

CHAPTER 4

Adjusting the accounts and preparing financial statements

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DEMONSTRATION PROBLEM

The unadjusted trial balance prepared for the Johnson Decorating Service on 31 July is shown below.

JOHNSON DECORATING SERVICE Unadjusted Trial Balance as at 31 July 2003		
Account title	Debit	Credit
Cash at bank	\$ 14 900	
Trade debtors	1 200	
Office supplies inventory	700	
Prepaid insurance	900	
Motor vehicle	21 000	
Office equipment	6 000	
Trade creditors		\$ 6 700
Unearned service fees		400
Loan payable		15 000
Mike Johnson, Capital		20 000
Service fee revenue		2 600
	<u>\$44 700</u>	<u>\$44 700</u>

Other information available at the end of July is as follows:

1. Depreciation on the motor vehicle for 1 month is \$500 and on the office equipment is \$100.
2. Interest accrued on the loan payable is \$150.
3. Received a \$240 invoice from Austral Oil Company for fuel used in the business.
4. Office supplies of \$425 was determined by a physical count.
5. The balance in the Prepaid Insurance account is the cost of a 12-month policy purchased on 1 July.
6. Electricity used in July but not paid for, \$825.

(continued)

Required:

- A. Prepare the necessary adjusting entries. The following account titles are to be added to those listed in the trial balance:
- Depreciation Expense
 - Motor Vehicle Expense
 - Insurance Expense
 - Office Supplies Expense
 - Electricity Expense
 - Interest Expense
 - Interest Payable
 - Accrued Expenses Payable
 - Accumulated Depreciation—Motor Vehicle
 - Accumulated Depreciation—Office Equipment
- B. Prepare an adjusted trial balance.

Solution to demonstration problem

A.

General Journal					
Date		Particulars	Post Ref.	Debit	Credit
July	31	Depreciation Expense Accumulated Depreciation— Motor Vehicle Accumulated Depreciation— Office Equipment To record depreciation for the month of July.		600	500 100
	31	Interest Expense Interest Payable To record interest on bills payable.		150	150
	31	Motor Vehicle Expense Accrued Expenses Payable To record unpaid fuel bills.		240	240
	31	Office Supplies Expense Office Supplies Inventory To record office supplies used in July.		275	275
	31	Insurance Expense Prepaid Insurance To record expired insurance.		75	75
	31	Electricity Expense Accrued Expenses Payable To record accrued expense.		825	825

(continued)

B.

JOHNSON DECORATING SERVICE

Adjusted Trial Balance

as at 31 July 2003

Account title	Account balance	
	Debit	Credit
Cash at bank	\$ 14 900	
Trade debtors	1 200	
Office supplies inventory	425	
Prepaid insurance	825	
Motor vehicle	21 000	
Accumulated depreciation—motor vehicle		\$ 500
Office equipment	6 000	
Accumulated depreciation—office equipment		100
Trade creditors		6 700
Unearned service fees		400
Loan payable		15 000
Interest payable		150
Accrued expenses payable		1 065
Mike Johnson, Capital		20 000
Service fee revenue		2 600
Depreciation expense	600	
Motor vehicle expense	240	
Insurance expense	75	
Office supplies expense	275	
Electricity expense	825	
Interest expense	150	
	<u>\$ 46 515</u>	<u>\$ 46 515</u>

ADDITIONAL PROBLEMS

Problem 4.1

Adjusting entries and corrections

K. Barth submits to you draft accounts for the year ended 31 December 2003, and statement of financial position as at that date. He explains that towards the end of the financial year his accountant resigned and he had completed the records himself. He thinks that errors have occurred and asks your help. An examination of the accounting records reveals the following:

