

Adjustments in Financial Statements

Adjustments on Interest on capital



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Interest on capital is the amount paid to the owners or partners of a business on their invested capital. It is generally calculated as a percentage of the capital invested and is used as a way to reward owners for their financial investment in the business. This is common in partnership firms and sole proprietorships but not typically applicable in companies where dividends are paid to shareholders instead.



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Interest on Capital means when the proprietor renders money to the firm for running the business, in turn, the firm provides interest on capital to the proprietor. The rate of interest shall be pre-determined on the basis of the time period. For example, if the proprietor has lent an amount at the beginning of the given period, he shall receive an interest on capital for the whole period and if it is lent between the year then the rate of interest on capital shall be calculated accordingly in the proportion of time.



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Adjustment:

A. If Interest on Capital is given outside the trial balance:



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In such case, two effects will take place:

- Interest on Capital will be shown on the debit side of the Profit & Loss A/c, being an item of expense for a business.
- It will be added to the Capital A/c in the Liabilities side of the Balance Sheet.



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Journal Entry				
Date	Particulars	L.F.	Amount(Dr.)	Amount(Cr.)
	Interest on Capital A/c <span style="float: right;">Dr.</span>		XXXX	
	To Capital A/c			XXXX
	(Being interest on capital charged)			

  

Dr.		Trading & P&L A/c		Cr.
Particulars	Amount(₹)	Particulars	Amount(₹)	
To Interest on Capital	XXXX			

  

Balance Sheet			
Liabilities	Amount(₹)	Assets	Amount(₹)
Capital	XXXX		
Add: Interest on Capital	XXXX		
	XXXX		

B. If Interest on Capital is given inside the trial balance:

In such a case, Interest on Capital will be shown only in the Dr. side of the Profit & Loss A/c, being an expense for a business.

Dr.		Trading & P&L A/c		Cr.
Particulars	Amount(₹)	Particulars	Amount(₹)	
To Interest on Capital	XXXX			

**Solved Example**

**Question:**

The Trial Balance of M/s XYZ Enterprises as on December 31, 2023, is as follows:

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Dr. Balances (₹)	Cr. Balances (₹)
Opening Stock	30,000
Purchases	1,00,000
Carriage Inwards	5,000
Plant and Machinery	50,000
Furniture	20,000
Salaries	25,000
Rent	10,000
Cash	15,000
Sundry Debtors	40,000
General Expenses	8,000
Insurance	3,000
Total	2,91,000

**Adjustments:**

1. Closing Stock as on December 31, 2023, is valued at ₹40,000.
2. Depreciation on Plant and Machinery is to be provided at 10% per annum.
3. Accrued Income of ₹2,000 for Commission.
4. Unearned Income of ₹4,000 for Rent received in advance.
5. Interest on Capital at 5% per annum is ₹10,000.

**Required:**

1. Pass the necessary journal entries for the above adjustments.
2. Prepare the adjusted Trading and Profit and Loss Account for the year ended December 31, 2023.
3. Prepare the adjusted Balance Sheet as on December 31, 2023.

**Solution:**

Journal Entries



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Date	Account	Dr. (₹)	Cr. (₹)
Dec 31, 2023	Depreciation Expense	5,000	
	To Accumulated Depreciation		5,000
Dec 31, 2023	Accrued Income (Commission)	2,000	
	To Commission Income		2,000
Dec 31, 2023	Unearned Rent Income		4,000
	To Rent Income	4,000	
Dec 31, 2023	Interest on Capital	10,000	
	To Capital		10,000
Dec 31, 2023	Prepaid Insurance	150	
	To Insurance		150
Dec 31, 2023	Rent Received in Advance		3,000
	To Rent Income	3,000	
Dec 31, 2023	Outstanding Wages	500	
	To Wages Expense		500



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**Trading Account**

Particulars	₹ (Dr)	Particulars	₹ (Cr)
To Opening Stock	20,000	By Sales	1,00,000
To Purchases	60,000	Less: Sales Returns	5,000
To Gross Profit c/d	15,000	By Closing Stock	30,000
<b>Total</b>	<b>1,25,000</b>	<b>Total</b>	<b>1,25,000</b>

**Profit & Loss Account**

Particulars	₹ (Dr)	Particulars	₹ (Cr)
To Wages	5,000	By Gross Profit b/d	15,000
To Salaries	15,000	By Interest Income	2,000
To Depreciation	5,000	By Unearned Rent Income	3,000
To Rent Expense	8,000	By Commission Income	1,500
To Accrued Income	2,000	By Net Profit	5,500
To Interest on Capital	5,500		
To Net Profit c/d	5,500		
<b>Total</b>	<b>45,000</b>	<b>Total</b>	<b>45,000</b>

**Balance Sheet as of December 31, 2023**

Liabilities	₹ (Cr)	Assets	₹ (Dr)
Capital	80,000	Fixed Assets	60,000
Add: Net Profit	5,500	Current Assets	
Less: Drawings	5,000	Less: Closing Stock	30,000
Outstanding Wages	500	Prepaid Insurance	150
Unearned Rent Income	3,000	Accrued Income	2,000
Current Liabilities	3,500	Cash	15,350
<b>Total Liabilities</b>	<b>87,000</b>	<b>Total Assets</b>	<b>87,000</b>



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**Assignment**

Ques 1: Trial Balance of M/s Alpha Traders as on March 31, 2024

Account Name	Dr. (₹)	Cr. (₹)
Opening Stock	25,000	
Purchases	1,20,000	
Sales		2,00,000
Returns Inwards	5,000	
Carriage Outwards	3,000	
Furniture	40,000	
Salaries	20,000	
Rent	12,000	
Insurance	6,000	
Cash in Hand	15,000	
Sundry Debtors	30,000	
Sundry Creditors		18,000
Capital		1,50,000
Bank Loan		30,000
Interest on Capital		
<b>Totals</b>	<b>2,76,000</b>	<b>2,98,000</b>

