



UNIT-IV

Final Accounts : Opening and Closing Entries Trading, Profit and Loss accounts and Balance Sheet.

Unit-IV

12. Closing Entries, Capital & Revenue Items and Final Accounts

12.1 – 12.49

Closing Entries, Capital & Revenue Items and Final Accounts

The two financial statements, Profit and Loss Account and Balance Sheet are inter related with each other. Both these statements are prepared from the balances appearing in trial balance. The items of revenue nature are taken to Profit & Loss Account, whereas items of capital nature are taken to Balance Sheet. As such a clear distinction between revenue and capital is very much necessary in order to prepare the two financial statements properly and correctly. So, first of all revenue is determined and then the expenses incurred for earning that revenue is matched with that revenue for determination of net income or net profit. It should be noted here that while matching cost with revenue, the fact that payment has been received and made is not material. However, one must understand very clearly the nature and concept of different types of income and expenditure, receipts and payments before matching revenue with expense for ascertaining the amount of profit or loss made during a particular period. Before we try to differentiate between capital and revenue we must discuss the following considerations which are not proper in determining Capital expenditure as Revenue expenditure :

(1) **Quantum of amount** : Only because the amount spent is large, it can not be treated as capital expenditure. It must be the nature of the amount spent which is important in this regard.

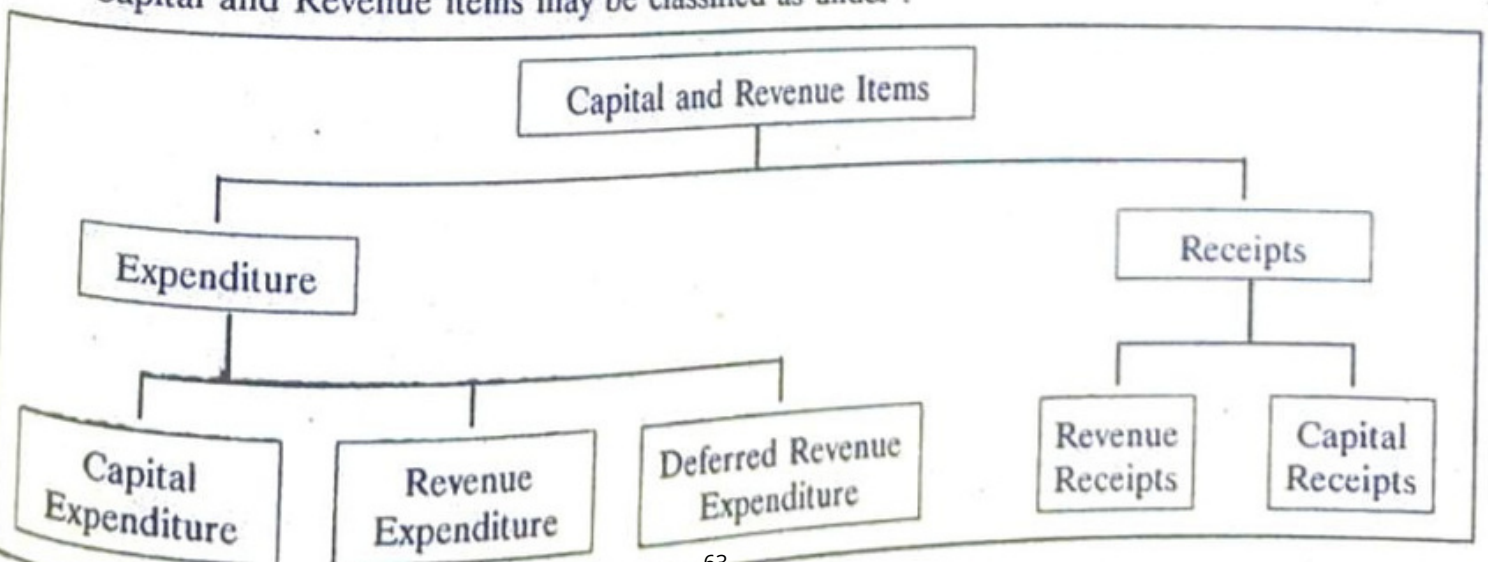
(2) **Source of payment** : For making the distinction between Capital and Revenue Expenditure the source from which amount has been arranged to make the payment is not material at all.

(3) **Nature in the hands of recipient** : For the party making the payment to differentiate between Capital and Revenue, it should not be considered as a proper basis that how is the recipient going to treat the money received by him.

(4) **Manner of payment** : In what manner the payment has been made can not be the basis to differentiate between the Capital or Revenue because both Revenue and Capital Expenditures may be paid for either in lump sum or in instalments.

Classification of Capital and Revenue Items :

Capital and Revenue items may be classified as under :



Classification of Items of Expenditure :

Items of expenditure incurred in the business are classified as under :

(1) **Capital Expenditure :** Capital Expenditure is that expenditure which is incurred for acquiring or bringing into existence an asset or for extending or improving a fixed asset or for substantial replacement of an existing fixed asset or which adds to the productivity or earning capacity of the asset. Thus capital expenditure normally yields benefit over a long period. The following types of expenditure are capital expenditure :

(i) **Expenditure incurred for the acquisition of a permanent asset :** All money spent for acquisition of an asset is to be considered as capital expenditure. Here an asset means anything which can be either used for a long period of time such as Land and Building, Plant and Machinery etc. or which can be converted into cash later.

(ii) **Expenditure which results in the extension of or improvement in fixed asset :** Due to any expenditure if the profit earning capacity has increased by way of lowering cost or increasing output, such expenditure is to be considered as capital expenditure.

(iii) **Expenditure which results in the acquisition of a tangible asset :** The expenditure incurred to acquire a tangible asset is to be treated as capital expenditure even if such asset does not prove to be profitable for the business.

(iv) **Expenditure in connection with the acquisition of the right to carry on business :** The cost of acquisition of the right such as the cost of the patent which is for the right to produce certain goods in a certain manner should be considered as capital expenditure. Similarly, the expenses necessary for either establishing the business such as preliminary expenses for commencing a newly established company, for obtaining necessary licence is also considered as capital expenditure. Only the initial expenditure is treated as capital expenditure. However, *renewal fees* in this regard are treated as revenue expenditure.

(v) **Expenditure incurred to purchase, receipt or erect a fixed asset :** In this regard the rule is that all such expenses which are incurred for making the asset ready for use, in addition to the purchase price of such asset are added to the cost of asset and thus are treated as capital expenditure for e.g., *overhauling charges of second hand machine purchased, the cost of installation of a new machine, interest on the loan taken to purchase the Machine etc.*

Accounting Treatment : All capital expenditures are debited to the respective Assets Accounts which are to be shown on the asset side of the balance sheet. These expenses are not shown on the debit side of Profit & Loss Account.

(2) **Revenue Expenditure :** All such expenditure which are to be incurred in the general administration of the business, or in making and promoting sales and distribution are considered as revenue expenditure. As such these expenditure yield benefits during the current year. It is to be shown in the Trading & Profit & Loss Account. Thus these expenses are incurred usually in the ordinary course of business or as routine business expense. Such expenses really maintain the assets only but do not increase their value or their earning capacity. Examples of such expenses are :

- (i) Expenses incurred for day-to-day running of the business, such as salaries, wages, rent, electricity charges, power and fuel etc.
- (ii) Expenses incurred on purchase of stocks of material and finished goods to the extent these are used up during the year,

(iii) Depreciation on fixed assets,

(iv) Expenses incurred for the upkeep of fixed assets, such as repairs and maintenance expenses, legal expenses for defending the dispute for title of assets etc.

However, the under mentioned expenses at first instance appear to be revenue expenses but in fact they are really capital expenses :

- (i) Expenses incurred in connection with the purchase of land and building such as registration expenses or fees paid to the lawyer,
- (ii) Expenses incurred for installation of a new machine;
- (iii) Wages paid to workers to produce a tool to be used by the factory itself or to fix or erect a machine, and
- (iv) Expenses incurred on the repairs and white-washing for the first time on purchase of an old building since these expenses are necessary to make the building usable or expenses incurred to upkeep and maintain fixed assets in properly usable condition.

Accounting treatment : All revenue expenditure are debited and to be shown at the debit side of Trading and Profit & Loss Account. Since revenue expenditure greatly affect the Gross Profit and Net Profit of the business, so these should be distinguished from capital expenditure.

(3) **Deferred Revenue Expenditure :** Some revenue expenses may be incurred in such circumstances as may bring the benefit therefrom over a period of more than one year i.e. *three or four years*. In fact such expenses are revenue expenses of capital nature which are very huge, so instead of charging the whole amount of expenditure in the year of the actual expense, the expenditure is split and written off over certain period. Pickles and Dunkerley, in their book accountancy have classified deferred revenue expenditure into four different types as under :

- (i) Expenditure wholly paid for in advance where no service has yet been rendered, necessitating its being carried forward;
- (ii) Expenditure partly paid in advance, where a proportion of the benefit has been derived within a period under review and the balance being as yet 'unused'.
- (iii) Expenditure in respect of service rendered which for any reason is considered as an asset; and
- (iv) Amounts representing losses of an exceptional nature.

As a rule, an item of deferred revenue expenditure will be shown as a Fictitious Asset which means although it is shown on the asset side of balance sheet but really it is not an asset. Examples of such expenses are Preliminary Expenses, Underwriting Commission, Heavy Advertisement Expenses, Loss of Issue of Shares and Debentures, Loss of Building because of an Earthquake etc. It may be noted that the amount which has not been charged to the Profit & Loss Account is shown in the Balance Sheet as an *Fictitious Asset*.

Accounting Treatment : These expenditures are capitalised and they will have to be written off over a certain period. The treatment will be made as similar as we treat for depreciation on assets.

Classification of Items of Receipts :

Items or Receipts related to business are classified as under :

(1) **Capital Receipts :** Capital receipts consist of additional payment made to the business either by shareholders of the company or by the proprietors of the business or receipts from sale of fixed assets of the business. Amount received through capital, long term loans, by issue of shares and

debentures are capital receipts. Thus capital receipts are not current liability. These receipts show a credit balance, they are capitalized and shown at the liabilities side of Balance Sheet. Similarly, capital receipts are excluded from the trading and profit & loss account.

(2) Revenue Receipts : These are the routine receipts of the business just a receipt from sale of goods. These receipts are shown either at the credit side of Trading Account or Profit & Loss Account. Examples of revenue receipts are sale of goods, interest earned, rent received, commission received, sale proceeds of old newspapers, packing materials and sundry receipts etc.

To sum up, as a clear distinction between capital and revenue expenditure is essential, in the same manner, capital receipts must be distinguished from revenue receipts.

Capital and Revenue Profits :

It is very important to note that while preparing the final accounts, distinction has to be made between capital profits and revenue profits. Revenue profits are earned in the normal course of business. They appear in the Profit and Loss Account and are available for distribution as profit, or for developing reserves and funds, or for being used in the business. However, capital profits, are those which are earned as a result of selling some fixed assets, or in connection with raising capital for the firm. For instance a building purchased for Rs. 2,50,000 was subsequently sold for Rs. 2,95,000, thus, Rs. 45,000 will be profit of capital nature. Similarly, when a company issues its shares of the face value of Rs. 10 for Rs. 12 each, it is said that shares have been issued at premium which is capital profit. Capital profits are either capitalised i.e. transferred to Capital Account or transferred to Capital Reserve Account which may be utilised for meeting capital losses.

Capital and Revenue Losses :

Revenue losses are the losses which are related to the normal course of business; whereas capital losses are those which are related to selling fixed assets or raising share capital. If a building purchased for Rs. 70,000 is sold for Rs. 55,000, there will be capital loss of Rs. 15,000. Similarly when shares of the face value of Rs. 10 are issued at Rs. 9 i.e. at a discount of Re. 1, the amount of discount will be a capital loss. Treatment of capital losses is not different from that of capital profits. Just as capital profits are not shown in Profit and Loss Account, similarly capital losses are not shown in the Profit & Loss Account. They are shown in the balance sheet on the assets side. As and when capital profits arise, capital losses are written off against them. If however, capital losses are in large amount, the common practice is to spread them over a number of years and charge a part thereof to Profit and Loss Account, to each such year. But if they are negligible, they are debited to Profit and Loss Account of the year in which they occur.

Illustration 12.1 :

State with reasons whether the following are Capital or Revenue Expenditure :

- (1) Expenses on a foreign tour for purchasing a new plant and machinery.
- (2) Freight and Insurance spent on the new plant and machinery.
- (3) Customs duty paid on import of a new machinery.
- (4) Cartage paid to bring the new machinery to factory premises.
- (5) Wages paid in connection with the erection of new machinery.
- (6) Rs. 4,000 spent on repairing a second hand machine before put to use.
- (7) Rs. 8,000 spent to remove a worn out part and replace it with a new engine.
- (8) A petrol driven engine of a passenger bus was replaced by a diesel engine.
- (9) Rs. 7,00,000 spent on advertising the introduction of a new product in the market, the benefit of which will be effective for 4 to 6 years.

- (10) Rs. 8,000 spent on repairing the factory building.
- (11) Heavy amount spent on research for a particular product which ultimately did not result in success.
- (12) Repairs for Rs. 8,000 necessitated by the negligence of an operator of machine.
- (13) Rs. 20,000 paid as compensation to employees who were retrenched.
- (14) Interest on a term loan for the purchase of Machinery. The commercial production has not begun till the last day of the accounting year.
- (15) Interest on a term loan for the purchase of Machinery. The commercial production has already begun.
- (16) Compensation paid for breach of contract to acquire stock-in-trade.
- (17) Rs. 70,000 spent as lawyer's fee to defend a suit that firm's factory belonged to the plaintiff. The suit was not successful.

Solution :

- (1) Items referred to in (1) to (6) represent capital expenditure since these expenses are incurred upto the point the machine is ready for use.
- (7) It should be treated as revenue expenditure since it is incurred to keep the asset in working order. Such expenditure has neither resulted in increasing the life or efficiency of an existing asset nor in bringing into existence an asset, as such cannot be treated as capital expenditure.
- (8) Such expenditure should be treated as capital expenditure since it will increase the profit earning capacity of the business through lowering of costs.
- (9) Such expenses should be treated as a deferred revenue expenditure and should be written-off each year over a period of 4 to 6 years.
- (10) Such expenses should be treated as a revenue expenditure since it is incurred to maintain the factory in good condition.
- (11) Such expenses should be treated as revenue expenditure if the amount is immaterial looking to the given circumstances, since the research has not resulted in creation of patent right etc. However, if the amount is material, such expenditure may be treated as a deferred revenue expenditure and may be written-off over a period of 2 to 6 years.
- (12) Such expenses should be treated as revenue expenditure since it is incurred to keep the asset in working order.
- (13) Such expenses should be treated as revenue expenditure since compensation paid will neither bring the benefit of endurable nature nor meant for enhancing the value of any asset.
- (14) Such expenditure should be treated as capital expenditure since the commercial production has not begun till the last day of the accounting year.
- (15) Such expenditure should be treated as revenue expenditure because the commercial production has already begun.
- (16) Such expenditure should be treated as revenue since it is neither bring the benefit of endurable nature nor enhancing the value of any asset.
- (17) Such expenditure should be treated as revenue expenditure since it is incurred for the upkeep of fixed asset.

