iii) Rs. 2,00,000 incurred in developing a new area for tea plantation
iv) Rs. 600 spent on transportation of stock to new site
v) Rs. 20,000 spent on experimenting a new product which was not **successful**
vi) **A** sum of Rs. 25,000 spent on overhauling the machinery. It increased the life of the machinery by three years

(Answer: i) **capital** ii) revenue **iii)** capital iv) deferred revenue v) deferred revenue vi) capital

Note: These questions will help you to understand the unit better. Try **to** write answers for them. But, do not submit your answers to the University. These are for your practice only.

UNIT 7 FINAL ACCOUNTS I

Structure

7.0 OBJECTIVES

After studying this unit you will be able to:

- explain the purpose of preparing final accounts
- prepare a trial balance from a given list of balances
- prepare trading and profit and loss account
- prepare balance sheet
- prepare manufacturing account and calculate cost of goods produced
- present the final accounts in vertical form.

7.1 INTRODUCTION

In Unit 6 you have learnt about the concepts which guide the preparation of final accounts. You know that the final accounts are primarily prepared for ascertaining the operational result and the financial position of the business. They consist of (i) Profit and Loss Account, and (ii) Balance Sheet. The Profit and Loss Account reveals the profit earned or loss incurred (operational result) during the accounting year and the Balance Sheet indicates the financial position as at the end of the year. In this unit you will learn about the basic framework of final accounts including their presentation in vertical form.

7.2 FINAL ACCOUNTS AND TRIAL BALANCE

You know final accounts are prepared with the help of a Trial Balance which shows all the ledger balances as at the end of an accounting period. Generally, when you are asked to prepare final accounts you are given a properly prepared Trial Balance and you have no difficulty in identifying the items of incomes, expenses, assets, and liabilities. But, sometimes you may not be given a proper Trial Balance. You may simply be asked to prepare the final accounts from the list of closing balances extracted from the books of some firm. In such a situation, it will be helpful if you first prepare the Trial Balance and then the final accounts. Hence it is important that you should know how to prepare! the Trial Balance from a given list of balances.

Normally when a Trial Balance is to be prepared, you have full details of ledger accounts with you. You can easily ascertain whether a particular account has a debit balance or a credit balance, and prepare the Trial Balance without any difficulty. The problem arises when you are given a list of balances but it is not indicated whether the account has a debit balance or a credit balance. Under such a situation you will have to determine the nature of each balance before you can prepare the Trial Balance. In this exercise your knowledge of rules of debit and credit will help you. For example you know that in case of nominal accounts all expenses and losses are debited and all incomes and gains are credited. Similarly, you know the rules for real and personal accounts according to which the account of assets like cash, machinery debtors, etc. will show debit balances while accounts like capital, creditors, etc. will show credit balances. For convenience however, a few guidelines should help you. They are

a) All accounts of expenses (including purchases) and losses will be debit balances.
b) All accounts of income (including sales) and gains will be credit balances.
c) All accounts of assets will be debit balances.
d) All accounts of liabilities will be credit balances.
e) Capital Account will normally be a credit balance.
f) Drawings Account will be a debit balance.

However, the problem may arise with regard to some item like rent, discount, commission and interest as they can be expenses as well as incomes. In such cases, the nature of the balance is usually indicated by mentioning (Dr.) or (Cr.) against each item, or the word 'received' or 'paid' is written after each item. This helps you to treat the item correctly. But, if there is only one item for which no such indication is given you can proceed with the preparation of Trial Balance and work out the totals of both the columns. You will find that the total of one column will be less than the other. This means that the unidentified balance pertains to the column which is short. For example, here is an item of commission of Rs. 300 appearing in the list of balances and it is not indicated whether it is paid or received. When you prepare the Trial Balance you will find that the debit total is short by Rs. 300. This would mean that the Commission Account has a debit balance. Now if you show it as such in the Trial Balance, it will tally.

Look at Illustration 1 and see how the Trial Balance has been prepared from a given list of balances where the nature of each balance has not been indicated.

Illustration 1

Prepare a Trial Balance from the following balances extracted from the books of Sudhakar as on March 31, 1987.

	Rs.		Rs.
Opening Stock	40,000	Drawings	10,000
Purchases	4,10,000	Wages	7,300
Sales	4,29,000	Salaries	11,000
Purchases Returns	1,250	Outstanding Expenses	1,000
Sales Returns	2,500	Prepaid Expenses	750
Carriage Inwards	1,500	Postage	900
Carriage Outwards	2,500	Discount Received	375
Bank Overdraft	21,000	Discount Allowed	1,000
Cash	4,000	Bad Debts	750
Capital	1,27,750	Sundry Debtors	1,00,000
Sundry Creditors	37,500	Interest	3,500
Loans	41,375	Interest Received	300
Investments	10,000	Provision for Bad Debts	1,750
Accrued Income	600	Furniture & Fixture	7,500
Machinery	47,500		

Solution:

Trial Balance of Sudhakar as on March 31, 1987

Particulars	Dr. Balances	Cr. Balances
	Rs.	Rs.
Opening Stock	40,000	
Purchases	4,10,000	
Sales		4,29,000
Purchases Returns		1,250
Sales Returns	2,500	
Carriage Inwards	1,500	
Carriage Outwards	2,500	
Bank Overdraft		21,000
Cash	4,000	
Capital		1,27,750
Sundry Creditors		37,500
Loans		41,375
Investments	10,000	
Accrued Income	600	
Machinery	47,500	
Drawings	10,000	
Wages	7,300	
Salaries	11,000	
Outstanding Expenses		1,000
Prepaid Expenses	750	
Postage	900	
Discount Received		375
Discount Allowed	1,000	
Bed Debts	750	
Sundry Debtors	1,00,000	
Interest	3,500	
Interest Received		300
Provision for Bad Debts		1,750
Furniture & Fixture	7,500	
Total	6,61,300	6,61,300

In Illustration 1 the Trial Balance has tallied i.e, the total of debit balances column is equal to the total of cre'dit balances column. This would mean that each balance has been entered in the appropriate amount column of the Trial Balance. **This** is not always true. It is quite possible that even when the Trial Balance has tallied, some balances may not have been entered in the correct columns. Look at Illustration 2. You will find that the Trial Balance has tallied (the totals of both Dr. balances and Cr. balances is the same i.e., Rs. 91,650 but there are a number of items which have been shown in the wrong columns. For example, bank overdraft which should have been shown in the Cr. balances column has been included in the Dr. balances column and Furniture which should have appeared in Dr. balances column has been shown in the Cr. balances column. So, the Trial Balance has been rewritten and all items shown correctly. Such situation arises on account of the compensating effect of the errors which is very rare.

Illustration 2

An inexperienced accountant provides you with the following Trial Balance. In case you find it to be incorrect prepare it again so as to remove its defects.

Trial Balance as on June 30, 1987

Name of Account	L.F.	Dr. Balances	Cr. Balances
		Rs.	Rs.
Stock (Opening)		10,500	
Buildings		31,500	
Bills Payable		1,800	
Bank Overdraft		1,500	
Capital			45,000
Furniture			12,000
Discount Allowed		90	
Sales		39,000	
Loan from Suresh		2,400	
Carriage Inwards		270	
Bills Receivable			3,000
Purchases			24,000
Salaries			3,300
Investments		3,000	
Interest on Investments			1,650
Returns Inwards		900	
Returns Outwards		300	
Insurance Premium		360	
Interest on Loan		30	
Advertisement			1,200
Drawings			1,500
Total		91,650	91,650

Solution:

Revised Trial Balance as on June 30, 1987

Name of Account	L.F.	Dr. Balances	Cr. Balances
		Rs.	Rs.
Stock (opening)		10,500	
Buildings		31,500	
Bills Payable			1,800
Bank Overdraft			1,500
Capital			45,000
Furniture		12,000	
Discount Allowed		90	
Sales			39,000
Loan from Suresh			2,400
Carriage Inwards		270	
Bills Receivable		3,000	
Purchases		24,000	
Salaries		3,300	
Investments		3,000	
Interest on Investments			1,650
Returns Inwards		900	
Returns Outwards			300
Insurance Premium ,		360	
Interest on Loan		30	
Advertisement		1,200	
Drawings		1,500	
Total		91,650	91,650

Check Your Progress A

Mention against each item whether it will generally show a debit balance or a credit balance.

