Final Accounts of Sole Trading Concerns

What are Final Accounts?

Final Accounts consists of

- Trading Account
- Profit and Loss Account
- Balance Sheet

Trading Account

It is a Nominal Account and is prepared for calculating the GROSS PROFIT or GROSS LOSS arising as a result of trading activities of a business.

According to J.R.Batliboi:-

'The Trading Account shows the results of buying and selling of goods. In preparing, this account, the general establishment charges are ignored and only the transactions in goods are included'

Importance of Trading Account

Trading Account is prepared for the following reasons

- To know the Gross Profit or Gross loss arising due to trading activities of the business.
- To find out the direct expenses incurred by the business for the goods sold during the year.
- Find out how much closing stock is left as compared to previous years and thus find out the performance of the business.
- Gives the trader an idea of the increase/decrease in Gross Profit /Gross Loss and to assess the performance of the business and take corrective measures, if needed.

Preparation of Trading Account

The following items usually appear in a Trading Account

Sales turnover

Both Cash and Credit sales are included. Net Sales is recorded after deducting Sales returns (Return inwards).

Opening Stock

The closing stock of the previous accounting year is taken as the Opening stock for the present year. If there is no Opening Stock then no entry is made. Opening stock is derived by balancing the Stock Account and bringing down its balance to the next period.

Purchases

Purchases include all the Cash and Credit purchases of goods made by the business during the year.

Purchase returns (Return outwards) is deducted from the Purchases to arrive at Net Purchases.

Direct Expenses

All expenses which are incurred in purchasing the goods and bringing them to the trading place are recorded under this category.

These include:

- Wages e.g. Warehouse worker wages.
- Carriage Inwards i.e. the cost of transport of goods to the trading place. The expense is usually borne by the buyer.
- Duty on purchases, for example, Import duty or excise duty.

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Closing Stock
All the goods which remain unsold at the end of the year are known as 'Closing stock'.
The closing is stock is valued at Cost price or Market price, whichever is lower.
The reason for taking the lower value of the two is in accordance with the 'Prudence Principle'.
Normally, 'Closing stock' is given outside the Trial Balance. This is so because its valuation is made after the accounts have been closed.

Note: Sometimes, the 'Closing Stock' may be given inside the Trail Balance. This means that the entry to incorporate the closing stock in the books has already been passed and it has already been deducted from the Purchases Account. In this case, 'Closing Stock' will not be shown in the Trading Account will only appear in the Asset side of Balance Sheet'.

Cost of goods sold
This means the finding the cost of only those goods which have been sold during the year. It can be calculated as follows:
(Net Purchases + Opening Stock) - Closing Stock

Profit and Loss Account
According to Prof. Carter:
'A Profit and Loss Account is an account into which all gains and losses are collected, in order to ascertain the excess of gains over the losses or vice-versa'.

Why Profit and loss account is made?
- To find out the Net Profit or Net Loss
- Compare the net profit of the business with previous years and to assess the performance of the business.
- Find out the amount of overheads of a business.

Items appearing on a Profit and Loss account

Any Incomes or gains
Any income or gains of the business from sources other than sales are recorded on the Credit side of Profit and loss account.

Gross Profit or Loss
It is transferred to the P/L account from the Trading Account. Gross Profit is transferred to the Debit side whereas Gross Loss is transferred to the Credit side.

Office and Administrative expenses
Example include salaries, office rent, lighting, stationery etc.

Selling and Distribution expenses
Include advertising expense, commission, carriage outwards, bad-debts etc.

Miscellaneous expenses Such as, interest on loan, interest on capital, depreciation etc.

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Balance Sheet

Balance Sheet is a statement which shows the financial position of the business on a particular day.

According to A. Palmer

"The Balance Sheet is a statement at a particular date showing on one side the trader's property and possessions and on the other hand the liabilities".

Thus we can say that

- Balance sheet is a statement not an account.
- It is prepared to show the financial position of the business.
- It records all the assets and liabilities of the business.
- It shows the financial position on a particular day not for a period of time.

Need and Importance of Preparing a Balance Sheet

A Balance Sheet serves the following purposes:

- The true financial position of the business can be ascertained at a particular point of time.
- Reveals the amount of assets owned by the business for example machinery, cash, debtors and so on.
- Show the liabilities of the business such as total creditors, share capital etc.
- To adjudge weather the firm is solvent or not.
- Opening entries for the next financial year are based on the Balance Sheet of the previous year.

