

UNIT 12 Work Sheet, Adjustments, Financial Statements

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So far in this chapter you have learned:

- That adjustments are necessary if financial statements are to be correct
- How to adjust prepaid expenses such as Supplies, Rent, and Insurance
- How to adjust fixed assets by recording Depreciation Expense

Adjustments are first prepared on the work sheet.

In this part of the chapter, you will learn how the adjustments are prepared on the work sheet and how the financial statements are prepared.

Eight-Column Work Sheet

The trial balance for Management Consultant Services is shown in Figure 6-5 on an eight-column work sheet. In Chapter 5, you learned how a six-column work sheet is used to help organize the financial statements. The trial balance is written on a work sheet. The accounts on the trial balance are then transferred to either the income statement section or the balance sheet section of the work sheet. The revenue and expense items are transferred to the income statement section. The difference in the totals of the income statement section is the net income or the net loss for the accounting period. The difference in the totals of the balance sheet section is also the net income or the net loss. This difference should of course be the same as that obtained in the income statement section.

The eight-column work sheet serves the same purpose. It is prepared in the same way as a six-column work sheet, but an *adjustments* section is added. It is also used by the accountant to *rough out* or plan the necessary adjustments so that the financial statements will be correct. There are four sections on an eight-column work sheet as shown in Figure 6-5:

- Trial balance
- Section to plan the adjustments
- Income statement section
- Balance sheet section

In the next few pages, the work sheet will be completed for Management Consultant Services. The period of time covered by this work sheet will be one full year. The first step in preparing the work sheet is to gather the information required to complete the adjustments. This information includes:

- A count made of all supplies on hand shows \$400 worth left on December 31.
- On January 1, a three-year insurance policy was purchased. One year of the policy is now expired.

Management Consultant Services
Work Sheet
For the year ended December 31, 19--

ACCOUNT TITLE	ACC. NO.	TRIAL BALANCE		ADJUSTMENTS		INCOME STATEMENT		BALANCE SHEET		
		DEBIT	CREDIT	DEBIT	CREDIT	DEBIT	CREDIT	DEBIT	CREDIT	
1 Cash	100	13 000								1
2 Accounts Receivable	102	7 000								2
3 Supplies	131	1 000								3
4 Prepaid Insurance	132	900								4
5 Prepaid Rent	133	5 100								5
6 Equipment	141	12 000								6
7 Accumulated Depreciation — Equip.	142		2 400							7
8 Accounts Payable	200		1 000							8
9 Bank Loan	221		3 000							9
10 J. Turner, Capital	300		10 400							10
11 J. Turner, Drawings	301	15 000								11
12 Fees Earned	400		144 000							12
13 Salaries Expense	500	89 500								13
14 Utilities Expense	501	1 300								14
15 Rent Expense	502	15 300								15
16 Miscellaneous Expense	503	700								16
17		<u>160 800</u>	<u>160 800</u>							17

Figure 6-5 Eight-column work sheet

- The balance in the Prepaid Rent account represents a payment on October 1 for the October, November, and December rents.
- The equipment depreciates 20 per cent a year. The declining-balance method is used.

Using this information, the adjustments are prepared on the work sheet.

Preparing Adjustments

In this example four accounts need to be adjusted. They are:

- Supplies
- Prepaid Insurance
- Prepaid Rent
- Equipment

Supplies

The asset account Supplies has a \$1 000 balance. However, the inventory taken at the end of the fiscal period indicates only \$400 worth of supplies are left. This means that \$600 worth of supplies have been *used* and should be recorded as an *expense*.

Supplies purchased	\$1 000
Supplies left	<u>400</u>
Supplies Expense	\$ 600

It is necessary to record the Supplies Expense of \$600 and to decrease the asset Supplies by \$600. This is done by debiting Supplies Expense and crediting Supplies. Figure 6-6 shows how this adjustment is prepared on the work sheet.

