



B.Com Honours

Semester II

Calicut University

Foundations of Accounting

Course Code: COM2FM106 • Module 4 Notes

1. Trial Balance and Preparation of Final Accounts

The final step in the accounting cycle is checking arithmetic accuracy using a Trial Balance and preparing the financial statements to report profit/loss and financial position. This final module covers trial balance preparation, distinguishing revenue and capital expenditures, and preparing trading accounts, profit & loss accounts, and balance sheets for sole proprietors.

Trial Balance & Expenditure Classifications

- **Trial Balance:** A statement listing all ledger debit and credit balances. If the totals match, it proves arithmetic accuracy, though some errors (errors of principle, compensating errors) can remain undetected.
- **Capital vs. Revenue Expenditure:**
 - **Capital Expenditure:** Costs that yield long-term benefits and increase asset value (e.g., buying machinery). Shown on the Balance Sheet.
 - **Revenue Expenditure:** Routine operational costs incurred to maintain daily business activities (e.g., salaries, rent). Charged to the Profit & Loss Account.

Preparation of Financial Statements

Sole proprietors prepare three interconnected financial statements at the end of the year:

Trading & Profit & Loss Account

- **Trading Account:** Matches direct revenues (sales) with direct costs (cost of goods sold) to calculate **Gross Profit** or **Gross Loss**.
- **Profit & Loss Account:** Debits indirect expenses (administration, selling costs) and credits indirect incomes to calculate **Net Profit** or **Net Loss**.

The Balance Sheet

A statement of financial position prepared at a specific date, displaying the assets, liabilities, and owner's capital. Assets and liabilities are organized systematically through **Marshalling** (either by liquidity order or permanence order), proving the fundamental equation:

$$\text{Assets} = \text{Liabilities} + \text{Capital}$$

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