

Dr. **Format (or) Pro-forma**
Trading Account of for the year ended on

Particulars	Rs	Particulars	Rs
To Opening Stock	—	By Net Sales:	
To Net Purchase:		Sales	
Purchases		Less: Sales Returns	
Less: Purchases Returns		By Closing Stock	
To Wages	—	By Abnormal Loss of Stock	
To Direct Expenses:		By Profit and Loss Account	
Freight Inward		(in case of Gross Loss)	
Carriage Inward		(Gross Loss t/f to P and L A/c)	
Carriage Inward			
(other expenses, if any)			
To Profit and Loss Account	—		
(in case of Gross Profit)			
(Gross Profit t/f to P and L A/c)			

Note: Prefixes "To" and "By" are not practiced nowadays.

Illustration: 1

From the following information prepare Trading Account for the year ending on Mar 31, 2009:

Opening Stock Rs 30,000; Cash Purchases Rs 70,000; Carriage Inwards Rs 5,000; Carriage Inwards Rs 3,000; Freight Inward Rs 2,500; Wages Rs 7,500; Credit Purchases Rs 50,000; Cash Sales Rs 60,000; Credit Sales Rs 1,50,000; Purchases Return Rs 10,000; Sales Returns Rs 15,000; Stock at the end Rs 40,000; Carriage Outwards Rs 10,000; Office Rent Rs 12,000.

Solutions: *Carriage Outwards and Office Rent (expenses relating to office) are not to be entered in Trading A/c.

*All the other items are recorded in the format as follows:

Dr. **Trading Account of for the year ended on Mar 31, 2009**

Particulars	Rs	Particulars	Rs
To Opening Stock	30,000	By Net Sales:	
To Net Purchase:		Cash Sales	60,000
Cash Purchase	Rs 70,000	Add: Credit Sales	1,50,000
Add: Purchases Returns	50,000		2,10,000
	120,000	Less: Sales Returns	15,000
Less: Purchases Returns	10,000	By Closing Stock	1,95,000
To Wages	7,500		40,000
To Carriage Inward	5,000		
To Carriage Inward	3,000		
To Freight Inward	2,500		
To Gross Profit transferred to Profit and Loss Account	77,000		
	2,35,000		2,35,000

Illustration: 2 (Treatment of Closing Stock)

Prepare the Trading Account for the year ended on Mar 31, 2009 from the following information:
Purchases (after adjustments) Rs 4,70,000; Sales Rs 5,65,000; Freight Rs 3,000; Carriage Rs 5,000; Freight and Carriage Outward Rs 7,000; Wages Rs 24,000; Closing Stock Rs 27,000; Sales Returns Rs 15,000.

Solution

Step 1: Purchases are shown as after adjustments. This means that closing stock is adjusted with purchases. (As explained earlier, closing stock may be adjusted either with purchases or cost of goods sold).

Remember Purchases (adjusted) = Net Purchases (i.e., Cash Purchases + Credit Purchases – Purchase Returns) + Opening Stock – Closing Stock

Step 2: Hence it will not entered in the Trading Account.

Step 3: Freight and carriage are not to be recorded in Trading Account because they are not direct expenses.

Step 4: Draw the format and enter the figures.

Step 5: Finally, balance the account as the net effect (Gross Profit or Gross Loss) has to be transferred to the next stage of the accounts, i.e. Profit and Loss Account.

Trading Account for the year ended on Mar 31, 2009

Particulars	Rs	Particulars	Rs
To Purchases	4,70,000	By Net Sales:	
(Given as after adjustments)		Sales	5,65,000
To Freight	3,000	Less: Sales Returns	15,000
To Carriage	5,000		5,50,000
To Wages	24,000		
To Gross Profit transferred to Profit and Loss Account	48,000		
	5,50,000		5,50,000

Illustration: 3

Prepare the Trading Account for the year ending on Mar 31, 2009 from the following information:

Cost of Goods Sold Rs 7,63,500;
Sales Rs 8,13,500; Sales Return Rs 40,000
Closing Stock Rs 15,500

Solution

In this illustration, cost of goods sold and closing stock are given.

