Financial Statements Analysis and Reporting

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Lecture – 21
Financial Statements with Adjustments Part-X

Welcome students. So, we are continuing with the problem that I discussed in the in my previous lecture.

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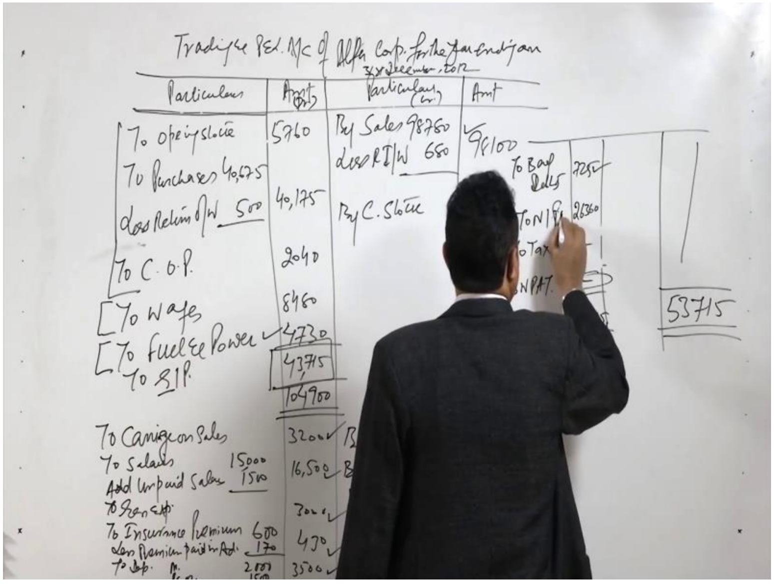

And we were talking about that after taking in to account to the direct expenses and direct incomes now in the lower part; this part is called as profit and loss account. We do not write here profit and loss account, but up to this part when you calculate the gross profit this part is called as trading account, trading account is ending here you have to close it by 2 lines and the trading account is complete. Now what you have to continue after that and continuing after that will give us idea about means will be preparing the profit and loss account where we will be talking about the indirect incomes, adding in to the direct incomes that is in the gross profit and then subtracting the indirect expenses and then calculating the final divisible profit which is called as profit after tax.

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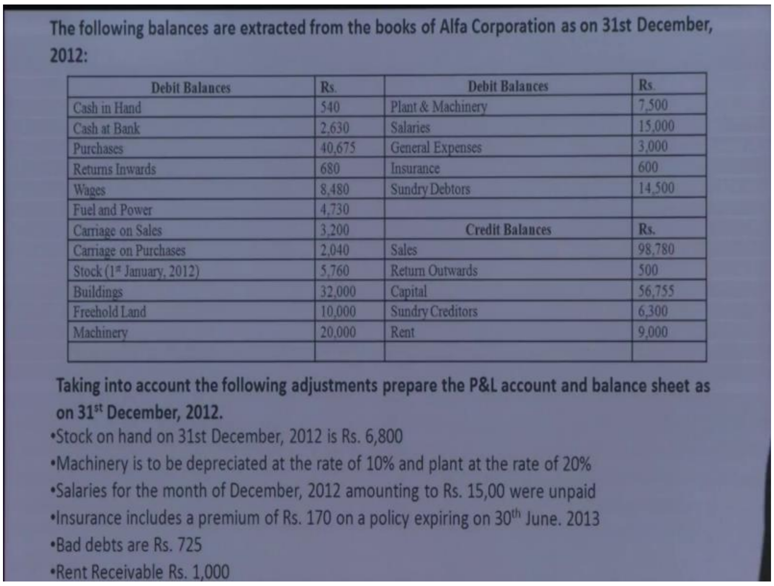
The following balances are extracted from the books of Alfa Corporation as on 31st December, 2012:

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, now we will take the expenses and expenses here are again you have to check it out cash, bank, purchases, inwards, fuel and power, carriage on sales, yes, this is the first indirect expense; carriage on sales. So, you can take it in the same order to carriage; to carriage on sales and the carriage on sales is 3,200s, is there any adjustment with regard to this carriage on sales, no, there is no adjustment we can find out. So, it is 3,200s; carriage on sales is 3,200.

