The ExP Group

ACCA FA | ExPress Notes

Financial Accounting

SBL SBR AFM APM ATX AAA

BT MA FA LW PM TX FR AA FM

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Contents

Steve Crossman
CEO The ExP Group

"Hello"

Thank you for downloading a copy of these ExPress notes and I hope you find them useful for your studies.

We provide these ExPress notes free of charge to individual students as part of our CSR initiatives. The notes are designed to help students assimilate and understand the most important areas for the exam as quickly as possible.

A word of warning though in that they have not been designed to cover everything in the syllabus so you should only use these notes for either an overview of the key areas before you start your main studies or as part of your final revision in the run up to your exams.

Importantly though, we want you to be successful in your exams so good luck with your studies and please do let us know how you get on.

All the best,

Steve

About The ExP Group

We were born with one passion, with one aim, with one desire. To use technology the way it should be used. To use technology to open up education, and in particular financial education, to whoever needs it regardless of their income, wealth, race, sex, religion or location.

We wanted to use technology to empower individuals to develop themselves through financial expertise, organisations to improve their performance through enhanced human capital and ultimately communities and families to benefit as a result.

We're on target and since our birth we have had the privilege of working with and learning from inspirational individuals and organisations from all 4 corners of the world in countries as varied as the UK in the north, Singapore in the east, South Africa in the south and the Cayman Islands in the west.

We're only part way through our journey but we're doing better than we expected. The best is yet to come though,

Education+Technology=Ethical Empowerment.

Thank you for being part of our story.

01 Financial Statements

The Big Picture

Financial statements (more colloquially called accounts) are a crucial part of managing a business and reporting to shareholders. A set of financial statements will need to be produced at least annually for presentation to external stakeholders, but generally much more frequently for management control within the business.

Frequent and accurate financial statements can add a great deal to the efficient running of a business.

A set of financial statements is produced periodically (often once a year for smaller businesses but as frequently as the users want them). A full set of financial statements for a limited company comprises a number of statements:

- A **statement of financial position**, referred to by some people as a balance sheet. This lists all the assets and liabilities of the business plus the equity of the business (which explains where the assets and liabilities came from). The statement of financial position is a snapshot of the assets and liabilities of a business at a moment in time.

- A **statement of profit or loss and other comprehensive income**. This shows all the gains and losses that the business has experienced in the period. The statement of comprehensive income is a record of what happened over a period to the net assets of a business.

- A **statement of cash flows**, which shows where the cash and short-term assets very similar to cash came from and went do during the period. Income isn't always the same as cash, as we'll see later.

- **Notes to the financial statements**, which give further detail to readers who want to know more than the summary story.

Statement of financial position of Sole Trader X at 30 June 20x1

ASSETS	**$**	**$**
Non-current assets		
License to operate		10,000
Land and buildings		35,000
Office equipment		20,000
Motor vehicles		30,000
Fixtures and fittings		10,000
		105,000
Current assets		
Inventory		20,000
Trade receivables	13,000	
Less: allowance for doubtful receivables	(1,000)	
		12,000
Prepayments		4,000
Cash at bank		3,000
Cash in hand		2,000
Total assets		146,000

EQUITY AND LIABILITIES		
Capital		
Initial capital introduced		30,000
Total cumulative comprehensive income at 1 July 20x0		85,700
Less: Cumulative withdrawals at 1 July 20x0		(24,000)
Total equity at 1 July 20x0		91,700
Total comprehensive income in the current period		16,000
Withdrawals in the current year		(8,000)
Total equity at 30 July 20x1		99,700

Non-current liabilities	
Bank loans	32,000
Current liabilities	
Bank overdraft	3,300
Trade payables	8,000
Accruals	3,000
Total liabilities	46,300
Total equity and liabilities	146,000

Principal features of the statement of financial position:

- It balances, with the total assets equaling equity (i.e. owner's interest) plus liabilities
- Each section is conventionally written in terms of increasing liquidity
- Non-current assets and liabilities are ones that are expected to remain on the SOFP next year. Current assets and liabilities are expected to be used up or paid within the coming year.