As explained earlier, closing stock may be adjusted either with purchases or cost of goods sold. Here, cost of goods sold is given. It means closing stock is adjusted with cost of goods sold and hence it will not appear in Trading Accounts.

Cost of Goods Sold = Opening Stock + Purchases + Direct expenses – Closing Stock

Trading Account for the year ended on Mar 31, 2009

Particulars	Rs	Particulars	Rs
To Cost of Goods Sold	7,63,500	By Net Sales:	
To Gross Profit transferred to Profit and Loss A/c	10,000	Sales	8,13,500
	7,73,000	Less: Sales Returns	40,000
			7,73,500

Illustration: 4

From the following particulars of Raj Chand, prepare the Trading Account for the year ending on Dec 31, 20....

	Rs		Rs
Opening Stock	60,000	Manager's Salary (Office)	1,20,000
Purchases	5,00,000	Manager's Salary (Factory)	1,25,000
Purchase Returns	10,000	Fuel, Gas, Water	30,000
Sales	11,00,000	Customs Duty	10,000
Sales Returns	20,000	Dock Dues	1,500
Clearing Charges	4,000	Rent (Office)	12,000
Carriage on Sales	7,700	Rent (Factory)	20,000
Royalty	5,000	Wages (Productive)	1,60,000
Factory Light and Power	25,000	Carriage and Freight	12,000
Office Insurance	19,000	Salary of Foreman	1,48,000
Octroi	2,500	Stock at the end	3,40,000
Factory Insurance	17,500		
General Expenses	67,500		

Solution

Raj Chand

Trading Account for the year ending on Dec 31, 20....

Dr.			Cr.
Particulars	Rs	Particulars	Rs
To Opening Stock	60,000	By Sales	11,00,000
To Purchases	5,00,000	Less: Returns	20,000
Less: Returns	10,000	By Stock at the end	3,40,000
To Clearing Charges	4,90,000		
To Royalty	4,000		
To Factory Light and Power	5,000		
To Octroi	25,000		
To Factory Insurance	2,500		
To Manager's Salary (Factory)	17,500		
To Fuel, Gas and Water	1,25,000		
To Customs Duty	30,000		
To Dock Dues	10,000		
To Rent (Factory)	1,500		
To Wages (Productive)	20,000		
To Carriage and Freight	1,60,000		
To Salary of Foreman	12,000		
To Gross Profit transferred	1,48,000		
To Profit and Loss Account	3,09,500		
	14,20,000		14,20,000

Notes

- Expenses relating to office are not recorded in the Trading Account. In this illustration such expenses are:
 - Carriage on sales
 - Office insurance
 - Rent (office)
 - Manager's salary (office)
 - General expenses
- Closing stock is included because it is not adjusted with purchases or cost of goods sold.

OBJECTIVE 3 : MANUFACTURING ACCOUNT**3.1 Meaning of Manufacturing Account**

Manufacturing Account is prepared by the business enterprises that are engaged in manufacturing activities. In order to ascertain the cost of goods manufactured, the Manufacturing Account is prepared. In this account, both direct and indirect expenses relating to the process of manufacturing are recorded (i.e., debited to this account). The Manufacturing Account is closed by transferring its balance (cost of goods produced) to the Trading Account.

3.2 Pro-forma of a Manufacturing Account

Dr.			Cr.
Particulars	Rs	Particulars	Rs
To Materials:		By Sale of Scrap	—
Opening Stock	—	By Closing Stock:	—
Raw Materials	—	Raw Materials	—
Work-in-progress	—	Work-in-progress	—
To Purchases:		By Cost of the goods	—
Raw Materials	—	(transferred to trading account)	—
Work-in-progress	—		
To Carriage Inwards	—		
To Factory Wages	—		
To Factory Rent	—		
To Fuel, Power, Gas	—		
To Factory Insurance	—		
To Depreciation	—		
To Overheads (Manufacturing)	—		
To Repairs	—		
To Taxes	—		
To Royalty on Production	—		
To General Expenses	—		
To Miscellaneous Expenses	—		
(manufacturing)	—		

Illustration: 5

The following were some of the ledger balances in the books of Dev and co. on Mar 31, 2009.

