

3-1 Nature of the Adjusting Process

In [Chapter 2](#), the November and December transactions for **NetSolutions** were recorded using the double-entry accounting system. After the transactions were recorded, an unadjusted trial balance was prepared on December 31 verifying that the total debit balances equal the total credit balances. Before financial statements can be prepared, however, some accounts in the unadjusted trial balance must be adjusted. These adjustments are necessary because the transactions for NetSolutions were recorded using the accrual basis of accounting.

Obj. 1 - Describe the nature of the adjusting process.

3-1a Accrual and Cash Basis of Accounting

Under the [accrual basis of accounting \(Under this basis of accounting, revenues and expenses are reported in the income statement in the period in which they are earned or incurred.\)](#), revenues and their related expenses are reported on the income statement in the period in which a service has been performed or a product has been delivered. Cash may or may not be received from customers during this period. For example, a cleaning company will record revenue after it cleans an office building, even if it is not paid for several weeks. The accrual basis of accounting also requires expenses to be recorded when they are incurred, not necessarily when cash is paid.

Although generally accepted accounting principles (GAAP) require the accrual basis of accounting, most individuals and some businesses use the cash basis of accounting. Under the [cash basis of accounting \(Under this basis of accounting, revenues and expenses are reported in the income statement in the period in which cash is received or paid.\)](#), revenues and expenses are reported on the

income statement in the period in which cash is received or paid. For example, fees are recorded when cash is received from clients; likewise, wages are recorded when cash is paid to employees. The net income (or net loss) is the difference between the cash receipts (revenues) and the cash payments (expenses).

Small service businesses may use the cash basis because they have few receivables and payables. For example, attorneys, physicians, and real estate agents may use the cash basis. For them, the cash basis provides financial statements similar to those of the accrual basis. For most large businesses, however, the cash basis will not provide accurate financial statements for user needs. For this reason, the accrual basis is required by GAAP and is used in this text.

Link to Pandora

Pandora uses the accrual basis of accounting in preparing its financial statements.

3-1b Revenue and Expense Recognition

To be useful for decision making, financial statements must be provided on a periodic basis. As a result, the economic life of a business is divided into time periods such as a month, quarter of a year, or full year. Under accrual accounting, the net income of a period is reported using revenue and expense recognition principles.

Link to Pandora

Subscription revenues from **Pandora's** customers are recorded equally over the subscription periods. For example, a yearly subscription would be recorded equally over 12 months.

Under the **revenue recognition principle** (The concept that supports recording revenues when services have been performed or products delivered to customers.), revenues are recorded when services have been performed or products have been delivered to customers. Revenue is measured as the value of the assets received, such as cash or accounts receivable. * The process of recognizing revenues is called **revenue recognition** (The process of recognizing revenue.) . *

Under the **expense recognition principle** (A principle, sometimes called the matching principle, that requires expenses to be recorded in the same period as the related revenue.), the expenses incurred in generating revenue must be reported in the same period as the related revenue. This is also called the **matching principle** (A concept of accounting in which expenses are matched with the revenue generated during a period by those expenses.). By matching revenues and expenses, net income or loss for the period is properly reported on the income statement. Adjusting entries are required to properly match revenues and expenses.

3-1c The Adjusting Process

At the end of an accounting period, an unadjusted trial balance is prepared to verify that the total debit balances equal the total credit balances. Many of these account balances are reported in the financial statements without change. For example, the balances of the cash and land accounts are normally the amounts reported on the balance sheet.

Some accounts on the unadjusted trial balance, however, require adjustments for the following reasons:

- Some revenues and expenses may be unrecorded at the end of the accounting period. For example, a company may have provided services to customers that it has not billed or recorded at the end of the accounting period. Likewise, a company may not pay its employees until the next accounting period even though the employees have earned their wages in the current period.
- Some expenses are not recorded daily. For example, the daily use of supplies would require many entries with small amounts. Also, information about the amount of supplies on hand on a day-to-day basis is normally not needed.
- Some revenues and expenses are incurred as time passes rather than as separate transactions. For example, rent received in advance (unearned rent) expires and becomes revenue with the passage of time. Likewise, prepaid insurance expires and becomes an expense with the passage of time.

Link to Pandora

Pandora computes royalty expense paid to an artist for a song that is streamed to listeners based upon the number of times it is played/streamed.

The analysis and updating of accounts at the end of the period before the financial statements are prepared is called the **adjusting process** (An analysis and updating of the accounts when financial statements are prepared.). The journal entries that bring the accounts up to date at the end of the accounting period are called **adjusting entries** (The journal entries that bring the accounts up to date at the end of the accounting period.). All adjusting entries affect at least one income statement account and one balance sheet account. Thus, an adjusting entry will always involve a revenue or an expense account *and* an asset or a liability account.

Example Exercise 3-1

Accounts Requiring Adjustment

Obj. 1 - Describe the nature of the adjusting process.

Indicate with a Yes or No whether or not each of the following accounts normally requires an adjusting entry:

Follow My Example 3-1

- a. Cash
- b. Utilities Expense
- c. Wages Expense
- d. Land
- e. Accounts Receivable
- f. Unearned Rent

Practice Exercises: [PE 3-1A](#), [PE 3-1B](#)

3-1d Types of Accounts Requiring Adjustment

The two general classifications of accounts requiring adjustment are as follows:

- Accruals
- Deferrals

Accruals

An **accrual** (An accrual occurs when revenue has been earned or an expense has been incurred but has not been recorded.) occurs when revenue has been earned or an expense has been incurred but has not been recorded. If the accrual is for revenue, the adjusting entry debits an asset (Accounts Receivable) and credits a revenue account. If the accrual is for an expense, the adjusting entry debits an expense account and credits a related liability account such as Accounts Payable or Wages Payable. [Exhibit 1](#) summarizes the accounting for accruals.

Exhibit 1

Accruals

ACCRUED REVENUE			
Initial Recording		End-of-Period	
Transaction	Journal Entry	Adjustment Data	Adjusting Entry
Revenue has been earned.	No journal entry has been made.	Revenue earned.	Accounts Receivable XXX Revenue XXX
ACCRUED EXPENSE			
Initial Recording		End-of-Period	
Transaction	Journal Entry	Adjustment Data	Adjusting Entry
Expense has been incurred.	No journal entry has been made.	Expense incurred.	Expense XXX Accounts Payable XXX

Deferrals

A **deferral** (A deferral occurs when cash related to a future revenue or expense has been initially recorded as a liability or an asset.) occurs when cash related to a future revenue or expense has been initially recorded as a liability or an asset. If the cash received is related to future revenue, it is initially recorded as a liability called **unearned revenue** (The liability created by receiving revenue in advance.) . The adjusting entry in the period when the revenue is earned debits an unearned revenue account and credits a revenue account. If the cash paid is related to a future expense, it is initially recorded as an asset called **prepaid expense** (Items such as supplies that will be used in the business in the future.) .

