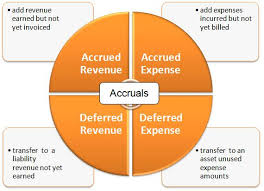
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|  | Chapter 21 | Accounting for Accruals, Deferrals, and Reversing Entries |

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To:My Awesome Advanced Accounting Students

From:Mrs. Cleary

Date:August 1, 2014

Re:Chapter 21 Learning Guide

**Lesson 21-1 – Determining the Quantity of Merchandise Inventory (Page 620)**

**Bridge:**

* Say you have a job working at StageRight. Will you be paid immediately for the wages you earned or will you be paid at a later date? Are employees paid for wages earned in the previous month?
* If you purchase a one-year subscription to a magazine on November 1, how much should of the subscription fee of $24.00 be recognized as revenue for November and December? The remaining $21.00 should be recorded as a deferred liability. Make sense?
* Adjusting entries must be recorded at the end of a fiscal period for both the balance sheet and the income statement to be accurate.
* In Chapter 15 you learned how to journalize the adjusting entry to accrued interest income. You’ll learn how to reverse the adjusting entry in this section.
* You will also learn how to calculate interest expense for a fraction of a year.
* The calculation of interest expense for a fraction of a year is the same as for accrued interest income.
* Reversing entries are the exact opposite of the adjusting entries that were recorded.
* Note: The number of days used in the calculations is 360. The 360-day year became popular because of its ease of computation; a 360-day year divides the year into twelve 30-day months.
* Carefully digest this: After the closing entry, Interest Expense has a zero balance because the interest for this period, which has not yet been paid, was recorded in the account—so it could be included in the total expenses—and then removed by the closing entry. When the note payable is paid in the next fiscal period, the cash will include the interest that was closed from this account at the end of the current fiscal period. **IMPORTANT:** When the full amount of interest is recorded in the next fiscal period, the part that was recorded in the current fiscal period will have been recorded twice. Reversing entries are recorded to avoid erroneously recording interest expense twice. *The effect of the reversing entry creates a credit balance in Interest Expense*, a balance opposite to the normal balance of an expense account. This abnormal balance will disappear when the interest expense is paid and recorded.
* Reversing entries simplify the accounting process by eliminating the need for accounting personnel to check each time a note is paid to ensure that the interest expense is not counted twice.

**Reading Guide** *(Please key your answers to the following questions.)*

1. What is an accrual?
2. What is a deferral?
3. Why should reversing entries be made?

|  |  |  |
| --- | --- | --- |
| **21-1 Sample Transactions** | **Account(s) Debited** | **Account(s) Credited** |
| Reversing entry for accrued interest income |  |  |
| Received cash for the maturity value of a 90-day note plus interest. |  |  |
| Adjusting entry for accrued interest expense |  |  |
| Reversing entry for accrued interest expense |  |  |
| Paid cash for the monthly payment on the long-term note payable, plus interest |  |  |

**Lesson 21-2 – Deferrals (Page 658)**

**Bridge:**

* Remember a liability is an amount owed. What if you receive cash for a service that you will be providing in the future. Is that a liability? Yes, you have the liability of providing a service.
* This lesson covers recording a revenue in advance of a good or service being provided.
* Yes, you will have to make a related adjusting entry too.
* Deferred expenses are sometimes called prepaid expenses.

**Reading Guide** *(Please key your answers to the following questions.)*

1. Please define unearned revenue and give an example.
2. Define deferred expenses and provide an example.
3. Why must adjusting entries for deferred revenue and deferred expenses be recorded at the end of a fiscal period?

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| **21-2 Sample Transactions** | **Account(s) Debited** | **Account(s) Credited** |
| Received cash for three months’ rent in advance. |  |  |
| Record the adjusting entry for deferred revenue earned. |  |  |
| Paid cash for three months’ rent in advance. |  |  |
| Record the adjusting entry for deferred expenses incurred. |  |  |