

# Financial Statements for a Sole Proprietorship

BEFORE You

READ

## What You'll Learn

1. Explain the purpose of the income statement.
2. Prepare an income statement.
3. Explain the purpose of the statement of changes in owner's equity.
4. Prepare a statement of changes in owner's equity.
5. Explain the purpose of the balance sheet.
6. Prepare a balance sheet.
7. Explain the purpose of the statement of cash flows.
8. Explain ratio analysis and compute ratios.
9. Define the accounting terms introduced in this chapter.

## Why It's Important

► Financial statements provide essential information for making sound decisions.



## Predict

1. What does the chapter title tell you?
2. What do you already know about this subject from personal experience?
3. What have you learned about this in the earlier chapters?
4. What gaps exist in your knowledge of this subject?

## Exploring the *Real World* of Business

### PREPARING FINANCIAL STATEMENTS

#### Tapatio Hot Sauce Company

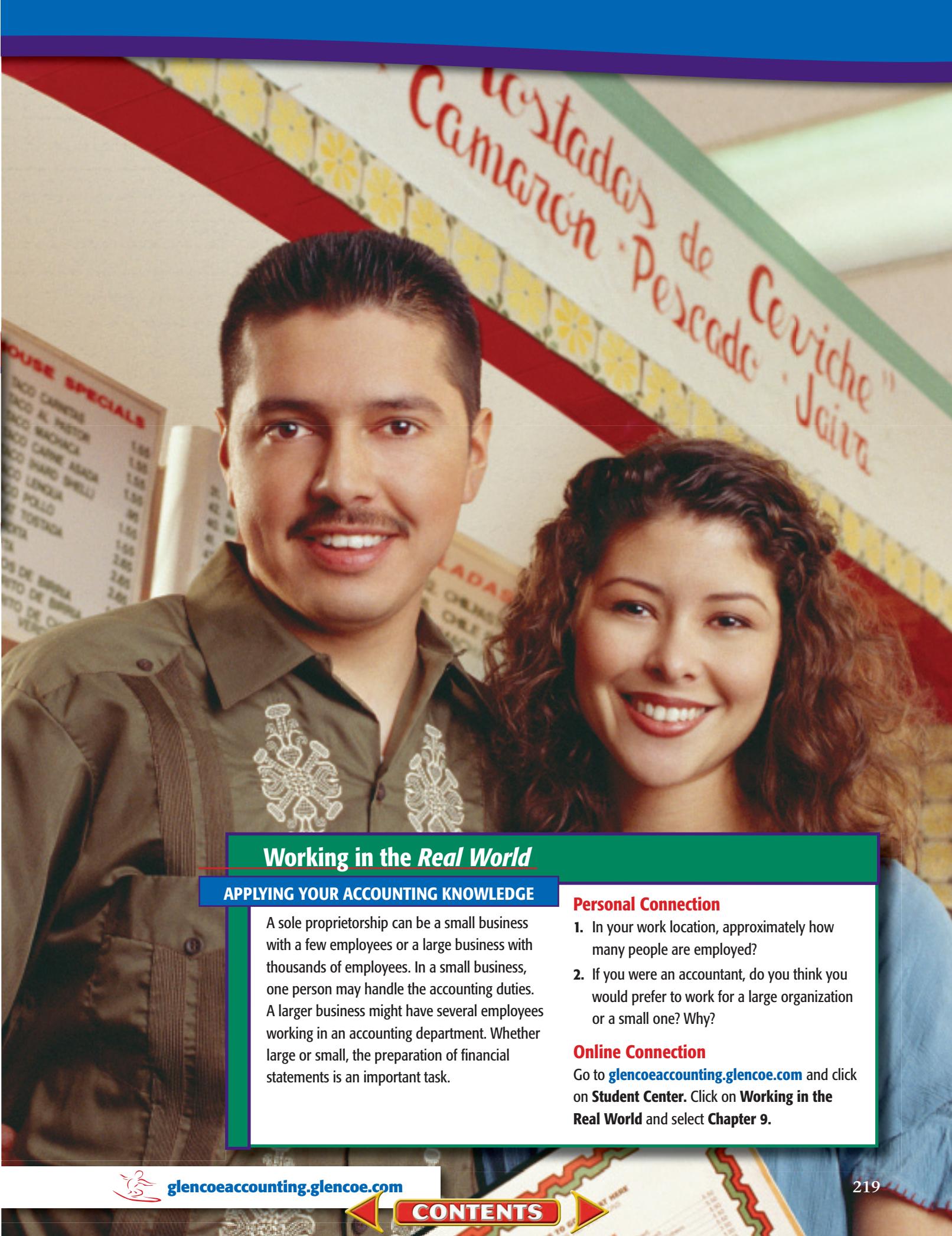
Not all businesses take off like wildfire. Some begin modestly, like **Tapatio Hot Sauce Company**. Jose-Luis Saavedra Sr. started it in 1971 in a tiny warehouse. He drove his own van for deliveries to stores and restaurants.

As **Tapatio** grew, Saavedra enlisted family to help meet the increased product demand. His son Jose-Luis Jr., a physician, became **Tapatio's** general manager. Daughter Dolores uses her law degree to handle the company's legal matters, and daughter Jacque runs the office. Today the company owns a state-of-the-art facility with a fully automated production line.

Early on, **Tapatio's** revenues were small, and its financial statements were simple compared to those it prepares now to reflect the company's national and international distribution of its hot sauce.

#### What Do You Think?

What types of accounts do you think **Tapatio** used in 1971? What accounts do you think have been added?



## Working in the *Real World*

### APPLYING YOUR ACCOUNTING KNOWLEDGE

A sole proprietorship can be a small business with a few employees or a large business with thousands of employees. In a small business, one person may handle the accounting duties. A larger business might have several employees working in an accounting department. Whether large or small, the preparation of financial statements is an important task.

### Personal Connection

1. In your work location, approximately how many people are employed?
2. If you were an accountant, do you think you would prefer to work for a large organization or a small one? Why?

### Online Connection

Go to [glencoeaccounting.glencoe.com](http://glencoeaccounting.glencoe.com) and click on Student Center. Click on Working in the Real World and select Chapter 9.





## SECTION 1

### BEFORE You READ

#### Main Idea

The income statement reports the net income or net loss for an accounting period.

#### Read to Learn...

- the four financial statements prepared for a business. (p. 220)
- how to prepare an income statement. (p. 221)

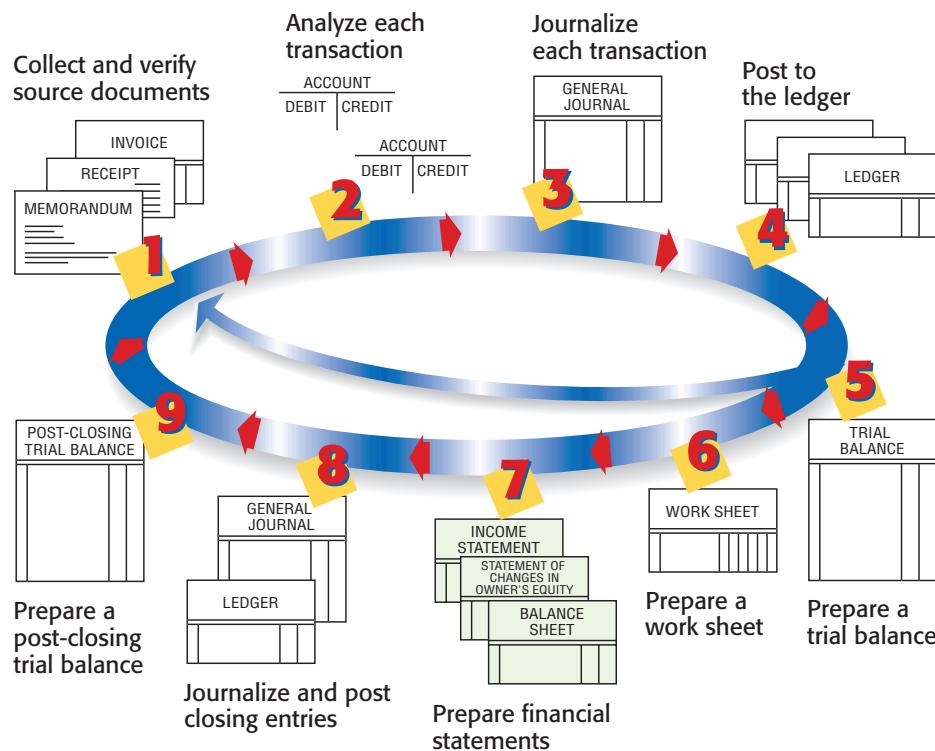
#### Key Terms

financial statements  
income statement

# The Income Statement

To operate a business profitably, the owner needs to have current financial information. Businesses ranging from an oil company to a dairy farm must organize financial information to evaluate profits or losses.

