I. Objective(s): By the end of today’s lesson, the student will be able to:

- define accounting terms related to financial statements for a service business organized as a proprietorship.
- identify accounting concepts and practices related to preparation of financial statements for a service business organized as a proprietorship.
- prepare an income statement for a service business organized as a proprietorship.
- analyze an income statement using component percentages.
- prepare a balance sheet for a service business organized as a proprietorship.

II. Materials:

- Textbook
- Workbook
- Transparencies

III. Anticipatory Set:

The financial information needed by managers and owners to make good business decisions can be found in the general ledger accounts. This information is summarized, organized, and reported to the owners and managers.

IV. Learning Activities:
Adequate Disclosure  (CONCEPT)

Financial statements contain all information necessary to understand a business’ financial condition.

* accurate and up-to-date financial information about a business is needed by owners, managers, lenders, and investors. All important financial information must be adequately and completely disclosed on financial statements.

Two financial statements prepared each fiscal period are the Income Statement and Balance Sheet.

Income Statement - reports financial information over a specific period of time, indicating the financial progress of a business in earning a net income or net loss.

Balance Sheet - reports financial information on a specific date, indicating the financial condition of a business.

The financial condition of a business refers to its financial strength. If a business has adequate available assets and few liabilities, that business is financially strong and is able to withstand adverse changes in the economy.  

Illustration 9-1, pg. 193

INCOME STATEMENT

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.

The revenue earned and the expenses incurred to earn that revenue must be reported in the same period.

Matching Expenses with Revenue  (CONCEPT)

Revenue from business activities and expenses associated with earning that revenue are recorded in the same accounting period.

* matching expenses with revenue gives a true picture of business operations for an accounting period, therefore, all revenue earned as a result of business operations and all expenses incurred in producing the revenue must be reported in the same period.
Information needed to prepare the Income Statement is obtained from the Work Sheet.

- the Account titles are obtained from the Account Title column.
- Account balances are obtained from the Income Statement columns.

**Illustration 9-2, pg. 194**

An Income Statement has four sections:

1) Heading
2) Revenue
3) Expenses
4) Net Income or Net Loss

**Heading of an Income Statement**  
(Illustration 9-3, pg. 194)

All financial statements have similar information in their **three-line headings**:

1) **Business name**
2) **Statement name**  
   *Income Statement*
3) **Date of statement**  
   *For Month Ended*

**Revenue section of an Income Statement**  
(Illustration 9-4, pg. 195)

- write the name of the section, **Revenue**, at the extreme left of the wide column on the first line.

- write the title of the revenue account, **Sales**, on the next line indented.
  
  * additional revenue accounts would be listed also, indented.

- record the balance of the account on the same line in the second amount column.

The two columns on the Income Statement are not debit and credit columns.

First column is for listing numbers; the second column is for totals.

**Expenses section of an Income Statement**  
(Illustration 9-5, pg. 195)
• write the name of the section, Expenses:, at the extreme left of the wide column on the next blank line.
• write the title of each expense account in the wide column indented.
• record the balance of each expense account in the first amount column on the same line as the account title.
• to indicate addition, rule a single line across the first amount column under the last expense account balance.
• write the words, Total Expenses, on the next blank line in the wide column.
• record the amount of total expenses on to same line in the second amount column.

Net Income section of an Income Statement (Illustration 9-6, pg. 197)
• net income calculated from information on the Income Statement:
  \[ \text{Total Revenue} - \text{Total Expenses} = \text{Net Income} \]
• the amount of net income from the Income Statement is always compared with the net income on the Work Sheet, which must be the same.
• a single line is drawn across the second amount column just below the amount of total expenses.
• write the words, Net Income, on the next line at the extreme left of the wide column.
• record the amount of net income on the same line in the second amount column.
• rule double lines across both amount columns below the amount of net income to show that the amount has been verified as correct.

Net Loss
If total expenses exceed total revenue, a net loss is reported on the Income Statement.
  • write the words, Net Loss, in the wide column.
  • record the amount of net loss in the second amount column in parentheses.
An amount written in parentheses on a financial statement indicates a negative amount.

Component Percentage analysis of an Income Statement
To make decisions about future operations, owners and managers analyze relationships between expenses and sales, and net income and sales.

**Component Percentage** - the percentage relationship between one financial statement item and the total that includes that item.

**Total expenses component percentage** is calculated as follows:

\[
\text{Total Expenses} / \text{Total Sales} = \text{Total Expenses Component %}
\]

• an acceptable total expenses component percentage is not more than 80.0%.

**Net income component percentage** is calculated as follows:

\[
\text{Net Income} / \text{Total Sales} = \text{Net Income Component Percentage}
\]

• an acceptable net income component percentage is not less than 20.0%.

**Net loss** - when there is a net loss, the component percentage is written in parentheses.

A net loss is considered unacceptable.

