

CUET · ACCOUNTANCY · CLASS XI · CODE 301

Financial Statements - I

CUET unit: Financial Statements

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Snapshot

- One step beyond the trial balance: a sole proprietor prepares the two principal financial statements — the **Trading and Profit and Loss Account** (income statement) and the **Balance Sheet** (position statement) (NCERT §8, p. 277).
- Three foundational ideas every CUET question on financial statements presumes: (a) who the stakeholders are and what information each needs (NCERT §8.1, p. 277-278); (b) how to draw the line between **capital and revenue** items — expenditure as well as receipts (NCERT §8.2, p. 279-281); and (c) how revenues, expenses, assets and liabilities flow from the trial balance into the final statements (NCERT §8.3, p. 281).
- The mechanics — opening stock, purchases less returns, direct expenses, gross profit c/d on the debit side of the Trading Account; sales less returns and closing stock on the credit side; indirect expenses on the debit side of the P&L; gross profit b/d plus other incomes on the credit side — are tested through both formula-recall and short numerical MCQs (NCERT §8.4, p. 282-296).
- **Operating profit (EBIT)**, plus **grouping** and **marshalling** of items in the balance sheet in two orders — liquidity and permanence — both classic NTA distractor traps (NCERT §8.5-§8.6.3, p. 297-304).
- The **opening entry** re-introduces the closing balances of assets and liabilities into the next year's books (NCERT §8.7, p. 308).
- keac202 builds on this with adjustment entries (outstanding/prepaid, depreciation, provisions, accrued income).

Detailed Notes

2.1 Core concepts

The **audience** of financial statements comes first. A **stakeholder** is any person associated with the business; stakes may be monetary or non-monetary, active or passive, direct or indirect (NCERT §8.1, p. 277-278). Users are classified as **internal** — current owners, managers — or **external** — prospective owner, government, banks, creditors, customers — each with distinct objectives and information requirements summarised in NCERT's Fig. 8.1 (p. 278). Financial statements are the principal communication channel from the firm to its stakeholders.

The pivotal classification skill is the distinction between **capital and revenue** items (NCERT §8.2, p. 279-281). First, **expenditure** differs from **expense**: expenditure is any outlay for a purpose other than the settlement of an existing liability, and the portion of expenditure consumed in the current year is the **expense** of that year (NCERT §8.2.1, p. 280). On this base, **revenue expenditure** is defined as expenditure whose benefit extends up to one accounting year only — salaries, rent, repairs, etc.; it is recurring, maintains earning capacity, and is transferred to the Trading and P&L Account (NCERT §8.2.1, p. 279-280). **Capital expenditure** benefits more than one accounting period — purchase of furniture, additions to a building, installation of a new machine; it is non-recurring, increases earning capacity, and is recorded in the Balance Sheet (subject to depreciation) (NCERT §8.2.1, p. 280). **Deferred revenue expenditure** sits in between — revenue in nature but with benefit extending beyond a single period, e.g., heavy advertising at the launch of a new product; the cost is written off over the expected period of benefit, like a capital item (NCERT §8.2.1, p. 280).

The symmetric treatment on the receipt side is given in §8.2.2 (NCERT p. 281): a **capital receipt** is one that creates an obligation to return the money (additional capital, bank loan) or arises from the sale of a fixed asset; all other receipts (sales, interest on investments, dividend, commission, rent received) are **revenue receipts**. The importance of the distinction (§8.2.3, p. 281) is operational: mis-classifying a revenue item as capital overstates profit and assets; mis-classifying a capital item as revenue understates them — the financial statements fail to give a true and fair view, and the firm's tax liability is mis-stated.

Financial statements (§8.3, p. 281-282) comprise (1) the Trading and Profit and Loss Account (income statement) showing financial performance during the year, and (2) the Balance Sheet showing financial position at the end of the year. Both are prepared from the trial balance supplemented by additional information (closing stock, depreciation, outstanding/prepaid items — covered in keac202).

