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18

FINANCIAL STATEMENTS - II

You have learnt that Income Statement i.e. Trading & Profit and Loss Account and Position Statement i.e., Balance Sheet are two financial statements, which are prepared by every business concern at the end of a period. Income statement shows the Net Profit or Net loss as the case may be for that period and Position Statement presents the financial position of the business on the specific date. These statements are prepared on the basis of Trial Balance and other information. It is possible that there are certain items of income or expenses which do not pertain to the accounting period for which Trial Balance is prepared or other such items which have accrued but have not been accounted for and hence are not reflected in Trial Balance. Both these types of incomes and expenses are to be fully accounted for, only then the above stated two statements will show the true and fair position of the business. These are called 'adjustments'. In this lesson we shall learn about accounting treatment of some of the adjustments and incorporation of these adjustments in financial statements.

OBJECTIVES

After studying this lesson you will be able to:

- recognise the need for accounting adjustments;
- explain the adjustments as to closing stock, outstanding and pre-paid expenses, accrued income and income received in advance;
- interest on capital and drawings, depreciation, provision for bad and doubtful debts; and
- incorporate the adjustments in Trading Account, Profit & Loss Account and Balance Sheet.

18.1 NEED FOR ACCOUNTING ADJUSTMENTS

You have already learnt that every business entity prepares Trading and Profit & Loss Account and Balance Sheet, the two financial statements, at the end of an accounting period which is generally one year. It needs to be ensured that such items of income and expenditure which do not pertain to the said accounting period, should not to be included. If some of these items have been included in the trial balance these must be excluded by making necessary adjusting entry. Similarly, there can be items which are left out and are needed to be accounted for. Adjustment entry will also be made for them. This is necessary in order to calculate the correct profit or loss and to show true and fair financial position of the business. For example, a firm closes its books on March 31, every year, Suppose it has not paid rent of the shop for the month of March. This will not be reflected in Trial Balance and hence it needs to be accounted for as it relates to the year for which accounts are being prepared. Similarly, suppose annual insurance premium has been paid up to June, 30. It means premium for three months has been paid in advance. This is included in the item of insurance appearing in the Trial Balance. This amount paid in advance needs to be excluded. This process of exclusion or inclusion of items into books of accounts at the time of preparing finanacial statements is called adjustments. These are to be incorporated to arrive at the true and fair position of the business.

INTEXT QUESTIONS 18.1

Fill in the blanks with suitable word/words :

(i) Trading and Profit & Loss Account shows the .... or ....

(ii) Adjustments are necessary to show the correct .... and .... of a business concern.

(iii) Items of income and expenditure which do not pertain to the accounting period should be ....

(iv) Items of income & expenditure which relate to the accounting period but are left out should be ....

18.2 ADJUSTMENTS AND THEIR INCORPORATION

The number and nature of adjustments differ from organisation to organisation. It depends upon the volume and nature of activities in the organisation, However, certain adjustments are common in all types of organisations. Moreover, while making adjustments you will have to follow the general principle of double entry i.e. the amount is to be debited to one account and credited to another account. Thus in the finanacial statements the item to be adjusted should appear at two places one representing the debit and the other representing the credit.

Let us, now discuss some of the items of adjustment and their accounting treatment in financial statements. These are as under :

1. Closing Stock
2. Outstanding Expenses.
3. Prepaid Expenses
4. Accrued Income.
5. Income received in advance
6. Interest on Capital
7. Interests on Drawings
8. Depreciation.
9. Further Bad Debts.
10. Provision for Bad and Doubtful Debts.
11. Provision for discount on debtors.
12. Managers Commission
13. Abnormal losses.
14. Drawing of Goods by the Proprietor.
15. Goods Distributed as free Sample.

Let us take up these adjustments one by one:

1. Closing Stock

Closing Stock is the stock of goods remaining unsold at the end of the accounting year. Ordinarily this does not appear in the Trial Balance. Hence, this needs to be incorporated in financial statements. This appears on the credit side of the Trading Account as well as Assets side of the Balance Sheet.

The adjustment entry will be:

Closing Stock A/c Dr

To Trading A/c

(Closing stock transferred to trading A/c)

The effect of the adjustment entry on financial statements is as under :

Trading A/c

Dr Cr

Particulars	*Amount* ₹	*Particulars*	*Amount* ₹
		Closing stock	......

Balance Sheet

Liabilities	*Amount* ₹	*Assets*	*Amount* ₹
		Closing stock	....

In case closing stock has already been accounted for it will form part of the Trial Balance and hence there is no need of making any adjustments in the Trading A/c. Then the adjusted closing stock will be on the asset side of the Balance Sheet only.

2. Outstanding Expenses

Expense which is related to the current accounting period but not yet paid is known as Outstanding Expense. Suppose the accounts are closed on 31st December every year. Salary for the month of December is due but not paid. It is an example of salary outstanding. Similarly, there are some other items like Rent outstanding, Wages outstanding etc. In case of Salaries Outstanding following adjustment entry will be made :

Salary A/c Dr.

To Salary Outstanding A/c

(Salary outstanding for the month of December)

In financial statements it will be recorded as :

Profit & Loss A/c

Dr. Cr.

Particulars	*Amount* ₹	*Particulars*	*Amount* ₹
Salaries *Add :* Salary outstanding			

Balance Sheet

Liabilities	*Amount* ₹	*Assets*	*Amount* ₹
Salary Outstanding			

Amount of expense outstanding will be added to its paid amount which is shown in the Trading A/c or Profit & Loss A/c as the case may be. It is also shown on the liabilities side of the Balance Sheet because it is an item of liabilities.

Notes

3. Prepaid Expenses

Sometimes a part of a certain expense paid may relate to the next accounting period. Such expenses is called prepaid expense or expenses paid in advance. For example, insurance premium paid in the current year may be for the year ending, the date of which falls in the next year. The part of insurance premium which relates to next accounting year is the insurance premium paid in advance. It is deducted from the amount paid and is shown as an item of asset. Similarly, such items may be rent prepaid, tax prepaid etc.

Adjustment entry for prepaid Insurance Premium

Prepaid Insurance Premium A/c Dr.

To Insurance Premium A/c

(Insurance premium paid in advance)

In financial statements, it is recorded as :

Profit & Loss A/c

Dr. Cr.

Particulars	*Amount* ₹	*Particulars*	*Amount* ₹
Insurance Premium *Less :* Prepaid Insurance premium			

Balance Sheet

Liabilities	*Amount* ₹	*Assets*	*Amount* ₹
		Prepaid insurance	

4. Accrued income (Due but not received)

Accrued income means income earned but not received till the end of the accounting year. For example, interest on securities or dividends on shares, which has become due but may be received on a date falling in the next year. Such income does not appear in the trial balance but should be duly accounted for in the year, because such income has accrued.

Adjustment entry for the transaction : suppose Rent receivable as it has become due but is not yet received

Rent Receivable (accrued) A/c Dr.

To Rent Received A/c

(Amount of rent due but not received)

In financial statements, it will be recorded as;

Profit & Loss A/c

Dr. Cr.

