Course: Accounting

Field of study: Economics

Form of classes and number of hours: lecture 30 h

Number of ECTS credits: 2

Learning outcomes:

After reading this guide, you will understand the outline of accounting, which is crucial in business and which is based on financial law. The course will explain how the accounting system works, the types of accounting books are and how the double-entry principle works on business transactions.

The student will understand how to account for transactions, how to value assets, liabilities, capital, revenues and costs and finally will be able to prepare basic financial statement.

Evaluation method of learning outcomes:

- tasks (work to do by students),
- test,
- exam.

Bibliography

Basic and complementary literature

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[4] Doupnik T., Finn M., Gotti G., Perera H., *International accounting.* Mc Graw Hill 2020.

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1. Introduction

Accounting is a system that has its own rules, techniques, principles underlying financial statement.
The role of an accounting system is to record monetary effects and create information about them for different users group.
This guide will:
- explain the context and purpose of accounting system,
- define the qualitative characteristics of financial information,
- demonstrate the use of double-entry principle,
- help to record transactions and events,
- explain how to prepare basic financial statements.

This guide is intended to assist students in going through accounting in the application of double-entry technique and the preparation of financial statements.

2. Context and purpose of financial accounting

Financial accounting is a system for recording, analysing, summarising and presenting financial data. Financial data are the actual transactions carried out by an enterprise, for example sales of goods and services, purchases of goods and services, payments for goods.

All these transactions are recorded in books of prime entry.

The transactions are then analysed in the books of prime entry and the totals are recorded in the general ledger accounts (so called T-accounts).

Finally, the transactions are summarised and presented in the financial statements.

Financial accounting is a method of reporting the financial performance and financial position of an enterprise, it also provides historical information. This system will not satisfy the information needs of persons not involved in running the business − these persons need information from management accounting.

Financial accounting is carried out by all business entities, for example by limited liability companies.

3. Users of financial statements and their needs

There are many groups of people, who may to be interested in financial information about the performance and position of a company.
These groups are:
a) The company's managers, who supervises the day-to-day operations of the company need the actual information for planning and control decisions in order to manage the business effectively and make the right decisions.

b) The company's shareholders, who want to assess how well its management is performing, how profitable the business is and how much profit they can withdraw for their own use.

c) Suppliers and customers, suppliers who supply goods for the company on credit, want to know about the ability to pay its obligations. Customers need to know whether there is any danger to scale down or close down the business.

d) Banks and other providers of finance to the company who provie short- and long-term financing by lending, so they need to know whether the company can maintain interest payments, repay the loan.

e) The taxation authorities will receive the information they need to make tax assessments.

f) Company employees who want to know whether the company is a secure source of their wages and salaries, which depend on its financial situation.

g) Financial analysts need information for their clients, to advise investors.

h) The government and its institutions are concerned with providing a basis for national statistics.

i) The public has different needs, such as the provision employment, the impact of the entity on the creation of local suppliers, or on the environment.

4. Main elements of financial statements

Financial statement is a collection of summary-level reports about an organization's financial results, financial position and cash flow. *The audited entities* are obligated to prepare the most complex financial statement which consists of the five elements: statement of financial position (the balance sheet), the statement of profit or loss (the income statement), statement of changes in equity, cash flow, additional information. *For the non- audited businesses,* the financial statement consists of statement of financial position (the balance sheet), the statement of profit or loss (the income statement), additional information. The outline of the financial statement is presented in annex no 1.

The basic elements of financial statements are the statement of financial position and profit and loss statement. Each position of financial statements is valued.

The directors are responsible for the preparation of the company's financial statements.

The statement of financial position is a statement of all assets and all the liabilities held by an entity at a given date.

Assets, according the IASB's Conceptual Framework for Financial Reporting, are resources controlled by an entity as a result of past events and from which future economic benefits are expected to flow to the entity.

Examples of assets include factories, office buildings, machinery, vehicles, office equipment, cash, material and goods.

Some assets are held and used on a long-term and short-term basis. Buildings, machinery, vans, trucks are used for many years in operation before they wear out.

Other assets are held for a short time, for example cash or materials.

The IASB's Conceptual Framework for Financial Reporting defines a liability as a present obligation of an entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources that include economic benefits.

Examples of liabilities are trade liabilities which are amounts owed to suppliers for goods purchased on credit, money owed to tax authorities, a bank overdraft.

Some liabilities are due to be repaid in the short term and some in the long term.

Capital or equity
Equity is the remaining share of an entity's assets after deducting all its liabilities.

Equity refers to the money invested by the owners in the business. In a limited liability company the equity is share capital – it takes a form of shares.

The statement of financial position is also called a balance sheet. In this statement total assets will be equal to the total liabilities and capital.
An example of the balance sheet is shown below.

A statement of financial position as at 31st December 20XX

Assets ($)	***100 000***	
Plant and machinery	60 000	
Inventory	22 000	
Receivables	18 000	
Cash and bank account	10 000	
Total assets	***100 000***	
Capital ($)		
Share capital	50 000	
Profit for the year	15 000	
Liabilities ($)		
Bank loan		15 000
Bank overdraft		5 000
Trade payables		12 000
Tax payables		3 000
Total capital plus liabilities		***100 000***

A profit and loss statement is a list of revenues (income) earned and costs (expenses) incurred during an accounting period. If an entity had more revenue than expenses it makes a profit, if vice verse it makes a loss.

