

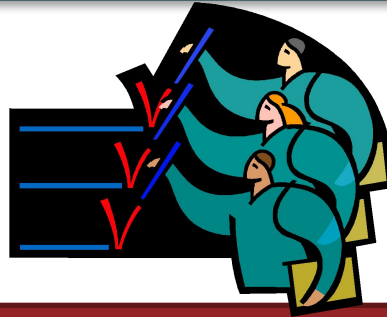
# The Accounting Cycle: Reporting Financial Results

## Chapter 5



# Preparing Financial Statements

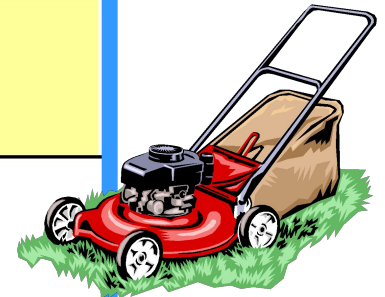
Publicly owned companies – those with shares listed on a stock exchange – have obligations to release annual and quarterly information to their stockholders and to the public.



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	\$	22,200	\$ 22,200

**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**

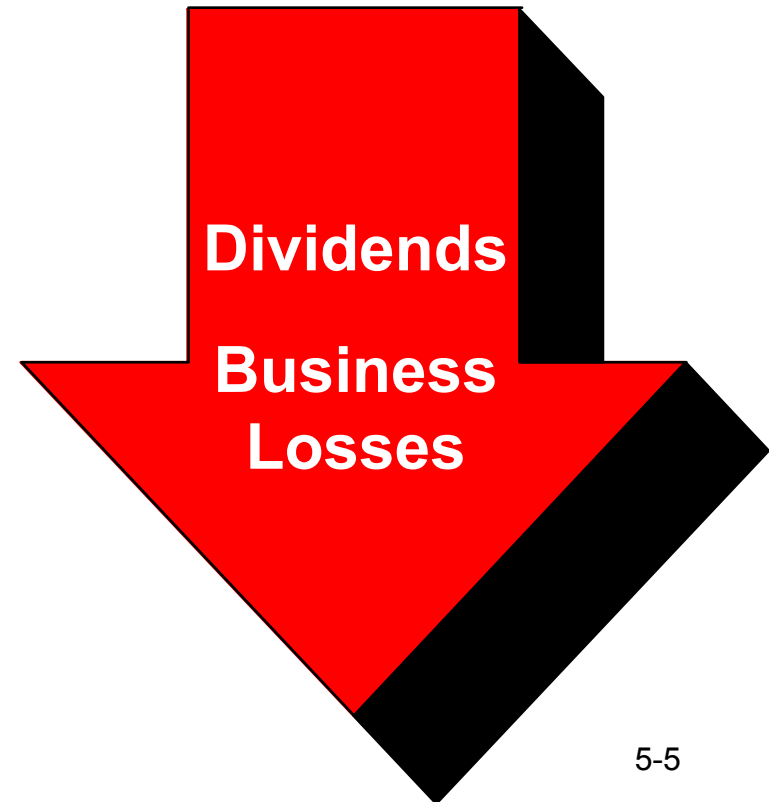
Sales revenue		\$	750
Operating expenses:			
Gasoline expense	\$	50	
Depreciation: tools & equipment		50	
Depreciation: truck		250	350
Net income		\$	<u>400</u>

**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**

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

**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
<b>Total assets</b>		<b>\$</b>	<b>21,350</b>

### Liabilities & Stockholders' Equity

#### Liabilities:

Notes payable	\$	13,000
Accounts payable		150
<b>Total liabilities</b>	<b>\$</b>	<b>13,150</b>

#### Stockholders' equity:

Capital stock	\$	8,000
Retained earnings		200
<b>Total stockholders' equity</b>		<b>8,200</b>
<b>Total liabilities &amp; stockholders' equity</b>	<b>\$</b>	<b>21,350</b>

