

## CONCEPT: INTRODUCTION TO ADJUSTING JOURNAL ENTRIES – PREPAID EXPENSES

- Some accounts need to be updated for the \_\_\_\_\_
  - ☐ **Deferrals** – an adjustment for the payment of an item or receipt of cash \_\_\_\_\_
    - Prepaid Expenses, Supplies, and Unearned Revenue
  - ☐ **Accruals** – Recording revenue or expense \_\_\_\_\_ collecting cash
    - Accrued Expenses, “Accrued” Revenue
  - ☐ **Depreciation** – allocation of the cost of a long-term asset over its \_\_\_\_\_
    - Depreciation Expense and Accumulated Depreciation

### Prepaid Expenses Adjusting Entry

- **Prepaid Expenses** – payment of an expense, typically rent or insurance, \_\_\_\_\_

**POP QUIZ:** Prepaid expenses are:

- a) Expenses
- b) Liabilities
- c) Assets
- d) Revenues

- ☐ There are two important dates for recording prepaid expenses:

Expense payment date: Pay for the expense (in advance) and create the Prepaid Expense account

On September 1, the company pays \$12,000 for a full year of rent in advance.

Adjusting date – Adjust the prepaid expense account based on the time passed (amount “used up”)

On December 31, the company adjusts its records for the passage of time.

Prepaid Rent:

Rent Expense:

Prepaid Rent:

Rent Expense:

- When dealing with prepaid expenses, it is best to consider what the \_\_\_\_\_ balance in each account **should** be
  1. Monthly expense: Take the total payment and \_\_\_\_\_ by the number of months covered by the payment
  2. Final Expense Balance: Multiply the monthly expense by the number of months that have actually \_\_\_\_\_
  3. Final Prepaid Expense Balance: Total payment \_\_\_\_\_ the Final Expense Balance

**EXAMPLE:** On September 1, a company paid \$24,000 for the next twelve months of rent. At this time, the company included the entire amount in the Prepaid Rent account. The adjusting entry necessary when preparing the December 31 year-end financial statements would include:

- a) Debit Prepaid Rent \$8,000; Credit Rent Expense \$8,000
- b) Debit Rent Expense \$8,000; Credit Prepaid Rent \$8,000
- c) Debit Prepaid Rent \$16,000; Credit Rent Expense \$16,000
- d) Debit Rent Expense \$16,000; Credit Prepaid Rent \$16,000

**PRACTICE:** On January 1, a company purchased a two-year insurance policy at \$2,400 per year in cash. At this time, the company included the entire value of the policy in Prepaid Insurance. The coverage began immediately. The adjusting entry necessary when preparing the June 30 financial statements would include:

- a) Debit Prepaid Insurance \$1,200; Credit Insurance Expense \$1,200
- b) Debit Insurance Expense \$1,200; Credit Prepaid Insurance \$1,200
- c) Debit Prepaid Insurance \$2,400; Credit Insurance Expense \$2,400
- d) Debit Insurance Expense \$2,400; Credit Prepaid Insurance \$2,400

**PRACTICE:** On January 1, a company signed a two-year rental agreement policy at \$4,800 per year in cash. At this time, the company included the payment of the lease in Rent Expense. The lease began immediately. The adjusting entry necessary when preparing the June 30 financial statements would include:

- a) Debit Prepaid Rent \$2,400; Credit Rent Expense \$2,400
- b) Debit Rent Expense \$2,400; Credit Prepaid Rent \$2,400
- c) Debit Prepaid Rent \$7,200; Credit Rent Expense \$7,200
- d) Debit Rent Expense \$7,200; Credit Prepaid Rent \$7,200

**PRACTICE:** The prepaid insurance balance on December 31, 2017 was correctly shown as \$900. On April 1, 2018 an additional premium of \$600 was paid by the company. The balance sheet at December 31, 2018 showed the appropriate amount of prepaid insurance as \$500. The correct amount of **insurance expense** for 2018 would be:

- a) \$600
- b) \$1,000
- c) \$1,400
- d) \$1,500