

## **SECTION 8**

**Balance Day Adjustments**

**Post Adjusted Trial Balance**



## ACCRUED & PREPAID EXPENSES

### ACCRUED EXPENSE

At balance date there will be many expenses that have been incurred but not yet paid by the business. Consequently it is necessary to create liabilities (amounts owing) and increase the expenses to achieve a more Relevant Profit or Loss result.

Expenses: Outflows or consumptions of economic benefits (or reductions in inflows), in the form of a decrease in assets or increase in liabilities that lead to a decrease in owners' equity.

Accrued expenses will all lead to an increase in liabilities. (Cash payment will occur at a later date.)

Accruals (amounts owing) will add to the expense account and create a temporary current liability representing the future obligation to pay resulting in an outflow of resources embodying economic benefits.

#### QUESTION 1

Payroll Timesheet for the week ended 26th June 2009 (Friday).

Employees	Hours	Pay	Tax	Net Pay	Wages paid to date
Gumbleton	40	800	240	560	35,000
Lloyd	40	700	210	490	30,000
Houli	40	500	150	350	22,000
Jetta	40	1000	300	700	45,000
Totals	160	\$3000	\$900	\$2100	\$132,000

The business closes its books on the 30th June 2009.

- (a) Assuming the employees work the same hours in the week ended 3rd July 2009 complete the necessary adjustments at the 30th June 2009. (Employees are paid Monday to Fridays).

Mon 22/6	Tues 23/6	Wed 24/6	Thur 25/6	Fri 26/6	Sat 27/6	Sun 28/6
Mon 29/6	Tues 30/6	Wed 1/7	Thur 2/7	Fri 3/7		

#### Adjusting Entry General Journal

Date 2009	Details	Debit	Credit

**Closing General Journal Entry**

Date 2009	Details	Debit	Credit

**Account: Wages Expense**

Date	Cross Reference	\$	Date	Cross Reference	\$

**Account: Accrued wages expense (CL)**

Date	Cross Reference	\$	Date	Cross Reference	\$

**TREATMENT IN SUBSEQUENT PERIOD**

When the wages are paid (\$3,000 CHQ. 20) on the 3rd July 2009 the amount that relates to last periods accrual must be debited to the Wages Owing account and wages expense in the current period debited to wages expense. This will avoid counting the Accrual twice. (And therefore overstating expenses and overstating Current Liabilities)

**Cash Payments Journal**

Date	Account	Chq No	Bank	Creditors	Drawings	Wages	Sundries

- (b) What qualitative characteristic is being observed by the use of time-sheets for wages? Explain.

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- (c) Show how wages will be reported in the Profit & Loss Statement for the period ended 30th June 2009.

Expenses	
Wages	133,200

**QUESTION 2**

Brock Lee received an electricity account for \$660 (including GST), covering energy usage for December 2009. As at balance date this account has not been paid.

- (a) Prepare the adjusting entry as at 31st December 2009.

Date	Details	DEBIT	CREDIT

- (b) Explain your treatment of GST in the adjusting entry.

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- (c) Complete the following ledgers:

**Account: Electricity Expense**

Date	Cross Reference	\$	Date	Cross Reference	\$
1Dec	Balance	5000			

**Account: Accrued Electricity Expense**

Date	Cross Reference	Debit	Date	Cross Reference	Credit

Cheque number 25 was paid to United Energy on 7th February 2010 for \$1100 (including GST of \$100)

- (d) Record this transaction in the Cash Payments Journal and Ledgers.

### Cash Payments Journal

Date	Account	Chq No	Bank	Creditors	Wages	GST	Sundries

- (e) Identify the effect on the accounting equation as a result of the balance day adjustment on the 31st December 2009.

	Increase Decrease No Effect	Amount

- (f) Identify the effect on the accounting equation as a result of the cash payment on the 7th February 2010.

	Increase Decrease No Effect	Amount

- (g) Explain how the adjusting entry meets the Reporting Period Principle and satisfies the Qualitative characteristic of Relevance.

