Accruals, Deferrals, and the Worksheet

Chapter **12**

Urban Outfitters, Inc.

www.urbanoutfittersinc.com

Urban Outfitters, Inc., is an innovative specialty retail company that targets highly defined customer niches. The brands—Urban Outfitters, Anthropologie, Free People, BHLDN, and Terrain—are all distinct. The company designs innovative stores that resonate with the target audience. Stores offer an eclectic mix of merchandise and unique product displays that incorporate found objects into creative selling vignettes.

The strategy is working. While many retailers struggled through tough economic times in the past few years, net sales at Anthropologie, Free People, and Urban Outfitters have been strong. Total company net sales for the first quarter of fiscal 2014 increased to a record $648 million, or 14 percent over the same quarter last year. "Our brands delivered solid growth across all channels in the first quarter, especially in our direct-to-consumer channel," said Chief Executive Officer Richard A. Hayne.

Given the context of an uncertain economic environment, the company recognizes that they need to be able to adapt to the ever-changing fashion trends. Because all of their stores are leased, typically for a term of 10 years, the company needs to recognize rental expenses every year for each of their Urban Outfitters, Anthropologie, Free People, Terrain, and BHLDN stores. By leasing their stores, it gives the company more freedom to relocate a store if conditions change or if they need to expand.

Seasonal fluctuations also affect their inventory levels, as they usually order merchandise in advance of peak selling periods and sometimes are forced to carry a significant amount of inventory, especially before the back-to-school and holiday selling periods. Nevertheless, the company monitors their store inventory closely and at year-end, prices their products to move in order to make room for new inventory to be stocked. They believe that their mix of products, together with their stores' inviting atmosphere, will continue to entice their core customers to shop frequently.

thinking critically

What types of inventory issues do you think Urban Outfitters reflects upon at the end of each year?

LEARNING OBJECTIVES

12-1. Determine the adjustment for merchandise inventory, and enter the adjustment on the worksheet.

12-2. Compute adjustments for accrued and prepaid expense items, and enter the adjustments on the worksheet.

12-3. Compute adjustments for accrued and deferred income items, and enter the adjustments on the worksheet.

12-4. Complete a 10-column worksheet.

12-5. Define the accounting terms new to this chapter.

NEW TERMS

- accrual basis
- accrued expenses
- accrued income
- deferred expenses
- deferred income
- inventory sheet
- net income line
- property, plant, and equipment
- unearned income
- updated account balances

Section 1

SECTION OBJECTIVES	TERMS TO LEARN
>> 12-1. **Determine the adjustment for merchandise inventory, and enter the adjustment on the worksheet.** WHY IT'S IMPORTANT The change in merchandise inventory affects the financial statements. >> 12-2. **Compute adjustments for accrued and prepaid expense items, and enter the adjustments on the worksheet.** WHY IT'S IMPORTANT Each expense item needs to be assigned to the accounting period in which it helped to earn revenue. >> 12-3. **Compute adjustments for accrued and deferred income items, and enter the adjustments on the worksheet.** WHY IT'S IMPORTANT The accrual basis of accounting states that income is recognized in the period it is earned.	accrual basis accrued expenses accrued income deferred expenses deferred income inventory sheet property, plant, and equipment unearned income

Calculating and Recording Adjustments

In Chapter 5, you learned how to make adjustments so that all revenue and expenses that apply to a fiscal period appear on the income statement for that period. In this chapter, you will learn more about adjustments and how they affect Whiteside Antiques, a retail merchandising business owned by Bill Whiteside.

The Accrual Basis of Accounting

Financial statements usually are prepared using the **accrual basis** of accounting because it most nearly attains the goal of matching expenses and revenue in an accounting period.

- *Revenue is recognized when earned, not necessarily when the cash is received.* Revenue is recognized when the sale is complete. A sale is complete when title to the goods passes to the customer or when the service is provided. For sales on account, revenue is recognized when the sale occurs even though the cash is not collected immediately.
- *Expenses are recognized when incurred or used, not necessarily when cash is paid.* Each expense is assigned to the accounting period in which it helped to earn revenue for the business, even if cash is not paid at that time. This is often referred to as *matching revenues and expenses.*

Sometimes cash changes hands before the revenue or expense is recognized. For example, insurance premiums are normally paid in advance, and the coverage extends over several accounting periods. In other cases, cash changes hands after the revenue or expense has been recognized. For example, employees might work during December but be paid in January of the following year. Because of these timing differences, adjustments are made to ensure that revenue and expenses are recognized in the appropriate period.

Using the Worksheet to Record Adjustments

The worksheet is used to assemble data about adjustments and to organize the information for the financial statements. Figure 12.1 on pages 400–401 shows the first two sections of the worksheet for Whiteside Antiques. Let's review how to prepare the worksheet:

- Enter the trial balance in the Trial Balance section. Total the columns. Be sure that total debits equal total credits.
- Enter the adjustments in the Adjustments section. Use the same letter to identify the debit part and the credit part of each adjustment. Total the columns. Be sure that total debits equal total credits.
- For each account, combine the amounts in the Trial Balance section and the Adjustments section. Enter the results in the Adjusted Trial Balance section, total the columns, and make sure that total debits equal total credits.
- Extend account balances to the Income Statement and Balance Sheet sections and complete the worksheet.

important!

Recognize

The word "recognize" means to record in the accounting records.

ADJUSTMENT FOR MERCHANDISE INVENTORY

>> 12-1. OBJECTIVE

Determine the adjustment for merchandise inventory, and enter the adjustment on the worksheet.

Merchandise inventory consists of the goods that a business has on hand for sale to customers. An asset account for merchandise inventory is maintained in the general ledger. During the accounting period, all purchases of merchandise are debited to the ***Purchases*** account. All sales of merchandise are credited to the revenue account ***Sales.***

Notice that no entries are made directly to the ***Merchandise Inventory*** account during the accounting period. Consequently, when the trial balance is prepared at the end of the period, the ***Merchandise Inventory*** account still shows the *beginning* inventory for the period. At the end of each period, a business determines the *ending* balance of the ***Merchandise Inventory*** account. The first step in determining the ending inventory is to count the number of units of each type of item on hand. As the merchandise is counted, the quantity on hand is entered on an inventory sheet. The **inventory sheet** lists the quantity of each type of goods a firm has in stock. This process is called a physical inventory. For each item, the quantity is multiplied by the unit cost to find the totals per item. The totals for all items are added to compute the total cost of merchandise inventory.

The trial balance for Whiteside Antiques shows ***Merchandise Inventory*** of $52,000. Based on a count taken on December 31, merchandise inventory at the end of the year actually totaled $47,000. Whiteside Antiques needs to adjust the ***Merchandise Inventory*** account to reflect the balance at the end of the year.

The adjustment is made in two steps, using the accounts ***Merchandise Inventory*** and ***Income Summary.***

recall

Income Summary

The ***Income Summary*** account is a temporary owner's equity account used in the closing process.

1. The beginning inventory ($52,000) is taken off the books by transferring the account balance to the ***Income Summary*** account. This entry is labeled **(a)** on the worksheet in Figure 12.1 and is illustrated in T-account form below.

Merchandise Inventory			
Bal.	52,000	Adj.	52,000

Income Summary			
Adj.	52,000		

(a)

2. The ending inventory ($47,000) is placed on the books by debiting ***Merchandise Inventory*** and crediting ***Income Summary.*** This entry is labeled **(b)** on the worksheet in Figure 12.1.

Merchandise Inventory			
Bal.	52,000	Adj.	52,000
Adj.	47,000		

Income Summary			
Adj.	52,000	Adj.	47,000

(a)
(b)

FIGURE 12.1 10-Column Worksheet—Partial

Whiteside Antiques
Worksheet
Year Ended December 31, 2016

	ACCOUNT NAME	TRIAL BALANCE		ADJUSTMENTS	
		DEBIT	CREDIT	DEBIT	CREDIT
1	*Cash*	13 136 00			
2	*Petty Cash Fund*	100 00			
3	*Notes Receivable*	1 200 00			
4	*Accounts Receivable*	32 000 00			
5	*Allowance for Doubtful Accounts*		250 00		(c) 800 00
6	*Interest Receivable*			(m) 30 00	
7	*Merchandise Inventory*	52 000 00		(b) 47 000 00	(a) 52 000 00
8	*Prepaid Insurance*	7 350 00			(k) 2 450 00
9	*Prepaid Interest*	225 00			(l) 150 00
10	*Supplies*	6 300 00			(j) 4 975 00
11	*Store Equipment*	30 000 00			
12	*Accumulated Depreciation—Store Equipment*				(d) 2 400 00
13	*Office Equipment*	5 000 00			
14	*Accumulated Depreciation—Office Equipment*				(e) 700 00
15	*Notes Payable—Trade*		2 000 00		
16	*Notes Payable—Bank*		9 000 00		
17	*Accounts Payable*		24 129 00		
18	*Interest Payable*				(i) 20 00
19	*Social Security Tax Payable*		1 084 00		(g) 74 40
20	*Medicare Tax Payable*		250 00		(g) 17 40
21	*Employee Income Taxes Payable*		990 00		
22	*Federal Unemployment Tax Payable*				(h) 7 20
23	*State Unemployment Tax Payable*				(h) 64 80
24	*Salaries Payable*				(f) 1 200 00
25	*Sales Tax Payable*		7 200 00		
26	*Bill Whiteside, Capital*		61 221 00		
27	*Bill Whiteside, Drawing*	27 600 00			
28	*Income Summary*			(a) 52 000 00	(b) 47 000 00
29	*Sales*		561 650 00		
30	*Sales Returns and Allowances*	12 500 00			
31	*Interest Income*		136 00		(m) 30 00
32	*Miscellaneous Income*		366 00		
33	*Purchases*	321 500 00			
34	*Freight In*	9 800 00			
35	*Purchases Returns and Allowances*		3 050 00		
36	*Purchases Discounts*		3 130 00		
37	*Salaries Expense—Sales*	78 490 00		(f) 1 200 00	
38	*Advertising Expense*	7 425 00			
39	*Cash Short or Over*	125 00			
40	*Supplies Expense*			(j) 4 975 00	

FIGURE 12.1 10-Column Worksheet—Partial (concluded)

	ACCOUNT NAME	TRIAL BALANCE DEBIT	TRIAL BALANCE CREDIT	ADJUSTMENTS DEBIT	ADJUSTMENTS CREDIT
41	*Depreciation Expense—Store Equipment*			(d) 2,400.00	
42	*Rent Expense*	27,600.00			
43	*Salaries Expense—Office*	26,500.00			
44	*Insurance Expense*			(k) 2,450.00	
45	*Payroll Taxes Expense*	7,205.00		(g) 91.80	
46				(h) 72.00	
47	*Telephone Expense*	1,875.00			
48	*Uncollectible Accounts Expense*			(c) 800.00	
49	*Utilities Expense*	5,925.00			
50	*Depreciation Expense—Office Equipment*			(e) 700.00	
51	*Interest Expense*	600.00		(i) 20.00	
52				(l) 150.00	
53	*Totals*	674,456.00	674,456.00	111,888.80	111,888.80

The effect of this adjustment is to remove the beginning merchandise inventory balance and replace it with the ending merchandise inventory balance. Merchandise inventory is adjusted in two steps on the worksheet because both the beginning and the ending inventory figures appear on the income statement, which is prepared directly from the worksheet.

