

Financial Management

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MGM 424

Lecture 2



Financial Management

Lecture 2

MGM424 Basic Financial Statements

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Chapter

02

Basic Financial Statements





Chapter

2

Basic Financial Statements

The Four Basic Financial Statements

Identify the income statement (Profit & loss)

Explain the statement of changes in owner's Equity.

Describe the classified balance sheet(Statement of financial position).

Identify Accrual Basis & Cash Basis and Cash flow statement.

The Four Basic Financial Statements

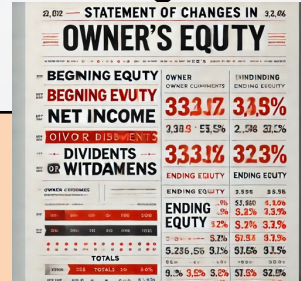
Financial Statements are prepared directly from the Trial Balance.

Companies prepare four financial statements:



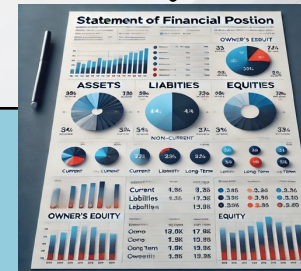
**Income Statement
(Profit & loss
statement)**

Period of time



**Changes in
owner's Equity
Statement**

Period of time



**Statement of
Financial Position
(Balance Sheet)**

Point in time



**Statement
of Cash Flows**

Period of time
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Income Statement

- Reports **revenues** and **expenses** for a specific period of time
- Lists revenues first, followed by expenses
- Shows net income (or net loss)
- Does not include investment and withdrawal transactions between owner and business in measuring net income



Business Name.... Single-Step income statement for the year ended Dec. 31, 2024	
Revenues :	
Sales Revenue	x
Service Revenue	x
Fees Earned	x
Commission Revenue	x
Consulting revenue	x
Dividends Revenue	x
Rental revenue	x
Total Revenues	xx
Expenses:	
Salary expenses	(x)
Wages expenses	(x)
Rent expenses	(x)
Utility expense	(x)
Repair expense	
Insurance expense	(x)
Interest expense	(x)
Depreciation expense	(x)
Advertising expense	(x)
Supplies expense	(x)
Total expenses	(xx)
Net income	xx

**Revenues and expenses determine if a net income
or net loss occurs as follows:**

- a. Revenues > Expenses: Net Income(Profit).**
- b. Revenues < Expenses: Net Income (loss).**

Changes in Owner's Equity Statement

- Reports **changes** in owner's equity for a specific period of time
- Time period is the same as that covered by the income statement



Business Name.... Changes in Owner's equity statement For the year ended Dec 31.2024	
Beginning Capital	×
Add (+)	+
Additional Investment	×
Net income (Profit)	×
Less (-)	
Drawings (Withdrawals)	(×)
Net income (Loss)	
Ending Capital	xx

Statement of Financial Position (**Balance sheet**)

- Reports **assets, liabilities, and owner's equity** at a specific date
- Lists assets at top, followed by liabilities and owner's equity
- Total assets **must equal** total owner's equity and liabilities
- Snapshot of company's financial condition at a specific moment in time (usually month-end or year-end)



Assets		
Current assets		
Cash	XX	
Short-term investment	XX	
Account receivable	XX	
Notes receivable	XX	
Inventories	XX	
Prepaid expenses	XX	
Total current assets		XX
Property, plant, and equipment (Fixed Assets)		
Land	XX	XX
Building (-) Accumulated Depreciation	XX	
Equipment (-) Accumulated Depreciation	XX	
Machinery (-) Accumulated Depreciation	XX	
Furniture (-) Accumulated Depreciation	XX	
Total property, plant, and equipment		XX
Intangible assets		
Goodwill	XX	
Copyright	XX	
Trademark	XX	
Total intangible assets		XX
Total assets	XX	
Liabilities & owner's equity		
Liabilities		
Current liabilities		
Notes payable	XX	XX
Account payable	XX	
Unearned revenue	XX	
Total current liabilities		XX
Long term liabilities		
Mortgage payable	XX	
Bank loan payable	XX	
Total long-term liabilities		XX
Total liabilities		XX
Owner's equity		
Capital		XX
Total liabilities & owner's equity		XX

Example (1)

Mohamed Hussein has the following Activities during the year:

Service revenue \$52800- Rent expense \$4800 - wages expense \$33080 - advertising expense \$5400- utilities expense \$3600 - Mohamed withdrawals \$2800- Cash \$6200- Accounts receivable \$3000-supplies \$400- land 4000- Accounts payable \$1800 - Mohamed beginning capital \$8680

Required

1. Prepare the income statement.
2. Prepare the statement of owner's equity.
3. Prepare the balance sheet for Mohamed Hussein proprietorship.

