Financial Statements for Profit and Not for Profit Organisations



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FINANCIAL STATEMENTS-II

You have learnt that Income Statement i.e. Trading & Profit and Loss Account and Position Statement i.e., Balance Sheet are two financial statements, which are prepared by every business concern at the end of a period. Income statement shows the Net Profit or Net loss as the case may be for that period and Position Statement presents the financial position of the business on the specific date. These statements are prepared on the basis of Trial Balance and other information. It is possible that there are certain items of income or expenses which do not pertain to the accounting period for which Trial Balance is prepared or other such items which have accrued but have not been accounted for and hence are not reflected in Trial Balance. Both these types of incomes and expenses are to be fully accounted for, only then the above stated two statements will show the true and fair position of the business. These are called 'adjustments'. In this lesson we shall learn about accounting treatment of some of the adjustments and incorporation of these adjustments in financial statements.



After studying this lesson you will be able to:

- recognise the need for accounting adjustments;
- explain the adjustments as to closing stock, outstanding and pre-paid expenses, accrued income and income received in advance;
- interest on capital and drawings, depreciation, provision for bad and doubtful debts;
- incorporate the adjustments in Trading Account and Profit & Loss Account and Balance Sheet.

15.1 NEED FOR ACCOUNTING ADJUSTMENTS

You have already learnt that every business entity prepares Trading and Profit & Loss Account and Balance Sheet, the two financial statements, at the end of an accounting period which is generally one year. It needs to be ensured that such items of income and expenditure which do not pertain to the said accounting period, should not to be included. If some of these items have been included in the financial statements these must be excluded by making necessary adjusting entry. Similarly, there can be items which are left out and are needed to be accounted for. Adjustment entry will also be made for them. This is necessary in order to calculate the correct profit or loss and to show true and fair financial position of the business. For example, a firm closes its books on March 31, every year, Suppose it has not paid rent of the shop for the month of March. This will not be reflected in Trial Balance and hence it needs to be accounted for as it relates to the year for which accounts are being prepared. Similarly, suppose annual insurance premium has been paid up to June, 30. It means premium for three months has been paid in advance. This is included in the item of insurance appearing in the Trial Balance. This amount paid in advance needs to be excluded. This process of exclusion or inclusion of items into books of accounts at the time of preparing financial statements is called adjustments. These are to be incorporated to arrive at the true and fair position of the business.



INTEXT QUESTION 15.1

Fill in the blanks with suitable word/words.

- (i) Trading and Profit & Loss Account shows the or
- (ii) Adjustments are necessary to show the correct and of a business concern.
- (iii) Items of income and expenditure which do not pertain to the accounting period should be
- (iv) Items of income & expenditure which relate to the accounting period but are left out should be

15.2 ADJUSTMENTS AND THEIR INCORPORATION

The number and nature of adjustments differ from organisation to organisation. It depends upon the volume and nature of activities in the organisation, However, certain adjustments are common in all types of

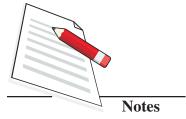
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organisations. Moreover, while making adjustments you will have to follow the general principle of double entry i.e. the amount is to be debited to one account and credited to another account. Thus in the finanacial statements the item to be adjusted should appear at two places one representing the debit and the other representing the credit.

Let us now discuss some of the items of adjustment and its accounting treatment in financial statements. These are as under:

- 1. Closing Stock
- 2. Outstanding Expenses.
- 3. Prepaid Expenses
- 4. Accrued Income.
- 5. Income received in advance
- 6. Interest on Capital
- 7. Interests on Drawings
- 8. Depreciation.
- 9. Further Bad Debts.
- 10. Provision for Bad and Doubtful Debts.

Let us take up these adjustments one by one:

1. Closing Stock: Closing Stock is the stock of goods remaining unsold at the end of the accounting year. Ordinarily this does not appear in the Trial Balance. Hence, this needs to be incorporated in financial statements. This appears on the credit side of the Trading Account as well as Assets side of the Balance Sheet.

