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.

Journal Entry

Date	Particulars	L.F.	Amount(Dr.)	Amount(Cr.)
	Interest on Loan A/c Dr.		XXXX	
	To Outstanding Expenses A/c			XXXX
	(Being interest on loan charged)			

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

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** Cr.

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.

<u>Adjustment:</u>
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.

Journal Entry

Date	Particulars	L.F.	Amount(Dr.)	Amount(Cr.)
	Bad Debts A/c Dr. To Debtors A/c (Being bad debts recorded)		XXXX	XXXX

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.

Adjustment:

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		

Manual Accounting - Module 31

Solved Example:

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

Debit Balances	*Amount* ₹	*Credit Balances*	*Amount* ₹
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.

Solution:

Solution:

Books of Yogita
Trading and Profit and Loss Account
for the year ended March 31, 2017

Dr. Expenses/Losses		Amount ₹	Revenues/Gains		Cr. Amount ₹
Opening stock		5,760			
Purchases	40,675		Sales	98,780	
Less Return outwards	(500)	40,175	*Less* Return inwards	(680)	98,100
Wages		8,480	Closing stock		6,800
Fuel and Power		4,730			
Carriage on purchases		2,040			
Gross profit c/d		43,715			
		1,04,900			1,04,900
Salaries	15,000		Gross profit b/d		43,715
Add Outstanding salaries	1,500	16,500	Rent	9,000	
Carriage		3,200	*Add* Accrued rent	1,000	10,000
General expenses		3,000			
Insurance	600				
Less Prepaid insurance	(85)	515			
Further bad debts	725				
Add Provision for doubtful debts	689	1.414			
Depreciation : machinery	2,000				
Patent	1,500	3,500			
Net profit (transferred to capital account)		25,586			
		53,715			53,715

Balance Sheet as at March 31, 2017

Dr. Liabilities		Amount ₹	Assets		Cr. Amount ₹
Sundry creditors		6,300	Cash in hand		540
			Cash in bank		2,630
Salaries outstanding		1,500	Sundry debtors	14,500	
Capital	62,000		*Less* Further bad debts	(725)	
				13,775	
			Less Provision for bad debts	(689)	13,086
Add Net profit 25,586			Insurance prepaid		85
	87,586		Stock		6,800
			Rent accrued		1,000
Less Drawings	(5,245)	82,341	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
		90,141			90,141

Assignments

Ques 1: Following are the Balances of Ashok Kumar as on 30th June, 2003. **[Hint: Balance Sheet Total = Rs 91,830]**

DEBIT	Rs.	CREDIT	Rs.
Cash in hand	540	Sales	98,780
Cash at bank	2,630	Returns outwards	500
Purchases	40,675	Capital	62,000
Returns inward	680	Sundry creditors	6,300
Wages	8,480	Rent	9,000
Fuel and power	4,730		
Carriage on sales	3,200		
Carriage on purchases	2,040		
Stock	5,760		
Buildings	22,000		
Freehold land	10,000		
Machinery	20,000		
Investment	10,000		
Patents	7,500		
Salaries	15,000		
General expenses	3,000		
Insurance	600		
Drawings	5,245		
Sundry debtors	14,500		

Adjustments:

1. Stock on Hand on 30th June, 2007 is Rs 6,800.
2. Machinery is to be depreciated @10% and patents @20%.
3. Salaries for the month June, 2007 amounting to Rs. 1500 were unpaid.
4. Insurance including the premium of Rs. 170 on a policy expiring on 31st December 2007.
5. Bad debts are Rs. 725.
6. Rent Received in advance Rs. 1,000.
7. Interest on investment of Rs. 2,000 is accrued.

Required:

1. **Pass necessary journal entries** for the above adjustments.
2. **Prepare the adjusted Trading and Profit & Loss Account** for the year ended June 30, 2007.
3. **Prepare the adjusted Balance Sheet** as on June 30, 2007.

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: **[Hint: Balance Sheet Total = Rs 3,57,700]**

Debit Balances	*Amount* ₹	*Credit Balances*	*Amount* ₹
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		
	6,40,000		6,40,000

Adjustments:

(a) Salaries outstanding Rs 12,000
(b) Wages outstanding Rs 6,000
(c) Commission is accrued Rs 2,400
(d) Depreciation on building 5% and plant 3%
(e) Insurance paid in advance Rs 700
(f) 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:

i. Additional bad debts amounted to Rs. 4,000.

ii. 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:

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

Manual Accounting - Module 31

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. **[Hint: Balance Sheet Total = Rs 3,42,300]**

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

Manual Accounting - Module 31

Adjustments to be made:

1. The closing stock was valued at ₹ 45,000.
2. Provision for doubtful debts is maintained at 2% of debtors.
3. Depreciation is charged on: furniture and fixture at 5%, plant and machinery at 6% and motor cars at 10%.

Ques 6: The following is the Trial Balance of Raj as on 31st December, 2008.
[Hint: Balance Sheet Total = Rs 43,540]

PARTICULARS	Dr. Rs.	Cr. Rs.
CAPITAL		25,000
BUILDING	30,000	
FURNITURE	2,640	
SCOOTER	4,000	
RETURNS INWARD AND RETURN OUTWARD	2,300	1,600
STOCK ON 1st Jan,2008	8,000	
PURCHASE AND SALES	33,800	56,040
BAD DEBTS	300	
CARRIAGE INWARD	700	
GENERAL EXP.	1,200	
BAD DEBTS PROVISION		700
BANK LOAN		5,000
INTEREST ON BANK LOAN	300	
COMMISION		900
INSURANCE AND TAXES	2,000	
SCOOTER EXPENSES	2,600	
SALARIES	4,400	
CASH IN HAND	2,000	
DEBTORS AND CREDITORS	3,000	8,000
	97,240	97,240

Adjustments:

1. Closing stock on 31st December 2008 was valued at 4,340.
2. Commission including Rs. 300 being commission received in advance.
3. Salaries have been paid for 11 months.
4. Bank loan taken at 10% per annum interest.
5. Depreciation on building is charged by 5% and scooter by 15%.
6. Write off Rs. 200 as further bad debt and maintain bad debts provision at 5% on remaining debtors.

You are requested to prepare Final Accounts for the year ending 31st December.