Financial Statements Analysis and Reporting

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Lecture - 20
Financial Statements with Adjustments Part-IX

Welcome students. So, in my previous lecture, we learned that how to prepare the financial statements when we are given the information more than in the trial balance, additional information and we have to adjust that information and prepare the 3 financial statements. Apart from that we discussed certain other aspects also some important issues pertaining to the financial statements that are the profit and loss account and balance sheet.

So, continuing with the process we will learn to prepare some more financial statements considering some more small problems of the same type and then we will increase the level of difficulty. So, that you learn different type of the issues, different type of the problems and you are really well conversant with the process of preparing the financial statements means any kinds of the problems comes to you, any kind of the issues come to you are able to address those issues and to prepare means any kind of the financial statements as the charted accountants can do, you should be able to means come up to that level and you should also be able to prepare any kind of the financial statements. So, I will be continuing for few more lectures, I will be continuing with this process. So, we will learn to prepare the financial statements of say non public limited company organizations like sole proprietors, partnership firms, private companies and then we will move to the public limited companies. So, it is little means elaborated and little complex not more complex, but we have some much more additional information as far as the company’s financial statement are concerned.

Till now I am talking about the other than public limited company’s financial statements. So, once you are conversant that these statements than we will be learning about the companies parts also.

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The following balances are extracted from the books of Alfa Corporation as on 31st December, 2012:

Debit Balances	Rs.	Debit Balances	Rs.
Cash in Hand	540	Plant & Machinery	7,500
Cash at Bank	2,630	Salaries	15,000
Purchases	40,675	General Expenses	3,000
Returns Inwards	680	Insurance	600
Wages	8,480	Sundry Debtors	14,500
Fuel and Power	4,730		
Carriage on Sales	3,200	**Credit Balances**	**Rs.**
Carriage on Purchases	2,040	Sales	98,780
Stock (1st January, 2012)	5,760	Return Outwards	500
Buildings	32,000	Capital	56,755
Freehold Land	10,000	Sundry Creditors	6,300
Machinery	20,000	Rent	9,000

Taking into account the following adjustments prepare the P&L account and balance sheet as on 31st December, 2012.

- Stock on hand on 31st December, 2012 is Rs. 6,800
- Machinery is to be depreciated at the rate of 10% and plant at the rate of 20%
- Salaries for the month of December, 2012 amounting to Rs. 15,00 were unpaid
- Insurance includes a premium of Rs. 170 on a policy expiring on 30th June. 2013
- Bad debts are Rs. 725
- Rent Receivable Rs. 1,000

So, today I will take up another small problem and from this problem also, we will try to prepare the profit and loss account and balance sheet and we will see that how we can adjust this additional information by preparing these statements. So, we will be continuing with this process of preparing these statements and we will and when we will solve number of problems then you will be more clear about that how to adjust the different type of an information and how to understand it.

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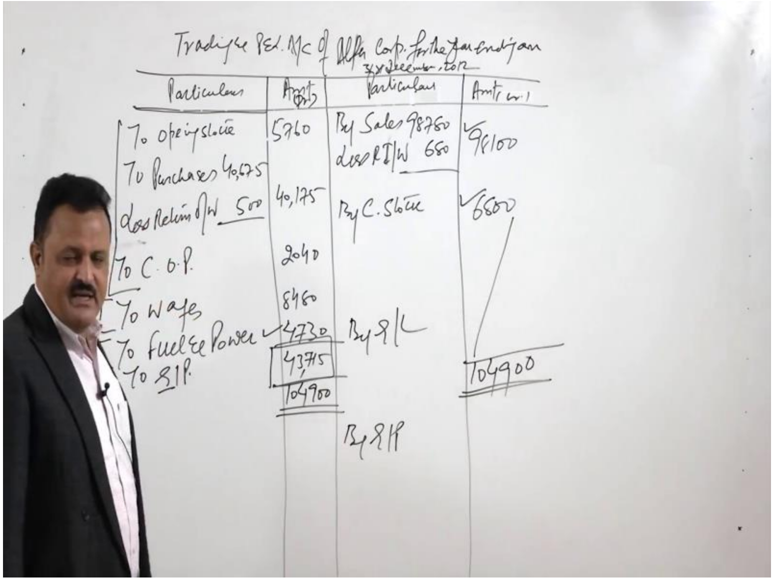

So, let us again have another column and try to learn again that how to prepare the financial statements we are taking in to account the different type of information so that the different issues we can address and we can declare about this process. So, I am writing here trading and profit and loss account of Alpha Corporation’s loss account of Alpha Corporations for the year ending on; for the year ending on 31st December 2012.

