2.4 Financial statements

Name: _____ Class: _____ Date: _____ **Total: 20 marks**

KEY WORDS income statement • statement of financial position

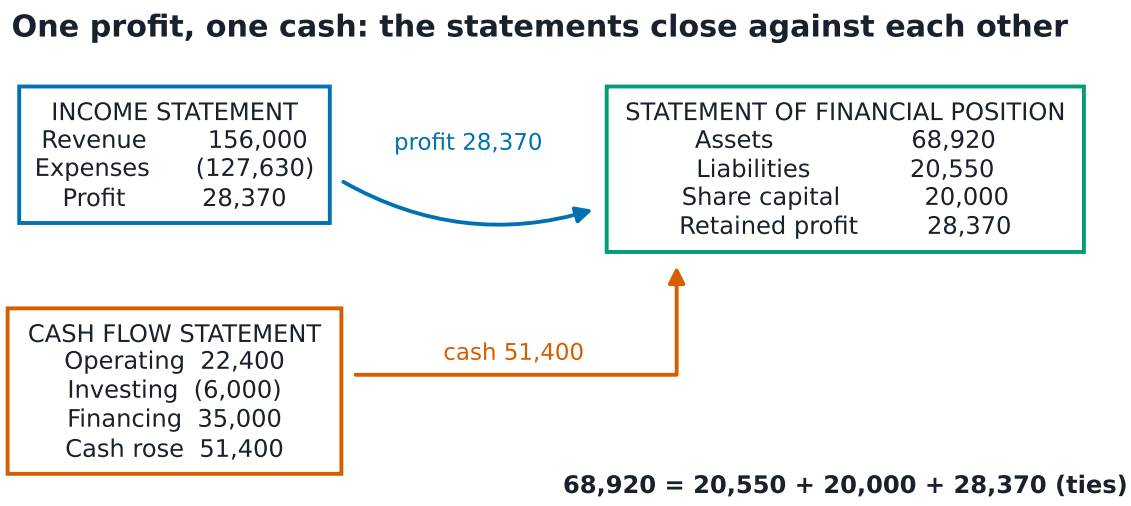
Objective

Prepare an income statement and statement of financial position, link them through profit and equity, and present them so a non-accountant can read both.

1 Key knowledge and worked examples

■ Two statements, one company

The **income statement** reports the period's income and matched expenses; the **statement of financial position** lists assets against liabilities and equity at a date, with the profit already inside equity as retained earnings. Nothing new is invented at statement stage.



One profit, one cash: the statements close against each other

■ Worked example. Nimbus year 1

Income statement: revenue 156,000, cost of sales 62,400, gross 93,600; wages 52,000, rent 3,000, other 8,000, depreciation 1,080, electricity 250, interest 900 – profit 28,370. Balance sheet: assets 68,920 = liabilities 20,550 + equity 48,370 ✓ (machine-verified).

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2 Practice

2.1 From Nimbus's figures, restate the income statement in the "non-accountant" order: what came in, what the bread cost, what running the business cost, what was left – and give each subtotal. [4]

2.2 Nimbus pays a £5,000 dividend from year-1 profit. State the effect on the income statement and on the balance-sheet equity. [3]

2.3 A junior drops the depreciation line from the balance sheet's equipment entry. Quantify both effects of that single omission. [3]

3 Exam-style questions

3.1 The café of sheet 2.3, fully assembled: owner contributed £20,000 and took a £25,000 loan (5%, interest unpaid) on 1 January; equipment £9,000 bought for cash; purchases £39,000 paid (closing inventory £2,600); revenue £98,000 of which £6,000 is receivables; wages £34,000 with £800 accrued; rent £9,600 paid (£1,600 expensed); other costs £7,300 paid; electricity £180 unpaid. Assemble the statement of financial position and verify the tie. [7]

3.2 Explain to a non-accountant why the balance sheet "balances" – and why that is a property of the definitions, not of good luck. [3]

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Solutions

2.1

- What came in: revenue 156,000.
- What the bread cost: 62,400, leaving gross 93,600 (60.0%).
- Running the business: 52,000 + 3,000 + 8,000 + 1,080 + 250 + 900 = 65,230.
- What was left: 93,600 − 65,230 = 28,370 ✓.

2.2

- No income-statement effect: dividends distribute profit, they are not an expense.
- Equity falls to 20,000 + 28,370 − 5,000 = 43,370.
- Cash falls 5,000; the balance sheet re-ties at both totals 63,920.

2.3

- Assets overstated by 1,080 (equipment at 6,000 not 4,920).
- Equity overstated by 1,080 (profit overstated, depreciation missed).
- The balance sheet still ties – the omission is symmetric, which is why it is caught by review, not by the tie.

3.1

- Cash: 20,000 + 25,000 + 92,000 − 9,000 − 39,000 − 33,200 − 9,600 − 7,300 = 38,900.
- Assets: 38,900 + receivables 6,000 + prepayment 8,000 + inventory 2,600 + equipment 6,875 = 62,375.
- Liabilities: wages 800 + electricity 180 + interest 1,250 + loan 25,000 = 27,230.
- Equity: 20,000 + profit 15,145 = 35,145.
- Tie: 27,230 + 35,145 = 62,375 ✓ (machine-verified).

3.2

- Every transaction is recorded as a double effect that preserves the equation, so the totals cannot drift apart.
- Profit flows into equity by definition; cash lands in assets by definition.
- The balance is an identity of the definitions – errors hide INSIDE the sides, which is why review is needed.