



# 13

## FINANCIAL STATEMENTS – AN INTRODUCTION

In the previous lessons you have learnt how to record the business transactions in various books of accounts and posting into ledger. You have also learnt about balancing the account and preparing the trial balance. One of the most important purposes of accounting is to ascertain financial results, i.e., profit or loss of the business operations of a business enterprise after a certain period and the financial position of it on a particular date. For this certain financial statements are prepared which are termed as income statement (i.e. Trading and Profit & Loss Account) to know what the business has earned during a particular period and the Position Statement (i.e. Balance Sheet) to know the financial position of the business enterprise on a particular date.

In this lesson you will learn about the financial statements that are prepared by a business unit for profit.



### OBJECTIVES

After studying this lesson you will be able to :

- explain the meaning and the objectives of financial statements;
- classify the financial statements into Trading and Profit & Loss Account and Balance Sheet;
- distinguish between capital expenditure and revenue expenditure, capital receipts and revenue receipts;
- explain the purpose of preparing Trading Account and Profit and Loss Account;
- draw the format of Trading Account and Profit and Loss Account;
- explain the Balance Sheet.

**Notes****13.1 FINANCIAL STATEMENTS : MEANING AND OBJECTIVES**

When a student has studied for a year, he/she wants to know how much he/she has learnt during that period. Similarly, every business enterprise wants to know the result of its activities of a particular period which is generally one year and what is its financial position on a particular date which is at the end of this period. For this, it prepares various statements which are called the financial statements.

Financial statements are the statements that are prepared at the end of the accounting period, which is generally one year. These include income statement i.e. Trading and Profit & Loss Account and Position statement i.e. Balance Sheet.

**Objectives of financial statements**

Financial statements are prepared to ascertain the profits earned or losses incurred by a business concern during a specified period and also to ascertain its financial position at the end of that specified period.

Financial statements are generally of two types (a) Income statement which comprises of Trading Account and Profit & Loss Account, and (b) Position Statement i.e., the Balance Sheet.

Following are the objectives of preparing financial statements: -

**1. Ascertaining the results of business operations**

Every businessman wants to know the results of the business operations of his enterprise during a particular period in terms of profits earned or losses incurred. Income statement serves this purpose.

**2. Ascertaining the financial position**

Financial statements show the financial position of the business concern on a particular date which is generally the last date of the accounting period. Position statement i.e. Balance Sheet is prepared for this purpose.

**3. Source of information**

Financial statements constitute an important source of information regarding finance of a business unit which helps the finance manager to plan the financial activities of the business and making proper utilisation of the funds.

**4. Helps in managerial decision making**

The Manager can make comparative study of the profitability of the concern by comparing the results of the current year with the results of the previous years and make his/her managerial decisions accordingly.

**5. An index of solvency of the concern**

Financial statements also show the short term as well as long term solvency of the concern. This helps the business enterprise in borrowing money from bank and other financial institutions and/or buying goods on credit.

**Capital Expenditure and Revenue Expenditure, Capital Receipts and Revenue Receipts**

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

Capital Expenditure refers to the expenditure incurred for acquiring fixed assets or assets which increase the earning capacity of the business. The benefits of capital expenditure to the firm extend to number of years. Examples of capital expenditure are expenditure incurred for acquiring a fixed asset such as building, plant and machinery etc.

Revenue expenditure, on the other hand, is an expenditure incurred in the course of normal business transactions of a concern and its benefits are availed of during the same accounting year. Salaries, carriage etc. are examples of revenue expenditure.

There is another category of expenditure called deferred revenue expenditure. These are the expenses incurred during one accounting year but are applicable wholly or in part in future periods. These expenditures are otherwise of a revenue nature. Example of deferred revenue expenditure are heavy expenditure on advertisement say for introducing a new product in the market, expenditure incurred on research and development, etc.

**Notes**



**Notes**

**Table 13.1** Difference between capital expenditure and revenue expenditure

<b>Basis of Difference</b>	<b>Capital Expenditure</b>	<b>Revenue Expenditure</b>
1. Purpose	It is incurred for acquiring of fixed assets.	It is incurred for the maintenance of fixed assets.
2. Earning capacity	It increases the earning capacity of the business.	It helps in maintaining the earning capacity of the business intact.
3. Periodicity of benefit	Its benefits are spread over a number of years.	Its benefits accrue only in one accounting year.
4. Placement in financial statements	It is an item of Balance Sheet and is shown as an item of asset.	It is an item of Trading and Profit and Loss Account and is shown on the debit side of either of the two.
5. Occurrence of expenditure	It is non-recurring in nature.	It is usually a recurring expenditure.

