

Name: _____

ACCOUNTING I

Chapter 16 Reading Guide



16-1 PREPARING AN INCOME STATEMENT

Please answer the following questions as you read Chapter 16, pages 470-513.

1. Reporting financial information the same way from one fiscal period to the next is an application of the accounting concept Consistent Reporting. In the preparation of financial statements, accounting principles are applied the same way from one fiscal period to the next. Which accounting concept is being applied when financial statements are prepared to provide managers with information to make sound business decisions?
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2. Why is the Consistent Reporting accounting concept important?
 - Comparing financial condition and progress for more than one fiscal period helps owners make good decisions. Therefore, financial information must be reported the same way from one fiscal period to the next.
3. Where is the information used to prepare an income statement come from?
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4. Please examine the Income Statement on page 474. What are the four main sections of an income statement? (Hint: Look for the colons following the subtitles.)
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5. The revenue earned by a business from its normal business operations is called operating revenue. The Operating Revenue section of the income statement lists the Sales account, two contra accounts, and net sales. How is the net sales amount determined?
 - Sales minus the two contra accounts equals net sales
6. The original price of all merchandise sold during a fiscal period is called the cost of merchandise sold. Net purchases affects cost of merchandise sold. How is net purchases determined?
 - Purchases minus the two contra accounts (Purchases Discounts and Purchase Returns and Allowances) equals net purchases
7. How is the total cost of merchandise available for sale calculated? Beginning merchandise inventory plus net purchases made during the fiscal period minus ending inventory equals _____.
 - Take the beginning inventory and add net purchases
 - Cost of goods sold
8. Once you know the total cost of merchandise available for sale along with the ending merchandise inventory, how can you calculate the cost of merchandise sold?
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9. Management uses gross profit as a measure for how effectively the business is performing in its primary functions of buying and selling merchandise. How is gross profit determined?
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10. What does the single ruled line in the illustration on the bottom of page 476 indicate?
- It indicates that the column is being totaled. The amount adjacent to the column is the sum of that column.
(The two contra accounts totaled 5,589.76)
11. What are the expenses incurred by a business in its normal operations called?
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12. Also known as Operating Income, please define income from operations.
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13. Businesses often earn income unrelated to their normal business operations and this information is often presented on the income statement under the heading "Other Revenue". Name the "Other Revenue" account shown in the income statement on page 478.
- Interest Income
14. Operating revenue less cost of merchandise sold equals gross profit, less expenses equals _____?
- Net income from operations
15. Increasing sales revenue while keeping cost of merchandise sold the same will increase gross profit. When a business's expenses are less than the gross profit, the difference is known as a _____?
-
16. A vertical analysis on an income statement is prepared by dividing each amount in the fourth amount column by _____.
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16-2 PREPARING A STATEMENT OF STOCKHOLDERS' EQUITY

17. Which financial statement shows changes in a corporation's ownership for a fiscal period? What are the two major sections of this statement?
- -
18. The information to prepare a statement of stockholders' equity is obtained from several sources. Please list them.
- Income statement, general ledger, and current year's adjusted trial balance.
19. A value assigned to and printed on each share of capital stock by a corporation is called par value. If the par value of a stock is \$2.00, and 800 shares were issued, what is the value of the 800 shares?
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20. Net income increases a corporation's total capital. What is some of the income retained for? What may some of the income be distributed as?
- Some of the income may be retained for business expansion.
 - Some of the income may be distributed as dividends to the shareholders.
21. What is the formula for obtaining the December 31 balance of retained earnings? Is the amount of dividends declared during the year presented on the Statement of Stockholder's Equity statement? *Circle: yes no*
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16-3 PREPARING A BALANCE SHEET

22. Some management decisions can best be made after the amount of assets, liabilities, and stockholders' equity in the business is determined. A corporation's balance sheet reports assets, liabilities, and stockholders' equity on a specific date. Where is the information used to prepare a balance sheet obtained from? Data needed to prepare the liabilities section of a balance sheet are obtained from which column of this document?
- The (adjusted) trial balance and the statement of stockholders' equity
 - The credit column of the adjusted trial balance
23. An asset's book value is reported on a balance sheet by listing three amounts: the balance of the asset account, the balance of the asset's contra account, and the book value. How is the book value determined?
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24. In the Plant Assets section of a balance sheet, what is the procedure for calculating total plant assets?
- You must determine the book value of the two equipment asset accounts by subtracting the contra account from the asset. Then you add the book values of the equipment to get the total plant assets.
25. What is the difference between a current liability and a long-term liability? Is Dividends Payable a current liability or a long-term liability?
- -
26. What does the Stockholders' Equity section of a balance sheet contain? Which statement contains this information?
- - Statement of Stockholders' Equity
27. A supporting schedule is a report prepared to give details about an item on a principal financial statement. What are two supporting schedules commonly prepared for a balance sheet? Why are they necessary?
- Schedule of Accounts Payable and Schedule of Accounts Receivable
 - The balance sheet only provides the accounts payable **total** amount. The schedule provides a **list** of the vendors and the amount owed to each one.

16-4 RECORDING CLOSING ENTRIES FOR INCOME STATEMENT ACCOUNTS

28. Closing entries for a corporation are made from information in the adjusted trial balance. What are the four closing entries recorded by a corporation?
- A closing entry for income statement accounts with credit balances (revenue and contra-cost accounts)
 - A closing entry for income statement accounts with debit balances (cost, contra revenue, and expense accounts)
 - A closing entry to record net income or net loss in the Retained Earnings account and close the Inc. Sum. Acct.
 - A closing entry for the Dividends account
29. To close a temporary account, an amount equal to its balance is recorded on the side opposite the balance. Where are the amounts needed for the closing entries obtained from?
- _____ and _____
30. The temporary accounts (AKA nominal accounts) that need to be closed include the revenue, cost, expense and dividends accounts. What is another temporary account that needs to be closed?
-

31. Income Summary does not have a normal balance side. What would have happened that would have resulted in an Income Summary debit balance?
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32. In the sample closing entry illustrated on page 495, how is the amount credited to Income Summary calculated?
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33. Which accounting concept is applied when closing entries are done?
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34. After the closing entry for income statement accounts with debit balances has been posted, what three amounts have been recorded in the Income Summary account? When is the Income Summary account closed?
- A debit for the amount of merchandise inventory adjustment, a credit for the entry to close the revenue and contra cost accounts, and a debit for the amount of then entry to close the contra revenue, cost, and expense accounts.
 - Income Summary will be closed when the third closing entry when net income is recorded.
35. What is the entry to close dividends?
- Debit: _____ Credit: _____

16-5 PREPARING A POST-CLOSING TRIAL BALANCE

36. Which accounts are not affected by closing entries?
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37. What is the purpose of a Post-Closing Trial Balance?
- This report proves the equality of debits and credits in the general ledger after closing entries are posted
38. What are the 12 steps in the accounting cycle for a merchandising business?
- Check and analyze source documents
 - Record transactions in journals
 - Post to AP ledger, AR ledger, and general ledger
 - Prepare schedule of AP and AR
 - Prepare unadjusted trial balance
 - Journalize adjusting entries
 - Post adjusting entries
 - Prepare adjusted trial balance
 - Prepare financial statements
 - Journalize closing entries
 - Post the closing entries
 - Prepare post-closing trial balance