Final Accounts (With Adjustments)

Financial Statements with Adjustments- Requirement and their effects

Objectives
After going through this lesson, you shall be able to understand the following topics.

- Meaning of Adjusting Entries
- Need of Adjusting Entries

Introduction

**** Note:*** *Excise duty has been replaced with Goods and Services Tax and hence will not be shown in the Trading Account.*

In the previous chapter, we have learnt the preparation of financial statements by a sole proprietor. We also know that the financial statements consist of mainly three parts, namely, Trading Account, Profit and Loss Account and Balance Sheet. These statements are prepared to reveal the financial position and performance of a business at the end of an accounting period.
Now, before we proceed further, let's have a quick review of the items that are recorded in these statements.

Financial Statements	What all are recorded?
Trading Account	Records all the direct expenses (i.e. expenses that are directly related to the production of goods and services)
Profit and Loss Account	Records all the indirect expenses (i.e. expenses that are not directly related to the production of goods and services)
Balance Sheet	Records all the assets and liabilities of a firm

With this review, we are now in a position to learn various adjustments and adjusting entries that you will face while preparing financial statements in this chapter.

Meaning of Adjustments and Adjusting Entries
Often while preparing the financial statements; it happens that a few items remain unrecorded. These items are either omitted to be recorded or are wrongly recorded in the books. In both these scenarios, financial statements are abstained from revealing the true and fair financial performances. Thus, in order to get a clear financial picture, it is mandatory to incorporate such adjustments. These adjustments are always given outside the Trial Balance. Also, as these adjustments provide additional information related to the financial items, so these are also termed as additional information. In order to incorporate such adjustments in the financial statements, we pass the required Journal entries, which are termed as adjusting entries.

Need and Purpose of Adjusting Entries
These adjusting entries help in disclosing the true financial position. The given below are the various purposes served by the adjusting entries.

i. It helps to assess the true financial position of a business on accrual basis of accounting.

ii. It helps to record the items which were omitted to be recorded in the books of accounts.

iii. It helps in knowing the actual figure of profit or loss.

iv. It helps in providing the depreciation on fixed assets.

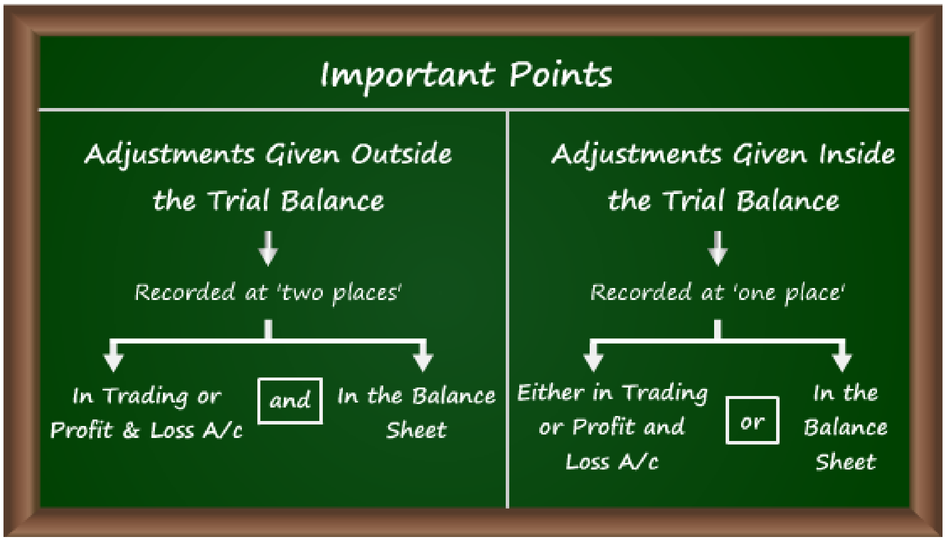
v. It assists in separating all the financial transactions into a year-wise category. The financial statements include only those transactions which belong to the current year. That is, it rules out the transactions related to the previous year and next years.

vi. It provides room for making various provisions which are made at the end of the year, after assessing the entire year's performance.

Some Important Points to be Noted

➢ According to the double-entry system, all the adjustments given outside the Trial Balance are posted at two places. That is, first, in the Trading or Profit and Loss Account and second, in the Balance Sheet.

➢ Lastly, all the adjustments given inside the Trial Balance are to be recorded only at one place. That is, either in the Trading and Profit and Loss Account or in the Balance Sheet.



Closing Stock, Outstanding Expenses and Prepaid Expenses

Objectives
After going through this lesson, you shall be able to understand the adjustment of the following items in preparation of the Final Accounts.

- Closing Stock
- Outstanding Expenses
- Prepaid Expenses

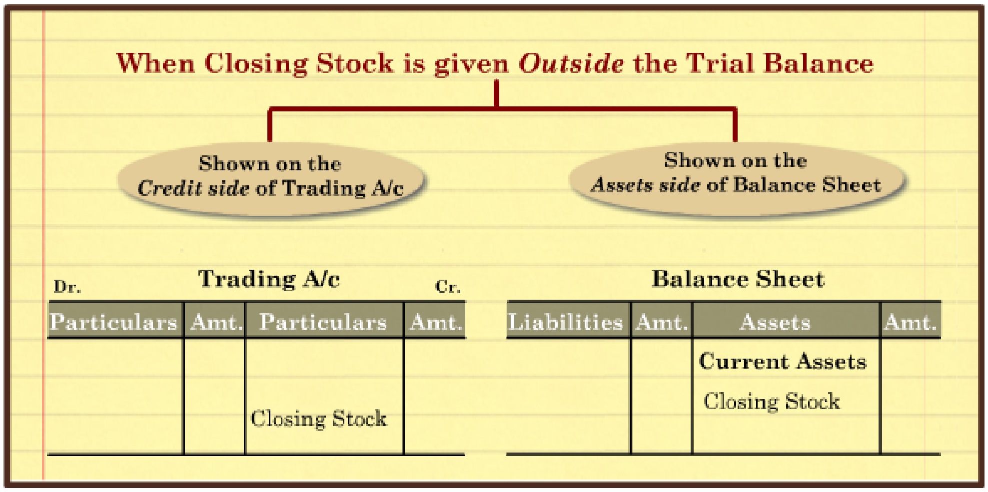
Closing Stock
Closing Stock is the amount of goods that remained unsold at the end of an accounting period. Closing Stock is always valued at the end of the year. Therefore, it is generally given outside the Trial Balance.
The Journal entry for recording the closing stock in the books is as follows.

Closing Stock A/c Dr. To Trading A/c (Closing Stock transferred to Trading Account)		

Treatment- The treatment of Closing Stock in the financial statements is as follows.

1. Firstly, it is recorded with the given amount on the Credit side of the Trading Account and
2. Secondly, being an asset, it is shown on the Assets Side of the Balance Sheet under the head Current Assets.

The disclosure of closing stock in the final accounts is given below



When both- 'Cost Price' and 'Market Price' of Closing Stock is given
Sometimes, it may happen that the two values of closing stock i.e. 'Cost' and 'Market Price' are given in the question. In such a case, closing stock is recorded in the books by following the accounting convention of 'Conservatism'. As per this, closing stock is valued at its 'Cost' or 'Market Price', *whichever is less*. That is, if at the end of the year, the market price of closing stock becomes lower than its cost, then closing stock will be recorded in the books at its market price and vice-versa. It is done in order to provide for the anticipated loss in the value of stock. Conservatism Principle states that "One shall not anticipate a profit but shall always provide for all prospective losses". This makes sure that the assets and incomes are not overstated, while the liabilities and losses are not understated.

For example, some goods were purchased at a cost of Rs 15,000. At the end of the year, its realisable value in the market is Rs 18,000. In this case, closing stock will be valued at Rs 15,000 and not at Rs 18,000.

***Example 1*: Show the treatment of closing stock in the books for the following cases given outside the Trial Balance-**

a. Closing stock valued at Rs 12,500.

b. Closing stock Rs 18,000 (market price Rs 21,000).

c. Closing stock Rs 28,500 (market price Rs 24,000).

Solution
Case- a

Trading Account

Dr.			Cr.
Particulars	**Amount**	**Particulars**	**Amount**
		Closing Stock	12,500

Balance Sheet

Liabilities	**Amount**	**Assets**	**Amount**
		Current Assets Closing Stock	 12,500

Case b

Trading Account

Dr.			Cr.
Particulars	**Amount**	**Particulars**	**Amount**
		Closing Stock	18,000

Balance Sheet

Liabilities	**Amount**	**Assets**	**Amount**
		Current Assets Closing Stock	 18,000

Note: *Closing stock is valued at Cost or Market Price, whichever is less. Here, cost of closing stock (i.e. Rs 18,000) is less than its Market Price (i.e. Rs 21,000). Therefore, closing stock is recorded with Rs 18,000 in the books.*

Case c

Trading Account

Dr. Particulars	Amount	Particulars	Cr. Amount
		Closing Stock	24,000

Balance Sheet

Liabilities	Amount	Assets	Amount
		Current Assets Closing Stock	24,000

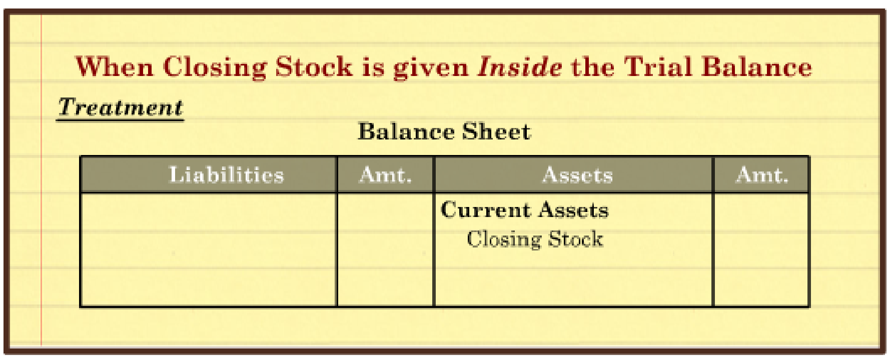
Note: *Closing stock is valued at Cost or Market Price, whichever is less. Here, Market Price of closing stock (i.e. Rs 24,000) is less than its Cost (i.e. Rs 28,500). Therefore, closing stock is recorded with Rs 24,000 in the books.*

In case Closing Stock is given *Inside* the Trial Balance

There may be a situation when the value of closing stock is not given outside the Trial Balance. Rather, it is given inside the Trial Balance. This implies that closing stock is already adjusted in the purchases and purchases given in the Trial Balance represents the Net Adjusted Purchases.
Algebraically, Net Adjusted Purchases can be written in the following form:
Net Adjusted Purchases = Purchases + Opening Stock – Closing Stock

From the above equation, it can be inferred that purchases given in the Trial Balance, are adjusted with both- opening as well as closing stock.

As we know, that adjustments given inside the Trial Balance are recorded only at one place. As in this case, Closing Stock is given inside the Trial Balance, so, it is shown only in the Balance Sheet and not in the Trading Account.



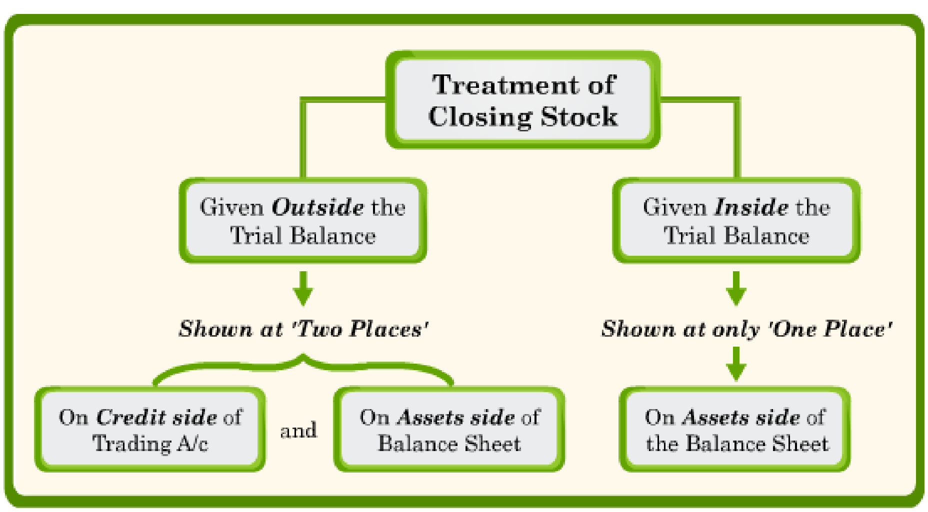
When Closing Stock is given *Inside* the Trial Balance

Treatment

Balance Sheet

Liabilities	Amt.	Assets	Amt.
		Current Assets Closing Stock	

Conclusion



***Example 2*: Given below is the extract of a Trial Balance. Show how the following items will appear in the final accounts.

Extract of Trial Balance		
Particulars	**Debit (Rs)**	**Credit (Rs)**
Opening Stock	5,000	
Purchases	12,000	

Additional Information: Closing stock valued at Rs 8,500.

Solution

Trading Account			
Dr.			**Cr.**
Particulars	**Amount**	**Particulars**	**Amount**
Opening Stock	5,000	Closing Stock	8,500
Purchases	12,000		

Balance Sheet			
Liabilities	**Amount**	**Assets**	**Amount**
		Current Assets	
		Closing Stock	8,500

***Example 3*: Given below is the extract of a Trial Balance. Show how the following items will appear in the final accounts.

Extract of Trial Balance	
Particulars	**Amount (Rs)**
Purchases	21,800
Closing Stock	5,700

Solution

Trading Account			
Dr.			**Cr.**
Particulars	**Amount**	**Particulars**	**Amount**
Purchases	21,800		

Balance Sheet			
Liabilities	**Amount**	**Assets**	**Amount**
		Current Assets	
		Closing Stock	5,700

Note: *Here, the closing stock is given inside the Trial Balance. This implies that the value of closing stock is already adjusted in the purchases given. Therefore, closing stock is not shown in the Trading Account. It is shown only on the Assets Side of the Balance Sheet.*

Outstanding Expenses

While carrying out the business activities, there may be certain expenses related to the current period that are still to be paid. These expenses are termed as ***Outstanding Expenses***. In other words, Outstanding Expenses are those expenses the services in respect of which have already been availed but the payments are not yet made.

For example, salary is to be paid @ Rs 5,000 per month. But, during the year, salary of only Rs 50,000 is paid by the business. In this case, salary for the two months of Rs 10,000 (Rs 5,000 × 2) is still to be paid during the year. Thus, here the amount of outstanding salary is Rs 10,000.

1. When Outstanding Expenses are given ***outside*** the Trial Balance

Generally, the information related to the outstanding expenses are given outside the Trial Balance.

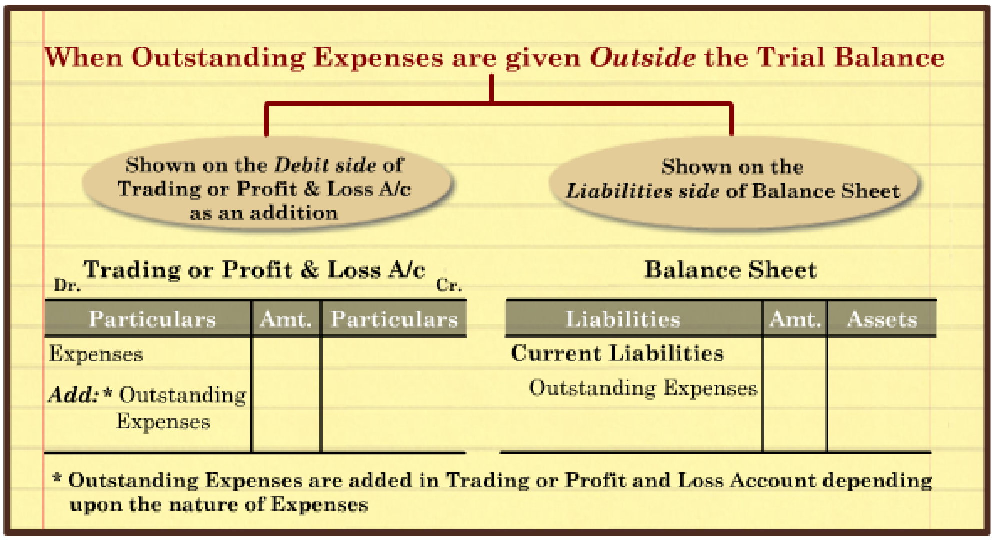
The adjusting Journal entry for recording outstanding expenses is given below.

Expenses A/c Dr. To Outstanding Expenses A/c (Expenses remained outstanding)		

Treatment- The treatment of Outstanding Expenses in the financial statements is as follows.

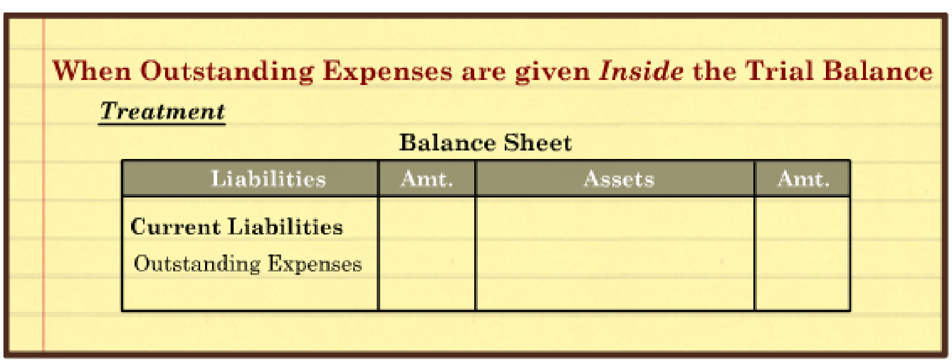
1. First, outstanding expenses are shown on the Debit side of the Trading or Profit and Loss Account as an addition to the related expense.
2. Secondly, it is shown on the Liabilities Side of the Balance Sheet under the head Current Liabilities. It is considered as a liability because these expenses are still to be paid.

The disclosure of outstanding expenses in final accounts is given below.

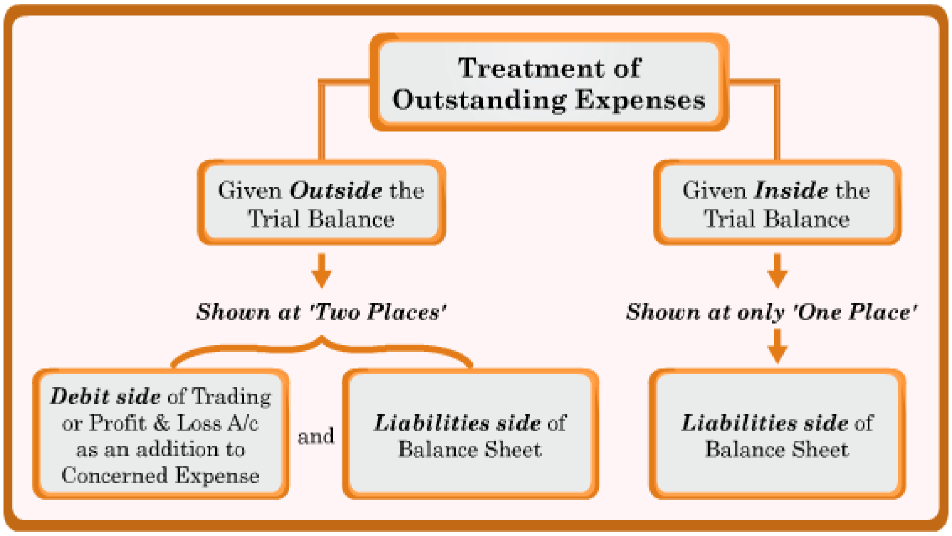


2. When Outstanding Expenses are given Inside the Trial Balance

Sometimes, there may be a situation when the outstanding expenses are given inside the Trial Balance. In such a case, these expenses are already adjusted in the concerned expenses. Therefore, there is no need to show them in the Trading or Profit and Loss Account as an addition to the related expenses. These are shown only in the Balance Sheet on the Liabilities Side.



Conclusion



Example 1: Given below is the extract of a Trial Balance. Show how the following expenses will be dealt while preparing the financial statements. Also pass the adjusting Journal entries.

Extract of Trial Balance

Particulars	**Amount (Rs)**
Telephone Expenses	5,400
Octroi	2,000

Additional Information: Telephone expenses Rs 300 and Octroi Rs 800 outstanding during the year.

Solution

Adjusting Entries-

Telephone Expenses A/c	Dr.	300	
To Outstanding Telephone Expenses A/c			300
(Telephone Expenses remained outstanding)			

Octroi A/c	Dr.	800	
To Outstanding Octroi A/c			800
(Octroi remained outstanding)			

Trading Account
for the year ended…

Dr. Particulars		Amount	Particulars	Cr. Amount
Octroi	2,000			
Add: Outstanding Octroi	800	2,800		

Profit and Loss Account
for the year ended…

Dr. Particulars		Amount	Particulars	Cr. Amount
Telephone Expenses	5,400			
Add: Outstanding Telephone Expenses	300	5,700		

Balance Sheet *as on…*			
Liabilities	**Amount**	**Assets**	**Amount**
Current Liabilities Outstanding Octroi Outstanding Telephone Expenses	 800 300		

Example 2: Given below is the extract of a Trial Balance. Show how the following expenses will be dealt in the financial statements.

Extract of Trial Balance

Particulars	Amount (Rs)
Wages	8,250
Rent	5,750
Outstanding Rent	1,350
Outstanding Wages	925

Solution

Trading Account *for the year ended…*			
Dr.			**Cr.**
Particulars	**Amount**	**Particulars**	**Amount**
Wages	8,250		

Profit and Loss Account *for the year ended…*			
Dr.			**Cr.**
Particulars	**Amount**	**Particulars**	**Amount**
Rent	5,750		

Balance Sheet *as on…*			
Liabilities	**Amount**	**Assets**	**Amount**
Current Liabilities Outstanding Wages Outstanding Rent	 925 1,350		

Note: *As outstanding wages and outstanding rent are given inside the Trial Balance, so it implies that, these are already adjusted in the concerned expenses. Therefore, these are not shown in the Trading and Profit and Loss Account. These are only shown on the Liabilities Side of the Balance Sheet.*

Example 3: Given below is the extract of a Trial Balance. Show how the following items will appear in the financial statements.

Extract of Trial Balance

Particulars	Amount (Rs)
Salary	22,000
Rent	15,500
Wages	7,800

Outstanding Rent Electricity Charges	850 9,550

Additional Information:

1. Electricity charges of Rs 1,600 still to be paid.
2. Salary paid for 11 months.
3. Wages outstanding Rs 2,200.
4. Closing stock valued at Rs 19,000 (Market Value Rs 16,500).

Solution

Trading Account
for the year ended…

Dr. **Cr.**

Particulars		Amount	Particulars	Amount
Wages	7,800		Closing Stock	16,500
Add: Outstanding Wages	2,200	10,000		

Profit and Loss Account
for the year ended…

Dr. **Cr.**

Particulars		Amount	Particulars	Amount
Salary	22,000			
Add: Outstanding Salary	2,000	24,000		
Rent		15,500		
Electricity Charges	9,550			
Add: Outstanding Charges	1,600	11,150		

Calculation of Outstanding Salary

Salary paid for 11 months = 22,000

$$\therefore \text{Salary per month} = \frac{22,000}{11} = 2,000$$

So, salary outstanding for 1 month = Rs 2,000

Balance Sheet
as on…

Liabilities	Amount	Assets	Amount
Current Liabilities		**Current Assets**	
Outstanding Wages	2,200	Closing Stock	16,500
Outstanding Salary	2,000		
Outstanding Rent	850		
Outstanding Electricity Charges	1,600		

Note 1: *Outstanding Rent is given inside the Trial Balance which implies that it is already adjusted in the rent given in the Trial Balance. Therefore, it is shown only on the Liabilities Side of the Balance Sheet and not in the Profit and Loss A/c.*

Note 2: *Closing stock is valued at Cost or Market Price, whichever is less. Here, Market Price of closing stock (i.e. Rs 16,500) is less than its Cost (i.e. Rs 19,000). Therefore, closing stock is recorded with Rs 16,500 in the books.*

Prepaid Expenses
Sometimes, a business makes payments of certain expenses in advance. These expenses are known as prepaid expenses. In short, these are the expenses the benefits of which have not been availed but the payment is already made in advance. It basically represents the advance payments made during the current year relating to the next accounting year.

For example, insurance premium of Rs 12,000 paid on June 30, 2013 for one year. Accounting year starts from 1st April 2013 till 31st March 2014. In this case, during the year 2013 insurance premium is paid only for 9 months (i.e. from July, 2013 to March, 2014) which is related to the current year 2013-14. The rest of the part of payment for the remaining 3 months (i.e. from April, 2014 to June, 2014) will be regarded as insurance paid in advance for the year 2014-15.

Therefore, the amount of Rs 3,000 $\left(\text{i.e.}\frac{12,000}{12}\times 3\right)$ is considered as prepaid insurance.

➢ When Prepaid Expenses are given *outside* the Trial Balance

Generally, the information related to the prepaid expenses is given outside the Trial Balance.

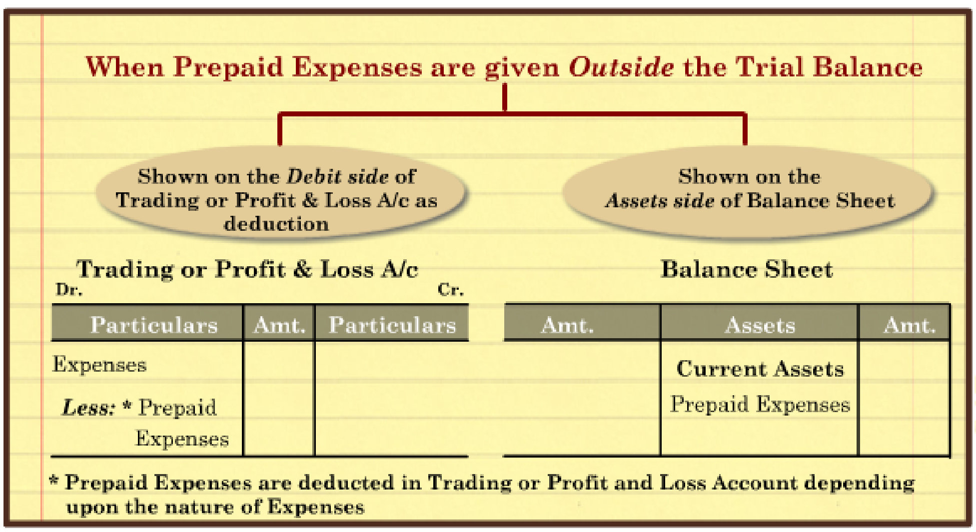
The adjusting Journal entry for prepaid expenses is given below.

Prepaid Expenses A/c Dr. To Expenses A/c (Expenses paid in advance)		

Treatment- The treatment of Prepaid Expenses in the financial statements is as follows.

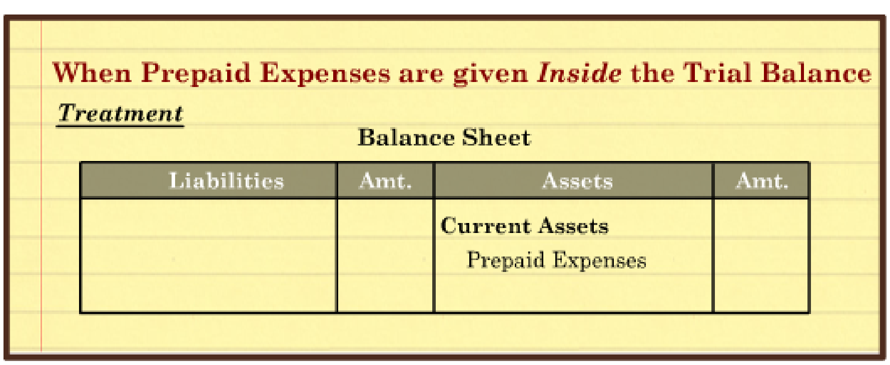
1. First of all, prepaid expenses are shown on the Debit side of the Trading or Profit and Loss Account as deduction from the related expense.
2. Secondly, it is shown on the Assets side of the Balance Sheet under the head Current Assets. It is considered as an asset because the benefits against these expenses are not yet availed.

The disclosure of prepaid expenses in final accounts is given below.

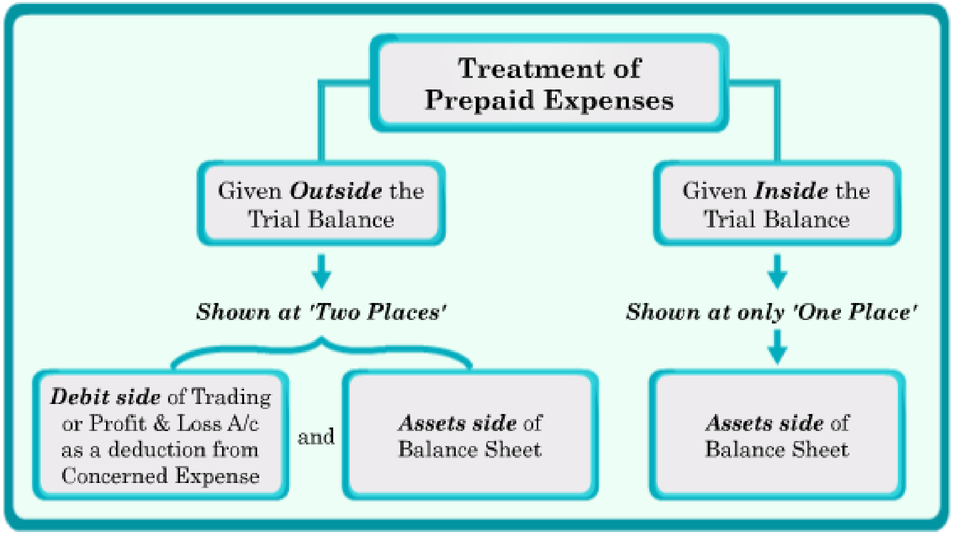


➢ When Prepaid Expenses are given *Inside* the Trial Balance

There may be a situation, when prepaid expenses are given inside the Trial Balance. In such a case, these expenses are already adjusted in the concerned expenses. Therefore, there is no need to show them in the Profit and Loss Account. These are shown only in the Balance Sheet.



Conclusion



***Example 1*:** Given below is the extract of a Trial Balance. Show how the interest paid will be shown while preparing the final account. Also pass the adjusting Journal entry.

Extract of Trial Balance

Particulars	Amount (Rs)
Interest Paid	13,500

Additional Information: Interest paid in advance Rs 1,700 during the year.
Solution
Adjusting Entry-

Prepaid Interest A/c To Interest A/c (Interest paid in advance)	Dr.	1,700	 1,700

Profit and Loss Account

Dr.			Cr.
Particulars	**Amount**	**Particulars**	**Amount**
Interest Paid 13,500 *Less*: Prepaid Interest (1,700)	 11,800		

Balance Sheet

Liabilities	Amount	Assets	Amount
		Current Assets Prepaid Interest	 1,700

***Example 2*:** Given below is the extract of a Trial Balance. Show how the insurance premium will be dealt in the financial statements.

