CBSE CLASS 11 ACCOUNTANCY

FINANCIAL STATEMENTS-2

REVISION NOTES

CHAPTER-10

FINANCIAL STATEMENTS-2

- **Need for Adjustments**

  Adjustments 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

- **Closing Stock**

  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:

1) by crediting it to the trading and profit and loss account.

2) 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

- **Outstanding Expenses**

When expenses of an accounting period remain unpaid at the end of an accounting period, they are termed as outstanding expenses. The entry to bring such expenses into account is:

Concerned expense A/c Dr.

To Outstanding expenses A/c

- **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

- **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

- **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

- **Depreciation**

  Depreciation is the decline in the value of assets on account of wear and tear and passage of time. It is treated as a business expense and is debited to profit and loss account. The entry for providing depreciation is:

Depreciation A/c Dr.

To Concerned asset A/c

- **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

- **Provision for Bad and Doubtful Debts**

  Some amount of debtors are not realized in the future. If it is not possible to accurately know the amount of such bad debts, 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 Discount on Debtors**

'Provision for discount' is made on good debtors which are arrived at by deducting further bad debts and the provision for doubtful debts. The following journal entry is recorded to create provision for discount on debtors:

Profit and loss A/c	Dr.
To Provision for discount on debtors A/c	

- **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 Rs. 110 before charging commission. If the manager is entitled to 10% of the profit before charging such commission, the commission will be calculated as:

$$= Rs.110 \times \frac{10}{100} = 11$$

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

= Profit before commission × Rate of commission/ (100 + commission)

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

- **Interest on Capital**

Sometimes, the proprietor may like to know the profit made by the business after providing for interest on capital. In such a situation, interest is calculated at a given rate of interest on capital as at the beginning of the accounting year. If however, any additional capital is brought during the year, the interest may also be computed on such amount from the date on which it was brought into the business. Such interest is treated as expense for the business and the following journal entry is recorded in the books of account:

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

Illustration: From the following balance extracted from the books of 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**.**

Debit balance	**Amount Rs.**	**Credit Balance**	**Amount Rs.**
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		
	3,00,400		**3,00,400**

Adjustments

1) Closing stock Rs. 14,000.
2) Wages outstanding Rs. 600, Salaries Outstanding Rs. 1,000, Rent outstanding Rs. 200.
3) Fire Insurance premium includes Rs. 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 Rs. 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 Rs. 160.

Solution:

Books of Hariharan Bros.

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

Dr. **Cr.**

Expenses/Losses	**Amount Rs.**	**Revenue/Gains**	**Amount Rs.**
Opening stock	16,000	Sales 1,60,000	
Purchases 40,000		Less Sales return (3,000)	1,57,000
Less purchases return (800)	39,200	Closing stock	14,000
Wages 6,600			
Add Outstanding Wages 600	7,200		
Carriage inwards	2,400		
Freight and Dock	4,800		
Gross profit c/d	1,01,400		
	1,71,000		**1,71,000**
Salaries 11,000		Gross profit b/d	1,01,400
Add Outstanding salary 1,000	12,000	Apprenticeship premium 3,000	
Carriage outwards	5,000	*Less* Advance premium (2,000)	1,000
Rates and Taxes	700	Accrued interest on loan	700
Printing and Stationery 500		Interest on drawings	160
Add Outstanding bill 60	560	Accrued interest on investment	150
Trade expenses	400		
Travelling expenses	300		
Fire insurance 1,800			
Less Prepaid insurance (600)	1,200		
Bad debts	4,200		
Rent 2,200			
Add Outstanding rent 200	2,400		
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		
	1,03,410		**1,03,410**

Balance Sheet as at December 31, 2017

Liabilities		Amount Rs.	Assets		Amount Rs.
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		14,00
		2,03,050			**2,03,050**