

Adjustments in Financial Statements

Adjustments on Interest on Capital



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Interest on capital is the amount paid to the owners or partners of a business on their invested capital. It is generally calculated as a percentage of the capital invested and is used as a way to reward owners for their financial investment in the business. This is common in partnership firms and sole proprietorships but not typically applicable in companies where dividends are paid to shareholders instead.



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Interest on Capital means when the proprietor renders money to the firm for running the business, in turn, the firm provides interest on capital to the proprietor. The rate of interest shall be pre-determined on the basis of the time period. For example, if the proprietor has lent an amount at the beginning of the given period, he shall receive an interest on capital for the whole period and if it is lent between the year then the rate of interest on capital shall be calculated accordingly in the proportion of time.



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Adjustment:

A. If Interest on Capital is given outside the trial balance:



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In such case, two effects will take place:



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- Interest on Capital will be shown on the debit side of the Profit & Loss A/c, being an item of expense for a business.
- It will be added to the Capital A/c in the Liabilities side of the Balance Sheet.



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Journal Entry				
Date	Particulars	L.F.	Amount(Dr.)	Amount(Cr.)
	Interest on Capital A/c Dr.		XXXX	
	To Capital A/c			XXXX
	(Being interest on capital charged)			

Dr.		Trading & P&L A/c		Cr.
Particulars	Amount(₹)	Particulars	Amount(₹)	
To Interest on Capital	XXXX			

Balance Sheet			
Liabilities	Amount(₹)	Assets	Amount(₹)
Capital	XXXX		
Add: Interest on Capital	XXXX	XXXX	

B. If Interest on Capital is given inside the trial balance:

In such a case, Interest on Capital will be shown only in the Dr. side of the Profit & Loss A/c, being an expense for a business.

Dr.		Trading & P&L A/c		Cr.
Particulars	Amount(₹)	Particulars	Amount(₹)	
To Interest on Capital	XXXX			

Solved Example

Question: The Trial Balance of M/s XYZ Enterprises as on December 31, 2023, is as follows: [Hint: Balance Sheet Total = Rs 2,52,000]

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Particulars	Debit (₹)	Credit (₹)
Plant and Machinery	180,000	
Capital		180,000
Sales		180,000
Purchases	90,000	
Rent Received in Advance		4,000
Commission Receivable		4,000
Furniture	40,000	
Wages	40,000	
Other Expenses	10,000	
Cash	4,000	
Bank	4,000	
Total	368,000	368,000

Adjustments:

- Closing Stock as on December 31, 2023, is valued at ₹40,000.
- Depreciation on Plant and Machinery is to be provided at 10% per annum.
- Accrued Income of ₹2,000 for Commission.
- Rent received in advance is ₹1,000.
- Interest on Capital at 5%.

Required:

- Prepare the adjusted Trading and Profit and Loss Account for the year ended December 31, 2023.
- Prepare the adjusted Balance Sheet as on December 31, 2023.

Solution:

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Trading and Profit and Loss Account For the year ending December 31, 2023			
Particulars	₹	Particulars	₹
To Purchases	90,000	By Sales	180,000
To Wages	40,000	By Closing Stock	40,000
To Gross Profit c/d	90,000		
	220,000		220,000
To Depreciation	18,000	By Gross Profit b/d	90,000
To Other Expenses	10,000	By Rent Received	4,000
To Interest on Capital	9,000	Less: Unearned Rent	1,000
To Net Profit c/d	62,000	By Commission Received	4,000
		Add: Accrued Commission	2,000
	99,000		6,000
			99,000

Balance Sheet as on December 31, 2023			
Liabilities	₹	Assets	₹
Capital A/c	180,000	Plant and Machinery	1,80,000
Add: Interest on Capital	9,000	Less Depreciation:	(₹18,000)
Add: Net Profit	62,000	Furniture	40,000
Rent Received in Advance	1,000	Closing Stock	40,000
		Accrued Income	2,000
		Cash	4,000
		Bank	4,000
	252,000		252,000



