Revision Notes

Class 11 Accountancy

Chapter 9 - Financial Statements Part- 1

Definition:

Financial Statements are the final statements that provide the summary of the accounts of a business enterprise stating its financial position and financial performance at the end of an accounting year.

Financial Statements include following statements:

1. Trading and Profit and Loss Account (or Income Statement) that depicts the financial performance of an enterprise.
2. Balance Sheet that presents the financial position of the enterprise at the end of an accounting year.
3. Notes to accounts or Schedules and notes forming part of Balance sheet and Income statement to give details of various items shown in both the statements.
4. Cash flow statement that helps to ascertain the flow of cash in the organization.

Objectives of preparing Financial Statements:

The objectives of preparing financial statements are:

1. To present the true and fair picture of the financial position of the business.
2. To reflect the true and fair picture of the financial performance of the business.
3. To provide detailed information regarding the resources of the company
4. To help in the decision making to the owner of the organization.

Expenditure:

Whenever there is a payment made for other than settling the existing liabilities it is called expenditure. On the basis of the nature of this payment expenditure are classified as:

1. **Capital Expenditure:** These are those non-recurring expenditure benefits of which are extended to more than one accounting year. For example, Expenditure incurred to purchase machinery, the benefits of machinery would definitely extend to more than one accounting year hence this is a capital expenditure.
   Capital expenditures are shown on the assets side of the Balance Sheet.

2. **Revenue Expenditure:** These are those recurring expenditures that are incurred for smooth conduct of the business benefits of which are extended to only one accounting year. Example, Salary paid to the employees, advertising expenditures, etc. These are shown on the debit side of Trading and Profit and Loss Account.

Receipts:
Receipts are the cash inflows that may or may not result in obligation to pay in future. On the basis of this nature, receipts can be classified as:

1. **Capital receipts:** These are those receipts that implies a future obligation to return the money in future. These are those receipts that are irregular and not received in the normal course of business. Example: Sale of machinery, Long-term loan taken, Capital brought in by the owner, etc. These are shown in the balance sheet, either increase in liabilities (Loan taken) or decrease in assets (Sale of Machinery).

2. **Revenue Receipts:** These are receipts that do not imply a future obligation to return the money in future. These are regular receipts that are necessary for operational activities of the business. Example, Rent received, Interest or commission received, etc. These are shown in the credit side of the Trading and Profit and Loss Account.

Trading and Profit and Loss Account:
It is the income statement that depicts the profit earned or the loss incurred at the end of the current accounting year. The net of revenue and expenditure is profit or loss.

Items comes under Trading and Profit and Loss Account:
Items on the debit side:
1. **Opening Stock:** It is the stock of goods that are in hand at the beginning of the year and is being carried forward from the previous year.

2. **Net Purchases:** Goods which are purchased during the year both cash and credit purchases less goods returned to the suppliers known as Purchase Returns gives Net Purchases.

3. **Wages:** These are direct wages paid to the factory workers as remuneration.

4. **Carriage Inwards/ Freight inwards:** These are the transportation costs that are incurred for bringing items to the place of purchase.

5. **Fuel/Water/Power/Gas**: These are those expenses that are incurred while production of goods.

6. **Packaging Materials and packing charges**: These form part of direct expenses for packing and packaging expenses of goods to be sold.

7. **Salaries:** These are the remuneration paid to administrative, office or godown staff for their services in the business.

8. **Rent Paid:** It is the expense of Rent for office, administration building, municipal taxes paid for running the business.

9. **Interest Paid**: It is the interest component paid on liabilities, i.e., Interest on loans, debentures, etc.

10. **Commission Paid**: It is the commission paid to sales agents that are an expense and are debited to Profit and Loss Account.

11. **Repairs:** These include the revenue expenditure made on maintenance and repairs of fixed assets.

12. **Miscellaneous Expenses:** Some petty or sundry expenses that are so small that can not come under one head are clubbed together and are written as Miscellaneous expenses.

13. **Depreciation:** It refers to decrease in the value of asset on account of wear and tear and passage of time.It is treated as expense and debited to profit and loss account and in the balance sheet deducted from asset value.

14. **Provision for bad debts:** It's not possible for the business to know the actual amount of bad debts,hence we make a reasonable estimate for the loss and provide the loss.It is known as provision for bad debts**.**

Items on the Credit Side:

1. **Net Sales:** It refers to the total sales made during the year both cash and credit sales less the Sales returns i.e., the goods returned by the customers.

2. **Other Incomes:** Incomes in the form of Interest received, Commission received, rent received comes under the credit side of the Profit and Loss Account.

3. **Closing Stock:** It is the stock of goods that are in hand at the end of the year and is being carried forward to the upcoming year.

Format of Profit and Loss Account:

Trading and Profit and Loss Account
for the year ended ……..

