



11112CH10

Financial Statements - II

10

LEARNING OBJECTIVES

After studying this chapter, you will be able to :

- describe the need for adjustments while preparing the financial statements;
- explain the accounting treatment of adjustments for outstanding and prepaid expenses, accrued and advance receipts of incomes;
- discuss the adjustments to be made regarding depreciation, bad debts, provision for doubtful debts, provision for discount on debtors;
- explain the concepts and adjustment of manager's commission and interest on capital;
- prepare profit and loss account and balance sheet with adjustments.

In chapter 9, you learnt about the preparation of simple final accounts in the format of trading and profit and loss account and balance sheet. The preparation of simple final accounts pre-supposes the absence of any accounting complexities which are normal to business operations. These complexities arise due to the fact that the process of determining income and financial position is based on the accrual basis of accounting. This emphasises that while ascertaining the profitability, the revenues be considered on earned basis and not on receipt basis, and the expenses be considered on incurred basis and not on paid basis. Hence, many items need some adjustment while preparing the financial statements. In this chapter we shall discuss all items which require adjustments and the way these are brought into the books of account and incorporated in the final accounts.

10.1 Need for Adjustments

According to accrual concept of accounting, the profit or loss for an accounting year is not based on the revenues realised in cash and the expenses paid in cash during that year. There may exist some receipts and expenses in the current year which partially relate to the previous year or to the next year. Also, there may exist incomes and expenses relating to the current year that still need to be brought into books of account. Such items duly adjusted, the final accounts will not reflect the true and fair view of the state of affairs of the business.

For example, an amount of ₹ 1,200 paid on July 01, 2016 towards insurance premium. Any general insurance premium paid usually covers a period of 12 months. Suppose the accounting year ends on March 31, 2017, it would mean that one fourth of the insurance premium is paid on July 01, 2016 relate to the next accounting year 2017-18. Therefore, while preparing the financial statements for 2016-17, the expense on insurance premium that should be debited to the profit and loss account is ₹ 900 (₹ 1,200 – ₹ 300).

Let us take another example. The salaries for the month of March, 2017 were paid on April 07, 2017. This means that the salaries account of 2016-17 does not include the salaries for the month of March 2017. Such unpaid salaries is termed as *salaries outstanding* which have to be brought into books of account and is debited to profit and loss account along with the salaries already paid for the month of April, 2016 up to February, 2017.

Similarly, adjustments may also become necessary in respect of certain incomes received in advance or those which have accrued but are still to be received. Apart from these, there are certain items which are not recorded on day-to-day basis such as depreciation on fixed assets, interest on capital, etc. These are adjusted at the time of preparing financial statements. The purpose of making various adjustments is to ensure that the final accounts reveal the true profit or loss and the true financial position of the business. The items which usually need adjustments are:

1. Closing stock
2. Outstanding/expenses
3. Prepaid/Unexpired expenses
4. Accrued income
5. Income received in advance
6. Depreciation
7. Bad debts
8. Provision for doubtful debts
9. Provision for discount on debtors
10. Manager's commission
11. Interest on capital

It may be noted that when we prepare the financial statements, we are provided with the trial balance and some other additional information in respect of the adjustments to be made. All adjustments are reflected in the final accounts at two places to complete the double entry. Our earlier example in chapter 9 (Page no. 336) which represents the trial balance of Ankit is reproduced in figure 10.1:

Trial Balance of Ankit as on March 31, 2017

| <i>Account Title</i> | <i>Elements</i> | <i>L.F.</i> | <i>Debit Amount</i> ₹ | <i>Credit Amount</i> ₹ |
|-------------------------------------|-----------------|-------------|--------------------------|---------------------------|
| Cash | Assets | | 1,000 | |
| Bank | Assets | | 5,000 | |
| Wages | Expense | | 8,000 | |
| Salaries | Expense | | 25,000 | |
| Furniture | Assets | | 15,000 | |
| Rent of building | Expense | | 13,000 | |
| Debtors | Assets | | 15,500 | |
| Bad debts | Expense | | 4,500 | |
| Purchases | Expense | | 75,000 | |
| Capital | | | | 12,000 |
| Equity | | | | |
| Sales | Revenue | | | 1,25,000 |
| Creditors | Liabilities | | | 15,000 |
| Long-term loan (raised on 1.4.2013) | Liabilities | | | 5,000 |
| Commission received | Revenue | | | 5,000 |
| Total | | | 1,62,000 | 1,62,000 |
| | | | | |

Additional Information : The stock on March 31, 2017 was ₹ 15,000.

Figure 10.1 : Showing the trial balance of Ankit

We will now study about the items of adjustments and you will observe how these adjustments are helpful in the preparation of financial statements in order to reflect the true profit and loss and financial position of the firm.

10.2 Closing Stock

As per the example in chapter 9 (Page no. 336), the closing stock represents the cost of unsold goods lying in the stores at the end of the accounting period. The adjustment with regard to the closing stock is done by (i) by crediting it to the trading and profit and loss account, and (ii) by showing it on the asset side of the balance sheet. The adjustment entry to be recorded in this regard is :

| | |
|-------------------|-----|
| Closing stock A/c | Dr. |
| To Trading A/c | |

The closing stock of the year becomes the opening stock of the next year and is reflected in the trial balance of the next year. The trading and profit and

loss account of Ankit for the year ended March 31, 2017 and his balance sheet as on that date shall appear as follows :

**Trading and Profit and Loss Account of Ankit
for the year ended March 31, 2017**

| Dr. | | | Cr. |
|--|---------------------|-----------------------|---------------------|
| <i>Expenses/Losses</i> | <i>Amount ₹</i> | <i>Revenues/Gains</i> | <i>Amount ₹</i> |
| Purchases | 75,000 | Sales | 1,25,000 |
| Wages | 8,000 | Closing stock | 15,000 |
| Gross profit c/d | 57,000 | | |
| | 1,40,000 | | 1,40,000 |
| Salaries | 25,000 | Gross profit b/d | 57,000 |
| Rent of building | 13,000 | Commission received | 5,000 |
| Bad debts | 4,500 | | |
| Net profit (transferred to Ankit's capital account) | 19,500 | | |
| | 62,000 | | 62,000 |

Sometimes the opening and closing stock are adjusted through purchases account. In that case, the entry recorded is as follows :

Closing stock A/c
 To Purchases A/c

Dr.

This entry reduces the amount in the purchases account and is also known as *adjusted purchases* which is shown on the debit side of the trading and profit and loss account. In this context, it may be noted, that the closing stock will not be shown on the credit side of the trading and profit and loss as it has been already been adjusted through the purchases account. Not only, in such a situation, even the opening stock will not be separately reflected in the trading and profit and loss account, as it is also adjusted in purchases by recording the following entry:

Purchases A/c
 To Opening stock A/c

Dr.

Another important point to be noted in this context is that when the opening and closing stocks are adjusted through purchases, the trial balance does not show any opening stock. Instead, the closing stock shall appear in the trial balance (not as additional information or as an adjustment item) and so also the adjusted purchases. In such a situation, the adjusted purchases shall be debited to the trading and profit and loss account.

The closing stock shall be shown on the assets side of the balance sheet as shown below:

Balance Sheet of Ankit as at March 31, 2017

| <i>Liabilities</i> | <i>Amount ₹</i> | <i>Assets</i> | <i>Amount ₹</i> |
|--------------------------------|---------------------|------------------------------------|---------------------|
| <i>Owners funds</i> | | <i>Non-Current Assets</i> | |
| Capital 12,000 | | Furniture 15,000 | 15,000 |
| Add Net profit <u>19,500</u> | 31,500 | <i>Current Assets</i> | |
| <i>Non-Current Liabilities</i> | | Debtors 15,500 | 15,500 |
| Long-term loan 5,000 | 5,000 | Bank 5,000 | 5,000 |
| <i>Current Liabilities</i> | | Cash 1,000 | 1,000 |
| Creditors 15,000 | 15,000 | Closing stock 15,000 | 15,000 |
| | 51,500 | | 51,500 |
| | | | |

10.3 Outstanding Expenses

It is quite common for a business enterprise to have some unpaid expenses in the normal course of business operations at the end of an accounting year. Such items usually are wages, salaries, interest on loan, etc.

When expenses of an accounting period remain unpaid at the end of an accounting period, they are termed as *outstanding expenses*. As they relate to the earning of revenue during the current accounting year, it is logical that they should be duly charged against revenue for computation of the correct amount of profit or loss. The entry to bring such expenses into account is :

Concerned expense A/c Dr.
To Outstanding expense A/c

The above entry opens a new account called *Outstanding Expenses* which is shown on the liabilities side of the balance sheet. The amount of outstanding expenses is added to the total of expenses under a particular head for the purpose of preparing trading and profit and loss account.

For example, refer to Ankit's trial balance (refer figure 10.1). You will notice that wages are shown at ₹ 8,000. Let us assume that Ankit owes ₹500 as wages relating to the year 2016-17 to one of his employees. In that case, the correct expense on wages amounts to ₹ 8,500 instead of ₹ 8,000. Ankit must show ₹ 8,500 as expense on account of wages in the trading and profit and loss account and recognise a current liability of ₹ 500 towards the sum owed to his staff. It will be referred to as *wages outstanding* and it will be adjusted to wages account by recording the following journal entry:

Wages A/c Dr. 500
To Wages outstanding A/c 500

The amount of outstanding wages will be added to wages account for the preparation of the trading and profit and loss account as follows :

**Trading and Profit and Loss Account of Ankit
for the year ended March 31, 2017**

| Dr. | | Cr. | |
|--|---------------------|-----------------------|---------------------|
| <i>Expenses/Losses</i> | <i>Amount ₹</i> | <i>Revenues/Gains</i> | <i>Amount ₹</i> |
| Purchases | 75,000 | Sales | 1,25,000 |
| Wages 8,000 | | Closing stock | 15,000 |
| Add Outstanding wages 500 | 8,500 | | |
| Gross profit c/d | 56,500 | | |
| | 1,40,000 | | 1,40,000 |
| Salaries | 25,000 | Gross profit b/d | 56,500 |
| Rent of building | 13,000 | Commission received | 5,000 |
| Bad debts | 4,500 | | |
| Net profit (transferred to Ankit's capital account) | 19,000 | | |
| | 61,500 | | 61,500 |

Observe carefully the trading and profit and loss account of Ankit. Did you notice the amount of net profit is reduced to ₹ 19,000 on account of outstanding wages. The item relating to outstanding wages will be shown in balance sheet as follows :

Balance Sheet of Ankit as at March 31, 2017

| <i>Liabilities</i> | <i>Amount ₹</i> | <i>Assets</i> | <i>Amount ₹</i> |
|--|---------------------|---------------------------|---------------------|
| <i>Owners Funds</i> | | <i>Non-Current Assets</i> | |
| Capital 12,000 | | Furniture | 15,000 |
| Add Profit 19,000 | 31,000 | <i>Current Assets</i> | |
| <i>Non-Current Liabilities</i> | | Debtors | 15,500 |
| Long-term loan | 5,000 | Bank | 5,000 |
| <i>Current Liabilities</i> | | Cash | 1,000 |
| Creditors | 15,000 | Closing stock | 15,000 |
| Outstanding wages | 500 | | |
| | 51,500 | | 51,500 |

10.4 Prepaid Expenses

There are several items of expense which are paid in advance in the normal course of business operations. At the end of the accounting year, it is found that the benefits of such expenses have not yet been fully received; a portion

of its benefit would be received in the next accounting year. This portion of expense, is carried forward to the next year and is termed as *prepaid expenses*. The necessary adjustment in respect of prepaid expenses is made by recording the following entry:

| | |
|--------------------------|-----|
| Prepaid expense A/c | Dr. |
| To concerned expense A/c | |

The effect of the above adjustment entry is that the amount of prepaid part is deducted from the total of the particular expense, and the new account of prepaid expense is shown on the assets side of the balance sheet. For example, in Ankit's trial balance, let us assume that the amount of salary paid by him to the employees includes an amount of ₹ 5,000 which was paid in advance to one of his employees upon his joining the office. This implies that Ankit has overpaid his staff by ₹ 5,000 on account of his salary. Hence, correct expense on account of salary during the current period will be ₹ 20,000 instead of ₹ 25,000. Ankit must show ₹ 20,000 expense on account of salary in the profit and loss account and recognise a current asset of ₹ 5,000 as an advance salary to the employee. It will be termed as prepaid salary account and will be recorded by the following journal entry :

| | | |
|--------------------|-----|-------|
| Prepaid salary A/c | Dr. | 5,000 |
| To salary A/c | | 5,000 |

The account of prepaid salary will be shown in the trading and profit and loss account as follows:

**Trading and Profit and Loss Account of Ankit
for the year ended March 31, 2017**

| Dr. | | Cr. | |
|--|---------------------|-----------------------|---------------------|
| <i>Expenses/Losses</i> | <i>Amount ₹</i> | <i>Revenues/Gains</i> | <i>Amount ₹</i> |
| Purchases | 75,000 | Sales | 1,25,000 |
| Wages | 8,000 | Closing stock | 15,000 |
| Add Outstanding wages | 500 | | |
| Gross profit c/d | 8,500 | | |
| | 56,500 | | |
| | 1,40,000 | | 1,40,000 |
| Salaries | 25,000 | Gross profit b/d | 56,500 |
| Less Prepaid salary | (5,000) | Commission received | 5,000 |
| Rent of building | 13,000 | | |
| Bad debts | 4,500 | | |
| Net profit (transferred to Ankit capital account) | 24,000 | | |
| | 61,500 | | 61,500 |

Observe how the prepaid salary has resulted in an increase of net profit by ₹ 5,000 making it as ₹ 24,000. Further, the item relating to prepaid salary will be shown in the balance sheet on the assets side as follows :

Balance Sheet of Ankit as at March 31, 2017

| <i>Liabilities</i> | <i>Amount ₹</i> | <i>Assets</i> | <i>Amount ₹</i> |
|--------------------------------|---------------------|------------------------------------|---------------------|
| <i>Owners Funds</i> | | <i>Non-Current Assets</i> | |
| Capital 12,000 | | Furniture 15,000 | |
| Add Profit <u>24,000</u> | 36,000 | <i>Current Assets</i> | |
| <i>Non-Current Liabilities</i> | | Debtors 15,500 | |
| Long-term loan 5,000 | 5,000 | Prepaid salary 5,000 | |
| <i>Current Liabilities</i> | | Bank 5,000 | |
| Creditors 15,000 | 15,000 | Cash 1,000 | |
| Outstanding wages 500 | 500 | Closing stock 15,000 | |
| | 56,500 | | 56,500 |
| | 56,500 | | 56,500 |

10.5 Accrued Income

It may also happen that certain items of income such as interest on loan, commission, rent, etc. are earned during the current accounting year but have not been actually received by the end of the same year. Such incomes are known as *accrued income*. The adjusting entry for accrued income is :

| | |
|-------------------------|-----|
| Accrued income A/c | Dr. |
| To Concerned income A/c | |

The amount of accrued income will be added to the related income in the profit and loss account and the new account of accrued income will appear on the asset side of the balance sheet.