# Relationships among the Financial Statements

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

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

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

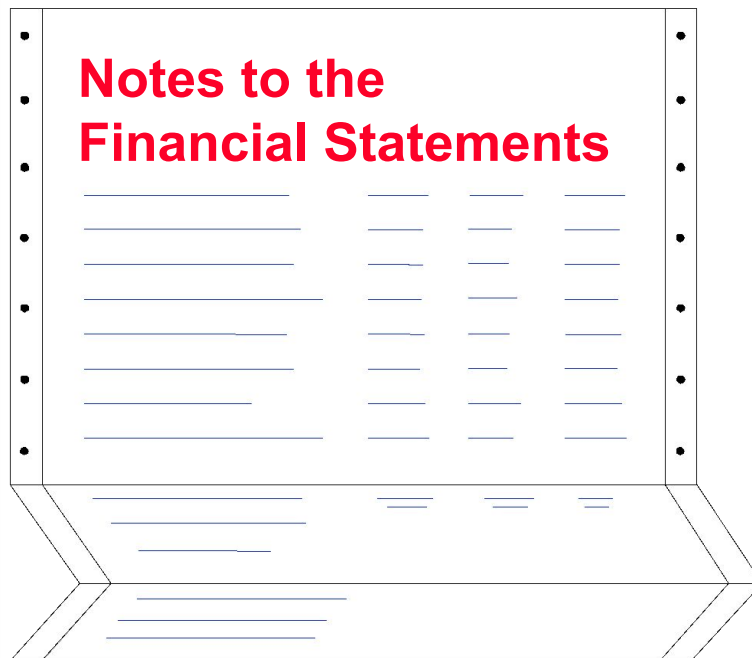
Sales revenue		\$ 750
Operating expenses:		
Gasoline expense	\$ 50	
Depreciation: tools & equipment	50	
Depreciation: truck	250	350
<b>Net income</b>		<b>\$ 400</b>

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

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



# 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

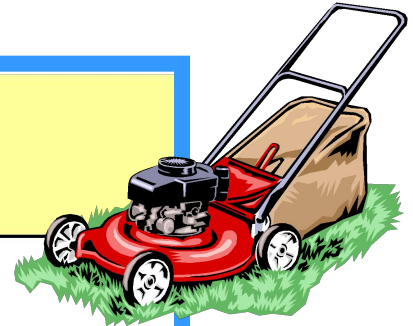
- Close Revenue accounts to Income Summary.
- ② Close Expense accounts to Income Summary.
- Close Income Summary account to Retained Earnings.
- ④ Close Dividends to Retained Earnings.

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
<b>Total</b>	<b>\$</b>	<b>21,650</b>	<b>\$ 21,650</b>



# Evaluating the Business

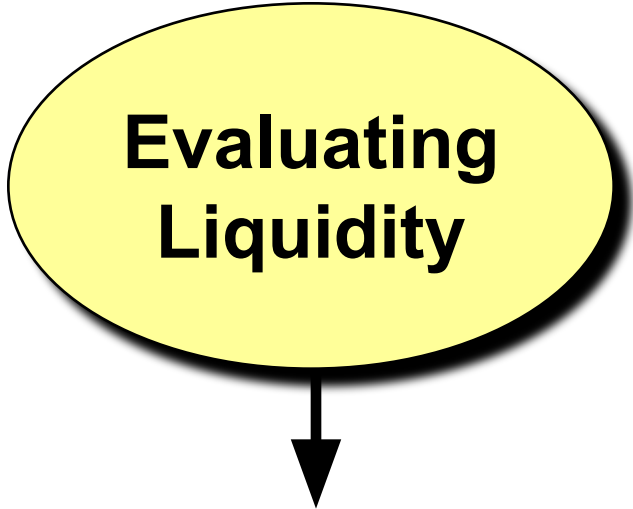
## Evaluating Profitability



$$\text{Net Income Percentage} = \frac{\text{Net Income}}{\text{Total Revenue}}$$