The adjustment entry will be:

Closing Stock A/c

Dr

To Trading A/c

(Closing stock transferred to trading A/c)

The effect of the adjustment entry on financial statements is as under:

Trading A/c

Dr			Cr
Particulars	Amount Rs	Particulars	Amount Rs
		Closing stock	

Balance sheet

Liabilities	Amount Rs	Assets	Amount Rs
		Closing stock	

In case closing stock has already been accounted for it will form part of the Trial Balance and hence there is no need of making any adjustments in the Trading A/c. The adjusted closing stock will be on the asset side of the Balance Sheet.

2. Outstanding Expenses

Dr.

Expense which is related to the current accounting period but not yet paid is known as Outstanding Expense. Suppose the accounts are closed on 31st December every year. Salary for the month of December is due but not paid. It is an example of salary outstanding. Similarly, there are some other items like Rent outstanding, Wages outstanding etc. In case of Salaries Outstanding following adjustment entry will be made:

> Salary A/c Dr.

> > To Salary Outstanding A/c

(Salary outstanding for the month of December)

In financial statements it will be recorded as:

Profit & Loss A/c

D 1.			er.
Particulars	Amount Rs	Particulars	Amount Rs
	17.5		IX3
Salaries			
Add: salary outstanding			
	Balance	e Sheet	
Liabilities	Amount	Assets	Amount
	Rs		Rs
Salary outstanding			

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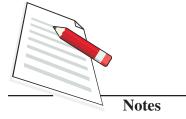
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Cr.

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Amount of expense outstanding will be added to its paid amount which is shown in the Trading A/c or Profit & Loss A/c as the case may be. It is also shown on the liabilities side of the Balance Sheet because it is an item of liabilities.

3. Prepaid expenses

Sometimes a part of a certain expense paid may relate to the next accounting period. Such expenses is called prepaid expense or expenses paid in advance. For example, insurance premium paid in the current year may be for the year ending, the date of which falls in the next year. The part of insurance premium which relates to next accounting year is the insurance premium paid in advance is deducted from the amount paid and is shown as an item of asset. Similarly, such items may be rent prepaid, tax prepaid etc.

Adjustment entry for prepaid Insurance Premium

Prepaid Insurance Premium A/c Dr

To Insurance Premium A/c

(Insurance premium paid in advance)

In financial statements, it is recorded as:

Dr.

Profit & loss A/c for the year ended on

Particulars	Amount Rs	Particulars	Amount Rs
Insurance Premium			
Less: prepaid			
Insurance premium			
	Balance As on		
* 1 1 111.1	Amount	A 4 -	A .
Liabilities	Amount	Assets	Amount
Liabilities	Rs	Assets	Amount Rs

Cr.

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4. Accrued income (Due but not received)

Accrued income means income earned but not received till the end of the accounting year. For example, interest on securities or dividends on shares, which has become due but may be received on a date falling in the next year. Such income does not appear in the trial balance but should be duly accounted for in the year, because such income has accrued.

Adjustment entry for the transaction : suppose Rent receivable as it has become due but is not yet received

Rent Receivable (accrued) A/c

Dr

To Rent Received A/c

(Amount of rent due but not received)

In financial statements, it will be recorded as;

Profit & Loss A/c

DI.			CI.
Particulars	Amount Rs	Particulars	Amount Rs
		Rent Received	
		Add: Rent Accrued	

Balance Sheet as on

Liabilities	Amount Rs	Assets	Amount Rs
		Rent Accrued	

5. Unearned income/income Received in Advance

Sometimes income is received before it becomes actually due. Such income is called "unearned income" or "income received in advance". Since this income does not relate to the accounting year, it should be deducted from the relevant head of income in the Profit & Loss A/c. It is a liability and hence is shown in the liability side of the Balance Sheet. Example of such income is rent that has been received for the months of January and February of the coming accounting year.

