

## UNIT - 8

### FINANCIAL STATEMENT OF SOLE PROPRIETORSHIP

#### Learning Objectives

After studying this chapter, you will be able to :

- ◆ state the nature of the financial statements;
- ◆ distinguish between the capital and revenue expenditure and receipts;
- ◆ explain the concept of trading and profit and loss account and its preparation;
- ◆ State the nature of gross profit, net profit and operating profit;
- ◆ describe the concept of balance sheet and its preparation;
- ◆ explain grouping and marshalling of assets and liabilities;
- ◆ prepare profit and loss account and balance sheet of a sole proprietary firm.

**Teaching methodology :** for teaching this topic the teacher should use discussion method, explanation method, illustration method.

#### Financial Statement

Financial statements are the statements which give information about the profitability (income statement) and the financial position (Balance Sheet) of the business **at the end of accounting period.**

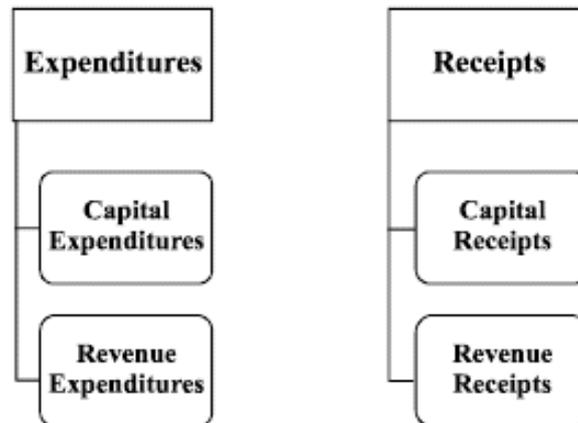
financial statements include two basic statements :

- (i) **Income statement** (Trading and Profit and Loss Account)- prepared to ascertain gross profit and net profit / loss during an accounting period.
- (ii) **Statement of Financial Position (Balance Sheet)** - prepared to ascertain financial position (assets, liabilities and capital) of an enterprise at a particular point of time.

In addition to the above two basic financial statements, two other statements also included in financial statements :

- (i) **Statement of Retained Earnings.**
- (ii) **Cash Flow Statements.**

But in class XI accountancy syllabus only two basic two statement treatment is to be done.



#### **Capital Expenditure :**

The amount which is incurred in **acquiring or improving** the value of **fixed assets** is called capital expenditure e.g. purchase of machinery / building/ furniture etc. and expenditure incurred for preparing an asset to ready for use (like installation exp., carriage, expenses incurred on second hand, fixed asset for ready to use).

#### **Nature of Capital Expenditure :**

- (i) When expenditure incurred for **increasing the earning capacity** of the business.
- (ii) Capital expenditure gives **benefit over a long period** (more than one accounting year).
- (iii) **Capital expenditure is recorded in balance sheet.**
- (iv) When an amount is incurred in **non-recurring** in nature.

#### **Examples of Capital Expenditure :**

1. Purchase of fixed assets such as land, building, machinery, furniture, motor vehicle etc.
2. Wages paid for erection of machinery.
3. Expenses of overhauling second-hand purchased machinery. (only for first time)

4. Interest on loan raised to purchase a fixed assets (upto the point of time ready to use of fixed assets).
5. Preliminary expenses for floating a company.
6. Expenses for obtaining a licence.
7. Initial expenditure for acquiring patent right.
8. Expenses incurred on purchase of goodwill, patents, trademark & copy-right etc.
9. Legal expenses incurred in connection with acquiring or defending suit for protecting fixed assets.
10. Expense incurred on repair and whitewash for the first time on the purchase of old building.
11. Expenses incurred on purchase of fixed assets e.g. registration expenses.
12. Cost of air-conditioning of the office or factory premises.

**Revenue Expenditure :**

The expenditure which is incurred for the **day to day running of the business** like expenses incurred for producing finished goods such as direct expenses, purchase of raw material and other expenses as rent, salary, repair etc.

**Nature of Revenue Expenditure :**

1. When an amount incurred on maintaining the earning capacity of the business (keep the assets in efficient working condition) e.g. repair of machinery.
2. The **benefit** of expenses would **last in one year**. (give benefit maximum of one year)
3. Revenue expenditures are recurring in nature and recorded in income statement (trading and profit and loss account)

**Examples of Revenue Expenditure :**

1. Renewal expenses/fee of patent.
2. Depreciation on fixed assets.
3. Repair of machinery normal or due to negligence of operator.
4. Insurance premium for an assets including tax on insurance.
5. Electricity bill paid, salary paid, wages paid, trading expenses, establishment changes, bad debt etc.

### **Deferred Revenue Expenditure :**

The expenditure which is **revenue in nature**, but the **amount is heavy and benefit** is likely to be derived **over a number of years** called deferred revenue expenditure. e.g. large expenses on advertising of a new product and hence it is treated same just like a fixed assets. Sometimes heavy losses due to natural calamities can also be treated as deferred revenue expenses.

**Accounting treatment of Deferred Revenue Expenditure :** As per **matching principle**, expenses incurred in an accounting period are matched with the revenue recognized in that accounting period. So the whole deferred revenue expenditure should be spread over the number of year over which benefit is likely to occur.

**During the current accounting year (a). Only that portion of the expenditure should be charge to the profit and loss account which has facilitated the enterprise to earn revenue during current year.**

**(b) Remaining amount of expenditure be carried forward to the next year and shown in the assets side of balance sheet (actually it is a fictitious assets).**

#### **Examples of deferred revenue expenditure :**

1. Heavy amount spent on advertisement on launching a new product.
2. Heavy repair expenditure incurred on machinery (which has not increased earning capacity of machinery) may be treated as deferred revenue expenditure and spread over a number of years.

