Module 3

THE COMPONENTS OF FINANCIAL STATEMENTS

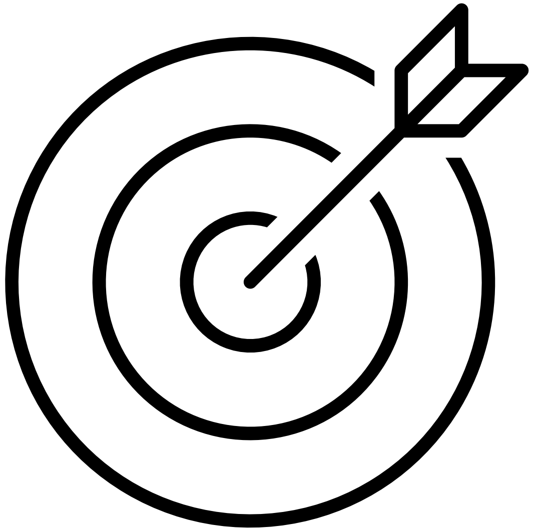
Module 3 – The components of financial statements

Learning outcomes:

At the end of this module, you should have an understanding of:

- The different types of assets
- The different types of liabilities
- Equity accounts for the different entity forms
- The main accounting operations
- How to account for revenue and inventory

Module 3 – The components of financial statements



Overall objectives are:

- Introduce more detail on assets, liabilities and equity
- Discuss the main accounting operations of revenue recognition and inventory management

Module 3 – Topics

3.1 More advanced accounting matters

3.2 Assets (cash, accounts receivable, provision for doubtful debts, prepaid expenses, inventories, PPE, intangible assets, impairment)

3.3 Liabilities (accounts payable, accrued expenses, loans and credits, provisions and taxes)

3.4 Equity (contrasts equity for a sole trader, a partnership and a company)

3.5 Main accounting operations

3.5.1 Revenue recognition

3.5.2 Inventory management

3.6 Exercises

3.1 More advanced accounting matters

Assets

- Current assets
- Non-current assets

Liabilities

- Current liabilities
- Non-current liabilities

Equity

Balance sheet elements

Assets

- Cash
- Accounts receivable (and provision for doubtful debts)
- Prepaid expenses
- Inventories
- PPE
- Intangible assets
- Impairment

Liabilities

- Accounts payable
- Accrued expenses
- Loans and credits
- Provisions
- Taxes

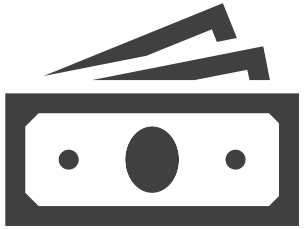
Equity

- Equity for a sole trader
- Equity for a partnership
- Equity for a company

3.2 Assets

3.2.1 Cash

- Refers to legal tender and cash equivalents
- Recognised at nominal (face) value



Cash held in a foreign bank

<u>Illustrative example 3.1: Restatement of foreign currency</u>

Mrs Algu has 1,000 USD in a foreign bank account. This amount was purchased at 3.20 CU per USD. Therefore, the balance of the account in Mrs Algu's ledger is CU3,200. At the end of the current accounting period, the exchange rate is 2.50CU per USD.

Required: Restate the bank account balance at the end of the accounting period.

Solution:

Journal	*Calculation:*	Debit	Credit
Year end:		CU	CU
Foreign bank account (balance sheet)		700	
Foreign exchange gain (income statement)	*(1,000x3.20) -(1,000x2.50)*		700
Restatement of bank account to exchange rate at end of current accounting period			

3.2.2 Accounts receivable

- Includes all the accounts that represent payment claims held by the enterprise for goods sold or services rendered
- Recognised at fair value which is the price at the time of the sale or service is rendered (i.e. cost at that date)
- Accounts receivable in a foreign currency will be stated using the exchange rate of the balance sheet date

3.2.2.1 Provision of doubtful accounts (i.e. debts)

<u>Illustrative example 3.2: Recognition of doubtful debt</u>

Required: Record the transactions in the journal of Sahara Company.

Solution:

Journal

		Debit	Credit
Feb		CU	CU
12	Accounts receivable (*Mr Gómez)*	30,000	
	Sales		30,000
	Cost of goods sold	25,000	
	Inventory		25,000
	Sale of goods on credit and recognition of expense (cost of sales)		
Mar			
10	Doubtful debts (expense)	10,000	
	Provision for doubtful debts (balance sheet)		10,000
	Recognition of impairment of accounts receivable		

3.2.3 Prepaid expenses

A prepaid expense (i.e. advance payment) is recognised as an asset for the portion of the expense for which the benefit will only be consumed in a future period.

What are some examples of prepaid expenses?

What journal entry would be required to adjust for prepaid expenses at year end?

3.2.4 Inventories

- Merchandise – goods acquired for the intention to sell as is.
- Raw materials – goods used in the production of other goods or to be transformed.
- Work in process – materials or goods that have been partially transformed. Its costs include the raw material cost and other production costs (i.e. direct labour and allocated indirect costs such as factory overheads).
- Finished goods – manufactured goods intended for resale.

<u>Illustrative example 3.3: Purchase of inventory for cash</u>

Kilimanjaro Enterprises bought merchandise for 10,000 CU and paid in cash.

Required: Record the purchase of Inventory in the journal of Kilimanjaro Enterprises.

