Chapter 12 | Preparation of Final Account

Financial Statements are the primary means of communicating information to the users of financial information. Financial statements are mainly prepared for decision making purposes. The information provided in the financial statements is helpful in drawing a meaningful conclusion.

Financial Analysis is the analysis and interpretation of financial statements. It allows an enterprise or business to understand the efficiency, profitability and financial soundness of a business concern.

The following are some of the characteristics of Financial Analysis:

1. **Knowing the Profitability of the concern:** Financial Analysis helps an organization to understand profits are being earned on the capital invested in the business or not. It also allows understanding the profit with the help of comparisons.
2. **Provide a comparisons:** Financial Analysis provides a basis of comparison between the value of two or more financial years. Value of assets and liabilities can be compared and the future prospects of the business can be understood.
3. **Financial Position of the concern:** The purpose of financial analysis is to assess the financial strength of the business. Analysis also helps in taking strategic decisions which help the business in overcoming.
4. **Future of the Business Concern:** Financial Analysis helps the business in understanding the future of the business. It shows the short term and long term solvency of the business concern. business enterprise in borrowing money from bank and other financial institutions or buying goods on credit.

The preparation of Trading Account and Profit and Loss Account requires the knowledge of revenue expenditure, revenue receipts and capital expenditure and capital receipts. The knowledge shall facilitate the classification of revenue items and put them in the Trading account and Profit and Loss Account on one hand and prepare Balance Sheet.

Capital Expenditure and Revenue Expenditure :

Basis	Capital Expenditure	Revenue Expenditure
	Capital Expenditure refers to the expenditure incurred for acquiring fixed assets or assets which increase the earning capacity of the business.	Revenue Expenditure is an expenditure incurred in the course of normal business transactions of a concern and its benefits are availed of during the same accounting year.

Cause	Acquiring Fixed Assets	Maintaince of Fixed Assets
Period	Capital Expenditure benefits spread over number of years	Revenue Expenditure benefits for one accounting year only
Nature of Transactions	Capital Expenditure is showing as Asset under Balance Sheet	It is item of trading and profit and loss account.
Nature of Transactions	Capital Expenditure is showing as Asset under Balance Sheet	It is item of trading and profit and loss account.
Expenditure Type	Non-Recurring Expenditure in Nature	Recurring Expenditure in Nature

Capital Receipts and Revenue Receipts :

Capital receipts are receipts which do not arise out of normal course of business. Examples of such receipts are sale of fixed assets, and raising of loans etc. Such receipts are not treated as income of the enterprise.

Revenue receipts are receipts which arise during the normal course of business, Sale of goods, rent from tenants, dividend received, etc. are some of the examples of revenue receipts. They are the items of incomes of the business entity.

Trading Account :

A business firm either purchases goods from others and sells them or manufactures and sells them to earn profit. This is known as trading activities. A Trading Account is a statement is prepared to know the results in terms of profit or loss of these activities. Trading Account is prepared to ascertain the results of the trading activities of the business enterprise. It shows whether the selling of goods purchased or manufactured has earned profit or incurred loss for the business unit.

Preparing the Trading Account is to ascertain gross profit or gross loss during the accounting period. Gross Profit is said to have been made when the sale proceeds exceed the cost of goods sold.

Need/Objectives for Trading Account :

The following are the need and objectives of trading account :

1. **To understand the Gross Profit/Gross Loss of the business concern:** A business enterprise either purchases goods or manufactures goods to sell in the market. Cost of goods sold is computed to know the profit earned (Gross Profit) or loss incurred (Gross Loss) from the trading activities of a business unit for a particular period.
2. **Helps in comparison of figures :** Trading Account helps in analyzing the comparison the value over a number of years. The success or failure of a business can be ascertained

by comparing net sales of the current year with that of the last year. It also helps in comparison of opening and closing stock of the business concern.

