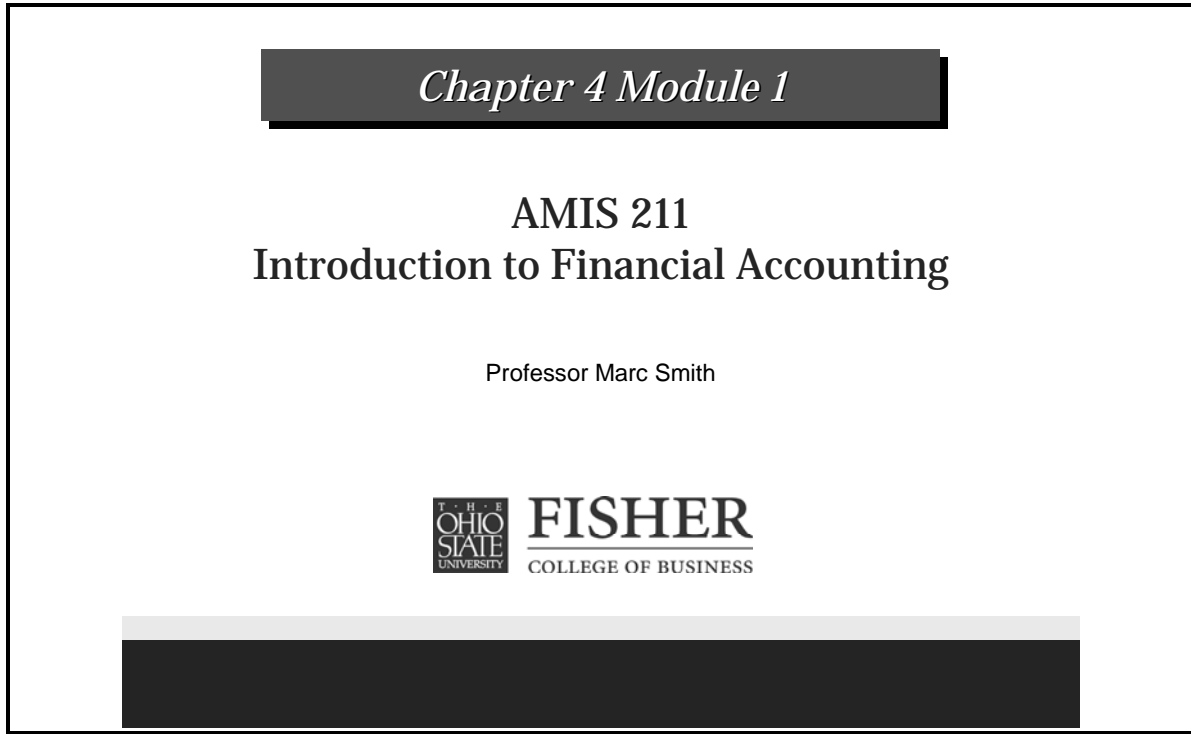


## Chapter 4, Module 1 – Adjusting Entries

### Slide 1

The slide content is enclosed in a black rectangular border. At the top, there is a dark grey horizontal bar with the text "Chapter 4 Module 1" in a white, italicized serif font. Below this bar, the text "AMIS 211" is centered in a bold, black, sans-serif font. Underneath "AMIS 211", the text "Introduction to Financial Accounting" is centered in a bold, black, serif font. Below the title, the text "Professor Marc Smith" is centered in a smaller, black, sans-serif font. At the bottom center, there is the logo for Fisher College of Business at Ohio State University, which includes a small square icon with "T H B" and "OHIO STATE UNIVERSITY" text, followed by "FISHER" in a large, bold, serif font and "COLLEGE OF BUSINESS" in a smaller, bold, sans-serif font below it. At the very bottom of the slide, there is a dark grey horizontal bar.

Hi everyone. Welcome back.

In this particular chapter, we are going to continue to build on the Accounting Cycle that we dealt with previously.

In fact, let's go ahead and get started.

