

MULTI-STEP INCOME STATEMENT

Key Terms and Concepts to Know

Single-Step Income Statement

- Total revenue – total expenses = Net Income

Multi-Step Income Statement

- Separates revenues into operating and non-operating
- Separates expenses into cost of goods sold, operating and non-operating
- May further divide Operating Expenses into Selling Expenses and Administrative Expenses
- Adds subtotals to increase usefulness of income statement

Comprehensive Income Statement

- Certain other gains or losses are not included in net income but are included in the more inclusive income measure, Comprehensive Income
- Gains or losses result from adjustments such as marking certain assets to their fair values

Cost of Goods Sold:

- Inventory that has been sold becomes an expense, Cost of Goods Sold, in the period of sale.

Gross Profit:

- Gross Margin = Gross Profit = Net Sales – Cost of Goods Sold
- Gross Margin ratio = Gross Margin / Net Sales
- First key indicator of profitability

Key Topics to Know

Single-Step Income Statement

- Very simple format:
 - One section for total revenue, including operating and non-operating revenues
 - Second section for total expenses, including operating and non-operating expenses
 - Single step is to subtract total expenses from total revenues to determine net income

Multi-Step Income Statement

- Highlights the components of net income:
 - Separates revenues into operating and non-operating
 - Separates expenses into cost of goods sold, operating and non-operating
 - May further divides Operating Expenses into Selling Expenses and Administrative Expenses
 - Operating results are reported as Income from Operations
 - Adds subtotals to increase usefulness of income statement
- More complex format:
 - $\text{Net Sales} = \text{Sales} + \text{transportation-in} - \text{sales returns and allowances} - \text{sales discounts}$
 - $\text{Gross Profit or Gross Margin} = \text{Net Sales} - \text{Cost of Goods sold}$
 - $\text{Operating Income} = \text{Gross Profit} - \text{Operating Expenses}$
(end of operating revenues and expenses)
 - $\text{Net Income} = \text{Operating Income} + \text{Non-operating Revenues} - \text{Non-operating Expenses} - \text{Income Tax Expense}$
 - $\text{Comprehensive Income} = \text{Net Income} + \text{Other Comprehensive Income} - \text{Other Comprehensive Expenses}$

Key changes compared to the single-step income statement include:

- Gross-to-Net Sales to account for contra-revenue accounts
- Gross Profit to report the margin or profit remaining after covering the cost of merchandise sold that is available to cover operating expenses
- May also separating Operating Expenses into Selling Expenses and Administrative Expenses to provide an additional level detail

- Income from Operations to report the profitability of the company's reason for being in business
- Other Income and Other Expense to identify the revenues and expenses not related to the company's reason for being in business
- Income tax expense would be reported between net other revenues and expenses and Net Income.

Gross Sales		\$500,000
Less: Sales Returns & allowances	\$5,000	
Less: Sales Discounts	<u>3,000</u>	<u>8,000</u>
Net Sales		492,000
Cost of Merchandise Sold		<u>294,000</u>
Gross Profit		198,000
Operating Expenses:		
Selling Expenses	50,000	
Admin Expense	<u>45,000</u>	
Total Operating Expenses		<u>95,000</u>
Income from Operations		103,000
Other Income:		
Interest Revenue	1,000	
Other Expenses:		
Interest Expense	<u>700</u>	<u>300</u>
Income tax expense		<u>30,000</u>
Net Income		\$73,700

Example #1

A portion of the adjusted trial balance for the G Company is shown below.

Sales (net of \$8,000 sales discounts and \$24,500 sales returns and allowances)		\$417,500
Cost of goods sold	\$210,000	
Salaries expense	38,000	
Depreciation expense—building	40,000	
Advertising expense	12,300	
Office supplies expense	3,500	
Gain on disposal of store equipment		3,000
Interest expense	1,000	

- Required:
- Prepare a single-step income statement
 - Prepare a multiple-step income statement

Solution #1

a)

**G Company
Income Statement
For the year ended December 31**

Revenues		
Net Sales	\$417,500	
Gain on disposal of store equipment	<u>3,000</u>	
Total revenues		\$420,500
Expenses:		
Cost of goods sold	\$210,000	
Sales salaries expense	38,000	
Depreciation expense—building	40,000	
Advertising expense	12,300	
Office supplies expense	3,500	
Interest expense	<u>1,000</u>	
Total expenses		<u>304,800</u>
Net income		<u>\$115,700</u>

b)

G Company
Income Statement
For the year ended December 31

Sales		\$450,000
Less: Sales discounts	\$8,000	
Sales returns and allowances	<u>24,500</u>	<u>32,500</u>
Net sales		\$417,500
Cost of goods sold		<u>210,000</u>
Gross profit		207,500
Operating expenses		
Sales salaries expense	\$38,000	
Depreciation expense—building	40,000	
Advertising expense	12,300	
Office supplies expense	<u>3,500</u>	
Total operating expenses		<u>93,800</u>
Income from operations		113,700
Other revenues and gains (expenses and losses)		
Gain on disposal of store equipment	3,000	
Interest expense	<u>(1,000)</u>	<u>2,000</u>
Net income		<u>\$115,700</u>

Practice Problems

Practice Problem #1

B Company provided an adjusted trial balance as of December 31.

