Chapter 05

Financial Statements Including the Adjustments

This chapter discusses the followings.

5.1 Introduction to adjusting entries

5.2 Recording of adjusting entries
- Accrued expenses
- Accrued income
- Bad debts
- Depreciation

5.3 Presentation of non-current assets in the Statement of Financial Position

5.4 Presentation of financial statements incorporating the adjusting entries

5.1 Introduction to adjustment entries

The recording of business transactions using the double entry system and preparation of the trial balance after balancing the ledger accounts are discussed previously. Even though every business transaction has to be recorded in the books of accounts some transactions may not have been adjusted in the accounting period. In addition some balances in the ledger accounts can only be taken to the trail balance after making the necessary adjustments.

Adjustment entries that are required to present the financial statements with the most relevant and accurate figures are called adjusting entries.

The adjustment entries are used to adjust the values of assets, liabilities, income and expense accounts according to the accounting period. In calculating the operational performance of the organization, expenses and income irrespective of they had been received in cash or not, the relevent amounts should be considered as relevant for the period. This is done according to the accrual concept.

In addition as per the accrual concept, irrespective of the amount received in cash the total income relevant for the period should be recorded as well as irrespective of the amount paid in cash, the total expense relevant for the period should be recorded.

General journal is used to record the adjustment entries to the books of account.

The importance of adjusting entries in preparing financial statements can be summarized as follows;

- The balances in the ledger accounts can be updated as at the end of the accounting period
- The operational result i.e., profit or loss of the period can be calculated accurately
- The assets, liabilities, and equity of the business as at the end of the period or the financial position at the end of the period can be accurately disclosed.
- The financial statements can be prepared according to the accepted policies and standards
- The stakeholders of the business can use accurate information to make accurate economic decisions.

5.2 Recording of adjustment entries

This chapter discusses only about the Preparation of Financial Statements of a sole proprietor and includes adjustments most relevant for that type of entity.

- Accrued expenses
- Income receivable
- Bad debts
- Depreciation

Figure 5.1

Accrued expenses

Accrued expenses are the expenses that an organization has incurred for obtaining the goods and services for a specific accounting period, but the payment for which is still outstanding. This is also called expenses payable. The value of accrued expense is a liability of the business.

Given below is the journal entry relevant for recording the accrued expenses

Relevant expense account	Dr.
Accrued expense account	Cr.

In the double entry system, an increase in expenses are debited while an increase in liabilities are credited. Therefore, the relevant accrued expense is debited to the expense account and increase of liability, the amount of accrued expense is credited to the liability account.

Examples :-

The accounting period of the Tharindu's business is from 01.01.20xx to 31.12.20xx the following information relates to the accrued expenses.

01. Annual insurance expense is Rs. 6 000 and the company has only paid Rs. 4 000 in cash.

02. Monthly salary of the sales person is Rs. 8 000 and he has been only paid for salaries of 10 months.

03. A bank loan has been obtained for Rs. 50 000 on 01.01.20xx at an interest rate of 12%. Bank interest for two months has not been paid.

As per the example, the accrued expenses as at 31.12.20xxare as follows;

1. Accrued insurance expense (Rs. 6 000 - Rs. 4 000) = Rs. 2 000
2. Accrued Salaries (Rs. 8 000 x 2) = Rs. 16 000
3. Accrued bank interest (Rs. 50 000 x $\frac{12}{100}$ x $\frac{2}{12}$) = Rs. 1 000

The journal entries relating to the above example are as follows:

General Journal

Date	Journal V.N.	Description	Dr. Rs.	Cr. Rs.
31.12.20xx	001	Insurance account Dr.	2 000	
		Accrued insurance expense a/c		2 000
		(Accounting for accrued insurance expense)		
31.12.20xx	002	Employee salaries account Dr.	16 000	
		Accrued employee salaries a/c		16 000
		(Accounting for the accrued employee salaries)		
31.12.20xx	003	Bank interest account Dr.	1 000	
		Accrued bank interest a/c		1 000
		(Accounting for interest for the bank loan)		

The accrued expense of the Tarindu's business is accounted in the books of accounts as follows;

Dr. Insurance expense account Cr.

Date	Description	L. F.	Value Rs.	Date	Description	L. F.	Value Rs.
.........20xx	Cash		4 000				
31.12.20xx	Accrued insurance exp.		2 000				

Dr. Accrued insurance expense account Cr.

