Case Study: Statement of Changes in Owner's Equity

by Sophia

WHAT'S COVERED

This lesson will cover the preparation of a statement of changes in owner's equity in the context of a case study, using a hypothetical business.

Our discussion breaks down as follows:

1. Case Study: Legacy Realty

The subject company for our case study is called Legacy Realty. Legacy Realty is a sole proprietorship, which is a type of company that is owned by one single individual, and where that individual and the business are legally treated as the same.

The purpose of Legacy Realty as a business is to own, lease, and manage its own rental properties. It purchases houses and condominiums and leases them out to tenants. They also perform their own management of their units, making repairs, performing maintenance, and collecting rent. Legacy Realty is located in Washington DC, and they have a small staff of five people.

Legacy Realty	
Type of company	Sole proprietorship
Business purpose	Own, lease, and manage rental properties
Business location(s)	Washington, D.C. Staff of 5 people

Legacy Realty needs a statement of changes in owner's equity to determine business performance. It details the owner activity, such as investments in the business and taking money out, to determine if there has been net income or net loss. This statement helps Legacy Realty to understand the change in owner's equity for a period; it's an activity-based statement, similar to the income statement, that generally covers one year or less of activity.

2. Case Study: Statement of Changes in Owner's

Equity

Let's begin preparing a statement of changes in owner's equity for Legacy Realty. We'll start with the trial balance worksheet because we need to pull some information from it in order to prepare the statement.

Here is the trial balance worksheet. Here's what we've done so far:

- Prepared the trial balance, listing all of the general ledger accounts, as well as their corresponding debit and credit balances.
- Prepared the adjustments and adjustment explanations, making corrections to the accounts to match revenues and expenses with the correct period. We've also corrected any errors or omissions that were made.
- Prepared the adjusted trial balance, which simply involves taking the trial balance and accounting for all of the adjustments that we made. Similar to the trial balance, the adjusted trial balance is a listing of all of the general ledger accounts and their corresponding debit or credit balances.

	Trial Balance		Adjustments		Adjusted Trial Balance	
Accounts	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	63,000				63,000	
Accounts Receivable	10,000				10,000	
Supplies	5,000			2,500 (a)	2,500	
Prepaid Insurance	12,000			6,000 (b)	6,000	
Buildings	500,000				500,000	
Land	50,000				50,000	
Accumulated Depreciation - Buildings				15,000 (c)		15,000
Accounts Payable		5,000		25,000 (e)		30,000
Unearned Revenue				10,000 (d)		10,000
Notes Payable		300,000				300,000
Retained earnings, 1/1/12		200,000				200,000
Owner's Drawing	10,000				10,000	
Revenue		600,000	10,000 (d)			590,000
Salaries Expense	325,000		25,000 (e)		350,000	
Repairs Expense	50,000				50,000	
Advertising Expense	10,000				10,000	
Rent Expense	50,000				50,000	
Interest Expense	20,000				20,000	
Depreciation Expense - Buildings			15,000 (c)		15,000	
Insurance Expense			6,000 (b)		6,000	
Supplies Expense			2,500 (a)		2,500	
Totals	1,105,000	1,105,000	58,500	58,500	1,145,000	1,145,000

Adjustments Explanation

(a) Adjust Supplies used

(b) Adjust Insurance incurred

(c) Record Depreciation Expense

(d) Correct incorrect Revenue recognition

(e) Accrue Salaries Expense

This adjusted trial balance is going to be the source for the financial statements for Legacy Realty, so we are ready to prepare their statement of changes in owner's equity.

Just as with other financial statements, we start with the header: the business name, Legacy Realty Partners, then "Statement of Changes in Owner's Equity," and finally, a line that says "For the period ending December 31, 2012." Similar to the income statement, this line is needed because this is an activity-based statement.

