Chapter 2 - Accounting Cycle

Learning Outcomes

- Describe general ledger, double-entry accounting system, how debits and credits are looked at in T-accounts, and normal balances
- Define and describe the expanded accounting equation and its relationship to analyzing transactions
- Define and describe the initial steps in the accounting cycle
- Analyze business transactions using the accounting equation and show the impact of business transactions on financial statements
- Use journal entries to record transactions and post to T-Accounts
- Prepare a trial balance
- Explain the concepts and guidelines affecting adjusting entries
- Discuss the adjustment process and illustrate common types of adjusting entries
- Prepare financial statements using the adjusted trial balance

2.1 Creating Accounting Transactions

If you want to start your own business, you need to maintain detailed and accurate records of business performance in order for you, your investors, and your lenders, to make informed decisions about the future of your company. Financial statements are created with this purpose in mind. A set of financial statements includes the income statement, statement of owner's equity, balance sheet, and statement of cash flows. This chapter explains the relationship between financial statements and several steps in the accounting process.

The Accounting Equation

The last chapter briefly discussed the accounting equation, which is important to the study of accounting because it shows what the organization owns and the sources of (or claims against) those resources. The accounting equation is expressed as follows:

Assets = Liabilities + Owner's Equity

Double-Entry Bookkeeping

The basic components of even the simplest accounting system are accounts and a general ledger. An **account** is a record showing increases and decreases to assets, liabilities, and equity—the basic components found in the accounting equation. Each of these categories includes many individual accounts, all of which a company maintains in

its general ledger. A **general ledger** is a comprehensive listing of all of a company's accounts with their individual balances.

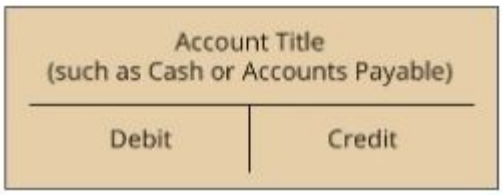
Accounting is based on what we call a **double-entry accounting system**, which requires the following:

- Each time we record a transaction, we must record a change in at least two different accounts. Having two or more accounts changed will allow us to keep the accounting equation in balance.
- Not only will at least two accounts change, but there must also be at least one debit and one credit side impacted.
- The sum of the debits must equal the sum of the credits for each transaction.

In order for companies to record the myriad of transactions they have each year, there is a need for a simple but detailed system. Journals are useful tools to meet this need.

Debits and Credits

Each account can be represented visually by splitting the account into left and right sides as shown. This graphic representation of a general ledger account is known as a **T-account**. A T-account is called a T-account because it looks like a T, as you can see with the T-account shown here.



A **debit** records financial information on the left side of each account. A credit records financial information on the right side of an account. One side of each account will increase and the other side will decrease. The **ending account balance** is found by calculating the difference between debits and credits for each account. You will often see the terms debit and credit represented in shorthand, written as DR or dr and CR or cr, respectively. Depending on the account type, the sides that increase and decrease may vary. We can illustrate each account type and its corresponding debit and credit effects in the form of an expanded accounting equation.

								Equity											
Assets		=	Liabilities		+	Common Stock		–	Dividends		+	Revenues		–	Expenses			
Debit	Credit		Debit	Credit		Debit	Credit		Debit	Credit		Debit	Credit		Debit	Credit		
Increase	Decrease		Decrease	Increase		Decrease	Increase		Increase	Decrease		Decrease	Increase		Increase	Decrease		

As we can see from this expanded accounting equation, Assets accounts increase on the debit side and decrease on the credit side. This is also true of Dividends and Expenses accounts. Liabilities increase on the credit side and decrease on the debit side. This is also true of Common Stock and Revenues accounts. This becomes easier to understand as you become familiar with the normal balance of an account.

Normal Balance of an Account

The **normal balance** is the expected balance each account type maintains, which is the side that increases. As assets and expenses increase on the debit side, their normal balance is a debit. Dividends paid to shareholders also have a normal balance that is a debit entry. Since liabilities, equity (such as common stock), and revenues increase with a credit, their normal balance is a credit. Table 3.1 shows the normal balances and increases for each account type.

Account Normal Balances and Increases		
Type of account	Increases with	Normal balance

Asset	Debit	Debit
Liability	Credit	Credit
Common Stock	Credit	Credit
Dividends	Debit	Debit
Revenue	Credit	Credit
Expense	Debit	Debit

Table 3.1

2.2 Building Upon The Accounting Equation

As you have learned, the accounting equation represents the idea that a company needs assets to operate, and there are two major sources that contribute to operations: liabilities and equity. The company borrows the funds, creating liabilities, or the company can take the funds provided by the profits generated in the current or past periods, creating retained earnings or some other form of stockholder's equity. Recall the accounting equation's basic form.

Assets = Liabilities + Equity

Expanded Accounting Equation

The **expanded accounting equation** breaks down the equity portion of the accounting equation into more detail. This expansion of the equity section allows a company to see the impact to equity from changes to revenues and expenses, and to owner investments and payouts. The expanded accounting equation is shown here.

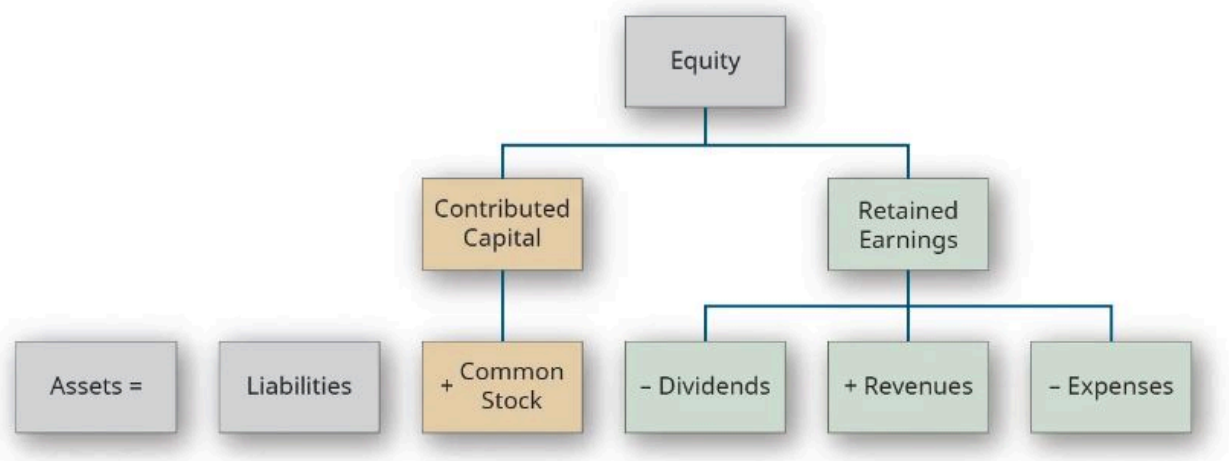


Figure 3.3 Expanded Accounting Equation. (attribution: Copyright Rice University, OpenStax, under CC BY-NC-SA 4.0 license)

Note that this expanded accounting equation breaks down Equity into four categories: common stock, dividends, revenues, and expenses. This considers each element of contributed capital and retained earnings individually to better illustrate each one's impact on changes in equity.

Chart of Accounts

Recall that the basic components of even the simplest accounting system are accounts and a general ledger. Accounts show all the changes made to assets, liabilities, and equity—the three main categories in the accounting equation. Each

of these categories, in turn, includes many individual accounts, all of which a company maintains in its general ledger.

When a company first starts the analysis process, it will make a list of all the accounts used in day-to-day transactions. For example, a company may have accounts such as cash, accounts receivable, supplies, accounts payable, unearned revenues, common stock, dividends, revenues, and expenses. Each company will make a list that works for its business type, and the transactions it expects to engage in. The accounts may receive numbers using the system presented in Table 3.2.

Account Numbering System			
Account category	**Assigned account number will start with**	**Account numbers for a small company**	**Account numbers for a large company**
Assets	1	100–199	1000–1999
Liabilities	2	200–299	2000–2999
Stockholders' equity	3	300–399	3000–3999
Revenues	4	400–499	4000–4999
Expenses	5	500–599	5000–5999

Table 3.2

We call this account numbering system a **chart of accounts**.

Breaking Down the Expanded Accounting Equation

Refer to the expanded accounting equation (Figure 3.3). We begin with the left side of the equation, the assets, and work toward the right side of the equation to liabilities and equity.

Assets and the Expanded Accounting Equation

On the left side of the equation are assets. Assets are resources a company owns that have an economic value and will provide a future benefit. Assets are represented on the balance sheet. Some common examples of assets are cash, accounts receivable, inventory, supplies, prepaid expenses, notes receivable, equipment, buildings, machinery, and land.

Cash includes paper currency as well as coins, checks, bank accounts, and money orders. Anything that can be quickly liquidated into cash is considered cash. Cash activities are a large part of any business, and the flow of cash in and out of the company is reported on the statement of cash flows.

Accounts receivable is money that is owed to the company, usually from a customer. The customer has not yet paid with cash for the provided good or service but will do so in the future. Common phrasing to describe this situation is that a customer purchased something on account, meaning that the customer has asked to be billed and will pay at a later date; Account because a customer has not paid us yet but instead has asked to be billed; Receivable because we will receive the money in the future.

Inventory refers to the goods available for sale. Service companies do not have goods for sale and would thus not have inventory. Merchandising and manufacturing businesses do have inventory. Examples of supplies (office supplies) include pens, paper, and pencils. Supplies are considered assets until an employee uses them. At the point they are used, they no longer have an economic value to the organization, and their cost is now an expense to the business.

Prepaid expenses are items paid for in advance of their use. They are considered assets until used. Some examples can include insurance and rent. Insurance, for example, is usually purchased for more than one month at a time (six months typically). The company does not use all six months of the insurance at once, it uses it one month at a time. However, the company prepays for all of it up front. As each month passes, the company will adjust its records to reflect the cost of one month of insurance usage.

Equipment examples include desks, chairs, and computers; anything that has a long-term value to the company that is used in the office. Equipment is considered a long-term asset, meaning you can use it for more than one accounting period (a year for example). Equipment will lose value over time, in a process called depreciation.

Buildings, machinery, and land are all considered long-term assets. Machinery is usually specific to a manufacturing company that has a factory producing goods. Machinery and buildings also depreciate. Unlike other long-term assets such as machinery, buildings, and equipment, land is not depreciated.

Liabilities and the Expanded Accounting Equation

The accounting equation emphasizes a basic idea in business; that is, businesses need assets in order to operate. There are two ways a business can finance the purchase of assets. First, it can sell shares of its stock to the public to raise money to purchase the assets, or it can use profits earned by the business to finance its activities. Second, it can borrow money from a lender such as a financial institution. Liabilities are obligations to pay an amount owed to a lender (creditor) based on a past transaction. Liabilities are reported on the balance sheet. It is important to understand that when we talk about liabilities, we are not just talking about loans. Money collected for gift cards, subscriptions, or as advance deposits from customers could also be liabilities. Essentially, anything a company owes and has yet to pay within a period is considered a liability, such as salaries, utilities, and taxes.