Items	Nature of Balance Debit or Credit
i) Sales Returns	....
ii) Carriage Inwards	....
iii) Carriage Outwards	....
iv) Capital	....
v) Loss by fire	....
vi) Overdraft	....
vii) Drawings	....
viii) Returns Outwards	....
ix) Bills Receivable	....
x) Goodwill	....
xi) Rent Paid	....
xii) Commission Received in Advance	....

7.3 TRADING AND PROFIT AND LOSS ACCOUNT

You know the Profit and Loss Account is prepared for ascertaining the profit or loss of the business. This is worked out in two stages. In the first stage we work out the gross profit or gross loss and in the second stage, the net profit or net loss. Hence, the profit and Loss Account is divided into two sections, The first section is called Trading Account. It reveals the gross profit or gross loss. The second section is called Profit and Loss Account which shows the net profit or net loss.

7.3.1 Trading Account

As stated above, the Trading Account is prepared for ascertaining the gross profit or gross loss. The gross profit is defined as the excess of sales revenue over cost of goods sold, This can be presented in the form of an equation as follows.

Gross Profit = Net Sales − Cost of Goods sold
Where i) Net Sales = Total sales − Sales Returns
ii) Cost of Goods Sold = Opening stock + Net Purchases + Direct Expenses − Closing stock

You know the terms 'Opening Stock' and 'Closing Stock' refer to the value of unsold goods as at the beginning of the year and at the end of the year respectively. Such stock may also include the semi-finished goods and raw materials. In order to arrive at the cost of goods sold the opening stock is added to the net purchases while the closing stock is deducted. The term 'Direct Expenses' refer to those expenses which are incurred on the goods purchased till they are brought to the place of business for sale. These include expenses such as freight, insurance, import duty, dock dues, clearing charges, octroi duty, carriage, cartage, etc. The administrative expenses, selling and distribution expenses, interest paid, etc. are termed as indirect expenses and, therefore, are excluded from the cost of goods sold.

Look at Illustrations 3 and 4 and study how Cost of Goods Sold and the Gross Profit are computed.

Illustration 3

The following figures have been extracted from the books of a firm. Calculate the Cost of Goods Sold.

	Rs.
Stock as on 1.1.1987	1,00,000
Purchases for 1987	15,00,000
Purchases Returns	40,000
Carriage Inwards	20,000
Octroi	80,000
Freight	15,000
Stock as on 31.12.87	1,70,000

Solution:

	Rs.
Opening Stock	1,00,000
Add Net Purchases	
(Purchases Rs. 15,00,000	
Purchases Returns Rs. 40,000)	14,60,000
Carriage Inwards	20,000
Octroi	80,000
Freight	15,000
	16,75,000
Less Closing Stock	1,70,000
Cost of Goods Sold	15 05,000

Illustration 4

On January 1,1987 a firm had stock of goods valued at Rs. 20,000. During the year the following transactions took place.

	Rs.
Sales	5,00,000
Purchases	3,00,000
Carriage Inwards	3,000
Freight Inwards	5,000
Sales Returns	10,000
Clearing charges	22,000
Purchases Returns	5,000

The closing stock of goods on December 31,1987 is Rs. 40,000.

Solution:

	Rs.	Rs.
Sales	5,00,000	
Less Sales Returns	10,000	
Net Sales		4,90,000
Less Cost of Goods Sold:		
Opening Stock	20,000	
Add Purchases	3,00,000	
	3,20,000	
Less Purchases Returns	5,000	
	3,15,000	
Add Carriage Inwards	3,000	
Freight Inwards	5,000	
Clearing Charges	22,000	
	3,45,000	
Less Closing Stock	40,000	3,05,000
Gross Profit		1,85,000

Form of Trading Account: The Equation for Gross Profit is also known as Trading Account Equation. This equation **forms** the basis of preparing the Trading Account. **The** Trading Account, like any other account in the ledger, has two sides—debit and credit. The opening stock, purchases (less returns) and all direct expenses are shown on the debit side of the Trading Account while sales (less returns) and the closing stock on the credit side. The gross profit appears as the last item on the debit side which, in fact is the excess of the total of credit side over the total of debit side. If however, the total of the debit side exceeds the total of the credit side, it will be treated as gross loss. This is shown as the last **item** on the debit side of the Trading Account. The gross **profit/gross** loss thus worked out is transferred to the Profit and Loss Account. Look at the Figure 7.1 for the form of Trading Account.

Figure 7.1
Form of **Trading** Account
Trading Account of ....
(Day, Month and Year)

Dr. Cr.

Particulars	hunt	Amount	**Particulars**	Amount	Amount
	Rs.	Rs.		Rs.	Rs.
To Opening Stock		...	By Sales	...	
To Purchases	...		Less Sales		
Less Purchases			Returns	...	
Returns	...				...
		...	By Closing		
To Direct Expenses			Stock		...
(specify individually)		...			
To Gross Profit					
(transferred to Profit					
and Loss Account)		...			
		...			...

Based on **the data given** in Illustration 4, **the** Trading Account will be prepared as follows.

Trading Account of..........
for the **year ending December** 31, 1987

Dr. a cr.

Particulars		**Amount**	**Particulars**		**Amount**
		Rs.			Rs.
To Opening Stock		20,000	By Sales	5,00,000	
To Purchases	3.00,000		Less Returns	10,000	
Less Returns	5,000				4,90,000
		2,95,000			
To Carriage Inwards		3,000	By Closing Stock		40,000
To Freight		5,000			
To Clearing Charges		22,000			
To Gross Profit		1,85,000			
(transferred to					
(P&L A/c)					
		5,30,000			5,30,000

Some Important Points

1 Purchases: This item refers to the goods pu chased for resale and includes both cash and credit purchases. The purchases of assets which are meant for permanent use in business such as machinery furniture, etc., are not included in the purchases, The amount taken to Trading Account will be the net amount of purchases (after deducting purchase returns/returns outwards.) If the proprietor has taken away some goods from the business for his personal use, the same should also be deducted from the total purchases.

2 Sales: It includes both cash and credit sales of goods and refers to the net amount of sales (after deducting sales returns-returns inwards). Sales of old furniture, car, machinery, etc. are not included in the sales. Similarly, sales of old newspapers etc. are also excluded from sales. Such items are shown as miscellaneous income in the Profit and Loss Account.

3 Wages: Wages are usually treated as a direct expense and so shown in the Trading Account. The difficulty arises when wages are clubbed with salaries (an indirect expense) and the Trial Balance includes a single amount for 'Wages and Salaries'. In such a situation, the amount may be shown in the Trading Account. It is based on the assumption that the item includes the salaries of the supervisory staff in the factory itself. But, if the item in the Trial Balance reads 'Salaries and Wages' it will be taken to the Profit and Loss Account on the assumption that the item includes wages of the office staff only. It should be noted that wages paid in connection with the purchases of fixed assets or the construction of building should not be charged to Trading Account. They are to be included in the cost of the concerned fixed asset. There is another important aspect in relation to wages which must be clarified. If a Manufacturing Account is prepared the wages paid to the factory labour is debited to Manufacturing Account about which you will learn later in this unit.