Extract of Trial Balance

Particulars	Amount (Rs)
Insurance	8,100
Prepaid Insurance	800

Solution

Profit and Loss Account Dr.			Cr.
Particulars	**Amount**	**Particulars**	**Amount**
Insurance	8,100		

Balance Sheet

Liabilities	Amount	Assets	Amount
		Current Assets Prepaid Insurance	 800

Note: *Here, prepaid insurance is given inside the Trial Balance. This implies that it is already adjusted in the given amount of insurance. Therefore, it is shown only in the Balance Sheet on the Assets side and not shown in the Profit and Loss A/c.*

<u>Example 3</u>**:** Given below is the extract of a Trial Balance. Show the treatment of the following items in the financial statements.

Extract of Trial Balance
as on December 31, 2013

Particulars	Amount (Rs)
Purchases	1,25,000
Salary	35,000
Insurance	48,000
Rent	23,500
Rent paid in advance	2,500
Closing Stock	27,000

Additional Information:

1. Salary paid for 10 months.
2. Insurance paid on October 01, 2013 for one year.

Solution

Trading Account ***for the year ended…*** Dr.			Cr.
Particulars	**Amount**	**Particulars**	**Amount**
Purchases	1,25,000		

Profit and Loss Account ***for the year ended…*** Dr.				Cr.
Particulars		**Amount**	**Particulars**	**Amount**
Salary	35,000			
Add: Outstanding Salary (***WN1***)	7,000	42,000		
Rent		23,500		
Insurance	48,000			
Less: Prepaid Insurance (***WN2***)	(36,000)	12,000		

Balance Sheet			
Liabilities	**Amount**	**Assets**	**Amount**
Current Liabilities		**Current Assets**	
Salary Outstanding	7,000	Closing Stock	27,000
		Rent paid in Advance	2,500
		Prepaid Insurance	36,000

Note 1: *Rent paid in advance is given inside the Trial Balance. Therefore, it is shown only in the Balance Sheet on the Assets side and not shown in the Profit and Loss A/c.*

Note 2: *Closing stock is given inside the Trial Balance. This implies that the value of closing stock is already adjusted in the given purchases. Therefore, closing stock is not shown in the Trading Account. It is shown only on the Assets Side of the Balance Sheet.*

Working Notes:

WN1: Calculation of Outstanding Salary

Salary paid for 10 months = 35,000

$$\therefore \text{Salary per month} = \frac{35,000}{10} = 3,500$$

So, salary outstanding for 2 month = 3,500 × 2= Rs 7,000

WN2: Calculation of Insurance Paid in Advance

Insurance paid for the year = 48,000

$$\therefore \text{Insurance per month} = \frac{48,000}{12} = 4,000$$

So, Insurance paid in advance for 9 months (*from Jan. 01 to Oct. 31, 2014*) = 4,000 × 9 = Rs 36,000

Accrued Income and Income Received in Advance

Objectives

After going through this lesson, you shall be able to understand the adjustment of the following items in preparation of the Final Accounts.

- Accrued/Outstanding Income
- Income Received in Advance

Accrued Income

Income of the current year which are still to be received by a business are known as accrued income. These are the incomes which a business earns during the current year but are not received in the same year. In short, these incomes are earned in the current year but are received in next accounting year. These incomes are also known as Outstanding Income or Income Receivable or Incomes earned but not received.

For example, rent is to be received @ Rs 2,000 per month. During the year rent received Rs 22,000. In this case, rent for one month i.e. Rs 2,000 is still to be received. Thus, the amount of Rs 2,000 is considered as outstanding rent or rent receivable.

➢ **When Accrued Incomes are given *outside* the Trial Balance**

Generally, the information related to the accrued income is given outside the Trial Balance.

The adjusting Journal entry for accrued incomes is given below.

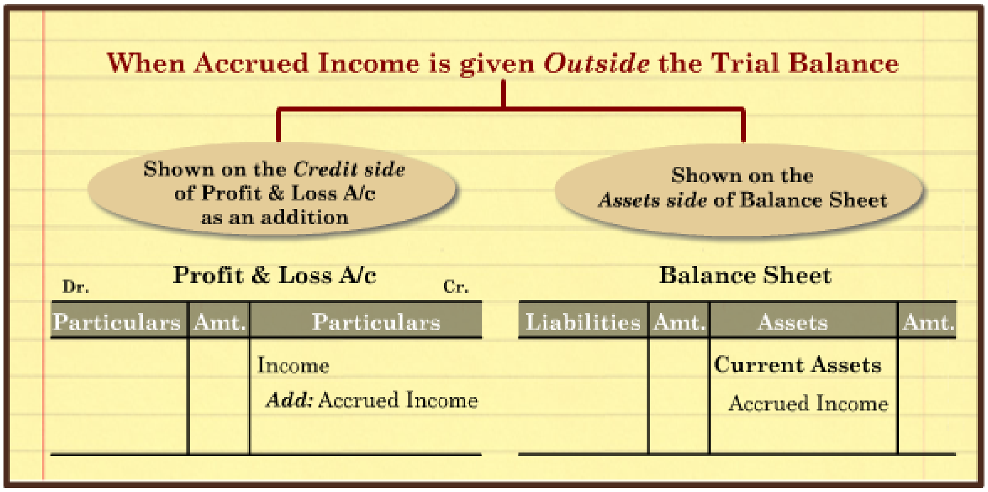
Accrued/Outstanding Income A/c To Income A/c (Income earned but not received)	Dr.		

Treatment- The treatment of Accrued Income in the final accounts is as follows.

1. Firstly, outstanding incomes are shown on the credit side of the Profit and Loss Account as an *addition* to the concerned income.

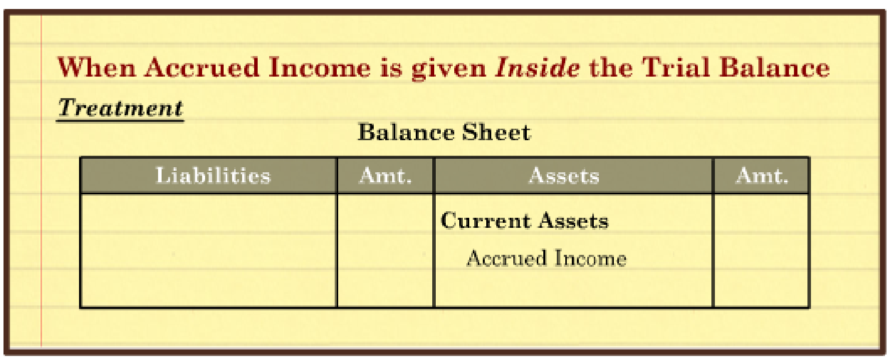
2. Secondly, it is shown on the Assets Side of the Balance Sheet under the head Current Assets. It is considered as an asset because it is an income of the business which is still to be received.

The disclosure of accrued incomes in final accounts is given below.

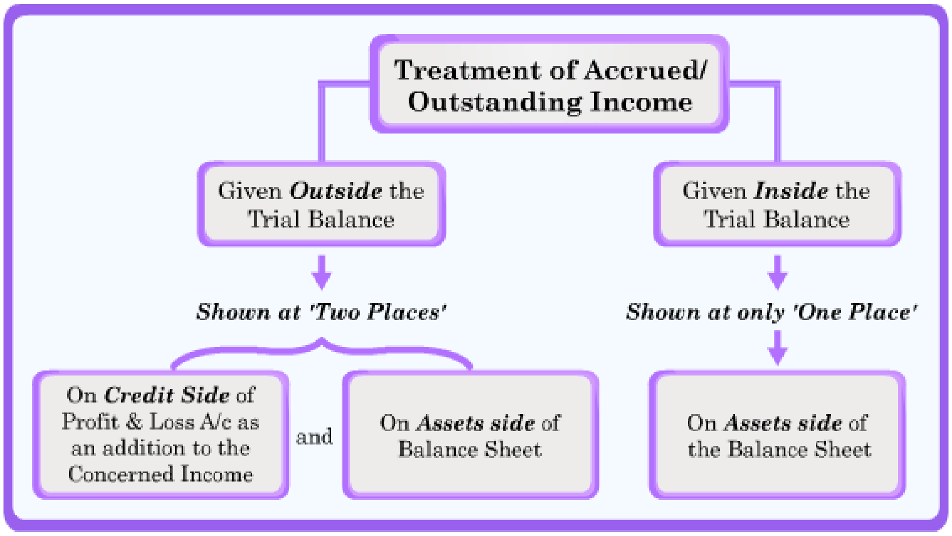


➢ **When Accrued Incomes are given *inside* the Trial Balance**

There may be a situation, when accrued incomes are given inside the Trial Balance. In such a case, these incomes are already adjusted in the concerned incomes. Therefore, there is no need to show them in the Profit and Loss Account. These are shown only on the Assets Side of the Balance Sheet.



Conclusion



Implication of GST on Certain Incomes

Income	Treatment	Explanation
1) Accrued Commission with GST	Accrued Commission A/c Dr. To Commission A/c (Amount of commission) To Output CGST A/c (Amount of CGST) To Output SGST A/c (Amount of SGST) Or To Output IGST A/c (Amount of IGST) (Being the accrued commission recorded in the books)	GST will be received on such an Income and will be considered a liability for the firm.
2) Accrued Rent with GST	Accrued Rent A/c Dr. To Rent A/c (Amount of rent) To Output CGST A/c (Amount of CGST) To Output SGST A/c (Amount of SGST) Or To Output IGST A/c (Amount of IGST) (Being the accrued rent recorded in the books)	GST will be received on such an Income and will be considered a liability for the firm.
3) Accrued Interest	GST will not be applicable on Interest. Hence, the entry passed will be: Accrued Interest A/c Dr. To Interest Received A/c (Being the accrued interest accounted)	
4) Income received in Advance along with GST	Income A/c Dr. To Income received in Advance To Output CGST A/c To Output SGST A/c (Being income received in advance along with GST)	GST will be received on such an Income and will be considered a liability for the firm.

Example 1: Given below is the extract of a Trial Balance. Show how the interest received will be shown in the final accounts. Also pass the adjusting Journal entry.

Extract of Trial Balance

Particulars	Amount (Rs)
Interest Received	3,500

Additional Information: Accrued interest Rs 750.

Solution
Adjusting Entry-

Accrued Interest A/c To Interest A/c (Interest earned but not received)	Dr.	750	 750

Profit and Loss Account				
Dr.				**Cr.**
Particulars	**Amount**	**Particulars**		**Amount**
		Interest	3,500	
		Add: Accrued Interest	750	4,250

Balance Sheet			
Liabilities	**Amount**	**Assets**	**Amount**
		Current Assets Accrued Interest	 750

Example 2: Given below is the extract of a Trial Balance. Show how the commission received will be shown in the final accounts.

Extract of Trial Balance

Particulars	**Amount (Rs)**
Commission Received	6,900
Accrued Commission	1,200

Solution

Profit and Loss Account			
Dr.			**Cr.**
Particulars	**Amount**	**Particulars**	**Amount**
		Commission Received	6,900

Balance Sheet			
Liabilities	**Amount**	**Assets**	**Amount**
		Current Assets Accrued Commission	 1,200

Note: *Here, accrued commission is given inside the Trial Balance. This implies that it is already adjusted in the commission received. Therefore, accrued commission is shown only in the Balance Sheet and not shown in the Profit and Loss Account.*

Example 3: Given below is the extract of a Trial Balance. Show how the following items will appear in the financial statements.

Extract of Trial Balance

Particulars	**Amount (Rs)**
Interest on Investments	2,900
Advertisement	5,400
Insurance Paid	3,800

Commission received	6,350
Commission outstanding	1,500

Additional Information:

1. Interest outstanding on investments Rs 1,300.
2. Outstanding advertisement expense Rs 1,600.
3. Insurance paid in advance Rs 800.

Solution

Profit and Loss Account

Dr. Particulars		Amount	Particulars		Cr. Amount
Advertisement	5,400		Interest on Investments	2,900	
Add: Outstanding Expenses	1,600	7,000	*Add*: Accrued Interest	1,300	4,200
Insurance Paid	3,800		Commission received		6,350
Less: Prepaid Insurance	(800)	3,000			

Balance Sheet

Liabilities	Amount	Assets	Amount
Current Liabilities		**Current Assets**	
Outstanding Advertisement	1,600	Accrued Interest on Investments	1,300
		Commission outstanding	1,500
		Prepaid Insurance	800

Income Received in Advance

The income which is not related to the current year but received during the year is known as income received in advance. In other words, this is the income the benefits of which are to be availed in the next accounting year. These incomes are also known as unearned incomes.

For example, commission received during an accounting period is Rs 12,000 including Rs 2,000 for the next accounting period. This commission of Rs 2,000 does not belong to the current year as it is related with the work to be done in the next accounting year. This amount of Rs 2,000 is considered as income received in advance.

• **In case Income Received in Advance is given *outside* the Trial Balance**

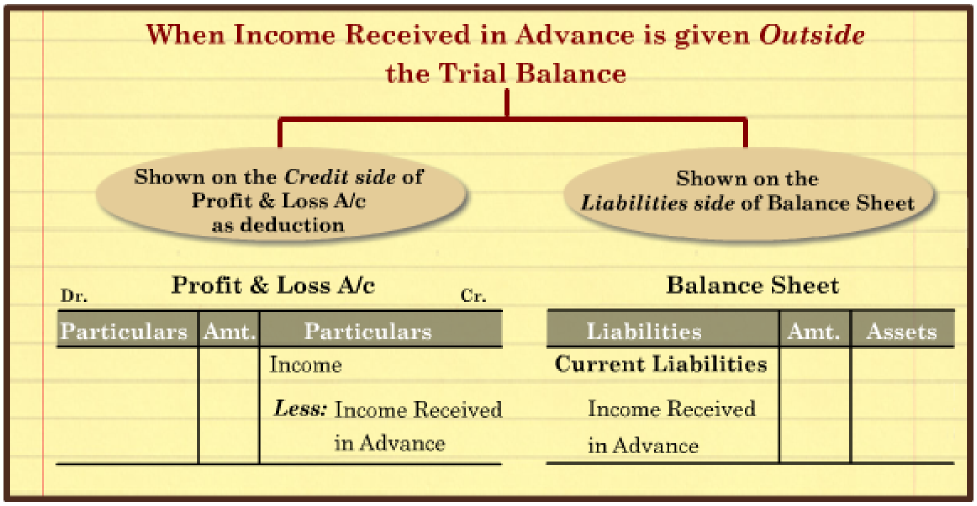
Generally, the information related to the income received in advance is given outside the Trial Balance. The adjusting Journal entry for income received in advance is given below.

Income A/c Dr. To Income Received in Advance A/c (Income received in advance)		

Treatment- The treatment of Income Received in Advance in the final accounts is as follows.

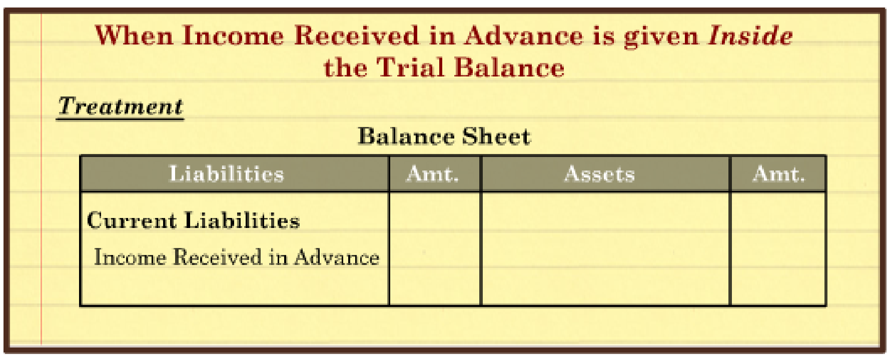
1. First, income received in advance is shown on the Credit side of the Profit and Loss Account as a *deduction* from the concerned income.
2. Secondly, it is shown on the Liabilities Side of the Balance Sheet under the head Current Liabilities.

The disclosure of income received in advance in the final accounts is given below.

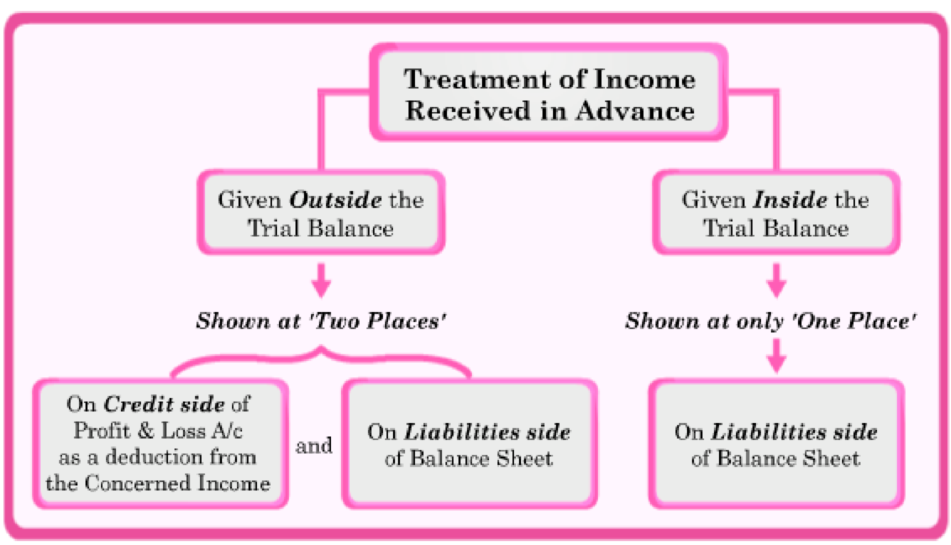


• **In case Income Received in Advance is given *Inside* the Trial Balance**

There may be a situation, when income received in advance is given inside the Trial Balance. In such a case, such income received is already adjusted in the concerned income. Therefore, there is no need to show it in Profit and Loss Account. It is shown only on the Liabilities Side of the Balance Sheet.



Conclusion



Example 1: Given below is the extract of a Trial Balance. Show how the commission received will be shown in the final accounts. Also pass the adjusting Journal entries.

Extract of Trial Balance

Particulars	Amount (Rs)
Commission Received	7,700

Additional Information: Commission Rs 1,900 received in advance.

Solution

Adjusting Entry-

Commission A/c Dr. To Commission Received in Advance A/c (Commission received in advance)	1,900	1,900

Profit and Loss Account

Dr. Particulars	Amount	Cr. Particulars		Amount
		Commission	7,700	
		Less: Commission Received in Advance	(1,900)	5,800

Balance Sheet

Liabilities	Amount	Assets	Amount
Current Liabilities			
Commission Received in Advance	1,900		

Example 2: Given below is the extract of a Trial Balance. Show how the rent received will be shown in the final accounts.

Extract of Trial Balance

Particulars	Amount (Rs)
Rent Received	16,250
Rent Received in Advance	4,000

Solution

Profit and Loss Account

Dr. Particulars	Amount	Cr. Particulars	Amount
		Rent Received	16,250

Balance Sheet

Liabilities	Amount	Assets	Amount
Current Liabilities			
Rent Received in Advance	4,000		

Note: *Here, rent received in advance is given inside the Trial Balance. This implies that, it is already adjusted in the amount of rent received given in the Trial Balance. Therefore, it is shown only on the Liabilities Side of the Balance Sheet and not shown in the Profit and Loss A/c.*

Example 3: Given below is the extract of a Trial Balance. Show how the following items will appear in the financial statements.

Extract of Trial Balance

Particulars	Amount (Rs)
Salary	18,000
Rent Received	21,900
Interest Received	11,000
Insurance Paid	16,200

Additional Information:

1. Rent received in advance Rs 2,900.
2. Insurance paid for 9 months.
3. Accrued interest Rs 3,800
4. Salary paid in advance Rs 3,000.
5. Closing Stock Rs 31,300 (Market Price Rs 38,500).

Solution

Trading Account

Dr. Particulars	Amount	Particulars	Cr. Amount
		Closing Stock	31,300

Profit and Loss Account

Dr. Particulars		Amount	Particulars		Cr. Amount
Salary	18,000		Rent	21,900	
Less: Paid in Advance	(3,000)	15,000	*Less*: Received in advance	(2,900)	19,000
Insurance Paid	16,200		Interest	11,000	
Add: Outstanding Insurance (***WN1***)	5,400	21,600	*Add*: Accrued Interest	3,800	14,800

Balance Sheet

Liabilities	Amount	Assets	Amount
Current Liabilities		**Current Assets**	
Insurance Outstanding	5,400	Closing Stock	31,300
Rent Received in Advance	2,900	Salary Paid in Advance	3,000
		Accrued Interest	3,800

Note: *Closing stock is valued at Cost or Market Price, whichever is less. Here, Cost of closing stock (i.e. Rs 31,300) is less than its Market Price (i.e. Rs 38,500). Therefore, closing stock is recorded with Rs 31,300 in the books.*

***Working Note*:**
WN1: *Calculation of Insurance Outstanding*

$$\text{Insurance paid for 9 months} = 16{,}200$$

$$\therefore \text{Insurance per month} = \frac{16{,}200}{9} = 1{,}800$$

$$\text{So, Insurance outstanding for 3 month} = 1{,}800 \times 3 = \text{Rs } 5{,}400$$

Depreciation, Amortisation of Intangible Assets

Objectives
After going through this lesson, you shall be able to understand the adjustment of the following items in preparation of the Final Accounts.

- Depreciation on Fixed Assets (or Tangible Assets)
- Amortisation of Intangible Assets

Depreciation on Fixed Assets

In chapter 7 we learnt that depreciation is a reduction in the value of fixed assets (tangible assets) such as furniture, building, machinery, etc. In this lesson, we will learn the accounting treatment of depreciation in the financial statements. Depreciation is charged on the cost of fixed assets at the end of an accounting period. It is considered as a loss for the business and is shown on the Debit side of the Profit and Loss Account.

➢ When depreciation is given outside the Trial Balance

However, the treatment of depreciation in the books depends on the following two cases.

i. When Provision for Depreciation is not maintained

ii. When Provision for Depreciation is maintained

The following are the Journal entries and the treatment of depreciation in the books of accounts.

Case 1- *When Provision for Depreciation is* ***not maintained***

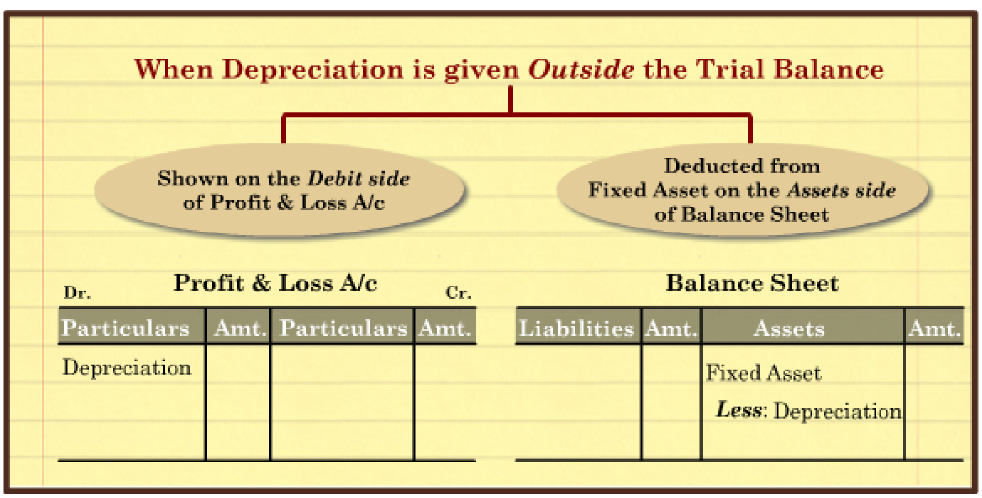
Journal Entries

Depreciation A/c To Assets A/c (Depreciation charged on assets) Profit and Loss A/c To Depreciation A/c (Depreciation transferred to Profit and Loss Account)	Dr. Dr.		

Treatment in the Financial Statements

1. First, depreciation charged during the year is shown on the Debit side of the Profit and Loss Account.
2. Secondly, it is shown as a *deduction* from the concerned asset in the Balance Sheet on which it has been provided.

The disclosure of depreciation in the final accounts is given below.



Case 2- *When Provision for Depreciation is* ***maintained***

Journal Entries

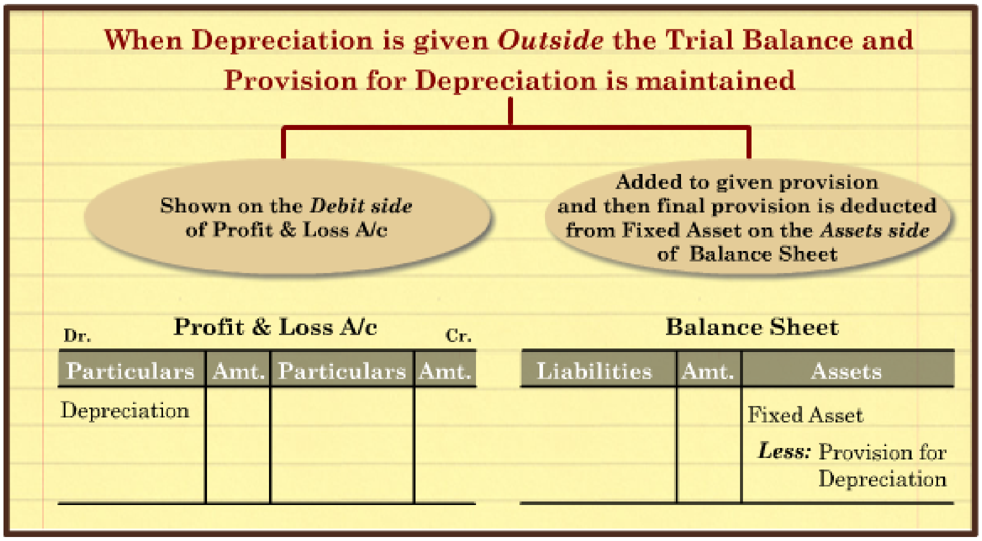
Depreciation A/c To Provision for Depreciation A/c (Provision for depreciation is made)	Dr.		

Profit and Loss A/c To Depreciation A/c (Depreciation transferred to Profit and Loss Account)	Dr.		

Treatment in the Financial Statements

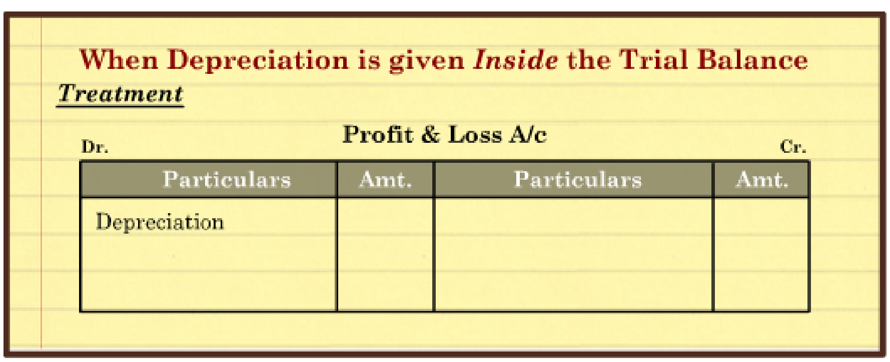
1. In this case also, depreciation charged during the year is first shown on the Debit side of Profit and Loss Account.
2. Secondly, the depreciation charged is added to the given amount of provision for depreciation. Then, the final amount of provision for depreciation is deducted from the original cost of the concerned asset in the Balance Sheet on which it has been provided.

The disclosure of depreciation in the final accounts is given below.

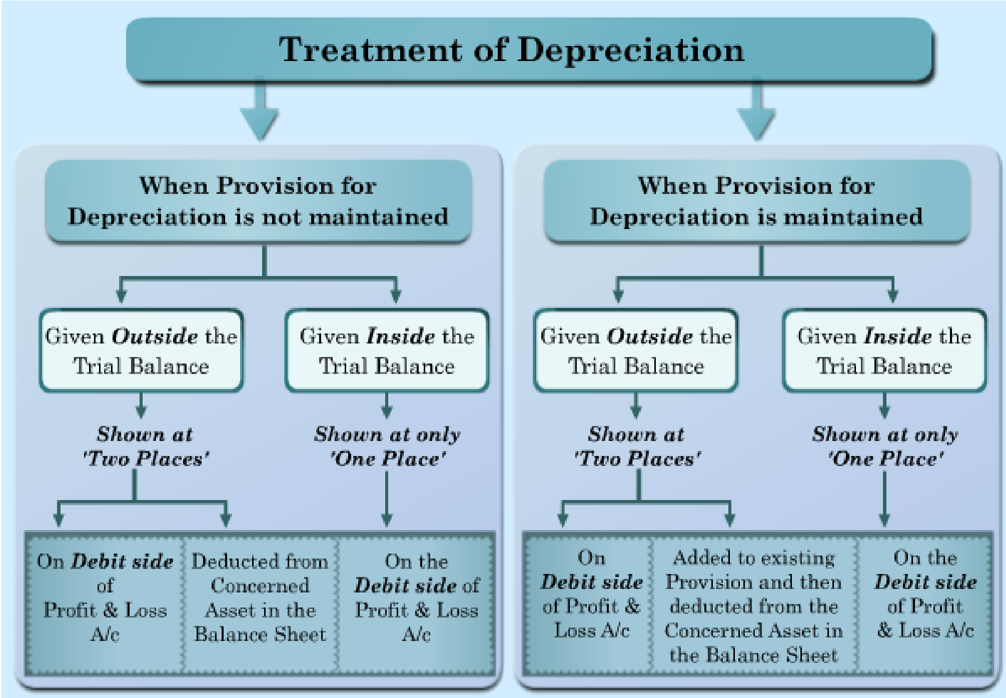


➢ **When Depreciation is given *Inside* the Trial Balance**

There may be a situation, when depreciation charged on the assets is given inside the Trial Balance. In such a case, the concerned asset in the Trial Balance is already shown at its diminished value i.e. after deducting the amount of depreciation. Therefore, depreciation is not required to be deducted again from the value of concerned fixed assets in the Balance Sheet. It is shown only on the Debit side of the Profit and Loss Account like any other expense.



Conclusion



Computation of Depreciation

Depreciation is charged on the cost of fixed assets in accordance with the method and rate as mentioned in the question. It is computed for the period for which the asset is used in the business. *For example*, a building is purchased on June 01, 2013 during an accounting period 2013-2014. In this case, depreciation will be charged for the period of 10 months (*i.e. from June 01, 2013 to March 31, 2014*).

In a similar way, if an old machine is sold on November 01, 2013 during the year 2013-2014, then, in this case depreciation will be charged for the period of 7 months (*i.e. for April 01, 2013 to November 01, 2013*).