The adjusting entry in the period when the expense is incurred debits an expense account and credits a prepaid expense (asset) account. [Exhibit 2](#) summarizes the accounting for deferrals.

Exhibit 2

Deferrals

UNEARNED REVENUE			
Initial Recording		End-of-Period	
Transaction	Journal Entry	Adjustment Data	Adjusting Entry
Cash has been received for revenue that will be earned in a future period.	Cash XXX Unearned Revenue XXX	Revenue has been earned.	Unearned Revenue XXX Revenue XXX
PREPAID EXPENSE			
Initial Recording		End-of-Period	
Transaction	Journal Entry	Adjustment Data	Adjusting Entry
Cash has been paid for a future expense.	Prepaid Expense XXX Cash XXX	Prepaid expense has been used to generate revenue.	Expense XXX Prepaid Expense XXX

Example Exercise 3-2

Type of Adjustment

Obj. 1 - Describe the nature of the adjusting process.

Classify the following items as (1) prepaid expense, (2) unearned revenue, (3) accrued expense, or (4) accrued revenue:

Follow My Example 3-2

- Wages owed but not yet paid.
- Supplies on hand.
- Fees received but not yet earned.
- Fees earned but not yet received.

Practice Exercises: [PE 3-2A](#), [PE 3-2B](#)

3-2 Adjusting Entries for Accruals

To illustrate adjusting entries, the December 31, 2018, unadjusted trial balance of **NetSolutions**, shown in [Exhibit 3](#), is used. An expanded chart of accounts for NetSolutions is shown in [Exhibit 4](#). The additional accounts used in this chapter are highlighted. The rules of debit and credit shown in [Exhibit 3](#) of [Chapter 2](#) are used to record the adjusting entries.

Obj. 2 - Prepare adjusting entries for accruals.

Exhibit 3

Unadjusted Trial Balance for NetSolutions

NetSolutions Unadjusted Trial Balance December 31, 2018			
	Account No.	Debit Balances	Credit Balances
Cash	11	2,065	
Accounts Receivable	12	2,220	
Supplies	14	2,000	
Prepaid Insurance	15	2,400	
Land	17	20,000	
Office Equipment	18	1,800	
Accounts Payable	21		900
Unearned Rent	23		360
Chris Clark, Capital	31		25,000
Chris Clark, Drawing	32	4,000	
Fees Earned	41		16,340
Wages Expense	51	4,275	
Supplies Expense	52	800	
Rent Expense	53	1,600	
Utilities Expense	54	985	
Miscellaneous Expense	59	455	
		<u>42,600</u>	<u>42,600</u>

Exhibit 4

Expanded Chart of Accounts for NetSolutions

Balance Sheet Accounts

1. Assets

- 11 Cash
- 12 Accounts Receivable
- 14 Supplies
- 15 Prepaid Insurance
- 17 Land
- 18 Office Equipment
- 19 Accumulated Depreciation—Office Equipment

2. Liabilities

- 21 Accounts Payable
- 22 Wages Payable
- 23 Unearned Rent

3. Owner's Equity

- 31 Chris Clark, Capital
- 32 Chris Clark, Drawing

Income Statement Accounts

4. Revenue

- 41 Fees Earned
- 42 Rent Revenue

5. Expenses

- 51 Wages Expense
- 52 Supplies Expense
- 53 Rent Expense
- 54 Utilities Expense
- 55 Insurance Expense
- 56 Depreciation Expense
- 59 Miscellaneous Expense

Chapter 3: The Adjusting Process: 3-2 Adjusting Entries for Accruals
Book Title: Accounting

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3-2a Accrued Revenues

During an accounting period, some revenues are recorded only when cash is received. Thus, at the end of an accounting period, there may be revenue that has been earned *but has not been recorded*. In such cases, the revenue is recorded by increasing (debiting) an asset account (Accounts Receivable) and increasing (crediting) a revenue account (Fees Earned).

To illustrate, assume that **NetSolutions** signed an agreement with Dankner Co. on December 15. The agreement provides that NetSolutions will answer computer questions and render assistance to Dankner Co.'s employees. The services will be billed to Dankner Co. on the fifteenth of each month at a rate of \$20 per hour. As of December 31, NetSolutions had provided 25 hours of assistance to Dankner Co. The revenue of \$500 (25 hours × \$20) will be billed on January 15. However, NetSolutions earned the revenue in December.

The claim against the customer for payment of the \$500 is an account receivable (*an asset*). Thus, the accounts receivable account is increased (debited) by \$500, and the fees earned account is increased (credited) by \$500. The adjusting journal entry and T accounts are as follow:

						Adjusting Journal Entry	
Dec.	31	Accounts Receivable	12	500			
		Fees Earned	41		500		
		Accrued revenues (25 hrs. × \$20).					

Assets		=	Liabilities	+	Owner's Equity (Revenue)	Accounting Equation Impact	
Accounts Receivable					Fees Earned	41	
Bal.	2,220				Bal.	16,340	
Dec. 31	500				Dec. 31	500	
Adj. Bal.	2,720				Adj. Bal.	16,840	

If the adjustment for the accrued revenue (\$500) is not recorded, Fees Earned and the net income will be understated by \$500 on the income statement. On the balance sheet, assets (Accounts Receivable) and owner's equity (Chris Clark, Capital) will be understated by \$500. The effects of omitting this adjusting entry are as follows:

Link to Pandora

Pandora's accrued revenues from advertising are recorded in its accounts receivable at the end of the year.

	Amount of Misstatement
Income Statement	
Revenues understated by	→ \$ (500)
Expenses correctly stated	XXX
Net income understated by	<u>\$ (500)</u> ←
Balance Sheet	
Assets understated by	→ <u>\$ (500)</u>
Liabilities correctly stated	\$ XXX
Owner's equity understated by	<u>(500)</u> ←
Total liabilities and owner's equity understated by	<u>\$ (500)</u>

Example Exercise 3-3

Adjustment for Accrued Revenues

Obj. 2 - Prepare adjusting entries for accruals.

At the end of the current year, \$13,680 of fees have been earned but have not been billed to clients. Journalize the adjusting entry to record the accrued fees.