Particulars	*Amount* ₹	*Particulars*	*Amount* ₹
		Rent Received *Add :* Rent Accrued	

Balance Sheet

Liabilities	*Amount* ₹	*Assets*	*Amount* ₹
		Rent Accrued	

5. Unearned income/income Received in Advance

Sometimes income is received before it becomes actually due. Such income is called "unearned income" or "income received in advance". Since this income does not relate to the accounting year, it should be deducted from the relevant head of income in the Profit & Loss A/c. It is a liability and hence is shown in the liability side of the Balance Sheet. Example of such income is rent that has been received for the months of January and February of the coming accounting year.

Adjustment entry for the same is

Rent Received A/c Dr

To Rent Received in Advance A/c

(Rent received in advance)

In financial statements

Profit and Loss A/c

Dr. Cr.

Particulars	*Amount* ₹	*Particulars*	*Amount* ₹
		Rent Received *Less :* Rent received in advance	

Balance Sheet

Liabilities	*Amount* ₹	*Assets*	*Amount* ₹
Rent received in advance			

INTEXT QUESTIONS 18.2

Fill in the blanks with suitable terms :

(i) Expenses related to the current accounting period but have not been paid are known as ....

(ii) Part of expenses paid if relates to the next accounting year, it is called ....

(iii) Income earned but not received till the end of the accounting year is termed as ....

(iv) Income if received before it becomes due is called ....

18.3 OTHER ADJUSTMENTS

6. Interest on Capital

As per business entity concept capital of the proprietor is a liability for the business. Like other loans, interest can be allowed on capital also. In case it is decided to allow interest on capital, adjustment entry will be as follows :

Interest on Capital A/c Dr

To Capital A/c

(Interest allowed on capital)

In financial statements it is shown as under:

Profit & Loss A/c

Dr. Cr.

Particulars	*Amount* ₹	*Particulars*	*Amount* ₹
Interest on capital			

Balance Sheet

Liabilities	*Amount* ₹	*Assets*	*Amount* ₹
Capital *Add :* Interest on Capital			

7. Interest on Drawings

Interest may also be charged on money withdrawn by the proprietor for personal use. Following journal entry is made.

Capital A/c Dr.

To Interest on Drawings A/c

(Interest on Drawings charged)

In financial statements, it will be shown as :

Profit & Loss A/c

Dr. Cr.

Particulars	*Amount* ₹	*Particulars*	*Amount* ₹
		Interest on Drawings	

Balance Sheet

Liabilities	*Amount* ₹	*Assets*	*Amount* ₹
Capital *Less :* Interest on drawings			

8. Depreciation

The value of fixed assets such as Plant and Machinery, Furniture and Fixtures, Land & Building, Motor Vehicles etc. goes on reducing year after year due to wear and tear, obsolescence or for any other reason.

As the fixed assets are used for earning revenue the amount by which the value of a fixed asset decreases is an item of expense, similar to other expenses. This is called depreciation. It should be charged to the Profit and loss Account. The value of such assets should also be shown in the Balance Sheet at the reduced value by the amount of depreciation:

The adjustment entry for depreciation will be

Depreciation A/c Dr

To Asset (by name) Account

It will be shown in the Profit and Loss A/c and Balance sheet as under :

Profit & Loss A/c

Dr. Cr.

Particulars	*Amount* ₹	*Particulars*	*Amount* ₹
Depreciation on Plant & Machinery Motor Vehicle (etc)			

Balance Sheet

Liabilities	*Amount* ₹	*Assets*		*Amount* ₹
		Plant & Machinery	....	
		Less : Depreciation	....	....
		Motor Vehicle	....	
		Less: Depreciation	....	....

Note : In case amount of depreciation has been calculated before closing of accounts, it will appear in the debit column of the Trial Balance. It will be shown only on the debit of profit & Loss A/c and further adjustment is not required in the Balance Sheet.

9. Further Bad Debts

When the goods are sold on credit basis some of the debtors partly pay the due amount or do not pay at all. If this amount cannot be recovered it is called bad debts and is a loss to the firm. This is entered on the debit side of the Profit & loss A/c. But then there may be amount of bad debt which was not recorded in the books of accounts and hence did not appear in the Trial Balance. But the same was discovered before preparing the financial statements. It is called further bad-debts. Following adjustment entry is made for the same :

Bad Debts A/c Dr.

To Debtors A/c

(Further bad debts recorded)

In Profit and Loss A/c and Balance sheet it is shown as under :

Profit & Loss A/c

Dr Cr

Particulars	*Amount* ₹	*Particulars*	*Amount* ₹
Bad Debts Add Further Bad debts			

Balance Sheet

Liabilities	*Amount* ₹	*Assets*	*Amount* ₹
		Sundry Debtors Less: Further Bad debts	

10. Provision for Bad and Doubtful debts

Some Debts of a particular year may become bad debts in the next year. It means the loss due to bad debts will be written off in the year it takes place instead of the year it belongs to. It will be a sound accounting practice that a suitable amount is kept aside in the current year to meet the possible loss of bad debts in the next year. Decision regarding maintenance for provision for Bad and Doubtful Debts is taken at the end of the year so it is an item of adjustment. It is called a provision for Bad and Doubtful Debt.

The adjustment entry will be as under :

Profit & loss A/c Dr.

To Provision for Doubtful Debts A/c

(Provision for doubtful debts created)

In the Profit and Loss A/c and Balance sheet it will be shown as under:

Profit & Loss A/c

Dr Cr

Particulars	*Amount* ₹	*Particulars*	*Amount* ₹
Bad Debts *Add :* Provision for Doubtful debts			

Notes

Notes

Balance Sheet

Liabilities	*Amount* ₹	*Assets*	*Amount* ₹
		Debtors *Less :* Provision for bad Debts	

Such Provision is created on Debtors at a given rate say 5%. In case there is further bad debts, provision for bad and doubtful Debts will be calculated on the amount of debtors after deducting from it the amount of further Bad Debts.

Over the years businessman might have experienced that a certain percentage of the debts created due to credit sales go bad every year. So a provision for bad and doubtful debt is made on the debtors of a year at a fixed percentage say 5%. This percentage may change if the circumstances have changed. For example, it may be reduced if the businessman has become selective in selling goods on credit.

Provision for bad and doubtful debt is maintained at every year at a fixed percentage of the debtors. Last year balance is carried forward in the current year. This may be called old provision for bad and doubtful debts. Current years bad debts or/and further bad debts is adjusted towards this provision and more provision is created, which may be called new provision for bad debts.

Arithmatically it is shown in the Profit and Loss A/c as follows :

Profit and Loss A/c

Dr Cr

Particulars	*Amount* ₹	*Particulars*	*Amount* ₹
Bad Debts *Add :* Further Bad Debts Add new provision for Bad and Doubtful Debts *Less :* Old provision for Bad and Doubtful Debts			

In case the balance amount of provision for bad and doubtful debts carried forward from last year is more than the amount of bad debts, amount of further Bad Debts and the amount of new provision for bad debts combined together, the excess balance will be credited to Profit and Loss A/c.

The amount of provision for Bad and Doubtful Debts is an item of liability. But usual practice is to show it as deducted from the amount of book debts/sundry debtors on the assets side of the Balance Sheet.

The above can best be explained by the following example :

Items appearing in the Trial Balance of a sole trader on 31st Dec, 2013.

Particulars	*Dr Balance ₹*	*Cr Balance ₹*
Sundry Debtors	24600	
Provision for Bad and Doubtful Debts		1000
Bad Debts	700	

Additional Information

Further bad debts amounted to ₹ 600. Make a provision for Bad and Doubtful debts on Debtors @ 5%.