**Capital and Revenue Receipts**

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

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

**Table 13.2** Distinction between Capital Receipts and Revenue Receipts

<b>Basis of difference</b>	<b>Capital Receipt</b>	<b>Revenue Receipt</b>
Source	Receipts that do not arise during the normal course of business.	Receipts that arise during the normal course of business.
Nature	These are of capital nature and hence are not treated as items of income of the business.	These are of revenue nature and hence are treated as items of income of the business.
Occurrence	These are of non-recurring in nature.	These are recurring in nature.



**INTEXT QUESTIONS 13.1**



**Notes**

- I. Classify the following items of expenditure into capital expenditure revenue expenditure and deferred revenue expenditure
  - (i) Amount spent on purchase of Machine.
  - (ii) Expenditure incurred on repairs of building.
  - (iii) Heavy expenditure on advertisement to introduce a new product in the market.
  - (iv) Purchase of Motor Vehicle for business use.
  
- II. One important objective of financial statements is to ascertain the results of business operations. List the other objectives of the financial statements :
  - (a) .....
  - (b) .....
  - (c) .....
  - (d) .....

**13.2 TRADING ACCOUNT**

Income statement consists of Trading and Profit and Loss Account. Let us first study the Trading Account. A business firm either purchases goods from others and sells them or manufactures and sells them to earn profit. This is known as trading activities. A statement is prepared to know the results in terms of profit or loss of these activities. This statement is called Trading Account.

Trading Account is prepared to ascertain the results of the trading activities of the business enterprise. It shows whether the selling of goods purchased or manufactured has earned profit or incurred loss for the business unit. Cost of goods sold is subtracted from the net sales of the business of that accounting year. In case the total sales value exceeds the cost of goods sold, the difference is called Gross Profit. On the other hand, if the cost of goods sold exceeds the total net sales, the difference is Gross Loss. All accounts related to cost of goods sold such as opening stock, net purchases i.e. purchase less returns outward, direct expenses such as wages, carriage inward etc. and closing stock with net sales (i.e. Sales minus Sales returns)

**Notes**

are taken to the Trading Account. Then this account is balanced. Credit balance shows the gross Profit and debit balance shows the gross loss.

It is necessary to understand the meaning of cost of goods sold before preparing Trading Account.

**Cost of goods sold and gross profit**

A business enterprise either purchases goods or manufactures goods to sell in the market. Cost of goods sold is computed to know the profit earned (Gross Profit) or loss incurred (Gross Loss) from the trading activities of a business unit for a particular period.

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

In case there is a stock of goods to be sold in the beginning of the year or at the end of the year, the cost of goods is calculated as follows :

$\text{Cost of goods sold} = \text{Opening stock} + \text{Net purchases} + \text{All direct expenses} - \text{Closing stock}$
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$\text{Gross Profit} = \text{Net sales} - \text{Cost of goods sold}$
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**Illustration 1**

Calculate the cost of goods sold from the following information :

	Rs
Opening stock	10000
Closing stock	8000
Purchases	80000
Carriage on purchases	2000
Wages	6600

**Solution :**

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

$$= \text{Rs. } [10000 + 80000 + 8600 \text{ (i.e. } 2000 + 6600) - 8000]$$

$$= \text{Rs. } 90600$$



**Illustration 2**

Calculate cost of goods sold and gross profit from the following information.

Sales	Rs. 62500
Sales Returns	Rs. 500
Opening Stock	Rs. 6400
Purchases	Rs. 32000
Direct Expenses	Rs. 4200
Closing Stock	Rs. 7200

**Notes**

**Solution :**

Net sales		Rs.
(Sales-Sales Returns i.e. 62500 – 500)		62000
Less : Cost of goods sold	Rs.	
Opening Stock	6400	
Add Purchases	32000	
Add Direct Expenses	4200	
Less Closing Stock	(7200)	35400
		26600

$$\begin{aligned} \text{Gross profit} &= \text{Net sales} - \text{cost of goods sold} \\ &= 62000 - 35400 = 26600 \end{aligned}$$

**Illustration 3**

From the following information for the year ending 31st March, 2006 furnished by Mr. Vikram, a trader, calculate cost of goods sold and also calculate Gross Profit/Gross Loss of business.

