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Credit (Cr.) Side - Income & Revenue: This side records all direct income generated from business operations. A trading account form consists of various elements that help businesses calculate their gross profit or loss. It includes details of income from sales and the direct costs associated with those sales. The account is divided into two sides: the credit (Cr.) side and the debit (Dr.) side. The credit side records revenue, sales, and returns. The debit side records the cost of goods sold, direct expenses, and closing stock. The balance sheet is prepared at the end of the accounting period. The closing stock is valued at either cost or market price, whichever is lower, following the accounting principle of conservatism. Businesses can prepare a trading account in a horizontal format (T-shape) or a vertical format, but the components remain the same. Also check: 14 Best Investment Options in India 2025: Safe Plans - Gross Profit is the key figure derived from a trading account. It shows a business's profit from selling goods before deducting indirect expenses. Gross Profit Formula: Gross Profit = Sales - Sales Returns + Closing Stock - (Opening Stock + Purchases - Purchase Returns + Direct Expenses) Apply the Formula: Gross Profit = Net Sales - Sales Returns + Closing Stock - (Opening Stock + Purchases - Purchase Returns + Direct Expenses) Step-by-Step Calculation Example: Find Net Sales: Total Sales - Sales Returns Determine Cost of Goods Sold (COGS): Opening Stock + Purchases - Purchase Returns + Direct Expenses Apply the Formula: Gross Profit = Net Sales - Sales Returns + Closing Stock - (Opening Stock + Purchases - Purchase Returns + Direct Expenses) Example: XYZ Traders (as of December 31, 2024) Opening Stock: ₹60,000 Purchases: ₹25,00,000 Purchase Returns: ₹15,00,000 Direct Expenses (Wages + Freight, etc.): ₹35,00,000 Sales: ₹38,00,000 Closing Stock: ₹85,000 Now, we will apply these figures in the trading account format: Trading Account for the Year Ended 31st December 2024 Dr. Cr. Particulars Amount (₹) Particulars Amount (₹) Opening Stock 60,000 Purchases 25,00,000 Direct Expenses (Wages + Freight, etc.) 35,00,000 Sales 38,00,000 Closing Stock 85,000 Balance b/d 60,000 Balance c/d 85,000 Total 31,00,000 Total 31,00,000 Gross Profit 4,00,000

IAS1 on an annual basis. Few countries follow this as per the calendar year, from 1st January to 31st December, while others follow their reporting period starting from 1st April and ending on 31st. Hence the purpose of uniformity of reporting period breaks here. For companies in some countries, this period is not the calendar year. Hence, even though financial statements are prepared for the reporting period, it doesn't solve the purpose of finding the results for every calendar year. They need to re-compute their financial results. If there is a change in the reporting period, there are cumbersome and tedious procedures, as mentioned in IFRS1, to be followed, which involve huge time, labor, and money, which doesn't make much sense. Any of the following reasons must be fulfilled to change the reporting period. For better preparation and presentation of financial statements, Required by the specific statute or act; Hence if any of the above reasons are fulfilled, along with its update in notes of the financial statements, specific reporting procedures, as mentioned in relevant IFRS, are to be followed to make the financial statements understandable. Hence, it concludes that even though there are a few disadvantages, it becomes beneficial for the general public to have a common reporting period to give the financial statements of every entity comparable, useful, uniform, and understandable. Income Statement You will need to open up an income statement for sole-proprietorship, partnership, private/public company, and manufacturing company. Purposes of Income Statement: 1) To calculate the profits or losses of a business; 2) To prepare reports for stakeholders, (stakeholders are people who are interested in your business, it could be creditors or investors); and 3) To calculate tax required by government policies. Understand Gross Profit Most people doesn't know what is the meaning of gross profit, they only know it's a form of profit! This is the same as knowing nothing at all! GROSS PROFIT is profit resulting from your sales over cost of goods sold. Imagine you yourself selling one DVD movie to one customer at \$4. This is your sale, \$4. The cost of your empty DVD disc is \$0.50. This is your cost of goods sold. * People tend to be confused with the term 'goods'. Goods is a term used to refer to a lot of things, and in this case, it means lots of empty DVDs. But for illustration purpose. I only used one DVD as an example. Go back