Illustration 12.2 :

Enran Ltd. construct a cinema house and incur the following expenditure during the first year ending 31st March, 2015 :

- (1) Second-hand furniture worth Rs. 1,45,000 was purchased; repainting of the furniture cost Rs. 45,000. The furniture was installed by own workmen, wages for this being paid Rs. 14,000.
- (2) Expenses in connection with obtaining a license for running the cinema worth Rs. 1,00,000. During the course of the year the cinema company was fined Rs. 5,000, for contravening rules. Renewal fee Rs. 10,000 for next year was also paid.
- (3) Fire insurance, Rs. 15,000 was paid on 1st October, 2014 for one year.
- (4) Temporary huts were constructed costing Rs. 16,000. They were necessary for the construction of the cinema. They were demolished when the cinema building was ready.
- (5) During the first week of the cinema's running free tickets were distributed. These were 10,000, the average cost being Rs. 50 per ticket.

Point out how would you classify the above items as capital and revenue?

Solution :

- (1) The total cost of the furniture should be treated as Rs. 2,04,000 i.e., all the amounts mentioned should be capitalised since without such expenditure the furniture would not be available for use. If Rs. 45,000 and Rs. 14,000 have been respectively debited to the Repairs Account and Wages Account, these accounts will be charged (debited) to the Furniture Account.
- (2) License for running the cinema house is necessary, as such its cost should be capitalised. But the fine of Rs. 5,000 is revenue expenditure. The renewal fee for the next year is also revenue expenditure but since it pertains to the next year, hence it is to be treated as prepaid expense.
- (3) Half of the insurance premium relate to the year beginning on 1st April, 2014. Hence such amount should be treated as prepaid expense. The remaining amount is revenue expense for the current year.
- (4) Since the temporary huts were necessary for the construction, of cinema house, its cost should be added to the cost of the Cinema Hall and thus be capitalised.
- (5) The cost of the tickets distributed free for advertisement purpose is revenue expenditure. But since no payment has been made, the amount should either be ignored or debited to the advertisement account and credited to the revenue account. Since the advantage of the advertisement may accrue for a few years the cost may be treated as deferred revenue expenditure and may be spread over three to five years.

Illustration 12.3 :

State which of the following receipts are of capital nature and which are of revenue nature?

- (1) Amount realised from sale of the old furniture.
- (2) Amount received from a debtor whose account was previously written off as bad.
- (3) Amount of loan taken from a bank.
- (4) Fees received from apprentices.
- (5) Amount realised from debtors against their debts.
- (6) Amount contributed by the proprietor to augment his Capital.
- (7) Rs. 1,50,000 received from sale of Machinery which had cost Rs. 1,30,000.

Solution :

- (1) Sale of old furniture only means conversion of one asset into another. Therefore, it is a capital receipt.
- (2) The amount realised from a debt previously written off as bad debts is to be treated as a revenue receipt because this amount is not refundable to the customer and the amount was previously written off as a loss.
- (3) The loan taken from a bank is repayable and, therefore, is a liability. This is a capital receipt.
- (4) Fees received from apprentices are not returnable and therefore, it is an income of the firm. It is a revenue receipt.
- (5) Amount realised from debtors against their debts is not revenue; it is merely conversion of one asset into another.
- (6) This item is capital receipt since it increases the firm's liability to the proprietor.
- (7) Out of Rs. 1,50,000, Rs. 1,30,000 will be treated as capital receipt as conversion of one asset into another (machinery into cash); the excess amount received Rs. 20,000 is a profit and therefore a revenue receipt.

Illustration 12.4 :

Keeping in view the principles of Capital and Revenue, pass Journal entries for the following transactions :

- (1) Purchased a second-hand machine for Rs. 1,70,000.
- (2) Spent Rs. 20,000 for its overhauling which includes Rs. 4,000 for its accessories. Its installation expenses amounted to Rs. 15,000.
- (3) On damage of the machine Rs. 14,500 were spent on repairs and the labour injured in accident was given Rs. 16,500 for compensation.
- (4) The machine was sold at a loss of Rs. 15,000.

Solution :

| Date | | Particulars | Journal Entries | |
|------|--|-------------|------------------|------------|
| | | | L.F. | Dr. Cr. |
| | | | Amount Rs. | Amount Rs. |
| 1 | Machinery A/c Dr. To Bank A/c (Purchase of second hand machinery) | | 1,70,000 | 1,70,000 |
| 2 | Machinery A/c Dr. To Bank A/c (Repairs and installation charges incurred on second hand machinery) | | 35,000 | 35,000 |
| 3 | Repairs A/c Dr. Compensation to Employee A/c Dr. To Bank A/c (Repairs and compensation to an employee paid) | | 14,500 16,500 | 31,000 |

| | | | | |
|---|---|------------|--------------------|----------|
| 4 | Bank A/c Loss on Sale of Machinery A/c To Machinery A/c (Being sale of old machinery and loss of Rs. 15,000 sustained) | Dr. Dr. | 1,90,000 15,000 | 2,05,000 |
|---|---|------------|--------------------|----------|

Final Accounts

Meaning : After the preparation of trial balance the management of a business enterprise is interested in knowing as to whether it has earned profits or incurred losses and as to what is its financial position at the end of the accounting period. For this purpose he prepares financial statements which are also known with their traditional name as 'Final Accounts'. The term 'Financial Statements' or 'Final Accounts' refer to two statements i.e., Income statement and Position statement. The term Income statement is traditionally known as Trading & Profit & Loss Account and Position Statement as Balance Sheet. Trading Account shows Gross Profit or Gross Loss; whereas Net Profit or Net Loss is available from Profit and Loss Account. Similarly the Balance Sheet exhibits the position of Assets and Liabilities at a certain date.

Preparation of Final Accounts :

The preparation of Final Accounts has been dealt within two separate parts to facilitate a proper understanding of their methodology :

- (A) Final Accounts without adjustments.
- (B) Final Accounts with adjustments.

Here, we shall study about 'Final Accounts without adjustments'. Final Accounts with adjustments are to be studied in the next chapter.

Stages of Preparation of Final Accounts :

There are three stages of preparing final accounts of a trading concern as under :

- (1) Trading Account.
(Manufacturing concerns prepare Manufacturing Account also before Trading Account)
- (2) Profit and Loss Account.
- (3) Balance Sheet.

Trading Account :

The first step in the preparation of final accounts is the preparation of the Trading and Profit and Loss Account. The first part of it is Trading Account which is designed to show the gross profit arising or gross loss incurred as a result of the trading activities of a business. Excess of sales and closing stock over opening stock, purchases and direct expenses is known as the gross profit. Gross loss is the excess of opening stock, purchases and direct expenses over sales and closing stock. In other words, it can be presented as under :

| | | |
|--------------------|---|--|
| Gross Profit | = | Net Sales - Cost of goods sold |
| Gross Loss | = | Cost of goods sold - Net Sales |
| Net Sales | = | Sales - (Sales return + Sales tax, if any) |
| Net Purchases | = | Purchases - Purchases return |
| Cost of goods sold | = | Sales - Gross Profit |
| or | | |
| Cost of goods sold | = | Opening-stock + Net purchases + Direct expenses - Closing stock |

Need or object of Preparing Trading Account :

The main purpose and importance of preparing a trading account may be explained as under :

- (1) It provides information about gross profit. The current figure can be compared with earlier ones to find out reasons for variations. According to this, plan can be made for future growth of the firm.
- (2) Comparison of 'stock in hand' of the current year with those of the previous years is possible. Reasons for variations can be ascertained and steps can be taken to adjust things more profitably.
- (3) Ratio of gross profit to sales can help the trader to improve his business administration.
- (4) Ratio of direct expenses to sales will help the trader to control and rationalise the expenses.
- (5) Ratio of cost of goods sold to total sale proceeds can help the trader in fixing the prices of his products.
- (6) Precautionary measures can be taken to avoid possible losses by analysing the items of direct expenses.
- (7) Ratio of direct expenses to gross profit is calculated and compared with the desired and previous performance so as to measure the operational efficiency of the firm.
- (8) Relationship between purchases and direct expenses is ascertained through trading account which indicates how far direct expenses are reasonable and adequate.

Illustration 12.5 :

Calculate Gross Profit from the following information :

| Details | Rs. | Details | Rs. |
|--------------------|--------|------------------|-------|
| Opening stock | 25,000 | Purchases return | 1,000 |
| Purchases | 35,000 | Sales return | 2,000 |
| Sales | 60,000 | Carriage | 3,000 |
| Salaries and wages | 4,000 | Octroi | 1,000 |
| Motive power | 3,000 | Freight outward | 4,000 |
| Closing stock | 22,000 | Wages | 7,000 |

Solution : Calculation of Gross Profit

$$\text{Gross Profit} = \text{Net sales} - \text{Cost of goods sold} = 58,000 - 51,000 = \text{Rs. } 7,000$$

Working Notes :

- (i) $\text{Cost of goods sold} = \text{Opening Stock} + \text{Net Purchases} + \text{Direct Expenses} - (\text{Closing Stock})$ or $[\text{Rs. } 25,000 + 34,000 + 14,000 - 22,000] = \text{Rs. } 51,000$
- (ii) $\text{Net Purchases} = \text{Purchases} - \text{Purchases Return}$ (or $35,000 - 1,000$) = Rs. 34,000
- (iii) $\text{Net Sales} = \text{Sales} - \text{Sales return}$ (or $60,000 - 2,000$) = Rs. 58,000
- (iv) $\text{Direct Expenses} = \text{Motive power} + \text{Carriage} + \text{Octroi} + \text{Wages}$
= $3,000 + 3,000 + 1,000 + 7,000$ or Rs. 14,000.

Proforma of the Trading Account

The general proforma of the Trading Account is shown as under :

| Dr. | | Trading Account for the year ending..... | | Cr. | |
|--|--|--|--|-----|--|
| | | Rs. | | Rs. | |
| To Opening Stock | | | By Sales (of goods) | | |
| To Purchases (of goods) | | | Less : Sales Returns | | |
| Less : Purchases Returns | | | By Closing Stock | | |
| To Wages (direct) | | | By Gross Loss transferred to Profit and Loss Account | | |
| or Wages and Salaries | | | | | |
| or Productive Wages | | | | | |
| or Manufacturing Wages | | | | | |
| To Carriage Inwards (on Purchases) | | | | | |
| To Customs or/Octroi Duty | | | | | |
| To Factory Lighting | | | | | |
| To Factory Power | | | | | |
| To Fuel (Coal, gas, water etc.) | | | | | |
| To Factory Rent & Rates | | | | | |
| To Other Factory Expenses | | | | | |
| To Gross Profit transferred to Profit & Loss Account | | | | | |

Main Points to be Kept in mind :

- (1) **Purchases :** (i) It includes both cash and credit purchases.
- (ii) It includes purchases of only such goods which are purchased for resale purpose. Purchase of assets such as motor vans, furniture, plant and machinery are not included in purchases.
- (iii) Total purchases are shown in the inner column of trading account and net purchases (after deducting purchases returns or returns outwards from the total purchases) are shown in the outer column. It is not correct to show returns outward on the credit side of the trading account.
- (iv) If the goods purchased are in transit then it is better to record them by debiting Goods-in-transit account and crediting the Supplier's account. The goods-in-transit appears as an asset and supplier's account as a liability in the balance sheet. **Trading Account remains unaffected by such purchases.**
- (v) Goods purchased by the proprietor for his personal use should first recorded as usual purchases and then it should be recorded as goods withdrawn by the proprietor. Goods withdrawn by the proprietor for his personal use are deducted from total purchases on the debit side and net purchases are shown in trading account.
- (vi) Sometimes, invoices of the goods are received in advance of goods. At such an occasion, since goods have not been received it is better not to record it at all. Such amount will not be added to purchases account on the debit side nor it will be added to 'stock at the end' on the credit side.
- (vii) Goods received on consignment should be kept separate.

- (2) **Sales :** (i) Sales will include sale of goods which are purchased for resale purpose.
- (ii) Sale of old furniture, building, car, etc., which are not purchased for sale purpose must not be added to sales but should be credited to that particular account.
- (iii) Both cash and credit sales will be included in it.
- (iv) Gross sales will appear in the inner column and net sales (after deducting sales returns or returns inwards) will be shown in the outer column. It is not correct to show sales returns on the debit side of trading account.
- (v) Goods sold on hire-purchase system should be recorded separately.
- (vi) Goods sold on consignment should be recorded in consignment account and should not be included in 'Sales.'
- (vii) Goods sold on approval should be recorded separately.
- (viii) If goods have been sold towards the end of the accounting period and have been included in sales, care should be taken that such goods which remain undelivered should not be included in the stock at the end.
- (3) **Wages, or Wages and Salaries :** Wages is a direct expense and is debited to trading account. Wages and salaries when shown as one account is conventionally treated as direct expense and is charged to trading account. But salaries and wages is charged to profit and loss account on the assumption that the item includes salaries and wages of the staff in the establishment office.
- (4) **Dock charges :** These charges are levied on ships and their cargo when entering or leaving docks. If dock charges are paid on goods purchased they are taken to the debit side of trading account.
- (5) **Duty :** This includes customs duty and excise duty. Customs duty is paid on import and export of goods. Customs duty paid on the purchase of goods is charged to trading account. Excise duty is paid on goods manufactured and consumed in the country. This is shown on the debit side of trading account.
- (6) **Freight, carriage and cartage :** If these are paid on the purchase of goods, they are debited to the trading account. Freight, carriage, cartage paid on the purchase of assets are capitalised by debiting the asset account "Freight in", "carriage in", and "cartage in" terms stand for payment made on purchase of goods and are charged to trading account.
- (7) **Royalty :** It is a payment made to the owner for using his rights or patents. They are productive expenses and are debited to trading account. Royalty, if based on the sale price of goods sold, it is charged to profit and loss account.
- (8) **Gas, electricity, water and fuel (coal, coke, wood, etc.) :** They are direct expenses and are taken to trading account.
- (9) **Factory expenses :** Rent of the factory, insurance of the factory, salary to the works manager, and salary of the foreman, are direct expenses and are taken to trading account.
- (10) **Packing materials and charges :** Packing charges essential to bring goods to a saleable state are treated as direct expenses to be charged to trading account. Packing made for the sale of goods is charged to profit and loss account. Packing of cigarettes in the packets of ten, or twenty is an essential charge for bringing into saleable condition and should be taken to trading account.