	Rs
Sales	120000
Purchases	80000
Octroi	1600
Carriage on purchases	4500
Purchase Returns	2400
Opening Stock	27600
Closing Stock	32400



**Notes**

**Solution :**

	Rs
<b>Cost of goods sold :</b>	
Opening stock	27600
Add Net Purchases	
(Rs 80000 – Rs 2400)	77600
Add carriage on Purchases	4500
Add Octroi	1600
Cost of goods available for sale	111300
Less closing stock	32400
Cost of goods sold	78900
<b>Gross Profit :</b>	<b>Rs</b>
Sales	120000
Less Cost of goods	
Sold	78900
Gross Profit	41100

**Need of Trading Account**

Trading Account serves the following purposes :

**1. Knowledge of Gross Profit**

Trading Account gives information about Gross Profit. It is the profit earned by a business enterprise from its trading activities. The percentage of gross profit on sales reflects the degree of success of business.

**2. Knowledge of All Direct expenses**

All direct expenses are taken to trading Account. Direct expenses are the expenses that can be directly attributed to purchase or manufacturing of goods for sale. Percentage of Direct expenses on sales of current year when compared with the same of previous years, helps the manager to exercise control over direct expenses.

**3. Precaution against future losses**

Trading Account, if shows gross loss, reasons for this loss can be found out and necessary corrective steps can be taken.





**Format of Trading Account**

**Trading Account  
for the year ending .....**

Dr.		Cr.	
Particulars	Amount Rs	Particulars	Amount Rs
Opening Stock		Sales	
Purchases		Less: Sales Returns	
Less Purchase Returns		Closing stock	
Direct Expenses :		Gross loss transferred to	
Carriage Inward		Profit & Loss Account	
Freight			
Wages			
Fuel & Power			
Excise Duty			
Factory Rent			
Heating & Lighting			
Factory Rent & Insurance			
Work Managers Salary			
Gross Profit transferred to Profit & Loss Account			

**Notes**

**Important items of Trading account**

Important items of Trading account are :

**1. Stock**

Stock refers to the goods lying unsold on a particular date. It can be of two types:

- (a) Opening stock and (b) Closing stock

(a) Opening stock

Opening stock refers to the value of goods lying unsold at the beginning of the accounting year. It is shown on the debit side of the Trading Account. In the first year of business there is no opening stock

(b) Closing Stock

It is the value of goods lying unsold at the end of the accounting year. It is valued at the cost price or market price whichever is less. It is shown on the credit side of the Trading Account.

**Notes****2. Purchases**

Purchases mean total items purchased for resale during the year. It can be both in cash and on credit. Purchases are shown on the debit side of the Trading account. These are always shown as net purchases i.e. amount of purchases returned (Purchase returns or return outwards) is deducted from the total amount of purchases made. Goods received on consignment basis are never treated as purchases. Similarly, goods received on 'sale or return' basis are never treated as purchases.

**3. Sales**

Sales refer to the total revenue from sale of goods of the business enterprise for which the Trading account is being prepared. It includes both cash sales and credit sales. These are recorded on the credit side of the Trading Account. Sales are shown at their net value i.e. sales return or returns inward is deducted from the total sales. Cash sales plus credit sales minus sales returns constitute net sales. Goods sent on 'sale or approval' are not part of sales until approval is received.

**4. Direct Expenses**

Direct expenses are the expenses that can be attributed directly to the purchase of goods or goods manufactured. These are shown on the debit side of the Trading Account. These are shown at the amount as shown in the Trial balance. For example, wages are recorded on the debit side of Trading Account at the amount shown in the Trial balance.

**Important items of direct expenses**

1. Wages i.e. wages relate to production. If amount under this head includes wages paid for construction of building or manufacturing of furniture for office it will be subtracted from the amount of wages.
2. Carriage Cartage Freight i.e. amount paid for carriage of goods purchased for sale or raw material purchased for manufacturing.
3. Other such direct expenses are customs and import duty, packing materials, gas, electricity water, fuel, oil, gas greese, heating and lighting, factory rent and insurance and many more such items.