Date	Description	L. F.	Value Rs.	Date	Description	L. F.	Value Rs.
				31.12.20xx	Insurance expense		2 000

Dr. Salaries account Cr.

Date	Description	L. F.	Value Rs.	Date	Description	L. F.	Value Rs.
..........20xx	Cash		80 000				
31.12.20xx	Accrued salaries		16 000				

Dr. Accrued salaries account Cr.

Date	Description	L. F.	Value Rs.	Date	Description	L. F.	Value Rs.
				31.12.20xx	Salaries		16 000

Dr. Interest expense of the bank loan A/C Cr.

Date	Description	L. F.	Value Rs.	Date	Description	L. F.	Value Rs.
..........20xx	Cash		5 000				
31.12.20xx	Accrued interest		1 000				

Dr. Accrued bank interest account Cr.

Date	Description	L. F.	Value Rs.	Date	Description	L. F.	Value Rs.
				31.12.20xx	Bank interest		1 000

When the accrued expenses are adjusted to the relevant expense accounts, the expenses relevant for the period is obtained. This should be shown in the Profit or Loss Statement. How those expenses are relevant for the period (including the accrued expenses) are included in the Profit or Loss Statement and how the accrued expenses are shown in the Statement of Financial Position under the current liabilities are depicted below;

Profit or Loss Statement (extracts)

	Rs.
Insurance expenses	6 000
Salaries	96 000
Bank loan interest	6 000

Statement of Financial Position (extracts)

	Rs.
Current liabilities	
Accrued insurance	2 000
Accrued salaries	16 000
Accrued bank interest	1 000

Activity 01

The accounting period of Nayani's business ends on 31.12.20xx. The transactions done in the business are given below

1. Monthly rent for the shop is Rs. 5 000 and only 08 months rent has been paid.
2. Rs. 18 000 has been paid as the electricity expenses; electricity expense of Rs. 3 000 relevant for the month of December has not been paid.
3. Bank loan has been obtained for Rs. 80 000 on 01.12.20xx at an interest of 12%. The interest for the month of December has not been paid.
4. Accrued telephone expense as at 31.12.20xx is Rs. 3 000.
5. Carriage expense of Rs.2 000 is to be paid.
6. The annual stationery expense is Rs. 19 000, but only Rs. 5 000 has been paid

01. Calculate the correct value for the expense account and note in the given chart

Expense account	Amount paid in cash	Accrued expense	Expense relevant for the period after adjustments
1.			
2.			
3.			
4.			
5.			
6.			

02. Write the correct double entries for the adjustments required.

Transaction	Account to debit with the value	Account to credit with the value
1.		
2.		
3.		
4.		
5.		
6.		

03. Indicate the of journal entries for the adjustments and record transactions in the ledger.

04. Show the extracts of the financial statements.

Profit or Loss Statement (extracts) Rs.

Statement of Financial Position (extracts) Rs.

Income receivable

Income receivable are the income receivable within the accounting period but has not been yet received at the end of the accounting period. These are also known as the accrued income.

The amount receivable is regarded as an asset and income receivable must be adjusted in presenting the accurate operational results and the financial position. The accrued income can be adjusted using the general journal.

The journal entry to record the accrued expenses are as follows;

Income receivable account	Dr.
Relevant income account	Cr.

Income receivable is an income relevant for the accounting period. The relevant income account is credited and the income receivable account is debited as per the double entry rule.

Example :-

The accounting period of Parami's business ends on 31.12.20xx.

1. Rent income of Rs. 12 000 has been received and rent income of Rs. 3 000 is yet to be received.

2. A fixed deposit of Rs. 120 000 at an interest of 10% has been opened on 01.04.20xx and the interest income has been accrued for the month of December.

As per the example, the accrued income of Parami's business as at 31.12.20xx is as follows;

01. Rent income receivable Rs. 3 000
02. Interest income receivable Rs. 1 000

Accordingly, the journal entries relating to the example is as follows;

General Journal

Date	Journal V.No.	Description	L.P.	Dr. Rs.	Cr. Rs.
31.12.20xx	001	Rent income receivable Dr.		3 000	
		Rent income a/c			3 000
		(Accounting for rent income receivable)			
31.12.20xx	002	Interest income receivable Dr.			
		Interest income		1 000	
		(Accounting for interest income receivable)			1 000

Recording of accrual income in to the ledger accounts are shown below

Dr. Rent income account Cr.

