

Accounting for a Service Enterprise

Learning Objectives

2.1 Use of Accounts for Recording Transactions

- Meaning & classification of Accounts
- Rules of Debits and Credits
- Sequence & Numbering of Ledger Accounts

2.2 Recording Transactions in a Journal

2.3 Posting the Journal

2.4 The Trial Balance: Uses & Limitations

2.5 Adjustments of Deferrals & Accruals

2.6 Worksheet for Preparation of Financial

2.1 Meaning of an Account

Account



- ◆ An individual detail accounting record of all increases and decreases in a specific asset, liability, equity, revenue, or expense item that have occurred during a specified period.

An Account can be illustrated in a T-Account form. It is a tool used to analyze transactions & has three parts

- ◆ Debit = "Left"

- ◆ Credit = "Right"



Left or Debit Side	Right or Credit Side

2.1 Meaning of an Account

- **Accounts** are the basic storage units for accounting data and are used to accumulate amounts from similar transactions.
 - An accounting system has a separate account for each asset, each liability, and each component of owner's equity, including revenues and expenses.
 - An account title should describe what is recorded in the account.
 - Each element of the Accounting Equation contains smaller elements called accounts.

2.1 Meaning of an Account

Tabular Analysis/Summary

Account Form

Cash		Cash	
+15000		(Debits)	(Credits)
-7000		15,000	7,000
+1,200		1,200	1,700
+1,500		1,500	250
-1,700		600	1,300
-250		Balance	
+600		8,050	
-1,300			
Balance			

2.1 Rules of Debits and Credits of an Account

Debit (Dr.)

An entry on the left side

- 1) An increase in an asset,
- 2) A decrease in a liability,
- 3) A decrease in a owner's equity item

Credit (Cr.)

An entry on the right side

- 1) A decrease in an asset,
- 2) An increase in a liability,
- 3) An increase in a owner's equity item

2.1 Rules of Debits and Credits of an Account

Owner's Equity	
Debit / Dr.	Credit / Cr.
	
	Normal Balance

Chapter
3-25

- ◆ Owner's investments and revenues increase owner's equity (credit).
- ◆ Owner's drawings and expenses decrease owner's equity (debit).

Owner's Capital	
Debit / Dr.	Credit / Cr.
	
	Normal Balance

Chapter
3-25

Owner's Drawing	
Debit / Dr.	Credit / Cr.
	
Normal Balance	

Chapter
3-23

2.1 Rules of Debits and Credits of an Account

Revenue	
Debit / Dr.	Credit / Cr.
	
	Normal Balance

Chapter
3-26

Expense	
Debit / Dr.	Credit / Cr.
	
Normal Balance	

Chapter
3-27

- ◆ Purpose of earning revenues is to benefit the owner(s).
- ◆ Effect of debits and credits on revenue accounts is the same as their effect on Owner's Capital.
- ◆ Expenses have the opposite effect:

2.1 Rules of Debits and Credits of ~~an Account~~

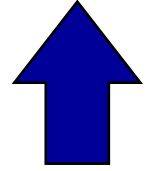
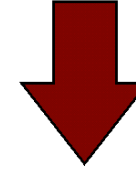
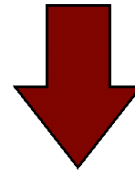
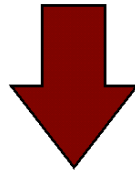
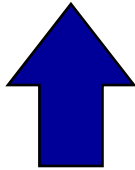
Balance Sheet

Income Statement

Asset = Liability + Equity

Revenue - Expense =

Debit



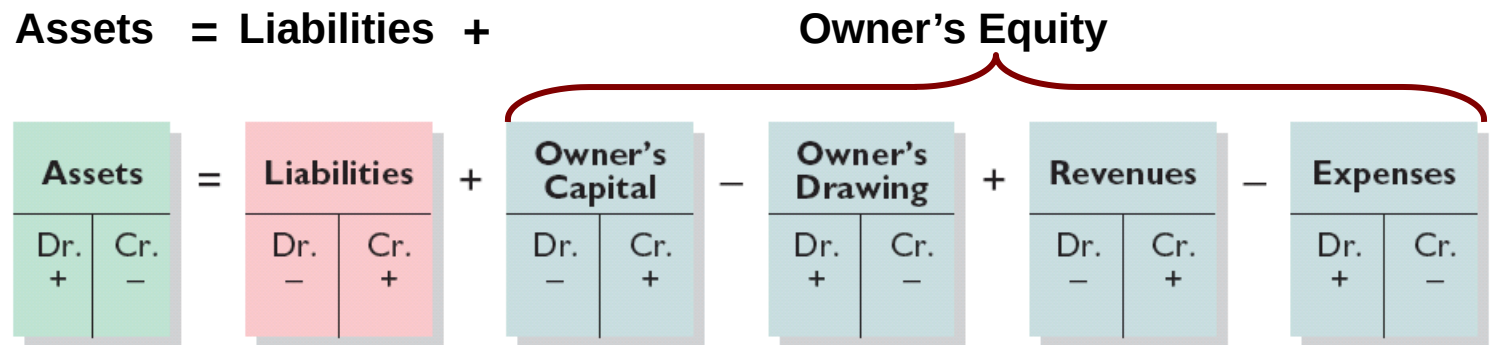
Credit



2.1 Rules of Debits and Credits of an Account

Relationship among the assets, liabilities and owner's equity of a business:

Basic Equation Expanded Basic Equation



The equation must be in balance after every transaction. For every **Debit** there must be a **Credit**.

2.1 Account Balance

The difference between the total debit footing (sum) and the total credit footing is called the

account balance

if Debits are greater than Credits, the account will have a debit balance.

Account Name		
	Debit / Dr.	Credit / Cr.
Transaction #1	\$10,000	\$3,000
Transaction #3	8,000	
Balance	\$15,000	

2.1 Account Balance

If Debits are **less than** Credits, the account will have a credit balance.

Account Name		
	Debit / Dr.	Credit / Cr.
Transaction #1	\$10,000	\$3,000
		8,000
Balance		\$1,000

2.1 Account Balance

- The **normal balance** of an account is its usual balance and is the side (debit or credit) that increases the account.

Account Category	Increases Recorded by		Normal Balance	
	Debit	Credit	Debit	Credit
Assets	×		×	
Liabilities		×		×
Owner's Equity:				
Owner's Capital		×		×
Withdrawals	×		×	
Revenues		×		×
Expenses	×		×	

2.1 Classification and Sequence of Ledger Accounts

Balance sheet accounts

Assets

Liabilities

Owner's

**Current
Assets**

**Current
Assets**

**Current
Liability**

**Non-
Current
Liability**

Receipt/use/sale or payment of assets expected to occur within one year or one operating cycle

Receipt/use/sale or payment of assets expected to occur more than one year after the balance sheet date

2.1 Classification and Sequence of Ledger Accounts

Balance sheet accounts

Assets

Liabilities

Owner's

Investment

Drawings

Revenues

Expenses

Revenues are increases in owner's equity as a result of selling services or products.
Expenses are the using up of assets or consuming of services to

2.1 Classification and Sequence of Ledger Accounts

- Balance sheet accounts: Permanent [Real] accounts that remain open, with nonzero balances, at the end of the reporting period.
- Income statement accounts: Temporary [Nominal] accounts that have a zero balance at the end of the reporting period

2.1 Coding/Numbering of Accounts

An account code/number is a tool or method used to identify the classification and location of an account in the ledger. Different set of digits could be used. For instance:

Asset accounts : 111 through

199

Liability accounts : 211 through

299

Owner's Equity accounts : 311 through

399

Revenue accounts : 411 through

499

Expense accounts : 511 through

599

2.1 Coding/Numbering of Accounts

Cash-111	1	1	1
	1 st digit	2 nd digit	3 rd digit
	Asset	Current asset	1 st position
A/c Receivable- 112	1	1	2
	1 st digit	2 nd digit	3 rd digit
	Asset	Current asset	2 nd position

2.1 Chart of Accounts

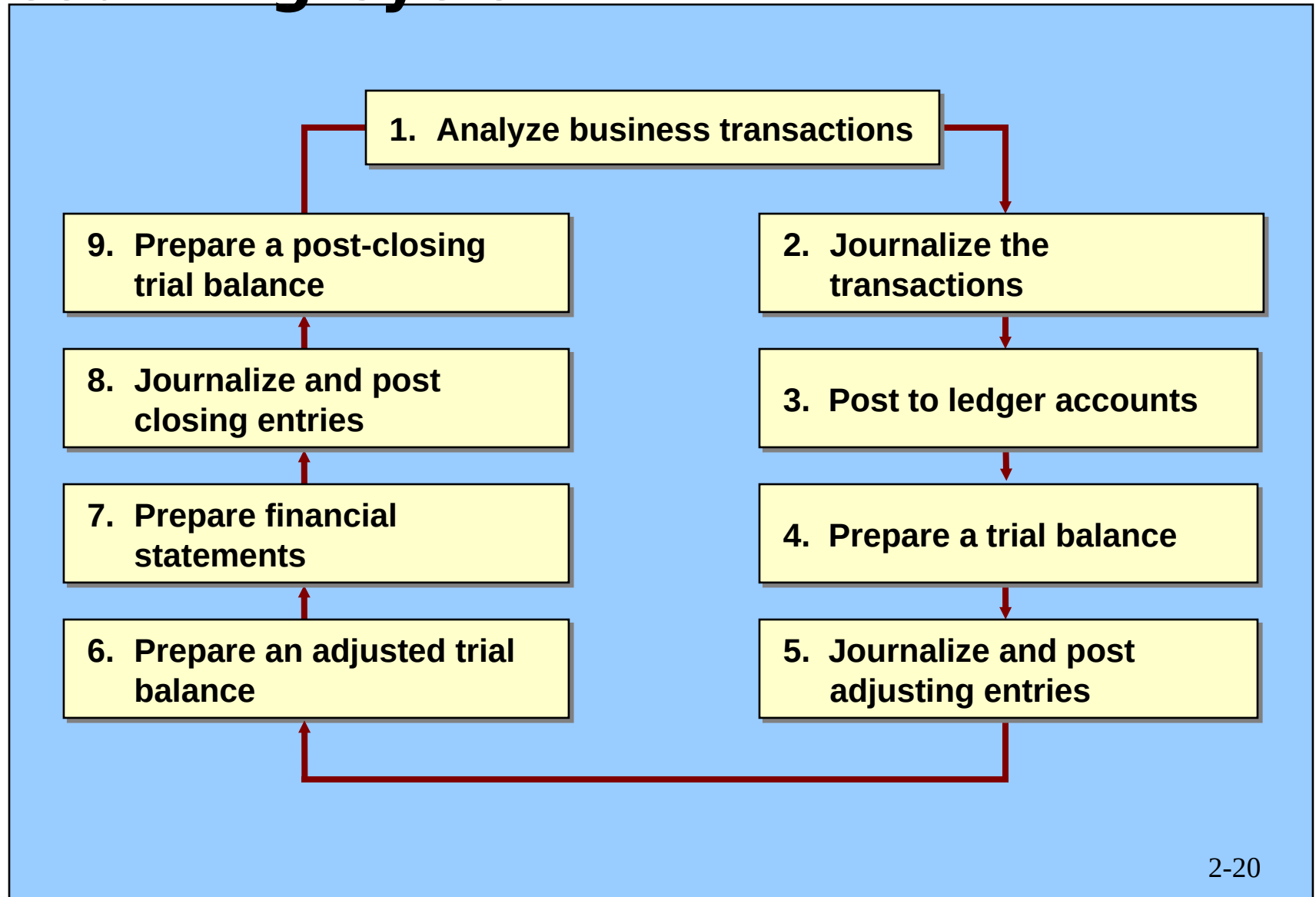
- In a manual accounting system, each account is kept on a separate page or card, which are placed together in a book or file called the **general ledger**. In computerized systems, the group of accounts is also called the *general ledger*, or simply *the ledger*.
- A **chart of accounts** is a table of contents for the ledger. It lists the account titles and the numbers that have been assigned to them. It usually lists the accounts in the order in which they appear in the ledger (the order in which they appear in the financial statements).