Revenue are increases in economic benefits (for example cash or other assets) arising from the basic operating activities of an entity (trading activities, production activities, service activities).
Costs are decreases in economic benefits during the economic period in the form of outflows of assets or incurrence of liabilities that lead to a decrease in equity.

The form of the profit and loss statement is presented below.

Position in $	
Revenue	***200 000***
Cost of goods sold	***120 000***
Gross profit	***80 000***
Other expenses	***30 000***
Net profit	***50 000***

5. Qualitative characteristics of financial information

In preparing financial statements it is necessary to comply with accounting rules.
The most important underlying assumption underlying the financial statements is ***the going concern*** assumption***.*** This assumption states that an entity will continue its basic activities for at least the next 12 months. This means that the entity will not scale down or cease its operations.

Another important rule in preparing the financial statements is ***the accruals assumption***.

This means that the effects of transactions are recognised in the financial statements when they occur. All transactions are recorded in the accounting records to which they relate.

The accruals assumption of accounting is related to ***the matching convention***, which requires that revenues earned must be matched with the expenditure incurred to obtain it.

For the preparation of the financial statements it is necessary to apply ***the prudence concept***. It requires that an entity operates under conditions of uncertainty, so that assets or income are not overstated and liabilities or expenses are not understated.

The second important rule is ***the business entity concept***, which means that an entity is separate entity from its owners when preparing financial statements.

The information contained in the financial statements should be useful to users and should have the following qualitative characteristics:

1. ***Comparability*** – information should be produced in a consistent manner so that valid comparisons and statements can be made with previous periods.
2. ***Understandability*** – information can be difficult to understand if it is incomplete or contains too much details.
3. ***Relevance*** – means that the information provided satisfies the needs of users and can evaluate both past and present and future events.
4. ***Consistency*** – means that an entity should value assets, capital liabilities, classify costs and present profit from one period to the next in the same way.
5. ***Faithful representation*** – information in financial statements should be complete, neutral (not manipulated to influence user's decision) and error-free (accurate, without errors or omissions).

6. Double-entry principle, ledger accounts system, books of prime entry

Economic transactions are recorded on ***source documents***, e.g. sales or purchase invoices, goods receipt note (prepared by the entity's warehouse for goods received), goods dispatch note (issued by the entity's warehouse for goods sent out to a customers), receipt (cash sales), credit note (negative invoices for returned goods).

Books of prime entry are books in which an accountant records transactions.

The main books of prime entry are:

a) sales day book which lists of invoices and credit notes sent to customers, it is the book for credit sales,
b) purchase day book which is a credit purchase book, it records all invoices that the entity receives,
c) sales returns day book which records all credit notes when customers return goods,
d) purchase returns day book which records credit notes received when goods are sent back to its suppliers by the company for some reason,
e) journal which records other transactions such as depreciation, payroll, error correction,
f) cash book which records all transactions that go through the bank account.

When a list of all transactions is placed in the various books of prime entry, then all transactions are summarised and posted to ***the general ledger accounts***. All accounts are collected in ***the general (nominal) ledger.***

The nominal ledger contains all accounts for assets, liabilities, capital income and expenditure, profit or loss. Examples of accounts in the nominal ledger:

- Plant and machinery at cost,
- Land and buildings at cost,
- Accumulated depreciation for plant and machinery,
- Materials,
- Goods for resale,
- Cash at bank,
- Cash,
- Trade receivables,
- Trade payables,
- Share capital,
- Premium capital,
- Bank loan,
- Wages,
- Depreciation,
- Revenues.

Apart from the main accounts in the nominal ledger in the financial system, we use detailed accounts:

a) for each supplier from which the entity purchases assets like goods or services on credit,
b) for each client to whom the entity sells goods or services on credit.

The detailed accounts are located in the payables ledger and the receivables ledger which contains accounts for each supplier or client. In this way the entity knows how much it owes to the each supplier or how much money is due from each client.

A ledger account has two sides – the left is the debit side and the right is credit side. Each account has a header at the top. Each entry should have the date the transaction originated, the date the transaction was recorded, its description and value.

Account name

Debit side	Credit side
Record as a debit entry (DR)	Record as a credit entry (CR)

An asset, liability, expense or sale account works like below:

Asset account

Debit side	Credit side
An increase in an asset	*A reduction in an asset*

Equity or liability account

Debit side	Credit side
A reduction in an equity or liability	*An increase in an equity or liability*

Expense account

Debit side	Credit side
An increase in an expense	*A reduction in an expense*

Sale account

Debit side	Credit side
A reduction in a sale	*An increase in a sale*

To transfer amounts from the books of prime entry into the nominal ledger, a method called ***double entry*** is used. This means each transaction is recorded twice, so that any debit is balanced by a credit. If we use accounts form the receivable or payable ledger to register transaction according to the clients or suppliers, we put the value on the same side as on the main account – Total receivables account or Total payables account.

A debit entry increases assets, decreases liabilities, increases expenses, while ***a credit entry*** decreases assets, increases liabilities, increases income.

