



Accounting

Today's Learning Goals

- record adjusting and closing entries for a service business (e.g., prepaid expenses, amortization, accruals);

The background of the slide features a repeating pattern of gold coins, likely quarters, scattered across a light-colored surface. The coins are rendered with a slight 3D effect, showing their edges and some of their faces.

Calculating **Depreciation** (a.k.a. 'amortization')

What is Depreciation?

- Let's say we purchased a VCR in 1992 for \$605



- How much would you pay for that VCR now??

- Probably not a whole lot!!
- Maybe you'd be willing to pay \$5



Residual Value

- The amount that an item is worth at the end of its life is called its 'residual value' or 'salvage value'
- Remember these terms!



The VCR

- So, we've decided that the VCR's residual value is \$5.
- In essence, we've **used up** \$600 worth of the VCR since 1992.

*($\$605 - 5$)

Depreciation

- Depreciation refers to how much of an asset is used up.
- In the case of our VCR, it has **depreciated** by \$600!

Yearly Depreciation

- How much has it depreciated each year?

VCR: \$600 over 20 years.

$$= \$600 / 20 = \mathbf{\$30 \text{ per year.}}$$

Depreciation of Assets



- All fixed assets are subject to depreciation

All assets except LAND

- The one exception to this rule is that Land is **not** depreciated.
- However these assets **are**:
 - Vehicles
 - Equipment
 - Buildings
 - Patents

So how do accountants calculate Depreciation?

- Let's take the VCR example again.
- We've used up \$600 worth of the asset over 20 years.
- (So how much did we use up EACH year?)

‘Straight Line’ Depreciation

The formula is:

original cost – residual value

years of life of the asset

‘Straight Line’ Depreciation

**Yearly depreciation (amortization) of
the VCR:**

$$\begin{array}{r} \$605 - \$5 \\ \hline = \$30 \\ 20 \end{array}$$

The 'Half-Year' Rule:

- Since we don't always buy items on January 1, we won't always have a full year of depreciation.
- So, in practice, we will depreciate for half a year (6/12) **in the year of purchase.**

Half Year Rule

- So, our VCR would be depreciated at \$30 per year, except in the year we purchased it.
- In that year, we would depreciate $(6/12)*\$30 = \15 .

Depreciation 'Schedule'

Example: A truck is purchased on January 1, 2011 for \$28,000. It is expected to last for 10 years and have a residual value of \$8,000.

	2011	2012	2013	2014	2015
Depreciation	\$1,000	\$2,000	\$2,000	\$2,000	\$2,000

Formula: $(\text{Original Price} - \text{Residual Value}) / \text{Useful Life}$
 $(\$28,000 - \$8,000) / 10 = \$2,000$

Review

- We record our entire expenditure for:
 - Supplies
 - Rent (as Prepaid Rent)
 - Insurance (as Prepaid Insurance)
 - Assets (like Truck or VCR)

ex. July 1 Prepaid Rent 12,000
Bank 12,000

Rent paid for one year.

Adjustments - 1

- However, each **December 31st**, we need to make adjustments to those accounts for the amount we have used up.

Dec 31	Supplies Expense	1000	
	Supplies		1000
<i>Adjusting Entry</i>			

Adjustments -2

The same is true for Rent and Insurance that we have used up.

Dec 31 Rent Expense 6,000

 Prepaid Rent 6,000

*Adjusting Entry: 6/12 * \$12,000*

Adjustments - 3

- We also make an adjustment for depreciation. We use the following entry.

Dec 31 Depreciation Expense	15	
Accumulated Depreciation-VCR		15

*Adjusting Entry: \$600/20 * (6/12)*

Adjustments - 3

- We also make an adjustment for depreciation. We use the following entry.

Dec 31 Depreciation Expense	15		
		Accumulated Depreciation-VCR	15

*Adjusting Entry: $\$600/20 * (6/12)$*

What's this?????

- So remember.... to the adjusting entry for depreciation is:

Dec 31	Depreciation Expense	\$50	
	Accumulated Depreciation- Asset		\$50
	<i>Adjusting Entry: Depreciation of Asset</i>		

ALWAYS!!!!!!!

Year end Adjustments:

Remember!

- **December 31:**
 - **Supplies**
 - **Prepaid Expenses**
 - **Depreciation**

HOMWORK (1 OF 2)

Page 309: Exercise 5

(see example below)

Policy	a.
Purchase	Oct-01
Year End	Dec-31
Term	1 year
Premium	\$360

Monthly Premium 30
Months used 3
Adjustment 90

Dec-31 Insurance Expense 90
 Prepaid Insurance 90
 Adjusting Entry: 3/12 * \$360

HOMework (2 of 2)

Page 348 Exercise 1 (A,B,C)

Also show the necessary **Adjusting Entry** for each year end.

Page 348 Exercise 2 (A)

Page 350 Exercise 4 (A)