Income Statements and Balance Sheet

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Purpose of Income Statements

Knowing what profits are made helps businesses to do many things, including:

- Planning ahead.
- Obtaining loans from banks, from other businesses, or from private individuals.
- Telling prospective business partners how successful the business is.
- Telling someone who may be interested in buying business how successful the business is.
- Calculating the tax due on the profits so that the correct amount of tax can be paid to the tax authorities.

Purpose of Income Statements

- In case of a trader (someone who is mainly concerned with buying and selling goods), the profits are calculated by drawing up an income statement.
- **Income Statement**: The financial statement in which the calculations of gross profit and then net profit are presented.
- It contains trading account, which is prepared in order to arrive at the figure for gross profit.
- **Trading account**: An account in which gross profit is calculated that is part of an income statement.
- **Gross profit**: Where sales revenue exceeds the cost of goods sold.

Purpose of Income Statements

- Below the trading account is shown a summary of another account- the profit and loss account. The profit and loss account are prepared as to arrive at the figure of net profit .
- Profit and loss account: An account in which net profit is calculated that is summarized and included in a separate edition of the income statement.
- Net profit: Where sales revenue plus other income, such as rent received , exceeds the sum of cost of goods sold plus other expenses.
- Both the trading account and the profit and loss are part of the double entry system. At the end of financial period, they are closed off.

Gross Profit

Gross profit is calculated as follows:

Sales-Cost of goods sold=Gross Profit

What we bought in the period:	Purchases
Less goods bough but not sold in the period:	(closing inventory)
	Cost of goods sold

Q) If Sales are $38500, purchases are $29000 and closing inventory is $3000, what is the gross profit?

Trading account

Dr		Sales	Cr
2008	$	2008	$
Dec 31 Trading	38500	Dec 31 Balance	38500

Dr		Purchases	Cr
2008	$	2008	$
Dec 31 Balance	29000	Dec 31 Trading	29000

Trading account

Dr	Closing Inventory		Cr
2008	$	2008	$
Dec 31 Trading	<u>3000</u>	Dec 31 Balance	<u>3000</u>

Dr	Trading		Cr
2008	$	2008	$
Dec 31 Purchases	29000	Dec 31 Sales	38500
31 Gross profit transferred to Profit and loss	<u>12500</u>	31 Closing inventory	3000
	<u>41500</u>		<u>41500</u>

Profit and Loss

Dr	Rent		Cr
2008 Dec 31 Balance	$ 2400	2008 Dec 31 Profit and Loss	$ 2400

Dr	Lighting exp		Cr
2008 Dec 31 Balance	$ 1500	2008 Dec 31 Profit and Loss	$ 1500

Dr	General Expense		Cr
2008 Dec 31 Balance	$ 600	2008 Dec 31 Profit and Loss	$ 600

Profit and Loss

Dr		Profit and Loss		Cr
2008		$	2008	$
Dec 31	Rent	2400	Dec 31 Gross profit transferred from Trading	12500
31	Lighting expenses	1500		
31	General expenses	600		
31	Net profit	8000		
		12500		12500

Effect on the Capital account

Dr	Capital		Cr
2008	$	2008	$
Dec 31 Drawings	7000	Jan 01 Cash	20000
31 Balance c/d	21000	Dec 31 Net profit	8000
	28000		28000
		2009	
		Jan 1 Balance b/d	21000

Dr	Drawings		Cr
2008	$	2008	$
Dec 31 Balance	7000	Dec 31 Capital	7000

B Swift

Income Statement for the year ending 31 December 2008

	$	$
Sales		38500
Less cost of goods sold		
Purchases	29000	
less closing inventory	(3000)	
		(26000)
Gross Profit		12500
Less Expenses		
Rent	2400	
Lighting expenses	1500	
General expenses	600	
		(4500)
Net Profit		8000

Statement of Financial Position

- Balance Sheet: s statement showing assets, liabilities and capital of a business.
- In drawing up a balance sheet, we do not enter anything in the various accounts. We do not transfer any balance, to the balance sheet. Nothing is entered in the ledger accounts.
- All we do is list the assets, capital and liabilities balances as to form a balance sheet.
- When the next accounting period starts, these accounts are still open and they all contain balances. As a result of future transactions, entries are then made in these accounts that add to deduct from these opening balances using double entry.

Statement of Financial Position Layout

- **Assets**: We are going to show assets under two headings, non-current assets and current assets.

  1-Non-current assets will are listed first in balance sheet starting with those the business will keep the longest, down to those which will not be kept so long.

Non-current Assets
1- Land and buildings 2-Fixtures and Fittings 3-Machinery 4-Motor Vehicles

Statement of Financial Position Layout

- **Assets**: We are going to show assets under two headings, non-current assets and current assets.

2-Current assets are listed in increasing order of liquidity-that is staring with the asset furthest away form being turned into cash, and finishing with the cash itself.

Current Assets
1-Inventory 2-Accounts receivable 3-Cash at bank 4-Cash in hand

Statement of Financial Position Layout

Liabilities

- **Current liabilities:** Examples include bank overdrafts, account payables.
- **Non-current liabilities:** Examples include bank loans, loans from other businesses.

Statement of Financial Position Layout

Leo **Statement of Financial Position at 31st March 2008**		
	$	$
Non-current assets		
Land and buildings		xxx
Computer equipment		xxx
Fixtures and Fittings		xxx
		xxx
Current Assets		
Inventory	xxx	
Account Receivables	xxx	
Cash at bank	xxx	xxx
Total Assets		xxx

Statement of Financial Position Layout (continued)

Leo Statement of Financial Position at 31st March 2008		
	$	$
Equity		
Capital	xxx	
Add profit for the year	xxx	
	xxx	
Less drawings	(xxx)	xxx
Non-current liabilities		
loan repayable in 2013		xxx
Current liabilities		
Bank loan repayable in Feb 2009	xxx	
Trade payables	xxx	
Bank overdraft	xxx	xxx
Total Capital and Liabilities		xxx