Unit 13

FINAL ACCOUNTS OF SOLE PROPRIETORS-II

Contents

Points to recall

The following points are to be recalled before learning final accounts of sole proprietors-II

- Final accounts
- Revenue recognition principle
- Matching principle
- Accrual principle
- Periodicity principle

AKIXJG

Learning Objectives

To enable the students to

- Understand the accounting treatment for adjustments
- Pass adjusting entries
- Prepare final accounts when adjustments are given

Key terms to know

- Adjustment entries
- Outstanding expenses
- Prepaid expenses
- Accrued income
- Income received in advance
- Bad debts
- Provision for bad and doubtful debts
- Provision for discount on debtors

13.1 Introduction

Student activity

Think: A trader has to pay rent of ₹5,000 per month, for the building occupied for is business. His accounting period ends on 31st December, every year. He has paid totally ₹40,000 for the period from 1st January, 2017 to 31st December, 2017. How much do you think that he should show as his expense for rent in the income statement?

The principal function of final accounts is to exhibit a true and fair view of the profitability and the financial position of the business to which they relate. Final accounts are prepared based on the ledger account balances as shown by the trial balance for an accounting period as a whole. The expenses and incomes for the whole accounting period must be taken into account while preparing the final accounts.

Sometimes, it is possible that certain expenses have been incurred but not paid and certain incomes have been earned but not received during the accounting period. Similarly, there may be expense or income which have been paid or received in the accounting period but they may pertain to another accounting period. These items are to be adjusted to include correct amounts of them in the final accounts at the end of the accounting period. Certain items like value of stock at the end might have been ascertained after closing the ledger accounts for the accounting period. Such items might also be included in the financial statements so that they represent a true and fair view of profitability and financial status. It becomes necessary to make adjustments for such items after the preparation of trial balance by passing journal entries, called adjustment entries. Both debit as well as credit aspects of these adjustments are to be recorded at the time of preparation of final accounts.

13.1.1 Rationale of making adjustments at the time of preparing final accounts

The important consideration in the preparation of final accounts with adjustments are as under:

Matching principle

Revenues earned during the period must be compared with the expenses incurred during that period.

13.2 Adjustment entries and accounting treatment of adjustments

13.2.1 Meaning of adjustment entries

Adjustment entries are the journal entries made at the end of the accounting period to account for items which are omitted in trial balance and to make adjustments for outstanding and prepaid expenses and revenues accrued and received in advance.

13.2.2 Purpose of adjustment entries

The main purpose of adjustment entries are to match current year revenue with the expenses incurred to earn these revenues. Other purposes are:

(i) To exhibit true and fair view of profitability

(ii) To exhibit true and fair view of financial status.

13.2.3 Need for adjustment entries

The need arises to pass adjusting entries for the following reasons:

(i) To record omissions in trial balance such as closing stock, interest on capital, interest on drawings, etc.

(ii) To bring into account outstanding and prepaid expenses.

(iii) To bring into account income accrued and received in advance.

(iv) To create reserves and provisions.

13.2.4 Adjustments and adjustment entries

The following are the common adjustments and adjustment entries which are made while preparing the final accounts.

(i) Closing stock (ii) Outstanding expenses (iii) Prepaid expenses

(iv) Accrued income (v) Income received in advance (vi) Interest on capital

(vii) Interest on drawings (viii) Interest on loan (ix) Interest on investment

(x) Depreciation (xi) Bad debts (xii) Provision for bad and doubtful debts

(xiii) Provision for discount on debtors (xiv) Income tax paid

(xv) Manager's commission

(i) Closing stock

The unsold goods in the business at the end of the accounting period are termed as closing stock. As per AS-2 (Revised), the stock is valued at cost price or net realisable value, whichever is lower.

According to Indian Accounting Standards, AS-2 (Revised), "Net realisable value is the estimated selling price in the ordinary course of business less the estimated cost of completion and the estimated cost necessary to make the sale."

The principle of valuation of stock is based on the convention of conservatism.

Adjusting entry

Particulars	L.F.	Debit ₹	Credit ₹
Stock (closing) A/c Dr. To Trading A/c (Closing stock brought into account)		xxx	xxx

Presentation in final accounts

In the Trading Account	Shown on the credit side.
In the Balance Sheet	Shown on the assets side under current assets.

Tutorial note

Closing stock is the opening stock for the next accounting period. At the beginning of the next accounting period this entry is reversed to bring into account the opening stock.

Example

The value of closing stock shown as adjustment on 31st March, 2016 is ₹10,000. The adjusting entry is:

Adjusting entry

Date	Particulars		L.F.	Debit ₹	Credit ₹
2016 March 31	Stock - in trade (closing) A/c To Trading A/c (Closing stock brought into account)	Dr.		10,000	10,000

In final accounts, it is presented as follows:

Dr. **Trading Account for the year ended 31st March, 2016** **Cr.**

Particulars	₹	₹	Particulars	₹	₹
			By Closing stock		10,000

Balance Sheet as on 31st March, 2016

Liabilities	₹	₹	Assets	₹	₹
			Stock-in-trade		10,000

Tutorial note

If closing stock is already adjusted, adjusted purchases account and closing stock will appear in trial balance. Adjusted purchases account will be shown on the debit side of the trading account and closing stock will be shown on the assets side of the balance sheet.

(ii) Outstanding expenses

Expenses which have been incurred in the accounting period but not paid till the end of the accounting period are called outstanding expenses. In other words, if certain benefits or services are received during the year but payment is not made for the services received and utilised, these are termed as outstanding expenses. Outstanding expense account is a representative personal account and expense account is a nominal account.

Adjusting entry

Particulars		L.F.	Debit ₹	Credit ₹
Concerned expense A/c To Outstanding expense A/c (Expense outstanding adjusted)	Dr.		xxx	xxx

Presentation in final accounts

In the Trading A/c or Profit and loss A/c	Amount outstanding is added to particular expense account in the trading account if it is direct expense and in the profit and loss account if it is an indirect expense.
In the Balance Sheet	Amount of outstanding expense is a current liability and is shown on the liabilities side of the balance sheet.

Tutorial note

1. If outstanding expenses account appears in the trial balance with credit balance, it means that journal entry has been made already for outstanding expenses. Hence, the outstanding expenses account will be shown only in the liabilities side of balance sheet. No adjustment is therefore necessary in expenses account as already expenses would have been adjusted.

2. At the beginning of the next accounting period the above entry is reversed to bring into account outstanding expenses at the beginning so that it is reduced from amount of expense of next year.

Example

For the year 2017, rent is payable @ ₹2,000 p.m. and during the year ₹20,000 is paid on account of rent.

Total rent for the year 2017 is ₹24,000 i.e., 2,000 p.m. x 12 months. The difference between total rent payable and actual rent paid ₹4,000 (i.e. ₹24,000 - ₹20,000) is outstanding rent. The adjusting entry is:

Adjusting entry

Date	Particulars		L.F.	Debit ₹	Credit ₹
2017 Dec 31	Rent A/c To Outstanding rent A/c (Rent outstanding adjusted)	Dr.		4,000	 4,000

In final accounts, it is presented as follows:

Dr. Trading Account for the year ended 31st December, 2017 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Rent	20,000				
Add: Outstanding	4,000	24,000			

Balance Sheet as on 31st December, 2017

Liabilities	₹	₹	Assets	₹	₹
Rent outstanding		4,000			

(iii) Prepaid Expenses

Prepaid expenses refer to any expense or portion of expense paid in the current accounting year but the benefit or services of which will be received in the next accounting period. They are also called as unexpired expenses. Though these expenses are paid in the accounting period, they are not incurred during the accounting period. Prepaid expense account is a representative personal account. Expense account is a nominal account.

Adjusting entry

Particulars		L.F.	Debit ₹	Credit ₹
Prepaid expense A/c To Concerned expense A/c (Expense paid in advance adjusted)	Dr.		xxx	 xxx

Presentation in final accounts

In Trading A/c or Profit and loss A/c	Amount prepaid is deducted from particular expense in the trading account or profit and loss account depending upon whether it is direct or indirect respectively.
In Balance Sheet	Amount of prepaid expense is shown on the assets side under current assets.

Deferred revenue expenses Vs. Prepaid expenses

Deferred revenue expenditure is that expenditure which yields benefits which extend beyond the current accounting period, but relatively a short period as compared to a capital expenditure. Prepaid expenses refer to amount paid in the current accounting period benefit of which will be received in the next accounting period.

Tutorial note

1. If prepaid expense already appears in trial balance it means that it is already adjusted and journal entry has already been made. Hence, prepaid expense is shown only in balance sheet.
2. At the beginning of the next accounting period, the above entry is reversed to bring into account prepaid expenses at the beginning so that it is added to amount of expense of next year.

Example

Insurance premium of ₹6,000 for one year is paid on 1st January, 2016 and the accounting year closes on 31st March, 2016.

In this example, insurance premium has been paid in advance or prepaid for nine months, i.e. from 1st April to 31st December amounting to ₹4,500 (i.e., ₹ 6000 × 9/12). The adjusting entry is:

Adjusting entry

Date	Particulars		L.F.	Debit ₹	Credit ₹
2016	Prepaid insurance premium A/c	Dr.		4,500	
March 31	To Insurance premium A/c				4,500
	(Insurance premium paid in advance adjusted)				

In final accounts, it is presented as follows:

Dr. Profit and loss account for the year ended 31st March, 2016 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Insurance premium	6,000				
Less: Prepaid insurance	4,500	1,500			

Balance Sheet as on 31st March, 2016

Liabilities	₹	Assets	₹
		Insurance premium prepaid	4,500

(iv) Accrued income

Accrued income is income or portion of income which has been earned during the current accounting year but not received till the end of that accounting year. It generally happens in case of amount to be received on account of commission, interest, dividend, etc.

Adjusting entry

Particulars	L.F.	Debit ₹	Credit ₹
Accrued income A/c Dr. To Concerned income A/c (Income accrued adjusted)		xxx	xxx

Presentation in final accounts

In Profit and loss A/c	Amount accrued is added to particular income.
In Balance Sheet	Amount of accrued income is shown on the assets side under current assets.

