

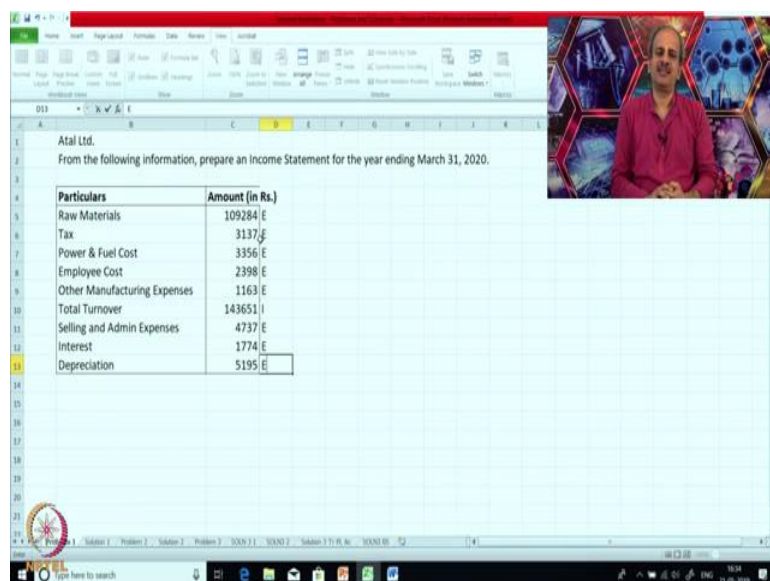
Financial Accounting
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Lecture – 09
Profit and Loss Account 2

Namaste. We have already discussed the basics of financial statements, then we have seen balance sheet both the basic format and the company format and we have also seen income statement or profit and loss account formats.

Now, let us try to prepare some basic financial statement in the form of Profit and Loss Account. This is not in the full fledged company format; this is for us to understand the basic format of income statement or P and L and to calculate the profit.

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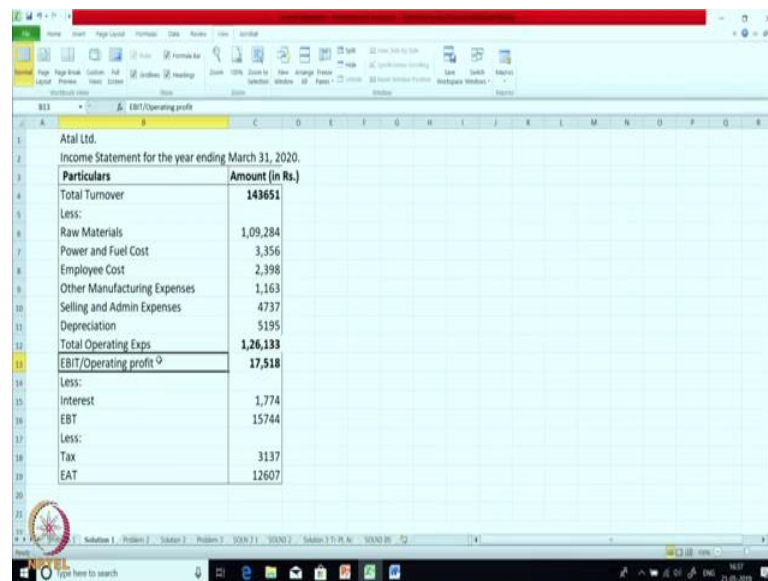
Atal Ltd.
From the following information, prepare an Income Statement for the year ending March 31, 2020.

| Particulars | Amount (in Rs.) |
|------------------------------|-----------------|
| Raw Materials | 109284 E |
| Tax | 3137 E |
| Power & Fuel Cost | 3356 E |
| Employee Cost | 2398 E |
| Other Manufacturing Expenses | 1163 E |
| Total Turnover | 143651 I |
| Selling and Admin Expenses | 4737 E |
| Interest | 1774 E |
| Depreciation | 5195 E |

So, the first case for that Atal limited, now a list of balances related to incomes and expenses are given and from that we have to make income statement. So, raw materials, taxes, power and fuel, employee cost you know all of these are various expenses, manufacturing expense is another expense. So, all these are being marked as a expense category right; total turnover is our revenue or our income. So, I will just mark it as a income and selling and admin expense, interest and depreciation are expenses.

So, in P and L it is very simple we will note income and we will reduce the expense from the same, we will break it down into two parts trading part and P and L part. So, please prepare the solution first and then check it with the solution which I am going to show. You can pause your video complete the work and then only look have a look at the solution.

