

# Final Accounts

Preparation of Trading & profit & loss A/c

Preparation of Balance sheet

# FINAL ACCOUNTS

Preparation of Final Accounts involve:

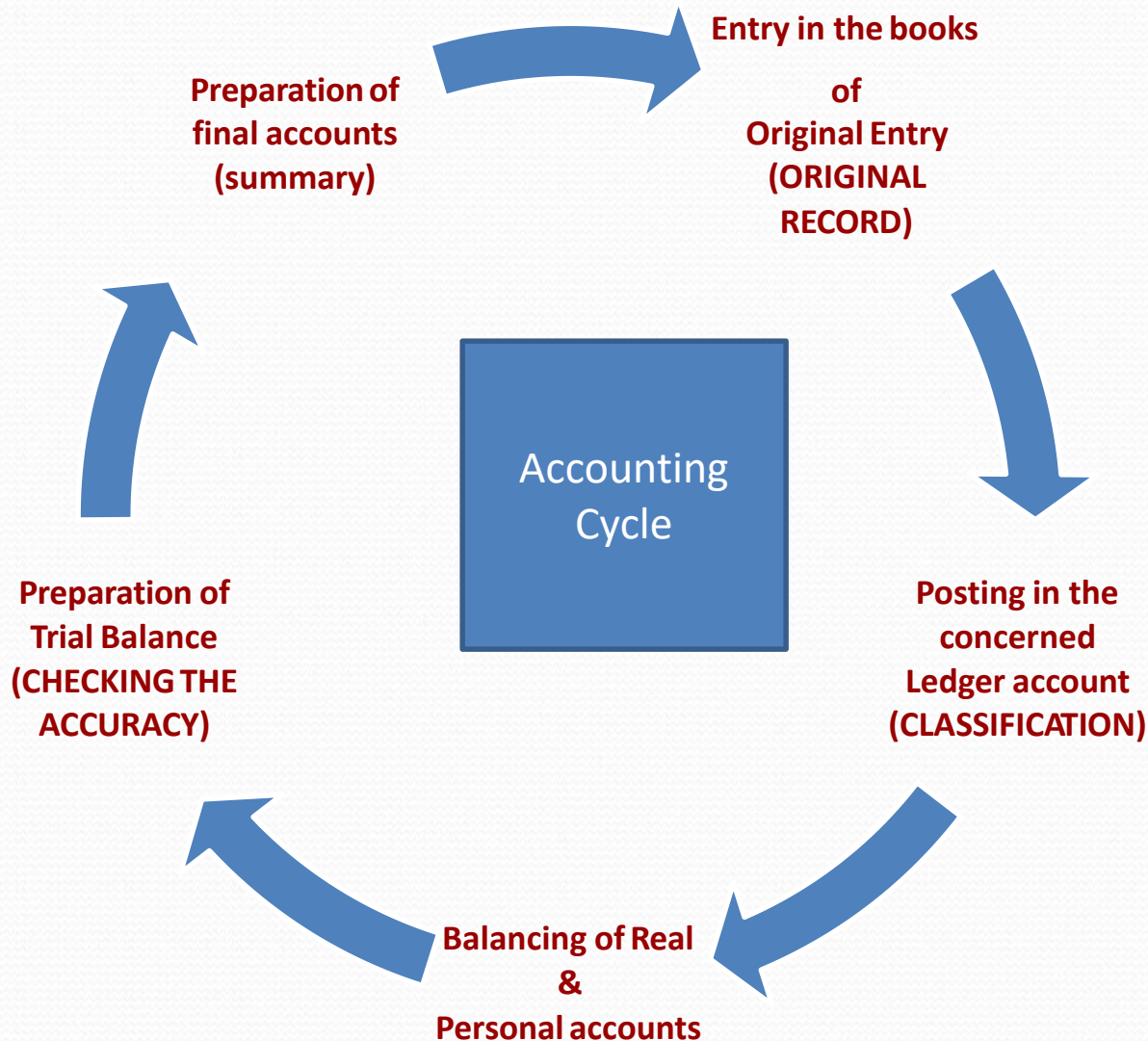
❑ **Trading Account** ( The objective is to ascertain the gross profit and gross loss of an organization during an accounting period.)