Important Points to be considered

a. If the rate of depreciation is mentioned in the question without the word '*per annum*', then in this case, depreciation is charged on the asset without considering the time factor. In simple words, depreciation is charged for the whole year.
For example, machinery costing Rs 10,000 purchased in the middle of the year is to be depreciated at the rate of 10% p.a. In this case, depreciation will be charged for the period of 6 months. Therefore, the amount of depreciation would be Rs 500 $\left(i.e. 10,000 \times \frac{10}{100} \times \frac{6}{12}\right)$. But if instead of 10% p.a. the depreciation rate is given as 10% (i.e. without using the word '*p.a.*'), then in this case, depreciation will be charged for the full year without considering the time factor. Therefore, the amount of depreciation would be Rs 1,000 $\left(i.e. 10,000 \times \frac{10}{100}\right)$.

b. If the purchase of asset during the year is given in the question, but no information regarding the date of purchase is given. In this case such asset is assumed to be purchased at the beginning of the year. Therefore, in such a situation, *depreciation is charged* for the whole year.

c. In a similar way, if the question mentions the sale of asset during the year but no information regarding the date of sale is given, then in this case such asset is assumed to be sold at the beginning of the year. In such a situation, *depreciation is not charged* on the value of asset sold.

Important Points

- Rate of Depreciation given without the word 'p.a.' → Depreciation is charged for the Full Year
- Date of Purchase is not given → Depreciation is charged for the Full Year
- Date of Sale is not given → Depreciation is not charged

Example 1: Given below is the extract of a Trial Balance. Show the treatment of depreciation in the final accounts. Also pass the adjusting Journal entry.

Extract of Trial Balance

Particulars	Amount (Rs)
Plant	80,000

Additional Information: Provide depreciation on plant @ 8% p.a.

Solution

Adjusting Entry-

Depreciation A/c	Dr.	6,400	
To Plant A/c			6,400
(Depreciation charged during the year)			

Profit and Loss Account

Dr. Particulars	Amount	Particulars	Cr. Amount
Depreciation on Plant	6,400		

Balance Sheet

Liabilities	Amount	Assets		Amount
		Fixed Assets		
		Plant	80,000	
		Less: Depreciation	(6,400)	73,600

Working Note: *Calculation of Depreciation*

$$\text{Depreciation on Plant} = 80{,}000 \times \frac{8}{100} = 6{,}400$$

Example 2: Given below is the extract of a Trial Balance. Show the treatment of depreciation in the final accounts. Also pass the adjusting Journal entry

Extract of Trial Balance

Particulars	Amount (Rs)
Building	32,000
Provision for Depreciation on Building	4,800
Plant	50,000
Provision for Depreciation on Plant	13,550

***Additional Information*:** Building is to be depreciated @ 5% p.a. as per straight line method and plant is to be depreciated @ 10% p.a. as per diminishing balance method.

Solution
Adjusting Entry-

Depreciation A/c (*WN*) To Provision for Depreciation on Building A/c (Provision for depreciation on building made)	Dr.	1,600	 1,600

Depreciation A/c (*WN*) To Provision for Depreciation on Plant A/c (Provision for depreciation on plant made)	Dr.	3,645	 3,645

Profit and Loss Account

Dr.			Cr.
Particulars	**Amount**	**Particulars**	**Amount**
Depreciation on Building Depreciation on Plant	1,600 3,645		

Balance Sheet

Liabilities	Amount	Assets		Amount
		Fixed Assets		
		Building	32,000	
		Less: Provision for Depreciation (4,800 + 1,600)	(6,400)	25,600
		Plant	50,000	
		Less: Provision for Depreciation (13,550 + 3,645)	(17,195)	32,805

Note 1: *Depreciation on building is charged on the cost as per the straight line method.*
Note 2: *Depreciation on plant is charged on the diminished value as per the diminishing balance method.*

***Working Note*:** *Calculation of Depreciation*

$$\text{On Building} = 32{,}000 \times \frac{5}{100} = 1{,}600$$

$$\text{On Plant} = (50{,}000 - 13{,}550) \times \frac{10}{100} = 3{,}645$$

***Example 3*:** Given below is the extract of a Trial Balance. Show the treatment of depreciation in the final accounts.

Extract of Trial Balance

Particulars	Amount (Rs)
Furniture	70,000
Building	90,000
Depreciation on Furniture	12,500
Depreciation on Building	10,800
Provision for Depreciation on Building	32,400

Solution

Profit and Loss Account			
Dr.			**Cr.**
Particulars	**Amount**	**Particulars**	**Amount**
Depreciation on Furniture Depreciation on Building	12,500 10,800		

Balance Sheet

Liabilities	Amount	Assets		Amount
		Fixed Assets		
		Furniture		70,000
		Building	90,000	
		Less: Provision for Depreciation	(32,400)	57,600

***Note 1**: Here, depreciation on furniture is given inside the Trial Balance. Therefore, it is shown only in the Profit and Loss A/c and not shown in the Balance Sheet.*
***Note 2**: Depreciation on building is also given inside the Trial Balance. Therefore, it is shown only in the Profit and Loss A/c and not added to the amount of provision for depreciation in the Balance Sheet.*

Example 4: Given below is extract of a Trial Balance. Show the treatment of depreciation in the final accounts.

Extract of Trial Balance

Particulars	Amount (Rs)
Plant	1,40,000
Furniture	75,000

***Additional Information*:**

i. Plant costing Rs 30,000 sold during the year.

ii. Furniture purchased during the year costing Rs 18,000.

iii. Depreciate plant and furniture @ 15% p.a. and 10% p.a. respectively.

Solution

Profit and Loss Account			
Dr.			**Cr.**
Particulars	**Amount**	**Particulars**	**Amount**
Depreciation on Plant (***WN***) Depreciation on Furniture (***WN***)	16,500 9,300		

Balance Sheet

Liabilities	Amount	Assets		Amount
		Fixed Assets		
		Plant	1,40,000	
		Less: Sales	(30,000)	
		Less: Depreciation	(16,500)	93,500
		Furniture	75,000	
		Add: Purchases	18,000	
		Less: Depreciation	(9,300)	83,700

***Note**: Here, the date of sale of plant and date of purchase of furniture is not mentioned in the question. Therefore, it is assumed that both the transactions took place at the beginning of the year. Therefore,*

a. Depreciation on the value of plant sold is not provided and

b. Depreciation on the value of furniture purchased is provided for the whole year.

Working Note: *Calculation of Depreciation*

$$\text{On Plant} = (1{,}40{,}000 - 30{,}000) \times \frac{15}{100} = 16{,}500$$

$$\text{On Furniture} = (75{,}000 + 18{,}000) \times \frac{10}{100} = 9{,}300$$

Amortisation of Intangible Assets

As depreciation is a reduction in the value of tangible fixed assets. In the same way, any reduction in the value of intangible assets such as goodwill, patents, trade marks, etc. is termed as amortisation. Similar to depreciation, amortisation is also a loss for the business which is shown on the debit side of the Profit and Loss Account.

For example, goodwill of a firm is Rs 10,000 and goodwill written-off during the year is Rs 2,500. In this case, reduction of Rs 2,500 in the value of goodwill is considered as amortisation of goodwill.

The adjusting Journal entry for amortisation of intangible assets or writing-off of intangible assets is given below.

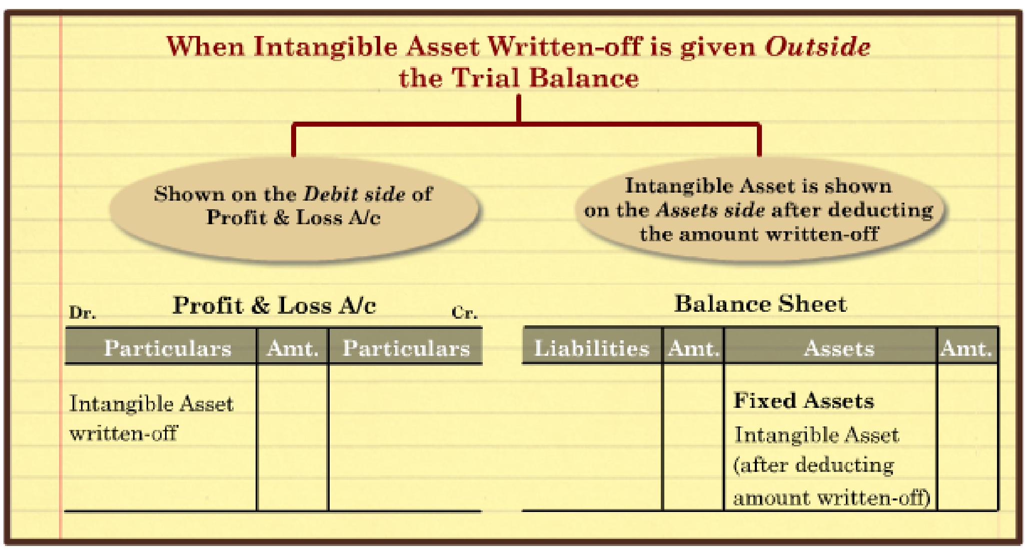
Profit and Loss A/c To Intangible Assets (Intangible asset written-off)	Dr.		

- **When Intangible Asset written off is given *outside* the Trial Balance**

Treatment- The treatment of amortisation of intangible assets in the final accounts is as follows.

1. First, the intangible assets written-off are shown on the Debit side of the Profit and Loss Account.
2. Secondly, the final value of intangible assets (i.e. the value after deducting the amount written-off) is shown on the Assets Side of the Balance Sheet under the head Fixed Assets.

The disclosure of amortisation of intangible assets in final accounts is given below.



- **When Intangible Assets written-off are given *Inside* the Trial Balance**

There may be a situation, when intangible assets written-off during the year are given inside the Trial Balance. In such a case, intangible assets given in the Trial Balance are already shown at their reduced values (i.e. after writing-off the amount). Therefore, amount written-off is not required to be deducted again from the concerned intangible assets in the Balance Sheet. It is shown only on the Debit side of the Profit and Loss Account like any other expense.

When Intangible Asset Written-off is given *Inside* the Trial Balance

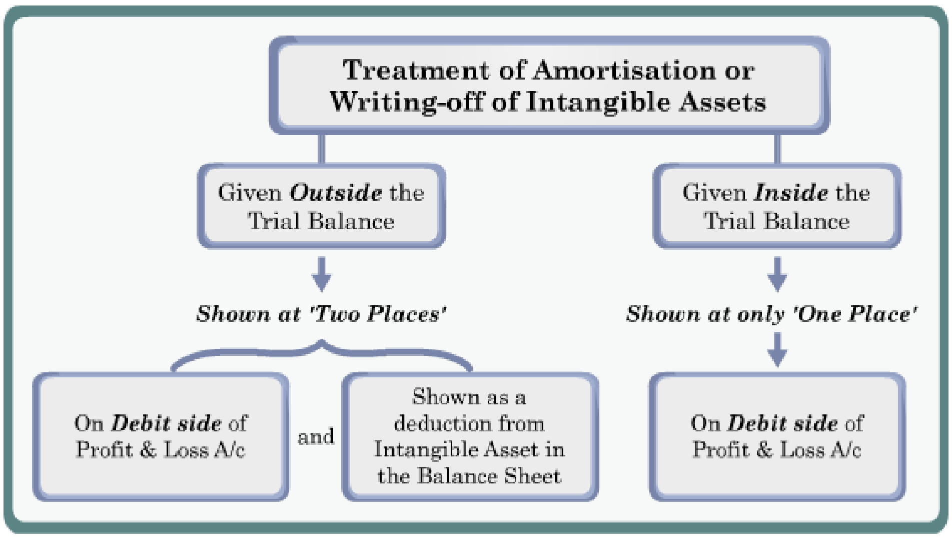
Treatment

Profit & Loss A/c

Dr. Cr.

Particulars	Amt.	Particulars	Amt.
Intangible Asset written-off			

Conclusion



***Example 1*:** Given below is the extract of a Trial Balance. Show the treatment of following item in the final accounts.

Extract of Trial Balance

Particulars	Amount (Rs)
Goodwill	35,000

***Additional Information*:** Goodwill written-off during the year Rs 4,500.

Solution

Profit and Loss Account

Dr. Cr.

Particulars	Amount	Particulars	Amount
Goodwill written-off	4,500		

Balance Sheet

Liabilities	Amount	Assets	Amount
		Fixed Assets	
		Goodwill (35,000 – 4,500)	30,500

***Example 2*:** Given below is the extract of a Trial Balance. Show the treatment of following item in the final accounts.

Extract of Trial Balance

Particulars	Amount (Rs)
Goodwill	80,000
Goodwill written-off	12,000

Solution

Profit and Loss Account

Dr. Particulars	Amount	Particulars	Cr. Amount
Goodwill written-off	12,000		

Balance Sheet

Liabilities	Amount	Assets	Amount
		Fixed Assets	
		Goodwill	80,000

Note: *Here, the amount of goodwill written-off is given inside the Trial Balance. This implies that Goodwill appearing in the Trial Balance is already at its net value (i.e. after deducting the amount written-off). Therefore, goodwill written-off is shown only in the Profit and Loss A/c and not deducted from the value of goodwill in the Balance Sheet.*

Example 3: Given below is the extract of a Trial Balance.

Extract of Trial Balance
as on March 31, 2013

Particulars	Amount (Rs)
Patents	60,000

Additional Information: Patents rights were purchased on April 01, 2009 for Rs 1,00,000 whose expected life at that time was 10 years.

Calculate the amount of patents written-off each year and show it in the relevant accounts.

Solution

$$\text{Amount of Patents Written-off} = \frac{\text{Cost of Patents}}{\text{Expected Life}} = \frac{1,00,000}{10} = \text{Rs } 10,000$$

Alternatively, it can also be calculated as follows.

$$\text{Amount of Patents Written-off} = \frac{\text{Book Value}}{\text{Remaining Life}} = \frac{60,000}{6} = \text{Rs } 10,000$$

Profit and Loss Account

Dr. Particulars	Amount	Particulars	Cr. Amount
Patents written-off	10,000		

Balance Sheet

Liabilities	Amount	Assets	Amount
		Fixed Assets	
		Patents (60,000 – 10,000)	50,000

Example 4: Given below is the extract of a Trial Balance. Show the treatment of following items in the final accounts.

Extract of Trial Balance

Particulars	Amount (Rs)
Machinery	1,80,000
Building	2,20,000
Goodwill	75,000
Provision for depreciation on machinery	54,000
Salary	35,000
Interest on Investments	14,800
Insurance	36,000
Commission received	25,000

Additional Information:

i. Salary @ Rs 3,500 outstanding for 2 months.

ii. Interest accrued on investments Rs 3,200.

iii. Insurance paid in advance for 3 months.

iv. Commission received in advance Rs 3,000.

v. Goodwill written-off Rs 15,000.

vi. Depreciate machinery @ 10% p.a. and building 8% p.a. respectively.

Solution

Profit and Loss Account
for the year ended…

Dr. Particulars		Amount	Particulars		Cr. Amount
Salary	35,000		Interest on Investments	14,800	
Add: Outstanding Salary($3,500 \times 2$)	7,000	42,000	*Add*: Accrued Interest	3,200	18,000
Insurance	36,000		Commission	25,000	
Less: Prepaid Insurance (***WN1***)	(7,200)	28,800	*Less*: Received in advance	(3,000)	22,000
Goodwill written-off		15,000			
Depreciation on:					
Machinery	18,000				
Building	17,600	35,600			

Balance Sheet
as on…

Liabilities	Amount	Assets		Amount
Current Liabilities		**Fixed Assets**		
Salary Outstanding	7,000	Machinery	1,80,000	
Commission received in Advance	3,000	*Less*: Provision for Depreciation (54,000 + 18,000)	(72,000)	1,08,000
		Building	2,20,000	
		Less: Depreciation	(17,600)	2,02,400
		Goodwill (75,000 – 15,000)		60,000
		Current Assets		
		Prepaid Insurance		7,200
		Accrued Interest on Investments		3,200

Working Note:

WN1: *Calculation of Insurance Paid in Advance*

Insurance paid for 15 months = 36,000

$$\therefore \text{Insurance per month} = \frac{36,000}{15} = 2,400$$

So, Insurance paid in advance for 3 month = 2,400 $\times$ 3= Rs 7,200

Interest on Capital, Interest on Drawings and Interest on Loan

Objectives
After going through this lesson, you shall be able to understand the adjustment of the following items in preparation of the Final Accounts.

- Interest on Capital
- Interest on Drawings
- Interest on Loan

Interest on Capital
It is the interest that is provided on the amount invested by a proprietor in the business. It represents the cost of capital invested in the business. As we know that owners are considered as separate entity from its business, so the amount invested by the owners becomes liability for a business. Therefore, any interest paid on capital is considered as an expense and is shown in the Profit and Loss Account.

The adjusting Journal entry for interest on capital as follows.

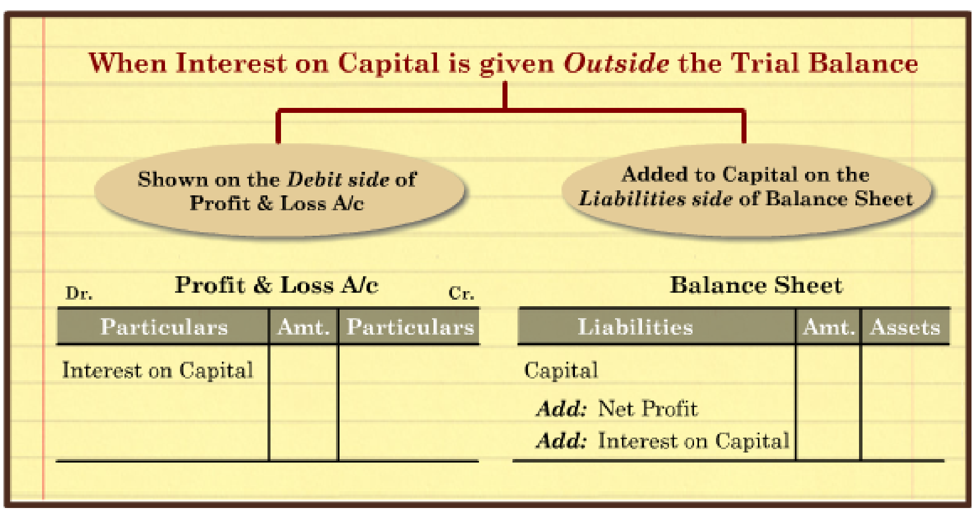
Interest on Capital A/c Dr. To Capital A/c (Interest provided on capital)		

- **When Interest on Capital is given *outside* the Trial Balance**

Treatment- The treatment of interest on capital in the final accounts is as follows.

1. First, interest on capital is shown on the Debit side of the Profit and Loss Account.
2. Secondly, it is added to the amount of capital on the Liabilities Side of the Balance Sheet.

The disclosure of interest on capital in the final accounts is depicted below.



- **When Interest on Capital is given *Inside* the Trial Balance**

There may be a situation, when interest on capital is given inside the Trial Balance. In such a case, capital in the Trial Balance is already appearing after adjusting the amount of interest on capital to it. Therefore, there is no need to add this interest to the capital in the Balance Sheet. It is shown only on the debit side of the Profit and Loss Account like any other expense.

When Interest on Capital is given *Inside* the Trial Balance

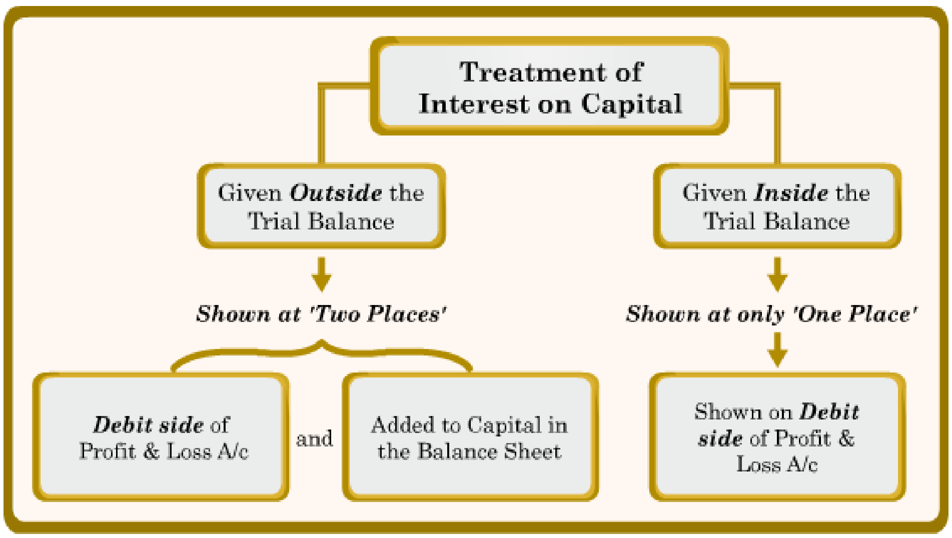
Treatment

Profit & Loss A/c

Dr. Cr.

Particulars	Amt.	Particulars	Amt.
Interest on Capital			

Conclusion



***Example 1*:** Given below is extract of a Trial Balance. Show the treatment of interest on capital in the final accounts. Also pass the adjusting Journal entry.

Extract of Trial Balance

Particulars	Debit (Rs)	Credit (Rs)
Capital		1,80,000

***Additional Information*:** Interest on capital to be allowed at 10% p.a.

Solution

Interest on Capital A/c To Capital A/c (Interest provided on capital)	Dr.	18,000	 18,000

Profit and Loss Account

Dr. **Cr.**

Particulars	Amount	Particulars	Amount
Interest on Capital	18,000		

Balance Sheet

Liabilities	Amount	Assets	Amount
Capital 1,80,000			

Add: Interest on Capital	18,000	1,98,000		

Working Note: *Calculation of Interest on Capital*

$$\text{Interest on Capital} = 1{,}80{,}000 \times \frac{10}{100} = \text{Rs } 18{,}000$$

Example 2: Given below is extract of a Trial Balance. Show the treatment of interest on capital in the final accounts.

Extract of Trial Balance

Particulars	**Amount (Rs)**
Capital Interest on Capital	2,46,000 22,500

Solution

Profit and Loss Account

Dr. **Cr.**

Particulars	**Amount**	**Particulars**	**Amount**
Interest on Capital	22,500		

Balance Sheet

Liabilities	**Amount**	**Assets**	**Amount**
Capital	2,46,000		

Note: *Here, interest on capital is given inside the Trial Balance. Therefore, it is shown only in the Profit and Loss A/*c and not added again to the capital in the Balance Sheet.

Interest on Drawings

Drawings are the amount of cash or goods withdrawn by the proprietor from the business for his/her personal use. However, frequent or excessive withdrawals from the business by the proprietor may adversely affect its working conditions. So, in order to discourage these frequent or excessive withdrawals, the business generally charges interest on the amounts so withdrawn. Such interest charged is known as interest on drawings. It is a gain for the business.

The adjusting Journal entry for interest on drawings is given below.

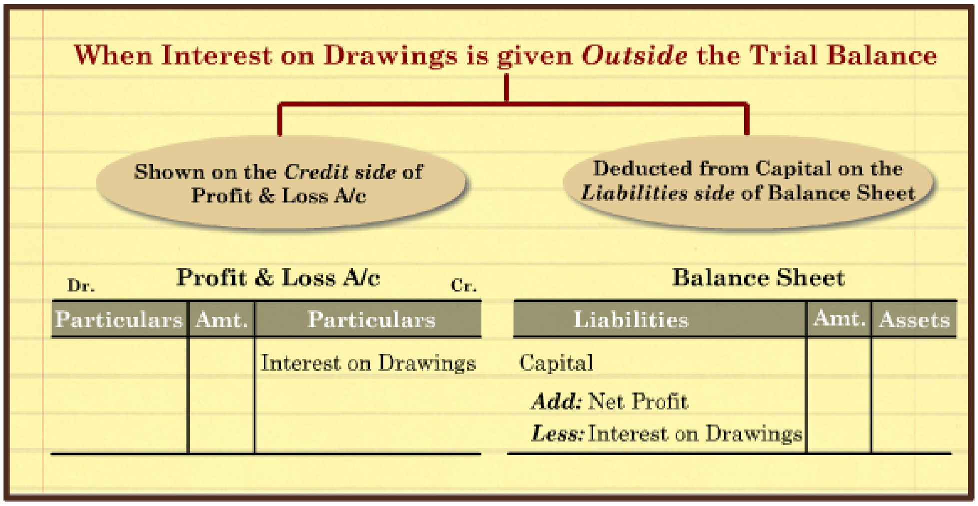
Drawings A/c Dr. To Interest on Drawings A/c (Interest charged on drawings)		

- **When Interest on Drawings is given *outside* the Trial Balance**

Treatment- The treatment of interest on drawings in the final accounts is as follows.

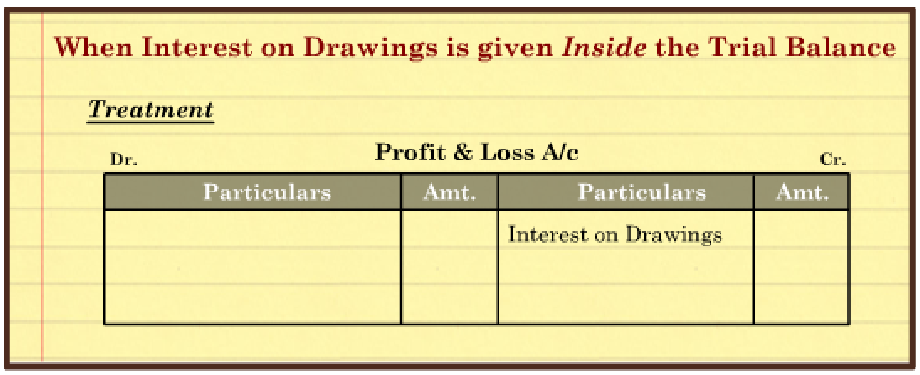
1. Firstly, interest on drawings is shown on the credit side of the Profit and Loss Account.
2. Secondly, it is deducted from the amount of capital on the Liabilities side of the Balance Sheet.

The disclosure of interest on drawings in the final accounts is shown below.

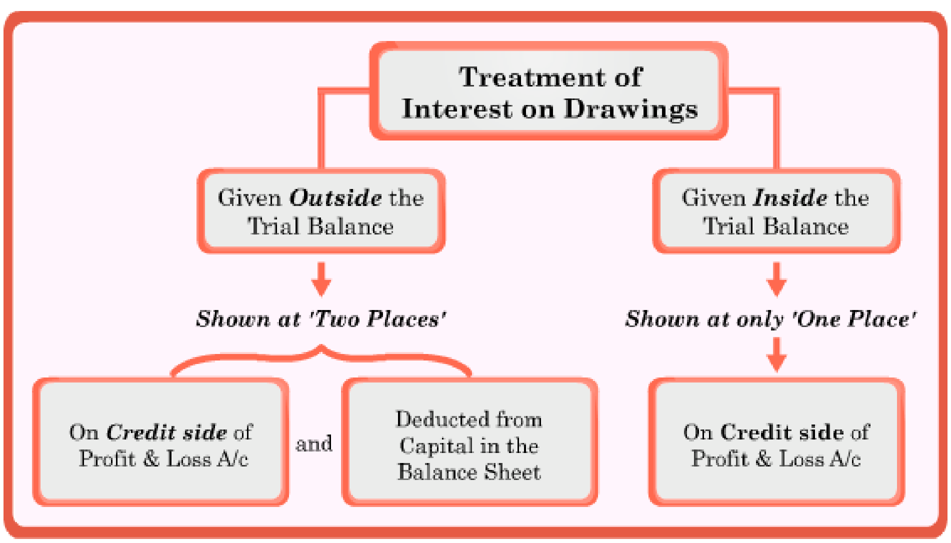


- **When Interest on Drawings is given *Inside* the Trial Balance**

There may be a situation, when interest on drawings is given inside the Trial Balance. In such a case, capital in the Trial Balance is already shown after deducting such interest on drawings. Therefore, there is no need to deduct this interest from the capital in the Balance Sheet and is shown only on the credit side of the Profit and Loss Account.



Conclusion



Example 1: Given below is the extract of a Trial Balance. Show the treatment of interest on drawings in the final accounts. Also pass the adjusting Journal entry.

Extract of Trial Balance

Particulars	Amount (Rs)
Capital Drawings	1,25,000 42,000

***Additional Information*:** Interest on drawings is charged Rs 5,000.

Solution

Drawings A/c To Interest on Drawings A/c (Interest charged on drawings)	Dr.	5,000	 5,000

Profit and Loss Account

Dr. **Cr.**

Particulars	Amount	Particulars	Amount
		Interest on Drawings	5,000

Balance Sheet

Liabilities		Amount	Assets	Amount
Capital *Less*: Drawings *Less*: Interest on Drawings	1,25,000 (42,000) (5,000)	 78,000		

***<u>Example 2</u>*:** Following is the extract of a Trial Balance. Show the treatment of interest on drawings in the final accounts.

Extract of Trial Balance

Particulars	Amount (Rs)
Capital Drawings Interest on Drawings	2,12,000 19,000 2,200

Solution

Profit and Loss Account

Dr. **Cr.**

Particulars	Amount	Particulars	Amount
		Interest on Drawings	2,200

Balance Sheet

Liabilities		Amount	Assets	Amount
Capital *Less*: Drawings	2,12,000 (19,000)	 1,93,000		

Note: *Here, interest on drawings is given inside the Trial Balance. Therefore, it is shown only in the Profit and Loss A/c and not deducted from capital in the Balance Sheet.*

***<u>Example 3</u>*:** Given below is the extract of a Trial Balance. Show the treatment of the following items in the final accounts.

Extract of Trial Balance

Particulars	Amount

	(Rs)
Capital	1,80,000
Drawings	42,000

Additional Information:

i. Interest on capital provided @ 12% p.a.

ii. Interest on drawings charged Rs 5,200.

Solution

Profit and Loss Account

Dr. Particulars	Amount	Particulars	Cr. Amount
Interest on Capital @ 12%	21,600	Interest on Drawings	5,200

Balance Sheet

Liabilities		Amount	Assets	Amount
Capital	1,80,000			
Add: Interest on Capital	21,600			
Less: Drawings	(42,000)			
Less: Interest on Drawings	(5,200)	1,54,400		

Interest on Loan

Many a times you must have observed that in the Trial Balance loan is recorded either on the credit side or on the debit side. If it appears on the credit side, then it implies that the loan is taken by the proprietor from its outsiders such as banks, financial institutions, etc. On the other hand, if the loan appears on the debit side of the Trial Balance, then it implies that the proprietor has granted loan to the other parties (or to the outsiders).

Loan taken by the proprietor is a liability for the business and thus interest on such loan is considered as an expense. Whereas, loan granted by the proprietor is an asset for the business and thus interest on such loan is considered as an income.

Thus, the accounting treatment of interest loan in the books depends on whether the given loan is loan taken or loan granted.

The adjusting Journal entry for interest on loan is given below.