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| Particulars | Amount (in Rs.) |
|------------------------------|-----------------|
| Total Turnover | 143651 |
| Less: | |
| Raw Materials | 1,09,284 |
| Power and Fuel Cost | 3,356 |
| Employee Cost | 2,398 |
| Other Manufacturing Expenses | 1,163 |
| Selling and Admin Expenses | 4737 |
| Depreciation | 5195 |
| Total Operating Exps | 1,26,133 |
| EBIT/Operating profit | 17,518 |
| Less: | |
| Interest | 1,774 |
| EBT | 15744 |
| Less: | |
| Tax | 3137 |
| EAT | 12607 |

So, in the interest of time we are immediately showing you the solution I hope you have made it yourself. So, the total turnover is the first item; here only one income item we have in the form of turnover this is also known as top line for the business from this certain expenses are deducted.

That is raw material, power, employee expense, manufacturing expense, selling expense and depreciation. What we have not reduced is or charged is interest because the items which are charged here are known as operating expenses. So, we will deduct first the operating expense which gives us a figure of operating profit it is also known as EBIT or PBIT; PBIT or EBIT refers to Earning Before Interest and Tax or Profit Before Interest and Tax; then less interest we get EBT or profit before tax. Now why is interest deducted separately in a separate step can somebody tell me the answer, can you think of it?

Because interest is not a regular expense related to the business; if you look at other items like raw material, power, employee, manufacturing etcetera they were essential part to run that business; whereas interest is a repayment made to bank or to some party

for loan which we have taken. So, it is not integral part to the operations of business; it is considered as a finance cost. If we have invested our own money of capital; we do not have to pay interest, interest is being paid because we have borrowed money, it does not necessarily have to do with the operations of business.

So, we have not kept it in operating expense we have reduced it separately. So, we get two levels of profit; first we have calculated EBIT and then we have calculated EBT. We have also deducted taxes separately whereas, where we will finally, get profit figure known as EAT or PAT. Now why is profit deducted separately; because profit as nothing to do with our policies. As per the prevailing law as per the taxation policy of the government the taxes have been calculated and they have been deducted to know the final profits available after taxes.

But we would also like to get one level before that to calculate profit before tax. So, that we know that from our own business we have got operating profit, we also deduct interest. So, we need to know how much profit we have made it our self that is profit before tax and then finally, what profit remains with us is a profit after tax. So, I hope you are all able to make it yourself; now let us go to the next case.

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| Particulars | Amount (in Rs.) |
|-----------------|-----------------|
| Cash | 2800 BS |
| Trade debtors | 10000 BS |
| Rent | 2750 E |
| Salaries | 6000 E |
| Trade Creditors | 9350 BS |
| Insurance | 2000 E |
| Petty Expenses | 1500 E |
| Opening Stock | 10000 E |
| Sales | 132500 I |
| Purchases | 90000 |
| Capital | 52950 |

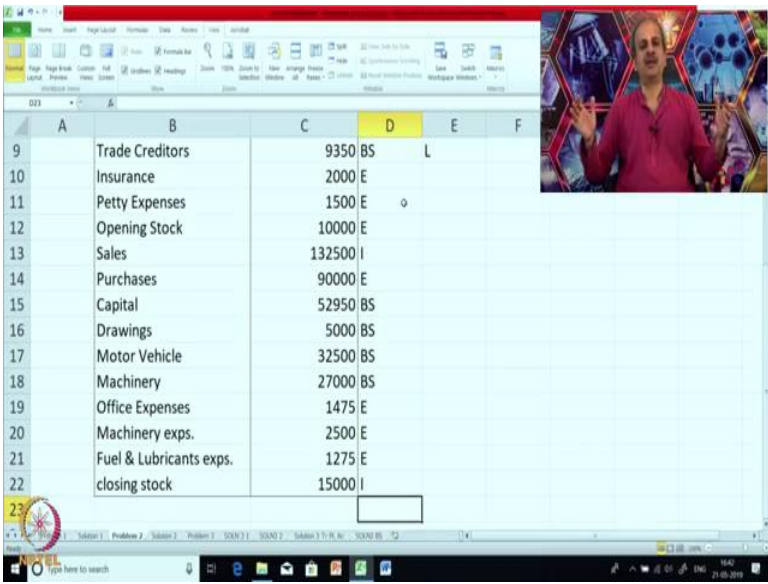
Next case here the balances of Shiva are given; certain items have been given and from this you have to make profit and loss account. But now we are going to make in two levels first the trading account and next the P and L account. The trading account is the

upper part of P and L, where we will record those items which are directly related to trading or manufacturing ok. This is a horizontal form of P and L we will make; in the last case we have made a vertical form now we are going to make a horizontal form ok.

