

Adjustments and the Ten-Column Work Sheet

BEFORE YOU READ

Predict

1. What does the chapter title tell you?
2. What do you already know about this subject from personal experience?
3. What have you learned about this in the earlier chapters?
4. What gaps exist in your knowledge of this subject?

What You'll Learn

1. Describe the parts of a ten-column work sheet.
2. Generate trial balances and end-of-period adjustments.
3. Determine which general ledger accounts to adjust.
4. Calculate the adjustments.
5. Prepare a ten-column work sheet.
6. Journalize the adjustments.
7. Define the accounting terms introduced in this chapter.

Why It's Important

- ▶ Not all financial changes are caused by transactions with other businesses or individuals. Some financial changes occur within a business.



Exploring the *Real World* of Business

ANALYZING ADJUSTMENTS

Plantronics, Inc.

“That’s one small step for man, one giant leap for mankind.” As Neil Armstrong stepped onto the moon’s surface in 1969, his famous words were delivered via a **Plantronics** headset.

Since then, **Plantronics, Inc.** has taken giant steps in the lightweight communications headset industry. Some of its best sellers include wireless headsets for cell phones and iPods. U.S. soldiers, emergency response teams, and air traffic controllers also use the company’s headsets.

Plantronics, like other companies, takes a physical count of inventory at the end of every fiscal period. Then it adjusts the accounting records so the **Merchandise Inventory** account matches the inventory it actually holds.

What Do You Think?

Can you think of other general ledger accounts like **Merchandise Inventory** that might need an adjustment?



Working in the *Real World*

APPLYING YOUR ACCOUNTING KNOWLEDGE

A merchandising business uses the work sheet for collecting and organizing financial information. In large businesses, several people might work on different parts of the work sheet. For example, one person might be responsible for accounts payable information and others for accounts receivable and payroll. The staff works as a team to prepare the work sheet. A team or project leader makes sure all team members complete their assigned sections.

Personal Connection

1. In your workplace are you asked to participate in group or team assignments?
2. How do team members work with each other?
3. What skills are needed to work well in a team?

Online Connection

Go to glencoeaccounting.glencoe.com and click on **Student Center**. Click on **Working in the Real World** and select **Chapter 18** to learn more about the real-world workplace.



Identifying Accounts to Be Adjusted and Adjusting Merchandise Inventory

BEFORE YOU READ

Main Idea

Adjustments transfer the cost of “used up” assets to expense accounts. Adjustments for changes in merchandise inventory are made directly to the **Income Summary** account.

Read to Learn...

- ▶ the purpose of the ten-column work sheet. (p. 518)
- ▶ how to use the ten-column work sheet for adjustments. (p. 518)

Key Terms

adjustment
beginning inventory
ending inventory
physical inventory

Recall that the work sheet is the basis for preparing end-of-period journal entries and financial statements. The purpose of all period-end reports is to provide essential information about a company’s financial position.

Completing End-of-Period Work

What Is the Purpose of the Ten-Column Work Sheet?

The general ledger summarizes the effects of business transactions on individual accounts for an accounting period. Managers, stockholders, and creditors need more than account totals, however, to evaluate performance. They need to know net income and the value of stockholders’ equity, which for a corporation is like owner’s equity for a sole proprietorship. They need this information to make sound business decisions.

Earlier you worked with a six-column work sheet prepared for a service business organized as a sole proprietorship. In this chapter you will prepare a ten-column work sheet for a merchandising business organized as a corporation. This work sheet is the basis for preparing end-of-period financial statements, adjusting entries, and closing entries.

The Ten-Column Work Sheet

How Is the Ten-Column Work Sheet Different from the Six-Column Work Sheet?

The work sheet in Chapter 8 had six amount columns. The work sheet in this chapter, however, has ten amount columns. The additional columns are for the *Adjustments* and *Adjusted Trial Balance* sections.

Prepared in the same way as the six-column work sheet, the ten-column work sheet has five amount sections instead of three:

- Trial Balance
- Adjustments
- Adjusted Trial Balance
- Income Statement
- Balance Sheet

Completing the Trial Balance Section

A trial balance is prepared to prove the equality of debits and credits in the general ledger. **Figure 18–1** shows the end-of-period trial balance for On Your Mark Athletic Wear.

To prepare the trial balance, the number and name of each account in the general ledger are entered on the work sheet in the Account Number

and Account Name columns. The accounts are listed in the order that they appear in the general ledger (Asset, Liability, Stockholders' Equity, Revenue, Cost of Merchandise, Expense). The balance of each account is entered in the appropriate Debit or Credit column of the Trial Balance section. Notice that every general ledger account is listed, even those with zero balances. After all balances are entered, the Trial Balance Debit and Credit columns are ruled, totaled, and proved. Then a double rule is drawn across both columns.

Calculating Adjustments

Not all changes in account balances result from daily business transactions. Some result from internal business operations or the passage of time.

	ACCT. NO.	ACCOUNT NAME	TRIAL BALANCE	
			DEBIT	CREDIT
1	101	Cash in Bank	15 179 00	
2	115	Accounts Receivable	10 404 00	
3	125	Merchandise Inventory	84 921 00	
4	130	Supplies	5 549 00	
5	135	Prepaid Insurance	1 500 00	
6	140	Delivery Equipment	19 831 00	
7	145	Office Equipment	9 825 00	
8	150	Store Equipment	5 200 00	
9	201	Accounts Payable		13 850 00
10	204	Fed. Corp. Inc. Tax Payable		
11	205	Employees' Fed. Inc. Tax Pay.		64 000
12	211	Employees' State Inc. Tax Pay.		8 000
13	212	Social Security Tax Payable		24 800
14	213	Medicare Tax Payable		5 800
15	214	Fed. Unemployment Tax Payable		1 836
16	215	State Unemployment Tax Payable		11 473
17	220	Sales Tax Payable		2 428 00
18	301	Capital Stock		75 000 00
19	305	Retained Earnings		19 771 19
20	310	Income Summary		
21	401	Sales		320 450 00
22	405	Sales Discounts	7 300 00	
23	410	Sales Returns & Allowances	2 000 00	
24	501	Purchases	206 700 00	
25	505	Transportation In	4 036 18	
26	510	Purchases Discounts		1 340 00
27	515	Purchases Returns & Allowances		1 800 00
28	601	Advertising Expense	2 450 00	
29	605	Bankcard Fees Expense	4 199 27	
30	630	Fed. Corp. Income Tax Expense	9 840 00	
31	635	Insurance Expense		
32	650	Maintenance Expense	3 519 25	
33	655	Miscellaneous Expense	3 482 28	
34	657	Payroll Tax Expense	3 826 83	
35	660	Rent Expense	14 000 00	
36	665	Salaries Expense	29 374 60	
37	670	Supplies Expense		
38	680	Utilities Expense	2 364 87	
39			435 798 28	435 798 28
40				

CULTURAL

Diversity

Holiday Observances When working with clients from other countries, be aware of their holiday schedules. There are over 800 holidays around the world during which businesses shut down. Some countries have such diverse ethnic populations that they observe religious holidays for over 10 major religions!

Figure 18-1 The Trial Balance Section of the Work Sheet





For example, supplies such as paper, pens, shopping bags, and sales slips are bought for use by the business. They are recorded in an asset account called **Supplies**. These supplies are used gradually during the accounting period. Another example is insurance premiums, which cover a certain period of time. The premiums are recorded in an asset account called **Prepaid Insurance**. During the period some insurance is used up, or expires. At the end of the period, the balances in accounts such as **Supplies** and **Prepaid Insurance** are brought up to date.

To illustrate, suppose that supplies costing \$500 were purchased during an accounting period and recorded in the **Supplies** account. At the end of the period, the **Supplies** account balance is \$500; however, only \$200 of supplies are still on hand. The account balance for **Supplies** is adjusted downward to show that the business used \$300 of supplies.

Permanent Accounts and Temporary Accounts. Up to this point, the general ledger account balances have been changed by journal entries made to record transactions that are supported by source documents. There are no source documents, however, for the changes in account balances caused by the internal operations of a business or the passage of time. Such changes are recorded through adjustments made at the end of the period to the account balance. An **adjustment** is an amount that is added to or subtracted from an account balance to bring that balance up to date. Every adjustment affects at least one permanent account and one temporary account.

At the end of the period, adjustments are made to transfer the costs of the assets consumed from the asset accounts (permanent accounts) to the appropriate expense accounts (temporary accounts). Accountants say that these assets are “expensed” because the costs of consumed assets are expenses of doing business. Thus, when an adjustment is recorded, the expenses for a given period are matched with the revenue for that period.

The work sheet’s Adjustments section is used to record the adjustments made at the period-end to bring various account balances up to date.

Determining the Adjustments Needed. How do you generate end-of-period adjustments? Review each account balance in the work sheet’s Trial Balance section. If the balance for an account is not up to date *as of the last day of the fiscal period*, that account balance must be adjusted.