The merchandise inventory adjustment is not necessary if the perpetual inventory system is used.

ADJUSTMENT FOR LOSS FROM UNCOLLECTIBLE ACCOUNTS

>> 12-2. OBJECTIVE

Compute adjustments for accrued and prepaid expense items, and enter the adjustments on the worksheet.

Credit sales are made with the expectation that the customers will pay the amount due later. Sometimes the account receivable is never collected. Losses from uncollectible accounts are classified as operating expenses.

Under accrual accounting, the expense for uncollectible accounts is recorded in the same period as the related sale. The expense is estimated because the actual amount of uncollectible accounts is not known until later periods. To match the expense for uncollectible accounts with the sales revenue for the same period, the estimated expense is debited to an account named ***Uncollectible Accounts Expense.***

Several methods exist for estimating the expense for uncollectible accounts. Whiteside Antiques uses the *percentage of net credit sales* method. The rate used is based on the company's past experience with uncollectible accounts and management's assessment of current business conditions. Whiteside Antiques estimates that four-fifths of 1 percent (0.80 percent) of net credit sales will be uncollectible. Net credit sales for the year were \$100,000. The estimated expense for uncollectible accounts is \$800 (\$100,000 × 0.0080).

THE BOTTOM LINE
Uncollectible Accounts Expense

Income Statement

Expenses	↑ 800
Net income	↓ 800

Balance Sheet

Assets	↓ 800
Equity	↓ 800

The entry to record the expense for uncollectible accounts includes a credit to a contra asset account, ***Allowance for Doubtful Accounts.*** This account appears on the balance sheet as follows:

Accounts Receivable	\$32,000
Allowance for Doubtful Accounts (\$800 + \$250)	1,050
Net Accounts Receivable	\$30,950

Adjustment **(c)** appears on the worksheet in Figure 12.1 for the expense for uncollectible accounts.

Uncollectible Accounts Expense	
Adj. 800	

Allowance for Doubtful Accounts	
	Bal. 250
	Adj. 800

(c)

When a specific account becomes uncollectible, it is written off:

- The entry is a debit to ***Allowance for Doubtful Accounts*** and a credit to ***Accounts Receivable.***
- The customer's account in the accounts receivable subsidiary ledger is also reduced.

Uncollectible Accounts Expense is not affected by the write-off of individual accounts identified as uncollectible. It is used only when the end-of-period adjustment is recorded.

Notice that net income is decreased at the end of the period when the adjustment for *estimated* expense for uncollectible accounts is made. When a specific customer account is written off, net income is *not* affected. The write-off of a specific account affects only the balance sheet accounts ***Accounts Receivable*** (asset) and ***Allowance for Doubtful Accounts*** (contra asset).

The balance of ***Allowance for Doubtful Accounts*** is reduced throughout the year as customer accounts are written off. Notice that ***Allowance for Doubtful Accounts*** already has a credit balance of $250 in the Trial Balance section of the worksheet. When the estimate of uncollectible accounts expense is based on sales, any remaining balance from previous periods is not considered when recording the adjustment.

ADJUSTMENTS FOR DEPRECIATION

Most businesses have long-term assets that are used in the operation of the business. These are often referred to as **property, plant, and equipment.** Property, plant, and equipment includes buildings, trucks, automobiles, machinery, furniture, fixtures, office equipment, and land.

Property, plant, and equipment costs are not charged to expense accounts when purchased. Instead, the cost of a long-term asset is allocated over the asset's expected useful life by depreciation. This process involves the gradual transfer of acquisition cost to expense. This concept was first introduced in Chapter 5. There is one exception. Land is not depreciated.

There are many ways to calculate depreciation. Whiteside Antiques uses the straight-line method, so an equal amount of depreciation is taken in each year of the asset's useful life. The formula for straight-line depreciation is:

$$\frac{\text{Cost} - \text{Salvage value}}{\text{Estimated useful life}} = \text{Depreciation}$$

Salvage value is an estimate of the amount that could be obtained from the sale or disposition of an asset at the end of its useful life. Cost minus salvage value is called the *depreciable base.*

Depreciation of Store Equipment The trial balance shows that Whiteside Antiques has $30,000 of store equipment. Estimated salvage value is $6,000. What is the amount of annual depreciation expense using the straight-line method?

important!

Depreciation
To calculate monthly straight-line depreciation, divide the depreciable base by the number of months in the useful life.

Cost of store equipment	$30,000
Salvage value	(6,000)
Depreciable base	$24,000
Estimated useful life	10 years

$$\frac{\$30{,}000 - \$6{,}000}{10 \text{ years}} = \$2{,}400 \text{ per year}$$

The annual depreciation expense is $2,400. Adjustment **(d)** appears on the worksheet in Figure 12.1 for the depreciation expense for store equipment.

Depr. Expense—Store Equipment	
Adj. 2,400	

Accum. Depr.—Store Equipment	
	Adj. 2,400

(d)

Depreciation of Office Equipment Whiteside Antiques reports $5,000 of office equipment on the trial balance. What is the amount of annual depreciation expense using the straight-line method if estimated salvage value is $800 and estimated life is 6 years?

Cost of office equipment	$5,000
Salvage value	(800)
Depreciable base	$4,200
Estimated useful life	6 years

$$\frac{\$5,000 - \$800}{6 \text{ Years}} = \$700 \text{ per year}$$

Annual depreciation expense is $700. Adjustment **(e)** appears on the worksheet in Figure 12.1 for depreciation expense for office equipment.

Depr. Expense—Office Equipment	
Adj. 700	

Accum. Depr.—Office Equipment	
	Adj. 700

(e)

As discussed in Chapter 5, ***Accumulated Depreciation*** is a contra asset account. It has a normal credit balance, which is opposite the normal balance of an asset account.

ADJUSTMENTS FOR ACCRUED EXPENSES

Many expense items are paid for, recorded, and used in the same accounting period. However, some expense items are paid for and recorded in one period but used in a later period. Other expense items are used in one period and paid for in a later period. In these situations, adjustments are made so that the financial statements show all expenses in the appropriate period.

Accrued expenses are expenses that relate to (are used in) the current period but have not yet been paid and do not yet appear in the accounting records. Whiteside Antiques makes adjustments for three types of accrued expenses:

- accrued salaries
- accrued payroll taxes
- accrued interest on notes payable

Because accrued expenses involve amounts that must be paid in the future, the adjustment for each item is a debit to an expense account and a credit to a liability account.

Accrued Salaries At Whiteside Antiques, all full-time sales and office employees are paid semimonthly—on the 15th and the last day of the month. The trial balance in Figure 12.1 shows the correct salaries expense for the full-time employees for the year. From December 28 to January 3, the firm hired several part-time sales clerks for the year-end sale. Through December 31, 2016, these employees earned $1,200. The part-time salaries expense has not yet been recorded because the employees will not be paid until January 3, 2017. An adjustment is made to record the amount owed, but not yet paid, as of the end of December.

Adjustment **(f)** appears on the worksheet in Figure 12.1 for accrued salaries.

Salaries Expense—Sales	
Adj. 1,200	

Salaries Payable	
	Adj. 1,200

(f)

Accrued Payroll Taxes Payroll taxes are not legally owed until the salaries are paid. Businesses that want to match revenue and expenses in the appropriate period make adjustments to accrue the

important!

Matching

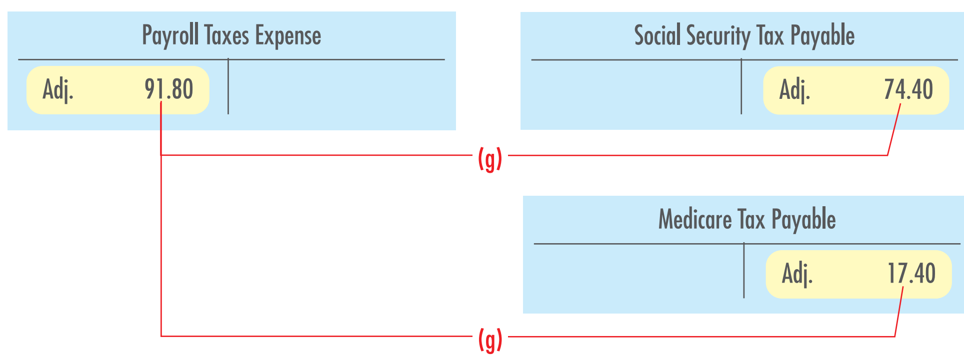
Adjustments for accrued expenses match the expense to the period in which the expense was used.

employer's payroll taxes even though the taxes are technically not yet due. Whiteside Antiques makes adjustments for accrued employer's payroll taxes.

The payroll taxes related to the full-time employees of Whiteside Antiques have been recorded and appear on the trial balance. However, the payroll taxes for the part-time sales clerks have not been recorded. None of the part-time clerks have reached the social security wage base limit. The entire $1,200 of accrued salaries is subject to the employer's share of social security and Medicare taxes. The accrued employer's payroll taxes are:

Social security tax	$1,200	×	0.0620	=	$74.40
Medicare tax	$1,200	×	0.0145	=	17.40
Total accrued payroll taxes					$91.80

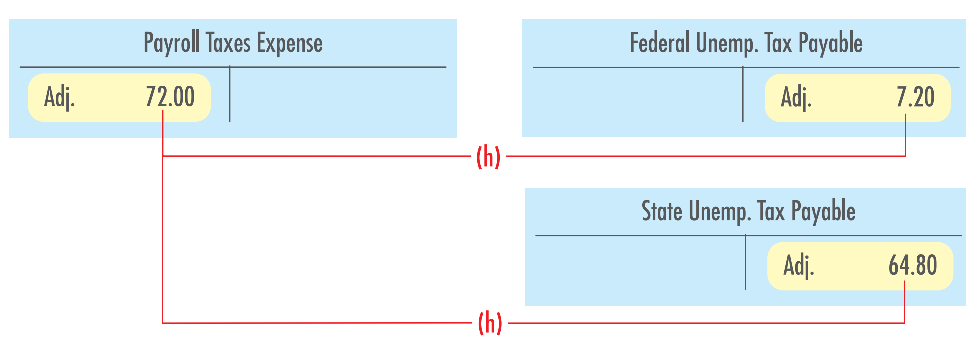
Adjustment **(g)** appears on the worksheet in Figure 12.1 for accrued payroll taxes.



The entire $1,200 of accrued salaries is also subject to unemployment taxes. The unemployment tax rates for Whiteside Antiques are 0.6 percent for federal and 5.4 percent for state.

Federal unemployment tax	$1,200	×	0.006	=	$ 7.20
State unemployment tax	$1,200	×	0.054	=	64.80
Total accrued taxes					$72.00

Adjustment **(h)** appears on the worksheet in Figure 12.1 for accrued unemployment taxes.



