CHAPTER: SIX
PREPARATION OF FINANCIAL STATEMENT

CHAPTER AT A GLANCE

- Financial statements
- Importance of financial statements for organization
- Limitations of financial statements
- Components of financial statements
- Income statement
- Types of income statement
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6.1: Financial Statement

Financial statement is a summary report that shows how a firm has used the funds entrusted to it by its stockholders (shareholders) and lenders, and what is its current financial position. It is final result of accounting work done during the accounting period.

6.2: Importance of financial statements for organization

Analysis of financial statements helps to ascertain the strengths and weaknesses of the business concern. Significance importance and usefulness of financial statements analysis are presented below:

- **Management:** Financial statements are of very helpful to management in understanding the progress, position and prospects of business. In the absence of information which is included in the financial statements, management can neither plan nor fulfill easily the functions of operation and control.
- **Investors:** Financial statements are also significant for investor both present and prospective. However, the investor looks to the financial position of business concern from a different angel.
- **Bankers:** A banker is primarily concerned with the ability of paying current debt and current operation results. They want not only the payment of advance but also want advance should be repaid at proper time also.
- **Government:** Central and State government and local authorities are also interested published financial statement in order to access their revenue through various taxes regulate capital issue and public utility regulation.
- **Trade creditors:** From the creditor's point of view, financial statement act as a magic eye highlighting the credit worthiness.
- **Public:** Financial statements are also valuable to the public who are interested in prospect of a concern, in one way or the other. It is the securities of the enterprise alone that are bought and sold on stock exchange and the public is interested, mostly in their financial standing and also to avoid hostile feelings of the public.
- **Mitigate errors:** Accurate financial statements are also essential to catch costly mistakes or internal wrongdoing early in the process. If any illegal activity is taking place, there is no better way to catch it than through discrepancies in the numbers. If an error has been made, reconciliation activities can find them.
- **Better decision making, planning and forecasting:** Analyzing financial statements is crucial when decisions are to be made. A finance manager would look at the value of the assets that he currently holds and decide if he can afford to purchase more. When the value of assets is severely depreciated, questions would arise if they need to be sold off.

6-3: Limitations of financial statements

Financial statements are basically representative of business financial activities. Financial statements are not free from limitations. Following are their limitations to investors:

1. Financial statements only reveal financial position of the company in a summarize manner. In case of balance sheet it shows the financial position of business on a particular day usually at the end of financial year.
2. Financial statements do not record non-monetary transaction.
3. Past financial performance does not signify what will happen with the investors in future. The financial statements are useless without the notes to the financials statements, which are complex.
4. Unless the statements are audited their authenticity is under doubt and they may be misleading and fraudulent.
5. The financial statements reflect the recorded facts and figure. Hence, these are not useful for control purpose.
6. Valuation of inventories, method of depreciation, treatment of expenditure as capital or revenue etc., are based upon personal judgment.
7. Financial statements are prepared based on the historical cost principle which does not present the true and fair view of the financial condition.

6-4: Components of financial statements

Financial statements represent a formal record of the financial activities of an entity. These are written reports that quantify the financial strength, performance and liquidity of a company. Financial statements reflect the financial effects of business transactions of the entity. There are four types of financial statements discussed below:

1. Statement of financial position (Balance sheet)
2. Income statement
3. Statement of changes in equity (Owner's equity statement)
4. Cash flow statement

1. Statement of financial position:

Statement of Financial Position, also known as the Balance Sheet, presents the financial position of an entity at a given date. It is comprised of the following three elements:

- ✓ **Assets:** Something a business owns or controls (e.g. cash, inventory, plant and machinery, etc)
- ✓ **Liabilities:** Something a business owes to someone (e.g. creditors, bank loans, etc)
- ✓ **Equity:** What the business owes to its owners. This represents the amount of capital that remains in the business after its assets are used to pay off its outstanding liabilities. Equity therefore represents the difference between the assets and liabilities.

2. Income statement:

Income statement, also known as the profit and loss statement, reports the company's financial performance in terms of net profit or net loss over a specified period. Income statement is composed of the following two elements:

- ✓ **Revenues:** What the business has earned over a period (e.g. sales revenue, service, etc.)
- ✓ **Expenses:** The cost incurred by the business over a period (e.g. salaries and wages,

depreciation, rental charges, etc.)

Net profit or net loss is arrived by deducting expenses from revenues.

3. Cash flow statement

Cash Flow Statement, presents the movement in cash and bank balances over a period. The movement in cash flows is classified into the following segments:

✓ **Operating Activities:** Represents the cash flow from primary activities of business.

✓ **Investing Activities:** Represents cash flow from the purchase and sale of assets other than inventories (e.g. purchase of a factory plant)

✓ **Financing Activities:** Represents cash flow generated or spent on raising and repaying share capital and debt together with the payments of interest and dividends.

4. Statement of changes in equity

Statement of changes in equity, often referred to as statement of retained earnings in U.S. GAAP, details the change in owners' equity over an accounting period by presenting the movement in reserves comprising the shareholders' equity.

Movement in shareholders' equity over an accounting period comprises the following elements:

Net profit or net loss during the accounting period attributable to shareholders-

- Increase or decrease in share capital reserves
- Dividend payments to shareholders
- Gains and losses recognized directly in equity
- Effect of changes in accounting policies
- Effect of correction of prior period error

6-5: Income statement

An income statement is a financial statement of a business which is used to measure a company's financial performance for a specified accounting period. This statement is prepared by calculating all revenues and subtracting all expenditures from revenues to get net income or net loss of a business. The income statement presents the results of the entity's operation during a period of time, such as one year. The simplest equation to describe income is:

Net Income = Revenues – Expenses

✓ **Revenues:** What the business has earned over a period (e.g. sales revenue, service, etc.)

✓ **Expense:** The cost incurred by the business over a period (e.g. salaries and wages, depreciation, rental charges, etc.)

6-6: Types of income statement

There are two types of income statement-

1. **Single step income statement**
2. **Multiple steps income statement**

✓ **Single-step income statement:** This income statement shows only one step—subtracting total expenses from total revenues—is required in determining net income or net loss.