Follow My Example 3-3

Practice Exercises: [PE 3-3A](#), [PE 3-3B](#)

3-2b Accrued Expenses

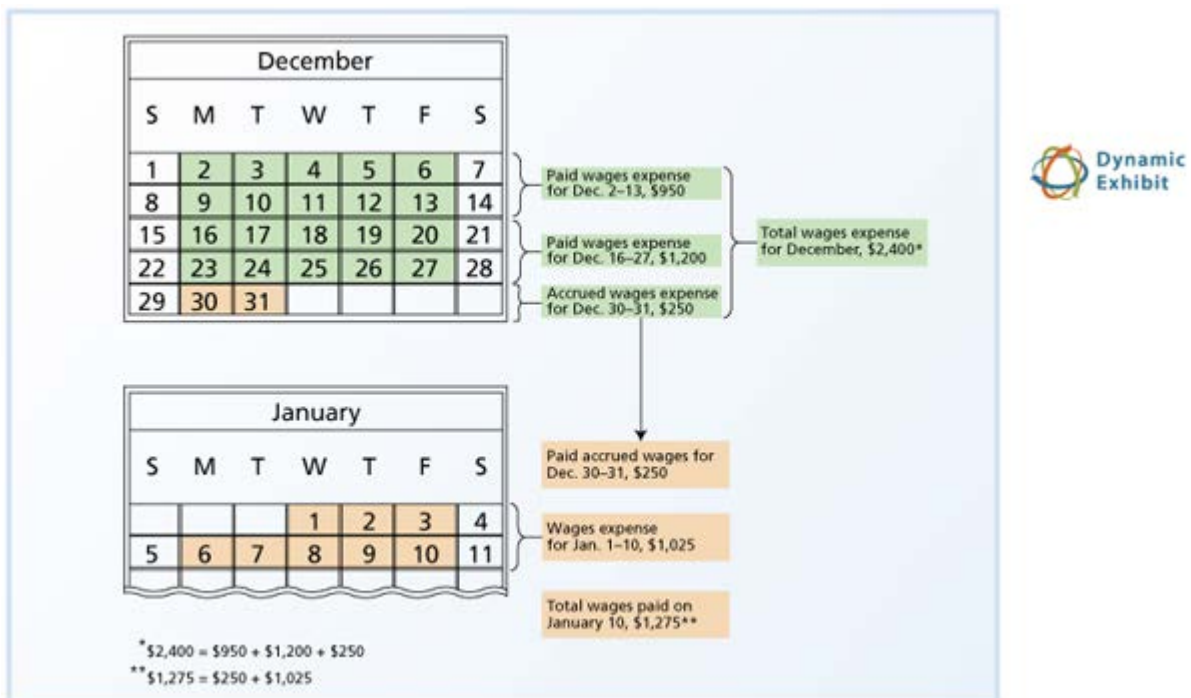
Some types of services used in earning revenues are paid for *after* the service has been performed. For example, wages expense is incurred hour by hour but is paid only daily, weekly, biweekly, or monthly. At the end of the accounting period, the amount of such *accrued* but unpaid items is an expense and a liability.

For example, if the last day of the employees' pay period is not the last day of the accounting period, an accrued expense (wages expense) and the related liability (wages payable) must be recorded by an adjusting entry. This adjusting entry is necessary so that expenses are properly matched to the period in which they were incurred in earning revenue.

To illustrate, **NetSolutions** pays its employees biweekly. During December, NetSolutions paid wages of \$950 on December 13 and \$1,200 on December 27. These payments covered pay periods ending on those days as shown in [Exhibit 5](#).

Exhibit 5

Accrued Wages



As of December 31, NetSolutions owes \$250 of wages to employees for Monday and Tuesday, December 30 and 31. Thus, the wages expense account is increased (debited) by \$250, and the wages payable account is increased (credited) by \$250. The adjusting journal entry and T accounts are as follows:

	Amount of Misstatement
Income Statement	
Revenues correctly stated	\$ XXX
Expenses understated by	(250)
Net income overstated by	<u>\$ 250</u>
Balance Sheet	
Assets correctly stated	<u>\$ XXX</u>
Liabilities understated by	(250)
Owner's equity overstated by	<u>250</u>
Total liabilities and owner's equity correctly stated	<u>\$ XXX</u>

Example Exercise 3-4

Adjustment for Accrued Expense

Obj. 2 - Prepare adjusting entries for accruals.

Sanregret Realty Co. pays weekly salaries of \$12,500 on Friday for a five-day week ending on that day. Journalize the necessary adjusting entry at the end of the accounting period, assuming that the period ends on Thursday.

Follow My Example 3-4

Practice Exercises: [PE 3-4A](#), [PE 3-4B](#)

Business Connection

Earning Revenues from Season Tickets

Madison Square Garden Company (MSG) owns the New York Knicks basketball team and the New York Rangers hockey team. The company sells season tickets prior to the season. The amounts received for season tickets are recognized as unearned revenue, a current liability. MSG recognizes revenue and reduces unearned revenue as the games are played through the season.

Chapter 3: The Adjusting Process: 3-2b Accrued Expenses

Book Title: Accounting

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3-3 Adjusting Entries for Deferrals

The unadjusted trial balance for **NetSolutions** in [Exhibit 3](#) indicates Unearned Rent of \$360. In addition, [Exhibit 3](#) indicates that NetSolutions has prepaid assets consisting of Supplies of \$2,000 and Prepaid Insurance of \$2,400. Each of these deferrals requires an adjusting entry.

Obj. 3 - Prepare adjusting entries for deferrals.

3-3a Unearned Revenues

The December 31 unadjusted trial balance of **NetSolutions** indicates a balance in the unearned rent account of \$360. This balance represents the receipt of three months' rent on December 1 for December, January, and February. At the end of December, one month's rent has been earned. Thus, the unearned rent account is decreased (debited) by \$120, and the rent revenue account is increased (credited) by \$120. The \$120 represents the rental revenue for one month ($\$360 \div 3$). The adjusting journal entry and T accounts are as follows:

Dec. 31				Unearned Rent				Rent Revenue				Rent earned (\$360 ÷ 3 months).				23	120	120	42

Assets

=

Liabilities

+

Owner's Equity (Revenue)

Accounting Equation Impact

Unearned Rent				Rent Revenue			
Dec. 31				Dec. 31			
120				120			

	Amount of Misstatement
Income Statement	
Revenues understated by	→ \$(120)
Expenses correctly stated	XXX
Net income understated by	← <u>\$(120)</u>
Balance Sheet	
Assets correctly stated	<u>XXX</u>
Liabilities overstated by	→ \$ 120
Owner's equity understated by	← <u>(120)</u>
Total liabilities and owner's equity correctly stated	<u>XXX</u>

Example Exercise 3-5

Adjustment for Unearned Revenue

Obj. 3 - Prepare adjusting entries for deferrals.

The balance in the unearned fees account, before adjustment at the end of the year, is \$44,900. Journalize the adjusting entry required if the amount of unearned fees at the end of the year is \$12,300.

Follow My Example 3-5

Practice Exercises: [PE 3-5A](#), [PE 3-5B](#)

3-3b Prepaid Expenses

The December 31, 2018, unadjusted trial balance of **NetSolutions** indicates a balance in the supplies account of \$2,000. In addition, the prepaid insurance account has a balance of \$2,400. Each of these accounts requires an adjusting entry.

Supplies

The balance in NetSolutions' supplies account on December 31 is \$2,000. Some of these supplies (paper and envelopes, for example) were used during December, and some are still on hand (not used). If either amount is known, the other can be determined. It is normally easier to determine the cost of the supplies on hand at the end of the month than to record supplies used on a daily basis.