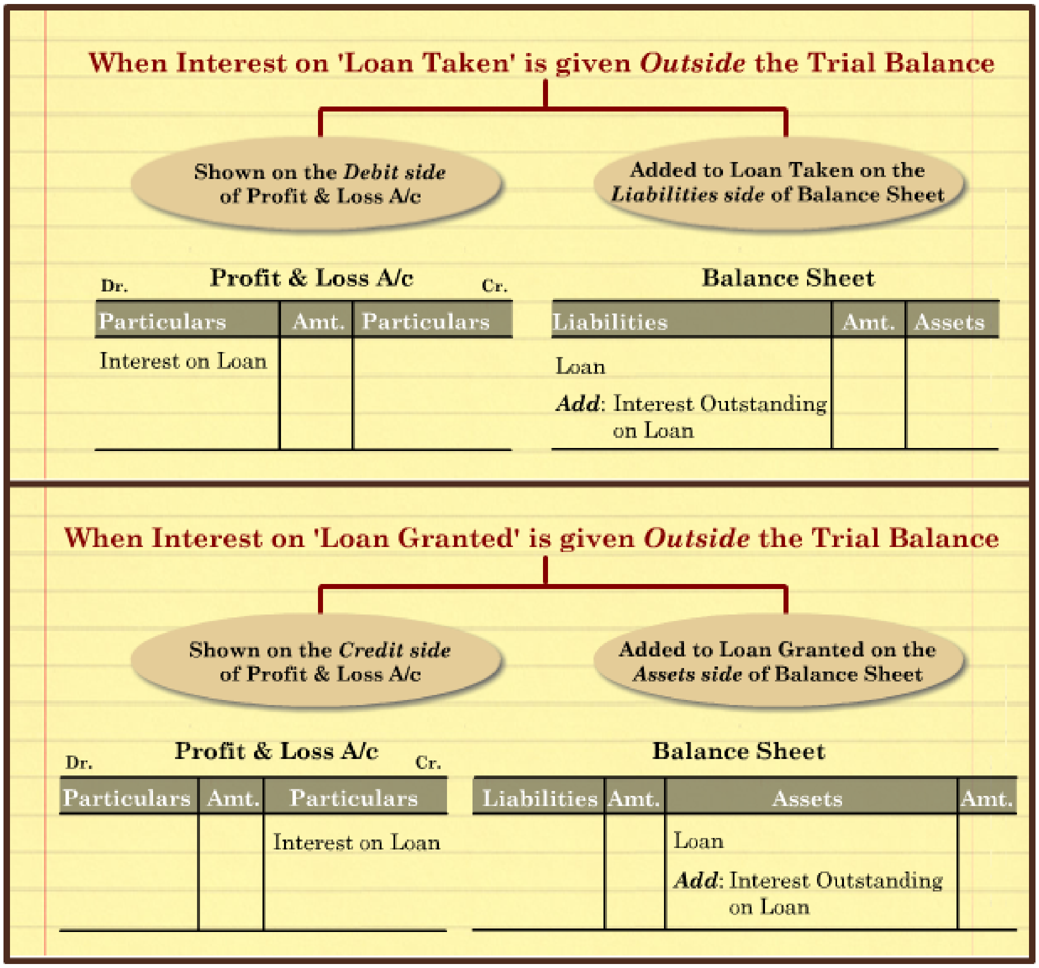
Interest on Loan Taken		Interest on Loan Granted	
Interest on Loan A/c	Dr.	Outstanding Interest A/c	Dr.
To Outstanding Interest A/c		To Interest on Loan A/c	
(Interest on loan provided)		(Interest on loan charged)	

- **When interest on loan is given *outside* the trial balance**

Accounting Treatment- The treatment of interest on loan in the final accounts is given below.

Treatment of Interest on Loan	
Treatment of Interest on Loan Taken	**Treatment of Interest on Loan Granted**
• Firstly, interest on loan taken is shown on the *Debit side* of the Profit and Loss Account.	• Firstly, interest on loan granted is shown on the *Credit side* of the Profit and Loss Account.
• Secondly, it is added to the amount of loan taken on the *Liabilities* Side of the Balance Sheet.	• Secondly, it is added to the amount of loan granted on the *Assets Side* of the Balance Sheet.

The disclosure of interest on loan in the final accounts is shown below.



• When Interest on Loan is given Inside the Trial Balance

There may be a situation, when the interest on loan is given inside the Trial Balance. In such a case, loan amount (whether taken or granted) in the Trial Balance is shown after adding such interest on loan. Therefore, there is no need to add this interest again to the amount of loan in the Balance Sheet. It is shown only in the Profit and Loss Account.

When Interest on 'Loan Taken' is given *Inside* the Trial Balance

Treatment

Profit & Loss A/c

Dr. Cr.

Particulars	Amt.	Particulars	Amt.
Interest on Loan			

When Interest on 'Loan Granted' is given *Inside* the Trial Balance

Treatment

Profit & Loss A/c

Dr. Cr.

Particulars	Amt.	Particulars	Amt.
		Interest on Loan	

ple 1: Given below is an extract of a Trial Balance. Show the treatment of interest on loan in the final accounts. Also pass the adjusting Journal entries.

Extract of Trial Balance

Particulars	Debit (Rs)	Credit (Rs)
Loan from Bank @ 8% p.a.		1,20,000
Loan to Mr. A @ 10% p.a.	80,000	

Solution

Interest on Loan A/c To Outstanding Interest A/c (Interest on loan provided)	Dr.	9,600	 9,600

Outstanding Interest A/c To Interest on Loan A/c (Interest on loan charged)	Dr.	8,000	 8,000

Profit and Loss Account

Dr. Cr.

Particulars	Amount	Particulars	Amount
Interest on loan (Dr.)	9,600	Interest on loan (Cr.)	8,000

Balance Sheet

Liabilities		Amount	Assets		Amount
Loan from Bank	1,20,000		Loan to Mr. A	80,000	
Add: Interest on loan	9,600	1,29,600	*Add*: Interest on loan	8,000	88,000

Example 2: Given below is the extract of a Trial Balance. Show the treatment of interest on loan in the final accounts.

Extract of Trial Balance

Particulars	Debit (Rs)	Credit (Rs)
Bank Loan		2,35,000
Loan Granted	1,68,000	
Interest on Loan (Dr.)	13,500	
Interest on Loan (Cr.)		9,200

Solution

Profit and Loss Account

Dr. **Cr.**

Particulars	Amount	Particulars	Amount
Interest on Loan	13,500	Interest on Loan	9,200

Balance Sheet

Liabilities	Amount	Assets	Amount
Bank Loan	2,35,000	Loan Granted	1,68,000

Note: *Here, both- interest on loan taken and interest on loan granted is given inside the Trial Balance. Therefore, it is shown only in the Profit and Loss A/c and not shown in the Balance Sheet.*

Example 3: Given below is the extract of a Trial Balance. Show the treatment of the following items in the final accounts.

Extract of Trial Balance

Particulars	Amount (Rs)
Capital	2,50,000
Drawings	95,000
Loan to Wife	50,000
Bank Loan	1,60,000

Additional Information:

i. Interest on capital provided @ 8% p.a.

ii. Interest on drawings charged Rs 7,800.

iii. Interest on Bank Loan Rs 12,500.

iv. Interest receivable on loan given to wife Rs 3,500.

Solution

Profit and Loss Account
for the year ended…

Dr. **Cr.**

Particulars	Amount	Particulars	Amount
Interest on Capital @ 8%	20,000	Interest on Drawings	7,800
Interest on Bank Loan	12,500	Interest on Loan to Wife	3,500

Balance Sheet
as on…

Liabilities		Amount	Assets		Amount
Capital	2,50,000		Loan to Wife	50,000	
Add: Interest on Capital	20,000		*Add*: Interest	3,500	53,500
Less: Drawings	(95,000)				
Less: Interest on Drawings	(7,800)	1,67,200			
Bank Loan	1,60,000				

Add: Interest	12,500	1,72,500		

Bad-Debts and Related Adjustments

Objectives

After going through this lesson, you shall be able to understand the following concepts.

- Meaning of Debtors
- Bad debts and its Accounting Treatment
- Provision for Bad and Doubtful Debts
- Provision for Discount on Debtors

Introduction

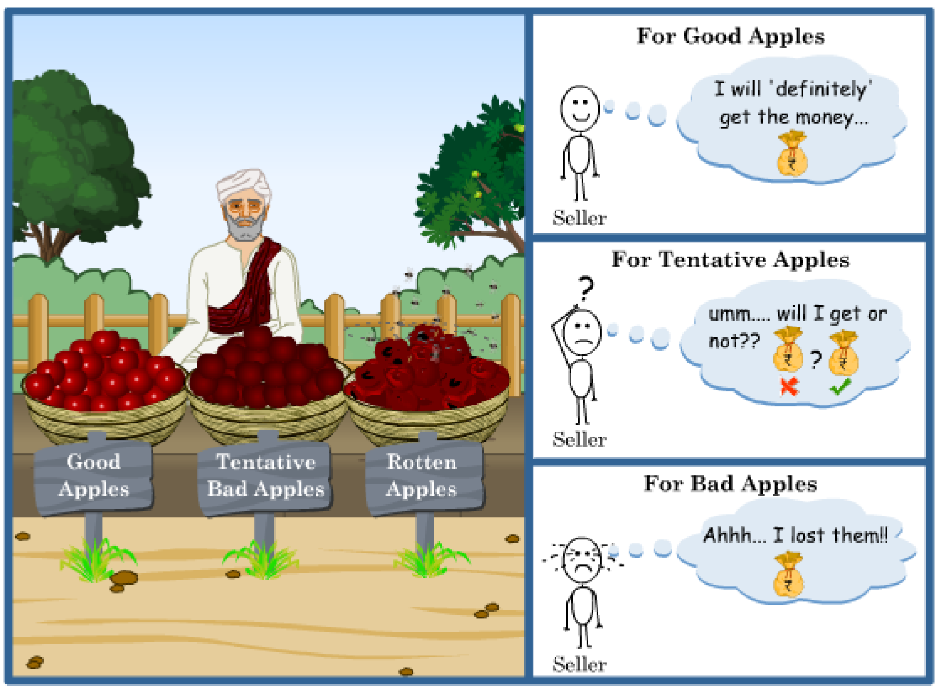
This is very common for any business to make sale of goods on credit basis. The persons to whom such credit sale is made are known as *debtors*. Debtors can be classified into three categories-

1. ***Good Debtors-*** These are the persons from whom the receipt of amount is certain.

2. ***Bad Debtors-*** These are the persons from whom amount is not recoverable.

3. ***Doubtful Debtors-*** These are the persons from whom receipt of amount is tentative (i.e. they may or may not pay)

Let us understand these terms with the real life example.
Suppose, a grocer has 15 kg of apples. Out of this, 2 kg apples are rotten and 3 kg are about to rot. This means, only 10 kg of tomatoes are in good condition.



Now, let's go through the video below, to understand the concept of debtors and its different types using the above example of the grocer.

After understanding the meaning of debtors, let us now move to learn its adjustment in the financial statements.

Bad Debts

In the above section, we learnt that there exists some debtors from whom the amount is not recoverable. The amount that becomes irrecoverable from the debtors are known as Bad debts. Bad debts are the loss for a business and therefore, it is shown in the Profit and Loss Account. The following are adjusting Journal entries for the treatment of Bad debts in the books.

Bad Debts A/c To Sundry Debtors A/c (Amount not recoverable from debtors)	Dr.		

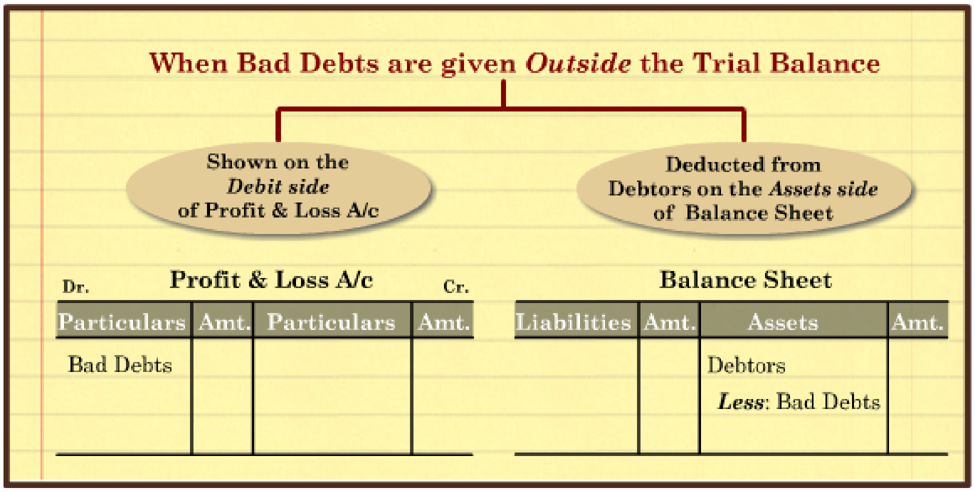
Profit and Loss A/c To Bad Debts A/c (Amount of bad debts transferred to Profit and Loss Account)	Dr.		

- **When Bad debts are given *outside* the Trial Balance**

Treatment- The treatment of Bad debts in the final accounts is given below.

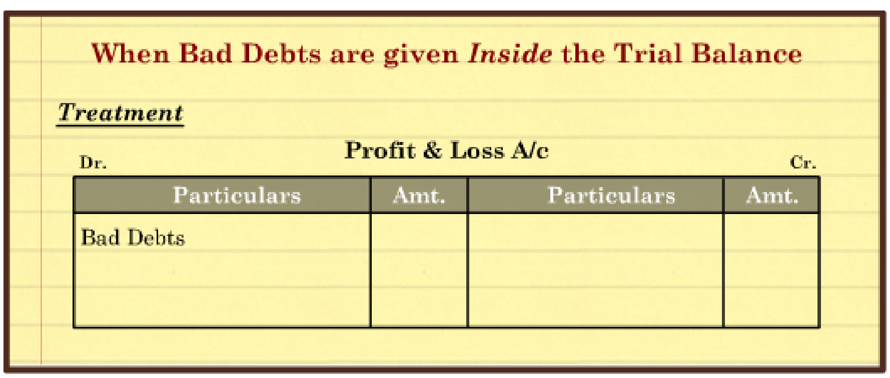
1. Firstly, Bad debts are shown on the debit side of the Profit and Loss Account.
2. Secondly, it is deducted from the amount of debtors on the Assets side of the Balance Sheet.

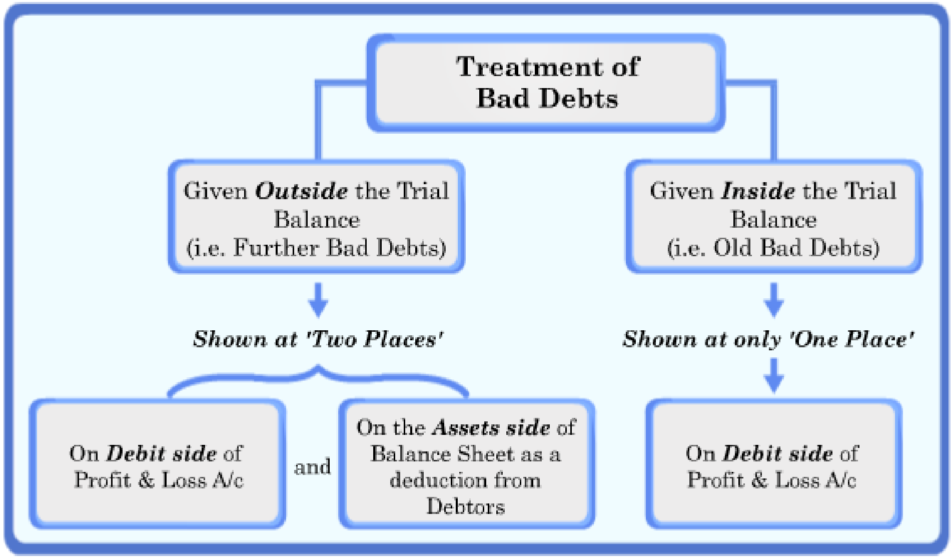
The disclosure of Bad debts in the final accounts is shown below.



- **When Bad Debts are given *Inside* the Trial Balance**

There may be a situation when Bad debts are already given inside the Trial Balance. In such a case, these Bad debts are already adjusted in the amount of given debtors. That means, debtors in the Trial Balance are recorded after deducting the amount of these Bad debts. Therefore, there is no need to deduct them again from the amount of debtors in the Balance Sheet. It is only shown on the debit side of the Profit and Loss Account.





Example 1: Given below is the extract of a Trial Balance. Show the treatment of Bad debts in the final accounts. Also pass the adjusting Journal entry.

Extract of Trial Balance

Particulars	**Amount (Rs)**
Debtors	32,500

Additional Information: Bad debts amounted to Rs 1,250.

Solution

Bad Debts A/c To Sundry Debtors A/c (Amount not recoverable from debtors)	Dr.	1,250	 1,250

Profit and Loss Account

Dr.			**Cr.**
Particulars	**Amount**	**Particulars**	**Amount**
Bad Debts	1,250		

Balance Sheet

Liabilities	**Amount**	**Assets**		**Amount**
		Debtors	32,500	
		Less: Bad Debts	(1,250)	31,250

Example 2: Given below is the extract of a Trial Balance. Show the treatment of Bad debts in the final accounts.

Extract of Trial Balance

Particulars	**Amount (Rs)**
Debtors	18,000
Bad debts	700

Solution

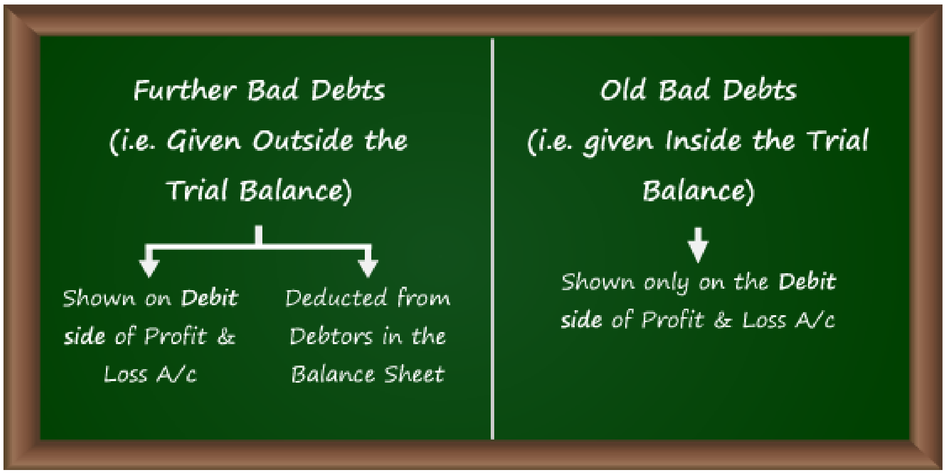
Profit and Loss Account

Dr.			**Cr.**
Particulars	**Amount**	**Particulars**	**Amount**
Bad debts	700		

Balance Sheet			
Liabilities	**Amount**	**Assets**	**Amount**
		Debtors	18,000

Note*: *Here, Bad debts are given inside the Trial Balance. Therefore, it is shown only in the Profit and Loss A/c and not shown in the Balance Sheet.

When Bad Debts appears at both places- *Inside as well Outside the Trial Balance*
Till now, we have studied that Bad debts either appear inside the Trial Balance or outside the Trial Balance. The Bad debts given inside the Trial Balance are often termed as old Bad debts whereas, Bad debts given outside the Trial Balance are often regarded as further or new Bad debts. It may happen that in the question both-old and further Bad debts are given. In such cases, the treatment will remain the same as we just learnt.



That is:
Further Bad debts (i.e. Bad debts given Outside the Trial Balance) - Shown in both the accounts. First, it is debited to the P&L A/c and secondly it is deducted from the amount of debtors in the Balance Sheet.
Old Bad debts (i.e. Bad debts given Inside the Trial Balance)- Shown only on the Debit side of the P&L A/c

Example 3: Given below is the extract of a Trial Balance. Show the treatment of bad debts in the final accounts.

Extract of Trial Balance	
Particulars	**Amount (Rs)**
Debtors	25,000
Bad Debts	1,400

Additional Information: Further bad debts amounted to Rs 2,000.

Solution

Profit and Loss Account *for the year ended…*				
Dr.				**Cr.**
Particulars		**Amount**	**Particulars**	**Amount**
Bad Debts	1,400			
Add: Further Bad Debts	2,000	3,400		

Balance Sheet *as on…*				
Liabilities	**Amount**	**Assets**		**Amount**
		Debtors	25,000	
		Less: Further Bad Debts	(2,000)	23,000

***Note**: Here, both- old as well as new Bad debts are given in the question. New Bad debts are shown in both the accounts, whereas, old Bad debts are shown only in the P&L A/c and not shown in the Balance Sheet.*

Bad Debts Recovered
It is the amount that was initially not recoverable from the debtors, but collected later. As we know that the amount of Bad debts are written-off in the books, therefore, when it is collected it becomes a gain for the business which is shown on the credit side of the Profit and Loss Account.

The following is the Journal entry for the amount of Bad debts recovered.

Cash/Bank A/c To Bad Debts Recovered A/c (Amount received from debtors)	Dr.		
Bad Debts Recovered A/c To Profit and Loss A/c (Bad debts recovered transferred to Profit and Loss Account)	Dr.		

Example 4: Given below is the extract of a Trial Balance. Show the treatment of Bad debts in the final accounts.

Extract of Trial Balance

Particulars	Amount (Rs)
Debtors	47,000
Bad Debts	5,100
Bad Debts Recovered	2,200

Additional Information: Further Bad debts amounted to Rs 4,300.

Solution

Profit and Loss Account
for the year ended…

Dr. Particulars		Amount	Particulars	Cr. Amount
Bad Debts	5,100		Bad Debts Recovered	2,200
Add: Further Bad Debts	4,300	9,400		

Balance Sheet
as on…

Liabilities	Amount	Assets		Amount
		Debtors	47,000	
		Less: Further Bad Debts	(4,300)	42,700

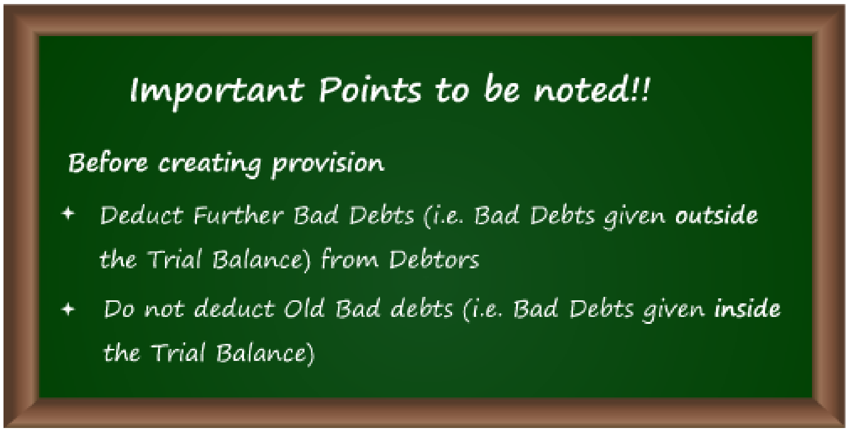
***Note**: Bad debts recovered is a gain for the business, therefore, it is shown on the credit side of the P&L A/c.*

Provision for Bad and Doubtful Debts
We know that in the case of credit sales, there is always a possibility of default in the payment (wholly or partly) by the customers. The actual irrecoverable amount from the debtors i.e. the amount of Bad debts for the current year will be known in the next year when the debtors are actually realised. In order to cover this risk of default, it is always advisable to make provision to meet this uncertainty. In this regard, the business maintains the provision for doubtful-debts with the motive of minimising the effect of actual loss caused by the bad-debts. It is maintained at a specific rate on the amount of debtors on the basis of accounting convention of Conservatism which states that provide for all anticipated expenses or losses, but do not provide for anticipated profits or gains

Computation of Provision for Bad and Doubtful Debts
It is calculated at a specific rate on the amount of total debtors. In case, any information relating to further Bad debts are

given outside the Trial Balance then-

- First, deduct further Bad debts from the amount of total debtors and then,
- Calculate the provision at a rate as mentioned in the question.



It should be noted that before creating provision, only further Bad debts given in adjustments are deducted from the debtors. The Bad debts given in the Trial Balance are not deducted because these are already deducted from the debtors appearing in Trial Balance.

Various cases for calculating Provision for Bad and Doubtful Debts
Case 1: *When **No** information regarding Bad debts and provision for doubtful debts is given*
From the given below information, calculate the amount of provision for doubtful debts.

Particulars	Amount (Rs)
Debtors	35,000

Additional Information: Create provision for doubtful debts @ 5%.

Solution

$$\text{Provision for Doubtful Debts} = \text{Amount of Debtors} \times \frac{\text{Rate}}{100}$$

$$= 35{,}000 \times \frac{5}{100} = \text{Rs } 1{,}750$$

Case 2: *When only Old Bad debts is given but **no** information regarding Further Bad debts is given*
From the given below information, calculate the amount of provision for doubtful debts.

Extract of Trial Balance	
Particulars	**Amount (Rs)**
Debtors	42,000
Bad debts	2,000

Additional Information: Create provision for doubtful debts @ 8%.

Solution

$$\text{Provision for Doubtful Debts} = \text{Amount of Debtors} \times \frac{\text{Rate}}{100}$$

$$= 42{,}000 \times \frac{8}{100} = \text{Rs } 3{,}360$$

Case 3: *When both Old as well as Further Bad debts are given*

From the given below information, calculate the amount of provision for doubtful debts.

Extract of Trial Balance	
Particulars	**Amount**

	(Rs)
Debtors	12,000
Bad debts	1,500

***Additional Information*:**

i. Further Bad debts amounted to Rs 2,000

ii. Create provision for doubtful debts @ 4% on Debtors.

Solution

$$\text{Provision for Doubtful Debts} = \text{Amount of Debtors} \times \frac{\text{Rate}}{100}$$

$$= (12{,}000 - 2{,}000) \times \frac{4}{100} = \text{Rs } 400$$

In this case, further bad debts are given.

Therefore, provision is calculated after deducting these further bad debts from the amount of debtors.

<u>Case 4</u>*: *When Old Provision is also given but no information regarding Further Bad debts are given
From the given below information, calculate the amount of provision for doubtful debts.

Balance Sheet				
Liabilities	**Amount**	**Assets**		**Amount**
		Debtors	25,000	
		Less: Provision for Doubtful Debts	(3,000)	22,000

***Additional Information*:** Create provision for doubtful debts @ 5% on debtors.

Solution

$$\text{Provision for Doubtful Debts} = \text{Amount of Debtors} \times \frac{\text{Rate}}{100}$$

$$= 25{,}000 \times \frac{5}{100} = \text{Rs } 1{,}250$$

Note: *Provision for doubtful debts is always calculated on the amount of total debtors, i.e. without deducting the amount of old provision.*

<u>Case 5</u>*: *When Old Provision is given along with the information Further Bad debts
From the given below information, calculate the amount of provision for doubtful debts.

Balance Sheet				
Liabilities	**Amount**	**Assets**		**Amount**
		Debtors	18,000	
		Less: Provision for Doubtful Debts	(2,000)	16,000

***Additional Information*:**

i. Further Bad debts amounted to Rs 3,000.

ii. Create provision for doubtful debts @ 10% on debtors.

Solution

$$\text{Provision for Doubtful Debts} = \text{Amount of Debtors} \times \frac{\text{Rate}}{100}$$

$$= (18{,}000 - 3{,}000) \times \frac{10}{100} = \text{Rs } 1{,}500$$

Note: *Although the provision for doubtful debts is calculated on the amount of total debtors, but in this case, further Bad debts are also given. Thus, provision is created after deducting the amount of further Bad debts from the amount of total* *debtors.*

Treatment of Provision for Doubtful Debts in the Final Accounts

The treatment of provision for doubtful debts in the final accounts depends on the following two situations.

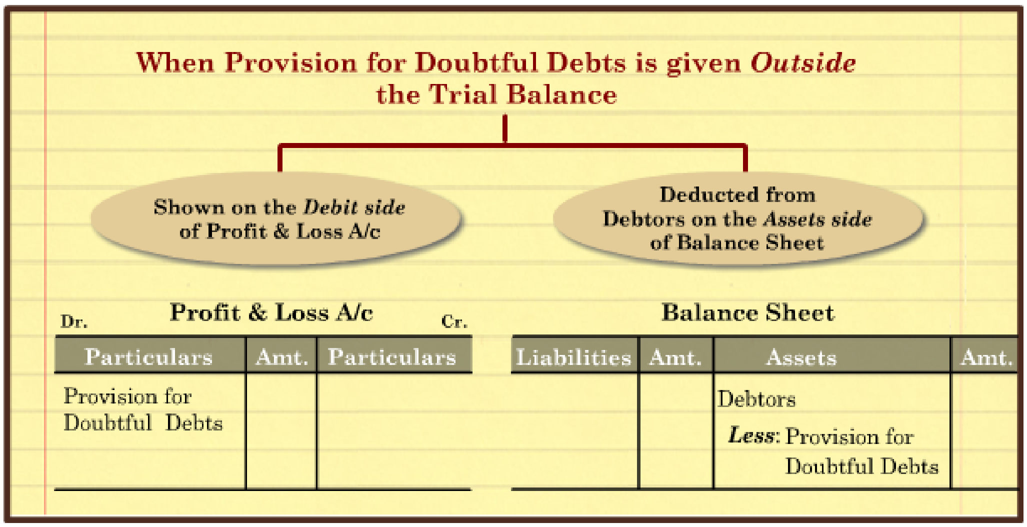
Situation 1- When there is ***No*** Old Provision for Doubtful Debts

This is a situation when there is no old provision for doubtful debts is given. That is, provision does not appear in the Trial Balance or Balance Sheet. It is given only in the adjustment. In this situation, the given below is the Journal entry for making provision for doubtful debts.

Profit and Loss A/c Dr. To Provision for Bad and Doubtful Debts A/c (Provision created for doubtful debts)	} With the amount given in the Adjustment

Treatment in Final Accounts

1. First of all, provision for doubtful debts is shown on the debit side of the Profit and Loss Account.
2. Secondly, it is deducted from the amount of debtors on the Assets side of the Balance Sheet.



Example 1: From the given below extract of a Trial Balance show the treatment of provision for doubtful debts in the final accounts. Also pass the adjusting Journal entry.

Extract of Trial Balance

Particulars	Amount (Rs)
Debtors	30,000

Additional Information: Create a provision for doubtful debts @ 5% on Debtors.

Solution

Adjusting Journal Entry

Profit and Loss A/c (*WN*)	Dr.	1,500	
To Provision for Bad and Doubtful Debts A/c (Provision created for doubtful debts)			1,500

Profit and Loss Account

Dr. **Cr.**

Particulars	Amount	Particulars	Amount
Provision for Doubtful Debts	1,500		

Balance Sheet				
Liabilities	**Amount**	**Assets**		**Amount**
		Debtors	30,000	
		Less: Provision for Doubtful Debts	(1,500)	28,500

Working Note: *Calculation of Provision for Doubtful Debts*

$$\text{Provision for Doubtful Debts} = \text{Amount of Debtors} \times \frac{\text{Rate}}{100} = 30{,}000 \times \frac{5}{100} = \text{Rs } 1{,}500$$

Situation 2- When there exists Old Provision for Doubtful Debts

Under this situation, old provision for doubtful debts also appears in the Trial Balance or in the Balance Sheet. This situation can be further bifurcated into two cases.

