Trading Profit and Loss Account

Trading Account

The trading account shows the income from sales and the direct costs of making those sales. It includes the balance of stocks at the start and end of the year. **The main purpose of this account is to determine Gross Profit** which is difference between the revenue from trading and the cost of sales.

Profit and Loss Account

The purpose of the profit and loss account is to

- Show whether a business has made a PROFIT or LOSS over a financial year.
- Describe how the profit or loss arose – e.g. categorising costs between "cost of sales" and operating costs.

In keeping with International Accounting Standards, the Trading, Profit and Loss account has been replaced by the Income Statement.

BALANCE SHEET

The accounting **balance sheet** is one of the major financial statements used by accountants and business owners. (The other major financial statements are the **income statement**, **statement of cash flows**, and **statement of stockholders' equity**) The balance sheet is also referred to as the **statement of financial position**.

The balance sheet presents a company's financial position at the end of a specified date. Some describe the balance sheet as a "snapshot" of the company's financial position at a point (a moment or an instant) in time. For example, the amounts reported on a balance sheet dated December 31, 2010 reflect that instant when all the transactions *through December 31* have been recorded.

Because the balance sheet informs the reader of a company's financial position as of one moment in time, it allows someone—like a creditor—to see what a company *owns* as well as what it *owes* to other parties as of the date indicated in the heading.[i]

GROUPING:

The balance sheet is generally marshaled in the order of liquidity or permanence.

The Order of Liquidity:

According to this method assets are entered up in the balance sheet following the order in which they can be converted into cash and the liabilities in the order in which they can be paid off. The following is a format of a balance sheet based on this order:

Current Liabilities	**Current Assets**
Accrued Expenses	Cash in hand
Trade Creditors	Cash at Bank
	Bills Receivables
	Debtors
	Stock (Closing)
Long-term Liabilities	**Fixed Assets:**
Bills Payable	Furniture & Fixtures
Loans	Plant & Machinery
	Land & Buildings

The Order of Permanence:

Long-term Liabilities	Fixed Assets:
Loans Bills Payable	Land & Buildings Furniture & Fixtures Plant & Machinery
Current Liabilities Trade Creditors Accrued Expenses	**Current Assets** Stock (Closing) Debtors Bills Receivables Cash at Bank Cash in hand

This method is the reverse of the first method. Under this method the assets are stated according to their permanency i.e., permanent assets are shown first and less permanent are shown one after another. Similarly the fixed liabilities are stated first and the floating liabilities follow. The following is a specimen of a balance sheet based on this order.

Introduction to Partnership Accounts

Partnership is defined as the relationship which exists between persons carrying on a business in common with a view of profit. In other words, a partnership is an arrangement between two or more individuals in which they undertake to share the risks and rewards of a joint business operations.

It is usual for a partnership to be established formally by means of a partnership agreement. However, if individuals act as though they are in partnership even if no written agreement exists, they it will be presumed in law that a partnership does exist and that its terms of agreement are the same as those laid down in the Partnership Act (1890).

THE PARTNERSHIP AGREEMENT

The partnership agreement is a written agreement in which the terms of the partnership are set out, and in particular the financial arrangements as between partners the items it should cover include the following.

- Capital
- Profit sharing ration
- Interest on capital
- Partners salaries
- Drawings
- Guaranteed minimum profit shares

In the absence of a formal agreement between the partners, certain rules laid down by the partnership act are presumed to apply instead.

- Residual profits are shared equally between the partners
- There are no partners' salaries
- Partners receive no interest on the capital they invest in the business
- Partners are entitled to interest of 5% per annul on any loans they advance to the business in excess of their agreed capital[ii]

Capital Account and Current Account in Partnership

CAPITAL ACCOUNT

The balance for the capital account will always be a brought forward credit entry in the partnership accounts, because the capital contributed by proprietors is a liability of the business. When a partnership is formed, each partner puts in some capital to the business. These initial capital contributions are recorded in a series of capital accounts, one for each partner. Partners do not have to put in the same amount.
In addition to capital account, each partner normally has a:

- **Current account.**
- **Drawing account.**

CURRENT ACCOUNT

A current account is used to record the profits retained in the business by the partner. The main differences between the capital and current account in accounting for partnerships are as follows;

- The balance on the capital account remains static from year to year.
- The current is continually fluctuating up and down, as the partnership makes profits which are shared out between the partners, and as each partner takes out drawings.
- A further difference is that when the partnership agreement provides for interest on capital, partners receive interest on the balance in their capital account, but not on the balance in their current account.

DRAWING ACCOUNT

The drawings accounts serve exactly the same purpose as the drawings account for a sole trader. Each partner's drawings are recorded in a separate account. At the end of an accounting period, each partner's drawings are cleared to his current account.

