Effective Bookkeeping and Payroll

Chapter 14 - Year End - Preparing to Close the Books

WORKBOOK

Slide 1

Year End – Inventory

Year end closing activities are quite busy for bookkeepers and accountants. Before the year end financial statements can be prepared, the following processes need to be performed:

- The accurate value of inventory on hand must be determined. (NEW)
- The required year-end adjustments must be identified.
- A worksheet will aid in preparing the financial statements and recording the year-end closing entries.

Slide 2

Year End – Inventory

There are two methods for determining the value of inventory at the end of the year.

- **Periodic Inventory** – This requires an actual physical count of all goods on hand in order to calculate inventory balances and cost of goods sold. This can be done monthly but must be done at the end of the year.
- **Perpetual Inventory** – this is when each purchase an sale of goods is monitored to track inventory at all times. This requires a computerized point of sale system. Often a full physical inventory is done to verify the end of year perpetual inventory.

Bookkeepers will participate in the count!

Slide 3

Year End – Adjusting Entries

Recall that at the end of the year, adjusting entries will be required to recognize revenues and expenses that have not yet been recorded. Often these entries are done monthly, however, year end must be extremely accurate.

- ✓ Prepaid Expenses
- ✓ Unearned Revenue
- ✓ Accrued Expenses
- ✓ Accrued Revenues
- ✓ Depreciation
- ✓ Bad Debts
- ✓ Inventory

Slide 4

Year End – Adjusting Entries Types

Accrued Expenses are expenses that have been incurred for the current year but have not yet been paid for and are then accrued.

Accrued Revenues are revenues that have been earned but not yet invoiced or entered on the books.

Depreciation this is the usage of physical assets over time.

- Straight Line Depreciation – An equal amount is posted to Depreciation expense and accumulated depreciation each month/year until the full value is zero.
- Accelerated Depreciation – There are methods of depreciation often used for tax purposes that expense more of the asset early in it’s useful life.

Bad Debts is the amount of current receivables that are estimated as uncollectible in the future and expensed.

Slide 5

Year End – Adjusting Entries Types

Prepaid Expenses are expenses that are paid in full earlier in the year and expensed as used. These are normally adjusted on a monthly basis; however, in a small business, it may not be adjusted until the end of the year.

Unearned Revenue are amounts received from customers in advance of services being completed or goods delivered. They must be adjusted based on what has been earned.

Inventory book to physical adjustments are made at the end of the year to adjust quantities found or not found during the physical count.

Inventory Obsolescence accrual must be made.

Slide 6

Inventory Obsolescence

Often, some of the inventory purchased or produced is written off or thrown out due to many different factors such as:

- Expiration date
- Breakage
- Old model
- Technology change
- No anticipated customer

Each year, we must estimate how much will be written off based on a detailed review of the inventory and historical write offs.

Slide 7

Inventory Obsolescence

We perform what is called and inventory obsolescence review. We try to identify specific inventory that we believe should be disposed of and estimate (only when needed) any additional that could be at risk.

Changing technology is one such reason that a reserve may be needed.

____

Slide 8

Inventory Reserves – Entries

At year end we estimate the inventory reserve. In January we will dispose of all inventory we identify as obsolete but keep that which is at risk but not certain.

ABC Tech Retail General Journal				Page GJ1
Date 2015	Description	Post Ref.	Debit	Credit
Dec 31	Inventory Obsolescence Expense		10,000.00	
	Obsolescence Reserve (contra-asset acc.)			10,000.00
	To record the reserve			
Jan 15	Obsolescence Reserve		8,000.00	
	Inventory			8,000.00
	To dispose of obsolete inventory			

Slide 9

Inventory Write Offs – Entries

Some companies regularly write off inventory that is at risk of not being sold. As such they do the following entry:

ABC Tech Retail General Journal					Page GJ1
Date 2015	Description	Post Ref.	Debit	Credit
Dec 31	Inventory Write Off		10,000.00	
	Inventory			10,000.00
	To dispose of obsolete inventory			

____

____

____

____

____

____

____

____

____

____

Slide 10

Year End – The Worksheet

Recall that a worksheet is prepared to assist with the closing process. The is a multi-column page (now normally on a spreadsheet) designed to arrange systematically all accounting data that will be required to prepare financial statements.

