

Course: Professional Issues in IT

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Lec # 9

Financial Accounting

After studying this chapter, you should understand the purpose of the three most important items in the annual report:

- ▶ *the balance sheet;*
- ▶ *the profit and loss account; and*
- ▶ *the cash flow statement.*

These are known as the financial statements and together they provide a picture of the overall financial health of the business. You should be able to interpret them in simple cases.

Annual Report

The limited companies, when liquidify, only loses the amount they have spent. However there is a check on the performance of these companies.

In UK the law requires that, every year, the company produces an annual report, which must be filed at Companies House.

In Pakistan the companies submit these reports to the license providing authority namely **SECP**; Securities and Exchange Commission of Pakistan .

The annual report contains information about the company and its activities during the preceding year.

Link: <https://www.secp.gov.pk/>

THE BALANCE SHEET

The balance sheet is that financial statement in the annual report which show

- ▶ what the company owns - its *assets*
- ▶ and what it owes - its *liabilities*.

Key words

- ▶ Current Assets
- ▶ Fixed Assets
- ▶ Depreciation
- ▶ Tangible
- ▶ Intangible
- ▶ Current liabilities
- ▶ Fixed liabilities

Balan

Assets	20X3	20X4
Current assets		
Cash	\$ 700,000	\$ 170,000
Accounts receivable	850,000	600,000
Inventory	<u>180,000</u>	<u>220,000</u>
Total current assets	<u>\$1,730,000</u>	<u>\$ 990,000</u>
Property, plant, & equipment		
Land	\$ 800,000	\$1,400,000
Building	1,000,000	700,000
Equipment	<u>1,050,000</u>	<u>900,000</u>
	\$2,850,000	\$3,000,000
Less: Accumulated depreciation	<u>(480,000)</u>	<u>(360,000)</u>
Total property, plant, & equipment	<u>\$2,370,000</u>	<u>\$2,640,000</u>
Total assets	<u>\$4,100,000</u>	<u>\$3,630,000</u>
Liabilities		
Current liabilities		
Accounts payable	\$ 270,000	\$ 200,000
Wages payable	<u>20,000</u>	<u>50,000</u>
Total current liabilities	\$ 290,000	\$ 250,000
Long-term liabilities		
Long-term loan payable	<u>900,000</u>	<u>1,800,000</u>
Total liabilities	<u>\$1,190,000</u>	<u>\$2,050,000</u>
Stockholders' equity		
Preferred stock	\$ 300,000	\$ -
Common stock (\$1 par)	910,000	900,000
Paid-in capital in excess of par	370,000	300,000
Retained earnings	<u>1,330,000</u>	<u>380,000</u>
Total stockholders' equity	<u>\$2,910,000</u>	<u>\$1,580,000</u>
Total liabilities and equity	<u>\$4,100,000</u>	<u>\$3,630,000</u>

Balance sheet

TABLE 6.1 *Balance sheet for a student*

Jemimah Puddleduck

Balance Sheet

As at 31 October 2004

	2004	2003
ASSET		
Cash in hand	25	40
Cash at bank	361	220
Pre-paid accommodation	300	200
Debts owed by friends	18	0
Computer	400	600
CD player	160	180
Total assets	1,264	1,240
LIABILITIES		
Credit card bill	174	64
Student loans	4,800	1,900
Total liabilities	4,974	1,964
NET WORTH	(3,710)	(724)

Jemimah's most obvious asset is money. She has, let us say, £25 in cash in

THE PROFIT AND LOSS ACCOUNT

The *profit and loss account* shows how much money has been received and how much has been spent in a given period - usually the organization's financial year.

In the case of non-profit-making organizations it is usually called an *income and expenditure* account.