Tutorial note

1. If accrued income account appears in the trial balance with debit balance, it means that journal entry has been made already for accrued income. Hence, the accrued income account will be shown only in the assets side of balance sheet. No adjustment is necessary in income account as already it would have been adjusted.
2. At the beginning of the next accounting period, the above entry is reversed to bring into account accrued income at the beginning, so that it is reduced from amount of income in the next year.

Example

A business has a fixed deposit of ₹1,00,000 with a bank for 12 months in the accounting period ending 31st March, 2018 @ 9% interest p.a. Interest received during the year was ₹6,750.

In this example, income earned is ₹9,000 (i.e., 1,00,000 × 9%). Income received is ₹6,750. Hence, the income earned but not received, is the accrued interest ie., ₹2,250 (9,000 - 6,750). The adjusting entry is:

Adjusting entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2018 March 31	Accrued interest on fixed deposit A/c Dr. To Interest on fixed deposit A/c (Interest accrued but not received adjusted)		2,250	2,250

In final accounts, it is presented as follows:

Dr. Profit and loss account for the year ended 31st March, 2018 Cr.

Particulars	₹	₹	Particulars	₹	₹
			By Interest on fixed deposit	6,750	
			Add: Accrued interest	2,250	9,000

Balance Sheet as on 31st March, 2018

Liabilities	₹	Assets	₹
		Accrued interest on fixed deposit	2,250

(v) Income received in advance

Income received in advance refers to income or portion of income received in an accounting year which is not earned in the accounting period. It is also known as unearned income or unexpired income. Though the amount is received in the current accounting year, the benefit is yet to be offered to the concerned person in the next accounting year.

Adjusting entry

Particulars		L.F.	Debit ₹	Credit ₹
Concerned income A/c	Dr.		xxx	
To Income received in advance A/c				xxx
(Income received in advance adjusted)				

Presentation in final accounts

In Profit and loss A/c	Amount received in advance is deducted from particular income.
In Balance Sheet	Amount of income received in advance being current liability is shown on the liabilities side of the balance sheet.

Tutorial note

1. If income received in advance account appears in the trial balance with credit balance, it means that journal entry has been made already for income received in advance. Hence, the income received in advance account will be shown only in the liabilities side of balance sheet. No adjustment is necessary in income account as already it would have been adjusted.
2. At the beginning of the next accounting period, the above entry is reversed to bring into account income received in advance at the beginning, so that it is added to the amount of income in the next year.

Example

The trial balance as on 31st March, 2017 shows commission received as ₹7,500.

Adjustment: One-third of the commission received is in respect of work to be done in the next accounting year.

Commission received includes one-third of the commission for the next accounting period. ₹7,500 × 1/3, that is ₹2,500 is received in advance. The adjusting entry is:

Adjusting entry

Date	Particulars		L.F.	Debit ₹	Credit ₹
2017	Commission received A/c	Dr.		2,500	
March 31	To Commission received in advance A/c				2,500
	(Commission received in advance adjusted)				

In final accounts, it is presented as follows:

Dr. Profit and loss account for the year ended 31st March, 2017 Cr.

Particulars	₹	₹	Particulars	₹	₹
			By Commission received	7,500	
			Less: Received in advance	2,500	5,000

Balance Sheet as on 31st March, 2017

Liabilities	₹	Assets	₹
Commission received in advance	2,500		

(vi) Interest on capital

According to separate entity concept business and proprietor are two separate entities. Capital contributed by proprietor is a liability to the business. Hence, interest may be provided on capital contributed by proprietor. It is treated as a business expense. The purpose is to know the true profit of the business.

Adjusting entry

Particulars		L.F.	Debit ₹	Credit ₹
Interest on capital A/c	Dr.		xxx	
To Capital A/c				xxx
(Interest on capital provided)				

Transfer entry

Particulars		L.F.	Debit ₹	Credit ₹
Profit and Loss A/c	Dr.		xxx	
To Interest on capital A/c				xxx
(Interest on capital transferred)				

Presentation in final accounts

In Profit and loss A/c	Amount of interest on capital is shown on the debit side.
In Balance Sheet	Amount of interest on capital is added to capital on the liabilities side of the balance sheet.

Tutorial note

Interest on capital is calculated on the opening balance of capital if there is no change in the capital account during the accounting year. If there is any additional capital introduced or capital withdrawn, then interest on capital is to be calculated proportionately on the balance outstanding.

Example

The trial balance prepared on 31st December, 2016 shows Capital of ₹5,00,000.
Adjustment: Provide interest on capital @ 4% p.a.

Interest on capital = ₹5,00,000 × 4/100 = ₹20,000. The adjusting entry is:

Adjusting entry

Date	Particulars		L.F.	Debit ₹	Credit ₹
2016	Interest on capital A/c	Dr.		20,000	
Dec. 31	To Capital A/c				20,000
	(Interest on capital provided)				

Transfer entry

Date	Particulars		L.F.	Debit ₹	Credit ₹
2016	Profit and Loss A/c	Dr.		20,000	
Dec. 31	To Interest on capital A/c				20,000
	(Interest on capital transferred)				

In final accounts, it is presented as follows:

Dr. Profit and loss account for the year ended 31st December, 2016 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Interest on capital		20,000			

Balance Sheet as on 31st December, 2016

Liabilities	₹	₹	Assets	Debit ₹	Credit ₹
Capital	5,00,000				
Add: Interest on Capital	20,000	5,20,000			

(vii) Interest on drawings

Drawings represent the amount or goods withdrawn by the proprietor from the business for his personal use. As business is separate from owner, interest charged on drawings, if any, is to be treated as business income.

Adjusting entry

Particulars	L.F.	Debit ₹	Credit ₹
Capital A/c Dr.		xxx	
To Interest on drawings A/c			xxx
(Interest on drawings provided)			

Transfer entry

Particulars	L.F.	Debit ₹	Credit ₹
Interest on drawings A/c Dr.		xxx	
To Profit and loss A/c			xxx
(Interest on drawings transferred)			

Presentation in final accounts

In Profit and loss A/c	Amount of interest on drawings is shown on the credit side as it is an income / gain.
In Balance Sheet	Amount of interest on drawings is deducted from the capital on the liabilities side of the balance sheet.

Example

The trial balance on 31st March, 2016 shows capital as ₹1,50,000 and drawings as ₹10,000. Adjustment: Charge interest on drawings at 4%.

Interest on drawings = ₹10,000 × 4/100 = ₹400. The adjusting entry is:

Adjusting entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2016	Capital A/c Dr.		400	
March 31	To Interest on drawings A/c			400
	(Interest on drawings provided)			

Transfer entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2016	Interest on drawings A/c Dr.		400	
Marh 31	To Profit and loss A/c			400
	(Interest on drawings transferred)			

In final accounts, it is presented as follows:

Dr. **Profit and loss account for the year ended 31st March, 2016** **Cr.**

Particulars	₹	₹	Particulars	₹	₹
			By Interest on drawings		400

Balance Sheet as on 31st March, 2016

Liabilities	₹	₹	Assets	₹	₹
Capital	1,50,000				
Less: Drawings	10,000				
	1,40,000				
Less: Interest on drawings	400	1,39,600			

(viii) Interest on loan

Business entities may have loans borrowed from banks and other financial institutions, private money lenders, etc. If any interest is payable on loan and not yet provided at the time of preparation of trial balance, it is necessary to provide for outstanding interest on loan. It is an outstanding expense.

Adjusting entry

Particulars	L.F.	Debit ₹	Credit ₹
Interest on loan A/c Dr.		xxx	
To Outstanding interest on loan A/c			xxx
(Interest on loan outstanding)			

Presentation in final accounts

In Profit and loss A/c	Amount outstanding is added to interest on loan on the debit side.
In Balance Sheet	Amount of interest outstanding is added to loan on the liabilities side as it is payable along with the loan.

Tutorial note

1. If the trial balance contains loan account specifying the percentage of interest and date of borrowing and interest paid appears in the trial balance, it is to be checked whether interest for the whole year is paid. If it is not paid, outstanding interest must be adjusted.
2. Similar to any other expenses outstanding, this entry also will be reversed at the beginning of the next accounting period.

Example

Extracts from the trial balance as on 31st December, 2017 is given below:

Particulars	Debit ₹	Credit ₹
Loan @ 12% p.a.		5,00,000
Interest paid on loan	45,000	

Adjustment: Interest on loan is unpaid for three months.

Interest unpaid = ₹5,00,000 × 12/100 × 3/12 = ₹15,000. The adjusting entry is:

Adjusting entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2017	Interest on loan A/c Dr.		15,000	
Dec. 31	To Outstanding interest on loan A/c			15,000
	(Interest on loan outstanding provided)			

In final accounts, it is presented as follows:

Dr. Profit and loss account for the year ended 31st December, 2017 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Interest on loan	45,000				
Add: Outstanding	15,000	60,000			

Balance Sheet as on 31st December, 2017

Liabilities	₹	₹	Assets	₹	₹
Loan @12%	5,00,000				
Add: Interest outstanding	15,000	5,15,000			

(ix) Interest on investment

Business entities may have investments in outside securities carrying specified rate of interest. If interest is due but not yet received, adjustment is to be made for the same in the accounting records before preparation of final accounts. Interest receivable on any investments in the form of shares, deposits, etc. made outside the business is called accrued interest. It is an accrued income.

Adjusting entry

Particulars		L.F.	Debit ₹	Credit ₹
Accrued interest on investment A/c	Dr.		xxx	
To Interest on investment A/c				xxx
(Interest on investment due adjusted)				

Presentation in final accounts

In Profit and loss A/c	Amount accrued is added to interest on investment on the credit side.
In Balance Sheet	Amount of accrued interest being current asset is shown on the assets side of the balance sheet.

Example

Extracts from the trial balance as on 31st December, 2017 is given below:

Particulars	Debit ₹	Credit ₹
Investment @ 12%	1,00,000	
Interest received on investment		9,000

Adjustment: Provide for accrued interest on investment ₹3,000. The adjusting entry is:

Adjusting entry

Date	Particulars		L.F.	Debit ₹	Credit ₹
2017	Accrued Interest on investment A/c	Dr.		3,000	
Dec. 31	To Interest on investment A/c				3,000
	(Interest on investments accrued)				

In final accounts, it is presented as follows:

Dr. Profit and loss account for the year ended 31st December, 2017 Cr.

