UNIT 4: PREPARATION OF FINAL ACCOUNTS

Final Accounts are the accounts, which are prepared at the end of a fiscal year. It gives a precise idea of the financial position of the business/organization to the owners, management, or other interested parties. Financial statements are primarily recorded in a journal; then transferred to a ledger; and thereafter, the final account is prepared (*as shown in the illustration*).

Usually, a final account includes the following components −

- Trading Account
- Manufacturing Account
- Profit and Loss Account
- Balance Sheet

Now, let us discuss each of them in detail −

Study of Debit side of Trading Account

- **Opening Stock** − Unsold closing stock of the last financial year is appeared in debit side of the Trading Account as "To Opening Stock"of the current financial year.
- **Purchases** − Total purchases (net of purchase return) including cash purchase and credit purchase of traded goods during the current financial year appeared as "To Purchases" in the debit side of Trading Account.
- **Direct Expenses** − Expenses incurred to bring traded goods at business premises/warehouse called direct expenses. Freight charges, cartage or carriage charges, custom and import duty in case of import, gas, electricity fuel, water, packing material, wages, and any other expenses incurred in this regards comes under the debit side of Trading Account and appeared as "To Particular Name of the Expenses".
- **Sales Account** − Total Sale of the traded goods including cash and credit sales will appear at outer column of the credit side of Trading Account as "By

Sales." Sales should be on net releasable value excluding Central Sales Tax, Vat, Custom, and Excise Duty.

- **Closing Stock** − Total Value of unsold stock of the current financial year is called as closing stock and will appear at the credit side of Trading Account.

  Closing Stock = Opening Stock + Net Purchases - Net Sale

- **Gross Profit** − Gross profit is the difference of revenue and the cost of providing services or making products. However, it is calculated **before** deducting payroll, taxation, overhead, and other interest payments. Gross Margin is used in the US English and carries same meaning as the Gross Profit.

  Gross Profit = Sales - Cost of Goods Sold

- **Operating Profit** − Operating profit is the difference of revenue and the costs generated by ordinary operations. However, it is calculated **before** deducting taxes, interest payments, investment gains/losses, and many other non-recurring items.

  Operating Profit = Gross Profit - Total Operating Expenses

Profit and Loss Account

Profit & Loss account represents the Gross profit as transferred from Trading Account on the credit side of it along with any other income received by the firm like interest, Commission, etc.

Balance Sheet

A balance sheet reflects the financial position of a business for the specific period of time. The balance sheet is prepared by tabulating the assets (fixed assets + current assets) and the liabilities (long term liability + current liability) on a specific date.

Assets

Assets are the economic resources for the businesses. It can be categorized as –

- **Fixed Assets** − Fixed assets are the purchased/constructed assets, used to earn profit not only in current year, but also in next coming years. However, it also depends upon the life and utility of the assets. Fixed assets may be tangible or intangible. Plant & machinery, land & building, furniture, and fixture are the examples of a few Fixed Assets.

- **Current Assets** − The assets, which are easily available to discharge current liabilities of the firm called as Current Assets. Cash at bank, stock, and sundry debtors are the examples of current assets.
- **Fictitious Assets** − Accumulated losses and expenses, which are not actually any virtual assets called as Fictitious Assets. Discount on issue of shares, Profit & Loss account, and capitalized expenditure for time being are the main examples of fictitious assets.
- **Cash & Cash Equivalents** − Cash balance, cash at bank, and securities which are redeemable in next three months are called as Cash & Cash equivalents.
- **Wasting Assets** − The assets, which are reduce or exhausted in value because of their use are called as Wasting Assets. For example, mines, queries, etc.
- **Tangible Assets** − The assets, which can be touched, seen, and have volume such as cash, stock, building, etc. are called as Tangible Assets.

Trading Account is an account that is prepared by the entities to know the profit earned or loss suffered from trading activities. On the other hand, Profit & Loss account is an account created to ascertain the net profit or loss for the period. This article excerpt deals with the difference between trading and profit & loss account.

There are two types of entities, i.e. manufacturing entities and non-manufacturing entities. Non-manufacturing entities are the entities engaged in trading of goods, without converting their form, meaning that they sell the products in their original form. At the end of the accounting period, it is important to identify the profit earned or loss suffered by the firm. For this purpose, the financial statement is prepared.

Financial Statement is the final product of the accounting process that involves the preparation of the summary of accounts, which are presented in a way that they depict the financial position and performance of the undertaking clearly.

Financial Statement is divided into two parts, income statement and position statement, wherein the former is further sub-classified into a trading account, and profit & loss account and the latter includes Balance Sheet.

BASIS FOR COMPARISON	TRADING ACCOUNT	PROFIT & LOSS ACCOUNT
Meaning	Trading account is an account which indicates the result of trading activities, such as purchase and sale of products.	Profit & loss account is an account, representing the actual profit earned or loss sustained by the business during the accounting period.
Preparation	It is prepared to ascertain gross profit for the period.	It is prepared to ascertain net profit for the period.
Transfer of balance	Balance of trading account is transferred to Profit & Loss Account.	Balance of profit & loss account is transferred to Capital Account.
Accounts for	Direct revenue and direct expenses	Operating and non-operating incomes and expenses.

