

Objectives

At the end of this chapter, students should be able to:

- Identify profit and loss items;
- Identify the format of a profit and loss account;
- Prepare a profit and loss account;
- Determine net profit or loss.

11.1 Introduction

In the previous chapter, you have learnt that the trading account is credited and debited with the buying and selling expenses to determine gross profits of a business for a given trading period. Such expenses are direct to selling e.g. delivery charges and carriage of goods from the factory. There are, however, other expenses which are indirect to trading activities. These are mainly administrative and maintenance expenses such as electricity, insurance, rent, rates and salaries. Another final account is normally prepared to record these indirect expenses and charged against gross profit in order to arrive at the actual profit or loss of a business. The account is known as the profit and loss account. The actual profit arrived at in this account is called Net Profit, if it is loss, it is called Net Loss.

11.2 Identification of Items of the Profit and Loss

Account

All indirect expenses are charged against the profit and loss account; if the benefits of the expenses are consumed during the selling period. Also, the gains or incomes other than sales of fixed assets are credited in the profit and loss account, if the gains are received during the trading period. Such items are shown in the profit and loss account.

Profit and Loss Account for the year ended 2009

	N		N
Rent	xxx	Gross profit	xxx
Rates	xxx	Interest received	xxx
Electricity	xxx	Discount received	xxx
Carriage outward	xxx	Net loss (if any)	xxx
Salaries and Wages	xxx		
Salesmen commission	xxx		
Advertising	xxx		
Insurance Premium	xxx		
Discount allowed	xxx		
Provision of depreciation	xxx		
Net profit (if any)	xxx		

Fig. 11.1: Specimen showing the format for Profit and Loss Account

11.3 Preparation of Profit and Loss Account

- The balance of indirect expenses accounts are transferred to the debit side of the profit and loss account. If a gross loss has been made in the trading account, the gross loss is first carried down in the debit side of the profit and loss account.
- On the credit side, if the gross profit is first carried down from the trading account, the balance of the accounts of items of gain and income are transferred to the credit side of the profit and loss account.
- The excess of the credit side expenses on the debit side is net profit. This must be transferred to the debit side to close the account.
- The excess of the debit side over the credit side is net loss. This must be carried to the credit side to close the account.

Example 11.1

The following information were taken from the books of Wale & Sons Enterprises:

Gross loss b/d from Trading a/c, N10,000 – Interest received, N5,000 – Discount received, N5,000 – Insurance, N5,000,

Selling expenses N2,000. Prepare the business profit and loss account for the year ended 2009.

Solution

Wale and Sons Enterprises			
Profit and Loss Account for the year ended 2009			
	N		N
Gross Loss b/d	10,000	Interest received	5,000
Salaries	5,000	Discount received	5,000
Insurance	5,000	Net Loss	12,000
Selling expenses	2,000		
	<u>22,000</u>		<u>22,000</u>

Note: Profit and Loss Account showing Net Loss

Example 11.2

The following balances were extracted from the ledgers of Adamson Jacobs Enterprises: salaries – N5,000, insurance – N500, rent – N2,000, rate – N300, discount received – N500, interest received N500. You are also informed that gross profit for the period was N8,000. Prepare the profit and loss account for the year ended 2009.

Solution

Adamson Jacobs Enterprises			
Profit and Loss Account for the year ended 2009			
	N		N
Salaries	5,000	Gross Profit b/d	8,000
Insurance	500	Discount received	500
Rent	2,000	Interest received	500
Rate	500		
Net profit	1,000		
	<u>9,000</u>		<u>9,000</u>

Example 11.3

The following balances appeared in the books Umodu Enterprises on December 31, 2009. Prepare the Trading, Profit and Loss Accounts.

	N
Sales	7,000
Purchases	3,000
Wages	1,000
General expenses	1,000
Cost of goods sold	4,500
Salary	1,000
Water rate	1,000

Solution

Umodu Enterprises Trading, Profit and Loss Accounts for the year ended, Dec.31, 2009

Cost of sales	N 4,500	Sales	7,000
Gross profit	2,500	sales	7,000
	<u>7,000</u>		<u>7,000</u>
Salary	1,000	Gross profit	7,000
General expenses	1,000		
Water rate	100		
Net profit	400		
	<u>2,500</u>		<u>2,500</u>

Activity

Visit some business concerns nearest to your school. Find out about the nature of the activities of each business and the items of expenses that constitute profit and loss account items. Prepare a format for each business visited by you.

11.4 Summary

In this chapter, students have learnt that:

- The gross profit or loss is determined in the trading account and the net profit and loss is arrived at after the administrative and other expenses have been charged in the profit and loss account.
- In preparing the profit and loss account, items of gains are credited while expense are debited to determine their net effect (profit or loss).
- The profit and loss account like the trading account is prepared for a trading period.

11.5 Revision Questions

1. Prepare a trading, profit and loss account from the following balances:

	N
Wages and Salaries	3,400
Purchases	32,000
Expenses	540
Rent and rate	1,200
Furniture	3,200
Electricity	97,000
Postages	80,000
Sales	42,300
Closing stock	2,000

2. The following balances were extracted from the books of Godwin and Sons. Prepare the trading, profit and loss account of the business for the period ended 30th Sept., 2009:

	N
Opening stock	5,000
Closing stock	500
Sales	8,000
Stationery and Wrapping	1,000
Telephone	100
Expenses	1,500

3. From the following, prepare the trading, profit and loss account for the year ended 31st December, 2009:

	N
Opening stock	1,400
Purchases	11,000
Sales	16,000
Insurance	240

Advertising	250
Electricity bill	350
Stationery	500
Salaries	2,000
Rate	200

4. Which of the following is not an item in the profit and loss account?

- A. Telephone
- B. Salaries

C. Land

D. Insurance premium

5. The profit and loss account is prepared to determine_____.

A. brought forward

B. net profit/loss

C. balance carried down

D. gross loss/profit

6. The profit of a sole trader increases his_____.

A. stock

B. assets

C. liability

D. capital

7. The entry for rent received in the profit and loss account will be_____.

A. credited

B. balanced off

C. debited

D. written off

8. The excess of income over expenditure in the profit and loss account for the year ended is termed_____.

A. overdraft

B. net profit

C. balance

D. gross profit