Chapter 3[1]

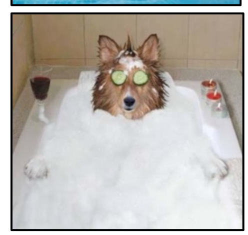
Adjusting Journal Entries & Preparing Financial Statements

Learning Objectives

- Explain the importance of *periodic* reporting and the time period or periodicity assumption.
- Explain why accrual basis accounting is preferable, when compared to cash basis accounting.
- Provide several examples of accruals.
- Illustrate your understanding of the difference between cash basis and accrual basis accounting.
- Explain how accrual accounting assists in complying with the periodicity assumption and the matching principle.
- Give examples of the adjustments or adjusting journal entries used to achieve the periodic matching of revenues and expenses in the income statement and accruals in the balance sheet.
- List the five journals or original books of entry.
- List the 3 journals necessary for cash basis accounting.
- List the 5 journals necessary for accrual basis accounting.
- Provide an example of the types of journal entries likely to be recorded in the general journal.
- Prepare a balance sheet, statement of retained earnings, and income statement, after making adjusting journal entries to an unadjusted trial balance.
- Prepare closing journal entries and a post-closing trial balance.
- Illustrate your understanding of the mechanics involved when using reversing entries.
- Define the profit margin, current ratio, and when and how reversing journal entries are made and used.

[1] Acknowledgement: An earlier version of this chapter was provided to all accounting faculty on November 13, 2014, for review notes, comments, and recommendations for improvement. Work on this text began in early 2014. The completion of this text was made possible through a spring 2015 sabbatical from West Chester University.

Quite a few students wanted some family photos included in the text. Okay…meet Kristian. Don’t let the pleasant demeanor and white belt fool you. He’s a terror and is probably up to no good. Kristian is one of the Cataldo grand critters. He does not have an accounting background, PhD, CPA, or any other credentials in accounting, and did not contribute to this text, but he does appear to enjoy posing for the camera, as he is quite photogenic.



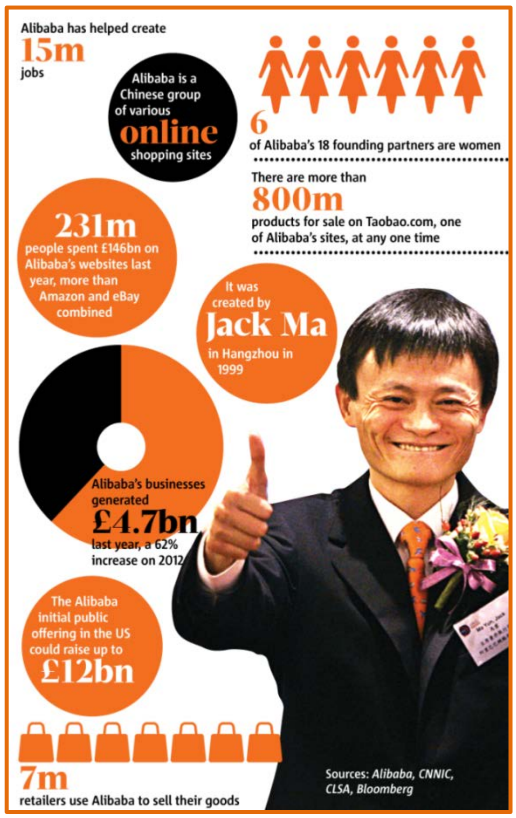
Professor Cataldo and his wife, Holley, at the West Chester vs. Bloomsburg football game in 2011 (left). Their sheltie, Dutch, learns to swim in 2013 (right). Dutch did not enjoy the swimming lessons, but he does like to relax with a glass of red wine in a hot bath with some candles, after a tough day of barking, chasing the ball, and patrolling the back yard perimeter for squirrels and other critters (right). A Capricorn, Dutch was the runt of a litter of 8, and is a very spoiled, one and only child.

Alibaba.com

Alibaba Group Holding Limited (NYSE: BABA) controls 80 percent of China's online shopping. Market capitalization, in billions of U.S. dollars and after its late 2014 IPO, compared favorably to Apple ($615), Google ($397), Microsoft ($384), and is higher than Facebook ($204). Alibaba's market cap approximated $215 billion in October 2014.

Google

Microsoft



Accounting Periods

For information to add value and improve decision-making, it must be provided in a timely fashion and at regular intervals. For this reason, accounting and financial information is prepared based on the time-period or periodicity assumption, which presumes that organizations can produce accounting and financial information at regular intervals – monthly, quarterly, semi-annually, or annually. While annual financial statements and reporting is common, many firms also prepare *interim* financial statements – monthly, quarterly, or semi-annually.

A firm might produce financial statements annually, but an organization can adopt a *fiscal* year end, which differs from the selection of a *calendar* year end (December 31st). For example, it is a common, industry practice for some retailers to use a 52-week reporting period (e.g., Gap, Walmart, and Target), for comparability, and a January 31st fiscal year end. These retailers rely on the holiday season for a significant portion of their revenues, and the end of January provides for a period after post-holiday season sales, when inventories are relatively low.

Cash Basis versus Accrual Basis Accounting

Cash basis accounting recognizes revenues when cash is received and expenses when cash is paid. Therefore, cash basis net income or net loss is the difference between cash receipts and cash disbursements. Cash basis accounting is not consistent with generally accepted accounting principles (GAAP). Cash basis accounting is too easy to manipulate. For example, if you want a higher net income (or a lower net loss) under cash basis accounting, you could simply delay paying bills to reduce cash disbursements or increase net income. Alternatively, you could prepay bills to increase cash disbursements and reduce net income.

The below illustrates just how easily a January cash basis income statement might be manipulated. Assume that the firm pays $2,000 per month for rent expense.

- If they simply pay their rent in January, on time, net income is $1,000.
- If they do not pay their January rent on time, perhaps in an effort to show a higher net income to qualify for a bank loan, their net income would increase to $3,000.

Example 1 Cash Basis	**$2,000 January Rent Paid on Time**	**$2,000 January Rent Not Paid on Time**	**Difference**
Revenues	$12,000	$12,000	$-0-
Expenses	$11,000	$9,000	$2,000
Net Income (Loss)	$1,000	$3,000	($2,000)

A firm might also attempt to use cash basis accounting to manipulate their cash basis income statement from a profit to a loss, perhaps for tax accounting purposes and to reduce their income taxes. Continue to assume that the firm pays $2,000 per month for rent expense.

- If they simply pay their rent in January, on time, net income is $1,000.
- If they pay their rent in January, on time, and also prepay their February rent in January, net loss is $1,000.

Example 2 Cash Basis	**$2,000 January Rent Paid on Time**	**$2,000 February Rent Prepaid in January & January Rent Paid on Time**	**Difference**
Revenues	$12,000	$12,000	$-0-
Expenses	11,000	13,000	(2,000)
Net Income (Loss)	$1,000	($1,000)	$2,000

Using the same, above fact patterns, where rent expense related cash disbursements are delayed or accelerated to generate a higher net income or net loss, respectively, the advantage of accrual accounting will be illustrated.

First, to illustrate the late payment of rent, but under accrual accounting:

Example 1 Cash Basis	**$2,000 January Rent Paid on Time**	**$2,000 January Rent Not Paid on Time**	**Difference**
Revenues	$12,000	$12,000	$-0-
Expenses	11,000	9,000	2,000
Net Income (Loss)	$1,000	$3,000	($2,000)
Example 1 Accrual Basis	**$2,000 January Rent Paid on Time**	**$2,000 January Rent Not Paid on Time**	**Difference**
Revenues	$12,000	$12,000	$-0-
Expenses	11,000	11,000	-0-
Net Income (Loss)	$1,000	$1,000	$-0-

Under cash basis accounting, no journal entry would be made to "accrue" the rent payable and "book" the rent expense. This is why expenses are $2,000 lower and net income is $2,000 higher in the above, cash basis example.

Under accrual accounting, the below journal entry would be made, at month end, to "accrue" the rent payable and "book" the rent expense:

Rent expense	**$2,000**	
Rent payable		**$2,000**

Second, to illustrate the early payment (or prepayment) of rent, but under accrual accounting:

Example 2 Cash Basis	**$2,000 January Rent Paid on Time**	**$2,000 February Rent Prepaid in January & January Rent Paid on Time**	**Difference**
Revenues	$12,000	$12,000	$-0-
Expenses	11,000	13,000	(2,000)
Net Income (Loss)	$1,000	($1,000)	$2,000
Example 2 Accrual Basis	**$2,000 January Rent Paid on Time**	**$2,000 February Rent Prepaid in January & January Rent Paid on Time**	**Difference**
Revenues	$12,000	$12,000	$-0-
Expenses	11,000	11,000	-0-
Net Income (Loss)	$1,000	$1,000	$-0-

Again, under cash basis accounting, no journal entry would be made to "accrue" the prepaid rent and "reclassify" the rent expense as an asset or prepayment. This is why expenses are $2,000 higher and net income is $2,000 lower in the above, cash basis example.