Date	Description	L. F.	Value Rs.	Date	Description	L. F.	Value Rs.
				..........20xx	Cash		12 000
				31.12.20xx	Rent income receivable		3 000

Dr. Rent income receivable account Cr.

Date	Description	L. F.	Value Rs.	Date	Description	L. F.	Value Rs.
31.12.20xx	Rent income		3 000				

Dr. Interest income account Cr.

Date	Description	L. F.	Value Rs.	Date	Description	L. F.	Value Rs.
				..........20xx	Cash		8 000
				31.12.20xx	Interest income rec.		1 000

Dr.		Interest income receivable account					Cr.
Date	Description	L. F.	Value Rs.	Date	Description	L. F.	Value Rs.
31.12.20xx	Interest income		1 000				

Once the receivable incomes are adjusted to relevant income accounts, the income relevant to the accounting period can be obtained. These need to be included in the Profit or Loss Statement.

- The rent income of Rs.15 000 relevant for the accounting period should be shown in the Profit or Loss Statement and the rent income receivable of Rs. 3 000 should be recorded in the Statement of Financial Position under the current assets.
- Rs. 9 000 of interest income relevant for the accounting period should be recorded in the Profit or Loss Statement and the accrued interest income should be listed under the current assets in the Statement of Financial Position.

Extracts of the Financial Statements

Profit or Loss Statement (extracts) Rs.

Rent income	15 000
Interest income	9 000

Statement of Financial Position (extracts) Rs.

Current assets	
Accrued rent income	3 000
Accrued interest income	1 000

Activity 02

The financial year of Dilahara Enterprise ends on 31.12.20xx

1. A shop has been rented for Rs. 6 000 per month from 01.01.20xx. Rent income relevant to only 08 months has been received in cash.
2. Money of the business has been deposited to open a fixed deposit for Rs. 50 000 on 01.05.20xx. Interest income of Rs. 4 000 has been received while Rs. 2 000 is to be received relevant to this fixed deposit.
3. Only Rs. 6 000 has been received out of the Rs. 8 000 of dividend income receivable.
4. Sales commission income of Rs. 4 000 is to be received as a result of selling goods owned by another enterprise.

Required;

01. Calculate the proper values and record them in the relevant columns.

Transaction	Income received in cash Rs.	Accrued income Rs.	Income relevant to the accounting period Rs.
1. 2. 3. 4.			

02. Write the correct journal entries including the value for the adjustment to be done.

Transaction	Account to debit Rs.	Account to credit Rs.
1. 2. 3. 4.		

03. Prepare and record the adjustments in the general journal and post them to the ledger accounts.

04. Show the extracts of the financial statements using the tables below

Profit or Loss Statement (extracts) Rs.

Statement of Financial Position (extracts) Rs.

Bad debts

When a business sells goods on credit, the amount of credit receivable is called trade debtors or trade receivables. The business sometimes may not be able to recover the credit receivable due to debtors being bankrupt or diseased.

When an organization cannot recover the money from trade debtors due to any reason, such unrecoverable amount is called "Bad debts".

As a result of bad debts, the asset of trade debtors is reduced and that is recognized as a loss to the business. This loss is recognized as an expense to the business and it is included in the Profit or Loss Statement.

Therefore, the unrecoverable amount from debtors should be deducted from the debtors account by crediting the account and should be debited to the bad debts account as an expense. The journal entry for the bad debts is given below

Bad debts account	Dr.
Trade debtors account	Cr.

Example :-

Kithsiri's Business has sold goods on credit to Sameera for Rs. 8 500 on 01.08.20xx As Sammera has died in an accident, it is decided to write off the dues from him as at 31.12.20xx.

The journal entries and ledger accounts are shown below

General Journal

Date	Journal V.No.	Description	L.P.	Dr. Rs.	Cr. Rs.
31.12.20xx		Bad debts account Dr.		8 500	
		Sameera's a/c (trade debtors)			8 500
		(Amount receivable from Sameera being written off as bad debts)			

Dr. Bad debts a/c Cr.

Date	Description	L. F.	Value Rs.	Date	Description	L. F.	Value Rs.
31.12.20xx	Sammera's a/c		8 500				

Dr. Sameera's a/c Cr.

