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AABS

FINANCIAL ACCOUNTING WORKSHOP

ELGRO HOTEL

JULY 2019

Workshop objectives

- Understand the difference between financial accounting and managerial accounting
- Understand NB accounting concepts
- Identify the different financial statements
- Distinguish between balance sheet and income statement accounts
- Process basic journal entries by demonstrating an understanding of the double entry concept
- Reconstruct an income statement and balance sheet

Financial vs managerial accounting

FINANCIAL ACCOUNTING

- Financial accounting is the field of accounting concerned with the **summary**, **analysis** and **reporting** of **financial transactions**.
- Involves the preparation of **financial statements** available for private and public use.
- Users? Stockholders, suppliers, banks, employees, government agencies, business owners and other stakeholders.
- Governed by both local and international **accounting standards**. Generally Accepted Accounting Principles (GAAP) / International Financial Reporting Standards (IFRS) / US GAAP etc dictate the standards, conventions and rules that accountants follow in recording and summarizing and in the preparation of financial statements.

MANAGERIAL ACCOUNTING

- Provides accounting information to help managers make **decisions** to manage the business

CHALLENGE IS TO FIND ONE SYSTEM OF ENTRY THAT MEETS BOTH FINANCIAL AND MANAGERIAL ACCOUNTING NEEDS

"the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are in part at least of a financial character and interpreting the results thereof."

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History and objectives of financial accounting

OLD CONCEPT

- Concept introduced **twenty-three centuries** ago by Indian scholar named Kautilya in his book Arthashastra.
- Kautilya described the art of proper account keeping and methods of checking accounts and over the years this has developed into a specialist field of its own to meet the challenges and changes of the business world.

OBJECTIVES

- To keep systematic records
- To ascertain profitability
- To ascertain the financial position of the business
- To assist in decision-making
- To fulfil compliance of Law

Why this workshop?

The CEO of your company has heard that you have successfully completed your MBA and has asked you to review the company's financial statements for the last three years and to provide the executive team with your findings and recommendations.

Links to other MBA modules

- Company project
- Strategy
- Financial management
- Managerial accounting

Accounting process

1. Collecting & analysing documents
2. Journal posting
3. Leger account
4. Trial balance
5. Adjusting entries
6. Adjusted trial balance
7. Prepare financial statements
8. Closing and roll-forward

Accounting process

Interpretation and analyses

NB

NB

NB

NB

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Accounting concepts

Business entity concept

- Business and owner of the business are two different entities

Money measurement concept

- Record only those transactions in our accounting records which can be *measured in monetary* terms

  Note: managerial accounting have a need for non-monetary data

Going concern concept

- Use values assuming that business is a going concern – not a "gone concern"

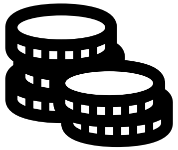
  Why is this important – what difference does it make?

Historical cost concept

- As a general rule, book transactions on cost basis, not on the net realizable value or market value of the assets

Dual aspect concept

- The principle of double entry – to complete any financial entry there should be a debit and credit
  - We get some benefit, and
  - We pay some benefit



Accounting concepts - continued

Accounting period concept

- To determine the profit or loss of a firm, and to ascertain its financial position, profit & loss accounts and balance sheets are prepared at regular intervals, but at least on annual basis
- Based on this concept, revenue expenditure and capital expenditure are treated differently
- **Matching concept**
- Linked to accounting period concept – expenses during a particular period matched with revenue for the same accounting period

? Why do we do this?

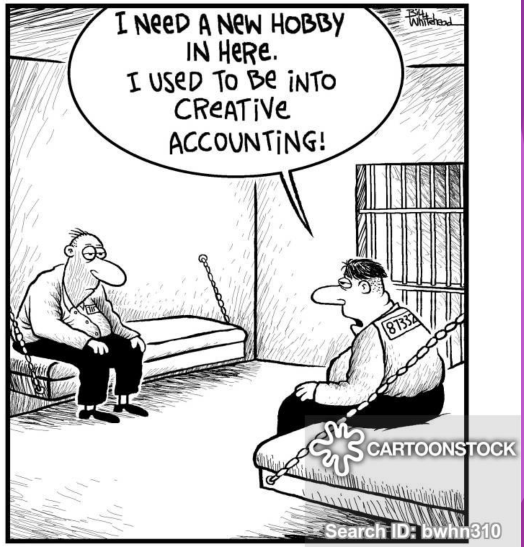
Accrual concept

- Do not limit transaction recording to cash basis only

? Examples of non-cash transactions?