❑ **Profit and Loss account** ( To ascertain net profit or net loss during an accounting period)

❑ **Balance Sheet** ( It shows the financial position of the of a business by detailing the sources of funds and utilization of funds.)

# ACCOUNTING CYCLE

## TRANSACTIONS





# Trading Account

Particulars	Amount	Particulars	Amount
To Opening Stock		By sales	
To Purchases		By Closing Stock	
Less Purchase Return			
To Carriage Inwards			
To wages			
Gas, water and Fuel			
Lighting and Heating			
Factory Expenses			
To Gross profit (IF)			

# Profit & Loss Account

For non-corporate business organisation Profit & Loss account is second part of income statement. It is prepared to know the net loss of business during a particular period. Every businessman has to spend on expenses other than on manufacture or purchase of goods which are called indirect expenses. There can be other incomes except sales. So gross profit or loss is adjusted keeping in view these indirect expenses and other incomes to find out net profit or net loss.



# Proforma of Profit & Loss Account

Particulars	Amt	Particulars	Amt
To Gross Loss b/d		By Gross Profit b/d	
To Establishment Charges		By Other Incomes	
To Administrative Charges		By Interest rec.	
To Selling & Distribution expenses		By Comm. Received Etc.	
To Financial Charges		By Net Loss (transferred to capital account)	

To Depreciation  
& Provisions  
To Abnormal  
Losses  
To Net Profit  
(transferred to  
Capital Account)

# Balance Sheet

Balance Sheet is a component of financial statements which shows balances of capital, liabilities & assets. All nominal accounts are closed by transferring these to Trading & Profit & Loss Account. Only personal & real accounts are left.

Balance Sheet is the final phase in accounting cycle. It is a 'mirror' which reflects the true position of the assets & liabilities of the business on a particular date.

“A statement of financial position of economic unit disclosing as at a given moment of time its assets, liabilities & ownership equities. Eric L.kohler



# *Meaning of Balance sheet:*

Balance sheet is a statement. It is not actually an account. It is a statement showing the financial position of the business on a particular date. It shows all the Assets and Liabilities of the business. It is the soul of the business.

Asset side of the balance sheet	Liability side of the balance sheet
1) Fixed Assets.	1) Fixed liability.
2) Current Assets.	2) Current liability.
3) Fictitious Assets.	3) Contingent liability.

Liabilities	Amt	Assets	Amt
Capital		Fixed Assets:	
Add: Net Profit		Goodwill	
Less: Drawings		Land and Buildings	
Fixed Liabilities:		Plant & Machinery	
Long term loan		Motor Vehicles	
Public deposits		Furniture	
Current Liabilities:		Patents & Trade Marks	
Unexpired Income		Live Stock	
Short Term Loans		Loose Tools	
Trade Creditors		Investments	
Bank Overdraft			

<p><b>Bill Payable</b></p> <p><b>Outstanding</b></p> <p><b>Expenses</b></p>		<p><b>Current Assets:</b></p> <p><b>Closing Stock</b></p> <p><b>Prepaid</b></p> <p><b>Expenses</b></p> <p><b>Accrued</b></p> <p><b>Income</b></p> <p><b>Debtors</b></p> <p><b>Bill Receivable</b></p> <p><b>Cash at Bank</b></p> <p><b>Cash in hand</b></p>	



ADJUSTMENTS

# ADJUSTMENTS

## CLOSING STOCK

The unsold goods lying in store at the end of accounting year. Treatment:

Stock a/c Dr.

To Trading a/c

Two fold effect of adjustment will be :-

- 1) Show on Credit side of the Trading account
- 2) On asset side of Balance Sheet

# OUTSTANDING EXPENSES

**Those expenses which have been incurred & not yet paid.**

**Treatment:**

**Expenses a/c Dr**

**To outstanding expenses**

**Two fold effect:**

- 1. Will be shown on debit side of trading & profit & loss a/c by way of addition to particular expense.**
- 2. Will be shown on liabilities side of Balance Sheet.**



# **PREPAID EXPENSES**

**Those expenses which have been paid in advance i.e., whose benefit will be available in future is called prepaid expenses. Treatment:**

