13

FINANCIAL STATEMENTS – AN INTRODUCTION

In the previous lessons you have learnt how to record the business transactions in various books of accounts and posting into ledger. You have also learnt about balancing the account and preparing the trial balance. One of the most important purposes of accounting is to ascertain financial results, i.e., profit or loss of the business operations of a business enterprise after a certain period and the financial position of it on a particular date. For this certain financial statements are prepared which are termed as income statement (i.e. Trading and Profit & Loss Account) to know what the business has earned during a particular period and the Position Statement (i.e. Balance Sheet) to know the financial position of the business enterprise on a particular date.

In this lesson you will learn about the financial statements that are prepared by a business unit for profit.

OBJECTIVES

After studying this lesson you will be able to :

- explain the meaning and the objectives of financial statements;
- classify the financial statements into Trading and Profit & Loss Account and Balance Sheet;
- distinguish between capital expenditure and revenue expenditure, capital receipts and revenue receipts;
- explain the purpose of preparing Trading Account and Profit and Loss Account;
- draw the format of Trading Account and Profit and Loss Account;
- explain the Balance Sheet.

13.1 FINANCIAL STATEMENTS : MEANING AND OBJECTIVES

When a student has studied for a year, he/she wants to know how much he/she has learnt during that period. Similarly, every business enterprise wants to know the result of its activities of a particular period which is generally one year and what is its financial position on a particular date which is at the end of this period. For this, it prepares various statements which are called the financial statements.

> Financial statements are the statements that are prepared at the end of the accounting period, which is generally one year. These include income statement i.e. Trading and Profit & Loss Account and Position statement i.e. Balance Sheet.

Objectives of financial statements

Financial statements are prepared to ascertain the profits earned or losses incurred by a business concern during a specified period and also to ascertain its financial position at the end of that specified period.

Financial statements are generally of two types (a) Income statement which comprises of Trading Account and Profit & Loss Account, and (b) Position Statement i.e., the Balance Sheet.

Following are the objectives of preparing financial statements: -

1. **Ascertaining the results of business operations**

   Every businessman wants to know the results of the business operations of his enterprise during a particular period in terms of profits earned or losses incurred. Income statement serves this purpose.

2. **Ascertaining the financial position**

   Financial statements show the financial position of the business concern on a particular date which is generally the last date of the accounting period. Position statement i.e. Balance Sheet is prepared for this purpose.

3. **Source of information**

   Financial statements constitute an important source of information regarding finance of a business unit which helps the finance manager to plan the financial activities of the business and making proper utilisation of the funds.

4. Helps in managerial decision making

The Manager can make comparative study of the profitability of the concern by comparing the results of the current year with the results of the previous years and make his/her managerial decisions accordingly.

5. An index of solvency of the concern

Financial statements also show the short term as well as long term solvency of the concern. This helps the business enterprise in borrowing money from bank and other financial institutions and/or buying goods on credit.

Capital Expenditure and Revenue Expenditure, Capital Receipts and Revenue Receipts

The preparation of Trading Account and Profit and Loss Account requires the knowledge of revenue expenditure, revenue receipts and capital expenditure and capital receipts. The knowledge shall facilitate the classification of revenue items and put them in the Trading account and Profit and Loss Account on one hand and prepare Balance Sheet based on capital items (expenditure as well as receipts) on the other hand.

Capital Expenditure refers to the expenditure incurred for acquiring fixed assets or assets which increase the earning capacity of the business. The benefits of capital expenditure to the firm extend to number of years. Examples of capital expenditure are expenditure incurred for acquiring a fixed asset such as building, plant and machinery etc.

Revenue expenditure, on the other hand, is an expenditure incurred in the course of normal business transactions of a concern and its benefits are availed of during the same accounting year. Salaries, carriage etc. are examples of revenue expenditure.

There is another category of expenditure called deferred revenue expenditure. These are the expenses incurred during one accounting year but are applicable wholly or in part in future periods. These expenditures are otherwise of a revenue nature. Example of deferred revenue expenditure are heavy expenditure on advertisement say for introducing a new product in the market, expenditure incurred on research and development, etc.

Table 13.1 Difference between capital expenditure and revenue expenditure

Basis of Difference	Capital Expenditure	Revenue Expenditure
1. Purpose	It is incurred for acquiring of fixed assets.	It is incurred for the maintenance of fixed assets.
2. Earning capacity	It increases the earning capacity of the business.	It helps in maintaining the earning capacity of the business intact.
3. Periodicity of benefit	Its benefits are spread over a number of years.	Its benefits accrue only in one accounting year.
4. Placement in financial statements	It is an item of Balance Sheet and is shown as an item of asset.	It is an item of Trading and Profit and Loss Account and is shown on the debit side of either of the two.
5. Occurrence of expenditure	It is non-recurring in nature.	It is usually a recurring expenditure.

Capital and Revenue Receipts

Capital receipts are receipts which do not arise out of normal course of business. Examples of such receipts are sale of fixed assets, and raising of loans etc. Such receipts are not treated as income of the enterprise.

Revenue receipts are receipts which arise during the normal course of business, Sale of goods, rent from tenants, dividend received, etc. are some of the examples of revenue receipts. They are the items of incomes of the business entity.

Table 13.2 Distinction between Capital Receipts and Revenue Receipts

Basis of difference	Capital Receipt	Revenue Receipt
Source	Receipts that do not arise during the normal course of business.	Receipts that arise during the normal course of business.
Nature	These are of capital nature and hence are not treated as items of income of the business.	These are of revenue nature and hence are treated as items of income of the business.
Occurrence	These are of non-recurring in nature.	These are recurring in nature.

INTEXT QUESTIONS 13.1

I. Classify the following items of expenditure into capital expenditure revenue expenditure and deferred revenue expenditure

(i) Amount spent on purchase of Machine.

(ii) Expenditure incurred on repairs of building.

(iii) Heavy expenditure on advertisement to introduce a new product in the market.

(iv) Purchase of Motor Vehicle for business use.

II. One important objective of financial statements is to ascertain the results of business operations. List the other objectives of the financial statements :

(a) .....

(b) .....

(c) .....

(d) .....

13.2 TRADING ACCOUNT

Income statement consists of Trading and Profit and Loss Account. Let us first study the Trading Account. A business firm either purchases goods from others and sells them or manufactures and sells them to earn profit. This is known as trading activities. A statement is prepared to know the results in terms of profit or loss of these activities. This statement is called Trading Account.

Trading Account is prepared to ascertain the results of the trading activities of the business enterprise. It shows whether the selling of goods purchased or manufactured has earned profit or incurred loss for the business unit. Cost of goods sold is subtracted from the net sales of the business of that accounting year. In case the total sales value exceeds the cost of goods sold, the difference is called Gross Profit. On the other hand, if the cost of goods sold exceeds the total net sales, the difference is Gross Loss. All accounts related to cost of goods sold such as opening stock, net purchases i.e. purchase less returns outward, direct expenses such as wages, carriage inward etc. and closing stock with net sales (i.e. Sales minus Sales returns)

are taken to the Trading Account. Then this account is balanced. Credit balance shows the gross Profit and debit balance shows the gross loss.

It is necessary to understand the meaning of cost of goods sold before preparing Trading Account.

