The bank reconciliation

- Lack of agreement between the firms books and bank statement can result for two main reasons:
  1. Time lags
  2. Errors
- What are the two records of a business's cash?
  1. Cash account: in business's own general ledger
  2. Bank statement: tells the actual amount of cash the business has in the bank

Items recorded by company not on bank statement	Items on bank statement not recorded by company
• Add: deposits in transit • Less: outstanding cheques	• Add: bank collections EFT cash receipts interest revenue • Debit: EFT cash payments Service charges Cost of printing cheques Other bank charges

- Should be prepared by an employee that has no other responsibilities pertaining to cash

2. Ethics and Accounting

- Most businesses have a code of ethics
- CPAA, ICAA and CIMA have a joint code of conduct
- What are the facts?
- Identify the ethical issue
- What are the options?
- What are the possible consequences?
- What shall I do?

Lecture 6

Statement of Financial Position

1. Nature and purpose of a statement of financial position

- Sets out the financial position of a business at a particular point in time
- Referred to as 'balance sheet'
- Contains a snapshot of assets, liabilities and equity position of the entity at a particular point in time

2. Assets

- 'resource controlled by the entity as a result of past events, and from which economic benefits are expected to flow to the entity
- main characteristics:
  - expected future economic benefit
  - business has exclusive right to control the benefit
  - benefit must arise from some past transaction or event
  - asset must be capable of reliable measurement in monetary terms
- these conditions limit the kind of items that may be referred to as 'assets' in financial reports
- include
  → cash
  → freehold premises
  → machinery and equipment
  → fixtures and fittings

  - → patents and trademarks
  - → accounts receivable
  - → investments
- may be tangible (with physical substance) or intangible (e.g. copyrights, trademarks, patents, goodwill)
- *External claims on assets*
  - liabilities
- *Internal claims on assets*
  - owners equity, capital
- Owners equity: the claim of the owner/s on the assets of the business

3. Liabilities

- AASB Framework definition
  ‘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’
- Twofold recognition criteria
  1. Probability of occurrence
  - More likely than not that a future sacrifice of economic benefits will occur – probability needs to be > 50%

  2. Reliability of measurement
  - the amount of the claim can be determined with acceptable precision or accuracy
- Include
  - → Accounts payable
  - → Staff entitlements
  - → Loans and other credit facilities
  - → Warranty provisions and other social/moral obligations
  - → Provision for employee bonuses or owners distribution (conservatism)
- Also: contingent liability – probability of a liability is high- hasn’t happened yet: put notes at bottom of financial statements to explain contingent liabilities

4. Owners Equity (OE): A - L

- The claim of the owner against the business
- AASB Framework definition:
  ‘residual interest in the assets of the entity after deducting all its liabilities’
- On the statement of financial position, there are two additional accounts
- *Owners equity retained:*
  - represents profits left in the business by the owners
- *Reserves*
  - represent ‘special purpose’ owners equity accounts e.g. ‘capital profits reserve’ – profits made from the sale of long-term assets
- Reserves represent ownership interests in the assets, not the assets themselves – reserves are not separate deposits of cash available for other purposes

5. The accounting equation

- The basic accounting equation (A = L + OE)
- Equation will always hold true, as total claims are always the same as total assets – ensuring that the balance sheet always ‘balances’
- Trading introduces additional transactions to the statement of financial position
- To cover the effect of trading, the statement of financial position equation is extended

6. Classification of assets

- Assets are normally categorized as either current or non-current

<u>Current assets:</u>
- not held on a continuing basis

- include cash & other assets expected to be consumed or converted into cash within the next 12 months or operating cycle
- include inventory, trade debtors & prepayments

- AASB 101 ‘Presentation of Financial Statements’ requires a ‘current asset’ to be classified according to this criteria:
    1. **1.** Expects to realize the asset, intends to sell or consume it in its normal operating cycle
    2. **2.** Holds the asset primarily for the purpose of trading
    3. **3.** Expects to realize the asset within 12 months after the accounting period
    4. **4.** Asset is cash or cash equivalent unless the asset is restricted from being exchanged or used to settle a liability for at least 12 months after the reporting period

<u>Non-current assets:</u>

- Held for the purpose of generating wealth, rather than for resale
- May be seen as the tools of the business
- Normally held on a continuing basis for a minimum period of one year
- Includes goodwill purchased
- AASB 101 ‘Presentation of Financial Statements’ requires assets to be classified as non-current if the do not satisfy any of the criteria for being classified as current

7. Classification of liabilities

- Current or non-current

<u>Current liabilities</u>

- Amounts due for repayment to outside parties within 12 months or one operating cycle of the statement of the financial position
- AASB 101 ‘Presentation of Financial Statements’ classifies liabilities under the same criteria as assets, except:
  - the entity doe not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting date

<u>Non-Current liabilities</u>

- Not due for payment within 12 months
- Liquidity classification – used for liabilities if it provides more relevant and reliable information

8. Classification of OE

1. owners equity contributed (paid-up capital, partners capital, accumulated funds)
2. reserves -‘special purpose’ owners equity accounts e.g. ‘capital profits reserve’ – profits made from the sale of long-term assets
3. retained profit

9. Factors influencing the form and content of the statement of financial position

- Three main influences on the accounts:
  <u>1. Traditional accounting conventions and doctrines</u>
    - Made up of doctrines, principles, assumptions and accepted ideas on which accounting rules, records and reports are based
    - Collectively known as GAAP (Generally Accepted Accounting Principles)
- *Business Entity Convention*
  in accounting terms, owner and business are distinct
- *Money Measurement Convention*
  accounting should only deal with those items which are capable of being expressed in monetary terms
- *Historic Cost Convention:*
  assets recorded at historic (acquisition) cost
- *Going Concern (continuity) Convention:*
  business will continue operations for the foreseeable future i.e. no intention or need to liquidate the business