

**Financial Accounting**  
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**Lecture – 57**  
**5.7 Tutorial – Preparation of P and L Account**

This is another tutorial video. In this video we are going to look at the preparation of the second section in the Profit and Loss Account; the section, of course, is called profit and loss account.

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The slide is titled "Preparing P&L Account" and features a list of account balances. The accounts are organized into two columns. The first column lists various expenses and income items, while the second column lists other income and expense items. A handwritten note "Exp/losses" with an arrow points to the "Discount (Dr. Balance)" item. The "Rent received on sub-letting" item is underlined and labeled "income". The slide also includes logos for the Indian Institute of Technology Mandi and NPTEL.


• Gross Profit	101,000	• Discount (Dr. Balance)	500
• Carriage outward (IE)	2500	• Interest income	1500
• Salaries	5500	• Printing and stationery	250
• Rent	4100	• Rates and taxes	350
• Fire insurance premium	900	• Travelling expenses	200
• Bad Debts	2100	• Trade expenses	300
• Income tax paid	3500	• <u>Rent received on sub-letting</u>	1000
• Insurance premium	3000		

*income*

On the screen I have a list of account balances and using these account balances, we are going to prepare the second section, the profit and loss account. I have the format on the slide as well.


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**Profit & Loss Account**



Particulars	Dr. Amount	Particulars	Cr. Amount
Carriage outward	2,500	Gross Profit b/d	101,000
Salaries	5,500	Interest Income	1,500
Rent	4,100	Rent earned	1,000
Fire Insurance Premium	900		
Bad Debts	2,100		
Insurance Premium	3,000		
Discount allowed	50		
Printing & Stationery	200		
Rates & Taxes	50		
Travelling exp	200		
Trade exp	300		
Income tax	3,500		
Net Profit c/d (Balance figure)	80,300		
	<u>103,500</u>		<u>103,500</u>

*Net Income*  
*Bottom line*



So, we are going to look at each item, discuss that and then bring it to the profit and loss account on the appropriate side, depending upon whether it is an expense or an income. The first item is gross profit; the gross profit is calculated in the first section of the profit and loss account. Let us say the first section was prepared as the trading account; we found the gross profit equal to 101,000. So, in the profit and loss account, we write gross profit brought down. We are just beginning; you have to assume that the trading account was prepared just before this. So, 101,000 is the gross profit. Then you have carriage outward. The word outward refers to the direction of the goods. Goods are going out of the business; meaning you did some sales and now you are giving a free home delivery to the customer. You are spending on transportation practically. So, this amount is an expense and this amount, this item is also an indirect expense for you. You will show this on the debit side in the profit and loss account. Carriage outward 2,500. So, let me write it here, 2,500; salaries are 5,500, we are assuming that these are also indirect expenses, 5,500 these are salaries. You have rent 4,100, again assuming this is an indirect expense, you pay rent. Fire insurance premium 900: this is the amount you pay every year to avail this benefit of fire insurance cover, fire insurance premium. Then, you have bad debts which are a loss; we show this in the profit and loss account as well, 2,100 bad debts. Income tax paid is 3,500; income tax is a mandatory expense; you have to pay it on the profit. Typically, you write it at the bottom, because the income tax amount is calculated based upon the profit that you earn during the year.

