

The Accounting Cycle

A company normally uses these accounting procedures to record transactions and prepare financial statements.

1) Identifying and Recording Transactions and Other Events

- ❖ An item should be recognized in the financial statements if such recognition provides users of financial statements with (a) relevant information about the asset or the liability and about any income, expenses, or changes in equity and (b) a faithful representation of the asset or the liability and of any income, expenses, or changes in equity.
- ❖ Skilled employees are an important asset (highly relevant), but the problems of determining their value and measuring it reliably have not yet been solved. Consequently, human resources are not recorded.
- ❖ Perhaps when measurement techniques become more sophisticated and accepted, such information will be presented.
- ❖ Transactions recorded may be an exchange between two entities where each receives and sacrifices value, such as purchases and sales of goods or services.

2) Post from the journals to the ledger (ledgers).

- A company records in accounts those transactions and events that affect its assets, liabilities, and equities.
- The general ledger contains all the asset, liability, and equity accounts.
- An account shows the effect of transactions on particular asset, liability, equity, revenue, and expense accounts
- A transaction affects two or more accounts, each of which is on a different page in the ledger. Therefore, in order to have a complete record of each transaction or other event in one place, a company uses a journal (also called “the book of original entry”).
- In its simplest form, a **general journal** chronologically lists transactions and other events, expressed in terms of debits and credits to accounts.

- As an example, Illustration below depicts the technique of journalizing, using two transactions for Softbyte A.Ş. These transactions are:
 - ❖ September 1, 2019 : Shareholders invested birr 15,000 cash in the company in exchange for ordinary shares. Purchased computer equipment for birr 7,000 cash.

GENERAL JOURNAL

J1

Account Titles and Explanation

Date

Ref

Debit

Credit

2019

Sept. 1

Cash

15,000

Share Capital—Ordinary

15,000

**(Issued ordinary shares
for cash)**

1

Equipment

7,000

Cash

7,000

Shambel T. (Mr)

**(Purchased equipment
for cash)**

- ❖ The J1 indicates these two entries are on the first page of the general journal.
- ❖ Each general journal entry consists of four parts:
 - (1) a date
 - (2) the accounts and amounts to be debited (Dr.)
 - (3) the accounts and amounts to be credited (Cr.), and
 - (4) an explanation.
- ❖ In some cases, a company uses **special journals** in addition to the general journal.
- ❖ **Special journals** summarize transactions possessing a common characteristic (e.g. cash, sales, purchases). As a result, using them reduces bookkeeping time.

Posting

- ❖ The procedure of transferring journal entries to the ledger accounts is called posting.
- ❖ Posting involves the following steps.
 - 1) In the ledger, enter in the appropriate columns of the debited account(s) the date, journal page, and debit amount shown in the journal.
 - 2) In the reference column of the journal, write the account number to which the debit amount was posted.
 - 3) In the ledger, enter in the appropriate columns of the credited account(s) the date, journal page, and credit amount shown in the journal.
 - 4) In the reference column of the journal, write the account number to which the credit amount was posted.
- ❖ The general ledger accounts in standard account form has three money columns—debit, credit, and balance.

GENERAL JOURNAL					J1
Date	Account Titles and Explanation	Ref.	Debit	Credit	
2019 Sept.1	Cash	101	15,000		
	Share Capital — Ordinary (Issued ordinary shares for cash)	311		15,000	

GENERAL LEDGER					
Cash					No.101
Date	Explanation	Ref.	Debit	Credit	Balance
2019 Sept.1		J1	15,000		15,000

Share Capital—Ordinary					No.311
Date	Explanation	Ref.	Debit	Credit	Balance
2019 Sept.1		J1		15,000	15,000

- Key:
- 1 Post to debit account—date, journal page number, and amount.
 - 2 Enter debit account number in journal reference column.
 - 3 Post to credit account—date, journal page number, and amount.
 - 4 Enter credit account number in journal reference column.

- The number in the posting reference column serves two purposes:
 - (1) It indicates the ledger account number of the account involved.
 - (2) It indicates the completion of posting for the particular item.
- Each company selects its own numbering system for its ledger accounts.
- Many begin numbering with asset accounts and then follow with liabilities, equity, revenue, and expense accounts, in that order.

Chart of Accounts

- Are **lists of the accounts** and the account numbers that **identify their location** in the ledger.
For Yazici Advertising A.Ş. (a service company).
- ❖ The ranges of the account numbers are as follows.
 - Accounts 101–199 indicate asset accounts
 - 200–299 indicate liabilities
 - 300–399 indicate equity accounts
 - 400–499, revenues
 - 500–599, expenses

- Illustration 1: Investment of Cash by Shareholders

Transaction

On October 1, C. R. Yazici invests ₺100,000 cash in an advertising company to be known as Yazici Advertising A.Ş.

Basic Analysis

The asset Cash increases ₺100,000; equity (specifically, Share Capital—Ordinary) increases ₺100,000.

Equation Analysis

<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Equity</u>	
Cash	=			Share Capital	
+100,000				+100,000	Issued Shares

Debit–Credit Analysis

Debits increase assets: debit Cash ₺100,000.
Credits increase equity: credit Share Capital—Ordinary ₺100,000.

Journal Entry

Oct. 1	Cash	101	100,000	
	Share Capital—Ordinary (Issued shares for cash)	311		100,000

Posting

Cash 101		Share Capital—Ordinary 311	
Oct. 1	100,000		Oct. 1 100,000

ILLUSTRATION 2: Purchase of Office Equipment

Transaction

On October 1, Yazici Advertising purchases office equipment costing ₺50,000 by signing a 3-month, 12%, ₺50,000 note payable.

Basic Analysis

The asset Equipment increases ₺50,000; the liability Notes Payable increases ₺50,000.

Equation Analysis

<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Equity</u>
Equipment	=	Notes Payable		
+50,000		+50,000		

Debit-Credit Analysis

Debits increase assets: debit Equipment ₺50,000.
Credits increase liabilities: credit Notes Payable ₺50,000.