1. Rent due by customers Cee and Dee amounting to \$480 is not included in the accounts.
2. A payment of \$800 for new office furniture has been incorrectly debited to Sundry Expenses account. The furniture had been purchased just before Christmas 2003.
3. Commission due to sales representatives for the month of December, \$1000, has been overlooked.
4. Repairs to Barth's private motor vehicle, \$640, have been debited to Vehicle Expenses account.
5. A payment of \$3000 on 1 January 2003 for additions to buildings has been debited to Repairs and Maintenance.
6. A fire insurance policy covering buildings was taken out on 31 October 2003, the annual premium of \$480 being paid in advance on this date and debited to the Prepaid Insurance account.
7. Interest of \$100 on the Telstra Bonds held by the business was due, but has not been received.
8. No depreciation has been recognised for the year ending 31 December. The draft statement of financial position shows the following:

Buildings (at cost)	\$80 000 *	
Accumulated depreciation	16 000	\$ 64 000
Office furniture and equipment (at cost)	10 500	
Accumulated depreciation	6 500	4 000

* Does not include additions to buildings in (5) above.

Depreciation is to be calculated as follows:

Buildings: 2% on cost

Office furniture and equipment: 20% on cost.

Required:

- A. Show the journal entries required to make the necessary adjustments above.
- B. Prepare a statement showing the effect (increase or decrease) of *each* of the adjustments on the net profit figure of \$13 040 as shown in the draft accounts.

Solution

A.

K BARTH General Journal

1. Rent Receivable	480	
Rent Revenue		480
(Rent revenue due)		
2. Office Furniture	800	
Sundry Expenses		800
(Correct error in recording)		
3. Commission Expense	1 000	
Commission Payable		1 000
(Amount owing to sales representatives)		
4. Drawings, K. Barth	640	
Vehicle Expenses		640
(Correcting entry to charge private repairs to drawings)		
5. Buildings	3 000	
Maintenance Expense		3 000
(Correcting entry on improvement to buildings)		
6. Insurance Expense	80	
Prepaid Insurance		80
(Adjusting entry to record expired insurance)		
7. Interest Receivable	100	
Interest Revenue		100
(Adjusting entry to record accrued interest)		
8. Depreciation expense – Building	1 660	
Accumulated depreciation – Building		1 660
(Calculation of depreciation on building 2% on adjusted cost \$83 000 = \$1660)		
Depreciation expense – office furniture	2 100	
Accumulated depreciation – office furniture		2 100
(Calculation of depreciation on office furniture 20% of \$10 500 = \$2 100) (Do not include December 2003 furniture acquired at the end of the month)		

B.

Calculation on effect on reported net profit.

$\$13\,040 + (1) \$480 + (2) \$800 - (3) \$1\,000 + (4) \$640 + (5) \$3\,000 - (6) \$80 + (7) \100
 $- (8) \$1\,660 - (8) \$2\,100 = \$13\,220$
 Adjusted net profit = \$13 220



Problem 4.2**Adjusting entries and effect on financial statements**

Suburban Realty ends its financial year on 30 June.

Required:

- A. Using the following information, make the necessary adjusting entries.
1. Rent of office premises of \$435 for the 3-month period ending 31 July is due to be paid in July.
 2. The telephone expense of \$105 is unpaid and unrecorded at 30 June.
 3. The supplies account had a \$205 debit balance on 1 July of the preceding year. Supplies costing \$980 were purchased during the year, and \$180 of supplies are in inventory as at 30 June.
 4. Suburban Realty borrowed \$9500 from ABC Bank on 15 February. The principal, plus 13.2% interest, is payable on 15 August. Accrued interest on 30 June was \$471.
 5. Annual depreciation on equipment is estimated to be \$4700. The balance in Accumulated Depreciation at the beginning of the financial year was \$7050.
 6. The office assistant earns \$32 a day. He will be paid in July for the 5-day period ending 3 July.
 7. On 1 June, Suburban received 2 months' rent in advance, totalling \$640. This was recorded by a credit to Unearned Rental Revenue.
 8. Suburban Realty purchased a 6-month insurance policy for \$405 on 1 November. A 24-month policy was purchased on 30 April for \$1272. Both purchases were recorded by debiting Prepaid Insurance.
- B. As you know, all adjusting entries affect one statement of financial position account and one statement of financial performance account. Based on your adjusting entries prepared in requirement A:
1. complete the schedule below
 2. calculate the increase or decrease in net profit
 3. calculate the increase or decrease in total assets, total liabilities and total owner's equity.