Particulars	₹	₹	Particulars	₹	₹
			By Interest on investment	9,000	
			Add: Accrued interest	3,000	12,000

Balance Sheet as on 31st December, 2017

Liabilities	₹	₹	Assets	₹	₹
			Investment @ 12%		1,00,000
			Accrued interest		3,000

(x) Depreciation

The decrease in book value of fixed assets due to usage or passage of time is called depreciation. It is a loss to the business. Therefore, it must be written off from the value of asset. Generally, a certain percentage on the value of the asset is calculated as the amount of depreciation.

Adjusting entry

Particulars		L.F.	Debit ₹	Credit ₹
Depreciation A/c	Dr.		xxx	
To Concerned fixed asset A/c				xxx
(Depreciation provided)				

Transfer entry

Particulars		L.F.	Debit ₹	Credit ₹
Profit and loss A/c	Dr.		xxx	
To Depreciation A/c				xxx
(Depreciation transferred)				

Presentation in final accounts

In Profit and loss A/c	Depreciation is shown on the debit side.
In Balance Sheet	Amount of depreciation is deducted from concerned fixed asset on the assets side.

Tutorial note

When depreciation already appears in trial balance, it means journal entry is already made and asset account has been already reduced to the extent of depreciation. Hence, depreciation will be shown only in profit and loss account.

Example

The trial balance prepared on 31st March, 2016 shows the value of buildings as ₹50,000. Adjustment: Depreciate buildings @ 10% p.a.

Amount of depreciation = ₹50,000 x 10/100 = ₹5,000. The adjusting entry is:

Adjusting entry

Date	Particulars		L.F.	Debit ₹	Credit ₹
2016	Depreciation A/c	Dr.		5,000	
Mar. 31	To Buildings A/c				5,000
	(Depreciation on buildings provided)				

Transfer entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2016 Mar. 31	Profit and Loss A/c Dr. To Depreciation A/c (Depreciation transferred)		5,000	5,000

In final accounts, it is presented as follows:

Dr. Profit and loss account for the year ended 31st March, 2016 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Depreciation on buildings	5,000				

Balance Sheet as on 31st March, 2016

Liabilities	₹	₹	Assets	₹	₹
			Buildings Less: Depreciation	50,000 5,000	45,000

DO YOU KNOW?

When a provision for depreciation account is created, the entry is

Profit and Loss A/c Dr. xxx

To Provision for depreciation A/c xxx

Here the asset account is not reduced with depreciation. It will appear in the balance sheet at its original cost. Provision for depreciation accumulated up to date will appear on the liabilities side of balance sheet.

(xi) Bad debts

When it is definitely known that amount due from a customer (debtor) to whom goods were sold on credit, cannot be realised at all, it is treated as bad debts. In other words, debts which cannot be recovered or irrecoverable debts are called bad debts. It is a loss for the business and should be charged against profit.

Student activity **Think:** Why do business entities sell goods on credit?

Adjusting entry

Particulars	L.F.	Debit ₹	Credit ₹
Bad debts A/c Dr. To Sundry debtors A/c (Bad debts written off)		xxx	xxx

Transfer entry

(if provision for bad and doubtful debts account is not maintained)

Particulars	L.F.	Debit ₹	Credit ₹
Profit and Loss A/c Dr. To Bad debts A/c (For transfer of bad debts)		xxx	xxx

Transfer entry

(if provision for bad and doubtful debts account is maintained)

Particulars	L.F.	Debit ₹	Credit ₹
Provision for bad and doubtful debts A/c Dr.		xxx	
To Bad debts A/c			xxx
(Bad debts transferred)			

Presentation in final accounts

In Profit and loss A/c	Amount of bad debt is shown on the debit side.
In Balance Sheet	Amount of bad debts is deducted from sundry debtors on the assets side.

Tutorial note

1. When bad debts already appears in the trial balance it means journal entry is already made, i.e., debtors is already reduced. Hence, bad debt is taken only to debit side of profit and loss account.
2. If there is bad debt in trial balance as well as in adjustments, total bad debt is debited in profit and loss account. Additional bad debt only is deducted from debtors in the balance sheet.

Example

The trial balance as on 31st December, 2016 shows sundry debtors as ₹1,02,000.

Adjustment: Write off ₹2,000 as bad debts. The adjusting entry is:

Adjusting entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2016	Bad debts A/c Dr.		2,000	
Dec. 31	To Sundry debtors A/c			2,000
	(Bad debts written off)			

Transfer entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2016	Profit and Loss A/c Dr.		2,000	
Mar. 31	To bad debts A/c			2,000
	(Bad debts transferred to profit and loss A/c)			

In final accounts, it is presented as follows:

Dr. Profit and loss account for the year ended 31st December, 2016 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Bad debts	2,000				

Balance Sheet as on 31st December, 2016

Liabilities	₹	₹	Assets	₹	₹
			Sundry debtors	1,02,000	
			Less: Bad debts	2,000	1,00,000

(xii) Provision for bad and doubtful debts

Provision for bad and doubtful debts refers to amount set aside as a charge against profit to meet any loss arising due to bad debt in future. At the end of the accounting period, there may be certain debts which are doubtful, i.e., the amount to be received from debtors may or may not be received. The reason may be incapacity to pay the amount or deceit.

In general, based on past experience, the amount of doubtful debts is calculated on the basis of some percentage on debtors at the end of the accounting period after deducting further bad debts (if any). Since the amount of loss is impossible to ascertain until it is proved bad, doubtful debts are charged against profit and loss account in the form of provision. A provision for doubtful debts is created and is charged to profit and loss account. When bad debts occur, it is transferred to provision for doubtful debts account and not to profit and loss account.

This is according to the convention of conservatism. Moreover, according to matching principle, all costs related to earning revenue in a period must be charged in the relevant period itself. Hence, it is appropriate that provision is created in the current year against debtors of current year.

Adjusting entry

Particulars		L.F.	Debit ₹	Credit ₹
Profit and loss A/c	Dr.		xxx	
To Provision for bad and doubtful debts A/c				xxx
(Provision for bad and doubtful debts created)				

Presentation in final accounts

In Profit and loss A/c	Amount of provision for bad and doubtful debts is shown on the debit side.
In Balance Sheet	Amount of provision for bad and doubtful debts is deducted from sundry debtors on the assets side.

Example

The trial balance prepared on 31st December, 2016 shows sundry debtors as ₹ 1,50,000.

Adjustment: Provide 5% for bad and doubtful debts on sundry debtors.

Provision for bad and doubtful debts = ₹ 1,50,000 x 5/100 = ₹ 7,500. The adjusting entry is:

Adjusting entry

Date	Particulars		L.F.	Debit ₹	Credit ₹
2016	Profit and loss A/c	Dr.		7,500	
Dec. 31	To Provision for bad and doubtful debts A/c				7,500
	(Provision for bad and doubtful debts made)				

In final accounts, it is presented as follows:

Dr. Profit and loss account for the year ended 31st December, 2016 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Provision for bad and doubtful debts	7,500				

Balance Sheet as on 31st December, 2016

Liabilities	₹	₹	Assets	₹	₹
			Sundry debtors Less: Provision for bad and doubtful debts	1,50,000 7,500	1,42,500

Tutorial note

When provision already exists and appears in trial balance, the accounting treatment is as below:

1. If the provision required at the end plus the bad debts written off, is higher than the existing provision, the difference amount will be created as provision in the current year and will appear on the debit side of profit and loss account.
2. If the provision required at the end plus bad debts written off, is lesser than the existing provision, the excess is written back and will appear on the credit side of profit and loss account.

The journal entries are:

(a) For bad debts written off Bad debts A/c To Debtors A/c	Dr.	xxx	xxx
(b) For transferring bad debts Provision for doubtful debts A/c To Bad debts A/c	Dr.	xxx	xxx
(c) For creating provision to the extent of difference Profit and Loss A/c To Provision for doubtful debts A/c	Dr.	xxx	xxx
(d) For writing back provision to the extent of difference Provision for doubtful debts A/c To Profit and Loss A/c	Dr.	xxx	xxx

(xiii) Provision for discount on debtors

Cash discount is allowed by the suppliers to customers for prompt payment of amount due either on or before the due date. A provision created on sundry debtors for allowing such discount is called provision for discount on debtors. This provision is a charge against profit and hence profit and loss account is debited.

Provision for discount on debtors is made on the basis of past experience at an estimated rate on sundry debtors. Discount should be calculated on sundry debtors after deducting bad debts and provision for bad debts.

Adjusting entry

Particulars		L.F.	Debit ₹	Credit ₹
Profit and loss A/c	Dr.		xxx	
To Provision for discount on debtors A/c				xxx
(Provision for discount on debtors created)				

Presentation in final accounts

In Profit and loss A/c	Amount of provision for discount on debtors is shown on the debit side.
In Balance Sheet	Amount of provision for discount on debtors is deducted from sundry debtors on the assets side.

Tutorial note

1 Provision for discount on debtors is calculated on the balance of debtors after deducting bad debts and provision for doubtful debts. This is because provision for discount is to be expected only on good book debts. When the amount realisable itself is doubtful, provision for discount is not to be made. Similar to bad debts and provision for doubtful debts, here also discount allowed to debtors must be transferred to provision for discount on debtors account if a provision exists.

2. When provision already exists and appears in trial balance, the accounting treatment is as below:

a. If the provision required at the end plus the discount allowed, is higher than the existing provision, the difference amount will be created as provision in the current year and will appear on the debit side of profit and loss account.

b. If the provision required at the end plus discount allowed, is lesser than the existing provision, the excess is written back and will appear on the credit side of profit and loss account.

The presentation in the balance sheet is as below:

Debtors	xxx
Less Bad debts (in adjustments)	xxx
	xxx
Less Provision for doubtful debts (end) (adjustment)	xxx
	xxx
Less Provision for discount on debtors (end) (adjustment)	xxx
Balance to be shown in balance sheet	xxx

Example

The trial balance for the year ended 31st March, 2016 shows sundry debtors as ₹50,000.
Adjustment: Create a provision for discount on debtors @ 1%.

