Statement of Changes in Owner's Equity

by Sophia

WHAT'S COVERED

This tutorial will cover the statement of changes in owner's equity.

Our discussion breaks down as follows:

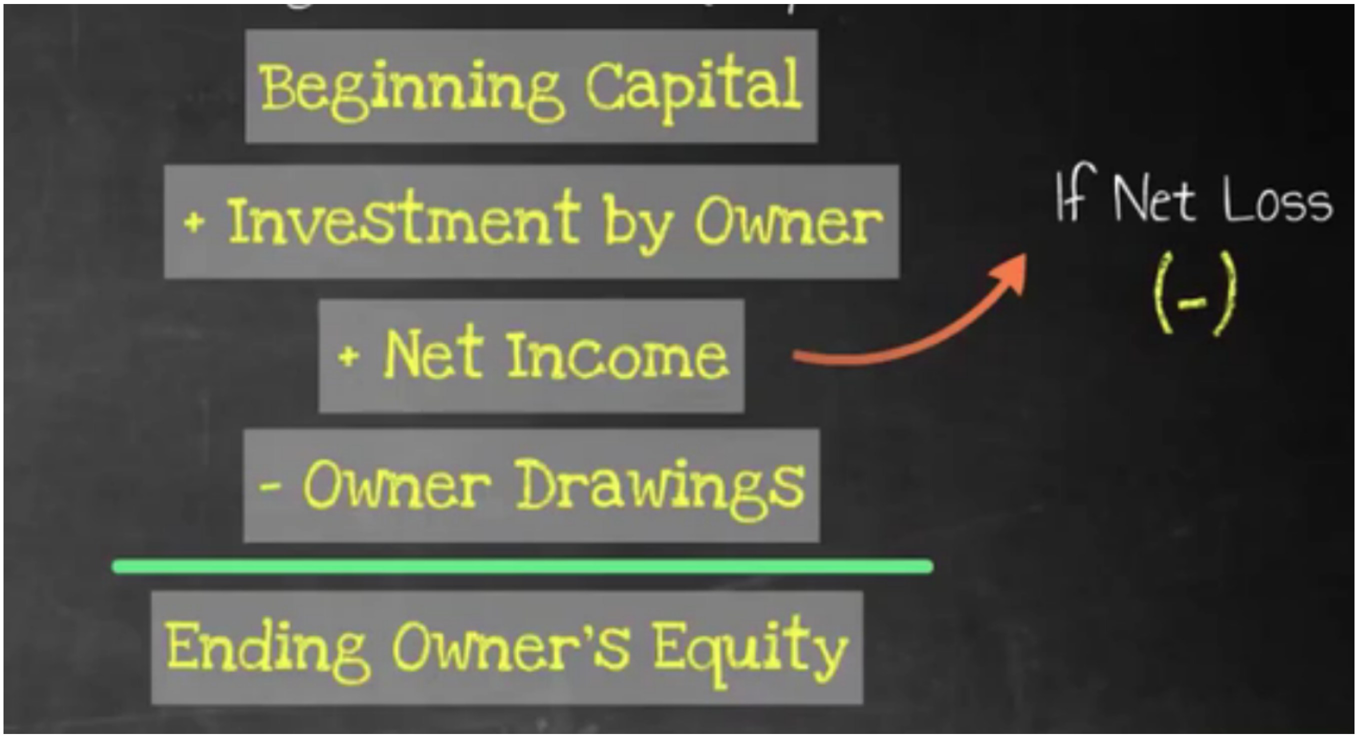
1. Statement of Changes in Owner's Equity

You may recall that **financial statements** are reports providing financial information about a business at a given time.

The **statement of changes in owner's equity**, then, is a financial statement that provides information about changes to the equity of the business for a given time period. It can also be referred to as the statement of retained earnings.

So, what is owner's equity? Well, it refers to owner activity--activity such as income, draws, or loss. Typically, the statement of changes in owner's equity involves one year or less of an activity period, detailing the changes in owner's equity for that time period, similar to the income statement.

The formula for the statement of changes in owner's equity starts with the beginning capital, or the beginning balance in owner's equity at the beginning of the year. Then, we add any investments by the owner, plus any net income that the business might have earned, and then subtract owner drawings, meaning any money that the owner or owners pulled out of the business. This results in the ending owner's equity, or the ending balance in the owner's equity account.



Now, if we have a net loss instead of having net income, we would have to subtract the net loss in this formula instead of adding that income.

FORMULA TO KNOW

Statement of Changes in Owner's Equity

$$\textit{Ending Owner's Equity} = \textit{Beginning Capital} + \textit{Investment by Owner} + \textit{Net Income} - \textit{Owner Drawings}$$

TERMS TO KNOW

Financial Statements

Reports providing financial information about a business at a given time.

Statement of Changes in Owner's Equity

A financial statement that provides information about changes to the equity of a business for a given time period.

