MBA in Food & Agribusiness

Financial Management

Measuring Business Income

Accrual Accounting

- Revenues and expenses are recorded in the periods in which they occur rather than in the periods when cash is received
  - or paid

HOW?

✓Recording revenues when **earned**

✓Recording expenses when **incurred**

=

✓Adjusting the accounts

The Adjustment Process

Balance sheet

Income statement

	Asset	Liability
Exp'n	1 Allocating recorded costs between two or more accounting periods	2 Recognizing unrecorded expenses
Rev'n	4 Recognizing unrecorded earned revenues	3 Allocating recorded unearned revenues between two or more accounting periods

Prepaid Rent Adjustment Illustrated

On July 3, Treadle Website Design paid two months' rent in advance, $3,200. The amount was recorded in the Prepaid Rent account.

Prepaid Rent		
July 3	3,200	

Rent Expense	

By July 31, half of the prepaid rent has expired and should be treated as an expense

This is the Y/E

Prepaid Rent Adjustment Illustrated

Adjustment July 31: Prepaid rent of $1,600 has expired for July. Adjust account by allocating the amount to the Rent Expense account.

Prepaid Rent

July 3	3,200	July 31	1,600
Bal.	1,600		

The account now reflects the prepaid August amount

Rent Expense

July 31	1,600		

The account now reflects the July rent expense amount

		Dr.	Cr.
July 31	Rent Expense	1,600	
	Prepaid Rent		1,600

P 3. The trial balance for Financial Strategies Service on December 31, 20xx, is as follows:

Financial Strategies Service
Trial Balance
December 31, 20xx

Cash	$ 16,500	
Accounts Receivable	8,250	
Office Supplies	2,662	
Prepaid Rent	1,320	
Office Equipment	9,240	
Accumulated Depreciation–Office Equipment		$ 1,540
Accounts Payable		5,940
Notes Payable		11,000
Unearned Service Revenue		2,970
L. Gang, Capital		24,002
L. Gang, Withdrawals	22,000	
Service Revenue		72,600
Salaries Expense	49,400	
Rent Expense	4,400	
Utilities Expense	4,280	
	$118,052	$118,052

The following information is also available:

a. Ending inventory of office supplies, $264.
b. Prepaid rent expired, $440.
c. Depreciation of office equipment for the period, $660.
d. Accrued interest expense at the end of the period, $550.
e. Accrued salaries at the end of the period, $330.
f. Service revenue still unearned at the end of the period, $1,166.
g. Service revenue earned but unrecorded, $2,200.

Required

1. Open T accounts for the accounts in the trial balance plus the following: Interest Payable; Salaries Payable; Office Supplies Expense; Depreciation Expense–Office Equipment; and Interest Expense. Enter the balances shown on the trial balance.
2. Determine the adjusting entries and post them directly to the T accounts.
3. Prepare an adjusted trial balance.
4. **User Insight:** Which financial statements do each of the above adjustments affect? Which financial statement is *not* affected by the adjustments?

Answer P3 - 1

Cash			
Bal.	16.500		

Accounts Receivable			
Bal.	8.250		
(g)	2.200		
Bal.	*10.450*		

Office Supplies			
Bal.	2.662	(a)	2.398
Bal.	*264*		

Prepaid Rent			
Bal.	1.320	(b)	440
Bal.	*880*		

Office Equipment			
Bal.	9.240		

Accumulated Depreciation-- Office Equipment			
		Bal.	1.540
		(c)	660
		Bal.	*2.200*

Answer P3 - 2

Accounts Payable			
		Bal.	5.940

Notes Payable			
		Bal.	11.000

Interest Payable			
		(d)	550

Salaries Payable			
		(e)	330

Unearned Service Revenue			
(f)	1.804	Bal.	2.970
		Bal.	*1.166*

L. Gang, Capital			
		Bal.	24.002

L. Gang, Withdrawals			
Bal.	22.000		

Service Revenue			
		Bal.	72.600
		(f)	1.804
		(g)	2.200
		Bal.	*76.604*

Salaries Expense			
Bal.	49.400		
(e)	330		
Bal.	*49.730*		

Rent Expense			
Bal.	4.400		
(b)	440		
Bal.	*4.840*		

Utilities Expense			
Bal.	4.280		

Office Supplies Expense			
(a)	2.398		

Answer P3 - 3

Depreciation Expense-- Office Equipment					Interest Expense			
(c)	660				(d)	550		

The T account illustrated

DR	Cash	CR
	100,000	70,000
	3,000	400
		1,200
	103,000	71,600
Normal balance	31,400	

Goes to Trial Balance

Not the same!

