	Rs.	Rs.'
Insurance	8,000	
Rent, Rates and Taxes (50% Factory)	24,000	
Postage and Telegram	5,600	
Miscellaneous Expenses	3,200	
Travelling and Conveyance (50% Factory)	7,000	
Carriage Outwards	5,200	
Machinery	80,000	
Furniture	10,000	
Debtors	1,20,000	
Creditors		1,07,000
	10,51,000	10,51,000

The Closing Stocks are as follows:

Raw Materials	80,000
Work-in-Progress	24,000
Finished Goods	16,000

(Answer; Cost of Production Rs. 6,26,750; Gross Profit Rs, 1,41,250; Net Profit Rs. 79,000; Balance Sheet Total Rs. 3,30,000).

> Note: These questions will help you to understand the unit better. Try to write answer for them. But do not submit your answers to the University for assessment. These are for your practice only.

UNIT 8 FINAL ACCOUNTS II

Structure

8.0 OBJECTIVES

After studying this unit you should be able to:

- explain why adjustment entries are necessary at the time of preparing the final accounts
- list the items in respect of which adjustments are usually made
- pass the necessary adjustment entries
- prepare final accounts with adjustments.

8.1 INTRODUCTION

In Unit 7 you learnt about the preparation of simple final accounts. They did not involve any adjustments. In practice, however, you are always required to make some adjustments while preparing the final accounts. It is because there may be many expenses and incomes relating to the current year which are still to be brought into the books of account. Then there may be certain items recorded in current year's books which actually relate to the previous year or the next year. Unless such items are duly adjusted in the books of account, the final accounts will not reveal the true and fair view of the state of affairs of the business. In this unit you will learn about all items which require adjustments and study how such adjustments are made in books of account and how they are incorporated in the final accounts.

8.2 NEED FOR ADJUSTMENTS

You know that the financialreporting requires tlie summarisation of business operations for a specific accounting period. It is quite possible that certain transactions recorded in current year's books may partly relate to the previous year or to the following year. It is also possible that certain expenditure incurred during the current year has not yet been paid and so not recorded. Siinilarly, there may be certain incomes earned during the current year which have not been recorded because they have not yet been received. If such items are not adjusted or brought into current year's books of account, the summary presented in the form of final accounts will not reveal the true picture. Let us take the example of an amount of Rs. 600 paid on July 1,1987 towards insurance premium. You know any general insurance usually covers a period of twelve months. Suppose the accounting year is ending on December 31, 1987 it would mean that half the amount of insurance premium paid on July 1,1987 pertains to the next accounting year i.e., 1988. Therefore, while preparing the final accounts of 1989, the expenditure on insurance premium that should be debited to the Profit and Loss Account is Rs. 300 (Ks. 600 paid - Rs. 300 pertaining to 1988). The remaining amount of Rs. 300 will he carried forward and charged to the Profit and Loss Account of 1988. Take another example. The wages of workers for the month of December, 1989 were paid on January 7, 1988. This means tlie Wages Account of 1987 does not include the wages for the month of December 1987. Such unpaid wages termed as 'Wages outstanding' have to be brought into the books and debited to the Trading Account along with the wages already paid. Similarly, adjustment may also become necessary in respect of certain incomes received in advance or those which are outstanding as at the end of tlie accounting year. Apart from these, there are certain items which cannot be recorded on day-to-day basis such as depreciation, interest on capital, etc. They are generally adjusted at the time of preparing the final accounts. All items which need alteration or which are to be brought into books at the time of preparing final accounts are called 'adjustments'. The purpose of making various adjustments is to ensure that the final accounts reveal the true financial position of the business. Therefore, when you are to prepare the final accounts of any business, you are provided with a Trial Balance and some additional information in respect of the adjustments to be made.

8.3 TREATMENT OF ADJUSTMENTS IN FINAL ACCOUNTS

There are several items which need adjustment at tlie tirne of preparing the final accounts. Some of the important and common adjustments are listed below:

1 Closing Stock
2 Outstanding or Accrued Expenses
3 Prepaid or Unexpired Expenses
4 Outstanding or Accured Incomes
5 incomes Received in Advance (Unearned Income)
6 Depreciation
7 interest on Capital
8 Interest on Drawings
9 Interest on Loan
10 Bad Debts
11 Provision for Bad Debts
12 Provision fur Discount on Debtors
13 Provision fur Discount on Creditors
14 Manager's Commission
15 Abnormal Loss
16 Drawing of Goods by the Proprietor

Let us now discuss tlie nature of each item of adjustment and its treatment in the final accounts. In this connection you must remember that the general principle of double entry has to be fully followed. Hence, for bringing any item into the books of account or adjusting the amount of any expense or income, you have to ensure that the amount is debited to one account and credited to another; and while showing it in the final accounts the item should appear at two places, one representing the debit and the other representing the credit, otherwise the Balance Sheet will not tally. Usually, **each adjustment will first** appear in the Trading **and Profit** and **Loss** Account and then in the Balance Sheet.

8.3.1 Closing Stock

You know that all goods purchased or produced during the year are not completely sold-aut by the end of the year. Some goods always remain unsold as at the end of the year which are called 'Closing Stock'. The Closing Stock does not usually appear in the Trial Balance. It is mostly given in the form of additional information. Since Gross Profit/Gross Loss cannot be worked out without accounting for the closing stock it is brought into books by means of the following adjustment entry.

Closing Stock A/c Dr.
To Trading A/c

The closing stock is treated in the final accounts as follows:

i) On the credit side of Trading Account: shown as a separate item, and
ii) On the assets side of the Balance Sheet: shown as a separate item under Current Assets.

Adjusted Purchases and Closing Stock: Sometimes the closing stock may be given in the Trial Balance itself. This would mean that both the opening and the closing stocks have been adjusted in the purchases. In such a situation, the opening stock will not appear in the Trial Balance. The Trial Balance will show only the figures of adjusted purchases and the closing stock. The adjusted purchases are in fact the cost of goods sold. They have been worked out by adding the opening stock to purchases and subtracting the closing stock therefrom. Hence, the adjusted Purchases are shown on the debit side of the Trading Account. In such a situation there is no need to show closing stock in the Trading Account as it already stands adjusted in purchases. It will be shown only on the asset side of the Balance Sheet.

8.3.2 Outstanding Expenses

Outstanding expenses are those expenses which have been incurred during the current accounting year but have not been paid till the end of the year. They are also called 'expenses accrued'. The common examples of such expenses are the salaries, wages and rent for the last month of the accounting year paid in the first month of the next year. Since they remained unpaid as at the end of accounting year, no entry might have been passed in the books of account. So, they must be taken into account while preparing the Trading and Profit and Loss Account otherwise it will not reveal the correct amount of profit or loss. The following adjustment entry is passed in respect of outstanding expenses.

Concerned Expense A/c Dr.
To Outstanding Expenses A/c

The outstanding expenses will be treated in final accounts as follows:

i) Added to the concerned expenses in the Trading and Profit and Loss Account, and
ii) Shown on the liabilities side of the Balance Sheet as a separate item under Current Liabilities.

8.3.3 Prepaid Expenses

Sometimes, the bedefit of some expenses will be available not only in the current accounting year but also during the next year. That portion of expense the benefit of which is yet to be received is called 'prepaid expense'. It is also called 'unexpired expense'. Examples of such expenses are unexpired insurance, interest paid in advance, etc. In such situations it is necessary to find out the unexpired portion and adjust it in the concerned'expense. The following adjustment entry is passed in respect of the prepaid expenses:

Prepaid Expenses A/c Dr.
To Concerned Expense A/c

The Prepaid expenses will be treated in final accounts as follows:

i) Subtracted from the concerned expense in the Trading and Profit and Loss Account, and
ii) Shown on the assets side of the Balance Sheet as a separate item under Current Assets.

