

PRINCIPLES OF ACCOUNTING I

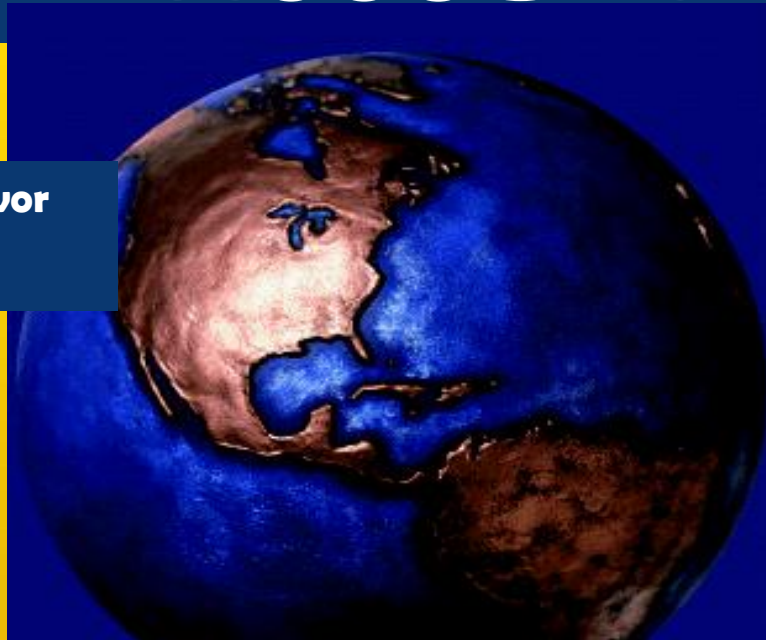
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TRADING AND PROFIT AND LOSS ACCOUNT

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Trading Account

The trading account is prepared to ascertain gross profit or loss on business trading. Gross profit is a profit which expenses have not been deducted. In other words it is a profit made before considering expenses incurred to earn that profit. The gross profit is obtained by subtracting cost of sales from sales. Cost of sales is opening stock, add purchases less closing stock.

Profit and Loss Account

Profit and loss account is prepared in order to ascertain the net profit or loss. Profit and loss group together all trading expenses and revenue. The revenue are added to gross profit and expenses matched against it within a particular period usually a year to ascertain a net profit or loss.

A net profit is the final or actual profit of the business.

Format of trading, profit and loss account

Trading, profit and loss account for the year ended December 31, 20...

| | GH¢ | GH ¢ | GH ¢ |
|----------------------------------|------------|------|------------|
| Sales | | | xxx |
| Less return inwards | | | xxx |
| | | | <u>xxx</u> |
| Less cost of sales: | | | |
| Opening stock | | xxx | |
| Add purchases | xxx | | |
| Add carriage inward | xxx | | |
| | <u>xxx</u> | | |
| Less return outwards | xxx | xxx | |
| Cost of goods available for sale | | xxx | |
| Less closing stock | | xxx | xxx |
| Gross profit | | | xxx |

Format of trading, profit and loss account

| | | GH ¢ | GH ¢ |
|--------------------------------|------------|------------|------------|
| Gross profit | | | xxx |
| Add other incomes: | | | |
| Rent received | | xxx | |
| Commission received | | xxx | |
| Discount received | | xxx | |
| Decrease in provision | | xxx | xxx |
| | | | xxx |
| Less operating expenses | | | |
| Insurance | | xxx | |
| Rent and rate | | xxx | |
| Wages and salaries | | xxx | |
| General expenses | | xxx | |
| Bad debt | | xxx | |
| Increase in provision | xxx | | |
| Depreciation | | xxx | xxx |
| Net profit or loss | | | xxx |

Question

Sister Paul is a business woman, she had in her business premises GH¢650,000 worth of goods on January 1, 2008. Purchases during the year amounted to GH¢920,000 and carriage cost on goods was GH¢45,000. Goods returned by customers was GH¢62,000 and sales during the year was GH¢2,200,000. There was still GH¢320,000 goods unsold at the end of the year. Goods returned to suppliers was GH¢72,000.

| Other transactions are as follows: | GH¢ |
|---|---------------|
| Insurance | 36,000 |
| Rent and rates | 50,000 |
| Commission received | 65,000 |
| Discount allowed | 12,000 |
| Carriage outwards | 18,000 |
| Discount received | 24,000 |

You are required to draw up the Trading, profit and loss account for the year ended December 31, 2008.

Balance Sheet

The balance sheet shows the financial position of the firm at a particular date. The balance sheet list all the assets, liabilities and capital of a firm. The balance sheet therefore is made up of two sides:

- 1. The assets at one side and liabilities and capital on the other side. The assets resolve itself into three parts:**

Intangible assets

Tangible fixed assets

Current assets

Balance Sheet

2. The liabilities also resolve itself into two parts:

Long-term liabilities

Short-term or current liabilities

It must be noted that the balance sheet does not follow the double entry principle since it is a statement and not account. Let us consider the items in the balance sheet one after the other.

Items in the balance sheet

Intangible assets

These are assets not having physical existence, you cannot touch and see them. Examples of such assets include: Goodwill, Treasury bills, Copyrights, investments, etc.

