Introduction to Retained Earnings Statement With Sage 50 Complete Accounting Section 0140A

Presentation Objectives

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

1. Recap of the flow of the four basic financial statements.
2. Recap accessing Sage 50 Complete Accounting financial reports.
3. An introduction into retained earnings statement basics.
4. Adjustments to date within Sage 50 Complete Accounting.
5. An introduction cash dividends.
6. An introduction stock dividends.
7. Alternative statements to the retained earnings statement.

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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, 0140A-Intro to the Retained Earnings Statement with Sage 50 Complete Accounting-2015-01-01, in support of this section. There are also PDF files of several companies annual shareholders' reports and SEC filings in the directory.

The Flow of the Four Basic Financial Statements

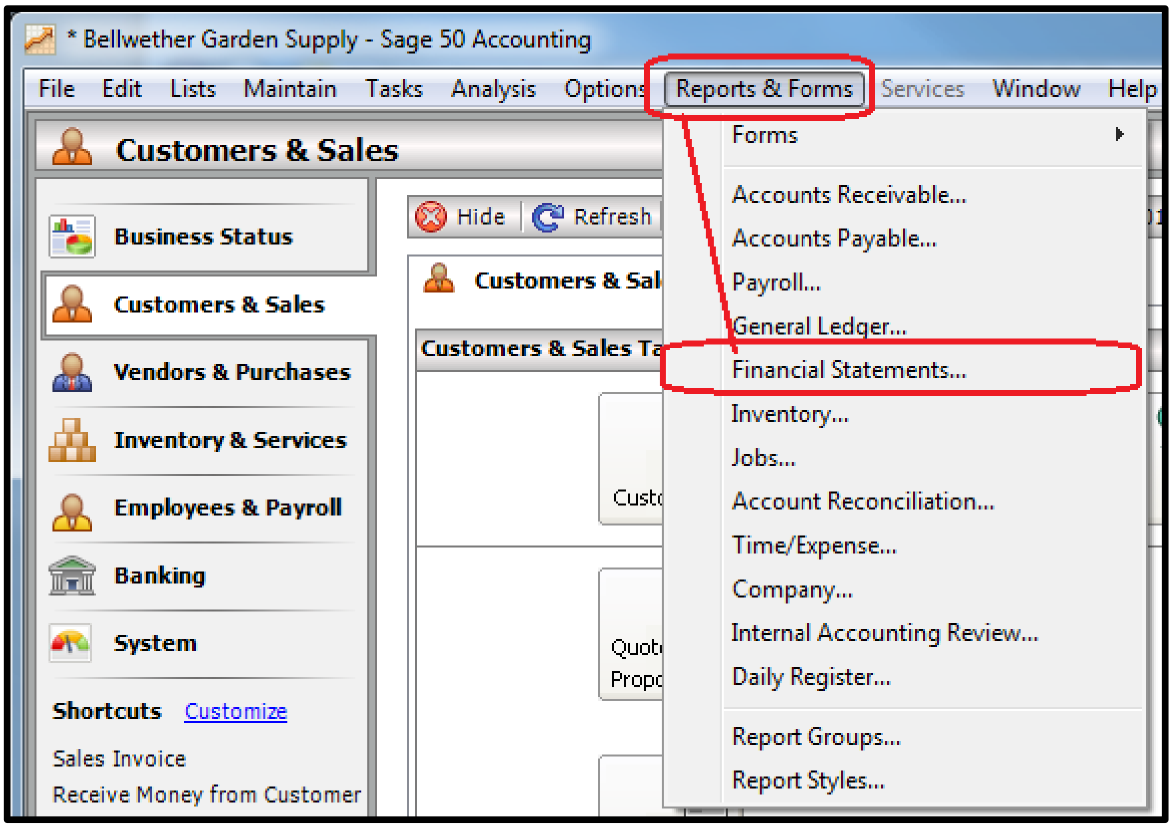
As presented in the 0120 series, Intro to Financial Statements with Sage 50 Complete Accounting, there are four financial statements and they flow in a sequence of the income statement, the retained earnings statement, balance sheet, and the statement of cash flows. The income statement and balance sheet have rather intense interactions passing through the statement of retained earnings as shown in the 0120 series. Computerized accounting applications such as Sage 50 Complete Accounting are primarily management and data manipulation tools. This is not a negative comment, the primary activity of management is to manage, not report, and presented information needs to be of assistance in that process. The output of these systems frequently does not meet the needs or desires for publicly released financial statements. If you look at the several of the reference files for company reporting in the Class Support Files directory you will see that the financials are "comparative," showing more than one year in all reports. This comparative presentation is usually done outside of the computerized accounting package in use by the company, often within an application such as Microsoft