Cost of goods sold and gross profit

A business enterprise either purchases goods or manufactures goods to sell in the market. Cost of goods sold is computed to know the profit earned (Gross Profit) or loss incurred (Gross Loss) from the trading activities of a business unit for a particular period.

Cost of goods sold = the amount of goods purchased + expenses incurred in bringing the goods to the place of sale or expenses incurred on manufacturing the goods (called direct expenses).

In case there is a stock of goods to be sold in the beginning of the year or at the end of the year, the cost of goods is calculated as follows :

Cost of goods sold = Opening stock + Net purchases + All direct expenses – Closing stock

Gross Profit = Net sales – Cost of goods sold

Illustration 1

Calculate the cost of goods sold from the following information :

	Rs
Opening stock	10000
Closing stock	8000
Purchases	80000
Carriage on purchases	2000
Wages	6600

Solution :

Cost of goods sold = opening stock + purchases + direct expenses (carriage on purchases + wages) – closing stock

= Rs. [10000 + 80000 + 8600 (i.e. 2000 + 6600) – 8000]

= Rs. 90600

Illustration 2

Calculate cost of goods sold and gross profit from the following information.

Sales	Rs. 62500
Sales Returns	Rs. 500
Opening Stock	Rs. 6400
Purchases	Rs. 32000
Direct Expenses	Rs. 4200
Closing Stock	Rs. 7200

Solution :

Net sales		Rs.
(Sales-Sales Returns i.e. 62500 – 500)		62000
Less : Cost of goods sold	Rs.	
Opening Stock	6400	
Add Purchases	32000	
Add Direct Expenses	4200	
Less Closing Stock	(7200)	35400
		26600

Gross profit = Net sales – cost of goods sold

= 62000 – 35400 = 26600

Illustration 3

From the following information for the year ending 31st March, 2006 furnished by Mr. Vikram, a trader, calculate cost of goods sold and also calculate Gross Profit/Gross Loss of business.

	Rs
Sales	120000
Purchases	80000
Octroi	1600
Carriage on purchases	4500
Purchase Returns	2400
Opening Stock	27600
Closing Stock	32400

Solution :

		Rs
Cost of goods sold :		
Opening stock		27600
Add Net Purchases		
(Rs 80000 – Rs 2400)		77600
Add carriage on Purchases		4500
Add Octroi		1600
Cost of goods available for sale		111300
Less closing stock		32400
Cost of goods sold		78900
Gross Profit :	**Rs**	
Sales	120000	
Less Cost of goods		
Sold	78900	
Gross Profit	41100	

Need of Trading Account

Trading Account serves the following purposes :

1. **Knowledge of Gross Profit**

   Trading Account gives information about Gross Profit. It is the profit earned by a business enterprise from its trading activities. The percentage of gross profit on sales reflects the degree of success of business.

2. **Knowledge of All Direct expenses**

   All direct expenses are taken to trading Account. Direct expenses are the expenses that can be directly attributed to purchase or manufacturing of goods for sale. Percentage of Direct expenses on sales of current year when compared with the same of previous years, helps the manager to exercise control over direct expenses.

3. **Precaution against future losses**

   Trading Account, if shows gross loss, reasons for this loss can be found out and necessary corrective steps can be taken.

Format of Trading Account

Trading Account
for the year ending ……..

Dr. Cr.

Particulars	Amount Rs	Particulars	Amount Rs
Opening Stock		Sales	
Purchases		Less: Sales Returns	
Less Purchase Returns		Closing stock	
Direct Expenses :		Gross loss transferred to	
Carriage Inward		Profit & Loss Account	
Freight			
Wages			
Fuel & Power			
Excise Duty			
Factory Rent			
Heating & Lighting			
Factory Rent & Insurance			
Work Managers Salary			
Gross Profit transferred to Profit & Loss Account			

Important items of Trading account

Important items of Trading account are :

1. Stock

Stock refers to the goods lying unsold on a particular date. It can be of two types:

(a) Opening stock and (b) Closing stock

(a) Opening stock

Opening stock refers to the value of goods lying unsold at the beginning of the accounting year. It is shown on the debit side of the Trading Account. In the first year of business there is no opening stock

(b) Closing Stock

It is the value of goods lying unsold at the end of the accounting year. It is valued at the cost price or market price whichever is less. It is shown on the credit side of the Trading Account.

2. Purchases

Purchases mean total items purchased for resale during the year. It can be both in cash and on credit. Purchases are shown on the debit side of the Trading account. These are always shown as net purchases i.e. amount of purchases returned (Purchase returns or return outwards) is deducted from the total amount of purchases made. Goods received on consignment basis are never treated as purchases. Similarly, goods received on 'sale or return' basis are never treated as purchases.

3. Sales

Sales refer to the total revenue from sale of goods of the business enterprise for which the Trading account is being prepared. It includes both cash sales and credit sales. These are recorded on the credit side of the Trading Account. Sales are shown at their net value i.e. sales return or returns inward is deducted from the total sales. Cash sales plus credit sales minus sales returns constitute net sales. Goods sent on 'sale or approval' are not part of sales until approval is received.

4. Direct Expenses

Direct expenses are the expenses that can be attributed directly to the purchase of goods or goods manufactured. These are shown on the debit side of the Trading Account. These are shown at the amount as shown in the Trial balance. For example, wages are recorded on the debit side of Trading Account at the amount shown in the Trial balance.

Important items of direct expenses

1. Wages i.e. wages relate to production. If amount under this head includes wages paid for construction of building or manufacturing of furniture for office it will be subtracted from the amount of wages.
2. Carriage Cartage Freight i.e. amount paid for carriage of goods purchased for sale or raw material purchased for manufacturing.
3. Other such direct expenses are customs and import duty, packing materials, gas, electricity water, fuel, oil, gas greese, heating and lighting, factory rent and insurance and many more such items.

5. Gross Profit/Gross Loss

It is the excess of net sales revenue over cost of goods sold. Gross Profit is equal to net sales minus cost of goods sold. If total of the credit side exceeds the total of debit side, the excess amount is termed as 'gross profit' and is shown

on the debit side of Trading Account. On the other hand if debit side is more than the credit side, the difference in amount is called gross loss and is shown on the credit side of the Trading Account.

Gross profit = Net sales – Cost of goods sold
Gross loss = Cost of goods sold – Net sales

INTEXT QUESTION 13.2

I. Fill in the blanks with suitable word/words :

1. Financial statements are generally of ..... Types.
2. Income statement comprises of ..... A/c and ..... A/c.
3. Trading Account is prepared to ascertain the ..... activities of the business.
4. The percentage of gross profit on sales reflects the degree of ..... of business.

II. Show the result in the following cases

(a) Sales – sales return =

(b) Purchases – purchases return =

(c) Total of the credit column of trading Account – total of the debit column of trading A/c =

(d) Total cost of goods sold – total sales =

13.3 TRANSFER ENTRIES

Before preparing Trading Account, closing transfer Journal entries are made in the Journal proper of the business enterprise. These journal entries are:

(a) For transferring debit balances

Trading A/c Dr.