Now, have a look at these balances mark the items of income and expense and then prepare trading and P and L account. So, cash what will you mark it as? Is it an income or expense? The answer is no actually you know it is a balance sheet item it is an asset in the balance sheet. So, it is not required as far as the P and L is concerned, but right now we will just mark it as BS. So, BS is balance sheet; so that you know that it is a balance sheet item those of you want to make balance sheet also you can even mark A after that because it is an asset item. But right now I am not going to give much time on it because we are going to focus on preparation of P and L.

Trade debtors; again a balance sheet item, rent again a balance sheet item? No; rent is an expense; so you should mark as E; salary again an expense, trade creditors balance sheet item; you know it is a liability you can mark it as L; if you are keen. Insurance, it is an expense petty expenses of course, are expenses; opening stock this is the last year stock which we are going to use it now; so, it becomes an expense item for us. Sales; sales is an income item, purchases; expense item, capital neither income neither expense it is a balance sheet item.

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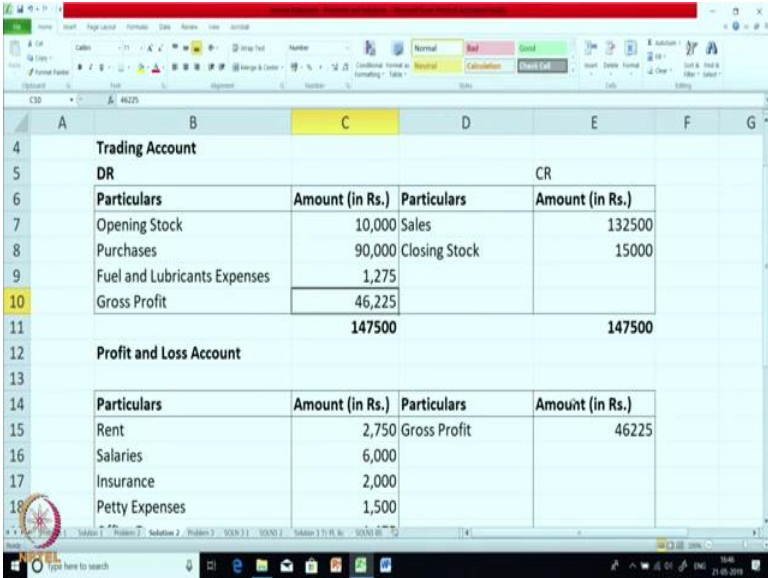


| | A | B | C | D | E | F |
|----|---|-------------------------|--------|----|---|---|
| 9 | | Trade Creditors | 9350 | BS | L | |
| 10 | | Insurance | 2000 | E | | |
| 11 | | Petty Expenses | 1500 | E | | |
| 12 | | Opening Stock | 10000 | E | | |
| 13 | | Sales | 132500 | I | | |
| 14 | | Purchases | 90000 | E | | |
| 15 | | Capital | 52950 | BS | | |
| 16 | | Drawings | 5000 | BS | | |
| 17 | | Motor Vehicle | 32500 | BS | | |
| 18 | | Machinery | 27000 | BS | | |
| 19 | | Office Expenses | 1475 | E | | |
| 20 | | Machinery exps. | 2500 | E | | |
| 21 | | Fuel & Lubricants exps. | 1275 | E | | |
| 22 | | closing stock | 15000 | I | | |

Drawings, again a balance sheet item; motor vehicles balance sheet item, machinery is a balance sheet item, office expense is an expense machinery expenses mark well these are maintains or such expenses on machinery they are not for purchase or for acquisition of machine. So, machinery is a balance sheet, but machinery expense is a expense item. Fuel and lubricant another expense and last item closing stock; this is an income item we are this is the remaining stock which we will use it in the next period.

So, for this period it becomes an income item; got it? Now only pick up E and I items prepare a profit and loss account in the horizontal format; upper part is known as trading lower part is known as P and L. So, please make your solution; I will halt here please pause the video and then after you are ready see the remaining part of video.

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| Trading Account | | | |
|------------------------------|-----------------|---------------|-----------------|
| DR | | CR | |
| Particulars | Amount (in Rs.) | Particulars | Amount (in Rs.) |
| Opening Stock | 10,000 | Sales | 132500 |
| Purchases | 90,000 | Closing Stock | 15000 |
| Fuel and Lubricants Expenses | 1,275 | | |
| Gross Profit | 46,225 | | |
| | 147500 | | 147500 |

| Profit and Loss Account | | | |
|-------------------------|-----------------|--------------|-----------------|
| DR | | CR | |
| Particulars | Amount (in Rs.) | Particulars | Amount (in Rs.) |
| Rent | 2,750 | Gross Profit | 46225 |
| Salaries | 6,000 | | |
| Insurance | 2,000 | | |
| Petty Expenses | 1,500 | | |

So, here we are now this is a solution of trading account. So, you can see the sales and closing stock are shown on credit side, this side is known as credit side where we show incomes this side is known as debit side.