✓ **Multiple-step income statement:** It shows several steps in determining net income. Two of these steps relate to the company's principal operating activities. A multiple-step statement also distinguishes between **operating** and **non-operating activities.**

6-7: Single-step income statement versus multi-step income statement

Basis of difference	Single-step income statement	Multi-step income statement
Steps	It has only one step.	It has numerous steps.
Income	It shows only net income or net loss.	It shows both gross income or loss and net income or loss.
Uses	It is generally used in service enterprises.	It is generally used in merchandise enterprises.
Size	It is naturally shorter.	It is naturally broader and details.
Cost of goods sold	It does not deal with cost of goods sold.	It deals with cost of goods sold.
Classification	It is not classified.	It is always classified.

6-8: Components of balance sheet

The balance sheet is prepared in order to report an organization's financial position as of a specified moment, such as on December 31.The balance sheet is based on the following fundamental accounting model:

Assets = Liabilities + Owner's Equity

A. Assets: Assets represent things of value that a company owns and has in its possession, or something that will be received and can be measured objectively. They are also called the resources of the business; some examples of assets include receivables, equipment, property and inventory. Assets are classified as follows:

1. Tangible assets
2. Intangible assets
3. Fictitious assets

1. **Tangible assets:** Assets which can be seen and felt by touch are called tangible assets. Tangible assets are classified into two groups:
   a. Fixed assets
   b. Floating assets or current assets

   a. **Fixed assets:** Assets which are durable in nature and used in business over and again are known as Fixed Assets. E.g. land and Building, Machinery, Trucks, etc.

   b. **Floating assets or current assets:** Current assets are
   ✓ meant to be converted into cash,
   ✓ meant for resale,
   ✓ likely to undergo change e.g. cash balance, stock, sundry debtors, etc.

2. **Intangible assets:** Assets which cannot be seen and has no fixed shape. Example, goodwill, patent, etc.
3. **Fictitious assets:** Assets which have no real value and will appear on the assets side of balance sheet are known as fictitious assets: Example, preliminary expenses, discount on creditors.

B. **Liabilities:** Liabilities are the debts owed by a business to creditors, suppliers, tax authorities, employees, etc. These are the obligations that must be paid under certain conditions and time frames. A business incurs many of its liabilities by purchasing items on credit to fund the business operations. Liabilities are known as credit balances in ledger. Classification of liabilities:

1. Long term liabilities
2. Current liabilities
3. Contingent liabilities

1. **Long term liabilities:** Liabilities will be redeemed after a long period of time i.e. 10 to 15 year .Example, capital, long term loans, etc.
2. **Current liabilities:** Liabilities, which are redeemed within a year, are called current liabilities or short-term liabilities. Example, trade creditors, bill payable, bank loan, etc.
3. **Contingent Liabilities:** A contingent liability is a potential liability that may occur, depending on the outcome of an uncertain future event. A contingent liability is recorded in the accounting records if the contingency is probable and the amount of the liability can be reasonably estimated. If both of these conditions are not met, the liability may be disclosed in a footnote to the financial statements or not reported at all.

C. **Owner's equity:** A company's equity represents retained earnings and funds contributed by its owners or shareholders, who accept the uncertainty that may come with ownership risk in exchange for what they hope, will be a good return on their investment.

6-9: Parts of cash flow statement

Cash flow statements classify cash receipts and payments from operating, investing, or financing activities. A cash flow statement is divided into three sections based on the functional areas of the business:

1. **Cash flow from operating activities:** Cash from operations is the cash generated from day-to-day business operations.
2. **Cash flow from investing activities:** Cash from investing is the cash used for investing in assets, as well as the proceeds from the sale of other businesses, equipment, or other long-term assets.
3. **Cash flow from financing activities:** Cash from financing is the cash paid or received from issuing and borrowing of funds. This section also includes dividends paid. (Although it is sometimes listed under cash from operations.)

Net increase or decrease in cash from previous year will be written normally, and decreases in cash are typically written in brackets.

Specimen of income Statement
X Company Limited
Income statement
For the year ended.....

Particulars	Details Tk.	Details Tk.	Total Tk.
Operating Revenue			
Gross Sales		XXX	
Less: Sales return and allowance	XXX		
Sales discount	XXX	XXX	
Net sales			XXX
Less; Cost of goods sold:			
Beginning merchandise inventory		XXX	
Add: Purchase	XXX		
Less: Purchase returns	(XXX)		
Less: Purchase discount	(XXX)		
Net Purchase		XXX	
Transportation in		XXX	
Cost of goods available for sales		XXX	
Less: Ending merchandise inventory		(XXX)	
Cost of goods sold			(XXX)
Gross margin/ profit			**(XXX)**
Less: Operating expenses			
Selling expenses:	XXX		
Salesman's sales executive's salaries	XXX		
Salesman's commission	XXX		
Sales persons' traveling expense	XXX		
Delivery expenses	XXX		
Advertising expense	XXX		
Rent store building	XXX		
Supplies used	XXX		
Utilities expenses	XXX		
Packing expenses	XXX		
Other selling expenses	XXX	XXX	
Administrative expenses			
Office salary	XXX		
Office supply used	XXX		
Rent administrative building	XXX		
Telephone expenses-Office	XXX		
Insurance	XXX		
Depreciation expenses-Office equipment	XXX		
Repair-Office equipment, furniture etc.	XXX		

Office administrative expenses	XXX	XXX	(XXX)
Net income from operation			XXX
Add: Non-operating revenues	XXX		
Interest on investment	XXX		
Interest on notes receivable	XXX		
Interest on account receivable	XXX		
Rent from sub-let	XXX		
Commission received	XXX		
Profit on sales of assets	XXX	XXX	
Less: Non operating expenses			
Interest on borrowed capital	XXX		
Loss of sale of assets	XXX		
Accidental loss	XXX	(XXX)	(XXX)
Net income			XXX

Specimen of an Unclassified Balance Sheet

X Company Limited
Balance Sheet
As at.........