**5. Gross Profit/Gross Loss**

It is the excess of net sales revenue over cost of goods sold. Gross Profit is equal to net sales minus cost of goods sold. If total of the credit side exceeds the total of debit side, the excess amount is termed as 'gross profit' and is shown

on the debit side of Trading Account. On the other hand if debit side is more than the credit side, the difference in amount is called gross loss and is shown on the credit side of the Trading Account.

$$\text{Gross profit} = \text{Net sales} - \text{Cost of goods sold}$$

$$\text{Gross loss} = \text{Cost of goods sold} - \text{Net sales}$$



Notes



**INTEXT QUESTION 13.2**

I. Fill in the blanks with suitable word/words :

1. Financial statements are generally of ..... Types.
2. Income statement comprises of ..... A/c and ..... A/c.
3. Trading Account is prepared to ascertain the ..... activities of the business.
4. The percentage of gross profit on sales reflects the degree of ..... of business.

II. Show the result in the following cases

- (a) Sales – sales return =
- (b) Purchases – purchases return =
- (c) Total of the credit column of trading Account – total of the debit column of trading A/c =
- (d) Total cost of goods sold – total sales =

**13.3 TRANSFER ENTRIES**

Before preparing Trading Account, closing transfer Journal entries are made in the Journal proper of the business enterprise. These journal entries are:

(a) For transferring debit balances

Trading A/c	Dr.
To Opening stock	
To Purchases	
To Direct expenses	
To Sales returns	

(Transfer of debit balances from trial balance)

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### Notes

(b) For transferring credit balances

Sales A/c	Dr.
Closing stock A/c	Dr.
Purchase Returns A/c	Dr.
To Trading A/c	

(Transfer of credit balances from trial balance)

(c) For transferring gross profit

Trading A/c	Dr
To Profit & Loss A/c	

(Transferring of gross profit)

(d) For transferring gross loss

Profit & Loss A/c	Dr.
To Trading A/c	

(Transferring of gross loss)

### Illustration 4

The ledger balances extracted at the close of a trading year on 31<sup>st</sup> March, 2006 are given as follows

Name of the Account	Amount (Rs.)
Opening stock	12,000
Purchases	52,000
Sales	74,000
Purchase Returns	2000
Carriage Inward	800
Wages	4200
Closing stock	13500

Make necessary journal entries in the journal proper.



**Solution :**

**Journal**

Date 2006	Particulars	LF	Dr Amount Rs	Cr Amount Rs
March 31	Trading A/c Dr To Opening stock A/c To Purchases A/c To Wages A/c To Carriage Inward A/c (Transfer of debit balances to trading Account)		69,000	12000 52000 4200 800
March 31	Sales A/c Dr Purchase Returns A/c Dr Closing stock A/c Dr To Trading A/c (Transfer of credit items to trading account)		74000 2000 13500	89500
March 31	Trading A/c Dr To Profit & Loss A/c (Transfer of gross profit to Profit & Loss Account)		20500	20500

**Notes**

**Illustration 5**

Following are the balances of accounts extracted from the ledger of Rohit & Sons at the close of the year 2006.

	Rs
Stock (1.1.2006)	21,000
Purchases	140000
Sales	224000
Purchases Returns	8000
Sales Returns	12000
Wages	15000
Factory Power	12000
Stock (31.12.2006)	26500

Make closing journal entries in the journal proper.

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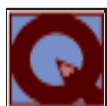


Notes

**Solution :**

### Journal

Date	Particulars	LF	Dr Amount Rs	Cr Amount Rs
2006 Dec. 31	Trading A/c Dr To Opening stock A/c To Purchases A/c To Sales Returns A/c To wages A/c To Factory power A/c (Closing entry of debit items transferred to Trading A/c)		200000	21000 140000 12000 15000 12000
	Sales A/c Dr Closing stock A/c Dr Purchase Returns A/c Dr To Trading A/c (Transfer of credit balances to Trading A/c)		224000 26500 8000	258500
	Trading A/c Dr To Profit & Loss A/c (Transfer of Gross Profit)		58500	58500



### INTEXT QUESTION 13.3

Write the “debit” if the items given below are to be taken to debit side of the Trading A/c and “Credit” they are taken to the credit side of the Trading Account.