For example, a company uses $400 worth of utilities in May but is not billed for the usage, or asked to pay for the usage, until June. Even though the company does not have to pay the bill until June, the company owed money for the usage that occurred in May. Therefore, the company must record the usage of electricity, as well as the liability to pay the utility bill, in May.

Eventually that debt must be repaid by performing the service, fulfilling the subscription, or providing an asset such as merchandise or cash. Some common examples of liabilities include accounts payable, notes payable, and unearned revenue.

Accounts payable recognizes that the company owes money and has not paid. Remember, when a customer purchases something on account, it means the customer has asked to be billed and will pay at a later date. In this case the purchasing company is the customer. The company will have to pay the money due in the future, so we use the word payable. The debt owed is usually paid off in less than one accounting period (less than a year typically) if it is classified as an account payable.

A note payable is similar to accounts payable in that the company owes money and has not yet paid. Some key differences are that the contract terms are usually longer than one accounting period, interest is included, and there is typically a more formalized contract that dictates the terms of the transaction.

Unearned revenue represents a customer's advanced payment for a product or service that has yet to be provided by the company. Since the company has not yet provided the product or service, it cannot recognize the customer's payment as revenue, according to the revenue recognition principle. Thus, the account is called unearned revenue. The company owing the product or service creates the liability to the customer.

Equity and the Expanded Accounting Equation

Stockholder's equity refers to the owner's (stockholders) investments in the business and earnings. These two components are contributed capital and retained earnings.

The owner's investments in the business typically come in the form of common stock and are called **contributed capital**. The company will issue shares of common stock to represent stockholder ownership.

Another component of stockholder's equity is company earnings. These retained earnings are what the company holds onto at the end of a period to reinvest in the business either by acquiring more assets or paying off liabilities, after any distributions to ownership occur. Distribution of earnings to ownership is called a dividend. The dividend could be paid with cash or other assets or be a distribution of more company stock to current shareholders. Either way, dividends will

decrease retained earnings. Dividends are considered a contra equity account. An account is a **contra account** if its normal balance is opposite of the normal balance of the category to which it belongs. The normal balance for the equity category is a credit balance whereas the normal balance for dividends is a debit balance resulting in dividends reducing total equity.

Also affecting retained earnings are revenues and expenses, by way of net income or net loss. Revenues are earnings from the sale of goods and services. An increase in revenues will also contribute toward an increase in retained earnings. Expenses are the cost of resources associated with earning revenues. An increase to expenses will contribute toward a decrease in retained earnings. Some examples of expenses include payments for utilities, employee salaries, and loan interest expense. A business does not have an expense until it is incurred. Incurred means the resource is used or consumed. For example, you will not recognize utilities as an expense until you have used the utilities. The difference between revenues earned and expenses incurred is called net income (loss) and can be found on the income statement.

Net income reported on the income statement flows into the statement of retained earnings. If a business has net income (earnings) for the period, then this will increase its retained earnings for the period. This means that revenues exceed expenses for the period, thus increasing retained earnings. If a business has net loss for the period, this decreases retained earnings for the period. This means that the expenses exceeded the revenues for the period, thus decreasing retained earnings.

You will notice that stockholder's equity increases with common stock issuance and revenues, and decreases from dividend payouts and expenses. Stockholder's equity is reported on the balance sheet in the form of contributed capital (common stock) and retained earnings. The statement of retained earnings computes the retained earnings balance at the beginning of the period, adds net income or subtracts net loss from the income statement, and subtracts dividends declared, to result in an ending retained earnings balance reported on the balance sheet.

Now that you have a basic understanding of the accounting equation, and examples of assets, liabilities, and stockholder's equity, you will be able to analyze the many transactions a business may encounter and determine how each transaction affects the accounting equation and corresponding financial statements.

2.3 The Accounting Cycle

The accounting cycle is a step-by-step process to record business activities and events to keep financial records up to date. The process occurs over one accounting period and will begin the cycle again in the following period. A period is one operating cycle of a business, which could be a month, quarter, or year.



As you can see, the cycle begins with identifying and analyzing transactions, and culminates in closing entries. The entire cycle is meant to keep financial data organized and easily accessible to both internal and external users of information. In this section, we focus on the first four steps in the accounting cycle: identify and analyze transactions, record transactions to a journal, post journal information to a ledger, and prepare a trial balance.

First Steps in the Accounting Cycle

The first four steps in the accounting cycle are (1) identify and analyze transactions, (2) record transactions to a journal, (3) post journal information to a ledger, and (4) prepare an unadjusted trial balance. We begin by introducing the steps and their related documentation.

Step 1. Identifying and analyzing transactions is the first step in the process. This takes information from original sources or activities and translates that information into usable financial data. An **original source** is a traceable record of information that contributes to the creation of a business transaction. For example, a sales invoice is considered an original source. Activities would include paying an employee, selling products, providing a service, collecting cash, borrowing money, and issuing stock to company owners. Once the original source has been identified, the company will analyze the information to see how it influences financial records.

Let's say that Mark Summers of Supreme Cleaners provides cleaning services to a customer. He generates an invoice for $200, the amount the customer owes, so he can be paid for the service. This sales receipt contains information such as how much the customer owes, payment terms, and dates. This sales receipt is an original source containing financial information that creates a business transaction for the company.

Step 2. The second step in the process is recording transactions to a journal. This takes analyzed data from step 1 and organizes it into a comprehensive record of every company transaction. A **transaction** is a business activity or event that has an effect on financial information presented on financial statements. The information to record a transaction

comes from an original source. A **journal** (also known as the book of original entry or general journal) is a record of all transactions.

For example, in the previous transaction, Supreme Cleaners had the invoice for $200. Mark Summers needs to record this $200 in his financial records. He needs to choose what accounts represent this transaction, whether or not this transaction will increase or decrease the accounts, and how that impacts the accounting equation before he can record the transaction in his journal. He needs to do this process for every transaction occurring during the period.

Step 3. The third step in the process is posting journal information to a ledger. **Posting** takes all transactions from the journal during a period and moves the information to a general ledger. As you've learned, account balances can be represented visually in the form of T-accounts.

Returning to Supreme Cleaners, Mark identified the accounts needed to represent the $200 sale and recorded them in his journal. He will then take the account information and move it to his general ledger. All of the accounts he used during the period will be shown on the general ledger, not only those accounts impacted by the $200 sale.

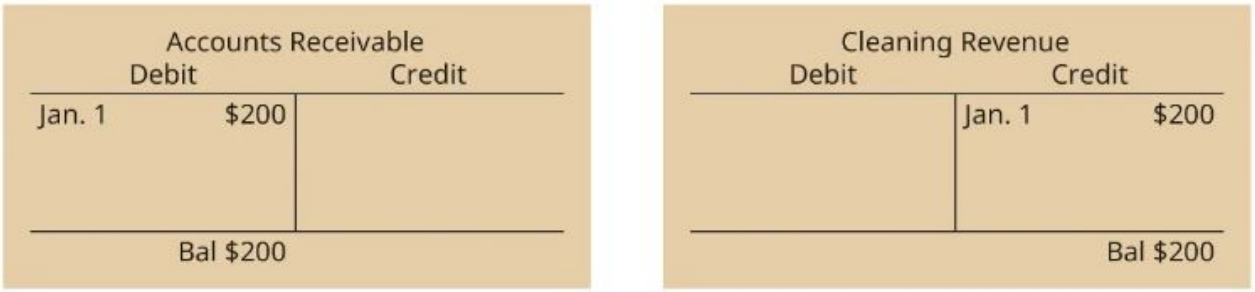


Figure 3.8 General Ledger in T-Account Form. (attribution: Copyright Rice University, OpenStax, under CC BY-NC-SA 4.0 license)

Step 4. The fourth step in the process is to prepare an unadjusted trial balance. This step takes information from the general ledger and transfers it onto a document showing all account balances, and ensuring that debits and credits for the period balance (debit and credit totals are equal).

Mark Summers from Supreme Cleaners needs to organize all of his accounts and their balances, including the $200 sale, onto a trial balance. He also needs to ensure his debits and credits are balanced at the culmination of this step.

SUPREME CLEAN Trial Balance April 30, 2018		
Account Title	**Debit**	**Credit**
Cash	XXX	
Accounts receivable	XXX	
Office supplies	XXX	
Prepaid insurance	XXX	
Equipment	XXX	
Accounts payable		XXX
Unearned cleaning revenue		XXX
Common stock		XXX
Dividends	XXX	
Cleaning revenue		XXX
Gas expense	XXX	
Advertising expense	XXX	
	XXX	XXX

Figure 3.9 Unadjusted Trial Balance. (attribution: Copyright Rice University, OpenStax, under CC BY-NC-SA 4.0 license)

It is important to note that recording the entire process requires a strong attention to detail. Any mistakes early on in the process can lead to incorrect reporting information on financial statements. If this occurs, accountants may have to go all the way back to the beginning of the process to find their error. Make sure that as you complete each step, you are careful and really take the time to understand how to record information and why you are recording it. In the next section, you will learn how the accounting equation is used to analyze transactions.

2.4 Reviewing and Analyzing Transactions

Now, we can consider some of the transactions a business may encounter. We can review how each transaction would affect the basic accounting equation and the corresponding financial statements.

Let us assume our business is a service-based company. We use Lynn Sanders' small printing company, Printing Plus, as our example. Please notice that since Printing Plus is a corporation, we are using the Common Stock account, instead of Owner's Equity. The following are several transactions from this business's current month:

1. Issues $20,000 shares of common stock for cash.
2. Purchases equipment on account for $3,500, payment due within the month.
3. Receives $4,000 cash in advance from a customer for services not yet rendered.
4. Provides $5,500 in services to a customer who asks to be billed for the services.
5. Pays a $300 utility bill with cash.
6. Distributed $100 cash in dividends to stockholders.

We now analyze each of these transactions, paying attention to how they impact the accounting equation and corresponding financial statements.

Transaction 1: Issues $20,000 shares of common stock for cash.

Assets	=	Liabilities	+	Equity
Cash +$20,000				Common Stock +$20,000

Analysis: Looking at the accounting equation, we know cash is an asset and common stock is stockholder's equity. When a company collects cash, this will increase assets because cash is coming into the business. When a company issues common stock, this will increase a stockholder's equity because he or she is receiving investments from owners.

Remember that the accounting equation must remain balanced, and assets need to equal liabilities plus equity. On the asset side of the equation, we show an increase of $20,000. On the liabilities and equity side of the equation, there is also an increase of $20,000, keeping the equation balanced. Changes to assets, specifically cash, will increase assets on the balance sheet and increase cash on the statement of cash flows. Changes to stockholder's equity, specifically common stock, will increase stockholder's equity on the balance sheet.

Transaction 2: Purchases equipment on account for $3,500, payment due within the month.

Assets	=	Liabilities	+	Equity
Equipment +$3,500		Accounts Payable +$3,500		

Analysis: We know that the company purchased equipment, which is an asset. We also know that the company purchased the equipment on account, meaning it did not pay for the equipment immediately and asked for payment to be billed instead and paid later. Since the company owes money and has not yet paid, this is a liability, specifically labeled as accounts payable. There is an increase to assets because the company has equipment it did not have before. There is also an increase to liabilities because the company now owes money. The more money the company owes, the more that liability will increase.

