

## **PREPARATION OF TRADING AND PROFIT & LOSS ACCOUNT AND BALANCE SHEET**

### **20.1 INTRODUCTION**

As you know that the main objective of business is to earn profit. Every businessman wants to know the results of business whether he has earned profit or incurred loss during a particular period. In order to know this, he has to prepare Trading and Profit and Loss Account. Besides knowing results, he also wants to assess the financial position of his business for which Balance Sheet is prepared.

In this lesson we shall study about the preparation of Trading and Profit and Loss Account and Balance Sheet.

### **20.2 OBJECTIVES**

After studying this lesson, you will be able to:

- identify the need for preparing Trading and Profit and Loss Account;
  - draw the format of Trading and Profit and Loss Account;
  - identify the items to be recorded on the debit and credit sides of Trading and Profit and Loss Account;
  - prepare Trading and Profit and Loss Account from the given information;
  - identify the need for preparing Balance Sheet;
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- draw the format of Balance Sheet;
- identify the accounts to be written on the Liabilities and Assets sides of Balance Sheet;
- prepare the Balance Sheet from the given information.

### 20.3 TRADING ACCOUNT : MEANING, FORMAT AND ITEMS TO BE RECORDED

Trading Account is prepared to ascertain the results of the Trading activities of the business. In other words, it shows whether purchasing and selling of goods have been profitable for the business or not. In order to know this, we take into account the cost of goods sold and the total sales. In case the total sales value exceeds the cost of goods sold the difference is called **Gross Profit**. On the other hand, if the cost of goods sold exceeds the total sales the difference is **Gross Loss**. Let us take an example to make it more clear.

#### Example 1.

From the following balances extracted from the Ledger of M/s Ajay Aggarwal and Sons at the end of the Trading year ended on 31st March, 1996, Calculate the amount of Gross Profit or Gross Loss made by the businessman:

Opening stock	16,000
Cash Purchases	20,000
Credit Purchases	40,000
Cash Sales	32,000
Credit Sales	50,000
Purchases Returns	1,200
Sales Returns	2,000
Carriage on Purchases	2,400
Wages	2,400
Closing Stock	12,000

#### Solution

#### Calculation of Gross Profit or Gross Loss:

Gross Profit = Net Sales - Cost of Goods Sold

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<b>Net Sales:</b>	<b>Rs.</b>	<b>Rs.</b>
Cash Sales	32,000	
Credit Sales	50,000	
<b>Total Sales</b>	<b>82,000</b>	
Less Sales Returns	- 2,000	
<b>Net Sales</b>		<b>80,000</b>
<b>Less Cost of Goods Sold</b>		
Opening Stock	16,000	
Purchases : Cash	20,000	
Credit	40,000	
<b>Total Purchases</b>	<b>60,000</b>	
Less Purchases Returns	- 1,200	
<b>Net Purchases</b>	<b>58,800</b>	
Carriage on Purchases	2,400	
Wages	2,400	
	<b>79,600</b>	
Less Closing Stock	12,000	
<b>Cost of Goods Sold</b>		<b>67,600</b>
<b>Gross Profit</b>		<b>12,400</b>

## **NEED OF THE TRADING ACCOUNT**

Trading Account serves the following purposes:

### **1. Knowledge of Gross Profit**

It gives information about Gross Profit. In order to study the success of business, the percentage of Gross Profit on sales could be found.

### **2. Knowledge of All Direct Expenses**

It gives information about all the direct expenses. These expenses can be compared with similar expenses of previous years by calculating percentage of these expenses on sales. This helps the trader to exercise control over direct expenses.

### 3. Comparison of current year's closing stock with previous year's closing stock

This helps the trader to have knowledge about the quantity of closing stock. If the closing stock is more, it may be due to huge purchases than the requirement or the sales are less.

### 4. Precautions Against Future Losses

In case of losses, the trader can find out the reasons for the same and take necessary steps.

### Format of Trading Account

The Trading Account is usually prepared in the following form:

Particulars	Amount Rs.	Particulars	Amount Rs.
To Opening Stock	.....	By Sales	.....
To Purchases	.....	Less Sales	
Less Purchase		Returns	.....
Returns	.....		
Net Purchases	.....	Net Sales	.....
To Direct Expenses:	.....		
Carriage/Carriage Inward	.....	By Closing Stock	.....
Freight/Freight Inward		By Gross Loss	
Octroi		Transferred to	
Wages/Wages and Salaries		P & L A/c	
Coal, Gas and Water			
Fuel and Power			
Excise Duty			
Import Duty			
Custom Duty (Inwards)			
Work manager's Salaries			
Heating and Lighting			
Factory Rent and Insurance			
Royalty on manufactured goods			
To Gross Profit transferred to P & L A/c			

**Note:** There will either be Gross Profit or Gross Loss and it is transferred to profit & Loss Account

## SOME IMPORTANT ITEMS OF TRADING ACCOUNT

### 1. Stock:

The term 'stock' means goods lying unsold on a particular date. The stock may be of two types:

- a) Opening Stock and
- b) Closing Stock

#### a) Opening Stock

The term 'Opening Stock' means goods lying unsold in the beginning of accounting year. In the first year of business, there is no opening stock. However, an existing business, generally has an opening stock. It is shown on the debit side of Trading Account usually as a first item.

