# Ch.10 Financial Statements and Closing Entries for a Merchandising Business

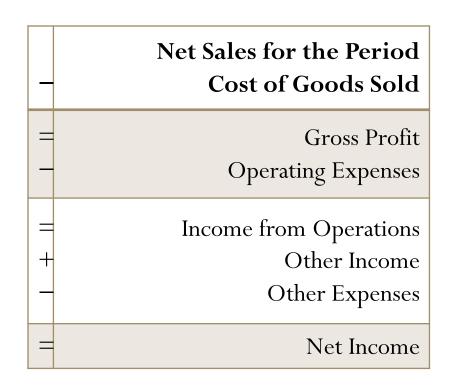
- Prepare financial statements for a merchandising business
- Journalize adjusting and closing entries for a merchandising business
- Prepare a post-closing trial balance
- Make reversing entries for accrued (unpaid) salaries

## Financial Statement Preparation

- The financial activities of a business are recorded in journals and posted to ledgers throughout the accounting period.
- At the end of the period, a work sheet is prepared to organize and summarize data.
- The completed work sheet is then used to prepare financial statements.
- Financial statements provide managers and owners with the primary information they need in order to make sound decisions about the future of a business.

#### Sections of the Classified Income statement

- Revenue
- Cost of Goods Sold
- Operating Expenses
- Income from Operations
- Other Income and Expenses

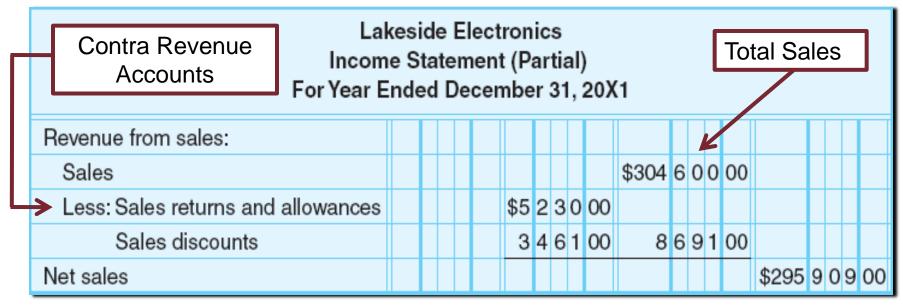


#### Terms on a Classified Income Statement

- Gross Profit the profit before subtracting the expenses of doing business
  - Calculated by subtracting cost of goods sold from net sales
  - Also referred to as gross margin
- Cost of Goods Sold the cost of merchandise sold to customers during the accounting period
- ➤ Net Sales the amount obtained by subtracting the amount of sales returns and allowances and the amount of sales discounts from the amount of sales

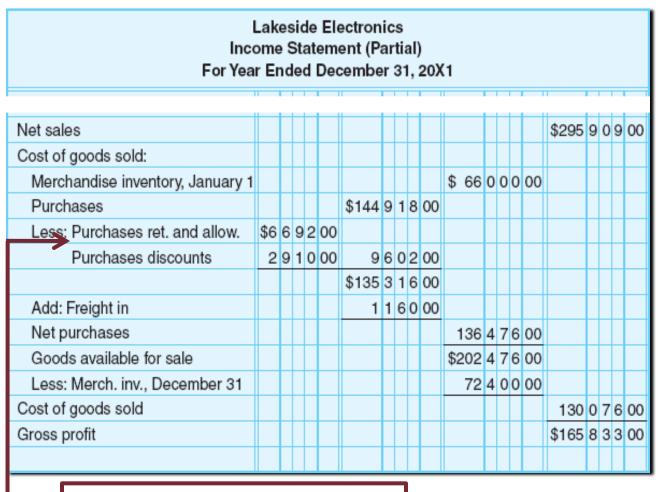
#### The Revenue Section

Provides a figure for net sales, which is the balance of the Sales account, less the balances of the Contra Sales accounts (Sales Returns and Allowances and Sales Discounts).



