



LIFEPAAC®

# Accounting

Student Book

Unit 7



# ACCOUNTING LIFE PAC 7

## ADJUSTING & CLOSING ENTRIES

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# ACCOUNTING LIFE PAC 7

## ADJUSTING & CLOSING ENTRIES

### OVERVIEW

The sixth step in the accounting cycle is recording and posting the adjusting and closing entries. After adjusting entries are completed on the worksheet, they must be journalized and posted to the general ledger. The entries made on a worksheet are not entered into the general ledger without first recording them in a general journal.

The **closing entries** are prepared at the end of a **fiscal period** to transfer the balances of revenue and expense accounts to the **Income Summary** account and then to the proprietor's Capital account. This process is necessary in order to close any temporary accounts for an accounting cycle before another one begins.

The **post-closing trial balance** is the seventh step in the accounting cycle. The post-closing trial balance checks the equality of the debits and credits in the general ledger accounts that remain open after the closing process has been completed.



### OBJECTIVES

When you have completed this LIFE PAC® you will be able to:

1. Define accounting terms related to adjusting and closing entries.
2. Explain why a worksheet is prepared.
3. Explain why adjustments are made to various accounts.
4. Record adjusting entries from the adjustments section of the worksheet to the general journal.
5. Post the adjusting entries to the general ledger accounts.
6. Explain why closing entries are made.
7. Record the closing entries from the income statement section of the worksheet to the general journal.
8. Post the closing entries to the general ledger.
9. Prepare a post-closing trial balance.



### VOCABULARY

**Adjusting Entries** – entries made in the journal to adjust the ledger accounts so that they will contain the same balances as shown on the worksheet.

**Adjustment** – an amount that is added to or subtracted from an account balance to bring the balance up to date.

**Assets/Expense Adjustment** – a type of deferral adjustment that distributes the expense of consumed assets (such as supplies) over more than one fiscal period.

**Balance Sheet** – a financial statement that reports assets, liabilities and owner's equity on a specific date.

**Closing Entries** – journal entries prepared at the end of a fiscal period to transfer the balances of revenue and expense accounts to the proprietor's Capital account.

**Consistent Reporting** – the same accounting concepts are applied the same way for each accounting period for as long as the business operates.

**Deferral Adjustments** – adjustments to accounts that delay the recognition of the expenses or revenue until a fiscal period later than the one during which the cash was paid or the liability incurred.

**Fiscal Period** – the length of the accounting cycle for which a business summarizes and reports financial information.

**Income Statement** – a financial statement that reports the revenue and expenses for a fiscal period.

**Income Summary Account** – a temporary account whose balance is transferred to the permanent Capital account at the end of each accounting period.

**Matching Expenses with Revenue** – all revenue and expenses associated with a business activity are to be recorded in the same accounting period.

**Net Income** – the difference between total revenue and total expenses when total revenue is greater than total expenses.

**Net Loss** – the difference between total revenue and total expenses when total expenses are greater than total revenue.

**Permanent Accounts** – accounts that accumulate financial information from one fiscal period to another; also known as real accounts.

**Post-Closing Trial Balance** – a trial balance completed to check the equality of the debits and credits in the general ledger accounts that remain open after the closing process has been completed.

**Temporary Accounts** – accounts that accumulate financial information until it is transferred to the owner's Capital account; also known as nominal accounts.

**Trial Balance** – a proof of the equality of debits and credits in a general ledger.

**Working Papers** – informal papers in the form of memoranda, analysis papers, and informal reports.

**Worksheet** – a columnar accounting form used to summarize the general ledger information needed to prepare financial statements.



## SECTION I. ADJUSTING ENTRIES



### The Purpose of a Worksheet

In LIFEPAC 5 you learned that the accountant uses various methods of providing the owners and managers with the information they need to make good business decisions. The accountant organizes the data that is presented on the formal financial reports by first preparing a **worksheet**. A worksheet is a columnar accounting form used to summarize the general ledger information needed to prepare the financial statements. This important **working paper** analyzes, sorts and updates the ledger account balances for the accountant or bookkeeper. It also provides a single source of information for the financial reports prepared at the end of the fiscal period.

