

## Financial statements

Limited companies are required to prepare Annual Financial statements in most advanced countries which adhere to the capitalistic system. The shareholders of Limited companies are permitted to limit their exposure to any loss to the amount of their paid-up shares provided they ensure they do not trade recklessly and do not trade whilst in an insolvent position. The shareholders of large companies rely on management to conduct the business of the company and they appoint auditors to ensure that management obey the laws of the country in which they are registered. The auditors are liable to be sued for not carrying out their duties and the directors are also liable for reckless conduct.

Individual traders and partnerships are liable to make good any loss they cause up to the extent of their net asset worth. Creditors are entitled to apply for sequestration of individual traders and members of a partnership with certain exceptions.

Limited companies are obliged to provide their shareholders with annual financial statements so, a shareholder with a very small shareholding would have access to their financial results. To guard against giving away operational secrets to competitors the companies only publish dead minimum information. Standards of minimum disclosure have been formatted by accounting standard boards around the world and investors will not invest in your company unless you comply with those standards, so the accounting authorities of most advanced countries adopt those standards to encourage business investment in their countries. The usual and most widely adopted standard appears to be full IFRS and IRFS for SMME's.

The type of business carried out by the company determines the way in which the company annual financial statements are drafted. In the case of ordinary trading companies buying stock for resale, one would show sales less the cost of sales giving the gross profit. The overhead and administration expenses would then be totalled and deducted from the gross profit to give the net profit. In the case of service companies and commission earning companies the gross commission would be displayed, and all other expenditure would be shown in a column and deducted from the gross commission in one globular amount. Service companies by their nature usually provide services delivered by employees and the salary bill is usually the main cost item. Construction companies usually carry out work in terms of a contract awarded to them and they receive lumpsum amounts which are known as draws or progress payments as they complete phases of the contract. A quantity surveyor usually prepares the worksheet and estimates the value of work done and percentage of the contract price to be paid to them. Another interesting business is housing development and here one allocates the cost of the completed houses to the sales revenue received and shows the balance in the work in progress.

Since in the example below there is only one shareholder, we will not bother with minimum disclosure and only add notes where the accounts do not disclose sufficient information We will begin with very simple accounts and limit the notes to the fixed assets. We will then progress to more complicated accounts. There is no intention of complying with the laws of any specific country or framework as this example is a teaching exercise to give guidance as to the structure of the income statement, statement of change in equity and balance sheet.

## Example 1

This is the first year of trading so there are no comparatives

**Cad Ltd****Trial balance on 31st December 2021**

Advertising	20000
Bank charges	12000
Computer expenses	15000
Depreciation	43900
Motor expenses	65000
Office expenses	24000
Printing and stationery	18000
Salaries	300000
Telephones	35000
Cost of sales	1248000
Sales	-1920000
Profit for period	-139100
Computers	30000
Provision for depreciation - computers	-10000
Furniture	6000
Provision for depreciation - furniture	-900
Motor vehicles	120000
Provision for depreciation - motor vehicles	-24000
Accounts receivable	160000
Loan Mr Cadman	-35000
Bank account	78000
Share capital	-100000
Accounts payable	-85000
	<u>0</u>

The computer package created the financial statements below which are for management purposes and these were delivered to the incumbent auditor for review and audit.

**CAD Ltd**

**Detailed income statement for the year ended 31st December 2021**

	2021
	\$
Sales	1920000
Less Cost of sales	1248000
	<u>672000</u>
Administration expenses	532900
Advertising	20000
Bank charges	12000
Computer expenses	15000
Depreciation	43900
Motor expenses	65000
Office expenses	24000
Printing and stationery	18000
Salaries - director	300000
Telephones	<u>35000</u>
Net income for the year	<u>139100</u>

**Statement of financial position on 31st December 2021**

	Notes	\$
Fixed assets	1	121100

Current assets		238000
Accounts receivable	160000	
Cash resources	<u>78000</u>	
		<u>359100</u>
Represented by: -		
Share capital and reserves		239100
Share capital	100000	
Retained income	<u>139100</u>	
Long term liabilities		35000
Loan from shareholder		
Current liabilities		85000
Accounts payable		<u>359100</u>

**Cad Ltd****Notes to the financial statements on 31st December 2021**

## 1 Property, plant and equipment

2021	Cost \$	Accum Deprec \$	Carrying Value \$
Computer equipment	30000	10000	20000
Furniture and fittings	6000	900	5100
Motor vehicles	120000	24000	96000
	<u>156000</u>	<u>34900</u>	<u>121100</u>