Let us, for example, assume that Ankit was giving a little help to a fellow businessman by introducing few parties to him on commission for this service. In the trial balance of Ankit you will notice an item of commission received amounting to ₹ 5,000. Assume that the commission amounting to ₹1,500 was still receivable from the fellow businessman. This implies that income from commission earned during 2016-17 is ₹ 6, 500 (₹5, 000 + ₹ 1,500) Ankit needs to record an adjustment entry to give effect to the accrued commission as follows :

| | | | |
|------------------------|-----|-------|-------|
| Accrued Commission A/c | Dr. | 1,500 | |
| To Commission A/c | | | 1,500 |

The account of accrued income will be recorded in trading and profit and loss account as follows :

**Trading and Profit and Loss Account of Ankit
for the year ended March 31, 2017**

| Dr. | | | Cr. |
|--|---------------------|----------------------------------|---------------------|
| <i>Expenses/Losses</i> | <i>Amount ₹</i> | <i>Revenues/Gains</i> | <i>Amount ₹</i> |
| Purchases | 75,000 | Sales | 1,25,000 |
| Wages 8,000 | 8,500 | Closing stock | 15,000 |
| Add Outstanding <u>500</u> | 56,500 | | |
| Gross profit c/d | 1,40,000 | | 1,40,000 |
| | 25,000 | Gross profit b/d | 56,500 |
| Salaries 25,000 | 20,000 | Commission received 5,000 | 6,500 |
| Less Prepaid salary (5,000) | 13,000 | Add Accrued 1,500 | 6,500 |
| Rent of building | 4,500 | commission | |
| Bad debts | 25,500 | | |
| Net profit (transferred to Ankit's capital account) | 63,000 | | 63,000 |
| | 63,000 | | 63,000 |

Observe that the accrued income has resulted in an increase in the net profit by ₹ 1,500 making it as ₹ 25,500. Further, it will be shown in the balance sheet of Ankit on the assets side under the head current asset.

Balance Sheet of Ankit as at March 31, 2017

| <i>Liabilities</i> | <i>Amount ₹</i> | <i>Assets</i> | <i>Amount ₹</i> |
|--|---------------------|---------------------------|---------------------|
| <i>Owners Funds</i> | | <i>Non-Current Assets</i> | |
| Capital 12,000 | 37,500 | Furniture | 15,000 |
| Add Profit <u>25,500</u> | | <i>Current Assets</i> | |
| <i>Non-Current Liabilities</i> | | Debtors | 15,500 |
| Long-term loan | 5,000 | Prepaid salary | 5,000 |
| <i>Current Liabilities</i> | | Accrued commission | 1,500 |
| Creditors | 15,000 | Bank | 5,000 |
| Outstanding wages | 500 | Cash | 1,000 |
| | 58,000 | Closing stock | 15,000 |
| | 58,000 | | 58,000 |

10.6 Income Received in Advance

Sometimes, a certain income is received but the whole amount of it does not belong to the current period. The portion of the income which belongs to the next accounting period is termed as income received in advance or an *Unearned Income*. Income received in advance is adjusted by recording the following entry:

Concerned income A/c Dr.
 To Income received in advance A/c

The effect of this entry will be that the balance in the income account will be equal to the amount of income earned for the current accounting period, and the new account of income received in advance will be shown as a liability in the balance sheet.

For example, let us assume Ankit has agreed in March 31, 2017 to sublet a part of the building to a fellow shopkeeper @ ₹ 1,000 per month. The person gives him rent in advance for the next three months of April, May and June. The amount received had been credited to the profit and loss account. However, this income does not pertain to current year and hence will not be credited to profit and loss account. It is *income received in advance* and will be recognised as a liability amounting to ₹ 3,000. Ankit needs to record an adjustment entry to give effect to income received in advance by way of following journal entry:

Rent received A/c Dr. 3,000
 To Rent received in advance A/c 3,000

This will lead a new account of rent received in advance of ₹ 3,000 which will appear as follows :

Balance Sheet of Ankit as at March 31, 2017

| <i>Liabilities</i> | <i>Amount</i> ₹ | <i>Assets</i> | <i>Amount</i> ₹ |
|---------------------------------------|--------------------|---------------------------|--------------------|
| <i>Owners Funds</i> | | <i>Non Current Assets</i> | |
| Capital 12,000 | | Furniture 15,000 | 15,000 |
| Add Net profit 25,500 | 37,500 | <i>Current Assets</i> | |
| <i>Non Current Liabilities</i> | | Debtors 15,500 | 15,500 |
| Long-term loan 5,000 | 5,000 | Prepaid salary 5,000 | 5,000 |
| <i>Current Liabilities</i> | | Accrued commission 1,500 | 1,500 |
| Creditors 15,000 | 15,000 | Bank 5,000 | 5,000 |
| Outstanding wages 500 | 500 | Cash 4,000 | 4,000 |
| Rent received in advance 3,000 | 3,000 | Closing stock 15,000 | 15,000 |
| | 61,000 | | 61,000 |

**Balance Sheet of Ankit
as at March 31, 2017**

| <i>Liabilities</i> | <i>Amount ₹</i> | <i>Assets</i> | <i>Amount ₹</i> |
|--------------------------------|---------------------|----------------------------------|---------------------|
| <i>Owners Funds</i> | | <i>Non-Current Assets</i> | |
| Capital 12,000 | | Furniture 15,000 | |
| Add Profit <u>24,000</u> | 36,000 | Less Depreciation (1,500) | 13,500 |
| <i>Non-Current Liabilities</i> | | <i>Current Assets</i> | |
| Long-term loan | 5,000 | Debtors | 15,500 |
| <i>Current Liabilities</i> | | Prepaid salary | 5,000 |
| Creditors | 15,000 | Accrued commission | 1,500 |
| Outstanding wages | 500 | Bank | 5,000 |
| Rent received in advance | 3,000 | Cash | 4,000 |
| | | Closing stock | 15,000 |
| | <u>59,500</u> | | <u>59,500</u> |

10.8 Bad Debts

Bad debts refer to the amount that the firm has not been able to realise from its debtors. It is regarded as a loss and is termed as *bad debt*. The entry for recording bad debt is:

| | |
|----------------|-----|
| Bad debts A/c | Dr. |
| To Debtors A/c | |

You will notice in Ankit's trial balance, that it contains bad debts amounting to ₹ 4,500. Whereas, the sundry debtors of Ankit are reported as ₹ 15,500. The existence of bad debts in the trial balance signifies that Ankit has incurred a loss arising out of bad debts during the year and which has been already recorded in the books of account.

However, assuming one of his debtors who owed him ₹ 2,500 had become insolvent, and nothing is receivable from him. But the amount of bad debts related to the current year is still to be account for. This fact appears as additional information and is termed as *further bad debts*. The adjustment entry to be recorded for the amount will be as follows. For this purpose, Ankit needs to record an adjustment entry as under :

| | | | |
|----------------|-----|-------|-------|
| Bad debts A/c | Dr. | 2,500 | |
| To Debtors A/c | | | 2,500 |

This entry will reduce the value of debtors to ₹ 13,000 (₹ 15,500 – ₹ 2,500) and increases the amount of bad debts to ₹ 7,000 (₹ 4,500 + ₹ 2,500).

The treatment of further bad debts in profit and loss account and balance sheet is shown below :

**Trading and Profit and Loss Account of Ankit
for the year ended March 31, 2017**

| Dr. | | | Cr. | |
|--|---------------------|---------------|-----------------------|-----------------|
| <i>Expenses/Losses</i> | <i>Amount</i> | <i>₹</i> | <i>Revenues/Gains</i> | |
| <i>Expenses/Losses</i> | <i>Amount</i> | <i>₹</i> | <i>Amount</i> | |
| <i>Expenses/Losses</i> | <i>₹</i> | <i>₹</i> | <i>₹</i> | |
| Purchases | 75,000 | | Sales | 1,25,000 |
| Wages | 8,000 | | Closing stock | 15,000 |
| Add Outstanding wages | <u>500</u> | 8,500 | | |
| Gross profit c/d | 56,500 | | | |
| | <u>1,40,000</u> | | | <u>1,40,000</u> |
| Salaries | 25,000 | | Gross profit b/d | 56,500 |
| Less Prepaid salary | <u>(5,000)</u> | 20,000 | Commission received | 5,000 |
| Rent of building | | 13,000 | Add Accrued | <u>1,500</u> |
| | | 1,500 | commission | 6,500 |
| Depreciation – Furniture | | | | |
| Bad Debts | 4,500 | | | |
| Add Further bad debts | <u>2,500</u> | 7,000 | | |
| Net profit (transferred to Ankit's capital account) | | 21,500 | | |
| | | <u>63,000</u> | | <u>63,000</u> |

Balance Sheet of Ankit as at March 31, 2017

| <i>Liabilities</i> | <i>Amount</i> | <i>₹</i> | <i>Assets</i> | <i>Amount</i> |
|---|---------------|----------|---------------------------------------|----------------|
| <i>Liabilities</i> | <i>₹</i> | <i>₹</i> | <i>Assets</i> | <i>₹</i> |
| <i>Owners Funds</i> | | | <i>Non-Current Assets</i> | |
| Capital | 12,000 | | Furniture | 15,000 |
| Add Profit | <u>21,500</u> | 33,500 | Less Depreciation | <u>(1,500)</u> |
| <i>Non-Current Liabilities</i> | | | 13,500 | |
| Long-term loan | 5,000 | | <i>Current Assets</i> | |
| | | | Debtors | 15,500 |
| <i>Current Liabilities and Provisions</i> | | | Less Further bad debts (2,500) | 13,000 |
| Creditors | 15,000 | | Prepaid salary | 5,000 |
| | | | Accrued commission | 1,500 |
| Outstanding Wages | 500 | | Bank | 5,000 |
| Rent received in advance | 3,000 | | Cash | 4,000 |
| | <u>57,000</u> | | Closing stock | 15,000 |
| | | | | <u>57,000</u> |

10.9 Provision for Bad and Doubtful Debts

In the above balance sheet, debtors now appears at ₹ 13,000, which is their estimated realisable value during next year. It is quite possible that the whole

of this amount may not be realised in future. However, it is not possible to accurately know the amount of such bad debts. Hence, we make a reasonable estimate of such loss and provide the same. Such provision is called *provision for bad debts* and is created by debiting profit and loss account. The following journal entry is recorded in this context :

Profit and Loss A/c Dr.
 To Provision for doubtful debts A/c

Provision for doubtful debts is also shown as a deduction from the debtors on the asset side of the balance sheet.

Let us assume, Ankit feels that 5% of his debtors on March 31, 2017 are likely to default on their payments next year. This implies he expects bad debts of ₹ 650 (₹ 13,000 × 5%). Ankit needs to record the adjustment entry as :

Profit and loss A/c Dr. 650
 To Provision for doubtful debts A/c 650

This implies that ₹ 650 will reduce the current year's profit on account of doubtful debts. In the balance sheet, it will be shown as a deduction from sundry debtors.

**Trading and Profit and Loss Account of Ankit
for the year ended March 31, 2017**

| Dr. | | Cr. | |
|---|---------------------|------------------------------|----------|
| <i>Expenses/Losses</i> | <i>Amount ₹</i> | <i>Revenues/Gains</i> | |
| Purchases | 75,000 | Sales | 1,25,000 |
| Wages 8,000 | | Closing stock | 15,000 |
| Add Outstanding 500 | 8,500 | | |
| Gross profit c/d | 56,500 | | |
| | 1,40,000 | | 1,40,000 |
| Salaries 25,000 | | Gross profit b/d | 56,500 |
| Less Prepaid salary (5,000) | 20,000 | Commission received 5,000 | |
| Rent of building | 13,000 | Add Accrued commission 1,500 | 6,500 |
| Depreciation - Furniture | 1,500 | | |
| Bad debts 4,500 | | | |
| Add Further bad debts 2,500 | 7,000 | | |
| Provision for doubtful debts | 650 | | |
| Net profit (transferred to Ankit's capital account) | 20,850 | | |
| | 63,000 | | 63,000 |

Balance Sheet of Ankit as at March 31, 2017

| <i>Liabilities</i> | <i>Amount</i> ₹ | <i>Assets</i> | <i>Amount</i> ₹ |
|---|--------------------|---|--------------------|
| <i>Owners Funds</i> | | <i>Non-Current Assets</i> | |
| Capital 12,000 | | Furniture 15,000 | |
| Add Net profit <u>20,850</u> | 32,850 | Less Depreciation <u>(1,500)</u> | 13,500 |
| <i>Non-Current Liabilities</i> | | <i>Current Assets</i> | |
| Long-term loan 5,000 | 5,000 | Debtors 15,500 | |
| | | Less Furtherbad debts <u>2,500</u> | |
| | | 13,000 | |
| | | Less Provision for <u>650</u> | 12,350 |
| | | doubtful debts | |
| <i>Current Liabilities & Provisions</i> | | Prepaid salary 5,000 | 5,000 |
| Creditors 15,000 | 15,000 | Accrued commission 1,500 | 1,500 |
| Outstanding wages 500 | 500 | Bank 5,000 | 5,000 |
| Rent received in advance 3,000 | 3,000 | Cash 4,000 | 4,000 |
| | | Closing stock 15,000 | 15,000 |
| | <u>56,350</u> | | <u>56,350</u> |

It may be noted that 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 doubtful debts brought forward from the previous year is called the *opening provision or old provision*. When such a provision already exists, the loss due to bad debts during the current year are adjusted against the same and while making provision for doubtful debts required at the end of the current year is called *new provision*. The balance of old provision as given in trial balance should also be taken into account.

Let us take an example to understand how bad debts and provision for doubtful debts are recorded. An extract from a trial balance on March 31, 2017 is given below :

| | |
|------------------------------|--------|
| | ₹ |
| Sundry debtors | 32,000 |
| Bad debts | 2,000 |
| Provision for doubtful debts | 3,500 |

Additional Information :

Write-off further bad debts ₹ 1,000 and create a provision for doubtful debts @ 5% on debtors.

In this case, the following journal entries will be recorded :

| Date | Particulars | L.F. | Debit Amount ₹ | Credit Amount ₹ |
|-------------------|---|------|----------------------|-----------------------|
| March 31, 2017 | (a) Bad debts A/c Dr. To Sundry debtors (Further bad debts) | | 1,000 | 1,000 |
| | (b) Provision for doubtful debts A/c Dr. To Bad debts A/c (Bad debts adjusted against the provision) | | 3,000 | 3,000 |
| | Profit and Loss A/c Dr. To Provision for doubtful debts A/c (Amount charges from profit and loss account) | | 1,050 | 1,050 |

**Profit and Loss Account
for the year ended March 31, 2017**

| | | | | |
|-------------------------------|--------------|-------|--|---|
| Provision for doubtful debts: | | ₹ | | ₹ |
| Bad debts | 2,000 | | | |
| Further bad debts | 1,000 | | | |
| New provision | <u>1,550</u> | | | |
| | 4,550 | | | |
| Less Old provision | <u>3,500</u> | 1,050 | | |

*Only relevant items.

Balance Sheet as at March 31, 2017

| | | | | |
|--|--------------------|----------------|--|--------|
| | | ₹ | | ₹ |
| | Sundry debtors | 32,000 | | |
| | Less Further | <u>(1,000)</u> | | |
| | bad debts | 31,000 | | |
| | Less Provision | <u>(1,550)</u> | | |
| | for doubtful debts | | | 29,450 |

*Only relevant items.

Note : The amount of new provision for doubtful debts has been calculated as follows:
₹ 31,000 × 5/100 = ₹ 1,550.

