LEARNING OBJECTIVES

1. Understand the time period assumption and differentiate between revenue and expense recognition under both accrual and cash basis accounting
2. Understand the four types of adjustments and prepare adjusting entries
3. Prepare financial statements from an adjusted trial balance
4. Prepare closing entries and a post-closing trial balance
5. Prepare a worksheet

CHAPTER OUTLINE

▲ Ruaridh Stewart/ Newscom

CHAPTER 3

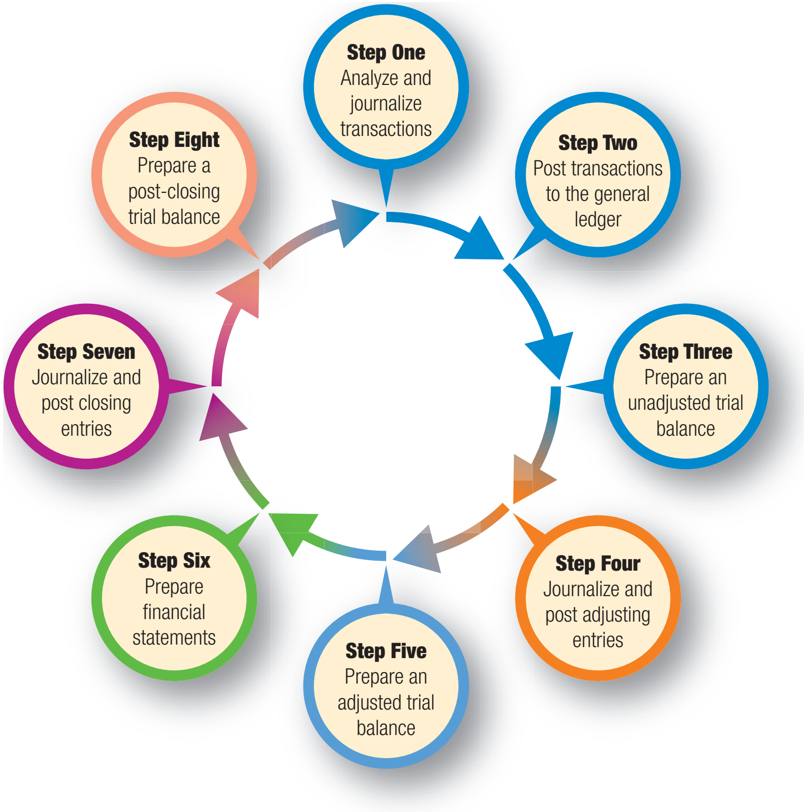
Adjusting and Closing Entries

BUSINESS, ACCOUNTING, AND YOU

It's year end and closing time at Best Buy. Everyone has worked hard. Millions of transactions have occurred and been recorded by the accountants, and it's time to wrap up the year and tabulate the score for Best Buy. How does Best Buy conclude a year's activities and prepare for a new year? There has to be an end for a new beginning.

Think of a sporting event, where there must be an end to the game. At the end of the game the scorekeeper must make sure the score properly reflects what happened. Accountants are the scorekeepers of the business, and they have things to do at the end of a period of time. They may need to go back and make sure they have recognized, measured, and reported all the business's transactions properly; given IFRS or ASPE rules, they may need to adjust the scorecard to better reflect what happened. They then need to summarize the transactions and prepare the final reports.

Whether you are an accountant or a manager who uses accounting information, you need to understand the process used by accountants to adjust and conclude (close) a business's financial records. Why? Because they affect the reports used to manage the business—they affect the final score used to judge a business's success.



In Chapter 2, we learned about journalizing and posting transactions for a business as well as how to prepare a trial balance and financial statements. These were steps one, two, three, and six of the accounting cycle, as you can see in the visual representation. Here in Chapter 3, we will learn how to prepare steps four to eight.

HOW DOES A COMPANY ACCURATELY REPORT ITS INCOME?

THE TIME PERIOD ASSUMPTION

L.O. 1 Understand the time period assumption and differentiate between revenue and expense recognition under both accrual and cash basis accounting

We briefly discussed the time period assumption in Chapter 1, but now we are going to see the implications it has for revenue and expense recognition. A business usually continues for many years. Owners, managers, and other stakeholders, however, would like to know the business's financial performance (mainly net income) more frequently and in shorter periods of time. Income is directly related to a period of time—whenever you mention an income figure it should be associated with a period of time. A company cannot declare that it generated a certain amount of income without mentioning the period in which this income was generated. Accountants must make a clear cut between each period of time to be able to measure net income during such period. This period is known as the **accounting period**. The accounting period artificially divides the life of a business into smaller periods. The accounting period could cover any period of time, such as a week, month, quarter, or year. Accounting financial statements that cover periods that are less than a year are usually referred to as **interim financial statements**. Annual financial statements usually cover a **fiscal year**, which is a set of 12 successive months, and hence, could differ from or comply with a calendar year. So, if the company starts its fiscal year in January and ends it at the end of December, then the fiscal year complies with the calendar year. Other companies might have an accounting period different from the calendar year, for example starting at the beginning of July and ending at the end of June, but this is still a 12-month period. Usually, the fiscal year-end date is the low point in business activity for the year.

WHEN TO RECOGNIZE REVENUES AND EXPENSES

The **revenue recognition principle** states that revenues should be recognized, or recorded, when they are *earned* regardless of when cash is received. Revenue is earned when the business fulfills its obligation towards its client in a certain business transaction. Obligations are fulfilled in most transactions by delivering goods or providing services.

Expenses are recognized or recorded when incurred. Expenses are incurred when assets are used up in generating revenues. Hence, expenses are related to revenues, and they are recognized in the same period in which the related revenues are generated. Expenses are matched with the related revenues, which is called the **matching principle**.

CASH VERSUS ACCRUAL ACCOUNTING

It is possible for a business to record revenues and expenses only when cash is received or paid, respectively. This is referred to **cash-basis accounting**. In many instances, when a company uses cash-basis accounting its financial statements usually do not present an accurate picture of how the company is performing. This is because a business may provide goods and services to customers "on account." In this case, the business has earned revenue prior to receiving cash from the customer. A business may also purchase goods and services from suppliers on account. In this case, expenses are incurred before cash is paid, so the flow of cash does not resemble the real activity. When revenues are earned before cash is received, or expenses are incurred before cash is paid, it is called an **accrual**. We have already seen accruals in Chapter 1 and Chapter 2 when we recorded transactions in Accounts Receivable and Accounts Payable. In such cases, revenues and expenses are recorded when the services or goods are delivered or when the expense is incurred regardless of when the cash changes hands. This is referred to as *accrual-basis accounting*. So under accrual-basis accounting there are three possible scenarios of completing a business transaction: either cash is exchanged before, at the same time as, or after services are provided or goods are delivered. Let us focus on services for now.

Exhibit 3-1 illustrates the first scenario, where cash is exchanged prior to the service being provided or goods delivered.

First Scenario

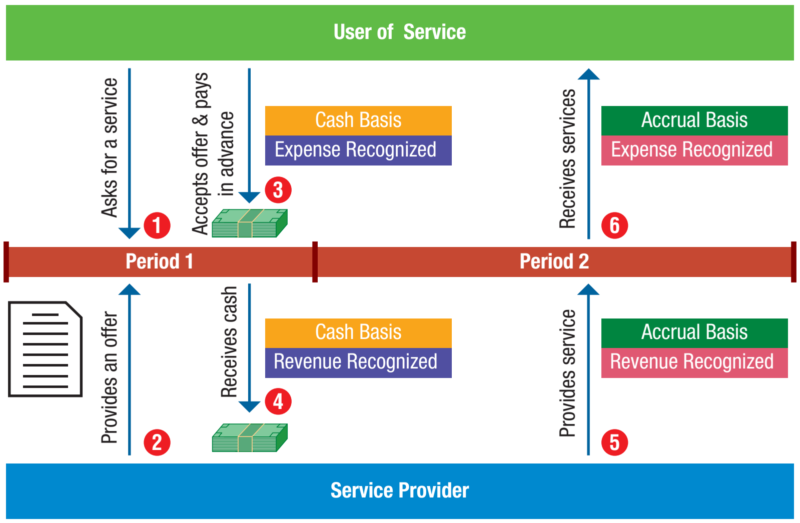


Exhibit 3-1

According to *cash-basis* accounting, revenues and expenses are recognized at *the time of cash transfer* regardless of when the services are provided (in Exhibit 3-1, expense is recognized for the user of service in step 3, and revenue is recognized for the service provided in step 4; in other words, recognition occurs in Period 1), while the *accrual basis* recognizes expenses and revenues based on *the timing of providing the service* regardless of the timing of transferring the cash (in Exhibit 3-1, expense is recognized for the user of service in step 5, and revenue is recognized for the service provided in step 6; in other words, in Period 2). In this case, from a service provider perspective, cash is received before revenue is earned, and therefore revenue is deferred (**unearned revenue**) until the service is provided. From a user of service perspective, payment might be paid for services prior to receiving those services from the supplier. In this case, cash is paid before an expense is incurred, and therefore the expense is deferred (prepaid) until it is consumed. When cash is received for services prior to the recognition of revenue, or cash is paid for services prior to the recognition of the expense, it is called a **deferral** (deferred revenues or deferred expenses, respectively).

Exhibit 3-2 illustrates the second scenario of completing a business transaction, where cash is exchanged at the time of providing the service.

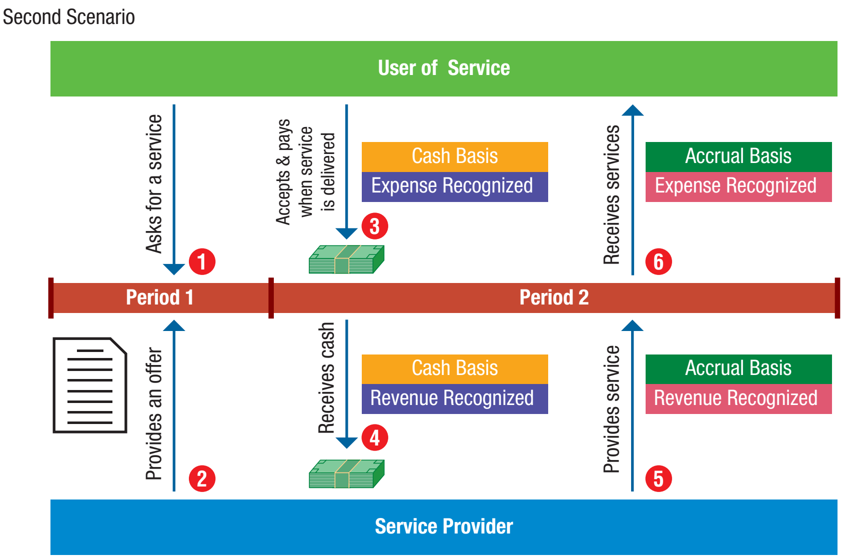


Exhibit 3-2

Both cash and accrual-basis accounting recognize revenues and expenses at the same point of time (Period 2) when cash is exchanged at the time of providing the service. In such a case there would be no difference between the two bases.

Exhibit 3-3 illustrates the third scenario, where cash is exchanged after providing the service or delivering the goods.

Since the service is provided before the cash is exchanged, accrual-basis accounting would recognize the revenues and expenses before the cash basis would. Referring to Exhibit 3-3, the service provider recognized revenue in step 4 when the service is delivered before receiving the cash in step 6 (Period 3) if *accrual-basis* accounting is implemented. However, revenue will only be recognized in step 6 (Period 3) if *cash-basis* accounting is implemented. From a user of service perspective under the *accrual basis*, Third Scenario

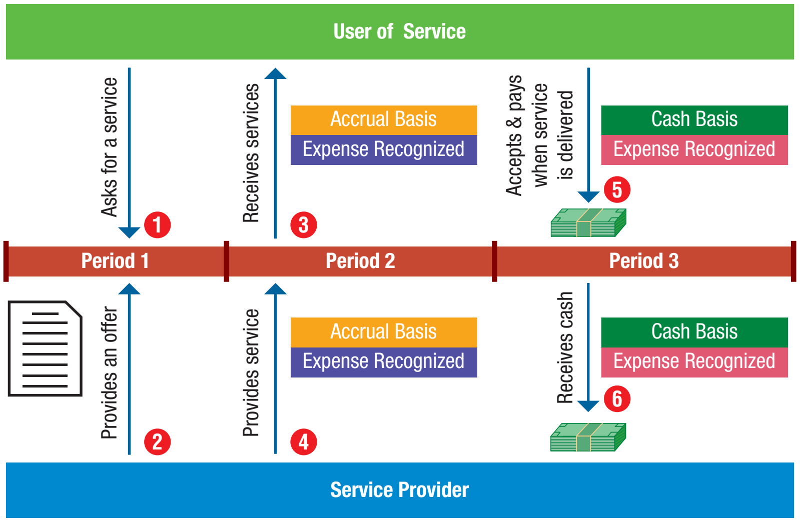


Exhibit 3-3

the expense will incur on step 3 (Period 2) when the service is used. However, under the *cash basis* the expense will only be recognized when the cash is paid in step 5 (Period 3).

Most businesses apply accrual-basis accounting because it reflects the business's performance more accurately than the cash basis since it recognizes revenues and expenses when services are provided or goods are delivered. Because the timing of transferring cash would differ from the timing of providing services or delivering goods, the cash basis would not reflect actual performance and hence it is not accurate in measuring business performance. In Exhibit 3-3, for example, all the efforts have been made in Period 2; however, the cash basis only recognized revenue in Period 3. For this reason, various accounting standards, such as IFRS and ASPE, require the use of accrual accounting. Accruals and deferrals can be summarized as follows:

3.1 **STILL DON'T GET IT?**
Visit MyAccountingLab for an alternate explanation of this important accounting concept.

	Now	Later
Accrued Revenue	Revenue is recognized	Cash is received
Accrued Expense	Expense is recognized	Cash is paid
Deferred (Unearned) Revenue	Cash is received	Revenue is recognized
Deferred (Prepaid) Expense	Cash is paid	Expense is recognized

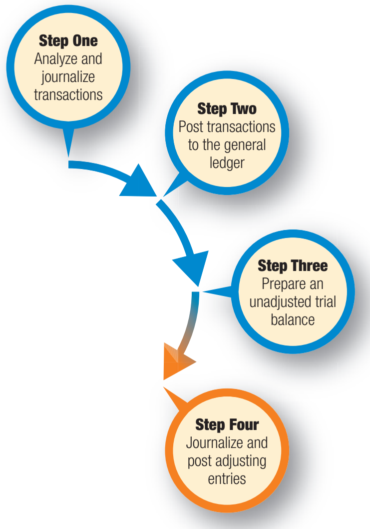
As we saw in Chapter 2, a business records transactions throughout the accounting period as the transactions occur. At the end of the period, the accountant prepares a trial balance and uses it to prepare financial statements. However, before most businesses can prepare accurate, up-to-date financial statements, the accountant will have to prepare **adjusting entries**.

WHAT IS THE ROLE OF ADJUSTING ENTRIES, AND WHEN ARE THEY PREPARED?

L.O. 2 Understand the four types of adjustments and prepare adjusting entries

Adjusting entries are journal entries that are needed at the end of the period to ensure that all revenues and expenses incurred during the period are recognized.

Adjustments may be needed for *accruals* when revenues have been earned or expenses incurred before cash is exchanged. Since cash has not been exchanged, it is possible that the revenue or expense has not been recorded. Hence, an adjusting entry is needed to record the revenue or expense. On the other hand, a *deferral* is created when cash is exchanged before the related revenue or expense is recognized. Adjustments may be needed for deferrals when revenues have been earned or expenses incurred during the period. Since cash has been exchanged in advance, it is possible that the revenue or expense has not been updated after being earned. **Exhibit 3-4** summarizes the required adjustments for both revenues and expenses under accrual accounting.



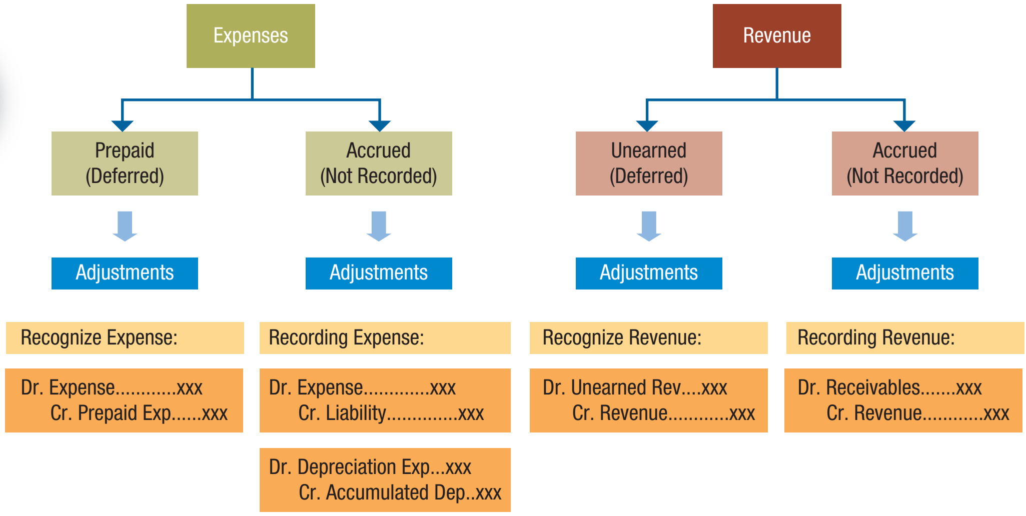


Exhibit 3-4

MEMORY TIPS
Trial balances must balance at all times.

At the end of the accounting period, accountants prepare a trial balance from the account information contained in the general ledger. This trial balance lists most of the revenues and expenses of the business, but these amounts are incomplete because the adjusting entries have not yet been prepared. Therefore, this trial balance is called an **unadjusted trial balance** (step three in the accounting cycle). Remember Hooray Consulting, Inc. from Chapter 2? **Exhibit 3-5** shows the unadjusted trial balance for Hooray Consulting at the end of its first quarter of operations at March 31, 2015.

Remember from Chapter 2 that transactions are recorded in the journal and posted to accounts in the general ledger. This process is still performed when adjusting the accounts. In this chapter, we will show how to record adjusting entries and how to post them to accounts. However, instead of using the real ledger account form, we will post adjustments to T-accounts. We use this method because it is easier to see how these entries affect the specific accounts as well as the accounting equation.

ADJUSTING ENTRIES FOR EXPENSES

Expenses need adjustments if there are accrued expenses that haven't been recorded or prepaid expenses that have been used up during the period.

Hooray Consulting, Inc. (Unadjusted) Trial Balance March 31, 2015		
	BALANCE	
ACCOUNT TITLE	DEBIT	CREDIT
Cash	$26,300	
Accounts Receivable	8,100	
Supplies	900	
Prepaid Rent	3,000	
Equipment	12,600	
Accounts Payable		$13,100
Unearned Service Revenue		450
Note Payable		5,000
Common Shares		20,000
Retained Earnings		10,150
Dividends	3,200	
Service Revenue		7,000
Salaries Expense	1,200	
Utilities Expense	400	
Total	$55,700	$55,700

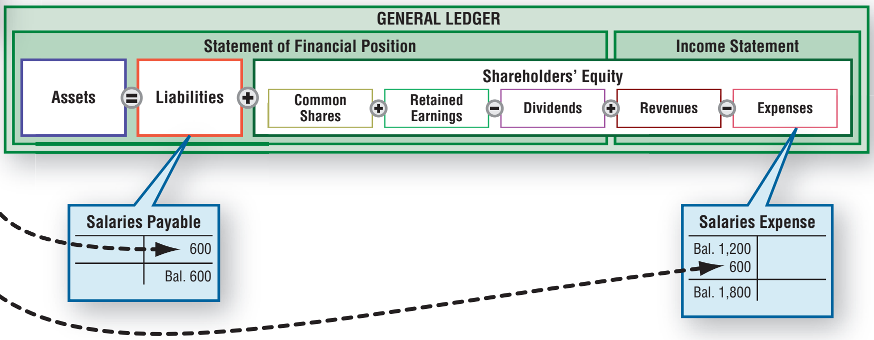
Exhibit 3-5

Adjusting Accrued Expenses

If an expense is accrued and not recorded, this will result in net income being inflated since expenses would be understated. To adjust that, the accrued expense must be debited and a liability must be credited. Let's look at some examples.

Salaries Payable: Suppose Hooray Consulting pays its employee a monthly salary of $600. Hooray pays the employee on the 15th of each month for the past month's work. So, on March 15, when salaries are paid, salaries expense is debited and cash is credited. On March 31, the following adjustment must be made to record the salaries expense for March:

GENERAL JOURNAL			
Date	Account	Debit	Credit
Mar 31	Salaries Expense	600	
	Salaries Payable		600



This is referred to as accruing the expense. **Accrued expenses**, such as the accrual for salaries expense, are expenses that the business has incurred but not paid.

Interest Payable: Businesses pay interest on loans. Interest is payable at a specific point in time, but interest accumulates during the period. At the end of the period, interest that has accumulated and not been paid should be recognized as an expense and a liability should be recorded.

Suppose Hooray Consulting, Inc. had obtained a loan for \$5,000 on March 1 and signed a six-month note payable bearing interest of 6%. Interest accrues during the month, and the interest due is calculated as follows:

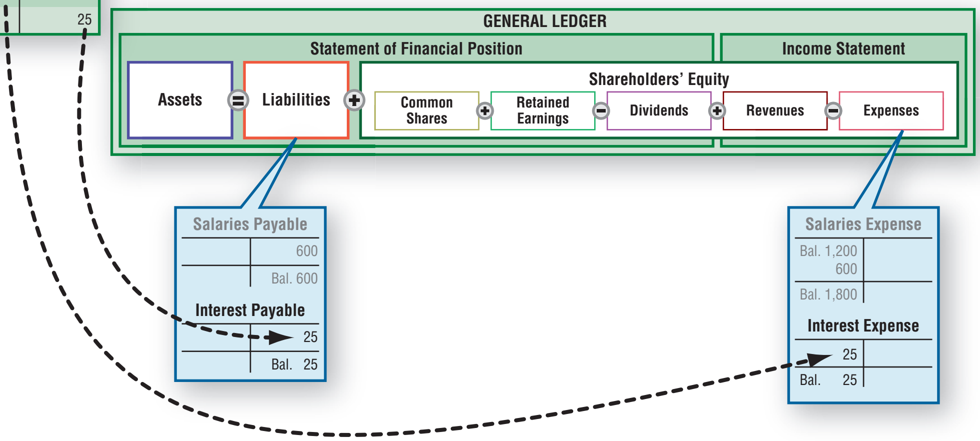
$$\text{Principal amount} \times \text{Interest rate} \times \text{period of time}$$

$$\$5{,}000 \times 6\% \times 1/12 = \$25$$

Assets	=	Liabilities	+	Shareholders' Equity
		+25		−25

On March 31, the following adjustment must be made to record the interest expense for the month of March:

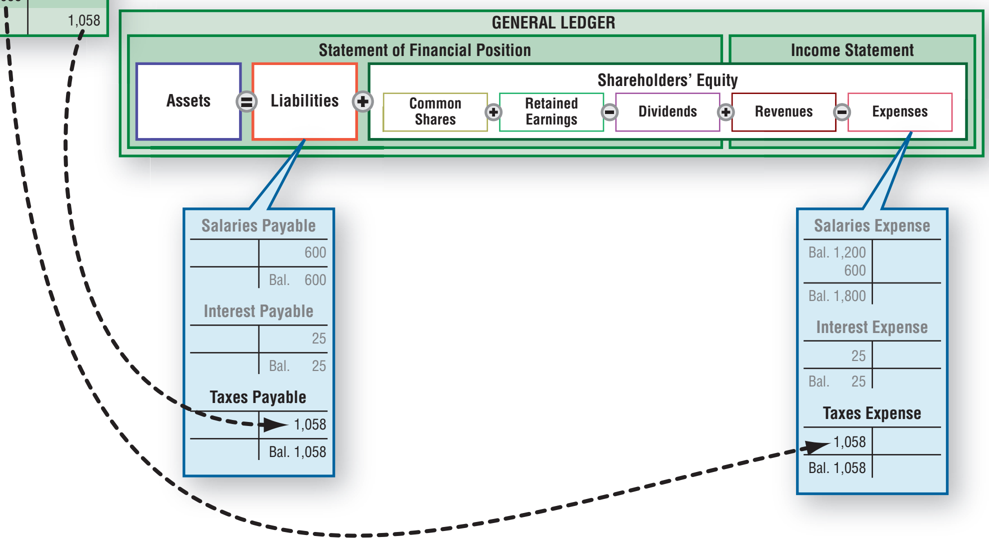
GENERAL JOURNAL			
Date	**Account**	**Debit**	**Credit**
Mar 31	Interest Expense	25	
	Interest Payable		25



Income Tax Payable: Suppose Hooray Consulting, Inc. had calculated its taxes to be \$1,058. Taxes are regarded as an expense because they decrease shareholders' equity. However, Hooray will not make the income tax payment to CRA (Canada Revenue Agency) on March 31. Therefore, Hooray needs to recognize a liability to CRA. On March 31, the following adjustment must be made to record the tax expense for the month of March:

Assets	=	Liabilities	+	Shareholders' Equity
		+1,058		−1,058

GENERAL JOURNAL			
Date	**Account**	**Debit**	**Credit**
Mar 31	Taxes Expense	1,058	
	Taxes Payable		1,058



Adjusting Prepaid Expenses

When an expense is paid in advance, such as prepaid rent or prepaid insurance, an asset account is created and it is debited by the appropriate amount. Prepaid expenses, also called **deferred expenses**, represent items that are paid for before they are used; as time passes, these assets are used up. Accordingly, at the end of the period an adjusting entry is needed to reduce the asset account by crediting it and to increase the expense account by debiting it. Let's have a closer look at some types of prepaid expenses.

