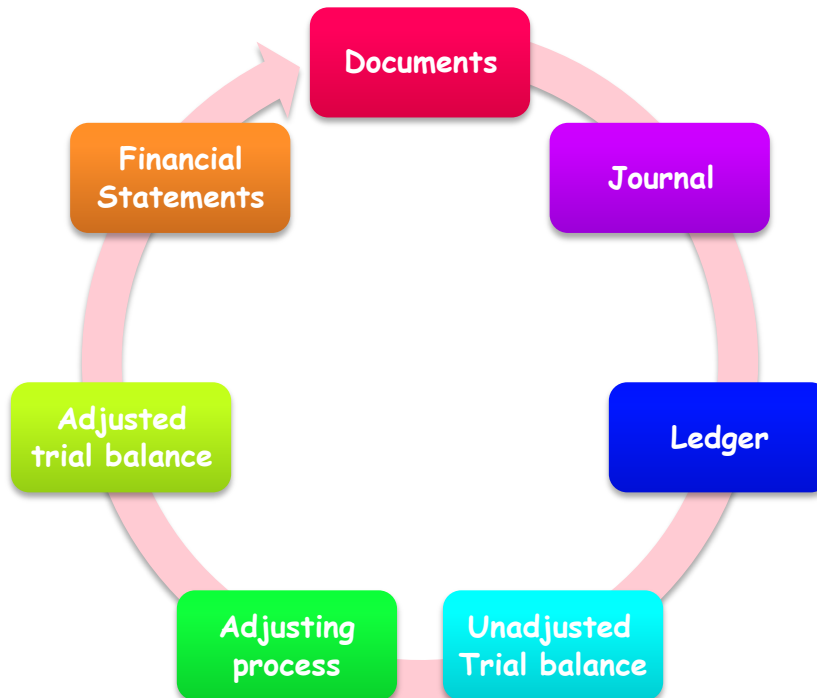


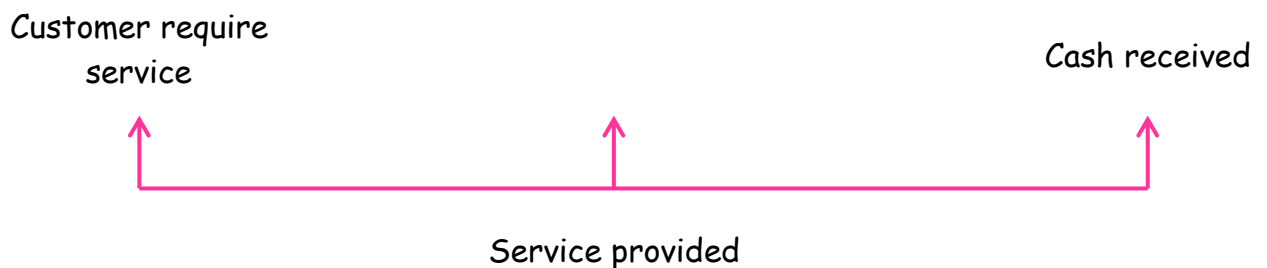
Chapter 3 the Adjusting Process

Learning Objective 1 Describe the nature of the adjusting process.



Nature of the Adjusting Process

→ **General concept:** revenues are earned when services provided.



It Is Not Related To Cash Payments And Cash Receipts.

- Under **the cash basis of accounting**, revenues and expenses are reported on the income statement in the period in which cash is received or paid.
- Under **the accrual basis of accounting**, revenues are reported on the income statement in the period in which they are earned. Thus, some of the accounts need updating at the end of the accounting period.

The Adjusting Process

- The analysis and updating of accounts at the end of the period before the financial statements are prepared is **called the adjusting process**.
- The journal entries that bring the accounts up to date at the end of the accounting period are **called adjusting entries**.

Types of Accounts Requiring Adjustment

- 1) **Prepaid expenses** are the advance payment of future expenses and are recorded as assets when cash is paid.
- 2) **Unearned revenues** are the advance receipt of future revenues and are recorded as liabilities when cash is received.
- 3) **Accrued revenues** are unrecorded revenues that have been earned and for which cash has yet to be received.
- 4) **Accrued expenses** are unrecorded expenses that have been incurred and for which cash has not yet been paid.

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Learning Objective 2 Journalize entries for accounts requiring adjustment

NetSolutions Unadjusted Trail Balance December 31, 2011		
	Debit Balances	Credit Balances
Cash	2,065	
Account receivable	2,220	
Supplies	2,000	
Prepaid insurance	2,400	
Land	20,000	
Office equipment	1,800	
Account payable		900
Unearned rent		360
Chris Clark, Capital		25,000
Chris Clark, Drawing	4,000	
Fees earned		16,340
Wages expense	4,275	
Rent expense	1,600	
Utilities expense	985	
Supplies expense	800	
Miscellaneous expense	455	
	<u>42,600</u>	<u>42,600</u>

A. Prepaid Expenses

The entries during the period (from Ch2)

C. On November 10, NetSolutions purchased supplies on account for \$1,350.			
Nov.10	Supplies Account payable	1,350	1,350
G. NetSolutions purchased \$1,350 of supplies on November 10. Chris Clark determined that the cost of supplies on hand on November 30 was \$550.			
Nov. 30	Supplies expenses supplies	800	800
T. On December 23, NetSolutions paid \$1,450 for supplies.			
Dec. 23	Supplies Cash	1,450	1,450

NetSolutions' supplies account has a balance of \$2,000 on the unadjusted trial balance. Some of these supplies have been used. On December 31, a count reveals that the amount of supplies on hand is \$760.

