

CHAPTER II  
FINANCIAL STATEMENTS

The are two questions that the owner of a business makes to the accountant periodically:

- (1) What is my profit?
- (2) What is my capital?

The simple balance of assets against liabilities and capital, provided by the accounting equation, is insufficient to give complete answers. (A) We must know the type and amount of income and the type and amount of each expense for the period in question. (B) It is necessary to obtain the type and amount of each asset, liability, and capital account at the end of the period. This information is provided by the income statement and the balance sheet.

Example:

After the transaction for the month of January has been recorded in the books of Mr. John Kelly, the accounts show the following balances.

| ACCOUNTS            | ASSETS   | LIABILITIES AND CAPITAL |
|---------------------|----------|-------------------------|
| CASH                | \$ 4,700 |                         |
| SUPPLIES            | 100      |                         |
| EQUIPMENT           | 2,500    |                         |
| ACCOUNT'S PAYABLE   |          | \$ 1,500                |
| JOHN KELLY, CAPITAL |          | 5,800                   |
| TOTAL:              | \$ 7,300 | \$ 7,300                |

INCOME STATEMENT

The income statement may be defined as a summary of the revenue, expenses, and net income of a business for a specific period of time. This may also be called a Profit and Loss Statement, or statement of Operations. Let us know the meaning of the elements.

Revenue. The increase in capital resulting from the delivery of goods or rendering of services by the business. In amount, the revenue is equal to the cash and receivables gained in compensation for the goods delivered or services rendered.

Net Income. The increase in capital resulting from profitable operations of a business; It is the excess of revenues over expenses for the accounting period.

Expenses. The decrease in capital caused by the business's revenue-producing operations. In amount, the expense is - - equal to the value of goods and services used up or consumed in obtaining revenue.

Note that, borrowing cash from a bank does not contribute to revenue and a cash payment is an expense only if it decreases capital.

In many companies there are hundreds and perhaps thousands - of income and expense transactions in one month. To lump all these transactions under one account would be very cumbersome and would, in addition, make it impossible to show relationship among the various items.

## VOCABULARY II

### - A -

- 1.- ASK - pedir, rogar, preguntar
- 2.- AT THE BEGINNING OF - a principios de
- 3.- AT THE END OF - a fines de
- 4.- ACCOUNTING PERIOD - ejercicio o período contable
- 5.- ALREADY - ya, antes de ahora
- 6.- AVAILABLE - disponible, útil, ventajoso
- 7.- ACCRUED ITEMS - partidas acumuladas
- 8.- AFFECT - afectar

### - B -

- 9.- BALANCE - saldo, balance
- 10.- BALANCE SHEET - balance general
- 11.- BUSINESS - negocio
- 12.- BEGINNING - principio, origen
- 13.- BORROWING - pedir prestado
- 14.- BEYOND - más adelante, más allá

### - C -

- 15.- CONTAINS - contiene
- 16.- CAPTIONS - títulos
- 17.- CURRENT - circulante

- 18.- CURRENT ASSETS - activos circulantes  
 19.- CONTRIBUTE - contribuir  
 20.- CURRENT LIABILITIES - pasivos circulantes  
 21.- CASH RECEIPT - ingreso en caja  
 22.- CUMBERSOME - embarazoso, pesado, complicado

## - D -

- 23.- DEFINED - definición, definido  
 24.- DELIVERY - entrega  
 25.- DUE - debido, vencido  
 26.- DETAILS - detalles

## - E -

- 27.- EQUAL - igual  
 28.- ENTER - asentar, anotar  
 29.- EARLIER - al principio, anteriormente

## - F -

- 30.- FOR INSTANCE - por ejemplo  
 31.- FIXED ASSETS - activos fijos

## - G -

- 32.- GOODS - mercancías, artículos

- 33.- GAINED - ganado  
 34.- GOOD WILL - crédito mercantil

## - H -

- 35.- HEADING - encabezado  
 36.- HUNDREDS - cientos  
 37.- HIGHER - más alto

## - I -

- 38.- IN PREPARING - al preparar  
 39.- INCURRED - causó, incurrió  
 40.- IN ADDITION - además  
 41.- INSTEAD - en lugar, en vez de  
 42.- INDEX - relación, índice

## - J -

- 43.- JOURNAL - diario, libro auxiliar

## - K -

- 44.- KNOWN - conocido

## - L -

- 45.- LET US REVIEW - repasemos  
 46.- LUMP - amontonar, *amontonamiento*  
 47.- LOWER - más bajo  
 48.- LESS - menos, inferior  
 49.- LONG LIVED ASSETS - activos a largo plazo  
 50.- LONG-TERM LIABILITIES - pasivos fijos

## - M -

- 51.- MORTGAGES PAYABLE - hipotecas por pagar  
 52.- MUST - deber  
 53.- MEANINGS - significados  
 54.- MATCHED - igualado

## - N -

- 55.- NET INCOME - utilidad neta

## - O -

- 56.- OVER - sobre  
 57.- OTHER ASSETS - otros activos  
 58.- ORIGINAL - primera, original  
 59.- OPERATING - operación  
 60.- ON HAND - en existencia

- 61.- OUGHT - deber

## - P -

- 62.- PROFIT AND LOSS STATEMENT - estado de pérdidas y ganancias  
 63.- PROFIT - ganancia  
 64.- PRODUCE - producir  
 65.- PREPAID RENT - renta pagada por adelantado  
 66.- PREVIOUS - previo, de antemano  
 67.- PREPAID EXPENSES - gastos pagados por adelantado

## - Q -

- 68.- QUALIFIES - califica

## - R -

- 69.- REVENUE - entrada, ingreso  
 70.- RENDERED - prestado, suministrado  
 71.- RELATE - estar en relación  
 72.- RECEIVABLES - cuentas y documentos por cobrar  
 73.- RELATIONSHIP - relación  
 74.- RATIO - cantidad, número, relación

- S -

- 75.- SET UP - establecer  
76.- SET - juego, serie, grupo

- T -

- 77.- TYPE - tipo  
78.- THUS - así, de este modo  
79.- THOUSANDS - millares

- U -

- 80.- UNDER - bajo, debajo

## BALANCE SHEET

Use of the balance sheet

By studying the balance sheet, the proprietor can obtain information that is useful to him in the management of his business. He can observe whether he has sufficient cash on hand or will collect enough from the accounts receivable to enable him to pay his liabilities when they are due.

