

Principles Accounting in English 2

CHAPTER THREE FINANCIAL STATEMENTS

ACCOUNTING DEPARTMENT

2022-2023

**CHAPTER THREE
FINANCIAL STATEMENTS**

- 1- **Income Statement.**
- 2- **Owner's Equity Statement.**
- 3- **Balance sheet Statement, sometimes referred to as the statement of financial position.**
- 4- **Cash flows Statement.**

1- INCOME STATEMENT

The income statement is the report that measures the success of company operations for a given period of time. (It is also often called the statement of income or statement of earnings. The business and investment community uses the income statement to determine profitability, investment value, and creditworthiness. It provides investors and creditors with information that helps them predict the amounts, timing, and uncertainty of future cash flows.

Usefulness of the Income Statement

1. *Evaluate the past performance of the company*
2. *Provide a basis for predicting future performance*
3. *Help assess the risk or uncertainty of achieving future cash flows*

Limitations of the Income Statement

1. *Companies omit items from the income statement that they cannot measure reliably.*
2. *Income numbers are affected by the accounting methods employed.*
3. *Income measurement involves judgment.*

Format of the income statement

the following are the format which is used for preparation of Income Statement:

- 1- **multiple-Step Income Statements**

Company Name
Income Statement
For the year ended Dec 31, 20XX

Description		Sub Amount	Sub Total	Grand Total
Net Revenue				
	Sales Revenue		x x x	
-	Sales Returns		(x x)	
-	Sales Allowance		<u>(x x)</u>	
Net Revenue				x x x x
Cost of goods sold				
	Beginning Inventory		x x x	
+	Net Purchase			
	Total Purchases	x x		
	Purchase Expense	x x		
-	Purchase Allowance & return	(x x)		
-	Purchase Discount	<u>(x x)</u>		
Net Purchase			<u>x x x</u>	
Available goods for sale			x x x	
-	Ending Inventory		<u>(x x)</u>	
Cost of goods sold				<u>x x x x</u>
Gross profit				x x x x
-	Operating Expenses			
	Selling & Marketing Expenses		x x x	
	Administrative Expenses		<u>x x x</u>	
Total of Operating Expense				<u>(x x x x)</u>
Operating Income				x x x x
+	Other Revenue & Expense			<u>x x x x</u>
-	Other Losses & Gains			<u>(x x x x)</u>
Income Before Tax				x x x x
-	Income Tax			<u>(x x)</u>
Net Income				<u>x x x x</u>

Equations uses for Income Statement

There are many equations which are used for preparing Income Statement, the below are these equations:

Net Sales

PRINCIPLES OF ACCOUNTING

$\text{Net Sales} = \text{Sales Revenues} - \text{Sales Discounts} - \text{Sales Return \& Allowances}$

Cost Of Goods Sold (COGS)

$\text{COGS} = \text{Beginning Inventory} + \text{Net Purchases} - \text{Ending Inventory}$

Net Purchases

$\text{Net Purchases} = \text{Purchases} - \text{Purchase Discount, Return \& Allowances} + \text{Purchase Expenses}$

Cost of Goods Available for Sale

$\text{Cost of Goods Available for Sale} = \text{Beginning Inventory} + \text{Net Purchases}$

Gross Profit

$\text{Gross Profit} = \text{Net Sales} - \text{Cost of Goods Sold}$

Income From Operation

$\text{Income From Operation} = \text{Gross Profit} - \text{Selling Exp.} - \text{Admin Exp.} + \text{Other Gains} - \text{Other Losses}$

Income Before Tax

$\text{Income Before Tax} = \text{Income From Operations} + \text{or} - \text{Interests}$

Net Income

$\text{Net Income} = \text{Income Before Tax} - \text{Income Tax}$

2- Single-Step Income Statements

In reporting revenues, gains, expenses, and losses, some companies often use a format known as the **single-step income statement** instead of a multiple-step income statement. The single-step statement consists of just two groupings: revenues and expenses. Expenses are deducted from revenues to arrive at net income or loss, hence the expression “single-step.” Frequently, companies report income tax separately as the last item before net income to indicate its relationship to income before income tax. Illustration below shows the single-step income statement of Cabrera Company.