Then we have carriage on purchases, we have already taken that in the trading account, carriage on purchases stock, we have already taken in to account, buildings, freehold land and machinery, we will not take that into account. Its assets, plant and machineries also asset, yes, next is the salaries, to salaries; to salaries is the other, but I think with regard to salaries we have some adjustments here. So, this adjustment is here, we will see what is this adjustment? First you put the amount of salaries and amount of salaries is 1; 15,000 that is in the inner column. This is salaries amount and salaries for the month of December 2012 amounting to rupees 1,500 were unpaid, this is called as expenses outstanding or unpaid expenses. Now you recall the adjustment, we have discussed while talking about the adjustments, I have discussed with you that if there is any expense which has become due, but not yet paid that is called as a outstanding expense and outstanding expenses have to be added in to the total means adjusting head of expenses.

So, head of expenses is salaries, we have paid 15,000 worth of salaries, but the total salaries due to be paid to the employees has become 15,000 plus 1,500. So, you have to add now this. So, it is unpaid salaries are add unpaid salaries and they are 1,500s. So, total salaries balance is 16,500s, total salaries is 16,500s. So, first effect of this I have taken here in the profit and loss account by adding this unpaid salaries into the adjusting balance of salaries and the second effect of it will come in the balance sheet and in the balance sheet, you will put it in the liability side until and unless you will pay the outstanding expense that is kept on showing as the liability that is the outstanding expense and it will go as a liability in the balance sheet. So, first effect is in the profit and loss account debit side and second effect will be in the liability side of balance sheet then we have general expenses next is the general expenses. So, it is 2 general expenses general expenses here are 3,000 and I guess there is no adjustment with regard to general expenses here if you look at this there is no adjustment with regard to general expenses similarly next is the insurance.

To insurance this is basically the insurance premium, we pay; we buy the insurance policies for the firm's assets and then we pay the premium on that. So, premium is the revenue expense which is paid only for one year. So, that is the insurance premium it is not written here that insurance premium or anything if insurance is written it means it is a insurance premium and this is 600; insurance premium is 600, we are taking here and there is some adjustment with regard to the insurance premium and that is insurance includes a premium of rupees 170 on a policy expiring on 30th June 2013.

Now what does it mean is it outstanding or is it paid in advance because we are preparing the financial statements as on 31st December 2012 when we are preparing these statements on 31st December 2012. It means this is the last date of the year for which we are preparing the financial statements. Now this amount 170 is a premium out of the total premium of 600 rupees, 170 is paid on a policy which is say expiring on 30th June 2013 means we have paid the premium in advance means that premium which will be expiring, we have already paid the premium till 2013 30th June till 2013. It means we will have to now take that in to account because we have paid it in advance.

Because we are preparing account till 12, we are not preparing it till 13. So, 13's premium if you paid till 13 that part is extra that is paid in advance. So, you have to subtract that less premium paid in advance premium paid in advance. So, it means this premium paid in advance is 170 and you have to subtract that. So, if you subtract that then this is how much? This is 470 rupees premium which has been paid in advance. So, we will have to means the total premium actually due for the year is 430 rupees not 600. So, we have to subtract that then is the sundry debtors. We will not take that in to account we will because this is an asset. So, we will take at the time when the asset when we prepare the balance sheet. So, we have then this adjustment stock we will do the second part in balance sheet yes now we come to the next thing that is the depreciation.

One of the important indirect expenses to depreciation and depreciation is a machinery to be depreciated at the rate of 10 percent and plant at the rate of 20 percent machinery at the rate of machinery is 20,000 worth. So, it is to be depreciated at the rate of 10 percent.

