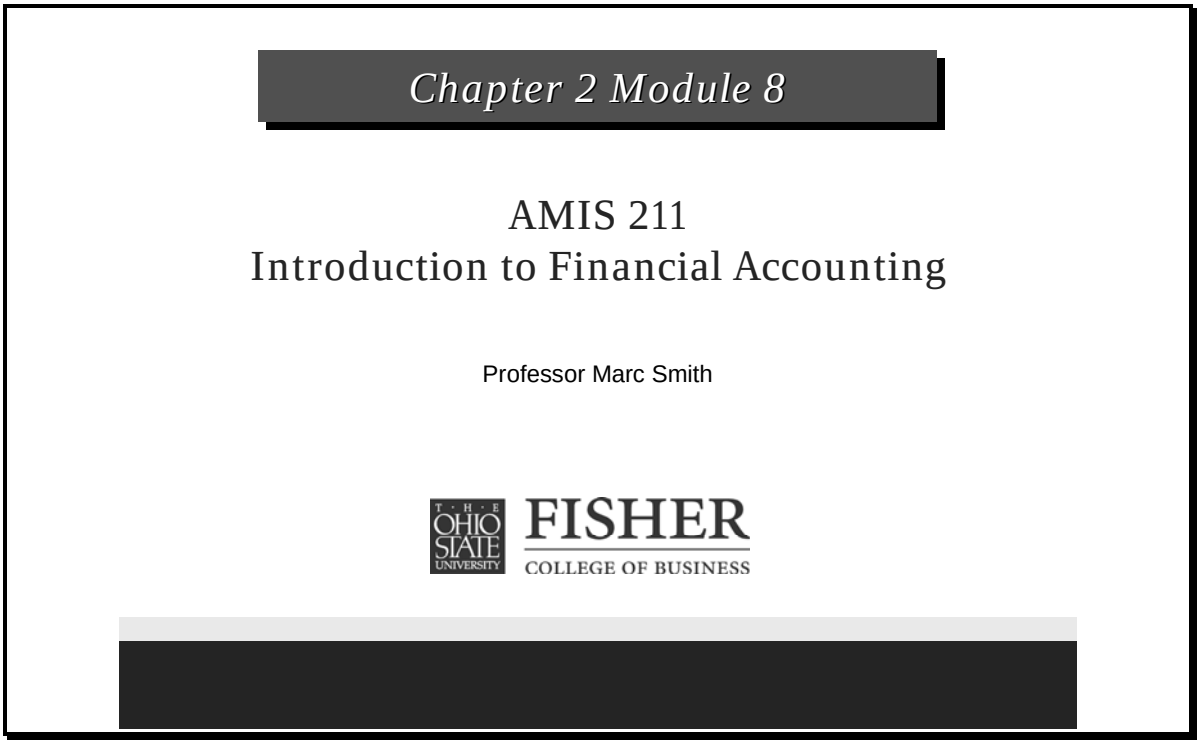
Chapter 2, Module 8 – Financial Statements

Slide 1



Hi everyone. Welcome back.

Let's do one more Example together.

The previous examples that we saw basically asked us to do some minor calculations given some numbers already from the Financial Statements. We kind of worked forward and backwards using those Financial Statement equations.

Example #3 asks us to actually put together a set of Financial Statements.

Example #3 says: "The following account balances were given for ABC Company at December 31st of 2003." And, you can see the account balances.

And, they, from that, want us to prepare an Income Statement and a Balance Sheet.

So, let's see if we can go ahead and do it.

Let's go to the next slide.

Slide 2

Chapter 2 Module 8: Example #3

1. Income Statement

Sales Revenue ……..		**450,000**
Cost of Goods Sold ……		**260,000**
Gross Profit ……..		**190,000**
Add: Interest Revenue ……..		**11,000**
Less Other Expenses:		
Salaries Expense …….	**61,000**	
Utilities Expense ……..	**10,000**	
Rent Expense ……	**42,000**	
Interest Expense ……..	**28,000**	
Income Tax Expense ……..	**24,000**	**165,000**
Net Income ……		**36,000**

Requirement 1 asks us for the Income Statement.

