

# **Adjustments**

## **Study Unit 6(B)**

Study Unit 6(B): Adjustments

# Depreciation

**Lecture 1**

# What is an depreciation?

- Fixed assets are purchased with the expectation that they will produce some kind of income, over more than one year
- Through the course of each year, the value of the asset is 'used up', as it produces income
- We are required to match the income and the related expense, so that the 'cost' of the income is as true a representation as possible

## Lecture 1

# Example

- ABC Enterprises purchased equipment on 1 June to the value of R25 000. At the end of the year, the asset value was estimated to be R22 000
- Step 1 & 2:
  - Identify the accounts that need adjustments & how they will be affected
    - Depreciation (debit)
    - Accumulated Depreciation: Equipment (credit)

# Example

- Step 3:
  - Calculate the amount of the adjustment
    - Value when purchased: R25 000
    - Value at yearend: R22 000
    - Depreciation: R3 000
- Step 4:
  - Record the adjustment

**How would this be recorded?**

**Lecture 1**

# Example: GJ

- General Journal

General Journal – February 2013

GJ1

Date	Details	Fol	Debit	Credit
28 Feb	Depreciation	N6	3 000	
	Accumulated Depreciation: Equipment	B7		3 000
	Depreciation on equipment at yearend			

Lecture 1



# Example

- Step 5:
  - Ensure the new balances are correct
    - Cost of equipment: R25 000
    - Value at yearend: R22 000
    - Difference: R3 000 ✓



# What effect does this have?

- Depreciation is an expense that indicates the cost of 'using' the worth of the equipment up
- Accumulated Depreciation is subtracted from the cost of the equipment in the Statement of Financial Position to indicate the value of the equipment.
  - We don't decrease the equipment itself, since we're not changing the cost of the equipment, and you'll always be able to see the cost, and the depreciation over the lifespan of the asset

## Lecture 1

Study Unit 6(B): Adjustments

# Consumable Inventory on Hand

**Lecture 2**

# What is Consumable Inventory on Hand?

- We purchase certain items and expense it as we purchase it, however, we should only recognise them as an expense when we actually USE them
- Thus, at yearend, we should show the items still on hand as an asset, since we will get the future value and use from them

# Example

- ABC Enterprises purchased R31 500 Stationery during the year. At yearend, there was R2 300 of that stationery still on hand.
- Step 1 & 2:
  - Identify the accounts that need adjustments & how they will be affected
    - Consumable Inventory on Hand (debit)
    - Stationery (credit)

# Example

- Step 3:
  - Calculate the amount of the adjustment
    - Given: R2 300
- 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	Consumable Inventory on Hand	B8	2 300	
	Stationery	N9		2 300
	Recording of Consumable Inventory on hand			

Lecture 2

# Example: Posting to GL

Dr Stationery N9 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	31 500		28 Feb	Consumable Inventory on Hand	GJ1	2 300
						Balance	c/d	29 200
			31 500					31 500
	Balance	b/d	29 200					

Dr Consumable Inventory on Hand B8 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	Purchases	GJ1	2 300					

## Lecture 2

# Example

- Step 5:
  - Ensure the new balances are correct
    - Purchases before adjustment: R31 500
    - Purchases after adjustment: R29 200
    - Difference: R2 300 ✓



# What effect does this have?

- Consumable inventory on hand, as a current asset, now reflects items that will bring economic benefit in the future
- The purchases account now only shows the cost of the stationery that was actually bought through the year

Study Unit 6(B): Adjustments

# Writing off credit losses

**Lecture 3**

# What are credit losses?

- Selling goods or services on credit always carries a risk of non-recovery of the debt
  - Credit controls are put in place to try prevent this, but it can still happen that a debtor can't or won't pay their account
- The sale is not reversed, since the goods have gone, the service has been rendered

# So what do we do with it?

- Although the sale isn't reversed, profits will still decrease, since we paid for goods for which we won't be reimbursed
- We write off the debt to a Credit Loss account as an expense
- The Debtors Control will have to be reduced, since we will not receive the money, there is no longer an asset

## Lecture 3

# Example

- ABC Enterprises received information that a debtor, W Smith, who owed them R850, had gone insolvent. They decided to write the debt off
- Step 1 & 2:
  - Identify the accounts that need adjustments & how they will be affected
    - Credit Loss (debit)
    - Debtors Control (credit)

# Example

- Step 3:
  - Calculate the amount of the adjustment
    - Given: R850
- 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	Credit Loss	N9	800	
	Debtors Control	B10		800
	Write off W Smith's debtors account			

Lecture 3

# Example: Posting to GL

Dr Credit Losses N9 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	Debtors Control	GJ1	850					

Dr Debtors Control B10 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	Credit Losses	GJ1	850

## Lecture 3



# Example

- Step 5:
  - Ensure the new balances are correct
    - Credit loss (expense) R850
    - Debtors Control: R850 ✓

# What effect does this have?

- The asset is reduced, to indicate less money will be received
- Expenses are increased and result in a decrease of profits since we've paid for goods that have left the business, for which no money will come in

# The post-adjustment Trial Balance

- Once the necessary adjustments are made, a new Trial Balance is created
- The new TB will be used to create the Financial Statements