To Opening stock

To Purchases

To Direct expenses

To Sales returns

(Transfer of debit balances from trial balance)

(b) For transferring credit balances

Sales A/c	Dr.
Closing stock A/c	Dr.
Purchase Returns A/c	Dr.
To Trading A/c	

(Transfer of credit balances from trial balance)

(c) For transferring gross profit

Trading A/c	Dr
To Profit & Loss A/c	

(Transferring of gross profit)

(d) For transferring gross loss

Profit & Loss A/c	Dr.
To Trading A/c	

(Transferring of gross loss)

Illustration 4

The ledger balances extracted at the close of a trading year on 31st March, 2006 are given as follows

Name of the Account	**Amount (Rs.)**
Opening stock	12,000
Purchases	52,000
Sales	74,000
Purchase Returns	2000
Carriage Inward	800
Wages	4200
Closing stock	13500

Make necessary journal entries in the journal proper.

Solution :

Journal

Date 2006	Particulars		LF	Dr Amount Rs	Cr Amount Rs
March 31	Trading A/c	Dr		69,000	
	To Opening stock A/c				12000
	To Purchases A/c				52000
	To Wages A/c				4200
	To Carriage Inward A/c				800
	(Transfer of debit balances to trading Account)				
March 31	Sales A/c	Dr		74000	
	Purchase Returns A/c	Dr		2000	
	Closing stock A/c	Dr		13500	
	To Trading A/c				89500
	(Transfer of credit items to trading account)				
March 31	Trading A/c	Dr		20500	
	To Profit & Loss A/c				20500
	(Transfer of gross profit to Profit & Loss Account)				

Illustration 5

Following are the balances of accounts extracted from the ledger of Rohit & Sons at the close of the year 2006.

	Rs
Stock (1.1.2006)	21,000
Purchases	140000
Sales	224000
Purchases Returns	8000
Sales Returns	12000
Wages	15000
Factory Power	12000
Stock (31.12.2006)	26500

Make closing journal entries in the journal proper.

Solution :

Journal

Date	Particulars		LF	Dr Amount Rs	Cr Amount Rs
2006 Dec. 31	Trading A/c	Dr		200000	
	To Opening stock A/c				21000
	To Purchases A/c				140000
	To Sales Returns A/c				12000
	To wages A/c				15000
	To Factory power A/c				12000
	(Closing entry of debit items transferred to Trading A/c)				
	Sales A/c	Dr		224000	
	Closing stock A/c	Dr		26500	
	Purchase Returns A/c	Dr		8000	
	To Trading A/c				258500
	(Transfer of credit balances to Trading A/c)				
	Trading A/c	Dr		58500	
	To Profit & Loss A/c				58500
	(Transfer of Gross Profit)				

INTEXT QUESTION 13.3

Write the "debit" if the items given below are to be taken to debit side of the Trading A/c and "Credit" they are taken to the credit side of the Trading Account.

(i) Closing sock

(ii) Carriage inward

(iii) Sales

(iv) Custom duty

13.4 PROFIT & LOSS ACCOUNT

As stated earlier, income statement consists of two accounts : Trading Account and Profit & Loss Account. You have seen that Trading account

is prepared to ascertain the Gross profit or Gross loss of the trading activities of the business. But these are not the final results of business operations of an enterprise. Apart from direct expenses, there are indirect expenses also. These may be conveniently divided into office and administrative expenses, selling and distribution expenses, financial expenses, depreciation and maintenance charges etc.

Similarly, there can be income from sources other than sales revenue. These may be interest on investments, discount received from creditors, commission received, etc. Another account is prepared in which all indirect expenses and revenues from sources other than sales are written. This account when balanced shows profit (or loss). This account is termed as Profit and Loss Account. The profit shown by this account is called 'net profit' and if it shows loss it is known as 'net loss'.

Format of Profit and Loss Account

Profit and Loss A/c of M/s .....….
for the year ended .....

Dr. Cr.

Particulars	Amount Rs	Particulars	Amount Rs
Gross loss b/d	—	Gross Profit b/d	—
Salaries	—	Discount Received	—
Rent, Rates & taxes	—	Commission Received	—
Insurance Premium	—	Dividend Received	—
Advertising	—	Interest on Investment	—
Commission paid	—	Rent Received	—
Discount Allowed	—	Net Loss transferred to capital account	—
Repairs & Renewals	—		
Bad Debts	—		
Establishment charges	—		
Travelling Expenses	—		
Bank Charges	—		
Sales Tax/Value added Tax	—		
Depreciation on fixed assets	—		
Net Profit transferred to Capital Account	—		

Some important items of Profit and Loss Account

As stated earlier Indirect expense are written on the debit side of Profit and Loss A/c. These can be classified under the following heads :

Debit items

1. Selling and distribution expenses

To materialise sales, the expenses incurred are called selling and distribution expenses. Examples are :

Carriage on sales/carriage outwards, advertisement, selling expenses, travelling expenses and salesman commission, depreciation of delivery van, salary of driver of the delivery van, etc.

2. Office and administration expenses

These are the expenses incurred on establishment and maintenance of office. Some of the expenses that may be under this head are: rent, rates and taxes, postage, printing and stationery, insurance, legal charges, audit fees, office salaries, etc.

3. Financial expenses

Finances are to be arranged for business. Expenses that are incurred in this connection are called financial expenses. Some of the financial expenses are: interest on loan, interest on capital, discount on bills, etc.

4. Depreciation and maintenance charges

The total value of a fixed asset like machinery, building, furniture, etc. is not charged to profit and loss account in the year in which it is purchased. Such assets help running business for a number of years to come. Therefore, only a part of the value of such assets is treated as an expense and is charged to Profit and Loss A/c as depreciation. Depreciation means decline in the value of fixed asset due to wear and tear, lapse of time, obsolescence, etc. Expense incurred on repairs and renewals and maintenance of assets are expenses other than depreciation under this category.

5. Other expenses

These are the expenses which are not included under the above mentioned heads of expenses for example, losses and expenses due to fire, theft etc.

Credit items

On the credit side of Profit and Loss Account, items of revenue and incomes are written. The first item on this side of Profit and Loss Account is the

gross profit transferred from trading account. Other items of the credit side are : (i) Interest on investment, fixed deposits etc. Rent Received, Commission Received, Discount Received, Dividend on shares.

Need of preparing Profit and Loss Account

Need of preparing profit and loss account by a business concern may be stated as follows :

(i) Knowledge of the net profit or net loss of a business for an accounting year.

(ii) Net profit of one year can be compared with net profits of previous year or years. It helps in ascertaining whether the business is being conducted efficiently or not.

(iii) Different expenses which are taken to Profit & Loss A/c in one year can be compared with the amounts incurred in previous year or years. This helps in ascertaining the need of applying control over such expenses.

INTEXT QUESTIONS 13.4

I. Following are the items of expenditure and income to be taken to Profit and Loss Account. Write 'E' for expenses and 'I' for income against each item.

(i) Interest on Fixed Deposit

(ii) Advertisement

(iii) Insurance Premium

(iv) Discount allowed by creditors

(v) Carriage on sales

II. State whether the following statements are 'true or false'. Write true for true statements and 'false' for false statements.

(i) Profit and Loss Account is prepared to ascertain the Gross Profit of a business unit.

(ii) Items of income are written on the credit side of Profit and Loss Account.

(iii) Net Profit calculated by preparing Profit and Loss Account is transferred to Trading Account.