	Adjusted Trial Balance		Income Statement	
Accounts	Dr.	Cr.	Dr.	Cr.
Cash	63,000			
Accounts Receivable	10,000			
Supplies	2,500			
Prepaid Insurance	6,000			
Buildings	500,000			
Land	50,000			
Accumulated Depreciation - Buildings		15,000		
Accounts Payable		30,000		
Unearned Revenue		10,000		
Notes Payable		300,000		
Retained earnings, 1/1/12		200,000		
Owner Drawings	10,000			
Revenue		590,000		590,000
Salaries Expense	350,000		350,000	
Repairs Expense	50,000		50,000	
Advertising Expense	10,000		10,000	
Rent Expense	50,000		50,000	
Interest Expense	20,000		20,000	
Depreciation Expense - Buildings	15,000		15,000	
Insurance Expense	6,000		6,000	
Supplies Expense	2,500		2,500	
Totals	1,145,000	1,145,000	503,500	590,000
Net Income			86,500	
Totals			590,000	590,000

Legacy Realty Partners
Statement of Changes in Owner's Equity
For the period ending December 31, 2012

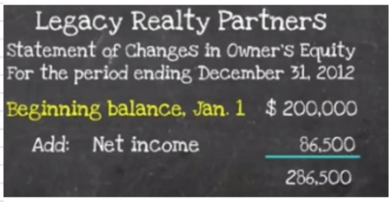
Again, here is the information from the adjusted trial balance, reflecting the permanent accounts--assets, liabilities, and equity. Equity is the key piece. We will also need to pull some information off of the income statement in order to prepare the statement of changes in owner's equity.

The first line is the beginning balance, January 1, in owner's equity, which is retained earnings in the amount of $200,000.

	Adjusted Trial Balance		Income Statement	
Accounts	Dr.	Cr.	Dr.	Cr.
Cash	63,000			
Accounts Receivable	10,000			
Supplies	2,500			
Prepaid Insurance	6,000			
Buildings	500,000			
Land	50,000			
Accumulated Depreciation - Buildings		15,000		
Accounts Payable		30,000		
Unearned Revenue		10,000		
Notes Payable		300,000		
Retained earnings, 1/1/12		200,000		
Owner Drawings	10,000			
Revenue		590,000		590,000
Salaries Expense	350,000		350,000	
Repairs Expense	50,000		50,000	
Advertising Expense	10,000		10,000	
Rent Expense	50,000		50,000	
Interest Expense	20,000		20,000	
Depreciation Expense - Buildings	15,000		15,000	
Insurance Expense	6,000		6,000	
Supplies Expense	2,500		2,500	
Totals	1,145,000	1,145,000	503,500	590,000
Net Income			86,500	
Totals			590,000	590,000

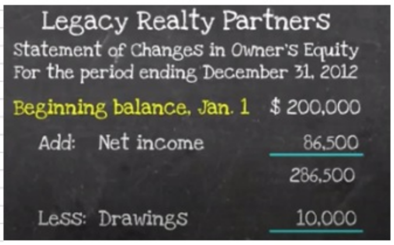
Next, we're going to add any owner investments or net income. In this case, Legacy Realty has net income of $86,500. There were no owner investments during the period, so the only item we need to add is net income. We subtotal the beginning balance and net income to get $286,500.

	Adjusted Trial Balance		Income Statement	
Accounts	Dr.	Cr.	Dr.	Cr.
Cash	63,000			
Accounts Receivable	10,000			
Supplies	2,500			
Prepaid Insurance	6,000			
Buildings	500,000			
Land	50,000			
Accumulated Depreciation - Buildings		15,000		
Accounts Payable		30,000		
Unearned Revenue		10,000		
Notes Payable		300,000		
Retained earnings, 1/1/12		200,000		
Owner Drawings	10,000			
Revenue		590,000		590,000
Salaries Expense	350,000		350,000	
Repairs Expense	50,000		50,000	
Advertising Expense	10,000		10,000	
Rent Expense	50,000		50,000	
Interest Expense	20,000		20,000	
Depreciation Expense - Buildings	15,000		15,000	
Insurance Expense	6,000		6,000	
Supplies Expense	2,500		2,500	
Totals	1,145,000	1,145,000	503,500	590,000
Net Income			86,500	
Totals			590,000	590,000