#### b) Closing Stock

The term 'Closing Stock' means the goods lying unsold at the close of accounting year. It is valued at cost price or market price whichever is less. The amount of the closing stock is shown on the credit side of Trading Account.

### 2. Purchases

The term 'purchases' means items purchased for resale. It includes both cash and credit purchases. It is shown on the debit side of Trading Account.

### 3. Purchase Returns>Returns outwards

If goods purchased are returned to their sellers, it is termed as **purchases returns** or **returns outwards**. Although it has credit account balance, yet it is shown on the debit side of Trading Account as a deduction from purchases to show the amount of net purchases.

### 4. Wages

Wages are taken as a direct expense as they are related to production and is debited to Trading Account. In case, a single amount for wages and salaries is given in the Trial Balance, the amount is shown as a debit in the Trading Account. However, if the Trial Balance shows 'Salaries & Wages', it is treated as an indirect expense and is charged to Profit and Loss A/c.

### 5. Carriage, Cartage or Freight

These are taken as direct expenses as they are incurred on purchases

of goods. They are taken to the debit side of the Trading Account. The terms 'Carriage In' 'carriage on purchases' or 'Cartage In' or 'Cartage on purchases' have the same meaning. Sometimes the term 'Inwards' is used for the term 'In'. In this way, 'Carriage' or 'Carriage In' or 'Carriage Inwards' are synonymous. The same is true for 'freight' or 'Cartage'.

**6. Customs and Import duty.**

If the goods have been imported from other countries, customs and Import Duty are paid. As these duties increase the cost of goods purchased, they are taken to the debit side of Trading Account as direct expenses.

**7. Packing Materials**

Packing materials used for packing the goods for making them saleable are direct expenses and are taken to the debit side of Trading Account.

**8. Gas, Electricity, Water, Fuel, Grease etc**

All these expenses are direct expenses as they are used in the production of goods. They are taken to the debit side of Trading Account.

**9. Sales**

The term 'Sales' means the revenue from sale of goods and includes both cash and credit. The total sales are taken to the credit side of Trading Account.

**10. Sales Returns**

When goods sold are returned by the customers, they are known as sales returns. Sales returns are subtracted from the total sales to show the net sales.

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### INTEXT QUESTIONS 20.1

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Fill in the blanks with suitable words :

- i) The items of direct cost are shown on the \_\_\_\_\_ side of Trading Account.
  - ii) Total Purchases means \_\_\_\_\_ purchases and \_\_\_\_\_ purchases.
  - iii) Net Purchases means total purchases minus \_\_\_\_\_
  - iv) Net sales means \_\_\_\_\_ sales minus \_\_\_\_\_ returns.
  - v) Gross Profit is \_\_\_\_\_ of sales over cost of goods sold.
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## 20.4 PREPARATION OF TRADING ACCOUNT

Before preparing Trading Account, Trial balance is prepared. As we have learnt in one of the previous lessons, Trial Balance is the list of ledger account balance. From these account balances, those relating to sales and cost of goods Sold are transferred to Trading Account. By 'transferring' is meant closing the ledger accounts and at the same time bringing the accounts in the Trading Account. For transferring the account to Trading Account two methods are adopted:

- I Journal Entry Method
- II Accounting Voucher Method

**Note:** Trading A/c is generally prepared for an accounting period usually a year. The specific year should be indicated in the title by putting the last date of the accounting period after the words for the year ended.

### I. Journal Entry Method

- a) For transferring debit balance accounts

Trading A/c ..... Dr  
    To Opening stock  
    To Purchases  
    To Direct Expenses  
    To Sales Returns

(For transfer of Debit balance accounts to Trading A/c)

- b) For transferring credit balance accounts like sales, closing stock etc.

Sales A/c ..... Dr  
Closing Stock A/c ..... Dr  
Purchases Returns A/c ..... Dr  
    To Trading A/c

(For transfer of credit balance accounts to Trading A/c)

- c) For transferring Gross Profit

Trading A/c (Gross Profit) ..... Dr  
    To Profit & Loss Account

(For transfer of Gross Profit)

- d) For transferring Gross Loss

Profit & Loss Account ..... Dr  
    To Trading Account (Gross Loss)

(For transfer of Gross Loss)

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## II Accounting Voucher Method

### A) For transferring debit balance accounts:

A voucher in the following format is prepared to transfer the debit balance accounts:

<i>Firm's Name</i>		<i>Date: .....</i>
<i>Voucher No.</i>		<i>Amount</i>
<i>Debit</i>	Trading Account	
<i>Credit</i>	Opening Stock Account Purchases Account Sales Returns Account Direct Expenses Account (For transfer of debit balances account to Trading Account)	
<i>Sd:</i> <i>Manager</i>		<i>Sd.</i> <i>Accountant</i>

### B) For transferring credit balance accounts:

Another voucher in the following format is prepared for transferring the credit balance accounts:

<i>Firm's Name</i>		<i>Date: .....</i>
<i>Voucher No.</i>		<i>Amount</i>
<i>Debit</i>	Sales Account Purchases Returns A/c Closing Stock A/c	
<i>Credit</i>	Trading Account (for transfer of Credit balance accounts to Trading Account)	
<i>Sd:</i> <i>Manager</i>		<i>Sd.</i> <i>Accountant</i>

Notes: a) Purchases Returns Account, though, has a credit account balance, is shown on the debit side of Trading Account as a deduction from purchases.

