

Final Accounts

I. Introduction

A. Meaning

- Accounts prepared at the final stage of the accounting cycle to show the financial performance and financial position of business concern are known as the **Final Accounts**.
- It is also known as financial statement.

B. Why Final Accounts

- One of the basic purpose of Accounting is that to generate and communicate the financial information of the business to the users of financial statement.
- Users have to make various decisions for which they require financial statement to know the profit/loss of the entity during an accounting period as well as the financial position of the business.

C. Type of Entities

I. Manufacturing Entities

These entities makes the products themselves and then sell them at a profit.

II. Non-Manufacturing Entities

These entities buys the saleable products from outside suppliers and sell them at a profit.

D. Contents of financial statement

- Financial statement comprises of Income statement (i.e. manufacturing A/c, trading A/c and profit and loss A/c) and position statement (i.e., Balance sheet).

Financial Statement

Income Statement

Position Statement

Shows Profit or loss of the entity during a Particular period by taking into consideration the expenses and revenues of the entity

Shows Position of the entity by taking into consideration the assets and liability of entity on a Particular day

Balance Sheet

Manufacturing Account

Trading Account

Profit and Loss Account

To show the resources owned by the entity and debts to be repaid.

• To show the cost of goods manufactured during the year

• To show the gross profit/loss during the year

• To show the net profit/loss during the year.

• Covers all manufacture using cost of product.

• Covers direct expenses and revenue from operation.

• Covers indirect expenses/ losses and other revenues.

Notes:-

i) Manufacturing A/c is prepared only by manufacturing entities. Other accounts and Balance sheet are prepared by both i.e., Manufacturing and Non manufacturing entities.

ii) Direct expenses means all expense that incurs to make the goods available for sale (purchase, wages, carriage inward, other factory expenses), rest all expenses are indirect expenses (salary, advertisements, Discmt, etc.)

iii) Revenue from operation means sales of goods and other revenues are interest, commission, etc.

2. Income Statement

A. Trading Account

Trading Account

For the year ended -----

Dr.	Amount ₹	Amount ₹	Particulars	Amount ₹	Cr.
To opening stock		✓	By sales	✓	
To purchase	✓		Add:- unrecorded sales	✓	
Add:- unrecorded purchase	✓			✓	
	✓		less:- Returns	(✓)	
less:- Returns	(✓)		:- Sale of Asset	(✓)	
:- Asset purchased	(✓)		:- Unapproved sale on approval	(✓)	
:- Drawings	(✓)				✓
:- Advertisement	(✓)		By stock with customer		✓
		✓			
To carriage inward		✓	By goods lost by fire		✓
To wages	✓		By goods sent on consignment		✓
less:- Installation of asset	(✓)		By closing stock		✓
		✓			
To freight		✓	By gross loss [Transferred to P/L]		✓
To power & fuel		✓			
To octroi		✓			
To other factory expenses		✓			
To gross profit [Transferred to P/L]		✓			
		✓			
		✓			

B. Profit and Loss Account

Profit and Loss Account

Dr.		Cr.		
Particulars		Amount ₹	Particulars	Amount ₹
To Gross Loss	✓	By Gross Profit	✓	
To Salary	✓	By Discount Received	✓	
To Rent	✓	By Interest Income	✓	
To Electricity	✓	By Provision for bad & doubtful debts (old)	✓	
To Lighting	✓			
To Repairs	✓			
To Interest on Loans	✓			
To Bank charges	✓			
To Printing and Stationery	✓			
To Telephone & Postage	✓			
To Travelling Expenses	✓			
To Insurance Premium	✓			
To Loss on sale of Assets	✓			
To Discount Allowed	✓			
To Bad debt	✓			
To Provision for bad and doubtful debts (new)	✓			
To Carriage outward	✓			
To General Expenses	✓			
To Depreciation	✓			
To loss by fire	✓	By NET loss	✓	
To Net Profit [Transferred to Capital]	✓	[Transferred to Capital]		
	✓		✓	