31st December 2012 will take here again the same format; particulars; then it is amount, particulars and amount. This is the debit column and this is the credit column debit and credit columns will have to take in to account. So, again first we will prepare the trading account and then we will prepare the profit and loss account and then we will try to find out that what comes out of this information, how much profit or loss this firm has and what is the financial position of this firm. So, will start with the same process that is we will search for the opening stock and here it is given that is the stock on first January 2012 and it means this is the beginning; stock means this is the opening stock. So, we have to take first as you have to take the raw materials. So, first we are taking the opening stock of raw material and opening stock of the raw material is 5,760; 5,760 is the opening stock then we have next thing is we will not take cash; we will not take cash at bank, yeah, we will take the purchases then means first we consume the opening stock of raw material then we go to the market for purchasing the fresh raw material and then that is the second part of the raw material.

So, to purchases; to purchases, so purchases part is 40,675; 40,675 and is there any purchase return? Yes, this term legally you call it as purchase return or return outwards it is the same thing and this will always have a credit balance purchase return you will find always in the credit balance. Similarly we have the sales return also which will have the debit balance because purchase return is this is simply real account. So, debit what comes in, credit what goes out. When we are returning these purchases back to the supplier, these purchases are going out. So, it means must; it must have a credit balance.

So, you have to search for the purchases purchase return in the credit balances not in the debit balances yes for the sales return you have to look at the or search in the debit balances. So, here I am directly looking at return outwards is the purchase return. So, this amount is about say 500 rupees less return outwards o oblige w and this is 500. So, this is 40,175. So, I think raw material part we have covered. So, we have 2 means levels of the raw materials first we will consume the opening stock and then once that is over then we will go the market to purchase the fresh raw material and form this purchases may be part of the material we have used in the current year and part is left that will be the closing stock of the raw material which will become the opening stock for the next year

So, closing stock of the current year is the opening stock of the next year. So, material is over I think then we go for the wages second is wages; wages is 8,480 and we have to look for any adjustment with regards to wages. If there is any adjustment with regards to the wages then we will have to take that in to account, but if that adjustment is not there then there is no issue. Then we have another direct expense, fuel and power, yes, this is fuel and power or if there is any carriage on the purchases, yes, there is a carriage on purchases, yes; we have to take that also. So, better it is before wages, we take the carriage on purchases before wages so that your material component is over. So, first you take raw material, opening stock, then purchases, then carriage on purchases, COP; carriage on purchases. So, we are paying because this is the transportation charges we are paying for bringing that material in the plant. So, we will have to take this.

So, now these 3 things make the total material cost purchased and consumed in the current year that is opening stock purchases and the carriage paid in the purchase’s total expenses on account of the raw material. We will have to account for now, we will talk about the wages to wages and this amount is 8,480; 8,480 then we have fuel and power;

fuel and power fuel and power fuel and power is 4,730; 4,730 is the fuel and power expense is there.

Any other direct expense which is required for the manufacturing of the process means no means fuel power we have taken. So, it means cash in hand will not take; cash at bank will not take purchases; we have taken return outwards, the return inwards is the sales return sales when they are coming in means we have to account at that time when we are taken the sales on the credit side of trading account. So, purchase return inwards is a sales return wages we have taken fuel and power we have taken carriage we have taken carriage on sorry carriage on purchases we have taken carriage on sales is a indirect expense that will come in the profit and loss account because even if you do not pay the carriage on sales production will be possible stock we have taken buildings freehold land and machinery they these are 3 assets will go to the balance sheet.

Similarly, plant and machinery will go to balance sheet, salaries will go to profit and loss account, general expenses again profit and loss account. So, it means there is nothing left to be taken on the debit side. So, now, we will take come to the credit side and this is by sales by sales. So, it means sales part is how it says sales is all also have the credit balance always have the credit balance because sales are going out. So, naturally debit what comes in credit what goes out purchases are coming in. So, they have the debit balance here are the purchases it has a debit balance because material is coming in it is a real account on the sales account sales are going out. So, debit what comes in credit what goes credit what goes out if you recall that rule of passing the journal entries in the journal or in the original book of accounts you would understand that why different accounts have the different balances.

So, here we have the balance of means the sales has a credit balance and this balance is sales by sales this amount is 98,780; 98,780. Now less return inwards; less return inwards; less return inwards and return inwards is 680. Inward means sales return, something is coming in; coming back what is sold out, part of that has come in; come back. So, it is 680. So, we are taking here also this is 98,100 is the sales balance.