**Prepaid Expenses a/c Dr**

**To Expenses a/c**

**Two fold effect:**

- 1. Will be shown in profit & loss a/c by way deduction from particular expense.**
- 2. Will be shown on asset side of Balance Sheet.**

# ACCRUED INCOME

**That income which has been earned but not received during the accounting year is called accrued income. Treatment:**

**Accrued Income a/c Dr**

**To Income a/c**

**Two fold effect:**

- 1. Will be shown on credit side of P & La/c**
- 2. Will be shown on asset side of Balance Sheet**



# UNEARNED INCOME

**Income received but not earned during accounting year is called income received in advance.**

**Treatment:**

**Income a/c Dr**

**To Income Received in advance**

**Two fold effect:**

- 1. Will be shown on credit side of P & L a/c by the way of deduction from particular income.**
- 2. Will be shown on liabilities side of Balance Sheet.**



# DEPRECIATION

**Depreciation is the reduction in the value of fixed asset due to its use, wear & tear. Treatment:**

**Depreciation a/c Dr**

**To Asset a/c**

**Two fold effect:**

- 1.Is shown on debit side of P & L a/c**
- 2.Is shown on the Asset side of the Balance Sheet by way of deduction from value of concerned asset**

# BAD DEBTS

**Debts which are definitely irrecoverable are called Bad Debts.**

**Treatment:**

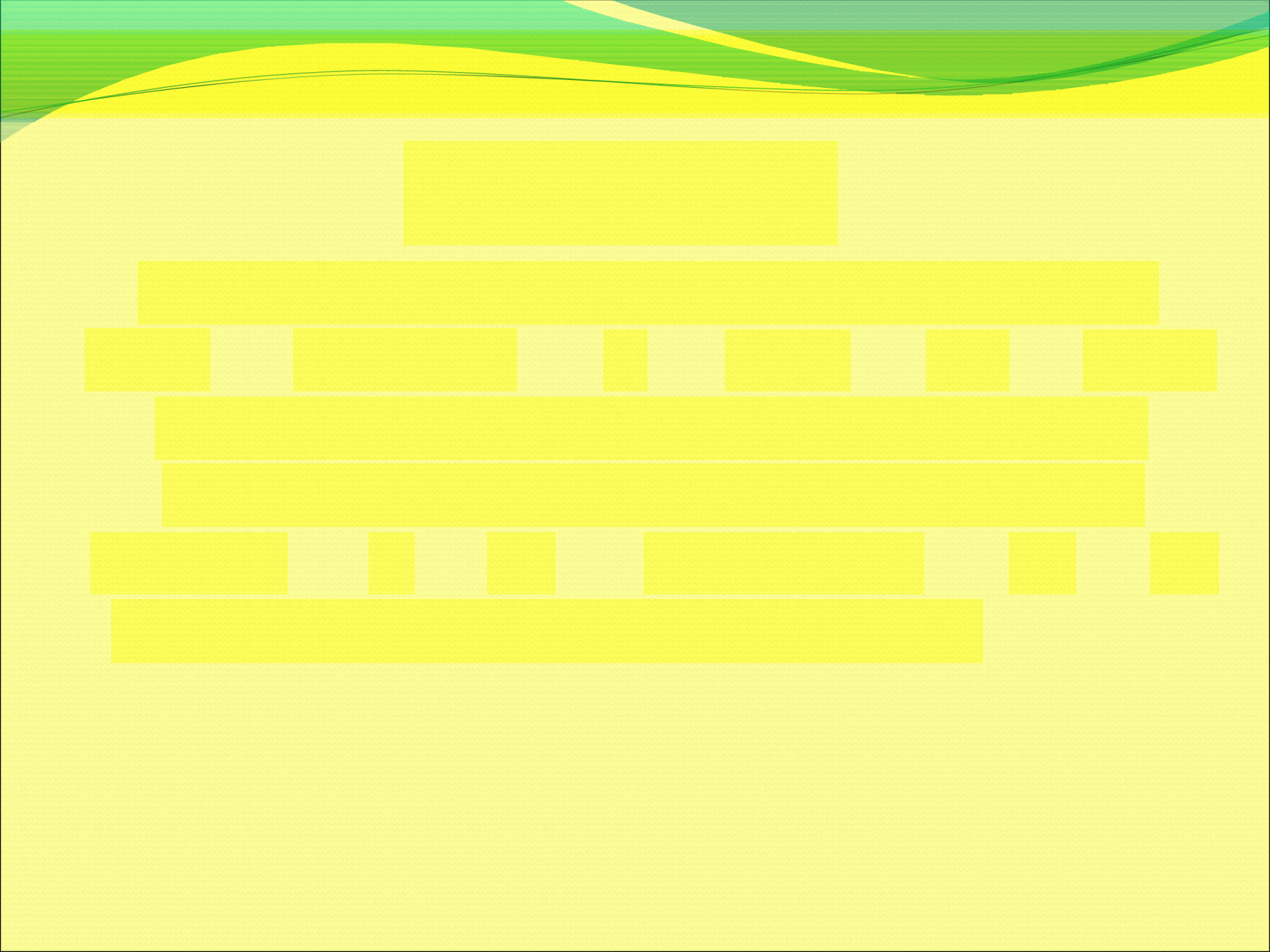
**Bad Debts A/c Dr**

**To Sundry Debtors a/c**

**Two fold effect:**

- 1. Is shown on debit side of P & L a/c.**
- 2. Is shown on assets side of Balance Sheet by way of deduction from Sundry Debtors.**





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**Illustration No. 10**

From the following Trial Balance and additional information, you are required to prepare profit and loss account and balance sheet.

**TRIAL BALANCE**  
as on 31<sup>st</sup> December, 2008

Particulars	Dr. Amount (Rs.)	Cr. Amount (Rs.)
Capital		20,000
Sundry Debtors	5,400	
Drawings	1,800	
Machinery	7,000	
Sundry Creditors		2,800