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

## Evaluating Liquidity

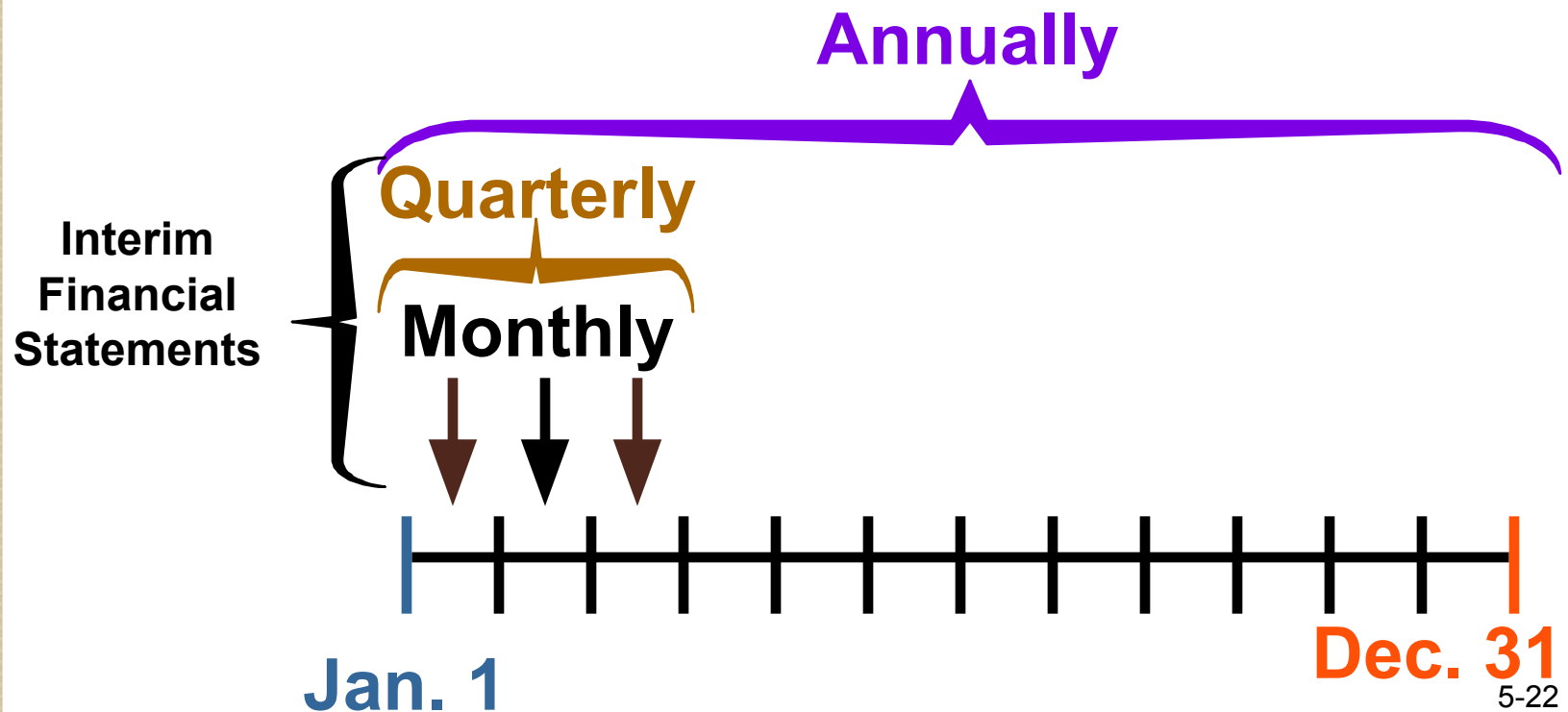


$$\text{Working Capital} = \text{Current Assets} - \text{Current Liabilities}$$

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

# 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.**





# End of Chapter 5