MEMORY TIPS

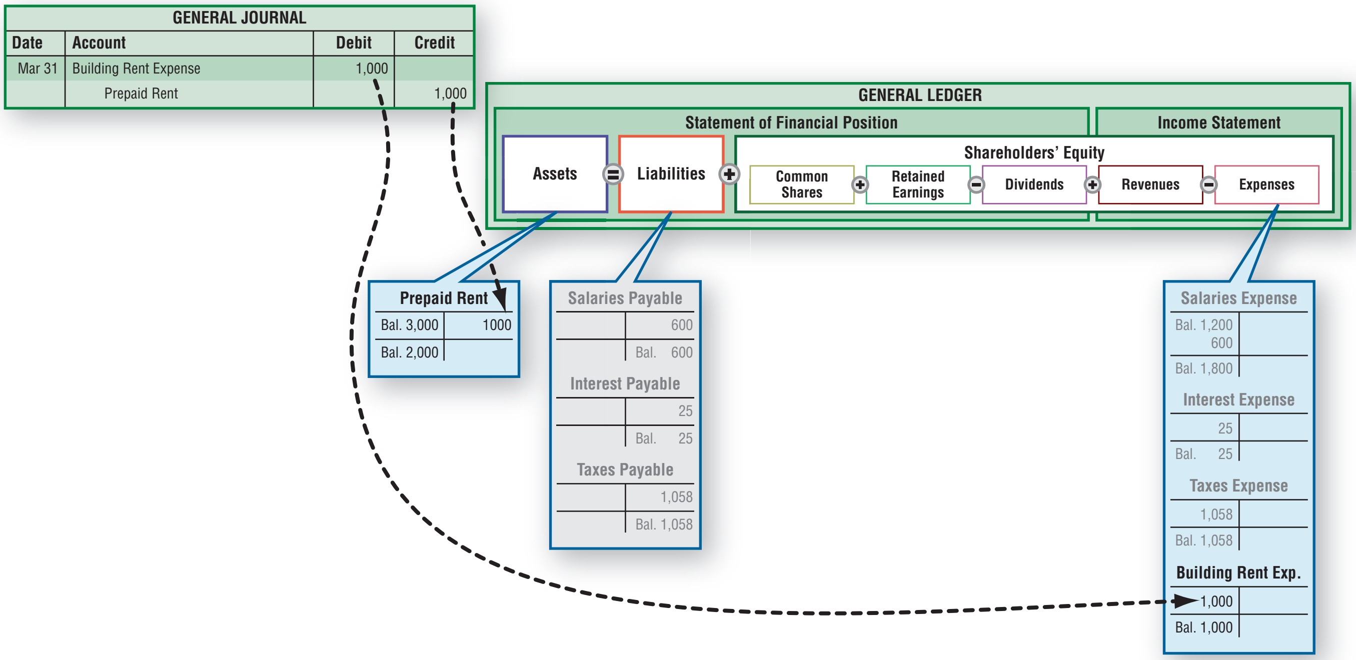
Prepaid expenses are assets.

Prepaid Rent: Suppose Hooray Consulting, Inc. moves to a new office and prepays three months' office rent on March 1, 2015. If the lease specifies a monthly rental of $1,000, the amount of cash paid is $3,000 ($1,000 × 3 months). The entry to record the payment is as follows:

DATE	ACCOUNTS	POST REF.	DR.	CR.
Mar 1	Prepaid Rent		3,000	
	Cash			3,000
	Paid three months' rent in advance.			

After posting, Prepaid Rent has a $3,000 debit balance. During March, Hooray Consulting has used the rented space for one month; therefore, the balance in Prepaid Rent is reduced by $1,000 (one month's rent). The required adjusting entry is as follows:

Assets	=	Liabilities	+	Shareholders' Equity
3,000				
−3,000				



The Building Rent Expense account is increased with a debit, which reduces Retained Earnings and, therefore, Shareholders' Equity. The asset account Prepaid Rent is decreased with a credit for the same amount. After posting, Prepaid Rent and Building Rent Expense show the correct ending balances.

Assets	=	Liabilities	+	Shareholders' Equity
−1,000				−1,000

If Hooray Consulting, Inc. had prepaid insurance, the same analysis would also apply to this asset account. The difference in the adjusting entry would be in the account titles, which would be Prepaid Insurance instead of Prepaid Rent and Insurance Expense instead of Building Rent Expense. The amount of the entry would also be different.

Supplies: Supplies receive the same treatment as prepaid expenses. On March 5, Hooray Consulting pays $900 for office supplies. The asset accounts Supplies and Cash are both affected—supplies increase by $900 while Cash decreases by $900, as shown here:

DATE	ACCOUNTS	POST REF.	DR.	CR.
Mar 5	Supplies		900	
	Cash			900
	Purchased office supplies.			

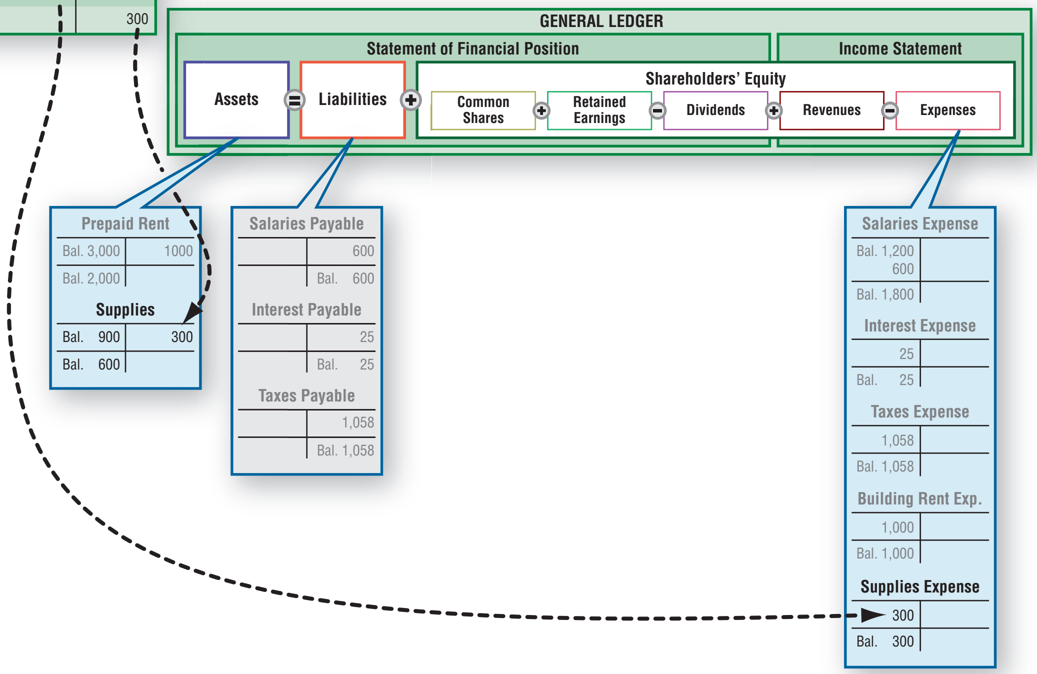
Assets = Liabilities + Shareholders' Equity
900
−900

During March, Hooray Consulting uses some of these supplies to conduct business. Therefore, Hooray Consulting's March 31 statement of financial position should *not* report supplies of $900. To figure out the amount of supplies used, Hooray Consulting counts the supplies on hand at the end of March, which are still an asset to the business. Assume that Hooray Consulting has supplies costing $600 at March 31. The supplies purchased ($900) minus the supplies on hand at the end of March ($600) equals the value of the supplies used during the month ($300). The amount of supplies used during the month will become the Supplies Expense. The March 31 adjusting entry updates the Supplies account and records Supplies Expense for the month:

Assets = Liabilities + Shareholders' Equity
−300 −300

GENERAL JOURNAL

Date	Account	Debit	Credit
Mar 31	Supplies Expense	300	
	Supplies		300



After the entry is posted to the general ledger, the correct account balances for Supplies and Supplies Expense are reflected.

Depreciation of Long-Term Assets: **Long-term assets** are assets that last for more than one year or one operating cycle, whichever is longer. Examples include land, buildings, equipment, and furniture. All of these assets (except land) are used up over time. As a long-term asset is used up, part of the asset's cost becomes an expense, just as supplies become supplies expense when they are used up. Expensing a long-term asset's cost over its useful life is called **depreciation**. No depreciation is recorded for land because it is never really used up.

We account for long-term assets in the same way as prepaid expenses and supplies because they are all assets. The major difference is the length of time it takes for the asset to be used up. Prepaid expenses and supplies are typically used within a year, while most long-term assets remain functional for several years. Suppose that on March 1 Hooray Consulting purchases equipment on account for $12,600 and records this journal entry:

DATE	ACCOUNTS	POST REF.	DR.	CR.
Mar 1	Equipment		12,600	
	Accounts Payable			12,600
	Purchased equipment on account.			

Assets = Liabilities + Shareholders' Equity
+12,600 = +12,600

After posting the entry, the Equipment account has a $12,600 balance. It is difficult to measure the amount of a long-term asset that has been used up over time, so the amount must be estimated. Several methods can be used to estimate the amount of depreciation. The most common method, which Hooray Consulting, Inc. uses, is called the **straight-line depreciation** method. Hooray Consulting believes the equipment will be useful for three years and will be worthless and have no **salvage (or residual) value** at the end of its life. Depreciation of this equipment is calculated using the straight-line method as follows:

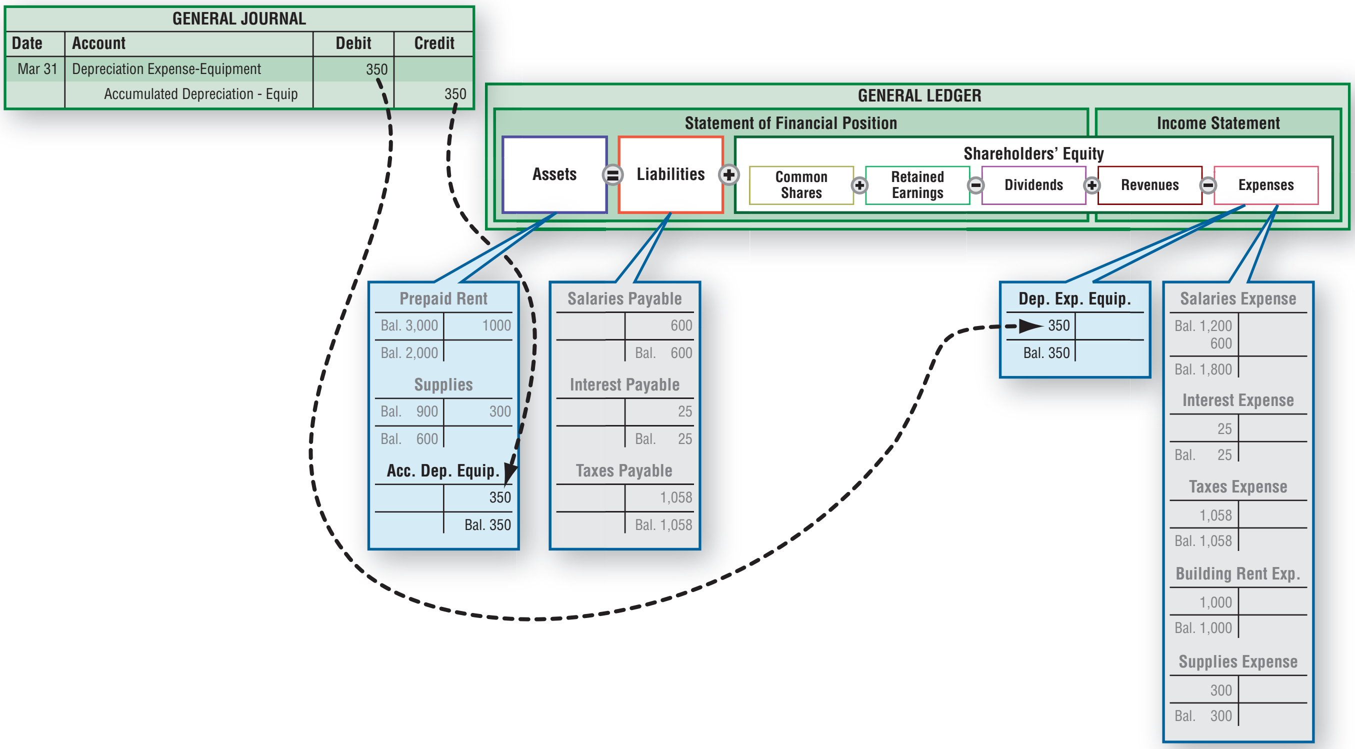
$$\text{Depreciation Expense per Year} = \frac{\text{Cost of Asset} - \text{Salvage Value of Asset}}{\text{Useful Life of Asset}} = \frac{\$12{,}600}{3} = \$4{,}200$$

Because Hooray Consulting purchased the equipment in the month of March, the accountant needs to calculate one month's depreciation expense. To do so, divide the yearly depreciation by twelve ($4,200/12 months = $350).

The Accumulated Depreciation Account: The depreciation expense for March is recorded by debiting the account Depreciation Expense. However, instead of crediting the asset account (as with supplies and prepaid expenses) to reduce it, an account called **Accumulated Depreciation**—Equipment will be credited. This is because the asset itself does not vanish, as in the case of supplies.

Assets = Liabilities + Shareholders' Equity
−350 −350

The journal entry to record depreciation expense for the month of March is as follows:



Accumulated Depreciation—Equipment is a contra-asset account. A **contra-account** has three main characteristics:

- It is linked to another account and will always appear with this account in the financial statements.
- The normal balance is always opposite of the account it is linked to.
- The balance is subtracted from the balance of the account it is linked to in order to find the **net value** of the two accounts.

Because it is linked to Equipment (an asset account), Accumulated Depreciation—Equipment will appear on the statement of financial position. Being an asset, the Equipment account has a debit balance, so the Accumulated Depreciation—Equipment account will have a credit balance because it is a contra-asset account. Since it's a contra-account, the balance of Accumulated Depreciation—Equipment is subtracted from Equipment. The net amount of a long-term asset is called its **book value**, or **carrying value**, and is calculated as follows:

	Book Value of a Long-Term Asset	
Cost	Equipment..	$12,600
− Accumulated Depreciation	Less: Accumulated Depreciation, Equipment.........	350
= Book (or Carrying) Value	Book Value..	$12,250

Accumulated Depreciation—Equipment increases over the life of the asset as the asset is used up, which reduces the book value of the equipment. By keeping the cost of the equipment separate from its accumulated depreciation, financial statement users can look at the Equipment account to see how much the asset originally cost and also look at the Accumulated Depreciation—Equipment account to see how much of the original cost has been used up. A business usually keeps an Accumulated Depreciation account for each type of depreciable long-term asset. If Hooray Consulting, Inc. had both buildings and equipment, it would use two Accumulated Depreciation accounts: Accumulated Depreciation—Buildings and Accumulated Depreciation—Equipment. Depreciation will be covered in more depth in Chapter 8.

An Alternate Way to Record Prepaid Expenses

Some accountants would find it more practical to record some prepaid expenses as expenses when they are first paid. If the prepaid expense is consumed totally during the period, then the accountant doesn't need to do any adjustments. However, if it is not totally consumed, an adjusting entry is required. To illustrate, assume that a company bought supplies on March 1 for $500 in cash. The accountant would record the total amount as an expense as follows:

DATE	ACCOUNTS	POST REF.	DR.	CR.
Mar 1	Supplies Expense		500	
	Cash			500
	Purchase of supplies to be used during the period.			

Assets	=	Liabilities	+	Shareholders' Equity
−500	=			−500

On March 31, a physical count is taken and if the supplies are used up, then nothing further is required to be done. However, let's assume that $200 worth of supplies are left. In such a case, an adjusting entry is required to recognize the existence of supplies as an asset and to decrease the expense which is now overstated by $200. The following entry is required:

DATE	ACCOUNTS	POST REF.	DR.	CR.
Mar 31	Supplies		200	
	Supplies Expense			200
	Adjusting the supplies expense and recognizing the supplies on hand.			

The previous entry increased the assets (in the form of supplies) by the amount of supplies on hand, and decreased the expense Supplies Expense (hence increasing shareholder's equity) since the Supplies Expense account was previously debited by $500, while it should be debited by $300 only. The following T-account shows the balance of the Supplies Expense account after the adjustments are done:

Assets	=	Liabilities	+	Shareholders' Equity
+200	=			+200

Supplies Expense

Mar 1		$500	Mar 31	Adj.	$200
Mar 31	Bal.	$300			

3.2 **STILL DON'T GET IT?**

Visit MyAccountingLab for an alternate explanation of this important accounting concept.

CONCEPT CHECK...

Jim Oda is the accountant for Crazy Critters, Inc., a local veterinary clinic. After Jim finished preparing the financial statements for the year, he realized that he had failed to make an adjusting entry to record $1,800 of depreciation expense for the year. What effect does this error have on Crazy Critter's financial statements?

Answer: To determine the effect of omitting an adjusting entry, we must examine what the adjusting entry should have been. The adjusting entry Jim should have recorded is as follows:

DATE	ACCOUNTS	POST REF.	DR.	CR.
	Depreciation Expense		1,800	
	Accumulated Depreciation			1,800

As we can see from the journal entry, Depreciation Expense should have been debited (increased), which would have increased total expenses for the year. An increase in total expenses causes a decrease in net income. So the omission of the adjusting entry for depreciation expense causes net income, and therefore retained earnings, to be overstated. We also see that the Accumulated Depreciation account should have been credited (increased), which would cause total assets to decrease because Accumulated Depreciation is a contra-asset account. So the omission of the adjusting entry for depreciation expense also causes the total assets to be overstated.

Assets	=	Liabilities	+	Shareholders' Equity
−1,800	=			−1,800

ADJUSTING ENTRIES FOR REVENUES

L.O. 2 Understand the four types of adjustments and prepare adjusting entries

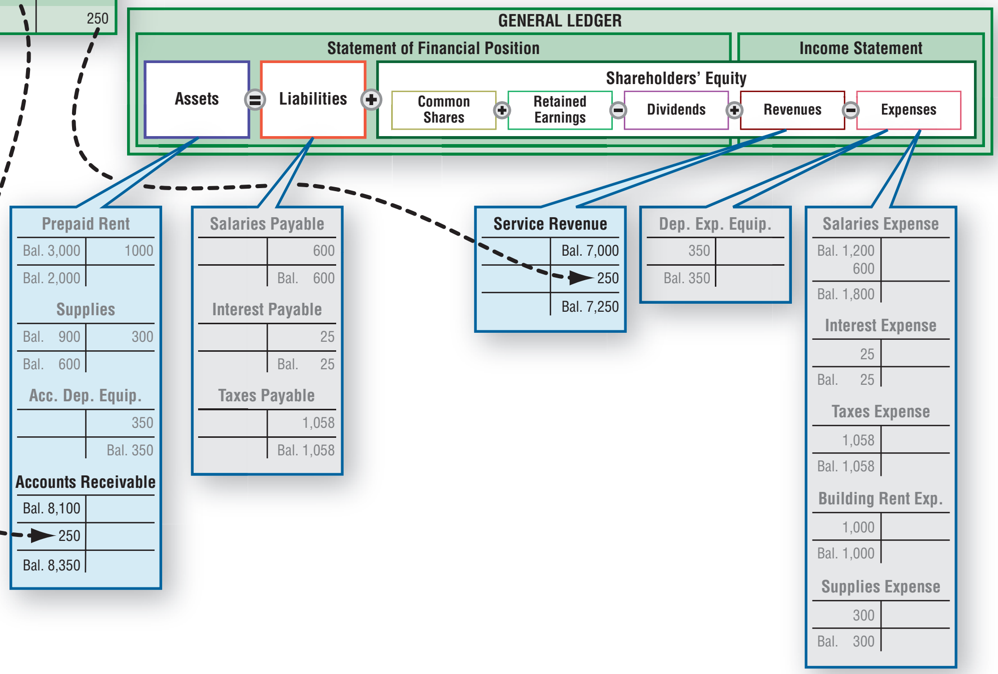
Revenues need adjustments if there are accrued revenues that haven't yet been recorded or if there are unearned revenues that have either partially or totally been earned during the period. Let's have a closer look at some types of accrued revenues.

Accounts Receivable

Businesses sometimes earn revenue by providing goods or services before they receive cash. Assume that a local car dealership hires Hooray Consulting, Inc. on March 15 as a computer consultant. Hooray Consulting, Inc. agrees to a monthly fee of $500, which the car dealership pays on the 15th of each month beginning on April 15. During March, Hooray earns half a month's fee, $250 ($500 × 1/2 month), for consulting work performed March 15 through March 31. On March 31, Hooray makes the following adjusting entry to reflect the accrual of the revenue earned during March (the beginning balance of each account is found on the unadjusted trial balance presented in Exhibit 3-5):

Assets	=	Liabilities	+	Shareholders' Equity
+250				+250

GENERAL JOURNAL			
Date	Account	Debit	Credit
Mar 31	Accounts Receivable	250	
	Service Revenue		250



Without the adjustment, Hooray Consulting's financial statements are inaccurate because they would understate both Accounts Receivable and Service Revenue.

Adjusting Deferred (Unearned) Revenues

MEMORY TIPS
Unearned Revenue is a liability.

It is possible for a business to collect cash from customers prior to providing goods or services. Receiving cash from a customer before earning it creates a liability called unearned revenue, or **deferred revenue**. It is classified as a liability because the company owes a product or service to the customer. Even though the account has the word "revenue" in its title, it is not a revenue account because the amounts in the account represent what has *not* yet been earned.

