# ACCOUNTING FOR ADJUSTING ENTRIES

## Key Terms and Concepts to Know

**The Accounting Cycle (steps 5 and 6):**
- Prepare and post adjusting entries
- Prepare adjusted trial balance

**Transactions:**
- External transactions occur between two different entities and are easy to record because there are always source documents evidencing the transaction
- Internal transactions occur within a single entity and are more difficult to record because source documents my not always be present

**Accounting Principles**
- Matching Principle
    - Forms the basis of accrual accounting
    - States that revenue earned and the costs incurred to produce that revenue must be recorded in the same period
- Revenue Recognition Principle
    - States that revenue must be recognized (recorded) in the period in which it is earned
- Expense Recognition Principle (same as the matching principle)
    - States that expenses must be recorded in the period in which the related revenue was recognized

**Accrual Basis Accounting:**
- Accrual vs. Cash Basis Accounting
- **Deferred Expenses** (prepaid expenses)
- **Deferred Revenues** (unearned revenues)
- **Accrued Expenses** (accrued liabilities)
- **Accrued Revenues** (accrued assets)
- Unbilled vs. unearned revenues

**Journalizing adjusting entries**

- Always have at least one income statement account (revenue or expense) and one balance sheet account (asset or liability)
- Never recorded for cash, dividends, capital stock or retained earnings

**Effects on the financial statements will be if adjusting entries are omitted**

| | | Effect of Omitting Adjusting Entry | |
|---|---|---|---|
| Type of Adjusting Entry | What Adjusting Entry Does | On Account Balance | On Financial statements |
| Deferred Expenses | Increase expense | Understates expense | Overstates net income |
| | Decrease asset | Overstates asset | Overstates total assets |
| Deferred Revenues | Increase revenue | Understate revenue | Understate net income |
| | Decrease liability | Overstate liability | Overstate total liabilities |
| Accrued Expenses | Increase expense | Understate expense | Overstates net income |
| | Increase liability | Understate liability | Understate total liabilities |
| Accrued Revenues | Increase revenue | Understate revenue | Understate net income |
| | Increase asset | Understate asset | Understates total assets |

**Depreciation**

- All long-lived assets are depreciated except for land
- Depreciation accounts for the decline in usefulness of a long-lived asset over its useful life
- Systematically records a portion of the cost of a long-lived asset as an expense to match against the revenue in the accounting period
- Depreciation expense is frequently calculated using the straight-line method
- Adjusting entry for depreciation is always

| | | |
|---|---|---|
| Depreciation expense | xxx | |
| Accumulated depreciation | | xxx |

- The asset account is NOT credited for the decline in value; instead the credit is recorded in a contra-asset account, accumulated depreciation

- Contra-asset means an account on the asset side of the accounting equation or balance sheet which has a normal credit balance
- Net Book Value is the balance in the asset account less the balance in the related accumulated depreciation account

**Adjusted Trial Balance:**

- Starts with trial balance before adjustments
- Adds or deducts adjusting entries as appropriate
- Forms the basis for preparing financial statements

# Key Topics to Know

## Adjusting Entries

- Adjusting entries are required to record internal transactions and to bring assets and liability accounts to their proper balances and record expenses or revenues in the proper accounting period.
- Therefore adjusting entries always affect one income statement account (revenue or expense) and one balance sheet account (asset or liability).
- Adjusting entries are prepared either when:
  - The current unadjusted balance in the account is known and the amount of the activity to be adjusted is known
  - The current unadjusted balance in the account is known and the required balance after adjustment is known.
- There are two basic types of adjusting entries: **Deferrals** and **Accruals**

**Example #1**

J Company has a $1,000 unadjusted balance in the Office Supplies account on December 31.

Required: What is the proper adjusting entry if Johnson could determine

a) The amount of supplies remaining unused?

b) The amount of supplies actually used?

