

Chapter 4 Adjustment Process

Topics:

- Adjusting entries & types
- Difference between cash basis and accrual basis accounting
- Resolving adjust required entries and preparing adjusted trial balance

Adjusting Entries

Adjusting entries assign revenues to the period in which they are earned and expenses to the period in which they are incurred. They are needed (a) to measure properly the period's income and (b) to bring related asset and liability accounts to correct balances for the financial statements.

The journal entries that are required to adjust the various accounts for the purpose of making provision for depreciation, allowance for doubtful debts and discounts, adjusting the payments in advance and bring the outstanding liabilities in account, etc., are known as adjusting entries.

Cash basis and accrual basis Accounting

Cash-Basis Accounting: Cash-basis accounting is an accounting system, which recognizes transactions when cash has been received or paid. In cash-basis accounting, the accountant does not record a transaction until cash is received or paid. Cash receipts are treated as revenues, and cash payments are handled as expenses.

Accrual-Basis Accounting: In accrual basis accounting, an accountant recognizes the impact of a business event as it occurs. It is a system of accounting in which revenue is recognized when it is earned and expenses are recognized as they are incurred. When the business performs a service, makes a sale or incurs an expense, the accountant enters the transaction into the books, whether or not cash has been received or paid.

GAAP requires that a business use the accrual basis. This means that the accountant records revenues as they are earned and expenses as they are incurred—not necessarily when cash changes hands.

The adjusting process

Adjusting entries can be divided into five categories:

- a) Prepaid expenses:
- b) Depreciation:
- c) Accrued expenses
- d) Accrued revenues
- e) Unearned revenues

Types	Category of Accounts	Debit	Credit
Prepaid expenses/ Supplies	Asset	Expense	Prepaid expense/ Supplies
Accrued expenses	Liability	Expense	Account Payable
Accrued revenues	Asset	Account Receivable	Revenue
Unearned revenues	Liability	Unearned revenues	Revenue
Depreciation	Expense	Depreciation expense	Accumulated Depreciation

Example 1

The trial balance of Meghna Ltd. Is given below:

Meghna Limited
Trial Balance (Partial)
As on 31 March 2006
(Amounts in Lacs)

SL No.	Name of Accounts	Ref.	Debit	Credit
	Prepaid Rent.....		Tk.1,000	-
	Supplies.....		600	-
	Accumulated Depreciation.....		-	Tk.3,000
	Advertising Expenses.....		800	-
	Salary Expense.....		1,300	-
	Unearned Commission Revenue.....		-	700

Adjustment data (Amounts in Lacs):

- Prepaid rent still in force on 31 March Tk.400.
- Supplies used during the month, Tk.200.
- Depreciation for the month, Tk.500.
- Accrued advertising expenses at March 31, 200.
- Accrued salary expenses on March 31, Tk.400.
- Unearned commission revenue at the end of March is Tk.200.

Requirements:

- Journalize the above adjusting entries.

Requirement (i)

Meghna Ltd.
Adjusting Journal Entries
As on 31 March 2006

Date	Particulars	Ref.	Debit	Credit
(a)	Rent Expense Prepaid Rent		Tk.600	Tk.600
(b)	Supplies Expense.....Dr. Supplies.....Cr.		200	200
(c)	Depreciation Expense.....Dr. Accumulated Depreciation.....Cr.		500	500
(d)	Advertising Expense.....Dr. Accounts Payable.....Cr.		200	200
(e)	Salary Expense.....Dr. Salary Payable.....Cr.		400	400
(f)	Unearned Commission Revenue....Dr. Commission Revenue.....Cr.		500	500

Example 2

Prepare the month end adjusting entries as follows:

- (a) Prepaid rent expired for the month. The unadjusted prepaid balance of Tk.3,600 relates to the period September through December.
- (b) Supplies on hand Tk.500. The unadjusted balance in Trial Balance of Supplies is Tk.800.
- (c) Depreciation on Furniture for the month. The cost of furniture is Tk.16,800. The estimated useful life of the furniture is four years.
- (d) Accrued salary expense for one day only. The five-day weekly payment is Tk.1,000.
- (e) Accrued service revenue at July 31, Tk.700.

Solution:

Adjustment Entries
31st July.....

Date	Particulars	Ref.	Debit	Credit
(a)	Rent Expense.....Dr. Prepaid Rent.....Cr.		900	900
(b)	Supplies Expense.....Dr. Supplies.....Cr.		300	300
(c)	Depreciation Expense.....Dr.		350	

(d)	Accumulated Depreciation.....Cr.			350
	Salary Expense.....Dr. Salary Payable.....Cr.		200	200
(e)	Accounts Receivable.....Dr. Service Revenue.....Cr.		700	700

Problem 3.

