



**[Academic Script]**

**Final Accounts with Adjustments**

<b>Subject:</b>	Business Economics
<b>Course:</b>	B.A., 1st Semester, Undergraduate
<b>Paper No. &amp; Title:</b>	Paper – 103 Fundamentals of Business & Accounting
<b>Unit No. &amp; Title:</b>	Unit – 3 (I) Final Accounts with Adjustments
<b>Lecture No. &amp; Title:</b>	Lecture – 1 Final Accounts with Adjustments

## **Academic Script**

### **1. Introduction**

Business transactions are recorded in the books of accounts to know the profit or loss of business and also to have an idea of the financial position of the entity.

To know the profit or loss earned and the assets and liabilities of the enterprise, two statements namely Profit and Loss Account and Balance Sheet respectively are prepared at the end of every financial year. The collective name given to these two is known as financial statements. It is also known as Annual Accounts and Final Accounts.

### **Features of Financial Statements:**

- I. Financial statement are expressed only in monetary term. The qualitative aspects like the potential strength of employees, the loyalty, the credibility, etc. are ignored. Thus, non-monetary events and assets are ignored by financial statement.
- II. They always present the past performance. Thus, they are historical in nature and do not consider future.
- III. Financial statements are prepared by covering only limited time period. This is generally one year.

### **2. Final Accounts of a sole proprietorship:**

Final accounts include the following

- (a) Trading Account
- (b) Profit and Loss Account
- (c) Balance Sheet
- (a) Trading Account

Trading Account is practically a part of Profit and Loss Account. It is prepared to find out the gross profit or gross loss.

Gross profit = Sale proceeds of goods - The cost of goods sold

Net Purchase of goods and direct expenses incurred by business are shown on the debit side of Trading Account.

Direct expenses include wages, carriage inwards, freight, import duties, octroi, royalty, packaging, materials, fuel used for production process, commission on purchases etc. incurred to bring a product to saleable condition.

Opening stock, lying with the entity in the beginning of the year should be debited to Trading Account while the closing stock at the end of the year should be shown on credit side of the Trading Account.

Net Sales made by the enterprise and any other outflow of goods from business by reason other than sale, (E.g. Goods distributed as samples, goods given in charity, goods burnt by fire, goods withdrawn for personal use etc.) are credited to Trading Account.

Goods going out of business by any reason other than sale should be recorded at cost.

### **Closing Entries for Trading Account:**

(1) For closing Purchases Account

Trading A/c... Dr.

To Purchases A/c

(2) For closing Purchase Return Account

Purchase Return A/c...Dr.

To Purchase A/c

[Net purchases are shown in the Trading Account. Purchase return are shown as deduction from Purchase instead of being credited to Trading Account.]

(3) For Closing Sales Account

Sales A/c      Dr.  
                    To Trading A/c

(4) For closing Sales Return Account

Sales A/c Dr.  
To Sales Return A/c

[Net Sales are to be shown in Trading Account. Thus sales return are subtracted from sales on credit side, instead of being debited to Trading Account]

(5) For closing Accounts of direct expenses

Trading A/c Dr.  
    To Wages A/c  
    To Carriage Inward A/c  
    To Import Duty A/c  
    To other direct expense A/c

(6) Closing Stock : Goods lying unsold at end of the year is closing stock. It is to be valued at lower of cost or net realizable value (Market price) of the goods as per principle of conservatism.

For recording closing stock into books following entry is passed.

Closing stock A/c Dr.  
                    To Trading A/c

This entry has two effects:

- I. Closing stock recorded on credit side of Trading Account
- II. Closing Stock being an asset recorded on asset side of Balancesheet.

(7) Opening Stock: In order to cancel the adjustment entry of the closing stock of previous year, a reverse entry is passed to rectify the effect at the beginning of the year.

Trading A/c Dr.  
                    To Opening Stock A/c

(8) Net Balance : Gross Profit / Gross Loss

After passing all the entries listed above, the balance of Trading Account is worked out. If the total of the credit side is more it shows that the income is more and therefore there is profit. The positive difference is called Gross Profit. It is recorded as follows.

Trading A/c Dr.  
To Profit and Loss A/c

If the total of the debit side is more it shows that cost of goods sold is more than the sales price realized. It is negative difference, which is called Gross Loss. It is recorded as follows  
Profit and Loss A/c Dr.