2.1 Chart of Accounts

Accounts and account numbers arranged in sequence in which they are presented in the

Pioneer Advertising Agency Chart of Accounts	
Assets	Owner's Equity
101 Cash	301 Owner's Capital
112 Accounts Receivable	306 Owner's Drawings
126 Supplies	350 Income Summary
130 Prepaid Insurance	
157 Equipment	Revenues
158 Accumulated Depreciation—Equipment	400 Service Revenue
Liabilities	Expenses
200 Notes Payable	631 Supplies Expense
201 Accounts Payable	711 Depreciation Expense
209 Unearned Service Revenue	722 Insurance Expense
212 Salaries and Wages Payable	726 Salaries and Wages Expense
230 Interest Payable	729 Rent Expense
	905 Interest Expense

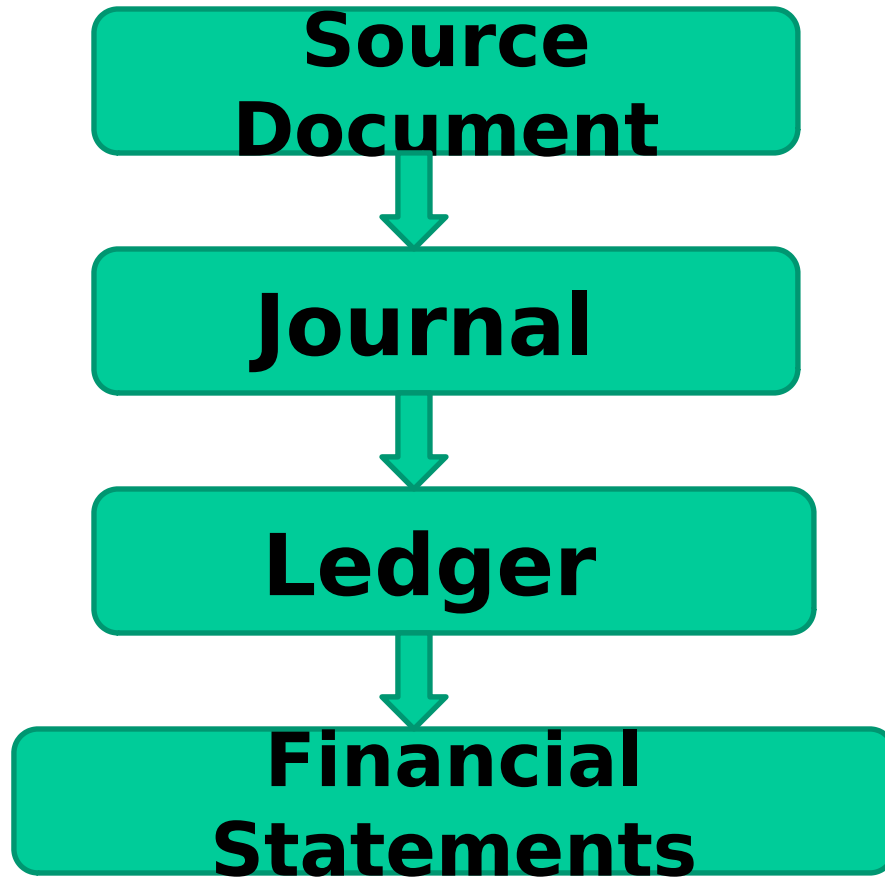
2.1 Steps in the Recording Process: The Accounting Cycle



2.1 Steps in the Recording

Process

- Flow of data in the Accounting System



2.2 Recording transactions in the Journal

The Journal

- ◆ Book of original entry.
- ◆ Transactions recorded in chronological order.
- ◆ Contributions to the recording process:
 1. Discloses the **complete effects of a transaction**.
 2. Provides a **chronological record** of transactions.
 3. Helps to **prevent or locate errors** because the debit and credit amounts can be easily compared.
 4. Permanent record of an entire transaction

2.2 Recording transactions in the Journal

- An individual record in a journal
- Shows the effects of transactions in terms of debits & credits
- Each journal entry reflects equal debits and credits
- Journalizing
 - The process of recording business transactions in a journal.

General Journal

Standardized Format & Steps

Page -8-

Date		Description	PR	Debit	Credit
<i>Year</i>	<i>Date</i>	<i>Name of Account to be Debited</i>		<i>Monetary Dr</i>	
<i>Month</i>		<i>Name of Account to be Credited</i>			<i>Monetary Cr</i>
		<i>Brief explanation about the transaction</i>			

The diagram illustrates the standardized format and steps for a journal entry. It shows a table with columns for Date, Description, PR, Debit, and Credit. Arrows point from numbered boxes to specific parts of the table:

- i** points to the *Date* column.
- ii** points to the *Description* column.
- iii** points to the *Debit* column.
- iv** points to the *Name of Account to be Debited* row.
- v** points to the *Brief explanation about the transaction* row.
- vi** points to the *PR* column.

2.2 Recording transactions in the Journal

- System to Analyze Transactions
 1. *What Accounts Affected*: Determine whether an asset, a liability, owner's equity, revenue, or expense account is affected by the transaction.
 2. *How the Accounts Affected*: Nature of Changes (Effect): For each account affected by the transaction, determine whether the account increases or decreases.
 3. *Debits & Credits*: Determine whether each

2.2 Rules of Double-Entry

Accounting

- Double-entry system follows two rules:
 - ▶ Each transaction must affect at least two accounts to keep the basic accounting equation in balance.
 - ❖ **Assets = Liabilities + Owner's Equity**
 - ▶ Total debits must equal total credits.
- For every transaction:
 - one or more accounts must be debited, or entered on the left side of a T account.
 - one or more accounts must be credited, or entered on the right side of a T account.

2.2 Recording transactions in the Journal

- Advantages of Journal
 - Ensure that all effects of a business transaction are recorded
 - Have in one place a complete information about a recorded transaction
 - Easily identify recording errors, and
 - Have an historical record of transactions.

2.2 Recording transactions in the Journal

■ Types of Journal

- General journal - a two-column form used to record any kind of business transaction.
- Special journal - a journal designed to record frequently occurring identical transactions like sales, purchases, cash collections, cash payments.

■ Journalizing

- Each entry in the general journal includes date, accounts, amounts, and an explanation.

- To indicate that an entry has been posted

2.2 Recording transactions in the Journal

Journalizing - Entering transaction data in the journal

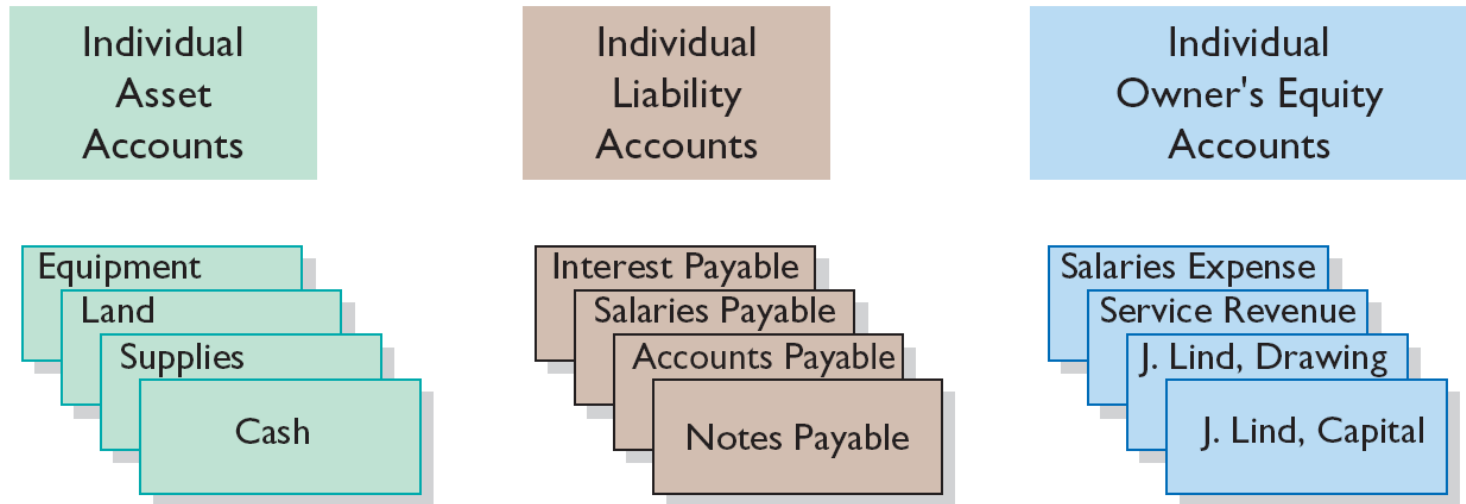
Illustration: On September 1, Ray Neal invested \$15,000 cash in the business, and Softbyte purchased computer equipment for \$7,000 cash.

