CHAPTER 4  
adjustments, financial statements,   
and financial results

# Student Learning Objectives and Related Assignment Materials

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| **Student Learning Objectives** | **Mini-Exercises** | **Exercises** | **Coached Problems** | **Problems (Groups  A & B)** | **Compre-hensive Problems** | **Skills Develop-ment Cases** | **Continuing Case** |
| LO 4-1 Explain why adjustments are needed. | 1, 2, 3 | 2, 3, 4, 5, 6, 7, 8, 10, 19\*^ | 2, 4 | A2, A4, B2, B4, | 2+, 3+, 4^+ | 1, 2, 3, 4^, 5, 6 | 1† |
| LO 4-2 Prepare adjustments needed at the end of the period. | 3, 4, 5\*, 6\*, 7, 8, 9\*, 10\*, 11^, 18, 19, 20\*, 21, 22, 23, 24, 26^ | 3, 4, 5, 6, 7, 8, 9, 10, 12, 13, 14, 15, 16, 19\*^ | 2, 3, 4 | A2, A3, A4, B2, B3, B4, | 1^+, 2+, 3+, 4^+, 5^, 6^+ | 4^, 5, 6 | 1† |
| LO 4-3 Prepare an adjusted trial balance. | 12, 13, 25^ | 1, 15, 16 | 1, 4 | A1, A4, B1, B4, | 1^+, 2+, 3+, 4^+ | 7 |  |
| LO 4-4 Prepare financial statements. | 12, 14, 15, 16, 26^ | 2, 11, 14, 17 |  | A3 | 1^+, 2+, 3+, 4^+, 5^, 6^+ | 3, 6, 7 |  |
| LO 4-5 Explain the closing process. | 17, 26^ | 12, 18 | 1 | A1, B1 | 2+, 3+, 4^+ |  |  |
| LO 4-6 Explain how adjustments affect financial results. |  | 8, 9, 13, 14, 19\*^ | 3, 4 | A3, A4, B3, B4 | 2+,3+, 4^+ | 1, 2, 4^, 5, 6, 7 |  |

\* Animated solution included in the PowerPoint Slides.

^ Particularly challenging; requires students to combine multiple concepts in order to advance to the next level of accounting knowledge.

+ The Comprehensive Problems are comprised of CP4-1, which also covers LO 2-3, 3-3, 4-2, 4-3, and 4-4, CP4-2, which also covers LO 2-3, 3-3, 4-1, 4-2, 4-3, 4-4, 4-5, and 4-6, and CP4-3, which also covers LO 2-3, 3-3, 4-1, 4-2, 4-3, 4-4, 4-5, and 4-6.

† CC4-1 is a continuing case that builds on the story of Nicole’s Getaway Spa, introduced in earlier chapters. This case focuses on identifying the need for and classifying adjustments, preparing the initial journal entries for deferral adjustments, and analyzing adjustments and preparing adjusting journal entries. This case will be extended in future chapters.

# Overview

The entrepreneur from chapters 1**–**3 is eager to evaluate SonicGateway’s results, but he first learns the importance of adjusting the accounting records for deferred items and yet-to-be accrued items.

Students learn how to adjust the accounting records, and prepare an income statement, statement of retained earnings, and balance sheet.

# Synopsis of Chapter Revisions

* New contemporary focus company: replaced pizza company with SonicGateway, thereby allowing repeated practice with depreciation and amortization
* New illustration to tie adjustments to accounting cycle (Exhibit 4.2)
* New illustration of adjustment effects on balance sheet and income statement (Exhibit 4.5)
* Continued use of new accounting equation format illustrating link between income statement and balance sheet
* Eliminated journal entry to record the simultaneous declaration/payment of dividends (journal entries for dividends are explained properly in Chapter 11)
* Reviewed and updated all end-of-chapter material, including new problem formats that automatically post journal entries to T-accounts and prepare trial balances

# PowerPoint Slides

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| --- | --- |
| **Student Learning Objective** | **PowerPoint® Slides** |
| LO 4-1 Explain why adjustments are needed. | 4-2 through 4-8 |
| LO 4-2 Prepare adjustments needed at the end of the period. | 4-9 through 4-27 |
| LO 4-3 Prepare an adjusted trial balance. | 4-28 through 4-29 |
| LO 4-4 Prepare financial statements. | 4-30 through 4-32 |
| LO 4-5 Explain the closing process. | 4-33 through 4-39 |
| LO 4-6 Explain how adjustments affect financial results. | 4-40 through 4-41 |

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| **Animated Builds and Animated Solutions** | **PowerPoint® Slides** |
| Mini-Exercise 4-5 | 4-43 |
| Mini-Exercise 4-6 | 4-44 |
| Mini-Exercise 4-9 | 4-45 through 4-47 |
| Mini-Exercise 4-10 | 4-48 through 4-50 |
| Mini-Exercise 4-20 | 4-51 |
| Exercise 4-19 | 4-52 through 4-57 |

# Summary of Related Video Program

**Spotlight Video Series   
Chapter 4 – Anatomy of a Business Failure (approximately 4:00)**

This video program covers financial performance. Circuit City once was a leading electronics retailer. But, as this video demonstrates, the company’s financial problems led to a free fall in the company’s stock price. This video walks students through the series of events that ultimately ended when Circuit City liquidated in January 2014.

# Chapter Summary

**LO 4-1 Explain why adjustments are needed.**

Adjustments are needed to ensure:

* Revenues are recorded when earned (the revenue recognition principle),
* Expenses are recorded when incurred to generate revenues (the expense recognition principle),
* Assets are reported at amounts representing the economic benefits that remain at the end of the current period, and
* Liabilities are reported at amounts owed at the end of the current period that will require a future sacrifice of resources.

**LO 4-2 Prepare adjustments needed at the end of the period.**

* The process for preparing adjustments includes

1. Analyzing the unadjusted balances in balance sheet and income statement accounts and calculating the amount of the adjustment needed, using a timeline where appropriate.

2. Preparing an adjusting journal entry to make the adjustment.

3. Summarizing the adjusting journal entry in the applicable ledger (T-accounts).

* Each adjusting journal entry affects one balance sheet and one income statement account.

**LO 4-3 Prepare an adjusted trial balance.**

An adjusted trial balance is a list of all accounts with their adjusted debit or credit balances indicated in the appropriate column to provide a check on the equality of the debits and credits.

**LO 4-4 Prepare financial statements.**

Adjusted account balances are used in preparing the following financial statements:

* Income Statement: Revenues – Expenses = Net Income.
* Statement of Retained Earnings: Beginning Retained Earnings + Net Income – Dividends = Ending Retained Earnings.
* Balance Sheet: Assets = Liabilities + Stockholders’ Equity.
* The statement of cash flows and notes to the financial statements are important components of adjusted financial statements, but they will be studied in later chapters.

**LO 4-5 Explain the closing process.**

* Closing journal entries are required to (*a*) transfer net income (or loss) and dividends into retained earnings, and (*b*) prepare all temporary accounts (revenues, expenses, dividends) for the following year by establishing zero balances in these accounts.
* Two closing journal entries are needed:

1. Debit each revenue account for the amount of its balance, credit each expense account for the amount of its balance, and record the difference (equal to net income) in Retained Earnings.