Adjustment entry for the same is

Rent Received A/c

Dr

To Rent Received in Advance A/c

(Rent received in advance)

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In financial statements

Profit and Loss A/c

Dr.			Cr.
Particulars	Amount	Particulars	Amount
	Rs		Rs
		Rent received	
		Less: rent received	
		in advance	
	Balance	e sheet	
Liabilities	Amount	Assets	Amount
	Rs		Rs
Rent received in advance			



INTEXT QUESTIONS 15.2

Fill in the blanks with suitable terms:

- (i) Expenses related to the current accounting period but have not been paid are known as
- (ii) Part of expenses paid if relates to the next accounting year, it is called
- (iii) Income earned but not received till the end of the accounting year is termed as
- (iv) income if received before it becomes due is called

15.3 OTHER ADJUSTMENTS

6. Interest on capital

As per business entity concept capital of the proprietor is a liability for the business. Like other loans interest can be paid on capital also. In case it is decided to allow interest on capital, adjustment entry will be as follows:

Interest on Capital A/c

Dr

To Capital A/c

(Interest allowed on capital)

In financial statements it is shown as under:

Profit & Loss A/c for the year ended on

Dr.			Cr.
Particulars	Amount Rs	Particulars	Amount Rs
Interest on capital			
	Balance As on		
Liabilities	Amount Rs	Assets	Amount Rs
Capital Add: Interest on Capital			

7. Interest on drawings

Interest may also be charged on money withdrawn by the proprietor for household use. Following journal entry is made.

Capital A/c

Dr

To Interest on Drawings A/c

(Interest on Drawings charged)

In financial statements, it will be shown as:

Profit & Loss A/c

Dr. Cr. Particulars Amount **Particulars** Amount Rs Rs Interest on Drawings **Balance sheet**

Liabilities	Amount	Assets	Amount
	Rs		Rs
Capital			
Less: interest on drawings			

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8. Depreciation

Dr

The value of fixed assets such as Plant and Machinery, Furniture and Fixtures, Land & Building, Motor Vehicles etc. goes on reducing year after year due to wear and tear, obsolescence or for any other reason.

As the fixed assets are used for earning revenue the amount by which the value of a fixed asset decreases is an item of expense, similar to other expenses. This is called depreciation. It should be charged to the Profit and loss Account. The value of such assets should also be shown in the Balance Sheet at the reduced value by the amount of depreciation:

The adjustment entry for depreciation will be

Depreciation A/c

Dr

Cr

To Asset (by name) Account

It will be shown in the Profit and Loss A/c and Balance sheet as under:

Profit & Loss A/c

Particulars	Amount	Particulars	Amount
	Rs		Rs
Depreciation on			
Plant & Machinery			
Motor Vehicle (etc)			
	Balance	e sheet	
Liabilities	Amount	Assets	Amount
	Rs		Rs
		Plant & Machinery	
		Less: Depreciation	
		Motor Vehicle	

Note: In case amount of depreciation has been calculated before closing of accounts, it will appear in the debit column of the Trial Balance. It will be shown only on the debit of profit & Loss A/c and further adjustment is not required in the Balance Sheet.

Less Depreciation

9. Further bad debts

When the goods are sold on credit basis some of the debtors partly pay the due amount or do not pay at all. If this amount cannot be recovered it is called bad debts and is a loss to the firm. This is entered on the debit side of the Profit & loss A/c. But then there may be amount of bad debt which was not recorded in the books of accounts and hence did not appear in the Trial Balance. But the same was discovered before preparing the financial statements. It is called further bad-debts. Following adjustment entry is made for the same:

Bad Debts A/c

Dr

To Debtors A/c

(Further bad debts recorded)

In Profit and Loss A/c and Balance sheet it is shown as under:

Profit & Loss A/c for the year ended on

Dr			Cr
Particulars	Amount Rs	Particulars	Amount Rs
Bad Debts			
Add Further			
Bad debts			

Balance Sheet As on

Liabilities	Amount	Assets	Amount
	Rs		Rs
		Sundry Debtors	
		Less: Further	
		Bad debts	

10. Provision for Bad and Doubtful debts

Some Debts of a particular year may become bad debts in the next year. It means the loss due to bad debts will be written off in the year it takes place instead of the year it belongs to. It will be a sound accounting practice that a suitable amount is kept aside in the current year to meet the possible loss of bad debts in the next year. Decision regarding maintenance for provision for Bad Doubtful Debts is taken at the end of the year so it is an item of adjustment. It is called a provision for Bad and Doubtful Debt.

