CBSE CLASS 11 ACCOUNTANCY

FINANCIAL STATEMENTS PART-2

REVISION NOTES

CHAPTER-8

FINANCIAL STATEMENTS-1

- **Financial Statements**

  The financial statement provides a summary of the accounts of a business enterprise. Financial statement include two statements include two statements:

  1) 'Trading and Profit and Loss Account or Income Statement' (To Know Profit or loss).
  2) Balance Sheet (To know value of assets and liabilities on the closing date of an accounting period).

- **Financial statements include the following statements:**

1) Income statement (Trading and Profit and Loss Account)—prepared to ascertain gross profit/loss and net profit/loss during an accounting period.
2) Statement of Financial Position (Balance Sheet)—prepared to ascertain position (assets, liabilities and capital) of an enterprise at a particular point of time.
3) Schedules and notes forming part of Balance sheet and Income statement —to give details of various items shown in both the statements.

- **Capital Expenditure**

  The non-recurring expenditure whose benefit is derived by the business for more than a year is called Capital Expenditure.

  It includes the amount spent or liabilities incurred to acquire or improve any fixed asset or acquiring any legal rights or first-time expenses incurred to make fixed assets workable e.g. purchase of machinery/building/furniture etc., expenses incurred to acquire Patents, Trademarks etc. and expenditure incurred for making an asset ready to use (like installation exp., carriage, first time expenses incurred on second hand fixed asset for

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making it ready to use). Capital expenditures are recorded on the assets side of the Balance sheet.

- **Revenue Expenditure**

  The recurring and routine nature expenditures which are incurred for operating the business smoothly and which help to maintain business's earning capacity, are called Revenue expenditures.

  E.g. expenses incurred for producing finished goods such as direct expenses, purchase of raw material and other expenses as rent, salary, repairs etc. The benefit of these expenses last upto one year (give benefit up to one year). These expenses are shown on Debit side of the income statement (trading and profit and loss account).

- **Capital Receipt**

  Capital receipts are those irregular receipts that don't affect profit or loss of the business; it either increases the liabilities (raising of loans) or reduces the fixed assets (sale of fixed assets), so they will be shown in the balance sheet. Capital receipts are not made available for distribution as profit to the owner.

- **Revenue Receipt**

  Revenue receipts are received in the normal and regular course of business like Receipts from sale of goods and rendering services to customers. Income from non-operating business activities like income from investment i.e. interest and dividend received and rent received, Commission and other fees received for non-operating business etc. These receipts increases profit and are shown on the credit side of the Trading and Profit and Loss account.

- **Trading and Profit and Loss Account**

  Trading and Profit and Loss account is prepared to determine the profit earned or loss sustained by the business enterprise during the accounting period. It is basically a summary of revenues and expenses of the business and calculates the net figure termed as profit or loss.

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- **Relevant Items in Trading and Profit and Loss Account**

A. **<u>Items on the debit side</u>**

1) **Opening stock:** It is the stock of goods in hand at the beginning of the accounting year.

2) **Purchases less returns:** Goods, which have been bought for resale appears as purchases on the debit side of the trading account.

3) **Wages:** Wages refer to renumeration paid to workers who are directly engaged in factory for loading, unloading and production of goods and are debited to trading account.

4) **Carriage inwards/Freight inwards:** These expenses are the items of transport expenses, which are incurred on bringing materials/goods purchased to the place of business.

5) **Fuel/Water/Power/Gas:** These items are used in the production process and hence are part of expenses.

6) **Packaging material and Packing charges:** Cost of packaging material used in the product are direct expenses as it refers to small containers which form part of goods sold.

7) **Salaries:** These include salaries paid to the administration, godown and warehouse staff for the services rendered by them for running the business.

8) **Rent paid:** These include office and godown rent, municipal rates and taxes, factory rent, rates and taxes.

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9) **Interest paid:** Interest paid on loans, bank overdraft, renewal of bills of exchange, etc. is an expense and is debited to profit and loss account.

10) **Commission paid:** Commission paid or payable on business transactions undertaken through the agents is an item of expense and is debited to profit and loss account.

11) **Repairs:** Repairs and small renewals/ replacements relating to plant and machinery, furniture, fixtures, fittings, etc.

12) **Miscellaneous expenses:** Though expenses are classified and booked under different heads, but certain expenses being of small amount clubbed together and are called miscellaneous expenses.