(11) **Consumable stores** : Consumable stores include engine-oil, cotton-waste, grease, soap-etc. They are required to keep the machine in workable condition. They are essential for production and are taken to trading account.

Closing Journal Entries :

The preparation of the Trading Account requires that accounts of all items due to appear therein are incorporated by transferring their balances into the Trading Account. The entries required for such transfer are called closing entries. The various closing journal entries are based upon the trial balance and can be summarised and grouped in two entries as under :

| | |
|---------------------------------------|-----|
| 1. Trading A/c | Dr. |
| To Opening Stock | |
| To Purchases A/c | |
| To Wages A/c | |
| To Carriage or Cartage or Freight A/c | |
| To Coal, Gas and Power A/c | |
| To Manufacturing Expenses A/c | |
| 2. Sales A/c | Dr. |
| Closing Stock A/c | Dr. |
| To Trading A/c | |

As stated above, the trading account is prepared in 'T' shape. It has debit and credit sides. The excess of the credit side over the debit side shows a gross profit, which is transferred from trading account to Profit and Loss Account.

| | |
|---|-----|
| (a) Trading A/c | Dr. |
| To Profit and Loss A/c | |
| (Being transfer of gross profit to profit and loss account) | |

If the debit side of trading account exceeds the credit side, the excess is supposed to be gross loss and transferred to Profit and Loss Account. A reverse entry will be made for the transfer of Gross Loss.

Illustration 12.6 :

The following information has been obtained from the books of Manav Bros. as on 31st March, 2015. Pass Closing Journal Entries and prepare Trading Account :

| | Rs. | | Rs. |
|---|--------|------------------------|-------|
| Opening Stock | 7,000 | Sales Return | 400 |
| Gross Sales | 18,000 | Manufacturing Expenses | 100 |
| Purchases Returns | 200 | Octroi | 500 |
| Wages Paid | 2,000 | Motive Power | 700 |
| Carriage Inward | 300 | Total Purchases | 8,000 |
| Closing stock (at 31st March, 2015 was Rs. 4,200) | | | |

Solution :

Book of Manav Bros. Closing Journal Entries

| Date | Particulars | L.F. | Amount | |
|-----------------|--|------------|-----------------|--|
| | | | Debit | Credit |
| 2015 Mar. 31 | Trading A/c To Opening Stock To Purchases To Wages To Carriage Inward To Manufacturing Expenses To Octroi To Motive Power (Being transfer of accounts of debit balance to trading Account) | Dr. | Rs. 18,600 | Rs. 7,000 8,000 2,000 300 100 500 700 |
| Mar. 31 | Purchases Return A/c To Purchases A/c (Being transfer of purchases return to purchases account) | Dr. | 200 | 200 |
| Mar. 31 | Sales A/c Closing Stock A/c To Trading A/c (Being transfer of sales and closing stock to the credit side of trading account) | Dr. Dr. | 18,000 4,200 | 22,200 |
| Mar. 31 | Sales A/c To Sales Return A/c (Being transfer of sales return to sales account) | Dr. | 400 | 400 |

Trading Account of Manav Bros.

| Dr. | | | | Cr. | |
|-------------------------------------|------------|---------------------|------------|--------|--|
| for the year ended 31st March, 2015 | | | | | |
| Particulars | Amount Rs. | Particulars | Amount Rs. | | |
| To Opening Stock | 7,000 | By Sales | 18,000 | | |
| To Purchases | 8,000 | Less : Sales Return | 400 | | |
| Less : Return | 200 | By Closing Stock | 4,200 | | |
| To Wages | 2,000 | | | | |
| To Carriage Inward | 300 | | | | |
| To Manufacturing expenses | 100 | | | | |
| To Octroi | 500 | | | | |
| To Motive power | 700 | | | | |
| To Gross Profit transferred | 3,400 | | | | |
| Profit & Loss A/c | | | | | |
| | 21,800 | | | 21,800 | |

Note : Gross profit is the balancing figure, i.e., excess of credit side over the debit side. It will be transferred to the credit of Profit and Loss Account.

Manufacturing Account :

A Manufacturing account is necessary to be prepared in a business where manufacturing work is carried on. Thus, a firm engaged in a manufacturing business also, prepares, (i) Manufacturing A/c, (ii) Trading A/c, (iii) Profit and Loss A/c. Where more than one articles are manufactured, a separate manufacturing account for each type of article will indicate the profit or loss in manufacturing each item of production. The following proforma will illustrate this Account :

Manufacturing Account of.....

Dr. for the year ending Cr.

| Particulars | Rs. | Particulars | Rs. |
|----------------------------------|-----|----------------------------------|-----|
| To Opening Work-in-progress | | By Sale of Scrap | |
| To Raw material consumed or used | | By Closing Work-in-progress | |
| Opening stock | | By Cost of Production or manu- | |
| Add : Purchases of material | | facturing transferred to Trading | |
| Add : Cartage Inwards | | Account | |
| Add : Freight Inwards | | | |
| Less : Return Inwards | | | |
| Less : Closing Stock | | | |
| To Wages | | | |
| To Salary of Works Manager | | | |
| To Power, Electricity & Water | | | |
| To Fuel (coal, gas etc.) | | | |
| To Depreciation on : | | | |
| Plant & Machinery | | | |
| Factory Land & Buildings | | | |
| To Repairs to : | | | |
| Plant & Machinery | | | |
| Factory Land & Buildings | | | |
| To Insurance | | | |
| Plant & Machinery | | | |
| Factory Land & Buildings | | | |
| To Rent & Taxes of Factory | | | |
| To General Expenses of Factory | | | |
| To Royalty based on production | | | |

Difference between Manufacturing Account and Trading Account :

A manufacturing account can be differentiated with a Trading Account as under :

(1) Purpose : A manufacturing account is prepared to ascertain the cost of goods manufactured while a Trading Account is prepared to ascertain the amount of gross profit or gross loss.

(2) Closure : The balance of Manufacturing Account is transferred to Trading Account while the balance of Trading Account is transferred to Profit and Loss Account.

(3) Sale of Scrap : Sale of scrap is not shown in the Trading Account but it is shown on the credit side of Manufacturing Account.

(4) Opening and Closing Stock of Finished Goods : These stocks are not to be shown in In Manufacturing Account, while they are to be shown in Trading Account.

(5) Size and Status : Trading Account is a part of Profit and Loss Account while Manufacturing Account is a part of Trading Account.

Illustration 12.7 :

On 31st March, 2015 the Trial Balance of Mr. Bhanu Pratap was as follows :

| Debit Balances | Rs. | Credit Balances | Rs. |
|--|----------|------------------------------|----------|
| Stock on 1st April 2014 : | | | |
| Raw Materials | 21,000 | Sundry Creditors | 15,000 |
| Work in Progress | 9,500 | Bills Payable | 7,500 |
| Finished goods | 15,500 | Sale of Scrap | 2,500 |
| Sundry Debtors | 24,000 | Commission | 450 |
| Carriage on Purchase | 1,500 | Provision for Doubtful Debts | 1,650 |
| Bills Receivable | 25,000 | Capital Account | 1,00,000 |
| Wages | 15,000 | Sales (Net) | 1,67,200 |
| Salaries | 10,000 | Current Account of Bhanu | 18,500 |
| Telephone, Postage etc. | 1,000 | | |
| Repairs to Plant | 1,100 | | |
| Repairs to office furniture and fittings | 350 | | |
| Purchases | 85,000 | | |
| Cash at Bank | 17,000 | | |
| Plant and Machinery | 70,000 | | |
| Office Furniture | 8,000 | | |
| Rent and Rates | 6,000 | | |
| Lighting and heating | 1,350 | | |
| General Expenses | 1,500 | | |
| | 3,12,800 | | 3,12,800 |

The following additional information is available :

(a) Stock on 31st March, 2015 Raw materials Rs. 16,200; Finished goods Rs. 18,100, Semi-finished goods Rs. 7,800.

(b) Machinery is to be depreciated by 10% and Furniture by 7.5%

(c) Provision for Doubtful Debts is to be maintained @ 1% on Sales.

(d) Office Premises occupy 1/4 of total area. Lighting is to be charged as to 2/3 to Factory and 1/3 to Office.

Prepare the Manufacturing Account and Trading Account for the year ended 31st March, 2015.

Solution :

Manufacturing Account of Mr. Bhanu Pratap
for the year ended 31st March, 2015

| Particulars | Rs. | Particulars | Rs. |
|-------------------------------|----------|-------------------------------|----------|
| To Work in Progress (Opening) | 9,500 | By Work in Progress (Closing) | 7,800 |
| To Materials consumed : | | By Sale of Scrap | 2,500 |
| Opening Stock | 21,000 | By Cost of Goods | |
| Add : Purchases | 85,000 | manufactured transferred to | |
| | 1,06,000 | trading account | |
| Less : Closing Stock | | (Balancing figure) | 1,19,000 |
| of material | 16,200 | | |
| To Wages | 89,800 | | |
| To Carriage on Purchases | 15,000 | | |
| To Repairs to Plant | 1,500 | | |
| To Rent & Rates (3/4) | 1,100 | | |
| To Lighting & heating (2/3) | 4,500 | | |
| To Depreciation on Plant | 900 | | |
| | 7,000 | | |
| | 1,29,300 | | 1,29,300 |

Trading Account

| Particulars | Rs. | Particulars | Rs. |
|------------------------------------|----------|------------------------------------|----------|
| To Opening Stock of Finished goods | 15,500 | By Sales | 1,67,200 |
| To Cost of Goods Manufactured | 1,19,000 | By Closing Stock of Finished goods | 18,100 |
| To Gross Profit c/d | 50,800 | | |
| | 1,85,300 | | 1,85,300 |

Profit and Loss Account

Profit and Loss Account is the second part of the Trading and Profit and Loss Account. After ascertaining gross profit, management of a business will be interested in knowing the net income earned, or net loss incurred, at the end of the accounting period. With this object in view, a Profit and Loss Account is prepared. Thus, the Profit and Loss Account is an account which is designed to highlight the net profit earned or net loss incurred by the business entity arising from its transactions during an accounting period. It contains all the items of revenue gains, losses and operating expenses relating to the accounting period.

Need or objects of Preparing Profit and Loss Account :

- The main purpose and importance of preparing a Profit and Loss Account is as under :
- (1) **Purpose** : The purpose of preparing profit and loss account is to ascertain the amount of net profit or net loss. This is the real profit available to the proprietor and credited to his Capital Account. The net profit is calculated after charging all indirect expenses. In case of net loss proprietor's capital account is debited or the Capital of the owner is reduced.
 - (2) **Comparison** : It is prepared to compare net profit or net loss of the current year with that of previous year(s) to know whether the performance of the business over the years is improving or declining.

(3) **Control** : It is prepared to guide in controlling expenses incurred on various items to improve profitability.

(4) **Provisions and Reserves** : The business has to maintain certain reserves and provisions to meet its future uncertainties which depends upon the net profit earned by it. Thus, it is necessary to prepare Profit and Loss Account, so the effective provision for uncertain future could be maintained.

(5) **Ratio between Net Profit and Sales** : By preparing Profit and Loss Account, this ratio is calculated and compared with the desired ratio and if there is any shortcoming, that will be removed. Similarly, it can also be compared with the ratio of previous years and may be used to improve future profitability.

(6) **Ratio between Expenses and Sales** : By preparing Profit and Loss Account, we can calculate ratios between individual expenses and sales and compare these with desired ratios and with the ratios of previous year(s). It will always be in the interest of the business that such ratio(s) should be kept minimum.

Proforma of the Profit and loss Account : The general proforma of the Profit and Loss Account is shown as under :

Profit and Loss Account of.....

Dr. Cr.
for the period ending on.....

| Particulars | Rs. | Particulars | Rs. |
|--|-----|------------------------------------|-----|
| To Gross Loss b/d | | By Gross Profit b/d | |
| To Salaries & Wages | | By Interest earned | |
| To Rent, Rates & Taxes | | By Commission earned | |
| To Fire Insurance Premium | | By Rent earned | |
| To Repairs & Maintenance | | By Profit on Sale of fixed assets | |
| To Depreciation on Fixed Assets | | By Income from Investments | |
| To Audit Fees | | By Sale of Scrap | |
| To Bank Charges | | By Miscellaneous Incomes | |
| To Legal Charges | | By Net Loss transferred to Capital | |
| To Miscellaneous Expenses | | Account | |
| To Discount Allowed | | | |
| To Carriage Outward | | | |
| To Freight Outward | | | |
| To Commission to Salesmen | | | |
| To Travelling Expenses | | | |
| To Entertainment Expenses | | | |
| To Sales Promotion Expenses | | | |
| To Advertising & Publicity Expenses | | | |
| To Bad Debts | | | |
| To Packing Expenses | | | |
| To Interest on Loan | | | |
| To Loss by Theft | | | |
| To Loss by Fire | | | |
| To Loss by Embezzlement | | | |
| To Net Profit transferred to Capital A/c | | | |

* Either Net Profit or Net Loss shall appear.

Contents :

The starting point of the Profit and Loss Account is the gross profit/gross loss brought down from the Trading Account. The other items shown in this account are those of expenses and losses as well as of incomes and gains. The other items of income or gain such as rent received, commission earned, interest received, etc. are shown on the credit side of the Profit and Loss Account. The expenses incurred in the administration of the business and in selling the goods and other revenue losses are shown on the debit side of the Profit and Loss Account.

According to Prof. Carter, "A Profit and Loss Account is an account into which all gains and losses are collected in order to ascertain the excess of gains over the losses or vice versa." It must be remembered that expenses relating to the owner or partners are not to be accounted for in the Profit and Loss Account of the firm. They are personal expenses and hence are transferred to the Drawings Account of the owner or the partners. These expenses are usually (i) Life Insurance Premium, (ii) Income-tax, and (iii) Household or Personal Expenses.

Debit Side of Profit and Loss Account :

(1) **Salaries** : Salaries are paid to employees of the business working in the office. The item 'Salaries and Wages' is treated as salaries and is debited to Profit and Loss Account. On the other hand, the item 'Wages and Salaries' is treated as wages and is debited to the Trading Account. The value of salaries paid in kind is also treated as indirect expense and is debited to Profit and Loss Account. Similarly, salaries paid to partners is an indirect expense, so it would be separately shown. As stated earlier, salaries paid to workers of the Factory, Works Manager, Production Engineer and Foreman is direct-expense and are debited to Trading Account.

(2) **Rent** : Rent of the office premises, shop, showroom etc. is an indirect expense and is debited to Profit and Loss Account. However, as stated earlier, rent of the factory building is a direct expense and is debited to Trading Account.

(3) **Interest** : The business has to pay interest on loan borrowed by it and interest on capital to partners, proprietor etc. It has also to pay interest on overdraft or bills over due. It is an indirect expense and is debited to Profit and Loss Account.