The mechanics of the **Trading Account (§8.4.1, p. 283-285)** are stable: the **debit side** carries Opening Stock, Purchases less Purchases Returns (net purchases), Wages, Carriage / Freight Inwards, Fuel / Water / Power / Gas, Packing material (direct), and Gross Profit c/d. The **credit side** carries Sales less Sales Returns (net sales), Closing Stock and — if the credit side falls short — Gross Loss c/d on this side instead (NCERT §8.4.1, p. 285 and Fig. 8.2, p. 288). The **Profit and Loss Account** is the second half: **debit side** — all indirect expenses (salaries, rent, interest paid, commission paid, repairs, miscellaneous expenses, bad debts, depreciation, carriage outwards); **credit side** — Gross Profit b/d plus other incomes (rent received, dividend received, interest received, discount received, commission received) (NCERT §8.4.1, p. 284-285).

Closing entries (§8.4.2, p. 285-286) move balances from the ledger to the Trading and P&L Account. Opening stock, purchases, wages, carriage inwards and other direct expenses are debited to Trading A/c. Purchases Returns is closed to Purchases A/c first; Sales Returns is closed to Sales A/c first; the net Sales balance is then transferred to the credit of Trading A/c. Expenses and losses are transferred to the debit of P&L A/c.

c; incomes and gains to the credit. The balance of the P&L A/c — net profit (or loss) — is finally transferred to the Capital A/c.

The two profit formulae the student must memorise are: **Gross Profit = Sales – (Purchases + Direct Expenses)** and **Net Profit = Gross Profit + Other Incomes – Indirect Expenses** (NCERT §8.4.3, p. 289). A connected formula is **Cost of Goods Sold = Opening Stock + Purchases + Direct Expenses – Closing Stock** (NCERT §8.4.4, p. 294-295). Note that closing stock does not normally appear in the trial balance and is brought in by the adjustment entry Dr Closing Stock A/c, Cr Trading A/c — closing stock then appears on the credit side of the Trading Account and on the asset side of the Balance Sheet.

Operating profit (EBIT) (§ 8.5, p. 297) is the profit earned through normal operations of the business. Exclusions are precise: abnormal items (loss by fire) and items of purely financial nature (interest paid on borrowings, dividend received on investments, profit or loss on sale of investments) are excluded. The reconciliation formula is **Operating Profit = Net Profit + Non-operating Expenses – Non-operating Incomes**.

The **Balance Sheet (§ 8.6, p. 299-304)** is a statement — not an account — showing the financial position of the business at a given date. For sole proprietors the horizontal format is used (NCERT §8.6.1, p. 300). The **liabilities side** carries Capital (adjusted by adding net profit and subtracting drawings/income tax), Non-current/Long-term Liabilities (long-term loans), and Current Liabilities (creditors, bills payable, bank overdraft, short-term loans, outstanding expenses). The **assets side** carries Fixed Assets (land, building, plant, machinery, furniture), Intangible Assets (goodwill, patents, trademarks), Investments (shown at cost), and Current Assets (cash, bank, debtors, bills receivable, stock, prepaid expenses, short-term investments) (NCERT §8.6.2, p. 301-302).

Marshalling (§ 8.6.3, p. 302-303) is the order in which items appear in the balance sheet. Two orders are recognised. In the **order of liquidity** the most liquid items appear first — cash, bank, debtors, stock, furniture on the asset side; current liabilities, then capital, on the liabilities side. In the **order of permanence** the order is reversed — the most permanent (long-lived) items appear first: goodwill, fixed assets first on the asset side; capital first on the liabilities side. NCERT's Figs. 8.10(a) and 8.10(b) (p. 303) present the same balance sheet under both orders. **Grouping (§ 8.6.3, p. 304)** is a separate idea — putting items of similar nature under a common head (Owner's Funds, Non-current Liabilities, Current Liabilities, Non-current Assets, Current Assets), as in Fig. 8.10(c).

