


# Preparing Year-end Adjusting Entries



Screen 001

The purpose of this illustration is to review the adjusting journal entries needed before preparing financial statements at year-end. In doing so, we review four types of situations that give rise to such entries: accrued revenues, unearned revenues, accrued expenses, and prepaid expenses. Some refer to unearned revenues and prepaid expenses as deferred revenues and expenses, respectively.

## Frank's Steakhouse

Frank's Steakhouse is completing its accounting process to prepare its financial statements at year-end 2009. Frank's accountant is considering the following transactions to see what additional adjusting entries may be needed before preparing the financial statements:

- A. On October 1, 2009, Frank's took out a loan from First National Bank for \$20,000. The loan requires payment of 8% interest each year, beginning on September 30, 2010.
- B. Frank's leases the building in which the restaurant is located and paid \$24,000 to the landlord. Frank's recorded rent expense for this amount. At year-end, \$2,000 has been paid that applies to the January 2010 rent.
- C. Frank's has equipment and fixtures that it purchased at the beginning of 2008 for \$60,000. The equipment has a five-year useful life and no estimated salvage value. Frank's uses the straight-line depreciation method.
- D. Frank's last employee payroll for the year was issued on December 22. Since then, employees have performed services for which they will be paid \$2,700 on January 5, 2010, the next payroll date.
- E. For the holiday season, Frank's sold \$3,000 in gift certificates. The certificates are able to be used starting in January 2010.
- F. During the year, Frank's bought some restaurant supplies for \$4,800 in cash, recording these as supplies inventory. Only \$450 of these supplies remain on hand at year-end.

Screen 002

Frank's Steakhouse is completing its accounting process to prepare its financial statements at year-end 2009. Frank's accountant is considering the following transactions to see what additional adjusting entries may be needed before preparing the financial statements:

- A. On October 1, 2009, Frank's took out a loan from First National Bank for \$20,000. The loan requires payment of 8% interest each year, beginning on September 30, 2010.
- B. Frank's leases the building in which the restaurant is located and paid \$24,000 to the landlord. Frank's recorded rent expense for this amount. At year-end, \$2,000 has been paid that applies to the January 2010 rent.
- C. Frank's has equipment and fixtures that it purchased at the beginning of 2008 for \$60,000. The equipment has a five-year useful life and no estimated salvage value. Frank's uses the straight-line depreciation method.
- D. Frank's last employee payroll for the year was issued on December 22. Since then, employees have performed services for which they will be paid \$2,700 on January 5, 2010, the next payroll date.
- E. For the holiday season, Frank's sold \$3,000 in gift certificates. The certificates are able to be used starting in January 2010.
- F. During the year, Frank's bought some restaurant supplies for \$4,800 in cash, recording these as supplies inventory. Only \$450 of these supplies remain on hand at year-end.

## Frank's Steakhouse

ANSWERS	
<input type="text"/>	A. On October 1, 2009, Frank's took out a loan from First National Bank for \$20,000. The loan requires payment of 8% interest each year, beginning on September 30, 2010.
<input type="text"/>	B. Frank leases the building in which the restaurant is located and paid \$24,000 to the landlord. Frank recorded rent expense for this amount. At year-end, \$2,000 has been paid that applies to the January 2010 rent.
<input type="text"/>	C. Frank's has equipment and fixtures that it purchased at the beginning of 2008 for \$60,000. The equipment has a six-year useful and no estimated salvage value. Frank's uses the straight-line depreciation method.
<input type="text"/>	D. Frank's last employee payroll for the year was issued on December 22. Since then, employees have performed services for which they will be paid \$2,700 on January 5, 2010, the next payroll date.
<input type="text"/>	E. For the holiday season, Frank sold in gift certificates and credited sales revenue. The gift certificates are able to be used starting in January 2010.
<input type="text"/>	F. During the year, Frank's bought some restaurant supplies for \$4,800 in cash, recording these as supplies inventory. Only \$450 of these supplies remain on hand at year-end.

Types of transactions:

- |                      |                        |
|----------------------|------------------------|
| 1. Accrued revenue;  | 3. Accrued expense; or |
| 2. Unearned revenue; | 4. Prepaid expense.    |

Screen 003

Before we make the adjusting journal entries, let's see if you can classify Frank's transactions properly. For each of these six transactions, Frank's needs to record an adjusting entry because it represents one of the following types of transactions:

1. accrued revenue;
2. unearned revenue;
3. accrued expense; or
4. prepaid (deferred) expense.

You are to identify each transaction, by placing a 1, 2, 3 or 4 in the cell space provided. When you are finished, click NEXT.

## Frank's Steakhouse

<u>Transaction</u>	<u>Your answer</u>	<u>Correct answer</u>
A	_____	3
B	_____	4
C	_____	4
D	_____	3
E	_____	2
F	_____	4

Screen 004

In this table, we compare your answers for the types of Frank's transactions to the actual correct answers. If you got them correct, congratulations! If not, Coach will provide a complete explanation for you.