And plant; plant and machinery is 7,500 so, 20 percent. So, we will take the depreciation here and we can calculate it for both put it in the inner column and take only one item in the outer column together. So, 2 depreciation; this is this amount is 10 percent on the machinery. So, 20,000 and 10 percent is 2,000 and then we have plant this is machinery and then we have plant and machinery which is 7,500 and it is 20 percent. So, this works out as 1,500 rupees that is 20 percent of 7,500 and this is 3,500s; 3,500 worth of the machinery. So, we will be here putting it here depreciation we have also taken. So, stock we have adjusted depreciation part we have taken in to account salaries we have taken in to account insurance premium we have taken in to account and rent receivable we have taken in to account.

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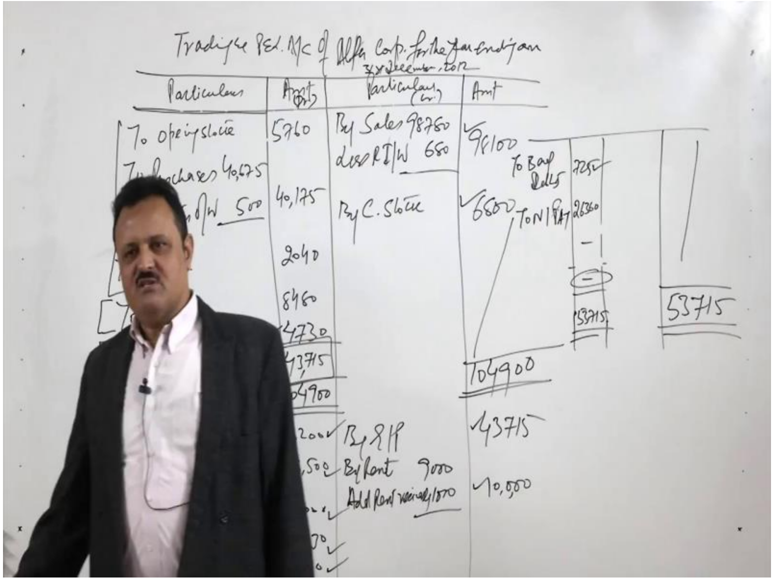

So, now, we will take in to account the bad debts. So, I am continuing with here means we will prepare a small here. So, it is the 2 bad debts. So, it is this part is will take it then continue to bad debts and bad debts amount is.

Bad debts amount is 725. So, this will come directly one item only 725. So, now, we are continuing with the incomes part and incomes total incomes if you count. So, 53,715 and this other income only 2 incomes are there. So, we have taken that in to account and then it is the expenses, we have already taken in to account. So, one is the carriage on sales, 3,200 salaries is total 16,500 general expense is three thousands insurance premium is 430 depreciation is 3,500 and then it is 725.

So, now, we will have to total it up and when we total it up again guess that this credit side is bigger in this case also as compared to the debit side. So, it means we have the credit balance here and credit balance in the profit and loss account is a profit not the loss. So, it is 53,715. So, we are closing it by 2 lines and the difference is to net profit to net profit. So, this net profit will be if you total these this, this, this and this and this and this; if you total it up you will get the net profit of 26,360, this is the difference 26,360 is the net profit. If you total it up, now this total will be equal to the 53,715 again we can check it of 5 and then it is this. So, it is 5.

So, we can say that it is 2; 8; 8 and then 11; 11; 11; means this is one then it is one then it is 8; 11; then it is 16; 16; is 20; 20 and this 25 and 2; 27. So, it is we can check it out that it is 53,715 is the net profit. Now if some tax related information is given then you will write here you will write here to net profit and NBPT; it is net profit before tax then you say to corp to tax or corporate tax or income tax whatever, it is written you will put it here and then you will find something that is to net profit you will not put a line here, but you will see that tax part and to net profit it is no N pat, N pat that is a net profit after tax and that will be here, but since we have not given any information about the tax part. So, we will assume that it is this firm is not liable to pay any tax.

So, whatever the profit we have calculated here that is the net profit after tax and that is the final profit divisible profit of the firm and the amount is 26,360 and that is the final profit of the firm which will be going to the balance sheet will be invested in the balance sheet had it been a public limited company though may be the part of the profit is going to be distributed as a dividend and then part of the profit is going to be transferred to the reserves that is specific reserves or the general reserves, but since it is a non company form of the organization. So, it means here we have the way that total profit is transfer to the balance sheet and added in the capital in the balance sheet.

