Go to index

Topic 9

Financial statements

After studying this chapter, you should be able to:
- complete the statement of comprehensive income/income statement of a service undertaking and a retail business,
- complete the statement of financial position/balance sheet of a service undertaking and of a retail business.

9.1 Introduction

The purpose of a business is to render a service in a service undertaking to obtain an income to increase the profit or to sell goods at a higher price in a retail business to create a profit. During the financial year all the entries are recorded in the subsidiary journals and posted to the ledger accounts. At the end of the financial year the trial balance is used to complete the financial statements.

Question 1

What is the main purpose of a business?

9.1.1 Accounting cycle

We will look at the accounting cycle so that you can understand where the financial statements fit in.

Step 1:	Each transaction is recorded on a source documents.
Step 2:	Transactions are completed in the subsidiary journals.
Step 3:	At the end of the month al the entries in the subsidiary journals are posted to the accounts in the general ledger.
Step 4:	A trial balance is prepared from the balances in the general ledger.
Step 5:	The trial balance is used to complete the income statement (Income and expenses to calculate profit and Balance sheet (Assets, liabilities and equity accounts).
Step 6:	Financial statements are analysed and interpreted to make decisions for future planning.

Question 2

Provide the accounting cycle in the correct order.

9.2 Financial statements

9.2.1 Statement of comprehensive income (previously called an income statement)

The main purpose of a service undertaking is to render services to make a profit. The purpose of a retail business entity is to sell trading stock at a higher price to make a profit.

The financial year can start at any month of the year for example 1 March stretching over the next 12 months. The financial year will end every year on the same date.

At the end of the financial year the total income and expenses for the financial year must be recorded in the statement of comprehensive income (income statement) to determine the net income.

Net profit is the difference between the total income and the total expenses for the financial year.

Question 3

What is the main purpose of an income statement?

9.2.2 Statement of financial position (balance sheet)

The financial position of a business is reflected in the balance sheet where all the balances of assets, liabilities and owner's equity are recorded on the last day of the financial year.
The statement of financial position must balance, because:

ASSETS = OWNER'S EQUITY AND LIABILITIES

Balance sheet
Equity:
Capital/ Drawings

Balance sheet accounts:
Assets:
- Land and buildings
- Equipment & machinery
- Vehicles
- Investments
- Bank, petty cash, cash float
- Inventories
- Debtors control

Liabilities:
- Loans
- Creditors control

Income statement
Nominal accounts (N-accounts):
Income:
- Rent income
- Interest income
- Sales

Expenses:
- Cost of sales
- Rent expense
- Water and electricity
- Insurance
- Advertising
- Salaries
- Telephone

The net profit increases the owner's equity while the net loss decreases the owner's equity.

Question 4

What is the main purpose of a balance sheet?

9.2.3 Financial statements of a service undertaking

The main purpose of a service undertaking is to render services to make a profit. Businesses must keep the expenses as low as possible to increase the profit. The statement of comprehensive (income statement) is prepared to calculate the financial profit. The statement of financial position (balance sheet) is prepared in to determine the financial position at the end of the financial year.

Example 1

The following information was obtained from the accounting records of Kim's Hairdresser.

Kim's Hairdresser **Trial balance on 30 June 2024**			
	Fol	**Debit**	**Credit**
Balance sheet accounts section			
Capital	B1		30 300
Drawings	B2	2 000	
Equipment	B3	30 000	
Bank	B4	6 200	
Petty cash	B5	500	
Fixed deposit: ABSA	B6	5 000	
Loan: Nedfin	B7		10 000
Nominal accounts section			
Current income	N1		70 000
Rent expense	N2	12 600	
Salaries	N3	28 400	
Material cost	N4	19 600	
Telephone	N5	2 300	
Water and electricity	N6	2 500	
Stationery	N7	400	
Insurance	N8	800	
		110 300	110 300

1. Complete the statement of comprehensive income for the year ended 30 June 2024.

Kim's Hairdresser **Statement of comprehensive income for the year ended 30 June 2024**	
Current income	⊙70 000
Less current expenses	✦(66 600)
Rent expense	♦12 600
Salaries	♦28 400
Material cost	♦19 600
Telephone	♦2 300
Water and electricity	♦2 500
Stationery	♦400
Insurance	♦800
Net profit for the year	■3 400

The format of the statement of comprehensive income:

The income is recorded first:

- Current income/Services rendered⊙
- Any other income, for example rent income, commission income, etc.

