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

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
<u>Deferred expense</u>	Expenses paid for in advance and subsequently incurred
<u>Deferred revenue</u>	Cash received in advance of revenue being earned
<u>Accrued expense</u>	Expenses incurred prior to being paid off
<u>Accrued revenue</u>	Revenues earned prior to the receipt of cash
<u>Depreciation</u>	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

Cost – Salvage Value	=	Annual Depreciation
Useful Life		

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
	<i>Adjusting entry for depreciation expense</i>		

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