	Debit	Credit
Cash	\$34,400	
Merchandise inventory	32,000	
Inventory returns estimated	4,000	
Store equipment	75,900	
Accumulated depreciation—store equipment		\$22,000
Office equipment	60,000	
Accumulated depreciation—office equipment		15,000
Accounts payable		35,000
Sales refund payable		7,000
Notes payable		10,000
Common stock		1,000
Retained earnings		109,700
Dividends	48,000	
Sales		325,000
Sales discounts	6,000	
Sales returns and allowances	16,500	
Cost of goods sold	195,000	
Selling expenses	32,500	
General and administrative expenses	19,800	
Interest expense	600	
Total	\$524,700	\$524,700

- Required:
- a) Prepare a single-step income statement
 - b) Prepare a multiple-step income statement

Practice Problem #2

Following are 6 statements about income statements.

1. _____ expenses are those costs that support a company's overall operations and include expenses related to accounting, human resource management, and financial management.
2. A _____ income statement format shows detailed computations of net sales and other costs and expenses, and reports subtotals for various classes of items.
3. A _____ income statement includes cost of goods sold as another expense and shows only one subtotal for total expenses.
4. Non-operating activities reported on the income statement that includes interest, dividend, and rent revenues, and gains from asset disposals are called _____.
5. Non-operating activities reported on the income statement that includes interest expense, losses from asset disposals, and casualty losses are called _____.
6. When a company has no reportable non-operating activities, its income from operations is reported as _____.

Required: Fill in the blanks with the correct answers.

Practice Problem #3

T Company reported the following information on its income statement for the first quarter of the year.

	<u>January</u>	<u>February</u>	<u>March</u>
Sales	\$375,000	\$750,000	?
Sales returns and allowances	32,000	?	25,000
Sales discounts	12,000	9,000	15,000
Net sales	?	736,000	?
Cost of merchandise sold	255,000	?	620,000
Gross profit	?	310,000	185,000

Required: Calculate the missing information.

Practice Problem #4

A multi-step income statement showed net sales of \$870,000, cost of goods sold of \$376,000, and total operating expenses of \$330,000 for the fiscal year ended December 31, 2016.

Required: a) What was the gross profit?
b) What was the net income from operations?

True / False Questions

1. A multiple-step income statement shows detailed computations of net sales and reports subtotals for various groups of items.
True False
2. Operating expenses in a multiple-step income statement are classified into two categories: selling expenses and cost of goods sold.
True False
3. Expenses related to accounting, human resource management, and financial management are classified as non-operating expenses in a multiple-step income statement.
True False
4. When a company preparing a multiple-step income statement has no reportable non-operating activities, its income from operations is simply labeled net income.
True False
5. A single-step income statement includes cost of goods sold as another expense and shows only one subtotal for total expenses.
True False
6. Advertising expense is reported as part of operating expenses in the seller's multiple-step income statement.
True False
7. Comprehensive Income includes gains and losses also included in the determination of net income
True False
8. If a company has beginning inventory of \$15,000, purchases during the year of \$75,000, and ending inventory of \$20,000, cost of goods sold equals \$70,000.
True False
9. Gross profit equals net sales of inventory less cost of goods sold.
True False
10. Sales revenue minus cost of goods sold is referred to as operating income.
True False

Multiple Choice Questions

1. An income statement that includes cost of goods sold as another expense and shows only one subtotal for total expenses is a:
 - a) Single-step income statement.
 - b) Balanced income statement.
 - c) Multiple-step income statement.
 - d) Simplified income statement.

2. Expenses that support the overall operations of a business and include the expenses relating to accounting, human resource management, and financial management are called:
 - a) Cost of goods sold
 - b) Operating expenses.
 - c) Non-operating expenses
 - d) Comprehensive expenses

3. P Company had cash sales of \$94,275, credit sales of \$83,450, sales returns and allowances of \$1,700, and sales discounts of \$3,475. P Company's net sales for this period equal:
 - a) \$94,275.
 - b) \$174,250.
 - c) \$172,550.
 - d) \$176,025.

