FABM2 LESSON 1

ADJUSTING ENTRIES

BY: DANI ROSE C. SALAZAR

CASH VS. ACCRUAL BASIS

CASH BASIS

- Revenue is recognized when **cash is received**.
- Expenses are recognized when **cash is paid.**
- Focuses only on cash flow

ACCRUAL BASIS

- Revenue is recognized **when earned,** regardless of cash receipt.
- Expenses are recognized **when incurred**, regardless of cash payment.

Follows:

- **Revenue Recognition Principle** – record revenue when earned.
- **Matching Principle** – match expenses with related revenues.

JOURNAL ENTRIES

- Recorded in the **General Journal.**
- Prepared at the **end of the accounting period.**
- Known as **end-of-period adjustments**.
- Used to update accounts before preparing financial statements.

PERIODICITY CONCEPTS

- Business operations are divided into **time periods** for reporting.
- Accounting periods may be **monthly, quarterly, or annually.**
- **Calendar Year**: January 1 to December 31.
- **Fiscal Year**: Any 12-month period not necessarily ending December 31.
- Financial statements must be prepared at **regular intervals.**

ADJUSTING ENTRIES

Adjusting entries ensure that revenues and expenses are recorded in the **proper accounting period** under the accrual basis.

Two Major Types:

1. **Accruals**

   Cash is received or paid **after** revenue is earned or expense is incurred.

2. **Deferrals**

   Cash is received or paid **before** revenue is earned or expense is incurred.

SEVEN CATEGORIES OF ADJUSTING ENTRIES

i. ACCRUALS

Accrued Expenses

- Expenses already incurred but **not yet paid.**
- Results in a **liability.**

Accrued Revenues

- Revenues already earned but **not yet collected.**
- Results in a **receivable (asset).**

SEVEN CATEGORIES OF ADJUSTING ENTRIES

ii. DEFERRALS

Prepaid Expenses

- Expenses paid in advance.
- Initially recorded as **asset or expense.**
- Adjusted as expense when used or expired.

Asset Method (Real Approach)

- Payment recorded as an asset.

Expense Method (Nominal Approach)

- Payment recorded as an expense.

Unearned Revenues

- Cash collected before service is performed or goods are delivered.
- Initially recorded as **liability or income.**
- Adjusted when revenue is earned.

Income Method (Nominal Approach)

- Cash receipt recorded as income.

Income Method (Nominal Approach)

- Cash receipt recorded as income.

SEVEN CATEGORIES OF ADJUSTING ENTRIES

iii. OTHER ADJUSTING ENTRIES

Depreciation

- Systematic allocation of the cost of long-term assets over their useful life.

Bad Debts / Uncollectible / Doubtful Accounts

- Recognition of receivables that may not be collected.

Merchandise Inventory

- Adjustment to reflect actual inventory on hand.
- Used to determine cost of goods sold accurately.

FABM2

LESSON 2

THANK YOU.

BY. DANI ROSE C. SALAZAR