3. **Understanding the Net Profit and Net loss of the business concern :** The success or failure of a business can be ascertained by comparing net sales of the current year with that of the last year. It should be noted that an increase in the amount of net sales of the current year over the last year may not be regarded as a sign of success, since sales may increase because of rise in price level.
4. **Helps in knowing the direct expenses of the company :** The Trading Account helps in knowing all the direct expenses incurred by the company. The comparison of expenses will help to disclose their cause which will help in controlling the amount of expenses.
5. **Calculation of Net Sales during the period :** The trading account gives a glance of the net sales during the year. It can be prepared for each department of an organization. It eliminates abnormal profit and loss of the business concern.

Format of Trading Account

Name of Business

Trading Account for the year ended

Particular	Amount	Particulars	Amount
To Stock (Opening)		By Sales	
Purchases		Less returns	
Less returns		By Stock (closing)	
To Carriage inward		" Gross loss (Transferred to P&l A/C)	
" Wages			
" Insurance in transit			
" Custom duty			
" Clearing charges			
" Freight inward			
" Transportation inward			
" Excise duty on goods			
" Royalty			
" Dock charges			
" Coal, Coke, Gas, fuel			
" Motive power			
" Oil, water			
" Gross profit (Transferred to P&l A/C)			
TOTAL		**TOTAL**	

years to ascertain the trend and required steps may be taken wherever required.

(5) **To provide information to safeguard against possible losses :** If the ratio of gross profit has decreased in comparison to the preceding year, effective measures may be taken to guard against future losses. For example, sale price of the goods may be increased or steps may be taken to analyse and control the direct expenses.

Contents of Trading Account:

Trading Account is an account like any other account. It has two sides – Debit and Credit. All expenses which relate to either purchase or manufacturing of goods are written on the Debit side of the Trading Account.

Items shown on the Debit side of the Trading Account :

(1) **Opening Stock (Opening Inventory) :** The stock of goods remaining unsold at the end of the last year is termed as the opening stock of the current year. In other words, the closing stock of the last year becomes the opening stock of the current year. This item is shown as the first item on the debit side of the Trading account. It should be kept in mind that there will be no opening stock in case of newly started business. Opening Stock will include the Stock of Raw Materials, Semi-finished goods and Finished goods. This item appears on the debit side of the trial balance. Stock of goods is also termed as inventory and, therefore, opening stock is termed as opening inventory.

(2) **Purchases :** Purchases includes goods which have been bought for resale. The amount of Purchases appearing in the trial balance include cash purchases as well as credit purchases. Purchases account show debit balance and hence it appears on the debit side of the Trial balance. While preparing the Final account, it is shown on the debit side of the Trading account.

Notes

(i) Purchase of asset should not be added with the purchases. If purchase of any asset is included in purchases, it should be deducted from the purchases and the net figure should be shown in the Trading account.

(ii) Purchase of goods for personal use should not be included in purchases. If any of the goods purchased for business have been taken for personal use, it should be deducted from purchases. Use of goods for personal purposes should be treated as drawings.

(iii) If the amount of purchases include goods received on approval, these should be excluded from purchases.

(iv) Only the purchase of goods (the product in which the business entity deals in) is treated as purchase.

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(3) **Purchases Return** : When goods are returned by the business, for some reasons, "Returns Outwards Account" or "Purchase Returns Account" is credited in the books of account and supplier's account is debited. "Purchases Returns Account" shows credit balance and appears on the credit side of the Trial balance. There are two ways of showing purchase returns in the Trading Account. It may be shown by way of deduction from Purchases on the debit side of the Trading Account. Alternatively, it may be shown on the Credit side of the Trading Account. However, normally it is shown by way of deduction from Purchases in order to show the figure of net purchase in the Trading Account.

(4) **Direct Expenses** : In case of a trading concern, all expenses incurred in purchasing the goods, bringing them to the godown and into saleable condition are treated as direct expenses and charged to trading account. For example, carriage inward, freight, wages etc. In case of manufacturing concern, cost of converting the raw materials into finished products form part of direct expenses. Direct expenses to be debited to trading account include the following:

(a) **Wages** : Wages are paid to workers who are engaged in the production of goods and as such are debited to the trading account. While preparing Trading Account, it should be noted that:

(i) If the item 'Wages and Salaries' is given in the problem, it will be shown in the trading account. On the contrary, if 'Salaries and Wages' is given it will be shown in the profit & loss account.

