

**FINANCIAL ACCOUNTING
WEEK 9 (LECTURE NINE)**

PREPARATION OF THE STATEMENT OF COMPREHENSIVE INCOME

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Learning Objectives:

Upon completion of this Lesson, you will be able to:

- Explain the meaning of the Statement of comprehensive Income
- Preparing of gross profit
- Appreciating Cost of Goods Sold (Cost of Sales)
- Prepare a Comprehensive Statement of Comprehensive Income

THE STATEMENT OF COMPREHENSIVE INCOME

A statement of comprehensive income is a broad financial metric that includes all incomes and expenses that affect a company's financial standing over a period.

Comprehensive income is the sum of a company's net income and other comprehensive income. For companies, comprehensive income sheds light on changes in equity. Since it includes net income and unrealized income and losses, it provides the big picture of a company's value.

Shareholders and investors mostly use this financial statement to determine a comprehensive understanding of a company's financial health. Learning how this statement works can help you create more accurate financial reports that give investors a better analysis of a company's performance.

Comprehensive income is a figure that represents the combined net income and other comprehensive income of a company. Companies use it to measure the changes in their equity over a certain period, and it includes net and unrealized income to provide a more comprehensive understanding of a company's value. Investors use comprehensive income to help them evaluate a company's performance compared to others, and it gives these stakeholders more information about the overall financial outlook of their investment.

Profit and Loss Account:

Initially, enterprises and organisation used to prepare a trading account which involved establishment of the Gross Profit and then Prepare a Profit and Loss account separately. In modern times this has however changed and the TWO accounts are combined to for a Statement of comprehensive Income for the given period.

The Profit and Loss account shows the net profit or net loss that the business has made from all the activities during a financial period. The net profit (or loss) is determined by deducting all the expenses from all the incomes of the same financial period.

In practice, the trading account is combined together with the net profit and loss account into one report called comprehensive statement of income (formerly, trading, profit and loss account) .

Importance of the statement of Comprehensive Income to users;

Comprehensive income allows companies to report more than just their net income. It also allows companies to disclose noncash items like depreciation and amortization, regularly. Companies may use comprehensive income for tax purposes, and it can help them follow the Financial Accounting Standards Board's accounting standards. In addition to its importance as an accounting entry, it's important for investors because it gives them a complete picture of a company's profitability. Comprehensive income can be useful for analyzing earnings stability over time.

The financial statement includes positive and negative items, such as losses and profits. It also helps investors understand how much of the company's total earnings come from its accounting and operating decisions. Comprehensive income also helps understand how a company performs relative to its competitors.

The statement of comprehensive income weighs all the expenses incurred by an entity and the incomes gained by the same. When the total revenues outweigh the total expenses, an entity makes profit and loss if the total revenues outweigh the total expenses.

ADJUSTMENTS TO FINANCIAL STATEMENTS

Revenue and costs must be recognized as they are earned or incurred, not as money is received or paid. They must be matched with one another so far as their relationship can be established or justifiably assumed, and dealt with in the profit and loss account of the period to which they

relate. Therefore, all incomes and expenses that relate to a particular financial period will be matched together to determine the profit for the year.

Before I delve into the format and deliberations on the comprehensive income, let me remind you of the changes which need to be taken care of before the income statement is made. These adjustments as covered in lesson week seven (7) change the figures in the Income statement and eventually the statement of financial position and the statement in changes in equity. These adjustments include; accrued expenses, accrued incomes, prepaid expenses, prepaid incomes, depreciation and appreciation of assets, bad debts and provision for bad and doubtful debts.

The income statement according to the IAS1 is prepared using the follow format:

Generally the Trading and Statement of comprehensive income will have the following format:

The income statement presents revenue, expenses, and net income. The components of the income statement include: revenue; cost of sales; sales, general, and administrative expenses; other operating expenses; non-operating income and expenses; gains and losses; non-recurring items; net income; and EPS.