The accounting equation remains balanced because there is a $3,500 increase on the asset side, and a $3,500 increase on the liability and equity side. This change to assets will increase assets on the balance sheet. The change to liabilities will increase liabilities on the balance sheet.

Transaction 3: Receives $4,000 cash in advance from a customer for services not yet rendered.

Assets	=	Liabilities	+	Equity
Cash +$4,000		Unearned Revenue +$4,000		

Analysis: We know that the company collected cash, which is an asset. This collection of $4,000 increases assets because money is coming into the business.

The company has yet to provide the service, so it has not fulfilled the obligation yet. According to the **revenue recognition principle**, the company cannot recognize that revenue until it meets this performance obligation or in other words provides the service. Therefore, the company has a liability to the customer to provide the service and must record the liability as unearned revenue. The liability of $4,000 worth of services increases because the company has more unearned revenue than previously.

The equation remains balanced, as assets and liabilities increase. The balance sheet would experience an increase in assets and an increase in liabilities.

Transaction 4: Provides $5,500 in services to a customer who asks to be billed for the services.

Assets	=	Liabilities	+	Equity
Accounts Receivable +$5,500				Revenue +$5,500

Analysis: The customer asked to be billed for the service, meaning the customer did not give any consideration yet, meaning they did not pay with cash immediately. The customer owes money and has not yet paid, signaling an accounts receivable. Accounts receivable is an asset that is increasing in this case. This customer obligation of $5,500 adds to the balance in accounts receivable.

The company did meet their performance obligation by providing the services. As a result, the revenue recognition principle requires recognition as revenue, which increases equity for $5,500. The increase to assets would be reflected on the balance sheet. The increase to equity would affect three statements. The income statement would see an increase to revenues, changing net income (loss). Net income (loss) is computed into retained earnings on the statement of retained earnings. This change to retained earnings is shown on the balance sheet under stockholder's equity.

Transaction 5: Pays a $300 utility bill with cash.

Assets	=	Liabilities	+	Equity
Cash –$300				Expense –$300

Analysis: The company paid with cash, an asset. Assets are decreasing by $300 since cash was used to pay for this utility bill. The company no longer has that money.

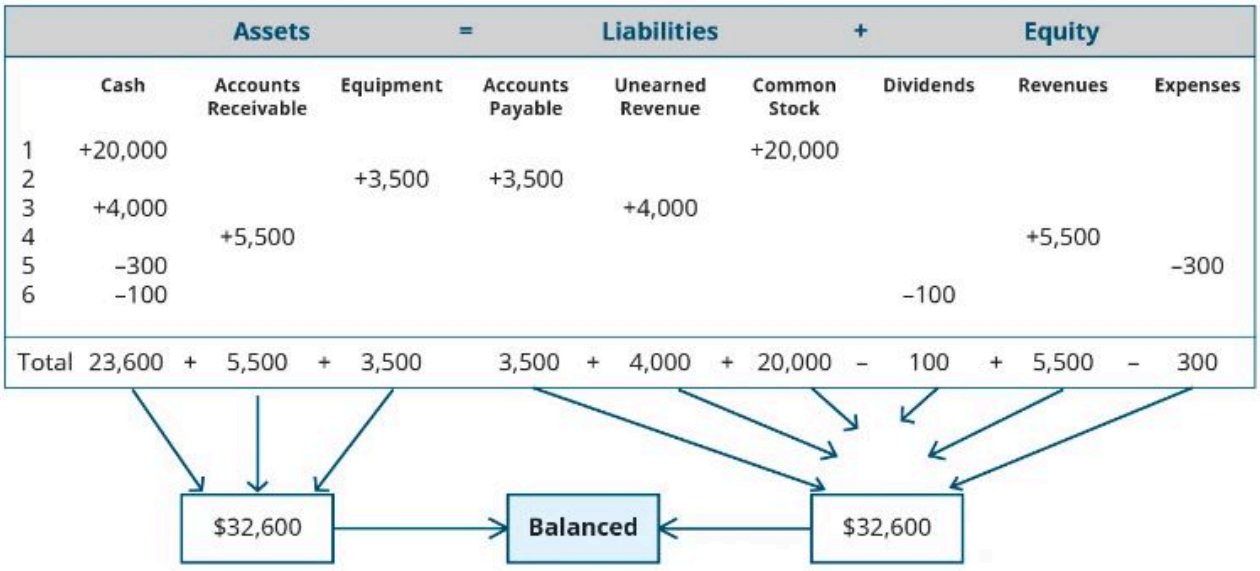
Utility payments are generated from bills for services that were used and paid for within the accounting period, thus recognized as an expense. The expense decreases equity by $300. The decrease to assets, specifically cash, affects the balance sheet and statement of cash flows. The decrease to equity as a result of the expense affects three statements. The income statement would see a change to expenses, changing net income (loss). Net income (loss) is computed into retained earnings on the statement of retained earnings. This change to retained earnings is shown on the balance sheet under stockholder's equity.

Transaction 6: Distributed $100 cash in dividends to stockholders.

Assets	=	Liabilities	+	Equity
Cash –$100				Dividends –$100

Analysis: The company paid the distribution with cash, an asset. Assets decrease by $100 as a result. Dividends affect equity and, in this case, decrease equity by $100. The decrease to assets, specifically cash, affects the balance sheet and statement of cash flows. The decrease to equity because of the dividend payout affects the statement of retained earnings by reducing ending retained earnings, and the balance sheet by reducing stockholder's equity.

Let's summarize the transactions and make sure the accounting equation has remained balanced. Shown are each of the transactions.



As you can see, assets total $32,600, while liabilities added to equity also equal $32,600. Our accounting equation remains balanced. In Use Journal Entries to Record Transactions and Post to T-Accounts, we add other elements to the accounting equation and expand the equation to include individual revenue and expense accounts.

2.5 Use Journal Entries to Record Transactions

Journals

Accountants use special forms called journals to keep track of their business transactions. A journal is the first place information is entered into the accounting system. A journal keeps a historical account of all recordable transactions with which the company has engaged. In other words, a journal is similar to a diary for a business. When you enter information into a journal, we say you are journalizing the entry. Making a journal entry requires the most analytical thought of any process in the Accounting Cycle. Journaling the entry is the second step in the accounting cycle. Here is a picture of a journal.

JOURNAL			
Date	**Account**	**Debit**	**Credit**

You can see that a journal has columns labeled debit and credit. The debit is on the left side, and the credit is on the right. Let's look at how we use a journal.

When filling in a journal, there are some rules you need to follow to improve journal entry organization.

Formatting When Recording Journal Entries

- Include a date of when the transaction occurred.
- The debit account title(s) always come first and on the left.
- The credit account title(s) always come after all debit titles are entered, and on the right.
- The titles of the credit accounts will be indented below the debit accounts.
- You will have at least one debit (possibly more).
- You will always have at least one credit (possibly more).
- The dollar value of the debits must equal the dollar value of the credits or else the equation will go out of balance.
- You will write a short description after each journal entry.
- Skip a space after the description before starting the next journal entry.

An example journal entry format is as follows. It is not taken from previous examples but is intended to stand alone.

JOURNAL			
Date	**Description**	**Debit**	**Credit**
Apr. 1, 2018	Cash Common Stock *Received cash in exchange for common stock*	5,000	5,000

Note that this example has only one debit account and one credit account, which is considered a **simple entry**. A **compound entry** is when there is more than one account listed under the debit and/or credit column of a journal entry (as seen in the following).

JOURNAL			
Date	**Account**	**Debit**	**Credit**
Apr. 1, 2018	Cash Supplies Common Stock *Received cash and supplies in exchange for common stock*	3,000 2,000	 5,000

Notice that for this entry, the rules for recording journal entries have been followed. There is a date of April 1, 2018, the debit account titles are listed first with Cash and Supplies, the credit account title of Common Stock is indented after the debit account titles, there are at least one debit and one credit, the debit amounts equal the credit amount, and there is a short description of the transaction.

Let's now look at a few transactions from Printing Plus and record their journal entries.

Recording Transactions

We now return to our company example of Printing Plus, Lynn Sanders' printing service company. We will analyze and record each of the transactions for her business and discuss how this impacts the financial statements. Some of the listed transactions have been ones we have seen throughout this chapter. More detail for each of these transactions is provided, along with a few new transactions.

1. On January 3, 2019, issued $20,000 shares of common stock for cash.
2. On January 5, 2019, purchased equipment on account for $3,500, payment due within the month.
3. On January 9, 2019, received $4,000 cash in advance from a customer for services not yet rendered.
4. On January 10, 2019, provided $5,500 in services to a customer who asks to be billed for the services.
5. On January 12, 2019, paid a $300 utility bill with cash.
6. On January 14, 2019, distributed $100 cash in dividends to stockholders.
7. On January 17, 2019, received $2,800 cash from a customer for services rendered.
8. On January 18, 2019, paid in full, with cash, for the equipment purchase on January 5.
9. On January 20, 2019, paid $3,600 cash in salaries expense to employees.
10. On January 23, 2019, received cash payment in full from the customer on the January 10 transaction.
11. On January 27, 2019, provided $1,200 in services to a customer who asks to be billed for the services.
12. On January 30, 2019, purchased supplies on account for $500, payment due within three months.

Transaction 1: On January 3, 2019, issues $20,000 shares of common stock for cash.

Analysis:

- This is a transaction that needs to be recorded, as Printing Plus has received money, and the stockholders have invested in the firm.
- Printing Plus now has more cash. Cash is an asset, which in this case is increasing. Cash increases on the debit side.
- When the company issues stock, stockholders purchase common stock, yielding a higher common stock figure than before issuance. The common stock account is increasing and affects equity. Looking at the expanded accounting equation, we see that Common Stock increases on the credit side.

JOURNAL			
Date	**Account**	**Debit**	**Credit**
Jan. 3, 2019	Cash	20,000	
	Common Stock		20,000
	To recognize issuance of common stock		

Impact on the financial statements: Both of these accounts are balance sheet accounts. You will see total assets increase and total stockholders' equity will also increase, both by $20,000. With both totals increasing by $20,000, the accounting equation, and therefore our balance sheet, will be in balance. There is no effect on the income statement from this transaction as there were no revenues or expenses recorded.

Assets	=	Liabilities	+	Stockholders' Equity
+$20,000	=	+$0	+	+$20,000
$20,000	=	$0	+	$20,000

Transaction 2: On January 5, 2019, purchases equipment on account for $3,500, payment due within the month.

Analysis:

- In this case, equipment is an asset that is increasing. It increases because Printing Plus now has more equipment than it did before. Assets increase on the debit side; therefore, the Equipment account would show a $3,500 debit.
- The company did not pay for the equipment immediately. Lynn asked to be sent a bill for payment at a future date. This creates a liability for Printing Plus, who owes the supplier money for the equipment. Accounts Payable is used to recognize this liability. This liability is increasing, as the company now owes money to the supplier. A liability account increases on the credit side; therefore, Accounts Payable will increase on the credit side in the amount of $3,500.

JOURNAL			
Date	**Account**	**Debit**	**Credit**
Jan. 5, 2019	Equipment Accounts Payable *To recognize purchase of equipment on account*	3,500	3,500

Impact on the financial statements: Since both accounts in the entry are balance sheet accounts, you will see no effect on the income statement.