## Frank's Steakhouse

On October 1, 2009, Frank's took out a loan from First National Bank for \$20,000. The loan requires payment of 8% interest each year, beginning on September 30, 2010.

*Type: An accrued expense*

### Adjusting entry:

Interest expense	\$400	
Accrued interest payable		\$400

$\$20,000 \times .08 \times 1/4 = \$400$

Screen 005

Now we will review each transaction situation and explain the appropriate adjusting entry required.

The first transaction is a loan taken out by Frank's on September 30, 2009. At year-end, no interest payments have been made in cash. This is an accrued expense situation because interest expense should be recorded for the time elapsed from September 30 until the end of the year. There is a three-month period, or one-fourth of the year, so Frank's needs to accrue one-fourth of a year's interest expense at an 8% annual rate. 8% of the \$20,000 loan is \$1,600 per year, so \$400 will be accrued. The adjusting entry is a debit to Interest expense for \$400 and a credit to Accrued interest payable for \$400.

## Frank's Steakhouse

Frank's leases the building in which the restaurant is located and paid \$24,000 to the landlord. Frank's recorded rent expense for this amount. At year-end, \$2,000 has been paid that applies to the January 2010 rent.

*Type: A prepaid (deferred) expense*

### Adjusting entry:

Prepaid rent	\$2,000
Rent expense	\$2,000

Screen 006

The second transaction involves Frank's \$24,000 in payments to the landlord during 2009. At year-end, \$2,000 of this amount paid pertains to rent for January 2010. This is a prepaid expense (i.e., deferred expense) situation because an asset needs to be included on the December 31, 2009 balance sheet for \$2,000 in prepaid rent. To this point, there is zero in the Prepaid rent account and, therefore, it is understated.

Correspondingly, there is \$2,000 too much in the Rent expense account. Thus, the adjusting entry is a debit to Prepaid rent for \$2,000 and a credit to Rent expense for \$2,000.

## Frank's Steakhouse

Frank's has equipment and fixtures that it purchased at the beginning of 2008 for \$60,000. The equipment has a five-year useful life and no estimated salvage value. Frank's uses the straight-line depreciation method.

*Type: A prepaid (deferred) expense*

### Adjusting entry:

Depreciation expense	\$12,000	
Accumulated depreciation		\$12,000

$(\$60,000/5 \text{ years}) = \$12,000/\text{year}$

Screen 007

The third transaction involves Frank's depreciation of its equipment and fixtures. \$60,000 of cost is being spread evenly over five years, or \$12,000 per year. This is a prepaid expense (i.e., deferred expense) situation because the expense for 2009 needs to be recorded, along with the change in the book value of the assets involved. Thus, the adjusting entry is a debit to Depreciation expense for \$12,000 and a credit to Accumulated depreciation for \$12,000.

## Frank's Steakhouse

Frank's last employee payroll for the year was issued on December 22. Since then, employees have performed services for which they will be paid \$2,700 on January 5, 2010, the next payroll date.

*Type: An accrued expense*

Adjusting entry:

Salaries and wages expense	\$2,700	
Accrued salaries and wages payable		\$2,700

Screen 008

The fourth transaction involves Frank's accrued payroll of \$2,700. This is an accrued expense situation because the salaries and wages expense for 2009 needs to be recorded in full, along with the obligation to pay for the work done during the last part of December. Thus, the adjusting entry is a debit to Salaries and wages expense for \$2,700 and a credit to Accrued salaries and wages payable for \$2,700.

## Frank's Steakhouse

For the holiday season, Frank's sold \$3,000 in gift certificates. The certificates are able to be used starting in January 2010.

*Type: An unearned (deferred) revenue*

### Adjusting entry:

**Sales revenue      \$3,000**  
**Unearned sales revenue   \$3,000**

Screen 009

The fifth transaction involves \$3,000 in gift certificates that Frank's sold and for which it has already recorded sales revenue. Because these gift certificates are still unused, the revenue for the services to be provided has not yet been earned. This is an unearned revenue (i.e., deferred revenue) situation. Thus, the adjusting entry is a debit to Sales revenue for \$3,000 and a credit to Deferred (unearned) sales revenue for \$3,000. This entry decreases the revenue reported in Frank's 2009 income statement and records the liability for this amount that Frank's will include on its year-end balance sheet.

## Frank's Steakhouse

During the year, Frank's bought some restaurant supplies for \$4,800 in cash, recording these as supplies inventory. Only \$450 of these supplies remain on hand at year-end.

*Type: A prepaid (deferred) expense*

### Adjusting entry:

Supplies expense	\$4,350	
Supplies inventory		\$4,350

$$\$4,800 - 450 = \$4,350$$

Screen 010

The final transaction reduces the supplies inventory for the amount used during the period and records that amount as a Supplies expense. This is an prepaid expense (or deferred expense) situation. The amount used is \$4,350, so the adjusting entry is a debit to Supplies expense for \$4,350 and a credit to Supplies inventory for \$4,350.