- (i) Closing stock
- (ii) Carriage inward
- (iii) Sales
- (iv) Custom duty

### 13.4 PROFIT & LOSS ACCOUNT

As stated earlier, income statement consists of two accounts : Trading Account and Profit & Loss Account. You have seen that Trading account



**Notes**

is prepared to ascertain the Gross profit or Gross loss of the trading activities of the business. But these are not the final results of business operations of an enterprise. Apart from direct expenses, there are indirect expenses also. These may be conveniently divided into office and administrative expenses, selling and distribution expenses, financial expenses, depreciation and maintenance charges etc.

Similarly, there can be income from sources other than sales revenue. These may be interest on investments, discount received from creditors, commission received, etc. Another account is prepared in which all indirect expenses and revenues from sources other than sales are written. This account when balanced shows profit (or loss). This account is termed as Profit and Loss Account. The profit shown by this account is called ‘net profit’ and if it shows loss it is known as ‘net loss’.

**Format of Profit and Loss Account**

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

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

**Notes****Some important items of Profit and Loss Account**

As stated earlier Indirect expense are written on the debit side of Profit and Loss A/c. These can be classified under the following heads :

**Debit items****1. Selling and distribution expenses**

To materialise sales, the expenses incurred are called selling and distribution expenses. Examples are :

Carriage on sales/carriage outwards, advertisement, selling expenses, travelling expenses and salesman commission, depreciation of delivery van, salary of driver of the delivery van, etc.

**2. Office and administration expenses**

These are the expenses incurred on establishment and maintenance of office. Some of the expenses that may be under this head are: rent, rates and taxes, postage, printing and stationery, insurance, legal charges, audit fees, office salaries, etc.

**3. Financial expenses**

Finances are to be arranged for business. Expenses that are incurred in this connection are called financial expenses. Some of the financial expenses are: interest on loan, interest on capital, discount on bills, etc.

**4. Depreciation and maintenance charges**

The total value of a fixed asset like machinery, building, furniture, etc. is not charged to profit and loss account in the year in which it is purchased. Such assets help running business for a number of years to come. Therefore, only a part of the value of such assets is treated as an expense and is charged to Profit and Loss A/c as depreciation. Depreciation means decline in the value of fixed asset due to wear and tear, lapse of time, obsolescence, etc. Expense incurred on repairs and renewals and maintenance of assets are expenses other than depreciation under this category.

**5. Other expenses**

These are the expenses which are not included under the above mentioned heads of expenses for example, losses and expenses due to fire, theft etc.

**Credit items**

On the credit side of Profit and Loss Account, items of revenue and incomes are written. The first item on this side of Profit and Loss Account is the



gross profit transferred from trading account. Other items of the credit side are : (i) Interest on investment, fixed deposits etc. Rent Received, Commission Received, Discount Received, Dividend on shares.

### Need of preparing Profit and Loss Account

Need of preparing profit and loss account by a business concern may be stated as follows :

- (i) Knowledge of the net profit or net loss of a business for an accounting year.
- (ii) Net profit of one year can be compared with net profits of previous year or years. It helps in ascertaining whether the business is being conducted efficiently or not.
- (iii) Different expenses which are taken to Profit & Loss A/c in one year can be compared with the amounts incurred in previous year or years. This helps in ascertaining the need of applying control over such expenses.



### INTEXT QUESTIONS 13.4

- I. Following are the items of expenditure and income to be taken to Profit and Loss Account. Write 'E' for expenses and 'I' for income against each item.
- (i) Interest on Fixed Deposit
  - (ii) Advertisement
  - (iii) Insurance Premium
  - (iv) Discount allowed by creditors
  - (v) Carriage on sales
- II. State whether the following statements are 'true or false'. Write true for true statements and 'false' for false statements.
- (i) Profit and Loss Account is prepared to ascertain the Gross Profit of a business unit.
  - (ii) Items of income are written on the credit side of Profit and Loss Account.
  - (iii) Net Profit calculated by preparing Profit and Loss Account is transferred to Trading Account.
  - (iv) Profit and Loss Account is prepared for an accounting year.



Notes





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### Notes

(iii) Profit & Loss A/c	Dr.	54010	
To Capital A/c			54010
(Transfer of Net Profit to Capital Account)			

### Illustration 7

The following ledger balances were extracted from the books of Rabina & Brothers at the end of accounting year 31st March, 2006. Make journal entries to transfer these balances to prepare Profit & Loss A/c for the year ending 31st March, 2006.

