
UNIT 1 FINAL ACCOUNTS-I

Structure

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1.0 OBJECTIVES

After studying this unit, you will be able to:

- explain the purpose of preparing final accounts;
- prepare a trial balance from a given list of balances;
- prepare trading and profit and loss account;
- prepare balance sheet;
- prepare manufacturing account and calculate cost of goods produced; and
- present the final accounts in vertical form.

1.1 INTRODUCTION

You know that the final accounts are primarily prepared for ascertaining the operational result and the financial position of the business. They consist of (i) Profit and Loss Account, and (ii) Balance Sheet. The Profit and Loss Account reveals the profit earned or loss incurred (operational result) during the accounting year and the Balance Sheet indicates the financial position as at the end of the year. In this unit, you will learn about the basic framework of final accounts including their presentation in vertical form.

1.2 FINAL ACCOUNTS AND TRIAL BALANCE

You know final accounts are prepared with the help of a Trial Balance which shows all the ledger balances as at the end of an accounting period. Generally, when you are asked to prepare final accounts, you are given a properly prepared Trial Balance and you have no difficulty in identifying the items of incomes, expenses, assets, and liabilities. But, sometimes you may not be given a proper Trial Balance. You may simply be asked to prepare the final accounts from the list of closing balances extracted from the books of some firm. In such a situation, it will be helpful if you first prepare the Trial Balance and then the final accounts. Hence it is important that you should know how to prepare the Trial Balance from a given list of balances.

Normally when a Trial Balance is to be prepared, you have full details of ledger accounts with you. You can easily ascertain whether a particular account has a debit balance or a credit balance, and prepare the Trial Balance without any difficulty. The problem arises when you are given a list but it is not indicated whether the account has a debit balance or a credit balance. Under such a situation you will have to determine the nature of each balance before you prepare the Trial Balance. In this exercise, your knowledge of rules of debit and credit will help you. For example you know that in case of nominal accounts all expenses and losses are debited and all incomes and gains are credited. Similarly, you know the rules for real and personal accounts according to which the account of assets like cash, machinery debtors, etc. will show debit balances while accounts like capital, creditors, etc. will show credit balances. For convenience however, a few guidelines should help you. They are

- a) All accounts of expenses (including purchases) and losses will be debit balances.
- b) All accounts of Income (including sales) and gains will be credit balances.
- c) All accounts of assets will be debit balances.
- d) All accounts of liabilities will be credit balances.
- e) Capital Account will normally be a credit balance.
- f) Drawings Account will be a debit balance.

However, the problem may arise with regard to some items like rent, discount, commission and interest as they can be expenses as well as incomes. In such cases, the nature of the balance is usually indicated by mentioning (Dr.) or (Cr.) against each item, or the word 'received' or 'paid' is written after each item. This helps you to treat the item correctly. But, if there is only one item for which no such indication is given you can proceed with the preparation of Trial Balance and work out the totals of both the columns. You will find that the total of one column will be less than the other. This means that the unidentified balance pertains to the column which is short. For example, there is an item of commission of Rs. 300 appearing in the list of balances and it is not indicated whether it is paid or received. When you prepare the Trial Balance you will find that the debit total is short by Rs. 300. This would mean that the Commission Account has a debit balance. Now if you show it as such in the Trial Balance, it will tally.

Look at illustration 1 and see how the Trial Balance has been prepared from a given list of balances where the nature of each balance has not been indicated.

Illustration 1

Prepare a Trial Balance from the following balances extracted from the books of Sudhakar as on March 31, 2018.

	Rs.		Rs.
Opening Stock	40,000	Drawings	10,000
Purchases	4,10,000	Wages	7,300
Sales	4,29,000	Salaries	11,000
Purchases Returns	1,250	Outstanding Expenses	1,000
Sales Returns	2,500	Prepaid Expenses	750
Carriage Inwards	1,500	Postage	900
Carriage Outwards	2,500	Discount Received	375
Bank Overdraft	21,000	Discount Allowed	1,000
Cash	4,000	Bad Debts	750
Capital	1,27,750	Sundry Debtors	1,00,000
Sundry Creditors	37,500	Interest	3,500
Loans	41,375	Interest Received	300
Investments	10,000	Provision for Bad Debts	1,750
Accrued Income	600	Furniture & Fixture	7,500
Machinery	47,500		

Solution:

Trial Balance to Sudhakar as on March 31, 2018

Particulars	Dr. Balances	Cr. Balances
	Rs.	Rs.
Opening Stock	40,000	
Purchases	4,10,000	
Sales		4,29,000
Purchases Returns		1,250
Sales Returns	2,500	
Carriage Inwards	1,500	
Carriage Outwards	2,500	
Bank Overdraft		21,000
Cash	4,000	
Capital		1,27,750
Sundry Creditors		37,500
Loans		41,375
Investments	10,000	
Accrued Income	600	
Machinery	47,500	
Drawings	10,000	
Wages	7,300	

Salaries	11,000	
Outstanding Expenses		1,000
Prepaid Expenses	750	
Postage	900	
Discount Received		375
Discount Allowed	1,000	
Bad Debts	750	
Sundry Debtors	1,00,000	
Interest	3,500	
Interest Received		300
Provision for Bad Debts		1,750
Furniture & Fixture	7,500	
Total	6,61,300	6,61,300

In illustration 1, the Trial Balance has tallied i.e., the total of debit balances column is equal to the total of credit balances column. This would mean that each balance has been entered in the appropriate amount column of the Trial Balance. This is not always true. It is quite possible that even when the Trial Balance has tallied, some balances may not have been entered in the correct columns. Look at illustration 2. You will find that the Trial Balance has tallied (the totals of both Dr. balances and Cr. balances is the same i.e., Rs. 91,650 but there are a number of items which have been shown in the wrong columns. For example, bank overdraft which should have been shown in the Cr. balances column has been included in the Dr. balances column and Furniture which should have appeared in Dr..balances column has been shown in the Cr. balances column. So, the Trial Balance has been rewritten and all items shown correctly. Such situation arises on account of the compensating effect of the errors which is very rare.

Illustration 2

An inexperienced accountant provides you with the following Trial Balance. In case you find it to be incorrect, I prepare it again so as to remove its defects.

Trial Balance as on June 30, 2018

Name of Account	L.F.	Dr. Balances	Cr. Balances
Stock (Opening)		Rs.	Rs.
Buildings Bills		10,500	
Payable Bank		31,500	
Overdraft		1,800	
Capital		1,500	
Furniture			45,000
Discount Allowed			12,000
Sales		90	
Loan from Suresh		39,000	

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Carriage Inwards	2,400	
Bills Receivable	270	3,000
Purchases		24,000
Salaries		3,300
Investments	3,000	
Interest on Investments		1,650
Returns Inwards	900	
Returns Outwards	300	
Insurance Premium	360	
Interest on Loan	30	
Advertisement		1,200
Drawings		1,500
Total	91,650	91,650

Solution:**Revised Trial Balance as on June 30, 2018**

Name of Account	L.F.	Dr. Balances	Cr. Balances
		Rs.	Rs.
Stock (opening)		10,500	
Buildings		31,500	
Bills Payable			1,800
Bank Overdraft			1,500
Capital			45,000
Furniture		12,000	
Discount Allowed		90	
Sales			39,000
Loan from Suresh			2,400
Carriage Inwards		270	
Bills Receivable		3,000	
Purchases		24,000	
Salaries		3,300	
Investments		3,000	
Interest on investments			1,650
Returns Inwards		900	
Returns Outwards			300
Insurance Premium		360	
Interest on Loan		30	
Advertisement		1,200	
Drawings		1,500	
Total		91,650	91,650

- 1) Mention against each item whether it will generally show a debit balance or a credit balance.

Items	Nature of Balance Debit or Credit
i) Sales Returns
ii) Carriage Inwards
iii) Carriage Outwards
iv) Capital
v) Loss by fire
vi) Overdraft
vii) Drawings
viii) Returns Outwards
ix) Bills Receivable
x) Goodwill
xi) Rent Paid
xii) Commission Received in Advance

1.3 TRADING AND PROFIT AND LOSS ACCOUNT

You know the Profit and Loss Account is prepared for ascertaining the profit or loss of the business. This is worked out in two stages. In the first stage, we work out the gross profit or gross loss and in the second stage, the net profit or net loss. Hence, the profit and Loss Account is divided into two sections. The first section is called Trading Account. It reveals the gross profit or gross loss. The second section is called Profit and Loss Account which shows the net profit or net loss.

1.3.1 Trading Account

As stated above, the Trading Account is prepared for ascertaining the gross profit or gross loss. The gross profit is defined as the excess of sales revenue over cost of goods sold. This can be presented in the form of an equation as follows.

$$\text{Gross Profit} = \text{Net Sales} - \text{Cost of Goods sold}$$

- Where
- i) $\text{Net Sales} = \text{Total Sales} - \text{Sales Returns}$
 - ii) $\text{Cost of Goods Sold} = \text{Opening Stock} + \text{Net Purchases} + \text{Direct Expenses} - \text{Closing Stock}$

You know the terms ‘Opening Stock’ and ‘Closing Stock’ refer to the value of unsold goods as at the beginning of the year and at the end of the year respectively. Such stock may also include the semi-finished goods and raw materials. In order to arrive at the cost of goods sold, the opening stock is added to the net purchases while the closing stock is deducted. The term ‘Direct Expenses’ refer to those

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expenses which are incurred on the goods purchased till they are brought to the place of business for sale These include expenses such as freight, insurance, import duty, dock dues, clearing charges, octroi duty, carriage, cartage, etc. The administrative expenses, selling and distribution expenses, interest paid, etc. are termed as indirect expenses and therefore, are excluded from the cost of goods sold.

Look at illustrations 3 and 4 and study how Cost of Goods Sold and the Gross Profit are computed.

Illustration 3

The following figures have been extracted from the books of a firm. Calculate the Cost of Goods Sold.

	Rs.
Stock as on 1.1.2018	1,00,000
Purchases for 2018	15,00,000
Purchases Returns	40,000
Carriage Inwards	20,000
Octroi	80,000
Freight	15,000
Stock as on 31.12.2018	1,70,000

Solution:

Opening Stock	1,00,000
Add: Net Purchases	
(Purchases Rs. 15,00,000	
Purchases Returns Rs. 40,000)	14,60,000
Carriage Inwards	20,000
Octroi	80,000
Freight	15,000
	<hr/>
	16,75,000
Less: Closing Stock	1,70,000
Cost of Goods Sold	<hr/> <hr/> 15,05,000

Illustration 4

On January 1, 2018 a firm had stock of goods valued at Rs. 20,000. During the year the following transactions took place.

	Rs.
Sales	5,00,000
Purchases	3,00,000
Carriage Inwards	3,000
Freight Inwards	5,000
Sales Returns	10,000
Clearing charges	22,000
Purchases Returns	5,000

The closing stock of goods on December 31, 2018 is Rs. 40,000.

