CONTENTS OF PUBLISHED ACCOUNTS (5.7)

(Chapter 34 - A level 5.7)

Accounts such as **income statements** and **statements of financial position** will often need amendment (minor changes). This is usually because :

- New/revised data has become available
- Accounts are needed for a different time period

There is a connection between the **statement of financial position** and **income statement** when **double-entry accounting** is used - which is a method of bookkeeping that recognizes both sides of a business transaction by debiting the amount of the transaction to one account and crediting it to another account so the total debits equal the total credits.

The connection is - **increased revenue and gains reported on the income statement will cause shareholder's equity to increase on the statement of financial position**, with the opposite occurring as well.

Cause	Impact on statement of financial position	Double entry
Sale of inventories for cash.	Inventories fall.	Cash increases (statement of financial position).
Creditors ask for early payment.	Accounts payable decreases.	Cash decreases (statement of financial position).
Additional shares sold and capital raised is used to buy property.	Share capital rises.	Fixed assets rise (statement of financial position).
Equipment depreciated.	Fixed assets fall.	Profits fall (income statement) and so shareholder equity (retained profits) falls (Statement of financial position).
Assets bought in part with a loan and in part with cash.	Assets increase (could be current or long term depending on nature of the asset).	In the statement of financial position, liabilities would increase by the extent of the loan and cash would decrease by the remainder amount.

Problems with valuing inventory :

Inventories are unsold goods. They might also be in the form of raw materials and components that have not been made into completed products yet. Over time, the items in your inventory fall apart from wear and tear, become outdated or get stolen - they **depreciate** in value. Depreciation can make it difficult to value inventory.

Valuing inventory can either be done through use of *historical cost* (the cost it was when bought) or **net realisable value**, whichever is smaller.

Net realisable value is the estimated selling price of goods, minus the cost of their sale or disposal. It is used in the determination of the lower cost or market for on-hand inventory items – it is only used on Statements of financial position when NRV is estimated to be below previous cost.

Depreciation

Depreciation is the decline in the estimated value of a non-current (equipment etc.) asset over time.

Assets decline in value for two main reasons :

- normal wear and tear through usage
- technological change, making either the asset, or the product it is used to make, obsolete

Most capital items such as machinery or vehicles have a limited life after which they must be replaced. A business needs to reflect in the accounts that the asset is worth less and less each year and that it is replaced when it needs to be.

This means reducing the value of the asset in the statement of financial position, and reducing the profit of the business by the same amount in the income statement - recognising the need to put aside money for the eventual replacement of the asset.

There are several different methods of depreciation, but the only one we need to know is **straight line depreciation** - where an asset depreciates the same amount each year.

$$\text{Straight Line Depreciation Method} = \frac{\text{Cost of an Asset} - \text{Residual Value}}{\text{Useful life of an Asset}}$$

To calculate the annual amount of depreciation, the following information will be needed :

■ the original cost of the asset
■ the expected useful life of the asset (years)
■ an estimation of the value of the asset at the end of its useful life – this is known as the ***residual value*** of the asset.