


**Chapter 4, Module 5 – Adjusting Entries: Accruals**

**Slide 1**

*Chapter 4 Module 5*

**AMIS 211**  
**Introduction to Financial Accounting**

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 **FISHER**  
COLLEGE OF BUSINESS

Hi everyone. Welcome back.

Let's continue our discussion of Adjusting Entries (AJEs).

And, in this module, let's talk a little bit about Accruals.

Let's go ahead to the next slide and jump right into it.

Slide 2

**Chapter 4 Module 5: Accruals**

**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 occurred before exchange of cash)

<p><b>Accrued Revenues</b> Revenues earned but not yet received in cash or recorded</p> <p><b>Example:</b> Sales of merchandise on account</p>	<p><b>Accrued Expenses</b> Expenses incurred but not yet paid in cash or recorded</p> <p><b>Example:</b> Salaries incurred but not yet paid for</p>
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An Accrual:

It is a transaction where the Revenue, or Expense, is recorded before cash is either received or paid.

An Accrual—which is the exact opposite of a Deferral—an Accrual is a transaction where the action occurs first—the action, of course, being the Revenue or Expense. So, the action occurs before the exchange of cash.

Now, we have Accrued Revenues.

Accrued Revenues are revenues that are earned but not yet received in cash.

And, a good example of an Accrued Revenue is selling goods on account.

You make the sale; you earn the revenue; you just won't collect the cash until a future point in time.

So, an Accrued Revenue: the revenue is earned but not yet received in cash or recorded in the accounting records.

An Accrued Expense is an expense that has been incurred but has not yet paid in cash.

A good example would relate to salaries.

Companies run a payroll every two weeks. So, sometimes, the payroll overlaps accounting periods—maybe one week in December; one week in January. But, we have to record the expense in the right year.

So, we will have to record some of that expense at the end of the December even though we have not yet paid it and won't pay it until the end of the first week of January.

That is what an Accrual is: it is a transaction where the action (i.e., the Revenue or Expense) happens first; and then, the cash exchanges hands at a future point in time.

Let's go to the next slide.

Slide 3

***Chapter 4 Module 5: Adjustments for Accruals***

- **Adjusting entries for accruals are required to record revenues earned and expenses incurred in the current period but not yet received or paid in cash.**
  
- **Accrued revenues**
  - **debit an asset account & credit a revenue account**
  
- **Accrued expenses**
  - **debit an expense account & credit a liability account**

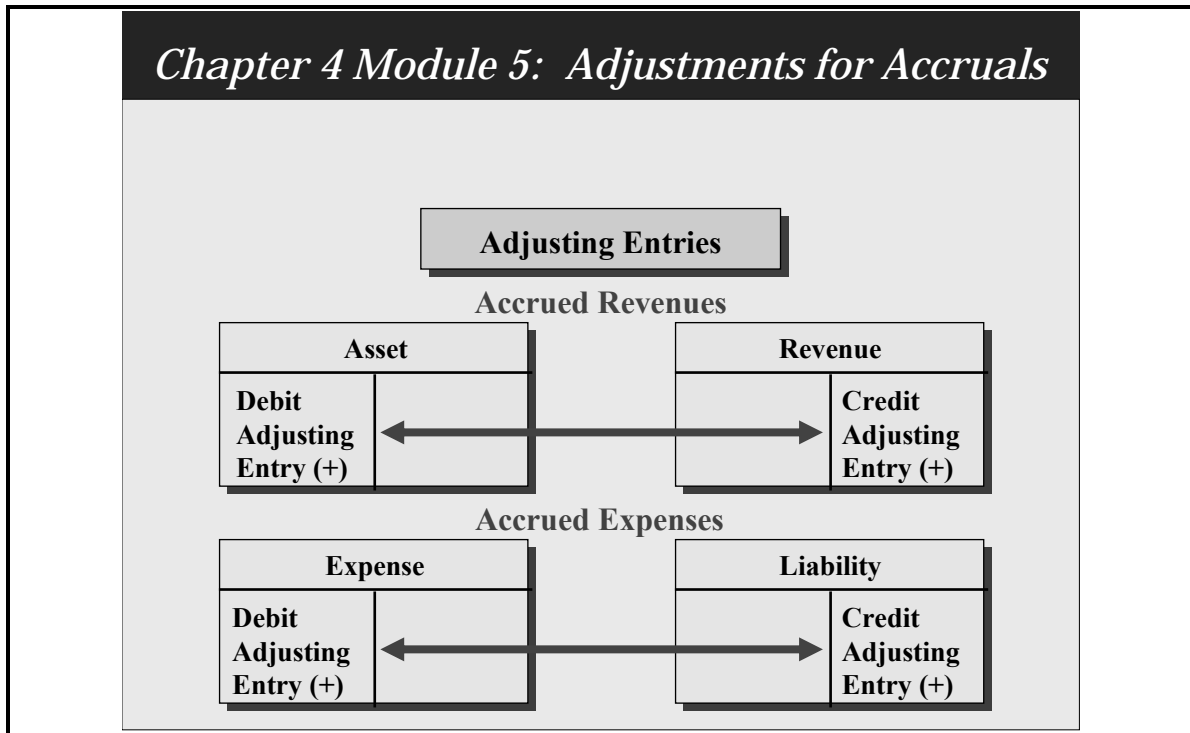
Adjusting Entries are needed for Accruals to reflect the revenue that has been earned or the expense that has been incurred without the exchange of cash.

