

# LECTURE 4

# INTRODUCTION TO FINANCIAL STATEMENTS

# LEARNING OUTCOMES

Upon completion of the lecture, the students should be able to:

- Understand the format of Trading and Profit and Loss account and Balance Sheet.
- Construct the above financial statements without any year end adjustments.

# **Trading and Profit and Loss Accounts**

- **The main reason why people establish businesses is to make profit. The calculation of profits and losses is arguably the most important objective of the accounting function. Among the benefits of knowing what profits are being made of are listed below:**
- **Planning ahead**
- **Obtaining loans**
- **Telling prospective business partners about how successful the business is**
- **Telling someone who may be interested in buying the business about how successful the business is**
- **Tax purposes**



# Gross Profit and Net Profit

- **Gross Profit**

**Is calculated in the Trading account. Gross profit is the excess of sales revenue over the cost of goods sold. Where the cost of goods sold is greater than the sales revenue, the result is gross loss.**

- **Net Profit**

**Is calculated in the Profit and Loss Account. Net profit is the excess of Gross profit over other expenses. Where other expenses is greater than the gross profit, the result is net loss.**



**Gross profit = Sales revenue > Cost of goods sold**

**Gross loss = Sales revenue < Cost of goods sold**



**Net profit = Gross profit > Other expenses**

**Net loss = Gross profit < Other expenses**

**Business's name**  
**Trading and Profit and Loss Account**  
**For the Year Ended 31 December 20x7**

	[\$]	[\$]	[\$]
Sales			XXXX
Less: Returns inwards			[xx]
<b>Net sales</b>			<b>xxx</b>
 <b>Less: Cost of Goods Sold</b>			
Opening stock		xxx	
Purchases	xxx		
Less: Returns outwards	[xxx]	[xxx]	
		<b>xxx</b>	
Carriage inwards		xx	
		<b>xxx</b>	
Less: Closing stock		[xxx]	[xx]
<b>Gross Profit / [loss]</b>			<b>xxx</b>
 <b>Less: Other Expenses</b>			
Rent		xx	
Carriage outwards		xx	[xx]
<b>Net profit / [loss]</b>			<b>xx</b>

# Balance Sheet

- **The balance sheet shows the financial position of an organisation at a point in time. It presents a snapshot of the organisation at the date when it was prepared. It lists the balances according to whether they are assets, liabilities, or owner's equity [capital].**
- **In addition, in the balance sheet, the assets and the liabilities are classified as current or non-current.**

- **Current Assets**

**These are cash or other assets that are expected to be converted to cash, sold or consumed within 12 months after the end of the last financial period of the entity. Examples of current assets are cash, debtors, bills receivables due within one year, prepaid expenses, and stock.**



- **Non-current Assets**

**These are all assets other than current assets. These assets are not held for sale but rather they are used to operate the business. Examples of non-current assets are land, buildings, and furniture and fixtures.**

- **Current Liabilities**

**Current liabilities are debts that are due to be paid by the business or entity within one year after the end of the entity's financial period. Examples of current liabilities are creditors, loans payable due within one year, salary payable, unearned revenue, and interest payable owed on loans taken.**



- **Non-current Liabilities**

**All liabilities that are not current are classified as non-current liabilities. Example of non-current liabilities is the loans payable (due more than one year).**

**Business's name**  
**Balance Sheet**  
**as at 31 December 20x7**

	[\$]	[\$]
<b>Fixed assets</b>		
Land		XXXX
 <b>Current assets</b>		
Stock	XX	
Debtors	XX	
Cash	XX	
	XXX	
<b>Less: Current liabilities</b>		
Creditors	[XX]	
<b>Net current assets</b>		<b>XXX</b>
		<b>XXX</b>
<b>Less: Non-current liabilities</b>		<b>[XX]</b>
		<b>XX</b>
 <b>Owner's equity</b>		
Capital		XXX
Net profit		XXX
Less: Drawings		[XX]
		<b>XX</b>