



Financial Statements

The Profit & Loss Account

Trading Business

- A **trading business** is an entity that **purchases** products called goods and **resale** it to customers with the intention of earning a **profit**.
 - **Retailers** (grocery stores, book shops, restaurants)
 - **Wholesalers** (beverage distributors, electrical suppliers, petrol importers)
- **Revenues** – total goods sold
- **Expenses** – operating expenses, cost of purchasing, advertisement, tax.....

Trading Business – Key Features

- **Primary functions** – purchasing, selling and profit determination.
 - **Purchasing goods** – from suitable manufacturers or suppliers (getting incentives, discounts)
 - **Selling** – to a customers for cash or on credit (maintaining inventory or stock)
 - **Profit Determination** – selling for higher prices to make profit

Non-trading assets – Furniture, fixtures and equipments

Income Statement

- **Profit & Loss Statement** - lists a firm's annual revenues and expenses so that a bottom line shows annual profit or loss.

Basic Format:



Revenues - Expenses = Net Income

The Income Statement

Revenues: Increases in assets and decreases in liabilities resulting from an entity's profit-oriented activities.

Expenses: Decreases in assets and increases in liabilities resulting from an entity's profit-oriented activities.

Income Statement



Value of Sales

Value of Sales

- A **sales return** – customer return previously purchased good
 - Cancel the item sold
 - Adjustment to the original price
- A **sales allowance** – seller agree to reduce the original sales price
- Recording the adjustment
 - Seller issues **credit note** to record adjustment
 - Debit to **sales return & allowances account** and credit to the **buyer's account**
 - In the Buyer's record, credit note value is debited to the **purchase return & allowances account** and credited to the **seller's account**

Value of Sales

- **Credit Note** – all the information related to the return good.

Value of Sales

- **After issuing the above credit note to the buyer, the seller would record as follows**

Value of Sales

- **After receiving the above credit note from the seller, the buyer would record as follows**

Value of Sales

Note: The invoice value of the items returned to the sellers sales return & allowances account rather than debiting it to the sales account.

Most trade businesses record this in a separate contra account, while it is costly, to determine the aggregate to study – **Why is the aggregate large?**

Reasons for returns

- Defective product
- Faulty packing
- Poor transportations
- Improper invoicing

Value of Sales

- Trading business receives a **credit note** for any purchase return to the supplier.
- Seller issues a **debit note** to the buyer
- Recordings occur vice versa to the credit note
- Sales return & allowance account has a **debit** balance and it is deducted from the **Sales amount** in the P&L statement.
- Purchase return & allowance account has a **credit** balance and it is deducted from the **purchase amount** in the P&L statement.

Value of Sales

- Discount allowed account
 - Accumulated in the **discount allowed account** in the seller's ledger and **discount received account** in the buyer's ledger
- The **Net Sales** for a period is calculated by subtracting the balance of the sales return and allowance account from the balance of the sales account
- For a given account period
 - Gross sale is Rs 577,240
 - Total sales return and allowances is Rs 12,000
 - Find the Net sale?

Revenue	
Sales	Rs. 577,000
Less: Sales return and allowances	12,000
Net Sales	565,000



Cost of Sales

Cost of Sales

- **Cost of sales** – is the main feature different from trading business to service business
 - Lead to determine the **gross profit**
 - Begins with the balance of unsold goods
 - Adding the Cost of purchase
 - Adding the transportation cost
 - Deducting the ending inventory
- Cost of sales is less, then the **gross profit** is high

Cost of Sales

- Example.

Cost of Sales

- **Trading stock/ stock-in trade/ stock.** is known as **inventory**

Cost of Sales

- ❑ After **receiving** the above credit note from the seller, the buyer would record as follows

Cost of Sales

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