

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 Dr. | | XXXX | |
| | To Trading A/c | | | XXXX |
| | (Being closing stock transferred to Trading A/c) | | | |

| Dr. | | Cr. | |
|-------------|-----------|------------------|-----------|
| Trading A/c | | | |
| 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 Dr. | | 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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Assignment

Ques 1:

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

1. Trial Balance Extracts:

- o Salaries Expense: ₹20,000
- o Inventory (Opening Stock): ₹50,000

2. Adjustments:

- o The value of the closing stock as on December 31, 2023, is ₹60,000.
- o An outstanding expense of ₹2,000 for salaries has not been paid till December 31, 2023.

Required:

1. Pass the necessary journal entries for the adjustments.
2. Prepare the adjusted Trading & Profit & Loss Account and Balance Sheet as of December 31, 2023.

Ques 2:

XYZ Pvt. Ltd. is preparing its financial statements for the year ending March 31, 2024. The following details have been provided:

Trial Balance Extracts:

- Salaries Expense: ₹30,000
- Rent Expense: ₹15,000
- Inventory (Opening Stock): ₹80,000

Adjustments:

1. The value of the closing stock as on March 31, 2024, is ₹90,000.
2. Outstanding salaries amount to ₹3,000.
3. Outstanding rent expense amounts to ₹2,000.

Required:

1. Pass the necessary journal entries for the adjustments.
2. Prepare the adjusted Trading & Profit & Loss Account and Balance Sheet as of March 31, 2024.

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Ques 3:

ABC Ltd. is preparing its financial statements for the year ending June 30, 2024. The following details have been provided:

Trial Balance Extracts:

- Wages Expense: ₹25,000
- Utilities Expense: ₹10,000
- Inventory (Opening Stock): ₹60,000
- Insurance premium: ₹3,500

Adjustments:

1. The value of the closing stock as on June 30, 2024, is ₹70,000.
2. Outstanding wages amount to ₹4,000.
3. Outstanding utilities expense amounts to ₹1,500.
4. Outstanding insurance premium amounts to ₹2,000.

Required:

1. Pass the necessary journal entries for the adjustments.
2. Prepare the adjusted Trading & Profit & Loss Account and Balance Sheet as of June 30, 2024.

Ques 4:

LMN Co. is preparing its financial statements for the year ending September 30, 2024. The following details have been provided:

Trial Balance Extracts:

- Rent Expense: ₹18,000
- Advertising Expense: ₹12,000
- Inventory (Opening Stock): ₹70,000
- Office supplies: ₹3,000

Adjustments:

1. The value of the closing stock as on September 30, 2024, is ₹85,000.
2. Outstanding rent expense amounts to ₹5,000.
3. Outstanding advertising expense amounts to ₹3,000.
4. Outstanding office supplies expense amounts to ₹1,500.

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Required:

1. Pass the necessary journal entries for the adjustments.
2. Prepare the adjusted Trading & Profit & Loss Account and Balance Sheet as of September 30, 2024.

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