Assets	=	Liabilities	+	Stockholders' Equity
+$3,500	=	+ $3,500	+	0
$3,500	=	$3,500	+	0

Transaction 3: On January 9, 2019, receives $4,000 cash in advance from a customer for services not yet rendered.

Analysis:

- Cash was received, thus increasing the Cash account. Cash is an asset that increases on the debit side.
- Printing Plus has not yet provided the service, meaning it cannot recognize the revenue as earned. The company has a liability to the customer until it provides the service. The Unearned Revenue account would be used to recognize this liability. This is a liability the company did not have before, thus increasing this account. Liabilities increase on the credit side; thus, Unearned Revenue will recognize the $4,000 on the credit side.

JOURNAL			
Date	**Account**	**Debit**	**Credit**
Jan. 9, 2019	Cash Unearned Revenue *To recognize receipt of customer advanced payment for services yet to be rendered*	4,000	4,000

Impact on the financial statements: Since both accounts in the entry are balance sheet accounts, you will see no effect on the income statement.

Assets	=	Liabilities	+	Stockholders' Equity
+$4,000	=	+$4,000	+	0
$4,000	=	$4,000	+	0

Transaction 4: On January 10, 2019, provides $5,500 in services to a customer who asks to be billed for the services.

Analysis:

- The company provided service to the client; therefore, the company may recognize the revenue as earned (revenue recognition principle), which increases revenue. Service Revenue is a revenue account affecting equity. Revenue accounts increase on the credit side; thus, Service Revenue will show an increase of $5,500 on the credit side.
- The customer did not immediately pay for the services and owes Printing Plus payment. This money will be received in the future, increasing Accounts Receivable. Accounts Receivable is an asset account. Asset accounts increase on the debit side. Therefore, Accounts Receivable will increase for $5,500 on the debit side.

JOURNAL			
Date	**Account**	**Debit**	**Credit**
Jan. 10, 2019	Accounts Receivable	5,500	
	Service Revenue		5,500
	To recognize revenue earned, billed customer		

Impact on the financial statements: You have revenue of $5,500. Revenue is reported on your income statement. The more revenue you have, the more net income (earnings) you will have. The more earnings you have, the more retained earnings you will keep. Retained earnings is a stockholders' equity account, so total equity will increase $5,500. Accounts receivable is going up so total assets will increase by $5,500. The accounting equation, and therefore the balance sheet, remain in balance.

Assets	=	Liabilities	+	Stockholders' Equity
+$5,500	=	0	+	+$5,500
$5,500	=	0	+	$5,500

Transaction 5: On January 12, 2019, pays a $300 utility bill with cash.

Analysis:

- Cash was used to pay the utility bill, which means cash is decreasing. Cash is an asset that decreases on the credit side.
- Paying a utility bill creates an expense for the company. Utility Expense increases, and does so on the debit side of the accounting equation.

JOURNAL			
Date	**Account**	**Debit**	**Credit**
Jan. 12, 2019	Utility Expense Cash *Paid utility bill with cash*	300	300

Impact on the financial statements: You have an expense of $300. Expenses are reported on your income statement. More expenses lead to a decrease in net income (earnings). The fewer earnings you have, the fewer retained earnings you will end up with. Retained earnings is a stockholders' equity account, so total equity will decrease by $300. Cash is decreasing, so total assets will decrease by $300, impacting the balance sheet.

Assets	=	Liabilities	+	Stockholders' Equity
–$300	=	0	+	–$300
$300	=	0	+	$300

Transaction 6: On January 14, 2019, distributed $100 cash in dividends to stockholders.

Analysis:

- Cash was used to pay the dividends, which means cash is decreasing. Cash is an asset that decreases on the credit side.
- Dividends distribution occurred, which increases the Dividends account. Dividends are a part of stockholder's equity and are recorded on the debit side. This debit entry has the effect of reducing stockholder's equity.

JOURNAL			
Date	**Account**	**Debit**	**Credit**
Jan.14, 2019	Dividends Cash *Paid dividends with cash*	100	100

Impact on the financial statements: You have dividends of $100. An increase in dividends leads to a decrease in stockholders' equity (retained earnings). Cash is decreasing, so total assets will decrease by $100, impacting the balance sheet.

Assets	=	Liabilities	+	Stockholders' Equity
–$100	=	0	+	–$100
$100	=	0	+	$100

Transaction 7: On January 17, 2019, receives $2,800 cash from a customer for services rendered.

Analysis:

- The customer used cash as the payment method, thus increasing the amount in the Cash account. Cash is an asset that is increasing, and it does so on the debit side.
- Printing Plus provided the services, which means the company can recognize revenue as earned in the Service Revenue account. Service Revenue increases equity; therefore, Service Revenue increases on the credit side.

JOURNAL			
Date	**Account**	**Debit**	**Credit**
Jan. 17, 2019	Cash Service Revenue *Collected cash for services rendered*	2,800	2,800

Impact on the financial statements: Revenue is reported on the income statement. More revenue will increase net income (earnings), thus increasing retained earnings. Retained earnings is a stockholders' equity account, so total equity will increase $2,800. Cash is increasing, which increases total assets on the balance sheet.

Assets	=	Liabilities	+	Stockholders' Equity
+$2,800	=	0	+	+$2,800
$2,800	=	0	+	$2,800

Transaction 8: On January 18, 2019, paid in full, with cash, for the equipment purchase on January 5.

Analysis:

- Cash is decreasing because it was used to pay for the outstanding liability created on January 5. Cash is an asset and will decrease on the credit side.
- Accounts Payable recognized the liability the company had to the supplier to pay for the equipment. Since the company is now paying off the debt it owes, this will decrease Accounts Payable. Liabilities decrease on the debit side; therefore, Accounts Payable will decrease on the debit side by $3,500.

JOURNAL			
Date	**Account**	**Debit**	**Credit**
Jan. 18, 2019	Accounts Payable Cash *Paid liability for equipment in full*	3,500	3,500

Impact on the financial statements: Since both accounts in the entry are balance sheet accounts, you will see no effect on the income statement.

Assets	=	Liabilities	+	Stockholders' Equity
–$3,500	=	–$3,500	+	0
$3,500	=	$3,500	+	0

Transaction 9: On January 20, 2019, paid $3,600 cash in salaries expense to employees.

Analysis:

- Cash was used to pay for salaries, which decreases the Cash account. Cash is an asset that decreases on the credit side.
- Salaries are an expense to the business for employee work. This will increase Salaries Expense, affecting equity. Expenses increase on the debit side; thus, Salaries Expense will increase on the debit side.

JOURNAL			
Date	**Account**	**Debit**	**Credit**
Jan. 20, 2019	Salaries Expense	3,600	
	Cash		3,600
	Paid employee salaries		

Impact on the financial statements: You have an expense of $3,600. Expenses are reported on the income statement. More expenses lead to a decrease in net income (earnings). The fewer earnings you have, the fewer retained earnings you will end up with. Retained earnings is a stockholders' equity account, so total equity will decrease by $3,600. Cash is decreasing, so total assets will decrease by $3,600, impacting the balance sheet.

Assets	=	Liabilities	+	Stockholders' Equity
–$3,600	=	0	+	–$3,600
$3,600	=	0	+	$3,600

Transaction 10: On January 23, 2019, received cash payment in full from the customer on the January 10 transaction.

Analysis:

- Cash was received, thus increasing the Cash account. Cash is an asset, and assets increase on the debit side.
- Accounts Receivable was originally used to recognize the future customer payment; now that the customer has paid in full, Accounts Receivable will decrease. Accounts Receivable is an asset, and assets decrease on the credit side.

JOURNAL			
Date	**Account**	**Debit**	**Credit**
Jan. 23, 2019	Cash	5,500	
	Accounts Receivable		5,500
	Received customer payment from Jan. 10		

Impact on the financial statements: In this transaction, there was an increase to one asset (Cash) and a decrease to another asset (Accounts Receivable). This means total assets change by $0, because the increase and decrease to assets in the same amount cancel each other out. There are no changes to liabilities or stockholders' equity, so the equation is still in balance. Since there are no revenues or expenses affected, there is no effect on the income statement.

Assets	=	Liabilities	+	Stockholders' Equity
+$5,500 –$5,500	=	0	+	0 0
$0	=	0	+	

Transaction 11: On January 27, 2019, provides $1,200 in services to a customer who asks to be billed for the services.

Analysis:

- The customer does not pay immediately for the services but is expected to pay at a future date. This creates an Accounts Receivable for Printing Plus. The customer owes the money, which increases Accounts Receivable. Accounts Receivable is an asset, and assets increase on the debit side.
- Printing Plus provided the service, thus earning revenue. Service Revenue would increase on the credit side.

JOURNAL			
Date	**Account**	**Debit**	**Credit**
Jan. 27, 2019	Accounts Receivable Service Revenue *Billed customer for services rendered*	1,200	1,200

Impact on the financial statements: Revenue is reported on the income statement. More revenue will increase net income (earnings), thus increasing retained earnings. Retained earnings is a stockholders' equity account, so total equity will increase $1,200. Cash is increasing, which increases total assets on the balance sheet.

Assets	=	Liabilities	+	Stockholders' Equity
+$1,200	=	0	+	+$1,200
$1,200	=	0	+	$1,200

Transaction 12: On January 30, 2019, purchases supplies on account for $500, payment due within three months.

Analysis:

- The company purchased supplies, which are assets to the business until used. Supplies are increasing because the company has more supplies than it did before. Supplies are an asset that is increasing on the debit side.
- Printing Plus did not pay immediately for the supplies and asked to be billed for the supplies, payable at a later date. This creates a liability for the company, Accounts Payable. This liability increases Accounts Payable; thus, Accounts Payable increases on the credit side.

JOURNAL			
Date	**Account**	**Debit**	**Credit**
Jan. 30, 2019	Supplies Accounts Payable *Billed customer for services rendered*	500	500

Impact on the financial statements: There is an increase to a liability and an increase to assets. These accounts both impact the balance sheet but not the income statement.

Assets	=	Liabilities	+	Stockholders' Equity
+$500	=	+$500	+	0
$500	=	$500	+	0

The complete journal for these transactions is as follows:

JOURNAL			
Date	**Account**	**Debit**	**Credit**
Jan. 3, 2019	Cash Common Stock *Recognize issuance of common stock*	20,000	20,000
Jan. 5, 2019	Equipment Account Payable *Recognize purchase of equipment on account*	3,500	3,500
Jan. 9, 2019	Cash Unearned revenue *Received advanced payment for services yet to be rendered*	4,000	4,000
Jan. 10, 2019	Accounts receivable Service Revenue *Revenue earned, billed customer*	5,500	5,500
Jan. 12, 2019	Utility Expense Cash *Paid utility bill*	300	300
Jan. 14, 2019	Dividends Cash *Paid out dividends*	100	100
Jan. 17, 2019	Cash Service Revenue *Collected cash for services rendered*	2,800	2,800
Jan. 18, 2019	Accounts Payable Cash *Paid liability for equipment in full*	3,500	3,500
Jan. 20, 2019	Salaries Expense Cash *Paid employee salaries*	3,600	3,600
Jan. 23, 2019	Cash Accounts Receivable *Received customer payment from Jan. 10*	5,500	5,500
Jan. 27, 2019	Accounts Receivable Service Revenue *Billed customer for services rendered*	1,200	1,200
Jan. 30, 2019	Supplies Accounts Payable *Paid for supplies on account*	500	500

We now look at the next step in the accounting cycle, Step 3: post journal information to the ledger.

