Name: ______________________________

ACCOUNTING I
Chapter 15 Reading Guide

15-1 Planning Adjusting Entries

Please answer the following questions as you read Chapter 15, pages 438-469.

1. A business can use any 12-month period for reporting its financial performance. At the end of a fiscal period, some general ledger accounts need to be brought up to date. Last semester adjusting entries were entered for supplies and prepaid insurance. These accounts had to be adjusted at the end of a fiscal period because their account balance did not reflect the value of supplies and insurance premiums that were used or expired during the fiscal period. We learned that the value of the insurance coverage used was recorded as a debit to Insurance Expense. In addition to the adjusting entries for supplies and prepaid insurance, what other accounts are adjusted by ThreeGreen in Chapter 15?
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2. What is the first step in preparing adjusting entries? What is the purpose of this document? Which accounts are listed?
   - An Unadjusted Trial Balance must be prepared.
   - The Unadjusted Trial Balance is created to provide proof that debits and credits are equal, and to provide a complete list of accounts that may need to be brought up to date.
   - All general ledger accounts are listed—even if they do not have a balance

3. What are the four questions that must be asked to analyze the adjustments?
   - What is the balance of the accounts being adjusted? What should be balances be for these accounts? What must be done to correct the account balances? What adjusting entries are made?

15-2 Adjusting Merchandise Inventory and Interest receivable

4. The adjustment unique to merchandising businesses adjusts Merchandise Inventory. Under a periodic inventory method, even though the actual amount of merchandise inventory in the store has fluctuated due to purchases and sales, at the end of the fiscal period, why is the balance of Merchandise Inventory on December 31 at the end of the year still the same as the beginning of the year January 1 balance?
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5. What is the amount of inventory on hand at the beginning of a fiscal period called?
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6. How is ending inventory determined?
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7. What must the balance of the Merchandise Inventory account at the end of the fiscal year be equal to?
   - The balance must equal the actual ending inventory balance.

8. When an account that requires adjusting does not have a related expense account, a different temporary account is used. Which two accounts are involved in the adjustment for Merchandise Inventory?
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9. Which account is debited and which account is credited when the actual ending Merchandise Inventory is higher than the beginning Merchandise Inventory balance? – What if the actual ending Merchandise Inventory is lower than the beginning Merchandise Inventory balance?
   - Debit: ___________________________________ Credit: ____
   - Debit: ___________________________________ Credit: ____

10. For a sale on account, revenue is earned on the day the goods are delivered to the customer. Which generally accepted accounting principal (GAAP) is this an application of?
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11. What is accrued revenue?
    - Accrued Revenue is revenue earned in one fiscal period but not received until a later fiscal period.

12. The amount of interest earned for a fiscal period must be recorded when financial statements are prepared. After the adjusting entry for accrued revenue is made, the income statement will report all revenue earned for a period, even though some of the revenue has not yet been received. The balance sheet will report all assets, including the interest receivable. To make these reports accurate, which two accounts (include debits and credits) are affected by the adjusting entry for interest receivable?
    - Debit: ___________________________________ Credit: ____

13. Accrued interest income on notes receivable is calculated using all of the following information: annual interest rate, principal, and date of the note. The time period involved for the number of days the note earned interest in the current fiscal period must be determined first. Then, what is the formula for calculating Accrued Interest Income?
    - Principal x Interest Rate x Time as Fraction of a Year = Accrued Interest Income.

15-3 ADJUSTING ACCUMULATED DEPRECIATION

14. What is the difference between current assets and plant assets?
    - Cash or assets expected to be exchanged for cash or consumed within a year are current assets. Plant assets are physical assets that will be used for a number of years in the operation of a business.

15. Depreciation is an application of the Matching Expenses with Revenue concept. What is the portion of a plant asset's cost that is transferred to an expense account in each fiscal period during that asset's useful life called?
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16. What are the three factors considered in calculating the annual amount of depreciation expense for a plant asset?
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17. Functional depreciation should be considered in estimating the useful life of computer equipment. How is physical depreciation different from functional depreciation?
    - Physical depreciation is caused by wear and deterioration from aging and weathering. Functional depreciation occurs when a plant asset becomes inadequate or obsolete.

18. Straight line depreciation involves recording an equal amount of depreciation expense for a plant asset in each year of its useful life. Remember that estimated salvage value has an impact on the estimated depreciation expense. What is the formula for calculating the annual depreciation expense?
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19. Accumulated depreciation is the total amount of depreciation expense that has been recorded since the purchase of a plant asset. How is accumulated depreciation determined?
    - The depreciation expense for the current year is added to the prior year's accumulated depreciation to update accumulated depreciation.

20. The book value of a plant asset is the original cost of a plan asset minus accumulated depreciation. How is the book value calculated?
    - The original cost minus the accumulated depreciation equals the book value.

21. Which account is debited and which account is credited to record the adjusting entry for the new depreciation expense for office equipment?
    - Debit: ____________________________________ Credit: ____

15-4 CALCULATING FEDERAL INCOME TAX

22. The adjustment for unpaid federal income tax includes which two accounts? (one liability and one expense)
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23. What is the formula for calculating income before federal income taxes?
    - After the adjusting entries are posted, an updated trial balance is prepared. All accounts except Federal Income Tax are entered on the trial balance. Then total the income statement credit column, and subtract the total of the income statement debit column. This equals the net income before federal income tax.

24. The Federal Government sets the amounts and rates of the tax brackets used to calculate federal income tax expense. Early in the year, corporations will estimate the amount of federal income tax that will be owed for the year, and each quarter <u>corporations pay quarterly installments</u> to help cover the estimated tax. At the end of the year, when the actual tax is known, the actual amount of federal income tax is calculated. What is a tax bracket? What is a marginal tax rate?
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25. The marginal tax rate increases as the net income before federal income tax increases. In the sample illustrated on page 458, the income subject to the marginal tax rate is $3,518.97. How was this number determined? Why is this amount multiplied by 39%?
    - The net income before federal income taxes was 103,518.97. The tax on the first 100,000 is 22,250. The amount over 100,000.00 that needs to be multiplied by the marginal tax rate is 3,518.97.
    - The marginal tax rate for that tax bracket is 39%. Multiplying 3,518.97 by 39% calculates the marginal income tax.

26. Once you have the Bracket Minimum Income tax and the Marginal Income tax calculated, what do you do with these two numbers?
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27. How is the actual adjustment for Federal Income Tax Expense calculated?
    - Subtract the Federal Income Tax Expense from the amount of income tax owed for the entire year. The difference between the two is the amount that must be adjusted as a debit to Federal Income Tax Expense and Credited to Federal Income Tax Payable.

28. Last question. ☺ When can the Adjusted Trial Balance be completed?
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