CABRERA COMPANY	
INCOME STATEMENT	
FOR THE YEAR ENDED DECEMBER 31, 2017	
Revenues	
Net sales	\$2,972,413
Dividend revenue	98,500
Rent revenue	72,910
Total revenues	<u>3,143,823</u>
Expenses	
Cost of goods sold	1,982,541
Selling expenses	453,028
Administrative expenses	350,771
Interest expense	126,060
Income tax expense	66,934
Total expenses	<u>2,979,334</u>
Net income	<u>\$ 164,489</u>
Earnings per common share	<u>\$1.74</u>

Example 1:

Starr Co. had sales revenue of \$540,000 in 2020. Other items recorded during the year were:

Cost of goods sold	\$330,000
Salaries and wages expense	120,000
Income tax expense	25,000
Increase in value of company reputation	15,000
Other operating expenses	10,000
gain on value of patents	20,000

Instructions

Prepare a single-step income statement for Starr for 2020. Starr has 100,000 shares of stock outstanding

Example 2:

Brisky Corporation had net sales of \$2,400,000 and interest revenue of \$31,000 during 2020. Expenses for 2020 were cost of goods sold \$1,450,000, administrative expenses \$212,000, selling expenses \$280,000, and interest expense \$45,000. Brisky’s tax rate is 30%. The corporation had 100,000 shares of common stock authorized and 70,000 shares issued and outstanding during 2020. Prepare a single-step income statement for the year ended December 31, 2020.

Instructions

prepare a condensed multiple-step income statement for Brisky Corporation

Example 3:

(Income Statement Items) Presented below are certain account balances of Paczki Products Co.

Rent revenue	\$ 6,500	Sales discounts	\$ 7,800
Interest expense	12,700	Selling expenses	99,400
Beginning retained earnings	114,400	Sales revenue	390,000
Ending retained earnings	125,000	Income tax expense	31,000
Dividend revenue	71,000	Cost of goods sold	184,400

PRINCIPLES OF ACCOUNTING

Sales returns and allowances	12,400	Administrative expenses	82,500
Allocation to noncontrolling interest	17,000		

Instructions

From the foregoing, compute the following: (a) total net revenue, (b) net income, and (c) income attributable to controlling stockholders.

Example 4:

(Multiple-Step and Single-Step Statements) Two accountants for the firm of Elwes and Wright are arguing about the merits of presenting an income statement in a multiple-step versus a single-step format. The discussion involves the following 2020 information related to P. Bride Company (\$000 omitted).

Administrative expense	
Officers' salaries	\$ 4,900
Depreciation of office furniture and equipment	3,960
Cost of goods sold	60,570
Rent revenue	17,230
Selling expense	
Delivery expense	2,690
Sales commissions	7,980
Depreciation of sales equipment	6,480
Sales revenue	96,500
Income tax	9,070
Interest expense	1,860

Instructions

- Prepare an income statement for the year 2020 using the multiple-step form. Common shares outstanding for 2020 total 40,550 (000 omitted).
- Prepare an income statement for the year 2020 using the single-step form.
- Which one do you prefer? Discuss.

Example 5:

(Multiple-Step and Single-Step Statements) The accountant of Latifa Shoe Co. has piled the following information from the company's records as a basis for an income statement for the year ended December 31, 2020.

Rent revenue	\$ 29,000
Interest expense	18,000
Market appreciation on land above cost	31,000
Salaries and wages expense (selling)	114,800
Supplies (selling)	17,600
Income tax	23,100
Salaries and wages expense (administrative)	135,900
Other administrative expenses	51,700
Cost of goods sold	496,000
Net sales	980,000
Depreciation on plant assets (70% selling, 30% administrative)	65,000
Cash dividends declared	16,000

There were 20,000 shares of common stock outstanding during the year.

Instructions

- Prepare a multiple-step income statement.
- Prepare a single-step income statement.
- Which format do you prefer? Discuss.

2-Balance Sheet

The **balance sheet**, sometimes referred to as the **statement of financial position**, reports the assets, liabilities, and stockholders' equity of a business enterprise at a specific date. This financial statement provides information about the nature and amounts of investments in enterprise resources, obligations to creditors, and the owners' equity in net resources. It therefore helps in predicting the amounts, timing, and uncertainty of future cash flows.

Usefulness of the Balance Sheet

- 1-Liquidity** describes "the amount of time that is expected to elapse until an asset is realized or otherwise converted into cash or until a liability has to be paid."
- 2-Solvency** refers to the ability of a company to pay its debts as they mature
- 3- Liquidity and solvency affect a company's financial flexibility**, which measures the "Ability of an enterprise to take effective actions to alter the amounts and timing of cash flows so it can respond to unexpected needs and opportunities."

Limitations of the Balance Sheet

1. Most assets and liabilities are reported at **historical cost**.
2. Companies use **judgments and estimates** to determine many of the items reported in the balance sheet.
3. The balance sheet necessarily **omits many items that are of financial value** but that a company cannot record objectively.

Elements of the Balance Sheet

1. Assets. Probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.

2. Liabilities. Probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer

assets or provide services to other entities in the future as a result of past transactions or events.