Journal Entry

Oct. 1	Equipment		157	50,000	
	Notes Payable		200		50,000
	(Issued 3-month, 12% note for office equipment)				

Posting

Equipment		157	Notes Payable		200
Oct. 1	50,000			Oct. 1	50,000

ILLUSTRATION 3: Receipt of Cash for Future Service

Transaction

On October 2, Yazici Advertising receives a ₺12,000 cash advance from R. Knox, a client, for advertising services that are expected to be completed by December 31.

Basic Analysis

The asset Cash increases ₺12,000; the liability Unearned Service Revenue increases ₺12,000 because the service has not been performed yet. That is, when Yazici receives an advance payment, it should record an unearned revenue (a liability) in order to recognize the obligation that exists. Note also that although many liabilities have the word "payable" in their title, unearned revenue is considered a liability because the liability is satisfied by providing a product or performing a service.

Equation Analysis

<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Equity</u>
Cash	=	Unearned Service Revenue		
+12,000		+12,000		

Debit-Credit Analysis

Debits increase assets: debit Cash ₺12,000.
Credits increase liabilities: credit Unearned Service Revenue ₺12,000.

Journal Entry

Oct. 2	Cash	101	12,000	
	Unearned Service Revenue (Received cash from R. Knox for future service)	209		12,000

Posting

Cash		101	Unearned Service Revenue		209
Oct. 1	100,000				
2	12,000				
				Oct. 2	12,000

Illustration 4: Payment of Monthly Rent

Transaction

On October 3, Yazici Advertising pays office rent for October in cash, ₺9,000.

Basic Analysis

Rent Expense increases ₺9,000 because the payment pertains only to the current month; the asset Cash decreases ₺9,000.

Equation Analysis

Assets	=	Liabilities	+	Equity
Cash	=			Expenses
-9,000				-9,000 Rent Expense

Debit-Credit Analysis

Debits increase expenses: debit Rent Expense ₺9,000.
Credits decrease assets: credit Cash ₺9,000.

Journal Entry

Oct. 3	Rent Expense	729	9,000	
	Cash	101		9,000
	(Paid October rent)			

Posting

Cash		101	
Oct. 1	100,000	Oct. 3	9,000
2	12,000		

Rent Expense		729
Oct. 3	9,000	

Illustration 5: payment of insurance

Transaction	On October 4, Yazici Advertising pays ₺6,000 for a one-year insurance policy that will expire next year on September 30.																						
Basic Analysis	The asset Prepaid Insurance increases ₺6,000 because the payment extends to more than the current month; the asset Cash decreases ₺6,000. Payments of expenses that will benefit more than one accounting period are prepaid expenses or prepayments. When a company makes a payment, it debits an asset account in order to show the service or benefit that will be received in the future.																						
Equation Analysis	$ \begin{array}{rcl} \text{Assets} & = & \text{Liabilities} + \text{Equity} \\ \hline \text{Cash} & + & \text{Prepaid Insurance} \\ -6,000 & & +6,000 \end{array} $																						
Debit–Credit Analysis	Debits increase assets: debit Prepaid Insurance ₺6,000. Credits decrease assets: credit Cash ₺6,000.																						
Journal Entry	Oct. 4	Prepaid Insurance Cash (Paid one-year policy; effective date October 1)	130 101	6,000	6,000																		
Posting	<table border="1"> <thead> <tr> <th colspan="2">Cash</th> <th>101</th> <th colspan="2">Prepaid Insurance</th> <th>130</th> </tr> </thead> <tbody> <tr> <td>Oct. 1</td> <td>100,000</td> <td></td> <td>Oct. 3</td> <td>9,000</td> <td></td> </tr> <tr> <td>2</td> <td>12,000</td> <td></td> <td>4</td> <td>6,000</td> <td></td> </tr> </tbody> </table>					Cash		101	Prepaid Insurance		130	Oct. 1	100,000		Oct. 3	9,000		2	12,000		4	6,000	
Cash		101	Prepaid Insurance		130																		
Oct. 1	100,000		Oct. 3	9,000																			
2	12,000		4	6,000																			

Illustration 6: Purchase of Supplies on Credit

Transaction

On October 5, Yazici Advertising purchases an estimated three-month supply of advertising materials on account from Aero Supply for ₺25,000.

Basic Analysis

The asset Supplies increases ₺25,000; the liability Accounts Payable increases ₺25,000.

Equation Analysis

<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Equity</u>
Supplies	=	Accounts Payable		
+25,000		+25,000		

Debit – Credit Analysis

Debits increase assets: debit Supplies ₺25,000.
Credits increase liabilities: credit Accounts Payable ₺25,000.

Journal Entry

Oct. 5	Supplies	126	25,000	
	Accounts Payable	201		25,000
	(Purchased supplies on account from Aero Supply)			

Posting

Supplies		126	Accounts Payable		201
Oct. 5	25,000			Oct. 5	25,000

Illustration 7: Declaration and Payment of Dividend

Transaction

On October 20, Yazici Advertising's board of directors declares and pays a ₺5,000 cash dividend to shareholders.

Basic Analysis

The Dividends account increases ₺5,000; the asset Cash decreases ₺5,000.

Equation Analysis

<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Equity</u>
Cash	=			Dividends
-5,000				-5,000

Debit-Credit Analysis

Debits increase dividends: debit Dividends ₺5,000.
Credits decrease assets: credit Cash ₺5,000.

Journal Entry

Oct. 20	Dividends	332	5,000	
	Cash	101		5,000
	(Declared and paid a cash dividend)			

Posting

Cash		101	Dividends		332
Oct. 1	100,000		Oct. 20	5,000	
2	12,000				
		Oct. 3			
		9,000			
		4			
		6,000			
		20			
		5,000			

Illustration 8: Payment of salary

On October 26, Yazici Advertising pays employee salaries and wages in cash. Employees are paid once a month, every four weeks. The total payroll is ₺10,000 per week, or ₺2,000 per day. In October, the pay period began on Monday, October 1. As a result, the pay period ended on Friday, October 26, with salaries and wages of ₺40,000 being paid.