10.10 Provision for Discount on Debtors

A business enterprise allows discount to its debtors to encourage prompt payments. Discount likely to be allowed to customers in an accounting year

Balance Sheet of Ankit as on March 31, 2017

| <i>Liabilities</i> | | <i>Amount</i> ₹ | <i>Assets</i> | | <i>Amount</i> ₹ |
|---|---------------|--------------------|---------------------------|----------------|--------------------|
| <i>Owners Funds</i> | | | <i>Non-Current Assets</i> | | |
| Capital | 12,000 | | Furniture | 15,000 | |
| Add Net profit | <u>20,623</u> | 32,623 | Less Depreciation | <u>(1,500)</u> | 13,500 |
| <i>Non-Current Liabilities</i> | | | <i>Current Assets</i> | | |
| Long-term loan | | 5,000 | Debtors | 15,500 | |
| | | | Less Further | 2,500 | |
| | | | bad debts | 13,000 | |
| | | | Less Provision | | |
| | | | for doubtful | 650 | |
| | | | debts | | |
| | | | | 12,350 | |
| | | | Less Provision | | |
| | | | for discount | | |
| | | | on debtors | (227) | 12,123 |
| <i>Current Liabilities & Provisions</i> | | | Prepaid salary | | 5,000 |
| Creditors | | 15,000 | Accrued commission | | 1,500 |
| Outstanding wages | | 500 | Bank | | 5,000 |
| Rent received in advance | | 3,000 | Cash | | 4,000 |
| | | | Closing stock | | 15,000 |
| | | <u>56,123</u> | | | <u>56,123</u> |

In the subsequent year, the discount will be transferred to the provision for discount on debtors account. The account will be treated in the same manner as the provision for doubtful debts.

10.11 Manager's Commission

The manager of the business is sometimes given the commission on the net profit of the company. The percentage of the commission is applied on the profit either *before charging such commission* or *after charging such commission*. In the absence of any such information, it is assumed that commission is allowed as a percentage of the net profit before charging such commission.

Suppose the net profit of a business is ₹ 110 before charging commission. If the manager is entitled to 10% of the profit before charging such commission, the commission will be calculated as :

$$= ₹ 110 \times \frac{10}{100} = ₹ 11$$

In case the commission is 10% of the profit after charging such commission, it will be calculated as :

$$= \text{Profit before commission} \times \text{Rate of commission} / (100 + \text{commission})$$

$$= ₹ 110 \times \frac{10}{110} = ₹ 10$$

The managers commission will be adjusted in the books of account by recording the following entry :

| | |
|-----------------------------|-----|
| Profit and loss A/c | Dr. |
| To Manager's commission A/c | |

Let us recall our example and assume that Ankit's manager is entitled to a commission @ 10%. Observe the following profit and loss account if it is based on :

- (i) amount of net profit before charging such commission
- (ii) amount of profit after charging such commission.

**(i) Trading and Profit and Loss Account of Ankit
for the year ended March 31, 2017**

| <i>Expenses/Losses</i> | <i>Amount ₹</i> | <i>Revenues/Gains</i> | <i>Amount ₹</i> |
|--|---------------------|-----------------------------|---------------------|
| Purchases | 75,000 | Sales | 1,25,000 |
| Wages 8,000 | | Closing stock | 15,000 |
| Add Outstanding wages <u>500</u> | 8,500 | | |
| Gross profit c/d | 56,500 | | |
| | 1,40,000 | | 1,40,000 |
| Salaries 25,000 | | Gross profit | 56,500 |
| Less Prepaid salary <u>(5,000)</u> | 20,000 | Commission received 5,000 | |
| Rent of building | 13,000 | Add Accrued <u>1,500</u> | 6,500 |
| | 1,500 | commission | |
| Depreciation - Furniture | | | |
| Bad debts 4,500 | | | |
| Add Further bad debts <u>2,500</u> | 7,000 | | |
| Provision for doubtful debts | 650 | | |
| Provision for discount on debtors | 227 | | |
| Manager's commission | 2,062 | | |
| Net profit (transferred to Ankit's capital account) | 18,561 | | |
| | 63,000 | | 63,000 |

Balance Sheet of Ankit as at March 31, 2017

| <i>Liabilities</i> | <i>Amount ₹</i> | <i>Assets</i> | <i>Amount ₹</i> |
|---|---------------------|---------------------------------------|---------------------|
| <i>Owners Funds</i> | | <i>Non-Current Assets</i> | |
| Capital 12,000 | | Furniture 15,000 | |
| Add Net profit <u>18,561</u> | 30,561 | Less Depreciation <u>(1,500)</u> | 13,500 |
| <i>Non-Current Liabilities</i> | | <i>Current Assets</i> | |
| Long-term loan | 5,000 | Debtors 15,500 | |
| | | Less Further bad debts <u>(2,500)</u> | 13,000 |
| | | | |
| <i>Current Liabilities and Provisions</i> | | Less Provision for | |
| Creditors | 15,000 | doubtful | <u>(650)</u> |
| | | debts | 12,350 |
| | | Less Provision for | |
| Outstanding wages | 500 | discount on debtors | <u>(227)</u> |
| Rent received in advance | 3,000 | | 12,123 |
| | | Prepaid salary | 5,000 |
| Manager's commission outstanding | 2,062 | Accrued commission | 1,500 |
| | | Bank | 5,000 |
| | | Cash | 4,000 |
| | | Closing stock | 15,000 |
| | <u>56,123</u> | | <u>56,123</u> |

(ii) Trading and Profit and Loss Account of Ankit for the year ended March 31, 2017

| <i>Dr.</i> | <i>Amount ₹</i> | <i>Cr.</i> | <i>Amount ₹</i> |
|--|---------------------|---------------------------|---------------------|
| <i>Expenses/Losses</i> | | <i>Revenues/Gains</i> | |
| Purchases | 75,000 | Sales | 1,25,000 |
| Wages 8,000 | | Closing stock | 15,000 |
| Add Outstanding wages <u>500</u> | 8,500 | | |
| Gross profit c/d | 56,500 | | |
| | <u>1,40,000</u> | | <u>1,40,000</u> |
| Salaries 25,000 | | Gross profit b/d | 56,500 |
| Less Prepaid salary <u>(5,000)</u> | 20,000 | | |
| Rent of building | 13,000 | Commission received 5,000 | |
| | 1,500 | Add Accrued <u>1,500</u> | 6,500 |
| Depreciation-Furniture | | commission | |
| Bad debts 4,500 | | | |
| Add Further bad debts <u>2,500</u> | 7,000 | | |
| Provision for | | | |
| doubtful debts | 650 | | |
| Provision for discount on | | | |
| debtors | 227 | | |
| Manager's commission | 1,875 | | |
| Net profit (transferred to Ankit's capital account) | 18,748 | | |
| | <u>63,000</u> | | <u>63,000</u> |

interest on capital shall be added to the capital, this effect shall be neutralised.
As shown below :

| | ₹ |
|-------------------------|---------------|
| Capital | 12,000 |
| Add Profit | <u>17,961</u> |
| | 29,961 |
| Add Interest on capital | <u>600</u> |
| | 30,561 |

Test Your Understanding

Tick the correct answer :

1. Rahul's trial balance provide you the following information :

| | |
|------------------------------|----------|
| Debtors | ₹ 80,000 |
| Bad debts | ₹ 2,000 |
| Provision for doubtful debts | ₹ 4,000 |

It is desired to maintain a provision for bad debts of ₹ 1,000
State the amount to be debited/credited in profit and loss account :

(a) ₹ 5,000 (Debit) (b) ₹ 3,000 (Debit)
(c) ₹ 1,000 (Credit) (d) none of these.
2. If the rent of one month is still to be paid the adjustment entry will be :
 - (a) Debit outstanding rent account and Credit rent account
 - (b) Debit profit and loss account and Credit rent account
 - (c) Debit rent account and Credit profit and loss account
 - (d) Debit rent account and Credit outstanding rent account.
3. If the rent received in advance ₹ 2,000. The adjustment entry will be :
 - (a) Debit profit and loss account and Credit rent account
 - (b) Debit rent account Credit rent received in advance account
 - (c) Debit rent received in advance account and Credit rent account
 - (d) None of these.
4. If the opening capital is ₹ 50,000 as on April 01, 2016 and additional capital introduced ₹ 10,000 on January 01, 2017. Interest charge on capital 10% p.a. The amount of interest on capital shown in profit and loss account as on March 31, 2017 will be :
 - (a) ₹ 5,250 (b) ₹ 6,000
 - (c) ₹ 4,000 (d) Rs, 3,000.
5. If the insurance premium paid ₹ 1,000 and pre-paid insurance ₹ 300. The amount of insurance premium shown in profit and loss account will be :
 - (a) ₹ 1,300 (b) ₹ 1,000
 - (c) ₹ 300 (d) ₹ 700.

| <i>Adjustment</i> | <i>Adjustment Entry</i> | | <i>Treatment in Trading and Profit and Loss Account</i> | <i>Treatment in Balance Sheet</i> |
|---|---|-----|---|-----------------------------------|
| 1. Closing stock | Closing stock A/c To Trading A/c | Dr. | Shown on the credit assets side and profit and loss account | Shown on the assets side |
| 2. Outstanding expenses | Expense A/c To outstanding expense A/c | Dr. | Added to the respective expense on the debit side | Shown on the liabilities side |
| 3. Prepaid/ Unexpired expenses | Prepaid expense A/c To Expenses A/c | Dr. | Deducted from the respective expense on the debit side | Shown on the assets side |
| 4. Income earned but not received | Accrued income A/c To Income A/c | Dr. | Added to the respective income on the credit side | Shown on the assets side |
| 5. Income received in advance | Income A/c To Income received in advance A/c | Dr. | Deducted from the respective income on the credit side | Shown on the liabilities sides |
| 6. Depreciation | Depreciaton A/c To Assets A/c | Dr. | Shown on the debit side | Deducted from the value of asset |
| 7. Provision for bad and doubtful debts | Profit and Loss A/c To Provision for doubtful debts | Dr. | Shown on the debit side | Shown as deduction from debtors |
| 8. Provision for discount on debtors | Profit and Loss A/c To Provision for discount debtors | Dr. | Shown on the debit side | Shown as deductoin form debtors |
| 9. Manager's commission | Manager's commission A/c To outstanding commission A/c | Dr. | Shown on the debit side | Shown on the liabilities side |
| 10. Interest on capital | Interest on capital A/c To capital A/c | Dr. | Shown on the debit side | Shown as addition to capital |
| 11. Further bad debts | Bad debts A/c To Sundry Debtors A/c | Dr. | Shown on the debit side | Deducted from debtors |

Fig. 10.2 : Showing treatment of various types of adjustments

Illustration 1

From the following balances, prepare the trading and profit and loss account and balance sheet as on March 31, 2017.

| <i>Debit Balances</i> | <i>Amount ₹</i> | <i>Credit Balances</i> | <i>Amount ₹</i> |
|-----------------------|---------------------|------------------------|---------------------|
| Drawings | 6,300 | Capital | 1,50,000 |
| Cash at bank | 13,870 | Discount received | 2,980 |
| Bills receivable | 1,860 | Loans | 15,000 |
| Loan and Building | 42,580 | Purchases return | 1,450 |
| Furniture | 5,130 | Sales | 2,81,500 |
| Discount allowed | 3,960 | Reserve for bad debts | 4,650 |
| Bank charges | 100 | Creditors | 18,670 |
| Salaries | 6,420 | | |
| Purchases | 1,99,080 | | |
| Stock (opening) | 60,220 | | |
| Sales return | 1,870 | | |
| Carriage | 5,170 | | |
| Rent and Taxes | 7,680 | | |
| General expenses | 3,630 | | |
| Plant and Machinery | 31,640 | | |
| Book debts | 82,740 | | |
| Bad debts | 1,250 | | |
| Insurance | 750 | | |
| | <u>4,74,250</u> | | <u>4,74,250</u> |

Adjustments

1. Closing stock ₹ 70,000
2. Create a reserve for bad and doubtful debts @ 10% on book debts
3. Insurance prepaid ₹ 50
4. Rent outstanding ₹ 150
5. Interest on loan is due @ 6% p.a.

Solution

**Trading and Profit and Loss Account
for the year ended March 31, 2017**

| Dr. | | Cr. | |
|------------------------|---------------------|-----------------------|---------------------|
| <i>Expenses/Losses</i> | <i>Amount ₹</i> | <i>Revenues/Gains</i> | <i>Amount ₹</i> |
| Opening stock | 60,220 | Sales | 2,81,500 |
| Purchase | 1,99,080 | Less : Sales return | (1,870) |
| Less Purchases return | (1,450) | Closing stock | 70,000 |
| Carriage | 5,170 | | |
| Gross profit c/d | 86,610 | | |
| | <u>3,49,630</u> | | <u>3,49,630</u> |

| | | | |
|---|----------------|-------------------|---------------|
| Discount allowed | 3,960 | Gross profit b/d | 86,610 |
| Bank charges | 100 | Discount received | 2,980 |
| Salaries | 6,420 | | |
| Rent and Taxes | 7,680 | | |
| Add Rent outstanding | <u>150</u> | | |
| General expenses | 3,630 | | |
| Insurance | 750 | | |
| Less Insurance prepaid | <u>(50)</u> | 700 | |
| Bad debts | 1,250 | | |
| Add New provision | <u>8,274</u> | | |
| for bad debts | 9,524 | | |
| Less Old provision | <u>(4,650)</u> | | |
| for bad debts | 4,874 | | |
| Interest on loan outstanding | 900 | | |
| Net profit (transferred to capital account) | 61,176 | | |
| | <u>89,590</u> | | <u>89,590</u> |

Balance Sheet as at March 31, 2017

| <i>Liabilities</i> | <i>Amount ₹</i> | <i>Assets</i> | <i>Amount ₹</i> |
|----------------------------------|---------------------|---------------------|---------------------|
| Creditors | 18,670 | Cash at bank | 13,870 |
| Loan | 15,000 | Book debts | 82,740 |
| Add Interest on loan outstanding | <u>900</u> | Less Reserve | <u>(8,274)</u> |
| Rent outstanding | 150 | for bad debts | 74,466 |
| Capital | 1,50,000 | Bills receivable | 1,860 |
| Add Net profit | <u>61,176</u> | Land and Building | 42,580 |
| | 2,11,176 | Furniture | 5,130 |
| Less Drawings | <u>(6,300)</u> | Plant and Machinery | 31,640 |
| | 2,04,876 | Insurance (prepaid) | 50 |
| | | Closing stock | 70,000 |
| | <u>2,39,596</u> | | <u>2,39,596</u> |

Illustration 2

The following were the balances extracted from the books of Yogita as on March 31, 2017:

| <i>Debit Balances</i> | <i>Amount ₹</i> | <i>Credit Balances</i> | <i>Amount ₹</i> |
|-----------------------|---------------------|------------------------|---------------------|
| Cash in hand | 540 | Sales | 98,780 |
| Cash at bank | 2,630 | Return outwards | 500 |
| Purchases | 40,675 | Capital | 62,000 |
| Return inwards | 680 | Sundry creditors | 6,300 |
| Wages | 8,480 | Rent | 9,000 |
| Fuel and Power | 4,730 | | |
| Carriage on sales | 3200 | | |
| Carriage on purchases | 2040 | | |
| Opening stock | 5,760 | | |
| Building | 32,000 | | |
| Freehold land | 10,000 | | |
| Machinery | 20,000 | | |
| Salaries | 15,000 | | |
| Patents | 7,500 | | |
| General expenses | 3,000 | | |
| Insurance | 600 | | |
| Drawings | 5,245 | | |
| Sundry debtors | 14,500 | | |

Taking into account the following adjustments prepare trading and profit and loss account and balance sheet as on March 31, 2017 :

- Stock in hand on March 31, 2017, was ₹ 6,800.
- Machinery is to be depreciated at the rate of 10% and patents @ 20%.
- Salaries for the month of March, 2017 amounting to ₹ 1,500 were outstanding.
- Insurance includes a premium of ₹ 170 on a policy expiring on September 30, 2017.
- Further bad debts are ₹ 725. Create a provision @ 5% on debtors.
- Rent receivable ₹ 1,000.

