

1. Income Statement: The income statement is a statement in which revenues and expenditures are matched to arrive at a figure of profit or loss. Many business try to distinction between a gross profit earned on trading, and a net profit after other income and expenses.

In the first part of the income statement (the Trading Account) revenue from selling goods is compared with direct costs of acquiring or producing the goods sold to arrive at a gross profit figure.

From gross profit figure, deductions are made in the second half of the income statement (which is called Income & Expenditure Account) in respect of indirect costs and additions for non-trading income. In other words, an income statement is divided into two halves:

- I) **Gross Profit** = Sales – Cost of goods Sold
- II) **Net Profit** = Gross Profit – Expenses + Non-Trading Income (income from other sources)

The income statement shows in detail how the profit or loss of a period has arisen.

Format of an INCOME STATEMENT is as under:

XY & Sons Income Statement For the year ended June 30, 200C		
Sales		XXX
Less: Sales returns		XXX
Sales discount	+ XXX	<u>(XXX)</u>
Net Sales		XXX
 Less: Cost of Goods Sold		
Opening Inventory		XXX
Add: Purchases	XXX	
Add: Transportation on purchase	+ XXX	
Total Purchases	XXX	
Less: Purchase returns		(XXX)
Purchase discount		(XXX)
Net purchase		+ XXX
Goods available for sale		XXX
Less: Closing Inventory		(XXX)
Cost of goods sold		<u>(XXX)</u>
Gross profit		XXX
 Less: Operating Expenses		
Distribution expenses		XXX
Selling expenses		XXX
Administration expenses		XXX
General expenses		XXX
Total operating expenses		(XXX)
Operating Income		XXX
 Add: Other incomes		
Interest Income/Commission Income		XXX
Net Income		<u>XXX</u>

2. **Balance Sheet:** A balance sheet is a statement of the liabilities, capital and assets of a business at a given moment in time.

In other words, a balance sheet is a list of assets, liabilities and capital of a business at some specific point of time. A balance sheet is prepared at the end of the accounting period to which the financial statements relate.

A balance sheet is very similar to the accounting equation. A balance sheet is divided into two halves:

- Capital and Liabilities in one half called 'Equity' section, and
- Assets in the other half

Format of a BALANCE SHEET is as under:

XY & Sons Balance Sheet As on June 30, 200C		
ASSETS		
Fixed Assets		
Building	XXX	XXX
Less: Allowance for depreciation	<u>(XXX)</u>	
Furniture & Fixtures	XXX	
Less: Allowance for depreciation	<u>(XXX)</u>	XXX
Motors vehicles	XXX	
Less: Allowance for depreciation	<u>(XXX)</u>	XXX
Total Fixed Assets		XXX
Current Assets		
Merchandise inventory	XXX	
Accounts Receivable	XXX	
Income Receivable	XXX	
Prepaid Expenses	XXX	
Bank	XXX	
Cash	<u>XXX</u>	
Total Current Assets		XXX
Total Assets		XXX
EQUITIES		
Capital		
Capital at start (opening balance)	XXX	
Add: Net Profit for the year	XXX	
Less: Drawings	<u>XXX</u>	XXX
Capital at end		XXX
Long-Term Liabilities		
Current Liabilities		
Accounts Payable	XXX	
Expenses Payable	XXX	
Tax Payable	XXX	
Bank Overdraft	<u>XXX</u>	XXX
Total Current Liabilities		XXX
Total Capital & Liabilities		XXX

Students also present Balance Sheet in following format:

**XY & Sons
Balance Sheet
As on June 30, 200C**

ASSETS		EQUITIES	
Fixed Assets		Capital	
Building	XXX	Capital at start (opening balance)	XXX
Less: Allowance for depreciation	(XXX)	Add: Net Profit for the year	<u>XXX</u>
Furniture & Fixtures	XXX	Less: Drawings	<u>XXX</u>
Less: Allowance for depreciation	(XXX)	Capital at end	XXX
Motors vehicles	XXX	Long-Term Liabilities	
Less: Allowance for depreciation	(XXX)	Current Liabilities	
Total Fixed Assets	XXX	Accounts Payable	XXX
Current Assets		Expenses Payable	XXX
Merchandise inventory	XXX	Tax Payable	XXX
Accounts Receivable	XXX	Bank Overdraft	<u>XXX</u>
Income Receivable	XXX	Total Current Liabilities	XXX
Prepaid Expenses	XXX	Total Equities	
Bank	XXX	<u>XXX</u>	
Cash	<u>XXX</u>		
Total Current Assets	XXX		
Total Assets	XXX		

The order of items in the Balance Sheet

A balance sheet lists assets, liabilities and capital in a particular order. This order is not compulsory, however, you should try to get into the habit of using the conventional order of items yourself.

