

Learning Module 1

Review of the Accounting Cycle of a Sole Proprietorship Form of Business

Overview

The work for each accounting period follows a cycle, which is called the **accounting cycle**. This refers to a series of sequential steps or procedures performed to accomplish the accounting process.

Accounting performs important tasks of recording daily transactions, classifying recorded data, summarizing recorded and classified data in order to prepare financial reports and providing interpretation of the summarized facts in informing interested people about business operation and financial condition. Accounting information is summarized in at least four basic financial reports, namely, (1) Statement of Comprehensive Income (SCI) or simply Income Statement; (2) Statement of Changes in Equity (SCE); (3) Statement of Financial Position (SFP); and (4) Cash Flows Statement (CFS) together with its accompanying notes to the financial statements.

The following are the basic steps in the accounting cycle. Worksheet preparation and journalizing and posting reversing entries are optional steps.



Learning Objectives

After studying this chapter, the student should be able to acquire the following competencies:

1. Practice recording business transactions and applying the rules of debits and credits.
2. Do the step posting in the general ledger using T-accounts.
3. Prepare and understand the importance of different trial balance.
4. Prepare the natural form of Income Statement for a single proprietorship
5. Prepare the Statement of Financial Position of a single proprietorship.
6. Prepare Cash Flows Statement using the direct method.
7. Perform the rest of the steps in completing the accounting cycle.

Business Case to Review the Accounting Cycle of a Sole Proprietorship Form of Business

Charito Couturier Shop

How time flies so fast! It seems just like yesterday when Charito started a small couturier shop out of her dress making and designing hobby. Look where her favorite pastime brought her! She is now considered by many to be a successful entrepreneur after putting Charito Couturier Shop two years ago!

Charito more than ever is really so concerned with the progress of her business operations on its third year of operation. She never forgets that the business to operate successfully must embody the principles of earning **profits** with utmost concern for the welfare of **people** and **planet**!

She reviewed the lessons on the different steps of the accounting cycle which she tried to learn when she was starting her small business. She started with the chart of accounts of the business as follows and proceeds with the journalizing of the various transactions for the month of December which is the end of the shop's reporting period for its third year of operation.

CHART OF ACCOUNTS

Account Number	Account Title
ASSETS	
101	Cash in Bank
102	Petty Cash Fund
103	Accounts Receivable
103-A	Allowance for Bad Debts
104	Notes Receivable
105	Advances to Employees
106	Interest Receivable
107	Sewing Supplies on Hand
201	Land
202	Buildings
202-A	Accumulated Depreciation-Building
203	Shop Equipment
203-A	Accumulated Depreciation-Shop Equipment
204	Furniture and Fixture
204-A	Accumulated Depreciation – Furniture and Fixture
LIABILITIES	
301	Accounts Payable
302	Notes Payable
303	Withholding Taxes Payable
304	Utilities Payable
305	Interest Payable
306	Unearned Service Income
310	Mortgage Payable
OWNER'S EQUITY	
401	Charito, Capital
401-A	Charito, Drawing
REVENUES	
501	Service Income
502	Interest Income
EXPENSES	
611	Salaries and Wages Expense
612	Depreciation Expense
613	Utilities Expense
614	Insurance Expense
615	Sewing Supplies Expense
616	Repairs and Maintenance Expense
617	SSS, Philhealth, and Pag-ibig Expense
618	Bad Debts Expense
619	Miscellaneous Expense
630	Interest Expense

The following is the trial balance prepared for Charito Couturier Shop as of November 30, 2020.

