ACC 101 LECTURE:

ADJUSTMENTS TO STATEMENT OF PROFIT AND LOSS AND STATEMENT OF FINANCIAL POSITION ACCOUNT

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CONTENTS

ADJUSTMENT OF INVENTORIES

- The monetary value of inventories left unsold at the end of accounting period is usually referred to as closing inventories. The composition of closing inventories are

a. Closing Inventory of raw materials
b. Closing inventory of work in progress
c. Closing Inventory of finished goods

Closing inventories are usually reflected in the note to the account in most questions. But when closing inventory appears in the trial balance the treatment will be different.

TREATMENT OF CLOSING INVENTORY APPEARING IN THE TRIAL BALANCE

Illustration 1

	DR
Inventory 1/1/2024	50,000
Inventory 31/12/2024	66,000
Purchases	964,000

Required

Prepare the statement of profit or loss account and the statement of financial position account Extract.

Solution:
Note: Closing inventory appearing on the debit side of the trial balance shows that the closing inventory had already been adjusted through purchases before extracting trial balance and therefore requires no further adjustment in the SOPL but will be shown on the asset side (CA) of SOFP.

Dr Statement of profit or loss extract Cr

	#	#
Opening Inventory	50,000	
Purchase	964,000	
Goods available		1,014,000
Closing Inventory		-
Cost of good sold		1,014,000

Statement of financial position (Extract)	
	#
	Current Asset Closing Inventory 66,000

Closing Inventory appearing below the trial balance as note to the account

- Anytime closing inventory is included in the note to the account the implication is that it has not been treated in the book prior to the extraction of the trial balance thus double entry principle has not been complied with. The two fold effect of this will be:

  (i) Closing inventory will be shown as a deduction against goods available for sale in the SOPL to produce the cost of goods sold.

  (ii) Closing inventory will be shown in the current asset side of the SOFP as asset owned by the business.

<u>Illustration 2</u>

Trial Balance Extract

	DR	CR
	#	**#**
Inventory 1/1/2024	300,000	
Purchases	1,900,000	

Note

Closing Inventory as at 31/12/2024 amounted to #155,000. Prepare the SOFP and SOPL extract.

Solution to illustration 2

Statement of profit or loss account			
	#		#
Opening Inventory	300,000		
Add Purchases	1,900,000		
Goods Available	2,200,000		
Closing Inventory	(155,000)		
	2,045,000		

Statement of Financial Position		
	Current Asset	#
	Inventory	155,000

Opening Inventory Appearing below the Trial Balance

Ordinarily opening inventory should appear in the trial balance but when this fails to happen, the meaning is that the closing inventory of the previous period was extended from the current year’s inventory account. To effect this adjustment:

1. Add the reported figure of the opeing inventory shown in the note to the account to purchases in the trading account.
2. Debit inventory account
3. It will increase the closing inventory figure which will be shown in the current asset side of the balance sheet

Illustration 3

Trial Balance

Statement of Profit or Loss account		
	DR	CR
	#	
Purchases 000	33,	
Carriage Inward	2,300	

Note: Inventory as at 1/1/2024 amounted to #6000

Inventory as at 31/12/2024 amounted to #4,000

You are required to prepare the necessary final adjustments and final accounts.

Solution 3

Statement of Profit or Loss Account		
	#	#
Opening Inventory	6000	
Purchases	33,000	
Carriage Inward	2,300	
	41,300	
Closing Inventory (#6,000 + #4,000)	10,000	
	31,300	

Statement of Financial Position		
	Current Asset	#
	Inventory (6000 +4000)	10,000

ADJUSTMENT FOR BAD DEBTS

Bad debts are debts that are partly or wholly irrecoverable having regard to the circumstances of the debtors, e.g. bankruptcy, death or disappearance of the debtor.

It is usually treated as an expense in the income statement for some older debts, there may be little or no prospect of the business being paid, usually because the customer has gone bankrupt or is out of business for one reason or another, a business might decide to give up expecting payment and to write off the debt.