B. <u>Items on the credit side</u>

1) **Sales less returns:** Sales account in trial balance shows gross total sales (cash as well as credit) made during the year.

2) **Other incomes:** Besides salaries and other gains and incomes are also recorded in the profit and loss account. Examples of such incomes are rent received, dividend received, interest received, discount received, commission received, etc.

- **A format trading and profit and loss account.**

Trading and Profit and Loss Account of ABC

for the year ended March 31, 2017

Dr. **Cr.**

Expenses/Losses	**Amount Rs.**	**Revenues/Gains**	**Amount Rs.**
Opening stock		Sales	

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Purchases Wages Carriage inwards Freight inwards/cartage Gross profit c/d Gross loss b/d			
	xxx		xxx
Rent/rates and taxes Salaries Repairs and renewals Bad debts Net profit (transferred to capital account)		Gross loss c/d Gross profit b/d Interest received Net loss	
	xxx		xxx

- **Concept of Gross Profit and Net Profit**

- **Gross Profit**

  The excess of sales over purchases and direct expenses is called gross profit. If the amount of purchases including direct expenses is more than the sales revenue, the resultant figure is 'gross loss'. The computation of gross profit can be shown in the form of equation as:

  Gross Profit = Sales – (Purchases + Direct Expenses)

  The gross profit or the gross loss is transferred to profit and loss account.

- **Net Profit**

  If the total of the credit side of the profit and loss account is more than the total of the debit side, the difference is the 'net profit' for the period of which it is being prepared.

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On the other hand, if the total of the debit side is more than the total of the credit side, the difference is the net loss incurred by the business firm. In an equation form, it is shown as follows:

Net Profit = Gross Profit + Other Incomes – Indirect Expenses

Net profit or net loss so computed is transferred to the capital account in the balance sheet.

Illustration: Prepare a trading account of M/s Prime Products from the following particulars pertaining to the year 2016-17.

	Rs.
Opening stock	50,000
Purchases	1,10,000
Return inwards	5,000
Sales	3,00,000
Return outwards	7,000
Factory rent	30,000
Wages	40,000

***Solution*:**

Books of Prime Products

Trading Account

for the year ended March 31, 2017

Dr. **Cr.**

Expenses/Losses	**Amount Rs.**	**Revenues/Gains**	**Amount Rs.**
Opening stock	50,000	Sales 3,00,000	
Purchases 1,10,000		Less: Return inwards 5,000	2,95,000
Less: Return outwards 7,000	1,03,000		
Factory rent	30,000		

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Wages Gross profit	40,000 72,000		
	2,95,000		2,95,000

- **Operating Profit (EBIT)**

  It is the profit earned through the normal operations and activities of the business. Operating profit is the excess of operating revenue over operating expenses. Operating profit is profit before interest and tax (EBIT).

Operating profit = Net Profit+ Non-Operating Expenses – Non Operating Incomes

Illustration: Following balance is extracted from the books of a trader ascertain gross profit, operating profit and net profit for the year ended March 31, 2017.

Particulars	Amount Rs.
Sales	75,250
Purchases	32,250
Opening stock	7,600
Sales return	1,250
Purchases return	250
Rent	300
Stationery and printing	250
Salaries	3,000
Misc. expenses	200
Travelling expenses	500
Advertisement	1,800
Commission paid	150
Office expenses	1,600

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Wages	2,600
Profit on sale of investment	500
Depreciation	800
Dividend on investment	2,500
Loss on sale of old furniture	300

Closing stock (March 31, 2017) valued at Rs. 8,000.

Solution:

Trading and Profit and Loss Account

for the year ended March 31, 2017

Dr. **Cr.**

Expenses/Losses	**Amount Rs.**	**Revenues/Gains**	**Amount Rs.**
Opening stock	7,600	Sales 75,250	
Purchases 32,350		Less: Sales return (1,250)	74,000
Less: Purchases return (250)	32,000	Closing stock	8,000
Wages	2,600		
Gross profit c/d	**39,800**		
	82,000		
Rent	300	Gross profit b/d	39,800
Stationery and printing	250		
Salaries	3,000		
Misc. expenses	200		
Travelling expenses	500		
Advertisement expenses	1,800		
Commission paid	150		
Office expenses	1,600		
Depreciation	800		
Operating profit c/d	**31,200**		
	39,800		39,800

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Loss on sale of old furniture Net Profit (transferred to capital account)	300 33,900	Operating profit b/d Profit on sale of investment Dividend on investment	**31,200** 500 2,500
	34,200		34,200

- **Balance Sheet**

  All the account of assets, liabilities and capital are shown in the balance sheet. Accounts of capital and liabilities are shown on the left hand side, known as Liabilities. Assets and other debit balances are shown on the right hand side, known as Assets.