Items appearing on a Balance Sheet

Assets

Assets of a business are what it owns. They can be classified as:

Fixed assets: All those assets which are owned by the business and last for more than an accounting year. Examples include Land, building, machinery, vehicle, furniture and fixtures and the like.

Current assets: It includes all those assets which either in the form of cash or can be easily converted into cash within one accounting period. Current Assets include Cash, Debtors and Stock.

Liabilities

Liabilities represents what the business owes to outside persons other than owners. These liabilities are classified on basis of time period of repayment.

Long term liabilities: These are liabilities which the business owes for more than one accounting period, e.g. long-term bank loans, debentures etc.

Current liabilities: These are short term debts of the business that are to be repaid within one accounting period, e.g. creditors and bank overdraft.

Owner's Equity

Owner's equity represents what the business owes its owner.

It is equal to total assets minus total liabilities.

Important points regarding Balance Sheet

- The Balance Sheet is not an account but a statement.
- It does not have debit or credit side but has two sections i.e. assets and liabilities.
- The heading of Balance Sheet is 'as on a particular date'. Thus, a Balance Sheet may have different figure on different dates.
- The balances shown in the Balance Sheet act as Opening Balances for the next accounting period.

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- Balance Sheet is based on the accounting equation

Assets= Owner's Equity + Liabilities

Difference between Trial Balance and Balance Sheet

Objective

Trial Balance is prepared to verify the arithmetical accuracy of the books of account whereas Balance Sheet shows the financial position of the business.

Headings

Trial Balance is two sides i.e. Debit and Credit whereas Balance Sheet has Assets and Liabilities. Profit and Loss Trial Balance does not show any information about the profit or loss of a business, whereas Balance Sheet records the Profit or Loss of the business.

Closing stock

The valuation of closing stock is not necessary to prepare a Trial Balance whereas Balance Sheet cannot be prepared unless the Closing stock for that particular accounting year is not ascertained.

Types of Accounts

Balances of all types of accounts are recorded in a Trial Balance i.e. Personal, real and nominal. Balance Sheet records balances of personal and real accounts only.

Adjustments

Adjustment for outstanding expenses, prepaid expenses and accrued incomes are not required for the preparation of Trial Balance. A Balance sheet is only complete after all the necessary adjustments are made.

Closing Stock

Closing stock refers to the goods remaining unsold during the year.
They are valued at Cost price or Market Price whichever is lower.

Closing entries

Closing Stock Account	Dr.
Trading Account	
(For closing Stock transferred to trading account)	

Treatment in Final Accounts

When closing stock is given outside the Trial Balance

It will appear on

- The credit side of the Trading Account
- Under Current Assets in the Balance Sheet.

When closing stock appears inside the Trail Balance

This means that the Closing stocks have already been deducted from the Purchases and thus it will ONLY appear in the Balance Sheet under Current Assets.

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Accrued expenses or outstanding expenses

Expenses which have been incurred but not been paid for till the end of the accounting year are known as Accrued expenses or outstanding expenses.

For example,

Total salaries to be paid for the year were $10,000, but by the end of the year $1000 were not paid and will be treated as outstanding salary.

Adjusting Entry

Salaries Account Dr.
    Outstanding Salaries Account
(Being salaries outstanding)

Accounting treatment

Outstanding expense amount is added to that particular expense account in the Profit and loss or Trading Account because it was the expense for that year. (Based on the matching principle)

Outstanding expenses are liabilities for the business. Thus they will appear under the Current Liabilities in the Balance Sheet.

Note: *If the Outstanding expense appears in the Trial Balance then it will only be recorded in the Liabilities side of the Balance Sheet.*

Prepaid Expenses

All those expenses which are due next year but paid for in advance during the current year are termed as Prepaid Expenses.

Adjustment Entries

Prepaid Expense Account Dr.
    Expense Account
(For expense paid in advance)

Accounting Treatment

The concerned expense will be deducted by the prepaid amount in the Trading Account or Profit & Loss account.

Prepaid expenses are assets for the business thus it will appear under the Current Assets in the Balance Sheet.

Note: *If the Prepaid expense is given inside the Trial Balance, then the prepaid expense will only appear in the Current Asset of the Balance Sheet.*

Depreciation

Depreciation is the fall in the value of fixed assets over a period of time.