4. Position Statement

Balance Sheet

Balance sheet

as on

Liabilities	Amount ₹	Amount ₹	Asset	Amount ₹	Amount ₹
Capital	✓		Goodwill		✓
Add:- Further capital	✓		Patent		✓
:- Net Profit	✓		Land and Building	✓	
			less:- Depreciation	(✓)	
less:- Drawings	(✓)		Plant & Machinery	✓	
[cash + goods]			less:- Depreciation	(✓)	
:- Net loss	(✓)				✓
		✓	Furniture	✓	
Long Term Loans		✓	less:- Depreciation	✓	
Creditors	✓		Other fixed Assets		✓
Add:- unrecorded Purch	✓		Closing stock		✓
less:- mutual set off	(✓)	✓	Insurance claim		✓
Bills Payable		✓	Receivable		
Bank overdraft		✓	Bills Receivable		✓
Outstanding Expenses		✓	Debtors	✓	
Pre-Received Income		✓	less:- mutual set off	(✓)	
			:- Bad debt	(✓)	
			Provision for	(✓)	
			bad debt		
					✓
			Prepaid Expenses		✓
			Accrued Incomes		✓
			Cash at Bank		✓
			Cash in hand		✓
		✓			✓
		✓			✓

Notes:- Common notes for point 3 & 4.

i) All items of Trial Balance should be posted at only one side (debit or credit) as journal entries for these have already been passed.

ii) Effect of adjustment should be posted both side (debit and credit).

iii) Items appearing in Trial balance should be posted according to its nature i.e.,

<u>Items</u>	<u>Nature</u>	<u>Posted To</u>
• Outstanding Expense	Liability	Balance Sheet
• Prepaid Expenses	Asset	Balance sheet
• Closing Stock	Asset	Balance Sheet
• Depreciation	Expenses	Profit and loss
• Bad Debt	Loss	Profit and loss

• no further treatment of above items are required i.e., depreciation shall not be deducted from asset, Closing Stock should not be shown at credit side of Trading A/c, etc.

5. Important Adjustments while Preparing Final Accounts

i) Unsold Stock or closing stock [Matching Concept]

Entry
Closing Stock A/c -- Dr.
 To Trading / Purchase A/c

Effect
1. Show closing stock in credit side of Trading A/c and
2. Closing stock as current asset in Balance Sheet.

Note:- value of stock will lower of cost and Net Realisable value. [Prudence Concept]

• If closing stock appears in Trial balance then show only in Balance Sheet as current asset and not in Trading A/c.

2.) Outstanding Expenses [Accrual Concept]

Entry

Expense A/c --- Dr.
To Outstanding Expense A/c

Effect

1. Increase respective Expense A/c and
2. Show as current liability in Balance Sheet.

Note:- If outstanding expenses appears in Trial Balance then show as current liability only.

3.) Prepaid Expenses [Accrual Concept]

Entry

Prepaid Expense A/c --- Dr.
To Expense A/c

Effect

1. Reduce from respective Expense and
2. Show as current asset in Balance Sheet.

Note:- If Pre-paid expenses appears in Trial Balance then show as current asset only.

4.) Accrued Income [Accrual Concept]

Entry

Accrued Income A/c --- Dr.
To Income A/c

Effect

1. Increase respective income and
2. Show as current asset in Balance Sheet.

Note:- If accrued income appears in Trial Balance then show as current asset only.

5.) Pre-received Income / Unearned Income [Accrual Concept]

Entry

Income A/c --- Dr.
To Pre-Received Income A/c

Effect

1. Reduce from respective income and
2. Show as current liability in Balance Sheet.

Note:- If Pre-receive income appears in Trial Balance then show as current liability only.

6.) Depreciation on fixed Asset [matching concept]

Entry

Depreciation on Asset
To Asset

Effect

1. Show Depreciation as an expense in P/L A/c and
2. Reduce Depreciation from respective asset.

Note:- If depreciation appears in Trial Balance then show depreciation as an expense in P/L A/c only.

7.) Unrecorded Purchase

Entry

Purchase A/c ---Dr.
To Cash
To Creditors A/c

Effect

1. Increase Purchase A/c and
2. Reduce from Cash/Bank if cash purchase and increase creditors if credit purchase.

8.) Unrecorded sales

Entry

Cash/Bank A/c ---Dr.
Debtors A/c -----Dr.
To Sales A/c

Effect

1. Increase Cash/Bank if it is cash sale and Debtors if it is credit sales. and
2. Increase Sales A/c.

Common note for adjustment 7 & 8

- If nothing is mentioned then assume it is a credit transaction.

9.) Mutual Set off [Receivable and Payable from same person]

Entry

Creditors A/c ---Dr.
To Debtors A/c

Effect

Reduce Creditors and Debtors both by lesser amount.

10) Bad debt

Entry

Bad Debt A/c --- Dr.
To Debtors A/c.