Solution:

	Rs.	Rs.
Sale	5,00,000	
Less: Sales Returns	<u>10,000</u>	
Net Sales		4,90,000
Less: Cost of Goods Sold		
Opening Stock	20,000	
Add: Purchases	<u>3,00,000</u>	
	3,20,000	
Less: Purchases Return	<u>5,000</u>	
	3,15,000	
Add:		
Carnage Inwards	3,000	
Freight Inwards	5,000	
Clearing Charges	<u>22,000</u>	
	3,45,000	
Less: Closing Stock	<u>40,000</u>	
		<u>3,05,000</u>
Gross Profit		<u>1,85,000</u>

Form of Trading Account : The Equation for Gross Profit is also known as Trading Account Equation. This equation forms the basis of preparing the Trading Account. The Trading Account, like any other account in the ledger, has two sides—debit and credit. The opening stock, purchases (less returns) and all direct expenses are shown on the debit side of the Trading Account while sales (less returns) and the closing stock on the credit side. The gross profit appears as the last item on the debit side which, in fact is the excess of the total of credit side over the total of debit side. If however, the total of the debit side exceeds the total of the credit side, it will be treated as gross loss. This is shown as the last item on the debit side of the Trading Account. The gross profit/gross loss thus worked out is transferred to the Profit and Loss Account. Look at the Figure 9.1 for the form of Trading Account.

Fig. 1.1
Form of Trading Account

Trading Account of
(Day, Month and Year)

Dr.			Cr.		
Particulars	Amount	Amount	Particulars	Amount	Amount
	Rs.	Rs.		Rs.	Rs.
To Opening Stock		.....	By Sales	.....
To Purchases	.....		Less: Sales Returns	.....
Less Purchases Returns	.....			<u> </u>
To Direct Expenses (specify individually)	<u> </u>		By closing Stock		.....
To Gross Profit (Transferred to Profit and Loss Account)		<u> </u>			<u> </u>
		<u> </u>			<u> </u>

Final Accounts

Based on the data given in illustration 4, the Trading Account will be prepared as follows.

Trading Account of . . . for the year ending December 31, 2018

Dr.	Amount	Amount	Cr.	Amount	Amount
Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Opening Stock		20,000	By Sales	5,00,000	Rs.
To Purchases	3,00,000		Less: Returns	10,000	4,90,000
Less: Returns	5,000	2,95,000			
To Carriage Inwards		3,000	By Closing Stock		40,000
To Freight		5,000			
To Clearing Charges		22,000			
To Gross Profit (Transferred to (P&L A/c))		1,85,000			
		5,30,000			5,30,000

Some Important Points

1. **Purchases :** This item refers to the goods purchased for resale and includes both cash and credit purchases. The purchases of assets which are meant for permanent use in business such as machinery furniture, etc., are not included in the purchases. The amount taken to Trading Account will be the net amount of purchases (after deducting purchase returns/returns outwards.) If the proprietor has taken away some goods from the business for his personal use, the same should also be deducted from the total purchases.
2. **Sales:** It includes both cash and credit sales of goods and refers to the net amount of sales (after deducting sales returns-returns inwards). Sales of old furniture, car, machinery, etc. are not included in the sales. Similarly, sales of old newspapers etc. are also excluded from sales. Such items are shown as miscellaneous income in the Profit and Loss Account.
3. **Wages:** Wages are usually treated as a direct expense and so shown in the Trading Account. The difficulty arises when wages are clubbed with salaries (an indirect expense) and the Trial Balance includes a single amount for 'Wages and Salaries'. In such a situation, the amount may be shown in the Trading Account. It is based on the assumption that the item includes the salaries of the supervisory staff in the factory itself. But, if the item in the Trial Balance reads 'Salaries and Wages' it will be taken to the Profit and Loss Account on the assumption that the item includes wages of the office staff only. It should be noted that wages paid in connection with the purchases of fixed assets or the construction of building should not be charged to Trading Account. They are to be included in the cost of the concerned fixed asset. There is another important aspect in relation to wages which must be clarified. If a Manufacturing Account is prepared the wages paid to the factory labour is debited to Manufacturing Account about which you will learn later in this unit.

4. **Freight, Carriage and Cartage:** When paid in connection with purchases of goods, they are shown in the Trading Account. Such freight and carriage are also termed as 'Freight Inwards' and 'Carriage Inwards' respectively. 'Freight Outwards' and 'Carriage Outwards' relate to sales and therefore taken to the debit of Profit and Loss Account.
5. **Royalties:** Royalties refer to the payments made for the use of copyright or a patent. The amount of royalty is generally based on the quantity produced. It is, therefore, treated as a direct expense and charged to Trading Account. But if it is calculated on the basis of quantity sold as in case of books, it is shown in the Profit and Loss Account. Royalties are also paid to the Government for extraction of minerals such as coal, diamond, gold, etc. These are charged to the Profit and Loss Account of the mining companies. You will learn about the accounting of such royalties later under a separate course.

1.3.2 Profit and Loss Account

After ascertaining the gross profit by preparing the Trading Account, the businessman proceeds to prepare the Profit and Loss Account in order to work out the net profit/net loss. You know the net profit is the excess of gross profit and other incomes over the indirect expenses and losses. So, while preparing the Profit and Loss Account, we show gross profit and other incomes such as rent received, discount received, commission received, interest and dividends etc. on the credit side, and all indirect expenses and losses on the debit side. Indirect expenses include all administrative, selling and distribution expenses such as salaries, rent and taxes, postage and stationery, insurance, depreciation, interest paid, office lighting, advertising, packing carriage outwards, etc., while losses refer to items like loss by fire, loss by theft etc. The difference between the two sides of the Profit and Loss Account represent either the net profit or net loss. If the total of the credit side is higher than the total of the debit side, the difference is called net profit and if the debit side total exceeds the credit side total, the difference is called net loss. The net profit/net loss belongs to the proprietor and it is therefore transferred to his Capital Account. Look at figure 9.2. It shows various expenses, losses, incomes, etc., which usually appear in the Profit and Loss Account

Fig. 1.2

Profit and Loss Account
for the period ended

Dr.		Cr.	
Particulars	Amount	Particulars	Amount
	Rs.		Rs.
To Gross Loss, if any, (Transferred from Trading Account)		By Gross Profit, if any (Transferred from Trading Account)	
To Salaries		By Interest Received	
To Rent, Rates and Taxes		By Discount Received	
To Postage and Telegrams		By Rent Received	
To Telephone Charges		By Commission Received	
To Printing and Stationery		By Dividend Received	

Final Accounts

To Legal Expenses	By Other Incomes and Gains
To Insurance	By Net Loss
To Office Lighting	(Transferred to
To Bad Debts	Capital Account)
To Depreciation	
To Advertising	
To Travelling Expenses	
To Carriage Outwards	
To Trade Expenses	
To Discount Allowed	
To Interest Paid	
To Repairs and Renewals	
To Loss by Fire	
To Loss by Theft	
To Other Expenses and	
Losses, if any	
To Net Profit	
(Transferred to	
Capital Account)	

Notes:

1. The heading for the Profit and Loss Account, as in the case of the Trading Account, indicates the name of the business or proprietor and the period for which it is being prepared.
2. In addition to the items shown in the above form, there are certain items such as depreciation, bad debts, provision for doubtful debts, interest on capital, interest on drawings, etc., which appear in the Profit and Loss Account as a result of the adjustment entries. We shall discuss them in Unit 10.

Some Important Points

1. **Rent, Rates and Taxes:** These are charges levied by the municipal bodies on the house property. It is a common item of indirect expenses debited to the Profit and Loss Account.
2. **Insurance:** Generally, assets are insured to cover the risk of loss, say, by fire. Premium paid to the insurance company should be treated as a business expense. When assets such as factory building, factory machinery, etc. are insured, the insurance premium should be debited to Trading Account. If on the other hand, the premium is paid for insurance of assets in the office building, office furniture, etc., it should be charged to Profit and Loss Account.
3. **Bad Debts:** Bad debts denote the amount which could not be recovered from the debtors to whom the goods were sold on credit. It is a loss and so debited to the Profit and Loss Account. You will learn more about their treatment in Unit 9.
4. **Depreciation:** Depreciation means decrease in the value of fixed assets due to normal wear and tear. You know that every fixed asset such as machinery, furniture, vehicle, etc. depreciates in value on account of its constant use. Such reduction in their value is a loss to the business and so charged to the Profit and Loss Account. If, however, a Manufacturing Account is also prepared, depreciation on machinery and factory building is charged to the Manufacturing

Account, while depreciation on office building, office furniture, office equipment, etc. is charged to the Profit and Loss Account.

5. **Trade Expenses:** This item represents various small expenses incurred in the business. They are also called General Expenses, Sundry Expenses or Miscellaneous Expenses.
6. **Packing:** The cost of packing materials such as polythene bags, wrapping materials, etc. for delivery is a distribution expense and hence charged to Profit and Loss Account. Where packing is essential to make the products fit for sale in the market as in the case of cigarettes, biscuits, medicines, oil, etc. it is called 'packaging' and such expenditure is charged to the Trading Account.
7. **Samples:** Generally, samples of goods are distributed free of charge to increase sales. The cost of such samples should be treated as a selling expense and so debited to Profit and Loss Account.
8. **Income Tax:** It is the tax payable by a person on his income. In the case of a sole trading concern, the tax paid by the proprietor on the profits of the business is treated as a personal expense. Hence, it should be added to drawings or directly deducted from capital.

Illustration 5

Prepare Profit and Loss Account from the following balance extracted from, the books of a business for the year 2018.

	Rs.
Gross Profit	1,85,000
Salaries	20,000
Rent and Rates	5,000
Stationery	1,000
Postage	500
Insurance	2,000
Repairs	1,500
Depreciation	5,000
Advertisement	5,000
Discount (Dr.)	500
Commission of Salesmen	5,000
Bad Debts	2,000
Loss by Fire	2,000
Interest on Investments	2,500
Profit on sale of Investments	2,000

Solution:

Profit and Loss Account of for the year ending December 31, 2018

Dr.		Cr.	
Particulars	Amount	Particulars	Amount
	Rs.		Rs.
To Salaries	20,000	By Gross Profit	1,85,000
To Rent and Rates	5,000	(Transferred from	
To Stationery	1,000	Trading A/c)	

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To Postage	500	By Interest on Investments	2,500
To Insurance	2,000	By Profit on Sale of	
To Repairs	1,500	Investments	2,000
To Depreciation	5,000		
To Advertisement	5,000		
To Discount	500		
To Commission to Salesmen	5,000		
To Bad Debts	2,000		
To Loss by Fire	2,000		
To Net Profit (Transferred to Capital Account)	1,40,000		
	1,89,500		1,89,500

In Practice, the Trading Account and the Profit and Loss Account are combined and one account called 'Trading and Profit and Loss Account' is prepared. This account is divided into two parts. The first part shows the Gross Profit and the second part shows the Net Profit.

Look at illustration 6 and see how combined Trading and Profit and Loss Account will be prepared.

Illustration 6

From the following figures, prepare Trading and Profit and Loss Account of Lakshmi & Co. for the year ended December 31, 2018.

