

DSE Trend

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
5.2A Purpose of preparing an income statement		P1 A14-2 P1 A19-2								
5.2B Preparation of an income statement for a trading firm			P1 B6a-5	P1 B5a-5	P1 A12-2 P1 A29-2 P1 A30-2	P1 B5a-5	P1 A6-2		P1 A14-2 P1 B5d-5	
5.2C Opening inventory vs. closing inventory			P1 B6a-5	P1 B5a-5						
5.2D Carriage inwards vs. carriage outwards	P1 A2-2		P1 B6a-5	P1 B5a-5			P1 A20-2	P1 A16-2		P1 A11-2
5.2E Returns inwards vs. returns outwards	P1 A2-2		P1 B6a-5	P1 B5a-5			P1 A20-2			
5.2F Discounts allowed vs. discounts received			P1 A18-2				P1 A20-2			P1 B5Aa-5

Common Errors

1 Failed to show the net sales figure on an income statement.

🔒 Explanation: Remember the following when preparing an income statement:

Sales – Returns inwards = Net sales

Net sales, instead of gross sales, should be used in the calculation of profits.

2 Failed to show the net purchases figure on an income statement.

🔒 Explanation: Remember the following when preparing an income statement:

Purchases + Carriage inwards – Returns outwards = Net purchases

Net purchases, instead of gross purchases, should be used in the calculation of the cost of goods sold.

3 Being unable to identify whether the inventory item in the trial balance represents the opening inventory or the closing inventory.

🔒 Explanation: Inventory count is usually carried out after preparing the trial balance. Therefore, inventory shown in the trial balance represents the opening inventory.

4 Mixed up carriage outwards with carriage inwards.

🔒 Explanation: Carriage inwards should be included in the calculation of the cost of goods sold while carriage outwards should be treated as an expense.

5 Mixed up trade discounts with cash discounts.

🔒 Explanation: Trade discounts should be directly deducted from sales or purchases and are not shown separately.

Cash discounts should be separately shown on the income statement with discounts allowed treated as an expense and discounts received treated as other revenues.

6 Being unable to identify returns inwards and returns outwards when the two items are shown together as 'returns' in a trial balance.

🔒 Explanation: On exam questions, returns inwards and returns outwards are sometimes shown together to test candidates' understanding of the two items. You should remember that:

→ Returns inwards usually have debit balances.

→ Returns outwards usually have credit balances.

7 Being unable to identify discounts allowed and discounts received when the two items are shown together as 'discounts' in a trial balance.

🔒 Explanation: Similarly, discounts allowed and discounts received are sometimes shown together on exam questions to test candidates' understanding of the two items. You should remember that:

→ Discounts allowed usually have debit balances.

→ Discounts received usually have credit balances.

Typical Questions


Based on the following information, answer Questions 1 and 2.

The following account balances were extracted from Linda Company's books as at 30 June 2022:

	\$
Sales	123,000
Purchases	47,200
Inventory as at 1 July 2021	32,000
Carriage outwards	3,700
Carriage inwards	2,500
Discounts allowed	3,300
Returns inwards	5,400

1 Given that inventory as at 30 June 2022 was valued at 27,000, what was the gross profit for the year ended 30 June 2022?


- A. \$57,500
- B. \$59,200
- C. \$62,900
- D. \$68,300

 Answer: C

$$\begin{aligned}
 \text{Gross profit} &= \text{Net sales} - \text{Cost of goods sold} \\
 &= (\text{Sales } \$123,000 - \text{Returns inwards } \\
 &\quad \$5,400) - (\text{Opening inventory } \$32,000 \\
 &\quad + \text{Purchases } \$47,200 + \text{Carriage inwards } \\
 &\quad \$2,500 - \text{Closing inventory } \$27,000) \\
 &= \$62,900
 \end{aligned}$$

2 What was the net profit for the year ended 30 June 2022?


- A. \$49,700
- B. \$52,200
- C. \$53,400
- D. \$55,900

 Answer: D

$$\begin{aligned}
 \text{Net profit} &= \text{Gross profit} - \text{Expenses} \\
 &= \text{Gross profit } \$62,900 - (\text{Carriage outwards } \\
 &\quad \$3,700 + \text{Discounts allowed } \$3,300) \\
 &= \$55,900
 \end{aligned}$$

3 Which of the following would not affect the gross profit for a trading firm?

- (1) Purchases
 - (2) Carriage inwards
 - (3) Carriage outwards
- A. (1) only
 - B. (3) only
 - C. (1) and (2) only
 - D. (2) and (3) only

 Answer: B

Carriage outwards should be treated as an expense and would not affect the gross profit.

