Creating Adjusting Entries

by Sophia

WHAT'S COVERED

This tutorial will cover a brief review of adjusting entries, followed by how to create adjusting entries.

Our discussion breaks down as follows:

1. Adjusting Entries: A Review

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.

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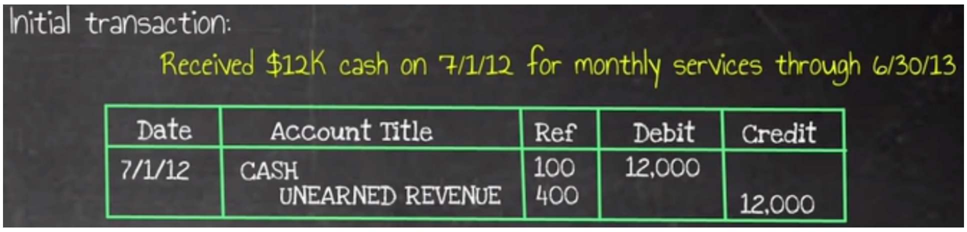
2. Adjusting Entries: Examples

Now we're going to look at examples of different types of adjusting entries and how they would be created in the general journal.

Note, for all of these examples today, we're going to be reporting at 12/31/12, the end of the year, and thus making our adjustments at the end of the year.

Unearned revenues

In the initial transaction, we received $12,000 of cash on July 1, 2012, for monthly services through June 30, 2013, so on that date, we recorded the cash and the unearned revenue. Note, it's unearned revenue because we haven't performed the services yet.

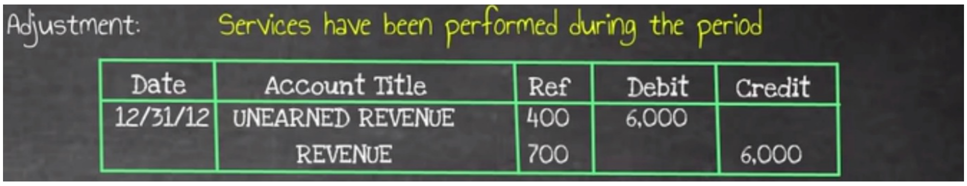


Initial transaction:

Received $12K cash on 7/1/12 for monthly services through 6/30/13

Date	Account Title	Ref	Debit	Credit
7/1/12	CASH	100	12,000	
	UNEARNED REVENUE	400		12,000

The adjustment is that services had been performed during the period, so at the end of the year, we have to reduce our unearned revenue and recognize the amount of revenue that we earned during the period.

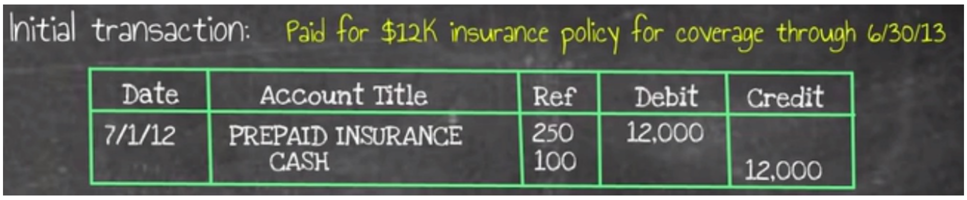


Adjustment: Services have been performed during the period

Date	Account Title	Ref	Debit	Credit
12/31/12	UNEARNED REVENUE	400	6,000	
	REVENUE	700		6,000

Prepaid expenses

Initially, we paid $12,000 for an insurance policy that includes coverage through June 30, 2013. You can see that we purchased that on July 1, 2012. We recorded our prepaid insurance, and cash being paid for it.



Initial transaction: Paid for $12K insurance policy for coverage through 6/30/13

Date	Account Title	Ref	Debit	Credit
7/1/12	PREPAID INSURANCE	250	12,000	
	CASH	100		12,000

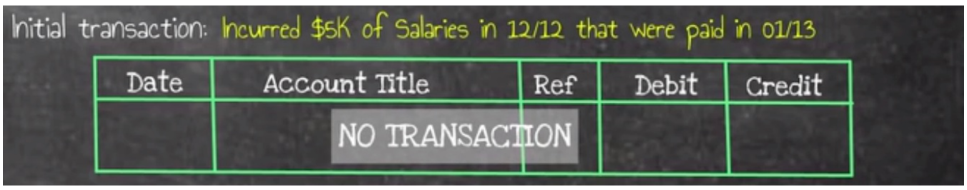
Our adjustment, now that expenses have been incurred during the period, is to record the insurance expense and reduce our prepaid insurance for the six months that we have covered.

