

Financial Accounting Chapter 3

Summary: Cheat Sheet

DEFERRAL OF EXPENSE

Prepaid expenses: Assets paid for in advance of receiving their benefits. When these assets are used, the advance payments become expenses.

Prepaid insurance expires:

Insurance Expense	100	
Prepaid Insurance		100

Supplies are used up:

Supplies Expense	1,050	
Supplies		1,050

Accumulated depreciation: A separate contra account. A contra account is an account linked with another account. It has an opposite normal balance and is a subtraction from that other account's balance.

Depreciation of assets:

Depreciation Expense	300	
Accumulated Depreciation-Equipment		300

DEFERRAL OF REVENUE

Unearned revenue: Cash received in advance of providing products services. When cash is accepted, the company has a liability to provide products or services.

Record unearned revenue (cash received in advance):

Cash	3,000	
Unearned Consulting Revenue		3,000

Reduce unearned revenue (products or services are provided):

Unearned Consulting Revenue	250	
Consulting Revenue		250

ACCRUED EXPENSE

Accrued expenses: Costs incurred in a period that are both unpaid and unrecorded. They are reported on the income statement for the period when incurred.

Salaries expense owed but not yet paid:

Salaries Expense	210	
Salaries Payable		210

Accrued interest formula:

$$\text{Principal amount owed} \times \text{Annual interest rate} \times \text{Fraction of year since last payment}$$

Payment of accrued expenses:

Salaries Payable (3 days at \$70 per day)	210	
Salaries Expense (7 days at \$70 per day)	490	
Cash		700

ACCRUED REVENUE

Accrued revenues: Revenues earned in a period that are both unrecorded and not yet received in cash.

Revenue earned but not received in cash:

Accounts Receivable	1,800	
Consulting Revenue		1,800

Receipt of accrued revenue:

Cash	2,700	
Accounts Receivable (20 days at \$90 per day)		1,800
Consulting Revenue (10 days at \$90 per day)		900

REPORTING AND ANALYSIS

Unadjusted trial balance: A list of ledger accounts and balances *before* adjustments are recorded.

Adjusted trial balance: A list of accounts and balances *after* adjusting entries have been recorded and posted to the ledger.

Preparing financial statements from adjusted trial balance:

Steps to Prepare Financial Statements

Step 1 Prepare income statement using revenue and expense accounts from trial balance

Step 2 Prepare statement of retained earnings using retained earnings and dividends from trial balance; pull net income from Step 1

Step 3 Prepare balance sheet using asset and liability accounts along with common stock from trial balance; pull updated retained earnings from Step 2

Step 4 Prepare statement of cash flows from changes in cash flows for the period (illustrated later in the book)

FASTFORWARD Adjusted Trial Balance December 31			
Acct No.	Account Title	Debit	Credit
101	Cash.....	\$ 4,275	
106	Accounts receivable	1,800	
126	Supplies	8,670	
128	Prepaid Insurance	2,300	
167	Equipment	26,000	
168	Accumulated depreciation–Equipment		\$ 300
201	Accounts payable		6,200
209	Salaries payable		210
236	Unearned consulting revenue		2,750
307	Common stock		30,000
318	Retained earnings		0
319	Dividends	200	
403	Consulting revenue		7,850
406	Rental revenue		300
612	Depreciation expense–Equipment	300	
622	Salaries expense	1,610	
637	Insurance expense	100	
640	Rent expense	1,000	
652	Supplies expense	1,050	
690	Utilities expense	305	
	Totals	<u>\$47,610</u>	<u>\$47,610</u>

Step 1 Prepare income statement

FASTFORWARD Income Statement For Month Ended December 31		
Revenues		
Consulting revenue	\$7,850	
Rental revenue	300	
Total revenues		\$8,150
Expenses		
Depreciation expense-Equipment	300	
Salaries expense	1,610	
Insurance expense	100	
Rent expense	1,000	
Supplies expense	1,050	
Utilities expense	305	
Total expenses		4,365
Net income		<u>3,785</u>

Step 2 Prepare statement of retained earnings

FASTFORWARD Statement of Retained Earnings For Month Ended December 31	
Retained earnings, December 1	\$ 0
Plus: Net income	<u>3,785</u>
	3,785
Less: Dividends	<u>200</u>
Retained earnings, December 31	<u>\$3,585</u>

Step 3 Prepare balance sheet

FASTFORWARD Balance Sheet December 31	
Assets	
Cash	\$ 4,275
Accounts receivable	1,800
Supplies	8,670
Prepaid insurance	2,300
Equipment	\$26,000
Less accumulated depreciation ..	<u>300</u>
	25,700
Total assets	<u>\$ 42,745</u>
Liabilities	
Accounts payable	\$ 6,200
Salaries payable	210
Unearned consulting revenue	<u>2,750</u>
Total liabilities	9,160
Equity	
Common Stock	30,000
Retained earnings	<u>3,585</u>
Total equity	<u>33,585</u>
Total liabilities and equity	<u>\$ 42,745</u>