	Rs.
Stock on January 1, 2018	40,000
Purchases	98,000
Commission Received	650
Rent, Rates and Taxes	8,600
Salaries & Wages	12,000
Sales	1,62,100
Returns Inwards	2,400
Returns Outwards	3,000
Sundry Expenses	2,500
Bank Charges	50
Discount Received	750
Carriage on Purchases	2,000
Discount Allowed	530
Carriage on Sales	1,700
Lighting and Heating	2,200
Postage	300
Income from Investments	500
Commission Paid	1,000
Interest paid on a bank loan	550

The stock on December 31, 2018 was valued at Rs. 26,000

Solution:

Trading and Profit & Loss Account of Lakshmi & Co.
for the year ended December 31, 2018

Dr.		Cr.	
Particulars	Amount	Particulars	Amount
To Opening Stock	40,000	By Sales	1,62,100
To Purchases	98,000	Less: Returns	2,400
Less: Returns	<u>3,000</u>	By closing Stock	26,000
To Carriage on Purchase	2,000		
To Gross Profit c/d	48,700		
	<u>1,85,700</u>		<u>1,85,700</u>
To Rent. Rates and Taxes	8,600	By Gross Profit b/d	48,700
To Salaries and Wages	12,000	By Commission Received	650
To Sundry Expenses	2,500	By Discount received	750
To Bank Charges	50	By Income from Investments	500
To Discount Allowed	530		
To Carriage on Sales	1,700		
To Postage	300		
To Commission Paid	1,000		
To Interest paid on loan	550		
To Lighting & Heating	2,200		
To Net Profit	21,170		
	<u>50,600</u>		<u>50,600</u>

1.3.3 Closing Entries

You learnt that all nominal accounts which represent items of expenses and incomes are closed at the end of the accounting year by transfer to either the Trading Account or the Profit and Loss Account. The journal entries passed for such transfer are called closing entries. You also know that accounts relating to expenses and losses always show debit balances while those representing incomes show credit balances. In order to close an account which shows a debit balance and is to be transferred to the Trading Account we credit the account concerned with an amount equal to its balance and debit the Trading Account, For example, the Carriage Inwards Account Shows a debit balance of Rs. 6,000. The closing entry for this will be as follows:

		Rs.	Rs.
Trading A/c	Dr.	6,000	
To Carriage Inwards A/c			6,000

Similarly, an account which shows a credit balance, will be closed by debiting it with an amount equal to the balance and crediting the Trading Account or Profit and Loss Account, as the case may be. The closing entries are passed in the Journal Proper and it is necessary to pass such entries for preparing the Trading and Profit and Loss Account. The entries required for the items which are to be transferred to the Trading Account are as follows:

Final Accounts

1. Trading Account Dr.
 - To Stock Account (opening)
 - To Purchases Account
 - To Sales Returns Account
 - To Direct Expenses Accounts (to be credited individually)

2. Sales Account Dr.
 - Purchases Returns Account Dr.
 - Stock Account (closing) Dr.
 - To Trading Account
 - Trading Account
 - To Profit and Loss Account
 - (for Gross Profit)

Note: If there is gross loss, the closing entry will be just the reverse of the above. When the closing entry is passed for gross profit or gross loss, the Trading Account stands closed.

The entries required for items to be transferred to the Profit and Loss Account are as follows:

1. Profit and Loss Account Dr.
 - To Expenses/Losses Accounts
 - (to be credited individually)

2. Incomes/Gains Accounts Dr.
 - (to be debited individually)
 - To Profit and Loss Account

3. Profit and Loss Account Dr.
 - To Capital Account
 - (for Net Profit)

Note: If there is net loss, the closing entry will be just the reverse of the above. Let us see how closing entries for the items given in illustration 4 will be passed. These are as follows:

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	Name of Account	L.F.	Dr. Balances	Cr. Balances
2018			Rs.	Rs.
Dec. 31	Trading A/c Dr. <ul style="list-style-type: none"> To Opening Stock A/c To Purchase A/c To Sales Returns A/c To Carnage Inwards A/c (Being closing entry)		1,42,400	40,000 98,000 2,400 2,000
Dec. 31	Sales Ac Dr. Purchases Returns A/c Dr. Closing Stock A/c Dr. <ul style="list-style-type: none"> To Trading A/c (Being closing entry)		1,62,100 3,000 26,000	1,91,100

Dec. 31	Trading A/c Dr. To Profit and Loss A/c (Being transfer of gross profit)	48,700	48,700
Dec. 31	Profit and Loss A/c Dr. To Rent, Rates & Taxes A/c To Salaries & Wages A/c To Sundry Expenses A/c To Bank Charges A/c To Discount Allowed A/c To Carriage Outwards A/c To Postage A/c To Commission Paid A/c To Interest Paid A/c To Lighting & Heating A/c (Being closing entry)	29,430	8,600 12,000 2,500 50 530 1,700 300 1,000 550 2,200
Dec. 31	Commission Received A/c Dr. Discount Received A/c Dr. Income from Inv. A/c Dr. To Profit and Loss A/c (Being closing entry)	650 750 1,500	2,900
Dec. 31	Profit and Loss A/c Dr. To Capital A/c (Being transfer from NP)	21,170	21,170

Check Your Progress B

1. Distinguish between Direct and Indirect Expenses.
.....
.....
.....

2. What is the purpose of preparing a Trading Account?
.....
.....
.....
.....

3. State whether the following statements are **True** or **False**.
 - i) The gross profit is the difference of total sales and credit sales
.....
 - ii) Direct expenses are those expenses which are directly attributable to purchase of goods for resale
 - iii) Stock is valued at cost or market price whichever is lower

Final Accounts

- iv) The net profit is the excess of gross profit and other incomes over the indirect expenses and losses
 - v) Income tax paid in case of a proprietary concern is charged to Profit and Loss Account
 - vi) Trade Expenses are recharged to Trading Account
- 4 Fill in the blanks:
- i) Carriage Outwards is an example of expenses.
 - ii) Cost of goods sold is equal to opening stock plus less
 - iii) Cost of samples distributed free of cost are treated as expenses.
 - iv) All direct expenses are debited to Account.
 - v) Loss on Account of theft is to Profit and Loss Account.
 - vi) Wages and salaries are charged to

5 Ascertain the cost of goods sold from the following data:

	Rs.
Direct Expenses	8,000
Opening Stock	12,000
Purchases	80,000
Interest Paid	500
Closing Stock	10,000

1.4 BALANCE SHEET

After ascertaining the net profit or net loss by preparing the Trading and Profit and Loss Account, the final step in preparing final accounts is the preparation of Balance Sheet. The purpose of Balance Sheet is to ascertain the financial position of a business i.e., to know what the business owes and what it owns on a certain date. Hence it shows all assets and liabilities of the business as at the end of the accounting year.

You know that final accounts are prepared from the Trial Balance. All items of expense and income appearing in Trial Balance are transferred to the Trading and Profit and Loss Account. The remaining items which represent the balances of personal and real accounts are shown in the Balance Sheet. The accounts showing debit balances represent assets and those showing credit balances represent liabilities.

Look at Figure 1.3 and note how various assets and liabilities appear in the Balance Sheet.

**Table 1:3 : Balance Sheet of
as on**

Dr.		Cr.	
Liabilities	Amount	Assets	Amount .
Current Liabilities	Rs.	Current Assets	Rs.
Bank Overdraft	.....	Cash in hand	.....
Bills Payable	.....	Bills Receivable	.....
Sundry Creditors	.....	Cash at bank	.....

Long-term Liabilities		Sundry Debtors	.....
Loan	.....	Closing Stock	.....
Mortgages	.....	Investments and	
Capital Balance	.....	Fixed Assets	
Add: Net Profit	.....	Vehicles	.....
Less: Drawings	.....	Furniture	.....
		Plant & Machinery	.....
		Land & Buildings	.....
		Goodwill	.....
		
		

You should know that the Balance Sheet is prepared to ascertain the financial position at a particular point of time and not for a period. Hence the heading of the Balance Sheet will always read 'Balance Sheet as on '(usually last date of the accounting year).

The total of assets should always be equal to the total of liabilities. If however, they do not tally, it would mean that some errors have been committed while preparing the final accounts. You must recheck the treatment of all items including the arithmetical aspect, and make the corrections where necessary so that the Balance Sheet tallies.

Assets: The term 'assets' denote the economic resources (property) of the business and includes all current and fixed assets. You know current assets are those assets which are likely to be realised within a period of one year (or during the normal operating cycle) and includes cash, stock, debtors, bills receivable, short-term investments, etc. The fixed assets, on the other hand, are those assets which are acquired for use in the business over a long period. They may be tangible like machinery and furniture, or intangible like goodwill, patents, etc. The assets also include certain expenses and losses which have not been written off in full. Examples of such expenses are: formation expenses, expenses incurred on issue of shares and debentures, unwritten amount of expenditure on advertising, etc. These are shown as the last item under 'Assets' in the Balance Sheet.

Liabilities: The term 'liabilities' denote all claims against the assets of the business whether those of the outsiders (creditors) or those of the owners of the business. The outsider's claim may be sub-divided into (i) current liabilities, and (ii) long-term liabilities. These are shown separately in the Balance Sheet (see Figure 9.3). The current liabilities are those obligation which are likely to be met within one year (or during the normal operating cycle). The long-term liabilities refer to item like loans which are not to be paid in the near future. The owner's claim is shown as capital after adjusting it with the amount of net profit and drawings during the year.

Look at illustration 7 and see how Balance Sheet is prepared from given list of balances.

Illustration 7

From the following balances extracted from the books of Deepak Brothers, prepare Balance Sheet as on December 31, 2018.

	Rs.		Rs.
Capital	12,00,000	Bills Payable	40,000
Net Profit for 2018	6,00,000	Debtors	2,50,000

Final Accounts

Land & Buildings	7,00,000	Bills Receivable	50,000
		Loan	1,60,000
Plant & Machinery (after depreciation)	4,00,000	Bank Overdraft	20,000
Furniture (after depreciation)	50,000	Cash in hand	60,000
Investment	3,50,000	Loose Tools	50,000
Creditors	2,00,000	Goodwill	1,00,000
Trade marks	25,000	Closing stock	1,85,000

Solution:

Balance Sheet of Deepak Brothers as on December 31, 2018

Liabilities	Amount	Assets	Amount
Current Liabilities	Rs.	Current Assets	Rs.,
Bank Overdraft	20,000	Cash in Hand	60,000
Bills Payable	40,000	Bills Receivable	50,000
Sundry Creditors	2,00,000	Sundry Debtors	2,50,000
		Stock in Hand	1,85,000
		Investments	3,50,000
Long-term Liabilities			
Loan	1,60,000	Fixed Assets	
Capital		Loose Tools	50,000
Balance as on		Furniture	50,000
Jan. 1, 2018	12,00,000	Plant & Machinery	4,00,000
Add: Net Profit	<u>6,00,000</u>	Land & Buildings	7,00,000
	18,00,000	Trade Marks	25,000
		Goodwill	1,00,000
	<u>22,20,000</u>		<u>22,20,000</u>

Now Look at illustration 8. It shows how the Trading and Profit and Loss Account and the Balance Sheet are prepared from a given Trial Balance.

Illustration 8

From the following Trial Balance of Gupta & Sons, prepare Trading and Profit and Loss Account for the year ended December 31, 2018 and a Balance Sheet as on that date.

Trial Balance

Particulars	Dr. Balances	Cr. Balances
	Rs.	Rs.
Capital		5,00,000
Sales		10,00,000
Sales Returns	25,000	
Purchases	5,00,000	
Purchase Returns		15,000
Inventory on 1.1.2018	60,000	
Land & Pilings	4,00,000	
Plant & Machinery	2,50,000	

Furniture	1,00,000	
Wages	50,000	
Carriage Inwards	10,000	
Carriage Outwards	5,000	
Cartage	5,000	
Salaries	40,000	
Loan		2,60,000
Debtors	1,50,000	
Creditors		85,000
Bills Receivable	40,000	
Acceptances		10,000
General Expenses	20,000	
Rent & Rates	10,000	
Investments	50,000	
Cash in Hand	50,000	
Bank Overdraft		10,000
Discount Allowed	4,500	
Depreciation on Plant & Machinery	50,000	
Interest on Investments		5,000
Interest on Bank Overdraft	500	
Goodwill	60,000	
Bad Debts	5,000	
	18,85,000	18,85,000

The inventory on December 31, 2018 was valued at Rs. 1,00,000.

