

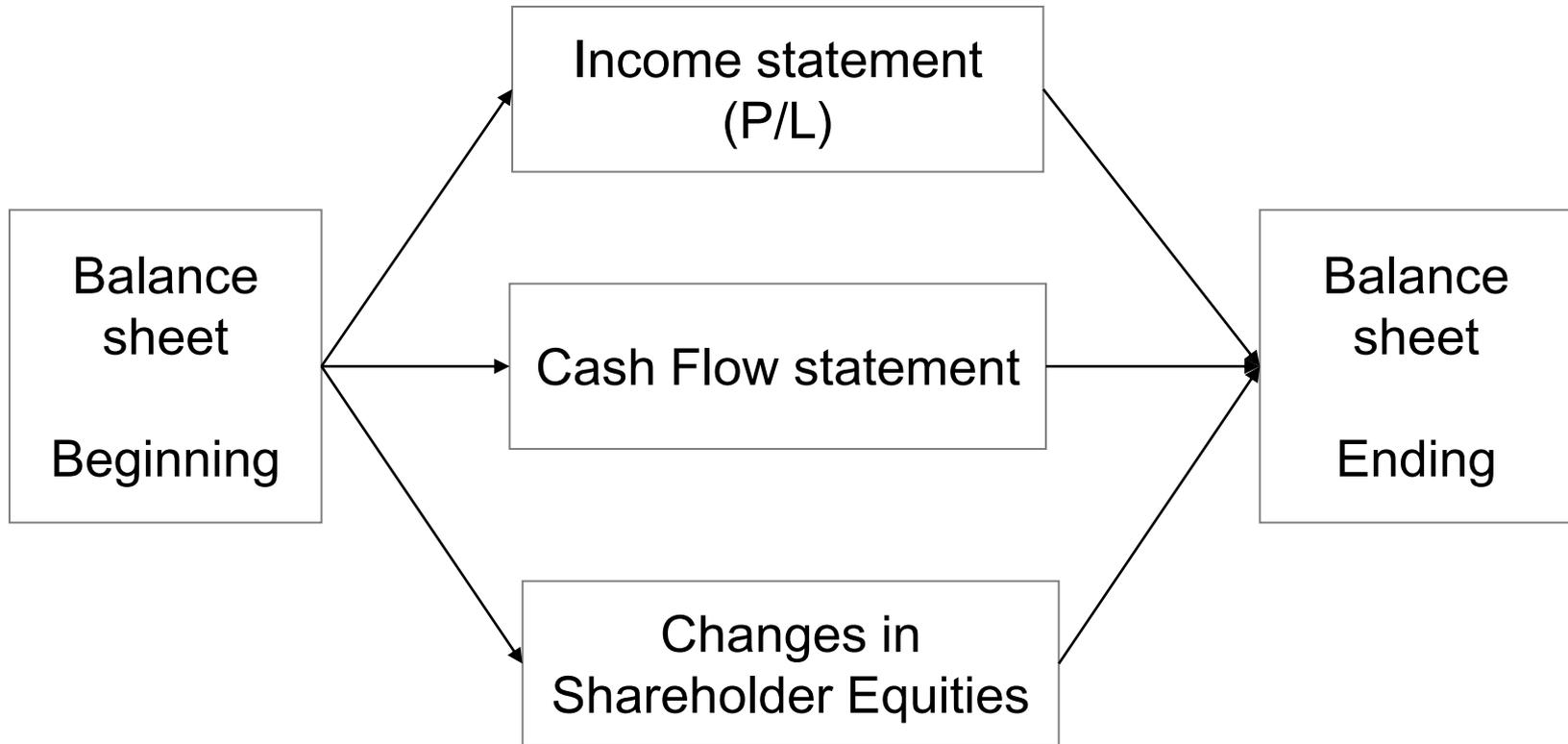
# Financials

## Lecture 5

# **Financials: Objectives**

To develop an understanding of financial statements to serve as a basis for all analysis of business situations.

