



Module-B Unit-2

JAIIB PAPER-3

Accounting & Financial Management for Bankers(AFM)



JAIIB AFM Module B Unit 2- Preparation of Final Accounts

Preparation of Trial Balance

The first step in the preparation of final accounts is the preparation of trial balance. So it is absolutely essential that we prepare the trial balance perfectly, so our final accounts do not contain any errors. Let us learn more about the methods and procedures of preparation of trial balance.

Trial Balance

A trial balance is a bookkeeping worksheet-like account that **reflects all the credit and debit balances of all the ledger accounts**. Once we prepare this statement, we can prepare the final accounts of the company on the basis of this trial balance.

One other important use of the trial balance is that it can determine the arithmetic accuracy of the accounts. So if both columns of the trial balance tally, we can be reasonably assured of the accuracy of the accounts. It does not ensure that the accounts are free of all errors but it can at least establish mathematical accuracy.

Trial Balance (ABC Trading as at 30 June 2018)

General ledger A/C	Dr. Debit	Cr. Credit
Cash at bank	10000	
Inventory	40000	
Vehicles	30000	
Fixtures and Fitting	32000	
Accounts Receivable	15000	
Credit card Payment		12000
Account payable		15000
Bank Loan		50000
Sales		175,000
Purchases	60,000	
Advertising	5000	
Wages	65000	
Rent	15000	
Electricity	5000	
Owner Capital		25000
Total	277,000	277,000

Adjustment Entries

An accountant or a bookkeeper makes adjustment entries either before preparation of trial balance or after preparation of trial balance.

Usually, adjustment entries are made after preparation of trial balance. In a case when he makes the adjustment entries after preparation of trial balance, he needs to treat each of the adjustment twice while preparing trading and profit and loss account and balance sheet.

In case adjustment entries made before preparation of trial balance, such adjustment appears in the trial balance. Also, such adjustments appear only once in the preparation of final accounts.

Adjustment Entries Relating to Income and Expendure

Some of the expenses may have been incurred but not paid: For example- Salary for the month of March has been incurred during the month but will be paid in April. For this, adjusting entries, will be passed in the ledger by debit to charges (salary) account and credit to “Salary payable” account.

Some of the expenses may have been paid in advance but not incurred: If a payment has been made in advance i.e. it does not pertain to the accounting period in question, it is not treated as an expense, and the person who received the amount is treated as a debtor.

Some income may have accrued but not received: For example, interest accrued on a fixed deposit with the bank which will be paid by the bank on maturity along with the principal. For accounting the interest income, credit ‘Interest income’ account and debit ‘interest receivable’ account.

Some incomes may have been received but not accrued: If an income has been received but not accrued, it should not be accounted for. For example, advance payment of rent by a tenant. This should not be taken into account. Therefore, rent account should be debited and ‘Advance rent Received’ account should be debited.

Preparation of Financial Statements from Trial Balance

If we have recorded all the transactions, their arithmetical accuracy has been checked by the trial balance and the required adjusting entries have been made, we should be able to find out the results of the operations during the accounting period (day year) and also know the financial position of the business at the close the year.

This is done through preparing the Profit and loss account and the Balance sheet (Both these are called the financial statements).

Entries Relating to Depreciation of Fixed Assets

Before we can start preparing the financial statements, it is important to pass entries for depreciation to include it in the records as an expense.

Entries Relating to closing stocks

Every sales transaction results in reduction in available stocks and every purchase transaction increases the stocks available in the godown. However, the entries passed in the ledger, do not affect the stocks account:

Example-

Purchase of goods worth Rs 2000 results in the following postings in the ledger-

Dr. Purchase A/C Rs. 2000

Cr. Cash A/c Rs. 2000

Similarly, sales of goods for Rs. 500 result in the following posting in the ledger-

Dr. Cash A/c Rs. 5000

Cr. Sales A/c Rs 5000

As no entry is passed in the stocks account during the year, the balance in it remains the same as in the beginning of the year, i.e. the opening balance of the stock (this is a debit balance and is shown in the balance sheet of the last year as closing stock)

As we will see in our discussion in the **P/L account, the Profit= sales- (purchases+ opening stock-closing stock+ expenses)**

In the above formula, all items, except the closing stock, are available from the ledger. As the amount of the closing stock is not available from the ledger, we will have to actually verify the available stock at the close of the year and value it. This is called 'Inventory Valuation' and has its impact on the Profit of loss of the firm during that year.

Entries Relating to other items

Other adjustments pertain to provision for bad and doubtful debts, writing off part fictitious assets like preliminary expenses etc. provisioning for contingent events etc.

Preparation of Profit and loss account

Closing Entries

At the end of each accounting period, all the income and expenses accounts should be closed by transferring the balance to the P & L account. The entries passed for this purpose are called Closing Entries.