- b) Sales Returns account, though, has a debit account balance is shown on the credit side of Trading Account as a deduction from sales.
  - c) Closing stock account is an Asset account and is debited. It will also appear in the Balance Sheet as an Asset.
- C) For Transferring Gross Profit to Profit and Loss Account.

A voucher in the following format is prepared to transfer the Gross Profit from Trading Account to Profit & Loss Account.

<i>Firm's Name</i>		<i>Date: .....</i>
<i>Voucher No.</i>	<i>Amount</i>	
Debit	Trading Account	
Credit	Profit & Loss Account (For the transfer of Gross Profit from Trading Account to P&L A/c)	
<i>Sd:</i> <i>Manager</i>		<i>Sd.</i> <i>Accountant</i>

In the same way, a voucher is prepared for transferring Gross Loss to Profit & Loss Account from Trading Account by debiting Profit & Loss Account and crediting Trading Account.

Both the above methods of transferring the account balances will be more clear by taking an example.

**Example 2**

The ledger balances extracted at the close of a trading year ended on 31st March, 1997 are given below. Show how will you transfer them to Trading Account through (1) Journal Entry Method and (2) Voucher method.

Name of Account	Account Balance Rs.
Opening Stock	8,000
Purchases	30,000
Sales	41,000
Purchases Returns	600
Carriage	1,200
Duty and Clearing Charges	400
Wages	800
Closing Stock	6,000

**Solution**

Transferring the account balances from ledger to Trading Account through:

**i) Journal Entry Method**

The following journal entries will be made:

**a) For transferring debit account balances:**

Trading Account .....	Dr.	41,400	
To Opening Stock A/c			8,000
To Purchases A/c			30,000
To Sales Returns A/c			1,000
To Carriage A/c			1,200
To Duty and Clearing Charges A/c			400
To wages A/c			800

(Being transfer of Accounts to Trading Account)

**b) For transferring Credit Account Balances**

Sales Account .....	Dr	41,000	
Purchases Returns A/c ....	Dr	600	
Closing Stock A/c ....	Dr	6,000	
			To Trading Account
			47,600

(For transfer of Accounts to Trading A/c)

**c) For transferring the Gross Profit**

Trading Account .....	Dr.	6,200	
			To Profit & Loss Account
			6,200

(For transfer of Gross Profit to P&L A/c)

**Note:** In case of Gross Loss, the above journal entry will be reversed i.e Profit & Loss Account is debited and Trading Account is credited.

**ii) Accounting Voucher Method**

For transferring the debit account balances, the following vouchers will be prepared:

a) For transferring debit account balances:

Firm's Name		Date: .....
Voucher No.		Amount Rs.
<b>Debit</b>	Trading Account	41,400
<b>Credit</b>	Opening Stock Account	8,000
	Purchases Account	30,000
	Sales Returns Account	1,000
	Carriage Account	1,200
	Duty & Clearing Charge Account	400
	Wages Account	800
	(Being Transfer of Account to Trading Account)	41,400
<b>Sd. Manager</b>		<b>Sd. Accountant</b>

b) For transferring Credit Account balances, the following voucher will be prepared.

Firm's Name		Date: 31.3.1997
Voucher No.		Amount Rs.
<b>Debit</b>	Sales Account	41,000
	Purchases Returns Account	600
	Closing Stock A/c	6,000
		47,600
<b>Credit</b>	Trading Account (Being the transfer of Accounts to Trading A/c)	47,600
<b>Sd. Manager</b>		<b>Sd. Accountant</b>

c) For transferring Gross Profit, the following voucher will be prepared.

Firm's Name		Date: 31.3.1997
Voucher No.		Amount Rs.
<b>Debit</b>	Trading Account	6,200
		6,200
<b>Credit</b>	Profit & Loss Account (Being the transfer of Gross Profit to Profit & Loss A/c)	6,200
<b>Sd. Manager</b>		<b>Sd. Accountant</b>

**Note:** In the same way, another voucher will be prepared for transferring Gross Loss to Profit & Loss Account by debiting P & L Account and crediting Trading Account. Let us now prepare Trading Account from the information given in Example 2.

**Trading Account of M/s Ajay Aggarwal & Sons**  
for the year end on 31st March, 1997

Dr.		Cr.	
Particulars	Amount Rs.	Particulars	Amount Rs.
To Opening Stock	8,000	By Sales 41,000	
To Purchases 30,000		Less Returns 1,000	
Less Returns 600		Net Sales	40,000
Net Purchases	29,400	By Closing Stock	6,000
To Carriage	1,200		
To Duty & Clearing Charges	400		
To Wages	800		
To Gross Profit transferred to P & L Account	6,200		
	46,000		46,000

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## INTEXT QUESTIONS 20.2

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- A) Make journal entries to transfer opening stock and closing stock Accounts to Trading A/c.
  - B) Make Journal entry to transfer Gross Profit from Trading Account to Profit and Loss A/c.
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## 20.5 PROFIT AND LOSS ACCOUNT : FORMAT AND ITEMS TO BE RECORDED