# Financial Statements



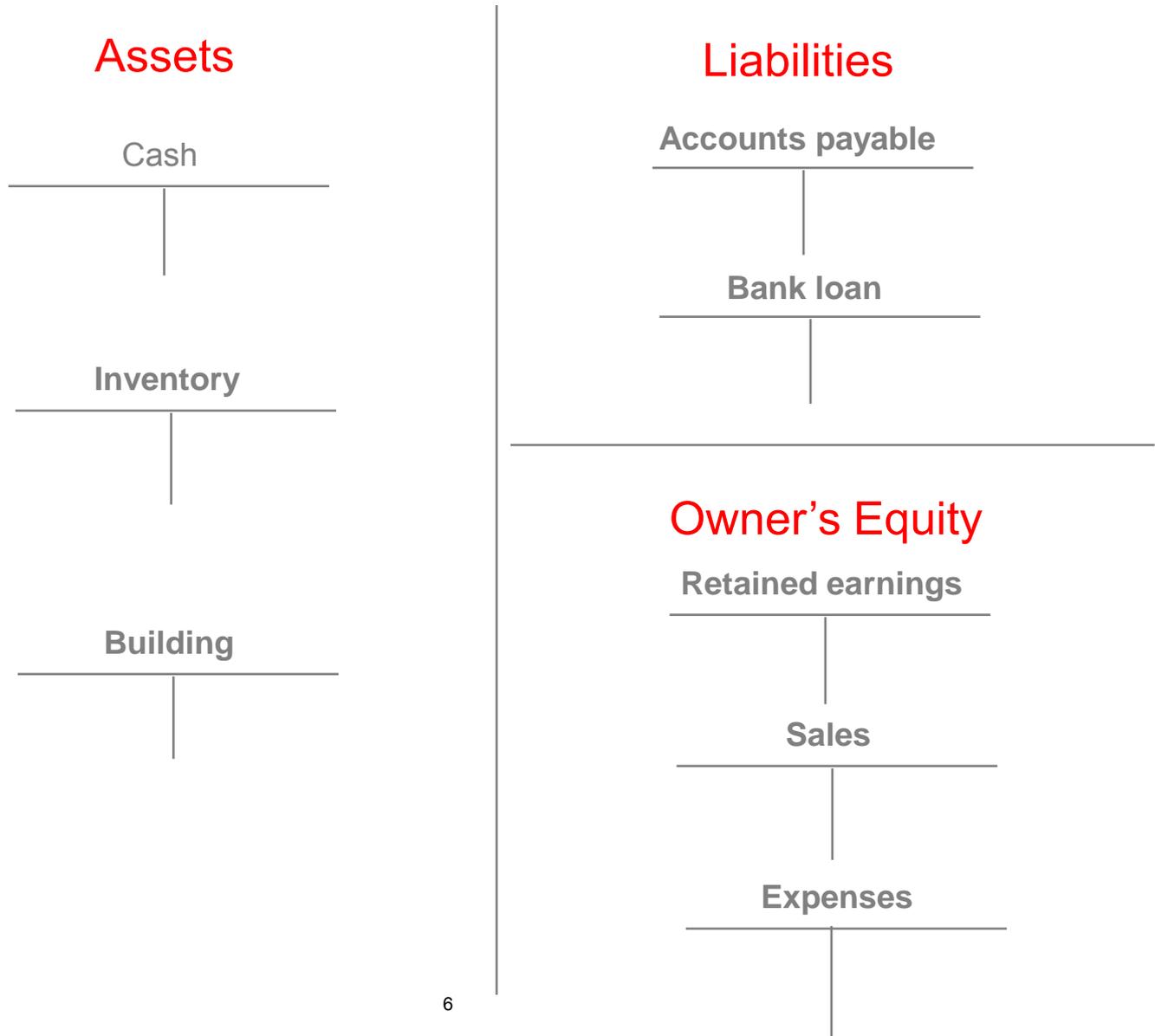
# Bookkeeping

- Chart of accounts
- T-account
- Journal entry

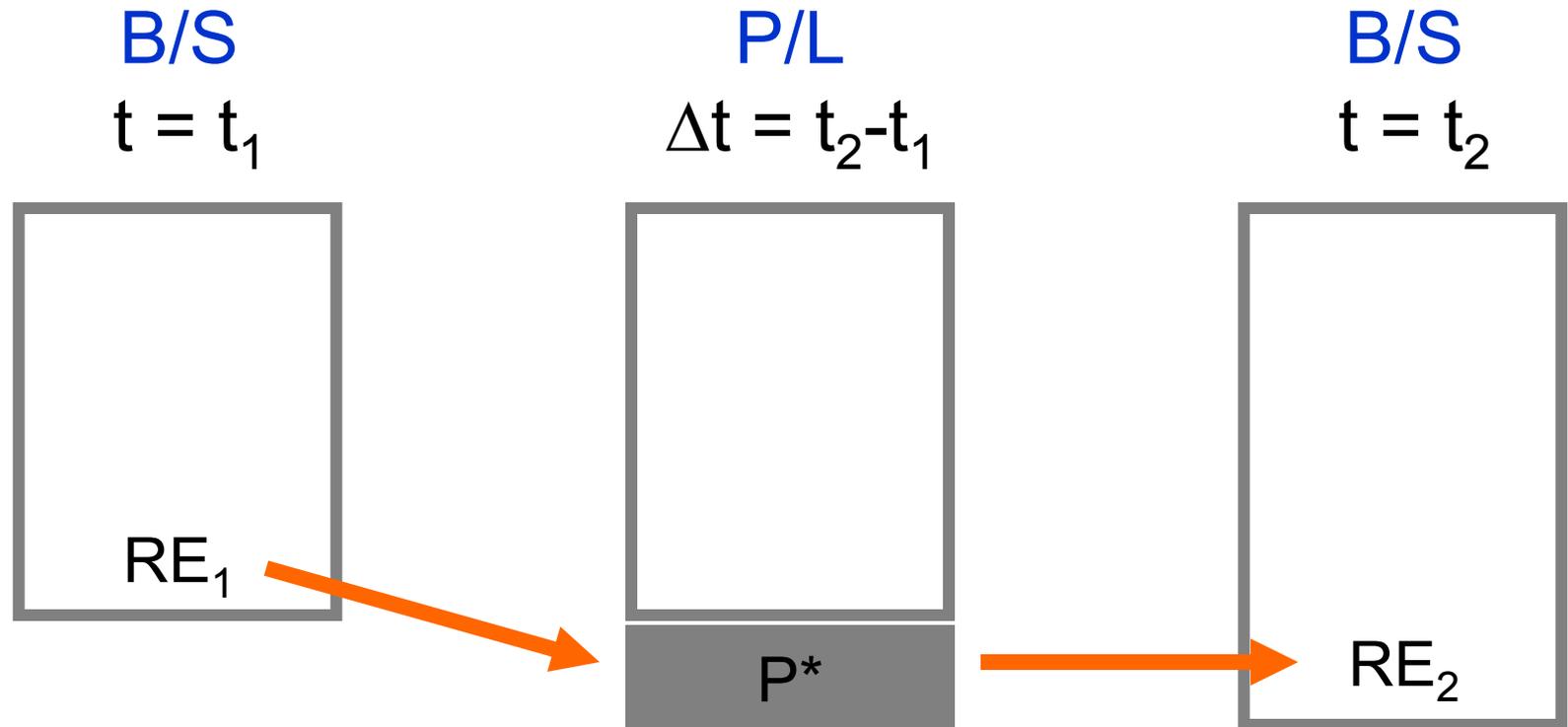
# T Account

Account	
debit	credit
+ / -	- / +

# Business Account



# Relationship of Financial Statements



$$RE_1 + P^* = RE_2$$

# Journal Entry: Debit & Credit

Assets = Liabilities + Equity

Cash	
(d)	(c)
+	-

A / P	
(d)	(c)
-	+

R / E	
(d)	(c)
-	+

Revenue	
(d)	(c)
	+

Expense	
(d)	(c)
+	

# Accounting Record Example

## Starting Balance

King's Shoe Store, Inc. Starting Balance 1-Jan-00		
	Accounts with Debit Balances	Accounts with Credit Balances
Cash (A)	30,000	
Account Receivable (A)	63,000	
Raw Materials Inventory (A)	10,000	
Work-in-Process Inventory (A)	10,000	
Merchandise Inventory (A)	175,000	
Land (A)	100,000	
Building and Equipment (A)	525,000	
Accumulated Depreciation (XA)		85,000
Accounts Payable (L)		135,000
Bonds Payable (L)		100,000
Common Stock (SE)		250,000
Additional Paid-in Capital (SE)		200,000
Retained Earnings (SE)		143,000
Total	913,000	913,000
(A) Asset (XA) Contra Account		
(L) Liability		
(SE) Shareholders' Equity		

## **Transactions - 1**

- (1) The firm purchases shoe-making equipment in cash costing \$10,000
- (2) The firm sells merchandise during the year 2000 at a total selling price of \$625,000. It receives \$225,000 immediately, with the remainder sold on account
- (3.1) The firm purchases raw materials costing \$25,000 on account
- (3.2) The firm issues raw materials costing \$20,000 to producing department
- (3.3) Shoes completed and transferred to the finished goods storeroom have a manufacturing cost of \$10,000
- (3.4) The cost of merchandise sold during the year 2000 is \$90,000
- (4) The firm pays salaries in cash of \$110,000 for employee services received during the year 2000
- (5) The firm collects cash of \$325,000 from customers who had purchased on account

## **Transactions - 2**

- (6) The firm makes payments of \$70,000 to merchandise supplies for purchases on account
  
- (7) The firm issues common stock of \$50,000 for cash on January 28, 2000.
  
- (8) The firm pays a premium of \$1,500 on January 1, 2000 for a three-year property and liability insurance policy

(1) The firm purchases shoe-making equipment in cash costing \$10,000

Transaction Number	Accounts	Debit	Credit
1	Building and Equipment (A)	10,000	
	Cash (A)		10,000

Asset		=	Liabilities		+	Shareholders' Equity	
<b>Cash (A)</b>			<b>Account Payable (L)</b>			<b>Retained Earnings (SE)</b>	
Bal. 1/1	30,000		135,000	Bal. 1/1		123,000	Bal. 1/1
	10,000 (1)		135,000	Bal. 12/31		123,000	Bal. 12/31
Bal. 12/31	20,000						
<b>Account Receivable (A)</b>			<b>Dividends Payable (L)</b>			<b>Sales Revenue (SE)</b>	
Bal. 1/1	63,000		-	Bal. 1/1		-	Bal. 1/1
Bal. 12/31	63,000		-	Bal. 12/31		-	Bal. 12/31
<b>Merchandise Inventory (A)</b>						<b>Cost of Goods Sold (SE)</b>	
Bal. 1/1	175,000				Bal. 1/1	-	
Bal. 12/31	175,000				Bal. 12/31	-	
<b>Prepaid Insurance (A)</b>						<b>Salary Expense (SE)</b>	
Bal. 1/1	-				Bal. 1/1	-	
Bal. 12/31	-				Bal. 12/31	-	
<b>Building and Equipment (A)</b>							
Bal. 1/1	525,000						
(1)	10,000						
Bal. 12/31	535,000						

(2) The firm sells merchandise during the year 2000 at a total selling price of \$625,000. It receives \$225,000 immediately, with the remainder sold on account

Transaction Number	Accounts	Debit	Credit
2	Cash (A)	225,000	
	Account Receivable (A)	400,000	
	Sales Revenue (SE)		625,000

Asset		=	Liabilities		+	Shareholders' Equity	
Cash (A)			Account Payable (L)			Retained Earnings (SE)	
Bal. 1/1	30,000		135,000	Bal. 1/1		123,000	Bal. 1/1
(2)	225,000						
	10,000	(1)	135,000	Bal. 12/31		123,000	Bal. 12/31
Bal. 12/31	245,000						
Account Receivable (A)						Sales Revenue (SE)	
Bal. 1/1	63,000					-	Bal. 1/1
(2)	400,000					625,000	(2)
Bal. 12/31	463,000					625,000	Bal. 12/31
Merchandise Inventory (A)						Cost of Goods Sold (SE)	
Bal. 1/1	175,000					-	
Bal. 12/31	175,000					-	
Prepaid Insurance (A)						Salary Expense (SE)	
Bal. 1/1	-					-	
Bal. 12/31	-					-	
Building and Equipment (A)							
Bal. 1/1	525,000						
(1)	10,000						
Bal. 12/31	535,000						