**Solution#1**

a): If J Company simply counted the remaining supplies on December 31 and determined that they had a cost of $450, the Office Supplies account would look like this:

| | Office Supplies | | |
|---|---|---|---|
| Unadjusted balance | $1,000 | | |
| ADJUSTMENT-> | | ? | Supplies used |
| Required ending balance | 450 | | |

The adjustment would be: \$1,000 – 450 = \$550, the amount used.

| | | | |
|---|---|---|---|
| Dec. 31 | Supplies expense | 550 | |
| | Office Supplies | | 550 |

b): If J Company had required employees to fill out a form noting the supplies used each time they were taken from the supply cabinet, the supplies used would add up as \$550. The Office Supplies account would look like this:

| | Office Supplies | | |
|---|---|---|---|
| Unadjusted balance | \$1,000 | | |
| ADJUSTMENT-> | | 550 | Supplies used |
| Required ending balance | ? | | |

The adjustment would be the amount used, \$550

| | | | |
|---|---|---|---|
| Dec. 31 | Supplies expense | 550 | |
| | Office Supplies | | 550 |

Notice several things about the adjusting entry:

- The entry was the same in both situations.
- The entry was made for the amount of activity or change in the account during the period.
- The entry included one balance sheet account, Office Supplies and one income statement account, Supplies Expense.
- The ending balance in the account WAS NOT part of the adjusting journal entry. Rather, the adjusting entry was recorded to create the proper ending balance in the account.

## Deferred Revenue and Expense

- Deferrals occur when cash changes hands prior to when the revenue is earned or expense is incurred. Recording the revenue or expense is postponed or deferred until a subsequent economic event has occurred which causes revenue to be earned or expense to be incurred.
- Deferred Revenues (also referred to as unearned revenue) are initially recorded as a liability and adjusted at the end of the period for the portion that has been

earned. This occurs when payment is received in advance of performing the service.

| | | |
|---|---|---|
| Any Date | Cash<br>Unearned Revenue | *(Cash received in advance)* |
| Dec. 31 | Unearned Revenue<br>Fees Earned | *(Amount earned as of year-end)* |

- Deferred Expenses (also referred to as prepaid expenses) are initially recorded as assets and adjusted at the end of the period for the portion that has been used up or expired.

| | | |
|---|---|---|
| Any Date | Prepaid Insurance<br>Cash | *(Cost of insurance policy)* |
| Dec. 31 | Insurance Expense<br>Prepaid Insurance | *(Portion of policy that has expired)* |

## Accrued Revenue and Expense

- Accruals occur when revenue is earned or expense is incurred prior to the cash changing hands. Deferred revenues and deferred expenses have not been recorded prior to preparing and recording the adjusting entry.
- Accrued Revenues – are revenues that have been earned, but have not been recorded. Payment has not been received.

| | | |
|---|---|---|
| Dec. 31 | Accounts Receivable<br>Fees Earned | *(amount earned as of year-end)* |

- Accrued Expenses – are expenses that have been incurred and a debt or liability is owed to a third party; however neither the expenses nor liability have been recorded.

| | | |
|---|---|---|
| Dec. 31 | Interest Expense<br>Interest Payable | *(amount owed as of year-end)* |

**Example #2**

The following information is available as of year-end.

| | | |
|---|---|---|
| a. | Unexpired insurance at December 31 | $1,500 |
| b. | Supplies on hand at December 31 | $400 |
| c. | Depreciation of building for the year | $1,750 |
| d. | Depreciation of equipment for the year | $5,800 |
| e. | Revenue unearned at December 31 | $2,000 |
| f. | Accrued salaries and wages at December 31 | $2,300 |
| g. | Fees earned but unbilled on December 31 | $4,850 |

F Company
Trial Balance
December 31

| | | |
|---|---|---|
| Cash | $8,700 | |
| Accounts Receivable | 20,600 | |
| Prepaid Insurance | 4,400 | |
| Supplies | 1,950 | |
| Land | 45,000 | |
| Building | 134,500 | |
| Accumulated Depreciation-Bldg | | $86,700 |
| Equipment | 80,100 | |
| Accumulated Depreciation-Equip. | | 61,300 |
| Accounts Payable | | 7,500 |
| Unearned Revenue | | 6,000 |
| Capital Stock | | 15,300 |
| Retained Earnings | | 54,000 |
| Dividends | 8,000 | |
| Fees Earned | | 199,400 |
| Salaries and Wages Expense | 70,200 | |
| Utilities Expense | 23,200 | |
| Advertising Expense | 18,000 | |
| Repairs Expense | 11,500 | |
| Miscellaneous Expense | 4,050 | |
| Totals | $430,200 | $430,200 |

Required: Journalize the adjusting entries and label them as accruals or deferrals, adding accounts as needed.

