

5-0700.00 PREPAID EXPENSES

5-0710.00 INTRODUCTION

5-0710.10 DEFINITIONS

“**Prepaid expenses**” are payments made during a fiscal year which apply to benefits to be received in a subsequent fiscal year. Prepaid expenses are assets which are gradually consumed or used over time and can be converted back to cash. The items recorded as prepaid expenses are usually regularly recurring costs of operations. For example, prepaid rent and unexpired insurance premiums, including workers’ compensation insurance premiums and comprehensive liability and fire insurance premiums, are items to be classified as prepaid expenses.

5-0710.20 BASIC ACCOUNTING PROCEDURES

Prepayments are recorded as assets when paid and are expensed over time by recording an expenditure each fiscal year for the amount of the related benefits received that year. The expenditure is normally recorded once a year at year-end closing for convenience. This method is called the “consumption method” of recording prepaid items. Alternatively, the district may record prepayments as expenditures when paid, then make adjustments at fiscal year-end to reflect the correct expenditure and prepaid expense (asset) balances. The two methods will provide the same account balances for reporting purposes and are shown below.

Items that constitute prepayments, but will not be recorded as such include maintenance agreements on equipment (if the annual cost is not material), subscriptions for periodicals, dues for organizations such as MASBO and School Administrators of Montana, travel advances, and small purchases usually under \$25 which a vendor requires to be paid in advance. The district will record those payments as expenditures when the warrants are written.

The purchase of textbooks and supplies should never be recorded as a prepaid expense. Record the expenditure as discussed in 5-0600 Supplies. Textbooks may be, but are not required to be, recorded as fixed assets. See 5-1200 Fixed Assets.

5-0720.00 RECORDING PREPAID EXPENSES

Method 1: Prepayment recorded as an asset when paid.

For example, assume the district purchases an insurance policy which covers 2 years beginning December 1 for \$24,000. The amount of expenditure to record for each month is \$24,000 divided by 24 months = \$1000.

To record the payment for a prepaid expense:

| | | |
|--------------------|--------------------------|----------|
| Debit: 240 | Prepaid Expenses | \$24,000 |
| Credit: 620 or 101 | Warrants Payable or Cash | \$24,000 |

(To record the asset and the payment for a contract lasting beyond the current fiscal year.)

5-0720.00 RECORDING PREPAID EXPENSES (Cont'd)

At fiscal year-end, to record an expenditure for the amount of prepaid expense which expired this year: For the first year, December through June 30, the expenditure is 7 months X \$1000 = \$7000.

Year 1

| | | |
|-------------|------------------|----------|
| Debit: 802 | Expenditures | \$ 7,000 |
| Credit: 240 | Prepaid Expenses | \$ 7,000 |

Expenditures Subsidiary Ledger

| | | |
|------------------|--------------------------------------|----------|
| XXX-XXX-XXXX-XXX | Any appropriate object for insurance | \$ 7,000 |
|------------------|--------------------------------------|----------|

(To record at fiscal year end, or periodically during the year, if needed, the portion of the prepaid asset which was used in the current period. That portion is recognized as an expenditure of the current period. The unused asset portion remains on the books as a prepaid expense until consumed in a subsequent period.)

At the end of year 2, when the second year of the prepaid expense has expired: The entry for year 2 of the contract would record 12 months X \$1000 = \$12,000 as expenditures and reduction of the asset.

Year 2

| | | |
|-------------|-----------------|----------|
| Debit: 802 | Expenditures | \$12,000 |
| Credit: 240 | Prepaid Expense | \$12,000 |

Expenditures Subsidiary Ledger

| | | |
|------------------|--------------------------------------|----------|
| XXX-XXX-XXXX-XXX | Any appropriate object for insurance | \$12,000 |
|------------------|--------------------------------------|----------|

(To record the portion of the prepaid asset "used" during the period by reducing the asset balance and recording the expenditure.)

At the end of year 3, when the last portion of the prepaid expense has expired: The entry for year 3 of the contract would record 5 months X \$1000 = \$5000 as expenditures and reduction of the asset.

The asset would be reduced to zero.

