

LESSON

7-1 Preparing an Income Statement



Learning Objectives

- LO1** Prepare an income statement for a service business.
- LO2** Calculate and analyze financial ratios using income statement amounts.

Reporting Financial Information

LO1

- The area of accounting that focuses on reporting information to external users is called **financial accounting**.
- The area of accounting that focuses on reporting information to internal users is called **managerial accounting**.

Preparing an Income Statement from Information on a Work Sheet

LO1

- Information needed to prepare the income statement is obtained from the work sheet.

Account titles are obtained from the work sheet's Account Title column.

Account balances are obtained from the work sheet's Income Statement columns.

		5		6	
ACCOUNT TITLE		INCOME STATEMENT			
		DEBIT		CREDIT	
12	<i>Sales</i>			5 8 2 0 00	12
13	<i>Advertising Expense</i>	3 9 7 00			13
14	<i>Cash Short and Over</i>	1 00			14
15	<i>Communications Expense</i>	8 0 00			15
16	<i>Equipment Rental Expense</i>	1 4 5 5 00			16
17	<i>Insurance Expense</i>	1 5 0 00			17
18	<i>Miscellaneous Expense</i>	4 5 00			18
19	<i>Supplies Expense</i>	5 3 0 00			19
20		2 6 5 8 00		5 8 2 0 00	20
21	<i>Net Income</i>	3 1 6 2 00			21
22		5 8 2 0 00		5 8 2 0 00	22

Heading of an Income Statement

LO1

Center the name of the company on the first line.

1

Delgado Web Services

Income Statement

For Month Ended January 31, 20--

3

Center the date of the report on the third line.

2

Center the name of the report, Income Statement, on the second line.

Revenue, Expenses, and Net Income Sections of an Income Statement

LO1

The diagram illustrates the components and calculation steps of an income statement. The table below shows the data, with callouts 1 through 14 pointing to specific parts of the statement.

	Account Title	Expense Amounts	% OF SALES
Revenue	Revenue: Sales	5 8 2 0 00	3
Expenses	Expenses:		
	Advertising Expense	3 9 7 00	
	Cash Short and Over	1 00	
	Communications Expense	8 0 00	
	Equipment Rental Expense	1 4 5 5 00	
	Insurance Expense	1 5 0 00	
	Miscellaneous Expense	4 5 00	
	Supplies Expense	5 3 0 00	
Total Expenses	Total Expenses	2 6 5 8 00	9
Net Income	Net Income	3 1 6 2 00	11

Callout 10: Calculate Net Income (points to the Net Income row)

Callout 12: Net Income (points to the Net Income label)

Callout 13: Record Net Income (points to the Net Income amount)

Callout 14: Double Rule (points to the Net Income amount)

Analyzing an Income Statement

LO2

- A comparison between two components of financial information is called a **financial ratio**.
- The calculation and interpretation of a financial ratio is called **ratio analysis**.
- Reporting an amount on a financial statement as a percentage of another item on the same financial statement is called **vertical analysis**.

Analyzing an Income Statement

LO2

Delgado Web Services						
Income Statement						
For Month Ended January 31, 20--						
						% OF SALES
Revenue:						
Sales				5 8 2 0 00		100.0
Expenses:						
Advertising Expense	3 9 7 00					
Cash Short and Over		1 00				
Communications Expense		8 0 00				
Equipment Rental Expense	1 4 5 5 00					
Insurance Expense		1 5 0 00				
Miscellaneous Expense		4 5 00				
Supplies Expense	5 3 0 00					
Total Expenses				2 6 5 8 00		45.7
Net Income				3 1 6 2 00		54.3

Total Expenses Ratio

Total Expenses ÷ Total Sales = Total Expenses Ratio
 $\$2,658.00 \div \$5,820.00 = 45.7\%$

Net Income Ratio

Net Income ÷ Total Sales = Net Income Ratio
 $\$3,162.00 \div \$5,820.00 = 54.3\%$

Income Statement with Two Sources of Revenue and a Net Loss

LO2

		Repair It Now										
		Income Statement										
		For Month Ended July 31, 20--										
Revenue	Account Titles											% OF SALES
	Revenue:											
	Sales—Riding Mowers	18	5	0	0	00						
	Sales—Push Mowers	2	7	0	0	00						
	Total Revenue						21	2	0	0	00	100.0
	Expenses:											
	Advertising Expense		2	3	7	5	00					
	Cash Short and Over					2	00					
	Communications Expense			3	5	0	00					
	Equipment Rental Expense	12	3	0	0	00						
	Insurance Expense			1	5	0	00					
	Miscellaneous Expense			5	5	0	00					
	Supplies Expense		8	4	0	0	00					
	Total Expenses						24	1	2	7	00	113.8
	Net Loss						(2	9	2	7	00)	(13.8)

1 Revenue
 2 Account Titles
 3 Revenue Amounts
 4 Total of Revenue
 5 Total Revenue
 6 Net Loss
 7 Record Net Loss

Lesson 7-1 Audit Your Understanding

1. List the four sections of an income statement.

ANSWER

Heading, revenue, expenses, and net income or net loss

Lesson 7-1 Audit Your Understanding

2. What is the formula for calculating the total expenses ratio?

ANSWER

Total Expenses *divided by* Total Sales
equals Total Expenses Ratio.

