Exercise walk-through

Financial statements ▪ 10.1

eXercise

You must be able to

- calculate gross, operating and net profit
- describe what the statement of financial position shows
- analyse and evaluate how stakeholders use financial statements

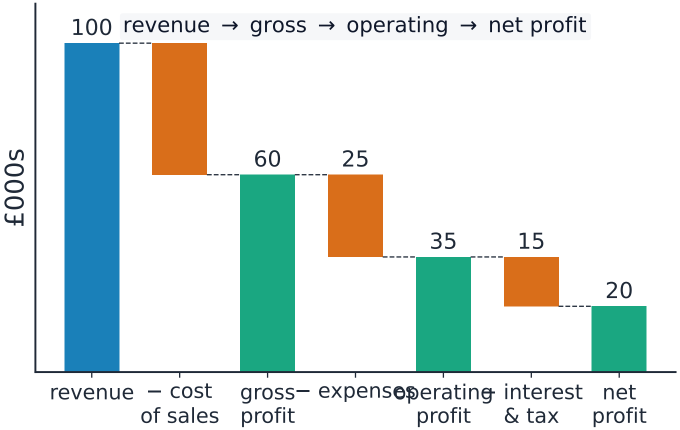
Method — Income statement and balance sheet

$$\text{gross profit} = \text{revenue} - \text{cost of sales}$$

- **Worked:** revenue \$500,000, cost of sales \$300,000 $\rightarrow$ gross profit $= \$200{,}000$.
- **Statement of financial position:** assets $=$ liabilities $+$ equity (it always balances).
- **Depreciation:** spreads a fixed asset's cost over its life, so profit is not overstated.

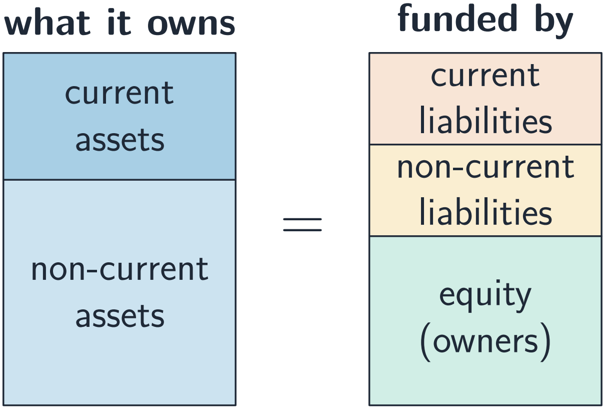
Answer shapes: AO1 + AO2 + AO3 (reasoning chain) + AO4 (a supported judgement *in context*).

Method — Income statement and balance sheet



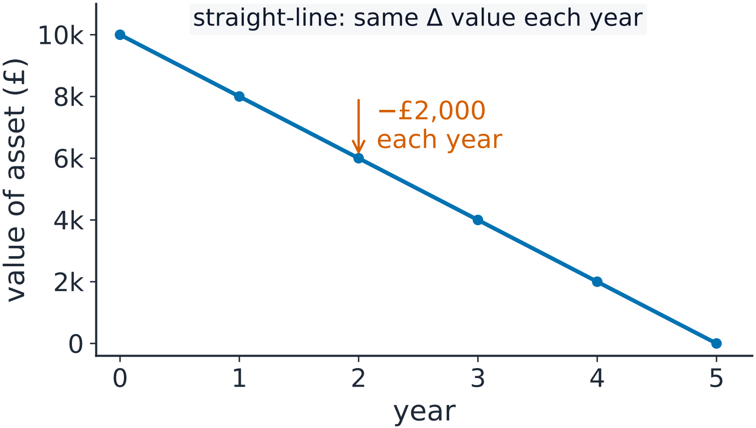
The income statement steps down from revenue to net profit

Method — Income statement and balance sheet



The two sides always balance: assets equal liabilities plus equity

Method — Income statement and balance sheet



Straight-line depreciation lowers an asset's value by the same amount each year

Practice 2.1 ▪ 2 marks

State the formula for *gross profit*.

Solution 2.1

Method: Income statement and balance sheet

Worked steps

gross profit = revenue − cost of sales (2 for the correct formula; 1 for a partial idea).

Practice 2.2 ▪ 2 marks

A firm has revenue of $400,000 and cost of sales of $250,000. Calculate its gross profit.

Solution 2.2

Method: Income statement and balance sheet

Worked steps

$\$400{,}000 - \$250{,}000 = \$150{,}000$ (2; award 1 for a correct method with the wrong figure).

Practice 2.3 ▪ 2 marks

Define the term *depreciation*.

Solution 2.3

Worked steps

spreading the cost of a non-current (fixed) asset over the years it is used, rather than all at once (2 for a clear definition; 1 for a partial idea).

Exam-style 3.1 ▪ 3 marks

Explain one reason why a company must publish its financial statements.

Solution 3.1

Worked steps

[3] **AO1** 1 — give a reason (it is a legal requirement; to inform shareholders; for tax). **AO2** up to 2 — develop it, e.g. publishing the accounts lets shareholders see the profit and return → they can decide whether to keep their shares → meeting the legal duty of a company (2 developed / 1 limited).

Exam-style 3.2 ▪ 8 marks

Analyse how two different **stakeholders** would use a firm's financial statements.

Solution 3.2

Worked steps

[8] For **each** of two stakeholders: **AO1** 1 + **AO2** 1 + **AO3** up to 2. Example chains — *a lender*: reads the statements → checks profit and existing debt → decides whether the firm can repay a new loan. *An investor*: reads the profit and ROCE → judges the return on their money → decides to buy or sell shares. Maximum 4 per stakeholder, 8 total.

Exam-style 3.3 ▪ 12 marks

‘Financial statements alone show how well a business is performing.’ Evaluate this view.

Solution 3.3

Method: Income statement and balance sheet

Worked steps

[12] **AO1** 2 / **AO2** 2 / **AO3** 2 / **AO4** up to 6. **For:** statements give clear, comparable figures on profit, assets and debt that show financial health. **Against:** they use past data, ignore non-money factors (brand, staff morale, market position) and can be window-dressed. Judgement: statements are essential but not enough on their own — a full view also needs ratios over time and non-financial information; their usefulness depends on what they are compared with.