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Describe The Nature and Purpose of an Adjusted Trial Balance

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Abstract

In accounting rules, after a trial balance is prepared, not all trial balance figures can be used for financial statements because some account balances, estimates, and account adjustments have not been able to show the correct value according to accounting rules. Therefore, there needs to be a change in the account balance and it must be adjusted in the company's general ledger at the end of the accounting cycle for the purpose of recording the unrecognized revenue or expense for the period. Adjusting journal entries are made to display the adjusted trial balance based on the actual situation. Financial statements based on an adjusted trial balance will reflect the actual state of the company based on accounting rules.

Through the literature study method, the author explains the nature and purpose of an adjusted trial balance, how to record adjusting journal entries, how to prepared adjusted trial balance and their impact on financial statements.

Keywords : Trial balance, adjusting journal entries, adjusted trial balance, financial statements.

1. INTRODUCTION

Trial balance contains the company's account balances, usually at the end of the accounting period. The trial balance contains a list of accounts in order of accounts in the general ledger, with debit balances listed in the left column and credit balances in the right column. The sum of the two columns must be the same.

The trial balance does not prove that the company records all transactions or that the general ledger is correct. Errors may occur even though the trial balance columns are the same. Therefore, it is necessary to make an adjusting entry to adjust for errors that may occur such as unrecorded transactions (Siahaan et al., 2018).

Entries in adjusting journal entries are classified as deferrals and accruals, each of which has two subcategories. Prepaid expenses and unearned revenues for deferrals and accrued revenues and accrued expenses for accruals.

Based on adjusting journal entries then adjusted trial balance can be compiled to show all account balances, including those adjusted at the end of the accounting period. An adjusted trial balance will show the impact of all financial events that occurred during the accounting period (Hasibuan et al., 2020). The financial statements based on the adjusted trial balance will reflect the actual state of the company. This paper reviews the description and discussion of the purpose of an adjusted trial balance, recording adjusting journal entries, preparing an adjusted trial balance, and preparing financial statements.

2. LITERATURE REVIEW

A trial balance is a list of accounts and their balances at a given time (Weygandt, Kimmel & Kieso 2018). A trial balance prepared by accounts in the general ledger is called an unadjusted trial balance. Before financial statements can be prepared, some accounts on the unadjusted trial balance must be adjusted. When preparing financial statements, the company's economic life is divided by time period, for example monthly, quarterly, or annually. The concept of accounting period requires that revenues and expenses be reported in the proper period (Warren, Carl S., dkk. 2017). Adjusting entries are required to follow the principles of revenue recognition and expense recognition in the accounting period concept. The use of adjusting entries makes it possible to properly report assets, liabilities, and equity in the statement of financial position, income and expenses correctly in the income statement (Safira et al., 2020).

Entries in adjusting journal entries are classified as deferrals and accruals, each of which has two subcategories.

- Adjusting entries for deferrals

Without deferral adjustments, asset and liability accounts would be overstated, and related expenses and revenues would be understated. Thus, adjusting entries for deferrals will decrease the value of the financial statements and increase the value of the statements on the income statement (Kieso, Weygandt, & Warfield, 2017).

Deferrals has two sub-categories, there are :

1. Prepaid Expense

Prepaid expenses are costs that expire with the passage of time (e.g., rent and insurance) or through use (e.g., supplies). The expiration of these costs does not require daily entries, which would be impractical and unnecessary. Accordingly, companie postpone the recogation of such cost expirations until they prepare financial statement. At each statement period and to show the remaining amounts in the asset accounts.

2. Unearned Revenue

Unearned revenue are revenues that receive in cash before services are performed. Unearned revenue recorded as a liability by increasing a liability account. During the accounting period, it is not pratical to make daily entries as the company performs services. Accordingly, companie postpone the recogation of revenue until they prepare financial statement. At each statement period and to show the remaining amounts in liability accounts.

- Adjusting entries for accruals

Without accrual adjustments, a revenue account (and related asset account) or expense account (and related liability account) is understated. Thus, adjusting entries for accruals will increase the statement of financial position account and the income statement account.

Accruals has two subcategories, there are :

1. Accured Revenues

The revenue recognition principle requires companies to recognize revenue in the accounting period in which the performance obligation is satisfied. Performance obligations are met by the company by performing services or providing goods to customers.

2. Accured Expenses

In recognizing expenses, accountants follow a simple rule “Let the expenses follow the revenues”. That is expense recognition is tied to revenue recognition.

The expense recognition principle requires companies to recognize expenses in the accounting period in which they make efforts (consume assets or incur liabilities) to generate revenue.

- Adjusting entries for depreciation

Fixed assets or plant assets are physical resources that are owned and used by a business and are permanent or have a long life. Fixed assets, such us office equipment, are used to generate revenue. As time passes, the equipment loses its ability to provide useful services. This decrease in usefulness is called depreciation (Warren, Carl S., dkk 2018). As a fixed asset depreciaties, a portion of its cost should be recorded as an expense, called depreciation expense. Then, an account entitled accumulated depreciation is increased (credited).