Example: If the salary account is showing the debit balance of Rs 300000 a credit entry 'By transfer to P&L account' will be posted in this account and debit entry will be posted to P & L account. Thus balance in the salary account will become Nil.

Trading Account

This is not a necessary step for preparation of the P & L account but many accountants prefer to prepare it. It forms part of the P & L account. A trading account takes into account only the direct costs associated with the materials in which the firm is dealing. The operating costs are not included. This means that we calculate the '**Cost of Goods Sold**' and subtract it from the Revenue to arrive at what is called '**Gross Profit**'. It is important to note here that under 'Cost of Goods Sold', we calculate the cost of only those goods which are sold and not the cost of entire goods purchased. If we have only purchased the goods during a year and not sold anything, there will be no cost associated with selling of goods as the purchase resulted in only increasing the inventory (**Closing stock**).

Cost of Goods Sold= (purchases + opening stock)- closing stock + expenses

Preparation of Profit and Loss account

There are prescribed formats for preparing Profit and loss accounts for all the companies in India. Such form is either provided in the Companies Act 2013 or the Banking Regulation Act or some other Act for specific types of companies. However, for other business entities, there is no prescribed format, Traditionally, all the formats used put sales and other incomes on the credit side and all the expenses on the debit side and arrive at the profit figure. This is achieved by passing the closing entries in respect of all the earnings and expenses accounts in the General Ledger so that the balances in all the remaining accounts in the GL, form the balance sheet, discussed in the next paragraphs. A typical format of a P & L account may be as under if the practice of preparation a Trading account is followed:

Profit and Account of	
For the year ending .....2019.....	
To salary	By Gross profit carried over
	From Trading a/c
To electricity charges	Gross Loss
To conveyance charges	
To depreciation	
To office charges	
To other charges	
To Taxes	
Net Profit	

If the practice of preparing the Trading account is not followed, the format may look as under.

Profit and loss Account of**For the year ending2019.....**

To opening stock	.....	By sales	.....
To purchases	.....	Less returns	.....
.....			
Less returns	.....	By closing stock	.....
To carriage inwards	.....	Gross loss	.....
To cartage	.....	
To dock charges	.....	
To Wages	.....	
To duty	.....	
To Freight	.....	
To clearing charges	.....	
To salary	.....	
To electricity	.....	
To telephone charges	.....	
To conveyance charges	.....	
To office charges	.....	
To other charges	.....	
To taxes	.....	
Net Profit	.....	

Profit and loss Appropriation account

Net profit, as arrived at in the P&L A/c, is utilized by the company, **for providing dividend, dividend distribution tax, adjustments to income tax and transfer to reserves etc.** This is done through the profit and loss Appropriation account.

Profit and loss Appropriation account is different from profit and loss account and is normally **put before the net profit figure in the same statement.** The net profit is transferred to the credit side of profit and loss appropriation account. Profit and loss account shows only the net profit or net loss from operations of business while the profit and loss appropriation accounts shows all non- operational adjustment.

A typical format of this account is given below. The items included may vary from company to company.

Particulars	Amount	Particulars	Amount
To transfer to reserves	By last year's balance brought down	.....
To debenture redemption reserve	By net profit of the year brought down	.....
To additional income tax provision for earlier year	By excess income tax provision of earlier years	.....
To interim dividend		
To dividend/ Proposed dividend		
To surplus carried over to the balance sheet		
Total	Total	.....

Preparation of Balance Sheet

Below are the steps mentioned to prepare a balance sheet.

Compose a trial balance- It is a regular report included in any accounting programme. If it is a manual mode, then create a trial balance by transferring every general ledger account's ending balance to a spreadsheet.

Arrange the trial balance- It is important to arrange the initial trial balance to assure that the balance sheet similar to the relevant accounting structure. While using adjusting entries to adjust the trial balance all the entry should be completely recorded so the auditors can understand why it was made.

Discard all expense and revenue accounts- The trial balance includes expenses, revenue, losses, gains, liabilities, equity, and assets. Delete all from the trial balance except equity, liabilities, and assets. However, the deleted accounts are used to create an income statement.

Calculate the remaining accounts- In this stage, sum up all the trial balance account used to create a balance sheet. The typical line items used in the balance sheet are:

- Cash
- Accounts receivable
- Inventory
- Fixed assets

- Other assets
- Accounts payable
- Accrued liabilities
- Debt
- Other liabilities
- Common stock
- Retained earnings

Validate the balance sheet- The total for all assets recorded in the balance sheet should be similar to the liabilities and stockholders' equity accounts.

Present in the required balance sheet format

Liabilities	Amount	Asset	Amount
Capital	Fixed Asset-land, Bldg	.....
Loan Taken	Current Assets	.....
Current Liabilities	Cash/Bank B/s	.....
Outstanding Expenses	Accounts Receivable (Debtors)	.....
Bank Overdraft	Bills Receivable
Account Payable (Creditors)	Inventories (stock)
	XYZ		XYZ

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