

14

FINANCIAL STATEMENTS (WITHOUT ADJUSTMENTS)

In the previous lessons you have learnt to record the business transactions in different books of accounts and their posting into the main book i.e. ledger. You have also learnt the balancing of accounts and preparation of trial balance. One of the important purposes of accounting is to find out the profit or loss of a business for a particular accounting period and also to know its financial position on a particular date.

For this purpose, Income Statement and Position Statement are prepared every year by all business organisations. Income statement is divided into two parts, which are as follows:

- (i) Trading Account and
- (ii) Profit and Loss Account.

Income Statement is prepared to know the earnings of a business during a particular accounting year or the loss suffered during the year. Position Statement, also known as Balance Sheet, is prepared to know the financial position of a business on a particular date.

In this lesson you will learn as to how the financial statements are prepared to find out the profit for an accounting year and to know its financial position on a particular date.



OBJECTIVES

After studying this lesson you will be able to:

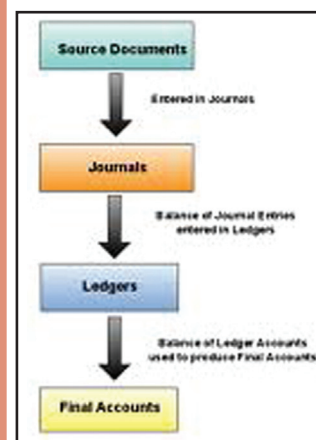
- explain the meaning of financial statements;
- explain the objectives of financial statements;
- classify the financial statements into Trading Account, Profit and Loss Account and Balance Sheet and
- prepare Trading Account, Profit and Loss Account and Balance Sheet.

MODULE - V

Preparation of Financial Statements



Notes



MODULE - V**Preparation of
Financial Statements****Notes****Financial Statements (Without Adjustment)****14.1 MEANING OF FINANCIAL STATEMENTS**

Like a student who eagerly waits for his/her annual examination result, every businessman also eagerly waits to know the result of his business for a particular financial year. The businessman also wants to know the financial position of his business on a particular date. This date is normally the last date of the financial year for which the accounts have been prepared. The statements, prepared to know the result of the business and the financial position of the business, are called financial statements. The statement prepared to ascertain gross profit/loss is called Trading Account. The statement prepared to ascertain the net profit is called Profit and Loss Account. Trading and Profit and Loss Account taken together is called the Income Statement. Statement prepared to know the financial position of the business is called the Balance Sheet or Position Statement.

14.2 OBJECTIVES OF FINANCIAL STATEMENTS

Following are the objectives of preparing financial statements:

- i) **Ascertain the result of business activities :** One of the important objectives of preparing financial statements is to ascertain the Income. Financial statements provide information about the profit earned or loss incurred during a particular accounting period or year.
- ii) **Ascertain the financial position of business :** Balance Sheet provides information about the financial position of business on a particular date.
- iii) **Correct decision making :** Financial statements are helpful in decision making for the business on the basis of the information provided by financial statements, future decisions can be taken correctly.
- iv) **Judging the performance of management :** Financial statements are helpful in judging the performance of management and utilization of resources of a business house.
- v) **Ascertaining the cash position of business :** The cash position indicated by the financial statements helps the business in planning the payment of cash to creditors, suppliers etc.

14.3 CLASSIFICATION OF FINANCIAL STATEMENTS

Financial Statements of a sole trader comprise of the following statements:

- I. Income Statement
 - (i) Trading Account and
 - (ii) Profit and loss Account
- II. Position Statement or Balance Sheet

Financial Statements (Without Adjustment)

Income Statement

Income statement is prepared to find out the profit or loss of business for a particular accounting year. Income statement is made up of the following accounts:

- Trading Account and
- Profit and loss Account

a) Trading Account : Trading Account is prepared to find out the Gross profit earned or Gross loss suffered by the business from business activities during an accounting year. This account is prepared in T-form. Following is the proforma of a Trading Account:

Trading Account of M/s XYZ for the year ending.....