After journalizing and posting all adjusting entries, an adjusted trial balance can be prepared. The adjusted trial balance will show the balances of all accounts, including the adjusted ones, at the end of the accounting period. Thus, the adjusted trial balance shows the impact of all financial events that occurred during the accounting period.

The adjusted trial balance is prepared to be used as a basis in the preparation of financial statements, so that the resulting financial statements can reflect the actual situation. Because, the Adjusting Journal before the adjusted trial balance has been prepared following the revenue recognition and expense recognition principles in the accounting period concept.

3. METHODS

The approach adopted in this study is to go through a collection of previous literature and examples to illustrate what an adjusting journal is and how it is recorded. This journal will provide examples of cases that may occur in the company.

The purpose of this journal is to help users how to record adjusting journals and prepare adjusted trial balance in company from accounting side as the basis for preparing financial statements.

Adjusting journal entries :

1. Prepaid Expense

Prepaid expenses are costs that expire with the passage of time (e.g., rent and insurance) or through use (e.g., supplies). Insurance, companies purchase insurance to protect

themselves from losses due to fire, theft, and unforeseen events. At the financial statement date, companies increase (debit) insurance expense and decrease (credit) prepaid insurance for the cost of insurance that has expired during the period. Unearned Revenue.
For the example :
PT RST, on April 4th, paid $12,000 for a one-year fire insurance policy, starting April 1st. PT RST debited the premium for prepaid insurance at that time. This account still shows a balance of $12,000 on the April 30th trial balance. This analysis reveals that the insurance expires each month for $1,000 ($12,000 : 12).

Adjusting Journal Entry :

Date	Account	Reff	Debet	Credit
April 30th	Insurance Expense		$1,000	
	Prepaid Insurance			$1,000

2. Accrued Revenue
The revenue recognition principle requires companies to recognize revenue in the accounting period in which the performance obligation is satisfied.
For the example :
PT RST provides advertising services to Grocery Store on April 30th. PT RST received $10,000 for the advertising services on May 20th. PT RST should have recorded revenue in April when it performed the service, rather than May when it received the cash. At April 30th, PT RST will report receivable on its statement of financial position and revenue in its income statement for the service performed.
Adjusting Journal Entry :

Date	Account	Reff	Debet	Credit
April 30th	Account Receivable		$10,000	
	Service Revenue			$10,000

3. Accured Expense
The expense recognition principle requires companies to recognize expenses in the accounting period in which they make efforts (consume assets or incur liabilities) to generate revenue.
For the example :
PT RST should report the salaries & wages expense incurred in performing the April 30th advertising service in the same period in which it recognizes the service revenue for $2,000.
The critical issue in expense recognition is when the expense makes its contribution to revenue. If PT RST does not pay the salaries & wages incurred on April 30th until May, it would report salaries & wages payable on its April 30th statement of financial position.
Adjusting Journal Entry :

Date	Account	Reff	Debet	Credit
April 30th	Salaries & Wages Expense		$2,000	
	Salaries & Wages Payable			$2,000

4. Depreciation

Fixed asset may be useful for a longer or shorter time than expected, depending on various factors. Thus, depreciation is an estimate rather than a factual measurement of expired cost. A common procesure in computing depreciation expense is to divide the cost of the assset by useful life. The adjusting entry to record depreciation of fixed assets, same as the adjustment for supplies. The account being debited is a depreciation account. However, the account credited is accumulated depreciation.

For example :

Cost of the office equipment PT RST is $30,000. Useful life is expected to be 5 years. Analysis reveals that annual depreciation is $6,000 ($30,000 : 5) or $500 per month ($6,000 : 12). The office equipment acquired by the company on january 1st .

Adjusting Journal Entry :

Date	Account	Reff	Debet	Credit
April 30th	Depreciatio Expense		$500	
	Accumulated Depreciation – Office Equipment			$500

4. RESULT AND DISCUSSION

4.1 Result

All transactions that have been adjusted in the adjusting journal will be used as the basis for changing the balance in the unadjusted trial balance into an adjusted trial balance.

Sample case for the conditions change from unadjusted trial balance into an adjusted trial balance use all the transaction that have been adjusted in the adjusting journal : There is unadjusted trial balance of PT RST on April 30th

PT RST Unadjusted Trial Balance For the Month Ended April 30			
Account	Reff	Debet	Credit
Cash		$17,000	
Account Receivable		3,500	
Supplies		15,000	
Prepaid Insurance		12,000	
Office Equipment		30,000	
Accumulated Depreciation - Office Equipment			1,500
Notes Payable			5,000
Account Payable			15,500
Unearned Service Revenue			15,000
Salaries and Wages Payable			1,000
Interest Payable			500
Share Capital - Ordinary			39,500
Retained Earings			-
Dividends		500	
		$78,000	**$78,000**

Adjusting journal entries that have been compiled based on the example of the PT RST case in April :

