Chapter 3    The Adjusting Process

Continuing Problem

The unadjusted trial balance that you prepared for Music Depot at the end of Chapter 2 should appear as follows:

<table>
<thead>
<tr>
<th>Music Depot Unadjusted Trial Balance</th>
<th>July 31, 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debit</td>
<td>Credit</td>
</tr>
<tr>
<td>-------------------------------------</td>
<td>--------------</td>
</tr>
<tr>
<td>Cash</td>
<td>12,780</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>3,150</td>
</tr>
<tr>
<td>Supplies</td>
<td>850</td>
</tr>
<tr>
<td>Prepaid Insurance</td>
<td>2,700</td>
</tr>
<tr>
<td>Office Equipment</td>
<td>5,000</td>
</tr>
<tr>
<td>Accounts Payable</td>
<td>5,680</td>
</tr>
<tr>
<td>Unearned Revenue</td>
<td>7,200</td>
</tr>
<tr>
<td>Lee Chang, Capital</td>
<td>10,500</td>
</tr>
<tr>
<td>Lee Chang, Drawing</td>
<td>1,700</td>
</tr>
<tr>
<td>Fees Earned</td>
<td>15,300</td>
</tr>
<tr>
<td>Wages Expense</td>
<td>2,400</td>
</tr>
<tr>
<td>Office Rent Expense</td>
<td>2,750</td>
</tr>
<tr>
<td>Equipment Rent Expense</td>
<td>1,100</td>
</tr>
<tr>
<td>Utilities Expense</td>
<td>860</td>
</tr>
<tr>
<td>Music Expense</td>
<td>2,810</td>
</tr>
<tr>
<td>Advertising Expense</td>
<td>1,600</td>
</tr>
<tr>
<td>Supplies Expense</td>
<td>180</td>
</tr>
<tr>
<td>Miscellaneous Expense</td>
<td>800</td>
</tr>
</tbody>
</table>

The data needed to determine adjustments for the two-month period ending July 31, 2010, are as follows:

a. During July, Music Depot provided guest disc jockeys for WHBD for a total of 120 hours. For information on the amount of the accrued revenue to be billed to WHBD, see the contract described in the July 3, 2010, transaction at the end of Chapter 2.

b. Supplies on hand at July 31, $175.

c. The balance of the prepaid insurance account relates to the July 1, 2010, transaction at the end of Chapter 2.

d. Depreciation of the office equipment is $60.

e. The balance of the unearned revenue account relates to the contract between Music Depot and WHBD, described in the July 3, 2010, transaction at the end of Chapter 2.

f. Accrued wages as of July 31, 2010, were $120.

Instructions

1. Prepare adjusting journal entries. You will need the following additional accounts:

   - 18 Accumulated Depreciation—Office Equipment
   - 22 Wages Payable
   - 57 Insurance Expense
   - 58 Depreciation Expense

2. Post the adjusting entries, inserting balances in the accounts affected.

3. Prepare an adjusted trial balance.

Special Activities

Cliff Hall opened Meridian Co. on January 1, 2009. At the end of the first year, the business needed additional capital. On behalf of Meridian, Cliff applied to Federal National Bank for a loan of $300,000. Based on Meridian financial statements, which had been prepared on a cash basis, the Federal National Bank loan officer rejected the loan as too risky.

After receiving the rejection notice, Cliff instructed his accountant to prepare the financial statements on an accrual basis. These statements included $48,500 in accounts...
receivable and $15,650 in accounts payable. Cliff then instructed his accountant to record
an additional $20,000 of accounts receivable for commissions on property for which a
contract had been signed on December 28, 2009, but which would not be formally
“closed” and the title transferred until January 5, 2010.
Cliff then applied for a $300,000 loan from First City Bank, using the revised finan-
cial statements. On this application, Cliff indicated that he had not previously been re-
jected for credit.
Discuss the ethical and professional conduct of Cliff Hall in applying for the loan
from First City Bank.

On December 30, 2010, you buy a Ford Expedition. It comes with a three-year, 36,000-
mile warranty. On March 5, 2011, you return the Expedition to the dealership for some
basic repairs covered under the warranty. The cost of the repairs to the dealership is
$1,645. In what year, 2010 or 2011, should Ford Motor Company recognize the cost of
the warranty repairs as an expense?

