

UNIT SIX

THEORY

ACCOUNTING
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Unit 6 | Sole Proprietorship Accounts

- Importance of financial statements of a sole proprietorship business
- Income Statement and Statement of Financial Position

6.1 | Importance of financial statements in a sole proprietorship

- Sole proprietorships
- Importance of financial statements

Sole proprietorships

- A sole proprietorship is a type of enterprise that is owned and run by one person, in which there is no legal distinction between the owner and the business entity.
- The sole trader receives all profits (subject to personal income tax and other relevant taxes) and has unlimited liability for all losses and debts.
- All the assets of the business are owned by the sole proprietor whilst all debts are also owed by the owner.
- The sole proprietorship does not have to be registered. However, it would have to legally trademark the business name if it differs from the name of the owner.

Advantages

- Easy to setup and dismantle
- All the profits belong to the owner
- Independent decision making
- Limited government restrictions
- Flexibility in operations

Disadvantages

- Unlimited liability
- Difficulty in raising capital
- Issues in continuity
- Limited size
- Lack of managerial expertise

Registering a business name

- If a sole proprietorship is conducting its business in a different name other than the full name of its owner, it is mandatory to register the name of the business.
 - Example: If John Doe conducts his business under the name of 'John Stores', the business name is required to be registered. However, note that a registration of the business name does **not** provide a legal entity to the business.
- The authorized officer to register business names is the Registrar of the respective Provincial Council in which the business is operating.
- It is required to submit an application to register the business name within 14 days of commencing a sole proprietorship.

Legal procedure for the registration of a business name

1. Obtain the relevant application forms from the respective Divisional Secretariat Office:
 - a. Application form to register the name of the business
 - b. Application form to obtain the required report from Grama Niladhari
2. Hand over the completed application form along with a certified report of the Grama Niladhari to the Divisional Secretary, with the registration fee.
3. The Divisional Secretary will issue the Certificate of Registration for the business name (it is required to display this certificate at the place of business).

Advantages of registering a business name

- Provides an identity and recognition for the business
- Provides an ownership of the business name
- Easier to obtain loans

Importance of financial statements in a sole proprietorship

- In a sole proprietorship, there is no legal distinction between the owner and the business entity. Hence, there is no legal requirement to maintain accounts.
- However, sole proprietors can prepare financial statements for particular periods to assess the financial performance and position of their business. It will also assist them to take decisions and assess personal tax liabilities.

Financial statements

Income statement	<ul style="list-style-type: none"> • Income statement is a document that is prepared to calculate the operating results for a particular period. • IS discloses the financial performance of the business to stakeholders. • Profit = Income – Expenses
Statement of Financial Position	<ul style="list-style-type: none"> • SFP is a document that discloses the connection between the assets, liabilities, and equity of the business as at a particular date. • SFP discloses the financial position of the business to stakeholders. • When profit or loss for the period is included to the capital invested by the owners, it is termed equity. • Assets = Equity + Liabilities

6.2 | Preparing the Income Statement and Statement of Financial Position

- Proforma financial statements
- Adjustments when preparing financial statements

Income Statement

Income Statement for the year ending ----- for ----- business			
Income Statement / Profit or Loss Statement			
			(Rs.)
Sales			xxx
Sales returns			(xx)
			xxx
Cost of sales			
Opening stocks		xx	
Purchases	xxx		
Transportation	xx		
Loading & unloading	xx		
	xxx		
Purchase returns	(xx)	xxx	
		xxx	
Closing stocks		(xx)	(xxx)
Gross Profit / Loss			xxx
Other income			
Discount received		xx	
Investment income		xx	
Profit on sale of property, plant & equipment		xx	xx
			xxx
Distribution expenses			
Advertising expenses	xx		
Bad debts	xx		
Discount allowed	xx		
Depreciation of delivery vehicles	xx		
Sales commissions	xx	xx	
Administration expenses			
Staff salaries & wages	xx		
Building rent and rates	xx		
Electricity expenses	xx		
Insurance charges	xx		
Depreciation of furniture	xx		
Depreciation of buildings	xx	xx	
Other expenses			
Stocks written off	xx		
Stock damages	xx		
Donations	xx	xx	
Financial expenses			
Bank charges	xx		
Loan interest	xx		
Overdraft interest	xx	xx	(xxx)
Net profit transferred to Capital account			xxx