**Charito Couturier Shop
Trial Balance
November 30, 2020**

Account Title	Debit	Credit
Cash in Bank	P 182,000	
Petty Cash Fund	10,000	
Accounts Receivable	123,000	
Allowance for Bad Debts		P 9,500
Sewing Supplies on Hand	72,500	
Land	700,000	
Buildings	800,000	
Accumulated Depreciation-Building		100,000
Shop Equipment	480,000	
Accumulated Depreciation-Shop Equipment		112,500
Furniture and Fixture	150,000	
Accumulated Depreciation – Furniture and Fixture		52,000
Accounts Payable		18,000
Notes Payable		20,000
Withholding Taxes Payable		7,200
Mortgage Payable		100,000
Charito, Capital		1,284,300
Charito, Drawing	70,000	
Service Income		2,250,000
Salaries and Wages Expense	1,121,250	
Insurance Expense	68,450	
Utilities Expense	85,200	
Repairs and Maintenance Expense	18,500	
Transportation Expense	8,250	
SSS, Philhealth, and Pag-ibig Expense	41,550	
Miscellaneous Expense	18,400	
Interest Expense	4,400	
Total	P 3,953,500	P 3,953,500

Step 1: Analyzing Business Transactions and Journalizing in the General Journal

Charito reviews the first step which is *journalizing business transaction*, now that all the business documents of his business for the month of December were properly sorted and filed. She recalled the definition that journalizing is the chronological recording of the business transactions in the book called the **general journal**. A **journal** is a daily record of business transactions that shows in one place the *complete debit and credit effect of each transaction on the accounts of the business in chronological order*.

She also remembered that in journalizing transactions it is not only important to know the form of business organization according to ownership (i.e., sole proprietorship, partnership, corporation, or cooperative) but to also know the form of business organization according to activity (i.e., service, merchandising, or manufacturing). *Service business* activity is rendering service, for example, designing and sewing clothing apparels similar to her own shop. *Merchandising or trading* business activity means the company is engaged in the buying and selling of finished goods or merchandise, for example drug store. *Manufacturing* business activity on the other hand is a business engaged in the processing of products or the conversion of raw materials into finished goods that are then sold like the furniture factory.

To understand what journalizing is all about, one must fully appreciate that debits and credits are fundamental in the bookkeeping procedure; that this is connected to the accounting equation.

$$\text{ASSETS} = \text{LIABILITIES} + \text{OWNER'S EQUITY}$$

Debit and Credit can be literally translated as LEFT for debit (i.e., LEFT hand column of an account) and as RIGHT for credit (i.e., RIGHT hand side of an account).

Don't Forget!

	Assets	Liabilities	Owner's Equity
Normal balance	Debit	Credit	Credit
Increased by	Debit	Credit	Credit
Decreased by	Credit	Debit	Debit

Activity 1.1 to DEMONSTRATE student's learning in step 1: Journalizing

The following is the list summarizing the various transactions of CCS for the month of December, 2020 which you are asked to record.

Dec. 1	Received 5%, 3-month, P30,000 note from Maffy for the party gown that CCS designed and delivered for the former today.
2	CCS purchased buttons, threads, and ribbons from Luz Sewing Supplies Store amounting to P 14,800 paying 50% down and the balance on account.
3	Romy, the master cutter in the shop made salary advances amounting to P3,000.
4	Michelle, a frequent customer of CCS paid P52,000 for the balance of the gown she requested Charito to specially design for her two months ago.
5	Charito withdrew buttons, ribbons, and threads amounting to P500 for her personal use at home.
6	Paid Efren Repair Service Center P1,500 for the repair of one of the sewing machines.
7	Delivered the debut gown of Rose and collected P25,000.
8	Paid the transportation fare of Rene, the liaison officer of CCS amounting to P750.
9	Paid the P18,000 accounts payable to Jose Building Maintenance Company.
10	Charito withdrew P20,000 cash permanently from the business fund.
18	CCS entered into a P350,000 contract of designing all the gowns for the wedding entourage of Joy and Rafael on June, 2021. The couple paid 20% down payment.
20	Paid the internet and telephone December bill received from GlobeSmart Telecom amounting to P1,200.
27	Billed Mary Renee Dance Company for P75,000 for the costumes designed and sewed for their theater actors and actresses.
31	CCS paid December salaries of its employees amounting to P89,700. <small>Note: SSS, Philhealth, Pag-ibig, and withholding tax deductions were not included in this transaction to simplify reviewing Step 1 – Journalizing of the accounting cycle.</small>

Required:

Using the following General Journal activity sheets, record the above transaction of CCS for the month of December, 2020. December 1 transaction was done for your example on how to record business transactions using the general journal.