### **Capital Receipt**

Capital receipts don't affect profit or loss of business; it either increase the liabilities or reduces the fixed assets (by sale of fixed assets). So **it will be shown in balance sheet.**

#### **Capital receipts includes following receipts :**

**I.** Fresh capital introduced or additional capital introduced

**II.** Loan raised.

**III.** Amount received which is not in the normal and ordinary course of business like sale of fixed assets.

**Capital receipts are not made available for distribution of profit to the owner.**

### Revenue Receipt

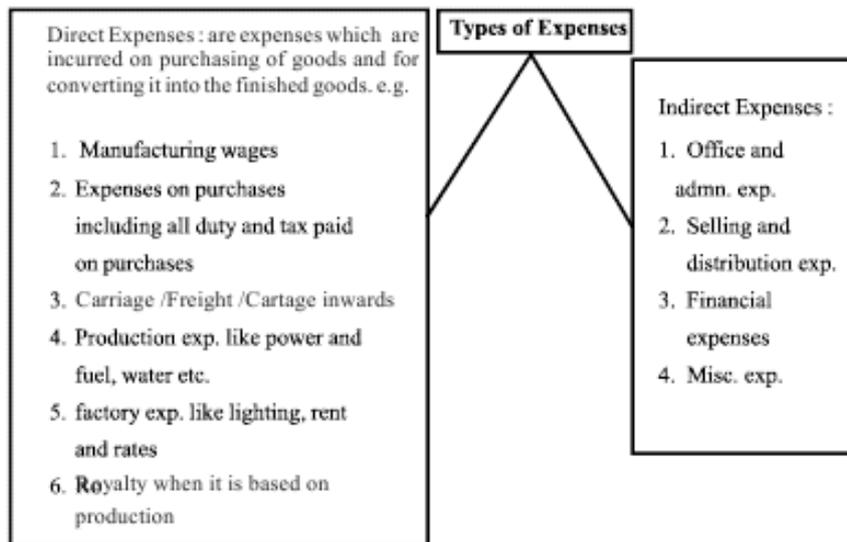
Revenue receipts are received in the normal and regular course of business like

- (i) Receipts from sale of goods and rendering services to customers.
- (ii) Income from non-operating business activities (like income from investment i.e. interest and dividend received and rent received).
- (iii) Commission and other fees received from non-operating business service rendered.

Accounting Treatment : **These receipts increases profit and shown in the credit side of the Trading and Profit and Loss account.**

### Income Statement

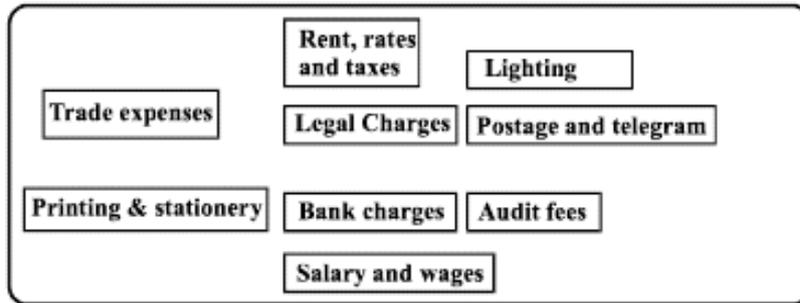
1. It is a **nominal account**.
2. It has two parts (a) Trading Account : for calculating gross profit/loss.  
(b) Profit and Loss account : for calculating net profit/loss.



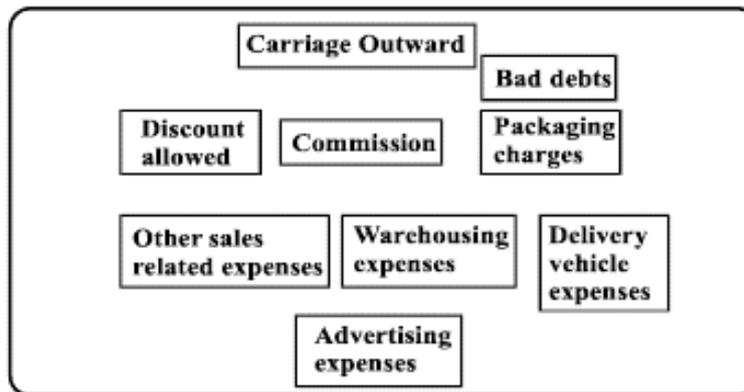
**Note :** All direct expenses are debited to Trading account and all indirect expenses are debited to Profit and Loss account.

**Examples of Indirect Expenses :**

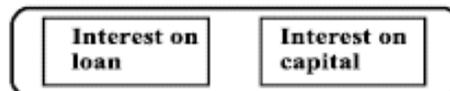
**(1) Office and admn. Expenses :**



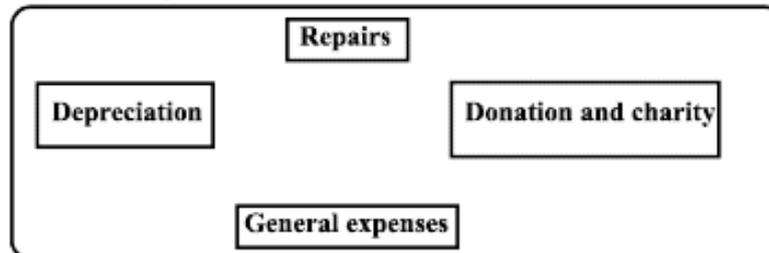
**(2) Selling and distribution Expenses :**



**(3) Financial Expenses :**



**(4) Misc. Expenses :**



**Calculation of Gross Profit :** Gross Profit = Net Sales - Cost of Goods Sold  
 Cost of Goods Sold = Net Sales - Gross Profit

**OR**

= Opening Stock + Purchases + Direct Expenses - Closing Stock.

**Calculation of Operating Profit :** Operating profit = Net sales – Operating cost.

**Operating Cost** = Cost of Goods Sold+office and admn. Expenses+selling and distribution exp.

**OR**

**Operating Profit = Gross Profit – (Office Admn. Expenses+selling and distribution exp.)**

**Net Profit** = Operating Profit +Non–operating profit -non-operating expenses.

**Operating expense :** the expenses which are related to the main or normal activities of the business e.g. office and admn. expenses, selling and distribution expenses.