Remember: What is the first thing that we will always see on our Income Statement?

It is our Sales Revenue—the revenue that we earned from selling our product. It is given in the problem: $450,000.

What gets subtracted from Sales Revenue?

That was the Cost of Goods Sold (CGS), right? It is given as: $260,000.

And that Sales Revenue minus (-) Cost of Goods Sold (CGS) is what we refer to as Gross Profit.

By the way, just as a quick little note:

I find it really helpful when working a problem like this when you are given a whole lot of different accounts: tick them off. As we use them in the financial statements, put a little check mark next to it knowing that or that should tell you that we have used it. And, that way if you get to the end and the Balance Sheet does not balance, you might be able to go back and look at the problem and see maybe you forgot to include one of the accounts.

So, go ahead and tick off Sales Revenue and the Cost of Goods Sold—already used here on the Income Statement.

What do we add to this next?

Remember, we add all of the Other Revenues that the company has earned.

Go ahead and look down your problem.

And see if you can pick out—I will tell you, there is only one. Can you pick out the other "revenue" that is given?

Take a second and look and look and look.

And, as you look down, you ought to be able to see the Other Revenue is Interest Revenue; given as $11,000.

So, add our Other Revenues.

We also have to subtract all our Other Expenses.

So, let's go down the list and see if we can pull out the expenses.

Remember: we kind of look for the key word: expense.

The very second item listed: Salaries Expense. That is given: $61,000. So, tick it off. We have used it.

The next expense listed: Utilities Expense ($10,000).

Keep going down the list.

The next one listed: Rent Expense. ($42,000).

We keep going down. We keep going down.

We, then, run into Interest Expense ($28,000).

Then we head all the way to the bottom. The final expense listed: The Income Tax Expense ($24,000).

We add those five items together ($61,000, $10,000 +42,000 + $28,000 + $24,000). The Total Other Expenses are: $165,000.

So, take that Gross Profit of $190,000 plus (+) your Other Revenues of $11,000, minus (-) the Other Expenses of $165,000. That gives us (=) our Net Income of 36 thousand bucks ($36,000).

That is what an Income Statement looks like.

You start with the profit earned from selling your inventory: Sales Revenue minus (-) Cost of Goods Sold (CGS). And then, include everything else: all of the Other Revenues and subtract (-) all of the Other Expenses.

Let's go to the next slide and see if we can do Requirement 2. It is a little bit more involved.

Slide 3

Chapter 2 Module 8: Example #3

2. Balance Sheet

ASSETS:

Current Assets

Cash ……	**25,000**
Accounts Receivable ……	**65,000**
Inventory ……..	**88,000**
Supplies ……..	**10,000**
Total Current Assets ……	**188,000**

NOTE: Current assets are listed in order of liquidity which means ease of converting into cash.

We will do a Balance Sheet.

And, we know we start with our Assets.

And, we also know that our Assets are divided into a couple of (2) different categories.

The first category of Assets are 1) the Current Assets—those assets that we will either convert into cash or use up within one (1) year.

Let's go down our list and pull out our Current Assets.

One Current Asset listed is: Cash.

Another Current Asset listed is: Accounts Receivable (A/R).

Quick! Don't look at the answer!

Tell me: What are the next two Current Assets?

What are the other two Current Assets that we listed out a few modules ago?

Inventory is certainly a Current Asset; and Supplies.

We have Total Current Assets of $188,000.

One thing to make note of: On the Balance Sheet, your Current Assets; they have a specific order.

And, the order is as you see on the screen there (Slide 3).

The order is: Current Assets must be shown in order of liquidity, which means: ease of converting into Cash.

Current Assets are listed from highest liquid to lowest liquid Current Asset.

The most liquid is, of course, Cash. It is already Cash.

Accounts/Receivable (A/R) is next. Then, Inventory. Then, Supplies.

Let’s go to the next slide.

