FUNDAMENTALS OF ACCOUNTING

MCA Semester - I

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Unit 4
Financial Statements of Sole Proprietorship

Introduction

A business organization is an establishment intended to carry commercial business by producing goods or services and meet the customers' needs. Main aim of the business organization to generate profit from business operations.

Meaning of Sole Proprietorship

This is the traditional and popular form of business organization. Its formation is simple, and the owners control the complete operations of a business and is liable for all financial burdens and debts. A long as they are the only owner, they have the right to operate any category of business. All the decisions related with business are taken by sole proprietor. For Example: Shop or Retail business, Home-based company, Individual consulting firm, etc.

Financial Statement

There are three account/statements included in the financial statements of an entity:

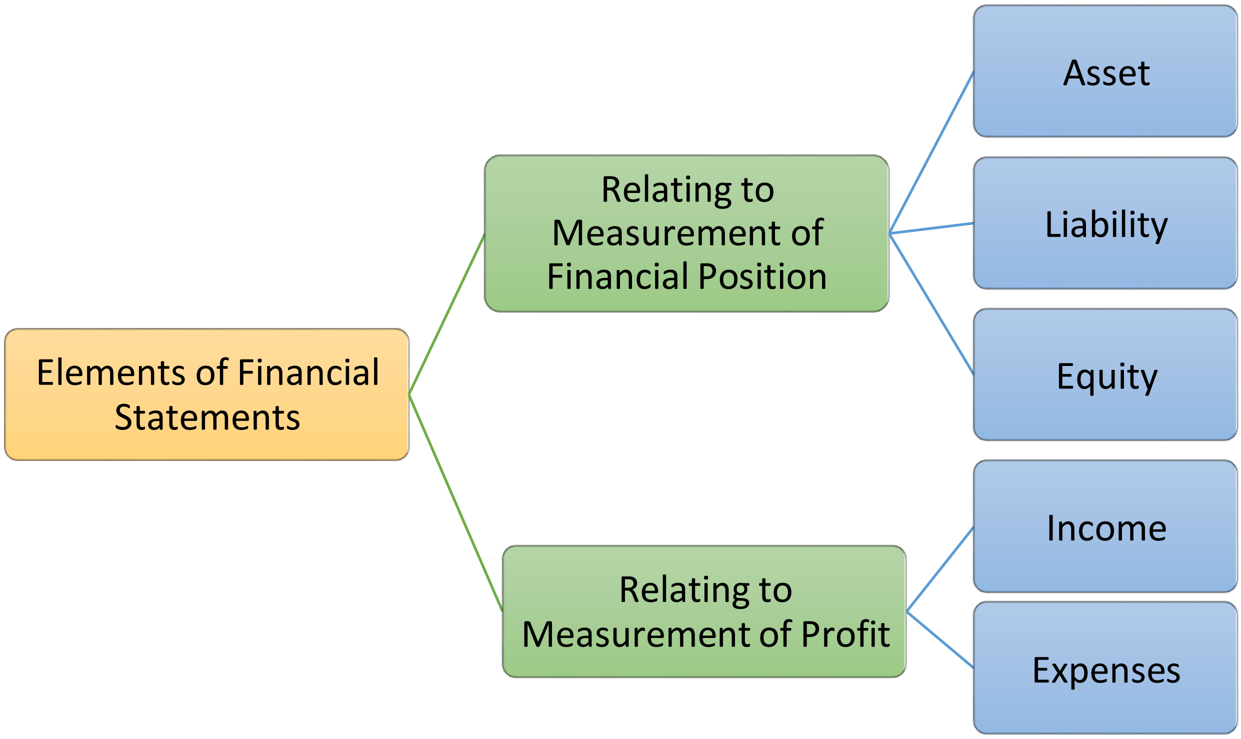
1. Trading Account
2. Profit & Loss Account
3. Balance Sheet

Meaning of Final Accounts

Final Accounts is the ultimate stage of the accounting process where the different ledger maintained in the trial balance (Books of Accounts) of the business organization are presented in the specified way to provide the profitability and financial position of the entity for a specified period to the stakeholders and other interested parties, i.e., Trading Account, Profit & Loss Account and Balance Sheet.