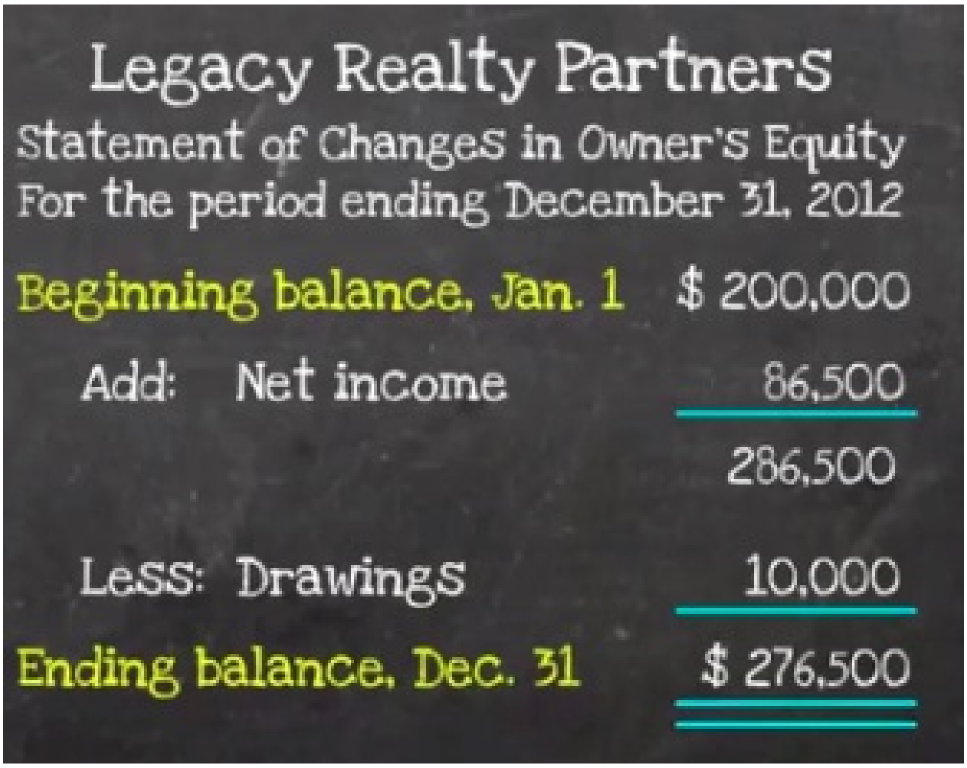


Now we need to take out any subtractions for owner's draws, meaning any money the owners pulled out of the business, as well as any net loss. Well, we know that Legacy Realty had net income, so the only item we need to subtract are the owner's drawings, shown in the adjusted trial balance.

Accounts	Adjusted Trial Balance Dr.	Adjusted Trial Balance Cr.	Income Statement Dr.	Income Statement Cr.
Cash	63,000			
Accounts Receivable	10,000			
Supplies	2,500			
Prepaid Insurance	6,000			
Buildings	500,000			
Land	50,000			
Accumulated Depreciation - Buildings		15,000		
Accounts Payable		30,000		
Unearned Revenue		10,000		
Notes Payable		300,000		
Retained earnings, 1/1/12		200,000		
Owner Drawings	10,000			
Revenue		590,000		590,000
Salaries Expense	350,000		350,000	
Repairs Expense	50,000		50,000	
Advertising Expense	10,000		10,000	
Rent Expense	50,000		50,000	
Interest Expense	20,000		20,000	
Depreciation Expense - Buildings	15,000		15,000	
Insurance Expense	6,000		6,000	
Supplies Expense	2,500		2,500	
Totals	**1,145,000**	**1,145,000**	503,500	590,000
Net Income			86,500	
Totals			**590,000**	**590,000**



We subtract owner draws to get to the Legacy Realty's ending balance on December 31, 2012, of $276,500 in owner's equity.



SUMMARY

Today we introduced our **case study** company called **Legacy Realty**, that is in the business of owning and leasing their own rental properties. We walked through an **example of preparing a statement of changes in owner's equity**, which details the owner activity for a period. We pulled some information from the adjusted trial balance and the income statement in order to create this statement.

Source: Adapted from Sophia instructor Evan McLaughlin.