2. **Balance sheet**  
   The statement of financial position provides information on the financial position of the business.

The balance sheet shows the financial position of a business on a specific date by listing the assets, liabilities and owner’s equity.

**Categories in the balance sheet**

**Assets definition1:** future economic benefits obtained/controlled by a particular entity as a result of past transactions/events.

**Assets definition 2:** A resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity’

Assets are divided into non-current assets and current assets.

*Non-current assets*
These are assets that are owned by an entity for more than one financial year. e.g. buildings, land, motor vehicles, furniture and fittings, computers etc.

*Current assets*
These are assets that are owned by an entity for one year or less. e.g. cash, stock, debtors, prepayments etc.

**Liabilities:** future sacrifices of economic benefits arising from present occupations of an entity to transfer assets/provide service to other entities in the future as a result of past transactions/events.

OR

These are amounts owed by the business to other firms.

OR

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 are divided into two:
Non-current liabilities
Current liabilities

**Equity:** residual interest in the assets that remain after deducting its liabilities.

3. **Statement of changes in owners’ equity**
   The statement of changes in equity provides information about how the equity of a company has changed over the period.
**FULL DISCLOSURE**
All relevant material facts must be incorporated into financial statements. Some information, such as contingent liability, is easily communicated with a footnote, while other information, such as the effect of inflation, requires more complex procedures.

**CONSISTENCY**
Accounting methods used to determine income and value balance sheet items must be consistently applied.

**CONSERVATISM**
Estimates requiring subjective analysis should not overstate revenue and asset values or understate expenses and liabilities.

**STABLE DOLLAR ASSUMPTION**
Historical costing assumes a stable dollar. Because the dollar is not stable, larger corporations, at FASB’s request, voluntarily prepare information on the effects of inflation on their financial statements.

**A conceptual framework**
- A conceptual framework is a coherent system of inter-related objectives and fundamentals that can lead to consistent standards and that prescribes the nature, function and limits of financial accounting and financial statements.
- The IASB’s conceptual framework is known as ‘the Conceptual Framework for Financial Reporting 2010 (‘the Framework’).
- The basic objective of the conceptual framework is to provide a logical and sensible guide for preparing accounting standards and applying them.

**Framework for the preparation and presentation of financial statements**
The framework represents the main ideas, concepts and principles upon which all International Financial Reporting Standards, and therefore financial statements, are based.

The framework is not a standard but a framework, - …“which sets out the objectives and concepts which underlie the preparation of financial statements…”

**Underlying assumptions**
According to the Framework there are two underlying assumptions with regard to financial statements.

These are:
1. The accrual basis, and
2. The going concern
Storing information in accounts

In accounting for an entity the different effects of its business transaction must be recorded and stored in separate locations so that they can be sorted and combined when financial reports are prepared. These locations in the accounting system are called ACCOUNTS.

A separate account summarises the increases and decreases in each asset, liability and owner’s equity item that appears in the balance sheet. A separate account is used for each revenue and expense item that appears on the income statements.

Types of accounts

**Personal accounts** – these are for debtors and creditors (i.e. customers and suppliers).

**Impersonal accounts** – divided between ‘real’ accounts and ‘nominal’ accounts.

**Real accounts** – accounts in which possessions are recorded. E.g. buildings, machinery, fixtures and inventory.

**Nominal accounts** – accounts in which expenses, income and capital are recorded.

Double entry system

- States that every transaction should be recorded twice (once Dr entry and once Cr entry).
- In summary for every Cr entry there should be a corresponding Dr entry from the same transaction. This follows from the fact that all business transaction affect two accounts simultaneously, where one account can be seen as a giver and the other as a receiver. The conventional accounting practise is to Cr the giving account and Dr the receiving account.

  **Cr the giver, Dr the receiver**

- When a business fails to maintain double entry, its records are recorded as incomplete and they don’t balance.

The ledger

A collection of all accounts grouped together.

- Sales ledger. This is for customer’s personal accounts
- Purchases ledger. This is for suppliers’ personal accounts.
- General ledger. This contains the remaining double entry accounts, such as those relating to expenses, non-current assets and capital.
Error of original entry
A sale of $38 to A Smiles was entered in the books as $28.

Error of transposition
A credit purchase from P. Mcloud costing $56 was entered in the books as $65.

Error of complete reversal
A payment of cash of $16 to M Dickies was entered on the receipts side of Cash Book in error and credited to M Dickies’s account.