The format most commonly used in the report form balance sheet (or vertical balance sheet format), which lists:

- (a) Net assets above and capital below; or
- (b) Fixed assets and net current assets above, with capital and long-term liabilities below; or
- (c) Assets above and liabilities (including capital) below; or
- (d) Capital and liabilities above, with assets below.

Note: there is no hard and fast rule about the order of items in a report form (or vertical) balance sheet.

Order of Items with in Categories

Students should note the following points:

- a) Fixed assets are listed in a descending order of 'length of useful life'. Building has a longer life than furniture & fixtures, which in turn perhaps have a longer life than motor vehicles. This is why the fixed assets are listed in the order shown above.
- b) Current assets are listed in descending order of the length of time it might be before the assets will be converted into cash. Broadly speaking, inventory will convert into accounts receivable, and accounts receivable will convert into cash, and so inventory, accounts receivable and cash will be listed in that order. Prepayments, because they are similar to accounts receivable, should be listed after account receivable and before cash.

Study Block -1: Concept Development**Question - 1****Income Statement and Classified Balance Sheet**

The trial balance of the Khalid Traders for the year ended December 31, 2004 is as under:

	Debit	Credit
Cash	10,000	
Accounts receivable	24,000	
Merchandise inventory (1-1-2004)	20,000	
Pre-paid insurance	3,000	
Office equipment	100,000	
Allowance for depreciation (office equipment)		24,000
Accounts payable		16,000
Capital (1-1-2004)		104,600
Drawing	12,000	
Sales		160,000
Sales discount	8,000	
Purchases	80,000	
Purchases return & allowance		10,000
Transportation in	11,600	
Advertising expense	14,600	
Salaries expense	24,000	
Insurance expense	5,000	
Depreciation expense (office equipment)	4,000	
Salaries payable		4,000
Pre-paid advertising	2,400	
Bad debts expense	2,400	
Allowance for Bad debts		2,400
	321,000	321,000

Merchandise inventory on December 31, 2004 was Rs.30,000

Required:

- Prepare Income Statement for the year ended December 31, 2004
- Prepare classified balance Sheet as on December 31, 2004.

Solution:

**Khalid Traders
Income Statement
For the year ended December 31, 2004**

Sales	160,000
Less: Sales discount	(8,000)
Net Sales	152,000
 Less: <u>Cost of Goods Sold</u>	
Opening Inventory	20,000
Add: Purchases	80,000
Add: Transportation on purchase	11,600
Total Purchases	91,600
Less: Purchase returns	(10,000)
Net purchase	81,600
Goods available for sale	101,600
Less: Closing Inventory	30,000
Cost of goods sold	(71,600)
 Gross profit	80,400
 Less: <u>Operating Expenses</u>	
Advertising expense	14,600
Salaries expense	24,000
Insurance expense	5,000
Depreciation expense	4,000
Bad debts expense	2,400
Total operating expenses	(50,000)
 Net Income	30,400

Khalid Traders
Balance Sheet
As on December 31, 2004

ASSETS**Fixed Assets**

Office equipment	100,000	
Less: Allowance for depreciation	(24,000)	
	<hr/>	76,000

Current Assets

Merchandise inventory	30,000	
Accounts Receivable	24,000	
Less: Allowance for bad debts	(2,400)	21,600
Income Receivable	3,000	
Prepaid Expenses	2,400	
Cash	10,000	
Total Current Assets	<hr/>	67,000
	<hr/>	143,000

Total Assets**EQUITIES****Capital**

Capital as on 1-1-2004	104,600	
Add: Net Profit for the year	30,400	
	<hr/>	135,000
Less: Drawings	(12,000)	
Capital as on 31-12-2004	<hr/>	123,000

Current Liabilities

Accounts Payable	16,000	
Expenses Payable	4,000	
Total Current Liabilities	<hr/>	20,000
Total Capital & Liabilities	<hr/>	143,000

Note:

- Net income determined in the income statement is transferred to the capital account in the balance sheet.
- Closing balance of merchandise inventory is deducted from the goods available for sale in the income statement, and is shown as current assets in the balance sheet.