Components of an Income Statement

The income statement may have minor variations between different companies, as expenses and income will be dependent on the type of operations or business conducted. However, there are several generic line items that are commonly seen in any income statement.

The most common income statement items include:

Revenue/Sales

Sales Revenue is the company's revenue from sales or services, displayed at the very top of the statement. This value will be the gross of the costs associated with creating the goods sold or in providing services. Some companies have multiple revenue streams that add to a total revenue line.

Cost of Goods Sold (COGS)

Cost of Goods Sold (COGS) is a line-item that aggregates the direct costs associated with selling products to generate revenue. This line item can also be called Cost of Sales if the company is a service business. Direct costs can include labor, parts, materials, and an allocation of other expenses such as depreciation (see an explanation of depreciation below).

Gross Profit

Gross profit is calculated by subtracting **Cost of Goods Sold** (or **Cost of Sales**) from Sales Revenue.

A gross profit margin is:
$$\frac{\text{Gross profit (Sales Revenue - COS/COGS)}}{\text{Sales Revenue}} \times 100$$

The ratio indicate the ability of the firm to control cost of sales expenses e.g gross profit margin of 40% means 60% of sales revenue was taken up by cost of sales while 40% was the gross profit. This means only 40 % is available to meet other operating expenses.

However if the cost of sales was 40% , the gross profit margin will be 60% , this leaves an organization with more resources to meet operational expenses and higher chances of something being left as net profit (Retained earnings)

Prudence business management entails keeping COS /COGS at management level.

Marketing, Advertising, and Promotion Expenses

Most businesses have some expenses related to selling goods and/or services. Marketing, advertising, and promotion expenses are often grouped together as they are similar expenses, all related to selling.

General and Administrative (G&A) Expenses

Selling, general, and administrative (SG&A Expenses) section that contains all other indirect costs associated with running the business. This includes salaries and wages, rent and office expenses, insurance, travel expenses, and sometimes depreciation and amortization, along with other operational expenses. Entities may, however, elect to separate depreciation and amortization in their own section.

EBITDA

While not present in all income statements, EBITDA stands for Earnings before Interest, Tax, Depreciation, and Amortization. It is calculated by subtracting SG&A expenses (excluding amortization and depreciation) from gross profit.

Depreciation & Amortization Expense

Depreciation and amortization are non-cash expenses that are created by accountants to spread out the cost of capital assets such as Property, Plant, and Equipment (PP&E)).

Operating Income (or EBIT)

Operating Income represents what's earned from regular business operations. In other words, it's the profit before any non-operating income, non-operating expenses, interest, or taxes are subtracted from revenues. EBIT is a term commonly used in finance and stands for Earnings before Interest and Taxes.

Interest

Income expense: It is common for companies to split out interest expense and interest income as a separate line item in the income statement. This is done in order to reconcile the difference between EBIT (Earnings before Interest and Tax) and EBT. (Earnings before Tax) Interest expense is determined by the debt schedule.

Other Expenses

Businesses often have other expenses that are unique to their industry. Other expenses may include fulfillment, technology, research and development (R&D), Stock-based compensation (SBC), Impairment charges, gains/losses on the sale of investments, foreign exchange impacts, and many other expenses that are industry or company-specific.

EBT (Pre-Tax Income)

EBT stands for Earnings before Tax, also known as pre-tax income, and is found by subtracting interest expense from Operating Income. This is the final subtotal before arriving at net income.

Income Taxes

Income Taxes refer to the relevant taxes charged on pre-tax income. The total tax expense can consist of both current taxes and future taxes.

Net Income (Retained Profit)

Net Income is calculated by deducting income taxes from pre-tax income. This is the amount that flows into retained earnings on the balance sheet, after deductions for any dividends.

