UNIT 19 FINAL ACCOUNTS WITH ADJUSTMENTS

Structure

19.0 OBJECTIVES

After studying this unit you should be able to:

- compute commission payable to Manager when it is based on profits
- deal with adjustment items if given in trial balance
- prepare final accounts with adjustments

19.1 INTRODUCTION

In the previous unit you learnt about various adjustments which are usually made at the time of preparing final accounts. You know the journal entry passed for each item of adjustment and also how each item is treated in the final accounts. In this unit you will learn how to prepare final accounts when you are given a Trial Balance along with some adjustments. We shall also take up a few more items that may need adjustment and provide some practical hints which may be useful in solving various problems on final accounts.

19.2 AN OVERVIEW

Let us briefly review what we have learnt earlier.

The purpose of recording business transactions is two-fold: (1) to know the net result of business activities, and (2) to know the financial position of business. This two-fold objective is achieved by preparing final accounts which consist of a Trading and Profit and Loss Account and a Balance Sheet. The final accounts are usually prepared annually.

The Trading and Profit and Loss Account is usually divided into two sections. The first section is called Trading Account and the second section is called Profit and Loss Account. The Trading Account reveals Gross Profit or Gross Loss and the Profit and Loss Account shows Net Profit or Net Loss. In the case of a trading concern the opening stock, purchases (net), and direct expenses are shown on the debit side of the Trading Account, and sales (net), and closing stock on its credit side. If the total of the credit side is higher than the total of the debit side, the difference is treated as Gross Profit. If the total of the debit side is higher than the total on the credit side, the difference is regarded as Gross Loss. The Gross Profit or Gross Loss is transferred to the Profit and Loss Account. In the case of manufacturing concern, we also prepare a Manufacturing Account. The purpose of preparing the Manufacturing Account is to ascertain the Cost of Goods Manufactured and the same is transferred to Trading Account.

The Profit and Loss Account is prepared to find out the Net Profit or Net Loss. The Gross Profit transferred from the Trading Account is shown on the credit side of the Profit and Loss Account and the indirect expenses and revenue losses on its debit side. If there are some other gains, they are also shown on its credit side. The Profit and Loss Account will generally show a credit balance which represents Net Profit. But, if it shows a debit balance, it means there is Net Loss. The Net Profit or Net Loss is transferred to the Capital Account of the proprietor.

In the Balance Sheet all assets are shown on the right hand side and all liabilities including capital on the left hand side. The totals on two sides of the Balance Sheet must tally.

At the time of preparing the final accounts we also have to make adjustments in respect of various items in order to arrive at the true profit or loss and the true financial position.

19.3 SOME PRACTICAL HINTS

The following hints will help you to work out the problems on final accounts:

1 Read the problem carefully and find out what exactly you are required to do. Normally you are asked to prepare the Trading and Profit and Loss Account, and the Balance Sheet. Hence, it is not necessary to parepare the Manufacturing Account unless you are specifically asked to do so.

2 Sometimes, Gross Profit is given in the Trial Balance. This indicates that the Trading Account has already been pepared and you are to prepare only the Profit and Loss Account and the Balance Sheet. In such a situation you will find that the closing stock also appear inside the Trial Balance. This is to be shown only on the assets side of the Balance Sheet.

3 There is no need to pass closing and adjustment entries, unless it is specifically asked. All adjustments should be treated directly in the final accounts.

4 You are aware that some of the items given in the Trial Balance are shown in Trading Account, some in Profit and Loss Account and others in Balance Sheet. Hence, in Trial Balance mark the items relating to Trading Account with 'T', those relating to Profit and Loss Account with 'P' and the Balance Sheet items with 'B'. Use 'M' for Manufacturing Account items, if you are also required to parepare the same.

5 A few adjustments are always given outside the Trial Balance. Find out the items which need adjustment and mark them in the Trial Balance with additional mark 'A'.

6 Now proceed to prepare the final accounts as learnt earlier. Do not forget to write the headings. Follow the order in which various items are usually presented in the final accounts.

7 Put a tick mark against each item in the Trial Balance and also in the adjustments as and when you show it in the final accounts. You know that the items given in the Trial Balance are shown in the final accounts only at one place. But each item given in adjustments is to be shown in the final accounts at two places. Hence, put two tick marks against each item of adjustment given outside the Trial Balance after both the aspects of adjustment are treated in the final accounts.

8 If all items given in the Trial Balance and adjustments are properly shown in the final accounts, the Balance Sheet will tally. If it does not tally, it would only mean that you have committed some mistakes. In such a situation, recheck your solution item by item, find out the mistakes and correct them. After the mistakes have been corrected, the Balance Sheet will tally.

Look at Illustration 1 and study how final accounts are prepared with various adjustments.

Illustration 1

From the following Trial Balance of Gopinath prepare Trading and Profit and Loss Account for the year ended December 31, 1986 and Balance Sheet as on that date.