Answer P3 - 4

Financial Strategies Service		
Adjusted Trial Balance		
December 31, 20xx		
Cash	**$ 16.500**	
Accounts Receivable	**10.450**	
Office Supplies	**264**	
Prepaid Rent	**880**	
Office Equipment	**9.240**	
Accumulated Depreciation--Office Equipment		**$ 2.200**
Accounts Payable		**5.940**
Notes Payable		**11.000**
Interest Payable		**550**
Salaries Payable		**330**
Unearned Service Revenue		**1.166**
L. Gang, Capital		**24.002**
L. Gang, Withdrawals	**22.000**	
Service Revenue		**76.604**
Salaries Expense	**49.730**	
Rent Expense	**4.840**	
Utilities Expense	**4.280**	
Office Supplies Expense	**2.398**	
Depreciation Expense--Office Equipment	**660**	
Interest Expense	**550**	
	$121.792	**$121.792**

Double Entry System

DEBIT	**CREDIT**
EXPENSE	**LIABILITIES**
ASSET	**INCOME**
DIVIDEND	**CAPITAL**

DR = CR

LO2, LO3 **Preparing Adjusting Entries**

P 7. On November 30, the end of the current fiscal year, the following information is available to assist Pinder Company's accountants in making adjusting entries:

a. Pinder Company's Supplies account shows a beginning balance of $2,174. Purchases during the year were $4,526. The end-of-year inventory reveals supplies on hand of $1,397.

b. The Prepaid Insurance account shows the following on November 30:

Beginning balance	$3,580	→ fully expired
July 1	4,200	→ 5/12 expired
October 1	7,272	→ 2/36 expired

The beginning balance represents the unexpired portion of a one-year policy purchased in September of the previous year. The July 1 entry represents a new one-year policy, and the October 1 entry represents additional coverage in the form of a three-year policy.

c. The following table contains the cost and annual depreciation for buildings and equipment, all of which Pinder Company purchased before the current year:

Account	Cost	Annual Depreciation
Buildings	$286,000	$14,500
Equipment	374,000	35,400

d. On September 1, the company completed negotiations with a client and accepted an advance of $16,800 for services to be performed in the next year. The $16,800 was credited to Unearned Services Revenue.

e. The company calculated that as of November 30, it had earned $4,000 on an $11,000 contract that would be completed and billed in January.

f. Among the liabilities of the company is a note payable in the amount of $300,000. On November 30, the accrued interest on this note amounted to $15,000.

g. On Saturday, December 2, the company, which is on a six-day workweek, will pay its regular salaried employees $12,300.

h. On November 29, the company completed negotiations and signed a contract to provide services to a new client at an annual rate of $17,500.

Required

1. Prepare adjusting entries for each item listed above.
2. Explain how the conditions for revenue recognition are applied to transactions **e** and **h**.

Answer P7 - 1

a.	Nov.	30	Supplies Expense	5.303	
			Supplies		5.303
			To record supplies used		
			$2.174 + $4.526 œ $1.397		
			= $5.303		
b.		30	Insurance Expense	5.734	
			Prepaid Insurance		5.734
			To record expired insurance		
			$3.580		
			1.750 [($4.200 ÷ 12 months)		
			x 5 months]		
			404 [($7.272 ÷ 36 months)		
			x 2 months]		
			$5.734		
c.		30	Depreciation Expense--Buildings	14.500	
			Depreciation Expense--Equipment	35.400	
			Accumulated Depreciation--Buildings		14.500
			Accumulated Depreciation--Equipment		35.400
			To record annual depreciation		

Answer P7 - 2

d.		30	Unearned Services Revenue	4.200	
			Service Revenue		4.200
			To record service revenue earned for		
			which payment was received in advance		
			($16.800 ÷ 12 months)		
			x 3 months = $4.200		
e.		30	Accounts Receivable	4.000	
			Service Revenue		4.000
			To record service revenue earned on		
			a contract to be billed in January		
f.		30	Interest Expense	15.000	
			Interest Payable		15.000
			To record accrued interest on note		
			payable		

Answer P7 - 3

g.	Nov.	30	Salaries Expense									8.200	
				Salaries Payable									8.200
					To record accrued salaries								
					(	$12.300	÷	6	days)	x	4 days		
					=	$8.200							
h.			No entry										

Inventories (IAS 2)

Inventory Cost under the Periodic Inventory System (collectief)

Inventory <u>cost</u> is determined using one of the following generally accepted methods, each *based on a different assumption of cost flow*:

1. Specific identification method
2. Average-cost method
3. First-in, first-out (FIFO) method
4. Last-in, first-out (LIFO) method

Basic Data

Inventory Data				
June 1	Inventory	80 units	@ $10.00	$ 800
June 6	Purchase	220 units	@ $12.50	2,750
June 25	Purchase	200 units	@ $14.00	2,800
Goods available for sale		500 units		$6,350
Sales		280 units		
On hand June 30		**220 units**		

First-In, First-Out (FIFO) Method

Inventory Data				
June 1	Inventory	80 units	@ $10.00	$ 800
June 6	Purchase	220 units	@ $12.50	2,750
June 25	Purchase	200 units	@ $14.00	2,800
Goods available for sale		500 units		$6,350
Sales		280 units		
On hand June 30		220 units		

First-In, First-Out (FIFO) Method

200 units @ $14.00 from purchase of June 25	$2,800
20 units @ $12.50 from purchase of June 6	250
220 units at a cost of	$3,050