(ii) If wages are paid for bringing a new machine or for its installation it will be added to the cost of the machine and hence such expenses or wages will not be shown in the trading account.

(b) **Carriage or Carriage on Purchases or Carriage Inward or Freight** : Carriage or Carriage Inward or Freight are the expenses which are paid for bringing the goods to the shop or to the factory and hence should be debited to trading account. However, if any carriage or freight is paid for carrying charge of an asset, the amount should be added to the asset account and should not be debited to trading account.

(c) **Manufacturing Expenses** : Manufacturing Expenses such as Coal, Gas, Fuel, Water, Power, Factory Rent, Factory Lighting etc. are the expenses which are incurred in the manufacture of goods and hence these are shown on the debit side of the trading account (where manufacturing account is not prepared).

(d) **Dock Charges** : Dock Charges are the charges levied on ships and their cargo while entering or leaving docks. If dock charges are paid on import of goods they are shown on the debit side of trading account. If dock charges are paid on export of goods they are shown on the debit side of Profit and Loss account. In the absence of specific instructions, these are debited to trading account.

(e) **Import Duty or Custom Duty :** Custom Duty is paid on import as well as on export of goods. Custom duty when paid on the purchase of goods is charged to trading account and when it is paid on the sale of goods it is charged to profit and loss account. In the absence of specific instructions, these are debited to trading account.

(f) **Royalty :** Royalty is the amount paid to the owner of a mine or patent for using his right or patent. Where the payment of royalty is based on production, it is usually charged to trading account because it increases the cost of production. However, if it is specifically stated in the problem that the Royalty is payable on the basis of sales, it will be charged to Profit and Loss account.

(g) **Packing Charges/Packing Expenses :** Packing materials are used for packing of materials at different stages. Following points are to be noted:

(a) If packing charges are incurred to make goods saleable or to bring it in a saleable condition, these are direct expenses. They are as such debited to the Trading Account.

(b) If the packing expenses are connected with sales or they have been incurred after the goods have been sold, they are treated as selling expenses and are debited to the Profit and Loss Account.

For example, a manufacturer of biscuits sell biscuits packed in poly packs. In order to make the biscuits available in saleable condition, this primary packing is necessary. Therefore, they are treated as direct expenses. Now, a person purchases three packets of such biscuits and the seller packs these three packets for handing over to the purchaser, the expenses incurred on such secondary packing is indirect and will be treated as selling expenses and debited to Profit and Loss Account.

Items shown on the Credit side of the Trading Account:

(1) **Sales :** Sales account appearing in the Trial Balance, shows the total sales made during the accounting period. This includes both cash and credit sales. Sales account shows credit balance. It is treated as revenue and as such it is shown on the credit side of the Trading account. In respect of sales, the following points must be noted :

(a) Only the sale of goods (the product/products in which the business entity deals in) is treated as sales for the purpose of preparation of Trading Account.

(b) If sales include sale of fixed asset, it should be deducted from sales.

(c) If any goods have been sold on approval and included in sales, it should be deducted from sales, if the approval period has not expired. Such sales should be recorded separately.

(2) **Sales Returns :** When goods are returned by the buyers, for some reasons, "Returns Inwards Account" or "Sales Return Account" is debited in the books

Trading Account Side:

1. **Opening Stock:** Opening stock refers to the closing stock of unsold goods at the end of previous accounting period which has been brought forward in the current accounting period.
2. **Closing Stock:** Closing stock refers to the stock of unsold goods at the end of the current accounting period.
3. **Purchase:** Purchases refer to those goods which have been bought for resale. It includes both cash and credit purchases of goods.
4. **Carriage Inward:** Carriage paid for bringing the goods to the godown is treated as carriage inward and it is debited to Trading Account..
5. **Freight and insurance:** Freight and insurance paid for acquiring goods or making them saleable.
6. **Wages:** Wages incurred in a business are direct expenses, when they are incurred on manufacturing or merchandise or on making it saleable.
7. **Fuel and power expenses:** These are incurred for running the machines. Being directly related to production, these are considered as direct expenses and debited to Trading Account.
8. **Octroi:** When goods are purchased within municipality limits, generally octroi duty has to be paid on it.
9. **Sales:** Sales include both cash and credit sales of those goods which were purchased for resale purposes. Some customers might return the goods sold to them (called sales return) which are deducted from the sales in the inner column and net amount is shown in the outer column.

Cost of goods sold = the amount of goods purchased + expenses incurred in bringing the goods to the place of sale or expenses incurred on manufacturing the goods it is also called direct expenses.

Cost of goods sold = Opening stock + Net purchases + All direct expenses – Closing stock

Gross Profit = Net sales - Cost of goods sold

Calculate the cost of goods sold from the following information :

Opening stock Rs 40000; Closing stock Rs 3000; Purchases Rs 70000; Carriage on purchases Rs 5000; Wages Rs 600

Cost of goods sold = opening stock + purchases + direct expenses (carriage on purchases + wages) – closing stock

= Rs. [40000 + 70000 + 5600 (i.e. 5000 + 600) - 3000]

= Rs. 1,12,600

Solved Illustration:

1. Prepare A Trading Account from the following particulars for the year ended March 31, 2018.

Opening Stock	50000
Purchases	150000
Sales	400000
Wages	45000

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FINANCIAL STATEMENTS

Meaning of Financial Statements:

The life of a business entity is divided into some periods. Each period is called Accounting period. At the end of each accounting period every business entity ascertains the amount of profit earned or loss incurred during the last accounting period. They also ascertain the financial position of the business at the end of the accounting period. This is done through the preparation of some statements popularly known as 'Financial Statements'. Financial Statements are the end products of the accounting system.

The term 'Financial Statements' refers to two basic statements viz:

(i) **Income Statement**: Income Statement shows the results of business operations during an accounting period. This statement is also termed as Trading and Profit and Loss Account; and

(ii) **Statement of Financial Position:** Statement of Financial Position shows financial position of an enterprise on a particular date. This statement is also termed as Balance Sheet or Position Statement. This statement shows the assets and liabilities of an entity on a particular date.

Now-a-days, in addition to the aforesaid two basic financial statements, two other statements namely - (i) Statement of Retained Earnings; and (ii) Cash Flow Statement are also generally included in financial statements. But these statements are prepared by the company form of business organisation only.

In the words of John N. Myer, "The financial statements provide a summary of the accounts of a business enterprise, the balance sheet reflecting the assets, liabilities and capital as on a certain date and the income statement showing the results of operations during a certain period."

Components of 'Final Accounts':

Two basic financial statements stated above, together are termed as 'Final Accounts'.

Following are the components of final accounts of sole proprietorship business carrying on trading activities:

(i) **Income statement** which is divided into two parts:

(a) Trading Account which shows the gross profit or gross loss;

(b) Profit and Loss Account which shows the net profit or net loss; and

(ii) **Balance Sheet.**

It may be noted that the components of 'Final Accounts' of a business entity depend on the nature of the business carried on by the entity. The nature of the business carried on may be trading only or manufacturing and trading activities. If the business entity carries on only trading activities, the components will be Trading account, Profit and Loss Account and Balance sheet. If manufacturing activities are also carried on, a Manufacturing account is also prepared by such business entity before the preparation of Trading Account. In such cases the components will be Manufacturing account, Trading account, Profit and Loss Account and Balance sheet.

Parties interested in Financial Statements:

Various parties, individuals and groups have interest in Financial Statements. There are a number of parties who are directly or indirectly concerned with an entity. The parties or user groups interested in Financial Statements may be broadly classified into:

(A) Internal users; and

(B) External users.