Note: Bad debt in a trial balance is dealt with once in the income statement by debiting it to income statement. The reason been that it has been adjusted against aggregate debtors before transfer was made to the income statement and need no further adjustment in the balance sheet, But if the bad debt is shown in the additional information the interpretation is that it has not been treated in the books and therefore required double treatment in the income statement and in the SOFP.

Illustration 4

The following entries were found in the Trial balance of Titi, a sole trader as at 31st of December, 2020.

Year to 31st December	Amount Owed at the end of the year (net of Bad debt)	Bad debt written off duing the period
	#	#
5-3	800,000	120,000
22-5	500,000	100,000
24-9	200,000	80,000

You are required to make appropriate accounting entries in the book of Titi and in the financial statement extract as at the end of the period.

Solution 4:

Note: The treatment was limited to debit entry in the SOPL and no further treatment in the SOFP, this is because the appropriate adjustments had been made earlier in the receivable accounts and therefore required no further adjustment in the SOFP.

BAD DEBT ACCOUNT			
	#		#
5/3 Debtors	120,000	Income Statement	300,000
22/5 Debtors	100,000		
24/9 Debtors	80,000		
	300,000		300,000

Statement of Profit or Loss Account			
	#		#
Bad Debt	300,000		

Illustration 5

The trial balance extract below was found in the book of Gbenga enterprises

	Dr	Cr
	#	#
Receivable	50,000	

Bad debt during the period was #3600. You are required to make appropriate entries in the financial statement.

Solution to Illustration 5

Statement of Profit or Loss Acount		
	#	
Bad debt	<u>3,600</u>	

Statement of Financial Position		
		#
	Current Assets	
	Receivables	50,000
	Less: Bad debts	<u>3,600</u>
<u>47, 400</u>		<u>47, 400</u>

Illustration 6: Provision for Bad debt Increase

The trial balance extract below was obtained from the books of Emmy enterprises as at the close of the business on 31-12-2024

	DR	CR
	#	#
Receivables	600,000	
Provision for bad and		
Doubtful debt 1/1/24		23,000
Bad debt written off	33,000	

Note: Increase the provision for bad debt by #4,000. Required: Prepare the statement of profit or loss and statement of financial position account.

Solution 6

Statement of Profit or Loss Account (Extract)		
	#	
Bad Debt written off	33,000	
Provision for Bad and Doubtful debt(Increase)	4,000	
	37,000	

Statement of Financial Position		
		#
	Receivable	600,000
	Less: Provision for BD (#23,000 + #4,000)	27,000
		573,000

ADJUSTMENTS FOR DRAWINGS

Drawings is defined as the value of all the goods, cash or any other property of the incorporated business taken out of the business by its owner for personal use.

Illustration 8

The following trial balance was extracted from the book of Ojogbon enterprises, a sole trader on December 31, 2024.

	DR	CR
	#	#
Sales	-	60,000
Purchases	46,000	
Salaries	2,000	
Cash at Bank	25,000	
Trade Payable		16,000
General Expenses	6,000	
Drawing	37,000	
Capital	………..	40,000
	116,000	116,000

Solution Illustration 8

Statement Of Profit or Loss Account			
	#		#
Purchases	46,000	Sales	60,000
Less: Closing Inventory	(3,500)		
Cost of Good Sold	42, 500		
Gross Profit	17, 500		
	60,000		60,000
		Gross Profit bal c/d	17,500
Less Expenses			
Salaries	2,000		
General Expenses	6,000		
Net Profit	9,500		…….
	17,500		17,500

continuation

Statement of Financial Position			
	#		#
Capital	40,000	Non Current Asset	-
Add: Net Profit	9,500	Current Asset	
	49,500	Inventory	3,500
Less Drawings	37,000	Cash at bank	25,000
	12,500		28,500
Current Liabilities			
Trade Payable	16,000 28,500		…………. 28,500

Statement of Financial Position			
	#		#
Non Current Asset	-	Capital	40,000
Current Asset		Add: Net Profit	9,500
Inventory	3,500		49,500
Cash at bank	25,000	Less Drawings	37,000
	28,500		12,500
		Current Liabilities	
	…………. 28,500	Trade Payable	16,000 28,500

ACCRUAL AND PREPAYMENT

- Accruals: Accruals concept states that revenue and expenditure are recognized as they are earned or incurred and dealt with in the statement of profit and loss for the period to which they relate and not the period they are paid and received. It can be divided into Accrued income and accrued expenses.