Solution:

Journal

		Debit	Credit
		CU	CU
1.	Inventory	10,000	
	Cash		10,000
	Inventory purchased for cash		

Illustrative example 3.4: Purchase of inventory for cash and credit

Mr Ruiz bought inventory for 25,000 CU paying 10,000 CU immediately and the rest is payable in six months time.

Required: Record the purchase of inventory in the journal of Mr Ruiz.

Solution:

Journal

		Debit	Credit
		CU	CU
1.	Inventory	25,000	
	Cash		10,000
	Accounts payable		15,000
	Inventory purchased for cash		
6 months later:			
2.	Accounts payable	15,000	
	Cash		15,000
	Payment of accounts payable		

Illustrative example 3.5: Purchase of inventory from a foreign supplier

In August, the Mrs Lim bought some inventory from a foreign supplier for an amount of 2,000 USD. The purchase was on credit and it will be paid in March next year. At the time of purchase the exchange rate was 3.20 CU per USD. At the end of the period the exchange rate was 2.90 and at the time the debt was paid it was 3.00.

Required: Record the purchase of inventory in the journal of Mrs Lim.

Solution: Journal

		Debit	Credit
Purchase of material:		CU	CU
1	Inventory	6,400	
	Foreign supplier (Accounts payable)		6,400
	Purchase of inventory when the exchange rate is CU3.20 = USD1.		
Adjustment at year end:			
2.	Foreign supplier	600	
	Foreign exchange gain (income statement)		600
	Restating the amount owing to the foreign supplier using the exchange rate at Y/E		
Pay the foreign supplier:			
3.	Foreign supplier	5,800	
	Foreign exchange loss (income statement)	200	
	Cash		6,000
	Payment of foreign creditor		

Illustrative example 3.6: Purchase of inventory with VAT

Mr Messi buys merchandise for 10,000 CU + 19% VAT and pays cash.

Required: Record the purchase of the merchandise in the journal of Mr Messi.

Solution:

Journal

	Debit	Credit
Purchase of merchandise:	CU	CU
Merchandise (inventory)	10,000	
Input Vat	1,900	
Bank		11,900
Purchase of merchandise for cash		

Note: If the purchaser is not a registered VAT vendor, the input VAT would become part of the cost of the merchandise.

Methods of recognising the cost of goods sold

Specific identification method	• used mainly if items are unique or if the cost of the item can be physically linked to the item sold • For example, items of jewelry are unique
Weighted average method	• items available for sale are best measured by a weighted cost
First-in first-out method	• items that are received first by the business, are the first items sold

Methods of recording the cost of goods sold

Periodic method

- Only once the ending inventory has been determined (at least annually), can cost of sales be determined

Perpetual method

- Cost of goods sold is calculated on a daily basis (or as sales take place)

Illustrative example 3.7: FIFO method

A retailer who commenced trading in 20X7 recorded the following movements in inventory during the year ended 31 December 20X7.

	Purchases	Purchases	Sales	Sales
20X7	Units	CU	Units	CU
1 August	1 000[1]	10,000		
15 August			200	4,000
1 November	400[2]	6,000		
1 December	200[3]	4,000		
14 December			700	35,000

Solution:

Scenario A: FIFO

	Calculation:	**CU**
Closing inventory	*(100[4] x CU10) + (400 x CU15) + (200 x CU20)*	11,000
Cost of sales	*900 x CU10*	9,000

[4] Bought 1000 units on 1 August and sold 900 units

Illustrative example 3.7: Weighted average method (on an annual basis)

A retailer who commenced trading in 20X7 recorded the following movements in inventory during the year ended 31 December 20X7.

20X7	Purchases Units	Purchases CU	Sales Units	Sales CU
1 August	1 000[1]	10,000		
15 August			200	4,000
1 November	400[2]	6,000		
1 December	200[3]	4,000		
14 December			700	35,000

Scenario B: WA and on annual basis

	Calculation:	**CU**
Closing inventory	*(CU10,000 + CU6,000 + CU4,000)/1600 units x 700 units*	8,750
Cost of sales	*900 units x 12.50CU[5]*	11 250

[5] *CU10 000 + CU6 000 + CU4000)/1600 units = 12.50 per unit*

Illustrative example 3.7: Weighted average method on a transaction by transaction basis

The details in the previous examples apply.

Scenario C: WA and on a transaction by transaction basis (W2)

	Calculation:	**CU**
Closing inventory	*700 units x 12.86*	9 000
Cost of sales	*2,000 + 9,000*	11 000[1]

[1](200 units x 10CU) + (700 units x 12.86CU)

Working 2: WA and transaction by transaction

	Units	Total cost (CU)	Average cost per unit (CU)
20X7			
1 August	1 000	10,000	10
15 August	(200)	(2,000)	10
1 November	400	6,000	15
	1 200	14,000	11.67
1 December	200	4,000	20
	1 400	18,000	12.86
14 December	(700)	(9,000)	12.86
31 December	700	9,000	12.86

Inventory is valued at the lower of cost and net realisable value at year end

- Net realisable value is the estimated selling price less estimated costs to sell
- The above rule can be applied for each item or for groups of similar items

<u>Illustrative example 3.8: Impairment of inventory at year end</u>

Ms Santiago purchases merchandise (inventory) for 12,000 CU for cash. At the year end, this merchandise is still on hand. Due to the economic situation in the market, Ms Santiago estimates that she will only be able to sell that merchandise at a price of 10,000 CU with selling costs of 500 CU.

