

# INTRODUCTION TO THE PREPARATION OF FINANCIAL STATEMENTS

Study unit 1

FAC1601

# OVERVIEW

- Conceptual framework
- Financial statements
  - Statement of profit or loss and other comprehensive income
  - Statement of financial position
  - Statement of changes in equity
  - Statement of cash flows
  - Notes

# CONCEPTUAL FRAMEWORK

- Assets
- Liabilities
- Equity
- Income
- Expenses

# FINANCIAL STATEMENTS

## ○ Identification

- Name of reporting entity
- Date at the end of reporting period
- Presentation currency
- Name of financial statement

STATEMENT OF PROFIT OR  
LOSS AND OTHER  
COMPREHENSIVE INCOME

# STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

- Revenue
- Cost of sales
- Gross profit
- Other income
  - List other income streams
- Distribution, administrative and other expenses
  - List expenses, e.g. rent & depreciation
- Finance cost
  - List finance costs, e.g. interest on bank overdraft
- Profit before tax
- Income tax expense
- Profit for the year
- Other comprehensive income
- Total comprehensive income for the year

# REVENUE

## ⦿ What:

- Income
- arising from transactions or other events
- in the course of ordinary (day2day) business activities

## ⦿ Calculation:

- Sales
- LESS
  - Sales returns
  - Settlement discount granted
  - Creation or increase in allowance for settlement discount granted
- PLUS
  - Forfeited settlement discount granted

# COST OF SALES

- ◉ Cost of inventory sold
- ◉ Calculation
  - Opening inventory
  - PLUS:
    - Purchases
    - Transportation costs of inventory
    - Storage, insurance, duties and other related costs
    - Settlement discount received - forfeited.
  - LESS:
    - Purchase returns
    - Closing inventory
    - Settlement discount received



# OTHER INCOME

- ⊙ Income from transactions not connected to day to day transactions of business
- ⊙ Examples
  - Rental income
  - Dividend income
  - Interest income
  - Gains on financial assets
  - Gains on sale of assets

# DISTRIBUTION, ADMINISTRATIVE AND OTHER EXPENSES

- ⦿ Expenses incurred by the entity excl CoS and Finance costs
- ⦿ Examples
  - Bank charges
  - Credit losses
  - Depreciation
  - Loss on financial assets and sale of assets
  - Rental
  - Stationary
  - Telephone expense
  - Water and electricity

# FINANCE COSTS

- ⦿ Costs to borrow money to build/purchase assets & maintain business operations
- ⦿ Examples
  - Interest on long-term loans
  - Interest on bank overdraft
  - Interest on mortgage

# STATEMENT OF FINANCIAL POSITION

# STATEMENT OF FINANCIAL POSITION (ASSETS)

## ○ Assets

- Non-current assets
  - Property, plant and equipment
  - Financial assets
- Current assets
  - Inventories
  - Trade and other receivables
  - Prepayments
  - Cash and cash equivalents
  - Current tax receivable
  - Other financial assets
- Total assets

# ASSETS

## ○ Non-current

- PPE - tangible assets @ carrying amount
- Financial assets (non-current) - examples
  - Equity instruments in non-listed company
  - Fixed deposits → mature beyond 1 year period

## ○ Current assets

- Assets that can be converted to cash within 1 yr
- Other financial assets
  - Fixed deposits → mature within 1 year
  - Listed shares

# STATEMENT OF FINANCIAL POSITION (EQUITY AND LIABILITIES)

- Total equity
  - Members' contribution
  - Retained earnings
  - Other components of equity (e.g. reserves)
- Total liabilities
  - Non-current liabilities
    - Long-term borrowings
    - Other financial liabilities
  - Current liabilities
    - Income received in advance
    - Trade and other payables
    - Short-term borrowings
    - Current portion of long-term borrowings
    - Other financial liabilities
    - Current tax payable
- Total equity and liabilities

# EQUITY & LIABILITIES

## ◉ Equity

- What owners invested in business
  - Depends on nature of business
    - Partnership v close corporation

## ◉ Liabilities

- Non-current
  - Obligations not payable within 1 year
- Current
  - Obligations payable within 1 year
  - Bank overdraft → ‘other financial liabilities’



# FINANCIAL ASSETS

# CATEGORIES

- ◉ **Financial asset held for trading at fair value through profit or loss:**
  - ◉ **Example:** - Shares held for speculative purposes (Listed investments)
  - ◉ “Other financial assets” under the Current Asset section of the SOFP.
  - ◉ Movements will be reflected in SOP or L&OCI as “Other income”
  
- ◉ **Financial asset at fair value through other comprehensive income:**
  - ◉ **Example:** - Investment in equity instruments (Unlisted investments)
  - ◉ “Financial assets” under the Non-Current Asset section of the SOFP