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The adjustment entry will be as under:

Profit & loss A/c

Dr

To Provision for Doubtful Debts A/c

(Provision for doubtful debts created)

In the Profit and Loss A/c and Balance sheet it will be shown as under:

Profit & Loss A/c

Dr Cr
Particulars Amount Rs Particulars Amount Rs

Bad Debts
Add: Provision for Doubtful debts

Balance Sheet as on

Liabilities	Amount Rs	Assets	Amount Rs
		Debtors Less: Provision	
		For Bad Debts	

Such Provision is created on Debtors at a given rate say 5%. In case there is further bad debts, provision for bad and doubtful Debts will be calculated on the amount of debtors after deducting from it the amount of further Bad Debts.

Over the years businessman might have experienced that a certain percentage of the debts created due to credit sales go bad every year. So a provision for bad and doubtful debt is made on the debtors of a year at a fixed percentage say 5%. This percentage may change if the circumstances have changed. For example, it may be less if the businessman has become selective in selling goods on credit.

Provision for bad and doubtful debt is maintained at every year at a fixed percentage of the debtors. Last year balance is carried forward in the current year. This may be called old provision of bad and doubtful debts. Current

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years bad debts or/and further bad debts is adjusted towards this provision and more provision is created, which may be called new provision for bad debts.

Arithmatically it is shown in the Profit and Loss A/c as follows:

Profit and Loss A/c for the year ending on

Dr			Cr
Particulars	Amount	Particulars	Amount
	Rs		Rs
Bad Debts			
Add Further Bad Debts			
Add new provision for Bad			
and Doubtful Debts			
Less: old reserve for Bad and			
Doubtful Debts			

In case the balance amount of provision for bad and doubtful debts carried forward from last year is more than the amount of bad debts, amount of further Bad Debts and the amount of new provision for bad debts combined together, the excess balance will be credited to Profit and Loss A/c.

The amount of provision for Bad and Doubtful Debts is an item of liability. But usual practice is to show it as deducted from the amount of book debts/sundry debtors in the assets side of the Balance Sheet.

The above can best be explained by the following example:

Items appearing in the Trial Balance of a sole trader on 31st Dec, 2006.

	Dr	Cr
Particulars	Balance	Balance
Sundry Debors	24600	
Provision for Bad and Doubtful Debts		1000
Bad Debts	700	

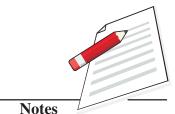
Additional Information

Further bad debts amounted to Rs 600. Make a provision for Bad and Doubtful debts on Debtors @5%.

Show the above items and adjustments in the financial statements as on that date.

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Proft and Loss A/c for the year ended 31st Dec., 2006

Dr			Cr
Particulars	Amount Rs	Particulars	Amount Rs
l 	13		13
Bad Debt 700			
Further Bad Debts 600			
Add New Provision for			
Bad and Doubtful			
Debts <u>1200</u>			
2500			
Less old provision			
for Bad and			
Doubtful Debts (1000)	1500		

Balance Sheet

As on 31st Dec., 2006

Liabilities	Amount Rs	Assets	Amount Rs
		Sundry Debtors 24600 Less: further 600 Bad Debts 24000	
		Less provision for Bad Debts @ 5% 1200	22800

Summarised view of Adjustment entries

	Adjustment	Adjustment entry		Treatment in Trading and Profit & Loss A/c	Treatment in Balance Sheet
1.	Closing stock	Closing stock A/c To Trading A/c	Dr	Shown on the credit side of Profit & Loss A/c	Shown on the Assets side
2.	Outstanding expenses	Expenses A/c To Outstanding expenses A/c	Dr	Added to respective expenses on the debit side	Shown on the liabilities side

3.	Prepaid expenses	Prepaid expenses A/c To Expenses A/c	Dr	Deducted from the respective expenses on the debit side	Shown on the Assets side
4.	Accrued income	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	Shownn on the liabilities side
6.	Interest on capital	Interest on capital A/c To capital A/c	Dr	Shown on the debit side	Shown as addition to capital on liabilities side
7.	Interest on drawings	Capital A/c To interest on drawing A/c	Dr	Shown on the credit side	Shown as deduction to capital on liabilities side
8.	Depreciation	Depreciation A/c To Assets A/c	Dr	Shown on the debit side	Deducted from the value of Assets
9.	Further bad debts	Bad Debts A/c To Debtors A/c	Dr	Shown on the debit side	Deducted from debtors, shown on Assets side
10.	Provision for bad and doubtful debts	Profit & Loss A/c To Provision for ba and doubtful debts		Shown on the debit side	Shown as deduction from debtors on Asset side.