Objective evidence concept

- Financial entries should be supported by some objective evidence



STEINHOFF

Tongaat Hulett

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What is happening in the world!

Another Steinhoff! Tongaat Hulett, Deloitte trickery blows up in fresh corporate scandal

4th June 2019 by Jackie Cameron

Steinhoff's window-dressing reveals the devil is in the details

SOUTH AFRICA

Darkness descends on KPMG

Auditing firm faces ruin as its reputation lies in tatters

20 September 2017 - 06:21

BY GRAEME HOSKEN

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Characteristics of financial information

- ***Relevant:*** The information directly relates to the facts you're trying to evaluate or understand.

- ***Reliable:*** It can be depended on to steer a business in the right direction.

- ***Comparable:*** The quality of the information is such that users can identity differences and similarities between companies and prior periods they are evaluating.

Different financial statements

Income statement (also called statement of profit and loss and other comprehensive income)

- The income statement shows a business' results of operations and will show whether a business has made a profit or loss during the financial period.
- All revenue, expenses, gains, and losses and taxes appear on the income statement.

Balance sheet

- The balance sheet shows the health of a business (financial position) from the day it started operations to the specific date of the balance sheet report.
- It lists the company's *assets* (resources such as cash and inventory), *liabilities* (claims against the assets), and *equity* (the difference between assets and liabilities, which reflects the owners' total investment in the business)

Assets = Equity + Liabilities

Cash flow statement

- The cash flow statement reveals how a company is generating or spending its cash.

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Some definitions worth knowing

- **Accounts Payable**

Unpaid supplier invoices and bills (that is money *owed by* the business *to other businesses*). These and are balance sheet accounts and shown as liabilities. Once paid it is removed from this group.

- **Accounts Receivable**

Unpaid sales invoices (that is money *owed to* the business by customers). These are found on the balance sheet under assets. Once the customer pays their invoice it is removed from this group.

- **Assets**

Items with value owned by a business.
Assets are found on the balance sheet and include current assets like cash in the bank accounts, cash in petty cash box, accounts receivable and non-current assets like equipment, land and buildings, vehicles.

- **Capital**

The funds a business owner contributes to a business.

- **Equity**

Equity is the net assets of a business (if A=E+L then E=A-L)

- **Depreciation**

Most assets belonging to a business decrease in value over time due to wear and tear and daily use – this is depreciation.

- **Expenses**

Purchases (assets excluded), utilities, office rent, accounting fees, etc and are found on the income statement.

- **Gross profit**

Business income or business revenue less cost of sales.

- **Liabilities**

Debts that the company owes to other parties and include accounts payable, loans and credit card balances and is found on the balance sheet.

- **Revenue**

The total amount of money earned by the company for goods sold or services provided during a certain time period.

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Quiz: Account classification

Account	Income Statement?	Balance Sheet?
Depreciation		
Finished goods: Inventory		
Legal fees		
Rental income		
Petty cash		
Land and buildings		
Salaries and wages		
Income tax expense		
Interest on long-term loans		
Accounts payable		
Share capital		

Solution: Account classification

Account	Income Statement?	Balance Sheet?
Depreciation	X	
Finished goods: Inventory		X
Legal fees	X	
Rental income	X	
Petty cash		X
Land and buildings		X
Salaries and wages	X	
Income tax expense	X	
Interest on long-term loans	X	
Accounts payable		X
Share capital		X

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Let’s talk debits and credits

As a result of the **double-entry** system every business transaction is recorded in at least two accounts. One account will receive a "debit" entry, meaning the amount will be entered on the *left* side of that account. Another account will receive a "credit" entry, meaning the amount will be entered on the *right* side of that account.