Accrued Interest on Notes Payable On December 1, 2016, Whiteside Antiques issued a two-month note for $2,000, with annual interest of 12 percent. The note was recorded in the ***Notes Payable—Trade*** account. Whiteside Antiques will pay the interest when the note matures on February 1, 2017. However, the interest expense is incurred day by day and should be allocated to each fiscal period involved in order to obtain a complete and accurate picture of expenses. The accrued interest amount is determined by using the interest formula Principal × Rate × Time.

Principal	×	Rate	×	Time		
$2,000	×	0.12	×	1/12	=	$20

The fraction 1⁄12 represents one month, which is 1/12 of a year.

Adjustment **(i)** appears on the worksheet in Figure 12.1 for the accrued interest expense.

Interest Expense	
Adj. 20	

Interest Payable	
	Adj. 20

(i)

Other Accrued Expenses Most businesses pay property taxes to state and local governments. They accrue these taxes at the end of the accounting period. Adjustments might also be necessary for commissions, professional services, and many other accrued expenses.

> In its December 31, 2011, balance sheet, JetBlue Airways Corporation reported the following current liabilities (all in millions of dollars): Accounts payable, $148; Air traffic liability, $627; Accrued salaries, wages, and benefits, $152; Other accrued liabilities, $199; Short-term borrowings, $88; and Current maturities of long-term debt and capital leases, $198.

ADJUSTMENTS FOR PREPAID EXPENSES

Prepaid expenses, or **deferred expenses,** are expenses that are paid for and recorded before they are used. Often a portion of a prepaid item remains unused at the end of the period; it is applicable to future periods. When paid for, these items are recorded as assets. At the end of the period, an adjustment is made to recognize as an expense the portion used during the period. Whiteside Antiques makes adjustments for three types of prepaid expenses:

- prepaid supplies
- prepaid insurance
- prepaid interest on notes payable

The adjusting entries for supplies used and insurance expired were introduced in Chapter 5. The adjusting entry for prepaid interest on notes payable is new to this chapter.

Supplies Used When supplies are purchased, they are debited to the asset account ***Supplies.*** On the trial balance in Figure 12.1, ***Supplies*** has a balance of $6,300. A physical count on December 31 showed $1,325 of supplies on hand. This means that $4,975 ($6,300 − $1,325) of supplies were used during the year. An adjustment is made to charge the cost of supplies used to the current year's operations and to reflect the value of the supplies on hand.

Adjustment **(j)** appears on the worksheet in Figure 12.1 for supplies expense.

Supplies Expense	
Adj. 4,975	

Supplies	
Bal. 6,300	Adj. 4,975

(j)

Expired Insurance On January 2, 2016, Whiteside Antiques wrote a check for $7,350 for a three-year insurance policy. The asset account ***Prepaid Insurance*** was debited for $7,350. On December 31, 2016, one year of insurance had expired. An adjustment for $2,450 ($7,350 × 1/3) was made to charge the cost of the expired insurance to operations and to decrease ***Prepaid Insurance*** to reflect the prepaid insurance premium that remains.

Adjustment **(k)** appears on the worksheet in Figure 12.1 for the insurance.

Insurance Expense	
Adj. 2,450	

Prepaid Insurance	
Bal. 7,350	Adj. 2,450

(k)

Prepaid Interest on Notes Payable On November 1, 2016, Whiteside Antiques borrowed $9,000 from its bank and signed a three-month note at an annual interest rate of 10 percent. The bank deducted the entire amount of interest in advance. The interest for three months is $225.

Principal	×	Rate	×	Time		
$9,000	×	0.10	×	3/12	=	$225

Whiteside Antiques received $8,775 ($9,000 − $225). The transaction was recorded as a debit to ***Cash*** for $8,775, a debit to ***Prepaid Interest*** for $225, and a credit to ***Notes Payable—Bank*** for $9,000.

On December 31, two months of prepaid interest ($225 × 2/3 = $150) had been incurred and needed to be recorded as an expense. The adjustment consists of a debit to ***Interest Expense*** and a credit to ***Prepaid Interest.***

Adjustment **(l)** appears on the worksheet in Figure 12.1 for the interest expense.

Interest Expense			
Adj.	150		

Prepaid Interest			
Bal.	225	Adj.	150

(l)

important!

Some assets and liabilities always require adjustments

Although prepaid expenses are usually charged to an asset account when they are paid, some businesses charge most prepayments to expense. In either case, at the time financial statements are prepared the accounts must be adjusted to show the correct expense and prepayment.

Other Prepaid Expenses Other common prepaid expenses are prepaid rent, prepaid advertising, and prepaid taxes. When paid, the amounts are debited to the asset accounts ***Prepaid Rent, Prepaid Advertising,*** and ***Prepaid Taxes.*** At the end of each period, an adjustment is made to transfer the portion used from the asset account to an expense account. For example, the adjustment for expired rent would be a debit to ***Rent Expense*** and a credit to ***Prepaid Rent.***

Alternative Method Some businesses use a different method for prepaid expenses. At the time cash is paid, they debit an expense account (not an asset account). At the end of each period, they make an adjustment to transfer the portion that is not used from the expense account to an asset account.

Suppose that Whiteside used this alternative method when purchasing the two-year insurance policy. On January 1, 2016, the transaction would have been recorded as a debit to ***Insurance Expense*** for $7,350 and a credit to ***Cash*** for $7,350. On December 31, 2016, after the insurance coverage for one year had expired, coverage for two years remained. The adjustment would be recorded as a debit to ***Prepaid Insurance*** for $4,900 ($7,350 × 2/3) and a credit to ***Insurance Expense*** for $4,900.

Identical amounts appear on the financial statements at the end of each fiscal period, no matter which method is used to handle prepaid expenses.

>> 12-3. OBJECTIVE

Compute adjustments for accrued and deferred income items, and enter the adjustments on the worksheet.

ADJUSTMENTS FOR ACCRUED INCOME

Accrued income is income that has been earned but not yet received and recorded. On December 31, 2013, Whiteside Antiques had accrued interest on notes receivable.

Accrued Interest on Notes Receivable Interest-bearing notes receivable are recorded at face value and are carried in the accounting records at this value until they are collected. The interest income is recorded when it is received, which is normally when the note matures. However, interest income is earned day by day. At the end of the period, an adjustment is made to recognize interest income earned but not yet received or recorded.

On November 1, 2016, Whiteside Antiques accepted from a customer a four-month, 15 percent note for $1,200. The note and interest are due on March 1, 2017. As of December 31, 2016, two months (November and December) of interest income was earned but not received. The amount of earned interest income is $30.

Principal	×	Rate	×	Time		
$1,200	×	0.15	×	2/12	=	$30

Adjustment **(m)** appears on the worksheet in Figure 12.1 for the interest income. To record the interest income of $30 earned, but not yet received, an adjustment debiting the asset account ***Interest Receivable*** and crediting a revenue account called ***Interest Income*** is made.

Interest Receivable			
Adj.	30		

Interest Income			
		Bal.	136
		Adj.	30

(m)

ADJUSTMENTS FOR UNEARNED INCOME

Unearned income, or **deferred income,** exists when cash is received before income is earned. Under the accrual basis of accounting, only income that has been earned appears on the income statement. Whiteside Antiques has no unearned income. The following is an example of unearned income for another business.

Unearned Subscription Income for a Publisher Magazine publishers receive cash in advance for subscriptions. When the publisher receives the cash, it is unearned income and is a liability. It is a liability because the publisher has an obligation to provide magazines during the subscription period. As the magazines are sent to the subscribers, income is earned and the liability decreases.

Tech Publishing Corporation publishes *Consumer Technology Today.* When subscriptions are received, ***Cash*** is debited and ***Unearned Subscription Income,*** a liability account, is credited. At the end of the year, ***Unearned Subscription Income*** had a balance of $450,000. During the year, $184,000 of magazines were delivered; income was earned in the amount of $184,000. The adjustment to recognize income is a debit to ***Unearned Subscription Income*** for $184,000 and a credit to ***Subscription Income*** for $184,000.

After the adjustment, the ***Unearned Subscription Income*** account has a balance of $266,000, which represents subscriptions for future periods.

Unearned Subscription Income			
12/31 Adj.	184,000	12/31 Bal.	450,000
		12/31 Bal.	266,000

Other Unearned Income Items Other types of unearned income include management fees, rental income, legal fees, architectural fees, construction fees, and advertising income. The cash received in advance is recorded as unearned income. As the income is earned, the amount is transferred from the liability account to a revenue account.

Alternative Method Some businesses use a different method to handle unearned income. At the time the cash is received, a credit is made to a revenue account (not a liability account). At the end of each period, the adjustment transfers the portion that is not earned to a liability account. For example, suppose Tech Publishing Corporation uses this method. When cash for subscriptions is received, it is credited to ***Subscription Income.*** At the end of the period, an adjustment is made to transfer the unearned income to a liability account. The entry is a debit to ***Subscription Income*** and a credit to ***Unearned Subscription Income.***

Identical amounts appear on the financial statements at the end of each fiscal period no matter which method is used to handle unearned income.

recall

Two Ways to Record Transactions

Earlier in this chapter you learned that prepaid expenses are usually charged to an asset account when paid, but may be charged to an expense account at that time. Likewise, unearned income is usually credited to a liability account when received, but may be credited to an income account. Be sure to understand how the transaction was originally entered before you begin making the adjusting entry.

Section 1 Self Review

QUESTIONS

1. Why is a 10-column worksheet used as part of the procedures for adjusting and closing accounts and preparing financial statements?
2. Why are there two amounts (a debit and a credit) in the adjustments column on the line for Merchandise Inventory in the 10-column worksheet?
3. Why are adjusting entries necessary?

EXERCISES

4. In Caymus Company's December 31 trial balance, a credit balance of $31,500 appears in Unearned Fee Income. This amount represents cash received from a customer on November 1 covering work to be performed by Caymus in November through January. At December 31, Caymus had earned $10,500 of the amount received on November 1. What account will be debited and what account will be credited in the adjusting entry on December 31? What is the amount of the adjustment?
5. Caymus Company adjusts and closes its accounts and prepares financial statements each month. In the December 31 Trial Balance column for debit balances, a balance of $9,000 is found in the Prepaid Rent account. A payment of $18,000 for prepayment of six months' rent was made on September 1.
   a. What is the amount of the adjusting entry for this item?
   b. What account would be debited and what account would be credited in the December 31 adjustments?

ANALYSIS

6. Your company prepares financial statements each month, using a 10-column worksheet to assemble data. What is the primary difference between the adjustments made on a monthly basis and those made on an annual basis?

(Answers to Section 1 Self Review are on page 434.)

Section 2

SECTION OBJECTIVE	TERMS TO LEARN
>> 12-4. Complete a 10-column worksheet. WHY IT'S IMPORTANT Using the worksheet is a convenient way to gather the information needed for the financial statements.	net income line updated account balances

Completing the Worksheet

After all adjustments have been entered on the worksheet, total the Adjustments Debit and Credit columns and verify that debits and credits are equal. The next step in the process is to prepare the Adjusted Trial Balance section.

Preparing the Adjusted Trial Balance Section

>> **12-4. OBJECTIVE**
Complete a 10-column worksheet.