Adjustment Entries

Depreciation Account Dr.
    Assets Account
(Being depreciation charged)

Accounting Treatment

Depreciation amount is entered as expense on the Debit Side of Profit and Loss account.

Depreciation is deducted from the value of the concerned asset in the Balance Sheet.

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Accrued Income
Incomes which are earned during the year but not received till the end of the accounting year are termed as Accrued Income / Earned Incomes/ Income Receivable.
Adjustment Entries

Accrued Income Account Dr.
Income Account
(Being income received in advance)

Accounting treatment
Accrued income will be added to the concerned income account in the Profit and Loss account because it the income for that particular year (matching principle)
Accrued incomes are asset for the business and appear under the Current Assets in the Balance Sheet.
Note: *If Accrued Incomes appear inside the Trial Balance then it will ONLY appear under the Current Assets in the Balance Sheet.*

Unearned Income/Revenue
All incomes or revenues which are received in advance but not earned during the year are treated as unearned revenue. There may be times when a certain income is received in the current year but the whole amount of it does not belong to the current year.
Adjusting Entries

Revenue Account Dr.
Revenue received in advance Account
(For revenue received in advance)

Accounting Treatment
Unearned incomes/revenues are not the actual income for that particular year and thus deducted from that particular revenue account in the Profit and Loss Account.
Unearned incomes/revenues are treated as liability for the business and thus appear under the Current Liabilities in the Balance Sheet.
Note: *If unearned income/revenue appears inside the Trial balance then it will ONLY appear under the Liabilities in the Balance Sheet.*

Interest on Capital
Usually the owner gets an Interest on his investment the business. According to the principle of separate entity, Capital is considered as Liability for the business and the owner is paid a certain amount of interest on the capital employed.
Accounting Entries

Interest on Capital Dr.
Capital Account
(Interest allowed on Capital)

Accounting Treatment in Final Accounts
Interest on Capital is an expense for the business and thus appears on the Debit side of the Profit and Loss account.
It is a gain for the owner and thus it is added to the Capital in the Balance Sheet.

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Interest on Drawings

Many times, during the operation of business, the owner may take out some cash from the business for his personal use. These withdrawals from the business are considered as Drawings. Considering the fact that the business is a separate accounting entity, it charges an interest on the drawings to the owner.

Adjusting Entries

Drawing Account Dr.
Interest on drawings account
(Being interest charged on drawings)

Accounting Treatment

Interest on drawings is an income for the business and appears on the Credit side of the Profit and Loss Account.

Interest on drawings is an expense for the proprietor and thus it is deducted from the Capital Account in the Balance Sheet.

Interest on Loan

Interest paid on loans taken by the business is treated as expense and will appear on the Debit side of the Profit and loss account.

Sometimes the interest on loan may not be fully paid and may be outstanding when the final account is prepared. In this case, the Interest on loan account will be debited by the outstanding interest amount.

Adjusting Entries

Interest on Loan account Dr.
Outstanding Interest account
(Being outstanding interest on loan)

Accounting treatment

Interest on loan is an expense for the business and appears on the Debit side of the Profit and Loss account.

Interest on loan is a liability for the business and is added to the Loan Account in the Liabilities section of the Balance Sheet.

Writing off Bad Debts

There may be occasions when the business might not be able to collect its debts. This may be due to the dishonesty of a debtor or may be due to the death or insolvency of a debtor.

Bad Debts Account Dr.
Debtors Account
(Bad debts written off)

This amount is then written off the books as 'Bad debts'. It is a loss for the business and thus it is written on the debit side of the Profit and Loss account

Closing Entry

Profit and Loss Account Dr.
Bad Debts Account
(Transfer of bad debts to Profit and loss Account)

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Accounting Treatment

Bad debts appear on the debit side of the Profit and Loss account because it is a loss.
Bad debts are deducted from the Debtors in the Current assets in the Balance Sheet.

Recovery of Bad Debts

Sometime a debts written off as Bad debts may be recovered later on. Cash is coming in thus Cash account is debited whereas 'Recovery of bad debts' is credited because it a gain.

