



UNIVERSITÀ
DEGLI STUDI
DI BERGAMO

Dipartimento
di Scienze Aziendali

Corso di Laurea Magistrale in
ACCOUNTING, GOVERNANCE AND
SUSTAINABILITY

The balance sheet and the income statement

International and Advanced Accounting

RELATORI

Prof. Daniele Gervasio
daniele.gervasio@unibg.it

SEDE

Bergamo

TODAY

Monday 28 September – the balance sheet and the income statement

Plan

- ✓ Debriefing of homework set 1 (20 min)
- ✓ The balance sheet: definitions of assets, liabilities, equity; structure and formats
- ✓ The income statement: income and expenses; by nature and by function
- ✓ From the trial balance to the statements: our website business
- ✓ What happens in reality: year-end adjustments
- ✓ Cash flow statement and statement of changes in equity in one slide

Homework

- ✓ Set 1 (exercises 1-4): debriefing now
- ✓ Set 2 (exercises 5-7: The Library, the retail shop, Bergamo Bikes): due Wednesday 30
- ✓ **Exercise 7 uses today's adjustments: start it after this lesson**

Guiding question for today: the trial balance already contains every number. Why do we need two statements, and why do they have to be adjusted before we can trust them?

HOMEWORK SET 1 – DEBRIEFING

Exercise 1: journal entries for November

Ref	Debit (use)	Credit (source)	Amount
1	Checking Account	Owner's Equity	1,500
2	Rent	Checking Account	500
3	Office Equipment (phone/fax)	Checking Account	75
4	Office Equipment (printer)	Checking Account	150
5	Office Supplies	Checking Account	75
6	Computer Hardware (server parts)	Checking Account	500
7	Bank Charges	Checking Account	10
	Totals		2,810 = 2,810

Checking Account after November: $1,500 - 1,310 = 190$ (debit balance).

HOMWORK SET 1 – DEBRIEFING

Exercise 2: journal entries for December

Ref	Debit (use)	Credit (source)	Amount
8	Checking Account	Owner's Equity	1,100
9	Office Furniture (chair)	Checking Account	700
10	Repairs & Maintenance (oil change)	Checking Account	25
11	Checking Account	Sales (advertising)	500
12	Phone Service	Accounts Payable	150
13	Electric Service	Accounts Payable	100
14	Credit Card Fees & Interest 30 · Office Furniture 245 · Fuel 25 · Subscriptions 65 · Meals 45 · Website Hosting 120 · Computer Hardware 400	Accounts Payable	930
15	Accounts Payable	Checking Account	500
16	Bank Charges	Checking Account	15
	Totals		4,020 = 4,020

HOMEWORK SET 1 – DEBRIEFING: EXERCISE 3

T-Accounts for December Transactions:

Checking Account	
1 1100	
	2 700
	3 25
4 500	
	8 500
	9 15
dr 1600	cr 1240
-1240	
dr \$360	

Owner's Equity	
1 1100	
cr \$1,100	

Computer Hardware	
7 400	
dr \$400	

Bank Charges	
9 15	
dr \$15	

Now, it's your turn!

Office Furniture	
2 700	
7 245	
dr \$945	

Repairs & Maintenance	
3 25	
dr \$25	

Sales	
4 500	
cr \$500	

Accounts Payable	
5 150	
6 100	
7 930	
8 500	
dr 500	cr 1180
	-500
	cr \$680

Phone Service	
5 150	
dr \$150	

Electric Service	
6 100	
dr \$100	

Credit Card Fees	
7 30	
dr \$30	

Fuel	
7 25	
dr \$25	

Subscriptions	
7 65	
dr \$65	

Meals	
7 45	
dr \$45	

Website Hosting	
7 120	
dr \$120	

|--|--|

HOMEWORK SET 1 – DEBRIEFING: EXERCISE 4

Cumulative Trial Balance at December 31

Account	Debits	Credits
Checking Account	550.00	
Office Equipment	225.00	
Computer Hardware	900.00	
Office Furniture	945.00	
Accounts Payable		680.00
Owners' Equity		2600.00
Sales		500.00
Website Hosting	120.00	
Rent	500.00	
Repairs & Maintenance	25.00	
Fuel	25.00	
Subscriptions	65.00	
Meals	45.00	
Phone Service	150.00	
Electric Service	100.00	
Office Supplies	75.00	
Bank Charges	25.00	
Credit Card Fees & Int	30.00	
Totals	\$3,780.00	\$3,780.00

