What are the end-of-period-adjustments in accounting?
Peter Baskerville

Explaining the place and reason for end-of-period-adjustments in accounting - Practicing Level

End-of-period-adjustments in accounting are journal entries made to the accounts of a business prior to the preparation and distribution of the financial statements for a given accounting period. End-of-period adjustments ensure that these financial statements reflect the true financial position and performance of a business by allocating to the appropriate period the income earned and expenses incurred. End-of-period adjustments are also known as year-end-adjustments, adjusting-journal-entries and balance-day-adjustments. End-of-period-adjustments apply the matching principle of accounting which include accruals, deferrals and asset value adjustments.

End-of-period-adjustments in accounting
Background to end-of-period-adjustments in accounting

Also known as year end adjustments, adjusting journal entries and balance-day-adjustments, end-of-period-adjustments is one step in the accounting process.
period-adjustments are completed by accountants and bookkeepers immediately prior to the preparation and presentation of the financial statements. Financial statements are prepared at the end of each accounting period which can be monthly for large corporations or annually for small to medium enterprises.

The primary purpose of completing the balance-day-adjustments is to ensure that the financial statements accurately reflect the financial position and performance of the business. Stakeholders in a business venture use the financial statements to make decisions, particularly about the best use of financial resources under their control. It is very important then for accountants and bookkeepers to present accurate financial statements so that sound financial resource decisions can be made by these stakeholders.

End-of-period adjustments become necessary in accounting to two key areas:

- the different time impacts of the accounting period and multi-period financial transaction (For example, a 12-month magazine subscription that benefits the business over 12 different monthly accounting periods)
- the need to make adjustments to the accounts to better reflect asset realities (For example, to adjust the inventory amount in the accounts to reflect the value of an actual stocktake done at the end-of period.)

The mismatch between the accounting time periods that stakeholders require financial information and the real life, conduct and transactions times of a business is one area requiring end-of-period adjustments. For example some transactions, like an insurance payment, may cover several accounting periods. Not all transactions fit neatly within the monthly, quarterly, half-yearly or annual reporting periods that stakeholders require and so end-of-period adjustments must be made to the accounts of a business so that only that part of the financial transaction that relates to the current period is included in the financial reports for the current period.
Apart from making end-of-period adjustments for the timing mismatches mentioned above, end-of-period adjustments must also be performed to appropriately adjust asset values. Prior to distributing financial statements to the stakeholders of the business, accountants and bookkeepers check to see that all the asset values in the accounts reflect their real value according to either the accounting standards, tax laws and/or organisational policies. Typical assets that need to be checked and adjusted when necessary include:

- merchandise inventory (to make adjustments to reflect the physical stocktake valuation)
- fixed assets (to make allowances for their depreciation)
- accounts receivable (to write-off bad debts and make provision for doubtful debts)
- supplies or stores (to record adjustments to the supplies or stores values according to the end of period stocktake)

End-of-period adjustments and accrual accounting

There are two methods that can be used by accountants and bookkeepers to record and report on the financial transactions of a business: one method is called 'cash accounting' and the other method is called 'accrual accounting'. Under the cash accounting method, financial transactions are only recorded in the accounts of a business when the cash is actually exchanged. For example, revenue is recorded when the money is received and expenses are recorded only when the actual payment is made.

Businesses using the accrual accounting method are required to record revenue when a legal obligation on the customer/client is created and record expenses when the business incurs a legally liability to pay, regardless of when the cash is actually exchanged. So by applying the accrual accounting method, the income earned in a given accounting period will accurately match the expenses incurred in earning that revenue. This is known in accounting as the matching principle. The matching principle
ensures that the financial reports accurately reflect the financial performance and the financial position of the business for the given accounting period.

The matching principle that is applied in accrual accounting requires that adjusting entries are made to the accounts to ensure that all the revenue earned in an accounting period together with all the expenses incurred in earning that revenue, are recorded and reported in the same accounting period.

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End-of-period adjustments - Accruals and deferrals

The two key end-of-period adjustments that need to be made under the matching principle are accruals and deferrals.

- **Accruals** are end-of-period adjustments made under the matching principle that recognize (bring to account) those revenues earned and expenses incurred in the current period but have not yet been recorded in the books of the business.

- **Deferrals** are end-of-period adjustments made under the matching principle that transfer to future accounting periods those revenues and expenses recorded in the current period but in fact belonging to these future periods.

The different types of end-of-period adjustments are detailed below:

- **Accrued Revenue**: adding transactions for revenue that has not yet been invoiced. For example, a staged monthly invoice for partially completed work $1,000 in a six (6) month contract worth $6,000.

- **Accrued Expense**: adding transactions for expenses that have not yet been recognized. For example, the electricity used in the current reporting period that has not yet been billed by the supplier. Note a special type of accrued expense is depreciation. Depreciation expense apportions the cost of a fixed asset over its useful life. The useful life of a fixed asset will cover a number of accounting periods.

- **Deferred Revenue**: transferring to future periods income transactions that while recorded in the current period actually belong to future periods. These amounts become liabilities of the business because the business has not yet performed the work and so has no claim to the customer payment. For example, $1,000
cash received by the business as a deposit for work that has not yet been commenced.

- Deferred Expense: transferring to future periods expense transactions that while recorded in the current period actually belong to future periods. These amounts become assets of the business because the value of the expense has not yet been used up or utilized. For example, transferring the remaining time covered under a 12 months insurance payment.

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Accruals
• Accrued revenue - earned but not yet invoiced
• Accrued expenses - incurred but not yet billed

Deferrals
• Deferred income - unearned income
• Deferred expenses - prepaid expenses

Asset adj.
• Accounts receivable - Bad & doubtful debts
• Fixed assets - depreciation
• Inventory - stocktake
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End of period adjustments

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