

Achievement Standard 90224

External Exam – Credits: 5

Prepare financial statements and related accounting entries for sole proprietors

Content studied in Standard	
Content	Revision Questions (Pages of NCEA Revision Guide) Pages 55 – 79
<p>You need to prepare the following financial statements incorporating balance day adjustments including:</p> <p>Accrued expenses Accrued Income Accounts payable Prepayments Income in advance Depreciation (straight-line, diminishing value and units of use Bad debts Doubtful debts.</p>	
Income Statement	Q6 – Q9, Q28(e)
Balance Sheet	Q10 – Q13, Q28(g – h)
Statement of Cash Flows	Q14 – Q18, Q27(a)
You will need to do journal entries and for:	
Balance day adjustments	Q19, Q21(a – d), Q22 (a)i,ii,iv, Q23(a-d), Q26, Q28(a)
Closing entries	Q22 (a),v,vi, Q23(e-f)
Reversing entries	Q21(g)
You will need to do ledger entries and for:	
Balance day adjustments	Q20, Q21(e –f), Q22(b), Q23(g – i), Q24, Q25, Q28(c – d)
Closing entries	
Reversing entries	

Preparation of Financial Statements

Remember:

- **Income Statement** – measure profit for period
- **Balance Sheet** – Shows what assets and liabilities the business has
- **Statement of Cash Flows** – Shows where cash has come from and how it has been spent over a period

When preparing financial statements:

- Carefully read the question and find out what you need to do
- Determine if it is for a trading firm or a service firm as this will affect the layout of your income statement. A trading firm has sales in their income whereas a service firm has fees received.
- Complete the balance day adjustments.
- Classify the items on the trial balance. Remember that Expenses, Drawings and Assets are always on the debit/left side of the trial balance and Liabilities, Income and Owner's Equity are on the right/credit side of the trial balance.
- Accumulated Depreciation is a contra (like a negative) asset and Drawings reduces Owner's Equity.
- Complete the financial statements.
- Remember to complete as much as you can in the headings that you know.
- When preparing financial statements never abbreviate and always use the actual name used in the trial balance.

Service Firm

- **Service Firm** – that is a firm that provides a service, and does not buy and sell a product.

Income Statement - Layout

Toni's Hairdressing Salon Income Statement for the year ended 31 March 2006

	\$	\$	\$
Revenue			
Fees Received			100,000
Interest Received			<u>1,000</u>
			101,000
Less Expenses			
Hairdressing Expenses (Group 1)			
Hairdressing Supplies used	5,000		
Hairdresser's Wages	25,000		
Laundry Expenses	1,000		
Cleaning Expenses	<u>4,000</u>	35,000	
Administrative Expenses			
Accountancy fees	2,000		
Insurance	3,000		
Depreciation of Building	1,000		
Telephone expenses	<u>4,000</u>	10,000	
Finance Costs			
Interest on mortgage	5,000		
Interest on Loan	<u>1,000</u>	<u>6,000</u>	
Total Expenses			51,000
Net Profit / Loss			<u>\$50,000</u>

Classification of Elements:

- All revenue/income for a service business is listed under the one revenue heading.
- **Group One expenses** – the name of this expense category will be provided and will be appropriate to the service firm being assessed, e.g. Plumbing Expenses for a Plumber. These are comprised of Distribution expenses (as per trading entity) and any other expenses specific to the provision and delivery of the service.
- **Administrative Expenses and Finance Costs** – see Income Statement for a trading Firm
- The balance sheet will be the same as for a trading firm

Trading Firm - Layout

- **Trading Firm** – that is a business that buys and sells a product

Income Statement for (business Name) For Year ended 31 March 2009			
Income			
Sales			780,000
Less Sales Returns			20,000
Net Sales			760,000
Less Cost of Goods Sold			214,000
Gross Profit			546,000
Add Other Income			
Interest Received		4,000	
Dividends Received		6,000	10,000
			556,000
LESS EXPENSES			
<u>Distribution Expenses</u>			
Advertising	30,000		
Delivery Expenses	10,000		
Sales Persons Wages	70,000	110,000	
<u>Administration Expenses</u>			
Accountancy fees	10,000		
Office Wages	60,000	70,000	
<u>Finance Cost</u>			
Interest on Loan	4,000		
Interest on Mortgage	16,000	20,000	
Total Expenses			200,000
Net Profit			356,000

Gross Profit

The income statement for a trading firm has the trading section which shows the gross profit, which is the difference between the income gained from selling the goods and the total cost of the goods sold.