The worksheet helps the accountant to do the following:

1. Prepare the unadjusted trial balance to prove the equality of the debit and credit balances taken from the ledger;
2. Show the effects of the **adjustments** on the account balances to bring them up to date;
3. Sort the account balances into columns according to whether that account is used in preparing an **income statement** or a **balance sheet**; and
4. Calculate the amount of the **net income** or **net loss** for the fiscal period.

The eight-column worksheet organizes the financial information into four sections:

1. The *trial balance section* proves the equality of the debits and credits in the ledger. This section of the worksheet is used to create the formal trial balance which you have already studied in LIFEPAC 4.

2. The *adjustments section* is used to update the balances of accounts such as Supplies and Prepaid Insurance. The balances of these accounts at the end of the fiscal period do not accurately reflect the changes that have occurred due to the daily internal operations of the business. Supplies that were purchased at the beginning of the fiscal period are not used up until a future fiscal period. Since insurance is usually paid for a year in advance, the unexpired insurance must be carried over as an asset for the next accounting cycle. The costs incurred in the operation of a business are expenses, and adjustments must be made to transfer these costs to the proper expense account.
3. The *income statement section* contains the updated balances of all revenue and expense accounts and is used to calculate net income or net loss.
4. The *balance sheet section* contains the permanent accounts of the business and provides all the necessary information to prepare the formal balance sheet and the formal income statement.

The major function of the worksheet as an accounting tool is to show the effects of the adjustments on general ledger accounts. The ledger accounts must be adjusted to contain the same balances shown on the worksheet.

### **The Need for Adjustments**

It is a common practice for many businesses to pay cash for expenses in one fiscal period, but the expense is not actually incurred until a later fiscal period. For example, supplies purchased in large quantities are usually less expensive. Therefore, businesses purchase supplies based not only on usage but also on the cost per item. These purchases must also be divided over various fiscal periods. The Supplies Expense account reflects the actual amount of supplies consumed during the fiscal period.



Insurance policies provide a larger discount if purchased for three or five years instead of yearly. During a monthly fiscal period, the unexpired insurance must be carried over as an asset for the next accounting cycle. The expired insurance becomes an expense for this fiscal period. The Insurance Expense account reflects the actual amount of insurance “consumed” during the fiscal period.

It is important that a business match the expenses with the revenue it produced during the fiscal period. The accounting concept of **matching expenses with revenue**, discussed previously in LIFEPAC 6, states that all revenue and expenses associated with a business activity are to be recorded in the same accounting period. By matching revenue with expenses, a more accurate indication of business performance is obtained than by comparing cash receipts and cash payments for the same period.

These normal business procedures require that accounts be adjusted. The updated balances will provide a more accurate financial picture of the entity at the end of a fiscal period. Adjustments are needed to provide an accurate reporting of the financial progress of the business and its financial position.

The adjusting entries that were considered in LIFEPAC 5 are referred to as deferral adjusting entries. A **deferral adjustment** defers or delays the recognition of expenses or revenue until a fiscal period later than the one during which the cash was paid or the liability was incurred. A major subdivision of deferral adjusting entries is the assets/expense adjustments. **Assets/expense adjustments** are required to distribute expenses over more than one fiscal period. The amounts in the assets account have been posted there for the current accounting cycle or for a prior fiscal period. The adjustment made must determine the portion of the cost that is an expense at the end of the fiscal period. This cost is determined from the company’s inventory of office or store supplies used in the day-to-day business operations.

Using the inventory method, it is possible to record each item as an expense when it is removed from inventory. However, this is not a practical method of bookkeeping or accounting. Instead, inventories are kept and the adjustments are made at the end of each fiscal period. These adjustments are made in the adjustments columns of the worksheet.