Solution

Books of Yogita
Trading and Profit and Loss Account
for the year ended March 31, 2017

| Dr. | | Amount ₹ | Cr. | | Amount ₹ |
|--|--------|-------------|-----------------------|--------|-------------|
| <i>Expenses/Losses</i> | | | <i>Revenues/Gains</i> | | |
| Opening stock | | 5,760 | Sales | 98,780 | |
| Purchases | 40,675 | | Less Return inwards | (680) | 98,100 |
| Less Return outwards | (500) | 40,175 | Closing stock | | 6,800 |
| Wages | | 8,480 | | | |
| Fuel and Power | | 4,730 | | | |
| Carriage on purchases | | 2,040 | | | |
| Gross profit c/d | | 43,715 | | | |
| | | 1,04,900 | | | 1,04,900 |
| Salaries | 15,000 | | Gross profit b/d | | 43,715 |
| Add Outstanding salaries | 1,500 | 16,500 | Rent | 9,000 | |
| Carriage | | 3,200 | Add Accrued rent | 1,000 | 10,000 |
| General expenses | | 3,000 | | | |
| Insurance | 600 | | | | |
| Less Prepaid insurance | (85) | 515 | | | |
| Further bad debts | 725 | | | | |
| Add Provision for doubtful debts | 689 | 1,414 | | | |
| Depreciation : machinery | 2,000 | | | | |
| Patent | 1,500 | 3,500 | | | |
| Net profit (transferred to capital account) | | 25,586 | | | |
| | | 53,715 | | | 53,715 |

Balance Sheet as at March 31, 2017

| Dr. | | Amount ₹ | Cr. | | Amount ₹ |
|----------------------|---------|-------------|-------------------|---------|-------------|
| <i>Liabilities</i> | | | <i>Assets</i> | | |
| Sundry creditors | | 6,300 | Cash in hand | | 540 |
| Salaries outstanding | | 1,500 | Cash in bank | | 2,630 |
| Capital | 62,000 | | Sundry debtors | 14,500 | |
| | | | Less Further | (725) | |
| | | | bad debts | 13,775 | |
| | | | Less Provision | (689) | 13,086 |
| | | | for bad debts | | |
| Add Net profit | 25,586 | | Insurance prepaid | | 85 |
| | 87,586 | | Stock | | 6,800 |
| Less Drawings | (5,245) | 82,341 | Rent accrued | | 1,000 |
| | | | Freehold land | | 10,000 |
| | | | Building | | 32,000 |
| | | | Machinery | 20,000 | |
| | | | Less Depreciation | (2,000) | 18,000 |
| | | | Patents | 7,500 | |
| | | | Less Depreciation | (1,500) | 6,000 |
| | | 90,141 | | | 90,141 |

Illustration 3

The following balances were extracted from the books of Shri R. Lal on March 31, 2017:

| <i>Account Title</i> | <i>Amount ₹</i> | <i>Account Title</i> | <i>Amount ₹</i> |
|--|---------------------|--------------------------|---------------------|
| Capital | 1,00,000 | Rent (Cr.) | 2,100 |
| Drawings | 17,600 | Railway freight on sales | 16,940 |
| Purchases | 80,000 | Carriage inwards | 2,310 |
| Sales | 1,40,370 | Office expenses | 1,340 |
| Purchases return | 2,820 | Printing and Stationery | 660 |
| Stock on April 01, 2016 | 11,460 | Postage and Telegram | 820 |
| Bad debts | 1,400 | Sundry debtors | 62,070 |
| doubtful debts reserve April 01, 2016 | 3,240 | Sundry creditors | 18,920 |
| Rates and Insurance | 1,300 | Cash in bank | 12,400 |
| Discount (Cr.) | 190 | Cash in hand | 2,210 |
| Bills receivable | 1,240 | Office furniture | 3,500 |
| Sales returns | 4,240 | Salaries and Commission | 9,870 |
| Wages | 6,280 | Addition to buildings | 7,000 |
| Buildings | 25,000 | | |

Prepare the trading and profit and loss account and a balance sheet as on March 31, 2017 after keeping in view the following adjustments :

- (i) Depreciate old building by ₹ 625 and addition to building at 2% and office furniture at 5%.
- (ii) Write-off further bad debts ₹ 570.
- (iii) Increase the bad debts reserve to 6% of debtors.
- (iv) On March 31, 2017 ₹ 570 are outstanding for salary.
- (v) Rent receivable ₹ 200 on March 31, 2017.
- (vi) Interest on capital at 5% to be charged.
- (vii) Unexpired insurance ₹ 240.
- (viii) Stock was valued at ₹ 14,290 on March 31, 2017.

Solution

Books of Shri R. Lal
Trading and Profit and Loss Account
for the year ended March 31, 2017

Dr.

Cr.

| <i>Expenses/Losses</i> | <i>Amount ₹</i> | <i>Revenues/Gains</i> | <i>Amount ₹</i> |
|----------------------------|---------------------|-----------------------|---------------------|
| Opening stock | 11,460 | Sales | 1,40,370 |
| Purchases | 80,000 | Less Sales Return | (4,240) |
| Less Purchase return | (2,820) | | 1,36,130 |
| Carriage inwards | 2,310 | | |
| Wages | 6,280 | Closing stock | 14,290 |
| Gross profit c/d | 53,190 | | |
| | <u>1,50,420</u> | | <u>1,50,420</u> |
| Railway freight on sales | 16,940 | Gross profit c/d | 53,190 |
| Office expenses | 1,340 | Rent | 2,100 |
| Postage and Telegram | 820 | Add Accrued rent | <u>200</u> |
| Printing and Stationery | 660 | Discount | 190 |
| Salary and Commission | 9,870 | | |
| Add Outstanding salary | 570 | | |
| Rates and Insurance | 1,300 | | |
| Less unexpired insurance | (240) | | |
| Bad debts | 1,400 | | |
| Add Further bad debts | 570 | | |
| Add New doubtful debts | <u>3,690</u> | | |
| provision | 5660 | | |
| Less Old provision | (3,240) | | |
| for bad debts | 2,420 | | |
| Interest on capital | 5,000 | | |
| Depreciation on building | 625 | | |
| Depreciation on addition | 140 | | |
| to building | | | |
| Depreciation on furniture | 175 | | |
| Net profit (transferred to | 16,060 | | |
| capital account) | | | |
| | <u>55,680</u> | | <u>55,680</u> |

Balance Sheet as at March 31, 2017

| <i>Liabilities</i> | <i>Amount</i> ₹ | <i>Assets</i> | <i>Amount</i> ₹ |
|-------------------------|--------------------|------------------------|--------------------|
| Sundry creditors | 18,920 | Cash at bank | 12,400 |
| Outstanding salaries | 570 | Cash in hand | 2,210 |
| Capital | 1,00,000 | Bills receivable | 1,240 |
| Add Net profit | 16,060 | | |
| Add Interest on capital | <u>5,000</u> | | |
| | 1,21,060 | Debtors | 62,070 |
| Less Drawings | <u>(17,600)</u> | Less Further bad debts | <u>(570)</u> |
| | 1,03,460 | | 61,500 |
| | | Less New provision | <u>(3,690)</u> |
| | | for doubtful debts | |
| | | Accrued rent | 200 |
| | | Unexpired insurance | 240 |
| | | Building | 25,000 |
| | | Less Depreciation | <u>(625)</u> |
| | | Addition to building | 7,000 |
| | | Less Depreciation | <u>(140)</u> |
| | | Office furniture | 3,500 |
| | | Less Depreciation | <u>(175)</u> |
| | | Closing stock | 14,290 |
| | <u>1,22,950</u> | | <u>1,22,950</u> |

Illustration 4

Prepare the trading profit and loss account of M/s Mohit Traders as on 31 March 2017 and draw necessary Journal entries and balance sheet as on that date :

| <i>Debit Balances</i> | <i>Amount</i> ₹ | <i>Credit Balances</i> | <i>Amount</i> ₹ |
|-----------------------|--------------------|------------------------|--------------------|
| Opening stock | 24,000 | Sales | 4,00,000 |
| Purchases | 1,60,000 | Return outwards | 2,000 |
| Cash in hand | 16,000 | Capital | 1,50,000 |
| Cash at bank | 32,000 | Creditors | 64,000 |
| Return inwards | 4,000 | Bills payable | 20,000 |
| Wages | 22,000 | Commission received | 4,000 |
| Fuel and Power | 18,000 | | |
| Carriage inwards | 6,000 | | |
| Insurance | 8,000 | | |
| Buildings | 1,00,000 | | |
| Plant | 80,000 | | |
| Patents | 30,000 | | |
| Salaries | 28,000 | | |
| Furniture | 12,000 | | |
| Drawings | 18,000 | | |
| Rent | 2,000 | | |
| Debtors | 80,000 | | |
| | <u>6,40,000</u> | | <u>6,40,000</u> |

Adjustments

| | ₹ |
|--|--------|
| (a) Salaries outstanding | 12,000 |
| (b) Wages outstanding | 6,000 |
| (c) Commission is accrued | 2,400 |
| (d) Depreciation on building 5% and plant 3% | |
| (e) Insurance paid in advance | 700 |
| (f) Closing stock | 12,000 |

Solution

**Books of Mohit Traders
Journal**

| Date | Particulars | L.F. | Debit Amount ₹ | Credit Amount ₹ |
|------------------|--|------|----------------------|-----------------------|
| 2017 March 31 | Salary A/c Dr. Wages A/c Dr. To Salary outstanding A/c To Wages outstanding A/c (Amount of salary and wages outstanding as on March 31, 2017) | | 12,000 6,000 | 12,000 6,000 |
| March 31 | Prepaid Insurance A/c Dr. To Insurance A/c (Insurance paid in advance) | | 1,400 | 1,400 |
| March 31 | Commission accrued A/c Dr. To Commission A/c (Commission accrued but not received) | | 2,400 | 2,400 |
| March 31 | Depreciation A/c Dr. To Building A/c To Plant A/c (Depreciation charged on plant and building) | | 7,400 | 5,000 2,400 |
| March 31 | Profit and Loss A/c Dr. To Capital A/c (Profit transferred to capital account) | | 1,23,700 | 1,23,700 |

Books of Mohit Traders
Trading and Profit and Loss Account
for the year ended March 31, 2017

Dr.

Cr.

| <i>Expenses /Losses</i> | <i>Amount</i> ₹ | <i>Revenue/Gains</i> | <i>Amount</i> ₹ |
|---|--------------------|----------------------|--------------------|
| Opening stock | 24,000 | Sales | 4,00,000 |
| Purchases | 1,60,000 | Less Returns | (4,000) |
| Less returns | (2,000) | Closing stock | 12,000 |
| Wages | 22,000 | | |
| Add Outstanding wages | 6,000 | | |
| Fuel and Power | 18,000 | | |
| Carriage inwards | 6,000 | | |
| Gross profit c/d | 1,74,000 | | |
| | 4,08,000 | | 4,08,000 |
| Salary | 28,000 | Gross Profit b/d | 1,74,000 |
| Add Outstanding salary | 12,000 | Commission received | (4,000) |
| Insurances | 8,000 | Add Accrued | 2,400 |
| Less Prepaid | (700) | commission | 6,400 |
| Rent | 2,000 | | |
| Depreciation on building | 5,000 | | |
| Plants | 2,400 | | |
| Net Profit (transferred to capital account) | 1,23,700 | | |
| | 1,80,400 | | 1,80,400 |

Balance Sheet as at March 31, 2017

| <i>Liabilities</i> | <i>Amount</i> ₹ | <i>Assets</i> | <i>Amount</i> ₹ |
|----------------------|--------------------|--------------------|--------------------|
| Creditors | 64,000 | Cash in hand | 16,000 |
| Bills payable | 20,000 | Cash at bank | 32,000 |
| Capital | 1,50,000 | Building | 95,000 |
| Add Net profit | 1,23,700 | Plant | 77,600 |
| | 2,73,700 | Patents | 30,000 |
| Less Drawings | (18,000) | Debtors | 80,000 |
| Outstanding salaries | 12,000 | Insurance prepaid | 700 |
| Outstanding wages | 6,000 | Commission accrued | 2,400 |
| | | Furniture | 12,000 |
| | | Closing stock | 12,000 |
| | 3,57,700 | | 3,57,700 |

Illustration 5

The following information has been extracted from the trial balance of M/s Randhir Transport Corporation.

| <i>Debit balances</i> | <i>Amount ₹</i> | <i>Credit balances</i> | <i>Amount ₹</i> |
|-----------------------|---------------------|-------------------------|---------------------|
| Opening stock | 40,000 | Capital | 2,70,000 |
| Rent | 2,000 | Creditors | 50,000 |
| Plant and Machinery | 1,20,000 | Bills payable | 50,000 |
| Land and Buildings | 2,55,000 | Loan | 1,10,000 |
| Power | 3,500 | Discount | 1,500 |
| Purchases | 75,000 | Sales | 1,50,000 |
| Sales return | 2,500 | Provision for bad debts | 1,000 |
| Telegram and Postage | 400 | General reserves | 50,000 |
| Wages | 4,500 | | |
| Salary | 2,500 | | |
| Insurance | 3,200 | | |
| Discount | 1,000 | | |
| Repair and Renewals | 2,000 | | |
| Legal charges | 700 | | |
| Trade taxes | 1,200 | | |
| Debtors | 75,000 | | |
| Investment | 65,000 | | |
| Bad debts | 2,000 | | |
| Trade expenses | 4,500 | | |
| Commission | 1,250 | | |
| Travelling expenses | 1,230 | | |
| Drawings | 20,020 | | |
| | <u>6,82,500</u> | | <u>6,82,500</u> |

Adjustments

1. Closing stock for the year was ₹ 35,500.
2. Depreciation charged on plant and machinery 5% and land and building 6%.
3. Interest on drawing @ 6% and Interest on loan @ 5%.
4. Interest on investments @ 4%.
5. Further bad debts 2,500 and make provision for doubtful debts on debtors 5%.
6. Discount on debtors @ 2%.
7. Salary outstanding ₹ 200.
8. Wages outstanding ₹ 100.
9. Insurance prepaid ₹ 500.

You are required to make trading and profit and loss account and a balance sheet on March 31, 2017.

