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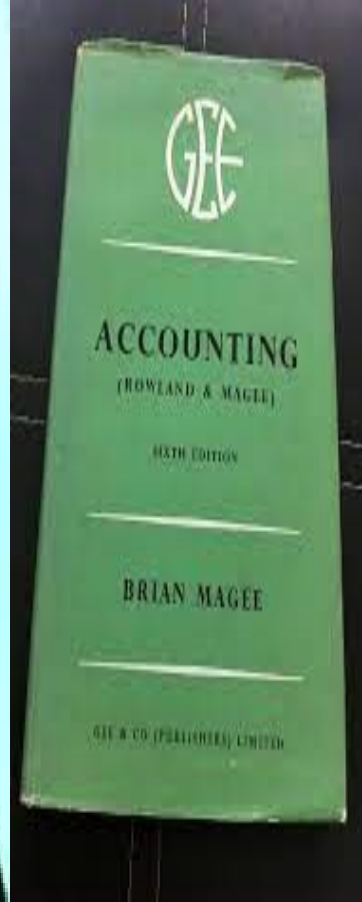
*Trial balance may be defined as a statement or a list of all ledger account balances taken from various ledger books on a particular date to check the arithmetical accuracy.*

# TRIAL BALANCE



*According to the Dictionary for Accountants by **Eric. L. Kohler**, Trial Balance is defined as “a list or abstract of the balances or of total debits and total credits of the accounts in a ledger, the purpose being to determine the equality of posted debits and credits and to establish a basic summary for financial statements”.*

# TRIAL BALANCE

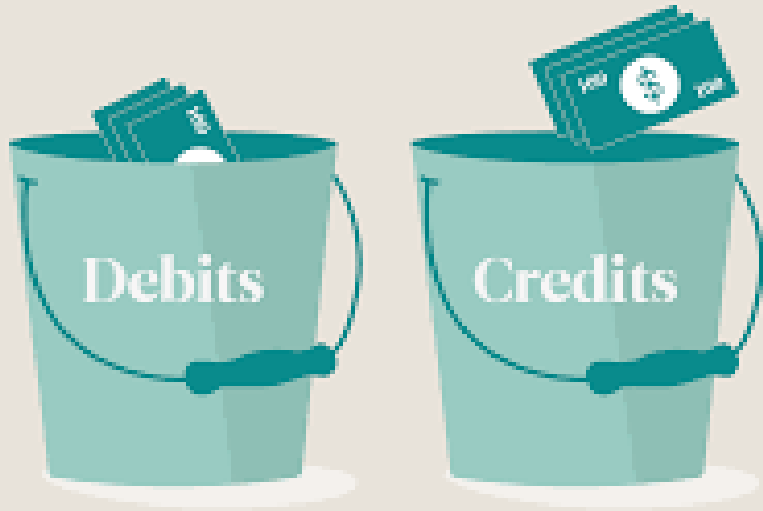


*According to W.S. Rowland, Trial Balance is defined as “The final list of balances, totaled and combined, is called Trial Balance”.*

# FEATURES OF TRIAL BALANCE



# 1. Merely a statement



*The trial balance is merely a statement prepare on a separate sheet of paper. It is neither prepare in the journal nor in the ledger.*

## 2. Not a part of the Double entry system



*The trial balance is not a part of the double entry system. Method of recording or posting of transaction has nothing to do with the preparation of trial balance .*

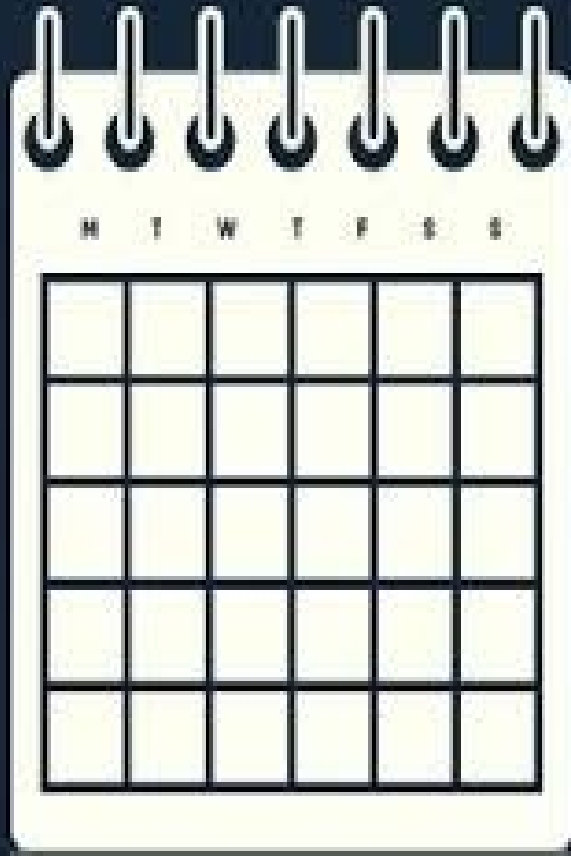
# 3. Periodicity of preparation

MONTH:

\_\_\_\_\_

YEAR:

\_\_\_\_\_



*The trial balance is prepared at the end of a certain period, namely , a day, week, month, quarter-year, half year, one year etc.*



# 4. Arithmetical Accuracy



*The trial balance is a means through which the arithmetical accuracy of the books of accounts can be tested.*

## 5. Not a conclusive proof of accuracy



*Even if the trial balance sheet agrees .it cannot be said with certainty that the books of accounts are correct in all respects.*