Required: Record the purchase of the inventory and its subsequent impairment in the journal of Ms Santiago.

Solution:

Journal		Debit CU	Credit CU
1	Inventory	12,000	
	Cash		12,000
	Purchase of merchandise for cash		
Year end:			
2.	Cost of goods sold/ Impairment of inventory (expense)	2,500	
	Inventory (balance sheet)		2,500
	Recognition of impairment of inventory		

3.2.4 Property, plant and equipment

- Land
- Buildings
- Machinery and operating equipment – used in manufacturing
- Other equipment
- Tools and replacement units

These assets are initially measured at cost. After initial recognition, these assets are measured at the cost less accumulated depreciation less accumulated impairment.

<u>Illustrative example 3.9: Depreciation</u>

A machine worth 10,000 CU is purchased and has an estimated useful life of five years. Each year the machine will be depreciated by 2,000 CU for 5 years. This will be reflected as an increase in accumulated depreciation (and is shown in the balance sheet as a deduction from the cost of the asset) and as a cost or expense for the same amount which is shown in the Income Statement where it is associated with helping to generate income during the period.

Year	Acquisition Cost	Accumulated Depreciation	Net Value
1	10,000	2,000	8,000
2	10,000	4,000	6,000
3	10,000	6,000	4,000
4	10,000	8,000	2,000
5	10,000	10,000	0

Explanation: 10.000/5 = 2,000 CU

The expense to be recognised each year in the income statement is CU2,000 each year for five years.

3.2.5 Intangible assets

- Intangible assets cannot be touched physically
- Like PPE, intangible assets also have a useful life and need to be amortized.

Illustrative example 3.10: Amortisation

A patent is bought for a price of 40,000 CU. This patent lasts 20 years. Dividing 40,000/20 = 2,000 each year. This amortisation will be reflected as an increase in accumulated amortisation (and is shown in the balance sheet as a deduction from the cost of the intangible asset) and as a cost or expense for the same amount which is shown in the Income Statement where it is associated with helping to generate income during the period.

3.2.6 Impairment

- An asset is impaired when it is unlikely to generate cash flows to absorb the carrying amount of the item over its useful life.

- Entries similar to accumulated depreciation / amortisation would be required to be processed.

Illustrative example 3.11: Pictorial presentation – property, plant and equipment reconciliation

Balance Sheet at 31 December 20X2	Note	20X2	20X1
		CU	CU
Assets			
Non-current assets			
Property, plant and equipment	4	176,500	142,000

1. Property, plant and equipment

	Land	Plant and equipment	Total
20X2			
Cost	100,000	55,000	155,000
Accumulated depreciation and impairments	-	(13,000)	(13,000)
Balance at the beginning of the year - 1 January 20X2	100,000	42,000	142,000
Additions	50,000	-	50,000
Disposals	(10,000)	-	(10,000)
Depreciation	-	(5,500)	(5,500)
Balance at the end of the year – 31 December 20X2	140,000	36,500	176,500
Cost	140,000	55,000	195,000
Accumulated depreciation and impairments	-	(18,500)	(18,500)
	140,000	36,500	176,500

Balance sheet elements

Assets

- Cash
- Accounts receivable (and provision for doubtful debts)
- Prepaid expenses
- Inventories
- PPE
- Intangible assets
- Impairment

Liabilities

- Accounts payable
- Accrued expenses
- Loans and credits
- Provisions
- Taxes

Equity

- Equity for a sole trader
- Equity for a partnership
- Equity for a company

3.3 Liabilities

3.3.1 Accounts payable

Obligations contracted by the enterprise from the purchase of goods and services arising from normal operations e.g. suppliers.

Record (recognise) at nominal value (i.e. cost) and reduce by any payments made.

3.3.2 Accrued expenses

Accrued expenses are recognised when a benefit has been received or used in the reporting period, but has not yet been paid.

Examples:

- Wages owing
- Electricity consumed

- What are some other examples of accrued expenses?
- What journal entry would be necessary to process for accrued expenses at year-end?

3.3.3 Loans and credits

These are obligations contracted by the enterprise with financial institutions for financing operations.

Examples:

- Loans from banks
- Lines credit - a revolving account that let borrowers draw, repay and redraw from available funds
- Leasing contracts (i.e. lease instalments still owing in terms of the agreement)

3.3.4 Provisions

These are the estimated value of a liability for which the amount or date is uncertain

Example:

Post-employment employee benefits

Recognition:

a) Present obligation arising from a past event

b) Probable that the enterprise will use resources to settle the obligation

c) The amount can be estimated reliably

3.3.5 Taxes

Includes all amounts owing to the revenue authorities

- VAT or GST
- Customs duties
- Income tax
- Regional and local taxes
- Tax on financial transactions

Balance sheet elements

Assets

- Cash
- Accounts receivable (and provision for doubtful debts)
- Prepaid expenses
- Inventories
- PPE
- Intangible assets
- Impairment

Liabilities

- Accounts payable
- Accrued expenses
- Loans and credits
- Provisions
- Taxes

Equity

- Equity for a sole trader
- Equity for a partnership
- Equity for a company

3.4 Equity

A – L = E

E = capital provided by the owners (paid-in capital) + retained earnings (profits or losses from past operations).