4 Freight, Carriage and Cartage: When paid in connection with purchases of goods, they are shown in the Trading Account. Such freight and carriage are also termed as 'Freight Inwards' and 'Carriage Inwards' respectively. 'Freight Outwards' and 'Carriage Outwards' relate to sales and therefore taken to the debit of Profit and Loss Account,

5 Royalties: Royalties refer to the payments made for the use of copyright or a patent. The amount of royalty is generally based on the quantity produced. It is, therefore, treated as a direct expense and charged to Trading Account. But if it is calculated on the basis of quantity sold as in case of books, it is shown in the Profit and Loss Account. Royalties are also paid to the Government for extraction of minerals such as coal, diamond, gold, etc. These are charged to the Profit and Loss Account of the mining companies, You will learn about the accounting of such royalties later under a separate course.

7.3.2 Profit and Loss Account

After ascertaining the gross profit by preparing the Trading Account, the businessman proceeds to prepare the Profit and Loss Account in order to work out the net profit/net loss. You know the net profit is the excess of gross profit and other incomes over the indirect expenses and losses. So, while preparing the Profit and Loss Account we show gross profit and other incomes such as rent received, discount received, commission received, interest and dividends etc. on the credit side, and all indirect expenses and losses on the debit side. Indirect expenses include all administrative, selling and distribution expenses such as salaries, rent and taxes,-postage and stationery, insurance, depreciation, interest paid, office lighting, advertising, packing carriage outwards, etc., while losses refer to items like loss by fire, loss by theft etc. The difference between the two sides of the Profit and Loss Account represent either the net profit or net loss. If the total of the credit side is higher than the total of the debit side, the difference is called net profit and if the debit side total exceeds the credit side total, the difference is called net loss. The net profit/net loss belongs to the proprietor and it is therefore transferred to his Capital Account. Look at figure 7.2. It shows various expenses. losses, incomes, etc. which usually appear in the Profit and Loss Account.

Figure 7.2
Profit and Loss Account..............
for the period ended..............

Dr. **Cr.**

Particulars	Amount	**Particulars**	**Amount**
	Rs.		**Rs.**
To Gross Loss, if any, (transferred from Trading Account)		By Gross Profit (transferred from Trading Account)	
To Salaries		By Interest Received	
To Rent, Rates and Taxes		By Discount Received	
To Postage and Telegrams		By Rent Received	
To Telephone Charges		By Commission Received	
To Printing and Stationery		By Dividend Received	
To Legal Expenses		By Other Incomes and Gains	
To Insurance		By Net Loss (transferred to Capital Account)	
To Office Lighting			
To Bad Debts			
To Depreciation			
To Advertising			
To Travelling Expenses			
To Carriage Outwards			
To Trade Expenses			
To Discount Allowed			
To Interest Paid			
To Repairs and Renewals			
To Loss by Fire			
To Loss by Theft			
To Other Expenses and Losses, if any			
To Net Profit (transferred to Capital Account)			

Notes:

1 The heading for the Profit and Loss Account, as in the case of the Trading Account, indicates the name of the business or proprietor and the period for which it is being prepared.

2 In addition to the items shown in the above form, there are certain items such as depreciation, bad debts, provision for doubtful debts, interest on capital, interest on drawings, etc., which appear in the Profit and Loss Account as a result of the adjustment entries. We shall discuss them in Unit 8.

Some Important Points

1 Rent, Rates and **Taxes:** These are charges levied by the municipal bodies on the house property. It is a common item of indirect expenses debited to the Profit and Loss Account.

2 Insurance: Generally, assets are insured to cover the risk of loss, say, by fire. Premium paid to the insurance company should be treated as a business expense. When assets such as factory building, factory machinery, etc. are insured, the insurance premium should be debited to Trading Account. If on the other hand, the premium is paid for insurance of assets in the office building, office furniture, etc., it should be charged to Profit and Loss Account.

3 Bad **Debts:** Bad debts denote the amount which could-not be recovered from the debtors to whom the goods were sold on credit. It is a loss and so debited to the Profit and Loss Account. You will learn more about their treatment in Unit 8.

4 **Depreciation:** Depreciation means decrease in the, value of fixed assets due to normal wear and tear. You. know that every fixed asset such as machinery, furniture, vehicle, etc. depreciates in value on account of its constant use. Such

reduction in their value is a loss to the business and so charged to the Profit and Loss Account. If, however, a Manufacturing Account is ako prepared, depreciation on machinery and factory building is charged to the Manufacturing Account, while depreciation on office building, office furniture, office equipment, etc. is charged to the Profit and Loss Account.

5 Trade Expenses: This item represents various small expenses incurred in the business. They are also called General Expenses, Sundry Expenses or miscellaneous Expenses.

6 Packing: The cost of packing materials such as polythene bags, wrapping materials, etc. for delivery is a distribution expense and hence charged to Profit and Loss Account. Where packing is essential to make the products fit for sale, in the market as in the case of cigarettes, biscuits, medicines, oil, etc. it is called 'packaging' and such expenditure is charged to the Trading Account.

7 Samples: Generally, samples of goods are distributed free of charge to increase sales. The cost of such samples should be treated as a selling expense and so debited to Profit and Loss Account.

8 Income Tax: It is the tax payable by a person on his income. In the case of a sole trading concern, the tax paid by the proprietor on the profits of the business is treated as a personal expense. Hence, it should be added to drawings or directly deducted from capital.

Illustration 5

Prepare Profit and Loss Account from the following balances extracted from the books of a business for the year 1987.

	Rs.
Gross Profit	1,85,000
Salaries	20,000
Rent and Rates	5,000
Stationery	1,000
Postage	500
Insurance	2,000
Repairs	1,500
Depreciation	5,000
Advertisement	5,000
Discount (Dr.)	500
Commission of Salesmen	5,000
Bad Debts	2,000
Loss by Fire	2,000
Interest on Investments	2,500
Profit on sale of Investments	2,000

Solution:

Rofit and Loss Account of... ....
tor the year ending December 31, 1987

Dr.			Cr.
Particulars	**Amount**	**Particulars**	**Amount**
	Rs.		Rs.
To Salaries	20,000	By Gross Profit (transferred from Trading A/c)	1,85,000
To Rent and Rates	5,000		
To Stationery	1,000		
To Postage	500	By Interest on Investments	2,500
To Insurance	2,000	By Profit on Sale of Investments	2,000
To Repairs	1,500		
To Depreciation	5,000		
To Advertisement	5,000		
To Discount	500		
To Commission to Salesmen	5,000		
To Bad Debts	2,000		
To Loss by fire	2,000		
To Net Profit (transferred to Capital Account)	1,40,000		
	1,89,500		1,89,500

In Practice the Trading Account and the Profit and Loss Account are combined and one account called 'Trading and Profit and Loss Account' is prepared. This account is divided into two parts. The first part shows the Gross Profit and the second part shows the Net Profit.

Look at Illustration 6 and see how combined Trading and Profit and Loss Account will be prepared.

Illustration 6

From the following figures prepare Trading and Profit and Loss Account of Lakshmi & Co. for the year ended December 31, 1987.