INCOME STATEMENT ACCOUNT

Dr	Cr
Outflow of economic benefit	**Inflow of economic benefit**
i.e.	i.e.
Salaries and wages	Interest received
Rates and taxes	Sales
Office rent	Discount received
Telephone costs	Rental income

BALANCE SHEET ACCOUNT

ASSET

Dr	Cr
Increase in balance	**Decrease in balance**
i.e.	i.e.
Deposit into bank account	Payment from bank account
Purchase of asset	

LIABILITY

Dr	Cr
Decrease in balance	**Increase in balance**

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Profits / losses

Using the same information as on the previous slide….A business sells a coffee machine that was purchased for R1 500 to a customer for R2 500 in cash. Also assume that the business initially took out a loan of R20 000 to buy its inventory of coffee machines.

Trial balance	**Dr**	**Cr**
Income statement accounts		
Sales		**2,500**
Cost of sales	**1,500**	
Balance sheet accounts		
Inventory	**18,500**	
Loans		**20,000**
Cash	**2,500**	
	22,500	**22,500**

What would the **trial balance** look like after the sale to the customer?

The ***trial balance*** is a summary of the closing balances of all the general ledger accounts (T-accounts)

Income statement on its own	**Dr**	**Cr**
Sales		**2,500**
Cost of sales	**1,500**	
Note: It does not balance		
Profit / loss for the period	**1,000**	
	2,500	**2,500**

Balance sheet on its own	**Dr**	**Cr**
Inventory	**18,500**	
Loans		**20,000**
Cash	**2,500**	
Note: It does not balance		
Accumulated profit / loss		**1,000**
	21,000	**21,000**

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Why will those who "crook the books" be caught (eventually)?

- The answer lies in the **double entry** principle

Assume the same information as previously. A business sells a coffee machine that was purchased for R1 500 to a customer for R2 500 in cash. Also assume that the business initially took out a loan of R20 000 to buy its inventory of coffee machines. The business owner however wants to take out a new loan and in an attempt to increase his profits, decides to inflate his sales and account for the sale above at R3 500.

- In real life, the business sells the coffee machine for R2 500 and receives R2 500 in cash. **What does he do with the fictitious R1 000 difference?**

Trial balance	**Dr**	**Cr**
Income statement accounts		
Sales		**3,500**
Cost of sales	**1,500**	
Balance sheet accounts		
Inventory	**18,500**	
Loans		**20,000**
Cash	**2,500**	
Fictitious debtor	**1,000**	
	23,500	**23,500**

Trial balance	**Dr**	**Cr**
Income statement accounts		
Sales		**3,500**
Cost of sales	**1,500**	
Balance sheet accounts		
Inventory	**19,500**	
Loans		**20,000**
Cash	**2,500**	
	23,500	**23,500**

The 4th Industrial Revolution and Accounting

How blockchain will shape the future of accounting

https://www.youtube.com/watch?v=v6patZu2otg

Triple Entry Accounting

Self-auditing books - it's tough to lie when everyone is watching

Alice's Books

Debit	Credit
5	
	2
	9
10	

Bob's Books

Debit	Credit
	5
2	
9	
	10

Public Book

Alice	Bob
-5	5
2	-2
9	-9
-10	10

Income Statement

Always take careful note of how the amounts are expressed – in this instance R1 = R1 million. You will lose marks unnecessarily if you are not attentive!

Financial ratios (Pty) Ltd

Income Statement	**2018 R'million**	**2017 R'million**	**2016 R'million**
Revenue	5,000	4,000	3,000
Cost of goods sold	(3,200)	(3,000)	(2,500)
Gross profit	*1,800*	*1,000*	*500*
General & administrative costs	(500)	(450)	(400)
Depreciation	(300)	(300)	(300)
Operating profit or Earnings before interest and tax (EBIT)	*1,000*	*250*	*(200)*
Interest	(50)	(50)	(50)
Earnings before tax	*950*	*200*	*(250)*
Tax	(225)	(20)	-
Net profit / (loss)	**725**	**180**	**(250)**

If any dividends were declared to shareholders it will appear after net profit / (loss)

Note: There is a logical sequence

What is the value of sales generated?