### (3.1) The firm purchases raw materials costing \$25,000 on account

Transaction Number	Accounts	Debit	Credit
3.1	Raw Materials Inventory (A)	25,000	
	Accounts Payable (L)		25,000

Asset		=	Liabilities		+	Shareholders' Equity	
<b>Cash (A)</b> Bal. 1/1    30,000 (2)    225,000    10,000    (1) Bal. 12/31 <u>245,000</u>			<b>Account Payable (L)</b> 135,000    Bal. 1/1 25,000    (3.1) 160,000    Bal. 12/31			<b>Common Stock (SE)</b> 250,000    Bal. 1/1 250,000    Bal. 12/31	
<b>Account Receivable (A)</b> Bal. 1/1    63,000 (2)    400,000 Bal. 12/31 <u>463,000</u>						<b>Retained Earnings (SE)</b> 123,000    Bal. 1/1 123,000    Bal. 12/31	
<b>Merchandise Inventory (A)</b> Bal. 1/1    175,000 Bal. 12/31 <u>175,000</u>						<b>Sales Revenue (SE)</b> -    Bal. 1/1 625,000    (2) 625,000    Bal. 12/31	
<b>Building and Equipment (A)</b> Bal. 1/1    525,000 (1)    10,000 Bal. 12/31 <u>535,000</u>						<b>Cost of Goods Sold (SE)</b> Bal. 1/1    - Bal. 12/31 <u>-</u>	
<b>Raw Materials Inventory (A)</b> Bal. 1/1    10,000 (3.1)    25,000 Bal. 12/31 <u>35,000</u>						<b>Salary Expense (SE)</b> Bal. 1/1    - Bal. 12/31 <u>-</u>	

### (3.2) The firm issues raw materials costing \$20,000 to producing department

Transaction Number	Accounts	Debit	Credit
3.2	Work-in-Process Inventory (A)	20,000	
	Raw Materials Inventory (A)		20,000

Asset		=	Liabilities		+	Shareholders' Equity	
<b>Cash (A)</b>			<b>Account Payable (L)</b>			<b>Common Stock (SE)</b>	
Bal. 1/1	30,000		135,000	Bal. 1/1		250,000	Bal. 1/1
(2)	225,000	10,000 (1)	25,000	(3.1)			
			<u>160,000</u>	Bal. 12/31		<u>250,000</u>	Bal. 12/31
Bal. 12/31	<u>245,000</u>						
<b>Account Receivable (A)</b>						<b>Retained Earnings (SE)</b>	
Bal. 1/1	63,000					123,000	Bal. 1/1
(2)	400,000						
Bal. 12/31	<u>463,000</u>					<u>123,000</u>	Bal. 12/31
<b>Merchandise Inventory (A)</b>						<b>Sales Revenue (SE)</b>	
Bal. 1/1	175,000					-	Bal. 1/1
Bal. 12/31	<u>175,000</u>					625,000	(2)
						<u>625,000</u>	Bal. 12/31
<b>Building and Equipment (A)</b>						<b>Cost of Goods Sold (SE)</b>	
Bal. 1/1	525,000				Bal. 1/1	-	
(1)	10,000				Bal. 12/31	<u>-</u>	
Bal. 12/31	<u>535,000</u>						
<b>Raw Materials Inventory (A)</b>						<b>Salary Expense (SE)</b>	
Bal. 1/1	10,000				Bal. 1/1	-	
(3.1)	25,000	20,000 (3.2)			Bal. 12/31	<u>-</u>	
Bal. 12/31	<u>15,000</u>						
<b>Work-in-Process Inventory (A)</b>							
Bal. 1/1	10,000						
(3.2)	<u>20,000</u>						
Bal. 12/31	<u>30,000</u>						

(3.3) Shoes completed and transferred to the finished goods storeroom have a manufacturing cost of \$10,000

Transaction Number		Accounts		Debit	Credit
3.3		Merchandise Inventory (A)		10,000	
		Work-in-Process Inventory (A)			10,000

Asset		=	Liabilities		+	Shareholders' Equity	
<b>Cash (A)</b>			<b>Account Payable (L)</b>			<b>Common Stock (SE)</b>	
Bal. 1/1	30,000			135,000	Bal. 1/1	250,000	Bal. 1/1
(2)	225,000			25,000	(3.1)		
			10,000	(1)			
				<u>160,000</u>	Bal. 12/31	<u>250,000</u>	Bal. 12/31
Bal. 12/31	<u>245,000</u>						
<b>Account Receivable (A)</b>						<b>Retained Earnings (SE)</b>	
Bal. 1/1	63,000					123,000	Bal. 1/1
(2)	400,000						
Bal. 12/31	<u>463,000</u>					<u>123,000</u>	Bal. 12/31
<b>Merchandise Inventory (A)</b>						<b>Sales Revenue (SE)</b>	
Bal. 1/1	175,000					-	Bal. 1/1
(3.3)	10,000					625,000	(2)
Bal. 12/31	<u>185,000</u>					<u>625,000</u>	Bal. 12/31
<b>Building and Equipment (A)</b>						<b>Cost of Goods Sold (SE)</b>	
Bal. 1/1	525,000					Bal. 1/1	-
(1)	10,000					Bal. 12/31	<u>-</u>
Bal. 12/31	<u>535,000</u>					<b>Salary Expense (SE)</b>	
<b>Raw Materials Inventory (A)</b>						Bal. 1/1	-
Bal. 1/1	10,000					Bal. 12/31	<u>-</u>
(3.1)	25,000		20,000	(3.2)			
Bal. 12/31	<u>15,000</u>						
<b>Work-in-Process Inventory (A)</b>							
Bal. 1/1	10,000						
(3.2)	20,000		10,000	(3.3)			
Bal. 12/31	<u>20,000</u>						

**(3.4) The cost of merchandise sold during the year 2000 is \$90,000**

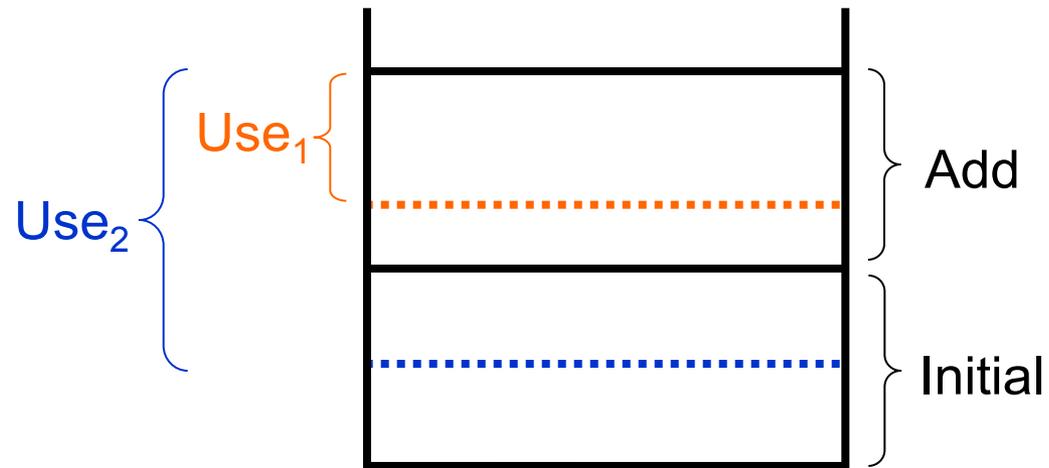
Transaction Number	Accounts	Debit	Credit
3.4	Cost of Goods Sold (SE)	90,000	
	Merchandise Inventory (A)		90,000