	Rs.
Stock on January 1,1987	40,000
Purchases	98,000
Commission Received	650
Rent, Rates and Taxes	8,600
Salaries & Wages	12,000
Sales	1,62,100
Returns Inwards	2,400
Returns Outwards	3,000
Sundry Expenses	2,500
Bank Charges	50
Discount Received	750
Carriage on Purchases	2,000
Discount Allowed	530
Carriage on Sales	1,700
Lighting and Heating	2,200
Postage	300
Income from Investments	500
Commission Paid	1,000
Interest paid on a bank loan	550

The stock on December 31,1987 was valued at Rs. 26,000

Solution:

Trading and Profit & Loss Account of Lakshmi & Co.
for the year ended December 31, 1987

Dr.					Cr.
Particulars		**Amount**	**Particulars**		**Amount**
		Rs.			Rs.
To Opening Stock		40,000	By Sales	1,62,100	
To Purchases	98,000		Less Returns	2,400	
Less Returns	3,000				
		95,000			1,59,700
To Carriage on Purchase		2,000	By Closing Stock		26,000
To Gross Profit c/d		48,700			
		1,85,700			1,85,700
To Rent, Rates and Taxes		8,600	By Gross Profit b/d		48,700
To Salaries & Wages		12,000	By Commission Received		650
To Sundry Expenses		2,500	By Discount received		750
To Bank Charges		50	By Income from Investments		500
To Discount Allowed		530			
To Carriage on Sales		1,700			
To Postage		300			
To Commission Paid		1,000			
To Interest paid on bank loan		550			
To Lighting & Heating		2,200			
To Net Profit		21,170			
		50,600			50,600

7.3.3 Closing Entries

You learnt in Unit 2 that all nominal accounts which represent items of expenses and incomes are closed at the end of the accounting year by transfer to either the Trading Account or the Profit and Loss Account. The journal entries passed for such transfer are called closing entries. You also know that accounts relating to expenses and losses always show debit balances while those representing incomes show credit balances. In order to close an account which shows a debit balance and is to be transferred to the Trading Account we credit the account concerned with an amount equal to its balance and debit the Trading Account. For example, the Carriage Inwards Account Shows a debit balance of Rs. 6,000. The closing entry for this will be as follows:

		Rs.	Rs.
Trading A/c	Dr.	6,000	
To Carriage Inwards A/c			6,000

Similarly, an account which shows a credit balance, will be closed by debiting it with an amount equal to the balance and crediting the Trading Account or Profit and Loss Account, as the case may be. The closing entries are passed in the Journal Proper and it is necessary to pass such entries for preparing the Trading and Profit and Loss Account. The entries required for the items which are to be transferred to the Trading Account are as follows:

1 Trading Account Dr.
  To Stock Account (opening)
  To Purchases Account
  To Sales Returns Account
  To Direct Expenses Accounts
  (to be credited individually)

2 Sales Account Dr.
  Purchases Returns Account Dr.
  Stock Account (closing) Dr.
  To Trading Account

3 Trading Account Dr.
To Profit and Loss Account
(For gross profit)

Note: If there is gross loss, the closing entry will be just the reverse of the above.

When the closing entry is passed for gross profit or gross loss the Trading Account stands closed. The entries required for items to be transferred to the Profit and Loss Account are as follows:

1 Profit and Loss Account Dr.
To Expenses/Losses Accounts
(to be credited individually)

2 Incomes/Gains Accounts Dr.
(to be debited individually)
To Profit and Loss Account

3 Profit and Loss Account **Dr.**
To Capital Account
(for Net Profit)

Note: If there is net loss, the closing entry will be just the reverse of the above.

Let us see how closing entries for the items given in Illustration 4 will be passed. These are as follows:

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Date	Particulars		L.F.	Dr. Amount	Cr. Amount
				Rs.	Rs.
1987 Dec 31	Trading A/c	Dr.		1,42,400	
	To Opening Stock A/c				40,000
	To Purchase A/c				98,000
	To Sales Returns A/c				2,400
	To Carriage Inwards A/c				2,000
	(Being closing Entry)				
" 31	Sales A/c	Dr.		1,62,100	
	Purchases Returns A/c	Dr.		3,000	
	Closing Stock A/c			26,000	
	To Trading A/c	Dr.			1,91,100
	(Being closing entry)				
" 31	Trading A/c	Dr.		48,700	
	To Profit and Loss A/c				
	(Being transfer of gross profit)				48,700
31	Profit and Loss A/c	Dr.		29,430	
	To Rent, Rates & Taxes A/c				8,600
	To Salaries & Wages A/c				12,000
	To Sundry Expenses A/c				2,500
	To Bank Charges A/c				50
	To Discount Allowed A/c				530
	To Carriage Outwards A/c				1,700
	To Postage A/c				300
	To Commission paid A/c				1,000
	To Interest paid A/c				550
	To Lighting & Heating A/c				2,200
	(Being closing entry)				
" 31	Commission Received A/c	Dr.		650	
	Discount Received A/c	Dr.		750	
	Income from Inv. A/c	Dr		1,500	
	To Profit and Loss A/c				2,900
	(Being closing entry)				
" 31	Profit and Loss A/c	Dr,		21,170	
	To Capital A/c				21,170
	(Being transfer of net profit)				

Check Your Progress B

1 Distinguish between **Direct** and Indirect **Expenses**.

....

....

....

....

2 What is the purpose of preparing a Trading Account?

....

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....

3 State whether the following statements are True or False.

i) The gross profit is the difference of total sales and credit sales ....

ii) Direct **expenses** are those expenses which are directly attributable to purchase of goods for resale. ....

iii) Stock is valued at **cost** or market price whichever is lower.. ....

iv) The het profit is the excess of gross profit and other incomes over the indirect expenses and losses.. ....

v) Income **tax** paid in case of a **proprietory** concern is charged to Profit and Loss Account.. ....

vi) **Trade Expenses are** charged to Trading Account.. ....

4 Fill in the blanks:

i) **Carriage Outwards is an** example of .... expenses.

ii) **Cost of goods** sold is equal to opening stock plus.. ....**less** ....

iii) Cost of samples distributed free of cost **are** **treated** as .... expenses.

iv) **All direct expenses are** debited to. .... Account:

v) **Loss on Account of** theft is .... to Profit, and Loss Account.

vi) **Wages and salaries are** charged to. ....

5 Ascertain **the cost** of goods sold from the following data:

	Rs.
Direct **Expenses**	**8,000**
Opening Stock	**12,000**
Purchases	**80,000**
Interest Paid	**500**
Closing Stock	**10,000**

7.4 BALANCE SHEET

After ascertaining the net profit or net loss by preparing the Trading and Profit and Loss Account, the final step in preparing final accounts is the preparation of Balance Sheet. The purpose of Balance Sheet is to ascertain the financial position of a business i.e., to know what the business owes and what it owns on a certain date. Hence it shows all assets and liabilities of the business as at the end of the accounting year.

You know that final accounts are prepared from the Trial Balance. All items of expense and income appearing in Trial Balance are transferred to the Trading and Profitand Loss Account. The remaining items which represent the balances of personal and real accounts are shown in the Balance Sheet. The accounts showing debit balances represent assets and those showing credit balances represent liabilities.

Look at figure7.3 and note how various assets and liabilities appear in the Balance Sheet.

Figure 7.3

Balance Sheet of ....
as on ....

Liabilities		Amount	Assets	Amount
Current Liabilities		Rs.	**Current Assets**	Rs.
Bank Overdraft		....	Cash in hand	....
Bills Payable		....	Bills Receivable	....
Sundry Creditors		....	Cash at bank	....
			Sundry Debtors	....
			Closing Stock	
Long-term Liabilities				
Loan		....	Investments	....
Mortgages		....	**Fixed Assets**	
Capital			Vehicles	....
Balance	.....		Furniture	....
Add Net			Plant & Machincry	....
Profit	.....		Land & Buildings	
Less			Goodwill	....
Drawings	.....	....		
		....		....

You should know that the Balance Sheet is prepared to ascertain the financial position at a particular point of time and not for a period. Hence the heading of the Balance Sheet will always read 'Balance Sheet as on ......' (usually last date of the accounting year).

The total of assets should always be equal to the total of liabilities. You learnt about this equality in Unit 1. If however, they do not tally, it would mean that some errors have been committed while preparing the final accounts. You must recheck the treatment of all items including the arithmetical aspect, and make the corrections where necessary so that the Balance Sheet tallies.