Transaction

Basic Analysis

Salaries and Wages Expense increases ₺40,000; the asset Cash decreases ₺40,000.

Equation Analysis

<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Equity</u>	
Cash	=			Expenses	
-40,000				-40,000	Salaries and Wages Expense

Debit–Credit Analysis

Debits increase expenses: debit Salaries and Wages Expense ₺40,000.
Credits decrease assets: credit Cash ₺40,000.

Journal Entry

Oct. 26	Salaries and Wages Expense	726	40,000	
	Cash	101		40,000
	(Paid salaries to date)			

Posting

Cash 101		Salaries and Wages Expense 726	
Oct. 1 100,000	Oct. 3 9,000	Oct. 26 40,000	
2 12,000	4 6,000		
	20 5,000		
	26 40,000		

Illustration 9: Receipt of Cash for Services Provided

Transaction

On October 31, Yazici Advertising receives ₺28,000 in cash and bills Copa Company ₺72,000 for advertising services of ₺100,000 performed in October.

Basic Analysis

The asset Cash increases ₺28,000; the asset Accounts Receivable increases ₺72,000; the revenue account Service Revenue increases ₺100,000.

Equation Analysis

Assets		=	Liabilities	+	Equity	
Cash	Accounts Receivable	=			Revenues	
+28,000	+72,000				+100,000	Service Revenue

Debit-Credit Analysis

Debits increase assets: debit Cash ₺28,000; Accounts Receivable ₺72,000. Credits increase revenues: credit Service Revenue ₺100,000.

Journal Entry

Oct. 31	Cash	101	28,000	
	Accounts Receivable	112	72,000	
	Service Revenue	400		100,000
	(Recognize revenue for services performed)			

Posting

Cash		101	Accounts Receivable		112	Service Revenue		400
Oct. 1	100,000		Oct. 31	72,000		Oct. 31	100,000	
2	12,000							
31	28,000							

3) Preparing Trial Balance (Unadjusted)

- It is proving the equality of the two columns.
- The following illustration presents the trial balance prepared from the ledger of Yazici Advertising A.Ş.

YAZICI ADVERTISING A.Ş
TRIAL BALANCE
OCTOBER 31, 2019

	Dibit	Credit
Cash	80,000	
Accounts Receivable	72,000	
Supplies	25,000	
Prepaid Insurance	6,000	
Equipment	50,000	
Notes Payable		50,000
Accounts Payable		25,000
Unearned Service Revenue		12,000
Share Capital—Ordinary		100,000
Dividends	5,000	
Service Revenue		100,000
Salaries and Wages Expense	40,000	
Rent Expense	9000	
	<u>287,000</u>	<u>287,000</u>
Shambel T. (Mr)		

- Note that the total debits (287,000) equal the total credits (287,000).
- A trial balance also often shows account numbers to the left of the account titles.
- A trial balance does not prove that a company recorded all transactions or that the ledger is correct.
- Numerous **errors** may exist even though the trial balance columns agree. For example, the trial balance may balance even when a company

- (1) fails to journalize a transaction,
- (2) omits posting a correct journal entry,
- (3) posts a journal entry twice,
- (4) uses incorrect accounts in journalizing or posting, or
- (5) makes offsetting errors in recording the amount of a transaction.

In other words, as long as a company posts equal debits and credits, even to the wrong account or in the wrong amount, the total debits will equal the total credits

4) Identify and prepare adjusting entries

- Adjustments ensure that companies follow the revenue recognition and expense recognition principles.
- Adjusting entries are required every time a company prepares **financial statements**.

Types of Adjusting Entries

- ❖ Adjusting entries are classified as either deferrals or accruals.
- ❖ Each of these classes has two subcategories.

A) Deferrals:

1. **Prepaid expenses:** Expenses paid in cash before they are used or consumed.

- ❖ Assets paid for and recorded before a company uses them are called prepaid expenses.
- ❖ When expenses are prepaid, a company debits an asset account to show the service or benefit it will receive in the future.
- ❖ Examples of common prepayments are insurance, supplies, advertising, and rent. In addition, companies make prepayments when they purchase buildings and equipment.

- We assume that Yazici uses an accounting period of one month. Thus, Yazici will make monthly adjusting entries, dated October 31.

Adjusting Entries for Deferrals

- To defer means to postpone or delay. Deferrals are expenses or revenues that are recognized at a date later than the point when cash was originally exchanged.
- The two types of deferrals are prepaid expenses and unearned revenues.
- If a company does not make an adjustment for these deferrals, the asset and liability are overstated, and the related expense and revenue are understated.
- Thus, the adjusting entry for deferrals will affect a statement of financial position account and an income statement account.

2) **Unearned revenues:** Cash received before services are performed.

B) Accruals:

1. **Accrued revenues:** Revenues for services performed but not yet received in cash or recorded.

2. **Accrued expenses:** Expenses incurred but not yet paid in cash or recorded.

ILLUSTRATION : Adjusting Entries for Deferrals

ADJUSTING ENTRIES

Prepaid Expenses



Unearned Revenues



- For example, Yazici Advertising purchased advertising supplies costing 25,000 on October 5. Yazici therefore debited the asset Supplies. This account shows a balance of 25,000 in the October 31 trial balance
- An inventory count at the close of business on October 31 reveals that 10,000 of supplies are still on hand.
Thus, the cost of supplies used is 15,000 (25,000 - 10,000). The analysis and adjustment for Supplies is summarized in Illustration below.

1. Adjustment for Supplies

Basic Analysis

The expense Supplies Expense is increased ₪15,000, and the asset Supplies is decreased ₪15,000.

Equation Analysis

$$(1) \quad \begin{array}{r} \text{Assets} \\ \text{Supplies} \\ \hline - \text{₪15,000} \end{array} = \begin{array}{r} \text{Liabilities} \\ \hline \end{array} + \begin{array}{r} \text{Equity} \\ \text{Supplies Expense} \\ \hline - \text{₪15,000} \end{array}$$

Debit-Credit Analysis

Debits increase expenses: debit Supplies Expense ₪15,000.
Credits decrease assets: credit Supplies ₪15,000.