Examples of recording transactions

Description	Debit record (DR)	Credit record (CR)
Purchasing raw materials from Supplier X with a value of $500 on credit	Materials	Trade payables And in the payables ledger: Supplier X account
Purchasing a vehicle with a value of $12 000 on credit	Non-current assets	Sundry payables
Selling finished goods to client A with a value of $1000 for 1500 on credit	Trade receivables (1500) And in the receivables ledger: Client A account Cost of good sold (1000)	Sales (1500) Finished goods (1000)
Paying telephone bill	External services (cost)	Cash
Loan raised from bank	Cash at bank	Bank loan

Example how works the double entry rule (using T-accounts):

1. In December 20X1 Tom sets up the business by putting 40 000$ into a bank account.

A bank account

1) 40 000	

Capital

	40 000(1

2. Tom buys goods for resale form supplier Z for $20 000 paying in cash $5 000 and the rest on credit.

Goods for resale		Cash		Total trade payables		Supplier Z account	
2) 20 000			5000 (1		15000 (1		15000 (1

3. Tom sells some goods to client X for resale costing $17 000 for $25 000 on credit.

Goods for resale		Total trade receivables		Client X account	
2) 20 000	17000 (3	3)17 000		3) 17 000	

At the end of an accounting period it is necessary to close each account and value the balances on every account. The balance on the the account is the difference between the total value of the debit records and the total value of the credit records.

If the total debits exceed the total credits, there is a debit balance.

If the total credits exceed the total debits, there is a credit balance.

The balance at the end of an accounting period is called carried down (c/d), which is transferred at the beginning of the next accounting period and is called brought down (b/d).

Example (continuing above):

On 31 December 20X1:

Goods for resale	
2) 20 000	17000 (3
20 000	17 000
	3 000 c/d
	debit balance
20 000	20 000

on 1 January 200X2:

Goods for resale	
b/d 3 000 debit balance	

Assets have the debit balances at the end of the accounting period, but equity and liabilities have the credit balances.

7. Tangible non-current assets

Non-current assets are assets which are used by an entity over a longer period of time (at least next 12 months). Non-current assets include tangible assets and intangible assets.
Tangible non-current assets are those that have a physical form.
The issue of tangible non-current assets is addressed in International Accounting Standard (IAS) 16 *Property, Plant and Equipment.*

According to IAS 16 these assets include:
- assets held by an entity for use (for production, supply services, administration purposes),
- assets expected to be used during more than one period.

Tangible non-current assets must be valued initially at cost, which means:
a) purchase price, including duties and fees paid, excluding trade discount and sales tax paid, Plus:
b) cost of initial delivery and handling,
c) installation and assembly costs,
d) tests costs,
e) personnel costs related to the construction or acquisition of assets (excluding employee training costs, which are expenses as incurred).

When these existing assets are improved, their value must be increased by the cost of:
a) modifications, when an item of plant will be used longer then originally intended or has an increased capacity,
b) machine upgrade to improve the quality of production,
c) Other costs that result in a large reduction in the cost of operating the facility.

During use these assets, an entity accrues depreciation. There are two methods of depreciation:
- straight line method,
- reducing balance method.

Depreciation is an expense that is calculated over estimate useful life of an asset. To estimate the useful life we need to know:
- the expected physical wear and tear of each type of these assets,
- ageing (due to technological improvements in production, reduction in demand for the product made by the asset),
- other factors that limit the use of the assets.

The useful life should be reviewed at least once a year (at the beginning of the year) and then the depreciation rates should be adjusted from the original estimates.

Depreciation is a means of spreading the cost of non-current asset over its useful life.

In order to calculate depreciation, it is necessary to estimate the residual value which means the amount, which is the amount the business expects to obtain for the asset at the end of its useful life.

Depreciation is charged to the profit and loss statement each financial year and deducted from the balance of non-current assets to obtain the carrying amount.

Carrying value of the asset = cost of asset – accumulated depreciation of asset

The straight-line method is the most common method of depreciation, it can be used for every kind of these assets.

It assumes the same rate of depreciation each year, so the carrying value of the asset decreases at a constant rate.

According to this method the annual depreciation is calculated as follows:
(Cost of assets – residual value)/expected useful life of the asset

Example 1.
A non current asset with a value of 40 000 and an estimated life of 10 years will be depreciated at the rate of $40 000/10 years = $4 000 per year.
Therefore, the carrying amount at the end of each year:

At the beginning of the useful life:
1 year $40 000
2 year $36 000 (40 000-4 000)
3 year $32 000 (40 000-8 000)
…
10 year $4000 (40 000-36 000)
11 year $0 (40 000-40 000)
If its residual value differs from zero, it will be as follows:

Example 2.
A non-current asset with a value of $25 000 has an estimated useful life 4 years and a residual value of $5 000. The annual depreciation will be: ($25 000-$5 000)/4 years = $5 000 per year.
At the beginning of its life:
1 year $25 000
2 year $20 000 (25 000-5 000)
3 year $15 000 (25 000-10 000)
4 year $10 000 (25 000-15 000)
5 year $5 000(25 000-20 000)
The other method of depreciation is the reducing balance method. According to this method, the annual depreciation charge is a fixed percentage of the carrying amount of the asset.

Example 3.
An asset with a value of $40 000 and a rate of 40% is depreciated using the reducing balance method. Its estimated residual value is 8 640.

Years	Depreciation base (carrying amount)	Depreciation	Accumulated depreciation
1	40 000	16 000	16 000
2	40 000 - 16 000 = 24 000	9 600	25 600
3	40 000 - 25 600 = 14 400	5 760	31 360
4	**40 000 - 31 360 = 8 640**	3 456	34 816

When a non-current asset is sold, the entity recognises a profit or loss on disposal.
The sales price of the asset is revenue and it carrying amount is an expense.

Example 4.
The entity purchased the machine on 1st January 2017 for $36 000. It has an estimated life of 5 year and an estimated residual value of $6 000. After 4 years it was sold for $15 000.
Calculate the profit or loss on the disposal.