Asset		=	Liabilities		+	Shareholders' Equity	
<b>Cash (A)</b>			<b>Account Payable (L)</b>			<b>Common Stock (SE)</b>	
Bal. 1/1	30,000		135,000	Bal. 1/1		250,000	Bal. 1/1
(2)	225,000	10,000	25,000	(3.1)			
			<u>160,000</u>	Bal. 12/31		<u>250,000</u>	Bal. 12/31
Bal. 12/31	<u>245,000</u>						
<b>Account Receivable (A)</b>						<b>Retained Earnings (SE)</b>	
Bal. 1/1	63,000					123,000	Bal. 1/1
(2)	400,000					<u>123,000</u>	Bal. 12/31
Bal. 12/31	<u>463,000</u>						
<b>Merchandise Inventory (A)</b>						<b>Sales Revenue (SE)</b>	
Bal. 1/1	175,000					-	Bal. 1/1
(3.3)	10,000	90,000				625,000	(2)
Bal. 12/31	<u>95,000</u>					<u>625,000</u>	Bal. 12/31
<b>Building and Equipment (A)</b>						<b>Cost of Goods Sold (SE)</b>	
Bal. 1/1	525,000					Bal. 1/1	-
(1)	10,000					(3.4)	<u>90,000</u>
Bal. 12/31	<u>535,000</u>					Bal. 12/31	<u>90,000</u>
<b>Raw Materials Inventory (A)</b>						<b>Salary Expense (SE)</b>	
Bal. 1/1	10,000					Bal. 1/1	-
(3.1)	25,000	20,000				Bal. 12/31	<u>-</u>
Bal. 12/31	<u>15,000</u>						
<b>Work-in-Process Inventory (A)</b>							
Bal. 1/1	10,000						
(3.2)	20,000	10,000					
Bal. 12/31	<u>20,000</u>						

# Inventory

## 1. Periodic



## 2. Perpetual

- Individual Record (RFID)

# Manufacturing Inventories

## 1. Raw Materials

- Purchase
- Freight-in

## 2. Work-in-Progress (WIP)

- Direct / Indirect Labor
- Supplies, etc.

## 3. Finished Goods

(4) The firm pays salaries in cash of \$110,000 for employee services received during the year 2000

Transaction Number	Accounts	Debit	Credit
4	Salary Expense (SE)	110,000	
	Cash (A)		110,000

Asset		=	Liabilities		+	Shareholders' Equity	
Cash (A)			Account Payable (L)			Common Stock (SE)	
Bal. 1/1	30,000		135,000	Bal. 1/1		250,000	Bal. 1/1
(2)	225,000		25,000	(3.1)			
	110,000	(1)	160,000	Bal. 12/31		250,000	Bal. 12/31
		(4)					
Bal. 12/31	<u>135,000</u>						
Account Receivable (A)			Retained Earnings (SE)				
Bal. 1/1	63,000			123,000			Bal. 1/1
(2)	400,000			123,000			Bal. 12/31
Bal. 12/31	<u>463,000</u>						
Merchandise Inventory (A)			Sales Revenue (SE)				
Bal. 1/1	175,000			-			Bal. 1/1
(3.3)	10,000	90,000		625,000			(2)
Bal. 12/31	<u>95,000</u>	(3.4)		625,000			Bal. 12/31
Building and Equipment (A)			Cost of Goods Sold (SE)				
Bal. 1/1	525,000			-			
(1)	10,000			(3.4) 90,000			
Bal. 12/31	<u>535,000</u>			Bal. 12/31			<u>90,000</u>
Raw Materials Inventory (A)			Salary Expense (SE)				
Bal. 1/1	10,000			-			
(3.1)	25,000	20,000		(4) 110,000			
Bal. 12/31	<u>15,000</u>	(3.2)		Bal. 12/31			<u>110,000</u>
Work-in-Process Inventory (A)							
Bal. 1/1	10,000						
(3.2)	20,000	10,000					
Bal. 12/31	<u>20,000</u>	(3.3)					

(5) The firm collects cash of \$325,000 from customers who had purchased on account

Transaction Number	Accounts	Debit	Credit
5	Cash (A)	325,000	
	Account Receivable (A)		325,000

Asset		=	Liabilities		+	Shareholders' Equity	
<b>Cash (A)</b>			<b>Account Payable (L)</b>			<b>Common Stock (SE)</b>	
Bal. 1/1	30,000		135,000	Bal. 1/1		250,000	Bal. 1/1
(2)	225,000	← 10,000 (1)	25,000	(3.1)			
(5)	325,000	110,000 (4)	160,000	Bal. 12/31		250,000	Bal. 12/31
Bal. 12/31	<u>460,000</u>						
<b>Account Receivable (A)</b>						<b>Retained Earnings (SE)</b>	
Bal. 1/1	63,000					123,000	Bal. 1/1
(2)	400,000	325,000 (5)					
Bal. 12/31	<u>138,000</u>					123,000	Bal. 12/31
<b>Merchandise Inventory (A)</b>						<b>Sales Revenue (SE)</b>	
Bal. 1/1	175,000					-	Bal. 1/1
(3.3)	10,000	90,000 (3.4)				625,000	(2)
Bal. 12/31	<u>95,000</u>					625,000	Bal. 12/31
<b>Building and Equipment (A)</b>						<b>Cost of Goods Sold (SE)</b>	
Bal. 1/1	525,000				Bal. 1/1	-	
(1)	10,000				(3.4)	90,000	
Bal. 12/31	<u>535,000</u>				Bal. 12/31	<u>90,000</u>	
<b>Raw Materials Inventory (A)</b>						<b>Salary Expense (SE)</b>	
Bal. 1/1	10,000				Bal. 1/1	-	
(3.1)	25,000	20,000 (3.2)			(4)	110,000	
Bal. 12/31	<u>15,000</u>				Bal. 12/31	<u>110,000</u>	
<b>Work-in-Process Inventory (A)</b>							
Bal. 1/1	10,000						
(3.2)	20,000	10,000 (3.3)					
Bal. 12/31	<u>20,000</u>						

(6) The firm makes payments of \$70,000 to merchandise supplies for purchases on account

Transaction Number	Accounts	Debit	Credit
6	Account Payable (L)	70,000	
	Cash (A)		70,000

Asset		=	Liabilities		+	Shareholders' Equity	
Cash (A)			Account Payable (L)			Common Stock (SE)	
Bal. 1/1	30,000			135,000		Bal. 1/1	250,000
(2)	225,000	10,000	(1)	25,000		(3.1)	
(5)	325,000	110,000	(4)	90,000		Bal. 12/31	250,000
		70,000	(6)				
Bal. 12/31	<u>390,000</u>						
Account Receivable (A)						Retained Earnings (SE)	
Bal. 1/1	63,000					Bal. 1/1	123,000
(2)	400,000	325,000	(5)			Bal. 12/31	<u>123,000</u>
Bal. 12/31	<u>138,000</u>						
Merchandise Inventory (A)						Sales Revenue (SE)	
Bal. 1/1	175,000					Bal. 1/1	-
(3.3)	10,000	90,000	(3.4)			(2)	625,000
Bal. 12/31	<u>95,000</u>					Bal. 12/31	<u>625,000</u>
Building and Equipment (A)						Cost of Goods Sold (SE)	
Bal. 1/1	525,000					Bal. 1/1	-
(1)	10,000					(3.4)	90,000
Bal. 12/31	<u>535,000</u>					Bal. 12/31	<u>90,000</u>
Raw Materials Inventory (A)						Salary Expense (SE)	
Bal. 1/1	10,000					Bal. 1/1	-
(3.1)	25,000	20,000	(3.2)			(4)	110,000
Bal. 12/31	<u>15,000</u>					Bal. 12/31	<u>110,000</u>
Work-in-Process Inventory (A)							
Bal. 1/1	10,000						
(3.2)	20,000	10,000	(3.3)				
Bal. 12/31	<u>20,000</u>						

(7) The firm issues common stock of \$50,000 for cash on January 28, 2000.

