**Adjusting Entries**

*Why do we prepare adjusting entries?*
- If we do not, our Financial Statements will be incorrect.

*What are the different categories and types of adjusting entries?*
1) Prepaid and Unearned Items
   a) **Prepaid Expenses (Assets)** - Certain expenses that were paid for in advance.
      Examples: Prepaid Rent, Prepaid Insurance, Supplies
      **General Rule:**
      Dr: _______ Expense  
      Cr: Prepaid Asset
   b) **Unearned Revenues** - The business received payment for the service/goods but have not provided the service/goods as of yet.
      Account affected - "Unearned".....
      **General Rule:**
      Dr: Unearned Revenue Account  
      Cr: Revenue Account

2) Accrued Items
   a) **Accrued Expenses** - Expenses that have been incurred but unrecorded.
      **General Rule:**
      Dr: _______ Expense  
      Cr: ________ Payable
   b) **Accrued Revenues** - These are revenues that have been earned and they are unrecorded.
      **General Rule:**
      Dr: __________ Receivable  
      Cr: Revenue Account

3) Estimated Items
   a) Depreciation
      **General Rule:**
      Dr: **Depreciation Expense** - "Asset's Name"  
      Cr: **Accumulated Depreciation** - "Asset's Name"
   b) **Bad Debts** - This will be covered in Chapter 9
**Multi-Step Income Statement**

**Sections:**

1) **Sales (Net Sales)**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales Revenue</td>
<td>420,000</td>
</tr>
<tr>
<td>Less: Sales Returns and Allowances</td>
<td></td>
</tr>
<tr>
<td>Sales Discounts</td>
<td></td>
</tr>
<tr>
<td><strong>Net Sales</strong></td>
<td>420,000</td>
</tr>
</tbody>
</table>

2) **Cost of Goods Sold**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Merchandise Inventory, Beginning</td>
<td>50,000</td>
</tr>
<tr>
<td>Purchases</td>
<td>120,000</td>
</tr>
<tr>
<td>Less: Purchases Returns and Allowances</td>
<td>(12,000)</td>
</tr>
<tr>
<td>Purchases Discounts</td>
<td>(5,000)</td>
</tr>
<tr>
<td>Net Purchases</td>
<td>103,000</td>
</tr>
<tr>
<td>Add: Freight-In</td>
<td>7,000</td>
</tr>
<tr>
<td><strong>Cost of Goods Purchased</strong></td>
<td>110,000</td>
</tr>
<tr>
<td>Cost of Goods Available for sale</td>
<td>160,000</td>
</tr>
<tr>
<td>Less: Inventory, Ending</td>
<td>(43,000)</td>
</tr>
<tr>
<td><strong>Cost of Goods Sold</strong></td>
<td>117,000</td>
</tr>
<tr>
<td>Gross Profit</td>
<td>303,000</td>
</tr>
</tbody>
</table>

3) **Operating Expenses**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>List all of your Operating Expenses</td>
<td>(103,000)</td>
</tr>
<tr>
<td><strong>Income from Operations</strong></td>
<td>200,000</td>
</tr>
<tr>
<td>Other Revenues and Gains</td>
<td>4,000</td>
</tr>
<tr>
<td><strong>Non-Operating Items</strong></td>
<td></td>
</tr>
<tr>
<td>Other Expenses and Losses</td>
<td>(3,000)</td>
</tr>
<tr>
<td>Net Income</td>
<td>201,000</td>
</tr>
</tbody>
</table>
**Statement of Owners' Equity**

Capital, Beginning  
Add:  
Investment made by the Owner  
**Net Income**  
Subtotal  
Less:  
Owners' Drawings  
**Net Loss**  
Capital, Ending  

**Classified Balance Sheet:**

Assets  
Current Assets - Listed according to Liquidity  
Long-Term Investments  
Property, Plant, and Equipment  
Intangible Assets  

**Liabilities**  
Current Liabilities  
Long-Term Liabilities  

Owners' Equity  
Owners’ Capital (Usually from the Statement of Owners' Equity)
4 Closing Entries

1) Closed all Income Statement accounts with credit balances into the Income Summary Account
   Dr: Income Statement Accounts with Credit Balances
   Cr: Income Summary

2) Closed all Income Statement accounts with Debit balances into the Income Summary Account
   Dr: Income Summary
   Cr: Income Statement Accounts with Debit Balances

3) Closed the Income Summary Account into the Owners' Capital
   a) If Income Summary has a Debit balance, the entry is:
      Dr: Owners' Capital
      Cr: Income Summary
      OR
   b) If Income Summary has a Credit balance, the entry is:
      Dr: Income Summary
      Cr: Owners' Capital

4) Closed the Owners' Drawings Account into the Owners' Capital
   Dr: Owners' Capital
   Cr: Owners' Drawings