Adjustment: Expenses have been incurred during the period

Date	Account Title	Ref	Debit	Credit
12/31/12	INSURANCE EXPENSE	905	6,000	
	PREPAID INSURANCE	250		6,000

Accrued expenses

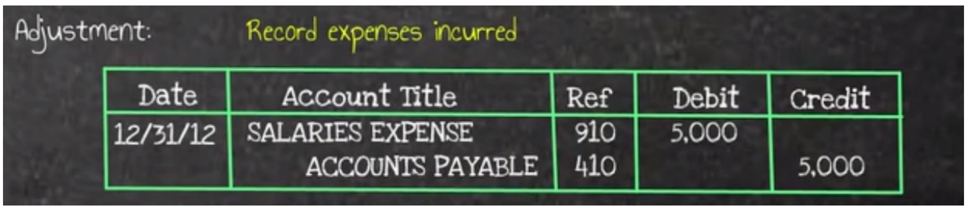
Initially, we incurred $5,000 of salaries in December of 2012 that were paid in January 2013. So, initially we didn't record anything.



Initial transaction: Incurred $5K of Salaries in 12/12 that were paid in 01/13

Date	Account Title	Ref	Debit	Credit
	NO TRANSACTION			

The adjustment is to record the expenses that we incurred, so at the end of the year, we have to record our salary's expense, and then record our accounts payable, or that money that is owed for those salaries.



Adjustment: Record expenses incurred

Date	Account Title	Ref	Debit	Credit
12/31/12	SALARIES EXPENSE	910	5,000	
	ACCOUNTS PAYABLE	410		5,000

Accrued revenues

We perform $20,000 of services in December 2012 that were paid for in January 2013. Now, we haven't recorded anything.

Initial transaction: Performed $20k of services in 12/12 that were paid for in 01/13

Date	Account Title	Ref	Debit	Credit
	NO TRANSACTION			

The adjustment we have to make is to record the revenues that we earned, "earned" being the keyword. In compliance with the matching principle, at 12/31/12, we have to record accounts receivable--the money that we're going to receive from our customer--and recognize that revenue of $20,000 that we earned in December.

Adjustment: Record revenues earned

Date	Account Title	Ref	Debit	Credit
12/31/12	ACCOUNTS RECEIVABLE	200	20,000	
	REVENUE	700		20,000

Supplies

Initially, we purchased $10,000 of supplies, so on January 1st, 2012, we recorded an asset of supplies in the amount of $10,000.

Initial transaction: Purchased $10K of Supplies

Date	Account Title	Ref	Debit	Credit
1/1/12	SUPPLIES	225	10,000	
	CASH	100		10,000

What is the adjustment? Well, $5,000 of those supplies were used during the period to help generate revenue for the business. Therefore, a twofold adjustment is needed. We have to record the expense of supplies that were used, and we also have to reduce that supplies asset to reflect the appropriate balance of the supplies account.

Adjustment: $5K of Supplies were used during the period

Date	Account Title	Ref	Debit	Credit
12/31/12	SUPPLIES EXPENSE	915	5,000	
	SUPPLIES	225		5,000

Depreciation

Initially, we purchased $50,000 of equipment at the beginning of the year on January 1, 2012, for cash.

Initial transaction: Purchased $50K equipment at the beginning of the year

Date	Account Title	Ref	Debit	Credit
1/1/12	EQUIPMENT	350	50,000	
	CASH	100		50,000

Adjustment-wise, we need to record the portion of the equipment's useful life that has been utilized, so at the end of the year, we have to record depreciation expense. We also recorded accumulated depreciation, which is where we track the total depreciation for that piece of equipment.

Adjustment: Record the portion of the equipment's useful life that has been utilized

Date	Account Title	Ref	Debit	Credit
12/31/12	DEPRECIATION EXPENSE	950	5,000	
	ACCUMULATED DEPRECIATION	299		5,000

Error corrections

Initially, on November 1, 2012, we recorded $5,000 of cash received as revenue.

Initial transaction: Recorded $5K cash received as revenue

Date	Account Title	Ref	Debit	Credit
11/1/12	CASH	100	5,000	
	REVENUE	700		5,000

Now, it turns out that the cash payment was for accounts receivable. However, we had already recognized that revenue. To correct this, at the end of the year, we have to reverse that revenue recognition out, meaning we need to debit our revenue. Then, we would credit our accounts receivable because it was a payment for accounts receivable. We have to reduce our revenue, as well as reduce our accounts receivable to correct for that error.