Depreciation per year = ($36 000 - $6 000)/ 5 years = $6 000
Cost of asset $36 000
Minus accumulated depreciation (after 4 years) $24 000
Carrying amount at the date of disposal $12 000
Sales price $15 000
Profit on disposal $3 000

Accounting

The most common transactions for tangible non-current assets – ledger entries are as follows:

Description	Debit entry (DR)	Credit entry (CR)
Purchase of tangible non-current asset on credit	Tangible non-current asset	Sundry payables
Improvement of non-current assets	Tangible non-current asset	Sundry payables
Repair and maintenance costs of tangible non-current assets	External services (cost)	Sundry payables
Revaluation of non-current assets	Tangible non-current asset	Revaluation surplus
Depreciation	Depreciation (cost)	Accumulated depreciation
Disposal of tangible non-current assets (original cost $20 000, with accumulated depreciation 50%, with a value of $10 000 is sold for $12 000)	Accumulated depreciation $10 000 Cash 1$2 000	Tangible non-current asset ($20 000) Disposal of tangible non-current assets (profit $2 000)

8. Intangible non-current assets

Intangible non-current assets are assets for long term use that have no physical form. Intangible assets consist of:
- goodwill,
- intellectual rights (patents, performance and authorship rights),
- research and development costs (R&D costs).

The issue of intangible non-current assets is addressed in International Accounting Standard (IAS) 38 *Intangible Assets.*

Under IAS 38, intangible assets are amortised over their useful lives. Amortisation is calculated in the same way as tangible assets:

Cost – residual value

Estimated useful life
The double entry for amortisation is as follows:
Debit entry (DR) amortisation (cost)
Credit entry (CR) accumulated amortisation

For example:
A patent costing $25 000$ will be used for the next 5 years. The annual amortisation will be $25000/5 years = $5 000 per year

Research and development costs
Research costs include all activities aimed at acquiring new knowledge in order to create new or improved products, services or to implement new methods within the company, which represent costs in the period in which they are incurred. They are presented in the profit and loss statement.
Development costs that are related to the application of new knowledge to the design of new products, services, processes are intangible assets.

They include activities such as:
- design, construction and testing of prototypes,
- design, construction and testing of new or improved materials.

Research and development costs include all costs relating to:
- remuneration of personnel involved in R&D activities,
- costs of materials and services used in R&D activities,
- depreciation of equipment used in R&D activities,
- Other costs that incurred in R&D activities.

The most common transactions for intangible non-current assets – ledger entries are as follows:

Description	Debit entry (DR)	Credit entry (CR)
Purchase of intangible non-current assets on credit	Intangible non-current asset	Sundry payables
Amortisation	Amortisation	Accumulated amortisation
Disposal of intangible non-current asset (original purchase price $2 500, with accumulated amortisation 2 000, value $500 sold for $200)	Accumulated amortisation $2 000 Cash $200 Tangible non-current asset disposal (loss $200)	Intangible non-current assets ($2 500)

9. Inventory

Inventories are one of the common current assets which include: materials, goods for resale, finished goods, work in progress. The presentation and valuation of inventories are covered by International Accounting Standard 2: Inventories.

The entries in the ledger relating to inventories are as follows:
The initial value of materials and goods for resale includes the price the entity pays for them and the inward transport cost (delivery costs).

When the entity issues materials for production or goods for sale they will be valued by one of the techniques as:
FIFO (firs in first out): according to it, materials are consumed in the order they are received.
LIFO (last in first out): assumes that materials are used from the last delivery.
AVCO (average cost): assumes the average price is taken of consumed materials.

Under the IAS 2, the LIFO method is not allowed.

Example of the FIFO and AVCO methods.

	Units	unit cost	total cost
Opening balance 1st January	200	4.00	800
Receipts 4th January	350	3.80	1 330
Receipts 7th January	500	3.50	1 750/total value = $4280
Issues 10th January	1000		

The receipts of materials, according to LIFO method:
500 · 3.50 + 350 · 3.80 + 150 · 4.00 = 1750 + 1330 + 600 = $3680
The closing inventory, according to LIFO method: 50 · 4.00 = $600
To use this, it is necessary to calculate average cost per unit = $4 280/1050 units = $4,08/unit
Material receipts, according to AVCO method:
1000 units · $4.08/unit = $4080
The closing inventory, according to AVCO method:
50 units · 4.08 = $200

During the year, the materials or goods may deteriorate, become worthless or be discarded, become obsolete or be stolen or lost and then their value is nil. The entity must then write them down to zero if there are worthless or to their current market value (net realisable value NRV). The net realisable value is often lower than the cost due to a decrease in demand and a decrease in the sales price.

Example
A clothing company $4 400 worth of merchandise in inventory. At the end of the accounting period, its net sales price is only $3 000, so the value in the financial statements will be $3 000. The company must write off the value of $1 400 as an impairment cost.

The inventory, according to IAS 2, should be measured at historical cost (purchase price plus delivery costs). The use of historical cost is sometimes excluded because the selling price of inventories is lower, in which case inventories should be measured at the lower of cost and selling price.

For example: inventory includes 4 000 units of fashion goods. The purchase price was $100, but because they are out of fashion, the current sales price is $40, the value of inventory will be:

4 000 units · $40 = $160 000 net realisable value

4 000 units · (100 – 40) = $240 000 is impairment costs.

The original cost of the inventory was: 4 000 units · $100 = $400 000.

The value $160 000 will appear in the statement of financial position.