Comparative Trial Balance at December 31

Account	November	December	Total
Checking Account	190.00	360.00	550.00
Office Equipment	225.00	0.00	225.00
Computer Hardware	500.00	400.00	900.00
Office Furniture	0.00	945.00	945.00
Accounts Payable	0.00	-680.00	-680.00
Owners' Equity	-1500.00	-1100.00	-2600.00
Sales	0.00	-500.00	-500.00
Website Hosting	0.00	120.00	120.00
Rent	500.00	0.00	500.00
Repairs & Maintenance	0.00	25.00	25.00
Fuel	0.00	25.00	25.00
Subscriptions	0.00	65.00	65.00
Meals	0.00	45.00	45.00
Phone Service	0.00	150.00	150.00
Electric Service	0.00	100.00	100.00
Office Supplies	75.00	0.00	75.00
Bank Charges	10.00	15.00	25.00
Credit Card Fees & Int	0.00	30.00	30.00
Totals	\$0.00	\$0.00	0.00

THE BALANCE SHEET: «YOU ARE HERE»



The Balance Sheet is like the “X” on a map that says “**You are Here**”. It tells you what your business owns, what it owes and what it is worth (book value).

Items listed on the **Balance Sheet** have **lasting value** and they remain on the balance sheet until they are disposed of.

Items that do not have lasting value are listed on the Income Statement.

ASSETS, LIABILITIES, EQUITY

The three definitions (IFRS Conceptual Framework, 2018)

Asset

A present economic resource controlled by the entity as a result of past events.

An economic resource is a right that has the potential to produce economic benefits.

Examples: cash, receivables, inventory, prepayments, buildings, equipment, patents.

Liability

A present obligation of the entity to transfer an economic resource as a result of past events.

Legally enforceable or constructive (e.g. repairing faults after the warranty has expired, by policy).

Examples: payables, wages and interest payable, loans, bonds, customer deposits, unearned revenue, warranty provisions.

Equity

The residual interest in the assets of the entity after deducting all its liabilities.

Sub-classified: share capital, share premium, reserves, retained earnings. Some reserves are legally restricted to protect creditors.

Book value ≠ market value of the company.

$$\text{Assets} = \text{Liabilities} + \text{Equity} \quad \text{Equity} = \text{Assets} - \text{Liabilities}$$

Before 2018 the definitions spoke of «expected future economic benefits»: the new wording removes the probability threshold from the definition and moves it to recognition.

THE STRUCTURE OF THE BALANCE SHEET

Two sections, two sorting logics

Assets (order of liquidity, IFRS / US practice)	Liabilities and equity
Current assets: cash, marketable securities, receivables, inventory, prepaid expenses	Current liabilities: payables, accrued expenses, taxes payable, unearned revenue, current portion of debt
Investments	Long-term liabilities: bank loans, bonds
Property, plant and equipment (net of accumulated depreciation)	Total liabilities
Intangible assets; other assets	Equity: common stock, paid-in capital, retained earnings
Total assets	Total liabilities and equity

Italian Civil Code (art. 2424)

Assets sorted by destination (fixed vs current) with maturities inside the items; liabilities by source (equity, provisions, TFR, payables). The format is mandatory, item by item.

IFRS (IAS 1 / IFRS 18)

Minimum line items, current / non-current split, but no mandatory format: companies choose the layout.

BALANCE SHEET – EXAMPLE (US PRACTICE)