Case 1- When Old Provision is less than the New Provision

This is a case when old provision falls short of the new provision. This implies that the business needs to create the provision with the difference amount. This difference amount will be considered as an expense and shown on the Debit side of the Profit and Loss Account.

In this case, the following is the Journal entry and the treatment for provision for doubtful debts in the books.

Profit and Loss A/c Dr. To Provision for Bad and Doubtful Debts A/c (Provision created for doubtful debts)	} With Net Amount**

***Net Amount is calculated as under-*

New Provision (as given in adjustment)	
Less: Old Provision (appearing in the Trial Balance)	
Net Amount of Provision	

Treatment in Final Accounts

1. First of all, the net amount (*as calculated above*) is shown on the debit side of the Profit and Loss Account.
2. Secondly, only the new provision (*as given in adjustment*) is deducted from the amount of debtors on the Assets side of the Balance Sheet.

Example 1: From the given below information show the treatment of provision for doubtful debts in the final accounts. Also pass the adjusting Journal entry.

Balance Sheet				
Liabilities	**Amount**	**Assets**		**Amount**
		Debtors	12,500	
		Less: Provision for Doubtful Debts	(900)	11,600

Additional Information: Create a provision for doubtful debts @ 8% on debtors.

Solution

Adjusting Journal Entry

Profit and Loss A/c (***WN2***) To Provision for Bad and Doubtful Debts A/c (Provision created for doubtful debts)	Dr.	100	100

Profit and Loss Account			
Dr.			**Cr.**
Particulars	**Amount**	**Particulars**	**Amount**
Provision for Doubtful Debts (***WN2***)	100		

Alternatively, provision for doubtful debts can also be shown in the Profit and Loss Account as follows.

Profit and Loss Account

Dr.				Cr.
Particulars		**Amount**	**Particulars**	**Amount**
New Provision for Doubtful Debts *Less*: Old Provision for Doubtful Debts	1,000 (900)	100		

Balance Sheet

Liabilities	**Amount**	**Assets**		**Amount**
		Debtors *Less*: New Provision for Doubtful Debts	12,500 (1,000)	11,500

Note: *In this case, old provision (i.e. Rs 900) is less than the new provision (i.e. Rs 1,000). Therefore, the difference of Rs 100 (1,000 – 900) is recorded on the debit side of Profit and Loss A/c. Also, the new provision is deducted from the amount of debtors in the Balance Sheet.*

<u>Working Notes:</u>

<u>WN1</u> *<u>Calculation of New Provision for Doubtful Debts</u>*

$$\text{New Provision for Doubtful Debts} = \text{Amount of Debtors} \times \frac{\text{Rate}}{100} = 12{,}500 \times \frac{8}{100} = \text{Rs } 1{,}000$$

<u>WN2</u> *<u>Calculation of Net Amount of Provision for Doubtful Debts</u>*

New Provision for Doubtful Debts	1,000
Less: Old Provision for Doubtful Debts	(900)
Net Amount	**100**

<u>Case 2</u>- When Old Provision is more than the New Provision

This is a case when old provision is more than the new provision. This implies that the business already has the sufficient amount of provision. Therefore, in this case the difference amount will be considered as a gain and shown on the Credit side of the Profit and Loss Account.

In this case, the following is the Journal entry and the treatment for provision for doubtful debts in the books.

Provision for Bad and Doubtful Debts A/c Dr. To Profit and Loss A/c (Provision created for doubtful debts)	} With Net Amount**

***Net Amount is calculated as under-*

Old Provision (appearing in the Trial Balance)	
Less: New Provision (as given in adjustment)	
Net Amount	

Treatment in Final Accounts

1. First of all, the net amount (*as calculated above*) is shown on the credit side of the Profit and Loss Account.
2. Secondly, only the new provision is deducted from the amount of debtorson the Assets side of the Balance Sheet.

<u>Example 1</u>: From the given below information show the treatment of provision for doubtful debts in the final accounts. Also pass the adjusting Journal entry.

Balance Sheet				
Liabilities	**Amount**	**Assets**		**Amount**
		Debtors	45,000	
		Less: Provision for Doubtful Debts	(5,000)	40,000

***Additional Information*:** Create a provision for doubtful debts @ 10% on Debtors.

Solution

Adjusting Journal Entry

Provision for Bad and Doubtful Debts A/c To Profit and Loss A/c (***WN*2**) (Provision created for doubtful debts)	Dr.	500	500

Profit and Loss Account			
Dr.			**Cr.**
Particulars	**Amount**	**Particulars**	**Amount**
		Provision for Doubtful Debts (***WN*2**)	500

Alternatively, provision for doubtful debts can also be shown in the Profit and Loss Account as follows.

Profit and Loss Account				
Dr.				**Cr.**
Particulars	**Amount**	**Particulars**		**Amount**
		Old Provision for Doubtful Debts	5,000	
		Less: New Provision for Doubtful Debts	(4,500)	500

Balance Sheet				
Liabilities	**Amount**	**Assets**		**Amount**
		Debtors	45,000	
		Less: New Provision for Doubtful Debts	(4,500)	40,500

Note: *In this case, old provision (i.e. Rs 5,000) is more than the new provision (i.e. Rs 4,500). Therefore, the difference of Rs 500 (5,000 – 4,500) is recorded on the credit side of Profit and Loss A/c. Also, the new provision of Rs 4,500 is deducted from the amount of debtors in the Balance Sheet.*

Working Notes:

WN1 *Calculation of New Provision for Doubtful Debts*

$$\text{New Provision for Doubtful Debts} = \text{Amount of Debtors} \times \frac{\text{Rate}}{100} = 45,000 \times \frac{10}{100} = \text{Rs } 4,500$$

WN2 *Calculation of Net Amount of Provision for Doubtful Debts*

Old Provision for Doubtful Debts	5,000
Less: New Provision for Doubtful Debts	(4,500)
Net Amount	**500**

Important Points	
Old Provision < New Provision	Old Provision > New Provision
Difference Amount is shown on Debit side of Profit & Loss A/c	Difference Amount in shown on Credit side of Profit & Loss A/c

__Example 2__**:** From the given below extract of Trial Balance show the treatment of provision for doubtful debts in the final accounts.

Extract of Trial Balance

Particulars	**Amount (Rs)**
Debtors	17,500
Bad debts	2,000
Provision for Doubtful Debts	600

Additional Information**:**

i. Further Bad debts amounted to Rs 1,500.

ii. Create a provision for doubtful debts @ 5% on Debtors.

Solution

Profit and Loss Account
for the year ended…

Dr.				**Cr.**
Particulars		**Amount**	**Particulars**	**Amount**
Bad debts	2,000			
Add: Further Bad debts	1,500			
Add: New Provision for Doubtful Debts	800			
Less: Old Provision for Doubtful Debts	(600)	3,700		

Balance Sheet
as on…

Liabilities	**Amount**	**Assets**		**Amount**
		Debtors	17,500	
		Less: Further Bad debts	(1,500)	
		Less: New Provision for Doubtful Debts	(800)	15,200

__Working Note__**:** *__Calculation of Provision for Doubtful Debts__*

$$\text{New Provision for Doubtful Debts} = \text{Amount of Debtors} \times \frac{\text{Rate}}{100} = (17,500 - 1,500) \times \frac{5}{100} = \text{Rs } 800$$

__Example 3__**:** From the given below extract of the Trial Balance show the treatment of provision for doubtful debts in the final accounts.

Extract of Trial Balance

Particulars	**Amount (Rs)**
Debtors	8,000

Bad debts Recovered Provision for Doubtful Debts	1,100 550

Additional Information:

i. Further Bad debts amounted to Rs 1,350.

ii. Create a provision for doubtful debts @ 12% on debtors.

Solution

Profit and Loss Account				
for the year ended…				
Dr.				**Cr.**
Particulars		**Amount**	**Particulars**	**Amount**
Further Bad debts	1,350		Bad debts Recovered	1,100
Add: New Provision for Doubtful Debts	798			
Less: Old Provision for Doubtful Debts	(550)	1,598		

Balance Sheet				
as on…				
Liabilities	**Amount**	**Assets**		**Amount**
		Debtors	8,000	
		Less: Further Bad ebts	1,350)	
		Less: New Provision for Doubtful Debts	(798)	5,852

Working Note: *Calculation of Provision for Doubtful Debts*

$$\text{New Provision for Doubtful Debts} = \text{Amount of Debtors} \times \frac{\text{Rate}}{100}$$

$$= (8,000 - 1,350) \times \frac{12}{100} = \text{Rs } 798$$

From the above examples the following can be concluded:

Word of Caution!!

- *Never show Old Bad Debts and Old Provision for Doubtful Debts in the New Balance Sheet.*
- *Show only Further Bad Debts and New Provision for Doubtful Debts in the New Balance Sheet.*

Old Bad debts and Old Provision are never shown in the New Balance Sheet. Only Further Bad debts and New Provision are shown in the New Balance Sheet.

Various Other Cases for Provision for Doubtful Debts

Case 1-

Balance Sheet				
Liabilities	**Amount**	**Assets**		**Amount**
		Debtors	10,000	
		Less: Provision for Doubtful Debts	(500)	9,500

***Additional Information*:** Provision for doubtful debts to be increased by Rs 300.

Solution

In this case, provision is to be increased by Rs 300. That means, new provision for doubtful debts is to be maintained at Rs 800 (i.e. 500 + 300). This increase of Rs 300 in the provision will be shown on the Debit side of the Profit and Loss Account. In addition to this, the new provision of Rs 800 will be deducted from the amount of debtors in the Balance Sheet. This treatment is shown below-

Profit and Loss Account

Dr.			Cr.
Particulars	**Amount**	**Particulars**	**Amount**
Provision for Doubtful Debts	300		

Balance Sheet

Liabilities	Amount	Assets		Amount
		Debtors	10,000	
		Less: New Provision for Doubtful Debts	(800)	9,200

Case 2-

Balance Sheet

Liabilities	Amount	Assets		Amount
		Debtors	22,000	
		Less: Provision for Doubtful Debts	(2,000)	20,000

***Additional Information*:** Provision for doubtful debts to be increased to Rs 2,500.

Solution

In this case, provision is to be increased to Rs 2,500. However, the old provision in the books is already maintained at Rs 2,000. So, this is the case when old provision is less than the new provision.

So, here, the extra amount of provision is to be created with the difference amount of Rs 500 (i.e. 2,500 – 2,000). This difference will be shown on the Debit side of the Profit and Loss Account. In addition to this, the new provision of Rs 2,500 will be deducted from the amount of debtors in the Balance Sheet. This treatment is shown below-

Profit and Loss Account

Dr.			Cr.
Particulars	**Amount**	**Particulars**	**Amount**
Provision for Doubtful Debts	500		

Balance Sheet

Liabilities	Amount	Assets		Amount
		Debtors	22,000	
		Less: New Provision for Doubtful Debts	(2,500)	19,500

Case 3-

Balance Sheet

Liabilities	Amount	Assets		Amount
		Debtors	35,000	
		Less: Provision for Doubtful Debts	(4,000)	31,000

***Additional Information*:** Provision for doubtful debts to be reduced by Rs 1,500.

Solution
In this case, provision is to be reduced by Rs 1,500. That means, new provision for doubtful debts is to be maintained at Rs 2,500 (i.e. 4,000 – 1,500). This decrease of Rs 1,500 in the amount of provision will be shown on the credit side of the Profit and Loss Account. In addition to this, the new provision of Rs 2,500 will be deducted from the amount of debtors in the Balance Sheet. This treatment is shown below-

Profit and Loss Account			
Dr.			**Cr.**
Particulars	**Amount**	**Particulars**	**Amount**
		Provision for Doubtful Debts	1,500

Balance Sheet				
Liabilities	**Amount**	**Assets**		**Amount**
		Debtors	35,000	
		Less: New Provision for Doubtful Debts	(2,500)	32,500

Case 4

Balance Sheet				
Liabilities	**Amount**	**Assets**		**Amount**
		Debtors	18,000	
		Less: Provision for Doubtful Debts	(3,500)	14,500

Additional Information: Provision for doubtful debts to be reduced to Rs 2,700.

Solution
In this case, provision is to be reduced to Rs 2,700. However, the old provision in the books is maintained at Rs 3,500. Clearly, this is the case when old provision is more than the new provision.
So, the difference of Rs 800 (i.e. 3,500 – 2,700) will be shown on the credit side of the Profit and Loss Account. In addition to this, the new provision of Rs 2,700 will be deducted from the amount of debtors in the Balance Sheet. This treatment is shown below-

Profit and Loss Account			
Dr.			**Cr.**
Particulars	**Amount**	**Particulars**	**Amount**
		Provision for Doubtful Debts	800

Balance Sheet				
Liabilities	**Amount**	**Assets**		**Amount**
		Debtors	18,000	
		Less: New Provision for Doubtful Debts	(2,700)	15,300

Provision for Discount on Debtors
It is a provision which is created to allow discount to those debtors who are ready to make the payment in one single shot. Such a discount acts as an encouraging factor for the debtors to repay their debt on time. The provision for discount on debtors is an expense for the business and therefore, it is shown on the debit side of the Profit and Loss Account.

Calculation of Provision for Discount on Debtors
It is calculated at a specific rate (*as given in the question*) on the amount of good debtors. We know the good debtors are those from whom the receipt of due amount is certain.

The amount of good debtors is calculated by deducting the amount of further bad-debts and new provision for doubtful-debts. Its calculation is given below.

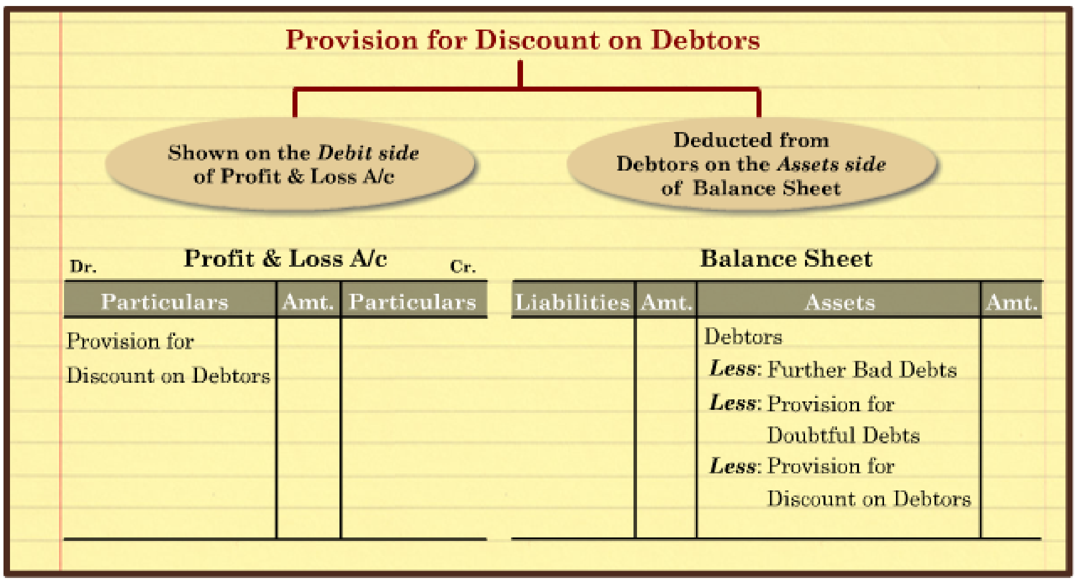
Debtors (as shown in the Trial Balance) *Less*: Further Bad debts *Less*: New Provision for Doubtful Debts	
Amount of Good Debtors	

The following is the adjusting Journal entry passed for creation of provision for discount on debtors.

Profit and Loss A/c Dr. To Provision for Discount on Debtors A/c (Provision for discount on debtors created on good debtors)		

Treatment- The treatment of provision for discount on debtors in the final accounts is given below.

1. First of all, provision for discount on debtors is shown on the debit side of the Profit and Loss Account.
2. Secondly, it is deducted from the amount of debtors in the Balance Sheet.



***<u>Example 1</u>*:** From the given below information, calculate the amount of provision for discount on debtors. Also show the relevant items in the final accounts.

Extract of Trial Balance

Particulars	Debit (Rs)	Credit (Rs)
Debtors	72,000	
Bad debts	5,400	
Provision for Doubtful Debts		3,500

Additional Information:

i. Further Bad debts amounted to Rs 6,200.

ii. Provision for doubtful debts is to be maintained @ 10% on Debtors.

iii. Create a provision for discount on debtors @ 5%.

Solution

<u>Calculation of Provision for Discount on Debtors</u>

$$\text{Provision for Discount on Debtors} = \text{Amount of Good Debtors} \times \frac{\text{Rate}}{100}$$

$$= 59{,}220 \times \frac{5}{100} = \text{Rs } 2{,}961$$

Calculation of Amount of Good Debtors

Debtors	72,000
Less: Further Bad debts	(6,200)
Less: New Provision for Doubtful Debts*	(6,580)
Amount of Good Debtors	**59,220**

$$^*\text{New Provision for Doubtful Debts} = \text{Amount of Debtors} \times \frac{\text{Rate}}{100} = (72{,}000 - 6{,}200) \times \frac{10}{100} = \text{Rs } 6{,}580$$

Profit and Loss Account

Dr. Particulars		Amount	Particulars	**Cr.** Amount
Bad Debts	5,400			
Add: Further Bad debts	6,200			
Add: New Provision for Doubtful Debts	6,580			
Less: Old Provision for Doubtful Debts	(3,500)	14,680		
Provision for Discount on Debtors		2,961		

Balance Sheet

Liabilities	Amount	Assets		Amount
		Debtors	72,000	
		Less: Further Bad debts	(6,200)	
		Less: New Provision for Doubtful Debts	(6,580)	
		Less: Provision for Discount on Debtors	(2,961)	56,259

Note 1: *Provision for doubtful debts* is created on the debtors after deducting the amount of further bad debts.

Note 2: *Provision for discount on debtors* is created on the amount of good debtors i.e. after deducting the amount of further bad debts and also the new provision for doubtful debts.

Example 2: From the given below information, calculate the amount of provision for discount on debtors. Also show the relevant items in the final accounts.

Balance Sheet

Liabilities	Amount	Assets		Amount
		Debtors	24,000	
		Less: Provision for Doubtful Debts	(1,500)	22,500

Additional Information:

i. Create Provision for doubtful debts @ 8%.

ii. Create Provision for discount on debtors @ 3%.

Solution

$$\text{New Provision for Doubtful Debts} = \text{Amount of Debtors} \times \frac{\text{Rate}}{100} = 24{,}000 \times \frac{8}{100} = \text{Rs } 1{,}920$$

Calculation of Provision for Discount on Debtors

$$\text{Provision for Discount on Debtors} = \text{Amount of Good Debtors} \times \frac{\text{Rate}}{100}$$

$$= 22{,}080 \times \frac{3}{100} = \text{Rs } 662 \text{ (Approx.)}$$

Calculation of Amount of Good Debtors

Debtors	24,000
Less: New Provision for Doubtful Debts	(1,920)
Amount of Good Debtors	**22,080**

Profit and Loss Account

Dr. **Cr.**

Particulars	Amount	Particulars	Amount
Provision for Doubtful Debts (1,920 – 1,500)	420		
Provision for Discount on Debtors	662		

Balance Sheet

Liabilities	Amount	Assets		Amount
		Debtors	24,000	
		Less: New Provision for Doubtful Debts	(1,920)	
		Less: Provision for Discount on Debtors	(662)	21,418

Note: *Here, further Bad debts are not given. Therefore, provision for discount on debtors is created after deducting only new provision for doubtful debts.*

Example 3: From the given below information, calculate the amount of provision for discount on debtors. Also show the relevant items in the final accounts.

Additional Information: Create Provision for discount on debtors @ 5%.

Extract of Trial Balance

Particulars	Debit (Rs)	Credit (Rs)
Debtors	12,000	
Bad debts Recovered		2,800

Solution

$$\text{Provision for Discount on Debtors} = \text{Amount of Good Debtors} \times \frac{\text{Rate}}{100} = 12{,}000 \times \frac{5}{100} = \text{Rs } 600$$

Profit and Loss Account

Dr. **Cr.**

Particulars	Amount	Particulars	Amount
Provision for Discount on Debtors	600	Bad debts Recovered	2,800

Balance Sheet

Liabilities	Amount	Assets		Amount
		Debtors	12,000	
		Less: Provision for Discount on Debtors	(600)	11,400

***Note**: In this case, there is no further Bad debts and new provision for doubtful debts. Therefore, discount on debtors is directly calculated on the amount of debtors given in the*

Trial Balance

Provision for Discount on Creditors and Mananger's Commission

Objectives
After going through this lesson, you shall be able to understand the adjustment of the following items in preparation of the Final Accounts.

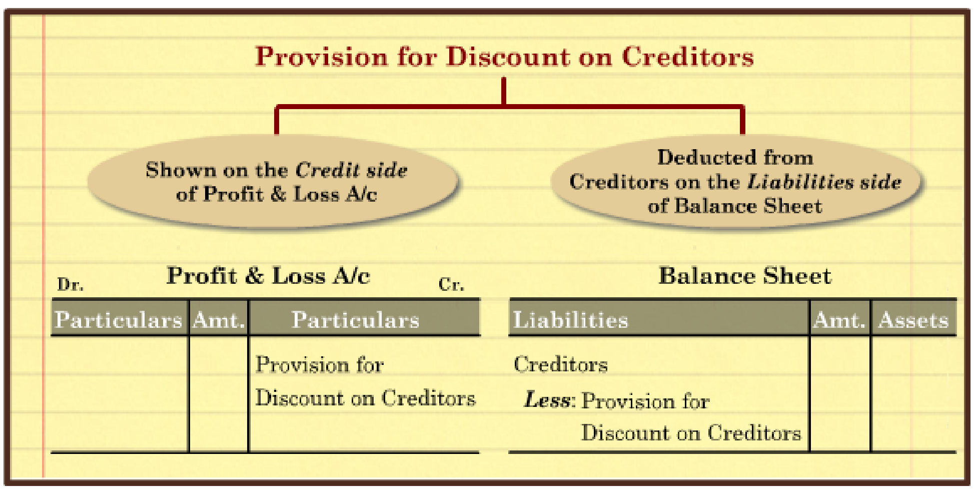
- Provision for Discount on Creditors
- Manager's Commission

Provision for Discount on Creditors
Similar to the discount on debtors, a firm may receive discount from its creditors for making the entire payment in one single shot. It may be possible that the business makes purchases in the current year, the payment of which is made in the next (or different) accounting year. In such a case, provision for such discount is made in the current year itself. This provision for discount on creditors is considered as a gain. The adjusting Journal entry for creation of provision for discount on creditors is given below.

Provision for Discount on Creditors A/c Dr. To Profit and Loss A/c (Provision created for discount on creditors)		

Treatment- The treatment of provision for discount on creditors in the final accounts is given below.

1. Firstly, provision for discount on creditors is shown on the Credit side of the Profit and Loss Account.
2. Secondly, it is deducted from the amount of creditors on the Liabilities Side of the Balance Sheet.



Example 1: From the given below information, calculate the amount of provision for discount on creditors. Also show the relevant items in the final accounts.

Trial Balance		
Particulars	**Debit (Rs)**	**Credit (Rs)**
Creditors		55,000

Additional Information: Create a provision for discount on creditors @ 3%.

Solution

Profit and Loss Account			
Dr.			**Cr.**
Particulars	**Amount**	**Particulars**	**Amount**
		Provision for Discount of Creditors	1,650

Balance Sheet				
Liabilities		Amount	Assets	Amount
Current Liabilities				
Creditors	55,000			
Less: Provision for Discount on Creditors	(1,650)	53,350		

Working Note: *Calculation of Provision for Discount on Creditors*

$$\text{Provision for Discount on Creditors} = \text{Amount of Creditors} \times \frac{\text{Rate}}{100}$$

$$= 55{,}000 \times \frac{3}{100} = \text{Rs } 1{,}650$$

Example 2: Show the treatment of the following items in the final accounts.

Extract of Trial Balance		
Particulars	Debit (Rs)	Credit (Rs)
Debtors	62,000	
Creditors		47,000
Bad Debts	2,000	
Provision for Doubtful Debts		1,500
Bad Debts Recovered		2,500

Additional Information:

i. Further bad debts amounted to Rs 4,000.

ii. Provision for doubtful debts is to be maintained @ 5% on Debtors.

iii. Create a provision for discount on debtors @ 10%.

iv. Discount on creditors @ 2%

Solution

Profit and Loss Account *for the year ended…*				
Dr.				**Cr.**
Particulars		Amount	Particulars	Amount
Bad Debts	2,000		Bad Debts Recovered	2,500
Add: Further Bad Debts	4,000		Provision for Discount of Creditors	940
Add: New Provision for Doubtful Debts	2,900			
Less: Old Provision for Doubtful Debts	(1,500)	7,400		
Provision for Discount on Debtors		5,510		

Balance Sheet *as on…*					
Liabilities		Amount	Assets		Amount
Creditors	47,000		Debtors	62,000	
Less: Provision for Discount on Creditors	(940)	46,060	*Less*: Further Bad Debts	(4,000)	
			Less: New Provision for Doubtful Debts	(2,900)	
			Less: Provision for		

		Discount on Debtors	(5,510)	49,590

***Working Notes*:**

WN1*: *Calculation of New Provision for Doubtful Debts

$$\text{New Provision for Doubtful Debts} = \text{Amount of Debtors} \times \frac{\text{Rate}}{100} = (62{,}000 - 4{,}000) \times \frac{5}{100} = \text{Rs } 2{,}900$$

WN2*: *Calculation of Provision for Discount on Debtors

Calculation of Amount of Good Debtors

Debtors	62,000
Less: Further Bad Debts	(4,000)
Less: New Provision for Doubtful Debts	(2,900)
Amount of Good Debtors	**55,100**

$$\text{Provision for Discount on Debtors} = \text{Amount of Good Debtors} \times \frac{\text{Rate}}{100} = 55{,}100 \times \frac{10}{100} = \text{Rs } 5{,}510$$

WN3*: *Calculation of Provision for Discount on Creditors

$$\text{Provision for Discount on Creditors} = \text{Amount of Creditors} \times \frac{\text{Rate}}{100} = 47{,}000 \times \frac{2}{100} = \text{Rs } 940$$

Manager's Commission

Commission is the amount that is paid to the managers in addition to their salary so as to motivate them to work with higher levels of interest and dedication. It is generally provided on the net profits of the firm. Manager's commission is an expense for a firm.

Usually, manager's commission is computed at the end of an accounting year, therefore, often it is considered as an outstanding expense.

The following is the adjusting Journal entry for manager's commission.

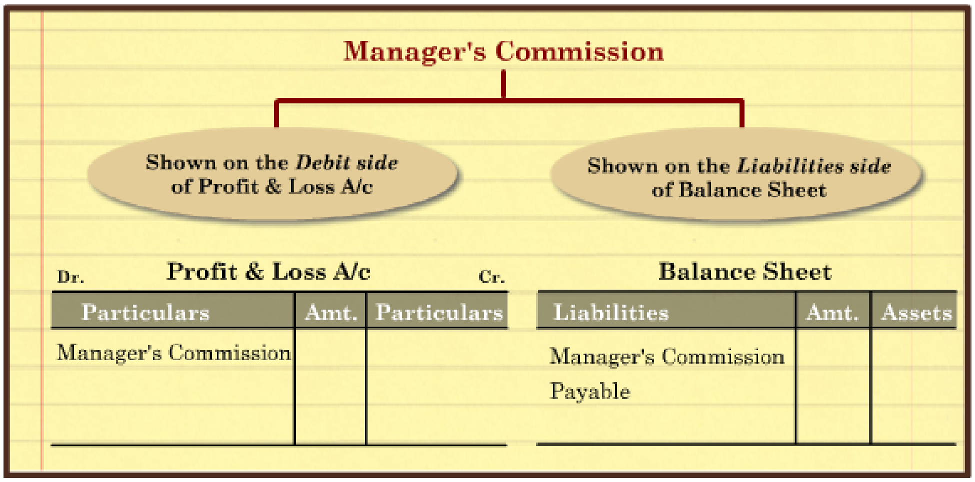
Manager's Commission A/c Dr. To Outstanding Commission A/c (Commission outstanding)		

Profit and Loss A/c Dr. To Manager's Commission A/c (Commission payable to manager transferred to Profit & Loss A/c)		

Treatment- The treatment of manager's commission in the final accounts is as follows.

1. Firstly, it is shown on the Debit side of the Profit and Loss Account.
2. Secondly, it is shown as a liability (being an outstanding expense) on the Liabilities Side of the Balance Sheet.

The disclosure of manager's commission in the final accounts is shown below.



Computation of Manager's Commission

There are two ways for computing the Manager's Commission on net profits.

1. On Net Profit *Before* Charging such Commission
2. On Net Profit *After* Charging such Commission

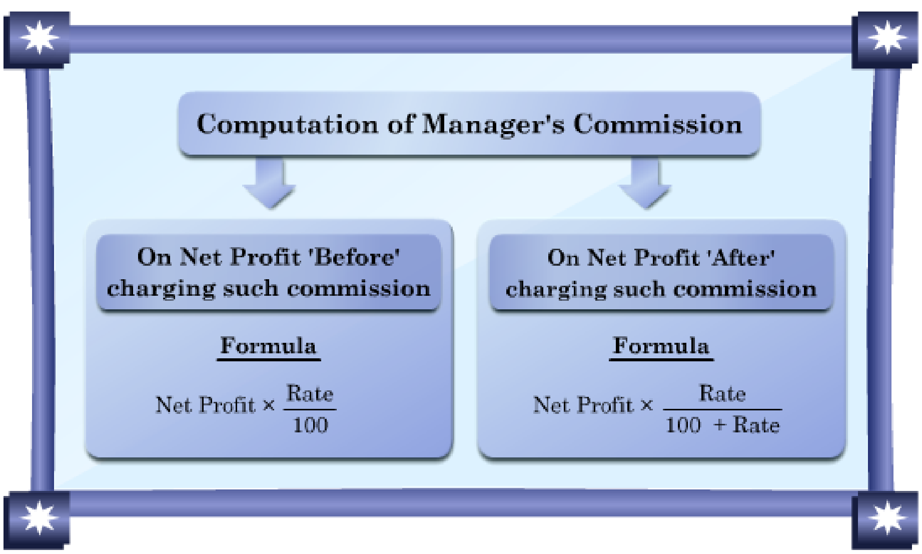
1. *__On Net Profit **Before** Charging such Commission__*

When the question asks to calculate the manager's commission on the net profits before charging such commission, then it is calculated with the help of given below formula-

$$\text{Manager's Commission} = \text{Net Profit} \times \frac{\text{Rate}}{100}$$ -

2. *__On Net Profit **After** Charging such Commission__*

When the question asks to calculate the manager's commission on the net profits after charging such commission, then it is calculated with the help of given below formula- $\text{Manager's Commission} = \text{Net Profit} \times \frac{\text{Rate}}{100 + \text{Rate}}$



__Example:__ The books of M/s Alka show the net profit during the year amounted Rs 49,500. Show the treatment of manager's commission in the final accounts if the manager is entitled to receive the commission @ 10% on-

i. Net Profit before charging such commission

ii. Net Profit after charging such commission

Solution

Case i- Net Profit *before* charging such Commission

Profit and Loss Account

Dr.			Cr.
Particulars	**Amount**	**Particulars**	**Amount**
Manager's Commission	4,950		

Balance Sheet

Liabilities	Amount	Assets	Amount
Current Liabilities			
Manager's Commission Payable	4,950		

Working Note:

$$\text{Manager's Commission} = \text{Net Profit} \times \frac{\text{Rate}}{100} = 49{,}500 \times \frac{10}{100} = \text{Rs } 4{,}950$$

Case ii- Net Profit *after* charging such Commission

Profit and Loss Account

Dr.			Cr.
Particulars	**Amount**	**Particulars**	**Amount**
Manager's Commission	4,500		

Balance Sheet

Liabilities	Amount	Assets	Amount
Current Liabilities			
Manager's Commission Payable	4,500		

Working Note:

$$\text{Manager's Commission} = \text{Net Profit} \times \frac{\text{Rate}}{100 + \text{Rate}} = 49{,}500 \times \frac{10}{110} = \text{Rs } 4{,}500$$

Example: Given below is the Trial Balance of M/s MNC Ltd. as on 31st December 2013.