to the definition of Gross Profit, We can rewrite it as Gross Profit = Sales - Cost of Goods Sold = 4 - 0.50 = 3.50 Understand Cost of Goods Sold Now, I wonder if you have realized that the phrase of 'cost of goods sold' does seem tricky. Cost of Goods Sold can be further broken down into it's part, 'Opening Inventory' + Purchases - Closing Inventory = Cost of Goods Sold You can skip the explanation if you want, but for some reason, I think learning it can actually reinforce your memory. There are cases where people sometimes couldn't recall their memory due to last minute revising. And this will be the time you apply your understanding. At the beginning of the year, you have 200 empty DVDs at hand. And during the year, you have purchased 400 empty DVDs. At the end of the year, you are left with 100 empty DVDs. Assume the price of Empty DVDs is \$0.50. If you really concentrate on the word Cost of Goods Sold, you will see that it means the original cost of empty DVDs that have been sold. Now, this 100 empty DVDs left are 'unsold'. Therefore, there are not included in the calculation of Cost of Goods Sold. Now, back to Opening Inventory and Purchases. Why do we have to add it up? Imagine your shop is selling DVDs, if you don't buy empty DVDs, how can you sell your final DVDs to customer? Now if you already have 200 empty DVDs at hand, you need to buy more in order to sell enough for your customers. This is the reason why Opening Stock needs to add up with Purchases. By combining all of this explanation, therefore we arrived at the same formula given earlier of: Cost Of Goods Sold = Opening Stock + Purchases - Closing Stock Now we are all done, this is how we can start to draw an income statement. (Please note that Trading & Profit and Loss Account = Income Statement! For the explanation below, I have retained earlier explanation for ease of understanding.) Trading Account Trading Account is simply a calculation of Gross Profit. You will get to see it later. But for now, just know this, Gross Profit = Sales - Cost of Goods Sold Gross Profit = Sales - (Opening Stock + Purchases - Closing Stock) Points to remember: 1) Mark is awarded to title. 2) Use Net Sales instead of Sales* 3) Use Net Purchase instead of Purchase* *If applicable, I will further explain it later on. Net Sales / Turnover Sales need to be net, i.e. after any deduction on sales. If you had been selling 400 DVDs to customers, they are bound to be some customers which would come after you claiming bad DVDs. And in this case, say 30 DVDs were returned to you. This is called Sales Return or Return Inward. You need to memorize both of the terms. Assuming the selling price was at \$4. Now we try to compute the Net Sales. Net Sales / Turnover = Sales - Sales Return / Return Inward Net Sales = (400 - 30) x 4 = 370 x 4 In exam, sales return was sometimes used instead of return inward, or otherwise. Therefore, it is important to remember their terms. Net Purchases Just like Net Sales, Net Purchases are any addition or deduction made to the original purchases. In this case, imagine you purchased 600 empty DVDs. The cost of this purchases may include cost of insurance, freight cost or transportation cost or carriage inwards, purchase return or return outwards and etc. As long as anything that you paid in order to get that 600 DVDs into your shop, you will have to add it. Whilst anything you return back to your suppliers, you deduct it from your original purchases. Net Purchases = Purchases + Any Cost That You Paid* - Return Outward * The reason that I put 'any cost that you paid' is because there are too many additions that can be included, students should remember the general rule of 'anything that you paid to get the DVDs into your shop.' Profit And Loss Account Inside Profit And Loss Account, Net Profit = Gross Profit + Revenues/Other Income- Expenses = A positive amount is called Net Profit = A negative amount is called Net Loss In most examination, the answers will always be Net Profit. Unless you are in A Level, then a loss is also possible. Other Income Other Income is any amount of money that profits a business. For instance, discount received from purchasing the empty DVDs. Position on Vertical format, below Gross Profit, above Expenses. Expenses Expenses are any amounts that will not profit a business but are necessary to keep the business operating. Example of expenses include rent, wages, salaries, electricity, depreciation, discount allowed and etc. Position on Vertical Format, below Revenues, above Net Profit. Income Statement - Vertical Format Updated on 12/11/2017 Edited grammatical errors. Changed 'Trading and Profit & Loss Account' to 'Income Statement'. Changed 'stock' to 'inventory'. Revised the format of Income Statement to GCSE 'O' Level Examination