Cost of goods avail. for sale	$6,350
Less June 30 inventory	3,050
Cost of goods sold	$3,300

*Inventory is priced at the price of the **last** items purchased*

Last-In, First-Out (LIFO) Method

Inventory Data				
June 1	Inventory	80 units	@ $10.00	$ 800
June 6	Purchase	220 units	@ $12.50	2,750
June 25	Purchase	200 units	@ $14.00	2,800
Goods available for sale		500 units		$6,350
Sales		280 units		
On hand June 30		220 units		

Last-In, First-Out (LIFO) Method	
80 units @ $10.00 from June 1 inventory	$ 800
140 units @ $12.50 from purchase of June 6	1,750
220 units at a cost of	$2,550

Cost of goods avail. for sale	$6,350
Less June 30 inventory	2,550
Cost of goods sold	$3,800

Inventory is priced at the price of the ***first*** *items purchased*

LO1, LO3 **Periodic Inventory System and Inventory Costing Methods**

P 2. The inventory, purchases, and sales of Product ISO for March and April are listed below. The company closes its books at the end of each month and uses the periodic inventory system.

Mar.	1	Beginning inventory	60 units @ $49
	10	Purchase	100 units @ $52

Mar.	19	Sale	90 units
	31	Ending inventory	70 units
Apr.	4	Purchase	120 units @ $53
	15	Purchase	50 units @ $54
	23	Sale	200 units
	25	Purchase	100 units @ $55
	30	Ending inventory	140 units

Required

1. Compute the cost of the ending inventory on March 31 and April 30 using the average-cost method. In addition, determine cost of goods sold for March and April. Round unit costs to cents and totals to dollars.
2. Compute the cost of the ending inventory on March 31 and April 30 using the FIFO method. Also determine cost of goods sold for March and April.
3. Compute the cost of the ending inventory on March 31 and April 30 using the LIFO method. Also determine cost of goods sold for March and April.
4. **User Insight:** Do the cash flows from operations for March and April differ depending on which inventory costing method is used—average-cost, FIFO, or LIFO? Explain.

Answer P2 - Weighted Average 1

	Units	Unit Price	Amount
March 1 beginning inventory	60	$49,00	$ 2.940
Purchase			
March 10	100	52,00	5.200
Cost of goods available for sale*	160	50,88	$ 8.140
Sales			
March 19	90		
March 31 ending inventory*	70	50,88	3.562
Cost of goods sold for March			$ 4.578

Answer P2 - Weighted Average 2

April 1 beginning inventory					70	$50,88	$ 3.562
		Units	Unit Price	Amount			
Purchases							
	April 4	120	$53	$6.360			
	April 15	50	54	2.700			
	April 25	100	55	5.500	270		14.560
Cost of goods available for sale					340	53,30	$18.122
Sales							
	April 23				200		
April 30 ending inventory					140	53,30	7.462
Cost of goods sold for April							$10.660

Answer P2 – FIFO 1

	Units	Unit Price	Amount
March 1 beginning inventory	60	$49	$ 2.940
Purchase			
March 10	100	52	5.200
Cost of goods available for sale	160		$ 8.140
Sales			
March 19	90		
March 31 ending inventory*	70	52	3.640
Cost of goods sold for March			$ 4.500

*From purchase on March 10.

Answer P2 – FIFO 2

April 1 beginning inventory					70	$52	$ 3.640
			Unit				
		Units	Price	Amount			
Purchases							
	April 4	120	$53	$6.360			
	April 15	50	54	2.700			
	April 25	100	55	5.500	270		14.560
Cost of goods available for sale					340		$18.200
Sales							
	April 23				200		
April 30 ending inventory*					140		7.660
Cost of goods sold for April							$10.540

*	From April 15 purchase:	40	units x	$54	=	$2.160
	From April 25 purchase:	100	units x	$55	=	5.500
						$7.660

Answer P2 – LIFO 1

	Units	Unit Price	Amount
March 1 beginning inventory	60	$49	$ 2.940
Purchase			
March 10	100	52	5.200
Cost of goods available for sale	160		$ 8.140
Sales			
March 19	90		
March 31 ending inventory*	70		3.460
Cost of goods sold for March			$ 4.680

*	March 1 beginning inventory					$2.940
	(	60	units x	$49	)	
	March 10 purchase					520
	(	10	units x	$52	)	$3.460

Answer P2 – LIFO 2

April 1 beginning inventory					70		$ 3.460
		Unit					
	Units	Price	Amount				
Purchases							
April 4	120	$53	$6.360				
April 15	50	54	2.700				
April 25	100	55	5.500		270		14.560
Cost of goods available for sale					340		$18.020
Sales							
April 23					200		
April 30 ending inventory*					140		7.170
Cost of goods sold for April							$10.850

*	March 1 beginning inventory:					$2.940
	(	60	units x	$49	)	
	March 10 purchases:					520
	(	10	units x	$52	)	
	April 4 purchases:					3.710
	(	70	units x	$53	)	$7.170