(4) **Commission** : The business has to avail of the services of the agents and brokers to sell its goods in the market. Such commission or brokerage paid to these agents are indirect expense and hence it should be debited to Profit and Loss Account. However, if it is paid on the purchase of goods, it will be direct expense and should be debited to Trading Account.

(5) **Carriage Outwards or Freight Outwards** : This is the amount paid by way of transportation charges in respect of goods sold. It is debited to the Profit and Loss Account. It may also be named as carriage or freight on sale. It should be noted that carriage inward is direct expense.

(6) **Bad Debts** : A debt which becomes irrecoverable is known as a bad debt. This is an item of loss for the business and appears on the debit side of the Profit and Loss Account.

(7) **Discount** : Discount is of two types—(a) Trade Discount; and (b) Cash Discount.

(a) **Trade Discount** : It is given on bulk sales. It is deducted from the amount of sales before it is recorded in the books. There is no further treatment of trade discount. Consequently, it will not appear in the Trial Balance. It is also known as off season discount, new year's discount bumper sale and festival discount etc.

(b) **Cash Discount** : It is allowed at the time or receiving payment. If the payment is made immediately or at an early date we may allow our debtors certain discount which is an indirect expense and should be debited to Profit and Loss Account.

(8) **Trade Expenses** : In addition to above, there are a number of expenses e.g. Printing and Stationery, Advertisement, Free samples, Insurance-Premium against Fire, Marine etc., and Sundry expenses, Miscellaneous expenses, Office expenses etc. So, all indirect expenses are also debited to Profit Loss Account.

(9) **Loss on Sale of Assets** : There may be loss on the sale of assets. This is a business loss and hence it should be debited to Profit and Loss Account. However, it should be noted that loss on sale of assets is not an operating loss. Thus, if operating net profit is to be calculated, such loss should be excluded from the debit side of Profit and Loss Account.

(10) **Other Losses** : Losses are the unwanted charge on profits in any business enterprise which it may be forced to bear. This type of losses may be loss by fire, loss by accident etc. So, such losses are also to be shown on the debit side of Profit and Loss Account.

Credit Side of Profit and Loss Account :

In addition to Gross Profit b/d from Trading Account, following miscellaneous incomes are shown on the credit side of Profit and Loss Account.

- (1) Rent received, Rent from tenant, Rent (Credit).
- (2) Interest received on fixed deposit, investments, loan advanced by the firm, interest (Credit), etc.
- (3) Discount received, Discount (Credit), Discount from Creditors.
- (4) Commission received.
- (5) Dividends received.
- (6) Compensation received.
- (7) Bad Debts previously written off, now recovered or bad debts recovered.
- (8) Dividends received on investments.
- (9) Profit from Sale of Assets.
- (10) Interest on Drawings, etc.

Expenses not to be shown in Profit and Loss Account :

Following expenses are not to be shown in the Profit and Loss Account :

(1) **Direct Expenses** : As stated earlier, all direct expenses add to the cost of goods purchased or manufactured, so they should be debited to Trading Account. It will be incorrect to debit these expenses to Profit and Loss Account.

(2) **Capital Expenditure** : Expenses incurred on acquiring assets are capital expenditure. These assets are shown at the assets side of Balance Sheet e.g. expenses incurred for purchases of land and building, plant and machinery, etc. or wages paid for construction of building or carriage paid for acquiring assets are capital expenditure. Such type of expenditure should not be shown at the debit side of Profit and Loss Account.

(3) **Income Tax** : Income tax is levied on the personal income of the proprietor, so it is deducted from capital on the liabilities side of Balance Sheet. Here, it is also to be noted that income tax charged from salaries of the employees as 'Tax deducted at source' is neither an income nor expense. So it is neither debited nor credited to Profit and Loss Account.

(4) **Private or Domestic Expenses** : These expenses are not business expenses, so they cannot be charged to Profit and Loss Account. These are the personal expense of the proprietor, so it will be known as drawings and deducted from capital at the liabilities side of balance sheet.

(5) **Life Insurance Premium** : The insurance premium has been paid on the personal life policy of the proprietor, so it is not a business expense. It should be treated as drawing and deducted from capital at the liabilities side of the balance sheet.

Closing Journal Entries :

For transfer of items regarding Profit and Loss Account from Trial Balance following closing journal entries are passed :

(1) For transfer of office, selling, distribution and financial expenses and losses to Profit & Loss Account :

| | | | |
|--|-----|--|--|
| Profit and Loss A/c | Dr. | | |
| To Sundry Expenses A/c | | | |
| To Salaries A/c | | | |
| To Rent A/c | | | |
| To Insurance A/c | | | |
| To Stationery A/c | | | |
| To Repairs A/c | | | |
| To Advertising A/c | | | |
| To Audit fee A/c | | | |
| To Depreciation A/c | | | |
| To Miscellaneous Indirect Expenses (Individually) | | | |
| (Being transfer of indirect expenses to the debit side of Profit and loss account) | | | |

(2) For transfer of sundry incomes :

| | | | |
|--|-----|--|--|
| Rent received A/c | Dr. | | |
| Discount received A/c | Dr. | | |
| Interest received A/c | Dr. | | |
| Commission received A/c | Dr. | | |
| Interest on drawings A/c | Dr. | | |
| Miscellaneous Income A/c | Dr. | | |
| (Individually) | | | |
| To Profit and Loss A/c | | | |
| (Being transfer of sundry income to Profit and Loss account) | | | |

(3) For transfer of Net Profit :

If the credit side of profit and loss account exceeds the debit side of profit and loss account the excess is assumed to be net profit and transferred to capital account.

| | | | |
|---|-----|--|--|
| Profit and Loss A/c | Dr. | | |
| To Capital A/c | | | |
| (Being transfer of net profit to capital account) | | | |

(4) For transfer of Net Loss :

Excess of the debit side of profit and loss account over the credit side is the net loss and transferred to capital account.

| | | | |
|---|-----|--|--|
| Capital A/c | Dr. | | |
| To Profit and Loss A/c | | | |
| (Being transfer of net loss to capital account) | | | |

Closure of or Transfer of Drawings Account :

Drawings of the proprietor/partners will be transferred to Capital Account by means of the following entry :

| | | | |
|-----------------|-----|--|--|
| Capital A/c | Dr. | | |
| To Drawings A/c | | | |

This will close the Drawing Account. This item relates to the Balance Sheet.

Illustration 12.8 :

From the following Trial Balance of Mr. Laxman pass the necessary closing entries and prepare Trading and Profit and Loss Account. Closing Stock on 31st March, 2015 valued at Rs. 15,380 :

| Debit Balances | | Credit Balances | |
|------------------------|--------|-------------------|--------|
| | Rs. | | Rs. |
| Opening Stock | 6,740 | Sales | 45,216 |
| Purchases | 24,395 | Purchases Return | 1,115 |
| Sales Return | 2,200 | Creditors | 6,200 |
| Carriage | 1,872 | Discount Received | 219 |
| Wages | 5,884 | Capital | 26,790 |
| Coal, Gas & Water | 4,286 | | |
| Manufacturing Expenses | 1,484 | | |
| Debtors | 6,790 | | |
| General Expenses | 689 | | |
| Salaries | 2,430 | | |
| Rent, Rates & Taxes | 2,191 | | |
| Cash in Hand | 807 | | |
| Cash at Bank | 11,472 | | |
| Drawings | 8,300 | | |
| | 79,540 | | 79,540 |

Solution :

Closing Entries

| Date | Particulars | L.F. | Dr. Cr. | |
|---------|--|------|---------|--------|
| | | | Amount | Amount |
| 2015 | | | Rs. | Rs. |
| Mar. 31 | Trading A/c Dr. | | 46,861 | |
| | To Stock A/c (Opening) | | | 6,740 |
| | To Purchases A/c | | | 24,395 |
| | To Sales Returns A/c | | | 2,200 |
| | To Carriage A/c | | | 1,872 |
| | To Wages A/c | | | 5,884 |
| | To Coal, Gas and Water A/c | | | 4,286 |
| | To Manufacturing Expenses | | | 1,484 |
| | (For Debit balances transferred to Trading Account) | | | |
| | Sales A/c Dr. | | 45,216 | |
| | Purchases Returns A/c Dr. | | 1,115 | |
| | To Trading A/c | | | 46,331 |
| | (For Credit balances transferred to Trading Account) | | | |
| | Closing Stock A/c Dr. | | 15,380 | |
| | To Trading A/c | | | 15,380 |
| | (For closing stock transferred to Trading A/c) | | | |
| | Trading A/c Dr. | | 14,850 | |
| | To Profit and Loss A/c | | | 14,850 |
| | (For Gross Profit transferred to P. & L. A/c) | | | |
| | Profit & Loss A/c Dr. | | 5,310 | |
| | To General Expenses A/c | | | 689 |
| | To Salaries A/c | | | 2,430 |
| | To Rent Rates and Taxes A/c | | | 2,191 |
| | (For balances of expenses and losses transferred to P. & L. A/c) | | | |
| | Discount Received A/c Dr. | | 219 | |
| | To Profit and Loss A/c | | | 219 |
| | (For discount received transferred to P. & L. A/c) | | | |
| | Profit & Loss A/c Dr. | | 9,759 | |
| | To Capital A/c | | | 9,759 |
| | (For Net Profit transferred to Capital A/c) | | | |
| | Capital A/c Dr. | | 8,300 | |
| | To Drawings A/c | | | 8,300 |
| | (For Drawings transferred to Capital A/c) | | | |

| Mr. Laxman's Trading and Profit & Loss Account for the year ended 31st March, 2015 | | | |
|--|------------|--------------------------|------------|
| Dr. | | Cr. | |
| Particulars | Amount Rs. | Particulars | Amount Rs. |
| To Opening Stock | 6,740 | By Sales | 45,216 |
| To Purchases | 24,395 | Less : Sales Return | 2,200 |
| Less : Purchases Return | 1,115 | By Closing Stock | 15,380 |
| To Carriage | 1,872 | | |
| To Wages | 5,884 | | |
| To Coal, Gas and Water | 4,286 | | |
| To Manufacturing Expenses | 1,484 | | |
| To Gross Profit transferred to P. & L. A/c | 14,850 | | |
| | 58,396 | | 58,396 |
| To Salaries | 2,430 | By Gross Profit b/d | 14,850 |
| To Rent, Rates & Taxes | 2,191 | By Discount Received A/c | 219 |
| To General Expenses | 689 | | |
| To Net Profit transferred to Capital A/c | 9,759 | | |
| | 15,069 | | 15,069 |

Balance Sheet :

After preparation of Manufacturing Account or/and Trading and Profit and Loss Account for ascertainment of the Profit or Loss, the businessman wants to know about the financial position of his business. A Balance Sheet is a statement which is prepared and presented for this purpose containing the assets and liabilities of a business enterprise on a given date. It shows the financial position of the business at the close of the accounting period. It is called a Balance Sheet because it is a sheet of balances of ledger accounts which are still open after the preparation of the Trading and Profit and Loss Account. This is also known as a Position statement. In a Balance Sheet, the total of all assets must be equal to the total of all liabilities and capital at a given date which is also supported by our accounting equation. Some important definitions of Balance Sheet may be quoted here as under :

A. Palmer has defined a Balance Sheet as follows : "The Balance Sheet is Statement at a given date showing on one side the trader's property and on the other hand possessions and the liabilities." According to Freeman, "A Balance Sheet is an itemwise list of the assets, liabilities and proprietorship of a business of an individual at a certain date."

The Committee on Terminology of American Institute of Certified Public Accountants (AICPA) has defined the Balance Sheet as, "a list of balances in the assets and liabilities accounts. This list depicts the position of assets and liabilities of a specific business at a specific point of time." Thus Balance Sheet is a mirror which reflects the true position of assets and liabilities on a particular date.

Characteristics of Balance Sheet : The Balance Sheet has the following characteristics or special features :

(1) **A Statement, not an Account** : A Balance Sheet is only a statement of Assets and Liabilities which has no debit side or credit side like an Account. However, it is an important part of the final accounts. The headings of the two sides of the Balance Sheet are 'Assets' and 'Liabilities'.

(2) **Particular Date, not for a Period** : A Balance Sheet shows the Assets and Liabilities of a business enterprise at the particular date on which it has been prepared. Even a single transaction would cause a change in the assets and liabilities of a business. Thus, it shows the position of assets and liabilities on a particular date and not for a particular period.

(3) **Proforma** : As stated above, it has no debit side or credit side, nor the words "To" and "By" are used before the names of accounts shown therein. The headings are 'Liabilities' and 'Assets'.

(4) **Summary of Balances** : A Balance Sheet is a summary of balances of accounts which have not been closed by transfer to the Trading and Profit and Loss Account.

(5) **Contents** : A Balance Sheet shows the nature and value of assets and the nature and amount of liabilities at a given date. It shows what the firm owes to others and also what others owe to the firm.

(6) **Verification** : According to the accounting equation, the total of Assets must be equal to Liabilities i.e. Creditors and Proprietor's Equity. If it is not equal, there is likely to be certain mistake.

Need of or objects of Preparing a Balance Sheet :

Balance Sheet is a vital part of final accounts. It has to be compulsorily prepared as per legal provisions. The need, purpose or importance of preparing a Balance Sheet is as under :

(1) **To Assess the Financial Position** : The main object of Balance Sheet is to assess the financial position of the firm. The short term and long term financial position of the firm can be assessed from the analysis of the Balance Sheet. A business is said to be financially sound, if its assets exceed its external liabilities.

(2) **To Ascertain Proprietary Ratio** : Proprietary Ratio shows the relationship between proprietor's funds and total assets. Proprietor's claim against business is said to be proprietor's fund i.e. Capital Reserves, Retained Earnings and Accumulated Profits etc. added to Proprietor's Capital which gives us Proprietor's fund. Balance Sheet provides requisite information to ascertain proprietary ratio.

(3) **To Maintain Ideal Current Ratio** : The ideal ratio between current assets and current liabilities is 2 : 1. If it is lesser than that the short term financial position of the firm cannot be said to be healthy. So, the Balance Sheet helps us in providing requisite information about the Current Assets and Current Liabilities.

(4) **To Ascertain Working Capital** : Working Capital is the excess of Current Assets over Current Liabilities. It should be sufficient to meet routine requirements of the business. Balance Sheet also helps to provide requisite information in this regard.

(5) **To Ascertain Sources and Uses of Funds** : For this purpose Funds Flow Statement is prepared. The total of inflow and outflow of funds is always equal. Balance Sheet helps in ascertaining sources from where additional funds have been obtained and where the funds have been applied.

(6) **To Compute Financial Ratios** : These ratios indicate the present and prospective financial position of the firm. Balance Sheet helps us in providing sufficient information for computation of short term and long term financial ratios.