Final Accounts means accounts which are prepared at the final stage to give the financial position of the business. The determination of the Profit or Loss is done by preparing a Trading and Profit & Loss Accounts. While the financial position is judged by means of preparing a Balance Sheet of the business.

Elements of Financial Statements



Relating to Measurement of Financial Position

1. **Asset**

   The term "Assets" denotes the resources acquired by the business from the funds made available either by the owners of the business or others. An enterprise usually employs its assets to produce goods or services capable of satisfying the wants or needs of customers. Since these goods or services can satisfy wants or needs, the customers are prepared to pay for them and hence contribute to the cash flow of the enterprise.

   Many assets have a physical form. For Example: land and building, plant, equipment etc. are of physical form. However, physical form is not necessary for the existence of an asset. For Example: patent, goodwill, copyright, etc.

❖ **Classification of Assets**

- **Current Assets**

  Current assets are those assets which are acquired with the intention of converting them into cash during the normal business operation of the enterprise. For Example: debtors, stock, bills receivable, etc.

- **Liquid Assets**

  Liquid assets are those assets which are immediately converted into cash without much loss.

- **Fixed Assets**
  Fixed assets are those assets which are acquired for relatively long period for carrying on the business of the enterprise.

- **Intangible Assets**
  Intangible assets are those assets which cannot be seen and touched. For Example: goodwill, patent, trademark, etc.

- **Fictitious Assets**
  There are assets not represented by tangible possession or property.

2. Liabilities
Liabilities are claim of the creditors against the enterprise arising out of past activities that are to be satisfied by the disbursement or utilization of corporate resources. Liabilities result from past transactions or other past events. Some liabilities can be measured only by using a substantial degree of estimation.

❖ **Classification of Liabilities**

- **Current Liabilities**

  The term "Current Liabilities" is used for such liabilities which are payable within a particular accounting period. For Example: bills payable, outstanding expenses, bank overdraft, etc.

- **Fixed Liabilities**

  All liabilities other than Current Liabilities come within this category. In other words, these are the liabilities which do not become due for payment in one year and which do not require current assets for their payment.

3. Equity
Equity is a residual interest in the assets of the enterprise after deducting its liabilities. The equity meaning in accounting refers to a company's book value, which is the difference between liabilities and assets on the balance sheet.
Equity = Assets – Liabilities. In a corporate enterprise equity is suitable sub-classified in the balance sheet. For Example: in India equity is classified as Share Capital and Reserve and Surplus.

Relating to Measurement of Profit

1. **Income**
   Income is increase in economic benefits during the accounting period in the form of inflows or enhancement of assets or decreases of liabilities that result in increase in equity, other than those relating to contribution from equity participation.
   The definition of income encompasses both revenue and gains. Income may also result from settlement of liabilities. Revenue arises in the course of the ordinary activities of an enterprise and is rendered by a variety of different names, including fees, interest, dividends and rent. Gain is a general increase in the value of an asset or property.

2. **Expenses**
   Expenses are decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences in liabilities that result in decreases in equities other than those relating to distribution to equity participants. For Example: cost of sales, wages, manufacturing expenses, depreciation.
   They usually take the form of an outflow or depletion of an asset such as cash and cash equivalent, inventory, property, plant and equipment. Losses represents other items that meet the definition of expenses and may or may not arising in the course of the ordinary activities of the enterprise. For Example: loss due to fire, loss due to flood, etc.

Closing Adjustment Entries

Treatment of items of adjustment appearing outside and inside in the Trial Balance. If any item of adjustment appears outside the Trial Balance, it will be shown at two appropriate places in the final accounts. If any item of adjustments appears inside the Trial Balance, it will be shown only at one appropriate place in the final accounts.

