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The license may not give you all of the permissions necessary for your intended use. For example, other rights such as publicity, privacy, or moral rights may limit how you use the material. A legal fees journal entry isn't very different from the other expense journal entries. It's just that the name and nature of the expense is different. So, the accounting treatment is the same. Fees paid to Legal Counsel or Attorney Fees Expenses incurred by Directors of the company or other persons representing the company or individuals themselves for attending the legal proceedings Expenses incurred in respect of lawsuit filed by or against the entity Court Costs/Statutory fees Legal Consultation fee Retainer-ship fees I think the above list helps to get a sense of the term "Legal Fees." All these expenses are not like capital. Therefore, recording these as expenses in the same year is appropriate unless the expenses have enduring benefits. These cases falling under the bucket of an enduring nature are very unusual. The short answer is yes. The Long answer is Legal fees are also an expenditure. If any expenditure benefits for more than a year then it can be deferred and carried over in the balance sheet as miscellaneous expenditure is possible. This deferment is in line with the matching concept as well. For instance, ABC Company notes that its copyright is infringed by XYZ company. Copyright is related to the ABC Company's most profitable product. ABC Company's reputation is at stake. So, Legal proceedings are initiated by the ABC Company. So, ABC Company hired the best legal counsel. Expenses are huge. A lawsuit filed against the company is favorable and resulted in high legal and court fees. However, these expenses result in benefits that do not relate to only one period. Further, the amounts can be so high that they can distort the current year's income if charged off as expenses. This is the best example of recording the expenditure as Miscellaneous expenses under the assets side. Ensure compliance with Laws and Regulations Ensure smooth running of the business Initiate or Defend Legal proceedings Also Read: TDS receivable Journal entry Legal Fees Journal Entry: Legal Fees are expenses. This is a nominal account. If we go back to the Golden Rules of Accounting, we debit all the expenses & losses and credit all the incomes & gains. Therefore, debit the Legal fees GL in the journal entry. The short answer is Bank or Liability. The long answer is it depends. If the payments are made immediately, then it would be a bank account. However, if a credit period is allowed and payment is deferred, then the liability account comes into the picture. For more convenience, the naming of the Liability GL account can be done with due respect to its nature. If it relates to Legal fees, then it's called Legal fees payable. What is the Legal fees journal entry? The net effect of the above two journal entries is a debit to Legal fees and credit to the bank account. Legal fees are also expenditures and fall under the nominal account. Per the Golden Rules of Accounting, all expenses need to be debited. So, the corresponding credit will be bank or liability based on full payment or deferring payment respectively. This accounting treatment isn't a new one. We just need to understand the nature of the transaction and confirm if we need to affect the legal fees GL or not. Hope this article gives a good understanding of the legal fees journal entry. Let us know your thoughts or questions in the comments section. Recommended Articles: Commission Received Journal EntryTDS Receivable Journal EntrySalary TDS Journal EntryOutstanding Expenses Journal Entry Write Off How Does an Inventory Write-Down Impact the Balance Sheet? for given inventory to match its current market value of a company's inventory drops below the recorded carrying value on the balance sheet.Often referred to as "inventory impairment", an inventory write-down is an accounting term describing the reduction in the inventory balance in the event that the market value of inventory falls below its book value, yet remains sellable.Under the reporting guidelines established by U.S. GAAP, the reduction in the inventory balance is intended to improve the transparency of a company's financial health, namely for the sake of not misleading investors.How to Write-Down Inventory? Compliance with U.S. GAAP reporting standards mandates that companies write off inventory as an expense right after the determination that the inventories lost a significant percentage of their original value.Inventory is reported on the balance sheet at its historical cost, however, reductions are often necessary based on the lower-of-cost-or-market (LCM) rule.The recorded cost can vary based on the inventory valuation method abided by the company. In practice, the three most common inventory accounting methods are the FIFO, LIFO and average cost methods. Inventory Accounting Method Description FIFO ("First In, First Out") The inventories purchased on an earlier date are first in line to be recognized and expensed on the income statement, usually within the cost of goods