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Accounting

Teach Yourself Series

Topic 10: Balance Day Adjustments

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Balance Day Adjustments

Accounting financial reports are required to determine the performance of a business over a reporting period. The Qualitative Characteristics of Relevance, Verifiability and Comparability require that the financial reports are accurate, based on reliable, unbiased information and apply the same accounting methods as previous periods so comparisons can be made.

In order to prepare financial reports that are accurate and provide more useful information for decision-making, some accounts require adjustments so the information presented is accurate and reflective of performance for that reporting period.

Initial terminology

As it appears in Units 4

At the end of the reporting period, prior to the preparation of reports, it is important that the records are accurate and that the financial reports are accurate. This is particularly the case for the profit figure reported and the financial position of the business as reflected in the Balance Sheet.

Consequently, to make the information in the reports more relevant for decision-making, some adjustments to existing accounts must occur.
Balance day adjustments can be grouped into two broad categories:

- Expense adjustments
- Revenue adjustments

Expense adjustments involve transactions for:

- Depreciation
- Bad Debts
- Inventory Loss
- Prepaid Expenses
- Accrued Expenses
- Inventory Write Down

Revenue adjustments involve transactions for:

- Inventory Gain
- Prepaid Sales Revenue
- Other Prepaid Revenue
- Accrued Revenue

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Review Questions

1. Explain with reference to a Qualitative Characteristic why balance day adjustments are required.

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Depreciation

As it appears in Unit 4

Depreciation is the allocation of the cost of an asset over its useful life. The calculation and recording and reporting of depreciation requires understanding of a number of key terms:

- Historical cost – the original purchase price of an asset plus any one-off costs associated with getting the asset into a position and condition for use by the business.
- Useful life – the length of time the business will keep an asset and that asset will provide an inflow of economic benefit to the business. This time period may not be the same as how the asset will last. Some businesses may have a policy of replacing Motor Vehicles every five years while we know a Motor Vehicle will last for longer than that.
- Residual value – the amount the business expects to receive for the asset when it is sold or traded-in at the end of its useful life.
- Depreciable value – the total amount to be depreciated over the useful life of the asset. Found by deducting Residual Value from Historical Cost.
- Depreciation expense – the part of the value of the asset that is consumed each reporting period.
- Accumulated depreciation – the total amount of depreciation charged against an asset at that point in time.
- Carrying value – the unallocated cost of an asset plus the residual value at a point in time. Found by deducting accumulated depreciation from historical cost.

Depreciation is charged at a fixed percentage (called the straight-line method) on the Historical Cost of an asset.

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