

Adjustments in Financial Statements

Adjustments on Interest on Loans

Interest on loans refers to the cost incurred by a business or individual for borrowing money from a lender, usually a bank or financial institution. This interest is generally paid periodically (e.g., monthly, quarterly, or annually) and is calculated based on the principal amount of the loan, the interest rate, and the time period.

**Key Points on Interest on Loans:**

1. **Expense for Borrower:** Interest on loans is considered an expense for the borrower and is recorded in the Profit & Loss Account under "Interest Expense."
2. **Income for Lender:** For the lender, the interest received is income and is recorded in the Profit & Loss Account under "Interest Income."
3. **Accrual Basis:** Interest on loans should be recorded on an accrual basis, meaning it is recognized in the period it is incurred, regardless of when the actual payment is made.
4. **Impact on Financial Statements:** Interest on loans affects both the Profit & Loss Account (as an expense) and the Balance Sheet (as part of the liabilities if unpaid).

A business usually takes loans from banks in order to make expenditures in their business. They also need to pay certain interest on this loan amount. If a business is unable to pay the interest on the loan in the same financial year, then this interest is called Outstanding Interest. The adjustments, in this case, are shown below:

**Adjustment:**

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

In such case, two effects will take place:

Firstly, Interest on the loan will be shown in the Dr. side of the Profit & Loss A/c, being an item of expense.

It will be added to the Loan 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 Loan A/c <span style="float: right;">Dr.</span>		XXXX	
	To Outstanding Expenses A/c			XXXX
	(Being interest on loan charged)			

  

Dr. Trading & P&L A/c <span style="float: right;">Cr.</span>			
Particulars	Amount(₹)	Particulars	Amount(₹)
To Interest on Loan	XXXX		

  

Balance Sheet			
Liabilities	Amount(₹)	Assets	Amount(₹)
Loan A/c	XXXX		
Add: Interest on Loan	XXXX	XXXX	

B. If Interest on Loan is given Inside the trial balance:

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

Dr. Trading & P&L A/c <span style="float: right;">Cr.</span>			
Particulars	Amount(₹)	Particulars	Amount(₹)
To Interest on Loan	XXXX		

**Adjustment for Bad Debts**

**Bad debts** refer to the amounts that are considered uncollectible from a customer or debtor. These are amounts that a business has recorded as receivable (i.e., money owed to the business) but, for some reason, the debtor is unable or unwilling to pay. Bad debts are typically treated as an expense in the Profit & Loss Account, as they represent a loss to the business.

Key Points on Bad Debts:

1. **Expense Recognition:** Bad debts are recognized as an expense when it becomes evident that the amount owed will not be collected.
2. **Reduction in Receivables:** The bad debt amount is deducted from the accounts receivable in the Balance Sheet.
3. **Provision for Bad Debts:** Businesses often create a provision for doubtful debts, which is an estimate of the amount of receivables that might turn into bad debts. This provision is an expense, but it helps in smoothing the impact of bad debts over time.

Every business makes cash and credit transactions in its day-to-day life. When the goods are sold on credit to any person or firm, we record them as debtors in books of account, and this shows that some amount is recoverable from them in the near future. When the business is unable to recover its payment for the goods given, bad debts take place, and this is a loss for the business, which is recorded in Trading and Profit & Loss A/c.

Adjustment:

The following treatment takes place in respect of Bad Debts:

A. If Bad Debts are given outside the trial balance:

In such a case, two effects will take place:

- First, bad debts will be shown in the Dr. side of the Profit & Loss A/c, being a loss for the business.
- Second, the amount of debtors appearing in the Balance Sheet would be reduced by the amount of bad debts.



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**Journal Entry**

Date	Particulars	L.F.	Amount(Dr.)	Amount(Cr.)
	Bad Debts A/c <span style="float:right">Dr.</span>		XXXX	
	To Debtors A/c			XXXX
	(Being bad debts recorded)			

**Dr. Trading & P&L A/c Cr.**

Particulars	Amount(₹)	Particulars	Amount(₹)
To Bad Debts	XXXX		

**Balance sheet**

Liabilities	Amount(₹)	Assets	Amount(₹)
		Debtors	XXXX
		Less: Bad Debts	(XXXX)      XXXX

B. If Bad Debts are given Inside the trial balance:

In such a case, these will be shown only on the Dr. side of the Profit & Loss A/c.

**Dr. Trading & P&L A/c Cr.**

Particulars	Amount(₹)	Particulars	Amount(₹)
To Bad Debts	XXXX		

**Adjustment of Provision for Bad and Doubtful Debts in Final Accounts (Financial Statements)**

Provision is created out of profits of the current accounting period to reduce the amount of loss that may take place in the future. A Provision for Bad and Doubtful Debts is created so that the debtors who are not able to make the payment of their liability on the due date has no major effect on the profits of the current year and the profits remain intact. This also helps to know the true picture of business following the principle of conservatism.