Entry	Account	Balance in the account before adjustment	Dollar effect of adjusting entries	Balance reported in 30 June Statement of financial position	Statement of financial position classification*
1.	Rent Payable				
2.	Telephone Account				
3.	Supplies Inventory				
4.	Interest Payable				
5.	Accumulated Depreciation				
6.	Salaries Payable				
7.	Unearned Rental Revenue				
8.	Prepaid Insurance				

*For each account, indicate whether it is an asset, liability or owner's equity, and whether it is classified as a current or non-current asset or liability.



Solution

A.

SUBURBAN REALTY General Journal

1. Rent Expense	290	
Rent Payable		290
To record rent due on office premises. [2/3 of \$435]		
2. Telephone Expense	105	
Telephone Account Payable		105
To record telephone bill due.		
3. Supplies Expense	1 005	
Supplies Inventory		1 005
To record supplies used.		
4. Interest Expense	471	
Interest Payable		471
To record accrued interest on bank loan.		
5. Depreciation Expense	4 700	
Accumulated Depreciation		4 700
To record depreciation on equipment.		
6. Salaries Expense	64	
Salaries Payable		64
To record salary owing to secretary.		
7. Unearned Rental Revenue	320	
Rental Revenue		320
To record rent earned.		
8. Insurance Expense	511	
Prepaid Insurance		511
To record insurance expired. (\$405 × 12/12) + (\$1 272 × 2/24)		



B. 1.

Entry	Account	Balance before adjustment	Dollar effect of adjusting entries	Balance Reported in 30/6 balance sheet	Statement of financial position classification
1.	Rent payable	—	+ \$290	\$290	Current liability
2.	Telephone a/c payable	—	+ 105	105	Current liability
3.	Supplies inventory	\$1 185	– 1 005	180	Current asset
4.	Interest payable	—	+ 471	471	Current liability
5.	Accumulated depreciation.	7 050	+ 4 700	11 750	Contra asset to the equipment acct
6.	Salaries payable	—	+ 64	64	Current liability
7.	Unearned rental revenue	640	– 320	320	Current liability
8.	Prepaid insurance	1 677	– 511	1 166	Current asset

2. Decrease in net profit, \$6 826

$$(-\$290 - \$105 - \$1\,005 - \$471 - \$4\,700 - \$64 + \$320 - \$511 = -\$6\,826)$$

3. (a) Decrease in total assets, \$6 216

$$-\$1\,005 - \$4\,700 - \$511 = \$6\,216$$

(b) Increase in total liabilities, \$755

$$+\$290 + \$105 + \$471 + \$64 - \$320 = \$610$$

(c) Decrease in owner's equity, \$6 826

Problem 4.3**Adjusting entries from financial statements**

Powerfix, owned by Justin Simon, is in the business of repairing power tools. Below is the trial balance (before adjustments) and the statement of financial performance and statement of financial position at 30 June 2004 of the business.

POWERFIX Trial Balance as at 30 June 2004		
Account title	Debit	Credit
Cash at bank	\$ 27 000	
Accounts receivable	6 000	
Prepaid insurance	3 000	
Supplies	9 000	
Equipment	120 000	
Accumulated depreciation—equipment		\$ 3 000
Bills payable		24 000
J. Simon, Capital		84 000
J. Simon, Drawings	9 000	
Service revenue		150 000
Salaries and wages expense	33 000	
Advertising expense	6 000	
Rent expense	45 000	
Sundry expenses	3 000	
	<u>\$ 261 000</u>	<u>\$ 261 000</u>

POWERFIX Statement of Financial Performance for the year ended 30 June 2004		
OPERATING REVENUES		
Service revenues		\$ 150 000
OPERATING EXPENSES		
Salaries and wages expense	\$ 33 000	
Advertising expense	6 000	
Rent expense	45 000	
Insurance expense	2 100	
Interest expense	1 440	
Depreciation expense—equipment	1 800	
Supplies expense	3 300	
Sundry expenses	3 000	
	<u>95 640</u>	
NET PROFIT		<u>\$ 54 360</u>