Supplies (balance on trial balance)	\$2,000
Supplies on hand, December 31	<u>- 760</u>
Supplies used	\$1,240

A	Dec. 31	Supplies Expense	1,240	1,240
		Supplies		
		Supplies used (2,000 - 760)		

Prepaid Insurance

I. On December 1, NetSolutions paid a premium of \$2,400 for an insurance policy for liability, theft, and fire. The policy covers a one-year period.

Dec. 1	Prepaid insurance	2,400	2,400
	Cash		

The debit balance of \$2,400 in NetSolutions' prepaid insurance account represents the December 1 prepayment of insurance for 12 months.

Dec. 31	Insurance Expense	200	200
	Prepaid insurance		
	Insurance expired (2,400/12)		

Hints!!!!

1. All adjusting entries are prepared at the end of the period.
2. Cash is never, never, never a part of an adjusting entry.
3. Each adjusting entry must affect an expense (Dr.) and asset or liability (Cr.) OR a revenue (Cr.) and an asset or liability (Dr.)

1) On Dec1, 2012, ABC Co. purchased an insurance policy for \$10,000 that covers a 5 months period.

- Journalize the entry?
- Prepare the adjustment entry at Dec 31, 2012.

2) On Dec 1, 2012 ABC Co. paid one of its employees an advance salary of \$4,000 for 4 months.

- Journalize the entry?
- Prepare the adjustment entry at Dec 31, 2012.

3) On Dec 1, 2012, ABC Co. paid a 2 months advance rent of \$10,000 for a lab.

- Journalize the entry?
- Prepare the adjustment entry at Dec 31, 2012.

4) On Nov 6, 2012. ABC Co. purchased supplies on account for \$2,000 on Dec 31, 2012. Records show that 1,350 of supplies were used.

- Journalize the purchasing transaction.
- Prepare the adjusting entry at the end of the period.

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Depreciation Expense

- **Fixed assets, or plant assets**, are physical resources that are owned and used by a business and are permanent or have a long life.
- As time passes, a fixed asset loses its ability to provide useful services. This decrease in usefulness **is called depreciation**.
- All fixed assets, except land, lose their usefulness and, thus, are said to depreciate.
- As a fixed asset depreciates, a portion of its cost should be recorded as an expense. This periodic expense **is called depreciation expense**.

Depreciation Expense

L. On December 4, NetSolutions purchased office equipment on account from Executive Supply Co. for \$1,800.

Dec. 4	office equipment Account payable	1,800	1,800
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NetSolutions estimates the depreciation on its office equipment to be \$50 for the month of December.

Date	Description	Debit	Credit
Dec. 31	Depreciation Expense Accumulated Depreciation - office equipment	50	50

1) ABC Co. purchased a car for \$30,000 cash at Jul 1, 2010. The expected depreciation for the car is \$1,250.

- Journalize the purchasing transaction.
- Journalize the adjusting entry at Dec 31, 2010.

2) ABC Co. purchased a building for \$300,000 on account at May 6, 2011. The depreciation cost \$10,000.

- Journalize the purchasing transaction.
- Journalize the adjusting entry at Dec 31, 2011.

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B. Unearned Revenues

K. On December 1, NetSolutions received an offer from a local retailer to rent the land purchased on November 5. The retailer plans to use the land as a parking lot for its employees and customers. NetSolutions agreed to rent the land to the retailer for three months, with the rent payable in advance. NetSolutions received \$360 for three months' rent beginning December 1.

Dec. 1	Cash	360	
	unearned rent		360

The credit balance of \$360 in NetSolutions' unearned rent account represents the receipt of three months' rent on December 1 for December, January, and February. At the end of December, one month's rent has been earned.

B	Dec. 31	Unearned rent	120	
		Rent revenue		120
		Rent earned (360/3 months)		

- 1) On the 1st of Nov, ABC Company received advance revenue of \$5,000. This revenue was supposed to be received on monthly basis of \$1,000.
 - Journalize the purchasing transaction.
 - Journalize the adjusting entry at Dec 31, 2011.

- 2) As of Dec 31, \$7,000 of the unearned revenue became earned.
 - Journalize the adjusting entry at Dec 31, 2011.

- 3) The unearned commissions account had a balance of \$10,000 during the year. At Dec 31, the amount of unexpired commissions related to future periods is \$4,220.
 - Journalize the adjusting entry at Dec 31, 2011.

- 4) The balance in the unearned fees account, before adjustment at the end of the year, is \$44,900. The amount of unearned fees at the end of the year is \$22,300.
 - Journalize the adjusting entry at Dec 31, 2011.