I am not going to jargons of why debit, why credit, but normally this is called as credit. I will just mark it; CR normally stands for credit and DR stands for debit. On debit side or on expense side we start with opening stock then record the items which are related to the core operations; so we have recorded purchases and fuel.

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| | A | B | C | D | E | F | G |
|----|---|--------------------------------|------------------------|--------------------|------------------------|--------|---|
| 10 | | Gross Profit | 46,225 | | | | |
| 11 | | | 147500 | | | 147500 | |
| 12 | | Profit and Loss Account | | | | | |
| 13 | | | | | | | |
| 14 | | Particulars | Amount (in Rs.) | Particulars | Amount (in Rs.) | | |
| 15 | | Rent | 2,750 | Gross Profit | 46225 | | |
| 16 | | Salaries | 6,000 | | | | |
| 17 | | Insurance | 2,000 | | | | |
| 18 | | Petty Expenses | 1,500 | | | | |
| 19 | | Office Expenses | 1,475 | | | | |
| 20 | | Machinery Expenses | 2,500 | | | | |
| 21 | | Net Profit | 30,000 | | | | |
| 22 | | | 46225 | | 46225 | | |
| 23 | | | | | | | |
| 24 | | | | | | | |

Whereas those which are general nature of expenses like rent etcetera are recorded in P and L account. So, rent, salary, insurance, petty expense, office expense and machinery expenses have been recorded in P and L; of course, this classification is not very strict.

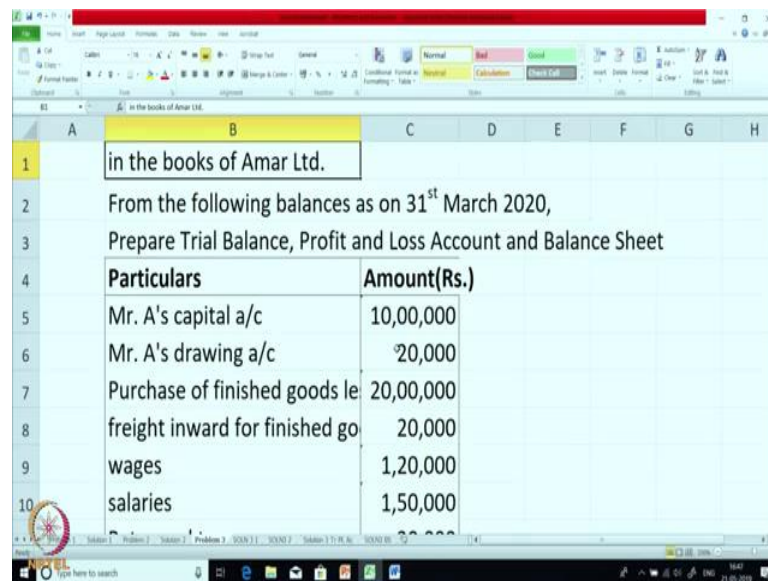
Some items like for example, machinery expenses if it is in a factory it can be written in a trading account, but we have assume that this is a small business which is not a manufacturing per say these are like more of a maintenance of machinery for day to day use. So, we have kept it in general expense category in the P and L account ok.

So, now based on your sales and closing stock we have charged first two items that is opening stock, purchases and fuel and the balance is called as gross profit. Are you able to calculate the gross profit? I will just show you the process; take the sum, the same amount will be carried over here since this is total I will make it bold.

Now, calculate the balance on the debit side that is 46225 that represents the profit from trading account, which is known as gross profit. Now this gross profit, we are caring it over on the credit side and then we will charge all the expense. Again following the same process take a total, take total on debit side also you will get a balance of 30000, this 30000 represents your final profit; generally known as net profit. Are you getting it? Net profit is the most important figure, so I am just making it bold.

So, for this particular period we have recorded all incomes and expenses and got a profit of 30000; this is the traditional way of writing it in a horizontal form all debit on one side and credit on one other side. More modern format is making a income statement in the vertical form which we had already seen in the last case; got it? Now let us go to the next one.

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| Particulars | Amount(Rs.) |
|-----------------------------------|-------------|
| Mr. A's capital a/c | 10,00,000 |
| Mr. A's drawing a/c | 20,000 |
| Purchase of finished goods | 20,00,000 |
| freight inward for finished goods | 20,000 |
| wages | 1,20,000 |
| salaries | 1,50,000 |