8.3.4 Accrued Income

Accrued Incomes are those incomes which have been earned during the current accounting year but have not been received till the end of the year. They are also called 'outstanding incomes' or 'incomes earned but not yet received'. Examples of such incomes are commission receivable, income on investments due but not yet received, etc. The following adjustment entry is passed in respect of accrued income.

Accrued Income A/c	Dr.
To Concerned Income A/c	

The Accrued income is treated in final accounts as follows:

i) Added to the concerned income in the Profit and Loss Account, and
ii) Shown on the asset side of the Balance Sheet as a separate item under Current Assets.

8.3.5 Income Received in Advance

Any income which belongs to the next accounting year but has been received during the current accounting year is called 'income received in advance' or 'unearned income'. It is the income in respect of which the service is yet to be provided. Examples of such incomes arc rent received in advance, interest received in advance, etc. In such a situation, the unearned portion of the income will have to be adjusted while preparing the final accounts. The following adjusting entry is passed in respect of the unearned income.

Concerned Income A/c	Dr.
To Income Received in Advance A/c	

The unearned income is treated in final accounts as foilows:

i) Deducted from the concerned income in the Profit and Loss Account, and
ii) Shown on the liabilities side of the Balance Sheet as a separate item under Current Liabilities.

Look at Illustration 1 and see how adjustments are made in the final accounts in respect of outstanding expenses, prepaid expenses, outstanding incomes and incomes received in advance.

Illustration 1

Show how you will record the following items in the Profit and Loss Account and the Balance Sheet.

The Trial Balance showed the following balances as on December 31,1987:

	Rs.
Salaries	10,000
Wages	20,000
Rent Received	6,600
Commission Received	
Interest on Investments	6,000

Additional Information

i) Salaries amounting to Rs. 2,000 are outstanding.
ii) Wages include Rs. 1,500 paid in advance.
iii) Interest on investment include Rs. 1,200 for the months of January, February and March, 1988.
iv) Rent for the month of December amounting to Rs. 600 is not yet received.

Gross Profit for the year is Rs. 40,000 and other expenses amounted to Rs. 10,000.

Profit and Loss Account
for the year ended December 31, 1987

Dr. **Cr.**

Particulars		Amount	Particulars		Amount
		Rs.			Rs.
To Salaries	10,000				
Add Outstanding	2,000		By Gross Profit b/d		40,000
		12,000	By Rent Received	6,600	
To Wages	20,000		Add Outstanding	600	
Less Prepaid	1,500				7,200
		18,500			
To Other Expenses		10,000	By Commission Received		2,000
To Net Profit (transferred to Capital A/c)		13,500	By Interest on Investments	6,000	
			Less Received in Advance	1,200	
					4,800
		54,000			54,000

Balance Sheet
as on December 31, 1987

Liabilities	Amount	Assets	Amount
	Rs.		Rs.
Current Liabilities:		Currents Assets:	
Salaries Outstanding	2,000	Wages Prepaid	1,500
Interest Received in Advance	1,200	Rent Outstanding	600

8.3.6 Depreciation

Depreciation means decrease in the value of fixed assets due to their usage and the passage of time. You know the fixed assets are used for the purpose of earning revenue. Therefore, the fall in their value should be considered as an expense or loss incurred in realising such revenue and should be charged to the Profit and Loss Account, Depreciation is not recognised on day-to-day basis. It is brought into the books only at the end of the accounting period by passing the following journal entry.

Depreciation A/c Dr.
To Concerned Asset A/c

Depreciation is treated in final accounts as follows:

i) On the debit side of the Profit and Loss Account: shown as a separate item giving details of depreciation on each fixed asset, and
ii) Deducted from the concerned asset in the Balance Sheet.

Sometimes depreciation is given in the Trial Balance itself. This is possible only if the entry in respect of depredation has already been passed in the books of account. **In such a situation depreciation will be shown in the Profit and Loss Account only.** It need not be adjusted in the fixed assets in the Balance Sheet because the fixed assets already stand reduced by the amount of depredation.

Depreciation is generally calculated at the given rate for the period for which the asset has been used in the accounting year. Thus, if an asset is purchased during the current year the depreciation should be calculated from the date of acquisition till the end of the year. If the date on which the additions were made is not given, you should calculate depreciation on additions also for the full year. In the case of old assets, depredation is calculated on the opening balance. Look at Illustration 2 and study how depreciation is treated at the time of preparing the final account.

Illustration 2

The following are the balances of assets as on January 1, 1987:

	Rs.
Plant and Machinery	1,20,000
Furniture	68,000

A new machinery costing Rs. 30,000 was acquired on July 1,1987. Depreciation is to be provided on Plant and Machinery at 10% and on furniture at 5% per annum. Show how depreciation will be shown in the final accounts.

Solution:

Calculation of Depreciation

		Rs.
On Furniture at 5% on Rs. 18,000,		900
On Plant and Machinery:		
10% on Rs. 1,20,000 for one year	12,000	
10% on Rs. 30,000 for six months	1,500	13,500
		14,4000

Treatment in Final Accounts

Profit and Loss Account
for the year ended December 31, 1981

Dr. Cr.

Particulars		Amount	Particulars	Amount
		Rs.		Rs.
To Depreciation:				
Plant and Machinery	13,500			
Furniture	900	14,400		

Balance Sheet
as on December 31, 1981

Liabilities	Amount	Assets		Amount
	Rs.			Rs.
		Fixed Assets:		
		Plant and Machinery	1,20,000	
		Add New Machinery	30,000	
			1,50,000	
		Less Depreciation	13,500	1,36,500
		Furniture	18,000	
		Less Depreciation	900	17,100

8.3.7 Interest on Capital

You know the funds provided by the proprietor to the business constitute **capital**. Sometimes, the proprietor may like to know the profits made by the business after taking into consideration the interest on this capital. In such a situation interest is allowed at a certain rate on the capital. It is calculated on the capital at the beginning of the year. If, however, any additional capital is introduced during the year, interest on additional capital will also be calculated from the date on which it was brought into the business. Such interest is treated as an expense for the business and the following adjustment entry is passed to bring it into the books of account.

Interest on Capital A/c Dr.
To Capital A/c

Interest on capital is treated in final accounts as follows:

i) On the debit side of Profit and Loss Account: shown as a separate item of expense and
ii) Added to Capital on the liabilities side of Balance Sheet. You should note that normally no interest on capital is to be provided.

8.3.8 Interest on Drawings

In case interest is allowed to the proprietor on his capital, it is a usual practice to also charge interest on his drawings. Interest on drawings will be a gain for the business and the following adjustments entry is passed to bring it into the books of account.

Capital A/c or Drawings A/c Dr.
To Interest on Drawings A/c

Interest on Drawings is treated in final accounts as follows:

i) On the credit side of Profit and Loss Account: shown as a separate item, and
ii) Deducted from Capital on the liabilities'side of Balance Sheet.

Interest on drawings is calculated at a given rate from the date of withdrawal till the end of the year. In case no date is mentioned, the interest is charged for six months assuming the amounts were drawn evenly throughout the year, Look at Illustration 3 and see how interest on drawings is calculated when the amount and the dates of withdrawal are given.

Illustration 3

	Rs.
Feb. 1	4,000
Apr. 1	6,000
Jul. 1,	3,000
Oct,' 31	2,000
Dec. 31	5,000

Calculate the interest chargeable to the proprietor if the rate of interest on drawings is 15% per annum.

Solution:

Date (1)	Amount (2)	Months upto December 31 (3)	Product 2 x 3 (4)
Feb, 1	4,000	11	44,000
Apr. 1	6,000	9	54,000
Jul. 1	3,000	6	18,000
Oct. 31	2,000	2	4,000
Dec. 31	5,000	0	0
			1,20,000

Interest on Drawings $= \frac{15}{100} \times 1{,}20{,}000 \times \frac{1}{12} =$ Rs. 1,500.