---

2. Statement of Changes in Owner's Equity vs. Income Statement and Balance Sheet

Next, let's compare the statement of changes in owner's equity with the income statement and the balance sheet.

The income statement reflects a period of time, which is similar to the statement of changes in owner's equity in that it is activity-based. The statement of changes in owner's equity reflects the change in the equity balance.

The balance sheet reflects a point in time, which is also similar to the statement of changes in owner's equity, because we are trying to get to the ending equity balance, which feeds into our balance sheet.

The income statement contains the net income or loss, which feeds into statement of changes in owner's equity, as you can see in the formula in the previous section. The balance sheet contains ending owner's equity, so the statement of changes in owner's equity feeds to the balance sheet.

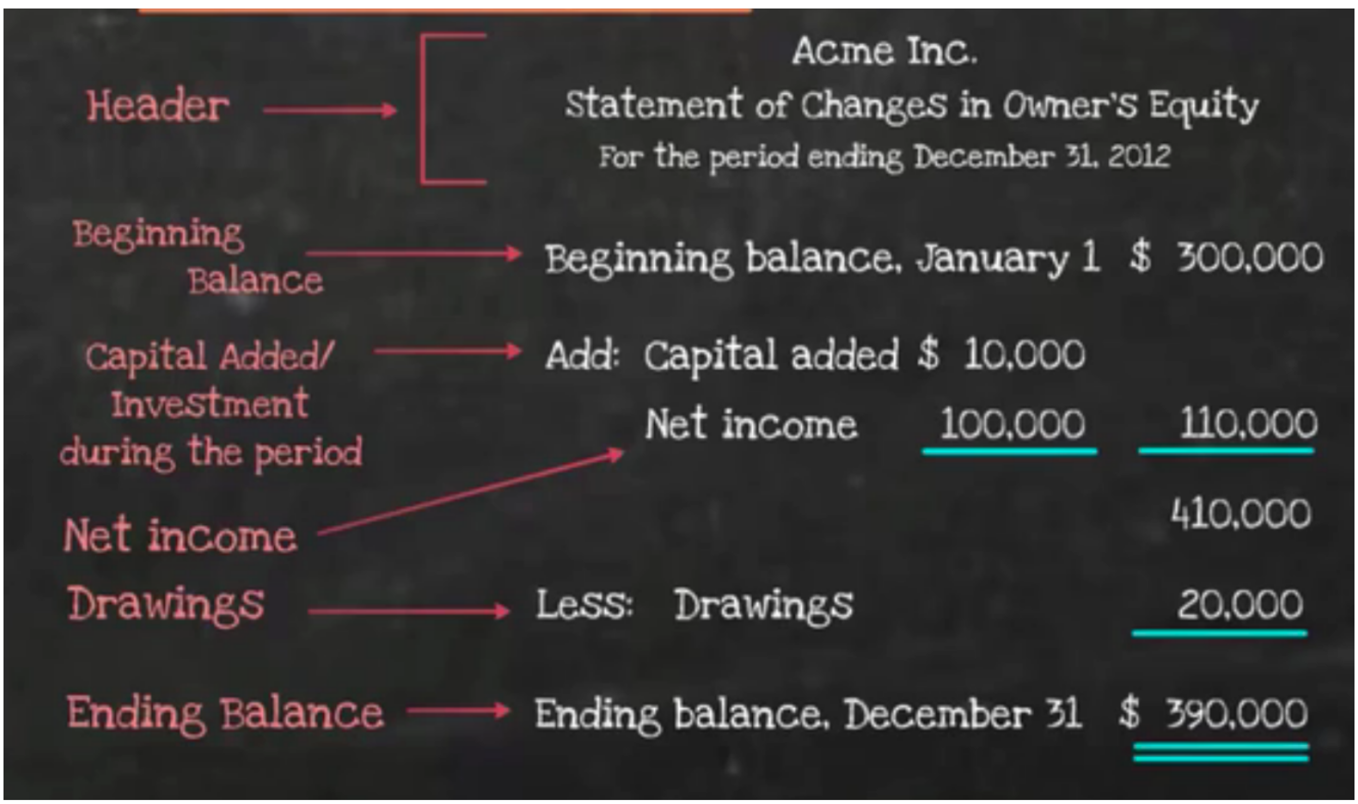
BIG IDEA

The statement of changes in owner's equity feeds *from* the income statement and feeds *to* the balance sheet.

