# Explain the matching principle as it relates to pre-paid expenses, unearned reven...

Finance

Matching Principle Matching Principle: Matching principle is a concept that requires the company to match the revenue and expenses for a specified period of time in order to show the definite results for the period. It relates closely to the accrual accounting concept, where the company computes only those expenses which were incurred in order to generate revenue (Loren A. Nikolai, 2009). This principle deals with the revenue and expenses and in practice it does not permit the management to soften the results by deferring expenses to next year.

Prepaid Expenses:

Prepaid expenses represent those expenses paid by the company the benefit of which has yet to be realized. They provide benefit for a long period of time so it will be necessary to apportion those expenses between more than one periods. For example prepaid insurance is paid for a longer period than one year so, only the expired portion of the prepaid insurance is charged in the income statement. Matching principle states that the prepaid expenses should be apportioned in the period to which they belong or in other words expenses should be recognized not when they are paid but when they are used to generate revenue (Stahl, 2004). The remaining balance of the prepaid expenses should appear in the balance sheet until they are recognized in the income statements.

Unearned Revenue:

Unearned revenues are the revenue of the prepaid expenses. Every entity which prepays an expense before the benefit is actually realized, another entity receives the revenue for which the services have not been rendered these are called unearned revenues or deferred revenue (Jay S. RiJefferson P

Jones, 2011). For example the courier services receive the payment in advance and they record it as deferred revenue until the delivery of the courier. The matching principle regarding the unearned income states that the only those revenues should be recognized for which the entity has incurred expenses and the rest should be shown as a liability because the company is not yet untitled to recognize them.

Operating Expenses:

Operating assets are expected to benefit the organization in more than one accounting period that is why they are classified under long term/fixed assets in the balance sheet. The most common examples of the operating assets are building, tools, furniture and equipments etc. Matching principle states that the benefit obtained from the operating assets should be realized on some logical basis over the asset's useful life. The application of the matching principle on operating assets is little more complex than the prepaid assets and unearned revenue because the pattern of the benefit realization is difficult to understand. For example some assets give more benefits in early years so the appropriate expense should be charged based on the benefit realization pattern. Reducing balance method is most commonly used to compute the depreciation expense. Other methods include straight line method and sum of the year digit method.

List of references

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