How much did it cost to generate those specific sales?

How much did it cost to support the business?

How much were the non-cash costs?

How much did it cost to finance the business?

How much tax is payable on profits?

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Balance Sheet

Financial ratios (Pty) Ltd

Balance Sheet	2018 R'million	2017 R'million	2016 R'million
ASSETS			
Current assets	***22,405***	***21,180***	***22,000***
Cash and cash equivalents	5,405	6,680	7,000
Accounts receivalbe	2,000	2,500	1,000
Inventory	15,000	12,000	14,000
Long-term assets	***50,000***	***45,000***	***40,000***
Property, plant and equipment	50,000	45,000	40,000
PPE - Cost	75,600	70,300	65,000
Accumulated depreciation - PPE	(25,600)	(25,300)	(25,000)
TOTAL ASSETS	**72,405**	**66,180**	**62,000**
EQUITY			
Share capital	30,000	30,000	30,000
Retained earnings	13,405	12,680	12,500
Shareholders' equity	***43,405***	***42,680***	***42,500***
LIABILITIES			
Current liabilities	***4,000***	***3,500***	***4,500***
Accounts payable	1,000	1,500	1,000
Current portion of long term debt	3,000	2,000	3,500
Long term liabilities	***25,000***	***20,000***	***15,000***
Long term loans	25,000	20,000	15,000
TOTAL EQUITY AND LIABILITIES	**72,405**	**66,180**	**62,000**

Remember
Assets = Equity + Liabilities?

Current assets are "short-term" assets that are either cash or that can be converted into cash in < 12 months.
Long-term assets are assets that a business intends to use for >12 months at date of acquisition

See if you can find the difference between 2018 & 2017 (A) and between 2017 and 2016 (B) on the income statement?

Current liabilities are "short-term" liabilities that need to be settled < 12 months.
Long-term liabilities are liabilities that a business would need to settle >12 months

(C) Loans increased with R5m, made a profit, but cash decreased, why?

Cash flow statement

Cash flow statement		2018 R'million		2017 R'million
CASH FLOW FROM OPERATING ACTIVITIES				
Cash received from customers	A	5,500	B	2,500
Cash paid to suppliers and employees		(7,200)		(950)
Cash generated from operations	C	(1,700)	D	1,550
Interest paid		(50)		(50)
Tax paid		(225)		(20)
Cash (utilised in) / generated by operations		(1,975)		1,480
CASH FLOW FROM INVESTING ACTIVITIES				
Additions to property, plant and equipment		(5,300)		(5,300)
Cash flow (utilised in) / generated by investing activities		(5,300)		(5,300)
CASH FLOW FROM FINANCING ACTIVITIES				
Proceeds from new loans		6,000		3,500
Cash (utilised in) / generated by financing activities		6,000		3,500
NET INCREASE / (DECREASE) IN CASH AND CASH EQUIVALENTS		(1,275)		(320)
Cash and cash equivalents at beginning of period		6,680		7,000
Cash and cash end at beginning of period		5,405		6,680

Cash received from customers				
Revenue per income statement		**5,000**		**4,000**
Change in trade receivables		**500**		**(1,500)**
	A	**5,500**	B	**2,500**

Operating profit or Earnings before interest and tax (EBIT)		1,000		250
Add back:				
Non-cash items				
Depreciation		300		300
Changes in working capital				
(Increase)/Decrease in accounts receivable		500		(1,500)
(Increase) / Decrease in inventory		(3,000)		2,000
Increase / (Decrease) in accounts payable		(500)		500
Cash generated by (utilised in) operations	C	**(1,700)**	D	**1,550**

Movement in Property, plant and equipment		
Opening balance - cost price	70,300	65,000
Closing balance - cost price	75,600	70,300
	(5,300)	**(5,300)**

Or....