The Trading Account discussed above simply reveals the Gross Profit or Gross Loss. But it is not the final result of business operations. While preparing Trading Account, only those expenses are considered which are directly related to the trading of goods. Yet there are certain other expenses which are essential for the efficient running of business. These expenses are known as **indirect expenses** e.g. Office and Administrative expenses, Selling and Distribution Expenses, Financial Expenses, Depreciation and Maintenance charges etc. In the same way, besides sales revenues, there may be other sources of income such as interest from deposits, discount from creditors, rent from tenants, etc. Such incomes and expenses are to be accounted for. To find out actual profit known as Net Profit or actual loss known as Net Loss, Profit and Loss Account is prepared and the Net Profit or Net Loss is calculated as:

$$\text{Net Profit or Net Loss} = \text{Gross Profit} + \text{Income from other sources} - \text{Indirect Expenses}$$

If the total of Gross Profit and Income from other sources is more than indirect expenses, the difference is known as Net Profit. On the other hand, if indirect expenses are more than the total of Gross Profit and Income from other sources, the difference is known as Net Loss.

Let us take an example to clarify the above and calculate the Net Profit.

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**Example 3**

M/s Sanjay Brothers gives the following information for the accounting year ended on 31st March, 1997.

	Rs.		Rs.
Gross Profit	92,200	Advertisement	8,000
Bank Charges	1,000	Discount Allowed	2,000
Carriage outwards	3,800	Discount Received	4,000
Salaries	40,000	Rent and Rates	5,000

Then net profit will be calculated as:

**Calculation of Net Profit of M/s Sanjay Brothers**

	Rs.
Gross Profit for the year ended 31.3.97	92,200
<b>Add: Income from other sources:</b>	
Discount received	4,000
	<u>96,200</u>
<b>Less Indirect Expenses</b>	
Bank Charges	1,000
Carriage outwards	3,800
Salaries	40,000
Advertisement	8,000
Discount Allowed	2,000
Rent and Rates	5,000
	(-) 59,800
<b>Net Profit</b>	<u><u>36,400</u></u>

**Format of Profit & Loss Account**

The Profit and Loss Account is usually prepared in the following form:

Profit and Loss A/c of M/s .....  
for the year ended .....

Particulars	Amount	Particulars	Amount
<ul style="list-style-type: none"> <li>• To Gross Loss</li> <li>  To Office and Administration Expenses               <ul style="list-style-type: none"> <li>-Salaries</li> <li>-Salaries &amp; Wages</li> <li>-Rent, Rates &amp; Taxes</li> <li>-Printing &amp; Stationery</li> <li>-Postage &amp; Telegrams</li> <li>-Lighting</li> <li>-Audit Fees</li> <li>-Legal Charges</li> <li>-Telephone expenses</li> <li>-Insurance Premium</li> <li>-Establishment expenses</li> <li>-Trade expenses</li> <li>-General expenses</li> </ul> </li> <li>  To Selling and Distribution Expenses               <ul style="list-style-type: none"> <li>Carriage outwards</li> <li>Advertisement</li> <li>Commission and Brokerage</li> <li>Export Duty</li> <li>Packing charges</li> <li>Bad debts</li> <li>Delivery Van expenses</li> <li>Travelling expenses</li> </ul> </li> <li>  To Financial Expenses               <ul style="list-style-type: none"> <li>Interest paid</li> <li>Interest on Capital</li> <li>Discount Allowed(Dr)</li> <li>Sales Tax</li> <li>Bank Charges</li> <li>Difference in Exchange(Dr)</li> <li>Depreciation and maintenance expenses</li> <li>Repairs and Renewals</li> <li>Dep. on fixed Assets</li> </ul> </li> <li>  To Miscellaneous Exp./Losses               <ul style="list-style-type: none"> <li>Entertainment expenses</li> <li>Donation and Charity</li> <li>Loss on sale of Asset,</li> </ul> </li> <li>  To Net Profit transferred to Capital Account</li> </ul>		<ul style="list-style-type: none"> <li>• By Gross Profit</li> <li>  By Rent from tenants</li> <li>  By Discount (Cr)</li> <li>  By Commission received</li> <li>  By Interest from Investment</li> <li>  By Dividend received</li> <li>  By Income from other sources</li> <li>  By Miscellaneous revenue receipts</li> <li>  By Difference in exchange(Cr)</li> <li>  By Profit on sale of Asset</li> <li>  By Net Loss Transferred to Capital A/c</li> </ul>	

NOTE: There will either be Gross Profit or Gross Loss.

### **Important items of Profit and Loss A/c**

The indirect expenses taken to Profit and Loss Account may be grouped under the following heads:

- i) Selling and Distribution Expenses
- ii) Office and Administration Expenses
- iii) Depreciation and Maintenance Charges
- iv) Financial Expenses, and
- v) Other Expenses/Losses.

### **Debit Items**

#### **(i) Selling and Distribution Expenses**

These are the expenses incurred to increase sales or to attract customers. These expenses are: carriage outwards, export expenses, advertisement, selling expenses, agents and travellers' expenses and commission, samples etc.

