

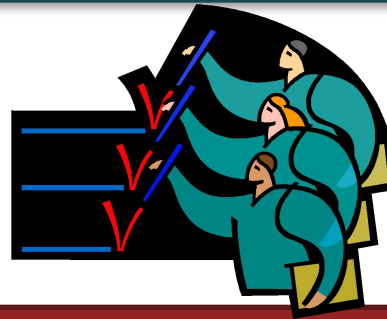
The Accounting Cycle: Reporting Financial Results

Chapter 5



Preparing Financial Statements

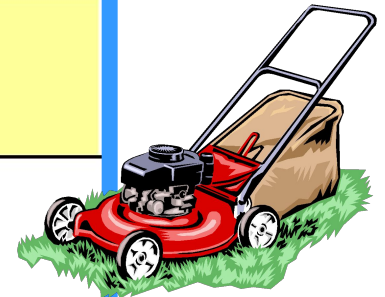
Publicly owned companies – those with shares listed on a stock exchange – have obligations to release annual and quarterly information to their stockholders and to the public.



The annual report includes comparative financial statements and other information relating to the company's financial position, business operations, and future prospects.

The financial statements contained in the annual report must be audited by a firm of certified public accountants (CPAs).

**JJ's Lawn Care Service
Adjusted Trial Balance
May 31, 2009**



Cash	\$	3,925	
Accounts receivable		75	
Tools & equipment		2,650	
Accumulated depreciation: tools & equipment			\$ 50
Truck		15,000	
Accumulated depreciation: truck			250
Notes payable			13,000
Accounts payable			150
Capital stock			8,000
Dividends		200	
Sales revenue			750
Gasoline expense		50	
Depreciation expense: tools & equipment		50	
Depreciation expense: truck		250	
Total		<u>\$ 22,200</u>	<u>\$ 22,200</u>

**Now, let's prepare the financial statements
for JJ's Lawn Care Service for May.**

The Income Statement



JJ's Lawn Care Service Income Statement

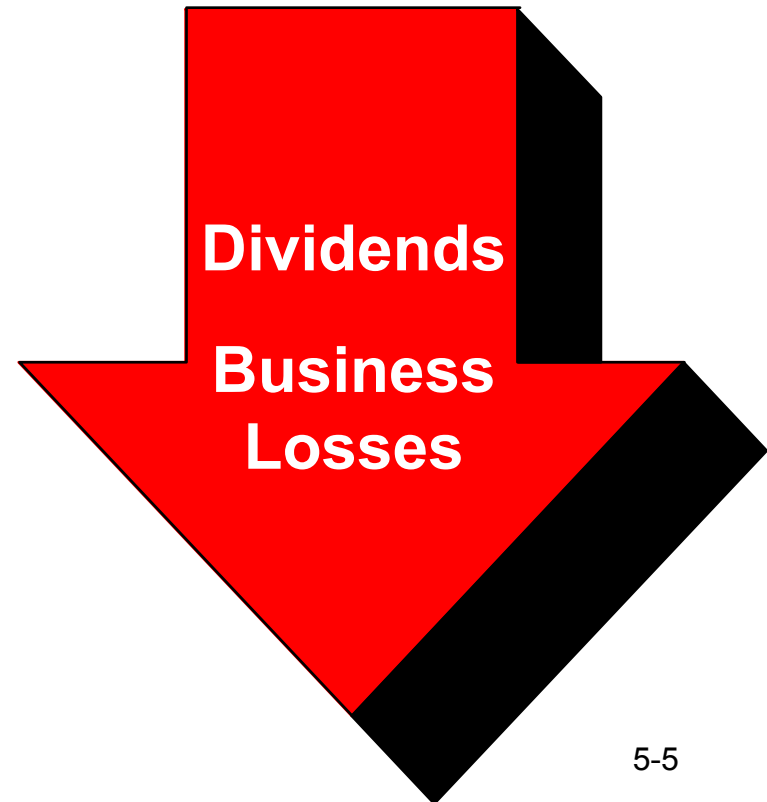
For the month ending May 31, 2009

Sales revenue		\$	750
Operating expenses:			
Gasoline expense	\$	50	
Depreciation: tools & equipment		50	
Depreciation: truck		250	350
Net income		\$	<u>400</u>

**Net income also appears on the
Statement of Retained Earnings.**

The Statement of Retained Earnings

Summarizes the increases and decreases in Retained Earnings during the period.