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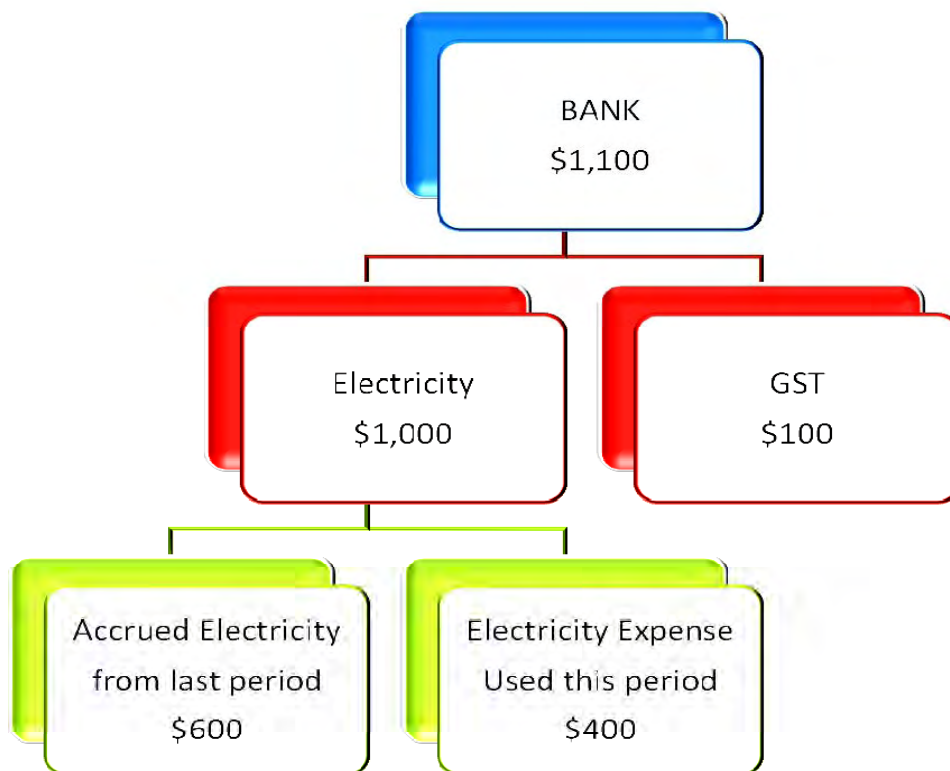
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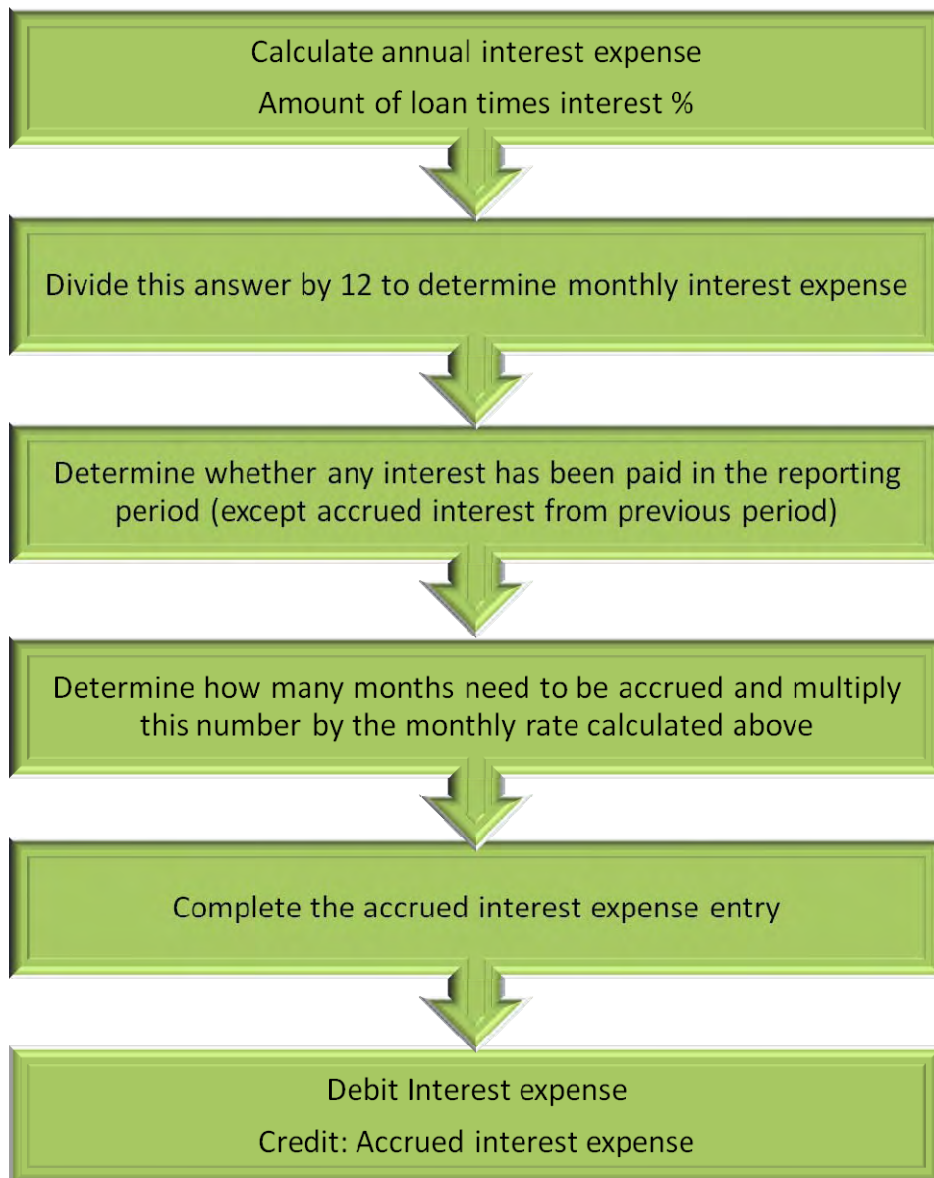
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- (h) Identify the effect on the accounting equation if the balance day adjustment is not completed on the 31st December 2009