4 Given the trial balance of Happy Plastic Co as at 31 March 2022:

Happy Plastic Co		
Trial Balance as at 31 March 2022		
	<i>Dr</i>	<i>Cr</i>
	\$	\$
Sales		351,610
Purchases	226,720	
Returns inwards	12,100	
Carriage outwards	9,050	
Wages	36,000	
Rent and rates	36,360	
Discounts received		11,000
Office equipment	73,000	
Trade receivables	62,900	
Trade payables		41,000
Bank overdraft		40,400
Capital		49,120
Inventory as at 1 April 2021	<u>37,000</u>	
	<u>493,130</u>	<u>493,130</u>

Inventory as at 31 March 2022 was valued at \$41,000.

Required:

Prepare for Happy Plastic Co an income statement for the year ended 31 March 2022.

(5 marks)

🔒 Answer:

Remember to write the heading properly with
(i) Company name; and
(ii) Income Statement **for the year ended**
(year-end date)

Happy Plastic Co		
Income Statement for the year ended 31 March 2022		
	\$	\$
Sales		351,610
<u>Less</u> Returns inwards		<u>12,100</u>
		339,510
<u>Less</u> Cost of goods sold:		
Opening inventory	37,000	0.5
<u>Add</u> Purchases	<u>226,720</u>	0.5
	263,720	
<u>Less</u> Closing inventory	<u>41,000</u>	0.5
		<u>222,720</u>
Gross profit		116,790
<u>Add</u> Other revenues:		
Discounts received		<u>11,000</u>
		127,790
<u>Less</u> Expenses:		
Carriage outwards	9,050	0.5
Wages	36,000	0.5
Rent and rates	<u>36,360</u>	0.5
		<u>81,410</u>
Net profit		<u>46,380</u>

Remember to show 'add' or 'less' to indicate the addition or deduction of certain items.

Show the relevant items in the correct sequence when calculating the cost of goods sold:

- Opening inventory
- + Purchases
- + Carriage inwards
- Returns outwards
- Closing inventory

Practice Questions

MCQ

1 The steps for preparing an income statement are:

- (1) Calculate the net profit/loss
- (2) Calculate the gross profit/loss
- (3) Show the other revenues and expenses
- (4) Calculate the net sales and the cost of goods sold

- A. (3) → (2) → (4) → (1)
- B. (3) → (1) → (4) → (2)
- C. (4) → (2) → (3) → (1)
- D. (4) → (1) → (3) → (2)

2 Which of the following would affect the gross profit of a firm?

- (1) Increase in sales
- (2) Increase in carriage inwards
- (3) Increase in carriage outwards

- A. (1) and (2) only
- B. (1) and (3) only
- C. (2) and (3) only
- D. (1), (2) and (3)

3 How will an increase in carriage outwards affect gross profit and net profit?

- | | <u>Gross profit</u> | <u>Net profit</u> |
|----|---------------------|-------------------|
| A. | Increases | Increases |
| B. | Decreases | Decreases |
| C. | Remains unchanged | Increases |
| D. | Remains unchanged | Decreases |

4 Which of the following will not appear on an income statement?

- (1) Closing inventory
- (2) Carriage inwards
- (3) Purchases of office equipment

- A. (3) only
- B. (1) and (2) only
- C. (1) and (3) only
- D. (2) and (3) only

5 XYZ Company purchased 1,800 items of goods on credit from a supplier on 1 May 2022. The list price was \$5 each and a 10% trade discount was received. The supplier also offered a cash discount of 5% for payment within 7 days. How much should be paid by XYZ Company on 4 May 2022?