2. Credit the Dividends account for the amount of its balance and debit Retained Earnings for the same amount.

**LO 4-6 Explain how adjustments affect financial results.**

Adjustments help ensure all revenues and expenses are reported in the period in which they are earned and incurred, as a result of a company’s activities. Without these adjustments, the financial statements present an incomplete and potentially misleading picture of the company’s financial performance.

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| Chapter Outline | Teaching Notes |
| I. Understanding the Business |  |
| ***LO 4-1 Explain why adjustments are needed.*** | |
| A. Why Adjustments are Needed |  |
| 1. Accounting systems are designed to record most recurring daily transactions, particularly any involving cash. |  |
| 2. If cash receipts and payments occur in the same accounting period as the related activities, then adjustments are not needed to report revenues and expenses in the proper period. |  |
| 3. In contrast, activities that lead to revenues and expenses occur in the current accounting period but their related cash receipts and payments often occur in other periods. |  |
| 4. **Adjustments**––Entries made at the end of every accounting period to report revenues and expenses in the proper period and assets and liabilities at appropriate amounts. | Examples of accounts affected by adjustments listed in Exhibit 4.1 |
| 5. Adjustments involve both income statement and balance sheet accounts. They are needed to ensure: | *Almost every account could require adjustment. Stress* |
| a. Revenues are recorded when earned (the revenue principle), | *that students should focus on learning what types of* |
| b. Expenses are recorded in the same period as the revenues to which they relate (the expense recognition (“matching”) principle), | *adjustments are needed rather than trying to memorize an endless list of* |
| c. Assets are reported at amounts representing the economic benefits that remain at the end of the current period, and | *adjusting entries.* |
| d. Liabilities are reported at amounts owed at the end of the current period that will require a future sacrifice of resources. |  |
| B. Deferral Adjustments |  |
| 1. Deferral adjustments are used to reduce amounts previously deferred on the balance sheet and increase corresponding accounts on the income statement. | *Remind students that the word* ***defer*** *means to postpone until later.* |
| a. Previously deferred amounts exist on the balance sheet because the company received cash before earning revenue or paid cash before incurring the expense. |  |
| b. When revenues are earned (as defined by the revenue principle) or expenses incurred (as defined by the expense recognition (“matching”) principle), the previously deferred amounts are transferred to the income statement. | Examples of accounts affected by deferral adjustments listed on left-side of Exhibit 4.1 |
| 2. Each deferral adjustment involves a pair of asset and expense accounts, or liability and revenue accounts. |  |

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| Chapter Outline | Teaching Notes |
| C. Accrual Adjustments |  |
| 1. Accrual adjustments are needed when a transaction has occurred but has not yet been recorded in the accounting system. |  |
| 2. This happens when a company has earned revenue or incurred an expense in the current period but has not yet recorded it because the related cash will not be received or paid until a later period. |  |
| 3. Accrual adjustments recognize revenue or expenses when they occur, prior to receipt or payment of cash. | Examples of accounts affected by accrual |
| 4. Each accrual adjustment involves a pair of asset and revenue accounts, or liability and expense accounts. | adjustments listed on right-side of Exhibit 4.1 |
| 5. Notice that this differs from deferral adjustments, which pair assets with expenses and liabilities with revenues. |  |
| II. Study the Accounting Methods |  |
| ***LO 4-2 Prepare adjustments needed at the end of the period.*** | |
| A. Making Required Adjustments |  |
| 1. Adjustments are made at the end of each accounting period immediately prior to preparing an adjusted trial balance and financial statements. | Exhibit 4.2 compares and contrasts journal entries and adjusting entries |
| 2. Adjustments are not made on a daily basis because it’s more efficient to do them all at once at the end of each period. | Exhibit 4.4 uses unadjusted trial balance to illustrate and explain adjustments needed |
| 3. **Adjusting journal entries** (AJEs)––Record the effects of each period’s adjustments in a debits-equal-credits format. | * Supplemental Enrichment Activity (Activity) #1 |
| B. Adjustment Analysis, Recording, and Summarizing |  |
| **Deferral Adjustments**—Used to update amounts that have been previously deferred on the balance sheet. |  |
| (a) Supplies used during the period—Of the $600 in supplies received in early September, $250 remain on hand at September 30; $350 (or $600 - $250) were used during September. | *Refer to illustrations of transactions in textbook for Step 3—Summarize (which includes posting to T-* |
| 1. Analyze: Assets = Liabilities + Stockholders’ Equity Supplies (A) –350; Supplies Expense (E) –350 | *accounts* |
| 2. Record: |  |
| |  |  |  | | --- | --- | --- | | Supplies Expense (+E, –SE) | 350 |  | | Supplies (–A) |  | 350 | |  |
| (b) Rent benefits expired during the period—Three months of rent were prepaid on September 1 for $7,200, but one month has now expired, $2,400 (or $7,200 ÷ 3) of the prepaid amount was used. | Timeline for expiration illustrated in Exhibit 4. |
| 1. Analyze: Assets = Liabilities + Stockholders’ Equity Prepaid Rent (A) –2,400; Rent Expense (E) –2,400 |  |
| 2. Record: |  |
| |  |  |  | | --- | --- | --- | | Rent Expense (+E, –SE) | 2,400 |  | | Prepaid Rent (–A) |  | 2,400 | |  |

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| Chapter Outline | Teaching Notes |
| **Carrying value**––The amount at which an asset or liability is reported (“carried”) in the financial statements; it is also known as the “net book value” or simply “book value.” |  |
| (c) Depreciation is recorded for use of equipment – The computer equipment, which was estimated to last two years, has now been used for one month, representing an estimated expense of $400. |  |
| 1. Expense recognition (“matching”) principles indicates that when equipment is used to generate revenues in the current period, part of its cost should be transferred to an expense account in that period. | *Depreciation might appear to mirror a decline in market value but that’s just a fluke.* |
| 2. **Depreciation**––The process of allocating the cost of buildings, vehicles, and equipment to the accounting periods in which they are used. | *Recording depreciation for the use of long-lived assets is a lot like recording the use of* |
| 3. **Contra-account**––An account that is an offset to, or reduction of, another account. | *supplies. Difference is that a contra-account is used.* |
| 4. **Accumulated Depreciation**––The contra-asset account that is created to keep track of all the depreciation recorded against the long-lived asset; like a negative asset account. | *“Contrary” to what you’d think, this contra-asset (xA) account has a credit balance* |
| 5. Analyze: Assets = Liabilities + Stockholders’ Equity Accumulated Depreciation (xA) –400; Depreciation Expense (E) –400 |  |
| 6. Record: |  |
| |  |  |  | | --- | --- | --- | | Depreciation Expense (+E, –SE) | 400 |  | | Accumulated Depreciation   (+xA, –A) |  | 400 | |  |
| 7. Four aspects that should be noted: |  |
| a. Accumulated Depreciation is a balance sheet account (that is subtracted from the related long-lived asset account in the assets section) while Depreciation Expense is an income statement account. |  |
| b. By recording depreciation in Accumulated Depreciation distinct from the Equipment account, you can report both the original cost of equipment and a running total of the amount that has been depreciated. |  |
| c. A contra-account always is recorded in a way that opposes the account it offsets. |  |
| d. The amount of depreciation depends on the method used for determining it. | *Depreciation methods will be discussed in Chapter 9.* |

