

Introduction to Financial Statements With Sage 50 Complete Accounting Section 0120A

Presentation Objectives

The goal of this section is to present the following concepts to the reader.

1. An introduction into the four basic financial statements.
2. The sequence of the financial statements.
3. An introduction into the income statement, the statement of retained earnings, the balance sheet, and the statement of retained earnings.
4. An introduction interaction of the income statement, the statement of retained earnings, and the balance sheet.
5. An introduction to accessing the financial reports available in Sage 50 Complete Accounting.
6. An introduction into the drill down function of Sage 50 Complete Accounting.

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Copyright and Legal Protection Issues

This text section is using Sage 50 Complete Accounting and the example companies, Bellwether Garden Supply and Stone Arbor Landscaping, provided for education, personal, and professional development within that product. Sage Software, Inc. has legal protections in place such as copyrights and patents for its products. I believe I am within those boundaries when I use their included assets for the use of education, personal, and professional development in this manner.

Support File

There is a Microsoft Excel file, 0120A-Intro to Financial Statements with Sage 50 Complete Accounting, in support of this section. There are also PDF files of several companies annual shareholders' reports and SEC filings in the directory.

The Four Basic Financial Statements

There are four basic financial statements and they should always be presented in the proper, flow, presentation. The first is the income statement, occasionally called the statement of operations. The second is the statement of retained earnings. Substitutions depending on the business structure may include the statement of owner's equity for a sole proprietorship, the statement of owners' equity for a partnership, or the statement of shareholders' / stockholders' equity for corporations. All of these substitutes contain different information than the statement of retained earnings so the primary presentation within this text work will remain with the statement of retained earnings and address the substitutes appropriately. The third statement is the balance sheet followed by the fourth, and final statement, the statement of cash flows. Each will be addressed in detail.

The Sequence of the Financial Statements

The reason for the sequence of presentation is the flow of values. There are many flows and patterns in accounting and the financial statements are a presentation of one of those flows. The income statement shows revenues and expenses and presents a value, revenues less expenses, of net income. Net income flows into the

statement of retained earnings and increases the beginning balance of retained earnings to an often unidentified subtotal which is reduced by dividends, to an ending balance of retained earnings. The ending balance of retained earnings flows into the bottom right corner of the balance sheet as a portion of owners' equity. From the balance sheet assets such as Inventory and liabilities such as Wages Payable flow into the income statement to provide the initiative of clients and customers to provide your company with revenues.

Therefore, within the income statement, statement of retained earnings, and balance sheet you have a perpetual motion device. You purchase inventory, or make it, or provide a service, the client or customer compensates you at a value greater than cost for your product or service, and your company grows.

The Income Statement

The following screen print is a very simple income statement. The income statement is occasionally referred to as the statement of operations. Income statements can be formatted with some degree of latitude to meet the desires of the company so other formats are common, however, they must remain logical and clear in presentation. With a proper titling block, the first three lines of the report, you know the formal, legal name of the company, the name of the report and the date or date range of the report. For the income statement, the third line states the date range of the report, in this case, the report shows the revenues, expenses, and net income for the month ended January 31, 2015. Other common periodicity options include quarters and years. In this income statement you see revenues and expenses. With continued participation you will see gains and losses presented in the income statement. There are subtotals which are not accounts, shown on the income statement such as total revenues, gross profit, total expenses, and net income.

Miramar Student Accounting Services		
Income Statement		
For the Month Ended January 31, 2015		
Revenues		
Sales Revenues	\$12,455.00	
Total Revenues		\$12,455.00
Cost of Goods Sold		4,625.00
Gross Profit		7,830.00
Expenses		
Wages Expense	2,455.00	
Rent Expense	1,750.00	
Utilities Expense	615.00	
Depreciation Expense	545.00	
Total Expenses		5,365.00
Net Income		\$2,465.00

In this presentation, you can see that Miramar Student Accounting Services had a total of \$12,455 in Sales Revenues, a Cost of Goods Sold of \$4,625. This results in a (Sales Revenues of \$12,455 less Cost of Goods Sold of \$4,625) Gross Profit of \$7,830. Total expenses of \$5,365 reduce this gross profit of \$7,830 to \$2,465. Dividends are not an expense and therefore are not shown on the income statement.