standard (also the terms used such as 'stock' to 'inventory'). Removed Horizontal Format style of Income Statement. (Please learn vertical format instead). Financial statements play a vital role in evaluating a business's profitability and overall financial health. A trading and profit and loss account aids in determining how much a company has earned or lost during a certain period. As an investor, it's vital for you to understand a trading profit and loss account and its format to understand where a business stands in terms of finance and whether it has earned profits or losses. A business can't complete its balance sheet without a proper trading and profit and loss account format. Trading Profit and Loss Account Format Before getting into the nitty-gritty of a trading profit and loss account format, note that it consists of two parts - the trading account and the profit and loss account. While a trading account determines the gross profit or loss from trading activities of a business, the profit and loss account shows total revenues and expenses over a specific period. The important components of a trading & P&L account format include: 1. Revenue: It's one of the important components of trading & profit & loss account format. It includes all the income you earn from your business activities. This income earned has different names, such as sales, gross receipts, and fees, among others. 2. Cost of Goods Sold (COGS): It refers to the direct cost of the goods sold, including expenses like raw materials and inventory. To find out your gross profit, you can subtract COGS from revenues. For instance, if you sell a product for ₹5000, but it costs ₹2000 to make, your gross profit is ₹3000. 3. Expenses: Expenses are the costs an organisation incurs to run a business. This may include advertising costs, inventory costs, salaries, professional fees, etc. 4. Net Profit or Loss: It refers to the total earnings after deducting taxes and expenses. It's this component that tells you whether a business is making profits or incurring losses. Trading & Profit & Loss Account Format Sample for trading and profit and loss account format: Particulars FY 24 (in INR) Revenue XXX Sale of Products XXX Sale of Services XXX Total Revenue XXX Expenses XXX Cost of Materials Consumed XXX Employee Benefit Expenses XXX Other Expenses XXX Profit or Loss Before Tax XXX Profit or Loss After Tax XXX As you can see, the total revenue and expenses column in a trading profit and loss account format does have a breakdown, which could include: Sale of products - Income a business generates after selling its goods Sale of services - Income earned from services/Other operating revenue - Additional income generated through fees and commission Cost of material consumed - Factors in materials used in production Employee benefit expenses - Costs incurred on employees' salaries and other benefits Other expenses - Additional costs incurred on marketing, office supplies, etc. While businesses can make trading & profit & loss accounts manually, today, there are various software such as MS Excel that make the task easy. Making a trading profit and loss account in excel format is straightforward, allowing automatic calculations, formatting, and easy data manipulation. Benefits of a Trading Profit and Loss Account Format Financial Clarity This account format provides a clear breakdown of a business's financial activities, making it easier for you, as an investor, to identify which areas are driving revenues and which ones are increasing costs. While it helps business owners understand the financial health of their business, it allows investors to judge a business's revenue streams. Evaluate Cost Management The trading & profit & loss account format allows you to find out a business's direct and indirect expenses. It enables you to evaluate how well a company manages its costs. For example, an enterprise with a high gross profit but low net profit is a reflection that a business may have issues with managing its indirect expenses. Assess Profitability The main objective of a trading & P&L account format is to find out about a company's overall financial health. By evaluating profits across different periods, you can find out whether a company is growing or facing challenges in its growth. Determine Return on Investment Through this all-important statement, you can calculate key financial ratios, which can help you evaluate the profitability of your investments. A higher ROI indicates the company is using its resources to generate profits, making it more attractive and vice versa. Assess Risk Factors This all-important statement highlights expenses which might affect a company's profitability. These could include debt, depreciation or unexpected one-time costs. You can use these factors