

# CH 1 — Financial Statements

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## The order (ascending)

1) Income Statement (during the year) — a.k.a. Statement of profit and loss

- Income = revenues and gains
- Expenses and losses
- Net income:

$$\text{Revenues} + \text{Gains} - \text{Expenses} - \text{Losses}$$

*Example — mini format*

ABC Corporation	
Income Statement	
Net sales	XX,XXX
Other revenue	+X,XXX
<b>Total revenues</b>	XX,XXX
Cost of goods sold	(XX,XXX)
<b>Gross margin</b>	XX,XXX
Selling, general, and administrative	(XX,XXX)
Income from operations	XX,XXX
Interest expense	(X,XXX)
Income before income taxes	XX,XXX
Income tax expense	(X,XXX)
<b>Total Income</b>	(X, XXX)

2) Statement of Retained Earnings (during the year)

- Positive balance indicates cumulative revenues exceeded expenses
- Negative suggests a problem
- Ending retained earnings:

$$\text{Beg. RE} + \text{Net Income} + \text{OCI} - \text{Dividends} = \text{End. RE}$$

- End. RE carries to equity section of the balance sheet

*Example — mini format*

ABC Corporation	
Statement of Retained Earnings	
For the Year Ended December 31, 20X2	

Retained earnings, December 31, 20X1	XX,XXX
Plus: Net income	+X,XXX
Less: Dividends	(X,XXX)
<b>Retained earnings, December 21, 20X1</b>	<b>(XX,XXX)</b>

### 3) Balance Sheet (end of the year)

- Owner's equity = shares + retained earnings
- Assets
  - **Current assets:** expected to convert to cash, be sold, or consumed within one year
    - cash and cash equivalents
    - short-term investments
  - **Non-current assets:** held longer than a year
    - land, building, equipment
    - intangibles
    - long-term investments
- Basic equation:

$$\text{Assets} = \text{Liabilities} + \text{Shareholders' Equity}$$

- Owns = Owes

### Properties of each statement

Question	Financial Statement	Answer
How much income did the company earn <b>during</b> the year?	Income statement	Revenues + gains – Expenses – losses Net income or net loss
Why did retained earnings change <b>during</b> the year?	Statement of retained earnings	Beg. retained earnings + Net income + Other comprehensive income – Dividends = End. retained earnings
What is the company's financial position <b>at the end</b> of the year?	Balance sheet	Assets = Liabilities + Owners' equity
How much cash was generated and spent <b>during</b> the year?	Statement of cash flows	Operating cash flows ± Investing cash flows ± Financing cash flows Change in cash

### Some definitions

	Proprietorship	Partnership	Corporation
Owner(s)	Proprietor – one	Partners – two or more	Shareholders – usually many
Personal liability of owner(s) for business debts	Proprietor is personally liable	Partners are usually personally liable	Shareholders are <b>not</b> personally liable