#### **(ii) Office and Administration Expenses**

There are the expenses incurred on establishment, maintenance of office. These expenses are: rent, rates and taxes, postage, printing and stationery, legal charges, audit fee, insurance etc.

#### **(iii) Depreciation and Maintenance Charges**

Depreciation means decline in the value of fixed asset due to wear and tear, lapse of time, obsolescence, exhaustion, accident, etc. Repairs and renewals and maintenance charges are also expenses counted under this head.

#### **(iv) Financial Expenses**

These are the expenses incurred to meet out the financial requirement of the business. These expenses are interest on loan, interest on capital, discount on bills, etc.

#### **(v) Other Expenses and Losses**

Sometimes there are certain expenses or losses due to fire, flood, theft and are considered as indirect expenses.

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## Credit Items

### Other Sources of Income

All those incomes which are not earned through sale of goods and are of recurring nature and are not received for a specific work are known as incomes from other sources. These income are : commission received, discount received, interest received, surplus on the sale of fixed assets etc.

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## INTEXT QUESTIONS 20.3

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- A. State whether the following statements are true or false by writing 'true' against true statements and 'false' against false statements:
- i) The Profit and Loss Account is prepared at the end of each month.
  - ii) The Profit and Loss Account is not the part of Income Statement.
  - iii) The excess of income over expenditure is known as Net Loss.
  - iv) All the revenue receipts except sales are written in the credit side of Profit and Loss Account.
  - v) The wages and salaries Account is debited in the Profit and Loss Account.
- B. Some items of expenditure are given below. Tick the items which are shown in the Profit and Loss Account.

### Items of Expenditure

- i) Salaries and Wages
  - ii) Carriage Inwards
  - iii) Rent
  - iv) Telephone
  - v) Purchases
  - vi) Coal, Gas and Water
  - vii) Printing and Stationery
  - viii) Depreciation
  - ix) Import Duty
  - x) Export Duty
-



All indirect expenses accounts will be written individually.

ii) For transferring Income from other sources

<i>Voucher No.</i>	<i>Firm's Name</i>	<i>Date .....</i> <i>Amount</i> <i>Rs.</i>
<i>Debit</i>	Income from other sources Account	
<i>Credit</i>	Profit and Loss Account (Being Transfer of Income from other sources to Profit and Loss Account)	
<i>Sd.</i> <i>Manager</i>		<i>Sd.</i> <i>Accountant</i>

All incomes from other sources will be written individually

iii) For transferring Net Profit

<i>Voucher No.</i>	<i>Firm's Name</i>	<i>Date .....</i> <i>Amount</i> <i>Rs.</i>
<i>Debit</i>	Profit and Loss Account	
<i>Credit</i>	Capital Accounts (Being transfer of Income Net Profit to Capital Account)	
<i>Sd.</i> <i>Manager</i>		<i>Sd.</i> <i>Accountant</i>

*Note:* In case of Net Loss, Capital Account will be debited and Profit & Loss Account will be credited.

Let us make it clear by taking an example:

**Example 4**

The following balances were extracted from the books of M/s Sameer & Sons at the end of accounting year i.e. 31st March, 1997. Transfer these balances by i) Journal entry method, and ii) Accounting voucher method and prepare Profit & Loss Account for the year ended 31st March, 1997.

	Rs.
Gross Profit	50,600
Carriage outwards	160
Office expenses	1,250
Discount allowed	800
Discount received	500
Rent paid	1,200
Commission received	900
Interest on loan	800
Travelling expenses	500
Export Duty	1,300

**Solution****D. Journal Entry Method****a) Transferring the debit account balances to P&L A/c**

Profit & Loss Account .....	Dr.	6,010
To Carriage outwards A/c		160
To Office expenses A/c		1,250
To Discount A/c		800
To Rent A/c		1,200
To Interest on Loan A/c		800
To Travelling expenses A/c		500
To Export duty A/c		1,300

(Being transfer of accounts to P &amp; L A/c)

**b) Transferring the credit account balances to P&L A/c**

Discount A/c .....	Dr.	500
Commission A/c .....	Dr.	900
To Profit & Loss Account		1,400

(Being transfer of Accounts to P&amp;L A/c)

**c) Transferring the Net Profit to Capital A/c**

Profit and Loss Account .....	Dr.	45,990
To Capital Account		45,990

(Being transfer of Net Profit to Capital A/c)

## II) Accounting voucher method

a) For transferring the debit balance accounts

M/s Sameer & Sons		Date 31.3.97
Voucher No.4		Amount Rs.
<b>Debit</b>	Profit and Loss A/c	6,010
		6,010
<b>Credit</b>	Carriage outwards A/c	160
	Office expenses A/c	1,250
	Discount A/c	800
	Rent A.c	1,200
	Interest on Loan A/c	800
	Travelling Expenses A/c	500
	Export Duty A/c	1,300
	(Being transfer of indirect expenses to P&L A/c)	6,010
<b>Sd.</b> Manager		<b>Sd.</b> Accountant

b) For transferring credit balance accounts

M/s Sameer & Sons		Date 31.3.97
Voucher No.5		Amount Rs.
<b>Debit</b>	Discount A/c	500
	Commission A/c	900
		1,400
<b>Credit</b>	Profit & Loss Account (Being transfer of other income accounts to P&L A/c)	1,400
<b>Sd.</b> Manager		<b>Sd.</b> Accountant

c) For transferring Net Profit to Capital Account

<b>M/s Sameer &amp; Sons</b>		<i>Date 31.3.97</i>
<i>Voucher No.6</i>		<i>Amount</i>
		<i>Rs.</i>
<b>Debit</b>	Profit & Loss Account	45,990
		45,990
<b>Credit</b>	Capital Account (Being transfer of Net Profit to Capital Account)	45,990
		45,990
<b>Sd.</b> <b>Manager</b>		<b>Sd.</b> <b>Accountant</b>