**Financial statements** summarize the changes resulting from business transactions that occur during an accounting period. As you can see in **Figure 9–1**, preparing financial statements is the seventh step in the accounting cycle.



**Figure 9–1** The Accounting Cycle with the Seventh Step Highlighted

## Financial Statements

### What Are the Four Financial Statements?

The primary financial statements prepared for a sole proprietorship are the income statement and the balance sheet. Two other statements, the statement of changes in owner's equity and the statement of cash flows, are also often prepared. The financial statements may be handwritten or typed but most often are prepared on a computer. With a computerized accounting system, the business owner can generate financial statements without first preparing a work sheet. Let's learn how to prepare financial statements for a service business such as Roadrunner Delivery Service.

# The Income Statement

## What Is the Purpose of the Income Statement?

The **income statement** reports the net income or net loss for a specific period of time. As you recall from Chapter 8, net income or net loss is the difference between total revenue and total expenses. For this reason the income statement is sometimes called a *profit-and-loss statement* or an *earnings statement*.

As You READ

### Key Point

**Income Statement** The income statement covers a specific period of time.

## Income Statement Sections

The income statement contains the following sections:

- the heading
- the revenue for the period
- the expenses for the period
- the net income or net loss for the period

**Heading.** Like the work sheet heading, the heading of an income statement has three parts:

1. The name of the business (**Who?**)
2. The name of the report (**What?**)
3. The period covered (**When?**)

The heading for Roadrunner's income statement is shown in Figure 9–2.

Each line of the heading is centered on the width of the statement.

When preparing an income statement heading, be sure to follow the wording and capitalization shown in Figure 9–2. The date line is especially important because the reporting period varies from business to business.

A business owner uses the same accounting periods year after year. This consistency allows the owner to compare the information from one period to the next.

**Revenue Section.** After the heading has been completed, enter the revenue earned for the period. Look at Figure 9–3 on page 222. The information used to prepare the income statement comes from the Income Statement section of the work sheet.

Roadrunner's income statement is prepared on standard accounting stationery, which has a column for account names and two amount columns. The first amount column is used to enter the balances of the individual revenue and expense accounts. The second amount column is used to enter totals: total revenue, total expenses, and net income (or net loss).

Refer to Figure 9–3 as you read the procedures for preparing an income statement:

1. Write *Revenue*: on the first line at the left side of the form. **A**
2. Enter the revenue account names beginning on the second line, indented about a half inch from the left edge of the form. **B**

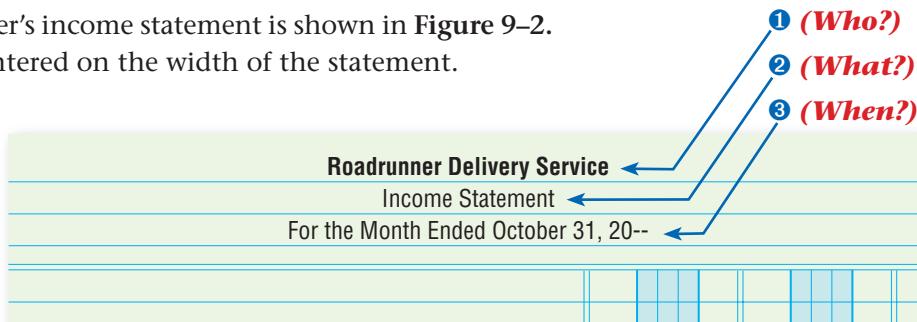


Figure 9–2 The Heading for an Income Statement



**Roadrunner Delivery Service**  
 Work Sheet  
 For the Month Ended October 31, 20--

ACCT. NO.	ACCOUNT NAME	TRIAL BALANCE		INCOME STATEMENT		BALANCE SHEET	
		DEBIT	CREDIT	DEBIT	CREDIT	DEBIT	CREDIT
1 101	<i>Cash in Bank</i>	21 125 00				21 125 00	
2 105	<i>Accts. Rec.—City News</i>	1 450 00				1 450 00	
3 110	<i>Accts. Rec.—Green Company</i>	—				—	
4 115	<i>Computer Equipment</i>	3 000 00				3 000 00	
5 120	<i>Office Equipment</i>	200 00				200 00	
6 125	<i>Delivery Equipment</i>	12 000 00				12 000 00	
7 201	<i>Accts. Pay.—Beacon Advertising</i>		75 00				75 00
8 205	<i>Accts. Pay.—North Shore Auto</i>		11 650 00				11 650 00
9 301	<i>Maria Sanchez, Capital</i>		25 400 00				25 400 00
10 302	<i>Maria Sanchez, Withdrawals</i>	50 000				50 000	
11 303	<i>Income Summary</i>	—	—	—	—		
12 401	<i>Delivery Revenue</i>		2 650 00		2 650 00		
13 501	<i>Advertising Expense</i>	75 00		75 00			
14 505	<i>Maintenance Expense</i>	600 00		600 00			
15 510	<i>Rent Expense</i>	700 00		700 00			
16 515	<i>Utilities Expense</i>	125 00		125 00			
17		39 775 00	39 775 00	1 500 00	2 650 00	38 275 00	37 125 00
18	<i>Net Income</i>			1 150 00			1 150 00
19				2 650 00	2 650 00	38 275 00	38 275 00
20							

<b>Roadrunner Delivery Service</b> Income Statement For the Month Ended October 31, 20--			
Revenue: A	Delivery Revenue B		2 650 00 C
Expenses: D			
Advertising Expense		75 00	75 00
Maintenance Expense		600 00	600 00
Rent Expense		700 00	700 00
Utilities Expense		125 00	125 00
Total Expenses G			H 1 500 00 I
Net Income K			J 1 150 00 L

**Figure 9–3** Preparing an Income Statement

3. Enter the balance of each revenue account. Since Roadrunner has only one revenue account, **Delivery Revenue**, total revenue is the same as the balance of the one revenue account. The balance is thus written in the second, or totals, column. **C**

Many businesses have more than one source of revenue and thus have a separate revenue account for each source. For example, a swim club might have accounts such as **Membership Fees** and **Pool Rental**. **Figure 9–4** illustrates the Revenue section of the income statement for a business with more than one revenue account. Notice that the words *Total Revenue* are indented about one inch from the left edge of the form.

## Expenses Section.

The expenses incurred during the period are reported next. The expense account names and the balances in the Income Statement section of the work sheet are used to prepare the Expenses section of the income statement. Refer to **Figure 9–3** as you read the following instructions:

## Figure 9–4 Income Statement with More Than One Revenue Account

1. On the line following the revenue section, write *Expenses*: at the left side of the form. **D**
2. On the following lines, write the names of the expense accounts, indented half an inch, in the order that they appear on the work sheet. Since there are several expense accounts, enter the individual balances in the first amount column. **E**
3. Draw a single rule under the last expense account balance. **F**
4. Write the words *Total Expenses* on the line following the last expense account name, indented about one inch. **G**
5. Add the balances for all expense accounts. Write the total expenses amount in the second amount column, one line below the last expense account balance. **H**

**Net Income Section.** The next step is to enter net income. Net income, remember, occurs when total revenue is more than total expenses. Refer to **Figure 9–3** as you read the following instructions for the preparation of the Net Income section.

1. Draw a single rule under the total expenses amount. **I**
2. Subtract the total expenses from the total revenue to find net income. Enter the net income in the second amount column under the total expenses amount. **J**
3. On the same line, write *Net Income* at the left side of the form. **K**
4. If the amount of net income matches the amount on the work sheet, draw a double rule under the net income amount. **L**

## Reporting a Net Loss

If total expenses are more than total revenue, a net loss exists. To determine the amount of net loss, subtract total revenue from total expenses. Enter the net loss in the second amount column under the total expenses amount. Write the words *Net Loss* on the same line at the left side of the form. **Figure 9-5** illustrates how to report a net loss.

