

## Understanding Basic Financial Statements

During the accounting cycle, the accounting system is used to track, organize and record the financial transactions of an organization. At the close of each period, the information is used to prepare the financial statements, which are usually composed of a balance sheet (statement of financial position); income statement (statement of income and expenses); statement of retained earnings (owners' equity); and a statement of cash flow.

*A sample set of financial statements) is shown below.*

Financial statements prepared by a Chartered Accountant with a Review Engagement Report or Audit Opinion attached, are prepared (unless noted otherwise) according to "Canadian generally accepted accounting principles", or GAAP. Financial statements that are only compiled or that have a "Notice to Reader" attached, are not necessarily prepared according to GAAP.

### Balance Sheet

The balance sheet is based on the equation: assets = liabilities + owners' equity. It indicates everything the company owns (assets), everything the company owes to creditors (liabilities) and the value of the ownership stake in the company (shareholders' equity, or capital). The balance sheet date is the ending date of the period or year, and is a continuation of the amounts recorded since the inception of the company or organization. The balance sheet is a "snapshot" of the financial position of the company at the balance sheet date and shows the accumulated balance of the accounts. Assets and liabilities are separated between *current* and *long-term*, where current items are those items, which will be realized or paid, within one year of the balance sheet date. Typical current assets are cash, prepaid expenses, accounts receivable and inventory.

### Income Statement

An income statement is a type of summary flow report that lists and categorizes the various revenues and expenses that result from operations during a given period - a year, a quarter or a month. The difference between revenues and expenses represents a company's net income or net loss. The amounts shown in the income statement are the amounts recorded for the given period - a year, a quarter or a month. The next period's income statement will start over with all amounts reset to zero. While the balance sheet shows accumulated balances since inception, the income statement only shows the amounts earned or expensed during the period in question.

### Statement of Retained Earnings

The statement of retained earnings shows the amount of accumulated earnings that have been retained within the company since its inception. At the end of each fiscal year-end, the amount of net income or loss is added to the opening amount of retained earnings to arrive at the closing retained earnings. Retained earnings can be decreased by such items as dividends paid to shareholders. On the sample financial statements shown below, the statement of retained earnings is combined with the income statement presentation.

### Statement of Cash Flow

The statement of cash flow shows all sources and uses of a company's cash during the accounting period. Sources of cash listed on the statement include revenues, long-term financing, sales of non-current assets, an increase in any current liability account or a decrease in any current asset account. Uses of cash include operating losses, debt repayment, equipment purchases and increases in current asset accounts.

**XYZ COMPANY LIMITED**  
**BALANCE SHEET**  
**AS AT**  
**JUNE 30, 2002**

**UNAUDITED - See "Notice to Reader"**

	<b><u>2002</u></b>	<b><u>2001</u></b>
<b><u>ASSETS</u></b>		
CURRENT		
Cash	\$ 11,552	\$ --
Accounts receivable	42,970	50,595
Deposits and prepaid expenses	2,942	2,688
Inventory	159,144	156,657
Investment - current portion	--	45,000
	216,608	254,940
PROPERTY, PLANT AND EQUIPMENT (Note 2)	59,890	76,318
INVESTMENTS	--	1
	\$ 276,498	\$ 331,259
<b><u>LIABILITIES</u></b>		
CURRENT		
Bank overdraft	\$ --	\$ 9,474
Bank loan	--	60,000
Accounts payable and accrued liabilities	82,053	91,343
Long-term debt - current portion	25,200	9,996
Income tax payable	14,387	--
	121,640	170,813
DUE TO SHAREHOLDER (Note 3)	35,591	170,789
LONG-TERM DEBT (Note 4 )	86,100	35,006
	243,331	376,608
<b><u>SHAREHOLDER'S EQUITY</u></b>		
STATED CAPITAL (Note 5)	1	1
RETAINED EARNINGS (DEFICIT)	33,166	(45,350)
	\$ 276,498	\$ 331,259
<b><u>APPROVED</u></b>		