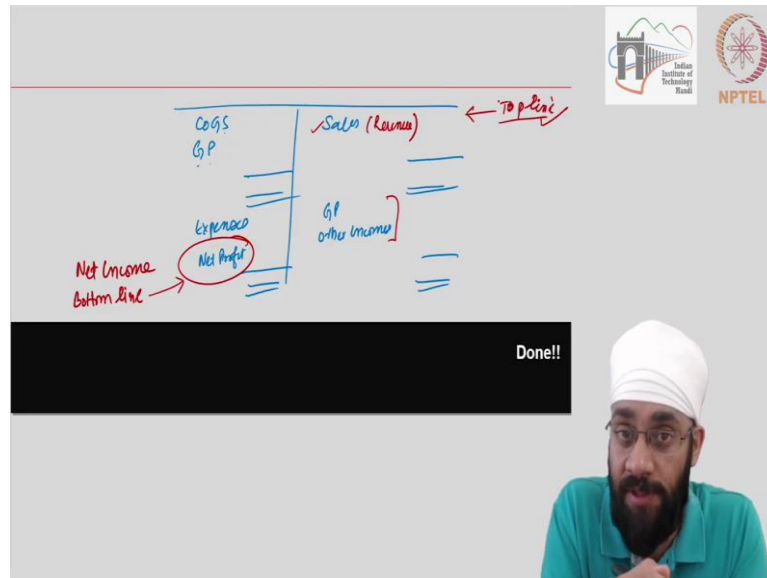
However, we have been given this amount right away. So, I am just going to write it at the bottom here. Then, you have another insurance 3,000, another type of insurance premium. This is not the personal life insurance premium of the owners of the business; the entity principle, the very first principle of accounting, says that owners are separate from the business. So, all these insurances being paid are not individuals' insurance; these are insurances for the purpose of business. You may very well pay the employees insurance, which can be part of the employee welfare expenses. The salary package that is offered to the employees that is a different kind of expense if you are paying medical insurance. But still companies do not offer life insurance to their employees; they only offer the medical, the health insurance cover basically. Insurance premium 3,000 is done. Then, you have a discount debit balance, we know only expenses and losses have the debit balance. So, this is an expense, discount is kind of a promotional expense; you are asking people to buy from you and you offer them discounts or pay you earlier and then, you offer them a discount. So, this is going to go to the debit side 500; this is a discount allowed to customers. Then you have interest income; this is an income that will go to the credit side, this is non-operating income 1500. This income is added to the total money that we have earned during the year. Printing and stationery 250. So, 250 printing and stationery, rates and taxes 350; traveling expenses 200, and then you have trade expenses, the amount is 300. Finally, you have rent received. When you are receiving it, this is clearly an income and you are subletting your building or something: 1000, this is an income. This is a non-operating income, you did not set up the business to rent out the buildings, this is a side income, this is an additional income, this is a non-operating income; not primary to the functioning of the business, this is not for which business was started.

The total income and total expenses you have everything on the sheet, and now all you need to do is, sum these things up and the total comes out to be 103,500; this is the total money that you have, out of which you are going to spend on a list of expenses. The list of expenses has been provided to us as well. The balancing figure is going to be our net profit; net profit carried down and this is a balancing figure. When you do this total, this total and take it out from 103500; the profit amount comes out to be 80300, there you go. This is how you prepare a profit and loss account.

Now, a couple of important pieces of information. This net profit is what is called net income of the business. This net income is also called the bottom line; because this line is at the bottom of the income statement, this is the profit made during the year after taking care of both direct

expenses and indirect expenses, all the operating, non-operating expenses. So, this is called bottom line or net income. Now, there is something called income, which is the revenue, the sales during the year, which is called top line.

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Let me go to the next slide. When you prepare an income statement or profit and loss account; you have sales here and you have your cost of goods sold and then you have your gross profit. This is the first section and you have all the direct expenses, etc. taken care of. Then, you have all the rest of expenses and then you have your net profit and the total. You have gross profit here and you have other incomes here.

So, what I just said is, this is called net income, this is also called the bottom line. Not the English language meaning of bottom line; but in the world of finance and accounting, the bottom line is the last line in the profit and loss account. This is the profit; what is the bottom line of the business? That is the net profit and this is the top line; because, this is what is going to result in the bottom line, sales, the revenue made during the year.

So, there you go, I have introduced you to two new terms; top line and the bottom line. Sales are top line, they are also called revenue. And then, you could think about sales plus all of this as revenue and so on. But if you think about the top line, you are talking about sales of the company.

Let me stop here; in this tutorial, we learnt to prepare the profit and loss account. We looked at a range of items and a list of expenses, which can be categorized as indirect expenses. But, whenever you have more information; you use the principle which is, whether these expenses are relating to manufacturing of the product or regarding the administrative expenses or regarding selling or the finance cost of the business. If it is not related to manufacturing of the product, in that case, this will be an expense and will be categorized as indirect expenses.