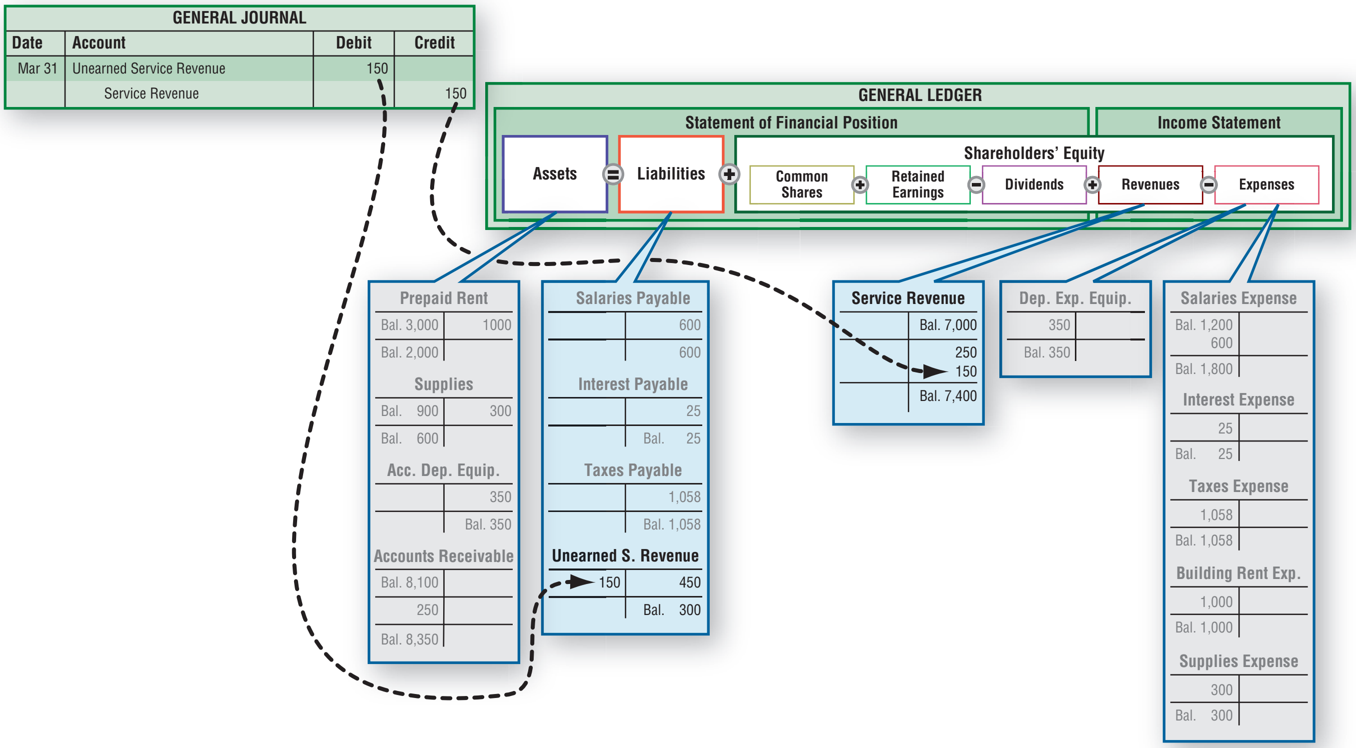
Assets	=	Liabilities	+	Shareholders' Equity
+450	=	+450		

Suppose a local real estate agency hires Hooray Consulting to provide consulting services, agreeing to pay $450 monthly, beginning immediately. Hooray Consulting collects the first amount from the real estate agency on March 21. Hooray Consulting records the cash receipt and a liability as follows:

DATE	ACCOUNTS	POST REF.	DR.	CR.
Mar 21	Cash		450	
	Unearned Service Revenue			450
	Collected revenue in advance.			

The liability account Unearned Service Revenue now shows that Hooray Consulting owes $450 of services because of its obligation to provide consulting services to the real estate agency.

During the last 10 days of March, Hooray Consulting earned one-third of the $450, or $150 ($450 × 1/3). Therefore, Hooray Consulting makes the following adjustment to record earning $150 of the revenue:



Service Revenue increases by $150, and Unearned Service Revenue decreases by $150. Now both accounts are up to date at March 31.

An Alternate Method for Adjusting Unearned Revenues

Some accountants will find it more practical to record all the cash collected in advance to provide service or to deliver goods as revenue. Then at the end of the period, if the service is not provided or the goods are not delivered, an adjusting entry is recorded; otherwise, nothing is required. To illustrate, assume that a customer paid a consulting company $1,000 on March 15 to provide consulting services. The accountant using such a method would record the entry as follows when the cash is received:

Assets	=	Liabilities	+	Shareholders' Equity
+1,000	=			+1,000

DATE	ACCOUNTS	POST REF.	DR.	CR.
Mar 15	Cash		1,000	
	Consulting Revenue			1,000
	Received cash for consulting services.			

3.3 STILL DON'T GET IT?

Visit MyAccountingLab for an alternate explanation of this important accounting concept.

If at the end of March the accountant found that all the services had been provided, and since revenue is already credited when the cash was collected, nothing further is required to be done. However, let's assume that only $600 worth of services is provided and the rest will be provided next month. In such a case an adjusting entry is needed to reduce March's revenue and to recognize a liability of $400. The following entry would be required:

Assets	=	Liabilities	+	Shareholders' Equity
	=	+400		−400

DATE	ACCOUNTS	POST REF.	DR.	CR.
Mar 15	Consulting Revenue		400	
	Unearned revenue			400
	Decreasing the consulting revenue by the value of services that are not provided and recognizing it as a liability.			

ACCOUNTING IN YOUR WORLD

StreetStock/Alamy

To better understand the difference between a prepaid expense and an unearned revenue, consider this example:

At the start of this semester in school, you paid your school the tuition that was due for the upcoming term. Your tuition will ultimately be an expense to you. However, before the term began, the amount you paid was not yet an expense to you because the school had not yet provided any classes. In other words, you had not yet received anything for your payment. Instead, the amount you paid represented an asset known as a prepaid expense. It was an asset because the school owes you either the classes or your money back.

Once classes started, you began to incur an expense. Technically, the amount of your asset, prepaid expense, would have decreased and the amount of your expenses would have increased every day. By the end of the semester, none of the tuition you paid would be considered to be a prepaid expense. Instead, it becomes an expense.

Now, let's look at the same example from the perspective of your school. When your school received the tuition payment from you, it did not have the right to record it as a revenue because it had not provided you with any classes. Instead, the school would record your tuition as a liability called unearned revenue. Unearned revenue represents a liability to the school because the school owes you either the classes or your money back.

Once classes started, your school began to earn revenue. The amount of its unearned revenue would have decreased and the amount of its revenue would have increased. By the end of the semester, the entire amount of tuition you paid would be considered to be revenue to your school. As you can see, one entity's prepaid expense is another entity's unearned revenue and vice versa.

DECISION GUIDELINES

DECISION	GUIDELINE	ANALYZE
I'm a new manager for a company, and I noticed that cash is collected in advance before the service is rendered. However, it is recorded as Service Revenue, assuming that service is going to be provided during the period. Can I trust the income figure?	To produce accurate income measurement, the revenue and expense recognition principle should be followed.	The income figure cannot be trusted without making the necessary adjustments. The revenue recognition principle requires that revenues be recorded only when they are earned regardless of when cash is received. The expense recognition principle requires that expenses are recorded only when they incur regardless of when the cash is paid. When the revenue and expense recognition principle is followed it is referred to as *accrual accounting*. The resulting income figure would then reflect the real performance.

CRITICAL THINKING

Take a minute to think about the impact of the errors in the following independent cases on each of the assets, liabilities, and shareholders' equity accounts, based on each of the scenarios. What are the entries required to make the account balance correct? Who might have found these errors?

- Depreciation of $1,000 on a delivery truck was debited as Depreciation Expense $1,000, and credited as Delivery Truck $1,000.
- An annual insurance premium of $1,200 was originally recorded in the Insurance Expense account. Four months of insurance premium have expired. No adjusting entry was made at the year end.
- A receipt of $6,000 from a customer for a three-month service contract was originally recorded in the Service Revenue account. One month of service has been provided. No adjusting entry was made at the year end.

Solution:

	Impact on Accounts					
	Assets	Liabilities	Shareholders' Equity	Required Entries to Correct Account Balances	Debit	Credit
1.	No	No	No	(a) Delivery Truck	1,000	
	There is no impact on the Assets account since the error involved recording the increase in the Accumulated Depreciation account as a reduction in the Delivery Truck account instead. The net effect on the total assets is the same.			Depreciation Expense		1,000
				(b) Depreciation Expense	1,000	
				Accumulated Depreciation, Delivery Truck		1,000
2.	Understated	No	Understated	(a) Prepaid Insurance	1,200	
	The Shareholders' Equity account is understated because the expenses are recorded too high, which reduced Retained Earnings and in turn reduces Shareholders' Equity.			Insurance Expense		1,200
				(b) Insurance Expense	400	
				Prepaid Insurance		400
3.	No	Understated	Overstated	(a) Service Revenue	6,000	
	Liabilities are understated because the Unearned Revenue account should have been increased, but wasn't.			Unearned Revenue		6,000
				(b) Unearned Revenue	2,000	
				Service Revenue		2,000

The first error may have been noticed by the manager responsible for the fleet of delivery trucks. The manager would notice that the recorded value of the trucks decreased for no reason. The second error would be spotted by the manager responsible for organizing the insurance. In a comparison from the previous year and the current year, there would be a noticeable increase in the insurance costs for the current year. The last error would be noticed by an internal auditor. The list of jobs that are not complete yet would not balance with the Unearned Revenue account since this job was not set up as a liability.

HOW ARE FINANCIAL STATEMENTS PREPARED FROM AN ADJUSTED TRIAL BALANCE?

THE ADJUSTED TRIAL BALANCE

L.O. 3 Prepare financial statements from an adjusted trial balance

Earlier in the chapter, the unadjusted trial balance in Exhibit 3-5 on page 141 showed the account balances for Hooray Consulting, Inc. before the adjustments had been made. After adjustment, Hooray Consulting's accounts would appear as presented in **Exhibit 3-6.**

Assets = Liabilities + Shareholders' Equity

Assets

Cash

Bal 26,300	

Accounts Receivable

Bal 8,100	
250	
Bal 8,350	

Supplies

Bal 900	300
Bal 600	

Prepaid Rent

Bal 3,000	1,000
Bal 2,000	

Equipment

Bal 12,600	

Accumulated Depreciation, Equipment

	350
	Bal 350

Liabilities

Accounts Payable

	Bal 13,100

Salaries Payable

	600
	Bal 600

Interest Payable

	Bal 25

Taxes Payable

	Bal 1,058

Unearned Service Revenue

150	Bal 450
	Bal 300

Notes Payable

	Bal 5,000

Shareholders' Equity

Common Shares

	Bal 20,000

Retained Earnings

	Bal 10,150

Dividends

Bal 3,200	

Service Revenue

	Bal 7,000
	250
	150
	Bal 7,400

Salaries Expense

Bal 1,200	
600	
Bal 1,800	

Interest Expense

Bal 25	

Taxes Expense

Bal 1,058	

Building Rent Expense

Bal 1,000	

Supplies Expense

Bal 300	

Depreciation Expense, Equipment

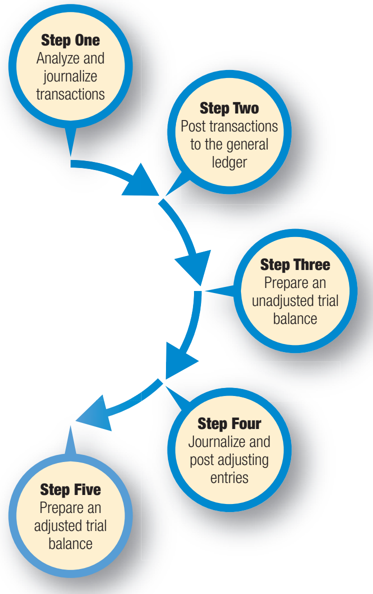
Bal 350	

Utilities Expense

Bal 400	

Exhibit 3-6

Prior to preparing the financial statements, an **adjusted trial balance** is prepared to make sure total debits still equal total credits after adjusting entries have been recorded and posted. The adjusted trial balance for Hooray Consulting is presented in **Exhibit 3-7**.



Hooray Consulting, Inc.
Adjusted Trial Balance
March 31, 2015

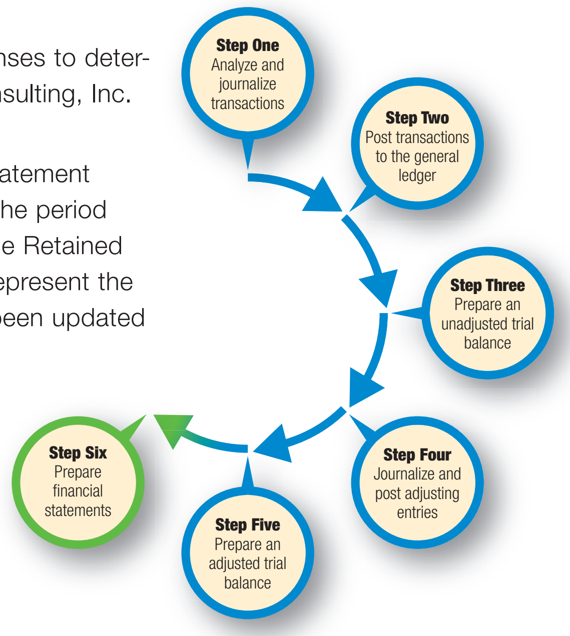
ACCT #	ACCOUNT	DEBIT	CREDIT
1010	Cash	$26,300	
1020	Accounts Receivable	8,350	
1030	Supplies	600	
1035	Prepaid Rent	2,000	
1040	Equipment	12,600	
1041	Accumulated Depreciation, Equipment		$ 350
2010	Accounts Payable		13,100
2020	Salaries Payable		600
2025	Interest Payable		25
2040	Unearned Service Revenue		300
2050	Taxes Payable		1,058
2080	Notes Payable		5,000
3010	Common Shares		20,000
3030	Retained Earnings		10,150
3040	Dividends	3,200	
4010	Service Revenue		7,400
5010	Salaries Expense	1,800	
5015	Building Rent Expense	1,000	
5030	Utilities Expense	400	
5040	Depreciation Expense, Equipment	350	
5050	Supplies Expense	300	
5060	Interest Expense	25	
5070	Tax Expense	1,058	
	Total	$57,983	$57,983

Exhibit 3-7

PREPARING THE FINANCIAL STATEMENTS

The March financial statements of Hooray Consulting, Inc. are prepared from the adjusted trial balance in Exhibit 3-7. The financial statements should be prepared in the same order that we used in previous chapters:

1. The income statement (**Exhibit 3-8**) reports the revenues and the expenses to determine net income or net loss for a period of time. Assume Hooray Consulting, Inc. pays 30% income tax on its profit.
2. The statement of retained earnings (**Exhibit 3-9**, a component of the statement of changes in equity) shows the changes in retained earnings during the period and computes the ending balance of retained earnings. Notice that the Retained Earnings balance of $10,150 on the adjusted trial balance does *not* represent the ending Retained Earnings balance because the account has not yet been updated for the current period's earnings or dividends.
3. The classified statement of financial position (**Exhibit 3-10**) reports the assets, liabilities, and shareholders' equity to see the financial position of the business at a specific point in time. There are two classes of assets: (a) current assets, which are assets that will be used or converted to cash within one year or one operating cycle, and (b) long-term assets, which will be kept for more than one year or one operating cycle.



3.4 **STILL DON'T GET IT?**
Visit MyAccountingLab for an alternate explanation of this important accounting concept.

Hooray Consulting, Inc.
Income Statement
Month Ended March 31, 2015

Revenue:		
Service Revenue		$7,400
Expenses:		
Salaries Expense	$1,800	
Building Rent Expense	1,000	
Utilities Expense	400	
Depreciation Expense—Equipment	350	
Supplies Expense	300	
Interest Expense	25	
Total Operating Expenses		3,875
Operating Income		3,525
Income Tax (30%)*		1,058
Net Income		$2,467

*During the preparation of the income statement, income taxes need to be recorded. At 30% of the income before taxes, the income tax expense becomes $3,525 × 30% = $1,058

Exhibit 3-8

Hooray Consulting, Inc.
Statement of Retained Earnings
Month Ended March 31, 2015

Retained Earnings, March 1, 2015	$10,150	
Add: Net Income	2,467	
Subtotal		12,617
Less: Dividends		3,200
Retained Earnings, March 31, 2015		$9,417

Exhibit 3-9

Hooray Consulting, Inc.
Statement of Financial Position
March 31, 2015

ASSETS			LIABILITIES		
Current Assets			Current Liabilities		
Cash	$26,300		Accounts Payable	$13,100	
Accounts Receivable	8,350		Salaries Payable	600	
Supplies	600		Unearned Service Revenue	300	
Prepaid Rent	2,000		Interest Payable	25	
Total Current Assets		$37,250	Income Tax Payable	1,058	
			Total Liabilities		$15,083
			Long Term Liabilities		
			Notes Payable	5,000	
			Total Long Term Liabilities		5,000
Equipment	$12,600		**SHAREHOLDERS' EQUITY**		
Less: Accumulated			Common Shares	$20,000	
			Retained Earnings	9,417	
Depreciation—Equipment	350	12,250	Total Shareholders' Equity		29,417
			Total Liabilities &		
Total Assets		$49,500	Shareholders' Equity		$49,500

Exhibit 3-10

As we first discussed in Chapter 1, all financial statements include these elements:

- Heading
  1. Name of the entity, such as Hooray Consulting, Inc.
  2. Title of the statement: income statement, statement of retained earnings, statement of financial position
  3. Date or period covered by the statement: Month ended March 31, 2015, or March 31, 2015
- Body of the statement

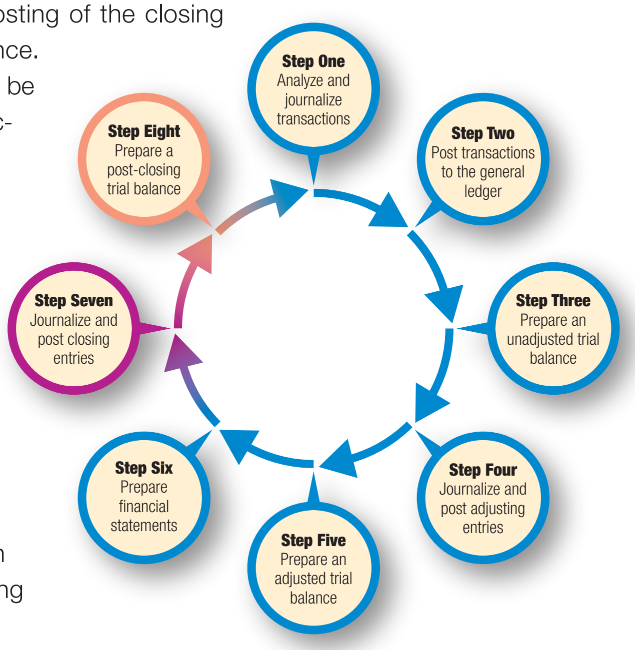
HOW DOES A COMPANY PREPARE FOR A NEW ACCOUNTING PERIOD?

COMPLETING THE ACCOUNTING CYCLE

L.O. 4 Prepare closing entries and a post-closing trial balance

We have now seen steps one through six in the accounting cycle completed for Hooray Consulting. The entire accounting cycle can be completed by finishing steps seven and eight. Step seven of the accounting cycle is the journalizing and posting of the closing entries, and step eight is the preparation of a post-closing trial balance.

In order to complete the accounting cycle, **closing entries** must be journalized and posted. Earlier in the chapter, we processed the transactions for Hooray Consulting and prepared the financial statements for the month of March. If we continue recording information in the revenue, expense, and dividend accounts, we will lose track of what activity happened in March compared to what happens in April, making it impossible to prepare accurate financial statements for the month of April.



In order to not confuse the transactions from the two different months, the revenue, expense, and dividend accounts must be reset back to zero before we start recording transactions for April. It is similar to resetting the scoreboard at the end of a game before you start a new game. Since we must keep the accounting equation in balance, we cannot just erase the balances in the revenue, expense, and dividend accounts. To keep the accounting equation in balance and still be able to zero out these accounts, we will use closing entries. Closing entries are utilized to accomplish two things:

- The revenue, expense, and dividend account balances from the current accounting period are set back to zero so that accounting for the next period can begin.
- The revenue, expense, and dividend account balances from the current accounting period are transferred into Retained Earnings so that the accounting equation stays in balance. Transferring the revenue and expense account balances into retained earnings actually transfers the net income, or net loss, for the current period into Retained Earnings. Transferring the dividend account balance into Retained Earnings decreases Retained Earnings by the amount of dividends for the period.

The revenue, expense, and dividend accounts are known as **temporary accounts**. They are called temporary because they are used temporarily to record activity for a specific period, the accounting period, and then they are closed into Retained Earnings. It is easy to remember the temporary accounts if you think of the color RED. The R in RED stands for revenues, the E stands for expenses, and the D stands for dividends. The RED accounts are closed at the end of each accounting period.

MEMORY TIPS

REVENUE

EXPENSES

DIVIDENDS

RED

Accounts are closed at the end of the period.

Before closing the accounts, the accounting equation for a corporation would be as follows:

				Shareholders' Equity				
Assets	=	Liabilities	+	Common Shares	+ Retained Earnings	− Dividends	+ Revenues	− Expenses

After closing the accounts, the accounting equation would be as follows:

				Shareholders' Equity	
Assets	=	Liabilities	+	Common Shares	+ Retained Earnings

The accounts that remain in the accounting equation after closing are called **permanent accounts**. Assets, liabilities, common shares, and retained earnings are *not* closed at the end of the period because they are not used to measure activity for a specific period. Consider Cash, Accounts Receivable, Accounts Payable, and Common Shares. These accounts do not represent business activity for a single period, so they are not closed at the end of the period. Their balances carry over to the next period. For example, the Cash balance at March 31, 2015, becomes the beginning balance on April 1, 2015.

THE THREE CLOSING ENTRIES: REVENUES, EXPENSES, AND DIVIDENDS

To journalize closing entries, complete the following steps:

Step 1 Close the revenue accounts and move their balances into the Retained Earnings account. To close revenues, debit each revenue account for the amount of its credit balance. Transfer the revenue balances to Retained Earnings by crediting the Retained Earnings account for the total amount of the revenues. This closing entry transfers total revenues to the credit side of Retained Earnings.

Step 2 Close the expense accounts and move their balances into the Retained Earnings account. To close expenses, credit each expense account for the amount of its debit balance. Transfer the expense balances to Retained Earnings by debiting the Retained Earnings account for the total amount of the expenses. This closing entry transfers total expenses to the debit side of Retained Earnings.

Step 3 Close the Dividends account and move its balance into the Retained Earnings account. To close the Dividends account, credit it for the amount of its debit balance and debit the Retained Earnings account. This entry transfers the dividends to the debit side of Retained Earnings.

Remember that net income is equal to revenues minus expenses. So, closing the revenues and expenses into retained earnings, Steps 1 and 2, has the effect of adding net income for the period to, or deducting a net loss for the period from, retained earnings. Once the Dividends account has been subtracted from retained earnings, Step 3, the balance in the retained earnings account should match ending retained earnings on the statement of retained earnings.

The process for making closing entries is the same as it is for making any entry: record the entries in the journal and post them to the proper accounts in the ledger.