Name of the Account	Dr. Balances	Cr. Balances
	Rs.	Rs.
Capital		27,000
Drawings	4,260	
Furniture	5,700	
Stock on January 1, 1987	8,760	
Purchases and Sales	62,172	71,436
Returns	1,260	1,746
Salaries	2,640	
Rent	720	
Carriage	1,500	
Rates and Taxes	1,200	
Apprentice Premium		750
Bank Overdraft		1,200
Bad Debts	1,032	
Sundry Debtors	19,200	
Cash in hand	288	
Sundry Creditors		6,000
Provision for Bad Debts		600
Bills Receivable	1,440	
Bills Payable		1,080
Discount		360
	1,10,172	1,10,172

You are required to consider the following adjustments:

1 Stock on December 31, 1986 was valued at Rs. 10,200.

2 Provide for doubtful debts at 5% on Sundry Debtors and for Discount on Creditors at 2%.

3 Rent due was Rs. 160.

4 Taxes of Rs. 320 were paid in advance.

5 Depreciate Furniture at 10% per annum.

6 Apprentice Premium of Rs. 120 was to be carried forward.

7 Calculate interest on capital at 5% per annum.

Solution:

Trading and Profit and Loss Account of Gopinath for the year ended December 31, 1986

Dr. Cr.

Particulars	Amount	Amount	Particulars	Amount	Amount
	Rs.	Rs.		Rs.	Rs.
To Opening Stock		8,760	By Sales	71,436	
To Purchases	62,172		Less Returns		
Less Returns Outwards	1,746		Inwards	1,260	
		60,426			70,176
To Carriage		1,500	By Closing Stock		10,200
To Gross Profit c/d		9,690			
		80,376			80,376
To Salaries		2,640	By Gross Profit b/d		9,690
To Rent	720		By Apprentice Premium	750	
Add Outstanding	160	880	Less Amount carried forward	120	630
To Rates and Taxes	1,200				
Less Taxes paid in advance	320		By Discount Received		360
		880	By Provision for Discount on Creditors		120
To Provision for Bad Debts:					
Provision required	960				
Add Bad Debts	1,032				
	1,992				
Less Existing provision	600	1,392			
To Depreciation on Furniture		570			
To Interest on Capital		1,350			
To Net Profit (Transferred to Capital Account)		3,088			
		10,800			10,800

Balance Sheet of Gopinath as on December 31, 1986

Liabilities	Amount	Amount	Assets	Amount	Amount
	Rs.	Rs.		Rs.	Rs.
Current Liabilities			*Current Assets:*		
Rent Outstanding		160	Cash in hand		288
Apprentice premium			Bills Receivable		1,440
carried forward		120	Sundry Debtors	19,200	
Bank Overdraft		1,200	Less Provision for		
Bills Payable		1,080	Doubtful Debts	960	
Sundry Creditors	6,000				18,240
Less Provision for Discount	120		Closing Stock		10,200
		5,880	Prepaid Taxes		320
Long-term Liabilities:			*Fixed Assets:*		
Capital:			Furniture	5,700	
Balance on 1-1-1986	27,000		Less Depreciation at 10%	570	5,130
Add Interest on Capital	1,350				
Add Net Profit for the year	3,088				
	31,438				
Less Drawings	4,260				
		27,178			
		35,618			35,618

Notes:

1 **Carriage:** It is not given whether expenses on carriage relate to purchases or sales.

In such situation (refer to Unit 14), it is assumed that they relate to purchases and so debited to Trading Account.

2 **Apprentice Premium:** It is an item of income. In adjustments it is stated that the Apprentice Premium of Rs. 120 is to be carried forward. It means that out of the total income of Rs. 750 received as Apprentice Premium, Rs. 120 relate to 1987. Hence it is treated as unearned income and adjusted accordingly in the final accounts.

3 **Discount:** It is not clear whether the discount is paid or received. Since it is shown as a credit item, it means it is an income and so treated as Discount Received.

4 **Provision for Bad Debts:** It is calculated at 5% on Sundry Debtors of Rs. 19,200. It works out to Rs. 960.

19.4 SOME OTHER ADJUSTMENTS

Apart from the adjustments explained in Unit 18, you may also find some other items which need adjustment at the time of preparing the final accounts. The common items are given below.

19.4.1 Commission Payable on Profits

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

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

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

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

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

The above amount can also be verified. After charging manager's commission, the net profit will work out as Rs. 57,143 (Rs. 60,000 - Rs. 2,857). Now calculate 5% on Rs. 57,143. It works out to Rs. 2,857 which means the amount of commission calculated by the given formula is correct. Look at Illustrations 2 and 3 and see how manager's commission has been calculated and treated in the final accounts.

19.4.2 Interest on Loan

If the firm has taken some loan, it has to pay interest thereon. Hence, when we notice a loan account in the Trial Balance, we must find out whether interest due on loan has been paid or not. The rate of interest and the date on which the loan was taken is usually given. If, however, the date on which loan was taken is not given, it means that it is an old loan and full year's interest is to be provided. So, note the amount of loan, the rate of interest and the period for which interest is to be provided. Culculate the amount of interest and find out from the Trial Balance whether the same has been paid or not. Generally, you will find that the interest has been paid but it is less than what is due. In such situation, the difference is regarded as outstanding interest, and the same is adjusted at the time of preparing **the** final accounts.