Mohamed Hussein
Single-Step income statement
for the year ended Dec. 31, 2024

Revenues :	
Service Revenue	52800
Expenses:	
Rent expenses	(4800)
Wages expenses	(33080)
Advertising expense	(5400)
Utility expense	(3600)
Total expenses	(46880)
Net income	5920

Mohamed Hussein
Owner's equity statement
For the year ended Dec 31.2024

Beginning Capital	8680
Add (+)	+
Additional Investment	0
Net income (Profit)	5920
Less (-)	
Drawings (Withdrawals)	(2800)
Ending Capital	11800

Mohamed Hussein
Balance Sheet
At the year ended Dec 31.2024

Assets		
Current assets:		
Cash	6200	
Accounts receivable	3000	
Supplies	400	9600
Fixed Assets		
Land	4000	4000
Total Assets		13600
Liabilities and owner's's equity		
Short term liabilities		
Accounts Payable		1800
Long term liabilities		
Loans (If found)		
Owner's equity		
Capital		11800
Total liabilities and Owner's equity		13600

Example(2)

Given the following trial balance:

FastForward Trial Balance December 31, 2011		
	<u>Debits</u>	<u>Credits</u>
Cash	\$ 4,350	
Accounts receivable	-	
Supplies	9,720	
Prepaid Insurance	2,400	
Equipment	26,000	
Accounts payable		\$ 6,200
Unearned consulting revenue		3,000
C. Taylor, Capital		30,000
Owner's Withdrawals	200	
Consulting revenue		5,800
Rental revenue		300
Salaries expense	1,400	
Rent expense	1,000	
Utilities expense	230	
Total	<u>\$ 45,300</u>	<u>\$ 45,300</u>

Instructions

1. Prepare the income statement.
2. Prepare the statement of owner's equity.
3. Prepare the statement of financial position.

FASTFORWARD
Income Statement
For the Month Ended December 31, 2011

Revenues:

Consulting revenue	\$ 5,800	
Rental revenue	<u>300</u>	
Total revenues		\$ 6,100

Expenses:

Rent expense	1,000	
Salaries expense	1,400	
Utilities expense	<u>230</u>	
Total expenses		2,630

Net income		<u>\$ 3,470</u>
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STATEMENT OF OWNER'S EQUITY

Connections

FASTFORWARD Statement of Owner's Equity For the Month Ended December 31, 2011	
C. Taylor, Capital 12/1/11	\$ -
Net income for December	3,470
Plus: Investments by Owner	30,000
	<u>33,470</u>
Less: Owner Withdrawals	200
C. Taylor, Capital, 12/31/11	<u>\$ 33,270</u>

FASTFORWARD Income Statement For the Month Ended December 31, 2011	
Revenues:	
Consulting revenue	\$ 5,800
Rental revenue	<u>300</u>
Total revenues	\$ 6,100
Expenses:	
Rent expense	1,000
Salaries expense	1,400
Utilities expense	<u>230</u>
Total expenses	2,630
Net income	<u>\$ 3,470</u>

BALANCE SHEET

FASTFORWARD Statement of Owner's Equity For the Month Ended December 31, 2011	
C. Taylor, Capital 12/1/11	\$ -
Net income for December	3,470
Plus: Investments by Owner	30,000
	<u>33,470</u>
Less: Owner Withdrawals	200
C. Taylor, Capital, 12/31/11	<u>\$ 33,270</u>

FASTFORWARD Balance Sheet December 31, 2011	
Assets	
Cash	\$ 4,350
Supplies	9,720
Prepaid insurance	2,400
Equipment	26,000
Total assets	<u>\$ 42,470</u>
Liabilities	
Accounts payable	\$ 6,200
Unearned revenue	3,000
Total liabilities	9,200
Equity	
C. Taylor, Capital	<u>\$ 33,270</u>
Total equity	<u>33,270</u>
Total liabilities and equity	<u>\$ 42,470</u>

Connections

Example(3)

Given the following trial balance:

Account title	Dr	Cr
Cash	100,000	
Accounts receivable	30,000	
Building	90,000	
Accumulated Depreciation -Building		20,000
Equipment	350,000	
Accumulated Depreciation -Equipment		50,000
Notes payable		60,000
Accounts Payable		90,000
Zaher ,Capital		280,000
Zaher , Withdrawals	30,000	
Service revenue		140,000
Salaries expense	20,000	
Insurance expense	8,000	
Advertising expense	9,000	
Rent expense	3,000	
Total	640,000	640,000

Instructions

1. Prepare the income statement.
2. Prepare the statement of owner's equity.
3. Prepare the statement of financial position.