Posting to the General Ledger

Recall that the general ledger is a record of each account and its balance. Reviewing journal entries individually can be tedious and time consuming. The general ledger is helpful in that a company can easily extract account and balance information. Here is a small section of a general ledger.

GENERAL LEDGER					
Cash					Account No. 101
Date	Description	Ref.	Debit	Credit	Balance
2019					

You can see at the top is the name of the account Cash, as well as the assigned account number 101. Remember, all asset accounts will start with the number one. The date of each transaction related to this account is included, a possible description of the transaction, and a reference number if available. There are debit and credit columns, storing the financial figures for each transaction, and a balance column that keeps a running total of the balance in the account after every transaction.

Let's look at one of the journal entries from Printing Plus and fill in the corresponding ledgers.

JOURNAL		
Date	Account	Deb
Jan. 3, 2019	Cash Common stock *Received cash in exchange for common stock*	

GENERAL LEDGER					
Cash					Account No. 101
Date	Description	Ref.	Debit	Credit	Balance
2019 Jan. 3	Cash for common stock		20,000		20,000
Common Stock					Account No. 301
Date	Description	Ref.	Debit	Credit	Balance
2019 Jan. 3	Cash for common stock			20,000	20,000

As you can see, there is one ledger account for Cash and another for Common Stock. Cash is labeled account number 101 because it is an asset account type. The date of January 3, 2019, is in the far left column, and a description of the transaction follows in the next column. Cash had a debit of $20,000 in the journal entry, so $20,000 is transferred to the general ledger in the debit column. The balance in this account is currently $20,000, because no other transactions have affected this account yet.

Common Stock has the same date and description. Common Stock had a credit of $20,000 in the journal entry, and that information is transferred to the general ledger account in the credit column. The balance at that time in the Common Stock ledger account is $20,000.

Another key element to understanding the general ledger, and the third step in the accounting cycle, is how to calculate balances in ledger accounts.

Calculating Account Balances

When calculating balances in ledger accounts, one must take into consideration which side of the account increases and which side decreases. To find the account balance, you must find the difference between the sum of all figures on the side that increases and the sum of all figures on the side that decreases.

For example, the Cash account is an asset. We know from the accounting equation that assets increase on the debit side and decrease on the credit side. If there was a debit of $5,000 and a credit of $3,000 in the Cash account, we would find the difference between the two, which is $2,000 (5,000 – 3,000). The debit is the larger of the two sides ($5,000 on the debit side as opposed to $3,000 on the credit side), so the Cash account has a debit balance of $2,000.

Another example is a liability account, such as Accounts Payable, which increases on the credit side and decreases on the debit side. If there were a $4,000 credit and a $2,500 debit, the difference between the two is $1,500. The credit is the larger of the two sides ($4,000 on the credit side as opposed to $2,500 on the debit side), so the Accounts Payable account has a credit balance of $1,500.

The following are selected journal entries from Printing Plus that affect the Cash account. We will use the Cash ledger account to calculate account balances.

JOURNAL			
Date	**Account**	**Debit**	**Credit**
Jan. 3, 2019	Cash	20,000	
	Common Stock		20,000
	Recognize issuance of common stock		
Jan. 9, 2019	Cash	4,000	
	Unearned Revenue		4,000
	Received advanced payment for services yet to be rendered		
Jan. 12, 2019	Utility Expense	300	
	Cash		300
	Paid utility bill		
Jan. 14, 2019	Dividends	100	
	Cash		100
	Paid out dividends		
Jan. 17, 2019	Cash	2,800	
	Service Revenue		2,800
	Collected cash for services rendered		
Jan. 18, 2019	Accounts Payable	3,500	
	Cash		3,500
	Paid liability for equipment in full		
Jan. 20, 2019	Salaries Expense	3,600	
	Cash		3,600
	Paid employee salaries		
Jan. 23, 2019	Cash	5,500	
	Accounts Receivable		5,500
	Received customer payment from Jan. 10		

The general ledger account for Cash would look like the following:

GENERAL LEDGER					
Cash					Account No. 101
Date	Item	Ref.	Debit	Credit	Balance
2019					
Jan. 3	Cash for common stock		20,000		20,000
Jan. 9	Payment from client		4,000		24,000
Jan. 12	Utility bill			300	23,700
Jan. 14	Dividends payment			100	23,600
Jan. 17	Cash for services		2,800		26,400
Jan. 18	Paid cash for equipment			3,500	22,900
Jan. 20	Paid employee salaries			3,600	19,300
Jan. 23	Customer payment		5,500		24,800

In the last column of the Cash ledger account is the running balance. This shows where the account stands after each transaction, as well as the final balance in the account. How do we know on which side, debit or credit, to input each of these balances? Let's consider the general ledger for Cash.

On January 3, there was a debit balance of $20,000 in the Cash account. On January 9, a debit of $4,000 was included. Since both are on the debit side, they will be added together to get a balance of $24,000 (as is seen in the balance column on the January 9 row). On January 12, there was a credit of $300 included in the Cash ledger account. Since this figure is on the credit side, this $300 is subtracted from the previous balance of $24,000 to get a new balance of $23,700. The same process occurs for the rest of the entries in the ledger and their balances. The final balance in the account is $24,800.

Checking to make sure the final balance figure is correct; one can review the figures in the debit and credit columns. In the debit column for this cash account, we see that the total is $32,300 (20,000 + 4,000 + 2,800 + 5,500). The credit column totals $7,500 (300 + 100 + 3,500 + 3,600). The difference between the debit and credit totals is $24,800 (32,300 – 7,500). The balance in this Cash account is a debit of $24,800. Having a debit balance in the Cash account is the normal balance for that account.

2.6 Preparing a Trial Balance

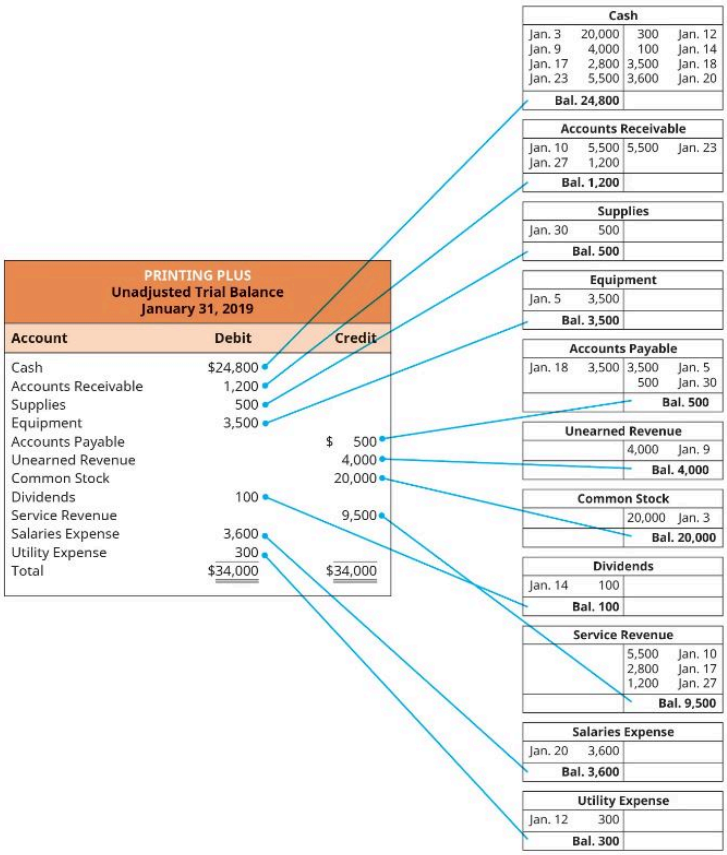
Once all the monthly transactions have been analyzed, journalized, and posted on a continuous day-to-day basis over the accounting period (a month in our example), we are ready to start working on preparing a trial balance (unadjusted). Preparing an unadjusted trial balance is the fourth step in the accounting cycle. A **trial balance** is a list of all accounts in the general ledger that have non zero balances. A trial balance is an important step in the accounting process, because it helps identify any computational errors throughout the first three steps in the cycle.

Note that for this step, we are considering our trial balance to be unadjusted. The **unadjusted trial balance** in this section includes accounts before they have been adjusted. As you see in Step 6 of the accounting cycle, we create another trial balance that is adjusted.

When constructing a trial balance, we must consider a few formatting rules, akin to those requirements for financial statements:

- The header must contain the name of the company, the label of a Trial Balance (Unadjusted), and the date.
- Accounts are listed in the accounting equation order with assets listed first followed by liabilities and finally equity.
- Amounts at the top of each debit and credit column should have a dollar sign.
- When amounts are added, the final figure in each column should be underscored.
- The totals at the end of the trial balance need to have dollar signs and be double-underscored.

Once all ledger accounts and their balances are recorded, the debit and credit columns on the trial balance are totaled to see if the figures in each column match each other. The final total in the debit column must be the same dollar amount that is determined in the final credit column. For example, if you determine that the final debit balance is $24,000 then the final credit balance in the trial balance must also be $24,000. If the two balances are not equal, there is a mistake in at least one of the columns.



PRINTING PLUS
Unadjusted Trial Balance
January 31, 2019

Account	Debit	Credit
Cash	$24,800	
Accounts Receivable	1,200	
Supplies	500	
Equipment	3,500	
Accounts Payable		$ 500
Unearned Revenue		4,000
Common Stock		20,000
Dividends	100	
Service Revenue		9,500
Salaries Expense	3,600	
Utility Expense	300	
Total	$34,000	$34,000

Once all balances are transferred to the unadjusted trial balance, we will sum each of the debit and credit columns. The debit and credit columns both total $34,000, which means they are equal and in balance. However, just because the column totals are equal and in balance, we are still not guaranteed that a mistake is not present.

PRINTING PLUS Unadjusted Trial Balance January 31, 2019		
Account	**Debit**	**Credit**
Cash	$24,800	
Accounts Receivable	1,200	
Supplies	500	
Equipment	3,500	
Accounts Payable		$ 500
Unearned Revenue		4,000
Common Stock		20,000
Dividends	100	
Service Revenue		9,500
Salaries Expense	3,600	
Utility Expense	300	
Total	$34,000	$34,000

What happens if the columns are not equal?

Locating Errors

Sometimes errors may occur in the accounting process, and the trial balance can make those errors apparent when it does not balance.

One way to find the error is to take the difference between the two totals and divide the difference by two. For example, let's assume the following is the trial balance for Printing Plus.

PRINTING PLUS Unadjusted Trial Balance January 31, 2019		
Account	**Debit**	**Credit**
Cash	$24,800	
Accounts Receivable	1,200	
Supplies	500	
Equipment	3,500	
Accounts Payable		$ 500
Unearned Revenue		4,000
Common Stock		20,000
Dividends		100
Service Revenue		9,500
Salaries Expense	3,600	
Utility Expense	300	
Total	$33,900	$34,100

You notice that the balances are not the same. Find the difference between the two totals: $34,100 – $33,900 = $200 difference. Now divide the difference by two: $200/2 = $100. Since the credit side has a higher total, look carefully at the numbers on the credit side to see if any of them are $100. The Dividends account has a $100 figure listed in the credit column. Dividends normally have a debit balance, but here it is a credit. Fix your error, and the debit total will go up $100 and the credit total down $100 so that they will both now be $34,000.

