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
- \bullet 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	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

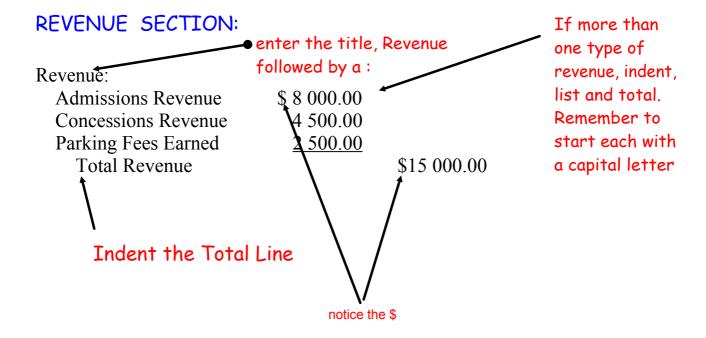
when - *** explains the accounting period covered by the

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

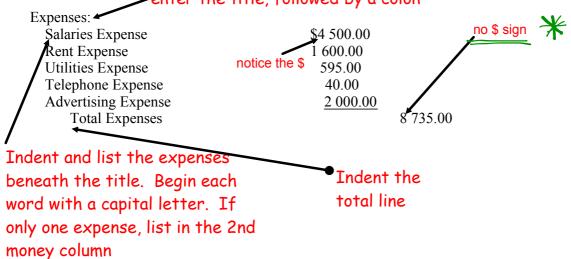


Source of Sales depends on the nature of a business operations

- 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:	44.500.00	
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

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



Diamond Thoatre Income Statement

For the Year Ended December 31, 2016

Revenue:

Admusions Revenue	\$ 909 000.00
Parking Fees Earned	3 570, so
Concessions Revenue Total Revenue	37500.00
Total Revenue	

\$ 263 070.00

Expenses:

Net Income

7		
Telephone Expense	A	119.00
Salaries Expense	9	6 300,00
Advertising Expense		6∞,∞
Insurance Expense		1500-00
Miscellaneous Expense		56.00
Building Rental Expense	(8 cm.00
Utilities Expense		3000.00
Film Rental Expense		5) 175.00
Projection Rental Expense		4 800,°
Total Expenses		

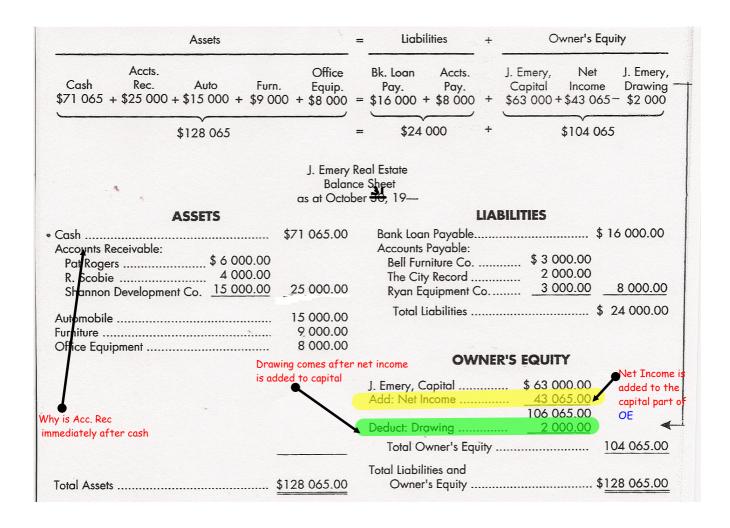
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PREPARING A RELATED BALANCE SHEET

-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)

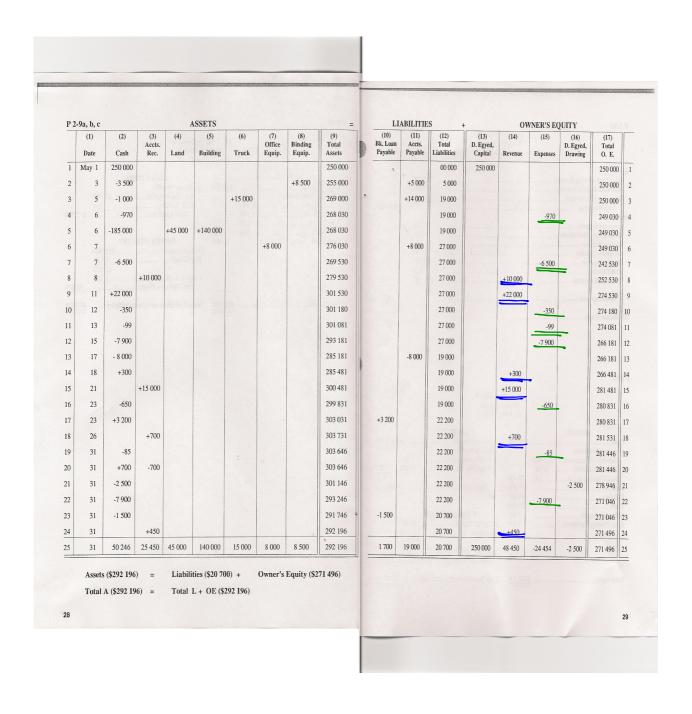
Concept Reinforcement Page 54-56 P2-8, P2-9

