**Step 4: Unadjusted Trial Balance**

Slide 1: As mentioned at the end of the Step 3 presentation, this time we will talk about preparing the Unadjusted Trial Balance. This video presentation will be a bit shorter than the last couple; we did a lot of the hard part in step 1 through 3…

Slide 2: Before we can prepare the Unadjusted Trial Balance, we first need to summarize activity in all the ledgers. In this part, remembering the normal balances is key. For example, if we totaled up the A/R ledger and had a credit balance, we would know something is wrong – the normal balance for an asset is a debit balance.

So, let’s take a minute to review. Those accounts where a debit balance is normal are Assets, Expenses and Distributions (in our example, dividends). To summarize these accounts, it’s easiest to total all the debits and subtract the credits.

Those Accounts where a credit balance is normal are Liabilities, Revenue and Equity accounts. To summarize these accounts, it’s easiest to total all the credits and subtract the debits. It’s also possible to go line by line, remembering what’s added and what’s subtracted. You can use the ledgers from your work in step 3 for the summarizing, if you want to work along.

Since we involved twelve accounts, I’m going to do three at a time for the next four slides…

Slide 3: Here, all the accounts involved are assets, so, we would expect them all to have debit balances. For cash, if we total all the debits we get 53,500; if we subtract the 20,700 in credits, we get a 32,800 debit balance (which is normal). A/R is a little easier: 7,900 minus 4,000 gives us a 3,900 debit balance (also normal). Prepaid Insurance is the easiest so far: just one 4,800 debit. We use the double underlines to show that we those are totals, subtotals.

Slide 4: Here, we have two asset accounts and one liability account; supplies and equipment should have a debit balance and A/P should have a credit balance. For the assets, with only one entry, readily prove that there are normal balances in those ledgers. Some quick math for A/P shows that we have a normal credit balance for that liability: 9,200 minus 3,600 equals a 5,600 credit balance.

Slide 5: Not much to do with these next three except to enter the balances at the bottom and employ the double underline. The two liabilities have credit balances and dividends has the normal debit balance/

Slide 6: Revenue accounts have normal credit balances; that is the case here as well. 4,500 plus 7,900 gives us a 12,400 credit balance. The two expenses have normal debit balances for 3,000 and 2,000 respectively.

Slide 7: If you want to work along, there is a Trial Balance blank in the Step 4 working papers.

The trial balance does exactly as it sounds: we’re going to attempt to make sure debits and credits are in balance, or equal. To do that, we enter the totals from our ledgers onto the Trial Balance, and then we total the debit and credit columns.

Just like during posting, we don’t really have to do any analyzing here – we just need to make sure we put the debit balances in the debit column and the credit balances in the credit column. In our example here, we see that each column totals 63,000. We are in balance and are ready to proceed to the next step.

I want to quickly prepare some preliminary financials, using this Unadjusted Trial Balance information. I have also prepared a financial statements blank so you can work along, should you wish to do so.

Slide 8: As we’ve discussed in prior videos, we prepare the Income Statement first; we do this because the next statement requires the Net Income from the Income Statement. We take total Revenues and subtract total Expenses and arrive at a positive Net Income of 7,400 (the same we saw in the Step 1 presentation).

We can now prepare the Statement of Retained Earnings. As mentioned earlier, this business just began, so there is no Beginning Balance – there were no prior earnings to retain. So, Zero plus 7,400 less 1,000 in dividends equals Ending Retained Earnings of 6,400. Now that we have that, we can prepare the Balance Sheet.

One thing I personally like to do is to write out the format and then enter the numbers – just like you using the statements blank provided. So, if we enter the numbers, compute current assets, plant assets liabilities and equity, and then compute total assets and Liabilities and Equity, we can see that, indeed, our balance sheet is in balance.

As mentioned previously, we won’t do the cash flow statement, as it will be covered in detail in a separate presentation.

Slide 9: While we do have financial statements, we can make them more accurate and will do that in Step 5. For instance, we don’t have any supplies expense and surely must have used some in order to generate revenues. The Step 5 process is known as Adjusting, and it concludes with the posting of adjustments.

In Step 6, we’ll prepare the second trial balance, known as the Adjusted Trial Balance. In Step 7, we’ll use that to prepare the final financial statements.