**income statement
for the year ended Dec. 31, 2024**

Revenues :	
Service Revenue	140000
Expenses:	
Salaries Expense	(20000)
Insurance expenses	(8000)
Advertising Expense	(9000)
Rent expense	(3000)
Total expenses	(40000)
Net income (Profit)	100,000

**Owner's equity statement
For the year ended Dec 31.2024**

Beginning Capital	280,000
Add (+)	+
Additional Investment	Zero
Net income (Profit)	100,000
Less (-)	
Drawings (Withdrawals)	(30,000)
Ending Capital	350,000

**Balance Sheet
At the year ended Dec 31.2024**

Assets		
Fixed assets (Non-Current Assets) :		
Building	90,000	
(-) Accumulated Depreciation	(20,000)	70,000
Equipment	350,000	
(-) Accumulated Depreciation	(50,000)	
		300,000
Current Assets		
Cash		100,000
Accounts receivable		30,000
Total Assets		500,000
Liabilities and stockholder's equity		
Short term liabilities		
Accounts payable		90,000
Notes payable		60,000
Long term liabilities		
Loans (If found)		
Owner's equity		
Capital		350,000
Total liabilities and Owner's equity		500,000

DO IT! Financial Statement Items

Presented below is selected information related to Li Fashions at December 31, 2024. Li reports financial information monthly.

Equipment	HK\$10,000	Utilities Expense	HK\$4,000
Cash	8,000	Accounts Receivable	9,000
Service Revenue	36,000	Salaries and Wages Expense	7,000
Rent Expense	11,000	Notes Payable	16,500
Accounts Payable	2,000	Owner's Drawings	5,000

- Determine the total assets at December 31, 2020.**
- Determine the net income reported for December 2020.**
- Determine the owner's equity at December 31, 2020.**

Multiple Choice Questions

1. The following items are taken from the financial statements of the Postal Service for the year ending December 31, 2014:

Accounts payable	\$ 18,000
Accounts receivable	11,000
Accumulated depreciation – equipment	28,000
Advertising expense	21,000
Cash	15,000
Owner's capital (1/1/14)	102,000
Owner's drawings	14,000
Depreciation expense	12,000
Insurance expense	3,000
Note payable, due 6/30/15	70,000
Prepaid insurance (12-month policy)	6,000
Rent expense	17,000
Salaries and wages expense	32,000
Service revenue	133,000
Supplies	4,000
Supplies expense	6,000
Equipment	210,000

What is the company's net income for the year ending December 31, 2014?

- a. \$12,000
- b. \$28,000
- c. \$42,000
- d. \$133,000

**income statement
for the year ended Dec. 31, 2014**

Revenues :	
Service Revenue	133000
Expenses:	
Advertising Expense	(21000)
Depreciation expenses	(12000)
Insurance Expense	(3000)
Rent expense	(17000)
Salaries & wages expense	(32000)
Supplies expense	(6000)
Total Expenses	(91000)
Net income (Profit)	42000

The correct Answer is

C

2. Misra Company compiled the following financial information as of December 31, 2023:

Revenues	\$340,000
Owner's Capital (1/1/23)	140,000
Equipment	80,000
Expenses	250,000
Cash	90,000
Owner's Drawings	20,000
Supplies	10,000
Accounts payable	40,000
Accounts receivable	70,000

Misra's owner's equity on December 31, 2023 is

- a. \$90,000.
- b. \$140,000.
- c. \$210,000.
- d. \$250,000.