sold (COGS) line item. LIFO ("Last In, First Out") The inventories purchased more recently are recorded ahead of those purchased in the past (and recognized sooner on the income statement). Average Cost Method The total cost of production is divided by the quantity of units produced, which serves as a compromise between FIFO and LIFO. However, irrespective of the inventory costing method used, the conservatism principle of accrual accounting of financial statements. The principle of conservatism establishes the guideline that revenue and assets can only be recognized when the probability of occurrence is near certain. Further, conservatism in accounting is rooted in the notion that understated revenue and asset values are preferable over the opposite scenario, where recorded costs and liabilities are understated. With that said, the conservatism principle is the centerpiece of the lower of cost or market rule (LCM), which requires assets like inventory to be reported at the lesser value between historical cost or market value as of the present date. On the other hand, losses must be recognized promptly soon after the cost or expense is quantifiable — for example, the receipt of an invoice from a supplier or vendor is enough to warrant an adjustment. What Causes Inventory Write-Down to Occur?An inventory write-down reduces the book value of inventory by the incremental loss in market value. Hence, the post-adjustment balance will be of lesser value than its prior book value.In most scenarios, write-downs are caused by external, unanticipated factors such as accidental damage, obsolescence, or material changes in market conditions (e.g. shifts in consumer preferences and behavioral patterns).The reason for the necessity of an inventory write-down can stem from numerous factors, such as the following: Inventory Issue Description Obsolescence Technological developments or significant secular shifts in a given market can completely alter an industry, resulting in obsolete inventory. Since the inventory could technically still be sold, the reduced value remains on the balance sheet — albeit, the pool of potential buyers is likely substantially reduced. Inventory Damage (or Physical Deterioration) Inventory can often become damaged from various factors such as accidental mistakes by employees or natural disasters. If the inventory is deemed repairable, the write-down must include the cost of repair. In the case of spoilage, the trade-off in spending between restoring the inventory and purchasing new inventory must be considered. If restoration costs more than placing a new order, it would not make sense economically to recover the inventory. Inventory Expiry Certain inventory, such as products with a limited shelf life, can approach their expiration date while under possession of the company. While the inventory could technically be sold, the company will likely need to discount any pricing (and once the estimated value is quantified, the downward adjustment must then be recorded). For inventory left unsold past the expiration date, the write-down would eventually become a write-off, which we'll elaborate upon in a later section. Unfavorable Secular Trends (Changes in Demand) Consumer behavioral patterns and preferences are continuously changing, and new product innovations can disrupt existing incumbents in the market and traditional norms. Regulatory Risk Regulations enforced by the federal government or related governmental bodies can influence margins and marketability (or perhaps even legality in certain states) for certain products. The incurred fees to adjust to the new regulatory environment and reduced market demand can create problems for the company, which must be reflected on the balance sheet for transparency. For instance, one sector prone to such risks and "hurdles" is healthcare (e.g. telemedicine). Quality Issues Inventory orders can often arrive with quality issues that render them unusable (and thus unsellable). Inventory unable to pass quality control inspections will likely need to be adjusted by a write-off. Excess Inventory Management can often order excess inventory, causing overstocking (i.e. the pile-up of unsold products). Over time, management's ability to perform internal demand planning and forecasting should improve, reducing the risk of excess inventory. Apple, Inc. Risk Factors Section (Source: AAPL 2023 10-K) Inventory Write-Down FormulaUnder U.S. GAAP accounting standards (FASB), the lower of cost or market (LCM) rule is used to value inventories. The LCM rule states that the inventory carrying balance recorded must reflect the lesser value of the original cost or current market value.The current market price is the expected replacement cost of inventory, or the cost of acquiring the asset on the reporting date.Inventory Write-Down = Historical Cost − Lower of Cost or Market (LCM)Under IFRS accounting standards, on the other hand, the write-down equals the difference between the historical value and net realizable value (NRV).Inventory Write-Down = Historical Cost − Lower of Cost or NRV (LCNR)The market value must be less than the net realizable value (NRV), including the NRV reduced by the normal