And, let's just go ahead to the next slide.

Slide 2

*Chapter 4 Module 1: Accounting Cycle*

**Accounting Cycle – Basic Steps:**

- 1. Record transactions in the journal**
- 2. Post from the journal to the ledger**
- 3. Prepare an unadjusted trial balance**
- 4. Record and post year-end adjusting entries**
- 5. Prepare an unadjusted trial balance**
- 6. From the adjusted trial balance, prepare financial statements**

If you remember when we last talked about the Accounting Cycle, we listed out the steps. And we said, “Well, it is really not the entire Cycle. There are other steps that are going to be included. And, we would deal with those later.”

Later is now here. And, we need to include a couple of additional steps in the Accounting Cycle.

Now, you can see here on the slide (Slide 2) I have listed out what we dealt with in the previous chapter.

Basic steps:

Step 1): Record transactions in the Journal with our Journal Entries.

Once we have recorded our transactions, Step 2): we post the debit and credit amounts from the Journal over to the Ledger—all of the different T-Accounts.

Once we do that, we are able to determine the Ending Balance in each account and we are able to Step 3): prepare what we called a Trial Balance.

Notice here on the slide (Slide 2) it says an Unadjusted Trial Balance. We will address that issue a little bit later in the chapter as to exactly what an Unadjusted Trial Balance is.

For now, it is simply a listing of accounts just as we had seen previously.

After the Unadjusted Trial Balance has been prepared, we now need to do a couple of other things before the financial statements can be done.

Step Number 4—which is what we are going to deal with in this and the next handful of modules—is to Step 4: Record and post our Year-End Adjusting Entries.

Step 5—which we will deal with a little bit later in the chapter—is to prepare what is called an Adjusted Trial Balance.

So what you see there on the slide (Slide 2) is the Accounting Cycle almost in full. There is still one piece that we will see later—but almost in full.

Step 1: Record transactions in the Journal; Step 2: Post debits and credits to the Ledger. From the Ledger, we can Step 3: Prepare an Unadjusted Trial Balance. We, then, Step 4: Record and post Adjusting Entries; and then Step 5: Prepare what is called an Adjusted Trial Balance.

Finally, from this Adjusted Trial Balance, we can go ahead and prepare financial statements.

We need to spend some time talking about Adjusting Entries. And, let's do that.

Let's go ahead to the next slide.

Slide 3

*Chapter 4 Module 1: Accrual Accounting*

**Accrual Accounting**  
Revenues recorded when earned  
Expenses recorded in the same period they help to earn revenues (i.e., when they are incurred)  
Required by GAAP

- **Realization principle (revenue recognition principle)**
- **Matching concept**

Remember back to Accrual Accounting when we dealt with this.

We said, “Hey look! That is what we are interested in.”

Accrual Accounting, which is Generally Accepted Accounting Principles (GAAP), requires that Revenues be recorded when they are earned. It requires Expenses to be recorded in the same period that they help to generate the Revenues.

Now, what are these? What are these two principles?

These are things that we really need to be comfortable with.