Adjustment: Cash was payment of accounts receivable, revenue already recognized

Date	Account Title	Ref	Debit	Credit
12/31/12	REVENUE	700	5,000	
	ACCOUNTS RECEIVABLE	200		5,000

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3. Trial Balance Worksheet: Example

Lastly, let's look at the trial balance worksheet and how these adjusting entries fit into that. Here is the trial balance worksheet, starting with our trial balance. We have a list of all the ledger accounts and a detail of all the debit or credit balances in those accounts.

	Trial Balance	
Accounts	**Dr.**	**Cr.**
Cash	138,000	
Accounts Receivable	10,000	
Supplies	10,000	
Prepaid Insurance	12,000	
Buildings	50,000	
Accumulated Depreciation - Buildings		
Accounts Payable		5,000
Notes Payable		25,000
Unearned Revenue		12,000
Common Stock		100,000
Retained earnings, 1/1/12		12,000
Revenue		200,000
Salaries Expense	121,500	
Advertising Expense	10,000	
Interest Expense	2,500	
Totals	**354,000**	**354,000**

We've identified all of our adjustments, so now we're going to enter these adjustments into the trial balance worksheet. As shown in the worksheet below, you can see all of the adjustments reflected in the adjustments columns.

	Trial Balance		Adjustments	
Accounts	**Dr.**	**Cr.**	**Dr.**	**Cr.**
Cash	138,000			
Accounts Receivable	10,000		20,000 (d)	5,000 (g)
Supplies	10,000			5,000 (e)
Prepaid Insurance	12,000			6,000 (b)
Buildings	50,000			
Accumulated Depreciation - Buildings				5,000 (f)
Accounts Payable		5,000		5,000 (c)
Notes Payable		25,000		
Unearned Revenue		12,000	6,000 (a)	
Common Stock		100,000		
Retained earnings, 1/1/12		12,000		
Revenue		200,000	5,000 (g)	20,000 (d)
				6,000 (a)
Salaries Expense	121,500		5,000 (c)	
Supplies Expense			5,000 (e)	
Advertising Expense	10,000			
Insurance Expense			6,000 (b)	
Interest Expense	2,500			
Depreciation Expense			5,000 (f)	
Totals	**354,000**	**354,000**	**52,000**	**52,000**

Adjustment Entries

(a) Unearned Revenues
(b) Prepaid Insurance
(c) Accrued Expenses
(d) Accrued Revenues
(e) Supplies
(f) Depreciation
(g) Error Corrections

Now we can prepare our adjusted trial balance, which is simply taking the trial balances within those individual accounts and adjusting them per the adjustments that we made in the middle column. As you can see, we now have balances in our supplies expense, insurance expense, and depreciation expense. Once all of our adjustments have been entered, we can then use the adjusted trial balance to create our financial statements.

	Trial Balance		Adjustments		Adjusted Trial Balance	
Accounts	**Dr.**	**Cr.**	**Dr.**	**Cr.**	**Dr.**	**Cr.**
Cash	138,000				138,000	
Accounts Receivable	10,000		20,000 (d)	5,000 (g)	25,000	
Supplies	10,000			5,000 (e)	5,000	
Prepaid Insurance	12,000			6,000 (b)	6,000	
Buildings	50,000				50,000	
Accumulated Depreciation - Buildings				5,000 (f)		5,000
Accounts Payable		5,000		5,000 (c)		10,000
Notes Payable		25,000				25,000
Unearned Revenue		12,000	6,000 (a)			6,000
Common Stock		100,000				100,000
Retained earnings, 1/1/12		12,000				12,000
Revenue		200,000	5,000 (g)	20,000 (d)		221,000
				6,000 (a)		
Salaries Expense	121,500		5,000 (c)		126,500	
Supplies Expense			5,000 (e)		5,000	
Advertising Expense	10,000				10,000	
Insurance Expense			6,000 (b)		6,000	
Interest Expense	2,500				2,500	
Depreciation Expense			5,000 (f)		5,000	
Totals	**354,000**	**354,000**	**52,000**	**52,000**	**379,000**	**379,000**

SUMMARY

Today we covered a **review of adjusting entries**, then walked through several **examples of creating adjusting entries**. Lastly, we looked at preparing an adjusted trial balance with an **example of a trial balance worksheet**.

Source: Adapted from Sophia instructor Evan McLaughlin.