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 (Full Business Name)

Line 2 - the name of the financial statement (Income Statement)

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

Example:

J. Emery Real Estate Income Statement

For the Month Ended October 31, 2009

Year

Body



- At the beginning of the body is a summary of reported <u>revenue</u> 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	
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	8 735. ° °	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

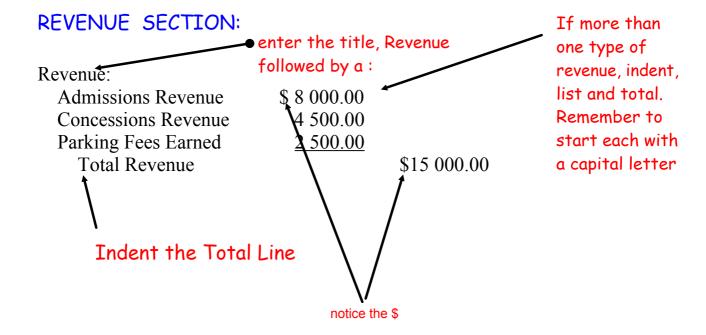
when - *** explains the accounting period covered by the

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

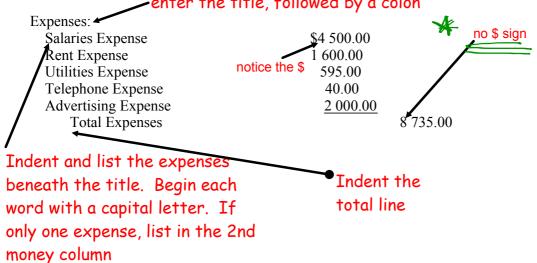


Source of Sales depends on the nature of a business operations

- 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 Farned

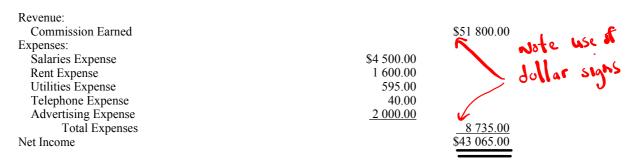
The EXPENSE SECTION

Starts on the line below the last entry in the revenue section enter the title, followed by a colon



NET INCOME or NET LOSS SECTION

- the income statement concludes with <u>net income</u> or <u>net loss</u>. 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



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

Do 2.7 For homework!

Q-7)

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

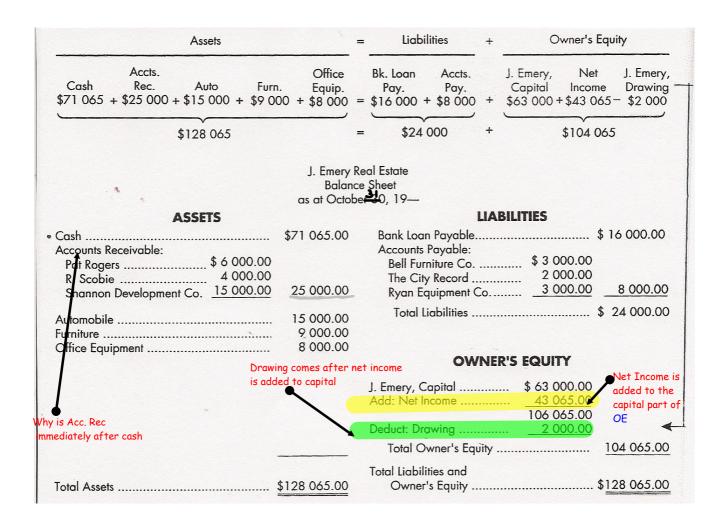
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PREPARING A RELATED BALANCE SHEET

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



What is the main goal of a business? Make PoFits 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. Drawings 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??? Drawings are

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 <u>2 000</u>

Total Owner's Equity 58 000
Total Liabilities & OE \$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