ACTIVITY SHEET No. 1.1

DATE	PARTICULARS	P/R	D E B I T					C R E D I T						
Dec. 1	Notes Receivable				3	0	0	0	0					
	Service Income									3	0	0	0	0
	Received 5%, 3-month promisory note.													
2														
3														
4														
5														
6														
7														

ACTIVITY SHEET No. 1.1

												P a g e 8						
DATE		PARTICULARS	P/R		D	E	B	I	T			C	R	E	D	I	T	
Dec.	8																	
	9																	
	10																	
	18																	
	20																	
	27																	
	31																	

Step 2: Posting to the General Ledger

After recording the above transactions, let us recall the lessons in *posting to the general ledger*. **Posting** is the process of transferring journal entries to the ledger accounts. The ledger is also called the **book of final entry**. It is in this book where all of the accounts listed in the company's chart of accounts are maintained. This book keeps all the information about the changes in every *account balance* and often very useful for management. An **account** is used as an accounting tool to record increases and decreases to individual accounting record in a specific asset, liability, or owner's equity item. An open account in the general ledger means that there is an amount posted in the ledger and has an existing balance. There are two possible forms of general ledger, namely: (1) running balance form and (2) standard form.

In lieu of the actual general ledger accounts, accountants use T-accounts to analyze business transactions. As the term implies, a **T-account** really looks like a capital letter **T** which consists of a horizontal and a vertical line. To make use of this tool of analysis for accounting, the account title is written just above the horizontal line. The vertical line provides an imaginary left and right side of the account where increases or decreases will be recorded similar to the standard form of general ledger.

Activity 1.2 to DEMONSTRATE student's learning in step 2: Posting to the Ledger

- Using the following activity sheets with T-accounts, post the journal entries recorded for the December transactions of CCS. The first transaction was posted for your sample.
- After posting the journal entries, compute for the December 31 balance of all the accounts that were affected by the December business transactions of CCS.

EXAMPLE of posting using T-accounts

On December 1, received 5%, 3-month, P30,000 note from Maffy for the party gown that CCS designed and delivered for the former today. The journal entry for this transaction follows:

DATE	PARTICULARS	P/R	D E B I T					C R E D I T						
Dec. 1	Notes Receivable			3	0	0	0	0						
	Service Income									3	0	0	0	0
	Received 5%, 3-month promisory note.													

This is how December 1 journal entry will be posted using T-accounts. Example of computing the balance as required by this activity was also shown for the Notes Receivable account.

ACTIVITY SHEET No. 1.2

Notes Receivable	
Nov. 30 balance	-
	30,000
Dec. 31 balance	

Service Income	
	3,250,000
	30,000

Nov. 30 balance

Cash	

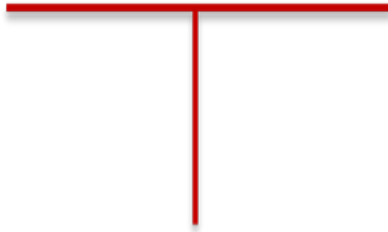
Charito, Capital	

Accounts Receivable	

Charito, Drawing	

ACTIVITY SHEET No. 1.2

Sewing Supplies on Hand



Advances to Employees



Accounts Payable



Unearned Service



Salaries and Wages Expense



Utilities Expense



Repairs and Maintenance Expense



Transportation Expense



Step 3: Trial Balance preparation

The *trial balance* is a list of schedule of open accounts in the general ledger with their corresponding account balances, i.e., the difference between the total debits and total credits of an account in the ledger. It is prepared to verify the *equality of debits and credits* in the ledger at the end of each accounting period or at any time the postings are updated.

The previous section has shown journalizing and posting business transactions, at this point in the sequence, it is advisable to check the work for arithmetic accuracy. Preparing the trial balance does this. The trial balance summarizes all the accounts in the general ledger and thus, provides a check on the equality of the debits and credit entries in the ledger. This schedule has the following characteristics:

1. It is a list of accounts.
2. The list of accounts is unclassified; it does not attempt to state whether accounts listed are assets or liabilities, current or long term.
3. The accounts listed are normally those with open balances, that is, they have peso amount balances.
4. The accounts are listed in ledger orders.