(continued)

POWERFIX
Statement of Financial Position
as at 30 June 2004

ASSETS		
Cash at bank		\$ 27 000
Accounts receivable		6 000
Prepaid insurance		900
Supplies		5 700
Equipment	\$ 120 000	
Accumulated depreciation	<u>4 800</u>	<u>115 200</u>
TOTAL ASSETS		<u>\$154 800</u>
LIABILITIES		
Interest payable	\$ 1 440	
Bills payable	<u>24 000</u>	
TOTAL LIABILITIES		\$ 25 440
OWNER'S EQUITY		
J. Simon, Capital		<u>129 360</u>
		<u>\$154 800</u>

Required:

Record all adjusting entries in the general journal of Powerfix at 30 June 2004.
(Narrations are required.)

Solution

JUSTIN SIMON
General Journal

2004			
June 30	Insurance Expense	2 100	
	Prepaid Insurance		2 100
	Insurance expense expired		
	Depreciation Expense – Equipment	1 800	
	Accum. Depreciation – Equipment		1 800
	Depreciation on equipment recorded		
	Interest Expense	1 440	
	Interest Payable		1 440
	Interest owing recorded		
	Supplies Expense	3 300	
	Supplies		3 300
	Supplies consumed in the year		

Problem 4.4 Adjusting entries and financial statements

The unadjusted trial balance of the general ledger of C. Sim on 31 December 2003 is presented below:

C. SIM Trial Balance as at 31 December 2003		
Account title	Debit	Credit
Cash at bank	\$ 7 000	
Investment in shares	18 600	
Accounts receivable	48 500	
Prepaid insurance	2 500	
Store equipment	90 000	
Accumulated depreciation—store equipment		\$ 10 000
Accounts payable		45 000
Mortgage payable (due 31 December 2006)		15 000
C. Sim, Capital		65 000
C. Sim, Drawings	5 500	
Services revenue		106 000
Advertising expense	4 900	
Other selling expenses	7 500	
Electricity expense	5 000	
Sundry expenses	9 550	
Rent expense	4 800	
Wages expense	38 000	
Interest on mortgage expense	750	
Rent revenue		1 600
	<u>\$242 600</u>	<u>\$242 600</u>

Additional data for adjustment purposes:

- Inventories on 31 December 2003 were:
 - Advertising supplies (originally debited to Advertising Expense) \$1200
 - Store supplies (originally debited to Sundry Expenses) \$300
- On 1 July 2003 the business rented some store equipment to Joy's Real Estate for 12 months and received a cheque for \$1600 representing the entire year's rental fee.
- Purchases of store equipment were as follows:

Purchase date	Cost	Useful life
1 January 1996	\$20 000	10 years
1 April 1999	\$70 000	20 years
- The Prepaid Insurance account consists of the following:

Policy no.	Date of policy	Life of policy	Total premiums
37457QL	1 January 2001	3 years	\$1500
74374NJ	1 July 2001	2 years	\$1000
- Wages earned by employees but unpaid as at 31 December 2003 totalled \$400.
- Interest on the mortgage payable is \$900 per year, paid in half-yearly instalments on 1 May and 1 November.

Required:

- Journalise adjustments in the general journal of C. Sim.
- Prepare a statement of financial performance for the year ended 31 December 2003.
- Prepare a statement of financial position of C. Sim as at 31 December 2003.
- Present the Interest on Mortgage Expense account showing detailed entries for the year ended 31 December 2003 as it would appear after all adjustments have been made.

Solution

A.

