

CHAPTER FIVE

ADJUSTING ENTRIES

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WHY ADJUSTING JOURNAL ENTRIES?

- All amounts must be correct before financial statements printed
- Test ending balance in each account
- Auditing
 - Test accounting system, internal controls
 - Verify ending balances are correct

ACCOUNT BALANCES CORRECT

- Record revenues earned for period
- Match expenses to revenues
- Count and value assets
- Accurately report liabilities

MATCHING PRINCIPLE

- Match EXPENSES to REVENUES
- Provides best measure of net income
- Detective work – are all revenues and expenses recorded?

WHY ENDING BALANCE NOT CORRECT?

- Received document and made error
 - Wrong amount
 - Wrong account
 - Entered twice
 - Not entered
- No documentation received

NO DOCUMENTATION

- Internal transactions
 - No document ever created
- External transactions
 - No document yet created, will be in future

EXTERNAL TRANSACTIONS

- **Involve outside parties**
 - Vendors
 - Customers
- **Involve documentation**
 - Invoices
 - Credit memos
 - Cash, checks

EXTERNAL TRANSACTIONS

- **If documentation received**
 - recorded in accounting cycle
- **If no documentation received**
 - adjusting journal entry required

NO DOCUMENTATION

- Requires adjusting journal entry**
- **Made purchase, invoice not received from vendor**
 - **Made sale, invoice not created by our accounting department**
 - **Internal transactions**
 - **Correct error**

INTERNAL TRANSACTIONS

- **Involve only our company**
 - Consume assets
 - Supplies
 - Prepaid insurance
 - Equipment used over lifetime
 - No document sent to accounting department
- **Requires adjusting journal entry**

FISCAL YEAR

- **Any twelve-month period**
- **May, or may not, be calendar year**
- **Schedule fiscal year to end when business is slow.**

ADJUSTING ENTRIES

Let's look at some adjusting entries for Jessica Jane's Campus Delivery.

SUPPLIES

During June, purchased supplies, \$80

		SUPPLIES
PURCHASED IN JUNE	\$80	

SUPPLIES

		SUPPLIES
BALANCE	<u>\$80</u>	
	\$80	

Count Supplies on hand at end of month: \$20 remaining

SUPPLIES

		SUPPLIES
BALANCE	<u>\$80</u>	
	\$80	

But unless there is an adjusting entry made, \$80 of Supplies will be shown on the Balance Sheet.

SUPPLIES

		SUPPLIES
BALANCE	<u>\$80</u>	
	\$80	

ADJUSTING ENTRY NEEDED

SUPPLIES

		SUPPLIES
		<u>\$80</u>
Bal. \$80		

\$80 Supplies
- \$20 Remaining
\$60 Used Up

SUPPLIES

		SUPPLIES
		<u>\$80</u>
Bal. \$80		
	\$60	

\$60 is credited to Supplies to remove the amount of supplies used during June.

SUPPLIES		SUPPLIES EXPENSE					
<table border="1" style="width: 100%; border-collapse: collapse;"> <tr><td style="text-align: center;"><u>SUPPLIES</u></td></tr> <tr><td style="text-align: center;">\$80</td></tr> <tr><td style="text-align: center;">Bal. \$80</td></tr> <tr><td style="text-align: center;">\$60</td></tr> </table>	<u>SUPPLIES</u>	\$80	Bal. \$80	\$60	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr><td style="text-align: center;"><u>SUPPLIES EXPENSE</u></td></tr> <tr><td style="text-align: center;">\$60</td></tr> </table>	<u>SUPPLIES EXPENSE</u>	\$60
<u>SUPPLIES</u>							
\$80							
Bal. \$80							
\$60							
<u>SUPPLIES EXPENSE</u>							
\$60							

\$60 is debited to Supplies Expense to recognize the amount of supplies used during June.

SUPPLIES		SUPPLIES EXPENSE						
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<u>SUPPLIES</u>								
\$80								
Bal. \$80								
\$60								
Bal. \$20								
<u>SUPPLIES EXPENSE</u>								
\$60								

Balance Sheet will show \$20 of Supplies!