The most common transactions for inventory − ledger entries are as follows:

Description	Debit entry (DR)	Credit entry (CR)
Purchase of materials on credit	Materials (inventory)	Trade payables
Purchase of materials for cash	Materials (inventory)	Cash
Issued materials for production	Used materials (cost)	Materials (inventory)
Goods (or materials) written off	Impairment cost (other operating cost)	Goods (materials)
Sales goods on credit (goods worth $4 000 for $5 000	Cash (5 000) Cost of goods sold (4 000)	Revenues (5 000) Goods (4 000)

10. Capital

The basic capital in a limited liability company is share capital. The company issues shares at par value (face value, legal value, nominal value).
Share capital is a capital paid in excess of par value. If the issue value is higher than the nominal value it is premium capital (it means that the company performs well).

Example
LLC issues 10 000 shares with nominal value of $1 for $1,20. What is the value of share capital and share premium?
Share capital = 10 000 · $1 = $10 000
Share premium = 10 000 · (1,20-1,00) = $2 000

The revaluation surplus is the result of a revaluation to the upside of a non-current asset. It is a reserve capital.

Reserve capitals are statutory reserves and include share premium and revaluation surplus. These statutory reserves are created by law and are not available for the payment of dividends.

Example
LCC has a share capital of $200 000 (400 000 shares with par value of $0,50$) and a premium capital $40 000$ (400 000 shares of $0,10 surplus). The company has declared an ordinary dividend of 10%.
Therefore, the dividend is: $200 000 · 10% = $20 000

Non-statutory reserves are reserves created from profits and allocate in to dividends.
Example:

Profit after taxation	$250 000
Dividend	$50 000
Reserve capital	$20 000
Retained earnings	$180 000

In practice, not all profits are distributed as dividends, some are retained within the company to finance future activities.

The most common transactions for capital – ledger entries are as follows:

1 000 ordinary shares of $1 each, issued for $1,50	Cash $1 500	Share capital $1 000 Share premium $500
Tax charged against profit	Profit and loss account (P/L)	Taxation
Tax paid	Taxation	Cash
Loan granted	Cash (bank account)	Loan
Interest on loan	Interest (cost)	Interest payable

11. Liabilities

A liability – according to IAS 37 – is the obligation of an entity to transfer economic benefits as a result of past transactions or events.
When an entity sells goods, services on credit, trade payables are created, otherwise – when non-current assets or financial assets are sold – the sundry payables are recognised.
Trade payables in the statement of financial position are short-term liabilities (both up to 12 months and over 12 months). Sundry payables are either short- or long-term liabilities, this depends on when they arise, e.g. if up to 12 months, they are short-term liabilities.
A provision is a liability of uncertain amount and maturity. To present a provision in a statement of financial position, an entity can estimate its reliable amount.
The double entry for a provision is:
DR Expenses CR Provision
During the year, the entity should adjust the amount of the provision, so it is sometimes necessary to calculate an increase or decrease in the provision.

Example provision valuation:
LCC sells its goods under a warranty of the first twelve months after purchase. Past statistics on repairs to goods help the entity in calculating the provision:

% of goods sold	defects	cost of defects ($)
80	none	0
15	minor	20 000
5	major	40 000

The value of provision = 80% · 0 + 15% · $20 000 + 5% · $40 000 = $3 000 + $2 000 = $5 000

The provision $5 000 will be presented in liabilities group in the statement of financial position.

Accruals are part of liabilities. Accruals are liabilities on which the amount and timing of the payment are certain, they arise when a company pays for goods or services received in the current period that have not be invoiced by the suppliers. Trade payables – as opposed to accruals – are payables for purchased goods or services received during the period for which an invoice was issued.
Despite of the absence of an invoice, an accrual is more reliable than a provision.
The double entry for the creation of accruals is: DR Costs CR accruals.

12. Preparing basic financial statements

The company commenced its activity with $5000 which was deposited into a business bank account. The following transactions took place during the first financial year:

a) Purchase of goods on credit $8 000
b) Payment on account of trade payables $6 000
c) Sales (half of goods) on credit $6 000
d) Cash received from trade receivables $3 500
e) Other expenses in cash $1 000
f) Non-current assets purchase on credit $12 000

The Bank granted an overdraft facility of up to $2 000.
Prepare a profit ad loss account for the financial year and a statement of financial position as at the end of the year.

Description	***Debit account***	***Credit account***
a. establishing business	Cash at bank 5 000	Capital 5 000
b. purchases of goods on credit	Goods (Inventory) 8 000	Trade payable 8 000
c. payment on account of trade payables	Trade payables 6 000	Cash at bank 6 000
d. sales on credit	Trade receivables 6 000 Cost of goods sold 4 000	Revenue 6 000 Inventory (Goods) 4 000
e. cash received from trade receivables	Cash 3 500	Trade receivables 3 500
f. other expenses in cash	Other expenses 1 000	Cash at bank 1 000
g. non- current assets purchased on credit 10 000, by cash 2 000	non-current assets 12 000	Sundry payables 10 000 Cash at bank 2 000

Profit and loss statement:

Revenue	6 000
Cost of goods sold	4 000
Gross profit	1 000
Expenses	1 000
Profit for the year	1 000

Statement of financial position as at the end of the year:

Assets ($)	***18 500***
Non-current assets	12 000
Current assets:	
Goods	4 000
Trade receivables	2 500
Capital and liabilities ($)	***18 500***
Capital	
At the beginning of the year	5 000
Profit for the year	1 000
At the end of the year	6 000
Current liabilities	
Sundry payables	10 000
Bank overdraft	500
Trade payables	2 000

Requirements for crediting the course

Test (example)

1. An entity purchases 200 goods at a resale cost of $8 per unit. It then sells 18 of them at $14 per unit. How much has it earned if its management and sales costs are $25.
   Prepare an income statement and a balance sheet.