Profit and Loss Account

www.Tally9Book.Com

Balasore, Orissa.
Mob: 09437264738

Profit & Loss A/c

Particulars	1-Apr-2008 to 30-Sep-2008	1-Oct-2008 to 31-Mar-2009
<u>Trading Account :</u>		
Sales Accounts	1,28,33,600.00	1,87,37,247.50
CST Sales	29,50,125.00	30,80,000.00
Local Sales	98,29,675.00	1,48,56,155.00
Sales @ 20%		2,88,000.00
Sales - Advertising Services	23,800.00	32,750.00
Sales AMC for Computers	30,000.00	35,000.00
Sales - Exports		70,342.50
Sales Bills to Make		3,75,000.00
Cost of Sales :	1,03,45,434.09	1,25,27,671.68
Opening Stock		24,22,573.41
Add: Purchase Accounts	1,27,51,387.50	1,14,47,310.00
Less: Closing Stock	24,22,573.41	13,58,831.73
	1,03,28,814.09	1,25,11,051.68
Direct Expenses	16,620.00	16,620.00
Assembling Charges	9,120.00	9,120.00
Carriage Inwards	7,500.00	7,500.00
Gross Profit :	24,88,165.91	62,09,575.82
<u>Income Statement :</u>		
Indirect Incomes		
	24,88,165.91	62,09,575.82
Indirect Expenses	8,22,096.49	16,36,653.32
Depreciation on Fixed Assets		6,02,622.20
Interest & Finance Charges	475.00	55,044.37
Operating Expenses	1,58,736.00	1,74,832.75
Salaries & Remuneration Paid	6,03,255.00	6,75,910.00
Selling & Distribution Expenses	6,100.00	13,300.00
Employer ESI Contributions	4,411.00	4,257.00
Employer PF Contributions	21,989.49	22,607.00
Bonus		50,000.00
Business Promotion Expenses		25,500.00
Legal Fees	16,500.00	
Miscellaneous Expenses	10,630.00	2,580.00
Research & Development Expenses		10,000.00
Nett Profit :	16,66,069.42	45,72,922.50

Profit loss account

XYZ Software Ltd		
Profit and Loss Account	2004	2003
Year ending 31 October 2004	£'000	£'000
TURNOVER		
Continuing operations	14,311	11,001
Acquisitions	407	
Total turnover	14,718	11,001
Cost of sales	(11,604)	(8,699)
Gross profit	3,114	2,302
Other operating expenses	(1,177)	(805)
OPERATING PROFIT	1,937	1,497
Interest payable	(23)	(27)
Profit on ordinary activities before taxation	1,914	1,470
Tax on profit on ordinary activities	719	480
Retained profit for the year	1,195	990

Income expenditure account

Income and Expenditure Account

Year ended 31 October 2004

2004

2003

INCOME

Contribution from parents

1,500

1,300

Income from summer job (net)

1,840

1,682

Total income

3,340

2,982

EXPENDITURE

Course fees

1,050

1,025

Hall fees

2,100

1,980

Books

30

25

Clothes and personal items

179

120

Transport

134

112

Food

1,400

1,247

Entertainment

1,303

840

Depreciation

220

220

Total expenditure

6,416

5,569

EXCESS OF INCOME OVER EXPENDITURE

(3,076)

(2,587)

THE CASH FLOW STATEMENT

Parents usually investigate about the expenses of their kids. Often during childhood we were asked for where we spent our money. If we bought any thing we were asked from where did the money come.

Thus creating a flow “from where to where” these accounts show cash flow.

The link that ties the balance sheet and the profit and loss account to the capital expenditure is the cash flow statement.

