

SESSION 2: COMPANIES FINANCIAL STATEMENTS PART 1

KEY CONCEPTS:

In this session we will look at:

- Introduction
- Users of Financial Statements
- Income Statement

X-PLANATION

INTRODUCTION

A company essentially has three different sets of financial statements.

The first set is the most comprehensive, and shows all items of income, expenditure, assets and liabilities. This set of financial statements is set up for use by management and other internal users. **We will be focusing on this particular set of financial statements.**

The second set has less information, and is set up for use by shareholders.

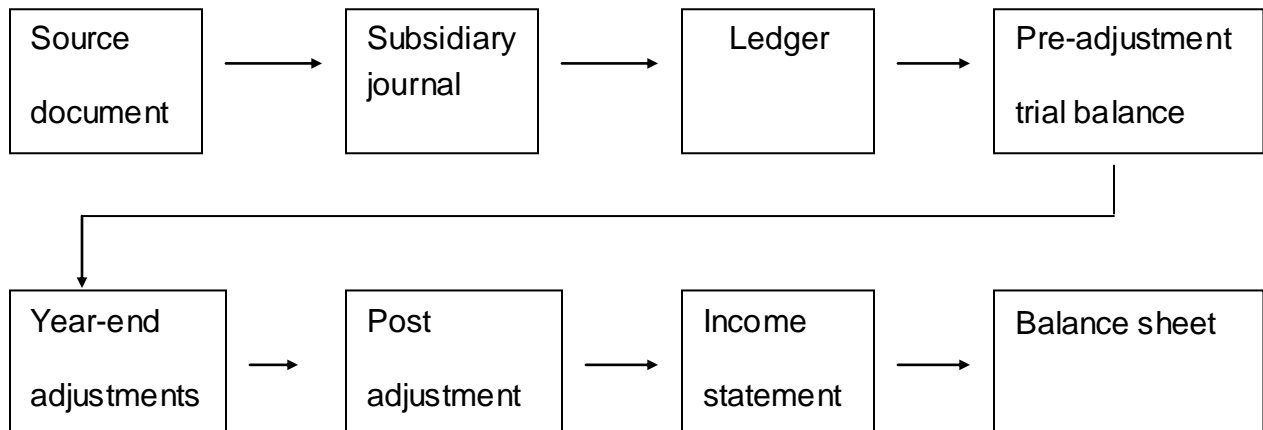
The third set is set up according to the express requirements of the Companies Act, and displays the least information of the three sets of statements. This is the version of the annual financial statements that should be published. (abridged financial statements)

USERS OF FINANCIAL STATEMENTS:

- Shareholders
- Prospective shareholders or investors
- Banks and other financial institutions
- Creditors
- Directors
- SARS:
- The **Income statement**, which gives an indication of the operating activities of the enterprise during the year (**result of operations**)
- The **Balance sheet**, which indicates the enterprises' financial position at the end of the year (**state of affairs**)

In terms of the recording of transactions of an enterprise, financial statements form the last step in this process. All transactions are recorded as they occur and at the end of the financial year the financial statements are prepared.

The following diagram illustrates the cycle followed when recording transactions:



INCOME STATEMENT

The Income Statement should reflect all incomes and expenses, which apply to the financial period under review. Therefore, this statement would only include income and expense accounts. The purpose of preparing this statement is to determine the net profit / loss for the period.

The income statement is prepared in keeping with the GAAP principals, especially the matching principal where incomes and expenses for the same period must be reflected.

The following table illustrates some income and expense accounts:

Incomes	Expenses
Sales	Cost of sales
Rent income	Rent expense
Discount received	Discount allowed
Interest on fixed deposit / investment	Interest on loan
Commission income	All operating expenses (e.g., telephone, wages etc.)
Bad debts recovered	Bad debts
Provision for bad debts (decrease)	Provision for bad debts (increase)
Trading inventory surplus	Trading inventory deficit
Profit on sale of asset	Loss on sale of asset
	Depreciation
	Directors fees
	Audit fees

Format of the company Income Statement:

LIMITED LIABILITY COMPANIES
INCOME STATEMENT – TRADING BUSINESS (Continuous inventory system)

Name of Company _____

Income statement for the year ended _____

	Notes	R	R
Turnover (sales – debtors allowances)			Xxxx
Cost of sales			(xxx)
Gross profit			Xxxx
Other operating income			Xxxx
(Incomes as illustrated in the table above, excluding interest)			Xxxx
Gross operating income			Xxxxx
(Operating expenses as illustrated in the table above, excluding interest)			(xxxx)
Operating profit / (loss)			Xxxxx
Interest income	1		Xx
Profit (loss) before interest expense			Xxxxx
Interest expense	2		(xx)
Profit / (loss) before tax			Xxxx
Taxation			(xxx)
Net profit / (loss) after tax for the year / period	9		Xxxxx

X-AMPLE QUESTIONS

Question 1: 55 marks (Adapted from New Era Study Guide)

FINANCIAL STATEMENTS

1.1 SIMPHIWE LIMITED

You are provided with the Pre-Adjustment Trial Balance of Simphiwe Limited. The company buys and sells uniforms, and they also repair uniforms for their customers, for which they charge a fee. These fees are credited to the Fee Income Account in the General Ledger.