Refer to **Figure 18–1** on page 519. The first account listed is **Cash in Bank**. All cash received or paid out during the period was journalized and posted to the **Cash in Bank** account. This balance is up to date. The next account, **Accounts Receivable** (controlling), is also up to date since all amounts owed or paid by charge customers were journalized and posted.

The third account is **Merchandise Inventory**, used to report the cost of merchandise on hand. The balance reported in the Trial Balance section (\$84,921) is the merchandise on hand at the *beginning* of the period.

The amount of merchandise on hand is constantly changing during the period. The changes are not recorded in the **Merchandise Inventory** account. During the period the cost of merchandise purchased is recorded in the **Purchases** account. As merchandise sales reduce inventory, the amount of each sale is recorded in the **Sales** account, not **Merchandise Inventory**.

As You READ

Instant Recall

Matching Principle

The matching principle requires revenue to be recorded in the same period as the expenses incurred to earn it.

At the end of the period, the balance in the **Merchandise Inventory** account does not reflect the amount of merchandise on hand. So the **Merchandise Inventory** account balance must be adjusted.

The other account balances on the work sheet are reviewed in the same manner. Additional adjustments are made as described later in this chapter.

Adjusting the Merchandise Inventory Account

Merchandise Inventory is an asset account used by merchandising businesses. **Beginning inventory** is the merchandise a business has on hand and available for sale at the *beginning* of a period. **Ending inventory** is the merchandise on hand at the *end* of a period. The ending inventory for one period becomes the beginning inventory for the next period.

The account balance of **Merchandise Inventory** does not change during the period. It is changed *only* when a physical inventory is taken. A **physical inventory** is an actual count of all merchandise on hand and available for sale. A physical inventory can be taken at any time. One is always taken at the end of a period.

For example, if a toy store counts inventory at the end of a period, it can calculate the cost of inventory. This is done by multiplying the quantity of each item by its unit cost.

At the end of each period, after the physical inventory has been taken and the cost of ending inventory has been calculated, the ending inventory amount replaces the beginning inventory amount recorded in **Merchandise Inventory**. This is accomplished by an adjustment to **Merchandise Inventory**.

Calculating the Adjustment for Merchandise Inventory.

When calculating the adjustment for **Merchandise Inventory**, you need to know (1) the **Merchandise Inventory** account balance and (2) the physical inventory amount. For On Your Mark, this is:

Merchandise Inventory account balance	\$84,921
Physical inventory	81,385

As You READ

Key Point

Adjustments

Adjustments help match expenses with related revenue.

Adjustment

To adjust the **Merchandise Inventory** account to reflect the physical inventory amount (\$81,385), the following transaction is recorded.

ANALYSIS	Identify	1. The accounts Merchandise Inventory and Income Summary are affected.
	Classify	2. Merchandise Inventory is an asset account (permanent). Income Summary is a stockholder's equity account.
	+/-	3. Merchandise Inventory is decreased by \$3,536. This amount is transferred to Income Summary .
DEBIT-CREDIT RULE		4. To transfer the decrease in Merchandise Inventory , debit Income Summary for \$3,536.
		5. Decreases to asset accounts are recorded as credits. Credit Merchandise Inventory for \$3,536.



T ACCOUNTS

6. Income Summary		Merchandise Inventory	
Debit	Credit	Debit	Credit
3,536		+	-
			3,536

The effect of all the purchases and sales during the period is a decrease to **Merchandise Inventory** of \$3,536 (\$84,921 – \$81,385). This reduction in inventory needs to be recorded as an adjustment in the accounting records. The two accounts affected by the inventory adjustment are **Merchandise Inventory** and **Income Summary**.

Merchandise Inventory	
Debit	Credit
+	-
3,305	

Income Summary	
Debit	Credit
	3,305

If the ending inventory amount is higher than beginning inventory, **Merchandise Inventory** is debited and **Income Summary** is credited. For example, suppose that the beginning inventory was \$84,921 and the ending inventory is \$88,226. Inventory increased by \$3,305 (\$88,226 – \$84,921). The **Merchandise Inventory** account is debited for \$3,305, and **Income Summary** is credited for \$3,305.

Entering the Adjustment for Merchandise Inventory on the Work Sheet.

Adjustments are entered in the Adjustments columns of the work sheet. The debit and credit parts of each adjustment are given a unique label. The label consists of a small letter in parentheses and is placed just above and to the left of the adjustment amounts. The adjustments are labeled as follows:

- First adjustment (a)
- Second adjustment (b)
- Third adjustment (c)

The number of adjustments varies depending on the business. Once the adjustments have been entered, the work sheet provides the information needed to make the adjusting journal entries.

Use the T accounts in step 6 of the preceding example as a guide to entering the inventory adjustment on the work sheet. Refer to **Figure 18–2**. To record the adjustment for **Merchandise Inventory**:

- In the Adjustments Debit column, enter the debit amount of the adjustment on the Income Summary line. Label this amount (a).
- In the Adjustments Credit column, enter the credit amount of the adjustment on the Merchandise Inventory line. Label it (a) also.

	ACCT. NO.	ACCOUNT NAME	TRIAL BALANCE		ADJUSTMENTS	
			DEBIT	CREDIT	DEBIT	CREDIT
1	101	Cash in Bank	15	179.00		
2	115	Accounts Receivable	10	404.00		
3	125	Merchandise Inventory	84	921.00		(a) 3 536.00
20	310	Income Summary			(a) 3	536.00
21						

Figure 18–2
Recording the Adjustment for Merchandise Inventory on the Work Sheet



AFTER
You READ**Reinforce the Main Idea**

Using a diagram like this one, summarize the steps for determining the **Merchandise Inventory** adjustment and entering it on the work sheet. Add answer boxes for steps as needed.

The Merchandise Inventory Adjustment

↓

↓

↓

**Do the Math**

Your company, Photo Shots, is looking to expand its merchandise, but the accounting manager wants to analyze inventory data for the last three years before recommending expansion. Using the data given, create a bar graph to depict the total amount of merchandise sold by year. Use the formula (Beginning Inventory + Purchases) – Ending Inventory = Cost of Merchandise Sold. Write a short paragraph summarizing your analysis of the results.

Merchandise Inventory in U.S.\$

Year	Beginning	Ending	Purchases
Year 1	900	1,000	5,000
Year 2	1,000	2,000	8,000
Year 3	2,000	1,500	7,500

**Problem 18–1 Analyzing the Adjustment for Merchandise Inventory**

Ely Corporation, a custom furniture manufacturer, has a general ledger account balance of \$73,395 for **Merchandise Inventory** as of July 1. On the following June 30, the end of the fiscal period, Ely took a physical inventory and determined it had \$74,928 in merchandise on hand. In your working papers, answer the following questions regarding the adjustment for **Merchandise Inventory**:

1. Is the value of the ending inventory more or less than the value of the beginning inventory?
2. What is the amount of the inventory adjustment?
3. Which account is debited?
4. Which account is credited?



SECTION 2

Adjusting Supplies, Prepaid Insurance, and Federal Corporate Income Tax

BEFORE YOU READ

Main Idea

Adjustments show the dollar amount of assets consumed during the period. They also recognize the corporation's income tax expense.

Read to Learn...

- ▶ how and why the **Supplies** account is adjusted. (p. 524)
- ▶ how and why the **Prepaid Insurance** account is adjusted. (p. 525)
- ▶ how and why the **Federal Corporate Income Tax Expense** account is adjusted. (p. 527)

Key Terms

prepaid expense

In Section 1 you learned that at the end of the period, the accountant must update the **Merchandise Inventory** account and adjust other accounts in the general ledger. For example insurance is a costly expense for high-risk businesses, such as building construction and demolition. Thus, the financial statements must reflect the proper insurance expenses each period. Supplies and federal corporate income taxes also represent significant expenses that must be reported accurately.

Adjusting the Supplies Account

Why Do You Make an Adjustment for Supplies?

A merchandising business buys various supplies for employees to use in the everyday operations of the business. Pencils, pens, computer paper, shopping bags, sales slips, price tags, and cash register tapes are purchased, and the cost is debited to the **Supplies** account.

Supplies are used daily. As they are consumed, they become expenses of the business. Keeping daily records of each item as it is used is inefficient, so the **Supplies** account is updated at the end of the period.

In the Trial Balance section of the work sheet in **Figure 18–1** on page 519, the balance of the **Supplies** account is \$5,549. This amount is the cost of the supplies on hand on January 1 *plus* the cost of the additional supplies purchased during the period.

At the end of December, On Your Mark took a physical inventory. It found that \$1,839 of supplies were on hand, meaning that it used \$3,710 of supplies during the period ($\$5,549 - \$1,839 = \$3,710$). The amount of supplies on hand decreased by \$3,710. Therefore, **Supplies** (a permanent asset account) is credited for \$3,710. **Supplies Expense** (a temporary account) is debited (increased) to record the cost of supplies used in the period.

Adjustment

Record the adjustment for supplies.

ANALYSIS

*Identify
Classify*

+/-

1. The accounts affected are **Supplies** and **Supplies Expense**.
2. **Supplies** is an asset account (permanent). **Supplies Expense** is an expense account (temporary).
3. **Supplies** is decreased by \$3,710. **Supplies Expense** is increased by \$3,710.

