

UNIT - 8

FINANCIAL STATEMENTS

Unit at a glance:

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- Trading Account
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“Financial Statements of a company shows its financial position for the current year”

Meaning :

The financial statement provide a summary of the accounts of a business enterprise.

Financial statement include two statements include two statements :

- i) ‘Trading and Profit and Loss Account’ or Income Statement’ (To Know Profit or loss)
- ii) Balance Sheet (To know value of assets and liabilities on the closing date of an accounting period)

Users of Accounting Information :

Internal Users : Management, Employees, Current owners

External Users : Potential Investors Government, Banks/Lenders, Stock Exchange, Suppliers and Trade Creditors, Public.

Capital Nature Items:

Capital Expenditure : Those expenditures which are incurred in acquiring and increasing the value of fixed assets. Ex.

1. Purchase of fixed assets or bringing into existence of fixed assets
2. Expenditure incurred on erection of a fixed asset
3. Payment of goodwill
4. Decrease in long term debts.
5. Capital Receipts : Any receipt from the sale of fixed assets is known as capital receipt.

Revenue Nature items :

Revenue Receipts : Receipts in the business of recurring nature are called as Revenue receipts ex: rent received, discount received, commission received

Revenue Expenditures : Recurring nature of expenditure done in the business which are done in order to earn profit are known as revenue expenditure ex.:

1. Purchase of goods during the year
 2. Money spent in acquiring or manufacturing goods like freight, carriage, wages etc.
- Any expenses for meeting day to day business like wages, salaries, postage etc.

OPERATING PROFIT AND NET PROFIT

After getting Gross Profit from the business. Profit may be divided into two parts :

1 Operating Profit, 2 Net Profit

Operating Profit : Operating profit is that profit which is earned through the normal activities of the business. It can be ascertained by deducting all operating expenses from the gross profit.

2. Net Profit : Net profit is that profit which is earned after deducting all operating as well as non operating expenses from the Gross Profit.

Trading Account :

Trading account is prepared to know the result of manufacturing and trading activities :

Ex: Prepare A Trading Account from the following particulars for the year ended March 31, 2007.

Opening Stock	56,250
Purchases	157500
Sales	405000
Wages	45000

Solution :

Trading Account for the year ended March 31, 2007

Particulars	Amount	Particulars	Amount
To Opening Stock	56,250	By Sales	4,05,000
To Purchases	1,57,500		
To Wages	45,000		
To Gross Profit	1,46,250		
	4,05,000		4,05,000

Question for Practice :

Prepare a Trading Account from the following particulars for the year ended 31st March, 2011

	Rs.		Rs.
Opening Stock	30,000	Wages	18,000
Purchases	1,00,000	Carriage on purchases	3,000
Sales	2,05,000	Manufacturing Exp.	20,000
Factory rent	10,000	Custom Duty	4,500
Purchases returns	3,000	Gas, Fuel and power	12,000
Sales returns	5,000	Dock charges	3,000

Profit and Loss Account :

Profit and loss account is prepared to know the result of the business in the term of net profit

Question for Practice:

Prepare Profit and Loss Account for the year ended 31st March, 2010 from the following particulars :

	Rs.		Rs.
Gross profit	90,500	Discount allowed	600
Trade expenses	2,400	Lighting	4,100
Rates and taxes	1,200	Interest on investment	500
Carriage outwards	7,500	Commission received	600
Salaries	13,600	Bad debts	1,000
Postage and telegram	2,400	Discount (Cr.)	600
Rent	9,000	Interest on loan	1,800
Legal charges	2,000	Stable expenses	1,600

Audit fee	2,400	Export duty	2,200
Depreciation	2,000	Miscellaneous receipts	200
Donation	500	Unproductive wages	2,100
General expenses	1,500	Travelling expenses	3,500
Selling expenses	4,000		

Solution :

Profit and Loss Account
(for the year ended 31st March 2010)