Under accrual accounting, the below journal entry would be made, at month end, to "reclassify" the February rent expense as prepaid rent, if expensed during January:

Prepaid Rent	**$2,000**	
Rent Expense		**$2,000**

Alternatively, the February prepayment might have been made, originally, as follows, which would eliminate the need for the above reclassification entry:

Prepaid rent	**$2,000**	
Cash		**$2,000**

The accrual method of accounting will produce the same results, whether rent payments are delayed or accelerated. This proper ***matching*** of revenues and expenses to the ***period*** when rent expense is incurred is <u>not</u> dependent on cash disbursement decisions. This is achieved through the use of accruals and accrual accounting. The matching principles and the periodicity assumption are fundamental to accrual accounting and GAAP.

The matching (or expense recognition) principle requires that revenues and the expenses incurred to generate these revenues be paired up and reported in the period in which both occurred. For example, the sale of an item for $10 should be matched to the $6 cost of the item. This permits the firm to more easily compute and conclude that a gross profit or gross margin of $4 ($10 less $6) was generated from the sale. Similarly, sales of $10,000 for the month and cost of goods sold of $6,000 per month, generating a gross margin of $4,000 for the month is best examined in an income statement that also provides rent, salary, utilities and other periodic expenses for the same month. If these revenues and expense were not matched for the month or period, the firm would not know if they were generating a profit or a loss and could not quickly and efficiently modify their operations or make informed decisions necessary to the survival of the firm.

The periodicity (or time-period) assumption requires that financial statements be prepared for easily understood time periods. A month, a quarter, a semi-annual or six month period, and a year are all examples of typical accounting periods. Most firms will prefer to have monthly financial statements, so that matters requiring management's attention and improved decision-making become apparent and strategic decisions can improve the operations of the firm.

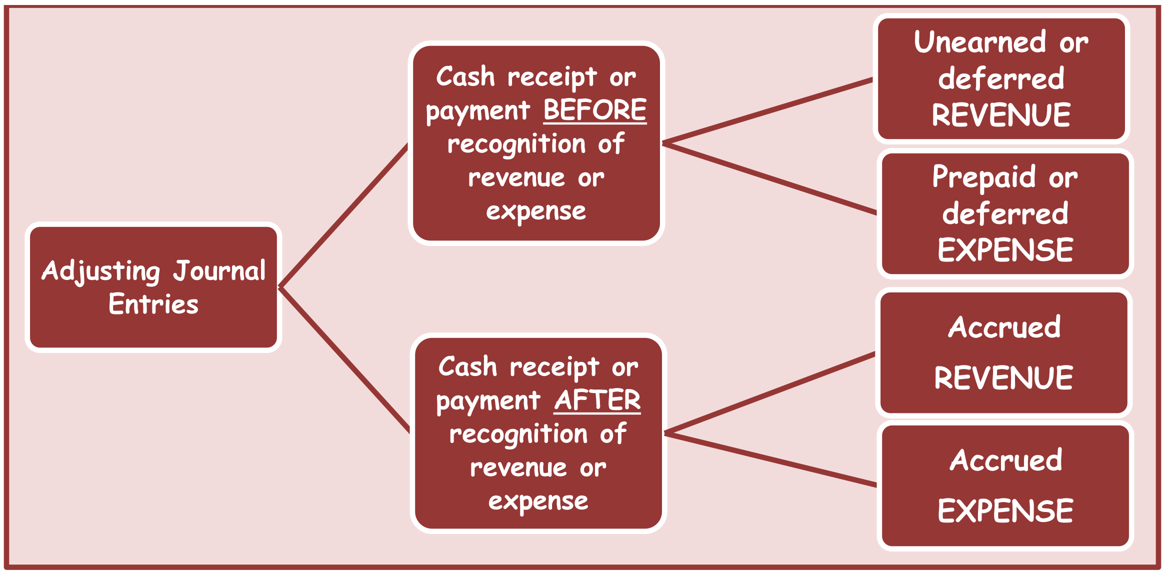
The matching principle and periodicity assumption are linked and consistent with each other. Revenues are matching to the period when generated and expenses follow the revenues they generated.

How Adjustments or Adjusting Journal Entries Achieve Periodic Matching

Adjustments or adjusting journal entries (AJEs) involve adjustment between balance sheet and related income statement accounts, focusing on the correct balance sheet account balance, which is more clearly determinable. It is easily determined, because the firm will have source documents providing end of month balances for these real accounts.

For example, (1) the bank reconciliation will provide the correct balance for cash, (2) a month-end listing of trade accounts receivable will provide the correct balance for accounts receivable, (3) a physical inventory will provide the correct balance for ending inventory, and so on. The generation and/or identification of the source documents for these balance sheet accounts with require adjusting journal entries to adjust the balance sheet account to its corrected balance. In the process, related income statement accounts will be involved and the income statement account balances will also be corrected. So, (1) the bank reconciliation might reveal some bank charges for the month, previously not recorded on the firm's books, (2) a month-end accounting of trade accounts receivable might reveal an uncollectible receivable or bad debt and/or a sale that did not occur and should not have been booked, and (3) a physical inventory might reveal some damaged or spoiled inventory items that must be expensed and result in an inventory account balance reduction.

A Framework for Adjustments or Adjusting Journal Entries
Adjusting journal entries result from timing differences between the period when a revenue or expense is realized and the cash receipt or payment and can viewed in the following framework:



Unearned (or Deferred) Revenue
Unearned revenue or deferred revenue accounts are used to separately account for cash received in advance of providing goods or services. When earned, unearned revenue or deferred revenue, which are liability accounts, become revenue.

Assume that a firm receives $1,000 in advance, on January 1, for a product or service to be provided on or before January 31:

Cash	**$1,000**	
Unearned revenue		**$1,000**

or

Cash	**$1,000**	
Deferred revenue		**$1,000**

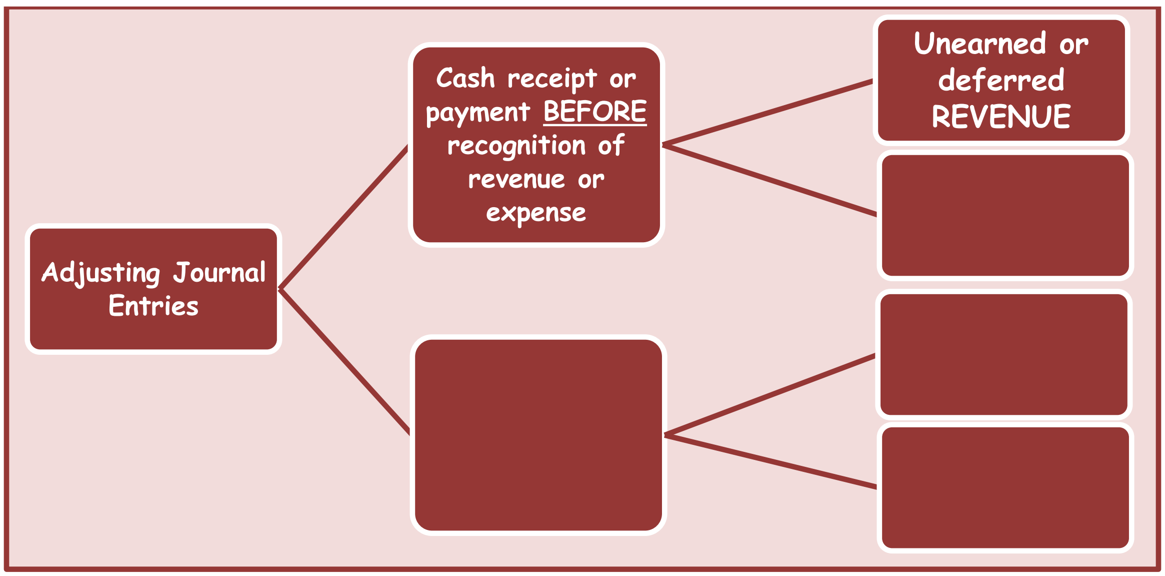
Assume that the product or service is 50 percent completed on or about January 31. The adjusting journal entry to ***match*** revenue to the ***period*** earned, recognizing $500 of the unearned revenue as revenue earned, follows:

Unearned revenue	**$500**	
Revenue		**$500**

Unearned Revenue	
	$1,000 Jan. 1
Jan. 31 $500	
	$500 Balance

Revenue	
	$500 Jan. 31
	$500 Balance

The above adjusting journal entry follows the path represented below. In this case, a cash receipt was received before the revenue was earned.



