

CHAPTER TWELVE

END OF PERIOD ADJUSTMENT

CHAPTER OUTLINE

- ❖ Closing Stock
- ❖ Drawings
- ❖ Prepayments
- ❖ Accruals
- ❖ Provision for bad and doubtful debts
- ❖ Provision for discount on debtors
- ❖ Bad debts.

Learning Objectives:

At the end of this chapter, the student should be able to:

- Explain what constitutes end of period adjustments.
- Differentiate between necessary adjustments in the final accounts.
- Carry out end of period adjustments.

12.1 END OF PERIOD ADJUSTMENTS.

To achieve a true view of the transactions of a business, it is necessary to make adjustments for items not dealt with or not completely dealt with in the ledger before the extraction of the trial balance. Information regarding such adjustments are always shown as additional information in the question.

Two concepts which are used to support this adjustment process are accrual and matching concepts. Recall that in chapter two of this book, accrual concept was discussed. It states that income should be recognized when

earned, not when received and expenses should be recognized or recorded when incurred, not when paid. The recognition of this concept gives rise to prepayments and accrued expenses. Simple implication of this is that if a company sells goods worth N50, 000 in year 2011 to a customer, the revenue is earned in 2011, whether the cash is received that year or not. This transaction must be reported in the 2011 statement of comprehensive income.

Matching concept on the other hand, simply states that for any accounting period, the earned revenue should be matched with the cost that earned it. Every income in a particular period must be matched with the related expenses for that period.

End of period adjustments therefore, arise as a result of one or a combination of the above issues which cannot be ignored, otherwise the fairness of the information presented will be undermined.

For easy comprehension, the end of period adjustment is presented in segments below:

12.2 CLOSING STOCK

Meaning: This refers to the remaining goods meant for resale at the end of an accounting period; or simply put, the unsold stock at the end of the period.

Treatment in statement of comprehensive income: This is deducted from cost of goods available for sale to arrive at cost of goods sold or it should be added to the net sales if the sale value of the goods is known. The more acceptable treatment is to deduct it from the cost of goods available for sale.

Treatment in statement of financial position: Closing stock is shown as a current asset.

Illustration 12.1. If the closing stock of Adewale Enterprises as at the end of the accounting period is N100, 000. Other necessary information includes:

Turnover	N 350,000
Opening stock	75,000

Purchases	120,000
Carriage Inwards	30,000
Sales return	15,000

You are required to show the treatment of the closing stock in the statement of comprehensive income and in the statement of financial position.

Solution 12.1

Adewale Enterprises'
Statement of Comprehensive Income for the period ending.....

	N	N
Turnover		350,000
Less Sales return		(15,000)
Net sales		335,000
Less Cost of sales:		
Opening stock	75,000	
Add purchases	120,000	
Add Carriage Inwards	30,000	
Cost of goods available	225,000	
Closing stock	(100,000)	
Cost of goods sold		(125,000)
Gross Profit		210,000

Adewale Enterprises'
Statement of Financial Position as at

	N	N
Assets:		
Non-Current Assets:		
Current Assets:		X
Stock		100,000

12.3 DRAWINGS

Drawings refer to value of goods or cash taken from the business for private use by the owner.

Treatment in the statement of comprehensive income: If drawings appear on the debit side of the trial balance, no further adjustment is required as it has already been treated but if it appears as additional

information, there is need to effect adjustment. If the drawing is in form of goods, it should be deducted from purchases or added to sales if the sales price is known. If it is cash withdrawn from cash till or bank and the necessary recording has been made, it has no effect on the profit but if the drawings are withdrawn from sales before recording the value then it should be added to sales figure for the day.

Treatment in the statement of financial position: Deduct the value of the drawings (if cash) from the capital to obtain owner's equity as at the date of statement of financial position.

Illustration 12.2. The extracts from the trial balance of Clinton Enterprises were as follows:

	N
Turnover	125,000
Opening stock	65,000
Purchases	80,000
Carriage Inwards	20,000
Sales return	(5,000)
Other expenses	5,000
Capital	150,000
Total Current Asset	100,000
Non-Current Asset (Total)	120,000
Total Current Liabilities	5,470,000

Additional information:

1. The closing stock is N50,000
2. Value of goods withdrawn by the owner for private use is N20,000
3. You are required to show the statement of comprehensive income and the statement of financial position from the above information.