Prepare adjusting entries as at 31st July for the end of the year 2004-05:-

- At July 31, the business has earned Tk. 1,420 of service revenue that has not yet been recorded.
- Supplies used during the year totaled Tk.3,060. Unadjusted balance of supplies in Trial Balance is Tk.3,400.
- Prepaid rent still in force at July 31 is Tk.1,040. Unadjusted balance of prepaid rent in Trial Balance is Tk.1,890.
- Depreciation for the year is based on Cleaning Equipment costing Tk. 37,300 and an estimated useful life of 10 years.
- At July 31, the entity has earned Tk.2,210 of the unadjusted balance of Unearned Service Revenue.
- At July 31, the business owes its employees accrued salaries for two-thirds of a four-week payroll. Total payroll for the four week is Tk.2,670.

Solution

Adjusting Entries 31st July 2004

Date	Particulars	Ref.	Debit	Credit
(a)	Unearned Service Revenue.....Dr. Service RevenueCr.		1420	1420
(b)	Supplies Expense.....Dr. Supplies.....Cr.		3060	3060
(c)	Rent Expense.....Dr. Prepaid Rent.....Cr.		850	850
(d)	Depreciation Expense.....Dr. Accumulated Depreciation.....Cr.		3730	3730
(e)	Unearned Service Revenue.....Dr. Service RevenueCr.		2210	2210
(f)	Salary Expense.....Dr. Salary Payable.....Cr. <u>2670X2</u> 3		1780	1780

Problem: 4

The Trial Balance of **Smart Airlines** at March 31 of the current year and the data needed for the month-end adjustments follow:

Smart Airlines
Unadjusted Trial Balance
March 31, 2006

Cash.....	Tk. 24,800	-
Accounts Receivable.....	2,250	-
Supplies.....	700	-
Prepaid Rent.....	3,000	-
Furniture.....	26,500	-
Accumulated Depreciation.....	-	Tk.10,000
Accounts Payable.....	-	13,100
Unearned Service Revenue.....	-	450
Capital.....	-	31,250
Withdrawal.....	3,200	-
Service Revenue.....	-	7,000
Salary Expense.....	950	-
Utilities Expense.....	400	----
Total.....	Tk. 61,800	Tk.61,800

Information for adjustments:

- a) Accrued service revenue Tk. 650.
- b) Supplies on hand Tk. 500.
- c) Prepaid rent expired Tk. 2,000.
- d) Depreciation on furniture Tk. 300.
- e) Accrued salary expense Tk. 1,200.
- f) Amount of unearned service revenue that has been earned Tk. 350.

Requirements:

- a) Give the adjusting entries.
- b) Prepare an adjusted trial balance.

Solution: 4**Req-(a):**

Adjustment Entries
March 31, 2006

Date	Particulars	Ref.	Debit	Credit
(a)	Accounts Receivable.....Dr. Service Revenue.....Cr.		650	650
(b)	Supplies Expense.....Dr. Supplies.....Cr.		200	200
(c)	Rent Expense.....Dr. Prepaid Rent.....Cr.		2,000	2,000
(d)	Depreciation Expense.....Dr. Accumulated Depreciation.....Cr.		300	300

(e)	Salary Expense.....Dr. Salary Payable.....Cr.		1,200	1,200
(f)	Unearned Service Revenue.....Dr. Service Revenue.....Cr.		350	350

Req-(b):

Smart Airlines
Adjusted trial balance
For the Month ended March 31, 2006

Accounts Title	Unadjusted Trial Balance		Adjustments		Adjusted Trial Balance	
	Debit	Credit	Debit	Credit	Debit	Credit
Cash	24,800	-	-	-	24,800	-
Accounts Receivable	2,250	-	650(a)	-	2,900	-
Supplies.....	700	-	-	200(b)	500	-
Prepaid Rent.....	3,000	-	-	2,000©	1000	-
Furniture.....	26,500	-	-	-	26,500	-
Accumulated Depreciation	-	10,000	-	300(d)	-	10,300
Accounts Payable.....	-	13,100	-	-	-	13,100
Unearned Service Revenue	-	450	350(f)	-	-	100
Capital.....	-	31,250	-	-	-	31,250
Withdrawal.....	3,200	-	-	-	3,200	-
Service Revenue.....	-	7,000	-	650+350(a+f)	-	8,000
Salary Expense.....	950	-	1,200(e)	-	2,150	-
Utilities Expense.....	400	-	-	-	400	-
Supplies Expense	-	-	200(b)	-	200	-
Depreciation Expense	-	-	300(d)	-	300	-
Salary Payable	-	-	-	1,200(e)	-	1,200
Rent Expense	-	-	2,000©	-	2,000	-
Total.....	61,800	61,800	4,700	4,700	63,950	63,950