(iv) Profit and Loss Account is prepared for an accounting year.

13.5 TRANSFER ENTRIES OF PROFIT AND LOSS ACCOUNT

Before preparing Profit and Loss Account as per the format given in the previous section, closing entries are made in the journal proper of the enterprise. Following journal entries are made :

(i) For transferring the indirect expense accounts :

Profit & Loss A/c Dr.

To Salaries A/c

To Insurance Premium A/c

To Bad Debts A/c

To Discount Allowed A/c

(Transfer of indirect expenses)

(ii) For transfer of items of incomes and gain

Interest on investment A/c Dr.

Rent Received A/c Dr.

Discount Received A/c Dr

To Profit & Loss A/c

(Transfer of items of income)

(iii) For transferring Net Profit :

Profit & Loss A/c Dr.

To Capital A/c

(Transfer of Net Profit to Capital A/c)

(iv) For transferring Net Loss

Capital A/c Dr.

To Profit & Loss A/c

(Transfer of Net Loss to Capital Account)

Illustration 6

The following balances were extracted from the books of Maya Gupta & Sons at the end of March 31, 2006. Make necessary closing entries as on that date :

Items	Dr. Balance (Rs)	Cr. Balance (Rs)
Gross Profit	65000	
Salaries	11500	
Audit fees	400	
Insurance Premium	800	
Interest received		1600
Discount (Cr)		460
Advertisement	1200	
Bad Debts	150	
Discount Allowed	340	
Depreciation	460	
Rent from tenants	—	1800

Solution :

Journal Entries

(i)	Profit & Loss A/c	Dr.	14850	
	To Salaries A/c			11500
	To Audit Fees A/c			400
	To Insurance Premium A/c			800
	To Advertisement A/c			1200
	To Bad Debts A/c			150
	To Discount Allowed A/c			340
	To Depreciation A/c			460
	(Transfer of items of expenses to profit & Loss A/c)			
(ii)	Interest A/c	Dr.	1600	
	Discount Received A/c	Dr.	460	
	Rent A/c	Dr.	1800	
	To Profit & Loss A/c			3860
	(Transfer of items of income to Profit & Loss A/c)			

(iii) Profit & Loss A/c Dr. 54010
To Capital A/c 54010
(Transfer of Net Profit to Capital Account)

Illustration 7

The following ledger balances were extracted from the books of Rabina & Brothers at the end of accounting year 31st March, 2006. Make journal entries to transfer these balances to prepare Profit & Loss A/c for the year ending 31st March, 2006.

	Rs
Gross Profit	65800
Salaries	8400
Rent paid	2400
Discount allowed	500
Interest on investments	3100
Advertisement	1800
Trading expenses	1600
Bad Debts	500
Depreciation	600
Insurance Premium	800
Commission received	2700

Solution :

Journal

Date	Particulars	LF	Dr Amount Rs	Cr Amount Rs
2007				
March 31	Profit & Loss A/c Dr		16600	
	To Salaries A/c			8400
	To Rent A/c			2400
	To Discount allowed A/c			500
	To Advertisement A/c			1800
	To Trading expenses A/c			1600

	To Bad Debts A/c			500
	To Depreciation A/c			600
	To Insurance Premium A/c			800
	(Transfer of accounts with debit balance to profit & Loss A/c)			
March 31	Commision A/c	Dr	2700	
	Interest A/c	Dr	3100	
	To Profit & Loss A/c			5800
	(Transfer of credit balance to Profit & Loss A/c)			
March 31	Profit & Loss A/c	Dr	55000	
	To Capital A/c			55000

Position Statement/Balance Sheet

Position Statement or Balance Sheet is another basis of financial statement. Balance Sheet is a statement prepared on a particular date, generally at the end of accounting year to ascertain the financial position of the entity. It consists of assets on the one hand and liabilities on the other.

> In the words of Francis R Steal, "Balance Sheet is a screen picture of the financial position of a going business at a certain moment." In the words of Freeman, "A Balance Sheet is an item wise list of assets, liabilities and proprietorship of a business at a certain date."

Financial position of a business is the list of assets owned by the business and the claims of various parties against these assets. The statement prepared to show the financial position is termed as Balance Sheet.

In the next lesson we shall discuss Balance Sheet in detail.

INTEXT QUESTIONS 13.5

I. Write 'debit' if Profit and Loss Account is to be debited and 'credit' if to be credited of the following items :

(a) Legal charges (b) Net Loss

(c) Rent Received (d) Discount Allowed

(e) Salaries

II. (a) Name the financial statement which is provided in addition to income statement.

(b) Why it is prepared?

(c) When it is prepared?

(d) Name its two elements.

WHAT YOU HAVE LEARNT

- Financial statements are of two types :

  (a) Income Statement i.e. Trading Account and Profit and Loss Account.

  (b) Position Statement i.e. Balance Sheet.

  Trading Account is prepared to ascertain the results of the trading activities of the business.

- Trading Account may show profit (i.e. the excess of sales to cost of goods sold or excess of credit side over debit side), which is termed as Gross Profit.

  Trading Account may show loss (i.e. Cost of goods sold exceeds sales or total of debit side exceeds total of credit side). This is called Gross Loss.

- Profit and Loss Account is prepared to find out Net Profit/Net Loss.

  Net Profit = Gross Profit + other incomes – Indirect expenses.

  It may also show a net loss.

  All indirect expenses are shown on the debit side of Profit & Loss Account.

  All incomes and gains are shown on the credit side of Profit & Loss Account.

- Balance Sheet is prepared to ascertain the financial position of a firm on a particular date.

TERMINAL QUESTIONS

1. State the meaning of financial statements.
2. Explain in brief the various objectives of finanacial statements.

3. Explain in brief the following terms with two examples each :
   (a) Revenue expenditure.
   (b) Revenue Receipts
   (c) Capital expenditure
   (d) Capital Receipts
4. Distinguish between capital expenditure and Revenue expenditure on the basis of :
   (a) Earning capacity
   (b) Placement in financial statements
   (c) Occurence of expenditure
5. Distinguish between capital receipts and revenue receipts.
6. How is cost of goods sold calculated?
7. What is Trading Account? Why it is prepared?
8. How is Gross Profit calculated?
9. What is meant by Profit and Loss Account? Why it is prepared?
10. When does Profit and Loss Account show Net Profit?
11. What are direct expenses? Give two examples of such expenses.
12. State the meaning of Balance Sheet.
13. From the following balances of Sabana calculate Gross Profit or Gross Loss by subtracting cost of goods sold from sales for the year ended 31st December, 2006

	Rs.
Stock (1.1.2006)	26500
Purchases	64600
Sales	86800
Purchases Returns	2600
Sales Returns	1800
Freight inward	750
Wages	1850
Closing Stock	31100

14. From the following balances extracted from the books of Seth Brothers. Make journal entries to prepare a Trading Account and Profit and Loss Account for year ended 31st March, 2007.

	Rs.		Rs.
Stock (1.4.2006)	20000	Electric Power	5000
Purchases	95000	Wages	14000
Return Inwards	2000	Selling Commission	5500
Carriage Inwards	1850	Repair & Renewals	2000
Carriage Outwards	1200	General Expenses	8000
Custom duty	3000	Insurance	2200
Return outwards	5000	Stock (31.3.2007)	45000
Sales	165000		
Discount Received	1500		

15. The balances from the books of Parimal Ghosh are given below. Make journal entries to prepare Trading and Profit & Loss Account for the year ended 31st March, 2007.

