Chapter 2 Anlayzing Changes in the Accounting Equation

Topic 1 and 2 Vocabulary

- -Business transactions
- -Drawing
- -Revenue and expense transactions
- -Commissions
- -Accounts receivable
- -Revenue
- -Revenue Principle
- -Expenses
- -Expense Principle
- -Matching Principle
- -Net Income
- -Net Loss

Topic 3 - ANALYZING THE INCOME STATEMENT AND THE RELATED BALANCE SHEET

In Topic 2 we saw how revenue and expense transactions expand the accounting equation under owner's equity so that net income (net loss) may be calculated for a certain time period.

The results of this expanded equation may be summarized in two kinds of accounting reports.

- 1.) An Income Statement summarizes the revenue and related expenses and reports the net income or net loss for a specific accounting period
- 2.) A Related Balance Sheet reports assets, liabilities and owner's equity as at the end of a specific accounting period.

ANALYZING AN INCOME STATEMENT

Turn to page 48 in your text for an example of an income statement printed and a hand written Income Statement

Income Statement - has 2 sections

- 1.) heading
- 2.) body

Heading has three lines

Line 1 - shows the name of the business
Line 2 - the name of the financial statement (what)

Line 3 - the specific period for which revenue and expenses are matched - notice the difference between the date in the income statement and the date in the balance sheet (When)

Example:

J. Emery Real Estate ✓ Income Statement

For the Month Ended October 31, 2009

Body

- At the beginning of the body is a summary of reported revenue for the accounting period
- Revenue is followed by expenses for the same accounting period
- The results of operating the business the net income or net loss for the accounting period concludes the income statement

Example:	1st column	2nd columr	l
Revenue: Commission Earned Expenses:		\$51 800.00	The second column is the
Salaries Expense Rent Expense Utilities Expense Telephone Expense Advertising Expense Total Expenses	\$4 500.00 1 600.00 595.00 40.00 2 000.00	8735.°°	main money column for the match-up of revenue with related expenses
Net Income		\$43 065.00	

PREPARING AN INCOME STATEMENT

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By Hand

HEADING - who

what

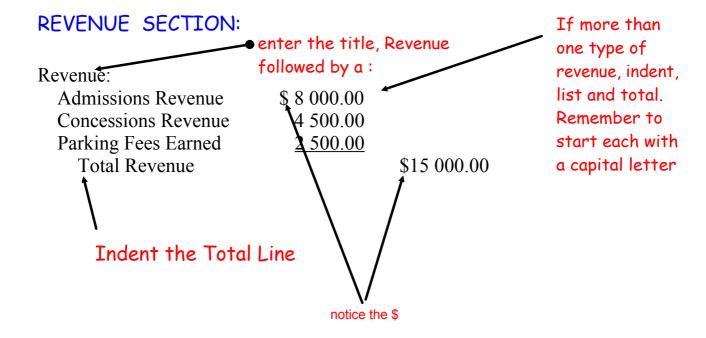
when - *** explains the accounting period covered by the

statement
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Examples:

one month (January 2009) For the Period Ended January 31, 2009 three months (Jan -Mar 2009) For the Quarter Ended March 31, 2009 calendar year (Jan-Dec 2009) For the Year Ended December 31, 2009

Note: the period has ended, incorrect to use ending

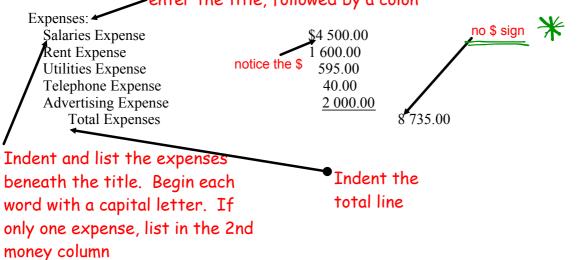


Source of Sales depends on the nature of a business operations

- Retailing, wholesaling and manufacturing businesses earn revenue mainly by selling goods. The may describe their main source of sales as Sales Revenue or simply Sales.
- •Businesses who charge a commission for their service may report their revenue as Commissions Earned.
- •Many service businesses are professional law, medicine, dentistry, accounting etc. These businesses charge a fee for their services. They may describe their source of revenue as Professional Fees Earned or Fees Earned.