The Statement of Retained Earnings

The statement of retained earnings has numerous acceptable substitutes, several addressed in other sections such as the statement of owner's equity for a sole proprietorship, the statement of partners' equity for partnerships, and the statement of shareholders' or stockholders' equity for corporations. The statement of retained earnings shows how the Retained Earnings account increased by period net income or decreased by period net loss and decreased by period dividends. The period net income comes from the income statement and the ending balance of Retained Earnings flows to the balance sheet. This format is simple $A + B = C - D = E$, Beginning Balance, Retained Earnings + Period Net Income = an often unidentified subtotal to show how large the company grew due to period activity. Then period dividends are deducted to result in the Ending Balance, Retained Earnings, which flows to the balance sheet.

Miramar Student Accounting Services	
Statement of Retained Earnings	
For the Month Ended January 31, 2015	
Beginning Balance, Retained Earnings	\$1,725.00
Period Net Income	2,465.00
	4,190.00
Period Dividends	425.00
Ending Balance, Retained Earnings	\$3,765.00

The Balance Sheet

The balance sheet, occasionally called the statement of financial position, shows assets, liabilities, and owners' equity. Notice the date line, the third line in the header. The balance is an "as of" report. From the first day of the company's existence the amount of cash retained through the last moment of January 31, 2015, is \$1,985. The amount of inventory available for use is \$1,250 and the amount owed to employees and creditors is \$49,635 as of the last moment of January 31, 2015. There are two common formats of the report. My preference is the book format where assets are shown on the left and liabilities and owners' equity accounts are shown on the right. This presents the accounting equation of $\text{Assets} = \text{Liabilities} + \text{Owners' Equity}$. The book format provides a hint, the principle asset accounts increase with debits, left entries, while the principle liabilities and owners' equity accounts increase with credits, right entries.

Miramar Student Accounting Services			
Balance Sheet			
January 31, 2015			
Assets		Liabilities and Owners' Equity	
Cash	\$1,985.00	Liabilities	
Inventory	1,250.00	Accounts Payable	\$385.00
Supplies	165.00	Wages Payable	1,750.00
Prepaid Insurance	395.00	Mortgage Payable	47,500.00
Land	\$45,460.00	Total Liabilities	49,635.00
Building	\$97,500.00	Owners' Equity	
Less Accumulated Depreciation	(31,250.00)	Common Stock	65,750.00
	\$66,250.00	Additional Paid-in Capital-C/S	9,495.00
Equipment	17,650.00	Retained Earnings	3,765.00
Less Accumulated Depreciation	(4,510.00)	Total Owners' Equity	79,010.00
	\$13,140.00	Total Liabilities and Owners' Equity	\$128,645.00
Total Assets	\$128,645.00		

In the report format the assets are over the liabilities and owners' equity accounts as shown here. Both formats, the book and report options, contain the same

information and values. There are numerous options regarding balance sheet presentations. Many of those will be addressed in the section on balance sheets.

Miramar Student Accounting Services	
Balance Sheet	
January 31, 2015	
Assets	
Cash	\$1,985.00
Inventory	1,250.00
Supplies	165.00
Prepaid Insurance	395.00
Land	\$45,460.00
Building	\$97,500.00
Less Accumulated Depreciation	(31,250.00)
	\$66,250.00
Equipment	17,650.00
Less Accumulated Depreciation	(4,510.00)
	\$13,140.00
Total Assets	\$128,645.00
Liabilities and Owners' Equity	
Liabilities	
Accounts Payable	\$385.00
Wages Payable	1,750.00
Mortgage Payable	47,500.00
Total Liabilities	49,635.00
Owners' Equity	
Common Stock	65,750.00
Additional Paid-in Capital-C/S	9,495.00
Retained Earnings	3,765.00
Total Owners' Equity	79,010.00
Total Liabilities and Owners' Equity	\$128,645.00