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Assignment

Ques 1: Following Trial Balance has been extracted from the books of M/s Ram Prasad and Sons on March 31, 2018. [Hint: Balance Sheet Total = Rs 20,50,000]

Particulars	Dr. ₹	Particulars	Cr. ₹
Machinery	4,00,000	Capital	9,00,000
Cash at Bank	1,00,000	Sales	16,00,000
Cash in Hand	50,000	Sundry Creditors	4,50,000
Wages	1,00,000	Interest Received	30,000
Purchases	8,00,000		
Stock on 1st April, 2017	6,00,000		
Sundry Debtors	4,40,000		
Bills Receivable	2,90,000		
Rent	45,000		
Commission General	25,000		
Expenses	80,000		
Salaries	50,000		
	29,80,000		29,80,000

Additional Information:

1. Outstanding salaries were Rs 45,000.
2. Depreciation on Machinery at 10% per annum.
3. Wages outstanding were Rs 5,000.
4. Rent prepaid of Rs 10,000.
5. Provide for Interest on Capital 5% per annum.
6. Stock on 31st March 2018 is Rs 8,00,000.

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Required

1. Prepare the adjusted Trading and Profit & Loss Account for the year ended March 31, 2018.
2. Prepare the adjusted Balance Sheet as on March 31, 2018.

Ques 2: The following balances have been extracted from the books of M/s Green House for the year ended March 31, 2017, prepare trading and profit and loss account and balance sheet as on this date. **[Hint: Balance Sheet Total = Rs 3,27,700]**

Account Title	Debit Amount ₹	Account Title	Credit Amount ₹
Purchases	80,000	Capital	2,10,000
Bank balance	11,000	Bills payable	6,500
Wages	34,000	Sales	2,00,000
Debtors	70,300	Creditors	50,000
Cash In hand	1,200	Return outwards	4,000
Legal expenses	4,000		
Building	60,000		
Machinery	1,20,000		
Bills receivable	7,000		
Office expenses	3,000		
Opening stock	45,000		
Gas and fuel	2,700		
Freight and Carriage	3,500		
Factory lighting	5,000		
Office furniture	5,000		
Patent right	18,800		
	4,70,500		4,70,500

Adjustments

1. Machinery is depreciated at 10% and buildings depreciated at 6%.
2. Interest on Capital is to be allowed at 4% per annum.
3. Outstanding Wages Rs 50.
4. Closing Stock Rs 50,000.

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Adjustment on Interest on Drawings

Interest on Drawings is an adjustment made in the accounts when a proprietor or partner withdraws funds from the business for personal use, and the business charges interest on those withdrawals. This interest is treated as an expense for the proprietor/partner and as income for the business.

Drawings is the amount withdrawn by partners for their personal use from the business. Therefore, the firm charges a certain rate of interest for the amount withdrawn by partners. The interest on Drawings is considered an income for the firm and an expense for the partners.

Adjustment:

A. If Interest on Drawings is given outside the trial balance:

In such case, two effects will take place -

Interest on Drawings will be shown in the Cr.. side of the Profit & Loss A/c, being an income for the business.

It will be added to the Drawings A/c and subtracted from the Capital A/c in the Liabilities side of the Balance Sheet.



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Journal Entry				
Date	Particulars	L.F.	Amount(Dr.)	Amount(Cr.)
	Drawings A/c Dr.		XXXX	
	To Interest on Drawings A/c			XXXX
	(Being Interest received on Drawings)			

Dr. Trading & P&L A/c Cr.			
Particulars	Amount(₹)	Particulars	Amount(₹)
		By Interest on Drawings	XXXX

Balance Sheet			
Liabilities	Amount(₹)	Assets	Amount(₹)
Capital	XXXX		
Less: Drawings	(XXXX)		
Less: Interest on Drawings	(XXXX)		
	XXXX		

B. If Interest on Drawings is given inside the trial balance:

In such a situation, Interest on Drawings will only be shown in the Cr. side of the Profit & Loss A/c, being an income for the business.