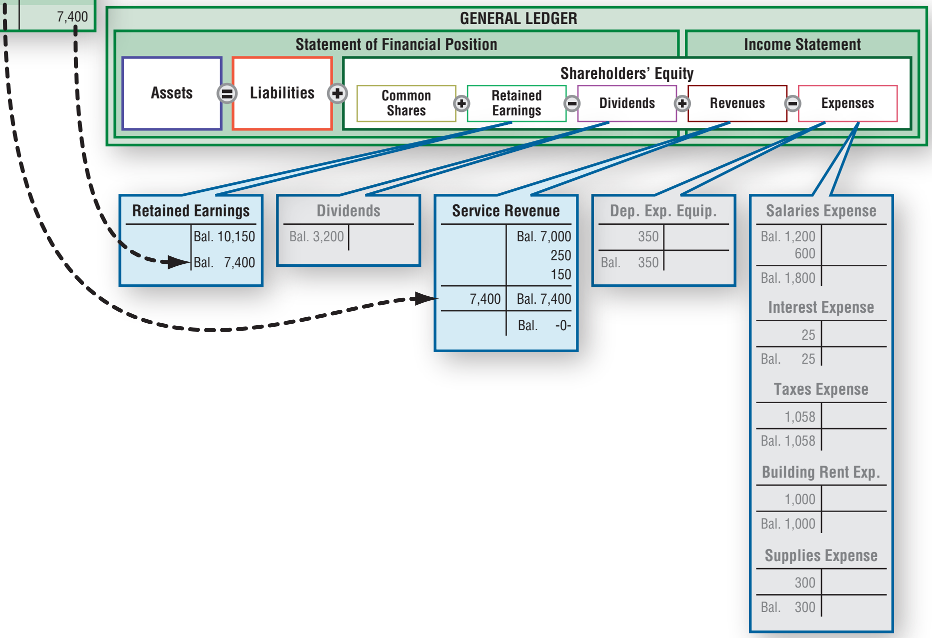
Now, let's apply this process to Hooray Consulting, Inc. for the month of March:

Assets = Liabilities + Shareholders' Equity

−7,400
+7,400

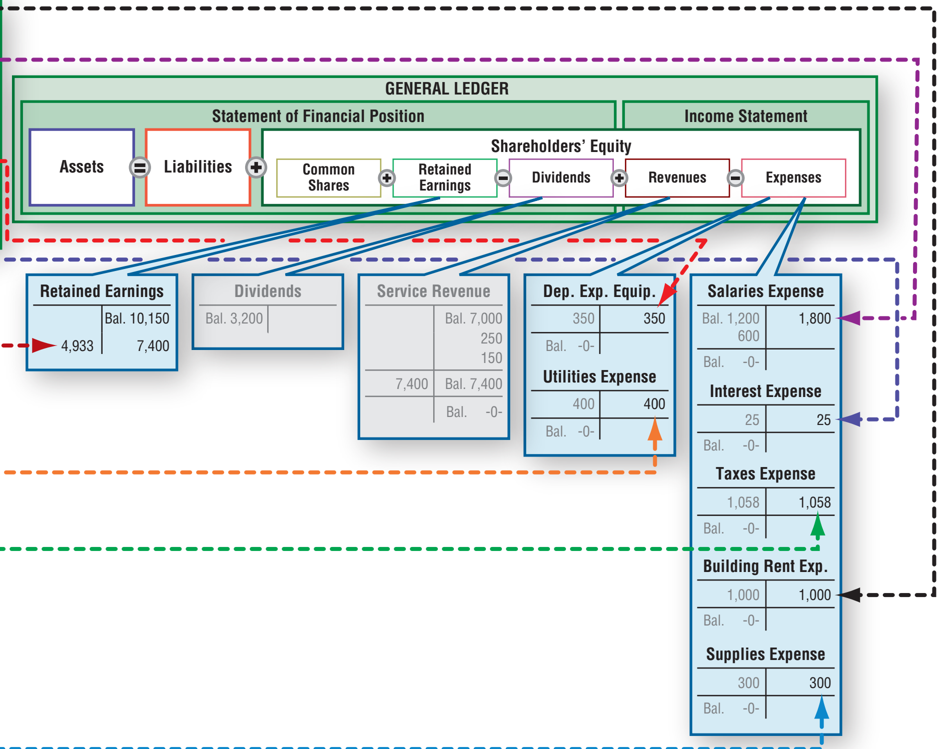
Step 1

GENERAL JOURNAL			
Date	Account	Debit	Credit
Mar 31	Service Revenue	7,400	
	Retained Earnings		7,400



Step 2

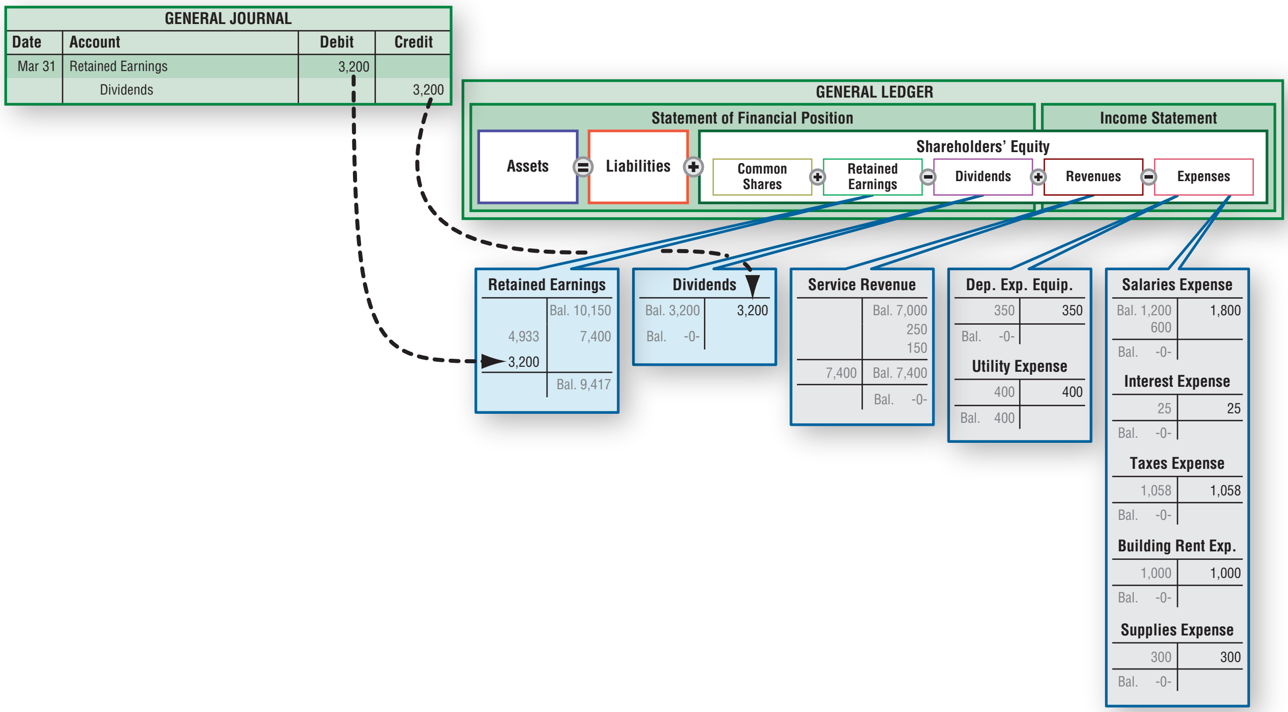
GENERAL JOURNAL			
Date	Account	Debit	Credit
Mar 31	Retained Earnings	4,933	
	Salaries Expense		1,800
	Building Rent Expense		1,000
	Utilities Expense		400
	Depreciation Exp., Equipment		350
	Supplies Expense		300
	Interest Expense		25
	Tax Expense		1,058



Assets = Liabilities + Shareholders' Equity

−4,933
+1,800
+1,000
+ 400
+ 350
+ 300
+ 25
+1,058

Step 3



Assets = Liabilities + Shareholders' Equity

−3,200
+3,200

At this point, the Retained Earnings account balance reflects all the net income earned, net loss incurred, and dividends paid during the life of Hooray Consulting, Inc. to date. After the closing entries, Retained Earnings ends with a balance of $9,417. This balance should, and does, match the balance on the statement of retained earnings and the statement of financial position presented in Exhibits 3-9 and 3-10 on page 154.

POST-CLOSING TRIAL BALANCE

The accounting cycle ends with the preparation of a **post-closing trial balance**, as seen in **Exhibit 3-11**. This trial balance lists the accounts and their adjusted balances after

Hooray Consulting, Inc.
Post-Closing Trial Balance
March 31, 2015

ACCT #	ACCOUNT	DEBIT	CREDIT
1010	Cash	$26,300	
1020	Accounts Receivable	8,350	
1030	Supplies	600	
1035	Prepaid Rent	2,000	
1040	Equipment	12,600	
1041	Accumulated Depreciation, Equipment		$ 350
2010	Accounts Payable		13,100
2020	Salaries Payable		600
2025	Interest Payable		25
2040	Unearned Service Revenue		300
2050	Taxes Payable		1,058
2080	Notes Payable		5,000
3010	Common Shares		20,000
3020	Retained Earnings		9,417
	Total	$49,850	$49,850

Exhibit 3-11

DECISION GUIDELINES

DECISION	GUIDELINE	ANALYZE
As the bookkeeper for a company, how do I ensure that my accounting records are ready to start a new period?	Prepare *closing entries* for the *temporary accounts*: • Revenues • Expenses • Dividends	The *temporary accounts* have balances that relate only to one accounting period and need to be reset to $0 before accounting for the next period can begin. To reset the temporary accounts, closing entries are made that close the account balances into Retained Earnings. This ensures that the net income for the following period can be tracked accurately. Assets, Liabilities, Common Shares, and Retained Earnings do not get closed. These accounts are referred to as *permanent accounts*. Their balances are carried forward into the next period. After temporary accounts have been closed, a post-closing trial balance is prepared to ensure that all of the temporary accounts were properly closed.

closing. Only assets, liabilities, and shareholders' equity appear on the post-closing trial balance. No temporary accounts—revenues, expenses, or dividends—are included because they have been closed. The accounts in the ledger are now up to date and ready for the next period's transactions.

SUMMARY OF THE ADJUSTING AND CLOSING PROCESS

Businesses record adjusting entries at the *end* of the accounting period to accomplish two purposes:

1. Report net income or net loss accurately on the income statement.
2. Reflect the correct account balances on the statement of financial position.

Each adjusting entry will always affect one income statement account, a revenue or an expense, and one statement of financial position account, an asset or a liability. *Cash is never included in a period-end adjusting entry because cash should always be recorded accurately at the time it is received or paid*.

Deferrals and accruals can be summarized as follows:

- A *deferred revenue or expense* is paid first, and recorded as a revenue or expense later as the revenue is earned or the expense is incurred.
- An *accrued revenue or expense* is recorded as a revenue or expense first as the revenue is earned or the expense is incurred, and paid later.

Exhibit 3-12 summarizes the accrual and deferral adjustments.

Businesses record closing entries at the *end* of the accounting period to accomplish two purposes:

1. Zero out the revenue, expense, and dividend accounts.
2. Transfer the balance of the revenue, expense, and dividend accounts into Retained Earnings.

Closing entries are the end-of-period journal entries that get the temporary accounts—revenues, expenses, and dividends—ready for the next accounting period by zeroing them out. Closing entries also transfer the balances from the temporary accounts into the Retained Earnings account. The post-closing trial balance is the final step in the accounting cycle. The post-closing trial balance is prepared to ensure that debits still equal credits before a new accounting period is started.

	First	Dr.	Cr.	Adjusting Entries — Later	Dr.	Cr.
Deferrals: Cash transaction comes first.						
Prepaid Expenses, Depreciable Assets	*Pay cash and record an asset:*			*Record an expense and decrease the asset:*		
	Prepaid Rent	XXX		Rent Expense	XXX	
	Cash		XXX	Prepaid Rent		XXX
Unearned Revenues	*Receive cash and record a liability:*			*Record a revenue and decrease the liability:*		
	Cash	XXX		Unearned Service Revenue	XXX	
	Unearned Service Revenue		XXX	Service Revenue		XXX
Accruals: Cash transaction comes later.	**First**	**Dr.**	**Cr.**	**Later**	**Dr.**	**Cr.**
Accrued Expenses	*Accrue an expense and the related liability:*			*Pay cash and decrease the liability:*		
	Salaries Expense	XXX		Salaries Payable	XXX	
	Salaries Payable		XXX	Cash		XXX
Accrued Revenues	*Accrue a revenue and the related asset:*			*Receive cash and decrease the asset:*		
	Accounts Receivable	XXX		Cash	XXX	
	Service Revenue		XXX	Accounts Receivable		XXX

Exhibit 3-12

FOCUS ON USERS

Concept	User	Why Is This Important to This User?
Adjusting Entries	**Creditors, Shareholders, and Potential Investors**	Creditors, shareholders, and potential investors are interested in the effect of adjusting entries because the adjusting entries highlight the difference between the timing of when cash is paid or received and when the revenues or expenses are recorded. This may have an impact on the ability of a company to pay its debts. It also has an impact on income measurement.
	Managers	Managers need to understand the adjusting entries because adjusting entries are quite often based on estimations. For example, an adjusting entry to change unearned revenue to revenue may be based on an estimate of how much of the work has been completed for the job that has been prepaid by the customer. What this means is that the adjusting entry is subjective and those in charge of making the estimations may be able to exaggerate situations for their own reasons. For example, a sales manager who receives a bonus based on the amount of revenues recorded would be interested in estimating as high an amount of revenues as possible to maximize his or her bonus.
Depreciation	**Shareholders and Potential Investors**	Shareholders watch the statement of financial position for the value of assets, the accumulated depreciation, and the net book value of long-term assets. Since the accumulated depreciation is an indication of the usage of the assets, the smaller the value of the net book assets, the more likely it is that the organization will need to invest in additional long-term assets.

One optional step that accountants may choose to include is to prepare adjusting entries and closing entries using a worksheet. A worksheet can be easily set up in a spreadsheet program, such as Excel. One of the benefits of preparing a worksheet is that it provides a bird's-eye view of the accounting process and adjusting and closing transactions. **Exhibit 3-13** shows a worksheet for Hooray Consulting, Inc. There are five sets of double columns of debit and credit: the first set of columns shows the unadjusted trial balance, the next set shows the six adjusting entries that updated the account balances, the third set is the adjusted trial balance, the fourth set shows the three closing entries that are required to zero out the temporary accounts, and the last set shows the post-closing trial balance. The only change occurring in the permanent accounts from the adjusted trial balance to the post-closing trial balance is in the Retained Earnings account. The net income and dividends have been closed to the Retained Earnings account, and therefore, the new balance of the Retained Earnings account reflects these changes.

L.O. 5 Prepare a worksheet

Hooray Consulting, Inc.
Worksheet
For the Month Ended March 31, 2015

		Unadjusted Trial Balance		Adjustments		Adjusted Trial Balance		Closing Entries		Post-Closing Trial Balance	
ACCT #	**ACCOUNT**	**DR.**	**CR.**	**DR.**	**CR.**	**DR.**	**CR.**	**DR.**	**CR.**	**DR.**	**CR.**
1010	Cash	$26,300				$26,300				$26,300	
1020	Accounts Receivable	8,100		① 250		$ 8,350				8,350	
1030	Supplies	900			⑤ 300	$ 600				600	
1035	Prepaid Rent	3,000			④ 1,000	$ 2,000				2,000	
1040	Equipment	12,600				$12,600				12,600	
1041	Accumulated Depreciation, Equipment				⑥ 350		350				$ 350
2010	Accounts Payable		$13,100				13,100				13,100
2020	Salaries Payable				② 600		600				600
2025	Interest Payable				⑧ 25		25				25
2020	Unearned Service Revenue		450	③ 150			300				300
2030	Income Tax Payable				⑦ 1,058		1,058				1,058
2080	Notes Payable		5000				5,000				5,000
3010	Common Shares		20,000				20,000				20,000
3030	Retained Earnings		10,150				10,150	②③ 8,133	① 7,400		9,417
3040	Dividends	3,200				$ 3,200			③ 3,200		
4010	Service Revenue		7,000		①③ 400		7,400	① 7,400			
5010	Salaries Expense	1,200		② 600		$ 1,800			② 1,800		
5015	Building Rent Expense			④ 1,000		$ 1,000			② 1,000		
5030	Utilities Expense	400				$ 400			② 400		
5040	Depreciation Expense, Equipment			⑥ 350		$ 350			② 350		
5050	Supplies Expense			⑤ 300		$ 300			② 300		
5060	Interest Expense			⑧ 25		$ 25			② 25		
5070	Income Tax Expense			⑦ 1,058		$ 1,058			② 1,058		
	Total	$55,700	$55,700	$3,733	$3,733	$57,983	$57,983	$15,533	$15,533	$49,850	$49,850

Exhibit 3-13

DEMO DOC

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PREPARATION OF ADJUSTING ENTRIES, ADJUSTED TRIAL BALANCE, FINANCIAL STATEMENTS, CLOSING ENTRIES, AND POST-CLOSING TRIAL BALANCE

LEARNING OBJECTIVE 2–4

Apex Architects, Inc. has the following unadjusted trial balance at December 31, 2015:

Apex Architects, Inc.
Unadjusted Trial Balance
December 31, 2015

ACCOUNT	DEBIT	CREDIT
Cash	$124,000	
Accounts Receivable	96,000	
Supplies	3,500	
Prepaid Rent	24,000	
Land	48,000	
Building	270,000	
Accumulated Depreciation, Building		$135,000
Accounts Payable		118,000
Unearned Service Revenue		36,000
Common Shares		50,000
Retained Earnings		64,700
Dividends	46,000	
Service Revenue		486,000
Salaries Expense	245,000	
Rent Expense	32,000	
Miscellaneous Expense	1,200	
Total	$889,700	$889,700

Apex Architects, Inc. must make adjusting entries related to the following items:

a. Supplies on hand at year-end, $800.

b. Six months of rent ($24,000) was paid in advance on September 1, 2015. No rent expense has been recorded since that date.

c. Depreciation expense has not been recorded on the warehouse for 2015. The building has a useful life of 30 years.

d. Employees work Monday through Friday. The weekly payroll is $3,500 and is paid every Friday. December 31, 2015, is a Wednesday.

e. Service revenue of $18,000 must be accrued.

f. A client paid $36,000 in advance on August 1, 2015, for services to be provided evenly from August 1, 2015, through January 31, 2016. None of the revenue from this client has been recorded.

g. Apex's tax rate is 30%.

REQUIREMENTS:

1. **Open the ledger T-accounts with their unadjusted balances.**
2. **Journalize Apex Architects' adjusting entries at December 31, 2015, and post the entries to the T-accounts.**
3. **Total all the T-accounts in the ledger.**
4. **Prepare an adjusted trial balance.**
5. **Prepare the income statement, the statement of retained earnings, and the statement of financial position. Draw arrows linking the three financial statements.**
6. **Journalize and post Apex Architects' closing entries.**
7. **Prepare a post-closing trial balance.**

DEMO DOC SOLUTION

REQUIREMENT 1

Open the ledger T-accounts with their unadjusted balances.

Part 1 | Part 2 | Part 3 | Part 4 | Part 5 | Part 6 | Part 7 | Demo Doc Complete

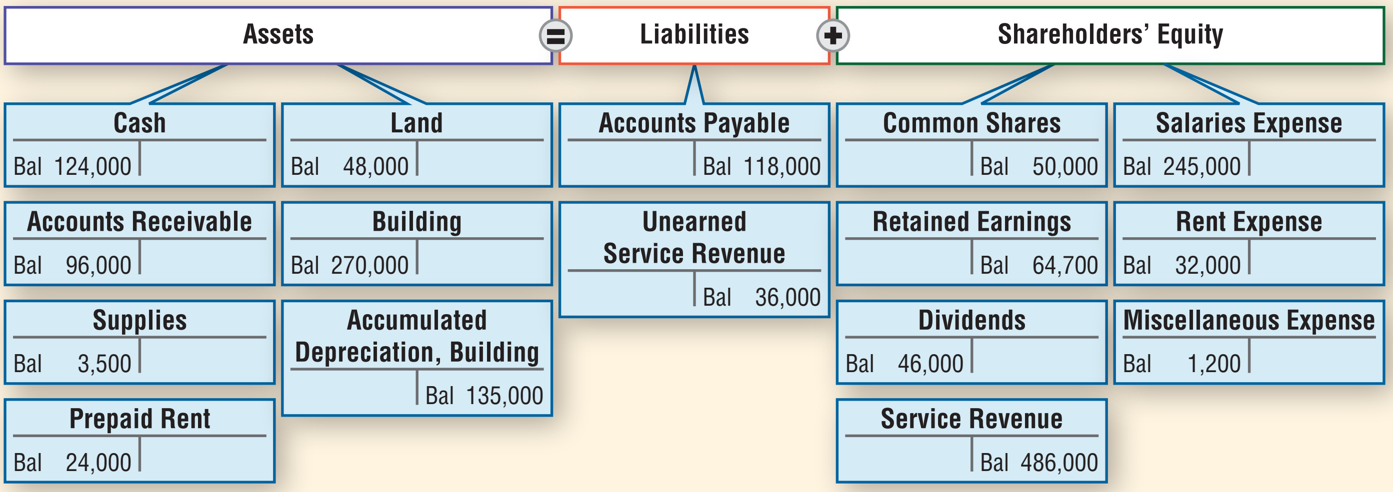
Remember from Chapter 2 that opening a T-account means drawing a blank account that looks like a capital T and putting the account title across the top. To help find the accounts later, they are usually organized into assets, liabilities, shareholders' equity, revenue, and expenses (in that order). If the account has a beginning balance, it *must* be put in on the correct side.

Remember that debits are always on the left side of the T-account and credits are always on the right side. This rule is true for *every* account.

The correct side to enter each account's beginning balance is the side of *increase* in the account. We expect all accounts to have a *positive* balance, or more increases than decreases.

For assets, an increase is a debit, so we would expect all assets to have a debit balance. For liabilities and shareholders' equity, an increase is a credit, so we would expect all of these accounts to have a credit balance. By the same reasoning, we expect revenues to have a credit balance and expenses and dividends to have a debit balance.

The unadjusted balances to be posted into the T-accounts are simply the amounts from the unadjusted trial balance.



REQUIREMENT ②

Journalize Apex Architects' adjusting entries at December 31, 2015, and post the entries to the T-accounts.

Part 1	**Part 2**	Part 3	Part 4	Part 5	Part 6	Part 7	Demo Doc Complete

a. Supplies on hand at year-end, $800.

On December 31, 2015, the unadjusted balance in supplies was $3,500. However, a count shows that only $800 of supplies actually remains on hand. The supplies that are no longer there have been used. When assets/benefits are used, an expense is created.

Apex Architects, Inc. will need to make an adjusting journal entry to reflect the correct amount of supplies on the statement of financial position. The amount to be shown on the statement is the actual amount of supplies on hand of $800. However, right now the Supplies account shows $3,500 (as we can see from the trial balance). This $3,500 is the "cost of asset available."

Cost of asset available	−	Cost of asset on hand at the end of the period	=	Cost of asset used (expense) during the period
$3,500	−	$800	=	$2,700

The supplies have decreased because they have been used up. The $2,700 of supplies expense must be recorded to show the value of supplies that were used.

Assets	=	Liabilities	+	Shareholders' Equity
−2,700				−2,700

DATE	ACCOUNTS	POST REF.	DR.	CR.
Dec 31	Supplies Expense		2,700	
	Supplies			2,700
	Record supply expense.			

