

## Financial Statement Review:

### Financial Statements Tutorial

**There are four major financial statements used to communicate information to external users (creditors, investors, suppliers, etc.) -**

1. Balance Sheet (assets, liabilities, and Shareholder's equity)
2. Income Statement (revenues and expenses)
3. Statement of Changes in Shareholder's Equity (contributed capital and retained earnings)
  - Statement of Retained Earnings
4. Statement of Cash Flows

### **Balance Sheet**

■ Financial statement that presents the financial position of the company on a particular date.

■ Summarized by the accounting equation which must always be in balance

(Assets=Liabilities + Shareholder's Equity)

■ Three categories of accounts:

#### 1. Assets

■ Three Characteristics of Assets

- a) It has probable future benefit that involves a capacity to contribute directly or indirectly to future net cash flows
- b) A particular entity can obtain the benefit and control other's access to the asset
- c) The transaction that resulted in the entity's right to the benefit of the asset has already occurred

■ Examples: Cash, Accounts Receivable, Land, Equipment, Construction in Progress, Patents, Copyrights, Goodwill, etc.

#### 2. Liabilities

■ Amounts that company owes to its creditors

■ Examples: Notes Payable, Accounts Payable, Unearned Revenue, etc.

#### 3. Owner's Equity (Stockholder's Equity or Shareholder's Equity)

■ The owner's claims to the assets of the company

■ Includes both retained earnings and capital stock (common stock, preferred stock)

■ Most companies prepare a classified balance sheet which is the same as a regular balance sheet except assets and liabilities are categorized as current and non-current.

#### 1. Current—will be used or paid for within the next year

■ Examples:

1. Current Assets: Cash, Accounts Receivable, Inventory
  2. Current Liabilities: Accounts Payable, Unearned Revenue
2. Non-current asset—will not be used or paid for within the next year
- Examples:
    1. Non-Current Assets: Land, Notes Receivable, Equipment
    2. Non-Current Liabilities: Notes Payable, Bonds Payable

### Income Statement

- Financial statement that reports the company's revenues and expenses over an interval of time (usually one accounting period)
- Shows whether the company was able to generate enough revenue to cover the expenses of running the business
  - Revenue - Expenses = Net Income or Net Loss
  - Revenues equal the selling price of a good or service
  - Expenses are costs incurred to earn revenue
  - Example: Tom sells Jane a t-shirt for \$20. It cost Tom \$15. Tom's revenue is \$20, his cost of goods sold (expense) is \$15, and his net income is \$5.
- Multiple Step Income Statement (only used for merchandising companies)

Sales  
-Cost of Goods Sold  
 Gross Profit  
-Operating Expenses  
 Operating Income  
+/- Miscellaneous  
 Net Income before taxes  
-Income Tax Expense  
 Net Income

### Statement of Changes in Shareholder's Equity

- Contributed Capital and retained earnings
- Retained Earnings :

Beginning Retained Earnings  
 Less Dividends  
Plus Net Income or Minus Net Loss  
 Ending Retained Earnings

### Statement of Cash Flows

- Financial statement that measures activities involving **cash** receipts and **cash** payments over an interval of time (usually one accounting period).
- Cash flows can be classified into one of three categories:
  1. Operating Activities - day-to-day general activities to run the business
    - Examples: Purchasing inventory for cash, selling inventory for cash, paying cash for a business license, paying cash for utilities, etc.

2. Investing Activities - purchase and sale of assets that last longer than one year
  - Examples: Purchasing land for cash, selling property for cash, etc.
3. Financing Activities - cash transactions involving a company's long-term creditors or owners
  - Examples: Receiving cash from a bank loan, receiving cash from the issue of common stock, receiving cash from the sale of bonds, paying cash for dividends, paying cash for principal on a loan

### Preparation of Financial Statements:

#### Example 1:

The following items were taken from the accounting records of Bowser Incorporated. The income statement account balances are for the year ending December 31, 2009. The balance sheet account balances are the balances at December 31, 2009 except for the retained earnings balance which is the balance at 1/1/2009:

Accounts Payable	\$ 61,000	Accounts Receivable	\$ 11,000
Equipment	132,000	Advertising Expense	26,200
Cash	54,500	Common Stock	5,000
Administrative Expense	12,300	Dividends	2,200
Insurance Expense	3,000	Notes Payable (long-term)	70,000
Prepaid Insurance	6,550	Rent Expense	17,000
Retained Earnings (beg)	16,310	Salaries Expense	32,000
Service Revenue	117,700	Office Supplies	4,000
Supplies Expense	6,000	Salaries Payable	3,100
Accumulated Depreciation	20,000	Additional Paid in Capital	20,000
Income tax rate 30%			

Instructions: Prepare an income statement, a statement of retained earnings, and a classified balance sheet for Bowser Incorporated for the year 2009.