If the accounts have been debited and credited with equal amounts for each transaction during the accounting period, and if the balances of all accounts have been accurately calculated, the sum of the debit balance accounts (the assets and the expenses) will equal the sum of the credit balance accounts (contra asset accounts, the liabilities, proprietor's capital and revenues).

It is important to note that the trial balance is a list prepared for all accounts with open (debit or credit) balances. Accounts with zero balances are excluded. The trial balance is not a complete proof of the correctness of the accounting entries recorded.

Activity 1.3 to DEMONSTRATE student's learning for step 3: Trial balance preparation

Using the following activity sheet, complete the trial balance of Charito Couturier Shop as of December 31, 2020 using the amounts of the 14 accounts that you posted and computed the balances in the T-accounts in Activity No. 2.

ACTIVITY SHEET No. 1.3

Charito Couturier Shop Trial Balance December 31, 2020

Account Title	Debit	Credit
Cash in Bank	P	
Petty Cash Fund	10,000	
Accounts Receivable		
Allowance for Bad Debts		P 9,500
Notes Receivable		
Advances to Employees		
Sewing Supplies on Hand		
Land	700,000	
Buildings	800,000	
Accumulated Depreciation-Building		100,000
Shop Equipment	480,000	
Accumulated Depreciation-Shop Equipment		112,500
Furniture and Fixture	150,000	
Accumulated Depreciation – Furniture and Fixture		52,000
Accounts Payable		
Notes Payable		20,000
Unearned Service Income		
Withholding Taxes Payable		7,200
Mortgage Payable		100,000
Charito, Capital		1,264,300
Charito, Drawing	70,500	
Service Income		
Salaries and Wages Expense		
Insurance Expense	68,450	
Utilities Expense		
Repairs and Maintenance Expense		
Transportation Expense		
SSS, Philhealth, and Pag-ibig Expense	41,550	
Miscellaneous Expense	18,400	
Interest Expense	4,400	
Total	P	P

Step 4: Worksheet Preparation

The **worksheet** is a multicolumn devised used to systematically assemble the accounting data used in the adjustment process, financial statements preparation and closing entries. A worksheet is just a temporary accounting record. It is not a journal or a part of the general ledger. The worksheet is commonly known as the “working paper” of accountants which makes it easier for them to record adjusting entries, determines the result of the firm’s operation (whether net income or net loss) and is used as a tool in preparing financial statements and closing entries. Although the use of worksheet is an optional step in the accounting cycle, it helps facilitate earlier release of financial statements to interested parties.

There are two basic forms in preparing a worksheet. The first is the *ten-column worksheet* and the second is the *eight column worksheet*.

Step 5: Journalizing and Posting Adjusting Entries

Many times, companies will find it difficult to determine in what year they should report some of the revenues they earned and the expenses incurred. Measuring net income or net loss requires proper timing. The need for proper timing is the reason why accountants thought of a convenient assumption of dividing the economic life of a business into artificial time periods known as **reporting or accounting** period. This is the basic accounting concept of “**periodicity**” or “**time period**”. The time period assumption is important in accomplishing the fifth step of the accounting cycle which is “**adjusting the books**”. Step 5 is fairly crucial in the preparation of accurate or fairly valued financial statements. It is a common practice for an entity to recognize expense before payment, recognize income before receipt, and pay for an expense before it is incurred, or received payment before it is earned. This means that accounting records are maintained using the *accrual* basis. To *accrue* means to collect and accumulate. These being the case, adjusting entries are necessary to present the fair valuation of every account in the financial statements at the end of every reporting period.

Adjusting entries are entries required at the end of each accounting period to recognize on an accrual basis revenues and expenses for the period and to report proper amounts for assets, liabilities and owner’s equity accounts. To adjust the book implies that the entity recognizes expenses, income, depreciation and bad debts accounts at the end of the accounting period to update the books because of the events that has transpired throughout the period.

Activity 1.4 to DEMONSTRATE student’s learning for step 5: Journalizing and Posting Adjusting Entries

Required:

1. Journalize the following adjustments in the books of Charito Couturier Shop using the general journal activity sheet provided.
2. Post using activity sheet for T-accounts the adjusting entries recorded and compute the balances of the accounts adjusted.
3. Complete the adjusted trial balance of Charito Couturier Shop as of December 31, 2020.