	Rs		Rs
Raw Materials Stock on Apr 1, 2008	20,000	Plant and Machinery as cost	80,000
Stock of Work-in-Progress	30,000	Leasehold Buildings as cost	50,000
Direct Wages	80,000	Provision for Depreciation	
Sales	2,70,000	Leasehold Building	7,000
Purchases	1,80,000	Plant and Machinery	5,000
Returns Inwards	10,000	Fixtures and Fittings	2,000
Carriage Inwards	2,500	Replacement cost of fixed assets	18,000
Direct Wages	70,000	Sale of Scrap	2,500
Repair to Buildings	3,000	Factory Power	7,500
Indirect Wages	9,000	Factory Rates	9,000
Bank Overdraft	20,000	Stock of Finished Goods as on Apr 1, 2008	45,000

Additional Information

- (1) Factory buildings are held on a 60-year lease
- (2) Stocks on Mar 31, 2009: Raw materials Rs 25,000; Work-in-Progress Rs 35,000; Finished Goods Rs 60,000
- (3) Depreciate the Plant and Machinery @10% p.a.
- (4) The factory production was charged to finished goods at cost
- (5) Prepare a Manufacturing Account for the year ended on Mar 31, 2009.

Solution**Notes**

1. Figures relating to finished goods are not taken into account.
2. Bank Overdraft and "provisions" are also not recorded.
3. Items relating to Fixed Assets are also not entered.
4. Depreciation on Plant and Machinery is worked out as $\text{Rs } 80,000 \times 10/100 = \text{Rs } 8,000$ for a year. In practice for 6 months, Rs 4,000 only is recorded as the exact date of purchase of machinery is not given. (Provision for Depreciation given in the question is to be ignored.)
5. It is customary to show one figure for raw materials as:

Raw materials (opening stock):

Add: Purchases:

Less: Closing stock:

But, Closing Stock is shown separately on the credit side.

Dev and Co.

Manufacturing Account for the year ended on Mar 31, 2009

Dr.

Cr.

Particulars	Rs	Particulars	Rs
To Stock as on Apr 1, 2008	Rs 20,000	By Stock as at the end (as on Mar 31, 2009)	Rs 25,000
Raw Materials	30,000	Raw Materials	35,000
Work-in-Progress	50,000	Work-in-Progress	60,000
To Purchases	2,70,000	By Sale of Scrap	2,500
To Carriage Inwards	2,500		

Dr.

Cr.

Particulars	Rs	Particulars	Rs
To Direct Wages	70,000	By Cost of goods transferred to Trading Account	3,62,500
To Indirect Wages	9,000		
To Factory Power	7,500		
To Factory Rates	9,000		
To Repairs to Buildings	3,000		
To Depreciation on Plant and Machinery	4,000		
	<u>4,25,000</u>		<u>4,25,000</u>

3.3 Differences Between Trading Account and Manufacturing Account

A Trading Account differs from Manufacturing Account on the following aspects:

Basis of Distinction	Trading Account	Manufacturing Account
1. Main objective of preparation	This is prepared to ascertain the gross profit or gross loss	The main object is to ascertain the cost of goods manufactured
2. Transfer of A/c	This is transferred to the Profit and Loss Account	This is transferred to Trading Account
3. Stock of finished goods	This account shows the stock of finished goods (opening and closing)	This account does not show the stock of Finished Goods (both opening and closing)
4. Raw Materials and work-in-progress	Trading Account does not deal with raw materials and work-in-progress. This deals with only finished goods	This account deals with raw materials and work-in-progress. This does not deal with finished goods

OBJECTIVE 4: PROFIT AND LOSS ACCOUNT

As already explained, Trading and Profit and Loss Account, a constituent of Final Accounts is divided into two sections (stages or parts). The first section is Trading Account. After the preparation of Trading Account, the next step in the accounting process is to prepare the Profit and Loss Account.

