific period of time.
- **Revenue principle:** Revenue must be recorded in the period in which it is earned.
- **Matching principle:** Expenses must be recorded in the same period as the revenue they generate.

Generally Accepted Accounting Principles (cont.)

- **Monetary unit principle:** Balances, shown in CDN dollars or other applicable local currency, can be used to express company performance.
- **Full disclosure principle:** Public companies must disclose all pertinent information.

Potential Account Balance Errors

- Amount incorrectly copied from a source document
- Transaction recorded using the wrong account
- Digit transposition (such as \$250 instead of \$520)
- Omission of a transaction
- Recording a single transaction multiple times

Accrual Basis of Accounting

- Revenue is recorded when earned, regardless of when cash changes hands.
- Expenses are recorded when incurred, regardless of when cash changes hands.
- This accounting basis:
 - is compliant with GAAP
 - requires adjusting entries

Cash Basis of Accounting

- Revenue is recorded when cash changes hands, regardless of when it is earned.
- Expenses are recorded when cash changes hands, regardless of when they are incurred.
- This accounting basis:
 - is not compliant with GAAP
 - eliminates the need for adjusting entries

Financial Statements

- **Income statement:** This displays ending balances for all revenue and expense accounts.
 - aka profit and loss statement
- **Statement of owner's equity:** This is a reconciliation summarizing activity related to owner's equity.
 - aka statement of capital, statement of retained earnings
- **Balance sheet:** This displays all asset, liability and owner's equity account balances.
- **Statement of cash flows:** This summarizes all uses and sources of cash.

Financial Statement Users

- **Internal users:** Work with the company
 - Finance professionals
 - Marketing professionals
 - Internal auditors
- **External users:** Work outside the company
 - Potential investors
 - Governmental agencies
 - Potential lenders

Permanent Accounts

The ending balance for one year becomes the beginning balance for the subsequent year.

- Asset accounts
- Liability accounts
- Owner's capital account

Temporary Accounts

The ending balance is closed to the owner's capital account. Begin each period with a \$0 balance.

- Revenue accounts
- Expense accounts
- Owner's withdrawal account