2. Write these entries on the T-accounts:
   <u>Trade Receivables:</u>
   Balance b/d $6 000
   Sales: $12 000
   Amount received from customers $15 000
   Calculate: balance c/d

   <u>Trade Payables:</u>
   Balance b/d $8 500
   Purchase: $10 500
   Money paid to the supplier (according to received invoice) $3 800
   Calculate: balance c/d

3. Which double entry should be used to record these transactions?
   A. Purchase of inventory worth $800 worth on credit
   B. Paying the telephone bill $25
   C. Selling inventory worth $450 for $650
   D. Paying $800 to the supplier

4. A company purchases goods with a value of $800. Sales tax is charged at 15%. Value the invoice. Which double entry should be used to record this purchase?

5. Which double entry should be used to record a cash sales for $316.25 (including sales tax at 15%)?

6. If a company had the following inventory information for October:
   October 1 Opening inventory 100 units at 5.00 cost per unit
   October 4 Purchased 400 units at 5.50 cost per unit
   October 10 Sold 200 units ……………………………..
   Calculate the cost of goods sold and the closing inventory value using the FIFO method.
   Which information will be shown at income statement and balance sheet?

7. Materials:
   1/ 100 units are added at 5.00 as opening stock
   2/ 400 units are added at 5.50 as purchases
   3/ 100 units are sold at 5.00 (the first units sold are those in the opening inventory)
   4/ 100 units are sold at 5.50 (the entire opening inventory has been used up, so some of the purchases at 5.50 are now sold)

   The cost of the goods sold would be 100 · 5.00 + 100 · 5.50 = 1 050. After the goods are sold, 300 units (100 + 400 – 100 – 100) remain in the closing inventory with a cost of 300 · 5.50 = 1 650

8. An entity pays insurance in advance on 1st July each year, the financial year ends 31st December. Calculate the charge to profit and loss statement for the financial year to 31st December 2018.

   Insurance paid at 1st July 2018, $600.

Lecturer:
Marta Targowicz, PhD Eng.

e-mail address: marta.targowicz@pwsz.nysa.pl

....
(entity stamp)

BALANCE SHEET

prepared on:..

calculation unit: ....

	ASSETS	state as of			LIABILITIES	state as of	
A	**Fixed assets**			A	**Equity (own fund)**		
I	**Intangible assets**			I	**Primary capital (fund)**		
1	Development costs			II.	**Supplementary capital (fund), including:**		
2	Value of the company				- surplus of sales value (issue value) over the nominal value of shares (stocks)		
3	Other intangible assets			III	**Revaluation Reserve (fund), including:**		
4	Advances on intangible assets				- due to revaluation of fair value		
II	**Tangible fixed assets**			IV	**Other reserve capital (funds), including:**		
1	Fixed assets				- created in accordance with the company's articles of association		
a)	land (including right of perpetual usufruct of land)				- for own shares and stocks		
b)	buildings, premises, rights to premises and civil engineering			V	**Profit/loss from previous years**		
c)	machinery and plant			VI	**Net profit/loss**		
d)	means of transport			VII	**Charges against net profit during the financial year (negative value)**		
e)	other fixed assets			B	**Liabilities and provisions for liabilities**		
2	Capital work in progress			I	**Provisions for liabilities**		
3	Prepayments for capital work in progress			1	Deferred income tax		
III	**Long-term receivables**			2	Provision for pensions and other post-employment benefits		
1	From related parties				- long-term		
2	From other entities in which the entity has equity exposure				- short-term		
3	From other entities			3	Other provisions		
IV	**Long-term investments**				- long-term		
1	Real estates				- short-term		
2	Intangible assets			II	**Long-term liabilities**		
3	Long-term financial assets			1	To related entities		
a)	in related entities			2	To other entities in which the entity has equity involvement		
	- shares or stocks			3	To other entities		
	- other securities			a)	credits and loans		
	- loans granted			b)	due to issuance of debt securities		
	- other long-term assets financial assets			c)	other financial liabilities		

b)	in other entities in which the entity has equity involvement			d)	liabilities on bills of exchange		
	- shares or stocks			e)	other		
	- other securities			III	**Short-term liabilities**		
	- loans granted			1	Liabilities due to related entities		
	- other long-term financial assets			a)	for deliveries and services, with the maturity date falling on:		
c)	in other entities				- up to 12 months		
	- shares or stocks				- over 12 months		
	- other securities			b)	other		
	- loans granted			2	Liabilities to other entities in which the entity has equity involvement		
	- other long-term assets financial assets			a)	for deliveries and services with the maturity date falling on:		
4	Other long-term investments				- up to 12 months		
V	**Long-term prepayments and accruals**				- over 12 months		
1	Assets due to deferred income tax			b)	other		
2	Other prepayments and accruals			3	Liabilities to other entities		
B	**Current assets**			a)	credits and loans		
I	**Reserves**			b)	due to issuance of debt securities		
1	Materials			c)	other financial liabilities		
2	Semi-finished products and products in progress			d)	for deliveries and services, with the maturity date falling on:		
3	Finished products				- up to 12 months		
4	Goods				- over 12 months		
5	Advances on deliveries and services			e)	Advances received on deliveries and services		
II	**Short-term receivables**			f)	liabilities on bills of exchange		
1	Receivables from related entities			g)	due to taxes, customs, social and health insurance and other public law titles		
a)	for deliveries and services, with the repayment date falling			h)	due to remunerations		
	- up to 12 months			i)	other		
	- over 12 months			4	Special funds		
b)	other			IV	**Accruals**		
2	Receivables from other entities in which the entity has equity exposure			1	Negative goodwill		
a)	for deliveries and services, with the repayment date falling			2	Other accruals		
	- up to 12 months				- long-term		
	- over 12 months				- short-term		
b)	other						
3	Receivables from other entities						
a)	for deliveries and services, with the repayment date falling						
	- up to 12 months						
	- over 12 months						

