

# Financial Statements – Statement of Financial Position (Balance Sheet) and Income Statement



**SILESIAN  
UNIVERSITY**

SCHOOL OF BUSINESS  
ADMINISTRATION IN KARVINA

**Ing. Markéta Šeligová, Ph.D.**

Financial Statements – Statement of  
Financial Position (Balance Sheet) and  
Income Statement



- Companies prepare five financial statements from the summarized accounting data:
    - An income statement
    - A retained earnings statement
    - A statement of financial position (balance sheet)
    - A statement of cash flows
    - A statement of stockholders' equity
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- **An income statement** – presents the revenues and expenses and resulting net income or net loss for a specific period of time
  - **A retained earnings statement** – summarizes the changes in retained earnings for a specific period of time
  - **A statement of financial position** – sometimes referred to as a *balance sheet*; reports the assets, liabilities, and equity of a company at a specific date
  - **A statement of cash flows** – summarizes information about the cash inflows (receipts) and outflows (payments) for a specific period of time
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# Statement of Financial Position – Balance Sheet

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- **The balance sheet is a financial statement that presents the financial position of the company on a particular date.**
- The balance sheet reports assets, liabilities, and stockholder s equity at a **point in time**, in contrast to the income statement which shows revenue and expense activities over an **interval of time**.
- Balance sheet consists of **assets** and **liabilities** and **equity**.
- The financial position of a company is summarized by the accounting equation:

$$Assets = Liabilities + Equity$$

$$Assets = Liabilities + Stockholders Equity$$

$$Resources = creditor s claims + owners s claims$$

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- Assets are the resources of company.
  - Assets are the resources a business owns.
  - The business uses its assets in carrying out such activities as production and sales.
  - The common characteristic possessed by all assets is **the capacity to provide future services or benefits.**
  - In a business, that service potential or future economic benefit eventually results in cash inflows (receipts).
  - For example, consider Taipai Pizza, a local restaurant. It owns a delivery truck that provides economic benefits from delivering pizzas.
  - **Other assets of Taipai Pizza are tables, chairs, cash register, oven, tableware, and of course cash.**
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- Assets include:
    - *Cash* – is a resource because it can be used to make purchases
    - *Accounts receivable* – is a resource because they represent the right to receive cash from customers that have already been provided products or services
    - *Supplies* – include resources used to run for example the soccer academy, such as paper, cleaning supplies, and soccer balls
    - *Equipment* – is a resource that can be used to provide services to customers
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- **Liabilities are the amounts owed by a company.**
  - Liabilities are claims against assets - that is, existing debts and obligations.
  - Businesses of all sizes usually borrow money and purchase merchandise on credit.
  - Liabilities include amounts owed to regular vendors (**accounts payable**), as well as amounts owed for other items such as employee salaries, utilities, interest, and bank borrowing (notes payable)
  - Many liabilities are referred to as payable, to signify amounts the company will pay in the future.
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- These economic activities result in payables of various sorts:
    - Taipai Pizza, for instance, purchases cheese, sausage, flour; and beverages on credit from suppliers. These obligations are called **accounts payable**.
    - Taipai Pizza also has a **note payable** to First National Bank for the money borrowed to purchase the delivery truck.
    - Taipai Pizza may also have **salaries and wages payable** to employees and **sales and real estate taxes payable** to the local government.
    - All of these persons or entities to whom Taipai Pizza owes money are its creditors.
    - **Creditors** may legally force the liquidation of a business that does not pay its debts.
    - In that case, the law requires that creditor claims be paid **before** ownership claims.
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- The ownership claim on a company's total assets.
  - It is equal to total assets minus total liabilities
  - **Why???:**
    - The assets of a business are claimed by either creditors or shareholders. To find out what belongs to shareholders, we subtract creditors' claims (the liabilities) from the assets.
  - The remainder is the shareholders' claim on the assets - equity.
  - It is often referred to as **residual equity** - that is, the equity left over after creditors' claims are satisfied.
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- Equity generally consists of:
  - **share capital – ordinary**
  - **and retained earnings.**