Figure 12.2 on pages 410–413 shows the completed worksheet for Whiteside Antiques. The Adjusted Trial Balance section of the worksheet is completed as follows:

1. Combine the amount in the Trial Balance section and the Adjustments section for each account.
2. Enter the results in the Adjusted Trial Balance section. The accounts that do not have adjustments are simply extended from the Trial Balance section to the Adjusted Trial Balance section. For example, the balance of the ***Cash*** account is recorded in the Debit column of the Adjusted Trial Balance section without change.
3. The accounts that are affected by adjustments are recomputed. Follow these rules to combine amounts on the worksheet:

Trial Balance Section	Adjustments Section	Action
Debit	Debit	Add
Debit	Credit	Subtract
Credit	Credit	Add
Credit	Debit	Subtract

- If the account has a debit balance in the Trial Balance section and a debit entry in the Adjustments section, add the two amounts. Look at the ***Salaries Expense—Sales*** account. It has a $78,490 debit balance in the Trial Balance section and a $1,200 debit entry in the Adjustments section. The new balance is $79,690 ($78,490 + $1,200). It is entered in the Debit column of the Adjusted Trial Balance section.
- If the account has a debit balance in the Trial Balance section and a credit entry in the Adjustments section, subtract the credit amount. Look at the ***Supplies*** account. It has a $6,300 debit balance in the Trial Balance section and a $4,975 credit entry in the Adjustments section. The new balance is $1,325 ($6,300 − $4,975). It is entered in the Debit column of the Adjusted Trial Balance section.

FIGURE 12.2 Ten-Column Worksheet—Complete

Whiteside Antiques
Worksheet
Year Ended December 31, 2016

	ACCOUNT NAME	TRIAL BALANCE		ADJUSTMENTS	
		DEBIT	CREDIT	DEBIT	CREDIT
1	Cash	13,136.00			
2	Petty Cash Fund	100.00			
3	Notes Receivable	1,200.00			
4	Accounts Receivable	32,000.00			
5	Allowance for Doubtful Accounts		250.00		(c) 800.00
6	Interest Receivable			(m) 30.00	
7	Merchandise Inventory	52,000.00		(b) 47,000.00	(a) 52,000.00
8	Prepaid Insurance	7,350.00			(k) 2,450.00
9	Prepaid Interest	225.00			(l) 150.00
10	Supplies	6,300.00			(j) 4,975.00
11	Store Equipment	30,000.00			
12	Accumulated Depreciation—Store Equipment				(d) 2,400.00
13	Office Equipment	5,000.00			
14	Accumulated Depreciation—Office Equipment				(e) 700.00
15	Notes Payable—Trade		2,000.00		
16	Notes Payable—Bank		9,000.00		
17	Accounts Payable		24,129.00		
18	Interest Payable				(i) 20.00
19	Social Security Tax Payable		1,084.00		(g) 74.40
20	Medicare Tax Payable		250.00		(g) 17.40
21	Employee Income Taxes Payable		990.00		
22	Federal Unemployment Tax Payable				(h) 7.20
23	State Unemployment Tax Payable				(h) 64.80
24	Salaries Payable				(f) 1,200.00
25	Sales Tax Payable		7,200.00		
26	Bill Whiteside, Capital		61,221.00		
27	Bill Whiteside, Drawing	27,600.00			
28	Income Summary			(a) 52,000.00	(b) 47,000.00
29	Sales		561,650.00		
30	Sales Returns and Allowances	12,500.00			
31	Interest Income		136.00		(m) 30.00
32	Miscellaneous Income		366.00		
33	Purchases	321,500.00			
34	Freight In	9,800.00			
35	Purchases Returns and Allowances		3,050.00		
36	Purchases Discounts		3,130.00		
37	Salaries Expense—Sales	78,490.00		(f) 1,200.00	
38	Advertising Expense	7,425.00			
39	Cash Short or Over	125.00			
40	Supplies Expense			(j) 4,975.00	

ADJUSTED TRIAL BALANCE		INCOME STATEMENT		BALANCE SHEET		
DEBIT	CREDIT	DEBIT	CREDIT	DEBIT	CREDIT	
13,136.00				13,136.00		1
100.00				100.00		2
1,200.00				1,200.00		3
32,000.00				32,000.00		4
	1,050.00				1,050.00	5
30.00				30.00		6
47,000.00				47,000.00		7
4,900.00				4,900.00		8
75.00				75.00		9
1,325.00				1,325.00		10
30,000.00				30,000.00		11
	2,400.00				2,400.00	12
5,000.00				5,000.00		13
	700.00				700.00	14
	2,000.00				2,000.00	15
	9,000.00				9,000.00	16
	24,129.00				24,129.00	17
	20.00				20.00	18
	1,158.40				1,158.40	19
	267.40				267.40	20
	990.00				990.00	21
	7.20				7.20	22
	64.80				64.80	23
	1,200.00				1,200.00	24
	7,200.00				7,200.00	25
	61,221.00				61,221.00	26
27,600.00				27,600.00		27
52,000.00	47,000.00	52,000.00	47,000.00			28
	561,650.00		561,650.00			29
12,500.00		12,500.00				30
	166.00		166.00			31
	366.00		366.00			32
321,500.00		321,500.00				33
9,800.00		9,800.00				34
	3,050.00		3,050.00			35
	3,130.00		3,130.00			36
79,690.00		79,690.00				37
7,425.00		7,425.00				38
125.00		125.00				39
4,975.00		4,975.00				40

FIGURE 12.2 Ten-Column Worksheet—Complete (concluded)

	ACCOUNT NAME	TRIAL BALANCE		ADJUSTMENTS	
		DEBIT	CREDIT	DEBIT	CREDIT
41	*Depreciation Expense—Store Equipment*			(d) 2,400.00	
42	*Rent Expense*	27,600.00			
43	*Salaries Expense—Office*	26,500.00			
44	*Insurance Expense*			(k) 2,450.00	
45	*Payroll Taxes Expense*	7,205.00		(g) 91.80	
46				(h) 72.00	
47	*Telephone Expense*	1,875.00			
48	*Uncollectible Accounts Expense*			(c) 800.00	
49	*Utilities Expense*	5,925.00			
50	*Depreciation Expense—Office Equipment*			(e) 700.00	
51	*Interest Expense*	600.00		(i) 20.00	
52				(l) 150.00	
53	*Totals*	674,456.00	674,456.00	111,888.80	111,888.80
54	*Net Income*				

- If the account has a credit balance in the Trial Balance section and a credit entry in the Adjustments section, add the two amounts. Look at ***Allowance for Doubtful Accounts.*** It has a $250 credit balance in the Trial Balance section and an $800 credit entry in the Adjustments section. The new balance is $1,050 ($250 + $800). It is entered in the Credit column of the Adjusted Trial Balance section.
- If the account has a credit balance in the Trial Balance section and a debit entry in the Adjustments section, subtract the debit amount. Whiteside Antiques had no such adjustments.

The Adjusted Trial Balance section now contains the **updated account balances** that will be used in preparing the financial statements.

Look at the ***Income Summary*** account. Recall that the debit entry in this account removed the *beginning* balance from ***Merchandise Inventory*** and the credit entry added the *ending* balance to ***Merchandise Inventory.*** Notice that the debit and credit amounts in ***Income Summary*** are not combined in the Adjusted Trial Balance section.

Once all the updated account balances have been entered in the Adjusted Trial Balance section, total and rule the columns. Confirm that total debits equal total credits.

Preparing the Balance Sheet and Income Statement Sections

To complete the Income Statement and Balance Sheet sections of the worksheet, identify the accounts that appear on the balance sheet. On Figure 12.2, the accounts from ***Cash*** through ***Bill Whiteside, Drawing*** appear on the balance sheet. For each account enter the amount in the appropriate Debit or Credit column of the Balance Sheet section of the worksheet.

For accounts that appear on the income statement, ***Sales*** through ***Interest Expense,*** enter the amounts in the appropriate Debit or Credit column of the Income Statement section. The ***Income Summary*** debit and credit amounts are also entered in the Income Statement section of the worksheet. Notice that the debit and credit amounts in ***Income Summary*** are not combined in the Income Statement section.

Calculating Net Income or Net Loss

Once all account balances have been entered in the financial statement sections of the worksheet, the net income or net loss for the period is determined.

ADJUSTED TRIAL BALANCE		INCOME STATEMENT		BALANCE SHEET		
DEBIT	CREDIT	DEBIT	CREDIT	DEBIT	CREDIT	
2,400.00		2,400.00				41
27,600.00		27,600.00				42
26,500.00		26,500.00				43
2,450.00		2,450.00				44
7,368.80		7,368.80				45
						46
1,875.00		1,875.00				47
800.00		800.00				48
5,925.00		5,925.00				49
700.00		700.00				50
770.00		770.00				51
						52
726,769.80	726,769.80	564,403.80	615,362.00	162,366.00	111,407.80	53
		50,958.20			50,958.20	54
		615,362.00	615,362.00	162,366.00	162,366.00	55
						56

1. Total the Debit and Credit columns in the Income Statement section. For Whiteside Antiques, the debits total $564,403.80 and the credits total $615,362.00. Since the credits exceed the debits, the difference represents net income of $50,958.20.
2. To balance the Debit and the Credit columns in the Income Statement section, enter $50,958.20 in the Debit column of the Income Statement section. Total each column again and record the final total of each column ($615,362.00) on the worksheet.
3. Total the columns in the Balance Sheet section. Total debits are $162,366.00 and total credits are $111,407.80. The difference must equal the net income for the year, $50,958.20.
4. Enter $50,958.20 in the Credit column of the Balance Sheet section. Total each column again and record the final total in each column ($162,366.00).
5. Rule the Debit and Credit columns in all sections to show that the worksheet is complete.

MANAGERIAL IMPLICATIONS <<

EFFECT OF ADJUSTMENTS ON FINANCIAL STATEMENTS

- If managers are to know the true revenue, expenses, and net income or net loss for a period, the matching process is necessary.
- If accounts are not adjusted, the financial statements will be incomplete, misleading, and of little help in evaluating operations.
- Managers need to be familiar with the procedures and underlying assumptions used by the accountant to make adjustments because adjustments increase or decrease net income.
- Managers need information about uncollectible accounts expense in order to review the firm's credit policy. If losses are too high, management might tighten the requirements for obtaining credit. If losses are very low, management might investigate whether easing credit requirements would increase net income.
- The worksheet is a useful device for gathering data about adjustments and for preparing the financial statements.
- Managers are keenly interested in receiving timely financial statements, especially the income statement, which shows the results of operations.
- Managers are also interested in the prompt preparation of the balance sheet because it shows the financial position of the business at the end of the period.

THINKING CRITICALLY

What are some possible consequences of not making adjusting entries?

Notice that the net income is recorded in two places on the **net income line** of the worksheet. It is recorded in the Credit column of the Balance Sheet section because net income *increases* owner's equity. It is recorded in the Debit column of the Income Statement section to balance the two columns in that section.

Section 2 Self Review

QUESTIONS

1. In the adjusting entry for depreciation, is the ***Depreciation Expense*** account increased or decreased? Is the book value of the asset being depreciated increased or is it decreased?
2. In its December 31, 2016, financial reports, St. Claire Company's accountant made two errors: (1) failed to record interest of $600 accrued on a note payable; and (2) failed to record interest of $1,600 accrued on a note receivable. What is the net effect of these two errors on assets, on liabilities, on expenses, on income, and on owner's equity?
3. The trial balance in the first two columns of the worksheet balances and the adjustments in the next two columns balance. However, the adjusted trial balance does not balance. What is the likely source of the trouble?