The balance sheet may then be defined as a statement showing the assets, liabilities, and capital of a business at a specific date. This statement is also called a statement of financial position or statement of financial condition.

Example "C"

JOHN KELLY

Balance Sheet

January 31, 197\_\_.

## ASSETS

|              |              |
|--------------|--------------|
| Cash         | \$ 4,700     |
| Supplies     | 100          |
| Equipment    | <u>2,500</u> |
| Total Assets | \$ 7,300     |

## LIABILITIES AND CAPITAL

## Liabilities

Accounts Payable

\$ 1,500

## Capital

Balance January 1, 197\_\_.

\$ 5,000

Net Income of January \$ 1,100

Less Withdrawals 300

Increase in capital 800

Total capital

\$ 5,800

Total liabilities and capital

\$ 7,300

The close relationship of the income statement and the balance sheet is apparent. The net income of \$ 1,100 for January, shown as the final figure on the income statement of Example "B", is also shown as a separate figure on the balance sheet of Example "C". The income statement is thus the connecting link between two balance sheets. As discussed earlier, the income and expense items are actually a further analysis of the capital account.

The balance sheet of Example "C" is arranged in report form, with the liabilities and capital sections shown below the asset section. It may be also arranged in account form, with the liabilities and capital sections to the right of, rather than below, the asset section.

## VOCABULARY III

- A -

- 1.- ACCOUNT FORM - forma de cuenta
- 2.- APPARENT - claro, patente, manifiesto

- B -

- 3.- CLASSIFY - clasificar
- 4.- CONNECTING - conectar, enlazar
- 5.- COSTLY - costoso, caro

- D -

- 6.- DECREASES - disminuciones

- G -

- 7.- GREAT MANY - gran número

- L -

- 8.- LINK - cadena, enlace
- 9.- LOST - perdió, perdido

- O -

- 10.- OBTAINED - obtenido

- P -

11.- REPORT FORM - forma de reporte

- T -

12.- TIME CONSUMING - tiempo gastado

- W -

13.- WAY - modo, forma, camino

14.- WITHDRAWAL - retiro

## THE BALANCE SHEET

The balance sheet becomes a more useful statement for comparison and financial analysis where the assets and liability groups are classified. For example, an important index of the financial state of business, derivable from the classified balance sheet, is the ratio of current assets to current liabilities. This current ratio ought generally to be at least 2 to 1; that is, current assets should be twice current liabilities. For our purpose we will designate the following classifications.

Current assets. Assets reasonably expected to be converted into cash or used in the current operation of the business. The current period is generally taken as one year. Examples are cash, inventory, notes receivable, accounts receivable, and prepaid expenses (prepaid insurance, prepaid rent, etc.)

Property plant, and equipment. Long-lived assets used in the production of goods or services. These assets, sometimes called fixed assets or plant assets, are used into the operation of the business rather than being held for sale, as are inventory items.

Other assets. Various assets other than current assets, fixed assets, or assets to which specific captions are given.

Current liabilities

Debts which must be satisfied from current assets within the

next operating period, usually one year. Examples are accounts payable, notes payable.

Long-term liabilities. Liabilities which are payable beyond the next year. Examples are bonds payable and mortgages payable.

## VOCABULARY IV

- A -

1.- AT LEAST - por lo menos

- B -

2.- BEYOND - más allá, más adelante

- C -

3.- COMPARISION - comparación, confrontación

4.- CAPTIONS - títulos, membretes

- D -

5.- DESIGNATE - apuntar, señalar

6.- DERIVABLE - derivable, deducible

- F -

7.- FINANCIAL STATEMENT - estado financiero

- I -

8.- INDEX - indicio, señal, índice

- O -

9.- OUGHT - deber

## - P -

- 10.- PURPOSE - propósito o fin  
 11.- PLANT ASSETS - activos de fábrica  
 12.- PROPERTY PLANT - propiedades del negocio

## - S -

- 13.- SOMETIMES - algunas veces

## - T -

- 14.- TAKEN - tomado  
 15.- TWICE - dos veces, al doble, duplicadamente

## - U -

- 16.- USEFUL - útil

## - W -

- 17.- WITHIN - dentro, adentro, dentro de

## CHAPTER III

## CLASSIFYING TRANSACTIONS

After each transaction would be cumbersome and costly to prepare a new equation. An efficient way is to <sup>laborious & costly</sup> classify the transactions according to the items on the balance sheet and income statement. The increases and decreases are then recorded according to type of item by means of a summary called an account.

The "t" Account

This account is known as the "t" account because it resembles the letter "t". This account has three parts (1) the name of the account and the account number (2) The debit side (left side), and (3) the credit side (right side). The abbreviations for debit and credit are Dr. and Cr., respectively.

The Double - Entry System

When an amount is entered on the left side of an account, it is a debit and the account is said to be debited. When an amount is entered on the right side, it is a credit and the account is said to be credited.

Increases and Decreases

Asset and expense increases are recorded as debits, liability, capital and income increases are recorded as credits. - Asset and expense decreases are recorded as credits, liabi-