Excel. This is most likely one of the reasons Sage 50 Complete Accounting has export tools to Microsoft Excel in almost all reports.

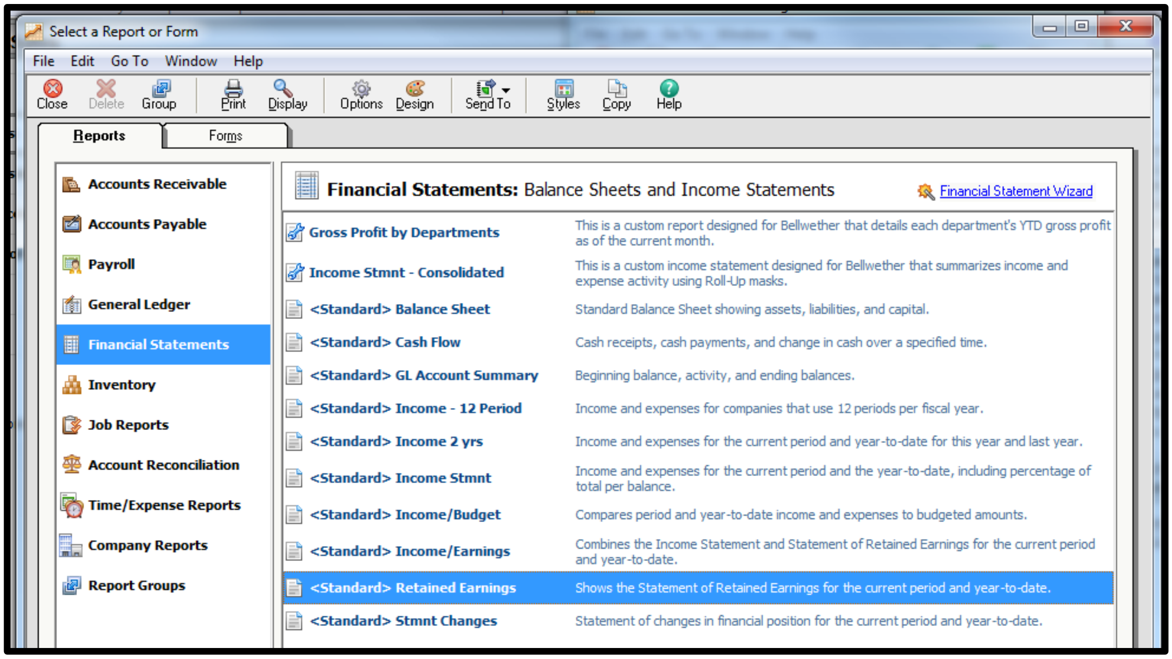
In this section we will look at several of the income related reports of Sage 50 Complete Accounting. I have downloaded many of them and saved them in the 0140A-Intro to the Retained Earnings Statement with Sage 50 Complete Accounting reference file. Only portions of them are reprinted here.

Accessing Sage 50 Complete Accounting Financial Reports

By clicking on Forms & Reports of the menu bar of Sage 50 Complete Accounting you will attain access to the drop-down menu options.



Click on the Financial Statements option to access the various financial statements available within Sage 50 Complete Accounting.