Dr.

Cr.

Particulars	Amount (₹)	Particulars	Amount (₹)
To Opening Stock		By Sales	
To Purchases		(i) Cash Sales	
(i) Cash Purchases		(ii) Credit Sales	
(ii) Credit Purchases		Total Sales	
Total Purchases		Less Sales Returns	
Less Purchase Returns		Net Sales	
Net Purchases		By Closing Stock	
Direct Expenses :		By Gross Loss transferred to P & L A/c (Balancing fig.)	
To Wages			
To Freight/Freight Inward			
To Carriage/Carriage Inward			
To Fuel & Power			
To Factory Rent			
To Gross Profit transferred to P & L A/c (Balancing fig.)			

Illustration 1

From the following balances extracted from the books of M/s Luxmi & Sons, prepare a Trading Account for the year ended 31st March, 2012.

Particulars	Amount (₹)
Opening stock	6,500
Purchases	45,000
Sales	72,000
Purchases Returns	500
Sales Returns	1,500
Carriage	1,200
Wages	4,800
Fuel & Power	3,200
Closing stock	8,000



MODULE - V

Preparation of Financial Statements



Notes

Financial Statements (Without Adjustment)

Solution

Trading Account of M/s Luxmi & Sons for the year ended March 31, 2012

Dr.		Cr.	
Particulars	Amount (₹)	Particulars	Amount (₹)
To Opening Stock	6,500	By Sales	72,000
To Purchases	45,000	Less : Returns	1,500
Less : Returns	500	By Closing Stock	8,000
To Carriage	1,200		
To Wages	4,800		
To Fuel & Power	3,200		
To Gross Profit transferred to P & L A/c (Balancing Figure)	18,300		
	78,500		78,500

Illustration 2

From the following balances extracted from the books of M/s Bhanu Bros, prepare a Trading Account for the year ended 31st March, 2012.

Particulars	Amount (₹)
Opening Stock as on 1.4.2011	32,000
Purchases	1,65,000
Freight	4,000
Power	6,500
Custom Duty	5,500
Sales	80,000
Closing Stock as on 31 st March, 2012	30,000

Solution

Trading Account of M/s Bhanu Bros. for the year ended March 31, 2012

Dr.		Cr.	
Particulars	Amount (₹)	Particulars	Amount (₹)
To Opening Stock	32,000	By Sales	80,000
To Purchases	1,65,000	By Closing Stock	30,000
To Freight	4,000	By Gross Loss transferred to P & L A/c (Balancing Figure)	1,03,000
To Power	6,500		
To Custom Duty	5,500		
	2,13,000		2,13,000



Notes



INTEXT QUESTIONS 14.1

Fill in the blanks with suitable word/words :

- i. Carriage is debited to _____ account.
- ii. Total Sales – Sales Returns = _____
- iii. Wages are debited to _____ account.
- iv. Closing stock is shown on the _____ side of Trading Account.
- v. Total Purchases – Purchase Returns = _____

b) Profit and Loss Account : After finding out the gross profit/ gross loss by preparing the Trading Account, Profit and Loss Account is prepared to find out the net profit / net loss of the business during an accounting year. This account is also prepared in T-form. Following is the proforma of a Profit and loss Account

**Profit and loss Account of M/s ABC
for the year ended _____**

Dr.

Cr.

Particulars	₹	Particulars	₹
To Gross Loss transferred from Trading A/c	_____	By Gross profit transferred from Trading A/c	_____
To Salaries	_____	By Commission Received	_____
To Office Rent	_____	By Discount received from creditors	_____
To Printing & Stationery	_____	By Rent Received	_____
To Insurance Premium	_____	By Interest Received	_____
To Interest Paid	_____	By Net Loss Transferred to Capital Account (Balancing Figure)	_____
To Freight outwards	_____		
To carriage outwards	_____		
To Discount Allowed to customers	_____		
To Postage	_____		
To Telephone Charges	_____		
To Office Expenses	_____		
To Sales Expenses	_____		
To Net Profit Transferred to Capital Account (Balancing Figure)	_____		
	_____		_____

Illustration 3

From the following information, prepare Profit and loss Account of M/s Sahil Bros for the Year ending on 31.03.2012.

