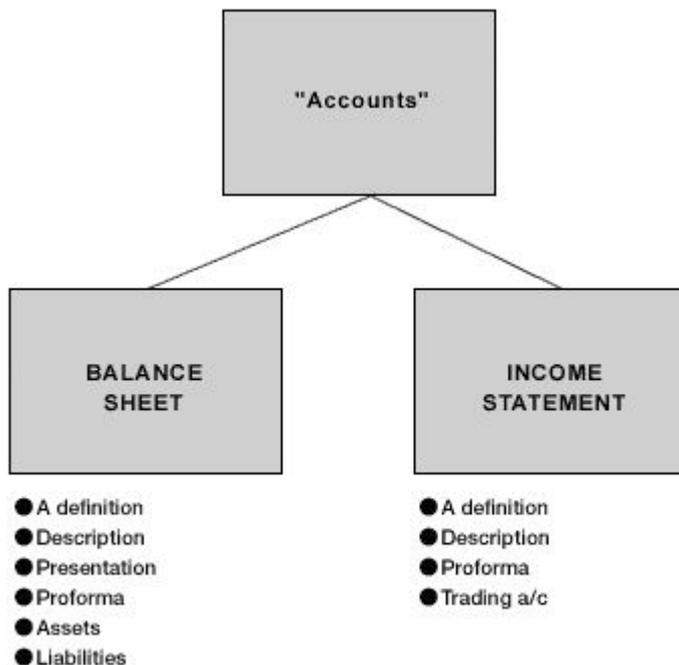


Balance Sheet & Income Statement

Overview

To present and explain the balance sheet and income statement in vertical format.



Balance Sheet

A statement of the *financial position* of the enterprise as at a stated date.

Description

- | Shows what the enterprise *owns* (assets) and *owes* (liabilities).
- | Usually presented in *vertical format*
- | The balance sheet *always balances* – what it owns (total assets) equals what it owes (to its suppliers, lenders and owners).
- | All items recorded have a monetary value attributed to them.

Presentation

- | To facilitate meaningful analysis, assets and liabilities are grouped according to classifications which are generally accepted (or legally required).
- | IAS 1 *Presentation of Financial Statements* sets out minimum requirements for all general purpose financial statements presented in accordance with IASs IAS.
- | The proforma which follows is suitable for a sole trader.

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Proforma

I Points to note

- It is dated at the point in time at which it is stated.
- Items are classified in order of liquidity (ie relative ease of conversion into cash). Non-current assets are placed first, working down to cash balances.

BALANCE SHEET AS AT			
ASSETS	\$	\$	\$
Non-current assets	<i>Cost</i>	<i>Depreciation</i>	
Property	x	x	x
Plant and equipment	x	x	x
	<u>x</u>	<u>x</u>	<u>x</u>
Current assets			
Inventories		x	
Trade and other receivables		x	
Prepayments		x	
Cash		x	
		<u>x</u>	<u>x</u>
Total assets			<u>x</u>
CAPITAL AND LIABILITIES			
Capital and reserves			
Capital b/fwd		x	
Profit/(loss)		x	
Drawings		<u>(x)</u>	
Capital c/fwd			x
Non-current liabilities			
Interest bearing borrowings			x
Current liabilities			
Trade and other payables		x	
Accrued expenses		x	
Operating overdrafts		x	
		<u>x</u>	<u>x</u>
Total capital and liabilities			<u>x</u>

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Receivables

- ∩ A general term for persons or entities who owe the enterprise money.
- ∩ Balance sheet amount is after deducting the *provision* or *allowance for doubtful debts* (representing the amount which may not be received).

Prepayments

- ∩ Amounts paid on or before the balance sheet date which relate to a period after the balance sheet date.

Cash

- ∩ Cash on hand (cheques, notes and coins) and demand deposits with a bank.
- ∩ If a bank account is overdrawn it is not an asset but a liability.

Liabilities

Financial Obligations of an enterprise.

- l Imply legal responsibilities to other parties.
- l Comprise *external* liabilities (eg to suppliers of goods) and *internal* liabilities (to owners, whether shareholders, partners or the proprietor).
- l Categorised by time.

Non-current liabilities

- ∩ Enterprises are frequently financed by credit obtained from sources other than the owners eg interest-bearing loans. A loan due to be repaid in 2004 will be a non-current liability in the 1999 balance sheet.

Current liabilities

- ∩ Amounts owed by the business falling due for payment *within one year* of the balance sheet date.

Accrued expenses

- ∩ Amounts which have not been invoiced to the business at the balance sheet date, but which are known to be due.

Income Statement

A statement of the *financial performance* of the enterprise over a period of time.

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Description

- ∩ The income statement comprises
 - A *trading* account summarising trading transactions (Revenue – Cost of sales = Gross profit)
 - An *income and expenditure* account (all other items of I&E legitimately earned as a result of business activities).

Proforma

- ∩ Points to note – For a *manufacturing* enterprise, the cost of goods sold will be manufacturing cost (ie including production labour and overheads), not just raw material purchase cost.

INCOME STATEMENT FOR THE YEAR ENDED. . . .		
	\$	\$
Revenue		
Less Cost of sales		
Opening inventory	x	
Add Purchases	x	
	—	
Less Closing inventory	(x)	
		(x)
Gross profit		x
Other operating income		x
Less Expenses		
Distribution costs	x	
Administrative expenses	x	
	—	
		(x)
Net profit		x

Trading account

Revenue

- ∩ Revenue reflects *all* sales made to customers in the year, regardless of whether or not they have been paid for.
- ∩ A sale is usually recognised as taking place when goods are despatched (or services provided) to a customer. The balance sheet reflects, as trade receivables, the extent to which credit sales made to customers have not been settled for cash.

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Cost of sales

- ∩ This is the cost of goods actually sold.
- ∩ Costs incurred are "matched" with revenues earned.

Example

Gilda starts a business selling shoes. During the first accounting period she

- (i) buys 100 pairs from a supplier for \$30 each
- (ii) sells 20 pairs for \$62 each.

Solution

Profit has been realised to the extent that sales have been made, ie on 20 pairs of shoes. This could be calculated as

	\$	
Turnover (20 × \$62) =	1,240	
Less Cost (20 × \$30) =	(600)	

Gross profit	640 (ie 20 × [62 – 30])	

However, this presentation only gives limited information about trading performance. The trading account is more informative in showing

- ∩ total purchases (100 × 30 = \$3,000); and
- ∩ goods that remain unsold (ie inventory 80 × 30 = \$2,400).

Trading activities are presented as

	\$	\$
Revenue (20 pairs)		1,240
Purchases (100 pairs)	3,000	
Less Closing inventory (80 pairs)	2,400	

Cost of sales (ie cost of goods sold)		600

Gross profit		640

Example

During the next accounting period Gilda

- (i) buys 20 pairs of shoes at \$30 each

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(ii) sells 90 pairs at \$62 each.

Solution

Part of the current period's revenue will come from opening inventory.

	\$	\$
Revenue (90 × \$62)		5,580
Opening inventory (80 pairs <i>Illustration 1</i>)	2,400	
Purchases (20 × \$30)	600	
	<u>3,000</u>	
<i>Available for sale</i>	3,000	
Less Closing inventory (10 pairs)	(300)	
	<u> </u>	
Cost of goods (<i>actually</i>) sold (90 pairs)		2,700
		<u> </u>
Gross profit (check 90 × [\$62– 30])		2,880
		<u> </u>