4.1 Profit and Loss Account: Meaning and Features

Profit and Loss Account is prepared to ascertain the net profit earned or net loss suffered by a business enterprise during an accounting period. This account starts with gross profit on the credit side much which is brought forward from the Trading Account. It is followed by any other item of revenue income. It is important to mention here that only items of revenue incomes and revenue losses will be recorded in this account. But profit or loss on sale of capital items is recorded here. On the debit side it starts with gross loss, in case of gross loss brought forward from Trading Account. It is followed by items relating to revenue expenses. (Items that are not recorded in Trading Account will have to be recorded in this account.)

After recording all items, both sides of the Profit and Loss Account are totalled. If the credit side total exceeds the debit side total, the difference is Net Profit. On the other hand, if the debit side exceeds the credit side such difference is termed as Net Loss. Profit and Loss Account is closed by transferring the Net Profit/ Loss to Capital Account in the Balance Sheet. Net profit is added to the Capital Account in the Balance Sheet while net loss is deducted from the Capital Account in the Balance Sheet.

4.2 Closing Entries Relating to Profit and Loss Account

The preparation of Profit and Loss Account requires the transfer of all items (nominal accounts relating to Profit and Loss Account) in the Trial Balance to the Profit and Loss Account with the help of the following closing entries:

- (A) For Debit: (items of revenue expenses and losses) (or for items other than those recorded in debit side of Trading Account)
 Profit and Loss A/c
 To Respective items A/c
 (individually)
 Dr.
- (B) For Credit: (items of revenue income and gains) (or for items other than those recorded in credit side of Trading Account)
 Respective items A/c
 (individually)
 Dr.
 To Profit and Loss Account
- (C) (i) For Net Profit:
 Profit and Loss Account
 Dr.
 To Capital account
- (ii) For Net Loss:
 Capital Account
 Dr.
 To Profit and Loss Account

4.3 Pro-forma of Profit and Loss Account

Refer Chapter 15.

4.3.1 Uses of Profit and Loss Account

1. **Determination of net income:** It is very essential for any kind of business entities to know the profit earned periodically for which this account facilitates the task of computing the net income with accuracy.
2. **Capital maintenance:** Capital should be maintained at an optimum level in business organisations. The preparation of this account extends a helping hand in determining how much amount can be kept in capital and how much can be earmarked for the other areas in the business firms. The income statement plays a vital role in this aspect.
3. **Tool of financial planning:** Only after ascertaining net profit, financial planning can be carried on without much hindrance. The business entities can plan how much to earmark to replace the assets and how much to keep in reserve to meet any unforeseen eventualities which may arise in future and the like.
4. **Source of internal financing:** It helps in maintaining the level of retained income which will act as a source for all other activities relating to finance within any enterprise.
5. **Basis for tax computation:** This account provides accurate basic data to calculate tax. But for this, it will not be easy to compute tax.
6. **Future investment decisions:** Level of earnings in future can be estimated based on the past level of earnings. This P and L Account throws much light on this aspect by which a proper investment decision can be made by a careful analysis of incomes and expenses occurred in the previous years.
7. **Managerial use:** Information regarding profitability can be had from income statement which is useful for management to streamline the different and varied activities of the larger enterprises.

4.4 Explanation of Some of the Terms Appearing in Profit and Loss Account

Some of the items that frequently appearing in the preparation of Profit and Loss Account have to be understood in the proper context. They are as follows:

- (i) **Outstanding income:** The amount which is due and receivable but not yet received is referred to as "outstanding income". A person is entitled to receive the "outstanding income" and it becomes due to him.

- (ii) **Accrued income:** The amount which is earned but not yet due and receivable is referred to as "Accrued income." This is calculated periodically. A person is not entitled to receive the "accrued income" legally.
- (iii) **Net profit:** Excess of operating revenues over operating expenses and losses is termed as "Operating Profit" (Operating Profit = Gross Profit – Operating Expenses). Operating expenses are such expenses that form part of normal business activities.
- (iv) **Operating loss:** Excess of operating expenses over the gross profit is known as operating loss:
 Operating Loss = Operating Expenses – Gross Profit
- (v) **Non-operating profit** = Non-operating profit arises from sources other than normal activities of the business entities. (In order to understand the concept of operating activities in detail, students are asked to refer the chapter "Cash Flow Statement".)