General Journal				
<i>Date</i>	<i>Account Title</i>	<i>Ref.</i>	<i>Debit</i>	<i>Credit</i>
Sept. 1	Cash		15,000	
	Owner's, Capital			15,000
	Equipment		7,000	
	Cash			7,000

2.3 Posting the Journal

The Ledger

- ◆ **General Ledger** contains the entire group of accounts maintained by a company.



2.3 Posting the Journal

■ Meaning

- A group of accounts for a business entity.
- Reference book of the accounting system
- Used to classify and summarize transactions and prepare data for financial statements

■ Posting [**Classification**]

- is the process of assigning all the transactions to appropriate categories, or accounts
- the process transferring monetary amounts of debit and credit entries from the general journal to the accounts in the ledger.
- Posting is necessary to classify and group similar business transactions in terms of their effects on specific asset, liability, capital, revenue and expense items.

2.3 Posting the Journal

- While the *general journal* is used to record the details of each transaction, the *general ledger* is used to update each account.
- The **ledger account form** is a form of the account that contains three/four columns for dollar amounts.
 - The Item column is rarely used because explanations already appear in the journal.
 - The Post. Ref. column is used to note the journal page on which the original entry for the transaction is found.

2.3 Posting the Journal

Standard Form of Account

Cash					No. 101
Date	Explanation	Ref.	Debit	Credit	Balance
2012					
June 1			25,000		25,000
2				8,000	17,000
3			4,200		21,200
9			7,500		28,700
17				11,700	17,000
20				250	16,750
30				7,300	9,450

2.3 Posting the Journal

■ Types of Ledger

1. General ledger

- Controlling account
- Contains all financial statement accounts

2. Subsidiary ledger

- Contains accounts showing details of general ledger

$$A = L + OE$$

$$A = A1 + A2 + \dots + A3; \quad L = L1 + L2 + \dots + L3$$

$$A1 = A/R = ar1 + ar2 + \dots + ar3; \quad L1 = A/P = ap1 + ap2 + \dots + ap3$$

2.3 Posting the Journal

General Ledger



Accounts Receivable

750		
ABC Co.	XYZ Co.	LMN Co.
150	200	400

Subsidiary Ledger

2.3 Posting the Journal

General Journal					Cash						Account No. 41					
Date	Description	PR	Debit	Credit	Date	Explanation	PR	Debit	Credit	Balance	Date	Explanation	PR	Debit	Credit	Balance
2000					2000											
June					June	1 Balance	-	-	-	500						
						2		100	-	600						
2	Cash.....	11	100													
	Sales.....	41		100												
	Sales of inventory															
	2 Supplies.....	ii	100													
	Cash.....			100												
	Purchase of supply															

Sales						Account No. 41					
Date	Explanation	PR	Debit	Credit	Balance	Date	Explanation	PR	Debit	Credit	Balance
2000						2000					
June	2	10		100	100						

2.3 Posting the Journal

- Posting-Transferring transactions from the journal to the ledger.
 - The steps in the posting process are:
 1. In the ledger, locate the debit account named in the journal entry.
 2. Enter the date of the transaction in the ledger and, in the Post. Ref. column, the journal page number of the entry.
 3. Enter the amount of the debit in the Debit column of the ledger account.
 4. Calculate the account balance and enter it in the appropriate Balance column.
 5. In the Post. Ref. column of the journal, enter the account number to which the amount has been posted.

Steps

Posting – process of transferring amounts from the journal to the ledger

GENERAL JOURNAL					J1
Date	Account Titles and Explanation	Ref.	Debit	Credit	
2012 Sept.1	Cash	101	15,000		
	Owner's Capital (Owner's investment of cash in business)	306		15,000	

GENERAL LEDGER					
Cash					No.101
Date	Explanation	Ref.	Debit	Credit	Balance
2012 Sept.1		J1	15,000		15,000

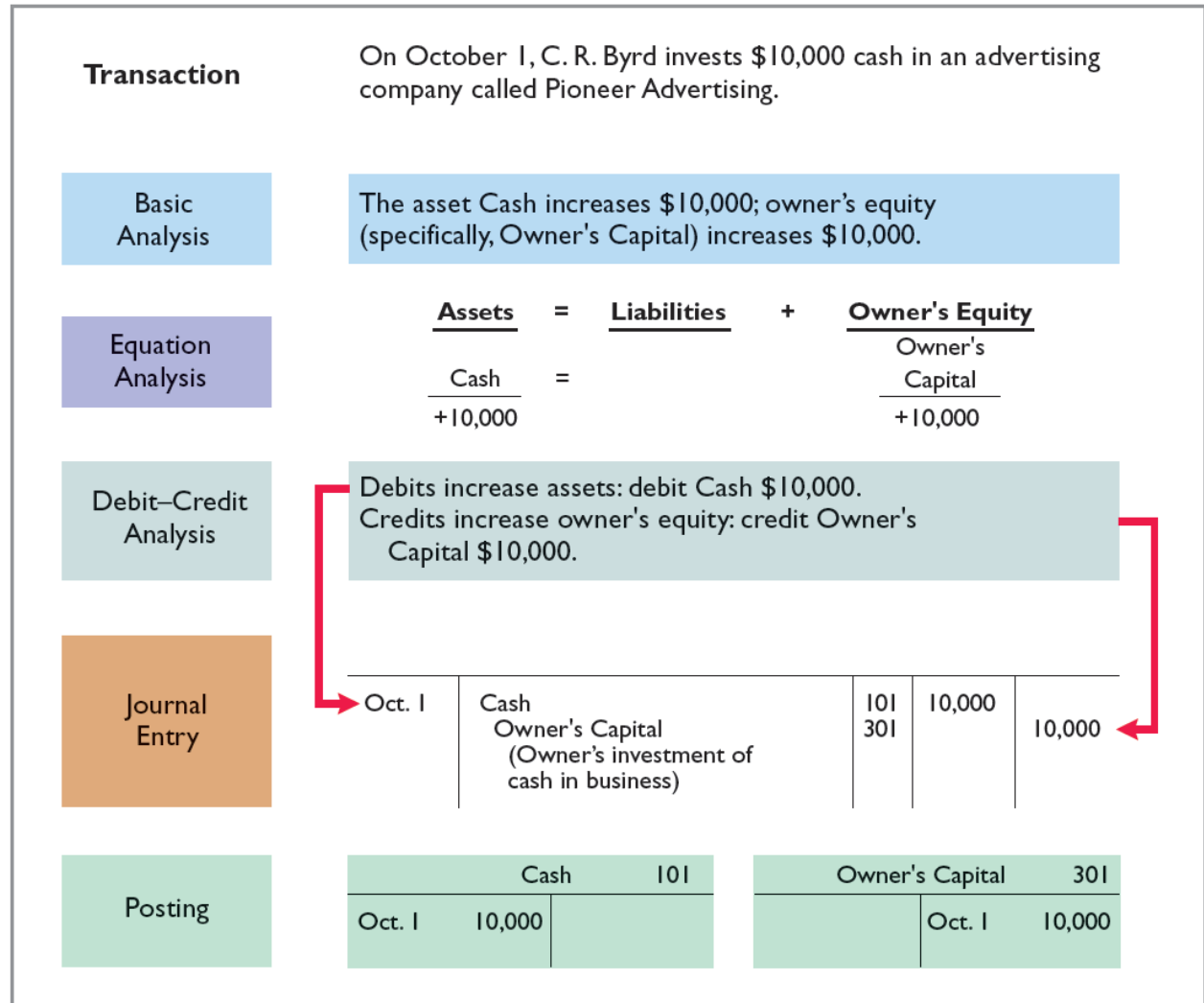
Owner's Capital					No.306
Date	Explanation	Ref.	Debit	Credit	Balance
2012 Sept.1		J1		15,000	15,000

- Key:
- 1 Post to debit account–date, journal page number, and amount.
 - 2 Enter debit account number in journal reference column.
 - 3 Post to credit account–date, journal page number, and amount.
 - 4 Enter credit account number in journal reference column.

The Recording Process Illustrated

Follow these steps:

1. Determine what type of account is involved.
2. Determine what items increased or decreased and by how much.
3. Translate the increases and decreases into debits and credits.



Purchase of office equipment

Transaction

On October 1, Pioneer purchases office equipment costing \$5,000 by signing a 3-month, 12%, \$5,000 note payable.

Basic Analysis

The asset Equipment increases \$5,000; the liability Notes Payable increases \$5,000.

Equation Analysis

<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Owner's Equity</u>
Equipment	=	Notes Payable		
+5,000		+5,000		

Debit–Credit Analysis

Debits increase assets: debit Equipment \$5,000.
Credits increase liabilities: credit Notes Payable \$5,000.

Journal Entry

Oct. 1	Equipment	157	5,000	
	Notes Payable	200		5,000
	(Issued 3-month, 12% note for office equipment)			

Posting

Equipment		157	Notes Payable		200
Oct. 1	5,000			Oct. 1	5,000

Receipt of cash for future

Transaction

On October 2, Pioneer receives a \$1,200 cash advance from R. Knox, a client, for advertising services that are expected to be completed by December 31.

Basic Analysis

The asset Cash increases \$1,200; the liability Unearned Service Revenue increases \$1,200 because the service has not been performed yet. That is, when Pioneer receives an advance payment, it should record an unearned revenue (a liability) in order to recognize the obligation that exists. Note also that although most liabilities have the word “payable” in their title, unearned revenue is considered a liability because the liability is satisfied by providing a product or performing a service.

Equation Analysis

<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Owner's Equity</u>
Cash	=	Unearned Service Revenue		
+1,200		+1,200		

Debit–Credit Analysis

Debits increase assets: debit Cash \$1,200.
Credits increase liabilities: credit Unearned Service Revenue \$1,200.

Journal Entry

Oct. 2	Cash	101	1,200	
	Unearned Service Revenue (Received cash from R. Knox for future service)	209		1,200

Posting

	Cash	101
Oct. 1	10,000	
2	1,200	

	Unearned Service Revenue	209
Oct. 2		1,200

Payment of monthly rent

Transaction

On October 3, Pioneer pays office rent for October in cash, \$900.

Basic Analysis

The expense account Rent Expense increases \$900 because the payment pertains only to the current month; the asset Cash decreases \$900.