## Solution #2

| | | | |
|---|---|---|---|
| a) | Deferred Expense | | |
| | Insurance Expense | 2,900 | |
| | Prepaid Insurance | | 2,900 |
| b) | Deferred Expense | | |
| | Supplies Expense | 1,550 | |
| | Supplies | | 1,550 |
| c) | Deferred Expense | | |
| | Depreciation Expense-Bldg | 1,750 | |
| | Accum. Depr.- Bldg | | 1,750 |
| d) | Deferred Expense | | |
| | Depreciation Expense-Equip | 5,800 | |
| | Accum. Depr.-Equipment | | 5,800 |
| e) | Deferred Revenue | | |
| | Unearned Revenue | 4,000 | |
| | Fees Earned | | 4,000 |
| f) | Accrued Expense | | |
| | Wages Expense | 2,300 | |
| | Wages Payable | | 2,300 |
| g) | Accrued Revenue | | |
| | Accounts Receivable | 4,850 | |
| | Fees Earned | | 4,850 |

## Example #3

Refer to the data in Example #2.

Required: Determine the adjusted balances of the accounts and prepare an adjusted trial balance.

**Solution #3**

F Company
Adjusted Trial Balance
December 31, 20--

| | | |
|---|---|---|
| Cash | $8,700 | |
| Accounts Receivable | 25,450 | |
| Prepaid Insurance | 1,500 | |
| Supplies | 400 | |
| Land | 45,000 | |
| Building | 134,500 | |
| Accumulated Depreciation-Bldg. | | $88,450 |
| Equipment | 80,100 | |
| Accumulated Depreciation-Equip. | | 67,100 |
| Accounts Payable | | 7,500 |
| Salaries & Wages Payable | | 2,300 |
| Unearned Revenue | | 2,000 |
| Capital Stock | | 15,300 |
| Retained Earnings | | 54,000 |
| Dividends | 8,000 | |
| Fees Earned | | 208,250 |
| Salaries and Wages Expense | 72,500 | |
| Utilities Expense | 23,200 | |
| Advertising Expense | 18,000 | |
| Repairs Expense | 11,500 | |
| Depreciation Expense-Equipment | 5,800 | |
| Depreciation Expense-Bldg | 1,750 | |
| Miscellaneous Expense | 4,050 | |
| Insurance Expense | 2,900 | |
| Supplies Expense | 1,550 | |
| Totals | $444,900 | $444,900 |

# Adjusting Entries and Errors

- Failure to journalize and post adjusting entries at the end of the period will cause multiple financial statement items to be misstated.
- At least one balance sheet account and one income statement account for each entry not made or incorrectly made.

**Example #4**

A Company failed to record accrued wages of $5,000 at the end of the period.

Required:
a) Determine the adjusting entry that should have been made.
b) Determine which accounts and financial statements would have been affected by the error.
c) Determine whether the accounts and financial statements would have been understated or overstated and the amount of the misstatement.

**Solution #4**

The adjusting entry should have been:

| | | |
|---|---|---|
| Wages Expense | 5,000 | |
| Wages Payable | | 5,000 |

This entry should have increased wages expense with a debit and increased wages payable with a credit. Failing to record this entry caused the following errors:

a) Wages Expense will be understated by $5,000, so
b) Total Expenses will be understated by $5,000, so
c) Net Income will be overstated by $5,000, and when closed to RE,
d) Retained Earnings will be overstated by $5,000.
e) Wages Payable will be understated by $5,000, so
f) Total Liabilities will be understated by $5,000

## Example #5

At the end of October, the first month of operations, the following selected data were taken from the financial statements of C Company:

| | |
|---|---|
| Net Income for October | $102,500 |
| Total Assets at October 31 | 228,750 |
| Total Liabilities at October 31 | 60,500 |
| Total Stockholders' Equity at October 31 | 168,250 |

The following adjusting entries were omitted at the end of the month:

| | | |
|---|---|---|
| a) | Supplies used during October | $800 |
| b) | Depreciation of equipment for October | $3,000 |
| c) | Unbilled fees earned at October 31 | $1,200 |
| d) | Accrued wages at October 31 | $500 |

Required:
a) Journalize the entries to record the omitted adjustments.
b) Determine the correct amounts for Net Income, Total Assets, Total Liabilities and Total Stockholders' Equity as of October 31.