INTEXT QUESTION 15.3

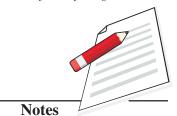
Give exact term for the following:

- I. (i) Provision against amount due from debtors
 - (ii) Fall in the value of fixed assets due to wear and tear
 - (iii) Debts which can not be recovered.
 - (iv) Stock of goods remaining unsold at the end of year.
- II. Complete the journal entries for the following adjustments
 - (i) Interest on capital allowed

Interest on capital A/c Dr
To

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(ii) Wages Outstanding

Wages A/c

To

(iii) Insurance Premium paid for six months in advance

Unexpired Insurance A/c

To

(iv) Commission received but not yet earned

Commission A/c

To

Illustration 1

From the following Trial Balance of M.B. Garments as on 31st December, 2006, prepare Trading A/c and Profit & Loss A/c for the year ended 31st December, 2006 and Balance Sheet as on that date:

Name of the Account	Dr amount Rs	Cr amount Rs
Capital	TCS	80000
Cash in hand	570	
Cash at bank	5600	
Purchases	43200	
Sales		78000
Wages	10400	
Power	4730	
Carriage inward	2040	
Carriage outward	3200	
Stock (1.1.2006)	5660	
Land & Building	40000	
Machinery	20000	
Salaries	4000	
Insurance	600	
Sundry Debtors	28000	
Sundry Creditors		10000
	168000	168000

Following adjustments are to be accounted for:

- (i) Stock on 31.12.2006 Rs. 10000.
- (ii) Machinery to be depreciated @10% p.a. and Building to be depreciated @ 2% p.a.
- (iii) Salaries for the month of December outstanding were Rs. 1200.
- (iv) Insurance Premium was paid for one year ending 30th June, 2007.

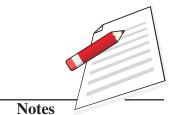
Make journal entries for the adjustments and prepare Trading and Profit & loss A/c and the Balance Sheet.

Solution

		Dr.	Cr
Date	Particulars	Amount	Amount
		Rs	Rs
2006			
Dec 31	Closing stock A/cDr	10000	
	To Trading A/c		10000
	(Closing stock taken to Trading A/c)		
Dec 31	Depreciation A/cDr.	2800	
	To Machinery A/c		2000
	To Land & Building A/c		800
	(Depreciation on machinery @ 10% p.a. and on land & Building @ 2% p.a. charged)		
Dec 31	Salaries A/cDr.	1200	
	To Salary Outstanding A/c		1200
	(Salary due but not paid for December, 2006)		
Dec 31	Prepaid Insurance A/cDr.	300	
	To Insurance A/c		300
	(Insurance paid in advance accounted for)		

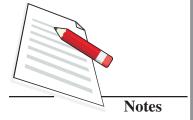
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Trading A/c

For the year ended 31st Dec, 2006

Dr			Cr
Particulars	Amount Rs	Particulars	Amount Rs
Stock	5660	Sales	78000
Purchase	43200	Closing stock	10000
Wages	10400		
Power	4730		
Carriage Inward	2040		
Gross Profit transferred			
to Profit & loss A/c	21970		
	88000		88000

Profit & Loss A/c

For the year ended 31st Dec. 2006

Particulars		Amount	Particulars	Amount
		Rs		Rs
Carriage outward		3200	Gross Profit	
Salaries	4000		transferred from	
Add : Salary Outstanding	1200	5200	Trading A/c	21970
Insurance	600			
Less : prepaid insurance	300	300		
Depreciation on				
Machinery	2000			
Land & building	800	2800		
Net Profit transferred				
to capital A/c		10470		
		21970		21970

Balance sheet

As at 31st Dec., 2006

Liabilities		Amount Rs	Assets		Amount Rs
Salary Outstanding		1200	Cash in hand		570
Sundry Creditors		10000	Cash at Bank		5600
Capital	80000		Sundry debtors		28000
Add: net profit	10470	90470	Closing stock		10000
			Prepaid Insurance		300
			Land & Building	40000	
			Less depreciation	(800)	39200
			Machinery	20000	
			Less depreciation	(2000)	18000
		101670			101670

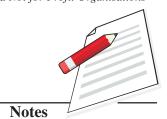
Illustration 2

From the following Trial Balance of Mustafa & Co., prepare Trading and Profit and loss A/c for the year ending on 31st Dec. 2006 and Balance Sheet as on that date after making necessary journal entries for adjustments.