Lesson 7-1 Audit Your Understanding

3. What is the formula for calculating the net income ratio?

ANSWER

Net Income *divided by* Total Sales *equals*
Net Income Ratio.

LESSON

7-2 Preparing a Balance Sheet



Learning Objectives

- LO3** Prepare a balance sheet for a service business organized as a proprietorship.

Preparing a Balance Sheet from Information on a Work Sheet

LO3

- Information needed to prepare the balance sheet is obtained from the work sheet.

Account titles are obtained from the work sheet's Account Title column.

Account balances are obtained from the work sheet's Balance Sheet columns.

		BALANCE SHEET			
ACCOUNT TITLE		DEBIT	CREDIT		
1	Cash	2 5 9 7 00			1
2	Petty Cash	1 0 0 00			2
3	Accounts Receivable—Main Street Services	3 0 0 00			3
4	Accounts Receivable—Valley Landscaping	4 0 0 00			4
5	Supplies	9 0 00			5
6	Prepaid Insurance	7 5 0 00			6
7	Accounts Payable—Canyon Office Supplies		1 2 0 00		7
8	Accounts Payable—Mountain Graphic Arts		1 0 5 00		8
9	Michael Delgado, Capital		2 0 0 0 00		9
10	Michael Delgado, Drawing	1 1 5 0 00			10
20		5 3 8 7 00	2 2 2 5 00		20
21	Net Income		3 1 6 2 00		21
22		5 3 8 7 00	5 3 8 7 00		22

Heading of a Balance Sheet

LO3

Center the name of the company on the first line.

1

Delgado Web Services

Balance Sheet

January 31, 20--

3

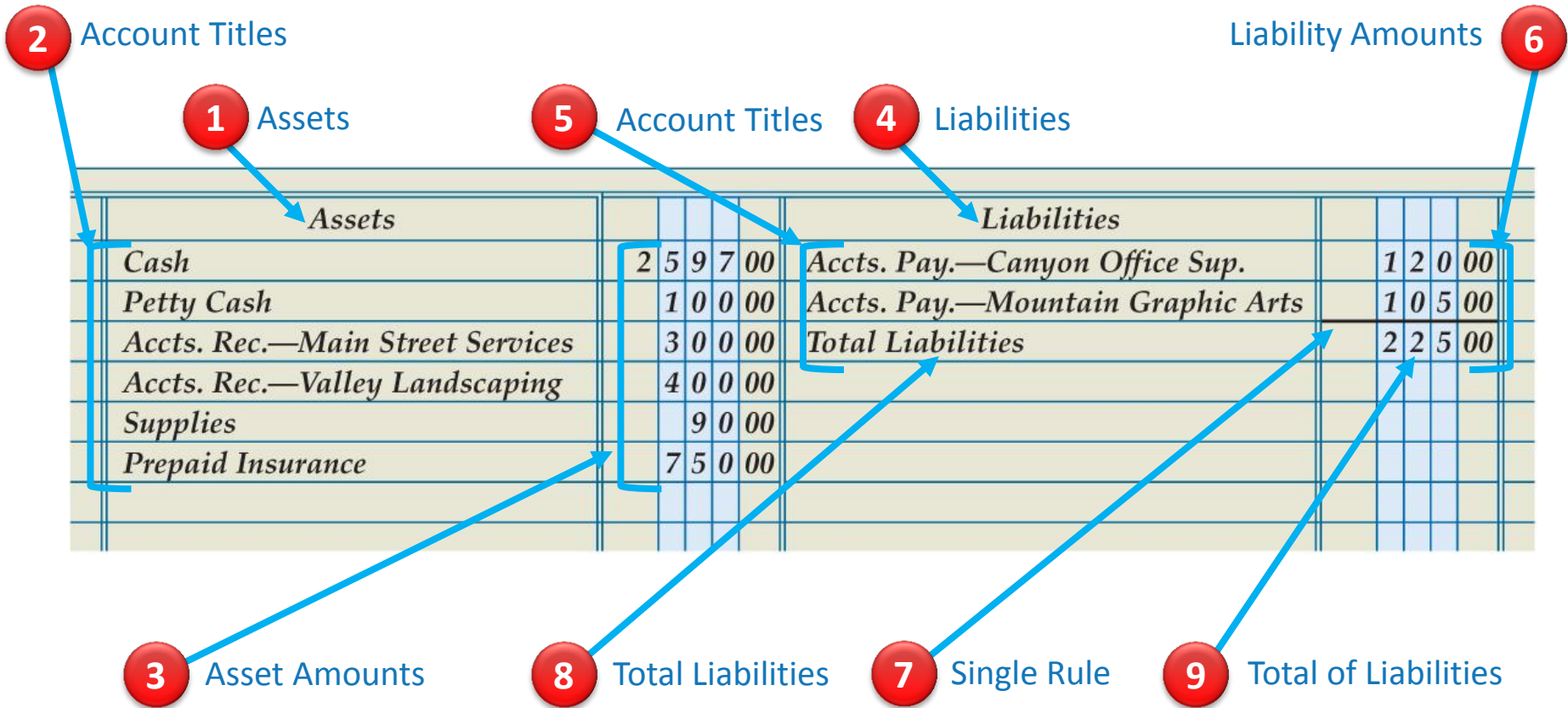
Center the date of the report on the third line.