Dr. Current account
Cr. Drawings account

The partnership balance sheet will therefore consist of:

- The capital accounts of each partner.
- The current accounts of each partner, net of drawings.[iii]

Appropriation of Net Profits in Partnerships

The net profit of a partnership is shared out between them according to the terms of their agreement. This sharing out is shown in a profit and loss appropriation account, which follows on from the profit and loss account itself.

The accounting entries are:

Dr. Profit and loss account with net profit c/d
    Cr. Profit and loss appropriation account with net profit b/d

Dr. Profit and loss appropriation account
    Cr. Current accounts of each partner with an individual share of profits for each partner

The way in which profit is shared out depends on the terms of the partnership agreement. The steps to take are as follows.

Step 1. Establish how much the net profit is.
Step 2. Account for interest on their drawings
Step 3. Appropriate interest on capital and salaries. Both of these items are an appropriation of profit and are not expenses in the profit and loss account.
Step 4. Residual profits, the difference between net profits plus any interest charged on drawings and appropriations for interest on capital and salaries is the residual profit. This is shared out between partners in the profit sharing ratio.
Step 5. Each partner's share of profits is credited to his current account.
Step 6. The balance on each partner's drawings account is debited to his current account.

In Practice each partner's capital account will occupy a separate ledger account, as will his current account. [iv]

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[i] *http://www.accountingcoach.com/online-accounting-course/05Xpg01.html*
[ii] *http://accounting-support.blogspot.com/2010/02/99-introduction-to-partnership-accounts.html*
[iii] *http://accounting-support.blogspot.com/2010/02/102-capital-and-current-accounts-in.html*
[iv] *http://accounting-support.blogspot.com/2010/02/104-appropriation-of-net-profits-in.html*

Partner A and Partner B
TRADING, PROFIT AND LOSS A/C
for period ended 31 December 2008

	$	$	$
Sales			xx
Sales Returns			(xx)
NET SALES			xx
Less Cost of Sales:			
Opening Stock		xx	
Purchases	xx		
Purchases returns	(xx)		
	xx		
Add: Carriage In	xx	xx	
Cost of Goods Available for sale		xx	
Closing Stock		(xx)	(xx)
GROSS PROFIT			xx
Add: Discount Received			xx
Profit on disposal of Fixed Asset			xx
			xx
Less Expenses:			
Salaries		xx	
Wages		xx	
Rent, rates and insurance		xx	
Carriage Outwards		xx	
Office expenses		xx	
Increase in Provision for Bad Debts		xx	
Cleaning and Sanitation		xx	
Discount allowed		xx	
Loss on disposal of Fixed Asset		xx	
Utilities		xx	
Depreciation:			
Leasehold premises		xx	
Plant and equipment		xx	
Office furniture		xx	xx
NET PROFIT			xx

Partner A and Partner B
BALANCE SHEET
as at 31 December 2008

	$	$	$
FIXED ASSETS	Cost	Acc. Dep.	NBV
Leasehold Premises	xx	xx	xx
Plant and Equipment	xx	xx	xx
Office Furniture	xx	xx	xx
	xx	xx	xx
CURRENT ASSETS			
Inventory		xx	
Accounts Receivable	xx		
Prov. For Bad Debt	(xx)	xx	
Bills Receivable		xx	
Prepayments		xx	
Cash at bank		xx	
Cash in hand		xx	
		xx	
CURRENT LIABILITIES:			
Accounts Payable	xx		
Accrued expense	xx		
Short-term borrowings	xx	xx	xx
			xx
Financed by:			
LONG TERM LIABILITIES			
Loan		xx	
Mortgage		xx	xx
CAPITAL ACCOUNTS			
Partner A		xx	
Partner B		xx	xx
CURRENT ACCOUNTS			
Partner A		xx	
Partner B		xx	xx
			xx

Partner A and Partner B
Profit and Loss Appropriation Account
31 December 2008

	$'000	$'000	$'000
Net Profit b/f			xx
Add:			
Interest on Drawings:			
Partner A		xx	
Partner B		xx	xx
			xx
Less:			
Interest in Capital			
Partner A	xx		
Partner B	xx	xx	
Salary:			
Partner A	xx		
Partner B	xx	xx	xx
			xx
Share of residual Profit/Loss			
Partner A		xx	
Partner B		xx	
		xx	xx

Partner A and Partner B
Current Accounts
31 December 2008

	$'000	$'000	$'000
	Partner A		Partner B
Balance b/f	xx		xx
Add:			
Interest on Capital	xx		xx
Salary	xx		xx
Share of Profit/(Loss)	xx		xx
	xx		xx
Less:			
Drawings	(xx)		(xx)
Interest on Drawings	(xx)		(xx)
Balance c/d	**xx**		**xx**

