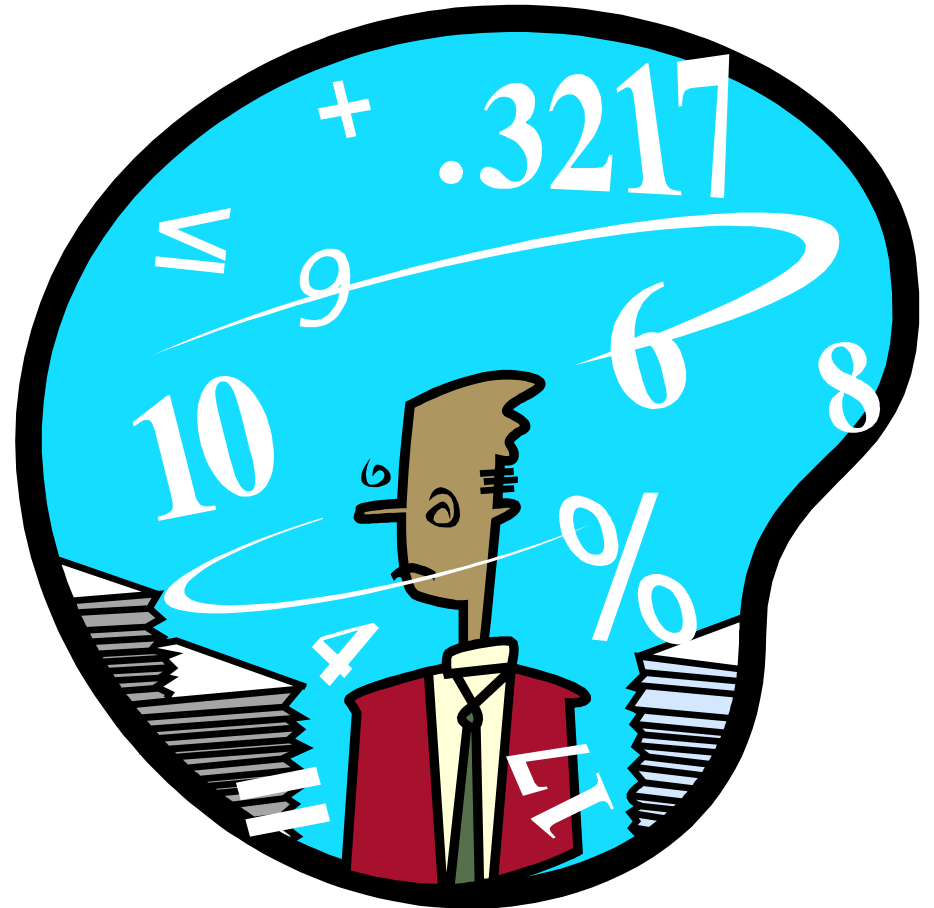


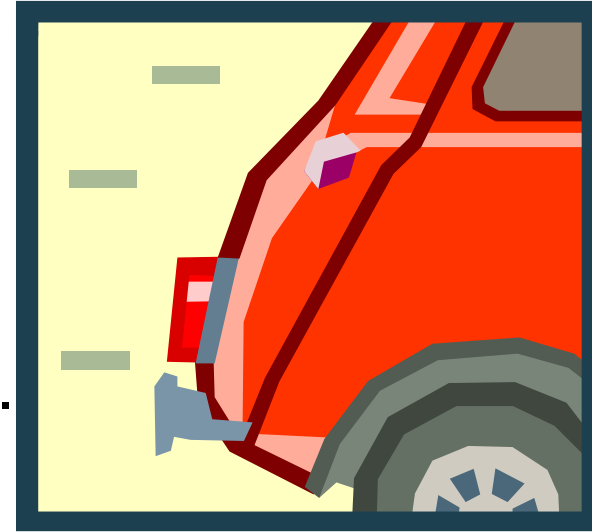
CHAPTER 4

Adjusting Entries



Courier Business

- John Black paid himself \$500 dividends.
- The interest on the bank loan is 12%.
- The car has an estimated life of three years. The estimated salvage value is \$4,200.
- On reviewing the sales records, John Black discovered that one customer had not yet paid for a delivery. She owed \$150.
- He also found that, of the \$1,500 cash received for deliveries, \$200 was from a customer who had paid \$200 in advance for four deliveries. Two of the deliveries had been made in May.



From the information on the previous slide, John Black made the following journal entries.