After posting, Supplies and Supplies Expense reflect correct ending balances:

EXPENSES

Supplies Expense

(a)	2,700		
Bal	2,700		

ASSETS

Supplies

Bal	3,500	(a)	2,700
Bal	800		

b. Six months of rent ($24,000) was paid in advance on September 1, 2015 for renting a warehouse. No rent expense has been recorded since that date.

When something is prepaid, it is a *future* benefit (an asset) because the business is now entitled to receive goods or services. Once those goods or services are received (in this case, once Apex Architects, Inc. has occupied the warehouse being rented), they become a *past* benefit, and therefore an expense.

Apex Architects, Inc. prepaid $24,000 for six months of rent on September 1, which means that Apex Architects, Inc. pays $24,000/6 = $4,000 a month for rent. At December 31, prepaid rent is adjusted for the amount of the asset that has been used up. Because Apex Architects, Inc. occupied the warehouse being rented for four months, we know that four months of the prepayment has been used. The amount of rent used is as follows:

$$4 \times \$4{,}000 = \$16{,}000$$

The amount of prepaid rent that will appear on the statement of financial position is the amount of prepaid rent that has not been used. In this case, two months' worth of prepaid rent has not been used, 2 × \$4,000 = \$8,000. However, right now the Prepaid Rent account shows \$24,000 (as we can see from the trial balance). This \$24,000 is the "total asset to account for."

Total asset to account for	−	Asset remaining at end of period	=	Cost of asset used (expense) during the period
\$24,000	−	\$8,000	=	\$16,000

Because the \$16,000 of prepaid rent is a *past* benefit, an expense is recorded. Rent Expense must be increased (a debit) and Prepaid Rent (an asset) must be decreased (a credit).

DATE	ACCOUNTS	POST REF.	DR.	CR.
Dec 31	Rent Expense		16,000	
	Prepaid Rent			16,000
	Record rent expense.			

Assets	=	Liabilities	+	Shareholders' Equity
−16,000				−16,000

ASSETS

Prepaid Rent			
Bal	24,000	(b)	16,000
Bal	8,000		

EXPENSES

Rent Expense		
Bal	32,000	
(b)	16,000	
Bal	48,000	

c. Depreciation expense has not been recorded on the building for 2015. The building has a useful life of 30 years.

Depreciation expense per year is calculated as follows:

$$\text{Depreciation Expense per Year} = \frac{(\text{Cost of Asset} - \text{Salvage Value of Asset})}{\text{Useful Life of Asset}}$$

The cost principle compels us to keep the original cost of a plant asset in that asset account. Because the Building account has a balance of \$270,000, we know that this is the original cost of the building. No salvage value is mentioned in the question, so we assume it is \$0. We are told in the question that the building's useful life is 30 years.

$$\text{Depreciation Expense per Year} = \frac{(\$270{,}000 - \$0)}{30 \text{ Years}}$$

$$= \$9{,}000 \text{ per Year}$$

We will record depreciation of \$9,000 in the adjusting journal entry.

The journal entry to record depreciation expense is *always* the same. It is only the *number* (dollar amount) in the entry that changes. It always involves an increase to Depreciation Expense (a debit) and an increase to the contra-asset account of Accumulated Depreciation (a credit).

DATE	ACCOUNTS	POST REF.	DR.	CR.
Dec 31	Depreciation Expense		9,000	
	Accumulated Depreciation, Building			9,000
	Record depreciation expense.			

Assets	=	Liabilities	+	Shareholders' Equity
−9,000				−9,000

ASSETS			EXPENSES
ASSET		CONTRA-ASSET	

Building

Debit		Credit	
Bal	270,000		
Bal	270,000		

Accumulated Depreciation, Building

Debit		Credit	
		Bal	135,000
		(c)	9,000
		Bal	144,000

Depreciation Expense, Building

Debit		Credit	
(c)	9,000		
Bal	9,000		

The book value of the building is its original cost (the amount in the Building T-account) minus the accumulated depreciation on the building:

Book Value of Plant Assets

Building	$ 270,000
Less: Accumulated Depreciation, Building	(144,000)
Book Value of the Building	$ 126,000

d. Employees work Monday through Friday. The weekly payroll is $3,500 and is paid every Friday. December 31, 2015, is a Wednesday.

Salary is an accrued expense. That is, it is a liability that incurs from an *expense* that hasn't been paid yet. Most employers pay their employees *after* the work has been done, which means that the work is a *past* benefit. This is salaries expense, and it grows each pay period until payday.

Apex Architects' employees are paid $3,500 for five days of work (Monday through Friday), which means they earn $3,500/5 = $700 per day. By the end of the day on Wednesday, December 31, the employees have worked for three days and have not been paid. Therefore, Apex Architects, Inc. owes employees $700 × 3 = $2,100 of salary at December 31.

If the salaries have not been paid, then they are pay*able* (or in other words, they are *owed*). They must be recorded in a payable account. We might be tempted to use Accounts Payable, but this account is usually reserved for *bills* received. Employees do not typically send their employers a bill. They simply expect to be paid and Apex Architects, Inc. knows that the salaries are owed. For this reason, we put this amount into another payable account. In this case, Salaries Payable is most appropriate.

Salary is not owed until work is performed, and we know that Apex Architects' employees have already worked for three days. We therefore need to record an expense (in this case, Salaries Expense) for the past benefit Apex Architects, Inc. received from its employees.

We record an increase to Salaries Expense (a debit) and an increase to the liability Salaries Payable (a credit) of $2,100.

Assets	=	Liabilities	+	Shareholders' Equity
		+2,100		−2,100

DATE	ACCOUNTS	POST REF.	DR.	CR.
Dec 31	Salaries Expense		2,100	
	Salaries Payable			2,100
	Accrue salaries expense.			

EXPENSES	LIABILITIES

Salaries Expense

Debit		Credit	
Bal	245,000		
(d)	2,100		
Bal	247,100		

Salaries Payable

Debit		Credit	
		(d)	2,100
		Bal	2,100

e. Service revenue of $18,000 must be accrued.

Accrued revenue is another way of saying "receivable" (or receipt in the future). If *accrued* revenue is recorded, it means that an account or note receivable is also recorded. Customers have received goods or services from the business, but the business has not yet received the cash. The business is entitled to these receivables because the revenue has been earned.

Service Revenue must be increased by $18,000 (a credit) and the Accounts Receivable asset must be increased by $18,000 (a debit).

DATE	ACCOUNTS	POST REF.	DR.	CR.
Dec 31	Accounts Receivable		18,000	
	Service Revenue			18,000
	Accrue service revenue.			

Assets	=	Liabilities	+	Shareholders' Equity
+18,000				+18,000

ASSETS

Accounts Receivable

Bal	96,000	
(e)	18,000	
Bal	114,000	

REVENUES

Service Revenue

	Bal	486,000
	(e)	18,000
	Bal	504,000

f. A client paid $36,000 in advance on August 1, 2015, for services to be provided evenly from August 1, 2015, through January 31, 2016. None of the revenue from this client has been recorded.

Apex Architects, Inc. received cash in advance for work not yet performed for the client. By accepting the cash, Apex Architects, Inc. also accepted the obligation to perform that work (or provide a refund if it did not). In accounting, an obligation is a liability. We call this liability "unearned revenue" because it *will* be revenue (after the work is performed) but it is not revenue *yet*.

The $36,000 paid in advance is still in the Unearned Service Revenue account. However, some of the revenue has been earned as of December 31. Five months of the earnings period have passed (August 1 through December 31), so five months' worth of the revenue has been earned.

The entire revenue earnings period is six months (August 1 through January 31), so the revenue earned per month is $36,000/6 = $6,000. The five months of revenue earned total:

$$5 \times \$6{,}000 = \$30{,}000$$

The amount of unearned revenue that will appear on the statement of financial position is the amount of unearned revenue that remains at the end of the period. In this case, one month of unearned revenue remains: 1 × $6,000 = $6,000. However, right now the Unearned Service Revenue account shows a balance of $36,000 (as we can see from the trial balance). This $36,000 is the "total to account for."

Total unearned revenue to account for	–	Unearned revenue remaining at the end of period	=	Revenue earned during the period
$36,000	–	$6,000	=	$30,000

So Unearned Service Revenue, a liability, must be decreased by $30,000 (a debit). Because the revenue is now earned, it can be recorded as normal service revenue. Therefore, Service Revenue also increases by $30,000 (a credit).

Assets	=	Liabilities	+	Shareholders' Equity
		−30,000		+30,000

DATE	ACCOUNTS	POST REF.	DR.	CR.
Dec 31	Unearned Service Revenue		30,000	
	Service Revenue			30,000
	Record unearned service revenue that has been earned.			

Essentially, the $30,000 has been shifted from "unearned" to "earned" revenue.

LIABILITIES

Unearned Service Revenue

(f)	30,000	Bal	36,000
		Bal	6,000

REVENUES

Service Revenue

		Bal	486,000
		(e)	18,000
		(f)	30,000
		Bal	534,000

Now we will summarize all of the adjusting journal entries:

DATE	ACCOUNTS	POST REF.	DR.	CR.
Dec 31	Supplies Expense		2,700	
	Supplies			2,700
	Record supply expense.			
Dec 31	Rent Expense		16,000	
	Prepaid Rent			16,000
	Record rent expense.			
Dec 31	Depreciation Expense, Building		9,000	
	Accumulated Depreciation, Building			9,000
	Record depreciation expense.			
Dec 31	Salaries Expense		2,100	
	Salaries Payable			2,100
	Accrue salaries expense.			
Dec 31	Accounts Receivable		18,000	
	Service Revenue			18,000
	Accrue service revenue.			
Dec 31	Unearned Service Revenue		30,000	
	Service Revenue			30,000
	Record unearned service revenue that has been earned.			

REQUIREMENT ③

Total all the T-accounts in the ledger.

Part 1 | Part 2 | **Part 3** | Part 4 | Part 5 | Part 6 | Part 7 | Demo Doc Complete

After posting all of these entries and totalling all of the T-accounts, we have the following:

Assets = **Liabilities** + **Shareholders' Equity**

Assets

Cash	
Bal 124,000	

Accounts Receivable	
Bal 96,000	
(e) 18,000	
Bal 114,000	

Supplies	
Bal 3,500	(a) 2,700
Bal 800	

Prepaid Rent	
Bal 24,000	(b) 16,000
Bal 8,000	

Land	
Bal 48,000	

Building	
Bal 270,000	

Accumulated Depreciation, Building	
	Bal 135,000
	(c) 9,000
	Bal 144,000

Liabilities

Accounts Payable	
	Bal 118,000

Salaries Payable	
	(d) 2,100
	Bal 2,100

Unearned Service Revenue	
(f) 30,000	Bal 36,000
	Bal 6,000

Shareholders' Equity

Common Shares	
	Bal 50,000

Retained Earnings	
	Bal 64,700

Dividends	
Bal 46,000	

Service Revenue	
	Bal 486,000
	(e) 18,000
	(f) 30,000
	Bal 534,000

Salaries Expense	
Bal 245,000	
(d) 2,100	
Bal 247,100	

Supplies Expense	
(a) 2,700	
Bal 2,700	

Rent Expense	
Bal 32,000	
(b) 16,000	
Bal 48,000	

Depreciation Expense, Building	
(c) 9,000	
Bal 9,000	

Miscellaneous Expense	
Bal 1,200	

REQUIREMENT ④

Prepare an adjusted trial balance.

Part 1 | Part 2 | Part 3 | **Part 4** | Part 5 | Part 6 | Part 7 | Demo Doc Complete

Apex Architects, Inc.
Adjusted Trial Balance
December 31, 2015

ACCOUNT	DEBIT	CREDIT
Cash	$124,000	
Accounts Receivable	114,000	
Supplies	800	
Prepaid Rent	8,000	
Land	48,000	
Building	270,000	
Accumulated Depreciation, Building		$144,000
Accounts Payable		118,000
Salaries Payable		2,100
Unearned Service Revenue		6,000
Common Shares		50,000
Retained Earnings		64,700
Dividends	46,000	
Service Revenue		534,000
Salaries Expense	247,100	
Rent Expense	48,000	
Depreciation Expense, Building	9,000	
Supplies Expense	2,700	
Miscellaneous Expense	1,200	
Total	$918,800	$918,800

REQUIREMENT ⑤

Prepare the income statement, the statement of retained earnings, and the statement of financial position. Draw arrows linking the three financial statements.

Part 1 | Part 2 | Part 3 | Part 4 | **Part 5** | Part 6 | Part 7 | Demo Doc Complete

Apex Architects, Inc.
Income Statement
Year Ended December 31, 2015

Revenue:		
Service Revenue		$534,000
Expenses:		
Salaries Expense	$247,100	
Rent Expense	48,000	
Depreciation Expense, Building	9,000	
Supplies Expense	2,700	
Miscellaneous Expense	1,200	
Total Operating Expenses		308,000
Operating Income		226,000
Income Tax (30%)		67,800
Net Income		$158,200

Apex Architects, Inc.
Statement of Retained Earnings
Year Ended December 31, 2015

Retained Earnings, January 1, 2015	$ 64,700
Add: Net Income	158,200
Subtotal	222,900
Less: Dividends	46,000
Retained Earnings, December 31, 2015	$176,900

Apex Architects, Inc.
Statement of Financial Position
December 31, 2015

ASSETS			LIABILITIES	
Current Assets			Accounts Payable	$118,000
Cash	$124,000		Salaries Payable	2,100
Accounts Receivable	114,000		Unearned Service Revenue	6,000
Supplies	800		Income Tax Payable	67,800
Prepaid Rent	8,000		Total Liabilities	$193,900
Total Current Assets		$246,800		
			SHAREHOLDERS' EQUITY	
Land		48,000	Common Shares	$ 50,000
Equipment	$270,000		Retained Earnings	176,900
Less: Accumulated Depreciation	144,000	$126,000	Total Shareholders' Equity	$226,900
Total Assets		$420,800	Total Liabilities & Shareholders' Equity	$420,800

The balance of the Income Tax Payable will be added to the liabilities in the statement of financial position, and the balance of the Income Tax Expense will be included within the expenses on the income statement.

g. Apex's tax rate is 30%.

Once the income statement is prepared, Apex knows the amount of tax expense incurred, which will need to be paid to the government shortly after the year-end. The income tax expense, $67,800, is calculated based on the income before taxes. Apex Architects, Inc. will need to make one additional adjusting entry to reflect the income tax incurred but not yet paid on December 31.

DATE	ACCOUNTS	POST REF.	DR.	CR.
Dec 31	Income Tax Expense		67,800	
	Income Tax Payable			67,800

Assets	=	Liabilities	+	Shareholders' Equity
		+67,800		−67,800

After posting, Income Tax Payable and Income Tax Expense reflect correct ending balances:

LIABILITIES

Income Tax Payable

		(g)	67,800
		Bal	67,800

EXPENSES

Income Tax Expense

(g)	67,800		
Bal	67,800		

REQUIREMENT ⑥

Journalize and post Apex Architects' closing entries.

Part 1 Part 2 Part 3 Part 4 Part 5 **Part 6** Part 7 Demo Doc Complete

We prepare closing entries for two reasons. First, we need to clear out the temporary accounts (the revenue, expense, and dividends accounts) to a zero balance. They need to begin the next period empty so that the next period's income statement can begin fresh. Second, we need to update the Retained Earnings account.

The first step in the closing process is to close the revenue accounts. Apex Architects, Inc. only has one revenue account, Service Revenue. Because the Service Revenue account has a credit balance we will need to debit it to bring its balance to zero. The credit side of the entry is to Retained Earnings. The effect of this entry is to move the revenues into the Retained Earnings account.

DATE	ACCOUNTS	POST REF.	DR.	CR.
Dec 31	Service Revenue		534,000	
	Retained Earnings			534,000
	Close revenue accounts.			

Assets	=	Liabilities	+	Shareholders' Equity
				−534,000 +534,000

Service Revenue

		Bal	486,000
		(e)	18,000
		(f)	30,000
Clo	534,000	Bal	534,000
		Bal	-0-

Retained Earnings

		Bal	64,700
		Clo	534,000

The next step in the closing process is to close the expenses into the Retained Earnings account.

Each of the expenses has a *debit* balance. To bring the accounts to zero, we must *credit* them. The debit side of the entry will go to the Retained Earnings account:

Assets = Liabilities + Shareholders' Equity

−375,800
+247,100
+ 48,000
+ 9,000
+ 2,700
+ 1,200
+ 67,800

DATE	ACCOUNTS	POST REF.	DR.	CR.
Dec 31	Retained Earnings		375,800	
	Salaries Expense			247,100
	Rent Expense			48,000
	Depreciation Expense, Building			9,000
	Supplies Expense			2,700
	Miscellaneous Expense			1,200
	Income Tax Expense			67,800
	Close expense accounts.			

Salaries Expense

Bal	245,000		
(d)	2,100		
Bal	247,100	Clo	247,100
Bal	0		

Supplies Expense

(a)	2,700		
Bal	2,700	Clo	2,700
Bal	0		

Miscellaneous Expense

Bal	1,200	Clo	1,200
Bal	0		

Rent Expense

Bal	32,000		
(b)	16,000		
Bal	48,000	Clo	48,000
Bal	0		

Retained Earnings

Clo	308,000	Bal	64,700
		Clo	534,000

Depreciation Expense, Building

(c)	9,000		
Bal	9,000	Clo	9,000
Bal	0		

Income Tax Expense

(g)	67,800		
Bal	67,800	Clo	67,800
Bal	0		

The final step in the closing process is to close the Dividends account to the Retained Earnings account, which moves the amount from Dividends to Retained Earnings. The Dividends account has a debit balance of $46,000, so to bring that to zero, we *credit* the Dividends account for $46,000. The balancing debit goes to the Retained Earnings account:

Assets = Liabilities + Shareholders' Equity

−46,000
+46,000

DATE	ACCOUNTS	POST REF.	DR.	CR.
Dec 31	Retained Earnings		46,000	
	Dividends			46,000
	Close Dividends account.			

Dividends

Bal	46,000	Clo	46,000
Bal	0		

Retained Earnings

Clo	375,800	Bal	64,700
Clo	46,000	Clo	534,000
		Bal	176,900

Notice that all temporary accounts (that is, the revenue, the expense, and the dividends accounts) now return to a zero balance and are ready to begin the next year.

REQUIREMENT ⑦

Prepare a post-closing trial balance.

Part 1 Part 2 Part 3 Part 4 Part 5 Part 6 **Part 7** Demo Doc Complete

Apex Architects, Inc.
Post-Closing Trial Balance
December 31, 2015

ACCOUNT	DEBIT	CREDIT
Cash	$124,000	
Accounts Receivable	114,000	
Supplies	800	
Prepaid Rent	8,000	
Land	48,000	
Building	270,000	
Accumulated Depreciation, Building		$144,000
Accounts Payable		118,000
Salaries Payable		2,100
Unearned Service Revenue		6,000
Income Tax Payable		67,800
Common Shares		50,000
Retained Earnings		176,900
Total	$564,800	$564,800

Notice that the post-closing trial balance only contains permanent accounts. This is because all of the temporary accounts have been closed and have zero balances.

DEMO DOC COMPLETE

Part 1 Part 2 Part 3 Part 4 Part 5 Part 6 Part 7 **Demo Doc Complete**

DECISION GUIDELINES

Completing the Accounting Cycle

In completing the accounting cycle for your business, you might encounter the following decisions:

DECISION	GUIDELINE	ANALYZE
As the bookkeeper for a company, how do I ensure that my accounting records are ready to start a new period?	Prepare *closing entries* for the *temporary accounts*: • Revenues • Expenses • Dividends	The *temporary accounts* have balances that relate only to one accounting period and need to be reset to $0 before accounting for the next period can begin. To reset the temporary accounts, closing entries are made that close the account balances into Retained Earnings. This ensures that the net income for the following period can be tracked accurately. Assets, Liabilities, Common Shares, and Retained Earnings do not get closed. These accounts are referred to as *permanent accounts*. Their balances are carried forward into the next period. After temporary accounts have been closed, a post-closing trial balance is prepared to ensure that all of the temporary accounts were properly closed.

ACCOUNTING VOCABULARY

THE LANGUAGE OF BUSINESS

ACCOUNTING PRACTICE

DISCUSSION QUESTIONS

MyAccountingLab

The exercises and problems in this chapter can be found on MyAccountingLab. You can practise them as often as you want, and they feature step-by-step guided solutions to help you find the right answer.

1. If XYZ Consulting performs a consulting service in June and bills the customer on June 28 and receives payment from the customer on July 19, on what date would revenue be recorded if
   a. XYZ uses the cash basis of accounting?
   b. XYZ uses the accrual basis of accounting?
2. Why does the time period in which revenue is recognized matter?
3. What is a deferral? Under which basis of accounting, cash or accrual, would deferrals come into play? Under what circumstances would a company record a deferral?
4. Why do companies prepare adjusting entries?
5. What are some similarities and differences between assets and expenses?
6. What type of account (asset, liability, revenue, or expense) would Joe's Towing debit when it pays (credits) cash for each of the following transactions?
   a. Pays $100 to fill tow truck with gas
   b. Pays $1,000 to have a gas company deliver gas for its on-site refueling station to be used next month.

   Did you choose the same type of account or different ones? Why?
7. Describe the type of transaction that gives rise to a deferred revenue journal entry during the year. Why might deferred revenues require adjustment?
8. What kind of account is Accumulated Depreciation? How is it reported on the financial statements?
9. What are the objectives of the closing process? Which kind of accounts get closed? What is the only account that is affected by the closing process but not closed?

SELF CHECK

1. The revenue recognition principle says
   a. record revenue only after you have earned it.
   b. record revenue only when you receive cash.
   c. match revenues and expenses to compute net income.
   d. divide time into equal periods to measure net income or net loss properly.
2. Adjusting the accounts is the process of
   a. recording transactions as they occur during the period.
   b. updating the accounts at the end of the period.
   c. zeroing out account balances to prepare for the next period.
   d. subtracting expenses from revenues to measure net income.
3. Which of the following terms describe the types of adjusting entries?
   a. Deferrals and depreciation
   b. Expenses and revenues
   c. Deferrals and accruals
   d. Prepaid expenses and prepaid revenues
4. Assume that the weekly payroll of IDT, Inc. is $3,500. December 31, the end of the year, falls on Tuesday, but the company won't pay employees for the full week until its usual payday, Friday. What adjusting entry will IDT, Inc. make on Tuesday, December 31?

DATE	ACCOUNTS	POST REF.	DR.	CR.
a.	Salaries Expense		1,400	
	Accumulated Salaries			1,400
b.	Salaries Expense		1,400	
	Cash			1,400
c.	Salaries Payable		1,400	
	Salaries Expense			1,400
d.	Salaries Expense		1,400	
	Salaries Payable			1,400

5. Unearned Revenue is always

a. a liability.
b. revenue.
c. an asset.
d. shareholders' equity.

6. The adjusted trial balance shows

a. amounts that may be out of balance.
b. revenues and expenses only.
c. assets, liabilities, and common shares only.
d. amounts that are ready for the financial statements.

7. Which of the following accounts is not closed?

a. Salaries Expense
b. Service Revenue
c. Accumulated Depreciation, Equipment
d. Dividends

8. What do closing entries accomplish?

a. Transfer revenues, expenses, and dividends to retained earnings
b. Zero out the revenues, expenses, and dividends to prepare them for the next period
c. Bring the Retained Earnings account to its correct ending balance
d. All of the above

9. Which of the following is not a closing entry?

DATE	ACCOUNTS	POST REF.	DR.	CR.
a.	Retained Earnings		300	
	Building Rent Expense			300
b.	Salaries Payable		700	
	Retained Earnings			700
c.	Service Revenue		1,100	
	Retained Earnings			1,100
d.	Retained Earnings		600	
	Dividends			600

10. Which correctly represents the flow of information from one financial statement to another?

a. Income statement to the statement of retained earnings
b. Statement of retained earnings to the statement of financial position
c. Both a and b are correct
d. None of the above is correct

Answers are given after Written Communication.