## **Journalizing Adjusting Entries**

The end-of-period adjustments are computed on the worksheet to provide correct account balances for the financial statements. The accounts in the general ledger, however, still show the incorrect balances. It is necessary, therefore, to journalize the adjustments in the general journal and post the entries to the ledger. After journalizing and posting the adjustments, the accounts in the general ledger will agree with the amounts on the financial statements. The information for the adjusting entries is found in the adjustments column of the worksheet. NOTE: The entries are *not* recorded on the same page as previous entries for the fiscal period but are recorded on the next blank journal page.

The first two **adjusting entries** to be recorded are:

1. An adjusting entry to update the Supplies account, and
2. An adjusting entry to update the Prepaid Insurance account.

**Adjusting Entry for Supplies.** The information needed to journalize the adjusting entry for Supplies is illustrated on the partial worksheet provided below.

ACCOUNT NAME	ADJUSTMENTS	
	DEBIT	CREDIT
Supplies		4 (a) 1300 00
Prepaid Insurance		(b) 300 00
John's Garage		
Wick Supplies		
Don Donaldson, Capital		
Don Donaldson, Drawing		
Sales		
Advertising Expense		
Insurance Expense	(b) 300 00	
Miscellaneous Expense		
Rent Expense		
Supplies Expense	3 (a) 1300 00	

JOURNAL							Page 2	
Date	Account Title and Explanation	Doc No.	Post. Ref.	General Debit		General Credit		
20—								
2	1 Adjusting Entries							
May 31	Supplies Expense			3	1300 00			
	Supplies					4	1300 00	

To journalize the adjusting entry for Supplies, turn to the next blank page of the journal following the last transaction of the fiscal period.

1. Enter the heading *Adjusting Entries* in the middle of the Account Title column of the journal. Using this heading eliminates the need of a source document to verify the transaction.
2. Enter the year and the date in the Date column of the journal. This date represents the end of the fiscal period.
3. Locate the (a) debit entry on the worksheet for Supplies Expense and enter the account name and the amount in the Debit column of the journal. Remember when journalizing that the debit entry is recorded first, followed by the credit entry.
4. Locate the (a) credit entry on the worksheet for Supplies and enter the account name and the amount in the Credit column of the journal.



**Adjusting Entry for Prepaid Insurance.** The information needed to journalize the next adjusting entry—Prepaid Insurance—is shown below.

ACCOUNT NAME	ADJUSTMENTS	
	DEBIT	CREDIT
<i>Supplies</i>		(a) 1300 00
<i>Prepaid Insurance</i>		<b>6</b> (b) 300 00
<i>John's Garage</i>		
<i>Wick Supplies</i>		
<i>Don Donaldson, Capital</i>		
<i>Don Donaldson, Drawing</i>		
<i>Sales</i>		
<i>Advertising Expense</i>		
<i>Insurance Expense</i>	<b>5</b> (b) 300 00	
<i>Miscellaneous Expense</i>		
<i>Rent Expense</i>		
<i>Supplies Expense</i>	(a) 1300 00	

JOURNAL							Page 2	
Date	Account Title and Explanation	Doc No.	Post. Ref.	General Debit		General Credit		
20—								
	<i>Adjusting Entries</i>							
May 31	<i>Supplies Expense</i>				1300 00			
	<i>Supplies</i>					1300 00		
31	<i>Insurance Expense</i>			<b>5</b>	300 00			
	<i>Prepaid Insurance</i>					<b>6</b>	300 00	

The next adjusting entry is for Prepaid Insurance. This journal entry is made directly underneath the adjusting entry for Supplies.

5. Locate the (b) debit entry on the worksheet for Insurance Expense and enter the account name and the amount to be debited in the journal. Remember that in journalizing the debit entry is recorded first, followed by the credit entry.
6. Locate the (b) credit entry on the worksheet for Prepaid Insurance and enter the account name and the amount to be credited in the journal.