Suppose there is an item of 10% loan (taken on April 1, 1987) Rs. 20,000 in the Trial Balance. Assuming the accounting year ends on December 31, the total interest on loan will work out as Rs. 1,500 (at 10% on Rs. 20,000 for nine months). On going through the Trial Balance you find that the interest paid is Rs. 1,000 only. It means Rs. 500 (Rs. 1,500 - Rs. 1,000) is the outstanding interest. So, you have to make the necessary adjustment i.e., add it to interest paid on the debit side of the Profit and Loss Account and also show it as outstanding interest under current liabilities in the Balance Sheet.

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

19.4.3 Drawing of Goods by Proprietor

You know when the proprietor takes away some goods from the business for his personal use, it is recorded in books of account by passing the following journal entry (refer to Unit 5).

Drawings Account	Dr.
To Purchases Account	

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

i) On the Debit side of the Trading Account: Deduct it from Purchases.

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

Look at Illustration 3. It is given as an adjustment item. Study how it has been treated in the final accounts.

Check Your Progress—A

1 Following figures relate to a firm:

	Rs.
Gross Profit	60,000
Indirect Expenses	38,000

Compute Manager's Commission under the following situations:

a) If he is entitled to 10% on net profit before charging such commission.

b) If he is entitled to 10% on net profits after charging such commission.

2 Following is an extract from the Trial Balance of a trader:

Name of the Account	Dr.	Cr.
	Rs.	Rs.
12% loan (taken on July 1, 1987)		20,000
Interest on loan	1,200	

Work out interest outstanding and explain how you will show it in final accounts. His accounting year ends on March 31, 1988.

3 If you find an item in adjustment stating that the proprietor took away goods costing Rs. 1,500 for personal use, how would you deal with it in the final accounts.

Illustration 2

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

Trial Balance as on March 31, 1987

Name of the Account	Dr. Balances	Cr. Balances
	Rs.	Rs.
Stock on April 1, 1986	24,200	
Cash in hand	4,000	
Cash at bank	12,900	
Leasehold Premises (lease for five years commencing from April 1, 1986,	20,000	
Machinery	30,000	
Furniture	15,000	
Buildings	60,000	
Drawings	5,000	
Capital		1,60,000
Purchases and Sales	96,000	1,45,000
Debtors and Creditors	50,000	40,000
Returns	3,000	4,300
Freight	6,000	
Wages	17,500	
Trade Expenses	4,750	
Salaries	12,000	
Printing and Stationery	1,800	
Bad Debts	4,000	
Provision for Bad Debts		4,000
Rent received		3,100
10% Loan (taken on October 1, 1986)		10,000
Interest on Loan	250	
Total	3,66,400	3,66,400

You are required to make the following adjustments:

a) Stock on March 31, 1987 was valued at Rs. 45,600.

b) Write off Rs. 2,000 as bad debts and make a provision for doubtful debts at 5% on sundry debtors.

c) Charge depreciation on Machinery at 10% and on Building at 2½%.

d) Calculate interest on capital and drawings at 6% per annum.

e) The Manager is entitled to a commission of 5% on the net profit before charging such commission.

Solution:

Trading and Profit and Loss Account of Ravinder
for the year ended March 31, 1987

Dr. **Cr.**

Particulars	Amount	Amount	Particulars	Amount	Amount
	Rs.	Rs.		Rs.	Rs.
To Stock, April 1, 1986		24,200	By Sales	1,45,000	
To Purchases	96,000		Less Returns		
Less Returns			Inwards	3,000	
Outwards	4,300				1,42,000
		91,700	By Stock on		
			March 31, 1987		45,600
To Freight		6,000			
To Wages		17,500			
To Gross Profit c/d		48,200			
		1,87,600			1,87,600
To Salaries		12,000	By Gross Profit b/d		48,200
To Printing & Stationery		1,800	By Rent Received		3,100
			By Interest on		
			Drawings		150
To Trade Expenses		4,750			
To Provision for					
Bad Debts:					
Provision Required	2,400				
Add Bad Debts	6,000				
	8,400				
Less Existing					
Provision	4,000	4,400			
To Depreciation on:					
Machinery	3,000				
Building	1,500	4,500			
To Leasehold Premises					
-1/5 written off		4,000			
To Interest on loan	250				
Add Outstanding	250	500			
To Interest on Capital		9,600			
To Commission					
to Manager		495			
To Net Profit					
(transferred to					
Capital A/c)		9,405			
		51,450			51,450

Balance Sheet of Ravinder as on March 31, 1987

Liabilities	Amount	Amount	Assets	Amount	Amount
	Rs.	Rs.		Rs.	Rs.
Current Liabilities:			*Current Assets:*		
Outstanding Interest on			Cash in hand		4,000
Loan		250	Cash at bank		12,900
Outstanding Commission			Debtors	50,000	
to Manager		495	Less Bad Debts	2,000	
Creditors		40,000	Less Provision for	48,000	
Long-term Liabilities:			Bad Debts	2,400	
					45,600
10% loan		10,000	Closing Stock		45,600
Capital:			*Fixed Assets:*		
Balance on 1-4-1986	1,60,000		Leasehold Premises	20,000	
Add Interest on Capital	9,600		Less 1/5 written off	4,000	16,000
Net profit for the year	9,405				
	1,79,005		Furniture		15,000
Less Drawing 5,000			Machinery	30,000	
Interest on			Less Depreciation at 10%	3,000	
Drawings 150	5,150	1,73,855	Building	60,000	27,000
			Less Depreciation at 2.5%	1,500	58,500
		2,24,600			2,24,600

Notes:

1 New Provision for Bad Debts amounts to Rs. 2,400. It has been calculated at 5% on Rs. 48,000 (Sundry Debtors) Rs. 50,000 minus further Bad Debts Rs. 2,000.