The Statement of Retained Earnings



JJ's Lawn Care Service Statement of Retained Earnings For the Month Ended May 31, 2009

Retained earnings, May 1	\$ -
Add: Net income	400
Subtotal	<u>\$ 400</u>
Less: Dividends	200
Retained earnings, May 31	<u><u>\$ 200</u></u>

Now, let's prepare the Balance Sheet.

The Balance Sheet



JJ's Lawn Care Service Balance Sheet May 31, 2009

Assets			
Cash		\$	3,925
Accounts receivable			75
Tools & equipment	\$	2,650	
Less: Accumulated depreciation		50	2,600
Truck	\$	15,000	
Less: Accumulated depreciation		250	14,750
Total assets		\$	21,350
Liabilities & Stockholders' Equity			
Liabilities:			
Notes payable		\$	13,000
Accounts payable			150
Total liabilities		\$	13,150
Stockholders' equity:			
Capital stock	\$	8,000	
Retained earnings		200	
Total stockholders' equity			8,200
Total liabilities & stockholders' equity		\$	21,350

Relationships among the Financial Statements

**JJ's Lawn Care Service
Balance Sheet
May 31, 2009**

Assets		
Cash		\$ 3,925
Accounts receivable		75
Tools & equipment	\$ 2,650	
Less: Accumulated depreciation	50	2,600
Truck	\$ 15,000	
Less: Accumulated depreciation	250	14,750
Total assets		\$ 21,350
Liabilities & Stockholders' Equity		
Liabilities:		
Notes payable		\$ 13,000
Accounts payable		150
Total liabilities		\$ 13,150
Stockholders' equity:		
Capital stock	\$ 8,000	
Retained earnings	200	
Total stockholders' equity		8,200
Total liabilities & stockholders' equity		\$ 21,350

**JJ's Lawn Care Service
Income Statement
For the month ending May 31, 2009**

Sales revenue		\$ 750
Operating expenses:		
Gasoline expense	\$ 50	
Depreciation: tools & equipment	50	
Depreciation: truck	250	350
Net income		\$ 400

**JJ's Lawn Care Service
Statement of Retained Earnings
For the Month Ended May 31, 2009**

Retained earnings, May 1	\$ -
Add: Net income	400
Subtotal	\$ 400
Less: Dividends	200
Retained earnings, May 31	\$ 200

Drafting the Notes that Accompany Financial Statements



Examples of Items Disclosed

- Lawsuits pending
- Scheduled plant closings
- Governmental investigations
- Significant events occurring after the balance sheet date
- Specific customers that account for a large portion of revenue
- Unusual transactions and related party transactions

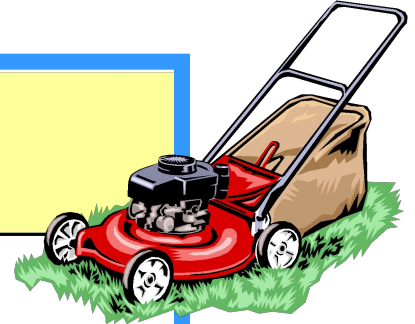
Closing the Temporary Accounts

- Close Revenue accounts to Income Summary.
- ② Close Expense accounts to Income Summary.
- Close Income Summary account to Retained Earnings.
- ④ Close Dividends to Retained Earnings.

The **closing** process gets the **temporary accounts** ready for the next accounting period.



Closing the Temporary Accounts



JJ's Lawn Care Service Adjusted Trial Balance May 31, 2009			
Cash	\$	3,925	
Accounts receivable		75	
Tools & equipment		2,650	
Accum. depreciation: tools & eq.			\$ 50
Truck		15,000	
Accum. depreciation: truck			250
Notes payable			13,000
Accounts payable			150
Capital stock			8,000
Dividends		200	
Sales revenue			750
Gasoline expense		50	
Depreciation exp.: tools & eq.		50	
Depreciation exp.: truck		250	
Total	\$	22,200	\$ 22,200

Closing Entries for Revenue Accounts

Since Sales Revenue has a credit balance, the closing entry requires a debit to the Sales Revenue account.