PREPERATION OF FINANCIAL STATEMENTS

- Every firm likes to measure the performance of its operations in terms of profits or loss. It also likes to know the values of its assets and liabilities on the closing date of an account period.
- In order to ascertain its income and also access the position of assets and liabilities, financial statements are prepared,
- Financial statements are also known with the traditional name as final accounts.

Example

At December 31, 2011 year end trial balance from the ledger of Window Store had the following transactions.

<table>
<thead>
<tr>
<th>Description</th>
<th>Dr</th>
<th>Cr</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>2400</td>
<td></td>
</tr>
<tr>
<td>Merchandise Inventory</td>
<td>61152</td>
<td></td>
</tr>
<tr>
<td>Office supplies expense</td>
<td>438</td>
<td></td>
</tr>
<tr>
<td>Store equipment expense</td>
<td>1410</td>
<td></td>
</tr>
<tr>
<td>Prepaid insurance expense</td>
<td>3276</td>
<td></td>
</tr>
<tr>
<td>Office equipment</td>
<td>10644</td>
<td></td>
</tr>
<tr>
<td>Accumulated depreciation – office equipment</td>
<td>3840</td>
<td></td>
</tr>
<tr>
<td>Accounts Payable</td>
<td>8766</td>
<td></td>
</tr>
<tr>
<td>Store equipment</td>
<td>38178</td>
<td></td>
</tr>
<tr>
<td>Accumulated Depreciation – Store equipment</td>
<td>15372</td>
<td></td>
</tr>
<tr>
<td>Capital: D. Walker</td>
<td>72540</td>
<td></td>
</tr>
<tr>
<td>Withdrawals: D. Walker</td>
<td>32400</td>
<td></td>
</tr>
<tr>
<td>Sales</td>
<td>342774</td>
<td></td>
</tr>
<tr>
<td>Sales returns &amp; allowances</td>
<td>2094</td>
<td></td>
</tr>
<tr>
<td>Sales discount (discount allowed)</td>
<td>3816</td>
<td></td>
</tr>
<tr>
<td>Purchases</td>
<td>205650</td>
<td></td>
</tr>
<tr>
<td>Purchases returns &amp; allowances</td>
<td>1332</td>
<td></td>
</tr>
<tr>
<td>Purchases discount (discount received)</td>
<td>5292</td>
<td></td>
</tr>
<tr>
<td>Transportation in (carriage inwards)</td>
<td>1158</td>
<td></td>
</tr>
<tr>
<td>Sales salaries expense</td>
<td>38304</td>
<td></td>
</tr>
<tr>
<td>Rent expense – Selling spares</td>
<td>23220</td>
<td></td>
</tr>
<tr>
<td>Advertising expense</td>
<td>684</td>
<td></td>
</tr>
<tr>
<td>Office salaries expense</td>
<td>22356</td>
<td></td>
</tr>
<tr>
<td>Rent expense – Office</td>
<td>2736</td>
<td></td>
</tr>
</tbody>
</table>

\[
\begin{array}{c|c|c}
\text{Dr} & \text{Cr} \\
439916 & 439916 \\
\end{array}
\]

Additional information
i. Estimated depreciation of store equipment $3 816.
ii. Estimated depreciation office equipment $690.
iii. Ending inventory $62 784.
Cash book (bank columns only: before balancing on 31.12.20X8

<table>
<thead>
<tr>
<th>20X8</th>
<th>20X8</th>
</tr>
</thead>
<tbody>
<tr>
<td>De c 1 Bal b/f</td>
<td>1 600</td>
</tr>
<tr>
<td>16 S Nyoni</td>
<td>800</td>
</tr>
<tr>
<td>23 K Shira</td>
<td>1 300</td>
</tr>
<tr>
<td>31 H Mvuri</td>
<td>720</td>
</tr>
</tbody>
</table>

Bank statement

<table>
<thead>
<tr>
<th>Withdrawal</th>
<th>Deposit</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dec 1 Bal b/f</td>
<td>1 600</td>
<td>450</td>
</tr>
<tr>
<td>11 34621</td>
<td>1 150</td>
<td>800</td>
</tr>
<tr>
<td>23 34622</td>
<td>350</td>
<td></td>
</tr>
<tr>
<td>24 Deposit</td>
<td>1 300</td>
<td>900</td>
</tr>
<tr>
<td>28 Bank Giro: G Cresta</td>
<td>240</td>
<td></td>
</tr>
<tr>
<td>31 Bank charges</td>
<td>400</td>
<td></td>
</tr>
</tbody>
</table>