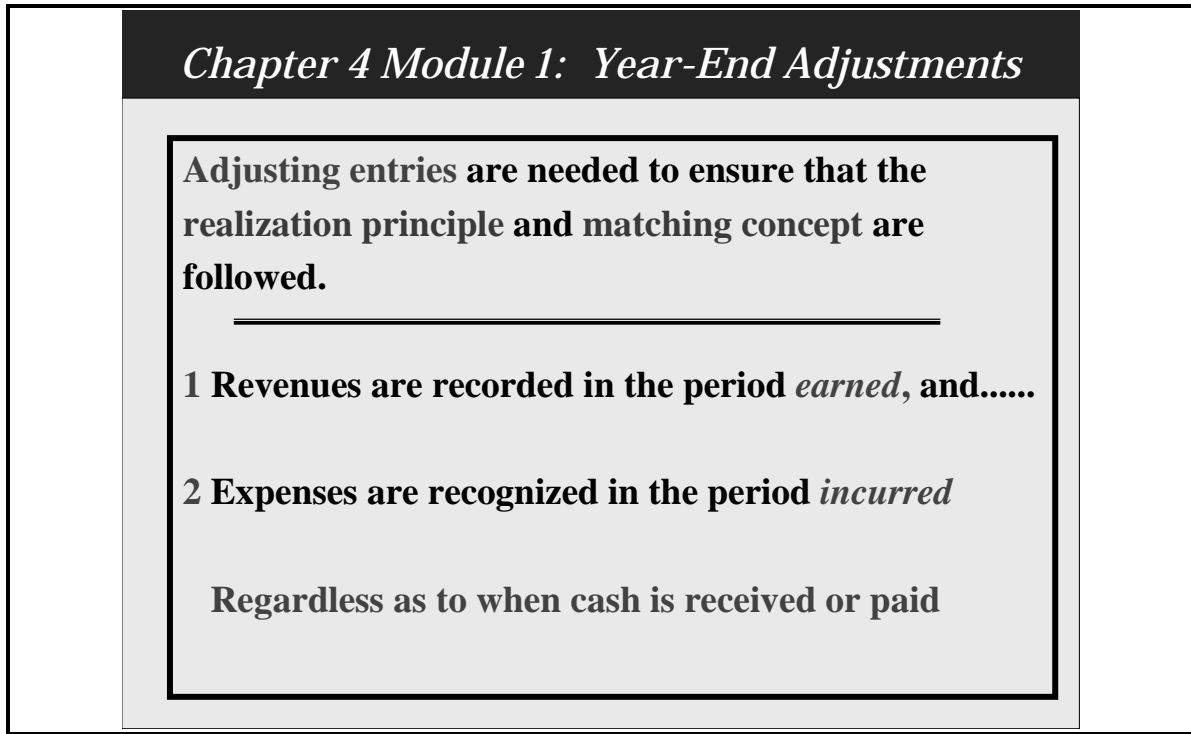
Recording Revenues in the period they are earned; we should know is: the Realization Principle also called the Revenue Recognition Principle.

And, recording Expenses in the period they helped to generate the Revenues; that is another big one—that is the other foundational principle. We should know that to be: the Matching Concept.

This is a little review.

Let's go to the next slide and we will see why that is important.

**Slide 4**

A rectangular box with a black border containing text. At the top, a dark grey header bar contains the text "Chapter 4 Module 1: Year-End Adjustments" in white, italicized font. Below this, a light grey background contains the text "Adjusting entries are needed to ensure that the realization principle and matching concept are followed." followed by a horizontal line. Below the line are two numbered items: "1 Revenues are recorded in the period earned, and....." and "2 Expenses are recognized in the period incurred". At the bottom of the light grey area, the text "Regardless as to when cash is received or paid" is centered.

*Chapter 4 Module 1: Year-End Adjustments*

**Adjusting entries are needed to ensure that the realization principle and matching concept are followed.**

---

**1 Revenues are recorded in the period *earned*, and.....**

**2 Expenses are recognized in the period *incurred***

**Regardless as to when cash is received or paid**

These Adjusting Entries that we are going to talk about—these Year-End Adjustments:

Adjusting Entries can be defined as Journal Entries made at the end of an accounting period to ensure that the Realization Principle and the Matching Concept have been followed.

That said; let's maybe rephrase just a little bit.

They are entries made at the end of an accounting period to ensure that Revenues are recorded in the period they are earned and Expenses are recorded in the period they are incurred.

And, what is sort-of the kicker here—regardless as to what?

It is regardless as to when cash changes hands—regardless as to when cash is received or paid—that is NOT the determining factor in when to record a Revenue or Expense.

So, these Adjusting Entries we are going to talk about—they are done to ensure that the Realization Principle and Matching Concept are being followed.

Go to the next slide with me.