Show the above items and related adjustments in the financial statements as on that date.

Proft and Loss A/c
for the year ended 31st Dec., 2013

Dr. Cr.

Particulars		*Amount ₹*	*Particulars*	*Amount ₹*
Bad Debts	700			
Further Bad Debts	600			
Add : New Provision for bad and Doubtful Debts	1200			
	2500			
Less : Old provision for bad and Doubtful Debts	(1000)	1500		

Balance Sheet
as on 31st Dec., 2013

Liabilities	*Amount ₹*	*Assets*		*Amount ₹*
		Sundry Debtors	24600	
		Less : Further Bad Debts	600	
			24000	
		Less : Provision for bad Debts @ 5%	1200	22800

Notes

18.4 ADJUSTMENTS IN PREPRATIONS OF FINANCIAL STATEMENTS

11. Provision for Discount on Debtors

Debtors outstanding at the end of year make payment in the next year and they may be entitled to cash discount if they make the payment by the due date. Because, the debt has arisen during the year, the discount is to be taken as expense for the year. Thus a Provision for Discount on Debtors is made.

The process is same as for the provision for doubtful debt. The likely amount of the discount to be allowed is debited to the Profit and Loss Account and credited to the Provision for Discount Account. This amount is deducted from book debts (debtors) in the balance sheet and is carried forward to the next year. Discount allowed to the existing debtors in the next year are debited to the Provision for Discount Account and not to the Profit and Loss Account. The debit reduces the balance in the provision account, it is made up to the required figure by a debit to the Profit & Loss Account and credit to the provisions account just like the Provision for Doubtful Debts Account.

An important point to note is that discount is not allowed on debts that became bad. Therefore, the provision for discount is made for good debts only. In other words, the amount of the Provision for Discount is calculated after deducting bad debts and the provision for doubtful debts from sundry debtros. Suppose, sundry debtors total ₹ 1,00,000; provision for doubtful debts is required at 5% and provision for discounts at 2.5%. So first we have to calculate provision for doubtful debts i.e. ₹ 1,00,000 x 5% = ₹ 5,000; the remaining amount is ₹ 95,000. Now we calculate Provision for Discount on Debtors i.e. ₹ 95,000 x 2.5% it will be ₹ 2,375.

Accounting Treatment

(i) For Discount Allowed :

Discount Allowed A/c Dr.

To Debtors A/c

(Being discount allowed to debtors)

(ii) For transferring the amount of discount to profit & loss Account.

Profit & Loss A/c Dr.

To Discount Allowed

(Being discount allowed transferred to Profit & Loss A/c)

(iii) If the existing provision appears in the books, then the discount allowed would be transferred to the Provision and Discount on Debtors Account instead of the Profit Loss Account. The entry would be :-

Provision for Discount on Debtors A/c Dr.

To Discount Allowed

(Being discount transferred to Provision for Discount on Debtors A/c)

(iv) For creating Provision for Discount on Debtors :

Profit and Loss A/c Dr.

To Provision for Discount on Debtors A/c

(Being balance of provision for discount account being charged to Profit & Loss A/c)

Illustration : 1

The Sundry Debts of a firm on 31st December, 2012 were ₹ 4,00,000. On that date, it was decided to create a Provision for Discount at 2% on Sundry Debtors. During 2013 the actual amount of discount allowed was ₹ 4000. The debtors on 31st December, 2013 were ₹ 3,00,000 and it was again decided to create a Provision for Discount over Debtors at 2%. Pass the Journal entries and prepare Discount Account and Provision for Discount Account for both the years.

Solution :

Journal

Date	*Particulars*	*L.F.*	*Dr. (₹)*	*Cr. (₹)*
2012				
Dec. 31	Profit and Loss A/c ...Dr.		8,000	
	To Provision for Discount on Debtors A/c			8,000
	(Being provision for discount on debtor credited)			
2013				
Dec. 31	Discount Allowed A/c ...Dr.		4,000	
	To Sundry Debtors A/c			4,000
	(Being discount allowed on payment received)			
Dec. 31	Provision for Discount on Debtors A/c ...Dr.		4,000	
	To Discount Allowed A/c			4,000
	(Being discount transferred to Provision Account)			
Dec. 31	Profit and Loss A/c ...Dr.		2,000	
	To Provision for Discount on Debtors A/c			2,000
	(Being provision created)			

Provision for Discount on Debtors Account

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
2012				**2012**			
Dec. 31	To Balance c/d		8,000	Dec. 31	By Profit and Loss A/c		8,000
2013				**2013**			
Dec. 31	To Discount Allowed A/c		4,000	Jan. 1	By Balance b/d		8,000
Dec. 31	To Balance c/d		6,000	Dec. 31	By Profit and Loss A/c		2,000
			10,000				10,000
				2014			
				Jan. 1	By Balance c/d		6,000

Discount Allowed Account

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
2013				**2013**			
Dec. 31	To Sundry Debtors A/c		4000	Dec. 31	By Provision for Discount A/c		4000

12. Manager's Commission

Sometimes, the manager is entitled to a commission on profits which is usually calculated as a fixed percentage of the profits. Suppose, the profit earned by the firm is ₹ 80,000 without considering the commission which is at 5%. The commission will be then ₹ 4,000. The profit will be reduced to ₹ 76,000. As the amount of commission ₹ 4,000 is still to be paid, it should be treated as an outstanding expense. Accordingly, the entry is:

Profit and Loss A/c ...Dr.

To Commission Payable or Outstanding Commission A/c

Commission Payable is a current liability and is shown in the Balance Sheet.

Sometimes, however, the commission is calculated on profits remaining finally after the commission. If the rate of the commission is 5%, and the profit remaining after the commission is ₹ 100; then the profit before the commission will be ₹ 105. That is in this case the commission of ₹ 5 should be out of every ₹ 105 of profit before the commission. The formula to calculate the commission in such a case is :

$$\frac{\text{Percentage of the commission}}{100 + \text{Percentage of the commission}} \times \text{Net Profit before charging the Commission}$$

If the profit before commission is ₹ 8,00,000 and the manager is entitled to a commission of 5% after deducting the commission, the amount will be ₹ 38,095, ₹ 8,00,000 of 5/105. This comission amount can be verified too. The profit after the commission is ₹ 7,61,905 and ₹ 38,095 is 5% of this figure. One can see that if we calculate it at 5% of ₹ 8,00,000 will be wrong since ₹ 40,000 is not 5% of ₹ 7,60,000.

Illustration : 2

The net profit of a firm amount to ₹ 1,05,000 before charging commission. The manager of the firm is entitled to a commission of Rs. 5% on the net profit. Calculate the comission payable to the manager under the following alternative cases :-

I. If the manager is allowed commission on the net profit before charging such commission, and

II. If the manager is allowed commission on the net profit after charging such commission. Also show the treatment in the final account ending on 31st March 2013.

