

The trial balance of Ravi's trading business as at 31.12.2020 is as follows.

	Debit (Rs.)	Credit (Rs.)
Capital.....		500 000
Stock (as at 01.01.2015).....	10 000	
Purchases.....	280 000	
Sales		350 000
Debtors	30 000	
Creditors		13 000
15% bank loan		50 000
Land and Building (at cost)	400 000	
Machinery (at cost)	150 000	
Bank loan interest	3 000	
Administrative salary.....	14 000	
Discount allowed	3 200	
Discount received.....		5 000
Rate	8 000	
Advertising	12 500	
Cash in hand	7 300	
	918 000	918 000

Additional information

1. Stock as at 31.12.2015 is Rs. 30 000
2. Machinery should be depreciated annually at 10% on the straight-line method
3. Rs. 3 000 of debtors should be written off as bad debts

Required:

1. Statement of Profit or Loss for the year ended 31.12.2020
2. Statement of Financial Position as at 31.12.2020

Let see how we should answer for this question step by step

Step 01

Read the requirement. Then write the titles and draw the tables of both financial statements.

5

☐

Divide both financial statements into sections.

Dividing the statement of profit or loss into sections

Let us divide the statement of profit or loss into sections based on the expense categories. The statement of profit or loss contains 04 expense categories. These are distribution expenses, administration expenses, other expenses, and financial expenses. Therefore, you need to refer to the trial balance and the additional information to keep the exact number of rules for each section of the expense category.

So, let's have a look at the given trial balance. Go through each balance in the trial balance and identify expense balances. Then identify the expense category of each expense balance. Mark a shortcode for each expense balance on the left side of the trial balance. You can use a shortcode for each expense category as follows.

- Distribution expenses – **DE**
- Administration expenses – **AE**
- Other Expenses – **OE**
- Financial Expenses – **FE**

Note: When you code the expense category if you find other income, then mark them as **OI**. So, you can easily find the other income balances in the trial balance.

The trial balance with the coded expense and other income balances

	Debit (Rs.)	Credit (Rs.)
Capital.....		500 000
Stock (as at 01.01.2015).....	10 000	
Purchases.....	280 000	
Sales		350 000
Debtors	30 000	
Creditors		13 000
15% bank loan		50 000
Land and Building (at cost)	400 000	
Machinery (at cost)	150 000	
FE Bank loan interest	3 000	
AE Administrative salary.....	14 000	
DE Discount allowed	3 200	
OI Discount received.....		5 000
AE Rate	8 000	
DE Advertising	12 500	
Cash in hand	7 300	
	<hr/>	<hr/>
	918 000	918 000
	<hr/>	<hr/>

There are 02 distribution expenses, 02 administration expenses, and 01 financial expense in the above trial balance. There are no other expenses.

However, we need to look at additional information to keep the exact number of rules for each expense category. This is because new expense balances can be occurred due to the adjustments. For example, have a look at the second point of additional information. It is about machinery depreciation. We know that machinery depreciation is an administration expense. So, you need to have one more rule for machinery depreciation under administration expenses.

Secondly, check the next point. It is about bad debts. Bad debt is a distribution expense. There is no existing balance for bad debts in the trial balance. So, we need to have one more rule for distribution expenses. As a result, we need to keep 03 rules for distribution expenses and 03 rules for administrative expenses in the profit or loss statement.

Go to your statement of profit or loss and leave about 12 rules from the beginning of the table. Then, on the 12th rule, you can write the heading "Less: Expenses". Below that write the heading "Distribution Expenses". Then keep 3 rules and write the next heading which is "Administration Expenses". Keep 3 rules for administration expenses and then write the next heading: "Financial Expenses".

It is crucial to keep the exact rules that take for each expense section when it comes to answering the O/L exam. This is because it is neat to show the statement within one page. In addition, you are given a limited number of rules per page (about 30 rules) in the exam. So, it is vital to well manage the limited space given on the page that you present your answers.