Second item we take here is as by closing stock; closing stock of the total material that is finished material finished goods raw material anything is closing stock of that is taken together and that stock closing stock you will find here because it is unadjusted item. So, it will have double effect. So, first item we have taken from the adjustments that is 6,800 and this is the closing stock is 6,800s. Other than this, I think there is no other information which has to be taken in to account here. So, we can total it up and try to find out the; so, you put a diagonal line here put a line here and total it up this is 0 0. This is 9, this is 4 and this is 1,049.00. So, you again see, this side seems to be bigger than this side. So, naturally we have the net result is the gross profit. So, gross profit is coming here and closes it.

So, it is to GP; gross profit. So, the gross profit will be if you calculate this if you total it up and if you try to find out the gross profit here then the gross profit will be 43,715; 43,715. If you total it up now, so means I have totaled it up separately till this point, you total it up separately; you total it separately from this from the bigger side.

If the sales side; credit size is bigger than the debit side then you subtract the say debit balances from the credit total and then will find out the difference. So, we have done the same thing and we have found out the total that is of the 43,715 is the gross profit and this gross profit makes now the total sides equal so, but this is the gross profit. This is the gross profit; this is not the final profit. This is just a broader comparison gross means the broader comparison of the input and output. So, this is the input and this is the output. So, this is, but this is not final profit of the firm against that you have to add some other indirect incomes also and then we have to add some indirect expenses also. Now I will take discuss certain things here that why we take only these items in the trading account and not other items why these are considered only as a direct expenses and other expenses as indirect expenses this is a simple line of division that those expenses without which production is not possible in any manufacturing concern no production is possible those items are considered as the direct expenses now for example, if you do not have the material you cannot think of production you plant will not run similarly if you do not pay wages to the people working on the plant then they will not come they will not work. So, the plant will not work similarly if fuel and power is not there. So, your plant will not work and it means you have to look for the 3 means the those expenses which are must for running the plant and manufacturing is possible.

That is the direct expenses and largely this are the 3 categories raw material wages and the other direct expenses 3 things, I have taken the same things up to this level, if you say this is material cost, sorry, this is the material cost, opening stock, purchases return and the carriage on purchases up to this point this is the material cost this is the cost of workers working on the plant, wages, wage cost and this is the other direct expenses fuel and power. So, we have taken the 3 costs. So, only you also have to take the 3 costs and you when we analyze the financial statements you have to look for the 3 expenses only not more not less and in this side we see that by investing this much money in the business this much raw material this much wages to the workers this much say expenses on fuel and power.

So, what is the net output and the net output is first in terms of sales how much we have sold in the market. So, this is the direct income of the business and then is the say less sale return how much has come back may be the order was may be some time what we supplied to our buyers part of that was defective or you can say that we misused order was lesser, but we sent him some more items. So, he returned it back may be any and because of any reason he is returning part of the goods we have to accept that and subtract it from the sales and similarly, we have to say calculate the remaining part which we had by investing this much we have the total.

So, this much is sold in the market and this much is still with us. So, it means we have the total output of 1,04,900; 1,04,900 and this is our expenses, up to this part; the expenses. So, this is income, this is the output, this is the input up to this point. So, net result is the gross profit; net result is the gross profit, but this profit is just broader profit not final profit in this profit we will now add some other indirect incomes and subtract other indirect expenses now we come to that what are the indirect incomes look that when the business is running for one thing is that if some firm is manufacturing furniture correct some firm or some firm is manufacturing say electronic items color TVs, when they are manufacturing the electronic items their main business is the electronics manufacturing the TVs, refrigerators, washing machines and selling them in the market, but apart from that they might have the other incomes also. For example, the firm has surplus profit surplus income we do not need the profit in the business. So, they are investing their profit outside when their profit is invested outside they will get the interest on that investment.

Similarly, for example, there is another head that is the firm has constructed a few buildings and those building or may be the firm has a surplus land and that land is rented out to be used by somebody else and that person is paying rent on those buildings or that land. So, that is again the income of the firm, but that is not the direct income that is not from the electronic business that is from the other sources. So, you have to add in to the direct income that is the gross profit you have to add that indirect incomes also like rent income interest income patents income consultancy income yeah in the previous lecture we talked about the apprentice premium that is training one company is giving to the other companies. So, so many other incomes are there. So, total of other incomes and direct incomes we will have to put in the profit and loss account here in the credit side and then you have to take the indirect expenses also.

