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Adjustments in Financial Statements

Adjustment of Prepaid Expenses

Prepaid expenses are payments made for expenses that will benefit more than one accounting period. At the end of an accounting period, the portion of the prepaid expense that relates to the current period should be recognized as an expense, while the remaining amount should be recorded as an asset.

A. If Prepaid Expenses are given outside the trial balance: In such case, two entries will be passed:

Will be deducted from the related Expenses A/c in the Dr. side of the Trading A/c or Profit & Loss A/c

Will be shown in the Assets side of the Balance Sheet (Because it is a Representative Personal A/c the benefit of which will be received in the next year)

Journal Entry				
Date	Particulars	L.F.	Amount(Dr.)	Amount(Cr.)
	Prepaid Expenses A/c Dr.		XXXX	
	To Expenses A/c			XXXX
	(Being prepaid expenses recorded)			

Dr.		Cr.	
Trading & P & L A/c			
Particulars	Amount(₹)	Particulars	Amount(₹)
To Expenses A/c	XXXX		
Less: Prepaid Expenses	(XXX) XXXX		

Balance Sheet			
Liabilities	Amount(₹)	Assets	Amount(₹)
		Prepaid Expenses	XXXX

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B. If Prepaid Expenses are given inside the trial balance: It will only be shown on the Assets side of the Balance Sheet. (Because it is a Representative Personal A/c and has a Dr. balance)

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Balance Sheet			
Liabilities	Amount(₹)	Assets	Amount(₹)
		Prepaid Expenses	XXXX

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Adjustment of Depreciation

Depreciation is the allocation of the cost of a tangible fixed asset over its useful life. At the end of each accounting period, depreciation needs to be recorded to reflect the reduction in value of the asset due to wear and tear, usage, or obsolescence.

Depreciation means a reduction in the value of assets which is a loss for the business. There are various causes of depreciation, like obsolescence, wear and tear, destruction, efflux of time, etc. All these factors influence the working life of assets and hence lead to a reduction in the value of assets over a period of time.

Adjustment:

The following treatment takes place in respect of Depreciation:

A. If Depreciation is given outside the trial balance:

In such a situation, two effects will take place:

- First, it will be shown in the Dr. side of the Profit & Loss A/c.
- Second, the amount of fixed assets appearing in the Balance Sheet would reduce by the amount of depreciation.

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Journal Entry

Date	Particulars	L.F.	Amount(Dr.)	Amount(Cr.)
	Depreciation A/c Dr.		XXXX	
	To Fixed Assets A/c			XXXX
	(Being reduction in the value of assets)			

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

Particulars	Amount(₹)	Particulars	Amount(₹)
To Depreciation	XXXX		

Balance sheet

Liabilities	Amount(₹)	Assets	Amount(₹)
		Fixed Assets XXXX	
		Less: Depreciation (XXXX)	XXXX

Solved Example

From the following trial balance of M/s Kaushal Traders, prepare Trading and Profit and Loss Account for the year ended 31st March 2012 and a Balance Sheet as on that date:



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Dr. Balances	₹	Cr. Balances	₹
Opening stock on 1st April, 2011	16,000	Capital	80,000
Purchases	75,000	Sales	2,00,000
Sales returns	5,000	Purchases returns	2,000
Carriage inwards	1,500	Discount	500
Plant and Machinery	40,000	Sundry creditors	10,000
Furniture and fixtures	5,000	Bills payable	1,500
Freehold property	45,650		
Cash in hand	5,000		
Carriage outwards	400		
Wages	30,000		
Salaries	18,000		
Lighting (factory)	800		
Sundry debtors	28,000		
Travelling expenses	1,200		
Rent and taxes	4,800		
Drawings	5,000		
Insurance	450		
General expenses	12,200		
	2,94,000		2,94,000

Adjustments :

- Stock on 31st March 2012 was valued at ₹ 38,000 (market value ₹ 20,000).
- Wages amounting to ₹ 2,000 and salaries amounting to ₹ 1,500 are outstanding.
- Prepaid insurance amounted to ₹ 150.
- Provide depreciation on plant and machinery at 5% and on furniture and fixtures at 10%.



