## 5.1. PREPARATION OF FINAL ACCOUNTS

Final accounts give a concise idea about the profitability and financial position of the business to management, owners and other interested parties of the business. After having determined the accuracy of the books of accounts with the help of a trial balance, the businessman is now interested in knowing the profit he has earned or the loss he has incurred for the period together with his financial position. Final accounts are prepared to achieve these objectives of the business.

Preparation of final accounts is governed by different acts, laws, standards and principles like Income tax law, Company Act, Partnership Act, Accounting Standards (AS), Generally Accepted Accounting Principles (GAAP), etc., used for valuation of financial transactions/events to standardize accounting information, which in turn depends upon type of organization concerned.

In other words, since different types of organizations operate under different legal framework, the methodology/procedure for preparation of final accounts will change accordingly.

There are three stages of preparing final accounts of a trading concern:

1) Trading account,
2) Profit and loss account, and
3) Balance sheet.

Trading account is prepared to know the gross profit or overall profit. Profit and loss account discloses net profit or clear profit of the business. The balance sheet shows the financial position of the business on a given date – generally on the last date of the accounting period.

## 5.2. TRADING ACCOUNT

The trading account is an account, which shows the result of buying and selling of goods/services. Therefore, it contains, in a summarized form, all the transactions occurring during a trading period which have a direct relation to the goods in which a business deals. It is obvious that the trading account does not include any item of operating expenses.

Every business likes to know, whether the firm has earned gross profit or suffered gross loss. Gross profit or loss is ascertained by preparing Trading Account. Excess of sales and closing stock over opening stock, purchases and direct expenses is known as the gross profit. Gross loss is the excess of opening stock, purchases and direct expenses over sales and closing stock.

## 5.2.1. Proforma of Trading Account

**Trading Account**
**(for the period ending ---------)**

| Dr. Particulars | ₹ | Particulars | Cr. ₹ |
|---|---|---|---|
| To Opening stock, or<br>Stock in the beginning, or<br>To Stock:<br>Raw material ……<br>Work in progress….<br>Finished goods<br>To Purchases<br>**Less:** Purchases return or<br>Returns outward<br>To Carriage or cartage or<br>Carriage on purchases<br>To Octroi or local taxes<br>To Import duty, customs, landing charges, clearing charges<br>To Wages or productive wage or manufacturing wages or direct wages or wages and salaries<br>To Coal gas and water<br>To Fuel<br>To Power or motive power<br>To Manufacturing expenses<br>To Consumable stores<br>To Packing charges<br>To Manufacturing expenses<br>To Direct expenses<br>To Factory expenses<br>To Productive expenses<br>To Royalty<br>To Gross Profit transferred to P/L Account (if **credit side exceeds the debit side)** | | By Sales<br>**Less:** Sales return or<br>Returns inward<br>By Closing stock or<br>Stock at the end of the year<br><br>By Stock:<br>Raw material ……<br>Work in progress….<br>Finished goods<br>By Gross loss – transferred to P/L Account<br>**(if debit side exceeds the credit side)** | |

## 5.2.2. Importance and Purpose of Trading Account

The importance and purpose of trading account are as follows:

1) **Ascertaining Gross Profit or Gross Loss:** The main purpose of prepar trading account is to ascertain gross profit or gross loss.

2) **Ascertaining Ratio of Direct Expenses to Gross Profit:** Trading acc shows the detail of **direct** expenses incurred in acquiring and manufactu goods.

3) **Ascertaining Ratio between Purchases and Direct Expenses:** Relation between purchases and direct expenses is ascertained through tra account.

4) **Calculation of Cost of Goods Sold:** Gross profit or loss is based upon of goods sold. Cost of goods sold is ascertained by adding opening st purchases and direct expenses and deducting closing stock from it.

5) **Calculation of Gross Profit Ratio:** The firm calculates gross profit ratio and measures the efficiency of its performance. Gross profit ratio is calculated by comparing gross profit to net sales.

6) **Comparison of Stock with the Stock of Previous Year:** Stock disclosed by trading account is compared with the closing stock of previous year. Stock is the part of goods remaining unsold with the firm.

7) **Comparing the Actual Performance with Desired Performance:** The actual performance shown by the trading account as regards purchases, sales, stock and cost of production can be compared with the desired performance.