Assuming that on December 31 the amount of supplies on hand is \$760, the amount to be transferred from the asset account to the expense account is \$1,240, computed as follows:

Supplies available during December (balance of account)	\$2,000
Supplies on hand, December 31	<u>760</u>
Supplies used (amount of adjustment)	<u>\$1,240</u>

At the end of December, the supplies expense account is increased (debited) for \$1,240, and the supplies account is decreased (credited) for \$1,240 to record the supplies used during December. The adjusting journal entry and T accounts for Supplies and Supplies Expense are as follows:

Adjusting Journal Entry

Journal						Page 2
Date		Description	Post. Ref.	Debit	Credit	
2018 Dec. 31		Supplies Expense	52	1,240		
		Supplies	14		1,240	
		Supplies used (\$2,000 – \$760).				

Accounting Equation Impact

Assets			=	Liabilities	+	Owner's Equity (Expense)		
Supplies						Supplies Expense		
Bal.	2,000	Dec. 31	1,240			Bal.	800	
Adj. Bal.	760					Dec. 31	1,240	
						Adj. Bal.	2,040	

The adjusting entry is highlighted in the T accounts to separate it from other transactions. After the adjusting entry is recorded and posted, the supplies account has a debit balance of \$760. This balance is an asset that will become an expense in a future period.

If the preceding adjustments for supplies (\$1,240) and insurance (\$200) are not recorded, the financial statements prepared as of December 31 will be misstated. On the income

statement, Supplies Expense and Insurance Expense will be understated by a total of \$1,440 (\$1,240 + \$200), and net income will be overstated by \$1,440. On the balance sheet, Supplies and Prepaid Insurance will be overstated by a total of \$1,440. Because net income increases owner's equity, Chris Clark, Capital will also be overstated by \$1,440 on the balance sheet. The effects of omitting these adjusting entries on the income statement and balance sheet are as follows:

	Amount of Misstatement
Income Statement	
Revenues correctly stated	\$ XXX
Expenses understated by	(1,440)
Net income overstated by	<u>\$1,440</u>
Balance Sheet	
Assets overstated by	<u>\$1,440</u>
Liabilities correctly stated	\$ XXX
Owner's equity overstated by	<u>1,440</u>
Total liabilities and owner's equity overstated by	<u>\$1,440</u>

Integrity, Objectivity, and Ethics in Business

Free Issue

Office supplies are often available to employees on a “free issue” basis. This means that employees do not have to “sign” for the release of office supplies but merely obtain the necessary supplies from a local storage area as needed. Just because supplies are easily available, however, doesn't mean they can be taken for personal use. There are many instances where employees have been terminated for taking supplies home for personal use.

Arrow (1) indicates the effect of the understated expenses on assets. Arrow (2) indicates the effect of the overstated net income on owner's equity.

Payments for prepaid expenses are sometimes made at the beginning of the period in which they will be *entirely used or consumed*. To illustrate, the following December 1 transaction of NetSolutions is used:

Dec. 1 NetSolutions paid rent of \$800 for the month.

On December 1, the rent payment of \$800 represents Prepaid Rent. However, the Prepaid Rent expires daily, and at the end of December, there will be no asset left. In such cases, the payment of \$800 is recorded as Rent Expense rather than as Prepaid Rent. In this way, no adjusting entry is needed at the end of the period.

Example Exercise 3-6

Adjustment for Prepaid Expense

Obj. 3 - Prepare adjusting entries for deferrals.

The prepaid insurance account had a beginning balance of \$2,400 and was debited for \$3,600 of premiums paid during the year. Journalize the adjusting entry required at the end of the year, assuming the amount of unexpired insurance related to future periods is \$3,250.

Follow My Example 3-6

Practice Exercises: [PE 3-6A](#), [PE 3-6B](#)

3-4 Adjusting Entries for Depreciation

Fixed assets (Long-term or relatively permanent tangible assets such as equipment, machinery, and buildings that are used in the normal business operations and that depreciate over time.) , or **plant assets**, are physical

resources that are owned and used by a business and are permanent or have a long life. Examples of fixed assets include land, buildings, and equipment. In a sense, fixed assets are a type of *long-term* prepaid expense. However, because of their normally high dollar amount and long life, they are discussed separately from other prepaid expenses.

Obj. 4 - Prepare adjusting entries for depreciation.

Fixed assets, such as office equipment, are used to generate revenue much like supplies are used to generate revenue. Unlike supplies, however, there is no visible reduction in the quantity of the equipment. Instead, as time passes, the equipment loses its ability to provide useful services. This decrease in usefulness is called **depreciation** (The systematic periodic transfer of the cost of a fixed asset to an expense account during its expected useful life.) .

All fixed assets, except land, lose their usefulness and, thus, are said to **depreciate** (To lose usefulness as all fixed assets except land do.) . As a fixed asset depreciates, a portion of its cost should be recorded as an expense. This periodic expense is called **depreciation expense** (The portion of the cost of a fixed asset that is recorded as an expense each year of its useful life.) .

The adjusting entry to record depreciation expense is similar to the adjusting entry for supplies used. The depreciation expense account is increased (debited) for the amount of depreciation. However, the fixed asset account is not decreased (credited). This is because both the original cost of a fixed asset and the depreciation recorded since its purchase are reported on the balance sheet. Instead, an account entitled **Accumulated Depreciation** (The contra asset account credited when recording the depreciation of a fixed asset.) is increased (credited).

Accumulated depreciation accounts are called **contra accounts** (An account offset against another account.) , or **contra asset accounts**. This is because accumulated depreciation accounts are deducted from their related fixed asset accounts on the balance sheet. The normal balance of a contra account is opposite the account from which it is deducted. Because the normal balance of a fixed asset account is a debit, the normal balance of an accumulated depreciation account is a credit.

The normal titles for fixed asset accounts and their related contra asset accounts are as follows:

Fixed Asset Account	Contra Asset Account
Land	None—Land is not depreciated.
Buildings	Accumulated Depreciation—Buildings
Store Equipment	Accumulated Depreciation—Store Equipment
Office Equipment	Accumulated Depreciation—Office Equipment

The December 31, 2018, unadjusted trial balance of **NetSolutions** (Exhibit 3) indicates that NetSolutions owns two fixed assets: land and office equipment. Land does not depreciate, and therefore does not have a contra account or an adjusting entry. Office equipment, however, does depreciate and requires an adjusting entry. Assume that the office equipment depreciates \$50 during December. The depreciation expense account is increased (debited) by \$50, and the contra account Accumulated Depreciation—Office Equipment is increased (credited) by \$50. ✨ The adjusting journal entry and T accounts are as follows:

						<i>Adjusting Journal Entry</i>	
Dec.	31	Depreciation Expense	56				
		Accumulated Depreciation—Office Equip.	19	50		50	
		Depreciation on office equipment.					