Income Statement and Classified Balance Sheet

Question - 2
The trial balance of the Raheel Traders for the year ended December 31, 2005 is as under:

	Debit	Credit
Cash	18,000	
Accounts receivable	43,200	
Merchandise inventory (1-1-200C)	36,000	
Pre-paid insurance	5,400	
Office equipment	180,000	
Allowance for depreciation (office equipment)		43,200
Accounts payable		28,800
Capital (1-1-200C)	21,600	
Drawing		188,280
Sales	14,400	
Sales discount	144,000	
Purchases		18,000
Purchases return & allowance	20,880	
Transportation in	26,280	
Advertising expense	43,200	
Salaries expense	9,000	
Insurance expense	7,200	
Depreciation expense (office equipment)		7,200
Salaries payable	4,320	
Pre-paid advertising	4,320	
Bad debts expense		4,320
Allowance for Bad debts	577,800	577,800

Merchandise inventory on December 31, 2004 was Rs.54,000

Required:

- Prepare Income Statement for the year ended December 31, 200C
- Prepare classified balance Sheet as on December 31, 200C.

Solution: Try yourself as same as Q - 1 above

Question - 3

Income Statement and Classified Balance Sheet

The following is the Trial Balance of Mr. Yassen as on June 30, 2005:

	Debit		Credit
Cash	70,000	All. for depreciation on furniture	21,000
Notes receivable	60,000	Note payable	140,000
Accounts receivable	110,000	Capital (July 1, 2004)	270,000
Merc. inventory (July 1, 2004)	120,000	Sales ✓	1,020,000
Supplies	21,000	Interest income	2,200
Furniture	80,000	Accounts payable	116,000
Drawing	20,000	Wages payable	6,600
Purchases	850,000	Unearned interest income	1,500
Wages expenses	161,600		
Rent expenses	50,000		
Interest expense	4,000		
Supplies expense	10,000		
Depreciation expense	5,000		
Prepaid wages	15,000		
Interest income receivable	700		
	1,577,300		1,577,300

Merchandise inventory on June 30, 2005 was Rs.85,000

Required:

- Prepare Income Statement for the year ended June 30, 2005
- Prepare classified balance Sheet as on June 30, 2005.

Solution:

**Mr. Yaseen
Income Statement
For the year ended June 30, 2005**

Sales	1,020,000
Less: Cost of Goods Sold	
Opening Inventory	120,000
Add: Purchase	850,000
Goods available for sale	970,000
Less: Closing Inventory	(85,000)
Cost of goods sold	<u>(885,000)</u>
Gross profit	135,000
Less: Operating Expenses	
Wages expenses	161,600
Rent expenses	50,000
Interest expense	4,000
Supplies expense	10,000
Depreciation expense	5,000
Total operating expenses	<u>(230,600)</u>
Operating Loss	<u>(95,600)</u>
Add: Other incomes	
Interest income	2,200
Net Loss	<u>(93,400)</u>

Mr. Yaseen
Balance Sheet
As on June 30, 2005

ASSETS		EQUITIES
Fixed Assets		
Furniture	80,000	
Less: Allowance for dep.	(21,000)	59,000
Current Assets		
Merchandise inventory	85,000	
Supplies	21,000	
Notes receivable	60,000	
Accounts receivable	110,000	
Interest income receivable	700	
Prepaid wages	15,000	
Cash	70,000	
Total Current Assets	361,700	
Total Assets	420,700	
Capital		
Capital as on 1-7-2004		270,000
Less: Net Loss for the year		(93,400)
		176,600
Less: Drawings		(20,000)
Capital as on 30-6-2005		156,600
Current Liabilities		
Note payable		140,000
Accounts payable		116,000
Wages payable		6,600
Unearned interest income		1,500
Total Current Liabilities		264,100
Total Capital & Liabilities		420,700

Note:

- Net loss determined in the income statement is transferred to the capital account in the balance sheet.
- Closing balance of merchandise inventory is deducted from the goods available for sale in the income statement, and is shown as current assets in the balance sheet.