And, the Adjusting Entry (AJE) for an Accrued Revenue will always be a debit to an Asset account and a credit to a Revenue account.

The Adjusting Entry (AJE) for an Accrued Expense will always be a debit to an Expense account and a credit to a Liability account.

And, to see how this is going to work, just go to the next slide with me.

## Slide 4



You can see the T-Accounts here (on Slide 4).

For Accrued Revenues, you are always going to have an Asset being recorded; specifically, some type of Receivable—most likely an Account Receivable (A/R).

And then, you will have the Revenue being recorded. We have earned the revenue; we just have not collected it in cash. Hence, we have a Receivable—this is money owed to us.

At the bottom of the slide (Slide 4), you can see the Adjusting Entry for an Accrued Expense.

We have to record the Expense and then credit a Liability—some type of Payable.

We have recorded an Expense—we have incurred an expense—without paying it in cash. So, now we owe the cash. Hence, we have the Payable account.

I think these past couple of slides—the last three—really will be helpful to you and your understanding of Accrued Revenues and Accrued Expenses.

Let’s go to the next slide and do an example of an Accrued Revenue.

**Slide 5**

<i>Chapter 4 Module 5: Example #1</i>					
<b>Case E:</b>					
<b>December 31, 1999 (adjusting entry)</b>					
<b>Salaries Expense</b>	.....	<b>6,500</b>			
<b>Salaries Payable</b>	.....	<b>6,500</b>			
<b>Salaries Expense</b>	=	<b>Expense</b>			
<b>Salaries Payable</b>	=	<b>Liability</b>			
<b>Rev</b>	<b>-</b>	<b>Exp</b>	<b>=</b>	<b>NI</b>	<b>A</b>
<b>NE</b>		<b>↑6,500</b>	<b>↓6,500</b>	<b>NE</b>	<b>=</b>
				<b>L</b>	<b>+</b>
				<b>↑6,500</b>	<b>+</b>
					<b>E</b>
					<b>↓6,500</b>

And, go to our Web site problems.

And, let’s look at Case E.

And, Case E says this: “XYZ Company pays its employees every two weeks. On January 10th of the Year 2000, the employees will be paid \$18,000. \$6,500 of this amount represents payment for work performed between December 29 and 31<sup>st</sup> of 1999—the previous year.”

Just to correct something real quickly. I think I had said: “So go to the next slide and do an example of an Accrued Revenue” but let’s look at an Accrued Expense first. And then, we will, of course, see an Accrued Revenue just a little bit later.

So, this is an example of an Accrued Expense.

Remember with an Accrual: the Adjusting Entry (AJE) is recorded first—the Revenue or Expense is recorded first; the exchange of cash is recorded later.