Illustrative example 3.12: Paid-in capital

Five individuals decide to form the Five Exports Company by contributing 20,000 CU each.

Required: Record the above transaction in the journal.
Solution:

Journal

	Debit	Credit
Date:	CU	CU
Cash	100,000	
Paid-in capital (Equity)		100,000
Recognition of cash received on formation of company		

Note: When a company is formed, shares (or stock) are issued to designate each shareholder's interest in the company. For instance, this company may have issued 100 000 shares with each shareholder receiving a certificate showing a holding of 20 000 shares.

<u>Illustrative example 3.13: Owner’s equity account of a sole proprietor</u>

Using the example of Joe Ngibe in Module 1, the equity account in the balance sheet is as follows:

Equity	
Balance at the beginning of the period	8,300
Profit	1,650
	9,950
Less: Drawings	(200)
Balance at the end of the period	9,750

Alternatively, this detail could be shown as a note to equity in the balance sheet.

Illustrative example 3.14: Owner's equity account of a partnership

Using the above example, assume there were two equal partners, with a profit-sharing ratio of 50%.

	Partner A	Partner B	Total
Equity			
Balance at the beginning of the period	4,150	4,150	8,300
Profit	825	825	1,650
	4,975	4,975	9,950
Less: Drawings (assuming each partner withdrew 100CU)	(100)	(100)	(200)
Balance at the end of the period	4,875	4,875	9,750

Alternatively, this detail could be shown as a note to equity in the balance sheet.

Illustrative example 3.15: Equity account of a company

Assuming Joe Nigibe is trading as a company with many shareholders, the equity account in the balance sheet is as follows:

Balance Sheet

Equity	*Calculation:*	
Issued capital (or Paid-in Capital)		8,300
Retained earnings	*(1,650 – 200 dividend*)*	1,450
		9,750

*a company would pay a dividend to its shareholders.

Statement of changes in Equity

	Share capital	Retained earnings	Total
Balance at the beginning of the period	8,300	-	8,300
Profit	-	1,650	1,650
Dividends	-	(200)	(200)
	8,300	1,450	9,750

Note: if a company pays a dividend, the deduction is shown in a separate statement entitled "Statement of Changes in Equity".

Components of the financial statements: Key points to remember
➢ Assets, when shown on the balance sheet, must be separated into Non-current assets and Current assets.
➢ Liabilities, when shown on the balance sheet, must be separated into Non-current liabilities and Current liabilities.
➢ Equity (or capital) represents the owners’ investment in the enterprise.
➢ Retained earnings are the profits not distributed and accumulated losses from previous years.

Quick quiz

1. What is the difference between non-current assets and current assets?

2. Can you name an example of each?

3. What is the difference between non-current liabilities and current liabilities?

4. Can you name an example of each?

5. Why is it necessary to impair inventory at year-end?

3.5 Main accounting operations

Revenue recognition

- Interest received
- Rendering of services
- Sale of goods

Inventory management

- Held for sale in the ordinary course of business
- In the production process to be sold (work in process)
- Materials and supplies consumed in production or rendering of services (raw materials)

Illustrative example 3.16: Recognition of interest

Ms Mkhize has 10,000 CU in a bank account that generated interest of 50CU at the end of the month.

Required: Record the interest received in the journal of Ms Mkhize.

Solution:

Journal	Debit	Credit
	CU	CU
Bank (balance sheet)	50	
Interest received (Income statement)		50
Interest income for the month		

Illustrative example 3.17: Rendering of services

LimpiaTodo provides cleaning services. The Clover Cheese Company hires LimpiaTodo SA to clean its factory 2 times. The first cleaning was performed during the current accounting period leaving the second for the next. LimpiaTodo SA received advance payment for both cleanings (30,000 CU) and it estimates reliably that each cleaning costs 8,000 CU.

Required: Record the above transactions in the journal of LimpiaTodo.

Solution:

Revenue of 30,000CU can be measured reliably. The completion can be measured at 50% complete. Each cleaning has a measured cost of 8,000 CU.

		Debit	Credit
1.	Cash	30,000	
	Deferred Revenue		30,000
	LimpiaTodo has not provided any cleaning services		
2	Deferred Revenue	15,000	
	Revenue		15,000
	LimpiaTodo recognises one half of the revenue		
3.	Cost of cleaning service rendered	8,000	
	Salaries payable		8,000
	Assuming only cost are the salaries of the staff concerned, then that portion of their salaries related to the cleaning contract is an expense		

Illustrative example 3.18: Rendering of services

Flower Enterprises hires Transformation SA to renovate its offices. Flower Enterprises pays in advance the total amount for the service, 15,000 CU. Renovation work started this period but it will be only be finished during the next period. Transformation SA has incurred in costs of 7,000 CU.

Required: Record the accounting entries in the journal of Transformation SA assuming that it is unable to measure the progress it had made on the renovation project.

Solution:

Journal of Transformation SA		Debit CU	Credit CU
1.	Cash	15,000	
	Deferred Revenue		15,000
	Transformation SA has not provided any renovation services at the time it receives the cash.		
2	Deferred Revenue	7,000	
	Revenue		7,000
	Cost of renovation work completed to date	7,000	
	Cash (assuming costs were paid in cash)		7,000
	Transformation SA is unable to measure how much of the renovation it has completed. In this case, revenue equal to the amount of costs incurred is recognised, i.e. profit measured is 0.		