Transaction Number	Accounts	Debit	Credit
7	Cash (A)	50,000	
	Common Stock (SE)		50,000

Asset		=	Liabilities		+	Shareholders' Equity	
Cash (A)			Account Payable (L)			Common Stock (SE)	
Bal. 1/1	30,000			135,000	Bal. 1/1	250,000	Bal. 1/1
(2)	225,000		10,000	25,000	(3.1)	50,000	(7)
(5)	325,000		110,000	90,000	Bal. 12/31	300,000	Bal. 12/31
(7)	50,000		70,000				
Bal. 12/31	440,000						
Account Receivable (A)						Retained Earnings (SE)	
Bal. 1/1	63,000					123,000	Bal. 1/1
(2)	400,000		325,000	(5)		123,000	Bal. 12/31
Bal. 12/31	138,000					Sales Revenue (SE)	
Merchandise Inventory (A)						-	Bal. 1/1
Bal. 1/1	175,000					625,000	(2)
(3.3)	10,000		90,000	(3.4)		625,000	Bal. 12/31
Bal. 12/31	95,000					Cost of Goods Sold (SE)	
Building and Equipment (A)						Bal. 1/1	-
Bal. 1/1	525,000					(3.4)	90,000
(1)	10,000					Bal. 12/31	90,000
Bal. 12/31	535,000					Salary Expense (SE)	
Raw Materials Inventory (A)						Bal. 1/1	-
Bal. 1/1	10,000					(4)	110,000
(3.1)	25,000		20,000	(3.2)		Bal. 12/31	110,000
Bal. 12/31	15,000					Work-in-Process Inventory (A)	
Work-in-Process Inventory (A)						Bal. 1/1	10,000
Bal. 1/1	10,000					(3.2)	20,000
(3.2)	20,000		10,000	(3.3)		Bal. 12/31	20,000
Bal. 12/31	20,000						

(8) The firm pays a premium of \$1,500 on January 1, 2000 for a three-year property and liability insurance policy

Transaction Number	Accounts	Debit	Credit
8	Prepaid Insurance (A)	1,500	
	Cash (A)		1,500

Asset		=	Liabilities		+	Shareholders' Equity	
Cash (A)			Account Payable (L)			Common Stock (SE)	
Bal. 1/1	30,000			135,000	Bal. 1/1	250,000	Bal. 1/1
(2)	225,000	10,000	(1)		(3.1)	50,000	(7)
(5)	325,000	110,000	(4)	70,000		300,000	Bal. 12/31
(7)	50,000	70,000	(6)	90,000	Bal. 12/31		
		1,500	(8)				
Bal. 12/31	<u>438,500</u>						
Account Receivable (A)			Retained Earnings (SE)				
Bal. 1/1	63,000			123,000	Bal. 1/1		
(2)	400,000	325,000	(5)			123,000	Bal. 12/31
Bal. 12/31	<u>138,000</u>						
Merchandise Inventory (A)			Sales Revenue (SE)				
Bal. 1/1	175,000			-	Bal. 1/1		
(3.3)	10,000	90,000	(3.4)		(2)	625,000	
Bal. 12/31	<u>95,000</u>					625,000	Bal. 12/31
Building and Equipment (A)			Cost of Goods Sold (SE)				
Bal. 1/1	525,000			-	Bal. 1/1		
(1)	10,000			90,000	(3.4)	90,000	
Bal. 12/31	<u>535,000</u>				Bal. 12/31	<u>90,000</u>	
Raw Materials Inventory (A)			Salary Expense (SE)				
Bal. 1/1	10,000			-	Bal. 1/1		
(3.1)	25,000	20,000	(3.2)		(4)	110,000	
Bal. 12/31	<u>15,000</u>				Bal. 12/31	<u>110,000</u>	
Work-in-Process Inventory (A)			Prepaid Insurance (A)				
Bal. 1/1	10,000			-	Bal. 1/1		
(3.2)	20,000	10,000	(3.3)		(8)	1,500	
Bal. 12/31	<u>20,000</u>				Bal. 12/31	<u>1,500</u>	

# Summary

Asset	=	Liabilities	+	Shareholders' Equity
Cash (A)				
Bal. 1/1				
30,000				
(2) 225,000				
(5) 325,000				
(7) 50,000				
Bal. 12/31				
438,500				
Account Receivable (A)				
Bal. 1/1				
63,000				
(2) 400,000				
Bal. 12/31				
138,000				
Merchandise Inventory (A)				
Bal. 1/1				
175,000				
(3.3) 10,000				
Bal. 12/31				
95,000				
Building and Equipment (A)				
Bal. 1/1				
525,000				
(1) 10,000				
Bal. 12/31				
535,000				
Raw Materials Inventory (A)				
Bal. 1/1				
10,000				
(3.1) 25,000				
Bal. 12/31				
15,000				
Work-in-Process Inventory (A)				
Bal. 1/1				
10,000				
(3.2) 20,000				
Bal. 12/31				
20,000				
Accumulated Depreciation (XA)				
		85,000		Bal. 1/1
		85,000		Bal. 12/31
Prepaid Insurance (A)				
Bal. 1/1				
-				
(8) 1,500				
Bal. 12/31				
1,500				
Account Payable (L)				
		135,000		Bal. 1/1
(6) 70,000		25,000		(3.1)
		90,000		Bal. 12/31
Bonds Payable (L)				
		100,000		Bal. 1/1
		100,000		Bal. 12/31
Common Stock (SE)				
		250,000		Bal. 1/1
		50,000		(7)
		300,000		Bal. 12/31
Retained Earnings (SE)				
		123,000		Bal. 1/1
		123,000		Bal. 12/31
Sales Revenue (SE)				
		-		Bal. 1/1
		625,000		(2)
		625,000		Bal. 12/31
Cost of Goods Sold (SE)				
Bal. 1/1		-		
(3.4) 90,000				
Bal. 12/31		90,000		
Salary Expense (SE)				
Bal. 1/1		-		
(4) 110,000				
Bal. 12/31		110,000		

## Unadjusted Balance

**King's Shoe Store, Inc.**  
Unadjusted Balance  
31-Dec-00

	Accounts with Debit Balances	Accounts with Credit Balances
Cash (A)	438,500	
Account Receivable (A)	138,000	
Raw Materials Inventory (A)	15,000	
Work-in-Process Inventory (A)	20,000	
Merchandise Inventory (A)	95,000	
Prepaid Insurance (A)	1,500	
Land (A)	100,000	
Building and Equipment (A)	535,000	
Accumulated Depreciation (XA)		85,000
Accounts Payable (L)		90,000
Bonds Payable (L)		100,000
Common Stock (SE)		300,000
Additional Paid-in Capital (SE)		200,000
Retained Earnings (SE)		143,000
Sales Revenue (SE)		625,000
Cost of Goods Sold (SE)	90,000	
Salary Expense (SE)	110,000	
Total	<u>1,543,000</u>	<u>1,543,000</u>

(A) Asset (XA) Contra Account  
(L) Liability  
(SE) Shareholders' Equity

## Adjusting Entries

- Adjusting the events that continually occur for which no specific transaction signals the requirement for a journal entry but that still affect the net income for the period and the financial position at the end of the period
- Adjusting entries prepared at the end of the accounting period change the balances in the general ledger accounts so that all revenues and expenses are recognized
- For example,
  - Recognition of accrued revenues and receivables
  - Recognition of accrued expenses and payables
  - Allocation of prepaid operating costs, e.g. prepaid insurance cost
  - Recognition of Depreciation
  - Correction of errors, etc.

### (1) Allocation of prepaid insurance cost

- King's Shoe Store paid \$1,500 on January 1, 2000, for a three-year insurance policy - Transaction #8
- During the year 2000, one-third of the coverage expired, so \$500 of the premium should leave the asset account on the balance sheet and become an insurance expense, reducing income and retained earnings.
- In other words, the balance sheet on December 31, 2000, should show only \$1,000 of prepaid insurance as an asset.

Transaction Number	Accounts	Debit	Credit
9	Insurance Expense (SE)	500	
	Prepaid Insurance (A)		500