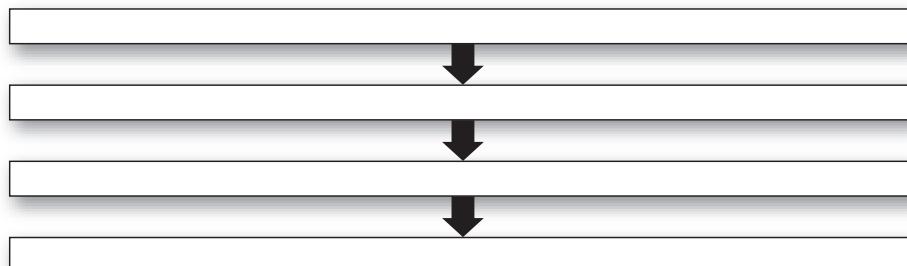
<i>Revenue:</i>					
<i>Delivery Revenue</i>					3 1 7 0 00
<i>Expenses:</i>					
<i>Advertising Expense</i>		2 7 5	00		
<i>Maintenance Expense</i>		7 5 0	00		
<i>Miscellaneous Expense</i>		2 7 0	00		
<i>Rent Expense</i>		1 9 0 0	00		
<i>Utilities Expense</i>		3 2 5	00		
<i>Total Expenses</i>				3 5 2 0	00
<i>Net Loss</i>				3 5 0	00

### Figure 9–5 Income Statement Showing a Net Loss



**Reinforce the Main Idea**

Using a diagram like this one, summarize the steps for creating an income statement. Add answer boxes for steps as needed.

**Creating an Income Statement****Do the Math**

Earth-Friendly Cleaning Service prepares monthly financial statements. The two revenue accounts show ending balances of \$8,740.00 and \$2,080.00. The following expense account balances also appear in the Income Statement section of this month's work sheet.

Advertising Expense	\$3,690.00
Maintenance Expense	2,745.00
Miscellaneous Expense	605.00
Rent Expense	3,400.00
Utility Expense	985.00

Calculate the amount of net income or net loss for the month.

**Problem 9–1 Analyzing a Source Document**

**Instructions** Based on the receipt shown here, answer the following questions in your working papers.

1. What is the name of the business that received the money?
2. How much money was received?
3. Who paid the money?
4. Why was the money paid?
5. When was the payment made?
6. Who received the money and made out the receipt?
7. Where is the business that received the money located?

Stratford Learning Center 243 Eastern Road Roxbury, NY 14752		RECEIPT No. 1834
RECEIVED FROM <u>Sandra Miller</u> \$ <u>832.00</u>		
Eight hundred thirty-two and <u>no/100</u> DOLLARS		
FOR <u>On account</u>		
RECEIVED BY <u>Rose Hughes</u>		



## SECTION 2

# The Statement of Changes in Owner's Equity

An important concern of a business owner is whether the owner's equity has increased or decreased during the period. An increase in owner's equity means the owner's claims to the assets of the business have grown. A decrease means the owner's claims to the assets of the business have been reduced.

## The Statement of Changes in Owner's Equity

### **Where Do You Find the Information Needed to Prepare This Financial Statement?**

The **statement of changes in owner's equity** summarizes changes in the owner's capital account as a result of business transactions that occur during the period. Eventually, the balances of revenues, expenses, and the owner's withdrawal account will be transferred to the owner's capital account. This statement is prepared at the end of the accounting period.

The heading of the statement of changes in owner's equity is set up in the same manner as the heading for the income statement.

1. The first line consists of the name of the business. (**Who?**)
2. The second line indicates the name of the statement. (**What?**)
3. The third line indicates the period covered. (**When?**)

Because the statement of changes in owner's equity and the income statement cover the same period, the third line of the heading of both statements will include the same wording and date.

The information to prepare this statement is found in three places:

- the work sheet
- the income statement
- the owner's capital account in the general ledger

## Completing the Statement of Changes in Owner's Equity

### **How Do You Prepare This Financial Statement?**

Look at Figure 9–6 on page 226. It is the statement of changes in owner's equity for Roadrunner Delivery Service for the month ended October 31. The illustration shows the steps needed to complete this financial statement.

**BEFORE  
YOU**

**READ**

### **Main Idea**

The statement of changes in owner's equity shows how the owner's financial interest changed during the accounting period.

### **Read to Learn...**

- the purpose of the statement of changes in owner's equity. (p. 225)
- how to prepare the statement of changes in owner's equity. (p. 225)

### **Key Terms**

statement of changes in owner's equity

**As  
You**

**READ**

### **Key Point**

**Statement of Changes in Owner's Equity** The statement of changes in owner's equity covers the same time period as the income statement.

Roadrunner Delivery Service	
Statement of Changes in Owner's Equity	
For the Month Ended October 31, 20--	
Beginning Capital, October 1, 20--	A
C Add: Investments by Owner	D 25 400 00
Net Income	E 1 150 00
Total Increase in Capital	26 550 00 F
Subtotal	26 550 00 G
Less: Withdrawals by Owner	500 00 H
Ending Capital, October 31, 20--	I 26 050 00 J

**Figure 9–6** Statement of Changes in Owner's Equity

1. On the first line, write the words *Beginning Capital* followed by a comma and then by the first day of the period. For Roadrunner that date is October 1, 20--. A
2. In the second amount column, enter the balance of the capital account at the beginning of the period. The source of this information is the capital account in the general ledger. Since Roadrunner was formed after the beginning of the period, there is no beginning capital balance. Place a line in the second amount column. B
3. Next, enter the *increases* to the capital account:
  - investments by the owner
  - net income
 Investments made by the owner during the period are recorded in the capital account. Maria Sanchez, the owner of Roadrunner, invested a total of \$25,400 during October. This includes \$25,000 cash and two phones valued at \$400. Write *Add: Investments by Owner*. C Enter the total investment in the first amount column. D
 

On the next line, write the words *Net Income*. Indent so that *Net Income* aligns on the left with *Investments by Owner* in the line above. In the first amount column, enter the net income amount from the income statement. Draw a single rule under the net income amount. E
4. Write the words *Total Increase in Capital* on the next line at the left side of the form. Add the investments by owner and net income amounts and enter the total in the second amount column. Draw a single rule under the amount. F
5. Write *Subtotal* on the next line, at the left side of the form. Add the amounts for beginning capital and total increase in capital. Enter the result in the second amount column. G
6. The next section of the statement lists the *decreases* to the capital account:
  - withdrawals
  - net loss
 Since Roadrunner did not have a net loss for the period, write the words *Less: Withdrawals by Owner* at the left side of the form. Find

As  
You

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### Compare and Contrast

#### Income Statement and Statement of Changes in Owner's Equity

In what ways are the income statement and statement of changes in owner's equity similar? How are they different?

the withdrawals amount on the work sheet. Enter the withdrawals amount in the second amount column. Draw a single rule under the withdrawals amount. **H**

7. On the next line, at the left side of the form, write the words *Ending Capital* followed by a comma and the last day of the period. **I**
8. Subtract the withdrawals amount from the subtotal to determine the ending balance of the capital account. Finally, draw a double rule below the ending capital amount. **J**

## Statement of Changes in Owner's Equity for an Ongoing Business

To prepare the statement of changes in owner's equity, you need to know the beginning balance of the owner's capital account. For an ongoing business, the balance entered on the work sheet for the capital account *may not* be the balance at the beginning of the period. If the owner made additional investments during the period, the investments would be recorded in the general journal, posted to the general ledger, and included in the amount shown on the work sheet.

For example, suppose the owner of Garo's Tree Service, James Garo, invested an additional \$1,000 during the period. Look at **Figure 9–7**. The ledger account reflects the additional capital investment. The amount entered on the work sheet for **James Garo, Capital** includes the balance at the beginning of the period (\$23,800) and the investment made during the period (\$1,000).

ACCOUNT <i>James Garo, Capital</i>			ACCOUNT NO. <i>301</i>				
	DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT	BALANCE	
						DEBIT	CREDIT
20--							
Apr.	1	Balance	✓				23 800 00
	15		G1		1 000 00		24 800 00

Garo's Tree Service									
Work Sheet									
For the Month Ended April 30, 20--									
	ACCT. NO.	ACCOUNT NAME	TRIAL BALANCE		INCOME STATEMENT		BALANCE SHEET		
			DEBIT	CREDIT	DEBIT	CREDIT	DEBIT	CREDIT	
12	301	<i>James Garo, Capital</i>		24 800 00				24 800 00	12
13	302	<i>James Garo, Withdrawals</i>	70 000				70 000		13
20	525	<i>Utilities Expense</i>	62 000		62 000				20
21			21 924 00	21 924 00	6 033 00	9 309 00	29 877 00	26 601 00	21
22		<i>Net Income</i>			3 276 00			3 276 00	22
23					9 309 00	9 309 00	29 877 00	29 877 00	23
24									24

**Figure 9–7** Statement of Changes in Owner's Equity for an Ongoing Business

Garо's Tree Service	
Statement of Changes in Owner's Equity	
For the Month Ended April 30, 20--	
Beginning Capital, April 1, 20--	23 800 00
Add: Investments by Owner	1 000 00
Net Income	3 276 00
Total Increase in Capital	4 276 00
Subtotal	28 076 00
Less: Withdrawals by Owner	7 00 00
Ending Capital, April 30, 20--	27 376 00

**Figure 9–7** Statement of Changes in Owner's Equity for an Ongoing Business (continued)

There are two ways to determine the owner's capital account balance at the beginning of the period:

- Look at the ledger.
- Subtract the additional investments from the account balance shown on the work sheet.