Assets		=	Liabilities	+	Owner's Equity (Expense)	<i>Accounting Equation Impact</i>	
Office Equipment					Depreciation Expense	56	
Bal.	1,800				Dec. 31	50	
Accumulated Depr.—Office Equip.							
					Dec. 31	50	

After the adjusting journal entry is recorded and posted, the office equipment account still has a debit balance of \$1,800. This is the original cost of the office equipment that was purchased on December 4. The accumulated depreciation—office equipment account has a credit balance of \$50. The difference between these two balances is the cost of the office equipment that has not yet been depreciated. This amount, called the **book value of the asset** (The difference between the cost of a fixed asset and its accumulated depreciation.) (or **net book value**), is computed as follows:

$$\text{Book Value of Asset} = \text{Cost of Asset} - \text{Accumulated Depreciation of Asset}$$

Thus, the book value of NetSolutions' office equipment at the end of December is \$1,750 (\$1,800 – \$50). The office equipment and its related accumulated depreciation are reported on the December 31, 2018, balance sheet as follows:

Office equipment	\$1,800	
Accumulated depreciation	<u>(50)</u>	\$1,750

The market value of a fixed asset usually differs from its book value. This is because depreciation is an *allocation* method, not a *valuation* method. That is, depreciation allocates the cost of a fixed asset to expense over its estimated life. Depreciation does not measure changes in market values, which vary from year to year. Thus, on December 31, 2018, the market value of NetSolutions' office equipment could be more or less than \$1,750.

Link to Pandora

On a recent balance sheet, **Pandora** reported property, plant, and equipment of \$57 million, accumulated depreciation of \$22 million, and a net book value of \$35 million.

If the adjustment for depreciation (\$50) is not recorded, Depreciation Expense on the income statement will be understated by \$50, and the net income will be overstated by \$50. On the balance sheet, assets (the book value of Office Equipment) and owner's equity (Chris Clark, Capital) will be overstated by \$50. The effects of omitting the adjustment for depreciation are as follows:

	Amount of Misstatement
Income Statement	
Revenues correctly stated	\$ XX
Expenses understated by	→ (50)
Net income overstated by	← <u>\$ 50</u>
Balance Sheet	
Assets overstated by	→ <u>\$ 50</u>
Liabilities correctly stated	\$ XX
Owner's equity overstated by	← <u>50</u>
Total liabilities and owner's equity overstated by	<u>\$ 50</u>

Example Exercise 3-7

Adjustment for Depreciation

Obj. 4 - Prepare adjusting entries for depreciation.

The estimated amount of depreciation on equipment for the current year is \$4,250. Journalize the adjusting entry to record the depreciation.

Follow My Example 3-7

Practice Exercises: [PE 3-7A](#), [PE 3-7B](#)

Chapter 3: The Adjusting Process: 3-4 Adjusting Entries for Depreciation
Book Title: Accounting

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3-5 Summary of Adjusting Process

A summary of the basic types of adjusting entries is shown in [Exhibit 6](#). The adjusting entries for **NetSolutions** are shown in [Exhibit 7](#). The adjusting entries are dated as of the last day of the period. However, because collecting the adjustment data requires time, the entries are usually recorded at a later date. An explanation is normally included with each adjusting entry.

Obj. 5 - Summarize the adjusting process.

Exhibit 6

Summary of Adjustments

ACCRUED REVENUES								
Examples	Reason for Adjustment	Adjusting Entry		Examples from NetSolutions			Financial Statement Impact if Adjusting Entry Is Omitted	
Services performed but not billed, interest to be received	Services have been provided to the customer but have not been billed or recorded. Interest has been earned but has not been received or recorded.	Asset Revenue	Dr. Cr.	Accounts Receivable Fees Earned	500 500		Income Statement: Revenues Expenses Net income Balance Sheet: Assets Liabilities Owner's equity (Owner's Capital)	Understated No effect Understated Understated No effect Understated
ACCRUED EXPENSES								
Wages or salaries incurred but not paid, interest incurred but not paid	Expenses have been incurred, but have not been paid or recorded.	Expense Liability	Dr. Cr.	Wages Expense Wages Payable	250 250		Income Statement: Revenues Expenses Net income Balance Sheet: Assets Liabilities Owner's equity (Owner's Capital)	No effect Understated Overstated No effect Understated Overstated
UNEARNED REVENUES								
Unearned rent, magazine subscriptions received in advance, fees received in advance of services	Cash received before the services have been provided is recorded as a liability. Some services have been provided to the customer before the end of the accounting period.	Liability Revenue	Dr. Cr.	Unearned Rent Rent Revenue	120 120		Income Statement: Revenues Expenses Net income Balance Sheet: Assets Liabilities Owner's equity (Owner's Capital)	Understated No effect Understated No effect Overstated Understated
PREPAID EXPENSES								
Supplies, prepaid insurance	Prepaid expenses (assets) have been used or consumed in the business operations.	Expense Asset	Dr. Cr.	Supplies Expense Supplies Insurance Expense Prepaid Insurance	1,240 200 200	1,240 200	Income Statement: Revenues Expenses Net income Balance Sheet: Assets Liabilities Owner's equity (Owner's Capital)	No effect Understated Overstated Overstated No effect Overstated
DEPRECIATION								
Depreciation of equipment and buildings	Fixed assets depreciate as they are used or consumed in the business operations.	Expense Contra Asset	Dr. Cr.	Depreciation Expense Accum. Depr.— Office Equipment	50 50		Income Statement: Revenues Expenses Net income Balance Sheet: Assets Liabilities Owner's equity (Owner's Capital)	No effect Understated Overstated Overstated No effect Overstated

Exhibit 7

Adjusting Entries—Netsolutions

Journal						Page 5
	Date	Description	Post. Ref.	Debit	Credit	
	2018	Adjusting Entries				
	Dec.	31	Accounts Receivable	12	500	
			Fees Earned	41		500
			Accrued fees (25 hrs. × \$20).			
		31	Wages Expense	51	250	
			Wages Payable	22		250
			Accrued wages.			
		31	Unearned Rent	23	120	
			Rent Revenue	42		120
			Rent earned (\$360 ÷ 3 months).			
		31	Supplies Expense	52	1,240	
			Supplies	14		1,240
			Supplies used (\$2,000 – \$760).			
		31	Insurance Expense	55	200	
			Prepaid Insurance	15		200
			Insurance expired (\$2,400 ÷ 12 months).			
		31	Depreciation Expense	56	50	
			Accum. Depreciation—Office Equipment	19		50
			Depreciation on office equipment.			

NetSolutions' adjusting entries are posted to the ledger shown in [Exhibit 8](#). The adjustments are highlighted in [Exhibit 8](#) to distinguish them from other transactions.