Accounting Entries

Cash Account Dr.
Recovery of bad debts
(Being bad debts recovered)

Recovery of bad debts Dr.
Profit and Loss account
(Being transfer of recovery of bad debts to Profit and Loss Account)

Partial Settlement of Debtors

Sometimes, a business might only be able to recover a part of the debts. This means the rest of the unrecovered debts will be written off as bad debts.

Accounting Entries

Cash Account Dr.
Bad Debts Account Dr.
Debtor's Account
(Being partial recovery of debts)

Provision for Doubtful Debts

Even after deducting the amount of actual bad-debts from the Debtors, there may still be some debts which may be regarded as bad or doubtful. Thus a business might make an estimate of the amount of such doubtful debts, that is, debts that are likely to become bad, and charge them as an expense against the current period's revenue.

When Provision for Doubtful Debts is set up for the first time

Accounting Entries

Doubtful Debts Account Dr.
Provision for doubtful debts
(Being creation of provision for doubtful debts)

Closing Entries

Doubtful Debts Account is an expense for the business and thus it will be debited to the Profit and Loss account

Profit and Loss Account Dr.
Doubtful debts Account
(Being transfer of doubtful debts expense to the Profit and Loss Account)

It will be deducted from the Sundry Debtors in the Balance Sheet.

Increasing the Existing Provision for Doubtful Debts

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Adjusting Entry

Doubtful debts Account Dr.
Provision for doubtful debts Account

(Being increase of provision for doubtful debts)

Closing Entry

Being a loss for the business the Doubtful Debts Account is transferred to the debit side of Profit and Loss Account.

Profit and Loss Account Dr.
Doubtful Debts
(Being transfer of doubtful debts expense to the Profit and Loss Account)

Decreasing the Existing Provision for Doubtful Debts

Adjusting Entry

Provision for doubtful debts Account Dr.
Doubtful debts Account
(Being decrease of provisions for doubtful debts)

Closing Entry

Being a gain for the business the Doubtful Debts Account is transferred to the Credit side of Profit and Loss Account.

Doubtful Debts Account Dr.
Profit and Loss Account
(Being transfer of doubtful debts expense to the Profit and Loss Account)

In the Balance Sheet the debtors will appear net of the Provision for Doubtful debts.

Provision for Discount on Debtors

A provision for discounts to debtors who pay early is created in the current year itself.

Accounting Entries

Profit and Loss Account Dr.
Provision for Discount on Debtors Account

(For provision for discount created on Debtors)

It is shown on the Debit side of the Profit and Loss Account. Provision for Discount on Debtors is deducted from the Debtors in the Balance Sheet.

Note: Provision for discount on debtors will be deducted after ‘Further bad debts’ and ‘Provision for doubtful debts’ are deducted from the Debtors.

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Provision for Discount on Creditors

When the business makes prompt payments of its debts, it is bound to receive Discounts from its creditors. Although the discounts will be earned in the next year, the discounts so earned are an income of the current year. A Provision for such discount is made in the current year itself so that that the discounts thus earned may be credited to the Profit and Loss Account of the current year.

Provision for Discount on Creditors Account Dr.
    Profit and Loss Account
(For provision for discount on Creditors)

Accounting Treatment

Provision for Discount on Creditors will be shown on the Credit side of the Profit and Loss Account.
It is deducted from Sundry Creditors on the Liabilities side of the Balance Sheet.

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Proformas/Formats/Sample Trading Account of Sole Trading Concern
HORIZONTAL FORM

Trading Account of XYZ for The Year Ending On……….

Dr. Cr

Particulars		Amount	Particulars		Amount
To Opening Stock		XXXX	By Sales	Xxxx	
To Purchases	Xxxx		Less: - Returns	Xxx	xxxxx
Less_ Returns	Xxx	XXXX	By Closing Stock		Xxxx
To Direct Expanses					
Wages	Xx		By Gross Loss		Xxxxx
Factory Expanses	xx		[Transfer to P & l A/c		
Carriage inwards	Xx				
Cartage	Xx				
Freight	Xx				
Factory Rent	Xx				
Belting	xx				
Motive Power	Xx				
Tallow & Oil, Coal, Gas & Water	Xx				
Excise Duty	xx				
Doc Charges	xx				
Octroi Charges	xx				
Royalties	xx				
To Gross Profit [Transfer to P& L A/c]	Xxxx				
		XXXX			XXXX