The Statement of Cash Flows

The statement of cash flows is the only financial statement based on cash flows in and out of the company in the “direct” format or the adjustments to net income and the cash flows associated with investing and financing activities in the “indirect” format. The indirect format is presented here. The statement of cash flows presentation here extremely simplified to present its logic and use. This is a range report, cash related events for the month ended January 31, 2015. Away from the title block of three lines and the reconciliation to cash in the bottom three lines, the statement of cash flows has three sections, in reverse alphabetical order – Operating, Investing, and Financing activities. Operating activities are generally associated with the everyday business activities of the company. The investing activities are normally associated with land, buildings, and equipment. The

financing activities are usually associated with the cash flows associated with capital and long-term debt issues.

Miramar Student Accounting Services		
Statement of Cash Flows		
For the Month Ended January 31, 2015		
Cash Flows from operating activities		
Net Income		\$2,465.00
Adjustments to reconcile net income to net cash provided by operating activities		
Add depreciation expense	\$545.00	
Less change in wages payable	125.00	420.00
Net Cash provided by Operations		2,885.00
Cash Flows from investing activities		
Used for purchase of equipment	1,250.00	
Net cash used in investing		1,250.00
Cash Flows from financing activities		
Proceeds from issuance of common stock	12,000.00	
Used for mortgage payable	(17,025.00)	
Net cash used in financing		(5,025.00)
Net increase <decrease> in cash		(890.00)
Cash Balance at Beg of Period		2,875.00
Cash Balance at End of Period		\$1,985.00

The Interaction of the Income Statement, the Statement of Retained Earnings, and the Balance Sheet

The screen print, provided below, shows the interactions of the income statement, the statement of retained earnings, and the balance sheet. The statement of cash flows is only linked to the beginning and ending balances of the cash accounts. We will address the flow step-by-step.

The first event to get this perpetual motion device called a company is put into motion with an investment in Common Stock, which provides cash for the company. On January 2, 2015, investors invest \$12,000 in the company in exchange for 10,000 shares of \$1 par common stock, contributing \$1.20 per share. The journal entry would look like this.

Jan 02, 2015	Cash	12,000.00	
	Common Stock		10,000.00
	Additional Paid-in Capital, Common Stock		2,000.00
	Company issued 10,000 shares of \$1 par C/S for \$1.20 per share.		

This journal entry provides a value in Cash as a debit, increasing it. The value in Common Stock is the value of par value per share times the number of shares issued, (\$1.00 par value \times 10,000 shares) \$10,000. The difference between the issued value and the par value times the number of shares issued, ($[\$1.20 - \$1.00] \times 10,000$ shares) \$2,000 is credited to Additional Paid-in Capital-Common Stock. All of these accounts are balance sheet accounts. This relationship is shown as the red arrow going from Common Stock to Cash on the balance sheet. Now the company can grow on its own activities.

Now the company must acquire Inventory, an asset which it intends to sell to its clients and customers for a value greater than the purchase cost.

Note: Cost is what we pay for items, price is what we sell items for.

On January 3, 2015, we purchase \$2,500 in inventory by paying Cash. The journal entry looks like this.

Jan 03, 2015	Inventory	2,500.00	
	Cash		2,500.00
	Purchased \$2,500 in inventory with cash.		

This journal entry, classified by some as a “converting entry” as it converts one asset into another asset (or one liability into another liability). Cash is decreased with the credit, right value while Inventory is increased with the debit, left entry. This relationship is shown on the balance sheet as the short line between Cash and Inventory.

On January 4, 2015, our company sells \$1,200 of its inventory for \$3,000 in cash. And the next interaction of accounts takes place. Using the perpetual inventory concept, the journal entry would look like this.