Equation Analysis

<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Owner's Equity</u>
Cash	=			Rent Expense
-900				-900

Debit-Credit Analysis

Debits increase expenses: debit Rent Expense \$900.
Credits decrease assets: credit Cash \$900.

Journal Entry

Oct. 3	Rent Expense Cash (Paid October rent)	729 101	900	900
--------	---	------------	-----	-----

Posting

Cash		101	Rent Expense		729
Oct. 1	10,000	Oct. 3	900		
2	1,200				

Payment for insurance

Transaction

On October 4, Pioneer pays \$600 for a one-year insurance policy that will expire next year on September 30.

Basic Analysis

The asset Prepaid Insurance increases \$600 because the payment extends to more than the current month; the asset Cash decreases \$600. Payments of expenses that will benefit more than one accounting period are prepaid expenses or prepayments. When a company makes a payment, it debits an asset account in order to show the service or benefit that will be received in the future.

Equation Analysis

Assets		=	Liabilities	+	Owner's Equity
Cash	+		Prepaid Insurance		
-600			+600		

Debit–Credit Analysis

Debits increase assets: debit Prepaid Insurance \$600.
Credits decrease assets: credit Cash \$600.

Journal Entry

Oct. 4	Prepaid Insurance	130	600	
	Cash	101		600
	(Paid one-year policy; effective date October 1)			

Posting

Cash				Prepaid Insurance			
			101				130
Oct. 1	10,000	Oct. 3	900	Oct. 4	600		
2	1,200	4	600				

Purchase of supplies on credit

Transaction

On October 5, Pioneer purchases an estimated 3-month supply of advertising materials on account from Aero Supply for \$2,500.

Basic Analysis

The asset Supplies increases \$2,500; the liability Accounts Payable increases \$2,500.

Equation Analysis

<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Owner's Equity</u>
Supplies	=	Accounts Payable		
+2,500		+2,500		

Debit–Credit Analysis

Debits increase assets: debit Supplies \$2,500.
Credits increase liabilities: credit Accounts Payable \$2,500.

Journal Entry

Oct. 5	Supplies	126	2,500	
	Accounts Payable	201		2,500
	(Purchased supplies on account from Aero Supply)			

Posting

Supplies		126	Accounts Payable		201
Oct. 5	2,500			Oct. 5	2,500

Hiring of employees

Event

On October 9, Pioneer hires four employees to begin work on October 15. Each employee is to receive a weekly salary of \$500 for a 5-day work week, payable every 2 weeks—first payment made on October 26.

Basic Analysis

A business transaction has not occurred. There is only an agreement between the employer and the employees to enter into a business transaction beginning on October 15. Thus, a debit–credit analysis is not needed because there is no accounting entry. (See transaction of October 26 for first entry.)

Withdrawal of cash by owner

Transaction

On October 20, C. R. Byrd withdraws \$500 cash for personal use.

The owner's equity account Owner's Drawings increases \$500; the asset Cash decreases \$500.

Equation Analysis

Assets

=

Liabilities

+

Owner's Equity

Cash

=

Owner's Drawings

-500

-500

Debit-Credit Analysis

Debits increase drawings: debit Owner's Drawings \$500.
Credits decrease assets: credit Cash \$500.

Journal Entry

Oct. 20	Owner's Drawings	306	500	
	Cash	101		500
	(Withdrew cash for personal use)			

Posting

Cash		101	
Oct. 1	10,000	Oct. 3	900
2	1,200	4	600
		20	500

Owner's Drawings		306	
Oct. 20	500		

Payment of salaries

Transaction

On October 26, Pioneer owes employee salaries of \$4,000 and pays them in cash. (See October 9 event.)

Basic Analysis

The expense account Salaries and Wages Expense increases \$4,000; the asset Cash decreases \$4,000.

Equation Analysis

<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Owner's Equity</u>
Cash	=			Salaries and Wages Expense
-4,000				-4,000

Debit–Credit Analysis

Debits increase expenses: debit Salaries and Wages Expense \$4,000.
Credits decrease assets: credit Cash \$4,000.

Journal Entry

Oct. 26	Salaries and Wages Expense	726	4,000	
	Cash	101		4,000
	(Paid salaries to date)			

Posting

Cash				Salaries and Wages Expense	
			101		726
Oct. 1	10,000	Oct. 3	900	Oct. 26	4,000
2	1,200	4	600		
		20	500		
		26	4,000		

Receipt of cash for services performed

Transaction

On October 31, Pioneer receives \$10,000 in cash from Copa Company for advertising services performed in October.

Basic Analysis

The asset Cash increases \$10,000; the revenue account Service Revenue increases \$10,000.

Equation Analysis

<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Owner's Equity</u>
Cash	=			Service Revenue
+10,000				+10,000

Debit–Credit Analysis

Debits increase assets: debit Cash \$10,000.
Credits increase revenues: credit Service Revenue \$10,000.

Journal Entry

Oct. 31	Cash	101	10,000	
	Service Revenue	400		10,000
	(Received cash for services performed)			

Posting

Cash		101	
Oct. 1	10,000	Oct. 3	900
2	1,200	4	600
31	10,000	20	500
		26	4,000

Service Revenue		400	
	Oct. 31		10,000

Summary Journalizing and Posting

GENERAL JOURNAL				PAGE J1
Date	Account Titles and Explanation	Ref.	Debit	Credit
2017				
Oct. 1	Cash	101	10,000	
	Owner's Capital	301		10,000
	(Owner's investment of cash in business)			
1	Equipment	157	5,000	
	Notes Payable	200		5,000
	(Issued 3-month, 12% note for office equipment)			
2	Cash	101	1,200	
	Unearned Service Revenue	209		1,200
	(Received cash from R. Knox for future service)			
3	Rent Expense	729	900	
	Cash	101		900
	(Paid October rent)			

GENERAL JOURNAL

PAGE J1

Date	Account Titles and Explanation	Ref.	Debit	Credit
4	Prepaid Insurance	130	600	
	Cash	101		600
	(Paid one-year policy; effective date October 1)			
5	Supplies	126	2,500	
	Accounts Payable	201		2,500
	(Purchased supplies on account from Aero Supply)			
20	Owner's Drawings	306	500	
	Cash	101		500
	(Withdrew cash for personal use)			
26	Salaries and Wages Expense	726	4,000	
	Cash	101		4,000
	(Paid salaries to date)			
31	Cash	101	10,000	
	Service Revenue	400		10,000
	(Received cash for services performed)			

GENERAL LEDGER

Cash No. 101

Date	Explanation	Ref.	Debit	Credit	Balance
2017					
Oct. 1		J1	10,000		10,000
2		J1	1,200		11,200
3		J1		900	10,300
4		J1		600	9,700
20		J1		500	9,200
26		J1		4,000	5,200
31		J1	10,000		15,200

Supplies No. 126

Date	Explanation	Ref.	Debit	Credit	Balance
2017					
Oct. 5		J1	2,500		2,500

Prepaid Insurance No. 130

Date	Explanation	Ref.	Debit	Credit	Balance
2017					
Oct. 4		J1	600		600

Equipment No. 157

Date	Explanation	Ref.	Debit	Credit	Balance
2017					
Oct. 1		J1	5,000		5,000

Notes Payable No. 200

Date	Explanation	Ref.	Debit	Credit	Balance
2017					
Oct. 1		J1		5,000	5,000

Accounts Payable No. 201

Date	Explanation	Ref.	Debit	Credit	Balance
2017					
Oct. 5		J1		2,500	2,500

Unearned Service Revenue No. 209

Date	Explanation	Ref.	Debit	Credit	Balance
2017					
Oct. 2		J1		1,200	1,200

Owner's Capital No. 301

Date	Explanation	Ref.	Debit	Credit	Balance
2017					
Oct. 1		J1		10,000	10,000

Owner's Drawings No. 306

Date	Explanation	Ref.	Debit	Credit	Balance
2017					
Oct. 20		J1	500		500

Service Revenue No. 400

Date	Explanation	Ref.	Debit	Credit	Balance
2017					
Oct. 31		J1		10,000	10,000

Salaries and Wages Expense No. 726

Date	Explanation	Ref.	Debit	Credit	Balance
2017					
Oct. 26		J1	4,000		4,000

Rent Expense No. 729

Date	Explanation	Ref.	Debit	Credit	Balance
2017					
Oct. 3		J1	900		900

Prepare a trial balance.



PIONEER ADVERTISING

Trial Balance

October 31, 2017

	<u>Debit</u>	<u>Credit</u>
Cash	\$ 15,200	
Supplies	2,500	
Prepaid Insurance	600	
Equipment	5,000	
Notes Payable		\$ 5,000
Accounts Payable		2,500
Unearned Service Revenue		1,200
Owner's Capital		10,000
Owner's Drawings	500	
Service Revenue		10,000
Salaries and Wages Expense	4,000	
Rent Expense	900	
	<u>\$28,700</u>	<u>\$28,700</u>

2.4 The Trial Balance

- Meaning: List of all accounts and their balances at a given point of time
- Uses
 - Prove the mathematical equality of debits and credits in the ledger after posting
 - Errors that are discovered through the TB:
 - Posting unequal debit and credit amounts for an entry;
 - Posting a debit entry as a credit or vice versa;
 - Arithmetic mistakes in balancing accounts;
 - Clerical errors in copying account balances into the trial balance;
- Listing a debit balance in the credit column of the trial balance or vice versa; and
- Errors in determining the debit and credit totals of the trial balance

2.4 The Trial Balance

Limitations of a Trial Balance

Trial balance may balance even when:

1. A transaction is not journalized.
2. A correct journal entry is not posted.
3. A journal entry is posted twice.
4. Incorrect accounts are used in journalizing or posting.
5. Offsetting errors are made in recording the amount of a transaction.