Statement of profit or loss with the expense sections

[illegible]

Next, section the statement of financial position. Dividing the statement of financial position is easy. Sections of the statement of financial position are:

1. Non-Current Assets
2. Current Assets
3. Equity
4. Non-Current Liabilities
5. Current Liabilities

We normally keep 4 to 5 rules for non-current assets and 5 rules for current assets. If there is a drawings balance in the trial balance, then we keep 5 rules under equity. If there is no drawings balance, then we keep only 3 rules for equity. Then, we keep 1- 2 rules for non-current liabilities and about 4 rules for current liabilities.

Statement of financial position with the sections
DE – Distribution Expenses,
CA – Current Assets

Once you enter the printed adjustments given in the additional information, next check for hidden adjustments. I refer to the balances that should be adjusted but not given in the additional information as hidden adjustment. Bank loan interest and fixed deposit interest income can be more frequently identified as hidden adjustments. You need to calculate the annual bank loan interest amount to check whether the bank loan interest has to be adjusted or not. So, check the amount of the bank loan and the annual interest rate mentioned in the trial balance.

As per this question, the bank loan balance is Rs. 50 000 and annual bank loan interest rate is 15%. Accordingly, the annual bank loan interest amount will be Rs. 7 500. Bank loan interest is a financial expense. Therefore, we should enter this annual bank loan interest amount (Rs. 7 500) in the profit or loss statement under financial expenses.

Then check the amount of bank loan interest paid in cash by this business. For that, you need to check whether there is an existing balance for bank loan interest in the trial balance. In this question, you can find the bank loan interest balance as Rs. 3000. Even though the annual bank loan interest to be paid is Rs. 7 500, this business has paid only Rs. 3 000. So, it is clear that Rs. 4 500 (Rs. 7 500 – 3 000) of bank loan interest is accrued/payable. Any accrued expense is a current liability. So we need to enter this accrued bank loan interest amount (Rs. 4 500) in the statement of financial position under current liabilities. However, there is no fixed deposit balance in this question. See, sometimes the adjustments are hidden and you need to check and identify them.

Workings for bank loan interest in the trial balance

	Debit (Rs.)	Credit (Rs.)
Capital.....		500 000
Stock (as at 01.01.2015).....	10 000	
Purchases.....	280 000	
Sales		350 000
Debtors	30 000	
Creditors		13 000
15% bank loan		$50\,000 \times \frac{15}{100} = 7\,500 \text{ FE}$
Land and Building (at cost)	400 000	
Machinery (at cost)	150 000	
Bank loan interest	3 000	$+ 4\,500 \text{ CL}$
Administrative salary.....	14 000	
Discount allowed	3 200	
Discount received.....		5 000
Rate	8 000	
Advertising	12 500	
Cash in hand	7 300	
	<hr/> 918 000	<hr/> 918 000

Trial balance with the working of adjustments

	Debit (Rs.)	Credit (Rs.)
Capital.....		500 000
Stock (as at 01.01.2015).....	10 000	
Purchases.....	280 000	
Sales		350 000
Debtors	30 000 – 3 000 DE = 27 000 CA	
Creditors		13 000
15% bank loan		$50\,000 \times \frac{15}{100} = 7\,500$ FE
Land and Building (at cost)	400 000	
Machinery (at cost)	$150\,000 \times \frac{10}{100} = 15\,000$ AE + AD	
Bank loan interest	3 000 + 4 500 CL	
Administrative salary.....	14 000	
Discount allowed	3 200	
Discount received.....		5 000
Rate	8 000	
Advertising	12 500	
Cash in hand	7 300	
	<hr/> 918 000	<hr/> 918 000 <hr/>

The following are the financial statements of Ravi's business after entering the adjusted balances.

Rs.	Rs.	Rs.
-----	-----	-----

Less: Expenses			
<u>Distribution Expenses</u>			
Bad debts	3 000		
<u>Administration Expenses</u>			
machinery depreciation	15 000		
<u>Financial Expenses</u>			
Bank loan interest		7 500	

Business of Ravi
Statement of Financial Position
As at 31.12.2015

<u>Non-current assets</u>	Cost (Rs.)	Accumulated Depreciation (Rs.)	Net Book Value (Rs.)
Machinery	150 000	15 000	135 000
<u>Current Assets</u>			
Debtors		27 000	
<u>Equity</u>			
<u>Non- current Liabilities</u>			
<u>Current Liabilities</u>			
Accrued bank loan interest		4 500	

Step 04

Enter the rest of the balances and finalize the financial statements.