2 Interest on drawings has been calculated on the whole amount for six months on the assumption that the money was drawn evenly throughout the year. Thus, interest on drawings at 6% on Rs. 5,000 for six months works out to Rs. 150.

3 The manager is entitled to a commission of 5% on the net profit before charging such commission. The net profit after taking into consideration all expenses except the manager's commission is Rs. 9,900. So, manager's commission at 5% on Rs. 9,900 works out to Rs. 495. It is still to be paid. Hence, like any other outstanding expense it has been debited to Profit and Loss Account and also shown on the liabilities side of the Balance Sheet.

4 In case of Premises it is mentioned in the Trial Balance that they were taken on lease for five years commencing from April 1, 1986. Hence one fifth of the lease amount i.e., Rs. 4,000 have been written off to Profit and Loss Account and the balance of Rs. 16,000 shown as an asset in Balance Sheet.

5 The adjustments are silent about the interest due on 10% Loan of Rs. 10,000 taken on October 1, 1986. In such situation, interest should be calculated at the given rate for the period commencing from the date on which the loan was taken to the end of the year. Interest so calculated should be compared with the amount of interest already paid as given in Trial Balance.

The interest on loan works out to Rs. 500 (at 10% on Rs. 10,000 for six months from October 1, 1986 to March 31, 1987). Out of this, Rs. 250 has already been paid as given in the Trial Balance. The remaining amount of Rs. 250 is treated outstanding. Hence, it has been added to interest paid which is shown on the debit side of Profit and Loss Account and also shows on the liabilities side of the Balance Sheet.

Illustration 3

Following are the closing balances in the ledger of Mahesh for the year ended June 30, 1987:

Debit Balances	Rs.	Credit Balances	Rs.
Opening Stock	12,600	Capital	60,000
Purchases	45,000	Sales	1,00,000
Sales Returns	500	Purchases Returns	1,000
Wages	7,500	Provision for Bad Debts	2,000
Carriage on Purchases	1,100	12% Bank Loan	20,000
Duty and Clearing Charges	800	Sundry Creditors	11,560
Salaries	5,200	Rent Received	3,000
Taxes and Insurance	1,700	Discount	1,440
Advertisement	2,800		
Drawings	5,000		
Bills Receivable	3,500		
Debtors	52,000		
Cash in hand	1,500		
Building	28,000		
Furniture	10,000		
Machinery	15,000		
Printing and Stationery	4,400		
Interest on Bank Loan	2,400		
	1,99,000		1,99,000

Prepare Trading and Profit and Loss Account for the year ended June 30, 1987 and Balance Sheet as on that date after taking into account the following information:

a) The stock on June 30, 1987 was valued at Rs. 26,800.
b) The proprietor had taken away goods worth Rs. 3,000 for personal use. This has not been recorded in books.
c) Depreciate Machinery at 20%.
d) Provision for Bad Debts required is Rs. 1,500.
e) Provide for Manager's Commission at 10% on the net profit after charging such commission.

Solution:

Trading and Profit and Loss Account of Mahesh
for the year ended June 30, 1987

Dr. Cr.

Particulars	Amount	Amount	Particulars	Amount	Amount
	Rs.	Rs.		Rs.	Rs.
To Opening Stock		12,600	By Sales	1,00,000	
To Purchases	45,000		Less: Sales Returns	500	99,500
Less Drawings of Goods	3,000		By Closing Stock		26,800
	42,000				
Less Purchases Returns	1,000	41.000			
To Carriage on Purchases		1,100			
To Duty and Clearing Charges		800			
To Wages		7,500			
To Gross Profit c/d		63,300			
		1,26,300			1,26,300
To Salaries		5,200	By Gross Profit b/d		63,300
To Taxes and Insurance		1,700	By Rent Received		3,000
To Printing and Stationery		4,400	By Discount Received		1,440
To Advertisment		2,800	By Provision for Bad Debts		
To Interest on Bank Loan		2,400	Existing Provision	2,000	
To Depreciation		3,000	Less: Provision		
To Commission to Manager		4,431	Required	1,500	500
To Net Profit (Transferred to Capital A/c)		44,309			
		68,240			68,240

Balance Sheet of Mahesh as on June 30, 1987

Liabilities	Amount	Amount	Assets	Amount	Amount
	Rs.	Rs.		Rs.	Rs.
Current Liabilities:			*Current Assets :*		
Outstanding Commission			Cash in hand		1,500
to Manager		4,431	Bills Receivable		3,500
Sundry Creditors		11,560	Debtors	52,000	
Long-term Liabilities:			Less Provision for		
12% Bank Loan		20,000	Bad Debts	1,500	50,500
Capital:			Closing Stock		26,800
Balance on 1-7-1986	60,000		*Fixed Assets :*		
Add Net Profit	44,309		Furniture		10,000
	1,04,309		Machinery	15,000	
Less Drawings			Less Depreciation	3,000	12,000
(including drawings of goods)	8,000	96,309	Building		28,000
		1,32,300			1,32,300

Notes:

1 The Proprietor took away goods worth Rs. 3,000 for personal use which had not been recorded in books. You know this is debited to Drawings Account and credited to Purchases Account (refer to Unit 5). Hence by way of adjustment it has been deducted from purchases and then included in drawings.