# Share Capital - Ordinary

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- A corporation may obtain funds by selling ordinary shares to investors.
  - **Share capital – ordinary** is the term used to describe the amounts paid in by shareholders for the ordinary shares they purchase.
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Retained earnings is determined by three items:

- *revenues* - are the gross increases in equity resulting from business activities entered into for the purpose of earning income (that it selling merchandise and so on)
  - *expenses* - are the cost of assets consumed or services used in the process of earning revenue (supplies, electric expense and so on)
  - *dividends* - net income represents an increase in net assets which is then available to distribute to shareholders
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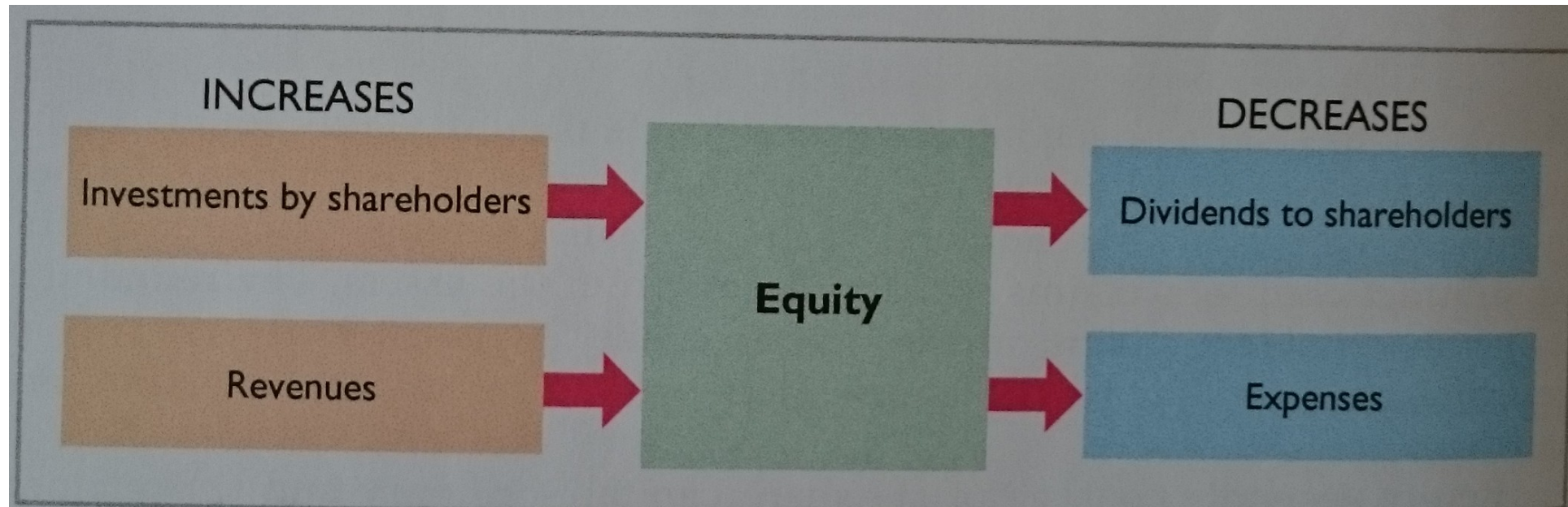