### Bowser Incorporated

#### Income Statement

For the year ending December 31, 2009

Service Revenues		117,700
Expenses:		
Administrative Expense	12,300	
Insurance Expense	3,000	
Supplies Expense	6,000	
Advertising Expense	26,200	
Rent Expense	17,000	
Salaries Expense	32,000	
Total Expenses		<u>96,500</u>
Net Income before taxes		21,200
Income tax expense		<u>6360</u>
Net Income		<u><u>14,840</u></u>

**Bowser Incorporated**  
**Statement of Retained Earnings**  
**For the year ending December 31, 2009**

Retained Earnings, January 1, 2009	16,310
Net income	14,840
Dividends	<u>2,200</u>
Retained Earnings, December 31, 2009	<u><u>28,950</u></u>

**Bowser Incorporated**  
**Classified Balance Sheet**  
**At December 31, 2009**

<u>Assets</u>		<u>Liabilities and Shareholder's Equity</u>	
<i>Current Assets:</i>		<i>Current Liabilities:</i>	
Cash	54,500	Accounts Payable	61,000
Accounts Receivable	11,000	Salaries Payable	<u>3,100</u>
Office Supplies	4,000	Total Current Liabilities	64,100
Prepaid Insurance	<u>6,550</u>		
Total Current Assets	76,050	<i>Non-current Liabilities:</i>	
		Notes Payable	<u>70,000</u>
<i>Non-current Assets</i>		Total Liabilities	134,100
Equipment	132,000		
Less Accumulated Depreciation	<u>-20,000</u>	<i>Shareholder's Equity:</i>	
Total Non-current Assets	<u>112,000</u>	Common Stock	5,000
		Additional Paid in Capital	20,000
Total Assets	<u><u>188,050</u></u>	Retained Earnings	<u>28,950</u>
		Total Shareholder's Equity	<u>53,950</u>
		Total Liabilities & Shareholder's Equity	<u><u>188,050</u></u>

**Example 2:**

Selected account information from Aphrodite Corporation for the year 2009 is presented below:

Cost of Goods Sold	\$225,000	Sales Revenue	\$800,000
Merchandise Inventory	23,000	Accounts Receivable	10,000
Selling Expenses	75,000	Administrative Expenses	60,000
Interest Expense	95,000	Interest Revenue	15,000
Salaries Expense	30,000	Advertising Expense	12,000
Utilities Expense	10,000	Income tax rate	35%

Instructions: Prepare a multiple step income statement.

**Aphrodite Corporation**  
**Multiple Step Income Statement**  
**For the year ending December 31, 2009**

Sales Revenue	800,000	
Cost of Goods Sold	225,000	
Gross Profit		575,000
Operating Expenses:		
Selling Expenses	75,000	
Administrative Expenses	60,000	
Salaries Expense	30,000	
Advertising Expense	12,000	
Utilities Expense	10,000	
Total Operating Expenses		187,000
Operating Income		388,000
Interest Expense	95,000	
Interest Revenue	15,000	
Net Income Before Taxes		308,000
Income tax Expense	107,800	
Net Income		200,200

**Practice Problems:**

***Problem 1***

The following items were taken from the accounting records of Talcom, Incorporated. The income statement account balances are for the year ending December 31, 2009. The balance sheet account balances are the balances at December 31, 2009 except for the retained earnings balance which is the balance at 1/1/2009:

Accounts Payable	\$ 52,000	Accounts Receivable	\$ 7,000
Land	121,000	Advertising Expense	11,000
Cash	108,000	Common Stock	15,000
Rent Expense	20,000	Dividends	1,000
Insurance Expense	5,000	Notes Payable (long-term)	62,000
Retained Earnings (beg)	52,300	Salaries Expense	22,000
Service Revenue	121,000	Inventory	3,000
Accumulated Depreciation	20,000	Supplies Expense	1,000
Salaries Payable	1,500	Additional Paid In Capital	100,000
Building	100,000	Income tax rate	40%

Instructions: Prepare an income statement, statement of retained earnings, and a classified balance sheet for Talcom Incorporated for the year 2009.