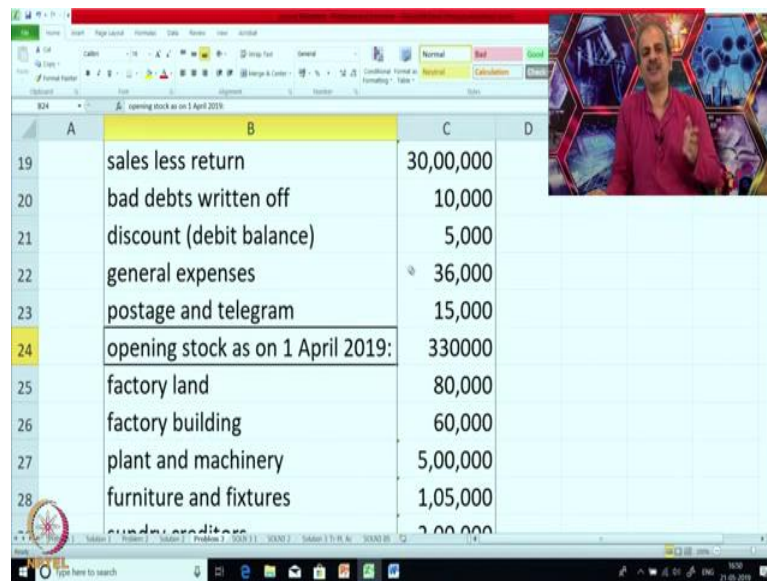
Now, this is more of a interesting item from the books of Amar limited, we are going to prepare trial balance, P and L account and balance sheet. So, far in the earlier cases we have seen how to prepare balance sheet, we have also seen how to prepare P and L; now we are going to next step where for the same case we will prepare P and L as well as balance sheet. In fact, we will also prepare one more statement known as trial balance. So, here there are list of balances; these balances would have been extracted from their ledger.

Now what is ledger they have made list of balances list of accounts if they calculate the balance of each account; they get the final balance as on 31st March 2020; they will make a list and this is what the list is. Now, what is a trial balance? Trial balance means this particular list will be categorized into debit balances and credit balances and we will check the total of debits and credits. Why do we check this? Because we want to check arithmetic accuracy of the accounts, this does not mean that 100 percent accuracy is ensured. But at the first stage trial balance helps us to know whether arithmetic accuracy

is there, whether we have missed any balance, whether any particular account has any issues. So, we will make a list of balances, prepare the trial balance and then make P and L and balance sheet ok.

So, for this list of balance now; please take a printout. For all the cases I have been telling you that based on this print out; prepare the solution yourself and then check with my solution there is a small error here.

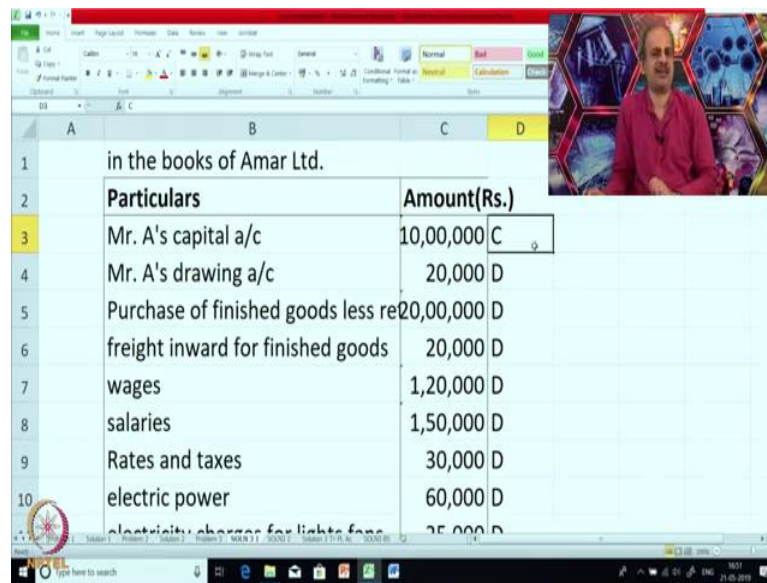
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| | A | B | C | D |
|----|---|-----------------------------------|-----------------|---|
| 19 | | sales less return | 30,00,000 | |
| 20 | | bad debts written off | 10,000 | |
| 21 | | discount (debit balance) | 5,000 | |
| 22 | | general expenses | 36,000 | |
| 23 | | postage and telegram | 15,000 | |
| 24 | | opening stock as on 1 April 2019: | 330000 | |
| 25 | | factory land | 80,000 | |
| 26 | | factory building | 60,000 | |
| 27 | | plant and machinery | 5,00,000 | |
| 28 | | furniture and fixtures | 1,05,000 | |
| | | total | 3,00,000 | |

Because we are given balance is on 31st March 2020. So, this opening stock must be on 1st April 2019, by typo error it was shown as 18; so I have now corrected it. Now please correct it in your sheet also and with these balances first make a trial balance. Now let us go to the solution I hope you have also made a trial balance.

