

## Adjustments in Financial Statements

Adjustments in financial statements are essential to make sure the financial information accurately reflects the real situation of a business. Here's why they matter, explained simply:

### 1. Matching Revenues and Expenses:

- **Why:** To ensure that the money a business earns and the costs it incurs are recorded in the same time period.
- **Impact:** This gives a true picture of whether the business made a profit or loss during that period.

### 2. Following Accounting Rules:

- **Why:** To make sure the financial statements follow standard accounting rules like GAAP or IFRS.
- **Impact:** Ensures the business reports its finances based on when things actually happen, not just when money changes hands.

### 3. Showing the Real Financial Situation:

- **Why:** To accurately show the company's financial status at the end of the period.
- **Impact:** This helps in presenting a clear view of what the business owns (assets), owes (liabilities), and its worth (equity).

### 4. Recording Revenue Correctly:

- **Why:** To recognize income when the business earns it, not just when it gets paid.
- **Impact:** This ensures the income statement reflects the actual earnings, making financial analysis more accurate.

### 5. Reporting Expenses Correctly:

- **Why:** To record costs when they happen, even if the payment is made later.
- **Impact:** This means the income statement includes all costs related to earning money in that period.

### 6. Valuing Assets and Liabilities Accurately:

- **Why:** To update the value of things the business owns and owes to their true amounts at the end of the period.
- **Impact:** This ensures the balance sheet shows accurate values for things like inventory, receivables, and payables.

## Adjustment for Closing stock

Closing stock is incorporated into the books of accounts through specific journal entries that reflect its impact on both the income statement and the balance sheet. Here's how it is done:



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**Adjustment:**

**A. If Closing Stock is given outside the trial balance:** Usually, closing stock is given outside the trial balance. In such case, two entries are passed:

- In the Cr. side of the Trading A/c.
- In the Assets side of the Balance Sheet.

Journal Entry				
Date	Particulars	L.F.	Amount(Dr.)	Amount(Cr.)
	Closing Stock A/c <span style="float: right;">Dr.</span>		XXXX	
	To Trading A/c			XXXX
	(Being closing stock transferred to Trading A/c)			

  

Dr.		Trading A/c		Cr.	
Particulars	Amount(₹)	Particulars	Amount(₹)		
		By Closing Stock	XXXX		

  

Balance Sheet			
Liabilities	Amount(₹)	Assets	Amount(₹)
		Closing Stock	XXXX

**B. If Closing Stock is given inside the trial balance:** If Closing Stock is given in the trial balance, then it will be recorded only once on the Assets side of the Balance Sheet.

Balance Sheet			
Liabilities	Amount(₹)	Assets	Amount(₹)
		Closing Stock	XXXX



Adjustments for Outstanding Expenses:

**What are Outstanding Expenses?** Outstanding expenses are costs that a business has incurred during an accounting period but has not yet paid by the end of that period. These expenses need to be recorded in the current period to ensure that the financial statements accurately reflect all the costs associated with generating revenue during that period.

**Why Adjust for Outstanding Expenses?** Adjusting for outstanding expenses ensures that the expenses are matched with the revenues of the same period, adhering to the accrual basis of accounting. This adjustment provides a true picture of the financial position and performance of the business.

**Steps to Adjust Outstanding Expenses:**

**1. Identify the Outstanding Expenses:**

- Determine which expenses have been incurred but not yet paid. Common examples include rent, salaries, electricity bills, etc.

**2. Make the Journal Entry:**

- To record outstanding expenses, make a journal entry that increases the expense account and creates a liability for the amount owed.

○ **Journal Entry:**

- Debit: Expense Account (e.g., Salaries Expense)
- Credit: Outstanding Expenses (a liability account)
- For example, if Rs 5,000 of salaries are outstanding:
  - Debit: Salaries Expense (Rs 5,000)
  - Credit: Outstanding Salaries (Rs 5,000)

**3. Reflect in Financial Statements:**

- **Income Statement:** The expense is added to the relevant expense category, reducing the net income for the period.
- **Balance Sheet:** The outstanding expense is recorded as a liability under current liabilities.

**Adjustment:**

**A. If Outstanding Expense is given outside the trial balance:** In such case, two entries will be passed:

- Will be added in the concerned item (expense) at the Dr. side of Trading A/c or Profit & Loss A/c.
- Will be shown on the liabilities side of the balance sheet.