Assets: The term 'assets' denote the economic resources (property) of the business and includes all current and fixed assets. You know current assets are those assets which are Likely to be realised within a period of one year (or during the normal operating cycle) and includes cash, stock, debtors, bills receivable, short-term investments, etc. The fixed assets, on the other hand, are those assets which are aquired for use in the business over a long period. They may be tangible like machinery and furniture, or intangible like goodwill, patents, etc. The assets also include certain expenses and losses which have not been written off in full. Examples of such expenses are: formation expenses, expenses incurred on issue of shares and debentures, unwritten amount of expenditure on advertising, etc. These are shown as the last item under 'Assets' in the Balance Sheet.

Liabilities: The term 'liabilities' denote all claims against the assets of the business whether those of the outsiders (creditors) or those of the owners of the business. The outsider's claims may be sub-divided into (i) current liabilities, **and (ii) long-term** liabilities. These are shown separately in the Balance Sheet (see figure 7.3). The current liabilities are those obligation which are likely to be met within one year (or during the normal operating cycle). The long-term liabilities refer to item like loans which are not to be paid in the near future. The owner's claim is shown as capital after adjusting it with the amount of net profit and drawings during the year.

Look at Illustration 7 and see how Balance Sheet is prepared from given list of balances.

Illustration 7

From the following balances extracted from the books of Deepak Brothers, prepare Balance Sheet as on December 31,1987.

	Rs.		Rs.
Capital	12,00,000	Bills Payable	40,000
Net Profit for 1987	6,00,000	Debtors	2,50,000
Land & Buildings	7,00,000	Bills Receivable	50,000
		Loan	1,60,000
Plant & Machinery (after depreciation)	4,00,000	Cash in hand	60,000
		Bank Overdraft	20,000
Furniture (after depreciation)	50,000	Loose Tools	50,000
Investment	3,50,000	Goodwill	1,00,000
Creditors	2,00,000		
Trade Marks	25,000	Closing Stock	1,85,000

Solution:

Balance Sheet of Deepak Brothers as on December 31, 1987

Liabilities		Amount	Assets	Amount
Current Liabilities		Rs.	**Current Assets:**	Rs.
Bank Overdraft		20,000	Cash in hand	60,000
Bills Payable		40,000	Bills Receivable	50,000
Sundry Creditors		2,00,000	Sundry Debtors	2,50,000
			Stock in hand	1,85,000
Long-Term liabilities			**Investments**	3,50,000
Loan		1,60,000		
Capital:			**Fixed Assets**	
Balance as on Jan. 1,1987	12,00,000		Loose Tools	50,000
Add Net Profit	6,043,000		Furniture	50,000
			Plant & Machinery	4,00,000
		18,00,000	Land & Buildings	7,00,000
			Trade Marks	25,000
			Goodwill	1,00,000
		22,20,000		22,20,000

Now **Look** at Illustration 8. It shows how the Trading and Profit and Loss Account **and** the Balance Sheet are prepared from a given Trial Balance.

Illustration 8

From the following Trial Balance of **Gupta** & Sons, prepare **Trading** and **Profit** and **Loss Account** for the year ended December 31,1987 and a Balance Sheet as on **that** date.

Trial Balance

Particulars	Dr. Balances	Cr. Balances
	Rs.	Rs.
Capital		5,00,000
Sales		10,00,000
Sales Returns	25,000	
Purchases	5,00,000	
Purchases Returns		15,000
Inventory as on 1.1.1987	60,000	
Land & Buildings	4,00,000	
Plant & Machinery	2,50,000	
Furniture	1,00,000	
Wages	50,000	
Carriage Inwards	10,000	
Carriage Outwards	5,000	
Cartage	5,000	
Salaries	40,000	
Loan		2,60,000
Debtors	1,50,000	
Creditors		85,000
Bills Receivable	40,000	
Acceptances		10,000
General Expenses	20,000	
Rent & Rates	10,000	
Investments	50,000	
Cash in hand	50,000	
Bank Overdraft		10,000
Discount Allowed	4,500	
Depreciation on Plant & Machinery	50,000	
Interest on Investments		5,000
Interest on Bank Overdraft	500	
Goodwill	60,000	
Bad Debts	5,000	
	18,85,000	18,85,000

The inventory on December 31, 1987 was valued at Rs. 1,00,000.

Solution:

Trading and Profit & Loss Account of Gupta & Sons
for the year ended December 31, 1987

Dr. Particulars		Amount	Particulars		Cr. Amount
		Rs.			Rs.
To Inventory (opening)		60,000	By Sales	10,00,000	
To Purchases	5,00,000		Less Returns	25,000	9,75,000
Less Returns	15,000	4,85,000			
To Wages		50,000	By Inventory (Closing)		1,00,000
To Carriage Inwards		10,000			
To Cartage		5,000			
To Gross Profit c/d		4,65,000			
		10,75,000			10,75,000
To Carriage Outwards		5,000	By Gross Profit b/d		4,65,000
To Salaries		40,000	By Interest on Investment		5,000
To General Expenses		20,000			
To Rent and Rates		10,000			
To Discount		4,500			
To Bad Debts		5,000			

To Depreciation	50,000		
To Interest on Bank Overdraft	500		
To Net Profit (transferred to Capital Account)	3,35,000		
	4,70,000		4,70,000

Balance Sheet of Gupta & Sons as on December 31, 1987

Liabilities		Amount	Assets	Amount
		Rs.		Rs.
Capital	5,00,000		Goodwill	60,000
Add Net Profit	3,35,000		Land & Building	4,00,000
		8,35,000	Plant& Machinery	2,50,000
			Furniture	1,00,000
			Investments	50,000
Loan		2,60,000	Inventory (closing)	1,00,000
Creditors		85,000	Debtors	1,50,000
Acceptances		10,000	Bills Receivables	40,000
Bank Overdraft		10,000	Cash in hand	50,000
		12,00,000		12,00,000

Note: In the above Balance Sheet all assets and liabilities have been shown in the order of permanence.

7.5 VERTICAL PRESENTATION OF FINAL ACCOUNTS

The Trading and Profit and Loss Account and the Balance Sheet have so far been presented as a two-sided statement. But, in practice, it is not necessary to present the final accounts in this form. Nowadays many firms present them in a simpler and more intelligible farm which is called a 'narrative style' or 'vertical presentation'. According to this style the Trading and Profit and Loss Account as well as the Balance: Sheet arc shown in the form of vertical statements. This form of presentation is adopted by many companies for publication of their final accounts. It helps the users of financial statements to appreciate the significance of different items without any difficulty. They can easily interpret the data and judge the profitability and the financial position of the company.

Look at Figure 7.4 and study how various items are shown in the Trading and Profit and Loss Account arid the Balance Sheet in vertical form.

Figure 7.4

Trading and Profit and Loss Account of.......... for the year ended ....

	Rs.	Rs.
SALES		....
Less Cast of *Goods* Sold:		
Opening Stock	....	
Add Purchases	....	
Add Direct Expenses	....	
	....	
Less Closing Stock	....	
		....
GROSS PROFIT		....
Add Other Incomes		....

	Rs.	Rs.
		....
Less Indirect Expenses:		
Salaries	....	
Rent	....	
Sundry Expenses	....	
Insurance	....	
		....
NET PROFIT		....

Balance Sheet of.. ....
as on.. ......

		Rs.	Rs.
Fixed Assets:			
Land and Buildings		....	
Plant and Machinery		....	
Furniture and Fixtures		....	
Vehicles		....	
			....
Current Assets:			
Stock-in-hand		....	
Debtors		....	
Cash at bank		....	
Cash in hand		....	
		....	
Less Current Liabilities:			
Creditors	....		
Bills Payable	....		
		....	
Working Capital			....
			....
Financed by:			
Capital:			
Balance as on 1.1.1987		....	
Add Net Profit for the year		....	
		....	
Less Drawings		....	
			....
			....
Loans			
			....

