Module 6 – Intro to Adjusting Entries

- Entries required at the end of each accounting period to recognize on accrual basis:
  - Revenues earned for the period
  - Expenses that match the revenue earned
  - And to report proper amounts for asset, liability, and owners’ equity accounts
Intro to Adjusting Entries

- Difficult because it is not signaled by a specific event such as the receipt of a bill or the receipt of cash from a customer

- Two step analysis
  - Determine if amounts recorded for all assets and liabilities are correct
  - Determine what revenue or expense adjustments are required as a result of changes in assets and liabilities
Types of Adjusting Entries

- Areas were adjusting entries are common
  - Unrecorded Receivables
  - Unrecorded Liabilities
  - Prepaid Expenses
  - Unearned Revenues
Unrecorded or Accrued Receivables

- Revenues earned during a period that have not been recorded by the end of that period
  - If earned but cash hasn’t been collected than a ‘receivable exists’
  - For example…a company contracts for a service such as laundry service. In the contract the bill is paid quarterly. So…
Unrecorded receivables example

Unrecorded laundry service revenue

12/31 Accounts Receivable 400
Laundry Service Revenue 400

Note: adjusting entry to record revenue recognized for the period
Unrecorded or Accrued Expenses

- Expenses incurred during a period that have not been recorded by the end of that period
  - For Example…A pay period for your employees straddles the end of the fiscal year........
Unrecorded expenses example

**Bi-weekly Payroll**

- December 18th
- December 25th
- December 31st (yearend)
- January 7th

**Unrecorded payroll expense**

12/31 Payroll Expense 500

Wages Payable 500

*Note: adjusting entry to record payroll expense for the period*
Prepaid Expenses

- Payments made in advance for items normally charged to expense
  - For example…
    - Rent paid for the year
    - Insurance premium paid for the year
Prepaid expenses example

12/31    Rent Expense                  900
         Prepaid Rent Expense            900

Note: adjusting entry to record rent expense for the period
Unearned Revenue

- Cash amounts received before they have been earned
  - For example... magazine subscriptions
    - You pay up front for a year or more
    - Until the magazine is sent to you the Publisher has not yet earned the cash you sent in at the beginning of the subscription
Unearned revenue example

September 1st: 4 months of magazines sent to customer

December 31st: yearend

**Unrecorded subscription revenue**

12/31 Unearned Revenue 20

Subscription Revenue 20

*Note: Adjusting entry to record revenue recognized for the period*
Problem – Adjusting Entries

1. On July 1, 2003, the company paid a three-year premium of $7,200 on an insurance policy that is effective July 1, 2003, and expires June 30, 2006.

2. On February 1, 2003, Boswell paid its property taxes for the year February 1, 2003, to January 31, 2004. The Tax bill was $1,800.
Adjusting Entries – solution #1

Sometimes it helps to understand the adjusting entry by preparing the original entries. So the company purchases 3 years of insurance for $7,200

7/1/03 Prepaid Insurance $7,200
Cash $7,200

Note: purchased 3 years of insurance
This is a Prepaid expenses example

6 full months of insurance used

Unrecorded insurance expense

12/31 Insurance Expense $1,200
Prepaid Insurance Expense $1,200

Note: adjusting entry to record insurance expense for the period
Adjusting Entries – solution #2

Sometimes it helps to understand the adjusting entry by preparing the original entries. The company paid its taxes in advance.

2/1/03 Prepaid Property tax Exp $1,800
Cash $1,800

Note: paid 1 year of property taxes in advance
This is another Prepaid expenses example

Unrecorded property tax expense

12/31 Property Tax Expense $1,650
Prepaid Property Tax Expense $1,650

Note: adjusting entry to record property tax expense for the period
Problem – Adjusting Entries

3. On May 1, 2003, the company paid $180 for a three year subscription to an advertising journal. The subscription starts May 1, 2003 and expires April 30, 2006.

4. Boswell received $1,800 on September 15, 2003, in return for which the company agreed to provide consulting services for 18 months beginning immediately.
Adjusting Entries – solution #3

Sometimes it helps to understand the adjusting entry by preparing the original entries. The company paid 3 years of subscription to an advertising journal.

5/1/03 Prepaid Subscription Exp  $180
Cash                $180

Note: paid 3 years for an advertising journal subscription
This is another Prepaid expenses example

May 1st

December 31st

April 30th

8 full months of subscription used

Unrecorded subscription expense

12/31 Subscription Expense $40
Prepaid Subscription Expense $40

Note: adjusting entry to record subscription expense for the period
Adjusting Entries – solution #4

Sometimes it helps to understand the adjusting entry by preparing the original entries. Received money for services yet to be completed.

9/15/03 Cash $1800

Unearned Revenue $1800

*Note: cash received for 18 month service contract*
Unearned revenue example

September 15th: 3½ months of services provided to the customer

December 31st: yearend

Unrecorded service revenue

12/31 Unearned Revenue $350
Service Revenue $350

Note: adjusting entry to record revenue recognized for the period
Problem – Adjusting Entries

5. Boswell rented part of its office space to Bristle Brush Company. Bristle paid $1,200 on November 1, 2003, for the next six months’ rent.

6. Boswell loaned $100,000 to a client. On November 1 the client paid $24,000, which represents two years’ interest in advance (November 1, 2003 through October 31, 2005)
Adjusting Entries – solution #5

Sometimes it helps to understand the adjusting entry by preparing the original entries. The company was paid 6 months of rent in advance.

11/1/03 Cash $1,200
     Unearned Rent Revenue $1,200

*Note: received 6 months of rent in advance*
Unearned revenue example

November 1st
2 months of rent provided to the customer

December 31st

Unrecorded service revenue

12/31 Unearned Rent Revenue $400
Rent Revenue $400

Note: adjusting entry to record revenue recognized for the period
Adjusting Entries – solution #6

Sometimes it helps to understand the adjusting entry by preparing the original entries. The company received 2 years of interest revenue in advance

11/1/03 Cash $24,000

Unearned Interest Rev $24,000

Note: received 2 years of interest revenue from a client
Unearned revenue example

November 1st

2 months of interest revenue earned

December 31st

yearend

Unrecorded interest revenue

12/31 Unearned Interest Revenue $2,000

Interest Revenue $2,000

Note: adjusting entry to record revenue recognized for the period