REVIEW OF TRIAL BALANCE, PROFIT AND LOSS ACCOUNT AND BALANCE SHEET

STAKEHOLDERS

- Internal stakeholders
- ● Managers of the company
- ● Employees
- ● Directors
- External stakeholders
- ● Shareholders
- ● Trade creditors (suppliers)
- ● Providers of finance
- ● Trade unions
- ● Financial analysts and advisers
- ● Government and their agencies, including The Inland Revenue
- ● The public
- ● Trade debtors (customers)

WHY MIGHT THE FOLLOWING STAKEHOLDERS BE INTERESTED IN FINANCIAL INFORMATION ABOUT A COMPANY?

- 1 Managers of the company. People appointed by the company's owners to supervise the daily activities of the company need information about the company's current and expected future financial situation. This helps efficient management and effective control and planning decisions.
- 2 Shareholders of the company want to assess how effectively management is performing and how much profit they can withdraw, or expect, from the business for their use.
- 3 Trade creditors/suppliers want to know about the company's ability to pay its debts; customers need to know that a company is a secure source of supply and is in no danger of closing down.

FINANCIAL AND MANAGEMENT ACCOUNTING

Financial Accounting	Management Accounting
legally required – - deals with the past - - uses prescriptive standards -reporting need – -- external scrutiny -mainly financially based – -- precision needed (e.g. bookkeeping) - - limited flexibility -	-not legally required -- deals with the future -- no prescription -- decision-making/planning and control use - no external scrutiny - other non financial factors considered - - less precision needed - - adapted to the needs of the individual business

WHY DO WE NEED ACCOUNTING STANDARDS

- Development of accounting standards 1942 by chartered accountants in UK

Statement of Standard Accounting Practices (SSAP)

Financial Reporting Standards (FRS)

International Accounting Standards (IAS)

International Financial Reporting Standards (IFRS)

1970S – ACCOUNTING STANDARD COMMITTEE (ASC)

- To narrow differences
- Disclosure of information and departures
- Development of New accounting standards
- Improving accounting standards
- Focus on HARMONISATION
- Reliability
- Comparability
- Materiality

DOUBLE ENTRY BOOKKEEPING PRINCIPLE

- For the accounts to remain in balance, a change in one account must be matched with a change in another account. These changes are made by debits and credits to the accounts.
- **Debit accounts** = Asset and Expenses (also debit money received into bank accounts)
- **Credit accounts** = Gains (income) and Liabilities (also credit money paid out of bank accounts)

- The following accounts have a normal balance of debit:
- Assets
- Accounts receivable: debts promised by other entities but not yet paid
- Drawings by the owners on equity
- Expenses

- The following accounts have a normal balance of credit:
- Liabilities
- Accounts payable and taxes payable, notes or loans payable: debts promised to outsiders but not yet paid
- Revenue
- Capital

DOUBLE ENTRY PRINCIPLE

- The following table summarizes how debits and credits affect the different elements of the accounts.
- ▲ = increase, ▼ = decrease
-

Account	Debit	Credit
Assets	▲	▼
Expenses	▲	▼
Liabilities	▼	▲
Equity	▼	▲
Revenue	▼	▲

EASY TO REMEMBER??

- Debit what comes in (goods, assets)
- Credit what goes out (goods, assets)

- Debit the receiver (Debtor, asset)
- Credit the giver (creditor, Liability)

- Debit all expenses
- Credit all incomes (revenue)

STRUCTURE OF P & L A/C

Revenue/Sales	1000000	Trading Account
COGS	(600000)	
Gross Profit	400000	
SG&A	(190000)	
Depreciation	(10000)	
Operating Profit	200000	
Interest Exp	(10000)	
Profit before tax	190000	
Tax 20%	(38000)	
Net Income/Profit	152000	

TRADING ACCOUNT

Sales			11000
Less sales return			(1000)
Net sales/ turnover			10000
Cost of goods			
Opening stock		5000	
Purchases	3000		
Less purchase returns	(1000)		
	2000		
Add carriage inwards	1000	3000	
		8000	
Less closing stock		2000	6000
Gross profit			4000

BALANCE SHEET

- Asset = Liability + Equity (Capital)
- Assets are probable current and future economic benefits
- Liabilities are probable future sacrifices of economic benefit. Obligations, transfer of assets in the future.