Particulars	Amount	Particulars	Amount
To Opening Stock To Purchases Less: Purchase Returns To Wages To Carriage Inwards To Gross Profit c/d		By Closing Stock By Sales Less: Sales Return	
To Salaries To General Expenses To Rent To Carriage outwards To Advertising To Net Profit (transferred to Capital account)		By Gross Profit b/d	

Gross Profit:
Gross Profit is the excess of Net Sales over the Net Purchases and Direct Expenses incurred for producing those goods.
Gross Profit= Net Sales- (Net Purchases + Direct expenses)
If the Net Sales is less than the sum of net purchases and direct expenses it results in Gross Loss. The Gross Profit/Loss is transferred to Profit and Loss Account.
When Cr side is less than Dr side, or the excess of sales over purchases and direct expenses is called gross profit. If the amount of purchases including direct expenses is more than the sales revenue, the resulting figure is 'gross loss'.

Net Profit:
If the total of the debit side of the Profit and Loss account that depicts the expenses is more than the credit side it results in Net loss and if the total of the debit is less than the credit side then it is the Net Profit for the period.
Net Profit= Gross Profit + Other Incomes – Indirect Expenses
The Net Profit/loss so computed is transferred to the Capital account in the liabilities side of the balance sheet.

Operating Profit (EBIT):
If the operating revenue is more than the operating expenses it results into operating profit. It is that profit that is earned through the normal operations of the business.
Operating Profit = Net Profit + Non-Operating Expenses- Non Operating Incomes

Balance Sheet:
It is the position statement that shows the financial position of the business for that period by showing the assets and liabilities of the business. On the left side there is Liabilities and on the right side of the balance sheet there is Assets.
It is prepared to know the exact financial position of the enterprise. All the accounts of assets, liabilities and capital are shown in the balance sheet.

Items comes under Balance Sheet:

1. **Current Assets:** These are those assets that can be liquified in cash easily i.e., they can be converted to cash within one year. For ex- Debtor, Bills receivables, Cash, Bank etc.

2. **Current Liabilities:** These are those liabilities that are paid within a period of one year. Such as Creditors, Bills payable, Outstanding expenses etc.

3. **Fixed Assets:** These are those long-term assets that are not easily liquified into cash and are kept in business for a longer period of time like, plant and Machinery.

4. **Intangible Assets**: These are those assets that are not tangible in nature i.e., they can not be seen or touched like goodwills, trademarks, etc.

5. **Investments:** These are the investments made in the securities of government or other businesses. They are generally represented at Cost price.

6. **Long-term liabilities**: These are those liabilities that are payable after one year such as long-term bank loan, long-term debentures.

7. **Capitals**: It is the amount brought in by the owner. It is the difference of liabilities due to outsiders from assets.

8. **Drawings**: These are the amounts withdrawn by the proprietor or the owner for personal use that reduce the amount of capital.

9. **Closing Stock:** It is the stock of goods that are in hand at the end of the year and is being carried forward to the upcoming year.

Format of Balance sheet:
Balance Sheet
as on ....

Liabilities	Amount	Assets	Amount
Capital Less: Drawings Add: Net Profit **Current Liabilities** Creditors		Fixed Assets: Machinery Current Assets: Debtors Cash Closing Stock	

Illustration: 1

From the following information prepare Trading and Profit and Loss Account and Balance Sheet for the year ended 31st March, 2021.

Account	Amount	Account	Amount
Capital	7,20,000	Salaries	1,20,000
Machinery	1,40,000	General Expenses	40,000
Sales	16,40,000	Rent	1,00,000
Purchases	8,00,000	Purchases Return	10,000
Sales Return	20,000	Debtors	6,00,000
Opening Stock	2,00,000	Cash	80,000
Drawings	80,000	Carriage Outwards	40,000
Wages	2,00,000	Advertising	40,000
Carriage Inwards	10,000	Creditors	1,00,000

Closing Stock was valued at Rs. 4,00,000.

Ans: Trading and Profit and Loss Account
for the year ended 31st March, 2021

Particulars	Amount	Particulars	Amount
To Opening Stock	2,00,000	By Closing Stock	4,00,000
To Purchases 8,00,000 Less: Purchase Returns (10,000)	7,90,000	By Sales 16,40,000 Less: Sales Return 20,000	16,20,000
To Wages	2,00,000		
To Carriage Inwards	10,000		
To Gross Profit c/d	8,20,000		
	20,20,000		20,20,000

To Salaries	1,20,000	By Gross Profit b/d	8,20,000
To General Expenses	40,000		
To Rent	1,00,000		
To Carriage outwards	40,000		
To Advertising	40,000		
To Net Profit (transferred to Capital account)	4,80,000		
	8,20,000		8,20,000

Balance Sheet
as on 31st March, 2021

Liabilities	**Amount**	**Assets**	**Amount**
Capital		Fixed Assets:	
7,20,000		Machinery	1,40,000
Less: Drawings	11,20,000	Current Assets:	
(80,000)		Debtors	6,00,000
Add: Net Profit		Cash	80,000
4,80,000	1,00,000	Closing Stock	4,00,000
	12,20,000		12,20,000
Current Liabilities:			
Creditors			