profit margin. If not, the inventory is not impaired and a write-down is not necessary.The formula for calculating the net realizable value (NRV) is the difference between the expected sale price from the ordinary course of business and the costs related to selling the inventory, such as repairing the inventory to improve its condition and marketability.Net Realizable Value (NRV) = Expected Sale Price - Total Sale Costs Expected Sale Price → The estimated price at which the inventory could be sold in the open markets, i.e. the replacement cost as of the present date. Total Sale Costs → The total costs expected to be incurred in the process of marketing and selling the asset to potential buyers. The current market value of the inventory, or replacement cost, cannot exceed the net realizable value (NRV), nor the NRV adjusted by a normal profit margin. If the inventory market value increased to $140k, rather than declining to $100k, the higher value would not be recognized per the lower of cost or market (LCM) guidelines. The lower figure is still the amount that appears on the balance sheet, reflecting the conservatism principle. Therefore, even if the market value exceeds the cost, the "gain" is not recognized until a sale occurs, such as after an acquisition. Note: The reversal of an inventory write-down is not permitted under US GAAP. In contrast, a reversal is permissible under IFRS. How Does an Inventory Write-Down Impact the 3 Financial Statements? Income Statement (P&L) → The less attributable to the inventory write-down is recognized as either cost of goods sold (COGS) or separately in the non-operating items section. The write-down is a non-recurring item not part of the core operations of the business, however, and reduces pre-tax income (EBT). In effect, net income in the current period and earnings per share (EPS) figures are reduced from the write-down. Cash Flow Statement (CFS) → In the cash flow from operations (CFO) section of the statement of cash flows, the inventory write-down is added back to net income since the reduction is a non-cash item. In other words, there was no real movement in cash. However, the free cash flow (FCF) of the company can be influenced by the change in the inventory line item. Balance Sheet (BS) → On the assets side of the balance sheet, the carrying value of inventory is reduced by the write-down. On the other hand, the corresponding impact on the liabilities and shareholders' equity side is via the reduction in net income, which flows into retained earnings. What is the Journal Entry for Inventory Write-Down?If a company recognizes an inventory write-down in a given period, the coinciding journal entry comprises recording a debit entry for "Loss on Inventory Write-Down", while a credit entry is applied to the "Inventory" account.Suppose a manufacturing company purchased inventory at an original cost of $120k but now its market value has decreased to $100k from reduced customer demand.The journal entry to reflect the $20k decline in inventory value would be as follows: Debit Entry → Loss on Inventory Write-Down Credit Entry → Allowance for Inventory Losses (or Cost of Goods Sold) Inventory Write-Down Journal Entry Example Journal Entry Debit Credit Loss on Inventory Write-Down $20,000 — Allowance for Inventory Losses — $20,000 The credit entry to the "Allowance for Obsolete Inventory" account — which functions as a contra-account — offsets the inventory line item to calculate the ending net value of inventory for the reporting period.In our hypothetical example, the "Inventory" account is adjusted by the debit entry of $20k, while the "Allowance for Obsolete Inventory" account reflects a credit balance of $20k.Therefore, the ending net inventory balance is $100k, the value recognized on the current period balance sheet. Ending Net Inventory = $120k − $20k = $100k Inventory Write-Down Journal Entry Example Journal Entry Debit Credit Loss on Inventory Write-Down $20,000 — Inventory — $20,000 Note: If the write-down amount is immaterial, the debit is applied to the cost of goods sold (COGS) account.Inventory Write-Down vs. Write-Off: What is the Difference?An inventory write-down and write-off are two common accounting adjustments to inventory that reduce the carrying value of inventory on the balance sheet. But while the circumstances for both share commonalities, one particular distinction must be understood. Inventory Write-Down → In an inventory write-down, the adjustment to the recorded inventory value occurs after the market value of the company's inventory falls below its book value. However, the written-down inventory still retains some residual market value and thus could be sold. Inventory Write-Off → An inventory write-off is conceptually the same as an inventory write-down. The distinction pertains to the severity of the loss in market value. For instance, the value of a company's inventory could be entirely wiped out by a fire or theft. Therefore, an inventory write-down is a partial reduction in market value, whereas an inventory write-off is the complete removal of the corresponding value from the company's books. An inventory write off is the process of reducing the