Operating profit also called **EBIT** (earning before interest and taxes)

**Format of a Trading and Profit and Loss Account**

Trading and Profit and Loss Account  
 (for the year ending.....)

Particulars	Amount ₹	Particulars	Amount ₹
To opening stock	.....	By Sales.....	
To purchases .....	.....	Less : Return inward.....	.....
Less : return outward .....	.....	By loss on sales of abnormal events	.....
To Direct expenses	.....	By Closing stock	.....
To Gross profit (transferred to profit and loss account Cr. side)	.....	By Gross loss (Transferred to profit & loss A/c Dr. side)	.....
To Gross loss (transferred from trading A/c)	.....	By Gross Profit (transferred from A/c)	.....
To office and Admn. Exp.	.....	By Non-operating income	.....
To selling and distribution exp.	.....	By Net Loss (to be transferred to capital A/c)	.....
To financial exp.	.....		
To misc. exp.	.....		
To Net Profit (to be transferred to capital A/c)	.....		

## BALANCE SHEET

In Trading and Profit and Loss account all nominal A/cs balances are transferred and balances of all the personal and real accounts grouped as assets and liabilities. Liabilities are shown on the left hand side of the balance sheet and assets on the right hand side of the balance sheet.

Main purpose of preparing balance sheet is to ascertain the financial position of the business at a particular point of time.

### Grouping and marshalling of assets and liabilities :

**Grouping** : means putting various assets and liabilities having the same nature under some common heading. e.g. the amount receivable from various customers will be shown under heading 'Sundry Debtors'. Similarly, under heading 'Current Assets' the balance of cash, bank, debtor, stock etc. will be shown.

**Marshalling** : is the arrangement of various assets and liabilities in a particular order like (a) in the order of liquidity (b) in the order of permanence-exactly the reverse of the order of liquidity.

(a) in the order of liquidity-More Liquid Assets → less liquid → permanent Assets

First item    to    Last item of assets    →

**Short term liabilities** → **medium term liabilities** → **Long term liabilities**

(b) in order of **permanence**- More permanence assets → less permanence → **liquid assets**

**Long term liabilities** → **medium term liabilities** → **short term liabilities**

### Balance Sheet

As on .....

Liabilities	Amount ₹	Assets	Amount ₹
Sundry Creditors	.....	Cash in hand	.....
Bills Payable	.....	Cash at bank	.....
Bank Loan	.....	Bills Receivables	.....
Outstanding expense	.....	Sundry debtors	.....
Income received in advance	.....	Advance payments	.....

Loan on mortgages	.....	Stock	.....
Reserves and surplus	.....	Investment	.....
Capital	.....	Furniture and fixture	.....
		Plant and machinery	.....
		Land and building	.....
		Trade mark	.....
		Copyrights	.....
		Patents	.....
		Goodwill	.....

The above balance sheet is given in the order of liquidity, if you need in permanency order reverse the order of assets and liabilities.

**Note 1.** If closing stock shown in Trial Balance then it will be shown in balance sheet only. It is assumed that purchases amount already get adjusted in trial balance.

- Salary and wages** will be shown in profit and loss A/c debit side (assuming that salary is prominent) while **Wages and salary** will be shown in trading A/c debit side. (wages are prominent)
- Freight, carriage, cartage** will be shown in Dr. side of trading A/c. if inward word attached with these then it also debited to trading a/c, if outward word attached with these item then it will be debited to profit and loss account.
- Any expenses related to factory are debited to trading account like factory lighting, factory rent if factory word is not given then lighting and rent will be debited to profit and loss account.
- Trade expenses** always debited to profit and loss a/c not as name indicate trading a/c.
- Packaging material** : cost of packaging material used in product are direct expenses as it refers to small containers which form part sold, it will debited to trading a/c.
- Packing** : the packing refers to the big containers that are used for transporting the goods and regarded as indirect expenses and debited to profit and loss account.

8. **Adjusted purchases** mean the amount of purchases is adjusted by way of adding opening stock and reduced by the amount of closing stock. *e.g.*, purchases ₹ 1,00,000; opening stock ₹ 12,000, closing stock ₹ 8,000. Calculate adjusted purchases.

$$\begin{aligned} \text{Adjusted purchases} &= \text{purchases} + \text{opening stock} - \text{closing stock} \\ &= ₹ 1,00,000 + ₹ 12,000 - ₹ 8,000 = ₹ 1,04,000 \end{aligned}$$

**When adjusted purchases is given in trail balance, then there is no need of debiting opening stock and crediting closing stock in trading a/c. In this case closing stock will be shown in balance sheet only.**

Calculation of cost of goods sold and preparation of trading account :

**Illustration :1.**

Stock as on 01.04.2010 Rs. 10,000;

Sales Rs. 2,00,000; Purchases Rs. 1,45,000; carriage inwards Rs. 4,000; clearing charges Rs. 5,000; sales returns Rs. 1,500; purchases return Rs.2,000; carriage outward Rs. 2,500; stock as on 31.03.2011 Rs. 15,000.

Calculate cost of goods sold and prepare trading account for the year ending 31.03.2011.

#### Trading Account

Dr. (for the year ending 31<sup>st</sup> march 2011) Cr.

Particulars	Amount	Particulars	Amount
To Opening stock	10,000	By Sales 2,00,000	
To Purchases 1,45,000		Less: return <u>1,500</u>	1,98,500
Less: Return <u>2,000</u>	1,43,000		
To Carriage inward	4,000	By Closing Stock	15,000
To Clearing charges	5,000		
To Gross profit (to be transferred to profit & loss a/c)	51,000		
	<b>2,13,500</b>		<b>2,13,500</b>

Cost of goods sold = net sales – gross profit

= 1,98,500 – 51,500 = ₹ 1,47,000

Or opening stock + net purchases + direct expenses – closing stock

= 10,000 + 1,43,000 + 4,000 + 5,000 – 15,000 = 1,47,000

**Illustration :2.** Calculate cost of goods sold and prepare trading account for the year ending 31.03.2011 from the following information.

