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Unit 6



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ACCOUNTING LIFE PAC 6

FINANCIAL STATEMENTS FOR A PROPRIETORSHIP

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ACCOUNTING LIFEPAC 6

FINANCIAL STATEMENTS

OVERVIEW

The fifth step in the accounting cycle is to prepare financial statements at the end of the accounting period. Financial statements assist owners and managers in making business decisions. These financial statements include the income statement, the equity statement and the balance sheet. These statements should present all financial information in an understandable manner in order to provide a clear and informative picture of the financial condition of the business.

In LIFEPAC 5 you learned about a very important tool that accountants use to organize this financial information prior to preparing financial statements—the worksheet. In this LIFEPAC® you will learn how to use the worksheet to prepare the income statement, the equity statement and the balance sheet.



OBJECTIVES

When you have completed this LIFEPAC you will be able to:

1. Define the accounting terms associated with the preparation of all financial statements.
2. Recognize accounting concepts and practices associated with a worksheet and financial statements for a service business.
3. Prepare an income statement for a service business organized as a sole proprietorship.
4. Prepare an equity statement for a service business organized as a sole proprietorship.
5. Prepare a balance sheet illustrating the financial condition of a service business organized as a sole proprietorship.

VOCABULARY

Account Format – a balance sheet format that lists the assets on the left and the liabilities and equity on the right, similar to the accounting equation.

Balance Sheet – a financial statement that reports assets, liabilities and owner's equity on a specific date.

Fiscal Period – the length of the accounting cycle for which a business summarizes and reports financial information.

Income Statement – a financial statement that reports the revenue and expenses for a fiscal period.

Net – the amount remaining after all deductions have been made.

Net Income – the difference between total revenue and total expenses when total revenue is greater than total expenses.

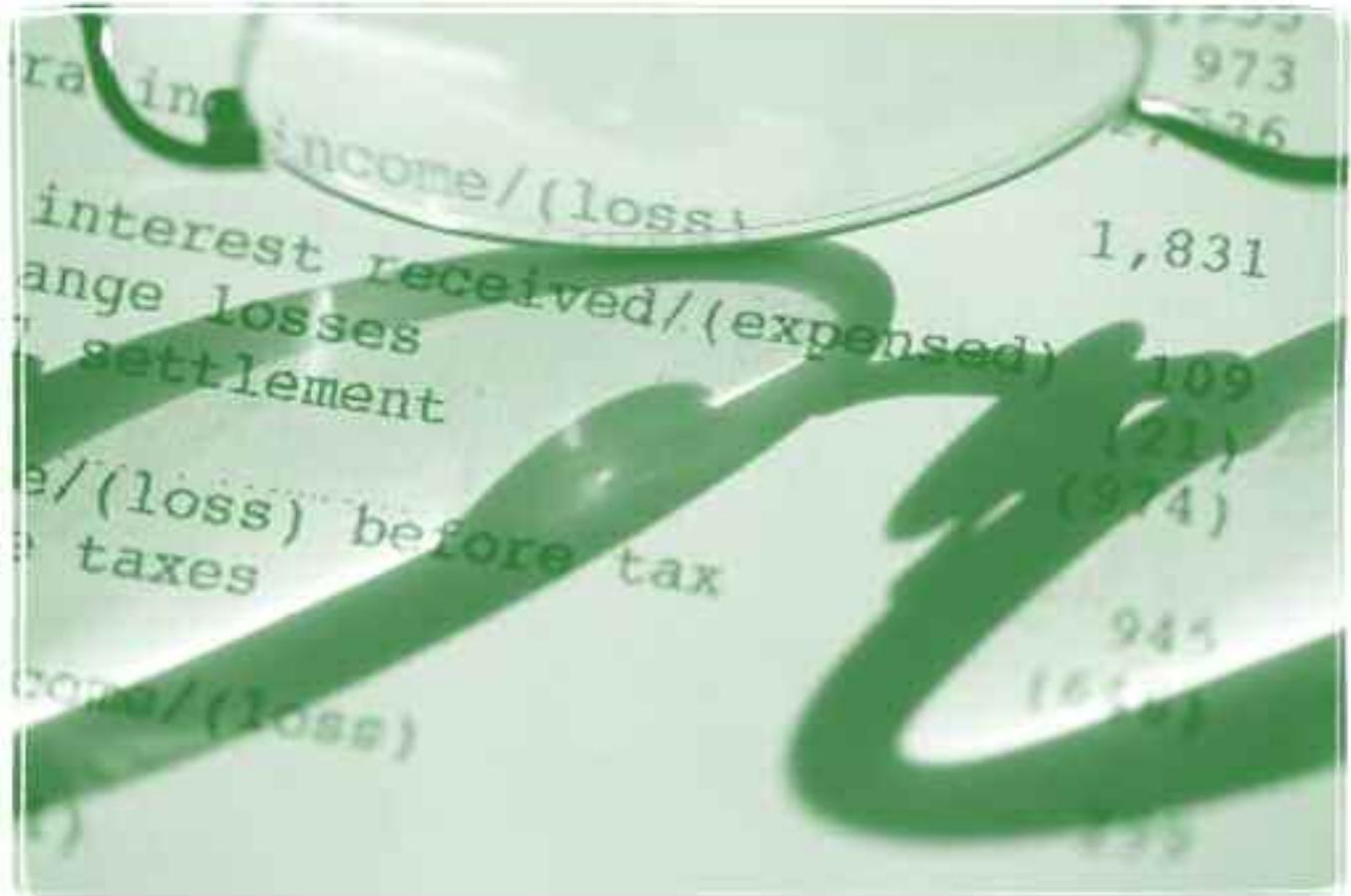
Net Loss – the difference between total revenue and total expenses when total expenses are greater than total revenue.