The EXPENSE SECTION





NET INCOME or NET LOSS SECTION

- the income statement concludes with <u>net income</u> or <u>net los</u>s. This is the final result of operating a business for an accounting period.
- draw a single line under the amount of total expenses
- subtract the difference between total revenue and total expenses, record
- -draw a double line under the amount of Net Income or Net Loss to indicate the match of revenue and related expenses, the statement is complete

Revenue: Commission Earned		\$51 800.00
Expenses:		
Salaries Expense	\$4 500.00	
Rent Expense	1 600.00	
Utilities Expense	595.00	
Telephone Expense	40.00	
Advertising Expense	2 000.00	
Total Expenses		8 735.00
Net Income		\$43 065.00

Dollar Signs:

- Income Statement is a formal financial statement so dollar signs should appear with the <u>first amount in each money column</u> and the $final\ result\ in\ the\ second\ money\ column$

Revenue:		
Commission Earned		\$51 800.00
Expenses:		
Salaries Expense	\$4 500.00	
Rent Expense	1 600.00	
Utilities Expense	595.00	
Telephone Expense	40.00	
Advertising Expense	2 000.00	
Total Expenses		8 735.00
Net Income		\$43 065.00
		===

Income Statement - a financial report of the results of matching revenues with related expenses for a definite accounting period

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Diamond Thoatre Income Statement

For the Year Ended December 31, 2016

Ð	•
Revenue	•

Admissions Revenue	\$ 900 000.00
Parking Fees Earned	}3 570,₩
Concessions Revenue	<u>37</u> 500.0°
Total Revenue	

\$ 263 070.00

Expenses:

Net Income

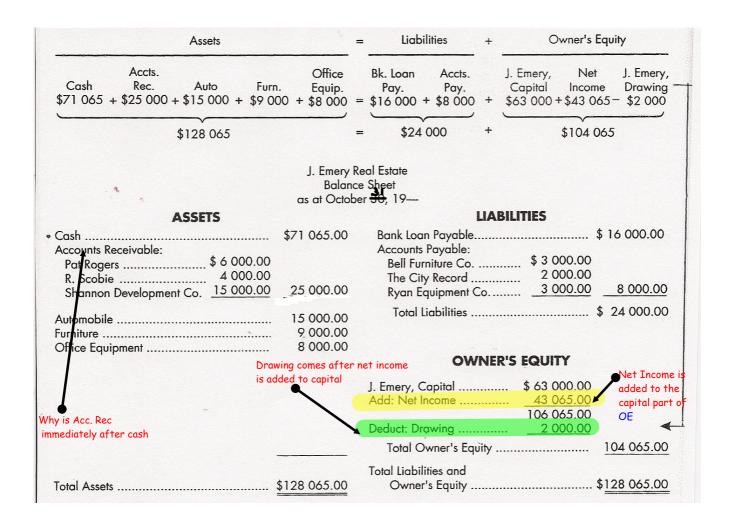
119.00
96 300,0
6 000.°
1500-00
56.00
18 000.00
300°
. 53 175.9
4 800.

PREPARING A RELATED BALANCE SHEET

-Remember - Income is the amount remaining after revenues and related expenses have been matched for an accounting period

Revenue means an inflow of assets (cash and/or accounts receivable through sales and expenses means an outflow of assets (cash) or an increase in liabilities (accounts payable), then certain balances must be updated to reflect these changes.

- Once the Income Statement is complete you must immediately prepara new balance sheet to report the new balances in assets, liabilities and owner's equity.



What is the main goal of a business? What is the main goal of the owner?

Drawing: payments made in anticipation of profits (net income)
In order to live the owner may have to withdraw cash. Drawing are
considered to be a distribution of profits. These payments
(withdrawals) are often before the net income has been computed and
recorded. - This is the reason it is very important to report
withdrawals only after net income has been added to capital in OE.

No withdrawal of assets for the owner's personal use should ever be reported in the income statement. WHY???

How do you report a Net Loss??