Illustration: 6

From the following information, prepare the Profit and Loss Account for the year ending on Mar 31, 20....

	Rs		Rs
Gross Profit	3,70,000	Apprenticeship Premium paid	2,000
Salaries	7,500	General Expenses	6,000
Carriage Outwards	2,500	Miscellaneous Income	3,500
Freight Outwards	3,000	Reinvestment on Fixed Assets	30,000
Discount Allowed	1,000	Machinery sold	12,000
Discount Received	1,500	(Book value Rs 15,000)	3,000
Commission Allowed	1,500	Interest Received	
Commission Received	2,000		
Rent (factory)	3,000		
Dividend Received	2,000		

Solution

Notes

1. As gross profit is given, Trading Account need not be prepared. Profit and Loss Account can be prepared straight away.
2. Gross profit is entered on the credit side and all the incomes of revenue nature are recorded one by one.
3. All expenses are entered (revenue nature) on the debit side.
4. Sale of machinery – only the loss on sale (Rs 15,000 – Rs 12,000) (book value – sale). Rs 3000 is entered on the debit side. Sale amount Rs 12,000 is not recorded in Profit and Loss Account.
5. Reinvestment on fixed assets is capital expenditure and hence not recorded in Profit and Loss Account.

Profit and Loss Account for the year ended on Mar 31, 20....

Dr.	Rs	Particulars	Rs
To Salaries	7,500	By Gross Profit	3,70,000
To Carriage Outwards	2,500	By Discount Received	1,000
To Freight Outwards	3,000	By Commission Received	2,000
To Discount Allowed	1,000	By Dividend Received	2,000
To Commission Allowed	1,500	By Miscellaneous Income	3,500

(continued)

(Continued)

Dr.			Cr.
Particulars	Rs	Particulars	Rs
To Rent (factory)	3,000	By Interest Received	3,000
To Apprenticeship Premium	2,000		
To General Expenses	6,000		
To Loss on sale of Machinery	3,000		
To Net Profit (transferred to Capital A/c in Balance Sheet)	3,52,000		
	<u>3,81,500</u>		<u>3,81,500</u>

Illustration: 7

From the following balances of Raj and Sons, prepare a Trading and Profit and Loss Account for the year ending Mar 31, 2009.

	Rs		Rs
Capital	75,000	Discount (Dr.)	100
Stock	3,000	Insurance	120
Sales	90,000	Carriage	400
Purchases	25,000	Carriage on Sales	350
Sales Returns	1,000	Wages	2,000
Purchases Returns	1,500	Depreciation	100
Cash in hand	2,500	General Expenses	600
Discount (Cr.)	160	Advertisement Expenses	250
Salaries	1,500	Travelling Expenses	300
Creditors	15,000	Building on lease	70,000
Bills Payable	12,000	Stock at the end (Mar 31, 2009)	5,000
Commission (Cr.)	300	Bad Debts	120

Solution**Raj and Sons**

Dr. Trading and Profit and Loss Account for the year ended on Mar 31, 2009 Cr.

Particulars	Rs	Particulars	Rs
To Stock	Rs 3,000		
To Purchases	25,000	By Sales	90,000
Less Returns	<u>1,000</u>	Less Sales Returns	<u>1,000</u>
To Wages	23,500		
To Carriage	2,000	By Stock at the end	5,000
To Gross Profit	400		
(transfer to Profit and Loss A/c)	65,100		
	<u>94,000</u>		
To Salaries	1,500	By Trading Account	94,000
To Discount	100	(Gross profit b/d)	65,100
To Insurance	120	By Discount	160
To Carriage on Sales	350	By Commission	300
To Depreciation	100		
To General Expenses	600		
	<u>600</u>		

Dr. Cr.

Particulars	Rs	Particulars	Rs
To Advertisement Expenses	250		
To Travelling Expenses	300		
To Bad Debts	120		
To Net Profit (transferred to Capital A/c in Balance Sheet)	62,120		
	<u>65,560</u>		<u>65,560</u>

Note: (i) Items relating to capital nature are not recorded in Profit and Loss Account.

(ii) Trading Account and Profit Loss Account is a single account and always has to be prepared, as explained in this illustration.