Particulars	Amount (Rs)
Creditors	10,000
Rent Received	60,000
Building	1,50,000
Capital	1,02,000
Insurance Premium Paid	3,000
Commission Received	6,000
Apprentice Premium Received	15,000
Bad debts	14,000
Discount Allowed	6,000
Salaries	5,000
Cash in hand	25,000
Cash at Bank	15,000
Closing Stock	20,000
Gross Profit	45,000

Prepare Profit and Loss A/c and Balance Sheet for the year ended 31st December 2013 after making the following adjustments:

1. Unexpired Insurance is Rs 100.
2. One-fourth amount of the rent received is accrued.
3. Salary is payable @ Rs 500 per month.
4. 1/3rd of the commission received belongs to the next year.
5. Depreciation is to be provided @ 10% p.a. on Building.
6. Provide Manager's Commission at 10% on:

    Case -1- Net Profit before charging such commission
    Case- 2- Net Profit after charging such commission

Solution:

Case-1: When Manager's Commission is provided on Net Profit before charging such commission.

Profit and Loss Account
for the year ending December 31, 2013

Dr.					**Cr.**
Particulars		**Amount (Rs)**	**Particulars**		**Amount (Rs)**
Insurance	3,000		Gross Profit		45,000
Less: Unexpired Insurance	100	2,900	Rent	60,000	
Bad debts		14,000	*Add:* Accrued Rent	15,000	75,000
Discount Allowed		6,000			
Salaries	5,000		Commission	6,000	
Add: Outstanding Salary	1,000	6,000	*Less:* Unaccrued Commission	2,000	4,000
Depreciation on:			Apprentice Premium Received		15,000
Building		15,000			
Manager's Commission **(*see video*)		9,510			
Net Profit		85,590			
		1,39,000			1,39,000

Working Note:

Manager's Commission=Net Profit×Rate100 =95,100×10100 =Rs 9,510

Case-2: When Manager's Commission is provided on Net Profit after charging such commission.

Profit and Loss Account
for the year ending December 31, 2013

Dr.					**Cr.**
Particulars		**Amount (Rs)**	**Particulars**		**Amount (Rs)**
Insurance	3,000		Gross Profit		45,000
Less: Unexpired Insurance	100	2,900	Rent	60,000	
Bad debts		14,000	*Add:* Accrued Rent	15,000	75,000
Discount Allowed		6,000			
Salaries	5,000		Commission	6,000	
Add: Outstanding Salary	1,000	6,000	*Less:* Unaccrued Commission	2,000	4,000
Depreciation on:			Apprentice Premium Received		15,000
Building		15,000			
Manager's Commission **(*see video*)		8,645			
Net Profit		86,455			
		1,39,000			1,39,000

Working Note:

$$\text{Manager's Commission} = \text{Net Profit} \times \frac{\text{Rate}}{100+\text{Rate}} \qquad = 95{,}100 \times \frac{10}{100+10} \qquad = \text{Rs } 8{,}645$$

Strengthen this topic Take a Topic Test
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Goods- Abnomal Loss, Utilised for Personal Use and Donation / Charity

Objectives
After going through this lesson, you shall be able to understand the following adjustments related to goods in preparation of the Final Accounts.

- Abnormal Losses
- Goods withdrawn for Personal Use
- Goods distributed as Free Samples
- Goods given as Charity/Donation

Abnormal Losses
There may be a situation when a business faces unforeseen losses such as those resulting from fire, accidents, earthquake, storms, floods, etc. Such situations are accidental and do not occur frequently during the normal course of business. These losses that arise due to unexpected or abnormal situations are known as abnormal losses (or accidental losses). The abnormal loss may include the destruction or damage of assets, goods and other properties of the business. On the basis of this, abnormal loss can be bifurcated into following two categories.

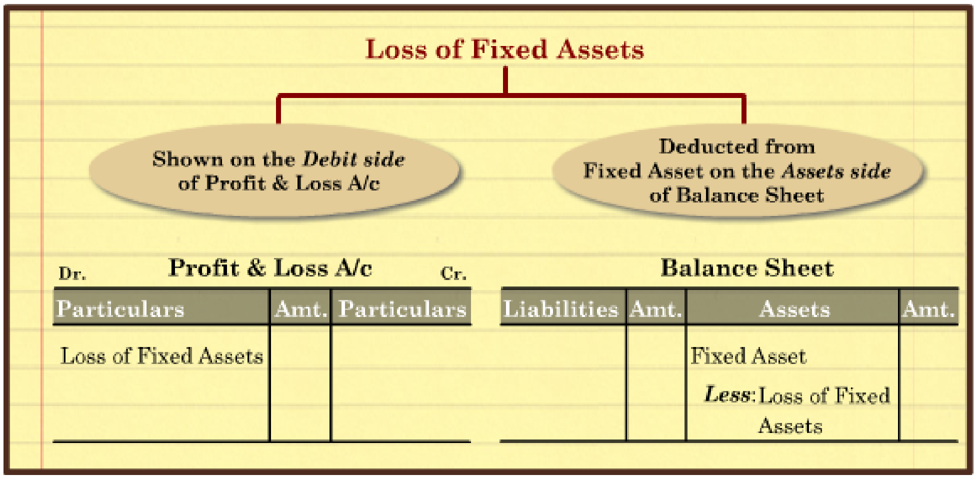
1. Loss of Fixed Assets
2. Loss of Goods

1. Loss of Fixed Assets
Destruction of assets of the business due to fire, earthquake, accidents or some other causes is known as loss of fixed assets. The treatment of loss of fixed assets in the financial statements is given below:

i. Firstly, it is recorded on the debit side of the Profit and Loss Account and

ii. Secondly, it is deducted from the value of concerned fixed assets in the Balance Sheet.

The recording of loss of fixed assets in the final accounts is given below.



Example: A business had furniture worth Rs 52,000. During the year, furniture of Rs 17,500 burnt due to a fire. Show the loss in the value of furniture in the books of the firm.

Solution

Profit and Loss Account

Dr. Particulars	Amount	Particulars	**Cr.** Amount
Loss of Furniture	17,500		

Balance Sheet

Liabilities	Amount	Assets		Amount
		Furniture	52,000	
		Less: Loss of Furniture	(17,500)	34,500

2. Loss of Goods

When the goods are damaged due to some accidents or other causes, it is known as loss of goods. This loss of goods is always shown on the credit side of the Trading Account. For this the following Journal entry is passed in the books.

Loss of Goods A/c To Trading A/c (Loss of goods)	Dr.		

Trading Account
for the year ended…

Dr. Particulars	Amount	Particulars	**Cr.** Amount
		Loss of Goods	

After recording the loss of goods in the Trading Account, this loss is transferred to Profit and Loss Account.
But sometimes, a business may get its goods insured in order to cover the loss of goods due to the accidental situations. In such a case, the recording of loss of goods in the Profit and Loss Account depends upon the following three situations.

i. Loss of Goods and Insurance Company *does not* admit the claim

ii. Loss of Goods or fire and Insurance Company admits the *Full* claim

iii. Loss of Goods and Insurance Company *Partly* admitted the claim

Let us take the above situations one by one and understand the treatment of loss of goods in each of these situations.

i. *Loss of Goods and Insurance Company does not admit the claim*

In this case, after recording the amount of goods lost on the Credit side of the Trading A/c, such loss is also shown on the Debit side of the Profit and Loss Account with the full amount of goods lost.
For this, the adjusting Journal entry and its disclosure in the books is given below.

Profit and Loss A/c Dr. To Loss of Goods A/c (Loss of goods)		

Profit and Loss Account			
Dr.			**Cr.**
Particulars	**Amount**	**Particulars**	**Amount**
Loss of Goods			

ii. *Loss of Goods due accident or fire and Insurance Company admits the 'Full' claim*

In case, the insurance company admits the full claim of the goods lost, then the goods lost are shown only on Credit side of the Trading A/c and not shown in the Profit and Loss Account. However, the insurance claim so admitted is shown on the Assets Side of the Balance Sheet as 'Claim due from Insurance Company'.
The given below is the Journal entry and its disclosure in the books.

Insurance Company A/c Dr. To Loss of Goods A/c (Claim admitted by Insurance Co. for goods lost)		

Balance Sheet			
Liabilities	**Amount**	**Assets**	**Amount**
		Current Assets Claim due from Insurance Co.	

iii. *Loss of Goods due accident or fire and Insurance Company 'Partly' admitted the claim*

There may be a situation when the insurance company does not admit the entire claim in respect of the goods lost. It may accept only a part of the claim. In such a case, the loss of goods is recorded in the following way

- First of all, the entire amount of goods lost is shown on the Credit side of the Trading A/c
- Then, this entire loss is also shown on the Debit side of the Profit and Loss A/c.
- After this, the claim admitted by the insurance company is shown as deduction from the above loss earlier written on the debit side of the Profit and Loss A/c. Or simply, the net loss is transferred to the Profit and Loss Account.
- The insurance claim so admitted is also shown on the assets side of the Balance Sheet as 'Claim due from Insurance Company'.

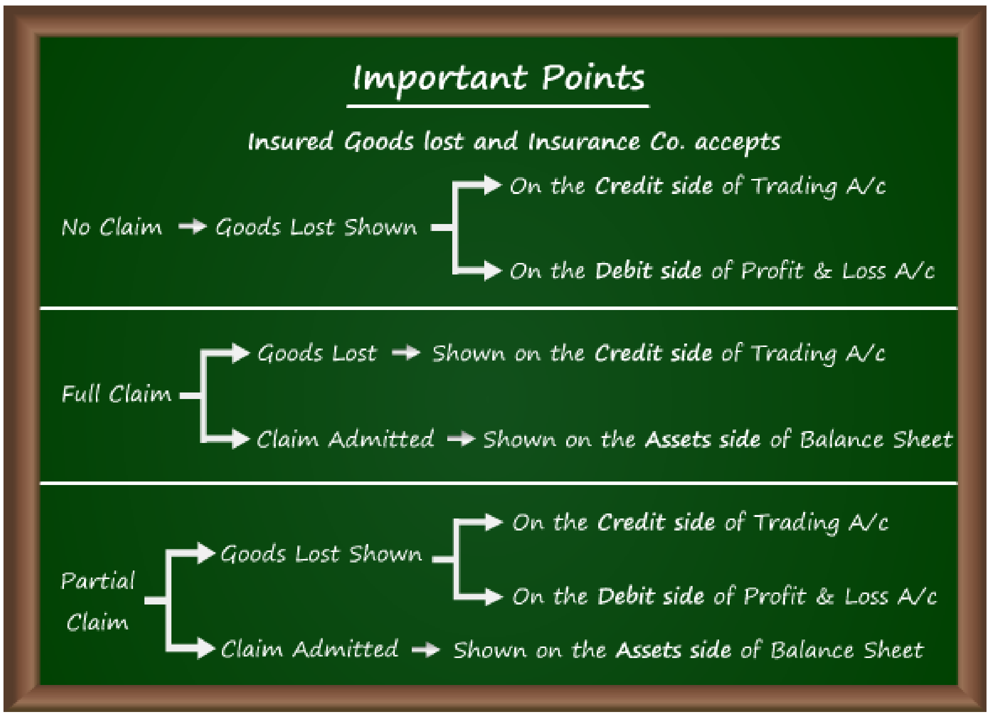
The following is the Journal entry and disclosure in the books in this case.

Insurance Company A/c Dr. Profit and Loss A/c Dr. To Loss of Goods A/c (Claim admitted by Insurance Co. for goods lost and remaining loss transferred to Profit and Loss Account)		

Profit and Loss Account			
Dr.			**Cr.**
Particulars	**Amount**	**Particulars**	**Amount**

Loss of Goods *Less:* Insurance claim admitted			

Balance Sheet			
Liabilities	**Amount**	**Assets**	**Amount**
		Current Assets Claim due from Insurance Co. (with the amount of claim admitted by the insurance co.)	



Example: The stock of goods worth Rs 1,40,000 was destroyed due to fire which were insured by an insurance company. Record the amount of goods lost in the final accounts under different situations given below. Also pass the necessary Journal entries.

i. If insurance company does not accept the claim of goods lost

ii. If insurance company accepts claim of only 65% of goods lost

iii. If insurance company accepts the full claim of goods lost

Solution

Case i- *If insurance company does not accept the claim of goods lost*

Goods lost by Fire A/c To Trading A/c (Goods lost due to fire)	Dr.	1,40,000	 1,40,000
Profit and Loss Account To Goods Lost by Fire A/c (Goods lost due to fire transferred to Profit and Loss Account)	Dr.	1,40,000	 1,40,000

Trading Account			
Dr.			**Cr.**
Particulars	**Amount**	**Particulars**	**Amount**
		Goods lost by fire	1,40,000

Profit and Loss Account			
Dr.			**Cr.**
Particulars	**Amount**	**Particulars**	**Amount**
Goods lost by fire	1,40,000		

Case ii- *If insurance company accepts claim of only 65% of goods lost*

Goods lost by Fire A/c To Trading A/c (Goods lost due to fire)	Dr.	1,40,000	 1,40,000
Insurance Company A/c Profit and Loss Account To Goods Lost by Fire A/c (65% of claim accepted by insurance co. and remaining loss transferred to profit and loss account)	Dr. Dr.	91,000 49,000	 1,40,000

Trading Account			
Dr.			**Cr.**
Particulars	**Amount**	**Particulars**	**Amount**
		Goods lost by Fire	1,40,000

Profit and Loss Account				
Dr.				**Cr.**
Particulars		**Amount**	**Particulars**	**Amount**
Goods lost by Fire *Less*: Claim Received	1,40,000 (91,000)	 49,000		

Balance Sheet			
Liabilities	**Amount**	**Assets**	**Amount**
		Current Assets Claim due from Insurance Co.	 91,000

Case iii- *If insurance company accepts the full claim of goods lost*

Goods lost by Fire A/c To Trading A/c (Goods lost due to fire)	Dr.	1,40,000	 1,40,000
Insurance Company A/c To Goods Lost by Fire A/c (100% claim accepted by Insurance co.)	Dr.	1,40,000	 1,40,000

Trading Account			
Dr.			Cr.
Particulars	**Amount**	**Particulars**	**Amount**
		Goods lost by Fire	1,40,000

Balance Sheet			
Liabilities	**Amount**	**Assets**	**Amount**
		Current Assets Claim due from Insurance Co.	 1,40,000

Goods Withdrawn for Personal Use

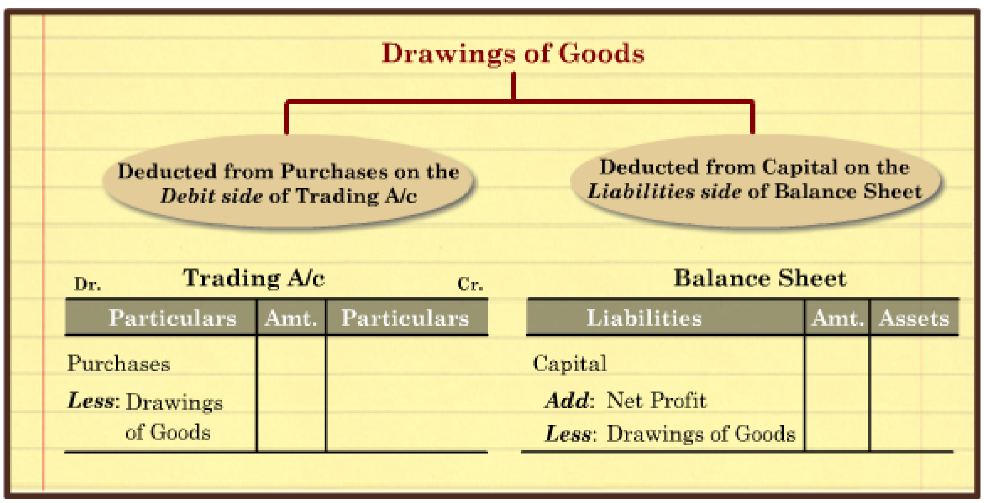
Sometimes, a sole proprietor may withdraw goods from the business for his/her personal use. Such withdrawal of goods from the business is known as Drawings. The drawings of goods reduce the stock of goods in the business. Therefore, such drawings made should be deducted from the purchases that are made for the business purposes. For recording the Journal entry for the drawings of goods is given below.

Drawings A/c Dr. To Purchases A/c (Goods withdrawn for personal use)		

Treatment- The treatment of drawings in the financial statements is as follows.

1. First of all, the cost of goods withdrawn is deducted from the purchases on the Debit side of the Trading Account.
2. Secondly, it is deducted from the Capital on the Liabilities Side of the Balance Sheet.

The disclosure of drawings of goods in the final accounts is shown below.



Example 1: Given below is the extract of Trial Balance. Show the treatment of goods withdrawn for personal use in the final accounts. Also pass the necessary Journal entry.

Trial Balance		
Particulars	**Debit (Rs)**	**Credit (Rs)**
Purchases Capital	74,000	 1,55,000

Additional Information: Goods worth Rs 22,000 withdrawn by proprietor for personal use.

Solution

Drawings A/c To Purchases A/c (Goods withdrawn for personal use)	Dr.	22,000	 22,000

Trading Account			
Dr.			**Cr.**
Particulars	**Amount**	**Particulars**	**Amount**
Purchases 74,000 *Less*: Drawings of Goods (22,000)	 52,000		

Balance Sheet			
Liabilities	**Amount**	**Assets**	**Amount**
Capital 1,55,000 *Less*: Drawings of Goods (22,000)	 1,33,000		

Goods Distributed as Free Samples

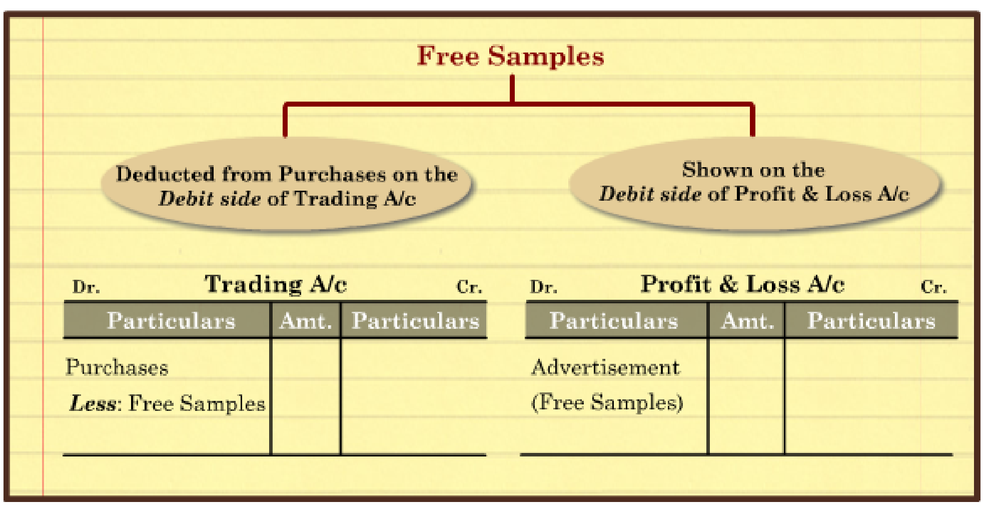
Sometimes, a firm may distributes the goods as free samples for promoting the sales of the business. Such distribution of goods is considered as an advertisement activity under which a business promotes or advertises its products/goods. The distribution of goods as free samples reduces the stock of goods in the business. The Journal entry for drawings of goods is given below.

Advertisement A/c To Purchases A/c (Goods distributed as free samples)	Dr.		

Treatment- The treatment of goods distributed as free samples in the final accounts is given below.

1. First of all, cost of goods distributed as free samples is deducted from the purchases on the debit side of the Trading Account.
2. Secondly, it is shown on the debit side of the Profit and Loss Account as an 'Advertisement Expense'.

The disclosure of goods distributed as free samples in the final accounts is shown below.



Example 1: Given below is the extract of a Trial Balance. Show the treatment of goods distributed as free samples in the final accounts. Also pass the necessary Journal entry.

Trial Balance		
Particulars	**Debit (Rs)**	**Credit (Rs)**
Purchases	21,000	

Additional Information: Goods worth Rs 1,800 distributed as free samples.

Solution

Advertisement A/c To Purchases A/c (Goods distributed as free samples)	Dr.	1,800	 1,800

Trading Account				
Dr.				**Cr.**
Particulars		**Amount**	**Particulars**	**Amount**
Purchases *Less*: Free Samples	21,000 (1,800)	 19,200		

Profit and Loss Account			
Dr.			**Cr.**
Particulars	**Amount**	**Particulars**	**Amount**
Advertisement	1,800		

***Example 2*:** Show the treatment of the following items in the final accounts.

Trial Balance		
Particulars	**Debit (Rs)**	**Credit (Rs)**
Purchases	90,000	
Capital		1,65,000

Additional Information:

i. Goods worth Rs 3,100 withdrawn by the proprietor for his personal use.

ii. Goods distributed as free samples worth Rs 7,800

iii. Goods lost by fire Rs 15,000. The Insurance company accepts the claim of only Rs 7,000.

Solution

Trading Account *for the year ended…*				
Dr.				**Cr.**
Particulars		**Amount**	**Particulars**	**Amount**
Purchases *Less*: Drawings of goods *Less*: Free Samples	90,000 (3,100) (7,800)	 79,100	Goods lost by Fire	15,000

Profit and Loss Account *for the year ended…*			
Dr.			**Cr.**
Particulars	**Amount**	**Particulars**	**Amount**
Advertisement (Free Samples)	7,800		

Goods lost by fire *Less*: Insurance claim accepted	15,000 7,000	8,000		

Balance Sheet				
Liabilities		Amount	Assets	Amount
Capital *Less*: Drawings of Goods	1,65,000 (3,100)	1,61,900	Claim due from Insurance Co.	7,000

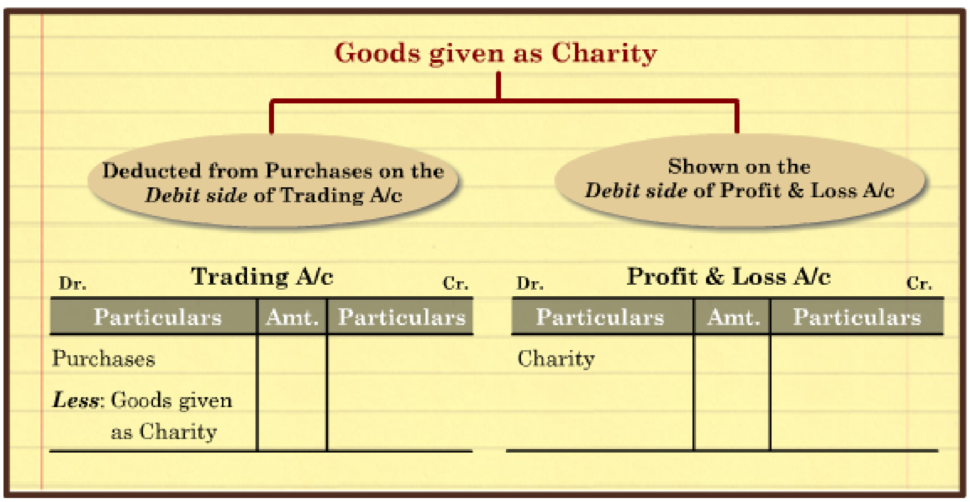
Goods Given as Charity/Donation
A sole proprietor, at certain time intervals, may opt to donate some amount of goods as a charity or donation. Such charity or donations reduces the stock of goods in the business. The Journal entry for recording the goods given as charity is given below.

Charity A/c To Purchases A/c (Goods given as charity)	Dr.		

Treatment- The treatment of Goods given as Charity in the final accounts is as follows.

1. First of all, cost of goods given as charity is deducted from the purchases on the Debit side of the Trading Account.
2. Secondly, it is shown on the Debit Side of the Profit and Loss Account as Charity.

The disclosure of goods given as charity in the final accounts is shown below.



***Example 1*:** Given below is the extract of a Trial Balance. Show the treatment of goods given as charity in the final accounts.

Trial Balance		
Particulars	Debit (Rs)	Credit (Rs)
Purchases	38,700	

Additional Information: Goods worth Rs 2,300 given as charity.

Solution

Charity A/c To Purchases A/c (Goods given as charity)	Dr.	2,300	2,300

Trading Account				
Dr.				**Cr.**
Particulars		**Amount**	**Particulars**	**Amount**
Purchases	38,700			
Less: Charity	(2,300)	36,400		

Profit and Loss Account			
Dr.			**Cr.**
Particulars	**Amount**	**Particulars**	**Amount**
Charity	2,300		

***Example 2*:** Given below is the extract of a Trial Balance. Show the treatment of following items in the final accounts.

Trial Balance		
Particulars	**Debit (Rs)**	**Credit (Rs)**
Purchases	1,35,500	
Capital		2,20,000

Additional Information:

i. Goods worth Rs 15,500 withdrawn for personal use.

ii. Goods worth Rs 11,200 given as charity.

iii. Goods worth Rs 21,000 distributed as free samples.

iv. Goods destroyed by fire Rs 34,000. Insurance Claim received Rs 19,000.

Solution

Trading Account *for the year ended…*				
Dr.				**Cr.**
Particulars		**Amount**	**Particulars**	**Amount**
Purchases	1,35,500		Goods Lost by Fire	34,000
Less: Drawings of Goods	(15,500)			
Less: Goods given as Charity	(11,200)			
Less: Free Samples	(21,000)	87,800		

Profit and Loss Account *for the year ended…*				
Dr.				**Cr.**
Particulars		**Amount**	**Particulars**	**Amount**
Charity		11,200		
Advertisement		21,000		
Goods Lost by Fire	34,000			
	(19,000)	15,000		

Balance Sheet			

Liabilities		Amount	Assets	Amount
Capital	2,20,000		Claim due from Insurance Co.	19,000
Less: Drawings of Goods	(15,500)	2,04,500		

***Example 3*:** Given below is the extract of a Trial Balance. Show the treatment of following items in the final accounts.

Extract of Trial Balance

Particulars	Debit (Rs)	Credit (Rs)
Purchases	1,30,000	
Capital		2,10,000
Drawings	25,000	
Furniture	60,000	
Debtors	45,000	
Creditors		37,000
Bad Debts	8,000	
Salary	24,000	
Insurance Paid	19,200	
Rent Received		22,600
Interest on Securities		13,200
Bad debts recovered		9,200

Additional Information:

i. Goods worth Rs 19,000 withdrawn for personal use.

ii. Goods worth Rs 13,500 given as charity and distributed as free samples worth Rs 17,800

iii. Goods destroyed by fire Rs 29,000. Insurance Co. accepts the full claim.

iv. Depreciation on furniture @ 10%.

v. Closing Stock valued at Rs 45,900 (Market value Rs 42,000).

vi. Write-off bad debts Rs 6,500.

vii. Create provision for doubtful debts @ 4%.

viii. Discount on creditors @ 2%.

ix. Salary outstanding for 2 months @ Rs 2,400 p.m.

x. Insurance paid for 15 months.

Solution

Trading Account

for the year ended…

Dr.				Cr.
Particulars		**Amount**	**Particulars**	**Amount**
Purchases	1,30,000		Goods Lost by Fire	29,000
Less: Drawings of Goods	(19,000)		Closing Stock	42,000
Less: Goods given as Charity	(13,500)			
Less: Free Samples	(17,800)	79,700		

Profit and Loss Account

for the year ended…

Dr.			Cr.
Particulars	**Amount**	**Particulars**	**Amount**
Charity	13,500	Bad debts recovered	9,200
Advertisement	17,800	Discount on creditors	740

Depreciation on Furniture @ 10%		6,000	Rent received	22,600
Bad debts	8,000		Interest on securities	13,200
Add: Further Bad Debts	6,500	14,500		
Provision for Doubtful Debts		1,540		
Salary	24,000			
Add: Outstanding Salary	4,800	28,800		
Insurance Paid	19,200			
Less: Pain in advance	(3,840)	15,360		

Balance Sheet

as on…

Liabilities		Amount	Assets		Amount
Capital	2,10,000		Furniture	60,000	
Less: Drawings	(25,000)		*Less*: Depreciation	(6,000)	54,000
Less: Drawings of Goods	(19,000)	1,66,000	Debtors	45,000	
Creditors	37,000		*Less*: Further Bad Debts	(6,500)	
Less: Discount on Creditors	(740)	36,260	*Less*: Provision for Doubtful Debts	(1,540)	36,960
Outstanding Salary		4,800	Closing Stock		42,000
			Claim due from Insurance Co.		29,000
			Prepaid Insurance		3,840

Note 1: *Closing stock is valued at 'cost' or 'market price' whichever is less. Here, market price (i.e. Rs 42,000) is less than its cost (i.e. Rs 45,900). Therefore, closing stock is recorded with Rs 42,000.*

Note 2: *Goods lost by fire Rs 29,000. The insurance company accepts the full claim. Therefore, this loss is shown only in the Trading A/c. Also, the insurance claim accepted by the company is shown on the Assets side of the Balance Sheet.*

Working Notes:

WN1: *Calculation of Provision for Doubtful Debts*

$$\text{Provision for Doubtful Debts} = \text{Amount of Debtors} \times \frac{\text{Rate}}{100} = (45{,}000 - 6{,}500) \times \frac{4}{100} = \text{Rs } 1{,}540$$

WN2: *Calculation of Discount on Creditors*

$$\text{Provision for Discount on Creditors} = \text{Amount of Creditors} \times \frac{\text{Rate}}{100} = 37{,}000 \times \frac{2}{100} = \text{Rs } 740$$

WN3: *Calculation of Insurance Paid in Advance*

$$\text{Insurance paid for 15 months} = 19{,}200$$

$$\text{Insurance per month} = \frac{19{,}200}{15} = \text{Rs } 1{,}280$$

$$\therefore \text{Insurance paid in advance for 3 months} = 1{,}280 \times 3 = \text{Rs } 3{,}840$$

Treatment of GST in certain cases:

Transaction	Treatment	Explanation
1) Goods taken for personal use.	Drawings A/c Dr. To Purchases A/c To Input CGST A/c To Input SGST A/c Or To Input IGST A/c (Being adjustment of goods taken for personal use)	A reverse entry is passed for the GST. Hence, this shall not be set off against GST received.
	Staff Welfare Expenses A/c Dr.	