In preparing the adjustment, it is necessary to add the account Supplies Expense to the bottom of the trial balance because the account Supplies Expense does not appear on the trial balance. The new account Supplies Expense is debited \$600 in the adjustments debit column. The asset Supplies is reduced by entering a credit of \$600 in the adjustments credit column in the same line as Supplies. The effect of this adjustment, in T-account form, is:

Supplies		Supplies Expense	
Dec. 31	1 000	Dec. 31	600
Balance	400	Dec. 31	600

This adjustment decreases the asset Supplies by \$600 to the correct balance of \$400. It also records the amount of supplies used (\$600) in the Supplies Expense account.

Prepaid Insurance

In January, a \$900, three-year insurance policy was purchased. At the end of the current year, two years of insurance remain. One-third of the policy has expired or been used up and it is necessary to reduce the Prepaid Insurance by \$300 ($\frac{1}{3} \times 900 = 300$)

Management Consultant Services
Work Sheet
For the year ended December 31, 19--

ACCOUNT TITLE	ACC. NO.	TRIAL BALANCE		ADJUSTMENTS		INCOME STATEMENT		BALANCE SHEET		
		DEBIT	CREDIT	DEBIT	CREDIT	DEBIT	CREDIT	DEBIT	CREDIT	
1 Cash	100	13 000								1
2 Accounts Receivable	102	7 000								2
3 Supplies	131	1 000			(a) 600					3
4 Prepaid Insurance	132	900								4
5 Prepaid Rent	133	5 100								5
6 Equipment	141	12 000								6
7 Accumulated Depreciation — Equip.	142		2 400							7
8 Accounts Payable	200		1 000							8
9 Bank Loan	221		3 000							9
10 J. Turner, Capital	300		10 400							10
11 J. Turner, Drawings	301	15 000								11
12 Fees Earned	400		144 000							12
13 Salaries Expense	500	89 500								13
14 Utilities Expense	501	1 300								14
15 Rent Expense	502	15 300								15
16 Miscellaneous Expense	503	700								16
17		<u>160 800</u>	<u>160 800</u>							17
18 Supplies Expense	504			(a) 600						18

Figure 6-6 The adjustment for Supplies is shown on lines 3 and 18 of the work sheet.

Management Consultant Services										
Work Sheet										
For the year ended December 31, 19--										
ACCOUNT TITLE	ACC. NO.	TRIAL BALANCE		ADJUSTMENTS		INCOME STATEMENT		BALANCE SHEET		
		DEBIT	CREDIT	DEBIT	CREDIT	DEBIT	CREDIT	DEBIT	CREDIT	
1 Cash	100	13 000								1
2 Accounts Receivable	102	7 000								2
3 Supplies	131	1 000			(a) 600					3
4 Prepaid Insurance	132	900			(b) 300					4
5 Prepaid Rent	133	5 100								5
6 Equipment	141	12 000								6
7 Accumulated Depreciation — Equip.	142		2 400							7
8 Accounts Payable	200		1 000							8
9 Bank Loan	221		3 000							9
10 J. Turner, Capital	300		10 400							10
11 J. Turner, Drawings	301	15 000								11
12 Fees Earned	400		144 000							12
13 Salaries Expense	500	89 500								13
14 Utilities Expense	501	1 300								14
15 Rent Expense	502	15 300								15
16 Miscellaneous Expense	503	700								16
17		<u>160 800</u>	<u>160 800</u>							17
18 Supplies Expense	504			(a) 600						18
19 Insurance Expense	505			(b) 300						19

Figure 6-7 The adjustment for Prepaid Insurance is shown on lines 4 and 19.