- The distribution of cash or other assets to shareholders is called **dividend**.
  - Dividends reduce retained earnings.
  - However, dividends are **not expenses**.
  - A corporation first determines its revenues and expenses and then computes net income or net loss.
  - If it has net income, and decides it has no better use for that income, a corporation may decide to distribute a dividend to its owners (the shareholders).
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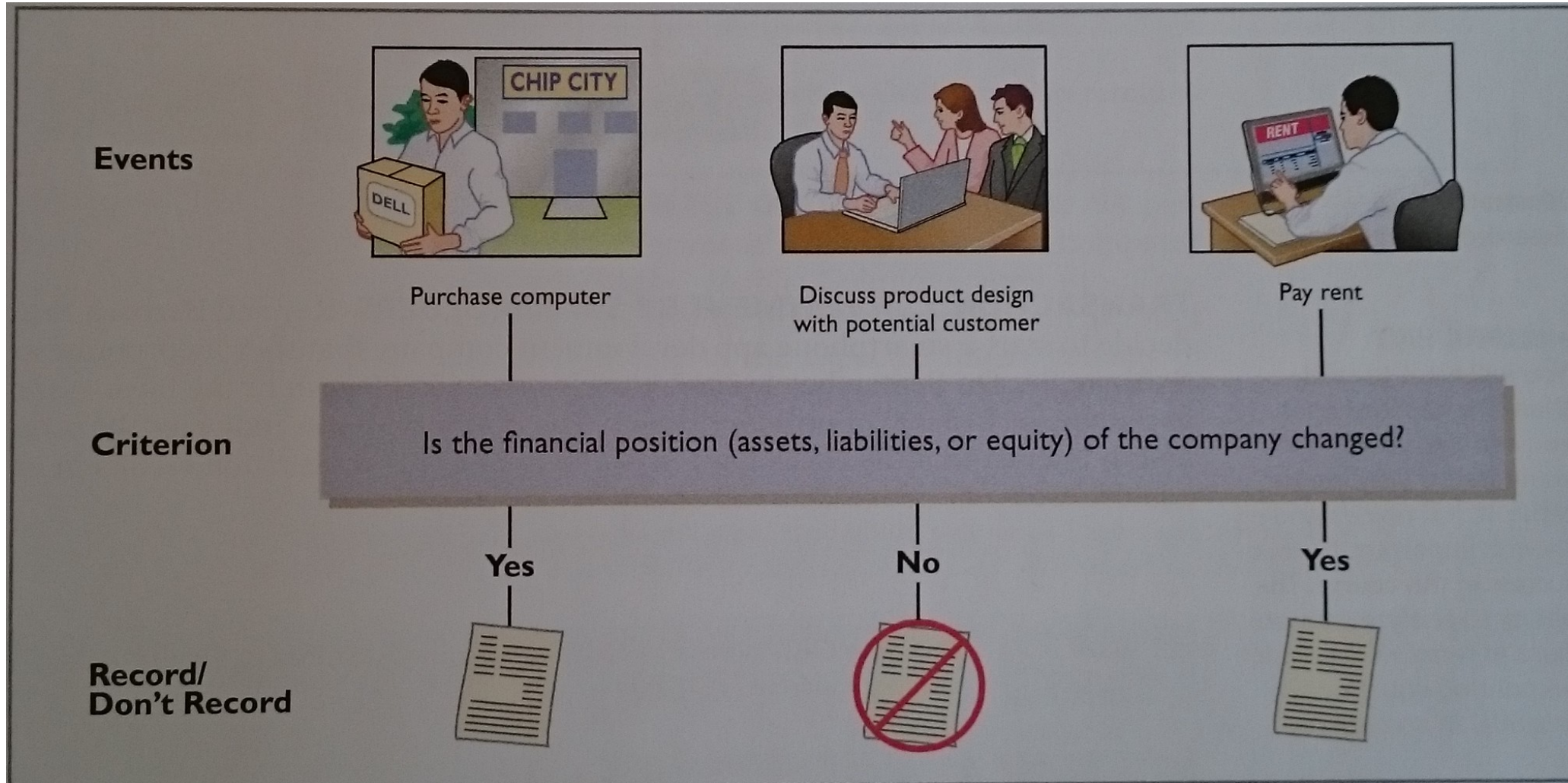
# Dividends



- In summary, the principal sources (increases) of equity are investments by shareholders and revenues from business operations.
- In contrast, reductions (decreases) in equity result from expenses and dividends.



