

Adjustments

Study Unit 6(A)

Study Unit 6: Adjustments

Introduction

Lecture 1

Adjustments are not corrections

- Corrections are errors that have been made, which need to be fixed
- Adjustments are entries made in respect of transactions / balances that need to be passed to accurately represent that item

Adjustment examples

- Adjustments we'll cover:
 - Accrued income
 - Income received in advance
 - Accrued and prepaid expenses
 - Consumable inventory on hand
 - Credit losses
 - Depreciation

Study Unit 6: Adjustments

Accrual Basis

Lecture 2

Accrual basis

- Financial information should be presented on the basis that the effect on transactions should be recognised when they *occur* rather than when the cash is paid
- Adjustments are sometimes necessary to get these transactions / balances to represent this

Study Unit 6: Adjustments

Recording adjustments: Steps

Lecture 3

Steps to record adjustments

1. Identify the accounts that need adjustments
2. Determine what the balances should be
3. Calculate the amount of the adjustment
4. Record the necessary adjustments in the General Journal and post to the General Ledger
5. Ensure the new balances are correct

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Accrued Expenses

Lecture 4

What is an accrued expense?

- Expenses that relate to the year, but haven't been recorded yet
 - Eg: Telephone; Water & Electricity
- Generally, the invoice is received after the month has ended, so you'll only know the amount in the next month
- Once the invoice is received, you need to record it, but in the month it relates to, NOT the month you receive the invoice!

Lecture 4

Example

- ABC Enterprises received their telephone bill for February 2013 on 12 March 2013. The bill for amounted to R1 245. The Telephone expenses balance at 28 February was R15 452 (yearend Feb)
- Step 1 & 2:
 - Identify the accounts that need adjustments & how they will be affected
 - Telephone (debit)
 - Accrued Expenses (credit)

Lecture 4

Example

- Step 3:
 - Calculate the amount of the adjustment
 - Given: R1 245
- Step 4:
 - Record the adjustment

How would this be recorded?

Example: GJ

- General Journal

General Journal – February 2013

GJ1

Date	Details	Fol	Debit	Credit
28 Feb	Telephone	N1	1 245	
	Accrued Expenses	B2		1 245
	Telephone account for February 2013 received in March 2013			

Lecture 4

Example: Posting to GL

Dr Telephone N1 Cr

<u>Date</u>	<u>Details</u>	<u>Fol</u>	<u>Amount</u>		<u>Date</u>	<u>Details</u>	<u>Fol</u>	<u>Amount</u>
28 Feb	Balance	b/d	15 452					
28 Feb	Accrued Expenses	GJ1	<u>1 245</u>					
			16 697					

Dr Accrued Expenses B1 Cr

<u>Date</u>	<u>Details</u>	<u>Fol</u>	<u>Amount</u>		<u>Date</u>	<u>Details</u>	<u>Fol</u>	<u>Amount</u>
					28 Feb	Telephone	GJ1	1 245

Lecture 4

Example

- Step 5:
 - Ensure the new balances are correct
 - Telephone before adjustment: R15 452
 - Telephone after adjustment: R16 697
 - Difference: R1 245 ✓

What effect does this have?

- Accrued expenses is shown as part of Trade and other Payables, since we still owe the money for the telephone expenses
- The telephone expense now includes all costs incurred up to the end of the year
 - Even though you'll only PAY for it later, you must reflect the full expenses for the year

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Prepaid Expenses

Lecture 5

What is a prepaid expense?

- In some cases, you make payments before you actually incur the cost
 - Paying in advance means that although you've paid the cash... there is no expense yet!
- This is seen as similar to an asset, since there will be future economic benefit the business will get from this

Example

- ABC Enterprises signed a contract with Ramsamy Financial Services who would do their payroll for the next 6 months. On 1 February, ABC paid over R6 900, being payment for three months from February and was recorded in the Accounting Expenses account
- Step 1 & 2:
 - Identify the accounts that need adjustments & how they will be affected
 - Prepaid expense (debit)
 - Accounting Expenses (credit)

Example

- Step 3:
 - Calculate the amount of the adjustment
 - Given: R6 900 for three months = R2 300 per month
 - February IS an expense, thus we need to adjust for two months:
 $R2\ 300 \times 2 = R4\ 600$
- Step 4:
 - Record the adjustment

How would this be recorded?

Lecture 5

Example: GJ

- General Journal

General Journal – February 2013

GJ1

Date	Details	Fol	Debit	Credit
28 Feb	Prepaid Expense	B3	4 600	
	Accounting Services	N3		4 600
	Two months payroll services paid in advance			

Lecture 5

Example: Posting to GL

Dr Accounting Services N3 Cr

<u>Date</u>	<u>Details</u>	<u>Fol</u>	<u>Amount</u>		<u>Date</u>	<u>Details</u>	<u>Fol</u>	<u>Amount</u>
28 Feb	Balance	b/d	6 900		28 Feb	Prepaid Expenses	GJ1	4 600
			6 900			Balance	c/d	2 300
			6 900					6 900
	Balance	b/d	2 300					

Dr Prepaid Expenses B3 Cr

<u>Date</u>	<u>Details</u>	<u>Fol</u>	<u>Amount</u>		<u>Date</u>	<u>Details</u>	<u>Fol</u>	<u>Amount</u>
					28 Feb	Accounting Expenses	GJ1	4 600

Lecture 5

Example

- Step 5:
 - Ensure the new balances are correct
 - Accounting Expenses before adjustment: R6 900
 - Accounting Expenses after adjustment: R2 300
 - Difference: R4 600 ✓

What effect does this have?