Adjustment	If given in Trial Balance	If not given in Trial Balance
1. Closing stock	Balance Sheet – Asset Side	(a) Trading A/c – Credit Side (b) Balance Sheet – Asset Side
2. Outstanding Expenses	Balance Sheet – Liability Side	(a) Trading/Profit & Loss A/c Debit Side. (b) Balance Sheet – Liability Side
3. Prepaid Expenses	Balance Sheet – Asset Side	(a) Trading/Profit & Loss A/c Debit Side. Deduct from the concerned expenses. (b) Balance Sheet - Asset Side.
4. Income Outstanding	Balance Sheet – Asset Side	(a) Profit & Loss A/c – Credit Side. Add to the concerned income. (b) Balance Sheet – Asset Side.
5. Incomes Received in Advance	Balance Sheet – Liability Side	(a) Profit & Loss A/c – Credit Side. Deduct from concerned

		income. (b) Balance Sheet – Liability Side
6. Bad Debts	Profit & Loss A/c – Debit Side	(a) Profit & Loss A/c – Debit Side. (b) Balance Sheet – Asset Side. Deduct from debtors.
7. Provision for Bad or Doubtful debts	Profit & Loss A/c – Debit Side	(a) Profit & Loss A/c – Debit Side. (b) Balance Sheet – Asset Side. Deduct from debtors after addition bad debts, if any.
8. Provision for Discount on Debtors	Balance Sheet – Asset Side Deduct from Debtors.	(a) Profit & Loss A/c – Debit Side. (b) Balance Sheet – Asset Side. Deduct from debtors after providing for provision for bad debts
9. Depreciation	Profit & Loss A/c – Debit Side	(a) Profit & Loss A/c – Debit Side. (b) Balance Sheet – Asset Side. Deduct from Respective Asset.
10. Interest on Capital	Profit & Loss A/c – Debit Side	(a) Profit & Loss A/c – Debit Side. (b) Balance Sheet – Liability Side. Add to Capital.
11. Interest on Drawings	Profit & Loss A/c – Credit Side	(a) Profit & Loss A/c – Credit Side. (b) Balance Sheet – Liability Side. Deduct from Capital.
12. Loss by Fire	Profit & Loss A/c – Debit Side	(a) Trading A/c – Credit Side (with full amount of loss) (b) Profit & Loss A/c – Debit Side (Actual loss, if any). (c) Balance Sheet – Asset Side (with insurance claim admitted by Insurance Co.)
13. Goods withdrawn for personal use	Trading A/c - Credit Side	(a) Trading A/c – Credit Side or Deduct from purchases. (b) Balance Sheet – Liability Side (Deduct from Capital as Drawings)
14. Goods Distributed as free samples	Profit & Loss A/c – Debit Side	(a) Trading A/c – Credit Side or Deduct from Purchases (b) Profit & Loss A/c – Debit Side

15. Sale of Goods on Approval Basis, approval not yet received	Usually, it is not given in Trial Balance	(a) Trading A/c – Credit Side. Deduct from Sales the selling price of goods sold and add to stock at cost price. (b) Balance Sheet – Asset Side. Deduct from Debtors the selling price of such sales and show the cost price of such sales along with closing stock.

Trading Account

Trading account is one of the financial statements which shows the result of buying and selling of goods and/or services during an accounting period. Trading account is prepared to know the gross profit or gross loss during the accounting period. At the end of the year, it is necessary to ascertain the net profit or the net loss. For this purpose, it is first necessary to know the gross profit or gross loss. Gross Profit is the difference between the selling price and the cost of the goods sold.