Another way to find an error is to take the difference between the two totals and divide by nine. If the outcome of the difference is a whole number, then you may have transposed a figure. For example, let's assume the following is the trial balance for Printing Plus.

PRINTING PLUS Unadjusted Trial Balance January 31, 2019		
Account	**Debit**	**Credit**
Cash	$24,800	
Accounts Receivable	1,200	
Supplies	500	
Equipment	5,300	
Accounts Payable		$ 500
Unearned Revenue		4,000
Common Stock		20,000
Dividends	100	
Service Revenue		9,500
Salaries Expense	3,600	
Utility Expense	300	
Total	$35,800	$34,000

Find the difference between the two totals: $35,800 – 34,000 = $1,800 difference. This difference divided by nine is $200 ($1,800/9 = $200). Looking at the debit column, which has the higher total, we determine that the Equipment account had transposed figures. The account should be $3,500 and not $5,300. We transposed the three and the five.

What do you do if you have tried both methods and neither has worked? Unfortunately, you will have to go back through one step at a time until you find the error.

If a trial balance is in balance, does this mean that all of the numbers are correct? Not necessarily. We can have errors and still be mathematically in balance. It is important to go through each step very carefully and recheck your work often to avoid mistakes early on in the process.

After the unadjusted trial balance is prepared and it appears error-free, a company might look at its financial statements to get an idea of the company's position before adjustments are made to certain accounts. A more complete picture of company position develops after adjustments occur, and an adjusted trial balance has been prepared.

2.7 Explain the Concepts and Guidelines Affecting Adjusting Entries

This section examines the next three steps in the cycle: record adjusting entries (journalizing and posting), prepare an adjusted trial balance, and prepare the financial statements (Figure 4.3).

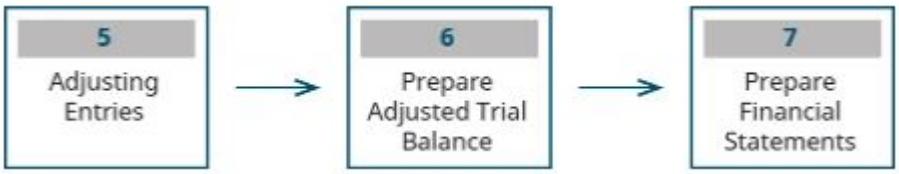


Figure 4.3 Steps 5, 6, and 7 in the Accounting Cycle. (attribution: Copyright Rice University, OpenStax, under CC BY-NC-SA 4.0 license)Caption

Accrual Accounting

Public companies reporting their financial positions use either US generally accepted accounting principles (GAAP) or International Financial Reporting Standards (IFRS), as allowed under the Securities and Exchange Commission (SEC) regulations. Also, companies, public or private, using US GAAP or IFRS prepare their financial statements using the rules of accrual accounting. Accrual basis accounting prescribes that revenues and expenses must be recorded in the accounting period in which they were earned or incurred, no matter when cash receipts or payments occur. It is because of accrual accounting that we have the revenue recognition principle and the expense recognition principle (also known as the matching principle).

The accrual method is considered to better match revenues and expenses and standardizes reporting information for comparability purposes. Having comparable information is important to external users of information trying to make investment or lending decisions, and to internal users trying to make decisions about company performance, budgeting, and growth strategies.

One fundamental concept to consider related to the accounting cycle—and to accrual accounting in particular—is the idea of the accounting period.

The Accounting Period

As we discussed, accrual accounting requires companies to report revenues and expenses in the **accounting period** in which they were earned or incurred. An accounting period breaks down company financial information into specific time spans, and can cover a month, a quarter, a half-year, or a full year.

2.8 The Adjustment Process & Adjusting Entries

When a company reaches the end of a period, it must update certain accounts that have either been left unattended throughout the period or have not yet been recognized. **Adjusting entries** update accounting records at the end of a period for any transactions that have not yet been recorded. One important accounting principle to remember is that just as the accounting equation (Assets = Liabilities + Owner's equity or common stock or capital) must be equal, it must remain equal after you make adjusting entries.

Why Some Accounts Have Incorrect Balances on the Trial Balance

The unadjusted trial balance may have incorrect balances in some accounts. Recall the trial balance from Analyzing and Recording Transactions for the example company, Printing Plus.

PRINTING PLUS Unadjusted Trial Balance January 31, 2019		
Account	**Debit**	**Credit**
Cash	$24,800	
Accounts Receivable	1,200	
Supplies	500	
Equipment	3,500	
Accounts Payable		$ 500
Unearned Revenue		4,000
Common Stock		20,000
Dividends	100	
Service Revenue		9,500
Salaries Expense	3,600	
Utility Expense	300	
Total	$34,000	$34,000

Figure 4.4 Unadjusted Trial Balance for Printing Plus. (attribution: Copyright Rice University, OpenStax, under CC BY-NC-SA 4.0 license)

The trial balance for Printing Plus shows supplies of $500, which were purchased on January 30. Since this is a new company, Printing Plus would more than likely use some of their supplies right away, before the end of the month on January 31. Supplies are only an asset when they are unused. If Printing Plus used some of its supplies immediately on January 30, then why is the full $500 still in the supply account on January 31? How do we fix this incorrect balance?

Similarly, what about Unearned Revenue? On January 9, the company received $4,000 from a customer for printing services to be performed. The company recorded this as a liability because it received payment without providing the service. To clear this liability, the company must perform the service. Assume that as of January 31 some of the printing services have been provided. Is the full $4,000 still a liability? Since a portion of the service was provided, a change to unearned revenue should occur. The company needs to correct this balance in the Unearned Revenue account.

Having incorrect balances in Supplies and in Unearned Revenue on the company's January 31 trial balance is not due to any error on the company's part. The company followed all of the correct steps of the accounting cycle up to this point. So why are the balances still incorrect?

Journal entries are recorded when an activity or event occurs that triggers the entry. Usually the trigger is from an original source. Recall that an original source can be a formal document substantiating a transaction, such as an invoice, purchase order, canceled check, or employee time sheet. Not every transaction produces an original source document that will alert the bookkeeper that it is time to make an entry.

The Need for Adjusting Entries

Adjusting entries update accounting records at the end of a period for any transactions that have not yet been recorded. These entries are necessary to ensure the income statement and balance sheet present the correct, up-to-date numbers. Adjusting entries are also necessary because the initial trial balance may not contain complete and current data due to several factors:

- The inefficiency of recording every single day-to-day event, such as the use of supplies.
- Some costs are not recorded during the period but must be recognized at the end of the period, such as depreciation, rent, and insurance.
- Some items are forthcoming for which original source documents have not yet been received, such as a utility bill.

The required adjusting entries depend on what types of transactions the company has, but there are some common types of adjusting entries.

Types of Adjusting Entries

Adjusting entries requires updates to specific account types at the end of the period. Not all accounts require updates, only those not naturally triggered by an original source document. There are two main types of adjusting entries that we explore further, deferrals and accruals.

Deferrals

Deferrals are prepaid expense and revenue accounts that have delayed recognition until they have been used or earned. This recognition may not occur until the end of a period or future periods. When deferred expenses and revenues have yet to be recognized, their information is stored on the balance sheet. As soon as the expense is incurred and the revenue is earned, the information is transferred from the balance sheet to the income statement. Two main types of deferrals are prepaid expenses and unearned revenues.

Prepaid Expenses

Prepaid expenses (prepayments) are assets for which advanced payment has occurred, before the company can benefit from use. As soon as the asset has provided benefit to the company, the value of the asset used is transferred from the balance sheet to the income statement as an expense. Some common examples of prepaid expenses are supplies, depreciation, insurance, and rent.

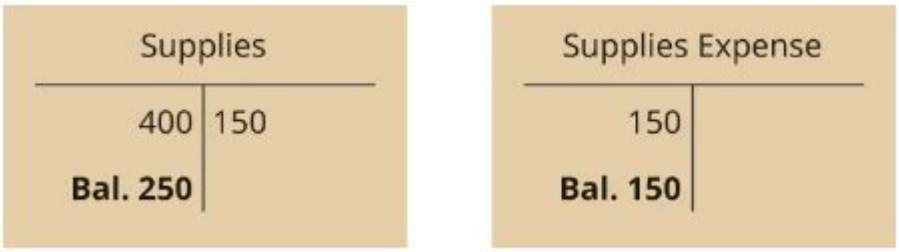
When a company purchases supplies, it may not use all supplies immediately. Let's say a company paid for supplies with cash in the amount of $400. At the end of the month, the company took an inventory of supplies used and determined the value of those supplies used during the period to be $150. The following entry occurs for the initial payment.

JOURNAL			
Date	**Account**	**Debit**	**Credit**
	Supplies	400	
	Cash		400
	To recognize purchase of supplies		

Supplies increase (debit) for $400, and Cash decrease (credit) for $400. When the company recognizes the supplies usage, the following adjusting entry occurs.

JOURNAL			
Date	**Account**	**Debit**	**Credit**
	Supplies Expense	150	
	Supplies		150
	To recognize supplies used during the period		

Supplies Expense is an expense account, increasing (debit) for $150, and Supplies is an asset account, decreasing (credit) for $150. This means $150 is transferred from the balance sheet (asset) to the income statement (expense). Notice that not all of the supplies are used. There is still a balance of $250 (400 – 150) in the Supplies account. This amount will carry over to future periods until used. The balances in the Supplies and Supplies Expense accounts show as follows.

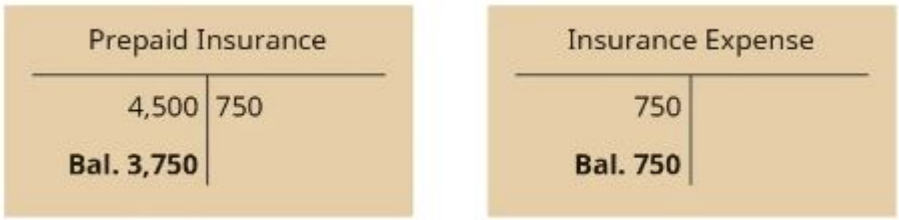


Insurance policies can require advanced payment of fees for several months at a time, six months, for example. The company does not use all six months of insurance immediately but over the course of the six months. At the end of each month, the company needs to record the amount of insurance expired during that month.

For example, a company pays $4,500 for an insurance policy covering six months. It is the end of the first month and the company needs to record an adjusting entry to recognize the insurance used during the month. The following entries show the initial payment for the policy and the subsequent adjusting entry for one month of insurance usage.