Date	Description	L. F.	Value Rs.	Date	Description	L. F.	Value Rs.
01.08.20xx	Sales		8 500	31.12.20xx	Bad debts a/c		8 500

Depreciation

In order to present the financial position and the performance in a better manner of a business organization, some assets of the business should be depreciated. These assets include the assets that are not intended to resale, but used in the operations of the business and have a long term existence. These assets include non-current assets such as buildings machinery, office equipment and motor vehicles. The amount of asset depletion during its economic useful life or due to asset being outdated is known as depreciation. Factors for depreciation includes economic factors such as being out of date and physical factors such as wear and tear.

The total cost of the asset include all the costs incurred for bringing the asset into the present location and usable condition. Such assets can be used for more than one year. These assets may be sold to another party at the end of the life of the asset and the amount obtained is known as scrap value.

Accordingly, there is an opportunity to recover a part of the cost of an asset through the scarp value. But the scarp value will not represent a significant portion of cost of an asset and therefore a major portion of an asset cost is not recoverable. This irrecoverable cost of the asset should be regarded as an expense over the years that the asset is expected to use.

Example :-

A machine has been obtained for a cost of Rs. 500 000 and it is expected to be used for 5 years. If the scarp value of the machine is Rs. 100 000, the irrecoverable portion of the cost of the asset is Rs. 400 000. Since the expected useful life of the machine is 5 years, this Rs. 400 000 should be expensed over the 5 years as an expense. Therefore this expense should be distributed between the said 05 years.

Accordingly, when an asset has a scrap value, the balance we get by deducting the scrap value from the cost should be distributed between its estimated economic life as an expense.

According to the example above, Rs. 400 000 which we get, once the scarp value of Rs. 100 000 is deducted from the cost of Rs. 500 000, should be distributed within the 5 years of economic useful life as an expense.

There are a number of factors that contribute in deciding the amount of depreciation per annum of an asset

01. Cost of the asset
02. Estimated use of life of the asset
03. Scrap value of the asset

The costs of asset includes the purchase cost of an asset and the costs incurred in brining the asset to the present location and usable condition.

Example :-

A business has purchased a machine for its production and the costs incurred relevant to the machine is given below

	Rs.
Purchase cost of the machine	200 000
Carriage inward cost	20 000
Installation cost	30 000
Total cost of the machine	250 000

The economic useful life of the asset is the time period the asset is expected to generate services or the number of units the asset is expected to produce.

Example :-

If a machine costing Rs. 250 000 is expected to be used for 10 years productively in the business, the economic useful life of the asset is considered as 10 years

As explained earlier, the scrap value is the net value expected to obtain by selling the asset at the end of its useful life.

Example :-

If an asset costing Rs. 250 000 can be sold for Rs. 30 000 at the end of its 10 year useful life, Rs. 30 000 is the scarp value of the asset.

The value obtained after deducting the scarp value of the asset from the cost of the asset is known as depreciable value of the asset. If the scarp value is not material (if not significant), the total cost of the asset can be considered as the depreciable value of the asset ignoring the scarp value of the asset.

Accordingly, the annual depreciation value of the asset can be calculated by considering the factors, cost of the asset, estimated useful life, and scarp value, after selecting a method to depreciate. There are several methods that can be used to depreciate assets. But here, only Straight-line depreciation method is discussed.

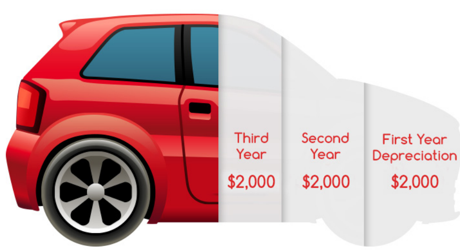

Figure 5.2

Using the straight line depreciation method, the depreciable value of an asset is depreciated annually over its useful life equally.

Therefore, the annual depreciation charged is equal over the depreciable years and following equation can be used to calculate the annual depreciation.

$$\text{Annual Depreciation} = \frac{\text{Cost – Scrap value}}{\text{Estimated useful life}}$$

Example :-

A business has purchased a machine to be used in its production and the following are the information relevant to the machine purchased.

	Rs.
Cost of the machine	820 000
Installation cost	30 000
Scrap value	50 000
Estimated useful life (in years)	10

Annual depreciation;

$$= \frac{850\ 000 - 50\ 000}{10 \text{ years}} = \frac{800\ 000}{10}$$

$$= \underline{\underline{\text{Rs. } 80\ 000}}$$

Instead of estimated useful life, a percentage can also be used. As per the above example, as the estimated useful life is 10 years, the depreciation should be done over 10 years. Accordingly, annual depreciation is 1/10th of the depreciable value. 1/10th is equal to 10%. If the depreciation done for 5 years, then the annual depreciation is 1/5th of the depreciable value and 1/5th is equal to 20%.