These are explained below:

(A) Internal users: Internal users are those persons who are associated with the management of the entity. This group includes:

(i) Owners/Partners/ Shareholders;

(ii) Board of Directors;

(iii) Manager of the business entity; and

(iv) Workers of the entity.

(B) External users: External users are those groups of persons or association which are not directly connected with the conduct of the business but they are directly or indirectly influenced by the accounting information conveyed through financial statements. They may be grouped as

(1) **Financing group:** This includes (i) Prospective investors;

(ii) Lender including Banks and;

(iii) Suppliers or creditors.

(2) **Public Group:** This includes:

(i) Employees' Union;

(ii) Credit rating agencies;

(iii) Stock Exchange authorities;

(iv) Government and Regulating agencies;

(v) Tax Authorities;

(vi) Research and academic institutions';

(vii) Financial analysts; and

(viii) Consumers.

Profit and Loss Account :

After preparation of gross profit and gross loss from trading account we prepare profit and loss account to understand the actual net profit/ net loss of the business concern. It is the second stage of preparation of financial statements.

Objectives of Profit and Loss Account :

1. It provides a information about the enterprise revenue, expenses and profit during a financial year.
2. It helps in comparison between two financial year which helps in knowing the changes.
3. Profit and Loss Account shows the true financial position of the business.
4. It helps in business forecasting i.e. helps in knowing the shortcoming as well as strength of the business.
5. Profit and Loss account includes all the prepaid expenses and income during the financial year.

Format of Profit and Loss Account :

Particulars	Amount	Particulars	Amount
To Gross loss b/d - " Salaries Rent, Rates & taxes – "Commission Received – "Insurance Premium – " Advertising – "Commission paid – " Discount Allowed "Repairs & Renewals – "Bad Debts – "Establishment charges – "Travelling Expenses – "Bank Charges – "Sales Tax/Value added Tax – "Depreciation on fixed assets – "Net Profit transferred to Capital Account		By Gross Profit b/d - "Discount Received - "Dividend Received - " Interest on Investment "Rent Received " Net Loss transferred - to capital account	

Operating Expenses :		
Loss by accident	1,000	21,000
Net Profit		**51,000**

Need and Importance of Profit & Loss Account :

(1) **To ascertain the Net Profit/ Net Loss :** Profit & Loss Account is prepared with the object of ascertaining the net profit (or net loss) available to the proprietor.

(2) **To compare with previous years' profits :** The net profit of the firm as disclosed by the Profit & Loss Account enables the businessman to know whether the business is being conducted efficiently or not by enabling it to compare the current year's net profit with those of the previous years.

(3) **To exercise control over expenses :** Profit & Loss Account helps in comparison of various expenses with those of the previous years. The percentage of each individual expenses to net profit may be calculated and compared with those of the previous years. Such comparison helps in taking concrete steps for controlling the unnecessary expenses.

(4) **To create reserves:** The decision whether to transfer a part of the profit to reserve or not can be taken only on the basis of the amount of net profit as disclosed by the Profit & Loss Account.

(5) **To help in the preparation of Balance Sheet :** A Balance Sheet can be prepared only after ascertaining the Net Profit/Net Loss through the preparation of Profit and Loss Account.

Preparation of Profit and Loss Account:

A Profit and Loss Account starts with the amount of gross profit or gross loss brought down from the Trading Account. As such, all those expenses and losses which have not been debited to the Trading Account will now be debited to Profit & Loss Account. These expenses include administrative expenses, selling expenses, distribution expenses etc. These are called 'Indirect Expenses'. Profit and Loss Account is an account of Incomes and Expenses and as such, all the expenses and losses are shown on its debit side and all the incomes and gains are shown on the credit side of this account.

Items shown on the Debit side of Profit & Loss Account :

(1) **Gross Loss :** If trading account discloses Gross Loss, it is shown as the first item on the debit side of the Profit and Loss Account.