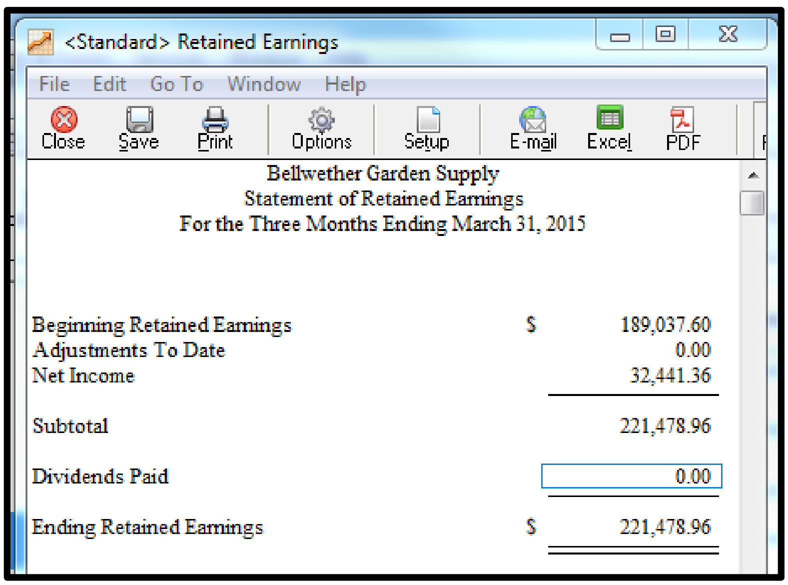
Within Sage 50 Complete Accounting there is one preformatted retained earnings statement option. The “<Standard>” in front of it lets you know that this is preformatted. You have the ability within Sage 50 Complete Accounting to create your own reports and establish the formats within some limits. All of these standard reports are actually reports focused on the needs of management presenting information for decision-making. The retained earnings statement for Bellwether Garden Supplies has been exported into the Microsoft Excel reference file, 0140A-Intro to the Retained Earnings Statement with Sage 50 Complete Accounting. It may have been slightly reformatted for easier reading and display.

Retained Earnings Statement Basics

The basics of the retained earnings statement is the presentation of Beginning Retained Earnings balance, any Adjustments to Date due to prior fiscal period issues followed by the period Net Income. These values are summed on the Subtotal line. In many other applications reports and in numerous textbook accounting textbooks this subtotal will not be labeled. From the subtotal Dividends Paid are deducted to the Ending Retained Earnings balance. This is a basic formula you will see in accounting, A + B = C – D = E. Restated as Beginning Balance + Increases = the high point – Costs or Expenses = Ending Balance.

The retained earnings statement follows the same header rules as the income statement and statement of cash flows. The first and second lines of the header are absolutes. The first line is the full, legal, name of the company. This cannot be changed or abbreviated. If the company's name is Miramar Student Accounting Services Incorporated, you cannot abbreviate it in the title line to Miramar Student Accounting Services Inc. because you feel it is too long to spell it out. For publicly traded companies the best location of the names is on the SEC filed reports. The second line will be the title of the report, such as Retained Earnings Statement or Statement of Retained Earnings.

The third line has some variations due to presentations. If only one fiscal period such as month, quarter, semi-annual period, or year is presented for management use the third line may read such as "For the Month Ended January 31, 2015." For publicly released financials, which are comparative, the third line may read "For the Year Ended December 31" with the years posted over the columns representing their values. The <Standard> Retained Earnings statement from Bellwether, shown here, has the third line of "For the Three Months Ending March 31, 2015."



Adjustments to Date

The Adjustments to Date are for the corrections of errors in prior periods. While the details are subject of higher level courses, here is a brief introduction to the logic. There are basically three types of errors in the financials for this consideration. One in which involves an expense account and an asset account. In this situation you either did not record enough expense or you recorded too much expense. Assume that Scenario A is the correct presentation of expenses and assets while Scenario B is recording too much expense which understates your assets and Scenario C is recording too little expense which overstates your assets.

The Scenario A journal entry, correctly, looks like this.

Jan 31, 2015	Insurance Expense	25.00	
	Prepaid Insurance		25.00
	Adjusting entry - Prepaid Insurance (Correct)		

The Scenario B journal entry, overstating Insurance Expense by $10 would look like this.