to determine the level of financial risks involved. Compare Companies in the Same Industry The standard structure in the trading and profit and loss account format allows you to compare companies in the same industry. This helps you identify the most promising companies within the sector and tailor your investment strategy accordingly. Conclusion The trading and profit and loss account format is an invaluable tool for businesses as well as investors that provides a comprehensive overview of a firm's financial health, operational efficiency and profitability. Whether you are a pro or just starting, getting a hold of this statement can help you make better investing decisions. If you are looking to invest in the stocks of promising companies on the go, look no further than HDFC SKY. With its competitive brokerage charges, HDFC SKY can help you invest in the stocks of companies across verticals at a cost-effective price point. Along with stocks, you can also invest in mutual funds, exchange-traded funds (ETFs) and many other financial instruments to build a well-diversified portfolio. Download HDFC Sky App now and start investing right away. The trading profit and loss account is made up of two separate accounts within the general ledger. The trading account The profit and loss account The purpose of the two accounts is to separately identify the gross profit and net profit of the business. The trading account is the top part of the trading profit and loss account and is used to determine the gross profit. The profit and loss account is the lower part of the trading profit and loss account and is used to determine the net profit of the business. Both the trading account and the profit and loss account form part of the double entry as they are used to close off the temporary accounts at the end of an accounting period. The trading and profit and loss accounts are discussed in more detail below. The Trading Account The trading account is particularly useful for a merchandising business or trading business involved in the buying and selling of finished products. The account allows the merchandiser to easily determine its overall gross profit and gross profit percentage which are important indicators of how efficiently a business is buying and selling its products. Trading Account Formula The trading account shows the gross profit which is determined by deducting the cost of goods sold from the net sales revenue of the business. The gross profit is calculated using the trading account formula. Gross profit = Net sales - Cost of goods sold In the formula net sales is equal to the gross sales of the business less sales returns, allowances, and discounts. It should be noted that carriage outwards is not included in the trading account. Carriage outwards is an expense included in the profit and loss account discussed below. The cost of goods sold used in the formula can be expanded using the following formula. Cost of goods sold = Net purchases + Beginning inventory - Ending inventory Net purchases is equal to the gross purchases of the business including carriage inwards less any purchase returns, allowances, and discounts. Preparation of Trading Account The trading account is prepared by closing the temporary revenue and purchases accounts and adjusting the inventory accounts using a closing journal entry as shown in the example below. Trading account closing journal entry Account Debit Credit Sales 105,000 Sales returns 5,000 Purchases 49,000 Purchase returns 3,000 Beginning inventory 8,000 Ending inventory 9,000 Trading Account 55,000 Total 117,000 117,000 Each account is closed and transferred to the trading account. The credit entry to the trading account of 55,000 represents the gross profit for the period. Trading Account Example After the closing journal entry has been posted the trading account would take the format shown in the example below. Trading account after closing journal entry Trading Account Debit Credit Sales returns 5,000 Sales 105,000 Purchases 49,000 Purchase returns 3,000 Beginning inventory 8,000 Ending inventory 9,000 Balance c/d 55,000 Total 117,000 117,000 Total 117,000 Balance b/d 55,000 For clarity, in this example each line item is posted to the general ledger trading account leaving a credit balance brought down of 55,000 which represents the gross profit of the business. In the example above the trading account has a net credit balance of 55,000 which indicates sales are greater than the cost of goods sold and the business has made a gross profit. If the trading account had a net debit balance brought down it would indicate (unusually) that sales were less than the cost of goods sold and the business had made a gross loss. Trading Account in Final Accounts In the final accounts the trading account is usually