

*Financial Statements
of Sole
Proprietorship*

Meaning of Financial statements

Financial statements are the statements prepared at the end of the accounting period to determine the financial performance, i.e. profit earned or loss incurred during the accounting period and also the financial position of the business as on that date.

** Financial statements includes:*

(i) Trading and Profit and loss account

(ii) Balance sheet.

** Financial statements are also known as final accounts.*

** Financial statements are the end product of accounting process prepared from the Trial Balance.*

** Financial statements are prepared to know*

(i) the profit earned or loss incurred by the business during the accounting period. It is calculated by Trading and Profit and loss Account.

(ii) The assets owned and liabilities owed as on the date , i.e., financial position , by preparing the Balance sheet.

** Trading and profit and loss account.*

Classification of Capital and Revenue Items

After the preparation of Trial Balance, the accounts therein are transferred either to Trading account or to the Profit and loss account or to the balance sheet.

Revenue nature are transfer to Trading or to profit and loss.

Capital Nature are transfer to Balance Sheet.

Trading and profit and loss account and Balance sheet are prepared on the above basis.

It is therefore necessary to under stand and classify the revenue and capital nature expenditure and receipts.

CAPITAL EXPENDITURE

Capital expenditure is the expenditure that gives the benefit of enduring nature ,i.e., the benefit from the expenditure will be period or periods beyond the accounting period.

Capital expenditure increases the earning capacity or reduce the operating expenses of the business.

Following types expenditure are usually accounted as capital expenditure:

(i) Expenditure incurred for acquisition of fixed assets such as land , building , machinery , furniture , motor vehicle etc.

(ii)Expenditure for the extension of or improvement of fixed assets: Such as increasing the seating capacity of a theater.

- (iii) Expenditure incurred to bring the fixed assets to the place of their use and expenditure incurred on their installation or erection: Such as freight on fixed assets, wages paid for the installation.*
- (iv) Expenditure incurred for reconditioning of old fixed assets: Such as expenditure on repairing or overhauling second hand machinery purchased.*
- (v) Expenditure incurred to acquire the right to do business. Expenses for obtaining licence or patents etc .Only initial expenditure is capital expenditure, renewal fee is a revenue expenditure.*

- (vi) Expenditure incurred for purchase of intangible assets such as Goodwill, patents, trademarks, copyrights, etc.*
- (vii) Legal expenses incurred for Acquiring a fixed assets*

***Treatment of Capital Expenditure:** Capital expenditure is debited to Relevant fixed asset account and is shown in the Balance sheet.*

Revenue Expenditure

Revenue Expenditure is the expenditure benefit of which is consumed or exhausted within the accounting period.

Example of such expenses are :

- (i) Expenses incurred day to day running of the business such as rent , salaries , wages , power, fuel etc.*
- (ii) Expenses are incurred for repairs and maintenance of fixed assets.*
- (iii) Expenses incurred for purchase of stock of materials during the year ; Remaining amount will be an asset.*
- (iv) Depreciation on fixed assets.*

Following expenses appear to be revenue expenses but they are capital expenses.

- 1. Expenses incurred on the repairs and whitewashing for the first time on the purchase of an old building , since these expenses are necessary to make the building such usable.*
- 2. Wages paid to workers to produce a tool to be used in the factory itself or to fix a machine.*
- 3. Expenses incurred for purchase of land or building such as fees paid to lawyer or registration expenses.*
- 4. Interest on loan raised to acquire an asset up to the point of time it is ready for use.*

Example No 1. State whether the following are capital or revenue in nature.

- (i) second hand Car was purchased for a sum of Rs1,00,000. A sum of Rs10,000 was spent on its overhauling.*
- (ii) Rs25,000 paid for the installation of a new machine.*
- (iii) Repairs for Rs 5,000 necessitated by negligence.*
- (iv) Cost of annual taxes paid and the annual insurance premium paid on the car mentioned above.*
- (v) Cost of air-conditioning of the office of the General Manager.*

Example No 2. *State whether the following are capital or revenue in nature*

(i) Custom duty paid on import of a machinery.

(ii) Wages paid in connection with the erection of new machinery.

(iii) Rs5,000 spent on repairing the factory.

(iv) Repairs for Rs2,000 necessitated by negligence of an operator of machine.

(v) Rs10,000 paid for electricity of bill.

Final Accounts

Income Statement: It is divided into two parts :

- 1. The first part is called ' Trading Account'. It shows the Gross profit or gross loss.*
- 2. The second Part is called Profit and Loss Account. It shows the net profit or net loss.*

Trading Account

- 1. It is the first stage in the preparation of final accounts of a trading activity.*
- 2. It records only net sales and direct cost of Goods sold.*
- 3. The balance of this account show Gross loss or Gross profit.*

4. *Gross profit or Gross loss is transferred to Profit and Loss Account.*

Formula to calculate the Gross Profit or Loss:

1. *Gross Profit = Net sales - Cost of goods Sold*

2. *Cost of Goods Sold = Opening stock + Net Purchase +
Direct Expenses - Closing stock.*

Note :

* *Net sales is also known as Revenue from Operation.*

Net sales = Total sales - Sales Return .

* *Direct expenses means expenses incurred for purchase or manufacturing or factory expenses.*

* *Direct expense include wages, carriage and freight inward, factory power and fuel, manufacturing expenses etc.*

* *Net purchase = Purchase - Purchase Return*

* *Adjusted purchase = Opening stock + purchase - c/o stock.*

Format of Trading Account

Trading Account

for the year ended March 31, 2020

Particulars	Amount	Particulars	Amount
To Opening stock	By sales
To Purchase	Less: Return
less : Return	By closing stock	
To wages	By sale of scrap	
To wages and salaries	By Gross Loss	
To Carriage inward		
To Factory expenses		
To Power & Fuel		
To Royalty		
To duty on purchase		
To Consumable stores		
To Gross Profit			