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| Chapter Outline | Teaching Notes |
| (d) Amortization is Recorded for Use of Software—The app software developed for SonicGateway, estimated to have three years of usefulness, has not been used for one month at an estimated expense of $250.. |  |
| 1. Amortization is similar to depreciation and applies to long-term assets that lack physical substance and have a limited period of usefulness; the long-term asset declines in usefulness over time, causing a reduction in the value of the asset, which creates an expense. | *Stress that amortization is not reported for long-term assets that have an unlimited period of usefulness.* |
| 2. Analyze: Assets = Liabilities + Stockholders’ Equity Accumulated Amortization (xA) –250 = Amortization Expense (E) –250 |  |
| 3. Record: |  |
| |  |  |  | | --- | --- | --- | | Amortization Expense (+E, –SE) | 250 |  | | Accumulated Amortization  (+xA, –A) |  | 250 | |  |
| (e) Gift Cards Redeemed for Service—SonicGateway redeemed $100 of gift cards that customers used to pay for game downloads. |  |
| 1. Analyze: Assets = Liabilities + Stockholders’ Equity Unearned Revenue (L) –100; Sales Revenue (R) +100 |  |
| 2. Record: |  |
| |  |  |  | | --- | --- | --- | | Unearned Revenue (–L) | 100 |  | | Sales Revenue (+R, +SE) |  | 100 | |  |
| **Accrual Adjustments**—Make the account records complete by including transactions that occurred but have not been recorded: |  |
| (f) Revenues Earned but Not Yet Recorded—SonicGateway provided $2,500 of promotional services to other app developers in September with payment to be received in October. |  |
| 1. Analyze: Assets = Liabilities + Stockholders’ Equity Accounts Receivable (A) +2,500; Sales Revenue (R) +2,500 |  |
| 2. Record: |  |
| |  |  |  | | --- | --- | --- | | Accounts Receivable (+A) | 2,500 |  | | Sales Revenue (+R, +SE) |  | 2,500 | |  |

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| Chapter Outline | Teaching Notes |
| (g) Wage Expense Incurred but Not Yet Recorded—SonicGateway pays its employees $300 per day; as of September 30, four additional days of work have been completed at a cost of $1,200 (or $300 x 4); this amount will not be paid until October. |  |
| 1. Analyze: Assets = Liabilities + Stockholders’ Equity Salaries and Wages Payable (L) +1,200; Salaries and Wages Expense (E) –1,200 |  |
| 2. Record: |  |
| |  |  |  | | --- | --- | --- | | Salaries and Wages Expense  (+E, –SE) | 1,200 |  | | Salaries and Wages Payable (+L) |  | 1,200 | |  |
| 3. When these salaries and wages are paid in cash the following month, SonicGateway will decrease Salaries and Wages Payable (with a debit) and Cash (with a credit). |  |
| (h) Interest Expense Incurred but Not Yet Recorded— SonicGateway has not paid or recorded the $100 interest that it owes for this month on its note payable to the bank. |  |
| 1. Analyze: Assets = Liabilities + Stockholders’ Equity Interest Payable (L) +100; Interest Expense (E) –100 |  |
| 2. Record: |  |
| |  |  |  | | --- | --- | --- | | Interest Expense (+E, –SE ) | 100 |  | | Interest Payable (+L) |  | 100 | |  |
| (i) Income Taxes Incurred but Not Yet Recorded— SonicGateway pays income tax at an average rate equal to 20% of the company’s income before taxes. |  |
| 1. Income tax is calculated by multiplying (1) the company’s adjusted income (before income taxes) of $1,000 by (2) the company’s tax rate of 20% to get the amount of income tax of $200. |  |
| 2. The unadjusted trial balance shows that no income tax has been recorded (both Income Tax Payable and Income Tax Expense are $0). |  |
| 3. Analyze: Assets = Liabilities + Stockholders’ Equity Income Tax Payable (L) +200; Income Tax Expense (E) –200 |  |
| 4. Record: |  |
| |  |  |  | | --- | --- | --- | | Income Tax Expense (+E, –SE) | 200 |  | | Income Tax Payable (+L) |  | 200 | |  |
| 5. Adjusting journal always include one balance sheet and one income statement account. |  |

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| Chapter Outline | Teaching Notes |
| ***LO 4-3 Prepare an adjusted trial balance.*** | |
| C. Adjusted Trial Balance | * Activity #2 |
| 1. **Adjusted trial balance**––A list of all accounts and their adjusted balances, which is used to check on the equality of recorded debits and credits. |  |
| 2. The only difference between an adjusted trial balance and an unadjusted trial balance is that the adjusted trial balance is prepared after all adjustments have been posted. |  |
| ***LO 4-4 Prepare financial statements.*** | |
| D. Income Statement and Statement of Retained Earnings | * Activity #3 |
| 1. Prepare the income statement by listing the names and amounts for each revenue and expense account from the adjusted trial balance. Each major category of items is subtotaled prior to computing net income for period. | See illustrations in Exhibit 4.10 |
| 2. Account balances from the adjusted trial balance are also used in the statement of retained earnings |  |
| a. The amount coming from the adjusted trial balance is the beginning-of-year balance for Retained Earnings. |  |
| b. This account balance doesn’t yet include revenues, expenses, and dividends for the current period because they’ve been recorded in their own separate accounts | *Eventually, we will close those accounts in the Retained Earnings account.* |
| c. For now, the Retained Earnings account on the adjusted trial balance provides the opening amount on the statement of retained earnings. |  |
| e. The amount for Net Income on the next line of the statement of retained earnings comes from the income statement, and the Dividends number comes from the adjusted trial balance. |  |
| 3. Balance Sheet |  |
| a. Like the other statements, the balance sheet is prepared from the adjusted trial balance. | Illustrated in Exhibit 4.11 |
| b. When preparing, watch out for three things: |  |
| i. Remember to classify assets and liabilities as current if they will be used up, turned into cash, or fulfilled within 12 months. |  |
| ii. Note that Accumulated Depreciation and Accumulated Amortization are reported in the assets section (and are subtracted from the accounts to which they are contra accounts). |  |
| iii. Get the Retained Earnings balance from the statement of retained earnings, not from the adjusted trial balance. (The adjusted trial balance still reports the period’s opening Retained Earnings balance.) |  |

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| Chapter Outline | Teaching Notes |
| ***LO 4-5 Explain the closing process.*** | |
| E. Closing Temporary Accounts |  |
| 1. Last step of accounting cycle is referred to as closing process; performed only at the end of the year after the financial statements have been prepared. |  |
| 2. Cleans up the records to get them ready to begin tracking the results in the following year. |  |
| 3. Closing Income Statement and Dividend Accounts | * Activity #4 |
| a. **Permanent accounts**––Accounts that track financial results from year to year by carrying their ending balances into the next year; the Retained Earnings account, like all other balance sheet accounts, is a permanent account because its ending balance from one year becomes its beginning balance for the following year. |  |
| b. **Temporary accounts**––Accounts that track financial results for a limited period of time by having their balances zeroed out at the end of each accounting year; all revenue, expense, and the dividends accounts are temporary accounts because they are used to track only the current period’s results and then are closed before the next year’s activities are recorded. |  |
| c. Closing process serves two purposes: |  |
| i. Transfer net income (or loss) and dividends to Retained Earnings. The balance in the Retained Earnings account will then agree with the statement of retained earnings and the balance sheet. |  |
| ii. Establish zero balances in all income statement and dividend accounts. The balances in the temporary accounts are reset to zero to start accumulating next year’s results. |  |
| d. Two closing journal entries are needed: | Illustrated in Exhibit 4.13 |
| i. Debit each revenue account for the amount of its credit balance, credit each expense account for the amount of its debit balance, and record the difference in Retained Earnings. (If the company has a net loss, Retained Earnings will be debited.) | *Stress that the amount credited to Retained Earnings should equal net income on the income statement.* |
| ii. Credit the Dividends account for the amount of its debit balance and debit Retained Earnings for the same amount. |  |