After you enter the adjusted balances, entering the rest of the balances is so easy. However, try to enter the balances under non-current assets and obtain the total net book value of non-current assets first. This is because the total net book value of non-current assets received 1/2 marks most of the time. Next, try to finalize the profit or loss statement to find out the net profit amount. Enter the rest of the balances from the beginning of the profit or loss statement.

Once you find the next profit, add that net profit to the capital balance and find the equity amount. Then, finalize the statement of financial position by entering the rest of the balances. Consequently, the statement of financial position will balance at Rs. 599 300. This means total assets will be equal to the total equity and liabilities of Ravi's business at Rs. 599 3 00.

The followings are the finalized financial statements of Ravi's business.

Business of Ravi
Statement of Profit or Loss
For the year ended 31.12.2015

	Rs.	Rs.	Rs.
Sales			350 000
Less: Cost of Sales			
Stock as at 01.01.2015		10 000	
Purchases		280 000	
Cost of goods presented for sales		290 000	
Less: Closing stock		(30 000)	(260 000)
Gross profit			90 000
Add: Other income			
Discount received			5 000
			95 000
Less: Expenses			
<u>Distribution Expenses</u>			
Bad debts	3 000		
Discount allowed	3 200		
Advertising	12 500	18 700	
<u>Administration Expenses</u>			
Machinery depreciation	15 000		
Administrative salary	14 000		
Rate	8 000	37 000	
<u>Financial Expenses</u>			
Bank loan interest		7 500	(63 200)
Net Profit transferred to the capital account			31 800

Business of Ravi
Statement of Financial Position
As at 31.12.2015

<u>Non-current assets</u>	Cost (Rs.)	Accumulated Depreciation (Rs.)	Net Book Value (Rs.)
Land and buildings	400 000	-	400 000
Machinery	150 000	15 000	135 000
	550 000	15 000	535 000
<u>Current Assets</u>			
Closing stock		30 000	
Debtors		27 000	
Cash in hand		7 300	64 300
Total Assets			599 300
<u>Equity</u>			
Capital		500 000	
Add: Net Profit		31 800	531 800
<u>Non- current Liabilities</u>			
Bank loan			50 000
<u>Current Liabilities</u>			
Creditors		13 000	
Accrued bank loan interest		4 500	17 500
Total Equity and Liabilities			599 300



Business of Ravi
Statement of Financial Position
As at 31.12.2015

<u>Non-current assets</u>	Cost (Rs.)	Accumulated Depreciation (Rs.)	Net Book Value (Rs.)
<u>Current Assets</u>			
<u>Equity</u>			
<u>Non- current Liabilities</u>			
<u>Current Liabilities</u>			

Step 03

Enter the adjusted balances in the relevant sections of the financial statements.

The additional information provides the information for adjustments. Therefore, read additional information and adjust the given balances in the trial balance accordingly. When you adjust the given balances, make a note of workings in the trial balance. Then straight away enter the adjusted balances in the relevant sections of the financial statements.

For instance, the second point of the additional information on this question asks to adjust machinery depreciation. According to the question, the machinery should be depreciated annually at 10% on the straight-line method. So, we need to calculate 10% of the cost of machinery. The cost of machinery is Rs. 150 000. 10% of Rs. 150 000 is Rs. 15 000. Therefore, annual machinery depreciation is Rs. 15 000. Machinery depreciation is an administration expense. So, we need to enter the annual depreciation of machinery of Rs. 15 000 in the statement of profit or loss under the section of administration expenses.

Then check for any provisions of machinery depreciation. In this trial balance, there are no provisions for machinery depreciation. So, it is clear that this asset (machinery) has not been depreciated in the previous years. As a result, Rs. 15 000 should be entered in the statement of financial position under the section of non-current assets in the accumulated depreciation column.