Journal Entry

Oct. 31	Supplies Expense	15,000	
	Supplies		15,000
	(To record supplies used)		

Posting

Supplies			126
Oct. 5	25,000	Oct. 31 Adj.	15,000
Oct. 31	Bal.	10,000	

Supplies Expense			631
Oct. 31	Adj.	15,000	
Oct. 31	Bal.	15,000	

- For example, on October 4, Yazici Advertising paid 6,000 for a one-year fire insurance policy, beginning October 1. Yazici debited the cost of the premium to Prepaid Insurance at that time. This account still shows a balance of 6,000 in the October 31 trial balance.
- An analysis of the policy reveals that 500 ($6,000 \div 12$) of insurance expires each month. The analysis and adjustment for insurance is summarized in Illustration [below](#).

2. Adjustment for Insurance

Basic
Analysis

The expense Insurance Expense is increased ₪500, and the asset Prepaid Insurance is decreased ₪500.

Equation
Analysis

$$(2) \quad \begin{array}{c} \text{Assets} \\ \hline \text{Prepaid Insurance} \\ \hline -\text{₪500} \end{array} = \begin{array}{c} \text{Liabilities} \\ \hline \end{array} + \begin{array}{c} \text{Equity} \\ \hline \text{Insurance Expense} \\ \hline -\text{₪500} \end{array}$$

Debit-Credit
Analysis

Debits increase expenses: debit Insurance Expense ₪500.
Credits decrease assets: credit Prepaid Insurance ₪500.

Journal
Entry

Oct. 31	Insurance Expense	500	
	Prepaid Insurance		500
	(To record insurance expired)		

Posting

Prepaid Insurance			130
Oct. 4	6,000	Oct. 31 Adj. 500	
Oct. 31	Bal. 5,500		

Insurance Expense			722
Oct. 31	Adj. 500		
Oct. 31	Bal. 500		

Depreciation

- **Depreciation** is the process of allocating the cost of an asset to expense over its useful life in a rational and systematic manner.
- Depreciation is an estimate rather than a factual measurement of the expired cost.
- Accumulated Depreciation—Equipment is a contra asset account.
- A contra asset account offsets an asset account on the statement of financial position. This means that the Accumulated Depreciation—Equipment account offsets the Equipment account on the statement of financial position.
- Its normal balance is a credit.
- The **book value (or carrying value)** of any depreciable asset is the difference between its cost and its related accumulated depreciation.

Equipment	50,000	
Less: Accumulated depreciation—equipment	400	49,600

- ❖ In the Yazici Advertising, it estimates depreciation on its office equipment to be 4,800 a year (cost 50,000 less residual value 2,000 divided by useful life of 10 years), or 400 per month.
- ❖ The analysis and adjustment for depreciation is summarized in Illustration below.

3. Adjustment for Depreciation

Basic Analysis

The expense Depreciation Expense is increased ₪400, and the contra asset Accumulated Depreciation—Equipment is increased ₪400.

Equation Analysis

<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Equity</u>
Accumulated Depreciation—Equipment	=			Depreciation Expense
-₪400	=			-₪400

Debit-Credit Analysis

Debits increase expenses: debit Depreciation Expense ₪400.
Credits increase contra assets: credit Accumulated Depreciation—Equipment ₪400.

Journal Entry

Oct. 31	Depreciation Expense	400	
	Accumulated Depreciation—Equipment		400
	(To record monthly depreciation)		

Posting

Equipment		157
Oct. 1	50,000	
Oct. 31	Bal. 50,000	

Accumulated Depreciation—Equipment		158
	Oct. 31 Adj. 400	
	Oct. 31 Bal. 400	

Depreciation Expense		711
Oct. 31	Adj. 400	
Oct. 31	Bal. 400	

- Depreciation expense identifies that portion of the asset's cost that expired during the period (in this case, October).
- Without this adjusting entry, total assets, total equity, and net income are overstated, and depreciation expense is understated.

Unearned Revenues

- ❖ When companies receive cash before services are performed, they record a liability by increasing (crediting) a liability account called **unearned revenues**.
- ❖ In other words, a company now has a performance obligation (liability) to provide service to one of its customers.
- ❖ Items like rent, magazine subscriptions, and customer deposits for future service may result in unearned revenues.
- ❖ Airlines, treat receipts from the sale of tickets as unearned revenue until they satisfy the performance obligation (provide the flight service).

- ❖ When a company receives payment for services to be performed in a future accounting period, it credits an unearned revenue (a liability) account to recognize the liability that exists and debits cash.
- ❖ The company subsequently recognizes revenue when it performs the service.
- ❖ Therefore, the company delays recognition of revenue until the adjustment process. Then, the company makes an adjusting entry to record the revenue for services performed during the period and to show the liability that remains at the end of the accounting period.
- ❖ Liabilities are overstated and revenues are understated prior to adjustment.
- ❖ Thus, the adjusting entry for unearned revenues results in a debit (decrease) to a liability account

- For example, Yazici Advertising received 12,000 on October 2 from R. Knox for advertising services expected to be completed by December 31.

Cash-----12000

Unearned revenue-----12000 (to record in advance collection)

- This liability account shows a balance of 12,000 in the October 31 trial balance.
- Based on an evaluation of the service Yazici performed for Knox during October, the company determines that it should recognize 4,000 of revenue in October.
- The liability (Unearned Service Revenue) is therefore decreased and equity (Service Revenue) is increased, as shown in Illustration below.

Adjustment for Unearned Service Revenue

Basic Analysis

The liability Unearned Service Revenue is decreased ₺4,000, and the revenue Service Revenue is increased ₺4,000.

Equation Analysis

<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Equity</u>
		Unearned Service Revenue		Service Revenue
		- \$4,000		+ \$4,000

Debit-Credit Analysis

Debits decrease liabilities: debit Unearned Service Revenue \$4,000.
Credits increase revenues: credit Service Revenue \$4,000.