Wages	10,000	
Purchases	19,000	
Opening Stock	4,000	
Bank Balance	3,000	
Carriage Charges	300	
Salaries	400	
Rent and Taxes	900	
Sales		29,000
	51,800	51,800

Additional Information:

- (i) Closing Stock Rs. 1,200.
- (ii) Outstanding Rent and Taxes Rs. 100.
- (iii) Charge depreciation on machinery at 10%.
- (iv) Wages prepaid Rs. 400.

**Solution:**

**TRADING AND PROFIT & LOSS ACCOUNT**  
for the year ending 31st December, 2008

Particulars	Amount Rs.	Particulars	Amount Rs.
To Opening Stock	4,000	By Sales	29,000
To Purchases	19,000	By Closing Stock	1,200
To Wages 10,000	9,600	By Gross Loss B/d	2,700
Less Prepaid Wages 400			
To Carriage	300		
	<u>32,900</u>		<u>32,900</u>

To Gross Loss b/d	2,700	By Net Loss transferred to Capital A/c	4,800
To Salaries	400		
To Rent and Taxes 900	1,000		
Add outstanding <u>100</u>			
To Depreciation on Machinery	700		
	<u>4,800</u>		<u>4,800</u>

**BALANCE SHEET**  
**As on 31<sup>st</sup> December, 2008** (Rs.)

Liabilities		Amount	Assets	Amount
Outstanding Rent & Taxes		100	Cash at Bank	3,000
Creditors		2,800	Debtors	5,400
Capital	20,000		Closing Stock	1,200
Less: Net Loss	<u>4,800</u>		Prepaid Wages	400
	15,200		Machinery	7,000
Less: Drawings	<u>1,800</u>	13,400	Less Depreciation	<u>700</u>
		<u>16,300</u>		<u>16,300</u>

**Note:** Carriage is treated as carriage inwards, hence shown in trading account.

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## **2. MEANING OF FINAL ACCOUNTS**

The trading and profit and loss account and Balance Sheet prepared at the end of the year is collectively known as final accounts. It is not proper to call these accounts as final accounts because balance sheet is only a statement but not an account. However in actual practice these accounts and statements are together called as final accounts. The final accounts are prepared on the basis of various ledger balances incorporated in the trial balance and other adjustments made at the time of preparation of trial balance.

