

INTRODUCTION

As explained earlier, the process of accounting starts with the recording of entries of business transactions in the books of journal, passing through various stages and reaches the final stage of preparing final accounts. The term “final accounts” usually represents three types of various accounts, viz. Trading Account, Profit and Loss Account and Balance Sheet. In the accounting principle, Balance Sheet is only a statement and not an account. But for all practical uses, Balance Sheet forms part of Final Accounts.

OBJECTIVE 1: ACCOUNTING PROCESS - PREPARATION OF FINAL ACCOUNTS FROM TRIAL BALANCE

The final phase – preparation of final accounts from Trial Balance – is discussed in detail in this chapter. The final accounts are to be prepared to ascertain the net profit or loss for a period (Trading and Profit and Loss Account) and the financial position of the business entities on the last date of a period (Balance Sheet).

OBJECTIVE 2: TRADING ACCOUNT

2.1 Trading Account: A Constituent of Final Accounts

Trading account is a constituent of financial statements. In practice, it is treated along with Trading and Profit and Loss Account, as one account and one unit. The Trading and Profit and Loss Account consists of two parts – the first part or stage or section is called Trading Account and the second part or stage or section is called Profit and Loss Account. The next stage after preparing the Trial Balance is the preparation of Trading Account. Trading Account is to be prepared for a particular accounting period, as this is not a static statement. It is important to mention here that trading account is not prepared at a particular time or date. Hence it is headed as “Trading and Profit and Loss Account for the period ended on....”

Trading Account is prepared to know whether a business enterprise has earned profit or suffered loss. Here profit or loss represents only gross profit or gross loss. Gross profit means the excess of operating revenues over direct operating expenses. To put in other words, gross profit is the excess of net sales revenue over cost of goods sold. In the preparation of Trading Account, selling prices of goods and services are matched with cost of goods sold and services rendered. Some concepts and terms associated with Trading Account are explained now.

- (i) Net Sales Revenue = Cash Sales + Credit Sales – Sales Returns
- (ii) Cost of Goods Sold = Opening Stock + Net Purchases – Closing Stock (stock at the end) + Direct Expenses
- (iii) Net Purchases = Cash Purchases + Credit Purchases – Purchases Returns
- (iv) Gross Profit = Net Sales Revenues – Cost of Goods Sold

Opening Stock refers to the goods existing at the beginning of the (accounting) period.

Direct expenses refer to the expenses that incurred from the purchase of goods till the conversion of goods into saleable goods.

This includes:

- (i) Freight inwards
- (ii) Carriage inwards
- (iii) Cartage inwards
- (iv) Wages
- (v) Import duty

- (vi) Octroi
- (vii) Packing expenses
- (viii) Forwarding charges
- (ix) Transit – insurance
- (x) Dock dues

Closing Stock refers to goods remain unsold at the end of the (accounting) year.

7.2 Preparation of Trading Account

2.2 Preparation of closing entries: The balances of accounts of all related items have to be transferred to the Trading Account by way of passing entries. The entries needed for such transfer are termed as “Closing Entries.” By passing such closing entries, the respective accounts will be closed. The closing entries are as follows:

- (1) For closing of debit accounts:
Trading Account

- To Opening Stock
- To Purchases Account
- To Sales Returns Accounts
- To Wages Account
- To Direct Expenses Account
- (Direct expenses to be shown separately)

- (2) For closing of credit accounts:
- | | | |
|-----|----------------------|--|
| Dr. | Sales A/c | |
| Dr. | Purchase Returns A/c | |
| | To Trading Account | |

- | | | |
|--|-------------------------------------|-----|
| | (3) For closing of Trading Account: | |
| | (a) For Gross Profit: | Dr. |
| | Trading Account | |
| | To Profit and Loss Account | |
| | (b) For Gross Loss: | |
| | Profit and Loss Account | Dr. |
| | To Trading Account | |

Note: The Trading Account is closed by transferring Gross Profit/Loss (balance in the account) to the Profit and Loss Account, i.e. to the second section (stage) of the account.

while receiving the Trading Account, care should be taken to treat the closing stock.

1. In case, if the Closing Stock does not appear in the Trial Balance (appear outside the Trial Balance), the following entry is passed to incorporate the closing stock:
Dr.

To Trading A/c

To Trading A/c
Net effect: It appears both on the credit side of the Trading Account and on the Assets side of the Balance Sheet.

2. In case, if Closing Stock appears in the Trial Balance, Closing Stock will not be shown separately in the Trading Account because as it was already adjusted in Purchases or Cost of Goods Sold. But Closing Stock will be shown in the Balance Sheet.