ACCT 100 – Intro to Acct.
Chapter 12: Accruals, Deferrals, and the Worksheet
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Where we have been: We have learned a lot about the selling and buying functions of merchandiser. You have learned many new accounts unique to the merchandising entity. We have also discussed the special topics of cash and payroll.

Where we are going: Although we have spent time on the recording process for a merchandiser, we need to know more about the remainder of the accounting cycle. In this chapter, we will spend time on the adjustment process in this chapter. In the next chapter we will discuss the summarizing process, the preparation of financial statements will reflect accurate balance.

A brief reminder of what time of adjustments we have **learned so far**:

1. Prepaids - We adjusted for the amount that had expired. The journal entry was to debit the related expense, and credit the asset.
2. Depreciation – We learned that plant assets lose their usefulness over time. We calculated depreciation using the straight-line method. We recorded depreciation by debiting depreciation expense and crediting accumulated depreciation.
3. Supplies - We learned that supplies were considered an asset when purchased, but that the usage of supplies required an adjusting entry to reflect the supplies expense. We learned how to compute the amount of supplies used up and we learned that the journal entry was to debit Supplies Expense and Credit the Supplies.

These adjustments are from previous chapters. We will review them again in this chapter.

New Adjustments

Inventory. Remember that account? We talked about it at the start of the special journals chapter. We said that we would not touch this account, except when a physical inventory was taken – usually at the end of the year. Remember that sales of merchandise are recorded in the Sales account, and purchases of merchandise are recorded in the Purchases account. (This is assuming the use of what's called a periodic inventory system. You will also learn how to use a perpetual inventory system in BUSA 101.) The inventory account needs to be adjusted at the end of the year when the physical count is taken. The first new adjustment we will learn is how to record this adjustment in two steps as follows:

- Take out the old
- Put in the new

Inventory – Take out the old

The inventory account is an asset and therefore it has a debit balance. We need to wipe it out, so the first part of the adjustment involves a credit to this account. The offsetting debit will go to income summary. (Remember that's the "dummy account" we learned of that's only used to temporary hold items.) So let's assume that last year's ending inventory balance was $25,000 and this year's ending inventory balance is $28,000. To take out the old, you would:

Dr.	Income Summary	25,000	
Cr.	Merchandise Inventory		25,000

Inventory – Put in the New

To put in the new amount of inventory based on the physical inventory, you would:

Dr.	Merchandise Inventory	28,000	
Cr.	Income Summary		28,000

You might ask yourself why you just couldn't make an adjustment for the difference. The answer is you can, but it will complicate your life. BOTH AMOUNTS ARE NEEDED to prepare the income statement. On the income summary line of the worksheet, DO NOT NET these amounts, but leave them both as separate items. Doing the adjustment using the take out the old, put in the new method will assist you in the preparation of a multi-step income statement in the next chapter.

Unearned Revenue

When someone pays you in advance for something, you have to create an unearned revenue account. The reason is because GAAP states that revenue is recognized when it's EARNED, not necessarily when cash is received. (It's the other side of the books for a prepaid. The person receiving the prepayment has to record the amount as a liability until the amount is earned.) So let's assume we are the owner of the Dodgers and we receive an amount of $1,000 for 50 home games. The Dodgers can't recognize any revenue until the games are played, because if something was to happen and the season didn't take place, they would have to refund your money. So here's what happens:

On receipt of founds

Dr. Cash 1000
Cr. Unearned Ticket Income 1000

Let's assume at year-end that 40 games have been played. The adjustment would be:
Dr. Unearned Ticket Income 800
Cr. Season Ticket Income 800

(1000 divided by 50 games = 20 per game: 20 per game x 40 games played = 800 earned)

The income statement would show revenue of 800. The balance sheet would now show a liability of 200. You can see this by making t-accounts.

Adjustment for Loss from Uncollectible Accounts

It is a fact that even when credit policies are strict and great care is taken in assessing risk, there will still be customers who do not pay amounts owed. Losses from uncollectible accounts are considered an operating expense or a cost of doing business. There are several GAAP accepted methods for computing these amounts. (These will be discussed in detail in the BUSA 101 class.) Once the amount is computed, the journal entry to record the loss is as follows:

Dr. Uncollectible Accounts Expense
    Cr. Allowance for Doubtful Accounts

The Allowance for Doubtful Accounts is a contra asset...which means it normally has a credit balance. It is used to reduce the amount of accounts receivable on the balance sheet to their net realizable value.

Adjustments for Accrued Expenses

Thee items represents expenses that have been incurred but not yet paid. The three most common are for accrued wages, for the accrued payroll taxes related to the wages, and for interest on notes payable.

We will practice how to compute the amount of wages that should be accrued. The journal entry to record this event is:

Dr. Wages or Salaries Expense
    Cr. Wages or Salaries Payable

With any wage accrual comes the accrual of the related payroll taxes. We will discuss how to accrue these taxes in class, but the journal entry is as follows:

Dr. Payroll Tax Expense
    Cr. Social Security Taxes Payable

Cr. Medicare Taxes Payable
Cr. FUTA payable
Cr. SUTA payable

If the company has any outstanding debt or loans at the end of the year, it is probably necessary to accrue the interest on the debt from the time of the last payment until the end of the fiscal year. This is done using the simple interest formula of principal X rate X time. We will discuss the mathematics behind this in class, but here is the journal entry:

Dr. Interest Expense
Cr. Interest Payable

Adjustment for Accrued Income

Just as we accrue interest expense on monies that we owe to others, we need to also accrue interest income on monies owed to us. Accrued income is income that has been earned but not yet received. We use the same interest formula and the same reasoning but the journal entry is as follows:

Dr. Interest Receivable
Cr. Interest Income

Some New Adjustments! – What else is in this chapter?

That’s the main point of this chapter … just the new adjustments.

Reminder: Any adjusting entries need to be recorded into the accounting system via journal entries. (ie just because you put them on the w-sheet; that doesn't get them into the accounting system.) So don't forget to journalize the adjustments just as we did in a previous chapter.

We will demonstrate the preparation of a worksheet in class in detail.