Solution :

I Case

[Commission allowed on the net profit before charging such commission]

$$\text{Commission} = \text{Net Profit before charging the Commission} \times \frac{\text{\% of Commission}}{100}$$

$$= ₹\,1{,}05{,}000 \times \frac{5}{100} = ₹\,5{,}250$$

Profit & Loss Account
for the year ended 31st March 2013

Particulars	₹	*Particulars*	₹
To Managers Commision	5,250		

Balance Sheet
as at 31st March 2013

Liabilities	₹	*Assets*	₹
Current Liabilities			
Manager's Com. Outstanding	5,250		

II Case

[Commission allowed on the net profit after charging such commission]

$$\text{Commission} = \text{Net Profit before charging the Commission} \times \frac{5}{105}$$

Notes

$$= ₹1,05,000 \times \frac{5}{105} = ₹5,000$$

Profit & Loss Account
for the year ended 31st March 2013

Particulars	₹	*Particulars*	₹
To Managers Commision	5,000		

Balance Sheet
as at 31st March 2013

Liabilities	₹	*Assets*	₹
Current Liabilities			
Manager's Com. Outstanding	5,000		

INTEXT QUESTIONS 18.3

I. Give exact term for the following:

(i) Provision against amount due from debtors.

(ii) Fall in the value of fixed assets due to wear and tear.

(iii) Debts which can not be recovered.

(iv) Stock of goods remaining unsold at the end of year.

II. Complete the journal entries for the following adjustments

(i) Interest on capital allowed

Interest on capital A/c Dr

To ……………..

(ii) Wages Outstanding

Wages A/c

To ………..

(iii) Insurance Premium paid for six months in advance

Unexpired Insurance A/c

To …………

(iv) Commission received but not yet earned

Commission A/c

To ………………..

III. *State whether the following statements are True or False :*

(i) Provision for discount on debtors is shown on the credit side of Profit & Loss A/c.

(ii) The Amount of Provision for discount on debtors is deducted from debtors.

(iii) Provision for discount on debtors is a income for a business.

(iv) Provision for discount on debtors is an asset for a company.

(v) If sundry debtors are of ₹ 10,000 and company creates provision for discount on debtors @ 10%. Then total provision is ₹ 1,000.

IV. *Fill in the blanks with appropriate words :*

(i) Manager's commission is shown in the ________ side of Profit & Loss A/c

(ii) Manager's commission is shown in the ___________ of Balance Sheet.

Illustration : 3

From the following Trial Balance of M.B. Garments as on 31st December, 2013, prepare Trading A/c and Profit & Loss A/c for the year ended 31st December, 2013 and Balance Sheet as on that date :

Name of the Account	*Dr. Amount* ₹	*Cr. Amount* ₹
Capital		80,000
Cash in hand	570	
Cash at bank	5,600	
Purchases	43,200	
Sales		78,000
Wages	10,400	
Power	4,730	
Carriage inward	2,040	
Carriage outward	3,200	
Stock (1.1.2006)	5,660	
Land & Building	40,000	
Machinery	20,000	
Salaries	4,000	

Insurance	600	
Sundry Debtors	28,000	
Sundry Creditors		10,000
	1,68,000	1,68,000

Following adjustments are to be accounted for:

(i) Stock on 31.12.2013 ₹ 10000.

(ii) Machinery to be depreciated @10% p.a. and Building to be depreciated @ 2% p.a.

(iii) Salaries for the month of December outstanding were ₹ 1200.

(iv) Insurance Premium was paid for one year ending 30th June, 2014.

Make journal entries for the adjustments and prepare Trading and Profit & loss A/c and the Balance Sheet.

Solution

Date	*Particulars*	*Dr. Amount ₹*	*Cr. Amount ₹*
2013			
Dec 31	Closing stock A/c ...Dr	10,000	
	To Trading A/c		10,000
	(Closing stock taken to Trading A/c)		
Dec 31	Depreciation A/c ...Dr.	2,800	
	To Machinery A/c		2,000
	To Land & Building A/c		800
	(Depreciation on machinery @ 10% p.a. and on land & Building @ 2% p.a.charged)		
Dec 31	Salaries A/c ...Dr.	1,200	
	To Salary Outstanding A/c		1,200
	(Salary due but not paid for December 2013)		
Dec 31	Prepaid Insurance A/c ...Dr.	300	
	To Insurance A/c		300
	(Insurance paid in advance accounted for)		

Notes

Trading A/c
for the year ended 31st Dec, 2013

Dr. Cr.

Particulars	*Amount* ₹	*Particulars*	*Amount* ₹
Stock	5,660	Sales	78,000
Purchases	43,200	Closing stock	10,000
Wages	10,400		
Power	4,730		
Carriage Inward	2,040		
Gross Profit transferred to Profit & Loss A/c	21,970		
	88,000		88,000

Profit & Loss A/c
for the year ended 31st Dec. 2013

Dr. Cr.

Particulars		*Amount* ₹	*Particulars*	*Amount* ₹
Carriage outward		3,200	Gross Profit transferred from	
Salaries	4,000		Trading A/c	21,970
Add : Salary Outstanding	1,200	5,200		
Insurance	600			
Less : Prepaid insurance	300	300		
Depreciation on				
Machinery	2000			
Land & building	800	2,800		
Net Profit transferred to capital A/c		10,470		
		21,970		21,970

Balance Sheet
as at 31st Dec. 2013

Liabilities	*Amount* ₹	*Assets*	*Amount* ₹
Salary Outstanding	1,200	Cash in hand	570
Sundry Creditors	10,000	Cash at Bank	5,600

Capital	80,000		Sundry debtors		28,000
Add: net profit	10,470	90,470	Closing stock		10,000
			Prepaid Insurance		300
			Land & Building	40,000	
			Less depreciation	800	39,200
			Machinery	20,000	
			Less depreciation	2,000	18,000
		1,01,670			1,01,670

Illustration : 4

From the following Trial Balance of Mustafa & Co., prepare Trading and Profit and loss A/c for the year ending on 31st Dec. 2013 and Balance Sheet as on that date after making necessary journal entries for adjustments.

	Dr. Balance (₹)		*Cr. Balance (₹)*
Land and Building	60,000	Capital	1,50,000
Plant and Machinery	40,000	Sundry Creditors	30,000
Bill Receivables	8,000	Sales	1,20,000
Stock on 1.1.2013	40,000	Reserve for Bad	4,500
Purchases	51,000	and Doubtful Debts	
Wages	20,000	Loan (12% p.a.)	10,000
Coal, Gas & Coke	5,800	Commission Received	2,000
Salaries	5,000		
Rent	2,800		
Cash at bank	25,000		
Sundry Debtors	45,000		
Repairs	1,800		
Bad Debts	5,500		
Sales Returns	2,000		
Furniture and Fixture	4,000		
Interest on Loan	600		
	3,16,500		3,16,500

Notes

Adjustments

1. Closing stock was valued at ₹ 30000.
2. Depreciate Plant & Machinery @ 5% and Furniture & Fixture @ 10%.
3. Provide for Bad and Doubtful Debts @ 5%.
4. Outstanding Wages ₹ 1000, Rent ₹ 500 and interest on loan outstandin ₹ 600.
5. Commission accrued ₹ 1000.

Solution.