# Dividends



- **The income statement is a financial statement that reports the company's revenues and expenses over an interval of time.**
  - The income statement reports the success or profitability of the company's operations over a specific period of time.
  - It shows whether the company was able to generate enough revenue to cover the expenses of running the business.
  - Income statement consists of **revenues** and **expenses**.
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$$\underline{\text{Revenues} - \text{Expenses} = \text{Net income (Net loss)}}$$

- If revenues exceed expenses, then the company reports net income.
  - If expenses exceed revenues (revenues do not exceed expenses), then the company reports net loss.
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- **Revenues are the amount recognized when the company sells products or provides services to customers.**
    - For example, when you or one of your employees provides soccer training to a customer, the company recognizes revenue.
  - However, as you've probably heard (It takes money to make money.)
  - To operate the company you'll encounter many costs.
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- **Revenues are the gross increases in equity resulting from business activities entered into for the purpose of earning income.**
  - Generally, revenues result from selling merchandise, performing services, renting property, and lending money.
  - Revenues usually result in an increase in an asset.
  - They may arise from different sources and are called various names depending on the nature of the business.
    - Taipai Pizza, for instance, has two categories of sales revenues - pizza sales and beverage sales.
  - Other titles for and sources of revenue common to many businesses are sales, fees, services, commissions, interest, dividends, royalties, and rent.
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- **Expenses are the costs of providing products and services and other business activities during the current period.**
    - For example, to operate the soccer academy, you ll have costs related to salaries, rent, supplies, and utilities.
  - These are typical expenses of most companies.
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- **Expenses are the cost of assets consumed or services used in the process of earning revenue.**
  - They are decreases in equity that result from operating the business.
  - Like revenues, expenses take many forms and are called various names depending on the type of asset consumed or service used.
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- For example, Taipai Pizza recognizes the following types of expenses:
    - cost of ingredients (flour, cheese, tomato paste, meat, mushrooms, etc.),
    - cost of beverages, wages expense,
    - utilities expense (electric, gas, and water expense),
    - telephone expense,
    - delivery expense (gasoline, repairs, licenses, etc.),
    - supplies expense (napkins, detergents, aprons, etc.),
    - rent expense, interest expense, and property tax expense.
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$$\underline{\text{Revenues} - \text{Expenses} = \text{Net income (Net loss)}}$$

- **Net income** is difference between revenues and expenses.
  - All business want revenues to be greater than expenses, producing a positive net income and adding to stockholders equity in the business.
  - However, if expenses exceed revenues, as happens from time to time, the difference between them is a negative amount - a **net loss**.
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# Financial Statements



SOFTBYTE SA Income Statement For the Month Ended September 30, 2017		
Revenues		
Service revenue		€ 4,700
Expenses		
Salaries and wages expense	€900	
Rent expense	600	
Advertising expense	250	
Utilities expense	200	
Total expenses		<u>1,950</u>
Net income		<u><b>€2,750</b></u>

SOFTBYTE SA Retained Earnings Statement For the Month Ended September 30, 2017		
Retained earnings, September 1		€ 0
Add: Net income		<u>2,750</u>
		2,750
Less: Dividends		<u>1,300</u>
Retained earnings, September 30		<u><b>€1,450</b></u>

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# Financial Statements



SOFTBYTE SA		
Statement of Financial Position		
September 30, 2017		
<b>Assets</b>		
Equipment		€ 7,000
Supplies		1,600
Accounts receivable		1,400
Cash		<u>8,050</u>
Total assets		<u>€18,050</u>
<b>Equity and Liabilities</b>		
Equity		
Share capital—ordinary	€15,000	
Retained earnings	<u>1,450</u>	€16,450
Liabilities		
Accounts payable		<u>1,600</u>
Total equity and liabilities		<u>€18,050</u>
SOFTBYTE SA		
Statement of Cash Flows		
For the Month Ended September 30, 2017		
Cash flows from operating activities		
Cash receipts from revenues		€ 3,300
Cash payments for expenses		<u>(1,950)</u>
Net cash provided by operating activities		1,350
Cash flows from investing activities		
Purchase of equipment		(7,000)
Cash flows from financing activities		
Sale of ordinary shares	€15,000	
Payment of cash dividends	<u>(1,300)</u>	13,700
Net increase in cash		8,050
Cash at the beginning of the period		<u>0</u>
Cash at the end of the period		<u>€ 8,050</u>

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Thank you for your attention.

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