Solution:

**Trading and Profit & Loss Account of Gupta & Sons
For the year ended December 31, 2018**

Dr.		Cr.	
Particulars	Amount	Particulars	Amount
	Rs.		Rs.
To Inventory (Opening)	60,000	By Sales	10,00,000
To Purchases	5,00,000	Less: Returns	<u>25,000</u>
Less: Returns	<u>15,000</u>	By Inventory (Closing)	1,00,000
To Wages	50,000		
To Carriage Inwards	10,000		
To Cartage	5,000		
To Gross Profit c/d	4,65,000		
	<u>10,75,000</u>		<u>10,75,000</u>
To Carriage Outwards	5,000	By Gross Profit b/d	4,65,000
To Salaries	40,000	By Interest on Investment	5,000
To General Expenses	20,000		
To Rent and Rates	10,000		
To Discount	4,500		
To Bad debts	5,000		
To Depreciation	50,000		

Final Accounts

To Interest on Bank overdraft	500		
To Net Profit (Transferred to Capital Account)	3,35,000		
	4,70,000		4,70,000

Balance Sheet of Gupta & Sons as on December 31, 2018

Liabilities	Amount	Assets	Amount
	Rs.		Rs.
Capital 5,00,000		Goodwill	60,000
Add: Net Profit 3,35,000	8,35,000	Land & Building	4,00,000
Loan	2,60,000	Plant & Machinery	2,50,000
Creditors	85,000	Furniture	1,00,000
Acceptances	10,000	Investment	50,000
Bank Overdraft	10,000	Inventory (closing)	1,00,000
		Debtors	1,50,000
		Bills Receivables	40,000
		Cash in Hand	50,000
	12,00,000		12,00,000

Note: In the above Balance Sheet all assets and liabilities have been shown in the order of permanence.

1.5 VERTICAL PRESENTATION OF FINAL ACCOUNTS

The Trading and Profit and Loss Account and the Balance Sheet have so far been presented as a two-sided statement. But, in practice, it is not necessary to present the final accounts in this form. Nowadays many firms present them in a simpler and more intelligible form which is called a 'narrative style' or 'vertical presentation'. According to this style the Trading and Profit and Loss Account as well as the Balance Sheet are shown in the form of vertical statements. This form of presentation is adopted by many companies for publication of their final accounts. It helps the users of financial statements to appreciate the significance of different items without any difficulty. They can easily interpret the data and judge the profitability and the financial position of the company.

Look at Figure 1.4 and study how various items are shown in the Trading and Profit and Loss Account and the Balance Sheet in vertical form.

Table 1.4 : Trading and Profit and Loss Account offor the year ended

	Rs.	Rs.
SALES		.....
Less Cost of Goods Sold:		
Opening Stock	.....
Add: Purchases	.....
Add: Direct Expenses	.....

Less Closing Stock	..... ..... -----	.....
GROSS PROFIT		.....
Add Other incomes		.....
Less Indirect Expenses :		
Salaries	.....
Rent	.....
Sundry Expenses	.....
Insurance	.....	.....
NET PROFIT	-----	----- -----

**Balance Sheet of.....
as on**

Fixed Assets:		
Land and Buildings	.....
Plant and Machinery	.....
Furniture and Fixtures	.....
Vehicles	.....	.....

Current Assets:		
Stock-in-hand	.....
Debtors	.....
Cash at bank	.....
Cash in hand	.....

Less Current Liabilities:		
Creditors	.....
Bills Payable	.....

Working Capital		----- -----
Financed by:		
Capital:		
Balance as on 1.1.2018	.....
Add Net Profit for the year	.....

Less: Drawings	.....	.....
Loans	-----	----- -----

Look at illustration 9 and study how Trading and Profit and Loss Account and the Balance Sheet have been prepared for vertical presentation.

Illustration 9

From the information given in illustration 6, prepare Trading and Profit and Loss Account and the Balance Sheet in the vertical form.

Solution:

*Trading and Profit and Loss Account of Gupta & Sons
for the year ended December 31, 2018*

	Rs.	Rs.
Sales Less Returns (Rs. 10,00,000—Rs. 25,000)		9,75,000
Less: Cost of Goods Sold:		
Inventory (beginning)	60,000	
Add: Purchases less Returns (Rs. 5,00,000—Rs. 15,000)	4,85,000	
Add: Wages	50,000	
Add: Carriage Inwards	10,000	
Add: Cartage	5,000	
	6,10,000	
Less: Inventory (ending)	1,00,000	5,10,000
GROSS PROFIT		4,65,000
Add: interest on Investments		5,000
		4,70,000
Less: Indirect Expenses:		
Cartage	5,000	
Salaries	40,000	
General Expenses	20,000	
Rent and Rates	10,000	
Discount	4,500	
Bad Debts	5,000	
Interest on Bank Overdraft	500	
Depreciation	50,000	
	1,35,000	
NET PROFIT		3,35,000

Balance Sheet of Gupta & Sons as on December 31, 2018

Fixed Assets:		
Goodwill	60,000	
Land & Building	4,00,000	
Plant & Machinery	2,50,000	
Furniture	1,00,000	
Investments	50,000	
	8,60,000	
Current Assets:		
Inventory (ending)	1,00,000	
Debtors	1,50,000	
Bills Receivables	40,000	
Cash in hand	50,000	
	3,40,000	

Less: Current Liabilities:			
Creditors	85,000		
Acceptances	10,000		
Bank overdraft	<u>10,000</u>	<u>1,05,000</u>	<u>2,35,000</u>
Working Capital			<u>10,95,000</u>
Financed by:			
Capital Balance on 1.1.2018		5,00,000	
Add: Net Profit		<u>3,35,000</u>	8,35,000
Long Term Loans			<u>2,60,000</u>
			<u>10,95,000</u>

Check Your Progress C

- What is a Balance Sheet?

- Why firms use vertical form of presenting the final accounts?

- Complete the following sentences choosing one of the two alternatives given within brackets.
 - Assets representbalances of personal and real accounts. (debit/credit)
 - All liabilities which become due within one year are classified asliabilities. (long-term/current)
 - Unwritten off amount of a deferred revenue expenditure is shown on theside of the Balance Sheet. (asset/liabilities)
 - Totals of assets and liabilities are always(different/equal)
 - Loose Tools are classified asassets. (fixed/current)
 - Mortgages are classified asliabilities. (current/long-term)

1.6 MANUFACTURING ACCOUNT

In case of trading concerns you can find out the cost of goods and the gross profit by preparing a Trading Account. But a manufacturing concern has to first prepare another account called Manufacturing Account with the help of which it works out the cost of goods produced. The cost of goods produced is then transferred to the Trading account for ascertaining the cost of goods sold and the gross profit.

A manufacturing concern purchases raw materials from the market and converts them into finished goods for sale. The cost of goods produced thus includes two major costs: (i) cost of raw materials consumed, and (ii) cost of conversion. These are explained below.

Final Accounts

Cost of Raw Materials Consumed: This represents the cost of raw materials used in course of manufacture which can be worked out by adjusting the opening and closing stocks of raw materials in the purchases of raw materials. For example, a firm purchased raw materials worth Rs. 6,50,000 during 2018, and its stock of raw materials on January 1, 2018 (opening stock) was Rs. 70,000 and on December 31, 2018 (closing stock) Rs. 90,000. The cost of raw materials consumed during 2018 will be worked out as follows:

	Rs.
Opening Stock of Raw Materials	70,000
Add: Purchases of Raw Materials	6,50,000
	7,20,000
Less: Closing Stock of Raw Materials	90,000
Cost of Raw Materials Consumed	6,30,000

The direct expenses incurred on the purchases of raw materials such as freight, import duty, dock dues, cartage, etc. can also be included in the cost of raw materials consumed. But the usual practice is to show them separately on the debit side of the Manufacturing Account.

Cost of Conversion: This includes all expenses incurred in the factory such as wages paid to labour, salaries of supervisory staff, factory rent and rates, motive power, repairs to plant and machinery, depreciation on plant and machinery, etc. All these expenses are debited to the Manufacturing Account.

Look at Figure 1.5 for the performing of a Manufacturing Account.

Manufacturing Account of Fig. 1.5 for the period end

Dr.					Cr.
Particulars	Amount	Amount	Particulars	Amount	Amount
	Rs.	Rs.		Rs.	Rs.
To Work-in progress at the beginning		.....	By Sale of Scrap		.....
To Raw Materials Consumed: Opening Stock of Raw Materials	.....		By Work-in-Progress at the end		.....
Add: Purchases of Raw Materials	.....		By Cost of Goods Produced (Transferred to Trading Account)		.....
Less: Closing Stock of Raw Materials	.....	.....	
To Carriage Inwards		.....		
To Freight, Import Duty, Dock Dues, etc.		.....		
To Manufacturing Wages		.....		
To Motive Power		.....		

To Coal, Gas and Water	.....		Final Accounts-I
To Oil and Grease	.....	
To Factory Lighting & Heating	.....	
To Factory Insurance	.....	
To Repairs to Factory Building	.....	
To Repairs to Plant and Machinery	.....	
To Depreciation on Factory Buildings	.....	
To Depreciation on Plant and Machinery	.....	
	-----		-----

	-----		-----

Some Important Points

Scrap: The term 'scrap' is used for waste materials coming out of the manufacturing process. Cuttings of cloth in readymade garments factory and metal cuttings in engineering factories are some examples of scrap. Any amount realised from the sale of scrap must be adjusted in the cost of goods produced. Hence, it is credited to the Manufacturing Account.

Work-in-Progress: It is quite likely that at the end of the year, there may be certain goods which are still in the process of manufacture. Such goods are called 'semi-finished goods' or 'work-in-progress'. There will always be some work-in-progress at the beginning as well as at the end of the accounting year. Their cost must be adjusted while working out the cost of goods produced. Hence the opening work-in-progress is shown on the debit side of the Manufacturing Account while the closing work-in-progress is shown on its credit side.

Stock of Finished Goods: Besides the stock of raw materials and semi-finished goods every firm will have the stock of finished goods. This is to be adjusted in the cost of goods sold and not in the cost of goods produced. Hence, it is not shown in the Manufacturing Account. As you learnt earlier, it will be shown in the Trading Account.

Look at illustration 10 and see how Manufacturing Account is to be prepared.

Illustration 10

Prepare Manufacturing Account from the following particulars relating to the year 2018.