Final Accounts of Sole Trading Concerns

Proformas/Formats/Sample P & L Account of Sole Trading Concern

HORIZONTAL FORM

Dr. **P & L Account of XYZ for The Year Ending On……….** **Cr**

Particulars		Amount	Particulars		Amount
To Gross Loss [Transferred from Trading A/C]		XXXX	**By Gross Profit** [Transferred from Trading A/c]		Xxxx
To Administration Expanses			**BY Income from investment**		
Salaries	xx		Dividend on shares	XXX	
Wages	xx		Miscellaneous income	XXX	
Rent & Taxes	Xx		Interest On money deposit	XXX	Xxx
Office Lighting	xx		By Commission Received		Xxx
Printing & Stationery	Xx		By Bad Debts Recovered		Xxx
Telephone Charges	Xx		By Income from other sources		Xxx
Fees & Expanses	Xx		By Discount Received		Xxx
Postage & Telegram	Xx		By Income From Investment		Xxx
Audit Fees	xx		By Profit earned from sale of assets		Xxx
Office Car keeping	Xx				
Office General Expanses	Xx	XXX			
To Selling & distribution Expanses					
Ware house & Store Rent	xx				
Packing Expanses	xx				
Freight & Carriage Outwards	xx				
Sampling Expanses	xx				
Cost of Catalogues	xx				
Bad Debts	xx				
Commission	xx				
Advertisement	Xx				
Expert Expanses	Xx				
Insurance Premium	Xx				
Brokerage	Xx				
Noting Chagres	xx				
Entertainment Exp.	Xx	xxx			
To Financial Expanses					
Discount allowed	Xx				
Interest on Capital	xx				
Loss in Exchange	xx				
Discounting Bill	Xx				
Discount on issue on Debentures	Xx	XXX			
Preliminary Expanses written Off	Xx				
To Depreciation & Maintenance					
Repairs & Renewals	Xx				
Loss by fire or theft	Xx	XXX			
Depreciation of Asset	XX				
To Net profit		XXXX			
[Transferred to Balance Sheet]					
		XXXX			XXXX

Final Accounts of Sole Trading Concerns

Proformas/Formats/Sample Balance Sheet of Sole Trading Concern

HORIZONTAL FORM

Balance sheet of XYZ for The Year Ending On……….

LIABILITIES		Amount	Assets	Amount
Current Liabilities:			**Current Assets**	
Bank overdraft		XXX	Cash In Hand	xxx
Bills payable		XXX	Cash at Bank	xxx
Outstanding Expenses		XXX	Bills receivable	xxx
Income received in advance		XXX	Prepaid expenses	Xxx
Sundry Creditors		XXX	Accrued income	Xxx
Short term loans		XXX	Investment	Xxx
Fixed Liabilities			Sundry debtors	Xxx
Long term loan		XXX	Stock (Closing)/closing Stock	Xxx
Reserves		XXX	Loose Tools	Xxx
Capital	xxx		**Fixed Assets**	
Add: Net Profit	Xxx		Goodwill	xxx
Add: Interest On Capital	Xxx		Furniture & Fixtures	xxx
	xxxx		Plant & Machinery	xxx
Less: Drawings	xxx		Long Term Investment	xxx
	xxx	XXX		
Less: invest on drawings		**XXXX**		**XXXX**

ALTERNATE STRUCTURE OF BALANCE SHEET

LIABILITIES		Amount	Assets	Amount
Capital	xxx		**Fixed Assets**	
Add: Net Profit	Xxx		Goodwill	xxx
Add: Interest On Capital	Xxx		Furniture & Fixtures	xxx
	xxxx		Plant & Machinery	xxx
Less: Drawings	xxx		Long Term Investment	xxx
Less: invest on drawings	xxx			
	xxx	XXX	**Current Assets**	
Fixed Liabilities			Cash In Hand	xxx
Long term loan		XXX	Cash at Bank	xxx
Reserves		XXX	Bills receivable	xxx
Current Liabilities:			Prepaid expenses	Xxx
Bank overdraft		XXX	Accrued income	Xxx
Bills payable		XXX	Investment	Xxx
Outstanding Expenses		XXX	Sundry debtors	Xxx
Income received in advance		XXX	Stock (Closing)/ Closing Stock	Xxx
Sundry Creditors		XXX	Loose Tools	Xxx
Short term loans		XXX		
		XXXX		**XXXX**