	Rs		Rs
Stock as on 1.4.2006	9480	Purchase Returns	1800
Purchases	50800	Advertising	1500
Wages	1200	Commission (Cr.)	3200
Salaries	3400	Rent from tenant	2800
Octroi	1320	Sales	72000
Rent & Taxes	850	Stock (31.3.2007)	10700
Bad Debts	250		
Discount (Dr.)	360		
Interest on capital	760		

16. From the following information calculate cost of goods sold for the year ending 31st March, 2007

	Rs		Rs
Opening Stock	14800	Factory expenses	7200
Purchases	65700	Closing stock	28400
Returns outward	1700		
Wages	12500		
Carriage Inward	2400		
Custom Duty	3200		
Rent paid	4500		
Establishment expenses	650		

17. From the following balances extracted from the books of Jai Bhagwan & Sons as on 31st March, 2007. Make journal entries to prepare Trading A/c and Profits & Loss A/c

	Rs		Rs
Opening Stock	16000	Rent	3600
Purchases	76000	Office expenses	1600
Machinery	28000	Carriage Inward	1200
Debtors	21600	Sales Returns	5400
Drawings	7200	**Credit Balance**	
Wages	1500	Capital	70000
Bank	12000	Creditors	14000
Depreciaiton	2800	Sales	108000
Closing stock	24000	Purchase Returns	2600

ANSWERS TO INTEXT QUESTIONS

Intext Question 13.1

I. (i) Capital (ii) Revenue

(iii) Deferred Revenue (iv) Capital

II. (a) Ascertaining the financial position

(b) Source of information

(c) Helps in managerial decision making

(d) An index of the solvency of the concern.

Intext Question 13.2

I. 1. Two 2. Trading and Profit & Loss

3. Gross Profit 4. Success

II. (a) Net sales (b) Net purchases

(c) Gross profit (d) Gross Loss

Intext Question 13.3

(i) Credit (ii) Debit

(iii) Credit (iv) Debit

Intext Question 13.4

I. (i) I (ii) E (iii) E (iv) I (v) E

II. (i) F (ii) T (iii) F (iv) T

Intext Question 13.5

I. (a) debit (b) credit
(c) Credit (d) debit
(e) debit

II. (a) Balance sheet
(b) to show the financial position of the concern
(c) At the end of an accounting year
(d) assets; liabilities

Answers to Practical Terminal Questions

13. Gross Profit : Rs 25000
14. Gross Profit : Rs 74150 Net Profit : Rs 56750
15. Gross Profit : 21700 Net Profit : Rs 20580
16. Cost of goods sold : Rs 75700
17. Gross Profit : Rs 21000 Net Profit : Rs 13000

Activity : Procure trial balance of at least four business concern and classify the items into :

(a) Revenue expenditure (b) Revenue receipts
(c) Capital expenditure (d) Capital Receiptes

Name of organisation	Item of expenditure	Revenue expenditure	Revenue receipts	Capital expenditure	Capital Receipts

14

FINANCIAL STATEMENTS-I

You have learnt the meaning of the financial statements and the need to prepare these for the business organisations. You have also learnt the format of these statements and the important items that are recorded in these statements. You would now like to learn how to prepare these statements. You know Trial Balance is the basis of preparation of these statements. Every business organisation prepares the financial statements i.e. Trading and Profit and Loss A/c and the Balance sheet.

In this lesson you will learn how to prepare these statements.

OBJECTIVES

After studying this lesson you will be able to :

- prepare Trading Account and Profit and Loss Account;
- explain the Balance Sheet as per format;
- appreciate the marshalling of Balance Sheet;
- classify the assets and liabilities;
- prepare Balance Sheet.

14.1 PREPARATION OF TRADING ACCOUNT AND PROFIT AND LOSS ACCOUNT

You have already learnt the meaning and format of Trading Account and Profit and Loss Account. You have also learnt how to make journal entries to transfer relevant ledger balances to Trading Account and Profit and Loss Account. Now you will learn the various steps to be followed in preparing these statements.

Steps to be followed while preparing Trading Account

A. Debit side

(i) We write the amount of opening stock (In case of a new firm there will not be any opening stock).

(ii) We write the amount of purchases Out of this purchases returns or returns outward is deducted. Purchases may be cash or credit or both.

(iii) Then we write the direct expenses such as carriage inward, wages, power, etc.

B. Credit side

(i) We write sales. Sales return or returns inward is deducted from the sales to get the net sales figure. Sales may be cash or credit or both.

(ii) Closing stock is the next item.

C. Ascertaining Gross Profit/Gross Loss

Finally Trading Account is closed by calculating the difference of the two sides. If credit side exceeds the debit side, the difference is written as Gross Profit on the debit side of the Trading A/c. In case debit side is more than the credit side, the difference amount is termed as 'Gross Loss' and is written on the credit side of the Trading A/c.

Total of Debit column > Total of credit column	
⇒	Gross profit
Total of credit column > Total of debit column	
⇒	Gross loss

Steps to be followed while preparing Profit and Loss Account

A. Debit side

(i) Gross Loss, if any, transferred from Trading A/c is written as the first item.

(ii) Next all items of revenue expenses and losses are written. These items may be salaries, rent paid, depreciation, etc.

B. Credit side

1. Gross Profit transferred from Trading A/c is the first item.
2. Next all items of revenue incomes and gains are written. These may be interest on investments, discount received, commission received, etc.

C. Ascertaining Net Profit/Net Loss

The next step is to get the balance. If credit side is more than the debit side the difference in amount is written as Net Profit. If debit side exceeds the credit side, the difference is Net Loss. This amount is transferred to Capital Account.

Total of Debit side > Total of credit side
⇒ Net profit
Total of credit side > Total of debit side
⇒ Net loss

Illustration 1

From the following information of M/s Nand Lal & Bros. for the year ending 31st March, 2006 prepare Trading A/c and Profit and Loss A/c for the year ended 31st March, 2006.

	Rs		Rs
Stock 1.4.2005	5800	Sales	72000
Purchases - cash	42000	Return Inward	2000
Purchases - credit	18000	Interest on Investment	1500
Freight Inward	1800	Discount Received	1200
Wages	4500	Closing stock	7200
Carriage on Sales	800		
Telephone Charges	1600		
Electricity Expenses	1200		
Office Rent Paid	6000		
Salaries	8000		
Depreciation	1400		

Solution :

Books of M/s Nand Lal & Bros.
Trading A/c
for the year ended 31st March, 2006

Dr. Cr.

Particulars		Amount Rs	Particulars		Amount Rs
Stock (1.4.2005)		5800	Sales	72000	
Purchases			Less Return Inward	2000	70000
Cash	42000		Closing stock		7200
Credit	18000	60000			
Freight Inward		1800			
Wages		4500			
Gross profit transferred to Profit and Loss A/c		5100			
		77200			77200

Profit and Loss A/c
for the year ending 31st March, 2006

Particulars	Amount (Rs)	Particulars	Amount (Rs)
Carriage on sale	800	Gross Profit transferred from Trading A/c	5100
Telephone charges	1600	Interest on Investment	1500
Electricity Expenses	1200	Discount Received	1200
Office Rent	6000	Net Loss transferred to capital A/c	11200
Salaries	8000		
Depreciation	1400		
	19000		19000

Illustration 2

Prepare Trading A/c and Profit and Loss A/c of Raman Irani from the following balances for the year ending 31st March, 2006.