Sales

Less: Cost of Goods Sold

= Gross Profit

Balance Sheet – Layout

Balance Sheet (Business Name) as at 31 March 2009			
<u>Current Assets</u>			
Accounts Receivable (Note 1)	16,000		
Bank	4,000		
Inventory (closing)	40,000	60,000	
<u>Non-Current Assets</u>			
<u>Investments</u>			
Shares in Voda Phone (Note 2)	18,000		
Term Deposit	28,000	46,000	
<u>Property, Plant and Equipment</u>			
Total Carrying Amount (Note 3)		111,200	
<u>Intangibles</u>			
Trade Mark	428,800		
Goodwill	40,000	100,000	
Total Assets			686,000
less Liabilities			
<u>Current Liabilities</u>			
Accounts Payable	20,000		
GST Payable	10,000	30,000	
<u>Non-Current Liabilities (Note 4)</u>			
Mortgage		200,000	
Total Liabilities			230,000
<u>Net Assets</u>			456,000
Owners Equity			
Opening Capital			200,000
Net Profit			356,000
			556,000
Less Drawings			100,000
Closing Capital			456,000

Notes to the Balance Sheet

1) Accounts Receivable

Accounts Receivable	17,000
Less Allowance for doubtful debts	1,000
	\$16,000

2) Investments

Investments comprise shares in Voda Phone. The current fair value of the shares is \$18,000 which is their market value on balance sheet date.

3) Property, Plant and Equipment

	Land	Equipment	Vehicles	Total
	\$	\$	\$	\$
For year ended 31 March ...				
Opening carrying amount	60 000	19 200	14 000	93 200
Plus additions	20 000	0	16 000	36 000
Less disposals	0	0	(14 000)	(14 000)
Less depreciation	0	(2 400)	(1 600)	(4 000)
Closing carrying amount	\$ 80 000	\$ 16 800	\$ 14 400	\$111 200
As at 31 March ...				
Cost	80 000	24 000	16 000	120 000
Accumulated depreciation	0	7 200	1 600	8 800
Carrying amount	\$80 000	\$16 800	\$14 400	\$111 200

Depreciation is calculated on a straight-line basis at the following rates

- Equipment 10% pa
- Vehicles 20% pa

4. Loan / Mortgage

The mortgage has an interest rate of 7% and a maturity date of January 2015

Classification of Elements:

Income Statement

Revenue

- Only Sales

Other Income

- All other revenues/income and gains
- **Examples** (but not limited to): *interest received, dividends received, rent received, commission received*

Expense Classifications:

Distribution Expenses: *Distribution expenses are costs incurred in transferring ownership of finished goods to the consumer.* Those expenses incurred through the promotion, storage, selling and delivery of the inventory for sale.

Administrative Expenses: *Administrative expenses are costs associated with the administration of the entity as a whole.*

Finance Costs: *Finance costs arise from an entity financing its operations from external sources.* Finance Costs are limited to *different types of interest paid.*

Revenue

- Sales
- (less) Sales Returns

Cost of Goods Sold

Other Income

- Dividends Received
- Interest Received
- Rent Received

Administrative Expenses

- Accountancy Fees
- Legal Fees
- Rent
- Insurance on office Equipment
- Telephone Expenses
- Bad Debts
- Discount allowed

Distribution Expenses

- Advertising
- Freight Outwards
- Vehicle Expenses
- Insurance on Vehicles
- Shop Rent
- Shop Electricity
- Depreciation on Shop Fittings

