



# Adjusting the Accounts

## Chapters 3 and 4

"Cash" Basis vs. "Accrual" Basis:

	<u>Cash</u>	<u>Accrual</u>
Revenue	_____	_____
Expenses	_____	_____

Generally Accepted Accounting Principles (GAAP) require using the \_\_\_\_\_ basis.

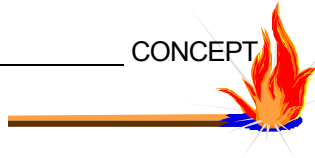
Why make A adjusting Journal Entries? \_\_\_\_\_

Recall previous "promises." New Promise: *Every adjusting entry will have \_\_\_\_\_ Balance Sheet and one \_\_\_\_\_ effect.*



INCOME STATEMENT attempts to accomplish: \_\_\_\_\_

ESSENTIALS OF \_\_\_\_\_ CONCEPT



1. \_\_\_\_\_
2. \_\_\_\_\_
3. \_\_\_\_\_

### I. Identifying accounts to be adjusted: Accruals and Deferrals

A. Perhaps the best way to distinguish deferrals and accruals is the timing of cash changing hands:



Deferrals have been recorded; accruals have not.

### B. Definitions

An ACCRUAL is an *expense* \_\_\_\_\_

or a *revenue* \_\_\_\_\_

Examples of accruals:

Expense: \_\_\_\_\_

Revenue: \_\_\_\_\_

A DEFERRAL is a \_\_\_\_\_  
already paid or of a *revenue* \_\_\_\_\_.

Examples of deferrals:

Expense: \_\_\_\_\_

Revenue: \_\_\_\_\_

## II. Accruals

### A. Expenses

#### 1. Example

Salaries increase as employees work each day, yet, for convenience, salaries are recorded when \_\_\_\_\_ . Since the cash is paid \_\_\_\_\_ the event, salaries are an example of \_\_\_\_\_ .

The adjusting entry necessary when payday and the end of the fiscal period are on different days would be:

\_\_\_\_\_

\_\_\_\_\_

#### 2. Decision tree conclusion

If this is the entry required for this \_\_\_\_\_, other *accrued expense* items must follow a similar format:

\_\_\_\_\_

\_\_\_\_\_

### B. Revenue

#### 1. Example

Your CPA firm is auditing a client's records; the engagement begins in mid-November and lasts through the end of February. Each day as work is being performed, revenue is earned. Since the cash will not be collected until completion of the engagement (after the event), this is an example of \_\_\_\_\_ .

The adjusting entry necessary on the CPA's records at the end of the year when financial statements are about to be prepared would be:

\_\_\_\_\_

\_\_\_\_\_

#### 2. Decision tree conclusion

If this is the entry required for this \_\_\_\_\_ item, other accrued revenue items would follow a similar format:

\_\_\_\_\_

\_\_\_\_\_

### C. "Reversing Entries" are presented in the appendix to Chapter 4.

What?	<i>opposite of AJEs</i>	
Which?	<i>all accruals</i>	
When?	<i>first day of new year</i>	
Why?	<i>helps next year go better</i>	
What Else?	<i>will learn more later</i>	

All \_\_\_\_\_ need to be reversed.

Watch for new rule and apply it here, too.

### III. DEFERRALS

#### A. (Prepaid) Expenses

1. Examples already encountered in chapters 1 and 2

\_\_\_\_\_

2. Two methods of accounting for deferred (prepaid) expenses

a. \_\_\_\_\_  
(emphasized in Chapter 3)

b. \_\_\_\_\_  
(covered in Appendix)

3. In order to identify the method used for deferred EXPENSES, consider

- a. where the initial transaction was recorded
- b. where the balance of the account is before adjustment

Which method would we be using if...

<u>Prepayment</u>	<u>Asset</u>	<u>Expense</u>
for insurance	_____	_____
for supplies	_____	_____
for rent	_____	_____

III. A. 4. Consider example of Supplies and Supplies Expense...

	Supplies		Supplies Expense
	*		*
Bal.	100	*	*
Pur.	400	*	*
	*		*
	*		*

Ending Inventory = \$50

a. Using the \_\_\_\_\_ method the AJE for supplies is:

\_\_\_\_\_

\_\_\_\_\_

b. Decision tree conclusion

\_\_\_\_\_

\_\_\_\_\_

5. Re-consider example of Supplies and Supplies Expense...  
(Appendix)

	Supplies		Supplies Expense
	*		*
	*	Bal.	100
	*	Pur.	400
	*		*
	*		*

Ending Inventory = \$50

a. Using the \_\_\_\_\_ method the AJE for supplies is:

\_\_\_\_\_

\_\_\_\_\_

b. Decision tree conclusion

\_\_\_\_\_

\_\_\_\_\_

Upon comparing the results, the *asset method* and the *expense method* accomplish

\_\_\_\_\_

The KEY to administering the methods is \_\_\_\_\_.