**income statement
for the year ended Dec. 31, 2023**

Revenues :	340,000
Less (-)	(-)
Expenses	250000
Net income (Profit)	90,000

**Owner's equity statement
For the year ended Dec 31.2023**

Beginning Owner's Capital	140,000
Add (+)	+
Additional Investment	Zero
Net income (Profit)	90,000
Less (-)	
Drawings (Withdrawals)	(20,000)
Ending Owner's Capital	210,000

The correct Answer is

C

3.The following items are taken from the financial statements of the Postal Service for the year ending December 31, 2014:

Accounts payable	\$ 18,000
Accounts receivable	11,000
Accumulated depreciation – equipment	28,000
Advertising expense	21,000
Cash	15,000
Owner’s capital (1/1/14)	102,000
Owner’s drawings	14,000
Depreciation expense	12,000
Insurance expense	3,000
Note payable, due 6/30/15	70,000
Prepaid insurance (12-month policy)	6,000
Rent expense	17,000
Salaries and wages expense	32,000
Service revenue	133,000
Supplies	4,000
Supplies expense	6,000
Equipment	210,000

What are total current assets at December 31, 2014?

- a. \$26,000
- b. \$36,000
- c. \$32,000
- d. \$42,000

Total current assets =
Accounts receivable
11,000+ Cash 15,000+
Prepaid insurance
6000+ Supplies 4000
= \$36000

The correct Answer is
B

5 .The income statement for the year 2023 of Nour Emad Co. contains the following information:

Revenues	\$70,000
Expenses:	
Salaries and Wages Expense	\$45,000
Rent Expense	12,000
Advertising Expense	10,000
Supplies Expense	6,000
Utilities Expense	2,500
Insurance Expense	<u>2,000</u>
Total expenses	<u>77,500</u>
Net income (loss)	<u>\$ (7,500)</u>

At **January 1**, 2023, **Nour** reported owner's equity of \$50,000. Owner drawings for the year totalled \$10,000. **At December 31, 2023, the company will report owner's equity of**

- a. \$17,500.
- b. \$32,500.
- c. \$40,000.
- d. \$42,500.

Owner's equity statement For the year ended Dec 31.2023	
Beginning Owner's Capital	50,000
Add (+)	+
Additional Investment	Zero
Less (-)	
Net income (loss)	(7500)
Drawings (Withdrawals)	(10,000)
Ending Owner's Capital	32,500

The correct Answer is
b

7. Misra Company compiled the following financial information as of December 31, 2014:

Revenues	\$340,000
Owner's Capital (1/1/14)	140,000
Equipment	80,000
Expenses	250,000
Cash	90,000
Owner's Drawings	20,000
Supplies	10,000
Accounts payable	40,000
Accounts receivable	70,000

Misra's assets on December 31, 2014 are

- a. \$180,000.
- b. \$250,000.
- c. \$360,000.
- d. \$490,000.

$$\begin{aligned}
 &\text{Total Assets=} \\
 &\text{Equipment } 80,000 + \\
 &\text{Cash } 90,000 + \text{Supplies} \\
 &\text{10,000} + \text{Accounts} \\
 &\text{receivable } 70,000 \\
 &= \$250,000
 \end{aligned}$$

The correct Answer is

b

8. As of December 31, 2014, Calexico Company has assets of \$42,000 and owner's equity of \$20,000. What are the liabilities for Calexico Company as of December 31, 2014?

- a. \$22,000.
- b. \$20,000.
- c. \$42,000.
- d. \$62,000.

The correct Answer is **a**

9. Net income results when

- a. Assets > Liabilities.
- b. Revenues = Expenses.
- c. Revenues > Expenses.
- d. Revenues < Expenses.

The correct Answer is **c**

10. Owner's capital at the end of the period is equal to

- a. owner's capital at the beginning of the period plus net income minus liabilities.
- b. owner's capital at the beginning of the period plus net income minus drawings.
- c. net income.
- d. assets plus liabilities.