2.4 The Trial Balance

- **Procedures to locate errors** - As a matter of fact, there is no one best way of locating errors. However, the following procedures, done sequentially, may save considerable time and effort in locating errors.
 - i. *Recalculate the debit and credit totals of the trial balance.*
 - ii. *Compare amounts listed on the trial balance with the related account balances in the ledger.*
 - iii. *Recalculate account balances in the ledger.*
 - iv. *Check accuracy of posting from the journal to the ledger.*
 - v. *Check the equality of dollar amounts of debit and credit entries in the journal.*

2.4 The Trial Balance

- **Troubleshooting Errors:** The difference between the total debit and total credit balances may indicate the nature and location of the error, thus, avoid the need for sequentially performing all the aforementioned procedures. For example,
- *A difference of 10; 100; 1000; etc, indicates addition error. In this case, you need to perform procedures (i) and (iii) to discover the error.*
- *A difference divisible evenly by 2 indicates posting to the ledger a debit entry or listing on the trial balance a debit balance as credit or vice versa or omission of a debit or credit entry posting to the ledger or a debit or credit balance of an account on the trial balance. In such cases, you need to perform procedures (ii) and (iv).*

2.4 The Trial Balance

- A difference divisible evenly by 9 indicates slide or transposition error.
- **Slide** error refers to error in placing decimal point, for example, writing 22.50 as 2.25 or 225.
- While **transposition** error refers to misplacement of digits, for example, writing 225 as 252 or 522.
- Such errors may happen in any step in the accounting process, thus, you need to perform all the procedures needed to locate an error without discrimination.

2.4 The Trial Balance

Correction of Errors

Error	Correction
Procedure	
1. Journal entry is incorrect	Draw a line through the error but not posted. and insert correct title or amount.
2. Journal entry is correct	Draw a line through the but posted incorrectly. posted error and post correctly.
3. Journal entry is incorrect	Journalize and post

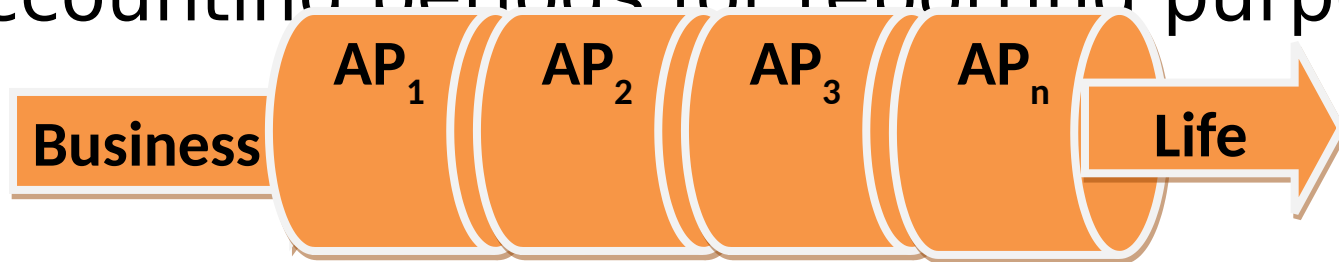
2.5 Adjustments

- **Definition:** Journal entries that are required at the end of the period in order to produce correct balances for the financial statements
- This is the process used to deal with the disconnect between transaction timing and actual cash flows
- Adjusting entries:
 1. Measure properly the period's income on the income statement:
 - Assign revenues to the period in which they are earned
 - Assign expenses to the period in which they are incurred
 2. Update the asset and liability accounts

2.5 Adjustments

Rationale (WHY)

- Product of accrual basis of accounting, i.e. recording revenues when earned and expenses when incurred instead of cash basis of accounting
- Periodicity assumption: business life is divisible into equal intervals of time called accounting periods for reporting purpose



2.5 Adjustments

- Accrual-basis accounting records the effect of every business transaction as it occurs, regardless of when the cash is received or paid.
- Cash-basis accounting records transactions only when cash receipts and cash payments

Accrual
Basis



Records revenues when they are earned/performed

Records expenses when they are incurred/used

Cash
Basis

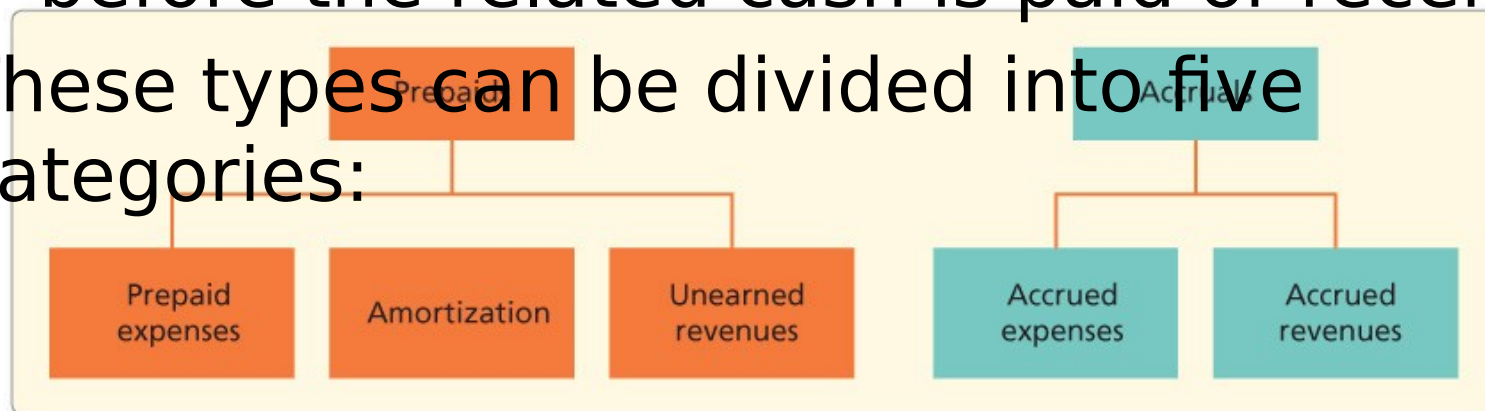


Records cash receipts as revenue

Records cash payments as expenses

2.5 Adjustments

- There are two main types of adjusting entries:
 - Prepaid (deferrals) – cash is paid or received before the related expense or revenue is recorded
 - Accruals – record the expense or revenue before the related cash is paid or received
- These types can be divided into five categories:



2.5 Adjustments

I. Accruals [Recording New Data]

1. Accrued Expenses: Expenses incurred but not yet paid (Use precedes payment)

➤ Liability/Expense Adjustment

➤ Expense xxx

 Liability xxx

2. Accrued Revenues: Revenues earned but not yet collected (Performance precedes collection)

➤ Asset/Revenue Adjustment

➤ Asset (e.g. A/R) xxx

 Revenue xxx

2.5 Adjustments

II. Deferrals [Adjusting Existing Data]

1. Prepaid Expenses: Advance payments (Expenses paid in advance but not yet incurred/Payment precedes incurrence)

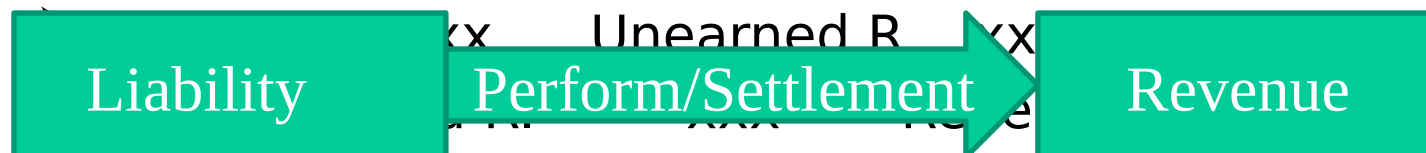
➤ Asset / Expense Adjustment

➤ Asset xxx Expense xxx



2. Unearned Revenues: Advance collections (Revenues collected in advance but not yet earned/Collection precedes earning)

➤ Liability/Revenue Adjustment



TYPES OF ADJUSTING ENTRIES

Deferrals:

1. **Prepaid expenses:** Expenses paid in cash and recorded as assets before they are used or consumed.
2. **Unearned revenues:** Cash received before service are performed.

Accruals:

1. **Accrued revenues:** Revenues for services performed but not yet received in cash or recorded.
2. **Accrued expenses:** Expenses incurred but not yet paid in cash or recorded.

2.5 Adjustments

Prepaid Insurance Example

- Insurance policies are usually **PAID** for in advance
- On May 1, 2016, HEC purchases an annual insurance policy for \$3,600; the journal entry would be:

Prepaid Insurance	3,600	
Cash		3,600

- After one month has passed, the adjusting entry on May 31, 2016 is:

Insurance Expense	300	
Prepaid Insurance		300

ASSETS			
Prepaid Insurance			
May 1	3,600	May 31	300
Bal.	3,300		

EXPENSES			
Insurance Expense			
May 31	300		
Bal.	300		

2.5 Adjustments



Supplies Example

- On May 2, 2016, HEC purchases supplies for \$1,500 **cash**
- The journal entry would be:

Supplies	1,500	
Cash		1,500
- On May 31, 2016, a physical count of the supplies indicated that \$1,000 remained; the adjusting entry would reduce the Supplies asset by \$500:

Supplies Expense	500	
Supplies		500

2.5 Adjustments

ASSETS				EXPENSES			
Office Supplies				Supplies Expense			
May 2	1,500	May 31	500	May 31	500		
Bal.	1,000			Bal.	500		

→

Correct asset
amount,
\$1,000

→

Total
accounted
for, \$1,500

←

Correct
expense
amount,
\$500

Amortization of Property, Plant, and Equipment, and Intangible Assets

- Property, plant, and equipment (PPE) are identifiable tangible capital assets (land, buildings, furniture, vehicles, machinery, and equipment)
- Amortization (depreciation) defined:
 - The process of allocating the cost of property, plant, and equipment (PPE) to an expense account over its estimated useful life

2.5 Adjustments

- On May 3, 2016, HEC purchases furniture for \$45,000 with an expected life of 5 years
- The journal entry, to record the purchase:

Furniture	45,000	
		45,000
Cash		

- A portion of the furniture's cost is transferred from the asset account to Amortization Expense each period the asset is used; after one month, the May 31, 2016 entry is:

Depreciation/Amortization Expense - Furniture	750
--	------------

Accumulated	750
--------------------	------------

Depreciation/Amortization - Furniture

$45,000 \div 5 \text{ years} = \$9,000 \text{ per year. } \$9,000 \div 12 \text{ months} = \$750 \text{ per month.}$

- Accumulated Amortization - Furniture is known as a *contra account*

2.5 Adjustments

- A contra account has:
 - a companion account
 - a normal balance opposite that of the companion account
- Accumulated Amortization is a contra account to property, plant, and equipment assets
- Used to show the cumulative sum of all amortization expense from the date of acquiring the asset
- It has a ***normal credit balance***

2.5 Adjustments

Unearned Revenue Example

- HEC receives a **cash advance** of \$3,000 on May 20, 2016 from a customer for a 30 day project
- The journal entry is:

May 20	Cash	3,000	
	Unearned Service Revenue		3,000
	Received revenue in advance.		

