I. Introduction and Review

A. Measuring Net Income
   1. Revenues - Expenses = Net Income
      a. Revenue
      b. Expenses

   2. Each revenue and expense has its own general ledger account

   3. Net Income is measured for a period of time (time period principle)
      a. Fiscal Year -- Calendar year.
      b. Measurement process is an estimate -- some transactions affect more than one
         of measurement period -- what amount goes to each?

   4. Going Concern Principle

B. Income Measurement Bases
   1. Cash Basis -- Not GAAP

   2. Accrual Basis
      a. Revenue Recognition Principle
         (1) Revenues when earned
      b. Expenses when incurred
         (1) This follows "matching" principle -- Let the expense follow
             the revenue to which it pertains.

II. Adjusting Entries

A. Needed when revenue and expenses pertain to more than one accounting period.
   Need to make a proper allocation to each period. Transactions are normally recorded
   as they occur, however, some "events" are not recorded on a day-by-day basis. (Ex--
   usage of supplies, employee earnings)

B. Necessary to comply with accrual basis, revenue recognition, and matching principle

C. Types of Adjusting Journal Entries
   1. Apportion recorded costs (deferred or prepaid expenses--insurance, supplies,
      etc.)
      a. Items paid in advance are assets until used. When used they become an
         expense.

      b. Using up long lived assets (buildings, equipment) is called depreciation

      c. Use of "Accumulated Depreciation" account
         (1) Contra account
2. Apportion recorded revenue (deferred or unearned revenues)
   a. Items collected before services are provided. We owe them services until we do the work

3. Accrued Revenues
   a. Revenue earned but not yet received
      (1) Hence, it is receivable
      (2) Interest formula ... Principal x Rate x Time

4. Accrued Expense
   a. Expenses incurred but not yet paid
      (1) Hence, it is payable

D. All adjusting journal entries affect an Income Statement and Balance Sheet account. Hence affects both financial statements. See Exhibit 5 on page 109.
   1. Note format of AJE’s are the same as regular journal entries.

E. After adjusting journal entries are prepared and posted, an Adjusted Trial Balance can be prepared
   1. Same objectives as unadjusted trial balance
   2. Financial Statements can be prepared directly from the adjusted trial balance

III. Summary
A. Do not try to memorize adjusting journal entries -- very logical process
B. Important to recognize how transaction was originally recorded when dealing with prepaid expense (unearned revenue) adjusting journal entries
   1. May have initially been recorded as an expense (or revenue)
   2. Now need to adjust to reflect portion which is prepaid (or unearned)

IV. Financial Statement Analysis

A. Vertical Analysis
   1. Each item on the Balance Sheet is expressed as a percentage of total assets.
   2. Each item on the Income Statement is expressed as a percentage of revenues earned.
   3. Shows efficiencies or inefficiencies that might not otherwise be evident.
      a. Logical means of comparing companies of different sizes.