SHORT EXERCISES

S3-1. Accounting principles (*Learning Objective 1*) 5–10 min.

Match the accounting term with the corresponding definition.

____ 1. Accrual basis accounting	a. Any consecutive 12-month period.
____ 2. Revenue recognition principle	b. Records the impact of a business event as it occurs regardless of whether the transaction affected cash.
____ 3. Fiscal period	c. Records revenue when it is earned.

S3-2. Accounting terminology (*Learning Objectives 2 & 3*) 5–10 min.

Match the accounting term with the corresponding definition.

____ 1. Accumulated depreciation	a. An account whose normal balance is opposite that of its companion account.
____ 2. Adjusted trial balance	b. Entry made to assign revenues to the period in which they are earned and expenses to the period incurred.
____ 3. Adjusting entry	c. A list of accounts with their adjusted balances.
____ 4. Book value	d. The cumulative sum of all depreciation recorded for an asset.
____ 5. Contra-account	e. The allocation of a long-term asset's cost to expense over its useful life.
____ 6. Depreciation	f. The asset's cost less its accumulated depreciation.
____ 7. Long-term asset	g. Long-lived asset used to operate the business.

S3-3. Types of adjusting entries (*Learning Objective 2*) 5–10 min.

The trial balance of Sampson & Associates includes the following statement of financial position accounts. For each account, identify the type of adjusting entry that is typically made for the account (deferred expense, deferred revenue, accrued expense, or accrued revenue), and give the related income statement account used in that adjustment. Example: Prepaid Insurance: deferred expense.

a. Interest Payable
b. Unearned Service Revenue
c. Accounts Receivable
d. Supplies
e. Accumulated Depreciation

S3-4. Adjusting journal entry—prepaid rent (*Learning Objective 2*) 5–10 min.

Alpine Ski Shop's Prepaid Rent balance is $4,500 on June 1. This prepaid rent represents six months' rent. Journalize and post the adjusting entry on June 30 to record one month's rent. Compute the balances of the two accounts involved.

S3-5. Adjusting journal entry—supplies (*Learning Objective 2*) 5–10 min.

Alpine Ski Shop's Office Supplies balance on September 1 is $1,200 and the balance in Office Supplies Expense is $0. On September 30, there is $500 of supplies on hand. Journalize and post the adjusting entry on September 30 for the supplies used. Compute the balances of the two accounts involved.

S3-6. Adjusting journal entry—interest expense (*Learning Objective 2*) 5–10 min.

To purchase equipment and supplies, ProPaint, Inc. borrowed $30,000 on August 1 by signing a note payable to First Nations Bank. Interest expense for ProPaint, Inc. is $200 per month. Journalize an adjusting entry to accrue interest expense at December 31, assuming no other adjusting entries have been made for the year. Use T-accounts to post to the two accounts affected by the adjustment.

S3-7. Adjusting journal entry—magazine subscriptions (*Learning Objective 2*) 5–10 min.

Wild Wonders, an outdoor magazine, collected $2,400 on April 1 for one-year subscriptions from subscribers in advance. Journalize and use T-accounts to post the adjusting entry on December 31 to record the revenue that *Wild Wonders* has earned, assuming no other adjusting entries have been made for the year. Compute the balances of the two accounts involved.

S3-8. Adjusting journal entry—salaries, accrued revenue, interest expense (*Learning Objective 2*) 5–10 min.

Journalize the following adjusting entries at December 31:

1. Services provided but not recorded, $1,500.
2. Salaries earned by employees but not recorded, $2,300.
3. Accrued interest on a note payable, $375.

S3-9. Adjusting journal entry—accrued service revenue (*Learning Objective 2*) 5–10 min.

Suppose you work summers mowing yards. Most of your customers pay you immediately after their lawn is mowed, but a few customers ask you to bill them at the end of the month. It is now September 30 and you have collected $1,200 from cash-paying customers. Your remaining customers owe you $150. How much service revenue would you record for the month of September according to accrual basis accounting?

S3-10. Closing entries (*Learning Objective 4*) 5–10 min.

From the following list of accounts from the adjusted trial balance, identify each as an asset, liability, shareholders' equity, revenue, or expense. Use the most detailed account type appropriate. Also state whether each account is a permanent or temporary account and if it is an account that gets closed at the end of the accounting period. Following the accounts is a sample of the format to use.

1. Depreciation Expense
2. Sales Revenue
3. Building
4. Cash
5. Unearned Service Revenue
6. Prepaid Rent
7. Dividends

Account	Type of Account	Permanent/Temporary	Closed
Supplies	Asset	Permanent	No

S3-11. Financial statements and closing entries (*Learning Objectives 3 & 4*) 10–15 min.

The following selected accounts and balances appear on the adjusted trial balance for Ray Service, Inc. on December 31, 2015:

Service Revenue	$1,200
Building Rent Expense	200
Salaries Expense	300
Dividends	500
Common Shares	4,000
Retained Earnings	3,500

1. What is the net income or net loss?
2. What is the change in Retained Earnings?
3. Journalize the closing entries required.

S3-12. Adjusting and closing entries (*Learning Objectives 2 & 4*) 5–10 min.

For the following series of journal entries, indicate whether each is an adjusting entry (ADJ) or a closing entry (CL).

TYPE OF ENTRY (ADJ OR CL)	ACCOUNTS	POST REF.	DR.	CR.
	Salaries Expense		400	
	Salaries Payable			400
	Service Revenue		900	
	Retained Earnings			900
	Retained Earnings		1,500	
	Dividends			1,500
	Unearned Revenue		800	
	Service Revenue			800

S3-13. Preparing a post-closing trial balance (*Learning Objective 4*) 5–10 min.

After closing its accounts at October 31, 2015, Simmons Realty, Inc. had the following account balances:

Notes Payable	$2,000	Cash	$1,850
Prepaid Rent	975	Service Revenue	0
Accounts Receivable	2,450	Retained Earnings	1,075
Prepaid Insurance	1,300	Common Shares	5,000
Accounts Payable	300	Salaries Expense	0
Equipment	1,800		

Prepare Simmons Realty's post-closing trial balance at October 31, 2015. List accounts in proper order.

EXERCISES (GROUP A)

E3-1A. Adjusting journal entries—unearned revenue and accrued revenue (*Learning Objective 2*) 10–15 min.

Suppose you started up your own tree trimming business. A customer paid you $175 in advance to trim his or her tree while he or she was on vacation. You trimmed trees for other customers but they have not paid you the due fees of $340 yet. A new customer pays you $150 cash for tree trimming. Answer the following questions about the correct way to account for your revenue under accrual basis accounting:

1. Name the accounts used to record these events.
2. Prepare the journal entries to record the three transactions.

E3-2A. Adjusting journal entry—prepaid insurance (*Learning Objective 2*) 5–10 min.

Calculate the missing amounts for each of the following Prepaid Insurance situations. For situation A, journalize the adjusting entry. Consider each situation separately.

	Situation			
	A	B	C	D
Beginning Prepaid Insurance	$ 300	$ 600	$?	$ 400
Payments for Prepaid Insurance during the year	1,200	?	1,300	?
Total amount to account for	?	?	2,000	1,900
Ending Prepaid Insurance	400	500	?	?
Insurance Expense	$?	$1,000	$1,200	$ 800

E3-3A. Common adjusting journal entries (*Learning Objective 2*) 10–15 min.

Journalize the adjusting entries for the following adjustments at December 31, the end of the accounting period, omitting explanations.

a. Employee salaries owed for Monday through Thursday of a five-day workweek equals $6,000.

b. Unearned service revenue now earned, $750.

c. Depreciation, $1,800.

d. Prepaid rent expired, $450.

e. Interest revenue accrued, $875.

E3-4A. Error analysis (*Learning Objective 2*) 10–15 min.

The adjusting entries for the following adjustments were omitted at year-end:

a. Prepaid insurance expired, $2,400.

b. Depreciation, $1,800.

c. Employee salaries owed for Monday through Wednesday of a five-day workweek, $2,700.

d. Supplies used during the year, $700.

e. Unearned service revenue now earned, $3,500.

Requirement

1. Compute the amount that net income for the year is overstated or understated by for each omitted entry. Use the following format to help analyze the transactions.

Transaction	Overstated/Understated	Amount
Sample a., b., etc.	Overstated	$5,000

E3-5A. Common adjusting journal entries (*Learning Objective 2*) 15–20 min.

Journalize the adjusting entry needed at October 31, the fiscal year-end, for each of the following independent situations (put the transaction letter in the date column to identify each transaction). No other adjusting entries have been made for the year.

a. On September 1, we collected $4,800 rent in advance. We debited Cash and credited Unearned Rent Revenue. The tenant was paying six months' rent in advance.

b. The business holds a $30,000 note receivable. Interest revenue of $650 has been earned on the note but not yet received.

c. Salaries expense is $1,700 per day, Monday through Friday, and the business pays employees each Friday. This year, October 31 falls on a Thursday.

d. The unadjusted balance of the Supplies account is $2,200. Supplies on hand total $700.

e. Equipment was purchased last year at a cost of $18,000. The equipment's useful life is four years.

f. On June 1, when we prepaid $1,500 for a one-year insurance policy, we debited Prepaid Insurance and credited Cash.

E3-6A. Common adjusting journal entries (*Learning Objective 2*) 15–20 min.

The accounting records of Vacations Unlimited include the following unadjusted balances at June 30: Accounts Receivable, $1,500; Supplies, $800; Salaries Payable, $0; Unearned Service Revenue, $900; Service Revenue, $3,900; Salaries Expense, $1,700; and Supplies Expense, $0. The following data pertain to the June 30 adjusting entries:

a. Service revenue accrued, $1,200.

b. Unearned service revenue that has been earned, $500.

c. Supplies on hand, $150.

d. Salary owed to employees, $1,100.

Requirement

1. Record the adjustments, then post them to T-accounts, labelling each adjustment by letter. Calculate each account's adjusted balance.

E3-7A. Income statement preparation (*Learning Objective 3*) 15–20 min.

The accountant for Henderson Roofing, Inc. posted adjusting entries (a) through (e) to the accounts at December 31, 2015. Selected statement of financial position accounts and all the revenues and expenses of the entity follow in T-account form.

Accounts Receivable			
	21,000		
(e)	1,500		

Supplies			
	2,800	(a)	1,200

Accumulated Depreciation, Equipment			
			5,600
		(b)	1,400

Accumulated Depreciation, Building			
			28,000
		(c)	2,000

Salaries Payable			
		(d)	2,900

Service Revenue			
			97,000
		(e)	1,500

Salaries Expense			
	14,000		
(d)	2,900		

Supplies Expense			
(a)	1,200		

Depreciation Expense, Equipment			
(b)	1,400		

Depreciation Expense, Building			
(c)	2,000		

Requirements

1. Calculate balances in the accounts and use the appropriate accounts to prepare the income statement of Henderson Roofing, Inc. for the year ended December 31, 2015. List expenses in order from largest to smallest.
2. Were the 2015 operations successful? Give the reason for your answer.

Quick solution:

Net Income = $77,000

E3-8A. Statement of retained earnings preparation (*Learning Objective 3*) 10–15 min.

Sigma Security, Inc. began the year with $15,000 of common shares and $32,000 of retained earnings. On May 5, investors bought $12,000 of additional shares in the business. On August 22, the business purchased land valued at $65,000. The income statement for the year ended December 31, 2015, reported a net loss of $11,000. During this fiscal year, the business paid $800 each month for dividends.

Requirements

1. Prepare Sigma Security's statement of retained earnings for the year ended December 31, 2015.
2. Did the retained earnings of the business increase or decrease during the year? What caused this change?

E3-9A. Recreating adjusting journal entries (*Learning Objective 2*) 10–15 min.

The adjusted trial balances of PDQ, Inc. at December 31, 2015 and December 31, 2016 include these amounts:

	2015	2016
Supplies	$ 2,800	$ 1,700
Salaries Payable	2,800	3,700
Unearned Service Revenue	18,000	16,300

Analysis of the accounts at December 31, 2016 reveals these transactions for 2016:

Purchase of supplies	$ 8,700
Cash payments for salaries	52,300
Cash receipts in advance for services revenue	106,400

Requirement

1. Compute the amount of supplies expense, salaries expense, and service revenue PDQ, Inc. will report for the year ended December 31, 2016. Solve by making T-accounts and posting the information to solve for the unknown amounts.

E3-10A. Financial statement preparation (*Learning Objective 3*) 15–20 min.

The adjusted trial balance for Country Cookin Catering, Inc. is presented next. Prepare the income statement, statement of retained earnings, and statement of financial position for Country Cookin Catering, Inc. for the month ended March 31, 2015.

Country Cookin Catering, Inc.
Adjusted Trial Balance
March 31, 2015

ACCOUNT	DEBIT	CREDIT
Cash	$ 4,000	
Accounts Receivable	8,000	
Supplies	1,300	
Equipment	22,500	
Accumulated Depreciation, Equipment		$ 8,800
Accounts Payable		2,100
Salaries Payable		600
Unearned Service Revenue		1,400
Common Shares		5,000
Retained Earnings		5,800
Dividends	800	
Service Revenues		18,600
Salaries Expense	3,600	
Rent Expense	1,200	
Depreciation Expense, Equipment	600	
Supplies Expense	300	
Total	$42,300	$42,300

E3-11A. Prepare closing entries (*Learning Objective 4*) 10–15 min.

Requirements

1. Using the following selected accounts of A to Z Electrical, Inc. at April 30, 2015, prepare the entity's closing entries:

Common Shares	$ 18,000	Accounts Receivable	$ 9,000
Service Revenue	127,000	Retained Earnings	6,500
Unearned Revenues	1,800	Salaries Payable	800
Salaries Expense	18,500	Depreciation Expense	8,200
Accumulated Depreciation	32,600	Building Rent Expense	5,100
Supplies Expense	1,700	Dividends	18,000
Interest Revenue	800	Supplies	1,800
Interest Expense	2,300		

2. What is A to Z Electrical's ending retained earnings balance at April 30, 2015?

E3-12A. Statement of retained earnings preparation (*Learning Objective 3*) 10–15 min.

From the following accounts of Kurlz Salon, Inc., prepare the business's statement of retained earnings for the year ended December 31, 2015:

Retained Earnings

Clo	95,000	Jan 1	188,000
Clo	76,000	Clo	234,000
		Bal	251,000

Dividends

Mar 31	18,000		
Jun 30	14,000		
Sep 30	23,000		
Dec 31	21,000		
Bal	76,000	Clo	76,000

E3-13A. Prepare a post-closing trial balance (*Learning Objective 4*) 10–15 min.

The following post-closing trial balance was prepared for Cunningham Photography, Inc. Prepare a corrected post-closing trial balance. Assume all accounts have normal balances and the amounts are correct.

Cunningham Photography, Inc.
Post-Closing Trial Balance
December 31, 2015

ACCOUNT	DEBIT	CREDIT
Cash	$ 9,450	
Accounts Receivable	33,100	
Supplies		$ 1,900
Equipment		68,000
Accumulated Depreciation, Equipment	19,700	
Accounts Payable	11,450	
Salaries Payable		2,500
Unearned Service Revenue	5,600	
Common Shares		30,000
Retained Earnings	43,200	
Total	$122,500	$102,400

E3-14A. Prepare closing entries (*Learning Objective 4*) 10–15 min.

The following is the adjusted trial balance of Qwik Care Clinic, Inc. for December 31, 2015.

Requirement

1. Journalize the closing entries at December 31.

Qwik Care Clinic, Inc.
Adjusted Trial Balance
December 31, 2015

ACCOUNT	DEBIT	CREDIT
Cash	$ 7,400	
Accounts Receivable	8,700	
Supplies	200	
Furniture	4,800	
Accumulated Depreciation, Furniture		$ 1,200
Equipment	32,000	
Accumulated Depreciation, Equipment		8,800
Accounts Payable		1,300
Salaries Payable		3,500
Unearned Service Revenue		3,100
Common Shares		10,000
Retained Earnings		18,500
Dividends	14,000	
Service Revenues		73,000
Salaries Expense	31,000	
Rent Expense	18,600	
Depreciation Expense, Equipment	1,600	
Depreciation Expense, Furniture	400	
Supplies Expense	700	
Total	$119,400	$119,400

E3-15A. Common adjusting journal entries and financial statement reporting (*Learning Objectives 2 & 3*) 15–20 min.

Chen Financial Services (CFS) is making adjusting entries for the year ended June 30, 2015. The accounting clerk gathered the following information:

a. Paid one-year insurance premium of $2,400 on December 1, 2014, for coverage beginning on January 1, 2015.

b. Office Supplies account showed a balance of $480 and $270 on June 30, 2014 and 2015, respectively. During the year, CFS purchased $860 of office supplies.

c. Received $3,600 from a customer who paid for a three-month financial service contract starting on June 1. Financial Services Revenue account was credited on June 1.

d. An employee borrowed $12,000 by signing a one-year, 5% interest-bearing note from CFS on April 1, 2015. The note specified that interest was payable on the 5th of each month starting May 2015.

e. Signed a contract on June 1 with a local advertising company for $1,500 monthly advertising fee. The advertising service started immediately after signing the contract, and the payment was to be made on the 2nd of each month, starting July 2015.

Requirements

1. Prepare the adjusting entry for each item (a) to (e).
2. What amount should be reported for revenue and expense accounts, from (a) to (e) on the income statement, for the year ended June 30, 2015?
3. What amount should be reported for each asset and liability account in the statement of financial position?

E3-16A. Analyzing the effects of errors on accounts and adjusting entries (*Learning Objective 2*) 10–15 min.

Patel Instruments, Inc. made the following errors in the year-end account adjustments on December 31:

a. Did not record $1,200 salary owed to employees for four days of work.

b. Did not adjust $1,600 of revenue earned from the Unearned Revenue account for the second half of December.

c. Recorded a full year of depreciation, based on an equipment cost of $26,000 and salvage value of $2,000, with a useful life of four years. The equipment was purchased on October 1.

d. Did not adjust $600 of unused office supplies that was originally recorded in the Office Supplies Expense account.

Requirements

1. What is the impact that each item has had on net income, and on the asset, liability, and shareholders' equity accounts? Show understatements by "U," overstatements by "O," and no effect by "NE," and identify their amounts.
2. Based on each item (a) to (d) described above, prepare the appropriate adjusting entry for each item to reflect the correct account balance.

E3-17A. Identify the type of adjustment and adjusting entries (*Learning Objectives 1 & 2*) 10–15 min.

Techco Computer Services had the following transactions during the year. Its year-end is on September 30.

a. One-year insurance premium $1,800 was purchased on April 30. Coverage began on May 1.

b. The monthly payroll was $4,200, and the payment to employees was on the 1st of the following month.

c. A server was purchased on February 1 for $16,000. Techco estimated that the server could last five years, with a salvage value of $1,000 at the end of the fifth year.

d. Computer maintenance service was performed for a client on September 28 for $2,600. The invoice was sent on October 5, after the year-end date.

e. The Unearned Service Revenue account showed a balance of $5,200, which represents a four-month service contract. Three-quarters of the service was performed by the end of September.

Requirements

1. Identify each of the above transactions as accrued revenue, accrued expense, deferred revenue, or deferred expense.
2. Record the adjusting entry for each transaction.

E3-18A. Adjusting entries and inferring transactions (*Learning Objectives 2 & 3*) 10–15 min.

Park Management Ltd's selected account balances are presented below.

Account Title	November 30	December 31
Rent Receivable	$8,200	$5,600
Prepaid Insurance	1,300	900
Unearned Rent Revenue	3,800	2,500
Salaries Payable	3,000	5,000

Additional information regarding transactions that occurred in December:

a. Collection from rent receivable was $12,500.

b. Additional insurance purchased was $600.

c. Cash paid in advance from customers was $1,600.

d. Salary paid to employees was $4,000.

Requirements

1. Record the transactions that occurred during December.
2. Record the adjusting entries on December 31.
3. What amount should be reported for revenue and expense accounts on the income statement for the month ended December 31?

EXERCISES (GROUP B)

E3-1B. Adjusting journal entries—unearned revenue and accrued revenue (*Learning Objective 2*) 10–15 min.

Suppose you started up your own landscaping business. A customer paid you $120 in advance to mow his or her lawn while he or she was on vacation. You performed landscaping services for a local business but the business hasn't paid you the $425 fee yet. A customer pays you $110 cash for landscaping services. Answer the following questions about the correct way to account for your revenue under accrual-basis accounting:

1. Name the accounts used to record these events.
2. Prepare the journal entries to record the three transactions.

E3-2B. Adjusting journal entry—prepaid advertising (*Learning Objective 2*) 5–10 min.

Calculate the missing amounts for each of the Prepaid Insurance situations. For situation A, journalize the adjusting entry. Consider each situation separately.

	Situation			
	A	B	C	D
Beginning Prepaid Insurance	$ 800	$1,100	?	$ 300
Payments for Prepaid Insurance during the year	1,500	?	1,600	?
Total amount to account for	?	?	3,200	2,700
Ending Prepaid Insurance	700	1,200	?	?
Insurance Expense	$?	$ 500	$2,600	$1,400

E3-3B. Common adjusting journal entries (*Learning Objective 2*) 10–15 min.

Journalize the adjusting entries at May 31, the end of the accounting period. Omit explanations.

a. Employee salaries owed for Monday through Thursday of a five-day workweek equals $7,500.

b. Unearned service revenue now earned, $1,250.

c. Depreciation, $1,900.

d. Prepaid rent expired, $550.

e. Interest revenue accrued, $980.

E3-4B. Error analysis (*Learning Objective 2*) 10–15 min.

The adjusting entries for the following adjustments were omitted at year-end:

a. Prepaid rent expired, $2,500.

b. Depreciation, $1,000.

c. Employee salaries owed for Monday through Wednesday of a five-day workweek, $3,100.

d. Supplies used during the year, $800.

e. Unearned service revenue now earned, $4,500.

Requirement

1. Compute the amount that net income for the year is overstated or understated for each omitted entry. Use the following format to help analyze the transactions.

Transaction	Overstated/Understated	Amount
Sample a., b., etc.	Overstated	$5,000

E3-5B. Common adjusting journal entries *(Learning Objective 2)* 15–20 min.

Journalize the adjusting entry needed at August 31, the fiscal year-end, for each of the following independent situations. No other adjusting entries have been made for the year.

a. On July 1, we collected $3,000 rent in advance. We debited Cash and credited Unearned Rent Revenue. The tenant was paying six months' rent in advance.

b. The business holds a $35,000 note receivable. Interest revenue of $520 has been earned on the note but not yet received.

c. Salaries expense is $2,900 per day, Monday through Friday, and the business pays employees each Friday. This year, August 31 falls on a Tuesday.

d. The unadjusted balance of the Supplies account is $1,400. Supplies on hand total $200.

e. Equipment was purchased last year at a cost of $8,000. The equipment's useful life is 10 years.

f. On April 1, when we prepaid $1,560 for a one-year insurance policy, we debited Prepaid Insurance and credited Cash.

E3-6B. Common adjusting journal entries (*Learning Objective 2*) 15–20 min.

The accounting records of Weddings Unlimited include the following unadjusted balances at April 30: Accounts Receivable, $1,900; Supplies, $1,100; Salaries Payable, $0; Unearned Service Revenue, $1,300; Service Revenue, $5,300; Salaries Expense, $3,100; and Supplies Expense, $0. The following data pertains to April 30 adjusting entries:

a. Service revenue accrued, $2,200.

b. Unearned service revenue that has been earned, $300.

c. Supplies on hand, $150.

d. Salary owed to employees, $700.