- A. \$7,695
- B. \$7,650
- C. \$8,100
- D. \$8,550

6 Which of the following is not included in the calculation of cost of goods sold?

- (1) Carriage inwards
 - (2) Carriage outwards
 - (3) Returns inwards
- A. (1) and (2) only
 - B. (1) and (3) only
 - C. (2) and (3) only
 - D. (1), (2) and (3)

Refer to the following information and answer Questions 7 and 8.

Johnny set up a trading firm in January 2022. The following balances were extracted from the firm's books as at 31 December 2022:

	\$
Sales	370,000
Purchases	126,000
Returns inwards	41,000
Returns outwards	15,000
Carriage outwards	9,800
Rent and rates	39,500
Wages	23,700

7 Inventory as at 31 December 2022 was valued at \$8,000. The gross profit for the year was

- A. \$226,000.
- B. \$210,000.
- C. \$196,000.
- D. \$187,000.

8 Total expenses for the year ended 31 December 2022 were

- A. \$24,800.
- B. \$33,500.
- C. \$63,200.
- D. \$73,000.

Refer to the following information and answer Questions 9 to 11.

Given the following figures:

	\$
Sales	167,000
Purchase of goods during the year	68,000
Returns inwards	3,700
Returns outwards	1,300
Carriage inwards	2,500
Carriage outwards	1,500
Opening inventory	19,500

Other information:

- (i) Goods costing \$5,000 were taken by the owner for his own use during the year.
- (ii) Inventory as at the year-end date was valued at \$21,000.

9 What is the amount of net sales?

- A. \$163,000
- B. \$163,300
- C. \$165,500
- D. \$165,700

10 What is the amount of the cost of goods sold?

- A. \$59,300
- B. \$60,300
- C. \$62,700
- D. \$67,700

11 What is the amount of net profit?

- A. \$94,100
- B. \$99,100
- C. \$104,100
- D. \$102,800

12 Cash discounts

- (1) are offered to trade debtors who pay within a specified period.
 - (2) are discounts given for bulk purchases.
 - (3) are discounts given for early payment.
- A. (1) and (2) only
 - B. (1) and (3) only
 - C. (2) and (3) only
 - D. (1), (2) and (3)

13 The income statement is a financial statement that reports

- (1) the closing balances of ledger accounts.
- (2) the financial performance of a business.
- (3) the financial position of a business.

- A. (2) only
- B. (1) and (2) only
- C. (1) and (3) only
- D. (1), (2) and (3)

14 _____ are recorded at cost while _____ are recorded at selling price.

- A. Sales; purchases
- B. Returns inwards; sales
- C. Purchases; Returns outwards
- D. Returns outwards; returns inwards

15 Information about Company A and Company B for the year ended 31 December 2022 is shown below:

	<u>Company A</u>	<u>Company B</u>
	\$	\$
Sales	30,800	45,000
Net sales	30,500	44,300
Cost of goods sold	12,000	19,500
Operating expenses	3,300	6,800

Based on the above information, which of the following are correct?

	<u>Company A</u>	<u>Company B</u>
(1) Returns inwards	\$300	\$700
(2) Gross profit	\$18,800	\$25,500
(3) Net profit	\$15,200	18,000

- A. (1) and (2) only
- B. (1) and (3) only
- C. (2) and (3) only
- D. (1), (2) and (3)

Short Questions

- 16 Duncan Ma started a trading firm on 1 January 2022. The firm's financial information for the year ended 31 December 2022 is as follows:

	\$
Returns inwards	5,400
Returns outwards	4,300
Sales	710,000
Purchases	280,000
Staff salaries	98,000
Carriage outwards	14,000
Inventory as at 31 December 2022	35,500

Required:

Prepare for Duncan Ma's firm an income statement for the year ended 31 December 2022. (5 marks)

- 17 Ingrid Chau's trading firm commenced on 1 April 2021. The following balances were extracted from her business' books as at 31 March 2022:

	\$
Sales	215,000
Purchases	124,000
Returns inwards	4,100
Returns outwards	2,700
Discounts allowed	1,100
Discounts received	1,600
Sundry expenses	39,100

Inventory as at 31 March 2022 was valued at \$22,500.