REQUIRED

1.1.1 Refer to Information 2J below.
Calculate the profit or loss on disposal of the computer. Show workings. You may prepare an Asset Disposal Account to identify the figure. (8)

1.1.2 Complete the Income Statement for the year ended 30 September 2009. The notes to the financial statements are NOT required. (47)

[55]

INFORMATION

1. SIMPHIWE LTD PRE-ADJUSTMENT TRIAL BALANCE AS AT 30 SEPTEMBER 2009

	DEBIT	CREDIT
Balance Sheet Accounts Section	R	R
Ordinary share capital		1 300 000
Share premium		170 730
Retained income (1 October 2008)		170 000
Loan from Stay Bank		90 000
Land and buildings at cost	1 628 520	
Vehicles at cost	220 000	
Equipment at cost	190 000	
Accumulated depreciation on vehicles (1 October 2008)		41 000
Accumulated depreciation on equipment (1 October 2008)		37 000
Debtors' control	36 600	
Creditors' control		17 960
Trading stock	479 000	
Bank		13 500
Petty cash	2 200	
SARS – Income tax	83 500	
Provision for bad debts		1 440

Nominal Accounts Section	R	R
Sales		2 720 000
Cost of sales	1 310 000	
Debtors' allowances	6 200	
Salaries and wages	162 000	
Discount allowed	905	
Fee income		104 750
Rent income		56 000
Insurance	11 000	
Sundry expenses	39 250	
Directors' fees	390 000	
Audit fees	53 705	
Consumable stores	24 000	
Interest income		2 500
Ordinary share dividends	88 000	

2. ADJUSTMENTS

- A. Prepaid expenses in respect of sundry expenses at the year- end, R3 200, have not been taken into account.

- B. On 30 September 2009, R580 was received from A Ethic whose account had previously been written off as irrecoverable. The amount was entered in the Debtors' Control column in the Cash Journal.
- C. The provision for bad debts must be adjusted to R1 830.
- D. There were two directors at the start of the accounting period. Directors' fees have been paid for the first half of the accounting period. On 1 April 2009, a third director was appointed. All three directors earn the same monthly fee. Provide for the outstanding fees owed to the directors.
- E. Rent has been received for 14 months.
- F. The following credit note was left out of the Debtors' Allowances Journal for September in error. The mark-up on goods sold was 50% on cost.

SIMPHEME LTD		CREDIT NOTE 4533	
		28 Sept. 2009	
Credit: Supaclean Ltd PO Box 340, Westmead, 3610		Unit price	Total
24	Uniforms returned	R400	R9 600
	Reduction on fee charged for repair of uniforms		R 750
			<u>R10 350</u>

- G. A physical stock count on 30 September 2009 reflected the stock of uniforms on hand as R490 000.

The loan statement from Stay Bank reflected the following:

H.	Balance at beginning of financial year	R 150 000
	Repayments during the year	R 78 000
	Interest capitalised	R ?
	Balance at end of financial year	R 90 000

- I. Depreciation on vehicles is calculated at 20% p.a. on the diminishing-balance method.

- J. Depreciation on equipment is calculated at 10% p.a. on the cost price. Note that an item of equipment was taken over by one of

the directors, Ivor Steele, on 30 June 2009 for personal use for R800 cash. The relevant page from the Fixed Asset Register is provided below. No entries have been made in respect of the disposal of this asset.

FIXED ASSET REGISTER		Page 12	
Item: VYE Computer		Ledger Account: Equipment	
Date Purchased: 1 April 2006		Cost Price: R22 000	
Depreciation Policy: 10% p.a. on cost price			
Date	Depreciation calculations	Current Depreciation	Accumulated Depreciation
2006 30 September	$R22\ 000 \times 10\% \times \frac{6}{12}$	R1 100	R1 100
2007 30 September	$R22\ 000 \times 10\% \times \frac{12}{12}$	R2 200	R3 300
2008 30 September	$R22\ 000 \times 10\% \times \frac{12}{12}$	R2 200	R5 500
2009 30 June	?	R ?	R ?