**Acceptable component percentages**

To determine acceptable levels of performance, businesses generally make comparisons with previous performance and with industry performance standards of similar companies that are published by industry organizations.

**Income Statement with two sources of Revenue**

(Illustration 9-7, pg. 198)

• write the section heading, *Revenue*, at the left of the wide column.
• write the titles of the revenue accounts in the wide column indented.
• record the balance of each account in the first amount column on the same line as the account title.
• total the revenue account balances and rule a single line across the first amount column under the last revenue account balance.
• write the total amount on the next line in the second amount column.
• write the words, *Total Sales*, in the wide column indented on the same line as the total amount.

FYI, pg. 198

**Assignment:**

**Be sure you know and understand:**

• term 1, pg. 206.
• questions 1 - 11, pg. 206.
• answer Cases 1 & 2, pg. 206.
• do Problem 9-1, pg. 207.
• read pages 199 - 205.
**BALANCE SHEET**

Information needed to prepare the Balance Sheet is obtained form the Work Sheet.

- the Account titles are obtained from the Account Title column.
- Account balances are obtained from the Balance Sheet columns.

**Illustration 9-8, pg. 199**

A Balance Sheet has four sections:

1) Heading
2) Assets
3) Liabilities
4) Owner’s Equity

**Heading of a Balance Sheet**  
(Illustration 9-9, pg. 200)

All financial statements have similar information in their three-line headings:

1) **Business name**
2) **Statement name**  
   *Balance Sheet*
3) **Date of statement**

**Assets section of a Balance Sheet**  
(Illustration 9-10, pg. 200)

The information needed to prepare the assets section is obtained from the Work Sheet’s Account Title column and the Balance sheet Debit column.

**Assets Section** - LEFT side of the balance sheet.

* center the word *Assets* on the first line of the wide column on the left side.
* under the heading, write each asset account title and amount.

**Equities section of a Balance Sheet**

The two types of equities reported on a balance sheet are liabilities and owner’s equity.

The information needed to prepare the liabilities section is obtained from the Work Sheet’s Account Title column and the Balance sheet Credit column.

**Liabilities Section** -RIGHT side of the balance sheet.  
(Illustration 9-11, pg. 201)
* center the word Liabilities on the first line of the wide column on the right side.
* under the heading, write each liability account title and amount.

**Owner’s Equity** - RIGHT side of the balance sheet.  
(Illustration 9-12, pg. 202)
* center the words Owner’s Equity on the next blank line of the wide column on the right side.
* under the heading, write the owner’s equity account title and amount.

Only the amount of current capital is reported on the Balance Sheet.
The amounts needed to calculate the current capital are found in the Work Sheet’s Balance sheet Debit and Credit columns.

The amount of current capital is calculated as follows:  
FYI, pg. 202

\[
\text{Capital Account Balance} + \text{Net Income} - \text{Drawing Account Balance} = \text{Current Capital}
\]

**Balance** - determine if the balance sheet is in balance.
* add all the asset amounts on the LEFT side.
* add the liabilities and owner’s equity amounts on the RIGHT side.
* the total on the right side must be the same as the total on the left side.
* if the balance sheet is NOT in balance, find the errors before completing any more work.

**Complete** - complete the balance sheet by ruling a single line across both amount columns.
* the placement of the total assets line is determined after the equities section is prepared so that the two final totals are on the same line.
* a single line means that amounts are to be added or subtracted.
* on the next line, write Total Assets and the amount of all assets in the wide column on the left side.
* on the same line on the left side, write Total Liabilities and Owner’s Equity and the amount.
* rule double lines below the amount column totals. Double lines mean that the totals have been verified as correct.
Words are to be spelled in full so there can be no doubt about what word was intended.
However, there may be times when you need to abbreviate words due to insufficient space.

When a business has a **Net loss**, current capital is calculated as follows:

Capital Account Balance - Net Loss - Drawing Account Balance = Current Capital

**Owner’s Equity reported in detail on a Balance Sheet**  
(Illustration 9-13, pg. 204)

Some businesses prefer to report in detail how the owner’s equity is calculated.

- Capital account balance as of the beginning of the fiscal period.
- Net income/Net loss.
- Drawing account balance.
- Capital account balance as of the end of the fiscal period.

**Summary Illustration 9-14, pg. 205** - Summary of financial statements for a proprietorship

**Assignment:**

Be sure you know and understand:

- questions 12 - 13, pg. 206.
- Drills 9-D1 and 9-D2, pgs. 206 & 207.
- Spreadsheet Option, pg. 203

**V. Closure:**

To review for test do Study Guide 9 and Problem 9-M.
VI. Evaluation of Student Learning:

Students will be evaluated using Problem 9-M and Chapter 9 test.

Reference List

