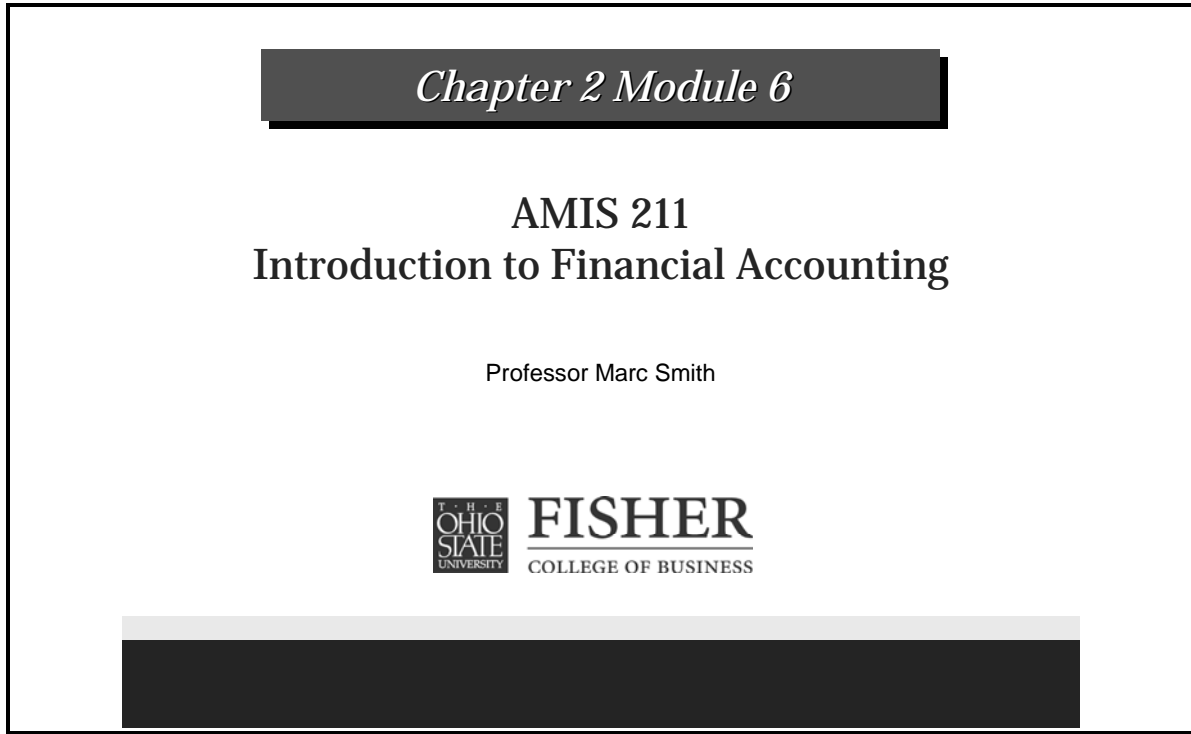


Chapter 2, Module 6 – Financial Statements

Slide 1

A rectangular box with a black border containing the slide content. At the top, a dark grey horizontal bar contains the text "Chapter 2 Module 6" in white italicized font. Below this, the text "AMIS 211" and "Introduction to Financial Accounting" is centered in a black serif font. Underneath, "Professor Marc Smith" is centered in a smaller black serif font. The Fisher College of Business logo is centered below, consisting of a small square with "T H B OHIO STATE UNIVERSITY" and the word "FISHER" in a large serif font above "COLLEGE OF BUSINESS". At the bottom of the box, there are two horizontal bars: a light grey one on top and a dark grey one on the bottom.

Hi everyone. Welcome back.

We have now talked about the four (4) major Financial Statements: 1) the Balance Sheet, 2) the Income Statement, 3) the Statement of Owners' Equity, and 4) the Statement of Cash Flows.

There is something very important that we need to discuss in this module related to those statements is: "How do they work together?"

