

CHAPTER 7 FINANCIAL STATEMENTS

In Chapters 1 through 6, your students used the sample company Bellwether Garden Supply. They learned how PCA's graphical user interface works and how to navigate the software. In Chapters 1 through 6, they also journalized and posted various types of transactions. Beginning with Chapter 9, students will learn how to set up companies from scratch as well as use the features learned in Chapters 1-7 in more detail.

In Chapter 7, your students learn about PCA's financial statements. Once journal entries have been recorded and posted, Peachtree automatically calculates financial statements. Business managers and owners have the primary responsibility for the organization. They depend on accounting information in the form of financial statements to understand what is happening.

All of the financial statements printed by PCA reflect the current month and year-to-date amounts.

Your students will print six financial statements in Chapter 7:

1. Balance Sheet.
2. Gross Profit by Departments.
3. Income Statement.
4. Statement of Cash Flow.
5. Statement of Retained Earnings
6. Statement of Changes in Financial Position

Balance Sheet

A balance sheet is a list of assets, liabilities, and capital of a business entity as of a specific date, such as the last day of an accounting period or the last day of the year.

Each financial statement may be modified to fit your needs. PCA includes a Design icon for that purpose. Later in this chapter, your students will learn about PCA's Help feature.

Gross Profit by Departments

A departmentalized accounting system provides information management can use to evaluate the profitability or cost effectiveness of a department's activities. The Gross Profit by Departments financial statement is a custom report designed for Bellwether that details each department's year-to-date gross profit as of the current month. The report shown in the text on page 208 lists the departmental gross profit totals for the following departments: Aviary, Books, and Equipment.

Some of Bellwether's chart of account numbers have a dash, then an AV or a BK. For example, Account No. 40000-AV, Sales - Aviary; and Account No. 40000-BK, Sales - BK show this departmental designation.

PCA includes a feature called masking which allows you to organize your business by department. Then, you can design custom forms to accommodate your departmentalized accounting system. The red flag to the left of some of Bellwether's financial statements indicates that those statements are custom-designed forms.

Income Statement

The income statement is a summary of the revenues and expenses a company accrues over a period of time, such as an accounting period or a year. Only revenue and expense accounts are displayed on the income statement. Net income is computed by subtracting total expenses from total revenues. Net income results when revenues exceed expenses. An excess of expenses over revenues results in a net loss. Bellwether's net income for the current month, March 1 through March 31, 2007, is \$281.23. Bellwether's year-to-date net income is \$28,383.66. When you print the Income Statement on page 209 you will see these amounts.

In addition to dollar figures, the income statement also includes percentage-of-revenue columns for the current month. The percentages shown for each expense, total expenses, and net income (or net loss) indicate the relationship of each item to total revenue.

Statement of Cash Flow

The cash flow from operations is roughly the same as income from operations plus depreciation, depletion, and adjusted for any other operating transactions that had no effect on cash during the period. The statement of cash flow also reports cash transactions associated with the purchase or sale of fixed assets (Investing Activities) and cash paid to or received from creditors and owners (Financing Activities).

The statement of cash flow provides the answers to three questions:

1. From where did cash receipts come?
2. For what were cash payments used?
3. What was the overall change in cash?

Statement of Retained Earnings

The Statement of Retained Earnings shows beginning and ending retained earnings amounts, adjustments made to retained earnings within the report period, and the detail for all Equity-gets closed accounts. The retained earnings balance is the cumulative, lifetime earnings of the company less its cumulative losses and dividends.

Statement of Changes in Financial Position

The statement of changes describes changes in a company's financial position that may not be obvious from other financial statements. The statement of changes shows the change in working capital, assets, and liabilities for a given period of time.

Interrelationship of Financial Statements

The financial statements work together. The net income (or net loss) from the income statement is on the balance sheet's capital section. The net income or net loss is used to update the capital amount: $\text{Capital Beginning of the Year} - \text{Net Loss (or + Net Income)} = \text{Total Capital}$.

On the statement of retained earnings, the Ending Retained Earnings balance is \$217,421.26. On the balance sheet, if you add the net income of \$28,383.66 to the balance sheet's retained earnings amount, \$189,037.60, the result is \$217,421.26. This amount, \$217,421.26, is the same as the Ending Retained Earnings balance on the Statement of Retained Earnings.

The total of all the cash accounts on the balance sheet including Petty Cash, Cash on Hand, Regular Checking Account, Payroll Checking Account, Savings Account, and Money-Market Fund is explained in detail on the statement of cash flow. The statement of cash flow uses information from both the balance sheet and income statement.

The statement of changes in financial position uses information from the income statement and balance sheet. The net income is shown from the income statement. Current assets and current liabilities are derived from the balance sheet.