### Problem 2

The following items were taken from the accounting records of Cadillac Ranch, Incorporated. The income statement account balances are for the year ending December 31, 2008. The balance sheet account balances are the balances at December 31, 2008 except for the retained earnings balance which is the balance at 1/1/2008:

Accounts Payable	\$ 45,000	Accounts Receivable, net	\$ 7,000
Prepaid Insurance	21,000	Unearned Revenue	14,000
Land	524,000	Advertising Expense	28,000
Cash	586,000	Common Stock	98,000
Freight out	11,000	Notes Receivable (long-term)	70,000
Rent Expense	10,000	Dividends	2,000
Cost of goods sold	100,000	Interest Revenue	16,000
Insurance Expense	2,500	Notes Payable (long-term)	48,000
Retained Earnings (beg)	1,045,000	Salaries Expense	85,000
Sales Revenue	232,000	Inventory	8,000
Equipment	65,000	Accumulated Depreciation	20,000
Supplies Expense	1,000	Salaries Payable	2,500
Income tax rate	45%		

Instructions: Prepare a multiple step income statement.

## Example 1

**Bowser Incorporated**  
**Income Statement**  
**For the year ending December 31, 2009**

Service Revenues		117,700
Expenses:		
Administrative Expense	12,300	
Insurance Expense	3,000	
Supplies Expense	6,000	
	26,	
Advertising Expense	200	
Rent Expense	17,000	
	32,	
Salaries Expense	000	
Total Expenses	<u>96,500</u>	
Net Income before taxes		<u>21,200</u>
Income tax expense		<u>6360</u>
Net Income		<u><u>14,840</u></u>

**Bowser Incorporated**  
**Statement of Retained Earnings**  
**For the year ending December 31, 2009**

Retained Earnings, January 1, 2009	16,310
Net income	14,840
Dividends	<u>2,200</u>
Retained Earnings, December 31, 2009	<u><u>28,950</u></u>

**Bowser Incorporated**  
**Classified Balance Sheet**  
**At December 31, 2009**

<u>Assets</u>		<u>Liabilities and Shareholder's Equity</u>	
<i>Current Assets:</i>		<i>Current Liabilities:</i>	
Cash	54,500	Accounts Payable	61,000
Accounts Receivable	11,000	Salaries Payable	<u>3,100</u>
Office Supplies	4,000	Total Current Liabilities	64,100
Prepaid Insurance	<u>6,550</u>	<i>Non-current Liabilities:</i>	
Total Current Assets	76,050	Notes Payable	<u>70,000</u>
<i>Non-current Assets</i>		Total Liabilities	134,100
Equipment	132,000	<i>Shareholder's Equity:</i>	
Less Accumulated Depreciation	<u>-20,000</u>	Common Stock	5,000
Total Non-current Assets	<u>112,000</u>	Additional Paid in Capital	20,000
Total Assets	<u><u>188,050</u></u>	Retained Earnings	<u>28,950</u>
		Total Shareholder's Equity	<u>53,950</u>
		Total Liabilities & Shareholder's Equity	<u><u>188,050</u></u>

# Example 2

**Aphrodite Corporation**  
**Multiple Step Income Statement**  
**For the year ending December 31, 2009**

Sales Revenue	800,000	
Cost of Goods Sold	<u>225,000</u>	
Gross Profit		575,000
Operating Expenses:		
	75,	
Selling Expenses	000	
Administrative Expenses	60,000	
	30,	
Salaries Expense	000	
	12,	
Advertising Expense	000	
Utilities Expense	<u>10,000</u>	
Total Operating Expenses		<u>187,000</u>
Operating Income		388,000
Interest Expense		95,000
Interest Revenue		<u>15,000</u>
Net Income Before Taxes		308,000
Income tax Expense		<u>107,800</u>
Net Income		<u><u>200,200</u></u>