Opening stock Rs. 2,00,000; purchases Rs. 3,50,000; closing stock Rs. 1,20,000; Wages Rs. 2,500; freight Rs. 4,500; carriage outward Rs. 5,500; trade expenses Rs. 2,500.

The percentage of gross profit on sales is 20%

**Sol:** Calculation of cost of goods sold = opening stock + purchases + direct exp. Closing stock

= 2,00,000 + 3,50,000 + 2,500 + 4,500 – 1,20,000

= ₹ 4,37,000

Let sales = ₹ 100; then gross profit = ₹ 20,

Therefore cost of goods sold will be = ₹. 100 – 20 = ₹ 80

If cost of goods sold is ₹ 80, then sales is = ₹ 100

If cost of goods sold is ₹. 4,37,000, then sales =  $100/80 \times 4,37,000 = ₹ 5,46,250$

#### Trading Account

Dr. (for the year ending 31<sup>st</sup> March 2011)

Cr.

Particulars	Amount	Particulars	Amount
To Opening stock	20,000	By Sales	5,46,250
To Purchases	3,50,000	By Closing stock	1,20,000
To Wages	2,500		
To Freight	4,500		
To Gross profit (to be transferred to profit loss a/c)	1,09,250		
	<b>6,66,250</b>		<b>6,66,250</b>

If gross profit is  $\frac{1}{5}$  of sales given (e.g.  $\frac{20}{100}$ ), then Gross profit = 20, sales = 100 And cost of goods sold =  $100 - 20 = 80$  i.e. gross profit is  $\frac{20}{80}$  of cost. (25% of cost)

**OR**

If gross profit is 20% of sales then it means 25% on cost

Gross profit is ₹ 20 and sales is ₹ 100 ( $\frac{20}{100}$ ) = (Cost  $100 - 20 = 80$ )  
gross profit is 20 and cost is 80 ( $\frac{20}{80}$ ) i.e.

20% of sales = 25% of cost

**Illustration 3 :** Calculate cost of goods sold and prepares trading account for the year ending 31.03.2011 form the following information :

Opening stock Rs. 30,000; cash sales Rs. 1,60,000; credit sales Rs. 80,000; direct expenses Rs. 5,000; purchases Rs. 1,90,000.

Rate of Gross profit on cost is  $33\frac{1}{3}\%$ .

**Sol.** Total sales = cash sales + credit sales

= 1,60,000 + 80,000

= 2,40,000

Let sales Rs. 100 and gross profit  $33\frac{1}{3}\%$ , =  $\frac{100}{3}\%$

If sales is 2,40,000 then gross profit =  $100/3 \times 1/100 \times 2,40,000 = 80,000$

Then cost of goods sold = net sales – Gross profit

= 2,40,000 – 80,000 = ₹ 1,60,000

**Calculation of closing stock**

Cost of goods sold = opening stock + purchases + direct expense – closing stock

1,60,000 = 30,000 + 1,90,000 + 5,000 – closing stock

Closing stock = 2,25,000 – 1,60,000 = ₹ 65,000

**Trading Account**  
(for the year ending 31<sup>st</sup> March 2011)

Dr.		Cr.	
Particulars	Amount ₹	Particulars	Amount ₹
To Opening stock	30,000	By Sales	2,40,000
To Purchases	1,90,000	By Closing stock	65,000
To Direct exp.	5,000		
To Gross profit (to be transferred to profit loss a/c)	80,000		
	<b>3,05,000</b>		<b>3,05,000</b>

**Illustration 4.** From the following information, prepare a profit and loss account for the year ending 31<sup>st</sup> March 2011.

Gross profit ₹ 70,000; Rent ₹ 5,000; Salary ₹ 15,000; Wages ₹ 8,000;  
Commission paid Rs. 7,000; Interest paid on long term loan ₹ 5,000; Advertising ₹ 3,000;  
Discount Received ₹ 2,000; Printing and Stationery ₹ 1,000; Legal Charges ₹ 2,500;  
Bad debts ₹ 1,500; Depreciation ₹ 1,000; Income received from investment ₹ 3,000;  
Loss by fire ₹ 2,200; Bad debts recovered ₹ 200; freight outward ₹ 600; Audit fees ₹ 450.

**Profit and Loss Account**  
(for the year ended 31<sup>st</sup> March, 2011)

Dr.		Cr.	
Particulars	Amount ₹	Particulars	Amount ₹
To Rent	5,000	By Gross Profit	70,000
To Salary	15,000	By Discount received	2,000
To Commission	7,000	By Bad debts recovered	200
To Interest on long term-loan	5,000	By income from investment	3,000
To Advertising	3,000		
To Printing and Stationery	1,000		

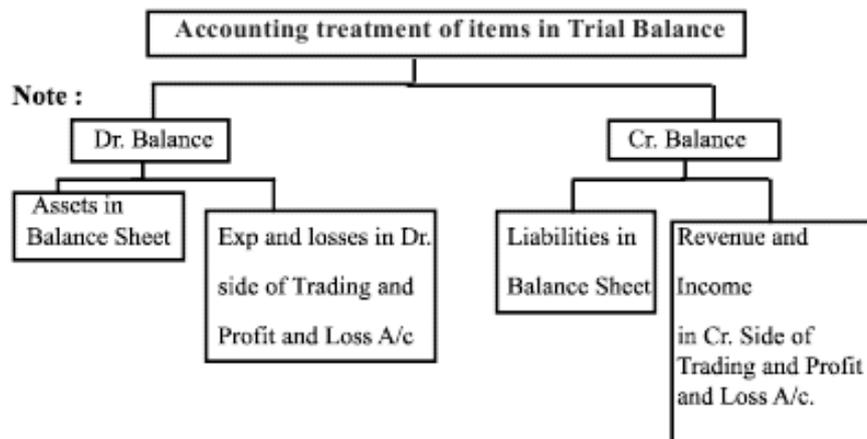
To Legal charges	2,500		
To Bad debts	1,500		
To Depreciation	1,000		
To Loss by fire	2,200		
To Freight outward	600		
To Audit fees	450		
To Net profit (to be transferred to Capital Account)	30,950		
	<b>75,200</b>		<b>75,200</b>

