CHAPTER 6: FINANCIAL STATEMENTS AND THE CLOSING PROCESS

SUMMARY

- 1. The information needed to prepare the income statement is found in the Income Statement columns of the work sheet. Revenue is shown first, followed by an itemized and totaled list of expenses. Net income may be calculated or copied from the Income Statement columns of the work sheet.
- **2.** Two approaches to listing the expenses in the income statement are:
 - a. the expenses could be listed in the same order that they appear in the chart of accounts.
 - **b.** the expenses could be listed in descending order, by dollar amount.
- 3. The Balance Sheet columns of the work sheet provide most of the information needed to prepare a statement of owner's equity. The capital account balance and the drawing account balance are in the Balance Sheet columns of the work sheet. The net income for the year can be found either on the work sheet at the bottom of the Balance Sheet columns or on the income statement. Additional investments must be identified in the owner's capital account.
- 4. If additional investments are made during the year, the owner's capital account in the general ledger must be reviewed. The owner's capital account in the general ledger contains the beginning balance. The additional investments will also be shown in the owner's capital account in the general ledger.
- 5. The work sheet and the statement of owner's equity are used to prepare the balance sheet. The asset and liability amounts can be found in the Balance Sheet columns of the work sheet. The ending balance for the owner's capital has been computed on the statement of owner's equity. This amount should be copied from the statement of owner's equity to the balance sheet.
- **6.** A permanent account is an account in which the balance is brought forward for each new period. Assets, liabilities, and the owner's capital account accumulate information across accounting periods. Their balances are brought forward for each new period. All accounts reported on the balance sheet are permanent accounts.
- 7. Three types of temporary accounts are revenue, expense, and drawing accounts. These accounts accumulate information for a specific accounting period.
- **8.** The four steps in the closing process are:
 - Step 1: Close revenue accounts to Income Summary.
 - Step 2: Close expense accounts to Income Summary.
 - Step 3: Close Income Summary to the owner's capital account.
 - Step 4: Close Drawing to the owner's capital account.
- 9. The net effect of the four closing entries on the balance of the owner's capital account is that the balance from Income Summary is transferred to the owner's capital account and the drawing account is closed to the owner's capital account. Upon completion of the four steps, all temporary accounts have zero balances and the earnings and withdrawals for the period have been transferred to the owner's capital account. This same amount, the increase or decrease in capital, is calculated on the statement of owner's equity.
- **10.** The purpose of the post-closing trial balance is to prove the equality of the debit and credit balances in the general ledger accounts, after posting the closing entries.
- 11. The 10 steps in the accounting cycle are:

During the Accounting Period

- 1. Analyze source documents.
- 2. Journalize the transactions.
- 3. Post to the ledger accounts.

End of Accounting Period

- 4. Prepare a trial balance.
- **5.** Determine and prepare the needed adjustments on the work sheet.
- 6. Complete an end-of-period work sheet.
- 7. Journalize and post the adjusting entries.
- 8. Prepare an income statement, a statement of owner's equity, and a balance sheet.
- **9.** Journalize and post the closing entries.
- **10.** Prepare a post-closing trial balance.

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Income Statement			
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Statement of Owner's Equity			
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Balance Sheet

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