Trading A/c

### FORMAT OF TRADING ACCOUNT

Trading Account for the year ended \_\_\_\_\_

Dr

Cr

Particular		A m o u n t	Particular	Am oun t
To Opening Stock		X X	By Sales	X X
To Purchase	X X		Less : Sales return	X X
Less :	X	X		
Purchase Return	X	X		
To Wages		X X		
To Carriage Inward		X X		
To Railway Freight		X X		
To Excise Duty		X X	By Closin g	XX

To Octroi	X	Stock	XX
	X	By	
		Gross	
		Loss	
To Custom	X		
Duty	X		
To Unloading	X		
Charges	X		
To Demurrage	X		
	X		
To Fuel used	X		
in production	X		
process			
To Royalty on	X		
Production	X		
To Clearing	X		
Charges	X		
To Dock	X		
charges	X		
To	X		
Commission	X		
on Purchase			
To Factory	X		
Expenses	X		
To Customs	X		
and Insurance	X		
To Gross Profit	X		
	X		
	X		
	X		
			XXX

## Profit and Loss account

Profit and Loss Account is prepared to ascertain the Net Profit. Net Profit can be said to be the profit earned by the entity from the business. It measures the net income by matching total revenue and total expenses of business enterprise.

Generally indirect expenses relating to administration and selling and distribution of firm that are not directly related to production are debited to Profit and Loss Account. Indirect expenses include:

- (a) Administrative expenses : These expenses incurred to administration an office/ business e.g. Salaries, taxes, rents, electricity charges, Insurance, Audit fees, Postage etc.
- (b) Selling and Distribution expenses : Expenses incurred on making or increasing sales are selling expenses and expenses incurred to dispatch goods to customer are called distribution exp. E.g. Publicity expenses, Salesman Salaries or commission, discount given to customers, carriage outward, Packaging expenses, Bad Debts etc.
- (c) Financial Expenses: Expenses incurred for procuring finance for business are financial expenses. E.g. Interest on Loan, Bank charges, discounts on bills etc.
- (d) Maintenance Expenses: Expenses related to maintaining of assets are maintenance expenses. E.g. Repairs charge, Depreciation etc.
- (e) Abnormal Loss / Gain : Abnormal losses faced by the firm on an unlikely event e.g. loss on sale of fixed asset, loss due to fire etc. should be debited to Profit and Loss Account. Abnormal gain such as insurance claim exceeding costs, Profit on Sale of fixed asset should be credited to Profit and Loss A/c.

Profit and Loss Account for year ended \_\_\_\_\_

Dr.

Cr.

Particular	A m o u n t	Particular	Am oun t
To Gross Loss b/d	X X	By Gross Profit B/d	XX
<u>Office and administrative expenses</u>			
To Salaries	X X	<u>Other Incomes</u>	
To Office Rent, Rates and Taxes	X X		
To Electricity Charges	X X	By Commission earned	XX
To Postage	X X	By Discount Received	XX
To Audit Fees	X X	<u>Non Trading Income</u>	
To Insurance	X X	By Dividend on shares	XX
To Legal Charges	X X	By Interest on securities	XX
<u>Selling and Distribution expenses</u>		<u>Abnormal Gains</u>	
To Carriage outward	X X	By Gain on sale of fixed assets	XX
To Advertisement / Publicity expense	X X	By Insurance claims exceeding cost	XX
To Commission	X X	By Net Loss	XX



To Godown Rent	X X	(Transferred to Capital Account)	
To Bad Debts	X X		
To Bad Debt Reserve	X X		
<u>Financial Exp</u>			
To Bank Charges	X X		
To Interest on Loan	X X		
To Legal Charges for arranging loan	X X		
To Discount on Bills	X X		
<u>Maintenance Expenses</u>			
To Repairs and Maintenance	X X		
To Depreciation	X X		
<u>Abnormal Loss</u>			
To Loss on sale of assets	X X		
To Loss by fire etc	X X		
To Net Profit	X X		
(Transferred to capital Account)			
	X X X		XXX

### Closing entries for Profit and Loss Account

- (i) For closing of all debit Accounts related to indirect exp.

Profit and Loss A/c Dr.

To Rent A/c

To Salaries A/c

To Electricity expenses A/c

To Postage expenses A/c

To Stationery A/c

To Publicity expenses A/c

To Other expenses A/c

(ii) For closing all credit accounts of indirect incomes

Rent received A/c Dr.

Interest Income A/c Dr.

Other Incomes A/c Dr.

To Profit and Loss A/c

(iii) For closing P and L Account

In case of profits( Credit side > Debit Side)

Profit and Loss A/c Dr.

To Capital A/c

In case of losses (Debit Side > Credit Side)

Capital A/c Dr.

To Profit and Loss A/c

## **Balance Sheet**

Balance sheet is a statement showing the financial position of business on a particular day, in which the balances of accounts of assets, liabilities, receivables and payables are shown. Thus balances of real and personal accounts are shown in balance sheet on a particular day and at a specific point of time.