Another way of calculating interest on drawings is to calculate it individually on each withdrawal and then add them.

8.3.9 Interest on Loan

If the firm has taken some loan, it has to pay interest theron. Hence, when we notice a loan Account in the Trial Balance, we must find out whether the full amount of due on loan has been paid or not. The rate of interest and the date on which the loan was taken is usually given. If, however, the date on which loan was taken is not given, it means that it is an old loan and full year's interest has to be provided. In any case, you should calculate the exact amount of interest due and find out from the Trial Balance whether the same has been paid or not. Generally, you will find that the interest has been paid but it is less than what is due. In such a situation, the difference is regarded as outstanding interest and the same must be adjusted at the time of preparing the final accounts. Suppose there is an item of 10% loan (taken on April 1,1987) of Rs. 20,000 appearing in the Trial Balance. Assuming the accounting year ends on December 31, the total interest on loan will work out as Rs. 1,500 (at 10% on Rs. 20,000 for nine months). On going through the Trial Balance you find that the interest paid is Rs. 1,000 only. It means Rs. 500 (Rs. 1,500 – Rs. 1,000) is the outstanding interest. This must be shown in final accounts accordingly i.e., Rs. 1,500 (Rs. 1,000 + Rs. 500 outstanding) as interest on loan on the debit side of the Profit and Loss Account and Rs. 500 as outstanding interest under current liabilities in the Balance Sheet.

It is possible that the adjustments given outside the Trial Balance already include this item. But, if they do not even then you have to account for it. This is called an implied adjustment.

Check Your Progress A

1 Fill in the blanks

i) Every adjustment has a ———— effect.
ii) Closing stock is shown on the ———— side of the Balance Sheet.
iii) Prepaid expenses are also called ———— expenses.
iv) Income received in advance is ———— for the business.
v) ———— is a decrease in the value of a fixed asset due to wear and tear.
vi) Interest on Drawings is ———— from the capital in the Balance Sheet.'

2 State whether the following statements are True or False.

i) Every adjustment affects either Trading and Profit and Loss Account or the Balance Sheet.
ii) Outstanding expense is first added to the relevant expense account and then shown on the liabilities side of the Balance Sheet.
iii) Interest on loan is an income for the business.
iv) Depreciation is deducted from the relevant fixed asset in the Balance Sheet and debited to Profit and Loss Account.
v) Proprietor is always entitled to interest on the capital invested.

8.3.10 Bad Debts

Sometimes, a debtor may fail to gay his debt either partially or completely. The amount of debt which cannot be recovered from the debtor is called Bad Debts and it will be a loss to the business. The following journal entry is passed when a debt becomes bad.

Bad Debts A/c	Dr.
To Concerned Debtor's A/c	

The effect of this entry will be (i) debtor's personal account stands, closed, and (ii) a new account called 'Bad Debts Account' is opened in the books.

The total amount of bad debts incurred during the year appears as a separate item in the Trial Balance and the sundry debtors appear at the reduced amount. The bad debts like any other expense or loss are charged to the Profit and Loss Account.

Bad Debts given outside the **Trial Balance:** Sometimes, the bad debts to be written off may be stated outside the Trial Balance as an adjustment item. It means that such bad debts have not yet been written off. In other words, the entry for such bad debts has not been passed. It is necessary to record such bad debts at the time of preparing the final accounts. This is done by passing the following adjustment entry:

Bad Debts Account	Dr.
To Sundry Debtors	

Such additional bad debts usually called **'further bad debts'** are treated in final accounts as follows:

i) On the debit side of Profit and Loss Account: shown as addition to bad debts already written off, and
ii) On the assets side of the Balance Sheet: shown as deduction from Sundry Debtors.

It is important to remember the difference between the treatment of bad debts given inside the Trial Balance and the bad debts given outside the Trial Balance. The bad debts given inside the Trial Balance and also those given outside the Trial Balance will be shown in the Profit and Loss Account. But only those bad debts will be deducted from Sundry Debtors in the Balance Sheet which are given outside the Trial Balance.

8.3.11 Provision for Bad Debts

In any business where goods are sold on credit, bad debts usually occur. When it is certain that a debt will not be recovered, the amount is written off as bad debt. But, it is also likely that some of the remaining debts may not be recovered in full. From experience we know that certain percentage of amounts due from debtors may not be recovered. This will be a loss to the business. You have learnt that accordingly to 'conservatism concept' all possible losses must be provided for. Hence, it is a common practice to make a suitable provision for doubtful debts at the time of preparing the final accounts. Otherwise, the Profit and Loss Account will not reveal the correct amount of profit or loss and the Balance Sheet will not show the true position of sundry debtors. The Provision for doubtful debts is usually calculated as a certain percentage of the total amount due from sundry debtors after writing of all known bad debts.

Provision for doubtful debts is also called 'Provision for Bad Debts' or 'Provision for Bad and doubtful Debts. Such a provision is made by debiting the amount of doubtful debts to the Profit and Loss Account, Thus, the journal entry for creating such provision will be as follows:

Profit and Loss A/c	Dr.
To Provision for Bad Debts A/c	

You will notice that when a debt is irrecoverable it is written off by crediting it to the personal account of the respective customer. But, when a debt is doubtful of recovery, the personal account of the customer will not be credited as the recovery is still possible. Hence, the creation of provision for bad debts does not affect the balance of debtors personal accounts. However, while showing sundry debtors in the Balance Sheet the amount of such provision is subtracted therefrom.

When provision for bad debts already exists in the books, the provision created for doubtful debts at the end of a particular year will be carried forward to the next year and it will be used for meeting the loss due to bad debts incurred during the next year. The provision for bad debts brought forward from the previous year is called 'opening provision' or 'old provision'. When such provision already exists, the loss due to bad debts during the current year will be adjusted against the same, and while making provision for bad debts required at the end of the current year called 'new provision' the balance of old provision should also be taken into account. Let us take an example and understand how these adjustments are done. Suppose old provision on January 1, 1987 was Rs.1,000. The bad debts written off during 1987 amounted to Rs.600 and the new provision required on December 31,1987 is Rs. 1,500, In such a situation, the Profit and Loss Account will be debited with Rs. 1,100 as calculated below:

	Rs.
Existing Provision for Bad Debts	1,000
Less Bad Debts	600
Surplus provision available	400
Provision required at the end of the year	1,500
Less Surplus of old provision	400
Amount to be debited to Profit and Loss Account	1,100

The above aspects will be shown on the debit side of the Profit and Loss Account as follows:

Profit and Loss Account
of the year ended.........

Dr.		Rs.		Rs. Cr.
To Provision for Bad Debts:				
Bad Debts	600			
Add New Provision	1,500			
	2,100	1,000		
Less Old Provision		1,100		

If however, the total of new provision and the actual bad debts are less than the old provision, the details will be shown on the credit side of the Profit and Loss Account as follows:

Profit and Loss Account
for the year ended...........

Dr.	Rs.			Rs. Cr.
		By Provision for Bad Debts,		
		Old Provision	......	
		Less Bad Debts	......	
			......	
		Less New Provision	......	
				....

In this **connection** you should note the following points.

1 If some bad debts are given in adjustments (further bad debts) they should also **be taken** into account.
2 The **new** provision should be calculated on sundry debtors after adjusting the **amount** of further bad debts.
3 In Balance Sheet **only** the further bad debts as given in adjustments and the **new** provision for bad debts should be subtracted from sundry debtors.

