

Name: _____

Lesson 7-1: Preparing an Income Statement

Objectives: LO1: Prepare an income statement for a service business.

LO2: Calculate and analyze financial ratios using income statement amounts.

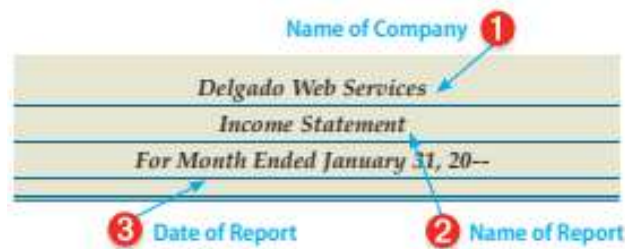
A. Reporting Financial Information

- Where is the information needed to make wise business decisions found? **General ledger accounts**
 - What needs to be done to make this detailed information useful for decisions?
Information must be summarized, organized, and reported
- Financial Accounting: **accounting done to report to external users**
 - Give two examples of external users of accounting information: **Bankers, creditors, government agencies, etc.**
- Managerial Accounting:
 - Give two examples of internal users of accounting information: **Company managers and officers**
- **All** financial information must be reported to make wise business decisions.
- **GAAP: Full Disclosure:** **financial statements contain all information necessary to understand a business's financial condition.**
- **GAAP: Going Concern:** **expectation that a business will remain in operation indefinitely**

B. Preparing an Income Statement from Information on a Work Sheet

- An income statement reports information over a **period of time** - showing is there is net income or net loss.
- An income statement has four sections:
 1. Heading
 2. Revenue
 3. Expenses
 4. Net income/loss

C. Heading of Income Statement



- Headings of financial statements answers: Who? What? When?
- What is another name for an Income Statement? (google if you are unsure!) **Profit and Loss**
- Three items listed on the heading are:
 - 1. **Company name**
 - 2. **Name of financial statement "Income Statement"**
 - 3. **Time period of income statement**
- Why isn't just a specific date stated in the third line of the heading?

An income statement shows revenue/expenses over a time period

						% OF SALES
Revenue:						
Sales					5 8 2 0 00	
Expenses:						
Advertising Expense		3 9 7 00				
Cash Short and Over		1 00				
Communications Expense		8 0 00				
Equipment Rental Expense		1 4 5 5 00				
Insurance Expense		1 5 0 00				
Miscellaneous Expense		4 5 00				
Supplies Expense		5 3 0 00				
Total Expenses					2 6 5 8 00	
Net Income					3 1 6 2 00	

D. Revenue, Expenses, and Net Income Sections of Income Statement

- IN YOUR WORDS, write the 14 steps to preparing an Income Statement
 - Write "Revenue" on the way left of the wide column.
 - Write the revenue accounts indented 1 cm
 - Record the balance of the revenue account in the second amount column.
 - Write "Expenses" on the way left of the wide column.
 - Write the expense account names, indented 1 cm.
 - Record the balance of each account in the first amount column.
 - Rule a single line across the first amount column to add and total the expenses
 - Write "Total Expenses" after the last expense account – indented 1 cm
 - Record the total of all expenses in the second amount column.
 - Calculate and verify net income (or loss)
 - Rule a single line across the second amount column under Total Expenses amount
 - Write "Net Income (or loss)" under "Total Expenses" to the far left of the column
 - To the right of the words "Net Income" write the net income total in the right amount column.
 - Double rule lines under both amount columns to show net income was verified with the work sheet.
- NOTE – the account balances are NOT listed as "left/right" "debit/credit" – Division totals (Revenue and Expenses) are ALWAYS in the right column. **Account Balances are in the left.**
- Where are the two SINGLE rules drawn? Under the last expense and under the total expenses
- Where do our Account Divisions (Revenue and Expenses) totals go? In the right amount column

- ALWAYS verify the Net Income calculated on the Income Statement matches the amount on the Work Sheet!

