# National University of computer and emerging sciences

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**Course: Accounting & Finance (AF-2031)**
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## Question No. 1

Give the answers to the following questions.

1. Describe the nature of the financial statements. Explain the role of generally accepted accounting principles in this process.
2. Illustrate and explain a balance sheet. Define the terms assets, Liabilities, and owner's equity, and discuss the basic accounting principles relating to asset valuation.
3. What is the statement of cash flows? Distinguish among operating, investing, and financing activities.
4. Explain the importance of adequate disclosure.
5. Explain the concept of financial statement articulation.
6. Define proprietorship, partnership, and the corporation as forms of business organization, and illustrate the effect of the form of organization on the presentation of owner's equity in the financial statements.
7. Explain accounting equation and illustrate the effects of business transactions upon this equation and balance sheet.
8. What is income statement? Emphasizing the nature of revenue and expenses.

# Answer

**1.**

**Nature of Financial Statements**

Financial statements are the summarized reports of **recorded facts** and are prepared the following accounting concepts, **conventions,** and **requirements of Law.**

**Recorded Facts**

- Financial Statements are prepared using recorded facts.
- Recorded facts means the data drawn from accounting records used for preparing financial statements.
- Financial Statements are not prepared basis market price or realizable value.

**Accounting Conventions**

Financial Statements are prepared following the fundamental accounting principles and conventions.

**Assumptions**

Financial statements are prepared on certain basic assumptions such as going concern assumption, money measurement assumption, realization assumption, etc.

**Personal Judgement**

Even though certain accounting conventions as followed in preparing financial statements, still personal opinion, estimates and judgement of the accountant and management plays a decisive role in accounting.

**For Example**

- The depreciation is provided taking into consideration the useful economic life of fixed assets.
- Provisions for doubtful debts are made on estimates and personal judgements
- Asset to be depreciated on SLM or WDV method
- Rate of depreciation
- Method of valuation of Inventory to be used.
- Rate of provision for doubtful debts vii. Classification of expenditure into capital and revenue in.
- Period for writing off intangible assets, etc.

The purpose of GAAP is to ensure that financial reporting is transparent and consistent from one public organization to another, and from one accounting period to another. GAAP is a term that refers to a set of accounting rules, standards, and practices used to prepare and standardize financial statements that are issued by a company. The goal of these standards is to help investors and creditors better compare companies by establishing consistency and transparency.

**2.**

**Balance Sheet** is the financial statement of a company which includes assets, liabilities, equity capital, total debt, etc. at a point in time. Balance sheet includes assets on one side, and liabilities on the other. For the balance sheet to reflect the true picture, both heads (liabilities & assets) should tally (Assets = Liabilities + Equity).

Balance sheet is more like a snapshot of the financial position of a company at a specified time, usually calculated after every quarter, six months or one year. Balance Sheet has two main heads –assets and liabilities.

**Assets**

Assets are those resources or things which the company owns. They can be divided into current as well as non-current assets or long-term assets.

**Liabilities**

Liabilities on are debts or obligations of a company. It is the amount that the company owes to its creditors. Liabilities can be divided into current liabilities and long-term liabilities.

**Owner's equity**

Another important head in the balance sheet is shareholder or owner's equity. Assets are equal to total liabilities and owners' equity. Owner's equity is used when the company is a sole proprietorship and shareholders' equity is used when the company is a corporation. It is also known as book value of the company.

The Valuation of a financial asset involves the following three steps:

(1) estimate the expected cash flows.

(2) determine the appropriate interest rate or interest rates that should be used to discount the cash flows; and

(3) calculate the present value of the expected cash flows using the interest rate or interest rates.

**3. Cash flow statement:**

A cash flow statement is a financial statement that provides aggregate data regarding all cash inflows a company receives from its ongoing operations and external investment sources. It also includes all cash outflows that pay for business activities and investments during a given period.

**Difference**:

**Operating activities**

- Day to day activities
- include cash activities related to net income.

**Investing activities**

- Long term assets
- include cash activities related to noncurrent assets.

**Financing activities**

- Equity and long term liabilities
- include cash activities related to noncurrent liabilities and owners' equity.