The correct Answer is **b**

Accrual Basis & Cash Basis

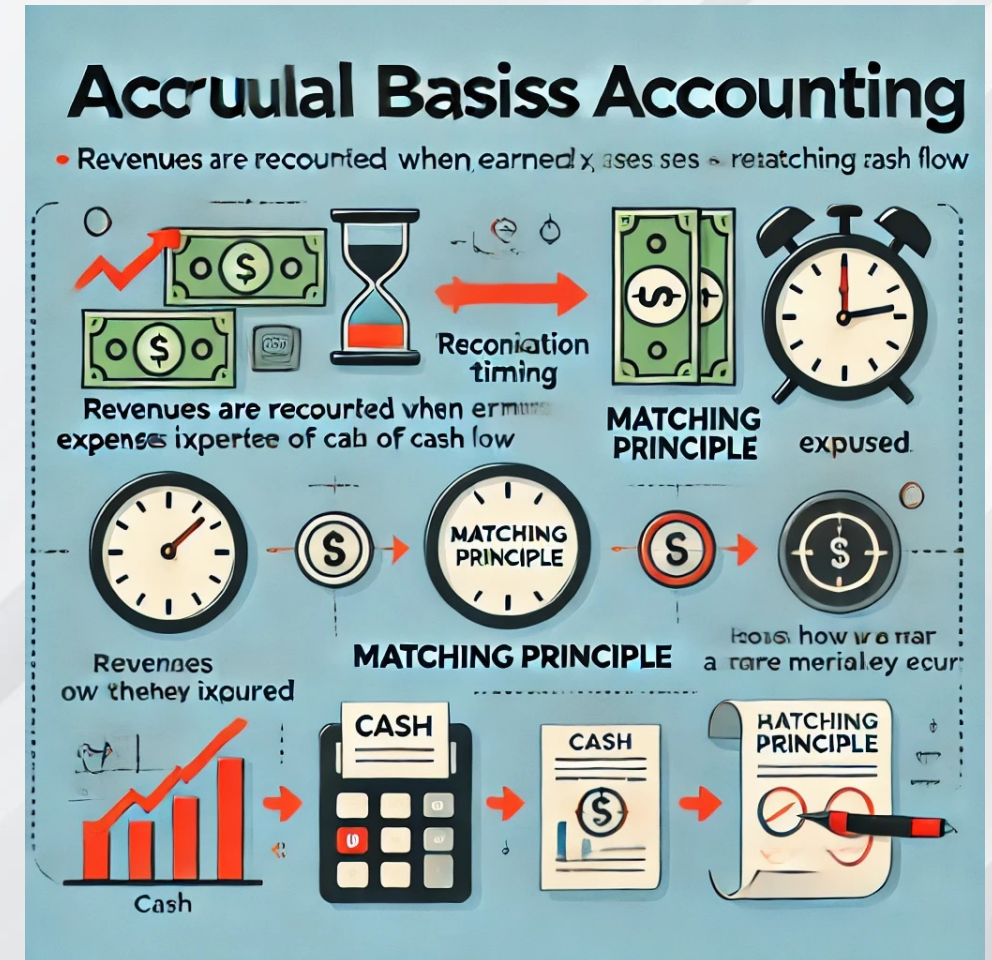
1. Accrual Basis Accounting:

• Recognition Timing:

- Revenues are recorded when **earned**, regardless of when the cash is received.
- Expenses are recorded when **incurred**, even if the cash hasn't been paid yet.

• Matching Principle:

- Revenues and expenses are matched to the period in which they occur, giving a more accurate picture of a company's financial performance.



Accrual Basis & Cash Basis

Cash Basis Accounting:

•Recognition Timing:

- Revenues are recorded only when **cash is received**.
- Expenses are recorded only when **cash is paid**.

•Simpler:

- This method is straightforward and easier to manage since it focuses only on actual cash flow.



Accrual Basis & Cash Basis

Aspect	Accrual Basis	Cash Basis
Timing of Revenue	Recognized when earned (before cash is received)	Recognized when cash is received
Timing of Expenses	Recognized when incurred (before cash is paid)	Recognized when cash is paid
Complexity	More complex, follows matching principle	Simple, focuses on cash inflows and outflows
Used By	Larger businesses, those following GAAP	Small businesses, freelancers, or cash- dependent

Question:

Company "Success" provided services in June worth \$10,000. Half of the amount (\$5,000) was received in cash in June, and the remaining amount will be received in July. The company also incurred expenses of \$3,000 in June, which will be paid in July.

Based on **accrual accounting**, what is the **net income** for the company in **June**?

- A) \$2,000
- B) \$7,000
- C) \$5,000
- D) \$10,000

The correct Answer is **b**

Question:

Company "Bright" provided services worth \$8,000 in May. The customer paid \$5,000 in May and will pay the remaining \$3,000 in June. In May, the company also received a bill for \$2,000 in expenses, which will be paid in June.

Based on **Cash Basis Accounting**, what is the **net income** for May?