E. Analyzing an Income Statement

- The revenue listed on the income statement is generally compared to what two items:
 1. Total expenses
 2. Net income
- Financial ratio: A comparison between two components of financial information
- Ratio analysis: The calculation and interpretation of a financial ratio
- On an income statement, amounts are divided by total sales to calculate financial ratios.
- Vertical analysis: Reporting an amount on a financial statement as a percentage of another item on the same financials
- Businesses compare these ratios with past ratios to check health of business
 1. Acceptable Financial Ratios
 - Must stay consistent to be able to provide insight to a company success/failure.
 2. Total Expenses Ratio
 - $\text{Total Expenses} \div \text{Total Sales} = \text{Total Expenses Ratio}$
 - What is acceptable? No more than 48.0%
 3. Net Income Ratio
 - $\text{Net Income} \div \text{Total Sales} = \text{Net Income Ratio}$
 - What is acceptable? No less than 52.0%
 - Return on Sales (ROS):
 - Listed in a **percentage** then it is named Net Income Ratio
 - Listed as **cents** per dollars of sale named ROS
 - (SAME calculation for both)

F. Income Statement with Two Sources of Revenue and a Net Loss

Repair It Now									
Income Statement									
For Month Ended July 31, 20--									
									% OF SALES
Revenue	Revenue:								
Account Titles	Sales—Riding Mowers	18	5	0	0	00			
	Sales—Push Mowers	2	7	0	0	00			
Total Revenue	Total Revenue						21	2	0
									100.0
	Expenses:								
	Advertising Expense	2	3	7	5	00			
	Cash Short and Over					2	00		
	Communications Expense					3	5	0	00
	Equipment Rental Expense	12	3	0	0	00			
	Insurance Expense					1	5	0	00
	Miscellaneous Expense					5	5	0	00
	Supplies Expense	8	4	0	0	00			
	Total Expenses						24	1	2
									113.8
	Net Loss						(2	9	2
									(13.8)

- If there is more than one revenue account, the account balances go in the first (left) column). Where does the TOTAL of all revenue accounts go? **The far right amount column, line after the last revenue account line.**
- How is a net loss indicated as a negative amount? **Parentheses**

Check yourself!

- List the four sections of an income statement.

Heading

Revenue

Expenses

Net income/loss

- What is the formula for calculating the total expenses ratio?

Total Expenses divided by Total Sales equals Total Expenses Ratio.

- What is the formula for calculating the net income ratio?

Net Income divided by Total Sales equals Net Income Ratio.

Lesson 7-2: Preparing a Balance Sheet

Objectives: L03: Prepare a balance sheet for a service business organized as a proprietorship.

A. Preparing a Balance Sheet from Information on a Work Sheet

- A balance sheet reports information on a **specific date**. It is like a screenshot of a business.
 - It shows the **financial condition** of a business.
 - Adequate assets and few liabilities → doing well
 - Inadequate assets and high liabilities → not doing well
 - Four sections of a balance sheet:
 1. **Heading**
 2. **Assets**
 3. **Liabilities**
 4. **Owner's Equity**

B. Heading of a Balance Sheet



- Three items listed on the heading are (WHO/WHAT/WHEN?):
 - 1. **Name of company**
 - 2. **Balance Sheet**
 - 3. Date Calculate

C. Assets and Liabilities Sections of a Balance Sheet

The diagram illustrates the layout of a balance sheet with the following components and callouts:

- 1 Assets:** Points to the heading of the left section.
- 2 Account Titles:** Points to the column for listing asset accounts.
- 3 Asset Amounts:** Points to the column for recording asset balances.
- 4 Liabilities:** Points to the heading of the right section.
- 5 Account Titles:** Points to the column for listing liability accounts.
- 6 Liability Amounts:** Points to the column for recording liability balances.
- 7 Single Line:** Points to a horizontal line drawn under the last liability account.
- 8 Total Liabilities:** Points to the entry 'Total Liabilities' in the liability section.
- 9 Total of Liabilities:** Points to the final total amount in the liability column.

Assets		Liabilities	
Account Titles	Asset Amounts	Account Titles	Liability Amounts
Cash	2 5 9 7 00	Accts. Pay.—Canyon Office Sup.	1 2 0 0 00
Petty Cash	1 0 0 0 00	Accts. Pay.—Mountain Graphic Arts	1 0 5 0 00
Accts. Rec.—Main Street Services	3 0 0 0 00	Total Liabilities	2 2 5 0 00
Accts. Rec.—Valley Landscaping	4 0 0 0 00		
Supplies	9 0 0 0 00		
Prepaid Insurance	7 5 0 0 00		

- The balance sheet reports information about the elements of the **accounting equation**.
- What is on the LEFT side of the balance sheet? **assets**
- What is on the RIGHT side of the balance sheet? **Liabilities and owner's equity**
- IN YOUR WORDS, write the 9 steps to preparing the Assets & Liabilities Sections of a Balance Sheet
 1. Write Assets in the middle of the left wide column
 2. Write asset titles below the heading on the left margin
 3. Record balance of each asset account in the left amount column
 4. Write the title Liabilities in the middle of the right wide column
 5. Write the liability titles below the heading on the left margin
 6. Record the balance of each liability account in the right amount column
 7. Rule a single line across the right amount column under the last amount
 8. Write "Total Liabilities" under the last liability account
 9. Record the total liabilities in the right amount column.