## Posting Adjusting Entries

Once the adjusting entries for Supplies and Prepaid Insurance have been journalized, they will need to be posted in order to bring the ledger accounts up to date.

**Posting the Adjustment for Supplies.** The illustrations below take you step by step through the procedure to post the adjustments from the journal to the Supplies and Supplies Expense ledger accounts.

JOURNAL								Page 2	
Date 20—	Account Title and Explanation		Doc No.	Post. Ref.	General Debit		General Credit		
	<i>Adjusting Entries</i>								
May 31	<i>Supplies Expense</i>		4	550	1300	00			
	<i>Supplies</i>		7	120			1300	00	
	31	<i>Insurance Expense</i>			300	00			
		<i>Prepaid Insurance</i>					300	00	

Account Title: <i>Supplies</i>							Account No. 120		
Date 20—	Explanation		Post. Ref.	Debit		Credit	Balance		
							Debit	Credit	
May 1			✓				2282	00	
	14		J1	1198	00		3480	00	
	31	5	J2			6 1300 00	2180	00	

Account Title: <i>Supplies Expense</i>							Account No. 550		
Date 20—	Explanation		Post. Ref.	Debit		Credit	Balance		
							Debit	Credit	
May 31		1	J2	2 1300	00		3 1300	00	

1. Enter the date in the date column of the Supplies Expense ledger account and the journal page (J2) in the Post. Ref. column.
2. Carry the amount from the journal's Debit column to the Debit column of the Supplies Expense account and compute the new account balance.
3. Bring the balance forward into the Debit Balance column.
4. Enter the Supplies Expense account number in the journal's Post. Ref. column.
5. To post the credit to Supplies, enter the date in the date column of the ledger account and the journal page number in the Post. Ref. Column.
6. Carry the amount from the journal's Credit column to the Credit column of the Supplies account, compute the new account balance and enter it in the Balance Debit column.
7. Enter the Supplies account number in the journal's Post. Ref. column.

**Posting the Adjustment for Prepaid Insurance.** The illustrations below take you step by step through the procedure to post the adjustments from the journal to the Prepaid Insurance and Insurance Expense ledger accounts.

JOURNAL								Page 2	
Date 20—	Account Title and Explanation	Doc No.	Post. Ref.	General Debit		General Credit			
	<i>Adjusting Entries</i>								
May 31	<i>Supplies Expense</i>		550	1300	00				
	<i>Supplies</i>		120			1300	00		
31	<i>Insurance Expense</i>	11	520	300	00				
	<i>Prepaid Insurance</i>	14	130			300	00		

Account Title: <i>Prepaid Insurance</i>						Account No. 130			
Date 20—	Explanation	Post. Ref.	Debit		Credit	Balance		Debit	Credit
May 1		✓				1200	00		
31	12	J2			13 300 00	900	00		

Account Title: <i>Insurance Expense</i>						Account No. 520			
Date 20—	Explanation	Post. Ref.	Debit		Credit	Balance		Debit	Credit
May 31	8	J2	9	300 00		10	300 00		

8. Enter the date in the date column of the Insurance Expense ledger account and the journal page (J2) in the Post. Ref. column.
9. Carry the amount from the journal's Debit column to the Debit column of the Insurance Expense account and compute the new account balance.
10. Bring the balance forward into the Debit Balance column.
11. Enter the Insurance Expense account number in the journal's Post. Ref. column.
12. To post the credit to Prepaid Insurance, enter the date in the date column of the ledger account and the journal page number in the Post. Ref. Column.
13. Carry the amount from the journal's Credit column to the Credit column of the Prepaid Insurance account, compute the new account balance and enter it in the Balance Debit column.
14. Enter the Prepaid Insurance account number in the journal's Post. Ref. column.