K. Income tax for the year amounts to R63 280.

Question 2: 69 marks 42 minutes

You are provided with information relating to Ruma Carpets. The business is owned by R. Rugg. They sell, fit and repair carpets. Installation and repair fees are reflected as fee income. You are required to prepare the financial statements on 28 February 2009. The bookkeeper has entered the pre-adjustment figures but does not know how to process the adjustments.

REQUIRED

1.1 Income Statement for year ended 28 February 2009.

(69)

INFORMATION

RUMA CARPETS: PRE-ADJUSTMENT TRIAL BALANCE ON 28 FEBRUARY 2009

Balance Sheet section	Debit	Credit
Capital		991 000
Drawings	360 000	
Bank	66 162	
Vehicles - at cost	666 000	
Accumulated depreciation on vehicles		299 700
Equipment - at cost	230 000	
Accumulated depreciation on equipment		95 000
Loan from Trusty Finance		210 000

Fixed deposits: Richnet Bank	160 000	
Trading stock	677 000	
Debtors control	255 000	
Provision for bad debts		16 000
Cash float	3 000	
Petty cash	2 000	
Creditors control		282 000
SARS (PAYE)		19 300
Medical Aid Fund		6 600
UIF		800
Nominal section		
Sales		3 060 000
Debtors allowances	510 000	
Cost of sales	1 800 000	
Fee income		1 045 000
Rent expense	90 400	
Salaries & wages	765 000	
Employer's contributions to UIF & Medical Aid	79 000	
Vehicle expenses	95 600	
Bank charges	28 000	
Bad debts	5 400	
Electricity & water	17 000	
Discount allowed	4 000	
Telephone	19 300	
Insurance	28 600	
Printing & stationery	17 700	
Consumable stores	132 000	
Interest income (on current bank account)		1 100
Sundry expenses	33 338	
	6 026 500	6 026 500

Adjustments and additional information:

- The water and electricity account for February has not yet been paid, R1 350.
- A cash customer, N Nokwe, paid R3 000 for installation fees in February, but the job will be done only in March 2009.
- The rent has been paid up to 30 April 2009. Note that the rent was increased by R900 per month on 1 January 20.9.
- During a burglary in February the following items were stolen:
 - Carpeting worth R60 000 (trading stock)
 - Consumable stores of R3 000.

The insurance company has agreed to pay out 80% of the loss, but this has not yet been received.
- A debtor, K Krumm, complained that the carpets that were fitted in his house in his absence were defective. Ruma Carpets issued a credit note for the following but this has not yet been recorded in the books:
 - Selling price of carpeting R22 000 (the cost price was R13 600)
 - Installation fee R2 600.

On closer inspection it was found that the entire batch of carpeting which had cost

- R48 000 was defective. This was returned to the manufacturer Carplex Ltd but no entry has been made. Mr Krumm is now using another carpet company.
6. The following items appeared in the bank statement for February 2009. These have not been entered in the books:
 - Bank charges R2 100
 - Interest on current bank account R220
 - Dishonoured cheque R4 700 (this was originally received from a debtor H Hill in settlement of his debt of R5 000)
 - Stop-order for insurance premium for February 2009, R2 600.
 7. Further bad debts of R4 000 are to be written off and the provision for bad debts is to be adjusted to 5% of trade debtors.
 8. A physical count at the year-end reflects the following on hand at cost price:
 - Trading stock R560 000
 - Consumable stores R18 500.
 9. The business owned three identical vehicles which were all purchased on the same date. Depreciation is at 20% p.a. on cost. On 30 November 2008 one of the vehicles was taken over by partner M Matt at a market value of R96 300. No entry has been made to record depreciation or the sale of the vehicle.
 10. New equipment costing R54 000 was bought on 1 January 2009. This has been properly recorded. Depreciation is to be calculated at 10% p.a. on the diminishing balance method.
 11. The loan statement from Trusty Finance reflects the following:
 - Balance on 1 March 2008 R284 000
 - Interest capitalised R ?
 - Repayments during the year including interest R74 000
 - Balance on 28 February 2009 R239 400

All repayments have been debited to the loan account in the ledger but no entry has been made to record interest. According to the loan agreement the loan will be reduced by R54 000 over the next 12 months.
 12. Interest of R8 800 has been earned on the fixed deposits but no entry has been made. The interest is capitalised. One of the fixed deposits valued at R32 000 will mature on 31 March 2009.
 13. One employee has been left out of the Salaries Journal in error. He has not yet been paid. His details are:

GROSS SALARY	DEDUCTIONS			NET SALARY
	PAYE	Medical Aid	UIF	
R6 200	R1 018	R800	R62	R4 320

The business contributes on a Rand-for-Rand basis to Medical Aid and UIF.