Provision for discount on debtors = ₹50,000 x 1/100 = ₹500. The adjusting entry is:

Adjusting entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2016 March 31	Profit and loss A/c Dr. To Provision for discount on debtors A/c (Provision for discount on debtors made)		500	500

In final accounts, it is presented as follows:

Dr. **Profit and loss account for the year ended 31st March, 2016** **Cr.**

Particulars	₹	₹	Particulars	₹	₹
To Provision for discount on debtors		500			

Balance Sheet as on 31st March, 2016

Liabilities	₹	₹	Assets	₹	₹
			Sundry debtors	50,000	
			Less: Provision for discount on debtors	500	49,500

Student activity

Think: Is it possible to change the rate of provision for bad and doubtful debts? Under what circumstances will the trader decide this?

(xiv) Income tax paid

As per the Indian Income Tax Act, 1961, business income of the sole proprietor is not assessed and taxed separately. It is the sole proprietor who is assessed to tax for his total income including the business income. Hence, income tax paid by the business is not a business expenditure and is treated as drawings.

Adjusting entry

Particulars		L.F.	Debit ₹	Credit ₹
Drawings A/c	Dr.		xxx	
To Bank A/c				xxx
(Income tax of the proprietor paid)				

Presentation in final accounts

Trading / Profit and loss account	Not shown.
In Balance Sheet	Shown as deduction from capital on the liabilities side. Shown as a deduction from bank balance on the assets side.

Example

Trial balance of Sibi as on 31st December, 2017 shows the capital as ₹ 1,05,000 and cash at bank as ₹ 80,000.

Adjustment: Income tax paid ₹ 15,000. The adjusting entry is:

Adjusting entry

Date	Particulars		L.F.	Debit ₹	Credit ₹
2017 Dec. 31	Drawings A/c	Dr.		15,000	
	To Bank A/c				15,000
	(Income tax paid)				

In final accounts, it is presented as follows:

Balance Sheet as on 31st December, 2017

Liabilities	₹	₹	Assets	₹	₹
Capital	1,05,000		Cash at bank	80,000	
Less: Drawings (income tax)	15,000	90,000	Less: Income tax	15,000	65,000

(xv) Manager's commission

Sometimes the manager is given commission as a percentage on profit of the business. It may be given at a certain percentage on the net profit before charging such commission or after charging such commission. Calculation procedure is explained below:x

a) Commission on net profit before charging such commission:

$$\text{Commission} = \text{Net profit before charging commission} \times \frac{\text{Rate of commission}}{100}$$

b) Commission on net profit after charging such commission:

$$\text{Commission} = \text{Net profit before charging commission} \times \frac{\text{Rate of commission}}{(100+ \text{Rate of commission})}$$

The purpose of giving such commission may be to motivate the managers to work with their full potential, to reward the managers for their efficiency and to retain the efficient managers by rewarding them sufficiently. Such commission can be calculated only at the end of the accounting period after calculating net profit. Hence, it remains outstanding at the end of the accounting period.

Student activity

Think: Do you think only money can motivate managers? What other factors can effect motivation?

Adjusting entry

Particulars	L.F.	Debit ₹	Credit ₹
Manager's Commission A/c Dr.		xxx	
To Outstanding Manager's commission A/c			xxx
(Manager's commission on profit provided)			

Transfer entry

Particulars	L.F.	Debit ₹	Credit ₹
Profit and loss A/c Dr.		xxx	
To Manager's commission A/c			xxx
(Commission on profit transferred)			

Presentation in final accounts

In Profit and loss account	Commission being an indirect expense is shown on the debit side of profit and loss account.

In Balance Sheet	Commission outstanding being a current liability is shown on the liabilities side of the balance sheet.

Example

On 31st March, 2017, Net profit before charging commission is ₹11,000.
The manager is entitled to receive 10% as commission on the profit before charging such a commission.
Commission = 11,000 x 10/100 = ₹1,100. The adjusting entry is:

Adjusting entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2017 March 31	Manager's Commission A/c Dr. To Outstanding Manager's commission A/c (Manager's commission on profit provided)		1,100	1,100

Transfer entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2016 Mar. 31	Profit and Loss A/c Dr. To Manager's commission A/c (Manager's commission transferred to profit and loss A/c)		1,100	1,100

In final accounts, it is presented as follows:

Dr. Profit and loss account for the year ended 31st March, 2017 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Manager's commission		1,100			
To Net profit (transferred to capital a/c)		9,900			

Balance Sheet as on 31st March, 2017

Liabilities	₹	₹	Assets	₹	₹
Manager's commission outstanding		1,100			

Example

On 31st March, 2017, Net profit before charging commission is ₹11,000.
Adjustment: Provide Manager's commission at 10% on the profit after charging such Manager's commission.

Manager's commission = $11{,}000 \times \dfrac{10}{(100+10)}$ = ₹ 1,000. The adjusting entry is.

Adjusting entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2017 March 31	Manager's commission A/c Dr. To Outstanding Manager's commission A/c (Commission on profit provided)		1,000	1,000

Transfer entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2016 Mar. 31	Profit and Loss A/c Dr. To Manager's commission A/c (Manager's commission A/c transferred to profit and loss A/c)		1,000	1,000

In final accounts, it is presented as follows:

Dr. Profit and loss account for the year ended 31st March, 2017 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Manager's commission		1,000			
To Net profit (transferred to capital a/c)		10,000			

Balance Sheet as on 31st March, 2017

Liabilities	₹	₹	Assets	₹	₹
Manager's commission outstanding		1,000			

Illustration 1

Show necessary entries to adjust the following on 31st December, 2017.

(i) Outstanding salaries ₹ 1,200 (ii) Outstanding rent ₹ 300

(iii) Prepaid insurance premium ₹ 450 (iv) Interest on investments accrued ₹ 400

(v) Bad debts written off ₹ 200

Solution

Adjusting entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2017 Dec. 31	Salaries A/c Dr. To Outstanding salaries A/c (Salaries outstanding provided)		1,200	1,200
Dec. 31	Rent A/c Dr. To Outstanding rent A/c (Provided for rent outstanding)		300	300
Dec. 31	Prepaid insurance premium A/c Dr. To Insurance premium A/c (Insurance prepaid)		450	450
Dec. 31	Accrued Interest on investment A/c Dr. To Interest on investment A/c (Provided for interest accrued)		400	400
Dec. 31	Bad debts A/c Dr. To Sundry debtors A/c (Bad debts written off)		200	200

Illustration 2

Pass adjusting entries for the following on 31st March, 2018.

(i) Charge interest on drawings at ₹ 50

(ii) Write off bad debts by ₹ 500

(iii) Depreciate furniture by ₹ 1,000

Solution

Adjusting entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2018 March 31	Capital A/c Dr. To Interest on drawings A/c (Interest on drawings provided)		50	50
March 31	Bad debts A/c Dr. To Sundry debtors A/c (Bad debts written off)		500	500
March 31	Depreciation A/c Dr. To Furniture A/c (Depreciation provided on furniture)		1,000	1,000

Illustration 3

Sundry debtors as per trial balance as on 31st March, 2016 is ₹ 10,000.

Adjustment: Write off bad debts amounting to ₹ 300.

Give adjusting entry and show how these appear in the final accounts as on 31st March, 2016.

Solution

Adjusting entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2016 March 31	Bad debts A/c Dr. To Sundry debtors A/c (Bad debts written off)		300	300

Dr. Profit and loss account for the year ended 31st March, 2016 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Bad debts		300			

Balance Sheet as on 31st March, 2016

Liabilities	₹	₹	Assets	₹	₹
			Sundry debtors Less: Bad debts	10,000 300	9,700

Illustration 4

Sundry debtors as per trial balance ₹ 26,000

Bad debts as per trial balance ₹ 1,000

Adjustment: Additional bad debts amounted to ₹ 2,500

Give adjusting entry and show how these appear in the final accounts on 31st March, 2016.

Solution

Adjusting entry

Date	Particulars		L.F.	Debit ₹	Credit ₹
2016 March 31	Bad debts A/c To Sundry debtors A/c (Bad debts written off)	Dr.		2,500	2,500

Dr. Profit and loss account for the year ended 31st March, 2016 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Bad debts	1,000				
Add: Additional bad debts	2,500	3,500			

Balance Sheet as on 31st March, 2016

Liabilities	₹	₹	Assets	₹	₹
			Sundry debtors	26,000	
			Less: Additional Bad debts	2,500	23,500

Illustration 5

An abstract of the trial balance as on 31st December, 2016 is as follows:

Particulars	₹
Sundry Debtors	20,000
Bad debts	500

Adjustment: Create a provision for bad and doubtful debts @ 5% on sundry debtors. Pass the adjusting entry and show how these items will appear in final accounts.

Solution

Provision for bad and doubtful debts = ₹20,000 x 5/100 = ₹1,000

Adjusting entry

Date	Particulars		L.F.	Debit ₹	Credit ₹
2016 Dec. 31	Profit and loss A/c To Provision for bad and doubtful debts A/c (Provision for bad and doubtful debts created)	Dr.		1,000	1,000

Dr. Profit and loss account for the year ended 31st December, 2016 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Bad debts		500			
Add: Provision for bad and doubtful debts		1,000			

Balance Sheet as on 31st December, 2016

Liabilities	₹	₹	Assets	₹	₹
			Sundry debtors Less: Provision for bad and doubtful debts	20,000 1,000	19,000

Illustration 6

Abstracts from the trial balance as on 31st March, 2016:

Particulars	Debit ₹
Sundry debtors	52,000
Bad debts	1,000

Adjustments:

(i) Additional bad debts ₹ 2,000

(ii) Create 5% provision for bad and doubtful debts

You are required to pass necessary adjusting entries and show how these items will appear in final accounts.