For James Garо, Capital, the \$1,000 additional investment in Garо's Tree Service is subtracted from the \$24,800 account balance shown on the work sheet to arrive at the beginning account balance of \$23,800.

Figure 9–7 shows the statement of changes in owner's equity for an ongoing business.

## Statement of Changes in Owner's Equity Showing a Net Loss

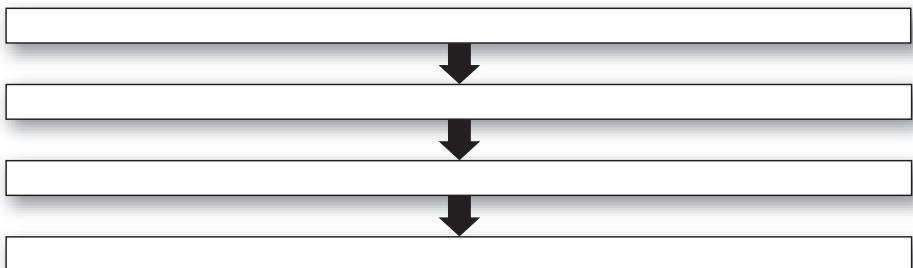
Figure 9–8 shows a statement of changes in owner's equity for an ongoing business with a net loss. Notice that since there is only one item that increases capital—investments by owner—the amount of the individual item is entered in the second amount column. Since there are two items that decrease capital—withdrawals by owner and net loss—the amounts of the individual items are entered in the first amount column. The total decrease in capital is entered in the second amount column.

Island Burgers	
Statement of Changes in Owner's Equity	
For the Month Ended April 30, 20--	
Beginning Capital, April 1, 20--	13 848 00
Add: Investments by Owner	1 500 00
Subtotal	15 348 00
Less: Withdrawals by Owner	9 00 00
Net Loss	8 35 00
Total Decrease in Capital	1 735 00
Ending Capital, April 30, 20--	13 613 00

**Figure 9–8** Statement of Changes in Owner's Equity Showing a Net Loss

**Reinforce the Main Idea**

Using a diagram like this one, summarize the steps for creating a statement of changes in owner's equity. Add answer boxes for steps as needed.

**Creating a Statement of Changes in Owner's Equity****Do the Math**

Tracy Murphy is a fashion designer who works from her home. She contributed her own funds and equipment to the business. She also continues to add new clients and increase her revenue. Tracy's investments in her business and the revenue she has earned over the past 10 months are shown below. Create a line graph, by date, comparing Tracy's investments to her revenue. What can you determine from this chart?

**Investments**

1/01/20--	Cash	\$20,000
1/01/20--	Sewing machines	6,000
1/01/20--	Mannequins	3,500
1/01/20--	Material	25,000
1/01/20--	Computer equipment	5,600
1/01/20--	Business cards	500
2/15/20--	Cash	12,000
3/10/20--	Material	<u>7,500</u>
Total Investments		\$80,100

**Revenue**

2/01/20--	\$ 5,000
3/01/20--	6,000
4/01/20--	12,000
5/01/20--	15,000
6/01/20--	17,500
7/01/20--	19,000
8/01/20--	20,000
9/01/20--	26,000
10/01/20--	20,000

**Problem 9–2 Determining Ending Capital Balances**

The financial transactions affecting the capital accounts of several different businesses are summarized below.

**Instructions** Use the form in your working papers. Determine the ending capital balance for each business.

**Beginning**

	<u>Capital</u>	<u>Investments</u>	<u>Revenue</u>	<u>Expenses</u>	<u>Withdrawals</u>
1.	\$60,000	\$ 500	\$ 5,100	\$2,400	\$ 700
2.	24,075	0	13,880	7,240	800
3.	28,800	1,000	6,450	6,780	0
4.	0	10,500	5,320	4,990	200
5.	6,415	0	4,520	3,175	700
6.	20,870	1,300	13,980	9,440	1,700

# Accounting Careers in Focus

## PARTNER

*PricewaterhouseCoopers LLP, New York,  
New York*  
**Alfred A. Peguero**

### Q: What is your main responsibility?

**A:** My job is to help the families and privately held corporations who are my clients. I look behind the numbers to show clients how to protect assets and pass them to the next generation. I always ask myself what needs to be done to ensure that client expectations are met. Being a partner is very much like owning your own business—with some constraints, of course.

### Q: How did you become interested in accounting?

**A:** I was an economics major in college, but in my senior year I took two accounting classes that I really enjoyed. I realized this is where the opportunities are. Accounting as a general profession is very broad. The basic principles are the same but you can focus on areas and industries that really interest you—anything from technology to farming.

### Q: Which skills are most important?

**A:** Analytical, reasoning, and communication skills are critical. Mathematical ability is also helpful.

### Q: What do you enjoy most about your job?

**A:** I enjoy offering solutions to my clients. Helping real people solve their problems and achieve peace of mind over their financial matters is very rewarding.

### Q: What advice do you have for accountants just beginning their careers?

**A:** Finding a good mentor is really important. Always follow through with what you say you're going to do and don't be afraid to ask questions.

## Tips from . . .

 Robert Half International Inc.

A paycheck is not all a company can offer. Many firms also provide profit-sharing plans, tuition reimbursement, and training opportunities. Consider the benefits a prospective employer offers when deciding whether to accept a job offer.

## CAREER FACTS

- **Nature of the Work:** Specialize in personal financial and business consulting; advise clients on complex accounting issues.
- **Training or Education Needed:** A bachelor's degree in business administration, accounting, or economics; a minor in communications and technology can be helpful; fulfill the requirements to become a CPA.
- **Aptitude, Abilities and Skills:** Communication, analytical, reasoning, and math skills.
- **Salary Range:** \$150,000 and up depending on experience, level of responsibility, and firm performance.
- **Career Path:** Gather hands-on experience with a major accounting firm or reputable regional firm. Once you have a flavor for the areas that most appeal to you, consider getting a master's degree. It usually takes 10 to 15 years to become a partner at most firms.

## Thinking Critically

What qualities do you think employers look for when hiring?



## SECTION 3

# The Balance Sheet and the Statement of Cash Flows

The third and fourth financial statements prepared at the end of the period are the balance sheet and the statement of cash flows. The balance sheet reflects the accounting equation at the end of the period. The statement of cash flows shows how the business acquired and spent cash during the period.

## The Balance Sheet

### What Is the Purpose of the Balance Sheet?

The **balance sheet** is a report of the balances in the permanent accounts at the end of the period. The main purpose of the balance sheet is to report the assets of the business and the claims against those assets *on a specific date*. In other words, the balance sheet states the financial position of a business at a specific point in time. The balance sheet summarizes the following information:

- what a business owns
- what a business owes
- what a business is worth

For this reason the balance sheet is sometimes called a *statement of financial position*.

The balance sheet is prepared from information in the Balance Sheet section of the work sheet and from the statement of changes in owner's equity. The balance sheet may be handwritten, typed, or, as in most cases, prepared by computer.

## The Sections of the Balance Sheet

The balance sheet contains the following sections:

- the heading
- the assets section
- the liabilities and owner's equity sections

**Heading.** Like the heading of the income statement, the heading of the balance sheet answers the questions *who?* *what?* *when?* The balance sheet heading includes:

1. The name of the business (**Who?**)
2. The name of the financial statement (**What?**)
3. The date of the balance sheet (**When?**)

BEFORE  
You

READ

### Main Idea

The balance sheet reports the financial position at a specific point in time. The statement of cash flows reports the sources and uses of cash during the accounting period.

### Read to Learn...

- how to prepare a balance sheet. (p. 231)
- the purpose of a statement of cash flows. (p. 234)
- how to perform ratio analysis. (p. 235)

### Key Terms

balance sheet	current assets
report form	current
statement of	liabilities
cash flows	working capital
ratio analysis	liquidity ratio
profitability ratio	current ratio
return on sales	quick ratio

As  
You  
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### Install Recall

#### Permanent Accounts

Permanent accounts are assets, liabilities, and the owner's capital account.