# OBJECTIVE /ADVANTAGES OF PREPARING A TRIAL BALANCE

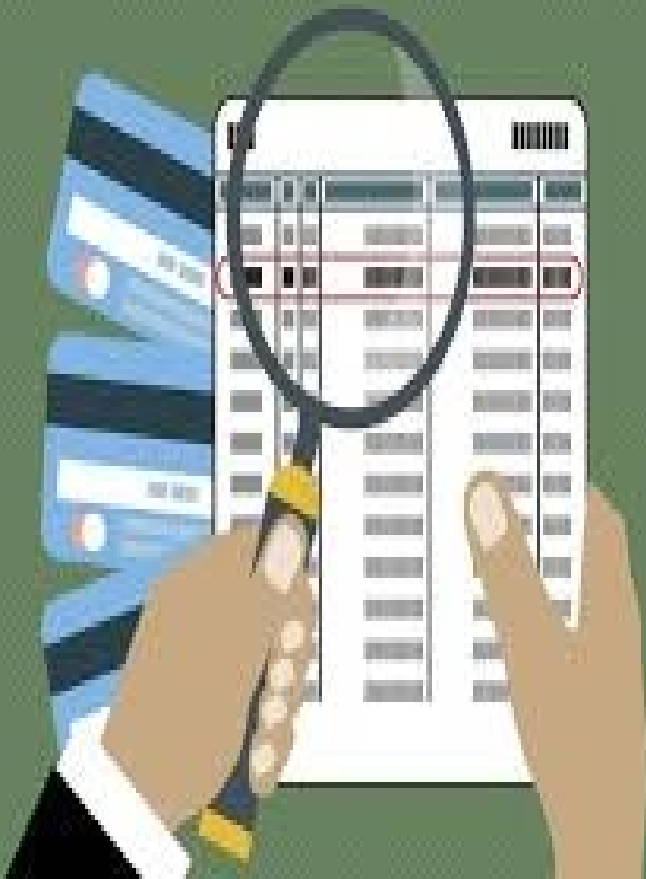


# 1. To check accuracy of ledger accounts



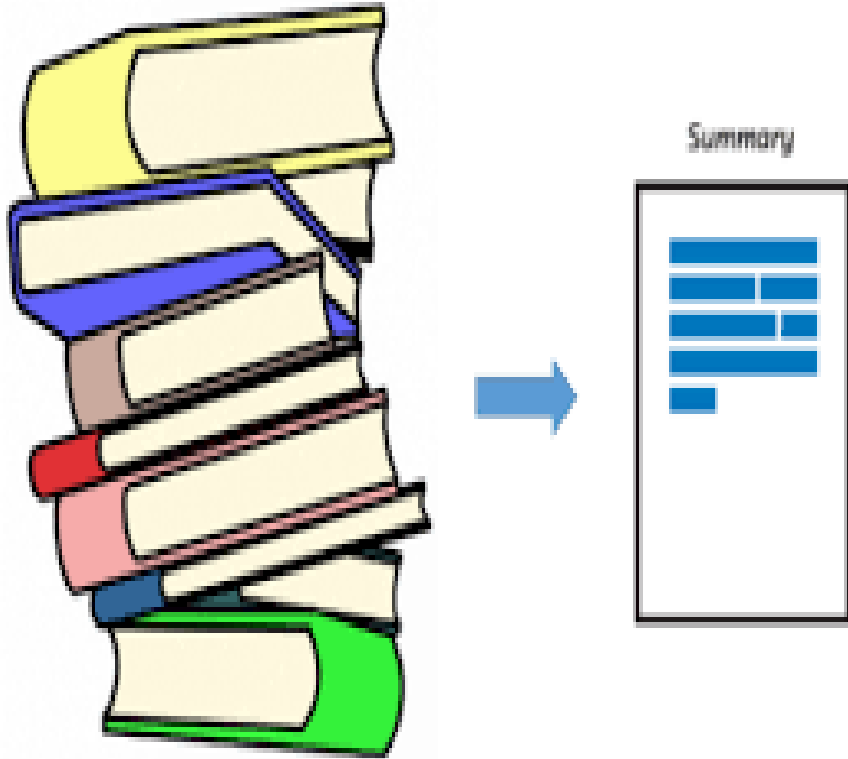
*The preparation of trial balance provides an opportunity to check the arithmetic accuracy of ledger accounts.*

## 2. Helpful in detection of Errors



*Trial balance helps in locating errors of posting and casting in the subsidiary books and ledger.*

# 3. Summary of each account



*Trial balance shows the summary of each account in ledger. It provides a condensed picture of each account in the ledger hence it is a source of information, in a condensed form, of the position of every ledger account.*

## 4. Identification of require adjustments



*The preparation of trial balance facilitate the identification of the items for which adjustments are require.*

# 5. Helps in preparing final account



**Final accounts**

*Final accounts can be prepared easily after the preparation of trial balance. The trial balance acts as a connecting link between ledger and final accounts.*



# LIMITATION OF A TRIAL BALANCE



# 1. Not a conclusive proof of accuracy



*An agreed trial balance does not prove that all transactions have been recorded and nothing has been left. For example, the omission to record a transaction in the journal will not be detected by a trial balance.*

## 2. Non – disclosure of error in books of original entry



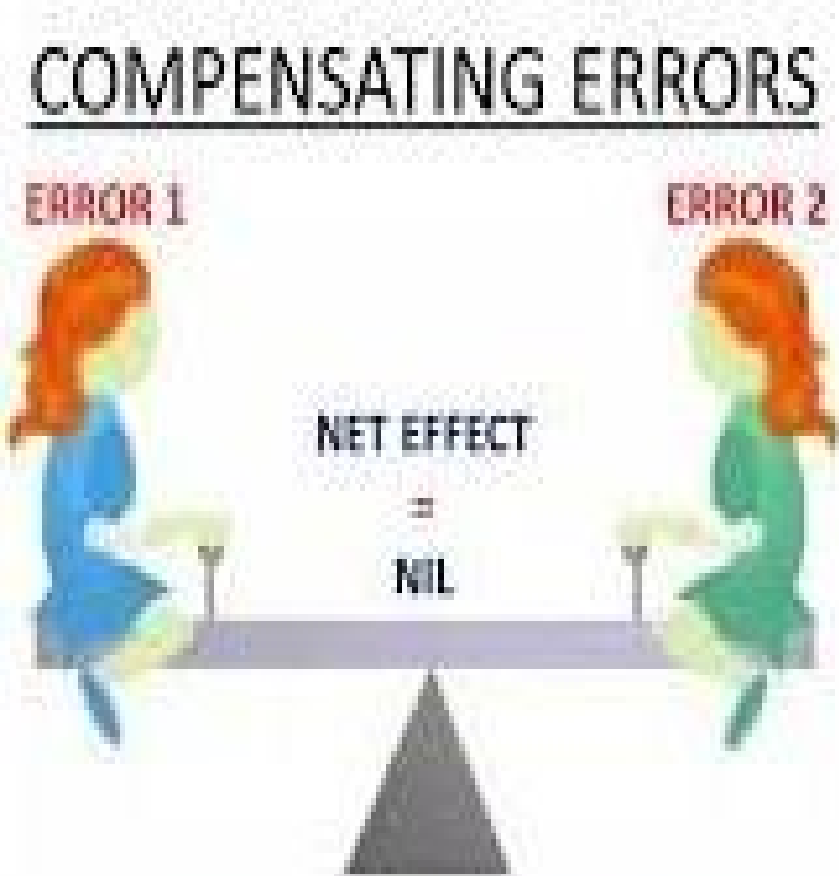
*There are certain types of errors such as entry of wrong amount , error of principle etc. which are not disclosed by a trial balance i.e. even if the trial balance agrees such errors relating to accounts may still be there.*

### 3. Non-disclosure of operational results



*The trial balance does not give any information regarding operational results and financial position.*

## 4. Non- disclosure of compensating error



*The trial balance does not disclose the compensating error.*

# Financial statements



## Financial Statements

(Ya-'honi)-shal 'stat-mants)

Written records that convey the business activities and the financial performance of a company.