SUPPLIES		SUPPLIES EXPENSE							
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\$80									
Bal. \$80									
\$60									
Bal. \$20									
<u>SUPPLIES EXPENSE</u>									
\$60									
Bal. \$60									

Income Statement will show \$60 of Supplies used during June.

GENERAL JOURNAL				
DATE	DESCRIPTION	PR	DEBIT	CREDIT
1	Adjusting Entries			
2	June 30			
3				
4				
5				
6				
7				
8				
9				
10				
11				

Each adjusting entry dated the last day of accounting period.

GENERAL JOURNAL					
DATE	DESCRIPTION	PR	DEBIT	CREDIT	
1					
2	June 30		Supplies Expense	60.00	
3			Supplies		60.00
4					
5					
6					
7					
8					
9					
10					
11					

PREPAID INSURANCE			
<p>During June, Jessica paid \$200 for an eight-month insurance policy with coverage beginning on June 1.</p>			
<p>8-month policy June 1 - Jan. 31</p>	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr><td style="text-align: center;"><u>PREPAID INSURANCE</u></td></tr> <tr><td style="text-align: center;">\$200</td></tr> </table>	<u>PREPAID INSURANCE</u>	\$200
<u>PREPAID INSURANCE</u>			
\$200			

PREPAID INSURANCE

During June, Jessica paid \$200 for an eight-month liability insurance policy with coverage beginning on June 1.

PREPAID INSURANCE

\$200

At the end of June we remove the cost of one month's insurance from this account.

PREPAID INSURANCE

PREPAID INSURANCE

\$200

\$200 for 8 months:
 $\$200 \div 8 = \25 per month

PREPAID INSURANCE

PREPAID INSURANCE

\$200

\$25

Prepaid Insurance is credited \$25 to remove June's insurance coverage that has expired.

PREPAID INSURANCE

PREPAID INSURANCE INSURANCE EXPENSE

\$200

\$25

\$25

Insurance Expense is debited \$25 to recognize the amount of insurance coverage for June.

PREPAID INSURANCE

PREPAID INSURANCE INSURANCE EXPENSE

\$200

\$25

\$25

Bal. \$175

The Balance Sheet will show \$175 (7 months) of Prepaid Insurance!

PREPAID INSURANCE

PREPAID INSURANCE INSURANCE EXPENSE

\$200

\$25

\$25

Bal. \$25

Bal. \$175

The Income Statement will show \$25 (1 month) of insurance consumed!

GENERAL JOURNAL					
	DATE	DESCRIPTION	PR	DEBIT	CREDIT
1					
2	June 30	Insurance Expense		25 00	
3		Prepaid Insurance			25 00
4					
5					
6					
7					
8					
9					
10					
11					

WAGES EXPENSE

Jessica paid employees \$650 on June 27. Since then, they have earned an additional \$50, but have not been paid.

WAGES EXPENSE	
	\$650
Balance	\$650

\$650 does not include all of the wages earned by employees during June.

WAGES EXPENSE

WAGES EXPENSE	
	\$650
	\$50

\$50 debit to Wages Expense for the wages earned on June 28, 29, 30.

WAGES EXPENSE

WAGES EXPENSE	WAGES PAYABLE
	\$50
	\$50

Jessica Jane owes employees additional wages. This liability is recorded in Wages Payable.

WAGES EXPENSE

WAGES EXPENSE	WAGES PAYABLE
	\$50
	\$50
Bal.	\$700

The Income Statement will show ALL wages earned by employees in June!

WAGES EXPENSE

WAGES EXPENSE	WAGES PAYABLE
	\$50
	\$50
Bal.	\$700

Balance Sheet will show liability for wages earned in June that will be paid in July.