So, now let us prepare the balance sheet for this firm and try to find out whether the financial position of the firm is acceptable or not that is the financial position is acceptable or the firm is acceptable or not that we have to do here now. So, we will check with the help of the profit and loss account we are trying to assess the profitability of the firm and by preparing the balance sheet we try to find out the financial position of the business that thing should be very clear to you that what is the purpose of profit and loss account that we check the profitability or the profit or loss position of the firm and by preparing the balance sheet, we check the financial position of the firm which is checked only for one day in a year and profit or loss is worked out for a period of one year that is over a period of one year twelve months that is accounting period how much profit or loss the firm has earned how much profit or loss the firm has earned that we have to check.

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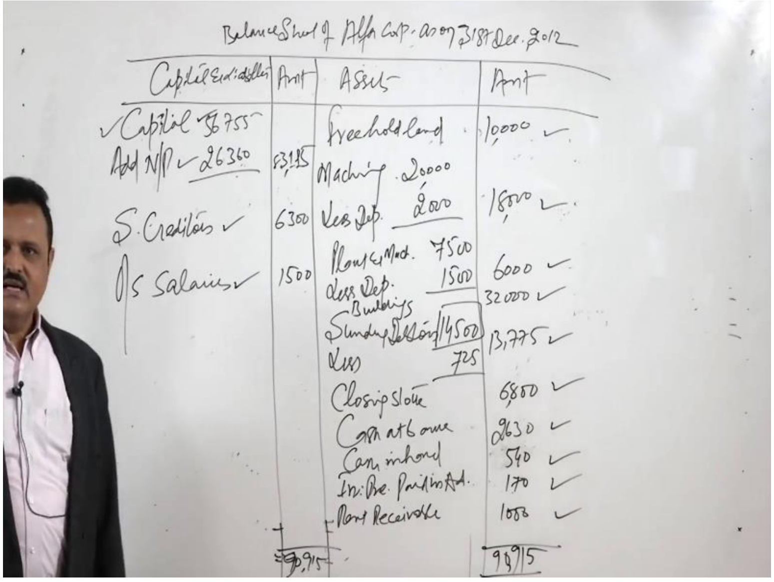

So, let us now calculate try to prepare the balance sheet again the same format; T format, we call it as a T format, this is the balance sheet balance sheet of alpha corporations corporation as on we write here as on 31st December; 31st December 2012 that is the balance sheet of alpha corporations as on 31st December 2012.

Here you will take capital and liability; capital and liabilities. This is the amount, this is assets and this is amount this is the asset and this is the amount. Now we will start with the capital and liabilities and then we will take all the assets and then try to see whether both the sides are equal or not. So, let us start prepare the balance sheet. So, it is the capital no to no by please bear in your mind we have to take no to no by. So, capital balance here is 56,755, this is one, in this, we will have to add the net profit and what was the net profit we had already calculated 26,360 for any drawings and any other information is there pertaining to drawings or anything if that is there then we will have to take that in to account, but if that is not there then that can be ignored means there is no other information. So, it means there is no drawings; nothing. So, you have to add this and add net profit. So, this is 5, this is 11, 1, this is 10, 11 1 and then it is 13 1 and this is 8.

So, it is 83,115 is the total capital of the business. So, it means initially we started in this year, we started with the capital of 56,755 and then we have earned profit of 26,360 and then the total capital; we added that profit in to the capital and our capital balance has gone up to the extent of 83,115. So, to 5, 5, 6, 11, 6, 5, 11, 1, 11, 1 then 1 and then, it is 83,115 is the balance of the capital another liability, yes, we have one more liability that is sundry creditors they are sundry creditors here we have sundry creditors. So, sundry creditors are 6,100; 6,300s. For any other liability if you look at this credit balances you do not find any liability here sales we have already taken return outwards we have taken capital we have taken here sundry creditors we have taken here rent we have already taken now you come down to this lower part of the adjustments stock is a asset will go in the asset side of the balance sheet machinery depreciation will be adjusted in the asset side of the balance sheet salaries yes outstanding salaries. So, outstanding salaries one effect we have done in the profit and loss account second effect we are doing here. So, it is you write here as outstanding oblige s salaries and outstanding salaries are 1,500.