FORMAT FOR A SOLE TRADER (ENTREPRENEUR)

FORMAT OF INCOME STATEMENT

**J FRANK
INCOME STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 20XX**

	\$.	\$
Sales		XXX
Less: Return inwards		(XXX)
		XXX
Less: Cost of goods sold		

Opening inventory	XXX	
Add: Purchases	XXX	
Add: Carriage inwards	XXX	
Less: Return inwards	(XXX)	
Cost of goods available for sale	XXX	
Less: Closing inventory	(XXX)	
Cost of sales		(XXX)
Gross profit		XXX
Add: Other incomes		
Rent received	XXX	
Discount received	XXX	
Commissioned received	XXX	XXX
		XXX
Less: Expenses		
Rent	XXX	
General expenses	XXX	
Rates	XXX	
Commission paid	XXX	
Postage	XXX	
Transport	XXX	
Carriage outwards	XXX	
Electricity	XXX	
Salaries and wages	XXX	
Bad debts	XXX	
Provision for bad debts	XXX	
Bank charges	XXX	
Insurance	XXX	
Audit fees	XXX	
Directors fees	XXX	
Depreciation	XXX	(XXX)
Net profit	XXX	XXX

FORMAT FOR COMPANY ACCOUNTS

XYZ

STATEMENT OF COMPREHENSIVE INCOME

FOR THE PERIOD ENDED 31-12.2xXX

Sales

xxx

Less return inwards

(xxx)

Net sales		XXX
Less cost of sales		
Opening stock	XXX	
Add purchases	XXX	
Carriage inwards	XXX	
Less return outwards	<u>(XXX)</u>	
Net purchases		
Goods available for sale	XXX	
Less closing stock	(XX)	
Cost of sales		XXX
Gross profit		
Add other incomes		
Discount received		XXX
Profit on disposal of assets		XXX
Income from investments		
Other incomes e.g. interest received from bank		XXX
Less: expenses		
Administrative expenses	XXX	
Operating expenses	XXX	
Selling and distribution expenses	XXX	
Debenture interest	XXX	
Audit fees	XXX	
Director's remuneration	XXX	
Amortization of goodwill	XXX	
Total expenses		XXX
Net profit for the period before tax		
Corporation tax		XXX
Net profit for the period after tax		XXX
Appropriation section:		
Net profit for the period after tax		XXX
Add retained profit b/f		XXX
Less transfers to general reserves	XXX	
Preference dividend		
Interim paid	XXX	
Final proposed	XXX	
Ordinary dividend		
Interim paid	XXX	

Final proposed
Retained profit

xxx

(xxx)
xxx

A Real Example of an Income Statement

GIGA ENTERPRISES STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2022

	\$'000'	\$'000'	\$'000'
Sales		872,000	
Sales returns (Returns in)		<u>(50,000)</u>	822,000
Less: Cost of Sales			
Opening Inventory		120,000	
Purchases	456,000		
Carriage Inwards	45,000		
Returns outwards	(62,000)		
Inventory Drawings	<u>(28,000)</u>	411,000	
Closing Inventory		<u>(140,000)</u>	<u>(391,000)</u>
GROSS PROFIT			431,000
Add Incomes:			
Rent income,			24,000
Discount Received			18,000
Commissions received			15,000
Gain on Disposal			30,000
Other incomes			<u>14,000</u>
			532,000
Less Total Expenses:			
Transport		17,000	
Electricity		8,000	
Advertising		11,000	
Water bills		19,000	
Salaries & Wages		48,000	
Rent & Rates		36,000	
Insurance		<u>22,000</u>	<u>(160,000)</u>
NET PROFIT for the year			<u>372,000</u>

ILLUSTRATIONS ONE: (WITH ADJUSTMENTS)

Equatorial Enterprises is a medium enterprise running a supply chain store. The following information relates to its activities for the year ended 31st December 2022.