Solution 12.2.

Clinton Enterprises' Statement of Comprehensive Income for the period ended.....

	N	N
Turnover		125,000
Sales return		(5,000)
Net sales		120,000
Less Cost of sales:		
Opening stock	65,000	
Add purchases	80,000	
Withdrawal (goods)	(20,000)	
Add Carriage Inwards	20,000	
Cost of goods available	145,000	
Less closing stock	(50,000)	
Cost of goods sold		(95,000)
Gross Profit		25,000
Other expenses		5,000
Net Profit		20,000

Clinton Enterprises' Statement of financial position as at

	Cost N	Acc. Depreciation N	Carrying Amount N
Non-Current Asset:			X
Current Assets:			100,000
Long Term Liabilities:			
Capital		150,000	
Add net Profit		20,000	
Less drawing		(20,000)	
Current liabilities			150,000
			70,000
			220,000

12.4 PREPAYMENTS

Prepayments can be expenses paid in advance i.e prepaid expenses (expenses already paid for but their benefits are not yet consummated) as at the end of the accounting period. The expenses relate to a future period. For instance, payment for rent made today could be to cover the next five years or more. It will be wrong to charge the total payment to the current accounting period, otherwise it will negate the matching concept.

Prepayments can equally be income received in the current period but which relates to future accounting period. i.e. income received but not yet due as at the end of the accounting period (advance income received or prepaid income). For instance, payment for electricity consumption in prepayment plat form. The entity receives the income even though they are yet to render the goods or services that the income represents.

Treatment in the statement of comprehensive income

a. Prepaid expenses: Determine the prepaid value and deduct it from total expenses shown in the trial balance. The difference is the expenses meant for the current period.

b. Advance income: Treat as in prepaid expenses above.

Treatment in statement of financial position.

a. Prepaid expenses: The value of prepaid expenses is shown as current asset.

b. Prepaid income: The value of income received in advance is shown as current liability in the statement of financial position.

Illustration 12.3.

Dokpesi Enterprises in addition to other expenses made for the business in 2011 accounting period paid N20, 000 to cover five years for insurance premium. You are required to prepare the insurance premium account, highlighting the prepaid expenses.

Solution 12.3

Dokpesi's
Insurance premium account

	N	N
2011 Bank	20,000	4,000
		Dec 31, 2011 P & L a/c
		Dec 31 bal c/d
	<u>20,000</u>	<u>16,000</u>
		<u>20,000</u>

Illustration 12.4.

Boboye started business on January 1, 2012. He prepares his final account on 31st December every year. On January 1, 2012 he paid for rent of N600, 000 by cheque to cover four years rent from that date.

You are required to show the necessary adjustments in Boboye's:

- (a). Bank account
- (b). Rent account
- (c). Statement of comprehensive income
- (d). Statement of financial position.

Solution 12.4.

Boboye's Bank account

(a)		N
	Jan 1, 2012 Rent	600,000
(b)		
	Boboye's Rent account	
	Jan 1, 2012	600,000
	Dec 31, 2012 P & L	125,000
	Dec 31, 2012 Bal c/d	475,000
	<u>600,000</u>	<u>600,000</u>

(c) Boboye's
Statement of comprehensive income for the year ended 31/12/2012

Gross Profit	N	XX
Rent	600,000	
Less Prepayment	<u>475,000</u>	125,000
Net Profit		<u>XX - 125,000</u>

(d) Boboye's
Statement of financial position for the year ended 31/12/2012

(d) Boboye's
Statement of financial position for the year ended 31/12/2012

Non-Current Asset	N	
Current asset	N	
Pre-paid rent		475,000
Long Term Liability		
Current Liability		
		XX
		XX
		XX

Illustration 12.5
Mr A. Solution in January 1, 2013 decided to rent part of his business premises to B Enterprises that paid N1,000,000 covering four years. You are required to show the necessary adjustments and recognition of this payment for the period concerned. (Note that this is a prepaid expenses to B Enterprises while it is a prepaid income to Mr A Solution.)