\_\_\_\_\_ means...

... during an accounting period, and  
... from one period to the next



What about reversing entries for deferred expenses under these methods?  
 Are they necessary?

"Rule" becomes "old rule"--won't work. These are \_\_\_\_\_, not accruals.

6. Reversing entries

New rule: one rule--two ways to say it

a. When an ADJUSTING entry \_\_\_\_\_ (first entry in the account)  
 \_\_\_\_\_, a reversing entry would be advantageous.

b. When the direction of a *deferral* ADJUSTING entry is \_\_\_\_\_  
 to \_\_\_\_\_, it should NOT be reversed.

When the direction of a *deferral* ADJUSTING entry is \_\_\_\_\_  
 to \_\_\_\_\_, it should be reversed.

For the SUPPLIES example...

Reversing entry for ASSET METHOD? \_\_\_\_\_

Reversing entry for EXPENSE METHOD? \_\_\_\_\_

????????????????????

On your own time try this one and check your answers by referring to the solution available on the class web site.

Prepaid Insurance		Insurance Expense
Bal. 1,000	*	
	*	
	*	
	*	
	*	

\$600 of premiums have expired

Make the adjusting entry necessary:

\_\_\_\_\_

\_\_\_\_\_

Which method is being used? \_\_\_\_\_

Reversed? \_\_\_\_\_

Why or why not? \_\_\_\_\_

????????????????????

Prepaid Insurance	Insurance Expense
*	*
*	Bal. 1,000
*	*
*	*
*	*

\$600 of premiums have expired

Again, you make the adjusting entry:


Which method is being used? \_\_\_\_\_

Reversed? \_\_\_\_\_

Why or why not? \_\_\_\_\_

### III. DEFERRALS

#### B. Revenue

##### 1. Examples

\_\_\_\_\_

Assume the attorneys Jones, Fraud, and Swindle, whose year ends December 31, received \$1,200 on September 1 for one year's service in advance.

*When CASH was debited, what was credited?*

##### 2. Two methods of accounting for deferred REVENUE

a. \_\_\_\_\_

b. \_\_\_\_\_

##### 3. In order to identify the method used for deferred REVENUE, consider

a. where the initial transaction was recorded

b. where the balance of the account is before adjustment

III. B. 4. Consider the example of the lawyers...

Unearned Fees	Fees Earned
*	*
*	* 9/1 1,200
*	*
*	*
*	*

a. Using the \_\_\_\_\_ method the adjusting entry is:

_____	_____
_____	_____

b. Decision tree conclusion

_____	_____
_____	_____

5. Re-consider the example of the lawyers...

Unearned Fees	Fees Earned
*	*
* 9/1 1,200	*
*	*
*	*
*	*

a. Using the \_\_\_\_\_ method the adjusting entry is:

_____	_____
_____	_____

b. Decision tree conclusion

_____	_____
_____	_____

Upon comparing results, the *liability method* and the *revenue method* accomplish

\_\_\_\_\_

What about reversing entries for deferred revenue under these methods?  
Are they necessary?

6. Reversing entries

for LIABILITY METHOD? \_\_\_\_\_

for REVENUE METHOD? \_\_\_\_\_

Try a couple on your own time ... and be sure to check you answers on the class web site.

Assume a prominent mid-western university collected \$4,000 in tuition on September 1. When cash was debited, the university credited...

????????????????????????????????

<u>Unearned Tuition</u>		<u>Tuition Earned</u>	
*		*	
*	4,000	*	
*		*	
*		*	
*		*	

Make the adjusting entry necessary at November 30:

\_\_\_\_\_

\_\_\_\_\_

Which method is being used?

\_\_\_\_\_

Reversed?

\_\_\_\_\_

Why or why not?

\_\_\_\_\_

????????????????????????????????

<u>Unearned Tuition</u>		<u>Tuition Earned</u>	
*		*	
*		*	4,000
*		*	
*		*	
*		*	

Make the adjusting entry necessary at November 30:

\_\_\_\_\_

\_\_\_\_\_

Which method is being used?

\_\_\_\_\_

Reversed?

\_\_\_\_\_

Why or why not?

\_\_\_\_\_



IV. Plant Assets (a form of deferrals)

A. Desire to maintain "cost" of account

B. "Decline in Usefulness" = \_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

C. "Nature" of Accumulated Depreciation is \_\_\_\_\_.

Represents TOTAL depreciation taken since asset acquired.

D. Result of "main" account and "contra" account worth naming:

)     Equipment  
      Accumulated Depreciation

= \_\_\_\_\_

***Use the decision tree as a study tool this week!***