Final Accounts or Financial Statements are the end products of the financial accounting process which involves the preparation of a summary of the accounts with a view to determine:

- (i) Net profit from the trading activities in terms of profit made or loss incurred for a given period, and
- (ii) Its financial position in terms of assets and liabilities as on the last date of the given period.

For the purpose of determining the profit or loss, a statement known as *Trading and Profit and Loss Account (Income Statement)* is prepared which incorporates all items of expenses and losses and all incomes and gains occurring during the accounting period.

# Financial statements

## WHAT IS A FINANCIAL STATEMENT?

In order to show the financial position on the last date of the accounting period, another statement known as Balance Sheet (*Position Statement*) is prepared which consists of all assets, liabilities and capital of the business. These two statements are collectively known as Final Accounts.

Final Accounts are prepared from the balances appearing in the trial balance. Debit balances of assets are transferred on the right hand side of the balance sheet while expenses and losses are debited to the Trading Account or to the Profit and Loss Account, depending upon the nature of expenditure or loss. Credit account balances like capital, liabilities, provisions and reserves are entered on the left hand side of the balance sheet while incomes and gains are credited to Trading Account or Profit and Loss Account.

# Objectives/purpose of Financial Statements





# (i) Reliable financial information



To provide reliable financial information about economic resources and obligations of a business enterprise.

## (ii) Net resources (resources less obligations)



To provide reliable information about the net resources (resources less obligations) of an enterprise that results from its activities.

### (iii) Assists in estimating the earning potentials



#### Earnings Power

*(ar-nigz 'pau(-s)l)*

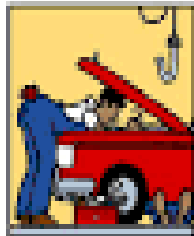
A figure that telegraphs a business's ability to generate profits over the long haul, assuming all current operational conditions generally remain constant.

To provide financial information that assists in estimating the earning potentials of a business.

## (iv) Changes in economic resources or obligations

### ECONOMIC RESOURCES

- Land
- Labor
- Capital



To provide other needed information about changes in economic resources or obligations.

(v) To disclose information related to the financial statements



To disclose, to the extent possible, other information related to the financial statements that is relevant to the needs of the users of these statements.

# Utility and significance/importance of the financial statements to various parties in the business concern



# (1) Owners



The owners provide funds for the operations of a business and they want to know whether their funds are being properly utilised or not. The financial statements prepared from time to time satisfy their curiosity.

## (2) Creditors



Creditors (i.e., suppliers of goods and services on credit, bankers and other lenders of money) want to know the financial position of a concern before giving loans or granting credit. The financial statements help them in judging such position.



# (3) Investors



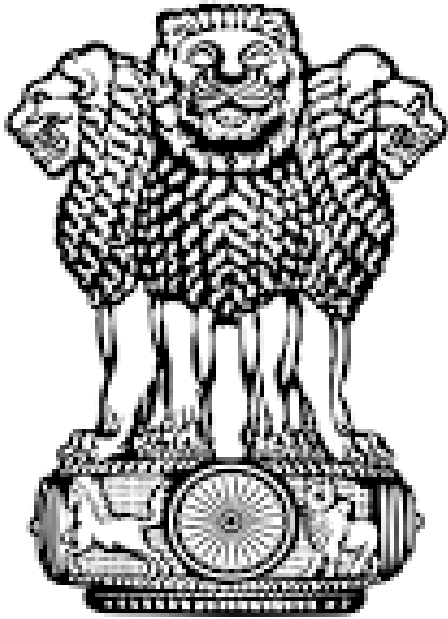
Prospective investors, who want to invest money in a firm, would like to make an is of the financial statements of that firm to know how safe the proposed investment will be.

# (4) Employees



Employees are interested in the financial position of a concern they serve, particularly when payment of bonus depends upon the size of the profits earned. They would like to know that the bonus being paid to them is correct; so they become interested in the preparation of correct Profit and Loss Account.

# (5) Government



सत्यमेव जयते

**Government Of India**

Central and State Governments are interested in the financial statements because they reflect the earnings for a particular period for purposes of taxation. Moreover, these financial statements are used for compiling statistics concerning business which, in turn, help in compiling national accounts.

## (6) Research Scholars



The financial statements, being a mirror of the financial position of a firm, are of immense value to the research scholar who wants to make a study into financial operations of a particular firm.

# (7) Consumers



Consumers are interested in the establishment of good accounting control so that cost of production may be reduced with the resultant reduction of the prices of goods they buy.

# (8) Managers



Management is the art of getting things done through others. This requires that the subordinates are doing work properly. Financial statements are an aid in this respect because they serve the manager in appraising the performance of the subordinates. Actual results achieved by employees can be measured against the budgeted performance they were expected to achieve and remedial action can be taken if the performance is not upto the mark.

# *Limitation of financial statement*



# (i) Interim Reports



Financial statements are essentially **interim reports** and therefore, cannot be final because the final gain or loss can be computed only at the termination of the business. Financial statements only reflect the progress and position of the business at frequent intervals during its life.



## (ii) Expressed in exact monetary terms



(ii) Financial statements though **expressed in exact monetary terms**, are not absolutely final and accurate. As the balance sheet is prepared on the basis of the going concern concept, asset valuation represents neither the realizable value nor replacement costs. Further, they depend on the judgment of the management in respect of various accounting policies.

### (iii) Depend upon the standards of the persons dealing



The values ascribed to the assets presented in the statements **depend upon the standards of the persons dealing** with them. For instance, the method of depreciation, mode of amortization of fixed assets, treatment of deferred revenue expenditure, all depend on the personal judgment of the accountant.

## (iv) Consideration only the financial factors



Financial statements take into **consideration only the financial factors**. They fail to bring out the significance of non-financial factors which may have considerable bearing on the operating results and financial conditions of an enterprise. For example, public image of the enterprise, the caliber of its management, efficiency and loyalty of its workers etc.

# (v) Window Dressing

## Example of Window Dressing

Offer discounts that are unusual in order to drive higher than usual revenue to impress shareholders.

