

Case Study: Expanded Income Statement

by Sophia



WHAT'S COVERED

This lesson will cover the preparation of an expanded income statement in the context of a case study, using a hypothetical merchandising company.

Our discussion breaks down as follows:

1. [Case Study: Legacy Clothing](#)
2. [Case Study: Expanded Income Statement](#)

1. Case Study: Legacy Clothing

The subject company for our case study is called Legacy Clothing. Legacy Clothing is a sole proprietorship, which is a company that is owned by a single individual, and where that individual and the business are legally treated as the same.

The purpose of Legacy Clothing as a business is to own and operate clothing/merchandise stores. It is similar to a department store chain, selling men's, women's, and children's clothing and other related items. Legacy Clothing has locations throughout Washington, DC, and they have a large staff of 50 people employed in their stores.

Legacy Clothing	
Type of company	Sole proprietorship
Business purpose	Own and operate clothing/merchandise stores
Business location(s)	Washington, D.C. Staff of 50 people

The Legacy Clothing needs an expanded income statement in order to understand the business's profitability. An expanded income statement can help Legacy Clothing determine the health and strength of their business, which is important information for owners, potential investors, and the banks that they are dealing with.

An expanded income statement also helps Legacy Clothing to understand the specific needs for their merchandising business, by providing critical information such as net sales, net purchases, and cost of goods sold, so that they are able to perform an analysis on that information to fully understand their business.

2. Case Study: Expanded Income Statement

Now, let's look at preparing an expanded income statement for Legacy Clothing. The starting point for preparing our financial statements is the adjusted trial balance, shown on the left.

The first thing we need to do is put in our header, which includes our company name, Legacy Clothing, "Income statement," and "For the period ending December 31, 2012."

The next step is to input our gross sales. We pull that sales number information, as you can see below, from our adjusted trial balance. Then, we can pull in our sales returns and allowances, as well as our sales discounts, which also come from the adjusted trial balance. This total provides our net sales.



FORMULA TO KNOW

Expanded Sales Calculation

$$\text{Gross Sales} - \text{Sales Returns and Allowances} - \text{Discounts} = \text{Net Sales}$$

ADJUSTED TRIAL BALANCE			EXPANDED INCOME STATEMENT		
Accounts	Dr.	Cr.	Legacy Clothing Income Statement For the period ending December 31, 2012		
Sales		990,000	Sales		990,000
Sales Returns and Allowances	30,000		Sales Returns and Allowances	30,000	
Sales Discounts	15,000		Sales Discounts	15,000	45,000
Purchases	163,000		Net Sales		945,000
Purchase Returns and Allowances		10,000			
Purchase Discounts		5,000			
Freight-in	5,000				
Salaries Expense	360,000				
Advertising Expense	10,000				
Rent Expense	50,000				
Interest Expense	20,000				
Depreciation Expense: Buildings	15,000				
Insurance Expense	4,000				
Supplies Expense	2,500				

The next piece needed is to calculate our cost of goods sold. In order to do this, let's dive deeper into the cost of goods sold calculation.

COST OF GOODS SOLD CALCULATION			
Beginning Inventory			200,000
Purchases		163,000	
Subtract: Purchase Returns and Allowances	10,000		
Purchase Discounts	50,000	15,000	
Net Purchases		148,000	
Add Freight-In		5,000	
Cost of Goods Purchased			153,000
Goods Available for Sale			353,000
Ending Inventory			125,000
Cost of Goods Sold			228,000

ADJUSTED TRIAL BALANCE		
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Sales		990,000
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Sales Discounts	15,000	
Purchases	163,000	
Purchase Returns and Allowances		10,000
Purchase Discounts		5,000
Freight-in	5,000	
Salaries Expense	360,000	
Advertising Expense	10,000	
Rent Expense	50,000	
Interest Expense	20,000	
Depreciation Expense: Buildings	15,000	
Insurance Expense	4,000	
Supplies Expense	2,500	

Please note that the "Purchase Discounts" in the image should read \$5,000.

To calculate cost of goods sold, we start with our beginning inventory from the beginning of the year. Then, we pull in our purchases from our adjusted trial balance. From purchases, we subtract our purchase returns and allowances, as well as subtract our purchase discounts--all information pulled from the adjusted trial balance--to give us our net purchases.

Now, we take those net purchases and add freight-in, which is the shipping costs to get those purchases to our business. This provides our cost of goods purchased.

Finally, we take our beginning inventory and add cost of goods purchased to give us our goods available for sale. Once we have this figure, we can subtract out our ending inventory to give us our cost of goods sold. We will take this cost of goods sold number and put it into our expanded income statement.

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Sales		990,000	Sales		990,000
Sales Returns and Allowances	30,000		Sales Returns and Allowances	30,000	
Sales Discounts	15,000		Sales Discounts	15,000	45,000
Purchases	163,000		Net Sales		945,000
Purchase Returns and Allowances		10,000	Cost of Goods Sold		228,000
Purchase Discounts		5,000	Gross Profit		717,000
Freight-in	5,000				
Salaries Expense	360,000				
Advertising Expense	10,000				
Rent Expense	50,000				
Interest Expense	20,000				
Depreciation Expense: Buildings	15,000				
Insurance Expense	4,000				
Supplies Expense	2,500				

Returning to the income statement, now we can plug in our \$228,000 cost of goods sold figure. Then, we take our net sales and subtract cost of goods sold to give us our gross profit.

Now we can detail the operating expenses, which, again, we pull from our adjusted trial balance. Therefore, we pull in our salaries expense, advertising expense, rent expense, depreciation expense, insurance, and supplies,

which are all of our operating expenses. We subtract our operating expenses from our gross profit to give us income from operations.

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Sales Returns and Allowances	30,000		Sales Returns and Allowances	30,000	
Sales Discounts	15,000		Sales Discounts	15,000	
Purchases	163,000		Net Sales		945,000
Purchase Returns and Allowances		10,000	Cost of Goods Sold		228,000
Purchase Discounts		5,000	Gross Profit		717,000
Freight-in	5,000				
Salaries Expense	360,000		Operating Expenses		
Advertising Expense	10,000		Salaries Expense	360,000	
Rent Expense	50,000		Advertising Expense	10,000	
Interest Expense	20,000		Rent Expense	50,000	
Depreciation Expense: Buildings	15,000		Depreciation Expense: Buildings	15,000	
Insurance Expense	6,000		Insurance Expense	6,000	
Supplies Expense	2,500		Supplies Expense	2,500	
			Income from Operations		443,500
			Other Revenue (Expenses)		
			Interest Expense		20,000
			Net Income		253,500

However, we're not quite done yet. Now we need to plug in any other revenue or expense items that we might have. In this case, all we have is our interest expense. So, we take our income from operations, subtract out our interest expense, to give us our net income.

This is what the final expanded income statement looks like for our subject company, Legacy Clothing.



SUMMARY

Today we introduced our **case study** company called **Legacy Clothing**, that is in the business of owning and operating multiple department store locations, selling men's, women's, and children's clothing and other related items. We walked through an **example of preparing an expanded income statement** for Legacy Clothing, using our adjusted trial balance and calculating cost of goods sold to prepare the expanded income statement.

Source: Adapted from Sophia instructor Evan McLaughlin.