## **3. TRADING ACCOUNT**

Trading account constitutes the first section of the income statement . It is an account which is prepared to ascertain the gross profit or loss of the business. It is called as trading account as it reveals the trading result



of the business. As in the case of other ledger accounts, it also has two sides, viz, debit side and credit side. On the debit side, the following items usually appear ; (a) Opening stock (b) Purchases of goods and returns outwards or purchase returns and (c) Direct expenses. On the credit side usually two items appear ; (a) Sales and Returns inwards or Sales returns and (b) Closing Stock. The excess of credit side over debit side is known as gross profit. On the other hand, the excess of debit side over credit side is known as gross loss.

### Debit Side of the Trading Account

**1. Opening Stock of goods :** The stock of goods unsold for the previous year is known as opening stock for the current year. This constitutes the first item on the debit side of the trading account. This may relate to opening stock of raw materials, semi-finished goods or work in progress and finished goods.

**2. Purchases of goods :** This includes only purchases of goods which are meant for resale. It includes both cash and credit purchases. Usually the total purchases of goods are recorded in the inner column of the trading account. The purchase returns, i.e., goods returned by the trader to the supplier owing to dissatisfaction are deducted from the total purchases and net purchases are then extended to outer column of the trading account. Sometimes the purchase returns are added in the credit side instead of deducting from the purchases. This is not recommended as it is not correct to show returns outwards on the credit side of the trading account. If the purchased goods are still in transit, such goods should not be recorded in the trading account. Instead a separate entry is to be passed by debiting “goods-in-transit a/c” and crediting suppliers account. The goods-in-transit represents an asset and suppliers account a liability in the balance sheet. Sometimes the trader may withdraw goods purchased for the business. In such a case the usual recording of the purchased goods is to be made in the trading account. A second entry is then to be passed for withdrawing the goods by debiting the drawings account (or capital a/c) of the proprietor and crediting the purchase account. It is to be emphasised that goods withdrawn should not be treated as a sale because goods are withdrawn at cost price and not at sale price.

The following transactions are to be excluded from treating as purchases.

- (a) Purchase of assets other than goods which are meant for sale.
- (b) Goods received on consignment.
- (c) Receipt of Invoice in advance of actual delivery of goods.

**3. Direct expenses :** It refers to all those expenses which are incurred in acquiring the goods and transporting the same to the godown for sales purpose. Direct expenses include the following.

(a) **Wages :** Wages are mostly incurred by a manufacturing concern and hence appear in a manufacturing account. When separate manufacturing account is prepared it is recorded on the debit side of trading account. Sometime the term “wages and salaries” are given together as an expense. This is also treated as a direct expense and therefore to be taken as trading item . But if it is worded as “Salaries and wages” it is to be treated as indirect expense and hence should be taken into the debit side of profit & loss account.

(b) **Dock charges :** It is a charge levied on ships and the goods carried by the ship. It is payable to dock authorities before taking delivery of goods. It is a direct expense and hence a trading item of expense.

(c) **Duty :** Duty payable by a trader may relate to customs duty, excise duty and octroi duty. Customs duty is lived on an imported goods whereas excise duty is levied on the goods manufactured within the country. Octroi duty is payable when goods are bought from another state of the same country. The duty payable on purchased goods appear on the debit side of the trading account.

(d) **Freight, carriage inwards and cartage inwards :** All these refers to transport expenses incurred on purchased goods until they reach the premises of the trader. All expenses incurred in transporting goods are treated as direct expenses and appear on the debit side of trading account. However, freight, carriage expenses

or cartage paid on purchase of assets should be capitalised by debiting asset account and crediting cash account and not to take into trading account.

(e) **Royalty** : It is the amount paid to the owner of the property or right or patents for using the property right or patent. This appears on the debit side of manufacturing account. When no manufacturing account is prepared, it is taken on the debit side of the trading account.

(f) **Gas, Coal, Electricity, Water** : All these expenses are related to manufacturing and as such taken on the debit side of manufacturing account. Where separate manufacturing account is not prepared, it is taken on the debit side of trading account.

(g) **Primary packing materials** : Primary packing materials such as bottles, tins, boxes etc. used to pack the finished goods such as ink, coffee powder, paint, Jam etc., are treated as direct expenses. Hence they are taken on the debit side of trading account.