I think this are the total liabilities to be taken to the liabilities side of the balance sheet. So, we have already taken these liabilities here. Now we come to the asset side and assets we start with the land. So, it is a freehold land it is the freehold land and the freehold land balance is how much that is 10,000 no adjustment nothing because land has no adjustment it is never it never depreciates it appreciates, but we do not record the appreciation. So, and we have taken then we have to go for the machinery, but you have already provided the depreciation on this. So, machinery balance is 20,000 and we have to charge the depreciation 10 percent.

So, it is less second effect of the depreciation one effect we have already taken in the profit and loss account. So, second effect is here 2,000 here. So, now, the balance of the machinery is 18,000s balance of the machinery is 18,000s then is the plant and machinery plant and machinery. So, what is the balance of plant and machinery it is 7,500s less depreciation. So, depreciation amount is 1,500. So, it is the balance left with us will be 6,000s, balance left with us is the 6,000s; plant and machinery we have taken any other asset you have with us plant and machinery salaries general expenses insurance sundry debtors.

Yes, sundry debtors; we are taking here now sundry debtors we are taking here sundry debtors and this is 14,500s, but we have the adjustment here that is the bad debts 725, it means this 725 are not adjusted already. So, it means they are part of sundry debtors. So, you have to write here less one effect of this we have taken in the profit and loss account debit side and now second effect we are taking here. So, 725, we are left with how much the balance of the debtors is that is 13,775; 13,775 is the balance of sundry debtors and then we have any other asset if you look at yes then we have the closing stock closing stock, we have closing stock. Here closing stocks balance is 6,000s. So, we have taken this also any other asset now if look at this side they are the 2 more assets which we have left cash in hand and cash at bank.

What is the balance of cash at bank? It is 2,630 that is the cash at bank, 2,630; cash at bank and then is a cash in hand is the 540; 540 is the cash in hand. So, we have taken this also now again apply a check we have taken the cash in hand we have taken the cash at bank purchases no return inwards no wages no fuel and power no carriage on sales no carriage on purchases no buildings yes we have forgotten the buildings very important part. So, we have to put it here before the debtors because it is a permanent asset long term asset. So, we prepare the balance sheet in the order of permanence.

So, buildings are 32,000s and there is no depreciation on the building. So, we will not have to provide any kind of the depreciation on the buildings directly will have to take the buildings here. So, we have taken the buildings we have taken the freehold land we have taken the machinery we have taken the plant and machinery and we have taken the salary general expenses and insurance they are not the subject of the balance sheet and then sundry debtors we have already taken and if you talk about here the credit balances are the liabilities we have already taken the liabilities.

So, nothing to worry about then stock in hand yes we have taken the closing stock here yes we have taken the closing stock then is the machinery we have taken depreciation on machinery and the plant and machinery we have already taken salaries gone already outstanding part is taken in the balance sheet that is 1,500s insurance include a premium of 170 on your policy expiring on 30th June, yes this is the insurance premium paid in advance insurance premium paid in advance insurance premium paid in advance and this is 170 rupees, yes, this is paid in advance then we have bad debts we have already adjusted the bad debts, yes I guess yes we have done that rent receivable rent which is income earned, but yet received.

So, this is the asset rent receivable rent receivable. So, rent receivable is how much. So, it is 1,000 you have taken the rent receivable 1,000. So, I guess all the assets we have taken in to account now there is nothing left stock we have taken machinery depreciation we have taken salaries we have taken insurance we have taken bad debts we have taken rent receivable we have taken. So, all assets all the liabilities we have taken them in to account and now we will have to see in the liability side also almost everything is over. So, let us see whether both the sides are equal or not and total it up.

