**Prepaid Expenses – Example insurance**

Often insurance is paid in advance. (Think of your own car insurance.) The journal entry would be either:

Prepaid Insurance 2,400 Prepaid Insurance 2,400

 Cash 2,400 Accounts Payable 2,400

 Accounts Payable 2,400

 Cash 2,400

Insurance policy is for 24 months.

An asset prepaid insurance is debited (It is an asset because it benefits future periods. If it had benefited the current period only, it would have been an expense). Cash is reduced with a credit. Or it is purchased on credit (accounts payable) and subsequently paid in cash.

The asset prepaid insurance will become an expense as each month expires to match the expense of the insurance to the revenue it helped to generate for the month. This will be done for each of the 24 months. To calculate the adjusting journal entry, you must determine the amount of time that has passed since the last financial statement date to determine the AJE. If one month has passed since the last F/S, the 1/24th of the insurance has changed from an asset to an expense. The AJE would be:

Insurance expense 100

 Prepaid insurance 100

Notice both an asset (B/S) and an expense (I/S) account were affected. The general ledger balance of the prepaid insurance account is now reduced by $100.



If the company were to change insurance carriers, they would request a refund but would only receive $2,300 because one month has expired.

If the example were to be prepaid rent, the same dynamics would hold.