2 In Illustration 2 the commission to manager was calculated on profits before charging such commission. In this problem it is to be calculated on profits after charging such commission. The Net Profit before charging commission is Rs. 48,740. Using the formula for the calculation of manager's commission, it will work out as follows:

$$\frac{10}{100 + 10} \times 48{,}740 = \frac{10}{110} \times 48{,}740 = \text{Rs. } 4{,}431$$

3 The old provision for bad debts (given in the Trial Balance) is Rs. 2,000. The new provision required (given in adjustments) is Rs. 1,500. Hence the surplus of Rs. 500 has been credited to Profit and Loss Account.

19.5 ADJUSTMENT ITEMS GIVEN IN TRIAL BALANCE

So far you have learnt how to deal with various adjustments in the final accounts when they are given outside the Trial Balance. Every adjustment is shown at two places in the final accounts so as to complete the double entry.

Sometimes, you may find that a few adjustment items such as Depreciation, Outstanding Expenses, Prepaid Expenses, Outstanding Incomes, etc., are given in the Trial Balance itself and not shown as adjustments outside the Trial Balance. This happens when their adjusting entries have already been passed and their postings made in the concerned accounts in the ledger. You know when an adjusting entry is passed, one aspect is posted to an existing account and for the other aspect a new account has to be opened in the books. For example, when you make a journal entry for depreciation on machinery you debit Depreciation Account and credit Machinery Account. The Machinery Account already exists in the ledger and the amount of depreciation is posted to its credit side. But, the Depreciation Account does not exist in the ledger. It will be a new account to which the amount will be debited. Similarly, when you pass a journal entry for outstanding salaries, you debit Salaries Account and credit Outstanding Salaries Account. The Salaries Account already exists in the ledger but you have to open the Outstanding Salaries Account before posting can be done. If the postings have been made, the balances of such new accounts will now appear in the Trial Balance.

When you find items like Depreciation and Outstanding Salaries in the Trial Balance, you have to show them only at one place in the final accounts. Normally, when they are given in adjustments you show them at two places in the final accounts. For example, depreciation when given in the adjustments, is first shown on debit side of Profit and Loss Account and then on the assets side of the Balance Sheet by way of deduction from the concerned fixed asset. But when it is given in Trial Balance, it will only be shown on the debit side of Profit and Loss Account because it is a loss. It will not be deducted from the concerned fixed asset in the Balance Sheet because the asset account has already been credited with the amount of depreciation. The balance of the asset account given in the Trial Balance is in fact a reduced balance. Similarly, when Outstanding Salaries Account is given in the Trial Balance, it will be shown only on the liabilities side of the Balance Sheet. It need not be added to salaries on the debit side of the Profit and Loss Account because salaries appearing in the Trial Balance are inclusive of the outstanding salaries.

Thus, if any item of adjustment appears in the Trial Balance, it will be shown only once at the appropriate place in the final accounts. Look at Table 19.1. It shows how each item of adjustment will be treated if given in the Trial Balance.

Table 19.1
Treatment of Adjustment Items if Given in Trial Balance

Adjustment Item	Treatment in Final Accounts
1 Closing Stock	Assets side of Balance Sheet
2 Outstanding Expenses	Liabilities side of Balance Sheet
3 Outstanding Incomes	Assets side of Balance Sheet
4 Prepaid Expenses	Assets side of Balance Sheet
5 Unearned Incomes	Liabilities side of Balance Sheet
6 Depreciation	Debit side of Profit and Loss A/c
7 Interest on Capital	Debit side of Profit and Loss A/c
8 Interest on Drawings	Credit side of Profit and Loss A/c

Check Your Progress—B

Tick (✓) the correct answers.

a) When Wages Outstanding are given in the Trial Balance, they are
   i) debited to Trading Account ( )
   ii) shown on the liabilities side of Balance Sheet ( )
   iii) shown on the assets side of Balance Sheet ( )

b) When Depreciation is given in the Trial Balance, it is
   i) debited to Profit and Loss Account ( )
   ii) deducted from the concerned asset in the Balance Sheet ( )
   iii) credited to Profit and Loss Account ( )

c) Income Received in Advance, if given in Trial Balance, is
   i) deducted from the concerned income in the Profit and Loss Account ( )
   ii) credited to Profit and Loss Account ( )
   iii) shown on the liabilities side of Balance Sheet ( )

d) Interest on Drawings, if given in Trial Balance, is
   i) credited to Profit and Loss Account ( )
   ii) debited to Profit and Loss Account ( )
   iii) deducted from capital in the Balance Sheet ( )

Illustration 4

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

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

Solution:

Trading and Profit and Loss Account of V. Ramana
for the year ended December 31, 1986

Dr. Cr.

