

Adjustment Entries

In the accounting process, there may be economic events that do not immediately trigger the recording of the transaction. These are addressed via **adjusting entries**, which serve to match expenses to revenues in the accounting period in which they occur. There are two general classes of adjustments:

- **Accruals** - revenues or expenses that have accrued but have not yet been recorded. An example of an accrual is interest revenue that has been earned in one period even though the actual cash payment will not be received until early in the next period. An adjusting entry is made to recognize the revenue in the period in which it was earned.
- **Deferrals** - revenues or expenses that have been recorded but need to be deferred to a later date. An example of a deferral is an insurance premium that was paid at the end of one accounting period for insurance coverage in the next period. A deferred entry is made to show the insurance expense in the period in which the insurance coverage is in effect.

How to Make Adjusting Entries

Like regular transactions, adjusting entries are recorded as journal entries. The following illustrates adjustments for accrued and deferred items.

Accrued Items

As an example of an accrued item, consider the accrual of interest revenue. The journal entry would be similar to the following:

Adjusting Entry for Interest Accrual

Accounts	Debit	Credit
Interest Receivable	xxx	
Interest Revenue		xxx

The date of the above entry would be at the end of the period in which the interest was earned. The adjusting entry is needed because the interest was accrued during that period but is not payable until sometime in the next period. The adjusting entry is posted to the general ledger in the same manner as other journal entries.

In the next period when the cash is actually received, one makes the following journal entry:

Journal Entry for Interest Received

Accounts	Debit	Credit
Cash	xxx	
Interest Receivable		xxx

Deferred Items

For deferrals, a journal entry already has been made in asset or liability accounts and an adjusting entry is needed to move the balances to expense or revenue accounts in the next accounting period. Consider the case in which the firm prepays insurance premiums in one period for insurance coverage in the next period. The journal entry made at the time of payment would be similar to the following:

Journal Entry for Prepayment of Rental

Accounts	Debit	Credit
Prepayment	xxxx	
Cash		xxxx

In the next period when the insurance coverage is in effect, one makes the following adjusting entry:

Adjusting Entry for Prepayment of Rental

Accounts	Debit	Credit
Rental Expense	xxx	
Prepayment		xxx

For a single deferred item, there may be several adjusting entries over subsequent accounting periods as the expense or revenue for the item is recognized over time.