	Understated Overstated No Change	Amount



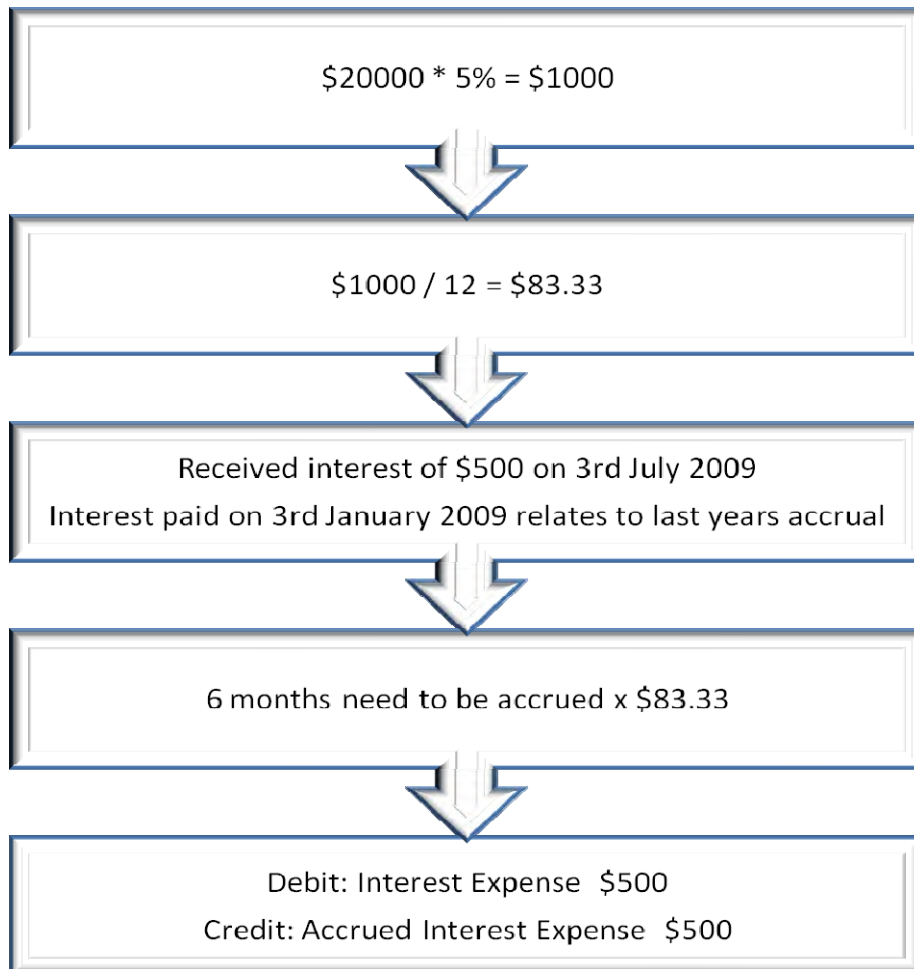
**PROCEDURE TO FOLLOW WHEN YOU ARE REQUIRED TO ACCRUE INTEREST EXPENSE**



**EXAMPLE**

Business borrowed \$20000 on 1st January 2006. Loan will be repaid on 1st January 2010. Interest on the loan is 5% per annum. Interest is paid every 6 months on the 3rd July and 3rd January each year.

Determine the adjustment for interest expense for the year ended 31st December 2009.



## PREPAID EXPENSES (ASSET APPROACH)

When expenses are paid in advance they are recorded in a prepaid expense account and then at the end of the period the total amount used up is transferred to expenses. If this is not done the expense will be understated. The prepaid amount represents the future economic benefit to the business and is recorded as a current asset.

Expenses: Outflows or consumptions of economic benefits (or reductions in inflows), in the form of a decrease in assets or increase in liabilities that lead to a decrease in owners' equity.



The balance in the prepaid insurance account at 30th April 2008 was \$450 (as per table below).

May-07	Jun-07	Jul-07	Aug-07	Sep-07	Oct-07	Nov-07	Dec-07	Jan-08	Feb-08	Mar-08	Apr-08
	NA										
NA		\$45	\$45	\$45	\$45	\$45	\$45	\$45	\$45	\$45	\$45

The motor cycle annual insurance of \$600 plus \$60 GST was renewed (paid) on the 1st May 2008 for 12 months.

### Cash Payments Journal

Date 2008	Account	Chq No	Bank	Creditors	Wages	GST	Sundries
May 1	Prepaid Insurance exp	20	660			60	600

Determine the monthly insurance expense. Divide annual rate (\$600) by 12 = \$50

May-08	Jun-08	Jul-08	Aug-08	Sep-08	Oct-08	Nov-08	Dec-08	Jan-09	Feb-09	Mar-09	Apr-09
\$50	\$50	\$50	\$50	\$50	\$50	\$50	\$50	\$50	\$50	\$50	\$50

Balance date is 30th June 2008.

The arrow head (the months to the right of balance date will represent the Future Economic Benefit - the current asset, Prepaid Insurance Balance)

**QUESTION 3**

- (a) Complete the appropriate entries at balance date (30/6/08) to determine the TOTAL expense for the period (1st July 2007 to 30th June 2008).

**Adjusting General Journal**

Date	Particulars	DEBIT	CREDIT

**Closing General Journal**

Date 2008	Particulars	DEBIT	CREDIT

- (b) Complete the ledger accounts.

**Account: PREPAID INSURANCE**

Date	Cross Reference	\$	Date	Cross Reference	\$

**Account: INSURANCE EXPENSE**

Date	Cross Reference	\$	Date	Cross Reference	\$

- (c) Identify and explain the effect if the adjusting entry is not completed.