Find out which transactions are missing from the cashbook

a) A bank giro credit of $240 made on December 30 by G Cresta

b) Bank charges of $400

Find out transactions missing from the bank statements

c) A cheque paid to P Chris for $250 on December 31 has not yet been presented

d) A bank lodgement has not yet been credited – the cheque of $720 received from H Mvuri on 31 December

Bank reconciliation statement as at 31 December 20X8

<table>
<thead>
<tr>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance as per cash book</td>
</tr>
<tr>
<td>Add: cheque not yet presented</td>
</tr>
<tr>
<td>less: bank lodgement not on statement</td>
</tr>
<tr>
<td>Balance per bank statement</td>
</tr>
</tbody>
</table>

When you have adjustments to make to both the cashbook and the bank account balances in order to reconcile them, this form of bank reconciliation statement is more useful than one that simply shows that you know why their balances are different.

NB* in reconciling cash book and bank statement always start with the balance as per cash book

Other terms used in banking

1. Standing orders- this is an instruction by a firm to a bank to pay regular amounts of money on stated dates. e.g. you may ask your bank to pay $2million a month to a building society to repay a mortgage.

2. Direct debits- these are payments which have to be made such as electricity bills, telephone bills, rates and insurance premiums. Instead of asking the bank to pay the money as with standing orders you give permission to the creditor to obtain the money directly from your bank account. This is particularly
Cash at bank as per bank column of the cash book 40 300
Unpresented cheques 7 300
Cheques received & paid into the bank but not yet entered on the bank statement 5 600
Credit transfers entered as banked on the bank statement but not entered in the cash book 3 400
Cash at hand as per bank statement 45 400

2. From the following draw up an overdraft

The bank statement for R Hood for the month of March 20X6 is:

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>DR</th>
<th>CR</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mar 1</td>
<td>Balance</td>
<td></td>
<td></td>
<td>4 200 O/D</td>
</tr>
<tr>
<td>8 T MacLeod</td>
<td>184</td>
<td></td>
<td></td>
<td>4 384 O/D</td>
</tr>
<tr>
<td>16 Cheque</td>
<td>292</td>
<td></td>
<td></td>
<td>4 092 O/D</td>
</tr>
<tr>
<td>20 W Milne</td>
<td>160</td>
<td></td>
<td></td>
<td>4 252 O/D</td>
</tr>
<tr>
<td>21 Cheque</td>
<td>369</td>
<td></td>
<td></td>
<td>3 883 O/D</td>
</tr>
<tr>
<td>31 G Frank: trader’s credit</td>
<td>88</td>
<td></td>
<td></td>
<td>3 795 O/D</td>
</tr>
<tr>
<td>31 TYF: standing order</td>
<td>32</td>
<td></td>
<td></td>
<td>3 827 O/D</td>
</tr>
<tr>
<td>31 Bank charges</td>
<td>19</td>
<td></td>
<td></td>
<td>3 846 O/D</td>
</tr>
</tbody>
</table>

Cash book for March 20X6

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>DR</th>
<th>CR</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mar 16</td>
<td>G Philip</td>
<td>292</td>
<td></td>
<td>4 200</td>
</tr>
<tr>
<td>21 J Forker</td>
<td>369</td>
<td></td>
<td></td>
<td>184</td>
</tr>
<tr>
<td>31 S O Hare</td>
<td>192</td>
<td></td>
<td></td>
<td>160</td>
</tr>
<tr>
<td>31 Bal c/d</td>
<td>4 195</td>
<td>30 S Porter</td>
<td>504</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>5 048</td>
</tr>
</tbody>
</table>

Required:

a. Write the cash book up to date
b. Draw up a bank reconciliation statement as on 31 March 20X6

Trade and other receivables

- A sale made without the buyer paying at the time of the sale is known as a credit transaction.
- The person or business owing money to an enterprise which originates from a credit sale is known as a trade debtor.
- A debtor accepts responsibility for paying the debt within a specific period.
- The period is known as a credit term and is predetermined in accordance with the credit policy of the enterprise making the sale.
- Because some debtors do not pay their accounts, many firms make provision for bad debts

Discount allowed
Discount is often offered to debtors in order to encourage a quick settlement of their debts within the stated credit term. The credit will be shown on the credit invoice.
under the double entry system, another account has to be credited with the same amount. In practise it is not the asset account but a contra asset account, the accumulated depreciation account, which is credited with the annual depreciation.

\[
\text{Accumulated Depreciation account) Depreciation} \quad \text{xxxx}
\]

The difference between the debit balance on the asset account and the credit balance on the accumulated depreciation account is the net carrying amount of the asset.