Particulars	Amount	Particulars	Amount
To Trade expenses	2,400	By Gross profit b/d	90,500
To Carriage outwards	7,500	By commission received	600
To Salaries	13,600	By Discount	600
To Postage and telegram	2,400	By Miscellaneous receipts	200
To Rent	9,000	By interest on investment	500
To Rates and taxes	1,200		
To Legal charges	2,000		
To Audit fee	2,400		
To Depreciation	2,000		
To Donation	500		
To General Expenses	1,500		
To Selling expenses	4,000		
To Discount allowed	600		
To Lighting	4,100		
To Bad Debts	1,000		
To Interest on loan	1,800		
]To Stable expenses	1,600		
To Export duty	2,200		
To Unproductive wages	2,100		
To Traveling expenses	3,500		
To Net Profit transferred to capital account	27,000		
	92,400		92,400

Question for Practice :

From the following trial balance of Raj & Co. prepare trading and profit and loss A/c for the year ending 31st March 2011 .

Debit Balance	Amount	Credit Balance	Amount
Stock	16,000	Sundry Creditors	20,000
Purchases	55,000	Purchases returns	1,000
Sales Returns	2,000	Sales	1,03,000
Carriage	3,500	Commission	4,500
Wages	12,500	Capital	56,000
Salaries	10,000	Bills Payable	8,500
Printing and stationery	3,400	Bank Loan	20,000
Trade expenses	2,000		
Cash in hand	3,500		
Bills receivables	8,000		
Sundry Debtors	22,000		
Land and buildings	30,000		
Plant and machinery	20,000		
Drawings	8,000		

Furniture and fixtures	10,600		
Rent and taxes	6,500		

Balance Sheet

The Balance Sheet is a statement prepared for showing the financial position of the business summarising its assets and liabilities at a given date.

Important Adjustments with their treatments

S.N.	Adjustment		Treatments
1	Closing Stock	:	Credit Side of Trading and Asset Side of B/S
2	Outstanding expenses	:	Add with concerned item in trading or profit and loss a/c and Liabilities side of B/S
3	Prepaid expenses	:	Less from concerned item in trading or profit and loss a/c and assets side of B/S
4	Accrued Income	:	Add with concerned income in P&L and Asset Side of B/S
5	Income Received in advance	:	Less from concerned item in P&L A/c and Liabilities side of B/S
6	Depreciation	:	Dr.Side of P&L A/c & Deduct from concerned asset in Balance sheet
7	Bad Debts	:	Dr.Side of P&L A/c & Deduct from debtors in B/S
8	Provision for doubtful debts	:	Dr. Side of P&L A/c and Deduct from Debtors
9	Provision for Discount on debtors	:	Dr. Side of P&L A/c and Deduct from Debtors
10	Manager's Commission	:	Dr.Side of P&L and Liabilities side of B/S

Ex:

From the following figures prepare Trading and Profit and Loss Account for the year ended 31st March, 2010 and a Balance Sheet as on that date :

Capital	86,800	Commission (Cr.)	1,000
Drawing	15,000		
Investments	14,000		
Cash	8,000		
Rent and Insurance	3,000		
Opening Stock	36,600		
Purchases	1,86,000		
Sales	3,05,000		
Sales return	5,000		
Wages	22,000		
Carriage	4,200		
Bad debts	700		
Bad debts provision	2,100		
Sundry debtors	40,400		
Sundry creditors	25,700		
Furniture	8,000		
Plant and machinery	50,000		
Salaries	11,000		
Advertisement	4,400		
Goodwill	6,000		
Freight	6,300		

Adjustments :

1. Stock on 31st march 2010 was Rs. 31,500
2. Salary and wages for March 2010 were unpaid.
3. Rent outstanding amounted to Rs. 600 and insurance unexpired amounted to Rs. 400.
4. Commission amounting to Rs. 200 has been received in advance.
5. Write off Rs. 400 as bad debts, create provision for doubtful debts at 5% on sundry debtors and provide 2% provision for discount on debtors and creditors.
6. Depreciate furniture and plant and machinery by 10%.