Particulars	Amount	Amount	Particulars	Amount	Amount
	Rs.	Rs.		Rs.	Rs.
To Adjusted Purchases		2,32,500	By Sales		2,95,000
To Freight		1,200			
To Gross Profit c/d		61,300			
		2,95,000			2,95,000
To Salaries		18,000	By Gross Profit b/d		61,300
To General Expenses		5,400	By Rent Received		6,000
To Insurance		600	By Discount Received		800
To Advertising		800	By Commission Received		1,500
To Discount Allowed		700			
To Depreciation		2,200			
To Loss by Fire		2,000			
To Net Profit (transferred to Capital Account)		39,900			
		69,600			69,600

Balance Sheet of V. Ramana as on December 31, 1986

Liabilities	Amount	Amount	Assets	Amount	Amount
	Rs.	Rs.		Rs.	Rs.
Current Liabilities :			*Current Assets* :		
Expenses Outstanding		2,500	Cash in hand		3,800
Rent Received in Advance		3,000	Cash at Bank		12,800
Trade Creditors		24,600	Trade Debtors		14,100
Long-term Liabilities :			Closing Stock		49,200
Capital:			Prepaid Insurance		300
Balance on 1-1-1986	70,000		*Fixed Assets* :		
Add Net profit for the year	39,900		Furniture		10,800
	1,09,900		Building		39,000
Less Drawings	10,000	99,900			
		1,30,000			1,30,000

Notes:

1 The items given in the above Trial Balance clearly indicate that it is prepared after making necessary entries in the relevent accounts in the ledger. Hence, the items such as Expenses Outstanding, Depreciation, Prepaid Insurance and Rent Received in Advance which appear in the Trial Balance have been shown at one place in the final accounts.

2 The Closing Stock has not been shown in the Trading Account. It is shown in the Balance Sheet because it appears in the Trial Balance alongwith Adjusted Purchases. This means the Closing Stock has already been adjusted in the Purchases.

Illustration 5

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

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

Prepare Profit and Loss Account for the year ended December 31, 1986 and Balance Sheet on that date, after keeping in view the following adjustments:

1 Depreciate Furniture and Fixtures by 5% and Plant and Machinery by 10%.

2 The value of Loose Tools on December 31, 1986 was Rs. 4,500.

3 Outstanding salaries Rs. 2,000.

4 Commission earned but not received amounted to Rs. 400.

5 Write off further bad debts Rs. 1,000 and maintain the provision for bad debts at 5% on Sundry Debtors.

Solution:

Profit and Loss Account of S. Karim for the year ended December 31, 1986

Dr. Cr.

Particulars	Amount	Amount	Particulars	Amount	Amount
	Rs.	Rs.		Rs.	Rs.
To Salaries and Wages	22,000		By Gross Profit		
Add Outstanding	2,000		(Transferred from		
		24,000	Trading A/c)		32,400
To Rent and Taxes		8,400	By Commission	2,100	
To Insurance	1,000		Add Outstanding	400	
Less Prepaid	100		By Net Loss (Transferred to		2,500
		900	Capital Account)		11,100
To Entertainment Expenses		300			
To General Charges		2,600			
To Provision for Bad Debts:					
Provision Required	2,000				
Add Bad Debts	1,500				
	3,500				
Less Existing Provision	800				
		2,700			
To Depreciation on:					
Furniture & Fixtures					
Plant & Machinery		7,100			
Loose Tools					
		46,000			46,000

Balance Sheet of S. Karim as on December 31, 1986

Liabilities	Amount	Amount	Assets	Amount	Amount
	Rs.	Rs.		Rs.	Rs.
Current Liabilities:			*Current Assets*:		
Outstanding Salaries		2,000	Cash in hand		2,300
Bank Overdraft		8,600	Sundry Debtors	41,000	
Sundry Creditors		36,000	Less Bad Debts	1,000	
Long-Term Liabilities:				40,000	
Capital:					
Balance on 1-1-1986	1,10,000		Less Provision for Bad Debts	2,000	38,000
Less Net loss for the			Outstanding Commission		400
year 11,100					
Drawings 15,000			Closing Stock		19,800
	26,100		Prepaid Insurance		100
		83,900	*Fixed Assets*:		
			Furniture and Fixtures	12,000	
			Less Depreciation at 5%	600	11,400
			Loose Tools	5,000	
			Less Depreciation at	500	4,500
			Plant and Machinery	60,000	
			Less Depreciation at 10%	6,000	54,000
		1,30,500			1,30,500

Notes:

1 The Trial Balance contains Gross Profit. It indicates that the Trading Account has already been prepared. Hence only the Profit and Loss Account and Balance Sheet are to be prepared. The Closing Stock has been shown in the Balance Sheet.

2 In the case of Loose Tools, the difference between the opening value (given in the Trial Balance) Rs. 5,000 and the closing value (given in the adjustments) Rs. 4,500 should be treated as depreciation.

3 There is an implied adjustment relating to Prepaid Insurance. It is stated in the Trial Balance that the amount of insurance includes premium of Rs. 400 per annum paid up to March 31, 1987. As the accounting year ends on December 31, 1986, the insurance premium for 3 months (from January 1 to March 31, 1986) amounting to Rs. 100 shall be treated as Prepaid Insurance.

19.6 LET US SUM UP

1 While preparing final accounts with adjustments, each item given outside the Trial Balance is shown at two places in the final accounts. But, if any adjustment item appears in the Trial Balance itself, this will be shown only at one place in the final accounts.

