## 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

Queter

Period

## 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
- 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	४ ७३५, <b>०</b> ०	main money column for the match-up of revenue with related expenses
Net Income		\$43 065.00	

## PREPARING AN INCOME STATEMENT

```
By Hand

HEADING - who

what

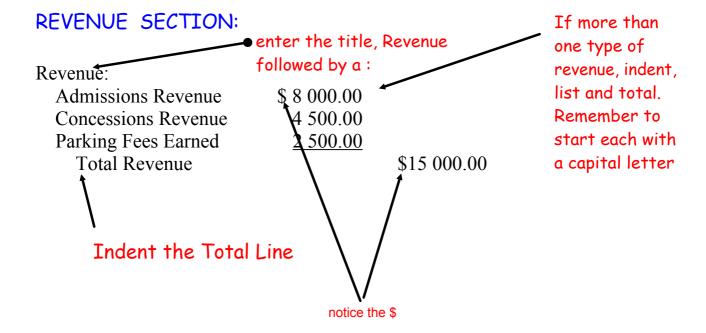
when - *** explains the accounting period covered by the

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

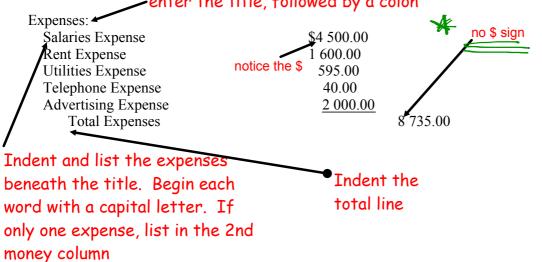


## Source of Sales depends on the nature of a business operations

- 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

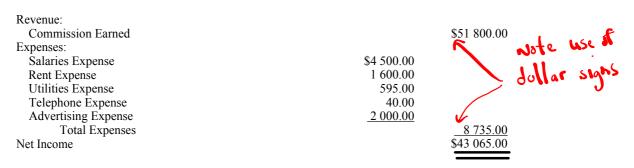
## The EXPENSE SECTION





## 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  $final\ result\ in\ the\ second\ money\ column$ 

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

Do 2.7 For homework:

(<del>2</del>-7)

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

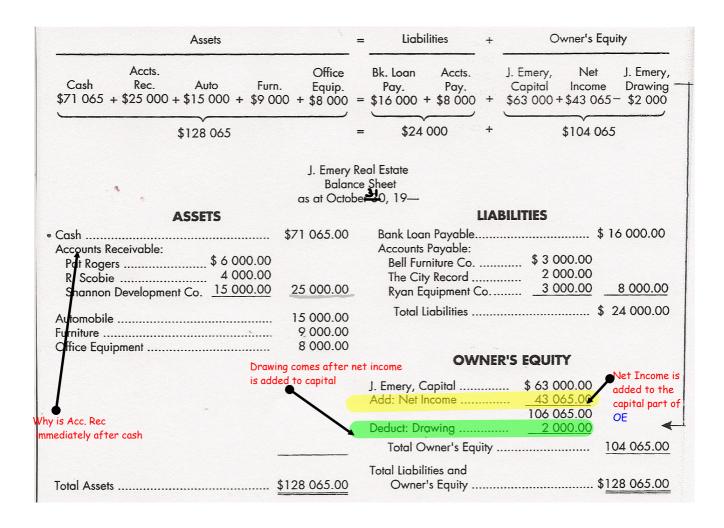
Revenue:		
Admissions Revenue	\$ 300 COO.°°	
Parking Fees Earned	33 570,00	
Concessions Revenue	_37500,00	
Total Revenue		\$ 263 070.00
Expenses:	.,	
Telephone Expense	119.00	
Salaries Expense	96 300.00	
Advertising Expense	6000,00	
Insurance Expense	1500-00	
Miscellaneous Expense	<b>5₀.°</b> °	
Building Rental Expense	18 000.00	
Utilities Expense	3000.00	
Film Rental Expense	5 <del>3</del> 175.°°	
Projection Rental Expense	4 800.°°	
Total Expenses	_	181943.00
Net Income		\$ 81 127.00

## 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 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>

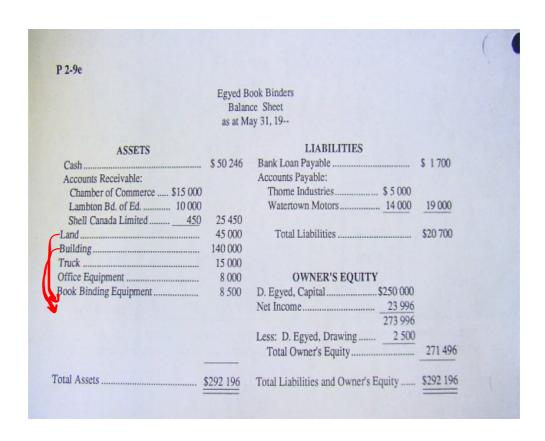
Total Owner's Equity 58 000
Total Liabilities & OE \$82 000

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

<u>Concept Reinforcement</u>
Page 54-56 P2-8, <u>P2-9</u>
Page 56-57 MC2-7, MC2-8, MC2-9

P 2-	9a, b, c				ASSETS				=	L	IABILITIE	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	(10) Bk. Loan Payable	(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		17700	00 000	250 000				250 000	1
2	3	-3 500	No.					+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			100				268 030			19 000			-970		249 030	
5	6	-185 000		+45 000	+140 000				268 030		1 100	19 000					249 030	
5	7		Bir i				+8 000		276 030		+8 000	27 000					249 030	
7	7	-6 500							269 530			27 000	,		-6 500		242 530	
8	8		+10 000						279 530			27 000		+10 000			252 530	
9	11	+22 000							301 530		MIS OF	27 000		+22 000			274 530	ı
0	12	-350			41111				301 180		012	27 000			-350		274 180	
1	13	-99							301 081			27 000			-99		274 081	1
2	15	-7 900							293 181		1	27 000			-7 900		266 181	1
13	17	- 8 000							285 181		-8 000	19 000					266 181	1
14	18	+300							285 481			19 000		+300			266 481	1
15	21		+15 000						300 481			19 000		+15 000			281 481	1
16	23	-650							299 831			19 000			-650		280 831	1
17	23	+3 200							303 031	+3 20	0	22 200	1				280 831	1
18	26		+700						303 731		4123	22 200	White Arm	+700			281 531	1
19	31	-85							303 646			22 200	\$388.785 B		-85	1212 1815	281 446	1
20	31	+700	-700						303 646		olo sign b	22 200	andina			OT	281 446	2
21	31	-2 500							301 146		4 127	22 200	190 PAGE 1			-2 500	278 946	2
22	31	-7 900							293 246			22 200			-7 900		271 046	2
23	31	-1 500							291 746	-1 50	0	20 700		13.0	TRE		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	170	0 19 000	20 700	250 000	48 450	-24 454	-2 500	271 496	2

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	



#### **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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