Then the expenses are recorded:

- Operating expenses are determined adding all the expenses together.✦
- All the individual expenses♦ are written in the block to calculate the total.

The net profit or loss:■

The net profit is calculated subtracting the operating expenses✦ from the income.⊙

- When the income is more than the operating expenses, a net profit is made.
- When the operating expenses is more than the income, a net loss is made.

2. Complete the statement of financial position on 30 June 2024.

Kim's Hairdresser		
Statement of financial position (balance sheet) on 30 June 2024		
ASSETS		
Non-current assets❖		**35 000**
Fixed assets		⬩30 000
Financial assets: Fixed deposit: ABSA		5 000
Current assets⌧		**6 700**
Trading and other receivable		-
Cash and cash equivalents		❈6 700
Total assets✽		41 700
EQUITY AND LIABILITIES		
Owner's equity✶		**✶31 700**
Non-current liabilities🌢		**10 000**
Loan: Nedfin		10 000
Current liabilities⌧		**-**
Trade and other payable		-
Total equity and liabilities⌘		41 700

The format of the statement of financial position:

The assets are disclosed at the top and includes the following:

Non-current assets:❖ (is divided between the following)

- Fixed assets, for example land and buildings, equipment, vehicles.
- Financial assets, for example fixed deposit, shares in other companies.

Current assets:⌧ (consist of the following)

- Trading stock.
- Trade and other receivables.
- Cash and cash equivalents, for example bank, petty cash and cash float.

Total assets.✽

The equity and liabilities appear below the total assets and is divided as follows:

Equity consist of the balance in the capital account plus net profit less drawings.✶

The liabilities are divided as follows:

Non-current liabilities: 🌢 (consist of the following)

- Mortgage loan, Loan.

Current liabilities:⌧ (consist of the following)

- Trade and other payables.
- Bank overdraft

Total equity and liabilities⌘

3. Complete the notes to the statement of financial position on 30 June 2024.

Kim's Hairdresser		
Notes to the statement of financial position		
1.	Fixed assets	
	Land and buildings	-
	Equipment	30 000
	Vehicles	-
		⬩30 000
2.	Cash and cash equivalents	
	Bank	6 200
	Petty cash	500
		❈6 700
3.	Owner's equity	
	Capital balance according to capital account	30 300

	Plus net profit	3 400
		33 700
	Less drawings	(2 000)
		✶31 700

The above notes are completed to indicate how the amounts in the balance sheet is calculated. After the notes are completed, the totals are entered in the balance sheet.

Question 5

How is the net profit or net loss calculated?

Question 6

6.1 Why must the balance sheet be prepared in a specific format?

6.2 What is included in the balance sheet to determine the total assets?

6.3 What is included in the balance sheet to determine the total equity?

6.4 What is included in the balance sheet to determine the total liabilities?

Question 7

The following information was obtained from the accounting records of Titans Transport.

Titans Transport **Trial balance at 31 August 2024**			
	Fol	**Debit**	**Credit**
Balance sheet accounts section			
Capital	B1		20 000
Drawings	B2	3 000	
Vehicles	B3	43 000	
Bank	B4	9 200	
Petty Cash	B5	500	
Fixed deposit: Nedbank	B6	3 000	
Loan: Nedcor	B7		9 000
Loan: ENB	B8		4 000
Nominal accounts section			
Current income	N1		85 000
Rent expense	N2	7 600	
Salaries	N3	18 100	
Vehicle expenses	N4	**?**	
Telephone	N5	2 300	
Water and electricity	N6	2 500	
Stationary	N7	400	
Insurance	N8	2 800	
		118 000	118 000