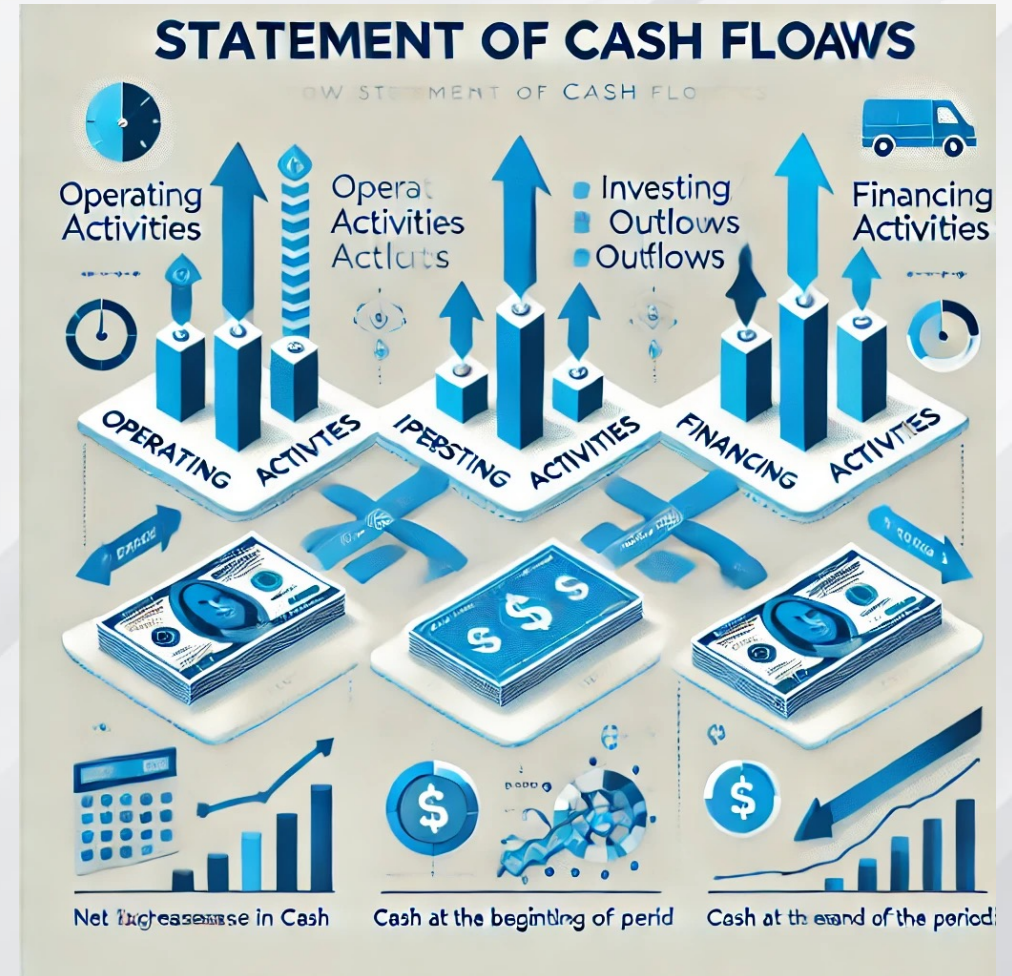
- A) \$3,000
- B) \$6,000
- C) \$5,000
- D) \$8,000

The correct Answer is **C**

STATEMENT OF CASH FLOWS

In a **Statement of Cash Flows**, cash flows are categorized as either **cash inflows** (money coming into the business) or cash **outflows** (money going out of the business). Here's a breakdown for each activity:

1. Operating Activities
2. Investing Activities
3. Financing Activities



STATEMENT OF CASH FLOWS

Income
statement

Net income

80,000,000

Accrual Basis

Cash flow
statement

Net cash flow

30,000,000

Cash Basis

Problem 1: Accrual Basis (Income Statement)

A company reports **\$80,000,000** in **Net Income** on its Income Statement, which is prepared using the **Accrual Basis**. This includes:

- **\$50,000,000** in revenue earned but not yet received in cash.
- **\$10,000,000** in expenses incurred but not yet paid.

Question:

How much of the company's net income is based on actual cash received?

The correct Answer is **b**

- A) \$70,000,000
- B) \$40,000,000
- C) \$80,000,000
- D) \$50,000,000

Problem 2: Cash Flow Statement (Cash Basis)

A company's **Cash Flow Statement** shows **\$30,000,000** in **Net Cash Flow**.

This includes:

- **\$40,000,000** cash received from customers.
- **\$10,000,000** paid to suppliers.
- **\$5,000,000** paid as taxes.
- **\$5,000,000** paid in dividends.

Question:

What is the company's **net cash flow from operations**?

The correct Answer is **C**

- A) \$30,000,000
- B) \$20,000,000
- C) \$25,000,000
- D) \$15,000,000



Thank You