Year 3

| | | |
|-------------|-----------------|---------|
| Debit: 802 | Expenditures | \$5,000 |
| Credit: 240 | Prepaid Expense | \$5,000 |

Expenditures Subsidiary Ledger

| | | |
|------------------|--------------------------------------|---------|
| XXX-XXX-XXXX-XXX | Any appropriate object for insurance | \$5,000 |
|------------------|--------------------------------------|---------|

(To record the portion of the prepaid asset "used" during the period.)

Method 2: Prepayment recorded as an expenditure when paid, then adjusted at year-end.

To record the payment for a prepaid expense during Year 1:

| | | |
|--------------------|--------------------------|----------|
| Debit: 802 | Expenditures | \$24,000 |
| Credit: 620 or 101 | Warrants Payable or Cash | \$24,000 |

Expenditures Subsidiary Ledger

| | | |
|------------------|--------------------------------------|----------|
| XXX-XXX-XXXX-XXX | Any appropriate object for insurance | \$24,000 |
|------------------|--------------------------------------|----------|

(To record the asset and the payment for a contract lasting beyond the current fiscal year.)

5-0720.00 RECORDING PREPAID EXPENSES (Cont'd)

At fiscal year-end of Year 1, to adjust expenditures to equal the amount of prepaid expense applicable to the current year: For the first year, December through June 30, the expenditure is 7 months X \$1000 = \$7000. Reduce current expenditures to equal that amount.

Year 1

| | | |
|-------------|------------------|----------|
| Debit: 240 | Prepaid Expenses | \$17,000 |
| Credit: 802 | Expenditures | \$17,000 |

Expenditures Subsidiary Ledger

| | | |
|------------------|--------------------------------------|----------|
| XXX-XXX-XXXX-XXX | Any appropriate object for insurance | \$17,000 |
|------------------|--------------------------------------|----------|

(To record the prepaid asset of \$17,000 (\$24,000 less \$7,000) and to reduce the expenditures to reflect the amount of prepayment applicable to the current year.)

ALTERNATIVELY, THE PRECEDING TWO ENTRIES COULD BE COMBINED: When the warrant is issued to pay the premium, the portion of the payment applicable to the current year may be recorded as an expenditure. The portion applicable to subsequent years should be recorded as an asset using 240 Prepaid Expenses.

Year 1

| | | |
|--------------------|--------------------------|----------|
| Debit: 802 | Expenditures | \$ 7,000 |
| Debit: 250 | Prepaid Expenses | \$17,000 |
| Credit: 620 or 101 | Warrants Payable or Cash | \$24,000 |

Expenditures Subsidiary Ledger

| | | |
|------------------|------------------------------------|----------|
| XXX-XXX-XXXX-XXX | Any appropriate expenditure object | \$ 7,000 |
|------------------|------------------------------------|----------|

(To record the payment for insurance premiums covering a three year period. Whether the preceding two entries or this combined entry are used, the following entries will be recorded.)

At the end of year 2, when the second year of the prepaid expense has expired: The entry for year 2 of the contract would record 12 months X \$1000 = \$12,000 as expenditures and reduction of the asset.

Year 2

| | | |
|-------------|-----------------|----------|
| Debit: 802 | Expenditures | \$12,000 |
| Credit: 240 | Prepaid Expense | \$12,000 |

Expenditures Subsidiary Ledger

| | | |
|------------------|--------------------------------------|----------|
| XXX-XXX-XXXX-XXX | Any appropriate object for insurance | \$12,000 |
|------------------|--------------------------------------|----------|

(To record the portion of the prepaid asset "used" during the period by reducing the asset balance and recording the expenditure.)

At the end of year 3, when the last portion of the prepaid expense has expired: The entry for year 3 of the contract would record 5 months X \$1000 = \$5000 as expenditures and reduction of the asset.

The asset would be reduced to zero.

Year 3

| | | |
|-------------|-----------------|---------|
| Debit: 802 | Expenditures | \$5,000 |
| Credit: 240 | Prepaid Expense | \$5,000 |

Expenditures Subsidiary Ledger

| | | |
|------------------|--------------------------------------|---------|
| XXX-XXX-XXXX-XXX | Any appropriate object for insurance | \$5,000 |
|------------------|--------------------------------------|---------|

(To record the portion of the prepaid asset "used" during the period.)