## Movement - 2021

	Additions	Current Deprec	Balance
	\$	\$	\$
Computer equipment	30000	10000	20000
Furniture and fittings	6000	900	5100
Motor vehicles	120000	24000	96000
	<u>156000</u>	<u>34900</u>	<u>121100</u>

The auditors suggested certain adjusting entries with which the sole shareholder was happy to comply and the audited accounts were prepared and delivered. These entries were as below: -

Audit fees	12000	
To Provision for audit fees		-12000
Being provision for audit fees for year		
Retained income	34000	
To Revenue Department for normal taxation		-34000
Liability for normal taxation raised on 31st December 2021		
Sales	1920000	
To Audit fees		-12000
To Advertising		-20000
To Bank charges		-12000
To Computer expenses		-15000
To Depreciation		-43900
To Motor expenses		-65000
To Office expenses		-24000
To Printing and stationery		-18000

To Salaries	-300000
To Telephones	-35000
To Cost of sales	-1248000
To Retained income	-127100
Closing entry on 31st December 2021	

The above closing journal entry is necessary for any manual accounting system since the books need to be closed off and the opening balances carried down to the new year. Some computer systems also need to be closed off if the system does not allow for automatic transfer of the expense and revenue accounts to the retained income account.

The income tax charge for the year needs to be debited straight to the retained income account. Some accounting packages reflect the income tax charge in the income and expenses portion of the trial balance which is completely misleading as income tax is not a trading expense. An additional problem is that the amount shown as being the tax charge for the year is usually wrong in that payments relating to prior years are often included in this account instead of debiting the liability account.

## **CAD Ltd**

### **Detailed income statement for the year ended 31st December 2021**

	2021
	\$
Sales	1920000
Less Cost of sales	1248000
	<u>672000</u>
Administration expenses	544900
Audit fees	12000
Advertising	20000
Bank charges	12000

Computer expenses	15000	
Depreciation	43900	
Motor expenses	65000	
Office expenses	24000	
Printing and stationery	18000	
Salaries	300000	
Telephones	35000	
Net income for the year		127100
Less Normal taxation		34000
Net income after taxation		93100

**CAD Ltd****Statement of financial position on 31st December 2021**

	note	2021 \$
Fixed assets	1	121100
Current assets		238000
Accounts receivable		160000
Cash resources		78000
		359100
Represented by : -		
Share capital and reserves		193100
Share capital		100000
Retained income		93100

Long term liabilities		35000
Loan from shareholder		
Current liabilities		131000
Accounts payable	85000	
Provisions	12000	359100
Taxation	34000	
		<u>359100</u>

**CAD Ltd****Statement of changes in Equity for the year ended 31st December 2021**

	Issued Share \$	Retained Income \$	Total \$
Shares allotted during the year	100000		100000
Income for the year		93100	93100
Balance on 31st December 2021	<u>100000</u>	<u>93100</u>	<u>193100</u>

Comparing this balance sheet to the earlier accounts forwarded to the auditors one will note that the retained income has been reduced by forty-six thousand dollars, and provisions have increased by twelve thousand dollars and the tax liability by thirty-four thousand dollars which together amount to the forty-six- thousand- dollar reduction in the retained income.

## Example 2

Just after six months into the following trading year CAD Ltd is offered a major contract worth five million dollars and to enable the company to finance this contract the company will need an overdraft facility of two and a half million dollars. The bank want management accounts for the six months to 30th June 2022 to make a judgement call on the risks involved in granting an overdraft of this magnitude.

The trial balance is extracted, and it is discovered that depreciation is still to be provided on the fixed assets and cost of sales have not yet been allocated from the stock account in respect two completed contracts. In addition, the stock on hand is still to be determined.

The director counts stock on hand which amounts to 30 000 dollars. The amount to be debited to cost of sales is one million, one hundred and seventy thousand dollars which is in line with the previous year's cost of sales percentages and is in line with the costing records when quoting on the projects.

**CAD****Trial balance on 30th June 2022**

	\$ Initial Trial Balance	JE no 1,3	JE no 2	Je.no 4	\$ Adjusted Trial Balance
Advertising	9000				9000
Auditing		6000			6000
Bank charges	9000				9000
Computer expenses	9000				9000
Depreciation			19900		19900
Lease of premises	60000				60000
Motor expenses	40000				40000
Office expenses	15000				15000
Printing and stationery	14000				14000
Salaries - director	100000				100000
Salaries - other	60000				60000
Telephones	20000				20000
Cost of sales	0	1170000			1170000
Sales	-1800000				-1800000
Profit for period	-1464000				-268100
Tax charge current period				70000	70000