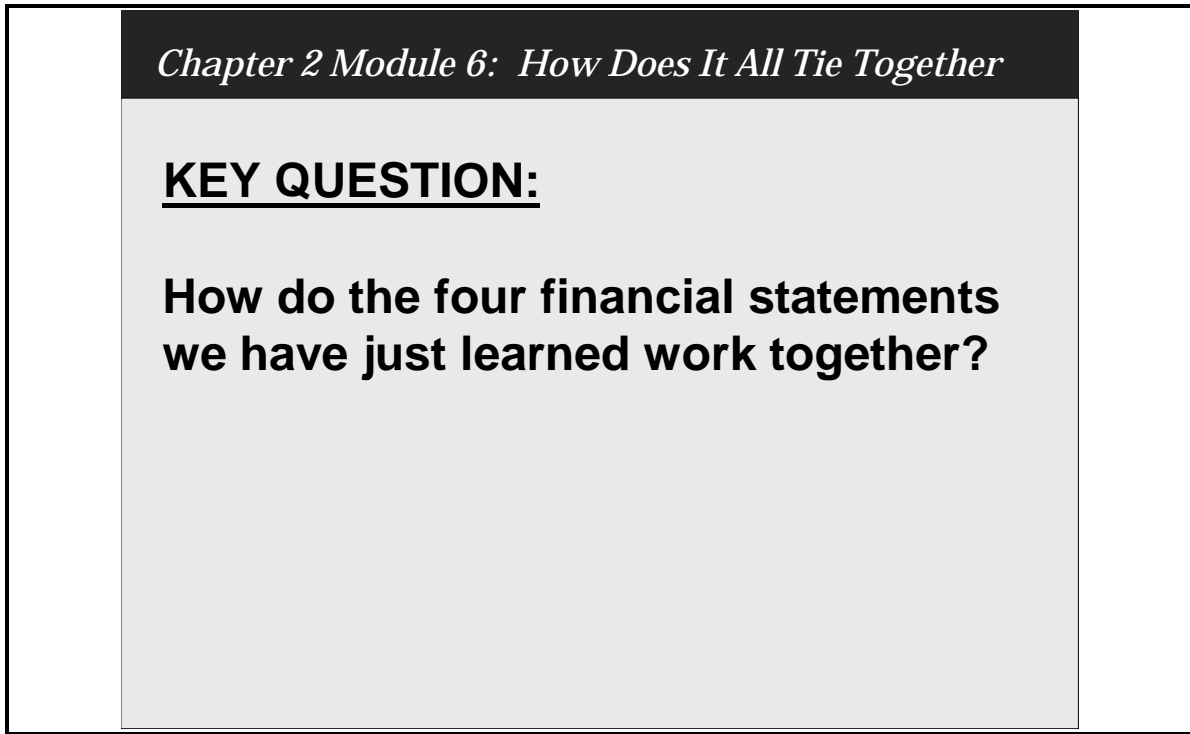
These statements do not exist independent of one another. They do not exist in some vacuum. They all work together and provide information to each other.

And, that is kind-of what we want to be able to get out of this module as well as when we walk away from this whole chapter: we want to understand how the statements work together.

So, let's go ahead and get started.

Let's go to the next slide.

Slide 2

A rectangular box with a black border containing slide content. The top part is a dark grey header with white text. Below it is a light grey background with bold black text.

Chapter 2 Module 6: How Does It All Tie Together

KEY QUESTION:

How do the four financial statements we have just learned work together?

Like I just said a second ago, the key question that we need to answer is:

How do the four (4) major financial statements, that we've just spent time talking about, interact with and work with one another?

Let's go to the next slide.

Slide 3

Chapter 2 Module 6: How Does It All Tie Together

ANSWER:

Start with the income statement. This allows you to determine net income.

You then use that number (net income) to complete the statement of owners' equity. Specifically, net income allows us to determine the ending balance in retained earnings.

The answer to that question:

Let's start with the Income Statement.

This Income Statement allows us to calculate the Net Income of the company.