EXERCISES

4. What account is debited and what account is credited to accrue interest on notes payable?
5. The amount of net income appears on the worksheet in the:
   - **a.** Credit column of the adjusted trial balance section.
   - **b.** Debit column of the balance sheet section.
   - **c.** Credit column of the income statement section.
   - **d.** Debit column of the income statement section.

ANALYZE

6. Explain why an error in the amount of an adjusting entry usually affects at least two accounting periods.

(Answers to Section 2 Self Review are on page 435.)

Chapter 12

Review and Applications

REVIEW Chapter Summary

Accrual basis accounting requires that all revenue and expenses for a fiscal period be matched and reported on the income statement to determine net income or net loss for the period. In this chapter, you have learned the techniques used to adjust accounts so that they accurately reflect the operations of the period.

Learning Objectives

12-1 **Determine the adjustment for merchandise inventory, and enter the adjustment on the worksheet.**

Merchandise inventory consists of goods that a business has on hand for sale to customers. When the trial balance is prepared at the end of the period, the ***Merchandise Inventory*** account still reflects the beginning inventory. Before the financial statements can be prepared, ***Merchandise Inventory*** must be updated to reflect the ending inventory for the period. The actual quantity of the goods on hand at the end of the period must be counted. Then the adjustment is completed in two steps:

1. Remove the beginning inventory balance from the ***Merchandise Inventory*** account. Debit ***Income Summary;*** credit ***Merchandise Inventory.***
2. Add the ending inventory to the ***Merchandise Inventory*** account. Debit ***Merchandise Inventory;*** credit ***Income Summary.***

12-2 **Compute adjustments for accrued and prepaid expense items, and enter the adjustments on the worksheet.**

Expense accounts are adjusted at the end of the period so that they correctly reflect the current period. Examples of adjustments include provision for uncollectible accounts and depreciation. Other typical adjustments of expense accounts involve accrued expenses and prepaid expenses.

- Accrued expenses are expense items that have been incurred or used but not yet paid or recorded. They include salaries, payroll taxes, interest on notes payable, and property taxes.
- Prepaid expenses are expense items that a business pays for and records before it actually uses the items. Rent, insurance, and advertising paid in advance are examples.

12-3 **Compute adjustments for accrued and deferred income items, and enter the adjustments on the worksheet.**

Revenue accounts are adjusted at the end of the period so that they correctly reflect the current period.

- Adjustments can affect either accrued income or deferred income.
- Accrued income is income that has been earned but not yet received and recorded.
- Deferred, or unearned, income is income that has not yet been earned but has been received.

12-4 **Complete a 10-column worksheet.**

When all adjustments have been entered on the worksheet, the worksheet is completed so that the financial statements can be prepared easily.

1. Figures in the Trial Balance section are combined with the adjustments to obtain an adjusted trial balance.
2. Each item in the Adjusted Trial Balance section is extended to the Income Statement or the Balance Sheet sections of the worksheet.
3. The Income Statement columns are totaled and the net income or net loss is determined and entered in the net income line.
4. The amount of net income or net loss is entered in the net income line in the Balance Sheet section. After net income or net loss is added, the total debits must equal the total credits in the Balance Sheet section columns.

12-5 **Define the accounting terms new to this chapter.**

Glossary

Accrual basis (p. 398) A system of accounting by which all revenues and expenses are matched and reported on financial statements for the applicable period, regardless of when the cash related to the transaction is received or paid

Accrued expenses (p. 403) Expense items that relate to the current period but have not yet been paid and do not yet appear in the accounting records

Accrued income (p. 406) Income that has been earned but not yet received and recorded

Deferred expenses (p. 405) See Prepaid expenses

Deferred income (p. 407) See Unearned income

Inventory sheet (p. 399) A form used to list the volume and type of goods a firm has in stock

Net income line (p. 414) The worksheet line immediately following the column totals on which net income (or net loss) is recorded in two places: the Income Statement section and the Balance Sheet section

Property, plant, and equipment (p. 402) Long-term assets that are used in the operation of a business and that are subject to depreciation (except for land, which is not depreciated)

Unearned income (p. 407) Income received before it is earned

Updated account balances (p. 412) The amounts entered in the Adjusted Trial Balance section of the worksheet

Comprehensive **Self Review**

1. Why is the accrual basis of accounting favored?
2. What is meant by the term "accrued income"?
3. How, if at all, does "accrued income" differ from "unearned income"?
4. A completed worksheet for Holiday Company on December 31, 2016, showed a total of $930,000 in the debit column of the Income Statement section and a total credit of $902,000 in the credit column. Does this represent a profit or a loss for the year? How much?
5. On July 1, 2016, a landlord received $36,000 cash from a tenant, covering rent from July 1, 2016, through June 30, 2017. The payment was credited to ***Unearned Rent Income.*** Assuming no entry has been made in the ***Unearned Rent Income*** account since the payment was received, what would be the adjusting entry on December 31, 2016?
6. On July 1, 2016, a landlord received $36,000 cash from a tenant, covering rent from that date through June 30, 2017. The payment was credited to ***Rent Income.*** Assuming no entry has been made in the income account since receipt of the payment, what would be the adjusting entry on December 31, 2016?

(Answers to Comprehensive Self Review are on page 435.)

Discussion Questions

1. What adjustment is made to record the estimated expense for uncollectible accounts?
2. When a specific account receivable is deemed uncollectible it is written off by debiting ____________ and crediting ____________.
3. Income Summary amounts are extended to which statement columns on the worksheet?
4. Why is depreciation recorded?
5. What types of assets are subject to depreciation? Give three examples of such assets.
6. Explain the meaning of the following terms that relate to depreciation:
   - **a.** Salvage value
   - **b.** Depreciable base
   - **c.** Useful life
   - **d.** Straight-line method
7. What adjustment is made for depreciation on office equipment?
8. What is an accrued expense? Give three examples of items that often become accrued expenses.
9. What adjustment is made to record accrued salaries?
10. What is a prepaid expense? Give three examples of prepaid expense items.

11. How is the cost of an insurance policy recorded when the policy is purchased?
12. What adjustment is made to record expired insurance?
13. What is the alternative method of handling prepaid expenses?
14. What is accrued income? Give an example of an item that might produce accrued income.
15. What adjustment is made for accrued interest on a note receivable?
16. What is unearned income? Give two examples of items that would be classified as unearned income.
17. How is unearned income recorded when it is received?
18. What adjustment is made to record income earned during a period?
19. What is the alternative method of handling unearned income?
20. ***Unearned Fees Income*** is classified as which type of account?
21. How does the worksheet help the accountant to prepare financial statements more efficiently?

APPLICATIONS

Exercises

connect ACCOUNTING

Determining the adjustments for inventory.

Exercise 12.1
Objective 12-1

The beginning inventory of a merchandising business was $131,000, and the ending inventory is $111,519. What entries are needed at the end of the fiscal period to adjust ***Merchandise Inventory?***

Determining the adjustments for inventory.

Exercise 12.2
Objective 12-1

The Income Statement section of the worksheet of Sampson Company for the year ended December 31, has $189,000 recorded in the Debit column and $212,344 in the Credit column on the line for the ***Income Summary*** account. What were the beginning and ending balances for ***Merchandise Inventory?***

Computing adjustments for accrued and prepaid expense items.

Exercise 12.3
Objective 12-2

For each of the following independent situations, indicate the adjusting entry that must be made on the December 31, 2016, worksheet. Omit descriptions.

a. During the year 2016, Johnson Company had net credit sales of $990,000. Past experience shows that 0.5 percent of the firm's net credit sales result in uncollectible accounts.

b. Equipment purchased by Chu Consultancy for $28,220 on January 2, 2016, has an estimated useful life of eight years and an estimated salvage value of $2,700. What adjustment for depreciation should be recorded on the firm's worksheet for the year ended December 31, 2016?

c. On December 31, 2016, Parrish Plumbing Supply owed wages of $5,700 to its factory employees, who are paid weekly.

d. On December 31, 2016, Parrish Plumbing Supply owed the employer's social security (6.2%) and Medicare (1.45%) taxes on the entire $5,700 of accrued wages for its factory employees.

e. On December 31, 2016, Parrish Plumbing Supply owed federal (0.6%) and state (5.4%) unemployment taxes on the entire $5,700 of accrued wages for its factory employees.

Computing adjustments for accrued and prepaid expense items.

Exercise 12.4
Objective 12-2

For each of the following independent situations, indicate the adjusting entry that must be made on the December 31, 2016, worksheet. Omit descriptions.

a. On December 31, 2016, the ***Notes Payable*** account at Queens Manufacturing Company had a balance of $19,000. This balance represented a three-month, 9 percent note issued on November 1.

b. On January 2, 2016, Campbell Computer Consultants purchased flash drives, paper, and other supplies for $6,230 in cash. On December 31, 2016, an inventory of supplies showed that items costing $1,610 were on hand. The ***Supplies*** account has a balance of $6,230.

c. On August 1, 2016, North Texas Manufacturing paid a premium of $13,440 in cash for a one-year insurance policy. On December 31, 2016, an examination of the insurance records showed that coverage for a period of five months had expired.

d. On April 1, 2016, Cathy's Crafts signed a one-year advertising contract with a local radio station and issued a check for $14,160 to pay the total amount owed. On December 31, 2016, the ***Prepaid Advertising*** account has a balance of $14,160.

Exercise 12.5
Objective 12-2

Recording adjustments for accrued and prepaid expense items.

On December 1, 2016, Jim's Java Joint borrowed $50,000 from its bank in order to expand its operations. The firm issued a four-month, 6 percent note for $50,000 to the bank and received $49,000 in cash because the bank deducted the interest for the entire period in advance. In general journal form, show the entry that would be made to record this transaction and the adjustment for prepaid interest that should be recorded on the firm's worksheet for the year ended December 31, 2016. Omit descriptions. Round your answers to the nearest dollar.

Exercise 12.6
Objective 12-2

Recording adjustments for accrued and prepaid expense items.

On December 31, 2016, the ***Notes Payable*** account at Beth's Boutique Shop had a balance of $64,000. This amount represented funds borrowed on a six-month, 12 percent note from the firm's bank on December 1. Record the journal entry for interest expense on this note that should be recorded on the firm's worksheet for the year ended December 31, 2016. Omit descriptions.

Exercise 12.7
Objective 12-3

Recording adjustments for accrued and deferred income items.