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The following treatment takes place for Provision for Bad and Doubtful Debts:

A. If Provision for Bad & Doubtful Debts is given outside the trial balance:

In such case, two effects would take place:

First, it will be shown in the Dr. side of the Profit & Loss A/c.

Second, amount of Provision for Bad & Doubtful Debts will be deducted from the Debtors in the Assets side of the Balance Sheet.

Journal Entry				
Date	Particulars	L.F.	Amount(Dr.)	Amount(Cr.)
	Profit and Loss A/c	Dr.	XXXX	
	To Provision for Doubtful Debts			XXXX
	(Being provision created for bad and doubtful debts)			

  

Dr.		Trading & P&L A/c		Cr.
Particulars	Amount(₹)	Particulars	Amount(₹)	
To Provision for Bad and Doubtful Debts	XXXX			

  

Balance sheet			
Liabilities	Amount(₹)	Assets	Amount(₹)
		Debtors	XXXX
		Less: Provision for B&D Debts (XXXX)	XXXX

B. If Provision for Bad & Doubtful Debts is given inside the trial balance:

In such a case, it will be shown only on the Dr. side of the Profit & Loss A/c.

Dr.		Trading & P&L A/c		Cr.
Particulars	Amount(₹)	Particulars	Amount(₹)	
To Provision for Bad and Doubtful Debts	XXXX			

**Solved Example:**

Ques : The following were the balances extracted from the books of Yogita as on March 31, 2017:

<i>Debit Balances</i>	<i>Amount ₹</i>	<i>Credit Balances</i>	<i>Amount ₹</i>
Cash in hand	540	Sales	98,780
Cash at bank	2,630	Return outwards	500
Purchases	40,675	Capital	62,000
Return inwards	680	Sundry creditors	6,300
Wages	8,480	Rent	9,000
Fuel and Power	4,730		
Carriage on sales	3200		
Carriage on purchases	2040		
Opening stock	5,760		
Building	32,000		
Freehold land	10,000		
Machinery	20,000		
Salaries	15,000		
Patents	7,500		
General expenses	3,000		
Insurance	600		
Drawings	5,245		
Sundry debtors	14,500		

Taking into account the following adjustments prepare trading and profit and loss account and balance sheet as on March 31, 2017 :

- (a) Stock in hand on March 31, 2017, was Rs 6,800.
- (b) Machinery is to be depreciated at the rate of 10% and patents @ 20%.
- (c) Salaries for the month of March, 2017 amounting to Rs 1,500 were outstanding.
- (d) Insurance includes a premium of Rs 170 on a policy expiring on September 30, 2017.
- (e) Further bad debts are Rs 725. Create a provision @ 5% on debtors.
- (f) Rent receivable Rs 1,000.

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Solution:

<b>Books of Yogita Trading and Profit and Loss Account for the year ended March 31, 2017</b>			
<b>Dr.</b>			<b>Cr.</b>
<i>Expenses/Losses</i>	<i>Amount ₹</i>	<i>Revenues/Gains</i>	<i>Amount ₹</i>
Opening stock	5,760	Sales	98,780
Purchases	40,675	Less Return inwards	(680)
Less Return outwards	(500)	Closing stock	6,800
Wages	8,480		
Fuel and Power	4,730		
Carriage on purchases	2,040		
Gross profit c/d	43,715		
	<u>1,04,900</u>		<u>1,04,900</u>
Salaries	15,000	Gross profit b/d	43,715
Add Outstanding salaries	1,500	Rent	9,000
Carriage	3,200	Add Accrued rent	1,000
General expenses	3,000		
Insurance	600		
Less Prepaid insurance	(85)		
Further bad debts	725		
Add Provision for doubtful debts	689		
Depreciation : machinery	2,000		
Patent	1,500		
Net profit (transferred to capital account)	25,586		
	<u>53,715</u>		<u>53,715</u>

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**Balance Sheet as at March 31, 2017**

Dr.					Cr.
<i>Liabilities</i>	<i>Amount</i>	<i>₹</i>	<i>Assets</i>	<i>Amount</i>	<i>₹</i>
Sundry creditors	6,300		Cash in hand	540	
Salaries outstanding	1,500		Cash in bank	2,630	
Capital	62,000		Sundry debtors	14,500	
			Less Further	(725)	
			bad debts	13,775	
			Less Provision	(689)	13,086
			for bad debts		
Add Net profit	25,586		Insurance prepaid	85	
	87,586		Stock	6,800	
Less Drawings	(5,245)	82,341	Rent accrued	1,000	
			Freehold land	10,000	
			Building	32,000	
			Machinery	20,000	
			Less Depreciation	(2,000)	18,000
			Patents	7,500	
			Less Depreciation	(1,500)	6,000
		<u>90,141</u>			<u>90,141</u>