NB* remember there is no depreciation on the VAT component of the purchase price of property plant and equipment as this is not included as part of the cost price.

**Methods of calculating depreciation**

There are various methods of determining the amount of annual depreciation to be written off. We will discuss only the:

- Straight line method
- Diminishing balance method
- Production unit method

E.g. suppose Braform Ltd bought a machine on 1 June 2011 for $500 000 with a discount of $60 000, transport costs of $15 000 and installation costs of $5 000. The depreciable cost price of the machine is:

\[
\begin{align*}
\text{Cost} & = 500 000 - 60 000 \\
& = 440 000 \\
\text{Less transport} & = 15 000 \\
\text{Less installation} & = 5 000 \\
\text{Carrying amount} & = 460 000
\end{align*}
\]

The estimated lifespan is 5 years. Braform Ltd's financial year ends 31 May.

We now examine the 3 methods using the information.

**Straight line method**

The straight line method involves charging equal amounts for depreciation year after year during the life span of the asset.

\[
\text{Depreciation} = \frac{\text{cost} - \text{RV}}{\text{No. of years}}
\]

**Reducing balance method**

- This method charges great amounts for depreciation during the assets earlier years and less amounts as the asset ages.
- This assumption is that the asset will be more productive when it is still new and less productive when old.
- In this case a fixed percentage of the carrying amount NBV is written off annually.
- This method does not use the depreciation amount (cost less residual value) as the basis for calculation but is based on the cost price less accumulated depreciation, or the carrying amount.

**Usage/ Production unit method**

Depreciation charged for a particular period depends on the rate of usage of the asset during that period. Usage can be in the form of mileage (vehicles), production (machinery and equipment) and time (machinery and equipment).

In this case the units produced by the machine are written off annually as a percentage of the units the machine is expected to produce over its total life span.
4. Record the amount earned on the realisation (note that the realisation account is credited in all three cases)

**Sold for cash**
Debit : bank  
Credit : realisation a/c  

**Sold on credit**
Debit : debtor  
Credit : realisation a/c  

**Asset traded in**
Debit : asset a/c  
Credit : realisation a/c  

5. Determine the profit or loss on the disposed asset:
- If the total of the debit side of the realisation account is bigger than that of the credit side, the asset was disposed of at a loss.  
- If the total of the credit side of the realisation account is bigger than that of the debit side, the asset was disposed of at a profit.  

6. Transfer the profit or loss to the profit or lose account on disposal of that types of assets

**Profit**
Debit : realisation a/c  
Credit : profit on disposal of ............ a/c  

**Loss**
Debit : loss on disposal of ...............a/c  
Credit : realisation a/c  

Example:
Suppose that in the Braform Ltd’s example the machine costing $460 000 was bought on 30 November 2011. The machine was sold for $60 000 when the accumulated depreciation was $402 500 using production unit method.

**Required:**
Account for the sale of the asset.

Notes to the financial statements
The property plant and equipment section of the balance sheet has important notes that should be disclosed in the financial statements due to the full disclosure principle.
1. The depreciation method and the percentage at which the assets are depreciated at  
2. Disclose if the land and buildings are classified as investment properties and are depreciated or not.  
3. Carrying amounts of the assets

Other non-current assets

Intangible assets
Are identifiable, non-monetary assets without physical substance held for use in the production or supply of goods and services, for rental to others or administrative purposes, which are controlled by an enterprise as a result of past events and from which future economic benefits are expected to flow to the enterprise.

**Examples of intangible assets include:**
- Brands  
- Licenses  
- Patents  
- Computer software  
- Trademarks  
- Copyrights  
- Franchises  
- Goodwill  

Intangible assets have an infinite life and should be amortised over their useful lives.
REVISION EXERCISES

Question One

Calculate the missing figures and indicate a loss by placing bracket ( ) around the amount. Show the workings.

A. Sales $333 000
   Beginning Inventory 117 000
   Purchases ?
   Ending Inventory 135 000
   COGS 144 000
   Gross Profit ?
   Expenses 99 000
   Net income or loss 90 000

B. Sales $288 000
   Beginning Inventory 108 000
   Purchases 171 000
   Ending Inventory ?
   Cost of Goods sold 189 000
   Gross Profit ?
   Expenses 126 000
   Net income or loss ?

Question Two