For each of the following independent situations, indicate the adjusting entry that must be made on the December 31, 2016, worksheet. Omit descriptions.

a. On December 31, 2016, the ***Notes Receivable*** account at Manton Materials had a balance of $21,000, which represented a six-month, 10 percent note received from a customer on September 1.

b. During the week ended June 7, 2016, Parker Media received $50,000 from customers for subscriptions to its magazine *Modern Business*. On December 31, 2016, an analysis of the ***Unearned Subscription Revenue*** account showed that half of the subscriptions were earned in 2016.

c. On November 1, 2016, Prentice Realty Company rented a commercial building to a new tenant and received $54,000 in advance to cover the rent for six months. Upon receipt, the $54,000 was recorded in the ***Unearned Rent*** account.

d. On November 1, 2016, the Mighty Bucks Hockey Club sold season tickets for 50 home games, receiving $8,500,000. Upon receipt, the $8,500,000 was recorded in the ***Unearned Season Tickets Income*** account. At December 31, 2016, the Mighty Bucks Hockey Club had played 4 home games.

PROBLEMS

Problem Set A

Problem 12.1A
Objectives 12-2, 12-3, 12-5

Recording adjustments for accrued and prepaid items and unearned income.

Based on the information below, record the adjusting journal entries that must be made for Garibaldi Consulting on June 30, 2016. The company has a June 30 fiscal year-end. Use 18 as the page number for the general journal.

a.–b. ***Merchandise Inventory,*** before adjustment, has a balance of $8,500. The newly counted inventory balance is $9,000.

c. ***Unearned Seminar Fees*** has a balance of $7,000, representing prepayment by customers for five seminars to be conducted in June, July, and August 2016. Two seminars had been conducted by June 30, 2016.

d. ***Prepaid Insurance*** has a balance of $18,000 for six months insurance paid in advance on May 1, 2016.

e. Store equipment costing $8,760 was purchased on March 31, 2016 It has a salvage value of $600, and a useful life of four years.

f. Employees have earned $350 that has not been paid at June 30, 2016.

g. The employer owes the following taxes on wages not paid at June 30, 2016: SUTA, $10.50; FUTA, $2.10; Medicare, $5.08; and social security, $21.70.

h. Management estimates uncollectible accounts expense at 1% of sales. This year's sales were $3,000,000.

i. ***Prepaid Rent*** has a balance of $8,100 for six months' rent paid in advance on March 1, 2016.

j. The ***Supplies*** account in the general ledger has a balance of $500. A count of supplies on hand at June 30, 2016 indicated $200 of supplies remain.

k. The company borrowed $10,100 from First Bank on June 1, 2016 and issued a four-month note. The note bears interest at 12%.

Analyze: After all adjusting entries have been journalized and posted, what is the balance of the ***Prepaid Rent*** account?

Recording adjustments for accrued and prepaid expense items and unearned income.

Problem 12.2A

Objectives 12-2, 12-3, 12-6

Sage 50 Complete Accounting

QB

On July 1, 2016, Sean McConnell established his own accounting practice. Selected transactions for the first few days of July follow.

INSTRUCTIONS

1. Record the transactions on page 1 of the general journal. Omit descriptions. Assume that the firm initially records prepaid expenses as assets and unearned income as a liability.
2. Record the adjusting journal entries that must be made on July 31, 2016, on page 2 of the general journal. Omit descriptions.

DATE		TRANSACTIONS
July	1	Signed a lease for an office and issued Check 101 for $14,700 to pay the rent in advance for six months.
	1	Borrowed money from First National Bank by issuing a four-month, 9 percent note for $40,000; received $38,800 because the bank deducted the interest in advance.
	1	Signed an agreement with Young Corp. to provide accounting and tax services for one year at $7,000 per month; received the entire fee of $84,000 in advance.
	1	Purchased office equipment for $15,900 from Office Outfitters; issued a two-month, 12 percent note in payment. The equipment is estimated to have a useful life of five years and a $1,500 salvage value. The equipment will be depreciated using the straight-line method.
	1	Purchased a one-year insurance policy and issued Check 102 for $1,740 to pay the entire premium.
	3	Purchased office furniture for $16,080 from Office Warehouse; issued Check 103 for $8,480 and agreed to pay the balance in 60 days. The equipment has an estimated useful life of four years and a $1,200 salvage value. The office furniture will be depreciated using the straight-line method.
	5	Purchased office supplies for $2,010 with Check 104. Assume $900 of supplies are on hand July 31, 2016.

Analyze: What balance should be reflected in ***Unearned Accounting Fees*** at July 31, 2016?

Problem 12.3A
Objectives 12-2, 12-3

Recording adjustments for accrued and prepaid expense items and earned income.

On July 31, 2016, after one month of operation, the general ledger of Michael Domenici, Consultant, contained the accounts and balances given below.

INSTRUCTIONS

1. Prepare a partial worksheet with the following sections: Trial Balance, Adjustments, and Adjusted Trial Balance. Use the data about the firm's accounts and balances to complete the Trial Balance section.
2. Enter the adjustments described below in the Adjustments section. Identify each adjustment with the appropriate letter.
3. Complete the Adjusted Trial Balance section.

ACCOUNTS AND BALANCES

Cash	$25,510	Dr.
Accounts Receivable	1,440	Dr.
Supplies	960	Dr.
Prepaid Rent	10,500	Dr.
Prepaid Insurance	2,220	Dr.
Prepaid Interest	400	Dr.
Furniture	14,760	Dr.
Accumulated Depreciation—Furniture		
Equipment	7,250	Dr.
Accumulated Depreciation—Equipment		
Notes Payable	17,700	Cr.
Accounts Payable	5,500	Cr.
Interest Payable		
Unearned Consulting Fees	6,000	Cr.
Michael Domenici, Capital	32,520	Cr.
Michael Domenici, Drawing	3,000	Dr.
Consulting Fees	9,000	Cr.
Salaries Expense	4,200	Dr.
Utilities Expense	270	Dr.
Telephone Expense	210	Dr.
Supplies Expense		
Rent Expense		
Insurance Expense		
Depreciation Expense—Furniture		
Depreciation Expense—Equipment		
Interest Expense		

ADJUSTMENTS

a. On July 31, an inventory of the supplies showed that items costing $630 were on hand.
b. On July 1, the firm paid $10,500 in advance for six months of rent.
c. On July 1, the firm purchased a one-year insurance policy for $2,220.
d. On July 1, the firm paid $400 interest in advance on a four-month note that it issued to the bank.
e. On July 1, the firm purchased office furniture for $14,760. The furniture is expected to have a useful life of eight years and a salvage value of $1,800.

f. On July 1, the firm purchased office equipment for $7,250. The equipment is expected to have a useful life of five years and a salvage value of $1,850

g. On July 1, the firm issued a three-month, 6 percent note for $9,800.

h. On July 1, the firm received a consulting fee of $6,000 in advance for a one-year period.

Analyze: By what total amount were the expense accounts of the business adjusted?

Recording adjustments and completing the worksheet.

Problem 12.4A
Objectives 12-1, 12-2, 12-3, 12-4

The Green Thumb Gardener is a retail store that sells plants, soil, and decorative pots. On December 31, 2016, the firm's general ledger contained the accounts and balances that appear below.

INSTRUCTIONS

1. Prepare the Trial Balance section of a 10-column worksheet. The worksheet covers the year ended December 31, 2016.
2. Enter the adjustments below in the Adjustments section of the worksheet. Identify each adjustment with the appropriate letter.
3. Complete the worksheet.

ACCOUNTS AND BALANCES

Cash	$ 6,700	Dr.
Accounts Receivable	3,600	Dr.
Allowance for Doubtful Accounts	62	Cr.
Merchandise Inventory	12,300	Dr.
Supplies	1,300	Dr.
Prepaid Advertising	1,080	Dr.
Store Equipment	8,700	Dr.
Accumulated Depreciation—Store Equipment	1,600	Cr.
Office Equipment	2,200	Dr.
Accumulated Depreciation—Office Equipment	380	Cr.
Accounts Payable	2,725	Cr.
Social Security Tax Payable	530	Cr.
Medicare Tax Payable	88	Cr.
Federal Unemployment Tax Payable		
State Unemployment Tax Payable		
Salaries Payable		
Beth Argo, Capital	30,677	Cr.
Beth Argo, Drawing	21,000	Dr.
Sales	95,048	Cr.
Sales Returns and Allowances	1,200	Dr.
Purchases	49,400	Dr.
Purchases Returns and Allowances	530	Cr.
Rent Expense	7,000	Dr.
Telephone Expense	690	Dr.
Salaries Expense	15,100	Dr.
Payroll Taxes Expense	1,370	Dr.
Income Summary		
Supplies Expense		
Advertising Expense		
Depreciation Expense—Store Equipment		
Depreciation Expense—Office Equipment		
Uncollectible Accounts Expense		

ADJUSTMENTS

a.–b. Merchandise inventory on December 31, 2016, is $13,321.

c. During 2016, the firm had net credit sales of $45,000; the firm estimates that 0.5 percent of these sales will result in uncollectible accounts.

d. On December 31, 2016, an inventory of the supplies showed that items costing $325 were on hand.

e. On October 1, 2016, the firm signed a six-month advertising contract for $1,080 with a local newspaper and paid the full amount in advance.

f. On January 2, 2015, the firm purchased store equipment for $8,700. At that time, the equipment was estimated to have a useful life of five years and a salvage value of $700.

g. On January 2, 2015, the firm purchased office equipment for $2,200. At that time, the equipment was estimated to have a useful life of five years and a salvage value of $300.

h. On December 31, 2016, the firm owed salaries of $1,930 that will not be paid until 2017.

i. On December 31, 2016, the firm owed the employer's social security tax (assume 6.2 percent) and Medicare tax (assume 1.45 percent) on the entire $1,930 of accrued wages.

j. On December 31, 2016, the firm owed federal unemployment tax (assume 0.6 percent) and state unemployment tax (assume 5.4 percent) on the entire $1,930 of accrued wages.

Analyze: By what amount were the assets of the business affected by adjustments?

Problem 12.5A
Objectives 12-1, 12-2, 12-3, 12-4
CONTINUING >>> Problem

Recording adjustments and completing the worksheet.

Healthy Eating Foods Company is a distributor of nutritious snack foods such as granola bars. On December 31, 2016, the firm's general ledger contained the accounts and balances that follow.

INSTRUCTIONS

1. Prepare the Trial Balance section of a 10-column worksheet. The worksheet covers the year ended December 31, 2016.
2. Enter the adjustments in the Adjustments section of the worksheet. Identify each adjustment with the appropriate letter.
3. Complete the worksheet.

Note: This problem will be required to complete Problem 13.4A in Chapter 13.

ACCOUNTS AND BALANCES

Cash	$ 30,100	Dr.
Accounts Receivable	35,200	Dr.
Allowance for Doubtful Accounts	420	Cr.
Merchandise Inventory	86,000	Dr.
Supplies	10,400	Dr.
Prepaid Insurance	5,400	Dr.
Office Equipment	8,300	Dr.
Accum. Depreciation—Office Equipment	2,650	Cr.
Warehouse Equipment	28,000	Dr.
Accum. Depreciation—Warehouse Equipment	9,600	Cr.
Notes Payable—Bank	32,000	Cr.
Accounts Payable	12,200	Cr.
Interest Payable		
Social Security Tax Payable	1,680	Cr.
Medicare Tax Payable	388	Cr.
Federal Unemployment Tax Payable		
State Unemployment Tax Payable		
Salaries Payable		
Phillip Tucker, Capital	108,684	Cr.

ACCOUNTS AND BALANCES (CONT.)