Exhibit 8

Ledger with Adjusting Entries—NetSolutions

Account <i>Cash</i>					Account No. 11	
Date	Item	Post. Ref.	Debit	Credit	Balance	
					Debit	Credit
2018						
Nov. 1		1	25,000		25,000	
5		1		20,000	5,000	
18		1	7,500		12,500	
30		1		3,650	8,850	
30		1		950	7,900	
30		2		2,000	5,900	
Dec. 1		2		2,400	3,500	
1		2		800	2,700	
1		2	360		3,060	
6		2		180	2,880	
11		2		400	2,480	
13		3		950	1,530	
16		3	3,100		4,630	
20		3		900	3,730	
21		3	650		4,380	
23		3		1,450	2,930	
27		3		1,200	1,730	
31		3		310	1,420	
31		4		225	1,195	
31		4	2,870		4,065	
31		4		2,000	2,065	

Account Accounts Receivable					Account No. 12	
Date	Item	Post. Ref.	Debit	Credit	Balance	
					Debit	Credit
2018						
Dec. 16		3	1,750		1,750	
21		3		650	1,100	
31		4	1,120		2,220	
31	Adjusting	5	500		2,720	

Account <i>Supplies</i>					Account No. 14	
Date	Item	Post. Ref.	Debit	Credit	Balance	
					Debit	Credit
2018						
Nov. 10		1	1,350		1,350	
30		1		800	550	
Dec. 23		3	1,450		2,000	
31	Adjusting	5		1,240	760	

Account <i>Prepaid Insurance</i>					Account No. 15	
Date	Item	Post. Ref.	Debit	Credit	Balance	
					Debit	Credit
2018						
Dec. 1		2	2,400		2,400	
31	Adjusting	5		200	2,200	

Account <i>Unearned Rent</i>					Account No. 23	
Date	Item	Post. Ref.	Debit	Credit	Balance	
					Debit	Credit
2018						
Dec. 1		2		360		360
31	Adjusting	5	120			240

Account <i>Land</i>					Account No. 17	
Date	Item	Post. Ref.	Debit	Credit	Balance	
					Debit	Credit
2018						
Nov. 5		1	20,000		20,000	

Account <i>Chris Clark, Capital</i>					Account No. 31	
Date	Item	Post. Ref.	Debit	Credit	Balance	
					Debit	Credit
2018						
Nov. 1		1		25,000		25,000

Account <i>Office Equipment</i>					Account No. 18	
Date	Item	Post. Ref.	Debit	Credit	Balance	
					Debit	Credit
2018						
Dec. 4		2	1,800		1,800	

Account <i>Chris Clark, Drawing</i>					Account No. 32	
Date	Item	Post. Ref.	Debit	Credit	Balance	
					Debit	Credit
2018						
Nov. 30		2	2,000		2,000	
Dec. 31		4	2,000		4,000	

Account <i>Accum. Depr.—Office Equip.</i>					Account No. 19	
Date	Item	Post. Ref.	Debit	Credit	Balance	
					Debit	Credit
2018						
Dec. 31	Adjusting	5		50		50

Account <i>Fees Earned</i>					Account No. 41	
Date	Item	Post. Ref.	Debit	Credit	Balance	
					Debit	Credit
2018						
Nov. 18		1		7,500		7,500
Dec. 16		3		3,100		10,600
16		3		1,750		12,350
31		4		2,870		15,220
31		4		1,120		16,340
31	Adjusting	5		500		16,840

Account <i>Accounts Payable</i>					Account No. 21	
Date	Item	Post. Ref.	Debit	Credit	Balance	
					Debit	Credit
2018						
Nov. 10		1		1,350		1,350
30		1	950		400	
Dec. 4		2		1,800		2,200
11		2	400		1,800	
20		3	900		900	

Account <i>Rent Revenue</i>					Account No. 42	
Date	Item	Post. Ref.	Debit	Credit	Balance	
					Debit	Credit
2018						
Dec. 31	Adjusting	5		120		120

Account <i>Wages Payable</i>					Account No. 22	
Date	Item	Post. Ref.	Debit	Credit	Balance	
					Debit	Credit
2018						
Dec. 31	Adjusting	5		250		250

Account <i>Wages Expense</i>					Account No. 51	
Date	Item	Post. Ref.	Debit	Credit	Balance	
					Debit	Credit
2018						
Nov. 30		1	2,125		2,125	
Dec. 13		3	950		3,075	
27		3	1,200		4,275	
31	Adjusting	5	250		4,525	

Account <i>Supplies Expense</i>					Account No. 52	
Date	Item	Post. Ref.	Debit	Credit	Balance	
					Debit	Credit
2018						
Nov. 30		1	800		800	
Dec. 31	Adjusting	5	1,240		2,040	

Account <i>Rent Expense</i>					Account No. 53	
Date	Item	Post. Ref.	Debit	Credit	Balance	
					Debit	Credit
2018						
Nov. 30		1	800		800	
Dec. 1		2	800		1,600	

Account <i>Utilities Expense</i>					Account No. 54	
Date	Item	Post. Ref.	Debit	Credit	Balance	
					Debit	Credit
2018						
Nov. 30		1	450		450	
Dec. 31		3	310		760	
31		4	225		985	

Account <i>Insurance Expense</i>					Account No. 55	
Date	Item	Post. Ref.	Debit	Credit	Balance	
					Debit	Credit
2018						
Dec. 31	Adjusting	5	200		200	

Account <i>Depreciation Expense</i>					Account No. 56	
Date	Item	Post. Ref.	Debit	Credit	Balance	
					Debit	Credit
2018						
Dec. 31	Adjusting	5	50		50	

Account <i>Miscellaneous Expense</i>					Account No. 59	
Date	Item	Post. Ref.	Debit	Credit	Balance	
					Debit	Credit
2018						
Nov. 30		1	275		275	
Dec. 6		2	180		455	

Business Connection

Microsoft's Deferred Revenues

Microsoft Corporation develops, manufactures, licenses, and supports a wide range of computer software products, including Windows® operating systems, Word®, Excel®, and the Xbox® gaming system. When Microsoft sells its products, it incurs an obligation to support its software with technical support and periodic updates. As a result, not all the revenue is earned on the date of sale; some of the revenue on the date of sale is unearned. The portion of revenue related to support services, such as updates and technical support, is earned as time passes and support is provided to customers. Thus, each year Microsoft makes adjusting entries transferring some of its unearned revenue to revenue. The following were taken from recent financial statements of Microsoft:

	Year 2	Year 1
Unearned revenue (in millions)	\$25,158	\$22,348

During Year 3, Microsoft expects to recognize \$23,150 of revenue from the \$25,158 of unearned revenue, which will have a significant impact on its operating results. At the same time, Microsoft will record additional unearned revenue from Year 3 sales.

Example Exercise 3-8

Effects of Adjustments

Obj. 5 - Summarize the adjusting process.

For the year ending December 31, 2019, Mann Medical Co. mistakenly omitted adjusting entries for (1) \$8,600 of unearned revenue that was earned, (2) earned revenue of \$12,500 that was not billed, and (3) accrued wages of \$2,900. Indicate the combined effect of the errors on (a) revenues, (b) expenses, and (c) net income for the year ended December 31, 2019.