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| Chapter Outline | Teaching Notes |
| F. Post-Closing Trial Balance |  |
| 1. After the closing journal entries are posted, all temporary accounts should have zero balances. These accounts will be ready for recording transactions next year. | Illustrated in Exhibit 4.14 |
| 2. The ending balance in Retained Earnings is now up to date (it matches the year-end amount on the statement of retained earnings and balance sheet) and is carried forward as the beginning balance for the next year. | *In this context, post means* |
| 3. **Post-closing trial balance**––An internal report prepared to check that total debits still equal total credits and that all temporary accounts have been closed. | *“after,” so a post-closing trial balance is an “after-closing” trial balance.* |
| III. Evaluate the Results |  |
| ***LO 4-6 Explain how adjustments affect financial results.*** |  |
| A. Adjusted Financial Results |  |
| 1. Adjustments help to ensure that all revenues and expenses are reported in the period in which they are earned and incurred. |  |
| 2. As a result of adjustments, the financial statements present the best picture of whether the company’s business activities were profitable that period and what economic resources the company owns and owes at the end of that period. | The “Spotlight on Financial Reporting” feature addresses the failure of Circuit City. |
| 3. Without these adjustments, the financial statements present an incomplete and misleading picture of the company’s financial performance. | * Spotlight Video Series— Chapter 4 |

# Supplemental Enrichment Activities

Note: These activities would be suitable for individual or group activities.

1. Handout 4**–**1

Use Handout 4**–**1 for an in-class activity designed to review transaction analysis (preparation of adjusting entries and impact on the accounting equation) and the posting to T-accounts. The solution follows the handout master.

1. Handout 4**–**2

If you used Handout 4**–**1, use Handout 4-2 for an in-class activity designed to review the preparation of an adjusted trial balance. The solution follows the handout master.

1. Handout 4**–**3

If you used Handout 4**–**2, use Handout 4**–**3 for an in-class activity designed to review the preparation of financial statements. The solution follows the handout master.

1. Handout 4**–**4

If you used Handout 4**–**2, use Handout 4**–**4 for an in-class activity designed to review the preparation of closing entries and a post-close trial balance. The solution follows the handout master.

# HANDOUT 4–1

# ADJUSTING ENTRIES AND POSTING TO T-ACCOUNTS

Prepare the required adjusting journal entry for each situation as of December 31, 2016. *See the last page for the unadjusted account balances shown in T-accounts.*

(a) Deana’s Decorating had $1,800 of supplies on hand on December 1, 2016. When counting the supplies on December 31, 2016, Deana’s found only $800 worth of supplies on hand.

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| Debit and credit the accounts affected. |
| |  |  |  |  | | --- | --- | --- | --- | | Dec. 31 |  |  |  | | 2016 |  |  |  | |
| Ensure the equation still balances and debits = credits. |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | |  |  |  |  |  |  |  |  | |

(b) Deana’s had paid $12,000 for six months’ rent on November 1, 2016. As of December, 31, 2016, two months’ (November & December) prepaid rent has expired.

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| Debit and credit the accounts affected. |
| |  |  |  |  | | --- | --- | --- | --- | | Dec. 31 |  |  |  | | 2016 |  |  |  | |
| Ensure the equation still balances and debits = credits. |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | |  |  |  |  |  |  |  |  | |

(c) Deana’s had paid $6,000 for one year’s insurance on June 1, 2016.

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| Debit and credit the accounts affected. |
| |  |  |  |  | | --- | --- | --- | --- | | Dec. 31 |  |  |  | | 2016 |  |  |  | |
| Ensure the equation still balances and debits = credits. |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | |  |  |  |  |  |  |  |  | |

# HANDOUT 4–1, continued

(d) The company had acquired equipment costing $40,000 on January 1, 2016. The depreciation on this equipment was calculated to be $2,000 for 2016.

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| Debit and credit the accounts affected. |
| |  |  |  |  | | --- | --- | --- | --- | | Dec. 31 |  |  |  | | 2016 |  |  |  | |
| Ensure the equation still balances and debits = credits. |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | |  |  |  |  |  |  |  |  | |

(e) On December 1, 2016, the company had sold $500 in gift certificates for decorating services to a customer. On December 31, 2016, the accountant received an envelope containing $400 worth of redeemed gift certificates, not yet recorded in the company’s books.

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| Debit and credit the accounts affected. |
| |  |  |  |  | | --- | --- | --- | --- | | Dec. 31 |  |  |  | | 2016 |  |  |  | |
| Ensure the equation still balances and debits = credits. |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | |  |  |  |  |  |  |  |  | |

(f) On June 30, 2016, the company invested $20,000 in a certificate of deposit that will yield 12% interest at the end of one year.

|  |
| --- |
| Debit and credit the accounts affected. |
| |  |  |  |  | | --- | --- | --- | --- | | Dec. 31 |  |  |  | | 2016 |  |  |  | |
| Ensure the equation still balances and debits = credits. |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | |  |  |  |  |  |  |  |  | |

# HANDOUT 4–1, continued

(g) The company borrowed a note payable from the bank for $30,000 on January 1, 2016, due with all interest on June 30, 2017. The note payable requires 10% interest.

|  |
| --- |
| Debit and credit the accounts affected. |
| |  |  |  |  | | --- | --- | --- | --- | | Dec. 31 |  |  |  | | 2016 |  |  |  | |
| Ensure the equation still balances and debits = credits. |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | |  |  |  |  |  |  |  |  | |

(h) The company calculated its income taxes as $26,110 for the year ended December 31, 2016.

|  |
| --- |
| Debit and credit the accounts affected. |
| |  |  |  |  | | --- | --- | --- | --- | | Dec. 31 |  |  |  | | 2016 |  |  |  | |
| Ensure the equation still balances and debits = credits. |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | |  |  |  |  |  |  |  |  | |

(i) On December 15, 2016, the company declared a $750 dividend, payable January 15, 2017.

|  |
| --- |
| Debit and credit the accounts affected. |
| |  |  |  |  | | --- | --- | --- | --- | | Dec. 31 |  |  |  | | 2016 |  |  |  | |
| Ensure the equation still balances and debits = credits. |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | |  |  |  |  |  |  |  |  | |

