

# **FINANCIAL STATEMENTS - I**

## **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.

## **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.

## **CLASSIFICATION OF FINANCIAL STATEMENTS**

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

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

### **1. 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:

- a) Trading Account and
- b) 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**

Dr.		For the year ending.....		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	
(iii) Total Purchases			Less: Sales Returns	
Less: Purchases Returns			Net Sales	
Net Purchases			By Closing Stock	
Direct Expenses:			By Gross Loss	
To Wages			transferred to P & LA/c	
To Freight/ Freight Inward			(Balancing fig.)	
To Carriage/ Carriage Inward				
To Fuel & Power				
To Factory Rent				
To Gross Profit				
transferred to P& L A/c				
(Balancing Figure)				

**Illustration**

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

**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	44,500	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	18,300		
(Balancing Figure)	78,500		78,500

**Illustration**

From the following balances extracted from the books of M/s Bhanu Bros, prepare a Trading Account for the year ended 31<sup>st</sup> 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 <sup>st</sup> March, 2012	30,000

**Solution:**

**Trading Account of M/s Luxmi & Sons**  
**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	1,03,000
To Power	6,500	transferred to P & L A/c	
To Custom Duty	5,500	(Balancing Figure)	
	2,13,000		2,13,000

- 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	Amount	Particulars	Amount
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)	_____		
	_____		_____

**Distinction between Trading Account and Profit and Loss Account :**

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 .

**2. 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.

#### Classification of Internal and External Liabilities :

Internal liabilities	External liabilities
Capital	Creditors
Profits of business	Bank loan and other loans
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
Land and building	Cash in hand
Plant & Machinery	Cash at Bank
Furniture	Stock of goods
Motor Vehicles etc.	Debtors etc.

#### Objectives of Preparing Balance Sheet :

- I. Balance sheet is prepared to achieve following objectives:
- II. To know the financial position of the business.
- III. To know the position of internal liabilities and external liabilities of the business so that timely arrangement can be made for their payment.
- IV. To know the position of fixed assets and current assets.
- V. To plan activities for future on the basis of present financial position.

#### PROFORMA OF BALANCE SHEET :

**Balance Sheet of M/s .....**  
**as on.....**

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