b)	due to taxes, customs, social and health insurance and other public law titles						
c)	other						
d)	receivables claimed in court						
III	**Short-term investments**						
1	Short-term financial assets						
a)	in related entities						
	- shares or stocks						
	- other securities						
	- loans granted						
	- other short-term financial assets						
b)	in other entities						
	- shares or stocks						
	- other securities						
	- loans granted						
	- other short-term financial assets						
c)	cash and other monetary assets						
	- cash in hand and on accounts						
	- other cash						
	- other monetary assets						
2	Other short-term investments						
IV	**Short-term prepayments and accruals**						
C	**Called up share capital (fund) not paid**						
D	**Own shares and stocks**						
	Total ASSETS **(total item A and B and C and D)**				**Total LIABILITIES** **(total item A and B)**		

....

(Date and signature of the person entrusted with keeping the books of account)

....

(Date and signature of the head of the unit, and if the unit is managed by a multi-person body, all members of this body)

Profit and loss account

made for the period ....

.... (entity stamp)

(multiple-step variant)

calculation unit: ....

Line	Specification	Data for the year	
A	**Net revenues from sales of products, goods and materials, including:**		
	- from related entities		
I	Net revenues from sales of products		
II	Net revenues from sales of goods and materials		
B	**Costs of sales of products, goods and materials, including:**		
	- from related parties		
I	Production costs of sold products		
II	Value of sold goods and materials		
C	**Gross profit (loss) from sales (A-B)**		
D	**Selling costs**		
E	**Overheads**		
F	**Profit (loss) from sales (C-D-E)**		
G	**Other operating revenues**		
I	Profit from the disposal of non-financial fixed assets		
II	Grants		
III	Revaluation of non-financial assets		
IV	Other operating revenue		
H	**Other operating costs**		
I	Loss from the disposal of non-financial fixed assets		
II	Revaluation of non-financial assets		
III	Other operating costs		
I	**Profit (loss) from operating activity (F+G-H)**		
J	**Financial revenues**		
I	Dividends and shares in profits, including:		
	a) from related entities, including:		
	- in which the entity has equity exposure		
	b) from other entities, including:		
	- in which the entity has equity exposure		
II	Interest, including:		
	- from related parties		
III	Profit on the disposal of financial assets, including:		
	- in related entities		
IV	Revaluation of financial assets		
V	Other		
K	**Financial expenses**		
I	Interest, including:		
	- from related entities		
II	Loss on the disposal of financial assets, including:		
	- in related entities		
III	Revaluation of financial assets		
IV	Other		
L	**Gross profit (loss) (I+J-K)**		
M	**Income tax**		
N	**Other mandatory decrease of profit (increase of loss)**		
O	**Net profit/loss (L-M-N)**		

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Profit and loss account

. . . .
(entity stamp)

made for the period . . . .

(comparative variant)

calculation unit: . . . .

Line	Specification	Data for the year	
A	**Net revenues from sales and equated with them, included:**		
	- from related entities		
I	Net revenues from sales of products		
II	Change in the status of products (increase - positive value, decrease - negative value)		
III	The cost of producing products for the individual's needs		
IV	Net revenues from sales of goods and materials		
B	**Operating expenses**		
I	Depreciation		
II	Consumption of materials and energy		
III	Outsourced services		
IV	Taxes and charges, including:		
	- excise duty		
V	Remunerations		
VI	Social insurance and other benefits, including:		
	- pension		
VII	Other operating expenses		
VIII	Value of sold goods and materials		
C	**Gross profit (loss) from sales (A-B)**		
D	**Other operating revenues**		
I	Profit from the disposal of non-financial fixed assets		
II	Grants		
III	Revaluation of non-financial assets		
IV	Other operating revenues		
E	**Other operating costs**		
I	Loss from the disposal of non-financial fixed assets		
II	Revaluation of non-financial assets		
III	Other operating costs		
F	**Profit (loss) from operating activity (C+D-E)**		
G	**Financial revenues**		
I	Dividends and shares in profits, including:		
	a) from related entities, including:		
	- in which the entity has equity exposure		
	b) from other entities, including:		
	- in which the entity has equity exposure		
II	Interest, including:		
	- from related entities		
III	Profit on the disposal of financial assets, including:		
	- in related entities		
IV	Revaluation of financial assets		
V	Other		
H	**Financial expenses**		
I	Interest, including:		
	- from related entities		
II	Loss on the disposal of financial assets, including:		
	- in related entities		
III	Revaluation of financial assets		
IV	Other		
I	**Gross profit (loss) (F+G-H)**		
J	**Income tax**		
K	**Other mandatory decrease of profit (increase of loss)**		
L	**Net profit (loss) (I-J-K)**		

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CASH FLOW STATEMENT

made for the period ....