	Overstated Understated No Effect	Amount \$
<b>Assets</b>		
<b>Liabilities</b>		
<b>Owners Equity</b>		

**Explain:**

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(d) Assuming no other vehicles, what was the annual insurance paid on the 1st May 2007?

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**QUESTION 4**

Brock Lee prepares his accounts on the 30th June each year. He had the following balance as at 31st May 2009.

Prepaid rent \$11,500

On the 5th June 2009 he paid \$3630 (including GST of \$330) covering office rent for the next 3 months. Chq no. 33.

(a) Complete the cash payments journal.

**Cash Payments Journal**

Date 2009	Account	Chq No	Bank	Creditors	Wages	GST	Sundries

(b) Complete the following ledger accounts.

**Account: Prepaid Rent**

Date	Cross Reference	\$	Date	Cross Reference	\$

**Account: Rent Expense**

Date	Cross Reference	Debit	Date	Cross Reference	Credit

- (c) Identify the effect on the accounting equation as a result of the balance day adjustment on the 30th June 2009

	Increase Decrease No Effect	Amount
<b>Assets</b>		
<b>Liabilities</b>		
<b>Owners Equity</b>		

- (d) Identify the effect on the accounting equation as a result of the cash payment on the 5th June 2009.

	Increase Decrease No Effect	Amount
<b>Assets</b>		
<b>Liabilities</b>		
<b>Owners Equity</b>		

- (e) Explain why a prepaid expense is classified as a current asset.

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- (f) Explain why an accrued expense is classified as a current liability.

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- (g) State and explain the effect if the adjusting entry on the 30th June 2009 is not completed.

	Overstated Understated No Effect	Amount \$
<b>Assets</b>		
<b>Liabilities</b>		
<b>Owners Equity</b>		

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### QUESTION 5

Post Trial Balance as at 31 December 2009.

	Debits	Credits
Wages	25000	
Accrued wages		1500
Prepaid insurance expense	600	
Insurance expense	2400	

As at the 1st January 2009 the business had the following balances:

Accrued wages: \$900  
Prepaid insurance expenses: \$450

(a) **Calculate** the amount paid for wages during the year ended 31 December 2009

<b>Cash Paid</b>	
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(b) **Calculate** the amount paid for insurance during the year ended 31 December 2009

<b>Cash Paid</b>	
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**QUESTION 6**

Outback Jack pays injury insurance in advance for guided tours through the Kimberley Ranges.

At the 31st of December 2006 he had Prepaid Insurance Expense of \$3,000. On the 1st April 2007 he paid his new annual insurance bill of \$14,400 plus \$1440 GST.

- (a) Record the payment on the 1st April 2007 in the cash payments journal. Chq No. 23.

**Cash Payments**

Date	Details	Chq No	Bank	Creditors	Wages	GST	Sundries

- (b) Complete the General Journal entry to record the balance day adjustment as at 31st December 2007.

		General Ledger		Subsidiary Ledger	
Date	Details	Debit	Credit	Debit	Credit

- (c) Complete the General Ledger accounts for Prepaid Insurance Expense and Insurance Expense as at 31st December 2007.

**Account: Prepaid Insurance Expense**

Date	Cross Reference	Debit	Date	Cross Reference	Credit

**Account: Insurance Expense**

Date	Cross Reference	Debit	Date	Cross Reference	Credit

- (d) **Identify** and explain the effect on the Profit & Loss Statement after the adjustment at the 31st December 2007 is completed?