Finally, **Opening Entry (§ 8.7, p. 308)** describes how, at the start of the next accounting period, the closing balances of assets and liabilities on the previous balance sheet are reopened: all asset accounts are debited and all liability and capital accounts are credited, in a single journal-proper entry.

2.2 Definitions to memorise

Term	Definition	Page
Stakeholder	Any person associated with the business; stake may be monetary or non-monetary, active or passive, direct or indirect (NCERT §8.1).	277
Expenditure	Outlay or incurrance of payment for a purpose other than settlement of an existing liability (NCERT §8.2.1).	279
Revenue Expenditure	Expenditure whose benefit extends up to one accounting year; recurring; transferred to Trading and P&L (NCERT §8.2.1).	279
Capital Expenditure	Expenditure whose benefit extends beyond one accounting year; non-recurring; appears on the balance sheet (NCERT §8.2.1).	280
Deferred Revenue Expenditure	Revenue in nature but benefit extends over several periods; written off over the period of benefit (NCERT §8.2.1).	280
Capital Receipt	Receipt creating an obligation to return the money or arising from sale of a fixed asset (NCERT §8.2.2).	281
Revenue Receipt	Receipt that neither creates a repayment obligation nor arises from sale of a fixed asset — sales, interest, commission (NCERT §8.2.2).	281
Trading Account	First section of the income statement computing gross profit/loss from buying and selling goods (NCERT §8.4.1).	283
Profit and Loss Account	Second section computing net profit/loss after indirect expenses and incomes (NCERT §8.4.1).	284
Gross Profit	Sales – (Purchases + Direct Expenses); excess of sales revenue over cost of goods sold (NCERT §8.4.3).	289
Net Profit	Gross Profit + Other Incomes – Indirect Expenses; transferred to Capital A/c (NCERT §8.4.3).	289
Cost of Goods Sold	Opening Stock + Purchases + Direct Expenses – Closing Stock (NCERT §8.4.4).	295
Operating Profit (EBIT)	Net Profit + Non-operating Expenses – Non-operating Incomes; profit before interest and tax (NCERT §8.5).	297
Direct Expenses	Expenses incurred to bring goods to the place of sale — wages, freight inwards, fuel, power, packaging (NCERT §8.4.1).	284
Indirect Expenses	Expenses not directly attributable to production — salaries, rent, advertisement, depreciation, bad debts, carriage outwards (NCERT §8.4.1).	285
Other Incomes	Non-sales revenue — rent received, dividend received, interest received, discount received, commission received (NCERT §8.4.1).	285
Balance Sheet		299

Term	Definition	Page
	A statement (not an account) showing the financial position of the business on a given date — assets equal liabilities plus capital (NCERT §8.6).	
Current Assets	Assets in cash form or convertible into cash within one year — cash, bank, debtors, bills receivable, stock, prepaid expenses, short-term investments (NCERT §8.6.2).	301
Current Liabilities	Liabilities to be paid within one year — creditors, bills payable, bank overdraft, short-term loans, outstanding expenses (NCERT §8.6.2).	302
Fixed Assets	Assets held on long-term basis, not for resale — land, building, plant, furniture (NCERT §8.6.2).	302
Marshalling	Arrangement of assets and liabilities in the balance sheet in a particular order — liquidity or permanence (NCERT §8.6.3).	302
Order of Liquidity	Most liquid items first — cash, bank, debtors on assets; current liabilities first on liabilities (NCERT §8.6.3).	303
Order of Permanence	Most permanent items first — goodwill / fixed assets on assets; capital first on liabilities (NCERT §8.6.3).	303
Grouping	Putting items of similar nature under a common head (NCERT §8.6.3).	304
Opening Entry	Entry at the start of the next period re-introducing balances of assets, liabilities and capital (NCERT §8.7).	308

2.3 Diagrams / processes to remember

Fig. 8.1 — Users of accounting information (NCERT p. 278). Tabular analysis of Current owners, Managers, Government, Prospective owners and Banks — their objectives and information needs.