For a trading firm, the cost of goods sold can be ascertained by adjusting the cost of goods still on hand at the end of the year against the purchases. It is done as follow:

- Cost of Goods Sold = Net Purchases – Closing Stock
- Closing Stock = Opening Stock + Purchases (Net) + Direct Expenses – Cost of Goods Sold
- Gross Profit = Net Sales – Cost of Goods Sold

Format of Trading Account

Dr. **Trading Account of… … for the year ended** **Cr.**

Particulars	**₹**	**₹**	**Particulars**	**₹**	**₹**
To Opening Stock		XXX	By Sales	XXX	
To Purchases	XXX		**Less:** Returns Inwards	XXX	XXX
Less: Returns outwards	XXX	XXX	By Closing Stock		XXX
			By Gross Loss c/d*		XXX
To Direct expenses:	XXX		**(Transferred to P&L A/c)**		
Freight & Carriage	XXX				
Customs & Insurance	XXX				
Wages	XXX				
Gas, Water & Fuel	XXX				
Factory Expenses	XXX	XXX			
Royalty on production		XXX			
To Gross Profit c/d*		XXX			XXX
(Transferred to P&L A/c)					

Profit and Loss Account

The Profit and Loss Account starts with gross profit on the credit side. If there is gross loss, it will be written on the debit side. After that all those expenses and losses, which have not been entered in the Trading Account, will be written on the debit side of Profit and Loss Account. Incomes and gains, other than sales, will be written on the credit side. Further, it may be noted that the expenses which are personal in nature will not be charged to Profit and Loss A/c.

Only those revenue expenses and losses which are related to the current year, are debited to Profit and Loss Account. Profit and Loss Account should be prepared in such a manner as will enable the reader to form a correct idea about the profit earned or loss suffered by the firm. All other expenses like administrative expenses, Selling and Distribution expenses and Finance related expenses are recorded in Profit & Loss account.

Format of Profit and Loss Account

Dr. **Profit and Loss Account of… … for the year ended** **Cr.**

Particulars	₹	₹	Particulars	₹	₹
To Gross Loss b/d*		XXX	By Gross Profit b/d*		XXX
Management expenses	XXX		**Other Income**	XXX	
To Salaries (administrative)	XXX		By Discount Received	XXX	XXX
To Office rent, rates and	XXX		By Commission Received		
Taxes	XXX			XXX	
To Printing and stationery	XXX		**Non-Trading Income**	XXX	
To Telephone charges	XXX		By Bank Interest	XXX	XXX
To Postage and telegrams	XXX		By Rent of property let-out		
To Insurance	XXX		By Dividend from shares	XXX	
To Audit Fees	XXX	XXX		XXX	XXX
To Legal Charges			**Abnormal Gains**		XXX
To Electricity Charges		XXX	By Profit on sale of machinery		
			By Profit on sale of investment		
Maintenance expenses	XXX				
To Repairs & renewals	XXX		**By Net Loss**		
To Depreciation on:	XXX	XXX	**(Transferred to Capital A/c)**		
Office Equipment					
Office Furniture					
Office Buildings					
Selling & Distribution	XXX				
expenses	XXX				
To Salaries (selling staff)	XXX				
To Advertisement	XXX				
To Godown rent	XXX				
To Carriage Outward	XXX				
To Bad Debts	XXX	XXX			
To Provision for bad debts					
To Selling commission	XXX				
	XXX				
Financial expenses	XXX				
To Bank charges					
To Interest on loans	XXX	XXX			
To Discount on bills					
To discount allowed	XXX				
to customers	XXX				
	XXX	XXX			
Abnormal Losses		XXX			
To Loss on sale of machinery		XXX			XXX
To Loss on sale of investment					

To Loss by fire **To Net Profit** **(Transferred to Capital A/c)**					

Balance Sheet

The balance sheet may be defined as “a statement which sets out the assets and liabilities of a firm or an institution as at a certain date.” It is called a Balance Sheet because it is a sheet of balances of those ledger accounts which have not been closed till the preparation of the Trading and Profit and Loss Account. Since even a single transaction will make a difference to some of the assets or liabilities, the balance sheet is true only at a particular point of time. That is the significance of the word “as at.” The assets are shown on the right-hand side and liabilities and capital on the left-hand side.