DEBIT-CREDIT RULE	<ol style="list-style-type: none"> Increases to expense accounts are recorded as debits. Debit Supplies Expense for \$3,710. Decreases to asset accounts are recorded as credits. Credit Supplies for \$3,710. 																
T ACCOUNTS	<ol style="list-style-type: none"> <table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th colspan="2" style="text-align: center;">Supplies Expense</th> <th colspan="2" style="text-align: center;">Supplies</th> </tr> </thead> <tbody> <tr> <td style="text-align: center;">Debit</td> <td style="text-align: center;">Credit</td> <td style="text-align: center;">Debit</td> <td style="text-align: center;">Credit</td> </tr> <tr> <td style="text-align: center;">+</td> <td style="text-align: center;">-</td> <td style="text-align: center;">+</td> <td style="text-align: center;">-</td> </tr> <tr> <td style="text-align: center;">3,710</td> <td></td> <td></td> <td style="text-align: center;">3,710</td> </tr> </tbody> </table> 	Supplies Expense		Supplies		Debit	Credit	Debit	Credit	+	-	+	-	3,710			3,710
Supplies Expense		Supplies															
Debit	Credit	Debit	Credit														
+	-	+	-														
3,710			3,710														

The adjustment for supplies is shown in **Figure 18–3** on page 526. To enter the adjustment on the work sheet, follow these steps:

- In the Adjustments Debit column, enter the debit amount of the adjustment on the Supplies Expense line. Since this is the second adjustment, label it *(b)*.
- In the Adjustments Credit column, enter the credit amount of the adjustment on the Supplies line. Label it *(b)* also.

Adjusting the Prepaid Insurance Account

Why Do You Make an Adjustment for Insurance?

On December 17 On Your Mark purchased an insurance policy for six months, mid-December through mid-May. The accounting clerk debited the premium of \$1,500 (\$250 per month) to the **Prepaid Insurance** account. This is an example of a **prepaid expense**, an expense paid in advance.

At the end of December, the **Prepaid Insurance** balance is \$1,500 (see the work sheet’s Trial Balance section in **Figure 18–1**). However, the coverage for half of a month, costing \$125, has expired. The value of the unexpired portion of the coverage has decreased to \$1,375 (\$1,500 – \$125), so the clerk adjusts **Prepaid Insurance** with a \$125 credit to update its balance. The adjustment records the expired portion as a business expense.

As You

READ

In Your Experience

Prepaid Have you heard the term *prepaid* before now? What type of product or service can be prepaid?

Adjustment	
<i>Record the adjustment for the expiration of one-half month’s insurance coverage.</i>	
ANALYSIS <i>Identify</i> <i>Classify</i> +/-	<ol style="list-style-type: none"> The accounts affected are Insurance Expense and Prepaid Insurance. Insurance Expense is an expense account (temporary). Prepaid Insurance is an asset account (permanent). Insurance Expense is increased by \$125. Prepaid Insurance is decreased by \$125.
DEBIT-CREDIT RULE	<ol style="list-style-type: none"> Increases to expense accounts are recorded as debits. Debit Insurance Expense for \$125. Decreases to asset accounts are recorded as credits. Credit Prepaid Insurance for \$125.



T ACCOUNTS

6. Insurance Expense		Prepaid Insurance	
Debit +	Credit -	Debit +	Credit -
125			125

	ACCT. NO.	ACCOUNT NAME	TRIAL BALANCE		ADJUSTMENTS	
			DEBIT	CREDIT	DEBIT	CREDIT
1	101	Cash in Bank	15 179 00			
2	115	Accounts Receivable	10 404 00			
3	125	Merchandise Inventory	84 921 00			(a) 3 536 00
4	130	Supplies	5 549 00			(b) 3 710 00
5	135	Prepaid Insurance	1 500 00			(c) 125 00
6	140	Delivery Equipment	19 831 00			
7	145	Office Equipment	9 825 00			
8	150	Store Equipment	5 200 00			
9	201	Accounts Payable		13 850 00		
10	204	Fed. Corp. Inc. Tax Payable				(d) 155 00
11	205	Employees' Fed. Inc. Tax Pay.		6 400 00		
12	211	Employees' State Inc. Tax Pay.		800 00		
13	212	Social Security Tax Payable		248 00		
14	213	Medicare Tax Payable		580 00		
15	214	Fed. Unemployment Tax Payable		183 60		
16	215	State Unemployment Tax Payable		1 147 30		
17	220	Sales Tax Payable		2 428 00		
18	301	Capital Stock		75 000 00		
19	305	Retained Earnings		19 771 19		
20	310	Income Summary			(a) 3 536 00	
21	401	Sales		320 450 00		
22	405	Sales Discounts	730 00			
23	410	Sales Returns and Allowances	2 000 00			
24	501	Purchases	206 700 00			
25	505	Transportation In	4 036 18			
26	510	Purchases Discounts		1 340 00		
27	515	Purchases Returns and Allowances		1 800 00		
28	601	Advertising Expense	2 450 00			
29	605	Bankcard Fees Expense	4 199 27			
30	630	Fed. Corp. Income Tax Expense	9 840 00		(d) 155 00	
31	635	Insurance Expense			(c) 125 00	
32	650	Maintenance Expense	3 519 25			
33	655	Miscellaneous Expense	348 28			
34	657	Payroll Tax Expense	3 826 83			
35	660	Rent Expense	14 000 00			
36	665	Salaries Expense	29 374 60			
37	670	Supplies Expense			(b) 3 710 00	
38	680	Utilities Expense	2 364 87			
39			435 798 28	435 798 28	7 526 00	7 526 00
40						

Figure 18–3
Recording the
Adjustments on the
Work Sheet

The adjustment for **Prepaid Insurance** is shown in **Figure 18–3**. To enter the adjustment on the work sheet, follow these steps:

1. In the Adjustments Debit column, enter the debit amount of the adjustment on the Insurance Expense line. Since this is the third adjustment, label it (c).



- In the Adjustments Credit column, enter the credit amount of the adjustment on the Prepaid Insurance line. Label it (c) also.

Adjusting the Federal Corporate Income Tax Accounts

Why Does This Company Make an Adjustment for Income Tax?

On Your Mark is organized as a corporation. A corporation is considered to be a legal entity separate from its owners. On Your Mark owns assets, pays its own debts, and enters into legal contracts.

A corporation pays federal corporate income taxes on its net income. Many states and cities also tax corporate income. For now, we will discuss only federal corporate income taxes. A corporation's accountant estimates its federal corporate income taxes for the coming year and pays that amount to the federal government in quarterly installments. At the end of the year, the exact net income and the tax on that income are determined. If the corporation owes additional taxes, it pays them when it files its corporate income tax return.

At the beginning of the year, On Your Mark's accountant estimated that its federal corporate income taxes would be \$9,840. The business made quarterly payments of \$2,460 in March, June, September, and December. These payments were journalized as debits to **Federal Corporate Income Tax Expense** and credits to **Cash in Bank**.

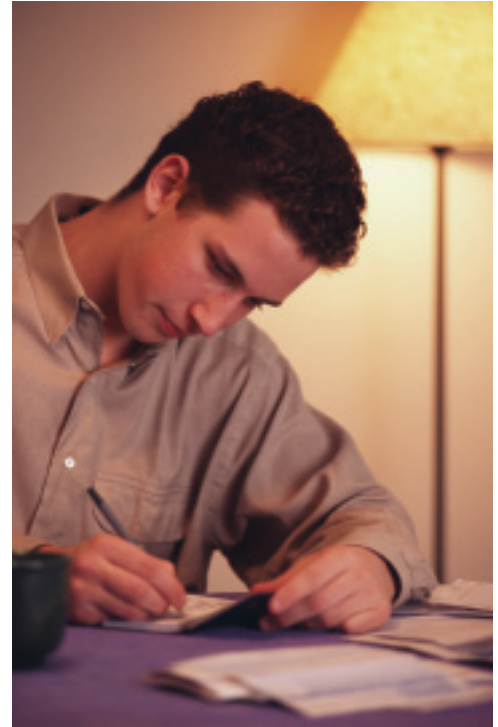
At the end of the year, On Your Mark's accountant determined that the federal corporate income tax for the year is \$9,995. On Your Mark has already paid \$9,840 ($2,460 \times 4$). Therefore the business owes an additional \$155 ($\$9,995 - \$9,840$).

To bring the accounting records up to date, **Federal Corporate Income Tax Expense** and **Federal Corporate Income Tax Payable** must both be increased by \$155. The following T accounts illustrate this adjustment.

Federal Corporate Income Tax Expense		Federal Corporate Income Tax Payable	
Debit	Credit	Debit	Credit
+	-	-	+
155			155

The adjustment for **Federal Corporate Income Tax Expense** is shown in **Figure 18-3**. Since this is the fourth adjustment, it is labeled (d).