Now, what are the indirect expenses indirect expenses are like say when one set of expenses are 3 material labor and other direct expenses which are required for manufacturing the process products, but manufacturing is just not the end of the process you have to take that material from the plant to the market and during that process you have to incur. So, many other expenses also for example, say you have to have employee you have a office apart from the factory you have to have so many offices.

Your administrative office is there, sales offices are there, marketing offices are there, advertising offices are there. So, many offices are there. So, offices means if the these offices are also not there even production will be possible that is why these are direct expenses and others are indirect expenses, but to say efficiently sell the product in the market you need the other support. So, you have the employees working in the different offices. So, their salaries are there we have say similarly when we are using plant building and machinery we have the depreciation cost also depreciation is considered as a indirect cost it is not a direct cost because plant will keep on running till the life of the plant. Plant will keep on running, but we have to replace the plant with a new plant. So, it means at that time we need the money. So, we provide for that and charge the depreciation, but is not a direct expense even you do not provide for depreciation production will be possible, but for the replacement where we need the funds we have to make provisions and we are making the provisions in the profit and loss account.

Similarly, bad debts all these things they are the indirect expenses and losses. So, will have to account for those indirect expenses and losses also, so total of direct and indirect incomes minus total of now direct expenses we have already subtracted and now we are going to subtract the indirect expenses and then we are going to find out the difference in this. So, we are going to prepare that and the profit and loss account and if you prepare the profit and loss account you will be able to find out that what are the items there in the profit and loss account we have to take for those items. So, we start with GP. So, why this GP becomes now comes in the credit side because this is the credit balance I told you when we if we recall when we prepare the ledger accounts I told you that from the ledger the balances will be taken to the trial balance and you should be knowing that the balance has to go to which side of the trial balance debit balance side or the credit balance side and the criteria for that was identifying that if the credit side is bigger the balance is more by credit side credit balance and if the debit side is bigger balance is known by the debit balance.

Now, debit of the credit balance is as we are identifying by the side and bigger the side same the balance is similarly here we are also talking about that yes this side is bigger. So, credit side is bigger. So, the balance has come here as a gross profit is because of the credit side being bigger. So, it means credit this is the credit balance and we have take taking this credit balance to the credit side in the profit and loss account because this is actually the credit balance is not the debit balance has this side been bigger and this side been shorter then this balance would have been coming here and that would behave would have called it by gross loss then it is called as GL, it is not GP, it is called as GP, but it is not a GP now. It is gross profit. So, gross profit means say the credit balance of the trading account is going to now the credit side of the profit and loss account and the same amount we are going to put here that is the 43,715.

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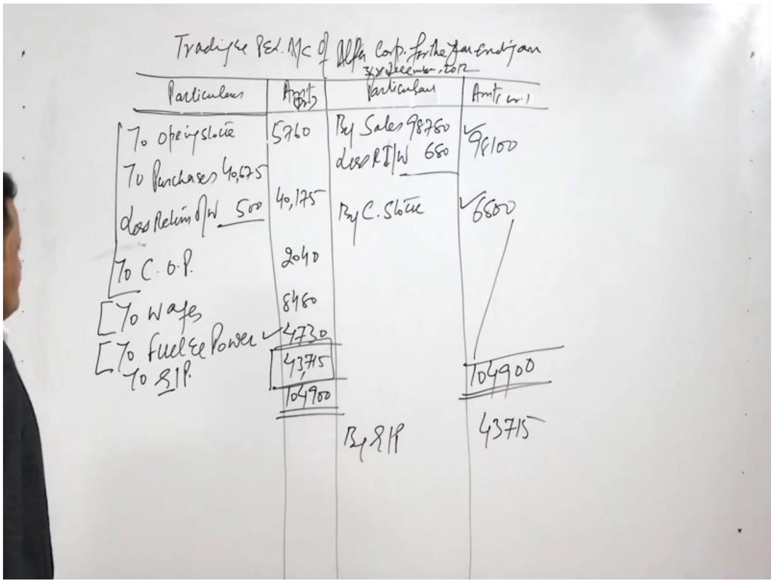

So, these; this and in this will have to add some other indirect incomes. So, if we took look at first we will talk about the indirect expenses and then we will talk about the. So, let us complete the indirect income part.

Indirect income part here is say now we have cash in hand cash at bank purchases return inward one thing you can do that items which you have already taken somewhere this one you can take them. So, that you are clear about these items I have already considered I will not consider it again and now I will be talking about the remaining items. So, otherwise as I am doing here you have to again look at from the beginning till end here and that is a little more time consuming. So, we should avoid that.