Transaction Number	Accounts	Debit	Credit
9	Insurance Expense (SE)	500	
	Prepaid Insurance (A)		500
<b>Asset</b>		<b>Liabilities + Shareholders' Equity</b>	
<b>Cash (A)</b>		<b>Account Payable (L)</b>	
Bal. 1/1	30,000	135,000	Bal. 1/1
(2)	225,000	10,000	25,000 (3.1)
(5)	325,000	110,000	90,000 Bal. 12/31
(7)	50,000	70,000	
		1,500	(8)
Bal. 12/31	<u>438,500</u>		
<b>Account Receivable (A)</b>		<b>Bonds Payable (L)</b>	
Bal. 1/1	63,000	100,000	Bal. 1/1
(2)	400,000	100,000	Bal. 12/31
Bal. 12/31	<u>138,000</u>		
<b>Merchandise Inventory (A)</b>		<b>Common Stock (SE)</b>	
Bal. 1/1	175,000	250,000	Bal. 1/1
(3.3)	10,000	50,000	50,000 (7)
Bal. 12/31	<u>95,000</u>	300,000	Bal. 12/31
<b>Building and Equipment (A)</b>		<b>Retained Earnings (SE)</b>	
Bal. 1/1	525,000	123,000	Bal. 1/1
(1)	10,000	123,000	Bal. 12/31
Bal. 12/31	<u>535,000</u>		
<b>Raw Materials Inventory (A)</b>		<b>Sales Revenue (SE)</b>	
Bal. 1/1	10,000	-	Bal. 1/1
(3.1)	25,000	625,000	(2)
Bal. 12/31	<u>15,000</u>	625,000	Bal. 12/31
<b>Work-in-Process Inventory (A)</b>		<b>Cost of Goods Sold (SE)</b>	
Bal. 1/1	10,000	-	Bal. 1/1
(3.2)	20,000	90,000	(3.4)
Bal. 12/31	<u>20,000</u>	90,000	Bal. 12/31
<b>Accumulated Depreciation (XA)</b>		<b>Salary Expense (SE)</b>	
	85,000	-	Bal. 1/1
	85,000	110,000	(4)
		110,000	Bal. 12/31
<b>Prepaid Insurance (A)</b>		<b>Insurance Expense (SE)</b>	
Bal. 1/1	-	-	Bal. 1/1
(8)	1,500	500	(9)
Bal. 12/31	<u>1,000</u>	500	Bal. 12/31

## (2) Recognition of Depreciation

- Although the assets of buildings and equipment provide services for a number of years, their future benefits expire as time passes. Therefore, accounting spreads an asset's cost over the periods of the assets' estimated useful life.
- The term *depreciation* refers to the charge made to the current operations for the portion of the cost of such assets consumed during the current period. The *straight-line method* is widely used for depreciation calculations
- King's Shoe Store's internal records show that annual depreciation is \$30,000 per year.

Transaction Number	Accounts	Debit	Credit
10	Depreciation Expense (SE)	30,000	
	Accumulated Depreciation (XA)		30,000

Transaction Number	Accounts	Debit	Credit		
10	Depreciation Expense (SE)	30,000			
	Accumulated Depreciation (XA)		30,000		
<b>Asset</b>		=	<b>Liabilities</b>	+	<b>Shareholders' Equity</b>
<b>Cash (A)</b>			<b>Account Payable (L)</b>		<b>Common Stock (SE)</b>
Bal. 1/1	30,000		135,000	Bal. 1/1	250,000
(2)	225,000	10,000 (1)	25,000	(3.1)	50,000
(5)	325,000	110,000 (4)	<u>90,000</u>	Bal. 12/31	<u>300,000</u>
(7)	50,000	70,000 (6)			
		1,500 (8)			
Bal. 12/31	<u>438,500</u>				
<b>Account Receivable (A)</b>			<b>Bonds Payable (L)</b>		<b>Retained Earnings (SE)</b>
Bal. 1/1	63,000		100,000	Bal. 1/1	123,000
(2)	400,000	325,000 (5)	<u>100,000</u>	Bal. 12/31	<u>123,000</u>
Bal. 12/31	<u>138,000</u>				
<b>Merchandise Inventory (A)</b>					<b>Sales Revenue (SE)</b>
Bal. 1/1	175,000			Bal. 1/1	-
(3.3)	10,000	90,000 (3.4)		(2)	625,000
Bal. 12/31	<u>95,000</u>			Bal. 12/31	<u>625,000</u>
<b>Building and Equipment (A)</b>					<b>Cost of Goods Sold (SE)</b>
Bal. 1/1	525,000			Bal. 1/1	-
(1)	10,000			(3.4)	90,000
Bal. 12/31	<u>535,000</u>			Bal. 12/31	<u>90,000</u>
<b>Raw Materials Inventory (A)</b>					<b>Salary Expense (SE)</b>
Bal. 1/1	10,000			Bal. 1/1	-
(3.1)	25,000	20,000 (3.2)		(4)	110,000
Bal. 12/31	<u>15,000</u>			Bal. 12/31	<u>110,000</u>
<b>Work-in-Process Inventory (A)</b>					<b>Insurance Expense (SE)</b>
Bal. 1/1	10,000			Bal. 1/1	-
(3.2)	20,000	10,000 (3.3)		(9)	500
Bal. 12/31	<u>20,000</u>			Bal. 12/31	<u>500</u>
<b>Accumulated Depreciation (XA)</b>					<b>Depreciation Expense (SE)</b>
	85,000	Bal. 1/1		Bal. 1/1	-
	<u>30,000</u>	(10)		(10)	30,000
	<u>115,000</u>	Bal. 12/31		Bal. 12/31	<u>30,000</u>
<b>Prepaid Insurance (A)</b>					
Bal. 1/1	-				
(8)	1,500	500 (9)			
Bal. 12/31	<u>1,000</u>				

### (3) Recognition of Income Tax Expense

- Let us assume that King's Shoe Store should pay income tax at 35% of operating income
- The operating income can be calculated by subtracting total operating expenses from total revenue, i.e.,

$$\begin{aligned}\text{Operating income} &= \text{Total revenue} - \text{Total operating expenses} \\ &= \text{Total revenue} - (\text{Cost of Goods Sold} + \\ &\quad \text{Salary Expense} + \\ &\quad \text{Insurance Expense} + \\ &\quad \text{Depreciating Expenses})\end{aligned}$$

Transaction Number	Accounts	Debit	Credit
11	Income Tax Expense (SE)	138,075	
	Income Tax Payable (L)		138,075

Transaction Number	Accounts	Debit	Credit
11	Income Tax Expense (SE)	138,075	
			138,075
Income Tax Payable (L)			
Asset		=	Liabilities + Shareholders' Equity
Cash (A)			Common Stock (SE)
Bal. 1/1	30,000		250,000 Bal. 1/1
(2)	225,000	10,000 (1)	50,000 (7)
(5)	325,000	110,000 (4)	<u>300,000</u> Bal. 12/31
(7)	50,000	70,000 (6)	
Bal. 12/31	<u>438,500</u>	1,500 (8)	
Account Receivable (A)			Retained Earnings (SE)
Bal. 1/1	63,000		123,000 Bal. 1/1
(2)	400,000	325,000 (5)	<u>123,000</u> Bal. 12/31
Bal. 12/31	<u>138,000</u>		
Merchandise Inventory (A)			Sales Revenue (SE)
Bal. 1/1	175,000		- Bal. 1/1
(3.3)	10,000	90,000 (3.4)	625,000 (2)
Bal. 12/31	<u>95,000</u>		<u>625,000</u> Bal. 12/31
Building and Equipment (A)			Cost of Goods Sold (SE)
Bal. 1/1	525,000		Bal. 1/1 -
(1)	10,000		(3.4) 90,000
Bal. 12/31	<u>535,000</u>		Bal. 12/31 <u>90,000</u>
Raw Materials Inventory (A)			Salary Expense (SE)
Bal. 1/1	10,000		Bal. 1/1 -
(3.1)	25,000	20,000 (3.2)	(4) 110,000
Bal. 12/31	<u>15,000</u>		Bal. 12/31 <u>110,000</u>
Work-in-Process Inventory (A)			Insurance Expense (SE)
Bal. 1/1	10,000		Bal. 1/1 -
(3.2)	20,000	10,000 (3.3)	(9) 500
Bal. 12/31	<u>20,000</u>		Bal. 12/31 <u>500</u>
Accumulated Depreciation (XA)			Depreciation Expense (SE)
	85,000	Bal. 1/1	Bal. 1/1 -
	30,000	(10)	(10) 30,000
	<u>115,000</u>	Bal. 12/31	Bal. 12/31 <u>30,000</u>
Prepaid Insurance (A)			Income Tax Expense (SE)
Bal. 1/1	-		Bal. 1/1 -
(8)	1,500	500 (9)	(11) <u>138,075</u>
Bal. 12/31	<u>1,000</u>		Bal. 12/31 <u>138,075</u>