- Prepaid expenses are shown as assets
 - Since the expense hasn't been incurred, the money would be refunded, and belongs to the company in the event that the expense doesn't happen
- The Accounting expense account is shown with only the actual expense in it

Study Unit 6: Adjustments

Income Received in Advance

Lecture 6

What is Income Received in Advance?

- As with prepaid expenses, money can change hands before the underlying transaction has taken place
 - With the prepaid expense, we were paying something before it happened
 - With income received in advance, we are receiving money before we render a service
- We can't recognise the income, since we'd have to pay them their money back if we couldn't perform the work

Lecture 6

Example

- ABC Enterprises received R4 000 from S Pillay on 15 February for services to be rendered in March. This was recorded as Services Rendered. Services Rendered was R65 000 after this transaction
- Step 1 & 2:
 - Identify the accounts that need adjustments & how they will be affected
 - Services Rendered (debit)
 - Income Received in Advance (credit)

Lecture 6

Example

- Step 3:
 - Calculate the amount of the adjustment
 - Given: R4 000
- Step 4:
 - Record the adjustment

How would this be recorded?

Example: GJ

- General Journal

General Journal – February 2013

GJ1

Date	Details	Fol	Debit	Credit
28 Feb	Services Rendered	N4	4 000	
	Income Received in Advance	B3		4 000
	Income Received in Advance from S Pillay			

Lecture 6

Example: Posting to GL

Dr Services Rendered N4 Cr

<u>Date</u>	<u>Details</u>	<u>Fol</u>	<u>Amount</u>		<u>Date</u>	<u>Details</u>	<u>Fol</u>	<u>Amount</u>
28 Feb	Income Received in Advance	GJ1	4 000		28 Feb	Balance	b/d	65 000
	Balance	c/d	<u>61 000</u>					
			65 000					65 000
						Balance	b/d	61 000

Dr Income Received in Advance B3 Cr

<u>Date</u>	<u>Details</u>	<u>Fol</u>	<u>Amount</u>		<u>Date</u>	<u>Details</u>	<u>Fol</u>	<u>Amount</u>
					28 Feb	Services Rendered	GJ1	4 000

Lecture 6

Example

- Step 5:
 - Ensure the new balances are correct
 - Services Rendered before adjustment: R65 000
 - Services Rendered after adjustment: R61 000
 - Difference: R4 000 ✓

What effect does this have?

- Income Received in Advance is shown as a liability
 - Since the income hasn't been earned, the money would be refunded to the client if we didn't perform the work at that later date
- The Services Rendered account is shown with only the actual income in it

Study Unit 6: Adjustments

Accrued Income

Lecture 7

What is Accrued Income?

- This is income which has been earned, but not yet received
- We must recognise the income, but since we don't have the money yet, we recognise an asset to show that money will be coming in for this

Example

- ABC Enterprises has a savings account that pays 9% interest annually on 30 April. They have R18 000 in the account.
- Step 1 & 2:
 - Identify the accounts that need adjustments & how they will be affected
 - Accrued Income (debit)
 - Interest Income (credit)

Example

- Step 3:
 - Calculate the amount of the adjustment
 - Interest per month: $R18\ 000 \times 9\% = R1\ 620 / 12 = R135$
 - Accrued period: May - February – 10 months
 - Accrued interest: $R135 \times 10 = R1\ 350$
- Step 4:
 - Record the adjustment

How would this be recorded?

Lecture 7

Example: GJ

- General Journal

General Journal – February 2013

GJ1

Date	Details	Fol	Debit	Credit
28 Feb	Accrued Interest	BS	1 350	
	Interest Income	NS		1 350
	2 Months interest income accrued			

Lecture 7

Example: Posting to GL

Dr Accrued Income BS Cr

<u>Date</u>	<u>Details</u>	<u>Fol</u>	<u>Amount</u>		<u>Date</u>	<u>Details</u>	<u>Fol</u>	<u>Amount</u>
28 Feb	Interest Income	GJ1	1 350					

Dr Interest Income NS Cr

<u>Date</u>	<u>Details</u>	<u>Fol</u>	<u>Amount</u>		<u>Date</u>	<u>Details</u>	<u>Fol</u>	<u>Amount</u>
					28 Feb	Accrued Income	GJ1	1 350

Lecture 7

Example

- Step 5:
 - Ensure the new balances are correct
 - Interest for the year: R1 620
 - Period after yearend before payment: March & April: $R135 \times 2 = R270$
 - Difference: $R1\ 620 - R270 = R1\ 350$ ✓

What effect does this have?

- Interest Income shows the income that has already been earned by the business. Just because it hasn't been paid yet, doesn't mean it doesn't belong to the company
- Accrued Income shows the amount as an asset, since it is money that will flow into the business