

1. Accounting adjustments are made because the amounts in the accounts do not automatically reflect the correct amounts of economic stocks and flows.
2. Accounting adjustments are necessary to:
 - 1) reflect a more accurate picture of the value of an asset used during the accounting period to generate revenues, or 2) to estimate the amount of value remaining from an asset using an allocation process.
3. Examples of adjustments could include:
 - 1) Depreciation or amortization of a long-lived asset.
 - 2) The recording of the "using up" of supplies or inventory.
 - 3) An accrual of an expense or revenue not reflected in the transactions that have been recorded.
4.
 - 1) The first approach is a "plug" approach. This approach determines what the ending balance of a balance sheet asset or liability should be. The amount of expense or revenue is the difference between the book value of the asset and what that ending value should be. An example would be adjusting the supplies account at year end to show the amount of supplies that have been used during the accounting period, after a physical count to determine what is left.
 - 2) The second approach is the "allocation" approach. This approach estimates the amount of expense by making an estimate of the benefit used up on an asset. An example of this approach would be depreciation or amortization of an asset.
5. The depreciation or amortization is an allocation approach.
6. The balance sheet approach focuses on estimating the value of the asset or liability on the balance sheet and determining the income statement number based on the numbers required on the balance sheet to arrive at the revenue or expense for the period.
7. The two properties of cash flows that affect their value are timing and uncertainty.
8. Interest is the charge levied to postpone the payment or receipt of funds. It is the cost of money.
9. Compound interest is computing interest on previous interest.
10. A future value is the amount to be received at a specified future date at a given interest rate.
11. A present value is the starting amount that will produce a given ending amount at some specified date in the future at a given interest rate.
12. Present values allow accountants to compute the current economic

values of cash flows, which affects the accounting values of some assets and liabilities.

13. An expected value of a cash flow is the sum of all possible cash flows, weighted by their probabilities of occurrence.
14. Present and expected values are combined when we discount expected cash flows. This process may be necessary to prepare adjustments for large balance sheet items such as fixed asset impairments, intangible assets, estimates of pension plan values, and health care benefits to be paid to retired workers.
15. Expected values provide estimates of future cash flows, which are necessary to determine the amount of accounting adjustments required on certain assets and liabilities.
16. Normal economic earnings of an asset are the result of the increase in value of an asset due to interest.
17. Because interest effects will only increase values, normal economic earnings are always positive.
18. Any change in value of an asset from its expected change in value is called abnormal economic earnings.
19. Abnormal economic earnings take into account both good and bad news. If good news arrives, abnormal economic earnings will be positive; if bad news arrives, they will be negative.