**Profit & Loss Account of M/s Sameer & Sons**  
for the year ended 31st March , 1997

Particulars	Amount	Particulars	Amount
To Carriage outwards	160	By Gross Profit transferred from Trading A/c	50,600
To Office Expenses	1,250	By Discount	500
To Discount	800	By Commission	900
To Rent	1,200		
To Travelling Expenses	500		
To Interest on Loan	800		
To Export Duty	1,300		
To Net Profit transferred to Capital A/c	45,990		
	52,000		52,000

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## **INTEXT QUESTIONS 20.4**

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1.
    - A. Make journal entries to transfer salary, discount allowed and discount received accounts to Profit & Loss Account.
    - B. Make journal entry to transfer Net Profit from Profit & Loss Account to Capital Account.
    - C. Make journal entry to transfer Net Loss from Profit & Loss Account to Capital Account.
- 

## **20.7 BALANCE SHEET : FORMAT AND PREPARATION**

After the preparation of Trading and Profit & Loss Account, a businessman naturally would like to know the financial position of his business. Financial position is the amount of claims against the resources of business. Resources of business are the assets of the business such as cash, cash at bank, stock of goods, furniture, machinery, debtors etc. The claims include the claim of owner and the claims of outside parties such as creditors, bankers etc. These claims exist against these resources. Therefore, the financial position is the list of assets owned by the business and the claims of various parties against these assets. The statement showing the financial position is termed as **Balance Sheet**. Balance Sheet is a statement and not an account. It contains the balances of assets and liabilities of the business on a particular date. It has two sides, the left hand side (containing the claims and liabilities) known as **liabilities side** and right hand side (containing the assets of the business) known as **Assets side**.

### **Format of Balance Sheet**

There is no prescribed form of Balance Sheet for a sole proprietary and partnership concerns. However, the Balance Sheet of these concerns may be prepared in any one of the following orders:

- a) Liquidity Order
  - b) Permanency Order
-

a) **Liquidity Order**

The concerns which follow this order, write the assets which are more readily convertible into cash first and those that cannot be so readily converted next and so on. The same rule applies in the case of liabilities. **The short term liabilities are written first and then the long-term liabilities.** Capital is written **at the end.** It will be more clear from the specimen of Balance Sheet given below:

**Balance Sheet of M/s .....**  
**As on .....**

Particulars	Amount Rs.	Particulars	Amount Rs.
Bank overdraft		Cash in hand	
Outstanding Expenses		Cash at bank	
Bills Payable		Prepaid Expenses	
Sundry Creditors		Bills Receivable	
Loans		Sundry Debtors	
Capital .....		Closing Stock	
Add Net Profit .....		Investments	
.....		Furniture	
		Plant and Machinery	
		Land & Building	
		Godowill	

b) **Permanency Order**

The concerns which follow this order write the assets which are more permanent first and then the less permanent assets and so on. In the same way capital and liabilities which are of long-term are written first followed by short-term liabilities. It is just the opposite of liquidity order. It will be more clear from the specimen of Balance Sheet given below.

## Balance Sheet of M/s .....

As on .....

Particulars	Amount Rs.	Particulars	Amount Rs.
Capital		Goodwill	
Loans		Land & Building	
Sundry creditors		Plant and Machinery	
Bills Payable		Furniture	
Outstanding Expenses		Investments	
Bank overdraft		Closing stock	
		Sundry Debtors	
		Bills receivable	
		Prepaid expenses	
		Cash at bank	
		Cash in hand	

**Note:** The companies are bound to follow the permanency order of Balance Sheet in the prescribed form as per Companies Act, 1956.

### Classification of Assets and Liabilities

The assets and Liabilities are classified as under:

#### 1. Assets

These can be classified according to their nature which are:

##### a) Fixed Assets

These assets are purchased for permanent use in the business and help in the earning of revenue. These are: Furniture, Plant and Machinery, Land and Building etc. These assets are not meant for sale but for the use in business for a long time.

**b) Tangible Assets**

These are the assets which can be seen, touched and have certain volume. These are: Cash, Stock, Machinery, Building etc.

**c) Intangible Assets**

These are the assets which can neither be seen nor touched and have no volume. These are: Patents, Trade Mark, Goodwill etc.

**d) Liquid Assets**

These are the assets which are either in cash or can immediately be converted into cash. These are: Cash, Cash at bank, Stock, Marketable Securities etc.

**e) Wasting Assets**

These are the assets which exhaust or reduce in value by their use. These are: Mines, Quarries etc.

**f) Current Assets**

These are the assets which are acquired with the intention of converting them into cash during the current financial year. These are: Cash, Stock, Cash at bank, Bills Receivable, Prepaid Expenses, etc.

