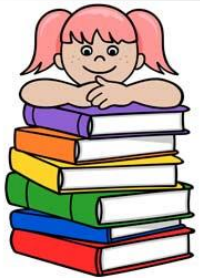
# UNIT 10: FINANCIAL ACCOUNTING


- UNIT 10: A/508/0496
- CREDIT VALUE: 15

# FINANCIAL ACCOUNTING

- LO 2: Prepare final accounts for sole-traders, partnerships or limited
- companies in accordance with appropriate principles, conventions
- and standards.

# THE BASIC SYLLABUS



- 1. Record Business transactions using double entry book keeping, and be able to extract a trial balance.
- 2.Prepare final accounts for sole-traders, partnerships and limited companies in accordance with appropriate principles, conventions and standards.
- 3.Perform bank reconciliations to ensure company and bank records are correct.
- 4.Reconcile control accounts and shift recorded transactions from the suspense accounts to the right accounts

# LEARNING OUTCOMES


- At the end of the class the students should be able to:

# OVERVIEW

- Trading, profit & loss account and balance sheet, all these three together, are called as **final accounts**. Final result of trading is known through Profit and Loss Account. Financial position is reflected by Balance Sheet. These are, usually, prepared at the close of the year hence known as final accounts.
- To support the application of the "true and fair view", accounting has adopted certain concepts and conventions which help to ensure that accounting information is presented accurately and consistently.

# FINANCIAL REPORTS

- Financial reporting involves the disclosure of financial information to management and the public (if the company is publicly traded) about how the company is performing over a specific period of time. Financial reports are usually issued on a quarterly and annual basis.

# FINANCIAL STATEMENTS


- Financial Statements represent a formal record of the financial activities of an entity. These are written reports that quantify the financial strength, performance and liquidity of a company. Financial Statements reflect the financial effects of business transactions and events on the entity.

# FINANCIAL STATEMENTS


- The four main types of financial statements are:
- **Statement of Financial Position**, also known as the **Balance Sheet**, presents the financial position of an entity at a given date. It is comprised of the following three elements:
- Assets: Something a business owns or controls (e.g. cash, inventory, plant and machinery, etc)

# FINANCIAL STATEMENTS


- Liabilities: Something a business owes to someone (e.g. creditors, bank loans, etc)
- Equity: What the business owes to its owners. This represents the amount of capital that remains in the business after its assets are used to pay off its outstanding liabilities. Equity therefore represents the difference between the assets and liabilities.

# FINANCIAL STATEMENTS


- **Income Statement,** also known as the ***Profit and Loss Statement***, reports the company's financial performance in terms of net profit or loss over a specified period. Income Statement is composed of the following two elements:
- Income: What the business has earned over a period (e.g. sales revenue, dividend income, etc)

# FINANCIAL STATEMENTS


- What the business has earned over a period (e.g. sales revenue, dividend income, etc)
- Expense: The cost incurred by the business over a period (e.g. salaries and wages, depreciation, rental charges, etc)
- Net profit or loss is arrived by deducting expenses from income

# FINANCIAL STATEMENTS


- **Cash Flow Statement**, presents the movement in cash and bank balances over a period. The movement in cash flows is classified into the following segments:
- Operating Activities: Represents the cash flow from primary activities of a business.
- Investing Activities: Represents cash flow from the purchase and sale of

# FINANCIAL STATEMENTS


- Investing Activities: Represents cash flow from the purchase and sale of assets other than inventories (e.g. purchase of a factory plant)
- Financing Activities: Represents cash flow generated or spent on raising and repaying share capital and debt together with the payments of interest and dividends.

# ACCURALS

- An accrual is an amount due, or the calculation of an amount due, in an accounting period which is unpaid at the end of that period, eg an insurance premium or an electricity bill not yet paid. In the financial statements, accrued expenses are:

# ACCURALS

- In added to the expense account (eg insurance account, electricity account) shown in the trial balance, before it is listed in the statement of profit or loss n shown as a liability in the year end statement of financial position.

# ACCURALS

- The reason for dealing with accruals in this way is to ensure that the statement of profit or loss records the expense that has been incurred for the year, instead of simply the amount that has been paid.

# ACCURALS

- In other words, the expense is adjusted to relate to the time period covered by the statement of profit or loss. The year end statement of financial position shows a liability for the amount that is due, but unpaid.

# DEPRECIATION

- IAS 16 defines depreciation as 'the measure of the cost or revalued amount of the economic benefits of the tangible non-current asset that has been consumed during the period'.
- In simple terms, depreciation is a mechanism to reflect the cost of using a non-current asset.
- Depreciation matches the cost of using a non-current asset to the revenues generated by that asset over its useful life.
- Depreciation must also be matched to the pattern of use of the asset. This must be regularly reviewed and may be changed if the method no longer matches the usage of the asset.

# DEPRECIATION

- This is achieved by recording a depreciation charge each year, the effect of which is twofold ('the dual effect'):
  - Reduce the statement of financial position value of the non-current asset by cumulative depreciation to reflect the wearing out.
  - Record the depreciation charge as an expense in the income statement to match to the revenue generated by the non-current asset.

# DEPRECIATION

- Depreciation may arise from:
- use
- physical wear and tear
- passing of time, e.g. a ten-year lease on a property
- obsolescence through technology and market changes, e.g. plant and machinery of a specialised nature
- depletion, e.g. the extraction of a mineral from a quarry.

# DEPRECIATION

- The purpose of depreciation is not to show the asset at its current value in the statement of financial position, nor is it intended to provide a fund for the replacement of the asset. It is simply a method of allocating the cost of the asset over the periods estimated to benefit from its use (the useful life).
- Land normally has an unlimited life and so does not require depreciation, but buildings should be depreciated.
- Depreciation of an asset begins when it is available for use.

# PREPAYMENTS


- . A prepayment is a payment made in advance, or the calculation of an amount paid in advance, of the accounting period to which it relates. A prepayment is, therefore, the opposite of an accrual: with a prepayment of expenses, some part of the expense has been paid in advance.

# PREPAYMENTS


- In the financial statements, prepaid expenses are: deducted from the expense account shown in the trial balance before it is listed in the statement of profit or loss n shown as an asset in the year end statement of financial position.

# CASH FLOW STATEMENT

- Although small companies, partnerships and sole traders do not have to prepare them, cash flow statements can be of considerable use to all organisations. FRS 1 prescribes a format for cash flow statements. It must be noted that , there are factors concerning partnerships and sole traders which do not occur in companies.

# CASH FLOW STATEMENT

- It will be of help to students if the cash flow statements for sole traders and partnerships are fashioned to be as like those for companies as is possible.
- Consequently, the layouts for cash flow statements of sole traders and partnerships in this book will follow either the style of layout as laid down in FRS 1 or the style of layout as laid down by IAS 7.

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