**Adjustments**

1. **Closing Stock** as on March 31, 2024, is valued at ₹35,000.
2. **Depreciation** on Furniture is to be provided at 10% per annum.
3. **Interest on Capital** is to be allowed at 5% per annum. The capital as on April 1, 2023, was ₹1,50,000.
4. **Insurance** includes a premium of ₹1,000 paid in advance.
5. **Rent** for March 2024 amounting to ₹1,000 is outstanding.
6. **Commission Income** earned but not received amounts to ₹2,500.
7. Goods worth ₹3,000 were taken by the proprietor for personal use; no entry has been made for this withdrawal.

**Required**

1. Pass necessary journal entries for the above adjustments.
2. Prepare the adjusted Trading and Profit & Loss Account for the year ended March 31, 2024.
3. Prepare the adjusted Balance Sheet as on March 31, 2024.

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**Ques 2: Trial Balance of M/s Beta Industries as on December 31, 2023**

Account Name	Dr. (₹)	Cr. (₹)
Opening Stock	50,000	
Purchases	2,00,000	
Sales		3,50,000
Returns Outwards		5,000
Machinery	1,00,000	
Wages	40,000	
Salaries	30,000	
Rent Received		12,000
Interest Received		4,000
Trade Expenses	10,000	
Cash at Bank	25,000	
Sundry Debtors	60,000	
Sundry Creditors		25,000
Capital		3,00,000
Drawings	20,000	
Totals	5,35,000	5,96,000

**Adjustments**

1. Closing Stock as on December 31, 2023, is valued at ₹55,000.
2. Depreciation on Machinery is to be provided at 15% per annum.
3. Interest on Capital is to be allowed at 8% per annum. The capital as on January 1, 2023, was ₹3,00,000.
4. Rent Received includes ₹2,000 received in advance.
5. Wages include ₹5,000 paid for installation of new machinery; this amount should be capitalized.
6. Interest Receivable amounting to ₹1,500 is still outstanding.
7. Provision for Doubtful Debts is to be created at 5% on Sundry Debtors.

**Required**

1. Pass necessary journal entries for the above adjustments.
2. Prepare the adjusted Trading and Profit & Loss Account for the year ended December 31, 2023.
3. Prepare the adjusted Balance Sheet as on December 31, 2023.

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Adjustment on Interest on Drawings

**Interest on Drawings** is an adjustment made in the accounts when a proprietor or partner withdraws funds from the business for personal use, and the business charges interest on those withdrawals. This interest is treated as an expense for the proprietor/partner and as income for the business.

Drawings is the amount withdrawn by partners for their personal use from the business. Therefore, the firm charges a certain rate of interest for the amount withdrawn by partners. The interest on Drawings is considered an income for the firm and an expense for the partners.

**Adjustment:**

A. If Interest on Drawings is given outside the trial balance:

In such case, two effects will take place -

Interest on Drawings will be shown in the Cr.. side of the Profit & Loss A/c, being an income for the business.

It will be added to the Drawings A/c and subtracted from the Capital A/c in the Liabilities side of the Balance Sheet.



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Journal Entry				
Date	Particulars	L.F.	Amount(Dr.)	Amount(Cr.)
	Drawings A/c <span style="float: right;">Dr.</span>		XXXX	
	To Interest on Drawings A/c			XXXX
	(Being Interest received on Drawings)			

  

Dr.		Cr.	
Trading & P&L A/c			
Particulars	Amount(₹)	Particulars	Amount(₹)
		By Interest on Drawings	XXXX

  

Balance Sheet			
Liabilities	Amount(₹)	Assets	Amount(₹)
Capital	XXXX		
Less: Drawings	(XXXX)		
Less: Interest on Drawings	(XXXX)		
	XXXX		

B. If Interest on Drawings is given inside the trial balance:

In such a situation, Interest on Drawings will only be shown in the Cr. side of the Profit & Loss A/c, being an income for the business.

Dr.		Cr.	
Trading & P&L A/c			
Particulars	Amount(₹)	Particulars	Amount(₹)
		By Interest on Drawings	XXXX

**Assignment**

**Ques:** Trial Balance of M/s Delta Enterprises as on March 31, 2024

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Account Name	Dr. (₹)	Cr. (₹)
Capital		3,00,000
Drawings	20,000	
Sales		5,00,000
Purchases	2,50,000	
Rent	30,000	
Wages	50,000	
Furniture	1,00,000	
Sundry Creditors		50,000
Cash in Hand	70,000	
Bank Loan		1,00,000
Sundry Debtors	40,000	
Rent Received		20,000
<b>Totals</b>	<b>5,60,000</b>	<b>9,70,000</b>

**Adjustments:**

- Interest on Drawings:** Interest on drawings is to be charged at **10% per annum**. The partner withdrew ₹20,000 on April 1, 2023.
- Closing Stock** as on March 31, 2024, is valued at **₹60,000**.
- Depreciation** on Furniture is to be provided at **10% per annum**.
- Salaries** amounting to **₹5,000** are outstanding.
- Accrued Commission Income** of **₹4,000** is still receivable.
- Rent Received** includes **₹2,000** received in advance.

**Required:**

- Pass necessary journal entries for the above adjustments.
- Prepare the adjusted Trading and Profit & Loss Account for the year ended March 31, 2024.
- Prepare the adjusted Balance Sheet as on March 31, 2024