The worksheet headings appear as shown here.

	Unadjusted Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Balance Sheet	
Account Title	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit

When completed, the worksheet will have totals that are used to prepare the financial statement and the adjustments are transferred to the G/L and posted to the accounts.

Slide 11

The Spreadsheet

Next , the debit and credit columns of the Adjusted Trial Balance are totaled to check for equality.

	Unadjusted Trial Balance		Adjustments		Adjusted Trial Balance	
Account Title	**Debit**	**Credit**	**Debit**	**Credit**	**Debit**	**Credit**
Cash	48,500.00				48,500.00	
Accounts Receivable			8,000.00		8,000.00	
Office Supplies	700.00			425.00	275.00	
Prepaid Insurance						
Buildings	20,000.00				20,000.00	
Accumulated Depr. - Buildings				1,000.00		1,000.00
Office Equipment						
Accounts Payable		500.00				500.00
Wages Payable				3,250.00		3,250.00
Unearned Rent		30,000.00	10,000.00			20,000.00
Capital Stock						
Dividends						
Retained Earnings						30,000.00
Fees Earned		10,000.00		8,000.00		18,000.00
Rent Revenue				10,000.00		10,000.00
Wages Expense			3,250.00		3,250.00	
Rent Expense	1,000.00				1,000.00	
Depreciation Expense			1,000.00		1,000.00	
Utilities Expense	300.00				300.00	
Office Supplies Expense			425.00		425.00	
Insurance Expense						
	70,500.00	70,500.00	22,675.00	22,675.00	82,750.00	82,750.00

Slide 12

The Spreadsheet

Add the Net Income or Net Loss to the Income Statement and Balance Sheet to verify equality.

	Adjusted Trial Balance		Income Statement		Balance Sheet	
Account Title	**Debit**	**Credit**	**Debit**	**Credit**	**Debit**	**Credit**
Cash	48,500.00				48,500.00	
Accounts Receivable	8,000.00				8,000.00	
Office Supplies	275.00				275.00	
Prepaid Insurance						
Buildings	20,000.00				20,000.00	
Accumulated Depr. - Buildings		1,000.00				1,000.00
Office Equipment						
Accounts Payable		500.00				500.00
Wages Payable		3,250.00				3,250.00
Unearned Rent		20,000.00				20,000.00
Capital Stock						
Dividends						
Retained Earnings		30,000.00				30,000.00
Fees Earned		18,000.00		18,000.00		
Rent Revenue		10,000.00		10,000.00		
Wages Expense	3,250.00		3,250.00			
Rent Expense	1,000.00		1,000.00			
Depreciation Expense	1,000.00		1,000.00			
Utilities Expense	300.00		300.00			
Office Supplies Expense	425.00		425.00			
Insurance Expense						
	82,750.00	82,750.00	5,975.00	28,000.00	76,775.00	54,750.00
Net Income (Loss)			22,025.00			22,025.00
			28,000.00	28,000.00	76,775.00	76,775.00

Questions

and

Answers

Review Questions:

1. The following adjustments are prepared and posted at year end:
    A. Prepaid expenses
    B. Book to physical inventory adjustments
    C. Accrued supplies inventory
    D. Only A and B

2. True or False: Perpetual inventory system requires an actual physical count of all goods on hand in order to calculate inventory balances and cost of goods sold.

3. True or False: The revenue recognition principle requires that we reserve for inventory when we believe it is at high risk of being obsolete.

4. True or False: When we reserve for probable inventory obsolescence, we credit a contra asset account rather than inventory account.

5. Inventory becomes obsolete and needs to be written off when:
    A. It has been in the warehouse for 6 months or more
    B. There is a change in technology
    C. It has expired
    D. Only B and C

Answer Key:

1. D
   Prepaid expenses and book to physical inventory adjustments are prepared and posted at year end.

2. B
   False. This is a periodic inventory system.

3. B
   False. The conservatism principle requires this practice.

4. A
   True. We credit the Obsolescence Reserve.

5. D
   Inventory that has been in the warehouse for 6 months or more does not need to be written off as obsolete.