ADJUSTING ENTRIES

Adjusting entries are a fundamental part of accounting that help ensure a company's financial statements accurately reflect its financial position and performance. Let's break it down in simple terms.

Consider your personal finances at home. You may have a savings bank account with a balance of Rs. 120,000 on January 1, 2023. You use this account to cover your various monthly expenses, such as rent, groceries, and utilities. At the end of the month, when you review your bank statement, you find that the balance in your account has decreased to Rs. 50,000 by January 31, 2023.

You might initially think your total expenses for the month were Rs. 70,000 (subtracting Rs. 50,000 from the initial balance of Rs. 120,000). However, it's essential to consider that there are potential factors at play. Sometimes, you may have outstanding bills, like telephone, electricity, cable, internet, or cleaning services, which you haven't received yet, and these need to be accounted for. Additionally, you might have earned income, such as teaching a course at a school, college, or university, or fees from freelancing, but you haven't received the payment yet.

In such cases, you must make adjustments to your financial records to provide a more accurate and complete picture of your financial situation.

In a business, adjusting-entries are like those corrections. They are made at the end of the financial year to make sure that the company's financial statements accurately show what's really going on. Here are a few common types of adjusting-entries:

1. **Prepaid-Expenses:** Imagine you pay a year's rent in advance. At the end of each month, you should reduce the prepaid-rent and recognize a portion as an expense for that month. Adjusting-entries do this to match your costs with the time you benefit from them.
2. **Accrued-Expenses:** Let's say you have a cleaning service that comes once a month, but they clean just before the month ends. When the month closes, you owe them for their services even though you haven't paid yet. This is an accrued expense, and you need to record it.
3. **Unearned Revenue:** If you receive money from a customer for a service or product you haven't delivered yet, you shouldn't count it as income until you actually provide the service or product. Adjusting-entries make sure this is done.
4. **Accrued-Revenue:** Conversely, sometimes you've delivered a service or product, but the customer hasn't paid you yet. This is accrued revenue, and adjusting-entries account for it.

5. **Depreciation:** When a company owns assets like machinery or buildings, these assets lose value over time. Depreciation adjusting-entries spread out the cost of these assets over their useful lives.
6. **Bad Debt Expense:** Bad Debt Expense occurs when a company expects that some of its customers may not pay the money they owe. For example, if a business sells products on credit, there's a chance that some customers won't be able to pay their bills. In such cases, the company needs to estimate how much of the accounts receivable (the money owed to them by customers) is likely to go unpaid.

To account for this, companies use an adjusting entry to recognize the estimated bad debt expense. This ensures that the company's financial statements accurately reflect the portion of accounts receivable that is unlikely to be collected. By doing so, the company is being more realistic about its expected income and assets.

So, adjusting entries are like the final touch-ups to your financial records to make sure they accurately represent your financial situation at the end of the year. They ensure that your income and expenses are matched to the right periods and that your financial statements are reliable for making important business decisions and complying with accounting rules.