### Credit side of Trading Account

**1. Sales** : Sales of goods is always taken to mean purchased goods which are meant for sale. Therefore sale of any asset such as machinery, furniture etc., should not be included in the trading account. Sale of goods include both cash and credit sales. Whenever there are any sales returns or returns inwards, *i.e.*, goods returned by customers owing to their dissatisfaction, they should be deducted from total sales and the net sales are then extended to outer column. Sometimes sales returns are shown on the debit side and added along with other items. This procedure is not correct although it gives the same amount of gross profit or gross loss. Any sale of goods under hire purchase system should be shown separately and not to be included in the trading account. Similarly goods sold on approval basis should also be shown separately and not to be taken to trading account. Sometimes the term adjusted “sales” is given on the credit side of the trial balance. This means the value of closing stock is added to the sales and brought into books of accounts before preparing the trial balance. In such a situation the closing stock appear on the debit side of trial balance. As the closing stock is already added to sales it should not be recorded again on the credit side of the trading account. It should be recorded only on the asset side of the balance sheet. Any free distribution of samples to prospective customers and goods lost, damaged or destroyed are to be shown on the credit side of trading account. Alternatively, they may be deducted from purchases on the debit side.

**2. Closing Stock** : The unsold stock for the given period is known as closing stock. It is taken on the credit side of the trading account. It may relate to raw materials, work-in-progress, and finished goods.

The following is the proforma of a trading account.

Trading account for the period ending -----

Date	Particulars	Amount	Date	Particulars	Cr.Amount
	To Opening stock	—		By Sales	—
	To Purchases —			Less returns outwards —	—
	Less returns inwards —	—		By Closing stock	—
	To Direct expenses :-	—		By Gross loss	—
	To Carriage inwards	—			
	To Freight	—			
	To Wages	—			
	To Duty	—			
	To Power, Fuel	—			
	To Packing Material	—			
	To Gross profit	—			

**Problem 1.** Prepare trading account in the books of Ravi from the following particulars for the period ending 31-3-2005

Opening Stock	Rs. 20,000
Closing stock	21,000
Returns Inwards	300
Purchases	45,200
Sales	60,300
Wages	8,000
Returns outwards	200

**Solution :****Trading A/c for the period ending 31-3-05**

<i>Particulars</i>	<i>Rs.</i>	<i>Rs.</i>	<i>Particulars</i>	<i>Rs.</i>	<i>Rs.</i>
To Opening stock		20,000	By Sales	60,300	
To Purchases	45,200		Less returns inwards	300	60,000
Less returns outwards	200		By Closing stock		21,000
		45,000			
To Wages		8,000			
To Gross profit c/d		8,000			
		81,000			81,000

**Problem 2.** Prepare trading account in the books of Shri Anil Kumar from the following particulars for the period ending 31-12-04

Opening Stock	75,000
Closing Stock	84,200
Wages	80,000
Import Charges	15,000
Sales	5,49,000
Dock dues & octroi	820
Work expenses	4,200
Purchases	2,62,000
Duty and clearance charges	3,420
Freight	1,050

**Solution :****Trading A/c for the period ending 31-12-04**

<i>Particulars</i>	<i>Rs.</i>	<i>Particulars</i>	<i>Rs.</i>
To Opening stock	75,000	By Sales	5,49,000
To Purchases	2,62,000	By Closing stock	84,200
To Import charges	15,000		
To Duty & clearance charges	3,420		
To Freight	1,050		
To Dock dues & Octroi	820		
To Work expenses	4,200		
To Wages	80,000		
To Gross profit c/d	1,91,710		
	6,33,200		6,33,200



**Profit & Loss A/c for the Period Ending .....**

<i>Particulars</i>	<i>Amount</i>	<i>Particulars</i>	<i>Amount</i>
To Salaries	—	By Gross profit b/d	—
To Rent & rates	—	By Interest received	—
To Printing & stationery	—	By Discount received	—
To Lighting	—	By Commission received	—
To Insurance	—	By Income from investment	—
To Depreciation	—	By Apprentice premium	—
To Repairs	—	By Profit on sale of investment	—
To Postage & telephone	—		
To Bank charges	—		
To Interest	—		
To Audit fee	—		
To Advertisement expenses	—		
To Discount allowed	—		
To Commission	—		
To Carriage outwards	—		
To Bad debts	—		
To Provision for doubtful debts	—		
To Loss on sale of assets	—		
To Loss by fire	—		
To Net profit	—		

**Problem 4. Trading and Profit & Loss A/c**

From the following trial balance of Shri Arvind prepare a trading and profit & loss account for the year ending 31st Dec. 2004.