Problem 5

The Trial Balance of **Global Insurance Agency** at October 31, 2004 and data needed for the month-end adjustments are as follows:

Adjustment data:

- Supplies on hand at the month ended, Tk.340.
- Prepaid rent still in force at October 31, Tk.1,800.
- Depreciation on Furniture and fixtures for the month Tk.500.
- Depreciation on Building for the month Tk.800.
- Accrued salary expense at October 31, Tk.1,200.
- Unearned service revenue still unearned at October 31, Tk.4,300.
- Accrued service revenue at October 31, Tk.1,500.

Global Insurance Agency

Trial Balance

As at October 31, 2004

Sl. No.	Name of Accounts	Ref.	Debit	Credit
	Cash		Tk. 10,400	-
	Accounts Receivable		12,310	-
	Supplies		1,840	-
	Prepaid Rent		2,700	-
	Furniture		26,840	-

	Accumulated Depreciation- Furniture		-	Tk. 3,400
	Building		68,300	-
	Accumulated Depreciation-Building		-	9,100
	Accounts Payable		-	7,290
	Salary Payable		-	-
	Unearned service revenue		-	5,300
	Haris's, Capital		-	85,500
	Haris's, Withdrawal		4,900	-
	Service revenue		-	19,560
	Salary expense		1,840	-
	Rent expense		-	-
	Utilities expense		530	-
	Depreciation expense-Furniture		-	-
	Depreciation expense-Building		-	-
	Supplies expense		-	-
	Advertisement expense		490	-
	Total		Tk. 1,30,150	Tk. 1,30,150

Required: Prepare a ten column worksheet of Global Insurance Agency.

Solution:

Global Insurance Agency

Work Sheet

For the Month ended October 31, 2004

Accounts Title	Unadjusted Trial Balance		Adjustments		Adjusted Balance		Income Statement		Balance Sheet	
	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit
Cash	10,400	-	-	-	10,400	-	-	-	10,400	-
Accounts Receivable	12,310	-	1,500 g	-	13,810	-	-	-	13,810	-
Supplies	1,840	-	-	1,500(a)	340	-	-	-	340	-
Prepaid Rent	2,700	-	-	900(b)	1800	-	-	-	1,800	-
Furniture	26,840	-	-	-	26,840	-	-	-	26,840	-
Accumulated Depreciation- Furniture	-	3,400	-	500 (c)	-	3,900	-	-	-	3,900
Building	68,300	-	-	-	68,300	-	-	-	68,300	-
Accumulated Depreciation-Building	-	9,100	-	800(d)	-	9,900	-	-	-	9,900
Accounts Payable	-	7,290	-	-	-	7,290	-	-	-	7,290
Salary Payable	-	-	-	1,200(e)	-	1,200	-	-	-	1,200
Unearned service revenue	-	5,300	1,000(f)	-	-	4,300	-	-	-	4,300
Haris's, Capital	-	85,500	-	-	-	85,500	-	-	-	85,500
Haris's, Withdrawal	4,900	-	-	-	4,900	-	-	-	4,900	-
Service revenue	-	19,560	-	1000 (f)+1500 (g)	-	22,060	-	22,060	-	-
Salary expense	1,840	-	1,200(e)	-	3,040	-	3,040	-	-	-
Rent expense	-	-	900(b)	-	900	-	900	-	-	-
Utilities expense	530	-	-	-	530	-	530	-	-	-
Depreciation expense-Furniture	-	-	500©	-	500	-	500	-	-	-
Depreciation expense-Building	-	-	800(d)	-	800	-	800	-	-	-
Supplies expense	-	-	1,500(a)	-	1,500	-	1,500	-	-	-
Advertisement expense	490	-	-	-	490	-	490	-	-	-
Net Income	-	-	-	-	-	-	14,300	-	-	14,300
Total	1,30,150	1,30,150	7,400	7,400	1,34,150	1,34,150	22,060	22,060	1,26,390	1,26,390

Problem 6.