Heavy  
Discounting



Inflate Sales  
in Short-term

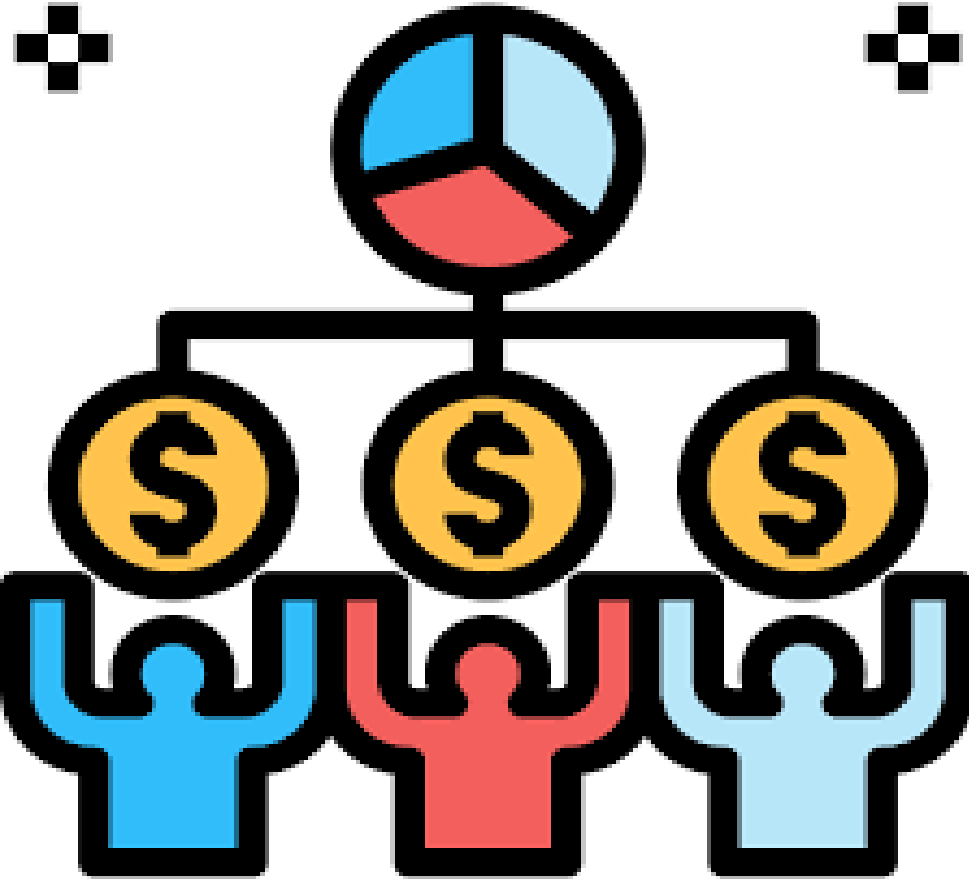


Mislead  
Shareholders



It is not always possible to discover false figures in financial statements. Unscrupulous managements generally resort to ‘**window dressing**’ in the preparation of such statements.

## (vi) Prepared primarily for shareholders



Financial statements are **prepared primarily for shareholders.** Other interested parties have to generally make many adjustments before they use them profitably.

## (vii) Do not disclose current worth of the business



Quite often, financial statements **do not disclose current worth of the business.** Only historical facts are presented and the true current worth is not reflected.

# (viii) Compiled on the basis of historical costs



## Historical Cost

*(hi-'stor-i-kal 'kost)*

A measure of value used in accounting in which the value of an asset on the balance sheet is recorded at its original cost when acquired by the company.

Owing to the fact that financial statements are **compiled on the basis of historical costs**, while there is a marked decline in the value of the monetary unit and resultant rise in prices, the balance sheet loses its function as an index on current economic realities. Again, the financial statements contain both historical and current costs items, hence figures are distorted.

# Profit and Loss Account and the Appropriation Account

In the case of a sole proprietorship, the whole of the net profit is credited to the proprietor's capital and the Capital Account is debited for any drawings. A distinction is required, in case of a partnership business, for computing and demonstrating the division of the profit or loss among the partners. Therefore, a new section, known as Profit and Loss Appropriation Account, is added to the Profit and Loss Account, which is an essential part of the partnership accounts. This account will show how the net profit of the business is being apportioned among partners. The Profit and Loss Appropriation Account includes interest on capital, interest on partner's loan, salaries to partners, commission to partners, interest on drawings and the share of profit. This account may also include any reserve that has been created by the business but will not include any drawings made by the partners.

This account is credited with the net profit (taken from Profit and Loss Account) and the interest on drawing charged to the partners (which is a loss to the partners but an income for the firm) and debited with interest on capital, salaries to partners, commission to partners, share or pronounce to reserve, etc. A specimen of this account is as under: A

*Let us assume that there are two partners: A and B. A is entitled to salary and B get a commission.*



# Profit and Loss Appropriation Account

Dr. For the year ended... Cr

Particulars	Rs	Particulars	Rs
To Reserve A/c — transferred to Reserve		By Profit and Loss A/C — Net profit	
To Interest on Capital A/C		By Interest on Drawings A/C	
A-		A-	
B-		B -	
To Interest on Partners' Loan A/c			
To Partners' Salary A/c   (Partner A)			
To Partners' Commission A/c (Partner A)			
To Share of Profit A/C (balancing figure)			
A-			
B-			

# Preparation of financial statement in conformity with Indian GAAP



## (i) Uniformity in accounting practices



Accounting principles are the general guidelines for accounting and reporting of financial transactions.

## (ii) Comparability of financial statements



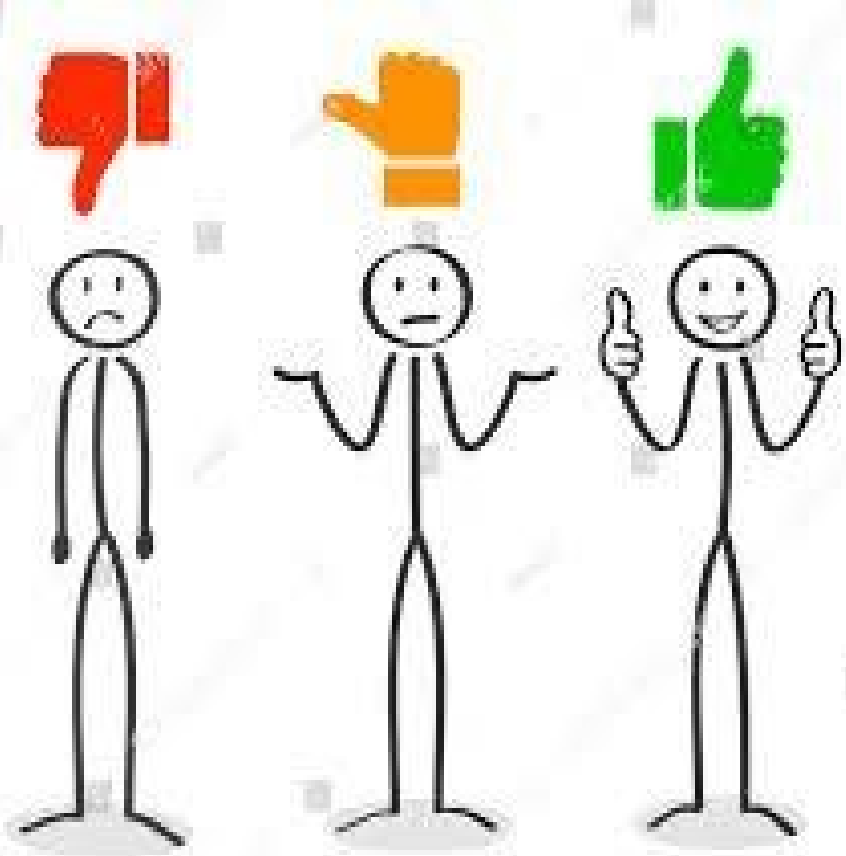
Uniformity in accounting practices has made the accounting statements comparable and understandable.