	Rs		Rs
Opening Stock	14600	Trading Expenses	1450
Purchases	68700	Discount allowed	1250
Sales	85300	Discount Received	800
Return outward	2200	Bill Receivables	4500
Carriage Inward	2100	Debtors	16800
Capital	50000	Closing stock	28700
Drawings	12000		
Insurance	1600		
Advertisement	2400		
Salesmen's Salaries	5200		

Solution :

Books of Raman Irani

Trading A/c
for the year ending 31st March, 2006

Dr. Cr.

Particulars		Amount Rs	Particulars	Amount Rs
Opening Stock		14600	Sales	85300
Purchases	68700		Closing stock	28700
Less Return outward	2200	66500		
Carriage Inward		2100		
Gross profit transferred to Profit and Loss A/c		30800		
		114,000		114,000

Profit and Loss A/c
for the year ended 31st March, 2006

Dr. Cr.

Particulars	Amount (Rs)	Particulars	Amount (Rs)
Insurance	1600	Gross Profit transferred from Trading A/c	30800
Advertisement	2400	Discount Received	800
Salesmen's salaries	5200		
Trading Expenses	1450		
Discount allowed	1250		
Net Profit transferred to capital A/c	19700		
	31600		31600

INTEXT QUESTIONS 14.1

Write the name of the Account (Trading A/c, Profit & Loss A/c) and the side (debit credit) against the items given below to which these are taken:

(i) Closing stock ....

(ii) Carriage outward ....

(iii)	Interest on Investment	.....	.....
(iv)	Custom duty	.....	.....
(v)	Fuel & Power	.....	.....
(vi)	Sales	.....	.....
(vii)	Salaries	.....	.....
(viii)	Rent from tenant	.....	.....

14.2 BALANCE SHEET

Apart from Trading Account and Profit and Loss Account, Balance Sheet is another financial statement that is prepared by the every business firm. Balance sheet is a statement which shows the financial position of a business organisation on a particular date which is generally the last date of the accounting period. Financial position of a business unit is the amount of claims against the resources of business. These resources are cash, stock of goods, furniture, machinery, etc. The claims include the claims of the owner capital and the claims of outsiders such as creditors, bankers, etc. Therefore, it can be stated that Balance Sheet is the statement which shows assets owned by the business and liabilities owed by it on a particular date. Balance Sheet is not an account. It has two sides. (i) Assets side and (ii) the Liabilities side. The Asset side has a list of fixed as well current assets. The liabilities side has a list of items of capital, long term as well as short term liabilities.

Need

1. Balance Sheet is prepared to measure the true financial position of a business entity at a particular point of time.
2. It is a systematic presentation of what a business unit owns and what it owes.
3. Balance Sheet shows the financial position of the concern at a glance.
4. Creditors, financiers are particularly interested in the Balance Sheet of a concern so that they can decide whether to deal with the concern or not.

Marshalling of Assets and Liabilities

As stated above Balance sheet has two sides i.e. Assets side, which has various items of assets of the concern and liabilities side which has the liability or claim of the owner as well as of the outside parties.

Assets refer to the financial resources of the business and can broadly be divided into Current Assets and Fixed Assets, Liabilities denote claims against the assets of the business. Liabilities can be of two types owners liability or capital and outsiders liabilities such as creditors, bills payable, Bank Loan etc.

There is no prescribed form of a Balance Sheet in which it should be prepared by a sole proprietary business or a partnership firm. However, an order is generally maintained in which assets and liabilities are written. This is to maintain uniformity/consistency which facilitates comparative analysis for decision making. Balance sheet may be prepared in any of the following orders :

(a) Liquidity order (b) Permanency order

(a) Liquidity order

Liquidity means convertibility of assets into cash. Every asset cannot be converted into cash at the same degree of ease and convenience. Assets are written in the order of their liquidity, Assets of highest liquidity is written first and next highest follows and so on. Similarly, liabilities are also written in this very order. Short term liabilities are written first and then long term liabilities and lastly the capital.

A specimen of the balance sheet prepared on the basis of liquidity order is given below :

Balance Sheet of M/s .....
As on .....

Liabilities	Amount Rs	Assets	Amount Rs
Bank overdraft	xxxx	Cash in hand	xxxx
Outstanding Expenses	xxxx	Cash at bank	xxxx
		Prepaid expenses	xxxx
		Investments (short term)	xxxx
Bill payables	xxxx	Bill Receivables	xxxx
Sundry creditors	xxxx	Sundry Debtors	xxxx
Loans	xxxx	Closing stock	xxxx
Capital	xxxx	Investments	xxxx
Add Net Profit	xxxx	Furniture	xxxx
Less drawings	xxxx	Plant & Machinery	xxxx
		Land & Building	xxxx
		Goodwill	xxxx
	xxxx		xxxx

(Investments on short term basis are marketable securities; they form part of current assets.)

Permanency order

While following the order of permanency, assets, which are to be used permanently i.e. for a long time and not meant for resale are written first. For example, Land and Building, Plant and Machinery, furniture etc. are written first. Assets which are most liquid such as cash in hand is written in the last. Order of liabilities is similarly changed. Capital is written first, then the long term liabilities and lastly the short term liabilities and provisions and Specimen of a Balance Sheet that can be prepared in the order of permanency is as follows :

Balance sheet of M/s .....

As on .....

Liabilities		Amount Rs	Asset	Amount Rs
Capital	xxxx		Goodwill	xxxx
Add : Net profit	xxxx		Land & Building	xxxx
Less : Drawings	xxxx	xxxx	Plant & Machinery	xxxx
Loans		xxxx	Furniture	xxxx
Sundry creditors		xxxx	Investments	xxxx
Bills payable		xxxx	Closing stock	xxxx
Outstanding expenses		xxxx	Sundry Debtors	xxxx
Bank overdraft		xxxx	Bills Receivables	xxxx
			Investments (short term)	xxxx
			Prepaid expenses	xxxx
			Cash at bank	xxxx
			Cash in hand	xxxx
		xxxx		xxxx

[In case of joint stock companies balance sheet is prepared as per schedule VI of the Companies Act 1956]

Illustration 3

From the balances given below prepare Balance sheet of M/s Bharat & Bros as on 31st December, 2006. In (a) liquidity order and, (b) in permanency order.