Assets	
Cash	XXX
Accounts receivable	XXX
Notes receivable	XXX
Office stores	XXX
Sales stores	XXX
Stock of goods	XXX
Prepaid expenses	XXX
Investment	XXX
Equipment	XXX
Furniture	XXX
Machinery	XXX
Buildings	XXX
Total Assets	XXX
Accounts payable	XXX
Notes payable	XXX
Expenses payable	XXX
Bank loan	XXX
Mortgage loan	XXX
Capital	XXX

Total liabilities and owner's equity	XXX

Specimen of an Classified Balance Sheet
X Company Limited
Balance Sheet
As at.........

Particulars	Details (Tk.)	Details (Tk.)	Total (Tk.)
Assets			
Current assets:			
Cash at hand		XXX	
Cash at bank		XXX	
Accounts receivable	XXX		
Less: Allowance for bad debts	(XXX)	XXX	
Notes receivable		XXX	
Accrued income		XXX	
Prepaid expenses		XXX	
Supplies on hand		XXX	
Inventories		XXX	
Total current assets			**XXX**
Investments:			
Investment in shares and debentures		XXX	
Investment in govt. bonds		XXX	
Other long-term investments		XXX	
Total investments			**XXX**
Plant assets or fixed assets.			
Land		XXX	
Building	XXX		
Less: Accumulated depreciation	(XXX)	XXX	
Leasehold premises	XXX		
Less: Accumulated depreciation	(XXX)	XXX	
Machinery	XXX		
Less: Accumulated depreciation	(XXX)	XXX	
Equipment	XXX		
Less: Accumulated depreciation	(XXX)	XXX	
Furniture and fixtures	XXX		
Less: Accumulated depreciation	(XXX)	XXX	
Vehicles	XXX		
Less: Accumulated deprecation	(XXX)	XXX	XXX
Total Fixed Assets			**XXX**

Intangible assets:		XXX	
Goodwill		XXX	
Trademarks, designs etc.		XXX	
Patents		XXX	
Preliminary expenses		XXX	XXX
Total intangible assets			**XXX**
Total assets			<u>**XXX**</u>
Current liabilities:			
Notes payable		XXX	
Accounts payable		XXX	
Expenses payable		XXX	
Unearned income		XXX	
Dividend payable		XXX	
Tax payable		XXX	
Advance from customers		XXX	
Bank loan		XXX	
Total current liabilities			**XXX**
		XXX	
Long-term liabilities:		XXX	
Mortgage loan		XXX	
Bond payable		XXX	
Debentures		XXX	
Total long-terms liabilities			**XXX**
Stockholders' equity:		XXX	
Capital stock		XXX	
Share premium		XXX	
Reserve fund		XXX	
Retained earnings		XXX	
Total stockholders' equity			**XXX**
Total liabilities and stockholders' equity			<u>**XXX**</u>

Problem- 1 (Ref: Accounting Principles, Kieso , Page: 193, Practices Problem)

The adjusted trial balance columns of Falcetto Company's worksheet for the year ended December 31, 2017, are as follows.

	Debit ($)		Credit($)
Cash	14,500	Accumulated dep.-Equipment	18,000
Accounts receivable	11,100	Accounts payable	25,000
Inventory	29,000	Notes payable	10,600
Prepaid insurance	2,500	Owner's capital	81,000
Equipment	95,000	Sales revenue	5,36,800
Owner's drawing	12,000	Interest revenue	2,500
Sales return and allowance	6,700		
Sales discount	5,000		
Cost of goods sold	3,63,400		
Freight-out	7,600		
Advertising expense	12,000		
Salaries and wages expenses	56,000		
Utilities expenses	18,000		
Rent expense	24,000		
Depreciation expense	9,000		
Insurance expense	4,500		
Interest expense	3,600		
	6,73,900		6,73,900

Instruction:

Prepare a multiple-step income statement for Falcetto Company.

Solution:

Falcetto Company

Income Statement

For the year ended December 31, 2017

Particulars	Amount ($)	Amount ($)
Sales revenue		5,36,800
Less:		
Sales returns and allowance	6,700	
Sales discount	5,000	(11,700)
Net sales		5,25,100
Less: Cost of goods sold		(3,63,400)
Gross profit		1,61,700
Less: Operating expense		
Salaries and wages expense	56,000	
Rent expenses	24,000	
Utilities expense	18,000	
Advertising expense	12,000	
Depreciation expense	9,000	

Freight-out	7,600	
Insurance expense	4,500	
Total operating expense		(1,31,100)
Income from operation		30,600
Add: Other revenue and gains		
Interest revenue	2,500	
Less: Other operating expenses and losses		
Interest expense	(3,600)	(1,100)
Net Income		29,500

Problem-2 (Ref: Accounting Principles, Kieso, Page: 201, P5-3A)

Big box store is located in midtown Madison. During the past several years, net income has been declining because of suburban shopping centers. At the end of the company's fiscal year on November 30, 2017, the following accounts appeared in two of its trial balances.

Account Titles	Unadjusted	Adjusted	Account Titles	Unadjusted	Adjusted
Accounts payable	25,200	25,200	Notes payable	37,000	37,000
Accounts receivable	30,500	30,500	Owner's capital	1,01,700	1,01,700
Accumulated dep.-equip.	34,000	45,000	Owner's drawing	10,000	10,000
Cash	26,000	26,000	Prepaid insurance	10,500	3,500
Cost of goods sold	5,18,000	5,18,000	Property taxes exp.		2,500
Freight-out	6,500	6,500	Property tax payable		2,500
Equipment	1,46,000	1,46,000	Rent expense	15,000	15,000
Depreciation expense		11,000	Salaries and wages exp.	96,000	96,000
Insurance expense		7,000	Sales revenue	7,20,000	7,20,000
Interest expense	6,400	6,400	Sales commission exp.	65,00	11,000
Interest revenue	2,000	2,000	Sales commission payable		4,500
Inventory	32,000	32,000	Sales return and allowance	8,000	8,000
			Utilities expense	8,500	8,500

Instructions:

(a) Prepare a multiple-step income statement, an owner's equity statement, and a classified balance sheet. Notes payable are due in 2020.

(b) Journalize the adjusting entries that were made.

(c) Journalize the closing entries that are necessary.