So, we have it is here 5, it is here one it is here 4 5 9 and this is 6 3 9 0 and then it is 90. So, it is 90,115; one side total is 90,115, sorry! 90,915 is the total of the liability side. So, is it equal to the asset side let us check here it is say 5 then we take here it as 7 3 10 14 then it is 21, yes, seems to be same 22 then it is 0 then is 9; 9 and 8 is the 17; 17 and 6, 23; 23 and 5, 28 29, yes very good. So, coming up equal that is 9 then it is. So, it was 29 2. So, it is 3 9 2 11 3 14 then it is 6 20 then it is 22 and it is. So, what happened here? So, we are going to have some different balance here that may be the different. So, it is 2 8 8 and 10. So, 10 and we have 6 16 16 and 2 18 18 and 3 21 21 and 6 29 29 and 232. So, it is going to be some different amount let us check the values.

We have the buildings 32,000s good then we have freehold land is 10,000 fine. Then we have machinery 18,000, fine then we have plant and machinery 6,000, fine, we have the same figures then it is sundry debtors 13,775, then we have yes, cash in hand; 540 then we have say cash at bank this is 2630 and then we say insurance is 170 good and then it is a rent, it is fine we have taken the same amount and then we talk about the closing stock. So, closing stock figure is 6,800 rupees all the figures are correct. So, it means we have to we have already checked. So, we have taken here it is the 5 then it is 7 3 1 then it is say 9 then will be taking here as say 0 and then we will be taking the last figure as 1 1 2 and then 3 5 6 and 3 9. So, it is 90,915, the balance sheet has equal balances both the sides are equal the balance sheet is balanced it should come little down. So, it should be because it should be looking like a balanced document both the side should be equal both the side should be balanced. So, it is 90,915. So, we have taken it and we have balanced the balance sheet. So, it means we can make observe for alpha corporations.

We calculated the gross profit and the gross profit figure was 43,715 then we further went down to the next step then we can calculated the net profit which worked out as 26,360 and then we came down to check the financial position of the firm and both the sides are equal and the positive part here is here because of the net profit their capital is appreciating the capital which was 56,755 that has become now 83,115; 83,115. So, capital is appreciating. So, it means it is a good sign for the firm and then sundry creditors who are the suppliers of the firm they are worth of 6,300 rupees not a big deal not a big figure it is acceptable then you have outstanding salaries which we have to pay later on.

So, all the liabilities are 90,915 all the assets which include your land machinery buildings plant and then sundry debtor credit sales figure is only just you can say about 14,500 it is not a big figure if you compare it to the sales, we have taken the sales figure is of how much 98,780 almost one lakh of the sales and 15 percent of the sales are on credit that is not a big deal that is acceptable figure.

And bad debts we have also accounted for closing stock is also not left much cash is also not very high that is a good sign and there other assets are also there. So, by taking this in to account we have prepared the balance sheet for this company and we have seen that yes both the sides are balanced and their financial position is good and means there is no doubt that whatever the total investment they are making by say borrowing money or say by way of the capital by having the resources from the sundry creditors or may be by some outstanding salaries, I told you that this is basically a spontaneous finance because employees work for thirty days in a year and they not ask for any salary till 30 days. So, it means to say spontaneous finance you can call it as a sundry creditors also it is a spontaneous finance this is the long term finance. So, in this firm we have the 2 sources that is the long term finance and spontaneous finance there are no funds from the short term finance and if you look at the liability and the asset side position than both the sides are equal it means the balance sheet of this firm is balanced.

So, some now little more complex kind of the problems we will be talking now we will continue talking because financial statements preparation is the most important part in this subject. So, we will learn from every angle what are the different ways and means from every angle we will try to learn to prepare the different kind of financial statements and then once we are total well worst with the process of preparing the financial statements then I will take you to the next step that is the analysis of the financial statements.

So, in the next lectures also or couple of lectures also we will be talking about the more financial statements more profit and loss account more balance sheets of the different types till then.

Thank you very much.