**Illustration 5.** From the illustration no. 4 information calculate operating profit.

**Sol.** Operating profit = Net profit – non operating income (income from investment) + non operating expenses (loss by fire and interest paid on long term loan)

$$= 30,950 - 3,000 + 2,200 + 5,000$$

$$= ₹ 35,150$$



**Illustration No 6.**

Following is the Trial Balance of Aradhya Trader as on 31<sup>st</sup> March, 2011.

<b>Particulars</b>	<b>Dr. ₹</b>	<b>Cr. ₹</b>
Plant and Machinery	1,45,000	—
Furniture	1,27,500	—
Motor Vehicles	337,250	—
Buildings	97,750	—
Stock as on 1 <sup>st</sup> April 2010	75,500	—
Stock as on 31 <sup>st</sup> March 2011	80,000	—
Purchases and Sales	7,00,000	11,75,000
Return	25,000	15,000
Carriage Inward	1,500	—
Carriage Outward	2,500	—
Salary and Wages	25,000	—
Power and fuel	2,000	—
Discount	2,500	2,000
Commission	1,500	2,500
Interest	2,500	2,500
Repairs	3,000	—
Postage and Telegrams	2,000	—
Trade Expenses	1,500	—
Rent	1,200	—
Sales Promotion exp.	2,500	—
Bad debts	1,500	—

Depreciation	70,000	—
Misc. Exp./Income	2,000	15,000
Debtors/Creditors	90,000	50,000
Bills Receivable/Bills Payable	25,000	12,500
Investment	50,000	—
Drawing	12,500	—
Cash in hand	2,500	—
Cash at bank	10,000	—
Capital	----	5,34,700
Loan from Bank (Long term)	----	90,000
<b>Total</b>	<b><u>19,00,200</u></b>	<b><u>19,00,200</u></b>

Prepare the Trading and Profit and Loss Account for the year ended 31<sup>st</sup> March, 2011 and the Balances Sheet as at that date.

**Trading and Profit and Loss Account**  
(for the year ended 31st March, 2011)

Dr.		Cr.	
Particulars	Amount ₹	Particulars	Amount ₹
To Opening Stock	75,500	By Sales 11,75,000	
To Purchases 7,00,000		Less: Return Inward <u>25000</u>	11,50,000
Less: Return outward <u>15000</u>	6,85,000		
To Carriage Inward	1,500		
To Power and Fuel	2,000		
To Gross Profit (transferred to P and L A/c)	3,86,000		
To Carriage Outward	<u>11,50,000</u>	By Gross Profit	<u>11,50,000</u>
To Salary & Wages	2,500	(transferred from	3,86,000
	25,000	Trading A/c)	

To Discount Allowed	2,500	By Discount Received	2,000
To Commission paid	1,500	By Commission received	1,500
To Interest Paid	2,500	By Interest received	2,500
To Repairs	3,000	By Misc. Incomes	15,000
To Postage and Telegrams	2,000		
To Trade Exp.	1,500		
To Rent	1,200		
To Sales Promotion Exp.	2,500		
To Bad debts	1,500		
To Depreciation	70,000		
To Misc. Exp.	2,000		
To Net Profit (trans ferred to Capital A/c)	2,89,300		
<b>Total</b>	<b><u>4,07,000</u></b>		<b><u>4,07,000</u></b>

**BALANCE SHEET**

As on 31<sup>st</sup> March, 2011

<b>Liabilities</b>	<b>Amount ₹</b>	<b>Assets</b>	<b>Amount</b>
Creditors	50,000	Plant and Machinery	1,45,000 ₹
Bills Payables	12,500	Furniture	1,27,500
Loan from Bank	90,000	Motor Vehicles	3,37,250
Capital 5,35,700		Buildings	97,750
Less : Drawings <u>12,500</u>		Closing Stock	80,000
5,23,200		Debtors	90,000
Add: Net <u>2,89,300</u>		Bills Receivables	25,000
Profit 8,12,500		Investment	50,000
		Cash in Hand	2,500
		Cash at Bank	10,000
	<b><u>9,65,000</u></b>		<b><u>9,65,000</u></b>



Accounting Treatment : (i) outstanding expenses are shown as **current liabilities in liabilities side of balance Sheet.**

(ii) The amount actually paid for the concerned expenses will be **increased** by the outstanding expenses amount in the **Dr. side of trading or profit and loss A/c** as per the case.

If **outstanding expenses have been mentioned inside** the Trial Balance, they will be shown in the liabilities side of Balance sheet only.

**3. Prepaid expenses (Exp. paid in advance) :** These are expenses which have been paid in current year and benefit of it will be available in next accounting year also like prepaid insurance, prepaid rent.

Adjustment entry : Prepaid expenses A/c Dr.

To concerned expenses A/c

(Being exp. paid in advance recorded in the books)

The word expenses may be replaced by the name of exp. like salary, wages, rent etc.

Accounting Treatment : (i) Prepaid expenses are shown as **current Assets in Assets side of balance sheet.**

(ii) The amount actually paid for the concerned expenses will be **reduced** by the prepaid expenses amount in the **Dr. side of trading or profit and loss A/c** as per the case.

If **prepaid expenses have been mentioned inside the Trial Balance, they will be shown in the Asset side only.**

**4. Accrued income or outstanding income / income receivable :** Income which have been earned during the current accounting period but not received till the end of accounting period is called accrued income. e.g. interest on investment due but not yet received.