Effect

1. Show bad debt as a loss in P/L or increase bad debt if already appears in P/L and
2. Reduce bad debt from Debtors in Balance sheet.

Note:- If bad debt appears in Trial Balance then show as a loss in P/L only.

11) Provision for Bad / Bad and Doubtful debts

[Prudence Concept]

Entry

Profit and loss A/c -- Dr.
To Provision for bad debts A/c

Effect

1. Show Provision for bad debt in P/L in debit side and
2. Reduce Provision from Debtors in Balance sheet.

Note:- Provision shall be calculated on balance amount of Debtors i.e., after all adjustment like mutual set off, unrecorded sales or sales return.

12) Provision for Discount on Debtors [Prudence Concept]

Entry

Profit and loss A/c -- Dr.
To Provision for discount on Debtors A/c

Effect

1. Show Provision in debit side of P/L A/c and
2. Reduce Provision from Debtors in Balance sheet.

Note:- Provision for discount on Creditors shall be calculated on balance amount of Debtors i.e., after all adjustments and after reducing amount of Provision for bad debt if any.

Common note for adjustment no. 11 & 12

- 1) Receivable from Debtors does not reduced by making Provision.

ii) Existing Provision (appears in Trial Balance), if any, can be shown in Credit side of P/L or reduced from new Provision.

iii) Amount of Bad debt, new Provision and existing Provision can be shown directly as -
= Bad Debt + New Provision - Existing Provision
- In case of Provision for discount on debtors Discount Allowed A/c shall be considered instead of Bad debt.

iv) Provision for discount from Creditors is not created due to Prudence Concept.

13.) Bad Debt Recovery

Entry	Effect
Cash/Bank A/c --- Dr To Bad Debt Recovered A/c	1. Increase Cash/Bank A/c and 2. Show Bad Debt recovery in Credit side of P/L A/c.

Notes:- i) If bad debt recovered A/c appears in Trial Balance then show in P/L only.

ii) If any debtor whose account had been written off as bad debt earlier and now agreed to pay the amount but not actually paid till date cannot be account for as bad debt recovery.

14.) Drawings [Separate Entity Concept]

Entry	Effect
Drawings A/c --- Dr To Cash/Bank A/c To Purchase A/c	1. Show drawings as a deduction from Capital in Balance Sheet and 2. Reduce Cash/Bank if owner withdraws Cash but reduce it from Purchase A/c, if goods withdrawn.

Notes:- i) If Drawings A/c appears in Trial Balance then Show only as a deduction from Capital in Balance Sheet.

ii) LIC and Income Tax are treated Drawings.

15.) Advertisements (Goods distributed as free sample)

<u>Entry</u>	<u>Effect</u>
Advertisement A/c --- Dr. To Purchase A/c	1. Show advertisement as an expense in P/L or increase it if already appears and 2. Reduce it from Purchase A/c.

Note:- If Advertisement A/c appears in Trial Balance then Show the same in P/L only.

16.) Asset Purchased shown as Purchase

<u>Entry</u>	<u>Effect</u>
Asset A/c ---- Dr. To Purchase A/c	1. Increase respective asset and 2. Reduce it from Purchase A/c

Note:- If any installation charges paid and debited to wages A/c then reduce it from wages and add the same in respective asset.

17.) Sale of Asset shown as Sales

<u>Entry</u>	<u>Effect</u>
Sales A/c --- Dr. To Asset A/c	1. Reduce Sales A/c by sale Proceed, 2. Reduce book value of asset sold from respective asset and 3. Record Profit or loss on sale of asset in P/L A/c.

18) Loss of Goods by Fire

Entry

Effect

- Goods lost by Fire A/c --- Dr.
To Trading / Purchase A/c
[Matching Concept]

1. Show Goods lost by Fire in Credit side of Trading A/c at cost of goods lost.

- Insurance Claim Receivable A/c --- Dr.
Loss by Fire A/c ----- Dr.
To Goods lost by Fire A/c

2. Show claim amount admitted as Insurance Claim Receivable as asset in Balance sheet and balance amount, if any, to be shown as loss in debit side of P/L A/c.

Note:- In case of loss of uninsured goods whole amount shall be transferred to P/L as loss.

6: Manufacturing Account

- Manufacturing refers to the processing of Raw material into finished goods through the use of tools, human labours, machinery, etc.