When using a percentage, to calculate depreciation;

Annual depreciation = (Cost – Scrap value) x Percentage of depreciation

Activity 03

A business has purchased a motor vehicle for administration purpose and following information relates to the motor vehicle purchased;

Purchase cost of the motor vehicle	Rs. 800 000
Carriage inward cost from the showroom	Rs. 20 000
Scrap value	Rs. 70 000
Estimated useful life (in years)	5

Calculate the followings;

1. Cost of the motor vehicle
2. Depreciable value of the motor vehicle
3. If the straight line method is used for depreciation, annual amount of depreciation

Accounting for depreciation

The annual depreciation is considered as an expense relevant for the accounting period and debited to the depreciation expense account. A separate account should be opened in the name of "Accumulated depreciation" to record the credit entry. This is because to keep the depreciation portion that is deducted from the annual profits until the relevant asset is disposed.

The double entry relevant for the depreciation relating to an accounting period is as follows;

Relevant depreciation account	Dr.
Accumulated depreciation account	Cr.

Example :-

The accounting period of Wathsala's Business ends on 31.12.20xx. the non-current assets of the business are depreciated using the straight line method annually at 10% and the business maintains an accumulated depreciation account.

The non-current assets which were purchased on 01.01.20xx are given below;

Motor vehicles (at cost)	Rs. 80 0000
Machinery and Equipments	Rs. 25 0000

Observe how the annual depreciation is being recorded in a general journal and posted in to the ledger accounts.

General Journal

Date	Journal V. No	Description	L. F.	Dr. Rs.	Cr. Rs.
31.12.20xx	001	Motor vehicle depreciation account Dr.		80 000	
		Accumulated motor vehicles depreciation a/c			80 000
		(Recording of annual motor vehicle depreciation in the books of accounts)			
31.12.20xx	002	Machinery depreciation account Dr.		25 000	
		Accumulated machinery depreciation a/c			25 000
		(Recording of annual machinery depreciation to the books of accounts)			

Dr. Motor vehicle account Cr.

Date	Description	L. F.	Value Rs.	Date	Description	L. F.	Value Rs.
01.01.20xx	Cash		800 000				

Dr. Motor vehicle depreciation account Cr.

Date	Description	L. F.	Value Rs.	Date	Description	L. F.	Value Rs.
31.12.20xx	Acc.dep. a/c. of motor vehicle		80 000				

Dr. Accumulated motor vehicle depreciation account Cr.

Date	Description	L. F.	Value Rs.	Date	Description	L. F.	Value Rs.
				31.12.20xx	Motor vehicle depreciation a/c		80 000

Dr. Machinery account Cr.

Date	Description	L. F.	Value Rs.	Date	Description	L. F.	Value Rs.
01.01.20xx	Cash		250 000				

Dr. Depreciation account - machinery Cr.

Date	Description	L. F.	Value Rs.	Date	Description	L. F.	Value Rs.
31.12.20xx	Accumulated depreciation a/c		25 000				

Dr. Accumulated machinery depreciation account Cr.

Date	Description	L. F.	Value Rs.	Date	Description	L. F.	Value Rs.
				31.12.20xx	Machinery depreciation a/c		25 000

The balances in the depreciation accounts should be recognized as expenses relevant for the period. The accumulated depreciation account should be balanced and bought forward to the next period. The depreciation amount of the next period should be added to the existing balance in the accumulated depreciation account. As a result, as at the end of any accounting period the balance in the accumulated depreciation account presents the total annual depreciation that has accumulated over the depreciated period. Hence the credit balance in the accumulated depreciation account presents the total accumulated depreciation for accounting period. This amount is deducted from the cost of the asset in the statement of the financial position.

As per the above example, motor vehicle depreciation of Rs. 80 000 and machinery depreciation of Rs. 25 000 should be included in the Profit or Loss Statement.

In the Statement of Financial Position, the accumulated depreciation of motor vehicle amount of Rs. 80 000 and accumulated depreciation of machinery amount of Rs. 25 000 should be presented as deductions from the cost of respective assets.

As this is the first year of depreciation, the depreciated amount and the accumulated depreciation amount are the same. When the amount of an accumulated depreciation of an asset is deducted from the cost of the asset, the balance is known as the net book value of the asset.