Jan 31, 2015	Insurance Expense	35.00	
	Prepaid Insurance		35.00
	Adjusting entry - Prepaid Insurance (Overstating expense by $10)		

The Scenario C journal entry, understating Insurance Expense by $10 would look like this.

Jan 31, 2015	Insurance Expense	15.00	
	Prepaid Insurance		15.00
	Adjusting entry - Prepaid Insurance (Understating expense by $10)		

The result is this on the same amount of revenues. Net Income in Scenario A is correctly stated, Net Income in Scenario B is understated by $10 due to the overstatement of Insurance Expense, and Net Income in Scenario C is overstated by the $10 understatement of Insurance Expense.

	Scenario A	Scenario B	Scenario C
Revenues	$100	$100	$100
Insurance Expense	25	35	15
Net Income	$75	$65	$85

These values flow into the statement of retained earnings.

	Scenario A	Scenario B	Scenario C
Beginning Balance	$60	$60	$60
Net Income	75	65	85
Subtotal	135	125	145
Dividends	15	15	15
Ending Balance	$120	$110	$130

The ending balance of retained earnings is correct for Scenario A. Since Net Income is understated in Scenario B the ending balance of retained earnings is overstated by the amount of the error, $10. With Net Income overstated in Scenario C the ending balance of retained earnings is understated by the amount of the error, $10.

Since there is a flow-through issue between assets, liabilities, owners' equity, revenues, and expenses, the balance sheet is also incorrect. The continued flow looks like this.

	Scenario A	Scenario B	Scenario C
Assets			
Cash	$2,200	$2,200	$2,200
Prepaid Insurance	250	240	260
Total Assets	$2,450	$2,440	$2,460
Liabilities	$1,000	$1,000	$1,000
Owners' Equity			
Common Stock	1,330	1,330	1,330
Retained Earnings	120	110	130
Total Owners' Equity	1450	1,440	1,460
Total Lia and OE	$2,450	$2,440	$2,460

Therefore, there are two errors in each column. Prepaid Insurance is misstated and Retained Earnings is misstated. You cannot correct this by increasing or decreasing the following period's Insurance Expense as that affects that period's net income. Therefore, on the first day of the earliest fiscal period still open you write a journal entry that looks like this for Scenario B.

Feb 1, 2015	Prepaid Insurance	10.00	
	Retained Earnings		10.00
	Correcting entry - Prepaid Insurance (Overstating expense by $10)		

This journal entry reduces Prepaid Insurance by the $10 that should have been in addition to the first Scenario B adjusting entry of $15 bring Prepaid Insurance up to $250 at the beginning of the fiscal period and increasing Retained Earnings by the same $10 value, the differential shown in the preceding tables.

Had you made the error shown in Scenario C, Prepaid Insurance and Retained Earnings are both overstated by the $10 error. Therefore, on the first day of the earliest fiscal period still open you write a journal entry that looks like this for Scenario C.

Feb 1, 2015	Retained Earnings	10.00	
	Prepaid Insurance		10.00
	Correcting entry - Prepaid Insurance (Understating expense by $10)		

With these journal entries the retained earnings statement looks like this.

	Scenario A	Scenario B	Scenario C
Beginning Balance	$120	$110	$130
Adjustment		10	(10)
Net Income (Period 2)	90	90	90
Subtotal	210	210	210
Dividends (Period 2)	30	30	30
Ending Balance	$180	$180	$180

The “adjustment” from the correcting entry first corrects the incorrect beginning balance, then the Period 2 Net Income is added the Period 2 Dividends are deducted. On the balance the results are this.

	Scenario A	Scenario B	Scenario C
Assets			
Cash	$2,450	$2,450	$2,450
Prepaid Insurance	225	225	225
Total Assets	$2,675	$2,675	$2,675
Liabilities	$1,165	$1,165	$1,165
Owners’ Equity			
Common Stock	1,330	1,330	1,330
Retained Earnings	180	180	180
Total Owners’ Equity	1,510	1,510	1,510
Total Lia and OE	$2,675	$2,675	$2,675

Now Prepaid Insurance and Retained Earnings are correct.