Follow My Example 3-8

Practice Exercises: [PE 3-8A](#), [PE 3-8B](#)

3-6 Adjusted Trial Balance

After the adjusting entries are posted, an [adjusted trial balance \(The trial balance prepared after all the adjusting entries have been posted.\)](#) is prepared.

Obj. 6 - Prepare an adjusted trial balance.

The adjusted trial balance verifies the equality of the total debit and credit balances before the financial statements are prepared. If the adjusted trial balance does not balance, an error has occurred. However, as discussed in [Chapter 2](#), errors may occur even though the adjusted trial balance totals agree. For example, if an adjusting entry were omitted, the adjusted trial balance totals would still agree.

[Exhibit 9](#) shows the adjusted trial balance for **NetSolutions** as of December 31, 2018. [Chapter 4](#) discusses how financial statements, including a classified balance sheet, are prepared from an adjusted trial balance.

Exhibit 9

Adjusted Trial Balance

NetSolutions
Adjusted Trial Balance
December 31, 2018

	Account No.	Debit Balances	Credit Balances
Cash	11	2,065	
Accounts Receivable.....	12	2,720	
Supplies	14	760	
Prepaid Insurance	15	2,200	
Land	17	20,000	
Office Equipment	18	1,800	
Accumulated Depreciation—Office Equipment.....	19		50
Accounts Payable	21		900
Wages Payable	22		250
Unearned Rent.....	23		240
Chris Clark, Capital	31		25,000
Chris Clark, Drawing	32	4,000	
Fees Earned.....	41		16,840
Rent Revenue	42		120
Wages Expense	51	4,525	
Supplies Expense.....	52	2,040	
Rent Expense	53	1,600	
Utilities Expense	54	985	
Insurance Expense	55	200	
Depreciation Expense	56	50	
Miscellaneous Expense	59	455	
		<u>43,400</u>	<u>43,400</u>

Example Exercise 3-9

Effect of Errors

Obj. 6 - Prepare an adjusted trial balance.

For each of the following errors, considered individually, indicate whether the error would cause the adjusted trial balance totals to be unequal. If the error would cause the adjusted trial balance totals to be unequal, indicate whether the debit or credit total is higher and by how much.

Follow My Example 3-9

- a. The adjustment for accrued fees of \$5,340 was journalized as a debit to Accounts Payable for \$5,340 and a credit to Fees Earned of \$5,340.

b. The adjustment for depreciation of \$3,260 was journalized as a debit to Depreciation Expense for \$3,620 and a credit to Accumulated Depreciation for \$3,260.

Practice Exercises: [PE 3-9A](#), [PE 3-9B](#)

Chapter 3: The Adjusting Process: 3-6 Adjusted Trial Balance

Book Title: Accounting

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3-7 Financial Analysis and Interpretation: Vertical Analysis

Comparing each item on a financial statement with a total amount from the same statement is useful in analyzing relationships within the financial statement. **Vertical analysis** (An analysis that compares each item in a current statement with a total amount within the same statement.) is the term used to describe such comparisons.

Obj. 7 - Describe and illustrate the use of vertical analysis in evaluating a company's performance and financial condition.



In vertical analysis of a balance sheet, each asset item is stated as a percent of the total assets. Each liability and owner's equity item is stated as a percent of total liabilities and owner's equity. In vertical analysis of an income statement, each item is stated as a percent of revenues or fees earned.

Vertical analysis is also useful for analyzing changes in financial statements over time. To illustrate, a vertical analysis of two years of income statements for J. Holmes, Attorney-at-Law, follows:

J. Holmes, Attorney-at-Law Income Statements For the Years Ended December 31				
	Year 2		Year 1	
	Amount	Percent*	Amount	Percent*
Fees earned	\$187,500	100.0%	\$150,000	100.0%
Operating expenses:				
Wages expense.....	\$ 60,000	32.0%	\$ 45,000	30.0%
Rent expense	15,000	8.0%	12,000	8.0%
Utilities expense	12,500	6.7%	9,000	6.0%
Supplies expense	2,700	1.4%	3,000	2.0%
Miscellaneous expense	2,300	1.2%	1,800	1.2%
Total operating expenses	\$ 92,500	49.3%	\$ 70,800	47.2%
Net income.....	\$ 95,000	50.7%	\$ 79,200	52.8%
*Rounded to one decimal place				

The preceding vertical analysis indicates both favorable and unfavorable trends affecting the income statement of J. Holmes, Attorney-at-Law. The increase in wages expense of 2% (32.0% – 30.0%) is an unfavorable trend, as is the increase in utilities expense of 0.7% (6.7% – 6.0%). A favorable trend is the decrease in supplies expense of 0.6% (2.0% – 1.4%). Rent expense and miscellaneous expense as a percent of fees earned were constant. The net result of these trends is that net income decreased as a percent of fees earned from 52.8% to 50.7%.

The analysis of the various percentages shown for J. Holmes, Attorney-at-Law, can be enhanced by comparisons with industry averages. Such averages are published by trade associations and financial information services. Any major differences between industry averages should be investigated.

Vertical analysis of operating income taken from two recent years of income statements for **Pandora Media, Inc.** follows:

Pandora Media, Inc. Operating Income Statements For the Years Ended January 31 (in thousands)				
	Year 2		Year 1	
	Amount	Percent*	Amount	Percent*
Revenues:				
Advertising.....	\$732,338	79.5%	\$489,340	81.5%
Subscription	188,464	20.5%	110,893	18.5%
Total revenues.....	<u>\$920,802</u>	<u>100.0%</u>	<u>\$600,233</u>	<u>100.0%</u>
Expenses:				
Cost of revenues	\$508,004	55.2%	\$357,083	59.5%
Sales and marketing	277,330	30.1%	169,005	28.2%
General and administrative.....	112,443	12.2%	69,300	11.5%
Product development	53,153	5.8%	31,294	5.2%
Total expenses.....	<u>\$950,930</u>	<u>103.3%</u>	<u>\$626,682</u>	<u>104.4%</u>
Operating income (loss).....	<u>\$ (30,128)</u>	<u>(3.3)%</u>	<u>\$ (26,449)</u>	<u>(4.4)%</u>
*Rounded to one decimal place				

The preceding illustration shows the usefulness of vertical analysis. Since Year 2 revenues are significantly larger than those of Year 1, it is difficult to compare operating results using only dollar amounts. Vertical analysis, however, provides a relative comparison. The analysis reveals that the operating loss decreased from 4.4% to 3.3% as a percent of total revenues. This improvement was the result of the net change in expenses as a percent of revenue. The cost of revenues decreased from 59.5% to 55.2% of revenues, while sales and marketing, general and administrative, and product development expenses all increased as a percent of sales. The percentage increase in these latter expenses was less than the percentage decrease in the cost of revenues. Thus, total expenses decreased from 104.4% to 103.3% as a percent of revenues.