After all adjustments have been entered, the Adjustments section of the work sheet is totaled and ruled. Each adjustment has an equal debit and credit, so the totals of the Adjustments Debit and Credit columns should be the same. When the Adjustments section has been proved, a double rule is drawn under the totals and across both columns, as shown in **Figure 18-3**.



AFTER
You READ**Reinforce the Main Idea**

Use a chart like this one to describe three adjustments discussed in Section 2. List the accounts to be debited and credited for each adjustment.

Description of Adjustment	Account Debited	Account Credited

**Do the Math**

You own a personal-training franchise called Your Body. You want to provide health insurance for your 10 employees. As you review the alternative plans, you have to make a decision based not only on affordability, but also on total benefits. Determine the total annual premium of each plan and decide which plan best fits your needs.

Type of plan	Plan #1	Plan #2	Plan #3
Monthly cost per employee	\$600	\$500	\$800
Co-pay for each employee	\$10	\$20	None

**Problem 18–2 Analyzing Adjustments**

Information related to accounts requiring adjustment on the work sheet for the year ended December 31 for Star City Resorts Corporation follows. Indicate in your working papers the amount of each adjustment, which account is debited, and which account is credited.

1. The Trial Balance section shows a balance of \$3,347.45 for **Supplies**. The amount of supplies actually on hand is \$892.75.
2. Star City paid an annual insurance premium of \$4,440 on November 1.
3. Star City made quarterly federal corporate income tax payments of \$945 each. Its actual tax, calculated at the end of the year, is \$3,885.

Completing the Work Sheet and Journalizing and Posting the Adjusting Entries

After the adjustments have been entered in the Adjustments section of the work sheet, proving that the accounts are still in balance is important. This is done by completing an *adjusted trial balance*. After proving the Adjusted Trial Balance section, the accountant can complete the work sheet.

Extending Work Sheet Balances

What Does Extending Balances Involve?

At this point the amounts for each account must be *extended to*, or carried over to, the Adjusted Trial Balance, the Income Statement, and the Balance Sheet sections.

Completing the Adjusted Trial Balance Section

The next step after entering all adjustments is to finish the Adjusted Trial Balance section. This work sheet section shows the updated balances of all general ledger accounts. To complete this section, the accountant combines the balance of each account in the Trial Balance section with the adjustment, if any, in the Adjustments section. The new balance is then entered in the appropriate Adjusted Trial Balance column.

Note the way new balances are computed in **Figure 18–4** on page 530. If there is no adjustment, the account balance shown in the Trial Balance section is simply extended to the same column (Debit or Credit) in the Adjusted Trial Balance section. The first two accounts, **Cash in Bank** and **Accounts Receivable**, have no adjustments, so those balances are extended to the Adjusted Trial Balance Debit column.

If the account balance in the Trial Balance section has an adjustment, the accountant calculates a new balance. The amount of the adjustment (from the Adjustments section) is added to or subtracted from the amount in the Trial Balance section. Add debits to debits; add credits to credits; subtract debits and credits.

The first account in the Trial Balance section to have an adjustment is **Merchandise Inventory**. As you know from Section 1, **Merchandise Inventory** has an unadjusted debit balance of \$84,921. Adjustment (a) is a credit of \$3,536. To calculate the new balance, the accountant subtracts the credit adjustment from the debit balance. The adjusted balance of \$81,385 ($\$84,921 - \$3,536$) is extended to the Adjusted Trial Balance Debit column.

BEFORE YOU READ

Main Idea

Adjustments affect the amount of net income (or net loss).

Read to Learn...

- ▶ how to complete the ten-column work sheet. (p. 529)
- ▶ how to journalize and post the adjusting entries. (p. 531)

Key Terms

adjusting entries

	ACCT. NO.	ACCOUNT NAME	TRIAL BALANCE		ADJUSTMENTS		ADJUSTED TRIAL BALANCE	
			DEBIT	CREDIT	DEBIT	CREDIT	DEBIT	CREDIT
1	101	Cash in Bank	15 179 00				15 179 00	
2	115	Accounts Receivable	10 404 00				10 404 00	
3	125	Merchandise Inventory	84 921 00			(a) 3 536 00	81 385 00	
4	130	Supplies	5 549 00			(b) 3 710 00	1 839 00	
5	135	Prepaid Insurance	1 500 00			(c) 125 00	1 375 00	
6	140	Delivery Equipment	19 831 00				19 831 00	
7	145	Office Equipment	9 825 00				9 825 00	
8	150	Store Equipment	5 200 00				5 200 00	
9	201	Accounts Payable		13 850 00				13 850 00
10	204	Fed. Corp. Inc. Tax Payable				(d) 155 00		155 00
11	205	Employees' Fed. Inc. Tax Pay.		64 000				64 000
12	211	Employees' State Inc. Tax Pay.		8 000				8 000
13	212	Social Security Tax Payable		248 00				248 00
14	213	Medicare Tax Payable		58 00				58 00
15	214	Fed. Unemployment Tax Payable		1836				1836
16	215	State Unemployment Tax Payable		11473				11473
17	220	Sales Tax Payable		2 428 00				2 428 00
18	301	Capital Stock		75 000 00				75 000 00
19	305	Retained Earnings		19 771 19				19 771 19
20	310	Income Summary			(a) 3 536 00		3 536 00	
21	401	Sales		320 450 00				320 450 00
22	405	Sales Discounts	73 000				73 000	
23	410	Sales Returns and Allowances	2 000 00				2 000 00	
24	501	Purchases	206 700 00				206 700 00	
25	505	Transportation In	4 036 18				4 036 18	
26	510	Purchases Discounts		1 340 00				1 340 00
27	515	Purchases Returns and Allowances		1 800 00				1 800 00
28	601	Advertising Expense	2 450 00				2 450 00	
29	605	Bankcard Fees Expense	4 199 27				4 199 27	
30	630	Fed. Corp. Income Tax Expense	9 840 00		(d) 155 00		9 995 00	
31	635	Insurance Expense			(c) 125 00		125 00	
32	650	Maintenance Expense	3 519 25				3 519 25	
33	655	Miscellaneous Expense	348 28				348 28	
34	657	Payroll Tax Expense	3 826 83				3 826 83	
35	660	Rent Expense	14 000 00				14 000 00	
36	665	Salaries Expense	29 374 60				29 374 60	
37	670	Supplies Expense			(b) 3 710 00		3 710 00	
38	680	Utilities Expense	2 364 87				2 364 87	
39			435 798 28	435 798 28	7 526 00	7 526 00	435 953 28	435 953 28
40								

Figure 18–4 Extending Balances to the Adjusted Trial Balance Section of the Work Sheet

The adjusted balances for **Supplies**, **Prepaid Insurance**, and **Federal Corporate Income Tax Expense** are calculated in the same way.

If an account has a zero balance in the Trial Balance section, the amount listed in the Adjustments section is extended to the Adjusted Trial Balance section. **Federal Corporate Income Tax Payable**, for example, has a zero balance in the Trial Balance section. Adjustment (d) is a credit of \$155. This amount is extended to the Adjusted Trial Balance Credit column.

After extending all account balances to the Adjusted Trial Balance section, the accountant totals both columns. If total debits equal total credits, this section has been proved. The accountant then draws a double



rule under the totals and across both columns. If total debits do not equal total credits, an error exists. To find it, re-add each column. If the error still exists, ensure that the Trial Balance and Adjustment amounts were extended properly to the Adjusted Trial Balance section.

Extending Amounts to the Balance Sheet and Income Statement Sections

Beginning with line 1, each account balance in the Adjusted Trial Balance section is extended to the appropriate column of either the Balance Sheet or the Income Statement section. See these extensions in **Figure 18–5** on pages 532 and 533.

The Income Statement section contains the balances of all temporary accounts. You will find the **Income Summary** and all revenue, cost of merchandise, and expense accounts in this section.

The Balance Sheet section contains the balances of all permanent accounts. In that section you will find all asset, liability, and capital accounts (**Capital Stock** and **Retained Earnings**).

Completing the Work Sheet

After all amounts have been extended to the Balance Sheet and Income Statement sections, the accountant draws a *single* rule across the columns in these sections and totals all four columns (see **Figure 18–5**). Notice that the words *Net Income* have been written in the Account Name column on the same line as the net income amount.

As you learned in Chapter 8, the totals of the debit and credit columns within the Balance Sheet and Income Statement sections are not equal at this point. The difference between the two column totals in each section is the amount of net income (or net loss) for the period. After the net income (or net loss) has been recorded, the columns in the Balance Sheet and Income Statement sections are ruled and totaled as shown in **Figure 18–5**.

If the totals of the two Income Statement columns are equal, and the totals of the two Balance Sheet columns are equal, a double rule is drawn across all four columns. The double rule indicates that these sections of the work sheet have been proved.

Journalizing and Posting Adjusting Entries

How Do You Journalize and Post Adjusting Entries?

The journal entries that update the general ledger accounts at the end of a period are called **adjusting entries**. The Adjustments section of the work sheet is the source of information for journalizing the adjusting entries. The accounts debited and credited in the Adjustments section are entered in the general journal.

