

# Accounting Foundations

Terry Marris May 2013

## 4 Trading and Profit and Loss Accounts

The primary purpose of a business is to make a profit. To this end business owners prepare Trading and Profit and Losses Accounts monthly. Then, if the business is seen to be making a loss, steps could be taken to turn the loss into a profit before the situation becomes irrevocable. Further, a trading and profit and loss statement at the end of the financial year is used to determine taxes to be paid.

A Trading and Profit and Loss statement has two parts: a Trading Account, and a Profit and Loss Account. From the Trading Account you can determine the gross profit (or loss). Gross profit is income from sales less cost of goods sold. The Profit and Loss Account shows the net profit (or loss). Net profit is gross profit less expenses such as wages, electricity and stationery. A Trading and Profit and Loss statement is shown below.

DR		Trading and Profit and Loss Account for Period Ending 31 May		CR	
		£		£	
Trading A/c	{	Purchases	16,000	Sales	24,040
		Gross Profit c/d	8,040		
			<u>24,040</u>		<u>24,040</u>
Profit & Loss A/c	{	Rates	420	Gross Profit b/d	8,040
		Insurance	180		
		Wages	1,840		
		Electricity	280		
		Stationery	130		
		Net Profit to Capital A/c	5,190		
		<u>8,040</u>		<u>8,040</u>	

A trading and profit and loss statement is derived from the nominal accounts of a business.

### 4.1 Closing Off Nominal Accounts

The essential process is to transfer the balances from the nominal accounts to the Trading and Profit and Loss Account and to close off the nominal accounts.

Shown below is the Purchases Account for G Wizz presented in Chapter Three.

DR		Purchases		CR	
		£		£	
May 5	Bank	6,000	May 31	Balance c/d	16,000
May 14	H Otell	8,400			
May 19	I Deal	1,600			
		<u>16,000</u>			<u>16,000</u>
May 31	Balance b/d	16,000			

As you can see, the account has already been balanced off to help prepare the Trial Balance for G Wizz.

Now we transfer the purchases to the Trading and Profit and Loss statement and close off the Purchases Account. The debit balance is recorded as a debit balance in the Trading and Profit and Loss statement, and to meet the double entry requirement, the amount transferred is recorded as a credit in the Purchases account.

DR		Purchases		CR	
		£			£
May 5	Bank	6,000	May 31	Balance c/d	16,000
May 14	H Otell	8,400			
May 19	I Deal	1,600			
		<u>16,000</u>			<u>16,000</u>
May 31	Balance b/d	16,000	May 31	To Trading A/c	16,000
		<u>16,000</u>			<u>16,000</u>

DR		Trading and Profit and Loss Account for Period Ending 31 May		CR	
		£			£
	Purchases	16,000			

The Purchases account is now ruled off i.e. closed off since its balance is recorded and preserved in the Trading and Balance and Loss Account. The Purchases account is now ready for re-use.

## 4.2 Trading and Profit and Loss Statement

Shown below is the set of nominal accounts for G Wizz presented in Chapter Three.

DR		Purchases		CR	
		£			£
May 5	Bank	6,000	May 31	Balance c/d	16,000
May 14	H Otell	8,400			
May 19	I Deal	1,600			
		<u>16,000</u>			<u>16,000</u>
May 31	Balance b/d	16,000			

DR		Sales		CR	
		£			£
May 31	Balance c/d	24,040	May 12	Cash	1,880
			May 20	Cash	4,200
			May 21	J Me	8,200
			May 27	Cash	4,800
			May 27	K Nine	3,300
			May 31	Cash	1,660
		<u>24,040</u>			<u>24,040</u>
			May 31	Balance b/d	24,040

DR		Rates		CR	
		£		£	
May 7	Bank	420			

DR		Insurance		CR	
		£		£	
May 16	Bank	180			

DR		Wages		CR	
		£		£	
May 17	Cash	860	May 31	Balance c/d	1,840
May 22	Cash	980			
		<u>1,840</u>			<u>1,840</u>
May 31	Balance b/d	1,840			

DR		Electricity		CR	
		£		£	
May 22	Bank	280			

DR		Stationery		CR	
		£		£	
May 22	Cash	130			

We close off each nominal account shown above, and construct a Trading and Profit and Loss Statement.