Agape Counseling Center
Trial Balance
May 31, 2013

Sl. No.	Name of Accounts	Ref.	Debit	Credit
	Cash		Tk.1,670	-
	Notes Receivable		10,340	-
	Supplies		560	-
	Prepaid Insurance		1,790	-
	Furniture		27,410	-
	Accumulated Depreciation- Furniture		-	Tk.1,480
	Building		55,900	-
	Accumulated Depreciation-Building		-	33,560
	Land		13,700	-
	Accounts Payable		-	14,730
	Unearned service revenue		-	6,800
	N/P-Long Term		-	18,700
	R. J. Capital		-	34,290
	R. J. Withdrawal		3,800	-
	Service revenue		-	9,970
	Salary expense		2,170	-
	Utilities expense		490	-
	Property Tax expense		640	-
	Advertisement expense		1,060	-
	Total		<u>1,19,530</u>	<u>1,19,530</u>

Additional data at May 31, 2013:

- a) Accrued salary expense Tk.600.
- b) Supplies on hand Tk.410.
- c) Prepaid insurance expired during May Tk.390
- d) Accrued interest expense Tk.220.
- e) Unearned service revenue earned during May Tk.4,400.
- f) Accrued advertising expense Tk.60.
- g) Accrued interest revenue Tk.170.
- h) Depreciation: Furniture Tk.380; Building Tk.160.

Complete a ten-column worksheet for May.

Solution

Agape Counseling Center

Ten-Column Work Sheet

May 31, 19X1

Accounts Title	Unadjusted Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Balance Sheet	
	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit
Cash	Tk. 1,670	-	-	-	1,670	-	-	-	1,670	-
Notes Receivable	10,340	-	-	-	10,340	-	-	-	10,340	-
Supplies	560	-	-	150	410	-	-	-	410	-
Prepaid Insurance	1,790	-	-	390	1,400	-	-	-	1,400	-
Furniture	27,410	-	-	-	27,410	-	-	-	27,410	-
Accumulated Depreciation- Furniture	-	Tk. 1,480	-	380	-	1,860	-	-	-	1,860
Building	55,900	-	-	-	55,900	-	-	-	55,900	-
Accumulated Depreciation-Building	-	33,560	-	160	-	33,720	-	-	-	33,720
Land	13,700	-	-	-	13,700	-	-	-	13,700	-
Accounts Payable	-	14,730	-	60	-	14,790	-	-	-	14,790
Unearned service revenue	-	6,800	4,400	-	-	2,400	-	-	-	2,400
N/P-Long Term	-	18,700	-	-	-	18,700	-	-	-	18,700
R. J. Capital	-	34,290	-	-	-	34,290	-	-	-	34,290
R. J. Withdrawal	3,800	-	-	-	3,800	-	-	-	3,800	-
Service revenue	-	9,970	-	4,400	-	14,370	-	14,370	-	-
Salary expense	2,170	-	600	-	2,770	-	2,770	-	-	-
Utilities expense	490	-	-	-	490	-	490	-	-	-
Property Tax expense	640	-	-	-	640	-	640	-	-	-
Advertisement expense	1,060	-	60	-	1,120	-	1,120	-	-	-
Salary Payable	-	-	-	600	-	600	-	-	-	600
Supplies expense	-	-	150	-	150	-	150	-	-	-
Insurance expense	-	-	390	-	390	-	390	-	-	-
Interest expense	-	-	220	-	220	-	220	-	-	-
Interest payable	-	-	-	220	-	220	-	-	-	220
Interest receivable	-	-	170	-	170	-	-	-	170	-
Interest revenue	-	-	-	170	-	170	-	170	-	-
Depreciation expense-Furniture	-	-	380	-	380	-	380	-	-	-
Depreciation expense-Building	-	-	160	-	160	-	160	-	-	-
Net Income	-	-	-	-	-	-	8,220	-	-	8,220
Total	1,19,530	1,19,530	6,530	6,530	1,21,120	1,21,120	14,540	14,540	1,14,800	1,14,800

Try Yourself

Exercise 1:

The Trial Balance of **Jannat Traders** at March 31 of the current year and the data needed for the month-end adjustments follow:

Jannat Traders
Trial Balance
March 31, 2010

Cash.....	Tk. 26,800	-
Accounts Receivable.....	4,250	-
Supplies.....	700	-
Prepaid Rent.....	3,000	-
Furniture.....	24,500	-
Accumulated Depreciation.....	-	Tk.11,000
Note Payable-Long Term.....	-	5,000
Accounts Payable.....	-	8,100
Unearned Service Revenue.....	-	450
Capital.....	-	32,250
Withdrawal.....	4,200	-
Service Revenue.....	-	9,000
Salary Expense.....	1,950	-
Utilities Expense.....	400	----
Total.....	<u>Tk. 65,800</u>	<u>Tk.65,800</u>

Information for adjustments:

- i) Accrued service revenue Tk. 2,800.
- j) Supplies on hand Tk.300.
- k) Prepaid rent expired Tk. 1,000.
- l) Depreciation on furniture Tk. 1,300.
- m) Accrued salary expense Tk. 1,500.
- n) Amount of unearned service revenue still unearned Tk. 200.