- During the last 10 days of the month—May 21 through May 31—HEC will have earned one-third (10 days divided by April's total 30 days) of the \$3,000,

May 31	Unearned Service Revenue	1,000	
	Service Revenue		1,000
	To record service revenue earned and paid from the advance ($\$3,000 \times \frac{1}{3}$).		

2.5 Adjustments

LIABILITIES

Unearned Service Revenue

May 31	1,000	May 20	3,000
		Bal.	2,000

REVENUES

Service Revenue

		24,000
	May 31	1,500
	May 31	1,000
	Bal.	26,500

Correct liability
amount,
\$2,000

Total
accounted
for, \$3,000

Correct revenue
amount,
\$1,000

2.5 Adjustments

Accrued Revenue Example

- HEC is hired on May 15 to provide monthly services for \$3,000 per month, with the first payment to be received on June 15. Service is provided from May 15 to May 30.
- The adjusting entry on May 30 to record two

May 31	Accounts Receivable	1,500	
	Service Revenue		1,500
	To accrue service revenue ($\$3,000 \times \frac{1}{2}$).		

- Adjusting for accrued revenues illustrates the concept of revenue recognition

2.5 Adjustments

Accrued Expense Example: Salaries

Expense

- HEC pays its two employees a bi-monthly salary of \$4,000 in total on the 15th and on the last day of the month
- The employees are paid on May 15, but May 30 is a Saturday: thus employees will receive their pay cheques on Monday, June 1
- Match the salaries expense to the period with a

May 31	Salaries Expense	4,000	
	Salaries Payable		4,000
	To accrue salaries expense.		

2.5 Adjustments

Exhibit 3-6 | Impact of Adjusting Entries on Financial Statements

Type of Adjusting Entry	Description	Adjusting Entry		Impact on Financial Statement if Adjusting Entries Are Not Made
Prepaid Expenses	Advance payments of expenses.	Expense Asset*	DR CR	Income Statement: expenses understated net income overstated Balance Sheet: assets overstated equity overstated
Unearned Revenues	Advance receipts of revenues.	Liability Revenue	DR CR	Balance Sheet: liabilities overstated equity understated Income Statement: revenues understated net income understated
Accrued Expenses	An expense that has been incurred but not paid.	Expense Liability	DR CR	Income Statement: expenses understated net income overstated Balance Sheet: liabilities understated equity overstated
Accrued Revenues	A revenue that has been earned but cash has not yet been collected.	Asset Revenue	DR CR	Balance Sheet: assets understated equity understated Income Statement: revenues understated net income understated

* If recording depreciation: the contra asset, Accumulated Depreciation, is credited.

ADJUSTMENTS

ACCOUNTING FOR UNEARNED REVENUES

Examples	Reason for Adjustment	Accounts Before Adjustment	Adjusting Entry
Rent, magazine subscriptions, customer deposits for future service.	Unearned Revenues recorded in liability accounts are now recognized as revenue for services performed.	Liabilities overstated. Revenues understated.	Dr. Liabilities Cr. Revenues

ACCOUNTING FOR PREPAID EXPENSES

Examples	Reason for Adjustment	Accounts Before Adjustment	Adjusting Entry
Insurance, supplies, advertising, rent, depreciation	Prepaid expenses recorded in asset accounts have been used.	Assets overstated. Expenses understated.	Dr. Expenses Cr. Assets

ADJUSTMENTS

ACCOUNTING FOR ACCRUED REVENUES

Examples	Reason for Adjustment	Accounts Before Adjustment	Adjusting Entry
Interest, rent, services performed but not collected.	Services performed but not yet received in cash or recorded.	Assets understated. Revenues understated.	Dr. Assets Cr. Revenues

ACCOUNTING FOR ACCRUED EXPENSES

Examples	Reason for Adjustment	Accounts Before Adjustment	Adjusting Entry
Interest, rent, salaries	Expenses have been incurred but not yet paid in cash or recorded.	Expenses understated. Liabilities understated.	Dr. Expenses Cr. Liabilities

6 The Work Sheet

Worksheet

- ◆ A multiple-column form that may be used in the adjustment process and in preparing financial statements.
- ◆ Manual or computer spreadsheet.
- ◆ A working tool, not a permanent accounting record.
- ◆ Neither a journal nor a part of the general ledger.

6 The Work Sheet

Accounts	Trial Balance		Adjustments		Adjusted TB	
	Dr	Cr	Dr	Cr	Dr	Cr

**Prepared from the general ledger.
Accounts are listed in the following
order: assets, liabilities, owner's
equity, revenues, and expenses.**

6 The Work Sheet

Accounts	Trial Balance		Adjustments		Adjusted TB	
	Dr	Cr	Dr	Cr	Dr	Cr

Adjustments are entered here. Two possibilities:

- 1. Deferrals – Existing balances are changed.**
- 2. Accruals – New information is entered.**

6 The Work Sheet

Accounts	Trial Balance		Adjustments		Adjusted TB	
	Dr	Cr	Dr	Cr	Dr	Cr

Adjustments are combined with the trial balance. Account balances are now adjusted.

2.7 Closing Entries

- Purpose
 - Journal entries that update the owner's equity account
 - Transfer/close the balance of nominal accounts to owner's equity account
 - Reduce the balance of nominal accounts to zero
- Steps
 - Close revenue accounts to income summary account
 - Close expense accounts to income summary account

NetSolutions
Work Sheet
For the Two Months Ended December 31, 2005

		Trial Balance		Adjustments		Adjusted Trial Balance	
	Account Title	Debit	Credit	Debit	Credit	Debit	Credit
1	Cash	2,065					
2	Accounts Receivable	2,220					
3	Supplies	2,000					
4	Prepaid Insurance	2,400					
5	Land	20,000					
6	Office Equipment	1,800					
7	Accounts Payable		900	The Unadjusted Trial Balance			
8	Unearned Rent		360				
9	Chris Clark, Capital		25,000				
10	Chris Clark, Drawing	4,000					
11	Fees Earned		16,340				
12	Wages Expense	4,275					
13	Rent Expense	1,600					
14	Utilities Expense	985					
15	Supplies Expense	800					
16	Miscellaneous Expense	455					
17		42,600	42,600				
18							
19							
20							
21							2-82
22							

Adjustments

- (a) The **Supplies** account has a debit of \$2,000. A count of supplies at the end of the period reveals that \$760 is on hand. Therefore, \$1,240 in supplies was used during the two-month period.
- (b) The **Prepaid Insurance** account has a debit balance of \$2,400, which represents prepayment of insurance for 24 months beginning December 1. Thus, the insurance expense for this month is \$100 ($\$2,400 \div 24$).
- (c) The **Unearned Rent** account has a credit balance of \$360, which represents the receipt of three-months' rent beginning with December 1. Thus, the rent earned for December is \$120.
- (d) Wages accrued but not paid at the end of December total \$250.
- (e) Fees accrued at the end of December, but not yet received, total \$500.
- (f) Depreciation of the office equipment is \$50 for December.

NetSolutions
Work Sheet
For the Two Months Ended December 31, 2005

		Trial Balance		Adjustments		Adjusted Trial Balance	
	Account Title	Debit	Credit	Debit	Credit	Debit	Credit
1	Cash	2,065					
2	Accounts Receivable	2,220					
3	Supplies	2,000			(a) 1,240		
4	Prepaid Insurance	2,400			(b) 100		
5	Land	20,000					
6	Office Equipment	1,800					
7	Accounts Payable		900				
8	Unearned Rent		360				
9	Chris Clark, Capital		25,000				
10	Chris Clark, Drawing	4,000					
11	Fees Earned		16,340				
12	Wages Expense	4,275					
13	Rent Expense	1,600					
14	Utilities Expense	985					
15	Supplies Expense	800		(a) 1,240			
16	Miscellaneous Expense	455					
17		42,600	42,600				
18	Insurance Expense			(b) 100			
19							
20							
21							
22	Accounts are added as needed.						

		Trial Balance		Adjustments		Adjusted Trial Balance	
	Account Title	Debit	Credit	Debit	Credit	Debit	Credit
1	Cash	2,065					
2	Accounts Receivable	2,220		(e) 500			
3	Supplies	2,000			(a) 1,240		
4	Prepaid Insurance	2,400			(b) 100		
5	Land	20,000					
6	Office Equipment	1,800					
7	Accounts Payable		900				
8	Unearned Rent		360	(c) 120			
9	Chris Clark, Capital		25,000				
10	Chris Clark, Drawing	4,000					
11	Fees Earned		16,340		(e) 500		
12	Wages Expense	4,275		(d) 250			
13	Rent Expense	1,600					
14	Utilities Expense	985					
15	Supplies Expense	800		(a) 1,240			
16	Miscellaneous Expense	455					
17		42,600	42,600				
18	Insurance Expense			(b) 100			
19	Rent Revenue				(c) 120		
20	Wages Payable				(d) 250		
21	Depreciation Expense			(f) 50			
22	Accum. Depreciation				(f) 50		
23				2,260	2,260		
24							
25							

Summed
and
ruled

Next, the unadjusted Trial Balance columns and the Adjustments columns are combined to determine the amounts displayed in the Adjusted Trial Balance.