Slide 4

Chapter 2 Module 8: Example #3

2. Balance Sheet (continued)

ASSETS:

P-P-E

Equipment ……..	**145,000**
Accumulated Depreciation …….	**<33,000>**
Total P-P-E ……	**112,000**
Total Assets ……	**300,000**

(188,000 of current assets + 112,000 of P-P-E)

And, continue with the Assets side of the Balance Sheet.

The next category of Assets would be: Property, Plant, and Equipment (P-P-E). Land, Building—neither of which are listed in the problem; but the third one is: the Equipment of $145,000.

Remember, there is that one other item that goes here. That thing called Accumulated Depreciation, shown as a decrease here in P-P-E.

Giving us: total Property, Plant, and Equipment (P-P-E) of $112,000, which allows us to calculate our Total Assets: the Total Current plus (+) Total P-P-E as $300,000.

As one other aside: note that there is another category of Assets that could exist—the Intangibles, things like patents, and trademarks, and copyrights—but none of those items are listed in the problem.

Hence, ABC Company does not have any Intangibles. And, they are not shown on the Balance Sheet then, giving the company Total Assets of: $300,000.

Let's go to the next slide and let's do the other side of the Balance Sheet.

Slide 5

Chapter 2 Module 8: Example #3

2. Balance Sheet (continued)

LIABILITIES:

Current Liabilities	
Accounts Payable ……..	**25,000**
Salaries Payable ……	**22,000**
Total Current Liabilities ……	**47,000**
Long-Term Liabilities	
Notes Payable ……	**30,000**
Total Liabilities ……..	**77,000**

Let's start with Liabilities.

They are also broken into two (2) categories.

Let's start with your Current Liabilities—those debts to be paid within one (1) year.

Examples of Current Liabilities that are in this problem: Accounts Payable (A/P) and Salaries Payable.

The Total Current Liabilities are $47,000.

We also have our Long-Term Liabilities.

And, we know that the Note Payable that is listed is Long-Term.

How do we know that? How do we know that the Note Payable is Long-Term?

It tells us in the problem, right?

It said that the Note Payable is not due until December 31 of 2008—five (5) years from the date of the Balance Sheet. It is not going to be paid within a year; hence, it is considered Long-Term, giving us: Total Liabilities of $77,000.

Go to the next slide with me.

Slide 6

Chapter 2 Module 8: Example #3

2. Balance Sheet (continued)

EQUITY:

Common Stock ……	**45,000**
Retained Earnings ……..	**178,000**
Total Equity ……	**223,000**

TOTAL LIABILITIES + EQUITY …… 300,000
(note this is equal to total assets from slide 4)

QUESTION: How did we come up with the retained earnings balance?

ANSWER: Beginning + Net Income - Dividends
159,000 + 36,000 - 17,000

And, let's look at our Equity portion of the Balance Sheet.

Remember, Equity consists of two (2) pieces: 1) the Common Stock or Contributed Capital, given as $45,000. And, take my word for it, just for a second, 2) the Retained Earnings of $178,000, giving us: Total Equity of $223,000.

And, when we add the Total Equity to the Liabilities, we have: $300,000.

And, we are happy, right? Because: that means Total Liabilities plus (+) Equity are equal to (=) the Total Assets we calculated just a couple of slides ago ($300,000).

We have one question for you before we wrap this up.

Remember, I said: "Trust me," just a couple of minutes ago. I said, "Trust me. Retained Earnings is $178,000."

How did I come up with that?

How did we develop that $178,000?

Because: in the problem they tell us Retained Earning is: $159,000.

What they tell us is Retained Earnings at January 1st is: $159,000.

What we need to know is: Beginning Retained Earnings plus (+) Net Income, minus (-) Dividends equals (=) the Ending Retained Earnings.

And, we can go ahead and solve that: $159,000 Beginning; plus (+) Net Income from the Income Statement (we calculated it together): $36,000; minus (-) the Dividends that are listed of $17,000); gives us: the $178,000 of Retained Earnings.

This is also a good example. It is well worth your time. Go back through this one. Make sure you are comfortable with putting together Income Statements and Balance Sheets.