20. Reversing Entries

Reversing entries are an optional accounting procedure which may prove useful in simplifying record keeping. A reversing entry is a journal entry to "undo" an adjusting entry. You will soon see how reversing entries can simplify the overall process.

First, consider this example, which does not utilize reversing entries. An adjusting entry was made to record $2,000 of accrued salaries at the end of 20X3. The next payday occurred on January 15, 20X4, when $5,000 was paid to employees. The entry on that date required a debit to Salaries Payable (for the $2,000 accrued at the end of 20X3) and Salaries Expense (for $3,000 earned by employees during 20X4):

Illustration without Reversing Entries

20X3	--		
12-31-X3	Salaries Expense (20X3)	2,000	
	Salaries Payable		2,000
	Adjusting entry for accrued salaries due to employees at the end of December		
	Note: closing would "zero-out" all expense account at the end of 20X3		
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20X4	--		
1-15-X4	Salaries Expense (20X4)	3,000	
	Salaries Payable	2,000	
	Cash		5,000
	To record payroll, part of which related to prior year service		

Let's revisit these facts using reversing entries. The adjusting entry in 20X3 to record $2,000 of accrued salaries is the same as above. However, the first journal entry of 20X4 simply reverses the adjusting entry. On the following payday, January 15, 20X5, the entire payment of $5,000 is recorded as expense:

Illustration with Reversing Entries

20X3	--		
12-31-X3	Salaries Expense (20X3)	2,000	
	Salaries Payable		2,000
	Adjusting entry for accrued salaries due to employees at the end of December		
	Note: closing would "zero-out" all expense account at the end of 20X3		

20X4			
1-1-X4	Salaries Payable	2,000	
	Salaries Expense (20X4)		2,000
	Reversing entry for accrued salaries		
1-15-X4	Salaries Expense (20X4)	5,000	
	Cash		5,000
	To record payment of salaries		

The net impact of these procedures is to record the correct amount of salary expense for 20X4 ($2,000 credit and $5,000 debit, produces the correct $3,000 net debit to salaries expense). You may find it odd to credit an expense account on January 1, because, by itself, it makes no sense. The credit only makes sense when coupled with the subsequent debit on January 15. Notice from the following diagram that both approaches produce the same final results:

WITHOUT REVERSING ENTRIES:

20X3			
12-31-X3	Salaries Expense	2,000	
	Salaries Payable		2,000
	Adjusting entry for accrued salaries due to employees at the end of December		
	Note: closing would "zero-out" all expense account at the end of 20X3		
20X4			
1-15-X4	Salaries Expense	3,000	
	Salaries Payable	2,000	
	Cash		5,000
	To record payroll, part of which related to prior year service		

WITH REVERSING ENTRIES:

20X3			
12-31-X3	Salaries Expense	2,000	
	Salaries Payable		2,000
	Adjusting entry for accrued salaries due to employees at the end of December		
	Note: closing would "zero-out" all expense account at the end of 20X3		
20X4			
1-1-X4	Salaries Payable	2,000	
	Salaries Expense		2,000
	Reversing entry for accrued salaries		
1-15-X4	Salaries Expense	5,000	
	Cash		5,000
	To record payment of salaries		

BY COMPARING THE ACCOUNTS AND AMOUNTS, NOTICE THAT THE SAME END RESULT IS PRODUCED!

In practice, reversing entries will simplify the accounting process. For example, on the first payday following the reversing entry, a "normal" journal entry can be made to record the full amount of salaries paid as expense -- without having to give special consideration to the impact of any prior adjusting entry. Reversing entries would ordinarily be appropriate for those adjusting entries that involve the recording of accrued revenues and expenses; specifically, those that involve future cash flows. Importantly, whether reversing entries are used or not, the same result is achieved!