(2) **Indirect Expenses:** Each and every business house is required to incur some other expenses other than the direct expenses in course of their day to day business activities. Such expenses include expenses of revenue nature other than the direct expenses such as Office and Administrative expenses, Selling and Distribution expenses, Financial charges etc. These expenses are termed as indirect expenses because they are not directly related to purchase of goods and bringing them into saleable condition. Indirect expenses debited to profit and loss account are stated below:

(a) ***Office and Administrative Expenses :*** Expenses such as salary of office employees, office rent, lighting, postage, printing, stationery, audit fee, legal charges etc. are treated as Office and Administrative Expenses.

(b) ***Selling and Distribution Expenses :*** Expenses such as advertisement charges, commission, carriage outwards, bad-debts, packing charges etc. are treated as Selling and Distribution Expenses.

(c) ***Financial charges :*** Expenses such as interest on loan, interest on capital, interest on overdraft etc. are treated as financial charges.

(d) ***Miscellaneous Expenses :*** Expenses such as interest on loan, interest on capital, repair charges, depreciation, charity etc. are treated as Miscellaneous Expenses.

(e) ***Other Losses :*** Loss such as loss by fire, loss due to accident etc.

(f) ***Provisions :*** Provision such as Provision for Doubtful Debts, Provision for Discount on Debtors etc.

Items shown on the Credit side of Profit & Loss Account :

(1) **Gross Profit :** If the Trading Account discloses Gross Profit, Gross Profit is shown as the first item on the credit side of Profit and Loss Account.

(2) **Other Incomes and Gains :** All items of incomes and gains such as income from investments, rent received, discount received, commission earned, interest received, bad debts recovered, Reserve for Discount on Creditors etc. are shown on the credit side of the Profit & Loss Account.

Balancing of Profit & Loss Account:

The balance of the Profit & Loss Account, after posting all nominal accounts to the respective side, is termed as Net profit or Net Loss. If the credit side of the profit and loss account is more than the total of the debit side, the difference is termed as net profit. On the other hand, if the total of the debit side exceeds the total of the credit side, the difference is termed as net loss. The Net Profit/Net Loss is transferred to the capital account. Net profit is added to the capital whereas net loss is deducted from the capital in the balance sheet.

Distinction between Trading Account and Profit and Loss Account

Sl. No.	*Basis of Distinction*	*Trading Account*	*Profit and Loss Account*
1.	Items included	Sales and all the items relating to ascertainment of cost of sales are shown in this account.	All the items of indirect expenditure such as salary, rent, bad debts, discount etc. are shown in this account
2.	Result	The balance of this Account is named as gross profit/ gross loss.	The balance of this Account is named as net profit / net loss.
3.	Transfer of balance	The balance of this Account is transferred to Profit and Loss Account.	The balance of this Account is transferred to capital account.
4.	Utility	Trading Account shows the trend of business activities. By comparing the Trading Account of consecutive periods steps can be taken to increase profitability.	This Account shows the net result of the business. By comparing net results of consecutive periods, steps can be taken for an all round development of the business.
5.	Sequence of preparation	It is prepared before the preparation of Profit and Loss Account.	It is prepared after the preparation of Trading Account

Distinction between Gross profit and Net Profit

Sl. No.	*Basis of Distinction*	*Gross profit*	*Net Profit*
1.	Source	Gross Profit is the difference between sales and cost of goods sold.	Net Profit is the difference between Gross profit and all other indirect expenses plus indirect Income.
2.	Manner of ascertainment	Gross profit is ascertained before taking in to account income from other sources.	Net profit is ascertained after taking into account income from other sources, if any.
3.	Utility	Gross Profit helps to measure the profit earning capacity of the business.	Net Profit is considered for measuring the return on capital employed.
4.	Transfer	Gross Profit is transferred to Profit and Loss Account.	Net profit is transferred to capital account in Balance Sheet.
5.	Relation with drawing	Amount of Drawing does not depend on Gross Profit as it is not the actual profit.	Amount of Drawing is dependent on the amount of net profit.

Format of Preparation of Profit and Loss A

Horizontal Format of Profit and Loss Account:

In the books of M/s. Barua Enterprises

Profit and Loss Account

Dr. *For the year ending............* Cr.