Sale of goods

Recognise when:

- The enterprise has transferred all the risks and benefits linked to ownership and control of the goods to the buyer
- The revenue can be measured reliably
- It is probable the enterprise will receive the economic benefits associated with the transaction
- The costs (associated with the revenue) can be measured reliably

Inventory management

Inventories are assets:

- Held for sale in the ordinary course of business (bought in or finished goods)
- In the production process to be sold (work in process)
- In the form of materials and supplies to be consumed in production or rendering services

Held for sale in the ordinary course of business

- Purchased for resale – measured at cost at date of acquisition
- Inventories being manufactured – measured at their production cost

Production cost of inventories

Costs of purchase

- Cost of materials
- Non-refundable taxes
- Transport, handling etc

Costs of conversion

- Direct labour
- Depreciation of machinery, consumables
- Appropriate allocation of fixed and variable production overheads

Other costs

- All other costs incurred in bringing the inventories to their present location and condition

Illustrative example 3.19: Pictorial presentation – Cost of production cost of inventory

Purchase price – direct materials	2,000	
Directly attributable costs (import duty, transport inwards, etc.)	200	
Trade discounts, rebates and subsidies	(300)	
Cost of purchase		1,900
Direct costs:		
Direct labour	2,000	
Indirect costs:		
Variable production overheads:		
• Indirect materials	150	
• Indirect labour	200	
Fixed production overheads:		
• Depreciation and maintenance of factory buildings and equipment	300	
• Cost of factory management and factory administration	150	
Costs of conversion		2,800
Other costs or overheads which clearly relate to putting the inventory into its present location or condition		200
Cost of inventory manufactured		4,900

Illustrative example 3.20: Work in process (manufacturing business)

A business that manufactures jeans had a beginning WIP inventory at the beginning of the year of 1,000CU. During the year the business incurred manufacturing costs of 5,000 and produced finished jeans costing 4,900CU.

Required: Calculate the cost of ending WIP.

Solution:	**CU**
Beginning WIP	1,000
Manufacturing costs	5,000
	6,000
Less: cost of finished jeans	4,900
Closing WIP	1,100

Note: This is basically an estimate of the cost of the WIP. If the production process is very short, such as in this case with the manufacturing of jeans, the business will probably not have any jeans in the process of manufacture at the year end.

Raw materials and supplies to be consumed on hand

Value at the lower of cost and net realisable value

Illustrative example 3.21: Pictorial presentation of inventory

Balance sheet

	Note	20X2	20X1
Assets		**CU**	**CU**
Current Assets			
Inventories	1, 2	62,200	38,100

Notes to the financial statements

1. **Summary of significant accounting policies**

   Inventories

   Inventories are valued at the lower of cost or net realisable value. The cost of raw material is determined on a first-in first-out basis. The cost of work in process and finished goods include the cost of raw materials plus an allocation of direct and indirect manufacturing costs.

2. **Inventories**

	20X2	20X1
Raw materials	18,200	9,100
Work in process	10,000	8,000
Finished goods	34,000	21,000
	62,200	38,100

Main accounting operations: Key points to remember
➢ An enterprise's main operations are focused on revenue recognition and inventory management.
➢ Revenue may consist of sale of goods, rendering of services and interest received.
➢ Inventories can be finished goods, work in process or raw materials and consumables.
➢ Inventories may consist of a number of components, such as the costs of purchase, costs of conversion, and other costs to bring the inventories to their present location and condition.
➢ Inventories are valued using either the specific identification, FIFO or WA method.
➢ Inventories are valued at the lower of cost or net realisable value.

3.6 Exercises

Exercises

Exercise 3.1 – Mr and Mrs Fridi – a partnership

Exercise 3.2 – Mrs Lau - a sole trader

Exercise 3.1

The balance sheet at 31 December 20X4 is provided in the question.

The transactions for January 20X5 are as follows (next slide):

During January 20X5, the partnership does the following:

1. Merchandise was bought for 60 CU but has not yet been paid for.
2. Purchase of a computer for 75 CU was paid in cash.
3. A sale of merchandise for 160 CU was received in cash. The cost of the sold goods was 80 CU.
4. Furniture is shown in the above balance sheet at a cost of 180 CU less accumulated depreciation of 30 CU. Depreciation of 5 CU must be recorded for the furniture for January 20X5.
5. Depreciation of the computer was recorded for the amount of 10 CU.
6. The salaries for the month amounted to 40 CU and was paid from bank. This included a salary for Mrs SA Fridi of 10 CU as she was actively running the business.
7. A customer paid 50 CU that was owed from a past purchase.
8. Monthly loan payment of 30 CU was made, of which 20 CU was to reduce the principal amount owing and 10 CU was for interest.
9. Mr Fridi and Mrs Fridi each withdrew 5 CU from the partnership at the end of January 20X5.