**2. Liabilities**

The main types of liabilities are:

**a) Long-Term Liabilities**

These are the liabilities which are not payable during the current accounting year. There are: Loans, Loans on mortgage, Bank Loan etc.

**b) Current Liabilities**

These are the liabilities which are payable during the current accounting year. These are: Bank overdraft, Creditors, Bills Payable, Outstanding Expenses etc.

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**Example 5**

From the balances given below, prepare Balance Sheet of M/s Shrey Brothers as on 31st March, 1997 in (a) Liquidity and (b) Permanency Order:

	Rs.		Rs.
Capital	30,000	Plant and Machinery	2,000
Building	32,500	Cash in hand	100
Furniture	1,500	Cash at bank	2,000
Sundry Debtors	9,750	Net Profit	19,450
Bills Receivable	1,500	Investments	1,500
Sundry Creditors	7,650	Drawings	1,500
Bills Payable	1,250	Closing Stock	3,500
Loan to Sameer	2,500		

**Solution**

**a) In Liquidity Order**

**Balance Sheet of M/s Shrey Brothers  
As on 31st March, 1997**

Liabilities	Amount Rs.	Assets	Amount Rs.
Bills Payable	1,250	Cash in hand	100
Sundry Creditors	7,650	Cash at bank	2,000
Capital:           30,000		Sundry Debtors	9,750
Add Net Profit   19,450		Bills Receivable	1,500
49,450		Investments	1,500
Less Drawings    1,500	47,950	Closing Stock	3,500
		Loan to Sameer	2,500
		Furniture	1,500
		Plant and Machinery	2,000
		Building	32,500
	56,850		56,850

## b) In Permanency Order

**Balance Sheet of M/s Shrey Brothers**  
As on 31st March, 1997

Liabilities		Amount	Assets	
		Rs.		Rs.
Capital	30,000		Building	32,500
Add Net Profit	19,450		Plant and Machinery	2,000
	<u>49,450</u>		Furniture	1,500
Less Drawings	1,500	47,950	Loan to Sameer	2,500
Sundry Creditors		7,650	Closing Stock	3,500
Bills Payable		1,250	Investments	1,500
			Bills Receivable	1,500
			Sundry Debtors	9,750
			Cash at bank	2,000
			Cash in hand	100
		<u>56,850</u>		<u>56,850</u>

**Example 6**

From the balances extracted from the books of M/s Sanjay Brothers, prepare Trading and Profit & Loss Account for the year ended 31st March, 1997 and Balance Sheet as on that date.

Cash in hand	100	Sales Returns	500
Motor Car	34,000	Travellers' Salaries	12,000
Drawings	9,000	Discount allowed	1,000
Audit Fee	1,500	Carriage Inwards	12,000
Plant and Machinery	1,00,000	Carriage outwards	7,000
Investments	25,000	Advertisement	6,500
Stock at the end	70,000	Wages	30,000
Purchases	1,46,000	Excise duty	3,400
Purchases Returns	1,000	Lighting	5,000
Trade expenses	2,000	Debtors	90,000
Sundry Creditors	38,000	Duty and clearing charges	7,000
Bank Loan	50,000	Postage and Telegram	600

Interest on Investment	1,000	Insurance Premium	1,200
Capital	75,000	Travelling Expenses	2,800
Discount Received	2,000	Patents	15,000
Sales	4,30,000	Office expenses	10,000

**Solution:**

**Trading and Profit & Loss Account of M/s Sanjay Brothers  
for the year ended 31st March 1997**

Dr.

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Particulars	Amount Rs.	Particulars	Amount Rs.
To Purchases	1,46,00	By Sales	4,30,000
Less Returns	<u>1,000</u>	Less Returns	<u>5,000</u>
	1,45,000		4,25,000
To Carriage	12,000		
To wages	30,000		
To Excise Duty	3,400		
To Duty and Clearing Charges	7,000		
To Gross Profit transferred to P&L A/c	2,27,600		
	<u>4,25,000</u>		<u>4,25,000</u>
To Audit fee	1,500	By Gross Profit transferred from Trading A/c	2,27,600
To Trade Expenses	2,000	By Interest on Investment	1,000
To Carriage Outwards	7,000	By Discount Received	2,000
To Advertisement	6,500		
To Lighting	5,000		
To Travellers' Salaries	12,000		
To Discount allowed	1,000		
To Postage and Telegram	600		
To Travelling Expenses	2,800		
To Office expenses	10,000		
To Insurance Premium	1,200		
To Net Profit transferred to Capital Account	1,81,000		
	<u>2,30,600</u>		<u>2,30,600</u>

**Balance Sheet of M/s Sanjay Brothers  
As on 31st March, 1997**

Liabilities	Amount Rs.	Assets	Amount Rs.
Creditors	38,000	Cash in hand	1,000
Bank Loan	50,000	Debtors	90,000
Capital                   75,000		Closing Stock	70,000
Add Net Profit <u>1,81,000</u>		Investments	25,000
2,56,000		Patents	15,000
Less Drawings <u>9,000</u>	2,47,000	Motor Car	34,000
		Plant and Machinery	1,00,000
	<u>3,35,000</u>		<u>3,35,000</u>

**Note:** When closing Stock is given in the Trial Balance, it is written in the Balance Sheet only and not in the Trading Account.