Fig. 8.2 — Trading and P&L Account format (NCERT p. 288). Debit side: opening stock, purchases (net), wages, carriage inwards, gross profit c/d (first section) → indirect expenses and net profit (second section). Credit side: sales (net), closing stock (first section) → gross profit b/d plus other incomes (second section).

Figs. 8.3 / 8.5 / 8.6 — Worked T&P L Account of Ankit (NCERT p. 290-297).

Gross profit moves from ₹42,000 (without closing stock) to ₹57,000 (with closing stock ₹15,000); interest on long-term loan ₹500 separates net profit from operating profit.

Fig. 8.7 — Horizontal Balance Sheet format (NCERT p. 300). For proprietorships / partnerships; no prescribed form (unlike companies under Schedule III).

Figs. 8.10(a) (b) (c) — Balance Sheet under three layouts (NCERT p. 303-304).

Same balance sheet of Ankit arranged in (a) order of permanence, (b) order of liquidity, (c) grouped under logical heads.

Process — Preparing a Trading Account. (i) List opening stock, purchases (less returns), wages, carriage inwards, fuel/power/packing as direct expenses on the debit side. (ii) List sales (less returns) and closing stock on the credit side. (iii) Compute the balance — if credit exceeds debit, it is Gross Profit c/d (debit side); if debit exceeds credit, Gross Loss c/d (credit side).

Process — Preparing a P&L Account. (i) Open with Gross Profit b/d on the credit side. (ii) Add other incomes to the credit side. (iii) List indirect expenses on the debit side. (iv) Balance the account; the closing figure is Net Profit (debit side) or Net Loss (credit side). (v) Transfer Net Profit/Loss to the Capital A/c.

Process — Operating Profit. Start from Net Profit; add back non-operating expenses (interest paid, loss by fire, loss on sale of investments); subtract non-operating incomes (dividend received, interest received, profit on sale of investments).

Process — Preparing a Balance Sheet. (i) Compute updated Capital = Opening Capital + Additions + Net Profit – Drawings – Income Tax. (ii) Group liabilities into Non-current and Current. (iii) Group assets into Fixed, Intangible, Investments, and Current. (iv) Decide on a marshalling order — liquidity or permanence — and arrange accordingly. (v) Cross-check total of liabilities = total of assets.

Process — Opening Entry. Reopen all assets and liabilities of the previous year by Dr each asset, Cr each liability and the balancing Capital A/c.

2.4 Common confusions / NTA trap points

1. **Order of liquidity vs order of permanence.** Liquidity: cash first; Permanence: capital / fixed assets first. NTA swaps these (NCERT §8.6.3, p. 302-303).
2. **Closing stock placement.** Credit side of Trading A/c + asset side of Balance Sheet — only if it appears in the trial balance is the treatment different (NCERT §8.4.4, p. 295).
3. **Wages vs Salaries.** Wages = direct expense (Trading); Salaries = indirect expense (P&L). The classic single-word trap (NCERT §8.4.1, p. 284-285).
4. **Carriage inwards vs carriage outwards.** Inwards = Trading; Outwards = P&L (NCERT §8.4.1, p. 284).
5. **Operating profit exclusions.** Interest paid, dividend received, profit/loss on sale of investments, abnormal losses (loss by fire) must be excluded (NCERT §8.5, p. 297).
6. **Deferred revenue expenditure.** Revenue in nature but treated like a capital item — written off over the period of benefit (NCERT §8.2.1, p. 280).
7. **Capital vs revenue receipt.** Sale of old machinery = capital; sale of goods = revenue (NCERT §8.2.2, p. 281).
8. **Balance Sheet is a statement, not an account.** A common factual MCQ (NCERT §8.6, p. 299).

9. **Drawings reduce Capital, not P&L.** Drawings + Income Tax appear as deductions from Capital on the balance sheet (NCERT §8.6.2, p. 301).
10. **Bad debts vs Provision for doubtful debts.** Bad debts are an actual expense (P&L Dr); provision is an estimated charge (P&L Dr, deducted from debtors on balance sheet).
11. **Bank overdraft is a current liability.** Not a negative asset (NCERT §8.6.2, p. 302).
12. **COGS includes direct expenses.** Many students compute COGS as Opening Stock + Purchases – Closing Stock, missing direct expenses (NCERT §8.4.4, p. 295).