Movement in Property, plant and equipment		
Opening balance - net carrying value	45,000	40,000
Closing balance - net carrying value	50,000	45,000
Movement in net carrying value	(5,000)	(5,000)
Adjust for: Depreciation (non-cash movement)	(300)	(300)
	(5,300)	**(5,300)**

In essence, the cash flow statement is reconciliation between opening and closing cash positions by using the income statement and movement in balance sheet accounts

Exercise - Income Statement Reconstruction

AFS reconstruction (Pty) Ltd

Income Statement	**2018 R'million**	**2017 R'million**	**2016 R'million**
Revenue	5,500	4,200	3,000
Cost of goods sold			(2,500)
Gross profit		*1,200*	*500*
General & administrative costs	(500)	(450)	(400)
Depreciation	(300)	(300)	(300)
Operating profit or Earnings before interest and tax (EBIT)	*1,500*	*450*	(200)
Interest	(50)	(50)	(50)
Earnings before tax	*1450*	*400*	(250)
Tax	(225)	(20)	-
Net profit / (loss)	**1225**	**380**	**(250)**

Exercise – Balance Sheet Reconstruction

AFS Reconstruction (Pty) Ltd			
Balance Sheet	**2018 R'million**	**2017 R'million**	**2016 R'million**
ASSETS			
Current assets	***23,105***		***22,000***
Cash and cash equivalents	5,905		7,000
Accounts receivalbe	2,000	2,500	1,000
Inventory	15,200	12,000	14,000
Long-term assets	***50,000***	***45,000***	***40,000***
Property, plant and equipment	50,000	45,000	40,000
TOTAL ASSETS	**73,105**	**66,380**	**62,000**
EQUITY			
Share capital	30,000	30,000	30,000
Retained earnings		12,880	12,500
Shareholders' equity		***42,880***	***42,500***
LIABILITIES			
Current liabilities	***4,000***	***3,500***	***4,500***
Accounts payable	1,000	1,500	1,000
Current portion of long term debt	3,000	2,000	3,500
Long term liabilities	***25,000***	***20,000***	***15,000***
Long term loans	25,000	20,000	15,000
TOTAL EQUITY AND LIABILITIES	**73,105**	**66,380**	**62,000**

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Solution - Income Statement Reconstruction

AFS reconstruction (Pty) Ltd

Income Statement	**2018 R'million**	**2017 R'million**	**2016 R'million**
Revenue	5,500	4,200	3,000
Cost of goods sold	(3,200)	(3,000)	(2,500)
Gross profit	*2,300*	*1,200*	*500*
General & administrative costs	(500)	(450)	(400)
Depreciation	(300)	(300)	(300)
Operating profit or Earnings before interest and tax (EBIT)	*1,500*	*450*	(200)
Interest	(50)	(50)	(50)
Earnings before tax	*1450*	*400*	(250)
Tax	(225)	(20)	-
Net profit / (loss)	**1225**	**380**	**(250)**

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Solution – Balance Sheet Reconstruction

AFS Reconstruction (Pty) Ltd			
Balance Sheet	**2018 R'million**	**2017 R'million**	**2016 R'million**
ASSETS			
Current assets	***23,105***	***21,380***	***22,000***
Cash and cash equivalents	5,905	6,880	7,000
Accounts receivalbe	2,000	2,500	1,000
Inventory	15,200	12,000	14,000
Long-term assets	***50,000***	***45,000***	***40,000***
Property, plant and equipment	50,000	45,000	40,000
TOTAL ASSETS	**73,105**	**66,380**	**62,000**
EQUITY			
Share capital	30,000	30,000	30,000
Retained earnings	14,105	12,880	12,500
Shareholders' equity	***44,105***	***42,880***	***42,500***
LIABILITIES			
Current liabilities	***4,000***	***3,500***	***4,500***
Accounts payable	1,000	1,500	1,000
Current portion of long term debt	3,000	2,000	3,500
Long term liabilities	***25,000***	***20,000***	***15,000***
Long term loans	25,000	20,000	15,000
TOTAL EQUITY AND LIABILITIES	**73,105**	**66,380**	**62,000**

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QUESTIONS?

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