JOURNAL			
Date	**Account**	**Debit**	**Credit**
	Prepaid Insurance	4,500	
	Cash		4,500
	To recognize payment for insurance policy covering six months		
	Insurance Expense	750	
	Prepaid Insurance		750
	To recognize insurance used during one month		

In the first entry, Cash decreases (credit) and Prepaid Insurance increases (debit) for $4,500. In the second entry, Prepaid Insurance decreases (credit) and Insurance Expense increases (debit) for one month's insurance usage found by taking the total $4,500 and dividing by six months (4,500/6 = 750). The account balances after adjustment are as follows:



Similar to prepaid insurance, rent also requires advanced payment. Usually to rent a space, a company will need to pay rent at the beginning of the month. The company may also enter into a lease agreement that requires several months, or years, of rent in advance. Each month that passes, the company needs to record rent used for the month.

Another type of deferral requiring adjustment is unearned revenue.

Unearned Revenues

Recall that unearned revenue represents a customer's advanced payment for a product or service that has yet to be provided by the company. Since the company has not yet provided the product or service, it cannot recognize the customer's payment as revenue. At the end of a period, the company will review the account to see if any of the unearned revenue has been earned. If so, this amount will be recorded as revenue in the current period.

For example, let's say the company is a law firm. During the year, it collected retainer fees, totaling $48,000 from clients. Retainer fees are money lawyers collect in advance of starting work on a case. When the company collects this money from its clients, it will debit cash and credit unearned fees. Even though not all of the $48,000 was probably collected on the same day, we record it as if it was for simplicity's sake.

JOURNAL			
Date	**Account**	**Debit**	**Credit**
	Cash	48,000	
	Unearned Fee Revenue		48,000
	To recognize collection of retainer fees		

In this case, Unearned Fee Revenue increases (credit) and Cash increases (debit) for $48,000.

At the end of the year, after analyzing the unearned fees account, 40% of the unearned fees have been earned. This 40% can now be recorded as revenue. Total revenue recorded is $19,200 ($48,000 × 40%).

JOURNAL			
Date	**Account**	**Debit**	**Credit**
	Unearned Fee Revenue	19,200	
	Fee Revenue		19,200
	To recognize fees earned		

For this entry, Unearned Fee Revenue decreases (debit) and Fee Revenue increases (credit) for $19,200, which is the 40% earned during the year. The company will have the following balances in the two accounts:

Unearned Fee Revenue	
19,200	48,000
	Bal. 28,800

Fee Revenue	
	19,200
	Bal. 19,200

Besides deferrals, other types of adjusting entries include accruals.

Accruals

Accruals are types of adjusting entries that accumulate during a period, where amounts were previously unrecorded. The two specific types of adjustments are accrued revenues and accrued expenses.

Accrued Revenues

Accrued revenues are revenues earned in a period but have yet to be recorded, and no money has been collected. Some examples include interest, and services completed but a bill has yet to be sent to the customer.

Previously unrecorded service revenue can arise when a company provides a service but did not yet bill the client for the work. This means the customer has also not yet paid for services. Since there was no bill to trigger a transaction, an adjustment is required to recognize revenue earned at the end of the period.

For example, a company performs landscaping services in the amount of $1,500. However, they have not yet received payment. At the period end, the company would record the following adjusting entry.

JOURNAL			
Date	**Account**	**Debit**	**Credit**
	Accounts Receivable Service Revenue *To recognize service revenue earned and due*	1,500	1,500

Accounts Receivable increases (debit) for $1,500 because the customer has not yet paid for services completed. Service Revenue increases (credit) for $1,500 because service revenue was earned but had been previously unrecorded.





Accrued Expenses

Accrued expenses are expenses incurred in a period but have yet to be recorded, and no money has been paid. Some examples include interest, tax, and salary expenses.

Interest expense arises from notes payable and other loan agreements. The company has accumulated interest during the period but has not recorded or paid the amount. This creates a liability that the company must pay at a future date.

For example, a company accrued $300 of interest during the period. The following entry occurs at the end of the period.

JOURNAL			
Date	**Account**	**Debit**	**Credit**
	Interest Expense Interest Payable *To recognize interest expense incurred but not paid*	300	300

Interest Expense increases (debit) and Interest Payable increases (credit) for $300. The following are the updated ledger balances after posting the adjusting entry.

Interest Payable	
	300
	Bal. 300

Interest Expense	
300	
Bal. 300	

Taxes are only paid at certain times during the year, not necessarily every month. Taxes the company owes during a period that are unpaid require adjustment at the end of a period. This creates a liability for the company. Some tax expense examples are income and sales taxes.

Many salaried employees are paid once a month. The salary the employee earned during the month might not be paid until the following month. For example, the employee is paid for the prior month's work on the first of the next month. The financial statements must remain up to date, so an adjusting entry is needed during the month to show salaries previously unrecorded and unpaid at the end of the month.

Let's say a company has five salaried employees, each earning $2,500 per month. In our example, assume that they do not get paid for this work until the first of the next month. The following is the adjusting journal entry for salaries.

JOURNAL			
Date	**Account**	**Debit**	**Credit**
	Salaries Expense	12,500	
	Salaries Payable		12,500
	To recognize salaries expense incurred but not paid		

Salaries Expense increases (debit) and Salaries Payable increases (credit) for $12,500 ($2,500 per employee × five employees). The following are the updated ledger balances after posting the adjusting entry.

Salaries Payable	
	12,500
	Bal. 12,500

Salaries Expense	
12,500	
Bal. 12,500	

Common Types of Adjusting Entries

Before beginning adjusting entry examples for Printing Plus, let's consider some rules governing adjusting entries:

- Every adjusting entry will have at least one income statement account and one balance sheet account.
- Cash will never be in an adjusting entry.
- The adjusting entry records the change in amount that occurred during the period.

With an adjusting entry, the amount of change occurring during the period is recorded. For example, if the supplies account had a $300 balance at the beginning of the month and $100 is still available in the supplies account at the end

of the month, the company would record an adjusting entry for the $200 used during the month (300 – 100). Similarly for unearned revenues, the company would record how much of the revenue was earned during the period.

Recording Common Types of Adjusting Entries

Jan. 3, 2019	issues $20,000 shares of common stock for cash
Jan. 5, 2019	purchases equipment on account for $3,500, payment due within the month
Jan. 9, 2019	receives $4,000 cash in advance from a customer for services not yet rendered
Jan. 10, 2019	provides $5,500 in services to a customer who asks to be billed for the services
Jan. 12, 2019	pays a $300 utility bill with cash
Jan. 14, 2019	distributed $100 cash in dividends to stockholders
Jan. 17, 2019	receives $2,800 cash from a customer for services rendered
Jan. 18, 2019	paid in full, with cash, for the equipment purchase on January 5
Jan. 20, 2019	paid $3,600 cash in salaries expense to employees
Jan. 23, 2019	received cash payment in full from the customer on the January 10 transaction
Jan. 27, 2019	provides $1,200 in services to a customer who asks to be billed for the services
Jan. 30, 2019	purchases supplies on account for $500, payment due within three months

On January 31, 2019, Printing Plus made adjusting entries for the following transactions.

1. On January 31, Printing Plus took an inventory of its supplies and discovered that $100 of supplies had been used during the month.
2. The equipment purchased on January 5 depreciated $75 during the month of January.
3. Printing Plus performed $600 of services during January for the customer from the January 9 transaction.
4. Reviewing the company bank statement, Printing Plus discovers $140 of interest earned during the month of January that was previously uncollected and unrecorded.
5. Employees earned $1,500 in salaries for the period of January 21–January 31 that had been previously unpaid and unrecorded.

We now record the adjusting entries from January 31, 2019, for Printing Plus.

Transaction 13: On January 31, Printing Plus took an inventory of its supplies and discovered that $100 of supplies had been used during the month.

Analysis:

- $100 of supplies were used during January. Supplies are an asset that is decreasing (credit).
- Supplies is a type of prepaid expense that, when used, becomes an expense. Supplies Expense would increase (debit) for the $100 of supplies used during January.

JOURNAL			
Date	**Account**	**Debit**	**Credit**
Jan. 31, 2019	Supplies Expense Supplies *To recognize supply usage for January*	100	100

Impact on the financial statements: Supplies is a balance sheet account, and Supplies Expense is an income statement account. This satisfies the rule that each adjusting entry will contain an income statement and balance sheet account. We see total assets decrease by $100 on the balance sheet. Supplies Expense increases overall expenses on the income statement, which reduces net income.

Assets	=	Liabilities	+	Stockholders' Equity
–$100	=	+$0	+	–$100
–$100	=	$0	+	–$100

Transaction 14: The equipment purchased on January 5 depreciated $75 during the month of January.

Analysis:

- Equipment lost value in the amount of $75 during January. This depreciation will impact the Accumulated Depreciation–Equipment account and the Depreciation Expense–Equipment account. While we are not doing depreciation calculations here, you will come across more complex calculations in the future.
- Accumulated Depreciation–Equipment is a contra asset account (contrary to Equipment) and increases (credit) for $75.
- Depreciation Expense–Equipment is an expense account that is increasing (debit) for $75.

JOURNAL			
Date	**Account**	**Debit**	**Credit**
Jan. 31, 2019	Depreciation Expense: Equipment Accumulated Depreciation: Equipment *To recognize equipment depreciation for January*	75	75

Impact on the financial statements: Accumulated Depreciation–Equipment is a contra account to Equipment. When calculating the book value of Equipment, Accumulated Depreciation–Equipment will be deducted from the original cost of the equipment. Therefore, total assets will decrease by $75 on the balance sheet. Depreciation Expense will increase overall expenses on the income statement, which reduces net income.

Assets	=	Liabilities	+	Stockholders' Equity
–$75	=	+$0	+	–$75
–$75	=	$0	+	–$75

Transaction 15: Printing Plus performed $600 of services during January for the customer from the January 9 transaction.

Analysis:

- The customer from the January 9 transaction gave the company $4,000 in advanced payment for services. By the end of January the company had earned $600 of the advanced payment. This means that the company still has yet to provide $3,400 in services to that customer.
- Since some of the unearned revenue is now earned, Unearned Revenue would decrease. Unearned Revenue is a liability account and decreases on the debit side.
- The company can now recognize the $600 as earned revenue. Service Revenue increases (credit) for $600.

JOURNAL			
Date	**Account**	**Debit**	**Credit**
Jan. 31, 2019	Unearned Revenue	600	
	Service Revenue		600
	To recognize revenue earned from January 9 transaction		

Impact on the financial statements: Unearned revenue is a liability account and will decrease total liabilities and equity by $600 on the balance sheet. Service Revenue will increase overall revenue on the income statement, which increases net income.

Assets	=	Liabilities	+	Stockholders' Equity
$0	=	–$600	+	+$600
$0	=	–$600	+	$600

Transaction 16: Reviewing the company bank statement, Printing Plus discovers $140 of interest earned during the month of January that was previously uncollected and unrecorded.

Analysis:

- Interest is revenue for the company on money kept in a savings account at the bank. The company only sees the bank statement at the end of the month and needs to record interest revenue that has not yet been collected or recorded.
- Interest Revenue is a revenue account that increases (credit) for $140.
- Since Printing Plus has yet to collect this interest revenue, it is considered a receivable. Interest Receivable increases (debit) for $140.

JOURNAL			
Date	**Account**	**Debit**	**Credit**
Jan. 31, 2019	Interest Receivable Interest Revenue *To recognize interest revenue earned but not yet collected*	140	140

Impact on the financial statements: Interest Receivable is an asset account and will increase total assets by $140 on the balance sheet. Interest Revenue will increase overall revenue on the income statement, which increases net income.

