**Financial Accounting**
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**Lecture – 62**
**5.11 Transactions to be adjusted in Final Accounts (Part – 2)**

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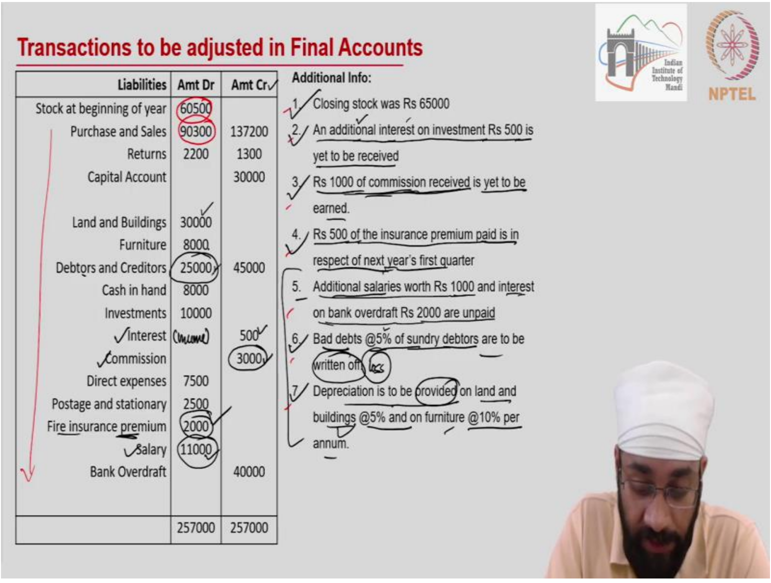


This is a continuation of the previous video and we are discussing the adjustments to be made to the Final Accounts. We have already looked at the first four adjustments on the page and we need to discuss three more. So, I am going to now look at the fifth adjustment, which says salaries worth 1,000 and interest on bank overdraft worth 2000 are unpaid. It says additional that means there must already be an expense called salaries. We have 11,000 rupees worth of salaries and for interest on bank overdraft, we do not have any interest on the debit column. So, only the salaries are additional and then interest on bank overdraft 2000: these are the two things. Let us go to the relevant slide.

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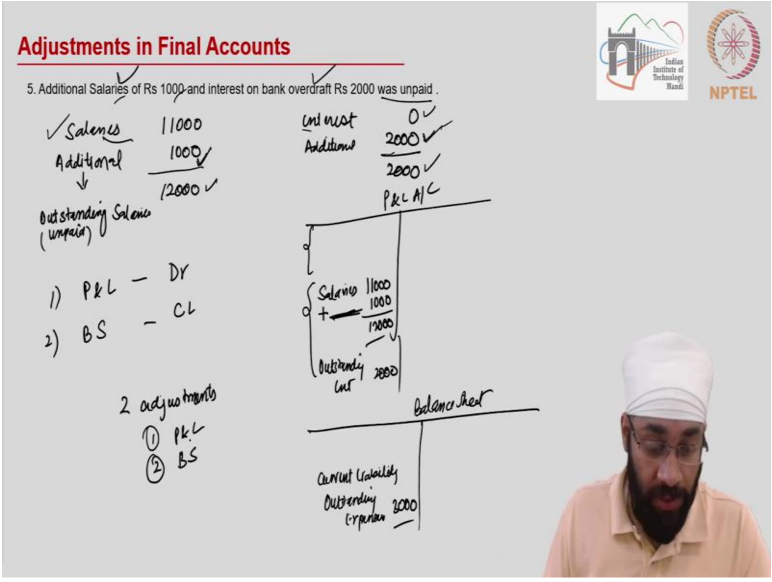