Balance sheet - example

<u>ASSETS</u>		<u>LIABILITIES</u>	
Current assets		Current liabilities	
Cash	\$ 2,100	Notes payable	\$ 5,000
Petty cash	100	Accounts payable	35,900
Temporary investments	10,000	Wages payable	8,500
Accounts receivable - net	40,500	Interest payable	2,900
Inventory	31,000	Taxes payable	6,100
Supplies	3,800	Warranty liability	1,100
Prepaid insurance	1,500	Unearned revenues	1,500
Total current assets	<u>89,000</u>	Total current liabilities	<u>61,000</u>
Investments	<u>36,000</u>	Long-term liabilities	
Property, plant & equipment		Notes payable	20,000
Land	5,500	Bonds payable	400,000
Land improvements	6,500	Total long-term liabilities	<u>420,000</u>
Buildings	180,000		
Equipment	201,000	Total liabilities	<u>481,000</u>
Less: accum depreciation	(56,000)		
Prop, plant & equip - net	<u>337,000</u>		
Intangible assets		<u>STOCKHOLDERS' EQUITY</u>	
Goodwill	105,000	Common stock	110,000
Trade names	200,000	Retained earnings	229,000
Total intangible assets	<u>305,000</u>	Less: Treasury stock	(50,000)
Other assets	<u>3,000</u>	Total stockholders' equity	<u>289,000</u>
Total assets	<u>\$ 770,000</u>	Total liabilities & stockholders' equity	<u>\$ 770,000</u>

BALANCE SHEET – ITALIAN CIVIL CODE FORMAT

STATEMENT OF THE FINANCIAL POSITION (art. 2424 c.c.)	
Attivo	Passivo
<i>A) Receivables from shareholders</i>	<i>A) Owners' Equity</i>
<i>B) Fixed assets</i>	I – Shareholders Capital
I – Intangible Fixed Assets	II – Share Premium Reserve
II – Tangible Fixed Assets	III – Revaluation Reserve
III – Financial Fixed Assets	IV – Legal Reserve
<i>C) Current Assets</i>	V – Statutory Reserve
I – Inventories	VI – Treasury Reserve
II – Trade Receivables	VII – Other Reserves
III – Financial Current Assets	VIII – Retained Earnings
IV – Cash and Equivalents	IX – Net income of the year
<i>D) Accruals and Prepayments</i>	<i>B) Provisions for risks and charges</i>
	<i>C) Employees Benefits</i>
	<i>D) Payables</i>
	<i>E) Accruals and Deferred Income</i>

THE INCOME STATEMENT

What it reports and how

What it reports

The profitability of a period: revenues and gains minus expenses and losses = net income (or net loss).

Income statement accounts have no lasting value: they are reset to zero every year and the result moves to equity.

The period can be a year, a quarter, a month: the heading says which.

Income and expenses (Framework 2018)

Income: increases in assets or decreases in liabilities that increase equity, other than contributions from owners.

Expenses: decreases in assets or increases in liabilities that decrease equity, other than distributions to owners.

Revenues arise in the ordinary course of business; gains and losses do not (sale of a building, a lawsuit).

Several measures of performance can be shown by grouping items differently: gross margin, operating profit, profit before tax, net income. The two classic layouts (next slides) differ in how expenses are grouped: by nature or by function.

INCOME STATEMENT BY NATURE

Income Statement (costs classified by nature)

Sales Revenues

Other income

Changes in inventories of finished goods and work in progress

Work performed by entity and capitalised

Raw material and consumables used

Employee benefit expense

Depreciation and amortisation expense

Impairment of property, plant and equipment

Other expenses

Finance costs

Share of profit/loss of associates and joint ventures accounted by equity method

Profit/loss before tax

Income tax expense

Profit/loss for the period

- attributable to minority interests

- attributable to equity holders of the parent

INCOME STATEMENT BY FUNCTION

Income Statement (costs classified by destination)

Sales Revenue

Cost of sales

Gross Profit

Distribution costs

General and administrative expenses

Other operating income

Other operating expenses

Finance costs

Share of profit of associates

Profit before income tax

Income tax expense

Profit/loss for the period

- attributable to minority interests
- attributable to equity holders of the parent

ITALIAN CIVIL CODE FORMAT – art. 2425

By nature, with a fixed structure (as amended in 2016)

Section	Content
A) Value of production	revenues, change in inventories of finished goods and WIP, capitalised internal work, other income
B) Costs of production	raw materials, services, rent, personnel, depreciation and write-downs, change in raw material inventories, provisions, other operating costs
A – B	difference (not the operating profit: includes non-operating and non-recurring items)
C) Financial income and expenses	
D) Adjustments to financial assets	
Result before taxes	then income taxes and net income

What changed in 2016

Section E) «extraordinary income and expenses» was abolished by D.Lgs. 139/2015: non-recurring items are now classified by nature and disclosed in the notes (art. 2427 n. 13).

Older textbooks and slides still show section E: it no longer exists.