Proforma of Balance sheet :

The general proforma of the Balance Sheet is given as under :

| Balance Sheet of Mr. | | | |
|---|---------------|---|---------------|
| as on | | | |
| De | Amount Rs. | Cr | Amount Rs. |
| Liabilities Current Liabilities Creditors Bills payable Bank overdraft Short term loans Fixed Liabilities Loan Mortgage Loan from financial institutions Debentures Capital <i>Add</i> : Net Profit <i>Less</i> : Drawings Reserves and Funds General Reserve Reserve Funds Employees Compensation fund | | Assets Current Assets Cash in hand Cash at bank Sundry Debtors or Book Debts Stock or Inventory Bills Receivable Short term Investment Investments Long term Investment Loans granted Fixed Assets Land and Building Freehold Premises Plant and Machinery Tools and Equipments or Loose Tools Furniture or Fixtures Goodwill Patents Trade mark Miscellaneous Expenses Advertisement Expenses Discount on Issue of Shares Discount on Issue of Debentures | |

Contents :

Its contents are those accounts which have not been closed till the preparation the Trading and Profit and Loss Account i.e. accounts of assets, liabilities and owner's equity are shown in the Balance Sheet either on the assets side or liabilities side, depending upon their nature. In our country, the right hand side of the Balance Sheet is called the 'Assets Side' and the left hand side is called the 'Liabilities Side'. It is worthwhile to note that account of Capital and Liabilities are shown on the left hand side, known as 'Liabilities'. Assets and other debit balances are shown on the right hand side, known as 'Assets'.

Assets Side of Balance Sheet :

Items which are generally shown on assets side of the Balance Sheet are explained as under :

1. **Liquid Assets** : These assets can be converted into cash easily e.g. Cash in Hand, Cash at Bank, Bills Receivable etc.

2. **Current Assets** : Those assets which are either in the form of cash or can be converted into cash within one year are termed as Current Assets. These assets are also called floating or circulating assets because their values go on changing many times even in a day. Thus, all liquid assets are Current Assets also. Examples of Current Assets are Cash in Hand, Cash at Bank, Debtors, Stock, Bills Receivable, Short Term Investments etc.

3. **Investments** : Investments represent the funds invested in Government Securities, Shares of a Company etc. Generally, they are shown at cost price. However, if, on the date of preparation of the Balance Sheet, their Market Price is lower than the Cost Price, a foot note to that effect may be given below the Balance Sheet.

4. **Fixed Assets** : Fixed Assets are those assets which are held on a long term basis to be used in the operation of business and not intended for sale. These assets increase the profit earning capacity of the business. The major part of Capital is blocked in these assets. Examples of these assets are Land and Building, Freehold Premises, Plant and Machinery, Loose Tools, Furniture of Fixtures, Intangible Assets are also shown under fixed assets, for example Goodwill, Patent, Trade mark, and Wasting Assets as Mines, Copyright and Leasehold Land, etc.

5. **Fictitious Assets (Miscellaneous Expenses)** : These Assets have got no real value such as Advertisement Expenses (deferred), Preliminary Expenses, Discount on Issue of Shares and Discount on Issue of Debentures, Underwriting Commission etc.

Liabilities Side of Balance Sheet :

Items which are generally shown on Liabilities side of the Balance Sheet are explained as under :

1. **Current Liabilities** : Liabilities, which are expected to be paid within one year and which are usually to be paid out of current assets are termed as Current Liabilities. Examples of Current Liabilities are Trade Creditors, Bills Payable, Bank Overdraft and Short Term Loans, etc.

2. **Fixed Liabilities or Long Term Liabilities** : Those liabilities which are paid after very long period or on the dissolution of the firm or not prior a period of one year are termed as Fixed Liabilities or Long Term Liabilities. In fact, Fixed Liabilities means long term funds of the business. Long term funds consists of long term loans and proprietor's funds. Examples of long term funds are loan from Financial Institutions as loans from IDBI, IBRD, IFC etc., Loans, Mortgages and Debentures etc. Similarly, examples of Proprietor's Fund are Capital Reserves and Funds and Accumulated Profits, etc.

3. **Capital** : It is the excess of assets over liabilities due to outsiders. It represents the amount originally contributed by the proprietor/partners which is further increased by adding profits and decreased by subtracting losses and drawings.

4. **Drawings** : Generally, proprietor withdraw money or takes away goods etc. for his personal use, which has the effect of reducing the balance of his Capital Account. As stated earlier, the balance of drawings account is transferred to his Capital Account. However, it is shown by way of deduction from Capital in the Balance Sheet on the liabilities side.

5. **Contingent Liabilities** : These are not the actual liabilities of the business on the date of preparing Balance Sheet. The word 'Contingent' means doubtful. Contingent liabilities are those liabilities which will be decided in future upon certain happenings of events. Examples of contingent

liabilities are (i) cases pending in the court of law regarding damages, (ii) amount of bills discounted, and (iii) guarantees undertaken, etc. Contingent liabilities are not shown in the Balance Sheet, as contingent liabilities may or may not prove to be actual liabilities, so they are mentioned in details as a footnote below the Balance Sheet. Contingent liabilities are shown in the footnote as a matter of convention of full disclosure.

Grouping and Marshalling of Assets and Liabilities :

The term 'grouping' means putting together items of a similar nature under common heading such as Trade Creditors, Sundry Debtors, Reserves and Surplus etc. and term 'marshalling' refers to the order in which the various assets and liabilities are shown in the Balance sheet. Assets and liabilities can be marshalled in two ways :

- (i) In the order of Liquidity, and
- (ii) In the order of Permanence, as under :

Order of Liquidity :

Assets can be shown in order of liquidity. Order of liquidity means the order which they can be converted into cash. The most liquid asset, i.e., cash in hand, is shown first. The least liquid asset, i.e., goodwill, is shown last. Similarly, the liabilities of business are arranged in order of urgency of payment. The one which is most urgent to be paid, i.e., short-term creditors, is shown first; the least urgent to be paid i.e. long term creditors, is shown last (See Illustration 12.9 below).

Order of Permanence :

Assets and liabilities can be shown in the order of permanence. Permanent assets and liabilities are shown first, followed by current assets and liabilities. This method is exactly the reverse of the first method given above. Business enterprises on the line of sole-proprietorship and partnership follow the first method to marshal their Balance Sheets. Joint stock companies prepare their balance sheets in order of permanence (See Illustration 12.9 below) :

Illustration 12.9 :

From the following information, prepare a Balance Sheet of Mr. Peters as at 31 March, 2015.
(a) In order of liquidity, and (b) In order of permanence :

| Names of Accounts | Amount Rs. | Names of Accounts | Amount Rs. |
|--------------------------|---------------|----------------------------------|---------------|
| Plant & Machinery | 1,00,000 | Furniture and Fixtures | 20,000 |
| Bills Payable | 3,000 | Bills Receivable | 2,000 |
| Sundry Debtors | 1,00,000 | Sundry Creditors | 99,000 |
| Bank Overdraft | 10,000 | Investments in Shares of P. Ltd. | 10,000 |
| Long-term Loan from Bank | 1,00,000 | Closing Stock | 85,000 |
| Capital | 2,00,000 | Buildings | 1,00,000 |
| Land | 10,000 | Goodwill | 10,000 |
| Drawings | 10,000 | Net Profit | 50,000 |
| Cash in Hand | 5,000 | Cash at Bank | 10,000 |

Solution : (a) Liquidity Order :

Balance Sheet of Mr. Peters
as on 31st March, 2015

| Liabilities | Amount Rs. | Assets | Amount Rs. |
|--------------------------------|---------------|-------------------------|---------------|
| <i>Current Liabilities :</i> | | <i>Current Assets :</i> | |
| Bank Overdraft | 10,000 | Cash in Hand | 5,000 |
| Bills Payable | 3,000 | Cash at Bank | 10,000 |
| Sundry Creditors | 99,000 | Bills Receivable | 2,000 |
| <i>Long-term Liabilities :</i> | | Sundry Debtors | 1,00,000 |
| Loan | 1,00,000 | Closing Stock | 85,000 |
| <i>Capital :</i> | | <i>Investments :</i> | |
| Opening Balance | 2,00,000 | Shares of X Ltd. | 10,000 |
| Add : Net Profit | 50,000 | <i>Fixed Assets :</i> | |
| | 2,50,000 | Furniture & Fixtures | 20,000 |
| Less : Drawings | 10,000 | Plant & Machinery | 1,00,000 |
| | 2,40,000 | Building | 1,00,000 |
| | | Land | 10,000 |
| | | Goodwill | 10,000 |
| | 4,52,000 | | 4,52,000 |

(b) In Permanence Order :

Balance Sheet of Mr. Peters
as on 31st March, 2015

| Liabilities | Amount Rs. | Assets | Amount Rs. |
|--------------------------------|---------------|-------------------------|---------------|
| <i>Capital :</i> | | <i>Fixed Assets :</i> | |
| Opening Balance | 2,00,000 | Goodwill | 10,000 |
| Add : Net Profit | 50,000 | Land | 10,000 |
| | 2,50,000 | Buildings | 1,00,000 |
| Less : Drawings | 10,000 | Plant & Machinery | 1,00,000 |
| | 2,40,000 | Furniture & Fixtures | 20,000 |
| <i>Long-term Liabilities :</i> | | <i>Investments :</i> | |
| Long-term Loan | 1,00,000 | Share of X Ltd. | 10,000 |
| <i>Current Liabilities :</i> | | <i>Current Assets :</i> | |
| Sundry Creditors | 99,000 | Closing Stock | 85,000 |
| Bills Payable | 3,000 | Sundry Debtors | 1,00,000 |
| Bank Overdraft | 10,000 | Bills Receivable | 2,000 |
| | | Cash at Bank | 10,000 |
| | | Cash in Hand | 5,000 |
| | 4,52,000 | | 4,52,000 |

Difference between Trial Balance and Balance Sheet :

The following are the main points of difference between Trial Balance and Balance Sheet :

| Point of Difference | Trial Balance | Balance Sheet |
|--|---|--|
| 1. Object | It is prepared to check the arithmetical accuracy of the posting of transactions to ledger. | It is prepared to know the financial position of the business enterprise on a given date. |
| 2. Periodicity | It can be prepared frequently. It may be prepared at the end of accounting yearly, quarterly, monthly, half-yearly, fortnightly, etc. | It is usually prepared at the end of an accounting period. |
| 3. Compulsion | It is desirable to prepare, though its preparation is not compulsory. | The preparation of Balance Sheet is a must. It is an integral part of final accounts and its preparation is compulsory. |
| 4. Closing Stock | Trial Balance does not furnish information regarding closing stock. | In a Balance Sheet the Closing Stock appears on the assets side. |
| 5. Opening Stock | It appears in the Trial Balance. | It does not appear in the Balance Sheet. |
| 6. Headings | The headings of the two columns are 'debit balances' and 'credit balances'. | The headings of the two sides are 'Liabilities' and 'Assets'. |
| 7. Types of Accounts | All types of accounts find their place in the Trial Balance. | In a Balance Sheet account of assets, liabilities, capital and those accounts which have still remained open on the date of preparation of Balance Sheet, are shown. |
| 8. Net Profit or Net Loss | Information about net profit or net loss is not provided by the Trial Balance. | In the Balance Sheet, information about net profit earned or net loss incurred is provided. |
| 9. Items of Adjustments (e.g. Outstanding Expenses etc.) | It can be prepared without incorporating the items of adjustments. | It cannot be prepared without incorporating the items of adjustments. |
| 10. To be used as Evidence | It cannot be produced as documentary evidence in the court of law. | It can be produced as documentary evidence in the court of law, before the taxation authorities and Banks etc. |

Illustration 12.10 :

Prepare a Trial Balance, Trading and Profit and Loss Account for the year ended 31st March 2015 and Balance Sheet of the Arihant Trading Company as on that date, from the following extracts of ledger balances and additional information given below :

| | Rs. |
|---------------------------|----------|
| Prateek's Capital Account | 1,19,400 |
| Drawings Account | 10,550 |
| Bills Receivable | 9,500 |
| Plant and Machinery | 28,800 |
| Wages (Productive) | 40,970 |
| Salaries to Office staff | 11,000 |
| Sundry Debtors | 62,000 |
| Sundry Creditors | 59,630 |
| Loan (Received) (Cr.) | 20,000 |
| Returns inward | 2,780 |
| Purchases | 2,56,590 |
| Sales | 3,56,430 |
| Commission received | 5,640 |
| Discount allowed | 5,870 |
| Rent and taxes | 5,620 |
| Stock on 1st April, 2014 | 89,680 |
| Travelling expenses | 1,880 |
| Insurance | 400 |
| Cash in hand | 530 |
| Bank Balance | 18,970 |
| Repairs and renewals | 3,370 |
| Bad debts written off | 3,620 |
| Fixtures & Fittings | 8,970 |

The following additional information is also available : Stock on hand on 31st March, 2015 was Rs. 1,28,960 :

Solution :

M/s Arihant Trading Company

Trial Balance for the year ending 31st March, 2015

| Name of the Account | Debit Balance | Credit Balance |
|-------------------------------|---------------|----------------|
| | Rs. | Rs. |
| Proprietor's Capital Account | | 1,19,400 |
| Proprietor's Drawings Account | 10,550 | |
| Bills Receivable | 9,500 | |
| Plant and Machinery | 28,800 | |
| Wages (Productive) | 40,970 | |
| Salaries to office staff | 11,000 | |
| Sundry Debtors | 62,000 | |
| Sundry Creditors | | 59,630 |
| Loan (Received) | | 20,000 |
| Returns Inward | 2,780 | |
| Purchases | 2,56,590 | |
| Sales | | 3,56,430 |
| Commission Received | | 5,640 |
| Discount allowed | 5,870 | |
| Rent and taxes | 5,620 | |
| Stock, 1st April, 2014 | 89,680 | |
| Travelling Expenses | 1,880 | |

| | | |
|----------------------|----------|----------|
| Insurance | 400 | |
| Cash in hand | 530 | |
| Bank Balance | 18,970 | |
| Repairs and Renewals | 3,370 | |
| Bad debts | 3,620 | |
| Fixtures & Fittings | 8,970 | |
| | 5,61,100 | 5,61,100 |

M/s Arihant Trading Co.
Trading Account and Profit & Loss Account

for the year ending 31st March, 2015

| Dr. | | Cr. | |
|---|---------------|------------------------|---------------|
| Particulars | Amount Rs. | Particulars | Amount Rs. |
| To Stock (Opening) | 89,680 | By Sales | 3,56,430 |
| To Purchases | 2,56,590 | Less : Returns inwards | 2,780 |
| To Wages | 40,970 | By Stock (closing) | 1,28,960 |
| To Gross Profit c/d (Bal. figure) (transferred to Profit & Loss A/c) | 95,370 | | |
| | 4,82,610 | | 4,82,610 |
| To Salaries of staff | 11,000 | By Gross Profit b/d | 95,370 |
| To Discount allowed | 5,870 | By Commission | 5,640 |
| To Rent and taxes | 5,620 | | |
| To Travelling expenses | 1,880 | | |
| To Insurance | 400 | | |
| To Repairs & renewals | 3,370 | | |
| To Bad debts | 3,620 | | |
| To Net Profit (Bal. figure) (transferred to Capital A/c) | 69,250 | | |
| | 1,01,010 | | 1,01,010 |