**Trial Balance as on 31-12-04**

	<i>Dr.</i>	<i>Cr.</i>
Purchases	21,750	
Discount allowed	1,300	
Wages	6,500	
Sales		30,000
Salaries	2,000	
Travelling expenses	400	
commission	425	
Carriage inwards	275	
Administration expenses	105	
Trade expenses	600	
Interest	250	
Building	5,000	
Furniture	200	
Debtors	4,250	
Capital		13,000
Creditors		2,100
Cash	2,045	
	45,100	45,100

Stock on 31-12-2004 was Rs. 6,000

**Solution :**

**Trading and Profit & Loss Account**  
(For the year ending 31-12-04)

<i>Particulars</i>	<i>Amount</i>	<i>Particulars</i>	<i>Amount</i>
To Purchases	21,750	By Sales	30,000
To Wages	6,500	By Closing stock	6,000
To Carriage inwards	275		
To Gross profit	7,425		
	36,000		36,000
To Discount	1,300	By Gross profit	7,475
To Salaries	2,000		
To Travelling expenses	400		
To Commission	425		
To Administration expenses	105		
To Trade expenses	600		
To Interest	250		
To Net profit	2,395		
	7,475		7,475

**Problem 5.** From the following balances extracted from the books of Naveen on 31st Dec. 2004, prepare a Trading and Profit and Loss a/c

**Trading and Profit & Loss Account**

Stock (opening)	Rs. 9,600
Wages and Salaries	3,200
Commission on purchases	200
Freight	300
Purchases less returns	11,850
Sales less returns	24,900
Trade expenses	20
Rent	200
Horse expenses	500
Repairs to plant	160
Income tax	550
Discount on purchases	400
Closing stock	3,500

**Solution :**

**Trading and Profit & Loss A/c**  
For the year ending 31-12-04

<i>Particulars</i>	<i>Amount</i>	<i>Particulars</i>	<i>Amount</i>
To Opening stock	9,600	By Sales	24,900
To Purchases less returns	11,850	By Closing stock	3,500

<i>Particulars</i>	<i>Amount</i>	<i>Particulars</i>	<i>Amount</i>
To Wages & Salaries	3,200		
To Commission on purchases	200		
To Freight	300		
To Gross profit	3,250		
	28,400		28,400
To Trade expenses	20	By Gross profit	3,250
To Rent	200	By Discount on Purchases	400
To Horse expenses	500		
To Repairs to plant	160		
To Net profit	2,770		
	3,650		3,650

**Problem 6.** The following particulars are extracted from the books of Dinesh. Prepare a trading and profit & loss account for the period ending 31-3-2005.

	Rs.
Factory fuel and power	542
office salaries	3,745
Factory lighting	392
Bad debts	300
Travelling expenses	925
Carriage on sales	960
Purchases	83,290
Wages	9,915
Rent and taxes	1,765
Office expenses	2,778
Carriage on purchases	897
Discount	422
Stock on 1-4-2004	21,725
Manufacturing expenses	2,680
Sales returns	7,422
Insurance	570
Sales	1,26,177
Purchase returns	3172
Commission	2,000
Rebate from Suppliers	1,000
Stock on 31-3-2005	16,580

**Solution :**

**Trading and Profit & Loss A/c**  
(For the year ending 31-3-05)

<i>Particulars</i>	<i>Amount</i>	<i>Amount</i>	<i>Particulars</i>	<i>Amount</i>	<i>Amount</i>
To Opening stock		21,725	By Sales	1,26,177	
To Purchases	83,290		Less returns	7,422	
Less returns	3,172	80,118			1,18,755



