

**BCM-102**  
**FINANCIAL ACCOUNTING**  
**UNIT-14 FINAL ACCOUNTS-INCOME**  
**STATEMENT**  
**(B. COM. FIRST YEAR)**

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# Financial statements

- Financial statements viz. Trading and Profit and loss account and Balance Sheet, prepared at the end of accounting year, serve the informational needs of a wide group of shareholders. They are not just the systematic record of financial transactions of a business maintained to comply with the legal requirements only, financial statements also serves as a tool for evaluating the performance of management, help the prospective investors in assessing the financial performance and financial position of a business, is a source of information for the management which helps it in taking appropriate decisions in time, helps the government in assessing tax liability of the business etc.

# Objectives of Preparing Financial Statements

- (a) Trading and Profit and Loss account is prepared to present a true and fair view of the financial performance of the business;
- (b) Balance Sheet helps to present a true and fair view of the financial position of the business;
- For a manufacturer, the financial statements consist of:
  - Manufacturing Account
  - Trading Account
  - Profit and Loss Account
  - Profit and Loss Appropriation Account and
- Balance Sheet

# Income Statement

- Income statement is composed of two parts i.e. trading account and second Profit and Loss account. It is also known as Trading and Profit and Loss account and is prepared to reveal the status of financial performance of a business in terms of profit earned or loss sustained by it over an accounting period, normally one year.
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- It is prepared on the basis of information contained in the Trial Balance and additional information, if any. To calculate the net figure termed as profit or loss all the incomes and expenses of revenue nature are transferred from the trial balance to Trading and Profit and Loss account. Profit is revenue less expenses. If expenses are more than revenues, the figure is termed as loss.

# Income Statement

- **Trading Account:** The trading account ascertains the result from basic operational activities of the business i.e. manufacturing, purchasing and selling of goods. It is prepared to ascertain whether direct trading business has been profitable or not. The net result of the trading account is either gross profit or Gross loss. Gross profit or loss is calculated after deducting cost of goods sold from net sales. Where cost of goods sold include cost of purchases and other direct expenses.

- $\text{Gross Profit} = \text{Sales} - \text{Purchases} + \text{Direct Expenses}$

- **Profit and Loss Account:**

- Profit and Loss account is the second part of income statement. It is prepared to find out the net result i.e. Net profit or loss earned from the business. The process of writing of profit and loss account starts with the transfer of Gross Profit or Gross loss to this account from trading account. Thereafter indirect expenses are transferred from the trial balance to the debit side of the profit and loss account and incomes of revenue nature other than sales are transferred to the credit side of the profit and loss account. If the total of the credit side of the profit and loss account is more than the total of the debit side, the difference is the net profit. On the other hand, if the total of the debit side is more than the total of the credit side, the difference is the net loss incurred by the business firm. Net profit/loss in the form of an equation is shown as follows:

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- $\text{Net Profit} = \text{Gross Profit} + \text{Other Incomes} - \text{Indirect Expenses}$

# Format of the Trading and Profit and Loss Account

## Trading and Profit and Loss Account of ABC for the year ended March 31, 2012

Dr.			Cr.
Expenses/Losses	Amount Rs.	Revenues/Gains	Amount Rs.
To Opening stock	xxxx	By Sales less return	xxxx
To Purchases less return	xxxx		
To Wages	xxxx		
To Carriage inwards	xxxx		
To Gross profit c/d (Balancing Fig.)	xxxx	By Gross loss b/d(Bal. fig)	xxxx
<b>Total</b>	<b>xxx</b>	<b>Total</b>	<b>xxx</b>
To Gross loss b/d	xxx		
		By Gross profit b/d	xxx
To Rent/rates and taxes	xxx	By Interest received	xxx
To Salaries	xxx		
To Repairs and renewals	xxx	By Net loss	xxx
To Bad debts	xxx		
To Net profit <sup>2</sup> (transferred to .. capital account)	xxx		
<b>Total</b>	<b>xxx</b>	<b>Total</b>	<b>xxx</b>

## Process of Preparing Trading and Profit and Loss Account

- Trading and profit and loss account is prepared on the basis of trial balance and additional information, if any. The process of writing the Trading and Profit and loss account is discussed under two different situations i.e.

1. Without Adjustments

2. With Adjustments

- The preparation of trading and profit and loss account requires that the balances of all the revenue incomes and expenses are transferred to it from the trial balance.
- **Note:** All the Income accounts and accounts representing gain as appearing in Trial balance are required to be credited individually to Profit and Loss account

## Preparation of Trading and Profit and Loss Account (With Adjustments)

- A large number of items are required to be adjusted while preparing the financial statements e.g. salary of March 2011 paid in April 2011 will have to be shown as expense in the Profit and Loss account of 2010-11, similarly electricity bill of Feb-March 2011 paid in April 2011 will have to be booked as expense of Profit and Loss account of 2010-11 etc. Similarly, adjustments will also be required in respect of certain incomes received in advance or those which have accrued but are still to be received. In this section of the unit, we shall discuss the procedure to be followed while preparing Trading and Profit and Loss account when adjustments are required to be made.
- The main objective of making various adjustments is to ensure that the final accounts reveal the true profit or loss and the financial position of the business. The items which usually need adjustments include:
  - 1. Closing stock
  - 2. Outstanding/expenses and Prepaid/Unexpired expenses
  - 4. Accrued income and Income received in advance
  - 6. Depreciation
  - 7. Bad debts and Provision for doubtful debts
  - 9. Provision for discount on debts etc.
- The information about transactions which need adjustment is given in the form of additional information along with Trial Balance. It is to be noted that since books of accounts are maintained as per double entry system, all adjustments are booked in the final accounts at two places.

# Summary

- Income statement is prepared at the end of accounting year. It is a summary statement of revenue incomes earned and an expense incurred by the organization during the concerned accounting year and is composed of two parts i.e. trading account and Profit and loss account. The basic purpose of preparing the Income statement is to find out the true picture of the financial performance of the organization. Preparation of trading and profit and loss account is easier when there are no adjustments as compared to the situation when adjustments are required to be incorporated.

# References

- SILM developed by Uttarakhand Open University for BCM-102 (Financial Accounting), Year 2017, ISBN: 978-93-85740-44-2