Jan 04, 2015	Cash	3,000.00	
	Sales Revenues		3,000.00
	Cost of Goods Sold	1,200.00	
	Inventory		1,200.00
	Sold \$1,200 in inventory for \$3,000 cash.		

The relationship works like this, Cash increased on the balance sheet by \$3,000 while Inventory decreased by only \$1,200. Therefore the total of assets increased by $(\$3,000 - \$1,200)$ \$1,800. At the moment, mid trip, our balance sheet does not balance. The next leg of this trip is Sales Revenues increases with a credit of \$3,000 on the income statement. This is reduced by the \$1,200 value of Cost of Goods Sold to provide a Gross Profit of $(\$3,000 - \$1,200)$ \$1,800. This moves through the rest of income statement to result in a net income related to this event of \$1,800.

The link of net income from the income statement to the statement of retained earnings comes into play. The net income of \$1,800 increases the Retained Earnings which flows to the owners' equity section of the balance sheet. Now the right side of the balance sheet increases by \$1,800 equalizing the difference between the cash received, \$3,000, and the inventory value of \$1,200. These relationships are shown in the flow from the income statement to the statement of retained earnings and from the statement of retained earnings to the Retained Earnings account on the balance sheet.

Another way to increase the value of the company is to render a service. You have an obligation to pay your employees on specific dates, not the dates they provide you revenue rendering services. You have an employee working as a salesman for you who earns \$15 per hour. On January 5, 2015, the salesman makes a sale of \$825 in inventory for \$2,250 in cash. This increases the value of the company by $(\$2,250 \text{ Sales Revenues} - \$825 \text{ Cost of Goods Sold})$ \$1,425 in Cash and in Retained Earnings as explained in the January 4, 2015, transaction.

Jan 05, 2015	Cash	2,250.00	
	Sales Revenues		2,250.00
	Cost of Goods Sold	825.00	
	Inventory		825.00
	Sold \$825 in inventory for \$2,250 cash.		

The expense of your employee reduces the Sales Revenues which reduces net income from this sale. Those Wages Payable increases the liabilities by an amount equal to what Wages Expense reduced net income by. This is shown by the red

arrow from Wages Payable to Wages Expense. The journal entry to record \$120 in wages earned and payable on January 6, 2015, would look like this.

Jan 06, 2015	Wages Expense	120.00	
	Wages Payable		120.00
Recorded salesman wages payable of \$120.			

Here is the partial map of accounting interactivities. The reason that the map is partial is because the number of relationships within the financial statements is almost unlimited. **HOWEVER**, they are always logical and simple if taken one step at a time. If cash had been paid for rent as Rent Expense, the left side of the balance sheet decreases by the amount of Cash and the amount of Retained Earnings is decreased by the effect of Rent Expense on Sales Revenues flowing into the statement of retained earnings and then into the owners' equity of the balance sheet. More of these relationships will be exposed as we work through the various sections of these text.

Miramar Student Accounting Services Income Statement For the Month Ended January 31, 2015			
Revenues			
Sales Revenues	\$12,455.00		
Total Revenues		\$12,455.00	
Cost of Goods Sold		4,625.00	
Gross Profit		7,830.00	
Expenses			
Wages Expense	2,455.00		
Rent Expense	1,750.00		
Utilities Expense	615.00		
Depreciation Expense	545.00		
Total Expenses		5,365.00	
Net Income		\$2,465.00	

Miramar Student Accounting Services Statement of Retained Earnings For the Month Ended January 31, 2015			
Beginning Balance, Retained Earnings		\$1,725.00	
Period Net Income		2,465.00	
		4,190.00	
Period Dividends		425.00	
Ending Balance, Retained Earnings		\$3,765.00	