Adjustment entry : Accrued Income A/c Dr.

To Concerned Income A/c

(Being income accrued during the year)

The word income may be replaced by the name of income like commission, interest etc.

Accounting Treatment : (i) Accrued income are shown as **current Assets in Assets side of balance sheet.**

(ii) The concerned income will be **increased** by the amount of accrued income amount in the **credit side of Trading or Profit and loss Account.**

If **Accrued Incomes have been mentioned inside the Trial Balance, they will be shown in the Asset side only.**





Provision for doubtful debts A/c      Dr.

To Bad Debts A/c

(Being bad debts written from old provision)

(ii) for creating New provision : with the amount of difference :

Profit and Loss A/c Dr.

To Provision for doubtful debts A/c

(New provision debts [old Provision total Bad debts])

**Illustration No. 7.**

**Trial Balance**

As on.....

Particulars	Dr.	Cr.
Bad Debts	3,000	
Provision for doubtful debts		5,000
Sundry Debtors	1,51,000	

Additional Information : Further Bad Debts amounted Rs. 1,000 and create provision for Doubtful Debts @ 5%.

**Profit and Loss Account**

for the year ended.....

Dr.		Cr.	
Particulars	₹	Particulars	₹
To Bad Debts	3,000		
Add: further Bad Debts	1,000		
	4,000		
Add: New Provision	7,500		
(1,50,000@5%)	11,500		
Less: Old Provision	5,000		
	6,500		



Dr.				Sundry Debtors A/c			Cr.	
Particulars	J.F.	Amount ₹	Date	Particulars	J.F.	Amount ₹		
To Balance b/d		1,51,000		By Bad debts A/c		1,000		
				By Balance c/d		1,50,000		
		<u>1,51,000</u>				<u>1,51,000</u>		

**Special Note :** If the amount of old Provision for doubtful debts (Trial balance) is more than the total of Bad debts (Old + New) and New Provision for doubtful debts.

**Illustration No. 8.**

**Trial Balance**

Particulars	Amount Dr. ₹	Amount Cr. ₹
Bad Debts	2,000	
Provison for doubtful debts		25,000
Sundry Debtors.	2,02,500	

**Additional information :** (i) Further bad debts 2,500.

(ii) Create a provision for doubtful debts @5% on Sundry debtors.

Dr.		Profit and Loss Account		Cr.	
Particulars	Amount ₹	Particulars	Amount ₹	Particulars	Amount ₹
		By Old Provision for doubtful debts	25,000		
		Less: Bad debts-	2,000		
		further bad debts	2,500		
		New Provision	<u>10,000</u> 14,500		10,500

### Balance Sheet

As at.....

Particulars	Amount ₹	Particulars	Amount ₹
		Debtors	2,02,500
		Less: further bad debts	<u>2,500</u>
			2,00,000
		Less: 5%New Provision	<u>10,000</u>
		for doubtful debts	<b>1,90,000</b>

**9. Provision for discount on debtors :** Generally, the business allows cash discount to those debtors from whom the payment is received within a fixed period. Since a provision for such discount is made in the current year for that debtors who will make early payment in the next accounting period.

**Note :** This provision is made only for good debtors at the end of year.  
 Good Debtor = total debtor – further bad debts-new provision for doubtful debts.

**Adjustment entry :** Profit and Loss A/c Dr.

To Provision for discount on debtors A/c

(Being provision made for discount on debtors)

**Accounting Treatment :** (i) The amount of provision of discount on debtor will be debited to profit and loss account.

(ii) The amount of sundry debtors will be reduced by the amount of provision for discount on debtors in the Assets side of Balance Sheet.

**10. Manager's Commission :** Generally, to motivate managers the business may allow a commission to managers in addition to salary. Such commission is calculated at the end of accounting period, so it is treated as outstanding expenses.

Commission rate is generally related to net profit.

**Adjustment entry :**

(i) Manager's Commission A/c Dr.

To Outstanding manager's Commission A/c

(Being commission due to the managers)

(ii) Profit and Loss A/c Dr.

To Manager's Commission A/c

(Being manager's commission transferred to profit and loss A/c).

**Accounting Treatment :** (i) The amount of manager's commission is to be debited to profit and loss account.

(ii) The amount of outstanding manager's commission will be shown as **current liabilities in the liabilities side of Balance sheet.**

There are two methods for calculation of commission :

(i) Commission allowed on the net profit before charging such commission :

**Net profit before charging such commission**  $\times$  **XX%** of commission / 100. e.g. if Net profit before charging such commission is 99,000 and rate of commission is 10% then, manager commission will be =  $99,000 \times 10/100 = 9,900$

(ii) Commission allowed on the net profit **after** charging such commission:

Net profit before charging such commission  $\times$  **XX%** of commission /  $100 +$  rate of commission.

e.g. if Net profit before charging such commission is 99,000 and rate of commission is 10% then, manager commission will be =  $99,000 \times 10/110 = 9000$ .

**11. Abnormal loss :** Sometimes losses occur due to some abnormal circumstances such as accident, fire, flood, earthquakes etc. such loss are called abnormal losses.

**(A) Loss of goods/ stock :**

(i) Loss by Accident A/c Dr.

To Trading A/c

(Being the accidental loss of goods transferred to Cr. Side of trading a/c)

(ii) Insurance Co. A/c Dr. (Amount of claim accepted by the Insurance co.)

Profit and Loss A/c Dr. (Value of irrecoverable loss)

To Loss by Accident A/c (Total loss)

(Being the loss transferred to profit and loss A/c and claim admitted by Insurance Co.)

**Accounting Treatment :** 1. Amount of loss of goods will be transferred to the **credit side of trading account** or it may be **deducted from the purchases.**

2. The claim admitted by the Insurance Co. **will be shown in the assets side of balance sheet.**

3. Amount **irrecoverable or uninsured** will be **debited to profit and loss** Account.

**(B) Abnormal Loss of Fixed Assets :**

Profit and Loss A/c Dr.

