

Chapter 2 Analyzing 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 (who)

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 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

The second column is the main money column for the match-up of revenue with related expenses

PREPARING AN INCOME STATEMENT

By Hand

HEADING - who

what

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

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

REVENUE SECTION:

Revenue:

Admissions Revenue
Concessions Revenue
Parking Fees Earned
Total Revenue

\$ 8 000.00
4 500.00
2 500.00

\$15 000.00

enter the title, Revenue followed by a :

If more than one type of revenue, indent, list and total. Remember to start each with a capital letter

Indent the Total Line

notice the \$

Source of Sales depends on the nature of a business operations

- Retailing, wholesaling and manufacturing businesses earn revenue mainly by selling goods. They 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

Starts on the line below the last entry in the revenue section

enter the title, followed by a colon

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		<u>8 735.00</u>	

notice the \$

no \$ sign



Indent and list the expenses beneath the title. Begin each word with a capital letter. If only one expense, list in the 2nd money column

Indent the total line

NET INCOME or NET LOSS SECTION

- the income statement concludes with net income or net loss. 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	<u>2 000.00</u>	
Total Expenses		<u>8 735.00</u>
Net Income		<u><u>\$43 065.00</u></u>

Dollar Signs:

- Income Statement is a formal financial statement so dollar signs should appear with the first amount in each money column 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	<u>2 000.00</u>	
Total Expenses		<u>8 735.00</u>
Net Income		<u><u>\$43 065.00</u></u>

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

(2-7)

Diamond Theatre
Income Statement
For the Year Ended December 31, 2016

Revenue:

Admissions Revenue	\$ 202 000. ⁰⁰	
Parking Fees Earned	23 570. ⁰⁰	
Concession's Revenue	37 500. ⁰⁰	
Total Revenue	<u>263 070.⁰⁰</u>	\$ 263 070. ⁰⁰

Expenses:

Telephone Expense	\$ 112. ⁰⁰	
Salaries Expense	96 300. ⁰⁰	
Advertising Expense	6 000. ⁰⁰	
Insurance Expense	1 500. ⁰⁰	
Miscellaneous Expense	56. ⁰⁰	
Building Rental Expense	18 000. ⁰⁰	
Utilities Expense	3 000. ⁰⁰	
Film Rental Expense	52 175. ⁰⁰	
Projection Rental Expense	<u>4 800.⁰⁰</u>	
Total Expenses		<u>181 943.⁰⁰</u>
Net Income		<u><u>\$ 81 127.⁰⁰</u></u>

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 prepare a new balance sheet to report the new balances in assets, liabilities and owner's equity.

Assets					=	Liabilities		+	Owner's Equity		
Cash	Accts. Rec.	Auto	Furn.	Office Equip.	=	Bk. Loan Pay.	Accts. Pay.	+	J. Emery, Capital	Net Income	J. Emery, Drawing
\$71 065	+\$25 000	+\$15 000	+\$9 000	+\$8 000	=	\$16 000	+\$8 000	+	\$63 000	+\$43 065	-\$2 000
\$128 065					=	\$24 000		+	\$104 065		

J. Emery Real Estate
Balance Sheet
as at October 30, 19—

ASSETS

• Cash	\$71 065.00
Accounts Receivable:	
Pat Rogers	\$ 6 000.00
R. Scobie	4 000.00
Shannon Development Co.	<u>15 000.00</u>
	25 000.00
Automobile	15 000.00
Furniture	9 000.00
Office Equipment	8 000.00

LIABILITIES

Bank Loan Payable.....	\$ 16 000.00
Accounts Payable:	
Bell Furniture Co.	\$ 3 000.00
The City Record	2 000.00
Ryan Equipment Co.	<u>3 000.00</u>
	8 000.00
Total Liabilities	\$ 24 000.00

OWNER'S EQUITY

J. Emery, Capital	\$ 63 000.00
Add: Net Income	<u>43 065.00</u>
	106 065.00
Deduct: Drawing	<u>2 000.00</u>
Total Owner's Equity	<u>104 065.00</u>

Total Assets \$128 065.00

Total Liabilities and Owner's Equity \$128 065.00

Why is Acc. Rec immediately after cash

Drawing comes after net income is added to capital

Net Income is added to the capital part of OE

What is the main goal of a business?
What is the main goal of the owner? } make profits
\$

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	<u>3 000</u>	
	60 000	
Less: Drawing	<u>2 000</u>	
Total Owner's Equity		<u>58 000</u>
Total Liabilities & OE		<u><u>\$82 000</u></u>

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