The second correcting entry is where an asset such as Factory Equipment is entered as Office Equipment with an incorrect journal entry such as this.

Jan 15, 2015	Office Equipment	25,000.00	
	Cash		25,000.00
	Purchased factory equipment with cash		

In this case, if Depreciation Expense was correct so Accumulated Depreciation is correct, the correcting journal entry does not affect Retained Earnings and looks like this.

Feb 1, 2015	Factory Equipment	25,000.00	
	Office Equipment		25,000.00
	Correcting entry - Purchased factory equipment with cash		

If Accumulated Depreciation is kept to detail in accounts such as Accumulated Depreciation – Office Equipment and Accumulated Depreciation – Factory Equipment you will have to write a journal entry to reposition that value which might look like this.

Feb 1, 2015	Accum Depreciation - Office Equipment	1,000.00	
	Accum Depreciation - Factory Equipment		1,000.00
	Correcting entry – Accum Depreciation Office to factory equipment		

Cash Dividends

Dividends are not an expense, consider them a reward to the investors for taking the risk of ownership. They do not affect net income so they do not belong on the income statement. As accountants we like to show and stress the good before addressing the not so good. Dividends are not bad, without dividends or stock value growth investors would not invest in many companies. With this “good then not so good” concept we show how big the company grew with that Subtotal value. Then we deduct Dividends to attain the Ending Balance Retained Earnings.

The value of Dividends on the retained earnings statement is the dividends declared in the fiscal period, not the dividends paid. With a simple, common stock only, structure there are three dates and two journal entries associated with dividends. The first is the date of date of declaration which makes the first journal entry a requirement. Assume on January 9, 2015, the company declares a $1.00 dividend on each of its 100 shares of common stock outstanding. At this point the company has a legal obligation to pay those dividends. This is a liability. The appropriate journal entry would look like this.

Jan 9, 2015	Dividends	100.00	
	Dividends Payable		100.00
	Declared $1 dividend on 100 shares of common stock		

The Dividends account is a contra equity account and carries a normal debit, left hand, balance. The Dividends Payable account is a liability account with a normal credit, right hand balance. Dividends is a retained earnings statement account while Dividends Payable is a balance sheet account.

The second date is the date of record. This date, assume January 16, 2015, is announced with the declaration of dividends. Those individuals and investment groups which own the stock on the last moment of the date of record will receive the dividends even if they sell the dividends at a later date. No journal is required for the date of record.

The third date and the second journal entry is made on the date of distribution or payment, which is also announced on the date of declaration. Assume this is January 26, 2015. The date of distribution or payment journal entry would look like this.

Jan 26, 2015	Dividends Payable	100.00	
	Cash		100.00
	Declared $1 dividend on 100 shares of common stock		

These are both balance sheet accounts with Cash, being an asset, carrying a normal debit balance and Dividends Payable, a liability account carrying a normal credit balance.

Stock Dividends

Stock dividends are distributions of retained earnings without distributing cash. Investors are usually after dividends, stock value growth, or both dividends and stock value growth as a reward for their accepting the risk of investing. There are times when the company has substantial values in Retained Earnings and does not have or does not want to distribute cash dividends. Stock Dividends may be the answer. Working with a concept of small stock dividends, less than 20% of the value of stock outstanding, this is down at current market price of the stock. Assume the company has 100 shares of common stock outstanding with a par value of $1.00 per share. This value is an important reference value.

The company declares a stock dividend of 10% when market trading value of the company's stock is $12.00 per share. Date of declaration is January 16, 2015, date of record is January 20, 2015, and date of distribution, not date of payment since no cash is being paid, is January 26, 2015.

First, compute the values. The company is distributing (100 shares of common stock outstanding × 10%) 10 shares of stock. The par value of this total distribution is (10 shares × $1.00 par value per share) $10.00. The Additional Paid-in Capital, Common Stock will be [($12.00 market - $1.00 par) × 10 shares) $110.00. The total value, as part of the double-check process is ($12.00 market value per share × 10 shares) $120.00 which equals the par value of $10.00 plus the Additional Paid-in Capital, Common Stock of $110.00. So we are pretty sure we have the numbers right.