**Slide 5**

***Chapter 4 Module 1: Adjusting Entries***

**Adjusting entries are journal entries made at the end of an accounting period (end of year, end of month) to update account balances.**

**These adjusting entries are required because of accrual accounting (i.e., recording revenues and expenses at a time OTHER than cash receipt or cash disbursement) and are required each time financial statements are prepared.**

Adjusting Entries—let's give it a little more meaningful definition:

Adjusting Entries are Journal Entries made at the end of an accounting period to update account balances. They are done or they are made due to the Realization and Matching Concepts—because of Accrual Accounting—because of recording Revenues and Expenses independent of cash coming in or cash going out.

Every time we prepare financial statements—be it every month—be it every year—whatever—every time we prepare financial statements, we must do Adjusting Entries.

Now, companies are required to do it at least once a year. So, these have to be done, at least, at the end of every year.

There are many companies out there that do financial statements every month. It kind-of lets them know where they stand month-to-month rather than waiting for just the year-end numbers.

If you do it monthly, you also should do Adjusting Entries to get an accurate picture of your financial condition.

So, Adjusting Entries is going to be the focus of this chapter.

They are Entries made at the end of an accounting period to update account balances to reflect the fact that the Revenues must be recorded when earned regardless of when cash is received; and Expenses must be recorded when they are incurred (i.e., when they help to generate Revenues) regardless as to when the cash is actually paid.

So, Adjusting Entries will be the focus of this chapter.

Please go to the next slide with me.

Slide 6

*Chapter 4 Module 1: Adjusting Entries*

Adjusting entries are required each time financial statements are prepared.  
**Two main categories of adjustments are:**

The diagram consists of two dark gray, teardrop-shaped icons arranged horizontally. The left icon contains the word 'DEFERRALS' in white, uppercase letters. The right icon contains the word 'ACCRUALS' in white, uppercase letters. Above the icons is a light gray rectangular box with a thin border containing the text 'Adjusting entries are required each time financial statements are prepared. Two main categories of adjustments are:'. The entire diagram is set against a light gray background within a black-bordered frame.

There are two (2) main types of Adjusting Entries.

Every time we prepare financial statements, there will be two (2) main types of adjustments that need to be made.

We have what are called 1) Deferrals.

And, we have what are called 2) Accruals.

These are two words that we are going to become awfully familiar with as we move through this chapter on Adjusting Entries.

Please go to the next slide with me.

Slide 7

*Chapter 4 Module 1: Adjusting Entries*

**2 Main Categories of Adjustments:**

1. **Deferrals**  
transactions for which cash has been received or paid while the related revenue or expense has not been recorded  
(exchange of cash has occurred before the action)
  
2. **Accruals**  
transactions for which cash has NOT yet been received or paid, but the related revenue or expense has been earned or incurred and thus must be recorded  
(action has occurred before the exchange of cash)

And, let's give these two (2) things a definition.

There are two (2) main categories of Adjustments: 1) Deferrals and 2) Accruals. And, before we say what the definitions are, I want you to remember one thing: why we are adjusting the accounts in the first place?

We are adjusting them because of the Realization and Matching Concepts—recording Revenues and Expenses independent of cash. Keep that in mind.

A Deferral:

A Deferral can be defined as a transaction for which cash has been received or paid; however, the Revenue or Expense has not yet been recorded.

Think of a Deferral this way: the exchange of cash occurs before what we call the “action”—the action being NOT exciting gunfights and car races—but the action, of course, being the recording of Revenues and Expenses.

A Deferral is a transaction where the exchange of cash happens first. Cash is either received or paid first before any recognition of Revenues or Expenses.

An Accrual is the exact opposite.

An Accrual is a transaction where the Revenue or Expense is recorded first; and then the exchange of cash—either receiving or paying it—happens later.

Think of an Accrual as a situation where the action happens first—being, we record the Revenue or Expense before the exchange of cash.

So, keep these two things in mind. They really are the focus of this chapter. Keep these two things in mind.

With a Deferral, we record the exchange of cash first and then the Revenue or Expense later.

In Accrual, it is the exact opposite; the Revenue or Expense is recorded first, followed by the exchange of cash.