❖ **Characteristics of Balance Sheet**

- It is prepared at a particular date, rather the close of a day and not for a period. It is true only on that date and not later.
- The balance sheet is prepared only after the preparation of the Profit and Loss Account.
- This is the reason why the Profit and Loss Account (including the Trading Account) and the Balance Sheet are together called Final Accounts.
- A Balance Sheet is only a statement and not an account. It has no debit side or credit side. The headings of the two sides are ‘Assets’ and ‘Liabilities’.
- Since capital always equals the difference between assets and liabilities and since the capital account will independently arrive at this figure.
- The two sides of the Balance Sheet must have the same totals. If it is not so, there is certainly an error somewhere.

Format of Balance Sheet

Balance Sheet of … … as on … …

Liabilities	**₹**	**₹**	**Assets**	**₹**	**₹**
Capital A/c:			**Tangible Fixed Assets:**		
Balance			Land and Building	XXX	
Add: Net Profit**/**	XXX		Plant and Machinery	XXX	
Less: Net Loss	XXX		Furniture and Fixture	XXX	
Less: Drawings	XXX	XXX	Vehicles	XXX	XXX
Long Term Loans:	XXX		**Intangibles Fixed Assets:**	XXX	
Term Loans	XXX	XXX	Goodwill	XXX	
Other Loans			Patent Rights	XXX	
	XXX		Trademark	XXX	XXX
Short Term Loans:	XXX		Copyright		
Cash Credit	XXX	XXX			XXX
Bank Overdrafts			**Investments:**		
Other Loans	XXX		Long term investments	XXX	
	XXX			XXX	
Current Liabilities:	XXX	XXX	**Current Assets:**	XXX	
Trade Payables			Inventory in Trade	XXX	
Outstanding Expenses	XXX		Trade receivables	XXX	
Advance Taken			Short term investments	XXX	
	XXX		Prepayments	XXX	XXX
Provision:	XXX	XXX	Advances		
Provision for Bad debts			Bank Balance		
Provision for Retirement Benefits		XXX	Cash In Hand		XXX
Provision for Taxation					

CW 1: From the following trial balance of Mr. A, prepare a Trading, Profit and Loss Account and Balance Sheet for the year ended on 31st March, 2022.

Trial Balance as on 31-03-2022 (Rs. In '000)

Particulars	Dr.	Cr.
Purchases and Sales	21,750	30,000
Discount allowed	1,200	
Wages	6,500	
Salaries	2,000	
Travelling Expenses	400	
Commission	425	
Carriage Inwards	275	
Administration Expenses	105	
Printing Expenses	600	
Interest	250	
Building	5,000	
Furniture	200	
Debtors and Creditors	4,250	2,100
Cash	2,045	
Capital		13,000

Stock on 31-03-2022 was Rs. 60,00,000.

CW 2: The below given is the Trial Balance of Mr. Rajababu. Prepare his Final Accounts.

Trial Balance as on 31st March’ 2022

Particulars	Amt.	Particulars	Amt.
Buildings	1,00,000	Return Outwards	5,000
Plant and Machinery	1,80,000	Discount Received	15,000
Sundry Debtors	50,000	Loan From B.O.B.	20,000
Salaries	60,000	Sundry Creditors	30,000
Advertisement Expenses	5,000	Mr. Rajababu’s Capital	3,30,000
Carriage Outward	15,000	Sales	13,00,000
Bad Debts	5,000	Travelling Expenses	30,000
Postage and Telephone	3,000	Insurance Charges	6,000
Printing and Stationery	10,000	Loss on Sale of Assets	3,000
Audit Fees	15,000	Sales Promotion Expenses	5,000
Conveyance	20,000	Return Inwards	15,000
Wages	48,000	Opening Stock	60,000
Carriage Inwards	30,000	Purchases	10,00,000
Drawings	40,000		

Additional Information:

1.) Closing Stock was valued at Rs. 1,50,000.
2.) Provide depreciation on Plant and Machinery @ 10%.
3.) Provide additional Bad debts Rs. 2,000 and new B.D.R. Rs. 1,000. Interest on loan is Rs. 6,000.
4.) Unrecorded Sales amounted to Rs. 30,000 and goods received on 30th March’12 are remained unrecorded in purchase book Rs. 10,000.
5.) Provision required Outstanding Salaries Rs. 15,000 and Delivery Charges Rs. 15,000 as on 31st March’22.
6.) Goods withdrawn for personal use Rs. 15,000.