Solution: (a)

Big Box
Income Statement
For the year ended November 30, 2017

Particulars	Amount ($)	Amount ($)	Amount ($)
Operating revenue			
Sales revenue		72,000	
Less: Sales returns and allowance		(8,000)	
Net-sales			7,12,000
Less: Cost of goods sold			(5,18,000)
Gross profit			1,94,000
Less: **Operating expense**			
Selling Expenses			
Freight-out	6,500		
Depreciation expense	11,000		
Insurance expense	7,000		
Salaries and wages expense	96,000		
Sales commissions expenses	11,000	1,31,500	
Total selling expense			
Administrative expenses			
Property tax expenses	2,500		
Rent expenses	15,000		
Utilities expenses	8,500	26,000	
Total administrative expenses			(1,57,500)
Total operating expenses			36,500
Income from operation			
Add: Non operating revenues			2,000
Interest revenue			38,500
Less: Non operating expenses			(6,400)
Interest expenses			32,100
Net income			

Big Box
Owner's Equity Statement
For the year ended November 30, 2017

Particulars	Amount ($)	Amount ($)
Beginning capital		1,01,700
Add : Net income		32,100
		1,33,800
Less : Owner's drawing		(10,000)
Ending capital		1,23,800

Big Box
Balance Sheet
November 30, 2017

Assets	**Amount ($)**	**Amount ($)**
Current Assets :		
Cash	26,000	
Accounts receivable	30,500	
Inventory	32,000	
Prepaid insurance	3,500	
Total current assets		92,000
Long – term assets :		
Equipment	1,46,000	
Less : Accumulated dep. –Equipment	(45,000)	
Total long-term assets		1,01,000
Total assets		1,93,000
Liabilities		
Current liabilities :		
Account payable	25,200	
Property tax payable	2,500	
Sales commission payable	4,500	
Note payable	37,000	
Total current liabilities		69,200
Owner's equity :		
Ending capital	1,23,800	
Total owner's equity		1,23,800
Total liabilities and owner's equity		1,93,000

(b)

Big Box
Adjusting Entries

Date	Account Titles and Explanation	Ref.	Debit	Credit
Nov.30	Depreciation expense Accumulated depreciation (To record depreciation expense on store equipment)		11,000	11,000
30	Insurance expense Prepaid insurance (To record prepaid insurance expired)		7,000	7,000
30	Property tax expenses		2,500	

	Property tax payable			2,500
	(To record accrued property tax expense)			
30	Sales commission expense		4,500	
	Sales commission payable			4,500
	(To record accrued sales commission expense)			

(b)

Big Box Store
Closing Entries

Date	Accounts titles and Explanation	Ref.	Debit ($)	Credit ($)
Dec.30	Sales		7,20,000	
	Interest revenue		2,000	
	Income summary			7,22,000
	(To close revenues)			
30	Income summary		6,89,900	
	Cost of goods sold			5,18,000
	Freight-out			6,500
	Dep. expense			11,000
	Insurance expense			7,000
	Interest expense			6,400
	Property tax expense			2,500
	Rent expense			15,000
	Salaries and wages expenses			96,000
	Sales commission expense			11,000
	Sales return and allowance			8,000
	Utilities expense			8,500
	(To close expenses)			
30	Income summary		32,100	
	Owner's capital			32,100
	(To close net income to the capital)			
30	Owner's capital		10,000	
	Owner's drawing			10,000
	(To close drawing to the capital)			

Problem-3 (Ref: Accounting Principles, Kieso , Page: 202, P5-6A)

At the end of Donaldson Department store's fiscal year on November 30, 2017, these accounts appeared in its adjusted trial balance.

Donaldson Department Store
Adjusted Trial Balance

Account titles	$
Freight-in	7,500
Inventory	40,000
Purchase	5,85,000
Purchase discounts	6,300
Purchase returns and allowance	2,700
Sales revenue	10,00,000
Sales returns and allowance	20,000

Additional facts:

1. Merchandise inventory on November 30, 2017 is $52,600.
2. Donaldson Department Store uses a periodic system.

Instructions

Prepare an income statement through gross profit for the year ended November 30, 2017.

Solution:

Donaldson Department Store
Income Statement
For the year ended November 30, 2017.

Particulars	Amount ($)	Amount ($)	Amount ($)
Operating revenue			
Sales revenue		10,00,000	
Less: Sales returns and allowance		(20,000)	
Net sales			9,80,000
Less: **Cost of goods sold**			
Beginning merchandise inventory		40,000	
Purchase	5,85,000		
Less: Purchase discount	(6,300)		
Purchase returns and allowance	(2,700)		
Net purchase	5,76,500		
Add: Freight-in	7,500		
Cost of goods purchased		5,83,500	
Cost of goods available for sale		6,23,500	
Ending merchandise inventory		(52,600)	
Cost of goods sold			(5,70,900)
Gross profit			4,09,100

Problem-4 (Ref: Accounting Principles, Kieso , Page: 202, P5-7A)

Kayla Inc. operates a retail operation that purchases and sells home entertainment products. The company purchases all merchandise inventories on credit and uses a periodic inventory system. The accounts payable account is used for recording inventory purchases only; all other current liabilities are accrued in separate accounts. You are provided with the following selected information for the fiscal years 2014 through 2017, inclusive.

Particulars	2014	2015	2016	2017
Income statement data				
Sales revenue		55,000	(e)	47,000
Cost of goods sold		(a)	14,800	14,300
Gross profit		38,300	35,200	(i)
Operating expenses		34,900	(f)	28,800
Net income		(b)	2,500	(j)
Balance sheet data				
Inventory	7,200	(c)	8,100	(k)
Accounts payable	3,200	3,600	2,500	(l)
Additional information				
Purchases of merchandise				
Inventory on accounts		14,200	(g)	13,200
Cash payments to suppliers		(d)	(h)	13,600

Instructions:

(a) Calculate the missing amounts.

(b) Sales declined over 3-year fiscal period, 2015-2017. Does that mean that profitability necessarily also declined? Explain, computing the gross profit rate and the profit margin ratio for each fiscal year to help support your answer.