Particulars	Amount (₹)	Particulars	Amount (₹)
To Trading A/c (Gross Loss transferred)		By Trading A/c (Gross Profit transferred)	
Office & Administrative Expenses :		By Rent (Cr.)	
To Salaries		By Rent of premises sub-let	
To Salaries & Wages		By Discount received Or Discount (Cr.)	
To Rent, Rates & Taxes		By Commission Received	
To Printing & Stationery		By Interest on Investments	
To Postage & Telegram		By Dividend on Shares	
To Lighting		By Sundry Receipts	
To Insurance Premium (office)		By Bad Debts Recovered	
To Telephone Charges		By Profit on sale of assets	
To Legal Charges		By Income from other Sources	
To Audit Fees		By Apprenticeship Premium	
To Travelling Expenses		By Sale of Scraps	
To Establishment Expenses		By Royalty Received	
To Trade Expenses [see note (ii)]		By Subsidy from Govt.	
To General Expenses		By Interest on Drawings	
To Royalty on sales		By Interest on Fixed Deposit	
To Establishment		By Interest on Loan (Advanced)	
To Commission to Office Manager		By Reserve for Discount on Creditors	
Selling and Distribution Expenses:		By Capital A/c [Net Loss Transferred]	
To Carriage Outwards, or Carriage on Sales			
To Advertisement/ Free Samples			
To Commission			
To Discount Allowed			
To Rebate Allowed			
To Brokerage			
To Bad debts			
To Export duty			
To Packing charges			
To Delivery Van Expenses.			
To Wages (Unproductive)			
To Commission to Sales Manager			

Particulars	Amount (₹)	Particulars	Amount (₹)
Finance charges			
To Interest on Loan			
To Bank Charges			
To Interest on Overdraft			
Sundry Expenses			
To Repairs			
To Depreciation on fixed assets			
To Entertainment Expenses			
To Staff Welfare Expenses			
To Contingencies			
To Conveyance Expenses			
To Donation and Charity			
To Loss on Sale of Assets			
To Loss by theft/ Fire			
Provisions			
To Provision for Doubtful Debts			
To Provision for Discount on Debtors			
Others			
To Interest on Capital			
To Capital A/c (Net Profit Transferred)			

NOTE

(i) Expenses not related to the business are not shown in the Profit and Loss Account. Such expenses are:

(a) Domestic and household expenses of the proprietor (Drawings),

(b) Income-Tax (In case of Sole-proprietorship business); and

(c) Life Insurance Premium on the life of the proprietor and his relatives etc.

These expenses, if paid from the business cash, are treated as Drawings and deducted from Capital on the liabilities side of the Balance Sheet.

(ii) In case the Trial balance contains both Trade Expenses and General Expenses/Office Expenses, Trade Expenses will be treated as direct and will be taken to the Trading A/c and General Expenses/Office Expenses will be taken to the Profit & Loss A/c.

(iii) If there is only Trade Expenses and no General expenses/Office Expenses, Trade Expenses will be taken to Profit and Loss Account.

(iv) Only those items of expenses and incomes, which have not been shown in the Trading Account, are shown in the Profit & Loss Account.

part is called Profit and Loss Account.

BALANCE SHEET

After ascertaining the net profit or loss of the business enterprise at the end of a particular period, the businessman would also like to know the financial position of his business as on that date. For this purpose a statement, wherein all the Assets and Liabilities of the business enterprise are included, is prepared. The statement so prepared is called a Balance Sheet. After the transfer of all nominal accounts either to the Trading Account or Profit & Loss Account, the balances of all the personal and real accounts are grouped as assets and liabilities and are shown in the balance sheet. The balance sheet has two sides – Assets side and the Liabilities side. Assets are shown on the right hand side and the liabilities are shown on the left hand side of the Balance Sheet. The balance sheet is based on the equation that what an entity owns on a given date must be equal to what it owes on that date. The total of both sides of the balance sheet i.e. assets side and the liabilities side will always be equal. As this statement shows the position of assets and liabilities of an entity on a particular date, it is also known as 'Position Statement'. The definition of Balance Sheet as given by some authors are as follows :

According to A. Palmer : "The Balance Sheet is a statement at a particular date showing on one side the trader's property and possessions and on the other hand the liabilities."