Adjustment Entries

Date	*Particulars*		*Amount* ₹	*Amount* ₹
2013				
Dec 31	Closing Stock A/c	Dr.	30,000	
	To Trading A/c			30,000
	(Closing stock taken into account)			
	Depreciation A/c	Dr.	2400	
	To Plant & Machinery			2000
	To Furniture & Fixture			400
	(Depreciation charged @ 5% on Plant & Machinery & @10% on Furniture)			
	Profit & loss A/c	Dr.	2250	
	To Reserve for Doubtful Debts			2250
	(Reserve for Doubtful Debts created)			
	Wages A/c	Dr	1000	
	Rent A/c	Dr	500	
	To Outstanding Expenses A/c			1500
	(Outstanding expenses provided for)			
	Commission Accrued A/c	Dr.	1000	
	To commission received			1000
	(Commission accrued taken into consideration)			
	Interest on loan A/c	Dr	600	
	To Interest on loan Outstanding A/c		600	
	(Interest on loan due but not paid)			

Notes

Trading and Profit & Loss A/c of M/s Mustafa & Co.
for the year ended on 31.12.2013

Dr. Cr.

Particulars		₹	*Particulars*		₹
Opening Stock		40,000	Sales	1,20,000	
Purchases		51,000	*Less :* Sales Returns	2,000	1,18,000
Wages	20,000		Closing Stock		30,000
Add : Outstanding	1,000	21,000			
Coal, Gas & Coke		5,800			
Gross Profit c/d		30,200			
		1,48,000			1,48,000
Salaries		5,000	Gross Profit b/d		30,200
Rent	2,800		Commission Received		
Add : Outstanding	500	3,300	Received	2,000	
Repairs		1,800	*Add :* Accrued		
Bad Debts	5,500		Commission	1,000	3,000
Add : New Reserve	2,250				
	7,750				
Less : Old Reserve	4,500	3,250			
Interest on Loan	600				
Add : Interest Outstanding	600	1,200			
Depreciation					
Plant & Machinery	2,000				
Furniture & Fixture	400	2,400			
Net Profit Transferred to Capital A/c		16,250			
		33,200			33,200

Balance sheet of M/s Mustafa & Co.
as at 31.12. 2013

Liabilities		₹	*Assets*		₹
Sundry creditors		30,000	Cash in Bank		25,000
Loan		10,000	Bill Receivables		8,000
Interest outstanding		600	Sundry Debtors	45,000	
Outstanding Expenses :			*Less :* Reserve for		
Wages	1,000		Doubtful Debts	2,250	42,750
Rent	500	1,500	Closing Stock		30,000

Capital	1,50,000		Furniture & Fixture	4,000	
Add : Net Profit	16,250	1,66,250	*Less :* Dep.	400	3,600
			Plant & Machinery	40,000	
			Less : Dep.	2,000	38,000
			Land & Building		60,000
			Commission Accrued		1,000
		2,08,350			2,08,350

Notes

Illustration : 5

From the following balances of the year ending 31st December, 2013 and additional information prepare the Trading and Profit and Loss Account and the Balance Sheet of M/s Kanohal and Sons.

	₹		₹
Capital	80,000	Insurance	600
Purchases	82,000	Salaries	12,500
Sales	1,10,000	Bad Debts	200
Return Outwards	1,000	Carriage on Purchase	200
Buildings	45,000	Commission (Cr.)	1,500
Opening Stock	15,000	Cash in Hand	5,000
Debtors	20,100	Cash at Bank	25,000
Creditors	28,000	Sales Tax Paid	5,000
Furniture	7,000	Sales Tax Collected	3,500
Wages	1,800	Interest on Investments	500
Rent	5,100		

Additional Information:

(a) Closing Stock was valued at ₹ 20,000.

(b) Provide Depreciation on building @5% and on furniture @10%.

(c) Outstanding salaries ₹ 1,000.

(d) Unexpired insurance ₹ 50.

(e) Accrued commission ₹ 300

(f) Provide for Manager's Commission at 5% on net profit after charging such commision.

Solution :

Trading and Profit & Loss Account
for the ended 31st December, 2013

Dr. Cr.

Particulars	₹	*Particulars*	₹
To Opening Stock	15,000	By Sales	1,10,000
To Purchases 82,000		By Closing Stock	20,000
Less : Return Outward 1,000	81,000		
To Wages	1,800		
To Carriage on Purchases	200		
To Gross Profit c/d	32,000		
	1,30,000		1,30,000
To Rent	5,100	By Gross Profit b/d	32,000
To Insurance 600		By Interest on Investment	500
Less : Unexpired Insurance 50	550	By Commission 1,500	
To Salaries 12,500		Add : Accrued	
Add : Outstanding		Commission 300	1,800
Salaries 1,000	13,500		
To Bad Debts	200		
To Depreciation on :			
Building 2,250			
Furniture 700	2,950		
To Net Profit before			
Manager's Commission	12,000		
	34,300		34,300
To Manager's Commission		By Net Profit before	
(5/105 x 12,000)	571	Manager's Commission	12,000
To Net Profit after Manager			
Commission	11,429		
	12,000		12,000

Balance Sheet
as at 31st December, 2013

Liabilities	₹	**Assets**	₹
Creditors	28,000	Cash in Hand	5,000
Outstanding Salary	1,000	Cash at Bank	25,000
Manager's Commission	571	Closing Stock	20,000

Capital	80,000		Debtors		20,100
Add : Net Profit	11,429	91,429	Advance Sales Tax Paid		
			(Sales Tax Paid - Sales Tax Collected)		1,500
			Accrued Commission		300
			Prepaid Insurance		50
			Building	45,000	
			Less : Depreciation	2,250	42,750
			Furniture	7,000	
			Less : Depreciation	700	6,300
		1,21,000			1,21,000

Notes

13. Abnormal Losses

Such losses occur because of fire, earthquakes or accidents. These may destroy some fixed assets of the firm. In such case an Asset Account is credited and the Profit and Loss Account is debited. The debit may be spread over two or three years.

Stock of goods may also be destroyed or damaged by fire, or other causes. It is obvious that because of this, the value of the stock will be lower than otherwise. This will reduce the amount of gross and net profit. It is, however, better to ascertain the gross profit which would have been earned without the loss since this enables the firm to judge its trading operations properly. To nullify the effect of loss of stock, the Trading Account is credited with the cost of the goods destroyed. If the goods destroyed are not insured then the cost price of the goods destroyed is debited to Profit and Loss Account. If the goods are insured, then the claim admitted by the insurance company is deducted and the claim not admitted is debited to the Profit and Loss Account. The adjusting entries are as follows :

(i) Accidental Loss of Stock A/c
or Loss by Fire ...Dr. [Total Value of Abnormal Loss]
To Trading A/c

(ii) Insurance Claim or Insurance Co. ...Dr. [Amount of Insurance Claim]
Profit and Loss A/c ...Dr. [Value of Irrecovered Loss]
To Accidental Loss of Stock A/c [Total Value of Abnormal Loss]

Insurance Company's Account will be shown as an asset in Balance Sheet

Note : If stock is not insured, following entry will be passed.

Profit and Loss A/c ...Dr. [Total Value of Abnormal Loss]
To Trading A/c

Notes

Illustration : 6

On 31st Dec. 2013, stocks worth ₹ 4,00,000 were destroyed by fire. The stock was insured and the insurance company admitted the claim of ₹ 3,00,000 only. Give the necessary journal entries and show how it will be treated in the Final Accounts.

Solution :

Journal

Date	*Particulars*		*LF.*	*Dr. (₹)*	*Cr. (₹)*
2013					
Dec. 31	Loss by Fire A/c	Dr.		4,00,000	
	To Trading A/c				4,00,000
	(Being loss of stock by fire)				
Mar. 31	Insurance Co.	Dr.		3,00,000	
	P & L A/c	Dr.		1,00,000	
	To Loss by fire A/c				4,00,000
	(Being insurance co. admitted a partial claim only)				

Trading Account
for the year ended 31st Dec. 2013

Dr. Cr.