	Rs.
Purchases of Raw Material	1,00,000
Stock on 1.1.2018	
Raw Materials	10,000
Work-in-Progress	5,000
Finished goods	25,000
Factory wages	15,000
Factory Rent	5,000
Fuel & Power	2,000
Carriage Inwards	1,000
Repairs of Plant	2,000
Depreciation on Plant	5,000
Sale of Scrap	500

Final Accounts

Stock on 31.12.2018	20,000
Raw Materials	7,500
Work-in-Progress	30,000
Finished Goods	
Solution:	

Manufacturing Account for the year ended December 31, 2018

Particulars	Amount	Particulars	Amount
	Rs.		Rs.
To Work-in-Progress at the beginning	5,000	By Sale of Scrap	500
To Raw Materials Consumed		By Work-in-Progress at the end	7,500
Opening Stock	10,000	By Cost of Goods Produced	1,17,000
Add: Raw Purchased	1,00,000	(transferred to Trading Account)	
	1,10,000		
Less: Closing Stock	20,000		
To Factory Wages	15,000		
To Factory Rent	5,000		
To Fuel & Power	2,000		
To Carriage Inwards	1,000		
To Repairs of Plant	2,000		
To Depreciation on Plant	5,000		
	1,25,000		1,25,000

You will observe that the stock of finished goods has not been shown in the Manufacturing Account. As stated earlier, it is to be taken to the Trading Account. Now, suppose the sales for the year 2018 were Rs. 1,60,000. The Trading Account will appear as follows

Trading Account of for the year ending December, 31 2018

Particulars	Amount	Particulars	Amount
	Rs.		Rs.
To Opening stock of Finished Goods	25,000	By Sales	1,60,000
To Cost of Goods Produced (Transferred from Mfg. A/c)	1,17,000	By Closing stock of Finished Goods	30,000
To Gross Profit (Transferred to Profit & Loss A/c)	48,000		
	1,90,000		1,90,000

You have learnt that a manufacturing concern has to prepare Manufacturing Account before preparing the Trading and Profit and Loss Account. Though considered desirable but many firms do not do so because it is not compulsory. You will also generally be asked to prepare only the Trading Account without preparing the

Manufacturing Account. In such a situation you will show all items of Manufacturing Account in the Trading Account itself. In other words, cost of raw materials consumed, expenses on purchases of raw materials, all manufacturing expenses, the opening and closing work-in-progress, sale of scrap, etc. will also be shown in the Trading Account. But, as per common practice, the items like depreciation and repairs to plant and machinery and factory building will be shown in the Profit and Loss Account and not in the Trading Account.

1.7 LET US SUM UP

At the end of the accounting year the businessman prepares the final accounts with the help of a Trial Balance. The final accounts consist of (i) Profit and Loss Account and (ii) Balance Sheet. The Profit and Loss Account is prepared for ascertaining the net profit/net loss of the business during the year and the Balance Sheet is prepared for ascertaining its financial position as at the end of the year.

The Profit and Loss Account is divided into two sections. The first section called Trading Account reveals the gross profit or gross loss and the second section called Profit and Loss Account shows the net profit or net loss. Gross profit is defined as the excess of sale revenue over the cost of goods sold which also includes the direct expenses. The net profit is worked out by-crediting the Profit and Loss Account with the amount of gross profit and other incomes and debiting it with all indirect expenses and losses. In practice, we usually prepare a combined Trading and Profit and Loss Account. It is also necessary to pass closing entries for transferring all expenses and incomes to the Trading and Profit and Loss Account.

The Balance Sheet shows all assets and liabilities of the business. The assets represent the debit balances of the real and personal accounts plus the unwritten off amounts of deferred revenue expenses. The liabilities, on the other hand, represent the credit balances of real and personal accounts including capital. The total assets should always be equal to the total of liabilities.

The manufacturing concerns may also prepare a Manufacturing Account for ascertaining the cost of goods produced, which is then transferred to the Trading Account for ascertaining the cost of goods sold and the gross profit. This, however, is not compulsory. Most manufacturing concerns prepare the Trading Account directly showing all-expenses incurred in the factory (including cost of raw materials consumed) in the Trading Account itself.

1.8 KEYWORDS

Closing Stock: Goods remaining unsold at the end of the accounting year.

Cost of Conversion: Expenses incurred in the factory (for converting raw materials into finished goods.)

Cost of Goods Sold: Difference between the cost of goods available for sale and the cost of goods in stock.

Cost of Production: It is the cost of goods produced which includes cost of raw materials consumed and all manufacturing expenses.

Current Assets: Assets which are likely to be realised within a period of one year or during the operating cycle. They are also called floating assets.

Current Liabilities: Liabilities which are likely to be paid within one year or during the operating cycle. They are also called short-term liabilities.

Direct Expenses: Expenses incurred on the goods purchased till they are brought to the place of business.

Fictitious Assets: Expenses and losses not yet written off and shown as assets in the Balance Sheet.

Fixed Assets: Assets acquired for use in the business for a long period. They are also called non-current assets.

Gross Profit: Excess of sales revenue over the cost of goods sold.

Indirect Expenses: All expenses other than direct expenses. These include expenses incurred in connection with general administration, financial matters and selling and distribution of goods.

Intangible Assets: Assets in the form of rights which cannot be seen or touched such as goodwill, patents, etc.

Net Profit: Excess of gross profit and other incomes over the indirect expenses and losses in the business.

Non-Current Liabilities : Liabilities payable after a long time. They are also called long-term liabilities.

Owner's Capital: Claim of owners against the assets of the business. It is also called owner's equity and is equal to excess of assets over outside liabilities.

Opening Stock: Stock of goods as at the beginning of the accounting year.

Scrap: Waste material which arises in the course of manufacture.

Tangible Assets: Assets which have physical form and can be seen and touched such as buildings, machinery, etc.

Work-in-Progress: Goods in respect of which some work still remains to be done. They are also called semi-finished goods.

1.9 SOME USEFUL BOOKS

Maheshwari, S.N. 2018. Introduction to Accounting, Vikas Publishing House: New Delhi.

Patil, V.A. and J.S. Korlahalli. 1986. Principles and Practice of Accounting, R. Chand & Co., New Delhi.

William Pickles. 1992. Accountancy, E.L.B:s. and Pitman: London.

Gupta, R.L. and M. Radhaswamy. 2018. Advanced Accountancy; Sultan Chand & Sons: New Delhi.

Shukla, M.C. and T.S. Grewal. 2018. Advanced Accountancy, S. Chand & Co.: New Delhi.

1.10 ANSWERS TO CHECK YOUR PROGRESS

- A 1. i) Debit ii) Debit iii) Debit iv) Credit v) Debit
vi) Credit vii) Debit viii) Credit ix) Debit x) Debit
xi) Debit xii) Credit
- B 3. i) False ii) True iii) True iv) True v) False vi) False.
4. i) indirect ii) purchases, closing stock iii) selling iv) Trading v) debited
vi) Trading Account
5. Rs. 90,000
- C 3. i) debit ii) current iii) asset iv) equal v) fixed vi) long-term

1.11 TERMINAL QUESTIONS/EXERCISES

Questions

- Distinguish between:
 - Cost of Goods Sold and Cost of Goods Processed
 - Gross Profit and Net Profit
 - Direct Expenses and Indirect Expenses
 - Trading Account and Manufacturing Account
 - Profit and Loss Account and Balance Sheet
- Give closing entries for Trading and Profit and Loss Account.
- What is a Balance Sheet? Describe different methods of arranging assets and liabilities.

Exercises

- Find out the Cost of Goods Sold from the following figures extracted from the books of Allied Ltd. for the year 2018:

	Rs.
Stock (1.1.2018)	50,000
Purchases	10,00,000
Sales	15,00,000
Purchases Returns	50,000
Stock (31-1-2018)	70,000
Direct Expenses	60,000
Indirect Expenses	1,00,000

(Answer: Rs. 9,90,000)

2. Find out the Cost of Goods Sold and Gross Profit from the following figures:

	Rs.
Inventory in the beginning	60,000
Purchases Less Returns	6,00,000
Carriage Inwards	20,000
Cartage Outwards	30,000
Cartage and Freight	10,000
Wages	50,000
Sales Less Returns	12,00,000
Inventory at the end	40,000

(Answer: Cost of Goods Sold Rs, 7,00,000; Gross Profit Rs. 5,00,000.)

- From the data given in Question No. 2 prepare Trading Account
- From the following balances of Shyam Sunder, prepare Profit and Loss Account for the year ended March 31, 2018.

	Rs.
Office Expenses	5,280
Advertising	3,000
Legal Charges	5,000
Postage and Telephone Charges	6,400
Salaries and Wages	60,000
Travelling Expenses	2,500
Interest Received	600
Rent, Rates and Taxes	20,800
Insurance	2,400
Office Lighting	1,500
Stationery	1,200
Repairs	920
Miscellaneous Income	800
Commission Paid	4,000
Bank Charges	200

The Gross Profit for the year was Rs. 73,000

(Answer: Net Loss Rs. 38,000)

- The following balances have been extracted from the books of Plaza Electricals Ltd. for the year 2018.

	Rs.
Sales	5,00,000
Purchases	3,00,000
Return Inwards	10,000
Return Outwards	15,000

Opening Stock	30,000
Wages	20,000
Carnage Inwards	5,000
Carriage Outwards	3,000
Salaries	25,000
General Expenses	10,000
Rent and Rates	4,000
Advertisement	5,000
Bad debts	3,000
Insurance	3,000
Trade Expenses	2,000
Depreciation	5,000

It was further given that the value of stock on December 31, 2018 was Rs. 50,000. You are required to prepare Trading and Profit and Loss Account of Plaza Electrical Ltd. for the year ending December 31, 2018.

(Answer: Gross Profit Rs. 2,00,000; Net Profit Rs. 1,40,000)

6. From the following data pertaining to the transactions of Mehta Bros. for the year 2018, prepare Trading and Profit and Loss Account for the year ending December 31, 2018.

	Rs.
Sales	10,00,000
Purchases	6,00,000
Sales Returns	20,000
Purchases Returns	10,000
Inventory (beginning)	40,000
Wages	50,000
Carriage Inwards	20,000
Carriage Outwards	15,000
Trade Expenses	10,000
Cartage and Freight	5,000
Salaries	30,000
General Expenses	10,000
Insurance	6,000
Rent & Rates	5,000
Distribution Expenses	6,000
Discount Received	1,000
Discount Allowed	2,000
Bad Debts	2,000
Depreciation	8,000
Interest on Investments	20,000
Interest on Bank Deposits	1,000
Interest on Bank Overdraft	500
Loss of Goods by Fire	2,500

Final Accounts

It was further given that the value of Inventory on December 31, 2018 was Rs. 80,000

(**Answer:** Gross Profit Rs. 3,55,000: Net Profit Rs. 2,80,000,

- 7 . From the following balances of Hitesh, prepare a Balance Sheet as on December 31, 2018

	Rs.
Hitesh's Capital	41,000
Drawings	6,100
Wife's Loan	4,000
Sundry Creditors	45,000
Cash in Hand	250
Cash at Bank	4,000
Sundry Debtors	40,500
Patents	2,000
Plant and Machinery	20,000
Land and Building	26,000
Stock in Hand	36,500

Net Profit for the year was Rs. 45,350

(**Answer:** Balance Sheet Total Rs. 1,29,250)

8. From the following Trial Balance of Sameer, prepare Trading and Profit and Loss Account for the year ended September, 30, 2018, and Balance sheet as on that date.