Report Format – the most common balance sheet format, with the asset section listed first, followed by the liability and equity sections. This is a two-column report similar to the income statement.

Statement of Owner's Equity – the financial statement that reports the changes in capital that have occurred between the beginning and ending of a given fiscal period.

Worksheet – a columnar accounting form used to summarize the general ledger information needed to prepare financial statements.

SECTION I. THE INCOME STATEMENT



Introduction

One of the most important functions of the accounting system is to accurately report the profitability of a business. This accountability is achieved by comparing concrete facts and figures. From the objective evidence provided, the profitability of the business can be determined. As an example, a business purchases an item for \$200.00 and sells it for \$250.00. After recording this business transaction, the accountant has the objective evidence to show a net income of \$50.00 for this item. Thus, by using the accounting concept of objective evidence, a formula has been created for determining business profit.

Any business organized today is created with the expectation of making a profit. Profit, or net income, is the main factor that indicates a business has reached this primary goal. For every firm, big or small, a profitable operation is necessary for survival in our free enterprise system. A profitable operation not only increases the owner's equity but also increases total assets. From the basic accounting equation ($A = L + C$), we have established that any change in an asset due to daily business operations (sale of a product or service or borrowing money from a bank) also must change another asset, a liability, or the owner's equity (capital). Also, any portion of the profit from business operations may be kept by the business for expansion. A profit retained is usually spent for new equipment, new research, or expanding sales territories. It is important many times to retain some of the profit to maintain a growing company.

accurately reflect the changes that have occurred due to the daily internal operations of the business. Supplies that were purchased at the beginning of the fiscal period are not used up until a future fiscal period. Since insurance is usually paid for a year in advance, the unexpired insurance must be carried over as an asset for the next accounting cycle. The costs incurred in the operation of a business are expenses, and adjustments must be made to transfer these costs to the proper expense account.

3. The *income statement* section contains the updated balances of all revenue and expense accounts and is used to calculate net income or net loss.
4. The *balance sheet* section contains the permanent accounts of the business and provides all the necessary information to prepare the formal balance sheet and the formal income statement.

Purpose of the Income Statement. The income statement provides the following information:

1. The accounting period (fiscal period) covered by the statement,
2. A summary of all sources of revenue for the fiscal period,
3. All expenses that are matched against the revenue for the period, and
4. The net income or net loss for the fiscal period.

Since an income statement is a part of the permanent and official records of a business, it is prepared in ink. It can be typed, prepared by computer, or handwritten. Since it will be scrutinized by managers, owners, and outside businessmen such as creditors, it is important that it be prepared accurately and neatly.

The Heading Section

Any financial statement heading must include three elements:

1. *Who* – the name of the business;
2. *What* – the name of the statement; and
3. *When* – the date of the statement.

1	<i>Lawson's Lawn Care</i>
2	<i>Income Statement</i>
3	<i>For the Month Ended July 31, 20—</i>

The date of the statement reflects the ending date of the current fiscal period. The heading above indicates that the fiscal period for Lawson's Lawn Care is one month. Fiscal periods can vary in length—one month, three months, a calendar year (January to December) or a fiscal year (the last day of a twelve-month period).