value of the inventory of a business to record the fact that the inventory has no value. The inventory write off can occur for a number of reasons such as loss from theft, deterioration, damage in transit, misplacement etc.As an example, suppose a business has a product in inventory which cost 1,000, and has had to scrap the product due to its damaged condition. In this case the business knows the value of the inventory is zero and throws it away. This is distinct from the situation where a business wants to make an allowance against the inventory value for an estimated reduction in value and writes down the value of the inventory.Inventory Write Off Journal EntryThe value of the inventory has fallen by 1,000, and the reduction in value needs to be reflected in the accounting records. The inventory write off journal entry is as follows:Inventory Write Off Journal EntryAccountDebitCreditLoss on inventory write off1,000Inventory1,000Total1,0001,000The journal entry above shows the inventory write-off expense being debited to the Loss on inventory write off account. Where an accounting textbook transaction using the phrase "on account" means that the goods have been received but payment will be made later. When a payment is owed, we record it in a liability account called "Accounts Payable." In the accounting equation, Assets = Liabilities + Owners Equity means that the total assets of the business are always equal to the total liabilities of the business This is true at any time and applies to each transaction. For this transaction the Accounting equation is shown in the following table. In this case, the asset of inventory has been decreased by a 1,000 and an expense of 1,000 (loss on inventory write off account) is included in the income statement. The expense reduces the net income of the business which reduces the retained earnings and therefore the owners equity in the business.A write off is similar to a write down, except that with a write down, the asset is still left with a book value whereas with a write off the value of the asset is reduced to zero.Popular Double Entry Bookkeeping ExamplesAnother double entry bookkeeping example for you to discover.Cash ReceiptAccrued Expenses ExampleLast modified October 22nd, 2019 by Michael Brown October 22, 2019 Asset Retirement Obligation Journal EntryAccounts receivable is a crucial current asset of the business. Are you wondering why it is? The answer is simple. It's just one step behind from being converted into money. Entities need liquidity to sustain in the business irrespective of the form of money (either ... [Read more...] about Accounts receivable interview questionsCapitalized Commissions journal entry is to recognize an expense as asset considering the tenure of the benefits flowing from it. Commissions is a percentage on the value of the original transaction. If the transaction pertains to the sale of goods, the commission is a ... [Read more...] about Capitalized commissions journal entryPerforming the cut off procedures in audit is a testing approach to identify if the recording of financial information occurs within correct period. Cut off is an audit assertion. Auditor test this assertion to obtain sufficient audit evidence that an account balance is ... [Read more...] about How to perform the cut off procedures in audit?SALY stands for Same as Last Year, an abbreviation used in public accounting. Auditors commonly use it in their work papers. SALY is used when the audit team plans to perform the same procedures as the prior year and the approach has not changed. The auditor's job often ... [Read more...] about What does SALY (Same as Last year) mean in public accounting terms? Perpetual inventory system and period inventory system are the two methods of accounting for inventory that is different from one to another. Likewise, the inventory sale journal entry will be different if one company follows the perpetual system while another company follows the periodic system.This is due to under the perpetual system, the company keeps updating the inventory record (i.e. inventory in or out) throughout the period while, under the periodic system, the company only updates the inventory record at the end of the accounting period.Hence, the inventory account will only show up in the inventory sale journal entry if the company uses the perpetual system. On the other hand, there will be only accounts receivable or cash account with sales revenue if the company uses the periodic system. In any case, the journal entry of inventory sale will affect both the balance sheet and the income statement.Inventory sale journal entryPerpetual inventory systemUnder the perpetual system, the company can account for inventory sale by making two journal entries. The first entry is to recognize the sale revenue that the company makes by debiting accounts receivable or cash and crediting sales revenue account. Another journal entry is to recognize the cost of goods sold as a result of sale by debiting the cost of goods sold account and crediting the inventory account.AccountDebitCreditAccounts receivable/cash000Sales revenue000AccountDebitCreditCost of goods sold000Inventory000In this