## Solution #5

| | | | |
|---|---|---|---|
| a. | Supplies Expense | 800 | |
| | Supplies | | 800 |
| b. | Depreciation Exp.-Equip. | 3,000 | |
| | Accum. Depr.- Equip. | | 3,000 |
| c. | Accounts Receivable | 1,200 | |
| | Fees Earned | | 1,200 |
| d. | Wages Expense | 500 | |
| | Wages Payable | | 500 |

| | Net Income | Assets | Liabilities | Equity |
|---|---|---|---|---|
| Reported Balance | $102,500 | $228,750 | | $60,500 |
| Corrections: | | | | |
| Adjustment (a) | -800 | -800 | --- | -800 |
| Adjustment (b) | -3,000 | -3,000 | --- | -3,000 |
| Adjustment (c) | +1,200 | +1,200 | --- | +1,200 |
| Adjustment (d) | -500 | --- | +500 | -500 |
| Corrected Balance | $ 99,400 | $ 226,150 | $ 61,000 | $ 165,150 |

# Trial Balance

- A Trial Balance is a summary of all account balances in the general ledger. Each account and its balance (debit or credit) is listed on the trial balance. Total of all debit account balances must equal the total of all credit debit balances.
- A trial balance is useful in determining whether the general ledger is in balance (total debits equal total credits). It will not identify errors in the general ledger or in preparing the trial balance for which debits equal credits or if an entry is not posted to the general ledger at all.
- Trial balances are typically prepared three times during the accounting cycle:
  - Unadjusted which is prepared prior to adjusting entries
  - Adjusted which is prepared after adjusting entries and is the basis for preparing financial statements
  - Post-closing which is prepared after closing entries.

# Practice Problems

## Practice Problem #1

S Company provided the following financial information as of year-end, August 31.

| | | |
|---|---|---|
| a) | Supplies on hand on August 31 | $800 |
| b) | Depreciation of equipment during the year | $3,400 |
| c) | Rent expired during the year | $11,000 |
| d) | Wages accrued, but not paid at August 31 | $2,500 |
| e) | Unearned fees at August 31 | $1,500 |
| f) | Unbilled fees at August 31 | $5,260 |

| | **Current Balance** | | **Adjust. Entry** | **Adjusted Balance** | |
|---|---|---|---|---|---|
| | Debit | Credit | (+ / - ) | Debit | Credit |
| Accounts Receivable | 12,350 | | | | |
| Supplies | 1,980 | | | | |
| Prepaid Rent | 20,000 | | | | |
| Equipment | 73,800 | | | | |
| Accumulated Depreciation-Equipment | | 24,700 | | | |
| Capital Stock | | 20,480 | | | |
| Dividends | 2,000 | | | | |
| Unearned Fees | | 7,500 | | | |
| Fees Earned | | 99,650 | | | |
| Wages Expense | 42,200 | | | | |
| Rent Expense | | | | | |
| Depreciation Expense | | | | | |
| Supplies Expense | | | | | |

Required:
a) Journalize the adjusting entries and label them as accruals or deferrals.
b) Update the account balances of the selected accounts in the chart.

**Practice Problem #2**

At the end of January, the first month of operations, the following selected data were taken from the financial statements of W Company:

| | |
|---|---|
| Net Income for January | \$88,450 |
| Total Assets at January 31 | 276,000 |
| Total Liabilities at January 31 | 77,800 |
| Total Stockholders' Equity at January 31 | 198,200 |

The following adjusting entries were omitted at the end of the month:

| | | |
|---|---|---|
| a. | Unbilled fees earned at January 31 | \$2,200 |
| b. | Supplies used during January 31 | \$1,800 |
| c. | Depreciation of equipment for January | \$7,500 |
| d. | Accrued wages at January 31 | \$1,500 |

Required:
a) Journalize the entries to record the omitted adjustments.
b) Determine the correct amounts for Net Income, Total Assets, Total Liabilities, and Total Stockholders' Equity as of January 31.

