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Adjusting Entries

LABYRINTH LEARNING®

LEARNING OBJECTIVES

- Format and complete a trial balance
- Record adjusting entries
- Calculate depreciation using the straight-line method
- Calculate depreciation using the double-declining balance method

Trial Balances

- Summarize account balances
- Include a debit column and a credit column
- Confirm total debits equal total credits
- Three trial balances are completed during each period:
  - Unadjusted trial balance
  - Adjusted trial balance
  - Post-closing trial balance

Trial Balance—Example

Accounts are listed in the following order:

- Assets
- Liabilities
- Capital
- Withdrawals
- Revenue
- Expenses

Nathan's Donut School
Unadjusted Trial Balance
March 31, 2027

	Debit	Credit
Cash	$ 12,300	
Accounts Receivable	2,200	
Supplies	500	
Furniture	1,000	
Equipment	20,000	
Accounts Payable		$ -
Nathaniel H. Spencer, Capital		35,000
Nathaniel H. Spencer, Drawing	400	
Service Revenue		3,350
Rent Expense	1,700	
Advertising Expense	250	
	$ 38,350	$ 38,350

The title lines show the company name, statement name, and the date completed.

A single underline signals a calculation (the figures above the line are being added). A double underline indicates the final total within the statement.

Adjusting Entries

These are recorded at the end of the period, after completion of the unadjusted trial balance.

ADJUSTING JOURNAL ENTRIES: TYPES	
Journal Entry Type	**Definition**
Deferred expense	Expenses paid for in advance and subsequently incurred
Deferred revenue	Cash received in advance of revenue being earned
Accrued expense	Expenses incurred prior to being paid off
Accrued revenue	Revenue earned prior to the receipt of cash
Depreciation	Estimated loss in value that an asset experiences over time

Impact of Adjusting Entries

Each category of adjusting entry has specific impacts on different types of accounts.

ADJUSTING JOURNAL ENTRIES: IMPACT ON ACCOUNTS						
	Total Revenues	**Total Expenses**	**Net Income**	**Owner's Capital**	**Total Assets**	**Total Liabilities**
Deferred Expenses	n/a	↑	↓	↓	↓	n/a
Deferred Revenues	↑	n/a	↑	↑	n/a	↓
Accrued Expenses	n/a	↑	↓	↓	n/a	↑
Accrued Revenues	↑	n/a	↑	↑	↑	n/a

Reversing Entries

- These are optional journal entries.
- They simplify the recording process.
- They are often recorded for accrued expenses and accrued revenues.
- They are the reverse of the associated adjusting entry.
- They are recorded on the first day of the period following the recording of the associated adjusting entry.

Depreciation

- Definition: the estimated loss in value experienced by a fixed asset
- Two primary methods are used to calculate depreciation:
  - Straight-line method
  - Double-declining balance method
- The book value of an asset is calculated by subtracting the *accumulated depreciation* from the original cost.

Straight-Line Depreciation

Under this method, the same amount of depreciation is recorded for each full year of an asset's useful life. It requires two estimates:

- **Useful life:** Number of years the company expects to use the asset
- **Salvage value:** The amount the company expects to receive for the asset at the time of disposal

$$\frac{\textbf{Cost} - \textbf{Salvage Value}}{\textbf{Useful Life}} = \textbf{Annual Depreciation}$$

Double-Declining Balance Depreciation

- Under this accelerated method, more depreciation is recorded in the early years of the asset's life.
- Calculation requires a three-step process:
  - **Determine the straight-line rate:** Divide "1" by the useful life.
  - **Determine the first year's depreciation:** Multiply the asset's cost by double the straight-line rate.
  - **Determine subsequent years' depreciation:** Subtract the accumulated depreciation from the cost, and then multiply by double the straight-line rate.

Double-Declining Balance Depreciation—Example

The depreciation of an asset with a $2,500 cost, 5-year useful life, and $250 salvage value is shown:

	Beginning Book Value	Double-Declining Rate	Depreciation Expense	Accumulated Depreciation	Ending Book Value
Year #1	$2,500	40%	$1,000	$1,000	$1,500
Year #2	$1,500	40%	$600	$1,600	$900
Year #3	$900	40%	$360	$1,960	$540
Year #4	$540	40%	$216	$2,176	$324
Year #5	$324	40%	*$74	$2,250	$250

* $324 (Y5 Beginning Book Value) - $250 (Salvage Value) = $74 (Y5 Depreciation)

Recording the Depreciation Adjusting Entry

This type of entry increases Accumulated Depreciation.

- Accumulated Depreciation is a contra-asset account that increases via a credit and decreases via a debit.

9/30	Depreciation Expense	260	
	Accumulated Depreciation		260
	Adjusting entry for depreciation expense		

Adjusted Trial Balance

- These are completed after the recording of the adjusting entries.
- This is the version that is used to subsequently complete the financial statements.

Nathan's Donut School
Adjusted Trial Balance
March 31, 2027

	Debit	Credit
Cash	$ 12,300	
Accounts Receivable	2,350	
Supplies	185	
Furniture	1,000	
Equipment	20,000	
Accounts Payable		$ -
Wages Payable		750
Nathaniel H. Spencer, Capital		35,000
Nathaniel H. Spencer, Drawing	400	
Service Revenue		3,500
Rent Expense	1,700	
Wages Expense	750	
Supplies Expense	315	
Advertising Expense	250	
	$ 39,250	$ 39,250