(Refer Slide Time: 18:05)

The screenshot shows a video lecture interface. On the right, a presenter in a pink shirt is visible against a background of colorful hexagonal patterns. On the left, a spreadsheet is open, displaying a list of business transactions. The spreadsheet has columns A, B, C, and D. Column A contains line numbers 1 through 10. Column B contains the descriptions of the transactions. Column C contains the amounts in Rupees (Rs.). Column D contains the debit or credit designation (C for Credit, D for Debit).

| | A | B | C | D |
|----|---|------------------------------------|--------------------|---|
| 1 | | in the books of Amar Ltd. | | |
| 2 | | Particulars | Amount(Rs.) | |
| 3 | | Mr. A's capital a/c | 10,00,000 | C |
| 4 | | Mr. A's drawing a/c | 20,000 | D |
| 5 | | Purchase of finished goods less re | 20,00,000 | D |
| 6 | | freight inward for finished goods | 20,000 | D |
| 7 | | wages | 1,20,000 | D |
| 8 | | salaries | 1,50,000 | D |
| 9 | | Rates and taxes | 30,000 | D |
| 10 | | electric power | 60,000 | D |
| | | electricity charges for lights fan | 25,000 | D |

Now, what I have done here is first I have marked every item as C and D. What is C and D? Credit and debit; like capital account this is the money which investors have put in our business; so, this has credit balance this is the amount which is repayable.

Drawings represents the money which we have paid to the owner mister A. So, we will mark it as D debit; purchase is an expense item, so we have mark it as D. Freight is a expense item we have marked it as D like that all the items first have been listed as C or D ok. C items can either become a liability in the balance sheet or can become an income item in the income statement. But right now we are not going for that we are just listing out items as C or D and let us prepare the trial balance from same.

(Refer Slide Time: 19:11)

| Particulars | Amount(Rs.) | Amount(Rs.) |
|--|-------------|-------------|
| Mr. A's capital a/c | 1000000 C | |
| reserve account | 50000 C | |
| sales less return | 3000000 C | |
| sundry creditors | 200000 C | |
| closing stock | 350000 C | 4600000 |
| Mr. A's drawing a/c | 20000 D | |
| Purchase of finished goods less return | 2000000 D | |
| freight inward for finished goods | 20000 D | |
| wages | 120000 D | |
| salaries | 150000 D | |
| Rates and taxes | 30000 D | |
| electric power | 60000 D | |

So, here now all C items have been taken together and we have one taken one total of all C items ok. So, this is like a trial balance, but we will prepare exact trial balance from this. We were given list of balances as on 31st March 2020 then we have mark this items as C and D and now we are going to make a trial balance as on 31st March 2020.

(Refer Slide Time: 20:35)

| Particulars | Amount(Rs.) | Amount(Rs.) |
|--|-------------|-------------|
| | credit | Debit |
| Mr. A's capital a/c | 1000000 | |
| reserve account | 50000 | |
| sales less return | 3000000 | |
| sundry creditors | 200000 | |
| closing stock | 350000 | 4600000 |
| Mr. A's drawing a/c | | 20000 |
| Purchase of finished goods less return | | 2000000 |
| freight inward for finished goods | | 20000 |
| wages | | 120000 |
| salaries | | 150000 |
| Rates and taxes | | 30000 |

So, what we have done is; all the items which we were marked as C, we have kept under the column C and all items which are marked as D have been kept in the column D.

And then we will take totals of credit column and debit column. Are you getting it? This simple statement is known as a trial balance; now this becomes a starting point for preparation of P and L and balance sheet. Now based on this let us go for preparation of P and L and balance sheet; I hope you are ready with the solution. Are you ready to see the solution? Since we have done it before; I hope you know the process for example, A's capital, where will you take it as?

(Refer Slide Time: 22:27)

| | | credit | Debit | | |
|--|--|---------|---------|----|---|
| Mr. A's capital a/c | | 1000000 | | BS | L |
| reserve account | | 50000 | | BS | L |
| sales less return | | 3000000 | | PL | I |
| sundry creditors | | 200000 | | | |
| closing stock | | 350000 | | | |
| Mr. A's drawing a/c | | | 20000 | | |
| Purchase of finished goods less return | | | 2000000 | PL | E |
| freight inward for finished goods | | | 20000 | | |
| wages | | | 120000 | | |
| salaries | | | 150000 | | |
| Rates and taxes | | | 30000 | | |
| electric power | | | 60000 | | |
| electricity charges for lights fans | | | 25000 | | |
| office rent | | | 30000 | | |

You know it is a liability item in the balance sheet. If you want you can go on marking it like this; results again a liability item in the balance sheet. Sales less returns, this is a profit and loss income item.