Solution

Books of Randhir Transport Corporation
Trading and Profit and Loss Account
for the year ended March 31, 2017

| <i>Expenses/Losses</i> | <i>Amount ₹</i> | <i>Revenue/Gains</i> | <i>Amount ₹</i> |
|--|---------------------|---------------------------------------|---------------------|
| Opening stock | 40,000 | Sales | 1,50,000 |
| Purchases | 75,000 | Less Sales return | (2,500) |
| Wages | 4,500 | Closing stock | 35,500 |
| Add Outstanding wages | <u>100</u> | | |
| Power | 3,500 | | |
| Gross profit c/d | 59,900 | | |
| | <u>1,83,000</u> | | <u>1,83,000</u> |
| Rent | 2,000 | Gross profit b/d | 59,900 |
| Telegram and Postage | 400 | Outstanding interest on investment | 2,600 |
| Salary | 2,500 | Discount | 1,500 |
| Add Outstanding salary | <u>200</u> | Interest on drawings | 1,200 |
| Insurance | 3,200 | | |
| Less Prepaid | (500) | | |
| Discount | 1,000 | | |
| Repair and Renewals | 2,000 | | |
| Legal charges | 700 | | |
| Trade taxes | 1,200 | | |
| Trade expenses | 4,500 | | |
| Outstanding interest on loan | 5,500 | | |
| Commission | 1,250 | | |
| Travelling expenses | 1,230 | | |
| Discount on debtors | 1,450 | | |
| Depreciation on Plant and Machinery | 6,000 | | |
| Depreciation on Land and Building | 15,300 | | |
| Bad debts | 2,000 | | |
| Add Further bad debts | 2,500 | | |
| Add New provision | <u>3,553</u> | | |
| | 8,053 | | |
| Less Old provision | (1,000) | | |
| Net Profit (transferred to capital account) | 7,053 | | |
| | 10,217 | | |
| | <u>65,200</u> | | <u>65,200</u> |

Balance Sheet as at March 31, 2017

| <i>Liabilities</i> | <i>Amount</i> ₹ | <i>Assets</i> | <i>Amount</i> ₹ |
|---------------------------|--------------------|----------------------|--------------------|
| Creditors | 50,000 | Debtors | 75,000 |
| Bills payable | 50,000 | Less Further | (2,500) |
| Loan | 1,10,000 | bad debts | 72,500 |
| Add Outstanding interest | <u>5,500</u> | Less Discount | (1,450) |
| General reserve | 50,000 | | 71,050 |
| Capital | 2,70,000 | Less New Provision | (3,553) |
| Add Net Profit | <u>10,217</u> | Investment | 65,000 |
| | 2,80,217 | Outstanding interest | 2,600 |
| Less Drawings | <u>(20,020)</u> | on investment | |
| | 2,60,197 | Insurance pre-paid | 500 |
| Less Interest on drawings | <u>1,200</u> | Plant and Machinery | 1,14,000 |
| Outstanding salary | 200 | Land and Building | 2,39,700 |
| Outstanding wages | 100 | Closing stock | 35,500 |
| | <u>5,24,797</u> | | <u>5,24,797</u> |

Illustration 6

From the following balances of M/s Keshav Bros. You are required to prepare trading and profit and loss account and a balance sheet of March 31, 2017.

| <i>Debit balances</i> | <i>Amount</i> ₹ | <i>Credit balances</i> | <i>Amount</i> ₹ |
|-----------------------|--------------------|-------------------------|--------------------|
| Plant and Machinery | 1,30,000 | Sales | 3,00,000 |
| Debtors | 50,000 | Return outwards | 2,500 |
| Interest | 2,000 | Creditors | 2,50,000 |
| Wages | 1,200 | Bills payable | 70,000 |
| Salary | 2,500 | Provision for bad debts | 1,550 |
| Carriage inwards | 500 | Capital | 2,20,000 |
| Carriage outwards | 700 | Rent received | 10,380 |
| Return inwards | 2,000 | Commission received | 16,000 |
| Factory rent | 1,450 | | |
| Office rent | 2,300 | | |
| Insurance | 780 | | |
| Furniture | 22,500 | | |
| Buildings | 2,80,000 | | |
| Bills receivable | 3,000 | | |
| Cash in hand | 22,500 | | |
| Cash at bank | 35,000 | | |
| Commission | 500 | | |
| Opening stock | 60,000 | | |
| Purchases | 2,50,000 | | |
| Bad debts | 3,500 | | |
| | <u>8,70,430</u> | | <u>8,70,430</u> |

Adjustment

- (i) Provision for bad debts @ 5% and further bad debts ₹ 2,000.
- (ii) Rent received in advance ₹ 6,000.
- (iii) Prepaid insurance ₹ 200.
- (iv) Depreciation on furniture @ 5%, plant and machinery @ 6%, building @ 7%.

Solution

Books of Keshav Bros.
Trading and Profit and Loss Account
for the year ended March 31, 2017

Dr.**Cr.**

| <i>Expenses/Losses</i> | <i>Amount</i> ₹ | <i>Revenue/Gains</i> | <i>Amount</i> ₹ |
|---|--------------------|----------------------|--------------------|
| Opening stock | 60,000 | Sales | 3,00,000 |
| Purchases | 2,50,000 | Less Return | (2,000) |
| Less Returns | (2,500) | Closing stock | 70,000 |
| Wages | 1,200 | | |
| Carriage inwards | 500 | | |
| Factory rent | 1,450 | | |
| Gross profit c/d | 57,350 | | |
| | 3,68,000 | | 3,68,000 |
| Interest | 2,000 | Gross profit b/d | 57,350 |
| Salary | 2,500 | Rent received | 10,380 |
| Carriage outwards | 700 | Less Advance rent | (6,000) |
| Office Rent | 2,300 | Commission received | 16,000 |
| Insurance | 780 | | |
| Less Prepaid insurance | (200) | | |
| Depreciation on furniture | 1,125 | | |
| Depreciation on Plant and Machinery | 7,800 | | |
| Depreciation on building | 19,600 | | |
| Commission | 500 | | |
| Bad debts | 3,500 | | |
| Add Further bad debts | 2,000 | | |
| Add New provision | 2,400 | | |
| | 7,900 | | |
| Less Old provision | (1,550) | | |
| Net Profit (transferred to capital account) | 34,275 | | |
| | 77,730 | | 77,730 |

Balance Sheet as at March 31, 2017

| <i>Liabilities</i> | <i>Amount ₹</i> | <i>Liabilities</i> | <i>Amount ₹</i> |
|--------------------|---------------------|---------------------|---------------------|
| Creditors | 2,50,000 | Cash In hand | 22,500 |
| Bills payable | 70,000 | Cash at bank | 35,000 |
| Advance rent | 6,000 | Bills receivable | 3,000 |
| Capital | 2,20,000 | Prepaid insurance | 200 |
| Add Net profit | <u>34,275</u> | Debtors | 50,000 |
| | 2,54,275 | Less Further | <u>(2,000)</u> |
| | | bad debts | 48,000 |
| | | Less New provision | (2,400) |
| | | Plant and Machinery | 1,22,200 |
| | | Furniture | 21,375 |
| | | Buildings | 2,60,400 |
| | | Closing stock | 70,000 |
| | <u>5,80,275</u> | | <u>5,80,275</u> |

Illustration 7

The following information have been taken from the trial balance of M/s Fair Brothers Ltd. You are required to prepare the trading and profit and loss account and a balance sheet as at March 31, 2017.

| <i>Debit Balances</i> | <i>Amount ₹</i> | <i>Credit balances</i> | <i>Amount ₹</i> |
|---|---------------------|------------------------|---------------------|
| Cash | 20,000 | Sales | 3,61,000 |
| Wages | 45,050 | Loan 12% (1.7.2016) | 40,000 |
| Return outwards | 4,800 | Discount received | 1,060 |
| Bad debts | 4,620 | Return (Purchase) | 390 |
| Salaries | 16,000 | Creditors | 60,610 |
| Octroi | 1,000 | Capital | 75,000 |
| Charity | 250 | | |
| Machinery | 32,000 | | |
| Debtors (Including a dishonoured bill of ₹1,600) | 60,000 | | |
| Stock | 81,600 | | |
| Purchases | 2,60,590 | | |
| Repairs | 3,350 | | |
| Interest on loan | 1,200 | | |
| Sales tax | 1,600 | | |
| Insurance | 2,000 | | |
| Rent | 4,000 | | |
| | <u>5,38,060</u> | | <u>5,38,060</u> |

Adjustments

1. Wages include ₹ 4,000 for erection of new machinery on April 01, 2016.
2. Provide 5% depreciation on furniture.
3. Salaries unpaid ₹1,600.
4. Closing stock ₹ 81,850.
5. Create a provision at 5% on debtors.
6. Half the amount of bill is recoverable.
7. Rent is paid up to July 30, 2017.
8. Insurance unexpired ₹ 600.

**Books of Fair Brothers Ltd.
Trading and Profit and Loss Account
for the year ended March 31, 2017**

Dr.**Cr.**

| <i>Expenses/Losses</i> | <i>Amount ₹</i> | <i>Revenue/Gains</i> | <i>Amount ₹</i> |
|---|---------------------|----------------------|---------------------|
| Opening stock | 81,600 | Sales | 3,61,000 |
| Purchases | 2,60,590 | Less Sales return | (4,800) |
| Less Purchases return | (390) | Closing stock | 81,850 |
| Wages | 45,050 | | |
| Less Prepaid wages | (4,000) | | |
| including erection of machines | 41,050 | | |
| Octroi | 1,000 | | |
| Gross profit c/d | 54,200 | | |
| | 4,38,050 | | 4,38,050 |
| Salaries | 16,000 | Gross profit b/d | 54,200 |
| Add Outstanding salary | 1,600 | Discount received | 1,060 |
| | 17,600 | | |
| Repairs | 3,350 | | |
| Bad debts | 4,620 | | |
| Add Further bad debts | 800 | | |
| Add New provision | 2,960 | | |
| Interest on loan | 1,200 | | |
| Add Outstanding interest | 2,400 | | |
| | 3,600 | | |
| Sales tax | 1,600 | | |
| Insurance | 2,000 | | |
| Less Prepaid insurance | (600) | | |
| | 1,400 | | |
| Charity | 250 | | |
| Rent | 4,000 | | |
| Less Prepaid rent | 1,000 | | |
| | 3,000 | | |
| Depreciation on machinery | 1,800 | | |
| Net profit (transferred to capital account) | 14,280 | | |
| | 55,260 | | 55,260 |

Balance Sheet as at March 31, 2017

| <i>Liabilities</i> | <i>Amount</i> ₹ | <i>Assets</i> | <i>Amount</i> ₹ |
|----------------------|--------------------|---------------------|--------------------|
| Creditors | 60,610 | Cash | 20,000 |
| Outstanding salaries | 1,600 | Debtors | 60,000 |
| Loan | 40,000 | Less Bad debts | (800) |
| Outstanding interest | 2,400 | Less Provision | <u>2,960</u> |
| Capital | 75,000 | Prepaid rent | 1,000 |
| Add Net profit | <u>14,280</u> | Unexpired insurance | 600 |
| | 89,280 | Machinery | 32,000 |
| | | Add Erection | <u>4,000</u> |
| | | Wages | 36,000 |
| | | Less Depreciation | <u>(1,800)</u> |
| | | Closing stock | 81,850 |
| | <u>1,93,890</u> | | <u>1,93,890</u> |

Illustration 8

From the following balance extracted from the books of M/s Hariharan Brother, you are required to prepare the trading and profit and loss account and a balance sheet as on December 31, 2017.

| <i>Debit balance</i> | <i>Amount</i> ₹ | <i>Credit balance</i> | <i>Amount</i> ₹ |
|-------------------------|--------------------|------------------------|--------------------|
| Opening stock | 16,000 | Capital | 1,00,000 |
| Purchases | 40,000 | Sales | 1,60,000 |
| Return inwards | 3,000 | Return outwards | 800 |
| Carriage inwards | 2,400 | Apprenticeship premium | 3,000 |
| Carriage outwards | 5,000 | Bills payable | 5,000 |
| Wages | 6,600 | Creditors | 31,600 |
| Salaries | 11,000 | | |
| Rent | 2,200 | | |
| Freight and Dock | 4,800 | | |
| Fire Insurance premium | 1,800 | | |
| Bad debts | 4,200 | | |
| Discount | 1,000 | | |
| Printing and Stationery | 500 | | |
| Rates and Taxes | 700 | | |
| Travelling expenses | 300 | | |
| Trade expenses | 400 | | |
| Business premises | 1,10,000 | | |
| Furniture | 5,000 | | |
| Bills receivable | 7,000 | | |
| Debtors | 40,000 | | |
| Machine | 9,000 | | |
| Loan | 10,000 | | |
| Investment | 6,000 | | |
| Cash in hand | 500 | | |
| Cash at bank | 7,000 | | |
| Proprietor's withdrawal | 6,000 | | |
| | <u>3,00,400</u> | | <u>3,00,400</u> |

Adjustments

1. Closing stock ₹ 14,000.
2. Wages outstanding ₹ 600, Salaries Outstanding ₹ 1,000, Rent outstanding ₹ 200.
3. Fire Insurance premium includes ₹ 1,200 paid in July 01, 2016 to run for one year from July 01, 2016 to June 30, 2017.
4. Apprenticeship Premium is for three years paid in advance on January 01, 2016.
5. Stationery bill for ₹ 60 remain unpaid.
6. Depreciation on Premises @ 5%, furniture @ 10%, Machinery @ 10%.
7. Interest on loan given accrued for one year @ 7%.
8. Interest on investment @ 5% for half year to December 31, 2016 has accrued.
9. Interest on capital to be allowed at 5% for one year.
10. Interest on drawings to be charged to him ascertained for the year ₹ 160.

*Solution***Books of Hariharan Bros.****Trading and Profit and Loss Account for the year ended December 31, 2017**

| Dr. | | Cr. | |
|---|---------------------|--------------------------------|---------------------|
| <i>Expenses/Losses</i> | <i>Amount ₹</i> | <i>Revenue/Gains</i> | <i>Amount ₹</i> |
| Opening stock | 16,000 | Sales | 1,60,000 |
| Purchases | 40,000 | Less Sales return | (3,000) |
| Less purchases return | (800) | Closing stock | 14,000 |
| Wages | 6,600 | | |
| Add Outstanding Wages | 600 | | |
| Carriage inwards | 2,400 | | |
| Freight and Dock | 4,800 | | |
| Gross profit c/d | 1,01,400 | | |
| | <u>1,71,000</u> | | <u>1,71,000</u> |
| Salaries | 11,000 | Gross profit b/d | 1,01,400 |
| Add Outstanding salary | 1,000 | Apprenticeship premium | 3,000 |
| Carriage outwards | 5,000 | Less Advance premium | (2,000) |
| Rates and Taxes | 700 | Accrued interest on loan | 700 |
| Printing and Stationery | 500 | Interest on drawings | 160 |
| Add Outstanding bill | 60 | Accrued interest on investment | 150 |
| Trade expenses | 400 | | |
| Travelling expenses | 300 | | |
| Fire insurance | 1,800 | | |
| Less Prepaid insurance | (600) | | |
| Bad debts | 4,200 | | |
| Rent | 2,200 | | |
| Add Outstanding rent | 200 | | |
| Interest on capital | 5,000 | | |
| Depreciation on premises | 5,500 | | |
| Depreciation on furniture | 500 | | |
| Depreciation on machinery | 900 | | |
| Discount | 1,000 | | |
| Net profit (transferred to capital account) | 63,750 | | |
| | <u>1,03,410</u> | | <u>1,03,410</u> |