Suggested solution to Exercise 3.1 **(Page 1 of 3 pages)**

GENERAL LEDGER of Mr and Mrs SA Fridi

Cash

450 Beg bal	75 (2)
160 (3)	40 (6)
50(7)	30 (8)
	10 (9)
	505 Bal c/f
660	660
505 Bal b/f	

Accounts receivable

280 Beg bal	50 (7)
	230 Bal c/f
280	280
230 Bal b/f	

Inventories

350 Beg bal	80 (3)
(1) 60	330 Bal c/f
410	410
330 Bal b/f	

Computer Equipment

75 (2)	

Furniture - cost

180 Beg bal	

Acc Dep. - furniture

	30 Beg bal
Bal c/f 35	5 (4)
35	35
	Bal b/f 35

Acc. Dep. Computer equip

	10 (5)

Accounts payable

	150 Beg bal
Bal c/f 210	60 (1)
210	210
	Bal b/f 210

Bank loan

(8) 20	280 Beg bal
Bal c/f 260	
280	280
	Bal b/f 260

Drawings – Mr Fridi

5 (9)	

Drawings – Mrs Fridi

5 (9)	

Cost of goods sold

(3) 80	

Depreciation expense

5 (4)	
10 (5)	

Interest

(8) 10	

Salaries

(6) 40	

Suggested solution to Exercise 3.1 (page 2 of 3 pages)

Sales			Equity/Capital account – Mrs Fridi		Equity/Capital account – Mr Fridi	
	160	(3)		400 Beg Bal		400 Beg bal

Mr and Mrs SA Fridi

Trial balance at 31 January 20X5

	CU	CU
Bank balance	505	
Accounts receivable	230	
Inventories	330	
Computer	75	
Furniture – cost	180	
Accumulated depreciation – furniture		35
Accumulated depreciation – computer		10
Accounts payable		210
Bank loan		260
Drawings – Mr Fridi	5	
Drawings – Mrs Fridi	5	
Equity account (Capital) – Mrs Fridi		400
Equity account (Capital) – Mr Fridi		400
Sales		160
Cost of goods sold	80	
Depreciation expense	15	
Interest	10	
Salaries	40	
	1,475	1,475

Mr and Mrs SA Fridi	
Income Statement	
for the month ended 31 January 20X5	
in currency units (CU)	
Sales	
Cost of goods sold	
Gross profit	
Depreciation	
Interest expense	
Salaries	
Profit for the month	

Suggested solution to Exercise 3.1 (1 page only)

Mr and Mrs SA Fridi
Income Statement
for the month ended 31 January 20X5
in currency units (CU)

Sales	160
Cost of goods sold	(80)
Gross profit	80
Depreciation	(15)
Interest expense	(10)
Salaries	(40)
Profit for the month	15

Mr and Mrs SA Fridi

Balance Sheet

as of 31 January 20X5

(in currency units)

ASSETS			LIABILITIES	
			EQUITY	

Note 1: Capital / equity accounts						
	Mrs Fridi	**Mr Fridi**	**Total**			
Beginning balances						
Share of profits						
Less: drawings						
Ending balances						

Mr and Mrs SA Fridi
Balance Sheet
as of 31 January 20X5
(in currency units)

ASSETS		**LIABILITIES**	
Non-current assets		*Current liabilities*	
		Accounts payable	210
Furniture and computer equipment (180+75-35-10)	210	Bank loan	260
		Total Liabilities	470
Current assets			
Inventories	330	**EQUITY**	
Accounts receivable	230	Capital / equity accounts (Note 1)	805
Bank	505		
	1,065	*Total Equity*	805
TOTAL ASSETS	**1,275**	**TOTAL LIABILITIES + EQUITY**	**1,275**

Note 1: Capital / Equity accounts

	Mrs Fridi	Mr Fridi	Total
Beginning balances	400	400	800
Share of profits	7.5	7.5	15
Less: drawings	(5)	(5)	(10)
Ending balances	402.5	402.5	805

Exercise 3.2

Mrs Lau starts her own company in January 20X5

Exercise 3.2: Mrs Lau starts her own company in January 20X5, and performs the following operations all in currency units (CU):

January 20X5

1. She calls her business Lau SA and establishes it with an initial contribution of 420,000 CU. The contribution is made as follows: Land 90,000; Building 120,000; Equipment 50,000; and 160,000 was paid in cash.
2. An insurance policy for the building is taken out for one year for the amount of 2,400. The amount is paid in cash.
3. Furniture is purchased for the amount of 25,000 on 1 January 20X5. It is paid in cash.
4. Merchandise is purchased for the amount of 25,000 (1000 units).
5. Merchandise worth 10,000 USD was purchased from a foreign supplier; the purchase is on credit; the exchange rate is 3.20CU/USD. 1 200 units are purchased.
6. 500 units of goods are sold for 30 CU/unit. The amount is paid in cash.
7. 200 are paid for electricity and 500 for the telephone.
8. The insurance fee (corresponding to one month of the total fee) is recognised as an expense.
9. The depreciation of the building (5% annually), furniture (10% annually) and equipment (25% annually) is recorded.
10. 1,500 units are sold and paid in cash. Each unit is sold for 35/unit.

Lau SA records all expenses, except cost of sales, to one expense account called “Administrative expenses”.