OBJECTIVE 5: BALANCE SHEET**5.1 Meaning and Features of a Balance Sheet**

The next step in the process of accounting after preparing Trading and Profit and Loss Account is the preparation of Balance Sheet. The process that started with the recording of Journal entries ends (as the last step) in the preparation of Final Accounts. But this term "Final Accounts" is applied collectively to comprise the three accounts, i.e. Trading Account, Profit and Loss Account and the Balance Sheet. Balance Sheet is not an account but a statement summarising the financial position of a business enterprise at a particular date. All the accounts that have not been closed by transfer to either the Trading Account or the Profit and Loss Account are to be recorded in the Balance Sheet. It summarises on the one side – the right-hand side – the assets of the business enterprise and on the left hand side the liabilities of the business. The capital – the business owes to the owner is recorded on the liabilities side. Net profit is added to it, while net loss is deducted from the capital. At the same time, Drawings (owner's debt to the business) is not recorded as a separate item on the assets side but it is deducted from Capital Account. Consequently, the total of two sides must show equal amounts. This equality is a proof of arithmetical accuracy. Hence, a Balance Sheet may be called a Statement of Assets and Liabilities of a business entity at a particular date.

5.2 Contents of the Balance Sheet

The right-hand side of a Balance Sheet is called the "Assets" side and the left-hand side is called the "Liabilities" side.

Items shown on the Assets side of a Balance Sheet: The debit balances of the ledger accounts that were not transferred to the Trading and Profit and Loss Account are to be shown on the Assets side of the Balance Sheet, because a debit balance in the real account and the personal account represents an "Asset." Assets are generally classified as Current Assets, Investments and Fixed Assets.

Further, fixed assets are classified into two categories: Tangible Assets and Intangible Assets.

Current Assets: Current Assets are those assets which are held for a short period and can easily be converted into cash (or sold or consumed).

Example: Cash in hand, cash at bank, raw material, stock of goods, bills receivable, debtors, prepaid expenses and so on. The current assets are also called floating assets or circulating assets. Turnover of these assets occur quickly and frequently. Generally, current assets are valued at cost price or market price whichever is less.

Investments: Acquisition of assets which in turn earn interest, dividend, rent or any other incomes are referred to as investments. For example, Shares, Debentures, Bonds and Fixed Deposits. These are usually

Fixed Assets: The term "Fixed Assets" refer to those assets which are acquired for use in business activities rather than for resale in the course of the business. They are usually held in the business for a relatively longer period. Fixed assets are classified into Tangible Fixed Assets and Intangible Fixed Assets.

Tangible Fixed Assets can be seen and they possess concrete physical existence. For example, Land Building, Plant, Machinery, Furniture and Fixtures, Vehicles and so on.

Intangible Fixed Assets cannot be seen and they do not possess any physical existence. Example: Goodwill, Patents, Copyrights, Trademarks and so on.

Some other assets also appear in the assets side because of the nature of account, i.e. a debit balance relating to special items such as "Suspense Account" of Advertisement, Interest, etc. Because of its status as a debit balance, it is shown as an asset.

Wasting Fixed Assets such as mines, oil wells, quarries also have the status of assets appearing on the Assets side of the Balance Sheet.

It is to be noted here that Contingent Assets are not shown on the assets side of the Balance Sheet, but they are shown as notes to the Balance Sheet now.

Items shown on the "Liabilities side" of a Balance Sheet: The credit balances of the ledger accounts that were not transferred to the Trading and Profit and Loss Account are to be shown on the "Liabilities side" of the Balance Sheet, because a credit balance in personal account is a liability. Liabilities may broadly be classified as follows: (i) Current Liabilities and (ii) Long-term Liabilities.

Current liabilities: Current liabilities represent the debts that have to be paid within a short period. For example, Creditors, Bills Payable, Outstanding Liabilities and Income received in advance.

- (i) **Creditors:** These include both trade and nontrade creditor's purchases of goods on credit basis, for use of services amount not yet paid are some of the examples for trade creditors. Money borrowed for a short period is nontrade creditor. All creditors are clubbed together and entered under the head "Creditors."