	Rs
Gross Profit	65800
Salaries	8400
Rent paid	2400
Discount allowed	500
Interest on investments	3100
Advertisement	1800
Trading expenses	1600
Bad Debts	500
Depreciation	600
Insurance Premium	800
Commission received	2700

### Solution :

### Journal

Date	Particulars	LF	Dr Amount Rs	Cr Amount Rs
2007				
March 31	Profit & Loss A/c	Dr	16600	
	To Salaries A/c			8400
	To Rent A/c			2400
	To Discount allowed A/c			500
	To Advertisement A/c			1800
	To Trading expenses A/c			1600



	To Bad Debts A/c			500
	To Depreciation A/c			600
	To Insurance Premium A/c			800
	(Transfer of accounts with debit balance to profit & Loss A/c)			
March 31	Commision A/c	Dr	2700	
	Interest A/c	Dr	3100	
	To Profit & Loss A/c			5800
	(Transfer of credit balance to Profit & Loss A/c)			
March 31	Profit & Loss A/c	Dr	55000	
	To Capital A/c			55000

**Notes**

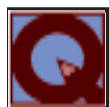
**Position Statement/Balance Sheet**

Position Statement or Balance Sheet is another basis of financial statement. Balance Sheet is a statement prepared on a particular date, generally at the end of accounting year to ascertain the financial position of the entity. It consists of assets on the one hand and liabilities on the other.

In the words of Francis R Steal, “Balance Sheet is a screen picture of the financial position of a going business at a certain moment.”  
 In the words of Freeman, “A Balance Sheet is an item wise list of assets, liabilities and proprietorship of a business at a certain date.”

Financial position of a business is the list of assets owned by the business and the claims of various parties against these assets. The statement prepared to show the financial position is termed as Balance Sheet.

In the next lesson we shall discuss Balance Sheet in detail.



**INTEXT QUESTIONS 13.5**

- I. Write ‘debit’ if Profit and Loss Account is to be debited and ‘credit’ if to be credited of the following items :
- (a) Legal charges
  - (b) Net Loss
  - (c) Rent Received
  - (d) Discount Allowed
  - (e) Salaries

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## Financial Statements – An Introduction

- II. (a) Name the financial statement which is provided in addition to income statement.
- (b) Why it is prepared?
- (c) When it is prepared?
- (d) Name its two elements.



### WHAT YOU HAVE LEARNT

- Financial statements are of two types :
  - (a) Income Statement i.e. Trading Account and Profit and Loss Account.
  - (b) Position Statement i.e. Balance Sheet.

Trading Account is prepared to ascertain the results of the trading activities of the business.

- Trading Account may show profit (i.e. the excess of sales to cost of goods sold or excess of credit side over debit side), which is termed as Gross Profit.

Trading Account may show loss (i.e. Cost of goods sold exceeds sales or total of debit side exceeds total of credit side). This is called Gross Loss.

- Profit and Loss Account is prepared to find out Net Profit/Net Loss.

$\text{Net Profit} = \text{Gross Profit} + \text{other incomes} - \text{Indirect expenses}$ .

It may also show a net loss.

All indirect expenses are shown on the debit side of Profit & Loss Account.

All incomes and gains are shown on the credit side of Profit & Loss Account.

- Balance Sheet is prepared to ascertain the financial position of a firm on a particular date.



### TERMINAL QUESTIONS

1. State the meaning of financial statements.
2. Explain in brief the various objectives of financial statements.



**Notes**

3. Explain in brief the following terms with two examples each :
  - (a) Revenue expenditure.
  - (b) Revenue Receipts
  - (c) Capital expenditure
  - (d) Capital Receipts
4. Distinguish between capital expenditure and Revenue expenditure on the basis of :
  - (a) Earning capacity
  - (b) Placement in financial statements
  - (c) Occurrence of expenditure
5. Distinguish between capital receipts and revenue receipts.
6. How is cost of goods sold calculated?
7. What is Trading Account? Why it is prepared?
8. How is Gross Profit calculated?
9. What is meant by Profit and Loss Account? Why it is prepared?
10. When does Profit and Loss Account show Net Profit?
11. What are direct expenses? Give two examples of such expenses.
12. State the meaning of Balance Sheet.
13. From the following balances of Sabana calculate Gross Profit or Gross Loss by subtracting cost of goods sold from sales for the year ended 31<sup>st</sup> December, 2006

	Rs.
Stock (1.1.2006)	26500
Purchases	64600
Sales	86800
Purchases Returns	2600
Sales Returns	1800
Freight inward	750
Wages	1850
Closing Stock	31100

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Financial Statements for Profit  
and Not for Profit Organisations



### Notes

## Financial Statements – An Introduction

14. From the following balances extracted from the books of Seth Brothers. Make journal entries to prepare a Trading Account and Profit and Loss Account for year ended 31<sup>st</sup> March, 2007.