So, here we talk about the when you talk about the incomes; incomes always have a credit balance expenses always have a debit balance I told you that when you have to identify certain items you have the 4 categories of the items incomes and expenses and assets and liabilities incomes and expenses come in the profit and loss account trading and profit and loss account and assets and liabilities come in the balance sheet right assets and liabilities are part in the of the balance sheet. So, always make a note of it is a standard golden rule that all the expenses will always have a debit balance you look at these are the debit balances and all expenses are here up to this part all incomes will have a credit balance. So, here sales are income credit balance then rent is a income credit balance. So, all incomes will always have a credit balance.

Then you come to the asset and liabilities all the assets will always have a debit balance all the assets because it is a real account and real account means debit what comes in when the asset is coming in the balance is going out and that is the debit balance and all the liabilities which are in the balance sheet and capital. Capital is also a liability, capital is also a liability because that also belongs to the owner of the company owner of the business. So, capital is also a liability. So, it means capital also has to have the credit balance.

So, all liabilities and capital will always have a credit balance and all assets will have a debit balance. So, you for example, you see cash in hand asset debit balance cash at bank asset debit balance purchases expense debit balance return inwards is a sales, but it is coming in. So, it has become from the sales to non-sales. So, it is adding as a in to the inventory in to the stock and stock is a asset. So, it is the return inwards is the asset wages are expense debit balance fuel and power expense debit balance carriage and sales debit balance then we have stock again debit balance being asset building asset debit balance then freehold land debit balance then machinery asset debit balance then we have plant and machinery debit balance salaries expense indirect expense debit balance general expenses again a debit balance and then it is insurance again a debit balance and sundry debtors they are assets.

They have again a debit balance. So, all expenses and assets will always have a debit balance yeah this is a one golden rule now we will come to the credit balance. So, sales income credit balance return outward we have purchased something which became assets of ours, but now we are returning it back. So, it is going out. So, it means it is now out of stock is declining going down. So, we are returning something. So, when the stock is declining we must have a credit balance because it is credit what goes out debit what comes in credit what goes out. So, the return outward has the credit balance capital is a liability. So, it is coming having a credit balance sundry creditors is a liability it is a credit balance rent is the income indirect income it has the credit balance.

So, we have to always make a rule that all expenses are losses all expenses and say your assets always have a debit balance and your all incomes and liabilities always have a credit balance. So, now, we look for the incomes first income we have taken here is as a gross profit that is 43,715. Now we will look for the other incomes head of incomes and you will find all the incomes here sales we have already taken return outward we have already taken capital we will take to balance sheet because it is a liability. So, it is the sundry creditors again a liability part of the balance sheet and now it is the rent.

Rent is the indirect income. So, you put here now the rent by rent. So, rent is; how much is the rent income? 9,000, but we have to put it in the inner column and check for the any adjustment here. So, stock on hand, no, does not belong to it, depreciation, does not belong to it, salaries, no, insurance, no, yes, last is the rent receivable. Rent receivable is 1,000. It means income earned, but not yet received. Income earned, but not yet received has always have the, but the double effect will be double effect will be there first it will be added in have it will be credited in the profit and loss account and will be added in to the adjusting head adjusting head is given here. So, in this much rent is means total rent earned was 9,000 plus 1,000; 10,000. Out of that 9,000, we have received.

So, we have completed the double entry process for that and only 1,000 remains to be received. So, this is the income earned, but not yet received. So, when any income is earned, but not yet received, it is considered as a accrued income and this has to be added it has become due and it has to be added in the income of the income head in the and to be credited in the profit and loss account and second effect of it will be until and unless it is received it will be shown as a asset in the balance sheet. So, it is add rent receivable rent receivable is 1,000. So, total is 10,000.

Total is 10,000 and I guess there is no other income here. Now there is no other income we have taken sales we have taken return outward we adjusted right capital is the liability sundry creditors are liabilities rent is the indirect income. So, we have taken. So, in this case, we have only 2 heads of income total direct plus indirect income direct income is the gross profit and indirect income is the rent to this firm. So, total we have taken on the credit side and now we will come to the debit side and we will add all the indirect expenses and then we subtract from the that total indirect income total direct and indirect income and try to find out what is the position of profit or loss of the firm so; that means, putting the expenses here on the debit side that I will discuss in the next lecture.

Thank you very much.