CHAPTER 7 -- FINANCIAL STATEMENTS FOR A PROPRIETORSHIP

I. The first financial statement to be prepared from the work sheet is the Income Statement.

A. Prepared over a period of time (For Month Ended . . .)

B. Shows the financial progress of a business in earning net income or net loss.

C. Revenue is the earnings of a business from business activities. Expenses are the amounts a business pays to operate the business and earn the revenue.

Matching Expenses with Revenue – The revenue earned and the expenses incurred to earn that revenue are reported in the same fiscal period (Accounting Concept).

D. Information needed to prepare an income statement is taken from the work sheet (Account Title column and from the Income Statement debit and credit columns).

E. Income Statement for a service business has four parts: heading, revenue, expenses, net income or net loss.

F. Heading – see Page 182

G. Revenue, expenses, and net income/net loss sections – see Page 183

H. Completed Income Statement – see Page 184

I. ***Component percentage*** – The percentage relationship between one financial statement item and the total that includes that item.

1. An owner/manager needs to know what percentages are acceptable for similar businesses in order to make the component percentage useful.

2. Total expenses component percentage – This is found by dividing the Total Expenses by the Sales. A commonly used acceptable percentage would be not more than 55.0% for a business like TechKnow Consulting.

3. Net income component percentage – This is found by dividing the Net Income or Net Loss by the Sales. A commonly used acceptable percentage would be not less than 45.0% for a business like TechKnow Consulting.

J. More than one Revenue source – see Page 185

K. If there is a net loss, put parentheses around the number; this indicates a negative in accounting Page 185

II. The second financial statement to be prepared from the work sheet is the Balance Sheet.

A. Prepared for a specific date.

B. Shows the financial condition of a business.

C. If a business has adequate assets and few liabilities, it is most likely financially strong. If a business is not financially strong, it may fail in the future.

D. Information needed to prepare a balance sheet is taken from the work sheet (Account Title column and from the Balance Sheet debit and credit columns)

E. Balance Sheet has four sections: heading, assets, liabilities, and owner's equity.

F. Heading – see Page 187

G. Assets and Liabilities sections – see Page 188

H. Owner's Equity section – to find the new capital figure, begin with the old capital (found in the Balance Sheet Credit column of the work sheet), add the net income (or subtract the new loss) and subtract drawing. See Page 189

I. Completed Balance Sheet – see Page 189

J. Reporting the Owner's Equity section in detail on a Balance Sheet – see Page 190