Question - 4

Income Statement and Classified Balance Sheet

The following is the Trial Balance of Mr. Ameen as on June 30, 2001:

	Debit	Credit
Cash	126,000	
Notes receivable	108,000	
Accounts receivable	198,000	
Merchandise inventory (July 1, 200A)	216,000	
Supplies	37,800	
Furniture	144,000	
Allowance for depreciation on furniture		37,800
Note payable		252,000
Capital (July 1, 200A)		486,000
Drawing	36,000	
Sales	1,530,000	
Purchases	290,880	
Wages expenses	90,000	
Rent expenses		3,960
Interest income		208,800
Accounts payable	7,200	
Interest expense	18,000	
Supplies expense	9,000	
Depreciation expense		11,880
Wages payable	27,000	
Prepaid wages	1,260	
Interest income receivable		2,700
Unearned interest income		2,839,140
	2,839,140	2,839,140

Merchandise inventory on June 30, 200B was Rs. 153,000

Required:

- Prepare Income Statement for the year ended June 30, 200B
- Prepare classified balance Sheet as on June 30, 200B.

Solution: Try yourself as same as Q – 3 above.

Question - 5**With Adjustments [XI-Commerce Karachi 1992 Q.7]**

Balance taken from the ledger of Haji Tabba, a sole trader, on June 30, 1992 before adjustments were as follows:

Debit Balances

Cash Rs.1,800; Accounts Receivable Rs.2,850; Merchandise Inventory (1.7.91) Rs.1,200; Office Equipment Rs.900; Purchases Rs.3,000; Prepaid Shop Rent Rs.1,200; Carriage in Rs.225; Salaries expense Rs.2,100; Insurance expense Rs.450; Sales Discount Rs.75.

Credit Balances

Accounts Payable Rs.2,250; Haji Tabba Capital Rs.4,725; Sales Revenue Rs.6,000; Purchase Discount Rs.105; Commission Income Rs.600; Allowance for Bad Debts Rs.120.

Supplementary data for adjustments on June 30, 1992

- (i) Salaries Payable Rs.285.
- (ii) Taxes Payable Rs.39
- (iii) Shop Rent Prepaid Rs.375.
- (iv) Insurance unexpired Rs.90
- (v) Commission Receivable Rs.66
- (vi) Merchandise Inventory was valued at Rs.1,950 on June 30, 1992.
- (vii) Allowance for bad debts was estimated at Rs.270.
- (viii) Allowance for Depreciation on Office Equipment was estimated at Rs.90.

Required:

- (1) Prepare Income Statement for the year ended on June 30, 1995.
- (2) Prepare Classified Balance Sheet as on June 30, 1995. (3) Prepare closing & opening entries (Note: You may prepare the two financial statement either in account form or in report form).

Solution:

**HAJI TABBA
INCOME STATEMENT
For the Period Ended June 30, 1992**

Sales Revenue	6,000
Less: Sales Discount	<u>(75)</u>
Net Sales	5,925
 Less: <u>Cost of Goods sold</u>	
Merchandise inventory (opening)	1,200
Add: Cost of Purchases	
Purchases	3,000
Add: Carriage-in	225
Total Purchases	3,225
Less: Purchases Discount	<u>(105)</u>
Net Purchases	<u>3,120</u>
Merchandise available for sale	4,320
Less: Merchandise Inventory (ending)	<u>(1,950)</u>
Cost of goods sold	<u>(2,370)</u>
Gross Income	3,555
 Less: <u>Operating Expenses</u>	
Salaries expenses	2,100
Add: Salaries payable	<u>285</u>
Insurance expenses	450
Less: Prepaid Insurance	<u>(90)</u>
Taxes expense	39
Shop rent expense	825
Bad Debts expense	150
Depreciation expense	<u>90</u>
Total operating expenses	<u>(3,849)</u>
 Add: <u>Other Income</u>	
Commission Income	600
Add: Commission Receivable	<u>66</u>
Total Other Income	<u>666</u>
 Net Income	<u>372</u>