journal entry, the company records the cost of goods sold as well as updates the inventory balances on the date of inventory sale. Likewise, the inventory balances will be up to date and the company can review it anytime without making physical inventory count. Of cause, the company still performs the physical count of inventory sometimes for the control purpose.Periodic inventory systemUnder the periodic system, the company makes only one journal entry for inventory sale by debiting accounts receivable or cash account and crediting the sales revenue account.AccountDebitCreditAccounts receivable/cash000Sales revenue000Unlike the perpetual inventory system, there is no cost of goods sold account or the inventory account in the above journal entry. This is due to, under the periodic system, the company does not record the cost of goods sold nor make any update to the inventory balances on the date of sale.Likewise, the inventory balances at the end of the accounting period will be based on the actual physical count of inventory. At the same time, the cost of goods sold during the period will be calculated by using the beginning inventory plus purchases minus the ending inventory.ExampleFor example, on October 15, 2020, the company ABC Ltd. makes a $2,000 sale to one of its customers on credit. The goods cost $1,300 in the inventory and the company uses the perpetual system to account for inventory.What is the journal entry for the sale transaction?If the company ABC Ltd. uses the periodic inventory system instead, what is the journal entry for the sale above?Solution:Perpetual inventory systemUnder the perpetual system, the company ABC Ltd. can make the journal entry for inventory sale on October 15, 2020, as below:AccountDebitCreditAccounts receivable2,000Sales revenue2,000AccountDebitCreditCost of goods sold1,300Inventory1,300In this journal entry, the company deducts $1,300 from the inventory balances and recognizes it as the cost of goods sold immediately after making sale on October 15, 2020. Likewise, the company can check the inventory account immediately and will see that the inventory balances are reduced by $1,300 after this transaction.Periodic inventory systemABC Ltd. uses the periodic inventory system instead, it will only make a journal entry for sales revenue and accounts receivable on October 15, 2020, as below:AccountDebitCreditAccounts receivable2,000Sales revenue2,000Under the periodic system, the company does not record the cost of goods sold on the date of sale, hence there is no journal entry for 1,300 the cost of goods sold and inventory like the perpetual system above.Likewise, there is no update to the figures of the cost of goods sold and inventory on October 15, 2020. So, if the company checks the inventory account or cost of goods sold after making the sale of $2,000, it will still show the old figures of the previous period. In the business, there may be a case of inventory loss for various reasons. In this case, we need to make the journal entry to write off the lost inventory in order to remove them from our balance sheet.In accounting, the inventory is recorded as a current asset on the balance sheet. Likewise, the lost inventory should be removed from the balance sheet as it no longer exists on the balance sheet.Hence, writing off the lost inventory is necessary in this case as it helps to prevent the overstatement of the total assets on the balance sheet. Additionally, as the lost amount needs to be charged to the income statement as an expense for the period, writing off the lost inventory will also prevent the understatement of total expenses on the income statement.Journal entry to write off the lost inventoryWe can make the journal entry to write off the lost inventory by debiting the loss on inventory write-off account and crediting the inventory account.AccountDebitCreditLoss on inventory write-off##inventory###In this journal entry, the loss on inventory account is an expense account that we need to charge to the income statement for the period. At the same time, the credit of the inventory account represents the decrease of the inventory balance on the balance sheet as a result of the loss that occurred.Writing off the lost inventory exampleFor example, on December 31, we have performed the physical count of the merchandise inventory in order to close the company's accounts at end of the accounting period as we use the periodic inventory system.However, after the count and reconciliation, we found out that there was a $10,000 loss in the merchandise inventory for some reason. Hence, we decide to write off the lost inventory in order to remove them from the balance sheet.In this case, we can make the journal entry to write off the lost inventory by debiting the $10,000 to the loss on inventory write-off account and crediting this same amount to the inventory account to remove this lost amount of inventory from the balance sheet.AccountDebitCreditLoss on inventory write-off10,000Inventory10,000This journal entry will decrease the total assets on the balance sheet by $10,000 as of December 31. And at the same time, it will increase total expenses on the income statement by the same amount