**Practice Problem #3**

H Company's unadjusted trial balance for the current year follows:

H Company
Trial Balance
December 31

| | | |
|---|---|---|
| Cash | $7,200 | |
| Prepaid property insurance | 2,400 | |
| Prepaid life insurance | 3,000 | |
| Shop supplies | 790 | |
| Shop equipment | 3,860 | |
| Accumulated depreciation - equipment | | $770 |
| Building | 59,500 | |
| Accumulated depreciation—building | | 3,840 |
| Land | 55,000 | |
| Unearned rent | | 7,600 |
| Accounts payable | | 3,720 |
| Long-term notes payable | | 50,000 |
| Common stock | | 1,000 |
| Retained earnings | | 47,860 |
| Rent earned | | 2,400 |
| Fees earned | | 23,400 |
| Wages expense | 3,200 | |
| Utilities expense | 690 | |
| Property taxes expense | 600 | |
| Interest expense | 4,350 | |
| Total | $140,590 | $140,590 |

Additional information:

a) A life insurance policy examination showed $1,040 of expired insurance.
b) An inventory count showed $210 of unused shop supplies still available.
c) Depreciation expense on shop equipment, $350.
d) Depreciation expense on the building, $2,020.
e) A beautician is behind on space rental payments, and this $200 of accrued revenues was unrecorded at the time the trial balance was prepared.
f) $2,800 of the Unearned Rent account balance was still unearned by year-end.
g) The one employee, a receptionist, works a five-day workweek at $50 per day. The employee was paid last week but has worked Tuesday through Friday this week for which she has not been paid.

h) Three months' property taxes, totaling $450, have accrued. This additional amount of property taxes expense has not been recorded.
i) One month's interest on the note payable, $600, has accrued but is unrecorded.
j) The Prepaid Property Insurance account has a $2,400 debit balance before adjustment. An examination of insurance policies shows $950 of unexpired insurance.
k) The company has three office employees who each earn $100 per day for a five-day workweek that ends on Friday. The employees were paid last Friday and worked full days on Monday, Wednesday and Friday this week for which they have not been paid.
l) On November 1, the company received 6 months' rent in advance from a tenant whose rent is $700 per month. The $4,200 was credited to the Unearned Rent account.
m) The company has not received a water and sewer services bill for December. Based on prior months' bills, the bill is expected to be $1,000 for the month.

Required: Journalize the necessary adjusting entries

**Practice Problem #4**

During the current year ended December 31, clients paid fees in advance for accounting services amounting to $15,000. These fees were recorded in an account called Unearned Accounting Fees. $3,500 of these fees remained unearned on December 31 of this year. The company also performed tax services for several clients prior to December 31, but did not issue invoices until after year-end.

Required: Journalize the necessary adjusting entries

**Practice Problem #5**

Following is a list of year-end adjusting entries that were not made.

| Error | Revenues | Expenses | Assets | Liabilities | Equity |
|---|---|---|---|---|---|
| 1. Did not record depreciation for this period | | | | | |
| 2. Did not record unpaid telephone bill | | | | | |
| 3. Did not adjust unearned revenue account for revenue earned this period | | | | | |
| 4. Did not adjust shop supplies for supplies used this period | | | | | |
| 5. Did not accrue employee salaries for this period | | | | | |
| 6. Recorded rent expense owed with a debit to insurance expense and a credit to rent payable | | | | | |

Required: Complete the table using a "+" for overstatements, a "-" for understatements, and a "0" for no effect.