Compare with IFRS 18 (from 2027): categories operating / investing / financing, a mandatory «operating profit» subtotal, and rules for management-defined performance measures such as adjusted EBITDA.

THE SIMPLEST INCOME STATEMENT

Income Statement Format

+ Revenue	Total Sales Amount
- Cost of Goods Sold	What it cost to purchase and/or manufacture products and/or provide services sold
= Gross Margin	Amount of Revenue left after direct costs to cover operating expenses
- Expenses	Operating Costs Consumed (No lasting Value)
= Net Income(Loss)	Profit(Loss) from sales after all consumable costs. Represents the increase or decrease, for the current year, in what the Business is worth

FROM THE TRIAL BALANCE TO THE STATEMENTS

Our website business: the cumulative trial balance becomes two statements

Income statement (Nov–Dec)	Amount
Sales	500
Rent	(500)
Phone Service	(150)
Website Hosting	(120)
Electric Service	(100)
Office Supplies	(75)
Subscriptions	(65)
Meals	(45)
Credit Card Fees & Interest	(30)
Repairs & Maint. 25 · Fuel 25 · Bank Charges 25	(75)
Net loss	(660)

Balance sheet at 31 December	Amount
Checking Account	550
Office Equipment	225
Computer Hardware	900
Office Furniture	945
Total assets	2,620
Accounts Payable	680
Owners' Equity (1,500 + 1,100)	2,600
Net loss	(660)
Total liabilities + equity	2,620

Rule: balance sheet accounts carry forward; income statement accounts are reset to zero every year and their net result moves to equity.

WHAT HAPPENS IN COMPANIES' REALITY

Before the statements can be trusted: year-end adjustments

Profit must be measured on the accrual basis: revenues of the period, and the costs of the inputs consumed to earn them. The ledger at 31 December still records payments and receipts; adjusting entries turn them into revenues and expenses of the period.

Adjustment	Typical entry	In Bergamo Bikes (exercise 7)
Inventory	closing inventory recognised; cost of goods sold for what was sold	30 unsold bikes: inventory 9,000
Depreciation / amortisation	depreciation expense / accumulated depreciation	equipment 24,000 over 6 years: 4,000
Accrued expenses and revenues	expense / accrued liability (not yet paid or billed)	interest 3 months: 250
Prepayments and deferred revenue	prepaid asset / expense (paid but not yet consumed)	rent paid for 12 months, 6 consumed: prepaid 3,000
Provisions and write-downs	expense / provision (probable future outflow); bad debts	not in the case: next lessons

Homework, exercise 7: Bergamo Bikes ends its first year with 34,000 in cash and a loss. Explain why, using this table.

THE OTHER TWO STATEMENTS

Cash flow statement and statement of changes in equity, in one slide

Statement of cash flows (IAS 7)

Explains the change in cash and cash equivalents over the period:

- ✓ operating activities: cash generated by running the business
- ✓ investing activities: purchases and sales of long-term assets
- ✓ financing activities: loans raised or repaid, share issues, dividends

Bergamo Bikes: operating –12,000, investing –24,000, financing +70,000 → cash +34,000.

Statement of changes in equity

Reconciles opening and closing equity: net income, other comprehensive income, dividends, share issues and buy-backs, corrections of errors.

Mandatory under IFRS; in Italy the information is in the notes (art. 2427).

Bergamo Bikes: $0 + 50,000 - 1,250 = 48,750$.

Both are covered in depth later in the course (IAS 7 on 14 October; changes in equity with IAS 1 on 12 October).

BEFORE YOU GO

Homework set 2 and three questions

Homework set 2 – due Wednesday 30

- ✓ Exercise 5 – The Library: journal, income statement, balance sheet
- ✓ Exercise 6 – The retail shop: the equation in one table
- ✓ Exercise 7 – Bergamo Bikes: adjustments and statements

Debriefing at the start of Wednesday's lesson.

Could you answer in three lines?

1. Why is the loss of our website business not visible in the trial balance, although every number is there?
2. A company sells a building for more than its book value: revenue or gain? Where does it appear?
3. Rent for twelve months is paid on 1 October: what is the expense of the year and what is the asset?

Wednesday 30 September: debriefing of set 2, then who writes the accounting rules (EU, Italy, IASB) and the two bookkeeping systems behind the income statement formats seen today.