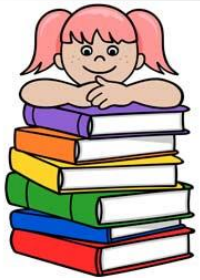
UNIT 10: FINANCIAL ACCOUNTING AND REPORTING

LECTURER: JUDITH ROBB-WALTERS

UNIT 10: FINANCIAL ACCOUNTING AND REPORTING

- LEARINING OUTCOME 2: BE ABLE TO PREPARE FINANCIAL STATEMENTS FROM COMPLETE OR INCOMPLETE RECORDS

THE BASIC SYLLABUS



- 1. Understand the regulatory framework for financial reporting.
- 2.Be able to prepare financial statements from complete or incomplete records.
- 3.Be able to present financial information in accepted formats for publication.
- 4. Be able to interpret financial statements.

LEARNING OUTCOMES

- Understand the regulatory framework for financial reporting.

- At the end of the class the students should be able to:
- 2.1 Prepare financial statements for a variety of businesses from a trial balance, making appropriate adjustments.

OVERVIEW

- Every business concern wants to know the various financial aspects for effective decision making. The preparation of financial statement is required in order to achieve the objectives of the firm as a whole. The term financial statement refers to an organized collection of data on the basis of accounting principles and conventions to disclose its financial information.
- Financial statements are broadly grouped into two:
- I. Income Statements (Trading, Profit and Loss Account)
- II. Balance Sheets In to financial statements supported by the following statements are prepared to meet the needs of the business concern:
- (a) Statement of Retained Earnings
- (b) Statement of Changes in Financial Position

TRIAL BALANCE

- Trial Balance can be defined as “a list of all balances standing
- in the Ledger Accounts and Cash Book of a concern at any given time.
- Advantages:
- 1. It is the shortest method of verifying the arithmetical accuracy of entries made in the Ledger. If the Trial balances agree, it is an indication that the Accounts are correctly written up; but it is not a conclusive proof.
- 2. It helps to prepare the Trading A/c, Profit & Loss a/c and Balance Sheet.
- 3. It presents to the businessman consolidated lists of all Ledger Balances

ASSETS

- Things of value owned by a business. An asset may be a physical property such as a building, or an object such as a stock certificate, or it may be a right, such as the right to use a patented process.
- *Current Assets* are those assets That can be expected to Turn into cash within a year or less. Current assets include cash, marketable securities, accounts receivable, and inventory.

ASSETS

- *Fixed assets* include land, buildings, machinery, equipment, furniture, and long - term investments.
- *Intangible Assets* Are items such as patents, copyrights, trademarks, licenses, franchises, and other kinds of rights or things of value to a company, which are not physical objects. These assets May be the most important ones a company owns. Often they do not appear on financial reports.

LIABILITIES

- This is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources
- embodying economic benefits.

LIABILITIES

- Current liability is debt with two key features:

- 1. Company expects to pay the debt from existing current assets or through the creation of other current liabilities.
- 2. Company will pay the debt within one year or the operating cycle, whichever is longer.

- **What is a Current Liability?**
- Current liabilities include notes payable, accounts payable, unearned revenues, and accrued liabilities such as taxes, salaries and wages, and interest payable.

LIABILITIES

- **Current liabilities:**

✓Accounts payable
✓- to suppliers, tax liabilities, from short-term bank and
✓trade loans etc.
✓Accrued liabilities
✓Payroll and payroll taxes

- **Non-current (Long-term) liabilities:**

✓Bank loans
✓Notes payable
✓Bonds payable

INCOME

- Income is therefore an increase in the net assets of the entity during an accounting period except for such increases caused by the contributions from owners. The first part of the definition is quite easy to understand as income must logically result in an increase in the net assets (equity) of the entity such as by the inflow of cash or other assets. However, net assets of an entity may increase simply by further capital investment by its owners even though such increase in net assets cannot be regarded as income.

INCOME

- There are two types of income:
- Sale Revenue: Income earned in the ordinary course of business activities of the entity;
- Gains: Income that does not arise from the core operations of the entity.
- For example, sale revenue of a business whose main aim is to sell biscuits is income generated from selling biscuits. If the business sells one of its factory machines, income from the transaction would be classified as a gain rather than sale revenue.

EXPENSES

- An expense in accounting is the money spent or cost incurred in an entity's efforts to generate revenue. Expenses represent the cost of doing business where doing business is the sum total of the activities directed towards making a profit.
- Expenses are recorded in the 'books of a business' according to the method/basis of accounting chosen by the business: Cash accounting and accrual accounting (also called cash-basis and accrual-basis). Under accrual accounting the expense will be recorded in the accounting system at the point when a legal obligation has been is created.

EXPENSES

- This is usually at the date of goods shipped/received or date that services was performed. Under cash accounting, the recording of the expense is delayed until the actual cash payment is made. (e.g. an electricity bill for the month of April but paid in May will be recorded as Electricity Expense in April under accrual accounting but recorded as Electricity Expense in May under cash accounting).

CAPITAL

- The term capital refers to the total investment of the company in terms of money, and assets. It is also called as total wealth of the company. When the company is going to invest large amount of finance into the business, it is called as capital. Capital is the initial and integral part of new and existing business concern. The capital requirements of the business concern may be classified into two categories:
- (a) Fixed capital
- (b) Working capital

CAPITAL

- ***Fixed capital*** is the capital, which is needed for meeting the permanent or long-term purpose
- of the business concern.
- ***Working capital*** is the capital which is needed to meet the day-to-day transaction of the business concern.