Solution: (a)

Particulars	2014	2015	2016	2017
Income statement data				
Sales revenue		55,000	50,000	47,000
Cost of goods sold		16,700	14,800	14,300
Gross profit		38,300	35,200	32,700
Operating expenses		34,900	32,700	28,800
Net income		3,400	2,500	4,100
Balance sheet data				
Inventory	7,200	4,700	8,100	7,000
Accounts payable	3,200	3,600	2,500	2,100
Additional information				
Purchases of merchandise				
Inventory on accounts		14,200	18,200	13,200
Cash payments to suppliers		13,800	18,300	13,600

Notes:

(a) Cost of goods sold= Sale revenue-Gross profit= 55,000-38,300 = 16,700

(b) Net income= Gross profit-Operating expenses= 38,300-34,900 = 3,400

(c) Inventory= Opening inventory+ Purchase-Costs of goods sold=7,200+ 14,200-16,700= 4,700

(d) Cash payment of suppliers= A/P(beginning)+ Purchase on account-A/P(ending)= 3,200+14,200-3,600= 13,800

(e) Sales revenue= Cost of goods sold+ Gross profit= 14800+35200 = 50000

(f) Operating expenses = Gross profit-Net profit = 35200-2500 = 32700

(g) Inventory on account = Cash payments+ Inventory (Opening)- Inventory(ending) = 14,800-4,700+8,100= 18,200

(h) Cash payment to suppliers= Purchase account+ Beginning A/P- Ending A/P = 18,200+ 3,600- 2,500= 19,300

(i) Gross profit= Sales revenue- Cost of goods sold= 47,000- 14,300= 32,700

(j) Net income= Gross profit- Operating expense= 32,700- 28,700= 4,100

(k) Inventory= Opening inventory+ Inventory purchased- Closing cost of goods sold 8,100+ 13,200- 14,300= 7,000

(l) Account payable= Purchase on account+ A/P(beginning)- Cash payment suppliers 13,200+ 2,500- 13,600= 2,100

(b)

According to the given data, the profitability does not decline although sales decline. The gross profit rates for 2015 to 2017 are 34,300/55,000 = 70%, 35,200/50,000= 70% and 32,700/47,000= 70%; indicate that the profitability is constant over 3 fiscal year.

Problem-5 (Ref. NU BBA Professional-2005)

Following is the trial balance of Mr. Chowdhury Enterprise as at December 31, 2005.

Mr. Chowdhury Enterprise
Trial Balance
December 31, 2005

Account Titles	Ref.	Debit (Taka)	Credit (Taka)
Account receivable		30,000	
Cash		37,500	
Accounts payable			20,000
Capital			100,000
Machinery		60,000	
Purchases		50,000	
Sales			90,000
Rent expenses		5,000	
Advertising expenses		4,000	
Apprenticeship premium			6,000
Merchandise inventory		25,000	
Goods return		3,000	2,000

Insurance expenses		7,000	
Supplies		6,000	
Allowance for doubtful accounts			400
6% Notes payable			20,000
Investments		10,000	
Gain on sales of fixed assets			1,600
Carriage inwards		2,500	
		2,40,000	2,40,000

Adjustment data:

(a) Merchandise inventory at December 31, 2005, cost Tk. 35,000.
(b) Insurance has been covered for two years of which one year has expired.
(c) Supplies on hand Tk. 500 at the end of the year.
(d) Maintain allowance of 5% on account receivable for doubtful accounts.
(e) Repair expense of Tk. 2,000 has been debited to machinery at the beginning of the year. Depreciated machinery at 10%.
(f) Interest is due for the whole year on note payable.
(g) Interest accrued on investments is Tk. 500.

Required: You are required to prepare balance sheet.

Solution:

Mr. Chowdhury Enterprise
Balance Sheet
December 31, 2005

Assets		Details (Tk.)	Total (Tk.)
Current Assets :			
Cash		37,500	
Account receivable (30,000- 1,500)		28,500	
Supplies		500	
Prepaid insurance (7,000-3,500)		3,500	
Interest receivable		500	
Merchandise inventory		35,000	
Total current assets			1,05,500
Long – term assets :			
Machinery	60,000		
Less : Accumulated dep. –Equipment	(5,800)		
Less: Repair exp.	(2,000)	52,200	
Long-term investment		10,000	
Total long-term assets			62,200
Total assets			1,67,700
Liabilities and Owner's Equity			
Current liabilities :		20,000	

Accounts payable		
Note payable	20,000	
Interest payable (20,000*6%)	1,200	
Total current liabilities		41,200
Owner's equity :		
Capital	1,26,500	
Total owner's equity		1,26,500
Total liabilities and owner's equity		1,67,700

Problem-6

(Ref. NU Professional BBA-2006)

The following is the trial balance of Hanif Enterprise as on December 31, 2006.

Hanif Enterprise
Trial Balance
December 31, 2006

Accounts Titles	Debit (Tk.)	Credit (Tk.)
Accounts receivable and payable	15, 000	13, 600
Notes receivable and payment payable	6, 000	4, 000
Furniture	30, 000	
Accumulated depreciation- Furniture		6, 000
Equipment	60, 000	
Accumulated depreciation- Furniture Equipment		12, 000
Hanif's capital		73, 000
Hanif's drawing	10, 000	
Allowance for doubtful debts		400
10% Mortgage loan		15, 000
Cash	20, 000	
Utilities expense	3000	
Apprenticeship premium		15, 000
Beginning inventory	20, 000	
Merchandise purchase	75, 000	
Sales		1,30, 000
Purchase return and allowance		5, 000
Sales return and allowance	3, 000	
Delivery expense	2, 000	
Rent expense	4, 000	
General expense	6, 000	
Salaries expense	7, 000	
Selling expense	13, 000	
Total	**2,74, 000**	**2,74,000**

The following adjustments are to be accounted for:

a. Ending inventory Tk. 30, 000.
b. Accrued salaries expense Tk. 1, 500.
c. Depreciation on furniture and equipment is to be provided for @ 10% per annum.
d. Make an allowance for bad debts at the rate of 6% on accounts receivable.
e. Apprenticeship premium received on first January, 2006 for a period of five years.
f. Hanif withdraw goods worth Tk.1,500 from business for personal use.
g. Rent prepaid is Tk. 1,000.