Solution :**Trading and Profit and Loss Account**For the year ending 31st March 2010

Particulars	Amount	Particulars	Amount
To Opening Stock	36,600	By Sales	3,05,000
To Purchases	1,86,000	Less : Sales Return	<u>5,000</u>
To Wages	22,000		3,00,000
Add : Outstanding	<u>2,000</u>	By Closing Stock	31,500
To Carriage	4,200		
To Freight	6,300		
To Gross Profit c/d	74,400		
	<u>3,31,500</u>		<u>3,31,500</u>
To Bad Debts	700	By Gross Profit b/d	74,400
Add : Further Bad Debts	400	By Commission	1,000
New Provision	<u>2000</u>	Less : Unearned	<u>200</u>
	3100		800
Less : Old Provision	<u>2100</u>	By Provision for Discount on	
	1,000	Creditors	514
To Provision for Discount on debtors	760		
To Salary	11,000		
Add:	<u>1,000</u>		
	12,000		
To Advertisement	4,400		
To Rent and Insurance	3,000		
Add : Outstanding Rent	<u>600</u>		
	3600		
Less :Prepaid Insurance	<u>400</u>		
	3200		
To Depreciation on			
Furniture	800		
Plant and Machinery	<u>5,000</u>		
	5,800		
To Net Profit transferred to			
Capital A/c	48,554		
	<u>75,714</u>		<u>75,714</u>

Balance Sheet (As on 31st March, 2010)

Liabilities	Amount	Assets	Amount
Salaries outstanding	1,000	Cash	8,000
Wages outstanding	2,000	Sundry Debtors	40,400
Outstanding Rent	600	Less : Bad Debts	<u>400</u>
Unearned commission	200		40,000
Creditors	25,700	Less : New Prov. for	
Less : Prov. for discount	<u>514</u>	Bad Debts.	<u>2,000</u>
Capital	86,800		38,000
Add : Net Profit	<u>48,554</u>	Less : Prov. for discount	<u>760</u>
	1,35,354	Closing Stock	31,500
Less : Drawing	<u>15,000</u>	Insurance Prepaid	400
	1,20,354	Investment	14,000
		Furniture	8,000
		Less : Depreciation	<u>800</u>
		Plant and Machinery	50,000
		Less : Depreciation	<u>5,000</u>
		Goodwill	6,000
	<u>1,49,340</u>		<u>1,49,340</u>

Question for Practice :

Following is the Trial Balance of Rama & Co. for the year ending 31st December 2010. Prepare Trading and Profit and Loss Account and Balance Sheet :

Name of Account	Dr. Balance	Cr. Balance
Drawing and Capital	4,000	23,000
Furniture	8,000	-
Apprentice Premium	-	1,000
Machinery	20,000	-
Bad debts	350	-
Provision for bad debts	-	500
Sundry debtors and Creditors	8,200	5,000
Stock on January 1, 2010	7,400	-
Purchases and sales	75,000	1,05,000
Bank overdraft	-	2,600
Sales return and purchase returns	500	400
Advertisement	2,400	-
Interest	200	-
Commission	-	400
Cash in hand	1,650	-
Taxes and Insurance	3,200	-
Carriage and Freight	1,500	-
Salaries	5,500	-

Adjustments :

The following adjustments are to be made :

- (i) Stock in hand on 31st December 2010 was value Rs. 8,250/-
- (ii) Salary is paid at Rs. 500 for month.
- (iii) Tax outstanding Rs. 300 and insurance is prepaid Rs 400.
- (iv) Write off furniture bad debts Rs. 200 and create provision for bad debts on debtors at 5%.
- (v) Apprentice Premium Rs. 300 is related to 2011.
- (vi) Commission Accrued Rs. 100.