Journalizing Adjustments

Before recording the first adjusting entry, the accountant writes the words *Adjusting Entries* in the Description column of the general journal.



On Your Mark
Work
For Year Ended

	ACCT. NO.	ACCOUNT NAME	TRIAL BALANCE		ADJUSTMENTS	
			DEBIT	CREDIT	DEBIT	CREDIT
1	101	Cash in Bank	15 179 00			
2	115	Accounts Receivable	10 404 00			
3	125	Merchandise Inventory	84 921 00			(a) 3 536 00
4	130	Supplies	5 549 00			(b) 3 710 00
5	135	Prepaid Insurance	1 500 00			(c) 125 00
6	140	Delivery Equipment	19 831 00			
7	145	Office Equipment	9 825 00			
8	150	Store Equipment	5 200 00			
9	201	Accounts Payable		13 850 00		
10	204	Fed. Corp. Inc. Tax Payable				(d) 155 00
11	205	Employees' Fed. Inc. Tax Pay.		640 00		
12	211	Employees' State Inc. Tax Pay.		80 00		
13	212	Social Security Tax Payable		248 00		
14	213	Medicare Tax Payable		58 00		
15	214	Fed. Unemployment Tax Payable		1836		
16	215	State Unemployment Tax Payable		11473		
17	220	Sales Tax Payable		2 428 00		
18	301	Capital Stock		75 000 00		
19	305	Retained Earnings		19 771 19		
20	310	Income Summary			(a) 3 536 00	
21	401	Sales		320 450 00		
22	405	Sales Discounts	730 00			
23	410	Sales Returns and Allowances	2 000 00			
24	501	Purchases	206 700 00			
25	505	Transportation In	4 036 18			
26	510	Purchases Discounts		1 340 00		
27	515	Purchases Returns and Allowances		1 800 00		
28	601	Advertising Expense	2 450 00			
29	605	Bankcard Fees Expense	4 199 27			
30	630	Fed. Corp. Income Tax Expense	9 840 00		(d) 155 00	
31	635	Insurance Expense			(c) 125 00	
32	650	Maintenance Expense	3 519 25			
33	655	Miscellaneous Expense	348 28			
34	657	Payroll Tax Expense	3 826 83			
35	660	Rent Expense	14 000 00			
36	665	Salaries Expense	29 374 60			
37	670	Supplies Expense			(b) 3 710 00	
38	680	Utilities Expense	2 364 87			
39			435 798 28	435 798 28	7 526 00	7 526 00
40		Net Income				
41						
42						
43						

Figure 18–5 On Your Mark Athletic Wear Completed Work Sheet

Writing this heading eliminates the need for an explanation to be written after each adjusting entry.

The following entries are recorded in the Adjustments columns of the work sheet:



Athletic Wear

Sheet

December 31, 20--

ADJUSTED TRIAL BALANCE		INCOME STATEMENT		BALANCE SHEET		
DEBIT	CREDIT	DEBIT	CREDIT	DEBIT	CREDIT	
15 179 00				15 179 00		1
10 404 00				10 404 00		2
81 385 00				81 385 00		3
1 839 00				1 839 00		4
1 375 00				1 375 00		5
19 831 00				19 831 00		6
9 825 00				9 825 00		7
5 200 00				5 200 00		8
	13 850 00				13 850 00	9
	1 550 00				1 550 00	10
	6 400 00				6 400 00	11
	8 000 00				8 000 00	12
	2 480 00				2 480 00	13
	5 800 00				5 800 00	14
	1 836 00				1 836 00	15
	11 473 00				11 473 00	16
	2 428 00				2 428 00	17
	75 000 00				75 000 00	18
	19 771 19				19 771 19	19
3 536 00		3 536 00				20
	320 450 00		320 450 00			21
73 000		73 000				22
2 000 00		2 000 00				23
206 700 00		206 700 00				24
4 036 18		4 036 18				25
	1 340 00		1 340 00			26
	1 800 00		1 800 00			27
2 450 00		2 450 00				28
4 199 27		4 199 27				29
9 995 00		9 995 00				30
1 250 00		1 250 00				31
3 519 25		3 519 25				32
348 28		348 28				33
3 826 83		3 826 83				34
14 000 00		14 000 00				35
29 374 60		29 374 60				36
3 710 00		3 710 00				37
2 364 87		2 364 87				38
435 953 28	435 953 28	290 915 28	323 590 00	145 038 00	112 363 28	39
		32 674 72			32 674 72	40
		323 590 00	323 590 00	145 038 00	145 038 00	41
						42
						43

Figure 18-5 On Your Mark Athletic Wear Completed Work Sheet (continued)

- (a) adjusting merchandise inventory
- (b) adjusting supplies
- (c) adjusting insurance
- (d) adjusting income tax



GENERAL JOURNAL										PAGE	22
	DATE	DESCRIPTION	POST. REF.	DEBIT			CREDIT				
1	20--	<i>Adjusting Entries</i>								1	
2	Dec. 31	<i>Income Summary</i>		3	5	3	6	00		2	
3		<i>Merchandise Inventory</i>							3	3	
4	31	<i>Supplies Expense</i>		3	7	1	0	00		4	
5		<i>Supplies</i>							3	5	
6	31	<i>Insurance Expense</i>		1	2	5	00			6	
7		<i>Prepaid Insurance</i>							1	7	
8	31	<i>Fed. Corporate Income Tax Exp.</i>		1	5	5	00			8	
9		<i>Fed. Corp. Income Tax Pay.</i>							1	9	
10										10	

Figure 18–6 Recording Adjusting Entries in the General Journal

The first adjustment, which was labeled (a) on the work sheet, is recorded in the general journal in **Figure 18–6** as a debit to **Income Summary** for \$3,536 and a credit to **Merchandise Inventory** for \$3,536. The label (a) is not recorded in the general journal.

Remaining adjustments are entered in the general journal in the same manner, with the debit part of the entry recorded first. The date for each adjusting entry is the last day of the period.

Posting Adjusting Entries to the General Ledger

After the adjusting entries have been recorded in the general journal, the accountant posts them to the general ledger accounts. Once the adjusting entries have been posted, the general ledger accounts are up to date. The balances in the general ledger accounts all agree with the amounts entered on the Income Statement and Balance Sheet sections of the work sheet.

Posting these entries accomplishes the following:

- The **Supplies Expense** account has been “charged” with the value of the supplies used in the period.
- The **Supplies** account reflects only the amount of items still remaining in inventory.
- The **Merchandise Inventory** account reflects the correct inventory value.
- The **Income Summary** account has been “charged” with the cost of goods sold for the period.
- The **Insurance Expense** account reflects the appropriate insurance expense for the period.
- The **Prepaid Insurance** account has been reduced by the amount of insurance expired.
- The **Federal Corporate Income Tax Payable** account has been increased to reflect the appropriate payable amount.
- The **Federal Corporate Income Tax Expense** account reflects the tax expense for the period.



Figure 18–7 shows the general journal and the general ledger accounts after the posting of the adjusting entries has been completed. Notice that the words *Adjusting Entry* have been written in the Description column of the general ledger accounts.

GENERAL JOURNAL							PAGE 22
	DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT		
1	20--	Adjusting Entries				1	
2	Dec. 31	Income Summary	310	3 5 3 6 00		2	
3		Merchandise Inventory	125		3 5 3 6 00	3	
4		Supplies Expense	670	3 7 1 0 00		4	
5		Supplies	130		3 7 1 0 00	5	
6		Insurance Expense	635	1 2 5 00		6	
7		Prepaid Insurance	135		1 2 5 00	7	
8		Fed. Corporate Income Tax Exp.	630	1 5 5 00		8	
9		Fed. Corp. Income Tax Pay.	204		1 5 5 00	9	
10						10	
11						11	

ACCOUNT Merchandise Inventory				ACCOUNT NO. 125			
DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT	BALANCE		
					DEBIT	CREDIT	
20--							
Jan. 1	Balance	✓			84 9 2 1 00		
Dec. 31	Adjusting Entry	G22		3 5 3 6 00	81 3 8 5 00		

ACCOUNT Supplies				ACCOUNT NO. 130			
DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT	BALANCE		
					DEBIT	CREDIT	
20--							
Dec. 1	Balance	✓			5 2 9 9 00		
15		P12	2 5 0 00		5 5 4 9 00		
31	Adjusting Entry	G22		3 7 1 0 00	1 8 3 9 00		

ACCOUNT Prepaid Insurance				ACCOUNT NO. 135			
DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT	BALANCE		
					DEBIT	CREDIT	
20--							
Dec. 17		CP14	1 5 0 0 00		1 5 0 0 00		
31	Adjusting Entry	G22		1 2 5 00	1 3 7 5 00		

Figure 18–7 Adjusting Entries Posted to the General Ledger



ACCOUNT <i>Federal Corporate Income Tax Payable</i>			ACCOUNT NO. <u>204</u>			
DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT	BALANCE	
					DEBIT	CREDIT
20--						
Dec. 31	Adjusting Entry	G22		1 5 5 00		1 5 5 00