Assets	=	Liabilities	+	Stockholder's Equity
+$140	=	$0	+	+$140
+$140	=	$0	+	+$140

Transaction 17: Employees earned $1,500 in salaries for the period of January 21–January 31 that had been previously unpaid and unrecorded.

Analysis:

- Salaries have accumulated since January 21 and will not be paid in the current period. Since the salaries expense occurred in January, the expense recognition principle requires recognition in January.
- Salaries Expense is an expense account that is increasing (debit) for $1,500.
- Since the company has not yet paid salaries for this time period, Printing Plus owes the employees this money. This creates a liability for Printing Plus. Salaries Payable increases (credit) for $1,500.

JOURNAL			
Date	**Account**	**Debit**	**Credit**
Jan. 31, 2019	Salaries Expense Salaries Payable *To recognize salaries expense but not yet paid*	1,500	1,500

Impact on the financial statements: Salaries Payable is a liability account and will increase total liabilities and equity by $1,500 on the balance sheet. Salaries expense will increase overall expenses on the income statement, which decreases net income.

Assets	=	Liabilities	+	Stockholder's Equity
$0	=	+$1,500	+	–$1,500
$0	=	+$1,500	+	–$1,500

2.9 Prepare Financial Statements

Once you have completed all adjusting entries , you are ready to prepare the financial statements. Preparing financial statements is the seventh step in the accounting cycle. Remember that we have four financial statements to prepare: an income statement, a statement of retained earnings, a balance sheet, and the statement of cash flows. These financial statements were introduced in Introduction to Financial Statements and Statement of Cash Flows dedicates in-depth discussion to that statement.

To prepare the financial statements, a company will look at the adjusted trial balance for account information. From this information, the company will begin constructing each of the statements, beginning with the income statement. Income statements will include all revenue and expense accounts. The statement of retained earnings will include beginning retained earnings, any net income (loss) (found on the income statement), and dividends. The balance sheet is going to include assets, contra assets, liabilities, and stockholder equity accounts, including ending retained earnings and common stock.

Income Statement

An income statement shows the organization's financial performance for a given period of time. When preparing an income statement, revenues will always come before expenses in the presentation. For Printing Plus, the following is its January 2019 Income Statement.

PRINTING PLUS
Income Statement
For the Month Ended January 31, 2019

Revenues		
Interest Revenue	$ 140	
Service Revenue	10,100	
Total Revenues		$10,240
Expenses		
Supplies Expense	100	
Depreciation Expense		
Equipment	75	
Salaries Expense	5,100	
Utility Expense	300	
Total Expenses		5,575
Net Income		$ 4,665

Revenue and expense information is taken from the adjusted trial balance as follows:

PRINTING PLUS
Adjusted Trial Balance
January 31, 2019

Account	Debit	Credit
Cash	$24,800	
Accounts Receivable	1,200	
Interest Receivable	140	
Supplies	400	
Equipment	3,500	
Acc. Dep: Equipment		$ 75
Accounts Payable		500
Salaries Payable		1,500
Unearned Revenue		3,400
Common Stock		20,000
Dividends	100	
Interest Revenue		140
Service Revenue		10,100
Supplies Expense	100	
Depreciation Expense:		
Equipment	75	
Salaries Expense	5,100	
Utility Expense	300	
Total	$35,715	$35,715

PRINTING PLUS
Income Statement
For the Month Ended January 31, 2019

Revenues		
Interest Revenue	$ 140	
Service Revenue	10,100	
Total Revenues		$10,240
Expenses		
Supplies Expense	100	
Depreciation Expense:		
Equipment	75	
Salaries Expense	5,100	
Utility Expense	300	
Total Expenses		5,575
Net Income		$ 4,665

Total revenues are $10,240, while total expenses are $5,575. Total expenses are subtracted from total revenues to get a net income of $4,665. If total expenses were more than total revenues, Printing Plus would have a net loss rather than a net income. This net income figure is used to prepare the statement of retained earnings.

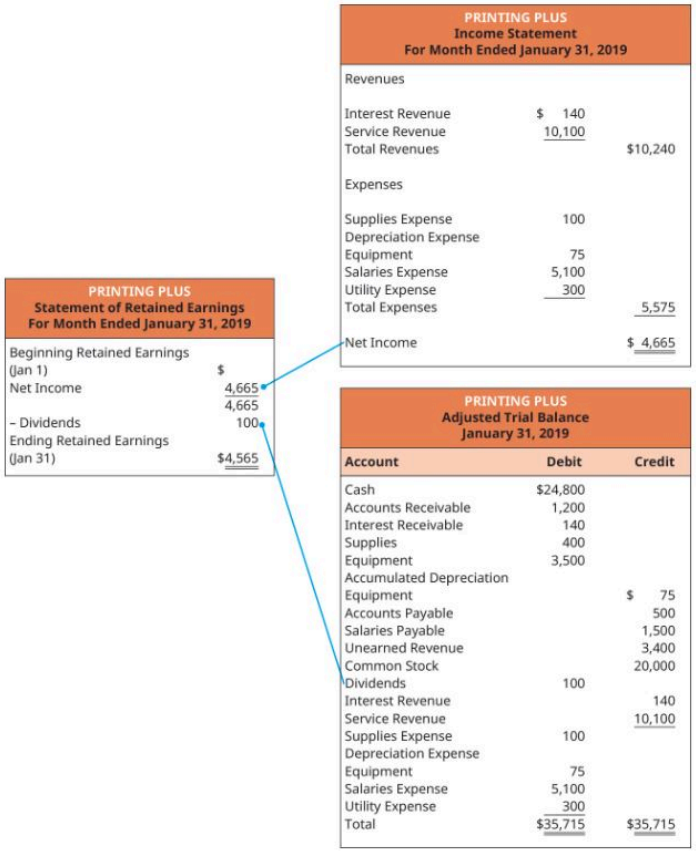
Statement of Retained Earnings

The statement of retained earnings (which is often a component of the statement of stockholders' equity) shows how the equity (or value) of the organization has changed over a period of time. The statement of retained earnings is prepared second to determine the ending retained earnings balance for the period. The statement of retained earnings is prepared before the balance sheet because the ending retained earnings amount is a required element of the balance sheet. The following is the Statement of Retained Earnings for Printing Plus.

PRINTING PLUS
Statement of Retained Earnings
For Month Ended January 31, 2019

Beginning Retained Earnings (Jan 1)	$
Net Income	4,665
	4,665
– Dividends	100
Ending Retained Earnings (Jan 31)	$4,565

Net income information is taken from the income statement, and dividends information is taken from the adjusted trial balance as follows.



PRINTING PLUS
Income Statement
For Month Ended January 31, 2019

Revenues		
Interest Revenue	$ 140	
Service Revenue	10,100	
Total Revenues		$10,240
Expenses		
Supplies Expense	100	
Depreciation Expense		
Equipment	75	
Salaries Expense	5,100	
Utility Expense	300	
Total Expenses		5,575
Net Income		$ 4,665

PRINTING PLUS
Statement of Retained Earnings
For Month Ended January 31, 2019

Beginning Retained Earnings (Jan 1)	$
Net Income	4,665
	4,665
– Dividends	100
Ending Retained Earnings (Jan 31)	$4,565

PRINTING PLUS
Adjusted Trial Balance
January 31, 2019

Account	Debit	Credit
Cash	$24,800	
Accounts Receivable	1,200	
Interest Receivable	140	
Supplies	400	
Equipment	3,500	
Accumulated Depreciation Equipment		$ 75
Accounts Payable		500
Salaries Payable		1,500
Unearned Revenue		3,400
Common Stock		20,000
Dividends	100	
Interest Revenue		140
Service Revenue		10,100
Supplies Expense	100	
Depreciation Expense Equipment	75	
Salaries Expense	5,100	
Utility Expense	300	
Total	$35,715	$35,715

The statement of retained earnings always leads with beginning retained earnings. Beginning retained earnings carry over from the previous period's ending retained earnings balance. Since this is the first month of business for Printing Plus, there is no beginning retained earnings balance. Notice the net income of $4,665 from the income statement is carried over to the statement of retained earnings. Dividends are taken away from the sum of beginning retained earnings and net income to get the ending retained earnings balance of $4,565 for January. This ending retained earnings balance is transferred to the balance sheet.

Balance Sheet

The balance sheet is the third statement prepared after the statement of retained earnings and lists what the organization owns (assets), what it owes (liabilities), and what the shareholders control (equity) on a specific date. Remember that the balance sheet represents the accounting equation, where assets equal liabilities plus stockholders' equity. The following is the Balance Sheet for Printing Plus.

PRINTING PLUS Balance Sheet January 31, 2019		
Assets		
Cash		$24,800
Accounts Receivable		1,200
Interest Receivable		140
Supplies		400
Equipment	$3,500	
Accumulated Depreciation: Equipment	(75)	3,425
Total Assets		**$29,965**
Liabilities		
Accounts Payable		$ 500
Salaries Payable		1,500
Unearned Revenue		3,400
Total Liabilities		5,400
Stockholders' Equity		
Common Stock		20,000
Ending Retained Earnings		4,565
Total Stockholders' Equity		24,565
Total Liabilities and Stockholders' Equity		**$29,965**

Ending retained earnings information is taken from the statement of retained earnings, and asset, liability, and common stock information is taken from the adjusted trial balance as follows.

PRINTING PLUS
Balance Sheet
January 31, 2019

Assets		
Cash		$24,800
Accounts Receivable		1,200
Interest Receivable		140
Supplies		400
Equipment	$3,500	
Accumulated Depreciation Equipment	75	3,425
Total Assets		$29,965
Liabilities		
Accounts Payable		$ 500
Salaries Payable		1,500
Unearned Revenue		3,400
Total Liabilities		5,400
Stockholders' Equity		
Common Stock		20,000
Ending Retained Earnings		4,565
Total Stockholders' Equity		24,565
Total Liabilities and Stockholders' Equity		$29,965

PRINTING PLUS
Adjusted Trial Balance
January 31, 2019

Account	Debit	Credit
Cash	$24,800	
Accounts Receivable	1,200	
Interest Receivable	140	
Supplies	400	
Equipment	3,500	
Acc. Dep: Equip.		$ 75
Accounts Payable		500
Salaries Payable		1,500
Unearned Revenue		3,400
Common Stock		20,000
Dividends	100	
Interest Revenue		140
Service Revenue		10,100
Supplies Expense	100	
Dep. Expense: Equip.	75	
Salaries Expense	5,100	
Utility Expense	300	
Total	$35,715	$35,715

PRINTING PLUS
Statement of Retained Earnings
For the Month Ended January 31, 2019

Beginning Retained Earnings (Jan. 1)	$ 0
Net Income	4,665
Dividends	(100)
Ending Retained Earnings (Jan. 31)	$4,565

Looking at the asset section of the balance sheet, Accumulated Depreciation–Equipment is included as a contra asset account to equipment. The accumulated depreciation ($75) is taken away from the original cost of the equipment ($3,500) to show the book value of equipment ($3,425). The accounting equation is balanced, as shown on the balance sheet, because total assets equal $29,965 as do the total liabilities and stockholders' equity.

The content was adapted from the Principles of Accounting Vol. 1 textbook created by

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