**Assignments**

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

**Trial Balance of M/s Gamma Traders as on March 31, 2024**

Account Name	Dr. (₹)	Cr. (₹)
Capital		4,50,000
Drawings	30,000	
Sales		7,00,000
Purchases	3,80,000	
Rent	60,000	
Wages	1,00,000	
Furniture	2,00,000	
Sundry Creditors		1,30,000
Cash in Hand	90,000	
Bank Loan		1,50,000
Sundry Debtors	1,50,000	
Rent Received		20,000
<b>Totals</b>	<b>9,10,000</b>	<b>14,50,000</b>

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**Adjustments:**

1. **Bad Debts:** ₹5,000 of Sundry Debtors are considered uncollectible and are to be written off as bad debts.
2. **Provision for Doubtful Debts:** Create a provision for doubtful debts at 5% of the remaining Sundry Debtors.
3. **Closing Stock** as on March 31, 2024, is valued at ₹80,000.
4. **Depreciation** on Furniture is to be provided at 10% per annum.
5. **Salaries** amounting to ₹7,000 are outstanding.
6. **Accrued Rent** of ₹3,000 is still receivable.

**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.

Ques 2: Prepare the trading profit and loss account of M/s Mohit Traders as on 31 March 2017 and draw necessary Journal entries and balance sheet as on that date :

<i>Debit Balances</i>	<i>Amount ₹</i>	<i>Credit Balances</i>	<i>Amount ₹</i>
Opening stock	24,000	Sales	4,00,000
Purchases	1,60,000	Return outwards	2,000
Cash in hand	16,000	Capital	1,50,000
Cash at bank	32,000	Creditors	64,000
Return inwards	4,000	Bills payable	20,000
Wages	22,000	Commission received	4,000
Fuel and Power	18,000		
Carriage inwards	6,000		
Insurance	8,000		
Buildings	1,00,000		
Plant	80,000		
Patents	30,000		
Salaries	28,000		
Furniture	12,000		
Drawings	18,000		
Rent	2,000		
Debtors	80,000		
	<u>6,40,000</u>		<u>6,40,000</u>

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**Adjustments:**

- Salaries outstanding Rs 12,000
- Wages outstanding Rs 6,000
- Commission is accrued Rs 2,400
- Depreciation on building 5% and plant 3%
- Insurance paid in advance Rs 700
- Closing stock 12,000

**Ques 3:**

Abstracts from the trial balance as on 31st December, 2016:

Particulars	Debit ₹	Credit ₹
Sundry debtors	1,04,000	
Bad debts	5,000	
Provision for bad and doubtful debts		2,000

Adjustments:

- Additional bad debts amounted to Rs. 4,000.
- Create a provision for bad and doubtful debts @ 5% on sundry debtors.

Pass necessary adjusting entries and show how the different items appear in final accounts.

**Ques 4: Give journal entries for the following adjustments listed below:**

- Outstanding salary was ₹ 3,500.
- Rent unpaid for one month was ₹ 6,000 per annum.
- Insurance prepaid for a quarter was ₹ 16,000 per annum.
- Purchase of furniture costing ₹ 7,000 was entered in the purchases book.

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Ques 5: From the following information, prepare the trading and profit and loss account for M/s Indian sports house for the year ending March 31, 2017.

Account Title	Amount	Account Title	Amount
	₹		₹
Drawings	20,000	Capital	2,00,000
Sundry debtors	80,000	Return outwards	2,000
Bad debts	1,000	Bank overdraft	12,000
Trade Expenses	2,400	Provision for bad debts	4,000
Printing and Stationery	2,000	Sundry creditors	60,000
Rent Rates and Taxes	5,000	Bills payable	15,400
Freight	4,000	Sales	2,76,000
Return inwards	7,000		
Opening stock	25,000		
Purchases	1,80,000		
Furniture and Fixture	20,000		
Plant and Machinery	1,00,000		
Bills receivable	14,000		
Wages	10,000		
Cash in hand	6,000		
Discount allowed	2,000		
Investments	40,000		
Motor car	51,000		
	5,69,400		5,69,400

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Adjustments to be made:

- The closing stock was valued at ₹ 45,000.
- Provision for doubtful debts is maintained at 2% of debtors.
- Depreciation is charged on: furniture and fixture at 5%, plant and machinery at 6% and motor cars at 10%.
- A Machine costing ₹ 30,000 was purchased by the business on October 01, 2016.

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