The following are the journal entries required when the provision for bad debts exists in the books:

a) **For writing off further bad debts given outside the Trial Balance:**
Bad Debts A/c Dr.
To Sundry **Debtors**

b) **For transferring the total bad debts to the provision for Bad Debts Account:**
Provision for Bad debts A/c Dr.
To Bad **Debts** A/c

c) **For debiting the Profit and Loss Account with the excess of the new pr-**
the total bad debts over the old provision:
Profit and Loss Account A/c Dr,
To Provision for Bad Debts A/c

d) For crediting the Profit and Loss Account with excess of the old provision over the total bad debts plus new provision:

Provision for Bad Debts A/c Dr.
To Profit and Loss A/c

Look at Illustration 4 and see how bad debts and provision for bad debts are recorded in the final Accounts.

Illustration 4

An extract from a trader Trial Balance on December 31,1987 is given below:

Name of the Account	Dr.	Cr.
	Re.	Rs.
Sundry Debtors	64,000	
Bad Debts	4,000	
Provision of Bed Debts		7,000

Adjustments: Write off further bad debts Rs. 2,000 and create a provision for doubtful debts at 5% on debtors. Pass the necessary journal entries and show Bad Debts and Provision for Bad Debts Accounts. Also show their treatment in the final accounts.

Journal

Date	Particulars		Rs.	Rs.
1987 Dec. 31	Bad Debts A/c	Dr.	2,000	
	To Sundry Debtors			
	(Being bad debts written off)			2,000
" 31	Provision for Bad Debts A/c	Dr.	6,000	
	To Bad Debts A/c			6,000
	(Being bad debts transferred to Provision for Bad Debts Account)			
" 31	Profit and Loss A/c	Dr.	2,100	
	To Provision for Bad Debts A/c			2,100
	(Being the Provision required for doubtful debts)'			

Dr. **Bad Debts Account** Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
1987 Dec. 31	To Balance b/d	4,000	1987 Dec. 31	By Prov. for Bad Debts A/c	6,000
" 31	To Sundry Debtors	2,000			
		6,000			6,000

Provision for Bad Debts Account

Date	Particulars	Rs.	Date	Particulars	Rs.
1987 Dec. 31	To Bad Debts A/c	6,000	1987 Jan. 1	By Balance b/d	7,000
,, 31	To Balance c/d	3,100	Dec. 31	By Profit and Loss A/c	2,100
		9,100			9,100
			1988 Jan. 1	By Balance b/d	3,100

Note: The new provision for bad debts has been calculated at 5% on Rs. 62,000 (sundry debtors Rs. 64,000—further bad debts Rs. 2,000).

Profit and Loss Account
for the year ended December 31, 1987

		Rs.		Rs.
To Provision for Bad Debts:				
Bad Debts	4,000			
Add Further Bad Debts	2,000			
Add New provision,	3,100			
Less Old	9,100			
Provision	7,000	2,100		

Balance Sheet
as at December 31, 1987

	Rs.			Rs.
		Current Assets:		
		Sundry Debtors	64,000	
		Less Further Bad Debts	2,000	
			62,000	
		Less Provision Bad Debts	3,100	58,900

8.3.12 Provision for Discount on Debtors

You know cash discount is allowed to debtors as an incentive for prompt payment. When the discount is allowed it is recorded through the Cash Book and posted to the credit side of the concerned debtor's personal accounts. But, in the case of debts outstanding at the end of the current year, discounts will be allowed in the next year if the debtors make prompt payments. So, as in the case of anticipated loss on account of doubtful debts, a provision must be made for the discount likely to be allowed to the debtors in the next year, such a provision is known as the 'Provision for Discount on Debtors' it is also calculated as a percentage on the net sundry debtors (remaining after subtracting the provision for bad debts and further bad debts). For example, if Sundry Debtors amount to Rs. 40,000 and the firm wants to create a provision for bad debts at 5% and a provision for discount at 2% on the debtors they will be calculated as follows:

i) The Provision for bad debts will be calculated at 5% on Rs. 40,000. It will amount to Rs. 2,000.
ii) The Provision for discount at 2% will be calculated on the debtors after subtracting the provision for bad debts i.e., on Rs. 38,000 (Rs. 40,000 – Rs. 2,000). It will amount to Rs. 760.

Note that when both provision for bad debts and provision for discount on debtors are to be calculated, the provision for bad debts is calculated first and then provision for discount is worked out on debtors after subtracting the provision for bad debts.
The adjustment entry for provision for discount on debtors is as follows:

Profit and Loss A/c Dr.
To Provision for Discount on Debtors A/c
(Being the Provision made for discount on debtors)

The Provision lor discount on debtors will be shown in the final accounts as follows:

i) On the debit side of Profit and Loss Account: shown as a separate item, and
ii) On the assets side of Balance Sheet: shown as a deduction from Sundry Debtors.

The balance of the provision for Discount on Debtors Account will be carried forward to the next year and the discounts allowed if any, in the next year will be set off against the provision for itself. The method of dealing with discounts allowed and provision for discount on debtors in the next year is similar to the method followed in case of bad debts and provision for bad debts.

8.3.13 Provision for Discount on Creditors

When prompt payment is received we allow cash discount to debtors. Similarly, we receive discount from the creditors when prompt payments are made by us. So the expected gain on account of discounts receivable from creditors in the next year should also be taken into account at the time of preparing the final accounts. Such a provision is called 'Provision for Discount on Creditors'.

It is calculated as a percentage on Sundry Creditors. The creation of such a provision, however, goes against the Conservatism Concept. Hence, it is usually avoided in practice. But you must learn how it is treated in final accounts if such a provision is required.

The adjustment entry for provision for discount on creditors is passed as follows:

Provision for Discount on Creditors A/c	Dr.
To Profit and Loss Account	
(Being the Provision made for discount on creditors)	

The provision for discount on creditors will appear in the final accounts as follows:

i) On the credit side of Profit and Loss Account: shown as a separate item, and
ii) On the liabilities side of the Balance Sheet: shown as a deduction from Sundry Creditors.

The balance of the Provision for Discount on Creditors Account will also be carried forward to the next year and the discount received, if any, will be adjusted against the provision itself.

8.3.14 Manager's Commission

Sometimes, the manager may also be entitled to a commission on profits earned by the business. Such commission is usually calculated as a fixed percentage on profits. Suppose the Net Profit of a firm after taking into consideration all expenses except the manager's commission is Rs. 60,000 and the manager is entitled to a commission of 5% on profits before charging such commission. His commission will work out as Rs. 3,000. However, it is still to be paid and therefore should be treated as an outstanding expense. It will be debited to Profit and Loss Account and also shown as a current liability in the Balance Sheet.

In the above example, manager's commission has been calculated on profits before charging the commission. But, sometimes, it is to be calculated on prfoit after charging such commission. In such a situation, the commission will be calculated by the following formula:

$$\frac{\text{Percentage of Commission}}{100 + \text{percentage of Commission}} \times \text{Net Profit before Commission}$$

If, in the above example, the manager's commission were to be calculated on profits after charging such commission, it will be as follows.

$$\frac{5}{100+5} \times 60{,}000 = \frac{5}{105} \times 60{,}000 = \text{Rs. } 2{,}857$$

The above amount can also be verified. After charging manager's commission the Net Profit will work out to Rs. 57,143 (Rs. 60,000 − Rs. 2,857). Now calculate 5% on Rs. 57,143. It works out to Rs. 2,857 which means the amount of commission calculated by the given formula is correct.

8.3.15 Abnormal Loss of Stock

In the course of business some loss of stock may also occur. It may occur in transit or at the godown. Such loss of stock may be normal or abnormal. Normal loss is due to inherent characteristics of goods such as evaporation, subdivision, drying up of goods, etc. On the other hand, if the loss occurs on account of seasons which are accidental or very rare, the loss is termed as abnormal loss, The examples of such losses are theft of goods, destruction of goods by fire, etc.