Journal Entry

Oct. 31	Unearned Service Revenue Service Revenue (To record revenue for services performed)	4,000	4,000
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Posting

Unearned Service Revenue		209
Oct. 31	Adj. 4,000	Oct. 2 12,000
		Oct. 31 Bal. 8,000

Service Revenue		400
	Oct. 31 100,000	
	31 Adj. 4,000	
	Oct. 31 Bal. 104,000	

Adjusting Entries for Accruals

- Without an accrual adjustment, the revenue account (and the related asset account) or the expense account (and the related liability account) are understated.
- Thus, the adjusting entry for accruals will increase both a statement of financial position and an income statement account. **The following** shows adjusting entries for accruals.

Adjusting Entries for Accruals

ADJUSTING ENTRIES

Accrued Revenues

Asset	
Debit Adjusting Entry (+)	

Revenue	
	Credit Adjusting Entry (+)

Accrued Expenses

Expense	
Debit Adjusting Entry (+)	

Liability	
	Credit Adjusting Entry (+)

Cont...

- In October, Yazici Advertising performed services worth 2,000 that were not billed to clients on or before October 31. Because these services are not billed(collected), they are not recorded. The accrual of unrecorded service revenue increases an asset account, Accounts Receivable. It also increases equity by increasing a revenue account, Service Revenue, as shown in Illustration [below](#).

Adjusting for unrecorded A/R

Basic Analysis

The asset Accounts Receivable is increased ₪2,000, and the revenue Service Revenue is increased ₪2,000.

Equation Analysis

Assets	=	Liabilities	+	Equity
Accounts Receivable	=			Service Revenue
+₪2,000	=			+₪2,000

Debit-Credit Analysis

Debits increase assets: debit Accounts Receivable ₪2,000.
Credits increase revenues: credit Service Revenue ₪2,000.

Journal Entry

Oct. 31	Accounts Receivable		2,000	
	Service Revenue			2,000
	(To record revenue for services performed)			

Posting

Accounts Receivable		112	Service Revenue		400
Oct 31	72,000		Oct. 31	100,000	
31	Adj. 2,000		31	4,000	
Oct. 31	Bal. 74,000		31	Adj. 2,000	
			Oct. 31	Bal. 106,000	

- The asset Accounts Receivable shows that clients owe 74,000 at the statement of financial position date. The balance of 106,000 in Service Revenue represents the total revenue for services performed during the month($100,000 + 4,000 + 2,000$).
- Without an adjusting entry, assets and equity on the statement of financial position, and revenues and net income on the income statement, are understated.

Accrued Expenses

- Expenses incurred but not yet paid or recorded at the statement date are called **accrued expenses**, such as interest, rent, taxes, and salaries.
- Accrued expenses result from the same causes as accrued revenues. In fact, an accrued expense on the books of one company is an accrued revenue to another company.
- For example, the 2,000 accrual of service revenue by Yazici Advertising is an accrued expense to the client that received the service.
- Adjustments for accrued expenses record the obligations that exist at the statement of financial position date and recognize the expenses that apply to the current accounting period.
- Prior to adjustment, both liabilities and expenses are understated. Therefore, the adjusting entry for accrued expenses results in a debit (increase) to an expense account and a credit (increase) to a liability account.

Accrued Interest.

- ❖ Yazici Advertising signed a three-month note payable in the amount of 50,000 on October 1.
- ❖ The note requires interest at an annual rate of 12 percent.
- ❖ Three factors determine the amount of the interest accumulation: (1) the face value of the note; (2) the interest rate, which is always expressed as an annual rate; and (3) the length of time the note is outstanding.
- ❖ For Yazici, the total interest due on the 50,000 note at its maturity date three months in the future is 1,500 ($50,000 \times 12\% \times 3/12$), or 500 for one month.

❖

Face Value of Note	x	Annual Interest Rate	x	Time in Terms of One Year	=	Interest
₺50,000	x	12%	x	1/12	=	₺500

iting the ear.

Adjustment for Interest

Basic Analysis

The expense Interest Expense is increased ₪500, and the liability Interest Payable is increased ₪500.

Equation Analysis

$$\begin{array}{c} \text{Assets} \\ \hline \end{array} = \begin{array}{c} \text{Liabilities} \\ \hline \text{Interest Payable} \\ + \text{₪500} \end{array} + \begin{array}{c} \text{Equity} \\ \hline \text{Interest Expense} \\ - \text{₪500} \end{array}$$

Debit-Credit Analysis

Debits increase expenses: debit Interest Expense ₪500.
Credits increase liabilities: credit Interest Payable ₪500.

Journal Entry

Oct. 31	Interest Expense		500	
	Interest Payable			500
	(To record interest on notes payable)			

