# Case 3 - Income Statement

Remember the following: An income statement has the following construction:

|  |
| --- |
| Total sales revenues |
| (Total costs of sales) |
| Gross profit (GP) |
| (Total operating expenses: for example SG&A, R&D expense, advertising, rent, insurance, depreciation and amortization …) |
| Operating income (OI) |
| Total other expense / income (for example interest expense, interest income) |
| Income before taxes |
| Provision for income taxes |
| Net Income (NI) |

Please indicate on the chart, below, which of the following balance sheet and income statement categories are affected by the transactions: assets (A), liabilities (L), equity (E), gross profit (GP), operating income (OI), and net income (NI). Ignore the impact of income taxes. Assume the transactions relate to CPSI corp (pdf file attached named FS for cases 2 & 3 in session 3 folder).

Also **optional** please construct journal entries for each of the following transactions.

**Example: Earned and received $233 in interest income.**

**Solution:**

**Cash (CA↑) 233**

**Interest income (NI↑, SE↑) 233**

Transactions and journal entries:

1. Recognized $213 of prepaid expenses as sales and marketing expense in the period.
2. Recognized $2,745 in revenue for goods sold. Payment had previously been received for the goods. Ignore the cost of the goods.
3. Sold inventory costing $8,111 for $10,777. Payment is due in three months. The inventory had been paid for previously.
4. Accrued general and administrative expenses amounting to $2,133.

1. Sold business management services for $14,545 in financing receivables due in six months and paid $13,082 in cash to the consultants that provided the services.

Effects on balance sheet and income statement:

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Transaction** | **Balance sheet** | | | **Income statement** | | |
| **A** | **L** | **E** | **GP** | **OI** | **NI** |
|  | **Example: Earned and received $233 in interest income.** | **+233** | **0** | **+233** | **0** | **0** | **+233** |
|  | Recognized $213 of prepaid expenses as sales and marketing expense in the period. | **-213** | **0** | **-213** | **0** | **-213** | **-213** |
|  | Recognized $2,745 in revenue for goods sold. Payment had previously been received for the goods. Ignore the cost of the goods. | **0** | **-2745** | **+2745** | **+2745** | **+2745** | **+2745** |
|  | Sold inventory costing $8,111 for $10,777. Payment is due in three months. The inventory had been paid for previously. | **+2666** | **0** | **+2666** | **+2666** | **+2666** | **+2666** |
|  | Accrued general and administrative expenses amounting to $2,133. | **0** | **+2133** | **-2133** | **0** | **-2133** | **-2133** |
|  | Sold business management services for $14,545 in financing receivables due in six months and paid $13,082 in cash to the consultants that provided the services. | **+1463** | **0** | **+1463** | **+1463** | **+1463** | **+1463** |

Part B

* The following three ratios are commonly used in financial statement analysis:
* Current ratio (CR) = Current Assets/Current Liabilities, a measure used to evaluate the firm’s liquidity.
* Return on Assets (ROA) = Net income/Total Assets, a measure used to evaluate the firm’s profitability independent of its capital structure.
* Debt to equity (D/E) = debt to total owners’ equity, a measure of leverage (debt is anything that bears interest).

Please record the effect on the numerator and denominator of each of the three ratios for the following 4 transactions. Please indicate +, - or 0.

|  |  |  |  |
| --- | --- | --- | --- |
| Event | CR | ROA | D/E |
| Recognized $213 of prepaid expenses as sales and marketing expense in the period. | - | - | 0 |
| 0 | - | - |
| Recognized $2,745 in revenue for goods sold. Payment had previously been received for the goods. Ignore the cost of the goods. | 0 | + | 0 |
| - | 0 | + |
| Sold inventory costing $8,111 for $10,777. Payment is due in three months. The inventory had been paid for previously. | + | + | 0 |
| 0 | + | + |
| Accrued general and administrative expenses amounting to $2,133. | 0 | - | 0 |
| + | 0 | - |
| Sold business management services for $14,545 in financing receivables due in six months and paid $13,082 in cash to the consultants that provided the services. | + | + | 0 |
| 0 | + | + |