ACCOUNT <i>Income Summary</i>			ACCOUNT NO. <u>310</u>			
DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT	BALANCE	
					DEBIT	CREDIT
20--						
Dec. 31	Adjusting Entry	G22	3 5 3 6 00		3 5 3 6 00	

ACCOUNT <i>Federal Corporate Income Tax Expense</i>			ACCOUNT NO. <u>630</u>			
DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT	BALANCE	
					DEBIT	CREDIT
20--						
Dec. 1	Balance	✓			9 8 4 0 00	
Dec. 31	Adjusting Entry	G22	1 5 5 00		9 9 9 5 00	

ACCOUNT <i>Insurance Expense</i>			ACCOUNT NO. <u>635</u>			
DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT	BALANCE	
					DEBIT	CREDIT
20--						
Dec. 31	Adjusting Entry	G22	1 2 5 00		1 2 5 00	

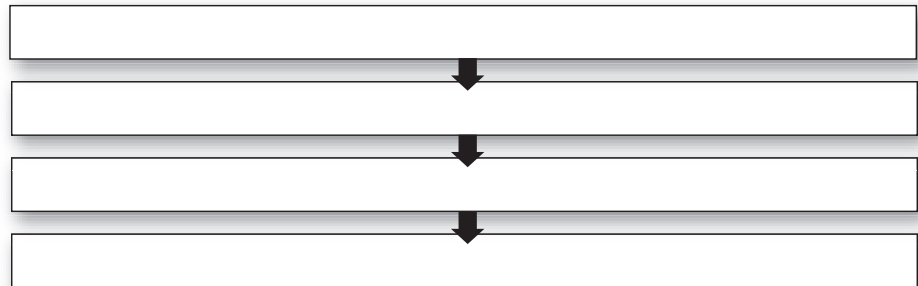
ACCOUNT <i>Supplies Expense</i>			ACCOUNT NO. <u>670</u>			
DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT	BALANCE	
					DEBIT	CREDIT
20--						
Dec. 31	Adjusting Entry	G22	3 7 1 0 00		3 7 1 0 00	

Figure 18-7 Adjusting Entries Posted to the General Ledger (continued)



AFTER
You READ**Reinforce the Main Idea**

Use a diagram like this one to describe the process of updating the general ledger accounts.

Updating the General Ledger Accounts**Do the Math**

The following column totals appear in the Balance Sheet section of the work sheet for Tonya's Toys on December 31.

Debit column	\$317,290
Credit column	\$323,730

Calculate the net income or net loss for the period.

**Problem 18-3 Analyzing the Work Sheet**

Refer to **Figure 18-5** and answer the following questions in your working papers:

1. What amount is extended to the Income Statement section for **Federal Corporate Income Tax Expense**?
2. To which section of the work sheet is the balance of **Prepaid Insurance** extended?
3. What is the total amount of supplies consumed during the period?
4. What is the total amount still owed to the federal government for corporate income tax?

**Problem 18-4 Analyzing a Source Document**

Answer these questions, based on the debit memorandum shown here.

1. Which company is returning the merchandise?
2. How many items are being returned?
3. What amount is entered in the journal entry?
4. Which account is debited?
5. Which account is credited?

Quantity		Item	Unit Price	Total
4		Locking Fixture #27304-78	\$ 36.95	\$ 147.80
2		Mirror/Reflectors #8935-231	11.24	22.48
		Subtotal		\$ 170.28
		Tax		6.81
		Total		\$ 177.09

Key Concepts

- The ten-column work sheet contains Debit and Credit columns for these five sections:
 - Trial Balance—includes all general ledger accounts, even those with zero balances.
 - Adjustments—records the adjustments made at the end of the period to bring various account balances up to date.
 - Adjusted Trial Balance—shows the updated balances of all general ledger accounts.
 - Income Statement—contains the balances of all temporary accounts, including **Income Summary** and revenue, cost of merchandise, and expense accounts.
 - Balance Sheet—contains the balances of all permanent accounts, including assets, liabilities, and stockholders' equity.
- To prepare the Trial Balance section, enter the number and name of each account in the general ledger in the appropriate columns in the order that they appear in the general ledger:
 - Asset
 - Liability
 - Stockholders' Equity
 - Revenue
 - Cost of Merchandise
 - Expense

An *adjustment* is an amount that is added to or subtracted from an account balance to bring that balance up to date.

- Adjustments reflect changes in account balances caused by the internal operations of the business or the passage of time.
 - Adjustments are made to match revenue with the expenses incurred to earn it.
 - Every adjustment affects one permanent and one temporary general ledger account.
 - Adjustments are recorded in the Adjustments section of the work sheet.
- A general ledger account needs to be adjusted if the balance shown is not up to date *as of the last day of the period*.
 - Common adjusting entries and the information needed to calculate them:

Adjustment	Information Needed
Merchandise Inventory	<ul style="list-style-type: none"> Merchandise Inventory account balance Physical inventory amount
Supplies	<ul style="list-style-type: none"> Supplies account balance Cost of supplies on hand
Prepaid Insurance	<ul style="list-style-type: none"> Expired portion of insurance coverage
Federal Corporate Income Tax	<ul style="list-style-type: none"> Federal Corporate Income Tax Expense account balance (estimated quarterly payments) Federal corporate income tax based on exact income

5. A work sheet is prepared
- to organize all of the data needed to update the accounts
 - to prepare the financial statements
 - to record end-of-period adjusting entries and closing entries

The completed work sheet lists all general ledger accounts and their updated balances and shows the net income (or net loss) for the period.

To prepare a ten-column work sheet:

- Complete the Trial Balance section. Enter the account numbers, names and balances for all general ledger accounts. Total, prove, and rule the section.
 - Calculate the adjustments needed and enter them in the Adjustments section.
 - Complete the Adjusted Trial Balance section. For each account, combine the Trial Balance section amount with the Adjustment section amount and enter the total in the Adjusted Trial Balance section.
 - Add debits to debits
 - Add credits to credits
 - Subtract debits and credits
 - Total, prove, and rule the Adjustments and Adjusted Trial Balance sections.
 - Extend the amounts in the Adjusted Trial Balance section to the appropriate columns in the Balance Sheet and Income Statement sections.
 - Complete the work sheet. Calculate the net income (or net loss) and enter it in the appropriate columns in the Income Statement and Balance Sheet sections. Total, prove, and rule the Income Statement and Balance Sheet sections.
6. The adjustments entered on the work sheet must be recorded in the general journal. The source of information for journalizing adjustments is the Adjustments section of the work sheet. *Adjusting Entries* is written in the Description column immediately above the first adjusting entry, eliminating the need to write an explanation after each entry. The debit part of the entry is recorded first. The date for each adjusting entry is the last day of the period.

Key Terms

adjusting entries	(p. 531)	ending inventory	(p. 521)
adjustment	(p. 520)	physical inventory	(p. 521)
beginning inventory	(p. 521)	prepaid expense	(p. 525)

AFTER
YOU READ**Check Your Understanding**

1. **Components of the Ten-Column Work Sheet**
 - a. What are the five sections of the ten-column work sheet?
 - b. What sections does the ten-column work sheet contain that the six-column work sheet does not?
2. **Trial Balance and Period-End Adjustments**
 - a. What is the purpose of preparing a trial balance?
 - b. What is an adjustment?
3. **Adjusted General Ledger Accounts**
 - a. Why must some general ledger accounts be updated at the end of the period?
 - b. What is the step to follow after adjusting entries have been recorded in the general journal?
4. **Adjustment Calculation**
 - a. How is the amount of merchandise on hand determined at the end of a period?
 - b. After the physical inventory is taken, what happens to the **Merchandise Inventory** account?
5. **Completion of the Ten-Column Work Sheet**
 - a. Which accounts are included on the Balance Sheet section of the work sheet?
 - b. Which accounts are included on the Income Statement section of the work sheet?
6. **Adjustments**
 - a. What is an *adjusting entry*?
 - b. What is the source of information for journalizing adjusting entries?

Apply Key Terms

As the accounting manager for several Homemade Fresh Ice Cream stores in your region, you oversee the preparation of end-of-period financial statements. Before you complete your end-of-period reports, you need your staff to verify their work sheets and trial balances. Write a memorandum to the staff to remind them to verify their data, make adjustments where needed, give beginning and ending inventory figures, and complete a physical inventory. In the body of your memorandum, provide a brief definition of each term.



adjusting entries
adjustment
beginning inventory

ending inventory
physical inventory
prepaid expense

Adjusting Entries

Making the Transition from a Manual to a Computerized System

Task	Manual Methods	Computerized Methods
Recording adjusting entries	<ul style="list-style-type: none"> From the general ledger, prepare a trial balance in the first two columns of a work sheet. Record adjustments on the work sheet. Calculate adjusted account balances in the Adjusted Trial Balance columns. Extend account balances to Income Statement or Balance Sheet columns in the work sheet. Calculate net income (loss) for the accounting period. Record adjusting entries in the general journal. Post adjusting entries to general ledger accounts. 	<ul style="list-style-type: none"> Print a Trial Balance. Record the adjusting entries in the general journal. General ledger accounts are automatically updated.