BALANCE SHEET

- Fixed assets
  - Less depreciation
- Current assets
  - Stock
  - Cash
  - Bank
  - Debtors
  - prepayments
- Current liability
  - Creditors
  - Outstanding/accruals
- Working capital (CA-CL)

Fixed assets	Cost	Depreciation	Net value
Land, building	50000	5000	45000
Current assets			
Debtors	3000		
Stock	7000		
Cash	10000		
Bank	20000		
Prepayments	6000	46000	
Current liability			
Creditors	35000		
Outstanding/accruals	5000	40000	
Working capital			6000

- Long-term Liability
  - Creditors
  - Loans from Bank
  - Debentures
- Capital
  - Share capital
  - Reserves
  - Net profit
  - Dividends
  - Less drawings
- Fixed assets + WC – Long term Liability = Capital

Long term liability			
Creditors	3000		
Loans	5000		
debentures	1000	9000	
Net total assets			42000
capital			
Share capital	22000		
reserves	8000		
Net profit	10000		
dividends	4000		
Less drawing	2000		42000

- The following information as at 31 March 2004 is also available:
- (1) £350 is owing for heat and light
- (2) £620 has been prepaid for rent and rates
- (3) Depreciation is to be provided for the year as follows:
- Equipment at 10% on cost and motor vehicles at 20% on cost
- (4) Stock at 31 March 2004 is £16,480
- **Required**:
- (b) Prepare the trading and profit and loss accounts for Ross.
- (c) Prepare the balance sheet for Ross as at 31 March 2004.

DEPRECIATION

- Depreciation is the reduction in the value of an asset due to usage, passage of time, wear and tear, technological outdating or obsolescence, depletion, inadequacy, rot, rust, decay or other such factors.
- *Salvage(scrap) value* is the estimated value of an asset at the end of its useful life.

DEPRECIATION CALCULATION

- Straight line depreciation
- Fixed amount depreciated each year

$$\text{Annual Depreciation Expense} = \frac{\text{Cost of fixed asset} - \text{Scrap Value}}{\text{Life span}(years)}$$

Eg. Asset cost 45,000. it will be used for 5 years and scrap value at the end will be 5000. what amount will be depreciated in a straight line method?

REDUCING BALANCE (ACCELERATED)

- Depreciation methods that provide for a higher depreciation charge in the first year of an asset's life and gradually decreasing charges in subsequent years are called **accelerated depreciation methods**. This may be a more realistic reflection of an asset's actual expected benefit from the use of the asset: many assets are most useful when they are new. One popular accelerated method is the **reducing-balance method**. Under this method the Book Value is multiplied by a fixed rate.

- Asset cost 45,000. depreciation for 5 yrs. reducing balance depreciation to be made at 30%.
- Year 1. Value 45000
  - Depreciation @30% = 13500
  - Year 2 beginning NBV = 31500
  - Depreciation @30% = 9450
  - Year 3 beginning NBV= 22050
  - Depreciation @30% = 6615
  - Year 4 beginning NBV = 15435
  - Depreciation @30%= 4630.5
  - Year 5 beginning NBV = 10804.5
  - Depreciation @30% = 3241.35
  - End of 5 year NBV = 7563.15

BREAKEVEN ANALYSIS

- Sales 1000pcs @2 20000
- COGS 1000pcs @1.5 15000
- Gross Profit 1000 pcs 5000

- UNIT BREAKDOWN
- Sale price per unit = 2
- Cost (variable) = 1.5
- Contribution per unit= .5

BREAKEVEN

- Sales per unit = 25
- Variable cost
  - Material per unit = 7
  - Labor per unit = 8
  - Total variable cost 15
- Contribution 10

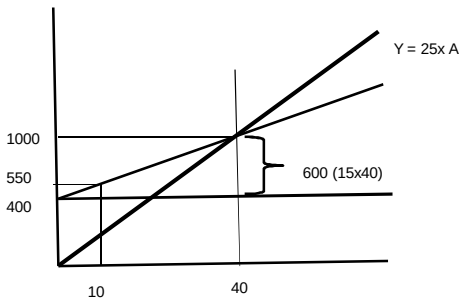
- Fixed Cost
  - Rent 200
  - Salaries 200
  - Total Fixed Cost 400

BREAKEVEN

- Breakeven = Total Fixed Cost
- . _____
- . Contribution per unit

- = 400/10 = 40 units

- Which means if he sells 40 units @ 25 (total income is 1000), he will make zero profit (expenses for 40 unit @ 15 = 600 plus fixed cost 400 equal 1000).



- Sales revenue = 4
- Variable cost = 2

- Fixed cost = 8000

- Breakeven = ???

- How many will he have to sell to make a profit of £100?

- Quantity required for profit =

- Fixed cost + required profit
- _____
- Contribution per unit

- 8000 + 100
- _____ = 4050
- 2

- Jacket factory has fixed cost of £50000. it produces 10000 jackets. Each jacket has a variable cost of £5. the jackets are sold for £15 per piece

- Find the contribution per unit
- Find the breakeven point
- How many jackets does it need to sell to make a profit of £2000 ?