presented in a more readable format. Assuming the figures relate to the month ended 31 December an example of a trading account might appear as follows. Trading account for the month ended December 31 2020 Net sales 100,000 Net purchases 46,000 Beginning inventory 9,000 Ending inventory 9,000 Cost of goods sold 45,000 Gross profit 55,000 Again the trading account shows the gross profit of 55,000 the business made on the products it buys and sells. In addition since the trading account shows the net sales the gross profit percentage can be easily calculated as follows. Gross profit % = Gross profit / Net sales Gross profit % = 55,000 / 100,000 = 55% The Profit and Loss Account The profit and loss account is used to determine the net profit of the business. The starting point for the profit and loss account is the balance carried down from the trading account which is the gross profit of the business. Profit and Loss Account Formula The profit and loss account shows the net profit which is the determined by deducting the expenses of the business from the trading account gross profit and adding other income. The net profit is calculated using the profit and loss account formula. Net profit = Gross profit - Expenses + Other income In the above formula expenses refers to all the costs of the business which are not included in cost of goods sold in the trading account such as wages and salaries, rents, insurance, bank charges etc. Other income refers to any income other than that included in sales revenue such as interest received. Preparation of Profit and Loss Account The profit and loss account is prepared by closing the trading account, expense accounts and other income accounts using a closing journal entry. Profit and loss account closing journal entry Account Debit Credit Trading Account 55,000 Expense accounts 48,000 Other income 5,000 Profit and Loss Account 12,000 Total 60,000 60,000 Each account is closed and transferred to the profit and loss account in the general ledger. The credit entry to the profit and loss account of 12,000 represents the net profit for the period. Profit and Loss Account Example After the closing journal entry has been posted the profit and loss account would take the format shown in the example below. Profit and loss account after closing journal entry Profit and loss account Debit Credit Gross profit b/d 55,000 Expenses 48,000 Other income 5,000 Balance c/d 12,000 Total 60,000 60,000 Balance b/d 12,000 Again for clarity, in this example each line item is posted to the general ledger profit and loss account leaving a credit balance brought down of 12,000 representing the net profit of the business. In the example above the profit and loss account has a net credit balance of 12,000 which indicates sales and other income are greater than the cost of goods sold and expenses and the business has made a net profit. If the profit and loss account had a net debit balance brought down it would indicate that sales and other income were less than the cost of goods sold and expenses and the business had therefore made a net loss for the accounting period. Profit and Loss Account in the Final Accounts The profit and loss account starting with gross profit is not usually shown as a separate statement and is normally combined with the trading account and shown as a combined trading profit and loss account format shown later in this post. For the sake of completeness, assuming the figures relate to the month ended 31 December, a separate profit and loss account starting with gross profit might appear as follows. Profit and loss account for month ended December 31 2020 Gross profit 55,000 Expenses 48,000 Other income 5,000 Net profit 12,000 Again the profit and loss account shows the net profit of 12,000 the business has made for the accounting period. Using the net sales from the trading account the business can quickly calculate the net profit percentage as follows. Net profit % = Net profit / Net sales Net profit % = 12,000 / 100,000 = 12% Trading Profit and Loss Account Format The trading account and the profit and loss account can be combined into a single summary known as a trading profit and loss account. An example trading profit and loss account format is shown below. Trading profit and loss account format - month ended December 31 2020 Net sales 100,000 Net purchases 46,000 Beginning inventory 9,000 Ending inventory 9,000 Cost of goods sold 45,000 Gross profit 55,000 Expenses 48,000 Other income 5,000 Net profit 12,000 By using the trading profit and loss account the merchandising business can clearly see both the gross and net profit of the business and can quickly calculate the gross and net profit percentages based on net sales. Last modified September 29th, 2022 by Michael Brown September 29, 2022