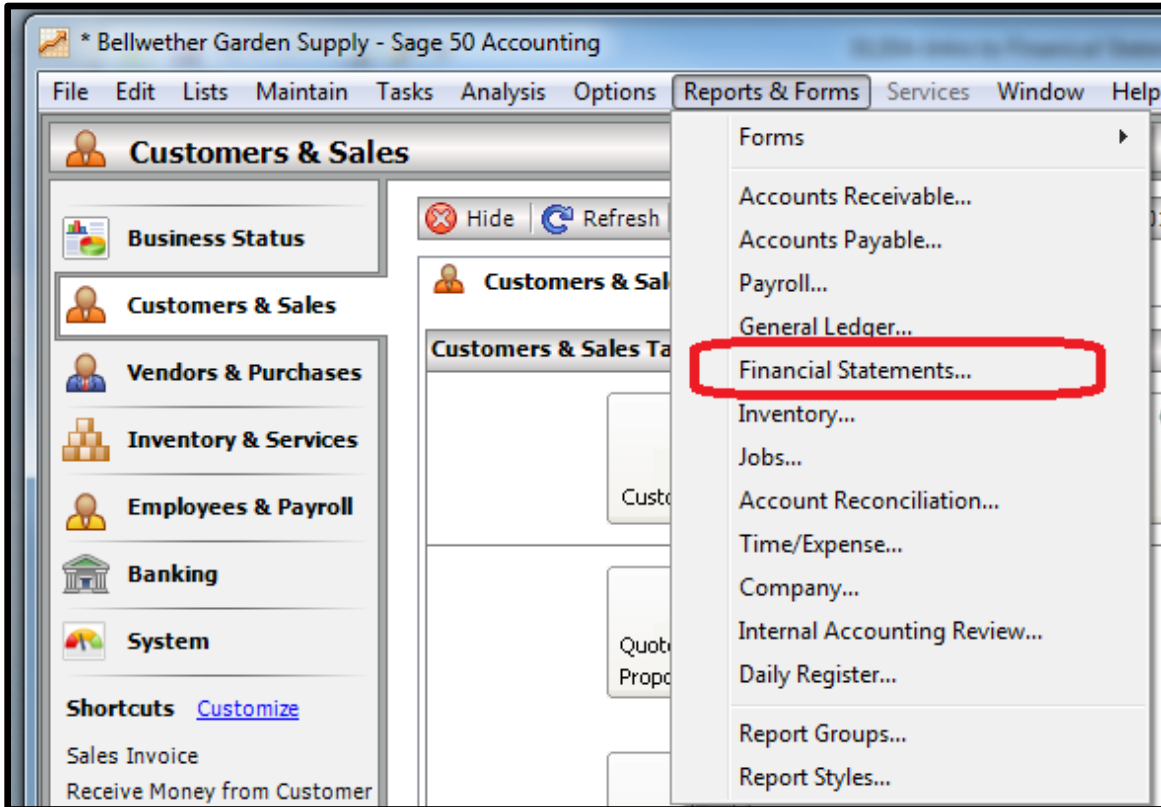
Miramar Student Accounting Services Balance Sheet January 31, 2015			
Assets		Liabilities and Owners' Equity	
Cash	\$1,985.00	Liabilities	
Inventory	1,250.00	Accounts Payable	\$385.00
Supplies	165.00	Wages Payable	1,750.00
Prepaid Insurance	395.00	Mortgage Payable	47,500.00
Land	\$45,460.00	Total Liabilities	49,635.00
Building	\$97,500.00	Owners' Equity	
Less Accumulated Depreciation	(31,250.00)	Common Stock	65,750.00
Equipment	17,650.00	Additional Paid-in Capital-C/S	9,495.00
Less Accumulated Depreciation	(4,510.00)	Retained Earnings	3,765.00
	\$13,140.00	Total Owners' Equity	79,010.00
Total Assets	\$128,645.00	Total Liabilities and Owners' Equity	\$128,645.00

The statement of cash flows explains the difference from the beginning balance and the ending balance of cash. While it is interactive the income statement, statement of retained earnings, and balance sheet, it is best kept within its own section due to two possible formats – indirect and direct, and the amount of detail. However, in a step-by-step process, the statement of cash flows is relatively easy to prepare. The very basic statement of cash flows for this example company is shown here.