Phillip Tucker, Drawing	56,000	Dr.
Sales	653,778	Cr.
Sales Returns and Allowances	10,000	Dr.
Purchases	350,000	Dr.
Purchases Returns and Allowances	9,200	Cr.
Income Summary		
Rent Expense	36,000	Dr.
Telephone Expense	2,200	Dr.
Salaries Expense	160,000	Dr.
Payroll Taxes Expense	13,000	Dr.
Supplies Expense		
Insurance Expense		
Depreciation Expense—Office Equip.		
Depreciation Expense—Warehouse Equip.		
Uncollectible Accounts Expense		
Interest Expense		

ADJUSTMENTS

a.–b. Merchandise inventory on December 31, 2016, is $78,000.

c. During 2016, the firm had net credit sales of $560,000; past experience indicates that 0.5 percent of these sales should result in uncollectible accounts.

d. On December 31, 2016, an inventory of supplies showed that items costing $1,180 were on hand.

e. On May 1, 2016, the firm purchased a one-year insurance policy for $5,400.

f. On January 2, 2014, the firm purchased office equipment for $8,300. At that time, the equipment was estimated to have a useful life of six years and a salvage value of $350.

g. On January 2, 2014, the firm purchased warehouse equipment for $28,000. At that time, the equipment was estimated to have a useful life of five years and a salvage value of $4,000.

h. On November 1, 2016, the firm issued a four-month, 12 percent note for $32,000.

i. On December 31, 2016, the firm owed salaries of $5,000 that will not be paid until 2017.

j. On December 31, 2016, the firm owed the employer's social security tax (assume 6.2 percent) and Medicare tax (assume 1.45 percent) on the entire $5,000 of accrued wages.

k. On December 31, 2016, the firm owed the federal unemployment tax (assume 0.6 percent) and the state unemployment tax (assume 5.4 percent) on the entire $5,000 of accrued wages.

Analyze: When the financial statements for Healthy Eating Foods Company are prepared, what net income will be reported for the period ended December 31, 2016?

Recording adjustments and completing the worksheet.

Problem 12.6A
Objectives 12-1, 12-2, 12-3, 12-4

The Artisan Wines is a retail store selling vintage wines. On December 31, 2016, the firm's general ledger contained the accounts and balances below. All account balances are normal.

Cash	28,386
Accounts Receivable	500
Prepaid Advertising	480
Supplies	300
Merchandise Inventory	15,000
Store Equipment	25,000
Accumulated Depreciation—Store Equipment	3,000
Office Equipment	5,000

Accumulated Depreciation—Office Equipment	1,500
Notes Payable, due 2017	20,000
Accounts Payable	2,705
Wages Payable	
Social Security Tax Payable	
Medicare Tax Payable	
Unearned Seminar Fees	6,000
Interest Payable	
Vincent Arroyo, Capital	32,700
Vincent Arroyo, Drawing	14,110
Income Summary	
Sales	153,970
Sales Discounts	200
Seminar Fee Income	
Purchases	91,000
Purchases Returns and Allowances	1,000
Freight In	225
Rent Expense	13,200
Wages Expense	24,000
Payroll Taxes Expense	3,324
Depreciation Expense—Store Equipment	
Depreciation Expense—Office Equipment	
Advertising Expense	
Supplies Expense	
Interest Expense	150

INSTRUCTIONS:

1. Prepare the Trial Balance section of a 10-column worksheet. The worksheet covers the year ended December 31, 2016.
2. Enter the adjustments below in the Adjustments section of the worksheet. Identify each adjustment with the appropriate letter.
3. Complete the worksheet.

ADJUSTMENTS:

a.–b. Merchandise inventory at December 31, 2016, was counted, and determined to be $13,000.

c. The amount recorded as prepaid advertising represents $480 paid on September 1, 2016, for 12 months of advertising.

d. The amount of supplies on hand at December 31 was $160.

e. Depreciation on store equipment was $3,000 for 2016.

f. Depreciation on office equipment was $1,125 for 2016.

g. Unearned Seminar Fees represents $6,000 received on November 1, 2016, for six seminars. At December 31, four of these seminars had been conducted.

h. Wages owed but not paid at December 31 were $500.

i. On December 31, 2016, the firm owed the employer's social security tax ($31.00) and Medicare tax ($7.25).

j. The note payable bears interest at 6% per annum. One month interest is owed at December 31, 2016.

Analyze: What was the amount of revenue earned by conducting seminars during the year ended December 31, 2016?

Problem Set B

Recording adjustments for accrued and prepaid items and unearned income.

Problem 12.1B
Objectives 12-2, 12-3, 12-6

Based on the information below, record the adjusting journal entries that must be made for June Kang Consulting Services on December 31, 2016. The company has a December 31 fiscal year-end. Use 18 as the page number for the general journal.

a.–b. ***Merchandise Inventory,*** before adjustment, has a balance of \$9,500. The newly counted inventory balance is \$10,500.

c. ***Unearned Seminar Fee***s has a balance of \$16,000, representing prepayment by customers for four seminars to be conducted in December 2016 and January 2017. Three seminars had been conducted by December 31, 2016.

d. ***Prepaid Insurance*** has a balance of \$15,000 for six months insurance paid in advance on October 1, 2016.

e. Store equipment costing \$6,000 was purchased on September 1, 2016. It has a salvage value of \$600, and a useful life of five years.

f. Employees have earned \$500 of wages not paid at December 31, 2016.

g. The employer owes the following taxes on wages not paid at December 31, 2016: SUTA, \$15.00; FUTA, \$3.00; Medicare, \$7.25; and social security, \$31.00.

h. Management estimates uncollectible accounts expense at 1.5% (0.015) of sales. This year's sales were \$4,000,000.

i. ***Prepaid Rent*** has a balance of \$18,000 for nine months' rent paid in advance on October 1, 2016.

j. The ***Supplies*** account in the general ledger has a balance of \$500. A count of supplies on hand at December 31, 2016, indicated \$125 of supplies remain.

k. The company borrowed \$12,000 on a two-month note payable dated December 1, 2016. The note bears interest at 6%.

Analyze: After all adjusting entries have been journalized and posted, what is the balance of the ***Unearned Seminar Fees*** account?

Recording adjustments for accrued and prepaid expense items and unearned income.

Problem 12.2B
Objectives 12-2, 12-3

On June 1, 2016, Penelope Bermudez established her own advertising firm. Selected transactions for the first few days of June follow.

1. Record the transactions on page 1 of the general journal. Omit descriptions. Assume that the firm initially records prepaid expenses as assets and unearned income as a liability.
2. Record the adjusting journal entries that must be made on June 30, 2016, on page 2 of the general journal. Omit descriptions.

DATE		TRANSACTIONS
2016		
June	1	Signed a lease for an office and issued Check 101 for $18,000 to pay the rent in advance for six months.
	1	Borrowed money from National Trust Bank by issuing a three-month, 10 percent note for $18,000; received $17,550 because the bank deducted interest in advance.
	1	Signed an agreement with Glass Decorations Inc. to provide advertising consulting for one year at $4,550 per month; received the entire fee of $54,600 in advance.
	1	Purchased office equipment for $15,400 from The Equipment Depot; issued a three-month, 12 percent note in payment. The equipment is estimated to have a useful life of five years and a $1,000 salvage value and will be depreciated using the straight-line method.
	1	Purchased a one-year insurance policy and issued Check 102 for $1,944 to pay the entire premium.
	3	Purchased office furniture for $17,400 from Office Gallery; issued Check 103 for $8,400 and agreed to pay the balance in 60 days. The furniture is estimated to have a useful life of five years and a $1,200 salvage value and will be depreciated using the straight-line method.
	5	Purchased office supplies for $2,810 with Check 104; assume $1,150 of supplies are on hand June 30, 2016.

Analyze: At the end of the year, 2016, how much of the rent paid on June 1 will have been charged to expense?

Problem 12.3B
Objectives 12-2, 12-3

Recording adjustments for accrued and prepaid expense items and unearned income.

On September 30, 2016, after one month of operation, the general ledger of Cross Timbers Company contained the accounts and balances shown below.

INSTRUCTIONS

1. Prepare a partial worksheet with the following sections: Trial Balance, Adjustments, and Adjusted Trial Balance. Use the data about the firm's accounts and balances to complete the Trial Balance section.
2. Enter the adjustments described below in the Adjustments section. Identify each adjustment with the appropriate letter. (Some items may not require adjustments.)
3. Complete the Adjusted Trial Balance section.

ACCOUNTS AND BALANCES

Cash	$26,460	Dr.
Supplies	740	Dr.
Prepaid Rent	4,200	Dr.
Prepaid Advertising	3,750	Dr.
Prepaid Interest	450	Dr.
Furniture	4,840	Dr.
Accumulated Depreciation—Furniture		
Equipment	9,000	Dr.
Accumulated Depreciation—Equipment		
Notes Payable	20,250	Cr.
Accounts Payable	4,400	Cr.
Interest Payable		

ACCOUNTS AND BALANCES (CONT.)

Unearned Course Fees	22,000	Cr.
Scott Nelson, Capital	6,730	Cr.
Scott Nelson, Drawing	2,000	Dr.
Course Fees		
Salaries Expense	1,600	Dr.
Telephone Expense	120	Dr.
Entertainment Expense	220	Dr.
Supplies Expense		
Rent Expense		
Advertising Expense		
Depreciation Expense—Furniture		
Depreciation Expense—Equipment		
Interest Expense		

ADJUSTMENTS

a. On September 30, an inventory of the supplies showed that items costing $705 were on hand.

b. On September 1, the firm paid $4,200 in advance for six months of rent.

c. On September 1, the firm signed a six-month advertising contract for $3,750 and paid the full amount in advance.

d. On September 1, the firm paid $450 interest in advance on a three-month note that it issued to the bank.

e. On September 1, the firm purchased office furniture for $4,840. The furniture is expected to have a useful life of five years and a salvage value of $340.

f. On September 3, the firm purchased equipment for $9,000. The equipment is expected to have a useful life of five years and a salvage value of $1,200.

g. On September 1, the firm issued a two-month, 8 percent note for $5,250.

h. During September, the firm received $22,000 fees in advance. An analysis of the firm's records shows that $7,000 applies to services provided in September and the rest pertains to future months.

Analyze: What was the net dollar effect on income of the adjustments to the accounting records of the business?

Recording adjustments and completing the worksheet.

Problem 12.4B

Objectives 12-1, 12-2, 12-3, 12-4

Fun Depot is a retail store that sells toys, games, and bicycles. On December 31, 2016, the firm's general ledger contained the following accounts and balances.

INSTRUCTIONS

1. Prepare the Trial Balance section of a 10-column worksheet. The worksheet covers the year ended December 31, 2016.
2. Enter the adjustments below in the Adjustments section of the worksheet. Identify each adjustment with the appropriate letter.
3. Complete the worksheet.

ACCOUNTS AND BALANCES

Cash	$ 26,400	Dr.
Accounts Receivable	22,700	Dr.
Allowance for Doubtful Accounts	320	Cr.
Merchandise Inventory	138,000	Dr.
Supplies	11,600	Dr.

ACCOUNTS AND BALANCES (CONT.)