The normal loss does not require any special treatment in the books of account. It is absorbed by the remaining units whose cost is inflated by such loss. But, the abnormal loss has to be shown separately in the books of account. After the amount of such loss is ascertained, the following adjustment entry is passed.

Loss by Fire A/c Dr.
To Trading Account
(Being stock lost by fire)

To avoid the burden of loss due to abnormal circumstances the businessmen may get the stock insured. Thus, the loss may be

1 Uninsured,
2 Fully insured, or
3 Partially insured.

Let us see what wilt be the accounting treatment in the above three situations.

1 When the stock's is not insured: In case the stock is not insured the total abnormal loss will be transferred to the Profit and Loss Account and the following entry will be passed.

Profit and Loss A/c Dr:
To Loss by Fire A/c

2 When the stock is fully insured: When the stock is fully insured, the total amount of loss is paid by the insurance company. In that case the company does not suffer any loss. So, nothing is debited to the Profit and Loss Account. The journal entry passed is as follows.

Insurance Company Dr.
To Loss by Fire A/c

3 When the loss is partially insured: In case the loss is partially insured the amount of insurance claim is debited to Insurance Company's Account and the remaining loss (the amount to be borne by the business) is debited to Profit and Loss Account. The following journal entry is passed.

Insurance Company Dr.
Profit and Loss A/c Dr.
To Abnormal Loss A/c

Thus, the treatment of abnormal loss in final accounts is as follows.

a) Credit the Trading Account with the total loss.
b) i) In case of uninsured stock debit Profit and Loss Account with full amount.
ii) In case of fully insured loss, insurance claim will be shown as an asset in the Balance Sheet.
iii) In case of partially insured loss, the amount of insurance claim is shown as an asset in the Balance Sheet and the remaining amount of loss is debited to the Profit and Loss Account.

Look at Illustration 5 and see how abnormal loss is treated in the books of account.

Illustration 5

On December 30,1987 the stock worth Rs. 40,000 was destroyed by fire. The stock was insured and the insurance company admitted a claim of Rs. 30,000 only. Pass the necessary journal entries and show how it will be treated in final accounts.

Journal

Date	Particulars		Dr. Amount	Cr. Amount
1987			Rs.	Rs.
Dec. 31	Loss by Fire A/c To Trading A/c (Being stock lost by fire)	Dr.	40,000	40,000
" 31	Insurance Company Profit and Loss A/c To Loss by Fire A/c (Being partial claim admitted by Insurance Company)	Dr. Dr.	30,000 10,000	40,000

Trading Account
for the year ended December 31,11887

Dr.			Cr.
		By Loss by Fire	Rs. 40,000

Profit and Loss Account
for the year ending December 31, 1987

		Rs.		
To Lass by Fire	40,000			
Less insurance claim	30,000	10,000		

Balance Sheet
as at December 31, 1987

			Rs.
		Current Assets: Claim due from insurance company	30,000

8.3.16 Drawing of Goods by the Proprietor

You know when the proprietor takes away some goods from the business for his personal use it is recorded in books of account by passing the following journal entry (refer to Unit 2).

Drawings Account Dr.
To Purchases Account

So, if you find that it has not been recorded in the books of account, you have to make the necessary adjustment in final accounts. The treatment in final accounts will be as Follows:

i) On the Debit side of the Trading Account: Deduct it from Purchases.
ii) On the Liabilities side of the Balance Sheet: Deduct it from capital either as a separate item or by including it in drawings.

Check Your Progress B

1 Why do you create a provision for bad debts?

....

....

....

....

2 Why provision for discount on creditors is regarded against the Conservatism Concept?

....

....

....

....

3 The Trial Balance shows the following balances.

	Rs.
Debtors	20,000
Bad Debts	100
Provision for bad Debts	200

8.4 PREPARATION OF FINAL ACCOUNTS WITH ADJUSTMENTS

You know there are various items which require adjustment at the time of preparing the final accounts. You have learnt how each adjustment is recorded in books through a journal entry and how it is reflected in the final accounts. However, while preparing the final accounts with adjustments you should remember that there is no need to pass the Journal entries for any adjustment unless specifically asked to do so. All adjustments must be shown directly in the final accounts. Look at Illustration 6 and 7 and see how final accounts are prepared with adjustments.

Illustration 6

From the following Trial Balance of Gupta & Sons, prepare Trading and Profit and Loss Account for the year ended December 31,1987 and a Balance Sheet as on that date.

Trial Balance

Name of the Account	Debit Balances	Credit Balances
	Rs.	Rs.
Capital		5,00,000
Sales		10,00,000
Sales Returns	25,000	
Purchases	5,00,000	
Purchases Returns		15,000
Inventory as on 1.1.87	60,000	
Land & Buildings	4,00,000	
Plant & Machinery	3,00,000	
Furniture	1,00,000	
Wages	50,900	
Carriage Inwards	10,009	
Provision for Bad Debts		7,000
Carriage Outwards	5,000	
Cartage	5,000	
Salaries	40,000	
Loan		2,60,000
Debtors	1,50,000	
Creditors		70,000
Pent		8,000
Bills Receivable	40,000	
Acceptances		10,000
General Expenses	20,000	
Rent & Rates	10,000	
Investments	50,000	
Cash in hand	50,000	
Bank Overdraft		10,000
Discount	4,500	
Bad Debts	5,000	
Interest on Investments		5,000
Interest on Bank Overdraft	500	
Goodwill	60,000	
Total	18,85,000	18,85,000

Additional Information

1 The value of inventory on December 31,1987 was Rs. 1,00,000.
2 Depreciation is to be provided on: **Land** & Building @ 5% **p.a.** Furniture @ 10% **p.a. Plant** & Machinery Rs. 50,000.
3 Provision for Bad Debts is to be **maintained** @ 5% on debtors.
4 Wages are outstanding to the extent of Rs. 4,000 and **Salaries** to **the** extent of Rs. 3,000.
5 Rent and Rates are prepaid to the extent of **1/4th** of the amount paid.
6 Interest on Investment **outstanding** is Rs. 1,000.
7 Rent to the extent of Rs. 2,000 has been received in advance.

Solution:

Trading & Profit and Loss Account
lor the year ended December 31, 1987

Dr. Cr.

Particulars		Amount	Particulars		Amount
					Rs.
To Inventory as on 1.1.87		60,000	**By** Sates	10,00,000	
To Purchases	5,00,000		**Less** Sales Returns	25,000	9,75,000
Less Purchases Returns	15,000	4,85,000	By Inventory as on 31.12.87		1,00,000
To Wages	50.000				
Add Wages Outstanding	4,000	54,000			
To Carriage Inwards		10,000			
To Cartage		5,000			
To Gross Profit c/d		4,61,000			
		10,75,000			10,75,000
To Carriage Outwards		5,000	By **Gross Profit** b/d		4,61,000
To Salaries	40,000		By Rent	8,000	
Add Outstanding	3,000	43,000	**Less Received** in advance	2,000	6,000
To **General Expenses**		20,000	By **Interest** on Investment	5,000	
To Rent & Rates	10,000		Add Outstanding	1,000	6,000
Less Prepaid	2,500	7,500			
To Diiunt **Allowed**		4,500			
To Bad Debts	5,000				
Add New **Provision**	7,500				
	12,500				
Less Old Provision	7,000	5,500			
To Depreciation on Plant & Machinery		50,000			
To Interest on Overdraft		500			
To Depreciation					
Land & Building	[illegible]				
Furniture	20,000	30,000			
To Net **Profit** (transferred to Capital **A/c**)		3,07,000			
		4,73,000			4,73,000

Balance Sheet as on December 31, 1987

Liabilities		Amount	Assets		Amount
		Rs.			Rs.
Capital			**Fixed Assets**		
Balance	5,00,000		Goodwill		60,000
Add Net Profit	3,07,000	8,07,000	Land & Building	4,00,000	
			Less Depreciation	20,000	3,80,000
Long Term Liabilities			Plant & Machinery	3,00,000	
Loan		2,60,000	Less Depreciation	50,000	2,50,000
Current Liabilities			Furniture	1,00,000	
Creditors		70,000	Less Depreciation	10,000	90,000
Acceptances		10,000			
Bank Overdraft		10,000	Investments		50,000
Wages Outstanding		4,000	Current Assets		
Salaries Outstanding		3,000	Cash in hand		50,000
Rent Received in Advance		2,000	Debtors	1,50,000	
			Less: Provision for Bad Debts	7,500	1,42,500
			Bills Receivable		40,000
			Closing Stock		1,00,000
			Prepaid Rent & Rates		2,500
			Interest on Investment Outstanding		1,000
		11,66,000			11,66,000

Illustration 7

From the following balances extracted from the book of Aristo Ltd., prepare a Trading and Profit and Loss Account for the year ended December 31, 1987 and a Balance Sheet as on that date.