- A 3-month fiscal period: "For the Quarter Ended July 31, 20—"
- A calendar year: "For the Year Ended December 31, 20—"
- A fiscal year: "For the Year Ended July 31, 20—"

The Revenue Section

The information to complete this section is found in the worksheet's account title section and the income statement section's credit column. Remember that revenue accounts always have credit balances and will, therefore, be listed in the credit column of the income statement section of the worksheet.

Steps for preparing the revenue section:

4. Write the classification "Revenue" on the first line against the left margin.
5. Write the account title for the revenue account on the second line, indented about five spaces.
6. Write the account balance in the second money column of the income statement. This balance is found in the income statement credit column on the worksheet. Since Lawson's Lawn Care has only one source of revenue there is no need to total the revenue section.

<i>Lawson's Lawn Care</i>				
<i>Income Statement</i>				
<i>For the Month Ended July 31, 20—</i>				
<i>Revenue:</i> 4				
<i>Sales</i> 5			64367	00



The Expense Section

After completing the revenue section of an income statement, it is necessary to enter the expenses for the fiscal period. Again, the account titles are found in the worksheet's account title column. The account balances are found in the income statement section's debit column. Expenses have debit balances and are listed in the debit column of the income statement section of the worksheet.

Steps for preparing the expense section:

7. Write the classification "Expenses" on the line following the revenue totals against the left margin.
8. Write the account titles for the expense accounts underneath the classification "Expenses." Indent the account titles about five spaces.
9. Write the account balances in the first money column of the income statement. These balances are found in the income statement debit column on the worksheet.
10. Draw a single line under the last expense amount in the first column.
11. Indent the words "Total Expenses" so they appear under the last listed expense account.
12. Total the balances of all the expense accounts, and write the total in the second column on the same line as the words "Total Expenses."

NOTE: The income statement contains two balance or money columns which are neither debit nor credit columns, but are used as *list* columns and *totals* columns. The first money column is used to list account balances, and the second money column is used for totals.

<i>Lawson's Lawn Care</i>				
<i>Income Statement</i>				
<i>For the Month Ended July 31, 20—</i>				
<i>Revenue:</i>				
<i>Sales</i>			4367	00
<i>Expenses: 7</i>				
8 <i>Advertising Expense</i>	9	86	00	
<i>Insurance Expense</i>		330	00	
<i>Miscellaneous Expense</i>		95	00	
<i>Rent Expense</i>		450	00	
<i>Supplies Expense</i>		1341	00	
<i>Utilities Expense</i>		125	00	
11 <i>Total Expenses</i>	10		122427	00

Calculating Net Income or Net Loss

Steps for determining net income or net loss:

13. Rule a single line under the total expense amount in the second column.
14. Subtract the total expenses from the total revenue to determine the net income. Enter the amount of the net income in the second column under the amount representing total expenses.
15. Write the words “Net Income” (or “Net Loss” if the expenses exceeded the revenue) at the left margin of the account title column.
16. To determine if the income statement net income or net loss is correct, match it with the net income or net loss shown on the previous worksheet. These figures must match in order to proceed with the financial report process. If the amount matches the net income or net loss on the worksheet, draw a double line across both columns under the amount representing the income or loss. This verifies that the amount is correct.

<i>Lawson's Lawn Care</i>				
<i>Income Statement</i>				
<i>For the Month Ended July 31, 20—</i>				
<i>Revenue:</i>				
<i>Sales</i>			4367	00
<i>Expenses:</i>				
<i>Advertising Expense</i>	86	00		
<i>Insurance Expense</i>	330	00		
<i>Miscellaneous Expense</i>	95	00		
<i>Rent Expense</i>	450	00		
<i>Supplies Expense</i>	1341	00		
<i>Utilities Expense</i>	125	00		
<i>Total Expenses</i>			2427	00
<i>Net Income</i> 15			1419	40

Income Statements With Multiple Revenue Accounts

Most small businesses record all income under one account such as Sales or Fees. However, many business owners prefer to present a more detailed account of their revenue, so they break down their sources of revenue into two or more accounts to give a clearer picture of all sources of revenue from the business.

The income statement shown below (based on the worksheet in Exercise 3.7 in LIFEPAC 5) illustrates how a business with more than one revenue account would list the accounts.