Balance Sheet as at December 31, 2017

| <i>Liabilities</i> | | <i>Amount</i> ₹ | <i>Assets</i> | | <i>Amount</i> ₹ |
|----------------------------------|----------|--------------------|----------------------|----------|--------------------|
| Capital | 1,00,000 | | Premises | 1,10,000 | |
| Add Interest on capital | 5,000 | | Less Depreciation | (5,500) | 1,04,500 |
| Add Net profit | 63,750 | | Furniture | | 4,500 |
| | 1,68,750 | | Machinery | | 8,100 |
| Less drawings | (6,000) | | Debtors | | 40,000 |
| | 1,62,750 | | Bills receivable | | 7,000 |
| Less Interest on drawings | (160) | 1,62,590 | Cash in hand | | 500 |
| Creditors | | 31,600 | Cash at bank | | 7,000 |
| Bills payable | | 5,000 | Loan | 10,000 | |
| Outstanding wages | | 600 | Add accrued interest | 700 | 10,700 |
| Outstanding salaries | | 1,000 | Investments | 6,000 | |
| Outstanding rent | | 200 | Add accrued interest | 150 | 6,150 |
| Outstanding stationery | | 60 | Pre-paid insurance | | 600 |
| Apprenticeship premium (advance) | | 2,000 | Closing stock | | 14,000 |
| | | <u>2,03,050</u> | | | <u>2,03,050</u> |

Illustration 9

The following balances have been extracted from the trial balance of M/s Kolkata Ltd. You are required to prepare the trading and profit and loss account on dated March 31, 2017. Also prepare balance sheet on that date.

| <i>Debit balances</i> | <i>Amount</i> ₹ | <i>Credit balances</i> | <i>Amount</i> ₹ |
|------------------------|--------------------|------------------------|--------------------|
| Opening stock | 6,000 | Capital | 20,000 |
| Furniture | 1,200 | Sales | 41,300 |
| Drawings | 2,800 | Purchases return | 4,000 |
| Cash in hand | 3,000 | Bank overdraft | 4,000 |
| Purchases | 24,000 | Bad debts provision | 400 |
| Sales return | 2,000 | Creditors | 5,000 |
| Establishment expenses | 4,400 | Commission | 100 |
| Bad debts | 1,000 | Bills payable | 5,000 |
| Debtors | 10,000 | Apprenticeship premium | 500 |
| Carriage | 1,000 | | |
| Bills receivable | 6,000 | | |
| Bank deposits | 8,000 | | |
| Wages | 1,000 | | |
| Trade expenses | 500 | | |
| Bank charges | 400 | | |
| General expenses | 1,000 | | |
| Salaries | 2,000 | | |
| Insurance | 1,500 | | |
| Postage and Telegram | 500 | | |
| Rent, Rates and Taxes | 2,000 | | |
| Coal, Gas, Water | 2,000 | | |
| | <u>80,300</u> | | <u>80,300</u> |

Adjustments

1. Outstanding salaries ₹ 100. Rent and taxes ₹ 200, Wages ₹ 100.
2. Unexpired insurance ₹ 500.
3. Commission is received in advances ₹ 50.
4. Interest ₹ 500 is to be received on bank deposits.
5. Interest on bank overdraft ₹ 750.
6. Depreciation on furniture @ 10%.
7. Closing stock ₹ 9,000.
8. Further bad debts ₹ 200 New provision @ 5% on debtors.
9. Apprenticeship premium received in advance ₹ 100.
10. Interest on drawings @ 6%.

*Solution***Books of Kolkata Ltd.****Trading and Profit and Loss Account for the year ended as at March 31, 2017****Dr.****Cr.**

| <i>Expenses /Losses</i> | <i>Amount ₹</i> | <i>Revenue/Gains</i> | <i>Amount ₹</i> |
|---|---------------------|------------------------------|---------------------|
| Opening stock | 6,000 | Sales 41300 | |
| Purchases 24,000 | | Less sales return (2,000) | 39,300 |
| Less purchases return (4,000) | 20,000 | Closing stock | 9,000 |
| Wages 1,000 | | | |
| Add Outstanding wages 100 | 1,100 | | |
| Coal, Gas, Water | 2,000 | | |
| Gross profit c/d | 19,200 | | |
| | 48,300 | | 48,300 |
| Establishment expenses | 4,400 | Gross profit b/d | 19,200 |
| Carriage | 1,000 | Commission 100 | |
| Trade expenses | 500 | Less Advance commission (50) | 50 |
| Bank charges | 400 | Accrued interest on deposits | 500 |
| General expenses | 1,000 | Apprenticeship premium 500 | |
| Salaries 2,000 | | Less Advance received 100 | 400 |
| Add Outstanding salary 100 | 2,100 | Interest on drawings | 168 |
| Insurance 1,500 | | | |
| Less Prepaid insurance (500) | 1,000 | | |
| Postage and Telegram | 500 | | |
| Rent, rates and Taxes | 2,200 | | |
| Interest on bank overdraft | 750 | | |
| Bad debts 1,000 | | | |
| Add Further bad debts 200 | | | |
| Add New provision 490 | | | |
| | 1,690 | | |
| Less Old provision (400) | 1,290 | | |
| Depreciation on furniture | 120 | | |
| Net profit (transferred to capital account) | 5,058 | | |
| | 20,318 | | 20,318 |

Balance Sheet as at March 31, 2017

| <i>Liabilities</i> | | <i>Amount</i> ₹ | <i>Assets</i> | | <i>Amount</i> ₹ |
|-----------------------------------|----------------|--------------------|---------------------------------|--------------|--------------------|
| Capital | 2,00,00 | | Insurance prepaid | | 500 |
| Net profit | <u>5,058</u> | | Bank deposits | 8,000 | |
| | 25,058 | | <i>Add</i> outstanding interest | 500 | 8,500 |
| <i>Less</i> Drawings | <u>(2,800)</u> | | Furniture | | 1,080 |
| | 22,258 | | Cash in hand | | 3,000 |
| <i>Less</i> Interest on drawings | <u>(168)</u> | 22,090 | Debtors | 10,000 | |
| Creditors | | 5,000 | <i>Less</i> Further | <u>(200)</u> | |
| Commission received in advance | | 50 | bad debts | 9,800 | |
| Apprenticeship premium | | 100 | <i>Less</i> Provision for | <u>(490)</u> | 9,310 |
| Outstanding wages | | 100 | doubtful debts | | |
| Outstanding salaries | | 100 | Bills receivable | | 6,000 |
| Outstanding rent, rates, taxes | | 200 | Closing stock | | 9,000 |
| Bank overdraft | 4,000 | | | | |
| <i>Add</i> Outstanding interest | <u>750</u> | 4,750 | | | |
| Bills payable | | 5,000 | | | |
| | | <u>37,390</u> | | | <u>37,390</u> |

Illustration 10

Prepare the trading and profit and loss account of M/s Roni Plastic Ltd. from the following trial balance and a balance sheet as at March 31, 2017.

| <i>Debit balances</i> | <i>Amount</i> ₹ | <i>Credit balances</i> | <i>Amount</i> ₹ |
|-------------------------|--------------------|------------------------|--------------------|
| Drawings | 6,000 | Creditors | 16,802 |
| Sundry debtors | 38,200 | Capital | 60,000 |
| Carriage outwards | 2,808 | Loan on mortgage | 17,000 |
| Establishment expenses | 16,194 | Bad debts provision | 1,420 |
| Interest on loan | 400 | Sales | 2,22,486 |
| Cash in hand | 6,100 | Purchases return | 2,692 |
| Stock | 11,678 | Discount | 880 |
| Motor car | 18,000 | Bills payable | 5,428 |
| Cash at bank | 9,110 | Rent received | 500 |
| Land and Buildings | 24,000 | | |
| Bad debts | 1,250 | | |
| Purchases | 1,34,916 | | |
| Sales return | 15,642 | | |
| Advertisement | 4,528 | | |
| Carriage inward | 7,858 | | |
| Rates, taxes, insurance | 7,782 | | |
| General expenses | 8,978 | | |
| Bills receivable | 13,764 | | |
| | <u>3,27,208</u> | | <u>3,27,208</u> |

Adjustments

1. Depreciation on land and building at @ 5% and Motor vehicle at @ 15%.
2. Interest on loan is @ 5% taken on April 01, 2016.
3. Goods costing Rs1,200 were sent to a customer on sale on return basis for ₹ 1,400 on March 30, 2017 and has been recorded in the books as actual sales.
4. Salaries amounting to ₹ 1,400 and Rates amounting to ₹ 800 are due.
5. The bad debts provision is to be brought up to @ 5% on sundry debtors.
6. Closing stock was ₹ 13,700.
7. Goods costing ₹ 1,000 were taken away by the proprietor for his personal use but not entry has been made in the books of account.
8. Insurance pre-paid ₹ 350.
9. Provide the manager's commission at @ 5% on Net profit after charging such commission.

Solution

Books of Roni's Plastic Ltd.
Trading and Profit and Loss Account for the year ended March 31, 2017

| Dr. | | Cr. | |
|---|---------------------|----------------------|---------------------|
| <i>Expenses/Losses</i> | <i>Amount ₹</i> | <i>Revenue/Gains</i> | <i>Amount ₹</i> |
| Opening stock | 11,678 | Sales | 2,22,486 |
| Purchases | 1,34,916 | Less Sales | <u>15,642</u> |
| | | return | 2,06,844 |
| Less Purchases return | <u>2,692</u> | Less Return basis | <u>(1,400)</u> |
| | 1,32,224 | | 2,05,444 |
| Less Goods withdrawn | <u>(1,000)</u> | Closing stock | 13,700 |
| Carriage inwards | 7,858 | | |
| Gross profit c/d | <u>68,384</u> | | |
| | <u>2,19,144</u> | | <u>2,19,144</u> |
| Outstanding salaries | 1,400 | Gross profit b/d | 68,384 |
| Carriage outwards | 2,808 | Discount | 880 |
| Establishment expenses | 16,194 | Rent | 500 |
| Bad debts | 1,250 | | |
| Add New provision | <u>1,840</u> | | |
| | 3,090 | | |
| Less Old provision | <u>(1,420)</u> | | |
| | 1,670 | | |
| Rates and Taxes | 7,782 | | |
| Less Prepaid | <u>(350)</u> | | |
| | 7,432 | | |
| Add Outstanding | <u>800</u> | | |
| Advertisement | 4,528 | | |
| Interest on loan | 400 | | |
| Add Outstanding Interest | <u>450</u> | | |
| | 850 | | |
| General expenses | 8,978 | | |
| Depreciation on : | | | |
| Land and Building | 1,200 | | |
| Motor car | <u>2,700</u> | | |
| | 3,900 | | |
| Manager commission | 1,010 | | |
| Net profit (transferred to capital account) | <u>20,194</u> | | |
| | <u>69,764</u> | | <u>69,764</u> |

Balance Sheet as at March 31, 2017

| <i>Liabilities</i> | <i>Amount</i> ₹ | <i>Assets</i> | <i>Amount</i> ₹ |
|---------------------------|--------------------|-------------------------|--------------------|
| Capital | 60,000 | Cash in hand | 6,100 |
| Add Net profit | <u>20,194</u> | Cash at bank | 9,110 |
| | 80,194 | Bills receivable | 13,764 |
| Less Drawings | <u>(6,000)</u> | Debtors | 38,200 |
| | (74,194) | Less sales return basis | <u>(1,400)</u> |
| Less Goods withdrawn loan | <u>1,000</u> | | 36,800 |
| | 17,000 | Less New provisions | <u>(1,840)</u> |
| Add interest | <u>450</u> | | 34,960 |
| Bills payable | 5,428 | Land and Building | 24,000 |
| Creditors | 16,802 | Less Depreciation | <u>(1,200)</u> |
| Outstanding Salaries | 1,400 | | 22,800 |
| Outstanding Rates Taxes | 800 | Motor car | 18,000 |
| Manager commission | 1,010 | Less Depreciation | <u>(2,700)</u> |
| | | | 15,300 |
| | | Prepaid insurance | 350 |
| | | Closing stock | 13,700 |
| | <u>1,16,084</u> | | <u>1,16,084</u> |

Do it yourself

1. From the following Trial Balance of M/s Karan on March 31, 2017, prepare a Trading and Profit and Loss Account and a Balance Sheet:

| <i>Particulars</i> | <i>Dr. (₹)</i> | <i>Cr. (₹)</i> |
|---|----------------|----------------|
| Creditors/Debtors | 2,05,000 | 96,000 |
| Bills Payable/Bills Receivables | 10,000 | 9,600 |
| 15% Loan | — | 50,000 |
| Sales/Purchases | 2,80,000 | 12,00,000 |
| Discount | 4,000 | 3,000 |
| Bad Debt Recovered/Bad Debt | 5,000 | 14,000 |
| Interest on Investments | — | 6,000 |
| Interest on Loan | 8,000 | 4,000 |
| Vehicles | 6,50,000 | — |
| Stock | 3,00,000 | — |
| 10% Investments (Purchased on 30 th September, 2016) | 1,80,000 | — |
| Cash in hand | 20,000 | — |
| Cash at bank | 37,000 | — |

| | | |
|-----------------------------------|------------------|------------------|
| Capital /Drawings | 9,000 | 4,50,000 |
| Carriage on Purchases | 1,600 | — |
| Carriage on sales | 4,400 | — |
| Primary Packing Expenses | 2,000 | — |
| Rent | 3,000 | 7,000 |
| Insurance | 3,600 | — |
| Office & Administrative Expenses | 4,000 | — |
| Discount | 2,000 | 3,000 |
| 10% Loan | 60,000 | — |
| Delivery Expenses | 4,000 | — |
| Selling and Distribution Expenses | 10,000 | — |
| Income Tax | 2,000 | — |
| Outstanding Salary | — | 1,000 |
| Sales Tax Collected | — | 3,000 |
| Apprenticeship Premium | — | 6,000 |
| Returns | 1,000 | 4,000 |
| Live Stock | 53,000 | — |
| Commission | 10,000 | 12,000 |
| | 18,68,600 | 18,68,600 |

(I) Additional Information

- The cost of closing stock was ₹ 50,000 but the market value was ₹ 40,000.
- Rent is due but not yet paid for March 2017 ₹ 500.
- Insurance carried forward ₹ 900.
- 1/3 of the commission received is in respect of work to be done in next year and commission paid represents only 1/4 of the actual commission to be paid during the year.
- Vehicles were valued at 90% of the book value.
- The Horse worth ₹ 30,000 was donated to a charitable organization.

- (II)** Name the accounting concept followed while treating the adjustment (a), (b) and (d) above?

2. The following balances were extracted from the books of Avika Enterprises on 31st March 2017.

| Particulars | Dr. (₹) | Cr. (₹) |
|------------------------------|-----------------|-----------------|
| Capital | — | 24,500 |
| Drawings | 2,000 | — |
| General Expenses | 2,500 | — |
| Buildings | 21,000 | — |
| Machinery | 9,340 | — |
| Stock (1.4.2016) | 16,200 | — |
| Power | 2,240 | — |
| Taxes and Insurance | 1,315 | — |
| Wages | 7,200 | — |
| Debtors and Creditors | 6,280 | 2,500 |
| Charity | 105 | — |
| Bad debts | 550 | — |
| Bank Overdraft | — | 11,180 |
| Sales and Purchases | 13,500 | 65,360 |
| Stock (31.03.2017) | 23,500 | — |
| Motor Vehicles | 2,000 | — |
| Motor Vehicle expenses | 500 | — |
| Provision for doubtful debts | — | 900 |
| Commission | — | 1,320 |
| Trade expenses | 1,280 | — |
| Bills payable | — | 3,850 |
| Cash | 100 | — |
| Total | 1,09,610 | 1,09,610 |

You are required to :

- (i) Prepare final accounts for the year ended March 31, 2017 after giving effect to the following adjustments:
 - (a) 1/5th of General expenses and Taxes & Insurance to be charged to factory and the balance to the office.
 - (b) Write off a further Bad debts of ₹ 160 and maintain the provision for doubtful debts at 5% and create a provision for discount on Debtors at 10%.
 - (c) Depreciate Machinery at 10% and Motor Vehicles by ₹ 240
 - (d) Provide ₹ 700 for interest on Bank Overdraft to be paid.
 - (e) ₹ 50 is to be carried forward to next year out of Insurance.
 - (f) Provide for Manager's Commission at 10% on the Net Profit after charging such commission.
- (ii) Name the accounting concepts which are followed while treating the adjustment (a), (b) and (d) above?