Peachtree® Q & A

Peachtree Question	Answer
How do I generate a trial balance for use in preparing adjustments?	<ol style="list-style-type: none"> From the <i>Reports</i> menu, select General Ledger. From the Report list, select Working Trial Balance. Click the Print button.
How do I journalize the adjusting entries?	<ol style="list-style-type: none"> List necessary adjustments on the Working Trial Balance form. From the <i>Tasks</i> menu, select General Journal Entry. Enter the adjusting entries. Click Save.

QuickBooks Q & A

QuickBooks Question	Answer
How do I generate a trial balance for use in preparing adjustments?	<ol style="list-style-type: none"> From the <i>Reports</i> menu, select Accountant & Taxes. From the Accountant & Taxes submenu, select Trial Balance. Click the Print button.
How do I journalize the adjusting entries?	<ol style="list-style-type: none"> Use the Trial Balance to help you prepare the adjusting entries. From the <i>Company</i> menu, select Make General Journal Entries. Enter the adjusting entries. Click Save & Close.

For detailed instructions, see your Glencoe Accounting Chapter Study Guides and Working Papers.

Complete problems using:

Manual Glencoe
Working Papers

OR

Peachtree Complete
Accounting Software

OR

QuickBooks
Templates

OR

Spreadsheet
Templates

SPREADSHEET SMART GUIDE

Step-by-Step Instructions: Problem 18-5

1. Select the spreadsheet template for Problem 18-5.
2. Enter your name and the date in the spaces provided on the template.
3. Complete the spreadsheet using the instructions in your working papers.
4. Print the spreadsheet and proof your work.
5. Complete the Analyze activity.
6. Save your work and exit the spreadsheet program.

Problem 18-5 Completing a Ten-Column Work Sheet

The August 31 trial balance for InBeat CD Shop is entered on the work sheet in your working papers. Listed below is the data needed to make the adjustments.

Instructions In your working papers, complete the ten-column work sheet for InBeat CD Shop for the month ended August 31.

Data for Adjustments

Merchandise Inventory, August 31	\$ 77,872
Supplies consumed during the period	2,171
Insurance premium expired during the period	489
Additional federal corporate income taxes owed	118

Analyze

After the adjustments are entered on the work sheet, assess which expense account has the highest balance.

Problem 18-6 Completing a Ten-Column Work Sheet

The August 31 trial balance for Shutterbug Cameras is listed on the next page. Also listed is the data needed for the adjustments.

Instructions In your working papers, complete the ten-column work sheet for Shutterbug Cameras for the month ended August 31.

Problems

CHAPTER 18

Peachtree®

SMART GUIDE

Step-by-Step Instructions: Problem 18-6

1. Select the problem set for Shutterbug Cameras (Prob. 18-6).
2. Rename the company and set the system date.
3. Print a Working Trial Balance and use it to help you prepare the adjustments.
4. Record the adjustments using the **General Journal Entry** option.
5. Print a General Journal report and proof your work.
6. Print a General Ledger Trial Balance report.
7. Complete the Analyze activity.
8. End the session.

TIP: Use the **Inventory Adjustment** account, not the **Income Summary** account, to record the adjustment for **Merchandise Inventory**.

		Trial Balance	
		Debit	Credit
101	Cash in Bank	\$13,873	
115	Accounts Receivable	5,382	
125	Merchandise Inventory	82,981	
130	Supplies	2,397	
135	Prepaid Insurance	1,350	
140	Store Equipment	30,769	
201	Accounts Payable		\$ 8,481
207	Federal Corporate Income Tax Payable		—
210	Employees' Federal Income Tax Payable		194
211	Employees' State Income Tax Payable		48
212	Social Security Tax Payable		119
213	Medicare Tax Payable		25
215	Sales Tax Payable		381
216	Federal Unemployment Tax Payable		19
217	State Unemployment Tax Payable		92
301	Capital Stock		80,000
305	Retained Earnings		28,568
310	Income Summary	—	—
401	Sales		95,487
405	Sales Discounts	37	
410	Sales Returns and Allowances	945	
501	Purchases	39,491	
505	Transportation In	2,039	
510	Purchases Discounts		656
515	Purchases Returns and Allowances		219
601	Advertising Expense	128	
605	Bankcard Fees Expense	219	
620	Federal Corporate Income Tax Expense	1,580	
630	Insurance Expense	—	
640	Maintenance Expense	2,513	
645	Miscellaneous Expense	652	
647	Payroll Tax Expense	1,953	
650	Rent Expense	9,000	
655	Salaries Expense	18,631	
660	Supplies Expense	—	
670	Utilities Expense	349	

Data for Adjustments

Merchandise Inventory, August 31	\$78,672
Supplies on hand, August 31	389
Insurance premium expired during the period	490
Additional federal income taxes owed	252

Analyze

Identify which account in the Balance Sheet section, **Accounts Payable** or **Accounts Receivable**, has the higher balance.



Peachtree®

SMART GUIDE

Step-by-Step Instructions: Problem 18-7

1. Select the problem set for Cycle Tech Bicycles (Prob. 18-7).
2. Rename the company and set the system date.
3. Print a Working Trial Balance and use it to help you prepare the adjustments.
4. Record the adjustments using the **General Journal Entry** option.
5. Print a General Journal report and proof your work.
6. Print a General Ledger Trial Balance report.
7. Complete the Analyze activity.
8. End the session.

QuickBooks

PROBLEM GUIDE

Step-by-Step Instructions: Problem 18-7

1. Restore the Problem 18-7.QBB file.
2. Print a Trial Balance and use it to help you prepare the adjustments.
3. Record the adjustments using the **Make General Journal Entries** option.
4. Print a Journal report and proof your work.
5. Print a Trial Balance.
6. Complete the Analyze activity.
7. Back up your work.

Problem 18-7 Completing a Ten-Column Work Sheet

The balances of the general ledger accounts of Cycle Tech Bicycles, as of August 31, are listed below. Also listed is the data needed for the adjustments.

Instructions In your working papers:

Prepare a ten-column work sheet for Cycle Tech Bicycles for the month ended August 31.

101 Cash in Bank	\$ 22,323
115 Accounts Receivable	1,737
125 Merchandise Inventory	23,654
130 Supplies	3,971
135 Prepaid Insurance	1,800
140 Store Equipment	25,395
145 Office Equipment	15,239
201 Accounts Payable	11,051
210 Federal Corporate Income Tax Payable	—
211 Employees' Federal Income Tax Payable	519
212 Employees' State Income Tax Payable	142
213 Social Security Tax Payable	408
214 Medicare Tax Payable	137
215 Sales Tax Payable	1,871
216 Federal Unemployment Tax Payable	51
217 State Unemployment Tax Payable	263
301 Capital Stock	40,000
305 Retained Earnings	14,908
310 Income Summary	—
401 Sales	128,231
405 Sales Discounts	214
410 Sales Returns and Allowances	1,289
501 Purchases	67,118
505 Transportation In	1,172
510 Purchases Discounts	810
515 Purchases Returns and Allowances	322
601 Advertising Expense	2,938
605 Bankcard Fees Expense	185
625 Federal Corporate Income Tax Expense	3,650
630 Insurance Expense	—
645 Maintenance Expense	2,450
650 Miscellaneous Expense	3,929
655 Payroll Tax Expense	834
657 Rent Expense	10,750
660 Salaries Expense	4,670
665 Supplies Expense	—
675 Utilities Expense	5,395

SMART GUIDE

Step-by-Step Instructions: Problem 18–8

1. Select the problem set for River's Edge Canoe & Kayak (Prob. 18–8).
2. Rename the company and set the system date.
3. Print a Working Trial Balance and use it to help you prepare the adjustments.
4. Record the adjustments using the **General Journal Entry** option.
5. Print a General Journal report and proof your work.
6. Print a General Ledger report.
7. Print a General Ledger Trial Balance report.
8. Complete the Analyze activity.
9. End the session.

TIP: Enter the adjustments as one multipart entry to save time.

QuickBooks

PROBLEM GUIDE

Step-by-Step Instructions: Problem 18–8

1. Restore the Problem 18-8.QBB file.
2. Print a Trial Balance and use it to help you prepare the adjustments.
3. Record the adjustments using the **Make General Journal Entries** option.
4. Print a Journal report and proof your work.
5. Print a General Ledger report.
6. Print a Trial Balance report.
7. Complete the Analyze activity.
8. Back up your work.

Data for Adjustments

Ending merchandise inventory	\$ 24,188
Ending supplies inventory	1,049
Insurance premium expired	675
Federal income tax expense for the month	3,827

Analyze

Determine which section of the work sheet, the Trial Balance section or the Balance Sheet section, had the higher balance for Merchandise Inventory.

Problem 18–8 Completing a Ten-Column Work Sheet

The balances of the general ledger accounts of River's Edge Canoe & Kayak, as of August 31, are listed below.