Prepaid (or Deferred) Expense – Prepaid Insurance
Prepaid expenses are assets until consumed. When consumed, prepaid expenses are expensed. Common examples used in financial accounting texts include prepaid insurance, but any expense can be prepaid.

Assume that the firm prepaid insurance for six months on January 1. On January 31, one-sixth of this insurance prepayment has expired or has been consumed. Both journal entries are presented, below:

Prepaid insurance	**$600**	
Cash		**$600**

Insurance expense	**$100**	
Prepaid insurance		**$100**

Prepaid insurance

Jan. 1 $600	
	$100 Jan. 31
Balance $500	

Insurance expense

Jan. 31 $100	
Balance $100	

Again, this transaction could have been accounted for differently. What if the entire six month insurance policy premium paid had been debited to the expense account on January 1? Again, the adjusting journal entry process would focus on the desired balance sheet account balance for prepaid insurance, where the appropriate ending balance is $500 on January 31. The adjusting journal entries and T-accounts follow:

Insurance expense	**$600**	
Cash		**$600**

Prepaid insurance	**$500**	
Insurance expense		**$500**

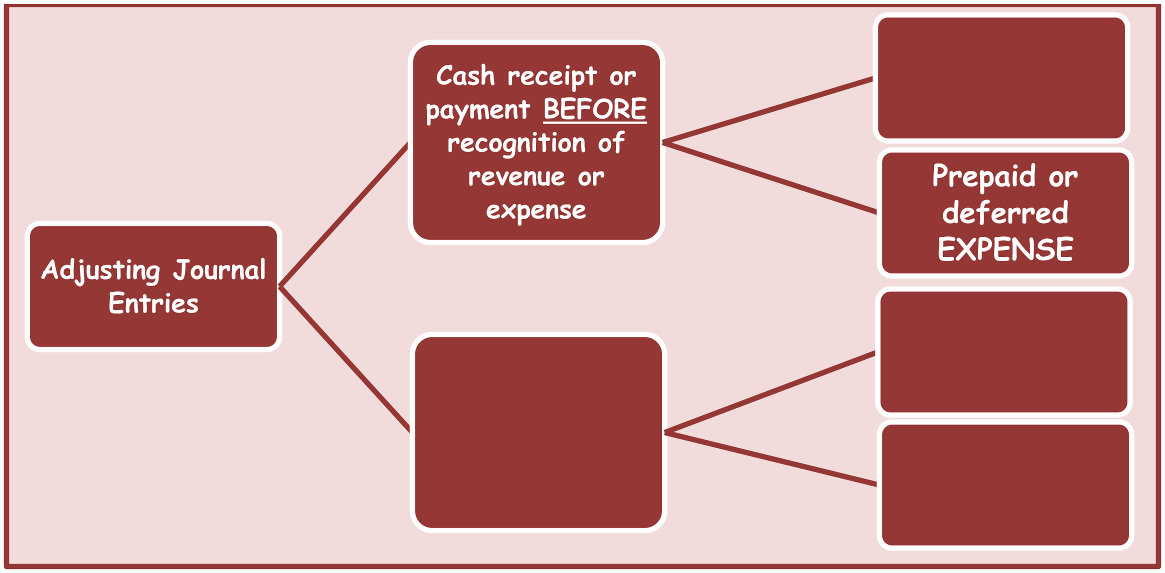
Prepaid insurance

Jan. 31 $500	
Balance $500	

Insurance expense

Jan. 1 $600	
	$500 Jan. 31
Balance $100	

The above adjusting journal entry follows the path represented below. In this case, a cash disbursement was made before the expense was incurred.



Accrued Interest Revenue

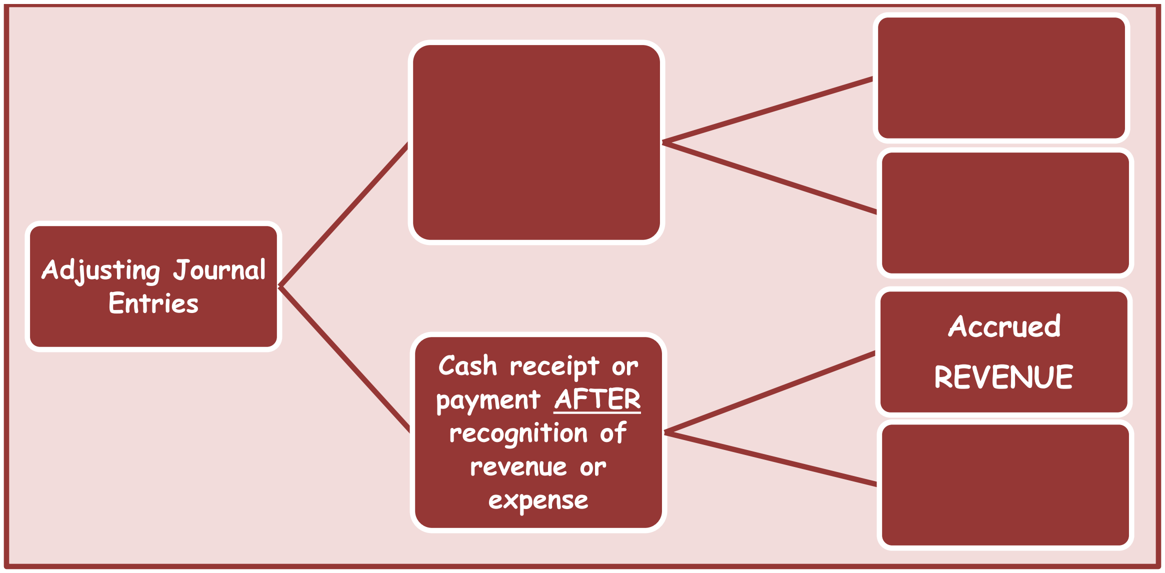
Interest revenue associated with receipts of interest or interest and principal payments that do not occur precisely at month-end will require an accrual journal entry to match the interest revenue to the appropriate period. For example, assume that a $100,000 note bearing interest at a rate of 12 percent per year (or 1 percent per month) requires a debtor to make mid-month payments on the 15th day of each month. This means that ½ of 1 percent accrues between the 16th day of the month and month-end, each and every month. Assuming a 30-day month (and 360 day year), ½ of 1 percent interest between Jan 16th and Jan. 31st amounts to $500 in interest revenue for the latter half of January. The journal entry to be made for the Jan. 31 month end follows:

Interest receivable	**$300**	
Interest revenue		**$300**

Interest receivable	
Jan. 31 $500	
Balance $500	

Interest revenue	
	$500 Jan. 31
	$500 Balance

The above adjusting journal entry follows the path represented below. In this case, revenue was accrued before the cash receipt.



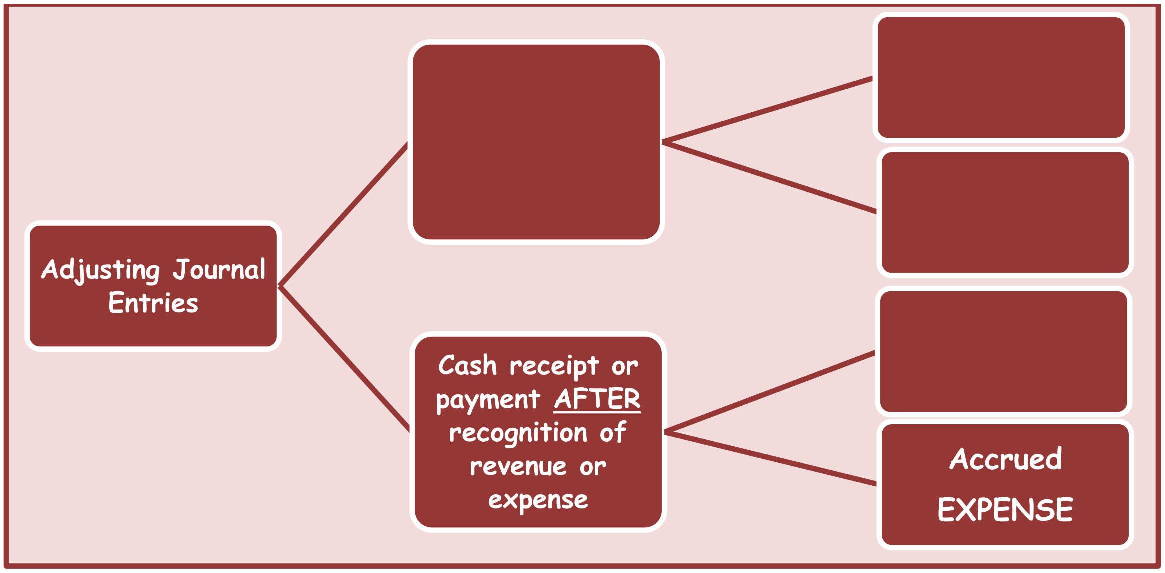
Accrued Interest Expense
Interest expense associated with payments of interest or interest and principal payments that do not occur precisely at month-end will require an accrual journal entry to match the interest expense to the appropriate period. For example, assume that a $100,000 note bearing interest at a rate of 12 percent per year (or 1 percent per month) requires mid-month payments on the 15th day of each month. This means that ½ of 1 percent accrues between the 16th day of the month and month-end, each and every month. Assuming a 30-day month (and 360 day year), ½ of 1 percent interest between Jan 16th and Jan. 31st amounts to $500 in interest expense for the latter half of January. The journal entry to be made for the Jan. 31 month end follows:

