

Adjusting Entries

§ Adjusting entries are required each time financial statements are prepared.

§ 3 types of adjusting entries:

1. Prepayments (prepaid expenses, unearned revenue)
2. Accruals (accrued revenue, accrued expenses)
3. Estimates (amortization)



Types of Adjusting Entries

1A. Prepaid Expenses — Expenses pre-paid in cash and recorded as assets before they are used.

1B. Unearned Revenues — Revenues pre-received in cash and recorded as liabilities before they are earned.

2A. Accrued Revenues — Revenues earned but not yet received in cash.

2B. Accrued Expenses — Expenses incurred but not yet paid in cash.

3. Amortization — Allocation of the cost of long-term assets to expense over their useful lives.



Prepayments – Prepaid Expenses

- Prepaid expense adjusting entries are required to record the portion of the prepayment that represents the **expense incurred during the period**.
- Prepaid expenses expire with the passage of time or through their use.
- Examples of prepaid expenses include supplies, rent, insurance, and property tax.

DR Prepaid Asset
CR Cash **ORIGINAL ENTRY**

DR Expense
CR Prepaid Asset **ADJUSTING ENTRY**

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Prepayments – Unearned Revenue

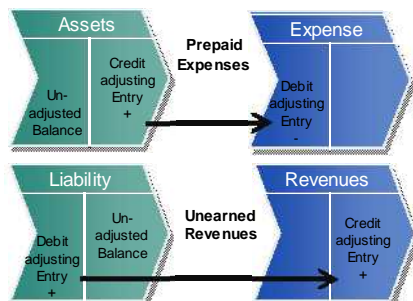
- Unearned revenues** are revenues received and recorded as liabilities before they are earned.
- Unearned revenues are subsequently earned by performing a service or providing a good to a customer.
- Examples of unearned revenues include rent, magazine subscriptions, airplane tickets, and tuition.

DR Cash
CR Unearned Revenue **ORIGINAL ENTRY**

DR Unearned Revenue
CR Revenue **ADJUSTING ENTRY**

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Adjusting Entries Prepayments



Accrued Revenues

§ Accrued revenues may accumulate with the passing of time or through services performed **but not billed or collected**.

§ Prior to adjustment, assets and revenues are understated.

§ Examples of accrued revenues: A/R, rent receivable, and interest receivable.



DR A/R or R/R or I/R
CR Revenue or R/Rev or I/Rev **ADJUSTING ENTRY**

Accrued Expenses

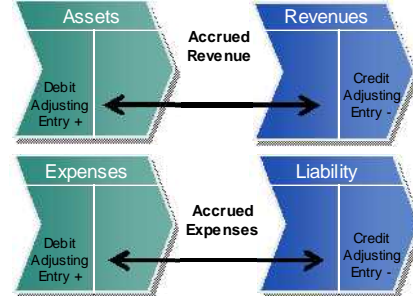
- § Accrued expenses are expenses **incurred but not yet paid**.
- § Prior to adjustment, liabilities and expenses are understated.
- § Examples of accrued expenses: A/P, rent payable, salaries payable, and interest payable.



DR Expense
CR A/P or S/Payable or I/Payable

ADJUSTING ENTRY

Adjusting Entries Accruals



Amortization

- § Amortization is the process of allocating the cost of long-term assets to expense over their useful life in a **rational and systematic manner**.
- § Amortization attempts to match the **cost** of a long-term asset to the **revenue** it generates in each period.
- § Amortization is an **estimate** rather than a factual amount of the cost of long-term asset for that period.



Amortization

DR Amortization Expense – Name of Asset
CR Accumulated Amortization – Name of Asset

ADJUSTING ENTRY

- § Accumulated Amortization is a **contra asset** account.
- § It has a CR balance.
- § It is subtracted from the asset account on B/S.

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Amortization

Balance Sheet Presentation

Office equipment	\$5,000	
Less: Accumulated amortization	<u>83</u>	Estimate
Net book value	<u>\$4,917</u>	

NBV = Cost of an Asset – AA

Summary of Adjusting Entries

Type of Adjustment	Account Relationship	Accounts Before Adjustment	ADJUSTING ENTRY
1A. Prepaid Expenses	Assets & Expenses	Assets Overstated Expenses Understated	DR Expense CR Asset
1B. Unearned Revenues	Liabilities & Revenues	Liabilities Overstated Revenues Understated	DR Liability CR Revenue
2A. Accrued Revenues	Assets & Revenues	Assets Understated Revenues Understated	DR Asset CR Revenue
2B. Accrued Expenses	Liabilities & Expenses	Liabilities Understated Expenses Understated	DR Expense CR Liability
3. Amortization	Expense & Contra Asset	Expenses Understated Assets Overstated	DR Amort. Exp. CR Acc. Amort.

Adjusted Trial Balance

- § An Adjusted T/B is prepared after all adjusting entries have been journalized and posted.
- § It shows the balances of all accounts at the end of the accounting period.
- § It proves the equality of the total DR and CR balances in the ledger after all adjustments have been made.
- § F/S can be prepared directly from the adjusted trial balance.



Preparing Financial Statements

- § Financial statements can be prepared directly from an adjusted trial balance:
 - § The I/S is prepared from the revenue and expense accounts.
 - § The statement of O/E or R/E is derived from the owner's capital and drawings accounts and the NI shown in the I/S.
 - § The B/S is prepared from the asset and liability accounts & the ending owner's capital balance as reported in the statement of O/E or R/E.



Accounting Cycle Steps