Trading and Profit and Loss Accounts: Further Considerations

Returns Inwards and Returns Outwards

A large number of firms return their goods to their suppliers (Returns Outwards). Also it is likely that through the course of the financial year that customers will return goods to your firm (Returns Inwards). Returns Inwards (Sales Returns) and Returns Outwards (Purchases Returns) are both recorded in the Trading Account.

Returns Inwards Account

Dr			Cr
2XX5	**$**	**2XX5**	**$**
6 Jan. Jake (Debtor)	**50**		
3 March Richard (Debtor)	**75**		
6 June Blinky (Debtor)	**25**	**31 Dec. Trading or Income St.**	**150**
	150		**150**

Returns Outwards Account

Dr			Cr
2XX5	**$**	**2XX5**	**$**
		12 Feb. Daley (Creditor)	**80**
		12 Nov. Shooter (Creditor)	**120**
31 Dec. Trading or Income St.	**220**	**13 Dec. Khan (Creditor)**	**20**
	220		**220**

B Swift (Horizontal Trading Account)

Trading & Profit and Loss Account (Income Statement) for the year ended 31.12.X5

	$	$		$	$
Purchases	**6240**		**Sales**	**8000**	
Less Returns Outwards	**220**	**6020**	Less Returns Inwards	**150**	**7850**
Less Closing Stock		**600**			
Cost of Goods Sold		**5420**			
Gross Profit Bal. c/d		**2430**			
		7850			**7850**
			Gross Profit Bal. b/d		**2430**

B Swift (Vertical Trading Account)

Trading & Profit and Loss Account (Income Statement) for the year ended 31.12.X5

	$	$
Sales	**8000**	
Less Returns Inwards	**150**	**7850**
Less Cost of Goods Sold		
Opening Stock	**0**	
Add Purchases or Inventory	**6240**	
Less Returns Outwards	**220**	
	6020	
Less Closing Stock	**600**	**5420**
Gross Profit		**2430**

Carriages Inwards and Outwards

The cost of the transport of goods (stock) into a firm is called *Carriage Inwards (Purchases Carriages)*. The cost of delivering goods from the firm to the customer is known as *Carriage Outwards (Sales Carriages)*.

If a supplier charges you for the delivery of the goods on top of the cost of the purchases then accountants add this to the cost of sales. Therefore the cost of carriage inwards is recorded in the Trading Account.

If you pay to deliver the goods to a customer then this cost is charged as an expense in the Profit and Loss Account of the firm. In both cases they are debit entries because they reduce the amount of sales located on the credit side of the trading and profit & loss account.

Example

Dr **Carriage Inwards Account** Cr

19X5		$	19X5		$
31 Dec.	Jeffs	200	31 Dec.	Trading or Income St.	200

Dr **Carriage Outwards Account** Cr

19X5		$	19X5		$
31 Dec.	Prince	300	31 Dec.	Profit & Loss or Income St.	300

B Swift (Horizontal Trading Account)
Trading & Profit and Loss Account (Income Statement) for the year ended 31.12.X5

	$	$		$	$
Purchases	**6240**		**Sales**	**8000**	
Less Returns Outwards	**220**		Less Returns Inwards	**150**	**7850**
Add Carriage Inwards	**200**	**6220**			
Less Closing Stock		**600**			
Cost of Goods Sold		**5620**			
Gross Profit Bal. c/d		**2230**			
		7850			**7850**
			Gross Profit Bal. b/d		**2230**
Less Expenses					
Electricity	**100**				
Wages	**1000**				
Carriage Outwards	**300**				
Rent	**400**	**1800**			
Net Profit Bal. c/d		**430**			
		2230			**2230**
			Net Profit Bal. b/d		**430**

The Vertical Trading and Profit and Loss Account Format

The vertical format is laid out in such a way so as to be more user-friendly for non accountants:

B Swift
Trading & Profit and Loss Account (Income Statement) for the year ended 31.12.X5

	$	$
Sales	**8000**	
Less Returns Inwards	**150**	**7850**
Less Cost of Goods Sold		
Opening Stock	**0**	
Add Purchases or Inventory	**6240**	
Less Returns Outwards	**220**	
Add Carriage Inwards	**200**	
	6220	
Less Closing Stock	**600**	**5620**
Gross Profit		**2230**
Less Expenses		
Rent	**400**	
Electricity	**100**	
Wages	**1000**	
Carriage Outwards	**300**	**1800**
Net Profit		**430**

Further Considerations:

1. **Sales Turnover = Sales – Sales Returns (Returns Inwards)**
2. **Net Purchases = Purchases – Purchases Returns (Returns Outwards)**
3. **How is gross profit affected if opening inventory (stock) is incorrect?**
a) **Overvalued Gross Profit decreases**
b) **Undervalued Gross Profit increase**
4. **How is gross profit affected if closing inventory (stock) is incorrect?**
c) **Overvalued Gross Profit increases**
d) **Undervalued Gross Profit decreases**
5. **Overvalued = overstated = overcast = overestimated = inflated**
6. **Undervalued = understated = undercast = underestimated = deflated**