# Post the adjusting entries above to the T-accounts on the following page.

# HANDOUT 4-1, continued

|  |  |  |
| --- | --- | --- |
| **Assets** | **Liabilities** | **Stockholders’ Equity** |
| + Cash –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 43,450 |  |  | |  |  |  |  | |  |  |  |  |   + Supplies –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 1,800 |  |  | |  |  |  | (a) | |  |  |  |  |   + Accounts Receivable –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 4,000 |  |  | |  |  |  |  | |  |  |  |  |   + Prepaid Rent –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 12,000 |  |  | |  |  |  | (b) | |  |  |  |  |   + Prepaid Insurance –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 6,000 |  |  | |  |  |  | (c) | |  |  |  |  |   + Certificate of Deposit –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 20,000 |  |  | |  |  |  |  | |  |  |  |  |   + Interest Receivable –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 0 |  |  | |  |  |  |  | |  |  |  |  |   + Property, Plant & Equipment –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 40,000 |  |  | |  |  |  |  | |  |  |  |  |   − Accumulated Depreciation +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 0 | Unadj. | |  |  |  |  | |  |  |  |  | | − Accounts Payable +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 250 | Unadj. | |  |  |  |  | |  |  |  |  |   − Dividend Payable +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 0 | Unadj. | |  |  |  |  | |  |  |  |  |   − Unearned Revenue +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 500 | Unadj. | |  |  |  |  | |  |  |  |  |   − Notes Payable +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 30,000 | Unadj. | |  |  |  |  |   − Interest Payable +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 0 | Unadj. | |  |  |  |  | |  |  |  |  |   − Income Taxes Payable +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 0 | Unadj. | |  |  |  |  | |  |  |  |  | | + Contributed Capital –   |  |  |  |  | | --- | --- | --- | --- | |  |  | 10,000 | Unadj. |   − Retained Earnings +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 0 | Unadj. |   + Dividends –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 0 |  |  | |  |  |  |  | |  |  |  |  |   − Service Revenue +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 120,000 | Unadj. | |  |  |  |  | |  |  |  |  |   + Interest Revenue –   |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  |   + Salaries and Wage Expense –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 32,000 |  |  |   + Utilities Expense –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 1,000 |  |  |   + Telephone Expense –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 500 |  |  |   + Supplies Expense –   |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  |   + Rent Expense –   |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  |   + Insurance Expense –   |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  |   + Depreciation Expense –   |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  |   + Interest Expense –   |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  |   + Income Tax Expense –   |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |

# HANDOUT 4–1 SOLUTION

# ADJUSTING ENTRIES AND POSTING TO T-ACCOUNTS

Prepare the required adjusting journal entry for each situation as of December 31, 2016. *See the last page for the unadjusted account balances shown in T-accounts.*

(a) Deana’s Decorating had $1,800 of supplies on hand on December 1, 2016. When counting the supplies on December 31, 2016, Deana’s found only $800 worth of supplies on hand.

|  |
| --- |
| Debit and credit the accounts affected. |
| |  |  |  |  | | --- | --- | --- | --- | | Dec. 31 | Supplies Expense (+E, –SE) | 1,000 |  | | 2016 | Supplies (–A) |  | 1,000 | |
| Ensure the equation still balances and debits = credits. |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | | Supplies | –1,000 |  |  |  |  | Supplies Expense | –1,000 | |

(b) Deana’s had paid $12,000 for six months’ rent on November 1, 2016. As of December, 31, 2016, two months’ (November & December) prepaid rent has expired.

|  |
| --- |
| Debit and credit the accounts affected. |
| |  |  |  |  | | --- | --- | --- | --- | | Dec. 31 | Rent Expense (+E, –SE) | 4,000 |  | | 2016 | Prepaid Rent (–A) |  | 4,000 | |
| Ensure the equation still balances and debits = credits. |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | | Prepaid Rent | –4,000 |  |  |  |  | Rent Expense | –4,000 | |

(c) Deana’s had paid $6,000 for one year’s insurance on June 1, 2016.

|  |
| --- |
| Debit and credit the accounts affected. |
| |  |  |  |  | | --- | --- | --- | --- | | Dec. 31 | Insurance Expense (+E, –SE) | 3,500 |  | | 2016 | Prepaid Insurance (–A) |  | 3,500 | |
| Ensure the equation still balances and debits = credits. |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | | Prepaid Insurance | –3,500 |  |  |  |  | Insurance Expense | –3,500 | |

# HANDOUT 4–1 SOLUTION, continued

(d) The company had acquired equipment costing $40,000 on January 1, 2016. The depreciation on this Equipment was calculated to be $2,000 for 2016.

|  |
| --- |
| Debit and credit the accounts affected. |
| |  |  |  |  | | --- | --- | --- | --- | | Dec. 31 | Depreciation Expense (+E, –SE) | 2,000 |  | | 2016 | Accumulated Depreciation (+xA, –A) |  | 2,000 | |
| Ensure the equation still balances and debits = credits. |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | | Accumulated Depreciation | –2,000 |  |  |  |  | Depreciation Expense | –2,000 | |

(e) On December 1, 2016, the company had sold $500 in gift certificates for decorating services to a customer. On December 31, 2016, the accountant received an envelope containing $400 worth of redeemed gift certificates, not yet recorded in the company’s books.

|  |
| --- |
| Debit and credit the accounts affected. |
| |  |  |  |  | | --- | --- | --- | --- | | Dec. 31 | Unearned Revenue (–L) | 400 |  | | 2016 | Service Revenue (+R, +SE) |  | 400 | |
| Ensure the equation still balances and debits = credits. |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | |  |  |  | Unearned Revenue | –400 |  | Service Revenue | +400 | |

(f) On June 30, 2016, the company invested $20,000 in a certificate of deposit that will yield 12% interest at the end of one year.

|  |
| --- |
| Debit and credit the accounts affected.. |
| |  |  |  |  | | --- | --- | --- | --- | | Dec. 31 | Interest Receivable (+A) | 1,200 |  | | 2016 | Interest Revenue (+R, +SE) |  | 1,200 | |
| Ensure the equation still balances and debits = credits. |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | | Interest Receivable | +1,200 |  |  |  |  | Interest Revenue | +1,200 | |

# HANDOUT 4–1 SOLUTION, continued

(g) The company borrowed a note payable from the bank for $30,000 on January 1, 2016, due with all interest on June 30, 2017. The note payable requires 10% interest.

|  |
| --- |
| Debit and credit the accounts affected. |
| |  |  |  |  | | --- | --- | --- | --- | | Dec. 31 | Interest Expense (+E, –SE) | 3,000 |  | | 2016 | Interest Payable (+L) |  | 3,000 | |
| Ensure the equation still balances and debits = credits. |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | |  |  |  | Interest Payable | +3,000 |  | Interest Expense | –3,000 | |

(h) The company calculated its income taxes as $26,110 for the year ended December 31, 2016.

|  |
| --- |
| Debit and credit the accounts affected. |
| |  |  |  |  | | --- | --- | --- | --- | | Dec. 31 | Income Tax Expense (+E, –SE) | 26,110 |  | | 2016 | Income Tax Payable (+L) |  | 26,110 | |
| Ensure the equation still balances and debits = credits. |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | |  |  |  | Income Tax Payable | +26,110 |  | Income Tax Expense | –26,110 | |

(i) On December 15, 2016, the company declared a $750 dividend, payable January 15, 2017.

|  |
| --- |
| Debit and credit the accounts affected. |
| |  |  |  |  | | --- | --- | --- | --- | | Dec. 31 | Dividends (+D, –SE) | 750 |  | | 2016 | Dividend Payable (+L) |  | 750 | |
| Ensure the equation still balances and debits = credits. |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | |  |  |  | Income Tax Payable | +750 |  | Dividends | –750 | |

