

FINANCIAL STATEMENTS AND ANALYZING TRANSACTIONS

Financial statements – the end product of financial accounting (annual report or 10-K)

- Income Statement
- Statement of Retained earnings (or more comprehensive Statement of Shareholders' Equity)
- Balance Sheet
- Statement of Cash Flows

Other elements of the 10-K

- Notes to the statements-
 - o used to be called footnotes, has a lot of information that provides additional details, descriptions and some required disclosures
- Auditor's report-
 - o independent accounting firm has to have looked at the statements prepared by the company and say if they fairly present what the company has told us happened. Check the companies system to make sure that it looks good and avoids problems and they have followed the rules based on what they see in the statement.
- Management discussion and analysis (MD&A)
 - o "spin" managements opportunity to talk about their point of view

Example #1 Financial Statements

A company reported the following accounts (in alphabetical order) with their balances as of December 31, 20X1.

Accounts payable	\$ 170	Notes payable	612
Accounts receivable	325	Other expenses	19
Advertising expense	119	Property and equipment	500
Capital Stock	950	Retained earnings	1,776
Cash	2,400	Revenue	875
Land	283	Wages expense	250

Required:

1. Determine the following:
 - a. **net income for the year 20X1**
- Company name
Income statement

For year ended 12/31/20X1	
Revenue	875
Expenses:	-388
Advertising expense	119
Wages expense	250
Other Expense	<u>19</u>
Total Expense	<u>388</u>
Net Income	487

b. total assets at December 31, 20X1 (balance sheet) =3508

Company Name
Balance sheet
12/31/20X1

Assets		Liabilities and Stockholders' Equity	
Cash	2400	AP	170
AR	325	NP	612
Land	283	Total Liability	782
P&E	<u>500</u>		
Total Assets	3508	CS	950
		RE	1776
		Total SE	<u>+2726</u>
		Balance L&SE	3508

- c. total liabilities at December 31, 20X1 (balance sheet) ^{^^^} =782
d. total equity at December 31, 20X1 (balance sheet) ^{^^^} =2726

2. Assume the company began 20X1 with a balance in Retained earnings of \$1,500. How much did the company distribute to the owners as dividends during 20X1? Why are dividends not included on the company's income statement?

Company Name
Statement of Retained Earnings
For Yr ended 12/31/X1

Beg blance RE, 1-1-X1	1500
+ Net Income	487
- Dividends	? (solve for ? = 211)
Ending balance RE 12-31-X1	<u>1776</u>

Dividends are not included on an income statement because the income statement shows revenue and expenses

Where does a company get the information about accounts and their balances in order to prepare financial statements?

- Transaction -
 - o financial event that has an impact on a company and can be recorded in dollars

- The accounting equation -
 - o AKA the balance sheet equation
 - o *****Assets = Liabilities + stockholders equity OR assets = liability + (common stock +retained earnings)*****

Every transaction

- must maintain the equality of the accounting (or balance sheet) equation
- must affect at least two accounts (in order to keep the equation "in balance")

Example #2 Transactions and the accounting equation

For each of the following independent events, determine the effect on the accounting equation.

		=	+	
	Transaction	Assets	Liabilities	Stockholders' equity
a.	owners invested cash in the business	Cash UP		Common Stock UP
b.	company borrowed cash from bank	Cash UP	Notes Payable UP	
c.	company paid cash to purchase equipment	Cash DOWN Equity UP		
d.	company purchased equipment by signing a note payable at the bank	Equity UP	Notes Payable UP	
e.	company completed job for customer and received cash = REVENUE UP	Cash UP		Retained Earnings UP
f.	company paid employee wages for current month = EXPENSES UP	Cash DOWN		Retained Earnings DOWN

*****WHEN REVENUE GOES UP THE RETAINED EARNINGS GOES UP BY THAT AMOUNT*****

Differences between expenses and payables- every time we record something our account has to stay balanced, so we affect two spots every time. PAYABLE means we owe money, often we have an EXPENSE because of a payable.