2) Goods distributed to the staff for their welfare.	To Purchases A/c To Input CGST A/c To Input SGST A/c Or To Input IGST A/c (Being adjustment of goods distributed to the staff)	A reverse entry is passed for the GST. Hence, this shall not be set off against GST received.
3) Loss of Stock due to an accident.	(i) Accidental Loss A/c[Total Value of Abnormal Loss] Dr. Or Loss of Stock by fire A/c[Total Value of Abnormal Loss] Dr. To Trading A/c To Input CGST A/c To Input SGST A/c Or To Input IGST A/c (Being adjustment of goods distributed to the staff) **(ii) If stock is insured:** Insurance Co. or Claim(Insurance Claim Amount) Dr. Profit and Loss A/c(Irrecoverable value of loss) To Accidental Loss A/c Dr. [Total Value of Abnormal Loss] Or To Loss of Stock by fire A/c [Total Value of Abnormal Loss] **(iii) If Stock is not insured:** Profit & Loss A/c(Total Value of Abnormal loss) To Trading A/c Dr. To Input CGST A/c To Input SGST A/c Or To Input IGST A/c	A reverse entry is passed for the GST. Hence, this shall not be set off against GST received.

Extraordinary Items- Rectification Entries

Objectives
After going through the lesson, you will be able to understand some of the important rectification of errors while preparation of final accounts along with some special adjustments.

***Goods sent on Approval Basis*:** Sometimes the goods are sent to the customers on a condition that within a certain period of time they may accept the goods or reject them. This facility is known as 'Goods Sent on Approval Basis' and is given to prospective buyer to enhance the sales. At the time when goods are sent to the customers, it is not recorded as a regular sale instead it is mere transfer of goods whose ownership lies with the transferring entity. The moment these are approved by the buyer or are retained beyond the stipulated time, it becomes a regular sale.

In case the goods have been recorded as regular sale and no consent has been received from the customer till the end of accounting period or has been rejected, then following entry will be passed to cancel the effect of sale:

Sales A/c To Debtor's (Customer's) A/c (Cancellation of sale) Stock with the customer's A/c* To Trading A/c (Recording of adjusting entry)	Dr. Dr.		

*At the cost or Market Price whichever is lower.

<u>Accounting Treatment:</u>

- Since this has been recorded as a regular sale, it will be reduced from the sales on the credit side of the Trading Account. Also, the same amount of debtors will be reduced as they are not liable to pay us any amount as it is not a sale till they approve them.

- The goods lying with the customer will be treated like stock of unsold goods lying with the customer. So, it will be added to the closing stock on the credit side of Trading Account and the stock thus increased will also be shown on the assets side of the balance sheet.

***Purchase of Fixed Asset passed through the Purchase Day book*:** The purchase of Fixed Asset is debited to the fixed assets account and not to the Purchases Account. Since it has been recorded in Purchase day Book, it means the purchase of Fixed Asset has been debited to the Purchases Account which will now be rectified by passing the following adjusting entry:

Fixed Assets A/c Dr. To Purchases A/c (Purchase of Fixed asset recorded in Purchase book now rectified)		

Accounting Treatment:

The purchase price of the Fixed assets will be deducted from the Purchases Account in trading account and will be added to the Fixed assets Account to be disclosed on the Assets side of the Balance Sheet.

***Mutual Indebtedness*:** In situation where the same person is both the debtor and creditor of the firm at the same time due to certain business transactions. Suppose, Ram & Co. purchased Tubes from Bharat Traders for Rs 5,000 and at the same time Ram & Co. sold Tyres to Bharat Traders for Rs 6,500. This means Bharat Traders is a creditor for Ram & Co. for Rs 5,000 and at the same time a debtor for Rs 6,500. Thus, Bharat Traders is both debtor and creditor in the books of Ram & Co. at the same time. But, as per accounting principles and practices one cannot be represented as a debtor and creditor both at the same time. It can either be debtor or creditor. Therefore, here Bharat Traders would be recorded as debtor for Rs 1,500 (6,500 – 5,000) in Ram & Co. books. The adjustment entry for this is

Creditors A/c Dr. To Debtors A/c (Adjustment for mutual indebtedness)		

Accounting Treatment:

In such cases one entity is to appear either as a debtor or creditor and for this adjustment is done in the amount of debtors or creditors. The adjustment is made by deducting the lesser of two amounts from both the total of debtors and the creditors by which one account stands cleared. In our example the lesser is Rs 5,000 which will be deducted from both the debtors and the creditors and we will be left with Rs 1,500 Debtors against the name of Bharat Traders.

***Capital Expenditure recorded as Revenue Expenditure*:** Sometimes the expenditure incurred on acquiring or increasing the value of fixed assets i.e. Capital Expenditure may have been treated as Revenue expenditure, which is any expenditure whose benefit is received during the current year itself. Few of such cases are:

- *Wages included amount spent on installation of machinery:* The amount spent on installation of machinery is a capital expenditure and is added to the cost of machinery. It would be debited to the Machinery account. In order to rectify this mistake, the amount of wages paid will be deducted from the wages and added to the amount of machinery.

- *Goods purchased for construction of Building , debited to Purchases Account:* Since, the amount spent on purchase of construction material is a capital expenditure and will be added to the Building Account and will be deducted from Purchases account. The treatment is quite similar to the adjustment of Purchase of Fixed Asset passed through Purchase day book.

- *Amount spent on erection of Scooter stand included in Repairs Account:* The amount so added to repairs will be deducted from Repairs account and will be added to Motor Vehicle account since it is a Capital expenditure.

Goods purchased on credit and included in stock but omitted to be recorded: Sometimes the goods are purchased and included in the stock but are not recorded in the books of accounts. It will be recorded in the books by passing the following entry:

Purchases A/c Dr. To Creditors A/c (Goods purchased but omitted to be recorded)		

Accounting Treatment:

In the above case the above goods will be added to the purchases on the debit side of Trading Account and secondly it will be added to the amount of creditors on the Liabilities side of the Balance Sheet.

Dishonour of Cheque/Bill Receivable but no entry was made in books of Accounts: In case the cheque/Bill receivable is dishonoured and no entry for the same has been made in books of accounts, then the following adjusting entry would be passed for the same:

Debtor's A/c Dr. To Bank/Bill Receivable A/c (Cheque / B/R dishonoured and recorded)		

Accounting Treatment:

In the above case the amount of dishonoured cheque/Bill receivable is added to the Debtors A/c, and the same amount is deducted from the Bank / Bills Receivable Account in the Balance Sheet.

Carriage includes carriage paid for purchase of assets: Carriage Inwards is the amount that is spent on Carriage of goods purchased by firm. The carriage inward is a direct expense and is shown in trading account, but carriage spent on purchase of assets is treated as Capital expenditure. The adjustment entry for this would be

Fixed Assets A/c Dr. To Carriage A/c (Carriage paid for purchase of fixed assets included in Carriage)		

Accounting Treatment:

In this case Carriage on the Purchase of Fixed Assets is a capital expenditure; it will be added to the Fixed Assets on the Assets side of Balance sheet and will be deducted from the Carriage on the debit side of Trading Account.

Salary paid to employee debited to his personal account: Salary paid to employee is to be debited to Salary Account, since it has been debited to personal account of employee, it will be credited by passing following adjustment entry:

Salary A/c Dr. To Employee's Personal A/c (Salaries debited to personal account being rectified)		

Comprehensive Examples

Objective

In the previous lessons, we learnt the treatment of various adjustments in the financial statements. In this lesson, we will tackle some comprehensive examples which will test your grasp and knowledge over the various concepts.

Example 1: Prepare a Trading Account, Profit and Loss Account and Balance Sheet from the given below Trial Balance as on December 31, 2013.

Trial Balance
as on December 31, 2013

Particulars	Amount (₹)	Particulars	Amount (₹)
Cash Purchases	82,000	Cash Sales	93,000
Credit Purchases	63,300	Credit Sales	1,05,000
Stock in the beginning	24,750	Return Outwards	1,980
Building	1,98,000	Commission	660
Short-Term Investments	8,250	Rent from Sublet	3,300
Furniture	22,400	Capital	2,70,000
Additional Furniture purchased on July 01, 2013	6,500		

Loan to Zoya	11,500	Bank Loan	10,000
Bills Receivable	34,320	Interest Accrued	500
Return Inward	3,300	Bills Payable	33,000
Dock Charges	660		
Freight and Duty	825		
Carriage on Purchases	1,815		
Salary	32,010		
Advertisement	7,590		
Carriage on Sales	1,490		
Insurance	1,320		
Incidental Expenses	1,650		
Stationery	1,900		
Travelling Expenses	3,960		
Drawings	9,900		
	5,17,440		**5,17,440**

Additional Information

i. Stock at the end valued at Rs 42,100 (Market value Rs 39,600).
ii. Commission earned but not received Rs 100.
iii. Stationery unused at the end of the year Rs 250.
iv. Interest on capital @ 8% p.a. and interest on drawings @ 5% p.a.
v. Salary is payable @ Rs 3,000 per month.
vi. Insurance is paid upto March 31, 2014.
vii. Depreciate building and furniture @ 5% p.a. and 10% p.a. respectively.

Solution

Trading Account
for the year ended December 31, 2013

Dr. Particulars		Amount (₹)	Particulars		Cr. Amount (₹)
Opening Stock		24,750	Cash Sales	93,000	
Cash Purchases	82,000		Credit Sales	1,05,000	
Credit Purchases	63,300		*Less*: Return Inwards	(3,300)	1,94,700
Less: Return Outwards	(1,980)	1,43,320	Closing Stock		39,600
Dock Charges		660			
Freight and Duty		825			
Carriage on Purchases		1,815			
Gross Profit (*Balancing Figure*)		62,930			
		2,34,300			**2,34,300**

Profit and Loss Account
for the year ended December 31, 2013

Dr. Particulars		Amount (₹)	Particulars		Cr. Amount (₹)
Salary	32,010		Gross Profit		62,930
Add: Outstanding (***WN1***)	3,990	36,000	Commission	660	
Advertisement		7,590	*Add*: Accrued Commission	100	760
Carriage on Sales		1,490	Rent from Sublet		3,300
Insurance	1,320		Interest on Drawings (9,900 × 5%)		495
Less: Paid in Advance (***WN2***)	(264)	1,056	Net Loss (*Balancing Figure*)		19,976
Incidental Expenses		1,650			
Stationery	1,900				
Less: Unused	(250)	1,650			
Travelling Expenses		3,960			
Interest on Capital (2,70,000 × 8%)		21,600			
Depreciation on:					

Building @ 5%	9,900			
Furniture (*WN3*)	2,565	12,465		
		87,461		**87,461**

Balance Sheet *as on December 31, 2013*					
Liabilities		**Amount (₹)**	**Assets**		**Amount (₹)**
Capital	2,70,000		**Fixed Assets**		
Less: Net Loss	(19,976)		Building	1,98,000	
Add: Interest on Capital	21,600		*Less*: Depreciation	(9,900)	1,88,100
Less: Drawings	(9,900)		Furniture	22,400	
Less: Interest on Drawings	(495)	2,61,229	*Add*: Additions	6,500	
			Less: Depreciation	(2,565)	26,335
Current Liabilities					
Bank Loan		10,000	**Current Assets**		
Interest Accrued		500	Bills Receivable		34,320
Bills Payable		33,000	Short-Term Investments		8,250
Outstanding Salary		3,990	Loan to Zoya		11,500
			Closing Stock		39,600
			Prepaid Insurance		264
			Accrued Commission		100
			Stationery Unused		250
		3,08,719			**3,08,719**

Note: Closing Stock is valued at 'cost' or 'market price' whichever is less. Here, the market value (i.e. Rs 39,600) is less than its cost (i.e Rs 42,100). Therefore, closing stock is shown at Rs 39,600.

Working Notes:

WN1 *Calculation of Salary Outstanding*

Salary for the year (3,000 × 12)	36,000
Less: Paid during the year	32,010
Outstanding Salary	**3,990**

WN2 *Calculation of Insurance Paid in Advance*

Insurance Paid upto March 31, 2014 (i.e. for 15 months) = 1,320

$$\text{Insurance per month} = \frac{1,320}{15} = \text{Rs } 88$$

$$\therefore \text{Insurance Paid in Advance} = 88 \times 3 = \text{Rs } 264$$

WN3 *Calculation of Depreciation on Furniture*

$$\text{On 22,400 for full year} = 22,400 \times \frac{10}{100} = 2,240$$

$$\text{On 6,500 for 6 months (from July 01 to Dec. 31)} = 6,500 \times \frac{10}{100} \times \frac{6}{12} = 325$$

$$\therefore \text{Total Depreciation } (2,240 + 325) = 2,565$$

***Example 2*:** The given below information has been extracted from the books of Ms. Gungun. Using this information, prepare the financial statements for the year ended March 31, 2013.

Using this information, prepare the financial statements for the year ended March 31, 2013.

Particulars	Amount (₹)	Amount (₹)
Purchases and Sales	2,10,500	3,24,000
Returns	3,800	2,500

Manufacturing Expenses	7,350	
Import Duty	4,000	
Factory Lighting	6,350	
Wages and Salaries	12,000	
Export Duty	8,100	
Income Tax	5,500	
Legal Charges	2,000	
Audit Fees	3,800	
Telephone Expenses	6,300	
Discount	2,200	2,850
Establishment Expenses	10,500	
Petty Expenses	1,400	
Bad Debts	4,200	
Provision for Doubtful Debts		3,900
Bad Debts Recovered		1,600
Interest on Wife's Loan		2,000
Commission received		4,500
Stock at the Commencement	38,900	
Capital and Drawings	23,500	2,49,000
Bank Overdraft		16,700
Loan to Wife @ 8%	32,000	
Cash in Hand	15,100	
Patents	35,000	
Debtors and Creditors	42,000	29,500
Plant and Machinery	55,000	
Livestock	27,050	
Business Premises	80,000	
	6,36,550	**6,36,550**

Additional Information-
i. Closing Stock valued at Rs 52,500.
ii. Debtors include an item of Rs 5,600 due from customer who has become insolvent and nothing is recoverable from his estate.
iii. Provision for Doubtful Debts increased to Rs 4,700.
iv. Provision for discount on debtors created at 2% and discount on creditors created at 3%.
v. Telephone expenses paid for 10 months.
vi. Loss of goods due to fire Rs 25,000. Insurance co. admitted the claim of 60% of the goods lost. Due to fire, part of machinery costing Rs 6,000 was also burnt and destroyed.
vii. Half of the commission is received in respect of work done for the next year.
viii. Only 1/4th of wages and salaries to be charged from Trading Account. Remaining to be charged from Profit and Loss Account.
ix. 1/5th of patents written-off.
x. Depreciation on business premises @ 15% p.a.

Solution

Trading Account
for the year ended March 31, 2013

Dr. **Cr.**

Particulars		**Amount (₹)**	**Particulars**		**Amount (₹)**
Opening Stock		38,900	Sales	3,24,000	
Purchases	2,10,500		*Less*: Sales Return	(3,800)	3,20,200
Less: Purchases Return	(2,500)	2,08,000	Closing Stock		52,500
Manufacturing Expenses		7,350	Loss of Goods by Fire		25,000
Import Duty		4,000			
Factory Lighting		6,350			
Wages and Salaries (1/4th)		3,000			
Gross Profit (*Balancing Figure*)		1,30,100			
		3,97,700			3,97,700

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

Dr. Particulars		Amount (₹)	Particulars		Cr. Amount (₹)
Export Duty		8,100	Gross Profit		1,30,100
Legal Charges		2,000	Discount received		2,850
Audit Fees		3,800			
Telephone Expenses	6,300		Bad Debts Recovered		1,600
Add: Outstanding Expense (***WN1***)	1,260	7,560	Interest on Wife's Loan	2,000	
			Add: Interest Outstanding (***WN2***)	560	2,560
Discount allowed		2,200	Commission Received	4,500	
Establishment Expenses		10,500	*Less*: Received for next year	(2,250)	2,250
Petty Expenses		1,400	Discount on Creditors (29,500 × 3%)		885
Wages and Salaries (3/4th)		9,000			
Loss of Goods by Fire		10,000			
Loss of Machinery due to Fire		6,000			
Bad Debts	4,200				
Add: Further Bad Debts	5,600				
Add: New Provision	4,700				
Less: Old Provision	(3,900)	10,600			
Provision for discount on debtors (***WN3***)		634			
Patents written-off (35,000/5)		7,000			
Depreciation on Business Premises		12,000			
Net Profit (*Balancing Figure*)		49,451			
		1,40,245			1,40,245

Balance Sheet
as on March 31, 2013

Liabilities		Amount (₹)	Assets		Amount (₹)
Capital	2,49,000		**Fixed Assets**		
Add: Net Profit	49,451		Live Stock		27,050
Less: Drawings	(23,500)		Patents (35,000 – 7,000)		28,000
Less: Income Tax	(5,500)	2,69,451	Plant and Machinery	55,000	
Current Liabilities			*Less*: Destroyed	(6,000)	49,000
Bank Overdraft		16,700	Business Premises	80,000	
Creditors	29,500		*Less*: Depreciation	(12,000)	68,000
Less: Discount on Creditors	(885)	28,615	**Current Assets**		
Commission Received in Advance		2,250	Debtors	42,000	
Outstanding Telephone Expenses		1,260	*Less*: Further Bad Debts	(5,600)	
			Less: New Provision	(4,700)	
			Less: Provision for Discount	(634)	31,066
			Cash in Hand		15,100
			Insurance Claim Admitted		15,000
			Loan to Wife @ 8%		32,000
			Accrued Interest on Wife's Loan		560
			Closing Stock		52,500
		3,18,276			**3,18,276**

Working Notes:

WN1 Calculation of Outstanding Telephone Expenses

Telephone Expenses paid for 10 months = 6,300

$$\text{Telephone Expenses per month} = \frac{6,300}{10} = 630$$

$\therefore$ Telephone Expenses outstanding for 2 months = 630×2 = Rs 1,260

WN2 Calculation of Interest Outstanding on Wife's Loan

$$\text{Interest on Wife's Loan @ 8\%} = 32{,}000 \times \frac{8}{100} = 2{,}560$$

$$\text{Interest paid during the year} = 2{,}000$$

$$\therefore \text{Interest Outstanding} = 2{,}560 - 2{,}000 = 560$$

WN3 Calculation of Provision for Discount Debtors

$$\text{Provision for Discount on Debtors} = \text{Amount of Good Debtors} \times \frac{\text{Rate}}{100}$$

$$\text{Amount of Good Debtors} = 42{,}000 - 5{,}600 - 4{,}700 = 31{,}700$$

$$\text{Amount of Good Debtors} = 31{,}700 \times \frac{2}{100} = 634$$

Note: Provision for discount on debtors is created on the amount of debtors after deducting further bad debts and new provision.

Example 3: From the given below Trial Balance, prepare Trading and Profit and Loss Account and the Balance Sheet as on March 31, 2013.

Trial Balance

as on March 31, 2013

Particulars	Amount (₹)	Particulars	Amount (₹)
Goodwill	72,000	Bank Loan @ 10%	52,000
Motor Car	56,000	Creditors	29,950
Cash Balance	39,500	Bills Payable	23,000
Debtors	60,000	Capital	3,70,000
Land and Building	1,15,000	Sales	1,90,700
Machinery	63,000	Rent from Tenant	30,000
Closing Stock	37,700	Apprentice Premium	18,500
Live Stock	23,500	Discount on Purchases	12,200
Drawings	12,900		
Printing and Stationery	7,800		
Advertisement	6,500		
Entertainment Expenses	7,850		
Depreciation on Machinery	7,000		
Audit Fees	22,500		
Discount on Sales	5,400		
Conveyance Charges	5,650		
Bank Charges	1,350		
Delivery Van Expenses	2,800		
Bad Debts	8,300		
Royalty on Sales	1,925		
Fire Insurance Premium	3,200		
Life Insurance Premium	5,100		
Dock Charges	2,300		
Custom Duty	1,875		
Royalty on Purchases	3,300		
Gas and Fuel	2,250		
Commission on Purchases	3,650		
Purchases	1,48,000		
	7,26,350		7,26,350

Additional Information-

i. Goods worth Rs 8,000 withdrawn for personal use, goods worth Rs 6,200 distributed as free samples and goods worth Rs 5,450 given as charity.
ii. Conveyance charges include Rs 2,000 for private purpose.
iii. Goodwill written-off Rs 7,200.
iv. Bank loan taken on July 01, 2013.
v. Bad debts Rs 10,000 and provision for doubtful debts to be created @ 6%.
vi. Depreciate motor car and land and building at 10% p.a. and 15% p.a. respectively.

vii. Goods lost in an accident worth Rs 12,000. Full insurance claim is admitted by the Insurance Co.
viii. Audit fee paid for 15 months.
ix. Printing and stationery unpaid Rs 2,200.

Solution

Trading Account
for the year ended March 31, 2013

Dr. Particulars		Amount (₹)	Particulars	Cr. Amount (₹)
Purchases	1,48,000		Sales	1,90,700
Less: Drawings in Goods	(8,000)		Loss of Goods due to accident	12,000
Less: Free samples	(6,200)			
Less: Charity	(5,450)	1,28,350		
Dock Charges		2,300		
Custom Duty		1,875		
Royalty on Purchases		3,300		
Gas and Fuel		2,250		
Commission on Purchases		3,650		
Gross Profit (*Balancing Figure*)		60,975		
		2,02,700		2,02,700

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

Dr. Particulars		Amount (₹)	Particulars	Cr. Amount (₹)
Printing and Stationery	7,800		Gross Profit	60,975
Add: Unpaid	2,200	10,000	Rent from Tenant	30,000
Advertisement		6,500	Apprentice Premium	18,500
Entertainment Expenses		7,850	Discount on Purchases	12,200
Depreciation on Machinery		7,000	Net Loss (*Balancing Figure*)	12,900
Audit Fees	22,500			
Less: Paid in Advance (***WN1***)	(4,500)	18,000		
Discount on Sales		5,400		
Conveyance Charges	5,650			
Less: For Private Use	(2,000)	3,650		
Bank Charges		1,350		
Delivery Van Expenses		2,800		
Bad Debts	8,300			
Add: Further Bad Debts	10,000			
Add: New Provision	3,000	21,300		
Royalty on Sales		1,925		
Fire Insurance Premium		3,200		
Depreciation on:				
Motor Car @ 10%	5,600			
Land and Building @ 15%	17,250	22,850		
Goodwill written-off		7,200		
Free Samples		6,200		
Charity		5,450		
Outstanding Interest on Bank Loan (***WN2***)		3,900		
		1,34,575		1,34,575

Balance Sheet

Liabilities		Amount (₹)	Assets		Amount (₹)
Capital	3,70,000		**Fixed Assets**		
Less: Net Loss	(12,900)		Goodwill (72,000 – 7,200)		64,800
Less: Drawings (***WN3***)	(22,900)		Motor Car	56,000	
Less: Life Insurance Premium	(5,100)	3,29,100	*Less*: Depreciation	(5,600)	50,400
Current Liabilities			Land and Building	1,15,000	
Creditors		29,950	*Less*: Depreciation	(17,250)	97,750
Bills Payable		23,000	Machinery		63,000
Bank Loan @ 10%		52,000	Live Stock		23,500
Interest Outstanding on Bank Loan		3,900			
Printing and Stationery Unpaid		2,200	**Current Assets**		
			Cash Balance		39,500
			Debtors	60,000	
			Less: Further Bad Debts	(10,000)	
			Less: New Provision	(3,000)	47,000
			Closing Stock		37,700
			Audit Fees Paid in Advance		4,500
			Insurance Claim Admitted		12,000
		4,40,150			**4,40,150**

Note 1: When the closing stock is given inside the Trial Balance, then it implies that it is already adjusted in the purchases. So, in this case, closing stock is not shown in the Trading Account. It is shown only on the Assets Side of the Balance Sheet.
Note 2: Life insurance premium is a personal expense, that is, why it is not debited to the Profit and Loss Account and deducted from the Capital in the Balance Sheet.
Note 3: Depreciation on machinery is given inside the Trial Balance. Therefore, it is shown only in the Profit and Loss A/c and not deducted from the amount of machinery in the Balance Sheet.
Note 4: The Insurance Co. admitted the full claim of the goods lost in accident. Therefore, such loss of goods is not shown in the Profit and Loss A/c. It is shown only in the Trading A/c and in the Balance Sheet.

Working Notes:
WN1 *Calculation of Audit Fees Paid in Advance*

$$\text{Audit Fees paid for 15 months} = 22{,}500$$

$$\text{Audit Fees per month} = \frac{22{,}500}{15} = 1{,}500$$

$$\therefore \text{Audit Fees paid in advance for 3 months} = 1{,}500 \times 3 = \text{Rs } 4{,}500$$

WN2 *Calculation of Interest on Bank Loan*

$$\text{Interest on Bank Loan for 9 months (from July 01 to March 31)} = 52{,}000 \times \frac{10}{100} \times \frac{9}{12} = 3{,}900$$

WN3: *Drawings made during the year*

Drawings (as given in Trial Balance)	12,900
Drawings of Goods	8,000
Conveyance Charges for private Use	2,000
Total Drawings	**22,900**

Example 4: From the given below Trial Balance, prepare Trading and Profit and Loss Account for the year ended March 31, 2013 and the Balance Sheet as on that date for Mr. Jhunnu.

Trial Balance
as on March 31, 2013

Particulars	Amount (₹)	Particulars	Amount (₹)
Purchases:		Sales:	
Domestic	1,21,000	Domestic	1,55,500
Foreign	1,50,000	Foreign	1,78,000
Stock as on April 01, 2012	42,350	Capital	3,28,400
Royalty on Production	5,125	Interest Received	5,685
Factory Expenses	7,900	Accounts Payable	80,200

Gas, Fuel and Coal	4,700	Accrued Commission	2,800
Excise Duty	2,600	Advance from Customers	1,39,900
Transportation Charges	5,895	Rebate Received	3,200
Packing Charges	3,100	Sundry Income	18,450
General Expenses	12,800	Loan from Father	60,000
Advertisement	14,500	Provision for Doubtful Debts	2,800
Godown Rent	6,250		
Distribution Expenses	9,885		
Law Charges	3,000		
Salary	14,800		
Rebate Allowed	2,500		
Loss on sale of furniture	1,250		
Drawings	18,800		
Live Stock	1,55,000		
Motor Vehicles	98,500		
Additional Motor Vehicle purchased Oct. 01, 2013	23,500		
Cash at Bank	34,980		
Short-term Investments	50,700		
Accounts Receivables	62,800		
Debtors	51,000		
Trade Marks	72,000		
	9,74,935		**9,74,935**

Additional Information-

i. Stock as on March 31, 2013 valued at Rs 59,700.
ii. Interest on Father's Loan payable Rs 4,800.
iii. General expenses include Rs 3,000 for income tax paid.
iv. Bad debts amounting to Rs 3,000.
v. Provision for Doubtful Debts to be reduced by Rs 500.
vi. 30% of the salary and law charges to be charged from Trading Account.
vii. Goods worth Rs 6,600 distributed as free samples.
viii. A new neon-board costing Rs 4,500 included in advertisement.
ix. Interest on drawings to be charged @ 5% p.a. and interest on capital @ 10% p.a.
x. Depreciate motor vehicle by 15% p.a.

Solution

Trading Account

for the year ended March 31, 2013

Dr. **Cr.**

Particulars		Amount (₹)	Particulars		Amount (₹)
Opening Stock		42,350	Sales		
Purchases			Domestic	1,55,500	
Domestic	1,21,000		Foreign	1,78,000	3,33,500
Foreign	1,50,000		Closing Stock		59,700
Less: Free Samples	(6,600)	2,64,400			
Royalty on Production		5,125			
Factory Expenses		7,900			
Gas, Fuel and Coal		4,700			
Excise Duty		2,600			
Salary (30%)		4,440			
Law Charges (30%)		900			
Gross Profit (*Balancing Figure*)		60,785			
		3,93,200			3,93,200

Profit and Loss Account

for the year ended March 31, 2013

Dr. **Cr.**

Particulars		Amount (₹)	Particulars	Amount (₹)
Transportation Charges		5,895	Gross Profit	60,785
Packing Charges		3,100	Interest Received	5,685
General Expenses	12,800		Rebate Received	3,200
Less: Income Tax Paid	(3,000)	9,800	Sundry Income	18,450
Advertisement	14,500		Interest on Drawings (18,800 × 5%)	940
Less: Neon Board	(4,500)	10,000	Net Loss (*Balancing Figure*)	35,358
Godown Rent		6,250		
Distribution Expenses		9,885		
Law Charges (70%)		2,100		
Salary (70%)		10,360		
Rebate Allowed		2,500		
Loss on sale of furniture		1,250		
Bad Debts	3,000			
Add: New Provision (***Note***)	2,300			
Less: Old Provision	(2,800)	2,500		
Interest on Capital (3,28,400 × 10%)		32,840		
Outstanding Interest on Father's Loan		4,800		
Depreciation on Motor Car		16,538		
Free Samples		6,600		
		1,24,418		1,24,418

Balance Sheet
as on March 31, 2013

Liabilities		Amount (₹)	Assets		Amount (₹)
Capital	3,28,400		**Fixed Assets**		
Less: Net Loss	(35,358)		Live Stock		1,55,000
Add: Interest on Capital	32,840		Motor Car	98,500	
Less: Drawings	(18,800)		*Add*: Addition	23,500	
Less: Interest on Drawings	(940)		*Less*: Depreciation	(16,538)	1,05,462
Less: Income Tax Paid	(3,000)	3,03,142	Trade Marks		72,000
Current Liabilities			Neon Board		4,500
Accounts Payable		80,200	**Current Assets**		
Accrued Commission		2,800	Cash at Bank		34,980
Advance from Customers		1,39,900	Short-term Investments		50,700
Loan from Father		60,000	Accounts Receivables		62,800
Outstanding Interest on Father's Loan		4,800	Debtors	51,000	
			Less: Bad Debts	(3,000)	
			Less: New Provision	(2,300)	45,700
			Closing Stock		59,700
		5,90,842			**5,90,842**

Note: *Provision for doubtful debts is to be reduced by Rs 500. Old provision is given as Rs 2,800. Therefore, the amount of new provision would be Rs 2,300 (i.e. 2,800 – 500).*

Working Notes:

WN1 Calculation of Depreciation on Motor Car

On 98,500 for full year $= 98{,}500 \times \frac{15}{100} = 14{,}775$

On 23,500 for 6 months (from Oct. 01 to Mar. 31) $= 23{,}500 \times \frac{15}{100} \times \frac{6}{12} = 1{,}763$ (Approx.)