<i>Bob's Boat Rental</i>			
<i>Income Statement</i>			
<i>For the Quarter Ended May 31, 20—</i>			
<i>Revenue:</i>			
<i>Boat Rental</i>	<i>16548</i>	<i>00</i>	
<i>Fishing Equipment Sales</i>	<i>18301</i>	<i>00</i>	
<i>Total Revenue</i>			<i>34849 00</i>
<i>Expenses:</i>			
<i>Advertising Expense</i>	<i>12165</i>	<i>00</i>	
<i>Insurance Expense</i>	<i>870</i>	<i>00</i>	
<i>Miscellaneous Expense</i>	<i>2158</i>	<i>00</i>	
<i>Rent Expense</i>	<i>6000</i>	<i>00</i>	
<i>Repair Expense</i>	<i>2603</i>	<i>00</i>	
<i>Supplies Expense - Office</i>	<i>742</i>	<i>00</i>	
<i>Supplies Expense - Store</i>	<i>1286</i>	<i>00</i>	
<i>Utilities Expense</i>	<i>2489</i>	<i>00</i>	
<i>Total Expenses</i>			<i>28313 00</i>
<i>Net Income</i>			<i>6536 00</i>

Income Statement With a Net Loss

The income statement shown below (based on the worksheet in Exercise 3.6 in LIFEPAC 5) illustrates how a net loss would be recorded.

<i>Fox Photography</i>			
<i>Income Statement</i>			
<i>For the Quarter Ended March 31, 20—</i>			
<i>Revenue:</i>			
<i>Sales</i>			<i>8628 00</i>
<i>Expenses:</i>			
<i>Advertising Expense</i>	<i>2775 00</i>		
<i>Insurance Expense</i>	<i>1400 00</i>		
<i>Miscellaneous Expense</i>	<i>615 00</i>		
<i>Rent Expense</i>	<i>1280 00</i>		
<i>Repair Expense</i>	<i>885 00</i>		
<i>Supplies Expense - Office</i>	<i>1849 00</i>		
<i>Supplies Expense - Store</i>	<i>1000 00</i>		
<i>Utilities Expense</i>	<i>25 00</i>		
<i>Total Expenses</i>			<i>9829 00</i>
<i>Net Loss</i>			<i>1201 00</i>

 Use the forms on the next page to complete the following activities.

- 1.1 Use the following account balances to prepare an income statement for **Holiday Tours** for the month ended March 31 of the current year:

Sales	\$1,200.00	Advertising Expense	\$ 75.00
Membership Fees	600.00	Miscellaneous Expense	440.00
		Rent Expense	955.00
		Utilities Expense	120.00

- 1.2 Use the following account balances to prepare an income statement for **Overview Tours** for the month ended July 31 of the current year:

Sales	\$1,200.00	Advertising Expense	\$ 50.00
		Miscellaneous Expense	150.00
		Rent Expense	450.00
		Utilities Expense	40.00

SELF TEST 1

Calculate the net income or net loss (each problem, 3 points).

	<i>Total Revenue</i>	<i>Total Expenses</i>	<i>Net Income</i>	<i>or</i>	<i>Net Loss</i>
1.01	\$ 6,000.00	\$ 5,500.00			
1.02	10,500.00	6,500.00			
1.03	2,450.00	875.00			
1.04	1,675.00	1,825.00			
1.05	21,565.00	16,945.00			
1.06	11,850.00	12,250.00			
1.07	18,765.00	10,980.00			
1.08	22,546.00	19,775.00			

<i>Fox Amusement Park</i>										
<i>Worksheet</i>										
<i>For the Month Ended October 31, 20—</i>										
ACCOUNT NAME	TRIAL BALANCE				INCOME STATEMENT				BALANCE SHEET	
	DEBIT	CREDIT	DEBIT	CREDIT	DEBIT	CREDIT	DEBIT	CREDIT		
<i>Cash</i>	4580 00						4580 00			
<i>Computer Supplies</i>	5800 00						5800 00			
<i>Repair Equipment</i>	7800 00						7800 00			
<i>Concession Supply Co.</i>		1560 00						1560 00		
<i>Jason Fox, Capital</i>		10200 00						10200 00		
<i>Jason Fox, Drawing</i>	900 00						900 00			
<i>Admissions Income</i>		11500 00		11500 00						
<i>Concessions Income</i>		2600 00		2600 00						
<i>Advertising Expense</i>	2500 00		2500 00							
<i>Rent Expense</i>	3500 00		3500 00							
<i>Utilities Expense</i>	780 00		780 00							
Totals	25860 00	25860 00	6780 00	14100 00	14100 00	19080 00	11760 00			
<i>Net Income</i>			7320 00				7320 00			
			14100 00	14100 00	14100 00	14100 00	19080 00	19080 00		