Interest expense	**$300**	
Interest payable		**$300**

Interest payable	
	$500 Jan. 31
	$500 Balance

Interest expense	
Jan. 31 $500	
Balance $500	

The above adjusting journal entry follows the path represented below. In this case, expense was accrued before the cash disbursement.



Some additional examples requiring adjustments or adjusting journal entries follow, in no particular order.

Supplies (Inventory and) Expense
Supplies inventory is an asset until consumed. Once consumed, supplies inventory becomes supplies expense.

The following T-Account assumes that a firm purchased $1,000 of supplies inventory on Jan. 15. Supplies inventory could have been purchased on account or with cash. Both alternatives, in general journal entry form, are presented below:

Supplies inventory	**$1,000**	
Accounts payable		**$1,000**

or

Supplies inventory	**$1,000**	
Cash		**$1,000**

On Jan. 31, a physical count was conducted. Remaining supplies inventory was $500. Therefore, $500 in supplies inventory was consumed during the month of January, as follows:

Supplies expense	**$500**	
Supplies inventory		**$500**

Supplies inventory	
Jan. 15 $1,000	
	$500 Jan. 31
Balance $500	

Supplies expense	
Jan. 31 $500	
Balance $500	

The above could have been accounted for differently. What if supply purchased on Jan. 15 were debited to the expense account? Again, the adjusting journal entry process would focus on the desired balance sheet account, supplies inventory, where the appropriate ending balance is $500 on January 31. The adjusting journal entries and T-Accounts follow:

Supplies expense	**$1,000**	
Accounts payable		**$1,000**

or

Supplies expense	**$1,000**	
Cash		**$1,000**

Supplies inventory	**$500**	
Supplies expense		**$500**

Supplies inventory	
Jan. 31 $500	
Balance $500	

Supplies expense	
Jan. 15 $1,000	
	$500 Jan. 31
Balance $500	

Accrued Salaries Expense

Salaries that have not been paid by the end of the month or accounting period will not be reflected as an expense on the period's income statement unless accrued. For example, assume that salaries approximating $100 per week day are paid weekly, on Fridays, and include salaries for the Friday day of payment. If month end occurs on a Wednesday, 3 days of salaries expense ($300) will have to be accrued for Monday, Tuesday and Wednesday. The journal entry to be made to accrue these 3 days of salary expense for the Jan. 31 month end follows:

Salary expense	**$300**	
Salary payable		**$300**

Salary payable	
	$300 Jan. 31
	$300 Balance

Salary expense	
Jan. 31 $300	
Balance $300	

Depreciation Expense
Depreciation represents a process of allocating costs of long-lived assets to the periods benefitting from their use. It is discussed, in greater detail, in Chapter 8, but introduced in this chapter.

Long-lived assets are expected to benefit the firm for more than one period. Several terms are used to describe them, including property, plant and equipment (PP&E) and fixed assets (FA). They include building, machines and furniture. Depreciation expense represents a systematic and rational means of acknowledging economic and physical obsolescence, as these long-lived assets wear out. The cost of the asset is allocated over its expected useful life. Land, of course, does not wear out or have a limited life, so land is not depreciated. The straight-line method of computing depreciation expense is used in the below example.

Assume that a long-lived asset, an automobile, has a cost of $10,000, a useful life of 5 years, and an estimated salvage value of $1,000, as follows:

	Cost	**$10,000**
less:	**Salvage**	**1,000**
equals:	**Depreciable Base or Cost**	**$9,000**
divided by:	**5 Year Life**	**÷ 5**
equals:	**Annual Depreciation Expense**	**$1,800**
divided by:	**12 Months per Year**	**÷ 12**
equals:	**Monthly Depreciation Expense**	**$150**

Further assume that this asset is purchased and placed in service on January 1, and you must make the adjusting journal entry, at the end of January, to record the first month's depreciation expense. The adjusting journal entry to record depreciation expense for January follows:

Depreciation expense	**$150**	
Accumulated depreciation		**$150**

Depreciation expense

Jan. 31 $150	
Balance $150	

Accumulated depreciation

	$150 Jan. 31
	$150 Balance

Accumulated depreciation is a contra asset account. Contra is short for "contrary." *Contra account* balances are increased and decreased in a fashion "contrary" to that ordinary anticipated. Therefore, while asset accounts are increased with debits, contra asset accounts are increased with credits.

After recording the depreciation expense for January, the automobile, a fixed asset, has a net fixed asset value, book value or carrying value of $9,850, as follows:

Equipment	**$10,000**
Less Accumulated Depreciation	**150**
Total Fixed Assets	**$9,850**

The adjusting journal entry to record depreciation expense for February, and for every month until the automobile is fully depreciated, follows:

Depreciation expense	**$150**	
Accumulated depreciation		**$150**

After recording the depreciation expense for February, the second month of useful service, the automobile has a net fixed asset value, book value or carrying value of $9,700, as follows:

Equipment	**$10,000**
Less: Accumulated Depreciation	**300**
Total Fixed Assets	**$9,700**

The accumulated depreciation account "accumulates" all depreciation expense taken over the life of the long-lived asset. This is reflected in the below T-Account for accumulated depreciation, as follows:

Accumulated Depreciation	
	$150 Jan. 31
	$150 Feb 28
	$300 Balance

Failure to make the adjusting journal entries to record depreciation expense for the month of January and each month, until fully depreciated, would (1) understate expenses by $150 and (2) overstate net income by $150 in the monthly income statements. Because accumulated depreciation is a contra account and net income is reduced by expenses, failure to make the adjusting journal entries to record depreciation expense each month would also (3) overstate assets by $150 and (4) overstate equity by $150.

Financial Statement Preparation begins with the (1) income statement, where the net income or net loss measure can, then, be used to prepare the (2) statement of retained earnings, providing the ending retained earnings measure necessary to complete the firm's (3) balance sheet. The (4) statement of cash flows requires a beginning balance sheet, an ending balance sheet, and income statement for the period.

Closing Journal Entries can be made after the income statement is prepared. This is when all temporary or nominal revenue and expense accounts can be closed (or zeroed out) to the income summary account. Then, both income summary and dividend account balances can be closed to the retained earnings account. After revenue, expense, and dividend accounts have been closed (or zeroed out), the firm can proceed with the accounting for transactions occurring during the next period's operations.

Classified Balance Sheet
A more meaningful balance sheet is provided to stakeholders of users of financial statements if classifications of assets, liabilities and equity components are provided. Assets and liabilities, and even equity items, are ordered in terms of liquidity.

The Balance Sheet & Order of Liquidity – Assets, Liabilities & Owners' Equity
Recall that the basic accounting equation is assets equal liabilities plus owners' equity:

ASSETS = LIABILITIES + OWNERS' EQUITY

Assets are listed in order of liquidity, with the most liquid asset, cash, listed first. Liabilities are also listed in order of liquidity, with the liability likely to be paid in cash, first, listed first. It is for this reason that the first liability listed, typically, is accounts payable. Owners' equity accounts are also listed in (reverse) order of liquidity, but with respect to the potential for issuance or cash distribution to shareholders. The below is presented to illustrate:

Assets	=	Liabilities	+	Owners' Equity
Current Assets		Current Liabilities		Preferred Stock
Non-Current Assets		Non-Current Liabilities		Common Stock
				Retained Earnings

A, L & OE ARE ORGANIZED IN ORDER OF LIQUIDITY

Assets	=	Liabilities	+	Owners' Equity
↓		↓		↑

Classified balance sheet presentation of assets and liabilities, in order of liquidity, will be apparent as explained in this chapter. The reverse liquidity presentation in the owners' equity section of the balance sheet will not be apparent in this chapter, but will make more sense after you have read and studied chapter 11, toward the end of this introductory course.