#### The Cost of Goods Sold Section

The cost of merchandise sold to customers during a period is subtracted from the net sales figure for the same period to get the amount of gross profit.



Contra purchase accounts

- The regular expenses of operating the business
- Most companies divide into selling expenses and general expenses
  - Selling Expenses all expenses directly related to the sale of merchandise
    - ✓ Sales Salaries Expense
    - ✓ Advertising Expense
    - ✓ Store Supplies Expense
    - ✓ Depreciation Expense Store Equipment
    - ✓ Miscellaneous Selling Expense

- General Expenses expenses related to the business's office, the overall administration of the business's office, or any other operating expenses that cannot be tied directly to sales activity
  - ✓ Office Salaries Expense
  - ✓ Rent Expense
  - ✓ Depreciation Expense Office Equipment
  - Utilities Expense
  - ✓ Miscellaneous General Expense

#### Lakeside Electronics Income Statement (Partial) For Year Ended December 31, 20X1

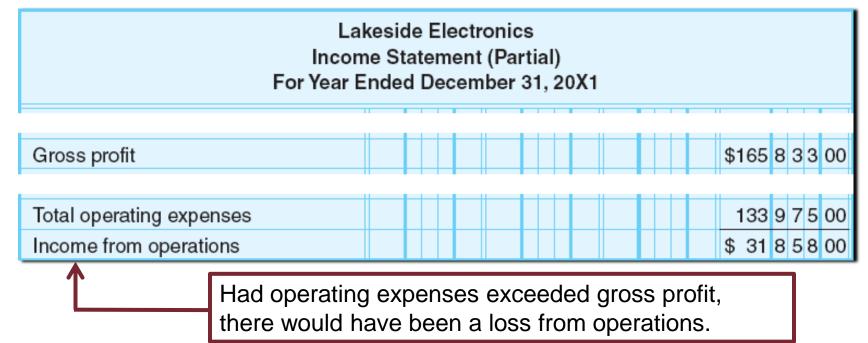
Gross profit											\$ 165	8	3	3	00
Operating expenses:															
Selling expenses:															
Sales salaries expense			\$69	1	0 (	00									
Advertising expense			5	8	4 (	00									
Store supplies expense			1	5	1 5	00									
Depr. exp.—store equipment				9	0 (	00									
Miscellaneous selling expense			2	1	0 (	00									
Total selling expenses							\$79	4	5 5	00					

#### Lakeside Electronics Income Statement (Partial) For Year Ended December 31, 20X1

General expenses:						1										Ť	
Rent expense			\$ 5	7	0	0	00										
Office salaries expense			31	1	5	3	00										
Insurance expense					9	0	00										
Depr. exp.—office equipment				8	2	0	00										
Depr. exp.—delivery equipment			9	2	0	0	00										
Utilities expense			6	2	4 (	0	00										
Office supplies expense				4	1	7	00										
Miscellaneous general expense				9	0	0	00										
Total general expenses								54	5	20	00						
Total operating expenses												1	33	9	7	5	00

## Income from Operations

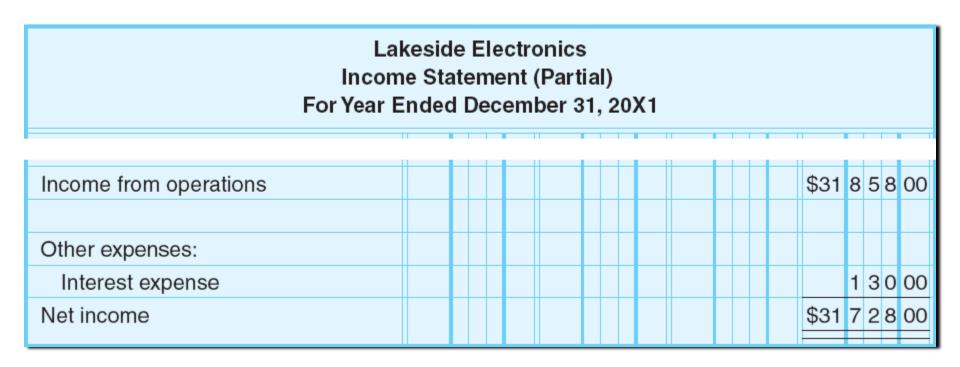
- Equals gross profit minus total operating expenses
- A measure of a firm's ongoing operations