<b>Roadrunner Delivery Service</b> Balance Sheet October 31, 20-- 	 <b>Point in Time</b>
<b>Roadrunner Delivery Service</b> Income Statement For the Month Ended October 31, 20-- 	 <b>Period of Time</b>

**Figure 9–9** Headings of Financial Statements

## As You READ

### Key Point

**Balance Sheet** The balance sheet is a “snapshot” of a business at a specific point in time.

Unlike the income statement, which covers the entire period, the balance sheet relates to a specific point in time. The amounts shown on the balance sheet are the general ledger balances in the accounts on the last day of the period. Notice the difference between the date lines on the balance sheet and on the income statement in **Figure 9–9**.

**Assets Section.** Refer to Roadrunner’s balance sheet in **Figure 9–10** as you read how to prepare the balance sheet. Roadrunner’s work sheet and statement of changes in owner’s equity are also included to show the information sources used to prepare the balance sheet. Roadrunner’s balance sheet is prepared in **report form**, listing the balance sheet sections one under the other.

The Assets section of the balance sheet is prepared as follows:

1. Write the word **Assets** on the first line in the center of the column containing the account names. **A**
2. On the following lines, list each asset account name and its balance in the same order as they appear in the Balance Sheet section of the work sheet. Enter the account balances in the first amount column. Draw a single rule under the last account balance. **B**
3. On the next line, write the words **Total Assets**, indented about half an inch. Add the individual asset balances and enter the total in the second amount column. **C**

Do *not* draw a double rule under the total yet. Enter it when the Liabilities and Owner’s Equity sections are complete and equal to total assets.

**Liabilities and Owner’s Equity Sections.** The information for the Liabilities and Owner’s Equity sections is taken from the work sheet and from the statement of changes in owner’s equity. Use the following steps to complete the Liabilities and Owner’s Equity sections.

1. On the line after **Total Assets**, write the heading **Liabilities** in the center of the column containing the account names. **D**
2. On the following lines, list the liability account names and their balances in the same order as on the Balance Sheet section of the work sheet. Enter the account balances in the first amount column. Draw a single rule under the last account balance. **E**



### Roadrunner Delivery Service

#### Work Sheet

For the Month Ended October 31, 20--

ACCT. NO.	ACCOUNT NAME	TRIAL BALANCE		INCOME STATEMENT		BALANCE SHEET	
		DEBIT	CREDIT	DEBIT	CREDIT	DEBIT	CREDIT
101	Cash in Bank	21 125 00				21 125 00	1
105	Accts. Rec.—City News	1 450 00				1 450 00	2
110	Accts. Rec.—Green Company	—				—	3
115	Computer Equipment	3 000 000				3 000 000	4
120	Office Equipment	200 000				200 000	5
125	Delivery Equipment	12 000 000				12 000 000	6
201	Accts. Pay.—Beacon Advertising		75 00				75 00
205	Accts. Pay.—North Shore Auto		11 650 00				11 650 00
9 301	Maria Sanchez, Capital		25 400 00				25 400 00
10 302	Maria Sanchez, Withdrawals	50 000				50 000	10
11 303	Income Summary	—	—	—	—	—	11
12 401	Delivery Revenue		2 650 00		2 650 00		12
13 501	Advertising Expense	75 00		75 00			13
14 505	Maintenance Expense	600 000		600 000			14
15 510	Rent Expense						15
16 515	Utility Expense						16
17							37 125 00
18	Net						1 150 00
19	Beginning Capital, October 1, 20--						38 275 00
20	Add: Investments by Owner	25 400 00					
	Net Income	1 150 00					
	Total Increase in Capital				26 550 00		
	Subtotal				26 550 00		
	Less: Withdrawals by Owner				500 00		
	Ending Capital, October 31, 20--				26 050 00		

### Roadrunner Delivery Service

#### Balance Sheet

October 31, 20--

<b>A</b>	<b>Assets</b>						
	Cash in Bank	21 125 00					
	Accounts Receivable—City News	1 450 00					
	Accounts Receivable—Green Company	—					
	Computer Equipment	3 000 000					
	Office Equipment	200 000					
	Delivery Equipment	12 000 000					
	<b>C Total Assets</b>				37 775 00		<b>K</b>
<b>D</b>	<b>Liabilities</b>						
	Accounts Payable—Beacon Advertising	75 00					
	Accounts Payable—North Shore Auto	11 650 00					
	<b>F Total Liabilities</b>				11 725 00		
<b>G</b>	<b>Owner's Equity</b>						
<b>H</b>	Maria Sanchez, Capital				26 050 00		
<b>I</b>	<b>Total Liabilities and Owner's Equity</b>				37 775 00		<b>K</b>

Figure 9–10 Preparing a Balance Sheet

3. On the next line, write the words *Total Liabilities*, indented about half an inch. Add the individual liability balances and enter the total in the second amount column. **F**
4. On the next line, enter the heading *Owner's Equity* in the center of the column containing the account names. **G**
5. On the next line, write the name of the capital account. In the second amount column, enter the ending balance of the capital account as shown on the statement of changes in owner's equity. **H**



## Proving the Equality of the Balance Sheet

Recall that the basic accounting equation must always be in balance. The balance sheet represents the basic accounting equation, so the Assets section total must equal the total of the Liabilities and Owner's Equity sections.

$$\text{Assets} = \text{Liabilities} + \text{Owner's Equity}$$

To prove the equality of the balance sheet, follow these steps:

1. Draw a single rule under the balance of the capital account. On the next line, write the words *Total Liabilities and Owner's Equity*, indented about half an inch. **I**
2. Add the total liabilities amount and the ending capital balance. Enter the total in the second amount column. **J** This total must equal the total assets amount. If the totals are not equal, there is an error. Most errors occur when transferring amounts from the work sheet or from the statement of changes in owner's equity. Verify that each account balance has been transferred properly. Find and correct the error and then complete the balance sheet.
3. When total assets equal total liabilities and owner's equity, draw a double rule under the total assets amount *and* under the total liabilities and owner's equity amount. **K** The balance sheet is now complete.

Refer again to the amounts and their placement in **Figure 9–10**. As you can see, completion of the work sheet is the basis for preparing the three financial statements studied so far.

## The Statement of Cash Flows

### What Is the Purpose of the Statement of Cash Flows?

Cash flowing through a business is like blood flowing through your body. The flow of cash keeps a business alive. It is essential to have cash available for the daily operations of the business and for unexpected expenses.

The **statement of cash flows** summarizes the following information:

- the amount of cash the business took in
- the sources of cash
- the amount of cash the business paid out
- the uses of cash

Like the income statement, the statement of cash flows covers a single accounting period.

This information is essential for sound management and investment decisions. You will learn more about the statement of cash flows in Chapter 19.

## Ratio Analysis

### What Is Ratio Analysis?

**Ratio analysis** is the process of evaluating the relationship between various amounts in the financial statements. Owners and managers use ratio analysis to determine the financial strength, activity, and debt-paying ability of a business.

## Profitability Ratios

**Profitability ratios** are used to evaluate the earnings performance of the business during the accounting period. The earning power of a business is an important measure of its ability to grow and continue to earn revenue.

One commonly used profitability ratio is return on sales. Business owners use the **return on sales** ratio to examine the portion of each sales dollar that represents profit. To calculate this ratio, divide net income by sales. For example, the return on sales for Roadrunner Delivery Service is calculated as follows:

$$\frac{\$1,150 \text{ net income}}{\$2,650 \text{ sales}} = 0.434 \text{ or } 43.4\%$$

This percentage indicates that each dollar of sales produced 43.4 cents of profit for Roadrunner. It can be compared to other accounting periods, to determine whether it is increasing or decreasing.

For example, if net income next year is \$2,750 and sales are \$5,000, the return on sales would be computed as follows:

$$\frac{\$2,750 \text{ net income}}{\$5,000 \text{ sales}} = 0.550 \text{ or } 55.0\%$$

As you can see, profit per sales dollar would increase by 11.6 cents.

## Liquidity Measures

**Liquidity** refers to the ease with which an asset can be converted to cash. **Current assets** are those used up or converted to cash during the normal operating cycle of the business. These might include **Accounts Receivable**, **Cash in Bank**, and **Supplies**. **Current liabilities** are debts of the business that must be paid within the next accounting period. **Accounts Payable** is an example of a current liability.

The amount by which current assets exceed current liabilities is known as **working capital**. Because current liabilities are usually paid out of current assets, working capital represents the excess assets available to continue operations. The working capital for Roadrunner is calculated as follows:

$$\text{Current Assets} - \text{Current Liabilities} = \text{Working Capital}$$
$$\$22,575 - \$11,725 = \$10,850$$



### MATH HINTS

#### Calculating Ratios

When calculating ratios, be sure to use the correct figures for the *divisor* and the *dividend*.

For example, to calculate the ratio of net income to sales:

- the net income amount is the *dividend*,
- and the sales amount is the *divisor*.