	Dr. Balance (Rs.)		Cr. Balance (Rs.)
Land and Building	60000	Capital	150000
Plant and Machinery	40000	Sundry Creditors	30000
Bill Receivables	8000	Sales	120000
Stock on 1.1.2006	40000	Reserve for Bad	4500
Purchases	51000	and Doubtful Debts	
Wages	20000	Loan (12% p.a.)	10000
Coal, Gas & Coke	5800	Commission Received	2000
Salaries	5000		
Rent	2800		
Cash at bank	25000		
Sundry Debtors	45000		
Repairs	1800		
Bad Debts	5500		
Sales Returns	2000		
Furniture and Fixture	4000		
Interest on Loan	600		
	3,16,500		3,16,500

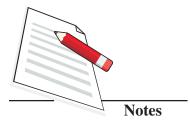
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Adjustments

- 1. Closing stock valued at Rs. 30000.
- 2. Depreciate Plant & Machinery @ 5% and Furniture & Fixture @ 10%.
- 3. Provide for Bad and Doubtful Debts @ 5%.
- 4. Outstanding Wages Rs. 1000, Rent Rs. 500 and interest on loan outstanding Rs 600.
- 5. Commission accrued Rs. 1000.

Solution.

Adjustment entries

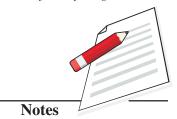
Date	Particulars		Amount Rs	Amount Rs
2006				
Dec 31	Closing Stock A/c	Dr.	30,000	
	To Trading A/c			30,000
	(Closing stock taken into acco	unt)		
	Depreciation A/c	Dr.	2400	
	To Plant & Machinery			2000
	To Furniture & Fixture			400
	(Depreciation charged @ 5% of & Machinery & @10% on Furthern			
	Profit & loss A/c	Dr.	2250	
	To Reserve for Doubtful D	ebts		2250
	(Reserve for Doubtful Debts c	reated)		
	Wages A/c	Dr	1000	
	Rent A/c	Dr	500	
	To Outstanding Expenses A	x/c		1500
	(Outstanding expenses provide	d for)		
	Commission Accrued A/c	Dr.	1000	
	To commission received			1000
	(Commission accrued taken in consideration)	to		
	Interest on loan A/c	Dr	600	
	To Interest on loan Outstand		600	
	(Interest on loan due but not p			

Trading and Profit & Loss A/c of M/s Mustafa & Co. for the year ended on 31.12.2006

Dr Cr **Particulars** Amount **Particulars** Amount Opening Stock 40000 Sales 120000 Purchases 51000 Less: Sales (2000)20000 Wages 118000 Returns Add: Outstanding 1000 Closing Stock 30000 21000 Coal, Gas & Coke 5800 Gross Profit c/d 30200 148000 148000 Salaries 5000 Gross Profit 30200 Rent 2800 b/d 500 Commission Add: Outstanding 3300 Received 2000 Repairs 1800 Add: Accrued **Bad Debts** 5500 Commission 1000 3000 Add: New Reserve 2250 7750 Less: Old Reserve (4500)3250 Interest on Loan 600 Add: Interest Outstanding 600 1200 Depreciation Plant & Machinery 2000 Furniture & Fixture 400 2400 Net Profit Transferred to Capital A/c 16250 33,200 33,200

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Financial Statements for Profit and Not for Profit Organisations