Posting

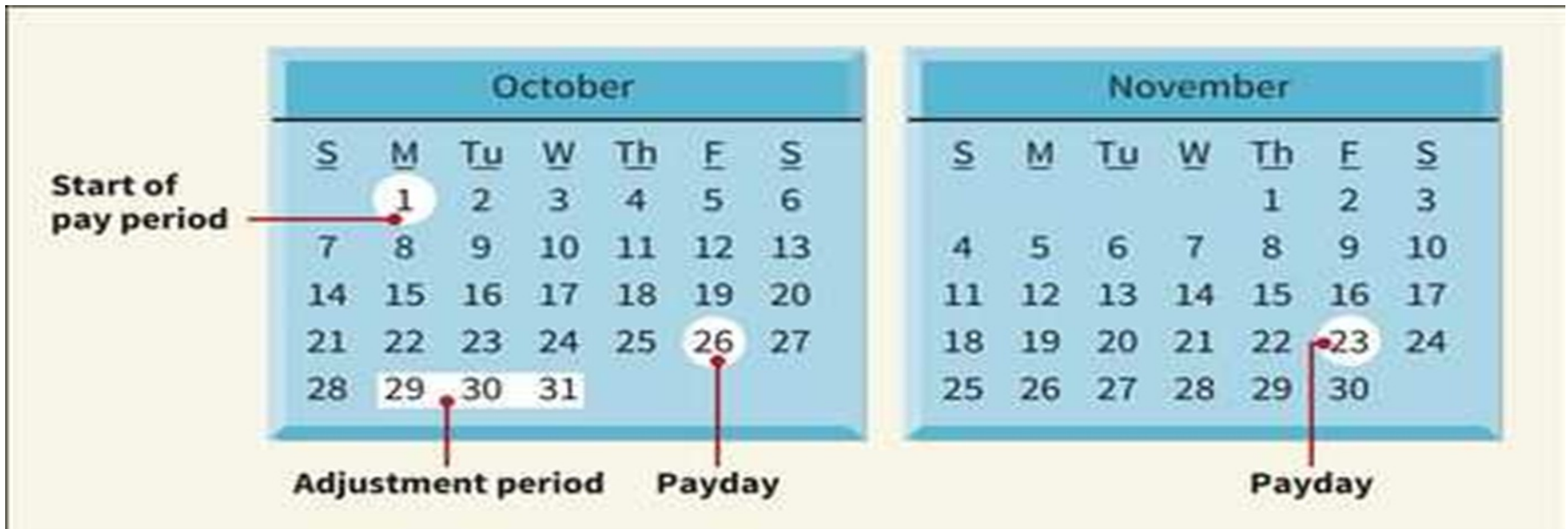
Interest Expense			905	Interest Payable			230
Oct. 31	Adj.	500			Oct. 31	Adj.	500
Oct. 31	Bal.	500			Oct. 31	Bal.	500

Cont..

- Why does Yazici use the Interest Payable account instead of crediting Notes Payable?
- By recording interest payable separately, Yazici discloses the two types of obligations (interest and principal) in the accounts and statements.
- Without this adjusting entry, both liabilities and interest expense are understated, and both net income and equity are overstated.

Accrued Salaries and Wages

- Companies pay for some types of expenses, such as employee salaries and wages, after the services have been performed.
- For example, Yazici Advertising last paid salaries and wages on October 26. It will not pay salaries and wages again until November 23.
- However, as shown in Illustration [below](#) the calendar below, three working days remain in October (October 29–31)



- At October 31, the salaries and wages for these days represent an accrued expense and a related liability to Yazici. The employees receive total salaries and wages of 10,000 for a five-day work week, or 2,000 per day. Thus, accrued salaries and wages at October 31 are 6,000 (2,000 × 3). The analysis and adjustment process is summarized in Illustration

Basic Analysis	The expense Salaries and Wages Expense is increased ₺6,000, and the liability Salaries and Wages Payable is increased ₺6,000.																																			
Equation Analysis	<table><tr><td><u>Assets</u></td><td>=</td><td><u>Liabilities</u></td><td>+</td><td><u>Equity</u></td></tr><tr><td></td><td></td><td>Salaries and Wages Payable</td><td></td><td>Salaries and Wages Expense</td></tr><tr><td></td><td></td><td>+ ₺6,000</td><td></td><td>- ₺6,000</td></tr></table>				<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Equity</u>			Salaries and Wages Payable		Salaries and Wages Expense			+ ₺6,000		- ₺6,000																	
<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Equity</u>																																
		Salaries and Wages Payable		Salaries and Wages Expense																																
		+ ₺6,000		- ₺6,000																																
Debit-Credit Analysis	<div>Debits increase expenses: debit Salaries and Wages Expense ₺6,000.</div> <div>Credits increase liabilities: credit Salaries and Wages Payable ₺6,000.</div>																																			
Journal Entry	<table><tr><td>Oct. 31</td><td>Salaries and Wages Expense</td><td>6,000</td><td></td></tr><tr><td></td><td>Salaries and Wages Payable</td><td></td><td>6,000</td></tr><tr><td></td><td colspan="3">(To record accrued salaries)</td></tr></table>				Oct. 31	Salaries and Wages Expense	6,000			Salaries and Wages Payable		6,000		(To record accrued salaries)																						
Oct. 31	Salaries and Wages Expense	6,000																																		
	Salaries and Wages Payable		6,000																																	
	(To record accrued salaries)																																			
Posting	<table><tr><td colspan="3">Salaries and Wages Expense</td><td>726</td><td colspan="3">Salaries and Wages Payable</td><td>212</td></tr><tr><td>Oct. 26</td><td>40,000</td><td></td><td></td><td></td><td></td><td></td><td></td></tr><tr><td>31</td><td>Adj. 6,000</td><td></td><td></td><td></td><td></td><td>Oct. 31</td><td>Adj. 6,000</td></tr><tr><td>Oct. 31</td><td>Bal. 46,000</td><td></td><td></td><td></td><td></td><td>Oct. 31</td><td>Bal. 6,000</td></tr></table>				Salaries and Wages Expense			726	Salaries and Wages Payable			212	Oct. 26	40,000							31	Adj. 6,000					Oct. 31	Adj. 6,000	Oct. 31	Bal. 46,000					Oct. 31	Bal. 6,000
Salaries and Wages Expense			726	Salaries and Wages Payable			212																													
Oct. 26	40,000																																			
31	Adj. 6,000					Oct. 31	Adj. 6,000																													
Oct. 31	Bal. 46,000					Oct. 31	Bal. 6,000																													

Shambel T. (Mr)

- After this adjustment, the balance in Salaries and Wages Expense of 46,000 (23 days × 2,000) is the actual salaries and wages expense for October.
- The balance in Salaries and Wages Payable of 6,000 is the amount of the liability for salaries and wages owed as of October 31.
- Without the 6,000 adjustment for salaries and wages, both Yazici's expenses and liabilities are understated by 6,000.
- Yazici pays salaries and wages every four weeks. Consequently, the next payday is November 23, when it will again pay total salaries and wages of 40,000.
- The payment consists of 6,000 of salaries and wages payable at October 31 plus 34,000 of salaries and wages expense for November (17 working days as shown in the November calendar × 2,000).
- Therefore, Yazici makes the following entry on November 23.