Solution

Working note:

Particulars	₹
Sundry debtors	52,000
Less: Additional Bad debts	2,000
	50,000

Provision for bad and doubtful debts = ₹ 50,000 x 5/100 = ₹ 2,500

Adjusting entry

Date	Particulars	L.F.	Debit ₹	Credit ₹
2016 March 31	Bad debts A/c Dr. To Sundry debtors A/c (Bad debts written off)		2,000	2,000
March 31	Profit and Loss A/c Dr. To Provision for bad and doubtful debts A/c (Provision for bad and doubtful debts created)		2,500	2,500

Dr. Profit and loss account for the year ended 31st March, 2016 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Bad debts	1,000				
Add: Additional bad debts	2,000	3,000			
To Provision for bad and doubtful debts		2,500			

Balance Sheet as on 31st March, 2016

Liabilities	₹	₹	Assets	₹	₹
			Sundry debtors	52,000	
			Less: Additional bad debts	2,000	
				50,000	
			Less: Provision for bad and doubtful debts	2,500	47,500

Illustration 7

Abstracts from the trial balance as on 31st December, 2016:

Particulars	Debit ₹	Credit ₹
Sundry debtors	1,04,000	
Bad debts	5,000	
Provision for bad and doubtful debts		2,000

Adjustments:

(i) Additional bad debts amounted to ₹ 4,000.

(ii) Create a provision for bad and doubtful debts @ 5% on sundry debtors.

Pass necessary adjusting entries and show how the different items appear in final accounts.

Solution

Working note:

Particulars	Debit ₹
Sundry debtors	1,04,000
Less: Additional bad debts	4,000
	1,00,000

Provision for bad and doubtful debts = ₹ 1,00,000 x 5/100 = ₹ 5,000

Adjusting entry

Date	Particulars		L.F.	Debit ₹	Credit ₹
2016	Bad debts A/c	Dr.		4,000	
Dec. 31	To Sundry debtors A/c				4,000
	(Bad debts written off)				
Dec. 31	Provision for bad and doubtful debts A/c	Dr.		9,000	
	To Bad debts A/c				9,000
	(Bad debts transferred to provision for bad and doubtful debts account (5000 + 4000))				
Dec. 31	Profit and Loss A/c	Dr.		12,000	
	To Provision for bad and doubtful debts A/c				12,000
	(Provision for bad and doubtful debts created) (9,000 + 5,000 - 2,000 = 12,000)				

Dr. **Profit and loss account for the year ended 31st December, 2016** **Cr.**

Particulars	₹	₹	Particulars	₹	₹
To Provision for bad and doubtful debts (closing)	5,000				
Add: Bad debts	5,000				
Add: Additional bad debts	4,000				
	14,000				
Less: Provision for bad and doubtful debts (Opening)	2,000	12,000			

Balance Sheet as on 31st December, 2016

Liabilities	₹	₹	Assets	₹	₹
			Sundry debtors	1,04,000	
			Less: Additional bad debts	4,000	
				1,00,000	
			Less: Provision for bad and doubtful debts (closing)	5,000	95,000

13.3 Summary of adjusting entries and accounting treatment of adjustments

Sl. No.	Adjustment	Journal entry	Treatment in: Trading A/c or P & L A/c	Treatment in: Balance Sheet
1	Closing stock	Stock in trade A/c Dr. To Trading A/c	Shown on the credit side of the trading A/c.	Shown on the assets side as a current asset.
2	Outstanding expenses	Concerned expense A/c Dr. To Outstanding expense A/c	Added to the concerned expense on the debit side of trading account if direct expense and profit and loss account if indirect expense.	Shown on the liabilities side as a current liability.
3	Prepaid expenses	Prepaid expense A/c Dr. To Concerned expense A/c	Deducted from the concerned expense on the debit side. of trading account if direct expense and profit and loss account if indirect expense.	Shown on the assets side as a current asset.
4	Accrued income	Accrued income A/c Dr. To Income A/c	Added to the concerned income on the credit side of profit and loss A/c.	Shown on the assets side as a current asset.
5	Income received in advance	Concerned income A/c Dr. To Income received in advance A/c	Deducted from the concerned income on the credit side of profit and loss account.	Shown on the liabilities side as a current liability.

6	Interest on capital	Interest on capital A/c Dr. To Capital A/c	Shown on the debit side of profit and loss A/c.	Shown on the liabilities side as an addition to capital.
7	Interest on drawings	Capital A/c Dr. To Interest on drawings A/c	Shown on the credit side of profit and loss A/c.	Shown on the liabilities side as a deduction from capital.
8	Interest on loan outstanding	Interest on loan A/c Dr. To Outstanding interest on loan A/c	Shown on the debit side of profit and loss A/c.	Shown on the liabilities side as a current liability.
9	Interest on investments accrued	Accrued interest on investments A/c Dr. To Interest on investment A/c	Shown on the credit side of profit and loss A/c.	Shown on the assets side as a current asset.
10	Deprecia-tion	Depreciation A/c Dr. To Concerned fixed asset A/c	Shown on the debit side of profit and loss A/c.	Shown on the assets side as a deduction from the value of concerned fixed asset.
11	Bad debts	Bad debts A/c Dr. To Sundry debtors A/c	Shown on the debit side of profit and loss A/c when there is no provision for bad and doubtful debts. (If there is a provision for bad and doubtful debts account existing, bad debts is to be transferred to provision for bad debts A/c).	Shown on the assets side by way of deduction from the amount of sundry debtors.
12	Provision for bad and doubtful debts	Profit & Loss A/c Dr. To Provision for bad and doubtful debts A/c	Shown on the debit side of profit and loss A/c	Shown on the assets side as a deduction from sundry debtors.
13	Provision for discount on debtors	Profit & Loss A/c Dr. To Provision for discount on debtors A/c	Shown on the debit side of profit and loss A/c.	Shown on the assets side as a deduction from sundry debtors.
14	Income tax paid	Drawings A/c Dr. To Bank A/c	Shown on the liabilities side as a deduction from capital.	Shown on the assets side as a deduction from bank balance.
15	Manager's commission	Manager's commission A/c Dr. To Outstanding manager's commission A/c	Shown on the debit side of profit and loss A/c.	Shown on the liabilities side as a current liability.

13.4 Final accounts with adjustments

Illustration 8

Prepare trading account from the following ledger balances presented by P. Sen as on 31st March, 2016.

Particulars	₹	Particulars	₹
Stock (1-4-2015)	10,000	Sales	3,00,000
Purchases	1,60,000	Returns inward	16,000
Wages	30,000	Returns outward	10,000
Carriage inwards	10,000	Gas and Fuel	8,000
Freight inwards	8,000		

Additional information:

(a) Stock on 31st March, 2016 ₹ 20,000

(b) Outstanding wages amounted to ₹ 4,000

(c) Gas and fuel was paid in advance for ₹ 1,000

Solution

Dr. **Trading account for the year ended 31st March, 2016** **Cr.**

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock		10,000	By Sales	3,00,000	
To Purchases	1,60,000		Less: Returns inward	16,000	2,84,000
Less: Returns outward	10,000	1,50,000	By Closing Stock		20,000
To Wages	30,000				
Add: Outstanding	4,000	34,000			
To Carriage inwards		10,000			
To Freight inwards		8,000			
To Gas and fuel	8,000				
Less: Prepaid	1,000	7,000			
To Gross profit c/d		**85,000**			
		3,04,000			3,04,000

Illustration 9

From the following particulars presented by Thilak for the year ended 31st March, 2017, prepare profit and loss account.

Particulars	₹	Particulars	₹
Gross profit	1,00,000	Interest received	6,000
Rent paid	22,000	Bad debts	2,000
Salaries	10,000	Provision for bad debts (1-4-2016)	4,000
Commission (Cr.)	12,000	Sundry debtors	40,000
Discount received	2,000	Buildings	80,000
Insurance premium paid	8,000		

Adjustments:

(a) Outstanding salaries amounted to ₹4,000
(b) Rent paid for 11 months
(c) Interest due but not received amounted to ₹2,000
(d) Prepaid insurance amounted to ₹2,000
(e) Depreciate buildings by 10%
(f) Further bad debts amounted to ₹3,000 and make a provision for bad debts @ 5% on sundry debtors
(g) Commission received in advance amounted to ₹2,000

Solution

Dr. Profit and Loss Account for the year ended 31st March, 2017 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Rent	22,000		By Gross profit b/d	-	1,00,000
Add: Outstanding	2,000	24,000	By Commission	12,000	
(22,000x1/11)			Less: Received in		
To Salaries	10,000		advance	2,000	10,000
Add: Outstanding	4,000	14,000	By Discount received		2,000
To Insurance premium	8,000		By Interest received	6,000	
Less: Prepaid insurance	2,000	6,000	Add: Accrued	2,000	8,000
To Provision for bad and					
doubtful debts (closing)	1,900				
Add: Bad debts	2,000				
Add: Further bad debts	3,000				
	6,900				
Less: Opening provision for					
bad and doubtful debts	4,000	2,900			
To Depreciation on building		8,000			
(80,000x10%)					
To Net profit (transferred to					
capital A/c)		**65,100**			
		1,20,000			1,20,000

Working Note:

Debtors	: 40,000
Less: Further bad debts	: 2,000
	38,000

Provision for bad and doubtful debts at 5% : 38,000 x 5% = ₹1,900

Illustration 10

From the following balances as on 31st December, 2017, prepare profit and loss account.

Particulars	₹	Particulars	₹
Gross profit	50,000	Rent received	2,000
Salaries	18,000	Discount received	3,000
Office rent paid	12,000	Carriage outwards	2,500
Advertisement	8,000	Fire insurance premium	6,500

Adjustments:

(a) Rent accrued but not yet received ₹ 500

(b) Fire insurance premium prepaid to the extent of ₹ 1,500

(c) Provide manager's commission at 10% on profits before charging such commission.