# True / False Questions

1. Accrual-basis accounting involves recording revenues when earned and recording expenses with their related revenues.
   True False

2. Adjusting entries should be prepared after financial statements are prepared.
   True False

3. Prepaid expenses involve payment of cash (or an obligation to pay cash) for the purchase of an asset before the expense is incurred.
   True False

4. Unearned revenues occur when cash is received after the revenue is earned.
   True False

5. The adjusting entry for an accrued expense always includes a debit to an expense account and a credit to a liability account.
   True False

6. Adjusting entries for accrued revenues always includes a debit to a liability account and a credit to a revenue account.
   True False

7. An adjusting entry can never record a transaction that exchanges one asset for another asset.
   True False

8. According to the revenue recognition principle, if a company provides services to a customer in the current year but does not collect cash until the following year, the company should report the revenue in the current year.
   True False

9. The matching principle states that we recognize expenses in the same period as the revenues they help to generate.
   True False

10. Adjusting entries involve recording events that have occurred but that have not yet been recorded by the end of the period.
    True False

11. The accrual basis of accounting recognizes revenues when cash is received from customers.
    True False

12. Prior to recording adjusting entries at the end of an accounting period, some accounts may not show correct balances even though all transactions were properly recorded.
    True False

13. Prepaid expenses, such as prepaid rent and prepaid insurance, represent liabilities for a business until they are used.
    True False

14. When a company receives cash in advance from a customer, it should debit Cash and credit Accounts Receivable.
    True False

15. The cost of a long-term asset, such as equipment, is transferred to expense as it is used during its life.
    True False

# Multiple Choice Questions

1. The revenue recognition concept
   a) Determines when revenue is credited to a revenue account.
   b) States that revenue is not recorded until the cash is received.
   c) Controls all revenue reporting for the cash basis of accounting.
   d) Is in conflict with accrual accounting.

2. The matching principle:
   a) Addresses the relationship between the journal and the ledger.
   b) Determines the normal balance of an account.
   c) Requires that expenses related to revenue and revenue be reported at the same time.
   d) Requires that the dollar amount of debits equal the dollar amount of credits in a journal entry.

3. Using accrual accounting, expenses are recorded only:
   a) When they are incurred and paid at the same time
   b) If they are paid before they are incurred
   c) If they are paid after they are incurred
   d) When they are incurred, whether or not cash is paid

4. The primary difference between deferred and accrued expenses is that deferred expenses have:
   a) Been recorded and accrued expenses have not been incurred
   b) Been incurred and accrued expenses have not
   c) Not been incurred and accrued expenses have been incurred
   d) Not been recorded and accrued expenses have been incurred

5. Adjusting entries affect at least one:
   a) Revenue and one expense account
   b) Asset and one liability account
   c) Revenue and one stockholders' equity account
   d) Income statement account and one balance sheet account

6. The year-end balance in the prepaid rent account before adjustment is $18,000, representing three months' rent paid on December 1. The adjusting entry required on December 31 is:
   a) Debit Rent Expense, $6,000; credit Prepaid Rent, $6,000
   b) Debit Prepaid Rent, $6,000; credit Rent Expense, $6,000
   c) Debit Rent expense, $12,000; credit Prepaid Rent, $12,000
   d) Debit Prepaid Rent, $12,000; credit Rent expense, $12,000

7. At the end of the fiscal year, the usual adjusting entry for accrued salaries owed to employees was omitted. Which of the following statements is true?
   a) Stockholders' equity at the end of the year was overstated
   b) Salary Expense for the year was overstated
   c) The total of the liabilities at the end of the year was overstated
   d) Net Income for the year was understated

8. What is the proper adjusting entry at June 30, the end of the fiscal year, based on a supplies account balance before adjustment, $7,200, and supplies inventory on June 30, $1,200?
   a) Debit Supplies, $1,200; credit Supplies Expense, $1,200
   b) Debit Supplies Expense, $1,200; credit Supplies, $1,200
   c) Debit Supplies Expense, $6,000; credit Supplies, $6,000
   d) Debit Supplies, $6,000; credit Supplies Expense, $6,000

9. A business enterprise pays weekly salaries of $45,000 on Friday for a five-day week ending on that day. The adjusting entry necessary at the end of the fiscal period ending on Thursday is:
   a) Debit Salaries Payable, $36,000; credit Cash, $36,000
   b) Debit Salary Expense, $36,000; credit Dividends, $36,000
   c) Debit Salary Expense, $36,000; credit Salaries Payable, $36,000
   d) Debit Dividends, $36,000; credit Cash, $36,000

10. At the end of the fiscal year, M Company omitted the usual adjusting entry for depreciation on equipment. Which of the following statements is true?
   a) Total assets will be understated at the end of the current year.
   b) The balance sheet, income statement, and retained earnings statement will be misstated for the current year.
   c) Expenses will be overstated at the end of the current year.
   d) Net income will be understated for the current year.