Accrued Revenue

These are income which are due in respect of current trading period but such income has not been received at the close of final account preparation. It is also referred to as outstanding income e.g. Rent Receivable, Commission Receivable. It represents an item, the use of which the firm has already dispensed with during the current accounting period, but which will not be received until the next accounting period. If we do not make an adjustment the profit for the current period will be understated.

Illustration :

Mr. Oloowolohun write up his ledger account as at 31st December 2019 showing the transfer to the final accounts. He earned commission from sales for the year 31st December, 2019 #8500, owing as at 31st December, 2018 #800, Owning as at 31st December 2019 #1,450.

Solution

Note: Accrued during the year (Income) ADD, Accrued Last Year (Subtract), Accrued Income will be CA, Accrued Expenses will be CL.

Dr COMMISSION RECEIVED Cr

	#		#
Bal b/f	800	Cash	8,500
Profit/loss	9,150	Bal b/d	1450
	9,950		9,950

The balance of #1450 should be treated as current asset in the statement of financial position

ACCRUED EXPENSES: <u>Note Accrued expenses during the year will be added accrued expenses last year will be subtracted.</u>

- **Accrued Expenses**

These are expenses, which accrue but have not been discharged.

Write up the ledger of Abdul-Rahmon as at 31st December, 2019

Motor expenses paid for the year #15,000

Motor expenses owing at 31st December, 2018 #3000

Motor expenses owing at 31st December, 2019 #2,700

Dr Motor Expenses A/c Cr

	#		#
Cash	15,000	bal B/f	3,000
Bal c/d	2,700	profit and Loss	14,700
	17,700		17,700

The balance of #2,700 should be treated as current liability in the SOFP

PREPAYMENTS

Prepayment represents amount paid in current period for a subsequent period. Expenses can be paid in advance and income can also be received in advance. It can be referred to as prepaid or paid in advance.

a. Prepaid Expenses

These are expenses like rent, insurance etc. which are paid in advance for subsequent period. Only the expenses for the period must be charged to the statement of profit and loss account.

Illustration : Prepaid Expenses

Write up the ledger account of Mr. Ajayi as at 31st December 2019. He paid insurance of #5,000 for the year ended 31st December 2019. Prepaid as at 31st December, 2018 #740, prepaid as at 31st December, 2019 #1,000.

Solution

Note: #1,000 will be taken to current Asset, Prepaid during the year will be subtracted, Prepaid last year will be added.

Dr Insurance Account Cr

	#		#
Cash paid	5,000	p or L	4,740
Bal b/f	740	Bal b/d	1000
	5,740		5,740

PREPAID INCOME REVENUE

These are the income received by the organization during the current period which relates to the next trading period. e.g Rent received in advance.

Illustration : note #6830 will treated as a current liability

Write up a ledger account of Mr. Shinayomi as at 31st December, 2019. He earned commission of #30,000 for the year 31st December 2019. Prepaid at 31st December 2018 #7,700. Paid in advance as at 31st December, 2019 was #6,830.

Solution

Dr COMMISSION RECEIVABLE Cr

	#		#
Profit or Loss	30,870	Cash	30,000
BAL B/D	6830	Bal b/F	7,700
	37,700		37,700

Summary of Prepayment and Accrued

	EXPENSES	INCOME	
ACCRUED	CURRENT LIABILITIES	CURRENT ASSET	
	CURRENT YEAR= ADD LAST YEAR = SUBTRACT	CURRENT YEAR= ADD LAST YEAR = SUBTRACT	
PREPAYMENT	CURRENT ASSET	CURRENT LIABILITIES	
	CURRENT YEAR= SUBTRACT LAST YEAR = ADD	CURRENT YEAR= SUBTRACT LAST YEAR = ADD	