Finance Costs

- Interest on Loan
- Interest on Mortgage
- Interest on Overdraft

Balance Sheet

Current Assets: *Cash, or will be turned into cash, in the next year/operating cycle of the business.*

Non-Current Assets: Assets which are no current:

- **Investments:** *Money invested over more than one year in fixed term deposits or shares.*
- **Property, Plant and Equipment:** *physical assets the business uses to generate its income or manage the business.*
- **Intangible Assets:** *Non-physical assets which benefit the business over more than one year.*

Current Liabilities: *Amounts owing which will be repaid within the next year/operating cycle of the business.*

Non-Current Liabilities: *Amounts owing which will be repaid over a number of years (more than one).*

Current Assets

- Bank
- Petty Cash (Imprest)
- Accounts Receivable
- Closing Inventory
- Accrued Income
- Prepayments

Investments

- Shares in a company
- Term Deposit

Property, Plant and Equipment

- Equipment
- Fixtures and fittings
- Premises

- Land
- Accumulated Depreciation on these

Intangible Assets

- Goodwill
- Copyright
- Patent

Current Liabilities

- Accounts Payable
- Bank Overdraft
- Accrued Expenses
- Income in Advance
- GST Payable

Non-Current Liabilities

- Mortgage
- Term Loan

(Owners) Equity

- Opening Capital
- Net Profit
- Drawings

Balance Day Adjustments

Balance day adjustments arise because the *life of a business is broken down into smaller periods (period reporting)* and profit is determined in those periods by subtracting expenses from revenues. Some transactions are not fully completed and *need to be included into the accounting period in which they relate (accrual accounting)*. The result is transactions which are incomplete on balance day, or which relate partly to different periods.

Adjustment	Income Statement	Balance Sheet
Amounts owing(due or accrued) for expenses	Add to relevant expense	Record Accrued Expense as a current liability
Amounts owing (due or accrued) for income	Add to relevant income	Record Accrued Income as a current asset
Amounts paid in advance for expenses	Subtract from relevant expense	Record as Prepayment in balance sheet
Amounts received in advance for income	Subtract from relevant income	Record as Income in Advance in balance sheet
Depreciation	Create depreciation expense on (name of relevant asset)	Add Depreciation to relevant Accumulated Depreciation . Subtract new total amount off Accumulated Depreciation from the PPE in the PPE note
Invoices on hand for credit sales	Add GST exclusive amount to sales	Add full amount (or create account) to Accounts Receivable. Add GST amount to GST Payable
Invoices on hand for credit purchases	Add GST exclusive amount to purchases	Add full amount to Accounts Payable . Subtract GST from GST Payable
Invoices on hand for credit purchase of property, plant and equipment		Add GST exclusive amount to property, plant and equipment item. Add Full amount to Accounts Payable. Subtract GST amount from GST Payable.
Write off Bad Debts	Add bad debts as a administration expense	Subtract full amount from Accounts Receivable and subtract GST from GST Payable
Adjusting/creating allowance for doubtful debts	Add/subtract from administration expense	Add/subtract amount from Allowance for Doubtful Debts in Note to Accounts Receivable

Cash Flow Statement

This statement shows the sources and uses of cash during a period of time and the resulting cash position of the business. It only includes cash items (either cash in or cash out).

It does not include non-cash items such as:

- Depreciation
- Gain/loss on sale – record the actual cash received from the sale
- Invoices on hand
- Drawings of goods

Note:

You may need to calculate cash received from Accounts Receivable/Customers on account by reconstruction the accounts Receivable ledger, or following this process:

Start with

- Opening Accounts receivable balance 100,000

Add:

- Credit Sales 800,000
900,000

Subtract:

- Bad debts 20,000
- Discount Allowed 10,000
- Closing accounts Receivable Balance 600,000 630,000

= Cash Received form Accounts Receivable 270,000

You may also need to calculate cash received from Accounts Payable by reconstruction the Accounts Payable ledger, or following this process:

Start with

- Opening Accounts Payable balance 200,000

Add:

- Credit Purchases 300,000
500,000

Subtract:

- Discount Received 10,000
- Closing accounts Receivable Balance 200,000 210,000

= Cash Received form Accounts Receivable 290,000

Layout of Cash Flow Statement

Business Name Cash Flow Statement for the Month/Year Ended ...		
	\$	\$
<i>Cash Was received from:</i>		
Sales	10,000	
Received from Accounts Receivable	5,000	
Interest Received	1,000	
Total Receipts		16,000
<i>Cash was applied to:</i>		
Sales wages	3,000	
Vehicle	4,000	
Purchases	4,900	
Bank Fees	100	
Total Payments		<u>12,000</u>
Net Increase (Decrease in Cash)		4,000
Plus Opening Bank Balance		6,000
Closing Bank Balance		10,000

General Journal Entries

Balance Day Adjustments

Accrued Expenses – For Example (Wages owing OR Interest owing – **no GST on these**)

	Debit	Credit
Wages OR Interest Expense	XX	
Accrued Expenses		XX
(Expense owing on balance Day)		

Accounts Payable (including GST) for expenses – invoice on hand dated before balance day

	Debit	Credit
Expense e.g. Advertising	XX	
GST	XX	
Accounts Payable		XX
(Expense owing – invoice on hand dated before balance day)		

Accrued Income – For Example (Interest earned but not yet received OR Dividends earned but not yet received – **no GST on these**)

	Debit	Credit
Accrued Income	XX	
Interest received OR Dividends received		XX
(revenue earned but not yet received)		

Prepayment – GST exclusive amount

	Debit	Credit
Prepayments	XX	
Expense e.g. Insurance		XX
(expense paid in advance)		

Income in Advance – GST exclusive amount

	Debit	Credit
Income e.g. rent received	XX	
Income in advance		XX
(revenue received in advance)		

Depreciation

	Debit	Credit
Depreciation – name of fixed asset	XX	
Accumulated Depreciation – name of fixed		XX

Closing Journal Entries

Close Income accounts

	Debit	Credit
Income accounts	XX	
Income Summary		XX
(Close revenue accounts)		

Close Expense accounts

	Debit	Credit
Income Summary	XX	
Expense accounts		XX
(Close Expense accounts)		

Note – A Trading firm that uses a Perpetual Inventory system would also close the Cost of Goods Sold Account as part of closing Expense Accounts.

Transfer Net Surplus or Net Deficit

	Debit	Credit
Income Summary	XX	
Capital		XX
(transfer Net Surplus to capital)		

Note - Entry is opposite if a net deficit

Close Drawings account

	Debit	Credit
Capital	XX	
Drawings		XX
(Close drawing account)		

Reversal Entries

Only reverse Accrued Expenses, Accrued Income, Prepayments, and Income in Advance on the **FIRST** day of the new accounting period.

Accrued Expenses

	Debit	Credit
Accrued Expenses	XX	
Wages OR Interest Expense		XX
(reversal of Expense owing)		

Accrued Income

	Debit	Credit
Interest received OR Dividends received	XX	
Accrued Income		XX
(reversal of accrued revenue)		

Prepayment

	Debit	Credit
Expense e.g. Insurance	XX	
Prepayments		XX
(reversal of Prepayments)		

Income in Advance

	Debit	Credit
Income in Advance	XX	
Revenue e.g. Rent Received		XX
(reversal of Revenue received in advance)		

Ledger Entries

Note: Some figures have been used to demonstrate the *various* entries in Ledger Accounts.