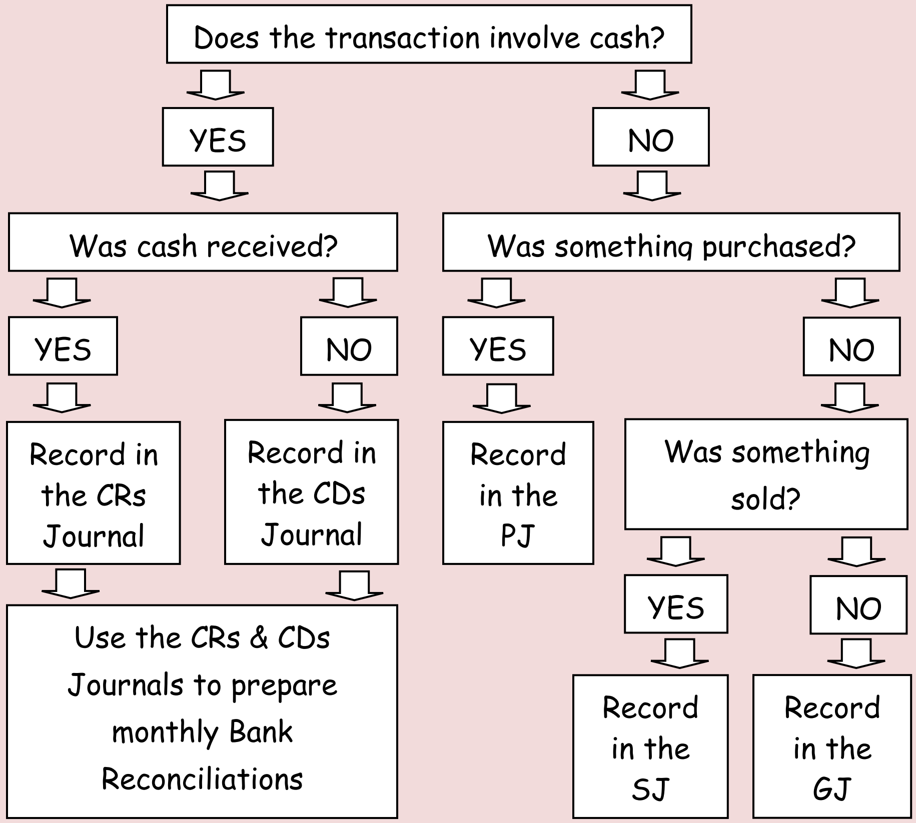
Typical classifications of assets, liabilities and equity items follow:

- Current assets (also referred to as short-term)
- Non-current assets (also referred to as long-term and including investments)
- Plant assets (also referred to as fixed assets or property, plant and equipment)
- Intangible assets
- Current liabilities (also referred to as short-term)
- Non-current liabilities (also referred to as long-term)
- Equity (sub-classifications are explained, in detail, in Chapter 11)

Journals Used for Cash Basis and Accrual Basis Accounting
All journal entries in accounting texts use the "general journal" format to illustrate which accounts to debit and which accounts to credit. In fact, the general journal is only used to summarize and record transactions that cannot more efficiently be recorded and summarized in the other 4 original books of entry.

The original books of entry are the (1) cash receipts journal, (2) the cash disbursements journal, (3) the sales journal, (4) the purchases journal, and (5) the general journal. The flowchart that follows is designed to assist you in your understanding of these journals or original books of entry. While this text will continue to illustrate the accounts debited and credited and the mechanics of accounting using the general journal form, the below should help you come to understand why using a general journal to record all transactions would be inefficient.

Summary Flowchart of Journals used for CASH and ACCRUAL Basis



Cash Basis System of Accounting:

- Cash Receipts (CRs) Journal
- Cash Disbursements (CDs) Journal
- General Journal (GJ)

Accrual Basis System of Accounting: ADD the following Journals

- Sales Journal (SJ) to record Accounts Receivable (A/R) Accruals
- Purchases Journal (PJ) to record Accounts Payable (A/P) Accruals

Preparing Financial Statements – A Single Fact Pattern

You have been asked to assist a new firm or start up with their financial statements from their first month of operations. They opened a separate checking account for the firm and did a very good job of preparing a cash receipts and cash disbursements journal, but want accrual basis financial statements and could not quite figure out how to develop sales, purchases and general journals or related adjusting journal entries to complete the process. You used their cash receipts and cash disbursements journals to determine their cash balance, at month end, and the following unadjusted trial balance:

Unadjusted Trial Balance

Acct. No.	Account Title	DR	CR
100	Cash	$4,000	
110	Accounts receivable	$0	
120	Supplies inventory	$10,000	
130	Prepaid expense	$3,000	
150	Equipment	$25,000	
155	Accumulated depreciation - Equipment		$0
210	Accounts payable		$0
220	Salaries payable		$0
230	Unearned revenue		$4,500
300	Common stock		$35,000
310	Retained earnings		$0
320	Dividends	$0	
410	Revenues		$6,000
555	Depreciation expense	$0	
560	Salaries expense	$2,000	
565	Insurance expense	$0	
570	Rent expense	$1,000	
575	Supplies expense	$0	
580	Utilities expense	$500	
	Totals	$45,500	$45,500

You roughed out a trial balance, complete with account numbers, above.

Note that there is no balance in the accounts receivable and accounts payable accounts. Recall that the firm did not know how to develop these measures, usually associated with the ongoing maintenance of a sales and purchases journal. You ask the owner if any credit sales or credit purchases were made during the month, and the following additional information was provided:

a. Sales made but cash not yet collected at $1,000.
b. Purchases of supplies made but cash not yet paid at $500.

You make the following journal entries to "book" the unrecorded credit sales and credit purchases, as follows:

Accounts receivable	**$1,000**	
Revenue		**$1,000**

Supplies inventory	**$500**	
Accounts payable		**$500**

A partially adjusted trial balance, after the first 2 adjusting journal entries, is provided, below:

	Partially Adjusted Trial Balance						
Acct.							
No.	Account Title	DR	CR	DR	CR	DR	CR
100	Cash	$4,000				$4,000	
110	Accounts receivable	$0		a $1,000		$1,000	
120	Supplies inventory	$10,000		b $500		$10,500	
130	Prepaid expense	$3,000				$3,000	
150	Equipment	$25,000				$25,000	
155	Accumulated depreciation - Equipment		$0				$0
210	Accounts payable		$0		b $500		$500
220	Salaries payable		$0				$0
230	Unearned revenue		$4,500				$4,500
300	Common stock		$35,000				$35,000
310	Retained earnings		$0				$0
320	Dividends	$0				$0	
410	Revenue		$6,000		a $1,000		$7,000
555	Depreciation expense	$0				$0	
560	Salaries expense	$2,000				$2,000	
565	Insurance expense	$0				$0	
570	Rent expense	$1,000				$1,000	
575	Supplies expense	$0				$0	
580	Utilities expense	$500				$500	
	Totals	$45,500	$45,500	$1,500	$1,500	$47,000	$47,000

You ask the firm if they took a month-end inventory of supplies. They did. They provide the summary, with a balance of $8,500. They also provide an invoice supporting the prepaid expense balance of $3,000. The invoice indicates that the entire balance was for insurance for a 6 month period, or $500 per month. Therefore, you have sufficient information to make adjusting journal entries relating to both supplies inventory and prepaid expenses, as follows:

c. Force or adjust ending supplies inventory from $10,500 to $8,500, based on a month-end accounting and physical count of supplies inventory.
d. Expense 1 month of the 6 month policy, which has been consumed or expired, while 5 months or $2,500 of the $3,000 cost remains unexpired or unconsumed.