Balance Sheet
as on 31st March, 2015

| Liabilities | Amount Rs. | Assets | Amount Rs. |
|------------------------------|---------------|-------------------------|---------------|
| Current Liabilities : | | Current Assets : | |
| Sundry Creditors | 59,630 | Cash in hand | 530 |
| Fixed Liabilities | | Cash at bank | 18,970 |
| Loan | 20,000 | Bills Receivable | 9,500 |
| Capital : Balance | 1,19,400 | Sundry Debtors | 62,000 |
| Add : Net Profit | 69,250 | Stock (Closing) | 1,28,960 |
| | 1,88,650 | Fixed Assets : | |
| Less : Drawings | (10,550) | Plant & Machinery | 28,800 |
| | 1,78,100 | Fixtures & Fittings | 8,970 |
| | 2,57,730 | | 2,57,730 |

Illustration 12.11 :

Following Trial Balance is extracted from the books of a merchant for the year ended 31st March, 2015 :

| Particulars | Debit | Credit |
|---------------------------------|----------|----------|
| | Rs. | Rs. |
| Capital of Merchant | 1,00,000 | |
| Drawings of Merchant | 18,000 | |
| Sales | 1,00,000 | |
| Land & Buildings | | 15,000 |
| Furniture and fittings | | 7,500 |
| Motor vans | | 25,000 |
| Loan from Mohan @ 12% per annum | | 15,000 |
| Interest paid on Mohan's Loan | | 450 |
| Purchases | | 75,000 |
| Stock on 1st April, 2014 | | 25,000 |
| Stock on 31st March, 2015 | 32,000 | |
| Establishment Expenses | | 15,000 |
| Freight Inward | | 2,000 |
| Freight Outward | 1,000 | |
| Commission Received | 7,500 | |
| Sundry Creditors | 10,000 | |
| Sundry Debtors | | 28,100 |
| Bank Balance | | 20,500 |
| | 2,68,500 | 2,28,500 |

The accountant located the following errors but is unable to proceed any further :

(a) A totalling error in bank column of payment side of Cash Book whereby the column was undertotaled by Rs. 500.

(b) Interest on loan paid for the quarter ending 30th, September, 2014 Rs. 450 was omitted to be posted in the ledger. There was no further payment of interest.

You are required to set right the trial balance and to prepare the Trading and Profit and Loss Account for the year ending 31st March, 2015 and the Balance Sheet as on that date, after carrying out the balance of interest due on the loan and depreciation of furniture 10% motor van & 25% and land and building @ 2.5% is also to be provided for.

Solution :

The corrected trial balance is prepared as follows :

| Trial Balance of the Merchant as on 31st March, 2015 | | | |
|---|--------|---------------------|----------|
| Dr. | Rs. | | Cr. |
| Land & Buildings | 15,000 | Capital | 1,00,000 |
| Drawings | 18,000 | Loan from Ram @ 12% | 15,000 |
| Motor Vans | 25,000 | Sales | 1,00,000 |
| Furniture and Fittings | 7,500 | Commission received | 7,500 |

| | | | |
|--|----------|------------------|----------|
| Interest on loan from Mohan (Rs. 450 + 450) | 900 | Sundry Creditors | 10,000 |
| Purchases | 75,000 | | |
| Stock Opening | 25,000 | | |
| Establishment expenses | 15,000 | | |
| Freight inward | 2,000 | | |
| Freight outward | 1,000 | | |
| Sundry debtors | 28,100 | | |
| Bank balance Rs. (20,500 - 500) | 20,000 | | |
| | 2,32,500 | | 2,32,500 |

Trading and Profit and Loss Accounts
for the year ending 31st March, 2015

| Particulars | Amount Rs. | Particulars | Amount Rs. |
|---|---------------|------------------------|---------------|
| To Opening Stock | 25,000 | By Sales | 1,00,000 |
| To Purchases | 75,000 | By Closing Stock | 32,000 |
| To Freight inward | 2,000 | | |
| To Gross Profit c/d | 30,000 | | |
| | 1,32,000 | | 1,32,000 |
| To Freight outward | 1,000 | By Gross Profit | 30,000 |
| To Establishment Expenses | 15,000 | By Commission Received | 7,500 |
| To Interest on loan Rs. (1,800-450) | 1,350 | | |
| To Depreciation (6,250 + 375 + 750) | 7,375 | | |
| To Net Profit transferred to Capital A/c | 12,775 | | |
| | 37,500 | | 37,500 |

Balance Sheet
as on 31st March, 2015

| Liabilities | Amount Rs. | Assets | Amount Rs. |
|------------------------------|---------------|------------------------|---------------|
| Sundry Creditors | 10,000 | Cash at Bank | 20,000 |
| Loan from Mohan | 15,000 | Stock (closing) | 32,000 |
| Outstanding interest on loan | 450 | Sundry Debtors | 28,100 |
| Capital | 1,00,000 | Motor Van | 25,000 |
| Add : Net Profit | 12,775 | Less : Depreciation | 6,250 |
| | 1,12,775 | Land & Building | 15,000 |
| Less : Drawings | 18,000 | Less : Depreciation | 375 |
| | 94,775 | Furniture and Fittings | 7,500 |
| | | Less : Depreciation | 750 |
| | 1,20,225 | | 1,20,225 |

Illustration 12.12 :

The following trial balance is given for M/s Modi Sons for the year ended 31st March, 2015 for which you are required to prepare final accounts.

| Debit Balances | Amount Rs. | Credit Balances | Amount Rs. |
|------------------------|-----------------|--------------------------|-----------------|
| Stock Opening | 20,000 | Sundry Creditors | 15,000 |
| Gross Purchases | 75,000 | Purchase Returns | 3,000 |
| Sales Return | 8,000 | Gross Sales | 2,50,000 |
| Freight and Carriage | 7,500 | Commission | 3,300 |
| Wages and Salaries | 36,500 | Capital of the Owner | 1,70,000 |
| Manager's Salary | 12,000 | Interest on Bank Deposit | 2,000 |
| Repairs & Renewals | 1,200 | Bills Payable | 6,200 |
| Trade Expenses | 4,000 | | |
| Rent and Taxes | 24,000 | | |
| Cash in hand | 5,700 | | |
| Bills Receivable | 4,000 | | |
| Sundry Debtors | 55,000 | | |
| Plant and Machinery | 1,60,000 | | |
| Withdrawals (Drawings) | 16,600 | | |
| Bank Deposit | 20,000 | | |
| | 4,49,500 | | 4,49,500 |

Stock Closing on 31st March amounted to Rs. 2,50,000

Solution :

Trading and Profit and Loss Accounts
for the year ending 31st March, 2015

| Particulars | Amount Rs. | Particulars | Amount Rs. |
|--|-----------------|-----------------------------|-----------------|
| To Opening Stock (Opening) | 20,000 | By Sales | 2,50,000 |
| To Purchases | 75,000 | Less : Sales Return | 8,000 |
| Less : Purchase Returns | 3,000 | By Closing Stock | 25,000 |
| To Freight & Carriage | 7,500 | | |
| To Wages & Salaries | 36,500 | | |
| To Gross Profit c/d | 1,31,000 | | |
| | 2,67,000 | | 2,67,000 |
| To Salary of the Manager | 12,000 | By Gross Profit b/d | 1,31,000 |
| To Repairs & Renewals | 1,200 | By Commission | 3,300 |
| To Trade Expenses | 4,000 | By Interest on Bank Deposit | 2,000 |
| To Rent & Taxes | 24,000 | | |
| To Net profit transferred to Capital A/c | 95,100 | | |
| | 1,36,300 | | 1,36,300 |

Balance Sheet
as on 31st March, 2015

| Liabilities | Rs. | Assets | Rs. |
|------------------|-----------------|---------------------|-----------------|
| Bills Payable | 6,200 | Cash in hand | 5,700 |
| Sundry Creditors | 15,000 | Bills Receivable | 4,000 |
| Capital of Owner | 1,70,000 | Sundry Debtors | 55,000 |
| Add : Net profit | 95,100 | Closing Stock | 25,000 |
| | 2,65,100 | Bank Deposit | 20,000 |
| Less : Drawings | (16,600) | Plant and Machinery | 1,60,000 |
| | 2,48,500 | | 2,48,500 |

Illustration 12.14 :

Prepare Trading Account and Profit & Loss Account for the following balances of Rishabh Traders for the year ending 31st March, 2015 :

| Particulars | Rs. | Particulars | Rs. |
|-----------------------------|--------|---------------------------|----------|
| Carriage on Goods Purchased | 8,000 | Cash in Hand | 2,500 |
| Carriage on Goods Sold | 3,500 | Banker's A/c (Cr.) | 30,000 |
| Manufacturing Expenses | 42,000 | Motor Car | 60,000 |
| Advertisement | 7,000 | Drawings | 8,000 |
| Freight and Octroi | 4,400 | Audit Fees | 2,700 |
| Lighting & Heating | 6,000 | Plant and Machinery | 1,53,900 |
| Customer's A/c | 80,000 | Repairs to Plant | 2,200 |
| Supplier's A/c | 61,000 | Stock at the end | 76,000 |
| Duty and Clearing Charges | 5,200 | Purchases less Returns | 1,60,000 |
| Postage and Telegram | 800 | Commission on Purchases | 2,000 |
| Fire Insurance Premium | 3,600 | Incidental Trade Expenses | 3,200 |
| Patents and Copy Rights | 12,000 | Investments at Cost | 30,000 |
| Income Tax | 24,000 | Interest on Investments | 4,500 |
| Office Expenses | 7,200 | Capital of Rishabh | 1,00,000 |
| | | Sales Less Returns | 5,20,000 |
| | | Rent and Taxes | 12,000 |
| | | Discount Allowed | 2,700 |
| | | Discount on Purchases | 3,400 |

Solution :

Trading and Profit and Loss Accounts
for the year ending 31st March, 2015

| Particulars | Rs. | Particulars | Rs. |
|--------------------------------|-----------------|-------------------------|-----------------|
| To Purchases less returns | 1,60,000 | By Sales Less : Returns | 5,20,000 |
| To Commission on Purchases | 2,000 | | |
| To Carriage on goods purchased | 8,000 | | |
| To Manufacturing Expenses | 42,000 | | |
| To Freight and Octroi | 4,400 | | |
| To Duty & Clearing Charges | 5,200 | | |
| To Gross Profit c/d | 2,98,400 | | |
| | 5,20,000 | | 5,20,000 |

| | | | |
|--|----------|----------------------------|----------|
| To Carriage on goods sold | 3,500 | By Gross Profit b/d | 2,98,400 |
| To Advertisement Expenses | 7,000 | By Interest on Investments | 4,500 |
| To Lighting and Heating | 6,000 | By Discount on Purchases | 3,400 |
| To Postage & Telegram | 800 | | |
| To Fire Insurance Premium | 3,600 | | |
| To Office Expenses | 7,200 | | |
| To Audit Fees | 2,700 | | |
| To Repair to Plant | 2,200 | | |
| To Incidental Trade Expenses | 3,200 | | |
| To Rent and Taxes | 12,000 | | |
| To Discount Allowed | 2,700 | | |
| To Net Profit Transferred to Capital Account | 2,55,400 | | |
| | 3,06,300 | | 3,06,300 |

BALANCE SHEET
as on.....

| Liabilities | | Amount | Assets | | Amount |
|------------------------------|----------|----------|-------------------------|--|----------|
| | Rs. | Rs. | | | Rs. |
| Bankers A/c (Cr.) | | 30,000 | Cash in hand | | 2,500 |
| Supplier's A/c | | 61,000 | Customer's A/c | | 80,000 |
| Capital | 1,00,000 | | Closing Stock | | 76,000 |
| Add : Net Profit | 2,55,400 | | Investment at Cost | | 30,000 |
| | 3,55,400 | | Motor Car | | 60,000 |
| Less : Drawings | (8,000) | | Plant and Machinery | | 1,53,900 |
| | 3,47,400 | | Patents and Copy Rights | | 12,000 |
| Less : Income Tax (Drawings) | 24,000 | 3,23,400 | | | |
| | | 4,14,400 | | | 4,14,400 |

Note : (i) Discount on Purchases means discount allowed by Suppliers, (ii) Since Closing Stock is given in trial balance, it will be shown at only one place i.e. on asset side of Balance Sheet.

Test Questions

Very Short Questions & Answers : (Not exceeding 40 words)

Q.1. What is meant by Capital expenditure?

Ans. : Capital expenditure are those expenses which are incurred for acquiring or bringing into existence an asset or for expanding or improving or substantial replacement of an existing fixed asset or which adds to the earning capacity of the asset.

Q.2. What is meant by Revenue Expenditure?

Ans. : All such expenses which are to be incurred in general administration of business or in making and promoting sales and distributing the goods sold are called revenue expenditure

Q.3. What is the accounting treatment of capital expenditure?

Ans. : All capital expenditures are debited to the respective Assets accounts which are to be shown on the Asset side of Balance Sheet. These expenses are not shown on the debit side of Profit & Loss Account.

Q.4. Give two examples of Capital Expenditure.

Ans. : (i) Expenses incurred for instalation of new Machine.
(ii) Wages paid to workers to produce some tools to be used by the factory itself or to fix or erect a machine.

Q.5. What is meant by deferred revenue expenditure?

Ans. : Some revenue expenses may be incurred in such circumstances as may bring the benefit therefrom over a period of more than one year i.e. three to five years. These expenses are revenue expenses but of capital nature which are quite huge in amount. As such, the whole amount of expenditure is split and written off over certain period.

Q.6. What are financial statements?

Ans. : Financial statements are those statements which provide information about the Profitability and the financial position of the Business. The term financial statements include, (i) Balance Sheet, and (ii) Trading and Profit and Loss Account.

Q.7. What is a Trading Account?

Ans. : Trading Account is the first part of Trading and Profit & Loss Account. It is designed to show gross profit or gross loss arising as a result of trading activities of a Business or from activities of buying or selling of goods and services.

Q.8. What is Gross Profit?

Ans. : Gross profit is the excess of sales and closing stock over opening stock, net purchases and direct expenses. In other words, gross profit is the excess of sales of goods over cost of goods sold. Cost of goods sold is aggregate of opening stock, net purchases and direct expenses minus closing stock.

Q.9. What is Net Profit?

Ans. : Net Profit is the excess of total revenue earned by a business during a specific period over all expenses and losses incurred by a business enterprise during the same period.

Q.10. What is meant by Profit & Loss Account?

Ans. : Profit & Loss Account is the second part of Trading and Profit and Loss Account. It is an account which is designed to high light the net profit earned or net loss incurred by a business enterprise arising from its transactions during an accounting period.