3. The following balances were extracted from the books of Anushka Enterprises on March 31, 2017.

| Particulars | Amount (₹) |
|----------------------------------|-------------------|
| Creditors | 2,00,000 |
| Loan from SBI | 2,00,000 |
| Sales | 12,30,000 |
| Debtors | 2,00,000 |
| Dividend Received on Shares | 20,000 |
| Bad Debt | 2,000 |
| Bad Debt Recovered | 12,000 |
| Bills Receivables | 1,50,000 |
| Interest on Loan | 50,000 |
| Goodwill | 4,00,000 |
| Purchases | 2,10,000 |
| Stock (1.4.2016) | 1,00,000 |
| Cash at Bank | 3,00,000 |
| Factory Repairs | 40,000 |
| Capital | 7,24,000 |
| Audit Fees | 6,000 |
| Petty Expenses | 4,000 |
| Salary | 70,000 |
| Life Insurance Premium | 15,000 |
| Premises | 4,00,000 |
| Insurance | 25,000 |
| Sales Returns | 12,000 |
| Employees Provident Fund | 60,000 |
| Provision for Doubtful Debts | 75,000 |
| Delivery Expenses | 8,000 |
| Dock Charges (Outward) | 6,000 |
| Packing Charges | 17,000 |
| Advance Salary | 30,000 |
| Warehouse Insurance | 13,000 |
| Loss in Exchange | 9,000 |
| Bank Charges | 5,000 |
| Bonus from Suppliers | 3,45,000 |
| Purchases Returns | 10,000 |
| Machinery | 8,00,000 |
| Discounting of Bills of Exchange | 1,000 |

You are required to :

- (i) Prepare final accounts for the year ended March 31, 2017 after giving effect to the following adjustments:
- Insurance is due but not yet paid for 31 March 2017 ₹ 500.
 - Salary Unexpired ₹ 900.
 - Write off a further Bad debts ₹ 2,000 and maintain the provision for bad debts at 5% on Debtors.
 - Machinery is to be valued at 90% less than the book value.
 - Goods kept in warehouse worth ₹ 10,0000 were used for staff welfare.
 - Half of the Bills Receivable were irrecoverable.
 - Closing Stock is ₹ 40,000
- (ii) Name the accounting concepts which will be followed while treating the adjustment (a), (b), (c) and (d) above?

4. The following balances were extracted from the books of Ankita Enterprises on March 31, 2017.

| Particulars | Dr. (₹) | Cr. (₹) |
|--------------------------|-----------------|-----------------|
| Capital | — | 1,92,680 |
| Cash | — | 60 |
| Purchases | 17,980 | — |
| Sales | — | 22,120 |
| Bank | 1,770 | — |
| Plant | 450 | — |
| Freehold Land | 3,000 | — |
| Heating and Lighting | 130 | — |
| Bills Receivables | — | 1,650 |
| Return Inwards | — | 60 |
| Salaries | 2,150 | — |
| Creditors | — | 63,780 |
| Debtors | 11,400 | — |
| Stock (as on 01.04.2016) | 6,000 | — |
| Printing | 450 | — |
| Bills Payable | 3,750 | — |
| Taxes | 380 | — |
| Discount Received | 890 | — |
| Commission (Dr.) | — | 800 |
| Trucks | 25,000 | — |
| Furniture | — | 12,000 |
| Wages | 2,00,000 | — |
| Drawings | — | 340 |
| Returns Outward | 400 | — |
| | 2,73,750 | 2,93,490 |

You are required to :

- (i) Redraft the Trial Balance.
- (ii) Prepare final accounts for the year ended March 31, 2017 after giving effect to the following adjustments:
 - (a) Taxes are paid for 10 months only.
 - (b) Creditors worth ₹ 780 have accepted bills payables.
 - (c) Depreciate furniture by 10%.
 - (d) Trucks were depreciated to the extent of ₹ 21,000.
 - (e) Wages includes ₹ 2,000 for the making of Furniture.
 - (f) Closing Stock is of ₹ 20,000.
 - (g) Provide for Manager's Commission at 10% on the Net Profit before charging such commission.
 - (h) Land was acquired on 1st April, 2016 by paying a claim at 50% less than market value to the owner.
- (iii) Name the accounting principles which will be followed while treating the adjustment (a), (c) and (e) above?
(Correct total of Trial Balance ₹ 2,83,620)

Key Terms Introduced in the Chapter

- Outstanding /Accrued expenses
- Accrued Incomes
- Depreciation
- Provision for doubtful debts
- Managers Commission
- Prepaid/Unexpired expenses
- Income received in advance
- Bad Debts
- Provision for discount on debtors
- Interest on Capital

Summary with Reference to Learning Objectives

1. *Need for adjustments* : For the preparation of financial statements, it is necessary that all the adjustments arising out of the accrual basis of accounting are made at the end of the accounting period. Another important consideration in the preparation of final accounts with adjustments, is the distinction between capital and revenue items. Entries which are recorded to give effect to these adjustments are known as adjusting entries.
2. *Outstanding expenses* : At the end of the accounting period sometimes a business enterprises is left with some unpaid expenses due to one reason or another. Such expenses are termed as outstanding expenses.

3. *Prepaid expenses* : At the end of the accounting year, it is found that the benefits of some expenses have not been fully received; a portion of total benefits would be received in the next accounting year. That portion of the expense, the benefit of which will be received during the next accounting period is known as 'prepaid expenses'.
4. *Accrued Income* : These are certain items is received by a business enterprise but the whole amount of it does not belong to the next period. Such portion of income which belongs to the next accounting period is income received in advance and is known as "unearned income".
5. *Depreciation* : Depreciation is the decline in the value of an asset an account of wear and tear or passage of time or with. It actually amounts to writing off a portion of the cost of an asset which has been used in the business for the purpose of earning profits. In the balance sheet, the asset is shown at loss minus the amount of depreciation.
6. *Provisions for bad and doubtful debts* : It is a normal feature of business operations that some debts prove irrecoverable which means that the amount to the realised from them becomes had to view of this. An attempt is made to bring in a certain element of certainty in the amount in respect of bad debts charged every year against incomes.

Questions for Practice

Short Answers

1. Why is it necessary to record the adjusting entries in the preparation of final accounts?
2. What is meant by closing stock? Show its treatment in final accounts?
3. State the meaning of:
 - (a) Outstanding expenses
 - (b) Prepaid expenses
 - (c) Income received in advance
 - (d) Accrued income
4. Give the Performa of income statement and balance in vertical form.
5. Why is it necessary to create a provision for doubtful debts at the time of preparation of final accounts?
6. What adjusting entries would you record for the following :
 - (a) Depreciation
 - (b) Discount on debtors
 - (c) Interest on capital
 - (d) Manager's commission
7. What is meant by provision for discount on debtors?
8. Give the journal entries for the following adjustments :
 - (a) Outstanding salary ₹ 3,500.
 - (b) Rent unpaid for one month at ₹ 6,000 per annum.
 - (c) Insurance prepaid for a quarter at ₹ 16,000 per annum.
 - (d) Purchase of furniture costing ₹ 7,000 entered in the purchases book.

Long Answers

1. What are adjusting entries? Why are they necessary for preparing final accounts?
2. What is meant by provision for doubtful debts? How are the relevant accounts prepared and what journal entries are recorded in final accounts? How is the amount for provision for doubtful debts calculated?
3. Show the treatment of prepaid expenses depreciation, closing stock at the time of preparation of final accounts when:
 - (a) When given inside the trial balance?
 - (b) When given outside the trial balance?

Numerical Questions

1. Prepare a trading and profit and loss account for the year ending March 31, 2017. from the balances extracted of M/s Rahul Sons. Also prepare a balance sheet at the end of the year.

| <i>Account Title</i> | <i>Amount ₹</i> | <i>Account Title</i> | <i>Amount ₹</i> |
|-----------------------|---------------------|------------------------------|---------------------|
| Stock | 50,000 | Sales | 1,80,000 |
| Wages | 3,000 | Purchases return | 2,000 |
| Salary | 8,000 | Discount received | 500 |
| Purchases | 1,75,000 | Provision for doubtful debts | 2,500 |
| Sales return | 3,000 | Capital | 3,00,000 |
| Sundry Debtors | 82,000 | Bills payable | 22,000 |
| Discount allowed | 1,000 | Commission received | 4,000 |
| Insurance | 3,200 | Rent | 6,000 |
| Rent Rates and Taxes | 4,300 | Loan | 34,800 |
| Fixtures and fittings | 20,000 | | |
| Trade expenses | 1,500 | | |
| Bad debts | 2,000 | | |
| Drawings | 32,000 | | |
| Repair and renewals | 1,600 | | |
| Travelling expenses | 4,200 | | |
| Postage | 300 | | |
| Telegram expenses | 200 | | |
| Legal fees | 500 | | |
| Bills receivable | 50,000 | | |
| Building | 1,10,000 | | |
| | <u>5,51,800</u> | | <u>5,51,800</u> |

Adjustments

1. Commission received in advance ₹1,000.
2. Rent receivable ₹ 2,000.
3. Salary outstanding ₹ 1,000 and insurance prepaid ₹ 800.

4. Further bad debts ₹ 1,000 and provision for doubtful debts @ 5% on debtors and discount on debtors @ 2%.
 5. Closing stock ₹ 32,000.
 6. Depreciation on building @ 6% p.a.
- (Ans : Gross loss ₹17,000 ; Net loss ₹43,189 ; Total balance sheet ₹2,83,611)
2. Prepare a trading and profit and loss account of M/s Green Club Ltd. for the year ending March 31, 2017. from the following figures taken from his trial balance :

| Account Title | Amount ₹ | Account Title | Amount ₹ |
|-----------------------|-----------------|-------------------------|-----------------|
| Opening stock | 35,000 | Sales | 2,50,000 |
| Purchases | 1,25,000 | Purchase return | 6,000 |
| Return inwards | 25,000 | Creditors | 10,000 |
| Postage and Telegram | 600 | Bills payable | 20,000 |
| Salary | 12,300 | Discount | 1,000 |
| Wages | 3,000 | Provision for bad debts | 4,500 |
| Rent and Rates | 1,000 | Interest received | 5,400 |
| Packing and Transport | 500 | Capital | 75,000 |
| General expense | 400 | | |
| Insurance | 4,000 | | |
| Debtors | 50,000 | | |
| Cash in hand | 20,000 | | |
| Cash at bank | 40,000 | | |
| Machinery | 20,000 | | |
| Lighting and Heating | 5,000 | | |
| Discount | 3,500 | | |
| Bad debts | 3,500 | | |
| Investment | 23,100 | | |
| | <u>3,71,900</u> | | <u>3,71,900</u> |

Adjustments

1. Depreciation charged on machinery @ 5% p.a.
 2. Further bad debts ₹1,500, discount on debtors @ 5% and make a provision on debtors @ 6%.
 3. Wages prepaid ₹1,000.
 4. Interest on investment @ 5% p.a.
 5. Closing stock 10,000.
- (Ans. : Gross Profit ₹79,000 ; Net Profit ₹52,565 ; Total Balance Sheet ₹1,57,565).

3. The following balances has been extracted from the trial of M/s Runway Shine Ltd. Prepare a trading and profit and loss account and a balance sheet as on March 31, 2017.

| <i>Account Title</i> | <i>Amount</i> ₹ | <i>Account Title</i> | <i>Amount</i> ₹ |
|-------------------------|--------------------|----------------------|--------------------|
| Purchases | 1,50,000 | Sales | 2,50,000 |
| Opening stock | 50,000 | Return outwards | 4,500 |
| Return inwards | 2,000 | Interest received | 3,500 |
| Carriage inwards | 4,500 | Discount received | 400 |
| Cash in hand | 77,800 | Creditors | 1,25,000 |
| Cash at bank | 60,800 | Bill payable | 6,040 |
| Wages | 2,400 | Capital | 1,00,000 |
| Printing and Stationery | 4,500 | | |
| Discount | 400 | | |
| Bad debts | 1,500 | | |
| Insurance | 2,500 | | |
| Investment | 32,000 | | |
| Debtors | 53,000 | | |
| Bills receivable | 20,000 | | |
| Postage and Telegraph | 400 | | |
| Commission | 200 | | |
| Interest | 1,000 | | |
| Repair | 440 | | |
| Lighting Charges | 500 | | |
| Telephone charges | 100 | | |
| Carriage outward | 400 | | |
| Motor car | 25,000 | | |
| | <u>4,89,440</u> | | <u>4,89,440</u> |

Adjustments

1. Further bad debts ₹ 1,000. Discount on debtors ₹ 500 and make a provision on debtors @ 5%.
2. Interest received on investment @ 5%.
3. Wages and interest outstanding ₹ 100 and ₹ 200 respectively.
4. Depreciation charged on motor car @ 5% p.a.
5. Closing Stock ₹ 32,500.

(Ans. : Gross profit ₹ 78,000 ; Net profit ₹ 66,010, Total balance sheet ₹ 2,97,350).

4. From the following Trial Balance you are required to prepare trading and profit and loss account for the year ending March 31, 2017 and Balance Sheet on that date.

| <i>Particulars</i> | <i>Amount</i> ₹ | <i>Particulars</i> | <i>Amount</i> ₹ |
|----------------------------|--------------------|--------------------------------------|--------------------|
| Opening stock | 25,000 | Sales | 7,00,000 |
| Furniture | 16,000 | Creditors | 72,500 |
| Purchases | 5,55,300 | Bank Overdraft | 50,000 |
| Carriage Inwards | 4,700 | Provision for bad and doubtful debts | 2,100 |
| Bad debts | 1,800 | Discount | 500 |
| Wages | 52,000 | Capital | 2,00,000 |
| Debtors | 80,000 | Purchases Return | 20,000 |
| Sales Return | 15,000 | | |
| Rent | 24,000 | | |
| Miscellaneous Expenses | 3,400 | | |
| Salaries | 68,000 | | |
| Cash | 8,900 | | |
| Drawings | 14,000 | | |
| Buildings | 1,60,000 | | |
| Advertising | 10,000 | | |
| Interest on Bank Overdraft | 7,000 | | |
| | 10,45,100 | | 10,45,100 |

Adjustments

1. Closing stock valued at ₹ 36,000.
2. Private purchases amounting to ₹ 5000 debited to purchases account.
3. Provision for doubtful debts @ 5% on debtors.
4. Sign board costing ₹ 4,000 includes in advertising.
5. Depreciate furniture by 10%.

(Ans : Gross Profit ₹1,09,000; Net loss ₹ 4,600; Total balance sheet ₹2,98,900).