	₹
Gross Profit	97,000
Discount allowed to customers	2,000
Printing and stationery	2,000
Officerent	5,000

MODULE - V

Preparation of Financial Statements



Notes

Financial Statements (Without Adjustment)

Repair	2,400
Insurance Premium	5,100
Telephone Charges	1,000
Discount received from Creditors	3,000
Interest earned during the year	5,000

Solution

Profit and loss Account of M/s Sahil Bros. for the year ended March 31, 2012

Dr.		Cr.	
Particulars	₹	Particulars	₹
To Discount allowed to customers	2,000	By Gross profit transferred from Trading A/c	97,000
To Printing and Stationery	2,000	By Discount received from creditors	3,000
To Office Rent	5,000	By Interest earned during the year	5,000
To Repairs	2,400		
To Insurance Premium	5,100		
To Telephone Charges	1,000		
To Net Profit transferred to Capital A/c (Balancing fig.)	87,500		
	1,05,000		1,05,000

Illustration 4

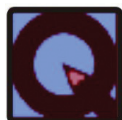
From the following information, prepare Profit & Loss Account of M/s Sarthak Traders for the year ending on 31.03.2012

	₹
Gross Profit	43,000
Discount allowed to customers	7,000
Salaries	45,000
Interest paid on loan	13,000
Postage	2,400
Discount received from creditors	6,000
Commission received	1,000
Sales expenses	10,000

Solution

Profit and loss Account of M/s Sarthak Traders for the year ended March 31, 2012

Dr.		Cr.	
Particulars	₹	Particulars	₹
To Discount allowed to customers	7,000	By Gross profit transferred from Trading A/c	43,000
To Salaries	45,000	By Discount received from Creditors	6,000
To Interest on loan	13,000	By Commission Received	1,000
To Postage	2,400	By Net Loss transferred to capital A/c	27,400
To Sales expenses	10,000		
	77,400		77,400



INTEXT QUESTIONS 14.2

State whether the following statements are True or False:

- i. Carriage inward is shown in Profit & Loss Account.
- ii. Telephone expenses are shown in Trading Account.
- iii. Carriage outward is shown in P&L A/c.
- iv. Gross Profit is transferred from Profit & Loss Account to Trading Account.

Distinction between Trading Account and Profit and Loss Account

The distinction between Trading A/c and Profit & Loss A/c is as follows:

S.No.	Trading Account	Profit and Loss Account
1.	This account shows the gross profit or gross loss for an accounting year.	This account shows the net profit or net loss for an accounting year.
2.	All direct expenses relating to business are shown on the debit side of this account.	All indirect expenses relating to business are shown on the debit side of this account.
3.	All direct revenue items are shown on the credit side of this account.	All indirect revenue items are shown on the credit side of this account.
4.	The balance of this account i.e. gross profit or gross loss is transferred to P&L A/c.	The balance of this account i.e. net profit or net loss is transferred to the capital account of the proprietor.

II. Position Statement or Balance Sheet

Balance Sheet or Position Statement is prepared to find out the financial position of a business on a particular date. Generally it is prepared on the last date of an accounting year. It is prepared after preparing Trading Account and Profit & Loss Account.

Balance Sheet has two sides. Left hand side is known as Liabilities side and right hand side is known as Assets side.

The Liabilities side is used for showing liabilities of the business. The term liabilities include 'Internal Liabilities' and 'External Liabilities' of the business. Internal liabilities means the amount payable by the business to its owner, while external liabilities mean the amount payable to outsiders.