Activity 04

Following information are relevant to a machine acquired by a business for its production purposes.

Purchase cost of the machine	Rs. 300 000
Carriage inwards cost	Rs. 20 000
Installation cost	Rs. 90 000
Estimated useful life	10 years
Scrap value	Rs. 60 000

Do the following calculations

1. Cost of the machine
2. The depreciable value of the machine
3. If the Straight-line depreciation method is used,

   i. The annual depreciation amount

   ii. Show the journal entries to record the first year depreciation and post the same in to the ledger accounts.

5.3 Presenting the non-current assets in the Statement of Financial Position

When depreciable non-current assets of the business are to be presented in the Statement of Financial Position, such assets should be present in a format using three columns as cost, accumulated depreciation, and the net book value. Such format is given below and observe it.

Non-current assets	Cost Rs.	Accumulated depreciation Rs.	Net book value Rs.
Buildings	xxx	xx	xx
Motor vehicles	xxx	xx	xx
	xxxx	xx	xx

Example :-

The accounting period of Radha ends on 31.12.20xx. The Non-current assets the business had as at 31.12.20xx is given below;

Non current assets	Cost Rs.	Accumulated depreciation as at 01.01.20xx Rs.
Buildings	400 000	60 000
Motor vehicles	500 000	100 000
Machinery	60 000	6 000
Furniture	30 000	3 000

The non-current assets are depreciated at cost by 5% per annum and to record the depreciation, an accumulated depreciation account is maintained.

The depreciation included in the profit or loss statement as an expense relevant for the accounting period is as follows,

Building depreciation $(400\ 000 \times \frac{5}{100}) = 20\ 000$
Motor vehicle depreciation = 25 000
Machinery depreciation = 3 000
Furniture depreciation = 1 500

The accumulated depreciation relating to the assets as at 31.12.20xx is as follows;

Non-current assets	Accumulated depreciation as at 01.01.20xx Rs.	+	Depreciation for the year Rs.	=	Accumulated depreciation as at 31.12.20xx Rs.
Buildings	60 000	+	20 000	=	80 000
Motor vehicles	100 000	+	25 000	=	125 000
Machinery	6 000	+	3 000	=	9 000
Furniture	3 000	+	1 500	=	4 500

The Non-current Assets as at 31.12.20xx is shown in the statement of Financial Position as follows;

Business of Radha
Statement of Financial Statement as at 31.12.20xx (extracts)

Non-current assets	Cost Rs.	Accumulated depreciation Rs.	Net book value Rs.
Buildings	400 000	80 000	320 000
Motor vehicles	500 000	125 000	375 000
Machinery	60 000	9 000	51 000
Furniture	30 000	4 500	25 500
	990 000	218 500	771 500

5.4 Preparation of Financial Statements with adjustments

The example below depicts how to prepare financial statements using the above explained adjusting entries. Observe it.

Example :-

The accounting period of Sarani's business ends on 31.12.20xx. the trial balance as at 31.12.20xx is given below.

Business of Sarani
Trail Balance as at 31.12.20xx

Description	Dr. Rs.	Cr. Rs.
Inventories as at 01.01.20xx	6 000	
Purchases	185 000	
Carriage inward expenses	4 000	
Sales		385 000
Rent expenses	20 000	
Insurance expenses	8 000	
Sales promotional expenses	14 000	
Sales person salaries	30 000	
Discount given	4 000	
Discount received		9 000
Bank loan interest	6 000	
Bank charges	2 000	
Delivery motor vehicle (at cost)	300 000	
Office equipment (at cost)	40 000	
Trade debtors	17 000	
Trade creditors		32 000
Bank loan to be settled after 3 years		50 000
Cash	20 000	
Fixed deposit (5 years)	70 000	
Capital		250 000
	726 000	726 000

Following additional information are also provided

1. Accrued expenses as at 31.12.20xx
   Insurance expenses Rs. 2 500
   Rent expenses Rs. 4 000
2. Interest receivable as at 31.12.20xx is Rs. 7 000
3. Rs.3 000 should be written off as bad debts from the trade debtors
4. Annual depreciation should be provided on the motor vehicles and office equipments on cost at 8% and 10% respectively.
5. All inventories has been sold out as at 31.12.20xx

From the above information, observe how the;

01. Journal entries relating to the adjustments
02. Profit or Loss Statement for the year ended 31.12.20xx
03. Statement of Financial Position as at 31.12.20xx have been prepared.

