

Visual Learning Maps

Introductory Financial Accounting



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VIRTUAL TEXT BOOK

FINANCIAL STATEMENTS – What Are They? What Do They Communicate? – 1 of 5

Financial statements are comprised of the following exhibits:

- Statement of Financial Position (also called the balance sheet)
- Statement of Income (Income Statement)
- Statement of Owner's Equity (proprietorships & partnerships)
- Statement of Cash Flows
- The Notes to the Financial Statements

- Statement of Retained Earnings (corporations)

Follow These Rules When You are Preparing Financial Statements

Homework, Exam & Test TIPS

When solving problems on tests and exams that require the preparation of the financial statements, there is a specific order of preparation that should be followed:

- Prepare the Income Statement **FIRST**
- Prepare the Owner's Equity Statement **SECOND** – transfer the Net Income or Loss from the Income Statement that you just finished to the Owner's Equity Statement
- Prepare the Balance sheet **LAST** – transfer the closing capital amount from the Owner's Equity Statement you just finished to the balance sheet – "Capital"

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Statement of Financial Position (Balance Sheet)

The balance sheet literally demonstrates the Foundation Equation $A = L + E$. Total assets are **always** equal to liabilities plus equity.

The balance sheet is a photograph - a snapshot - a frozen moment in time of the “**position**” of the business on a certain day. The balance sheet **always** defines the day with the words “**as at.**” These are the sub categories of assets:

- Current assets
- Long Term assets
- Property, Plant and Equipment
- Intangible assets



These are totalled to get the A side of the equation

The components of these asset categories are explained in the virtual text book section “Assets – the Different Kinds and Their Characteristics.”

The next section of the balance sheet is Liabilities & Equity. There are two kinds of liabilities:

- Current liabilities
- Long Term liabilities



These are totalled to get the L in the equation

The components of these liability categories are explained in the virtual text book section “Liabilities.”

The last item to be shown on the balance sheet is “**Capital.**” This is the CLOSING capital amount that comes from the Owner’s Equity Statement. It is the **E** in the equation.

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Here is what the balance sheet looks like:

<u>M & R Statement of Financial Position As At December 31, 2004</u>		
<u>ASSETS</u>		
Current		
Cash /Bank	5,000	
Accounts receivable	9,000	
Prepaid lease	4,000	
Inventory	35,000	
Supplies	2,000	
Temporary investments	<u>6,000</u>	
Total current assets		61,000
Long term		
Bonds	6,000	
Mortgage	<u>7,000</u>	
Total long term assets		13,000
Property, Plant & Equipment		
Buildings	712,000	
Less; accumulated depreciation	<u>100,000</u>	
	612,000	
Vehicles	75,000	
Less; accumulated depreciation	<u>25,000</u>	
	<u>50,000</u>	
Total PP&E		662,000
Intangible – trademark		<u>10,000</u>
Total Assets		<u>\$746,000</u>
<u>LIABILITIES and EQUITY</u>		
<u>Liabilities</u>		
Current		
Accounts payable	30,000	
Unearned revenue	<u>10,000</u>	
Total current liabilities		40,000
Long term – mortgage		<u>110,000</u>
Total liabilities		150,000
<u>Equity</u>		
Capital		<u>596,000</u>
Total Liabilities and Equity		<u>\$746,000</u>

This comes from the Statement of Owner's Equity – —

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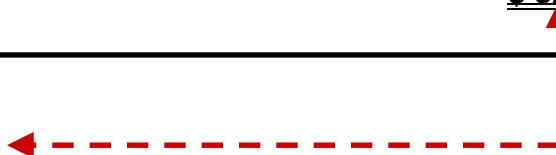
Statement of Income - (Income Statement)

The income statement is **not** a photograph. It is more of a movie. The movie is for the time period of last month or last quarter or last year. The income statement defines the time period with the words “for the ‘period’ ended.”

The income statement has only two sections – one for revenue and one for expense. Expense is subtracted from revenue to get **Net Income** (also called Net Profit). Here is what the income statement for a service business looks like:

M & R Statement of Income for the Year Ended December 31, 2004		
<u>REVENUE</u>		
Consulting fees	56,000	
Interest on customer accounts	1,000	
Miscellaneous	<u>2,000</u>	
Total Revenue		59,000
<u>EXPENSE</u>		
Advertising	12,000	
Cleaning	1,000	
Depreciation	1,200	
Supplies	2,000	
Salaries	6,000	
Travel	<u>2,000</u>	
Total Expense		<u>26,200</u>
NET INCOME		<u>\$ 32,800</u>

This must be transferred to
The Owner's Equity Statement



FINANCIAL STATEMENTS – **continued** – 5 of 5

Statement of Owner's Equity - (Owner's Equity Statement)

The Owner's Equity is **always** for the same time period as the income statement.

The purpose of the OE Statement is to communicate to readers specifically how the capital account has changed. The format:

- **Always** begins with "Opening Capital (or beginning capital)"
- Add "Additional Investment by Owner" (if applicable)
- Add Net Income (or subtract Net Loss) – which comes from the income statement
- Subtract "Withdrawals" (also called Drawings – this is money gone out of the business for personal use of the owner)
- **Always** ends with "Ending Capital (also called closing capital)" – always ends with "Closing Capital" (or ending capital)

Last period's Closing Capital **always = new period's Opening Capital.**

Opening Capital		550,200
Additional Investment by Owner	35,000	
Net Income	<u>32,800</u>	
Sub total		<u>67,800</u>
Sub total		618,000
Less: withdrawals		<u>22,000</u>
Closing Capital		<u>\$ 596,000</u>

→ This comes from the Income Statement

↑ This goes to the Balance Sheet

The Statement of Retained Earnings is covered under a separate heading in the Virtual Text Book index.