Total Liabilities		\$24 000
OWNER'S	EQUITY	
J. Emery, Capital	\$63 000	
Less: Net Loss	3 000	
	60 000	
Less: Drawing	2 000	
Total Owner's Ec	quity	<u>58 000</u>
Total Liabilities & OF	3	\$82 000

Page 54 Problem P2-7 (we will do together)

Concept Reinforcement Page 54-56 P2-8, P2-9

Page 56-57 MC2-7, MC2-8, MC2-9

KEY FOR TOPIC 3 PROBLEMS		
P 2-7a		
P 2-7a Diamond Theatre		
Income Statement		
For the Year Ended December 31, 19		
Revenues:		
Admissions Revenue	\$202 000	
Parking Fees Earned	23 570	
Concessions Revenue	37 500	
Total Revenues	A American	\$263
Expenses:	¢06.200	
Salaries Expense	\$96 300 112	
Advertising Expense	6 000	
Insurance Expense	1 500	
Miscellaneous Expense	56	
Building Rental Expense	18 000	
Utilities Expense	3 000 52 175	
Film Rental Expense	4 800	
Total Expenses		181
a sement of the latter views of the Court of the latter to the latter than the		
Net Income (Loss)		\$ 81
P 2-8a		
J.K. Teaching Services		
Income Statement		
For the Month Ended October 31, 19		
Revenue:		
Fees Earned	\$9 600	
Total Revenue		\$9 (
Expenses:	6700	
Rent Expense	\$700 55	
Telephone Expense Office Supplies Expense	120	
Salaries Expense	1 300	
Utilities Expense	90	
Advertising Expense	210	
		24
Total Expenses		\$7 1
Total Expenses		

	Balan	hing Services ace Sheet ober 31, 19					
ASSETS Cash	\$17 335	LIABILITIES Accounts Payable: B.C. Ed. Supplies\$2 500 B.C. Herald				\$ 2710	
A. White600 Equipment	3 400 13 000	J. Kara, Capi Net Income Less: J. Kar	a, Drawing.	\$25 7 32	125 125 100	31 025	
Total Assets	\$33 735	Total Liabili	ties and Ow	ner's Equity		\$33 735	
					. 61		

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Soft-Back $\rightarrow \partial$	∂ ČW +	15000 +	700 =	37 700)
P2-9d Spiral Binding >	300	+450 =	750		
P 2-9d - \	MICH	Book Binders			
	0,	ne Statement	2016		
Fo		h Ended May 31,	19		
Revenues:					
Hard-Back Binding Revenue		•••••		\$10 000	
Soft-Back Binding Revenue				37 700	
Spiral Binding Revenue	••••••			<u>750</u> •	* 40 4 *
Expenses:					\$48 45
Insurance Expense				\$ 970	
Binding Supplies Expense				6 500	
Telephone Expense		••••••		350 99	
Salaries Expense				15 800 •	
Heat Expense	•••••		•••••	650	
Gas and Oil Expense			•••••••••	85	
Total Expenses					24 45
Net Income (Loss)					222.00
	λ 1		••••••		\$23 99
Salarics -> 7900 +	اد میا	= 15800			
	Balar	Book Binders ace Sheet			
	as at M	$1ay 31, 19 - \partial$	016		
ASSETS		I	LIABILITIES		
Cash	\$ 50 246	Bank Loan Pa	yable	•••••	\$ 170
Chamber of Commerce \$15 000		Accounts Pay	able: ustries	\$ 5,000	
Lambton Bd. of Ed 10 000		Watertown	Motors	14 000	19 00
Shell Canada Limited 450	25 450			- 1	
Land	45 000 140 000	Total Lia	bilities		\$20 70
Truck	15 000	1			
Office Equipment	8 000	*OWI	NER'S EQUI	TY	
Book Binding Equipment	8 500	D. Egyed, Cap Net Income	ital	\$250 000	
		THE HICOHIC		23 996 273 996	
		Less: D. Egye	d, Drawing	2 500	
		Total Owne	r's Equity		271 496
Total Assets	\$292 196	Total Liabilitie	s and Owner's	Equity 9	292 196
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0		0.11 .1	1 1		
		Add N	et Inco	ne	
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			17 (10)		

KEY FOR TOPIC 3 MINI-CASES

MC 2-7a

The GAAP that affects the income statement is the matching principle. It states that wherever possible the revenues and expenses of a similar period should be matched together in order to arrive at the net income (loss) figure for that period of time.