As a proof that the adjusting entries in the general journal have been posted correctly to the appropriate accounts in the general ledger, the new balances in the Supplies Expense and Insurance Expense accounts will agree with the balances that appear on the income statement. The Prepaid Insurance and Supplies ledger account balances will also agree with the amounts that appear on the balance sheet.



**Complete the following activity.**

- 1.1 Use the information on the worksheet below to journalize and post the adjusting entries for **Lawson's Lawn Care**. After completing the exercise, compare the adjusted balances on the income statement and balance sheet columns of the worksheet with your ledger account balances to verify that your work is correct. NOTE: The ledger accounts on the next page are arranged in numerical order.

<i>Lawson's Lawn Care</i>									
<i>Worksheet</i>									
<i>For the Month Ended July 31, 20—</i>									
ACCOUNT TITLE	TRIAL BALANCE		ADJUSTMENTS		INCOME STATEMENT		BALANCE SHEET		
	DEBIT	CREDIT	DEBIT	CREDIT	DEBIT	CREDIT	DEBIT	CREDIT	
Cash	7822 00						7822 00		
Petty Cash	300 00						300 00		
Supplies	4319 00			(a) 1341 00			2978 00		
Prepaid Insurance	1600 00			(b) 330 00			1270 00		
John's Garage		1630 00						1630 00	
Wick Supplies		300 00						300 00	
D. Lawson, Capital		9000 00						9000 00	
D. Lawson, Drawing	500 00						500 00		
Sales		4367 00				4367 00			
Advertising Expense	86 00				86 00				
Insurance Expense			(b) 330 00		330 00				
Miscellaneous Expense	95 00				95 00				
Rent Expense	450 00				450 00				
Supplies Expense			(a) 1341 00		1341 00				
Utilities Expense	125 00				125 00				
<b>Totals</b>	<b>15297 00</b>	<b>15297 00</b>	<b>1671 00</b>	<b>1671 00</b>	<b>2427 00</b>	<b>4367 00</b>	<b>12870 00</b>	<b>10930 00</b>	
Net Income					1940 00			1940 00	
					4367 00	4367 00	12870 00	12870 00	

# JOURNAL

Date	Account Title and Explanation	Doc No.	Post. Ref.	General Debit	General Credit

Account Title: <i>Supplies</i>						Account No. <i>130</i>				
Date <i>20—</i>	Explanation	Post. Ref.	Debit		Credit	Balance				
						Debit	Credit			
<i>July</i> 1		✓					4319	00		

Account Title: <i>Prepaid Insurance</i>						Account No. <i>140</i>				
Date <i>20—</i>	Explanation	Post. Ref.	Debit		Credit	Balance				
						Debit	Credit			
<i>July</i> 1		✓					1600	00		

Account Title: <i>Insurance Expense</i>						Account No. <i>520</i>				
Date	Explanation	Post. Ref.	Debit		Credit	Balance				
						Debit	Credit			

Account Title: <i>Supplies Expense</i>						Account No. <i>550</i>				
Date	Explanation	Post. Ref.	Debit		Credit	Balance				
						Debit	Credit			



Review the material in this section in preparation for the Self Test. The Self Test will check your mastery of this particular section. The items missed on this Self Test will indicate specific areas where restudy is needed for mastery.