Particulars	Amount Rs	Particulars	Amount Rs
Capital	50000	Sundry Debtors	24000
Loan from Bank	20000	Bills Payable	8000
Cash in hand	2500	Drawings	6000
Cash at Bank	12800	Building	25000
Closing stock	24700	Furniture	4500
Sundry creditor	15000	Investments	15000
		Net Profit	21500

Solution :

A. Liquidity order

Balance sheet of M/s Bharat & Bros as on 31st Dec., 2006

Liabilities		Amount Rs	Assets	Amount Rs
Bills Payable		8000	Cash in hand	2500
Sundry creditors		15000	Cash at Bank	12800
Loan from Bank		20000	Sundry Debtors	24000
Capital	50000		Closing stock	24700
Add Net Profit	21500		Investments	15000
	71500		Building	25000
Less drawings	6000	65500	Furniture	4500
		108500		108500

B. In permanency order

Balance sheet of M/s Bharat & Bros as on 31st Dec., 2006

Liabilities		Amount Rs	Assets	Amount Rs
Capital	50000		Building	25000
Add Net Profit	21500		Furniture	4500
Less drawings	6000	65500	Investments	15000
Loan from Bank		20000	Closing stock	24700
Sundry creditors		15000	Sundry Debtors	24000
Bills payable		8000	Cash at Bank	12800
			Cash in hand	2500
		108500		108500

INTEXT QUESTIONS 14.2

I. Arrange the following Assets in (i) Liquidity order (ii) Permanency order.

(i) Closing stock

(ii) Furniture

(iii) Cash in hand

(iv) Investments

(v) Bills Receivable

(vi) Goodwill

(vii) Building

(viii) Debtors

II. Arrange the following items of liabilities (i) Liquidity order and (ii) in permanency order

(i) Bills Payable

(ii) Sundry Creditors

(iii) Loan on Mortgage

(iv) Outstanding Expenses

(v) Capital

14.3 CLASSIFICATION OF ASSETS AND LIABILITIES

Assets and Liabilities are of various types. These can be classified as under:

(a) Fixed Assets

These are the assets that are purchased for permanent i.e. long term use and these help the business to earn revenue. Examples of such assets are Building, Machinery, Motor Vehicle, etc. These assets are not for sale in ordinary course of business but can be disposed off, if no more needed for business use.

(b) Current Assets

These are the assets which are acquired by the business either for resale or for converting them into cash. These are normally realised within a period

of one year. Examples of such assets are : cash in hand, cash at bank, bill receivable, debtors, stock etc.

(c) Tangible Assets

These are the assets that can be seen, touched and have certain volume. Building, Machinery, goods etc. are tangible assets.

(d) Intangible Assets

Assets which can neither be seen nor touched and have no volume are called intangible assets. Patents, trademark, goodwill etc are the examples of such assets.

(e) Liquid Assets

These are the assets which are either in cash or can be easily converted into cash. For example cash, stock, marketable securities etc.

(f) Wasting Assets

These are the assets which exhaust or reduce in value by their use. Mines, quarries etc come under this category.

(g) Fictitious Assets

These are not the real assets. These are the items of such expenses and losses which have not been written off in full. For example, preliminary expenses, under writing commission, etc.

Liabilities

Liabilities can be classified as follows :

(a) Long term Liabilities

These are the liabilities which are not payable during the current accounting year. Generally, the funds raised through such means are used for purchase of fixed assets. Examples of such liabilities are loan on mortgage, loan from financial institutions.

(b) Current Liabilities

These are the liabilities which are payable during the current year. These include Bank overdraft, trade creditors, bill payable etc.

(c) Owners' funds

The amount owing to the proprietor or proprietors is called owners' funds. As per business entity concept this is a liability of the business. Apart from capital it also includes undistributed profits and reserves. Amount of drawings by the proprietor is deducted from it.

INTEXT QUESTIONS 14.3

I. Write the type of assets against the items given below :

(i) Goodwill .....

(ii) Bills Receivable .....

(iii) Preliminary Expenses .....

(iv) Mines .....

(v) Furniture .....

II. Write the type of liabilities against the items given below :

(i) Loan on mortgage .....

(ii) Creditors .....

(iii) Outstanding expenses .....

(iv) Capital .....

14.4 PREPARATION OF BALANCE SHEET

Balance sheet has two sides : Assets and Liabilities. On the assets side we write all types of assets such as Cash, Bills Receivable, Stock, Building etc.

On the liabilities side all liabilities, are written both long term liabilities and current liabilities, such as Bills Payable, trade creditors, bank loan etc. Next we write owners' capital. Net profit is added to it. If there is net loss it is deducted from the capital. Amount of drawings is also deducted from the capital. Finally the two sides are totalled and the totals should agree.

Illustration 4

From the following Trial Balance of M/s Vikram Brothers prepare Trading and Profit and Loss Account for the year ended 31st March 2006 and Balance Sheet as on that date.

Particulars	Dr. Balances Rs	Particulars	Cr. Balance Rs
Cash in hand	500	Capital	70000
Motor car	25000	Discount Received	2000
Drawings	48000	Sales	230000
Legal charges	1500	Creditors	46000
Plant & Machinery	60000	Interest on investment	5200
Investments	40000	Purchases Return	3800
Opening stock	35000	Bills payable	34000
Sales Returns	2500		
Salaries	12000		
Discount allowed	600		
Carriage Inward	1800		
Wages	21000		
Postage	400		
Debtors	60000		
Interest	1500		
Insurance Premium	1200		
Purchases	80000		
	391000		391000

Closing stock as on 31.3.2006 Rs 28000

Solution :

Trading A/c
for the year ended 31st March, 2006

Dr. Cr.

Particulars		Amount Rs	Particulars		Amount Rs
Opening stock		35000	Sales	230000	
Purchases	80000		Less sales Returns	2500	227500
Less purchase return	3800	76200	Closing stock		28000
Wages		21000			
Carriage Inward		1800			
Gross Profit transferred to Profit & Loss A/c		121500			
		255500			255500

Profit & Loss A/c
for the year ended 31st March, 2006

Particulars	Amount Rs	Particulars	Amount Rs
Salaries	12000	Gross Profit transferred from Trading A/c	121500
Insurance Premium	1200	Discount Received	2000
Discount allowed	600	Interest on Investments	5200
Postage	400		
Interest	1500		
Legal charges	1500		
Net Profit Transferred to Capital A/c	111500		
	128700		128700

Balance Sheet
As on 31st March, 2006

Liabilities		Amount Rs	Assets	Amount Rs
Bills Payable		34000	Cash in hand	500
Capital	70000		Debtors	60000
Add Net Profit	111500		Closing stock	28000
	181500		Investments	40000
Less drawings	48000	133500	Motor car	25000
Creditors		46000	Plant & Machinery	60000
		213500		213500

Illustration 5

Following is the Trial Balance extracted from the books of Jasmine Enterprises as on 31st March, 2006. Prepare Trading and Profit & Loss A/c from the information given in Trial Balance for the year ending 31st March, 2006. Also prepare the Balance Sheet as on that date.

Particulars	Dr. Amount (Rs.)	Cr. Amount (Rs.)
Stock (1.4.2005)	18500	
Purchases & Sales	78500	154200
Return Inwards & Return Outwards	2200	2500
Debtors & Creditors	16500	18000

Bills Receivable & Bills Payable	14000	21000
Commission paid	2000	
Audit fees	1800	
Building	65000	
Furniture	12000	
Salaries	14000	
Telephone charges	4200	
Insurance	2100	
Discount allowed	1000	
Octroi	1200	
Wages	16000	
Freight Inward	2400	
Bad debts	600	
Depreciation	4200	
Bank loan		32000
Cash in hand and at Bank	25000	
Capital		100000
Drawing	16500	
Machinery	30000	
	327700	327700

Stock as on 31.3.2006 Rs 19600

Solution :

Trading A/c
For the year ended 31st March, 2006

Dr. Cr.

