

35.2 An exercise on the nature of some accounting adjustments

Describe and explain the different accounting treatments of:

- closing stock
- fixed assets
- prepayments

In what way are these items similar? Why is the accounting procedure for each of them different, at the end of a period?

Response

Closing stock, fixed assets and prepayments are all unconsumed inputs, which should be excluded from the P&L Account.

Closing stock consists of inputs like purchases, acquired for use in the short term, but not yet consumed at the end of the current period. The usual accounting practice is to put the value of all such inputs into the P&L Account, and then take the unconsumed portion out again. This roundabout treatment is probably adopted because it reflects the only practical method of determining the value of such inputs consumed in a period – by taking stock at the end of a period, and deducting the value of unconsumed inputs from the value of inputs available for consumption.

Fixed assets are inputs acquired for use in the longer term. With these, the usual accounting treatment is to transfer to the P&L only that part of their value that has been consumed in the current period. This treatment is the most logical and direct, even though the value consumed must in any case be estimated.

Prepayments reflect inputs recorded in the accounts because they have been paid for, even though the firm has not yet received the input. Here the usual treatment is in effect to take the value of input not yet received out of the input account before transferring the remaining value to the P&L Account.