Suggested solution to Exercise 3.2

Workings for cost of sales:

	Units	CU	
Purchased	1,000	25,000	
Purchased	1,200	32,000	
	2,200	57,000	
Sold	(500)	(12,955)	500/2200 x 57,000
Balance	1,700	44,045	
Sold	(1,500)	(38,864)	1500/1700 x 44,045
Balance – 31 January 20X5	200	5,181	

Journal (in CUs) for January 20X5			*Calculation:*	**DEBIT**	**CREDIT**
1.	Land (B)	(B = balance sheet)			
	Building (B)				
	Equipment (B)				
	Cash (B)				
		Paid-In capital / Equity (B)			
2.	Advance payment (B)				
		Cash (B)			
3.	Furniture (B)				
		Cash (B)			
4.	Inventories (B)				
		Cash (B)			
5.	Inventories (B)				
		Suppliers (B)			
6.	Cash (B)				
	Cost of goods sold (I)				
		Sales (I)			
		Inventories (B)			
7.	Administrative expenses (I)				
		Cash (B)			
8.	Administrative expenses (I)				
		Advance payment (B)			
9.	Administrative expenses (I)				
		Acc. Dep. building (B)			
		Acc. Dep. equipment (B)			
		Acc. Dep. furniture (I)			
10.	Cash (B)				
	Cost of goods sold (I)				
		Sales (I)			
		Inventories (B)			

Journal (in CUs) for January 20X5			*Calculation:*	DEBIT	CREDIT
1.	Land (B)	(B = balance sheet)		90,000	
	Building (B)			120,000	
	Equipment (B)			50,000	
	Cash (B)			160,000	
		Paid-In capital /Equity (B)			420,000
2.	Advance payment (B)			2,400	
		Cash (B)			2,400
3.	Furniture (B)			25,000	
		Cash (B)			25,000
4.	Inventories (B)			25,000	
		Cash (B)			25,000
5.	Inventories (B)		*(10,000USD x 3.20)*	32,000	
		Suppliers (B)			32,000
6.	Cash (B)			15,000	
	Cost of goods sold (I)		*(500/2200 x (25,000+32,000)*	12,955	
		Sales (I)	*(500 units x 30 CU)*		15,000
		Inventories (B)			12,955
7.	Administrative expenses (I)		*(200 elect + 500 telephone)*	700	
		Cash (B)			700
8.	Administrative expenses (I)		*(2,400/12months = 200)*	200	
		Advance payment (B)			200
9.	Administrative expenses (I)			1,750	
		Acc. Dep. building (B)	*(5% x 120,000 x 1/12)*		500
		Acc. Dep. equipment (B)	*(25% x 50,000 x 1/12)*		1,041.66
		Acc. Dep. furniture (I)	*(10% x 25,000 x 1/12)*		208.33
10.	Cash (B)			52,500	
	Cost of goods sold (I)		*(1500/1700 x 44,045)*	38,864	
		Sales (I)	*(1500 units x 35 CU)*		52,500
		Inventories (B)			38,864

Suggested solution to Exercise 3.2

GENERAL LEDGER – LAU SA

Cash

	Debit	Credit	
1	160,000	2,400	2
6	15,000	25,000	3
		25,000	4
		700	7
10	52,500		
Bal	**174,400**		

Advance Payments

	Debit	Credit	
2	2,400	200	8
Bal	**2,200**		

Inventories

	Debit	Credit	
4	25,000	12,955	6
5	32,000	38,864	10
Bal	**5,181**		

Suppliers

	Debit	Credit	
		32,000	5

Building

	Debit	Credit	
1	120,000		

Equipment

	Debit	Credit	
1	50,000		

Furniture

	Debit	Credit	
3	25,000		

Paid-in Capital / Equity

	Debit	Credit	
		420,000	1

Sales

	Debit	Credit	
		15,000	6
		52,500	10
		67,500	**Bal**

Administrative expenses

	Debit	Credit	
7	700		
8	200		
9	1,750		
Bal	**2,650**		

Cost of goods sold

	Debit	Credit	
6	12,955		
10	38,864		
Bal	**51,819**		

Land

	Debit	Credit	
1	90,000		

Acc. depreciation building

	Debit	Credit	
		500	9

Acc. depreciation equipment

	Debit	Credit	
		1,042	9

Acc. depreciation furniture

	Debit	Credit	
		208	9

LAU SA – Trial balance – 31 January 20X5		
	Debit	Credit
	CU	CU
Cash		
Advance payments		
Inventories		
Suppliers		
Buildings		
Acc depreciation - buildings		
Furniture		
Acc depreciation - furniture		
Equipment		
Acc depreciation - equipment		
Land		
Paid-in capital (Equity)		
Sales		
Cost of goods sold		
Administration expenses		

LAU SA – Trial balance – 31 January 20X5

	Debit	Credit
	CU	CU
Cash	174,400	
Advance payments	2,200	
Inventories	5,181	
Suppliers		32,000
Buildings	120,000	
Acc depreciation - buildings		500
Furniture	25,000	
Acc depreciation - furniture		208
Equipment	50,000	
Acc depreciation - equipment		1,042
Land	90,000	
Paid-in capital (Equity)		420,000
Sales		67,500
Cost of goods sold	51,819	
Administration expenses	2,650	
	521,250	521,250

LAU SA

Income Statement for the month ended 31 January 20X5

(in currency units)

	CU
Sales	67,500
(-) Cost of goods sold	(51,819)
Gross profit	15,681
(-) Selling expenses	0
(-) Administrative expenses	(2,650)
(-) Finance expenses	0
Profit before tax	13,031
(-) Income tax expense	0
Profit after tax	13,031

