# 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	1
Revenue: Commission Earned		\$51 800.00	The second column is the
Expenses: 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

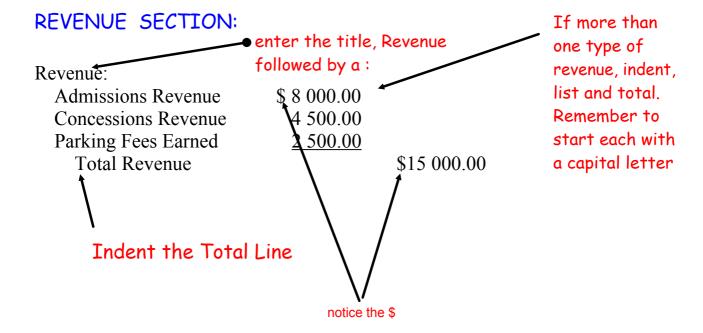
when - *** explains the accounting period covered by the

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

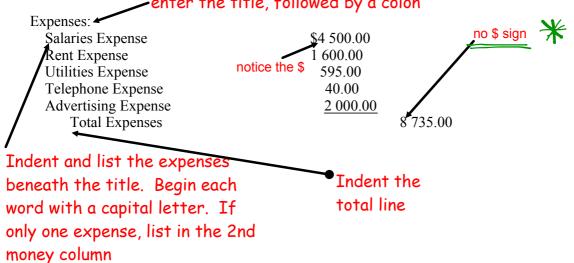


#### Source of Sales depends on the nature of a business operations

- 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 <u>final result in the second money column</u>

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

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Diamond Theatre Income Statement

For the Year Ended December 31, 2016

# Revenue:

Admusions Revinue	\$ 900 000.°°
Parking Fees Earned	<b>∂</b> 3 570,80
Concessions Revenue Total Revenue	37,500,00
Total Revenue	

\$ 263 070.00

# Expenses:

Net Income

Telephone Expense	\$
Salaries Expense	96
Advertising Expense	6
Insurance Expense	1
Miscellaneous Expense	
Building Rental Expense	18
Utilities Expense Film Rental Expense	3
Film Rental Expense	. 5
Projection Rental Expense	4
Total Expenses	

112.00 6 300.00 6 000.00 1 500.00 56.00 5 175.00 4 800.00

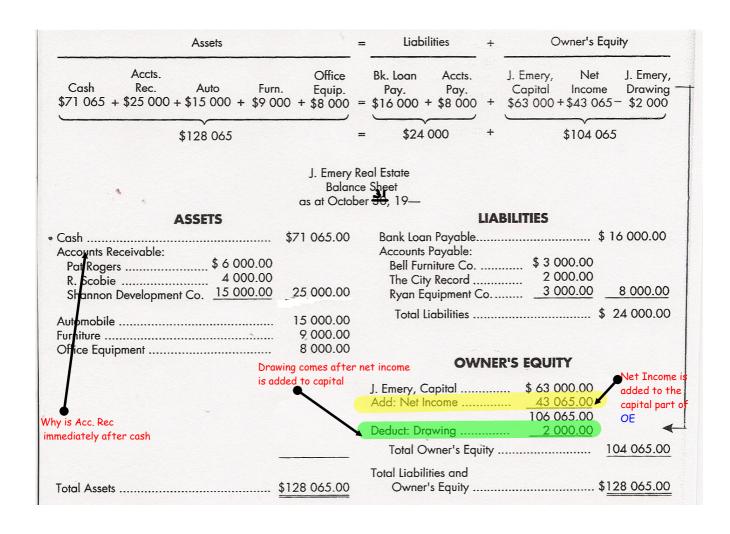
181 943.00 \$ 81 107.00

#### 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??

<b>Total Liabilities</b>		\$24 000
OWNER'S I	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