D. Owner's Equity Section of a Balance Sheet

Delgado Web Services Balance Sheet January 31, 20--			
Assets		Liabilities	
Cash	2 5 9 7 00	Accts. Pay.—Canyon Office Sup.	1 2 0 00
Petty Cash	1 0 0 00	Accts. Pay.—Mountain Graphic Arts	1 0 5 00
Accts. Rec.—Main Street Services	3 0 0 00	Total Liabilities	2 2 5 00
Accts. Rec.—Valley Landscaping	4 0 0 00	Owner's Equity	
Supplies	9 0 0 00	Michael Delgado, Capital	4 0 1 2 00
Prepaid Insurance	7 5 0 00	Total Liabilities and Owner's Equity	4 2 3 7 00
Total Assets	4 2 3 7 00		

- To complete the OE section of the Income Statement, we must know the current amount of the Capital Account. How do we find/calculate this?

Capital account + Net Income (Minus net loss) - Drawing = Current Capital

- NOTE: The single rule is always under whichever is longer (Assets or Capital – usually assets) AND they are ALWAYS on the same line on both left and right amount column!
- IN YOUR WORDS, write the 10 steps to preparing the Owner's Equity Section of a Balance Sheet

- Write "Owner's Equity" in the middle directly below "Total Liabilities"
- Write the title of the capital account below the Owner's Equity heading
- Record the current amount in the capital account after calculation.
- Rules a single line under the last amount in the longer left amount column. Rule a single line ON THE SAME LINE in the right amount column.
- Write "Total Assets" on the line below the last asset account
- Record the total amount of assets in the left amount column
- Write "Total Liabilities and Owner's Equity" on the same line as "Total" Assets
- Record the amount of total liabilities and owner's equity
- Compare the two totals (Total Assets and Total Liabilities & Owner's Equity)
- Double rule to prove

If detail of OE is listed on Balance Sheet

Beginning Capital 1		Beginning Capital Amount 2							
Total Liabilities								2	2
Owner's Equity								5	00
Michael Delgado, Capital, January 1		2,000.00							
Net Income 3	Net Income	3,162.00							
	Less Michael Delgado, Drawing	1,150.00	2,012.00						
Ending Capital 7	Michael Delgado, Capital, January 31							4	0
	Total Liabilities and Owner's Equity							4	2
								3	7
								00	

6 Difference
 8 Current Capital Amount
 9 Total Liabilities and Owner's Equity
 4 Drawing
 5 Single Line

If detail of OE is listed on Balance Sheet

Beginning Capital 1		Beginning Capital Amount 2							
Total Liabilities								2	2
Owner's Equity								5	00
Michael Delgado, Capital, January 1		2,000.00							
Net Income 3	Net Income	3,162.00							
	Less Michael Delgado, Drawing	1,150.00	2,012.00						
Ending Capital 7	Michael Delgado, Capital, January 31							4	0
	Total Liabilities and Owner's Equity							4	2
								3	7
								00	

6 Difference
 8 Current Capital Amount
 9 Total Liabilities and Owner's Equity
 4 Drawing
 5 Single Line

- IN YOUR WORDS, write the 10 steps to preparing the Owner's Equity Section DETAIL of a Balance Sheet
 1. Under Owner's Equity heading, write the name of capital account as of the first date of the period being analyzed.
 2. Record amount in the wide column on the right margin
 3. Write "Net Income" (Or "Less Net Loss" if a loss). And record the amount in the wide column indented off of the right margin
 4. Write "Less...Drawing" and record the amount below the Net Income/Loss amount)
 5. Rule a single line under the drawing amount
 6. Subtract the drawing from the net income and record the total to the right of the Drawing amount in the wide column. Single rule it.
 7. Write the name of the capital account as of the last day of the period being reported on
 8. Add the beginning capital and the amount calculated above. Record this amount in the amount column on the same line as "last day of period" heading
 9. Total and rule the liabilities and owner's equity.

Check yourself!

1. List the four sections on a balance sheet.

Heading, Assets, Liabilities, Owner's Equity

2. What is the formula for calculating current capital?

Capital Account Balance plus Net Income (or less Net Loss) less Drawing Account Balance equals Current Capital.