# HANDOUT 4-1 SOLUTION, continued

|  |  |  |
| --- | --- | --- |
| **Assets** | **Liabilities** | **Stockholders’ Equity** |
| + Cash –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 43,450 |  |  | |  |  |  |  | | Adj. | 43,450 |  |  |   + Supplies –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 1,800 |  |  | |  |  | 1,000 | (a) | | Adj. | 800 |  |  |   + Accounts Receivable –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 4,000 |  |  | |  |  |  |  | | Adj. | 4,000 |  |  |   + Prepaid Rent –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 12,000 |  |  | |  |  | 4,000 | (b) | | Adj. | 8,000 |  |  |   + Prepaid Insurance –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 6,000 |  |  | |  |  | 3,500 | (c) | | Adj. | 2,500 |  |  |   + Certificate of Deposit –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 20,000 |  |  | |  |  |  |  | | Adj. | 20,000 |  |  |   + Interest Receivable –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 0 |  |  | | (f) | 1,200 |  |  | | Adj. | 1,200 |  |  |   + Property, Plant & Equipment –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 40,000 |  |  | |  |  |  |  | | Adj. | 40,000 |  |  |   − Accumulated Depreciation +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 0 | Unadj. | |  |  | 2,000 | (d) | |  |  | 2,000 |  | | − Accounts Payable +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 250 | Unadj. | |  |  |  |  | |  |  | 250 | Adj. |   − Dividend Payable +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 0 | Unadj. | |  |  | 750 | (i) | |  |  | 750 | Adj. |   − Unearned Revenue +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 500 | Unadj. | | (e) | 400 |  |  | | Adj. | 100 |  |  |   − Notes Payable +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 30,000 | Unadj. | |  |  | 30,000 | Adj. |   − Interest Payable +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 0 | Unadj. | |  |  | 3,000 | (g) | |  |  | 3,000 | Adj. |   − Income Taxes Payable +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 0 | Unadj. | |  |  | 26,110 | (h) | |  |  | 26,110 | Adj. | | + Contributed Capital –   |  |  |  |  | | --- | --- | --- | --- | |  |  | 10,000 | Unadj. |   − Retained Earnings +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 0 | Unadj. |   + Dividends –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 0 |  |  | | (i) | 750 |  |  | | Adj. | 750 |  |  |   − Service Revenue +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 120,000 | Unadj. | |  |  | 400 | (e) | |  |  | 120,400 | Adj. |   + Interest Revenue –   |  |  |  |  | | --- | --- | --- | --- | |  |  | 1,200 | (f) |   + Salaries and Wage Expense –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 32,000 |  |  |   + Utilities Expense –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 1,000 |  |  |   + Telephone Expense –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 500 |  |  |   + Supplies Expense –   |  |  |  |  | | --- | --- | --- | --- | | (a) | 1,000 |  |  |   + Rent Expense –   |  |  |  |  | | --- | --- | --- | --- | | (b) | 4,000 |  |  |   + Insurance Expense –   |  |  |  |  | | --- | --- | --- | --- | | (c) | 3,500 |  |  |   + Depreciation Expense –   |  |  |  |  | | --- | --- | --- | --- | | (d) | 2,000 |  |  |   + Interest Expense –   |  |  |  |  | | --- | --- | --- | --- | | (g) | 3,000 |  |  |   + Income Tax Expense –   |  |  |  |  | | --- | --- | --- | --- | | (h) | 26,110 |  |  | |

# HANDOUT 4–2

Use the balances in the T-accounts in handout 4**–**1 to prepare an adjusted trial balance.

Deana’s Decorators

Adjusted Trial Balance

December 31, 2016

|  |  |  |
| --- | --- | --- |
|  | Debit | Credit |
| Cash |  |  |
| Supplies |  |  |
| Accounts Receivable |  |  |
| Prepaid Rent |  |  |
| Prepaid Insurance |  |  |
| Certificate of Deposit |  |  |
| Interest Receivable |  |  |
| Property, Plant & Equipment |  |  |
| Accumulated Depreciation |  |  |
| Accounts Payable |  |  |
| Dividend Payable |  |  |
| Unearned Revenue |  |  |
| Notes Payable |  |  |
| Interest Payable |  |  |
| Income Taxes Payable |  |  |
| Contributed Capital |  |  |
| Retained Earnings |  |  |
| Dividends |  |  |
| Service Revenue |  |  |
| Interest Revenue |  |  |
| Salaries and Wage Expense |  |  |
| Utilities Expense |  |  |
| Telephone Expense |  |  |
| Supplies Expense |  |  |
| Rent Expense |  |  |
| Insurance Expense |  |  |
| Depreciation Expense |  |  |
| Interest Expense |  |  |
| Income Tax Expense |  |  |
| Totals |  |  |

# HANDOUT 4–2 SOLUTION

Use the balances in the T-accounts in handout 4**–**1 to prepare an adjusted trial balance.

## Deana’s Decorators Adjusted Trial Balance December 31, 2016

|  |  |  |
| --- | --- | --- |
|  | Debit | Credit |
| Cash | $ 43,450 |  |
| Supplies | 800 |  |
| Accounts Receivable | 4,000 |  |
| Prepaid Rent | 8,000 |  |
| Prepaid Insurance | 2,500 |  |
| Certificate of Deposit | 20,000 |  |
| Interest Receivable | 1,200 |  |
| Property, Plant & Equipment | 40,000 |  |
| Accumulated Depreciation |  | $ 2,000 |
| Accounts Payable |  | 250 |
| Dividend Payable |  | 750 |
| Unearned Revenue |  | 100 |
| Notes Payable |  | 30,000 |
| Interest Payable |  | 3,000 |
| Income Taxes Payable |  | 26,110 |
| Contributed Capital |  | 10,000 |
| Retained Earnings |  | 0 |
| Dividends | 750 |  |
| Service Revenue |  | 120,400 |
| Interest Revenue |  | 1,200 |
| Salaries and Wage Expense | 32,000 |  |
| Utilities Expense | 1,000 |  |
| Telephone Expense | 500 |  |
| Supplies Expense | 1,000 |  |
| Rent Expense | 4,000 |  |
| Insurance Expense | 3,500 |  |
| Depreciation Expense | 2,000 |  |
| Interest Expense | 3,000 |  |
| Income Tax Expense | 26,110 |  |
| Totals | $193,810 | $193,810 |

# HANDOUT 4–3

# FINANCIAL STATEMENTS

Use the adjusted trial balance in Handout 4**–**2 to prepare in good form an income statement, a statement of retained earnings, and a classified balance sheet for Deana’s Decorators.

Deana’s Decorators

Income Statement

For the year ended December 31, 2016

|  |  |
| --- | --- |
|  |  |
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Deana’s Decorators

Statement of Retained Earnings

For the year ended December 31, 2016

|  |  |
| --- | --- |
|  |  |
|  |  |
|  |  |
|  |  |
|  |  |

# HANDOUT 4–3, continued

Deana’s Decorators

Balance Sheet

December 31, 2016

|  |  |
| --- | --- |
| **Assets** | |
|  |  |
|  |  |
|  |  |
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|  |  |
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|  |  |
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|  |  |
|  |  |
|  |  |
| **Liabilities** | |
|  |  |
|  |  |
|  |  |
|  |  |
|  |  |
|  |  |
|  |  |
|  |  |
|  |  |
| **Stockholders’ Equity** | |
|  |  |
|  |  |
|  |  |
|  |  |

# HANDOUT 4–3 SOLUTION

# FINANCIAL STATEMENTS

Use the adjusted trial balance in Handout 4**–**2 to prepare in good form an income statement, a statement of retained earnings, and a classified balance sheet for Deana’s Decorators.