It's Not What It  
Seems

**Liquidity** When you think of *liquidity*, you might think of water or other liquids that flow freely. In accounting, *liquidity* refers to how easily an asset can be converted to cash.

A **liquidity ratio** is a measure of the ability of a business to pay its current debts as they become due and to provide for an unexpected need for cash. Two common ratios that are used to determine liquidity follow.

**Current Ratio.** The **current ratio** reflects the relationship between current assets and current liabilities. The current ratio is calculated by dividing the dollar amount of current assets by the dollar amount of current liabilities. The current ratio for Roadrunner based on the balance sheet in Figure 9–10 is:

$$\frac{\text{Current Assets}}{\text{Current Liabilities}} = \text{Current Ratio} \quad \frac{\$22,575}{\$11,725} = 1.92 \text{ or } 1.9:1$$

The current liabilities of a business must be paid within a year. These liabilities are paid from current assets.

A ratio of 2:1 or higher is considered favorable by creditors. It indicates that a business is able to pay its debts and that a business has twice as many current assets as current liabilities. A low ratio may indicate that a company could have trouble paying its debts.

**Quick Ratio.** A **quick ratio** is a measure of the relationship between short-term assets and current liabilities. Short-term liquid assets—those that can be quickly converted to cash—are cash and net receivables. The quick ratio is computed by dividing the total cash and receivables by total current liabilities.

The quick ratio for Roadrunner based on the Balance Sheet in Figure 9–10 is:

$$\frac{\text{Cash and Receivables}}{\text{Current Liabilities}} = \text{Quick Ratio} \quad \frac{\$22,575}{\$11,725} = 1.92:1$$

In some instances the current ratio and the quick ratio can be the same, as in the case in this example.

A quick ratio of 1:1 is considered adequate. This indicates that a business can pay its current debts with cash from incoming receivables. If a business has a quick ratio of 1:1 or higher, the business has \$1.00 in liquid assets for each \$1.00 of current liabilities.

Quick ratios may also be compared from one year to the next. For example, suppose that cash and receivables for the previous year were \$48,653 and current liabilities were \$53,245. That year's quick ratio would be computed as:

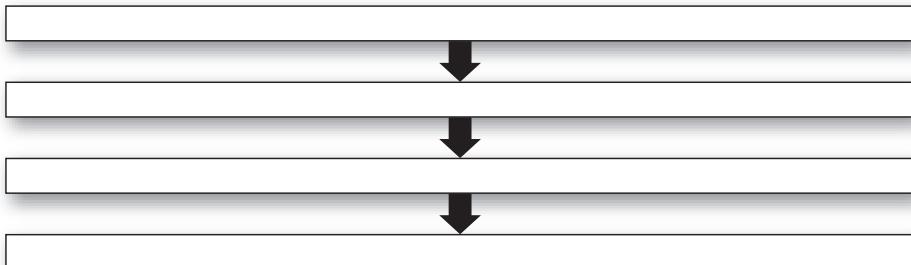
$$\frac{\$48,653}{\$53,245} = 0.91:1$$

As you can see, Roadrunner has improved its liquidity position in the current year. The \$1.92 in liquid assets per \$1.00 in current liabilities (current year) is stronger than \$0.91 in liquid assets per \$1.00 in current liabilities (previous year).



**Reinforce the Main Idea**

Using a diagram like this one, summarize the steps for creating a balance sheet. Add answer boxes for steps as needed.

**Creating a Balance Sheet****Do the Math**

Compute the four amounts that are missing from the balance sheet below. On a separate sheet of paper, write the description and the dollar value of the four missing amounts.

Interactive Communication	
Balance Sheet	
December 31, 20--	
<i>Assets</i>	
Cash in Bank	944 0 0 0 00
Accounts Receivable—Chamber of Commerce	200 0 0 0 00
Office Equipment	?
Computer Equipment	1,000 0 0 0 00
<i>Total Assets</i>	2,994 0 0 0 00
<i>Liabilities</i>	
Accounts Payable—Tip Top Advertising	275 5 0 0 00
Interest Payable	?
Salaries Payable	2 1 0 0 00
<i>Total Liabilities</i>	?
<i>Owner's Equity</i>	
Chuck Thompson, Capital	2,715 1 0 0 00
<i>Total Liabilities and Owner's Equity</i>	?

**Problem 9–3 Calculating Return on Sales**

The Gawle Company is a family-owned and operated appliance rental and repair business. The income statement for the month ended August 31 includes the following:

Rental Revenue	\$3,256	Rent Expense	\$2,100
Repair Revenue	2,140	Utilities Expense	483
Advertising Expense	575	Net Income	1,108
Maintenance Expense	1,130		

**Instructions** Calculate the return on sales for the month for The Gawle Company.

## Key Concepts

1. The *income statement* reports revenue earned and the expenses incurred for a specific period of time. It also reports the net income or net loss for the period.
2. **Sections of the income statement:**

Section	Information Presented
Heading	<ul style="list-style-type: none"> <li>• Name of the business</li> <li>• Name of the report</li> <li>• Accounting period covered</li> </ul>
Revenue	Balance of each revenue account for the period. The information comes from the Income Statement section of the work sheet.
Expenses	Balance of each expense account for the period. The information comes from the Income Statement section of the work sheet.
Net income	Total expenses subtracted from total revenue. The result is net income or net loss.

3. The *statement of changes in owner's equity* summarizes the impact that the period's business transactions had on the capital account.
4. **Sections of the statement of changes in owner's equity:**

Section	Information Presented
Heading	<ul style="list-style-type: none"> <li>• Name of the business</li> <li>• Name of the report</li> <li>• Accounting period covered</li> </ul>
Beginning Capital	The information comes from the owner's capital account in the general ledger.
Increases in Capital	<ul style="list-style-type: none"> <li>• Investments by Owner</li> <li>• Net Income</li> </ul> <p>Information about investments by the owner comes from the owner's capital account in the general ledger. Information about net income comes from the income statement.</p>
Decreases in Capital	<ul style="list-style-type: none"> <li>• Withdrawals by Owner</li> <li>• Net Loss</li> </ul> <p>Information about withdrawals by the owner comes from the work sheet. Information about net loss comes from the income statement.</p>
Ending Capital	Beginning Capital + Increases – Decreases

5. The *balance sheet* reports the balances in the permanent accounts at the end of the period. It states the financial position of a business *on a specific date*. Information comes from the Balance Sheet section of the work sheet and the statement of changes in owner's equity.

6. **Sections of the Balance Sheet:**

Section	Information Presented
Heading	<ul style="list-style-type: none"><li>• Name of the business</li><li>• Name of the report</li><li>• Date of the last day of the accounting period</li></ul>
Assets	Balance of each asset account. The information comes from the Balance Sheet section of the work sheet.
Liabilities	Balance of each liability account. The information comes from the Balance Sheet section of the work sheet.
Owner's Equity	The balance of the owner's capital account. The information comes from the statement of changes in owner's equity.

7. The *statement of cash flows* reports how much cash the business took in and paid out during the period and why the **Cash in Bank** account increased or decreased.

8. Ratio analysis evaluates the relationship between various financial statement amounts.

Profitability ratio	Earnings performance during the accounting period
Return on sales	Determines the percent of each sales dollar that is profit: $\text{Return on Sales} = \text{Net Income} / \text{Sales}$
Liquidity ratio	Ease with which an asset can be converted to cash
Current ratio	$\frac{\text{Current Assets}}{\text{Current Liabilities}}$
Quick ratio	$\frac{\text{Cash and Receivables}}{\text{Current Liabilities}}$

## Key Terms

balance sheet	(p. 231)	liquidity ratio	(p. 236)	statement of cash flows	(p. 234)
current assets	(p. 235)	profitability ratio	(p. 235)	statement of changes in owner's equity	(p. 225)
current liabilities	(p. 235)	quick ratio	(p. 236)	working capital	(p. 235)
current ratio	(p. 236)	ratio analysis	(p. 235)		
financial statements	(p. 220)	report form	(p. 232)		
income statement	(p. 221)	return on sales	(p. 235)		

AFTER  
YOU

READ

## Check Your Understanding

- 1. Income Statement**
  - a. What is the purpose of the income statement?
  - b. What is the source of information used to prepare the income statement?
- 2. Preparing an Income Statement**
  - a. List the sections of the income statement.
  - b. How is net income or net loss calculated?
- 3. Statement of Changes in Owner's Equity**
  - a. What is the purpose of the statement of changes in owner's equity?
  - b. What sources of information are used to prepare the statement of changes in owner's equity?
- 4. Preparing a Statement of Changes in Owner's Equity**
  - a. In a statement of changes in owner's equity, what items are totaled in the "Add" section?
  - b. What items are subtracted from the subtotal?
- 5. Balance Sheet**
  - a. What is the purpose of the balance sheet?
  - b. How does the date in a balance sheet heading differ from the other financial statements?
- 6. Preparing a Balance Sheet**
  - a. What sources of information are used to prepare the balance sheet?
  - b. How are balance sheet account names shown using the report form?
- 7. Statement of Cash Flows**
  - a. What is the purpose of the statement of cash flows?
  - b. Why does management need the information in the statement of cash flows?
- 8. Ratio Analysis**
  - a. What is the purpose of computing ratios from amounts on financial statements?
  - b. Who might be interested in the profitability ratio of a business?