7.1 Calculate the missing "vehicle expenses" amount in the provided trial balance.

7.2 Complete the amounts in the statement of comprehensive income for the year ended 31 August 2024.

Titans Transport **Statement of comprehensive for the year ended 31 August 2024**	
Current income	
Minus Current expenses	
Rent expense	
Salaries	
Vehicle expenses	
Telephone	
Water and electricity	
Stationary	
Insurance	
Net profit for the year	

7.3 Complete the statement of financial position at 31 August 2024.

Titans Transport **Statement of financial position (balance sheet) at 31 August 2024**		
ASSETS		
Non-current assets		
Fixed assets		
Financial assets: Fixed deposit: Nedbank		
Current assets		
Trade and other receivables		
Cash and cash equivalents		
Total assets		
EQUITY AND LIABILITY		
Equity		
Non-current liabilities		
Loan: Nedcor		
Loan: EBN		
Current liabilities		
Trade and other receivables		
Total equity and liabilities		

7.4 Complete the notes for the statement of financial position.

Titans Transport **Notes to the statement of financial position**		
1.	Fixed assets	
	Land and buildings	-
	Equipment	
	Vehicles	

2.	Cash and cash equivalents	
	Bank	
	Petty cash	
3.	Owner's equity	
	Capital balance according to capital account	
	Plus net profit	
	Less drawings	

Question 8

The following information is obtained from the accounting records of Tillie Garden Services:

Tillie Garden Services **Trial balance on 28 February 2024**			
	Fol	**Debit**	**Credit**
Balance sheet accounts section			
Capital	B1		1 222 647
Drawings	B2	102 000	
Land and buildings	B3	300 000	
Equipment	B4	1 200 000	
Vehicles	B5	85 000	
Bank	B6	103 147	
Petty cash	B7	4 300	
Fixed deposit: FNB	B8	15 000	
Mortgage loan	B9		205 000
Nominal accounts section			
Current income	N1		690 500
Commission income	N2		13 000
Salaries	N3	200 000	
Stationery	N4	3 800	
Insurance	N5	21 000	
Wages	N6	67 000	
Repairs	N7	6 500	
Water and electricity	N8	23 400	
		2 131 147	2 131 147

8.1 Complete the statement of comprehensive income for the year ended 28 February 2024.

Tillie Garden Services **Statement of comprehensive for the year ended 28 February 2024**	
Current income	
Other income	
Commission income	
Minus Current expenses	
Salaries	
Stationery	
Insurance	
Wages	
Repairs	
Water and electricity	
Net profit for the year	

8.2 Complete the statement of financial position on 28 February 2024.

Tillie Garden Services **Statement of financial position (balance sheet) on 28 February 2024**		
ASSETS		
Non-current assets		
Fixed assets		
Financial assets: Fixed deposit: Nedbank		
Current assets		
Trade and other receivables		
Cash and cash equivalents		
Total assets		
EQUITY AND LIABILITY		
Equity		
Non-current liabilities		
Mortgage loan: ABSA		
Current liabilities		
Trade and other receivables		
Total equity and liabilities		

8.3 Complete the notes to the statement of financial position

Tillie Garden Services **Notes to the statement of financial position op 28 February 2024**		
1.	Fixed assets	
	Land and buildings	
	Equipment	
	Vehicles	
2.	Cash and cash equivalents	
	Bank	
	Petty cash	
3.	Owner's equity	
	Capital balance according to capital account	
	Plus net profit	
	Less drawings	

7.2.4 Financial statements of a trading concern

The main purpose of any business is to make a profit. In a trading concern goods are purchased with the purpose to sell to make a profit. Businesses must keep the expenses as low as possible to increase the profit. The statement of comprehensive (income statement) is prepared to calculate the financial profit. Then the statement of financial position (balance sheet) is prepared in to determine the financial position at the end of the financial year.

Example 2

The following information is obtained from the accounting records of Wool Shop that buys and sells wool. The business maintains a profit mark-up of 70% on cost price.