Date	Account	Debit	Credit
May 31	Revenue Unearned Revenue (to correct the Revenue account)	200	200
May 31	Dividends Cash (Cheque #3)	500	500

Courier Business – Trial Balance

Account	Debit	Credit
Cash	1,800	
Prepaid Insurance	1,200	
Car	15,000	
Bank Loan		12,000
Account Payable		250
Unearned Revenue		200
Capital Stock		5,000
Dividends	500	
Revenue		1,300
Delivery Expense	250	
Total	18,750	18,750

Retained Earnings

Retained earnings, May 1	\$ -0-
+ Net income	<u>1,250</u>
Subtotal	\$1,250
- Dividends	<u>500</u>
Retained earnings, May 31	<u>\$ 750</u>

Shareholder's Equity

Shareholder's Equity	
Capital Stock	\$5,000
Retained Earnings	<u>750</u>
Total Shareholder's Equity	\$5,750

**Courier Business
Balance Sheet
May 31**

ASSETS

Cash	\$ 1,800
Prepaid Insurance	1,200
Car	<u>15,000</u>

**Does this
represent the
business?**

Total Assets **\$18,000**

LIABILITIES

Bank Loan	\$12,000
Accounts Payable	<u>250</u>
Total Liabilities	\$12,250

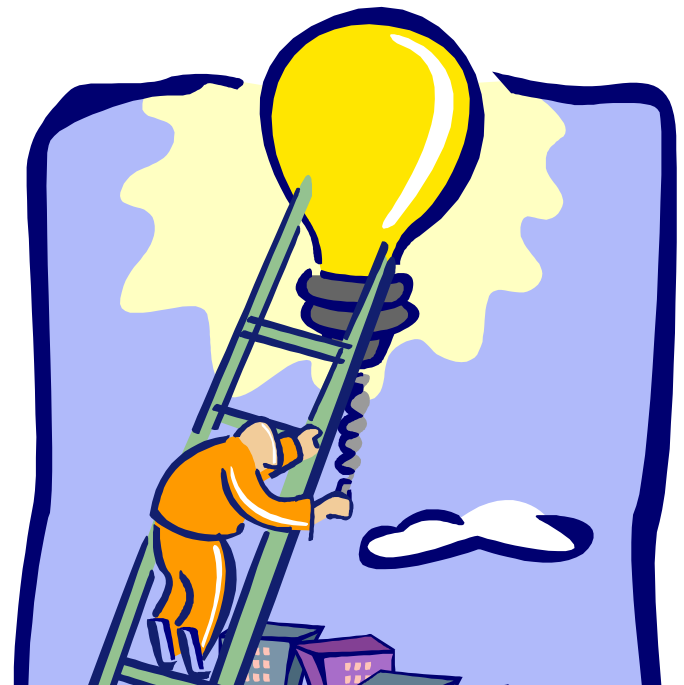
SHAREHOLDER'S EQUITY

Capital Stock	\$ 5,000
Retained Earnings	<u>750</u>
Total Shareholder's Equity	<u>\$ 5,750</u>

**Total Liabilities and
Shareholder's Equity** **\$18,000**

TYPES OF ADJUSTING ENTRIES

- Converting assets to expenses
- Converting liabilities to revenues
- Accruing unrecorded expenses
- Accruing unrecorded revenues