Closing Journal Entries

Revenues

Date	Particulars	Debit	Credit	Balance
31 March 02	Balance		35,000	35,000 Cr
	Income Summary	35,000		00

Expenses

Date	Particulars	Debit	Credit	Balance
31 March 02	Balance	25,000		25,000 Dr
	Income Summary		25,000	00

Income Summary

Date	Particulars	Debit	Credit	Balance
31 March 02	Revenues		35,000	35,000 Cr
	Expenses	25,000		10,000 Cr
	Capital (Net Profit)	10,000		00

Capital

Date	Particulars	Debit	Credit	Balance
1 April 01	Balance			65,000 Cr
	Income Summary (Net Profit)		10,000	75,000 Cr
	Drawings	8,000		67,000 Cr

Drawings

Date	Particulars	Debit	Credit	Balance
31 March 02	Balance	8,000		8,000 Dr
	Capital		8,000	00

Bad Debts, Doubtful Debts, Accounts Receivable

Note **An example has been used to demonstrate the various entries in Ledger Accounts**

1 April 2001 Accounts Receivable Balance \$25,625
 Allowance for Doubtful Debts \$500

31 March 2002 Additional Bad Debts of \$5625 (including GST) are to be written off and adjust the Allowance for Doubtful Debts to be adjusted to 5% of Accounts Receivable.

Bad Debts

Date	Particulars	Debit	Credit	Balance
31 March 02	Balance			8,000 Dr
	Accounts Receivable	5,000		13,000 Dr
	Income Summary		13,000	00

Doubtful Debts

Date	Particulars	Debit	Credit	Balance
31 March 02	Allowance for Doubtful Debts	500		500 Dr
	Income Summary		500	00

Allowance for Doubtful Debts

Date	Particulars	Debit	Credit	Balance
1 April 01	Balance			500 Cr
31 March 02	Doubtful Debts		500	1,000 Cr

Accounts Receivable

Date	Particulars	Debit	Credit	Balance
1 April 01	Balance			25,625 Dr
31 March 02	Bad Debts & GST		5,625	20,000 Dr

Balance Day Adjustments, Closing Entries and Reversals

Accrued Expenses

Wages paid during the year \$50,000. On Balance Day there are \$10,000 wages owing.

Wages

Date	Particulars	Debit	Credit	Balance
31 March 02	Balance			50,000 Dr
	Accrued Expenses (BDA)	10,000		60,000 Dr
	Income Summary (Closing)		60,000	00
1 April 03	Accrued Expenses (Reversing)		10,000	10,000 Cr

Accrued Expenses

Date	Particulars	Debit	Credit	Balance
31 March 02	Wages (BDA)		10,000	10,000 Cr
1 April 03	Wages (Reversing)	10,000		00

Prepayments

Insurance paid during the year \$8,000. On Balance Day \$240 (exl. GST) has been paid in advance.

Insurance

Date	Particulars	Debit	Credit	Balance
31 March 02	Balance			8,000 Dr
	Prepayments (BDA)		240	7,760 Dr
	Income Summary (Closing)	7,760		00
1 April 03	Prepayments (Reversing)	240		240 Dr

Prepayments

Date	Particulars	Debit	Credit	Balance
31 March 02	Insurance (BDA)	240		240 Dr
1 April 03	Insurance (Reversing)		240	00

Accrued Income

Interest received to date \$3,500. On Balance Day there is \$500 interest earned but not yet received.

Interest Received

Date	Particulars	Debit	Credit	Balance
31 March 02	Balance			3,500 Cr
	Accrued Revenue (BDA)		500	4,000 Cr
	Income Summary (Closing)	4,000		00
1 April 03	Accrued Revenue (Reversing)	500		500 Dr

Accrued Income

Date	Particulars	Debit	Credit	Balance
31 March 02	Rent Received (BDA)	500		500 Dr
1 April 03	Rent Received (Reversing)		500	00

Income in Advance

Rent received during the year \$35,000. On Balance Day \$9,000(exl. GST) has been received in advance.

Rent Received

Date	Particulars	Debit	Credit	Balance
31 March 02	Balance			35,000 Cr
	Income in Advance (BDA)	9,000		26,000 Cr

	Income Summary (Closing)	26,000		00
1 April 03	Income in Advance (Reversing)		9,000	9,000 Cr

Income in Advance

Date	Particulars	Debit	Credit	Balance
31 March 02	Rent Received (BDA)		9,000	9,000 Cr
1 April 03	Rent Received (Reversing)	9,000		00