PT RST **Adjusting Journal Entries** **For the Month Ended April 30**			
Account	Reff	Debet	Credit
Insurance Expense Prepaid Insurance *(Prepaid Expense)*		$1,000	$1,000
Supplies Expense Supplies *(Prepaid Expense)*		$10,000	$10,000
Unearned Service Revenue Service Revenue *(Unearned Revenue)*		$5,000	$5,000
Account Receivable Service Revenue *(Accrued Revenue)*		$10,000	$10,000
Salaries & Wages Expense Salaries & Wages Payable *(Prepaid Expense)*		$2,000	$2,000
Depreciation Expense		$500	
Accumulated Depreciation – Office Equipment *(Prepaid Expense)*			$500

To prepare an adjusted trial balance of PT RST, the amounts in the adjusting journal entries must be compared with the amounts in the unadjusted trial balance. The amounts highlighted in color are those affected by the adjusting entries.

PT RST Unadjusted Trial Balance For the Month Ended April 30			
Account	Reff	Debet	Credit
Cash		$17,000	
Account Receivable		13,500	
Supplies		5,000	
Prepaid Insurance		11,000	
Office Equipment		30,000	
Accumulated Depreciation - Office Equipment			2,000
Notes Payable			5,000
Account Payable			15,500
Unearned Service Revenue			10,000
Salaries and Wages Payable			3,000
Interest Payable			500
Share Capital - Ordinary			39,500
Retained Earings			-
Dividends		500	
Service Revenue			15,000
Insurance Expense		1,000	
Supplies Expense		10,000	
Salaries & Wages Expense		2,000	
Depreciation Expense		500	
		$90,500	**$90,500**

By using an adjusted trial balance, PT RST can directly prepare financial statements. Because the adjusted trial balance has been prepared in accordance with the principles of revenue recognition and expense recognition in the accounting period concept.

PT RST Income Statement For the Month Ended April 30		
Revneues		
Service Revenue		$15,000
Expenses		
Insurance Expense	$ 1,000	
Supplies Expense	$10,000	
Salaries & Wages Expense	$ 2,000	
Depreciation Expense	$ 500	
Total Expenses		$13,500
Net Income		**$ 1,500**

PT RST Retained Earnings Statement For the Month Ended April 30	
Retained Earnings, April 1	-
Add : Net Income	$1,500
	$1,500
Less : Dividends	($ 500)
Retained Earnings, April 30	**$1,000**

PT RST Income Statement For the Month Ended April 30					
Assets			**Liabilities & Equity**		
Cash		$ 17,000	Liabilities		
Account Receivable		$ 13,500	Notes Payable	$ 5,000	
Supplies		$ 5,000	Account Payable	$ 15,500	
Prepaid Insurance		$ 11,000	Unearned Service Revenue	$ 10,000	
Office Equipment	$ 30,000		Salaries and Wages Payable	$ 3,000	
Less : Accumulated Depreciation - Office Equipment	($2,000)		Interest Payable	$ 500	
		$ 28,000	Total Liabilities		$ 34,000
			Equity		
			Share Capital - Ordinary	$ 39,500	
			Retained Earings	$ 1,000	
			Total Equity		$ 40,500
Total Assets		**$ 74,500**	**Total Liabilities & Equity**		**$ 74,500**

The financial statements of PT RST above are prepared based on the adjusted trial balance. So it has reflected the actual situation of PT RST for the month ended April 30th .

4.2 Discussion

The trial balance that has been prepared at the end of the period based on the list of accounts in the general ledger still has to be adjusted to show the actual state of the company. By making adjusting entries, an adjusted trial balance can be prepared in accordance with the principles of revenue recognition and expense recognition in the accounting period concept. The use of adjusting entries will make it possible to properly report assets, liabilities, and equity in the statement of financial position, income and expenses correctly in the income statement. The adjusted trial balance, then prepared by comparing the unadjusted trial balance with the adjusting journal entries. The purpose of an adjusted trial balance are to show the balances of all accounts, including the adjusted ones, at the end of the accounting period, to shows the impact of all financial events that occurred during the accounting period and to used as the basis for preparing financial statements, so that the resulting financial statements can reflect the actual situation.

5. CONCLUTION

A trial balance is a list of accounts and their balances at a given time (Weygandt, Kimmel & Kieso 2018). Before financial statements can be prepared, some accounts on the unadjusted trial balance must be adjusted. The use of adjusting entries will make it possible to properly report assets, liabilities, and equity in the statement of financial position, income and expenses correctly in the income statement. Entries in adjusting journal entries are classified as deferrals and accruals, each of which has two subcategories. Prepaid expenses and unearned revenues for deferrals and accrued revenues and accrued expenses for accruals also there is adjusting entries for depreciation. The adjusted trial balance can prepared by comparing the unadjusted trial balance with the adjusting journal entries. The purpose of an adjusted trial balance are to show the balances of all accounts, including the adjusted ones, at the end of the accounting period and to shows the impact of all financial events that occurred during the accounting period. The adjusted trial balance will used as the basis for preparing financial statements, so that the resulting financial statements can reflect the actual situation of the company.

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