Management Consultant Services
Work Sheet
For the year ended December 31, 19--

	ACCOUNT TITLE	ACC. NO.	TRIAL BALANCE		ADJUSTMENTS		INCOME STATEMENT		BALANCE SHEET		
			DEBIT	CREDIT	DEBIT	CREDIT	DEBIT	CREDIT	DEBIT	CREDIT	
1	Cash	100	13 000								1
2	Accounts Receivable	102	7 000								2
3	Supplies	131	1 000		(a) 600						3
4	Prepaid Insurance	132	900		(b) 300						4
5	Prepaid Rent	133	5 100		(c) 5 100						5
6	Equipment	141	12 000								6
7	Accumulated Depreciation — Equip.	142		2 400							7
8	Accounts Payable	200		1 000							8
9	Bank Loan	221		3 000							9
10	J. Turner, Capital	300		10 400							10
11	J. Turner, Drawings	301	15 000								11
12	Fees Earned	400		144 000							12
13	Salaries Expense	500	89 500								13
14	Utilities Expense	501	1 300								14
15	Rent Expense	502	15 300		(c) 5 100						15
16	Miscellaneous Expense	503	700								16
17			<u>160 800</u>	<u>160 800</u>							17
18	Supplies Expense	504			(a) 600						18
19	Insurance Expense	505			(b) 300						19

Figure 6-8 The adjustment for Prepaid Rent is shown on lines 5 and 15.

Management Consultant Services Work Sheet For the year ended December 31, 19--										
ACCOUNT TITLE	ACC. NO.	TRIAL BALANCE		ADJUSTMENTS		INCOME STATEMENT		BALANCE SHEET		
		DEBIT	CREDIT	DEBIT	CREDIT	DEBIT	CREDIT	DEBIT	CREDIT	
1 Cash	100	13 000						13 000		1
2 Accounts Receivable	102	7 000						7 000		2
3 Supplies	131	1 000		(a) 600				400		3
4 Prepaid Insurance	132	900		(b) 300				600		4
5 Prepaid Rent	133	5 100		(c) 5 100						5
6 Equipment	141	12 000						12 000		6
7 Accumulated Depreciation — Equip.	142		2 400	(d) 1 920					4 320	7
8 Accounts Payable	200		1 000						1 000	8
9 Bank Loan	221		3 000						3 000	9
10 J. Turner, Capital	300		10 400						10 400	10
11 J. Turner, Drawings	301	15 000						15 000		11
12 Fees Earned	400		144 000				144 000			12
13 Salaries Expense	500	89 500				89 500				13
14 Utilities Expense	501	1 300				1 300				14
15 Rent Expense	502	15 300		(c) 5 100		20 400				15
16 Miscellaneous Expense	503	700				700				16
17		<u>160 800</u>	<u>160 800</u>							17
18 Supplies Expense	504			(a) 600		600				18
19 Insurance Expense	505			(b) 300		300				19
20 Depreciation Expense — Equipment	506			(d) <u>1 920</u>		<u>1 920</u>				20
21				<u>7 920</u>	<u>7 920</u>	<u>114 720</u>	<u>144 000</u>	<u>48 000</u>	<u>18 720</u>	21
22 Net Income						<u>29 280</u>			<u>29 280</u>	22
23						<u>144 000</u>	<u>144 000</u>	<u>48 000</u>	<u>48 000</u>	23

Figure 6-9 Completed work sheet

and record an expense of \$300. This is done by adding the account Insurance Expense to the work sheet. A debit of \$300 is written beside Insurance Expense in the adjustments debit column. The asset Prepaid Insurance is reduced by entering a credit of \$300 in the adjustments credit column opposite Prepaid Insurance. The work sheet in Figure 6-7 illustrates how Prepaid Insurance is adjusted.

The effect of this adjustment is to lower the asset Prepaid Insurance to \$600 and to record the Insurance Expense for one year of \$300.

Prepaid Rent

On October 1, rent of \$5 100 was prepaid for October, November, and December. On December 31, the rent for those three months is no longer prepaid. It has been *used up* and an expense must be recorded.

Since there is already a Rent Expense account on the trial balance, all that is required to adjust Prepaid Rent is to decrease the asset by a credit of \$5 100. The rent expense for the three months is recorded by debiting Rent Expense \$5 100. Because the rent is no longer prepaid, the effect of the credit to Prepaid Rent is to reduce this asset to zero. Figure 6-8 illustrates the rent adjustment.