November 23		
Salaries and Wages Payable	6,000	
Salaries and Wages Expense	34,000	
Cash	0	40,000
(To record November 23 payroll)		

This entry eliminates the liability for Salaries and Wages Payable that Yazici recorded in the October 31 adjusting entry. This entry also records the proper amount of Salaries and Wages Expense for the period between November 1 and November 23.

Bad Debts

- ❖ Proper recognition of revenues and expenses dictates recording **bad debts as an expense** of the period in which a company records revenue for services performed instead of the period in which the company writes off the accounts or notes.
- ❖ **The proper valuation of the receivable balance also requires recognition of uncollectible receivables.**
- ❖ Proper recognition and valuation require an adjusting entry. At the end of each period, a company estimates the amount of receivables that will later prove to be uncollectible.
- ❖ The company bases the estimate on various factors: the amount of bad debts it experienced in past years, general economic conditions, how long the receivables are past due, and other factors that indicate the extent of uncollectibility.
- ❖ To illustrate, assume that, based on past experience, Yazici Advertising reasonably estimates a bad debt expense for the month of 1,600. The analysis and adjustment process for bad debts is summarized in Illustration below

Adjustment for Bad Debt Expense

Basic Analysis

The expense Bad Debt Expense is increased ₺1,600, and the contra asset Allowance for Doubtful Accounts is increased ₺1,600.

Equation Analysis

Assets	=	Liabilities	+	Equity
Allowance for Doubtful Accounts	=			Bad Debt Expense
-₺1,600	=			-₺1,600

Debit-Credit Analysis

Debits increase expenses: debit Bad Debt Expense ₺1,600.
Credits increase contra assets: credit Allowance for Doubtful Accounts ₺1,600.

Journal Entry

Oct. 31	Bad Debt Expense	1,600	
	Allowance for Doubtful Accounts		1,600
	(To record monthly bad debt expense)		

Posting

	Accounts Receivable	112
Oct. 31	72,000	
31	2,000	
Oct. 31	Bal. 74,000	

	Allowance for Doubtful Accounts	113
	Oct. 31 Adj. 1,600	
	Oct. 31 Bal. 1,600	

	Bad Debt Expense	910
Oct. 31	Adj. 1,600	
Oct. 31	Bal. 1,600	

- Without this adjustment, assets will be overstated, and expenses will be understated.
- The Allowance for Doubtful Accounts is a contra asset account and is shown on the statement of financial position, similar to Accumulated Depreciation—Equipment.
- A company often computes bad debts by adjusting the Allowance for Doubtful Accounts to a certain percentage of the trade accounts receivable and trade notes receivable at the end of the period.

5. Adjusted Trial Balance

- After journalizing and posting all adjusting entries, Yazici Advertising prepares another trial balance from its ledger accounts (shown in Illustration below).
- This trial balance is called an **adjusted trial balance**.
- The **purpose of an adjusted trial balance is to prove the equality of the total debit balances and the total credit balances in the ledger after all adjustments.**
- Because the accounts contain all data needed for financial statements, the adjusted trial balance is the primary basis for the preparation of financial statements.

Adjusted Trial Balance

YAZICI ADVERTISING A.S Adjusted Trial Balance October 31, 2019		
	<u>Debit</u>	<u>Credit</u>
Cash	₺ 80,000	
Accounts Receivable	74,000	
Allowance for Doubtful Accounts		₺ 1,600
Supplies	10,000	
Prepaid Insurance	5,500	
Equipment	50,000	
Accumulated Depreciation—Equipment		400
Notes Payable		50,000
Accounts Payable		25,000
Unearned Service Revenue		8,000
Salaries and Wages Payable		6,000
Interest Payable		500
Share Capital—Ordinary		100,000
Dividends	5,000	
Service Revenue		106,000
Salaries and Wages Expense	46,000	
Supplies Expense	15,000	
Rent Expense	9,000	
Insurance Expense	500	
Interest Expense	500	
Depreciation Expense	400	
Bad Debt Expense	<u>1,600</u>	
	₺297,500	₺297,500

6. Preparing Financial Statements

Income Statement and R/E Statement

YAZICI ADVERTISING A.Ş. Adjusted Trial Balance October 31, 2019			YAZICI ADVERTISING A.Ş. Income Statement For the Month Ended October 31, 2019	
Account	Debit	Credit		
Cash	₺ 80,000		Revenues	
Accounts Receivable	74,000		Service revenue	₺106,000
Allowance for Doubtful Accounts		₺ 1,600	Expenses	
Supplies	10,000		Salaries and wages expense	₺46,000
Prepaid Insurance	5,500		Supplies expense	15,000
Equipment	50,000		Rent expense	9,000
Accumulated Depreciation— Equipment		400	Insurance expense	500
Notes Payable		50,000	Interest expense	500
Accounts Payable		25,000	Depreciation expense	400
Unearned Service Revenue		8,000	Bad debt expense	1,600
Salaries and Wages Payable		6,000	Total expenses	73,000
Interest Payable		500	Net income	₺ 33,000
Share Capital—Ordinary		100,000		
Retained Earnings		-0-		
Dividends	5,000			
Service Revenue		106,000		
Salaries and Wages Expense	46,000			
Supplies Expense	15,000			
Rent Expense	9,000			
Insurance Expense	500			
Interest Expense	500			
Depreciation Expense	400			
Bad Debt Expense	1,600			
	₺297,500	₺297,500		

YAZICI ADVERTISING A.Ş. Retained Earnings Statement For the Month Ended October 31, 2019	
Retained earnings, October 1	₺ -0-
Add: Net income	33,000
	33,000
Less: Dividends	5,000
Retained earnings, October 31	₺28,000
To the statement of financial position	