Now, remember, we use that Net Income in the Statement of Owners' Equity to figure out the Ending Retained Earnings balance.

Remember that little equation that I told you that was one of the ones you needed to know:

Beginning Retained Earnings plus (+) Net Income (from the Income Statement), minus (-) Dividends is (=) the Ending Retained Earnings.

Now, once you have done the Statement of Owners' Equity...and please go to the next slide with me.

Slide 4

Chapter 2 Module 6: How Does It All Tie Together

ANSWER (continued):

Next, you are to use the ending balance in retained earnings to complete the balance sheet. Remember, retained earnings is part of owners' equity which is found on the balance sheet.

Finally, the statement of cash flows describes in depth the changes in cash (an asset found on the balance sheet).

Once you have done the Statement of Owners' Equity, you get the Ending Contributed Capital and the Ending Retained Earnings. Those numbers go to the Balance Sheet.

Remember Retained Earnings and Contributed Capital were both part of Equity that we find on the Balance Sheet as the: Assets = Liabilities plus (=) Equity ($A = L + E$).

Finally, the Cash Flow Statement fits into this puzzle.

And, by the way, that is a way of thinking about Accounting. It is just one big giant jigsaw puzzle and we are trying to put in the pieces in the right place.

And, where the Cash Flow Statement fits is:

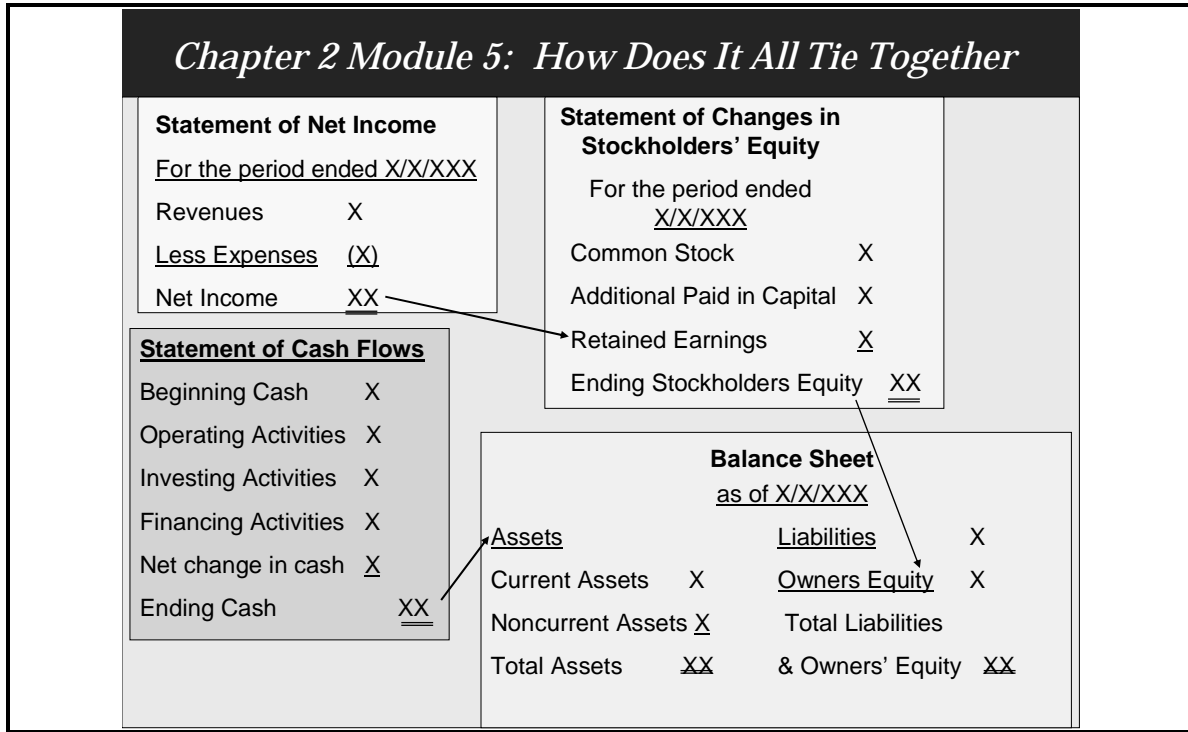
It describes the changes in cash.

