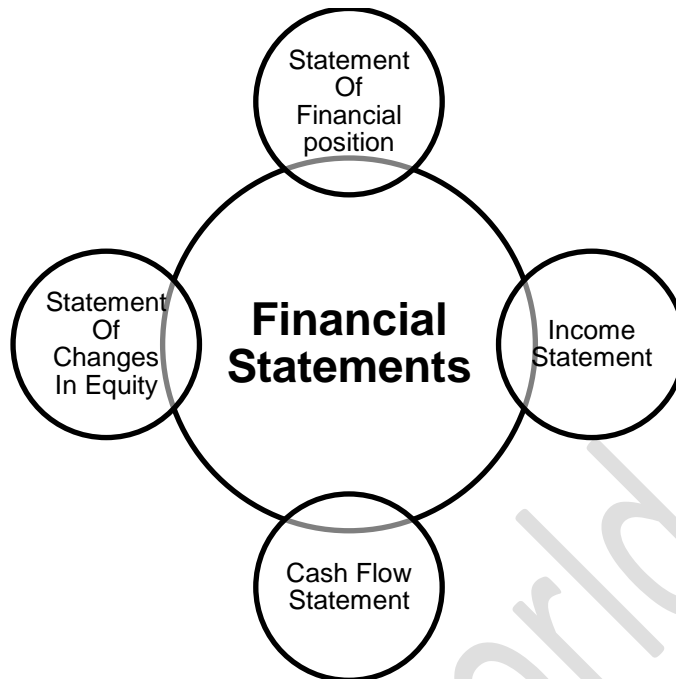


CHAPTER 8: Income Statement And Statement Of Financial Position



Income Statement: Financial statement which shows financial performance of business over a specific accounting period (one year). Financial performance is assessed by giving a summary of how the business incurs its revenues and expenses through both operating and non-operating activities. It also shows the net profit or loss incurred over a specific accounting period.

Income statement includes;

- Revenue
- Cost of sales
- Gross profit
- Operating (other) expenses
- Operating profit
- Other incomes
- Profit for the year

Purpose & Use

Income Statement provides the basis for measuring performance of an entity over the course of an accounting period. Performance can be assessed from the income statement in terms of the following:

- Change in sales revenue over the period and in comparison to industry growth
- Change in gross profit margin, operating profit margin and net profit margin over the period
- Increase or decrease in net profit, operating profit and gross profit over the period
- Comparison of the entity's profitability with other organizations operating in similar industries or sectors

Income statement also forms the basis of important financial evaluation of an entity when it is analysed in conjunction with information contained in other financial statements such as:

- Change in earnings per share over the period
- Analysis of working capital in comparison to similar income statement elements (e.g. the ratio of receivables reported in the SOFP to the credit sales reported in the income statement, i.e. receivables turnover ratio)
- Analysis of interest cover and dividend cover ratios

Statement Of Financial Position: Financial statement which shows financial position of an entity at a specific date. It describes total of assets, liabilities and equity values at prepared date.

It includes;

- Noncurrent assets
- Current assets
- Total assets
- Equity
- Noncurrent liabilities
- Current liabilities

Purpose & Importance

Statement of financial position helps users of financial statements to assess the financial health of an entity. When analysed over several accounting periods,

- SOFP may assist in identifying underlying trends in the financial position of the entity.
- It is particularly helpful in determining the state of the entity's liquidity risk, financial risk, credit risk and business risk.
- When used in conjunction with other financial statements of the entity and the financial statements of its competitors, SOFP may help to identify relationships and trends which are indicative of potential problems or areas for further improvement.
- Analysis of the statement of financial position could therefore assist the users of financial statements to predict the amount, timing and volatility of entity's future earnings.