5. From the following information prepare trading and profit and loss account of M/s Indian sports house for the year ending March 31, 2017.

| <i>Account Title</i> | <i>Amount ₹</i> | <i>Account Title</i> | <i>Amount ₹</i> |
|-------------------------|---------------------|-------------------------|---------------------|
| Drawings | 20,000 | Capital | 2,00,000 |
| Sundry debtors | 80,000 | Return outwards | 2,000 |
| Bad debts | 1,000 | Bank overdraft | 12,000 |
| Trade Expenses | 2,400 | Provision for bad debts | 4,000 |
| Printing and Stationery | 2,000 | Sundry creditors | 60,000 |
| Rent Rates and Taxes | 5,000 | Bills payable | 15,400 |
| Feright | 4,000 | Sales | 2,76,000 |
| Return inwards | 7,000 | | |
| Opening stock | 25,000 | | |
| Purchases | 1,80,000 | | |
| Furniture and Fixture | 20,000 | | |
| Plant and Machinery | 1,00,000 | | |
| Bills receivable | 14,000 | | |
| Wages | 10,000 | | |
| Cash in hand | 6,000 | | |
| Discount allowed | 2,000 | | |
| Investments | 40,000 | | |
| Motor car | 51,000 | | |
| | <u>5,69,400</u> | | <u>5,69,400</u> |

Adjustments

- Closing stock was ₹45,000.
 - Provision for doubtful debts is to be maintained @ 2% on debtors.
 - Depreciation charged on : furniture and fixture @ 5%, plant and Machinery @ 6% and motor car @ 10%.
 - A Machine of ₹30,000 was purchased on October 01, 2016.
 - The manager is entitle to a commission of @ 10% of the net profit after charging such commission.
- (Ans. : Gross profit ₹1,01,000 ; Net profit ₹68,909 ; Total balance sheet ₹ 3,43,200 ; Manager's commission ₹6,891).

6. Prepare the trading and profit and loss account and a balance sheet of M/s Shine Ltd. from the following particulars.

| <i>Account Title</i> | <i>Amount ₹</i> | <i>Account Title</i> | <i>Amount ₹</i> |
|-------------------------|---------------------|-------------------------|---------------------|
| Sundry debtors | 1,00,000 | Bills payable | 85,550 |
| Bad debts | 3,000 | Sundry creditors | 25,000 |
| Trade expenses | 2,500 | Provision for bad debts | 1,500 |
| Printing and Stationary | 5,000 | Return outwards | 4,500 |
| Rent, Rates and Taxes | 3,450 | Capital | 2,50,000 |
| Freight | 2,250 | Discount received | 3,500 |
| Sales return | 6,000 | Interest received | 11,260 |
| Motor car | 25,000 | Sales | 1,00,000 |
| Opening stock | 75,550 | | |
| Furniture and Fixture | 15,500 | | |
| Purchases | 75,000 | | |
| Drawings | 13,560 | | |
| Investments | 65,500 | | |
| Cash in hand | 36,000 | | |
| Cash in bank | 53,000 | | |
| | <u>4,81,310</u> | | <u>4,81,310</u> |

Adjustments

1. Closing stock was valued ₹ 35,000.
2. Depreciation charged on furniture and fixture @ 5%.
3. Further bad debts ₹ 1,000. Make a provision for bad debts @ 5% on sundry debtors.
4. Depreciation charged on motor car @ 10%.
5. Interest on drawing @ 6%.
6. Rent, rates and taxes was outstanding ₹200.
7. Discount on debtors 2%.

(Ans. : Gross loss Rs,17,050 ; Net loss ₹27,482 ; Total balance sheet ₹ 3,18,894).

7. Following balances have been extracted from the trial balance of M/s Keshav Electronics Ltd. You are required to prepare the trading and profit and loss account and a balance sheet as on March 31, 2017.

| <i>Account Title</i> | <i>Amount ₹</i> | <i>Account Title</i> | <i>Amount ₹</i> |
|----------------------|---------------------|----------------------|---------------------|
| Opening stock | 2,26,000 | Sales | 6,80,000 |
| Purchases | 4,40,000 | Return outwards | 15,000 |
| Drawings | 75,000 | Creditors | 50,000 |
| Buildings | 1,00,000 | Bills payable | 63,700 |
| Motor van | 30,000 | Interest received | 20,000 |
| Freight inwards | 3,400 | Capital | 3,50,000 |
| Sales return | 10,000 | | |
| Trade expense | 3,300 | | |
| Heat and Power | 8,000 | | |
| Salary and Wages | 5,000 | | |
| Legal expense | 3,000 | | |
| Postage and Telegram | 1,000 | | |
| Bad debts | 6,500 | | |
| Cash in hand | 79,000 | | |
| Cash at bank | 98,000 | | |
| Sundry debtors | 25,000 | | |
| Investments | 40,000 | | |
| Insurance | 3,500 | | |
| Machinery | 22,000 | | |
| | <u>11,78,700</u> | | <u>11,78,700</u> |

The following additional information is available :

1. Stock on March 31, 2017 was ₹ 30,000.
2. Depreciation is to be charged on building at 5% and motor van at 10%.
3. Provision for doubtful debts is to be maintained at 5% on Sundry Debtors.
4. Unexpired insurance was ₹ 600.
5. The Manager is entitled to a commission @ 5% on net profit after charging such commission.

(Ans. : Gross profit ₹,37,600 ; Net profit ₹ 25,381 ; Total balance sheet ₹4,15,350 ; Manager's commission ₹1,269).

8. From the following balances extracted from the books of Raga Ltd. prepare a trading and profit and loss account for the year ended March 31, 2017 and a balance sheet as on that date.

| <i>Account Title</i> | <i>Amount ₹</i> | <i>Account Title</i> | <i>Amount ₹</i> |
|----------------------|---------------------|----------------------|---------------------|
| Drawings | 20,000 | Sales | 2,20,000 |
| Land and Buildings | 12,000 | Capital | 1,01,110 |
| Plant and Machinery | 40,000 | Discount | 1,260 |
| Carriage inwards | 100 | Apprentice premium | 5,230 |
| Wages | 500 | Bills payable | 1,28,870 |
| Salary | 2,000 | Purchases return | 10,000 |
| Sales return | 200 | | |
| Bank charges | 200 | | |
| Coal, Gas and Water | 1,200 | | |
| purchases | 1,50,000 | | |
| Trade Expenses | 3,800 | | |
| Stock (Opening) | 76,800 | | |
| Cash at bank | 50,000 | | |
| Rates and Taxes | 870 | | |
| Bills receivable | 24,500 | | |
| Sundry debtors | 54,300 | | |
| Cash in hand | 30,000 | | |
| | 4,66,470 | | 4,66,470 |

The additional information is as under :

1. Closing stock was valued at the end of the year ₹, 20,000.
2. Depreciation on plant and machinery charged at 5% and land and building at 10%.
3. Discount on debtors at 3%.
4. Make a provision at 5% on debtors for doubtful debts.
5. Salary outstanding was ₹100 and Wages prepaid was ₹ 40.
6. The manager is entitled a commission of 5% on net profit after charging such commission.

(Ans. : Gross profit ₹,21,240 ; Net profit ₹12,664 ; Total balance sheet ₹ 2,23,377 ; Manager's commission ₹633).

9. From the following balances of M/s Jyoti Exports, prepare trading and profit and loss account for the year ended March 31, 2017 and balance sheet as on this date.

| <i>Account Title</i> | <i>Debit Amount</i> ₹ | <i>Account Title</i> | <i>Credit Amount</i> ₹ |
|----------------------|--------------------------|----------------------|---------------------------|
| Sundry debtors | 9,600 | Sundry creditors | 2,500 |
| Opening stock | 22,800 | Sales | 72,670 |
| Purchases | 34,800 | Purchases returns | 2,430 |
| Carriage inwards | 450 | Bills payable | 15,600 |
| Wages | 1,770 | Capital | 42,000 |
| Office rent | 820 | | |
| Insurance | 1,440 | | |
| Factory rent | 390 | | |
| Cleaning charges | 940 | | |
| Salary | 1,590 | | |
| Building | 24,000 | | |
| Plant and Machinery | 3,600 | | |
| Cash in hand | 2,160 | | |
| Gas and Water | 240 | | |
| Octroi | 60 | | |
| Furniture | 20,540 | | |
| Patents | 10,000 | | |
| | <u>1,35,200</u> | | <u>1,35,200</u> |

Closing stock ₹10,000.

- To provision for doubtful debts is to be maintained at 5 per cent on sundry debtors.
- Wages amounting to ₹ 500 and salary amounting to ₹ 350 are outstanding.
- Factory rent prepaid ₹ 100.
- Depreciation charged on Plant and Machinery @ 5% and Building @ 10%.
- Outstanding insurance ₹100.

(Ans : Gross profit ₹23,250 ; Net profit ₹15,895 ; Total balance Sheet ₹ 76,945).

10. The following balances have been extracted from the books of M/s Green House for the year ended March 31, 2017, prepare trading and profit and loss account and balance sheet as on this date.

| <i>Account Title</i> | <i>Amount ₹</i> | <i>Account Title</i> | <i>Amount ₹</i> |
|----------------------|---------------------|----------------------|---------------------|
| Purchases | 80,000 | Capital | 2,10,000 |
| Bank balance | 11,000 | Bills payable | 6,500 |
| Wages | 34,000 | Sales | 2,00,000 |
| Debtors | 70,300 | Creditors | 50,000 |
| Cash in hand | 1,200 | Return outwards | 4,000 |
| Legal expenses | 4,000 | | |
| Building | 60,000 | | |
| Machinery | 120,000 | | |
| Bills receivable | 7,000 | | |
| Office expenses | 3,000 | | |
| Opening stock | 45,000 | | |
| Gas and fuel | 2,700 | | |
| Freight and Carriage | 3,500 | | |
| Factory lighting | 5,000 | | |
| Office furniture | 5,000 | | |
| Patent right | 18,800 | | |
| | <u>4,70,500</u> | | <u>4,70,500</u> |

Adjustments :

- Machinery is depreciated at 10% and buildings depreciated at 6%.
- Interest on capital @ 4%.
- Outstanding wages ₹ 50.
- Closing stock ₹ 50,000.

(Ans : Gross profit ₹ 83,750 ; Net Profit ₹ 52,750 ; Total balance sheet ₹ 3,27,700).

11. From the following balances extracted from the book of M/s Manju Chawla on March 31, 2017. You are requested to prepare the trading and profit and loss account and a balance sheet as on this date.

| <i>Account Title</i> | <i>Amount ₹</i> | <i>Amount ₹</i> |
|---------------------------|---------------------|---------------------|
| Opening stock | 10,000 | |
| Purchases and Sales | 40,000 | 80,000 |
| Returns | 200 | 600 |
| Wages | 6,000 | |
| Dock and cleaning charges | 4,000 | |
| Lighting | 500 | |
| Misc. Income | | 6,000 |
| Rent | | 2,000 |
| Capital | | 40,000 |
| Drawings | 2,000 | |
| Debtors and Creditors | 6,000 | 7,000 |
| Cash | 3,000 | |
| Investment | 6,000 | |
| Patent | 4,000 | |
| Land and Machinery | 43,000 | |
| Donations and Charity | 600 | |
| Sales tax collected | | 1,000 |
| Furniture | 11,300 | |
| | <u>1,36,600</u> | <u>1,36,600</u> |

Closing stock was ₹ 2,000.

- Interest on drawings @ 7% and interest on capital @ 5%.
- Land and Machinery is depreciated at 5%.
- Interest on investment @ 6%.
- Unexpired rent ₹100.
- Charge 5% depreciation on furniture.

(Ans. : Gross profit ₹ 21,900 ; Net profit ₹ 25,185 ; Total balance sheet ₹ 71,185).

12. The following balances were extracted from the books of M/s Panchsheel Garments on March 31, 2017.

| Account Title | Debit Amount ₹ | Account Title | Credit Amount ₹ |
|------------------|-------------------|-----------------|--------------------|
| Opening stock | 16,000 | Sales | 1,12,000 |
| Purchases | 67,600 | Return outwards | 3,200 |
| Return Inwards | 4,600 | Discount | 1,400 |
| Carriage inwards | 1,400 | Bank overdraft | 10,000 |
| General expenses | 2,400 | Commission | 1,800 |
| Insurance | 4,000 | Creditors | 16,000 |
| Scooter expenses | 200 | Capital | 50,000 |
| Salary | 8,800 | | |
| Cash in hand | 4,000 | | |
| Scooter | 8,000 | | |
| Furniture | 5,200 | | |
| Buildings | 65,000 | | |
| Debtors | 6,000 | | |
| Wages | 1,200 | | |
| | <u>1,94,400</u> | | <u>1,94,400</u> |

Prepare the trading and profit and loss account for the year ended March 31, 2017 and a balance sheet as on that date.

- Unexpired insurance ₹ 1,000.
- Salary due but not paid ₹ 1800.
- Wages outstanding ₹ 200.
- Interest on capital 5%.
- Scooter is depreciated @ 5%.
- Furniture is depreciated @ 10%.
- Closing stock was ₹ 15,000.

(Ans.: Gross profit ₹ 39,200 ; Net profit ₹ 22,780 ; Total balance sheet ₹ 1,03,280).

13. Prepare the trading and profit and loss account and balance sheet of M/s Control Device India on March 31, 2017 from the following balance as on that date.

| <i>Account Title</i> | <i>Debit Amount ₹</i> | <i>Credit Amount ₹</i> |
|-----------------------|-------------------------------|--------------------------------|
| Drawings and Capital | 19,530 | 67,500 |
| Purchase and Sales | 45,000 | 1,12,500 |
| Salary and Commission | 25,470 | 1,575 |
| Carriage | 2,700 | |
| Plant and Machinery | 27,000 | |
| Furniture | 6,750 | |
| Opening stock | 42,300 | |
| Insurnace premium | 2,700 | |
| Interest | | 7,425 |
| Bank overdraft | | 24,660 |
| Rent and Taxes | 2,160 | |
| Wages | 11,215 | |
| Returns | 2,385 | 1,440 |
| Carriage outwards | 1,485 | |
| Debtors and Creditors | 36,000 | 58,500 |
| General expenses | 6,975 | |
| Octroi | 530 | |
| Investment | 41,400 | |
| | 2,73,600 | 2,73,600 |

Closing stock was valued ₹ 20,000.

- Interest on capital @ 10%.
- Interest on drawings @ 5%.
- Wages outstanding ₹ 50.
- Outstanding salary ₹ 20.
- Provide a depreciation @ 5% on plant and machinery.
- Make a 5% provision on debtors.

(Ans.: Gross profit ₹ 29,760 ; Net loss ₹ 8,973 ; Total balance sheet ₹ 1,28,000)

14. The following balances appeared in the trial balance of M/s Kapil Traders as on March 31, 2017

| | |
|------------------------------|--------|
| | ₹ |
| Sundry debtors | 30,500 |
| Bad debts | 500 |
| Provision for doubtful debts | 2,000 |

The partners of the firm agreed to records the following adjustments in the books of the Firm: Further bad debts ₹300. Maintain provision for bad debts 10%. Show the following adjustments in the bad debts account, provision account, debtors account, profit and loss account and balance sheet.

(Ans : Dr. Profit and Loss account ₹1,820)

15. Prepare the bad debts account, provision for account, profit and loss account and balance sheet from the following information as on March 31, 2017

| | ₹ |
|------------------------------|--------|
| Debtors | 80,000 |
| Bad debts | 2,000 |
| Provision for doubtful debts | 5,000 |

Adjustments :

Bad debts ₹500 Provision on debtors @ 3%.

(Ans : Credit Profit and Loss account ₹115)

Checklist to Test Your Understanding

1. (c), 2. (d), 3. (b), 4. (a), 5. (d)