P 2	9a, b, c			A	SSETS				=		LIA	BILITIE	S +	18	OW	NER'S EQ	UITY		
	(1) Date	(2) Cash	(3) Accts. Rec.	(4) Land	(5) Building	(6) Truck	(7) Office Equip.	(8) Binding Equip.	(9) Total Assets	Bk. L Paya	oan	(11) Accts. Payable	(12) Total Liabilities	(13) D. Egyed, Capital	(14) Revenue	(15) Expenses	(16) D. Egyed, Drawing	(17) Total O. E.	
1	May 1	250 000							250 000			1 200	00 000	250 000				250 000	1
2	3	-3 500	Zin.					+8 500	255 000			+5 000	5 000					250 000	
3	5	-1 000				+15 000			269 000			+14 000	19 000					250 000	
4	6	-970							268 030				19 000			-970		249 030	I
5	6	-185 000		+45 000	+140 000				268 030			1	19 000				000	249 030	I
6	7		BILL				+8 000		276 030			+8 000	27 000					249 030	ı
7	7	-6 500							269 530				27 000			-6 500		242 530	ı
8	8		+10 000						279 530				27 000		+10 000			252 530	ı
9	11	+22 000							301 530			W15 -22	27 000		+22 000			274 530	ı
0	12	-350							301 180			1111	27 000			-350		274 180	ı
1	13	-99							301 081				27 000			-99		274 081	
2	15	-7 900							293 181				27 000			-7 900		266 181	
13	17	- 8 000							285 181			-8 000	19 000					266 181	
4	18	+300							285 481				19 000		+300			266 481	
5	21		+15 000						300 481				19 000		+15 000			281 481	
6	23	-650							299 831				19 000		2562	-650		280 831	
7	23	+3 200							303 031	+	3 200	-100	22 200					280 831	
18	26		+700						303 731			ne l	22 200	a destroy as	+700			281 531	
19	31	-85							303 646				22 200	\$388.00% o		-85	212 61	281 446	
20	31	+700	-700						303 646			Della de	22 200					281 446	1
21	31	-2 500							301 146				22 200	- ISOSOLI I			-2 500	278 946	1
22	31	-7 900							293 246				22 200			-7 900		271 046	2
23	31	-1 500							291 746	-	1 500	1 50	20 700		43.0	10 K		271 046	2
24	31		+450						292 196	-			20 700		+450			271 496	2
25	31	50 246	25 450	45 000	140 000	15 000	8 000	8 500	292 196	E	1 700	19 000	20 700	250 000	48 450	-24 454	-2 500	271 496	1

P 2-9d			
Egyed Book Binders			
Income Statement			
For the Month Ended May 31, 19			
Revenues:			
Hard-Back Binding Revenue	\$10 000		
Soft-Back Binding Revenue	37 700		
Spiral Binding Revenue	750		
Total Revenues		\$48 450	
Expenses:			
Insurance Expense	\$ 970		
Binding Supplies Expense	6 500		
Utilities Expense	350		
Telephone Expense	99		
Salaries Expense	15 800		
Heat Expense	650		
Gas and Oil Expense	85		
Total Expenses		24 454	
Net Income (Loss)		\$23 996	

P 2-9e				
	Egyed B	ook Binders		
		ice Sheet		
	as at M	ay 31, 19		
ASSETS		LIABILITIES		
Cash	\$ 50 246	Bank Loan Payable	\$ 1700	
Accounts Receivable:		Accounts Payable:		
Chamber of Commerce \$15 000		Thome Industries \$ 5 000		
Lambton Bd. of Ed 10 000		Watertown Motors 14 000	19 000	
Shell Canada Limited 450	25 450			
Land	45 000	Total Liabilities	\$20 700	
Building	140 000			
Truck	15 000			
Office Equipment	8 000	OWNER'S EQUITY		
Book Binding Equipment	8 500	D. Egyed, Capital\$250 000		
		Net Income 23 996		
		273 996		
		Less: D. Egyed, Drawing 2 500		
		Total Owner's Equity	271 496	
Total Assets	\$202.106	Total Liabilities and Owner's Equity	\$292 196	