Notes

MODULE - V

Preparation of Financial Statements



Notes

Financial Statements (Without Adjustment)

Classification of Internal and External Liabilities

Internal liabilities		External liabilities	
a.	Capital	Creditors	
b.	Profits of business	Bank loan and other loans	
c.	Reserves of business	Expenses payable or due	

The Assets side is used for showing the assets of the business. The term assets includes fixed assets and current assets of the business.

Classification of Assets

Fixed Assets		Current Assets	
a.	Land and building	Cash in hand	
b.	Plant & Machinery	Cash at Bank	
c.	Furniture	Stock of goods	
d.	Motor Vehicles etc.	Debtors etc.	

Objectives of Preparing Balance Sheet

Balance sheet is prepared to achieve following objectives:

- i) To know the financial position of the business.
- ii) To know the position of internal liabilities and external liabilities of the business so that timely arrangement can be made for their payment.
- iii) To know the position of fixed assets and current assets.
- iv) To plan activities for future on the basis of present financial position.

Proforma of Balance Sheet

Balance Sheet of M/s _____
as on _____

Liabilities	₹	Assets	₹
Bank overdraft	_____	Cash in hand	_____
Creditors	_____	Cash at Bank	_____
Loans/Bank Loan	_____	Debtors	_____
Capital	_____	Stock	_____
Add : Net Profit	_____	Investments	_____
Less : Net Loss	_____	Furniture	_____
Less Drawings	_____	Motor Vehicles	_____
	_____	Plant & Machinery	_____
	_____	Land & Building	_____
	_____		_____

Financial Statements (Without Adjustment)

MODULE - V

Preparation of Financial Statements



Illustration 5

From the following information supplied by Mr. Roshan Lal, prepare a Balance Sheet of Mr. Roshan Lal as on 31st March, 2012

	₹
Capital	50,000
Furniture	15,000
Debtors	25,000
Creditors	30,000
Plant and Machinery	58,000
Investments	5,000
Cash in hand	1,000
Cash at Bank	1,000
Stock at the end	10,000
Bank Overdraft	8,000
Bank Loan	20,000
Net Profit	10,000
Drawings	3,000

Notes

Solution

Balance Sheet of Mr. Roshan Lal as on March 31, 2012

Dr.

Cr.

Liabilities	₹	Assets	₹
Bank overdraft	8,000	Cash in hand	1,000
Creditors	30,000	Cash at Bank	1,000
Bank Loan	20,000	Debtors	25,000
Capital	50,000	Stock	10,000
Add : Net Profit	10,000	Investments	5,000
	60,000	Furniture	15,000
Less Drawings	- 3,000	Plant & Machinery	58,000
	1,15,000		1,15,000

Illustration 6

From the following information supplied by Mr. Arun Kumar, prepare a Balance Sheet as on 31st March, 2012.

	₹
Creditors	30,000
Debtors	35,000
Cash in hand	24,500
Cash at Bank	27,500
Stock	22,500
Furniture	25,000

MODULE - V

Preparation of Financial Statements



Notes

Financial Statements (Without Adjustment)

Loan	50,000
Plant & Machinery	32,500
Land & Building	52,000
Capital	1,37,000
Net Profit	12,000
Drawings	10,000

Solution

Balance Sheet of Mr. Arun Kumar as on March 31, 2012

Dr.		Cr.	
Liabilities	₹	Assets	₹
Creditors	30,000	Cash in hand	24,500
Loan	50,000	Cash at Bank	27,500
Capital	1,37,000	Debtors	35,000
Add : Net Profit	12,000	Stock	22,500
	1,49,000	Furniture	25,000
Less : Drawings	10,000	Plant & Machinery	32,500
	1,39,000	Land & Building	52,000
	2,19,000		2,19,000



INTEXT QUESTIONS 14.3

I. Fill in the Blanks :

- Assets are shown on the _____ side of the Balance Sheet.
- Capital is shown on the liabilities side of _____ .
- Total of Assets side and liabilities side of balance sheet are always _____.
- Stock is an example of _____ asset.
- Furniture is an example of _____ asset.