And, remember cash is an Asset we find on the Balance Sheet.

So, the Cash Flow Statement simply shows us the changes in a very important asset on the Balance Sheet: Cash.

If you would go to the next slide with me...

Slide 5



Let's take a look at this little diagram: it kind-of shows what we just spent the last couple of minutes talking about.

If you look at the upper left part of the diagram, you see the Income Statement:

Revenues minus (-) Expenses is (=) Net Income.

That Net Income number is then taken over to the Statement of Owners' Equity to calculate the Retained Earnings.

So, from the Statement of Owners' Equity, we are able to figure out our Total Stockholders' Equity—the Contributed Capital plus (+) Retained Earnings.

And then, that total Equity goes down—and you can see the arrow—it goes down to the Balance Sheet.

That allows us to (quote/unquote) “balance” the Balance Sheet—to see that Assets equal (=) Liabilities plus (+) Equity ($A = L + E$).

Finally, you can see there (on Slide 5) in the bottom left, the Cash Flow Statement fits in here because it describes the changes in cash through the Operating, Investing, and Financing activities. And, Cash is an asset found on the Balance Sheet.

What do you want to walk away with from this little discussion?

You want to recognize that these financial statements interact with and work together.

And, we are going need to be able to work with each of them in order to solve problems and enhance our understanding of the Financial Statements, which are a major element of this course.

Let's go to the next slide.

Slide 6

*Chapter 2 Module 5: How Does It All Tie Together***KEY FINANCIAL STATEMENT RELATIONSHIPS:**

$$1. \text{ Assets} = \text{ Liabilities} + \text{ Equity}$$

$$2. \text{ Revenues} - \text{ Expenses} = \text{ Net Income}$$

$$3. \text{ Beginning Retained Earnings} + \\ \text{ Net Income} - \text{ Dividends} = \\ \text{ Ending Retained Earnings}$$

And, I would like to wrap up this little module with a review of some of the key relationships on the Financial Statements we have talked about.

The fundamental accounting equation—the number one most important relationship is the first thing listed: the Balance Sheet.

1) Assets = Liabilities + Equity ($A = L + E$).

On the Income Statement, we will see #2: how to calculate Net Income.

2) Revenues minus (–) Expenses equals (=) Net Income.

The third one on this slide (Slide 6) is a very important one—one that a lot of folks tend to forget but it pops up a lot on exams and quizzes. So, you really want to be comfortable with it.

3) The Retained Earnings equation:

Beginning Retained Earnings plus (+) Net Income (from the Income Statement), minus (-) the Dividends, equals (=) the Ending Retained Earnings balance.

And, when you go to the next slide, you will see the other two.

Slide 7

Chapter 2 Module 5: How Does It All Tie Together

KEY FINANCIAL STATEMENT RELATIONSHIPS:

**4. Sales Revenue - Cost of Goods Sold =
Gross Profit**

**5. Total Equity = Contributed Capital +
Retained Earnings**

Remember that the Income Statement is sort-of divided into the top part, which deals with our primary activity: selling inventory.

And that shows 4) the Sales Revenue minus (-) the Cost of Goods Sold (CGS) referred to as Gross Profit—which is the profit earned from selling our product. We then add (+) the other Revenues and subtract (-) the Expenses to get Net Income.

But, you want to be able to calculate Gross Profit.

And, finally, you want to recognize that your Equity on the Balance Sheet consists of two (2) components. Those two (2) components: 5) the Contributed Capital plus (+) the Retained Earnings.

Those past couple of slides (Slide 6 and Slide 7) kind-of give you a cheat sheet, if you will, of the five important relationships that you need to be able to deal with in order to solve the problems that you are asked on quizzes, exams, homeworks, and the like.