Financial Statements-II

Balance sheet of M/s Mustafa & Co. as on 31.12, 2006

Liabilities		Amount	Assets		Amount
Sundry creditors		30000	Cash in Bank		25000
Loan		10000	Bill Receivables		8000
Interest outstanding		600			
Outstanding Expenses	:				
Wages	1000		Sundry Debtors	45000	
Rent	500	1500	Less:		
Capital	150000		Reserve for	2250	
Add: Net Profit	16250	166250	Doubtful Debts		42750
			Closing Stock		30000
			Furniture & Fixture	4000	
			Less: Dep.	(400)	3600
			Plant & Machinery	40000	
			Less: Dep.	(2000)	38000
			Land & Building		60000
			Commission Accrued	1	1000
		208350			208350



WHAT YOU HAVE LEARNT

- Adjustments are needed to be accounted for so that Income Statement and Position Statement show the correct profit or loss and financial position.
- There can be items of income and expenditure which do not pertain to the accounting year for which financial statements are being prepared. These are to be excluded. These are called prepaid items.
- There can be items of expenses and income which are left out and are to be accounted for which are called outstanding expenses or accrued incomes.
- Other important adjustments to be carried out are Closing Stock, Depreciation on fixed assets, interest on capital and interest on Drawings.
- There may be additional bad debts and provision for bad and doubtful debts need to be made on debtors.
- Additional bad debts are irrecoverable debts in addition to what has been shown in the Trial Balance as bad debts
- Provision for bad and doubtful debts is created for future payments due from debtors but seems to be irrecoverable. It is created on the basis of past experiences.



TERMINAL QUESTIONS

- 1. Answer following questions in brief.
 - (a) Why adjustments are needed?
 - (b) Why outstanding expenses are treated as liabilities?
 - (c) What is the difference between accrued income and unearned income?
- 2. Write journal entries for following adjustments:
 - 1. Wages outstanding
 - 2. Depreciation on Furniture
 - 3. Interest on Investment accrued but not received
 - 4. Insurance Premium paid in advance
- 3. Why reserve for doubtful debts is created?
- 4. From the following trial balance of M/s V.B. Fertilizers prepare Trading & Profit and Loss Account for the year ending 31st December, 2006 and Balance Sheet as on that date. Also make Journal entries for the adjustments:

Particulars	Dr. Balance	Particulars	Cr Balance
Stock (1.1.2006)	13800	Capital	65000
Purchases	52000	Bills payable	18000
Wages	4000	Sales	74400
Return inward	2400	Return outward	1500
Land & Building	40000	Discount	450
Plant & machinery	24500	Creditors	6500
Bills receivable	12000	Interest	600
Debtors	5500	Bad debts Reserve	250
Cash in hand & at Bank	8750	Loan	8000
Rent (office)	2200	Commission	700
Bad Debts	400		
Insurance	1500		
Freight inward	1400		
Fuel & Power	2450		
Furniture	4500		
	175400		175400

Adjustments

- 1. Stock on 31.12.2006 Rs. 25000.
- 2. Write off depreciation on furniture 10% and on plant & machinery 20%.

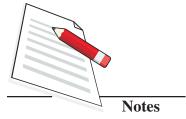
MODULE - 3

Financial Statements for Profit and Not for Profit Organisations



Notes

Financial Statements for Profit and Not for Profit Organisations



Financial Statements-II

- 3. Provide for wages outstanding Rs 650 and rent outstanding Rs. 200. Prepaid insurance amounted to Rs. 300.
- 4. Further bad debts amounted to Rs. 100. Make a provision for bad & doubtful debts @ 5% on debtors.
- 5. Interest on capital to be allowed @ 6%.
- **5.** On 1st April, 2006 reserve for Bad Debts shows a balance of Rs. 3200 Bad debts during the year as per ledger were Rs.2100. Debtors amounted to Rs 7000. After closing of the ledger, it was found that there were bad debts of Rs. 800. It was decided to create a reserve for doubtful debts on creditors @6%.

Make necessary journal entries and show the items in Profit & loss account and Balance Sheet.