Required:
Prepare a multiple step income statement, owner's equity statement for the year ended December 31, 2006 and classified balance sheet as on that date.

Solution:

Hanif Enterprise
Income Statement
For the year ended December 31, 2006

Particulars	Amount (Tk.)	Amount (Tk.)	Amount (Tk.)
Operating revenue			
Sales		1,30,000	
Less: Sales return		(3,000)	
Net sales			1,27,000
Less: **Cost of goods sold**			(58,500)
Gross profit			68,500
Less: **Operating expenses**			
Selling expense			
Selling expense	13,000		
Delivery expenses	2,000		
Total selling expense		15,000	
Administrative expenses			
Utilities expense	3,000		
Rent expense	3,000		
Salaries expenses	8,500		
General expense	6,000		
Depreciation expenses	9,000		
Allowance for doubtful accounts	500		
Total administrative expenses		30,000	
Total operating expenses			(45,000)
Income from operations			23,500
Add: Other revenues and gains			
Apprenticeship premium			3,000
Less: Other expenses and losses			26,500
Interest expense			(1,500)
Net income			25,000

Working: Cost of goods sold: Beginning Inventory 20,000+ (Purchase 75,000-Purchase Return 5000 –Drawing by Owners 1,500- Ending Inventory 30,000)

Hanif Enterprise
Owner's Equity
For the year ended December 31, 2006

Accounts Titles	Amount	Amount
Beginning capital		73,000
Add : Net income		25,000
		98,000
Less : Owner's drawing		(11,500)
Ending capital		86,500

Hanif Enterprise
Balance Sheet
December 31, 2006

Assets		Amount	Amount
Current Assets :			
Cash		20,000	
Account receivable		14,100	
Notes receivable		6,000	
Prepaid rent		1,000	
Merchandise Inventory		30,000	
Total current assets			71,100
Long – term assets :			
Machinery	30,000		
Less: Repair exp.	(9,000)	21,000	
Equipment	60,000		
Less: Accumulated dep.	(18,000)	42,000	
Total long-term assets			63,000
Total assets			1,34,100
Liabilities and Owner's Equity			
Current liabilities :			
Accounts payable		13,600	
Note payable		4,000	
Unearned apprenticeship premium		12,000	
Interest payable		1,500	
Salaries payable		1,500	
Total current liabilities			32,600
Long-term liabilities:			
10% Mortgage loan			15,000
Owner's equity :			
Capital			86,500
Total liabilities & owner's equity			1,34,100

(Ref. NU BBA Professional-2007)

Problem-7

The trial balance of Rebeka Fashion Center contained the following accounts at December 31, the end of the company's fiscal year.

Rebeka Fashion Center
Trial Balance
December 31, 2006

Account Titles	Ref.	Debit (Taka)	Credit (Taka)
Cash		29,000	
Account receivable		33,700	
Merchandise inventory		44,700	
Store supplies		6,200	
Store equipment		87,000	
Accumulated dep.-Equip.			22,000
Delivery equipment		50,000	
Accumulated dep.-Deliver equipment			6,000
Notes payable			52,000
Accounts payable			50,000
Rebeka's capital			1,10,000
Rebeka's drawing		12,000	
Sales			7,60,000
Sales return and allowance		8,800	
Cost of goods sold		4,97,400	
Salaries expense		1,40,000	
Advertising expenses		24,400	
Utilities expenses		14,000	
Repaid expenses		12,100	
Delivery expenses		16,700	
Rent expenses		24,000	
		10,00,000	10,00,000

Adjustment data:

(a) Store supplies on hand totaled Tk. 3,200.
(b) Depreciation is Tk. 8,000 on the store equipment and Tk. 4,000 on the delivery equipment.
(c) Interest of Tk. 4000 is accrued on notes payable at December 31.
(d) Merchandise inventory actually on hand is Tk. 44,400.
(e) Tk. 25,000 of notes payable are due for payment next year.
(f) 50% of rent expenses related to sales.

Required: Prepare a multi-step income statement, owner's equity and classified balance sheet of December 31, 2006.

Solution:

Rebeka Fashion Center
Income Statement
December 31, 2006

Particulars	Details (Tk.)	Details (Tk.)	Total (Tk.)
Operating revenue			
Sales		7,60,000	
Less: Sales return		(8,800)	
Net sales			7,51,200
Less: **Cost of goods sold**			(4,97,700)
Gross profit			2,53,500
Less: **Operating expense**			
Selling expense	24,000		
Advertising expense	12,000		
Rent expense	16,700		
Delivery expenses	4,000		
Dep. exp.- delivery equipment	8,000		
Dep. exp.- store equipment		65,100	
Total selling expense			
Administrative expenses	14,000		
Utilities expense	12,000		
Rent expense	1,40,000		
Salaries expenses	1,2,100		
Repair expense	3,000		
Supplies expenses		1,81,100	
Total administrative expenses			(2,46,200)
Total operating expenses			7,300
Income from operations			
Less: Other expenses and losses			(4,000)
Interest expense			
Net income			3,300

Rebeka Fashion Center
Owner's Equity
For the year ended December 31, 2006

Accounts titles	Amount	Amount
Beginning capital		1,10,000
Add : Net income		3,300
		1,13,300
Less : Owner's drawing		(12,000)
Ending capital		1,01,300

Rebeka Fashion Center
Balance Sheet
December 31, 2006

Assets and Liabilities and Owner's Equity		Tk.	Tk.
Assets			
Current Assets:			
Cash		29,000	
Account receivable		33,700	
Store supplies (6200 – 3000)		3,200	
Merchandise inventory		44,400	
Total current assets			1,10,300
Long-Term Assets:			
Store equipment	87,000		
Less: Accumulated Dep.	(30,000)	57,000	
Delivery equipment	50,000		
Less: Accumulated Dep.	(10,000)	40,000	
Total Long-term assets			97,000
Total assets			2,07,300
Liabilities			
Current Liabilities:			
Account payable		50,000	
Notes payable		27,000	
Interest payable		4,000	81,000
Total current liabilities			
Long term liabilities:			
Notes payable		25,000	25,000
Total long term liabilities			
Total liabilities			1,06,000
Owner's Equity			
Rebeka's Capital, December 31		1,01,300	
Total owner's equity			1,01,300
Total liabilities and owner's equity			2,07,300

Answer:

i. Net income = Tk 3,300
ii. Ending capital = Tk 1,01,300
iii. Balance sheet totals = Tk 2,07,300

Problem-8

(NU BBA Professional-2007)

The following adjusted trial balance has been taken from the books of accounts of the Rupa Trading & Co.

