

Adjusting Entries (strategies)

Accounting Principles and Assumptions' definition that are related:

- ◆ Time period assumption: the economic life of a business can be divided into artificial time periods. Example: a month, a quarter, a year.
- ◆ Revenue recognition principle: revenue is recognized in the accounting period in which it is earned.
- ◆ Matching principle: expenses are matched with revenues in the period when efforts are expended to generate revenues.

❖ **What is adjusting?**

Adjusting is the recording process to recognize unnoticed revenues or expenses which have been earned during accounting period.

❖ **When do we need to adjust?**

Adjustment is made at the end of the accounting period.

❖ **Why do we need to adjust?**

To ensure the revenue recognition principle and matching principle are followed.

❖ **How do we adjust?**

Before we do the adjustment, we have to know first what accounts are usually adjusted and check if the adjustments are necessary. Here is the strategy to begin your adjusting:

1. Check the company's *asset* accounts.

- ✓ Does the company have any prepaid expense accounts (e.g. prepaid insurance, prepaid rent)? If it does, check the term of your rent, insurance, or any prepayments you have. Note the time period of the company's rent or insurance, when the company paid the prepayments, and the amount the company paid. For example, the company paid a 2 year-rent for \$3,000 on April 1. The time period for the rent is 2 years, the company paid the rent on April 1st, and the amount the company paid is \$3,000. The journal entry looks like:

Date	Accounts	Debit	Credit
12/31/09	Insurance expense	xxx	
	Prepaid Insurance		xxx

- ✓ If the company has a supplies account, check how many supplies on hand the company retains. Record the amount of supplies used. The journal entry looks like:

Date	Accounts	Debit	Credit
12/31/09	Supplies expense	xxx	
	Supplies		Xxx

- ✓ Does the company have a fixed asset (e.g. machine, property, equipment)? Estimate the fixed asset's depreciation for that period, and record it. The journal entry looks like:

Date	Accounts	Debit	Credit
12/31/09	Depreciation expense	xxx	
	Accumulated Depreciation		xxx

2. Check the company's *liabilities* accounts.

- ✓ Does the company have an unearned revenue* account? If it does, check how much has been redeemed by the customers, or how much revenue is recognizable for that year. The journal entry looks like:

Date	Accounts	Debit	Credit
12/31/09	Unearned Revenue	xxx	
	Revenue		xxx

- ✓ Does the company have an interest bearing notes payable or bonds payable? If it does, the company has to adjust accrued[†] interest for those accounts. The journal entry looks like:

Date	Accounts	Debit	Credit
12/31/09	Interest Expense	xxx	
	Interest Payable		xxx

*Note: Unearned revenue is the advance payment made by customers for services or merchandises in the future. In other words, the company has received the money from customers, but it has not performed any services or given out the merchandise yet.

[†] Note: Accrued means you recognize it before it has been paid.

3. Check if the company has any unbilled revenue to the customer. Sometimes the company has performed a service to the customer, but the company hasn't billed the customer yet. Record any unbilled revenue to the adjustment. The journal entry looks like:

Date	Accounts	Debit	Credit
12/31/09	Accounts Receivable	xxx	
	Revenue		xxx

4. Check if the company has any accrued expenses. For example, accrued salary, accrued tax, etc. For accrued salary, we have to know how many employees the company owes, what their wage rate is, and how much the company owes. The journal entry looks like:

Date	Accounts	Debit	Credit
12/31/09	Salary expense	xxx	
	Salary Payable		xxx