December 31 Summary of Adjustments to be recorded in the books of CCS

Accrued Income is a revenue item that have not been collected or recorded but was earned during the accounting period covered. Even though cash payments have not been received, the revenues are considered earned and should be reported as income for the period.

- a) Interest for one month amounting to P125 from the 5%, 3-month, P30,000 promissory note received from Maffy on December 1 is considered accrued and must be recorded as an adjustment (i.e., $P30,000 \times 5\% \times 3 \div 12 \div 3 = P125$).

Accrued Expense is an expense incurred in a particular period but not recorded/paid during that same period.

- b) Received electricity bill from Meco Electric Company for the month of December but has not been paid by the store amounting to P6,800.

Prepaid Expense is an expense that is paid, but not yet incurred.

- c) Sewing supplies consumed during the year amounted to P81,500.

Bad Debts Expense

Under the “allowance method”, estimating and recording bad debts or doubtful accounts expense is required when it is deemed to be material in amount. In this method, expense for the uncollectible accounts is properly matched against revenues in the same accounting period in which the income was generated.

- d) The shop management decided that the allowance for doubtful accounts be increased to 8% of the outstanding Accounts Receivable balance as of December 31, which is equivalent to P2,180 (i.e., $P146,000 \times 8\% = P11,680 - 9,500 = P2,180$).

Depreciation Expense

Depreciation expense is recorded at the end of every accounting period in order to recognize that the usefulness of any plant asset, except land may decline because of wear and tear or obsolescence or inadequacy.

- e) The store uses the straight-line method in recognizing depreciation for all its fixed asset accounts. Depreciation expense for the current year has not been recorded yet. Details of the depreciable assets are given below.

Description	Date of Purchase	Estimated Useful Life	Cost	Salvage Value	Depreciable Cost	Depreciation Expense
Building	2 years ago	15 years	P 800,000	P 50,000	P 750,000	P 50,000
Equipment	2 years ago	8 years	P 480,000	P 30,000	P 450,000	P 56,250
Furniture	2 years ago	5 years	P 150,000	P 20,000	P 130,000	P 26,000

ACTIVITY SHEET No. 1.4

Journalizing Adjusting Entries

		P a g e 9														
DATE		PARTICULARS	P/R	D	E	B	I	T			C	R	E	D	I	T
Dec.	31	Interest Receivable					1	2	5							
a.		Interest Income												1	2	5
		Interest earned but not yet recorded.														
	31															
b.																
	31															
c.																
	31															
d.																
	31															
e.																

ACTIVITY SHEET No. 1.4

Posting Adjusting Entries Using T-accounts

Interest Receivable	
Dec. 31 balance	-
	125
Dec. 31 balance	125
	125

Interest Income		
		Dec. 31 balance
		-
		125
Dec. 31 balance		Dec. 31 balance
		125
		125