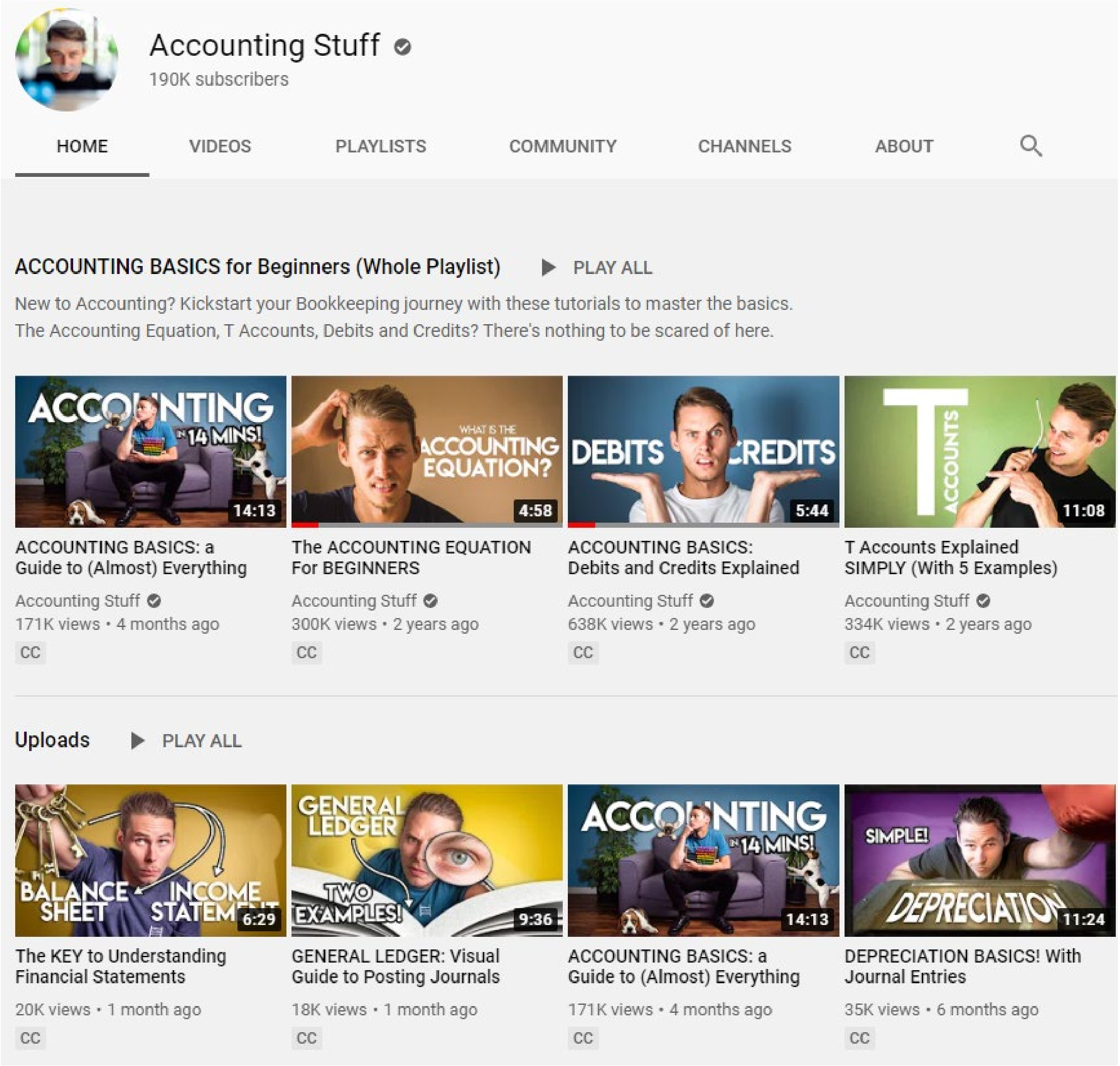
LAU SA
Balance Sheet as of 31 January 20X5
(in currency units)

ASSETS		**LIABILITIES**	
Current assets		Current liabilities	
Cash	174,400		
Advance payments	2,200		
Inventories	5,181	Suppliers	32,000
Current assets	**181,781**	**Total liabilities**	**32,000**
Non-current assets			
Furniture	25,000		
Acc. dep. furniture	(208)		
Equipment	50,000	**EQUITY**	
Acc. dep. equipment	(1,042)		
Building	120,000	Paid-in capital	420,000
Acc. dep. building	(500)	Profit for January	13,031
Land	90,000		
Total non-current assets	**283,250**	**Total equity**	**433,031**
TOTAL ASSETS	**465,031**	**TOTAL LIABILITIES + EQUITY**	**465,031**

LAU SA

Cash Flow Statement for the month ended 31 January 20X5

Cash flows resulting from operating activities	
Profit before tax	13,031
Depreciation and amortization (500 + 208 + 1,042)	1,750
(Increase) Decrease in Advance payments	(2,200)
(Increase) Decrease in Inventories	(5,181)
Increase (Decrease) in Suppliers	32,000
Increase (Decrease) in Accounts payable	-
Paid interest	-
Paid income taxes	-
Net cash provided by operating activities:	**39,400**
Cash flows resulting from investing activities	**-**
Sale (purchase) of non-current assets[1]	(25,000)
Net cash provided by investing activities:	**(25,000)**
Cash flows resulting from financing activities	**-**
Receipt (Payment) of Bank loans	-
Contributions (Repayment of capital)	160,000
Net cash provided by financing activities:	**160,000**
Net increase (Decrease) in cash	174,400
Cash at the beginning of the period	-
Cash at the end of the period, 31 January 20X5	**174,400**



https://www.youtube.com/watch?v=VhwZ9t2b3Zk

End of Module 3