Equipment

Fixed assets such as Equipment depreciate each year. Equipment may be depreciated at a rate of up to 20 per cent a year. For income tax purposes, the declining-balance method must be used. The year's depreciation on Equipment using a 20 per cent rate on the declining balance is \$1 920.

To record the depreciation, a debit is entered in the Depreciation Expense — Equipment account and a credit is entered in the Accumulated Depreciation — Equipment account. It is necessary to add Depreciation Expense — Equipment to the work sheet. This account is debited \$1 920 in the adjustments debit column. The Accumulated Depreciation — Equipment account is credited \$1 920 in the adjustments credit column. Figure 6-9 illustrates this adjustment.

Four adjustments have now been made on the work sheet and placed in the adjustments section; each adjustment has been labelled. For example, the supplies adjustment has an (a) beside the debit and an (a) beside the credit. The other adjustments were labelled (b), (c), and (d) respectively. These labels ensure that there is a debit for every credit and provide a reference for checking the adjustments.

The mathematical accuracy of the adjustments section of the work sheet is proven by adding the two columns. The debit column total should equal the credit column total. If this is the case, the columns are double-ruled.

Completing the Work Sheet

After the adjustments have been completed and the adjustments columns totalled, the items on the trial balance are transferred to either the income statement or balance sheet sections of the work sheet. The income and expenses are transferred to the income statement section. The assets, liabilities, and equity accounts are transferred to the balance sheet section.

For example, Figure 6-9 shows that Cash, \$13 000, is transferred to the balance sheet debit column (line 1). Accounts Receivable, \$7 000, is also transferred to the

balance sheet debit column (line 2). However, there is a complication on line 3 of the work sheet. The asset Supplies has a *debit* of \$1 000 and a *credit* of \$600 in the adjustments section. The difference between a debit of \$1 000 and a credit of \$600 is \$400. Because Supplies is an asset account, the \$400 balance is transferred to the balance sheet debit column.

Prepaid Insurance is handled in the same way as Supplies. The difference between the \$900 debit and the \$300 credit is \$600. This amount (\$600) is transferred to the balance sheet debit column (line 4). On line 5, the difference in the Prepaid Rent account is zero ($5\ 100\ \text{debit} - 5\ 100\ \text{credit} = 0$). Therefore, there is no balance shown in the balance sheet section for Prepaid Rent. There is no change in the Equipment account. Thus \$12 000 is transferred to the balance sheet debit column (line 6). On line 7, there are two credits for Accumulated Depreciation — Equipment. These are added and the balance, \$4 320, is transferred to the balance sheet credit column. Accounts Payable, Bank Loan, and J. Turner, Capital are all transferred to the balance sheet credit column, and J. Turner, Drawings is transferred to the balance sheet debit column.

Fees Earned, on line 12, is the revenue of Management Consultant Services and is transferred to the income statement credit column.

Salaries Expense, Utilities Expense, and Miscellaneous Expense did not require adjustment and are transferred to the income statement debit column. Rent Expense on line 15 has two debits. These are added and the total of \$20 400 appears in the income statement debit column. At the bottom of the work sheet are found the remaining expenses, including Supplies Expense, Insurance Expense, and Depreciation Expense — Equipment, which required adjustments. These expenses are transferred to the income statement debit column.

Determining the Net Income or Net Loss

After all the amounts have been transferred to either the balance sheet or income statement sections, it is quite simple to determine the net income or net loss. First, add the income statement debit and credit columns and then find the difference between them. This difference is the net income or the net loss. *There is net income if the credit column total is bigger than the debit column total. Conversely, there is net loss if the debit column has a bigger total than the credit column.* Looking at Figure 6-9, it can be seen that the credit column total of the income statement section is bigger and thus shows a net income (\$29 280).

Next, add the balance sheet debit and credit columns and determine the difference between them. The difference is the net income or net loss. There is net income if the debit column total is bigger than the credit column total, and net loss if the credit column total is the larger of the two. Notice that the debit column total in Figure 6-9 is bigger and the difference is the *same* as the difference in the income statement columns — both differences are \$29 280. This should come as no surprise as both differences are measuring the same thing — net income.