Increase Decrease No effect	Amount \$

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- (e) **Identify** the effect on the Balance Sheet if the balance day adjustment on the 31st December 2007 was **not** completed:

	Understated Overstated No Effect	Amount \$
Assets		
Liabilities		
Owners Equity		

**PREPAID Insurance Expense**

2007												2008		
Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar
1000	1000	1000	1200	1200	1200	1200	1200	1200	1200	1200	1200	1200	1200	1200
Balance			Bank											
\$3,000			\$14,400											

Expense =  $3 \times 1000 + 9 \times 1200 = 13800$       Prepaid Balance =  $3 \times 1200 = 3600$

**Accrued Interest Expense**

Loan	\$10,000
Interest	6%
Expense =	\$600 per year
	\$50 per month

2007					Jun	Jul	Aug	Sep	Oct	Nov	Dec
Jan	Feb	Mar	Apr	May							
50	50	50	50	50	50	50	50	50	50	50	50
					Bank			Bank			Bank
					\$150			\$150			\$150
					31-Mar			30-Sep			31-Dec

Expense =  $150 + 100 = 250$   
 Paid      Accrued

**QUESTION 7**

On the 1st January 2007, Outback Jack borrowed \$10,000 from ANZ Finance Company for 5 years, at an interest rate of 6% per annum. Interest is paid quarterly at the end of March, June, September and December.

Outback prepares six-monthly accounts on 31 May and 30 November each year.

- (a) **Prepare** the following general ledger accounts to record all transactions and the balance day adjustment required as at the 31st may 2007.

**Name: Loan – ANZ Finance**

Date	Cross Reference	Debit	Date	Cross Reference	Credit

**Name: Interest Expense**

Date	Cross Reference	Debit	Date	Cross Reference	Credit

**Name: Accrued Interest Expense**

Date	Cross Reference	Debit	Date	Cross Reference	Credit

- (b) Calculations:

On the 30th June a direct debit was charged to Outback Jack's Bank statement for \$150 for interest on the Loan. Record this entry in the cash payments journal.

(c) **Adjust** the previous ledger accounts to reflect this entry.

**Cash payments**

Date	Details	Chq No.	Bank	Creditors	Wages	GST	Sundries

(d) **Identify** the effect on Assets, Liabilities and Owners Equity after the above cash payment has been recorded.

	Increase Decrease No Effect	Amount \$
Assets		
Liabilities		
Owners Equity		

(e) **Identify** the effect on the Balance Sheet if the balance day adjustment on the 31st May 2007 was **not** completed.

	Understated Overstated No Effect	Amount \$
Assets		
Liabilities		
Owners Equity		

**QUESTION 8** - 2007 Exam (amended)

At the end of the next year, 30 June 2008, the following pre-adjustment Trial Balance was prepared.

**Bountiful Beds**  
**Pre-adjustment Trial Balance 30 June 2008**

Account	Debit	Credit
Bank	28 400	
Debtors Control	10 600	
Prepaid Office Supplies	6 000	
Stock Control	106 000	
Creditors Control		16 000
GST Clearing	3 000	
Capital		120 000
Loan – ABC Bank		40 000
Showroom Fittings	60 000	
Accumulated Depreciation - Showroom Fittings		10 000
Drawings	38 000	
Sales		453 900
Wages	93 900	
Cost of Sales	250 000	
Prepaid Rent Expense	44 000	
	639 900	639 900

*The loan is repaid at the rate of \$1000 per month.*

The following adjustments were required at 30 June 2008.

1. Office Supplies on hand at 30 June: \$1 500
2. Wages owing at 30 June: \$1 100
3. A payment of \$12 000 plus \$1 200 GST for June, July and August rent was incorrectly debited to the GST Clearing account.
4. Rent Expense is \$4 000 per month.



- (c) **Show** how the Wages account would appear in the General Ledger after adjusting and closing entries were completed.

**Wages**

Date 2008	Cross-reference	Amount \$	Date 2008	Cross-reference	Amount \$
30 June	Bank	93 900			

- (d) Excluding the calculation of profit, explain why revenue and expense accounts are closed each period. Identify one accounting principle to support your answer.

<b>Explanation</b>
<b>Accounting principle</b>

- (e) On the first pay day in July, wages totaling \$8 900 were paid (9 July. Chq. 7324). This amount included the \$1100 wages owing at 30 June 2008.