Cash flow

TABLE 6.5 *Cash flow statement for a student*

Jemimah Puddleduck

Cash flow statement

Year ended 31 October 2004

2004

2003

Cash inflow

Addition to student loan

2,900

1,900

Add back depreciation

220

220

Total cash inflow

3,120

2,120

Cash outflow

From income and expenditure account

3,076

2,587

Loans made to friends

18

0

Total cash outflow

3,104

2,587

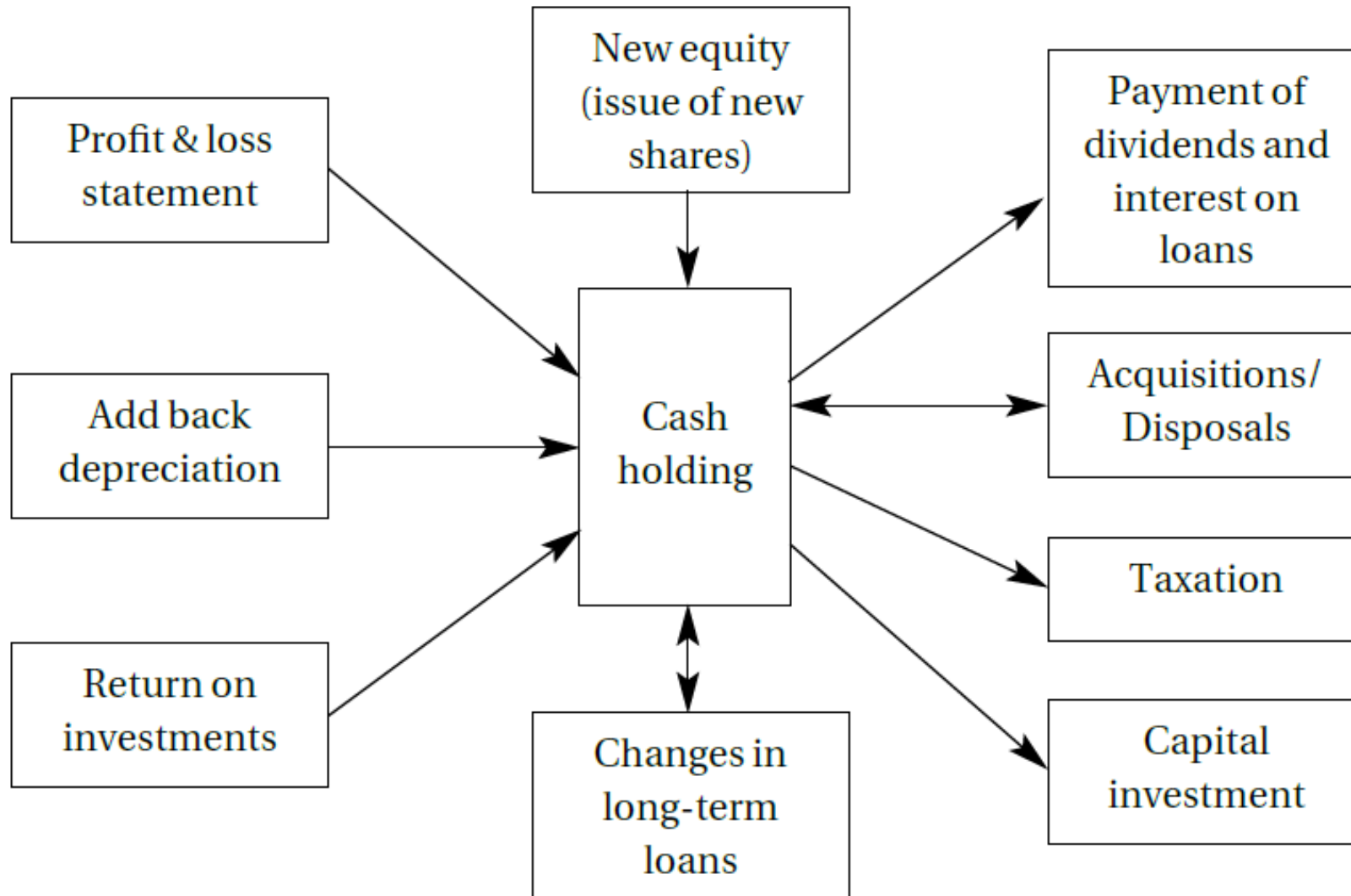
Increase/(Decrease) in cash over the year

16

(467)