Salaries are 11000, which is given to us in the trial balance. And, now there is an additional amount of 1000. The interest, on the other hand, you have currently not paid, it is 0. The additional interest which has not been taken into account is 2000. All we are doing is using the matching principle. The matching principle says expenses of this year to be matched to incomes of this year. Salaries worth rupees 1000 have not been paid in this year, cash has not been paid, but services have been rendered by the employees. So, you have to pay the employees, the employees have a claim on the business. The actual expense for this year is 12,000 and same for the interest on bank overdraft. You took the overdraft, the interest is due, you have not paid it. The accounts are prepared on an accrual basis. So, the two principles, matching and accrual, dictate that we show 12,000 plus 2000 as the expense. Now, what is going to be the impact? The first impact is going to be in the profit and loss account: of course, in the profit and loss account in the second section you have salaries. You are going to show 11000 plus additional 1000. The total amount to be shown for salaries is 12000, and this additional amount is going to be called outstanding: outstanding means unpaid. So, this is unpaid salaries, outstanding salary. We are going to write that name here and we will do this when we do the practice problem. This is the amount to be shown. You have interest as well. Now there was no existing interest amount. So, we are just going to show outstanding interest. We will write outstanding interest 2000, that is it. That is the effect of these 2 transactions: we just clubbed these 2 transactions which are of similar nature. The only difference is that for salaries there was an existing balance while for interest there was no existing balance. The other impact in the balance sheet is going to be on the current liabilities. If you have to pay the additional 1000 within the next one year, and also this 2000 within the next one year, then we are going to call this a current liability. So, we will club this under outstanding expenses. Outstanding expenses, total 3000, you could show them one by one as well. This is internal accounting so you would actually want as much breakdown as possible. You would show two different items: 3000 in the liability side. The two impacts are in the profit and loss account. We show on the debit side in the balance sheet under the current liabilities. Again, as there are two adjustments for each transaction, salary and interest on overdraft, these are two transactions clubbed into one. If you think about these two transactions separately, for each of the transactions, you have two adjustments- one in the profit and loss account and the other one in the balance sheet. The trend is converting itself into a fact. We can now agree that any additional information which has not been adjusted in the trial balance before, any such adjustment, is going to affect both the profit and loss account and the balance sheet. It will go to one of the sides in the profit and loss account, either the debit side or credit side, and one of the places in the balance sheet, either asset side or the liability side.

Let us go to another transaction, transaction 6 which has not been accounted for in the books. It says, bad debts 5% on debtors are to be written off: sundry means various. You club small debtors amounts to be recovered. You have information that 5 percent of this amount will not be recovered; it is a bad debt. So, we need to write off these bad debts. The words *write off* essentially mean that you have to show them as a loss. So, writing off means that you cannot any longer show the same amount due from debtors. Let me look for the debtors and creditors: here the debit side, 25,000 is the amount of debtors. You have to write off 5 percent which is 1250. You cannot show 25,000 as your debtors as the current asset, it has to be reduced by the amount of 5%. Clearly one thing that we get from the transaction right away is that we have to reduce the amount of debtors which are shown in the balance sheet. Thus, one adjustment has been identified. The other adjustment will be that you show this as a loss in the profit and loss account, simple as that.

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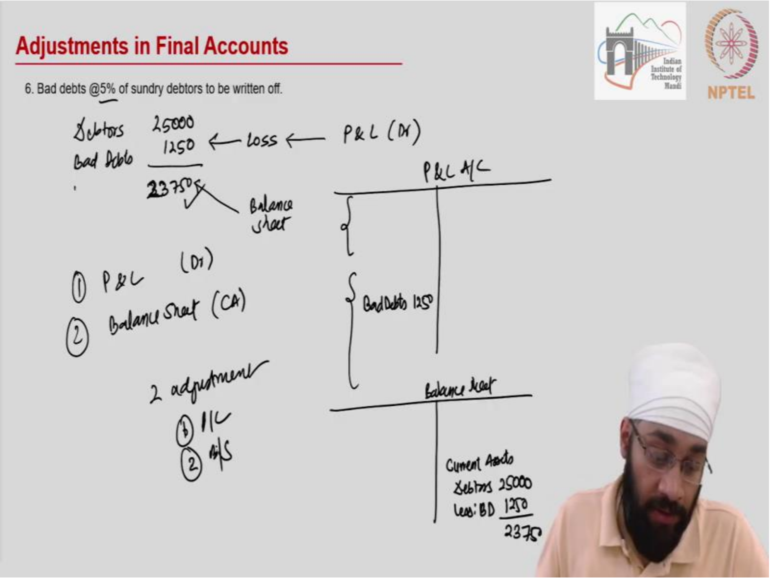