01. Journal entries relating to the adjustments

General Journal

Date	Journal V. No	Description	L. F.	Dr. Rs.	Cr. Rs.
31.12.20xx	001	Insurance account Dr.		2 500	
		Accrued insurance expense a/c			2 500
		(Accounting for accrued insurance expense)			
31.12.20xx	002	Rent expense account Dr.		4 000	
		Accrued rent expenses a/c			4 000
		(Accounting for the accrued rent expense)			
31.12.20xx	003	Interest receivable account Dr.		7 000	
		Interest income a/c			7 000
		(Accounting for interest receivable for the fixed deposit)			
31.12.20xx	004	Bad debts account Dr.		3 000	
		Trade debtors account			3 000
		(Accounting for bad debts)			
31.12.20xx	005	Motor vehicle depreciation account Dr.		24 000	
		Accumulated motor vehicle dep. a/c			24 000
		(Accounting for annual motor vehicle depreciation)			
31.12.20xx	006	Office equipment depreciation a/c Dr.		4 000	
		Accumulated office equipment dep. a/c			4 000
		(Accounting for annual office equipment depreciation)			

02. Profit or Loss Statement for the year ended 31st December 20xx

Sarani's Business
Profit or Loss Statement
For the year ended 31st December 20xx

	Rs.	Rs.	Rs.
Sales			385 000
Less: cost of sales			
Inventory as at 01.01.20xx		6 000	
Purchases		185 000	
Carriage inward expense		4 000	(195 000)
Gross Profit			190 000
Add : other income			
Discount received		9 000	
Interest income		7 000	16 000
			206 000
Less : expenses			
Distribution expenses			
Sales promotional expenses	14 000		
Salaries to sales personnel	30 000		
Discount given	4 000		
Motor vehicle depreciation	24 000		
Bad debts	3 000	75 000	
Administration expenses			
Rent expense	24 000		
Insurance expense	10 500		
Depreciation office equipment	4 000	38 500	
Financial expenses			
Bank loan interest expense	6 000		
Bank charges	2 000	8 000	(121 500)
Net profit transferred to the capital a/c			84 500

03. Statement of Financial Position as at 31st December 20xx

Sarani's Business
Statement of Financial Position
As at 31st December 20xx

	Cost Rs.	Accumulated dep. Rs.	Net book value Rs.
Non current assets			
Motor vehicles	300 000	24 000	276 000
Office equipments	40 000	4 000	36 000
	340 000	28 000	312 000
Fixed deposit (5 years)			70 000
			382 000
Current assets			
Trade debtors		14 000	
Interest receivable		7 000	
Cash		20 000	41 000
Total assets			423 000
Capital 01.01.20xx		250 000	
Add: net profit		84 500	334 500
Non current liabilities			
Bank loan			50 000
Current liabilities			
Trade creditors		32 000	
Accrued insurance expense		2 500	
Accrued rent expense		4 000	38 500
Equity and liabilities			423 000

In the example above, Sarani's business has sold the entire stock that was presented for sale, as a result, there is no closing stock and the entire stock that was presented for sale has been turned in to cost of sales.

Example :-

The accounting period of Kanishka's business ends on 31.12.20xx
The trial balance as at 31.12.20xx is given below

Description	Dr. Rs.	Cr. Rs.
Sales		520 000
Inventory as at 01.01.20xx	18 000	
Purchases	230 000	
Machinery (at cost)	80 000	
Delivery motor vehicle (at cost)	600 000	
Trade debtors	36 000	
Trade creditors		44 000
Bank loan at 10% payable after 4 years		120 000
Bad debts	4 000	
Accumulated depreciation as at 01.01.20xx		
Motor vehicles		90 000
Machinery		16 000
Drawings	18 000	
Fixed deposit (5 years)	80 000	
Stationery expenses	9 000	
Electricity	12 000	
Selling expenses	35 000	
Cash	18 000	
Capital as at 01.01.20xx		350 000
	1 140 000	1 140 000

Additional Information are provided below;

1. Closing stock as at 31.12.20xx is valued at Rs. 24 000.
2. The fixed deposit balance is available from the beginning of financial period. 10% annual interest rate is applicable for this fixed deposit.
3. Interest for the bank loan for the year end 31.12.20xx has been accrued.
4. It has been decided to write off further Rs.2 000 as bad debts.
5. Depreciation has to be provided annually at 10% on motor vehicles and machinery.