### (iii) Reliability of financial statements



Accounting principles provide sound techniques for recording financial transactions.

## (iv) Neutrality in Accounting



Accounting principles make accounting and reporting of financial transactions free from personal biasedness.

# Trading Accounting

Trading Account is the first part of income statement which is prepared to ascertain the gross profit or gross loss for a given accounting period. Trading Account is prepared before the preparation of profit & loss account. It shows the result of trading activities relating to purchases & sales of goods & services. Trading account is prepared to calculate separately the profit from sale & purchase transactions only. The profit or loss is termed as gross profit or gross loss as various other expenses of an organisation like administrative, selling & distribution and maintenance expenses etc. are not deducted. Only the direct expenses which are incurred to bring goods into saleable condition like freight, insurance, carriage inwards, fuel, power, and royalties on production, consumption of stores etc. are taken into account to calculate gross profit/loss.

**Gross Profit** = Net Sales – Cost of the Goods Sold.

**Gross Loss** = Cost of the Goods Sold – Sales

**Net Sales** = Total Sales – Sales Returns (Return Inwards)

**Cost of goods sold** = Opening stock of goods + net purchases - closing stock of goods at the end + all direct expenses

**Net Purchases** = Total Purchases – Purchases Returns (Returns Inwards)

# *Need and importance of Trading Account*



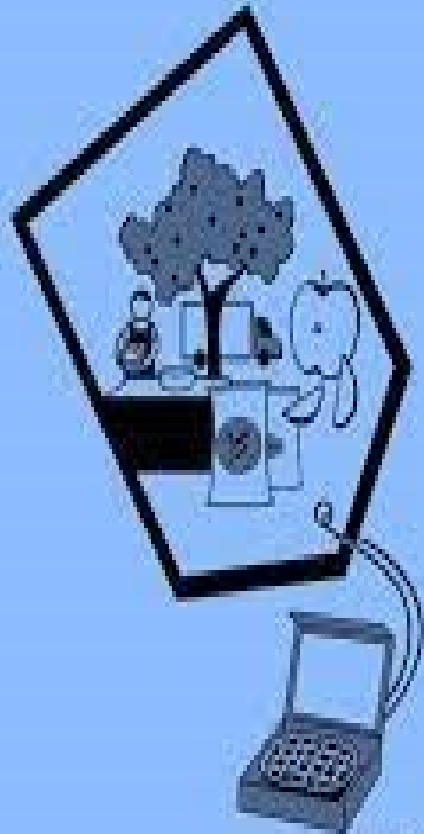


## **(1) It provides information about gross profit and gross loss**

$$\text{Gross Profit} = \text{Net Revenue} - \text{COGS}$$

it informs of the gross profit or gross loss as a result of buying and selling the goods during the year. The percentage of current year's gross profit on the amount of sales can be calculated and compared with those of the previous years. Thus, it provides data for comparison, analysis and planning for a future period.

## (2) It provides information about the direct expenses



### Direct Cost

(di-'rekt 'kost)

A price that can be directly tied to the production of specific goods or services.

All the expenses incurred on the purchase and manufacturing of goods are recorded in the trading Account in a summarized form. Percentage of such expenses on sales can be calculated and compared with those of the previous years. In this way it enables the management to control and rationalize the expense.

### (3) Comparison of closing stock with those of the previous years



closing stock has to be valued and recorded in a trading account. This stock can be compared with the closing stock of the previous years and if the stock shows increasing trends, the reason may be inquired into.

## (4) It provides safety against possible losses



if the ratio of gross profit has decreased in comparison to the preceding year, the businessman can take effective measures to safeguards himself against future losses. For example, he may increase the sale price of his goods or may proceeds to analyze and control the direct expanses.

# *Profit and loss Account*

Profit and Loss Account is prepared to calculate the net profit or loss of the business for a given accounting period. The balance of Trading Account i.e. gross profit/gross loss is transferred to the Profit and Loss Account which is the starting point of the preparation of this account. Thereafter, all those expenses and losses which have not been debited already to the Trading Account are debited to the Profit and Loss Account. Other incomes and gains, if any, are credited to this account, e.g. interest earned or commission received etc. The net profit, thus arrived at is transferred to Capital Account of the proprietor/partners. Specimen of Profit & Loss Account is given on next page. Net profit increases the capital whereas net loss decreases the capital.

**Net profit** = Total Revenues – Total Expenses

**Net Loss** = Total Expenses – Total Revenues

# *Need and importance of profit and loss Account*



# **(1) To ascertain the net profit or net loss**



A trading Accounts only disclose the gross profit earned as a result of trading activities , whereas the profit and loss Account disclose the net profit( or net loss) available to the proprietor and credited to his capital account.

## (2) Comparison with previous year's profit



The net profit of the current years can be compared with that of the previous years. It enables the businessman to know whether the business is being conducted efficiently or not.



### (3) Control or Expense



Profit and loss account helps in comparing various expenses with the expenses of the previous year. Also the percentage of each individual expense to net profit is calculated and compared with the similar ratio of previous years. Such comparison will be helpful in taking concrete steps for controlling the unnecessary expense.