Particulars	₹	*Particulars*	₹
		By Loss by Fire A/c	4,00,000

Profit and Loss Account
for the year ended 31st Dec. 2013

Dr. Cr.

Particulars		₹	*Particulars*	₹
To Loss by fire	4,00,000			
Less : Ins. Claim	3,00,000	1,00,000		

Balance Sheet
as at 31st Dec. 2013

Liabilities	₹	*Asset*	₹
		Current Assets	
		Claim due from Insurance Co.	3,00,000

Notes

Illustration : 7

From the following Ledger balances of Mr. Ghanshyam, prepare the Trading and Profit and Loss Account for the year ended 31st March 2013 and the Balance Sheet as on that date after making the necessary adjustments.

Particulars	₹	*Particulars*	₹
Trade Expenses	8,000	Purchases	8,20,000
Freight and Duty	20,000	Stock on (1.4.2012)	1,50,000
Carriage Outwards	5,000	Plant and Machinery (1.4.2012)	2,00,000
Sundry Debtors	2,06,000	Pland and Machinery (additions	
Furniture and Fixtures	50,000	on 1.10.2012)	50,000
Return Inwards	20,000	Drawings	60,000
Printing and Stationery	4,000	Capital	8,00,000
Rent, Rates and Taxes	46,000	Reserve for Doubtful Debts	8,000
Sundry Creditors	1,00,000	Rent for Premises Sublet	16,000
Sales	12,00,000	Insurance Charges	7,000
Return Outwards	10,000	Salaries and wages	2,13,000
Postage and Telegraphs	8,000	Cash in Hand	62,000
		Cash at Bank	2,05,000

Adjustments :

(i) Stock on 31st March 2013 was ₹ 1,40,000.

(ii) Write off ₹ 6,000 as Bad Debts.

(iii) Provision for Doubtful Debts is to be maintained @5%.

(iv) Provide Depreciation on furniture and fixtures at 5% p.a. and on plant and machinery at 20% p.a.

(v) Insurance prepaid was ₹ 1,000.

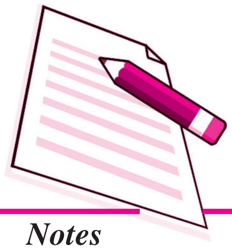
(vi) A fire occurred in the godown and stock of the value of ₹ 50,000 was destroyed. It was insured and the insurance company admitted full claim.

Solution :

Trading and Profit and Loss Account
for the year ended 31st March, 2013

Dr. Cr.

Particulars		₹	*Particulars*		₹
To Opening Stock		1,50,000	By Sales	12,00,000	
To Purchases	8,20,000		**Less :** Return Inwards	20,000	11,80,000
Less : Return Outwards	10,000	8,10,000	By Loss of Stock by Fire A/c		50,000
To Freight and Duty		20,000	By Closing Stock		1,40,000
To Gross Profit c/d		3,90,000			
		13,70,000			13,70,000



Notes

To Trade Expenses		8,000	By Gross Profit b/d	3,90,000
To Carriage Outwards		5,000	By Rent for Premises	16,000
To Depreciation on Furniture				
and Fixtures		2,500		
To Dep. on Plant and Machinery				
2,00,000 x 20/100	40,000			
5,000 x 20/100 x 6/12	5,000	45,000		
To Printing & Stationery		4,000		
To Rent, Rates and Taxes		46,000		
To Insurance	7,000			
Less : Prepaid	1,000	6,000		
To Salaries and Wages		2,13,000		
To Postage and Telegraphs		8,000		
To Provision for Doubtful				
Debts (Closing)				
(₹ 2,00,000 x 5/100)	10,000			
Add : Bad Debts	6,000			
	16,000			
Less: Provison for Doubtful				
Debts (Opening)	8,000	8,000		
To Net Profit transferred				
to Capital A/c		60,500		
		4,06,000		4,06,000

Balance Sheet
as at 31st March, 2013

Libilities		₹	*Assets*		₹
Current Liabilities			**Current Assets**		
Sundry Creditors		1,00,000	Cash in Hand		62,000
Capital			Cash at Bank		2,05,000
Opening Balance	8,00,000		Sundry Debtors	2,06,000	
Add: Net Profit	60,500		*Less:* Further Bad Debts	6,000	
	8,60,500			2,00,000	
Less: Drawings	60,000	8,00,500	*Less:* Provision for		
			Doubtful Debts	10,000	1,90,000
			Closing Stock		1,40,000
			Insurance Claim		50,000
			Prepaid Insurance		1,000
			Fixed Assets		
			Furniture and Fixture	50,000	
			Less: Depreciation	2,500	47,500

		Plant and Machinery	2,50,000	
		Less: Depreciation	45,000	2,05,000
	9,00,500			9,00,500

14. Drawings of Goods by the Proprietor

When the proprietor draws some goods or cash from the business for his/her personal use, it is a drawing.

Now, if you find that this has not been recorded in the books, you have to make the necessary adjustments to take it into the Final Accounts. Then the treatment of such drawings of goods by the proprietor in the Final Account is as follows:

i. Deduct it from purchases on the debit side of Trading A/c.

ii. Deduct it either from the capital or add to drawings on the liability side of the Balance Sheet.

Accounting Treatment of Drawings

I. Drawing made in cash

(i) Drawings A/c Dr.

To Cash/Bank A/c

(Being cash withdrawn for personal use)

(ii) Capital A/c Dr.

To Drawings A/c

(Being drawings transferred)

II. Withdrawal of Goods by the Proprietor

(i) Drawings A/c Dr.

To Purchases A/c

(Being goods withdrawn for personal use)

(ii) Capital A/c Dr.

To Drawings A/c

(Being drawings transferred)

III. Income Tax Paid by sole proprietor out of the entity's (business) cash

(i) Income Tax A/c Dr.

To Cash/Bank A/c

(Being Income Tax Paid)

Notes

(ii) Drawings A/c Dr.

To Income Tax

(Being Income Tax Transferred)

(iii) Capital A/c Dr.

To Drawings

(Being drawings transferred)

15. *Goods Distributed as Free Samples*

For sales promotion, some of the goods may be distributed as free samples. For example, if goods worth ₹ 10,000 are distributed as free samples then it will be an advertisement for the concern but on the other hand the stocks will be less by goods of such value. In order to bring this into the books of accounts the following entry is passed :

Advertisement A/c Dr.

To Purchases A/c

(Being goods distributed as free samples)

The two-hold effect of this entry will be :

i. It is shown on the credit side of Trading A/c, or deducted from the purchases.

ii. It is shown on the debit side of the profit and loss A/c as advertisement expenses.