		Trial Balance		Adjustments		Adjusted Trial Balance	
	Account Title	Debit	Credit	Debit	Credit	Debit	Credit
1	Cash	2,065					
2	Accounts Receivable	2,220		(e) 500			
3	Supplies	2,000			(a) 1,240		
4	Prepaid Insurance	2,400			(b) 100		
5	Land	20,000					
6	Office Equipment	1,800					
7	Accounts Payable		900				
8	Unearned Rent		360	(c) 120			
9	Chris Clark, Capital		25,000				
10	Chris Clark, Drawing	4,000					
11	Fees Earned		16,340		(e) 500		
12	Wages Expense	4,275		(d) 250			
13	Rent Expense	1,600					
14	Utilities Expense	985					
15	Supplies Expense	800		(a) 1,240			
16	Miscellaneous Expense	455					
17		42,600	42,600				
18	Insurance Expense			(b) 100			
19	Rent Revenue				(c) 120		
20	Wages Payable				(d) 250		
21	Depreciation Expense			(f) 50			
22	Accum. Depreciation				(f) 50		
23				2,260	2,260		
24							
25							2-87

		Trial Balance		Adjustments		Adjusted Trial Balance	
	Account Title	Debit	Credit	Debit	Credit	Debit	Credit
1	Cash	2,065				2,065	
2	Accounts Receivable	2,220		(e) 500		2,720	
3	Supplies	2,000			(a) 1,240	760	
4	Prepaid Insurance	2,400			(b) 100	2,300	
5	Land	20,000				20,000	
6	Office Equipment	1,800				1,800	
7	Accounts Payable		900				900
8	Unearned Rent		360	(c) 120			240
9	Chris Clark, Capital		25,000				25,000
10	Chris Clark, Drawing	4,000				4,000	
11	Fees Earned		16,340		(e) 500		16,840
12	Wages Expense	4,275		(d) 250		4,525	
13	Rent Expense	1,600				1,600	
14	Utilities Expense	985				985	
15	Supplies Expense	800		(a) 1,240		2,040	
16	Miscellaneous Expense	455				455	
17		42,600	42,600				
18	Insurance Expense			(b) 100		100	
19	Rent Revenue				(c) 120		120
20	Wages Payable				(d) 250		250
21	Depreciation Expense			(f) 50		50	
22	Accum. Depreciation				(f) 50		50
23				2,260	2,260	43,400	43,400
24							2-88
25							

The Work Sheet

Accounts	Adjusted TB		Income State.		Balance Sheet	
	Dr	Cr	Dr	Cr	Dr	Cr

Revenue and expense balances in the Adjusted Trial Balance column are extended to the Income Statement column.

The Work Sheet

Accounts	Adjusted TB		Income State.		Balance Sheet	
	Dr	Cr	Dr	Cr	Dr	Cr

Asset, liability, owner's equity, and drawing balances in the Adjusted Trial Balance column are extended to the Balance Sheet column.

		Adjusted Trial Balance		Income Statement		Balance Sheet	
	Account Title	Debit	Credit	Debit	Credit	Debit	Credit
1	Cash	2,065				2,065	
2	Accounts Receivable	2,720				2,720	
3	Supplies	760				760	
4	Prepaid Insurance	2,300				2,300	
5	Land	20,000				20,000	
6	Office Equipment	1,800				1,800	
7	Accounts Payable		900				900
8	Unearned Rent		240				240
9	Chris Clark, Capital		25,000				25,000
10	Chris Clark, Drawing	4,000				4,000	
11	Fees Earned		16,840		16,840		
12	Wages Expense	4,525		4,525			
13	Rent Expense	1,600		1,600			
14	Utilities Expense	985		985			
15	Supplies Expense	2,040		2,040			
16	Miscellaneous Expense	455		455			
17							
18	Insurance Expense	100		100			
19	Rent Revenue		120		120		
20	Wages Payable		250				250
21	Depreciation Expense	50		50			
22	Accum. Depreciation		50				50
23	43,400	43,400					
24							2-91
25							

		Adjusted Trial Balance		Income Statement		Balance Sheet	
	Account Title	Debit	Credit	Debit	Credit	Debit	Credit
1	Cash	2,065				2,065	
2	Accounts Receivable	2,720				2,720	
3	Supplies	760				760	
4	Prepaid Insurance	2,300				2,300	
5	Land	20,000				20,000	
6	Office Equipment	1,800				1,800	
7	Accounts Payable		900				900
8	Unearned Rent		240				240
9	Chris Clark, Capital		25,000				25,000
10	Chris Clark, Drawing	4,000				4,000	
11	Fees Earned		16,840		16,840		
12	Wages Expense	4,525		4,525			
13	Rent Expense	1,600		1,600			
14	Utilities Expense	985		985			
15	Supplies Expense	2,040		2,040			
16	Miscellaneous Expense	455		455			
17							
18	Insurance Expense	100		100			
19	Rent Revenue		120		120		
20	Wages Payable		250				250
21	Depreciation Expense	50		50			
22	Accum. Depreciation		50				50
23	43,400	43,400	9,755	16,960	33,645	26,440	
24							2-92
25							

The difference between the Income Statement column totals is the net income (or net loss) for the period.

The difference between the Balance Sheet column totals is also the income (or net loss) for the period.

Income Statement

Balance Sheet

9,755	16,960	33,645	26,440
7,205			7,205
16,960	16,960	33,645	33,645

Net Income

Net Income

NetSolutions
Income Statement
For Two Months Ended December 31, 2005

Fees earned	\$16,840		
Rent revenue	120		
Total revenues	\$16,960		
Expenses:			
Wages expense	\$ 4,525		
Supplies expense	2,040		
Rent expense	1,600		
Utilities expense	985		
Insurance expense	100		
Depreciation expense	50		
Miscellaneous expense	455		
Total expenses	9,755		
Net income	\$ 7,205		

Every amount on this income statement was taken from the
Income Statement column of the work sheet.

NetSolutions
Statement of Owner's Equity
For the Two Months Ended December 31, 2005

Chris Clark, Capital, November 1, 2005	\$	0	
Investment on November 1, 2005	\$25,000		
Net income for November and December	<u>7,205</u>		
	\$32,205		
Less withdrawals	<u>4,000</u>		
Increase in owner's equity	28,205		
Chris Clark, Capital, December 31, 2005	\$28,205		

NetSolutions
Balance Sheet
December 31, 2005

Assets

Current assets:

Cash	\$ 2,065
Accounts receivable	2,720
Supplies	760
Prepaid insurance	<u>2,300</u>
\$ 1,390	

Total current assets \$ 7,845

Property, plant, and
equipment:

Land	\$20,000
Office equip.	\$1,800
Less accum. depreciation	<u>50</u> <u>1,750</u>

Total property, plant
28,205

and equipment

21,750

Liabilities

Current liabilities:

Accounts payable	\$900
Wages payable	250
Unearned rent	<u>240</u>

Total liabilities

Owner's Equity

Chris Clark, Capital

Total liabilities and

Adjusting and Closing Entries

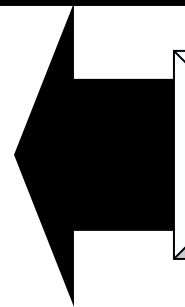
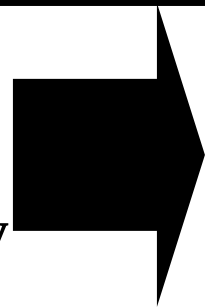
Adjusting entries are recorded in the journal at the end of the accounting period.

The Closing Process

Income Summary

2

Expenses are transferred to Income Summary



1

Revenues are transferred to Income Summary

3

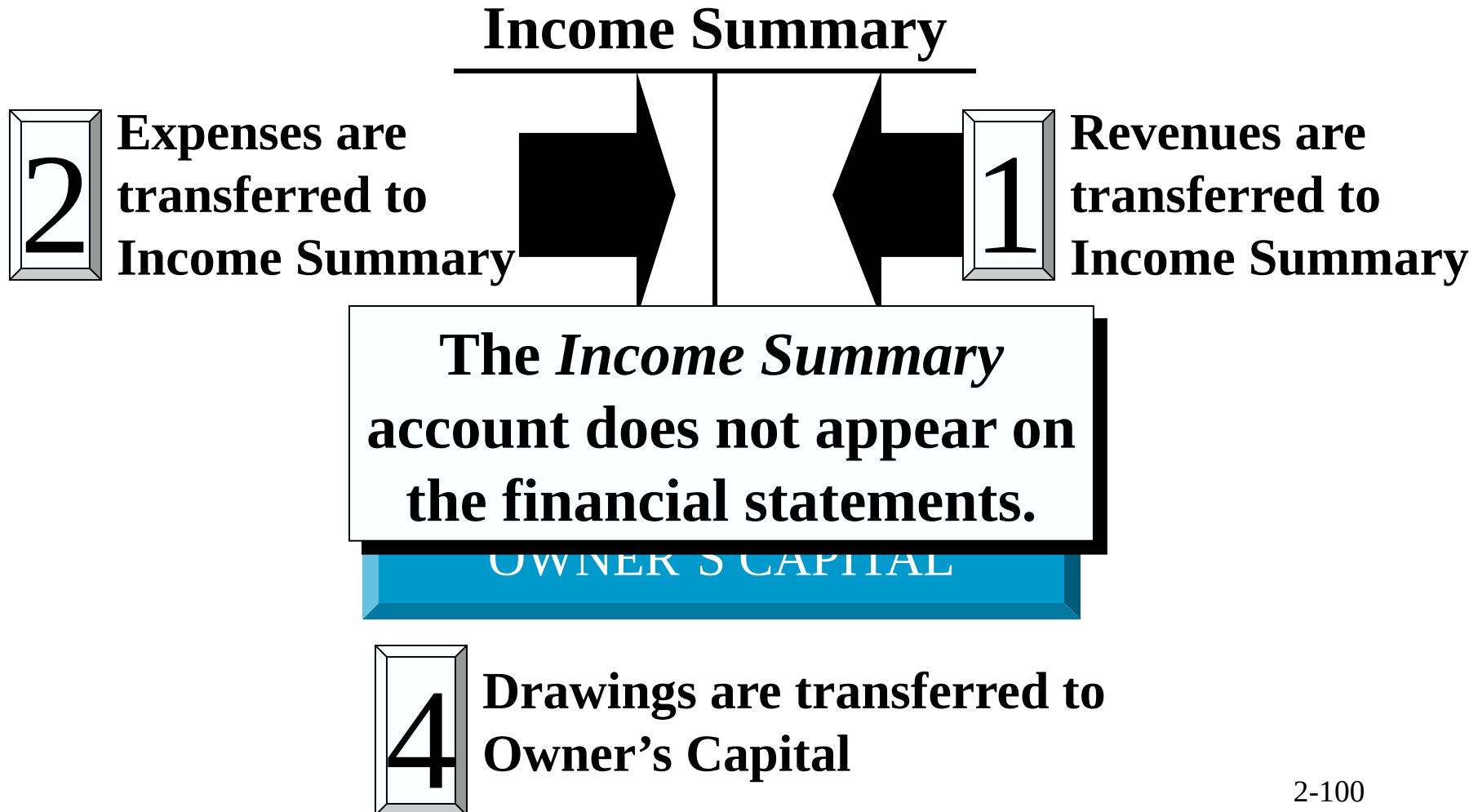
Net Income or Net Loss is transferred to Owner's Capital

OWNER'S CAPITAL

4

Drawings are transferred to Owner's Capital

Adjusting and Closing Entries



The Closing Process

Wages Expense

Bal. 4,525

Rent Expense

Bal. 1,600

Depreciation Expense

Bal. 50

Utilities Expense

Bal. 985

Supplies Expense

Bal. 2,040

Insurance Expense

Bal. 1,000

Miscellaneous Expense

Bal. 455

Income Summary

Fees Earned

Bal. 16,840

Rent Revenue

Bal. 120

Note: The balances shown are adjusted balances before closing. The following sequence demonstrates the closing process.