Utilities Expense	
Dec. 31 balance	86,400
Dec. 31 balance	

Utilities Payable		
		Dec. 31 balance
		-
Dec. 31 balance		Dec. 31 balance

Sewing Supplies on	
Dec. 31 balance	86,800
Dec. 31 balance	

Sewing Supplies		
		Dec. 31 balance
		-
Dec. 31 balance		Dec. 31 balance

Bad Debts Expense	
Dec. 31 balance	-
Dec. 31 balance	

Allowance for Bad	
	9,500
Dec. 31 balance	

Depreciation Expense	
Dec. 31 balance	-
Dec. 31 balance	

Accumulated Depreciation-Building	
	100,000
Dec. 31	

Accumulated Depreciation – Shop	
	112,500
Dec. 31 balance	

Accumulated Depreciation-Furniture	
	52,000
Dec. 31	

**Charito Couturier Shop
Adjusted Trial Balance
December 31, 2020**

Account Title	Debit	Credit
Cash in Bank	P 187,450	
Petty Cash Fund	10,000	
Accounts Receivable	146,000	
Allowance for Bad Debts		
Notes Receivable	30,000	
Advances to Employees	3,000	
Interest Receivable		
Sewing Supplies on Hand		
Land	700,000	
Buildings	800,000	
Accumulated Depreciation-Building		
Shop Equipment	480,000	
Accumulated Depreciation-Shop Equipment		
Furniture and Fixture	150,000	
Accumulated Depreciation – Furniture and Fixture		
Accounts Payable		P 7,400
Notes Payable		20,000
Unearned Service Income		70,000
Utilities Payable		
Withholding Taxes Payable		7,200
Mortgage Payable		100,000
Charito, Capital		1,264,300
Charito, Drawing	70,500	
Service Income		2,380,000
Interest Income		
Salaries and Wages Expense	1,210,950	
Depreciation Expense		
Sewing Supplies Expense		
Insurance Expense	68,450	
Utilities Expense		
Repairs and Maintenance Expense	20,000	
Bad Debts Expense		
Transportation Expense	9,000	
SSS, Philhealth, and Pag-ibig Expense	41,550	
Miscellaneous Expense	18,400	
Interest Expense	4,400	
Total	P	P

Step 6: Financial Statements Preparation

Accounting being the language of business summarizes the recorded and classified data in the four basic financial reports namely; (1) Statement of Comprehensive Income, also known as Income Statement; (2) Statement of Changes in Equity, (3) Statement of Financial Position, and (4) Statement of Cash Flows together with the *computational notes to the financial statements*. These financial statements are used in informing interested people about business operations and financial condition of the company.

The **Statement of Comprehensive Income (SCI) or Income Statement or Statement of Profit** is the report where the results of business operations are summarized and reported whether it earned profits or incurred losses on a specific time period, e.g., month or a year. The **Statement of Changes in Equity (SCE)** is the report that presents a summary of the changes that occurred in the owner's capital during a specific time period. The **Statement of Financial Position (SFP)** is the report that shows what the business is worth in terms of the properties it owns (i.e., the assets), the debts it owes (i.e., the liabilities), and the investment of its owner/s (i.e., the proprietorship) as of a specific date. The **Statement of Cash Flows (SCF)** is the statement that reports the firm's receipt and disbursement of cash which are classified according to the company's major activities, namely: operating, investing, and financing.

Activity 1.5 to DEMONSTRATE student's learning for step 6: Financial Statements Preparation

Required: Using the provided information, help Charito in preparing the following financial statements CCS for her to know whether the business is indeed doing well on its third year of operation.

- 1) Using the completed adjusted trial balance in Activity 4 (Activity Sheet No. 4 of 4) prepare the following financial statements of Charito Couturier Shop for the year ended December 31, 2020:
 - a) Income Statement
 - b) Statement of Changes in Equity
 - c) Statement of Financial Position
 - d) Computational Notes to the Financial Statements
- 2) Using the following additional information, prepare using the *direct method* the Statement of Cash Flows of Charito Couturier Shop for the year ended December 31, 2020.

Summary of cash inflows and outflows

Cash received from designing and sewing services	P 2,034,125
Collections on accounts receivable	52,500
Payment of various accounts payable during the year	385,000
Payment for various operating expenses	1,543,050
Payment of interest expense	4,400
Partial payment of bank loan (part of mortgage payable)	50,000

Additional data:

Cash in Bank balance, January 1, 2020 amounted to P 83,275

ACTIVITY SHEET No. 1.5

Charito Couturier Shop Income Statement For the year ended December 31, 2020

Service Income		P 2,380,000
Add: Interest Income		
Total Income		<hr/> P
Less: Operating Expenses		
Salaries and wages Expense	P 1,210,950	
Depreciation Expense		
Sewing Supplies Expense		
Utilities Expense		
Insurance Expense		
SSS, Philhealth, and Pag-ibig Expense		
Repairs and Maintenance Expense		
Transportation Expense		
Bad Debts Expense		
Miscellaneous Expense		
Interest Expense		4,400
Net income		<hr/> <hr/> P

Charito Couturier Shop Statement of Changes in Owner's Equity For the year ended December 31, 2020

