

5.2.3. Items Appearing in Trading Account

The preparation of trading account will not be completed until one highlight the items which appear in the debit and credit side of trading account.

5.2.3.1. Items Appearing on Debit Side of Trading Account

The following items will appear on the **debit side** of trading account:

- 1) **Purchases:** Goods which have been bought for resale appear as purchases on the debit side of the trading account. They include cash as well as credit purchases. If goods are withdrawn by the proprietor for his personal use, they should be debited to his drawing account, and deducted from purchases.
- 2) **Purchases Returns:** Goods which are returned to suppliers are termed as purchases returns or returns outwards. The purchases returns account will have a credit balance. Purchases returns are shown by way of deduction from purchases.
- 3) **Opening Stock:** The amount of opening stock appears on the debit side of the trading account. This is actually the closing stock of the last year and the balance sheet has been brought forward in the current year.
- 4) **Wages:** Wages are paid to workers who are engaged in production. In case the manufacturing account is not prepared, they are debited to the trading account.
- 5) **Carriage Inwards/Freight-in:** Carriage inwards or freight-in is paid in respect of purchases made during the year. It appears on the debit side of the trading account. In the absence of any other information, carriage/freight is considered to be carriage inwards/freight-in and is debited to the trading account.
- 6) **Customs and Import Duty:** In case the goods are imported, the customs duty or import duty paid in such cases is debited to the trading account.
- 7) **Royalty:** Royalty is the amount paid to the owner for using his rights. For example, royalty is paid by a lessee to the owner of a coalmine, for taking out the coal from the coalmine. Since, this being a direct expense, it is debited to trading account. In some cases, where royalty is paid based on the sales, it can be charged to the profit and loss account.

- 8) **Gas, Electricity, Water and Fuel, etc.:** All these expenses are direct expenses and therefore, they are charged to the trading account.
- 9) **Packing Material:** Packing materials purchased for bringing the goods or for converting them into saleable condition are direct expense and hence debited to trading account.

5.2.3.2. Items Appearing on Credit Side of Trading Account

The following items will appear on the **credit side** of trading account:

- 1) **Sales:** Sales appear on the credit side of the trading account. They include credit as well as cash sales. It does not include the sale of assets.
- 2) **Sales Returns:** Goods returned by customers are called returns inwards or sales returns. The sales returns account has a debit balance. These are shown by the way of deduction from sales.
- 3) **Closing Stock:** The amount of goods unsold at the end of the year is called closing stock. It is shown on the credit side of the trading account.

Generally, the closing stock is given outside the trial balance. This is so because the closing stock account does not appear in the ledger.

Example 1: From the following information, prepare the trading account for the year ending on 31st March, 2008:

Opening Stock ₹1,50,000, Cash Sales ₹60,000, Credit Sales ₹12,00,000, Returns Outwards ₹10,000, Wages and Salaries ₹4,000, Carriage Inward ₹2,000, Freight Inward ₹3,000, Cartage Inward ₹1,000, Cash Purchases ₹50,000, Credit Purchases ₹10,00,000, Returns Inward ₹20,000, Closing Stock as on 31.3.2008, ₹90,000 but its market value is ₹84,000.

Solution:

Trading Account For the year ending 31st March, 2011

Dr.		Cr.	
Particulars	₹	Particulars	₹
To Opening Stock	1,50,000	By Sales	
To Purchases		Cash Sales	60,000
Cash Purchases	50,000	Credit Sales	<u>12,00,000</u>
Credit Purchases	<u>10,00,000</u>	Total Sales	12,60,000
Total Purchases	10,50,000	Less: Return Inward	<u>20,000</u>
Less: Return Outward	<u>10,000</u>	By Closing Stock	12,40,000
To Freight Inward	3,000		84,000
To Gross profit	1,31,000		
	<u>13,24,000</u>		<u>13,24,000</u>

5.3. PROFIT AND LOSS ACCOUNT

5.3.1. Meaning of Profit and Loss Account

The income statement, also known as the profit and loss account, summarizes the financial results of a company during a particular period of time. The time period, known as the accounting period, is usually one year and this is indicated as profit and loss account for the period ended 2009-10 or profit and loss account for the year ended 2010.

An income statement is a type of flow report, as compared to the balance sheet, which is a status report. Financial flows in firms are continuous.

The income statement focuses on the:

- 1) Inflows (or creation) of assets, cash, or accounts receivables that result from the sale of goods and services to customers or clients. These receivables are known as revenues; and
- 2) Outflows (or consumption) of resources that are required in order to generate revenues. These outflows are known as expenses.

Profit, net income, or net earnings is the amount by which revenues exceed expenses. If expenses exceed revenue, the amount of difference is known as loss or net loss.

Thus, the profit and loss account is an account, which is designed to highlight the net profit, earned or net loss incurred by the business entity arising from its transactions during an accounting period. It contains all the items of revenue gains, losses and operating expenses pertaining to the accounting period.

All the nominal accounts which are left after preparing a trading account are to be transferred to this account. This transfer, however, is to be made on the basis of double entry principle, i.e., all expenses and losses (i.e., office and administration, selling and distribution, all non-operating expenses, and abnormal losses) will appear on the debit side of this account and all incomes and gains (i.e. operating, non-operating, abnormal gains etc.) will appear on the credit side of this account with the amount of gross profit or gross loss.