- **Relevant Items in the Balance Sheet**

1) **Current Assets:** Current assets are those which are either in the form of cash or a can be converted into cash within a year.

2) **Current Liabilities:** Current liabilities are those liabilities which are expected to be paid within a year and which are usually to be paid out of current assets.

3) **Fixed Assets:** Fixed assets are those assets, which are held on a long-term basis in the business. Such assets are not acquired for the purpose of resale,

4) **Intangible Assets:** These are such assets which cannot be seen or touched. Goodwill, Patents, Trademarks are some of the examples of intangible assets.

5) **Investments:** Investments represent the funds invested in government securities, shares of a company, etc. They are shown at cost price.

6) **Long-term Liabilities:** All liabilities other than the current liabilities are known as long-term liabilities. Such liabilities are usually payable after one year of the date of the balance sheet.

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7) **Capital:** It is the excess of assets over liabilities due to outsiders. It represents the amount originally contributed by the proprietor/ partners as increased by profits and interest on capital and decreased by losses drawings and interest on drawings.

8) **Drawings:** Amount withdrawn by the proprietor is termed as drawings and has the effect of reducing the balance on his capital account.

Illustration: From the following balances prepare a trading and profit and loss account and balance sheet for the year ended March 31, 2017.

Account Title	**Amount Rs.**	**Account Title**	**Amount Rs.**
Carriage on goods purchased	8,000	Cash in hand	2,500
Carriage on goods sold	3,500	Bank overdraft	30,000
Manufacturing expenses	42,000	Motor car	60,000
Advertisement	7,000	Drawings	8,000
Excise duty	6,000	Audit fees	2,700
Factory lighting	4,400	Plant	1,53,900
Debtors	80,000	Repairs to plant	2,200
Creditors	61,000	Stock at the end	76,000
Dock and Clearing charges	5,200	Purchases less return	1,60,000
Postage and Telegram	800	Commission on purchases	2,000
Fire Insurance Premium	3,600	Incidental trade expenses	3,200
Patents	12,000	Investment	30,000
Income tax	24,000	Interest on investment	4,500
Office expenses	7,200	Capital	1,00,000
		Sales less return	5,20,000
		Sales tax paid	12,000
		Discount allowed	2,700
		Discount on purchases	3,400

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Solution:

Trading and Profit and Loss Account

for the year ended March 31, 2017

Dr. **Cr.**

Expenses/Losses	**Amount Rs.**	**Revenues/Gains**	**Amount Rs.**
Purchases less return	1,60,000	Sales less return	5,20,000
Commission on purchases	2,000		
Carriage on goods purchased	8,000		
Manufacturing expenses			
Factory lighting	42,000		
Dock and Clearing charges	4,400		
Gross profit c/d	5,200		
	2,98,400		
	5,20,000		5,20,000
Carriage on sales	3,500	Gross profit b/d	2,98,400
Advertisement	7,000	Interest on investment	4,500
Excise duty	6,000	Discount on purchases	3,400
Postage and telegram	800		
Fire Insurance premium	3,600		
Office expenses	7,200		
Audit fees	2,700		
Repairs to plant	2,200		
Incidental trading expenses	3,200		
Sales tax paid	12,000		
Discount allowed	2,700		
Net profit (transferred to capital account)	2,55,400		
	3,06,300		3,06,300

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Balance Sheet as at March 31, 2017

Liabilities		Amount Rs.	Assets	Amount Rs.
Bank overdraft		30,000	Cash in hand	2,500
Creditors		61,000	Debtors	80,000
Capital	1,00,000		Closing stock	76,000
Add Net profit	<u>2,55,400</u>		Investment	30,000
	3,55,400		Motor car	60,000
Less Drawings	<u>(8,000)</u>		Plant	1,53,900
	3,47400		Patents	12,000
Less Income tax	<u>(24,000)</u>	3,23,400		
		4,14,400		**4,14,400**

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