## Adjusted Balance

**King's Shoe Store, Inc.**  
Adjusted Balance  
31-Dec-00

	Unadjusted Balance		Adjusting Entries			Adjusted Balance	
	Debit	Credit	Debit	Credit	Transaction Number	Debit	Credit
Cash (A)	438,500					438,500	
Account Receivable (A)	138,000					138,000	
Raw Materials Inventory (A)	15,000					15,000	
Work-in-Process Inventory (A)	20,000					20,000	
Merchandise Inventory (A)	95,000					95,000	
Prepaid Insurance (A)	1,500			500	(9)	1,000	
Land (A)	100,000					100,000	
Building and Equipment (A)	535,000					535,000	
Accumulated Depreciation (XA)		85,000		30,000	(10)		115,000
Accounts Payable (L)		90,000					90,000
Income Tax Payable (L)				138,075	(11)		138,075
Bonds Payable (L)		100,000					100,000
Common Stock (SE)		300,000					300,000
Additional Paid-in Capital (SE)		200,000					200,000
Retained Earnings (SE)		143,000					143,000
Sales Revenue (SE)		625,000					625,000
Cost of Goods Sold (SE)	90,000					90,000	
Salary Expense (SE)	110,000					110,000	
Insurance Expense (SE)			500		(9)	500	
Depreciation Expense (SE)			30,000		(10)	30,000	
Income Tax Expense (SE)			138,075		(11)	138,075	
<b>Total</b>	<u>1,543,000</u>	<u>1,543,000</u>	<u>168,575</u>	<u>168,575</u>		<u>1,711,075</u>	<u>1,711,075</u>

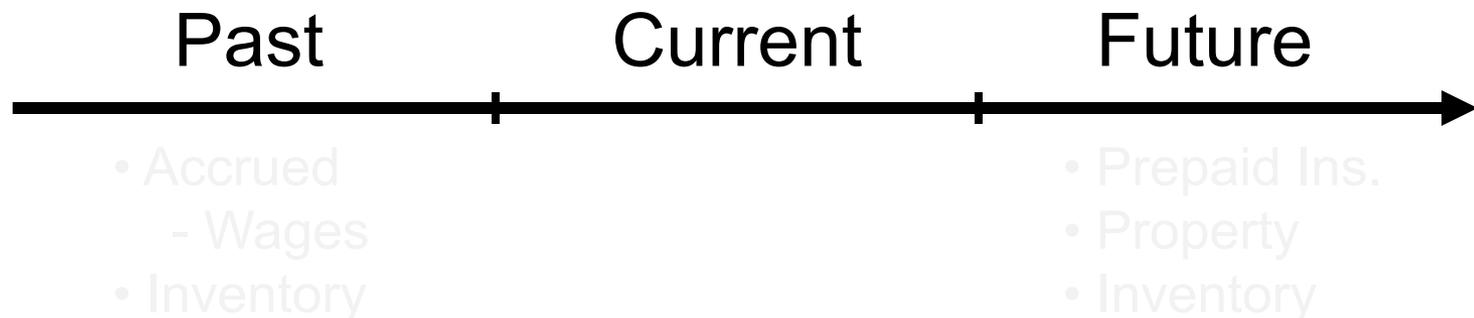
# Closing Entries

**King's Shoe Store, Inc.**  
Adjusted Balance  
31-Dec-00

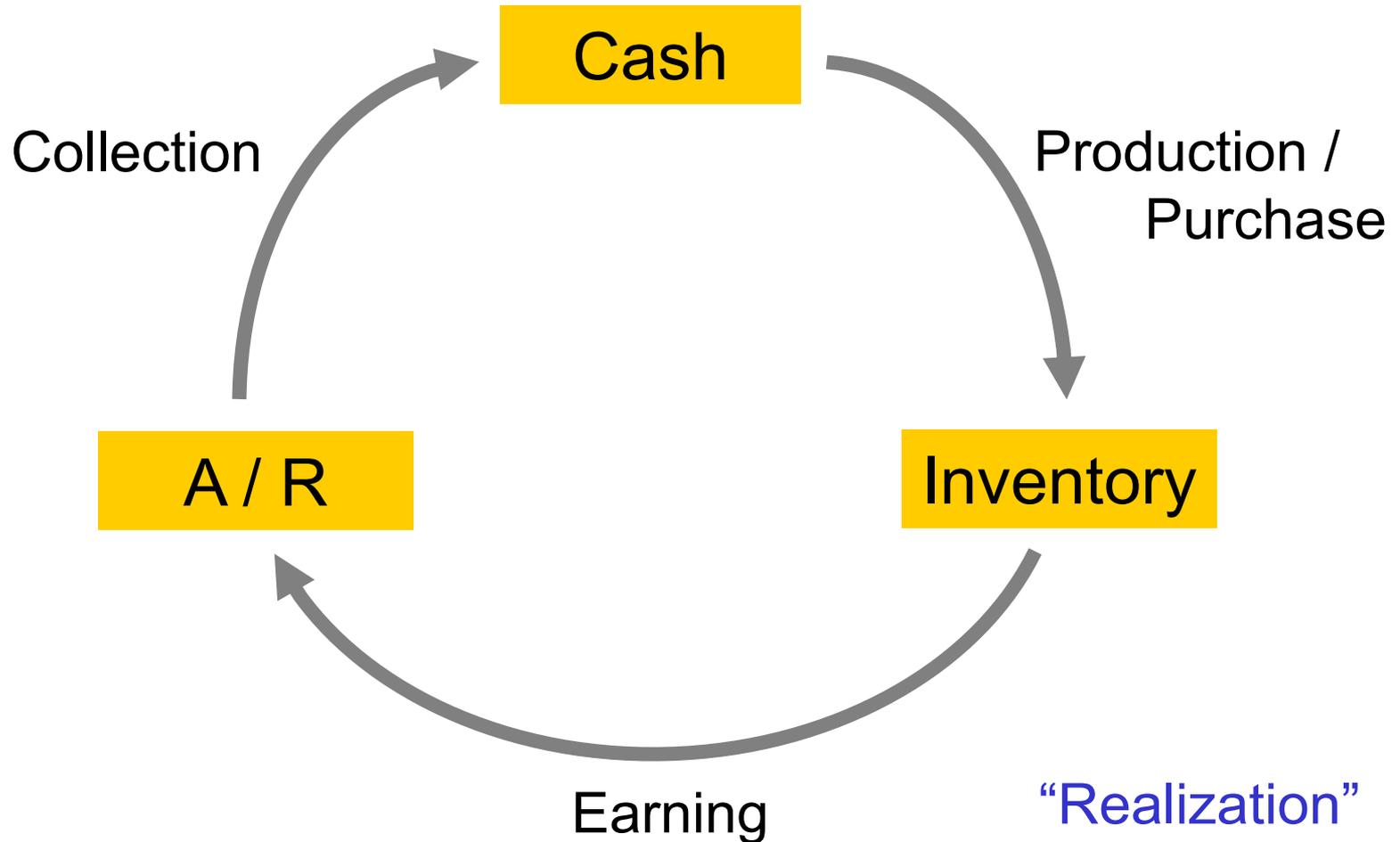
	Unadjusted Balance		Adjusting Entries			Adjusted Balance		Closing Entries (Income Statement)		Post-Closing Balance (Balance Sheet)	
	Debit	Credit	Debit	Credit	Transaction Number	Debit	Credit	Debit	Credit	Debit	Credit
Cash (A)	438,500					438,500				438,500	
Account Receivable (A)	138,000					138,000				138,000	
Raw Materials Inventory (A)	15,000					15,000				15,000	
Work-in-Process Inventory (A)	20,000					20,000				20,000	
Merchandise Inventory (A)	95,000					95,000				95,000	
Prepaid Insurance (A)	1,500			500	(9)	1,000				1,000	
Land (A)	100,000					100,000				100,000	
Building and Equipment (A)	535,000					535,000				535,000	
Accumulated Depreciation (XA)		85,000		30,000	(10)		115,000				115,000
Accounts Payable (L)		90,000					90,000				90,000
Income Tax Payable (L)				138,075	(11)		138,075				138,075
Bonds Payable (L)		100,000					100,000				100,000
Common Stock (SE)		300,000					300,000				300,000
Additional Paid-in Capital (SE)		200,000					200,000				200,000
Retained Earnings (SE)		143,000					143,000				399,425
Sales Revenue (SE)		625,000					625,000	625,000			-
Cost of Goods Sold (SE)	90,000					90,000			90,000		-
Salary Expense (SE)	110,000					110,000			110,000		-
Insurance Expense (SE)			500		(9)	500			500		-
Depreciation Expense (SE)			30,000		(10)	30,000			30,000		-
Income Tax Expense (SE)			138,075		(11)	138,075			138,075		-
<b>Total</b>	<u>1,543,000</u>	<u>1,543,000</u>	<u>168,575</u>	<u>168,575</u>		<u>1,711,075</u>	<u>1,711,075</u>	<u>625,000</u>	<u>625,000</u>	<u>1,342,500</u>	<u>1,342,500</u>