A SOFP may be rearranged into a number of ways. As above shows:

Total assets = Equity + total liabilities

Equally validly therefore:

Total assets – total liabilities = Equity

Given that equity = capital + cumulative profit – cumulative withdrawals, then the equation could be written in any number of ways such as:

Total assets – total liabilities = Capital + cumulative profit – cumulative withdrawals

Or

Cumulative profit = Total assets – total liabilities – capital + cumulative withdrawals.

This is sometimes called the "accounting equation" and often comes up in the FA exam. The task is to drop in the figures that you know and find the missing figure, whatever it might be.

Statement of profit or loss and other comprehensive income for the year ended 30 June 20x1

	$	$
Sales revenue		154,000
Cost of sales		(100,000)
Gross profit		54,000
Distribution costs		(11,000)
Admin and selling expenses		(22,000)
Operating profit		21,000
Less: Finance costs		(1,000)
Profit before tax		10,000
Tax		(2,000)
Profit for the year		8,000
Other comprehensive income:		
Revaluation gain on property		2,000
Total comprehensive income in the period		10,000

You may be required in the exam to calculate revenue, cost of sales, gross profit and total comprehensive income from given data.

Unusual items

Sometimes, it is necessary for one-off items to be disclosed separately in the financial statements if they are very large or arise from an unusual, often non-recurring, source. Typical examples might be write-off of an unusually large debt as irrecoverable, or business relocation costs. Disclosing it separately allows readers of the accounts a more in-depth understanding of what the business is doing.

Key Knowledge - Elements of financial statements

There are five elements of financial statements, from which all financial statements are produced. These definitions are very useful throughout your ACCA studies and could easily be part of a question in paper FR.

Elements of the statement of financial position:

- An **asset** is a resource that is controlled by an entity as a result of past events and from which future economic benefits are expected to flow to the entity.

- A **liability** is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

- **Equity** is the residual interest in the assets of the entity after deducting all its liabilities. Depending on the type of business, this may be called just capital (sole trader), partners' current account (partnership) or share capital and reserves (for a limited company). For a limited company, reserves show the net cumulative gains above cumulative losses, less all dividends paid. This therefore explains the difference between what the net assets were when the share capital was originally paid in and what the net assets are at the reporting date.

Elements of the statement of comprehensive income:

- **Income** is an increase in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants.

- An **expense** is a decrease in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrence of liabilities that result in decreases in equity, other than those relating to distributions to equity participants.

Note that income and expenditure are defined effectively as the reason that a change in net assets happened.

Key Knowledge - Relationship between the statements: the business equation

An increase in net assets of a business will come from a mixture of these sources:

- Total comprehensive income made in the period (a profit will increase net assets)
- New capital introduced by the owner (will always increase net assets)
- Withdrawals made in the period (will always reduce net assets).

This is sometimes called the accounting equation or the business equation. It can be summarised:

Closing net assets = Opening net assets + total comprehensive income in the period + new capital introduced in the period – withdrawals in the period.

This is also a frequent exam question, with some figures given and the others having to be deduced.

Remember that net assets = equity + liabilities, by definition. So net assets may be given in a question separately as equity and liabilities.

Separate accounting entity

Even with a sole trader (a person who runs a business on their own, but the business has never been set up formally to be a separate legal identity), there is a distinction between personal income/ expenses and business income/ expenses. The accounts will largely be maintained so that the sole trader can report business profits to the tax authority. Personal expenditure such as personal holidays is not deductible against tax! The accountant will therefore only record transactions that are considered to be legitimate business transactions; personal transactions will be ignored. In smaller businesses, one of the first steps when producing accounting records for clients is to separate the business transactions from the personal, as the latter will not be recorded anywhere.

Sole traders and limited companies. We will look at these in more detail in each chapter, but here's a summary:

	Sole trader	Limited company
Number of investors	1 (the sole trader!)	Can be between 1 and an unlimited large number
Must produce accounts for the tax authority	Yes	Yes
Must produce accounts to file with the commercial register	No	Yes
Business name	Normally just the name of the owner "trading as" the name of the business	Must end Ltd (if private limited company) or plc (if public limited company)
Can offer shares to the public?	No	Yes, if a plc. No if Ltd.
Equity part of the SOFP	Initial capital Cumulative profit Cumulative withdrawals	Share capital Reserves: (revaluation reserve, retained earnings, etc).