Balancing the Work Sheet

After the net income (or net loss) has been determined, the amount (in this example \$29 280) is added to the smaller column total of both the income statement and the

balance sheet sections of the work sheet. *The net income figure is added to both the debit column of the income statement section and to the credit side of the balance sheet. A net loss would be added to the credit side of the income statement section and to the debit side of the balance sheet section.* The columns are then double-ruled as shown in Figure 6-9.

Steps in Preparing the Eight-Column Work Sheet

To summarize, these are the steps followed when preparing an eight-column work sheet:

- (1) Write the heading on the work sheet.
- (2) Write the trial balance on the work sheet.
- (3) Gather the data needed to prepare the adjustments.
- (4) Prepare the adjustments and total, balance, and rule the adjustment columns.
- (5) Transfer all items to either the income statement or balance sheet columns.
- (6) Total the income statement and balance sheet columns and determine the net income or net loss.
- (7) Balance and rule the work sheet.

Ten-Column Work Sheet

Many businesses use a ten-column work sheet instead of the eight-column work sheet. The extra two columns are used to prepare an “adjusted trial balance.” This trial balance is prepared on the work sheet after the adjustments have been completed. It is prepared to ensure that the ledger accounts are still in balance; that is, to ensure that the *debit balances* equal the *credit balances*. If the ledger is still in balance, then the accountant proceeds to complete the work sheet. The work sheet for Management Consultant Services is shown in Figure 6-10 using the ten-column format. Notice that the adjusted trial balance section comes after the adjustments section and before the financial statement sections.

Steps in Preparing the Ten-Column Work Sheet

These steps are followed when completing a ten-column work sheet:

- (1) Write the heading on the work sheet.
- (2) Write the trial balance on the work sheet.
- (3) Gather the data needed to prepare the adjustments.
- (4) Prepare the adjustments and total, balance, and rule the adjustment columns.
- (5) Transfer *all* items to the adjusted trial balance columns and recalculate the balances where necessary. Total, balance, and rule the adjusted trial balance columns.
- (6) Transfer all items from the adjusted trial balance to either the income statement or the balance sheet columns.
- (7) Total the income statement and balance sheet columns and determine the net income or net loss.
- (8) Balance and rule the work sheet.

Management Consultant Services
Work Sheet
 For the year ended December 31, 19—

ACCOUNT TITLE	ACC. NO.	TRIAL BALANCE		ADJUSTMENTS		ADJUSTED TRIAL BALANCE		INCOME STATEMENT		BALANCE SHEET		
		DEBIT	CREDIT	DEBIT	CREDIT	DEBIT	CREDIT	DEBIT	CREDIT	DEBIT	CREDIT	
1 Cash	100	13 000				13 000				13 000		1
2 Accounts Receivable	102	7 000				7 000				7 000		2
3 Supplies	131	1 000		(a) 600	600	400				400		3
4 Prepaid Insurance	132	900		(b) 300	300	600				600		4
5 Prepaid Rent	133	5 100		(c) 5 100	5 100							5
6 Equipment	141	12 000				12 000				12 000		6
7 Acc. Depreciation — Equip.	142		2 400	(d) 1 920	1 920		4 320				4 320	7
8 Accounts Payable	200		1 000				1 000				1 000	8
9 Bank Loan	221		3 000				3 000				3 000	9
10 J. Turner, Capital	300		10 400				10 400				10 400	10
11 J. Turner, Drawings	301	15 000				15 000				15 000		11
12 Fees Earned	400		144 000				144 000	144 000				12
13 Salaries Expense	500	89 500				89 500		89 500				13
14 Utilities Expense	501	1 300				1 300		1 300				14
15 Rent Expense	502	15 300		(c) 5 100	5 100	20 400		20 400				15
16 Miscellaneous Expense	503	700				700		700				16
17		<u>160 800</u>	<u>160 800</u>									17
18 Supplies Expense	504			(a) 600	600	600		600				18
19 Insurance Expense	505			(b) 300	300	300		300				19
20 Deprec. Expense — Equip.	506			(d) 1 920	1 920	1 920		1 920				20
21				<u>7 920</u>	<u>7 920</u>	<u>162 720</u>	<u>162 720</u>	114 720	144 000	48 000	18 720	21
22 Net Income								29 280			29 280	22
23								<u>144 000</u>	<u>144 000</u>	<u>48 000</u>	<u>48 000</u>	23