Charito, Capital	P 264,300
Add: Net Income	
Sub-total	<hr/> P
Less: Charito, Drawing	
Charito, Capital	<hr/> <hr/> P

ACTIVITY SHEET No. 1.5

Charito Couturier Shop Statement of Financial Position December 31, 2020

ASSETS

Current Assets		
Cash (Note 1)	P	
Trade and other receivables (Note 2)		
Sewing Supplies on Hand	<u>5,300</u>	P
Non-Current Assets		
Property, Plant and Equipment (Note 3)		<u> </u>
Total Assets		<u><u>P</u></u>

LIABILITIES AND OWNER'S EQUITY

Current Liabilities		
Trade and other payables (Note 4)		P
Non-Current Liabilities		
Mortgage Payable		<u>100,000</u>
Total Liabilities		P
Owner's Equity		
Charito, Capital		<u> </u>
Total Liabilities and Owner's Equity		<u><u>P</u></u>

ACTIVITY SHEET No. 1.5

Notes to the Financial Statement

Note 1: Cash

Cash in Bank		P	
Petty Cash Fund			10,000
Total Cash		P	<u><u> </u></u>

Note 2: Trade and Other Receivables

Accounts Receivable	P 146,000		
Allowance for Doubtful Accounts		P	<u> </u>
Notes Receivable			
Advances to Employees			
Interest Receivable			<u> </u>
Total Trade and Other Receivables		P	<u><u> </u></u>

Note 3: Property, Plant and Equipment

Land		P	700,000
Building	P 800,000		
Less: Accumulated Depreciation			<u> </u>
Shop Equipment	P 480,000		
Less: Accumulated Depreciation			<u> </u>
Furniture and Fixture	P 150,000		
Less: Accumulated Depreciation			<u> </u>
Total Carrying Value		P	<u><u> </u></u>

Note 4: Trade and Other Payables

Accounts Payable		P	
Notes Payable			
Unearned Service Income			
Withholding Taxes Payable			
Utilities Payable			<u> </u>
Total Trade and Other Payables		P	<u><u> </u></u>

ACTIVITY SHEET No. 1.5

Charito Couturier Shop
Statement of Cash Flows
For the year ended December 31, 2020

Cash flows from operating activities

Inflow

Cash service fees from designing and sewing P 2,034,125

Collections on accounts receivable _____ P

Outflow

Payment of account purchases of sewing supplies 385,000

Payment of various operating expenses

Interest Expense

Net cash from operating activities _____ P

Cash flows from financing activities

Outflow

Partial payment of bank loan (part of mortgage payable) _____ 50,000

Net increase in Cash in Bank P

Add: Cash in Bank, January 1 _____ 83,275

Cash in Bank, December 31 _____ P

Step 7: Journalizing and Posting Closing Entries

After producing the required financial reports at year end, the company performs the closing of the books on the last day of the current accounting period to prepare the accounts for recording transactions for the next accounting period. The term ***closing the books*** simply refers to setting the balances of the income and expense accounts back to zero.

This step is done by journalizing and posting closing entries in order that net income or net loss may be computed on a yearly basis. Income and expense accounts are also called nominal or temporary accounts. The closing procedure applies only to nominal accounts. In step 7, the income and expense accounts are closed to a temporary account called ***Income Summary*** account, which collects or summarizes in one account the total debit for the sum of all expenses and the total credit for the sum of all income for the period.

The Income Summary account can be likened to a “holding vessel” where the amounts of all nominal accounts are transferred in order to determine the result of the company’s operation. A credit balance in the Income and Expense Summary means net income and a debit balance implies net loss for the period covered. The Income Summary account balance under the *indirect method of closing the book* will then be closed or transferred to the owner’s drawing account for a sole proprietorship form of business and finally, the owner’s drawing account is closed or transferred to the owner’s capital account.

After recording and posting the closing entries, all nominal accounts will be closed. This means that the balances of all income and expense accounts will be equal to zero. The following is an illustration using T-accounts on what happened after closing entries were posted.