Supplies expense	**$2,000**	
Supplies inventory		**$2,000**

Insurance expense	**$500**	
Prepaid expenses		**$500**

A partially adjusted trial balance, after the first 4 adjusting journal entries, is provided, below:

Partially Adjusted Trial Balance

Acct. No.	Account Title	DR	CR		DR		CR	DR	CR
100	Cash	$4,000						$4,000	
110	Accounts receivable	$0		a	$1,000			$1,000	
120	Supplies inventory	$10,000		b	$500	c	$2,000	$8,500	
130	Prepaid expense	$3,000				d	$500	$2,500	
150	Equipment	$25,000						$25,000	
155	Accumulated depreciation - Equipment		$0						$0
210	Accounts payable		$0			b	$500		$500
220	Salaries payable		$0						$0
230	Unearned revenue		$4,500						$4,500
300	Common stock		$35,000						$35,000
310	Retained earnings		$0						$0
320	Dividends	$0						$0	
410	Revenue		$6,000			a	$1,000		$7,000
555	Depreciation expense	$0						$0	
560	Salaries expense	$2,000						$2,000	
565	Insurance expense	$0		d	$500			$500	
570	Rent expense	$1,000						$1,000	
575	Supplies expense	$0		c	$2,000			$2,000	
580	Utilities expense	$500						$500	
	Totals	$45,500	$45,500		$4,000		$4,000	$47,000	$47,000

You believe that the cash balance, accounts receivable balance, supplies inventory balance, and prepaid expense balance have all been adjusted to the correct amount for month end preparation of the firm's financial statements. The next item is equipment. You ask the firm about the equipment purchased for $25,000 during the first month of operations. They provide invoices for furniture and fixtures, totaling $25,000, and tell you these items are expected to last 10 years and should be worth about $2,500 at the end of this period. You compute an estimate of the consumption of these long-lived assets at $188 per month, rounded to the nearest dollar, as follows:

	Cost	$25,000
less:	Salvage	($2,500)
equals:	Amount to expense	$22,500
divided by:	10 years	÷ 10
equals:	Annual expense	$2,250
divided by:	12 months	÷ 12
equals:	Monthly expense	$188

Depreciation expense and the alternative techniques used to reflect economic and functional obsolescence for long-lived assets is covered in great detail in Chapter 8 of this text. For now, this "straight-line" method will be used.

e. Depreciation expense and accumulated depreciation will be recorded at $188 for the first month on operations, as follows:

Depreciation expense	**$188**	
Accumulated depreciation		**$188**

A partially adjusted trial balance, after this 5th adjusting journal entry, is provided, below:

Acct. No.	Account Title	DR	CR		DR		CR	DR	CR
	Partially Adjusted Trial Balance								
100	Cash	$4,000						$4,000	
110	Accounts receivable	$0		a	$1,000			$1,000	
120	Supplies inventory	$10,000		b	$500	c	$2,000	$8,500	
130	Prepaid expense	$3,000				d	$500	$2,500	
150	Equipment	$25,000						$25,000	
155	Accumulated depreciation - Equipment		$0			e	$188		$188
210	Accounts payable		$0			b	$500		$500
220	Salaries payable		$0						$0
230	Unearned revenue		$4,500						$4,500
300	Common stock		$35,000						$35,000
310	Retained earnings		$0						$0
320	Dividends	$0						$0	
410	Revenue		$6,000			a	$1,000		$7,000
555	Depreciation expense	$0		e	$188			$188	
560	Salaries expense	$2,000						$2,000	
565	Insurance expense	$0		d	$500			$500	
570	Rent expense	$1,000						$1,000	
575	Supplies expense	$0		c	$2,000			$2,000	
580	Utilities expense	$500						$500	
	Totals	$45,500	$45,500		$4,188		$4,188	$47,188	$47,188

The next item requiring a possible adjustment is salaries payable. You ask the firm if the last payday occurred on the last day of the month. It did not. The firm estimates that $200 in salaries were payable on the last day of the month.

f. Salaries payable and additional salaries expense, in the amount of $200, are recorded for month end, as follows:

Salaries expense	**$200**	
Salaries payable		**$200**

A partially adjusted trial balance, after this 6th adjusting journal entry, is provided, below:

Acct. No.	Account Title (Partially Adjusted Trial Balance)	DR	CR		DR		CR	DR	CR
100	Cash	$4,000						$4,000	
110	Accounts receivable	$0		a	$1,000			$1,000	
120	Supplies inventory	$10,000		b	$500	c	$2,000	$8,500	
130	Prepaid expense	$3,000				d	$500	$2,500	
150	Equipment	$25,000						$25,000	
155	Accumulated depreciation - Equipment		$0			e	$188		$188
210	Accounts payable		$0			b	$500		$500
220	Salaries payable		$0			f	$200		$200
230	Unearned revenue		$4,500						$4,500
300	Common stock		$35,000						$35,000
310	Retained earnings		$0						$0
320	Dividends	$0						$0	
410	Revenue		$6,000			a	$1,000		$7,000
555	Depreciation expense	$0		e	$188			$188	
560	Salaries expense	$2,000		f	$200			$2,200	
565	Insurance expense	$0		d	$500			$500	
570	Rent expense	$1,000						$1,000	
575	Supplies expense	$0		c	$2,000			$2,000	
580	Utilities expense	$500						$500	
	Totals	$45,500	$45,500		$4,388		$4,388	$47,388	$47,388

Your inquiries regarding the$4,500 in unearned revenues lead you to conclude that 90 percent of these revenues were earned prior to month end, as follows:

g. The following journal entry records the 90 percent of revenues earned ($4,050), while 10 percent of the balance ($450) remains in the unearned revenue or liability account, as follows:

Unearned revenue	**$4,050**	
Revenue		**$4,050**

After this last adjusting journal entry, you ask management if any dividends were paid or decided upon during this first month of operations. They decided not to accrue or pay dividends during this first month of operations.

If the firm paid dividends during the period, the credit to cash would have been recorded and summarized in the cash disbursements journal. The journal entry would be as follows:

Dividends	**$XXX**	
Cash		**$XXX**

If the firm accrued, but did not pay dividends during the period, an additional account would be added to the chart of accounts for a dividend payable, and the journal entry would be as follows:

Dividends	**$XXX**	
Dividends payable		**$XXX**

Dividends were not paid, so the adjusted trial balance after this 7th and final adjusting journal entry follows:

	Adjusted Trial Balance								
Acct.									
No.	Account Title	DR	CR		DR		CR	DR	CR
100	Cash	$4,000						$4,000	
110	Accounts receivable	$0		a	$1,000			$1,000	
120	Supplies inventory	$10,000		b	$500	c	$2,000	$8,500	
130	Prepaid expense	$3,000				d	$500	$2,500	
150	Equipment	$25,000						$25,000	
155	Accumulated depreciation - Equipment		$0			e	$188		$188
210	Accounts payable		$0			b	$500		$500
220	Salaries payable		$0			f	$200		$200
230	Unearned revenue		$4,500	g	$4,050				$450
300	Common stock		$35,000						$35,000
310	Retained earnings		$0						$0
320	Dividends	$0						$0	
410	Revenue		$6,000			a	$1,000		$11,050
						g	$4,050		
555	Depreciation expense	$0		e	$188			$188	
560	Salaries expense	$2,000		f	$200			$2,200	
565	Insurance expense	$0		d	$500			$500	
570	Rent expense	$1,000						$1,000	
575	Supplies expense	$0		c	$2,000			$2,000	
580	Utilities expense	$500						$500	
	Totals	$45,500	$45,500		$8,438		$8,438	$47,388	$47,388

Notes:

Generating the Balance Sheet from the Adjusted Trial Balance

The balance sheet is developed from the top portion of the adjusted trial balance. Note that the chart of accounts began with assets (100s), followed by liabilities (200s), and the last classification of the balance sheet, equity accounts (300s), are all organized with this in mind.

Below, the adjusted trial balance and the balance sheet, without any heading, are provided, side by side, for you to compare their development.

Account Title	DR	CR
Cash	$4,000	
Accounts receivable	$1,000	
Supplies inventory	$8,500	
Prepaid expense	$2,500	
Equipment	$25,000	
A.D. - Equipment		$188
Accounts payable		$500
Salaries payable		$200
Unearned revenue		$450
Common stock		$35,000
Retained earnings		$0
Dividends	$0	
Revenue		$11,050
Depreciation expense	$188	
Salaries expense	$2,200	
Insurance expense	$500	
Rent expense	$1,000	
Supplies expense	$2,000	
Utilities expense	$500	
Totals	$47,388	$47,388

Assets		
Cash		$4,000
Accounts receivable		$1,000
Supplies inventory		$8,500
Prepaid expense		$2,500
Equipment	$25,000	
A.D. - Equipment	$188	$24,812
Total Assets		$40,812
Liabilities		
Accounts payable		$500
Salaries payable		$200
Unearned revenue		$450
Total Liabilities		$1,150
Equity		
Common stock		$35,000
Retained earnings		$4,662
Total Liabilities and Equity		$40,812

Because the statement of retained earnings has not yet been developed, the balance in the above balance sheet is a plug until verified. This amount can easily be determined, since debits equal credits and assets equal liabilities and equity.

Notes: ______________________________

Generating the Income Statement from the Adjusted Trial Balance
The income statement is developed from the bottom portion of the adjusted trial balance. Note, again, that the chart of accounts proceeds, sequentially, from assets, liabilities, and equity to revenues (400s) and expenses (500s). Again, accounts in the chart of accounts are organized in a fashion to facilitate the preparation of the financial statements.