## Apply Key Terms

As a game store owner, you want to develop an information sheet for the store manager. Explain the importance of financial statement preparation using these key terms.

balance sheet  
current assets  
current liabilities  
current ratio  
financial statements  
income statement  
liquidity ratio  
profitability ratio

quick ratio  
ratio analysis  
report form  
return on sales  
statement of cash flows  
statement of changes in owner's equity  
working capital



## Preparing Financial Statements

### Making the Transition from a Manual to a Computerized System

Task	Manual Methods	Computerized Methods
Preparing an income statement	<ul style="list-style-type: none"> <li>Transfer all revenue and expense accounts and their balances from the work sheet.</li> <li>Subtract expenses from revenue to determine net income or net loss.</li> </ul>	<ul style="list-style-type: none"> <li>From the <i>Reports</i> menu, select <b>Income Statement</b> or <b>Profit and Loss</b>, depending on the accounting software.</li> <li>Click <b>Print</b>.</li> </ul>
Preparing a statement of changes in owner's equity	<ul style="list-style-type: none"> <li>Transfer the beginning balance of the capital account from the work sheet.</li> <li>Add additional investments and net income or loss.</li> <li>Subtract withdrawals.</li> <li>Calculate the ending balance for the capital account.</li> </ul>	<ul style="list-style-type: none"> <li>Since the software automatically computes the ending balance of the capital account for you, it is not necessary to prepare this statement.</li> </ul>
Preparing a balance sheet	<ul style="list-style-type: none"> <li>Transfer permanent accounts and their balances from the work sheet.</li> <li>Transfer the ending capital account balance from the statement of changes in owner's equity.</li> <li>Total all asset account balances.</li> <li>Total all liabilities and owner's equity account balances.</li> <li>Verify that assets equal liabilities and owner's equity.</li> </ul>	<ul style="list-style-type: none"> <li>From the <i>Reports</i> menu, select <b>Balance Sheet</b>.</li> <li>Click <b>Print</b>.</li> </ul>



## Peachtree® Q & A

Peachtree Question	Answer
How do I prepare financial statements in Peachtree?	<ol style="list-style-type: none"> <li>From the <i>Reports</i> menu, select <b>Financial Statements</b>.</li> <li>Choose the statement you wish to print from the Reports list.</li> <li>Click <b>Print</b> when the statement appears on the screen.</li> </ol>



## QuickBooks Q & A

QuickBooks Question	Answer
How do I prepare financial statements in QuickBooks?	<ol style="list-style-type: none"> <li>From the <i>Reports</i> menu, select <b>Company &amp; Financial</b>.</li> <li>Choose the report you wish to print from the list.</li> <li>Click <b>Print</b>.</li> </ol>

For detailed instructions, see your Glencoe Accounting Chapter Study Guides and Working Papers.

# CHAPTER 9

# Problems

Complete problems using:

Manual Glencoe Working Papers OR Peachtree Complete Accounting Software OR QuickBooks Templates OR Spreadsheet Templates

**Peachtree®**

## SMART GUIDE

**Step-by-Step Instructions:**  
**Problems 9–4, 9–5**

1. Select the problem set for Wilderness Rentals (Prob. 9–4, 9–5).
2. Rename the company and set the system date.
3. Print a General Ledger Trial Balance, Income Statement, Statement of Changes in Owner's Equity, and Balance Sheet.
4. Complete the Analyze activity.
5. End the session.

**Peachtree®**

## SMART GUIDE

**Step-by-Step Instructions:**  
**Problem 9–6**

1. Select the problem set for Hot Suds Car Wash (Prob. 9–6).
2. Rename the company and set the system date.
3. Print a General Ledger Trial Balance, Income Statement, Statement of Changes in Owner's Equity, and Balance Sheet.
4. Complete the Analyze activity.
5. End the session.

**QuickBooks**

## PROBLEM GUIDE

**Step-by-Step Instructions:**  
**Problem 9–6**

1. Restore the Problem 9–6.QBB file.
2. Print a Trial Balance, Profit & Loss report, and Balance Sheet.
3. Complete the Analyze activity.
4. Back up your work.

## Problem 9–4 Preparing an Income Statement

The work sheet for Wilderness Rentals for the month ended September 30, 20-- is in your working papers.

**Instructions** Using the work sheet, prepare an income statement for Wilderness Rentals.

**Analyze**

Compute the return on sales for the period.

## Problem 9–5 Preparing a Statement of Changes in Owner's Equity

**Instructions** Using the work sheet for Wilderness Rentals in your working papers and the income statement prepared in Problem 9–4, prepare a statement of changes in owner's equity and a balance sheet. Ronald Hicks made an additional investment in the business of \$500 during the period.

**Analyze**

Compute the current ratio for Wilderness Rentals as of September 30.

## Problem 9–6 Preparing Financial Statements

The trial balance for the Hot Suds Car Wash is listed below and in your working papers.

**Instructions**

1. Complete the work sheet in your working papers.
2. Prepare an income statement for the quarter ended September 30, 20--.
3. Prepare a statement of changes in owner's equity. Regina Delgado made no additional investments during the period.
4. Prepare a balance sheet in report form.

Hot Suds Car Wash			
Trial Balance			
For the Quarter Ended September 30, 20--			
		Debit	Credit
101	Cash in Bank	8,457.00	
105	Accts. Rec.—Linda Brown	584.00	
110	Accts. Rec.—Valley Auto	619.00	
115	Detailing Supplies	810.00	
120	Detergent Supplies	460.00	
125	Office Equipment	15,240.00	
130	Office Furniture	2,160.00	
135	Car Wash Equipment	7,522.00	
201	Accts. Pay.—Allen Vacuum Systems		3,528.00
205	Accts. Pay.—O'Brian's Office Supply		1,215.00
301	Regina Delgado, Capital		23,845.00
305	Regina Delgado, Withdrawals	1,500.00	
310	Income Summary		
401	Wash Revenue		9,623.00
405	Wax Revenue		8,019.00
410	Interior Detailing Revenue		2,628.00
501	Advertising Expense	1,963.00	
505	Equipment Rental Expense	4,137.00	
510	Maintenance Expense	1,186.00	
520	Rent Expense	3,500.00	
530	Utilities Expense	720.00	
		48,858.00	48,858.00

**Analyze**

Calculate the return on sales for the period.

**Problem 9-7 Preparing Financial Statements**

The general ledger accounts and balances for Kits & Pups Grooming follow.

**General Ledger**

101 Cash in Bank	\$ 4,296
105 Accts. Rec.—Juan Alvarez	1,528
110 Accts. Rec.—Nathan Carlsbad	904
115 Accts. Rec.—Martha Giles	1,219
120 Grooming Supplies	1,368
125 Office Equipment	8,467
130 Office Furniture	3,396
135 Computer Equipment	2,730
140 Grooming Equipment	1,974
145 Kennel Equipment	7,412
201 Accts. Pay.—Able Store Equipment	3,876
205 Accts. Pay.—Dogs & Cats Inc.	2,746
207 Accts. Pay.—Pet Gourmet	1,281
301 Abe Shultz, Capital	30,928
305 Abe Shultz, Withdrawals	1,900
310 Income Summary	—
401 Boarding Revenue	11,989
405 Grooming Revenue	4,420
501 Advertising Expense	3,934
505 Equipment Repair Expense	943
510 Maintenance Expense	2,483
520 Rent Expense	8,850
530 Utilities Expense	3,836

**Instructions**

1. Prepare a work sheet for the month ended September 30, 20--.
2. Prepare an income statement for the period.
3. Prepare a statement of changes in owner's equity. Abe Shultz made an additional investment of \$2,500 during the period.
4. Prepare a balance sheet in report form.

**Analyze**

Compute the quick ratio as of September 30.

**Problem 9-8 Preparing a Statement of Changes in Owner's Equity**

**Instructions** Use the balance sheet and income statement shown to prepare a statement of changes in owner's equity. (The owner made an additional investment of \$4,000 and withdrew \$1,500 during the period.)