Dr. Profit and Loss Account for the year ended 31st December, 2017 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Salaries		18,000	By Gross profit b/d		50,000
To Office rent		12,000	By Rent received	2,000	
To Advertisement		8,000	Add: Rent accrued	500	2,500
To Carriage outwards		2,500	By Discount received		3,000
To Fire insurance premium	6,500				
Less: Prepaid	1,500	5,000			
To Manager's commission		1,000			
To Net profit (transferred to capital account)	-	**9,000**			
		55,500			55,500

Working note:

$$\text{Manager's Commission} = \text{Net profit before charging commission} \times \frac{\text{Rate of commission}}{100}$$

Net profit = 55,500 – (18,000 + 12,000 + 8,000 + 2,500 + 5,000) = ₹ 10,000

$$\text{Manager's commission} = 10,000 \times \frac{10}{100} = 1,000$$

Illustration 11

From the following balances obtained from the books of Siva, prepare trading and profit and loss account.

Particulars	₹	Particulars	₹
Stock on 01.01.2016	9,000	Bad debts	1,200
Purchases	22,000	Sundry expenses	1,800
Sales	42,000	Discount allowed	1,700
Expenses on purchases	1,500	Expenses on sale	1,000
Bank charges paid	3,500	Repairs on office furniture	600

Adjustments:

a) Closing stock on, 31st December, 2016 was ₹ 4,500

b) Manager is entitled to receive commission @ 5% of net profit after providing such commission.

Solution

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2016 Cr.

Particulars	₹	Particulars	₹
To Opening stock	9,000	By Sales	42,000
To Purchases	22,000	By Closing stock	4,500
To Expenses on purchases	1,500		
To Gross profit c/d	**14,000**		
	46,500		46,500
To Bank charges	3,500	By Gross profit b/d	14,000
To Bad debts	1,200		
To Sundry expenses	1,800		
To Discount allowed	1,700		
To Expenses on sale	1,000		
To Repairs on office furniture	600		
To Manager's commission	200		
To Net profit (transferred to capital A/c)	**4,000**		
	14,000		14,000

Working note:

$$\text{Commission} = \text{Net profit before charging commission} \times \frac{\text{Rate of commission}}{(100+ \text{Rate of commission})} \times 100$$

Net profit = 14,000 – (3,500 + 1,000+1,200+1,800+1,700+600) = ₹ 4,200

$$\text{Manager's commission} = 4{,}200 \times \frac{5}{105} = ₹\ 200$$

Illustration 12

Given below are the balances extracted from the books of Nagarajan as on 31st March, 2016.

Particulars	₹	Particulars	₹
Purchases	10,000	Sales	15,100
Wages	600	Commission received	1,900
Freight inwards	750	Rent received	600
Advertisement	500	Creditors	2,400
Carriage outwards	400	Capital	5,000
Cash	1,200		
Machinery	8,000		
Debtors	2,250		
Bills receivable	300		
Stock on 1st January, 2016	1,000		
	25,000		25,000

Prepare the trading and profit and loss account for the year ended 31st March, 2016 and the balance sheet as on that date after adjusting the following:

(a) Commission received in advance ₹ 400 (b) Advertisement paid in advance ₹ 150

(c) Wages outstanding ₹ 200 (d) Closing stock on 31st March 2016, ₹ 2,100

Solution

In the books of Nagarajan

Dr. Trading and Profit and Loss Account for the year ended 31st March, 2016 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening stock		1,000	By Sales		15,100
To Purchases		10,000	By Closing stock		2,100
To Wages	600				
Add: Outstanding	200	800			
To Freight inwards		750			
To Gross profit c/d		**4,650**			
		17,200			17,200
To Advertisement	500		By Gross profit b/d		4,650
Less: Prepaid advertisement	150	350	By Commission received	1,900	
To Carriage outwards		400	Less: Received in advance	400	1,500
To Net profit (transferred to capital a/c)		**6,000**	By Rent received		600
		6,750			6,750

Balance Sheet as on 31st March, 2016

Particulars	₹	₹	Particulars	₹	₹
Capital	5,000		Machinery		8,000
Add: Net profit	6,000	11,000	Stock in trade		2,100
Creditors		2,400	Debtors		300
Commission received in			Bills receivable		2,250
advance		400	Advertisement prepaid		150
Outstanding wages		200	Cash		1,200
		14,000			14,000

Illustration 13

Consider the following balances extracted from the books of Jain as on 31st December, 2016. Prepare the final accounts.

Particulars	₹	Particulars	₹
Capital	20,000	Office Salaries	6,600
Debtors	8,000	Establishment expenses	4,500
Creditors	10,500	Selling expenses	2,300
Purchases	60,000	Furniture	10,000
Sales	80,000	Cash at bank	2,400
Income tax of Jain paid	500	Miscellaneous receipts	600
Opening stock	12,000	Drawings	4,800

Adjustments

(a) Salaries outstanding for December, 2016 amounted to ₹ 600

(b) Provide depreciation on furniture @ 10% p.a.

(c) Provide interest on capital for the year @ 5% p.a.

(d) Stock on 31st December, 2016 ₹ 14,000

Solution

In the books of Jain

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2016 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock		12,000	By Sales		80,000
To Purchases		60,000	By Closing Stock		14,000
To Gross Profit c/d		**22,000**			
		94,000			94,000
To Office salaries	6,600		By Gross Profit b/d		22,000
Add: Outstanding	600	7,200	By Miscellaneous receipts		600
To Establishment expenses		4,500			
To Selling expenses		2,300			
To Depreciation on furniture (10,000 x 10%)		1,000			
To Interest on capital (20,000 x 5%)		1,000			
To Net profit (transferred to capital A/c)		**6,600**			
		22,600			22,600

Balance Sheet as on 31st December, 2016

Liabilities		₹	₹	Assets	₹	₹
Capital		20,000		Furniture	10,000	
Add: Net profit		6,600		Less: Depreciation	1,000	9,000
Add: Interest on capital		1,000		Stock in trade		14,000
		27,600		Debtors		8,000
Less: Drawings	4,800			Cash at bank		2,400
Income tax	500	5,300	22,300			
Creditors			10,500			
Office salaries outstanding			600			
			33,400			33,400

Illustration 14

Edward's books show the following balances. Prepare his trading and profit and loss A/c for the year ended 31st December, 2016 and a balance sheet on at that date.

Debit balances	₹	Credit balances	₹
Drawings	5,000	Capital	1,31,500
Sundry debtors	60,000	Loan at 6% p.a.	20,000
Coal, gas and water	10,500	Sales	3,56,500
Returns inward	2,500	Interest on investments	2,550
Purchases	2,56,500	Sundry creditors	40,000
Stock on 1-1-2016	89,700		
Travelling expenses	51,250		
Interest on loan paid	300		
Petty cash	710		
Repairs	4,090		
Investments	70,000		
	5,50,550		5,50,550

Adjustments:

(a) Closing stock was ₹ 1,30,000 on 31st December, 2016.

(b) Create 5% provision for bad and doubtful debts on sundry debtors

(c) Create provision at 2% for discount on debtors

(d) Interest on loan due for 9 months.

Solution

In the books of Edward

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2016 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock		89,700	By Sales	3,56,500	
To Purchases		2,56,500	Less: Returns inward	2,500	3,54,000
To Coal, gas and water		10,500	By Closing stock		1,30,000
To Gross profit c/d		**1,27,300**			
		4,84,000			4,84,000
To Travelling expenses		51,250	By Gross Profit b/d		1,27,300
To Interest on loan paid	300		By Interest on		
Add: Interest outstanding	900	1,200	investments		2,550
(20,000 x 6/100 x 9/12)					
To Repairs		4,090			
To Provision for bad and doubtful debts		3,000			
To Provision for discount on debtors		1,140			
To Net profit (transferred to capital A/c)		**69,170**			
		1,29,850			1,29,850

Balance Sheet as on 31st December, 2016

Liabilities	₹	₹	Assets	₹	₹
Capital	1,31,500		Investments		70,000
Add: Net profit	69,170		Stock in trade		1,30,000
	2,00,670		Sundry debtors	60,000	
Less: Drawings	5,000	1,95,670	Less: Provision for bad and doubtful debts (60,000 x 5/100)	3,000	
6% Loan	20,000			57,000	
Add: Interest outstanding	900	20,900	Less: Provision for discount on debtors (57,000 x 2/100)	1,140	55,860
Sundry creditors		40,000	Petty cash		710
		2,56,570			2,56,570

Illustration 15

Given below are the balances of Pandian as on 31st March, 2016.

Particulars	Debit ₹	Credit ₹
Capital		1,20,000
Sundry debtors and creditors	22,000	22,500
Sales		59,700
Drawings	2,000	
Cash in hand	8,200	
Cash at bank	30,000	
Wages	2,500	
Purchases	10,000	
Opening stock	30,000	
Business premises	60,000	
Bills receivable	14,500	
Office telephone expenses	3,500	
General expenses	9,000	
Goodwill	10,500	
	2,02,200	2,02,200

Adjustments:

(a) The stock value at the end of the accounting period was ₹ 5,000

(b) Interest on capital at 6% is to be provided

(c) Interest on drawing at 5% is to be provided

(d) Write off bad debts amounting to ₹ 2,000

(e) Create provision for bad and doubtful debts on sundry debtors @ 10%

Prepare final accounts for the year ended 31st March, 2016.

Solution

In the books of Pandian

Dr. Trading and Profit and Loss Account for the year ended 31st March, 2016 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening stock		30,000	By Sales		59,700
To Purchases		10,000	By Closing Stock		5,000
To Wages		2,500			
To Gross Profit c/d		**22,200**			
		64,700			64,700
To Office telephone expenses		3,500	By Gross profit b/d		22,200
To General expenses		9,000	By Interest on drawings		100
To Interest on capital		7,200	(2000 x5/100)		
(1,20,000 x 6/100)			By Net loss		**1,400**
To Bad debts		2,000	(transferred to capital		
To Provision for bad and			account)		
doubtful debts		2,000			
		23,700			23,700

Balance Sheet as on 31st March, 2016

Liabilities	₹	₹	Assets	₹	₹
Capital	1,20,000		Goodwill		10,500
Less: Net loss	1,400		Business premises		60,000
	1,18,600		Stock in trade		5,000
Add: Interest on capital	7,200		Sundry debtors	22,000	
	1,25,800		Less: Bad debts	2,000	
Less: Drawings and				20,000	
Interest on drawings	2,100	1,23,700	Less: Provision for bad		
(2000+100)			and doubtful debts		
Sundry creditors		22,500	(20,000 x 10/100)	2,000	18,000
			Bills receivable		14,500
			Cash at bank		30,000
			Cash in hand		8,200
		1,46,200			1,46,200

Illustration 16

From the trial balance of Ajith and the adjustments given below, prepare trading and profit and loss A/c for the year ended 31st March, 2016 and the balance sheet as on that date.