HAJI TABBA
Balance Statement
As on June 30, 1992

ASSETS	Rs.	EQUITES	Rs.
Current Assets:		Current Liabilities:	
Cash		Accounts Payable	2,250
Accounts Receivable	1,800	Salaries payable	285
Less: Allowance for bad debts	(270)	Taxes Payable	39
Net Accounts receivable	2,580	Total Current Liabilities	2,574
Merchandise Inventory	1,950		
Prepaid shop Rent (1,200 – 825)	375		
Prepaid Insurance	90		
Commission Receivable	66		
Total Current Assets	6,861	Haji Tabba, Capital	4,725
Non-Current Assets		Add: Net Income	372
Office Equipment	900	Total Owner's Equity	5,097
Less: Accumulated depreciation	(90)		
Net Office Equipment	810		
Total Assets	7,761	Total Equities	7,671

Additional Working (Adjusting Entries)

Date	Particulars	Debit	Credit	Date	Particulars	Debit	Credit
1.	Salaries expense	285		5.	Commission Receivable	66	
	Salaries payable		285		Commission Income		66
2.	Taxes expense	39		6.	Merchandise Inventory	1,950	
	Taxes Payable		39		Exp & Revenue Summary		1,950
3.	Shop Rent expense	825		7.	Bad Debts expense	150	
	Prepaid Shop Rent		825		Allow. for bad debts		150
4.	Prepaid Insurance	90		8.	Depreciation expense	90	
	Insurance expense		90		Accumulated Dep.(OE)		90

Question - 6**With Adjustments**

The following balances have been taken from the ledger of Shams & Co. on December 31, 200B, the close of their financial year:

Debit Balances		Credit Balances	
Cash	9,000	Sales Revenue	122,400
Accounts Receivable	18,000	Purchase Discount	1,800
Merchandise Inventory(1-1-200A)	14,400	Commission Income	5,400
Prepaid Shop Rent	9,000	Accounts Payable	10,800
Sales Equipment	54,000	Capital (1-1-200A)	54,000
Purchases	43,200		
Carriage-inward	900		
Advertising Expense	4,500		
Miscellaneous Expense	2,700		
Office Supplies Expense	3,600		
Delivery Expense	900		
Salaries Expense	32,400		
Sales Return & Allowance	900		
Allowance for Bad Debts	900		

Supplementary data for adjustments December 31, 200B

- i) Prepaid Shop Rent was Rs.1,800.
- ii) Office Supplies unused Rs.720.
- iii) Allowance for Bad Debts was estimated at Rs.900.
- iv) Salaries outstanding Rs.9,000.
- v) Allowance for Depreciation on Sales Equipment was estimated at Rs.3,600.
- vi) Commission Unearned Rs.1,800.
- vii) Merchandise Inventory was valued on December 31, 200B at Rs.18,000.

Required

- i) Income Statement for the year ended December 31, 200B.
- ii) Balance Sheet as of December 31, 200B.

Solution: Try yourself as same as Q – 5 above

Question - 7

The following balances have been taken from the ledger of Gulistan & Co. on December 31, 2003, they close of their financial year:

Debit Balances		Credit Balances	
Cash	5,000	Sales Revenue	68,000
Accounts Receivable	10,000	Purchase Discount	1,000
Merchandise Inventory(1-1-2003)	8,000	Commission Income	3,000
Prepaid Shop Rent	5,000	Accounts Payable	6,000
Sales Equipment	30,000	Capital	30,000
Purchases	24,000		
Carriage-inward	500		
Advertising Expense	2,500		
Miscellaneous Expense	1,500		
Office Supplies Expense	2,000		
Delivery Expense	500		
Salaries Expense	18,000		
Sales Return & Allowance	500		
Allowance for Bad Debts	500		

Supplementary data for adjustments December 31, 2003

- (i) Prepaid Shop Rent was Rs.1,000.
- (ii) Office Supplies unused Rs.400.
- (iii) Allowance for Bad Debts was estimated at Rs.500.
- (iv) Salaries outstanding Rs.5,000.
- (v) Allowance for Depreciation on Sales Equipment was estimated at Rs.2,000.
- (vi) Commission Unearned Rs.1,000.
- (vii) Merchandise Inventory was valued on December 31, 2003 at Rs.10,000.