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

KEY FOR TOPIC 3 PROBLEMS		
P 2-7a Diamond Theatre		
Income Statement		
For the Year Ended December 31, 19		
the settlement for Lemma to a store the south solve in the settlement is a settlement to a set		
Revenues:	¢202.000	
Admissions Revenue	\$202 000 23 570	
Concessions Revenue	37 500	
Total Revenues		\$263
Expenses:		
Salaries Expense	\$96 300	
Telephone Expense	112 6 000	
Advertising Expense	1 500	
Miscellaneous Expense	56	
Building Rental Expense	18 000	
Utilities Expense	3 000	
Film Rental Expense	52 175 4 800	
Projection Rental Expense	4 800	181
		101
Net Income (Loss)		\$ 81
P 2-8a		
r 2-0a		
J.K. Teaching Services		
Income Statement		
For the Month Ended October 31, 19		
Revenue: Fees Earned	\$9 600	
· · · · · · · · · · · · · · · · · · ·		
Total Revenue		\$9 €
Expenses:	E GRAN	
Rent Expense	\$700	
Telephone Expense	55 120	
Office Supplies Expense	1 300	
Utilities Expense	90	
Advertising Expense	210	
Total Expenses		24
Net Income (Loss)		\$7 1
		===

		Balan	ning Services ce Sheet ober 31, 19				
ASSETS Cash	.\$ 500 . 1 300 . 1 000 600	3 400 13 000	Accounts Pay B.C. Ed. Si B.C. Herald Total Lia OW. J. Kara, Capita Net Income Less: J. Kara,	applies d bilities NER'S EQ al	QUITY \$25 \$25 	210 \$ 000 125 125 100	3 2 710
Total Assets	<u>\$</u>	33 735	Total Owner Total Liabilitie			H T	31 025 33 735
							No.
						ni.	