2.5 Journal entry templates

(a) Closing the Purchases account into Trading A/c (NCERT §8.4.2, p. 285)

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Mar 31	Trading A/cDr.		15,00,000	
	To Purchases A/c			15,00,000
	(Being purchases transferred to Trading A/c)			

(b) Closing Sales into Trading A/c (NCERT §8.4.2)

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Mar 31	Sales A/cDr.		40,00,000	
	To Trading A/c			40,00,000
	(Being sales transferred to Trading A/c)			

(c) Bringing closing stock into the books (NCERT §8.4.4, p. 295)

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Mar 31	Closing Stock A/cDr.		2,50,000	
	To Trading A/c			2,50,000
	(Being closing stock brought into the books at year-end)			

(d) Transfer of gross profit from Trading to P&L (NCERT §8.4.3, p. 289)

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Mar 31	Trading A/cDr.		11,70,000	
	To Profit and Loss A/c			11,70,000
	(Being gross profit transferred to P&L)			

(e) Transfer of net profit from P&L to Capital (NCERT § 8.4.3, p. 289)

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Mar 31	Profit and Loss A/cDr.		5,00,000	
	To Capital A/c			5,00,000
	(Being net profit for the year transferred to Capital)			

(f) Drawings transferred to Capital at year-end (NCERT § 8.6.2, p. 301)

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Mar 31	Capital A/cDr.		60,000	
	To Drawings A/c			60,000
	(Being drawings adjusted against Capital)			

(g) Opening entry on Apr 1 (NCERT § 8.7, p. 308)

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Apr 1	Cash A/cDr.		20,000	
	Stock A/cDr.		2,50,000	
	Furniture A/cDr.		80,000	
	Debtors A/cDr.		1,50,000	
	To Creditors A/c			90,000
	To Capital A/c			4,10,000
	(Being opening entry for the new accounting year)			

(h) Recording deferred revenue expenditure (NCERT § 8.2.1, p. 280)

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Apr 1	Advertisement Suspense A/c (DRE)Dr.		5,00,000	
	To Bank A/c			5,00,000
	(Being heavy advertising — revenue in nature, capitalised as DRE; ₹1,00,000 written off each year)			

Practice MCQs

Q1. Which of the following is the correct formula for **Gross Profit?**

- A. $\text{Gross Profit} = \text{Sales} - (\text{Purchases} + \text{Indirect Expenses})$
- B. $\text{Gross Profit} = \text{Sales} - (\text{Purchases} + \text{Direct Expenses})$
- C. $\text{Gross Profit} = \text{Net Profit} + \text{Indirect Expenses}$
- D. $\text{Gross Profit} = \text{Sales} - \text{Operating Expenses}$

Q2. From the books of Simmi and Vimmi Ltd., Opening stock ₹15,00,000, Net purchases ₹15,00,000, Direct expenses ₹80,000, Closing stock ₹2,50,000 and Net sales ₹40,00,000. What is the **gross profit?**

- A. ₹10,90,000
- B. ₹11,70,000
- C. ₹12,30,000
- D. ₹13,50,000

Q3. Which one of the following is a **capital receipt?**

- A. Sale of goods for cash
- B. Interest received on investments
- C. Sale of old machinery
- D. Commission earned

 **12 more MCQs + answer key**

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PYQ Alignment

The Financial Statements unit is among the most heavily weighted areas of CUET (UG) Accountancy — past papers (2023-25) routinely carry six to eight questions mixing direct conceptual recall (capital vs revenue, operating profit definition, marshalling), short numerical computation (gross profit, COGS, net profit from given balances) and



treatment-based questions on where individual items (closing stock, carriage inwards, deferred revenue expenditure) appear in the final statements. See /pyq/accountancy for drill sets.