## (4) helpful in the preparation of balance sheet

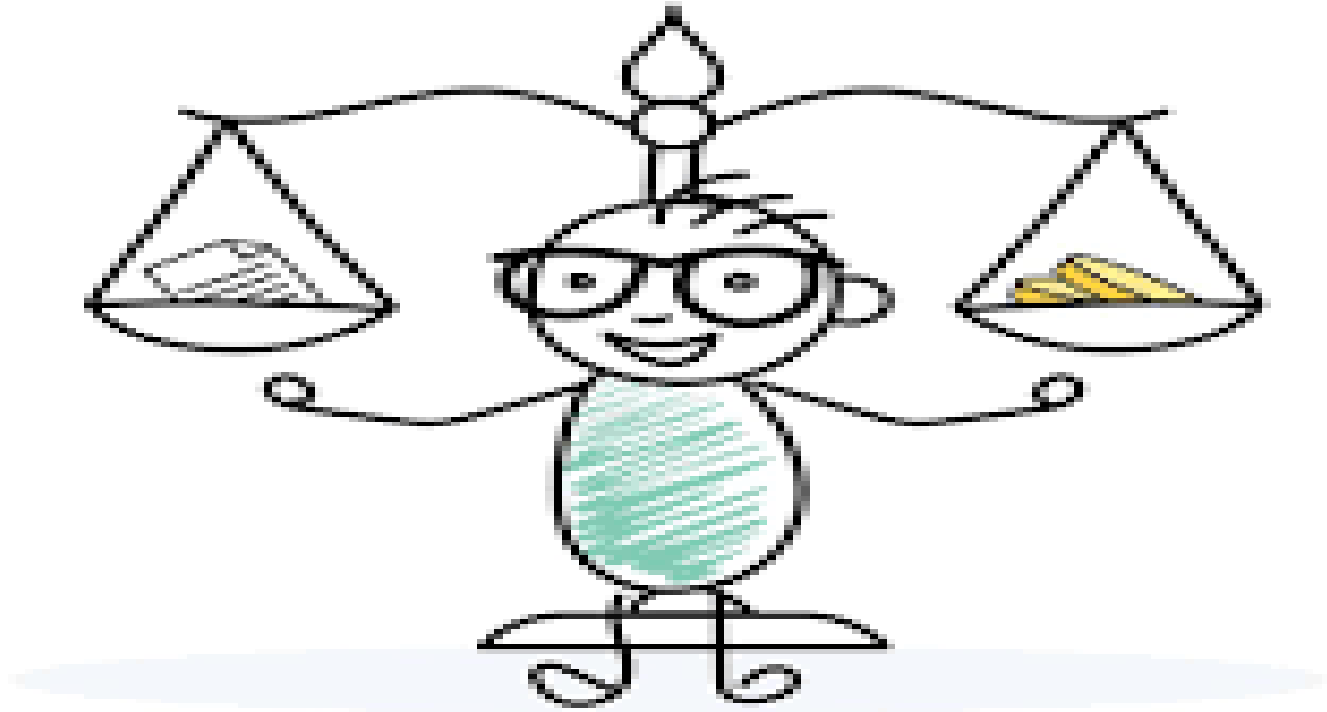


A balance sheet can only be prepared after ascertain the net profit through the preparation of profit and loss Account.

# Difference between Trading Account and profit and loss Account

Basis of differences	Trading Account	Profit and Loss Account
<b>1.Stage of final account</b>	It is the first stage of final account.	It is the second stage of final accounts
<b>2.objective</b>	Trading account is prepared to calculate the gross profit (loss) for a particular period.	Profit and loss account is prepared to arrive at the net profit (loss)
<b>3.contents</b>	In trading account, cost of goods sold, sales and direct expenses are accounted.	In profit and loss account, indirect expenses, such as administrative expenses, selling expenses, etc, are charged against the gross profit and other revenues.
<b>4. transfer of profit</b>	The result of trading account i.e. gross profit (loss) is transferred to profit and loss account.	The balance in profit and loss account i.e. net profit (loss) is transferred to capital account which will be shown in the balance sheet.
<b>5.Indicator</b>	It indicates the efficiency in purchasing and selling activities	It indicates the efficiency of the management of the business as a whole.
<b>6.True profit</b>	True profit or loss of a business cannot be found from trading account because it ignores indirect expenses.	Profit and loss account reveals or discloses final or ultimate profit or loss after taking into consideration all incomes and all expenses.

# Balance Sheet



# Balance sheet

Balance sheet is a statement which shows the financial position i.e. the balances of assets, liabilities and capital, of a business entity at a given date. It is prepared from the real accounts and personal accounts of trial balance. A debit balance in a real account or personal account represents an asset of the concern/firm. Likewise a credit balance in a personal account represents a liability. There can be some newly opened accounts as well on account of adjustment entries. The assets and liabilities are arranged in a proper way and the resultant statement is the balance sheet. On the right hand side, assets are arranged while on the left hand side, liabilities are recorded. The totals of the two sides of the balance sheet must agree because of the equation.

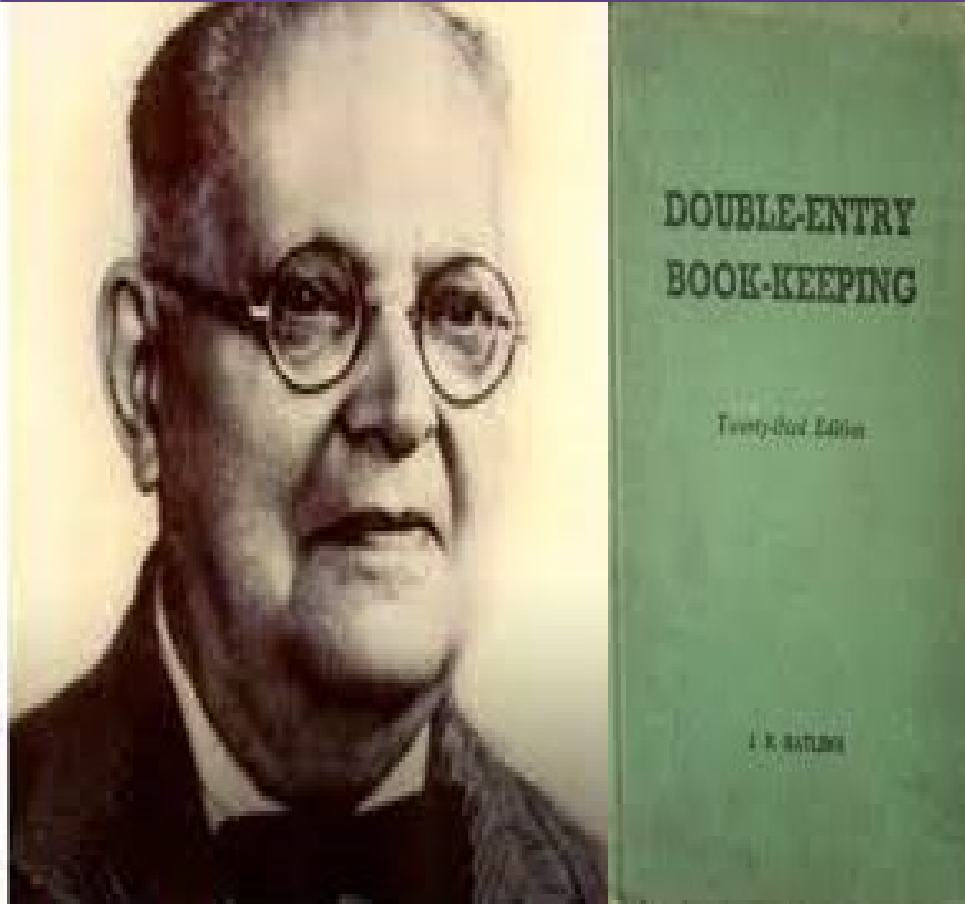
$$\text{Assets} = \text{Liabilities} + \text{Capital}.$$

# According to Palmer



The balance sheet is a statement at a particular date showing on one side, the trader's property and possessions and on the other side his liabilities.