Required:

Prepare for Ingrid Chau's firm an income statement for the year ended 31 March 2022. (5 marks)

18 The following information was extracted from the books of Tony Cheng's business on 30 June 2022:

	<i>Dr</i>	<i>Cr</i>
	\$	\$
Returns	31,100	12,500
Discounts	5,800	6,700
Purchases and sales	349,000	857,000
Salaries	99,600	
Utilities	35,400	
Inventory	98,000	

Inventory was valued at \$102,200 as at 30 June 2022.

Required:

Prepare for Tony Cheng's business an income statement for the year ended 30 June 2022. (5 marks)

Answers

MCQ

- 1 C
2 A
3 D
4 A
5 A $(1,800 \times \$5) \times 90\% \times 95\%$
6 C
7 A $(\$370,000 - \$41,000) - (\$126,000 - \$15,000 - \$8,000)$
8 D $\$9,800 + \$39,500 + \$23,700$
9 B $\$167,000 - \$3,700$
10 C $\$19,500 + (\$68,000 - \$1,300 + \$2,500) - \$5,000 - \$21,000$
11 B $\$163,300 - \$62,700 - \$1,500$
12 B
13 A
14 D
15 B

	<u>Company A</u>	<u>Company B</u>
(1) Returns inwards:	$\$30,800 - \$30,500 = \$300$	$\$45,000 - \$44,300 = \$700$
(2) Gross profit:	$\$30,500 - \$12,000 = \$18,500$	$\$44,300 - \$19,500 = 24,800$
(3) Net profit:	$\$30,500 - \$12,000 - \$3,300$ $= \$15,200$	$\$44,300 - \$19,500 - \$6,800$ $= \$18,000$

Short Questions

16

Duncan Ma		0.5
Income statement for the year ended 31 December 2022		
	\$	\$
Sales		710,000
Less Returns inwards		<u>5,400</u>
		704,600
Less <i>Cost of goods sold:</i>		
Purchases	280,000	0.5
Less Returns outwards	<u>4,300</u>	0.5
	275,700	
Less Closing inventory	<u>35,500</u>	240,200
Gross profit		464,400
Less <i>Expenses:</i>		
Staff salaries	98,000	0.5
Carriage outwards	<u>14,000</u>	112,000
Net profit		<u>352,400</u>

17

Ingrid Chau		0.5
Income statement for the year ended 31 March 2022		
	\$	\$
Sales		215,000
<i>Less</i> Returns inwards		4,100
		210,900
<i>Less</i> <i>Cost of goods sold:</i>		
Purchases	124,000	0.5
<i>Less</i> Returns outwards	2,700	0.5
	121,300	
<i>Less</i> Closing inventory	22,500	0.5
Gross profit		112,100
<i>Add</i> <i>Other revenues:</i>		
Discounts received		1,600
		113,700
<i>Less</i> <i>Expenses:</i>		
Discounts allowed	1,100	0.5
Sundry expenses	39,100	0.5
Net profit		73,500

18

Tony Cheng		
Income statement for the year ended 30 June 2022		
	\$	\$
Sales		857,000
<i>Less</i> Returns inwards		31,100
		825,900
<i>Less</i> <i>Cost of goods sold:</i>		
Opening inventory	98,000	0.5
<i>Add</i> Purchases	349,000	0.5
	447,000	
<i>Less</i> Returns outwards	12,500	0.5
	434,500	
<i>Less</i> Closing inventory	102,200	0.5
Gross profit		493,600
<i>Add</i> <i>Other revenues:</i>		
Discounts received		6,700
		500,300
<i>Less</i> <i>Expenses:</i>		
Discounts allowed	5,800	0.5
Salaries	99,600	0.5
Utilities	35,400	0.5
Net profit		359,500