No single financial statement tells the entire story. The income statement indicates how much revenue a business has earned during a specific period of time, but it says nothing about how much of that amount has or has not been received in cash. For information about cash and accounts receivable, we have to look at the balance sheet, statement of cash flow, and statement of changes in financial position.

SOFTWARE OBJECTIVES: In Chapter 7 your students use the software to:

1. Restore data from Exercise 6-2.
2. Use Peachtree's Help feature.
3. Print the financial statements.
4. Use drill down to go from the income statement to the general ledger and task windows.
5. Make an optional backup of Chapter 7. The backups that were made in Chapter 6 include the data for this chapter.

WEB OBJECTIVES: In Chapter 7, your students do these Internet activities:

1. Use their Internet browser to go to the book's website.
2. Complete the Internet activity for Peachtree Software
3. Complete the steps shown for this activity.

There is no new data entered in Chapter 7. Your students will print the financial statements after restoring their Exercise 6-2 backup disk. It is up to you whether or not you want your students to make another backup disk at the end of Chapter 7. If students want to do a backup, they will need three blank formatted disks.

Chapter 7 ends with true/make true questions. Exercises 7-1 and 7-2 have questions that relate to the financial statements. There is no need to back up data for either Exercise 7-1 or 7-2.

PCA TIPS, CHAPTER 7

- Since students backed up all the data necessary for the financial statements in Chapter 6, there is no need to back up again in Chapter 7.

LECTURE OUTLINE FOR CHAPTER 7

- A. Software Objectives, page 197
- B. Web Objectives, page 197
- C. Financial Statements, pages 197-198
 1. Balance Sheet, page 198
 2. Gross Profit by Departments, page 198
 3. Income Statement, page 199
 4. Statement of Cash Flow, page 199

5. Statement of Retained Earnings, page 199
 6. Statement of Changes in Financial Position, page 200
 7. Interrelationship of Financial Statements, page 200
- D Getting Started, page 201
- E. Using Peachtree's Help Feature, pages 202-204
- F. Printing the Financial Statements, pages 205-212
1. Drill down from the income statement to task windows, pages 209-210.
- G. Backing Up Chapter 7 Data, pages 213-214
- Backing up chapter 7 is optional because all the data for this chapter is included in the Exercise 6-2 backup. The *Instructor's Resource CD-ROM* and the Instructor Center link online at www.mhhe.com/yacht2005 includes a back up for Chapter 7.
- H. Internet Activity, page 214
- I. Summary and Review, pages 214-215
1. Going to the Net, page 215
 - 2 True/Make True, pages 215-217
 3. Exercise 7-1, page 218
 4. Exercise 7-2, page 218
 5. Chapter 7 Index, page 219

ANSWERS TO GOING TO THE NET

1. Assets that can be easily converted into cash are called liquid assets.
2. The first section on a balance sheet is called current assets. Current assets are assets that a company has at its disposal that can be easily converted into cash within one operating cycle.

3. Students select two links in the How to Read a Balance Sheet: Introduction list. The links include Current Assets; Current Liabilities; Debt and Equity; Current and Quick Ratio; Working Capital; and Price/Book, DSO & Turns. Students define each selected link and include the website address(es).

ANSWERS TO TRUE/MAKE TRUE QUESTIONS

1. In Chapter 7, you printed six financial statements:
 - a. Balance Sheet.
 - b. Gross Profit by Departments.
 - c. Income Statement.
 - d. Statement of Cash Flow.
 - e. Statement of Retained Earnings
 - f. Statement of Changes in Financial Position
2. True.
3. The balance sheet lists the assets, liabilities, and capital of a business entity as of a specific date, such as the last day of an accounting period or the last day of the year.
4. The statement of cash flow explains the difference between the beginning and ending cash balances. Cash flow from operations is roughly the same as income from operations plus depreciation, depletion, and adjusted for any other operating transactions that had no effect on cash during the period.
5. True.
6. All the financial statements printed by PCA reflect the current month and year-to-date amounts.
7. Standard refers to statements that PCA has already set up.
8. True.
9. False. Bellwether Garden Supply shows a net income for the current month (March 31, 2007) of \$281.23.

10. The statement of changes in financial position derives its information from *both* the income statement and the balance sheet.

SOLUTION TO EXERCISE 7-1:

1. \$502,139.54
2. \$322,421.26
3. \$281.23
4. \$64,536.07
5. \$64,254.84

SOLUTION TO EXERCISE 7-2:

1. \$51,502.64
2. \$21,283.44
3. \$48,626.99
4. \$189,037.60
5. \$217,421.26