Cash Flow

CASH FLOW STATEMENT			
FOR THE YEAR ENDED 30 JUNE 2008			
	Note	2008 \$'000	2007 \$'000
CASH FLOWS FROM OPERATING ACTIVITIES			
Inflows:			
Output receipts		5,974	5,765
User charges		223	181
GST input tax credits from ATO		141	145
GST collected from customers		23	24
Interest receipts		-	9
Outflows:			
Employee expenses		(4,498)	(4,468)
Supplies and services		(1,432)	(1,221)
GST paid to suppliers		(145)	(147)
GST remitted to ATO		(25)	(22)
Other		(35)	(41)
Net cash from operating activities	16	226	225
CASH FLOWS FROM INVESTING ACTIVITIES			
Inflows:			
Outflows:			
Payments for plant and equipment		(8)	(28)
Net cash provided by (used in) investing activities		(8)	(28)
CASH FLOWS FROM FINANCING ACTIVITIES			
Inflows:			
Equity injections		40	-
Outflows:			
Equity withdrawal		-	(120)
Net cash provided by (used in) financing activities		40	(120)
Net increase (decrease) in cash held		258	77
Cash at beginning of the financial year		221	144
Cash at end of the financial year	8	479	221
The accompanying notes form part of these statements.			

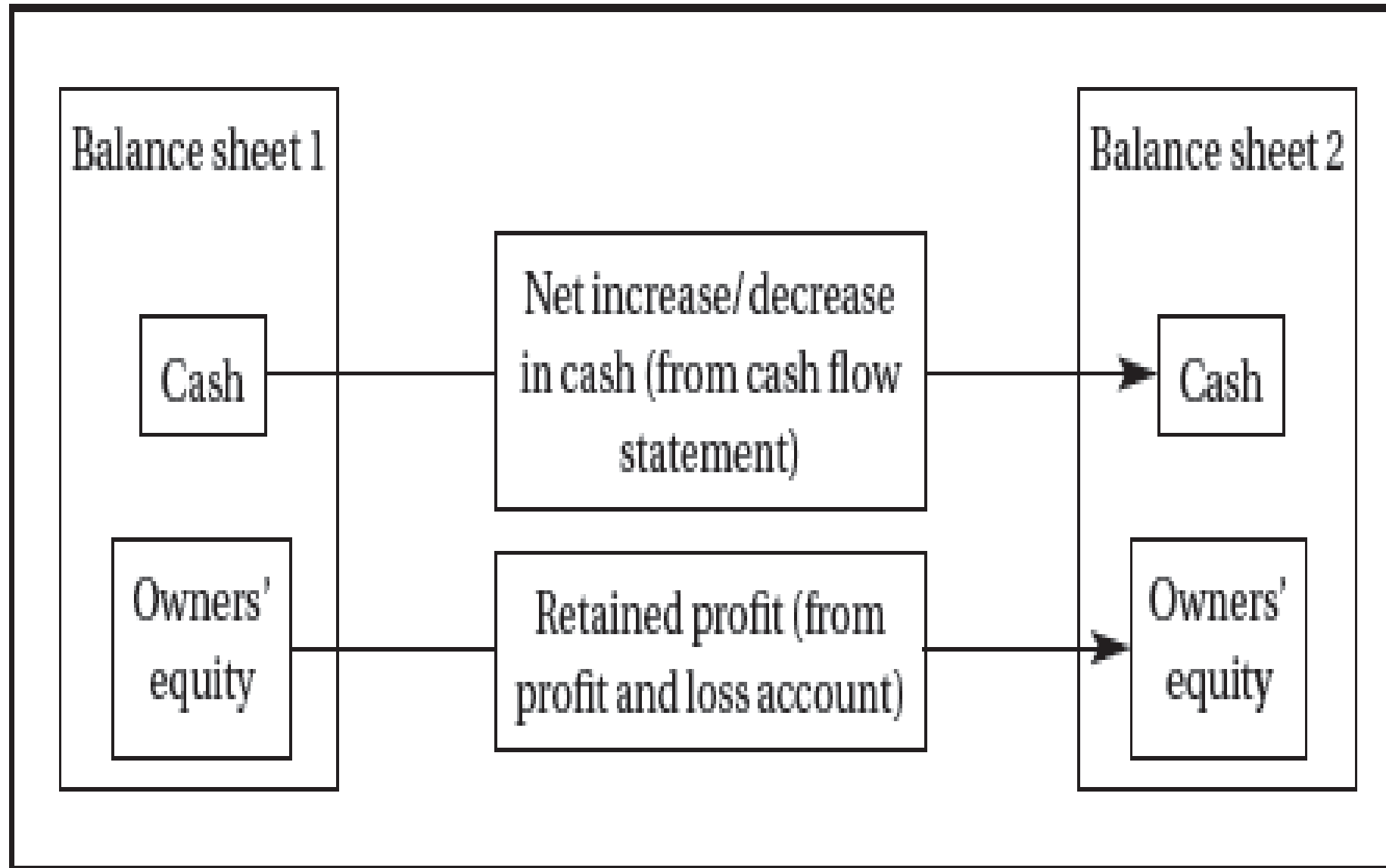


Sources and destinations of cash flows

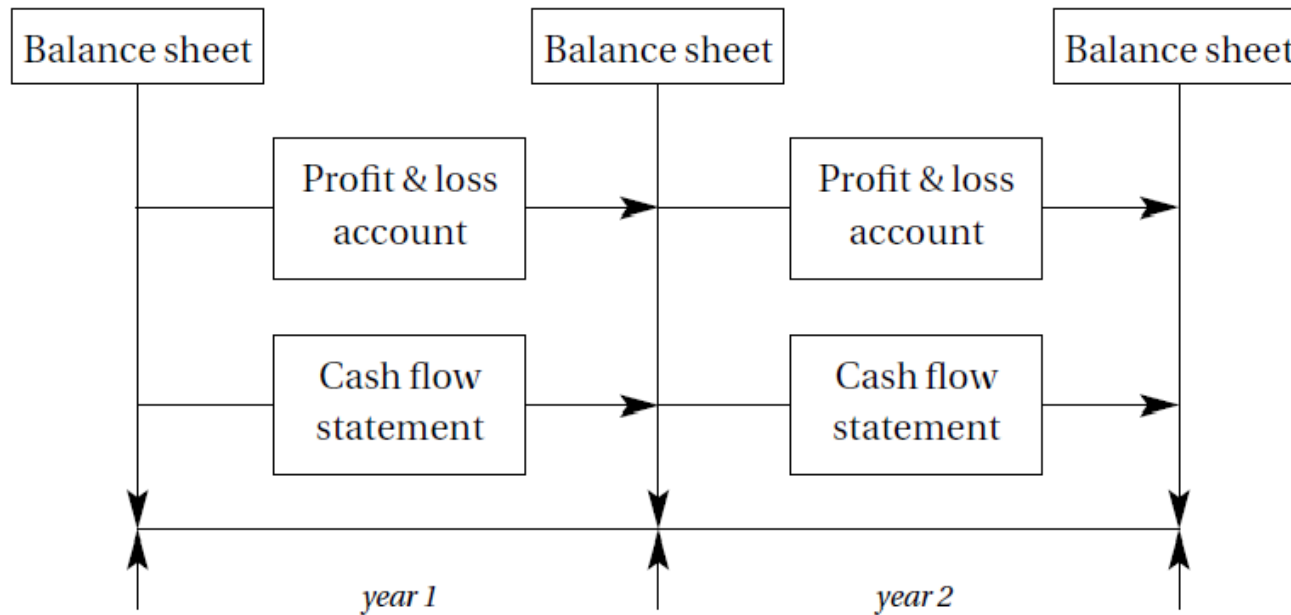
THE OVERALL PICTURE

The balance sheet, the profit and loss account, and the cash flow statement can none of them be understood or interpreted in isolation. Their relationship to each other needs to be understood and they need to be looked at together when assessing the financial state of a company.

FIGURE 6.3 *How the cash flow statement and the profit and loss account affect the items in the balance sheet*



The relationship between the three financial statements



Some questions

- ▶ **What is the difference between current assets and non-current assets?**
- ▶ **Which financial statement can I find noncurrent assets on?**
- ▶ **On which financial statements does a company report its long-term debt?**
- ▶ **What items on the balance sheet are most important in fundamental analysis?**
- ▶ **What are some common examples of noncurrent assets?**