Instructions In your working papers:

1. Prepare a ten-column work sheet for River's Edge Canoe & Kayak for the month ended August 31. The account names are entered on the work sheet. The data for the adjustments follows:
 - (a) The cost of the ending merchandise inventory is \$45,669.
 - (b) The cost of the supplies on hand on August 31 is \$619.
 - (c) The one-year insurance premium of \$1,680 was paid on April 1.
 - (d) The total federal income taxes owed for the year are \$2,635.
2. Enter the journal entries for the adjustments on page 31 of the general journal.
3. Post the journal entries to the general ledger accounts.

101 Cash in Bank	\$ 15,387
115 Accounts Receivable	2,852
130 Merchandise Inventory	49,205
135 Supplies	3,027
140 Prepaid Insurance	1,680
145 Delivery Equipment	19,437
150 Store Equipment	29,504
201 Accounts Payable	13,339
204 Federal Corporate Income Tax Payable	—
210 Employees' Federal Income Tax Payable	632
211 Employees' State Income Tax Payable	117
212 Social Security Tax Payable	472
213 Medicare Tax Payable	108
215 Sales Tax Payable	2,931
216 Federal Unemployment Tax Payable	77
217 State Unemployment Tax Payable	315
219 U.S. Savings Bonds Payable	150
301 Capital Stock	50,000
305 Retained Earnings	25,425
310 Income Summary	—

CONTINUE

401	Sales	144,945
405	Sales Discounts	203
410	Sales Returns and Allowances	1,381
501	Purchases	79,310
505	Transportation In	1,192
510	Purchases Discounts	1,292
515	Purchases Returns and Allowances	576
601	Advertising Expense	3,151
605	Bankcard Fees Expense	288
625	Federal Corporate Income Tax Expense	2,480
635	Insurance Expense	—
650	Maintenance Expense	1,381
655	Miscellaneous Expense	3,772
658	Payroll Tax Expense	1,219
660	Rent Expense	10,350
665	Salaries Expense	11,965
670	Supplies Expense	—
680	Utilities Expense	2,595

Analyze

Calculate River's Edge net income (net loss) if it had *not* taken any purchases discounts for paying creditors within the discount period.



Problem 18–9 Locating Errors on the Work Sheet

The Trial Balance and adjustment sections for Buzz Newsstand have been prepared in your working papers. It is apparent from the totals on the work sheet that errors have been made in preparing these portions of the work sheet.

The accounting records show:

1. The merchandise on hand at the end of the month is valued at \$12,950.
2. The supplies on hand on August 31 are valued at \$529.
3. The insurance premium was paid on August 1. The premium was \$980 and covers the period from August 1 to November 30.
4. The total federal income tax owed for the period is \$249.

Instructions In your working papers:

1. Find and correct the error(s) in the Trial Balance section.
2. On the line provided on the work sheet, write in the corrected totals for the Trial Balance section.
3. Find and correct the error(s) in the Adjustments section.
4. Write in the corrected totals for the Adjustments columns.

Analyze

Explain your calculations for the Merchandise Inventory adjustment.

Practice your test-taking skills! The questions on this page are reprinted with permission from national organizations:

- Future Business Leaders of America
- Business Professionals of America

Use a separate sheet of paper to record your answers.



Future Business Leaders of America

MULTIPLE CHOICE

1. Which of the following statements is incorrect concerning an adjusted trial balance?
 - a. An adjusted trial balance lists account balances and their locations in the ledger.
 - b. An adjusted trial balance shows proper balance sheet and income statement amounts.
 - c. An adjusted trial balance is prepared before the adjusting entries have been journalized and posted.
 - d. An adjusted trial balance can be used to prepare the financial statements.
 - e. All of the above are true statements.
2. A store purchased a one-year insurance policy for \$1,800 on September 1. Its fiscal period ended December 31. What is the amount of the adjustment and what accounts are debited and credited on December 31?
 - a. \$1,800; insurance expense and prepaid insurance
 - b. \$600; insurance expense and prepaid insurance
 - c. \$1,200; insurance expense and prepaid insurance
 - d. \$600; prepaid insurance and insurance expense
3. The Income Summary amount in a work sheet's Adjustments Debit column represents the
 - a. decrease in Merchandise Inventory.
 - b. increase in Merchandise Inventory.
 - c. beginning Merchandise Inventory.
 - d. ending Merchandise Inventory.



Business Professionals of America

MULTIPLE CHOICE

4. The ending balance of the Supplies account appears
 - a. in the Trial Balance columns of the work sheet.
 - b. in the Balance Sheet columns of the work sheet.
 - c. in the Income Statement columns of the work sheet.
 - d. on the statement of changes in owner's equity.
5. What entries are recorded at the end of the fiscal period to update general ledger accounts?
 - a. Closing
 - b. Adjusting
 - c. Post-closing
 - d. Reversing

Need More Help?

Go to glencoeaccounting.glencoe.com and click on **Student Center**. Click on **Winning Competitive Events** and select **Chapter 18**.

- Practice Questions and Test-Taking Tips
- Concept Capsules and Terminology

CRITICAL Thinking

Adjustments and the Ten-Column Work Sheet

1. What is the term for the actual counting of merchandise on hand and available for sale at the end of the fiscal period?
2. Explain what *expensing an asset* means.
3. Compute the adjustment for **Supplies** if the business had \$3,000 in supplies at the beginning of the period, bought \$4,000 during the period, and estimated that it had used 60% of all supplies during the period.
4. Compare the **Federal Corporate Income Tax Expense** account with the **Federal Corporate Income Tax Payable** account. How are they different?
5. Explain where you could obtain the information needed to determine the amount of the insurance adjustment in the work sheet's Adjustments section.
6. Defend the concept that businesses cannot track supplies as they are used.

CASE STUDY

Merchandising Business: Training Videos

You are an accountant for EZ Training Systems. The company CEO has asked you to prepare financial statements without the appropriate adjusting entries.

INSTRUCTIONS Analyze this information for adjustments and complete the tasks.

	<u>Beginning</u>	<u>Ending</u>
Supplies	\$5,000	\$1,200
Prepaid Insurance	6,400	800

1. Net income before adjustments is \$22,400. Calculate net income after the adjustments have been made.
2. Explain why the financial statements do not present an accurate picture of the company without considering the adjusting entries.

a matter of ETHICS

Out-of-Date Goods

The local bakery where you work as an accounting clerk does not sell its day-old baked goods but allows employees to have them. One day a mother with three children who cannot afford fresh donuts asks to buy some day-old ones. You consider giving her several that are about to be thrown away.

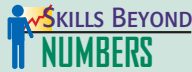
ETHICAL DECISION MAKING

1. What are the ethical issues?
2. What are the alternatives?
3. Who are the affected parties?
4. How do the alternatives affect the parties?
5. What would you do?

COMMUNICATING ACCOUNTING

Training New Employees

You are preparing a presentation for the board of directors of Kids-n-Teens. As you review the quarterly financial statements, you see that the new clerk extended the account balances from the Adjusted Trial Balance section to the Balance Sheet section but not to the Income Statement section. Select a classmate and practice an explanation of how to extend to both sections.



Leadership

You have just been promoted to Accounting Director for a national toy store chain. In reviewing the end-of-period financial reports, you see that net income was lower than in past periods. You believe a new line of toys could boost net income for the next period. Lee Rainwater, the Marketing Director, has been with the company for 25 years, and his decisions are rarely questioned.

INSTRUCTIONS Explain how you would approach Lee to discuss adding a new toy line.



Accounting for Inflation

If your money does not go as far as it used to, the cause is probably *inflation*. When there is a general increase in the cost of goods and services, inflation exists. Countries use different methods of accounting for inflation.

INSTRUCTIONS Explain why investors should know how inflation accounting is handled when reviewing financial statements.



Your Household Supplies

Your family probably handles its kitchen supplies the way a business handles its supplies. That is, a family member buys them as needed. No one tracks them. When the supply gets low, someone decides to buy more.

PERSONAL FINANCE ACTIVITY List supplies a family might purchase weekly, monthly, and once or twice a year. Identify the group with the most items and methods to determine when to reorder items.

PERSONAL FINANCE ONLINE Log on to glencoeaccounting.glencoe.com and click on **Student Center**. Click on **Making It Personal** and select **Chapter 18**.



Classifying the Balance Sheet—Assets and Liabilities

Accounts on the balance sheet are *classified* or grouped into related categories. These classifications provide subtotals which can be used to compute ratios and do comparisons. For example any portion of a long-term liability that is due within the next year is classified as a current liability. This affects the company's liquidity ratios and working capital. (See pages 235–236 in Chapter 9.)

INSTRUCTIONS Use PETSMART's balance sheet in Appendix F to answer these questions.

1. What is the working capital as of February 1, 2004?
2. Obtain PETSMART's most recent annual report from the Internet or library. What is the working capital as of the balance sheet date?
3. Describe any change from the fiscal year ending February 1, 2004.



Online Business Transactions

Online transactions usually update general ledger accounts automatically. Visit glencoeaccounting.glencoe.com and click on **Student Center**. Click on **WebQuest** and select **Unit 4** to continue your Internet project.