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	14411	Maydl	11440			
Soft-Back → di	→ 2	15000 +	700	=	37 700)
P2-9d Spral Binding >	200	LUCA	750			
P 2-9d	May 18	+450 =	100			
	Egyed	Book Binders				
And the second of the second o		ne Statement	9016			
ro	or the Month	h Ended May 31,	19			
Revenues:						
Hard-Back Binding Revenue					\$10 000	
Soft-Back Binding Revenue					37 700	
Spiral Binding Revenue	••••••	•••••			<u>750</u> •	
Total Revenues	•••••••	•••••				\$48
Expenses: Insurance Expense						
Insurance Expense	••••••	••••••			\$ 970	
Binding Supplies Expense	••••••••	•••••	•••••		6 500	
Telephone Expense	••••••	•••••••			350	
Salaries Expense		•••••	••••••		99 15 800 •	
Heat Expense			••••••		650	
Gas and Oil Expense		***************************************			85	
Total Expenses	•••••					_24
Net Income (Loss)						000
	10					\$23
Salarics -> 7900 +	1900	= 15800				
Salarics -> 7900 + -	1900	= 15800				
	Egyed I	Book Binders				
	Egyed F Balar	Book Binders nce Sheet				
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P 2-9e	Egyed F Balar as at M	Book Binders nce Sheet Iay 31, 19 I	JABILIT			\$ 1
ASSETS Cash Accounts Receivable:	Egyed F Balar	Book Binders nce Sheet Iay 31, 19 I Bank Loan Pa	yable			\$ 1
ASSETS Cash	Egyed F Balar as at M	Book Binders nce Sheet Iay 31, 19 I Bank Loan Pa Accounts Pay	yable able:	••••••		\$ 1
ASSETS Cash	Egyed F Balar as at M \$ 50 246	Book Binders nce Sheet Iay 31, 19 I Bank Loan Pa Accounts Pay Thorne Ind	yable able: ustries		\$ 5 000 14 000	\$ 1 19
ASSETS Cash	Egyed F Balar as at M \$ 50 246	Book Binders hice Sheet Hay 31, 19 I Bank Loan Pa Accounts Pay Thorne Ind Watertown	yable able: ustries Motors		\$ 5 000 <u>14 000</u>	
ASSETS Cash	Egyed F Balar as at M \$ 50 246 25 450 45 000	Book Binders hice Sheet Hay 31, 19 I Bank Loan Pa Accounts Pay Thorne Ind Watertown	yable able: ustries Motors		\$ 5 000	
ASSETS Cash	Egyed F Balar as at M \$ 50 246 25 450 45 000 140 000	Book Binders hice Sheet Hay 31, 19 I Bank Loan Pa Accounts Pay Thorne Ind Watertown	yable able: ustries Motors		\$ 5 000 <u>14 000</u>	19
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ASSETS Cash	Egyed F Balar as at M \$ 50 246 \$ 50 246 25 450 45 000 140 000 15 000 8 000	Book Binders ace Sheet Bay 31, 19 I Bank Loan Pa Accounts Pay Thorne Ind Watertown Total Lial	yable able: ustries Motors bilities	QUIT	\$ 5 000 14 000	19
ASSETS Cash	Egyed F Balar as at M \$ 50 246 \$ 50 246 25 450 45 000 140 000 15 000	Book Binders nce Sheet lay 31, 19 I Bank Loan Pa Accounts Pay Thorne Ind Watertown Total Lial OWN D. Egyed, Cap	yable able: ustries Motors bilities NER'S Edital	QUIT	\$ 5 000 14 000 250 000	19
ASSETS Cash	Egyed F Balar as at M \$ 50 246 \$ 50 246 25 450 45 000 140 000 15 000 8 000	Book Binders ace Sheet Bay 31, 19 I Bank Loan Pa Accounts Pay Thorne Ind Watertown Total Lial	yable able: ustries Motors bilities NER'S Edital	QUIT	\$ 5 000 14 000 14 000 \$250 000 23 996	19
ASSETS Cash	Egyed F Balar as at M \$ 50 246 \$ 50 246 25 450 45 000 140 000 15 000 8 000	Book Binders hice Sheet lay 31, 19 I Bank Loan Pa Accounts Pay Thorne Ind Watertown Total Lial OWN D. Egyed, Cap Net Income	yable able: ustries Motors bilities NER'S Edital	QUIT	\$ 5 000 14 000 14 000 \$250 000 23 996 273 996	19
ASSETS Cash	Egyed F Balar as at M \$ 50 246 \$ 50 246 25 450 45 000 140 000 15 000 8 000	Book Binders hee Sheet Tay 31, 19 I Bank Loan Pay Accounts Pay Thorne Ind Watertown Total Lial OWN D. Egyed, Cap Net Income Less: D. Egye	yable able: ustries Motors bilities NER'S Edital	QUIT	"Y"\$250 000\$250 000\$273 996\$2500	<u>19</u> \$20
ASSETS Cash	Egyed F Balar as at M \$ 50 246 \$ 50 246 25 450 45 000 140 000 15 000 8 000 8 500	Book Binders hice Sheet lay 31, 19 I Bank Loan Pa Accounts Pay Thorne Ind Watertown Total Lial OWN D. Egyed, Cap Net Income	yable able: ustries Motors bilities NER'S Edital	QUIT	"Y"\$250 000\$250 000\$273 996\$2500	<u>19</u> \$20
ASSETS Cash	Egyed F Balar as at M \$ 50 246 \$ 50 246 25 450 45 000 140 000 15 000 8 000 8 500	Book Binders hee Sheet Tay 31, 19 I Bank Loan Pay Accounts Pay Thorne Ind Watertown Total Lial OWN D. Egyed, Cap Net Income Less: D. Egye	yable able: ustries Motors bilities NER'S Edital d, Drawir r's Equity	QUIT	**************************************	19
ASSETS Cash	Egyed F Balar as at M \$ 50 246 \$ 50 246 25 450 45 000 140 000 15 000 8 000 8 500	Book Binders hice Sheet Hay 31, 19 I Bank Loan Pa Accounts Pay Thorne Ind Watertown Total Lial OWN D. Egyed, Cap Net Income Less: D. Egye Total Owne	yable able: ustries Motors bilities NER'S Edital d, Drawir r's Equity	QUIT	**************************************	19 \$20 271 4

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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