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

CREDIT NOTE no. CR001 Date 8 March 2008

Handyman Hardware Store

VAT Reg. No. 446010111

To: Mike Dauce
PO Box 888
Hillgrassy House,
1685

27 Olifants Road
Emmarentia
Johannesburg
2196
☎(011)310-1390

Qty	Description	Price Excl.	Discount	Amount Excl
	Repairs to roof Refund on Invoice IN0001	450.00	-	450.00

Sub Total	450.00
VAT @ 14%	63.00
Invoice Total	513.00

E.&O.E. (Inclusive of 14 % VAT)

RED Willow Ltd
51 Belcover Avenue
Welshire

To: R. Pusey
43 Belcower Store
Spanish Town
St. Catherine

Tel (…6) 45…
…(0186) 4518

DEDIT NOTE No…

	Per Unit	Total
	$	$
2 cases of Lava Wi…	50	500
3 ca… …up	10	110
		610

EARNINGS RECORD FOR QUARTER ENDED *Sept. 30, 20--*

EMPLOYEE NO. *7* NAME *Ames, Virginia C.* SOCIAL SECURITY NO. *512-36-7216*

MARITAL STATUS *M* WITHHOLDING ALLOWANCES *3* HOURLY RATE *$6.00* SALARY

DEPARTMENT *Golf* POSITION *Salesclerk*

1	2	3	4	5	6	7	8	9	10	11
PAY PERIOD		TOTAL EARNINGS	DEDUCTIONS						NET PAY	ACCUMULATED EARNINGS
NO.	ENDED		FEDERAL INCOME TAX	STATE INCOME TAX	SOC. SEC. TAX	MEDICARE TAX	OTHER	TOTAL		6340 00
1	7/2	525 00	12 00	26 25	34 13	7 88	H 16 00 L 12 80	109 06	415 94	6865 00
2										

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.

	Dr	Cr
Cash	2 400	
Merchandise Inventory	61 152	
Office supplies expense	43[illegible]	
Store equipment expense	1 4[illegible]0	
Prepaid insurance expense	3 276	
Office equipment	10 644	
Accumulated depreciation – office equipment		3 840
Accounts Payable		8 766
Store equipment	38 178	
Accumulated Depreciation – Store equipment		15 372
Capital: D. Walker		72 540
Withdrawals: D. Walker	32 400	
Sales		342 774
Sales returns & allowances	2 094	
Sales discount (discount allowed)	3 816	
Purchases	205 650	
Purchases returns & allowances		1 332
Purchases discount (discount received)		5 292
Transportation in (carriage inwards)	1 158	
Sales salaries expense	38 304	
Rent expense – Selling spares	23 220	
Advertising expense	684	
Office salaries expense	22 356	
Rent expense – Office	2 736	
	449 916	449 916

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

20X8	$	20X8	$
De c 1 Bal b/f	1 600	Dec 8 V Vanbeak	1 150
16 S Nyoni	800	21 Grigori	350
23 K Shira	1 300	28 P Chris	250
31 H Mvuri	720		

Bank statement

20X8	**Withdrawal**	**Deposit**	**Balance**
Dec 1 Bal b/f			1 600
11 34621	1 150		450
14 Deposit		800	1 250
23 34622	350		900
24 Deposit		1 300	2 200
28 Bank Giro: G Cresta		240	2 440
31 Bank charges	400		2 040

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 for $720 received from H Mvuri on 31 December

Bank reconciliation statement as at 31 December 20X8

	$
Balance as per cash book	2 510
Add: cheque not yet presented	250
	2 760
less: bank lodgement not on statement	(720)
Balance per bank statement	2 040

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:

20X6	DR	CR	BALANCE
Mar 1 Balance			4 200 O/D
8 T MacLeod	184		4 384 O/D
16 Cheque		292	4 092 O/D
20 W Milne	160		4 252 O/D
21Cheque		369	3 883 O/D
31 G Frank: trader's credit		88	3 795 O/D
31 TYF: standing order	32		3 827 O/D
31 bank charges	19		3 846 O/D

Cash book for March 20X6

20X6	$	20X6	$
Mar 16 G Philip	292	Mar 1 balance b/d	4 200
21 J Forker	369	6 T MacLeod	184
31 S O Hare	192	30 W Milne	160
31 Bal c/d	4 195	30 S Porter	504
	5 048		5 048

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**

Areas covered in this study:

1. How debtors are encouraged to pay their accounts on time
2. Writing off of bad debts
3. Creation and adjustment of the 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.

Accumulated Depreciation account)

		Depreciation	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 depriciation 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 depreciatiable cost price of the machine is:

$500 000
(60 000)
440 000
15 000
5 000
$460 000

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

We now examine the 3 methods using this information.

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

$$\textbf{Depreciation} = \frac{\textbf{cost – RV}}{\textbf{No. of years}}$$

Reducing balance method

- This method charges great amounts for deprecation 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