Trial Balance as on September 30, 2018

Name of Account	Dr. Balances Rs.	Cr Balances Rs
Capital		40,000
Drawings	7,500	
Stock on July 1, 2017	8,000	
Purchases	47,250	
Sales		90,000
Carriage Inwards	2,300	
Returns .Inwards	2,000	
Returns Outwards		1,500
Wages	7,000	
Plant and Machinery	30,000	
Furniture and fittings	7,500	

Coal, Gas and Water	2,100	
Power	2,000	
Salaries	9,000	
Discount Allowed	750	
Discount Received		600
Office Rent	2,400	
Factory Rent	3,000	
Postage and telephone	900	
Insurance	250	
Sundry Expenses	800	
Trade Debtors	20,000	
Trade Creditors		27,150
Cash in hand	700	
Cash at Bank	4,100	
Carriage Outwards	1,700	
	<u>1,59,250</u>	<u>1,59,250</u>

The Stock on September 30, 2018 was valued at Rs. 9,250.

(**Answer:**Gross Profit Rs. 27,100; Net Profit Rs. 11,900; Balance Sheet Total Rs. 71,550)

9. The following figures have been extracted from the books of a manufacturer.

	Rs.
Stock 1.1.2018	
Raw Materials	25,000
Work-in-Progress	10,000
Finished Goods	50,000
Purchases of Raw Materials	3,00,000
Factory Wages	40,000
Factory Rent	5,000
Fuel & Power	5,000
Carriage Inwards	2,500
Repairs of Plant	25,000
Depreciation on Plant	25,000
Sale of Scrap	2,000
Stock on 31.12.2018	
Raw Materials	40,000
Work-in-Progress	15,000
Finished Goods	60,000

You are required to prepare a Manufacturing Account and ascertain the Cost of Goods Produced.

(**Answer:**Cost of Goods Produced: Rs. 3,75,500)

10. From the following Trial Balance, prepare Manufacturing Account and the Trading and Profit and Loss Account for the year ended March 31, 2018, and

Balance Sheet as at the end of the year.

Name of Account	Dr. Balances	Cr Balances
	Rs.	Rs
Opening Stock of Raw Materials	60,000	
Opening Stock of Finished Goods	32,000	
Opening Stock of the Work-in- Progress	10,000	
Capital		1,44,000
Purchase of Raw Materials	5,00,000	
Sales		8,00,000
Purchase of Finished Goods	16,000	
Carriage Inwards	8,000	
Wages	1,00,000	
Salaries (75% Factory)	52,000	
Commission	6,000	
Bad Debts	4,000	
Insurance	8,000	
Rent, Rates and Taxes (50% Factory)	24,000	
Postage and Telegram	5,600	
Miscellaneous Expenses	3,200	
Travelling and Conveyance (50% Factory)	7,000	
Carriage Outwards	5,200	
Machinery	80,000	
Furniture	10,000	
Debtors	1,20,000	
Creditors		1,07,000
	10,51,000	10,51,000

The Closing Stocks are as follows:

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

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

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

UNIT 2 FINAL ACCOUNTS-II

Structure

- 2.0 Objectives
- 2.1 Introduction
- 2.2 Need for Adjustments
- 2.3 Treatment of Adjustments in Final Accounts
 - 2.3.1 Closing Stock
 - 2.3.2 Outstanding Expenses
 - 2.3.3 Prepaid Expenses
 - 2.3.4 Accrued Income
 - 2.3.5 Income Received in Advance
 - 2.3.6 Depreciation
 - 2.3.7 Interest on Capital
 - 2.3.8 Interest on Drawings
 - 2.3.9 Interest on Loan
 - 2.3.10 Bad Debts
 - 2.3.11 Provision for Bad Debts
 - 2.3.12 Provision for Discount on Debtors
 - 2.3.13 Provision for Discount on Creditors
 - 2.3.14 Manager's Commission
 - 2.3.15 Abnormal Loss of Stock
 - 2.3.16 Drawings of Goods by the Proprietor
- 2.4 Preparation of Final Accounts with Adjustments
- 2.5 Adjustments given in Trial Balance
- 2.6 Let Us Sum Up
- 2.7 Key Words
- 2.8 Some Useful Books
- 2.9 Answers to Check Your Progress
- 2.10 Terminal Questions/Exercises

2.0 OBJECTIVES

After studying this unit you should be able to:

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

2.1 INTRODUCTION

In Unit 8 you learnt about the preparation of simple final accounts. They did not involve any adjustments. In practice, however, you are always required to make some adjustments while preparing the final accounts. It is because there may be many expenses and incomes relating to the current year which are still to be brought into the books of account. Then there may be certain items recorded in current year's books which actually relate to the previous year or the next year. Unless such items are duly adjusted in the books of account, the final accounts will not reveal the true and fair view of the state of affairs of the business. In this unit you will learn about all items which require adjustments and study how such adjustments are made in books of account and how they are incorporated in the final accounts.

2.2 NEED FOR ADJUSTMENTS

You know that the financial reporting requires the summarisation of business operations for a specific accounting period. It is quite possible that certain transactions recorded in current year's books may partly relate to the previous year or to the following year. It is also possible that certain expenditure incurred during the current year has not yet been paid and so not recorded. Similarly, there may be certain incomes earned during the current year which have not been recorded because they have not yet been received; If such items are not adjusted or brought into current year's books of account, the summary presented in the form of final accounts will not reveal the true picture. Let us take the example of an amount of Rs. 600 paid on July 1, 2018 towards insurance premium. You know any general insurance usually covers a period of twelve months. Suppose the accounting year is ending on December 31, 2018 it would mean that half the amount of insurance premium paid on July 1, 2018 pertains to the next accounting year i.e., 2019. Therefore, while preparing the final accounts of 2018, the expenditure on insurance premium that should be debited to the Profit and Loss Account is Rs. 300 (Rs. 600 paid Rs. 300 pertaining to 2019). The remaining amount of Rs. 300 will be carried forward and charged to the Profit and loss Account of 2019. Take another example. The wages of workers for the month of December, 2018 were paid on January 7, 2019. This means the Wages Account of 2018 does not include the wages for the month of December 2018. Such unpaid wages termed as 'Wages outstanding' have to be brought into the books and debited to the Trading Account along with the wages already paid. Similarly, adjustment may also become necessary in respect of certain incomes received in advance or those which are outstanding as at the end of the accounting year. Apart from these, there are certain items which cannot be recorded on day-to-day basis such as depreciation, interest on capital, etc. They are generally adjusted at the time of preparing the final accounts.

All items which need alteration or which are to be brought into books at the time of preparing final accounts are called 'adjustments'. The purpose of making various adjustments is to ensure that the final accounts reveal the true financial position of the business. Therefore, when you are to prepare the final accounts of any business, you are provided with a Trial Balance and some additional information in respect of the adjustments to be made.

2.3 TREATMENT OF ADJUSTMENTS IN FINAL ACCOUNTS

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

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

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

2.3.1 Closing Stock

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

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

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

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

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

2.3.2 Outstanding Expenses

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

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

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

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

2.3.3 Prepaid Expenses

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

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

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

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

2.3.4 Accrued Income

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

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

The Accrued income is treated in final accounts as follows:

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

2.3.5 Income Received in Advance

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

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

The unearned income is treated in final accounts as follows:

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

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

Illustration 1

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

The Trial Balance showed the following balances as on December 31, 2018:

	Rs.
Salaries	10,000
Wages	20,000
Rent Received	6,600
Commission Received	2,000
Interest on Investments	6,000

Additional Information

- i) Salaries amounting to Rs. 2,000 are outstanding.

- ii) Wages include Rs. 1,560 paid in advance.
- iii) Interest on investment include Rs. 1,200 for the months of January, February and March, 2019.
- iv) Rent for the month of December amounting to Rs. 600 is not yet received.

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

Profit and Loss Account for the year ended December 31, 2018

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

Balance Sheet As on December 31, 2018

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

2.3.6 Depreciation

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

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

Depreciation is treated in final accounts as follows:

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

Sometimes depreciation is given in the Trial Balance itself. This is possible only if the entry in respect of depreciation has already been passed in the books of account. **In**

such a situation depreciation will be shown in the Profit and Loss Account only.

It need not be adjusted in the fixed assets in the Balance Sheet because the fixed assets already stand reduced by the amount of depreciation.

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

Illustration 2

The following are the balances of assets as on January 1, 2018:

	Rs.
Plant and Machinery	1,20,000
Furnitur	18,000

A new machinery costing Rs. 30,000 was acquired on July, 1, 2018. Depreciation is to be provided on Plant and Machinery at 10% and on furniture at 5% per annum. Show how depreciation will be shown in the final accounts.

Solution :

Calculation of Depreciation

	Rs.
On Furniture at 5% on Rs. 18,000	900
On Plant and Machinery:	
10% on Rs. 1,20,000 for one year	12,000
10% on Rs. 30,000 for six months	1,500
	13,500
	14,400

Solution:

Treatment in Final Accounts

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

Balance Sheet as on December 31, 2018

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

2.3.7 Interest on Capital

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

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

Interest on capital is treated in final accounts as follows:

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

2.3.8 Interest on Drawings

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

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

Interest on Drawings is treated in final accounts as follows:

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

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

Illustration 3

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

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

Solution:

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

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

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

2.3.9 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 the full amount of due on loan has been paid or not. The rate of interest and the date on which the loan was taken is usually given. If, however, the date on which loan was taken is not given, it means that it is an old loan and full year's interest has to be provided. In any case, you should calculate the exact amount of interest due and find out from the Trial Balance whether the same has been paid or not. Generally, you will find that the interest has been paid but it is less than what is due. In such a situation, the difference is regarded as outstanding interest and the same must be adjusted at the time of preparing the final accounts. Suppose there is an item of 10% loan (taken on April 1, 2018) of Rs. 20,000 appearing in the Trial Balance. Assuming the accounting year ends on December 31, the total interest on loan will work out as Rs. 1,500 (at 10% on Rs. 20,000 for nine months). On going through the Trial Balance you find that the interest paid is Rs. 1,000 only. It means Rs. 500 (Rs. 1,500—Rs. 1,000) is the outstanding interest. This must be shown in final accounts accordingly i.e., Rs. 1,500 (Rs. 1,000 + Rs. 500 outstanding) as interest on loan on the debit side of the Profit and Loss Account and Rs. 500 as outstanding Interest under current liabilities in the Balance Sheet.

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

Check Your Progress A

1. Fill in the blanks
 - i) Every adjustment has a effect.
 - ii) Closing stock is shown on the side of the Balance Sheet.

be shown in the Profit and Loss Account. But only those bad debts will be deducted from Sundry Debtors in the Balance Sheet which are given outside the Trial Balance.

2.3.11 Provision for Bad Debts

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

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

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

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

When provision for bad debts already exists in the books, the provision created for doubtful debts at the end of a particular year will be carried forward to the next year and it will be used for meeting the loss due to bad debts incurred during the next year. The provision for bad debts brought forward from the previous year is called 'opening provision' or 'old provision'. When such provision already exists, the loss due to bad debts during the current year will be adjusted against the Same, and while making provision for bad debts required at the end of the current year called 'new provision' the balance of old provision should also be taken into account. Let us take an example and understand how these adjustments are done. Suppose old provision on January 1, 2018 was Rs. 1,000. The bad debts written off during 2018 amounted to Rs.600 and the new provision required on December 31, 2018 is Rs. 1,500. In such a situation, the

Profit and Loss Account will be debited with Rs. 1,100 as calculated below:

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

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

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

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

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

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

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

In this connection you should note the following points.