Using the above information, Profit or Loss Statement for the year ended 31.12.20xx and Statement of Financial Position as at 31.12.20xx has been prepared. Go through the statements.

Business of Kanishka
Profit or Loss Statement
For the year ended 31.12.20xx

Sales			520 000
Less: cost of sales			
Stock as at 01.01.20xx		18 000	
Purchases		230 000	
Cost of goods presented for sales		248 000	
Less: stock as at 31.12.20xx		(24 000)	(224 000)
Gross profit			296 000
Interest income			8 000
			304 000
Distribution expenses			
Bad debts	6 000		
Motor vehicle depreciation	60 000		
Selling expenses	35 000	101 000	
Administration expenses			
Depreciation of machinery	8 000		
Stationery expenses	9 000		
Electricity expenses	12 000	29 000	
Financial expenses			
Bank loan interest	12 000	12 000	(142 000)
Net profit			162 000

Business of Kanishka
Statement of Financial Position as at 31.12.20xx

	Cost Rs.	Acc. dep. Rs.	Net book value Rs.
Non-current assets			
Motor vehicles	600 000	150 000	450 000
Machinery	80 000	24 000	56 000
	680 000	174 000	506 000
Fixed deposit (5 years)			80 000
			586 000
Current assets			
Closing stocks		24 000	
Trade debtors		34 000	
Interest receivable		8 000	
Cash		18 000	84 000
Total Assets			670 000
Capital as at 01.01.20xx		350 000	
Add: net profit		162 000	
		512 000	
Less: drawings		(18 000)	494 000
Noncurrent liabilities			
Bank loan at 10%			120 000
Current liabilities			
Trade creditors		44 000	
Accrued bank loan interest		12 000	56 000
Equity and liabilities			670 000

Activity 05

The trail balance as at 31.12.20xx of Sahan Abeynayakas' business is as follows;

Description	Dr. Rs.	Cr. Rs.
Capital 20xx.01.01		300 000
Purchases and sales	340 000	660 000
Trade debtors & trade creditors	65 000	82 000
Administration salaries	34 000	
Sales force salaries	42 000	
Carriage inwards	12 000	
Closing stock as at 01.01.20xx	28 000	
Discount given and discount received	5 000	8 000
Fixed deposit at 8%	150 000	
Traveling expense	5 000	
Delivery vehicles (at cost)	500 000	
Sales promotional expenses	7 000	
Furniture and fittings (at cost)	60 000	
Bank loan at 12% (payable after 5 years)		200 000
Bank interest paid in cash	12 000	
Accumulated depreciation as at 01.01.20xx		
Delivery vehicle		50 000
Furniture and fittings		12 000
Electricity	8 000	
Cash in hand and bank balance	44 000	
	1 312 000	1 312 000

Prepare the financial statements considering the following information;

1. Value of closing stock as at 31.12.20xx is Rs. 30 000.
2. Accrued expenses as at 31.12.20xx are as follows;
   Administration expenses Rs. 2 000
   Electricity Rs. 6 000
3. Write off Rs.1 000 as bad debts as at 31.12.20xx
4. Depreciation must be provided at cost at 10% for the delivery vehicle and furniture and fittings annually.

Activity 06

The trial balance of Nadeeka's business as at 31.12.20xx is given below

Purchases	350 000	
Sales		725 000
Buildings (at cost)	300 000	
Equipment (at cost)	40 000	
Accumulated depreciation as at 01.01.20xx		
Buildings		45 000
Equipments		6 000
Loading expenses	13 000	
Inventory as at 01.01.20xx	30 000	
Discounts given	8 000	
Discounts received		5 000
Insurance expenses	6 000	
Sales promotional expenses	42 000	
Bank loan		80 000
Interest on bank loan	8 000	
Bad debts	4 000	
Trade debtors	70 000	
Trade creditors		52 000
Cash	292 000	
Capital as at 01.01.20xx		250 000
	1 163 000	1 163 000

Additional information are given below;

1. Closing stock as at 31.12.20xx is Rs. 40 000
2. Accrued expenses as at 31.12.20xx
   Insurance expenses 2 000
   Sales promotional expenses 3 000
3. Building and equipments must be depreciated at 5% per annum.

Required;
1. Profit or Loss Statement for the year ended 31.12.20xx
2. Statement of Financial Position as at 31.12.20xx.