- (ii) **Outstanding liabilities:** Amount not yet paid (for the expenses already incurred) till the date of preparation of Balance Sheet is called outstanding liabilities. For example, outstanding rent, tax, salary, wages, interest, etc.

- (iii) **Income received in advance:** As on the date of Balance Sheet, amount would have been received but expense for which will incur on a later date.

- (iv) **Bills payable:** It is an instrument to pay money to the creditor for purchase of goods or services.

Long-term liabilities: Long-term liabilities represent the debts that need not be paid in a short period. Due date for payment of such liabilities will be usually for a period of more than a year. Long-term liabilities may be classified as (i) Secured Loans and (ii) Unsecured Loans.

- (i) **Secured Loans:** In case, if loan is obtained by mortgaging a fixed asset as security, such loan is said to be a secured loan, i.e. loans are availed against security.
- (ii) **Unsecured Loans:** No security is to be provided to secure a loan in this type of liability.

Examples: Debentures and loan from financial institutions.

Contingent liabilities: A contingent liability is not a liability on the date of Balance Sheet, but it may be a liability or may not be a liability on a future date. Uncertainty clouds over the amount pertaining to those liabilities. The obligation to discharge these liabilities on the date of Balance Sheet is uncertain.

Examples: Bills of exchange discounted; law suit against business enterprises, still pending; surety or guarantee given to others and arrears of dividends on cumulative preference shares.

As contingent liability is not an actual liability on the date of Balance Sheet, it will not be recorded on the liabilities side of the Balance Sheet but it is shown as footnote or explanation to the Balance Sheet.

5.3 Grouping and Marshalling of Assets and Liabilities: Meaning of Grouping and Marshalling

Grouping: Arranging items of a similar nature together under a common heading is known as "grouping."

Examples: Creditors, Debtors.

Creditors: This includes accounts of all the supplies from whom goods were purchased on credit. **Debtors:** This includes accounts of all debtors arising from the credit sales of goods, i.e. the balances of all the ledger accounts of debtors are totalled and written under the head "Debtors."

Marshalling: The order in which the assets and liabilities are recorded in the Balance Sheet is referred to as marshalling. The items in the Balance Sheet are generally marshalled in the following two ways: (i) in the order of liquidity and (ii) in the order of permanency.

5.4 In the Order of Liquidity

- (i) Assets are arranged in the order of liquidity (liquidity means the ability to convert the asset into cash or time taken to convert the asset into cash) – the most liquid asset is shown first and the least is shown last.

- (ii) The liabilities are arranged in the order in which they have to be paid off – the most emergent amount has to be made is recorded first and other liabilities are arranged in the order of emergency to be paid off.

The sole proprietorship, partnership firms, banking and financial entities usually adopt this kind of preparing balance sheets in order of liquidity.

Format of Balance Sheet (Items shown in the order of liquidity)
Balance Sheet as on

Liabilities	Rs	Assets	Rs
Current Liabilities:		Current Assets:	
Bank Overdraft	—	Cash in hand	—
Bills Payable	—	Cash at bank	—
Bank loan (short-term)	—	Bills Receivable	—
Income received in advance	—	Sundry Debtors	—
Long-term Liabilities:		Prepaid Expenses	—
Loan (Long-term)	—	Accrued Income	—
Loan on Mortgages	—	Stock	—
Capital:	Rs	Investments:	
Opening balance	Fixed Assets:	
Add: Net Profit	Furniture and Fixtures	—
or		Plant and Machinery	—
Less: Net Loss	Building	—
Less: Drawings	Land	—
		Patents	—
		Trademarks	—
		Goodwill	—
	xxx		xxx

5.5 In the Order of Performance

Items are arranged in the order of performance according to the purpose. This order is just the reverse of the liquidity order.

The assets are arranged in the order of their performance – the least liquid asset is to be recorded first and the most liquid asset is recorded last, i.e. just the reverse order of the liquidity order.

The liabilities (also the reverse of the liquidity order), the least urgent payment is to be recorded first and vice versa.

It is mandatory for companies incorporated under the Companies Act 1956 to prepare the Balance Sheet in the order of performance.