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

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

a) Forwriting off further bad debts given outside the Trial Balance:

Bad Debts A/c	Dr.
To Sundry Debtors	

b) For transferring the total bad debts to the provision for Bad Debts Account:

Provision for Bad debts A/c	Dr.
To Bad Debts A/c	

c) For debiting the Profit and Loss Account with the excess of the new pr' the total bad debts over the old provision:

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

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

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

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

Illustration 4

An extract from a Trader's Trial Balance on December 31, 2018 is given below:

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

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

Journal

2018		Rs	Rs.
Dec. 31	Bad Debts A/c Dr. To Sundry Debtors (Being bad debts written off)	2,000	2,000
“ 31	Provision for Bad Debts A/c Dr. To Bad Debts A/c (Being bad debts transferred to Provision for Bad Debts Account)	6,000	6,000
“ 31	Profit and Loss A/c Dr. To Provision for Bad Debts A/c (Being the Provision required for doubtful debts)	2,100	2,100

Bad Debts Account

2018	Rs.	2018	Rs.
Dec. 31	To Balance b/d	Dec. 31	By Prov. Fro Bad Debts
Dec. 31	To Sundry Debtors		
	6,000		6,000

Provision for Bad Debts Account

		Rs			Rs.
2018			2018		
Dec. 31	To Bad Debts A/c	6,000	Dec. 31	By Balance b/d	7,000
“	31	To Balance c/d			By Profit and Loss A/c
		3,100			2,100
		9,100	2019		9,100
			Jan. 1	By Balance b/d	3,100

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

Profit and Loss Account For the year ended December 31, 2018

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

Balance Sheet as at December 31, 2018

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

2.3.12 Provision for Discount on Debtors

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

- i) The Provision for bad debts will be calculated at 5% on Rs. 40,000. It will amount to Rs. 2,000.

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

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

The adjustment entry for provision for discount on debtors is as follows:

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

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

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

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

2.3.13 Provision for Discount on Creditors

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

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

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

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

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

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

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

2.3.14 Manager's Commission

Sometimes, the manager may also be entitled to a commission on profits earned by the business. Such commission is usually calculated as a fixed percentage on profits. Suppose

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

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

Percentage of Commission

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

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

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

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

2.3.15 Abnormal Loss of Stock

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

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

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

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

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

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

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

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

2. When the stock Isfully Insured: When the stock is fully insured, the total amount of loss is paid by the insurance company. In that case the company does not suffer fly loss.

So, nothing is debited to the Profit and Loss Account. The journal entry passed is as follows.

Insurance Company Dr.
 To Loss by Fire A/c

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

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

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

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

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

Illustration 5

On December 30, 2018 the stock worth Rs. 40,000 was destroyed by fire. The stock was insured and the insurance company admitted a claim of Rs. 30,000 only. Pass the necessary journal entries and show how it will be treated in final accounts.

Journal

Date	Particulars		Dr. Amount	Cr. Amount
2018 Dec.31	Loss by Fire A/c Dr. To Trading A/c (Being stock lost by fire) Rs.		40,000	40,000

“ 31	Insurance Company	Dr.	30,000	
	Profit and Loss A/c	Dr.	10,000	
	To Lossby Fire A/c			40,000

Trading Account
For the year ended December 31, 2018

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

Profit and Loss Account
For the year ending December 31, 2018

Dr.				Cr.
		Rs.		Rs.
	To Loss by fire	40,000		
	Less: Insurance claim	30,000	10,000	

Balance Sheet
As at December 31, 2018

For the year ending December 31, 2018

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

2.3.16 Drawing of Goods by the Proprietor

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

Drawings Account Dr.
 To Purchases Account

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

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

Check Your Progress B

1. Why do you create a provision for bad debts?

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

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3. The Trial Balance shows the following balances.

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

Adjustments:

- a) Bad Debts of Rs. 200 not yet written off.
- b) Create a provision for Doubtful Debts at 5% on Debtors
- c) Discount on Debtors is to be provided at 2%.

Calculate the provision for Bad Debts and provision for Discount on Debtors.

4. Stock worth Rs. 20,000 was lost by fire. Insurance claim was admitted for three-fourth of the value of goods lost. What amount you will (i) credit to the Trading A/c, (ii) debit to the Profit & Loss A/c, and (iii) show on the asset side of the Balance Sheet.

2.4 PREPARATION OF FINAL ACCOUNTS WITH ADJUSTMENTS

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

Illustration 6

From the following Trial Balance of Gupta & Sons, prepare Trading and Profit and Loss Account for the year ended December 31, 2018 and a Balance Sheet as on that date.

Trial Balance

Name of the Account	Debit Balances	Credit Balances
	Rs.	Rs.
Capital		5,00,000
Sales		10,00,000
Sales Returns	25,000	

Final Accounts

Purchases	5,00,000	
Purchases Returns		15,000
Inventory as on 1.1.18	60,000	
Land & Buildings	4,00,000	
Plant & Machinery	3,00,000	
Furniture	1,00,000	
Wages	50,000	-
Carriage Inwards	10,000	
Provision for Bad Debts		7,000
Carriage Outwards	5,000	
Cartage	5,000	
Salaries	40,000	
Loan		2,60,000
Debtors	1,50,000	
Creditors		70,000
Rent		8,000
Bills Receivable	40,000	
Acceptances		10,000
General Expenses	20,000	
Rent & Rates	10,000	
Investments	50,000	
Cash in hand	50,000	
Bank Overdraft		10,000
Discount	4,500	
Bad Debts	5,000	-
Interest on Investments		5,000
Interest on Bank Overdraft	500	
Goodwill	60,000	
Total	18,85,000	18,85,000

Additional Information

1. The value of inventory on December 31, 2018 was Rs. 1,00,000.
2. Depreciation is to be provided on: Land & Building @ 5% p.a. Furniture @ 10% p.a. Plant & Machinery Rs. 50,000.
3. Provision for Bad Debts is to be maintained @ 5% on debtors.
4. Wages are outstanding to the extent of Rs. 4,000 and Salaries to the extent of Rs. 3,000.
5. Rent and Rates are prepaid to the extent of 1/4th of the amount paid.
6. Interest on Investment outstanding is Rs. 1,000.
7. Rent to the extent of Rs. 2,000 has been received in advance.

Solution:

Trading & Profit and Loss Account
for the year ended December 31, 2018

Dr.		Cr.	
Particulars	Amount	Particulars	Amount
	Rs.		Rs.
To Inventory as on 1.1.18	60,000		
To Purchases	5,00,000	By Sales	10,00,000
Less: Purchases Returns	<u>15,000</u>	Less: Sales Returns	<u>25,000</u>
	4,85,000		9,75,000
To Wages	50,000	By Inventory as on 31.12.18	1,00,000
Add: Wages Outstanding	<u>4,000</u>		
	54,000		
To Carriage Inwards	10,000		
To Cartage	5,000		
To Gross Profit c/d	4,61,000		
	<u>10,75,000</u>		<u>10,75,000</u>
To Carriage Outwards	5,000	By Gross Profit b/d	4,61,000
To Salaries	40,000	By Rent	8,000
Add: Outstanding	<u>3,000</u>	Less: Received in advance	<u>2,000</u>
	43,000		6,000
To General Expenses	20,000		
		By Interest on Investment	5,000
To Rent & Rates	10,000	Add: Outstanding	<u>1,000</u>
Less: Prepaid	<u>2,500</u>		6,000
	7,500		
To Discount Allowed	4,500		
To Bad Debts	5,000		
Add: New Provision	<u>7,500</u>		
	12,500		
Less: Old Provision	<u>7,000</u>		
	5,500		
To Depreciation on Plant & Machinery	50,000		
To Interest on Overdraft	500		
To Depreciation			
Land & Building	20,000		
Furniture	<u>10,000</u>		
	30,000		
To Net Profit (Transferred to Capital A/c)	3,07,000		
	<u>4,73,000</u>		<u>4,73,000</u>

Balance Sheet as on December 31, 2018

Liabilities	Amount	Assets	Amount
	Rs.		Rs.
Capital		Fixed Assets	
Balance	5,00,000	Goodwill	60,000
Add: Net Profit	<u>3,07,000</u>	Land & Building	4,00,000
	8,07,000	Less: Depreciation	<u>20,000</u>
			3,80,000

Final Accounts				
Long Term Liabilities				
Loan	2,60,000	Plant & Machinery	3,00,000	
		Less: Depreciation	50,000	2,50,000
Current Liabilities				
Creditors	70,000	Furniture	1,00,000	
Acceptances	10,000	Less: Depreciation	10,000	90,000
Bank Overdraft	10,000	Investments		
Wages Outstanding	4,000	Current Assets		
Salaries Outstanding	3,000	Cash in hand		50,000
Rent Received in Advance	2,000	Debtors	1,50,000	
		Less: Provision for		
		Bad Debts	7,500	1,42,500
		Bills Receivable		40,000
		Closing Stock		1,00,000
		Prepaid Rent & Rates		2,500
		Interest on Investment		
		Outstanding		1,000
		11,66,000		11,66,000

Illustration 7

From the following balances extracted from the book of Aristo Ltd., prepare a Trading and Profit and Loss Account for the year ended December 31, 2018 and a Balance Sheet as on that date.

Trial Balance

Name of the Account	Debit Balances Rs.	Credit Balances Rs.
Capital		2,00,000
Sales		5,00,000
Sales Returns	10,000	
Purchases	2,40,000	
Purchases Returns		10,000
Stock on 1.1.2018	40,000	
Land & Buildings	2,00,000	
Plant & Machinery	1,00,000	
Wages	25,000	
Furniture	50,000	
Provision for Bad Debts		5,000
Salaries	25,000	
Debtors	82,000	
Creditors		1,00,000
Bad Debts	3,000	
Bills Payable		30,000

Investments	50,000	
General Expenses	20,000	
Cash in hand	5,000	
Cash at bank	15,000	
Depredation on Land & Buildings	20,000	
	8,45,000	8,45,000

Additional Information

- The inventory on 31.12.18 has been valued at Rs. 80,000. The inventory of the value of Rs 20,000 was destroyed by fire on 1.12.18 and a claim of Rs. 15,000 was admitted by the insurance company.
- Depreciation is to be provided on Plant & Machinery and furniture at 10% per annum.
- Debtors are bad to the extent of Rs. 2,000. Provision for bad debts is to be made at 5% on debtors and a provision for discount on debtors at 2%.
- Wages for outstanding to the extent of Rs. 5,000.
- Salaries are prepaid to the extent of Rs. 2,000.
- Create a provision for discount on creditors at the rate of 1%.
- Create a provision for repairs to the extent of Rs. 4,000.