Adjusting Entries – Deferred

Type 1 – Prepaid asset is used up

Dr. Expense

Cr. Prepaid asset

Type 2 - Unearned revenue is earned

Dr. Unearned revenue

Cr. Revenue



Adjusting Entries -- Accrued

Type 3 - Unrecorded revenue is earned

Dr. Asset

Cr. Revenue

Type 4 - Unrecorded expenses incurred

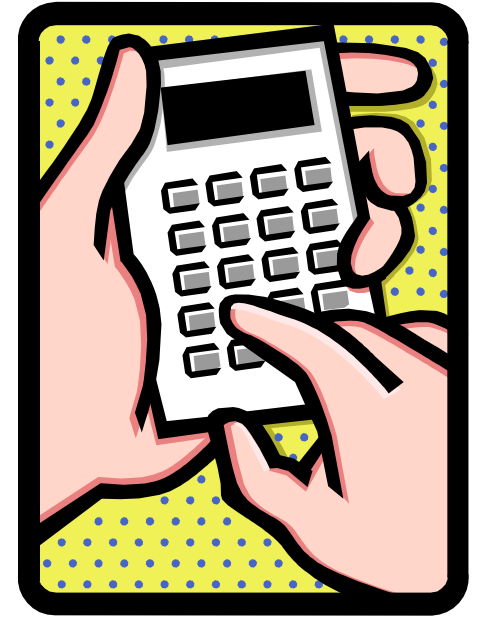
Dr. Expense

Cr. Liability

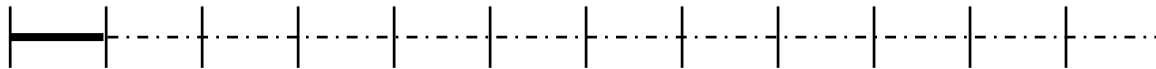


Courier Business

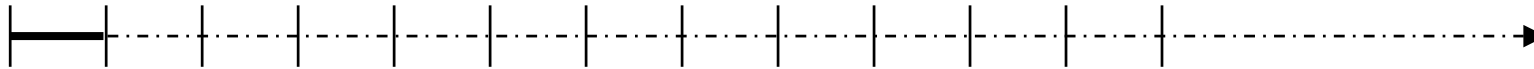
Deferred Items



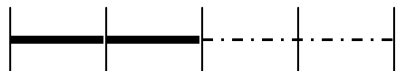
1. Insurance – 12 month policy



2. Car – estimated life is 36 month



3. Unearned Revenue – two of four shipments made in May



1. Car: $15,000 - 4,200 / 36 = 300$ per month

2. Prepaid Insurance: $1,200 / 12 = 100$ per month

3. Unearned Revenue earned: $2 / 4 \times \$200 = \100

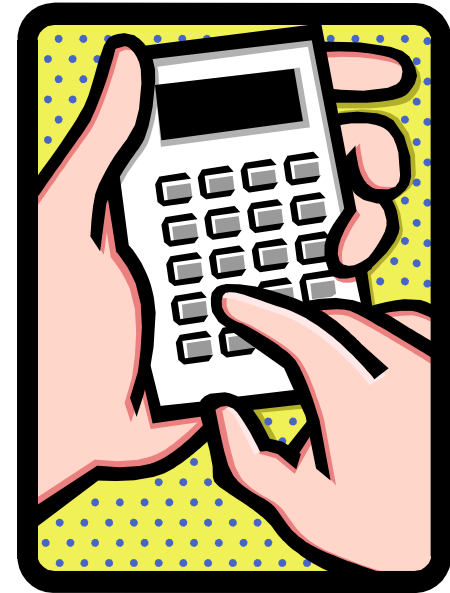
Courier Business

Accrued Items

1. Unrecorded, uncollected delivery made in May

2. Interest – one month

—



1. Unrecorded May delivery -- \$150

2. Interest Expense -- $\$12,000 \times 0.12 / 12 \text{ months} = \$120.$

Recording Adjusting Entries – Deferred Items

Date	Account	Debit	Credit
May 31	Insurance Expense Prepaid Insurance (Insurance for May)	100	100
May 31	Depreciation Expense Accumulated depreciation (Depreciation for May)	300	300
May 31	Unearned Revenue Revenue (Earned for May deliveries)	100	100

Recording Adjusting Entries – Accrued Items

Date	Account	Debit	Credit
May 31	Accounts Receivable – S. Collins Revenue (Invoice #18 – Sharon Collins)	150	150
May 31	Interest Expense Interest Payable (May interest on car loan)	120	120

The adjusting entries are posted to the General Ledger accounts

Courier Business – Adjusted Trial Balance

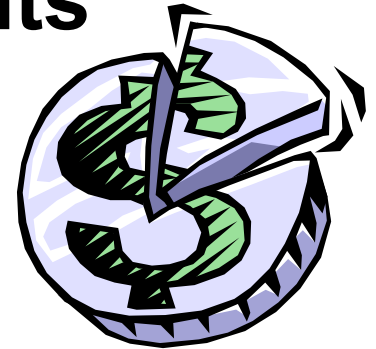
Account	Debit	Credit
Cash	1,800	
Accounts Receivable	150	
Prepaid Insurance	1,100	
Car	15,000	
Accumulated Depreciation		300
Bank Loan		12,000
Accounts Payable		250
Interest Payable		120
Unearned Revenue		100
Capital Stock		5,000
Dividends	500	
Revenue		1,550
Delivery Expense	250	
Insurance Expense	100	
Depreciation Expense	300	
Interest expense	120	
Total	19,320	19,320