(a)

Mr A Solution's Bank Account	N	Jan 1 2013 Rent	1,000,000
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(b)

Mr. A Solution's Rent account	N	Jan 1, 2013	Bank 1,000,000
		Dec 31, 2013 Cash	250,000
		Dec 31, 2013 Bal/c/d	750,000
			<u>1,000,000</u>

(c) Mr. A Solution's
Statement of comprehensive income for the year ended Dec. 31, 2013

Gross profit	N	
Rent	N	1,000,000
Advance receipt		750,000
Net profit		<u>250,000</u>
		XX-250,000

(d) Mr A Solution's
Statement of Financial position (extract) as at Dec. 31, 2013

Non-current Asset	X	
Current Assets	XX	
Long term liability		
Current liability		<u>750,000</u>

12.5 ACCRUALS
This refers to expenses already consummated but not yet paid for or incomes due as at the end of accounting period but not yet received. They may be referred to as accrued expenses or accrued incomes.
Accrued expenses: These are expenses incurred for the accounting period but not yet paid for that must be recognized in the accounting period concerned in obedience to the accrual concept. For example, salaries owed to workers at the end of the accounting period. The unpaid salaries are expenses of the accounting year and should accordingly be included in the amount of salaries to be charged to the statement of comprehensive income. Note that the balance shown in the trial balance in respect of each expenses account is normally the actual amount of expenses paid during the period. If there are accruals or prepayments, they are usually shown as additional information.

Accrued Income: This is an income due for receipt in a particular accounting period but is not yet received; hence the business is being owed and is therefore a creditor.

Treatment in the statement of comprehensive income (SOI). Add the accrued expenses to the expenses shown on the trial balance to get the total expenses incurred. If it is accrued income, then add it to the income shown on the trial balance to obtain the total income earned.

Treatment in the statement of financial position. Show the accrued expenses as a current liability whereas the accrued income is shown as a current asset.

Illustration 12.5

XYZ Company rented its premises at an annual rental fee of ₦12, 000. At the end of December 2014, only ₦10, 000 was actually paid by the company leaving outstanding of ₦2, 000. You are required to adjust the rent account and show the amount that should be charged to profit and loss account.

Solution 12.5

XYZ'S Rent account				
		N	N	
Dec, 31 2014	Bank	10,000	Dec 31, 2014 P & L	12,000
Dec, 31 2014	Bal c/d	<u>2,000</u>		
		<u>12,000</u>		<u>12,000</u>
			Jan 1, 2015 Bal b/d	2,000

Note: The balance b/d of ₦2,000 represents the amount owed by the company as at the end of the accounting period.

Illustration 12.6

Obollo Trading Enterprises sublet its premises for a monthly rent of ₦4,000 which amounts to ₦48,000 per annum. At the end of December 2012, the trial balance showed that only ₦40,000 has been received for the accounting period.

You are required to show the rent receivable account, indicating clearly the amount of income from rent that should be credited to P or L account.

Solution 12.6

Obollo Trading Enterprises' Rent receivable account				
		N	N	
Dec 31, 2012	P & L	48,000	Dec 31, Bank	40,000
			Dec 31 bal c/d	8,000
		<u>48,000</u>		<u>48,000</u>

The accrued income of ₦8, 000 shown as balance c/d in the account will be treated as a current asset in the statement of financial position.

Illustration 12.7

Assuming Jomo Enterprises' rent is ₦720, 000 per annum. As at the trial balance date of 31st December, it was shown in the trial balance that the rent paid for the year is 600, 000. Additional information number 2 equally stated that two months' rent is accrued but not yet paid.

You are required to show the presentation of the above information in the final account of Jomo Enterprises.

Solution 12.7

Journal		
	Dr	Cr
Dec 31	N	N
Rent Account	120,000	
Rent receivable A/c		120,000
Being two months' rent due but not paid.		