## SELF TEST 1

**Match the following accounting terms with their definitions** (each answer, 2 points).

- |       |  |                                   |
|-------|--|-----------------------------------|
| 1.01  | _____ occurs when total revenue is greater than total expenses   | a. adjustment                     |
| 1.02  | _____ informal papers in the form of memoranda, analysis papers, and informal reports                                    | b. balance sheet                  |
| 1.03  | _____ the length of the accounting cycle for which a business summarizes and reports financial information               | c. matching expenses with revenue |
| 1.04  | _____ a financial statement that reports the revenue and expenses for a fiscal period                                    | d. fiscal period                  |
| 1.05  | _____ occurs when total expenses are greater than total revenue  | e. income statement               |
| 1.06  | _____ all revenue and expenses associated with a business activity are to be recorded in the same accounting period      | f. net income                     |
| 1.07  | _____ entries made in the journal to adjust the ledger accounts to contain the same balances as shown on the worksheet   | g. net loss                       |
| 1.08  | _____ a financial statement that reports assets, liabilities and owner's equity on a specific date                       | h. deferral adjustments           |
| 1.09  | _____ a columnar accounting form used to summarize the general ledger information needed to prepare financial statements | i. working papers                 |
| 1.010 | _____ an amount that is added to or subtracted from an account balance to bring the balance up to date                   | j. worksheet                      |
| 1.011 | _____ delays the recognition of expenses or revenue until a later fiscal period  | k. adjusting entries              |

- 1.012 **Journalize the worksheet adjustments** (34 points).

Use the information from the worksheet on the next page to journalize the worksheet adjustments for the **Floor-Shine Company**.

*Floor-Shine Company*

*Worksheet*

*For the Month Ended November 30, 20—*

ACCOUNT TITLE	TRIAL BALANCE		ADJUSTMENTS		INCOME STATEMENT		BALANCE SHEET	
	DEBIT	CREDIT	DEBIT	CREDIT	DEBIT	CREDIT	DEBIT	CREDIT
<i>Cash</i>	5844 00						5844 00	
<i>Petty Cash</i>	300 00						300 00	
<i>Supplies</i>	1900 00			(a) 600 00			1300 00	
<i>Prepaid Insurance</i>	800 00			(b) 400 00			400 00	
<i>Tyson Office Supply</i>		166 00						166 00
<i>Office Systems, Inc.</i>		60 00						60 00
<i>Mike Ford, Capital</i>		8000 00						8000 00
<i>Mike Ford, Drawing</i>	560 00						560 00	
<i>Sales</i>		1628 00				1628 00		
<i>Advertising Expense</i>	75 00				75 00			
<i>Insurance Expense</i>			(b) 400 00		400 00			
<i>Miscellaneous Expense</i>	15 00				15 00			
<i>Rent Expense</i>	250 00				250 00			
<i>Repair Expense</i>	85 00				85 00			
<i>Supplies Expense</i>			(a) 600 00		600 00			
<i>Utilities Expense</i>	25 00				25 00			
<b>Totals</b>	9854 00	9854 00	1000 00	1000 00	1450 00	1628 00	8404 00	8226 00
<i>Net Income</i>					178 00			178 00
					1628 00	1628 00	8404 00	8404 00

**JOURNAL**

Page 5

Date	Account Title and Explanation	Doc No.	Post. Ref.	General Debit	General Credit

1.013 **Post the adjusting entries for the Floor-Shine Company** (40 points).

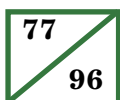
Post the adjusting entries from the journal on the previous page. The ledger accounts are arranged in numerical order.

Account Title: <i>Supplies</i>							Account No. <i>130</i>				
Date 20—		Explanation	Post. Ref.	Debit		Credit		Balance			
								Debit		Credit	
<i>Nov.</i>	<i>1</i>		✓					<i>1900</i>	<i>00</i>		

Account Title: <i>Prepaid Insurance</i>							Account No. <i>140</i>				
Date 20—		Explanation	Post. Ref.	Debit		Credit		Balance			
								Debit		Credit	
<i>Nov.</i>	<i>1</i>		✓					<i>800</i>	<i>00</i>		

Account Title: <i>Insurance Expense</i>							Account No. <i>520</i>				
Date		Explanation	Post. Ref.	Debit		Credit		Balance			
								Debit		Credit	

Account Title: <i>Supplies Expense</i>							Account No. <i>560</i>				
Date		Explanation	Post. Ref.	Debit		Credit		Balance			
								Debit		Credit	



Score \_\_\_\_\_  
 Adult Check \_\_\_\_\_  
 Initial \_\_\_\_\_ Date \_\_\_\_\_