Trial Balance

Name of the Account	Debt Balances	Credit Balances
	Rs.	Rs.
Capital		2,00,000
Sales		5,00,000
Sales Returns	10.000	
Purchases	2,00,000	
Purchases Returns		10,000
Stock on 1.1.87	40,000	
Land & Buildings	2,00,000	
Plant & Machinery	1,00,000	
Wages	25,000	
Furniture	50,000	
Provision far Bad Debts		5,000
Salaries	25,000	
Debtors	82,800	
Creditors		1,00,000
Bad Debts	3,000	
Bills Payable		30,000
Investments	50,000	
General Expenses	20,000	
Cash in hand	5,000	
Cash at bank	15,000	
Depreciation on Land & Buildings		
	8,45,000	8,45,000

Additional Information

1 Thp inventory on 31.12.87 has been valued at Rs. 80,000. The inventory of the value of Rs 20,000 was destroyed by fire on 1.12.87 and a claim of Rs. 15,000 was admitted by the insurance company.

2 Depreciation is to be provided on Plant & Machinery and furniture at 10% per annum.

3 Debtors are bad to the extent of Rs. 2,000. Provision for bad debts is to be made at 5% on debtors and a provision for discount on debtors at 2%.
4 Wages are outstanding to the extent of Rs. 5,000.
5 Salaries are prepaid to the extent of Rs. 2,000.
6 Create a provision for discount on creditors at the rate of
7 Create a provision for repairs to the extent of Rs. 4,000.

Trading & Profit and Loss Account
for the year ended December 31, 1987

Dr. Cr.

Particulars		Amount	Particulars		Amount
		Rs.			Rs.
To Opening Stock		40,000	By Sales	5,00,000	
			Less Sales Returns	10,000	4,90,000
To Purchases	2,00,000				
Less Purchases Returns	10.000	1,90,000	By Closing Stock		80,000
			By Loss by Fire		20,000
To Wages	25,000				
Add Outstanding	5,000	30,000			
To Gross Profit c/d		3,30,000			
		5,90,000			5,90,000
To Salaries	25,000				
Less Prepaid	2,000	23,000	By Gross Profit b/d		3,30,000
			By Provision for Discount on Creditors		1,000
To Bad Debts	3,000				
Add Further Bad Debts	2,000				
Add New Provision	4,000				
	9,000				
Less Old Provision	5,000	4,000			
To General Expenses		20,000			
To Depreciation on Land & Buildings		20,000			
To Loss by Fire		5,000			
To Depreciation on Plant & Machinery		10,000			
To Depreciation on Furniture		5,000			
To Provision for Discount on Debtors		1,520			
To Provision for Repairs		4,000			
To Net Profit (transferred to Balance Sheet)		2,38,480			
		3,31,000			3,31,000

Balance Sheet as on December 31, 1987

Liabilities		Amount	Assets		Amount
		Rs.			Rs.
Capital	2,00,000		Land & Buildings		2,00,000
Add Net Profit	2,38,480				
		4,38,480	Plant & Machinery	1,00,000	
			Less Depreciation	10,000	90,000
Creditors	1,00,000		Furniture	50,000	
Less Provision			Less Depreciation	5,000	45,000
for Discount	1,000	99,000			
Bills Payable		30,000	Investments		50,000
Wages Outstanding		5,000	Cash in hand		5,000
Provision for Repairs		4,000	Cash at bank		15,000
			Closing Stock		80,000
			Debtors	82,000	
			Less Further Bad Debts	2,000	
				80,000	
			Less Provision for Bad Debts	4,000	
				76,000	
			Less Provision for Discount	1,520	74,480
			Insurance Claim Outstandings		15,000
			Salaries Prepaid		2,000
		5,76,480			5,76,480

Notes: 1 Depreciation on Land & Buildings is given in the Trial Balance. Hence, it is shown in the Profit and Loss Account only.
2 Provision for Bed Debts has been calculated at 5% on debtors after subtracting further bad debts.
3 Provision for Discount on Debtors has been calculated at 2% on debtors after subtracting further bad debts as well as provision for bad debts.
4 Loss by fire has been charged to Profit and Loss Account after taking into consideration the claim from insurance company.

8.5 ADJUSTMENTS GIVEN IN TRIAL BALANCE

You know that the adjustments are usually given outside the Trial Balance and they are shown at two places in the final accounts. But, sometimes a few adjustment items appear in the Trial Balance itself. In Illustration 7 you noticed it in respect of depreciation on Land & Buildings. It is possible that items like outstanding or prepaid insurance also appear in the Trial Balance. This happens when the journal entry in respect of an adjustment has already been passed and the same has been posted into the concerned ledger accounts. For example, when you pass journal entry for the adjustment for outstanding salaries, you will debit Salaries Account and credit Salaries Outstanding Account. The Salaries Account already exists in the ledger and the amount of outstanding salaries is also posted thereto. This leads to an increased balance in Salaries Account. But the Salaries Outstanding Account does not exist in the ledger. This will have to be opened and the outstanding amount credited thereto. When the Trial Balance is prepared, it will show the increased balance of Salaries Account in the debit balances column and the balance of Salaries Outstanding Account in the credit balances column. Now the question arises how to treat it in the final accounts. In such a situation, you will simply show Salaries Outstanding in the liabilities. No addition will be made to salaries in the Profit and Loss Account because salaries given in Trial Balance already include this amount. Thus, when salaries outstanding appear in the Trial Balance it is shown in final accounts only at one place. This applies to all items of adjustments when they are included in the Trial Balance.

In actual practice all adjustment items with the exception of closing stock are invariably incorporated in the Trial Balance before preparing the final accounts. The Trial Balance so prepared is called 'Final Trial Balance' or 'Adjusted Trial Balance'.

Look at *Chart* 8.1 and note how each item of adjustment is treated in final accounts. (i) if it is given outside the Trial Balance, and (ii) if it appears in the Trial Balance itself.