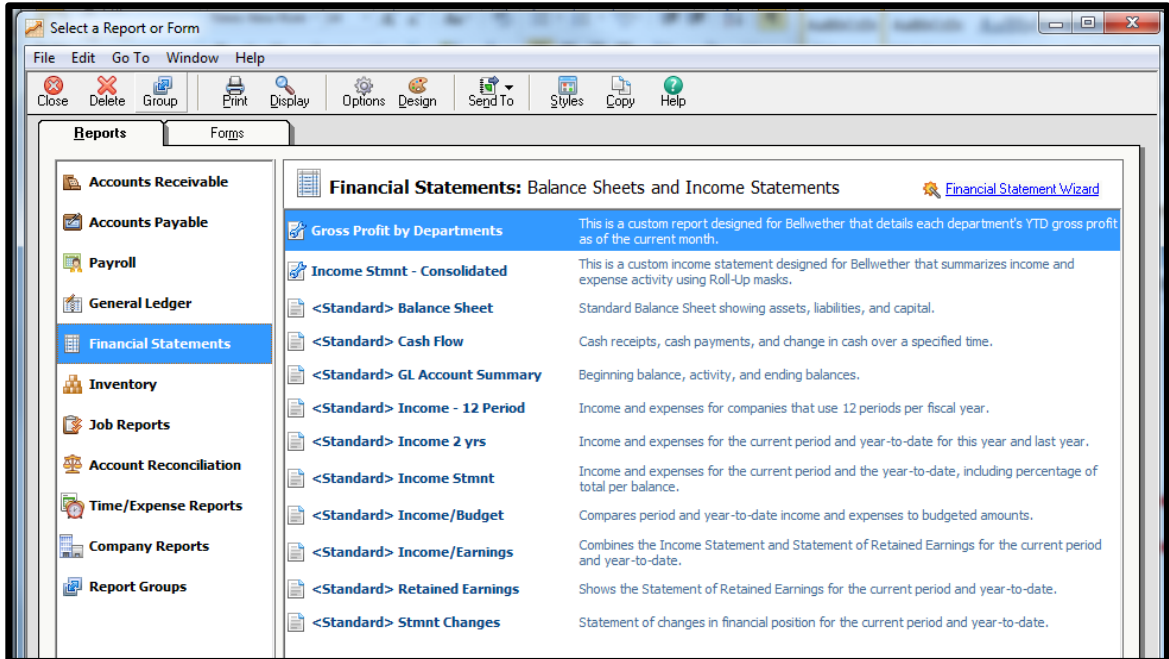
Miramar Student Accounting Services		
Statement of Cash Flows		
For the Month Ended January 31, 2015		
Cash Flows from operating activities		
Net Income		\$2,465.00
Adjustments to reconcile net income to net cash provided by operating activities		
Add depreciation expense	\$545.00	
Less change in wages payable	125.00	420.00
Net Cash provided by Operations		2,885.00
Cash Flows from investing activities		
Used for purchase of equipment	1,250.00	
Net cash used in investing		1,250.00
Cash Flows from financing activities		
Proceeds from issuance of common stock	12,000.00	
Used for mortgage payable	(17,025.00)	
Net cash used in financing		(5,025.00)
Net increase <decrease> in cash		(890.00)
Cash Balance at Beg of Period		2,875.00
Cash Balance at End of Period		\$1,985.00

Financial Statement Access in Sage 50 Complete Accounting

To access the financial statements within Sage 50 Complete Accounting click onto the Reports & Forms option on the Menu bar, then click on Financial Statements from the options on the drop-down menu.



The Select a Report or Form dialog box is shown here. Along with the titles Sage 50 Complete Accounting also provides a description of the statement, a nice feature.