ABC
Income Statement
For The Year Ended _____

	\$	\$	\$
Revenue (sales)		XXX	
Return inward (sales return)		(XX)	XXX
Cost Of Sales:			
Opening inventory		XXX	
Purchases	XXX		
Carriage inward	XXX		
Return out ward	(XX)	XXX	
Closing inventory		(XXX)	(XXX)
Gross profit			XXX
Other incomes:			
Rent received		XX	
Discount received		XX	
Commission received		XX	XXX
			XXXX
Expenses:			
Rent		XXX	
Wages & salaries		XXX	
Repairs		XXX	
Insurance		XXX	
Telephone charges		XXX	
Discount allowed		XXX	
Carriage outward		XXX	
Lighting and heating		XXX	
Bad debts		XXX	
Maintenance cost		XXX	
Sundry expenses		XXX	
Bank charges		XXX	
Finance cost (interest on loan)		XXX	(XXX)
Profit for the year (/ loss)			XXX

ABC
Statement Of Financial Position
As At _____

	\$	\$
Non current Assets:		
Premises (land & building)	XXX	
Plant & machinery	XXX	
Furniture, fixtures & fittings	XXX	
Motor vehicles	XXX	XXXX
Current assets:		
Inventory	XXX	
Trade receivables	XXX	
Cash at bank (bank)	XXX	
Cash in hand (cash)	XXX	XXXX
TOTAL ASSETS		XXXXXX
Financed By:		
Capital (equity)	XXX	
Profit for the year	XXX	XXX
Drawings		(XXX)
Non current liabilities:		XXX
Bank loans	XXX	XXX
Current liabilities:		
Trade payables	XXX	
Bank overdraft	XXX	XXX
		XXXXXX

Practice Questions:

1 Fraz is in business as a sole trader. The following balances were extracted from his books on 31 January 2014.

	\$
Land and buildings (cost)	130 000
Fixtures and fittings (cost)	17 000
Computer equipment (cost)	36 000
Discount received	1 000 Cr
Bank loan (repayable 30 April 2020)	110 000
Bank	17 430 Dr
Trade receivables	45 000
Trade payables	37 650
Rent received	1 400
Revenue	362 500
Purchases	172 400
Returns inwards	7 200
Returns outwards	8 800
Inventory at 1 February 2013	17 970
Distribution expenses	16 300
Insurance	5 900
Light and heat	7 850
Wages and salaries	69 500
Marketing expenses	31 000
General expenses	9 200
Commission received	11 400
Drawings	20 000
Capital	80 000
Discount Allowed	2 000
Carriage outward	3 500
Finance Cost	3 000
Carriage inward	1 500

Additional information at 31 January 2014;

Inventory was valued at \$15 600.

Required:

Prepare income statement and statement of financial position of Fraz for the year ended 31 jan 2014.

Answer:

Gross profit \$187 830. Expenses \$148 250. Profit for the year \$53 380.

Non current assts \$183 000. Current assets \$78 030. Total assets \$261 030.

Financed by \$113 380. Total liabilities \$147 650.

2 The following balances were extracted from the books of Patricia Chin on 31 March 2013.

	\$
Premises	67 000
Fixtures and fittings (cost)	20 000
Motor vehicle (cost)	18 000
Rent Received	4 400
Revenue	141 140
Purchases	60 200
Purchases returns	2 900
Inventory at 1 April 2012	5 430
Wages	20 960
General expenses	9 100
Insurance	12 600
Motor vehicle expenses	5 670
Discount allowed	1 428
Discount received	884
Trade receivables	7 546
Trade payables	4 920
Finance cost	1 800
Bank overdraft	2 330
Bank loan (repayable 30 June 2018)	30 000
Equity	56 000
Drawings	12 840

Inventory was valued at 31 march 2013 \$4200.

REQUIRED:

Prepare the income statement for the year ended 31 March 2013.

Prepare the statement of financial position at 31 March 2013.

Answer:

Gross profit \$82 610. Expenses \$51 558. Profit for the year \$36 336.

Non current assts \$105 000. Current assets \$11 746. Total Assets \$116 746.

Financed by \$79 496. Total liabilities \$37 250.