GENERAL JOURNAL				
Date		Account Titles and Explanation	Debit	Credit
May	31	Sales Reveune	750	
		Income Summary		750
		To close the revenue account.		

Closing Entries for Revenue Accounts

Income Summary	
	750
	750

Sales Revenue	
750	750
	-



Closing Entries for Expense Accounts

Since expense accounts have a debit balance, the closing entry requires a credit to the expense accounts.

GENERAL JOURNAL				
Date		Account Titles and Explanation	Debit	Credit
May	31	Income Summary	350	
		Gasoline Expense		50
		Depreciation Exp.: Tools & Equipment		50
		Depreciation Exp.: Truck		250
		To close the expense accounts.		

Closing Entries for Expense Accounts

Gasoline Exp.	
50	50
	-

Depr. Exp.: Tools & Equipment	
50	50
	-

Depr. Exp.: Truck	
250	250
	-

Income Summary	
350	750
	400

Net Income

Closing the Income Summary Account

Since Income Summary has a \$400 credit balance, the closing entry requires a debit to Income Summary.

GENERAL JOURNAL				
Date		Account Titles and Explanation	Debit	Credit
May	31	Income Summary	400	
		Retained Earnings		400
		To close Income Summary.		

Closing the Income Summary Account

Retained Earnings	
	400
	400

Income Summary	
350 400	750
	-

The balance in Income Summary is now **zero**.

Closing the Dividends Account

Since the Dividends account has a debit balance, the closing entry requires a credit to the Dividends account.

GENERAL JOURNAL

Date		Account Titles and Explanation	Debit	Credit
May	31	Retained Earnings	200	
		Dividends		200
		To close the Dividends account.		

Closing the Dividends Account

Dividends	
200	200
	-



Retained Earnings	
200	400
	200

After-Closing Trial Balance



**JJ's Lawn Care Service
After-Closing Trial Balance
May 31, 2009**

Cash	\$	3,925	
Accounts receivable		75	
Tools & equipment		2,650	
Accum. depreciation: tools & eq.			\$ 50
Truck		15,000	
Accum. depreciation: truck			250
Notes payable			13,000
Accounts payable			150
Capital stock			8,000
Retained earnings			200
Total	\$	21,650	\$ 21,650