Particulars	Debit ₹	Particulars	Credit ₹
Opening stock	15,000	Capital	25,000
Furniture and fixtures	30,000	Returns outward	1,000
Purchases	40,000	Bills payable	10,000
Sales returns	2,000	Sales	1,24,000
Carriage inwards	10,000	Provision for doubtful debts	500
Office rent	23,000	Provision for discount on debtors	100
Sundry debtors	20,100		
Bank balance	19,600		
Bad debts	900		
	1,60,600		1,60,600

Adjustments:

(a) Stock at the end of the year was ₹ 8,000

(b) Further bad debts amounted to ₹ 100

(c) Create 2% provision for doubtful debts on sundry debtors

(d) Create 1% provision for discount on sundry debtors

In the books of Ajith

Dr. Trading and Profit and Loss Account for the year ended 31st March, 2016 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening Stock		15,000	By Sales	1,24,000	
To Purchases	40,000		Less: Sales returns	2,000	1,22,000
Less: Returns outward	1,000	39,000	By Closing stock		8,000
To Carriage inwards		10,000			
To Gross profit c/d		**66,000**			
		1,30,000			1,30,000
To Office rent		23,000	By Gross profit b/d		66,000
To Provision for bad and doubtful debts (closing)	400				
Add: Bad debts	900				
Add: Further bad debts	100				
	1,400				
Less: Provision for bad and doubtful debts (opening)	500	900			
To Provision for discount on debtors (closing)	196				
Less: Provision for discount on debtors (opening)	100	96			
To Net profit (transferred to capital A/c)		**42,004**			
		66,000			66,000

Balance Sheet as on 31st March, 2016

Liabilities	₹	₹	Assets	₹	₹
Capital	25,000		Furniture and fixtures		30,000
Add: Net profit	42,004	67,004	Sundry debtors	20,100	
Bills payable		10,000	Less: Further bad debts	100	
				20,000	
			Less: Provision for bad and doubtful debts (20,000 × 2%)	400	
				19,600	
			Less: Provision for discount (19,600 × 1%)	196	19,404
			Stock-in-trade		8,000
			Cash at bank		19,600
		77,004			**77,004**

Illustration 17

The following trial balance has been extracted from the books of Rajesh on 31st December, 2016.

Debit balance	₹	Credit balance	₹
Drawings	44,000	Capital	1,76,000
Plant and machinery	1,00,000	Cash sales	1,72,000
Opening stock	20,000	Provision for bad and doubtful debts	2,000
Purchases	2,70,000		
Wages	62,000	Bank overdraft	20,000
Salaries	70,000	Discount received	6,000
Insurance	45,000	Credit sales	3,00,000
Rent and taxes	17,000	Sundry creditors	24,000
Sundry debtors	50,000		
Suspense A/c	22,000		
	7,00,000		7,00,000

The following adjustments are to be made:

(a) Stock on 31st December, 2016 was ₹ 28,000

(b) Unexpired insurance was ₹ 15,000

(c) Provision for doubtful debts is to be maintained at 5% on sundry debtors.

(d) Depreciate plant and machinery at 20%.

You are required to prepare trading and profit and loss account for the year ended 31st December, 2016 and a balance sheet as on that date.

Solution

In the books of Rajesh

Dr. Trading and Profit and Loss Account for the year ended 31st December, 2016 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Opening stock		20,000	By Sales: Cash	1,72,000	
To Purchases		2,70,000	Credit	3,00,000	4,72,000
To Wages		62,000	By Closing stock		28,000
To Gross profit c/d		**1,48,000**			
		5,00,000			5,00,000
To Salaries		70,000	By Gross profit b/d		1,48,000
To Insurance	45,000		By Discount received		6,000
Less: Unexpired	15,000	30,000	By Provision for bad		
To Rent and taxes		17,000	and doubtful debts		
To Depreciation on plant			(opening)	2,000	
and machinery		20,000	Less: Closing		
(1,00,000 × 20%)			provision	1,000	1,000
To Net profit (transferred					
to capital A/c)		**18,000**			
		1,55,000			**1,55,000**

Balance Sheet as on 31st December, 2016

Liabilities	₹	₹	Assets	₹	₹
Capital	1,76,000		Plant & Machinery	1,00,000	
Add: Net profit	18,000		Less: Depreciation	20,000	80,000
	1,94,000		Stock-in-trade		28,000
Less: Drawings	44,000	1,50,000	Sundry debtors	50,000	
Sundry creditors		24,000	Less: Provision		
Bank overdraft		20,000	for bad and doubtful		
			debts (2%)	1,000	49,000
			Unexpired insurance		15,000
			Suspense A/c		22,000
		1,94,000			**1,94,000**

Points to remember

- Adjustment entries are the journal entries made at the end of the accounting period to bring into account items which are omitted in trial balance but which relate to the relevant accounting period.
- Adjustment entries are made so that the financial statements represent a true and fair view of profitability and financial position.
- Closing stock is valued at cost price or net realisable value whichever is lower.
- Outstanding expense and income received in advance are current liabilities.
- Prepaid expense and accrued income are current assets.
- Provision is created for bad and doubtful debts and discount on debtors in the current accounting period against debtors of current accounting period.

Self-examination questions

I Multiple choice questions

Choose the correct answer

1. A prepayment of insurance premium will appear in
   - (a) The trading account on the debit side
   - (b) The profit and loss account on the credit side
   - (c) The balance sheet on the assets side
   - (d) The balance sheet on the liabilities side

2. Net profit is
   - (a) Debited to capital account (b) Credited to capital account
   - (c) Debited to drawings account (d) Credited to drawings account

3. Closing stock is valued at
   - (a) Cost price (b) Market price
   - (c) Cost price or market price whichever is higher
   - (d) Cost price or net realisable value whichever is lower

4. Accrued interest on investment will be shown
   - (a) On the credit side of profit and loss account (b) On the assets side of balance sheet
   - (c) Both (a) and (b) (d) None of these

5. If there is no existing provision for doubtful debts, provision created for doubtful debts is
   - (a) Debited to bad debts account (b) Debited to sundry debtors account
   - (c) Credited to bad debts account (d) Debited to profit and loss account

Answer

1 (c)	2 (b)	3 (d)	4 (c)	5 (d)

II Very short answer questions

1. What are adjusting entries?
2. What is outstanding expense?
3. What is prepaid expense?
4. What are accrued incomes?
5. What is provision for discount on debtors?

III Short answer questions

1. What is the need for preparing final accounts?
2. What is meant by provision for doubtful debts? Why is it created?
3. Explain how closing stock is treated in final accounts.
4. Give the adjusting entries for interest on capital and interest on drawings.
5. Explain the accounting treatment of bad debts, provision for doubtful debts and provision for discount on debtors.

IV Exercises

1. Pass adjusting entries for the following:
   - (a) The closing stock was valued at ₹ 5,000
   - (b) Outstanding salaries ₹ 150
   - (c) Insurance prepaid ₹ 450
   - (d) ₹ 20,000 was received in advance for commission.
   - (e) Accrued interest on investments is ₹ 1,000.

2. For the following adjustments, pass adjusting entries:
   (a) Outstanding wages ₹ 5,000.
   (b) Depreciate machinery by ₹ 1,000.
   (c) Interest on capital @ 5% (Capital: ₹20,000)
   (d) Interest on drawings ₹ 50
   (e) Write off bad debts ₹ 500

3. On preparing final accounts of Suresh, bad debt account has a balance of ₹ 800 and sundry debtors account has a balance of ₹ 16,000 of which ₹ 1,200 is to be written off as further bad debts. Pass adjusting entry for bad debts. And also show how it would appear in profit and loss account and balance sheet.

(**Answer**: Profit and loss account: ₹2,000 (Dr.);
Balance of sundry debtors in balance sheet: ₹14,800)

4. The trial balance on March 31, 2016 shows the following:
   Sundry debtors ₹ 30,000; Bad debts ₹ 1,200
   It is found that 3% of sundry debtors is doubtful of recovery and is to be provided for. Pass journal entry for the amount of provision and also show how it would appear in the profit and loss account and balance sheet.

(**Answer**: Profit and loss account: ₹900 (Dr.);
Balance of sundry debtors in balance sheet: ₹29,100)

5. The trial balance of a trader on 31st December, 2016 shows sundry debtors as ₹ 50,000.
   Adjustments:
   (a) Write off ₹ 1,000 as bad debts
   (b) Provide 5% for doubtful debts
   (c) Provide 2% for discount on debtors
   Show how these items will appear in the profit and loss A/c and balance sheet of the trader.

(**Answer**: Profit and loss account: ₹4,381 (Dr.),
Balance of sundry debtors in balance sheet: ₹45619)

6. The following are the extracts from the trial balance.
   Sundry debtors ₹30,000; Bad debts ₹5,000
   Additional information:
   (a) Write off further bad debts ₹ 3,000.
   (b) Create 10% provision for bad and doubtful debts.
   You are required to pass necessary adjusting entries and show how these items will appear in profit and loss account and balance sheet.

(**Answer**: Profit and loss account: ₹10,700 (Dr.),
Balance of sundry debtors in balance sheet: ₹24,300)

7. The following are the extracts from the trial balance.

Particulars	Debit ₹	Credit ₹
Sundry debtors	50,000	
Provision for doubtful debts		5,000
Bad debts	3,000	

Additional information:
   (a) Additional bad debts ₹ 3,000.

(b) Keep a provision for bad and doubtful debts @ 10% on sundry debtors.

You are required to pass necessary adjusting entries and show how these items will appear in profit and loss account and balance sheet.

(**Answer**: Profit and loss account: ₹ 5,700 (Dr.),
Balance of sundry debtors in balance sheet: ₹ 42,300)

8. The following are the extracts from the trial balance.

Particulars	Debit ₹	Credit ₹
Sundry debtors	50,000	
Discount on debtors	2,000	
Bad debts	3,000	

Additional information:

(a) Create a provision for doubtful debts @ 10% on sundry debtors.