11. Data for an adjusting entry described as "accrued wages, $800" means to debit:
    a) Capital Stock and credit Wages Payable
    b) Wages Expense and credit Wages Payable
    c) Wages Payable and credit Wages Expense
    d) Accounts Receivable and credit Wages Expense

12. If cash is received in advance from a customer, then
    a) Assets will decrease.
    b) Retained earnings will increase.
    c) Liabilities will increase.
    d) Stockholders' equity will decrease.

13. If the adjusting entry is not made for unearned revenues the result will be to
    a) Overstate assets and understate liabilities.
    b) Overstate liabilities and understate revenues.
    c) Understate net income and overstate retained earnings
    d) Understate retained earnings and overstate revenues.

14. G Company received a check for $30,000 on October 1 which represents a one year advance payment of rent on an office it rents to a client. Unearned Rental Revenue was credited for the full $30,000. Financial statements are prepared on December 31. The appropriate adjusting journal entry to make on December 31 would be
    a) Debit Rental Revenue $2,500; credit Unearned Rental Revenue $2,500.
    b) Debit Unearned Rental Revenue $7,500; credit Rental Revenue $7,500
    c) Debit Unearned Rental Revenue $22,500; credit Rental Revenue $22,500
    d) Debit Rental Revenue $22,500; credit Unearned Rental Revenue $22,500

15. If revenues are recognized only when a customer pays, what method of accounting is being used?
    a) Accrual basis
    b) Recognition basis
    c) Cash basis
    d) Matching basis

# Solutions to Practice Problems

## Practice Problem #1

| | | Debit | Credit |
|---|---|---|---|
| a) | Deferred Expense | | |
| | Supplies Expense | 1,180 | |
| | Supplies | | 1,180 |
| b) | Deferred Expense | | |
| | Depreciation Expense-Equip | 3,400 | |
| | Accum. Depr.- Equip | | 3,400 |
| c) | Deferred Expense | | |
| | Rent Expense | 11,000 | |
| | Prepaid rent | | 11,000 |
| d) | Accrued Expense | | |
| | Wages Expense | 2,500 | |
| | Wages Payable | | 2,500 |
| e) | Deferred Revenue | | |
| | Unearned Revenue | 6,000 | |
| | Fees Earned | | 6,000 |
| f) | Accrued Revenue | | |
| | Accounts Receivable | 5,260 | |
| | Fees Earned | | 5,260 |

| | Current Balance | | Adjustment | Adjusted Balance | |
|---|---|---|---|---|---|
| | Debit | Credit | (+ / - ) | Debit | Credit |
| Accounts Receivable | 12,350 | | +5,260 | 17,610 | |
| Supplies | 1,980 | | -1,180 | 800 | |
| Prepaid Rent | 20,000 | | -11,000 | 9,000 | |
| Equipment | 75,800 | | ----- | 75,800 | |
| Accumulated Depreciation-Equipment | | 24,700 | +3,400 | 0 | 28,100 |
| Capital Stock | | 20,480 | | 0 | 20,480 |
| Wages Payable | | 0 | +2,500 | 0 | 2,500 |
| Unearned Fees | | 7,500 | -6,000 | 0 | 1,500 |
| Fees Earned | | 99,650 | +11,260 | 0 | 110,910 |
| Wages Expense | 42,200 | | +2,500 | 44,700 | 0 |
| Rent Expense | | | +11,000 | 11,000 | 0 |
| Depreciation Expense | | | +3,400 | 3,400 | 0 |
| Supplies Expense | | | +1,180 | 1,180 | 0 |
| | 152,330 | 152,330 | | 163,490 | 163,490 |