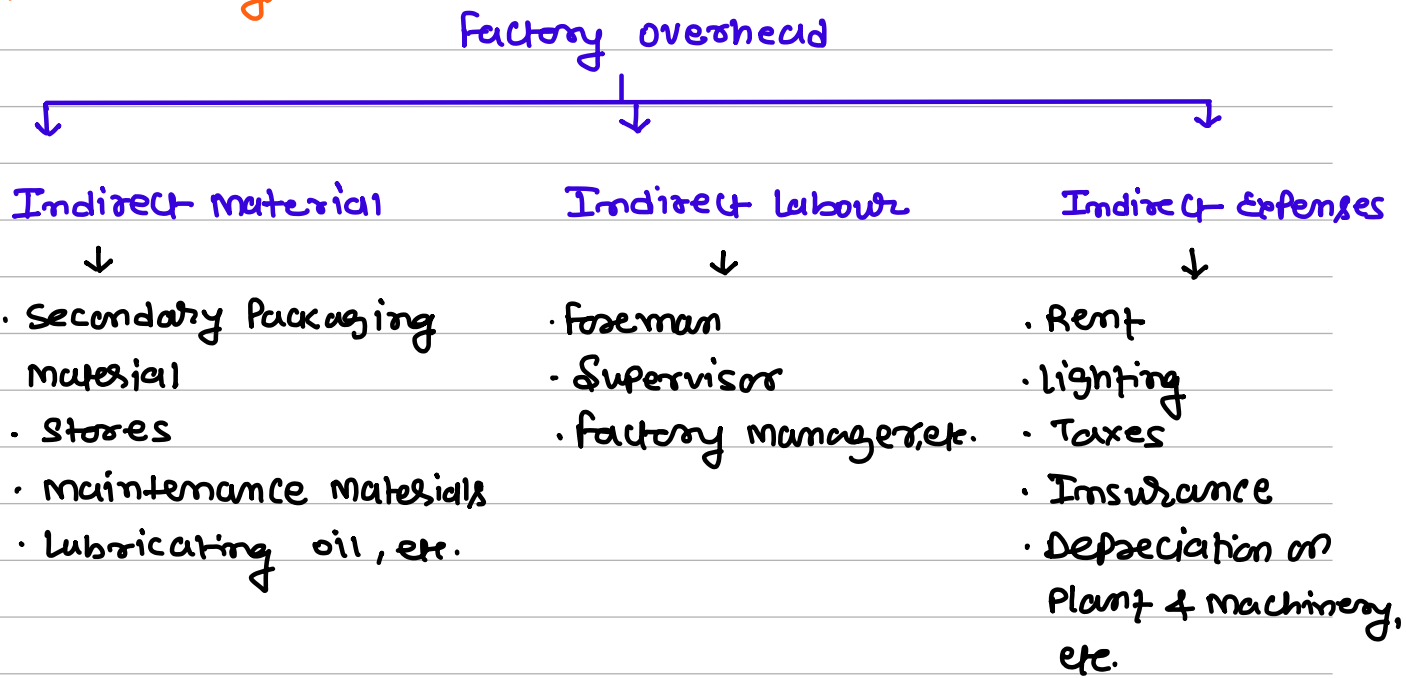
- Manufacturing entities prepare an additional account apart from Trading, Profit & Loss and Balance sheet, called Manufacturing A/c to show separately the cost of goods manufacturing during the period.

- Manufacturing Account covers costs of Raw material, Direct labour, Direct Expenses and manufacturing/factory overheads.

Manufacturing Account
for the year ended

Dr.				Cr.	
Particulars	Amount ₹	Amount ₹	Particulars	Amount ₹	
To Opening work-in-Progress		✓	By closing work-in-Progress	-	
To Raw material consumed -			By Sale of Scrap	✓	
. opening	✓				
Add: - Purchase	✓				
	✓				
less: - Returns	(✓)		By Trading A/c		
:- closing stock	(✓)		[Cost of goods manuf		
		✓	- actuals transferred to		
		✓	Trading Account]		
To Carriage Inward		✓			
To Power & fuel		✓			
To Import Duty		✓			
To Direct Labour		✓			
To Direct Expenses		✓			
. Royalty on Production		✓			
. Hire charges on special machinery					
To factory overheads		✓			
		✓			
		✓			

note on factory overhead



note:- Primary Packing materials e.g., Bottles, Product labels, etc. are treated as Direct material whereas secondary Packing materials like wooden cases, binding wire etc. are treated as Indirect materials.