Wool Shop
Trial balance on 28 December 2024

	Fol	Debit	Credit
Balance sheet accounts section			
Capital	B1		?
Drawings	B2	3 000	
Equipment	B3	22 000	
Bank	B4	9 000	
Petty cash	B5	1 700	
Fixed deposit: Nedbank	B6	5 000	
Loan: Nedcor	B7		16 000
Nominal accounts section			
Sales	N1		**?**
Cost of sales	N2	48 000	
Interest on fixed deposit	N3		300
Rent expense	N4	7 600	
Salaries	N5	18 100	
Telephone	N6	1 900	
Water and electricity	N7	1 500	
Stationery	N8	400	
Interest expense	N9	1 920	
		120 120	

2.1 Calculate the missing figure for "sales" in the trial balance.

Cost price	100%	48 000	
Profit	70%		
Sales price	170%	48 000 x 170/100	81 600

2.2 Calculate the capital balance.

Debit - total		120 120
Credit - total	16 000 + 81 600 + 300	(97 900)
Capital balance		22 220

2.3 Calculate the annual percentage interest payable on the loan.

$$\frac{y}{100} \times \frac{16\ 000}{1} = 1\ 920$$

$$Y = \frac{1\ 920}{16\ 000} \times 100 = 12\%$$

2.4 Calculate the annual percentage interest on the fixed deposit.

$$\frac{y}{100} \times \frac{5\ 000}{1} = 300$$

$$Y = \frac{300}{5\ 000} \times \underline{100}$$

6%

2.5 Complete the statement of comprehensive income for the year ended 31 December 2024.

Wool Shop **Statement of comprehensive income for the year ended 31 December 2024**	
Sales	81 600
Cost of sales	(48 000)
Gross profit	33 600
Other current income	-
Commission income	-
Current liabilities	(29 500)
Rent expense	7 600
Salaries	18 100
Telephone	1 900
Water and electricity	1 500
Stationery	400
Operating profit	4 100
Interest income	300
Profit before interest expense	4 400
Interest expense	(1 920)
Net profit for the year	2 480

2.6 Complete the statement of financial position on 31 December 2024.

Wool Shop **Statement of financial position (balance sheet) at 31 December 2024**		
ASSETS		
Non-current assets		27 000
Fixed assets	1	22 000
Financial assets: Fixed Deposit Nedbank		5 000
Current assets		10 700
Trade and other receivables		-
Cash and cash equivalents	2	11 700
Total assets		37 700
EQUITY AND LIABILITIES		
Equity	3	21 700
Non-current liabilities		16 000
Loan: Nedcor		16 000
Current liabilities		-
Trade and other payables		-
Total equity and liabilities		37 700

2.7 Complete the notes to the statement of financial position.

Notes to the statement of financial position		
1.	Fixed assets	
	Land and buildings	-
	Equipment	22 000
	Vehicles	-
		22 000
2.	Cash and cash equivalents	
	Bank	9 000
	Petty cash	1 700
		10 700
3.	Owner's equity	
	Capital balance according to ledger account	22 220
	Plus net profit	2 480
		24 700
	Less drawings	(3 000)
		21 700

Go to index

Question 9

The following information was obtained from the accounting records of Persian Stores.

Persian stores Trial balance at op 31 December 2024			
	Fol	**Debit**	**Credit**
Balance sheet accounts section			
Capital	B1		25 000
Drawings	B2	3 000	
Equipment	B3	42 000	
Bank	B4	9 000	
Petty cash	B5	1 700	
Fixed deposit: Nedbank	B6	3 600	
Loan: Nedcor	B7		8 000
Nominal accounts section			
Sales	N1		**?**
Interest income	N2		2 000
Rent expense	N3	7 600	
Salaries	N4	18 100	
Cost of sales	N5	31 000	
Telephone	N6	2 300	
Water and electricity	N7	2 500	
Stationary	N8	400	
Interest expense	N9	2 800	
		124 000	124 000