Prepaid Advertising	5,280	Dr.
Store Equipment	32,500	Dr.
Accumulated Depreciation—Store Equipment	5,760	Cr.
Office Equipment	8,400	Dr.
Accumulated Depreciation—Office Equipment	1,440	Cr.
Accounts Payable	8,600	Cr.
Social Security Tax Payable	5,920	Cr.
Medicare Tax Payable	1,368	Cr.
Federal Unemployment Tax Payable		
State Unemployment Tax Payable		
Salaries Payable		
Janie Fielder, Capital	112,250	Cr.
Janie Fielder, Drawing	100,000	Dr.
Sales	1,043,662	Cr.
Sales Returns and Allowances	17,200	Dr.
Purchases	507,600	Dr.
Purchases Returns and Allowances	5,040	Cr.
Rent Expense	125,000	Dr.
Telephone Expense	4,280	Dr.
Salaries Expense	164,200	Dr.
Payroll Taxes Expense	15,200	Dr.
Income Summary		
Supplies Expense		
Advertising Expense	6,000	Dr.
Depreciation Expense—Store Equipment		
Depreciation Expense—Office Equipment		
Uncollectible Accounts Expense		

ADJUSTMENTS

a.–b. Merchandise inventory on December 31, 2016, is $148,000.

c. During 2016, the firm had net credit sales of $440,000. The firm estimates that 0.7 percent of these sales will result in uncollectible accounts.

d. On December 31, 2016, an inventory of the supplies showed that items costing $2,960 were on hand.

e. On September 1, 2016, the firm signed a six-month advertising contract for $5,280 with a local newspaper and paid the full amount in advance.

f. On January 2, 2015, the firm purchased store equipment for $32,500. At that time, the equipment was estimated to have a useful life of five years and a salvage value of $3,700.

g. On January 2, 2015, the firm purchased office equipment for $8,400. At that time, the equipment was estimated to have a useful life of five years and a salvage value of $1,200.

h. On December 31, 2016, the firm owed salaries of $8,000 that will not be paid until 2014.

i. On December 31, 2016, the firm owed the employer's social security tax (assume 6.2 percent) and Medicare tax (assume 1.45 percent) on the entire $8,000 of accrued wages.

j. On December 31, 2016, the firm owed federal unemployment tax (assume 0.6 percent) and state unemployment tax (assume 5.4 percent) on the entire $8,000 of accrued wages.

Analyze: If the adjustment for advertising had not been recorded, what would the reported net income have been?

Recording adjustments and completing the worksheet.

◀ **Problem 12.5B**

Objectives 12-1, 12-2, 12-3, 12-4

CONTINUING >>> Problem

Whatnots is a retail seller of cards, novelty items, and business products. On December 31, 2016, the firm's general ledger contained the following accounts and balances.

INSTRUCTIONS

1. Prepare the Trial Balance section of a 10-column worksheet. The worksheet covers the year ended December 31, 2016.
2. Enter the adjustments in the Adjustments section of the worksheet. Identify each adjustment with the appropriate letter.
3. Complete the worksheet.

Note: This problem will be required to complete Problem 13.4B in Chapter 13.

ACCOUNTS AND BALANCES

Cash	$ 3,235	Dr.
Accounts Receivable	6,910	Dr.
Allowance for Doubtful Accounts	600	Cr.
Merchandise Inventory	16,985	Dr.
Supplies	750	Dr.
Prepaid Insurance	2,400	Dr.
Store Equipment	6,000	Dr.
Accumulated Depreciation—Store Equip.	2,000	Cr.
Store Fixtures	15,760	Dr.
Accumulated Depreciation—Store Fixtures	4,100	Cr.
Notes Payable	4,000	Cr.
Accounts Payable	600	Cr.
Interest Payable		
Social Security Tax Payable		
Medicare Tax Payable		
Federal Unemployment Tax Payable		
State Unemployment Tax Payable		
Salaries Payable		
Preston Allen, Capital	39,780	Cr.
Preston Allen, Drawing	8,000	Dr.
Sales	236,560	Cr.
Sales Returns and Allowances	6,000	Dr.
Purchases	160,000	Dr.
Purchases Returns and Allowances	2,000	Cr.
Income Summary		
Rent Expense	18,000	Dr.
Telephone Expense	2,400	Dr.
Salaries Expense	40,000	Dr.
Payroll Tax Expense	3,200	Dr.
Supplies Expense		
Insurance Expense		
Depreciation Expense—Store Equipment		
Depreciation Expense—Store Fixtures		
Uncollectible Accounts Expense		
Interest Expense		

ADJUSTMENTS

a.–b. Merchandise inventory on hand on December 31, 2016, is $15,840.

c. During 2016, the firm had net credit sales of $160,000. Past experience indicates that 0.8 percent of these sales should result in uncollectible accounts.

d. On December 31, 2016, an inventory of supplies showed that items costing $245 were on hand.

e. On July 1, 2016, the firm purchased a one-year insurance policy for $2,400.

f. On January 2, 2014, the firm purchased store equipment for $6,000. The equipment was estimated to have a five-year useful life and a salvage value of $1,000.

g. On January 4, 2014, the firm purchased store fixtures for $15,760. At the time of the purchase, the fixtures were assumed to have a useful life of seven years and a salvage value of $1,410.

h. On October 1, 2016, the firm issued a six-month, $4,000 note payable at 9 percent interest with a local bank.

i. At year-end (December 31, 2016), the firm owed salaries of $1,450 that will not be paid until January 2017.

j. On December 31, 2016, the firm owed the employer's social security tax (assume 6.2 percent) and Medicare tax (assume 1.45 percent) on the entire $1,450 of accrued wages.

k. On December 31, 2016, the firm owed federal unemployment tax (assume 0.6 percent) and state unemployment tax (assume 5.0 percent) on the entire $1,450 of accrued wages.

Analyze: After all adjustments have been recorded, what is the net book value of the company's assets?

Problem 12.6B
Objectives 12-1, 12-2, 12-3, 12-4

Recording adjustments and completing the worksheet.

The Game Place is a retail store that sells computer games, owned by Matt Huffman. On December 31, 2016, the firm's general ledger contained the accounts and balances below. All account balances are normal.

Cash	34,465
Accounts Receivable	1,669
Prepaid Advertising	480
Supplies	425
Merchandise Inventory	18,500
Store Equipment	30,000
Accumulated Depreciation—Store Equipment	3,000
Office Equipment	4,800
Accumulated Depreciation—Office Equipment	1,500
Notes Payable, due 2017	22,500
Accounts Payable	5,725
Wages Payable	
Social Security Tax Payable	
Medicare Tax Payable	
Unearned Seminar Fees	7,500
Interest Payable	
Matt Huffman, Capital	43,000
Matt Huffman, Drawing	18,000
Income Summary	
Sales	163,660
Sales Discounts	180
Seminar Fee Income	
Purchases	92,500
Purchases Returns and Allowances	770
Freight In	275
Rent Expense	26,400
Wages Expense	18,000

ACCOUNTS AND BALANCES (CONT.)

Payroll Taxes Expense	1,811
Depreciation Expense—Store Equipment	
Depreciation Expense—Office Equipment	
Advertising Expense	
Supplies Expense	
Interest Expense	150

INSTRUCTIONS

1. Prepare the Trial Balance section of a 10-column worksheet. The worksheet covers the year ended December 31, 2016.
2. Enter the adjustments below in the Adjustments section of the worksheet. Identify each adjustment with the appropriate letter.
3. Complete the worksheet.

ADJUSTMENTS

a.–b. Merchandise inventory at December 31, 2016, was counted, and determined to be $21,200.

c. The amount recorded as prepaid advertising represents $480 paid on September 1, 2016, for six months of advertising.

d. The amount of supplies on hand at December 31 was $125.

e. Depreciation on store equipment was $4,500 for 2016.

f. Depreciation on office equipment was $1,500 for 2016.

g. Unearned seminar fees represents $7,500 received on November 1, 2016, for five seminars. At December 31, three of these seminars had been conducted.

h. Wages owed but not paid at December 31 were $800.

i. On December 31, 2016, the firm owed the employer's social security tax ($49.60) and Medicare tax ($11.60).

j. The note payable bears interest at 8% per annum. One month interest is owed at December 31, 2016.

Analyze: How did the balance of merchandise inventory change during the year ended December 31, 2016?

Critical Thinking Problem 12.1

Completing the Worksheet

The unadjusted trial balance of Ben's Jewelers on December 31, 2016, the end of its fiscal year, appears on page 432.

INSTRUCTIONS

1. Copy the unadjusted trial balance onto a worksheet and complete the worksheet using the following information:

a.–b. Ending merchandise inventory, $98,700.

c. Uncollectible accounts expense, $1,000.

d. Store supplies on hand December 31, 2016, $625.

e. Office supplies on hand December 31, 2016, $305.

f. Depreciation on store equipment, $11,360.

g. Depreciation on office equipment, $3,300.

h. Accrued sales salaries, $4,000, and accrued office salaries, $1,000.

i. Social security tax on accrued salaries, $326; Medicare tax on accrued salaries, $76. (Assumes that tax rates have increased.)

j. Federal unemployment tax on accrued salaries, $56; state unemployment tax on accrued salaries, $270.

2. Journalize the adjusting entries on page 30 of the general journal. Omit descriptions.
3. Journalize the closing entries on page 32 of the general journal. Omit descriptions.
4. Compute the following:
   a. net sales
   b. net delivered cost of purchases
   c. cost of goods sold
   d. net income or net loss
   e. balance of ***Ben Waites, Capital*** on December 31, 2016.

Analyze: What change(s) to ***Ben Waites, Capital*** will be reported on the statement of owner's equity?

BEN'S JEWELERS
Trial Balance
December 31, 2016

Cash	$ 13,050	Dr
Accounts Receivable	49,900	Dr.
Allowance for Doubtful Accounts	2,000	Cr.
Merchandise Inventory	105,900	Dr.
Store Supplies	4,230	Dr.
Office Supplies	2,950	Dr.
Store Equipment	113,590	Dr.
Accumulated Depreciation—Store Equipment	13,010	Cr.
Office Equipment	27,640	Dr.
Accumulated Depreciation—Office Equipment	4,930	Cr.
Accounts Payable	4,390	Cr.
Salaries Payable		
Social Security Tax Payable		
Medicare Tax Payable		
Federal Unemployment Tax Payable		
State Unemployment Tax Payable		
Ben Waites, Capital	166,310	Cr.
Ben Waites, Drawing	30,000	Dr.
Income Summary		
Sales	862,230	Cr.
Sales Returns and Allowances	7,580	Dr.
Purchases	504,810	Dr.
Purchases Returns and Allowances	4,240	Cr.
Purchases Discounts	10,770	Cr.
Freight In	7,000	Dr.
Salaries Expense—Sales	75,950	Dr.
Rent Expense	35,500	Dr.
Advertising Expense	12,300	Dr.
Store Supplies Expense		
Depreciation Expense—Store Equipment		
Salaries Expense—Office	77,480	Dr.
Payroll Taxes Expense		
Uncollectible Accounts Expense		
Office Supplies Expense		
Depreciation Expense—Office Equipment		