2 Manager may be entitled to commission on profits. It is calculated as a fixed percentage either on net profits before charging commission or on net profits after charging such commission.

3 When rate of interest and the date on which loan was taken is given, it must be ensured that proper amount of interest is shown in the final accounts.

4 When the propietor takes away goods from the business for personal use and the same has not been recorded, it is necessary that its cost is adjusted in purchases and also included in drawings.

19.7 SOME USEFUL BOOKS

Grewal, T.S. 1987. *Double Entry Book-keeping,* Sultan Chand & Sons: New Delhi. (Chapter 9)

Maheshwari, S.N. 1986. *Principles of Accountancy*, Arya Book Depot: New Delhi. (Chapter 14)

Patil, V.A., and Korlahalli, J.S. 1987. *Principles and Practice of Book-keeping,* R. Chand & Co.: New Delhi. (Chapter 20)

19.8 ANSWERS TO CHECK YOUR PROGRESS

A 1 (a) Rs. 2,200 (b) Rs. 2,000

2 Rs. 600
- i) add to interest on loan on debit side of Profit and Loss Account, and
- ii) show it on the liabilities side of the Balance Sheet under current liabilities.

3 i) deduct it from purchases on the debit side of Trading Account, and
- ii) deduct it from capital in the Balance Sheet.

B (a) ii (b) i (c) iii (d) i

19.9 TERMINAL QUESTIONS/EXERCISES

Exercises

1 The following balances were extracted from the books of A. Anand on March 31, 1987.

Name of the Account	Dr.	Cr.
	Rs.	Rs.
Capital		80,000
Drawings	10,000	
General Expenses	5,240	
Building	52,000	
Machinery	38,000	
Stock	22,400	
Coal and Power	5,400	
Taxes and Insurance	2,600	
Wages	14,400	
Sundry Debtors	12,400	
Sundry Creditors		15,000
Discount	1,000	1,200
10% Loan		15,000
Sales		1,60,800
Purchases	94,000	
Furniture	23,000	
Provision for Bad Debts		1,800
Bills Payable		8,700
Commission		2,400
Salaries	13,600	
Cash in hand	260	
Bank Overdraft		9,600
Charity	200	
Total	2,94,500	2,94,500

Prepare the final accounts for the year ended March 31, 1987 after giving effect to the following adjustments:

a) Stock on March, 31, 1987 was valued at Rs. 54,000

b) Outstanding Salaries Rs. 1,400

c) Unexpired Insurance Rs. 100

d) Write off Rs. 400 as Bad Debts, and maintain the Provision for the Bad Debts at 5% on Debtors

e) Depreciate Building by 2.5%, Machinery by 5% and Furniture by 10%.

(**Answer** : Gross Profit Rs. 78,600; Net Profit Rs. 52,060; Balance Sheet Total Rs. 1,73,260)

2 Motilal Trial Balance appeared as follows on December 31, 1986:

Name of the Account	Dr.	Cr.
	Rs.	Rs.
Capital		1,00,000
Creditors		29,500
Bills Payable		7,300
Sales		1,82,600
Provision for Bad Debts		1,500
Salaries	19,600	
Cash at bank	16,500	
Cash in hand	1,700	
Purchases	1,22,200	
Interest on Investments		200
Motor Truck	62,000	
Furniture	24,000	
Debtors	33,000	
Opening Stock	14,500	
Bills Receivable	5,600	
Carriage Inwards	1,500	
Carriage Outwards	900	
General Expenses	5,600	
Insurance	800	
Bad Debts	900	
Travelling Expenses	600	
Disçount	1,200	
Sales Returns	500	
6% Investments	10,000	
Total	3,21,100	3,21,100

Prepare the Trading and Profit and Loss Account for the year ended December 31, 1986 and a Balance Sheet as on that date, after making the following adjustments:

i) Stock on December 31, 1986 was valued at Rs. 22,400.

ii) Depreciate Motor Truck by 20% and Furniture by 5%.

iii) Maintain Provision for Doubtful Debts at 5% on Debtors.

iv) A commission of 10% on Net Profits after charging such commission is to be provided for the General Manager.

(**Answer** : Gross Profit Rs. 66,300; Net Profit Rs. 21,409 Commission to General Manager Rs. 2,141; Balance Sheet Total Rs. 1,60,350)

3. From the following Trial Balance of Sujit as on September 30, 1986, yor are required to prepare the Trading and Profit and Loss Account for the year ended September 30, 1986, and a Balance Sheet as on that date, after making the necessary adjustments:

Name of the Account	Dr.	Cr.
	Rs.	Rs.
Opening Stock	14,000	
Capital		1,60,000
Drawings	18,000	
Land and Buildings	70,000	
Furniture and Fixtures	20,000	
Leasehold Premises (Lease to run for 5 years from 1-4-1986)	30,000	
Sales		1,90,000
Returns Outwards		5,000
Sundry Debtors	24,000	
Purcahses	1,00,000	
Returns Inwards	4,000	
Freight and Duty	6,000	
Sundry Expenses	3,500	
Printing and Stationery	1,300	
Insurance	1,800	
Provision for Bad Debts		2,000
Advertising	1,400	
Salaries	24,000	
Sundry Creditors		28,000
Cash at bank	15,400	
Cash in hand	1,600	
Goodwill	50,000	
Total	3,85,000	3,85,000