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**Journal Entry**

Date	Particulars	L.F.	Amount(Dr.)	Amount(Cr.)
	Expenses A/c <span style="float:right">Dr.</span>		XXXX	
	To Outstanding Expenses A/c			XXXX
	(Being outstanding expenses recorded)			

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

Particulars	Amount(₹)	Particulars	Amount(₹)
To Expenses A/c	XXXX		
Add: O/s Expenses	XXX XXXX		

**Balance Sheet**

Liabilities	Amount(₹)	Assets	Amount(₹)
O/s Expenses	XXXX		

**B. If Outstanding Expense is given inside the trial balance:** It will be only shown on the liabilities side of the Balance Sheet. (Because it is a Representative Personal A/c, which has a Cr. balance)

**Balance Sheet**

Liabilities	Amount(₹)	Assets	Amount(₹)
O/s Expenses	XXXX		

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**Solved Example**

XYZ Ltd. is preparing its financial statements for the year ending December 31, 2023. The following details have been provided:

Account Name	Debit (₹)	Credit (₹)
Cash in hand	10,000	
Cash at bank	25,000	
Purchases	50,000	
Purchase return		9,000
Sales		120,000
Sales return	3,000	
Gas, fuel, and water	2,500	
Wages	8,000	
Salary	12,000	
Carriage on purchase	2,000	
Carriage on sales	1,500	
Opening stock	20,000	
Building	80,000	
Patents	15,000	
Goodwill	30,000	
Machinery	50,000	
General expenses	4,000	
Insurance	5,000	
Debtors	40,000	
Creditors		45,000
Factory Rent	6,000	
Drawing	7,000	
Commission received		18,000
Bills payable		17,000
Bills receivable	12,000	
Discount allowed	1,000	
Discount received		2200
Bad debts	3,500	
Trade expenses	2,500	
Rent, rates, and taxes	3,000	

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Printing & stationery	1,200	
Investment	25,000	
Capital		160,000
Bad debts recovered		3,000
Bank overdraft		18,000
Bank loan		27,000
<b>Total</b>	<b>419,200</b>	<b>419,200</b>

Adjustments:

- The value of the closing stock as on December 31, 2023, is ₹60,000.
- An outstanding wage of ₹5,000 has not been paid.
- An outstanding salary of ₹3,000 has not been paid.
- An outstanding insurance of ₹2,000 has not been paid.
- An outstanding rent of ₹1,500 has not been paid.

Required:

Prepare the adjusted Trading & Profit & Loss Account and Balance Sheet as of December 31, 2023.

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Solution:

Trading and Profit & Loss A/c for the year ending December 31st, 2023			
Particulars	Amount (₹)	Particulars	Amount (₹)
To Opening Stock	20,000	By Sales	120,000
To Purchases	50,000	Less: Sales Return	3000
Less: Purchase Return	9000		
	41,000	By Closing Stock	60,000
To Gas, Fuel, and Water	2,500		
To Carriage on Purchases	2,000		
To Factory Rent	6000		
Add: Outstanding Rent	1500		
	7,500		
To Wages	8000		
Add: Outstanding Wages	5000		
	13,000		
To Gross Profit c/d	91,000		
	177,000		177,000
To Salary	12,000	By Gross Profit b/d	91,000
Add: Outstanding Salary	3,000	By Commission Received	18,000
	15,000	By Bad Debts Recovered	3,000
To Insurance	5000	By Discount Received	2,200
Add: Outstanding Insurance	2000		
	7,000		
To General Expenses	4,000		
To Trade Expenses	2,500		
To Discount Allowed	1,000		
To Carriage on Sales	1,500		
To Bad Debts	3,500		
To Rent, Rates, and Taxes	3,000		
To Printing & Stationery	1,200		
To Net Profit c/d	75,500		
	114,200		114,200

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Balance Sheet as of December 31st, 2023			
Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	45,000	Cash in Hand	10,000
Bills Payable	17,000	Cash at Bank	25,000
Bank Overdraft	18,000	Debtors	40,000
Bank Loan	27,000	Bills Receivable	12,000
Outstanding Wages	5000	Closing Stock	60,000
Outstanding Salary	3000	Building	80,000
Outstanding Insurance	2000	Patents	15,000
Outstanding rent	1500	Goodwill	30,000
Capital	160,000	Machinery	50,000
Add: Net Profit	75500	Investment	25,000
Less: Drawings	7000		
	228,500		
	347,000		347,000