Account Title	DR	CR
Cash	$4,000	
Accounts receivable	$1,000	
Supplies inventory	$8,500	
Prepaid expense	$2,500	
Equipment	$25,000	
A.D. - Equipment		$188
Accounts payable		$500
Salaries payable		$200
Unearned revenue		$450
Common stock		$35,000
Retained earnings		$0
Dividends	$0	
Revenue		$11,050
Depreciation expense	$188	
Salaries expense	$2,200	
Insurance expense	$500	
Rent expense	$1,000	
Supplies expense	$2,000	
Utilities expense	$500	
Totals	$47,388	$47,388

Revenue		$11,050
Expenses		
Depreciation expense	$188	
Salaries expense	$2,200	
Insurance expense	$500	
Rent expense	$1,000	
Supplies expense	$2,000	
Utilities expense	$500	
Total expenses		$6,388
Net income		$4,662

Because no dividends were paid during the period, note that net income is precisely equal to the balance of retained earnings at the end of the period, at $4,662.

Notes: ______________________________

Generating the Statement of Retained Earnings from the Adjusted Trial Balance
The statement of retained earnings provides a beginning of period to end of period reconciliation of this equity accounts. Retained earnings are increased during a period for net income, decreased during a period for net loss, and decreased for any earnings paid to shareholders for dividends. The statement of retained earnings links the net income from the income statement and for the period to the ending retained earnings and equity balance in the balance sheet prepared for the end of the period or ending point in time.

Account Title	DR	CR
Cash	$4,000	
Accounts receivable	$1,000	
Supplies inventory	$8,500	
Prepaid expense	$2,500	
Equipment	$25,000	
A.D. - Equipment		$188
Accounts payable		$500
Salaries payable		$200
Unearned revenue		$450
Common stock		$35,000
Retained earnings		$0
Dividends	$0	
Revenue		$11,050
Depreciation expense	$188	
Salaries expense	$2,200	
Insurance expense	$500	
Rent expense	$1,000	
Supplies expense	$2,000	
Utilities expense	$500	
Totals	$47,388	$47,388

Retained earnings, beginning	$0
Add: Net income	$4,662
	$4,662
Less: Dividends	$0
Retained earnings, ending	$4,662

Notes:

Closing Entries and the Post-Closing Trial Balance
Closing entries are adjusting journal entries used to close temporary or nominal income statement and dividend accounts to the income summary, preparing the revenue and expense accounts with zero balances to begin the next accounting period. Illustrations of these closing entries follow

Revenue	**$11,050**	
Income summary		**$11,050**

Income summary	**$6,388**	
Depreciation expense		**$188**
Salaries expense		**$2,200**
Insurance expense		**$500**
Rent expense		**$1,000**
Supplies expense		**$2,000**
Utilities expense		**$500**

Notes: ____

After closing all revenue and expense accounts to the income summary, the net balance (income or loss) in the income summary account is closed out to the retained earnings account, as follows:

Income summary	**$4,662**	
Retained earnings		**$4,662**

Notes: ____

The post-closing trial balance is provided, below. Note that all income statement accounts have zero balances, and, therefore, have been prepared to record transactions relevant to the "next" accounting period (i.e., periodicity assumption and matching principle).

Acct. No.	Account Title	DR	CR
100	Cash	$4,000	
110	Accounts receivable	$1,000	
120	Supplies inventory	$8,500	
130	Prepaid expense	$2,500	
150	Equipment	$25,000	
155	A.D. - Equipment		$188
210	Accounts payable		$500
220	Salaries payable		$200
230	Unearned revenue		$450
300	Common stock		$35,000
310	Retained earnings		$4,662
320	Dividends	$-0-	
410	Revenue		$-0-
555	Depreciation expense	$-0-	
560	Salaries expense	$-0-	
565	Insurance expense	$-0-	
570	Rent expense	$-0-	
575	Supplies expense	$-0-	
580	Utilities expense	$-0-	
	Totals	$41,000	$41,000

Notes: ______________________________

The Adjusted Trial Balance (TB), Balance Sheet, Income Statement, and Post-Closing Trail Balance Worksheet

The adjusted trial balance is provided, below. The balance sheet and income statement are prepared from this worksheet. Note the dark shading for the balance sheet and income statement measures. Since all temporary or nominal accounts are closed to retained earnings, after the balance sheet and income statement are prepared, note that there are no measures for the income statement accounts in the post-closing TB columns.

Acct.		Adjusted TB		Balance Sheet		Income Statement		Post-Closing TB	
No.	Account Title	DR	CR	DR	CR	DR	CR	DR	CR
100	Cash	$4,000		$4,000				$4,000	
110	Accounts receivable	$1,000		$1,000				$1,000	
120	Supplies inventory	$8,500		$8,500				$8,500	
130	Prepaid expense	$2,500		$2,500				$2,500	
150	Equipment	$25,000		$25,000				$25,000	
155	A.D. - Equipment		$188		$188				$188
210	Accounts payable		$500		$500				$500
220	Salaries payable		$200		$200				$200
230	Unearned revenue		$450		$450				$450
300	Common stock		$35,000		$35,000				$35,000
310	Retained earnings		$0		$0				$4,662
320	Dividends	$0							
410	Revenue		$11,050				$11,050		
555	Depreciation expense	$188				$188			
560	Salaries expense	$2,200				$2,200			
565	Insurance expense	$500				$500			
570	Rent expense	$1,000				$1,000			
575	Supplies expense	$2,000				$2,000			
580	Utilities expense	$500				$500			
	Subtotals	$47,388	$47,388	$41,000	$36,338	$6,388	$11,050	$41,000	$41,000
	Income summary				$4,662	$4,662			
	Totals			$41,000	$41,000	$11,050	$11,050		

Notes: ____

Appendix A

Profit Margin

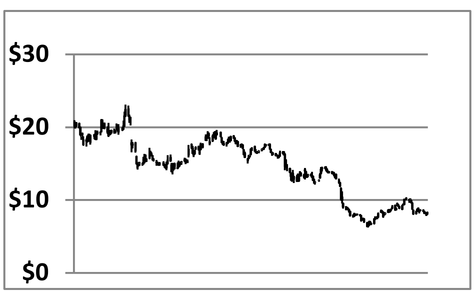
Profit margin or *return on sales* provides a useful measure of a firm's operating results. Recall, from Chapter 1, that operations are one of the three basic business activities:

(1) **Operating** – involving the use of resources for short-term or current operations.
(2) **Investing** – involving the use of long-term or noncurrent assets to achieve both short-term and long-term (or current and noncurrent) operating goals and objectives.
(3) **Financing** – involving the use debt (and financial leverage) and equity to achieve both short-term and long-term (or current and noncurrent) goals and objectives.

The profit margin represents the percent of profit for each dollar of sales, as follows:

Profit Margin = Net Income ÷ Net Sales

JCPenney (NYSE: JCP) saw its stock price decline from about $20 per share to about $8 per share during 2013 (lower left). With a 52-week high at $11.30 and a 52-week low at $5.22 per share, the firm has a difficult road ahead to restore shareholder confidence, but continues to trade in the $8 per share range (see 5 year chart below).



The firm's last profitable quarter was February 1, 2014 (see below, from Yahoo!Finance), with a profit margin of less than 1%, as follows:

0.93% = $35,000 ÷ $3,782,000

Period Ending	Nov 1, 2014	Aug 2, 2014	May 3, 2014	Feb 1, 2014
Total Revenue	**2,764,000**	**2,799,000**	**2,801,000**	**3,782,000**
Cost of Revenue	1,751,000	1,791,000	1,875,000	2,708,000
Gross Profit	**1,013,000**	**1,008,000**	**926,000**	**1,074,000**
Operating Expenses				
Research Development	-	-	-	-
Selling General and Administrative	899,000	913,000	993,000	1,001,000
Non Recurring	12,000	5,000	22,000	50,000
Others	156,000	160,000	158,000	161,000
Total Operating Expenses	-	-	-	-
Operating Income or Loss	**(54,000)**	**(70,000)**	**(247,000)**	**(138,000)**
Income from Continuing Operations				
Total Other Income/Expenses Net	(34,000)	-	-	-
Earnings Before Interest And Taxes	(88,000)	(70,000)	(247,000)	(138,000)
Interest Expense	103,000	106,000	97,000	97,000
Income Before Tax	(191,000)	(176,000)	(344,000)	(235,000)
Income Tax Expense	(3,000)	(4,000)	8,000	(270,000)
Minority Interest	-	-	-	-
Net Income From Continuing Ops	(222,000)	(172,000)	(352,000)	35,000
Non-recurring Events				
Discontinued Operations	-	-	-	-
Extraordinary Items	-	-	-	-
Effect Of Accounting Changes	-	-	-	-
Other Items	-	-	-	-
Net Income	**(188,000)**	**(172,000)**	**(352,000)**	**35,000**
Preferred Stock And Other Adjustments	-	-	-	-
Net Income Applicable To Common Shares	**(188,000)**	**(172,000)**	**(352,000)**	**35,000**

Appendix B

Current Ratio

A firm's ability to pay near-term debts or liabilities is quickly and easily assessed by computing their *current ratio*, as follows:

Current Ratio = Current Assets ÷ Current Liabilities

Suppliers and creditors would use this ratio to formulate a decision with respect to the firm's credit worthiness. They would compute and use this measure to assist them in deciding whether they might decide to extend credit to the firm.

