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

Quarter

Period

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:

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

Revenue:		
Admissions Revenue	$ 8 000.00	
Concessions Revenue	4 500.00	
Parking Fees Earned	<u>2 500.00</u>	
Total Revenue		$15 000.00

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. 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

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		8 735.00

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	2 000.00	
Total Expenses		8 735.00
Net Income		$43 065.00

note use of dollar signs

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	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.

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	
Concessions Revenue	37 500.00	
Total Revenue		$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	4 800.00	
Total Expenses		181 943.00
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.

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~~ 31, 19—

ASSETS

Cash		$71 065.00
Accounts Receivable:		
Pat Rogers	$ 6 000.00	
R. Scobie	4 000.00	
Shannon Development Co.	15 000.00	25 000.00
Automobile		15 000.00
Furniture		9 000.00
Office Equipment		8 000.00
Total Assets		$128 065.00

Why is Acc. Rec immediately after cash

LIABILITIES

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

OWNER'S EQUITY

Drawing comes after net income is added to capital

J. Emery, Capital	$ 63 000.00	
Add: Net Income	43 065.00	
	106 065.00	
Deduct: Drawing	2 000.00	
Total Owner's Equity		104 065.00
Total Liabilities and Owner's Equity		$128 065.00

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. 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 <u>after</u> 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 not the same as expenses

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 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

	ASSETS								=	LIABILITIES		+	OWNER'S EQUITY					
	(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			00 000	250 000				250 000	1
2	3	-3 500						+8 500	255 000		+5 000	5 000					250 000	2
3	5	-1 000				+15 000			269 000		+14 000	19 000					250 000	3
4	6	-970							268 030			19 000			-970		249 030	4
5	6	-185 000		+45 000	+140 000				268 030			19 000					249 030	5
6	7						+8 000		276 030		+8 000	27 000					249 030	6
7	7	-6 500							269 530			27 000			-6 500		242 530	7
8	8		+10 000						279 530			27 000		+10 000			252 530	8
9	11	+22 000							301 530			27 000		+22 000			274 530	9
10	12	-350							301 180			27 000			-350		274 180	10
11	13	-99							301 081			27 000			-99		274 081	11
12	15	-7 900							293 181			27 000			-7 900		266 181	12
13	17	- 8 000							285 181		-8 000	19 000					266 181	13
14	18	+300							285 481			19 000		+300			266 481	14
15	21		+15 000						300 481			19 000		+15 000			281 481	15
16	23	-650							299 831			19 000			-650		280 831	16
17	23	+3 200							303 031	+3 200		22 200					280 831	17
18	26		+700						303 731			22 200		+700			281 531	18
19	31	-85							303 646			22 200			-85		281 446	19
20	31	+700	-700						303 646			22 200					281 446	20
21	31	-2 500							301 146			22 200				-2 500	278 946	21
22	31	-7 900							293 246			22 200			-7 900		271 046	22
23	31	-1 500							291 746	-1 500		20 700					271 046	23
24	31		+450						292 196			20 700		+450			271 496	24
25	31	50 246	25 450	45 000	140 000	15 000	8 000	8 500	292 196	1 700	19 000	20 700	250 000	48 450	-24 454	-2 500	271 496	25

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 Book Binders
Balance Sheet
as at May 31, 19--

ASSETS

Cash		$ 50 246
Accounts Receivable:		
Chamber of Commerce	$15 000	
Lambton Bd. of Ed.	10 000	
Shell Canada Limited	450	25 450
Land		45 000
Building		140 000
Truck		15 000
Office Equipment		8 000
Book Binding Equipment		8 500
Total Assets		$292 196

LIABILITIES

Bank Loan Payable		$ 1 700
Accounts Payable:		
Thorne Industries	$ 5 000	
Watertown Motors	14 000	19 000
Total Liabilities		$20 700

OWNER'S EQUITY

D. Egyed, Capital	$250 000	
Net Income	23 996	
	273 996	
Less: D. Egyed, Drawing	2 500	
Total Owner's Equity		271 496
Total Liabilities and Owner's Equity		$292 196

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.