Let me go to the relevant slide. Here the amount of debtors in the trial balance is 25,000 and now there are bad debts at the rate of 5%. So, 1250 is the amount which you do not expect to recover. So, 23,750 is the revised amount for debtors. This is the new amount which should be shown. And, this is going to be considered as a loss. The loss goes to the profit and loss account debit side, and the new balance is shown in the balance sheet. These are the two impacts. Let me illustrate them. In the profit and loss account, you have two sections. In the second section, you are going to write bad debts. Bad debts 1,250 and in the balance sheet under the current assets you show debtors. So, you show the debtors as 25,000, and then you deduct the bad debts out of it, and you are going to show 23,750 finally, as the debtor amount that is to be recovered realistically. This is invoking the principle of conservatism, whenever you foresee a loss, you adjust for it. So, that is what we are doing. We know from our experience, or from the new information that we just received, that 5 percent is not going to be recovered. Again, these two transactions have effect both on the profit and loss account and balance sheet, on the debit side and under the current assets. So, two adjustments were made; one in the profit and loss account and the second in the balance sheet. Let us go to the last transaction. In fact, let me go to the trial balance first. This transaction says there is depreciation to be provided on land and building at the rate of 5 percent and on furniture at the rate 10 percent. To be provided means you have to reduce the amount, reduce the value of this asset: this process is called providing depreciation or providing for depreciation. Sometimes it is also called charging depreciation. Let me look for depreciation. There is no depreciation mentioned here, but there certainly should be building and furniture. So, building is land & building is 30,000 furniture is 8,000.

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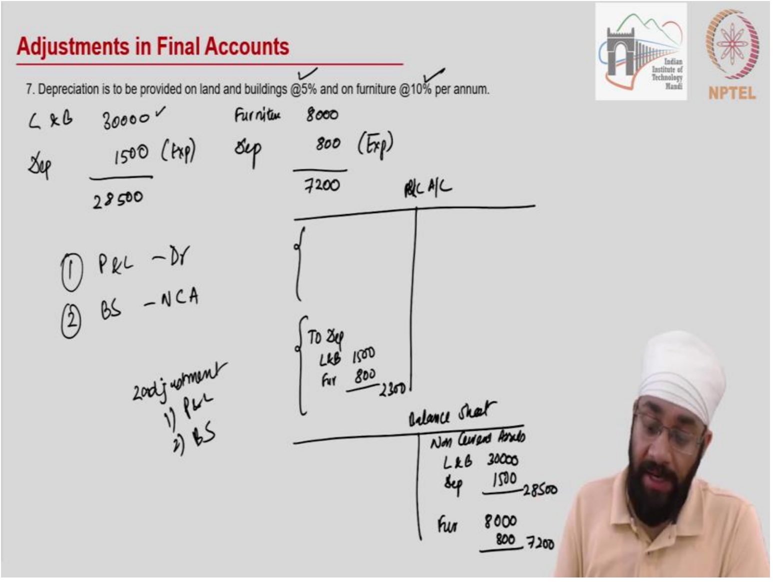