Balance Sheet

Income Statement

Courier Business

Preparing Financial Statements Step One. The Income Statement



Courier Business Income Statement For the Month of May

Revenue		\$1,550
Operating Expenses		
Delivery Expense	\$250	
Insurance Expense	100	
Depreciation Expense	300	
Interest Expense	<u>120</u>	
Total Expenses		<u>770</u>
Net Income		<u>\$ 780</u>

Net Income is
Transferred to
Retained Earnings

Courier Business

Preparing Financial Statements Step Two. The Statement of Retained Earnings



Courier Business Statement of Retained Earnings For the Month of May

Retained Earnings, May 1	\$ -0-
Net Income	<u>780</u>
Subtotal	780
Dividends	<u>500</u>
Retained Earnings, May 31	<u>\$ 280</u>

Retained Earnings is
Reported on the
Balance Sheet

Courier Business

Step Three. The Balance Sheet



Courier Business

Balance Sheet

May 31

Assets		Liabilities and Shareholder's Equity	
Cash	\$ 1,800	Liabilities	
Accounts Receivable	150	Accounts Payable	\$ 250
Prepaid Insurance	1,100	Interest Payable	120
Car	\$15,000	Unearned Revenue	100
Accumulated		Bank Loan	<u>12,000</u>
Depreciation	<u>300</u>	Total Liabilities	
\$12,470	<u>14,700</u>	Shareholder's Equity	
		Capital Stock	\$5,000
		Retained Earnings	<u>280</u>
		Total Shareholder's Equity	<u>5,280</u>
Total Assets	\$17,750	Total Liabilities and Shareholder's Equity	\$17,750

Closing the Accounts

- Close revenue accounts to income summary
- Close expense accounts to income summary
- Close income summary to retained earnings
- Close dividends to retained earnings



Closing Entries

Date	Account	Debit	Credit
May 31	Revenue	1,550	
	Income Summary		1,550
	(Close Revenue account)		
May 31	Income Summary		770
	Delivery Expense	250	
	Insurance Expense	100	
	Interest Expense	120	
	Depreciation Expense	300	
	(Close Expense accounts)		
May 31	Income Summary	780	
	Retained Earnings		780
	(Close Income Summary to Retained Earnings)		
May 31	Retained Earnings	500	
	Dividends		500
	(Close Dividends to Retained Earnings)		

The closing entries are posted to the general ledger accounts

Post-Closing Trial Balance

Account	Debit	Credit
Cash	1,800	
Accounts Receivable	150	
Prepaid insurance	1,100	
Car	15,000	
Accumulated Depreciation		300
Accounts Payable		250
Interest Payable		120
Unearned Revenue		100
Bank loan		12,000
Capital stock		5,000
Retained earnings		280
Total	18,050	18,050

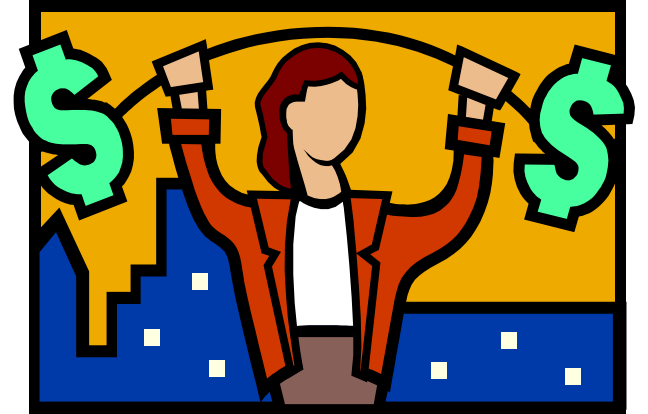
**NOTE: NO REVENUE OR EXPENSE
ACCOUNTS APPEAR IN THE
POST-CLOSING TRIAL BALANCE.**

Accounting Principles

- Matching principle
- Realization (recognition) principle
- Full disclosure principle



Evaluating Net Income



Profitability

Return on investment =

$$\frac{\text{Net Income}}{\text{Average Shareholder's Equity}}$$

$$\$780 / 5,140 = 15.2\% \text{ for 1 month}$$

Evaluating Solvency



- Will the business be able to pay its debts as they fall due.

Short term – assuming the car payments are not more than \$400 or \$500 a month there doesn't appear to be a problem. The balance in cash is \$1,800. The only other liability requiring cash payment is the VISA account – \$250.