

ACCT 100 - Chapter 12

There are several adjusting entries in Chapter 12. We will be revisiting the adjusting entries covered in Chapter 5 and adding six (6) new adjusting entries in Chapter 12.

I. Adjusting Entries for a Merchandising Company

A. Accrual Basis of Accounting

1. Revenue is recognized when earned, not necessarily when the cash is received.
2. Expenses are recognized when incurred or used, not necessarily when cash is paid.

Therefore, we must make adjustments to update the accounts so the financial statements include all transactions that happened up to and including the last day of the accounting period, even if the cash has already been received or paid, or if it will be received or paid in the future.

B. New Accounts Introduced

	Account Name	Type	Normal Balance	Used to:
1.				
2.				
3.				
4.				
5.				
6.				

C. Adjustments discussed previously:

1. Supplies
2. Prepaid Expenses
3. Depreciation

II. The Adjustments

1. **Inventory** is the account used to report the total amount of merchandise on hand on the balance sheet date. We only use the Inventory account once a year, to make the year-end adjustment.

Additions to inventory throughout the year are debited to the Purchases account. At the end of the year, we will take a physical count of the inventory in stock. The amount counted will be the amount reported on the balance sheet in the asset account Inventory.

Since we have not used the Inventory account since the end of the previous year, the adjustment will be a two-step process:

1. Close the beginning inventory balance

Inventory	Income Summary
52,000	

	DATE	DESCRIPTION	POST REF	DEBIT	CREDIT	
1	20X1					1
2	Dec	31				2
3						3
4						4

After the first step, the inventory account should have a zero balance.

2. Increase inventory to \$47,000, the amount counted at the end of the year

Inventory	Income Summary
52,000 52,000	52,000

	DATE	DESCRIPTION	POST REF	DEBIT	CREDIT	
1	20X1					1
2	Dec	31				2
3						3
4						4

The amount of the second step should be the balance reported in the balance sheet for inventory.

2. Uncollectible Accounts – throughout the semester, the majority of our sales have been ‘on account’, however, sales on account do not guarantee payment of those accounts. Businesses must estimate and report possible losses from uncollectible accounts. While there are several ways to estimate uncollectible accounts, we will only cover one, the Percentage of Sales method.

We estimate that 0.8% of our \$100,000 of net credit sales will not be collected in cash.

Uncollectible Accounts Expense	Allowance for Doubtful Accounts
	250

			DESCRIPTION	POST REF	DEBIT	CREDIT	
1	20X1						1
2	Dec	31					2
3							3
4							4

- 3a. Accrued Expenses - expenses that have already happened, but we have not paid for them yet. The most common accrued expense is for Wages Expense. This is an accrued expense when our employees work in the current accounting period but will be paid in the next accounting period.

Our employees are paid every Friday. They were paid on Friday, December 27, 20X1, for the week ending Dec. 27, 20X1. The next pay day is Friday, January 3, 20X2. Our employees earn a combined \$600 per day.

If our employees work in December of 20X1, the expense needs to be recorded in December 20X1. (Note: we will ignore the payroll taxes in the adjustments.)

Wages Expense	Wages Payable
78,490	

	DATE		DESCRIPTION	POST REF	DEBIT	CREDIT	
1	20X1						1
2	Dec	31					2
3							3
4							4

3b. Accrued Payroll Taxes – as we learned in Chapter 11, employers must pay taxes based on the gross wages earned by employees. As such, taxes are owed on the accrued wages at the end of the year. We must accrue the employer payroll taxes on the amount of wages accrued at year end.

The employer payroll taxes are: Social Security (6.2%), Medicare (1.45%), Federal Unemployment Tax (0.6%), and State Unemployment Tax (5.4%). The entry for the adjustment is the same as the entry we prepared in chapter 11 for the pay period.

	DATE		DESCRIPTION	POST REF	DEBIT	CREDIT	
1	20X1						1
2	Dec	31					2
3							3
4							4
5							5
6							6
7							7

4. Accrued Interest on Notes Payable – any interest owed at the end of the year that will not be paid until the next year must be accrued as the interest must be recorded in the months that the note was outstanding.

Whiteside Antiques issued a two-month, 12%, \$2,000 Note Payable on December 1, 20X1. The note is not due until January 31, 20X2, at which time two months of interest will be paid. However, one month of interest to be paid on January 31, 20X2, applies to December of 20X1.

Interest Expense

Interest Payable

	DATE		DESCRIPTION	POST REF	DEBIT	CREDIT	
1	20X1						1
2	Dec	31					2
3							3
4							4

5. Accrued Interest on Notes Receivable – any interest due to us by the end of the year that we will not receive until the next year must be accrued as the Interest Income must be recorded in the year earned, which may not be the same year as the interest is earned.

On November 1, 20X1, Whiteside Antiques accepted a four-month, 15%, \$1,200 Note Receivable from a customer. The note and interest are due on March 1, 20X2.

Interest Receivable	Interest Income

	DATE		DESCRIPTION	POST REF	DEBIT	CREDIT	
1	20X1						1
2	Dec	31					2
3							3
4							4

6. Unearned Income – in some cases we may receive money from our customers before we actually earn the revenue. When this happens we will credit an account called Unearned Revenue. At the end of the year we will need to make an adjustment to transfer from the Unearned Revenue account any amount that we have earned by the end of the year.

Whiteside Antiques publishes a weekly magazine. We had received a total of \$450,000 from subscribers in advance. By December 31, 20X1, \$184,000 of the income had been earned.

Unearned Subscriptions Income	Subscriptions Income
450,000	

	DATE		DESCRIPTION	POST REF	DEBIT	CREDIT	
1	20X1						1
2	Dec	31					2
3							3
4							4

General Journal

	DATE	DESCRIPTION	PR	DEBIT	CREDIT	
1						1
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General Journal

	DATE	DESCRIPTION	PR	DEBIT	CREDIT	
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General Journal

	DATE	DESCRIPTION	PR	DEBIT	CREDIT	
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General Journal

	DATE	DESCRIPTION	PR	DEBIT	CREDIT	
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