---

3. Statement of Changes in Owner's Equity: Examples

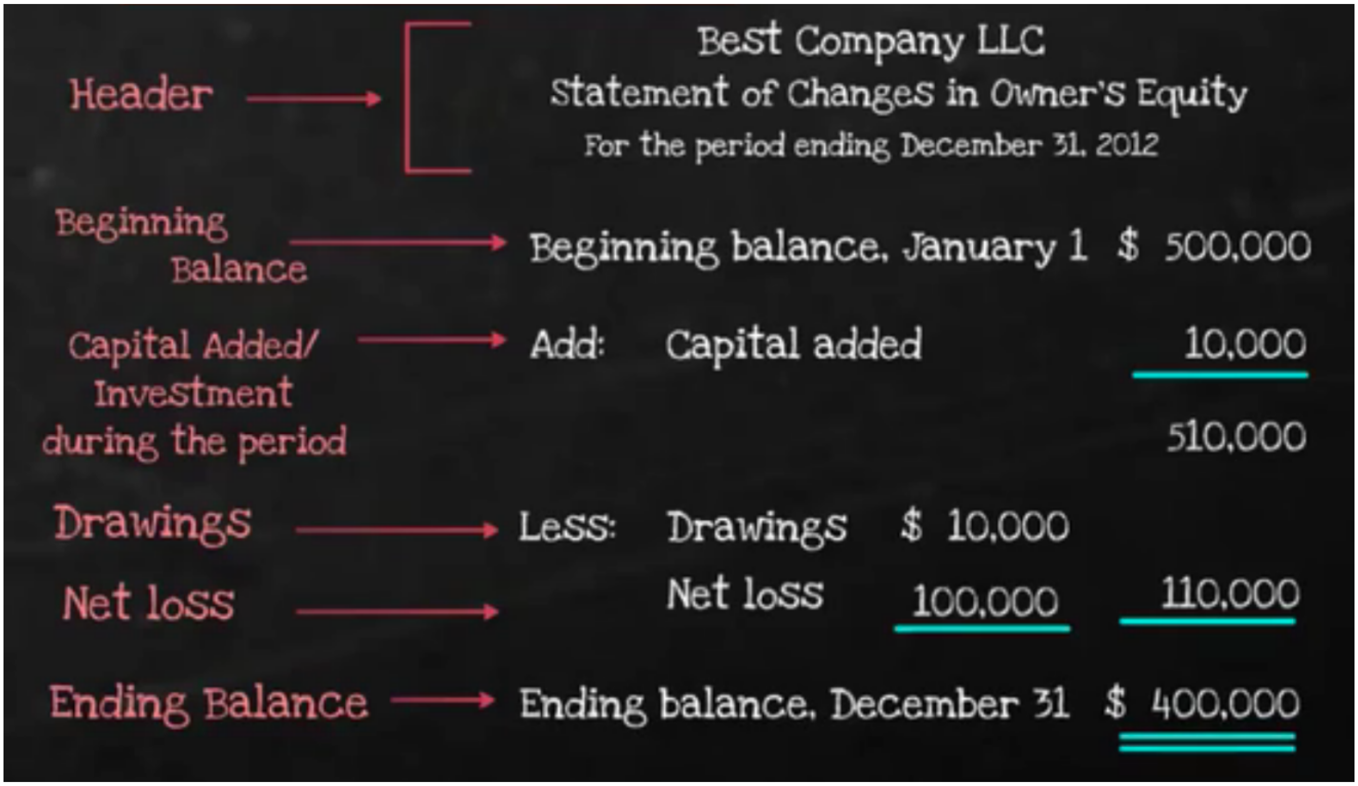
Let's look at two examples of preparing a statement of changes in owner's equity.



- We start with the header, which includes the company name, the name of the statement--"Statement of Changes in Owner's Equity"--and, similar to the income statement, "For the period ending...", in this case, December 31, 2012, because it is activity-based.
- Next, we identify our beginning balance at the beginning of the year.

- We input any capital added or investment made during the period, such as if the owners put money into the business.
- We add any net income.
- Take all of the additions, $110,000 in this case, and add it to the beginning balance, to arrive at a total of $410,000.
- Next, subtract any drawings to arrive at our ending balance at the end of the year. Note, if we had a net loss, it would go there as well, but in this case, we had net income, so as of December 31, we had a balance of $390,000 in our owner's equity.

Let's look at a second example of the statement of changes in owner's equity.



- Again, we have our header--business name, "Statement of Changes in Owner's Equity," and "For the period ending December 31, 2012," because it's an activity-based statement.
- We start with our beginning balance at the start of the year.
- Input any capital added or investments made during the period.
- In this case, there is no net income to add, so we make a subtotal.
- Then, we subtract our drawings. In this case, we have a net loss, so we include this with our subtractions to arrive at our ending balance at the end of the year of $400,000.

SUMMARY

Today we learned about the **statement of changes in owner's equity**, which is a financial statement that provides information about changes to the equity of a business for a given time period. Keep in mind that it is period- or activity-based. We also compared the **statement of changes in owner's equity vs. the income sheet and balance sheet**. Remember, the statement of changes in owner's equity feeds information to the balance sheet and gets information from the income statement. Lastly, we examined two **examples of a statement of changes in owner's equity**.

Source: Adapted from Sophia instructor Evan McLaughlin.

TERMS TO KNOW

Financial Statements
Reports providing financial information about a business at a given time.

Statement of Changes in Owner's Equity
A financial statement that provides information about changes to the equity of a business for a given time period.