**Depreciation summary spread sheet for six months (additions bought on 1st January 2022)**

	Cost	Deprec Dec-21	Balance Dec-21	Deprec Jun-22	Balance Jun-22
Computer equipment	30000	-10000	20000	-5000	15000
Furniture and fittings	6000	-900	5100	-450	4650
Motor vehicles	120000	-24000	96000	-12000	84000
Balance 31st December 2021	156000	-34900	121100		
Additions					
Computers	12000			-2000	10000
Furniture and fittings	6000			-450	5550
Balance 30th June 2022	174000	-34900		-19900	119200

Proforma journal entries entered on spread sheet  
For six months to 30th June 2022

	Dr	Cr
	\$	\$
Cost of sales	1170000	
To Stock		1170000
Being cost of two completed contracts transferred		
<hr/>		
Depreciation	19900	
To Provision for depreciation - computer equipment		-7000
To Provision for depreciation - furniture		-900
To Provision for depreciation - motor vehicles		-12000
Being depreciation for six months		
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Audit fees	6000	

To Provision for expenditure	-6000
Provision for six months of estimated annual charge	

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Taxation charge for current period	70000
To Taxation due to state	-70000
Being provision for ordinary company tax for six months	

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**CAD Ltd****Draft detailed income statement for six months ended 30th June 2022**

	Six Months 2022 \$	Year 2021 \$
Sales	1800000	1920000
Less Cost of sales	1170000	1248000
	<u>630000</u>	<u>672000</u>
Administration expenses	361900	544900
Audit fees	6000	12000
Advertising	9000	20000
Bank charges	9000	12000
Computer expenses	9000	15000
Depreciation	19900	43900
Lease of premises	3 60000	-

Motor expenses		40000	65000
Office expenses		15000	24000
Printing and stationery		14000	18000
Salaries - Director	4	100000	300000
Salaries - Other		60000	-
Telephones		20000	35000
Net income for the year		268100	127100
Less Normal taxation		70000	34000
Net income after taxation		198100	93100

**CAD Ltd****Draft Statement of financial position on 31st December 2021**

		Six months June 2022 \$	Year ended December 2021 \$
	notes		
Fixed assets	1	119200	121100
Current assets		509000	238000
Inventories		30000	
Accounts receivable		269000	160000
Cash resources		210000	78000
		628200	359100
Represented by : -			
Share capital and reserves		391200	193100

Share capital	2	100000	100000
Retained income		<u>291200</u>	<u>93100</u>
Long term liabilities		35000	35000
Loan from shareholder			
Current liabilities		202000	131000
Accounts payable		92000	85000
Provisions		6000	12000
Taxation		<u>104000</u>	<u>34000</u>
		<u>628200</u>	<u>359100</u>

**CAD Ltd****Draft Statement of changes in Equity for the year ended 31st December 2021**

	Issued Share \$	Retained Income \$	Total \$
Shares allotted during the year	100000		100000
Income for the year		93100	93100
Balance at 31st December 2021	100000	93100	193100
Income for six months ended 30th June 2022		198100	198100
Balance at 30th June 2022	<u>100000</u>	<u>291200</u>	<u>391200</u>

**CAD Ltd****Notes to the draft financial statements at 30th June 2022**

## 1 Property, plant and equipment

2022	Cost \$	Accum Deprec \$	Carrying Value \$
Computer equipment	42000	17000	25000
Furniture and fittings	12000	1800	10200
Motor vehicles	120000	36000	84000
	<u>174000</u>	<u>54800</u>	<u>119200</u>

2021	Cost \$	Accum Deprec \$	Carrying Value \$
Computer equipment	30000	10000	20000
Furniture and fittings	6000	900	5100
Motor vehicles	120000	24000	96000
	<u>156000</u>	<u>34900</u>	<u>121100</u>

## Movement - six months to 30th June 2022

	Opening Balance \$	Additions \$	Current Deprec \$	Closing Balance \$
Computer equipment	20000	12000	7000	25000
Furniture and fittings	5100	6000	900	10200
Motor vehicles	96000	-	12000	84000
	<u>121100</u>	<u>18000</u>	<u>19900</u>	<u>119200</u>

## Movement - 2021

	Additions	Current Deprec	Balance
	\$	\$	\$
Computer equipment	30000	10000	20000
Furniture and fittings	6000	900	5100
Motor vehicles	120000	24000	96000
	<u>156000</u>	<u>34900</u>	<u>121100</u>
		2022	2021
		\$	\$
2 Share capital			
Authorised and issued			
100000 shares of \$ 1 each fully paid		<u>100000</u>	<u>100000</u>
3 Lease of premises			
Total lease commitment			
Current year		60000	
Thereafter		<u>120000</u>	
		<u>180000</u>	
4 Director's emoluments			
J Cadman - sole director			
For services as director		Nil	Nil

Other services

100000      300000

100000      300000

The bank will want as much information as possible so there is no point in preparing minimum information management accounts. The bank will probably want personal guarantees from the sole shareholder and director. The director's son has now been employed in the business and is being trained to take control should the incumbent sole director be incapacitated in any way. This is always a major consideration in respect of any loan advances and bank overdraft facilities being granted.