The “<Standard> Income Stmtnt” is the income statement is shown in segments here. Numerous Bellwether Garden Supply financial statements have been downloaded into Microsoft Excel and placed in the Class Support Files directory for this section. This file is the 0120A-Intro to Financial Statements with Sage 50 Complete Accounting Microsoft Excel file. Of interest the column starting with “0.34” and “0.11” are vertical analysis percentages, an issue covered under financial statement analysis. This point brings forth that these statements are intended to be used as management reports.

	Current Month		Year to Date	
Revenues				
Sales	\$ 295.00	0.34	\$ 295.00	0.11
Sales - Aviary	7,127.71	8.10	51,652.86	18.40
Sales - Books	149.75	0.17	7,293.10	2.60
Sales - Equipment	17,298.91	19.65	59,652.40	21.26
Other Income				
Sales Discounts	(123.22)	(0.14)	(133.12)	(0.05)
Total Revenues	88,018.80	100.00	280,647.63	100.00
Cost of Sales				
Product Cost	(68.50)	(0.08)	(68.50)	(0.02)
Product Cost - Aviary	2,077.80	2.36	20,821.45	7.42
Product Cost - Books	14.27	0.02	2,361.37	0.84
Product Cost - Equipment	7,159.00	8.13	23,915.50	8.52
Product Cost - Food/Fert	466.30	0.53	2,127.54	0.76
Product Cost - Hand Tools	287.15	0.33	2,813.85	1.00
Product Cost - Pots	3,148.60	3.58	3,423.60	1.22
Materials Cost	1,352.45	1.54	1,352.45	0.48
Materials Cost - Nursery	5,438.40	6.18	9,668.50	3.45
Subcontractors - Landscaping	335.50	0.38	335.50	0.12
Total Cost of Sales	22,856.14	25.97	77,340.38	27.56
Gross Profit	65,162.66	74.03	203,307.25	72.44
Expenses				
Freight	0.00	0.00	50.00	0.02
Advertising Expense	1,325.00	1.51	1,325.00	0.47
Auto Expense	274.56	0.31	274.56	0.10
Payroll Tax Exp	5,138.71	5.83	15,332.15	5.46
Rent or Lease Expense	550.00	0.62	1,100.00	0.39
Repairs Expense	125.00	0.14	3,694.00	1.32
Supplies Expense	2,873.42	3.26	2,873.42	1.02
Utilities Expense	303.45	0.34	303.45	0.11
Wages Expense	44,809.52	50.91	134,428.56	47.90
Other Expense	464.90	0.53	464.90	0.17
Purchase Disc- Expense Items	(8.11)	(0.01)	(8.11)	0.00
Total Expenses	60,823.73	69.10	170,865.89	60.88
Net Income	\$ 4,338.93	4.93	\$ 32,441.36	11.56

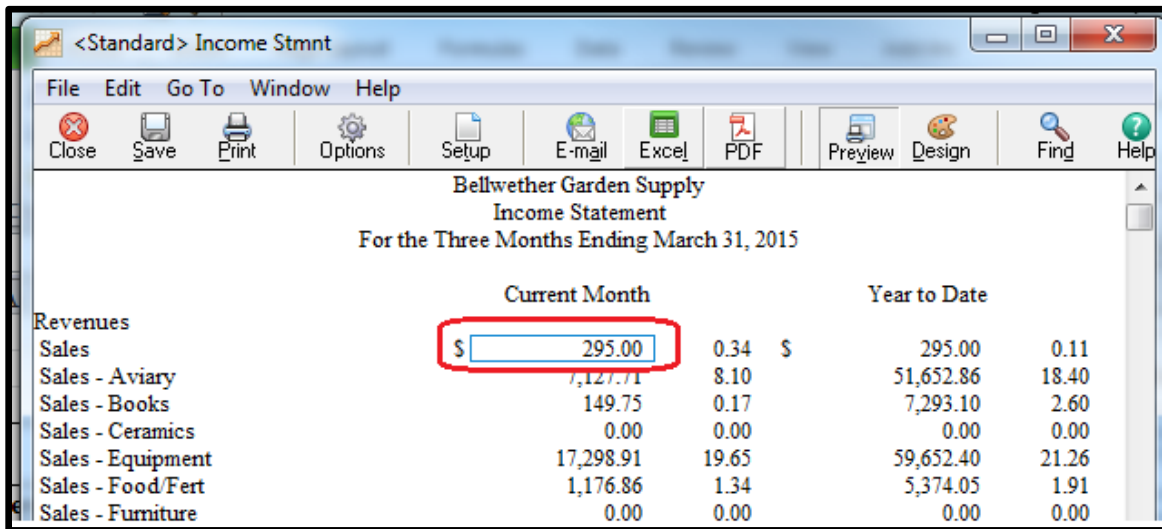
This income statement is significantly different than those you see in the published company financial statements in the Class Support Files directory. In almost all cases the financial statements are downloaded from the computerized accounting program into an application such as Microsoft Excel, Sage 50 Complete Accounting has this ability. Then they are reformatted, often to reduce or conceal detail. For example, there are nineteen lines of accounts associated with sales revenues being received. In publicly released financials these would most likely be reduced to two – “Sales Revenues” and “Other Revenues.” Sage 50 Complete Accounting provides information for management. Management will modify this information for financial statement release.