The Adjusting Entry here—if you would just look back to the previous slide with the T-Accounts (Slide 4), you know we are to debit an Expense account—in this case, Salaries Expense; and credit a Liability account—in this case, Salaries Payable.

The amount is \$6,500. That is the amount of salaries earned by employees in 1999. That is the amount of Salaries Expense that must be recorded in 1999. That is why we need an Adjusting Entry (AJE).

Even though, we will not pay these folks for ten (10) more days, the expense was still incurred in 1999, and thus, it must be recorded in that year.

Now, we know: Salaries Expense is an Expense account and Salaries Payable is a Liability account.

So, the effects of this Adjusting Entry on our accounting items:

It increases the Expense and decreases the Net Income, which, of course, decreases Retained Earnings, which is Equity.

And, at the same time, we have an increase to our Liabilities. We now owe our employees—as of the end of 1999, we owe them \$6,500.

We are still in balance.

If you go to the next slide with me...

## Slide 6

**Chapter 4 Module 5: Example #1****Case E:****January 10, 2000 (record payment of salaries)**

<b>Salaries Expense</b> .....	<b>11,500</b>
<b>Salaries Payable</b> .....	<b>6,500</b>
<b>Cash</b> .....	<b>18,000</b>

<b>Salaries Expense</b>	=	<b>Expense</b>
<b>Salaries Payable</b>	=	<b>Liability</b>
<b>Cash</b>	=	<b>Asset</b>

<b>Rev</b>	<b>-</b>	<b>Exp</b>	<b>=</b>	<b>NI</b>	<b>A</b>	<b>=</b>	<b>L</b>	<b>+</b>	<b>E</b>
<b>NE</b>		<b>↑11,500</b>		<b>↓11,500</b>	<b>↓18,000</b>		<b>↓6,500</b>		<b>↓11,500</b>

The next question that we need to answer is:

What is going to happen when we pay them?

With an Accrual, the expense is recorded first. And, we did that on December 31<sup>st</sup>, 1999.

The exchange of cash happens later. It happens in this case on January 10<sup>th</sup> of the Year 2000.

So, what are we going to need to record on this date?

This is going to be a little challenging.

One thing we have to record is our cash. We have to credit: Cash. We are spending \$18,000 of cash.

Another thing that has to be recorded is: We have to debit the Liability. We are paying off our debt. We have to reduce the debt or liability: Salaries Payable that was created with our Adjusting Entry at the end of 1999.

But, you see our Journal Entry does not balance.

What are we missing?

We also have to record Salaries Expense—the \$11,500—the difference between the total cash and the expense of the previous year—the \$11,500 is payment for employees working between January 1<sup>st</sup> and January 10<sup>th</sup> of the Year 2000.

That amount should be an Expense, thus, in the Year 2000. And, that is why it is Salaries Expense, here (on Slide 6).

Now, we know Salaries Expense is an Expense account; Salaries Payable is a Liability; and Cash is an Asset.

So, we have a bunch of things affected.

The impact on our financial statements:

Increased Expenses of \$11,500—the amount of the Salaries Expense for the year. That decreases Net Income, which in turn, decreases Equity—Retained Earnings—by \$11,500.

We also have a decrease to our Liabilities. We have paid the debt created at the end of last year. Our Liabilities go down by \$6,500.

Finally, our Assets: Cash decrease as well by the amount of \$18,000.

Overall, we still balance.

The Asset side decreases by \$18,000. The Liability plus (+) Equity side decreases by a total of \$18,000.

That is an Accrued Expense.

Let's go to the next slide.

## Slide 7

**Chapter 4 Module 5: Example #1****Case F:****December 31, 1999 (adjusting entry)**

<b>Accounts Receivable</b> .....	<b>800</b>	
<b>Rental Revenue</b> .....		<b>800</b>

<b>Accounts Receivable</b>	=	<b>Asset</b>
<b>Rental Revenue</b>	=	<b>Revenue</b>

<u>Rev</u>	-	<u>Exp</u>	=	<u>NI</u>		<u>A</u>	=	<u>L</u>	+	<u>E</u>
↑800		NE		↑800		↑800		NE		↑800

And, now we can talk about the much anticipated Accrued Revenues.

And, let's take a look at Case F.