Requirement

1. Record the adjustments, then post them to T-accounts, labelling each adjustment by letter. Calculate each account's adjusted balance.

E3-7B. Income statement preparation (*Learning Objective 3*) 15–20 min.

The accountant for Metal Main, Inc. posted adjusting entries (a) through (e) to the accounts at August 31, 2015. Selected statement of financial position accounts and all the revenues and expenses of the entity follow in T-account form.

Accounts Receivable

19,200	
(e) 2,250	

Supplies

2,200	(a) 1,600

Accumulated Depreciation, Equipment

	4,200
	(b) 1,400

Accumulated Depreciation, Building

	46,000
	(c) 1,000

Salaries Payable

	(d) 2,500

Service Revenue

	6,400
	(e) 2,250

Salaries Expense

13,500	
(d) 2,500	

Supplies Expense

(a) 1,600	

Depreciation Expense, Equipment

(b) 1,400	

Depreciation Expense, Building

(c) 1,000	

Requirements

1. Calculate balances in the accounts and use the appropriate accounts to prepare the income statement of Metal Main, Inc. for the year ended August 31, 2015. List expenses in order from largest to smallest.

2. Were the 2015 operations successful? Give the reason for your answer.

E3-8B. Statement of retained earnings preparation (*Learning Objective 3*) 10–15 min.

Zeta Safety, Inc. began the year with $15,000 of common shares and $34,000 of retained earnings. On August 5, investors bought $19,000 of additional shares in the business. On October 22, the business purchased land valued at $45,000. The income statement for the year ended December 31, 2015, reported a net loss of $5,000. During this fiscal year, the business paid $550 each month for dividends.

Requirements

1. Prepare Zeta Safety's statement of retained earnings for the year ended December 31, 2015.

2. Did the retained earnings of the business increase or decrease during the year? What caused this change?

E3-9B. Recreating adjusting journal entries (*Learning Objective 2*) 10–15 min.

The adjusted trial balances of CAS, Inc. at March 31, 2015, and March 31, 2016, include these amounts:

	2015	2016
Supplies	$ 1,700	$ 1,200
Salaries Payable	4,000	4,500
Unearned Service Revenue	17,000	15,100

Analysis of the accounts at March 31, 2016, reveals these transactions for 2016:

Purchases of supplies	$ 9,000
Cash payments for salaries	55,500
Cash receipts in advance for service revenue	58,000

Requirement

1. Compute the amount of supplies expense, salaries expense, and service revenue CAS, Inc. will report for the year ended March 31, 2016. Solve by making T-accounts and posting the information to solve for the unknown amounts.

E3-10B. Financial statement preparation (*Learning Objective 3*) 15–20 min.

The adjusted trial balance for Spruce Up Catering, Inc. is presented next. Prepare the income statement, statement of retained earnings, and statement of financial position for Spruce Up Catering, Inc. for the month ended January 31, 2015.

Spruce Up Catering, Inc.
Adjusted Trial Balance
January 31, 2015

ACCOUNT	DEBIT	CREDIT
Cash	$ 6,500	
Accounts Receivable	6,000	
Supplies	400	
Equipment	26,600	
Accumulated Depreciation, Equipment		$ 6,800
Accounts Payable		2,300
Salaries Payable		1,100
Unearned Service Revenue		1,900
Common Shares		5,200
Retained Earnings		11,100
Dividends	1,100	
Service Revenue		20,100
Salaries Expense	3,800	
Rent Expense	1,700	
Depreciation Expense, Equipment	1,500	
Supplies Expense	900	
Total	$48,500	$48,500

E3-11B. Prepare closing entries (*Learning Objective 4*) 10–15 min.

Requirements

1. Using the following selected accounts of Juba Electrical, Inc. at September 30, 2015, prepare the entity's closing entries:

Common Shares	$17,000	Accounts Receivable	$14,000
Service Revenue	49,000	Retained Earnings	7,900
Unearned Revenues	2,500	Salaries Payable	700
Salaries Expense	21,900	Depreciation Expense	5,000
Accumulated Depreciation	32,600	Building Rent Expense	5,600
Supplies Expense	2,300	Dividends	14,000
Interest Revenue	300	Supplies	2,300
Interest Expense	2,400		

2. What is Juba Electrical's ending retained earnings balance at September 30, 2015?

E3-12B. Statement of retained earnings preparation (*Learning Objective 3*) 10–15 min.

From the following accounts of Resch Restore, Inc. prepare the business's statement of retained earnings for the year ended January 31, 2015:

Retained Earnings

Clo	110,000	Feb 1	77,000
Clo	82,000	Clo	299,000
		Bal	184,000

Dividends

Apr 30	17,000		
Jul 31	14,000		
Oct 31	24,000		
Jan 31	27,000		
Bal	82,000	Clo	82,000

E3-13B. Prepare a post-closing trial balance (*Learning Objective 4*) 10–15 min.

The following post-closing trial balance was prepared for Fonzarelli Photo, Inc. Prepare a corrected post-closing trial balance. Assume all accounts have normal balances and the amounts are correct.

Fonzarelli Photo, Inc.
Post-Closing Trial Balance
March 31, 2015

ACCOUNT	DEBIT	CREDIT
Cash	$10,250	
Accounts Receivable	25,000	
Supplies		$ 600
Equipment		17,000
Accumulated Depreciation, Equip.	5,000	
Accounts Payable	8,800	
Salaries Payable		5,200
Unearned Service Revenue	2,200	
Common Shares		20,000
Retained Earnings	11,650	
Total	$62,900	$42,800

E3-14B. Prepare closing entries (*Learning Objective 4*) 10–15 min.

The following is the adjusted trial balance of Happy Health, Inc. for August 31, 2015.

Happy Health, Inc.
Adjusted Trial Balance
August 31, 2015

ACCOUNT	DEBIT	CREDIT
Cash	$ 9,000	
Accounts Receivable	11,000	
Supplies	170	
Furniture	5,200	
Accumulated Depreciation, Furniture		$ 1,800
Equipment	39,000	
Accumulated Depreciation, Equipment		4,500
Accounts Payable		1,200
Salaries Payable		3,500
Unearned Service Revenue		2,200
Common Shares		18,000
Retained Earnings		7,970
Dividends	14,000	
Service Revenue		77,000
Salaries Expense	27,000	
Rent Expense	6,000	
Depreciation Expense, Equipment	1,500	
Depreciation Expense, Furniture	1,300	
Supplies Expense	2,000	
Total	$116,170	$116,170

Requirement

1. Journalize the closing entries at August 31.

E3-15B. Common adjusting journal entries and financial statement reporting (*Learning Objectives 2 & 3*) 15–20 min.

Fung Cleaning Services (FCS) is making adjusting entries for the year ended September 30, 2015. The accounting clerk gathered the following information:

a. Paid one-year insurance premium of $1,800 on January 21, 2015, for coverage beginning on February 1, 2015.

b. Cleaning Supplies account showed a balance of $520 and $430 on September 30, 2014 and 2015, respectively. During the year, FCS purchased $780 of cleaning supplies.

c. Received $3,600 from a restaurant customer who paid for a six-month cleaning service contract starting on July 1. Cleaning Services Revenue account was credited on July 1.

d. An employee borrowed $9,000 by signing a one-year, 4% interest-bearing note from FCS on September 1. The note specified that interest was payable on the 5th of each month, starting October 2015.

e. Signed a contract on July 1 with a local advertising company for $1,750 monthly advertising fee. The advertising service started immediately after signing the contract, and the payment was to be made on the 2nd of each month, starting August 2015.

Requirements

1. Prepare the adjusting entry for each item (a) to (e).
2. What amount should be reported for revenue and expense accounts, from (a) to (e) on the income statement, for the year ended September 30, 2015?
3. What amount should be reported for each asset and liability account on the statement of financial position? (You can assume that interest payments have been received on time and payments for advertising have been made on time.)

E3-16B. Analyzing the effects of errors on accounts and adjusting entries (*Learning Objective 2*) 10–15 min.

Rupinder Delivery Services made the following errors in the year-end account adjustments on June 30:

- **a.** Did not record $1,800 gasoline charges on the credit card for the week of June 26.
- **b.** Did not adjust $900 of delivery services provided to a client for the second half of June. The invoice for the service was sent out on July 3.
- **c.** Recorded a full year of depreciation, based on a delivery truck cost of $27,000 and salvage value of $2,000, with a useful life of five years. The delivery truck was purchased on April 1.
- **d.** Did not adjust for unexpired insurance. A one-year insurance premium of $2,400 was paid on February 1 and the coverage started immediately. The transaction was recorded in the Insurance Expense account.

Requirements

1. What is the impact that each item has had on net income, and asset, liability, and shareholders' equity accounts? Show understatements by "U," overstatements by "O," and no effect by "NE," and identify their amounts.
2. Based on each item described above, prepare the appropriate adjusting entry to reflect the correct account balance.

E3-17B. Identify the type of adjustment and adjusting entries (*Learning Objectives 1 & 2*) 10–15 min.

BT Spa had the following transactions during the year. Its year-end is on June 30.

- **a.** The Unearned Revenue account showed a balance of $800, which represented four gift certificates of $200 each sold in June. Three gift certificates had been redeemed in June.
- **b.** The Prepaid Rent account showed a balance of $6,000, which represented six months' rent paid on April 1.
- **c.** An exercise machine was purchased on March 1 for $7,500. BT estimated that the machine could last eight years, with a salvage value of $300 at the end of the eighth year.
- **d.** Five employees each earned $100/day. Salary for the last seven days of June would be paid on July 2.
- **e.** A fitness service was performed for a business client on June 30 for $350. The invoice was sent on July 5, after the year-end date.

Requirements

1. Identify each of the above transactions as accrued revenue, accrued expense, deferred revenue, or deferred expense.
2. Record the adjusting entry for each transaction.

E3-18B. Adjusting entries and inferring transactions (*Learning Objectives 2 & 3*) 10–15 min.

Giuseppe Landscaping Ltd's selected account balances are presented below.

Account Title	May 31	June 30
Accounts Receivable	$4,200	$6,300
Landscaping Supplies	1,200	1,400
Unearned Revenue	2,100	2,400
Salaries Payable	4,000	3,500

Additional information regarding transactions that occurred in June:

a. Collection from accounts receivable was $7,500.

b. Additional landscaping supplies purchased were $1,000.

c. Cash paid in advance from customers was $1,800.

d. Salary paid to employee that was owing from the previous month was $4,000.

Requirements

1. Record the transactions that occurred during June.
2. Record the adjusting entries on June 30.
3. What amount should be reported for revenue and expense accounts on the income statement for the month ended June 30?

EXERCISES (ALTERNATES 1, 2, AND 3)

These alternative exercise sets are available for your practice benefit on **MyAccountingLab**.

PROBLEMS (GROUP A)

P3-1A. Common adjusting journal entries (*Learning Objective 2*) 15–20 min.

Journalize the adjusting entry needed at December 31, the end of the current accounting year, for each of the following independent cases affecting Canyon Riders, Inc. No other adjusting entries have been made for the year.

a. Prior to making the adjusting entry on December 31, the balance in Prepaid Insurance is $3,600. Canyon Riders, Inc. pays liability insurance each year on August 1.

b. Canyon Riders, Inc. pays employees each Friday. The amount of the weekly payroll is $16,500 for a five-day workweek. December 31, the fiscal year-end, is a Tuesday.

c. Canyon Riders, Inc. received notes receivable from some customers for services provided. For the current year, accrued interest amounts to $300 and will be collected next year.

d. The beginning balance of Supplies was $900. During the year, $4,500 of supplies were purchased. At December 31, the supplies on hand total $1,800.

e. During the year, Canyon Riders, Inc. received $17,200 in advance for services to be provided at a later date. As of December 31, Canyon Riders, Inc. earned $5,100 of the total fees received in advance during the current year.

f. Depreciation for the current year includes Vehicles, $2,990, and Equipment, $1,300.

P3-2A. Recreating adjusting journal entries from trial balances (*Learning Objective 2*) 15–20 min.

Assume the unadjusted and adjusted trial balances for Kristy's Consulting, Inc. at June 30, 2015, show the following data:

Kristy's Consulting, Inc.
Trial Balance
June 30, 2015

	UNADJUSTED TRIAL BALANCE		ADJUSTED TRIAL BALANCE	
ACCOUNT	**DR.**	**CR.**	**DR.**	**CR.**
Cash	$ 6,200		$ 6,200	
Accounts Receivable	5,800		5,800	
Supplies	1,400		300	
Prepaid Rent	2,800		2,100	
Equipment	18,000		18,000	
Accumulated Depreciation, Equipment		$ 7,500		$ 7,750
Accounts Payable		1,800		1,800
Salaries Payable				1,250
Interest Payable				150
Unearned Service Revenue		2,600		900
Notes Payable		7,000		7,000
Common Shares		5,000		5,000
Retained Earnings		4,900		4,900
Dividends	13,600		13,600	
Service Revenues		47,400		49,100
Salaries Expense	23,400		24,650	
Rent Expense	3,500		4,200	
Depreciation Expense, Equipment	1,250		1,500	
Interest Expense	250		400	
Supplies Expense			1,100	
Total	$76,200	$76,200	$77,850	$77,850

Requirement

1. Journalize the adjusting entries that account for the differences between the two trial balances.

P3-3A. Prepare adjusting journal entries and an adjusted trial balance (*Learning Objectives 2 & 3*) 25–30 min.

The trial balance of Alpha Advertising, Inc. at November 30, 2015, and the data needed for the month-end adjustments follow:

Alpha Advertising, Inc.
Trial Balance
November 30, 2015

ACCOUNT	DEBIT	CREDIT
Cash	$ 22,800	
Accounts Receivable	39,400	
Prepaid Insurance	2,700	
Supplies	900	
Equipment	83,800	
Accumulated Depreciation, Equipment		$ 64,300
Accounts Payable		1,900
Salaries Payable		
Unearned Service Revenue		2,200
Common Shares		50,000
Retained Earnings		29,300
Dividends	3,600	
Service Revenues		8,400
Salaries Expense	2,900	
Insurance Expense		
Depreciation Expense, Equipment		
Utilities Expense		
Supplies Expense		
Total	$156,100	$156,100

a. Insurance coverage still remaining at November 30, $300.

b. Supplies used during the month, $250.

c. Depreciation for the month, $1,200.

d. Accrued utilities expense at November 30, $300. (Use Accounts Payable as the liability account needed.)

e. Accrued salaries at November 30, $450.

f. Service revenue still unearned at November 30, $800.

Requirements

1. Open T-accounts for the accounts listed in the trial balance and insert their November 30 unadjusted balances.
2. Journalize the adjusting entries and post them to the T-accounts. Reference the posted amounts by letters (a) through (f). Calculate the adjusted balance in each account.
3. Prepare the adjusted trial balance.
4. How will the company use the adjusted trial balance?

P3-4A. Effects of adjusting journal entries on income statement accounts (*Learning Objectives 2 & 3*) 20–25 min.

Helgeson Enterprises, Corp. completed the following selected transactions and prepared these adjusting entries during January:

Jan 1	Prepaid insurance for January through March, $750.
3	Performed service on account, $1,800.
6	Purchased office furniture on account, $350.
8	Paid property tax expense, $600.
12	Purchased office equipment for cash, $1,400.
18	Performed services and received cash, $4,700.
23	Collected $900 on account.
26	Paid the account payable from the January 6 transaction.
30	Paid salaries expense, $2,400.
31	Recorded an adjusting entry for January insurance expense related to the January 1 transaction.
31	Recorded an adjusting entry for unearned revenue now earned, $400.

Requirements

1. State whether the transaction would increase revenues, decrease revenues, increase expenses, decrease expenses, or have no effect on revenues or expenses. If revenues or expenses are affected, give the amount of the impact on revenues or expenses for January. Use the following format for your answer.

Revenues and Expenses for January		
Date	**Impact on Revenues or Expenses**	**$ Effect on Revenues or Expenses**
Jan XX	Increase Revenues	$500

2. Compute January net income or net loss under the accrual basis of accounting.
3. State why the accrual basis of accounting results in an accurate measurement of income.

P3-5A. Prepare financial statements (*Learning Objective 3*) 20–25 min.

The adjusted trial balance of Lighthouse Realty, Inc. at December 31, 2015, follows:

Lighthouse Realty, Inc.
Adjusted Trial Balance
December 31, 2015

ACCOUNT	DEBIT	CREDIT
Cash	$ 6,300	
Accounts Receivable	11,600	
Prepaid Rent	1,200	
Supplies	900	
Equipment	48,000	
Accumulated Depreciation, Equipment		$ 12,000
Accounts Payable		5,400
Unearned Service Revenue		2,100
Interest Payable		750
Salaries Payable		1,800
Notes Payable		12,000
Common Shares		20,000
Retained Earnings		8,200
Dividends	14,000	
Service Revenue		97,000
Interest Revenue		650
Salaries Expense	51,000	
Rent Expense	18,000	
Depreciation Expense, Equipment	4,200	
Utilities Expense	2,700	
Interest Expense	1,300	
Supplies Expense	700	
Total	$159,900	$159,900

Requirements

1. Prepare Lighthouse Realty's 2015 income statement, statement of retained earnings, and year-end statement of financial position. List expenses in decreasing order on the income statement.
2. **a.** Which financial statement reports Lighthouse Realty's results of operations? Were operations successful during 2015? Cite specifics from the financial statements to support your evaluation.

   b. Which statement reports the company's financial position?

P3-6A. Prepare closing entries and a post-closing trial balance (*Learning Objective 4*) 20–25 min.

The June 30, 2015, adjusted trial balance of Energized Espresso, Inc. is shown next.

Energized Espresso, Inc.
Adjusted Trial Balance
June 30, 2015

ACCOUNT	DEBIT	CREDIT
Cash	$ 4,900	
Accounts Receivable	9,600	
Prepaid Rent	1,800	
Supplies	600	
Equipment	26,000	
Accumulated Depreciation, Equipment		$ 4,200
Accounts Payable		2,400
Unearned Service Revenue		1,100
Salaries Payable		1,800
Notes Payable		3,000
Common Shares		10,000
Retained Earnings		11,950
Dividends	2,000	
Service Revenue		43,000
Interest Revenue		400
Salaries Expense	24,500	
Rent Expense	6,000	
Depreciation Expense, Equipment	1,200	
Utilities Expense	700	
Supplies Expense	550	
Total	$77,850	$77,850

Quick solution:

2. Retained Earnings = $20,400

3. Trial balance totals = $42,900

Requirements

1. Prepare the June closing entries for Energized Espresso, Inc.
2. Calculate the ending balance in retained earnings.
3. Prepare a post-closing trial balance.

P3-7A. Effects of errors on assets, liabilities, shareholders' equity, and net income (*Learning Objectives 2 & 3*) 15–20 min.

The following errors were made in the accounting records of Garceau Corp. in 2015 and were not discovered until 2016.

a. The journal entry to record a receipt of $3,170 for Consulting Revenue was incorrectly recorded as $7,310.

b. A $2,400 credit to Accumulated Amortization, Automobile account was incorrectly credited to Automobile account.

c. A payment of $2,800 for dividends was incorrectly debited to Salaries Expense account.

d. Salaries expense for 2015 of $1,650 was not recorded. It was recorded as Salaries Expense in 2016 when it was paid.

e. A $1,850 credit to Unearned Revenue was posted to Accounts Receivable.

Requirements

For each of the independent errors in parts (a) through (e), identify the net effect on assets, liabilities, shareholders' equity, and net income for 2015 and 2016. Show understatements by "U," overstatements by "O," and no effect by "NE," and identify their amounts.

	Assets		Liabilities		Shareholders' Equity		Net Income	
	2015	2016	2015	2016	2015	2016	2015	2016
a								
b								
c								
d								
e								

P3-8A. Adjusting entries using a worksheet (*Learning Objectives 1, 2, 3 & 5*) 35–40 min.

Klean Laundry Services (KLS) has been providing commercial laundry services to restaurants and hotels for several years. KLS's year-end is on June 30. The unadjusted trial balance on June 30, 2015, was as follows:

Klean Laundry Services
Worksheet
For Month Ended June 30, 2015

		UNADJUSTED TRIAL BALANCE		ADJUSTMENTS		ADJUSTED TRIAL BALANCE	
ACCT #	ACCOUNT	DR.	CR.	DR.	CR.	DR.	CR.
1010	Cash	$ 5,100					
1020	Accounts Receivable	9,300					
1030	Laundry Supplies	8,600					
1035	Prepaid Insurance	3,600					
1040	Laundry Machines	50,000					
1041	Accumulated Depreciation, Laundry Machines		$ 15,000				
2010	Accounts Payable		3,700				
2015	Salaries Payable						
2020	Unearned Laundry Revenue		2,100				
2025	Interest Payable						
2030	Income Tax Payable						
2100	Note Payable – 3 years		21,000				
3010	Common Shares		10,000				
3030	Retained Earnings		18,500				
3040	Dividends	4,500					
4010	Laundry Revenue		98,000				
5010	Salaries Expense	62,000					
5015	Insurance Expense	9,000					
5030	Utilities Expense	8,400					
5040	Depreciation Expense, Laundry Machines						
5050	Laundry Supplies Expense	7,800					
5060	Interest Expense						
5070	Income Tax Expense						
	Total	$168,300	$168,300				

Additional information about several transactions that occurred during the year:

a. Laundry services provided to hotels amounted to $7,500 in June. The client would pay on July 5.

b. A physical count of laundry supplies showed that there was $3,200 of cleaning supplies on hand on June 30. The balance of Laundry Supplies Expense, $7,800 on June 30, represents laundry supplies purchased during the year.

c. The balance of Prepaid Insurance represents one-year insurance premium paid on February 1.

d. Laundry machines were estimated to last for eight years, with a salvage value of $2,000 at the end of the eigth year. No adjustment was made for this fiscal year.

e. Four workers each earned $60/day. Six days of wages were earned by employees, but not paid by June 30.

f. Seventy percent of the unearned revenue was earned in June.

g. On March 1, KLS borrowed $21,000 from the RBC bank by signing a three-year note with a 5% interest rate. KLS was required to make annual interest payments at the end of each year.

h. The utilities expense for June was estimated at $1,200. The utility bill usually arrived during the first week of the following month.

i. KLS's income tax rate was 30%.

Requirements

1. Indicate the type of adjustments for each transaction.
2. Prepare the adjusting entry and enter the amount for each transaction in the worksheet.
3. Prepare the adjusted trial balance in the worksheet.
4. What is the age of the laundry machines?
5. Prepare the income statement, statement of retained earnings, and statement of financial position.
6. Record the adjusting entry for the income tax.

P3-9A. Closing entries using a worksheet (*Learning Objectives 4 & 5*) 10–15 min.

Refer to P3-8A.

Requirement

Using the adjusted trial balance from P3-8A, prepare the closing entries for 2015 and the post-closing trial balance in the worksheet.

PROBLEMS (GROUP B)

P3-1B. Common adjusting journal entries (*Learning Objective 2*) 15–20 min.

Journalize the adjusting entries needed at December 31, the end of the current accounting year, for each of the following independent cases affecting Mountain Mania, Inc. No other adjusting entries have been made for the year.

a. Prior to making the adjusting entry on December 31, the balance in Prepaid Insurance is $1,200. Mountain Mania, Inc. pays liability insurance each year on April 30.

b. Mountain Mania, Inc. pays employees each Friday. The amount of the weekly payroll is $12,500 for a five-day workweek. December 31, the fiscal year-end, is a Monday.

c. Mountain Mania, Inc. received notes receivable from some customers for services provided. For the current year, accrued interest amounts to $640 and will be collected next year.

d. The beginning balance of Supplies was $1,025. During the year, $4,300 of supplies were purchased. At December 31, the supplies on hand total $2,500.

e. During the year, Mountain Mania, Inc. received $17,200 in advance for services to be provided at a later date. As of December 31, Mountain Mania, Inc. earned $4,700 of the total fees received in advance during the current year.

f. Depreciation for the current year includes Vehicles, $2,550, and Equipment, $1,300.