Trading & Profit and Loss Account for the year ended December 31, 2018

Particulars		Amount	Particulars		Amount
		Rs.			Rs.
To Opening Stock		40,000	By Sales	5,00,000	
To Purchases	2,00,000		Less: Sales Returns	<u>10,000</u>	4,90,000
Less: Purchases Returns	<u>10,000</u>	1,90,000	By Closing Stock		80,000
To Wages	25,000		By Loss by Fire		20,000
Add: Outstanding	<u>5,000</u>	30,000			
To Gross Profit c/d		<u>3,30,000</u>			
		<u>5,90,000</u>			<u>5,90,000</u>
To Salaries	25,000		By Gross Profit b/d		3,30,000
Less: Prepaid	<u>2,000</u>	23,000	By Provision for		
			Discount on Creditors		1,000
To Bad Debts	3,000				
Add: Further Bad Debts	2,000				
Add: New Provision	<u>4,000</u>				
	9,000				
Less: Old Provision	<u>5,000</u>	4,000			
To General Expenses		20,000			
To Depreciation on Land & Buildings		20,000			
To Loss by Fire		5,000			

Final Accounts

To Depreciation on Plant & Machinery	10,000	
To Depreciation on Furniture	5,000	
To Provision for Discount on Debtors	1,520	
To Provision for Repairs	4,000	
To Net Profit (Transferred to Balance Sheet)	2,38,480	
.	<u>3,31,000</u>	<u>3,31,000</u>

Balance Sheet as on December 31, 2018

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

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

2.5 ADJUSTMENTS GIVEN IN TRIAL BALANCE

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

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

Look at Chart 10.1 and note how each item of adjustment is treated in final accounts. (i) if it is given outside the Trial Balance, and (ii) if it appears in the Trial Balance itself.

Chart 2.1

Treatment of Adjustment Items in Final Accounts

S.No.	Item	Treatment In Final Accounts	
		If given in Adjustments	If given in Trial Balance
1.	Closing Stock	i) Credit side of Trading A/c : Shown as a separate item ii) Assets side of Balance Sheet : Shown as a separate item under Current Assets	Assets side of Balance Sheet only
2	Outstanding Expenses	i) Debit side of Trading A/c or Profit and Loss A/c: Added to the concerned expense ii) Liabilities side of Balance Sheet. Shown as a separate item under Current Liabilities	Liabilities side of Balance Sheet only.

Final Accounts

3. Prepaid Expenses	<ul style="list-style-type: none">i) Debit side of Profit and Loss A/c: Deducted from the concerned expenseii) Assets side of Balance Sheet: Shown as a separate item under Current Assets	Assets side of Balance Sheet only.
4. Outstanding incomes	<ul style="list-style-type: none">i) Credit side of Profit and Loss A/c: Added to the concerned incomeii) Asset side of Balance Sheet: Shown as a separate item under Current Assets	Assets side of Balance Sheet only.
5. Income Received in Advance	<ul style="list-style-type: none">i) Credit side of Profit and Loss A/c: Deducted from concerned incomeii) Liabilities side of Balance Sheet. Shown as a separate item under Current Liabilities	Liabilities side of Balance Sheet only.
6. Depreciation	<ul style="list-style-type: none">i) Debit side of Profit and Loss A/c: Shown as a separate itemii) Assets side of Balance Sheet: Deducted from the concerned fixed asset	Debit side of Trading & Profit and Loss Account only.
7. Interest on Capital	<ul style="list-style-type: none">i) Debit side of Profit and Loss A/c: Shown as a separate itemii) Liabilities side of Balance Sheet: Added to Capital	Debit side of Profit and Loss Account only.
8. Interest on Drawings	<ul style="list-style-type: none">i) Credit side of Profit and Loss A/c: Shown as a separate itemii) Liabilities side of Balance Sheet: Deducted from Capital	Credit side of Profit and Loss Account only.
9. Interest on Loan	<ul style="list-style-type: none">i) Debit side of Profit and Loss A/c: Shown as a separate itemii) Liabilities side of Balance Sheet: Added to Loan.	Debit side of Profit and Loss Account only.
10. Bad Debts	<ul style="list-style-type: none">i) Debit side of Profit and Loss A/c: Added to Bad Debtsii) Assets side of Balance Sheet: Deducted from Sundry Debtors	Debit side of Profit and Loss Account only.
11. Provision for bad debts	<ul style="list-style-type: none">i) Debit side of Profit and Loss A/c: shown as a separate itemii) Assets side of Balance Sheet: Deducted from Sundry Debtors	Deduct from sundry debtors assuming it is a closing balance.

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

Illustration 8

From the following Trial Balance of Pitam Stores prepare Trading and profit and Loss Account for the year ended December 31, 2018 and the Balance Sheet as on that date.

Trial Balance

Account	Debit Balances	Credit Balances
	Rs.	Rs.
Capital		60,000
Drawings	5,000	
Purchases	1,00,000	
Sales		2,10,000
Opening Stock	20,000	
Wages	15,000	
Wages Outstanding		5,000
Carriage Inwards	2,000	
Salaries	13,000	
Insurance	1,500	

Final Accounts

Insurance Prepaid	1,500	
Income from Investments		30,000
Accrued Income from Investments	10,000	
Machinery	50,000	
Buildings	95,000	
Cash in hand	2,000	
Debtors	35,000	
Creditors		60,000
Depreciation on Buildings	5,000	
Rent	10,000	
	<u>3,65,000</u>	<u>3,65,000</u>

Additional Information : The value of stock on December 31, 2018 was Rs. 40,000.

Solution:**Trading and Profit and Loss Account for the year ended December 31, 2018**

Particulars	Amount	Particulars	Amount
	Rs.		Rs.
To Opening Stock	20,000	By Sales	2,10,000
To Purchases	1,00,000	By Closing Stock	40,000
To Wages	15,000		
To Carriage Inwards	2,000		
To Gross Profit c/d	<u>1,13,000</u>		
	<u>2,50,000</u>		<u>2,50,000</u>
To Salaries	13,000	By Gross Profit b/d	1,13,000
To Insurance	1,500	By Income from	
To Rent	10,000	Investments	30,000
To Depreciation on Building	5,000		
To Net Profit (Transferred to Capital A/c)	1,13,500		
	<u>1,43,000</u>		<u>1,43,000</u>

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

2.6 LET US SUM UP

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

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

2.7 KEY WORDS

Abnormal Loss: Loss caused by abnormal causes.

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

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

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

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

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

Doubtful Debts: Debts of doubtful recovery.

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

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

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

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

2.8 SOME USEFUL BOOKS

Maheshwari, S.N., 2018. Introduction to Accounting, Vikas Publishing House: New Delhi.

Patil, V.A. and J.S. Korlahalli, 2018. Principles and Practice of Accounting, R. Chand & Co., New Delhi.

William Pickles. 1992. Accountancy, E.L.B.S. and Pitman, London.

Gupta, R.L. and M. Radhaswamy, 2018. Advanced Accountancy, Sultan Chand & Sons, New Delhi.

Shukla, M.C. and T.S. Grewal, 2018. Advanced Accountancy, S. Chand & Co., New Delhi.

2.9 ANSWERS TO CHECK YOUR PROGRESS

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

2.10 TERMINAL QUESTIONS/EXERCISES

Questions

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

Exercises

1. Give journal entries for the following adjustments:

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

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

Debtors as on 31.12.2018	Rs. 25,000
Bad Debts during 2018	Rs. 1,000

Provision for Bad Debts is to be maintained at 5% of debtors.

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

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

3. The Proprietor withdrew the following amounts during the year ended

December 31, 2018.	Rs.
Feb. 28	4,000
May 1	6,000
Aug. 31	5,000
Nov. 1	2,000
Dec. 1	1,000

Calculate interest on drawings if the rate is 6% per annum.

(Answer: Rs. 565)

4. From the following Trial Balance of Puri & Sons as on June 30, 2018, prepare Trading and Profit and Loss Account and the Balance Sheet.

Trial Balance

Name at the Account	Debit	Credit
	Rs.	Rs.
Capital		1,00,000
Drawings	5,000	
Purchases less returns	2,00,000	
Sales less Returns		5,00,000
Inventory (beginning)	50,000	
Wages	20,000	
Carriage Inwards	3,000	
Salaries	25,000	
Freight	2,000	
Trade Expenses	5,000	
Rent		20,000
Packing Charges	2,000	
Land & Buildings	2,00,000	
Plant & Machinery	2,50,000	

Final Accounts

Furniture	50,000	
Bad Debts	5,000	
Debtors	75,000	
Creditors		80,000
Cash in hand & at bank	5,000	
Bills Receivable	3,000	
Loan	2,00,000	
Total	9,00,000	9,00,000

Additional Information :

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

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

5. From the following Trial Balance of Kawatra stores, prepare Trading and Profit and Loss Account for the year ended December 31, 2018, and a Balance Sheet as on that date.

Trial Balance

Name at the Account	Debit	Credit
Capital		
Drawings	20,000	
Purchases	4,00,000	
Purchases Returns		10,000
Sales		7,00,000
Sales Returns	20,000	
Inventory (beginning)	1,00,000	
Land & Building	3,00,000	
Plant & Machinery	1,50,000	
Goodwill	50,000	
Trade Marks	30,000	
Wages.	40,000	
Trade Expenses	20,000	
Furniture	50,000	
Provision for Bad Debts		10,000
Debtors	1,07,000	

Bad Debts	3,000	
Salaries	60,000	
Creditors		1,00,000
Acceptances		80,000
Investments	10,000	
Rent	15,000	
Distribution Expenses	5,000	
Cash in hand and at bank	10,000	
Depreciation on Furniture	10,000	
Total	4,00,000	4,00,000

Additional information:-

- i) The inventory on December 31, 2018 was valued at Rs. 1,50,000. Inventory of the value Rs. 10,000 was destroyed by fire on 1.12.2018. It was fully insured and a claim of Rs. 10,000 was admitted by the insurance company.
 - ii) Depreciation is to be provided on the following assets:
 - Land & Buildings @ 5% p.a.
 - Plant & Machinery @ 12½% p.a.
 - iii) Debtors are bad to the extent of Rs. 2,000. Provision of 5% on debtors is to be created in respect of bad debts and a provision for discount on debtors is to be created at 2% of debtors.
 - iv) Wages are outstanding to the extent of Rs. 10,000.
 - v) Rent is prepaid to the extent of Rs. 5,000.
 - vi) The general manager is to be provided a commission of 2% on net profits before charging such commission.
- (Answer: Gross Profit Rs. 3,00,000; Net Profit Rs. 1,55,887;
Balance Sheet total Rs. 8,29,005)
6. From the following Trial Balance of V. Ramana, prepare his final accounts for the year ended December 31, 2018

Name of the Account	Dr.	Cr.
	Rs.	Rs.
Capital		70,000
Drawings	10,000	2,95,000
Adjusted Purchases	2,32,500	2,95,000
Sales		
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	
Insurance	600	
Prepaid Insurance	300	
Rent Received		6,000
Rent Received in Advance		3,000
Trade Debtors	14,100	
Trade Creditors		24,000
Loss by Fire	2,000	
Commission		1,500
Stock on December 31, 2017	49,200	4,03,000
Total	4,03,000	4,03,000

7. The Trial Balance of S Karim as on December 31, 2018

Name of the Account	Dr.	Cr.
	Rs.	Rs.
Capital		1,10,000
Drawings	15,000	
Gross Profit earned during 2018		32,000
Salaries and Wages	22,000	
Rent and Taxes	8,400	
Cash in hand	2,300	
Bank Overdraft		8,600
Sundry Debtors and Creditors		36,000
Insurance (including premium of	41,000	

Rs.400 per annum paid upto March 31, 2018)	1,000	
Loose Tools	500	800
Bad Debts		
Provision for Bad Debts	300	
Entertainment Expenses		2,100
Commission	2,600	
General Charges	12,000	
Furniture and Fixtures	60,000	
Plant and Machinery	19,800	
Stock on December 31, 2017		
	1,89,000	1,89,000

Prepare the Profit and Loss Account for the year ending December 31, 2018 and the Balance Sheet as on that date.

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

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