Figure 6-10 Ten-column work sheet

Preparing the Financial Statements

When the work sheet has been completed, the formal financial statements are prepared. All the information necessary for the preparation of the income statement is found on the work sheet in the income statement columns. Similarly, all the necessary data for the balance sheet is found on the work sheet in the balance sheet columns.

Financial statements are prepared from the work sheet.

Figures 6-11 and 6-12 illustrate the financial statements prepared from the completed work sheet. Note the following about the two statements:

- The new expenses resulting from the adjustments are included on the income statement. These are Supplies Expense, Insurance Expense, and Depreciation Expense — Equipment.
- The Accumulated Depreciation is shown as a subtraction from Equipment in the fixed asset section of the balance sheet.

Book Value of Assets

The concept of “book value” is an important one in accounting. In Unit 11, you learned that book value is the amount remaining after the accumulated depreciation has been subtracted from the cost price of a fixed asset.

The book value of Equipment owned by Management Consultants is \$7 680. This is the net value of the asset. It is determined by subtracting the Accumulated Depreciation from the cost of the asset. The book value should not be confused with the market value or cost of the asset. It is simply the remaining value of the asset that has not yet been converted to expense (that is, it is the undepreciated value).

Management Consultant Services Income Statement For the year ended December 31, 19--		
Revenue		
Fees Earned		\$144 000
Expenses		
Salaries Expense	\$89 500	
Utilities Expense	1 300	
Rent Expense	20 400	
Miscellaneous Expense	700	
Supplies Expense	600	
Insurance Expense	300	
Depreciation Expense — Equipment	1 920	
		<u>114 720</u>
Net Income		<u>\$ 29 280</u>

Figure 6-11 Income statement prepared from the work sheet

Management Consultant Services Balance Sheet December 31, 19--			
Assets			
Current Assets			
Cash		\$13 000	
Accounts Receivable		7 000	
Supplies		400	
Prepaid Insurance		600	
Total Current Assets			\$21 000
Fixed Assets			
Equipment		12 000	
Less: Accumulated Depreciation		4 320	
Total Fixed Assets			7 680
Total Assets			<u>\$28 680</u>
Liabilities and Owner's Equity			
Current Liabilities			
Accounts Payable		\$1 000	
Bank Loan		3 000	
Total Current Liabilities			\$ 4 000
Owner's Equity			
J. Turner, Capital January 1		10 400	
Add: Net Income for the year	\$29 280		
Less: J. Turner, Drawings	15 000		
Increase in Capital		14 280	
J. Turner, Capital December 31			24 680
Total Liabilities and Owner's Equity			<u>\$28 680</u>

Figure 6-12 Balance sheet prepared from the work sheet

What Have I Learned in Unit 12?

- To prepare adjustments on a work sheet for prepaid expenses and depreciation of fixed assets
- To complete an eight-column work sheet
- To complete a ten-column work sheet
- To prepare financial statements from a work sheet

If you have learned the material in Unit 12, you are ready to proceed to Unit 13. To determine if you are ready to proceed, your teacher may now wish to give you a review sheet and test for Unit 12.

Check Your Reading

Questions

13. (a) What are the two new columns added to an eight-column work sheet?

(b) For what are the two new columns used?
14. How is the net income or net loss determined on the work sheet?

15. When there is a net loss, which column of the income statement section of the work sheet is greater? Which column of the balance sheet section is greater when there is a net loss?
16. When there is a net income, to which columns on the work sheet is the amount of the net income added?
17. List the seven steps in preparing an eight-column work sheet.
18. How is the book value of an asset determined? Give an example.