### **Features of Balance sheet:**

- I. Balance sheet is a statement of position of an entity and not an account.
- II. Liabilities are recorded on left side and assets are recorded on right side
- III. Assets and Liabilities need to be shown in a particular way it be in an order of liquidity or permanency.
- IV. As assets are not closed and transferred to Balance Sheet, these assets do not require closing entries.

## Format of Horizontal Balance sheet.

Balance Sheet as at \_\_\_\_\_ (In order of permanency)

Liabilities	Amount	Assets	Amount
Capital Account	XX	Goodwill, Patents, Other Intangible assets	XX
Reserve and Surplus	XX		XX
Loan on Mortgages	XX	Land and Building	XX
Bank Loan	XX	Plant and Machinery	XX
Income Received in Advance	XX	Furniture and Fittings	XX
Outstanding Exp	XX	Investments	XX
Bills Payable	XX	Stock (Closing Stock)	XX
Sundry Creditors	XX	Sundry Debtors	XX
		Bills Receivables	XX
		Cash at Bank	XX
		Cash in Hand	XX
		Deferred Revenue	XX

		Exp.	
	XXX		XXX

### 3. Adjustments

#### Meaning

Adjustment entries are those entries which need to be passed at the end of the accounting period so as to arrive at true profit / loss and fair financial position of the business.

Accounting Treatment for various Adjustments

- 1) Closing stock : For accounting the closing stock after valuation at the end of the year, following adjustment entry is passed :

Closing Stock A/c Dr.

To Trading A/c

It is presented in financial statement as follows :

- (a) On the credit side of Trading Account
- (b) On the asset side of Balancesheet

- 2) Outstanding Expenses : Outstanding expenses are the expenses or part of expenses which are due but not paid. For recording the same following adjustment entry

Respective expense A/c Dr.

To Outstanding expense A/c

It shall be presented in financial statements as follows:

- (a) Debited to Trading and P& L Account incase of direct expense or indirect expense respectively
- (b) On the liability side of the balance sheet under current liabilities.

- 3) Prepaid Expenses: The expense or the part of expense that had been paid well in advance and actual occurrence of expense is after the Accounting period. The following entry is passed.

Prepaid expenses A/c Dr.

To Concerned Expense A/c

Effect in financial statement

- (i) Advance expenses are deducted from their respective direct or indirect expense forming part of Trading and P& L Account respectively.
- (ii) Shown on the asset side of Balance Sheet

4) Accrued Income: The income or part of income which has been earned, but the amount is not received during the accounting year in which such services or goods were provided.

The following adjustment entry is passed:

Accrued Income A/cDr

To Respective Income A/c

Effect in financial statements :

- (a) Added to the particular direct or indirect income falling under credit side of Trading and P&L Account
- (b) On the asset side of Balance Sheet

5) Income received in Advance : The Income or part of income which is received in advance before the service being provided or goods being delivered is income received in advance.

Respective Income A/c Dr.

To Income Received in Advance A/c

Effect in Financial Statements:

- (i) Deducted from the direct or indirect income under the Trading & P & L Account Respectively.
- (ii) On the liability side of Balance Sheet under current liabilities.

6) Depreciation : The wear & tear out of the depreciable asset due to its usage and other factors is known as depreciation.

Adjustment entry :-

Depreciation A/c Dr.

To Respective Asset A/c

Effect in final accounts:

- (i) Depreciation is debited to Profit & Loss Account
- (ii) The amount of depreciation is deducted from asset and net value of that asset should be shown on asset side of B/S.

7) Bad Debt: The debtors from whom the amount of debt owed by them to us or portion of that can no longer be recovered.

It is treated as bad debt. The adjustment entry :

Bad Debt A/c Dr.

To Debtors A/c

Effect in Financial Statement:

- (i) Debit to Profit & Loss Account

(ii) Deducted from Debtors and Net amount of debtors is shown on the asset side of Balance Sheet.

8) Provision of Doubtful Debts : It is a provision set aside for meeting any loss of bad debts that may arise in futures.

Adjustment entry:

P & L A/c Dr.

To Provision of Doubtful Debts A/c

Effect of adjustment :

(i) Debited to P & L Account

(ii) Deducted from the amount of debtors in B/S

9) Abnormal Loss : The losses that have occurred due to natural calamities or natural calamities like earthquake, flood etc. are called abnormal losses.