Chris Clark, Capital

Bal.
25,000

Chris Clark, Drawing

Bal. 4,000

The Closing Process

<u>Wages Expense</u>	
Bal.	4,525
<u>Rent Expense</u>	
Bal.	1,600
<u>Depreciation Expense</u>	
Bal.	50
<u>Utilities Expense</u>	
Bal.	985
<u>Supplies Expense</u>	
Bal.	2,040
<u>Insurance Expense</u>	
Bal.	1,000
<u>Miscellaneous Expense</u>	
Bal.	455

<u>Income Summary</u>	
	16,960

<u>Chris Clark, Capital</u>	
	Bal. 25,000
<u>Chris Clark, Drawing</u>	
Bal.	4,000

<u>Fees Earned</u>	
16,840	Bal. 16,840
<u>Rent Revenue</u>	
120	Bal. 120

Step 1

Debit each revenue account for the amount of its balance, and credit ***Income Summary*** for the total revenue.

The Closing Process

Wages Expense	
Bal. 4,525	4,525
Rent Expense	
Bal. 1,600	1,600
Depreciation Expense	
Bal. 50	50
Utilities Expense	
Bal. 985	985
Supplies Expense	
Bal. 2,040	2,040
Insurance Expense	
Bal. 100	100
Miscellaneous Expense	
Bal. 455	455

Income Summary	
9,775	16,960

Chris Clark, Capital	
	Bal. 25,000
Chris Clark, Drawing	
Bal. 4,000	

Fees Earned	
16,840	Bal. 16,840
Rent Revenue	
120	Bal. 120

Step 2

Debit ***Income Summary*** for the total expenses and credit each expense account for its balance.

The Closing Process

Wages Expense		
Bal.	4,525	4,525
Rent Expense		
Bal.	1,600	1,600
Depreciation Expense		
Bal.	50	50
Utilities Expense		
Bal.	985	985
Supplies Expense		
Bal.	2,040	2,040
Insurance Expense		
Bal.		100
Miscellaneous Expense		
Bal.		455
	455	

Income Summary		
	9,775	16,960
	7,205	

Chris Clark, Capital		
		Bal. 25,000
		7,205
Chris Clark, Drawing		
Bal.	4,000	

Fees Earned		
16,840	Bal.	
		16,840
Rent Revenue		
120	Bal.	120

Step 3
Debit ***Income Summary*** for the amount of its balance (in this case, the net income) and credit the capital account.

The Closing Process

Wages Expense		
Bal.	4,525	4,525
Rent Expense		
Bal.	1,600	1,600
Depreciation Expense		
Bal.	50	50
Utilities Expense		
Bal.	985	985
Supplies Expense		
Bal.	2,040	2,040
Insurance Expense		
Bal.		100
Miscellaneous Expense		
Bal.		455
	455	

Income Summary	
9,775	16,960
7,205	

Fees Earned	
16,840	Bal. 16,840
Rent Revenue	
120	Bal. 120

Chris Clark, Capital	
4,000	Bal. 25,000
	7,205
Chris Clark, Drawing	
Bal. 4,000	4,000

Step 4

Debit the capital account for the balance of the drawing account, and credit drawing for the same

Review of the Closing Process

Wages Expense

Bal.	4,525		4,525
------	-------	--	-------

Rent Expense

Bal.	1,600		1,600
------	-------	--	-------

Depreciation Expense

Bal.	50		50
------	----	--	----

Utilities Expense

Bal.	985		985
------	-----	--	-----

Supplies Expense

Bal.	2,040		2,040
------	-------	--	-------

Insurance Expense

Bal.			100
------	--	--	-----

Miscellaneous Expense

Bal.			455
	455		

Income Summary

9,775	16,960
7,205	

Fees Earned

16,840	Bal. 16,840
--------	-------------

Rent Revenue

120	Bal. 120
-----	----------

Chris Clark, Capital

4,000	Bal.
	7,205

Chris Clark, Drawing

Bal. 4,000	4,000
------------	-------

Close Revenues

Close Expenses

Close Income Summary

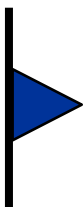
Close Drawing

Post-closing Trial Balance

NetSolutions Post-Closing Trial Balance December 31, 2005

Cash	2	065	00			
Accounts Receivable	2	720	00			
Supplies		760	00			
Prepaid Insurance	2	300	00			
Land	20	000	00			
Office Equipment	1	800	00			
Accumulated Depreciation					50	00
Accounts Payable					900	00
Wages Payable					250	00
Unearned Rent					240	00
Chris Clark, Capital				28	205	00
	29	645	00	29	645	00

DO IT!



2

Adjusting Entries for Deferrals

The ledger of Hammond, Inc. on March 31, 2017, includes these selected accounts before adjusting entries are prepared.

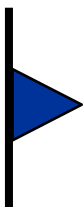
	<u>Debit</u>	<u>Credit</u>
Prepaid Insurance	Br 3,600	
Supplies	2,800	
Equipment	25,000	
Accumulated Depreciation—Equipment		
Br5,000		
Unearned Service Revenue		
9,200		

An analysis of the accounts shows the following.

1. Insurance expires at the rate of Br100 per month.
2. Supplies on hand total Br800.
3. The equipment depreciates Br200 a month.
4. During March, services were performed for Br4,000 of the unearned service revenue reported.

Prepare the adjusting entries for the month of March.

DO IT!



2

Adjusting Entries for Deferrals

The ledger of Hammond, Inc. on March 31, 2017, includes these selected accounts before adjusting entries are prepared.

	<u>Debit</u>	<u>Credit</u>
Prepaid Insurance	Br 3,600	
Supplies	2,800	
Equipment	25,000	
Accumulated Depreciation—Equipment		
Br5,000		
Unearned Service Revenue		
9,200		

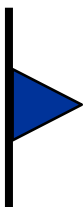
Prepare the adjusting entries for the month of March.

1. Insurance expires at the rate of Br100 per month.

SOLUTION

Insurance Expense	100	
Prepaid Insurance		100

DO IT!



2

Adjusting Entries for Deferrals

The ledger of Hammond, Inc. on March 31, 2017, includes these selected accounts before adjusting entries are prepared.

	<u>Debit</u>	<u>Credit</u>
Prepaid Insurance	Br 3,600	
Supplies	2,800	
Equipment	25,000	
Accumulated Depreciation—Equipment		
Br5,000		
Unearned Service Revenue		
9,200		

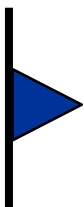
Prepare the adjusting entries for the month of March.

2. Supplies on hand total Br800.

SOLUTION

Supplies Expense	2,000
Supplies	2,000

DO IT!



2

Adjusting Entries for Deferrals

The ledger of Hammond, Inc. on March 31, 2017, includes these selected accounts before adjusting entries are prepared.

	<u>Debit</u>	<u>Credit</u>
Prepaid Insurance	Br 3,600	
Supplies	2,800	
Equipment	25,000	
Accumulated Depreciation—Equipment		
Br5,000		
Unearned Service Revenue		
9,200		

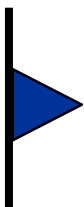
Prepare the adjusting entries for the month of March.

3. The equipment depreciates Br200 a month.

SOLUTION

Depreciation Expense	200	
Accumulated Depreciation		200

DO IT!



2

Adjusting Entries for Deferrals

The ledger of Hammond, Inc. on March 31, 2017, includes these selected accounts before adjusting entries are prepared.

	<u>Debit</u>	<u>Credit</u>
Prepaid Insurance	Br 3,600	
Supplies	2,800	
Equipment	25,000	
Accumulated Depreciation—Equipment		
Br5,000		
Unearned Service Revenue		
9,200		

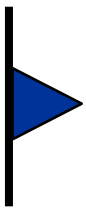
Prepare the adjusting entries for the month of March.

4. During March, services were performed for Br4,000 of the unearned service revenue reported.

SOLUTION

Unearned Service Revenue	4,000
Service Revenue	4,000

DO IT!



3

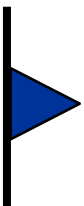
Adjusting Entries for Accruals

Micro Computer Services Inc. began operations on August 1, 2017. At the end of August 2017, management attempted to prepare monthly financial statements. The following information relates to August.

1. At August 31, the company owed its employees Br800 in salaries that will be paid on September 1.
2. On August 1, the company borrowed Br30,000 from a bank on a 15-year mortgage. The annual interest rate is 10%.
3. Revenue for services performed but unrecorded for August totaled Br1,100.

Prepare the adjusting entries needed at August 31, 2017.

DO IT!



3

Adjusting Entries for Accruals

Micro Computer Services Inc. began operations on August 1, 2017. At the end of August 2017, management attempted to prepare monthly financial statements. Prepare the adjusting entries needed at August 31, 2017.

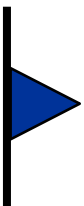
1. At August 31, the company owed its employees Br800 in salaries that will be paid on September 1.

SOLUTION

Salaries and Wages Expense 800

 Salaries and Wages Payable 800

DO IT!



3

Adjusting Entries for Accruals

Micro Computer Services Inc. began operations on August 1, 2017. At the end of August 2017, management attempted to prepare monthly financial statements. Prepare the adjusting entries needed at August 31, 2017.

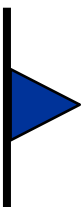
2. On August 1, the company borrowed Br30,000 from a bank on a 15-year mortgage. The annual interest rate is 10%.

SOLUTION

Interest Expense	250
------------------	-----

Interest Payable	250
------------------	-----

DO IT!



3

Adjusting Entries for Accruals

Micro Computer Services Inc. began operations on August 1, 2017. At the end of August 2017, management attempted to prepare monthly financial statements. Prepare the adjusting entries needed at August 31, 2017.

3. Revenue for services performed but unrecorded for August totaled Br1,100.

SOLUTION

Accounts Receivable	1,100
Service Revenue	1,100