II. Classify the following assets as fixed assets and current assets:

Assets	Type of Asset (Fixed or Current)
i. Debtors	
ii. Land & Building	
iii. Plant & Machinery	
iv. Cash at Bank	
v. Motor Vehicle	
vi. Cash in hand	

Financial Statements (Without Adjustment)

Illustration 7

From the following Balances of M/s Pawan Sales on 31/3/2012, prepare a Trading and Profit & Loss Account and a Balance Sheet as on that date.

Particulars	Amount (₹)	Particulars	Amount (₹)
Drawings	8,000	Sales	2,58,000
Capital	48,000	Return Inwards	2,000
Sundry Creditors	80,000	Return Outwards	2,200
Sundry Debtors	1,26,000	Office Salaries	18,000
Bills Receivable	10,000	Manufacturing Wages	8,000
Opening stock	90,000	Commission	9,000
Fixtures and Fittings	13,000	Trade Expenses	5,000
Cash in hand	2,000	Rent	4,400
Machinery	24,800	Discount received	8,000
Bank Overdraft	10,000	Bills Payable	14,000
Purchases	1,00,000		

The closing stock on 31.3.2012 was ₹ 1,04,000

Solution

Trading and Profit and Loss A/c M/s Pawan for the year ended March 31, 2012

Particulars	Amount (₹)	Particulars	Amount (₹)
To Opening Stock	90,000	By Sales	2,58,000
To Purchases	1,00,000	Less : Returns	2,000
Less : Returns	2,200	By Closing Stock	1,04,000
To Manufacturing Wages	8,000		
To Gross Profit c/f	1,64,200		
	3,60,000		3,60,000
To Office Expenses	18,000	By Gross Profit b/f	1,64,200
To Commission	9,000	By Discount received	8,000
To Trade Expenses	5,000		
To Rent	4,400		
To Net Profit c/f	1,35,800		
	1,72,200		1,72,200

Balance Sheet as on March 31, 2012

Liabilities	₹	Assets	₹
Bills Payables	14,000	Cash in hand	2,000
Sundry Creditors	80,000	Bills Receivable	10,000
Bank Overdraft	10,000	Sundry Debtors	1,26,000

MODULE - V

Preparation of Financial Statements



Notes

MODULE - V

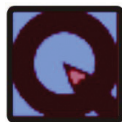
Preparation of Financial Statements



Notes

Financial Statements (Without Adjustment)

Capital	48,000		Stock	1,04,000
Less : Drawings	8,000		Fixtures and Fittings	13,000
	40,000			
Add : Net Profit	1,35,800	1,75,800		
		2,79,800		2,79,800



INTEXT QUESTIONS 14.4

I. Mention whether following statements are True or False :

- i. A Balance Sheet shows the financial position of a business for the whole year.
- ii. Both P & L Account and Balance Sheet are position statements.
- iii. Asset side of a balance sheet shows only the fixed assets of a business.
- iv. Liabilities side of a Balance Sheet shows both internal and external liabilities.

II. Multiple Type Questions

- i. Which of the following financial statement is prepared to ascertain gross profit of a business?
 - a) Profit and Loss Account
 - b) Trading Account
 - c) Balance Sheet
 - d) None of the above
- ii. Which of the following financial statements is prepared to ascertain the positions of assets and liabilities of the business?
 - a) Balance Sheet
 - b) Profit and Loss Account
 - c) Trading Account
 - d) None of the above
- iii. Gross profit is the difference between
 - a) Total assets and total liabilities
 - b) Sales and all expenses
 - c) Sales and indirect expenses
 - d) Sales and cost of goods solds
- iv. Which of the following is not an indirect expense?
 - a) Freight inward
 - b) Discount allowed
 - c) Rent paid
 - d) Commission paid
- v. Which of the following is a current asset?
 - a) Land
 - b) Building
 - c) Cash at bank
 - d) Machinery


WHAT YOU HAVE LEARNT

- Financial Statements are prepared to ascertain the Gross Profit and Net profit earned by a business enterprise during a period and the positions of its assets and liabilities on a particular date, generally on the last date of the accounting year.
- Trading account is prepared to ascertain gross profit earned or gross loss suffered during a period and profit and loss account is prepared to ascertain the net profit earned or net loss suffered by the business during a period. Trading and profit and loss account taken together is called income statement.
- Balance sheet is prepared to know the position of assets and liabilities of the business on a particular date. This is called the position statement.
- Financial statements are prepared to know the result of business activities, to know the financial position of the business, to help in decision making, to judge the performance of the management, to know the cash position of the business etc.