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**Trading and Profit and Loss Account
for the year ending 31st March, 2012**

Dr.		Cr.	
Particulars	Amount ₹	Particulars	Amount ₹
To Opening stock	16,000	By Sales	200,000
To Purchases	75,000	Less : Sales returns	5,000
Less : Purchases returns	2,000	By Closing stock	20,000 ¹
<u>73,000</u>			
To Carriage inwards	1,500		
To Wages	30,000		
Add : Outstanding wages	2,000		
<u>32,000</u>			
To Factory lighting	800		
To Gross profit c/d	91,700		
	2,15,000		2,15,000
To Carriage outwards	400	By Gross profit b/d	91,700
To Salaries	18,000	By Discount	500
Add : Outstanding salaries	1,500		
<u>19,500</u>			
To Travelling expenses	1,200		
To Rent and taxes	4,800		
To Insurances	450		
Less : Prepaid insurance	150		
<u>300</u>			
To General expenses	12,200		
To Depreciation on :			
Plant and machinery	2,000		
Furniture and fixtures	500		
<u>2,500</u>			
To Net profit transferred to Capital A/c	51,300		
	92,200		92,200

**Balance Sheet
as on 31st March 2012**

Liabilities	Amount ₹	Assets	Amount ₹
Bills payable	1,500	Cash in hand	5,000
Sundry creditors	10,000	Sundry debtors	28,000
Outstanding wages	2,000	Closing stock	20,000 ¹
Outstanding salaries	1,500	Prepaid insurance	150
Capital	80,000	Furnitures and fixtures	5,000
Add : Net profit	51,300	Less : Depreciation	500
<u>1,31,000</u>		Plant and machinery	40,000
Less : Drawings	5,000	Less : Depreciation	2,000
<u>1,26,300</u>		Freehold property	45,650
	1,41,300		1,41,300

Note : (1) Closing stock is valued at cost price or market price whichever is less.

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Assignment

Ques 1: From the following trial Balance of M/s. Gupta Furnitures as on 31st December, 2012 you are required to prepare a Trading and Profit & Loss A/c for the year ended 31st Dec. 2012 and a Balance Sheet as at that date after making the necessary adjustments. **[Hint: Balance Sheet Total = Rs 86,320]**

Particulars	Dr (₹)	Cr. (₹)
Capital A/c of Mr. Gupta		80,000
Cash in hand	540	
Cash in bank	2,630	
Purchase A/c	43,120	
Sales A/c		78,100
Wages A/c	10,480	
Fuel and Power A/c	4,730	
Carriage on Sales A/c	3,200	
Carriage on Purchase A/c	2,040	
Stock (on 1-1-2012)	5,760	
Land & Building A/c	40,000	
Machinery A/c	20,000	
Salaries A/c	15,000	
Insurance A/c	600	
Sundry Debtors A/c	20,000	
Sundry Creditors A/c		10,000
	1,68,100	1,68,100

Taking into consideration the following adjustments, make necessary journal entries and prepare final accounts.

- i. Stock on hand 31.12.2012 is ₹ 5,000
- ii. Machinery is to be depreciated @ 10% p.a.
- iii. Salaries for the month of December outstanding amounted to ₹ 3,500
- iv. Insurance prepaid for 3 months.

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Ques 2: From the following trial balance of M/s Gupta Enterprises, prepare the Trading and Profit & Loss Account for the year ended 31st March 2023, and a Balance Sheet as on that date: [**Hint: Balance Sheet Total = Rs 3,97,300**]

Account Name	Debit (₹)	Credit (₹)
Cash in hand	10,000	
Cash at bank	25,000	
Purchases	50,000	
Purchase return		9,900
Sales		110,000
Sales return	3,000	
Gas, fuel, and water	2,500	
Wages	28,000	
Salary	1,200	
Carriage on purchase	2,000	
Carriage on sales	2,300	
Opening stock	27,600	
Building	80,000	
Patents	15,000	
Goodwill	37,000	
Machinery	50,000	
General expenses	4,000	
Insurance	5,100	
Debtors	35,800	
Creditors		45,600
Rent	6,000	
Drawing	7,200	
Commission received		38,000
Bills payable		27,000
Bills receivable	39,000	
Discount allowed	1,000	
Discount received		6400
Bad debts	3,500	
Trade expenses	2,500	

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Rent, rates, and taxes	3,500	
Printing & stationery	4,200	
Investment	29,500	
Capital		160,000
Bad debts recovered		19,000
Bank overdraft		22,000
Bank loan		37,000
Total	474,900	474,900

Adjustments:

1. Closing Stock valued at Rs 87,000.
2. Outstanding Rent amounts to Rs 3,400.
3. Outstanding Wages amounts to Rs 5,600.
4. Prepaid Salary amounts to Rs 800.
5. Depreciation at 10% on Machinery and Building.
6. Prepaid Insurance amounts to Rs 1,200.

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Instructions:

1. Prepare the Trading Account to calculate the Gross Profit or Loss for the year ended 31st March 2023.
2. Prepare the Profit & Loss Account to determine the Net Profit or Loss for the same period.
3. Prepare the Balance Sheet as on 31st March 2023 after incorporating the necessary adjustments.