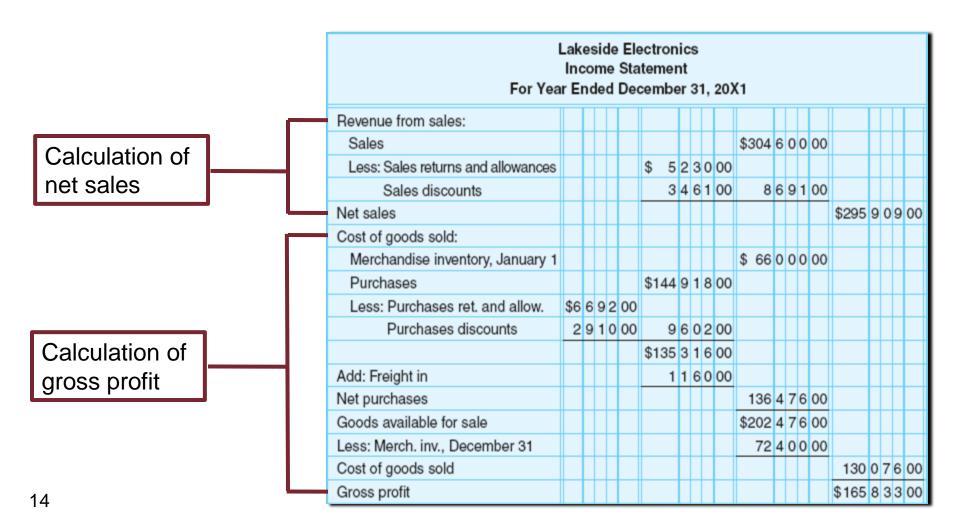
# Other Income and Expenses

- Other Income
  - Revenue earned not directly associated with the normal operation of the business
  - Such as income from vending machine sales or interest earned
- Other Expenses
  - Expenses not directly associated with the normal operation of the business
  - Such as interest expense