**XYZ COMPANY LIMITED**  
**STATEMENT OF INCOME AND RETAINED EARNINGS**  
**FOR THE YEAR ENDED**  
**JUNE 30, 2002**

**UNAUDITED - See "Notice to Reader"**

	<u>2002</u>	<u>2001</u>
<b>REVENUE</b>	\$ <u>1,104,786</u>	\$ <u>1,133,736</u>
<b>COST OF SALES</b>		
Opening inventory	156,657	146,278
Delivery	1,607	1,249
Purchases	<u>740,994</u>	<u>794,101</u>
	899,258	941,628
Closing inventory	<u>159,144</u>	<u>156,657</u>
	740,114	784,971
<b>GROSS MARGIN</b>	<u>364,672</u>	<u>348,765</u>
<b>OPERATING EXPENSES</b> (schedule)	<u>286,817</u>	<u>339,905</u>
<b>INCOME FROM OPERATIONS</b>	<u>77,855</u>	<u>8,860</u>
<b>OTHER INCOME (EXPENSES)</b>		
Loss on disposal of property, plant and equipment	--	(387)
Gain on sale of investment	16,149	--
Miscellaneous	<u>(1,101)</u>	<u>337</u>
	15,048	(50)
<b>NET INCOME BEFORE TAX</b>	92,903	8,810
<b>INCOME TAX EXPENSE</b>	<u>14,387</u>	<u>--</u>
<b>NET INCOME</b>	78,516	8,810
<b>RETAINED EARNINGS (DEFICIT) - Beginning of Year</b>	<u>(45,350)</u>	<u>(54,160)</u>
<b>RETAINED EARNINGS (DEFICIT) - End of Year</b>	<u>\$ 33,166</u>	<u>\$ (45,350)</u>

**XYZ COMPANY LIMITED**  
**SCHEDULE OF OPERATING EXPENSES**  
**FOR THE YEAR ENDED**  
**JUNE 30, 2002**

**UNAUDITED - See "Notice to Reader"**

	<u>2002</u>	<u>2001</u>
<b>EXPENSES</b>		
Advertising	\$ 18,801	\$ 30,715
Amortization	17,854	16,856
Bad debts	199	179
Bank charges and interest	5,510	9,356
Insurance	4,779	4,035
Interest on long-term debt	11,876	10,469
Legal and accounting	13,155	1,297
Management fees	--	12,525
Memberships and licenses	3,212	3,413
Office and general	12,382	15,155
Rent and utilities	18,795	21,955
Repairs and maintenance	4,289	4,979
Subcontracting	19,825	18,692
Supplies	4,571	8,557
Travel	3,736	8,003
Wages and benefits	142,713	168,806
Vehicle	5,120	4,913
	<u>\$ 286,817</u>	<u>\$ 339,905</u>

**XYZ COMPANY LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED**  
**JUNE 30, 2002**

**UNAUDITED - See "Notice to Reader"**

**1. SIGNIFICANT ACCOUNTING POLICIES AND GENERAL INFORMATION**

**Nature of Business**

The company is a Canadian-controlled private corporation subject to the Business Corporations Act, 1982 (Ontario), was incorporated on July 17, 1980 and operates as a wholesaler of widgets in Anytown, Ontario.

**Significant Accounting Policies**

**INVENTORY**

The inventory is valued at the lower of cost or market, with cost being determined on a first-in, first-out basis.

**PROPERTY, PLANT AND EQUIPMENT**

Property, plant and equipment are stated at cost less accumulated amortization. Amortization is recorded at rates designed to amortize the cost of the assets over their estimated useful lives. Amortization rates used are as follows:

Furniture and equipment	20% declining balance
Computer equipment	30% declining balance
Leasehold improvements	Straight-line 5 years

**2. PROPERTY, PLANT AND EQUIPMENT**

	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Net Book Value 2002</u>	<u>Net Book Value 2001</u>
Furniture and equipment	\$ 28,340	\$ 20,469	\$ 7,871	\$ 9,213
Computer equipment	50,868	43,676	7,192	9,474
Leasehold improvements	64,034	19,207	44,827	57,631
	<u>\$ 143,242</u>	<u>\$ 83,352</u>	<u>\$ 59,890</u>	<u>\$ 76,318</u>

**XYZ COMPANY LIMITED**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED**  
**JUNE 30, 2002**

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**3. DUE TO SHAREHOLDER**

The amount due to shareholder bears interest at a rate determined annually and has no fixed terms of repayment. Interest paid for 2002 was \$1,823 (2001 - \$1,396)

**4. LONG - TERM DEBT**

	<u>2002</u>	<u>2001</u>
Any Bank term loan bearing interest at prime plus 2%, repayable in monthly principal installments of \$833.00 plus interest to December 2005, secured by a term deposit.	\$ 45,002	\$ --
Less current portion	9,996	--
	\$ 35,006	\$ --

Approximate principal repayments are as follows:

2004	\$	9,996
2005		9,996
2006		9,996
2007		5,018
	\$	35,006

**5. STATED CAPITAL**

Authorized:

Unlimited number of Common shares

	<u>2002</u>	<u>2001</u>
Issued:		
100 Common shares	\$ 1	\$ 1