

## **FINANCIAL STATEMENTS - I**

### **Multiple Choice Questions**

1. Which of the following financial statement is prepared to ascertain gross profit of a business?
  - a) Profit and Loss Account
  - b) Trading Account
  - c) Balance Sheet
  - d) None of the above
2. Which of the following financial statements is prepared to ascertain the positions of assets and liabilities of the business?
  - a) Balance Sheet
  - b) Profit and Loss Account
  - c) Trading Account
  - d) None of the above
3. Gross profit is the difference between
  - a) Total assets and total liabilities
  - b) Sales and all expenses
  - c) Sales and indirect expenses
  - d) Sales and cost of goods solds
4. Which of the following is not an indirect expense?
  - a) Freight inward
  - b) Discount allowed
  - c) Rent paid
  - d) Commission paid
5. Which of the following is a current asset?
  - a) Land
  - b) Building
  - c) Cash at bank
  - d) Machinery

### **Long Type Questions**

1. What do you mean by term financial statements? What are its advantages and disadvantages?
2. State the objectives of preparing Balance Sheet.
3. Distinguish between direct expenses and indirect expenses.
4. From the following balances prepare trading account for the year ended 31<sup>st</sup> March 2012

Particulars	Amount	Particulars	Amount
Opening Stock	6,000	Purchases	11,500
Purchase return	500	Sales	48,000
Sales return	600	Freight & Octori	500

Carriage on purchases	1,000	Wages	2,500
Factory lighting	600	Import duty	900
Office rent	1,200	Carriage on sales	3,000
Coal, gas & water	800		

5. Prepare Profit and Loss account for the year ended 31<sup>st</sup> March 2012 from the following particulars.

Particulars	Amount	Particulars	Amount
General Expenses	800	Gross Profit	32,100
Charity	100	Carriage on sales	900
Electricity charges	175	Office expenses	650
Law charges	180	Insurance premium	1,200
Advertisement	440	Telephone expenses	600
Commission	870	Sales tax	800
Rent	1,800	Establishment expenses	700
Interest on investment	700	Miscellaneous expenses	750
Sundry receipts	700	Discount received	1,090
Indirect expenses	340	Traveller salary	300
Printing and stationary	65	Repair	270

## Answers

### Multiple Choice Questions

1. (b) 2. (a) 3. (d) 4. (a) 5. (c)

### Long Type Questions

#### **Answer 1.**

##### **Financial Statements :**

Financial statements are a collection of summary-level reports about an organization's financial results, financial position, and cash flows. They include the income statement, balance sheet, and statement of cash flows.

##### **Advantages of Financial Statements :**

- ✓ Financial Statements are useful for the following reasons:
- ✓ To determine the ability of a business to generate cash, and the sources and uses of that cash.
- ✓ To determine whether a business has the capability to pay back its debts.
- ✓ To track financial results on a trend line to spot any looming profitability issues.
- ✓ To investigate the details of certain business transactions, as outlined in the disclosures that accompany the statements.

### **Disadvantages of Financial Statements :**

- ✓ There are few downsides to issuing financial statements. A possible concern is that they can be fraudulently manipulated, leading investors to believe that the issuing entity has produced better results than was really the case. Such manipulation can also lead a lender to issue debt to a business that cannot realistically repay it.

### **Types of Financial Statements:**

#### **1. The Balance Sheet :**

One of the financial statements is the balance sheet. It shows an entity's assets, liabilities, and stockholders' equity as of the report date. In this report, the total of all assets must match the combined total of all liabilities and equity. The asset information on the balance sheet is subdivided into current and long-term assets. Similarly, the liability information is subdivided into current and long-term liabilities. This stratification is useful for determining the liquidity of a business. Ideally, the total of all current liabilities should exceed the total of all current liabilities, which implies that a business has sufficient assets to pay off its current obligations. The balance sheet is also used to compare debt levels to the amount of equity invested in the business, to see if its leverage level is appropriate.

#### **2. The Income Statement :**

Another financial statement is the income statement. It shows the results of an entity's operations and financial activities for the reporting period. It usually contains the results for either the past month or the past year, and may include several periods for comparison purposes. Its general structure is to begin with all revenues generated, from which the cost of goods sold is subtracted, and then all selling, general, and administrative expenses. The result is either a profit or loss, which is net of income taxes.

### **Answer 2.**

#### **Objectives of Preparing Balance Sheet :**

- a) Balance sheet is prepared to achieve following objectives:
- b) To know the financial position of the business.
- c) To know the position of internal liabilities and external liabilities of the business so that timely arrangement can be made for their payment.
- d) To know the position of fixed assets and current assets.
- e) To plan activities for future on the basis of present financial position.

### **Answer 3.**

#### **Direct Expenses :**

Direct expenses are the expenditures that is used in the process of creating a product and its services after the product is manufactured. These expenditures are traceable as they are restricted to a specific department and workers.

**Indirect Expenses :**

Indirect expenses are not bound to the expense of production. It is all office expenditures. They exist in the daily process of a business. They cannot be traced as they are not administered to one particular department.

**Difference Between Direct and Indirect Expenses**

Parameter of comparison	Direct expenses	Indirect expenses
Meaning	The expenditures that are connected to the production procedure or investment of goods.	The expenditures are not connected to the cost of production or procedure of production.
Purpose of calculation	It is calculated to know the gross profit of the business.	It is calculated to know the net profit of the business.
Cost of production	These are included in the expense of goods sold or manufactured.	These are included in the expense of rents, taxes, utility expense, etc.
Financial Statements	They are posted in the business account.	They are broadcasted in the profit and loss report.
Pertained to	These expenses associated with the factory.	Office-related payments allied with indirect expenses.

**Answer 4.** Gross Profit Rs. 24,100

**Answer 5.** Net Profit Rs. 24,450.