**CONTINUE**

**Peachtree®**

**SMART GUIDE****Step-by-Step Instructions:****Problem 9-7**

1. Select the problem set for Kits & Pups Grooming (Prob. 9-7).
2. Rename the company and set the system date.
3. Print a General Ledger Trial Balance, Income Statement, Statement of Changes in Owner's Equity, and Balance Sheet.
4. Complete the Analyze activity.
5. End the session.

**QuickBooks****PROBLEM GUIDE****Step-by-Step Instructions:**  
**Problem 9-7**

1. Restore the Problem 9-7.QBB file.
2. Print a Trial Balance, Profit & Loss report, and Balance Sheet.
3. Complete the Analyze activity.
4. Back up your work.

SPREADSHEET  
SMART GUIDEStep-by-Step Instructions:  
Problem 9-8

1. Select the spreadsheet template for Problem 9-8.
2. Enter your name and the date in the spaces provided on the template.
3. Complete the spreadsheet using the instructions in your working papers.
4. Print the spreadsheet and proof your work.
5. Complete the Analyze activity.
6. Save your work and exit the spreadsheet program.

Outback Guide Service	
Income Statement	
For the Month Ended September 30, 20--	
Revenue:	
Guide Service Revenue	8 9 1 3 0 0
Expenses:	
Advertising Expense	3 7 5 0 0
Maintenance Expense	1 3 8 0 0
Rent Expense	1 2 5 0 0
Salaries Expense	1 5 0 0 0
Utilities Expense	1 1 6 1 0
Total Expenses	4 4 2 4 0
Net Income	4 4 8 9 0

Outback Guide Service	
Balance Sheet	
September 30, 20--	
Assets	
Cash in Bank	3 1 1 7 0 0
Accounts Receivable—Mary Johnson	4 2 3 0 0
Accounts Receivable—Feldman, Jones & Ritter	4 4 3 0 0
Accounts Receivable—Podaski Systems Inc.	1 0 0 8 0 0
Hiking Supplies	1 5 3 0 0
Office Supplies	3 3 8 0 0
Office Equipment	6 4 9 2 0 0
Office Furniture	3 0 8 4 0 0
Computer Equipment	3 6 2 4 0 0
Hiking Equipment	1 0 1 5 0 0
Rafting Equipment	9 1 8 6 0 0
Total Assets	2 8 8 8 3 0 0
Liabilities	
Accounts Payable—A-1 Adventure Warehouse	6 5 4 5 0 0
Accounts Payable—Peak Equipment Inc.	1 3 2 5 0 0
Accounts Payable—Premier Processors	6 4 2 0 0
Total Liabilities	8 5 1 2 0 0
Owner's Equity	
Juanita Ortega, Capital	2 0 3 7 1 0 0
Total Liabilities and Owner's Equity	2 8 8 8 3 0 0

## Analyze

Identify the largest expense for this business during the period.

Practice your test-taking skills! The questions on this page are reprinted with permission from national organizations:

- Future Business Leaders of America
- Business Professionals of America

Use a separate sheet of paper to record your answers.



## Future Business Leaders of America

### MULTIPLE CHOICE

1. The balance sheet shows how a business is doing
  - for a period of 12 months.
  - on a specific date during the year.
  - regarding its profit or loss.
  - All of the above
2. Financial statements are prepared in the following order:
  - income statement, balance sheet, owners' equity.
  - income statement, statement of owners' equity, balance sheet.
  - statement of owners' equity, balance sheet, income statement.
  - balance sheet, income statement, statement of owners' equity.
3. The purpose of the Income Statement is to report
  - all assets, liabilities, and owner's equity at a specified time.
  - all the accounts used in journalizing a business's transactions.
  - balances in the capital accounts in order to determine the net income or loss.
  - the net income or loss for a fiscal period.



## Business Professionals of America

### MULTIPLE CHOICE

4. At the end of a fiscal period when a balance sheet is prepared, from which document may we find the ending owner's capital balance?

a. Worksheet	c. Trial Balance
b. Income Statement	d. Statement of Changes in Owner's Equity
5. During the month of February, Tom had the following transactions involving revenue and expenses:

Paid \$75 phone bill

Provided services to clients for \$1,200 cash

Paid salaries of \$650 to employees

Paid \$125 for computer maintenance

Provided services on account totaling  
\$2,000

What was Tom's net income or net loss for the period?

- Net Income \$350
- Net Loss \$1,650
- Net Income \$2,350
- Net Income \$3,200

### Need More Help?

Go to [glencoeaccounting.glencoe.com](http://glencoeaccounting.glencoe.com) and click on Student Center. Click on Winning Competitive Events and select Chapter 9.

- Practice Questions and Test-Taking Tips
- Concept Capsules and Terminology



**Critical Thinking****CASE STUDY*****A Matter of Ethics*****Financial Statements**

1. Name the one piece of information that is included on both the income statement and the statement of changes in owner's equity.
2. Explain why the date line on the balance sheet is different from the one on the other statements.
3. The net income computed on the income statement is different from the amount computed on the work sheet. How do you resolve this problem?
4. Explain why the **Withdrawals** account is reported on the statement of changes in owner's equity but is not reported on the income statement.
5. What items are needed to complete the first three financial statements? List office supplies, forms, and any information needed.
6. Assess the value of using the income statement, the statement of changes in owner's equity, and the balance sheet for making business decisions.

**Service Business: Video Arcade**

Taki Yamamoto owns a video arcade business called Arcadia. Taki has hired your accounting firm to record Arcadia's financial information. Taki hands you a folder containing these documents:

- Canceled checks with June dates: \$800 for rent, \$120 for electricity, \$70 for telephone service, \$180 for insurance, \$250 for newspaper advertising, and \$200 for a cleaning service.
- Invoice dated June 16 for a used video game sold on account for \$2,000.
- Cash register tapes for June showing total cash sales of \$5,890.

**INSTRUCTIONS**

1. Using the preceding information, make a list of accounts needed to record the transactions indicated by the financial documents Taki has given you.
2. Prepare an income statement for Arcadia for the month of June.

**Financial Report or Repair?**

Your favorite uncle, who owns a restaurant, has asked you to help with his bookkeeping. He desperately needs a bank loan and wants you to prepare the financial statements. After going over his accounting records, you do not believe a bank will give him a loan; but you notice that by leaving out an expense or two, your uncle's business could look more promising. After all, he does have some good ideas for improving the business.

**ETHICAL DECISION MAKING**

1. What are the ethical issues?	4. How do the alternatives affect the parties?
2. What are the alternatives?	5. What would you do?
3. Who are the affected parties?	

**Presenting the Balance Sheet**

Team up with a classmate and give a brief presentation of the purpose and use of a balance sheet. Create a sample balance sheet for your presentation.



## Using Computers to Process Information

Being able to use computers and software is essential for most business tasks.

### ON THE JOB

As the accounting clerk for Jewels and Treasures, you manually prepared the income statements in the past. This year you will use a spreadsheet program.

### INSTRUCTIONS

Prepare a list of reasons why using a spreadsheet program is an improvement over manually preparing financial statements.



## The Euro

Financial statements are generally prepared in the currency of the country in which the business operates. Many European countries use a single currency, the *euro*. Nations in the European Union began using the euro in 2002. Individuals and businesses both benefit by having a single currency. Travelers can use one currency in multiple countries. Businesses have a more stable business environment due to the elimination of exchange rate fluctuations.

**INSTRUCTIONS** Imagine that you own a business with locations in Italy and France. Describe how the adoption of the euro in both countries has changed your financial statement preparation.



## Your Business

Do you dream of having your own business? The experience of tracking your own finances can help you create the general ledger accounts for that business.

**PERSONAL FINANCE ACTIVITY** Create an income statement for a typical high school student. List revenue and expense accounts, and identify expenses that some, but not all, students would have.

**PERSONAL FINANCE ONLINE** Log on to [glencoeaccounting.glencoe.com](http://glencoeaccounting.glencoe.com) and click on **Student Center**. Click on **Making It Personal** and select **Chapter 9**.



## Return on Sales

Business owners are especially interested in the *return on sales* (see page 235). This percentage shows how much of each revenue dollar becomes profit for the business.

**INSTRUCTIONS** Use Roadrunner's income statement on page 222 to calculate its return on sales. (Use \$1,100 as net income instead of \$1,150.) If total sales are about equal from month to month but return on sales decreases each month, what does this say about the business? What suggestions can you offer to improve the return on sales?



## Financial Statements in Sports

Financial statements summarize results for owners, managers, and other interested parties. Visit [glencoeaccounting.glencoe.com](http://glencoeaccounting.glencoe.com) and click on **Student Center**. Click on **WebQuest** and select **Unit 2** to continue your Internet project.