Evaluating the Business

Evaluating Profitability

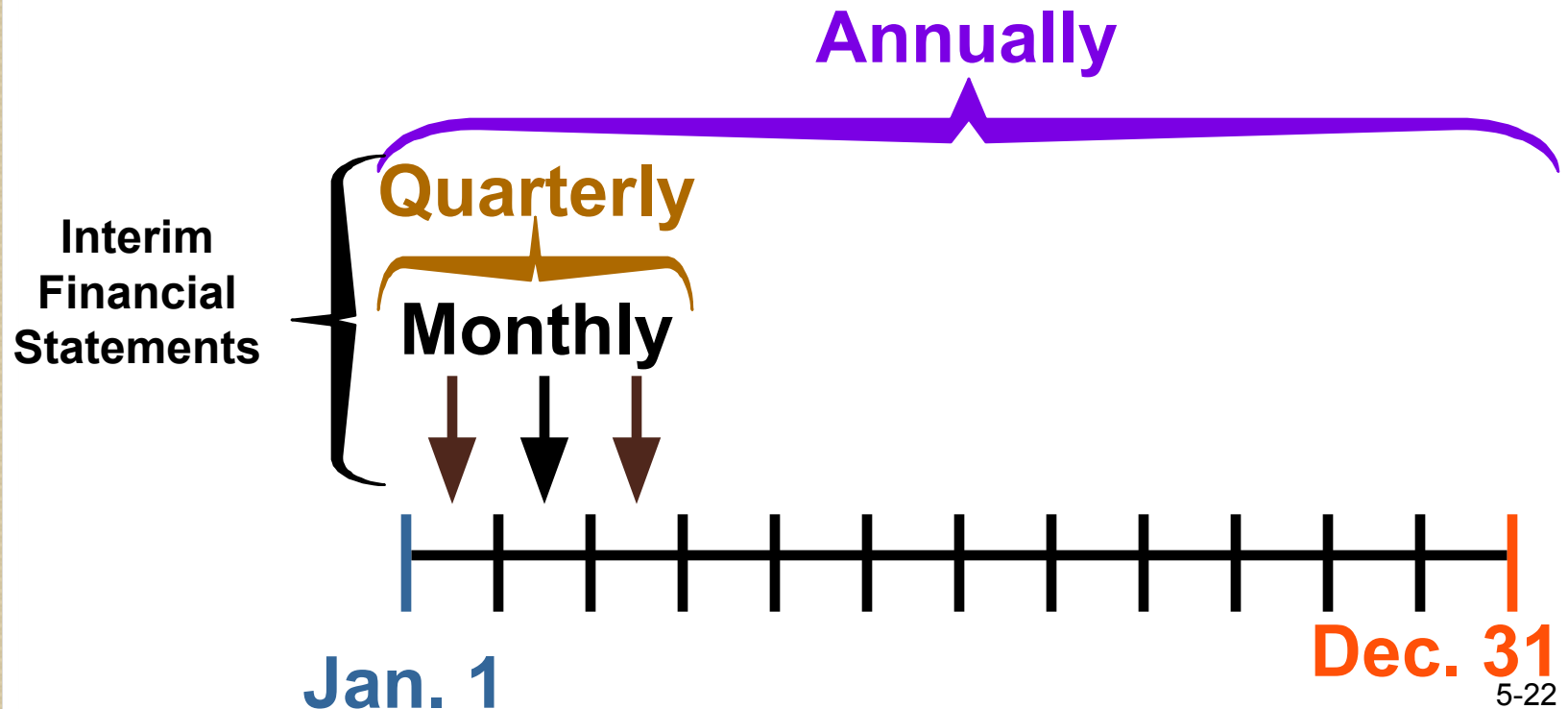
$$\text{Net Income Percentage} = \frac{\text{Net Income}}{\text{Total Revenue}}$$
$$\text{Return on Equity} = \frac{\text{Net Income}}{\text{Avg. Stockholders' Equity}}$$

Evaluating Liquidity

$$\text{Working Capital} = \text{Current Assets} - \text{Current Liabilities}$$
$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

Preparing Financial Statements Covering Different Periods of Time

Many companies prepare financial statements at various points throughout the year.



Ethics, Fraud, and Corporate Governance

A company should disclose any facts that an intelligent person would consider necessary for the statements to be interpreted properly.

Public companies are required to file annual reports with the Securities and Exchange Commission (SEC). The SEC requires that companies include a section labeled “Management Discussion and Analysis” (MD&A) because the financial statements and related notes may be inadequate for assessing the quantity and sustainability of a company’s earnings.

Supplemental Topic: The Worksheet

OVERNIGHT AUTO SERVICES

Worksheet

For the Year Ended December 31, 2009

Balance Sheet Accounts	Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Balance Sheet		
	Dr	Cr	Dr	Cr	Dr	Cr	Dr	Cr	Dr	Cr	
Cash	18,592				18,592				18,592		
Accounts Receivable	6,500		(h) 750		7,250				7,250		
Shop Supplies	1,800			(a) 600	1,200				1,200		
.....											
Notes Payable		4,000				4,000				4,000	
Accounts Payable		2,690				2,690				2,690	
.....											
Income Statement Accounts											
Repair Service Revenue		171,250		(h) 750		172,000		172,000			
Advertising Expense	3,900				3,900		3,900				
Wages Expense	56,800		(f) 1,950	58,750		58,750					
.....											
Totals											
	272,000	272,000	12,200	12,200	279,100	279,100	135,058	175,000	144,042	104,100	
Net Income							39,942			39,942	
Totals							175,000	175,000	144,042	144,042	

End of Chapter 5