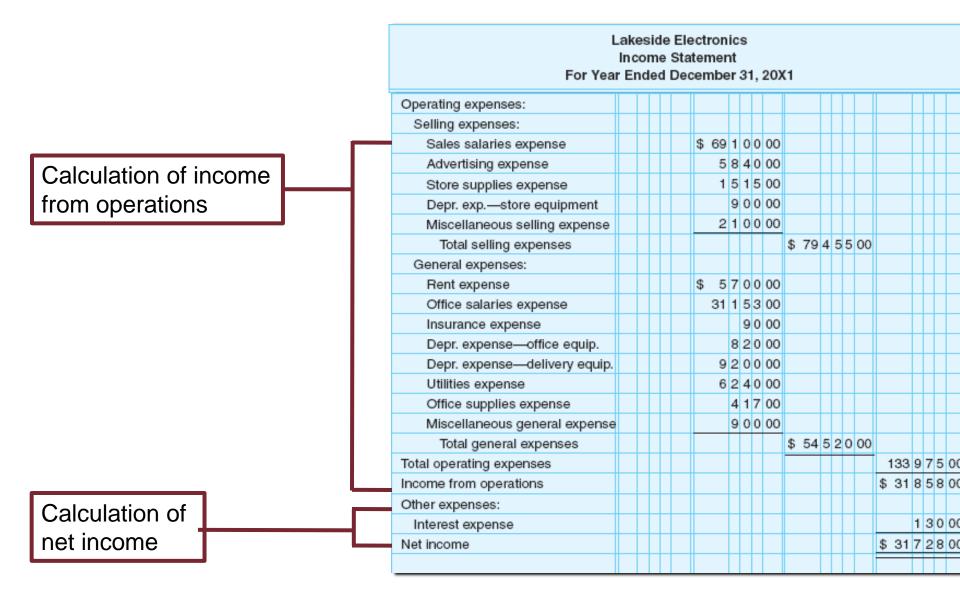
# Other Income and Expenses



## Completed Income Statement



#### Completed Income Statement

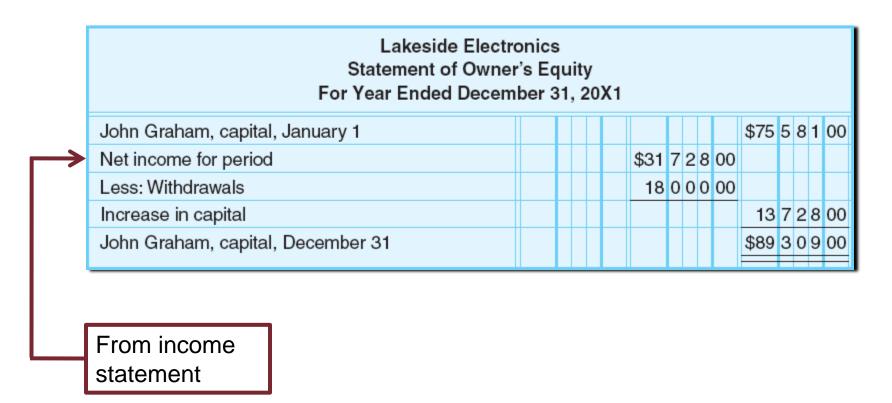


## Statement of Owner's Equity

The link between the income statement and the balance sheet

- The net income (or net loss) figure from the income statement is entered on the statement of owner's equity as a necessary part of updating the owner's capital.
- This updated capital is then entered on the balance sheet.

# Statement of Owner's Equity



#### Classified Balance Sheet

- The principal objective of the balance sheet is to present the reader with as much information as possible about the financial condition of a business at a particular point in time.
- A classified balance sheet groups items into classifications in the asset, liability, and owner's equity section of the balance sheet.