Rupa Trading & Co.
Adjusted Trail Balance
December 31, 2007

Accounts Titles	Debit Taka	Accounts Titles	Credit Taka
Cash	20,800	Accumulated dep.-Building	52,500
Account receivable	50,300	Accumulated dep.-Equipment	42,900
Prepaid insurance	2,400	Rupa's capital	1,76,600
Equipment	1,10,000	Interest revenue	5,000
Building	1,90,000	Interest payable	4,000
Cost of goods sold	4,12,700	Mortgage payable	80,000
Depreciation exp. -Building	1,0400	Accounts payable	78,700
Depreciation exp.- Equipment	12,700	Property tax payable	4,800
Rupa's drawing	28,000	sales	6,28,000
Insurance exp.	9,200	Sales commission payable	5,300
Offices salaries exp.	32,000	Utilities payable	1,000
Interest exp.	11,000		
Utilities exp.	12,000		
Sales salaries exp.	76,000		
Merchandise inventory	75,000		
Property tax exp.	4,800		
Sales commission exp.	15,500		
Sales return and allowance	6,000		
	10,78,800		10,78,800

Additional data:

i. Insurance expense utilities expense are 60% selling and 40% administrative.
ii. Tk. 20000 of the mortgage is due for a payment in the next year.
iii. Deprecation on building and property tax exp. are administrative expense.
iv. Deprecation on equipment is a selling expense.

Required:

Prepare the following for the year 2007.

a. Prepare a multi-step income statement.
b. Prepare a statement of owner's equity.
c. Prepare a classified balance sheet.

Solution: a)

Rupa Trading
Income Statement
For the year ended December 31, 2007

Particulars	Tk.	Tk.	Tk.
Operating revenues:			
Sales		6,28,000	
Less: Sales return		(6,000)	
Net sales			6,22,000
Less: Cost of goods sold :			(4,12,700)
Gross Profit			2,09,300
Less: Operating expense			
Selling expense			
Sales salaries	76,000		
Sales commission	15,500		
Dep. exp. equipment	12,700		
Insurance exp. (9200*60%)	5,520		
Utilities exp. (12000*60%)	7,200		
Total selling expense		1,16,920	
Administrative expense			
Offices salaries Exp.	32,000		
Insurance exp. (9200*40%)	3,680		
Utilities exp.(12000*40%)	4,800		
Property tax exp.	4,800		
Dep. exp. building	10,400		
Total administrative expense		55,680	
Total operating expense			(1,72,600)
Income from operations			36,700
Add: Other revenue and gains			
Interest revenue			5,000
			41,700
Less: Other expense and losses			
Interest expense			(11,000)
Net income			30,700

(b)

Rupa Trading & Co.
Owner's Equity Statement
For the year ended December 31, 2007

Particulars	**Amount (Tk)**	**Amount(Tk)**
Rupa capital, January 1, 2007		1,76,600
Add: Net income		30,700
		2,07,300
Less: **Rupa, drawing**		(28,000)
Rupa capital, December 31, 2007		1,79,300

Solution: C)

Rupa Trading & Co.
Balance Sheet
December 31, 2007

Assets and liabilities and Owner's equity		Tk.	Tk.
Assets			
Current Assets:			
Cash		20,800	
Account receivable		50,300	
Prepaid insurance		2,400	
Merchandise inventory		75,000	
Total current assets			1,48,500
Long-term Assets:			
Equipment	1,10,000		
Less: Accumulated depreciation	(42,900)	67,100	
Building	1,90,000		
Less: Accumulated depreciation.	(52,500)	1,37,500	
Total long term assets			2,04,600
Total assets			3,53,100
Liabilities and Owner's Equity			
Current Liabilities:			
Account payable		78,700	
Interest payable		4,000	
Mortgage payable		60,000	
Property tax payable		4,800	
Sales commission payable		5,300	
Utilities payable		1,000	
Total current liabilities			1,53,800
Long term liabilities:			
Mortgage payable		20,000	20,000
Total liabilities			1,73,800
Owner's equity			
Rupa, Capital, December 31, 2007		1,79,300	
Total owner's equity			1,79,300
Total liabilities and owner's equity			3,53,100

Answer:

a. Net income:Tk.30,700
b. Ending capital: Tk.1,79,300
c. Balance sheet totals: Tk. 3,53,100

(NU BBA Professional-2009)

Problem-9

The trail balance of Navana Ltd. for the year ending December 31, 2008 in show below:

Navana Ltd

Trial Balance

December 31, 2008

Account Titles	Debit (Tk.)	Credit (Tk.)
Cash	30,000	
Accounts receivable	55,200	
Merchandise inventory	60,000	
Prepaid insurance	3,600	
Equipment	70,000	
Land	14,000	
Accumulated dep. - Equipment		20,000
Accounts payable		62,400
Sales		4,82,000
Sales returns and allowances	9,200	
Capital		1,00,600
Sales discount	7,800	
Purchase	3,44,000	
Freight-in	10,000	
Purchase return and allowances		2,400
Purchase discount		4,000
Salaries exp.	41,400	
Interest	14,000	
Utilities	12,200	
Total	6,71,400	6,71,400

Other information:

i. Merchandise inventory on hand at December 31, 2008 is Tk. 80,000.
ii. Prepaid salaries Tk. 4,000.
iii. Insurance expired Tk. 2,000 during the year.
iv. Charge depreciation 10% on equipment.

Requirements:

a) Prepare a multiple-step income statement for the year ending December 31, 2008.
b) Prepare a classified balance sheet at December 31, 2008.