**EQUATORIAL ENTERPRISES
TRIAL BALANCE
FOR THE YEAR ENDED 31ST DECEMBER 2022**

	Dr. \$ '000'	Cr. \$ '000'
Land & Buildings	8,000	
Motor Vehicles	6,000	
Inventory (01/01/2022)	3,000	
Sales & Purchases	28,000	52,700
Returns	2,000	1,000
Discounts	1,500	2,800
Rent	200	
Fixtures & fittings	4,000	
Creditors & debtors	5,000	4,000
Provision for Abd & Doubtful debts		300
Telephone	300	
Bad debts	2,000	
Electricity	300	
Carriage inwards	200	
General Expenses	3,000	
Carriage outwards	300	
Salaries & wages	4,000	
Drawings	2,000	
Capital	<u>-----</u>	<u>9,000</u>
	<u>69,800</u>	<u>69,800</u>

ADDITIONAL INFORMATION:

- (i) Inventory as at 31/12/2022 was \$ 2,000,000.
- (ii) Provision for bad and doubtful debts is to be increased to 5%.
- (iii) Rent outstanding at the end of the year amounted to \$150,000 while salaries and wages paid in advance amounted to \$ 160,000.

- (iv) Electricity and telephone bills prepaid were \$50,000 and \$ 150,000 respectively
- (v) General expenses in arrears in the year amounted to \$200,000.
- (vi) Depreciation on non-current assets is to be provided as follows: Motor vehicles and fixtures and fittings at 15% p.a. on cost. The rest remains unchanged.

Required:

- (a) Prepare Equatorial Enterprises statement of Comprehensive Income and
- (b) Prepare the statement of financial position for the given financial year (SFP).

SUGGESTED SOLUTION:

To solve such a case of financial accounting case, begin with the adjustments and establishing their effects on the individual items as listed in the trial balance as follows;

Item	Calculations	Effect on Income Statement	SFP
Closing Inventory		-Trading account: \$2,000,000	+ Current Assets: +\$2,000,000
Provision for Bad debts	5% X 5,000,000=250,000 This \$50,000 more than last year	+ \$50,000 to gross profit	-250,000 from debtors
Rent expense	200,000 + 150,000	+expenses \$350,000	Current Liabilities: +\$150,000
Telephone expense	300,000-150,000	+Expenses: \$150,000.	Current Assets: +\$150,000
Salaries & Wages Expenses	4,000,000 -160,000	+ Expenses \$3,840,000	
Electricity expense	300,000-50,000	+Expenses: \$250,000	
General Expenses	3000,000+200,000	+Expenses: \$3,200,000	Current Liabilities: +\$200,000
Depreciation: Motor Vehicles	15% X 6,000,000	+Expenses: \$900,000	Non-Current Assets; (M.V) -900,000
Depreciation on Fixtures & Fittings:	15% X4,000,000	+Expenses: 600,000	Non-Current Assets: -600,0000

EQUATORIAL ENTERPRISES
STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31ST DECEMBER 2022

	\$ '000'	\$ '000'	\$ '000'
Sales		52,700	
Less: Sales Returns		<u>(2,000)</u>	50,700
Less: Cost Of Sales			
Opening Inventory		3,000	
Purchases	28,000		
Add: Carriage inwards	200		
Less: Purchases Returns	<u>(1,000)</u>	27,200	
Closing Inventory		<u>(2,000)</u>	<u>(28,200)</u>
ROSS PROFIT FOR YEAR:			22,500
Add: Reduction in Provision for Bad Debts			50
Discounts Received			<u>2,800</u>
Total Revenue			25,350
LESS: EXPENSES			
Rent		350	
Electricity		250	
Salaries & Wages		3,840	
Telephone		150	
Motor Vehicle Depreciation		900	
Fixtures & Fittings Depreciation		600	
General Expenses		3,200	
Discounts Allowed		1,500	
Bad debts		2,000	
Carriage out		<u>300</u>	<u>(13,090)</u>
NET PROFIT FOR THE YEAR			<u>12,260</u>