P3-2B. Recreating adjusting journal entries from trial balances (*Learning Objective 2*) 15–20 min.

Assume the unadjusted and adjusted trial balances for Milky Way Theatre, Inc. at November 30, 2015, show the following data:

Milky Way Theatre, Inc.
Trial Balance
November 30, 2015

	UNADJUSTED TRIAL BALANCE		ADJUSTED TRIAL BALANCE	
ACCOUNT	**DR.**	**CR.**	**DR.**	**CR.**
Cash	$ 9,200		$ 9,200	
Accounts Receivable	6,200		6,200	
Supplies	2,200		800	
Prepaid Rent	3,600		2,700	
Equipment	26,000		26,000	
Accumulated Depreciation, Equipment		$ 4,700		$ 6,200
Accounts Payable		2,600		2,600
Salaries Payable				1,250
Interest Payable				290
Unearned Service Revenue		3,000		2,100
Notes Payable		7,000		7,000
Common Shares		15,000		15,000
Retained Earnings		2,900		2,900
Dividends	12,000		12,000	
Service Revenue		53,400		54,300
Salaries Expense	23,600		24,850	
Rent Expense	4,800		5,700	
Depreciation Expense, Equipment	750		2,250	
Interest Expense	250		540	
Supplies Expense			1,400	
Total	$88,600	$88,600	$91,640	$91,640

Requirement

1. Journalize the adjusting entries that account for the differences between the two trial balances.

P3-3B. Prepare adjusting journal entries and an adjusted trial balance (*Learning Objectives 2 & 3*) 25–30 min.

The trial balance of Nina's Novelty, Inc. at September 30, 2015, and the data needed for the month-end adjustments follow:

Nina's Novelty, Inc.
Trial Balance
September 30, 2015

ACCOUNT	DEBIT	CREDIT
Cash	$ 25,000	
Accounts Receivable	17,400	
Prepaid Insurance	2,400	
Supplies	1,200	
Equipment	59,000	
Accumulated Depreciation, Equipment		$ 50,000
Accounts Payable		2,000
Salaries Payable		
Unearned Service Revenue		2,400
Common Shares		25,000
Retained Earnings		22,800
Dividends	9,700	
Service Revenue		16,200
Salaries Expense	3,700	
Insurance Expense		
Depreciation Expense		
Utilities Expense		
Supplies Expense		
Total	$118,400	$118,400

a. Insurance coverage still remaining at September 30, $800.

b. Supplies used during the month, $900.

c. Depreciation for the month, $2,200.

d. Accrued utilities expense at September 30, $1,000. (Use Accounts Payable as the liability account needed.)

e. Accrued salaries at September 30, $800.

f. Service revenue still unearned at September 30, $1,600.

Requirements

1. Journalize the adjusting entries.
2. Open T-accounts for the accounts listed in the trial balance and insert their September 30 unadjusted balances. Post the adjusting entries to the T-accounts. Reference the posted amounts by letters (a) through (f). Calculate the adjusted balance in each account.
3. Prepare the adjusted trial balance.
4. How will the company use the adjusted trial balance?

P3-4B. Effects of adjusting journal entries on income statement accounts (*Learning Objectives 2 & 3*) 20–25 min.

Moore, Corp. completed the following selected transactions and prepared these adjusting entries during May:

May 1	Prepaid insurance for May through July, $2,700.
3	Performed service on account, $2,500.
6	Purchased office furniture on account, $900.
8	Paid property tax expense, $500.
12	Purchased office equipment for cash, $1,500.
18	Performed services and received cash, $3,500.
23	Collected $800 on account.
26	Paid the account payable from the May 6 transaction.
30	Paid salaries expense, $1,300.
31	Recorded an adjusting entry for May insurance expense related to the May 1 transaction.
31	Recorded an adjusting entry for unearned revenue now earned, $1,100.

Requirements

1. State whether the transaction would increase revenues, decrease revenues, increase expenses, decrease expenses, or have no effect on revenues or expenses. If revenues or expenses are affected, give the amount of the impact on revenues or expenses for May. Use the following format for your answer.

Revenues and Expenses for May

Date	Impact on Revenues or Expenses	$ Effect on Revenues or Expenses
May XX	Increase Revenues	$XXX

2. Compute May net income or net loss under the accrual basis of accounting.
3. State why the accrual basis of accounting results in an accurate measurement of income.

P3-5B. Prepare financial statements (*Learning Objective 3*) 20–25 min.

The adjusted trial balance for Destination Realty, Inc. at October 31, 2015, follows:

Destination Realty, Inc.
Adjusted Trial Balance
October 31, 2015

ACCOUNT	DEBIT	CREDIT
Cash	$ 6,500	
Accounts Receivable	12,100	
Prepaid Rent	2,500	
Supplies	500	
Equipment	42,500	
Accumulated Depreciation, Equipment		$ 11,300
Accounts Payable		4,300
Unearned Service Revenue		2,800
Interest Payable		720
Salaries Payable		9,000
Notes Payable		8,000
Common Shares		3,960
Retained Earnings		9,700
Dividends	5,000	
Service Revenue		85,000
Interest Revenue		420
Salaries Expense	40,000	
Rent Expense	20,000	
Depreciation Expense, Equipment	2,500	
Utilities Expense	1,800	
Interest Expense	1,100	
Supplies Expense	700	
Total	$135,200	$135,200

Requirements

1. Prepare Destination Realty's income statement, statement of retained earnings, and year-end statement of financial position. List expenses in decreasing order on the income statement.
2. **a.** Which financial statement reports Destination Realty's results of operations? Were operations successful during 2015? Cite specifics from the financial statements to support your evaluation.

   b. Which statement reports the company's financial position?

P3-6B. Prepare closing entries and a post-closing trial balance (*Learning Objective 4*) 20–25 min.

The September 30, 2015, adjusted trial balance of Java Jolt, Inc. is shown next.

Java Jolt, Inc.
Adjusted Trial Balance
September 30, 2015

ACCOUNT	DEBIT	CREDIT
Cash	$ 5,800	
Accounts Receivable	7,000	
Prepaid Rent	2,300	
Supplies	300	
Equipment	30,000	
Accumulated Depreciation, Equipment		$ 3,800
Accounts Payable		3,000
Unearned Service Revenue		1,900
Salaries Payable		1,400
Notes Payable		10,000
Common Shares		3,100
Retained Earnings		11,200
Dividends	4,000	
Service Revenue		41,000
Interest Revenue		1,000
Salaries Expense	18,500	
Rent Expense	5,400	
Depreciation Expense, Equipment	1,700	
Utilities Expense	800	
Supplies Expense	600	
Total	$76,400	$76,400

Requirements

1. Prepare the September closing entries for Java Jolt, Inc.
2. Calculate the ending balance in retained earnings.
3. Prepare a post-closing trial balance.

P3-7B. Effects of errors on assets, liabilities, shareholders' equity, and net income (*Learning Objectives 2 & 3*) 15–20 min.

The following errors were made in the accounting records of Gagnon Corp. in 2015 and were not discovered until 2016.

a. Management revenue of $3,750 earned in 2015 was not recorded until it was collected in 2016.

b. One year of Amortization Expense, $4,200, was recorded instead of three-quarters of the amount.

c. A deposit of $4,000 for Management Service to be delivered in 2016 was recorded as Management Revenue in 2015.

d. One-year insurance premium of $3,300 for 2016 was recorded as Insurance Expense for 2015 when it was paid.

e. Half of the unearned revenue of $4,500 was earned in 2015, but was not recorded.

Requirements

1. For each of the independent errors in parts (a) through (e), identify the net effect on assets, liabilities, shareholders' equity, and net income for 2015 and 2016. Show understatements by "U," overstatements by "O," and no effect by "NE," and identify their amounts.

	Assets		Liabilities		Shareholders' Equity		Net Income	
	2015	2016	2015	2016	2015	2016	2015	2016
a								
b								
c								
d								
e								

P3-8B. Adjusting entries using a worksheet (*Learning Objectives 1, 2, 3 & 5*) 35–40 min.

Muse Daycare Centre (MDC) has been providing daycare services to its local community for several years. MDC's year-end is on December 31. The unadjusted trial balance on December 31, 2015 was as follows:

Muse Daycare Centre
Worksheet
For Year Ended December 31, 2015

		UNADJUSTED TRIAL BALANCE		ADJUSTMENTS		ADJUSTED TRIAL BALANCE	
ACCT #	ACCOUNT	DR.	CR.	DR.	CR.	DR.	CR.
1010	Cash	$ 6,200					
1020	Accounts Receivable	2,700					
1030	Art Supplies	3,200					
1035	Prepaid Rent	3,600					
1040	Playground Equipment	43,000					
1041	Accumulated Depreciation, Playground Equipment		$ 7,800				
2010	Accounts Payable		2,450				
2015	Salaries Payable						
2020	Unearned Daycare Revenue		2,100				
2030	Income Tax Payable						
3010	Common Shares		25,000				
3030	Retained Earnings		10,500				
3040	Dividends	5,000					
4010	Daycare Revenue		95,000				
5010	Salaries Expense	60,000					
5015	Rent Expense	9,000					
5030	Utilities Expense	5,350					
5040	Depreciation Expense, Playground Equipment						
5050	Art Supplies Expense	4,800					
5060	Income Tax Expense						
	Total	$142,850	$142,850				

Additional information about several transactions that occurred during the year:

a. Several parents did not pay the fee for the last week of daycare. These parents would pay $1,400 (which included $700 owed in December) in the first week of January.

b. A physical count of art supplies showed that there was $1,500 of art supplies on hand on December 31. The balance of Art Supplies Expense, $4,800 on December 31, represents art supplies purchased during the year.

c. The balance of Prepaid Rent represents the four months of rent paid on November 1.

d. Playground Equipment was estimated to last for 10 years, with a salvage value of $4,000 at the end of the tenth year. No adjustment was made in 2015.

e. Three daycare workers each earned $80/day. Seven days of wages were earned by employees, but not paid on December 31.

f. Half of the unearned revenue was earned in December.

g. The utilities expense for December was estimated at $480. The utility bill usually arrived during the first week of the following month.

h. MDC's income tax rate was 30%.

Requirements

1. Indicate the type of adjustments for each transaction.
2. Prepare the adjusting entry and enter the amount for each transaction in the worksheet.
3. Prepared the adjusted trial balance in the worksheet.
4. What is the age of the playground equipment?
5. Prepare the income statement, statement of retained earnings, and classified statement of financial position.
6. Record the adjusting entry for the income tax.

P3-9B. Closing entries using a worksheet (*Learning Objectives 4 & 5*) 10–15 min.

Refer to P3-8B.

Requirements

Using the adjusted trial balance from P3-8B, prepare the closing entries for 2015 and the post-closing trial balance in the worksheet.

PROBLEMS (ALTERNATES 1, 2, AND 3)

These alternative problem sets are available for your practice benefit on **MyAccountingLab**.

CONTINUING EXERCISE

This exercise continues the accounting process for Graham's Yard Care, Inc. from the Continuing Exercise in Chapter 2. Refer to the T-accounts and the trial balance that you prepared for Graham's Yard Care, Inc. at June 30, 2015.

Requirements

1. Open these additional T-accounts: Accumulated Depreciation, Equipment; Depreciation Expense, Equipment; Supplies Expense.
2. A physical count shows $20 of lawn supplies on hand at June 30, 2015. Depreciation on equipment for the month totals $30. Journalize any required adjusting journal entries and post to the T-accounts, identifying all items by date.
3. Prepare the adjusted trial balance.
4. Journalize and post the closing entries at June 30.
5. Prepare a post-closing trial balance.

CONTINUING PROBLEM

This problem continues the accounting process for Aqua Elite, Inc. from the Continuing Problem in Chapter 2. The trial balance for Aqua Elite, Inc. at June 30, 2015, should look like this:

Aqua Elite, Inc.
Trial Balance
June 30, 2015

ACCOUNT	DEBIT	CREDIT
Cash	$16,855	
Accounts Receivable	3,800	
Supplies	1,610	
Land	15,000	
Furniture	3,300	
Equipment	4,700	
Vehicles	31,000	
Accounts Payable		$ 3,890
Notes Payable		31,000
Common Shares		38,500
Dividends	2,800	
Service Revenue		12,000
Salaries Expense	2,700	
Rent Expense	1,800	
Utilities Expense	1,225	
Advertising Expense	325	
Miscellaneous Expense	275	
Total	$85,390	$85,390

During July, the following transactions occurred:

Jul 1	Paid three months' rent, $5,400.
4	Performed service for a customer and received cash, $2,100.
9	Received $3,600 from customers for services to be performed later.
12	Purchased $750 of supplies on account.
15	Billed customers for services performed, $2,800.
16	Paid receptionist's salary, $675.
22	Received $3,100 on account.
25	Paid $2,800 on account.
28	Received $1,200 cash for services performed.
30	Paid $600 of dividends.

Requirements

1. Journalize the transactions that occurred in July. Omit explanations.
2. Using the four-column accounts from the Continuing Problem in Chapter 2, post the transactions to the ledger creating new ledger accounts as necessary; omit posting references. Calculate the new account balances.
3. Prepare the unadjusted trial balance for Aqua Elite, Inc. at the end of July.

4. Journalize and post the adjusting entries for July based on the following adjustment information.
   a. Record the expired rent.
   b. Supplies on hand, $350.
   c. Depreciation: $400 equipment, $210 furniture, $650 vehicles.
   d. Services performed but unbilled, $1,900.
   e. Accrued salaries, $675.
   f. Unearned service revenue earned as of July 31, $800.
5. Prepare an adjusted trial balance for Aqua Elite, Inc. at the end of July.
6. Prepare the income statement, statement of retained earnings, and statement of financial position for the three-month period May through July, 2015.
7. Prepare and post closing entries.
8. Prepare a post-closing trial balance for the end of the period.

APPLY YOUR KNOWLEDGE

ETHICS IN ACTION

Case 1. Jennifer Baxter was preparing the adjusting journal entries for Jennifer's Java, a business that uses the accrual basis of accounting, to prepare the adjusted trial balance and financial statements. She knew that $750 of salaries related to the current accounting period had accrued but wouldn't be paid until the next period. Jennifer thought that simply not including the adjustment for these salaries would mean that salaries expense would be lower, and reported net income would be higher than it would have been if she had made the adjustment. Further, she knew that the Salaries Payable account would be zero, so the liabilities reported on the statement of financial position would be less, and her business would look even better. Besides, she reasoned that these salaries would be reported eventually, so it was merely a matter of showing them in one period instead of another. Dismissing the reporting as just a timing issue, she ignored the adjustment for the additional salaries expense.

Is Jennifer acting unethically by failing to record the adjustment for accrued salaries? Does it matter that, shortly into the new accounting period, the salaries will ultimately be paid? Is it really simply a matter of timing? What are the potential problems of failing to include all the adjusting journal entries?

Case 2. Jim Anderson and his banker were reviewing the quarterly income statements for his consulting business, Anderson and Associates, Inc. The banker was impressed with the growth of sales revenue and net income for the second quarter this year as compared to the second quarter of last year. Jim knew it had been a good quarter, but didn't think it had been spectacular. Suddenly, Jim realized that he failed to close out the revenue and expense accounts for the prior quarter, which ended in March. Because those temporary accounts were not closed out, their balances were included in the second quarter amounts for the current year. Jim then realized that the banker had the financial statements but not the general ledger or any trial balances. Thus, the banker would not be able to see that the accounting cycle was not properly closed and that this failure was creating a misstated income statement for the second quarter of the current year. The banker then commented that the business appeared to be performing so well that he would approve a line of credit for the business. Jim decided to not say anything because he did not want to lose the line of credit. Besides, he thought, it really did not matter that the income statement was misstated because his business would be sure to repay any amounts borrowed.

Should Jim have informed the banker of the mistake made and should he have redone the second quarter's income statement? Was Jim's failure to close the prior quarter's revenue and expense accounts unethical? Does the fact that the business will repay the loan matter?

KNOW YOUR BUSINESS

FINANCIAL ANALYSIS

Purpose: To help familiarize you with the financial reporting of a real company to further your understanding of the chapter material you are learning.

This case will help you to better understand the effect of adjusting journal entries on the financial statements. We do not have access to the journals and ledgers used by Bombardier Inc., but we can see some of the adjusted accounts on the company's financial statements. Refer to the Bombardier Inc. income statements, "Consolidated Statements of Income," and the Bombardier Inc. statements of financial position in MyAccountingLab. Also, Note 19 titled "Property, Plant and Equipment" on page 168 of the Bombardier Annual Report uses the term amortization instead of depreciation. You can consider these two terms to mean the same thing at this point.

Requirements

1. Open T-accounts for the following accounts and their balances as of December 31, 2012, prior to closing. (All amounts in millions of US$.)

PP&E	$4,330
Trade and other payables	$3,361
Advances and progress billings in excess of related long-term contract Inventories	$1,232
Accumulated amortization and impairment	$2,146

2. Using the following information for Bombardier Inc.'s 2012 operations, make the appropriate year-end journal entries.

a. Payment of Accrued Liabilities of $1,021.

b. Amortization expense, $156.

c. Accrued Accounts Payable and Accrued Liabilities, $1,213.

d. Additional Advances and progress billings in excess of related long-term contract costs, $783.

3. Post the journal entries to the T-accounts you set up. Check the updated ending balances in each account against the balances reported by Bombardier Inc. as of January 31, 2012. You can determine the net PP&E by subtracting the Amortization from PP&E balance.

INDUSTRY ANALYSIS

Purpose: To help you understand and compare the performance of two companies in the same industry.

Go to the Bombardier Annual Report located in MyAccountingLab. Now access the Annual Report for The Boeing Company. To do this from the internet, go to the company's web page for Investor Relations at http://www.boeing.com/companyoffices/financial/quarterly.htm and download the annual report for the year ended December 31, 2012.

Requirement

1. Identify three accounts for each company that indicate that both Bombardier and Boeing use the accrual basis of accounting. Why do you think using the accrual basis of accounting would be more helpful for analysis purposes than the cash basis for these two companies?

SMALL BUSINESS ANALYSIS

Purpose: To help you understand the importance of cash flows in the operation of a small business.

It's the end of the month and cash flow has been a little slow, as it usually is during this time of the accounting period. It just seems to be a little slower this month. You know that Wednesday the 31st is payday, which always requires a large cash outlay. However, you also know that your bank is looking for a set of financial statements as of the end of the month because the loan on your building is coming up for renewal soon. In some of the previous meetings with your bankers, you know that they were always concerned with the cash balance, so you want to have your cash balance as high as possible.

You come up with a tentative plan to not only preserve some of your cash balance at the end of the month, but you believe it will also help your bottom line, your net income. That's the other thing that the bankers are always concerned about. You don't want to make any mistakes with your financial statements at this crucial point, so you decide to contact your accountant to run the idea by her. The conversation goes something like this:

"Good morning, Linda. This is Jerry from BCS Consultants, Inc. Our financial statements have to look really good this month because the bank is going to be scrutinizing them pretty closely for our pending loan renewal. I know that the two things they concentrate on are the cash balance and the net income. So, I've got a plan to help in both of those areas. I'm going to hold off paying my employees until after the first of the month. Plus, last month, I made a big insurance payment to cover me for the next six months, so I won't need to show any insurance expense this month. Both of those will help my net income because I won't be showing those expenses on my income statement. Plus, by not writing the paycheques until the first of the month, I'll be helping to show a higher cash balance. It's really only one day, but the bank won't know that my cash balance should be lower. These certainly sound like some good ideas that would help with my situation, but just in case, I wanted to check with you to see what you thought. Any comments?"

The first words out of the accountant's mouth are "Jerry, you know that your financial statements are prepared using the accrual basis of accounting."

Requirement

1. Complete the thought process of the accountant concerning Jerry's plan. What does she mean by the accrual basis of accounting? What effect will that have on the net income? Is Jerry correct in his assessment of the big insurance payment he made last month covering the next six months? What effect will that have on the net income? And in regard to the last item, what about Jerry's plan to keep the cash balance as high as possible and his statement "the bank won't know that my cash balance should be lower"?

WRITTEN COMMUNICATION

You received a letter from a disgruntled client concerning this year's tax return that you just completed for his or her company. The client's business is in the second year of operations, and you remembered that it seemed to be much more profitable this year than during the first year of operations. You also recall that this particular client's year-end work was assigned to a relatively new staff accountant, which might be part of the problem. The gist of the letter is that last year's taxable net income was about $25,000, and according to the company's calculations, the net income from this year should have been about $50,000. And so the client is wondering why the company is showing taxable net income of $75,000 on this year's return and paying income tax on that amount. You retrieve the file to review it and immediately see the problem. The staff accountant failed to make the closing entries at the end of the first year of operations!

Requirement

1. Prepare a letter to this client explaining the situation and, most importantly, explaining the importance of doing closing entries at the end of each and every year. Also, suggest a solution to this problem for the client, knowing that just explaining the accounting issue might not be enough to retain this client in the future.

Self Check Answers

1. a 2. b 3. c 4. d 5. a 6. d 7. c 8. d 9. b 10. c

COMPREHENSIVE PROBLEM

JOURNALIZING, POSTING, ADJUSTING, PREPARING FINANCIAL STATEMENTS, AND CLOSING

Waters Landscaping, Inc. completed the following transactions during its first month of operations for January 2015:

- **a.** Gary Waters invested $7,500 cash and a truck valued at $15,000 to start Waters Landscaping, Inc. The business issued common shares in exchange for these assets.
- **b.** Purchased $300 of supplies on account.
- **c.** Paid $1,200 for a six-month insurance policy.
- **d.** Performed landscape services for a customer and received $800 cash.
- **e.** Completed a $4,500 landscaping job on account.
- **f.** Paid employee salary, $600.
- **g.** Received $1,100 cash for performing landscaping services.
- **h.** Collected $1,500 in advance for landscaping service to be performed later.
- **i.** Collected $2,500 cash from a customer on account.
- **j.** Purchased fuel for the truck, paying $80 with a company credit card. Credit Accounts Payable.
- **k.** Performed landscaping services on account, $1,600.
- **l.** Paid the current month's office rent, $750.
- **m.** Paid $50 on account.
- **n.** Paid cash dividends of $500.

Requirements

1. Record each transaction in the general journal. Use the letter corresponding to each transaction as the transaction date. Explanations are not required.
2. Post the transactions that you recorded in Requirement 1 in the following T-accounts.

Cash	Salaries Payable	Service Revenue
Accounts Receivable	Unearned Service Revenue	Salaries Expense
Supplies	Common Shares	Depreciation Expense
Prepaid Insurance	Retained Earnings	Insurance Expense
Truck	Dividends	Fuel Expense
Accumulated Depreciation		Rent Expense
Accounts Payable		Supplies Expense

3. Prepare an unadjusted trial balance as of January 31, 2015.

4. Journalize and post the adjusting journal entries based on the following information:

- **a.** Accrued salaries expense, $600.
- **b.** Depreciation expense, $375.
- **c.** Record the expiration of one month's insurance.
- **d.** Supplies on hand, $75.
- **e.** Earned 1/3 of the Unearned Service Revenue during January.
- **f.** Waters Landscaping's income tax rate is 30%.

5. Prepare an adjusted trial balance as of January 31, 2015. Use the adjusted trial balance to prepare Waters Landscaping's income statement, statement of retained earnings, and statement of financial position for January. On the income statement list expenses in decreasing order by amount—that is, the largest expense first, the smallest expense last.

6. Journalize and post the closing entries.

7. Prepare a post-closing trial balance at January 31, 2015.