Format of Balance Sheet (items shown in the order of performance)
Balance Sheet of ... as on ...

Liabilities	Rs	Assets	Rs
Capital:	Rs		
Opening Balance	...	Fixed Assets:	
Add: Net Profit	...	Goodwill	—
(or)	—	Trademarks	—
Less: Net Loss	...	Patents	—
Less: Drawing	...	Land	—
Long-Term Liabilities:	—	Buildings	—
Long (Long Term)	—	Plant and Machinery	—
Loan on Mortgages	—	Furniture and Fixtures	—
Current Liabilities:		Investments:	
Income received in advance	—	Current Assets:	
Outstanding Expenses	—	Stock	—
Bank Loan (short term)	—	Accrued Income	—
Bills Payable	—	Prepaid Expenses	—
Bank Overdraft	—	Sundry Debtors	—
		Bills Receivables	—
		Cash at Bank	—
		Cash in Hand	—

OBJECTIVE 6: USES OF BALANCE SHEET

- To ascertain the nature and value of assets of business entities at a particular date.
- To ascertain the nature and value of the liabilities and their values of the business on a particular date.
- To assess the solvency of the business.
- To examine how much capital is distributed among the various assets to strengthen the efficiency of the firms.
- To assess exactly the financial position of a business.
- To facilitate comparison within the enterprise and with the enterprises of similar nature in the market.

OBJECTIVE 7: DIFFERENCES BETWEEN TRIAL BALANCE AND BALANCE SHEET

A Trial Balance may differ from Balance Sheet in the ways as shown in the tabular column.

Basis of Distinction	Trial Balance	Balance Sheet
1. Object of preparation	The main object is to test the arithmetical accuracy of the ledger postings	This is prepared to ascertain the financial position of a firm
2. Periodically of preparation	Trial balance may be prepared more than once in a year	Balance Sheet is prepared only once at the end of an accounting period

Basis of Distinction	Trial Balance	Balance Sheet
3. Types of accounts	All types of accounts, i.e. personal, real and nominal accounts are recorded	Only personal and real accounts are recorded
4. Contents	All the ledger accounts are shown	The balances of ledger accounts, which were not closed till Trading and Profit and Loss Account is prepared, are shown
5. Stock	It always contains opening stock and only rarely closing stock	It contains only closing stock
6. Headings	The headings of the Trial Balance columns are "Debit balance" and "Credit balance"	The headings in the Balance Sheet are "Liabilities" and "Assets"
7. Adjustments	Adjustments (in respect of outstanding expenses, prepaid, accrued income, etc.) are not necessary in the preparation of a Trial Balance	Adjustments relating to certain items are absolutely necessary to prepare a Balance Sheet
8. Net Result	Net profit or net loss cannot be known from the Trial Balance	Net result can be best obtained from the Balance Sheet
9. Mandatory	Preparation of Trial Balance is only obligatory. It is not mandatory	Preparation is mandatory for companies registered under Companies Act
10. Ends or means	A Trial Balance is a means to know the financial position of a business enterprise	A Balance Sheet is the end to know the financial position of an enterprise

Adjustments

To be made at the time of preparing Balance Sheet - (Final Accounts)

Adjustments of various items in the preparation of Final Accounts

At times, balances in the Trial Balance do not show the correct amounts for the full accounting period. Revenue recognition is one kind of principle to be followed for making adjustments. According to this principle, the revenue should be recognised in the period in which the sale is said to have taken place.

Matching principle is another kind of principle which emphasises that the expenses will have to be recognised in the same accounting period with revenues. Any expense is recognised in relation to its revenue. "No revenue, No expense" policy is the motive behind such principle.

As final accounts are prepared on accrual basis, adjustments are necessary to record all assets and liabilities at their correct values. For this, the amount relating to a transaction may be received/spent in the previous year, such amount must be added this year. Similarly, if any amount has been received/spent for the next year, it must be deducted as it relates only to the next accounting period. Irrespective of the year in which it was received/spent, MUST be brought to this year, if it pertains to this year and get adjusted with that time. Such adjustments are made to ensure a proper match of revenue and expense.

Some of the items of adjustments required to be made at the end of the accounting period are explained below.