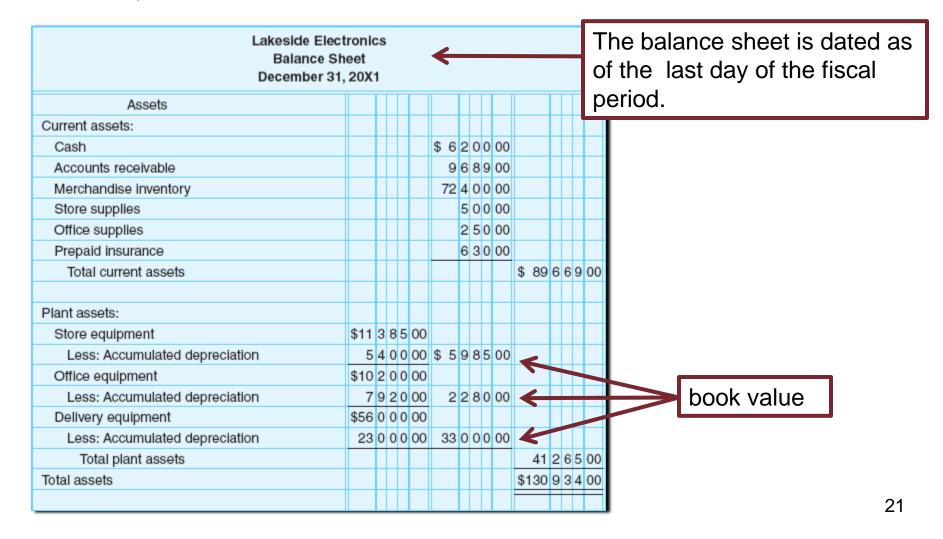
#### **Assets**

- Current Assets cash and other assets that through normal operations are expected, to be
  - Sold
  - Converted to cash
  - Used up
  - Expired
  - Used within one year of the balance sheet date
- Plant Assets
  - Assets that are expected to be used in the business for more than one year
  - Acquired for use in the operation of a business
  - Not intended for resale to customers
  - Tangible
  - Examples: land, buildings, machinery and equipment, furniture, and automobiles

#### Liabilities

- Current Liabilities
  - Short term liabilities, due for payment within one year
  - Examples: accounts payable, salaries payable, current portion of notes payable
- Long-Term Liabilities
  - Debt that will not come due for payment within one year
  - Examples: long-term notes payable, mortgages payable
- The balance sheet requires an up-to-date amount for the owner's capital.
- This amount will be supplied by the statement of owner's equity.

#### Classified Balance Sheet



#### Classified Balance Sheet

Lakeside Electronics Balance Sheet December 31, 20X1																
Liabilities									Ť						T	
Current liabilities:																
Accounts payable	\$14	0	2	5	00				Ι							
Salaries payable	1	6	0	0	00				Ι							
Total current liabilities						\$15	6	2	5 (	00						
Long-term liabilities:																
Notes payable						26	0	0	0	00						
Total liabilities									Ι		\$	41	6	2	5	00
									Ι						Ι	
Owner's Equity																
John Graham, capital												89	3	0	9	00
Total liabilities and owner's equity									ſ		\$1	30	9	3	4	00

#### Working Capital

- Computed as current assets minus current liabilities
- Represents the funds available to replace inventory and to acquire credit

#### Current Ratio

- Computed as current assets divided by current liabilities
- Gives an indication of the ability of a business to pay its current liabilities

# Journalizing Adjusting Entries

- The work sheet is useful for recording adjustments
- However, the worksheet is not a journal, and no posting is ever made from the work sheet to the ledger
- To get the adjusting entries into the ledger, formal journal entries must be made
- Adjusting entries are dated as of the last day of the accounting period

#### Objectives of the Closing Process

- To reduce the balances of the temporary accounts to zero and thus make the accounts ready for entries in the next accounting period
- To update the balance of the owner's capital account

#### Steps in the Closing Process

- ✓ Step 1 Close the Sales account and other income statement accounts with credit balances to the Income Summary account.
- ✓ Step 2 Close each expense account and other income statement accounts with debit balances to the Income Summary account.
- ✓ Step 3 Close the Income Summary account to the owner's capital account.
- ✓ Step 4 Close the balance of the owner's drawing account to the owner's capital account.

# The Post-Closing Trial Balance

- Prepared after the adjusting and closing entries have been posted
- The purpose to prove that the ledger is still in balance
- The only accounts appearing on the post-closing trial balance are the permanent accounts because the temporary accounts have been closed.
  - Permanent accounts: assets, liabilities, and owner's equity
  - Temporary accounts: revenue, expenses, and drawing

# Reversing Entries

- Avoids allocating amounts between two accounting periods in the entry to record payment of an accrued expense
- Optional, but used extensively in practice
- Eliminates the balance of the liability account and sets up a credit balance in the expense account
- Intended to simplify the bookkeeping for transactions that involve accrued expenses
- Always made as of the first day of the next accounting period — never on the last day of the period

#### Interim Statements

- Financial statements prepared during the fiscal year for periods of less than 12 months, such as monthly, quarterly, and semiannually
- To prepare, the accountant assembles adjustment data for the interim period
- The adjustments are entered on a work sheet, and the interim statements are prepared from the completed work sheet
- The adjusting and closing entries are not journalized; thus they are not entered in the ledger
- Those entries are recorded only at the end of the fiscal year