Rent Account

Date	Particulars	Folio	Amount ₦	Date	Particulars	Folio	Amount ₦
Dec 1	Bank		600,000	Dec 31	SOCI		720,000
Dec 31	Bal (Amount Accrued) c/d		120,000				
			720,000				720,000
				Jan 1	Bal.(amount accrued) b/d		120,000

Jomo Enterprises'

Statement of comprehensive income for the year ended Dec. 31.....

Gross profit		X
Less Expense:		
Rent	600,000	
Add: Accrual	120,000	720,000

Jomo Enterprises'

Statement of financial position as at Dec. 31.....

Assets:	
Non-Current Asset:	X
Current Assets:	
Rent Pre Paid	X
Current Liabilities:	
Rent Accrued*	120,000

12.6 PROVISION FOR BAD AND DOUBTFUL DEBTS

This is the amount of money set aside from the profit of the business to take care of estimated irrecoverable debt.(bad) or debts whose recoverability is not guaranteed (doubtful)

Treatment in the statement of comprehensive income: Charge the provision as an expense in the first year. In the second and subsequent years, compare the current provision with the former. Increase in provision is

Treatment in the statement of financial position: Deduct the year's provision from the receivables to get the realizable value.

12.7 PROVISION FOR DISCOUNT ON DEBTORS

This is an amount of money set aside from the profits of the business to take care of estimated cash discounts allowable.

Treatment in the statement of comprehensive income: Treat as in provision for bad and doubtful debts.

Treatment in the statement of financial position: Treat as in provision for bad and doubtful debts above.

12.8 BAD DEBTS

These are debts or receivables that are 100% irrecoverable as at the end of the accounting period.

Treatment in the statement of comprehensive income: Add the bad debt shown on the trial balance to that given in additional information, and then charge the sum as an expense for the period.

Treatment in the statement of financial position: Take no action if bad debt appears in the trial balance but if it is given as additional information, then deduct it from debtors or receivables to get the value of debtors.

Comprehensive illustration.

The following trial balance was extracted from the books of Buhari Stores as at 31st December, 2011.

	Dr	Cr
Purchases	460,500	
Capital		125,000
Returns Outward		7,750
Sales		647,375
Drawings	17,625	
Discount Allowed	12,750	
Receivables	56,250	

Drawings	17,625	
Discount Allowed	12,750	
Receivables	56,250	
Freehold Premises	95,000	
Returns Inward	9,125	
Discount Received		10,500
Stock 1 st Jan. 2011	42,875	
Payables		71,375
Motor Vehicles	15,000	
Cash at bank	8,625	
Salaries	50,750	
Furniture	3,125	
Provision for depreciation on motor vehicle		5,625
Provision for depreciation on Furniture		1,250
Carriage Inwards	27,750	
Stationery	5,437.50	
General Expenses	39,500	
Carriage Outward	12,875	
Provision for bad/doubtful debt		2,500
Electricity	6,125	
Insurance	2,250	
Bad debt	500	
Rent received		4,750
Commission received		14,000
Bank fixed deposit (deposited on 1 July 2010)	25,000	
Interest received on deposit		937.50
	<u>891,062.50</u>	<u>891,062.50</u>

Additional Information.

- Closing stock as at 31st December 2011 is N39,750
- Prepaid expenses includes: Insurance 500
General Expenses 625
- Accrued Expenses: Salaries 2,250
Electricity 1,000
- Additional bad debt to be written off is N750.
- Adjust provision for bad debt to 4% of trade receivables balance and

- raise a provision for discount allowable to 2.5% of trade receivables.
- Interest on the fixed deposit is outstanding for October – December 2011.
 - Depreciate non-current assets at the following rates:
 - Furniture at 10%
 - Motor Vehicle at 20%.
 - Rent received in advance was N 250
 - The following drawings were made but yet to be accounted for.

Cash	N3,750
Goods	N2,500

Required: Prepare:

- Buhari Stores Statement of Comprehensive Income
- Statement of Financial Position. Take note of all the necessary adjustments.