PROFIT AND LOSS ACCOUNTS

- The profit and loss account (also called the 'income and expenditure account' or the 'trading account') is the basic measure of the financial performance of an organisation.
- It tells you:

➢ What the value of the work done was,

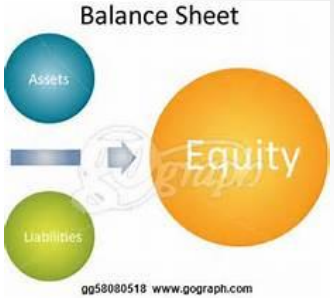
➢ What the value of goods, labour and services used to do that work was,

➢ Whether the value of the work done was more or less than the value of what was put in to it i.e. whether you made a profit or a loss.

BALANCE SHEET

- The balance sheet for a business it gives you a 'snapshot' view of what the business is worth, its assets and liabilities, at one particular moment in time. Usually this is at the end of the financial year and allows you to compare the situation of the business from one year to the next but you can also draw up quarterly or even monthly balance sheets. The balance sheet should be produced once your trading profit and loss account has been drawn up.

BALANCE SHEET



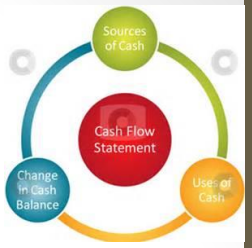
- A balance sheet is concerned with 3 things:

➢ Assets

➢ Liabilities

➢ Capital

CASH FLOW STATEMENT



- The purpose of a statement of cash flows is to provide information about the cash receipts and cash payments of the entity, and how they relate to the entity's operating, investing, and financing activities.

CASH FLOW STATEMENT

- Readers of financial statements use this information to assess the solvency of a business and to evaluate its ability to generate positive cash flows in future periods, pay dividends, and finance growth.

NOTES TO THE ACCOUNTS

- The notes to the accounts are a series of notes that are referred to in the main body of the financial statements.
- The notes give further details on the numbers given in the accounts. The importance of these numbers should not be underestimated. The accounts are not complete without the notes. Investors who rely on the main body of the accounts and ignore the notes are likely to find themselves misled.

STATEMENT OF RECOGNISED GAINS AND LOSSES

- The statement of total recognised gains and losses (STRGL) is an attempt to present details of the other elements making up a company's total performance.
- The STRGL presents:
- profit for the financial year before dividends
- unrealised gains and losses on revaluation of assets
- currency translation differences
- prior year adjustments.
- The profit for the year is, of course, the figure in the profit and loss account. This will already include any realised gains or losses arising on the disposal of assets. That leaves the unrealised gains and losses to be disclosed as the second item in the STRGL.

STATEMENT OF RECOGNISED GAINS AND LOSSES

	$m
Surplus/deficit on revaluation of properties	X
Surplus/deficit on revaluation of investments	X
Net gains not recognised in the income statement	X
Net profit for the period	X
Total recognised gains and losses	X

International Equivalents under the International Accounting Standards (IAS)

- IAS 1 changes the titles of financial statements as they will be used in IFRSs:
- • 'balance sheet' will become 'statement of financial position'
- • 'income statement' will become 'statement of comprehensive income'
- Entities (businesses) are not required to use the new titles in their financial statements but all existing Standards and Interpretations are being amended to reflect the new terminology.

International equivalents under the International Accounting Standards (IAS)

- The components of the Financial Statements
- A complete set of financial statements as set out in the Standard, comprises:
- - balance sheet (from 1/1/2009 – ‘a statement of financial information as at the end of ….)
- - income statement (from 1/1/2009 – ‘a statement of comprehensive income for the period)
- - a statement of changes in equity
- - a statement of cash flow - cash flow statement (also has to its own specific IAS)
- - accounting policies and explanatory notes (also has its own specific IAS)

REVIEW QUESTION

Nation Wholesale					
Trial Balance as at December 31,2015					
				DR	CR
				$	$
Sales					339,500.00
Returns Inwards				5,400.00	
Returns Outwards					11,500.00
Opening Stock				25,000.00	
Purchases				201,000.00	
Machinery and Equipment - Depreciation					12,500.00
Wages and Salaries				30,000.00	
Rent				31,600.00	
Drawings				14,600.00	
Insurance				8,500.00	
Capital					121,800.00
Premises				80,000.00	
bad debts				4,500.00	
Machinery and Equipment at Cost				60,000.00	
Debtors				30,000.00	
Creditors					25,000.00
Bank				6,000.00	
Cash				2,500.00	
Carriage Inwards				1,200.00	
General expenses				10,000.00	
TOTAL				510,300.00	510,300.00

REVIEW QUESTION

Additional Information:		
Closing Stock		$9,500
Rent paid in advance		$4,000
Wages and salaries owing		$5,800
Insurance owing		$800
Provision fo doubtful debt		$3,000
Depreciation on machinery and Equipment		$2,500

REVIEW QUESTION

- Prepare the following for Nation Wholesale:-
- 1. Trading Profit and Loss account for the year ended December 31,2015
- 2. The Balance Sheet as at December 31,2015.

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