Chart 8.1
Treatment of Adjustment Items in Final Accounts

S. No.	Item	Treatment in Final Accounts: If given in Adjustments	Treatment in Final Accounts: If given in Trial Balance itself
1	Closing Stock	i) Credit side of Trading A/c: Shown as a separate item ii) Assets side of Balance Sheet: Shown as a separate item under Current Assets	Assets side of Balance Sheet only.
2	Outstanding Expenses	i) Debit side of Trading A/c or Profit and Loss A/c: Added to the concerned expense ii) Liabilities side of Balance Sheet. Shown as a separate item under Current Liabilities	Liabilities side of Balance Sheet only.
3	Prepaid Expenses	i) Debit side of Profit and Loss A/c: Deducted from the concerned expense ii) Assets side of Balance Sheet: Shown as a separate item under Current Assets	Assets side of Balance Sheet only.
4	Outstanding Incomes	i) Credit side of Profit and Loss A/c: Added to the concerned income ii) Asset side of Balance Sheet: Shown as a separate item under Current Assets	Assets side of Balance Sheet only.
5	Income Received in Advance	i) Credit side of Profit and Loss A/c: Deducted from concerned income ii) Liabilities side on Balance Sheet. Shown as a separate item under Current Liabilities	Liabilities side of Balance Sheet only.
6	Depreciation	i) Debit side of Profit and Loss A/c: Shown as a separate item ii) Assets side of Balance Sheet: Deducted from the concerned fixed asset	Debit side of Trading & Profit and Loss Account only.
7	Interest on Capital	i) Debit side of Profit and Loss A/c: Shown as a separate item ii) Liabilities side of Balance Sheet: Added to Capital	Debit side of Profit and Loss Account only.
8	Interest on Drawings	i) Credit side of Profit and Loss A/c: Shown as a separate item ii) Liabilities side of Balance Sheet: Deducted from Capital	Credit side of *Profit* and Loss Account only.
9	Interest on Loan	i) Debit side of Profit and Loss A/c: Shown as a separate item ii) Liabilities side of Balance Sheet: Added to Loan.	Debit side of Profit and Loss Account only.
10	Bad Debts	i) Debit side of Profit and Loss A/c: Added to Bad Debts ii) Assets side of Balance Sheet: Deducted from Sundry Debtors	Debit side of Profit and Loss Account only.

11	**Provision for bad debts**	i) **Debit side of Profit and Loss A/c:** Shown as a separate item ii) **Assets** side of Balance Sheet: Deducted **from Sundry** Debtors	**Deduct from sundry debtors assuming** it **is** a closing balance.
12	**Provision for Discount on Debtors**	i) **Debit side of Profit and Loss A/c:** Shown as a separate item ii) **Assets** side of Balance Sheet: Deducted from Sundry Debtors	**Debit side of Profit and Loss Account only.**
13	**Provision for Discount on Creditors**	i) **Credit side of Profit and Loss A/c:** Shown as a separate item ii) **Liabilities** side of Balance Sheet: Deducted from **Sundry Creditors**	**Credit side of Profit and Loss Account only.**
14	**Manager's Commission**	i) **Debit side of Profit and Loss A/c: Shown as a separate item** ii) **Liabilities side of Balance Sheet:** Shown as a separate item	**Liabilities side of Balance Sheet only.**
15	Abnormal Loss	i) **Credit side of Trading A/c: Shown as a separate item with full amount of loss** ii) Debit Profit & Loss **A/c with** the uncovered Loss iii) **Insurance** claim will be **shown** on Assets side of Balance Sheet under Current **Assets**	**Debit side of Profit and Loss Account only.**
16	**Drawing of Goods by the Proprietor**	i) **Debit side of Trading A/c: Deducted from purchases** ii) **Liabilities side of Balance Sheet: Deducted from capital**	Deduct **from Capital.**

Illustration 8

From the following Trial Balance of **Pitam** Stores prepare Trading and Profit and **Loss** Account for the year ended December 31,1987 and the Balance Sheet as on that date.

Trial Balance

Account	**Debit Balances**	**Credit Balances**
	Rs.	**Rs.**
Capital		**60,000**
Drawings	**5,000**	
Purchases	**1,00,000**	
Sales		**2,10,000**
Opening *Stock*	**20,000**	
Wages	**15,000**	
Wages Outstanding		**5,000**
Carriage **Inwards**	**2,000**	
Salaries	**13,000**	
Insurance	**1,500**	
Insurance Prepaid	**1,500**	
Income **from** Investments		**30,000**
Accrued Income from **Investments**	**10,000**	
Machinery	**50,000**	
Buildings	**95,000**	
Cash in hand	**2,000**	
Debtors	**35,000**	
Creditors		**60,000**
Depreciation on **Buildings**	**5,000**	
Rent	**10,000**	
	3,65,000	**3,65,000**

Additional Information

The value of stock on December 31,1987 **was Rs. 40,000**

Solution:

Trading and Profit and **Loss** Account
for the year **ended December** 31, 1987

Dr. Cr.

Particulars	Amount	Particulars	Amount
	Rs.		Rs.
To Opening Stock	20,000	By Sales	2,10,000
To Purchases	1,00,000	By Closing Stock	40,000
To Wages	15,000		
To Carriage Inwards	2,000		
To Gross Profit c/d	1,13,000		
	2.50.000		2,50,000
To Salaries	13,000	By Gross Profit b/d	1,13,000
To Insurance	1,500	By Inwme from Investments	30.000
To Rent	10,000		
To Depreciation on Building	5,000		
To Net Profit (transferred to Capital A/c)	1,13,500		
	1.43.000		1,43,000

Balance Sheet
as on **December** 31, 1987

Dr. Cr.

Liabilities		Amount	Assets	Amount
		Rs.		Rs.
Capital	60,000		Building	95,000
Add Net Profit	1,13,500		Machinery	50,000
			Closing Stock	40,000
	1,73,500			
Less Drawings	5,000		Debtors	35,0110
		1,68,500	Cash in hand	2,000
Creditors	..	60,000	Insurance Prepaid	1,500
Wages Outstanding		5,000	Accrued Income from Investments	10,000
		2,33,500		2,33,500

8.6 LET US SUM UP

At the time of preparing the final accounts a number of items need adjustments. It is because certain expenses may relate to two or more **accounting** years or certain expenses incurred during the current year may still remain to be paid. Unless such adjustments are made, the final accounts will not reveal the true picture. Such items are usually given outside the Trial Balance and are shown at two places in the final accounts so as to complete the double entry,

Adjustment entries can be passed in the journal for each item of adjustment. But, **normally** they are directly adjusted in the final accounts. In practice the adjustment entries are always passed for such items and a revised Trial Balance called 'Adjusted Trial Balance' or 'Final Trial Balance' is prepared. In such a situation, the adjustments will appear in the Trial Balance itself. Any item of adjustment which appears in the Trial Balance is shown only at one place in the final accounts.

8.7 KEY WORDS

Abnormal Loss: **Loss** caused by abnormal causes.

Adjustment Entry: Journal entry passed to **make** an adjustment in the relevant accounts.

Adjustment Item: An item **given** outside the Trial Balance which requires adjustment at the time of preparing final accounts.

Adjusted Purchases: Amount of purchases after adjusting both the opening and closing stocks.

Adjusted **Trial** Balance: Trial Balance prepared after incorporating various adjustments.

Depreciation: A permanent decrease in the value of a fixed asset caused by wear and tear or the passage of time.

Doubtful Debts: Debts of doubtful recovery.

Outstanding Expenses: Expenses incurred during the accounting year but not yet paid.

Outstanding Incomes: Incomes earned during the accounting year but not yet received.

Prepaid Expenses: Expenses paid but the benefit of which is yet to be received.

Unearned Income: Income in respect of which the services are yet to be rendered.