Solution: Comprehensive illustration

Buhari Stores'

Statement of Comprehensive Income for the year ended 31 December, 2011

	N
Revenue (Wk.1)	638,250
Cost of sales (Wk.2)	(481,125)
Gross Profit	157,125
Other Income:(Wk. 4)	31,155
	<u>188,280</u>
Other Expenses (Wk. 8)	(137,707)
Profit for the year	<u>50,573</u>

Workings 1: Computation of Revenue

	N
Sales	647,375
Less sales Returns	9,125
Revenue	<u>638,250</u>

Workings 2: Computation of cost of sales

	N
Opening stock	42,875
Purchases (Wk.3)	458,000
Return outward	(7,750)
Carriage inward	27,750
Goods available for Sale	520,875
Closing stock	(39,750)
Cost of goods sold	<u>481,125</u>

Workings 3: Computation of purchases

	N
Purchases per trial balance	460,500
Less Goods withdrawn	2,500
Net Purchases	<u>458,000</u>

Workings 4: Other Incomes:

Discount received	10,500
Rent (Wk.5)	4,500
Commission received	14,000
Interest on fixed deposit (Wk. 6)	1,875
Decrease in provision for bad debts (Wk.7)	280
	<u>31,155</u>

Workings 5: Computation of Rent Received

Rent as per trial balance	4,750
Less; Rent received in advance	250
	<u>4,500</u>

Workings 6: Computation of Interest on fixed deposit.

	N
Interest received as per trial balance	937.50
Add Accrued Interest Oct – Dec 2011 (15% * 25,000* 3/12)	937.50
	<u>1,875</u>

Workings 7: Computation of decrease in provision for bad debts.

	N
Receivables as per trial balance	56,250
Less additional bad debt written off	750
	<u>55,500</u>
Provision for bad debt (previously) as per trial balance	2,500
Provision for bad debt currently (4% *55,500)	2,220
Decrease in provision for bad debt	280

Workings 8: Other expenses.

	N
Discount allowed	12,750
Stationery	5,437.50
Salaries (50,750+2,250)	53,000
Carriage outward	12,875
Electricity (6,125 + 1000)	7,125
General expenses (39,500 – 625)	38,875
Insurance (2,250 + 500)	2,750
Bad Debt (500 + 750)	1,250
Provision for discount allowed (wk.9)	1,332
Depreciation	3,000
Motor vehicle (20% * 15,000)	3,000
Furniture (10% * 3,125)	312.50
	<u>138,707</u>

Workings 9: Calculation of provision for discount allowed

Trade Receivables (Wk.7)	55,500
Less provision for bad debt	2,220
	<u>53,280</u>
Provision for discount allowable (2.5% * 53,280)	<u>1,332</u>

Workings 10: Computation of depreciation

		N
	Motor vehicle	Furniture
As per trial balance	5,625	1,250
Depreciation	10% X 3125	312.50
	20% X 15,000	3,000
Total accumulated depreciation	<u>8,625</u>	<u>1,562.50</u>

Buhari Stores'

Statement of Financial Position as at 31st December, 2011

	N	N	N
	Cost	Accumulated Depreciation	Carrying Amount
ASSETS:			
Non-Current Assets:			
Freehold Premises	95,000	-	95,000
Furniture	3,125	1,562.50	1,562.50
Motor Vehicle	15,000	8,625	<u>6,375</u>
15% Fixed Deposit			102,937.50
Current Assets:			25,000
Inventories		39,750	
Trade receivables (Wk 7)	55,500		
Provision for bad debts (Wk 7)	(2,220)		
Provision for discount (Wk 9)	(1,332)		
Prepayments (500 + 625)		51,948	
Accrued on fixed Deposit (Wk 6)		1,125	
Bank (8,625 - 3,750)		937.50	
Total Assets.		<u>4,875</u>	<u>98,635.50</u>
EQUITY AND LIABILITIES			
Capital as at 1 January 2011			125,000
Net Profit for the year			<u>50,573</u>
Less Drawing (17,625 + 2,500 + 3,750)			(23,875)
Current Liabilities:			<u>151,698</u>
Trade and other payables		71,375	
Accruals (2,250 + 1,000)		3,250	
Advance rent received		<u>250</u>	
			<u>74,875</u>
			<u>226,573</u>