JCPenney (NYSE: JCP) was not in any immediate threat of insolvency at the end of 2013, as the below, from Yahoo!Finance, suggests a current ratio for the most recent quarter (MRQ) at 1.77, however, cash at $684 million and debt at $5.43 billion might be of long-term concern to some:

Balance Sheet	
Total Cash (mrq):	684.00M
Total Cash Per Share (mrq):	2.24
Total Debt (mrq):	5.43B
Total Debt/Equity (mrq):	223.33
Current Ratio (mrq):	1.77
Book Value Per Share (mrq):	7.97

Note that the firm has total cash per share at $2.24 and a book value of $7.97 per share. The stock is trading at only a tiny bit above book value, as of February 13, 2015, which is not favorable.

Appendix C

Reversing Journal Entries

An additional adjusting journal entry (AJE) might be preferred by some, presumably, to simplify the firm's recordkeeping process. The additional journal entry is referred to as reversing journal entry (RJE).

Most accounting texts, and accountants, do not use reversing journal entries. RJEs are used for post-closing accruals.

The accrual of salaries payable and salaries expense prior to year-end closing and before and after year-end financial statement preparation is used to illustrate the alternatives.

Accounting <u>without</u> reversing journal entries
Assume that ABC Corporation has employee salaries that approximate $500 per day, 5 days per week ($2,500 per week). Paydays are weekly and on Fridays, in this case, the last payday (Friday) before year-end is December 28th. Year-end occurs on a Monday, in this case, the day before New Years' day is a working day and on December 31st. Therefore, the following AJE must be made to "book the accrual" on December 31st, the day before New Years' Day:

Salaries expense	**$500**	
Salaries payable		**$500**

Salaries Expense

Dec. 31 $500	
	Dec. 31 $500
-0-	-0-

Salaries Payable

	$500 Dec. 31

While all temporary or nominal (revenue and expense) accounts were closed out to the income summary account on December 31st, immediately after all AJEs. The debit and credit mechanics of the impact on the salaries expense account is provided, as follows:

Income summary	**$500**	
Salaries expense		**$500**

Accounting <u>with</u> reversing journal entries
Assume the same fact pattern, but ABC Corporation decides to use reversing entries, post-closing, and after the financial statements are prepared.

The same journal entry is made on December 31st, as follows:

Salaries expense	**$500**	
Salaries payable		**$500**

Salary payable	
	$500 Dec. 31
	$500 Balance

Salary expense	
Dec. 31 $500	
Balance $-0-	$-0- Balance

Again, all temporary or nominal (revenue and expense) accounts were closed out to the income summary account on December 31st, immediately after all AJEs. The debit and credit mechanics of the impact on the salaries expense account is provided, as follows:

Income summary	**$500**	
Salaries expense		**$500**

The additional step is the RJE, where the accrual balance, a credit balance in salaries payable is eliminated on Jan. 1, as follows:

Salaries payable	**$500**	
Salaries expense		**$500**

Salary payable	
	$500 Dec. 31
Jan. 1 $500	
Balance $-0-	$-0- Balance

Salary expense	
	$500 Jan. 1
	$500 Balance

Note that the RJE establishes a beginning credit balance in an expense account, salaries expense. This is one of the arguments against using RJEs. However, when payroll is, again, posted and paid on the following Friday (one week from December 28 or January 5 of the next year), the adjusted balance in the salaries expense account is automatically maintained at the correct, month-do-date balance ($2,000). This is one of the arguments for using RJEs, as follows:

Salaries expense	**$2,500**	
Salaries payable		**$2,500**

Salaries Expense

	$500 Jan. 1
Jan. 5 $2,500	
$2,000	

Cash

	$2,500 Jan. 5

Date		Amount	January Salary Expense	DR Salary Expense	CR Cash	CR Salary Payable	DR Salary Expense	CR Cash	CR Salary Payable	Notes	
31-Dec	M	$500		$500		($500)	$500		($500)	(a)	AJE
1-Jan	T	$500	$500	($500)		$500				(b)	RJE
2-Jan	W	$500	$500								
3-Jan	TH	$500	$500								
4-Jan	F	$500	$500	$2,500	($2,500)		$2,500	($2,500)		(c)	CDs
5-Jan	Sat										
6-Jan	Sun										
7-Jan	M	$500	$500								
8-Jan	T	$500	$500								
9-Jan	W	$500	$500								
10-Jan	TH	$500	$500								
11-Jan	F	$500	$500	$2,500	($2,500)		$2,500	($2,500)		(d)	CDs
12-Jan	Sat										
13-Jan	Sun										
14-Jan	M	$500	$500								
15-Jan	T	$500	$500								
16-Jan	W	$500	$500								
17-Jan	TH	$500	$500								
18-Jan	F	$500	$500	$2,500	($2,500)		$2,500	($2,500)		(e)	CDs
19-Jan	Sat										
20-Jan	Sun										
21-Jan	M	$500	$500								
22-Jan	T	$500	$500								
23-Jan	W	$500	$500								
24-Jan	TH	$500	$500								
25-Jan	F	$500	$500	$2,500	($2,500)		$2,500	($2,500)		(f)	CDs
26-Jan	Sat										
27-Jan	Sun										
28-Jan	M	$500	$500								
29-Jan	T	$500	$500								
30-Jan	W	$500	$500								
31-Jan	TH	$500	$500	$2,000		($2,000)				(g)	AJE
							$1,500		($1,500)	(h)	AJE
1-Feb	F	$500		($2,000)		$2,000				(i)	RJE
				$2,500		($2,500)	$2,500		($2,500)	(j)	CDs
2-Feb	Sat										
3-Feb	Sun										
January			$11,500	$11,500	($10,000)	($1,500)	$11,500	($10,000)	($1,500)		

(a) This entry is made and does not change, regardless of whether the firm is or is not using reversing entries. The accrual must be "booked" prior to the preparation of the firm's balance sheet and income statement, to show the salary expense, matched to the period, and record the liability on the firm's balance sheet.

(b) This entry is only made if the reversing entry approach is preferred. Note that a credit balance is initiated in the salary expense account.

(c) This entry is made and does not change, regardless of whether the firm is or is not using reversing entries. This is a cash disbursement for salary.

(d) This entry is made and does not change, regardless of whether the firm is or is not using reversing entries. This is a cash disbursement for salary.

(e) This entry is made and does not change, regardless of whether the firm is or is not using reversing entries. This is a cash disbursement for salary.

(f) This entry is made and does not change, regardless of whether the firm is or is not using reversing entries. This is a cash disbursement for salary.

(g) This adjusting journal entry is required to "plug" both expense and liability accounts to their "correct" balance prior to the preparation of the firm's balance sheet and income statement. Note that the amount differs from (h), below, by the $500 difference from the RJE in (b), above.

(h) This adjusting journal entry is required to "plug" both expense and liability accounts to their "correct" balance prior to the preparation of the firm's balance sheet and income statement. Note that the amount differs from (g), above, by the $500 difference from the RJE in (b), above.

(i) This entry is only made if the reversing entry approach is preferred. Note that a credit balance is initiated in the salary expense account. This is the same type of reversing journal entry made in (b), above.

(j) This entry is made and does not change, regardless of whether the firm is or is not using reversing entries. The accrual must be "booked" prior to the preparation of the firm's balance sheet and income statement, to show the salary expense, matched to the period, and record the liability on the firm's balance sheet. This is a February entry, so it is not highlighted or included when the January financial statements are prepared.

Summary

The decision to use or avoid the use of RJEs is a "taste and preference" issue. Some accountants prefer to use them and some prefer to avoid their use. In both cases, the financial statements achieve the same measures or balances. Their use does, of course, represent an additional step in the accounting and recordkeeping process.