Required:

- i) Give the adjusting entries
- ii) Prepare an adjusted trial balance.

Exercise 2:

The Trial Balance of **Global Insurance Agency** at October 31, 2004 and data needed for the month-end adjustments are as follows:

Adjustment data:

- a. Supplies on hand at the month ended, Tk.340.
- b. The unadjusted prepaid rent is for three months.
- c. Depreciation on Furniture and fixtures for the month Tk.500.

- d. Depreciation on Building for the month Tk.800.
- e. Accrued salary expense at October 31 for two days. Salary for 5 days work week is Tk.1,500.
- f. Unearned service revenue still unearned at October 31, Tk.4,300.
- g. Accrued service revenue at October 31, Tk.1,500.

Global Insurance Agency

Trial Balance

As at October 31, 2004

Name of Accounts	Ref.	Debit	Credit
Cash		Tk. 10,400	-
Accounts Receivable		12,310	-
Supplies		1,840	-
Prepaid Rent		2,700	-
Furniture		26,840	-
Accumulated Depreciation- Furniture		-	Tk. 3,400
Building		68,300	-
Accumulated Depreciation-Building		-	9,100
Accounts Payable		-	7,290
Salary Payable		-	-
Unearned service revenue		-	5,300
Haris's, Capital		-	85,500
Haris's, Withdrawal		4,900	-
Service revenue		-	19,560
Salary expense		1,840	-
Rent expense		-	-
Utilities expense		530	-
Depreciation expense-Furniture		-	-
Depreciation expense-Building		-	-
Supplies expense		-	-
Advertisement expense		490	-
Total		Tk.1,30,150	Tk.1,30,150

Requirement: Prepare adjusting entries and an adjusted trial balance.

Exercise 3:

Lopez Tailoring Service

Trial Balance

April 30, 2012

SL. No	Accounts Title	Ref.	Debit	Credit
	Cash		2,370	-
	Accounts Receivable		23,540	-
	Supplies		10,570	-
	Prepaid Insurance		7,660	-

	Equipment		63,930	-
	Accumulated Depreciation- Equipment		-	21,730
	Building		74,330	-
	Accumulated Depreciation-Building		-	15,050
	Accounts Payable		-	19,550
	Interest Payable		-	-
	Wage Payable		-	-
	Unearned service revenue		-	8,840
	N/P-Long Term		-	69,900
	M. Lpoez, Capital		-	46,200
	M. Lopez, Withdrawals		47,500	-
	Service revenue		-	92,170
	Depreciation expense-Equipment		-	-
	Depreciation expense-Building		-	-
	Wages expense		28,970	-
	Insurance expense		-	-
	Interest expense		5,890	-
	Utilities expense		5,670	-
	Property Tax expense		3,010	-
	Supplies expense		-	-
	Total		2,73,440	2,73,440

Additional data at April 30, 2012:

- Supplies used during the year Tk.6,880.
- Prepaid insurance expired during the year, Tk.5,370.
- Accrued Interest expense Tk.2,280.
- Accrued service revenue Tk.2,200.
- Depreciation for the year: equipment Tk.6,700; building 3,210.
- Accrued wage expense Tk.830.
- Unearned service revenue earned during the year Tk.5,180.

Prepare a ten column worksheet.

Exercise 4

MASASI COMPANY
Trial Balance
June 30, 2010

SL. No	Accounts Title	Ref.	Debit	Credit
	Cash		Tk. 7,150	
	Accounts Receivable		6,000	
	Supplies		2,000	
	Prepaid Insurance		3000	

	Office Equipment		15000	
	Accounts Payable			4500
	Unearned Service Revenue			4000
	T. Masasi Capital			21750
	Service Revenue			7900
	Salaries Expense		4000	
	Rent Expense		1000	
	Total		<u>38150</u>	<u>38150</u>

Other data:

1. Supplies on hand at June 30 are Tk.600.
2. A utility bill for Tk.150 has not been recorded and will not be paid until next month.
3. The insurance policy is for a year.
4. Tk.2,500 of unearned service revenue has been earned at the end of the month.
5. Salaries of Tk.2,000 are accrued at June 30.
6. The office equipment has a 5-year life with no salvage value. It is being depreciated at Tk.250 per month for 60 months.
7. Invoices representing Tk.1,000 of services performed during the month have not been recorded as of June 30.

Requirements:

- (a) Prepare the adjusting entries for the month of June.
- (b) Prepare a ten column worksheet on June 30, 2010.