EQUATORIAL ENTERPRISES
STATEMENT OF FINANCIAL POSITION
AS AT 231ST DECEMBER 2022

	\$ '000'	\$ '000'	\$ '000'
NON-CURRENT ASSETS	Cost	Depreciation	Net Book Value
Land & Buildings	8,000		8,000
Motor Vehicles	6,000	(900)	5,100
Fixtures & Fittings	<u>4,000</u>	<u>(600)</u>	<u>3,400</u>
	<u>18,000</u>	<u>(1,500)</u>	<u>16,500</u>
Current Assets			
Inventory	2,000		
Debtors (5,000 -250)	4,750		
Prepaid Expenses	<u>360</u>	7,110	
Current Liabilities			
Creditors	4,000		
Accrued Expenses	<u>350</u>	<u>(4,350)</u>	<u>(2,760)</u>
NET ASSETS			<u>19,260</u>
Capital + Liabilities			
Capital			9,000
Net Profit for the year			12,260
Drawings			(2,000)
Non-Current Liabilities			<u>-----</u>
CAPITAL EMPLOYED			<u>19,260</u>

ILLUSTRATION TWO: (Without Adjustments)

The following Trial Balance relate to Upperhill Enterprises a medium Scale Enterprise in Seoul city, showing information for the period ended 31st December 2021.

**UPPER HILL ENTERPRISES
TRIAL BALANCE
FOR THE YEAR ENDED 31ST DECEMBER 2022**

Items	\$ '000'	\$ '000'
Capital		21,000
Sale and Purchases	24,000	40,500
Creditors & Debtors	6,000	6,000
Telephone	2,000	
Electricity	1,500	
Salaries & wages	2,000	
General Expenses	1,500	
Inventory (01/01/2021)	3,000	
Water	2,000	
Cash at bank	2,500	
Insurance	1,000	
Commissions	2,000	
Advertising	1,000	
Fixtures	2,000	
Motor Vehicles	8,000	
Land & Buildings	<u>9,000</u>	<u>-----</u>
	<u>67,500</u>	<u>67,500</u>

NB: Inventory in the premises on 31/12/2021 was \$. 4,000,000

Required:

Prepare the Statement of Comprehensive income and Statement of Financial Position as at 31st December 2021 for the Enterprise;

**SUGGESTED SOLUTION:
UPPER HILL ENTERPRISES
STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31ST DECEMBER 2021**

	\$ '000'	\$ '000'
Sales		40,500
Less: Cost of Sales		
Opening Inventory	3,000	
Purchases	24,000	
Closing Inventory	<u>(4,000)</u>	<u>(23,000)</u>
GROSS PROFIT		17,500
Less: Expenses:		
Advertising	1,000	
Commissions	2,000	
General Expenses	1,500	
Insurance	1,000	
Electricity	1,500	
Salaries & Wages	2,000	
Water	2,000	
Telephone	<u>2,000</u>	<u>(13,000)</u>
NET PROFIT FOR THE PERIOD		<u>4,500</u>

**UPPER HILL ENTERPRISES
STATEMENT OF FINANCIAL POSITION
FOR THE YEAR ENDED 31ST DECEMBER 2021**

	\$ '000'	\$ '000'
Non-Current Assets		
Land & Buildings		9,000
Motor Vehicles		8,000
Fixtures		<u>2,000</u>
		19,000
Current Assets:		
Inventory	4,000	

Debtors (Receivables)	6,000	
Cash at bank	<u>2,500</u>	
	12,500	
Current Liabilities		
Creditors (Accounts Payables)	<u>(6,000)</u>	<u>6,500</u>
NET ASSETS		<u>25,500</u>
Capital + Non-Current Liabilities		
Capital		21,000
Net Profit for the Year		<u>4,500</u>
CAPITAL EMPLOYED		<u>25,500</u>

REFERENCES

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Williams, J., Haka, S., Bettner, M. S., Meigs, R. (2002). Financial accounting. Irwin/McGraw-Hill.