CW 3: The following is the trial balance of Akshay as on 31.03.2022 Prepare his final accounts:

Particulars	Debit Rs.	Credit Rs.
Opening Stock	50,000	
Capital & Drawings	15,000	66,000
Postage & Telegram	1,000	
Purchases & Sales	70,000	1,40,000
Personal Account	52,000	47,000
Cash & Bank	1,000	2,000
Plant & Machinery	60,000	
Return Accounts	1,000	500
Discount	200	400
Interest	200	
Wages & Octroi	800	
General Expenses	1,200	
Bad Debts & Bad Debts Reserves	1,500	2,000
Salaries	4,000	
	2,57,900	2,57,900

Adjustments:

1.) Closing stock is of Rs. 40,000 out of which cost of 10% of stock is 20% less while of 10% more.

2.) Depreciate Plant & Machinery by 10%.

3.) Calculate interest on capital @ 10 % and on Drawings Rs. 400.

4.) Goods of Rs. 5,000 were burnt by fire. Insurance Company admitted 60% claim.

PW 1: From the following information of Jansons Ltd. on 31st March, 2023 you are required to prepare the Trading, Profit and Loss A/c and Balance Sheet:

Opening Stock 5,000

Capital 89,500

Bills Receivable 22,500

Commission (Cr.) 2,000

Purchases 1,95,000

Return Outward 2,500

Wages 14,000

Trade Expenses 1,000

Insurance 5,500

Office Fixtures 5,000

Sundry Debtors 1,50,000

Cash in Hand 2,500

Carriage Inward 4,000

Cash at Bank 23,750

Commission (Dr.) 4,000

Rent & Rates 5,500

Interest on Capital 3,500

Carriage Outward 7,250

Stationery 2,250

Sales 2,50,000

Return Inward 6,500

Bills Payable 15,000

Creditors 98,250

Closing Stock 12,500

PW 2: Given below are the balances extracted from the books of Nagarajan as on 31st March, 2016.

Particulars	₹	Particulars	₹
Purchases	10,000	Sales	15,100
Wages	600	Commission received	1,900
Freight inwards	750	Rent received	600
Advertisement	500	Creditors	2,400
Carriage outwards	400	Capital	5,000
Cash	1,200		
Machinery	8,000		
Debtors	2,250		
Bills receivable	300		
Stock on 1st January, 2016	1,000		
	25,000		25,000

Prepare the trading and profit and loss account for the year ended 31st March, 2016 and the balance sheet as on that date after adjusting the following:

(a) Commission received in advance Rs. 400

(b) Advertisement paid in advance Rs. 150

(c) Wages outstanding Rs. 200

(d) Closing stock on 31st March 2016, Rs. 2,100

PW 3: From the following trial balance of Ramesh as on 31st March, 2017, prepare the trading and profit and loss account and the balance sheet as on that date.

Particulars	Debit ₹	Credit ₹
Stock (01.04.2016)	40,000	
Purchases	85,000	
Sales		1,90,000
Sundry creditors		48,000
Furniture and fixtures	65,000	
Debtors	45,000	
Cash at bank	21,000	
Wages	37,500	
Drawings	15,000	
Telephone charges	3,000	
Bad debts	2,000	
Provision for bad debts		2,500
Discount received		3,000
Capital		85,000
Advertising	15,000	
	3,28,500	3,28,500

Adjustments:

(a) Closing stock was valued at ₹ 35,000

(b) Unexpired advertising ₹ 250

(c) Provision for bad and doubtful debts is to be increased to ₹ 3,000

(d) Provide 2% for discount on debtors.

(e) Charge interest on drawings @ 10%.

(**Answer**: Gross profit ₹ 62,500; Net profit ₹ 45,910; Balance sheet total ₹ 1,62,410)