Ans. G.P. 29250, NP 18300 and B/S 46000

Generally Students commit these mistakes please avoid

1- Calculation of Cost of Goods Sold

Solution : To calculate Cost of Goods Sold the following formula will be applied :

$$\text{COGS} = \text{Opening Stock} + \text{Net Purchase} + \text{Direct Expenses} \\ (\text{Carriage on purchase} + \text{wages}) - \text{Closing Stock}$$

2- Confusion in calculating operating profit :

Solution: To calculate operating profit the following formula will be used :

$$\text{Operating Profit} = \text{Net Profit} + \text{Non Operating} \\ \text{Expenses} - \text{Non Operating Incomes}$$

3- Marshalling and Grouping of Assets and Liabilities :

Solution : Arrangement of assets and liabilities in a particular order is known as marshalling.

4- Provision for Bad Debts :

First of all deduct bad debts given in adjustment from the debtors

Calculate provision for doubtful debts on the amount of debtors

Deduct the amount of provision for doubtful debts given in credit side of trial balance

Questions for practice:

1. What are financial statements ?
2. Differentiate Capital Expenditure and Revenue Expenditure
3. Differentiate Capital Receipts and Revenue Receipts.

4. Prepare Final Accounts of Mr. Sharad for theyear 31-3-09. Trial Balance 31-3-09

Particulars	Amount	Particulars	Amount
Stock	20,000	Capital	1,60,000
Purchases	2,92,000	Sales	5,90,000
Duty and clearing charges	34,000	Rent	19,000
Rent	10,000	Creditors	1,35,000
Return inwards	16,000		
Discount	15,000		
Drawings	58,100		
Goodwill	16,000		
Furniture and Fittings	58,000		
Repairs	2,900		
Bank	24,000		
General expenses	18,000		
Salaries	1,10,000		
Debtors	2,30,000		
	9,04,000		9,04,000

Adjustments :

1. General expenses include Rs. 5,000 chargeable to furniture pursued on ist October 1998.
2. Create a reserve of 5% on Debtors for Bad and Doubtful debts after treating Rs. 30,000 as a Bad Debt.
3. Balance at Bank as ascertained from the pass book is Rs. 22,500, the difference representing bank charges.
4. Rent for 2 months is outstanding.
5. Depreciate furniture and fittings @ 10% p.a.
6. Closing Stock was Rs. 40,000. There was a loss by fire on 20th March to the extent of Rs. 8,000. Insurance Company admitted the claim in full.
7. Goods costing RS. 2,500 were used by the proprietor.
8. Goods costing Rs. 1,500 were distributed as free samples.

Ans. G.P. 2,80,000, N.P. 97050 B/S 3,33,450

5. From the following Trial Balance of Mr.Sarthak for the year ended 31st March 2011.. Prepare Final Accounts.

Particulars	Amount	Amount
Capital	-	2,73,000
Furniture and fittings	48,100	-
Cash at Bank	73,230	-
Land and Building	4,94,000	-
Stock	10,530	-
Debtors and Creditors	84,890	26,780
Purchase and Sales	3,55,790	6,77,120
Carriage outwards	4,030	-
Salaries	54,210	-
General expenses	31,200	-
10% Loan "(1-4-2010)	-	2,60,000
Returns	1,690	1,430
Rent	1,820	-
Wages	71,170	-
Interest	13,000	-
Bills Payable	-	8,970
Electricity Charges (Factory)	3,640	-
	12,47,300	12,47,300

Additional Information :

1. Goods costing Rs. 5,200 were taken by Sarthan for the personal use.
2. Salaries include Rs. 2,210 paid for the year ending 31-12-2012.
3. The debtors include Rohan who owned us Rs. 1,690 and has become insolvent and nothing is recoverable from his estate.
4. General expenses include Rs. 2,600 paid for wages.
5. Create a provision for doubtful debts @ 5% p.a.
6. Depreciate land and building @ 10% p.a. and furniture and fittings @ 20% p.a.
7. Closing stock was valued at Rs.20,280.

(Ans. G.P. Rs. 2,58,610 N.P. Rs. 81,290, Balance Sheet Rs.6,57,840)