# Income Statement

- Cash method
- Accrual method
  - Store up expenses until sold
  - “Match” revenues w/expenses
  - Expenses (Timing of)

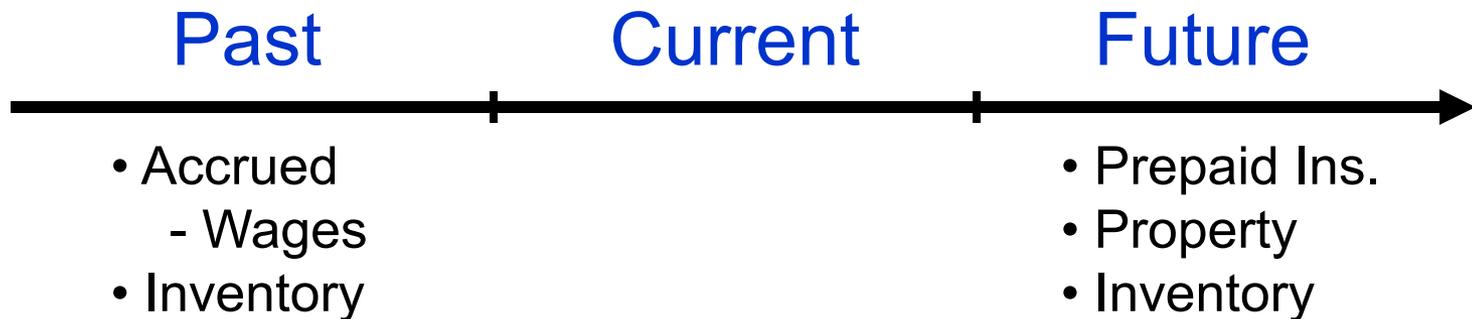


# Business Financial Flow

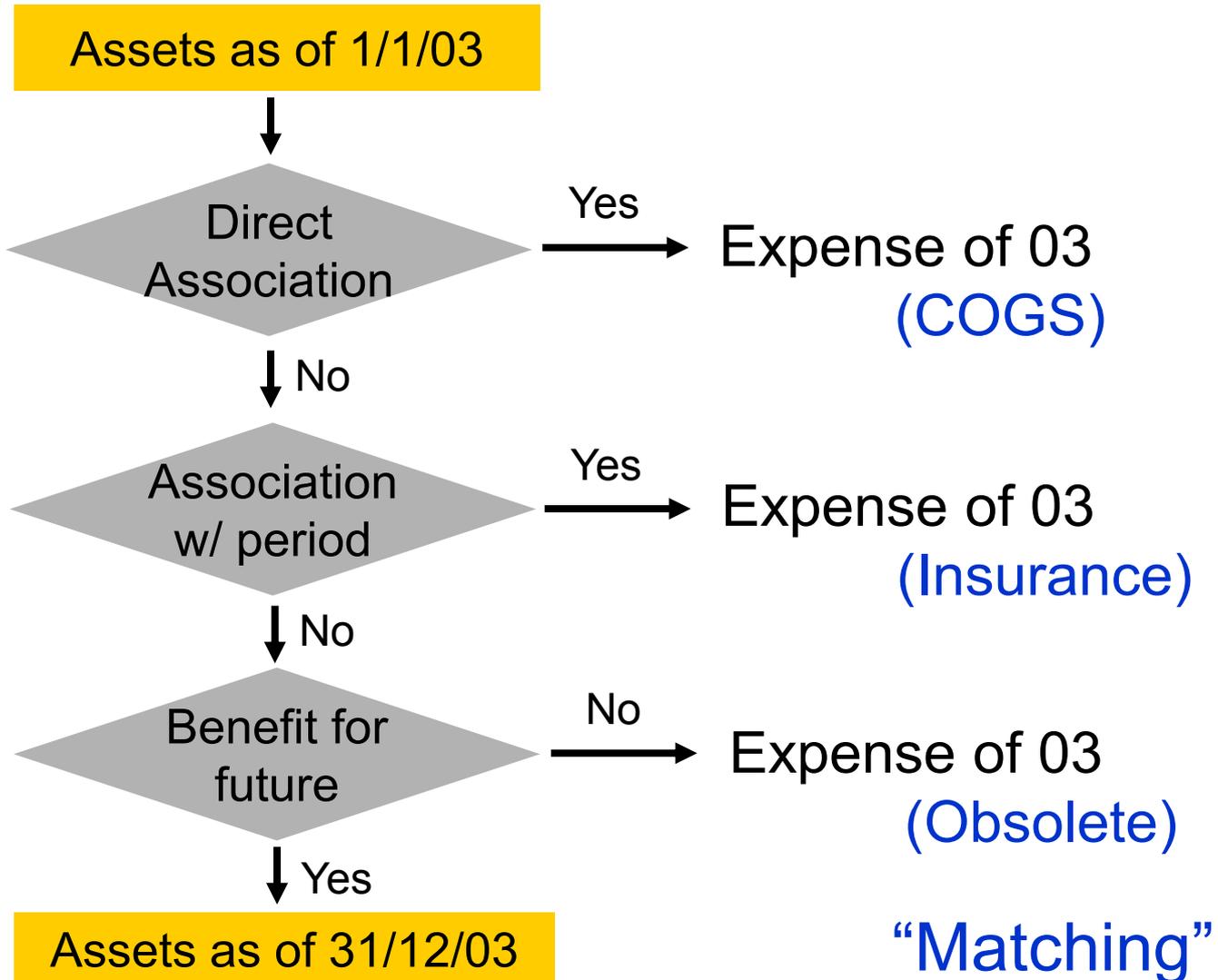


# Income Statement

- Cash method
- Accrual method
  - Store up expenses until sold
  - “Match” revenues w/expenses
  - Expenses (Timing of)



# Expenditures in 1/1/03 – 31/12/03



“Matching”

## Income Statement

### King's Shoe Store, Inc.

Income Statement for the Year Ending December 31, 2000

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<b>Revenue:</b>		
Sales Revenue	625,000	
Other Revenue	<u>-</u>	
Total Revenue		<u>625,000</u>
<b>Expenses:</b>		
Cost of Goods Sold	90,000	
Salary Expense	110,000	
Insurance Expense	500	
Depreciation Expense	<u>30,000</u>	
Total Expense		<u>230,500</u>
<b>Operating Income</b>		<u>394,500</u>
Less Income taxes (35%)		<u>(138,075)</u>
<b>Net Income</b>		<u>256,425</u>

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## Balance Sheet

King's Shoe Store, Inc.  
**Comparative Balance Sheet**  
 As of December 31, 1999 and 2000

Assets	Liabilities and Shareholders' Equity			
	December 31, 2000	December 31, 1999	December 31, 2000	December 31, 1999
<b>Current Assets:</b>			<b>Current Liabilities</b>	
Cash	438,500	30,000	Account Payable	90,000
Account Receivable	138,000	63,000	Income Tax Payable	138,075
Raw Materials Inventory	15,000	10,000	Total Current Liabilities	135,000
Work-in-Process Inventory	20,000	10,000	<b>Long-Term Debt</b>	
Merchandise Inventory	95,000	175,000	Bonds Payable	100,000
Prepaid Insurance	1,000	-	Total Liabilities	235,000
Total Current Assets	707,500	288,000		
<b>Property, Plant, and Equipment</b>			<b>Shareholders' Equity</b>	
Land	100,000	100,000	Common Stock (at par value)	300,000
Building and Equipment (at acquisition cost)	535,000	525,000	Additional Paid-in Capital	200,000
Less: Accumulated Depreciation	(115,000)	(85,000)	Retained Earnings	399,425
Building and Equipment (net)	420,000	440,000	Total Shareholders' Equity	593,000
Total Property, Plant, and Equipment	520,000	540,000	Total Liabilities and Shareholders' Equity	1,227,500
Total Assets	1,227,500	828,000		828,000

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