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**Assignment**

**Ques 1: Mansi Pvt. Ltd.** is preparing its financial statements for the year ending March 31, 2024. The following details have been provided: **[Hint: Balance Sheet Total = Rs 2,75,000]**

Account Name	Debit (₹)	Credit (₹)
Cash in hand	10,000	
Cash at bank	25,000	
Purchases	50,000	
Purchase return		11,000
Sales		220,000
Commission Received		8,000
Gas, fuel, and water	2,500	
Wages	8,000	
Salary	12,000	
Trade Expenses	2,000	
Carriage on sales	1,500	
Opening stock	20,000	
Building	50,000	
Patents	15,000	
Goodwill	30,000	
Machinery	35,000	
General expenses	4,000	
Interest Received		26,000
Debtor	50,000	
Rent	40,000	
Bills Receivable	20,000	
Printing and Stationary	40,000	
Capital		1,50,000
	<b>4,15,000</b>	<b>4,15,000</b>

**Adjustments:**

1. The value of the closing stock as on March 31, 2024, is ₹40,000.
2. Outstanding salaries amount to ₹2500.
3. Outstanding wages amount to ₹3000.
4. Outstanding rent amount to ₹5,000.

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**Required:**

1. Prepare the adjusted Trading & Profit & Loss Account and Balance Sheet as of March 31, 2024.

**Ques 2:** Vishakha Joshi Ltd. is preparing its financial statements for the year ending June 30, 2024. The following details have been provided: **[Hint: Balance Sheet Total = Rs 2,77,000]**

Account Name	Debit (₹)	Credit (₹)
Cash in hand	50,000	
Cash at bank	50,000	
Purchases	50,000	
Purchase return		9,000
Sales		120,000
Sales return	10,000	
Gas, fuel, and water	2,500	
Machinery	50,000	
General expenses	9,000	
Insurance	25,000	
Debtors	40,000	
Creditors		23,000
Rent	6,000	
Drawing	7,000	
Commission received		11,000
Bills payable		23,000
Bills receivable	2,000	
Discount allowed	1,000	
Discount received		21,700
Bad debts	3,500	
Trade expenses	2,500	
Rent, rates, and taxes	3,000	
Printing & stationery	1,200	
Investment	15,000	
Capital		1,20,000
	327,700	327,700

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Adjustments:

1. The value of the closing stock as on June 30, 2024, is ₹70,000.
2. Outstanding insurance amounts to ₹1,500.
3. Outstanding rent amounts to ₹2,000.

Required:

1. Prepare the adjusted Trading & Profit & Loss Account and Balance Sheet as of June 30, 2024.

**Ques 3:** LMN Co. is preparing its financial statements for the year ending September 30, 2024. The following details have been provided: **[Hint: Balance Sheet Total = Rs 6,47,000]**

Account Name	Debit (₹)	Credit (₹)
Cash in hand	15,000	
Cash at bank	30,000	
Purchases	55,000	
Purchase return		10,500
Sales		140,000
Sales return	4,200	
Gas, fuel, and water	1,800	
Machinery	35,000	
General expenses	6,000	
Insurance	4,000	
Debtors	30,000	
Creditors		27,000
Rent	8,000	
Drawing	8,000	
Commission received		22,000
Bills payable		23,000
Bills receivable	4,000	
Discount allowed	2,000	
Discount received		10,000
Bad debts	3,500	
Trade expenses	2,000	

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Rent, rates, and taxes	4,000	
Printing & stationery	2,000	
Investment	18,000	
Capital		4,80,000
Building	2,00,000	
Patent	80,000	
Goodwill	65,000	
Furniture and Fixture	1,35,000	
	712,500	712,500

Adjustments:

1. The value of the closing stock as on September 30, 2024, is ₹35,000.
2. Outstanding insurance amounts to ₹1,500.
3. Outstanding rent amounts to ₹3,500.
4. Outstanding trade expenses amounts to ₹800.

Required:

1. Prepare the adjusted Trading & Profit & Loss Account and Balance Sheet as of September 30, 2024.