Required

- (a) Prepare Closing entries in General Journal (with out passing adjusting entries).
- (b) Set up the Expense and Revenue Summary Account and complete postings to it from the General Journal.
- (c) Close the Expense & Revenue Summary Account.

Solution:**Additional Working (Adjusting Entries)**

Date	Particulars	Debit	Credit	Date	Particulars	Debit	Credit
1.	Shop Rent expense Prepaid Shop Rent	4,000	4,000	5.	Depreciation expense Accumulated Dep.(SE)	2,000	2,000
2.	Office Supplies Office Supplies Expense	400	400		Commission Income Unearned Commission	1,000	1,000
3.	Bad Debts expense Allow. for bed debts	1,000	1,000	7.	Merchandise Inventory Exp. & Revenue Summary	10,000	10,000
4.	Salaries expense Salaries payable	5,000	5,000				

**Gulistan & Co.
Closing Entries**

Date	Particulars	P/R	Debit	Credit
2003 Dec.31	Expense and revenue summary Merchandise Inventory (opening) Purchases Carriage-in Sales return Advertising expense Misc. expense Office supplies expense Delivery expense Salaries expense Shop rent expense Bad depts. Expense (500 + 500) Depreciation expense (To close all expenses into expense & revenue summary a/c)		69,100	8,000 24,000 500 500 2,500 1,500 1,600 500 23,000 4,000 1,000 2,000

Dec.31	Sales Purchase discount Commission income Mer. Inventory (closing) Expense and revenue summary <i>(To close all incomes into expense & revenue summary a/c)</i>		68,000 1,000 2,000 10,000		81,000
Dec.31	Expense and revenue summary Capital <i>(To transfer net income a/c into capital a/c)</i>			11,900	11,900

Expense & Revenue Summary A/c

Dec. 31, 2003	Dec. 31, 2003
Mer. Inventory (opening)	8,000
Purchases	24,000
Carriage-in	500
Sales return	500
Advertising expense	2,500
Misc. expense	1,500
Office supplies expense	1,600
Delivery expense	500
Salaries expense	23,000
Shop rent expense	4,000
Bad depts. Expense	1,000
Depreciation expense	2,000
Net Income (balancing figure)	11,900
	81,000
	81,000

Note:

1. Only expenses and revenues are closed to Expense & Revenue Summary (or Profit & Loss A/c).
2. Assets, liabilities and capital are not closed to Expense & Revenue Summary (or Profit & Loss A/c), they transferred to Balance Sheet.

Question – 8**Only Closing Process**

The following balances have been taken from the ledger of Jamal & Co. on December 31, 2004, they close of their financial year:

Debit Balances	Credit Balances
Cash	9,000
Accounts Receivable	18,000
Merchandise Inventory(1-1-2004)	14,400
Prepaid Shop Rent	9,000
Sales Equipment	54,000
Purchases	43,200
Carriage-inward	900
Advertising Expense	4,500
Miscellaneous Expense	2,700
Office Supplies Expense	3,600
Delivery Expense	900
Salaries Expense	32,400
Sales Return & Allowance	900
Allowance for Bad Debts	900
	Sales Revenue
	Purchase Discount
	Commission Income
	Accounts Payable
	Capital
	122,400
	1,800
	5,400
	10,800
	54,000

Supplementary data for adjustments December 31, 2004.

- Prepaid Shop Rent was Rs.1,800.
- Office Supplies unused Rs.720.
- Allowance for Bad Debts was estimated at Rs.900.
- Salaries outstanding Rs.9,000.
- Allowance for Depreciation on Sales Equipment was estimated at Rs.2,000.
- Commission Unearned Rs.1,800.
- Merchandise Inventory was valued on December 31, 2004 at Rs.18,000.

Required

- Prepare Closing entries in General Journal (without passing adjusting entries).
- Set up the Expense and Revenue Summary A/c and complete postings to it from the General Journal.
- Close the Expense & Revenue Summary Account.

solution: Try yourself as same as Q – 7 above