#### NOMINAL ACCOUNTS

DR		Purchases		CR	
		£		£	
May 5	Bank	6,000	May 31	Balance c/d	16,000
May 14	H Otell	8,400			
May 19	I Deal	1,600			
		<u>16,000</u>			<u>16,000</u>
May 31	Balance b/d	16,000	May 31	To Trading A/c	16,000
		<u>16,000</u>			<u>16,000</u>

DR		Sales		CR	
		£			£
May 31	Balance c/d	24,040	May 12	Cash	1,880
			May 20	Cash	4,200
			May 21	J Me	8,200
			May 27	Cash	4,800
			May 27	K Nine	3,300
			May 31	Cash	1,660
		<u>24,040</u>			<u>24,040</u>
May 31	To Trading A/c	24,040	May 31	Balance b/d	24,040
		<u>24,040</u>			<u>24,040</u>

DR		Rates		CR	
		£			£
May 7	Bank	420	May 31	To P & L A/c	420
		<u>420</u>			<u>420</u>

DR		Insurance		CR	
		£			£
May 16	Bank	180	May 31	To P & L A/c	180
		<u>180</u>			<u>180</u>

DR		Wages		CR	
		£			£
May 17	Cash	860	May 31	Balance c/d	1,840
May 22	Cash	980			
		<u>1,840</u>			<u>1,840</u>
May 31	Balance b/d	1,840	May 31	To P & L A/c	1,840
		<u>1,840</u>			<u>1,840</u>

DR		Electricity		CR	
		£			£
May 22	Bank	280	May 31	To P & L A/c	280
		<u>280</u>			<u>280</u>

DR		Stationery		CR	
		£			£
May 22	Cash	130	May 31	To P & L A/c	130
		<u>130</u>			<u>130</u>

DR		Trading and Profit and Loss Account for Period Ending 31 May		CR	
		£		£	
	Purchases	16,000		Sales	24,040
	Gross Profit c/d	8,040			
		<u>24,040</u>			<u>24,040</u>
	Rates	420		Gross Profit b/d	8,040
	Insurance	180			
	Wages	1,840			
	Electricity	280			
	Stationery	130			
	Net profit to Capital A/c	5,190			
		<u>8,040</u>			<u>8,040</u>

Notice that the net profit is profit for the owner of the business and so the real Capital account is credited with the profit.

DR		Capital		CR	
		£		£	
			May 1	Cash	100,000
			May 31	Net Profit from P&L a/c	5,190

### 4.3 Losses

If expenses exceed gross profit then a loss has been made.

DR		Trading and Profit and Loss Account for Period Ending 31 May		CR	
		£		£	
	Purchases	36,000		Sales	60,000
	Gross Profit c/d	24,000			
		<u>60,000</u>			<u>60,000</u>
	Various expenses (listed)	28,000		Gross Profit b/d	24,000
		<u>28,000</u>		Net Loss to Capital A/c	4,000
					<u>28,000</u>

Notice that the net loss is a loss for the owner of the business and is posted as a debit to the real Capital Account.

DR		Capital		CR	
		£		£	
May 31	Net Loss from P & L a/c	4,000	May 1	Cash	100,000

**Exercise 4.1**

1 Prepare a Trading and Profit and Loss Account for the accounts of L Der shown below.

**Accounts for L Der****REAL ACCOUNTS**

DR	Cash		CR
01-Jun Capital	160,000	02-Jun Premises	80,000
06-Jun Sales	4,800	04-Jun Bank Curr A/c	60,000
		04-Jun Bank Dep A/c	10,000
		12-Jun Petrol	36
		16-Jun Wages	620
		27-Jun Wages	560
		30-Jun General Expenses	1,600
		30-Jun Balance c/d	<u>11,984</u>
	<u>164,800</u>		<u>164,800</u>
30-Jun Balance b/d	11,984		

DR	Capital		CR
	£		£
		01-Jun Cash	160,000

DR	Bank Current A/c		CR
	£		£
04-Jun Cash	60,000	07-Jun Rates	1,240
		10-Jun Vehicle	7,000
		12-Jun Vehicle Expenses	300
		12-Jun Vehicle Expenses	170
		18-Jun Tools	800
		24-Jun Telephone	160
		30-Jun Balance c/d	<u>50,330</u>
	<u>60,000</u>		<u>60,000</u>
30-Jun Balance b/d	50,330		

DR	Bank Deposit A/c		CR
	£		£
04-Jun Cash	10,000		

DR	Premises (Warehouse)		CR
	£		£
02-Jun Cash	80,000		

DR	Vehicle		CR
	£		£
10-Jun Bank Curr A/c	7,000		

DR	Tools		CR
	£		£
18-Jun Bank Curr A/c	800		

DR	M Pty		CR
	£		£

30-Jun Balance c/d	20,000	03-Jun Purchases (stock)	14,000
		22-Jun Purchases (stock)	6,000
	<u>20,000</u>		<u>20,000</u>
		30-Jun Balance b/d	20,000