GENERAL JOURNAL					
	DATE	DESCRIPTION	PR	DEBIT	CREDIT
1					
2	June 30	Wages Expense		50 00	
3		Wages Payable			50 00
4					
5					
6					
7					
8					
9					
10					
11					

COST PRINCIPLE

- Assets valued at original purchase cost
- The cost remains on the books as long as the business owns the asset
- No adjustments are made for changes in market value

USEFUL LIFE

- The period of time an asset will produce revenues.
- Allocate cost of asset over life of asset.

DEPRECIATION EXPENSE

- *Matching* an asset's cost against the revenue produced over the useful life.
- Many depreciation methods
- Based on estimates of useful lives and salvage values.

SALVAGE VALUE

- The expected market value of asset at the end of its useful life
- Also called
 - Scrap Value
 - Residual Value

ACCUMULATED DEPRECIATION

- Contra account
 - Paired with primary account
 - Opposite balance
 - One is a debit, one is a credit
 - On financial statement show
Primary – Contra = Net book value

BOOK VALUE

- Value carried in accounting records
- **Book Value equals:**
 - Original Cost - Accumulated Depreciation
- Also called **Undepreciated Cost**

DEPRECIATION EXAMPLE

Motor scooters

- Cost of \$3,600
- Life of 3 years
- No salvage value

Allocate \$3,600 cost
over next three years.

STRAIGHT-LINE METHOD

1st step: Calculate Depreciable Cost.

FORMULA:

$$\begin{array}{r r r r r} \text{Original} & - & \text{Salvage} & = & \text{Depreciable} \\ \text{Cost} & & \text{Value} & & \text{Cost} \\ \$3,600 & - & \$0 & = & \$3,600 \end{array}$$

Calculating Depreciation Expense

2nd step: Determine depreciation expense for this accounting period.

FORMULA:

$$\frac{\text{Depreciable Cost}}{\text{Estimated Useful Life}} = \frac{\$3,600}{\text{Estimated Useful Life}}$$

Estimated Useful Life

Since we are trying to compute depreciation for one month, we will use months instead of years.

Calculating Depreciation Expense

2nd step: Determine depreciation expense for this accounting period.

FORMULA:

$$\frac{\text{Depreciable Cost}}{\text{Estimated Useful Life}} = \frac{\$3,600}{36 \text{ months}}$$

Calculating Depreciation Expense

2nd step: Determine depreciation expense for this accounting period.

FORMULA:

$$\frac{\text{Depreciable Cost}}{\text{Estimated Useful Life}} = \frac{\$3,600}{36 \text{ months}} = \$100 \text{ per month}$$

DEPRECIATION EXPENSE

DELIVERY EQUIPMENT
\$3,600

We do NOT adjust this account. It should always reflect the ORIGINAL COST of the asset.

DEPRECIATION EXPENSE

DELIVERY EQUIPMENT	ACCUMULATED DEPRECIATION - DELIVERY EQUIPMENT
\$3,600	\$100

Depreciation is credited to this contra-asset account instead of the Equipment account.

DEPRECIATION EXPENSE

DELIVERY EQUIPMENT	ACCUMULATED DEPRECIATION - DELIVERY EQUIPMENT
\$3,600	\$100
DEPRECIATION EXPENSE	
\$100	

GENERAL JOURNAL

	DATE	DESCRIPTION	PR	DEBIT	CREDIT
1					
2	June 30	Depr. Expense - Equipment		100 00	
3		Accum. Depr. - Equipment			100 00
4					
5					
6					
7					
8					
9					
10					
11					

DEPRECIATION

Balance sheet at end of June, first month

Assets:

Delivery equipment	\$3,600
Less Accumulated Depreciation	<u>100</u>
Book value	\$3,500

GENERAL JOURNAL

	DATE	DESCRIPTION	PR	DEBIT	CREDIT
1					
2	July 31	Depr. Expense - Equipment		100 00	
3		Accum. Depr. - Equipment			100 00
4					
5					
6					
7					
8					
9					
10					
11					

Make same entry at end of each month for 36 months

DEPRECIATION

Balance sheet end of July, second month

Assets:

Delivery equipment	\$3,600
Less Accumulated Depreciation	<u>200</u>
Book value	\$3,400

End of Chapter 5

