

Chapter 3 - Effect of Omitting Adjusting Journal Entries

Deferrals -- The cash has changed hands. The cost has been recorded as assets or liabilities and but will be recognized as expenses or liabilities over time or through the normal operations of the business.

Accruals -- The cash has NOT changed hands. The expenses or revenues have not been recorded in the accounts but need to because a certain event has taken place which requires the accounts to be adjusted.

Examples:

		Type	Effect of not making the adjustment
Supplies Adjustment	This adjustment is needed because supplies are initially recorded as an asset. As they are used up they must be expensed because the cost has expired	DE	Expenses Understated Net Income Overstated Assets Overstated Equity Overstated
Adjustment of a Prepaid	This adjustment is needed because when a cost is paid ahead of time (like insurance) it is recorded as a debit to an asset account. As time passes, the cost becomes expired or used up and must be charged to an expense. The JE is to debit an expense (like insurance expense) and credit the asset account (like prepaid insurance.)	DE	Expenses Understated Net Income Overstated Assets Overstated Equity Overstated
Adjustment of an unearned account	This adjustment is the OTHER SIDE of a prepaid adjustment. In other words, if we made our insurance payment to State Farm, then that company would Dr. Cash and Cr. Unearned Insurance Income (a liab. account.) When the time passes, and State Farm earns that money, it transfers the cash to a regular income account, by debiting the liability account, unearned income, and crediting a Insurance Income or other revenue account .	DR	Revenues Understated Net Income Understated Liabilities Overstated Equity Understated
Wage Accrual	This adjustment is needed when a pay period falls between two fiscal years. At the end of the year, it is necessary to accrue for wages earned (but not paid) through the end of the fiscal year. You must also do the same for related payroll taxes, but the book does not demonstrate	AE	Expenses Understated Net Income Overstated Liabilities Understated Equity Overstated

this. The JE is to debit wages expense and credit wages payable.