Look at Illustration 9 and study how Trading and Profit and Loss Account and the Balance Sheet have been prepared for vertical presentation.

Illustration 9

From the information given in Illustration 6, prepare Trading and Profit and Loss Account and the Balance Sheet in the vertical form.

Solution:

Trading and Profit and Loss Account of Gupta & Sons
for the year ended December 31,1987

	Rs.	Rs.
Sales Less Returns (Rs. 10,00,000–Rs. 25,000)		9,75,000
Less Cost of Goods Sold:		
Inventory (beginning)	60,000	
Add Purchases less Returns (Rs. 5,00,000 – Rs. 15,000)	4,85,000	
Add Wages	50,000	
Add Carriage Inwards	10,000	
Add Cartage	5,000	
	6,10,000	
Less Inventory (ending)	1,00,000	
		5,10,000

		Rs.	Rs.
GROSS PROFIT			4,65,000
Add interest on Investments			5,000
			4,70,000
Less Indirect Expenses:			
Carriage		5,000	
Salaries		40,000	
General Expenses		20,000	
Rent and Rates.		10,000	
Discount		4,500	
Bad Debts		5,000	
Interest on Bank Overdraft		500	
Depreciation		50,000	
			1,35,000
NET PROFIT			3,35,000

Balance Sheet of Gupta & Sons as on December 31,1987

		Rs.	Rs.
Fixed Assets:			
Goodwill		60,000	
Land & Building		4,00,000	
Plant & Machinery		2,50,000	
Furniture		1,00,000	
Investments		50,000	
			8,60,000
Current Assets:			
Inventory (ending)		1,00,000	
Debtors		1,50,000	
Bills Receivables		40,000	
Cash in hand		50,000	
		3,40,000	
Less Current Liabilities:			
Creditors	85,000		
Acceptances	10,000		
Bank overdraft	10,000		
		1,05,000	
Working Capital			
			10,95,000
Financed by:			
Capital			
Balance on 1.1.1987		5,00,000	
Add Net Profit		3,35,000	
			8,35,000
Long Term Loans			2,60,000
			10,95,000

Check Your Progress C

1 What is a Balance Sheet?

....

....

....

....

2 Why firms use vertical form of presenting the final accounts?

....

....

....

....

3 Complete the following sentences choosing one of the two alternatives given within brackets.

i) Assets represent....,..... balances of personal and real accounts. (debit/credit)

ii) All liabilities which become due within one year are classified as.,,.....,.. iabilities. (long-term/current)

iii) Unwritten off amount of a deferred revenue expenditure is shown on the......... side of the Balance Sheet. (asset/liabilities)

iv) Totals of assets and liabilities are always.. ......,.. (differentlequal)

v) Loose Tools are classified as......... assets. (fixed/current)

vi) Mortgages are classified as.........liabilities. (current/long-term)

7.6 MANUFACTURING ACCOUNT

In case of trading concerns you can find out the cost of goods and the gross profit by preparing a Trading Account. But a manufacturing concernhas to first prepare another account called Manufacturing Account with the help of which it works out the cost of goods produced, The cost of goods produced is then transferred to tha Trading Account for ascertaining the cost of goods sold and the gross profit.

A manufacturing concern purchases raw materials from the market and converts them into finished goods for sale. The cost of goods produced thus includes two major costs: (i) cost of raw materials consumed, and (ii) cost of conversion. These are explained below.

Cost of Raw Materials Consumed: This represents the cost of raw materials used in course of manufacture which can be worked out by adjusting the opening and closing stocks of raw materials in the purchases of raw materials. For example, a firm purchased raw materials worth Rs. 6,50,000 during 1967, and its stock of raw materials on January 1,1987 (opening stock) was Rs. 70,000 and on December 31, 1987 (closing stock) Rs, 90,000. The cost of raw materials consumed during 1987 will be worked out as follows:

	Rs.
Opening Stock of Raw Materials	70,000
Add Purchases of Raw Materials	6,50,000
	7,20,000
Less Closing Stock of Raw Materials	90,000
Cost of Raw Materials Consumed	6,30,000

The direct expenses incurred on the purchaees of raw materials such as freight, import duty, dock dues, cartage, etc. can also be included in the cost of raw materials consumed. But the usual practice is to show them separately on the debit side of the Manufacturing Account.

Cost of Conversion: This includes all expenses incurred in the factory such as wages paid to labour, salaries of supervisory staff, factory rent and rates, motive power, repairs to plant and machinery, depreciation on plant and machinery, etc, All these expenses are debited to the Manufacturing Account.

Look at Figure 7.5 for the **proforma** of a Manufacturing Account.

Figure 7.5
Manufacturing Account of.........
for the period ended.........

Dr.					**Cr.**
Particulars	Amount	Amount	**Particulars**	**Amount**	Amount
	Rs.	**Rs.**		Rs.	**Rs.**
To Work-in progress at the beginning		...	By Sale of Scrap		...
To Raw Materials Consumed:			By Work-in-Progress at the end		...
Opening Stock of Raw Materials	...		By Cost of Goods Produced (Transferred to Trading Account)		...
Add Purchases of Raw Materials	...				
Less Closing Stock of Raw Materials	...	....			
		....			
To Carriage Inwards					
To Freight, Import Duty, Dock Dues, etc.		...			
To Manufacturing Wages		...			
To Motive Power		...			
To Coal, Gas and Water		...			
To Oil and Grease		...			
To Factory Lighting & Heating		...			
To Factory Insurance		...			
To Repairs to Factory Building		...			
To Repairs to Plant and Machinery		...			
To Depredation on Factory Buildings		...			
To Depreciation on Plant and Machinery		...			
		...			
		...			...

Some Important Points

Scrap: The **term** 'scrap' is used for waste materials coming out of the manufacturing process, Cuttings of cloth in readymade garments factory and metal cuttings in engineering **factories are** some examples of scrap. Any amount realised from the sale of **scrap** must be adjusted in the cost of goods produced. Hence, it is credited to the Manufacturing Account.

Work-in-Progress: It is quite likely that at the end of the year, there may be certain goods which are still in the process of manufacture. Such goods are called 'semi-finished goods' or 'work-in-progress'. There will always be some work-in-progress at the beginning as well as at the end of the accounting year. Their cost must be adjusted while working out the cost of goods produced. Hence the opening work-in-progress is shown on the debit side of the Manufacturing Account while the closing work-in-progress **is** shown on its credit side.

Stock of Finished **Goods:** Besides the stock of raw materials and semi-finished goods every firm will have the stock of finished goods. This is to be adjusted in the cost of goods sold and not in the cost of goods produced. Hence, it is not shown in the Manufacturing Account. As you learnt earlier, it will be shown in the Trading Account.

Look at Illustration 10 and see how Manufacturing Account is to be prepared.

Illustration 10

Prepare Manufacturing Account from the following particulars relating to the year 1987.