Here is what it says:

“On December 1<sup>st</sup>, 1999, XYZ Company entered into a contract to rent equipment to a Customer for \$800 a month. XYZ will receive their first payment from this Customer on January 5<sup>th</sup> of the next year (2000).”

Once again, we have an Accrual.

Once again, we have done our part. We have allowed the Customer to rent the equipment from us. We have earned our revenue.

So, as of December 31<sup>st</sup>, we need an Adjusting Entry (AJE) to reflect the revenue earned.

So, if you would go back to that slide with the T-Accounts (Slide 4), you will see that the Adjusting Entry (AJE) must have a debit to an Asset and a credit to a Revenue.

In this case, we will debit Accounts Receivable—money owed to us. We have earned the revenue; the Customer just won't pay us for another five days.

We, of course, then have to credit the Rental Revenue to reflect the fact that revenue has been earned.

As I just said, Accounts Receivable is an Asset; Rental Revenue is a Revenue account.

The impact on our financial statements:

Revenues go up \$800, causing Net Income to go up \$800, which causes Equity—specifically, Retained Earnings—to increase \$800.

We also have an increase to our Assets—our Accounts Receivable. We are now owed \$800 by this Customer.

Go to the next slide with me.

## Slide 8

**Chapter 4 Module 5: Example #1****Case F:****January 5, 2000 (record receipt of cash)**

**Cash** ..... **800**  
**Accounts Receivable** ..... **800**

**Cash** = **Asset**  
**Accounts Receivable** = **Asset**

<b>Rev</b>	<b>-</b>	<b>Exp</b>	<b>=</b>	<b>NI</b>	<b>A</b>	<b>=</b>	<b>L</b>	<b>+</b>	<b>E</b>
<b>NE</b>		<b>NE</b>		<b>NE</b>	<b>NE</b>		<b>NE</b>		<b>NE</b>

Let's remember what an Accrual is, real quick: an Accrual is a transaction where the action—the Revenue or Expense is recorded first and the exchange of cash is recorded later.

So, on December 31<sup>st</sup> 1999, we recorded the action—the earning of the revenue.

On January 5<sup>th</sup> of the next year, we will record the exchange of cash—the Customer sending in the money.

To do this: we will simply debit the Cash and credit the Accounts Receivable we created five (5) days earlier.

We know—or should know—Cash and Accounts Receivable are both Assets—causing an overall No Effect (NE) to any of the financial statements.

We have one Asset going up: Cash; and another Asset going down: Accounts Receivable.

Overall, there is no change (NE) to the financial statement elements.

Those are Accruals.

Let's go to the next slide and let's do one little review and then we can wrap up Accruals.

### Slide 9

**Chapter 4 Module 5: Accrued Expenses**

**REVIEW QUESTION**

**ADJUSTING ENTRY-SALARIES**

Teri Ziegler earned a salary of \$400 for the last week of September. She will be paid on October 1. What is the required adjusting entry at September 30?

Account	Debit	Credit
Salaries Expense	\$400	
Salaries Payable		\$400

This entry recognizes an expense for the salary earned by Teri in the last week of September, and a liability for the amount due to Teri at September 30<sup>th</sup>.

Here is another review question.

Here is what it says:

“Teri Ziegler earned a salary of \$400 for the last week. (She must work for Ohio State.) She earned this salary of \$400 the last week of September and OSU will pay her on October the 1<sup>st</sup>.”

“What is the necessary Adjusting Entry (AJE) that would be made at September 30<sup>th</sup> by OSU?”

Teri has earned the salary; she just has not been paid yet.

For the Adjusting Entry (AJE):

We are going to debit Salaries Expense for the \$400 that Teri has earned—because we have now incurred the expense as the organization.

We have not paid her yet.

So, the credit is, of course, to Salaries Payable. We now have a Liability. We now owe her this \$400.

We will pay it to her the very next day—on October 1<sup>st</sup>.

The key point here to recognize is: the Entry that we have just recorded recognizes an Expense of the salary earned by the employee during the last week of September.

We also had to record a Liability because we did not pay her yet. The payment will not be made until the 1<sup>st</sup> of the next month (October).