3. Equity. Residual interest in the assets of an entity that remains after deducting its liabilities. In a business enterprise, the equity is the ownership interest.⁶

FRANKLIN COMPANY

Balance Sheet
October 31, 2010

Assets

Current assets

Cash	\$ 6,600	
Short-term investments	2,000	
Accounts receivable	7,000	
Notes receivable	1,000	
Inventories	3,000	
Supplies	2,100	
Prepaid insurance	<u>400</u>	
Total current assets		\$22,100

Long-term investments

Investment in stock of Walters Corp.	5,200	
Investment in real estate	<u>2,000</u>	7,200

Property, plant, and equipment

Land	10,000	
Office equipment	\$24,000	
Less: Accumulated depreciation	<u>5,000</u>	<u>19,000</u>
		29,000

Intangible assets

Patents		<u>3,100</u>
Total assets		<u>\$61,400</u>

Liabilities and Owner's Equity

Current liabilities

Notes payable	\$11,000	
Accounts payable	2,100	
Salaries payable	1,600	
Unearned revenue	900	
Interest payable	<u>450</u>	
Total current liabilities		\$16,050

Long-term liabilities

Mortgage note payable	10,000	
Notes payable	<u>1,300</u>	
Total long-term liabilities		<u>11,300</u>
Total liabilities		27,350

Owner's equity

B. Franklin, Capital		<u>34,050</u>
Total liabilities and owner's equity		<u>\$61,400</u>

Example 1:

PIONEER ADVERTISING AGENCY

Adjusted Trial Balance
October 31, 2010

	<u>Dr.</u>	<u>Cr.</u>
Cash	\$15,200	
Accounts Receivable	200	
Advertising Supplies	1,000	
Prepaid Insurance	550	
Office Equipment	5,000	
Accumulated Depreciation—Office Equipment		\$ 40
Notes Payable		5,000
Accounts Payable		2,500
Unearned Revenue		800
Salaries Payable		1,200
Interest Payable		50
C. R. Byrd, Capital		10,000
C. R. Byrd, Drawing	500	
Service Revenue		10,600
Salaries Expense	5,200	
Advertising Supplies Expense	1,500	
Rent Expense	900	
Insurance Expense	50	
Interest Expense	50	
Depreciation Expense	40	
	<u>\$30,190</u>	<u>\$30,190</u>

Instructions

Prepare the financial statement

Example 2:

	Before Adjustment		After Adjustment	
	Dr.	Cr.	Dr.	Cr.
Cash	\$10,400		\$10,400	
Accounts Receivable	8,800		9,800	
Office Supplies	2,300		700	
Prepaid Insurance	4,000		2,500	
Office Equipment	14,000		14,000	
Accumulated Depreciation—Office Equipment		\$ 3,600		\$ 4,500
Accounts Payable		5,800		5,800
Salaries Payable		–0–		1,100
Unearned Rent Revenue		1,500		600
T. Garcia, Capital		15,600		15,600
Service Revenue		34,000		35,000
Rent Revenue		11,000		11,900
Salaries Expense	17,000		18,100	
Office Supplies Expense	–0–		1,600	
Rent Expense	15,000		15,000	
Insurance Expense	–0–		1,500	
Depreciation Expense	–0–		900	
	<u>\$71,500</u>	<u>\$71,500</u>	<u>\$74,500</u>	<u>\$74,500</u>

Instructions

Prepare the financial statement

Example 3:

APACHI COMPANY

Adjusted Trial Balance
July 31, 2010

<u>Account Titles</u>	<u>Debits</u>	<u>Credits</u>
Cash	\$ 14,840	
Accounts Receivable	8,780	
Equipment	15,900	
Accumulated Depreciation		\$ 7,400
Accounts Payable		4,220
Unearned Rent Revenue		1,800
B. J. Apachi, Capital		45,200
B. J. Apachi, Drawing	16,000	
Commission Revenue		65,000
Rent Revenue		6,500
Depreciation Expense	4,000	
Salaries Expense	55,700	
Utilities Expense	14,900	
	<u>\$130,120</u>	<u>\$130,120</u>

Instructions

Prepare the financial statement

Example 4:

E4-14 The adjusted trial balance for Karr Bowling Alley at December 31, 2010, contains the following accounts.

<u>Debits</u>		<u>Credits</u>	
Building	\$128,800	Sue Karr, Capital	\$115,000
Accounts Receivable	14,520	Accumulated Depreciation—Building	42,600
Prepaid Insurance	4,680	Accounts Payable	12,300
Cash	18,040	Note Payable	97,780
Equipment	62,400	Accumulated Depreciation—Equipment	18,720
Land	64,000	Interest Payable	2,600
Insurance Expense	780	Bowling Revenues	14,180
Depreciation Expense	7,360		<u>\$303,180</u>
Interest Expense	2,600		
	<u>\$303,180</u>		

Instructions

- (a) Prepare a classified balance sheet; assume that \$13,900 of the note payable will be paid in 2011.