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C. Accrued Revenues

NetSolutions signed an agreement with Danker Co. on December 15 to provide service to Danker. As of December 31, NetSolutions had provided \$500 of services. The revenue will be billed on January 15.

C	Dec. 31	Accounts receivable	500	
		Fees earned		500
		Accrued fees (25 hrs. * 20)		

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1) At the end of 2013, \$13,680 of fees have been earned but have not billed to clients.

- Journalize the adjusting entry at Dec 31, 2011.

D. Accrued Wages

On 31 Dec, the amount of accrued wages was \$250.

D	Dec. 31	Wages expense	250	
		Wages payable		250
		Accrued wages		

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Learning Objective 3 Summarize the adjustment process.

Adjusting Entries Adjusting Entries—NetSolutions

Journal			
Date	Description	Debit	Credit
A Dec. 31	Supplies Expense Supplies Supplies used (2,000 - 760)	1,240	1,240
Dec. 31	Insurance Expense Prepaid insurance Insurance expired (2,400/12)	200	200
Dec. 31	Depreciation Expense Accumulated Depreciation - office equipment Depreciation on office equipment	50	50
B Dec. 31	Unearned rent Rent revenue Rent earned (360/3 months)	120	120
C Dec. 31	Accounts receivable Fees earned Accrued fees (25 hrs. * 20)	500	500
D Dec. 31	Wages expense Wages payable Accrued wages	250	250

Ledger with Adjusting Entries

T ACCOUNTS

cash	
25,000	20,000
7,500	3,650
360	950
3,100	2,000
650	2,400
2,870	800
	180
	400
	950
	900
	1,450
	1,200
	310
	225
	2,000
Bal. 2,065	

Chris Clark, Capital	
	25,000
	25,000 Bal.
Fees earned	
	7,500
	3,100
	1,750
	2,870
	1,120
	500
	16,840 Bal.
Unearned Rent	
120	360
	240 Bal.

Supplies	
1,350	800
1,450	
Bal. 2,000	
	1,240
Bal. 760	

Account payable	
950	1,350
400	1,800
900	
	900 Bal.

Land	
20,000	
Bal. 20,000	

Wages expenses	
2,125	
950	
1,200	
250	
Bal. 4,525	

Miscellaneous expenses	
275	
180	
Bal. 455	

Rent expenses	
800	
800	
Bal. 1,600	

Supplies expenses	
800	
1,240	
Bal. 2,040	

Utilities expenses	
450	
310	
225	
Bal. 985	

Chris Clark, Drawing	
2,000	
2,000	
Bal. 4,000	

Prepaid insurance	
2,400	
Bal. 2,200	200

Account receivables	
1,750	650
1,120	
500	
Bal. 2,720	

office equipment	
1,800	
Bal. 1,800	

Wages payable	
	250
	250 Bal.

Accumulated Depreciation - office equipment	
	50
	50 Bal.

Rent revenue	
	120
	120 Bal.

Depreciation Expense	
	50
Bal. 50	

Insurance expense	
200	
Bal. 200	

Learning Objective 4 Prepare an adjusted trial balance.

Adjusted Trial Balance

- The purpose of the adjusted trial balance is to verify the equality of the total debit and credit balances before the financial statements are prepared.

NetSolutions Adjusted Trail Balance December 31, 2011		
	Debit Balances	Credit Balances
Cash	2,065	
Account receivable	2,720	
Supplies	760	
Prepaid insurance	2,200	
Land	20,000	
Office equipment	1,800	
Accumulated depreciation - office equipment ...		50
Account payable		900
Wages Payable		250
Unearned rent		240
Chris Clark, Capital		25,000
Chris Clark, Drawing	4,000	
Fees earned		16,840
Rent Revenue		120
Wages expense	4,525	
Rent expense	1,600	
Depreciation Expenses	50	
Utilities expense	985	
Supplies expense	2,040	
Insurance expense	200	
Miscellaneous expense	455	
	<u>43,400</u>	<u>43,400</u>

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Summary Adjustments

Expenses	
Prepaid Expense	Accrued Expense
Advance payment for future expense	Expense has been incurred (Not recorded & not paid)
recorded as assets	recorded as Liabilities
Journal Entry	
Prepaid Expense xxx cash xxx paid an expense in advance	No entry has been recorded
Adjusting Entry	
Expense xxx Prepaid expense xxx adjustment for prepaid expense	Expense xxx liability (payable) xxx adjustment for accrued expense
Revenues	
Unearned Revenue	Accrued Revenue
Advance receipt for future revenues	unrecorded revenue (has not received cash)
recorded as Liabilities	recorded as assets
Journal Entry	
cash xxx unearned revenue xxx received cash for unearned revenue	No entry has been recorded
Adjusting Entry	
unearned revenue xxx revenue xxx adjustment for unearned revenue	Asset (receivable) xxx revenue xxx adjustment for accrued revenue
Depreciation Expense	
Depreciation Expense xxx Accumulated Depreciation - Fixed assets xxx Depreciation on fixed assets	