Solution: a)

Navana Ltd.
Income Statement
For the year ended December 31, 2008

Particulars	Details (Tk.)	Details (Tk.)	Total (Tk.)
Operating revenues:			
Sales		4,82,000	
Less: Sales return		(9,200)	
Less: Sales discount		(7,800)	
Net sales			4,65,000
Less: Cost of goods sold :			
Cost of goods sold (60,000+3,44,000+10,000-2,400-4,000- 80,000)			(3,27,600)
Gross Profit			1,37,400
Less: Operating expense			
Selling expense:			
Dep. exp. Equipment	7,000		
Total selling expense		7,000	
Administrative expense:			
Insurance Exp.	2,000		
Utilities Exp.	12,200		
Salaries exp.(41,400-4,000)	37,400		
Total Administrative Expense		51,600	
Total operating expense			(58,600)
Income from operation			78,800
Less: Other expense and losses:			
Interest expense			(14,000)
Net income			64,800

Navana Ltd.
Owner's Equity statement
For the year ended December 31, 2008

Particulars	Amount(Taka)	Amount(Taka)
Capital, January 1		1,00,600
Add: Net income		64,800
Capital, December 31		1,65,400

Solution: b)

Navana Ltd.
Balance Sheet
December 31, 2008

Assets and liabilities and Owner's equity		Details (Taka)	Total (Taka)
Assets			
Current Assets:			
Cash		30,000	
Account receivable		55,200	
Prepaid insurance (3,600-2,000)		1,600	
Prepaid salaries		4,000	
Merchandise inventory		80,000	
Total current assets			1,70,800
Long-term Assets:			
Land		14,000	
Equipment	70,000		
Less: Accumulated dep.	(27,000)	43,000	
Total long term assets			57,000
Total assets			2,27,800
Liabilities and Owner's Equity			
Current liabilities:			
Account payable		62,400	
Total current liabilities			62,400
Long term liabilities:			
Total Long Term liabilities		-	-
Total liabilities			62,400
Owner's equity			
Capital, December 31		1,65,400	
Total owner's equity			1,65,400
Total liabilities and owner's equity			2,27,800

Answer:

a. Net income: Tk.64,800
b. Ending capital: Tk.1,65,400
c. Balance sheet totals: Tk. 2,27,800

Problem-10 (NU Professional BBA-2010)

After the first month of operation, the adjusted trial balance of Marine Enterprise was the following:

Marine Enterprise
Trial Balance
September 30, 2010

Account Titles	Debit (Tk.)	Credit (Tk.)
Cash	54,000	
Accounts receivable	28,000	
Supplies	10,000	
Prepaid insurance	22,000	
Equipment	6,00,000	
Accumulated dep. - Equipment		9,000
Note payable		4,00,000
Accounts payable		24,000
Interest payable		5,000
Owner's capital		3,00,000
Owner's drawing	1,000	
Service revenue		49,000
Salaries exp.	32,000	
Utilities exp.	8,000	
Advertising exp.	4,000	
Insurance exp.	2,000	
Supplies exp.	3,000	
Depreciation exp.	9,000	
Interest exp.	5,000	
Total	7,87,000	7,87,000

Requirements:

a) Prepare an income statement of Marine Enterprise for September, 2010.

b) Prepare a classified balance sheet assuming that Tk. 3,50,000 of notes payable is long term.

c) Journalize the closing entries.

Solution:

Marine Enterprise
Income Statement
For the end of September 30, 2010

Particulars	Tk.	Tk.	Tk.
Service revenues:			
Service revenue		49,000	
Total Service Revenue			49,000
Gross profit			
Less: Operating Expenses:			
Selling expense:			
Advertise Expenses	4,000		
Total selling expense		4,000	
Administrative expense:			
Salaries exp.	32,000		
Utilities exp.	8,000		
Insurance exp.	2,000		
Supplies exp.	3,000		
Depreciation exp.	9,000		
Total administrative expense		54,000	
Total operating expense			(58,000)
Income from operation			(9,000)
Less: Other expense and losses:			
Interest expense			(5,000)
Net loss			14,000

Solution: b)

Marine Enterprise
Owner's Equity Statement
For the end of September 30, 2010

Particulars	Amount(Tk)	Amount(Tk)
Capital,		3,00,000
Less: Net loss		(14,000)
		2,86,000
Less: Drawing		(10,000)
Owner's capital		2,76,000

Solution: c)

Marine Enterprise
Balance Sheet
September 30, 2010

Assets and liabilities and Owner's equity		Details (Tk.)	Total (Tk.)
Assets			
Current assets:			
Cash		54,000	
Account receivable		28,000	
Supplies		10,000	
Prepaid insurance		22,000	
Total current assets			1,14,000
Long-term assets:			
Equipment	600000		
Less: Accumulated dep.	(9,000)	5,91,000	
Total long term assets			5,91,000
Total assets			7,05,000
Liabilities			
Current liabilities:			
Notes payable		50,000	
Account payable		24,000	
Interest payable		5,000	
Total current liabilities			79,000
Long term liabilities:			
Notes payable		3,50,000	
Total long term liabilities			3,50,000
Total liabilities			4,29,000
Owner's equity			
Owner's capital		2,76,000	
Total owner's equity			2,76,000
Total liabilities and owner's equity			7,05,000

Answers:

a) Net loss: Tk.14,000
b) Ending capital: Tk.2,76,000
c) Balance sheet totals: Tk. 7,05,000

Marine Enterprise
Closing Entries

Date	Accounts titles and explanation	Ref	Debit	Credit
Sept. 30	Service revenue		49,000	
	Income summary			49,000
	(To close revenue account)			
30	Income summary		63,000	
	Salaries exp.			32,000
	Utilities exp.			8,000
	Advertising exp.			4,000
	Insurance exp.			2,000
	Supplies exp.			3,000
	Depreciation exp.			9,000
	Interest exp.			5,000
	(To close expense accounts)			
30	Capital		14,000	
	Income summary			14,000
	(To close Income summary accounts)			
30	Capital		10,000	
	Drawing			10,000
	(To close drawing accounts)			

Questions

1. What is financial statement? Explain the importance and usefulness of financial statements.
2. Explain different types of financial statements.
3. What are the limitations of financial statements?
4. What are the differences between single step and multiple step income statements?
5. What is balance sheet? Discuss different types of assets according to classified balance sheet?
6. Explain different parts of a cash flow statement.