Let me write it here and 8,000 for furniture, and 30,000 for land and building. The adjustments to be made which we forgot to do earlier. According to the matching concept you have to show all expenses of a year in the same year. Depreciation is one of the recognized expenses, which you have to show as an expense in the profit and loss account. The depreciation at the rate 5 percent for a land and building is going to be 1500, you have to show this as an expense. At the same time for furniture you have 10 percent. There you go. Therefore, at the end of the year, the balance in the land and building is not 30,000; in effect the balance is 28,500 and for the furniture the balance is 7,200 and not 8,000. If we do not adjust for the amount of depreciation, we will be overstating the value of land and building and the furniture. Now, the depreciation is a recognized expense and expenses are shown on the debit side of the profit and loss account. In the profit and loss account, there are two sections. I will show the depreciation in the second section. So, total depreciation to be shown is going to be 1,500 plus 800, so, 2300 is the total depreciation and this is on land & building and this amount on furniture. Again, you write the longer forms. In the balance sheet under non-current assets you reduce the value of these assets. So, when you show land and building, you are going to take out the amount of depreciation 1500 from 30000 and then show 28500. Same for furniture: you show 8000 minus 800. So, the net amount that you show is going to be 7200 in the books of accounts. In fact, in the balance sheet you show the final numbers and there is attached an annexure to it or a note, which we have seen earlier in the earlier videos. There you have the depreciation to be charged on various types of assets. At one place all the details are provided, but the adjustment is again affecting the profit and loss account on the debit side and the balance sheet under non-current assets.

So, two adjustments: one goes to the profit and loss and the other goes to the balance sheet. This is true of all the adjustments that need to be made: adjustments go to two places. Now why is that happening? The reason it is happening is that all the adjustments were supposed to be written through the journal entries, ledger posting and trial balance. That process, which is a double entry system, means all the accounts actually affect two accounts. For all the journal entries that you have written, you have already affected two accounts. But, for these transactions for which the journal entry has not been written, they still have to affect two accounts. And, that is how these transactions go to two places; one in income statement, the other in balance sheet. Hence, they take that effect of the double entry system as they would have done, if you would have written the journal entries and ledger posting and trial balance earlier.

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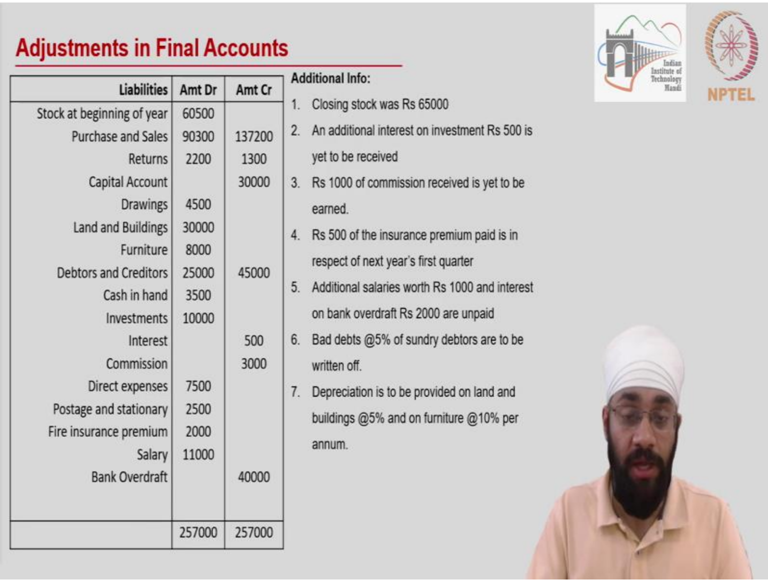


To sum up, all the adjustments are going to go to two places. And, compared to the balances shown in the trial balance, in the from the trial balance, we have learned all the items go to only one place, either the balance sheet or the income statement.

However, for the additional information all the transactions go to two places; one in the balance sheet, other in the income statement. So, with that learning I will close this video and I will see you in the next video, where we are going to take this trial balance and additional information and then we are going to prepare the final accounts and make the adjustments. I will see you in the next video.