Adjustment entries :-

(a) Loss on fixed asset

P & L A/c Dr

To Fixed Asset

Effect on financial statement :-

(a) Debited to P & L Account

(b) Deducted from corresponding asset Account in B/S

(b) Loss to Stock

(i) Loss by fire A/c Dr.

To Purchase A/c

(ii) Insurance Co A/c Dr. (Amount of Insurance )

P & L Account Dr. (Value of irrecoverable item)

To Loss by Fire Account (Total Value of abnormal Loss)

Effect in financial Statement :

(a) Amount of goods destroyed shall be deducted from purchase Account or can be shown on credit side of Trading Account. Amount of loss irrecoverable from the Insurance Company shall be debited to P & L Account.

(b) Amount admitted as claim by Insurance Co. shall be shown on asset side of Balance Sheet

10) Goods taken for Personal use

When the proprietor withdrawn goods for his personal use from his business

Adjustment entry:

(i) Drawings A/c Dr.

To Purchase A/c

- (ii) Capital A/c Dr.  
To Drawings A/c

Effect in final accounts:

- i) Deducted from purchases in Trading Account  
ii) Deducted from capital in the B/S.

### EXAMPLE OF FINAL ACCOUNT

The following balances were extracted from the books of Mr. Sanjay as on 31-03-2015. Prepare Trading and Profit and Loss Account for the year ended 31st March 2015 and the Balance sheet as on that date after taking into account the following adjustments.

Particular	DR (Rs.)	CR (Rs.)
Sanjay's Capital		330000
Sanjay's Drawings	24450	
Opening Stock	200000	
Bills Receivable	25000	
Purchases	275000	
Sales		420000
Bills Payable		60000
Returns Outwards		4500
Returns Inwards	5000	
Plant and Machinery	100000	
Loose Tools	25000	
Patents	25000	
Sundry Debtors	125000	
Sundry Creditors		140000
Cash in Bank	77550	
Salaries and Wages	50000	
Repairs and Renewals	7500	
Insurance	3000	
Carriage Inward	3500	
Printing and Stationery	2000	
Micellaneous Expenses	6500	

**TOTAL****954500****954500****Adjustments:**

- a) Closing Stock was worth Rs.200000
- b) Depreciation Plant & Machinery by 5% and Patents by 15%.
- c) Revalue Tools at Rs.20,000
- d) Provide for Bad and Doubtful Debts at 5% on Debtors
- e) Provide for outstanding expenses as follows :
  - i) Salaries Rs. 25000
  - ii) Wages Rs.1000
- f) Insurance paid in advance to the extent of Rs.750.

**In the Books of Mr. Sanjay****Trading and Profit and Loss account for the year ended 31-03-2015**

Dr			Cr	
Particulars	Rs	Particulars	Rs	
To Opening Stock	200000	To Sales	420000	
				415000
To Purchase	50000	Less : Return Inward	5000	
Less : Return outward	4500			
To Carriage Inward	3500	By Closing Stock	200000	



	d				00
	To Gross Profit c/d		141000		
			615000		615000
	To Salaries & Wages				By Gross Profit b/d 141000
		5000			
	(+)	3500	53500		
	Outstanding	00	00		
	To Repairs & Renewals		7500		
		3000			
	To Insurance				
		00			
	Less : Prepaid	750	2250		
	To Miscellaneous Expenses		6500		

To Printin g & Statio nery To Provisi on for RDD To Depre ciation on : Plant & Machi nery	2 0 0 0 6 2 5 0  5 0 0 0 5 0 0 0 3 7 5 0 4 9 2 5 0		
Tools	0 0 3 7		
Patent s	5 0 4 9 2 5 0		
Net Profit	0		
	<b>1 4 1 0 0 0</b>		<b>1 4 1 0 0 0</b>

### Balance Sheet of Mr. Sanjay as on 31-03-2015

Liabil ities	R s	Assets	R s
Capit al	3 3	Cash in Hand	7 7

	0000				550
	24450			10000	
Less : Drawing			Plant & Machinery		
	30550			5000	9500
			Less : 5% Depreciation		
		354800		25000	
Add : Net Profit			Loose Tools		
				5000	2000
			Less : Depreciation		
		60001400		25000	
Bills Payable			Patents		
Sundry Creditors			Less : 15% Depreciation		21250
				1250	
Outstanding Salaries and Wages		3500	Sundry Debtors		
			Less : 5%		1

		PBDD	2 5 0	1 8 7 5 0 2 5 0 0 0 0 0 0 7 5 0
		Bills Receivable		0 0 2 0 0 0 0 0 0 7 5 0
		Closing Stock		0 0 0 7 5 0
		Prepaid Insurance		5 0
	5 5 8 3 0 0			5 5 8 3 0 0