# According to J.R. BatliBoi



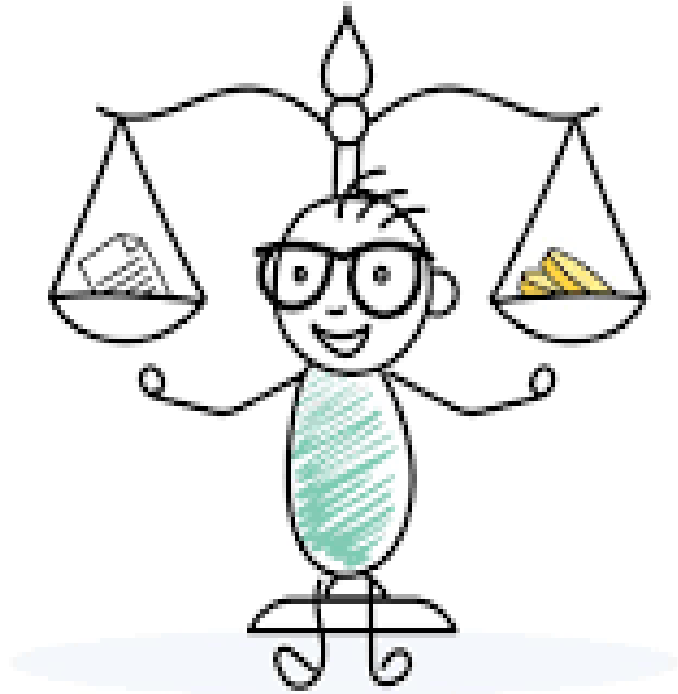
A balance sheet is a statement prepared with a view to measure the exact financial position of a business on a particular date.

# Features of Balance Sheet





## (i) To ascertain the financial position of a concern



The primary objective of the preparation of balance sheet is to **ascertain the financial position of a concern.**

## (ii) Nature and value of assets



It shows (a) the nature and value of assets, (b) the nature and value of liabilities and (c) the position of capital.

### **(iii) Prepared on a certain date**



Balance sheet is always **prepared on a certain date**, never for a particular period.

## (iv) Not an account



Balance sheet, unlike a trading and profit and loss account, is **not an account**. It is a statement containing information regarding assets, liabilities and capital.

# A Balance Sheet is a statement and not an account

It is quite true that a balance sheet is a statement and not an account. Like an account it has two sides but the sides are not debit side and credit side. They are assets side and liabilities side. The debit balances of the nominal accounts appear the debit side and the credit balances of the nominal accounts appear on the credit side of the profit and Loss Account. But in the Balance Sheet, the debit balances of real and personal accounts appear on the assets side or right hand side and the credit balance of personal accounts appear on the liabilities side or the left hand side. Moreover, the words “Dr.’ Cr’ ‘To’ and ‘By’ applicable in case of an account are not applicable in case of a Balance Sheet.

The account contains transactions for a particular period but a Balance Sheet contains assets and liabilities as they stand on a particular date. An account does not show the picture of the business for the whole of the period.

Therefore, we may say that Balance Sheet is not an account but a statement of assets and liabilities on a given date

# Marshalling of Balance Sheet

	Assets	Rs. (000)	Liabilities	Rs. (000)
<i>Least liquid</i>	Land		Debentures	
	Building		Loans	
<i>Permanency</i>	Plant & Machinery		Trade Creditors	
<i>Decreasing</i>	Office equipment		Bills Payable	
	Inventory		Overdraft	
	Debtors			
	Notes receivable			
	Cash at Bank			
<i>Most liquid</i>	Cash in hand			

	Assets	Rs. (000)	Liabilities	Rs. (000)
<i>Most liquid</i>	Cash in hand		Overdraft	
	Cash at Bank		Bills Payable	
	Notes receivable		Trade Creditors	
<i>Liquidity</i>	Debtors		Loans	
<i>Decreasing</i>	Inventory		Debentures	
	Office equipment			
	Plant & Machinery			
	Building			
<i>Least liquid</i>	Land			

The arrangement of assets and liabilities in accordance with a particular order is known as marshalling of balance sheet. The items in the balance sheet are generally marshalled in two ways-

# (i) Liquidity order

	Assets	Rs. (000)	Liabilities	Rs. (000)
Most liquid	Cash in hand		Overdraft	
	Cash at Bank		Bills Payable	
	Notes receivable		Trade Creditors	
Liquidity	Debtors		Loans	
Decreasing	Inventory		Debentures	
	Office equipment			
	Plant & Machinery			
	Building			
Least liquid	Land			

(i) Liquidity order or according to time: In liquidity order, the assets are stated in the order in which they can be easily converted into cash and the liabilities in the order in which they have to be paid off. Generally, **sole proprietors and partnership firms** prepare their balance sheet in the order of liquidity.

## (ii) Permanence order

	Assets	Rs. (000)	Liabilities	Rs. (000)
Least liquid	Land		Debentures	
	Building		Loans	
	Plant & Machinery		Trade Creditors	
Permanency	Office equipment		Bills Payable	
Decreasing	Inventory		Overdraft	
	Debtors			
	Notes receivable			
	Cash at Bank			
Most liquid	Cash in hand			

(ii) Permanence order or according to purpose: In permanence order, assets which are to be used permanently in the business and are not meant for sale are shown first and the assets that are liquid are shown last in order. Similarly, liabilities may also be shown according to the permanence arrangement.