....
(entity stamp)

(indirect method)

calculation unit: ....

Line	Specification	Data for the year	
A.	**Cash flow from operating activities**		
I.	**Net profit/loss**		
II.	**Total adjustments**		
1.	Depreciation		
2.	Profits (losses) related to foreign exchange differences		
3.	Interest and shares in profits (dividends)		
4.	Profit (loss) from investment activities		
5.	Change in the provision for outstanding claims		
6.	Change in inventories		
7.	Change in receivables		
8.	Change in short-term liabilities, except for loans and credits		
9.	Change in prepayments		
10.	Other adjustments		
III.	**Net cash flow from operating activities (I+/-II)**		
B.	**Cash flow from investment activities**		
I.	**Income**		
1.	Disposal of intangible assets and property, plant and equipment		
2.	Disposal of investments in real estate and intangible assets		
3.	From financial assets, including:		
	a) in related entities		
	b) in other entities		
	- disposal of financial assets		
	- dividends and shares in profits		
	- repayment of long-term loans		
	- interest		
	- other inflows from financial assets		
4.	Other investment income		
II.	**Expenditures**		
1.	Acquisition of intangible assets and property, plant and equipment		
2.	Investment in investments in real estate and intangible assets		
3.	For financial assets, including:		
	a) in related entities		
	b) in other entities		
	- acquisition of financial assets		
	- long-term loans granted		
4.	Other investment expenditures		
III.	**Net cash flow from investment activities (I-II)**		
C.	**Cash flow from financial activities**		
I.	**Inflows**		
1.	Net income from issuing shares (issue of shares) and other capital instruments and additional capital contributions		
2.	Credits and loans		
3.	Issue of debt securities		
4.	Other investment inflows		
II.	**Expenditures**		
1.	Acquisition of own shares (stock)		
2.	Dividends and other payments to owners		
3.	Other than distributions to owners, expenditure on the distribution of profit		
4.	Repayment of loans and borrowings		
5.	Acquisition of debt securities		
6.	Due to other financial liabilities		
7.	Payments of liabilities under financial leasing agreements		
8.	Interests		
9.	Other investment expenditures		
III.	**Net cash flow from financial activities (I-II)**		
D.	**Net cash flow, total (A.III+/-B.III+/-C.III)**		
E.	**Balance sheet change in cash, including:**		
	- change in cash balance from foreign exchange differences		
F.	**Cash at the beginning of the period**		
G.	**Cash at the end of the period (F+/-D), including:**		
	- with limited means of disposal		

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. . . .
(entity stamp)

STATEMENT OF CHANGES IN EQUITY

made for the period . . . .

calculation unit: . . . .

Line	Specification	Data for the year	
I.	**Opening balance of equity (BO)**		
	- changes in accounting principles (policies)		
	- corrections of errors		
I.a.	**Opening balance of equity (BO), after adjustments**		
1.	**Opening share capital (fund)**		
1.1.	Change in share capital (fund)		
	a) increase (due to)		
	- issue of shares (stock issue)		
	-		
	-		
	-		
	b) decrease (due to)		
	- redemption of shares (stock)		
	-		
	-		
	-		
1.2.	Share capital (fund) at the end of the period		
2.	**Opening supplementary capital (fund)**		
2.1.	Change in supplementary capital (fund)		
	a) increase (due to)		
	- issue of shares above the nominal value		
	- profit distribution (statutory)		
	- profit distribution (above the statutory minimum threshold)		
	-		
	-		
	-		
	b) decrease (due to)		
	- covering loss		
	-		
	-		
	-		
2.2.	Closing balance of supplementary capital (fund)		
3.	**Revaluation capital (fund) at the beginning of the period - changes to the adopted accounting principles (policy)**		
3.1.	Changes in the capital (fund) from revaluation		
	a) increase (due to)		
	-		
	-		
	-		
	b) decrease (due to)		
	- disposal of fixed assets		
	-		
	-		
	-		
3.2.	Revaluation capital (fund) at the end of the period		

4.	**Other opening reserve capitals (funds)**		
4.1.	Changes in other reserve capitals (funds)		
	a) increase (due to)		
	-		
	-		
	-		
	b) decrease (due to)		
	-		
	-		
	-		
4.2.	Other closing reserve capitals (funds)		
5.	**Profit (loss) from previous years at the beginning of the period**		
5.1.	Profit from previous years at the beginning of the period		
	- changes to the adopted accounting principles (policy)		
	- corrections of errors		
5.2.	Profit from previous years at the beginning of the period, after adjustments		
	a) increase (due to)		
	- distribution of profit from previous years		
	-		
	-		
	-		
	b) decrease (due to)		
	-		
	-		
	-		
5.3.	Closing balance of profit from previous years		
5.4.	Loss from previous years at the beginning of the period		
	- changes to the adopted accounting principles (policy)		
	- corrections of errors		
5.5.	Loss from previous years at the beginning of the period, after adjustments		
	a) increase (due to)		
	- loss from previous years carried over for distribution		
	-		
	-		
	-		
	b) decrease (due to)		
	-		
	-		
	-		
5.6.	Closing balance of loss from previous years		
5.7.	Closing balance of profit (loss) from previous years		
6.	**Net result**		
	a) net profit		
	b) net loss		
	c) profit write-off		
II.	**Closing balance of equity (BO)**		
III.	**Equity including proposed profit distribution (loss coverage)**		

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