6. From the following trial balance of Pranaya as at 31st December, 2006, prepare Trading and Profit & loss account for the year ended 31st December, 2006 and a Balance Sheet as on that date after making necessary adjustments. Also Give journal entries for the adjustments

Trial Balance as at 31-12-2006

Name of Account	Dr. Balances (Rs)	Dr. Balances (Rs)
Pranaya's Capital Account		100000
Drawings	24000	_
Plant and Machinery	45000	_
Stock (1 st Jan, 2006)	15000	_
Purchases	85000	_
Return inwards	5000	_
Sundry Debtors	24600	_
Freight and duty	2000	_
Carriage outwards	1600	_
Rent Rates & Taxes	3800	_
Sundry Creditors	_	22000
Postage & Courier Expenses	1800	
Sales	_	135000
Provision for Bad Debts	_	600
Discount	_	800
Insurance Premium	900	_
Wages	23000	_
Cash in Hand	6200	_
Cash at Bank	20500	_
	258400	258400

70

Adjustments

- 1. Stock on 31st December, 2006 was valued at Rs. 24000.
- 2. Write off Rs. 600 as bad debts.
- 3. Provision for doubtful debts is to be maintained at 5% on sundry debtors.
- 4. Provide depreciation on plant and machinery at 20%. A machine costing Rs. 1500 was purchased on 1st July, 2006.
- 5. Wages outstanding amounted to Rs. 1500, and Insurance Prepaid was Rs. 250.
- 7. The following are the balances extracted from the books of Chinmay Aggarwal on 31st March 2007.

Chinmay's Capital	60000	Stock (1.4.06)	44200
Furniture & Fixtures	5000	Debtors	36000
Bank Overdraft	8400	Rent received	2000
Creditors	27600	Purchases	220000
Business Premises	50000	Sales	300000
Discount (Dr)	3200	Sales Returns	4000
Tax & Insurance	4000	Bills Payable	10000
Salaries	20000		
Commission (Cr.)	2000		
Carriage inward	3600		
Bad Debts	1600		
Motor Vehicle	14400		
Investments	4000		

Following adjustments are to be made:

- (i) Stock on 31 March, 2007 Rs 35000.
- (ii) Write off depreciation on: Business Premises Rs 800 Furniture & Fixture Rs 500 Motor Vehicle 10% p.a.
- (iii) Interest on bank overdraft Rs. 150.
- (iv) Interest on capital allowed @ 6% p.a.

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Financial Statements for Profit and Not for Profit Organisations



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Financial Statements for Profit and Not for Profit Organisations



Financial Statements-II

- (v) Make a provision of 5% on debtors for doubtful debts.
- (vi) Carry forward Rs. 500 for unexpired insurance.

Prepare Trading and Profit & loss A/c for the year ended 31st March, 2007 and Balance Sheet as on that date.

- 8. Pass necessary journal entries for the following adjustments
 - 1. 1/3rd of the total commission received during the year of Rs.12000 relates to the next year
 - 2. Insurance premium of Rs.8000 is paid for the year ending 30st June. Accounts are closed on 31st March every year.
 - 3. Interest on drawing is charged for the year amounting to Rs. 450.



ANSWERS TO INTEXT QUESTIONS

Intext Questions 15.1

- (i) profit, loss
- (ii) profit or loss, financial position
- (iii) excluded
- (iv) accounted for

Intext Questions 15.2

- (i) Outstanding expenses
- (ii) Prepaid expenses
- (iii) Accrued income
- (iv) Income received in advance

Intext Questions 15.3

- I. (i) provision for bad & doubtful debts
 - (ii) depreciation
 - (iii) bad debts
 - (iv) closing stock

- II. (i) To capital account
 - (ii) To wages outstanding A/c
 - (iii) To insurance premium A/c
 - (iv) To commission received in advance A/c

Answers to Practical Terminal Questions

4. (G.P. Rs. 24200; N.P. Rs 12580

Total of Balance Sheet Rs 114830

6. G.P. Rs 27500; N.P. Rs 10400

Total Balance Sheet Rs 109900

7. G.P. Rs 63200; N.P. Rs 30610

Total balance Sheet: Rs 140360



Activity: Analyse the financial statements of at least four business concerns and record the rate at which depreciaiton is charged on various fixed assets and provision is made for doubtful debts and find out the reasons of variation.

S.No.	Name of business concern	Rate of Depreciation	Reasons of variation

MODULE - 3

Financial Statements for Profit and Not for Profit Organisations

