

Adjusting Entries

by Sophia



WHAT'S COVERED

This tutorial will cover the topic of adjusting entries.

Our discussion breaks down as follows:

1. Adjusting Entries

An **adjusting entry** is an entry that is made at the end of an accounting period to report any unrecognized income or expenses for that period.

The purpose of an adjusting entry is to correct values, which speaks to the concept of matching principles-- revenue recognition and expense recognition. We need to match those revenues and expenses with the correct period. An adjusting entry is also used to correct errors and omissions. If any errors or mistakes were made during the journalizing and posting process, they can be corrected through an adjusting entry.

As mentioned in the definition, adjusting entries are entered at the end of the period, *not* the beginning. They are not recorded as part of the daily activity.

Now, where are these adjusting entries entered? They are entered in the general journal, which then gets posted to the general ledger. Adjusting entries are also put in the trial balance worksheet, which we work through at the end of the period.



TERM TO KNOW

Adjusting Entry

An entry that is made at the end of an accounting period to report any unrecognized income or expenses for that period.

2. Types of Adjusting Entries

There are several different types of adjusting entries.

Unearned Revenues

| | |
|-------------------------------------|---|
| Why is this adjustment made? | <i>Initial Transaction:</i> Services were paid for, but had not been performed <i>During the period:</i> Services were performed |
| What adjustment is needed | <i>End of period:</i> Recognize revenue earned during the period (revenue recognition principle) |

With unearned revenue adjusting entries, in the initial transaction, services were paid for, but had not been performed, meaning cash was received, but no revenue was recorded. Then, during the period, services were performed.

At the end of the period, we have to recognize the revenue earned during the period, which speaks to revenue recognition principle.

| Prepaid Expenses | |
|-------------------------------------|--|
| Why is this adjustment made? | <i>Initial Transaction:</i> Expense was paid for but had not been incurred <i>During the period:</i> Expense incurred |
| What adjustment is needed | <i>End of period:</i> Record expense incurred during the period (expense recognition principle) |

With prepaid expense adjusting entries, initially, the expense was paid for, but had not been incurred, meaning cash was paid, but no expense was incurred or recorded. Then, during the period, the expense was incurred.

At the end of the period, we have to record the expense incurred during the period, speaking to the expense recognition principle--we have to recognize that expense.

| Accrued Expenses | |
|-------------------------------------|---|
| Why is this adjustment made? | <i>Initial Transaction:</i> No transaction recorded <i>During the period:</i> Expense incurred but not paid/recorded |
| What adjustment is needed | <i>End of period:</i> Record expense incurred during the period (expense recognition principle) |

With accrued expense adjusting entries, initially no transaction was recorded. Then, during the period, an expense was incurred, but not paid or recorded.

The expense incurred during the period needs to be recorded before paid.

| Accrued Revenues | |
|-------------------------------------|---|
| Why is this adjustment made? | <i>Initial Transaction:</i> No transaction recorded <i>During the period:</i> Revenue earned but not paid/recorded |
| What adjustment is needed | <i>End of period:</i> Record revenue earned during the period (revenue recognition principle) |

With accrued revenues adjusting entries, initially no transaction was recorded. Then, during the period, revenue has been earned, but not paid or recorded.

At the end of the period, we have to record the revenue that we earned during the period, speaking to the revenue recognition principle: record revenue as it is earned.

| Supplies | |
|-------------------------------------|---|
| Why is this adjustment made? | <i>Initial Transaction:</i> Purchased supplies - recorded as asset <i>During the period:</i> Supplies were used in business operations |
| What adjustment is needed | <i>End of period:</i> Record use of the supplies as expense (expense recognition principle) |

With supplies adjusting entries, initially, when the supplies were purchased, they were recorded as an asset. Then, during the period, those supplies were used in business operations, to generate revenue, so now there aren't as many supplies on hand.

At the end of the period, we record the use of those supplies as an expense (expense recognition principle). It is also to reflect the appropriate asset value in our supplies account, as we now have less on hand than when we purchased them.

| Depreciation | |
|-------------------------------------|--|
| Why is this adjustment made? | <i>Initial Transaction:</i> Purchased an asset <i>During the period:</i> A portion of the asset's useful life has been used |
| What adjustment is needed | <i>End of period:</i> Record the portion of the useful life used as expense |

With depreciation adjusting entries, initially, an asset, such as equipment, was purchased. A portion of the asset's useful life has now been used, to generate revenue.

At the end of the period, we have to record the portion of the useful life used as a depreciation expense.

| Error Correction | |
|-------------------------------------|--|
| Why is this adjustment made? | <i>Initial Transaction:</i> Performed services, recorded revenue and receivable <i>During the period:</i> Received cash payment and recorded as revenue |
| What adjustment is needed | <i>End of period:</i> Correct revenue recorded from cash payment |

With error correction adjusting entries, services were performed, and at that time, revenue and a receivable were recorded. Then, during the period, cash payment was received from that customer, and it was recorded as revenue again. Therefore, revenue was recorded twice.

At the end of the period, we have to correct the revenue that we recorded from our cash payment, because we correctly recorded it when we performed those services. We have to make that correction for the double counting of revenue.



SUMMARY

Today we learned about **adjusting entries**, which are done at the end of the period. They are used to match revenues and expenses with the correct period, as well as to correct errors or omissions. We also learned about the different **types of adjusting entries**, exploring several examples of adjusting

entries that are common in practice.

Source: Adapted from Sophia instructor Evan McLaughlin.



TERMS TO KNOW

Adjusting Entry

An entry that is made at the end of an accounting period to report any unrecognized income or expenses for that period.