	Rs.
Purchases of Raw Material	1,00,000
Stock on 1.1.1987	
Raw Materials	10,000
Work-in-Progress	5,000
Finished goods	25,000
Factory wages	15,000
Factory Rent	5,000
Fuel & Power	2,000
Carriage Inwards	1,000
Repairs of Plant	2,000
Depreciation on Plant	5,000
Sale of Scrap	500
Stock on 31.12.1987	
Raw Materials	20,000
Work-in-Progress	7,500
Finished Goods	30,000

Solution:

Manufacturing Account for the year ended December 31,1987

Dr. **Cr.**

Particulars		Amount	Particulars	Amount
		Rs.		Rs.
To Work-in-Progress at the beginning		5,000	By Sale of Scrap	500
To Raw Materials Consumed			By Work-in-Progress at the end	7,500
Opening Stock	10,000		By Cost of Goods Produced (transferred to Trading Account)	1,17,000
Add Raw Material Purchased	1,00,000			
	1,10,000			
Less Closing Stock	20,000	90,000		
To Factory Wages		15,000		
To Factory Rent		5,000		
To Fuel & Power		2,000		
To Carriage Inwards		1,000		
To Repairs of Plant		2,000		
To Depreciation on Plant		5,000		
		1,25,000		1,25,000

You will observe that the stock of finished goods has not been shown in the Manufacturing Account. As stated earlier, it is to be taken to the Trading Account. Now, suppose the sales for the year 1987 were Rs. 1,60,000, the Trading Account will appear as follows:

Trading Account of........
for the year ending December, 31 1987

Dr.			Cr.
Particulars	Amount	Particulars	Amount
	Rs.		Re.
To Opening stock of Finished Goods	25,000	By Sales	1,60,000
To Cost of Goods Produced (transferred from Mfg. A/c)	1,17,000	By Closing stock of Finished Goods	30,000
To Gross Profit (transferred to Profit & Loss A/c)	48,000		
	1,90,000		1,90,000

You have learnt that a manufacturing concern has to prepare Manufacturing Account before preparing the Trading and Profit and Loss Account. Though considered desirable but many firms do not do so because it is not compulsory. You will also generally be asked to prepare only the Trading Account without preparing the Manufacturing Account. In such a situation you will show all items of Manufacturing Account in the Trading Account itself. In other words, cost of raw materials consumed, expenses on purchases of raw materials, all manufacturing expenses, the opening and closing work-in-progress, sale of scrap, etc. will also be shown in the Trading Account. But, as per common practice, the items like depreciation and repairs to plant and machinery and factory building will be shown in the Profit and Loss Account and not in the Trading Account,

7.7 LET US SUM UP

At the end of the accounting year the businessman prepares the final accounts with the help of a Trial Balance. The final accounts consist of (i) Profit and Loss Account and (ii) Balance Sheet. The Profit and Loss Account is prepared for ascertaining the net profit/net loss of the business during the year and the Balance Sheet is prepared for ascertaining its financial position as at the end of the year.

The Profit and Loss Account is divided into two sections, The first section called Trading Account reveals the gross profit or gross loss and the second section called Profit and Loss Account shows the net profit or net loss. Gross profit is defined as the excess of sales revenue over the cost of goods sold which also includes the direct expenses. The net profit is worked out by crediting the Profit and Loss Account with the amount of gross profit and other incomes and debiting it with all indirect expenses and losses, In practice, we usually prepare a combined Trading and Profit and Loss Account. It is also necessary to pass closing entries for transferring all expenses and incomes to the Trading and Profit and Loss Account.

The Balance Sheet shows all assets and liabilities of the business. The assets represent the debit balances of the real and personal accounts plus the unwritten off amounts of deferred revenue expenses. The liabilities, on the other hand, represent the credit balances of real and personal accounts including capital, The total assets should always be equal to the total of liabilities.

The manufacturing concerns may also prepare a Manufacturing Account for ascertaining the cost of goods produced, which is then transferred to the Trading Account for ascertaining the cost of goods sold and the gross profit. This, however, is not compulsory. Most manufacturing concerns prepare the Trading Account directly by showing all expenses incurred in the factory (including cost of raw materials Consumed) in the Trading Account itself.

7.8 KEY WORDS

Closing **Stock:** Goods remaining unsold at the end of the accounting year.

Cost of Conversion: Expenses incurred in the factory (for converting raw materials into finished goods.)

Cost of **Goods** Sold: Difference between the cost of goods available for sale and the cost of goods in stock.

Cost of Production: It is the cost of goods produced which includes cost of raw materials consumed and all manufacturing expenses.

Current Assets: Assets which are likely to be realised within a period of one year or during the operating cycle. They are also called floating assets.

Current Liabilities: Liabilities which are likely to be paid within one year or during the operating cycle. They are also called short-term liabilities.

Direct Expenses: Expenses incurred on the goods purchased till they are brought to the place of business.

Fictitious Assets: Expenses and losses not yet written off and shown as assets in the Balance Sheet.

Fixed Assets: Assets acquired for use in the business for a long period. They are also called non-current assets.

Gross Profit: Excess of sales revenue over the cost of goods sold'.

Indirect Expenses: All expenses other than direct **expenses**. These include expenses incurred in connection with general administration, financial matters and selling and distribution of goods.

Intangible Assets: Assets in the form of rights which cannot be seen or touched such as goodwill, patents, etc.

Net **Profit:** Excess of gross profit and other incomes over the **indirect** expenses and losses in the business.

Non-Current Liabilities: Liabilities payable **after** a long time. **They** are also called long-term liabilities.

Owner's Capital: Claim of owners against the assets of the business. It is also called owner's equity and is equal to excess of assets over outside liabilities.

Opening **Stock:** Stock of **goods** as at the beginning of the accounting year,

Scrap: Waste material which arises in the course of manufacture.

Tangible **Assets:** Assets which have physical form and can be seen and touched such as buildings, machinery, etc.

Work-in-Progress. Goods in respect of which some work still **remains** to be done. They are also called semi-finished goods.

7.9 SOME USEFUL BOOKS

1 Maheshwari, S.N. **1986.** ***Introduction to Accounting,*** Vikas Publishing House: New Delhi. (Chapter **10).**

2 Patil, V.A. and J.S. Korlahalli, 1986. Principles ***and Practice of Accounting,*** R. **Chand** & Co.: New Delhi. (Chapter 20).

3 William Pickles. **1982.** ***Accountancy,*** **E.L.B.S.** and **Pitman: London. (Chapter** 5)

4 Gupta, **R.L.** and **M.** Radhaswamy. **1986.** ***Advanced Accountancy,*** Sultan Chand **&** Sons: New Delhi. (Chapters 4,5).

5 Shukla, M.C. and **T.S. Grewal**. 1987. ***Advanced Accountancy.*** S. Chand **&** Co.: New **Delhi. (Chapter** 2).

7.10 ANSWERS TO CHECK YOUR PROGRESS

A i)Debit ii)Debit iii)Debit iv)Credit v)Debit vi)Credit vii)Debit viii)Credit ix)Debit x)Debit xi)Debit xii)Credit

B 3 i)False ii)True iii)True iv)True v)False vi)False.

4 i)indirect ii)purchases, closing stock iii)selling iv)Trading v)debited vi)Trading Account

5 Rs. 90,000

C i)debit ii)current iii)asset iv)equal v)fixed vi)long-term

7.11 TERMINAL QUESTIONS/EXERCISES

Questions

1 Distinguish between:
   a) Cost of Goods Sold and Cost of Goods Processed
   b) Gross Profit and Net Profit
   c) Direct Expenses and Indirect Expenses
   d) Trading Account and Manufacturing Account
   e) Profit and Loss Account and Balance Sheet

2 Give dosing entries for Trading and Profit and Loss Account.

3 What is a Balance Sheet? Describe different methods of arranging assets arid liabilities.

Exercises

1 Find out the Cost of Goods Sold from the following figures extracted from the books of Allied Ltd. for the year 1987:

	Rs.
Stock (1.1.1987)	50,000
Purchases	10,00,000
Sales	15,00,000
Purchases Returns	50,000
Stock (31-1-1987)	70,000
Direct Expenses	60,000
Indirect Expenses	1,00,000

(Answer: Rs. 9,90,000)

2 Find out the Cost of Goods Sold and Gross Profit from the following figures:

	Rs.
Inventory in the beginning	60,000
Purchases Less Returns	6,00,000
Carriage 'Inwards	20,000
Cartage Outwards	30,000
Cartage and Freight	10,000
Wages	50,000
Sales Less Returns	12,00,000
Inventory at the end	40,000

(Answer: Cost of Goods Sold Rs. 7,00,000; Gross Profit Rs. 5,00,000.)