**Prepare** the Cash Payments Journal entry to record the payment of wages on 9 July.

**Cash Payments Journal**

Date	Details	Ch. No.	Bank	Disc. Rev.	Creditors	Stock	Wages	GST	Sundries

**QUESTION 9 - 2003 exam**

On 31 July 2003 Sam purchased a computer-linked cash register system (cost \$4 000). There was an additional cost of \$840 for an annual service agreement. The cash register was supplied and installed, on credit, by Ace Computers. An invoice for \$4 840 (plus \$484 GST) was received on the same day.

- (a) Show how the service agreement would be reported in the Balance Sheet at 30 June 2004.

**Balance Sheet Extract as at 30th June 2004**

	\$

Sam provides you with a list of all assets and liabilities at 30 June 2003.

	\$
Accrued Wages	1 050

The next date for payment of wages is 4 July 2003 when \$5 000, including the accrued wages, will be paid. The payment of wages is based on information contained in time sheet records. The accountant maintains the time sheet records for each employee.

- (b) Show how the payment of wages of \$5 000 (Cheque No. 442) on 4 July 2003 would be recorded in the Cash Payments Journal.

**Cash Payments Journal**

Date	Details	Chq No	Bank	Disc. Rev.	Creditors	Stock	Wages	GST	Sundries

- (c) State the qualitative characteristic that would be achieved through the use of time sheet records as the basis for the payment of wages.

<b>Qualitative Characteristic</b>	
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Prepaid insurance at 1 July 2003 was \$1 500. This insurance policy expires on 30 September 2003. A new 12 month policy commencing 1 October 2003 costing \$8 400 (plus \$840 GST) was paid on 20 September 2003. The necessary adjusting and closing entries were made on 30 June 2004.

- (d) Show how the Prepaid Insurance and Insurance Expense accounts would appear in the General Ledger of Surf's Up at 30 June 2004 after all entries have been posted. (Balance the ledger accounts as appropriate.)

**Account: Prepaid Insurance Expense**

Date	Cross Reference	\$	Date	Cross Reference	\$

**Account: Insurance Expense**

Date	Cross Reference	\$	Date	Cross Reference	\$

- (e) State and explain how the Prepaid Insurance would be reported in the Balance Sheet as at 30 June 2004.

<b>Classification</b>	
<b>Explanation</b>	

Post Adjusting Trial Balance as at 31st December 2009	ASSETS	LIABILITIES
	EXPENSES DRAWINGS	REVENUES ACC. DEP'N Owner's EQUITY
ACCOUNT NAME	DEBITS	CREDITS
Cash at Bank	20,000	
Debtors Control	30,000	
<b>Prepaid Rent<sup>1</sup></b>	<b>2,200</b>	
<b>Stock Control<sup>2</sup></b>	<b>48,000</b>	
Creditors Control		15,000
Loan – ABC Bank		18,000
<b>Accrued wages expense<sup>3</sup></b>		<b>500</b>
GST Clearing		2,000
Capital		55,500
Discount Expense	200	
Cost of Sales	90,000	
Sales revenue		180,000
Discount Revenue		400
<b>Stock Loss<sup>2</sup></b>	<b>2,000</b>	
<b>Acc.Dep. - Motor Vehicle<sup>4</sup></b>		<b>12,000</b>
Interest Revenue		600
<b>Wages<sup>3</sup></b>	<b>20,500</b>	
<b>Depreciation – Motor Vehicle<sup>4</sup></b>	<b>2,000</b>	
Drawings	16,000	
<b>Office Rent<sup>1</sup></b>	<b>12,600</b>	
Motor Vehicle	40,000	
Interest Expense	500	
<b>TOTALS</b>	<b>284,000</b>	<b>284,000</b>

Four balance day adjustments have been completed to enable the production of a Post Trial Balance. (8 entries – four effect Profit & Loss accounts and the other four effect Balance Sheet accounts)

1. Transfer rent used from the Prepaid Rent account to rent expense.
2. Record stock loss expense after completion of physical stock-take. Reduce stock control.
3. Increase wages expense and create liability for amounts owing to employees.
4. Record depreciation expense and increase accumulated depreciation of vehicles.