The following is an excerpt from a conversation between Joel Loomis and Krista Truitt
just before they boarded a flight to Paris on Delta Air Lines. They are going to Paris to
attend their company’s annual sales conference.

Joel: Krista, aren’t you taking an introductory accounting course at college?
Krista: Yes, I decided it’s about time I learned something about accounting. You know, our annual bonuses
are based on the sales figures that come from the accounting department.
Joel: I guess I never really thought about it.
Krista: You should think about it! Last year, I placed a $750,000 order on December 28. But when I got
my bonus, the $750,000 sale wasn’t included. They said it hadn’t been shipped until January 3, so it
would have to count in next year’s bonus.
Joel: A real bummer!
Krista: Right! I was counting on that bonus including the $750,000 sale.
Joel: Did you complain?
Krista: Yes, but it didn’t do any good. Ashley, the head accountant, said something about matching
revenues and expenses. Also, something about not recording revenues until the sale is final. I figure I’d
take the accounting course and find out whether she’s just jerking me around.
Joel: I never really thought about it. When do you think Delta Air Lines will record its revenues from this flight?
Krista: Hmm . . . I guess it could record the revenue when it sells the ticket . . . or . . . when the
boarding passes are taken at the door . . . or . . . when we get off the plane . . . or when our com-
pany pays for the tickets . . . or . . . I don’t know. I’ll ask my accounting instructor.
Discuss when Delta Air Lines should recognize the revenue from ticket sales to prop-
erly match revenues and expenses.

Several years ago, your brother opened Niagara Appliance Repairs. He made a small ini-
tial investment and added money from his personal bank account as needed. He with-
drew money for living expenses at irregular intervals. As the business grew, he hired an
assistant. He is now considering adding more employees, purchasing additional service
trucks, and purchasing the building he now rents. To secure funds for the expansion, your
brother submitted a loan application to the bank and included the most recent financial
statements (shown below) prepared from accounts maintained by a part-time bookkeeper.

**Niagara Appliance Repairs**

**Income Statement**

**For the Year Ended October 31, 2010**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Service revenue</td>
<td>$112,500</td>
</tr>
<tr>
<td>Less: Rent paid</td>
<td>$31,200</td>
</tr>
<tr>
<td>Wages paid</td>
<td>24,750</td>
</tr>
<tr>
<td>Supplies paid</td>
<td>7,000</td>
</tr>
<tr>
<td>Utilities paid</td>
<td>6,500</td>
</tr>
<tr>
<td>Insurance paid</td>
<td>3,600</td>
</tr>
<tr>
<td>Miscellaneous payments</td>
<td>9,100</td>
</tr>
<tr>
<td>Net income</td>
<td><strong>$ 30,350</strong></td>
</tr>
</tbody>
</table>

(continued)
Chapter 3    The Adjusting Process

Niagara Appliance Repairs
Balance Sheet
October 31, 2010

Assets
Cash ............................................. $15,900
Amounts due from customers ..................... 18,750
Truck ............................................. 55,350
Total assets ................................... $90,000

Equities
Owner’s capital ................................ $90,000

After reviewing the financial statements, the loan officer at the bank asked your brother if he used the accrual basis of accounting for revenues and expenses. Your brother responded that he did and that is why he included an account for “Amounts Due from Customers.” The loan officer then asked whether or not the accounts were adjusted prior to the preparation of the statements. Your brother answered that they had not been adjusted.

a. Why do you think the loan officer suspected that the accounts had not been adjusted prior to the preparation of the statements?

b. Indicate possible accounts that might need to be adjusted before an accurate set of financial statements could be prepared.

Obtain a copy of your college or university’s student code of conduct. In groups of three or four, answer the following question:

1. Compare this code of conduct with the accountant’s Codes of Professional Conduct, which is linked to the text Web site at academic.cengage.com/accounting/warren.

2. One of your classmates asks you for permission to copy your homework, which your instructor will be collecting and grading for part of your overall term grade. Although your instructor has not stated whether one student may or may not copy another student’s homework, is it ethical for you to allow your classmate to copy your homework? Is it ethical for your classmate to copy your homework?