(b) Create a provision for discount on debtors @ 5% on sundry debtors.

You are required to pass necessary adjusting entries and show how these items will appear in the final accounts.

(**Answer**: Profit and loss account: Provision for bad and doubtful debts ₹ 8,000 (Dr.),
Provision for discount on debtors: ₹ 4,250 (Dr.);
Balance of sundry debtors in balance sheet: ₹ 42,750).

9. Prepare trading account of Archana for the year ending 31st December, 2016 from the following information.

Debit balance	₹	Credit balance	₹
Opening stock	80,000	Purchases returns	10,000
Purchases	8,60,000	Sales returns	3,16,000
Freight inwards	52,000	Import duty on purchases	30,000
Wages	24,000	Sales	14,40,000

Adjustments:

(a) Closing stock ₹ 1,00,000 (b) Wages outstanding ₹ 12,000

(c) Freight inwards paid in advance ₹ 5,000

(**Answer**: Gross Profit: ₹ 1,81,000)

10. Prepare profit and loss account of Manoj for the year ending on 31st March, 2016

Particulars	₹	Particulars	₹
Gross profit	25,000	Travelling expenses	500
Salaries	5,600	Stationery	75
Insurance	200	Rent	650
Discount allowed	400	Interest on loan	225
Discount received	300	Repairs	125
Commission received	100	Office expenses	55
Advertisement	450	General expenses	875
Printing charges	375	Postage	175

Adjustments:

(i) Salary outstanding ₹ 400 (ii) Rent paid in advance ₹ 50

(iii) Commission receivable ₹ 100

(**Answer**: Net profit: ₹ 15,445)

11. From the trial balance of Sumathi and the adjustments prepare the trading and profit and loss account for the year ended 31st March, 2016, and a balance sheet as on that date.

Particulars	Debit ₹	Credit ₹
Stock on April 1, 2015	900	
Purchases	2,000	
Sales		4,000
10% Loan		2,000
Carriage on purchases	200	
Rent from tenant		250
Interest on loan	100	
Machinery	400	
Postage	100	
Salary	650	
Commission received		200
Cash in hand	75	
Furniture	4,000	
Capital		1,975
	8,425	8,425

Adjustments

(a) Six months interest on loan is outstanding.

(b) Two months rent is due from tenant, the monthly rent being ₹ 25.

(c) Salary for the month of March 2016, ₹ 75 is unpaid.

(d) Stock in hand on March 31, 2016 was valued at ₹ 1,030.

(**Answer**: Gross profit: ₹ 1,930; Net profit ₹ 1,405, Balance sheet total ₹ 5,555)

12. The following trial balance was extracted from the books of Arun Traders as on 31st March, 2018.

Particulars	Debit ₹	Credit ₹
Buildings	17,500	
Plant and machinery	12,000	
Cash purchases	30,000	
Credit purchases	8,500	
Sales		63,250
Bills receivable	6,750	
Coal and water	1,625	
Office expenses	5,250	
Rent received		1,750
Carriage outwards	2,875	
Repairs and maintenance	500	
Wages	9,250	
Debtors and creditors	9,000	8,500
Cash	2,000	
Capital		44,750
Opening stock	13,000	
	1,18,250	1,18,250

Prepare trading and profit and loss account for the year ending 31st March, 2018 and balance sheet as on that date after considering the following:

(a) Depreciate Plant and machinery @ 20%

(b) Wages outstanding amounts to ₹ 750.

(c) Half of repairs and maintenance paid is for the next year.

(d) Closing stock was valued at ₹ 15,000.

(**Answer**: Gross profit: ₹ 15,125; Net profit ₹ 6,100, Balance sheet total ₹ 60,100)

13. From the following trial balance of Ramesh as on 31st March, 2017, prepare the trading and profit and loss account and the balance sheet as on that date.

Particulars	Debit ₹	Credit ₹
Stock (01.04.2016)	40,000	
Purchases	85,000	
Sales		1,90,000
Sundry creditors		48,000
Furniture and fixtures	65,000	
Debtors	45,000	
Cash at bank	21,000	
Wages	37,500	
Drawings	15,000	
Telephone charges	3,000	
Bad debts	2,000	
Provision for bad debts		2,500
Discount received		3,000
Capital		85,000
Advertising	15,000	
	3,28,500	3,28,500

Adjustments:

(a) Closing stock was valued at ₹ 35,000

(b) Unexpired advertising ₹ 250

(c) Provision for bad and doubtful debts is to be increased to ₹ 3,000

(d) Provide 2% for discount on debtors.

(e) Charge interest on drawings @ 10%.

(**Answer**: Gross profit ₹ 62,500; Net profit ₹ 45,910; Balance sheet total ₹ 1,62,410)

14. Following are the ledger balances of Devi as on 31st December, 2016.

Debit balance	₹	Credit balance	₹
Purchases	35,000	Goodwill	40,000
Salaries	11,750	Sundry debtors	20,500
Drawings	4,500	Furniture	31,000
Opening Stock	6,250	General expenses	3,250
Capital	50,000	Commission received	2,750
Sales	78,500	Loan	44,000
Carriage inwards	21,800	Cash at bank	3,100
Bad debts	600	Provision for bad debts	2,500

Prepare trading and profit and loss account for the year ended 31st December, 2016 and balance sheet as on that date.

(a) Stock on 31st December, 2016 ₹ 5,800.

(b) Write off bad debts ₹ 500.

(c) Make a provision for bad debts @ 5%.

(d) Provide for discount on debtors @ 2%.

(**Answer:** Gross profit: ₹21,250; Net profit ₹9,020, Balance sheet total ₹98,520)

15. Prepare trading and profit and loss account and balance sheet from the following trial balance of Madan as on 31st March, 2018

Debit balance	₹	Credit balance	₹
Sundry debtors	61,000	Capital	70,000
Plant and machinery	80,000	Purchases return	2,000
Bank charges	4,200	Sales	2,55,000
Wages	7,000	Bank overdraft	77,000
Sales return	5,000		
Purchases	1,52,000		
Opening stock	30,000		
Drawings	22,000		
Establishment expenses	20,000		
Bad debts	800		
Business premises	22,000		
	4,04,000		4,04,000

Adjustments:

(a) The closing stock was ₹ 80,000

(b) Provide depreciation on plant and machinery @ 20%

(c) Write off ₹ 800 as further bad debts

(d) Provide the doubtful debts @ 5% on sundry debtors

(**Answer**: Gross profit ₹ 1,43,000; Net profit ₹ 98,190; Balance sheet total ₹ 2,23,190)

16. From the following information prepare trading and profit and loss account and balance sheet of Kumar for the year ending 31st December, 2017.

Debit balance	₹	Credit balance	₹
Purchases	14,500	Sales	20,100
Coal and fuel	600	Bills payable	400
Carriage inwards	750	Rent received	2,500
Advertisement	500	Creditors	2,000
Carriage outwards	400	Capital	5,000
Bank	1,200		
Furniture	8,000		
Debtors	2,250		
Bills receivable	300		
Stock on 1st January, 2017	1,500		
	30,000		30,000

Adjustments:

a) The closing stock on 31st December, 2017 was valued at ₹ 3,900.

b) Carriage inwards prepaid ₹ 250

c) Rent received in advance ₹ 100

d) Manager is entitled to receive commission @ 5% of net profit after providing such commission.

(**Answer**: Gross profit ₹ 6,900; Manager's commission ₹ 400;
Net profit ₹ 8,000; Balance sheet total ₹ 15,900)

17. From the following information, prepare trading and profit and loss account and balance sheet in the books of Sangeetha for the year ending 31st March, 2018.

Particulars	₹	Particulars	₹
Capital	20,000	Salaries	6,600
Bills receivable	8,000	Establishment expenses	4,500
Bills payable	10,500	Advertisement	2,300
Purchases	75,000	Furniture	10,000
Sales	95,000	Cash at bank	3,200
Opening stock	12,000	Miscellaneous receipts	600
Drawings	4,500		

Adjustments:

(a) Stock on 31st March, 2018 ₹ 14,200

(b) Income tax of Sangeetha paid ₹ 800

(c) Provide interest on capital @ 10%

(d) Provide managerial remuneration @ 10% of net profit before charging such commission.

(**Answer**: Gross profit ₹ 22,200; Manager's commission ₹ 740; Net profit ₹ 6,660; Balance sheet total ₹ 34,600)

CASE STUDY

James is a trader who sells washing machines on credit. But, he does not remember the due date to collect the money from his debtors. Some of his customers do not pay on time. His cash inflow is becoming worse. As a result, he could not pay his telephone bill and rent at the end of the accounting period. Hence, he showed only the amount paid as expense. He has many washing machines unsold at the year end. He is worried about the performance of his business. So, he is planning to appoint a manager to take care of his business. The new manager insists James to apply the accounting principle of prudence and matching and also to allow cash discount.

Now, discuss on the following points:

- Why does James sell on credit?
- Are there any ways to encourage his debtors to make the payment on time?
- What might happen if the debtors do not pay?
- In what ways prudence and matching principles can be applied for the business of James?
- What will be the impact on income statement and the balance sheet, if the outstanding expenses are not adjusted?
- On what basis the unsold washing machines should be valued?
- What can be done to motivate the new manager to retain him in the business of James?

To explore further

'Profit does not necessarily mean cash inflow' – Do you agree?

Reference

1. M C Shukla, T S Grewal and S C Gupta, Advanced Accounts, 19th ed., 2017, S.Chand Publishing, New Delhi.
2. R L Gupta and V K Gupta, Financial Accounting, 11th ed., 2014, Sultan Chand and Sons, New Delhi.
3. S P Jain and K L Narang, Advanced Accountancy Vol – I, 2016, Kalyani Publishers, New Delhi.
4. Dalston L Cecil and Jenitra L Merwin, Financial Accounting, 3rd ed., 2017, Learntech Press, Trichy.
5. Fundamentals of Accounting, 2017, The Institute of Chartered Accountants of India, New Delhi.