Deana’s Decorators

Income Statement

For the year ended December 31, 2016

|  |  |
| --- | --- |
| Revenues: |  |
| Service Revenue | $120,400 |
| Interest Revenue | 1,200 |
| Total Revenues | 121,600 |
| Expenses: |  |
| Salaries and Wage Expense | 32,000 |
| Utilities Expense | 1,000 |
| Telephone Expense | 500 |
| Supplies Expense | 1,000 |
| Rent Expense | 4,000 |
| Insurance Expense | 3,500 |
| Depreciation Expense | 2,000 |
| Interest Expense | 3,000 |
| Income Tax Expense | 26,110 |
| Total Expenses | 73,110 |
| Net Income | $ 48,490 |
|  |  |

Deana’s Decorators

Statement of Retained Earnings

For the year ended December 31, 2016

|  |  |
| --- | --- |
| Balance, January 1 | $0 |
| Add: Net Income | 48,490 |
| Less: Dividends | (750) |
| Balance, December 31 | $47,740 |
|  |  |

# HANDOUT 4–3 SOLUTION, continued

|  |  |
| --- | --- |
| Deana’s Decorators Sheet | |
| Balance Sheet | |
| December 31, 2016 | |
|  | |
| **Assets** | |
| Current Assets |  |
| Cash | $ 43,450 |
| Certificate of Deposit | 20,000 |
| Supplies | 800 |
| Accounts Receivable | 4,000 |
| Interest Receivables | 1,200 |
| Prepaid Rent | 8,000 |
| Prepaid Insurance | 2,500 |
| Total Current Assets | 79,950 |
| Property, Plant & Equipment, Net of |  |
| Accumulated Depreciation | 38,000 |
| Total Assets | $117,950 |
|  |  |
| **Liabilities** | |
| Current Liabilities: |  |
| Accounts Payable | $ 250 |
| Dividends Payable | 750 |
| Unearned Revenue | 100 |
| Note Payable | 30,000 |
| Interest Payable | 3,000 |
| Income Taxes Payable | 26 110 |
| Total Current Liabilities | 60,210 |
|  |  |
| **Stockholders’ Equity** | |
| Contributed Capital | 10,000 |
| Retained Earnings | 47,740 |
| Total Stockholders’ Equity | 57,740 |
| Total Liabilities and Stockholders’ Equity | $117,950 |

# HANDOUT 4–4

# CLOSING ENTRIES, POSTING TO T-ACCOUNTS, PREPARATION OF POST-CLOSING TRIAL BALANCE

## Prepare the required closing entries for Deana’s Decorators using the adjusted account balances set forth in Handout 4–2. Post the entries to the T-accounts shown on the next page. Then, prepare a post-closing trial balance.

|  |  |  |  |
| --- | --- | --- | --- |
| Date | Accounts | Debit | Credit |
|  |  |  |  |
|  |  |  |  |
|  |  |  |  |
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|  |  |  |  |
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|  |  |  |  |

# HANDOUT 4–4, continued

|  |  |  |
| --- | --- | --- |
| **Assets** | **Liabilities** | **Stockholders’ Equity** |
| + Cash –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 43,450 |  |  | |  |  |  |  | | Adj. | 43,450 |  |  |   + Supplies –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 1,800 |  |  | |  |  | 1,000 | (a) | | Adj. | 800 |  |  |   + Accounts Receivable –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 4,000 |  |  | |  |  |  |  | | Adj. | 4,000 |  |  |   + Prepaid Rent –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 12,000 |  |  | |  |  | 4,000 | (b) | | Adj. | 8,000 |  |  |   + Prepaid Insurance –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 6,000 |  |  | |  |  | 3,500 | (c) | | Adj. | 2,500 |  |  |   + Certificate of Deposit –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 20,000 |  |  | |  |  |  |  | | Adj. | 20,000 |  |  |   + Interest Receivable –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 0 |  |  | | (f) | 1,200 |  |  | | Adj. | 1,200 |  |  |   + Property, Plant & Equipment –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 40,000 |  |  | |  |  |  |  | | Adj. | 40,000 |  |  |   − Accumulated Depreciation +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 0 | Unadj. | |  |  | 2,000 | (d) | |  |  | 2,000 |  | | − Accounts Payable +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 250 | Unadj. | |  |  |  |  | |  |  | 250 | Adj. |   − Dividend Payable +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 0 | Unadj. | |  |  | 750 | (i) | |  |  | 750 | Adj. |   − Unearned Revenue +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 500 | Unadj. | | (e) | 400 |  |  | | Adj. | 100 |  |  |   − Notes Payable +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 30,000 | Unadj. | |  |  | 30,000 | Adj. |   − Interest Payable +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 0 | Unadj. | |  |  | 3,000 | (g) | |  |  | 3,000 | Adj. |   − Income Taxes Payable +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 0 | Unadj. | |  |  | 26,110 | (h) | |  |  | 26,110 | Adj. |   **Stockholders’ Equity**  + Depreciation Expense –   |  |  |  |  | | --- | --- | --- | --- | | (d) | 2,000 |  |  | |  |  |  |  |   + Interest Expense –   |  |  |  |  | | --- | --- | --- | --- | | (g) | 3,000 |  |  | |  |  |  |  |   + Income Tax Expense –   |  |  |  |  | | --- | --- | --- | --- | | (h) | 26,110 |  |  | |  |  |  |  | | + Contributed Capital –   |  |  |  |  | | --- | --- | --- | --- | |  |  | 10,000 | Unadj. |   − Retained Earnings +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 0 | Unadj. | |  |  |  |  | |  |  |  |  |   + Dividends –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 0 |  |  | | (i) | 750 |  |  | | Adj. | 750 |  |  | |  |  |  |  |   − Service Revenue +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 120,000 | Unadj. | |  |  | 400 | (e) | |  |  | 120,400 | Adj. | |  |  |  |  |   + Interest Revenue –   |  |  |  |  | | --- | --- | --- | --- | |  |  | 1,200 | (f) | |  |  |  |  |   + Salaries and Wage Expense –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 32,000 |  |  | |  |  |  |  |   + Utilities Expense –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 1,000 |  |  | |  |  |  |  |   + Telephone Expense –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 500 |  |  | |  |  |  |  |   + Supplies Expense –   |  |  |  |  | | --- | --- | --- | --- | | (a) | 1,000 |  |  | |  |  |  |  |   + Rent Expense –   |  |  |  |  | | --- | --- | --- | --- | | (b) | 4,000 |  |  | |  |  |  |  |   + Insurance Expense –   |  |  |  |  | | --- | --- | --- | --- | | (c) | 3,500 |  |  | |  |  |  |  | |

# HANDOUT 4–4, continued

Deana’s Decorators

Post-Closing Trial Balance

December 31, 2016

|  |  |  |
| --- | --- | --- |
| Account | Debit | Credit |
| Cash |  |  |
| Supplies |  |  |
| Accounts Receivable |  |  |
| Prepaid Rent |  |  |
| Prepaid Insurance |  |  |
| Certificate of Deposit |  |  |
| Interest Receivable |  |  |
| Property, Plant & Equipment |  |  |
| Accumulated Depreciation |  |  |
| Accounts Payable |  |  |
| Dividend Payable |  |  |
| Unearned Revenue |  |  |
| Notes Payable |  |  |
| Interest Payable |  |  |
| Income Taxes Payable |  |  |
| Contributed Capital |  |  |
| Retained Earnings |  |  |
| Dividends |  |  |
| Revenue |  |  |
| Interest Revenue |  |  |
| Salaries and Wage Expense |  |  |
| Utilities Expense |  |  |
| Telephone Expense |  |  |
| Supplies Expense |  |  |
| Rent Expense |  |  |
| Insurance Expense |  |  |
| Depreciation Expense |  |  |
| Interest Expense |  |  |
| Income Tax Expense |  |  |
| Totals |  |  |