Salaries and Wages Expense		Service Income	
Dec. 31 balance	1, 210, 950	2, 380, 000	2, 380, 000 Dec. 31 balance
Dec. 31 balance	0		0 Dec. 31 balance

Activity 1.6 to DEMONSTRATE student’s learning for step 7: Closing Entries

Required: Using the Income Statement prepared in Activity Sheet No. 5, record the closing entries required at year end to close the books of Charito Couturier Shop.

ACTIVITY SHEET No. 1.6

Journalizing Closing Entries

		P a g e 10													
DATE	PARTICULARS	P/R	D	E	B	I	T	C	R	E	D	I	T		
Dec. 31	Service Income		2	3	8	0	0	0	0						
	Interest Income					1	2	5							
	Income Summary								2	3	8	0	1	2	5
	Close nominal accounts with normal CREDIT balances.														
31	Income Summary														
	Salaries and Wages Expense								1	2	1	0	9	5	0
	Interest Expense										4	4	0	0	
	Close nominal accounts with normal DEBIT balances.														
31	Income Summary														
	Charito, Drawing														
	Close result of business operation (Net income).														
31	Charito, Drawing														
	Charito, Capital														
	Close drawing account to capital account.														

Step 8: Preparing Post-Closing Trial Balance

After closing the books, only assets, liabilities and capital (real) accounts are left open in the general ledger of the company. These real account ending balances are to be carried forward to the next accounting period. Step eight, which is the preparation of the post-closing trial balance, will summarize all these accounts.

The **post-closing trial balance** lists all the real accounts' balances as of the end of the accounting period covered and would be a final check on the equality of total debits and credits of all existing

accounts with balances in the general ledger. This step ensures that the ledger is in balance for the start of the next accounting period.

Activity 7 to DEMONSTRATE student’s learning for step 8: Preparing Post Closing Trial Balance

Required: Using the Statement of Financial Position together with the notes to the financial statement prepared in Activity Sheet No. 5, prepare the post-closing trial balance of Charito Couturier Shop.

ACTIVITY SHEET No. 1.7

**Charito Couturier Shop
Post-Closing Trial Balance
December 31, 2020**

Account Title	Debit	Credit
Cash in Bank	P 187,450	
Petty Cash Fund		
Accounts Receivable		
Allowance for Bad Debts		P
Notes Receivable		
Advances to Employees		
Interest Receivable		
Sewing Supplies on Hand		
Land		
Buildings		
Accumulated Depreciation-Building		
Shop Equipment		
Accumulated Depreciation-Shop Equipment		
Furniture and Fixture		
Accumulated Depreciation – Furniture and Fixture		
Accounts Payable		
Notes Payable		
Unearned Service Income		
Utilities Payable		
Withholding Taxes Payable		
Mortgage Payable		
Charito, Capital		1,892,045
Total	P	P

Step 9: Journalizing and Posting Reversing Entries

Reversing **entries** are special entries recorded at the beginning of every accounting period to reverse some of the adjusting entries made on the prior period. Although this is another optional step in the accounting cycle, just like worksheet preparation, this step may be done for the reason of **convenience** and **consistency**.

Reversing entries are most often used for accrual adjustments and for deferral but only if the expense and income method were used. A reversing entry switches the debit and credit of a previous adjusting entry. The reversing entry is the exact opposite of an adjusting entry recorded on a prior year.

Activity 8 to DEMONSTRATE student's learning for step 9: Reversing Entries

Review the different adjusting entries recorded in Step 5 and check whether you can understand the following reversing entries recorded in the books of CCS as of January 1, 2021.

DATE		PARTICULARS	P/R	D E B I T				C R E D I T					
2021													
Jan.	1	Interest Income				1	2	5					
		Interest Receivable								1	2	5	
		Interest earned but not yet recorded											
	1	Utilities Payable				6	8	0	0				
		Utilities Expense								6	8	0	0
		Electricity bill for the month of December											



Well done! You have finished reviewing the accounting cycle involving a sole proprietorship form of business.

References:

Manalo, M., Ferrer, R., Tang, A., Aquino, A. (2020). Fundamentals of Partnership: Utilizing Financial Statements for Decision Making

Manalo, M., and Rapatan, M. (2016). Learning to Succeed in Business with Accounting. Phoenix Publishing House, Inc.