See now your work is very simple because we have separated credit balances and debit balances. If you go to let us say purchases; it is a profit and loss expense item almost all debits are going to be profit and loss expense few would be balance sheet assets. Only one for example, drawing will be reduced from the balance sheet liability side ok.

So, now your job will be simple; using this data let us go to income statement and the balance sheet. So, if you are ready we will go to the solution.

(Refer Slide Time: 23:49)

The screenshot shows an Excel spreadsheet with two tables. The first table is the Trading account, and the second is the Profit and Loss Account.

| Trading account | | | |
|------------------------------------|-----------------|-------------------|-----------------|
| Particulars | Amount (in Rs.) | Particulars | Amount (in Rs.) |
| Opening Stock as on 1st April 2019 | 330000 | Sales less Return | 3000000 |
| Purchase of Finished Goods Less | 2000000 | Closing Stock | 350000 |
| Freight Inward for Finished Goods | 20000 | | |
| Wages | 120000 | | |
| Gross profit | 880000 | | |
| | 3350000 | | 3350000 |

| Profit and Loss Account | | | |
|-------------------------|-----------------|--------------|-----------------|
| Particulars | Amount (in Rs.) | Particulars | Amount (in Rs.) |
| Salaries | 150000 | Gross profit | 880000 |

So, here is a solution for P and L account; are you getting it? So, trading account we have got two credit items sales and closing stock; the total is 3350000 and there are four debit items, opening stock, purchase, freight inward and wages. So, we get gross profit of 880000; I hope it is matching with you.

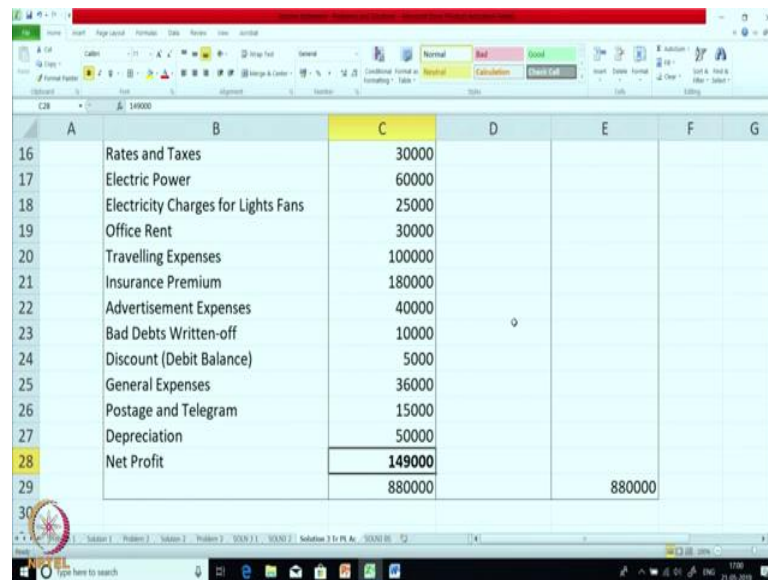
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The screenshot shows an Excel spreadsheet with a table for the Profit and Loss Account.

| Particulars | Amount (in Rs.) | Particulars | Amount (in Rs.) |
|-------------------------------------|-----------------|--------------|-----------------|
| Salaries | 150000 | Gross profit | 880000 |
| Rates and Taxes | 30000 | | |
| Electric Power | 60000 | | |
| Electricity Charges for Lights Fans | 25000 | | |
| Office Rent | 30000 | | |
| Travelling Expenses | 100000 | | |
| Insurance Premium | 180000 | | |
| Advertisement Expenses | 40000 | | |
| Bad Debts Written-off | 10000 | | |
| Discount (Debit Balance) | 5000 | | |
| General Expenses | 36000 | | |
| Postage and Telegram | 15000 | | |
| Depreciation | 50000 | | |

This 880 is then carried to the lower part of P and L known as profit and loss account.