	Rs.		Rs.
Stock (1.4.2006)	20000	Electric Power	5000
Purchases	95000	Wages	14000
Return Inwards	2000	Selling Commission	5500
Carriage Inwards	1850	Repair & Renewals	2000
Carriage Outwards	1200	General Expenses	8000
Custom duty	3000	Insurance	2200
Return outwards	5000	Stock (31.3.2007)	45000
Sales	165000		
Discount Received	1500		

15. The balances from the books of Parimal Ghosh are given below. Make journal entries to prepare Trading and Profit & Loss Account for the year ended 31<sup>st</sup> March, 2007.

	Rs		Rs
Stock as on 1.4.2006	9480	Purchase Returns	1800
Purchases	50800	Advertising	1500
Wages	1200	Commission (Cr.)	3200
Salaries	3400	Rent from tenant	2800
Octroi	1320	Sales	72000
Rent & Taxes	850	Stock (31.3.2007)	10700
Bad Debts	250		
Discount (Dr.)	360		
Interest on capital	760		

16. From the following information calculate cost of goods sold for the year ending 31<sup>st</sup> March, 2007

	Rs		Rs
Opening Stock	14800	Factory expenses	7200
Purchases	65700	Closing stock	28400
Returns outward	1700		
Wages	12500		
Carriage Inward	2400		
Custom Duty	3200		
Rent paid	4500		
Establishment expenses	650		





17. From the following balances extracted from the books of Jai Bhagwan & Sons as on 31st March, 2007. Make journal entries to prepare Trading A/c and Profits & Loss A/c

	Rs		Rs
Opening Stock	16000	Rent	3600
Purchases	76000	Office expenses	1600
Machinery	28000	Carriage Inward	1200
Debtors	21600	Sales Returns	5400
Drawings	7200	<b>Credit Balance</b>	
Wages	1500	Capital	70000
Bank	12000	Creditors	14000
Depreciaton	2800	Sales	108000
Closing stock	24000	Purchase Returns	2600

**Notes**



**ANSWERS TO INTEXT QUESTIONS**

**Intext Question 13.1**

- I. (i) Capital (ii) Revenue  
 (iii) Deferred Revenue (iv) Capital
- II. (a) Ascertaining the financial position  
 (b) Source of information  
 (c) Helps in managerial decision making  
 (d) An index of the solvency of the concern.

**Intext Question 13.2**

- I. 1. Two 2. Trading and Profit & Loss  
 3. Gross Profit 4. Success
- II. (a) Net sales (b) Net purchases  
 (c) Gross profit (d) Gross Loss

**Intext Question 13.3**

- (i) Credit (ii) Debit  
 (iii) Credit (iv) Debit



**Notes**

**Intext Question 13.4**

- I. (i) I (ii) E (iii) E (iv) I (v) E  
 II. (i) F (ii) T (iii) F (iv) T

**Intext Question 13.5**

- I. (a) debit (b) credit  
 (c) Credit (d) debit  
 (e) debit  
 II. (a) Balance sheet  
 (b) to show the financial position of the concern  
 (c) At the end of an accounting year  
 (d) assets; liabilities

**Answers to Practical Terminal Questions**

13. Gross Profit : Rs 25000  
 14. Gross Profit : Rs 74150 Net Profit : Rs 56750  
 15. Gross Profit : 21700 Net Profit : Rs 20580  
 16. Cost of goods sold : Rs 75700  
 17. Gross Profit : Rs 21000 Net Profit : Rs 13000



**Activity :** Procure trial balance of at least four business concern and classify the items into :

- (a) Revenue expenditure (b) Revenue receipts  
 (c) Capital expenditure (d) Capital Receiptes

Name of organisation	Item of expenditure	Revenue expenditure	Revenue receipts	Capital expenditure	Capital Receipts