$\therefore$ Total Depreciation (14,775 + 1,763) = 16,538

Example 5: Given below is the Trial Balance of Mr. Sachin Patil for the ending March 31, 2013. Prepare Trading Account, Profit and Loss Account and the Balance Sheet as on that date.

Trial Balance

Particulars	Debit Balance (₹)	Credit Balance (₹)
Cash	4,500	
Opening Stock	25,320	
Bad Debts	800	
Interest Received		2,600
Plant and Machinery	45,300	
Purchases	24,460	
Office Expenses	2,140	
Sales		56,670
Return Outward		1,230
Carriage Inward	890	
Sundry Creditors		9,100
Capital of Mr. Sachin Patil		83,600
Salaries and Wages	4,590	
Patents and Trademarks	7,800	
Carriage Outward	1,050	
Insurance	3,240	
Advertisement	1,570	
Sundry Debtors	12,660	
Bills Payable		2,520
Travelling Expenses	1,360	
General Expenses	950	
Rent	3,800	
Electricity Charges	2,790	
Furniture	12,500	
	1,55,720	**1,55,720**

Additional Information-

i. Stock as on March 31, 2013 valued at Rs 35,500.

ii. Depreciate plant and machinery by 10% p.a. and furniture by 8% p.a.

iii. Rent paid during the year is for 6 months only.

iv. Amount of Rs 2,500 received in respect of private loan advanced by Mr.Sachin Patil was wrongly credited to sundry debtors. This amount received is kept for the business use.

v. Salaries were outstanding to the extent of Rs 1,200

vi. Insurance was paid on October 01, 2012 for 12 months.

Solution

Books of Sachin Patil

Trading Account

for the year ending March 31, 2013

Dr. **Cr.**

Particulars		Amount (₹)	Particulars	Amount (₹)
Opening Stock		25,320	Sales	56,670
Purchases	24,460		Closing Stock	35,500
Less: Return Outwards	(1,230)	23,230		
Carriage Inward		890		
Gross Profit (*Balancing Figure*)		42,730		
		92,170		92,170

Profit and Loss Account

for the year ending March 31, 2013

Dr. **Cr.**

Particulars	Amount (₹)	Particulars	Amount (₹)

Bad Debts		800	Gross Profit	42,730
Depreciation on:			Interest received	2,600
Plant and Machinery	4,530			
Furniture	1,000	5,530		
Office Expenses		2,140		
Carriage Outwards		1,050		
Insurance	3,240			
Less: Prepaid Insurance	(1,620)	1,620		
Travelling Expenses		1,360		
General Expenses		950		
Rent	3,800			
Add: Rent Outstanding	3,800	7,600		
Electricity Charges		2,790		
Salaries and Wages	4,590			
Add: Salaries Outstanding	1,200	5,790		
Advertisement		1,570		
Net Profit (*Balancing Figure*)		14,130		
		45,330		45,330

Balance Sheet
as on March 31, 2013

Liabilities		Amount (₹)	Assets		Amount (₹)
Capital	83,600		**Fixed Assets**		
Add: Private loan realised	2,500		Plant and Machinery	45,300	
Add: Net Profit	14,130	1,00,230	*Less*: Depreciation	(4,530)	40,770
Current Liabilities			Furniture	12,500	
Sundry Creditors		9,100	*Less*: Depreciation	(1,000)	11,500
Bills Payable		2,520	Patents and Trademarks		7,800
Salaries Outstanding		1,200	**Current Assets**		
Rent Outstanding		3,800	Closing Stock		35,500
			Sundry Debtors	12,660	
			Add: Private Loan wrongly credited	2,500	15,160
			Prepaid Insurance		1,620
			Cash		4,500
		1,16,850			**1,16,850**

Note: Private loan realised Rs 2,500 was wrongly credited to sundry debtors. That means, we need to add back this to the amount of sundry debtors. Also, this amount is kept within the business. Therefore, it is treated as fresh capital and added to the amount of capital in the business.

Example 6: Prepare the financial statements of Mr. Satish from the given below Trial Balance for the year ending December 31, 2013.

Particulars	Debit Amount (₹)	Credit Amount (₹)
Bank	3,600	
Creditors		14,520
Rent	4,880	
Investments	8,640	
Wages	2,330	
Purchases	10,500	
Debtors	20,680	
Provision for Bad Debts		1,390
Freight	1,560	
Building	32,800	
Return Outward		3,650
Return Inward	2,580	
Printing and Stationery	1,750	
Sales		53,780
Opening Stock	24,120	

Dividend Received		2,360
Interest Received on Investments		1,570
Audit Fees	3,600	
Repairs	4,020	
Capital A/c		58,500
Accrued Interest on Investments	250	
Import Duty	2,810	
Bad Debts	400	
Salaries	8,450	
Cash	2,050	
Life Insurance Premium of Proprietor	750	
	1,35,770	**1,35,770**

Additional Information:
i. Closing stock valued at Rs 36,400.
ii. Bonus declared but not paid Rs 2,500.
iii. Bad debts of current year increased to Rs 900.
iv. Provision for doubtful debts to be created @ 12%.
v. Sales includes goods worth Rs 8,000 sent on approval basis that remain unsold till December 31, 2013. These goods are sold at a profit of 25% on sales.
vi. Uninsured goods worth Rs 1,200 were lost due to fire.
vii. Depreciate building by 10%.

Solution

Books of Satish

Trading Account
for the year ending December 31, 2013

Dr. Particulars		Amount (₹)	Cr. Particulars		Amount (₹)
Opening Stock		24,120	Sales	53,780	
Purchases	10,500		*Less*: Return Inwards	(2,580)	
Less: Return Outwards	(3,650)	6,850	*Less:* Goods on Approval Basis	(8,000)	43,200
Wages		2,330	Closing Stock	36,400	
Freight		1,560	*Add*: Goods sent on approval basis (Cost i.e. 8,000 – 2,000)	6,000	42,400
Import Duty		2,810	Goods lost by fire		1,200
Gross Profit (*Balancing Figure*)		49,130			
		86,800			86,800

Profit and Loss Account
for the year ending December 31, 2013

Dr. Particulars		Amount (₹)	Cr. Particulars	Amount (₹)
Depreciation on Building		3,280	Gross Profit	49,130
Goods lost by fire		1,200	Dividend Received	2,360
Bonus Payable		2,500	Interest Received	1,570
Printing and Stationery		1,750		
Audit Fees		3,600		
Bad Debts	400			
Add: Further Bad Debts	500			
Add: New Provision (***WN1***)	1,462			
Less: Old Provision	(1,390)	972		
Repairs		4,020		
Rent		4,880		
Salaries		8,450		

Net Profit (*Balancing Figure*)	22,408			
	53,060			53,060

Balance Sheet
as on December 31, 2013

Liabilities		Amount (₹)	Assets		Amount (₹)
Capital	58,500		**Fixed Assets**		
Less: Life Insurance Premium	(750)		Building	32,800	
Add: Net Profit	22,408	80,158	*Less*: Depreciation @ 10%	(3,280)	29,520
Current Liabilities			Investments		8,640
Sundry Creditors		14,520	**Current Assets**		
Bonus Payable		2,500	Closing Stock (36,400 + 6,000)		42,400
			Sundry Debtors	20,680	
			Less: Goods sent on Approval Basis	(8,000)	
			Less: Further Bad Debt	(500)	
				12,180	
			Less: Provision for Doubtful Debts	(1,462)	10,718
			Bank		3,600
			Cash		2,050
			Accrued Interest on Investment		250
		97,178			**97,178**

Note 1: When the goods are sent on approval basis and remained unsold till the end of the year, then the cost of such goods (that are sent on approval) is added to the closing stock. This is because such goods are still not sold and should be included in the stock of the business at the end of the year. On the other hand, the sale price of goods sent on approval basis is also deducted from the sales.
Note 2: During the current year bad debts increased to Rs 900. Old bad debts are Rs 400. That means, further bad debts during the year amounts to Rs 500 (i.e. 900 – 400).

Working Notes:
WN1: *Calculation of Cost of Goods Sent on Approval Basis*

Particulars	Amount (₹)
Sale Price of Goods Sent	8,000
Less: Profit @ 25% on Sale	(2,000)
Cost Price of Goods Sent	**6,000**

WN2: *Calculation of New Provision for Doubtful Debts*

Amount of Debtors = 20,680
Less: Further Bad debts = (500)
Less: Goods sent on Approval Basis* = (8,000)
12,180

$$\therefore \text{New Provision for Doubtful Debts} = 12{,}180 \times \frac{12}{100} = \text{Rs } 1{,}462$$

**The sale price of goods sent on approval basis isdeducted from the debtors because these goods are not yet sold till the end ofthe year.*

Example 7: Prepare the financial statements of Mr. Kishan Singh from the given below Trial Balance for the year ending March 31, 2013.

Particulars	Debit Amount (₹)	Credit Amount (₹)
Packing Charges	1,200	
Carriage Inward	600	
Rebate allowed	850	
Car Expenses	1,020	

Rent from Subletting		5,200
Purchases	14,800	
Opening Stock	8,460	
Sales		22,580
Capital Account		80,500
Loose Tools	3,500	
Bank Overdraft		4,890
Bills Receivables	2,450	
Salaries	4,960	
Petty Expenses	1,280	
Rent and rates	6,200	
Outstanding Salaries		1,800
Furniture	9,200	
Sundry Debtors	12,540	
Cash in hand	3,610	
General Expenses	2,420	
Car	42,000	
Sundry Creditors		5,320
Travelling Expenses	2,460	
Miscellaneous Receipts		800
Advertisement	2,150	
Repairs and Maintenance	1,390	
	1,21,090	**1,21,090**

Additional Information-

i. Closing Stock valued Rs 25,800 (Market Value Rs 28,000).
ii. Miscellaneous receipts represent proceed on sale of old furniture, written down value of which was Rs 1,200.
iii. Travelling expenses include proprietor personal travelling expense Rs 850.
iv. Car was used partly for office purpose and partly for private purpose.
v. Goods of Rs 500 was used for personal purpose and of Rs 300 was distributed as free sample.
vi. Depreciate car by 10% and furniture by 5%.

Solution

Books of Kishan Singh

Trading Account
for the year ending March 31, 2013

Dr. **Cr.**

Particulars		**Amount (₹)**	**Particulars**	**Amount (₹)**
Opening Stock		8,460	Sales	22,580
Purchases	14,800		Closing Stock	25,800
Less: Drawings of goods	(500)			
Less: Free Samples	(300)	14,000		
Carriage Inward		600		
Gross Profit (*Balancing Figure*)		25,320		
		48,380		48,380

Profit and Loss Account
for the year ending March 31, 2013

Dr. **Cr.**

Particulars		**Amount (₹)**	**Particulars**	**Amount (₹)**
Rebate Allowed		850	Gross Profit	25,320
Packing Charges		1,200	Rent from Subletting	5,200
Repair and Maintenance		1,390		
Advertisement	2,150			
Add: Distributed as Free Samples	300	2,450		

Car Expenses	1,020			
Less: Expenses for Private Use (50%)	(510)	510		
Petty Expense		1,280		
Travelling Expenses	2,460			
Less: Drawings (Personal Travelling)	(850)	1,610		
General Expenses		2,420		
Loss on Sale of Furniture (1,200 – 800)		400		
Rent and Rates		6,200		
Depreciation on:				
Car (50% of 4,200)	2,100			
Furniture	400	2,500		
Salaries		4,960		
Net Profit (*Balancing Figure*)		4,750		
		30,520		30,520

Balance Sheet
as on March 31, 2013

Liabilities		Amount (₹)	Assets		Amount (₹)
Capital	80,500		**Fixed Assets**		
Less: Drawings(***WN1***)	(3,960)		Car	42,000	
Add: Net Profit	4,750	81,290	*Less*: Depreciation @ 10%	(4,200)	37,800
Current Liabilities			Furniture	9,200	
Sundry Creditors		5,320	*Less*: Sold	(1,200)	
Bank Overdraft		4,890		8,000	
Outstanding Salaries		1,800	*Less*: Depreciation @ 5%	(400)	7,600
			Current Assets		
			Closing Stock		25,800
			Sundry Debtors		12,540
			Loose Tools		3,500
			Bills Receivable		2,450
			Cash		3,610
		93,300			**93,300**

Note 1: Closing Stock is valued at 'cost' or 'market price' whichever is less. Here, the cost (i.e. 25,800) is *less than* its market price (i.e Rs 28,000). Therefore, closing stock is shown at Rs 25,800.
Note 2: Car was used partly for office purpose and partly for private purpose. Therefore, half of the car expenses and depreciation on car should be charged from the personal account of Mr. Kishan Singh.

***Working Notes*:**
WN1: *Drawings made during the year*

Car Expenses (Half)	510
Personal Travelling Expenses	850
Depreciation on Car (Half)	2,100
Goods used for Personal Purpose	500
Total Drawings	**3,960**

Example 8: From the following Trial Balance extracted from the books of Mr. Pushpinder Singh, prepare Trading Account, Profit and Loss Account and the Balance Sheet for the year ending March 31, 2013.

Particulars	Debit Amount (₹)	Credit Amount (₹)
Audit Fees	1,900	
Custom Duty	2,650	
Purchases	24,200	
Freight	600	
Discount Received		470

Bills Receivables	5,250	
Interest received from Mr. Kapil Kaushik		800
Debtors	14,800	
Stock as on April 01, 2012	12,560	
Insurance	1,750	
Sales		28,600
Capital Account		1,17,500
Salaries	6,000	
Land	30,000	
Cash in hand	2,400	
Creditors		12,360
Plant and Machinery	25,000	
Advertisement	2,600	
Printing and Stationery	1,540	
Loan to Mr. Kapil Kaushik	10,000	
Bad Debts	600	
Bills Payable		5,100
Office Equipments	5,000	
Postage and Telegram	280	
Amit (Salary paid to temporary employee)	1,200	
Freehold Premises	16,500	
	1,64,830	**1,64,830**

Additional Information-

i. Closing Stock valued at Rs 18,500
ii. Salary for the month of March 2013 amounting Rs 1,500 paid in April 2013.
iii. Machinery of Rs 5,000 purchased in April 2012 wrongly included in the Purchases Account.
iv. Bills Receivable includes one dishonoured bill of Rs 2,500.
v. Debtors include:
  a. Rs 2,200 due from Vishal considered definitely good.
  b. Rs 1,000 due from Naveen considered definitely bad.
  c. Rs 500 due from Ankush considered very much doubtful.
vi. Create provision for doubtful debts @ 10% on debtors. Provision is to be made @ 100% on the very much doubtful debtors.
vii. Depreciate plant and machinery by 12% and office equipments by 5%.
viii. Salaries paid to a temporary employee, Amit Rs 1,200 stands debited to his personal account and it is to be corrected.

Solution

Books of Pushpinder Singh

Trading Account

for the year ending March 31, 2013

Dr. **Cr.**

Particulars		**Amount (₹)**	**Particulars**	**Amount (₹)**
Opening Stock		12,560	Sales	28,600
Purchases	24,200		Closing Stock	18,500
Less: Machinery purchased	(5,000)	19,200		
Custom Duty		2,650		
Freight		600		
Gross Profit (*Balancing Figure*)		12,090		
		47,100		47,100

Profit and Loss Account

for the year ending March 31, 2013

Dr. **Cr.**

Particulars	**Amount**	**Particulars**	**Amount**

		(₹)		(₹)
Audit Fees		1,900	Gross Profit	12,090
Insurance		1,750	Discount Received	470
Postage and Telegram		280	Interest received from Mr. Kapil Kaushik	800
Bad Debts	600		Net Loss (*Balancing Figure*)	10,720
Add: Further Bad Debts	1,000			
Add: Provision for Bad Debts (***WN1***)	1,860	3,460		
Advertisement		2,600		
Salaries	6,000			
Add: Salaries paid to Amit	1,200			
Add: Outstanding Salaries	1,500	8,700		
Printing and Stationery		1,540		
Depreciation on:				
Office Equipments	250			
Plant and Machinery	3,600	3,850		
		24,080		24,080

Balance Sheet
as on March 31, 2013

Liabilities		Amount (₹)	Assets		Amount (₹)
Capital	1,17,500		**Fixed Assets**		
Add: Net Profit	(10,720)	1,06,780	Office Equipments	5,000	
Current Liabilities			*Less*: Depreciation @ 5%	(250)	4,750
Sundry Creditors		12,360	Plant and Machinery	25,000	
Bills Payable		5,100	*Add*: Purchased	5,000	
Outstanding Salaries		1,500		30,000	
			Less: Depreciation @ 12%	(3,600)	26,400
			Land		30,000
			Freehold Premises		16,500
			Current Assets		
			Closing Stock		18,500
			Sundry Debtors	14,800	
			Add: Bill Dishonoured	2,500	
			Less: Further Bad Debts	(1,000)	
				16,300	
			Less: New Provision for Bad Debts	(1,860)	14,440
			Loan to Mr.Kapil Kaushik		10,000
			Amit	1,200	
			Less: Adjusted as Salaries	1,200	–
			Bills Receivable	5,250	
			Less: Bill Dishonoured	(2,500)	2,750
			Cash in hand		2,400
		1,25,740			**1,25,740**

***Working Note*:**

WN1: Calculation of Provision for Doubtful Debts

Debtors (Book Value)	14,800
Add: Bills Dishonoured	2,500
Less: Bad Debts (Naveen)	(1,000)
Less: Good Debts (Vishal)	(2,200)
Less: Very much doubtful (Ankush- 100% provision is required for them)	(500)
Remaining Debtors (Doubtful)	13,600
Provision for Doubtful Debts	
On Doubtful Debtors (13,600 × 10%)	1,360
On Very much doubtful debtors (Ankush- Full provision required)	500

Total New Provision required	1,860

Example 9: Prepare the financial statements of Ram Prasad Sharma with the help of the given below Trial Balance for the year ending December 31, 2013.

Particulars	Debit Amount (₹)	Credit Amount (₹)
Land and Building	25,000	
Accounts Receivable	8,200	
Cash at Bank	3,600	
Rent Paid	6,000	
Purchases	15,820	
10% Investment	26,000	
Opening Stock	10,840	
Advertisement	3,560	
Purchases Return		2,180
Sales Return	2,560	
Interest on Capital	4,050	
Trade Expenses	950	
Accounts Payable		10,540
Sales		36,780
Wages	2,080	
Capital Account		1,17,270
Carriage	1,470	
Motor Vehicles	22,450	
Insurance Prepaid	1,120	
Miscellaneous Expenses	260	
Repair and Maintenance	1,350	
Depreciation	5,060	
Patents	15,000	
Telephone and Internet Charges	6,540	
Salaries	4,860	
	1,66,770	1,66,770

Additional Information-

i. Closing stock valued Rs 32,400 (Market value Rs 27,800).
ii. Patents to be written-off within 5 years from now.
iii. Goods costing Rs 1,200 were destroyed by fire and insurance company admitted the claim of Rs 1,050.
iv. Advance of Rs 1,200 to an employee against his salary in January 2014 has been debited to his Salary Account.
v. Manager is given commission of 10% on net profit after charging his commission.
vi. Accounts payable include Rs 5,000 loan taken from Ajit on July 31, 2013 at an interest of 8%.

Solution

Books of Ram Prasad Sharma

Trading Account
for the year ending December 31, 2013

Dr. Particulars		Amount (₹)	Particulars		Cr. Amount (₹)
Opening Stock		10,840	Sales	36,780	
Purchases	15,820		*Less*: Sales Return	(2,560)	34,220
Less: Purchase Return	(2,180)	13,640	Closing Stock		27,800
Wages		2,080	Loss goods by fire		1,200
Carriage		1,470			
Gross Profit (*Balancing Figure*)		35,190			
		63,220			63,220

Profit and Loss Account
for the year ending December 31, 2013

Dr.				Cr.
Particulars		**Amount (₹)**	**Particulars**	**Amount (₹)**
Rent Paid		6,000	Gross Profit	35,190
Patents Written-off (***WN1***)		3,000	Interest on Investments	2,600
Loss of goods by Fire		150		
Salaries	4,860			
Less: Advance against Salary	(1,200)	3,660		
Telephone and Internet Charges		6,540		
Miscellaneous Expenses		260		
Advertisement		3,560		
Interest on Capital		4,050		
Interest on Loan outstanding		200		
Trade Expenses		950		
Repair and Maintenance		1,350		
Depreciation		5,060		
Manager Commission (***WN2***)		274		
Net Profit (*Balancing Figure*)		2,736		
		37,790		**37,790**

Balance Sheet
as on December 31, 2013

Liabilities		**Amount (₹)**	**Assets**	**Amount (₹)**
Capital	1,17,270		**Fixed Assets**	
Add: Net Profit	2,736	1,20,006	Land and Building	25,000
Current Liabilities			Motor Vehicles	22,450
Accounts Payable	10,540		Patents (15,000 – 3,000)	12,000
Less: Loan @ 8% from Ajit	(5,000)	5,540	10% Investments	26,000
Loan @ 8% from Ajit	5,000		**Current Assets**	
Add: Interest Outstanding	200	5,200	Closing Stock	27,800
Manager Commission Outstanding		274	Accounts Receivables	8,200
			Insurance Claim admitted	1,050
			Prepaid Insurance	1,120
			Advance against Salary	1,200
			Cash at Bank	3,600
			Accrued Interest on Investments	2,600
		1,31,020		**1,31,020**

Note 1: Closing Stock is valued at 'cost' or 'market price' whichever is less. Here, the market value (i.e. 27,800) is *less than* its cost (i.e Rs 32,400). Therefore, closing stock is shown at Rs 27,800.

Working Notes:

WN1: *Calculation of Amount of Patents to be Written-off*

Value of Patents = 15,000

Life of Patents = 5 years

$$\therefore \text{Patents to be written-off each year} = \frac{15,000}{5} = 3,000$$

WN2: *Calculation of Manager's Commission*

$$\text{Manager's Commission} = \text{Net Profit before charging the Commission} \times \frac{\text{Rate of Commission}}{100 + \text{Rate of Commission}}$$

$$= 3,010 \times \frac{10}{110} = 274 \text{ (Approx.)}$$

Example 10: The given below is the Trial Balance extracted from the books of Vinay Sehgal for the year ending March 31, 2013.

Particulars	Debit Amount (₹)	Credit Amount (₹)
Advertisement	6,000	
Fuel and Power	2,500	
Income Tax	800	
Accrued Commission	1,160	
Freehold Land	32,000	
Sales Tax paid	2,400	
Insurance	1,850	
Plant and Machinery	25,000	
Dividend Received		660
Sales Tax Collected		3,200
Postage	450	
Opening Stock	10,450	
Trading Commission		1,600
Capital Account		1,00,000
Purchases	22,860	
Printing and Stationery	1,450	
Sundry Debtors	18,540	
Delivery Van	17,500	
Delivery Van Expenses	1,760	
Sales		34,450
Goodwill	10,200	
Loan Creditors		14,500
Trade Creditors		8,800
Furniture and Fixtures	6,000	
Bad Debts	850	
Rent and Rates	1,440	
	1,63,210	**1,63,210**

Prepare the financial statements after considering the following-

i. Closing Stock valued Rs 24,450.

ii. Depreciate furniture by10%, plant and machinery by15% and delivery van by 8%.

iii. Unexpired Insurance Rs 800.

iv. Purchases of Rs 1,200 were omitted to be recorded in the Purchase Day Book.

v. Advertisement includes Rs 4,000 spent to run a campaign, whose benefit is expected to avail for at least next 4 years.

vi. Make provision for doubtful debts @ 10% and provision for discount on debtors @ 5%.

Solution

Books of Vinay Sehgal

Trading Account

for the year ending March 31, 2013

Dr. **Cr.**

Particulars		Amount (₹)	Particulars	Amount (₹)
Opening Stock		10,450	Sales	34,450
Purchases	22,860		Closing Stock	24,450
Add: Purchases omitted	1,200	24,060		
Fuel and Power		2,500		
Gross Profit (*Balancing Figure*)		21,890		
		58,900		58,900

Profit and Loss Account

for the year ending March 31, 2013

Dr. **Cr.**

Particulars	Amount (₹)	Particulars	Amount (₹)

Postage		450	Gross Profit	21,890
Advertisement	6,000		Dividend Received	660
Less: Deferred Revenue Expenditure	(3,000)	3,000	Trading Commission	1,600
Insurance	1,850			
Less: Unexpired Insurance	(800)	1,050		
Printing and Stationery		1,450		
Delivery Van Expenses		1,760		
Bad Debts	850			
Add: New Provision for Doubtful Debts	1,854	2,704		
Provision for Discount on Debtors		834		
Rent and Rates		1,440		
Depreciation on:				
Furniture	600			
Plant and Machinery	3,750			
Delivery Van	1,400	5,750		
Net Profit (*Balancing Figure*)		5,712		
		24,150		24,150

Balance Sheet

as on March 31, 2013

Liabilities		Amount (₹)	Assets		Amount (₹)
Capital	1,00,000		**Fixed Assets**		
Less: Income Tax	(800)		Freehold Land		32,000
Add: Net Profit	5,712	1,04,912	Plant and Machinery	25,000	
			Less: Depreciation	(3,750)	21,250
Current Liabilities			Delivery Van	17,500	
Loan Creditors		14,500	*Less*: Depreciation	(1,400)	16,100
Trade Creditors	8,800		Furniture and Fixtures	6,000	
Add: Purchases Omitted	1,200	10,000	*Less*: Depreciation	(600)	5,400
Sales Tax (3,200 – 2,400)		800	Goodwill		10,200
			Current Assets		
			Closing Stock		24,450
			Sundry Debtors	18,540	
			Less: New Provision for Doubtful Debts	(1,854)	
				16,686	
			Less: Provision for Discount on Debtors	(834)	15,852
			Deferred Revenue Expenditure		3,000
			Unexpired Insurance		800
			Accrued Commission		1,160
		1,30,212			**1,30,212**

Note 1: Advertisement expenditure of Rs 4,000 is likely to give its benefits for next 4 years. Therefore, this expenditure is recognised as deferred revenue expenditure and need to be written-off in 4 years. So, in the current year only Rs 1,000 (4,000/4) is to be charged from the Profit and Loss account and the remaining expenditure of Rs 3,000 (4,000 – 1,000) is shown on the Assets side of the Balance Sheet.

Note 2: A business is bound to pay the sales tax collected to the government. In the Trial Balance sales tax collected is Rs 3,200 and sales tax paid is Rs 2,400. This implies that, proprietor need to pay the difference of Rs 800 (3,200 – 2,400) to the government. It is shown as a liability on the Liabilities side of the Balance Sheet.

***Working Note*:**

Calculation of Provision for Doubtful Debts and Discount on Debtors

$$\text{Provision for Doubtful Debts} = 18{,}540 \times \frac{10}{100} = \text{Rs } 1{,}854$$

$$\text{Provision for Discount on Debtors} = (18{,}540 - 1{,}854) \times \frac{5}{100} = \text{Rs } 834 \text{ (Approx.)}$$

Example 11: (With GST) : Prepare a Trading Account, Profit and Loss Account and Balance Sheet from the given below Trial Balance as on 31st March, 2018.

Trial Balance as on 31st March' 2018

S. No.	Accounts	L.F.	Debit Amount (₹)	Credit Amount (₹)
1.	Cash A/c		7,040	
2.	Capital A/c			50,000
3.	Drawings A/c		1,120	
4.	Bank A/c		1,09,300	
5.	Bank Loan A/c			1,00,000
6.	Purchases A/c		9,000	
7.	Sales A/c			20,000
8.	Furniture A/c		5,000	
9.	Stationery A/c		500	
10.	Debtor's A/c		22,400	
11.	Discount Received A/c			500
12.	Rent A/c		5,000	
13.	Wages and Salaries A/c		10,000	
14.	Input IGST A/c		1,080	
15.	Output IGST A/c			2,400
16.	Input CGST A/c		1,230	
17.	Input SGST A/c		1,230	
	Total		**1,72,900**	**1,72,900**

Additional Information i. Stock at the end valued at Rs 800 (Market value Rs 700). ii. Goods costing Rs.200 were distributed among staff members at free of cost subject to CGST and SGST @6% each. iii. Interest on capital @ 10% p.a. and interest on drawings @ 5% p.a. iv. Salary to office staff is payable @ Rs 300 per month but nothing has been paid for the year. v. Depreciate furniture @ 10% p.a.

Solution

Trading Account
for the year ended March 31, 2018

Dr. Particulars		Amount (₹)	Particulars	Amount (₹) Cr.
Opening Stock		Nil	Sales	20,000
Purchases	9000		Closing Stock	700
Less: Free to Staff	200	8,800		
Wages and Salaries		10,000		
Gross Profit c/d		1,900		
		20,700		**20,700**

Profit and Loss Account
for the year ended March 31, 2018

Dr. Particulars	Amount (₹)	Particulars	Amount (₹) Cr.
Rent	5,000	Gross Profit b/d	1,900
Interest on capital	5,000	Discount Received	500
Staff welfare expense (Cost + CGST + SGST)	224	Interest on drawings	28
Salary (outstanding)	3,600	Net Loss t/d to Capital A/c	11,896
Depreciation on furniture	500		
	14,324		**14,324**

Balance Sheet
as on March 31, 2018

Liabilities	Amount	Assets	Amount

	(₹)		(₹)
Capital 50,000 *Less*: Net Loss 11,896 *Add*: Interest on Capital 5,000 *Less*: Drawings 1,120 *Less*: Interest on Drawings 28	41,956	**Fixed Assets** Furniture 5,000 *Less*: Depreciation 500	4,500
Bank Loan	1,00,000	**Current Assets**	
Current Liabilities		Cash	7,040
Outstanding Salary	3,600	Bank	1,09,300
		Stationery	500
		Debtors	22,400
		Stock	700
		Input CGST	558
		Input SGST	558
	1,45,556		**1,45,556**

Working Note 1

Particulars	IGST	CGST	SGST
Output	2,400	–	–
Input	1,080	1,230	1,230
Set off–Normal	–1320	–660	–660
Set off–Staff welfare	Nil	–12	–12
Receivable	Nil	558	558

Working Note 2

Journal Entry for goods distributed against staff welfare:

Date	Particulars		L.F.	Debit Amount (₹)	Credit Amount (₹)
	Staff Welfare Expense A/c	Dr.		224	
	To Purchases A/c				200
	To Input CGST A/c				12
	To Input SGST A/c				12
	(Being goods distributed free of cost)				

Topics

- Financial Statements with Adjustments- Requirement and their effects
- Closing Stock, Outstanding Expenses and Prepaid Expenses
- Accrued Income and Income Received in Advance
- Depreciation, Amortisation of Intangible Assets
- Interest on Capital, Interest on Drawings and Interest on Loan
- Bad-Debts and Related Adjustments
- Provision for Discount on Creditors and Mananger's Commission
- Goods- Abnomal Loss, Utilised for Personal Use and Donation / Charity
- Extraordinary Items- Rectification Entries
- Comprehensive Examples