Question 5

Mary, Jane and Barry operate The Cook Shop sharing profits in the ratio 2:1:1 respectively. On December 31,2007 the following Trial Balance was extracted from the books of The Cook Shop:

Trial Balance

Accounts	Dr$	Cr$
Capital: Mary		200,000
Jane		100,000
Barry		100,000
Current Account: Mary		80,000
Jane	40,000	
Barry		60,000
Drawings: Mary	30,000	
Jane	25,000	
Barry	35,000	
Purchases	750,000	
Sales		3,050,000
Premises	1,000,000	
Motor vehicle	925,000	
Salaries	80,000	
Electricity	20,000	
Stationery	5,000	
Stock (01/01/07)	150,000	
Sales returns	50,000	
Insurance	30,000	
Debtors	200,000	
Cash	250,000	
	3,590,000	3,590,000

Note:

(i) Stock at December 31,2007 was valued at $100,000.
(ii) Partners are to receive 5% interest on their capital.
(iii) Interest on drawings is to be charged at 5%.
(iv) Jane and Barry are to receive salaries of $100,000 each.
(v) There was an amount of $35,000 outstanding for salaries at December 31,2007.
(vi) $40,000 was due but unpaid for carriage outwards.
(vii) Insurance paid in advance amounted to $10,000.
(viii) Depreciation is to be charged as follows: Motor vehicle-10% p.a. straight line; Premises-10% p.a. straight line.

Required:

(a) The partners Trading and Profit and Loss Accounts for the period ending December 31,2007
(b) The partners Profit and Loss Appropriation Account.
(c) The partners Capital Account. Current account
(d) A Balance Sheet as December 31,2007.

Mary, Jane and Barry
TRADING, PROFIT AND LOSS A/C
for year ended 31 December 2007

	$	$	$
Sales			3,050,000
Sales Returns			(50,000)
NET SALES			3,000,000
Less Cost of Sales:			
Opening Stock		150,000	
Purchases		750,000	
Cost of Goods Available for sale		900,000	
Closing Stock		(100,000)	(800,000)
GROSS PROFIT			2,200,000
Less Expenses:			
Salaries (80000+35000)		115,000	
Electricity		20,000	
Stationery		5,000	
Insurance (30000-10000)		20,000	
Carriage Outwards		40,000	
Depreciation:			
Motor Vehicle (10% x 925,000)		92,500	
Premises (10% x 1,000,000)		100,000	(392,500)
NET PROFIT			1,807,500

Partner A and Partner B
BALANCE SHEET
31 December 2008

	$	$	$
FIXED ASSETS	Cost	Acc. Dep.	NBV
Premises	1,000,000	100,000	900,000
Motor Vehicle	925,000	92,500	832,500
	1,925,000	192,500	1,732,500
CURRENT ASSETS			
Stock		100,000	
Debtors		200,000	
Prepaid Insurance		10,000	
Cash		250,000	
		560,000	
CURRENT LIABILITIES:			
Accrued expenses (35,000+40,000)		(75,000)	485,000
			2,217,500
Financed by:			
CAPITAL ACCOUNTS			
Mary		200,000	
Jane		100,000	
Barry		100,000	400,000
CURRENT ACCOUNTS			
Mary		854,500	
Jane		436,750	
Barry		526,250	1,817,500
			2,217,500

Mary, Jane and Barry
Profit and Loss Appropriation Account
for year ended 31 December 2007

	$	$	$
Net Profit b/f			1,807,500
Add:			
Interest on Drawings:			
Mary (5% x 30,000)		1,500	
Jane (5% x 25,000)		1,250	
Barry (5% x 35,000)		1,750	4,500
			1,812,000
Less:			
Interest in Capital			
Mary (5% x 200,000)	10,000		
Jane (5% x 100,000)	5,000		
Barry (5% x 100,000)	5,000	20,000	
Salary:			
Jane	100,000		
Barry	100,000	200,000	(220,000)
			1,592,000
Share of residual Profit/Loss			
Mary (2/4)		796,000	
Jane (1/4)		398,000	
Barry (1/4)		398,000	1,592,000

Mary, Jane and Barry
Current Accounts
for year ended 31 December 2007

	$	$	$
	Mary	Jane	Barry
Balance b/f	80,000	(40,000)	60,000
Add:			
Interest on Capital	10,000	5,000	5,000
Salary		100,000	100,000
Share of Profits	796,000	398,000	398,000
	886,000	463,000	563,000
Less:			
Drawings	(30,000)	(25,000)	(35,000)
Interest on Drawings	(1,500)	(1,250)	(1,750)
Balance c/d	**854,500**	**436,750**	**526,250**