2003

Dec. 31	Advertising Supplies	1 200	
	Advertising Expense		1 200
	To record advertising supplies not yet used.		
	Stores Supplies	300	
	Sundry Expenses		300
	To record store supplies not yet used.		
	Rent Revenue	800	
	Unearned Rent Revenue		800
	To record rent not yet earned.		
	Depreciation - Store Equipment	4 625	
	Accum. Depreciation - Store Equipment		4 625
	(\$2 000 p.a. + \$70 000/ 20 × 3/4)		
	To record depreciation on store equipment.		
	Insurance Expense	750	
	Prepaid Insurance		750
	(\$1 500 × 1/3 + \$1 000 × 1/4)		
	To record insurance expired.		
	Wages Expense	400	
	Wages Payable		400
	To record accrued wages.		
	Interest Expense	150	
	Interest Payable		150
	To record interest accrued on mortgage.		

B.

C. SIM

Statement of Financial Performance for the year ended 31 December 2003

OPERATING REVENUE

Service revenue	\$106 000
Rent	<u>800</u>
	106 800

OPERATING EXPENSES

Advertising Expense	\$3 700
Other selling Expenses	7 500
Electricity Expense	5 000
Rent Expense	4 800
Wages Expense	38 400
Insurance Expense	750
Depreciation of store equipment	4 625
Sundry Expense	9 250
Interest Expense	<u>900</u>
	<u>74 925</u>

NET PROFIT

\$31 875

(continued)

C.

C. SIM
Statement of Financial Position
as at 31 December 2003

ASSETS

CURRENT ASSETS:

Cash at bank	\$7 000	
Accounts receivable	48 500	
Prepaid insurance	1 750	
Advertising supplies	1 200	
Store supplies	300	
Marketable securities	<u>18 600</u>	
TOTAL CURRENT ASSETS		\$7 350

NON-CURRENT ASSETS:

Store equipment	90 000	
Less: Accum. depreciation. - store equipment	<u>14 625</u>	
TOTAL NON-CURRENT ASSETS		<u>75 375</u>

TOTAL ASSETS **\$152 725**

LIABILITIES

CURRENT LIABILITIES:

Accounts payable	\$45 000	
Wages payable	400	
Interest payable	150	
Unearned rent	<u>800</u>	
TOTAL CURRENT LIABILITIES		\$46 350

NON-CURRENT LIABILITIES:

Mortgage payable	<u>15 000</u>	
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TOTAL LIABILITIES **61 350**

NET ASSETS **\$91 375**

OWNER'S EQUITY

C. Sim, Capital - 1/1/01	\$65 000	
Net profit for year	<u>31 875</u>	
	96 875	
Less Drawings	<u>5 500</u>	

TOTAL OWNER'S EQUITY **\$91 375**

D.

Interest Expense

2003			2003		
May 1	Cash	450	Jan 1	Interest. Payable	
Nov. 1	Cash	450		(rev. entry)	150
Dec. 31	Adjusting entry	<u>150</u>	Dec. 31	P & L Summary	<u>900</u>
		<u>1 050</u>			<u>1 050</u>

Problem 4.5**Opening T accounts, adjusting entries and preparation of financial statements**

United Rentals rents appliances and furniture. The unadjusted trial balance of the business appears as shown below.

UNITED RENTALS Unadjusted Trial Balance as at 30 June 2004		
Account title	Debit	Credit
Cash at bank	\$ 3 500	
Trade debtors	2 400	
Prepaid insurance	1 200	
Appliances	31 400	
Accumulated depreciation—appliances		\$ 17 600
Furniture	47 300	
Accumulated depreciation—furniture		23 000
Trade creditors		6 800
K. Maclean, Capital		18 710
K. Maclean, Drawings	18 310	
Rental fees revenue		74 700
Salaries expense	26 500	
Rent expense	5 700	
Maintenance expense	3 100	
Electricity expense	1 400	
	<u>\$ 140 810</u>	<u>\$ 140 810</u>

The following information is supplied:

- Expired insurance amounts to \$790.
- The June electricity account for \$120 has not been paid or recorded.
- Depreciation on the appliances is \$5870, and depreciation on the furniture is \$9200.
- Rental fees of \$1030 were received in advance and were not considered to be revenue.
- The Rent Expense account contains \$440 paid for July 2004 rent.
- A rental fee of \$110 paid in cash was recorded by debiting Accounts Receivable.
- Salaries earned amounting to \$180 will be paid in July and have not been recorded.

