

6.

Income statements

The main reason why people set up businesses is to make profits. Calculation of such profits and losses is probably the most important objective of the accounting function. Profits are calculated by drawing up income statements.

Purpose of income statements

- i) Planning ahead
- ii) Obtaining loan from financial institutions
- iii) Telling prospective business partners how successful the business is
- iv) Telling potential buyer of a business how successful it is
- v) Calculating tax due on the profits so that correct amount of tax can be paid to tax authorities

When the income statement is shown in detail rather than in summary form (as in the case of published income statement of companies) it contains the **trading account**. The trading account is prepared in order to arrive at **gross profit**.

Below the trading account is shown a summary of another account- the **profit and loss account**. This is prepared to arrive at the figure for the net profit (loss).

These two accounts together comprise the income statement.

- Both the trading account and the profit and loss account are part of the double entry system. At the end of the financial period they are closed off. But the income statement is not part of double entry system.

Note:

Sales - cost of goods sold = Gross profit

Purchase – closing stock = Cost of goods sold

Trading account

2010	Sh	2010	Sh
Dec 31 Purchases	xx	Dec 31 Sales	xx
31 Gross profits transferred to P& L a/c	xx	31 Closing inventory	xx
	—		—
	XX		XX

Profit and loss account

2010	sh	2010	Sh
Dec 31 Rent	xx	Dec 31 Gross profit transferred from trading account	xx
Dec 31 Lighting Expense	xx		
Dec 31 General Expenses	xx		
Dec 31 Depreciation On	<u>xx</u>		
Dec 31 Net Profit	<u>xx</u>		<u>xx</u>

Illustration (1)

The following trial balance relates to B Lane enterprises

Trial balance as at 30th June 2010

	Dr.	Cr.
	Sh	Sh
Sales		265 900
Purchases	154 870	
Rent	4 200	
Lighting & heating expenses	530	
Salaries & Wages	51 400	
Insurance	2 100	
Buildings	85 000	
Fixtures	1 100	
Accounts receivable	31 300	
Sundry expenses	412	
Accounts payable		15 910
Cash at bank	14 590	
Drawings	30 000	
Vans	16 400	
Motor vehicle expenses	4 110	
Capital		<u>114 202</u>
	<u>396 012</u>	<u>396 012</u>

Required:

Draw up an income statement for the year ending 30th June 2010

SOLUTION**B Lane Enterprises****Income statement for the year ending 30th June 2010**

	Sh
Sales	265,900
<i>Less: cost of sales</i>	
Purchases	154,870
<i>Less: closing inventory</i>	<u>16,280</u>
	<u>138,590</u>
Gross profit c/d	127,310
<i>Less: expenses:</i>	
Salaries and wages	51,400
Rent	4,200
Lighting and heating	530
Insurance	2,100
Motor vehicle expenses	4,110
Sundry expenses	<u>412</u>
	<u>62752</u>
NET PROFIT	64,558

Illustration 2

Y. Henry is a sole trader who keeps records of his cash and bank transactions. His transactions for the month of March 2010 were as follows

March

- 1 Cash at hand £100, cash at bank £ 5 672
- 4 Henry received a cheque for £ 1246 from, Arnold which was paid directly into his bank
This represented sales
- 6 Paid wages in cash £ 39
- 8 Sold good for cash £ 152
- 10 Received cheque form G.Smart for £315, in full settlement of debt of £344, this was paid directly into the bank

- 11 Paid sundry expenses £ 73
 14 Purchases goods by cheque for £ 800
 18 Paid J. Sandra a cheque of £185 in full settlement of a debt of £ 201
 23 Withdraw £ 100 from bank for office use.
 24 Paid wages for cash £39
 26 Sold good for cash £ 94
 28 Paid salaries by cheque £230
 31 Retained cash amounting to £150 and paid the remainder into the bank.

Required

- Enter the above transaction in T- accounts and bring down the balance
- Assuming no opening figure for accounts receivable, accounts payable or, inventory, prepare an income statement for the month ending 31 March.

Solution

		Bank				Cash	
Bal b/d	5672	Purchases	800	Bal b/d	100	Wages	39
W Arnold	1246	Office Exp.	100	Sales	152	Sundry Exp	73
G smart	315	Salaries	230	Sales	94	Wages	39
Cash	45	Bal c/d	5981			Bank	45
	<u>7278</u>		<u>7278</u>			Bal c/d	<u>150</u>
Bal b/d	5981			Bal b/d	<u>346</u>		<u>346</u>
				Bal b/d	<u>150</u>		

		Sales				W Arnold	
Bal c/d	1492	W Arnold	1246	Sales	1246	Bank	1246
		Cash	152		<u>1246</u>		<u>1246</u>
		Cash	94				
	<u>1492</u>	Bal b/d	<u>1492</u>				

Wages

G. Smart

Cash	39	Bal c/d	78
Cash	<u>39</u>		<u>—</u>
	<u>78</u>		<u>78</u>
Bal b/d	<u>78</u>		

Bal b/d	344	Bank	315
	<u>344</u>	Disc. Allowed	<u>29</u>
			<u>344</u>

Discount allowed

G. smart	29	Bal c/d	29
	<u>29</u>		<u>29</u>
Bal b/d	<u>29</u>		

Sundry expenses

Cash	73	Bal c/d	73
	<u>73</u>		<u>73</u>
Bal b/d	<u>73</u>		

Purchases

Bank	800	Bal c/d	800
	<u>800</u>		<u>800</u>
Ba b/d	<u>800</u>		

J. Sandra

Bank	185	Bal b/d	201
Disc received	<u>16</u>		<u>—</u>
	<u>201</u>		<u>201</u>

Discount Received

Bal c/d	16	J. Sandra	16
	<u>16</u>		<u>16</u>
Bal b/d	<u>100</u>		

Office Expenses

Bank	100	Bal c/d	100
	<u>100</u>		<u>—</u>
Bal b/d	<u>100</u>		<u>100</u>

Salaries

Bank	230	Bal c/d	230
	<u>230</u>		<u>230</u>
BAL b/d	<u>230</u>		

Y HENRY
Income statement for the month ended
31st march 2010

Sales	1492
<i>Less: cost of goods sold – purchases</i>	<u>800</u>
Gross profit	692
Add: discount received	<u>16</u>
	708
<i>Less</i>	
Wages	78
Discount allowed	29
Sundry expenses	73
Office expenses	<u>230</u> <u>(510)</u>
NET PROFIT	<u>198</u>