8.8 SOME USEFUL BOOKS

1 Maheshwari, S.N. 1986. ***Introduction to Accounting,*** Vikas Publishing House: New Delhi. (Chapter 10)
2 Patil, V.A. and J.S. **Korlahalli**, 1986. ***Principles and Practice of Accounting,*** R. Chand & Co., New Delhi. (Chapter 20)
3 William Pickles. 1982. ***Accountancy,*** E.L.B.S. and **Pitman**, London. (Chapter 5)
4 Gupta, **R. L** and M. **Radhaswamy**. 1986 ***Advanced Accountancy,*** Sultan Chand & Sons, New Delhi. (Chapter **4,5**)
5 Shukla, **M. C** and T.S. **Grewal**. 1987. ***Advanced Accountancy, S.*** Chand & Co., New Delhi. (Chapter 2)

8.9 ANSWERS TO CHECK YOUR PROGRESS

A 1 i) dual ii) asset iii) unexpired iv) liability v) Depreciation vi) subtracted
2 **i)False ii)True iii)False iv)True v)False**
B 3 Provision for Bad Debts Rs. 990
Provision for Discount on Debtors Rs. 376.20
4 **i)Rs.** 20,000 **ii)Rs. 5,000 iii)Rs. 15,000**

8.10 TERMINAL QUESTIONS/EXERCISES

Questions

1 Why some adjustments become necessary at the time of preparing the final accounts? Name any two items of adjustment and explain how they are shawn in the final accounts.
2 Distinguish between:
a) Outstanding Expenses and Unexpired Expenses
b) Provision for Discount on Debtors and Provision for Discount on Creditors
c) Normal Loss and Abnormal Loss

Exercises

1 Give journal entries for the following adjustments:
i) Interest received in advance Rs. 600
ii) Interest on drawings Rs. 1,200
iii) Provision for discount on creditors Ks. 200
iv) Loss of goods by theft Rs. 8,500
v) Drawings of goods by the proprietor Rs. 750

2 The following information is extracted from the hooks of a businessman:

Debtors as on 31.12.1987	Rs. 25,000
Bad Debts during 1987	Rs. 1,000

Provision for Bad Debts is to be maintained at 5% of debtors.
A Provision for discount on debtors is also to be made at 2%. You are required to calculate the amounts to be set aside in respect of provision for bad debts and provision for discount on debtors respectively.

(**Answer:** Provision for Bad Debts Rs. 1,250; Provision for Discount on Debtors Rs. 475)

3 The Proprietor withdrew the following amounts during the year ended December 31,1987.

	Rs.
Feb. 28	4,000
May 1	6,000
Aug. 31	5,000
Nov. 1	2,000
Dec. 1	1,000

Calculate interest on drawings if the rate is 6% per annum.
(**Answer:** Rs. 565)

4 From the following Trial Balance of Puri & Sons as on June 30,1988, prepare Trading and Profit and Loss Account and the Balance Sheet.

Trial Balance

Name of the Account	Debit	Credit
	Rs.	Rs.
Capital		1,00,000
Drawings	5,000	
Purchases less Returns	2,00,000	
Sales less Returns		5,00,000
Inventory (beginning)	50,000	
Wages	20,000	
Carriage Inwards	3,000	
Salaries	25,000	
Freight	2,000	
Trade Expenses	5,000	
Rent		20,000
Packing Charges	2,000	
Land & Buildings	2,00,000	
Plant & Machinery	2,50,000	
Furniture	50,000	
Bad Debts	5,000	
Debtors	75,000	
Creditors		80,000
Cash in hand & at bank	5,000	
Bills Receivable	3,000	
Loan		2,00,000
Total	9,00,000	9,00,000

Additional information

i) **Inventory (ending):** Rs. 30,000.
ii) Depreciation is to be provided as **follows:**
 Land & building @ 5% p.a
 Plant & Machinery **@** 4% **p.a.**
 Furniture @ 10% p.a
iii) **Debtors** are bad **to the** extent of Rs. 5,**000.**
iv) **Salaries are** outstanding **to** the extant of Rs. 5,000.
v) Wages are prepaid to the extent of Rs. **2,000.**
vi) Rent received **in** advance Rs. **3,000.**

(**Answer:** Gross Profit Rs. 2,57,000; Net Profit Rs. 2,02,000; **Balance** Sheet **total Rs. 5,85,000)**

5 From the following Trial Balance of **Kawatra** stores, prepare Trading and Profit and **Loss** Account for the year ended December 31,1987, and a **Balance** Sheet as on that date.

Trial Balance

Name of the Account	Debit	Credit
	Rs.	Rs.
Capital		5,00,000
Drawings	20,000	
Purchases	4,00,000	
Purchases Returns		10,000
Sales		7,00,000
Sales Returns	20,000	
Inventory (beginning)	1,00,000	
Land & Building	3,00,000	
Plant & Machinery	1,50,000	
Goodwill	50,000	
Trade Marks	30,000	
Wages	40,000	
Trade Expenses	20,000	
Furniture	50,000	
Provision for Bad Debts		10,000
Debtors	1,07,000	
Bad Debts	3,000	
Salaries	60,000	
Creditors		1,00,000
Acceptances		80,000
Investments	10,000	
Rent	15,000	
Distribution Expenses	5,000	
Cash in hand and at bank	10,000	
Depreciation on Furniture	10,000	
Total	14,00,000	14,00,000

Additional information,

i) The **inventory** on December 33,1987 was valued at Rs. **1,50,000.** Inventory **of** the value Rs. **10,000** was destroyed by fire on 1.12.1987. It was fully insured and a claim of Rs. **10,000** was admitted by the insurance company.
ii) Depreciation is to be provided on the following assets:
 Land & Buildings @ 5% **p.a.**
 Plant & Machinery @ **12½%** p.a.
iii) Debtors are bad to the extent of Rs. **2,000.** Provision of 5% on debtors is to be created in respect of bad debts and a provision for discount on debtors is to be created at 2% of debtors.
iv) Wages **are** outstanding to the extent of Rs. 10,000.
v) Rent is prepaid to the extent of Rs. 5,000.
vi) The general manager is to be provided a commission of 2% on net profits before charging such **commission.**

(Answer: Gross Profit Rs. **3,00,000;** Net Profit Rs. **1,55,887;** Balance Sheet **total** Rs. **8,29,005)**

6 From the following Trial Balance of V. Ramana prepare his final accounts for the year ended December 31,1986.

Name of the Account	Dr.	Cr.
	Rs.	Rs.
Capital		70,000
Drawings	10,000	
Adjusted Purchases	2,32,500	
Sales		2,95,000
Cash in hand	3,800	
Cash at bank	12,800	
Salaries	18,000	
Freight	1,200	
Advertising	800	
General Expenses	5,400	
Furniture	10,800	
Expenses Outstanding		2,500
Depreciation	2,200	
Building	39,000	
Discount	700	800
Insurance	600	
Prepaid Insurance	300	
Rent Received		6,000
Rent Received in Advance		3,000
Trade Debtors	14,100	
Trade Creditors		24,600
Loss by Fire	2,000	
Commission		1,500
Stock on December 31,1986	49,200	
Total	4,03,400	4,03,400

(Answer: Gross Profit Rs. 61,300; Net Profit Rs. 39,900; Balance Sheet total Rs. 1,30,000)

7 The Trial Balance of S. Karim as on December 31,1986 was as under:

Name of the Account	Dr.	Cr.
	Rs.	Rs.
Capital		1,10,000
Drawings	15,000	
Gross Profit earned during 1986		32,400
Salaries and Wages	22,000	
Rent and Taxes	8,400	
Cash in hand	2,300	
Bauk Overdraft		8,600
Sundry Debtors and Creditors	41,000	36,000
Insurance (including premium of Rs. 400 per annum paid up to March 31, 1987)	1,000	
Loose Tools	5,000	
Bad Debts	500	
Provision for Bad Debts		800
Entertainment Expenses	300	
Commission		2,100
General Charges	2,600	
Furniture and Fixtures	12,000	
Plant and Machinery	60,000	
Stock on December 31,1986	19,800	
	1,89,900	1,89,900

Prepare the Profit and Loss Account for the year ending December 31, 1986 and the Balance Sheet as on that date.

(Answer : Net Loss Rs. 11,100; Balance Sheet total Rs. 1,30,500)

> Note: These questions will help you to understand the unit better. Try to write answers for them. But do not submit your answers to the University. These are for your practice only.