MC 2-7b

The first two lines of the income statement and balance sheet are similar. They provide the name of the company and the name of the statement. The date line, however, is different. The date line in the balance sheet heading states the date "as at a particular day." The income statement date line tells you the period of time over which the net income (loss) has been calculated and that this period of time is historical; that is, the period of time has ended on the date reported on the date line.

MC 2-7c

The balance sheet is dependent upon the income statement. The net income (loss) figure calculated in the income statement is transferred to the owner's equity section of the balance sheet. It is this number that causes the balance sheet to come into agreement. In other words, the total assets equal the total liabilities plus the total owner's equity.

MC 2-8a

The income statement tells the reader:

- · the name of the company
- the period of time over which the net income (loss) was calculated
- · the total of the revenue earned for the period of time being measured
- the total of the expenses incurred for the period of time being measured
- · the net income or net loss for the period of time being measured

MC 2-8b

The balance sheet tells the reader:

- · the name of the company
- · the date as at the balances of all assets, liabilities, and owner's equity are reported
- · the details of individual assets, liabilities, and the owner's equity accounts of the business
- the total assets of the business as at a particular date
- the total liabilities of the business as at a particular date
- the total owner's equity of the business as at a particular date
- · that the total assets is equal to the total liabilities and total owner's equity

MC 2-9a

GAAPs involved in the preparation and presentation of the income statement include:

- revenue and expense recognition principles. Revenues and expenses are recognized according to these two principles. As a result, the appropriate revenues and expenses are reported in the income statement.
- matching principle. This principle ensured that all revenues earned and all expenses incurred during the same period are matched to determine the net income or net loss for that period.

GAAPs involved in the preparation and presentation of the balance sheet include:

- cost principle. All assets are reported at their cost value; that is, at the original cost of acquiring those assets.
- objectivity principle. The cost principle is supported by the objective evidence provided by the source documents resulting from the purchase of the assets of the business.

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Date	Cash	Accou nts Receiv able	Van	Office Equip ment	Office Furnit ure	Total Assets	Bank Loan Payabl e	Accou nts Payabl e	Total Liabilit ies	A. Coope r, Capital	Reven ue	Expen ses	A. Coope r, Drawi ng	Total Owner 's Equity
Feb. 1	+4500 0					+4500 0				+4500 0				+4500 0
Feb. 1	-250					-250						-250		-250
Feb. 3	-2500			+7500		+5000		+5000	+5000					
Feb. 5	-6000		+2370 0			+1770 0		+1770 0	+1770 0					
Feb. 6	-850					-850						-850		-850
Feb. 7					+1000 0	+1000 0		+1000 0	+1000 0					
Feb. 8		+7500				+7500					+7500			+7500
Feb.	+600					+600					+600			+600
Feb.	-135					-135						-135		-135
Feb.	-85					-85						-85		-85
Feb. 15	-250					-250						-250		-250
Feb. 15	-1300					-1300						-1300		-1300
Feb. 17	-10000					-10000		-10000	-10000					
Feb.	+600					+600					+600			+600
Feb. 19		+4000				+4000					+4000			+4000
Feb. 23	-160					-160						-160		-160
Feb. 23	+8500					+8500	+8500		+8500					
Feb. 25		+900				+900					+900			+900
Feb. 26	-4300					-4300						-4300		-4300
Feb. 27	-4200					-4200							-4200	-4200
Feb. 28	+900	-900				0								
Feb. 28	-1300					-1300						-1300		-1300
Feb. 28	-1100					-1100	-1100		-1100					
Totals	23170	11500	23700	7500	10000	75870	7400	22700	30100	45000	13600	-8630	-4200	45770

Andrea's Delivery
Income Statement
For the Month Ended February 28 2016

•	\mathcal{J}
Revenue: Delivery Revenue	\$ 13600,00
Expense:	
Rent Expense	\$ 500.00
Insurance Expense	850.°°
Utilities Expense	135.00
Telephone Expense	85.00
Salares Expense	3600'∞
Heating Expense	160.00
Gas + Oil Expense	4300. 00
Total Expenses	<u>8630</u> , 00
Net Income	\$ 4970.00