Workings for machinery depreciation in the trial balance

	Debit (Rs.)	Credit (Rs.)
Capital.....		500 000
Stock (as at 01.01.2015).....	10 000	
Purchases.....	280 000	
Sales		350 000
Debtors	30 000	
Creditors		13 000
15% bank loan		50 000
Land and Building (at cost)	400 000	
Machinery (at cost)	150 000	$\times \frac{10}{100} = 15\ 000\text{ AE} + \text{AD}$
Bank loan interest	3 000	
Administrative salary.....	14 000	
Discount allowed	3 200	
Discount received.....		5 000
Rate	8 000	
Advertising	12 500	
Cash in hand	7 300	
	<u>918 000</u>	<u>918 000</u>

AE – Administration expenses + AD – Accumulated depreciation

Next, the question requires to adjust bad debts. Here, we need to deduct bad debts amount (Rs. 3 000) from the debtors' amount (Rs. 30 000). Consequently, the net debtors will become Rs. 27 000. The net debtors' amount should be shown under the current assets in the statements of financial position. Bad debt is a distribution expense. Therefore we enter Rs. 3000 of bad debts in the statements of profit or loss under distribution expenses.

Workings for bad debts in the trial balance

	Debit (Rs.)	Credit (Rs.)
Capital.....		500 000
Stock (as at 01.01.2015).....	10 000	
Purchases.....	280 000	
Sales		350 000
Debtors	30 000 – 3 000 DE = 27 000 CA	
Creditors		13 000
15% bank loan		50 000
Land and Building (at cost)	400 000	
Machinery (at cost)	150 000	
Bank loan interest	3 000	
Administrative salary.....	14 000	
Discount allowed	3 200	
Discount received.....		5 000
Rate	8 000	
Advertising	12 500	
Cash in hand	7 300	
	<u>918 000</u>	<u>918 000</u>

Step 04

Enter the rest of the balances and finalize the financial statements.

After you enter the adjusted balances, entering the rest of the balances is so easy. However, try to enter the balances under non-current assets and obtain the total net book value of non-current assets first. This is because the total net book value of non-current assets received 1/2 marks most of the time. Next, try to finalize the profit or loss statement to find out the net profit

amount. Enter the rest of the balances from the beginning of the profit or loss statement.

Once you find the next profit, add that net profit to the capital balance and find the equity amount. Then, finalize the statement of financial position by entering the rest of the balances. Consequently, the statement of financial position will balance at Rs. 599 300. This means total assets will be equal to the total equity and liabilities of Ravi's business at Rs. 599 3 00.

The followings are the finalized financial statements of Ravi's business.

Business of Ravi
Statement of Profit or Loss
For the year ended 31.12.2015

	Rs.	Rs.	Rs.
Sales			350 000
Less: Cost of Sales			
Stock as at 01.01.2015		10 000	
Purchases		280 000	
Cost of goods presented for sales		290 000	
Less: Closing stock		(30 000)	(260 000)
Gross profit			90 000
Add: Other income			
Discount received			5 000
			95 000
Less: Expenses			
<u>Distribution Expenses</u>			
Bad debts	3 000		
Discount allowed	3 200		
Advertising	12 500	18 700	
<u>Administration Expenses</u>			
Machinery depreciation	15 000		
Administrative salary	14 000		
Rate	8 000	37 000	
<u>Financial Expenses</u>			
Bank loan interest		7 500	(63 200)
Net Profit transferred to the capital account			31 800

Business of Ravi
Statement of Financial Position
As at 31.12.2015

<u>Non-current assets</u>	Cost (Rs.)	Accumulated Depreciation (Rs.)	Net Book Value (Rs.)
Land and buildings	400 000	-	400 000
Machinery	150 000	15 000	135 000
	550 000	15 000	535 000
<u>Current Assets</u>			
Closing stock		30 000	
Debtors		27 000	
Cash in hand		7 300	64 300
Total Assets			599 300
<u>Equity</u>			
Capital		500 000	
Add: Net Profit		31 800	531 800
<u>Non- current Liabilities</u>			
Bank loan			50 000
<u>Current Liabilities</u>			
Creditors		13 000	
Accrued bank loan interest		4 500	17 500
Total Equity and Liabilities			599 300