Adjustments

1 The Stock on hand on September 30, 1986 was valued at Rs. 24,000.

2 The Provision for Bad Debts should be maintained at 5% on Debtors

3 Make a Provision of 2% for Discount on Debtors and Creditors

4 Sujit has utilised goods of the value of Rs. 2,000 for his personal use but no record was made of it.

5 Depreciate Land and Buildings by 2% and Furniture and Fixtures by 10%.

(**Hint** : Depceriation on Leasehold Premises is to be calculated for six months.)
(**Answer** : Gross Profit Rs. 97,000; Net Profit Rs. 59,504; Balance Sheet Total Rs. 2,26,944)

4 From the following Trial Balance of Atul prepare his Final Accounts relating to 1986.

Name of the Account	Dr.	Cr.
	Rs.	Rs.
Capital		60.000
Sales (net)		2,70,000
Adjusted Purchases	1,83,000	
Salaries	24,000	
Salaries Outstanding		2,000
Carriage Inwards	2,500	
Carriage Outwards	1,400	
Lighting	1,200	
Rates and Insurance	1,600	
Prepaid Insurance	200	
Building	39,000	
Furniture	9,500	
Depreciation	1,500	
Sundry Creditors		21,000
Petty Cash	90	
Cash at bank	3,010	
Stock on December 31, 1986	26,000	
Sundry Debtors	30,000	
Sales Van	30,000	
Total	3,53,000	3,53,000

(**Answer** : Gross Profit Rs. 84,500; Net Profit Rs. 54,800; Total of Balance Sheet Rs. 1,37,800).

5 The following Trial Balance has been extracted from the books of M. Sailesh on December 31, 1986.

Name of the Account	Dr.	Cr.
	Rs.	Rs.
Drawings	6,000	
Plant and Machinery	80,000	
Furniture and Fixtures	25,000	
Capital		1,10,000
Sales		2,30,000
Loose Tools	10,000	
Opening Stock	16,000	
Returns Outwards		2,000
Trade Expenses	4,500	
Purchases	1,10,000	
Returns Inwards	4,000	
Wages	40,000	
Outstanding Wages		2,000
Sundry Creditors		27,000
Provision for Bad Debts		1,000
Apprentice Premium		1,000
Carriage Inwards	7,000	
Salaries	24,000	
Office Expenses	4,300	
Insurance	1,200	
Rent and Taxes	12,400	
Postage and Telegrams	2,000	
Income Tax	4,000	
Bank Overdraft		10,000
Sundry Debtors	30,000	
Cash	2,600	
Total	3,83,000	3,83,000

The following additional information is available:

a) Stock on December 31, 1986, was Rs. 16,400.

b) Depreciate Plant and Machinery by 5% and Furniture and Fixtures 6%.

c) Loose Tools are revalued at Rs. 8,500.

d) Provision for Bad Debts is to be maintained at 5% on Sundry Debtors.

e) Unexpired Insurance was Rs. 300.

f) Apprentice Premium received in advance was Rs. 400.

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

(**Answer** : Gross Profit Rs. 71,400; Net Profit Rs. 16,400; Total of Balance Sheet Rs. 1,55,800)

6 From the following Trial Balance of K.R. Kaur prepare the Trading and Profit and Loss Account for the year ended June 30, 1987, and a Balance Sheet as on that date.

Name of the Account	Dr.	Cr.
	Rs.	Rs.
Capital		1,72,000
Cash in hand	4,500	
Cash at bank	19,600	
Purchases and Sales	1,22,000	2,37,000
Productive Wages	34,000	
Power and Fuel	9,600	
Salaries and Wages	20,000	
Carriage Outwards	2,400	
Carriage Inwards	5,000	
Stock (1-7-1986)	14,600	
Building	80,000	
Plant and Machinery	50,000	
Furniture	12,000	
Debtors and Creditors	30,000	18,000
General Expenses	6,300	
Insurance	1,400	
Commission		2,400
Drawings	18,000	
Total	4,29,400	4,29,400

You are given the following further information:

i) Stock on June 30, 1987 was valued at Rs. 18,000.

ii) Building, Plant and Machinery and Furniture are to be depreciated by Rs. 4,000, Rs. 5,000 and Rs. 1,200 respectively.

iii) Calculate interest on Capital and Drawings by 5%.

iv) Commission earned but not received Rs. 600.

v) The figure of Sundry Creditors includes an amount of Rs. 2,000 received from Rahul and credited to his account. The amount was written off as a bad debt in the previous year.

vi) The Manager is entitled to a commission of 10% on the net profit before charging such commission.

(**Answer** : Gross Profit Rs. 69,800; Net Profit Rs. 23,715; Total of Balance Sheet Rs. 2,04,500).

(**Hint** : Adjustment (v): Bad Debt recovered Rs. 2,000 was wrongly credited to the customer's account. Hence, it should be deducted from Sundry Creditors and shown as an income in Profit and Loss Account.)

Note : These questions and exercises will help you to understand the unit better. Try to write answers for them. Do not send your answers to the University for assessment. These are for your practice only.