The first journal occurs on the date of declaration. Since a stock dividend will not be resolved with cash and affect Common Stock, Additional Paid-in Capital, Common Stock, and Stock Dividends, the journal entry is a bit different. It looks like this.

Jan 16, 2015	Stock Dividends	120.00	
	Additional Paid-in Capital-Common Stock		110.00
	Stock Dividends Distributable		10
	Declared a 10% stock dividend on 100 shares at market value of $12		

Stock Dividends is a contra owners' equity account while Stock Dividends Distributable is an owners' equity account or adjunct owners' equity account. It is not a liability. The "middle value" of $110 can go to Additional Paid-in Capital, Common Stock on the date of declaration as Additional Paid-in Capital, Common

Stock does not vote. And, Common Stock does but it cannot vote until distributed so it must be held in the Stock Dividends Distributable account of owners' equity.

On the date of record, no journal entry is appropriate. The holders of the common stock on the last moment of this date, January 20, 2015, will receive the stock dividends on January 26, 2015. On January 26, 2015, the journal entry converts the Stock Dividends Distributable to Common Stock as shown in this journal entry.

Jan 26, 2015	Stock Dividends Distributable	10.00	
	Common Stock		10.00
	Declared a 10% stock dividend on 100 shares at market value of $12		

At this point in time the common stock can be voted by the receivers, the owners from the date of record.

Alternative Statements to the Retained Earnings Statement

While the retained earnings statement is the primary statement between the income statement's nominal or temporary accounts and the permanent or real accounts of the balance sheet there are options available. In formal financial reporting these are usually found as additional statements.

Statement of Owner's Equity

The statement of owner's equity is singular possessive in nature and therefore associated with a sole proprietorship. It contains the same requirements for the first three lines, full, legal name, title of the report, and the date line. Following the header it may have the A + B = C – D = F format for investments and drawings or withdrawals, the term for dividends in sole proprietorship businesses. This report may look like this.

Miramar Student Accounting Services
Statement of Owner's Equity
For the Month Ended January 31, 2015

Beginning Balance, Capital	$25,000
Period Net Income	4,750
	29,750
Withdrawals	2,250
Ending Balance, Capital	27,500

Depending on the preferences of the owner or the author of the textbook, there may be variances of this format. It is not an SEC formatted report.

Statement of Owners' Equity

The statement of owners' equity is plural possessive in nature and therefore associated with partnerships. It contains the same requirements for the first three lines, full, legal name, title of the report, and the date line. Following the header it may have the A + B = C – D = F format for investments and drawings or withdrawals, the term for dividends in partnership businesses. This report may look like this.

Miramar Student Accounting Services
Statement of Owners' Equity
For the Month Ended January 31, 2015

Beginning Balance,			
Capital	Andy	Bobby	Dana
	$20,000	$18,000	$21,000
Period Net Income	$24,750		
	8,250	8,250	8,250
Subtotal	28,250	26,250	29,250
Drawings	2,500	1,750	3,000
Ending Balance,			
	$25,750	$24,500	$26,250

Depending on the preferences of the owners or the author of the textbook, there may be variances of this format. It is not an SEC formatted report.

Statement of Shareholders' / Stockholders' Equity

The statement of shareholders' or stockholders' equity is plural possessive in nature for corporations. Its format is not an SEC requirement. It is frequently formatted into contributed capital and retained earnings in this type of format.

Miramar Student Accounting Services, Incorporated
Statement of Shareholders' Equity
For the Month Ended January 31, 2015

Contributed Capital		
Preferred Stock	$250,000	
Additional Paid-in Capital, P/S	45,000	$295,000
Common Stock	1,750,000	
Additional Paid-in Capital, C/S	440,000	2,190,000
Total Contributed Capital		2,485,000
Retained Earnings		375,000
Total Shareholders' Equity		$2,860,000

Depending on the preferences of the company or the author of the textbook, there may be variances of this format. It is not an SEC formatted report.

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