### Example 3

Three brothers acquired an existing business from the deceased estate of the former employer of one of the brothers. They bought the fixed assets and the debtor book from the estate and no goodwill payment was involved. They formed their own limited liability company which commenced trading on 1st January 2017 so this is the first year of trading.

### Big Ben Computing Ltd

#### Trial balance on 31st December 2017

\$ Trial Balance

Advertising	90000
Auditing	60000
Bank charges	150000
Computer expenses	1100000
Depreciation	856000
Insurance	160000
Interest paid - loans	108900
Lease of premises	1200000
Motor expenses	600000
Office expenses	400000
Printing and stationery	800000
Salaries - directors	1500000
Salaries - other	7000000
Staff pension contribution	350000
Telephones	2000000
Fee income	<u>-18000000</u>

Profit for period	-1625100
Tax charge current period	400000
Retained profit	0
Computers	1500000
Provision for depreciation - computers	-500000
Furniture	240000
Provision for depreciation - furniture	-36000
Motor vehicles	1600000
Provision for depreciation - motor vehicles	-320000
Accounts receivable	2800000
Loan A Ben	-1036300
Loan B Ben	-1036300
Loan C Ben	-1036300
Bank account	420000
Share capital	-900000
Accounts payable	-70000
Provisions	0
Taxation due to State	-400000
	<u>0</u>

### Big Ben Computing Ltd

#### Detailed income statement for the year ended 31st December 2017

	Notes	2017 \$
Fee income		18000000
Administration expenses		16374900
Advertising		90000
Audit fees		60000

Bank charges		150000
Computer expenses		1100000
Depreciation		856000
Insurance		160000
Interest paid - loans		108900
Lease of premises	3	1200000
Motor expenses		600000
Office expenses		400000
Printing and stationery		800000
Salaries - directors	4	1500000
Salaries - other		700000
Staff pension contributions		350000
Telephones		2000000
Net income for the year		1625100
Less Normal taxation		400000
Net income after taxation		1225100

**Big Ben Computing Ltd****Statement of financial position on 31st December 2021**

	Notes	2021 \$
Fixed assets	1	2484000
Current assets		3220000
Accounts receivable		2800000
Cash resources		420000
		5704000

Represented by: -

Share capital and reserves		2125100
Share capital	2	900000
Retained income		<u>1225100</u>
Long term liabilities	5	3108900
Loans from shareholders		
Current liabilities		470000
Accounts payable		70000
Taxation		<u>400000</u>
		<u>5704000</u>

**Big Ben Computing Ltd****Statement of changes in Equity for the year ended 31st December 2017**

	Issued Share \$	Retained Income \$	Total \$
Shares allotted during the year	900000		900000
Income for the year		1225100	1225100
Balance at 31st December 2017	<u>900000</u>	<u>1225100</u>	<u>2125100</u>

**Big Ben Computing Ltd****Notes to the financial statements on 31st December 2017**

## 1 Property, plant and equipment

2017	Cost \$	Accum Deprec \$	Carrying Value \$
Computer equipment	1500000	500000	1000000
Furniture and fittings	240000	36000	204000
Motor vehicles	1600000	320000	1280000
	<u>3340000</u>	<u>856000</u>	<u>2484000</u>

## Movement - 2017

	Additions \$	Current Deprec \$	Balance \$
Computer equipment	1500000	500000	1000000
Furniture and fittings	240000	36000	204000
Motor vehicles	1600000	320000	1280000
	<u>3340000</u>	<u>856000</u>	<u>2484000</u>

2017  
\$

## 2 Share capital

## Authorised and issued

900000 shares of \$ 1 each fully paid

900000

## 3 Lease of premises

## Total lease commitment

Current year	1300000
Thereafter	4200000
	<u>5500000</u>

## 4 Directors' emoluments

A Ben - for services as a director	Nil
B Ben - for services as a director	Nil
C Ben - for services as a director	Nil
A Ben - other services	525000
B Ben - other services	525000
C Ben - other services	525000
	<u>1575000</u>

## 5 Loans from shareholders

A Ben	1036300
B Ben	1036300
C Ben	1036300
	<u>3108900</u>

These loans are unsecured with no fixed terms of repayment and carry interest at 3 % per annum.