Statement of Financial Position from the Adjusted Trial Balance

YAZICI ADVERTISING A.Ş. Adjusted Trial Balance October 31, 2019			YAZICI ADVERTISING A.Ş. Statement of Financial Position October 31, 2019		
Account	Debit	Credit	<u>Assets</u>		
Cash	₺80,000		Equipment	₺50,000	
Accounts Receivable	74,000		Less: Accumulated depreciation— equipment	400	₺49,600
Allowance for Doubtful Accounts		₺ 1,600	Supplies		10,000
Supplies	10,000		Prepaid insurance		5,500
Prepaid Insurance	5,500		Accounts receivable	74,000	
Equipment	50,000		Less: Allowance for doubtful accounts	1,600	72,400
Accumulated Depreciation— Equipment		400	Cash		80,000
Notes Payable		50,000	Total assets		₺217,500
Accounts Payable		25,000	<u>Equity and Liabilities</u>		
Unearned Service Revenue		8,000	Equity		
Salaries and Wages Payable		6,000	Share capital—ordinary	₺100,000	
Interest Payable		500	Retained earnings	28,000	
Share Capital—Ordinary	100,000		Total equity		₺128,000
Retained Earnings		-0-	Liabilities		
Dividends	5,000		Notes payable	50,000	
Service Revenue		106,000	Accounts payable	25,000	
Salaries and Wages Expense	46,000		Unearned service revenue	8,000	
Supplies Expense	15,000		Salaries and wages payable	6,000	
Rent Expense	9,000		Interest payable	500	
Insurance Expense	500		Total liabilities		89,500
Interest Expense	500		Total equity and liabilities		₺217,500
Depreciation Expense	400				
Bad Debt Expense	1,600				
	₺297,500	₺297,500			

7. Closing Entries (Prepare closing journal entries and post to the ledger(s)).

- The closing process reduces the balance of nominal (temporary) accounts to zero in order to prepare the accounts for the next period's transactions.
- In the closing process Yazici Advertising transfers all of the revenue and expense account balances (income statement items) to a clearing or suspense account called Income Summary.
- The Income Summary account matches revenues and expenses.

- **Closing Entries-** companies generally prepare closing entries only at the end of a company's annual accounting period.

Closing Entries Journalized

General Journal				J3
Date	Account Titles and Explanation	Ref.	Debit	Credit
	<u>Closing Entries</u>			
	(1)			
Oct. 31	Service Revenue		106,000	
	Income Summary			106,000
	(To close revenue account)			
	(2)			
31	Income Summary		73,000	
	Supplies Expense			15,000
	Depreciation Expense			400
	Insurance Expense			500
	Salaries and Wages Expense			46,000
	Rent Expense			9,000

	Interest Expense			500
	Bad Debt Expense			1,600
	(To close expense accounts)			
	(3)			
31	Income Summary		33,000	
	Retained Earnings			33,000
	(To close net income to retained earnings)			
	(4)			
31	Retained Earnings		5,000	
	Dividends			5,000
	(To close dividends to retained earnings)			

Dividends do not close through the Income Summary account. Dividends are not expenses, and they are not a factor in determining net income.

Posting Closing Entries to the ledger

- All temporary accounts have zero balances after posting the closing entries.
- the balance in Retained Earnings represents the accumulated undistributed earnings of Yazici Advertising at the end of the accounting period.
- Yazici uses the **Income Summary account only in closing**. It does not journalize and post entries to this account during the year.
- **temporary accounts**—revenues, expenses, and dividends.
- It does not close the **permanent accounts**—assets, liabilities, and equity (Share Capital—Ordinary and Retained Earnings).
- After the closing process, each **income statement account and the dividend account have zero balances** and are ready for use in the next accounting period.

Supplies Expense 631		
15,000	(2)	15,000

Depreciation Expense 711		
400	(2)	400

Insurance Expense 722		
500	(2)	500

Salaries and Wages Expense 726		
40,000	(2)	46,000
6,000		
46,000		

Rent Expense 729		
9,000	(2)	9,000

Interest Expense 905		
500	(2)	500

Bad Debt Expense 910		
1,600	(2)	1,600

Income Summary 350		
(2) 73,000	(1) 106,000	
(3) 33,000		
106,000	106,000	

Service Revenue 400		
(1) 106,000	100,000	
	4,000	
	2,000	
106,000	106,000	

Retained Earnings 320		
(4) 5,000	0	
	(3) 33,000	
	BaL 28,000	

Dividends 332		
5,000	(4) 5,000	

- Key:
- 1 Close Revenues to Income Summary.
 - 2 Close Expenses to Income Summary.
 - 3 Close Income Summary to Retained Earnings.
 - 4 Close Dividends to Retained Earnings.

8. Post-Closing Trial Balance

- A company may take a **third trial balance** after posting the closing entries.
- The trial balance after closing is called the **post-closing trial balance**.
- The purpose of the post-closing trial balance is to **prove the equality of the permanent account balances that the company carries forward into the next accounting period**.

ILLUSTRATION: Post-Closing Trial Balance

YAZICI ADVERTISING A.Ş.
Post-Closing Trial Balance
October 31, 2019

<u>Account</u>	<u>Debit</u>	<u>Credit</u>
Cash	₺ 80,000	
Accounts Receivable	74,000	
Allowance for Doubtful Accounts		₺ 1,600
Supplies	10,000	
Prepaid Insurance	5,500	
Equipment	50,000	
Accumulated Depreciation—Equipment		400
Notes Payable		50,000
Accounts Payable		25,000
Unearned Service Revenue		8,000
Salaries and Wages Payable		6,000
Interest Payable		500
Share Capital—Ordinary		100,000
Retained Earnings		<u>28,000</u>
	<u>₺219,500</u>	<u>₺219,500</u>

The Accounting Cycle Summarized

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A summary of the steps in the accounting cycle shows a logical sequence of the accounting procedures used during a fiscal period:

1. Enter the transactions of the period in appropriate journals.
 2. Post from the journals to the ledger (or ledgers).
 3. Prepare an unadjusted trial balance (trial balance).
 4. Prepare adjusting journal entries and post to the ledger(s).
 5. Prepare a trial balance after adjusting (adjusted trial balance).
 6. Prepare the financial statements from the adjusted trial balance.
 7. Prepare closing journal entries and post to the ledger(s).
 8. Prepare a trial balance after closing (post-closing trial balance).
 9. Prepare reversing entries (optional) and post to the ledger(s).
- A company normally completes all of these steps in every fiscal period.

THE END!!!