Illustration : 8

From the following Trail Balance, Prepare the Trading and Profit & Loss A/c for the year ended March 31, 2014 and the balance sheet as on that date :

Debit Balance	₹	*Credit Balance*	₹
Salaries	10,600	Sales	66,420
Bills Receivable	6,000	Capital	50,000
Investments	40,000	Pro. for Doubtful Debts.	2,500
Furniture	12,000	10% Loan (1.10.2013)	10,000
Opening Stock	4,500	Discount Received	400
Purchases	30,000	Sundry Creditors	9,300
Sundry Debtors	20,000	Bills Payable	5,000
Interest on Loan	400	Outstanding Salaries	500
Insurance Premium	900	Bad Debts Recovered	200
Wages	4,600	Interest on Investments	2,000

Notes

Rent	1,520	Trading Commission	7,000
Bad Debts	1,200		
Carriage Outwards	600		
Cash at Bank	10,000		
Depreciation on Furniture	2,500		
Accrued Commission	1,000		
Advertisement	7,500		
	1,53,320		1,53,320

Adjustments :

i. Closing Stock - ₹ 6,000.

ii. Goods costing ₹ 1,000 were distributed as free samples while goods costing ₹ 500 were taken by the proprietor for personal use.

iii. A credit sale of ₹ 2,000 was not recorded in the sales book.

iv. Closing Stock included goods costing ₹ 1,000 which were sold and recorded as sales but not delivered to the customer.

v. Maintain provision for Doubtful Debts @5%.

vi. Only one-third advertising expenses are to be written off.

Solution

Trading and Profit & Loss Account
for the year ending 31st March, 2014

Dr. Cr.

Particulars		₹	*Particulars*		₹
To Opening Stock		4,500	By Sales	66,420	
To Purchases	30,000		*Add :* Credit Sales	2,000	68,420
Less: Free Samples	1,000		By Closing Stock	6,000	
	29,000		*Less:* Cost of Goods sold		
Less : Drawing of Goods	500	28,500	but not delivered	1,000	5,000
To Wages		4,600			
To Gross Profit c/d		35,820			
		73,420			73,420
To Salaries		10,600	By Gross Profit b/d		35,820
To Interest on Loan	400		By Old Pro. for Bad Debts	2,500	
Add: Outstanding Interest			*Less:* Bad Debts	1,200	
on Loan	100	500		1,300	
To Insurance Premium		900	*Less :* New Provision	1,100	200

Notes

To Rent	1,520	By Discount Received	400
To Carriage Outwards	600	By Bad Debts Recovered	200
To Depreciation of Furniture	2,500	By Interest on Investment	2,000
To Advertisement	2,500	By Trading Commission	7,000
To Free Samples	1,000		
To Net Profit transferred to Capital A/c	25,500		
	45,620		45,620

Balance Sheet
as at 31st March, 2013

Liabilities		₹	*Assets*		₹
Capital	50,000		Bill Receivable		6,000
Add: Net Profit	25,500		Investments		40,000
	75,500		Furniture		12,000
Less: Drawings	500	75,000	Debtors	20,000	
10% Loan		10,000	*Add:* Credit Sales Not		
Outstanding Interest on Loan		100	Recorded	2,000	
Creditors		9,300		22,000	
Bills Payable		5,000	*Less:* New Provision	1,100	20,900
Outstanding Salaries		500	Accrued Commission		1,000
			Closing Stock		5,000
			Bank		10,000
			Unexpired Advertisement Exp.		5,000
		99,900			99,900

Summarised view of Adjustment Entries

Adjustment	*Adjustment entry*	*Treatment in Trading and Profit & Loss A/c*	*Treatment in Balance Sheet*
1. Closing stock	Closing stock A/c Dr To Trading A/c	Shown on the credit side of Trading A/c	Shown on the Assets side
2. Outstanding expenses	Expenses A/c Dr To Outstanding expenses A/c	Added to respective expenses on the debit side	Shown on the liabilities side
3. Prepaid expenses	Prepaid expenses A/c Dr To Expenses A/c	Deducted from the respective expenses on the debit side	Shown on the Assets side
4. Accrued income	Accrued income A/c Dr To Income A/c	Added to the respective income on the credit side	Shown on the Assets side


Notes

5. Income received in advance	Income A/c Dr To income received in advance A/c	Deducted from the respective income on the credit side	Shownn on the liabilities side
6. Interest on capital	Interest on capital A/c Dr To capital A/c	Shown on the debit side of P&L A/c	Shown as addition to capital on liabilities side
7. Interest on drawings	Capital A/c Dr To interest on drawing A/c	Shown on the credit side P&L A/c	Shown as deduction to capital on liabilities side
8. Depreciation	Depreciation A/c Dr To Assets A/c	Shown on the debit side P&L A/c	Deducted from the value of Assets
9. Further bad debts	Bad Debts A/c Dr To Debtors A/c	Shown on the debit side P&L A/c	Deducted from debtors, shown on Assets side
10. Provision for bad and doubtful debts	Profit & Loss A/c Dr To Provision for bad and doubtful debts	Shown on the debit side P&L A/c	Shown as deduction from debtors on Assets side.
11. Provision for Discount on Debtors	Profit & Loss A/c Dr. To Provision for Discount	Shown on the debit side P&L A/c	Shown as deduction from debtors on Assets side.
12. Commission to Manager	Profit & Loss A/c Dr. To Manager's Commission	Shown on the debit side P&L A/c	Shown in liability side
13. Extra Ordinary Loss	Profit & Loss A/c Dr. To Extra Ordinary Loss	Shown on the debit side P&L A/c	Shown as deduction from concerned Asset on Assets side.
14. Drawings of goods by the Owner	Drawings A/c Dr. To Purchases A/c	To be deducted from purchases.	Shown as deduction from Capital on Liabilities side.
15. Distribution of goods as free samples	Advertisement A/c Dr. To Purchases A/c	To be deducted from purchases.	Shown on debit side of P & L A/c

Notes

INTEXT QUESTIONS 18.4

State whether the following statements are True or False :

i. Proprietor draws some goods or cash from the business is a drawing.

ii. If proprietor draws goods then it will be deducted from purchases.

iii. Drawing is an asset.

iv. Good distributed as free samples is advertisement for the business.

v. Goods distributed as free sample is shown on the debit side of trading A/c.

WHAT YOU HAVE LEARNT

- Adjustments are needed to be accounted for so that Income Statement and Position Statement show the correct profit or loss and financial position.
- There can be items of income and expenditure which do not pertain to the accounting year for which financial statements are being prepared. These are to be excluded. These are called prepaid items.
- There can be items of expenses and income which are left out and are to be accounted, which are called outstanding expenses or accrued incomes.
- Other important adjustments to be carried out are Closing Stock, Depreciation on fixed assets, interest on capital and interest on Drawings.
- There may be further bad debts and provision for bad and doubtful debts need to be made on debtors.
- Further bad debts are irrecoverable debts in addition to what has been shown in the Trial Balance as bad debts
- Provision for bad and doubtful debts is created for future payments due from debtors but seems to be irrecoverable. It is created on the basis of past experiences.
- The Process of creating provision for discount on debtors is same as provision for doubtful debts. The likely amount of the discount to be allowed is debited to the P&L A/c and the same will be deducted from debtors in the balance sheet.
- If the manager is allowed commission on the net profit before charging such commission then the following formula should be used :

$$\text{Net Profit} \times \frac{\text{\% of commission}}{100}$$

and if the manager is entitled for commission. On the net profit after charging such commission then the following formula should be used :

$$\text{Net Profit} \times \frac{\%\text{ of commission}}{(100 + \%\text{ of commission})}$$

- Abnormal losses occur because of fire, earthquakes or accidents. These may destroy some fixed assets of the firm. In such case an Asset Account is credited to trading A/c and debited to profit and loss A/c debited.
- Drawings of goods by the propriter is deducted from purchases on the debit side of Trading A/c., and deducted from capital in Balance Shet.
- Goods distributed as free sample is duducted from purchases and shown in the debit side of P&L A/c as advertisement.