Required:

- Set up T accounts for the accounts listed in the trial balance.
 - Post the account balances from the trial balance to the T accounts.
 - Post the adjusting information directly to the T accounts.
- Prepare an adjusted trial balance.
- Prepare a statement of financial performance for the year ended 30 June 2004.
- Prepare a statement of financial position as at 30 June 2004.

(continued)



Solution

A.

UNITED RENTALS

Cash at Bank			Trade Debtors		
	3 500		2 400	(6)	110
(6)	110				
Prepaid Insurance			Prepaid Rent		
	1 200	(1) 790	(5)	440	
Appliances			Accum. Depr. –Appliances		
	31 400				17 600
				(3)	5 870
Furniture			Accum. Depr. –Furniture		
	47 300				23 000
				(3)	9 200
Trade Creditors			Salaries Payable		
		6 800		(7)	180
Electricity Account Payable			Unearned Rental Fees		
		(2) 120		(4)	1 030
K. Maclean, Capital			K. Maclean, Drawings		
		18 710		18 310	
Rental Fees Revenue			Salaries Expense		
(4)	1 030	74 700		26 500	
			(7)	180	
Rent Expense			Maintenance Expense		
	5 700	(5) 440		3 100	
Electricity Expense			Deprec. Expense – Appliances		
	1 400		(3)	5 870	
(2)	120				
Deprec. Expense - Furniture			Insurance Expense		
(3)	9 200		(1)	790	

B.

UNITED RENTALS
Adjusted Trial Balance
as at 30 June 2004

	<u>Debit</u>	<u>Credit</u>
Cash at bank	\$3 610	
Trade debtors	2 290	
Prepaid insurance	410	
Prepaid rent	440	
Appliances	31 400	
Accum. depr. - appliances		\$23 470
Furniture	47 300	
Accum. depr. - furniture		32 200
Trade creditors		6 800
Salaries payable		180
Electricity account payable		120
Unearned rental fees		1 030
K. Maclean, Capital		18 710
K. Maclean, Drawings	18 310	
Rental fees revenue		73 670
Salaries expense	26 680	
Rent expense	5 260	
Maintenance expense	3 100	
Electricity expense	1 520	
Depr. expense (\$5870 + 9200)	15 070	
Insurance expense	<u>790</u>	
	<u>\$156 180</u>	<u>\$156 180</u>

C.

UNITED RENTALS
Statement of Financial Performance
for the year ended 30 June 2004

Revenue:		
Rental fees revenue		\$73 670
Expenses:		
Salaries expense	\$26 680	
Rent expense	5 260	
Maintenance expense	3 100	
Electricity expense	1 520	
Depreciation expense	15 070	
Insurance expense	<u>790</u>	
		<u>52 420</u>
Net profit		<u>\$21 250</u>

(continued)

D.

UNITED RENTALS
Statement of Financial Position
as at 30 June 2004

ASSETS

CURRENT ASSETS:

Cash at bank	\$3 610	
Trade debtors	2 290	
Prepaid Insurance	410	
Prepaid rent	<u>440</u>	\$6 750

NON-CURRENT ASSETS:

Appliances	31 400	
Less: Accum. depreciation	<u>23 470</u>	\$7 930
Furniture	47 300	
Less: Accum. depreciation	<u>32 200</u>	<u>15 100</u>

23 030

TOTAL ASSETS

29 780

LIABILITIES

CURRENT LIABILITIES:

Trade creditors	6 800	
Salaries payable	180	
Electricity account payable	120	
Unearned rental fees	<u>1 030</u>	8 130

NET ASSETS

\$21 650

OWNER'S EQUITY

K. Maclean, Capital - 30 June 2004

21 650*

TOTAL OWNER'S EQUITY

\$21 650

* \$21 650 = \$18 710 + \$21 250 - \$18 310



WILEY