Particulars		Amount Rs	Particulars		Amount Rs
Stock (1.4.2005)		18500	Sales	154200	
Purchases	78500		Less Return Inward	2200	152000
Less return outward	2500	76000	Closing stock		19600
Wages		16000			
Freight Inward		2400			
Octroi		1200			
Gross Profit transferred to Profit & Loss A/c		57500			
		171600			171600

Profit & Loss A/c
For the year ended 31st March, 2006

Particulars	Amount Rs	Particulars	Amount Rs
Salaries	14000	Gross Profit transferred from Trading A/c	57500
Insurance Premium	2100		
Bad debts	600		
Depreciation	4200		
Audit fees	1800		
Discount allowed	1000		
Commission paid	2000		
Net Profit Transferred to Capital A/c	27600		
	57500		57500

Balance Sheet
As at 31st March, 2006

Liabilities		Amount Rs	Assets	Amount Rs
Bills Payable		21000	Cash in hand & at Bank	25000
Sundry creditors		18000	Bill receivable	14000
Bank Loan		32000	Sundry Debtors	16500
Capital	100000		Closing stock	19600
Add Net Profit	27600		Machinery	30000
	127600		Building	65000
Less Drawings	16500	111100	Furniture	12000
		182100		182100

INTEXT QUESTIONS 14.4

Fill in the blanks with appropriate word/words :

(i) The amount by which credit side of Trading A/c exceeds the debit side is written as .....

(ii) The amount by which debit side exceeds the credit side of Profit & Loss A/c is written as .....

(iii) The totals of the two sides of the Balance sheet should always be .....

(iv) Bank loan is shown on the ..... side of the Balance sheet.

WHAT YOU HAVE LEARNT

1. To prepare Trading Account on the debit side we write opening stock, net purchases and direct expenses on the credit we write net sales and closing stock. The difference of the two sides is calculated which may be Gross Profit or Gross Loss. The same is transferred to Profit & Loss Account.
2. All items of revenue expenditure and losses are written on the debit of Profit and Loss Account and the on the credit we write items of revenue receipts and gains. The difference of the two sides is calculated which may be either Net Profit or Net Loss.
3. Balance sheet is a statement showing the financial position of a business unit on the last date of the accounting year.
4. Balance sheet is a systematic presentation of what a business unit owns and what it owes.
5. Balance sheet has two sides Assets and Liabilities.
6. Assets and Liabilities may be written in (i) Liquidity order or (ii) Permanency order.
7. Assets may be classified as : fixed assets, current assets, tangible assets, intangible assets, liquid assets, wasting assets and fictitious assets.
8. Liabilities can be long term liabilities, current liabilities and owners funds.

TERMINAL EXERCISE

1. State the steps taken while preparing Trading Account.
2. Explain the term Balance Sheet. Also explain the objectives of preparing a Balance sheet.
3. Explain showing assets in 'liquidity order' and 'permanency order' in a Balance Sheet.
4. Explain the following types of assets with two examples each :

   (a) Intangible Assets (b) Fictitious Assets

   (c) Fixed Assets (d) Current Assets

5. What are owners' funds ?

6. From the following information extracted from the books of P. Mukherjee, prepare Trading Account for the year ending 31st March, 2006.

	Rs		Rs
Opening stock	6500	Cash	4500
Purchases	45000	Office expenses	3200
Sales	72000	Office Rent	6800
Return Inward	1500		
Return Outward	500		
Carriage on Purchases	1200		
Wages	4800		
Fuel & Power	3200		

Closing stock on 31st March, 2006 was Rs 8600

7. From the following information of Rashmi prepare Profit & Loss Account for the year ending 31st March, 2006.

	Rs		Rs
Gross Profit	64800	Discount Received	600
Bad debts	1500	Commission Received	2100
Depreciation	2500	Freight outward	1600
Office rent	4800	Prepaid Insurance	600
Insurance	3200	Salary	6400
Telephone charges	1700	Stationery	700
Interest on loan	2400	Furniture	6000
Building	50000		

Closing stock as on 31st March, 2006 Rs 20000

8. From the following Trial Balance of M/s Krishna Murthi Garments as on 31st March, 2006, you are required to prepare Trading Account, Profit and Loss A/c for the year ended 31st March, 2006 and a Balance sheet as on that date.

Trial Balance of M/s Krishna Murthi Garments as at 31st March, 2006

Particulars	Dr. Balances Rs	Cr. Balances Rs
Cash in hand	2000	2000
Bank overdraft		35000
Stock (1.4.2005)	32000	
Purchases	80000	
Freight Inward	4000	
Custom duty	5500	
Power	6500	
Machines	40000	
Furniture	20000	
Sales		165000
Bills Payable		18000
Sundry Debtors	28000	
Sundry creditors		22000
Salaries	6500	
Salesmen's commission	7800	
Rent of Godown	7200	
Insurance	2400	
Land & Building	75000	
Carriage on sales	3600	
Advertisement	4500	
Capital		100000
Drawings	15000	
	340000	340000

Closing stock as on 31st March, 2006 Rs 38000

ANSWERS TO INTEXT QUESTIONS

Intext Questions 14.1

(i)	Trading A/c	credit
(ii)	Profit & Loss A/c	debit
(iii)	Profit & Loss A/c	credit
(iv)	Trading A/c	debit
(v)	Trading A/c	debit
(vi)	Trading A/c	credit
(vii)	Profit & Loss A/c	debit
(viii)	Profit & Loss A/c	credit

Intext Questions 14.2

I.	Liquidity order	Permanency order
	Cash in hand	Goodwill
	Bills Receivable	Furniture
	Sundry Debtors	Building
	Closing stocks	Investments
	Investments	Closing stock
	Building	Sundry Debtors
	Furniture	Bills Receivable
	Goodwill	Cash in hand
II.	Liquidity order	Permanency order
	Outstanding expenses	Capital
	Bills payable	Loan on Mortgage
	Creditors	Creditors
	Loan on Mortgage	Bill payable
	Capital	Outstanding expenses

Intext Questions 14.3

I. (i) Intangible Asset (ii) Current Asset
(iii) Fictitious Asset (iv) Wasting Asset
(v) Fixed Asset

II. (i) Long term liability (ii) Current liability
(iii) Current liability (iv) Owner fund

Intext Questions 14.4

(i) Gross Profit (ii) Net Loss
(iii) Equal (iv) Liabilities

Answers to Practical Terminal Questions

6. Gross profit Rs. 10300

7. Net Profit Rs 42700

8. Gross Profit Rs 75000

   Net Profit Rs 44000

   Total of Balance Sheet Rs 203000

Activity : Visit a number of business firms of your locality, parents of your friends and of your relatives and collect the information about assets which are not common because of the nature of their business and classify them into relevant categories.

Name of the firm	Nature of business	Name of the asset	Category of the asset
1.			
2.			
3.			
4.			
5.			

Activity : Analyse the Balance Sheet of a business enterprise being run by your father/father of your friend or by a relative and check the marshalling of Assets and Liabilities. If these are not in order place them in liquidity order or permanency order. If these are already in liquidity order place them in permanency order and vice-versa.