To fixed assets A/c

(Abnormal loss of fixed assets recorded)

12. **Goods taken for personal use :** it is treated as drawing.

Drawing A/c Dr.

To Purchases A/c

(Being goods taken for personal use)

**Accounting treatment :** (1) cost of goods taken will be **deducted from the purchase in debit side of trading account.**

(ii) Amount of drawing will be **deducted from the capital on the liabilities side of balance sheet.**

**13. Goods distributed as free samples :** This is a sales promotion method, it is assumed as advertisement expenses.

Advertisement A/c Dr.

To Purchases A/c

(Goods distributed as free sample)

Accounting treatment : (i) cost of goods distributed as free samples will be **deducted from purchases in the debit side of trading account.**

(ii) Advertisement expenses account will be **debited to profit and loss account.**

**Illustration No. 9.**

Following is the Trial Balance of Rajesh Export as on 31<sup>st</sup> March, 2011.

<b>Dr.</b>		<b>Cr.</b>	
<b>Particulars</b>	<b>Amount ₹</b>	<b>Particulars</b>	<b>Amount ₹</b>
Opening Stock	18,000	Sales	5,70,000
Purchases	3,50,000	Return outward	20,000
Return inward	30,000	Discount Received	1,100
Carriage inward	1,200	Interest Received	9,500
Carriage outward	1,500	VAT collected	21,600
Discount allowed	900	Supplier's A/c's	25,000
Factory heating and lighting	12,000	Bank overdraft	35,000
Wages and Salary	25,000	Capital A/c	3,10,000
Insurance	1,200	Commission	2,800
Postage and Telegrams	500	Misc. receipt	5,000
Rent	10,000	12% Loan from Bank	2,00,000
VAT Paid	13,800		
Manufacturing Exp.	9,900		
Plant and Machinery	1,50,000		
12% Investment	1,00,000		
Land and Building	3,85,000		
Interest paid on Loan	15,000		
Income tax	11,000		
Customer's A/cs.	45,000		
Cash in hand	20,000		
	<b><u>12,00,000</u></b>		<b><u>12,00,000</u></b>

**Additional Information** (i). Closing Stock at market value as on 31/03/2011 is Rs. 50,000, However its cost was Rs. 60,000.

(ii) Provide depreciation on Plant and machinery and Land and Building @10% and 5% respectively.

(iii) Insurance was prepaid to the interest of Rs. 200.

(iv) Outstanding liabilities in respect of Wages and Salary is Rs. 5,000.

(v) Loan taken from Bank on 1<sup>st</sup> July 2010.

(vi) Investment was purchased on 01<sup>st</sup> April, 2010.

(vii) 10% of the Commission received is in respect of work to be done in next year.

You are required to prepare (i) Trading and Profit and Loss account for the year ended 31<sup>st</sup> March, 2011. and

(ii) Balance sheet as at that date.

**Solution :**

**Trading and Profit and Loss Account**

for the year ended 31<sup>st</sup> March, 2011

Dr.		Cr.	
Particulars	Amount ₹	Particulars	Amount ₹
To Opening Stocks	18,000	By Sales 5,70,000	
To Purchases 3,50,000		Less: Return <u>30,000</u>	
Less : Return outward <u>20,000</u>	3,30,000	Inward	5,40,000
To Carriage Inward	1,200	By Closing Stock	50,000
To factory heating and Lighting	12,000		
To Wages and Salary 25,000			
Add: Outstanding <u>5,000</u>	30,000		
To Manufacturing Exp.	9,900		
To Gross Profit			
(to be transferred	1,88,900		
to profit and loss A/c)	<u>5,90,000</u>		<u>5,90,000</u>

To Carriage outwards	1,500	By Gross Profit	1,88,900
To Discount allowed	900	By Discount received	1,100
To Insurance 1200		By Interest Received 9,500	
Less: Prepaid Insurance- 200	1,000	Add: Interest Received 2,500	12,000
To Postage and Telegram	500		
To Rent	10,000	By Commission 2,800	
To Interest on Loan 15,000		Less: Commission 280	2,520
Add: outstanding Int. 3,000	18,000	Received in Advance	
To Dep. on Plant and Machinery	15,000	By Misc. Receipts	5,000
To Dep. on Land and Building	19,250		
To Net Profit (to be transferred to Capital A/c).	1,43,370		
	<b>2,09,520</b>		<b>2,09,520</b>

**Balance Sheet**

As at 31<sup>st</sup> March, 2011

Liabilities	Amount ₹	Assets	Amount ₹
Creditors	25,000	Cash in hand	20,000
Bank overdraft	35,000		
Outstanding Wages and Salary	5,000	Debtors	45,000
Commission Recieved in Advance	280	Prepaid Insurance	200
Bank Loan 2,00,000		Closing Stock	50,000
Add: Outstanding Interest 3,000	2,03,000	12% Investment	1,00,000
VAT collected 21,600		Accrued interest on Invest.	2,500
Less: VAT Paid 13,800	7,800	Plant and Mahinery 1,50,000	
Capital A/c 3,10,000		Less: Dep. 1,5000	1,35,000
Less: Income tax 11000		Land Building 3,85000	
(Drawing) 2,99,000		Less: Dep. 19,250	3,65,750
Add: Net Profit 1,43,370	4,42,370		
	<b>7,18,450</b>		<b>7,18,450</b>

**Note :** (1) Closing stock is recorded cost or market price whichever is lower.

(2) Outstanding Wages and Salary Rs. 5,000 added to Wages and Salary in debit side of Trading A/c and Shown in liabilities side of B/S.

(3) Interest on Loan is calculated for 9 Months.

01/07/2010 to 31/03/2011 — 9 Months.

$$\text{Int. due } 200,000 \times \frac{9}{12} \times \frac{12}{100} = 18,000$$

Int. Due	18,000
Less Int. Paid	<u>15,000</u>
Outstanding Int.	3,000

Outstanding Interest 3000 Shown in profit and loss Dr. side and Liabilites side of Balance sheet.

