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 accoun	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 Understatec 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.

Unbilled Items	This adjustment is needed when goods or services are provided prior to the end of the fiscal year, but it has not yet been billed out. The JE is to put an account receivable on the books, as well as to recognize the income earned	**AR**	Revenues Understated Net Income Understatec Assets Understated Equity Understated
Depreciation of an Asset	This adjustment is needed to record the usage of an asset or it's loss of usefulness. If we didn't record this adjustment, then our assets would remain on the books for what we paid for them, even years later. The JE to record the depreciation is to debit depreciation expense and credit accumulated depreciation.	**DE**	Expenses Understated Net Income Overstated Assets Overstated Equity Overstated
Accrued Interest	This adjustment is needed to record interest that has been earned (Interest Receivable) on an asset such as a CD or saving account or interest that is due (but hasn't been paid) on a debt instrument, such as a loan There are two major types of adjustments related to interest:		
	Interest due to you — Dr. Interest Receivable Cr. Interest Income	**AR**	Revenues Understated Net Income Understatec Assets Understated Equity Understated
	Interest Owed by you — Dr. Interest Expense Cr. Interest Payable	**AE**	Expenses Understated Net Income Overstated Liabilities Understatec Equity Overstated

Remember: ADJUSTING ENTRIES AFFECT AT LEAST ONE INCOME STATEMENT ACCOUNT AND ALSO A BALANCE SHEET ACCOUNT. THIS MEANS THAT IF AN ENTRY IS OMITTED, OR DONE IMPROPERLY, ALL OF THE FINANCIAL STATEMENTS ARE AFFECTED.