# HANDOUT 4–4 SOLUTION

# CLOSING ENTRIES, POSTING TO T-ACCOUNTS, PREPARATION OF POST-CLOSING TRIAL BALANCE

## Prepare the required closing entries for Deana’s Decorators using the adjusted account balances set forth in Handout 4–2. Post the entries to the T-accounts shown on the next page. Then, prepare a post-closing trial balance.

|  |  |  |  |
| --- | --- | --- | --- |
| Date | Accounts | Debit | Credit |
| Dec. 31 | Service Revenue (–R) | 120,400 |  |
| 2016 | Interest Revenue (–R) | 1,200 |  |
|  | Salaries and Wage Expense (–E) |  | 32,000 |
|  | Utilities Expense (–E) |  | 1,000 |
|  | Telephone Expense (–E) |  | 500 |
|  | Supplies Expense (–E) |  | 1,000 |
|  | Rent Expense (–E) |  | 4,000 |
|  | Insurance Expense (–E) |  | 3,500 |
|  | Depreciation Expense (–E) |  | 2,000 |
|  | Interest Expense (–E) |  | 3,000 |
|  | Income Tax Expense (–E) |  | 26,110 |
|  | Retained Earnings (+SE) |  | 48,490 |
|  |  |  |  |
| Dec. 31 | Retained Earnings (–SE) | 750 |  |
| 2016 | Dividends (–D) |  | 750 |

# HANDOUT 4–4 SOLUTION, continued

|  |  |  |
| --- | --- | --- |
| **Assets** | **Liabilities** | **Stockholders’ Equity** |
| + Cash –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 43,450 |  |  | |  |  |  |  | | Adj. | 43,450 |  |  |   + Supplies –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 1,800 |  |  | |  |  | 1,000 | (a) | | Adj. | 800 |  |  |   + Accounts Receivable –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 4,000 |  |  | |  |  |  |  | | Adj. | 4,000 |  |  |   + Prepaid Rent –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 12,000 |  |  | |  |  | 4,000 | (b) | | Adj. | 8,000 |  |  |   + Prepaid Insurance –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 6,000 |  |  | |  |  | 3,500 | (c) | | Adj. | 2,500 |  |  |   + Certificate of Deposit –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 20,000 |  |  | |  |  |  |  | | Adj. | 20,000 |  |  |   + Interest Receivable –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 0 |  |  | | (f) | 1,200 |  |  | | Adj. | 1,200 |  |  |   + Property, Plant & Equipment –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 40,000 |  |  | |  |  |  |  | | Adj. | 40,000 |  |  |   − Accumulated Depreciation +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 0 | Unadj. | |  |  | 2,000 | (d) | |  |  | 2,000 |  | | − Accounts Payable +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 250 | Unadj. | |  |  |  |  | |  |  | 250 | Adj. |   − Dividend Payable +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 0 | Unadj. | |  |  | 750 | (i) | |  |  | 750 | Adj. |   − Unearned Revenue +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 500 | Unadj. | | (e) | 400 |  |  | | Adj. | 100 |  |  |   − Notes Payable +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 30,000 | Unadj. | |  |  | 30,000 | Adj. |   − Interest Payable +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 0 | Unadj. | |  |  | 3,000 | (g) | |  |  | 3,000 | Adj. |   − Income Taxes Payable +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 0 | Unadj. | |  |  | 26,110 | (h) | |  |  | 26,110 | Adj. |   **Stockholders’ Equity**  + Depreciation Expense –   |  |  |  |  | | --- | --- | --- | --- | | (d) | 2,000 | 2,000 | Close | | Bal | 0 |  |  |   + Interest Expense –   |  |  |  |  | | --- | --- | --- | --- | | (g) | 3,000 | 3,000 | Close | | Bal | 0 |  |  |   + Income Tax Expense –   |  |  |  |  | | --- | --- | --- | --- | | (h) | 26,110 | 26,110 | Close | | Bal | 0 |  |  | | + Contributed Capital –   |  |  |  |  | | --- | --- | --- | --- | |  |  | 10,000 | Unadj. |   − Retained Earnings +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 0 | Unadj. | | Close | 750 | 48,490 | Close | |  |  | 47,740 | Bal |   + Dividends –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 0 |  |  | | (i) | 750 |  |  | | Adj. | 750 | 750 | Close | | Bal. | 0 |  |  |   − Service Revenue +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 120,000 | Unadj. | |  |  | 400 | (e) | | Close | 120,400 | 120,400 | Adj. | |  |  | 0 | Bal |   + Interest Revenue –   |  |  |  |  | | --- | --- | --- | --- | | Close | 1,200 | 1,200 | (f) | |  |  | 0 | Bal |   + Salaries and Wage Expense –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 32,000 | 32,000 | Close | | Bal | 0 |  |  |   + Utilities Expense –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 1,000 | 1,000 | Close | | Bal | 0 |  |  |   + Telephone Expense –   |  |  |  |  | | --- | --- | --- | --- | | Unadj. | 500 | 500 | Close | | Bal | 0 |  |  |   + Supplies Expense –   |  |  |  |  | | --- | --- | --- | --- | | (a) | 1,000 | 1,000 | Close | | Bal | 0 |  |  |   + Rent Expense –   |  |  |  |  | | --- | --- | --- | --- | | (b) | 4,000 | 4,000 | Close | | Bal | 0 |  |  |   + Insurance Expense –   |  |  |  |  | | --- | --- | --- | --- | | (c) | 3,500 | 3,500 | Close | | Bal | 0 |  |  | |

# HANDOUT 4–4 SOLUTION, continued

Deana’s Decorators

Post-closing Trial Balance

December 2016

|  |  |  |
| --- | --- | --- |
| Account | Debit | Credit |
| Cash | $ 43,450 |  |
| Supplies | 800 |  |
| Accounts Receivable | 4,000 |  |
| Prepaid Rent | 8,000 |  |
| Prepaid Insurance | 2,500 |  |
| Certificate of Deposit | 20,000 |  |
| Interest Receivable | 1,200 |  |
| Property, Plant & Equipment | 40,000 |  |
| Accumulated Depreciation |  | $ 2,000 |
| Accounts Payable |  | 250 |
| Dividend Payable |  | 750 |
| Unearned Revenue |  | 100 |
| Notes Payable |  | 30,000 |
| Interest Payable |  | 3,000 |
| Income Taxes Payable |  | 26,110 |
| Contributed Capital |  | 10,000 |
| Retained Earnings |  | 47,740 |
| Dividends | 0 |  |
| Service Revenue |  | 0 |
| Interest Revenue |  | 0 |
| Salaries and Wage Expense | 0 |  |
| Utilities Expense | 0 |  |
| Telephone Expense | 0 |  |
| Supplies Expense | 0 |  |
| Rent Expense | 0 |  |
| Insurance Expense | 0 |  |
| Depreciation Expense | 0 |  |
| Interest Expense | 0 |  |
| Income Tax Expense | 0 |  |
| Totals | $119,950 | $119,950 |