DR		Nuff	CR
		£	£
20-Jun Sales	4,800		

DR		O Pinion	CR
		£	£
28-Jun Sales (of Stock)	15,000		

### NOMINAL ACCOUNTS

DR		Purchases (of Stock)	CR
		£	£
03-Jun M Pty	14,000	30-Jun Balance c/d	20,000
22-Jun M Pty	6,000		
	<u>20,000</u>		<u>20,000</u>
30-Jun Balance b/d	20,000		

DR		Sales (of Stock)	CR
		£	£
30-Jun Balance c/d	24,600	06-Jun Cash	4,800
		20-Jun Nuff	4,800
		28-Jun O Pine	15,000
	<u>24,600</u>		<u>24,600</u>
		30-Jun Balance b/d	24,600

DR		Rates	CR
		£	£
07-Jun Bank Curr A/c	1,240		

DR		Vehicle Expenses	CR
		£	£
12-Jun Bank Curr A/c	300	30-Jun Balance c/d	506
12-Jun Bank Curr A/c	170		
12-Jun Cash	36		
	<u>506</u>		<u>506</u>
30-Jun Balance b/d	506		

DR		Wages	CR
		£	£
16-Jun Cash	620	30-Jun Balance c/d	1,180
28-Jun Cash	560		
	1,180		<u>1,180</u>
30-Jun Balance b/d	1,180		

DR	Telephone	CR
	£	£
24-Jun Bank Curr A/c	160	

DR	General Expenses	CR
	£	£
30-Jun Cash	1,600	

## Trial Balance as at 30 June

	DR	CR
	£	£
Cash	11,984	
Capital		160,000
Bank Current A/c	50,330	
Bank Deposit A/c	10,000	
Premises	80,000	
Vehicle	7,000	
Tools	800	
Creditors		20,000
Debtors	19,800	
Purchases	20,000	
Sales		24,600
Rates	1,240	
Vehicle Expenses	506	
Wages	1,180	
Telephone	160	
General Expenses	1,600	
	<u>204,600</u>	<u>204,600</u>

**2** Construct a Trading and Profit and Loss statement for the accounts of P Knutt shown below.

**Accounts for P Knutt****|REAL ACCOUNTS**

DR	Cash	CR
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	£		£
01-Jul Capital	4,000	02-Jul Equipment	140
16-Jul Sales	400	04-Jul Equipment	80
		06-Jul Insurance	120
		07-Jul Bank	3,000
		18-Jul Wages	80
		31-Jul Balance c/d	980
	<u>4,400</u>		<u>4,400</u>
31-Jul Balance b/d	980		

DR	Capital	CR
	£	£
		01-Jul Cash
		4,000

DR	Bank	CR	
	£	£	
07-Jul Cash	3,000	20-Jul Purchases	320
		27-Jul Vehicle	1,600
		29-Jul Q Beck	180
		31-Jul Balance c/d	900
	<u>3,000</u>		<u>3,000</u>
31-Jul Balance b/d	900		

DR	Equipment	CR	
	£	£	
02-Jul Cash	140	31-Jul Balance c/d	220
04-Jul Cash	80		
	220		<u>220</u>
31-Jul Balance b/d	220		

DR	Vehicle	CR	
	£	£	
27-Jul Bank	1,600		

DR	Q Beck	CR	
	£	£	
29-Jul Bank	180	10-Jul Materials	180
	180		<u>180</u>

DR	R Right	CR	
	£	£	
26-Jul Sales	1,080		

### NOMINAL ACCOUNTS

DR	Purchases (of Materials)	CR	
	£	£	
10-Jul Q Beck	180	31-Jul Balance c/d	500
20-Jul Bank	320		
	500		<u>500</u>
31-Jul Balance b/d	500		

DR	Sales	CR
	£	£

31-Jul Balance c/d	1,480	16-Jul Cash	400
		26-Jul R Right	<u>1,080</u>
	1,480		<u>1,480</u>
		31-Jul Balance b/d	1,480

DR	Insurance	CR
	£	£
06-Jul Cash	120	

DR	Wages	CR
	£	£
18-Jul Cash	80	

## Trial Balance as at 31 July

	DR	CR
	£	£
Cash	980	
Capital		4,000
Bank	900	
Equipment	220	
Vehicle	1,600	
Debtors	1,260	
Creditors		180
Purchases	500	
Sales		1,480
Insurance	120	
Wages	80	
	<u>5,660</u>	<u>5,660</u>

**We have** seen how Trading and Profit and Loss statements are prepared. **Next** we see how to construct a balance sheet.

### Bibliography

HARRISON W *Stage One Financial Accounting* Northwick Publishers 1986 pp 38..49