4. Multiple-step income statements:
 - a) Are required by the FASB and IASB.
 - b) List cost of goods sold as an operating expense.
 - c) Are only used by service businesses
 - d) Contain more detail than a simple listing of revenues and expenses.

5. S Company has net sales of \$752,000 and cost of goods sold of \$543,000. Its net income is \$17,530. The company's gross margin and operating expenses, respectively, are:
 - a) \$209,000 and \$191,470
 - b) \$191,470 and \$209,000
 - c) \$525,470 and \$227,000
 - d) \$227,000 and \$525,470

6. G Company had \$800,000 in net sales, \$350,000 in gross profit, and \$200,000 in operating expenses. Cost of goods sold equals:
 - a) \$150,000.
 - b) \$450,000.
 - c) \$800,000.
 - d) \$350,000.

7. C Company had \$800,000 in sales, sales discounts of \$12,000, sales returns and allowances of \$18,000, cost of goods sold of \$380,000, and \$275,000 in operating expenses. Gross profit equals:
 - a) \$770,000.
 - b) \$115,000.
 - c) \$390,000.
 - d) \$402,000.

8. Which of the following would be classified as Other Income or Other Expense?
 - a) Advertising Expense
 - b) Interest Expense
 - c) Transportation Out
 - d) Cost of merchandise sold

9. Gross Margin is calculated as:
 - a) Sales less cost of merchandise sold
 - b) Sales less merchandise inventory
 - c) Sales less expenses
 - d) Sales less operating expenses

10. A Company's gross profit ratio has steadily declined for 5 years while the net profit ratio has remained constant. The most likely reason for this pattern is:
 - a) Cost of merchandise sold and operating expenses both increased each year
 - b) Selling price and operating expenses have both decreased each year
 - c) Cost of merchandise sold and operating expenses both decreased each year
 - d) Selling price decreased and operating expenses increased each year

Solutions to Practice Problems

Practice Problem #1

a)

B Company Income Statement For the year ended December 31

Revenues:		
Net sales		302,500
Expenses:		
Cost of goods sold		195,000
Operating expenses		52,300
Interest expense		<u>600</u>
Total expenses		<u>247,900</u>
Net income		<u>\$54,600</u>

b)

B Company Income Statement For the year ended December 31

Sales		\$325,000
Less: Sales discounts	\$6,000	
Sales returns and allowances	<u>16,500</u>	<u>22,500</u>
Net sales		302,500
Cost of goods sold		<u>195,000</u>
Gross profit		107,500
Operating expenses		
Selling expenses	32,500	
General and administrative expenses	<u>19,800</u>	
Total operating expenses		<u>52,300</u>
Income from operations		55,200
Other expenses		
Interest expense		<u>600</u>
Net income		<u>\$54,600</u>

Practice Problem #2

1. Operating
2. Multiple-step
3. Single-step
4. Other revenues and gains
5. Other expenses and losses
6. Net income

Practice Problem #3

January

Sales		\$375,000
- Sales Returns & Allowances	(32,000)	
- Sales Discounts	<u>(12,000)</u>	
Net Sales		331,000
-Cost of Merchandise Sold		<u>(255,000)</u>
Gross Profit		\$76,000

February

Sales	\$750,000	$750,000 - x - 9,000 = 736,000$
- Sales Returns & Allowances	x	$741,000 - x = 736,000$
- Sales Discounts	<u>(9,000)</u>	$x = 5,000$
Net Sales	736,000	$736,000 - y = 310,000$
- Cost of Merchandise Sold	y	$y = 426,000$
Gross Profit	\$310,000	

March

Sales	X	$x - 25,000 - 15,000 = y$
- Sales Returns & Allowances	(25,000)	
- Sales Discounts	<u>(15,000)</u>	$y - 620,000 = 185,000$
Net Sales	Y	$y = 805,000$
- Cost of Merchandise Sold	<u>(620,000)</u>	$x = 845,000$
Gross Profit	185,000	

Practice Problem #4

Net Sales	\$870,000
Cost of Goods Sold	<u>376,000</u>
Gross Margin	494,000
Operating Expenses	<u>330,000</u>
Net Income from Operations	\$164,000

Solutions to True / False Problems

1. True
2. False – operating expenses are classified as either selling expenses or administrative expenses
3. False – these are operating expenses
4. True
5. True
6. True
7. False – comprehensive income includes gains and losses not included elsewhere on the income statement
8. True
9. True
10. False - sales revenue minus cost of goods sold equals gross profit.

Solutions to Multiple Choice Questions

- | | |
|-----|---|
| 1. | A |
| 2. | B |
| 3. | C |
| 4. | D |
| 5. | A |
| 6. | B |
| 7. | C |
| 8. | B |
| 9. | A |
| 10. | B |