2

Center the name of the report, Balance Sheet, on the second line.

Assets and Liabilities Sections of a Balance Sheet

LO3



Owner's Equity Section of a Balance Sheet

LO3

Assets		Liabilities	
Cash	2 5 9 7 00	Accts. Pay.—Canyon Office Sup.	1 2 0 00
Petty Cash	1 0 0 00	Accts. Pay.—Mountain Graphic Arts	1 0 5 00
Accts. Rec.—Main Street Services	3 0 0 00	Total Liabilities	2 2 5 00
Accts. Rec.—Valley Landscaping	4 0 0 00	Owner's Equity	
Supplies	9 0 0 00	Michael Delgado, Capital	4 0 1 2 00
Prepaid Insurance	7 5 0 00		
Total Assets	4 2 3 7 00	Total Liabilities and Owner's Equity	4 2 3 7 00

Delgado Web Services
Balance Sheet
January 31, 20--

1 Owner's Equity

2 Account Title

3 Capital Amount

4 Single Rule

5 Total Assets

6 Total of Assets

7 Total Liabilities and Owner's Equity

8 Total of Liabilities and Owner's Equity

9 Compare Totals

10 Double Rule

Owner's Equity Reported in Detail on a Balance Sheet

LO3

The diagram illustrates the components of a balance sheet related to owner's equity. It features a table with the following rows and values:

<i>Total Liabilities</i>										2	2	5	00
<i>Owner's Equity</i>													
<i>Michael Delgado, Capital, January 1</i>													2,000.00
<i>Net Income</i>													3,162.00
<i>Less Michael Delgado, Drawing</i>													<u>1,150.00</u>
													<u>2,012.00</u>
<i>Michael Delgado, Capital, January 31</i>													4 0 1 2 00
<i>Total Liabilities and Owner's Equity</i>													<u>4 2 3 7 00</u>

Callouts and their corresponding values in the table:

- 1** Beginning Capital: Points to the 2,000.00 value in the "Michael Delgado, Capital, January 1" row.
- 2** Beginning Capital Amount: Points to the 2,000.00 value in the "Michael Delgado, Capital, January 1" row.
- 3** Net Income: Points to the 3,162.00 value in the "Net Income" row.
- 4** Drawing: Points to the 1,150.00 value in the "Less Michael Delgado, Drawing" row.
- 5** Single Rule: Points to the 2,012.00 value in the "Less Michael Delgado, Drawing" row.
- 6** Difference: Points to the 2,012.00 value in the "Less Michael Delgado, Drawing" row.
- 7** Ending Capital: Points to the 4,012.00 value in the "Michael Delgado, Capital, January 31" row.
- 8** Current Capital Amount: Points to the 4,012.00 value in the "Michael Delgado, Capital, January 31" row.
- 9** Total Liabilities and Owner's Equity: Points to the 4,237.00 value in the "Total Liabilities and Owner's Equity" row.

Lesson 7-2 Audit Your Understanding

1. List the four sections on a balance sheet.

ANSWER

Heading, assets, liabilities, and owner's equity

Lesson 7-2 Audit Your Understanding

2. What is the formula for calculating current capital?

ANSWER

Capital Account Balance *plus* Net Income (or *less* Net Loss) *less* Drawing Account Balance *equals* Current Capital.