Q.11. State five such expenses which are not to be shown in Profit & Loss Account.

Ans. : The following expenses are not to be shown in Profit and Loss Account of a business entity.

- Direct expenses which are added to Cost of goods sold.
- Expenses of capital nature.
- Income Tax, to be treated as drawing.
- Private or Domestic expenses of the owner.
- Life Insurance premium.

Q.12. What is meant by Balance Sheet.

Ans. : Balance sheet is a list of balances of assets and liabilities accounts. This list depicts the position of assets and liabilities of a specific business at a specific point of time. Thus it is a mirror which reflects the true position of assets and liabilities on a particular date.

Q.13. What is meant by grouping and marshalling of Assets and Liabilities?

Ans. : The term 'grouping' means putting together items of a similar nature under common heading, for example Sundry Creditors, Sundry Debtors, Reserves and Surpluses etc. The term 'marshalling' refers to the order in which various assets and liabilities are shown in the Balance Sheet.

Q.14. What is meant by 'Order of Liquidity' ?

Ans. : Order or liquidity means the order in which the assets are converted into Cash. The most liquid assets, cash in hand, Cash at Bank are shown first, and the least liquid asset line goodwill is shown last. Similarly, the liabilities of Business are arranged.

Q.15. What do you mean by order of Permanance?

Ans. : When permanent assets are liabilities of the Business and shown first, followed by current assets and current liabilities, it is called order of permanance.

Q.16. When does closing stock appear inside the Trial Balance?

Ans. : Generally closing stock is given outside the trial balance, but sometimes closing stock may be given inside the trial balance when the entry to incorporate closing stock in books has been passed. It would mean that closing stock must have been adjusted in purchases. As such, it will not be shown in Trading Account but will appear as an assets in Balance Sheet.

Q.17. What are fictitious assets?

Ans. : Fictions assets, also known as nominal assets from which no further benefit can be derived. These are not the assets in real terms but are shown on the assets side only for the purpose of transferring there to Profit & Loss A/c to be written off gradually.

Q.18. Give four examples of fictitious assets.

Ans. : Nominal Assets are :

- (i) Debit Balance of Profit & Loss Accounts.
- (ii) Heavy amount of Advertisement not yet written off.
- (iii) Discount on Issue of Shares and Debentures.
- (iv) Preliminary Expenses.

Short Questions and Answers : (Not exceeding 80 words)

Q.1. Differentiate Between Capital Expenditure and Revenue Expenditure.

Ans. : Capital Expenditure is that expenditure which is incurred for acquiring or bringing into existence an asset for long term use. Similarly any expenditure incurred for the expansion or improvement of fixed asset or for replacement of an existing fixed asset or which adds to the productivity or earning capacity of an asset are also called capital expenditure. Thus capital expenditure normally yields benefit over a long period.

On the otherhand, Revenue expenditure are all such expenditure which are incurred on general administration of business or in making sales. Thus these expenses are incurred for day to day

business operations. These are routine expenses are spent in ordinary course of business. These expenses yield benefit only in the year of their incurrence.

Q.2. Give five examples of capital expenditure.

Ans. : Examples of Capital Expenditure

- (i) Any expenditure incurred for the acquisition of a permanent asset.
- (ii) All such expenditure which results in extension or improvement of fixed assets.
- (iii) Expenditure incurred for the purchase, receipt and erection of a fixed asset.
- (iv) Expenditure incurred in connection with the acquisition of right to carry on business.
- (v) Expenditure in connection with the acquisition of Intangible Asset.

Q.3. Give five examples of Revenue Expenditure.

Ans. : Examples of Revenue Expenditure

- (i) Expenses incurred for the day-to-day running of the business, such as salary, wages, rent, electricity charges etc.
- (ii) Expenses incurred on purchase of stocks of material and finished goods to the extent these are used up during the year,
- (iii) Depreciation on fixed assets,
- (iv) Expenses incurred for the upkeep of fixed assets, such as repairs and maintenance expenses, legal expenses for defending the dispute for title etc.
- (v) Expenses incurred which yields benefits for the current year on lift, e.g. telephone, telegrams, stationery.

Q.4. Write short notes on Current Assets and Current Liabilities :

[BCA 2009]

Ans. : **Current Assets :** The term 'current assets' includes those assets which are either in the form of cash or can be converted into Cash within a period of 12 months, usually an Accounting year. These assets are also called floating or circulating assets since their values go on changing many times even in a day. Thus all liquid assets are current assets, for example Cash, Bank, Trade Debtors, Bills Receivable, Stock, Short term Investments, Prepaid Expenses etc.

Current Liabilities : The term 'Current Liabilities' include all those obligations which are expected to be paid within a period of 12 months, usually an Accounting year. Such liabilities are generally disposed off out of current assets. Examples of current liabilities are Bank overdraft, Trade Creditors, Bills Payable, Accrued Expenses and Short term loans.

Q.5. What is meant by Deferred Revenue Expenditure? Give some Examples.

Ans. : **Deferred Revenue Expenditure :** Some revenue expenses may be incurred in such circumstances as may bring the benefit herefrom over a period of more than one year i.e. three or four years. Infact such expenses are revenue expenses of capital nature which are very huge in amount. So instead of charging the whole amount of expenditure in the year of the actual expense, the expenditure is split and written off over certain period. Pickles and dunkerley, in their book accountancy have classified deferred revenue expenditure into four different types as under :

- (i) Expenditure wholly paid for in advance where no service has yet been rendered, necessitating its being carried forward.
- (ii) Expenditure partly paid in advance, where a proportion of the benefit has been derived within a period under review and the balance being as yet 'unused'.

- (iii) Expenditure in respect of service rendered which for any reason is considered as an asset, and
 (iv) Amounts representing losses of an exceptional nature.

Q.6. What is meant by Intangible assets? Give five examples of such assets.

Ans.: Intangible Assets are those assets which do not possess any physical existence. Such assets cannot be seen or felt. These cannot be touched. Examples of such assets are : Goodwill, Trade mark, Patents Prepaid Expenses, Copyright. These assets are also valuable assets. These assets helps the firm in earning profit as much as tangible assets. Hence both tangible and intangible assets are valuable assets and the value of intangible assets is based on the benefit and facility available to the business from time to time.

Q.7. Define Balance Sheet and give its characteristics.

[R.U. BCA 2009]

Ans.: A Balance sheet is a statement which is prepared and presented for the purpose of depicting the financial position of the Business. It contains the assets and liabilities of a business enterprise on a given date. It shows the financial position of the business at the close of the accounting period. It is called a Balance Sheet because it is a sheet of balances of ledger accounts which are still open after the preparation of the Trading and Profit and Loss Account. This is also known as a position statement. In a Balance Sheet the total of all assets must be equal to the total of all liabilities and capital at a given date which is also supported by our accounting equation.

Characteristics of Balance Sheet :

- (i) It is a statement and not an Account. Its two sides are Assets and Liabilities.
- (ii) Balance sheet shows the Assets and Liabilities on a particular date, not for a particular period.
- (iii) It is a summary of Balances of Accounts which are not closed.
- (iv) A Balance sheet shows the nature and value assets and also of liabilities.
- (v) The proforma of Balance Sheet does not bear 'To' and 'By' on debit and credit sides, which are called liabilities and Asset sides.

Q.7. What are the objectives of preparing a Balance Sheet.

[R.U. BCA 2009]

Ans.: Balance sheet is a vital part of final accounts. It has to be prepared compulsorily as per legal provisions. The following are the objectives of its preparation :

- (i) To assess the financial position, short term and long term, of the firm.
- (ii) To ascertain proprietary Ratio which shows relationship between proprietary fund and total assets.
- (iii) To maintain ideal current ratio of 2 : 1.
- (iv) To find out working capital of the Business which is excess of current assets over current liabilities.
- (v) To ascertain various sources and uses of or inflow or outflow of funds of a business entity.

Q.8. Show, by giving reasons, whether the following items of expenditure are capital or revenue :

- (1) Carriage paid on goods purchased.
- (2) Wages of workmen employed for installation of new Machinery
- (3) Replacement cost of a worn-out part of Plant.
- (4) Repairs of furniture purchased second-hand.
- (5) Damages paid on account of the breach of a contract to supply certain goods.

Ans.: (1) Revenue; (2) Capital; (3) Revenue; (4) Capital; (5) Revenue.]

Q.9. Suman Industries removed their works to a more suitable premises :

- (1) A sum of Rs. 7,750 was expended on dismantling, removing and re-installing Plant, Machinery and Fixtures.
- (2) Plant and Machinery which stood in the books at Rs. 8,500 included a machine at a book value of Rs. 2,700. This being obsolete was sold off at Rs. 450 and was replaced by a new machine which cost Rs. 4,400.
- (3) The freight and cartage on the new machine amounted to Rs. 450 and the erection charges cost Rs. 575.
- (4) A sum of Rs. 3,100 was spent on painting the new factory. State which item of expenditure would be charged to Capital and which to Revenue; give reasons.

Ans.: (1) Deferred Revenue; (2) Revenue Loss Rs. 2,250, Capital Expenditure Rs. 4,400; (3) Capital; (4) Revenue]

Q.10. Explain the term order of liquidity. List out the items of Assets and Liabilities in order of Reverse-liquidity.

Ans.: **Order of Liquidity :**

Assets can be shown in order of liquidity. Order of liquidity means the order which they can be converted into cash. The most liquid asset, i.e., cash in hand, is shown first. The least liquid asset, i.e., goodwill, is shown last. Similarly, the liabilities of business are arranged in order of urgency of payment. The one which is most urgent to be paid, i.e., short-term creditors, is shown first; the least urgent to be paid i.e. long term creditors, is shown last. Order of Reverse Liquidity is as under :

Ans.: **Order of Reverse Liquidity :**

| Liabilities | Assets |
|--|--|
| Capital : Opening Balance of Capital Add : Net Profit Less : Drawings Long-term Liabilities : Long-term Loan Institutional Loan Mortgage Current Liabilities : Sundry Creditors Bills Payable Bank Overdraft | Fixed Assets : Goodwill Land Buildings Plant & Machinery Furniture & Fixtures Investments : Share of X Ltd. Current Assets : Closing Stock Sundry Debtors Bills Receivable Cash at Bank Cash in Hand |

Q.11. Differentiate Between Trial Balance and Balance Sheet.

Ans.: Distinction Between Trial Balance and Balance Sheet.

The following are the main points of difference between Trial Balance and Balance Sheet :

| Point of Difference | Trial Balance | Balance Sheet |
|----------------------|---|--|
| 1. Object | It is prepared to check the arithmetical accuracy of the posting of transactions to ledger. | It is prepared to know the financial position of the business enterprise on a given date. |
| 2. Periodicity | It can be prepared frequently. It may be prepared at the end of accounting year, quarter, month, half-year, fortnight, etc. | It is usually prepared at the end of an accounting period. |
| 3. Compulsion | It is desirable to prepare, though its preparation is not compulsory. | The preparation of Balance Sheet is a must. It is an integral part of final accounts and its preparation is compulsory. |
| 4. Closing Stock | Trial Balance does not furnish information regarding closing stock. | In a Balance Sheet the Closing Stock appears on the assets side. |
| 5. Opening Stock | It appears in the Trial Balance. | It does not appear in the Balance Sheet. |
| 6. Headings | The headings of the two columns are 'debit balances' and 'credit balances'. | The headings of the two sides are 'Liabilities' and 'Assets'. |
| 7. Types of Accounts | All types of accounts find their place in the Trial Balance. | In a Balance Sheet account of assets, liabilities, capital and those accounts which have still remained open on the date of preparation of Balance Sheet, are shown. |

Q.12. Opening Stock Rs. 7,000; Sales Rs. 16,000; Carriage inward Rs. 1,000; Sales returns Rs. 1,000; Gross Profit Rs. 6,000; Purchases Rs. 10,000; and Purchases returns Rs. 900. Calculate the closing stock and the cost of goods sold.

Ans. : Ans. (a) We Know that
 Gross Profit = Net Sales - Cost of Goods Sold or
 Cost of Goods sold = Net Sales - Gross Profit
 = Rs. 15,000 - Rs. 6,000 or Rs. 9,000

Now, Cost of goods sold
 = Opening stock + Net Purchases + Direct Expenses - Closing Stock or
 Rs. 9,000 = Rs. 7,000 + (10,000 - 900) + 1,000 - x
 Or Rs. 9,000 = Rs. 17,100 - x or x = Rs. 17,100 - 9000 = Rs. 8,100

Q.13. Calculate Net Profit from the following information :

| | |
|---|--------|
| Capital as on April 01, 2014, | Rs. |
| Drawings made during the year | 20,500 |
| Fresh capital introduced during the year | 6,000 |
| Purchased a calculator for proprietor's son | 1,000 |
| Capital as on March 31, 2015 | 500 |
| | 32,500 |

Ans. : When opening and closing capitals are given, Net Profit is ascertained with the help of following equations.

Net Profit = Closing Capital + Drawings - (Opening Capital + Additional Capital) Or
 Net Profit = Rs. 32,500 + 6,000 + 500 - (Rs. 20,500 + 1,000)
 = Rs. 39,000 - Rs. 21,500 or Rs. 17,500.

Thus net profit = Rs. 17,500.

Q.14. From the following information, prepare a Profit & Loss Account for the year ending on 31st March, 2015 :

Gross Profit Rs. 1,27,000, Rent Rs. 14,000, Salary Rs. 30,000, Commission paid Rs. 14,000, Interest on Loan Rs. 10,000, Advertising Rs. 8,000, Discount received Rs. 6,000, Printing & Stationary Rs. 4,000, Legal Charges Rs. 10,000, Bad Debts Rs. 2,000, Depreciation Rs. 4,000, Interest received Rs. 8,000, Loss by fire Rs. 6,000.
 [Ans. : Net Profit Rs. 39,000]

Ans. : Profit & Loss Account
 Dr. for the year ended 31st March, 2015 Cr.

| Particulars | Amount Rs. | Particulars | Amount Rs. |
|----------------------------------|------------|----------------------|------------|
| To Rent paid | 14,000 | By Gross Profit b/d | 1,27,000 |
| To Salaries Paid | 30,000 | By Discount Received | 6,000 |
| To Commission Paid | 14,000 | By Interest Received | 8,000 |
| To Interest on Loan | 10,000 | | |
| To Advertising Exps. | 8,000 | | |
| To Printing & Stationery | 4,000 | | |
| To Legal Charges | 10,000 | | |
| To Bad debts | 2,000 | | |
| To Loss by fire | 6,000 | | |
| To Depreciation | 4,000 | | |
| To Net Profit c/d to Capital A/c | 39,000 | | |
| | 1,41,000 | | 1,41,000 |

(Ans. : Net Profit = Rs. 39,000).