<i>Particulars</i>	<i>Amount</i>	<i>Amount</i>	<i>Particulars</i>	<i>Amount</i>	<i>Amount</i>
To Factory fuel & power		542	By Closing stock		16,580
To Factory lighting		392			
To Wages		9,915			
To Carriage on purchases		897			
To Manufacturing expenses		2,680			
To Gross profit		19,066			
		1,35,335			1,35,335
To office salaries		3,745	By Gross Profit b/d		19,066
To Bad debts		300	By Commission		2,000
To Travelling expenses		925	By Rebate from Suppliers		1,000
To Carriage on sales		960			
To Rent & Taxes		1,765			
To Office expense		2,778			
To Discount		422			
To Insurance		570			
To Net profit		10,601			
		22,066			22,066

## 6. BALANCE SHEET

A balance Sheet is a statement which portrays the financial position of the business. It is so called because it is a sheet of all ledger balances pertaining to assets and liabilities for a given period of time. Its purpose is to know the exact financial position, *i.e.*, solvency or insolvency of a business for a specified time. After the preparations of trial balance and trading and profit & loss account all nominal accounts gets closed. In the ledger only personal and real accounts will show the balances. In other words they constitute liabilities and assets. The balance sheet is prepared showing the classified list of such balances. It should be noted that a balance sheet is a position statement and strictly speaking it is not a part of the double entry ledger account. Therefore no transfer of the ledger account balances are necessary. Only the relevant particulars are extracted from the ledger while preparing a balance sheet.

### Feature of a Balance Sheet :

1. It is part of final accounts and is prepared along with trading and profit and loss account.
2. It is prepared on a particulars date to show the financial position on that date but not for a period .
3. It is a statement but not an account. This statement has two sides known as asset side and liability side. If the value of assets are more than the liabilities (third party liabilities) it indicates a sound financial position. On the other hand, if third party liabilities are more than assets it indicates a weak financial position.
4. The two sides of the Balance sheet *i.e.* asset side and liability side are always same.
5. The two sides of the Balance sheet is not prefixed with “To” and “By” as in the case of ledger accounts.

### Arrangement of Assets and Liabilities in a Balance Sheet

The process of arranging assets and liabilities in a definite order is known as “marshalling of balance sheet”. There are two ways of arranging assets and liabilities. *viz* (1) In the order of permanency and (2) in the order of liquidity. Under the first method, the assets are arranged on the basis of their permanent use in the business. This method is usually followed by higher forms of business organisation such as joint stock companies. Under the second method, assets and liabilities are arranged according to ability to convert an asset easily in the form of cash so as to enable payments to liability holders. This arrangement is followed by sole traders and partnership firms. The usual method of arranging assets by a trader takes the following forms:

**Form of a Balance Sheet**

There is no format laid down for preparing the balance sheet of a sole trading concern and partnership firm. However, higher forms of organisation such as joint stock companies must prepare balance sheet as per the statute regulating the business. A specimen form of balance sheet of a trader is given below :

**Balance sheet of \_\_\_\_\_ as on \_\_\_\_\_**

<i>Liabilities</i>	<i>Rs.</i>	<i>Assets</i>	<i>Rs.</i>
Capital a/c	× ×	Land & Buildings	× ×
Add additional capital invested	× ×	Plant & Machinery	× ×
Add Interest on Capital	× ×	Investment	× ×
	× ×	Furniture & fixture	× ×
Add net profit	× ×	Vehicles	× ×
	× ×	Goodwill	× ×
Less Drawings	× ×	Patents & Trade mark	× ×
	× ×	Patterns	× ×
Less Interest on Drawings	× ×	Closing stock	× ×
	× ×	Bills receivable	× ×
Less Net loss (if there is any)	× ×	Prepaid expenses	× ×
	× ×	Accrued income	× ×
Long term loan from Bank	× ×	Cash at bank	× ×
Loan on Mortgage	× ×	Cash in hand	× ×
Loan from wife	× ×	Fictious assets :-	
Sundry creditors	× ×	Preliminary expenses	× ×
Bills payable	× ×	Advertising expenses	× ×
Bank overdraft	× ×		
Outstanding expenses	× ×		
Income received in advance	× ×		