Example Exercise 3-10

Vertical Analysis

Obj. 7 - Describe and illustrate the use of vertical analysis in evaluating a company's performance and financial condition.

Two income statements for Fortson Company follow:

Fortson Company		
Income Statements		
For the Years Ended December 31, 2019 and 2018		
	2019	2018
Fees earned	\$425,000	\$375,000
Operating expenses	<u>263,500</u>	<u>210,000</u>
Operating income	<u>\$161,500</u>	<u>\$165,000</u>

Follow My Example 3-10

- a. Prepare a vertical analysis of Fortson Company's income statements.
- b. Does the vertical analysis indicate a favorable or an unfavorable trend?

Practice Exercises: [PE 3-10A](#), [PE 3-10B](#)

3-8 Chapter Review

At a Glance 3

Obj. 1

Describe the nature of the adjusting process.

Key Points

The accrual basis of accounting requires that revenues be reported in the period in which they are earned and expenses be matched with the revenues they generate. The updating of accounts at the end of the accounting period is called the adjusting process. Each adjusting entry affects an income statement and balance sheet account. The two general classifications for accounts requiring adjustment are accruals and deferrals. Accruals include accrued revenues and accrued expenses. Deferrals include unearned revenues and prepaid expenses.

Learning Outcomes

Explain why accrual accounting requires adjusting entries.

Describe the revenue and expense recognition principles.

List accounts that do and do *not* require adjusting entries at the end of the accounting period. [Example Exercise 3-1](#) [Practice Exercises 3-1A, 3-1B](#)

Give an example of accrued revenue, accrued expense, deferred (unearned) revenue, and deferred (prepaid) expense. [Example Exercise 3-2](#) [Practice Exercises 3-2A, 3-2B](#)

Obj. 2

Prepare adjusting entries for accruals.

Key Points

Adjusting entries for deferrals include unearned revenues and prepaid expenses. The adjusting entry for an unearned revenue debits an unearned revenue account such as Unearned Rent and credits a revenue account such as Rent Revenue. The adjusting entry for an accrued expense debits an expense account such as Wages Expense and credits a liability account such as Wages Payable.

Learning Outcomes

Prepare an adjusting entry for an unearned revenue. [Example Exercise 3-3](#)
[Practice Exercises 3-3A, 3-3B](#)

Prepare an adjusting entry for a prepaid expense. [Example Exercise 3-4](#)
[Practice Exercises 3-4A, 3-4B](#)

Obj. 3

Prepare adjusting entries for deferrals.

Key Points

Adjusting entries for accruals include accrued revenues and expenses. The adjusting entry for an accrued revenue debits Accounts Receivable and credits a revenue account such as Fees Earned. The adjusting entry for an accrued expense debits an expense account such as Wages Expense and credits a liability account such as Wages Payable.

Learning Outcomes

Prepare an adjusting entry for an accrued revenue. [Example Exercise 3-5](#)
[Practice Exercises 3-5A, 3-5B](#)

Prepare an adjusting entry for an accrued expense. [Example Exercise 3-6](#)
[Practice Exercises 3-6A, 3-6B](#)

Obj. 4

Prepare adjusting entries for depreciation.

Key Points

The adjusting entry for depreciation of a fixed asset debits Depreciation Expense and credits a contra asset account, Accumulated Depreciation. The book value of

a fixed asset equals its cost less its accumulated depreciation. Land is a fixed asset that does not depreciate.

Learning Outcomes

Describe assets that require the recording of an adjusting entry for depreciation. [Example Exercise 3-7](#) [Practice Exercises 3-7A, 3-7B](#)

Prepare an adjusting entry for depreciation expense.

Obj. 5

Summarize the adjusting process.

Key Points

A summary of adjustments, including the type of adjustment, reason for the adjustment, the adjusting entry, and the effect of omitting an adjustment on the financial statements, is shown in [Exhibit 6](#).

Learning Outcomes

Determine the effect on the income statement and balance sheet of omitting an adjusting entry for prepaid expense, unearned revenue, accrued revenue, accrued expense, and depreciation. [Example Exercise 3-8](#) [Practice Exercises 3-8A, 3-8B](#)

Obj. 6

Prepare an adjusted trial balance.

Key Points

After all of the adjusting entries have been posted, the equality of the total debit balances and the total credit balances is verified using an adjusted trial balance.

Learning Outcomes

Prepare an adjusted trial balance.

Determine the effect of errors on the equality of the adjusted trial balance.
[Example Exercise 3-9](#) [Practice Exercises 3-9A, 3-9B](#)

Obj. 7

Describe and illustrate the use of vertical analysis in evaluating a company's performance and financial condition.

Key Points

Comparing each item on a financial statement with a total amount from the same statement is called vertical analysis. On the balance sheet, each asset is expressed as a percent of total assets, and each liability and owner's equity is expressed as a percent of total liabilities and owner's equity. On the income statement, each revenue and expense is expressed as a percent of total revenues or fees earned.

Learning Outcomes

Describe vertical analysis.

Prepare a vertical analysis report of a financial statement. [Example Exercise 3-10](#) [Practice Exercises 3-10A, 3-10B](#)

Chapter Review

3-8a Illustrative Problem

Three years ago, T. Roderick organized Harbor Realty. At July 31, 2019, the end of the current year, the unadjusted trial balance of Harbor Realty follows:

Harbor Realty Unadjusted Trial Balance July 31, 2019		
	Debit Balances	Credit Balances
Cash	3,425	
Accounts Receivable	7,000	
Supplies	1,270	
Prepaid Insurance	620	
Office Equipment	51,650	
Accumulated Depreciation—Office Equipment		9,700
Accounts Payable		925
Wages Payable		0
Unearned Fees		1,250
T. Roderick, Capital		29,000
T. Roderick, Drawing	5,200	
Fees Earned		59,125
Wages Expense	22,415	
Depreciation Expense	0	
Rent Expense	4,200	
Utilities Expense	2,715	
Supplies Expense	0	
Insurance Expense	0	
Miscellaneous Expense	1,505	
	<u>100,000</u>	<u>100,000</u>

The data needed to determine year-end adjustments follow:

- Supplies on hand at July 31, 2019, \$380.
- Insurance premiums expired during the year, \$315.
- Depreciation of equipment during the year, \$4,950.
- Wages accrued but not paid at July 31, 2019, \$440.

- Accrued fees earned but not recorded at July 31, 2019, \$1,000.
- Unearned fees on July 31, 2019, \$750.

Instructions

1. Prepare the necessary adjusting journal entries on July 31. Include journal entry explanations.
2. Determine the balance of the accounts affected by the adjusting entries and prepare an adjusted trial balance.

Chapter 3: The Adjusting Process: 3-8a Illustrative Problem

Book Title: Accounting

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