**Practice Problem #2**

| | | Debit | Credit |
|---|---|---|---|
| a. | Accounts Receivable | 2,200 | |
| | Fees Earned | | 2,200 |
| b. | Supplies Expense | 1,800 | |
| | Supplies | | 1,800 |
| c. | Depreciation Expense-Equip. | 7,500 | |
| | Accum. Depr.-Equip. | | 7,500 |
| d. | Wages Expense | 1,500 | |
| | Wages Payable | | 1,500 |

| | Net Income | Assets | Liabilities | Equity |
|---|---|---|---|---|
| Reported Balance | $88,450 | $276,000 | $77,800 | $198,200 |
| Corrections: | | | | |
| Adjustment (a) | +2,200 | +2,200 | --- | +2,200 |
| Adjustment (b) | -1,800 | -1,800 | --- | -1,800 |
| Adjustment (c) | -7,500 | -7,500 | --- | -7,500 |
| Adjustment (d) | -1,500 | --- | +1,500 | -1,500 |
| Corrected Balance | $79,850 | $268,900 | $79,300 | $189,600 |

**Practice Problem #3**

| | | | |
|---|---|---|---|
| a) | Insurance expense | 1,040 | |
| | Prepaid life insurance | | 1,040 |
| b) | Shop supplies expense | 580 | |
| | Shop supplies | | 580 |
| | $790 - 210 = 580 used | | |
| c) | Depreciation expense - equipment | 350 | |
| | Accumulated depreciation - equipment | | 350 |
| d) | Depreciation expense, Building | 2,020 | |
| | Accumulated depreciation – Building | | 2,020 |
| e) | Accounts receivable | 200 | |
| | Rent earned | | 200 |
| f) | Unearned rent | 4,800 | |
| | Rent earned | | 4,800 |
| | $7,600 - $2,800 = $4,800 earned | | |
| g) | Wages expense | 200 | |
| | Wages payable | | 200 |
| | $50/day * 4 days = $200 | | |
| h) | Property taxes expense | 450 | |
| | Property taxes payable | | 450 |
| i) | Interest expense | 600 | |
| | Interest payable | | 600 |
| j) | Insurance expense | 1,450 | |
| | Prepaid property insurance | | 1,450 |
| | $2,400 – 950 = $1,450 | | |
| k) | Wages expense | 900 | |
| | Wages payable | | 900 |
| | $100/day * 3 days * 3 employees = $900 | | |
| l) | Unearned rent | 1,400 | |
| | Rent income | | 1,400 |
| | $4,200/6mo = $700/mo * 2 mo = $1,400 | | |
| m) | Utilities expense | 1,000 | |
| | Accounts payable | | 1,000 |

## Practice Problem #4

| | | |
|---|---|---|
| Unearned Accounting Fees | 11,500 | |
| Accounting Fees Earned | | 11,500 |
| Accounts Receivable | 8,300 | |
| Tax services Earned | | 8,300 |

## Practice Problem #5

| Error | Revenues | Expenses | Assets | Liabilities | Equity |
|---|---|---|---|---|---|
| 1. Did not record depreciation for this period | 0 | -- | + | 0 | + |
| 2. Did not record unpaid telephone bill | 0 | -- | 0 | -- | + |
| 3. Did not adjust unearned revenue account for revenue earned this period | -- | 0 | 0 | + | -- |
| 4. Did not adjust shop supplies for supplies used this period | 0 | -- | + | 0 | + |
| 5. Did not accrue employee salaries for this period | 0 | -- | 0 | -- | + |
| 6. Recorded rent expense owed with a debit to insurance expense and a credit to rent payable | 0 | 0 | 0 | 0 | 0 |

# Solutions to True / False Problems

1. True
2. False - adjusting entries should be prepared before financial statements are prepared.
3. True
4. False - unearned revenues occur when cash is received before the revenue is earned.
5. True
6. False - the debit is to an asset account.
7. True
8. True
9. True
10. True
11. False – Accrual accounting recognizes revenue when it is earned, regardless of whether the cash has been received.
12. True
13. False – prepaid expenses are assets
14. False - the credit should be to Unearned Revenue, a liability.
15. True

# Solutions to Multiple Choice Questions

| | |
|---|---|
| 1. | A |
| 2. | C |
| 3. | D |
| 4. | C |
| 5. | D |
| 6. | A |
| 7. | A |
| 8. | C |
| 9. | C |
| 10. | B |
| 11. | B |
| 12. | C |
| 13. | B |
| 14. | B |
| 15. | C |