9.1 Calculate the missing "Sales" amount in the provided trial balance.

9.2 Complete the state of comprehensive income for the year ended 31 December 2024.

Persian Stores Statement of comprehensive income for the year 31 December 2024.	
Sales	
Cost of sales	
Gross profit	
Other operating income	
Commission received	
Operating expenses	
Salaries and wages	
Sundry expenses	
Operating profit	
Interest received	
Profit before interest expense	
Interest expense	
Net profit for the year	

9.3 Complete the statement of financial position at 31 December 2024.

Persian Stores **Statement of financial position (balance sheet) at 31 December 2024.**	
ASSETS	
Non-current assets	
Fixed assets	
Financial assets: Fixed Deposit Nedbank	
Current assets	
Trade and other receivables	
Cash and cash equivalents	
Total assets	
EQUITY AND LIABILITIES	
Equity	
Non-current liabilities	
Loan: Nedcor	
Current liabilities	
Trade and other payables	
Total equity and liabilities	

9.4 Complete the notes to the statement of financial position on 31 December 2024.

Notes to the statement of financial position		
1.	Fixed assets	
	Land and buildings	-
	Equipment	
	Vehicles	
2.	Cash and cash equivalents	
	Bank	
	Petty cash	
3.	Owner's equity	
	Capital balance according to ledger account	
	Plus net profit	
	Less drawings	

Go to index

Questions

1. Which ledger account balances must be recorded in the statement of comprehensive income?
2. Which ledger account balances must be recorded in the statement of financial position?
3. What is the purpose of the statement of comprehensive income?
4. What is the purpose of the statement of financial position?
5. Why is the statement of financial position divided in two sections?
6. Why are the notes completed for the statement of financial position?
7. How are the assets divided in the statement of financial position?
8. How are the liabilities divided in the statement of financial position?
9. How is the gross profit calculated in the statement of comprehensive income?
10. How is the net profit calculated in the statement of comprehensive income?
11. Why is the net profit lower than the gross profit?
12. How is the equity calculated in the statement of financial position?

Solution

1. Income and expenses.
2. Assets, liabilities and equity.
3. Calculate the profit for the year.
4. Calculate the financial position on the last day of the financial year.
5. According to the accounting equation Assets = Equity + liabilities.
   The assets are recorded in the top part of the statement of financial position. The equity and liabilities are recorded in the bottom part. The total of the assets must be equal to the total of equity and liabilities.
6. Calculate the amounts recorded in the statement of financial position.
7. Non-current assets and current assets.
8. Non-current liabilities and current liabilities.
9. Sales less cost of sales.
10. Income less expenses.
11. The net profit is determined after all the expenses are deducted.
12. Capital balance in the ledger plus net profit less drawings.

Go to index

Terms and concepts

Cash and cash equivalents:	Consist of money in the current bank account, money in the petty cash to pay small amounts and cash float in the till.
Consumable stores:	Goods purchased to use in the business, for example stationery, consumable stores, packing material, oil, petrol, cleaning materials and refreshments.
Current assets:	Assets used where the value will change in the next twelve months, for example trading stock, debtors, bank balance, petty cash and cash float.
Current liabilities:	Liabilities where the value will change in the next twelve months, for example creditors and bank overdraft.
Expenses:	Expenses reduce the profit.
Gross operating income:	Gross profit and other income.
Gross profit:	The difference between sales and cost of sales.
Income:	Income increases profit.
Interest expense:	Interest paid on a loan to decrease the profit.
Interest income:	Interest received on a fixed deposit to increase the profit.
Net profit:	The difference between income and expenses.
Non-current assets:	Assets that will have the same value for more than a year in the future, for example land and buildings, vehicles, equipment and fixed deposit.
Non-current liabilities:	Liabilities that will have the same value for more than a year in the future, for example loan, mortgage loan.
Statement of comprehensive income:	All the income and expenses are recorded in the statement of comprehensive income to calculate profit for the year.
Statement of financial position:	All the assets, liabilities and equity are recorded in the statement of financial position of the business at the end of the financial position.
Service undertaking:	A business that renders a service to earn an income to make the profit.
Trading concern:	A business buying goods to sell to create an income to generate a profit.
Trading stock:	Goods purchased with the purpose to sell.