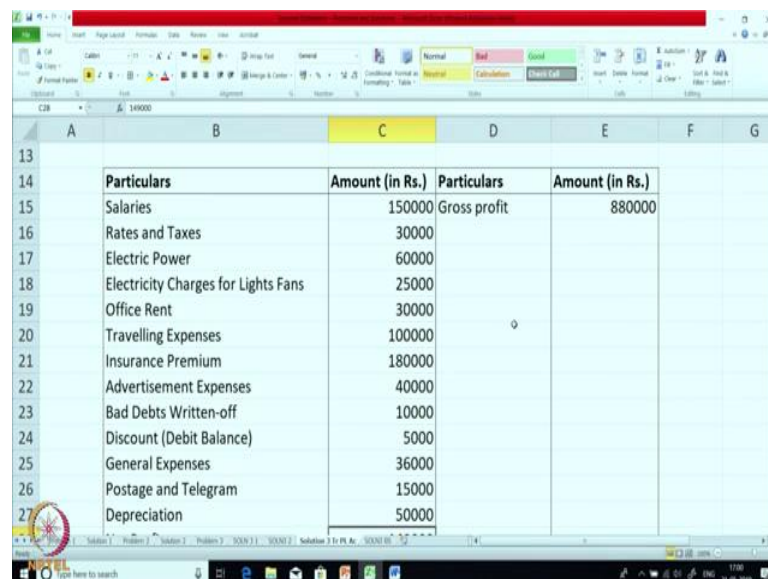
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| | A | B | C | D | E | F | G |
|----|---|-------------------------------------|--------|---|---|--------|---|
| 16 | | Rates and Taxes | 30000 | | | | |
| 17 | | Electric Power | 60000 | | | | |
| 18 | | Electricity Charges for Lights Fans | 25000 | | | | |
| 19 | | Office Rent | 30000 | | | | |
| 20 | | Travelling Expenses | 100000 | | | | |
| 21 | | Insurance Premium | 180000 | | | | |
| 22 | | Advertisement Expenses | 40000 | | | | |
| 23 | | Bad Debts Written-off | 10000 | | | | |
| 24 | | Discount (Debit Balance) | 5000 | | | | |
| 25 | | General Expenses | 36000 | | | | |
| 26 | | Postage and Telegram | 15000 | | | | |
| 27 | | Depreciation | 50000 | | | | |
| 28 | | Net Profit | 149000 | | | | |
| 29 | | | 880000 | | | 880000 | |

And then we will list out all the expenses to get a net profit of 149000 have you got this?

(Refer Slide Time: 25:21)



| | A | B | C | D | E | F | G |
|----|---|-------------------------------------|-----------------|--------------|-----------------|---|---|
| 13 | | | | | | | |
| 14 | | Particulars | Amount (in Rs.) | Particulars | Amount (in Rs.) | | |
| 15 | | Salaries | 150000 | Gross profit | 880000 | | |
| 16 | | Rates and Taxes | 30000 | | | | |
| 17 | | Electric Power | 60000 | | | | |
| 18 | | Electricity Charges for Lights Fans | 25000 | | | | |
| 19 | | Office Rent | 30000 | | | | |
| 20 | | Travelling Expenses | 100000 | | | | |
| 21 | | Insurance Premium | 180000 | | | | |
| 22 | | Advertisement Expenses | 40000 | | | | |
| 23 | | Bad Debts Written-off | 10000 | | | | |
| 24 | | Discount (Debit Balance) | 5000 | | | | |
| 25 | | General Expenses | 36000 | | | | |
| 26 | | Postage and Telegram | 15000 | | | | |
| 27 | | Depreciation | 50000 | | | | |

This is the profit and loss account; let us go to balance sheet now. Now, based on the items which are given in the trial balance; prepare the balance sheet; I am deliberately not showing you the solution, I hope you are able to make it yourself now.

(Refer Slide Time: 25:49)

| Balance Sheet as on 31st March 2020 | | | |
|-------------------------------------|---------|------------------------|---------|
| Liabilities | Rs | Assets | Rs. |
| Mr. A's capital a/c | 1000000 | factory land | 80000 |
| Mr. A's drawing a/c | -20000 | factory building | 60000 |
| reserve account | 50000 | plant and machinery | 500000 |
| Net Profit | 149000 | furniture and fixtures | 105000 |
| sundry creditors | 200000 | sundry debtors | 600000 |
| | | cash in hand | 20000 |
| | | cash in bank | 14000 |
| | 1379000 | | 1379000 |
| | | | 0 |

So, balance sheet on 31st March 2020; if you have made it yourself earlier, check it if not make it now along with me. Now, from the trial balance those items which were; those items which were marked as balance sheet items, now carry them to balance sheet. Then from debit side there are many assets item, carry them to asset side. After that; take total of assets and liabilities it should match; is it matching? If not what is a problem? Which item is missing?

You have to go back to trial balance and find out whether item is missing and also check whether your carried profit from profit and loss account because, it must be added in the balance sheet. So, we have not yet added profit; so this net profit let us add, now is it matching? Still there is a difference we need to find out which item has been wrongly added; so there is a difference of 20000.

If you look carefully, we have excluded this drawing of 20000 that also needs to be considered. So, it is reduced from capital, it is going to be a minus figure and once you consider this it is going to tally. Is it matching? Are you getting it? This is how trial balance helps you to find out the errors. Trial balance helps you to find out which item was missing and which item was wrongly added or which item the amount is wrong and from trial balance you can make P and L and balance sheet.

In coming sessions we will do it for company, but this is based on a proprietary concern type of a simple transaction and the balance sheets from the simple transactions.

Namaste