3 From the data given in question No. 2 prepare Trading Account

4 From the following balances of Shyam Sunder, prepare Profit and Loss Account for the year ended March 31,1987.

	Rs.
OfficeExpenses	5,280
Advertising	3,000
Legal Charges	5,000
Postage and Telephone Charges	6,400
Salaries and Wages	60,000
Travelling Expenses	2,500
Interest Received	600
Rent, Rates and Taxes	20,800
Insurance	2,400
Office Lighting	1,500
Stationery	1,200
Repairs	920
Miscellaneous Income	800
Commission Paid	4,000
Bank Charges	200

The Gross Profit for the year was Rs. 73,000

(Answer: Net Loss Rs. 38,000)

5 The following balances have been extracted from the books of Plaza Electricals Ltd. for the year 1987.

	Rs.
Sales	5,00,000
Purchases	3,00,000
Return Inwards	10,001)
Return Outwards	15,000
Opening Stock	30,000
Wages	20,000
Carriage Inwards	5,000
Carriage Outwards	3,000
Salaries	25,000
General Expenses	10,000
Rent and Rates	4,000
Advertisement	5,000
Bad debts	3,000
Insurance	3,000
Trade Expenses	2,000
Depreciation	5,000

It was further given that the value of stock on December 31,1987 was Rs. 50,000. You are required to prepare Trading and Profit and Loss Account of Plaza Electrical Etd. for the year ending December 31,1987.

(Answer: Gross Profit Rs. 2,00,000; Net Profit Rs. 1,40,000)

6 From the following data pertaining to the transactions of Mehts Bros. for the year 1987, prepare Trading and Profit and Loss Account for the year ending December 31,1997.

	Rs.
Sales	10,00,000
Purchases	6,00,000
Sales Returns	20,000
Purchases Returns	10,000
Inventory (beginning)	40,000
Wages	50,000
Carriage Inwards	20,000
Carriage Outwards	15,000
Trade Expenses	10,000
Cartage and Freight	5,000
Salaries	30,000

	Rs.
General Expenses	10,000
Insurance	6,000
Rent & Rates	5,000
Distribution Expenses	6,000
Discount Received	1,000
Discount Allowed	2,000
Bad Debts	2,000
Depreciation	8,000
Interest on Investments	20,000
Interest on Bank Deposits	1,000
Interest on Bank Overdraft	500
Loss of Goods by Fire	2,500

It was further given that the value of Inventory on December 31,1987 was Rs. 80,000

(Answer: Gross Profit Rs. 3,55,000: Net Profit Rs. 2,80,000)

7 From the following balances of Hitesh, prepare a Balance Sheet as on December 31,1987

	Rs.
Hitesh's Capital	41,000
Drawings	6,100
Wife's Loan	4,000
Sundry Creditors	45,000
Cash in hand	250
Cash at bank	4,000
Sundry Debtors	40,500
Patents	2,000
Plant and Machinery	20,000
Land and Building	26,000
Stock in hand	36,500

Net Profit for the year was Rs. 45,350

(Answer: Balance Sheet Total Rs. 1,29,250)

8 From the following Trial Balance of Sameer prepare Trading and Profit and Loss Account for the year ended September, 30,1987, and Balance sheet as on that date.

Trial Balance as on September 30, 1987

Name of Account	Dr. Balances	Cr. Balances
	Rs.	Rs.
Capital		40.000
Drawings	7,500	
Stock on July 1, 1986	8,000	
Purchases	47,250	
Sales		90,000
Carriage Inwards	2,300	
Returns .Inwards	2,000	
.Returns Outwards		1,500
Wages	7,000	
Plant and Machinery	30,000	
Furniture and fittings	7,500	
Coal, Gas and Water	2,100	
Power	2,000	
Salaries	9,000	
Discount Allowed	750	
Discount Received		600
Office Rent	2,400	
Factory Reqt	3,000	

	Rs.	Rs.
Postage and telephone	900	
Insurance	250	
Sundry Expenses	800	
Trade Debtors	20,000	
Trade Creditors		27,150
Cash in hand	700	
Cash at Bank	4,100	
Carriage Outwards	1,700	
	1,59,250	1,59,250

The Stock.on September 30,1987 was valued at Rs. 9,250.
(Answer: Gross Profit Rs. 27,100; Net Profit Rs. 11,900; Balance Sheet Total Rs. 71,550)

9 The following figures have been extracted from the books of a manufacturer.

	Rs.
Stock 1.1.1987	
Raw Materials	25,000
Work-in-Progress	10,000
Finished Goods	50,000
Purchases of Raw Materials	3,00,000
Factory Wages	40,000
Factory Rent	5,000
Fuel & Power	5,000
Carriage Inwards	2,500
Repairs of Plant	20,000
Depredation on Plant	25,000
Sale of Scrap	2,000
Stuck on 31.12.1987	
Raw Materials	40,000
Work-in-Progress	15,000
Finished Goods	60,000

You are required to prepare a Manufacturing Account and ascertain the Cost of Goods Produced.

(Answer: Cost of **Goods Produced:** Rs. 3,75,500)

10 From the following Trial Balance prepare Manufacturing Account and the Trading and Profit and Loss Account for the year ended March 31, 1988, and Balance Sheet as at the end of the year.

Particulars	Dr. Balances	Cr. Balances
	Rs.	Rs.
Opening Stock of Raw Materials	60,000	
Opening Stock of Finished Goods	32,000	
Opening Stock of the Work-in-Progress	10,000	
Capital		1,44,000
Purchase of Raw Materials	5,00,000	
Sates		8,00,000
Purchase of Finished Goods	16,000	
Carriage Inwards	8,000	
Wages	1,00,000	
Salaries (75% Factory)	52,000	
Commission	6,000	
Bad Debts	4,000	

	Rs.	Rs.
Insurance	8,000	
Rent, Rates and Taxes (50% Factory)	24,000	
Postage and Telegram	5,600	
Miscellaneous Expenses	3,200	
Travelling and Conveyance (50% Factory)	7,000	
Carriage Outwards	5,200	
Machinery	80,000	
Furniture	10,000	
Debtors	1,20,000	
Creditors		1,07,000
	10,51,000	10,51,000

The Closing Stocks are as follows:

Raw Materials	80,000
Work-in-Progress	24,000
Finished Goods	16,000

(Answer: ***Cost*** of Production Rs. **6,26,750;** Gross Profit Rs. **1,41,250;** Net Profit **Rs.** 79,000; **Balance Sheet** Total Rs. 3,30,000**).**

> Note: These questions will help you to understand the unit better. Try to write answer for them. But do not submit your answers to the University for assessment. These are for your practice only.

UNIT 8 FINAL ACCOUNTS II

Structure

8.0 OBJECTIVES

After studying this unit you should be able to:
- explain why adjustment entries are necessary at the time of preparing the final accounts
- list the items in respect of which adjustments are usually made
- pass the necessary adjustment entries
- prepare final accounts with adjustments.

8.1 INTRODUCTION

In Unit 7 you learnt about the preparation of simple final accounts. They did not involve any adjustments. In practice, however, you are always required to make some adjustments while preparing the final accounts. It is because there may be many expenses and incomes relating to the current year which are still to be brought into the books of account. Then there may be certain items recorded in current year's books which actually relate to the previous year or the next year. Unless such items are duly adjusted in the books of account, the final accounts will not reveal the true and fair view of the state of affairs of the business. In this unit you will learn about all items which require adjustments and study how such adjustments are made in books of account and how they are incorporated in the final accounts.