Other options in the Select a Report or Form dialog box include management rather than reports focused on publicly released financial reporting. So there are at least two categories of “financial reports.” The first is for management as it is portraying the movement of values through the company needed to make decisions and evaluate the company internally. The second is to provide the financial information which allows the company to structure its financial information for public release. Both of these concepts is based on the same information. Buying, selling, collecting, and paying activities within the company.

Feel free to explore the other report options within the Financial Statements as well as the other report or form categories.

Drill Down in Sage 50 Complete Accounting Reports

With the income statement, or most other reports and screens open in Sage 50 Complete Accounting you will often see that when you position your cursor over a value the cursor pointer will turn into a magnifying glass with a Z in the lens area. When this happens you can “drill down” into the detail that provided this value. For example, using the Bellwether Garden Supply sample company provided by Sage Software, position your cursor over the \$295.00 reported for Sales.



	Current Month		Year to Date	
Revenues				
Sales	\$ 295.00	0.34	\$ 295.00	0.11
Sales - Aviary	1,127.71	8.10	51,652.86	18.40
Sales - Books	149.75	0.17	7,293.10	2.60
Sales - Ceramics	0.00	0.00	0.00	0.00
Sales - Equipment	17,298.91	19.65	59,652.40	21.26
Sales - Food/Fert	1,176.86	1.34	5,374.05	1.91
Sales - Furniture	0.00	0.00	0.00	0.00

When your cursor changes from a pointer to the magnifying glass with the Z in the lens double-click the value. Sage 50 Complete Accounting will “drill down” to the Sales general ledger account as shown here.

Bellwether Garden Supply
General Ledger
For the Period From Mar 1, 2015 to Mar 31, 2015

Filter Criteria includes: 1) IDs from 40000 to 40000. Report order is by ID. Report is printed with shortened descriptions and in Detail Format.

Account ID	Account Description	Date	Reference	Jrnl	Trans Description	Debit Amt	Credit Amt	Balance
40000		3/1/15			Beginning Balance			
Sales		3/2/15	CH31703	CRJ	Kenton Golf and T		150.00	
		3/5/15	CH5000	CRJ	Holland Properties		25.00	
		3/14/15	10341	SJ	Chapple Law Offic		35.00	
		3/15/15	10339	SJ	Armstrong Landsc		50.00	
		3/15/15	10340	SJ	Franklin Botanical		35.00	
					Current Period Ch		295.00	
		3/31/15			Ending Balance			-295.00

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Sage Software, Inc.

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Adobe Systems Incorporated

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<http://get.adobe.com/reader/?promoid=KLXME>

Their contact information is Adobe Systems Incorporated, 345 Park Avenue, San Jose, CA 95110-2704.

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