**Joint stock companies are required under the companies act to prepare balance sheet in the order of permanence.**



# (iii) Mixed order

यूनियन बैंक ऑफ इंडिया Union Bank of India



BALANCE SHEET AS ON 1<sup>st</sup> APRIL, 2020

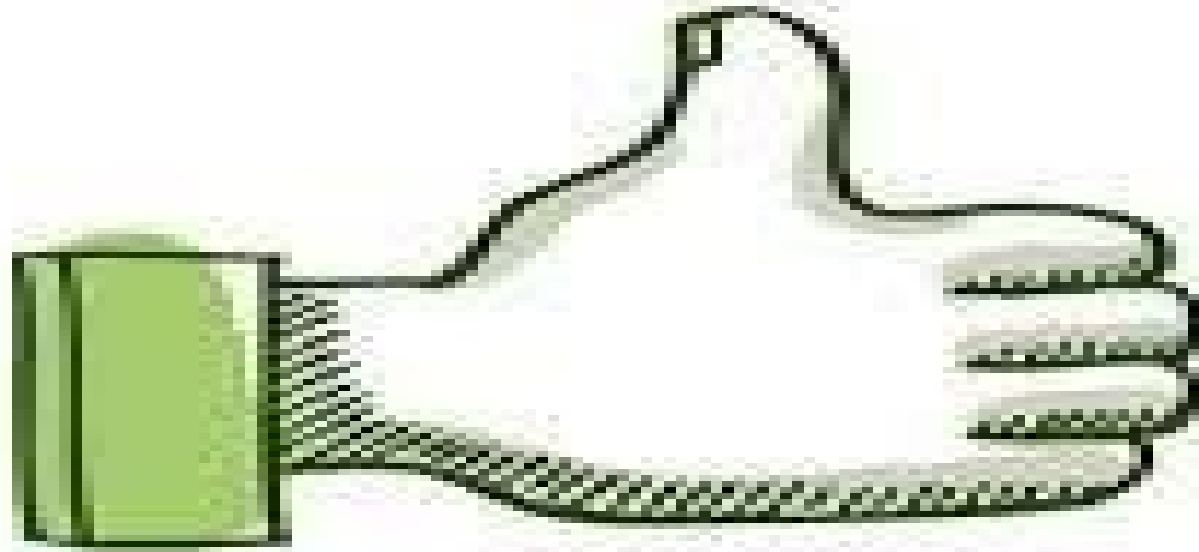
Particulars	Schedule Number	As on 1st April 2020
<b>CAPITAL AND LIABILITIES</b>		
Capital	1	6,40,68,444
Reserves and Surplus	2	53,52,75,483
Deposits	3	8,68,63,26,111
Borrowings	4	68,91,68,961
Other Liabilities and Provisions	5	24,39,06,965
<b>TOTAL</b>		<b>10,21,87,45,964</b>
<b>ASSETS</b>		
Cash and Balances with Reserve Bank of India	6	43,59,28,367
Balances with Banks and Money at Call and Short Notice	7	39,63,36,010
Investments	8	2,80,32,46,433
Advances	9	5,99,82,97,530
Fixed Assets	10	7,62,44,311
Other Assets	11	50,86,93,313
<b>TOTAL</b>		<b>10,21,87,45,964</b>
Contingent Liabilities	12	3,63,98,07,603
Bills for Collection		49,51,16,105
Significant Accounting Policies	13	
Notes to Accounts	14	

The Schedules referred to above form an integral part of the Standalone Balance Sheet

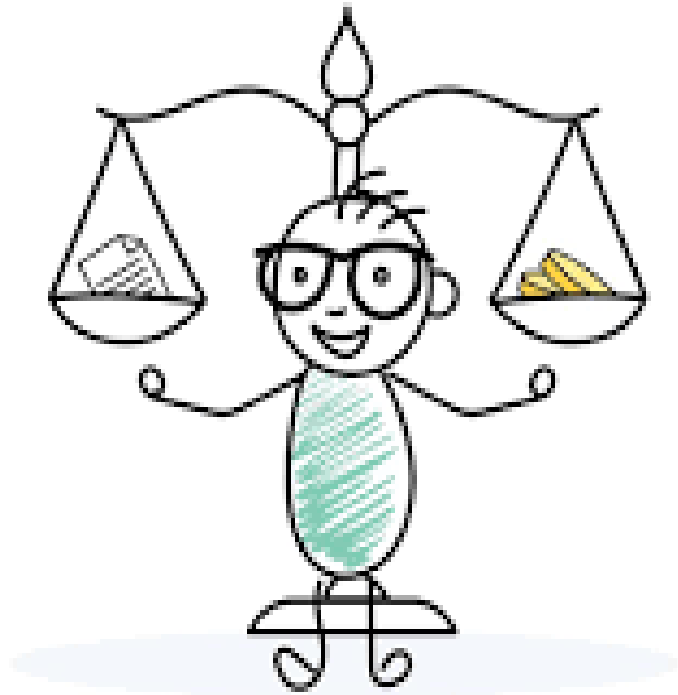
iii) Mixed order: it is the mixture of liquidity order and permanency order. Under this order of arrangement, assets are shown in liquidity order and liabilities are shown in permanency order.

**Banking and insurance companies follow this order.**

# Advantages of marshalling



# (i) Financial Position



It is easy to know the **financial position** of the enterprise.

## (ii) Nature and value of assets



It shows (a) the nature and value of assets, (b) the nature and value of liabilities and (c) the position of capital.

### (iii) Prepared on a certain date



Balance sheet is always **prepared on a certain date**, never for a particular period.

## (iv) Not an account



Balance sheet, unlike a trading and profit and loss account, is **not an account**. It is a statement containing information regarding assets, liabilities and capital.

# Difference between Trial balance and Balance sheet

Basis of differences	Trial balance	Balance sheet
<b>1 statement</b>	It is a statement of debit balances and credit balances taken from the ledger.	It is a statement of assets and liabilities
<b>2 objective</b>	It is prepared to test the arithmetical accuracy of books of account.	It is prepared to ascertain the financial position of the organization on a particular date.
<b>3 balance of accounts</b>	Balances of all types of accounts i.e. personal, real, and nominal accounts are shown.	Balances of real and personal accounts only are shown.
<b>4 preparation</b>	It is usually prepared at the end of each month, three months, six months or at the end of accounting year before the preparation of trading and profit and loss account.	It is usually prepared at the end of the year after the preparation of trading and profit and loss account.
<b>5 closing stock</b>	Closing stock does not appear in the trial balance.	Closing stock is shown on the assets side of the balance sheet.
<b>6 uses</b>	It is prepared for internal use.	It is prepared for external use, i.e. for outside parties such as, creditors, shareholders (in case of companies), government authorities etc.

# Difference between profit and loss Accounts and Balance sheet

Basis of differences	Profit and loss Account	Balance sheet
<b>1 statement/accounts</b>	Profit and loss account is an account	Balance sheet is a statement of assets and liabilities.
<b>2 objectives</b>	Profit and loss account shows the profits earned or losses incurred for the accounting period	Balance sheet shows financial position of the business.
<b>3 preparation</b>	Profit and loss account is prepared for the accounting period	Balance sheet is prepared as at the last day of the accounting period.
<b>4 transfer</b>	The accounts that are transferred to the profit and loss account are closed and cease to exist.	The accounts which are shown in the balance sheet do not lose their identity and become the opening balances in the next accounting period