Dr. Trading & P&L A/c Cr.			
Particulars	Amount(₹)	Particulars	Amount(₹)
		By Interest on Drawings	XXXX

Assignment

Ques 1: Trial Balance of M/s Delta Enterprises as on March 31, 2024. [Hint: Balance Sheet Total = Rs 4,19,000]

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Particulars	Debit (₹)	Credit (₹)
Capital		280,000
Drawings	20,000	
Sales		400,000
Purchases	250,000	
Rent	30,000	
Wages	50,000	
Furniture	160,000	
Goodwill	35,000	
Trademark	25,000	
Sundry Creditors		50,000
Cash	70,000	
Bank Loan		100,000
Rent Received		20,000
Sundry Debtors	40,000	
Commission Paid	70,000	
Salary Paid	50,000	
Copyright	50,000	
Total	850,000	850,000

Adjustments:

- Interest on Drawings:** Interest on drawings is to be charged at 10% per annum. The partner withdrew ₹20,000 on April 1, 2023.
- Closing Stock** as on March 31, 2024, is valued at ₹60,000.
- Depreciation** on Furniture is to be provided at 10% per annum.
- Salaries** amounting to ₹5,000 are outstanding.
- Accrued Commission Income** of ₹4,000 is still receivable.
- Rent Received** includes ₹2,000 received in advance.

Required:

- Prepare the adjusted Trading and Profit & Loss Account for the year ended March 31, 2024.
- Prepare the adjusted Balance Sheet as on March 31, 2024.

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Ques 2: From the following balances extracted from the book of M/s Manju Chawla on March 31, 2017. You are requested to prepare the trading and profit and loss account and a balance sheet as on this date. [Hint: Balance Sheet Total = Rs 72,945]

Account Title	Amount ₹	Amount ₹
Opening Stock	10,000	
Purchases and Sales	40,000	80,000
Returns	200	600
Wages	6,000	
Dock and Cleaning Charges	4,000	
Lighting	500	
Misc. Income		6,000
Rent		2,000
Capital		40,000
Drawings	2,000	
Debtors and Creditors	6,000	7,000
Cash	3,000	
Investment	6,000	
Patent	4,000	
Land and Machinery	43,000	
Donations and charity	600	
Sales tax collected		1,000
Furniture	11,300	
	1,36,600	1,36,600

Closing Stock was Rs 2,000.

Adjustments:

1. Interest on drawings @ 7% and interest on capital @ 5%.
2. Land and Machinery is depreciated at 5%.
3. Interest on investment @ 6%.
4. Unexpired rent ₹ 100.
5. Charge 5% depreciation on furniture.

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Ques 3: The following balances were extracted from the books of M/s Panchsheel Garments on March 31, 2017. [Hint: Balance Sheet Total = Rs 1,03,280]

Account Title	Debit Amount ₹	Account Title	Credit Amount ₹
Opening stock	16,000	Sales	1,12,000
Purchases	67,600	Return outwards	3,200
Return Inwards	4,600	Discount	1,400
Carriage inwards	1,400	Bank overdraft	10,000
General expenses	2,400	Commission	1,800
Insurance	4,000	Creditors	16,000
Scooter expenses	200	Capital	50,000
Salary	8,800		
Cash in hand	4,000		
Scooter	8,000		
Furniture	5,200		
Buildings	65,000		
Debtors	6,000		
Wages	1,200		
	1,94,400		1,94,400

Prepare the trading and profit and loss account for the year ended March 31, 2017 and a balance sheet as on that date.

- (a) Unexpired insurance ₹ 1,000.
- (b) Salary due but not paid ₹ 1800.
- (c) Wages outstanding ₹ 200.
- (d) Interest on capital 5%.
- (e) Scooter is depreciated @ 5%.
- (f) Furniture is depreciated @ 10%.

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