Financial Statements

LESSON 15

What are Financial Statements?

Financial statements are reports that give a detailed picture of a business's financial status for a given period of time. Financial statements detail changes in a business's financial status. Study of financial statements can tell a business owner whether the business is on a successful path or if there are financial troubles ahead. Two of the most common financial statements are the income statement and the balance sheet.

The Income Statement

An income statement is a report that outlines projected business revenue and projected business expenses for a given period of time. Revenue is the money collected for products sold by a business. The difference between revenue and expenses is the business's profit. This statement, also known as the P and L (profit and loss), is the most frequently used financial statement. It is your main "scorecard" for projecting profit or loss for a specified period of time—a month, three months, or a year. When business owners refer to the "bottom line," they're talking about the bottom line of the income statement: profit. Profit is the money made by a business once costs and expenses have been deducted from the revenue. The information contained in an income statement will tell a business owner how well his or her business is doing. There are many components of an income statement:

Main Idea

Business owners must have accurate and timely information about the financial status of their business to make the best decisions. Most of this financial information is derived from financial statements. Well-prepared financial statements can provide a guide for getting the business started and for keeping it on a successful path.

After completing this lesson you will be able to:

- Define the components of an income statement
- Identify the line items that make up a balance sheet
- Explain how financial statements can be used to evaluate past business and predict future performance
- Calculate equity based on assets and liabilities
- Compute revenue, net sales, gross margin, and net profit
- Identify different businesses based on financial statements

Key Terms

- Financial Statements
- Income Statement
- Revenue
- Profit
- Gross Sales
- Net Sales
- Cost of Goods Sold
- Gross Margin
- Operating Expenses
- Taxes
- Net Income
- Net Profit or Loss
- Balance Sheet
- Equity

Financial statements often prepared based on projections or estimates of future events, such as sales or purchases, are referred to as pro forma financial statements. Pro forma is a Latin term that means "according to form." Pro forma financial statements are used in business plans when the business being proposed has not yet been started.

Business Plans and Financial Statements

A business plan is a map or blueprint for starting a new business. As we will learn in the unit on business plans, financial information is a major part of a business plan. A business plan requires financial information that includes projected income and expenses, projected cash flow, and a projected balance sheet for the first business year.

Summary

In this unit we have looked at the purpose and importance of financial statements to both new and established businesses. We specifically examined the information contained in income statements and balance sheets. Additionally, we discussed the importance of analyzing the information provided by financial statements and how that analysis can be useful. Lastly, we reviewed some of the mathematics used in producing financial statements.

MATH EXERCISES

Financial Statements

LESSON 15

1. A business prices its merchandise in three categories: \$3.99, \$5.99, and \$10.99. The \$3.99 category has 500 units and the two remaining categories have 200 units each. What would be the projected total sales revenue for the combined three categories?

2. On the current balance sheet at the end of the first year, a business has \$50,000 in total assets and \$18,000 in total liabilities. Compute the business equity at the end of the first year.

3. A new business has total net sales of \$5,000 and the cost of goods sold is \$3000. What is the total gross margin from sales?

4. A new business has total sales of \$10,000, applied \$1,000 in merchandise discounts, and had returns of \$100. Calculate the business's total net sales.

COMPUTER EXERCISE

Financial Statements

LESSON 15

GOAL: Your goal is to match four stores with their financial statements.

YOUR SITUATION: You can browse all views of all four stores but cannot access the Financials, Products, or Vital Signs reports.

1. Run the **Basics** section of the **Tutorial**.
2. Open the **Financial Statements** lesson.
3. On the next page you will find financials for the four stores in the current city. Look over the financial statements carefully.
4. In the simulation under **View** you will find the name of each store in your city. Click on each individual store and check out all the views of each store.
5. Click **Go** to see some action. Watch the stores in operation. If a lot of time passes, re-open the activity file so that the state of the store matches the printed financials.
6. Match each store to its financial statement. Fill in your answers on **Worksheet 1**. (Hint: One major factor identifies each store.)

WORKSHEET 1

Store	Financials	Major Indentifying Characteristic
Russell's		
Irving's		
Chas's		
Howard's		