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Adjusting Entries

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 Balances (cont.)

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	
	<u>\$ 38,350</u>	<u>\$ 38,350</u>

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.

	Total Revenue	Total Expenses	Net Income	Owner's Capital	Total Assets	Total Liabilities
Deferred Expenses	n/a	↑	↓	↓	↓	n/a
Deferred Revenue	↑	n/a	↑	↑	n/a	↓
Accrued Expenses	n/a	↑	↓	↓	n/a	↑
Accrued Revenue	↑	n/a	↑	↑	↑	n/a

Reversing Entries

- Optional journal entries
- Simplify the recording process
- Often recorded for accrued expenses and revenue
- The reverse of the associated adjusting entry
- Recorded on the first day of the period following the recording of the associated adjusting entry

Depreciation

- Estimated loss in value of a fixed asset
- Two primary methods to calculate depreciation:
 - Straight-line method
 - Declining balance (or accelerated) method
- $\text{Book value} = \text{Cost} - \text{Accumulated Depreciation}$

Straight-Line Depreciation

The same amount of depreciation is recorded for each full year of an asset's useful life.

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

Cost – Salvage Value	=	Annual Depreciation
Useful Life		

Declining Balance Depreciation

- Accelerated method, where more depreciation is recorded in the early years of the asset's life
- Three-step calculation:
 - **Determine the straight-line rate:** Divide 1 by the useful life
 - **Determine the first year's depreciation:** Multiply asset cost by double the straight-line rate
 - **Determine the subsequent years' depreciation:** Subtract accumulated depreciation from cost and then multiply by double the straight-line rate

Declining Balance Depreciation Example

Depreciation of an asset with a \$2,500 cost, 5-year useful life and \$250 salvage value:

	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.

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

Adjusted Trial Balance

- Completed after the recording of adjusting entries
- Debits and credits must be equal, but the total amount is meaningless (not found elsewhere)

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	
	<u>\$ 39,250</u>	<u>\$ 39,250</u>