Notes

TERMINAL EXERCISE

1. What do you mean by term financial statements?
2. State the objectives of preparing financial statements.
3. State the objectives of preparing Balance Sheet.
4. Distinguish between direct expenses and indirect expenses.
5. Distinguish between Trading Account and Profit and Loss Account.
6. Give five examples each of fixed assets and current assets.
7. Give three examples each of internal liabilities and external liabilities.
8. From the following balances prepare trading account for the year ended 31st March 2012

Particulars	₹	Particulars	₹
Opening Stock	6,000	Purchases	11,500
Purchase return	500	Sales	48,000
Sales return	600	Freight & Octroi	500
Carriage on purchases	1,000	Wages	2,500
Factory lighting	600	Import duty	900
Office rent	1,200	Carriage on sales	3,000
Coal, gas & water	800		

MODULE - V

Preparation of Financial Statements



Notes

Financial Statements (Without Adjustment)

9. Prepare Profit and Loss account for the year ended 31st March 2012 from the following particulars.

Particulars	₹	Particulars	₹
General Expenses	800	Gross Profit	32,100
Charity	100	Carriage on sales	900
Electricity charges	175	Office expenses	650
Law charges	180	Insurance premium	1,200
Advertisement	440	Telephone expenses	600
Commission	870	Sales tax	800
Rent	1,800	Establishment expenses	700
Interest on investment	700	Miscellaneous expenses	750
Sundry receipts	700	Discount received	1,090
Indirect expenses	340	Traveller salary	300
Printing and stationary	65	Repair	270

10. From the following trial balance of Gopal Nath and Sons, prepare Trading and Profit and Loss Account for the year ending 31st December 2012 and a Balance Sheet as at that date:

Particulars	₹	Particulars	₹
Opening Stock	4,000	Bills Payable	1,200
Purchases	12,000	Purchase return	300
Carriage	1,170	Sundry creditors	2,700
Wages	1,000	Sales	20,000
Sales return	200	Capital	30,000
Drawings	1,500	Commission received	120
Office expenses	250		
Salaries	1,600		
Discount	300		
Repairs	1,200		
Advertisements	500		
Sundry debtors	6,000		
Plant & Machinery	12,000		
Building	10,000		
Cash in hand	600		
Cash at bank	2,000		
	54,320		54,320

The value of stock in hand on 31st December 2012 was ₹ 6,000.



ANSWER TO INTEXT QUESTIONS

- 14.1** (i) Trading Account (ii) Net Sales (iii) Trading Account
(iv) Credit Side (v) Net Purchases
- 14.2** (i) False (ii) False (iii) True (iv) False
- 14.3** **I.** (i) Right hand side (ii) Balance Sheet (iii) Equal
(iv) Current (v) Fixed
- II.** (i) Current (ii) Fixed (iii) Fixed
(iv) Current (v) Fixed
- 14.4** **I.** (i) False (ii) False (iii) False (iv) True
- II.** (i) b (ii) a (iii) d (iv) a (v) c



ANSWER TO TERMINAL EXERCISE

8. Gross Profit Rs. 24,100
9. Net Profit Rs. 24,450.
10. Gross Profit Rs. 7,930; Net Profit Rs. 4,200; Total of Balance Sheet Rs. 36,600.

ACTIVITY FOR YOU

- Visit a small business organisation in a nearby area, request them to show you their final accounts, with the help of an accountant learn the technique of preparing the final accounts.