### INTEXT QUESTIONS 20.5

- A.** Write 'true' or 'false' against the following statements:
- (i) Balance Sheet is an account.
  - (ii) Balance Sheet is prepared on a particular date.
  - (iii) Balance Sheet is a test for the arithmetical accuracy of accounts.
  - (iv) Balance Sheet contains the balances of all accounts.
  - (v) Balance Sheet is a statement of financial position.
- B.** Fill in the blank with suitable words.
- (i) Balance Sheet contains the balances of \_\_\_\_\_ accounts.
  - (ii) Balance Sheet may be prepared in \_\_\_\_\_ order and \_\_\_\_\_ order.
  - (iii) On the right hand side of Balance Sheet \_\_\_\_\_ are written.
  - (iv) Balance Sheet is prepared to know the \_\_\_\_\_ position of a business.
  - (v) Capital Account is written on the \_\_\_\_\_ side of Balance Sheet.

C. Write the following Assets and Liabilities in the (i) Liquidity form and (ii) Permanency form of Balance Sheet.

(a) Cash at bank (b) Goodwill (c) Capital (d) Bills Receivable (e) Creditors (f) Debtors (g) Building (h) Bank Loan (i) Investment (j) Outstanding expenses (k) Bills Payable.

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## **20.8 WHAT YOU HAVE LEARNT**

1. Trading Account is prepared to ascertain the results of the trading activities of the business.
  2. Gross Profit is the difference between sales and the cost of goods sold.
  3. Gross Loss is the excess of cost of goods sold over total sales.
  4. Items relating to cost of goods sold and the sales are transferred to Trading Account Account either through Journal Entries or Transfer Vouchers.
  5. Profit and Loss Account is prepared to find out Net Profit or Net Loss.
  6. Net Profit is the excess of Gross Profit and other incomes over indirect expenses.
  7. Net Loss is the excess of indirect expenses over Gross Profit and other incomes.
  8. Items relating to indirect expenses and income from the other sources are transferred to Profit and Loss Account either through journal entries or transfer vouchers.
  9. Balance sheet is a statement showing the financial position of a business.
  10. Balance Sheet lists out the assets and liabilities of the business.
  11. Assets can be classified as fixed assets, tangible assets, intangible assets, liquid assets, wasting assets, current assets etc.
  12. Liabilities can be classified as long-term liabilities and short-term or current liabilities.
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## 20.9 TERMINAL QUESTIONS

1. Which of the following indicates Gross Profit?  
a) Trading Account b) Profit & Loss Account c) Balance Sheet
2. Which of the following indicates Net Loss?  
a) Trading Account b) Profit & Loss Account c) Balance Sheet
3. Which of the following contains Bank Loan?  
a) Balance Sheet b) Profit & Loss Account c) Trading Account
4. What is Trading Account? How is it prepared? Explain. (75-100 words).
5. What is Profit & Loss Account? How do you prepare it? Explain briefly. (75-100 words).
6. What is Balance Sheet? What types of accounts does it contain? (30-50 words).
7. Explain, in brief, the two orders in which a Balance Sheet can be prepared with examples. (About 100 words).
8. From the following balances, calculate Gross Profit or Gross Loss of M/s Aditi Agarwals.

	Rs.
Stock as on 1.1.96	10,250
Purchases made during the year	25,750
Sales made during the year	45,000
Purchases returned during the year	500
Carriage on purchases	1,000
Wages incurred	2,000
Sales Returned during the year	500
Stock as on 31.12.96	4,500

9. The following balances were extracted from the books of Shrey Brothers, prepare a Trading and Profit and Loss Account for the year ended 31st March 1997:

	Rs.		Rs.
Stock on 1.4.96	60,000	Electric Power	5,000
Purchases	1,75,000	Fuel, Gas and water	4,500
Returns Inwards	2,000	Selling Commission	5,500
Carriage Inwards	1,850	Salaries	16,000
Carriage Outwards	1,200	Motor Repairs	2,000
Dock Charges	3,000	General Expenses	10,000
Returns Outwards	18,500	Rent and Insurance	1,200
Sales	2,55,000	Stock on 31.3.97	90,000
Discount Received	1,500		

10. From the balances extracted from the books of Mrs. Seema, prepare Trading and Profit & Loss Account for the year ended 31st March, 1997 and Balance Sheet as on that date:

	Rs		Rs.
Stock as on 1.4.96	9,360	Sales Returns	1,720
Purchases	48,600	Carriage Inwards	3,530
Wages	1,000	Carriage onwards	620
Drawings	3,400	Office salaries	2,170
Duty on goods imported	1,200	Bills Receivable	1,500
Rent and Taxes	940	Capital	21,500
Trade Expenses	140	Discount Received	350
Cash in hand	500	Purchases Returns	1,060
Cash at bank	1,320	Sales	57,920
Bad Debts	180	Loan	4,000
Discount allowed	310	Bills Payable	2,000
Land and Building	7,500	Sundry Creditors	20,000
Furniture and Fitting	600	Sundry Debtors	21,860
Interest on Loan	480		

The value of stock on 31st March, 1997 was Rs. 15,620