DEFINITION OF TRADING ACCOUNT

In the income statement, trading account represents the first part, which is prepared to know the gross result, i.e. profit (loss) for the period. The account shows the outcome of trading activities, i.e. the profit earned or loss suffered on purchase or sale of goods.

The account consists of two sides; debit side indicates direct expenses and credit side is for direct incomes. Direct expenses which are incurred by the organization, to bring goods into the condition, fit for sale. Such expenses include fuel, power, freight, insurance, carriage inward, consumption of stores, etc. On the other hand, direct incomes refer to income from the activities that are earned from the sale of goods.

DEFINITION OF PROFIT & LOSS ACCOUNT

Profit and loss account is a part of the financial statement, which takes into account operating and non-operating revenues and expenses incurred, during an accounting period. It ascertains, net profit earned or loss sustained by the business.

Profit & Loss account is prepared after the preparation of trading account, with the help of trial balance. The balance of trading account is transferred to this account, which acts as the initial point, after which all expenses and losses are debited, and all incomes and gains are credited to this account.

When the debit side of the account exceed the credit side, it is a net loss, and when the credit side is more than the debit one, the result is net profit. The balance (net profit or net loss) is transferred to the capital account, on the balance sheet.

TRADING ACCOUNT IN HORIZONTAL FORMAT

Trading Account

(For the year ended...)

Dr. Cr.

Particulars		Amount	Particulars		Amount
To Opening stock		Xxx	By Sales	xxx	
To Purchases	xxx		Less: Return Inwards	(xxx)	Xxx
Less: Return Outwards	(xxx)	Xxx	By Closing stock		Xxx
To Wages		Xxx	By Gross Loss		Xxx
To Carriage Inwards		Xxx			
To Freight Inwards/cartage		Xxx			
To Gross Profit c/d		Xxx			
		xxx			xxx

PROFIT AND LOSS ACCOUNT IN HORIZONTAL FORMAT

Profit & Loss Account

Dr. (For the year ended…) Cr.

Particulars	Amount	Particulars	Amount
To Gross loss b/d	Xxx	By Gross Profit b/d	Xxx
To Salaries	Xxx	By Discount Received	Xxx
To Office rent, rates and taxes	Xxx	By Commission Received	Xxx
To Printing & stationery	Xxx	By Bank Interest	Xxx
To Telephone expenses	Xxx	By Rent received	Xxx
To Postage & telegram	Xxx	By Dividend on shares	Xxx
To Discount Allowed	Xxx	By Interest earned on debentures	Xxx
To Insurance	Xxx	By Profit on sale of asset	Xxx
To Audit Fees	Xxx	By Net loss	Xxx
To Electricity charges	Xxx		
To Repairs & renewals	Xxx		
To Depreciation	Xxx		
To Advertisement	Xxx		
To Carriage Outwards	Xxx		
To Bad Debts	Xxx		
To Provision for Bad debts	Xxx		
To Selling commission	Xxx		
To Bank Charges	Xxx		
To Interest on loans	Xxx		
To Loss on sale of asset	Xxx		
To Net Profit	Xxx		
	xxx		xxx

BALANCE SHEET

Balance sheet shows the value of a business's assets and liabilities on a particular date.

It records what the firm owns (assets), what it owes (liabilities), what it is owed and how it is financed (owner's equity).

BALANCE SHEET IN VERTICAL FORMAT

LIABILITIES	Amount	ASSETS	Amount
Capital	XX	Fixed Assets-Land, Bldg.	XX
Loan taken	XX	Current Assets	
Current Liabilities		•Cash / Bank B/s	XX
•Outstanding Expenses	XX	•Accounts Receivable (Debtors)	XX
•Bank Overdraft	XX	•Bills Receivable)	XX
•Accounts Payable (Creditors)	XX	•Inventories (Stock)	XX
	XYZ		XYZ

Horizontal Form of Balance Sheet

PROFIT AND LOSS APPROPRIATION ACCOUNT

The main intention of preparing a **profit and loss appropriation account i**s to show the distribution of **profits** among the partners. It is debited with interest on capital and remuneration to partners and credited with the net **profits** b/d from the **profit and loss account** and interest on drawings.

PARTNERSHIP FIRM

The Indian Partnership Act, 1932 defines partnership as "the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all".

Profit & Loss Appropriation Account			
Particulars	**Amount**	**Particulars**	**Amount**
To Reserves A/C (Any transfer to reserves)		By Profit and Loss A/C (Net Profit)	
To Interest on Capital A/C		By Interest on Drawings A/C	
Partner A -		Partner A -	
Partner B -		Partner B -	
To Interest on Partner's Loan A/C		www.AccountingCapital.com	
To Partner's A Salary A/C			
To Partner's B Salary A/C			
To Share of Profit A/C (Balance)			
Partner A -			
Partner B -			
Total		**Total**	