Items in the balance sheet

Fixed assets

These are the properties of the business having physical existence, you can see and touch. Fixed assets are bought for permanent use in the business and not for resale. Examples include: land and building, plant and machinery, office equipment, furniture and fittings, motor vehicles etc.

Items in the balance sheet

Current assets

These are also known as floating, circulating or trading assets. They are called circulating or floating assets because they are easily turned into cash and including those for resale. Examples of current assets are stock, debtors, bills receivable, prepayments/payment in advance, bank balance and cash in hand.

Items in the balance sheet

Current liabilities

This is a short-term indebtedness due for payment by the firm to its creditors. Such liabilities are settled within the near future usually a year. Examples of current liabilities are creditors, bank overdraft, bills payable, etc.

Items in the balance sheet

Long-term liabilities

This consist of long term loan taking by the company which is payable after one year. Examples of long term liabilities are bank loans, debentures, etc.

Items in the balance sheet

Capital

Capital is the amount of money which the owner of a business contribute to start a business. In the case of a sole trader, the net profit or loss from trading, profit and loss account is added to and/or subtracted from the capital in the balance sheet.

Accounting equation

The balance sheet is drawn having in mind the accounting equation which states that:

$$\mathbf{Assets = Capital + Liabilities}$$

$$\mathbf{Capital = Asset - Liabilities}$$

$$\mathbf{Liabilities = Assets - Capital}$$

Format of a balance sheet

Balance sheet as at December 31, 20.....

| | Cost GH¢ | Depreciation GH¢ | NBV GH¢ |
|--------------------------|-------------|---------------------|------------|
| Intangible assets | | | |
| Goodwill | xxx | ---- | xxx |
| Investments | xxx | xxx | xxx |
| Fixed assets | | | |
| Land and building | xxx | xxx | xxx |
| Motor van | xxx | xxx | xxx |
| Equipment | xxx | xxx | xxx |
| Furniture and fittings | xxx | xxx | xxx |
| | <u>xxx</u> | <u>xxx</u> | <u>xxx</u> |
| Current assets | | | |
| Stock | | xxx | |
| Debtors | | xxx | |
| Bills receivable | | xxx | |
| Prepayments | | xxx | |
| Cash at bank | | xxx | |
| Cash in hand | | xxx | |
| | | <u>xxx</u> | |

Format of a balance sheet

| | GH¢ | GH¢ | GH¢ |
|------------------------------|------------|--------------|------------|
| Current liabilities | | | |
| Creditors | xxx | | |
| Bills payable | xxx | | |
| Accruals | <u>xxx</u> | <u>(xxx)</u> | |
| Working capital | | | <u>xxx</u> |
| Capital employed | | | <u>xxx</u> |
| Financed by: | | | |
| Capital | | | xxx |
| Add net profit/loss | | | <u>xxx</u> |
| | | | xxx |
| Less drawings | | | <u>xxx</u> |
| | | | xxx |
| Long-term liabilities | | | |
| Bank loans | | xxx | |
| Debentures | | <u>xxx</u> | xxx |
| Capital employed | | | <u>xxx</u> |

Question

The following is an extract from the books of a sole trader for the year ended December 31, 2008.

| | DR GH¢ | CR GH¢ |
|------------------------------|------------------|------------------|
| Land and building | 580,000 | |
| Furniture and fittings | 414,000 | |
| Bank overdraft | | 185,000 |
| Goodwill | 130,000 | |
| Motor van | 220,000 | |
| Bills receivable and payable | 65,000 | 82,000 |
| Office equipment | 133,000 | |
| Creditors | | 290,000 |
| Cash in hand | 240,000 | |
| Drawings | 240,000 | |
| Debentures | | 360,000 |
| Bank loan | | 155,000 |
| Debtors and creditors | 170,000 | 929,000 |
| | <u>2,001,000</u> | <u>2,001,000</u> |

Adjustments to final account

There are some items which do not appear on the trial balance but are found in the footnote. Adjustment must be made on such items before recording it in the financial statement. Such items are discussed here.

Closing stock

These are goods which remain unsold in the business at the end of the financial year. The closing stock must be deducted from cost of goods available for sale. It is also entered in the balance sheet under current assets.

Prepayment/advance payment

These are expenses that have been paid during the current accounting period but relate to the next accounting period. Prepayments are assets to the firm and are deducted from the particular expense provided in the trial balance. It is shown under current asset in the balance sheet.

Accrued expenses/owing

These are expenses that has been incurred during the accounting period but has not yet been paid. Accrued expenses are liabilities to the firm and are therefore shown under current liabilities in the balance sheet. Accrued expenses increase expenses in the profit and loss account and as such they are added to expenses provided in the trial balance.

Depreciation

The amount of depreciation worked out should be charged against profit and loss. The amount of depreciation must also be deducted from the particular asset in the balance sheet to arrive at the net book value. If there is accumulated depreciation in the trial balance, add current year's depreciation (amount charged against profit and loss account) and deduct from the cost of the asset in the balance sheet.

Bad debt provision

Provision is an amount set aside to meet unknown liability. Normally, a firm may make provisions for bad debt so that when it occur it can be taken care of. Provision may either increase or decrease. Bad debt provision would be given in the trial balance, so that whatever charges are given in the footnote would be deducted from the amount given in the trial balance. If there is increase in provision add the margin of increase to expenses in the profit and loss account and if there is decrease, add the margin of decrease to gross profit.

THANK YOU



Thank you