Q.15. From the following information, prepare a Balance Sheet as at 31st March, 2015 (a) in order of liquidity and (b) in order of permanence :

Cash in hand Rs. 8,800; Cash at bank Rs. 20,000, Capital Rs. 3,40,000. Machinery Rs. 1,20,000. Furniture Rs. 39,200, Debtors Rs. 1,70,000. Creditors Rs. 60,000, Stock Rs. 54,000. Bills Payable Rs. 14,000, Prepaid Expenses Rs. 2,000.

[Ans : Total of Balance Sheet Rs. 4,14,000]

Ans. : Order of Liquidity

Order of Permanency

| Liabilities | Rs. | Assets | Rs. | Liabilities | Rs. | Assets | Rs. |
|---------------|----------|---------------|----------|--------------|----------|---------------|----------|
| Creditors | 60,000 | Cash | 8,800 | Capital | 3,40,000 | Furniture | 39,200 |
| Bills Payable | 14,000 | Bank | 20,000 | Bill Payable | 14,000 | Machinery | 1,20,000 |
| Capital | 3,40,000 | Debtors | 1,70,000 | Creditors | 60,000 | Prepaid Exps. | 2,000 |
| | | Stock | 54,000 | | | Stock | 54,000 |
| | | Prepaid Exps. | 2,000 | | | Debtors | 1,70,000 |
| | | Machinery | 1,20,000 | | | Bank | 20,000 |
| | | Furnitures | 39,200 | | | Cash | 8,800 |
| Total | 4,14,000 | | 4,14,000 | | 4,14,000 | | 4,14,000 |

Essay Type or Long Answers Questions :

- What do you understand by deferred revenue expenditure ? How are these items shown while preparing final accounts ? Give any four examples of such expenditure.
(See page nps. 12.3)
- What do you mean by closing entries ? Why are they passed ? Explain giving an example.
(See page nps. 12.12 and 12.20)
- Explain the rationale of preparing a Balance sheet. How does it differ from a Trial Balance.
(See page nps. 12.23 and 12.24)
- How would you treat the following items while preparing final accounts : (a) Returns in and return out; (b) Carriage; (c) Freight; (d) Wages and Salaries; (e) Salaries and Wages; (f) Commission; (g) Discount : Trade and Cash; (h) Rent; (i) Interest on capital and on drawings; (j) Apprenticeship premium; (k) Bad debts.
(See page nps. 12.11 and 12.12)

Numericals :

- Q.1. State with reasons whether the following items are of Capital or Revenue nature :
- An old motor car whose book value was Rs. 80,000, was sold for Rs. 90,000. The cost of its purchase was Rs. 85,000.
 - Spent Rs. 12,000 as legal expenses to stop abuse of Trade Mark.
 - Received Rs. 5,00,000 from the issue of Equity Shares of the Company and the expenses on issue of shares were Rs. 20,000.
 - Got a school building constructed for the children of the employees at a cost Rs. 10,00,000.
 - Land purchased for agricultural farm with Rs. 3,00,000 and its annual land revenue charges were Rs. 3,000.
 - Spent Rs. 40,00,000 in the construction of Railway Sidings.

- Ans. : (i) Rs. 90,000 is Capital Receipt, Rs. 5,000 Capital Profit, Rs. 5,000 Revenue Profit.
(ii) Any expenditure incurred for maintaining a fixed asset is of Revenue nature.
(iii) Amount received by issue of share capital is Capital Receipt since it increases Capital of business and cost or expenses on issue are capital expenditure.
(iv) Capital expenditure since fixed asset is created.
(v) Purchase of Land (fixed asset) is capital expenditure and annual charges is revenue expense.
(vi) Capital expenditure since fixed assets is created.

Q.2. State with reasons whether the following items are of Capital or Revenue nature.

- Sale of milk, butter and dung by a Dairy.
- Legal expenses incurred in recovering money from debtors.
- Premium paid for purchasing a leasehold property.
- Research and Development expenses leading to Patent of a new product.
- Expenditure incurred on Research and Development for a new product which resulted in a failure.
- Received capital subsidy from Central Government.
- Donation given for the Building of Rajasthan Chamber of Commerce.
- Obsolescence loss pertaining to a fixed asset.
- Labour Welfare Expenses Rs. 20,000.
- Air-conditioning expenditure on office building Rs. 50,000.

[Ans : (1) Revenue Receipt, (2) Revenue Expense, (3) Capital Expenditure, (4) Capital Expense, (5) Deferred Revenue Expense, (6) Capital Income, (7) Revenue Expense, (8) Revenue loss (if amount is large it will be deferred revenue expense), (9) Revenue expense, (10) Capital expenditure.]

Q.3. The Profit and Loss Account of Jaipur Stationers was prepared incorrect. You are required to rectify the errors and also to prepare a correct Profit & Loss Account :

Profit & Loss Account

| Dr. | | Cr. | |
|--------------------------------------|------------|------------------------|------------|
| For the year ending 31st March, 2015 | | | |
| Particulars | Amount Rs. | Particulars | Amount Rs. |
| To Gross Profit b/d | 43,900 | By Interest on Capital | 8,000 |
| To Salaries | 3,000 | By Rent Paid | 10,000 |
| To Rent Received | 4,000 | By Furniture | 25,000 |
| To Commission Received | 3,000 | By Bad Debts | 7,000 |
| To Trade Expenses | 4,000 | By Depreciation | 9,000 |
| To Advertisement | 5,000 | By Machinery | 30,000 |
| To Interest on Drawings | 6,000 | | |
| To Net Loss | 20,100 | | |
| | 89,000 | | 89,000 |

[Ans. : Net Profit Rs. 10,900]

Ans : Corrected Profit & Loss Account for the year ended 31st March, 2015

| Particulars | Amount Rs. | Particulars | Amount Rs. |
|------------------------------|------------|------------------------|------------|
| To Salaries | 3,000 | By Gross Profit b/d | 43,900 |
| To Trade Expenses | 4,000 | By Rent Received | 4,000 |
| To Advertisement | 5,000 | By Commission Received | 3,000 |
| To Interest Capital | 8,000 | By Int. on Drawings | 6,000 |
| To Rent paid | 10,000 | | |
| To Bad debts | 7,000 | | |
| To Depreciation | 9,000 | | |
| To Net Profit c/d to capital | 10,900 | | |
| | 56,900 | | 56,900 |

Q.4. From the following Balances, prepare final accounts of M/s Raman and Sons for the year ending 31st March, 2015 :

Salaries Rs. 5,400; Insurance Rs. 2,500; Cash Rs. 400; Purchases Rs. 84,170; Rent Received Rs. 3,150; Drawings Rs. 2,100; Bills Payable Rs. 3,900; Debtors Rs. 38,080; Stock (1.4.2014) Rs. 29,500; Bank overdraft Rs. 9,700; Carriage Rs. 2,200; Creditors Rs. 4,200; Trade expenses Rs. 4,900; Sales Returns Rs. 4,700; Machinery Rs. 12,000; Wages Rs. 45,000; Sales Rs. 1,47,200; Purchases Returns Rs. 3,900; Capital Rs. 58,900; Closing Stock (31.3.2015) Rs. 36,200.

[Ans : G.P. Rs. 21,730; N.P. Rs. 12,080; B/S Total Rs. 86,680]

Ans : Trading and Profit & Loss Account for the year ended & 1st March, 2015

| Particulars | Amount Rs. | Particulars | Amount Rs. |
|-------------------------------------|------------|-----------------------|------------|
| To Opening Stock | 29,500 | By Sales Rs. 1,47,200 | |
| To Purchases Rs. 84,170 | | Less : S/R 4,700 | 1,42,500 |
| Less : P/R 3,900 | 80,270 | By Closing Stock | 36,200 |
| To Carriage 2,200 | | | |
| To Wages 45,000 | | | |
| To Gross Profit C/d 21,730 | | | |
| | 1,78,700 | | 1,78,700 |
| To Salaries 5,400 | | By Gross Profit b/d | 21,730 |
| To Insurance 2,500 | | By Rent Received | 3,150 |
| To Expenses 4,900 | | | |
| To Net Profit C/d to Capital 12,080 | | | |
| | 24,880 | | 24,880 |

Balance Sheet as at 31st March, 2015

| Liabilities | Amount Rs. | Assets | Amount Rs. |
|------------------|------------|----------------|------------|
| Bank Overdraft | 9,700 | Cash in hand | 400 |
| Sundry Creditors | 4,200 | Sundry Debtors | 38,080 |
| Bills Payable | 3,900 | Stock Closing | 36,200 |
| Capital | 58,900 | Machinery | 12,000 |
| Add : Net Profit | 12,080 | | |
| | 70,980 | | |
| Less : Drawings | (2,100) | | |
| | 68,880 | | |
| | 86,680 | | 86,680 |

Q.5. From the following information, prepare the final accounts for the year ending 31st March, 2015 :

| | Rs. | | Rs. |
|----------------------------------|--------|-------------------|----------|
| Cash in hand | 8,700 | Bills Receivable | 2,500 |
| Building | 40,000 | Furniture | 5,000 |
| Drawings | 4,000 | Capital | 61,700 |
| Creditors | 34,200 | Wages | 8,000 |
| Bad Debts | 1,000 | Debtors | 30,000 |
| Postage & Telegram | 400 | Misc. Expenses | 700 |
| Printing | 1,500 | Insurance | 2,200 |
| Discount allowed | 2,000 | Discount received | 1,000 |
| Carriage | 4,200 | Rent & Rates | 4,500 |
| Returns Outward | 2,300 | Stock (Opening) | 18,000 |
| Purchases | 70,000 | Returns Inward | 1,500 |
| Outstanding Expenses | 1,000 | Sales | 1,00,000 |
| Unsold Stock on 31st March, 2015 | | Bills Payable | 4,000 |
| Rs. 26,000, Market Price being | | | |
| Rs. 30,000 | | | |

[Ans : G.P. Rs. 26,600, N.P. Rs. 15,300, Total of B/S Rs. 1,12,200]

Hint for solution : Net Sales (1,00,000 - 1,500) = 98,500 + Closing Stock 26,000 = 1,24,500
 (-) [Rs. 18,000 + (70,000 - 2,300) 67,700 + 8,000 (Wages) + 4,200 (Carriage)] = 97,900
 Gross Profit 26,600

P & L A/c : Expenses are -
 Rs. 1,000 + 400 + 1,500 + 2,000 + 700 + 2,200 + 4,500 = 12,300

Net Profit : G.P. + Discount Received - Total expenses as above
 = Rs. 26,600 + 1,000 - 12,300 or Rs. 15,300

Balance Sheet as on 31st March, 2015

| Liabilities | Amount Rs. | Assets | Amount Rs. |
|-----------------------|------------|----------------|------------|
| Creditors | 34,200 | Cash in hand | 8,700 |
| Bills Payable | 4,000 | Sundry Debtors | 30,000 |
| Out standing Expenses | 1,000 | Stock Closing | 2,500 |
| Capital Rs. 61,700 | | Furniture | 26,000 |
| Add : Net Profit | 15,300 | Building | 5,000 |
| | 77,000 | | 40,000 |
| Less : Drawings | (4,000) | | |
| | 73,000 | | |
| | 1,12,200 | | 1,12,200 |

Q.6. The Trial Balance of M/s ABC & Sons shows the following balances as on 31.3.2015 :

| Debit Balances | Amount Rs. | Credit Balances | Amount Rs. |
|-----------------------|------------|-------------------|------------|
| Purchases | 60,000 | Capital Accounts | 1,13,075 |
| Sales Returns | 1,500 | Sales | 1,27,000 |
| Plant and Machinery | 90,000 | Purchases Returns | 1,275 |
| Opening Stock | 40,000 | Discount Received | 800 |
| Discount Allowed | 350 | Sundry Creditors | 25,000 |
| Bank Charges | 100 | | |
| Sundry Debtors | 45,000 | | |
| Salaries | 7,000 | | |
| Wages | 10,000 | | |
| Freight : In | 1,000 | | |
| Freight : Out | 1,200 | | |
| Rent, Rates and Taxes | 2,000 | | |
| Advertisement | 2,000 | | |
| Cash in Bank | 7,000 | | |
| | 2,67,150 | | 2,67,150 |

Closing Stock at Cost Rs. 35,000. Prepare final account for the year ended 31.3.2015.

[Ans : G.P. Rs. 50,775; N.P. Rs. 38,925; B/S Rs. 1,77,000]

Hint for solution : Freight In (Trading A/c), Freight Out (P&L A/c) Total of Trading A/c Rs. 1,60,500; total of P&L A/c = 50,775 + 800 or Rs. 51,575.

Q.7. From the following Trial Balance of M/s XYZ., prepare Trading Account, Profit & Loss Account for the year ending 31st March, 2015 and Balance Sheet as on that date :

| Name of Accounts | Debit Rs. | Credit Rs. |
|--------------------------------------|------------------|------------------|
| Drawings and Capital | | 2,50,000 |
| Purchases and Sales | 3,70,000 | 6,35,000 |
| Sundry Debtors | 37,000 | |
| Opening Stock | 87,000 | |
| Selling Expenses | 34,000 | |
| Bills Receivables and Bills Payables | 35,000 | |
| Bank Loan | 25,000 | 12,000 |
| Fire Insurance Premium | | 20,000 |
| Returns of goods | 2,000 | |
| Sundry Creditors | 4,000 | 2,000 |
| Factory Fuel and Power | | 70,000 |
| Salaries and Wages | 20,000 | |
| Discount Received | 43,000 | |
| Interest on Bank Loan | | 8,000 |
| Provision for Doubtful Debts | 7,000 | |
| Carriage Outwards | | 5,000 |
| Furniture | 5,000 | |
| Machinery | 72,000 | |
| Building | 1,20,000 | |
| Cash in Hand | 1,25,000 | |
| | 16,000 | |
| Closing stock Rs. 70,000 | | |
| Total | 10,02,000 | 10,02,000 |

[Ans : Gross Profit Rs. 2,79,000; Net Profit Rs. 1,95,000; Total of B/S Rs. 5,15,000]

Hint : Net Sales Rs. 6,31,000 + Closing stock Rs. 70,000 = Rs. 7,01,000

Less : 34,000 + Net Purchases Rs. 3,68,000 + 20,000 = (4,22,000)

G.P. = 2,79,000

P&L A/c (Cr.) G.P. + Discount Received = Rs. 2,87,000

Total of Expenses = 92,000

Net Profit = 1,95,000

Rs.

Liabilities side : Capital 2,50,000 + 1,95,000 - 37,000 = 4,08,000

or Creditors + B/P + Bank Loan + Provision or B.D. + 1,07,000

(70,000 + 12,000 + 20,000 + 5,000) = 5,15,000

Current Assets : Rs. 16,000 + 87,000 + 25,000 + 70,000 = Rs. 1,98,000

Fixed Assets : Rs. 72,000 + 1,20,000 + 1,25,000 = 3,17,000

Total = 5,15,000

□□□