(4) Interest on Investment is due for 12 month

$$100,000 \times \frac{12}{100} = 12,000$$

Less Interest Recivied     9,500

Interest accrued but not received ₹2,500

Rs. 2,500 will be added to interest recieved amount in profit and loss Credit side and in Assets side of balance sheet.

**Illustration No. 10.**

From the following Trial Balance of M/s Rahul Traders as on 31<sup>st</sup> March 2011. Prepare Trading and Profit and Loss Account and Balance Sheet on that date.

<b>Dr.</b>		<b>Cr.</b>	
<b>Particulars</b>	<b>Amount ₹</b>	<b>Particulars</b>	<b>Amount ₹</b>
Purchases	2,80,000	Sales	4,30,000
Drawings	72,000	Capital	3,00,000
Stock (01/04/2010)	90,000	Return Outward	5,000
Return Inward	4,000	10% Bank Loan (01/04/2010)	50,000
Wages and Salary	10,000	Creditors	32,000
Power and Fuel	6,000	Provision for Doubtful Debts	3,000
Plant and Machinery	1,50,000		
Furniture	50,000		
Rent	10,000		

Insurance	3,600		
Sundry Debtors	70,000		
Bad debts	4,400		
Trade Exp.	8,000		
Cash in Hand	12,000		
Cash at Bank	50,000		
	<b><u>8,20,000</u></b>		<b><u>8,20,000</u></b>

**Additional Information :**

- (1) Cost of stock as on 31.03.2011 stand at Rs. 1,20,000, while market value of the same was Rs. 1,00,000.
- (2) Provide depreciation on Plant and Machinery and furniture @ 10% and @5% respectively.
- (3) Sundry debtors Includes an amount, ₹ 500 due from Sohan, who has become Insolvent.
- (4) A provision for doubtful is to be creats @5% on Sundry debtor and a provision for discount on debtor @2% to be made on debtors.
- (5) Goods costing Rs. 8,000 have been destroyed by fire and insurance company admitted a claim for Rs. 5,000 only.
- (6) Goods costing Rs. 2,000 were distributed as free samples while goods costing Rs. 1500 were taken by the proprietor for personal use.
- (7) Provide for manager's commission at 5% on Net profit after charging such commission.

**Trading and Profit and Loss A/c**  
(for the year ended 31<sup>st</sup> March, 2011)

<b>Dr.</b>		<b>Cr.</b>	
<b>Particulars</b>	<b>Amount ₹</b>	<b>Particulars</b>	<b>Amount ₹</b>
To Opening Stock	90,000	By Sales 4,30,000	
To Purchases 2,80,000		Less: Return <u>4,000</u>	4,26,000
Less: Return outward -5000		Inward	
-free sample - 2000		By Goods Cost by fire	8,000
-Drawing of goods- <u>15,000</u>	2,71,500	By Closing Stock	1,00,0000
To Wages and Salary	10,000		

To Power and Fuel	6,000		
To Gross Profit	1,56,500		
(To be transferred to profit and loss A/c)	5,34,000		5,34,000
To Goods Lost by fire	3,000	By Gross Profit	1,56,500
To Advertising	2,000		
To Rent	10,000		
To Insurance	3,600		
To Interest on Bank Loan	5,000		
To Trade Expenses	8,000		
To Dep. on Machinery	15,000		
To Dep. on Furniture	2,500		
To Bad Debts. 4,400			
Add: further Bad debts 5000			
Add: New Provision 5,200			
	14,600		
Less: old provision 3000	11,600		
Doubtful debts. _____			
To provision for Discount on Debtors	1,196		
To Manager's commission	4,505		
$94604 \times \frac{5}{105}$			
To Net Profit (to be transferred to Capital A/c)	90,099		
	<b>1,56,500</b>		<b>1,56,500</b>

### Balance Sheet

As on 31<sup>st</sup> March, 2011

Liabilities	Amount ₹	Assets	Amount ₹
Creditors	32,000	Cash in hand	12,000
Bank Loan 50,000		Cash at Bank	50,000
Add: Outstanding		Insurance Company	5,000

Interest	<u>5,000</u>	55,000	Stock	1,00,000
Mananer's commission		4505	Debtors	70,000
Payable	3,00,000		Less: further Bad debts	5000
Less: Drawing			Less: New Provision	
(72000+1500) =	<u>73500</u>		@8%	<u>-5200</u>
	2,26,500			59800
Add: Net Profit	<u>90,099</u>	31,6599	Less: 2% Provision-	<u>1196</u>
			for discount debtors	58604
			Machinery	1,50,000
			Less 10% Dep.	<u>15,000</u>
			Furniture	50,000
			Less: 5% Dep.	<u>2,500</u>
				47,500
		<b>4,08,104</b>		<b>4,08,104</b>

**Note:.**

- (1) Net profit before charging manager's commission is ₹. 94,604 (1,56,500 – 61,896)
- (2) The amount of purchases is redirect by the amount of good distributed as free sample and the drawing of goods.
- (3) Goods lost by fire credited to Trading A/c by cost 8,000 ₹ 3,000 is net loss because it is not recoverable from insurance co. So ₹ 3,000 debited to P & L A/c and Rs. 5,000 claim accepted by musurance Co. is Treated as assets in balance sheet.
- (4) Provision for discount on Debtors is always calculate on the good debtors *i.e.*, after deducting bad debts and New provision *i.e.*, 70,000–5,000–5,200 New provision =  $59,800 \times \frac{2}{100} = 1,196$ .
- (5) New provision for doubtful debt is calculating on debtors which are not bad *i.e.* the amount of bad debt is reduced from sundry debtor & then we calculate new provision *i.e.* 70,000 – 5,000 Bad debts =  $65,000 \times \frac{8}{100} = 5,200$  New provision.