According to Karlson : "A business firm showing what is owed and what the proprietor is worth, is called a Balance Sheet."

According to J. R. Batliboi : "A Balance Sheet is a statement prepared with a view to measure the exact financial position of a business on a certain fixed date."

Need and Importance of Preparing a Balance Sheet:

The need and importance of preparing a Balance Sheet are as follows :

(1) ***Ascertainment of financial position:*** The main purpose of preparing a Balance Sheet is to ascertain the true financial position of the business at a particular point of time.

(2) ***Ascertaining of nature and cost of various assets and liabilities :*** The balance sheet helps in ascertaining the nature and cost of various assets and liabilities of the business such as the amount of fixed assets, amount receivable from Debtors, Closing Stock, amount of fictitious assets, the amount payable to Creditors etc.

(3) ***Information about the exact amount of capital:*** The balance sheet gives information about the exact amount of capital at the end of the year and the addition or deduction made into it in the current year.

(4) ***Information about the solvency of the business:*** The balance sheet helps in finding out whether the business entity is solvent or not. The firm is solvent if the assets exceed the external liabilities. It would be insolvent if opposite is the case.

(5) ***Helpful in the preparation of books of account in the next year:*** The balance sheet helps in passing the opening entries and preparing the books of account at the beginning of the next year.

Characteristics of Balance Sheet :

The following are the characteristics of a balance sheet:

(1) A Balance Sheet is a part of the Final Accounts because the Trading and Profit and Loss Account and the Balance Sheet are together called 'Final Accounts'.

(2) The Balance Sheet is a statement and not an account.

(3) The Balance Sheet does not have debit or credit side. The two sides of the balance sheet are called 'assets side' and the 'liabilities side'.

(4) The words 'To' and 'By' are not used before the names of the accounts shown in the balance sheet.

(5) A Balance Sheet is a summary of the Personal and Real Accounts, which have not been closed by transfer to the Trading and Profit & Loss Account.

(6) The totals of the two sides of the Balance Sheet must be equal. If the totals are not equal, there will be an error somewhere.

(7) Balance Sheet is prepared on a particular date and not for a particular period. Therefore, the balance sheet is dated 'as at ....' or 'as on.....' a particular date usually at the end of the year. As such, it discloses the financial position of a business on a particular date and not for a particular period. The information disclosed by a balance sheet is true only for the date on which it is prepared because even a single transaction would cause a change in the composition of assets and liabilities and hence in the financial position of the business.

(8) It shows the financial position of the business according to the going concern concept.

Balance Sheet is the Second Trial balance:

Balance Sheet is also termed as second trial balance on account of some similarities between the two. Following are the similarities between the two:

(a) Both the Balance Sheet and Trial Balance are statements.

(b) Both the statements are prepared on a particular date.

(c) Both the statements contain balances of ledger accounts.

(d) Like trial balance, agreement of a balance sheet also proves that the books are arithmetically correct.

Distinction between Trial Balance and Balance Sheet

Sl. No.	*Basis of Difference*	*Trial Balance*	*Balance Sheet*
1.	Object	It is prepared to check the arithmetical accuracy of the books of accounts.	It is prepared to know the true financial position of the firm.
2.	Necessity	Though desirable, its preparation is not necessary.	It is necessary to prepare a Balance Sheet.
3.	Name of columns	The names of its two columns are debit and credit.	The name of its two sides are assets and liabilities.
4.	Period	It is normally prepared every month or whenever needed.	It is normally prepared at the end of the accounting period.
5.	Types of Accounts included	All types of accounts whether personal, real or nominal/ accounts of assets, liabilities, capital, expenses and revnue are included in it.	Only personal and real accounts/ accounts of assets, liabilities and capital are included in it.