TERMINAL EXERCISE

1. Answer the following questions in brief.

   (a) Why are adjustments needed?

   (b) Why are outstanding expenses treated as liabilities?

   (c) What is the difference between accrued income and unearned income?

2. Pass necessary journal entries for following adjustments :

   i. Wages outstanding

   ii. Depreciation on Furniture

   iii. Interest on Investment accrued but not received

   iv. Insurance Premium paid in advance

3. Why reserve is created for doubtful debts?

4. From the following trial balance of M/s V.B. Fertilizers prepare Trading & Profit and Loss Account for the year ending 31st December, 2013 and Balance Sheet as on that date. Also pass Journal entries for the adjustments:

Particulars	*Dr. (₹)*	*Particulars*	*Cr (₹)*
Stock (1.1.2013)	13,800	Capital	65,000
Purchases	52,000	Bills payable	18,000
Wages	4,000	Sales	74,400
Return inward	2,400	Return outward	1,500
Land & Building	40,000	Discount	450
Plant & machinery	24,500	Creditors	6,500
Bills receivable	12,000	Interest	600
Debtors	5,500	Bad debts Reserve	250

Notes

Cash in hand & at Bank	8,750	Loan	8,000
Rent (office)	2,200	Commission	700
Bad Debts	400		
Insurance	1,500		
Freight inward	1,400		
Fuel & Power	2,450		
Furniture	4,500		
	1,75,400		1,75,400

Adjustments

i. Stock on 31.12.2013 ₹ 25,000.

ii. Write off depreciation on furniture 10% and on plant & machinery 20%.

iii. Provide for wages outstanding ₹650 and rent outstanding ₹ 200. Prepaid insurance amounted to ₹ 300.

iv. Further bad debts amounted to ₹ 100. Make a provision for bad & doubtful debts @ 5% on debtors.

v. Interest on capital to be allowed @ 6%.

5. On 1st April, 2013 reserve for Bad Debts shows a balance of ₹ 3,200 Bad debts during the year as per ledger were ₹ 2,100. Debtors amounted to ₹7,000. After closing of the ledger, it was found that there were bad debts of ₹ 800. It was decided to create a reserve for doubtful debts on creditors @6%.

Pass necessary journal entries and show the items in Profit & Loss account and Balance Sheet.

6. From the following trial balance of Pranaya as at 31st December, 2014, prepare Trading and Profit & loss account for the year ended 31st December, 2014 and a Balance Sheet as on that date after making necessary adjustments. Also Give journal entries for these adjustments

Trial Balance
as at 31-12-2014

Name of Account	*Dr. Balances (₹)*	*Dr. Balances (₹)*
Pranaya's Capital Account		1,00,000
Drawings	24,000	–
Plant and Machinery	45,000	–
Stock (1st Jan, 2014)	15,000	–
Purchases	85,000	–
Return inwards	5,000	–
Sundry Debtors	24,600	–

Freight and duty	2,000	–
Carriage outwards	1,600	–
Rent Rates & Taxes	3,800	–
Sundry Creditors	–	22,000
Postage & Courier Expenses	1,800	
Sales	–	1,35,000
Provision for Bad Debts	–	600
Discount	–	800
Insurance Premium	900	–
Wages	23,000	–
Cash in Hand	6,200	–
Cash at Bank	20,500	–
	2,58,400	2,58,400

Adjustments

i. Stock on 31st December, 2014 was valued at ₹ 24,000.

ii. Write off ₹ 600 as bad debts.

iii. Provision for doubtful debts is to be maintained at 5% on sundry debtors.

iv. Provide depreciation on plant and machinery at 20%. A machine costing ₹ 1,500 was purchased on 1st July, 2014.

v. Wages outstanding amounted to ₹ 1,500, and Insurance Prepaid was ₹ 250.

7. The following are the balances extracted from the books of Chinmay Aggarwal on 31st March 2014.

	₹		₹
Chinmay's Capital	60,000	Stock (1.4.2013)	44,200
Furniture & Fixtures	5,000	Debtors	36,000
Bank Overdraft	8,400	Rent received	2,000
Creditors	27,600	Purchases	2,20,000
Business Premises	50,000	Sales	3,00,000
Discount (Dr)	3,200	Sales Returns	4,000
Tax & Insurance	4,000	Bills Payable	10,000
Salaries	20,000		
Commission (Cr.)	2,000		
Carriage inward	3,600		
Bad Debts	1,600		
Motor Vehicle	14,400		
Investments	4,000		

Following adjustments are to be made :

(i) Stock on 31 March, 2014 ₹ 35,000.

(ii) Write off depreciation on :

Business Premises ₹ 800

Furniture & Fixture ₹ 500

Motor Vehicle 10% p.a.

(iii) Interest on bank overdraft ₹ 150.

(iv) Interest on capital was to be allowed @ 6% p.a.

(v) Make a provision of 5% on debtors for doubtful debts.

(vi) Carry forward ₹ 500 for unexpired insurance.

Prepare Trading and Profit & loss A/c for the year ended 31st March, 2014 and Balance Sheet as on that date.

8. Pass necessary journal entries for the following adjustments :

   i. 1/3rd of the total commission received during the year of ₹12000 relates to the next year

   ii. Insurance premium of Rs.8000 is paid for the year ending 30st June. Accounts are closed on 31st March every year.

   iii. Interest on drawing is charged for the year amounting to ₹ 450.

9. Explain the following adjustments with examples :

   i. Provision for discount on debtors.

   ii. Manager's Commission

10. What do you mean by Abnormal loss? Also explain its accounting treatment with the help of an example.

11. Explain the accounting treatment of drawing of goods by the proprietor and goods distributed as free samples.

ANSWERS TO INTEXT QUESTIONS

18.1 (i) profit, loss (ii) profit or loss, financial position

(iii) excluded (iv) accounted for

18.2 (i) Outstanding expenses (ii) Prepaid expenses

(iii) Accrued income (iv) Income received in advance

18.3 I. (i) provision for bad & doubtful debts

(ii) depreciation (iii) bad debts (iv) closing stock

Notes

II. (i) To capital account (ii) To wages outstanding A/c

(iii) To insurance premium A/c

(iv) To commission received in advance A/c

III. (i) False (ii) True (iii) False (iv) False (v) True

IV. (i) Debit (ii) Liability

18.4 (i) True (ii) True (iii) False (iv) True (v) False

ANSWERS TO TERMINAL EXERCISE

4. (G.P. ₹ 24200; N.P. ₹ 12580

   Total of Balance Sheet ₹ 114830

6. G.P. ₹ 27500; N.P. ₹ 10400

   Total Balance Sheet ₹ 109900

7. G.P. ₹ 63200; N.P. ₹ 30610

   Total balance Sheet : ₹ 140360

ACTIVITY

Analyse the financial statements of at least four business concerns and record the rate at which depreciaiton is charged on various fixed assets and provision is made for doubtful debts and find out the reasons of variation.

S.No.	*Name of Business concern*	*Rate of Depreciation*	*Reasons of variation*