4. **Importance of adequate disclosure:**

Adequate disclosure is an accounting concept that ensures that all necessary information is provided in financial statements so that an investor or creditor can depend on them when examining a company's financial statements.

The capacity of financial statements, Footnotes, and additional schedules to offer a thorough and clear picture of a Company's financial status is referred to as adequate disclosure.

5.

**Financial Statement Articulation**

- The Income Statement is prepared first
- Net income from the income statement is used to prepare statement of Retained Earnings
- The ending balance on the Statement of Retained Earnings is used to prepare the Balance Sheet
- The ending cash balance on the Statement of Cash Flows is equal to the cash balance on the Balance Sheet
- The net change in cash on the Statement of Cash Flows is equal to the difference between the ending cash balance and the beginning cash balance on the Balance Sheet

6.

**Sole proprietorship**

Business owned by one person and operated for his or her own profit.

**Partnership**

business owned by two or more people and operated for profit.

**Corporation**

- entity created by law
- have the legal powers of an individual
- it can sue and be sued,
- make and be party to contracts, and
- acquire property in its own name.

Broadly, the two major types of changes that effect the Statement of Owners Equity are-

(1) changes that originate from transactions with the owners (shareholders) such as issue of new shares, payment of dividends, etc. and

(2) changes that result from changes in net income for the period, total comprehensive income, revaluation of fixed assets, changes in fair value of available for sale investments, etc.

7. **Accounting Equation**

This is where we look at all accounts that affects the balance sheet and establishing how each transaction relates to the balance sheet. This is a great foundation, and explanation, of the double-entry accounting system.

**Effects of transaction on accounting equation:**

Presented below are six business transactions. List the letters (a), (b), and so on with columns for assets, liabilities, and owner's equity. For each column, indicate whether the transactions increased (+), decreased (-), or had no effect (NE) on assets, liabilities, and owner's equity.

1. Purchased supplies on account.
2. Received cash for performing a service.
3. Paid accounts payable in cash.
4. Invested cash in the business.
5. Withdrawal of cash by owner.
6. Received cash from accounts receivable.

| Assets = | Liabilities + | Owners equity |
|---|---|---|
| (a) + | + | NE |
| (b) + | NE | + |
| (c) - | - | NE |

| | | |
|---|---|---|
| (c) + | NE | + |
| (d) - | NE | - |
| (e) NE | NE | NE |

8. **Income statement:**

Income statement is a financial report showing revenues, expenses and profits, for which there are subtotals of the various revenue and expense classifications.

If revenue exceeds from Expenses means Profit.

If Expenses exceeds from Revenue means Loss.

**Revenues**

Income earned by an individual or a business, from the sale of any products or services offered.

**Revenue = price of product or service x number of units so**

**Expenses**:

Cost of operations that a company incurs to generate revenue.

**Operating expenses = Salaries + Sales Commissions**

**+ Advertising + Rental + Utilities (etc.)**

# Question No. 2

The balance sheet items for The City Butcher (arranged in alphabetical order) were as follows at July 1, 2011. (You are to compute the missing figure for Retained Earnings.)

| | | | |
|---|---|---|---|
| Accounts Payable | $ 7,000 | Equipment and Fixtures | $25,000 |
| Accounts Receivable | 8,200 | Land | 50,000 |
| Building | 90,000 | Notes Payable | 40,000 |
| Capital Stock | 100,000 | Salaries Payable | 3,700 |
| Cash | 4,100 | Supplies | 7,000 |

During the next few days, the following transactions occurred:

**July 4** Additional capital stock was sold for $30,000. The accounts payable were paid in full. (No payment was made on the notes payable or salaries payable.)

**July 5** Equipment was purchased at a cost of $6,000 to be paid within 10 days. Supplies were purchased for $1,000 cash from a restaurant supply center that was going out of business. These supplies would have cost $2,000 if purchased through normal channels.

**Instructions**

**a.** Prepare a balance sheet at July 1, 2011.

**b.** Prepare a balance sheet at July 5, 2011, and a statement of cash flows for July 1–5. Classify the payment of accounts payable and the purchase of supplies as operating activities.

**c.** Assume the notes payable do not come due for several years. Is The City Butcher in a stronger financial position on July 1 or on July 5? Explain briefly.

# Answer

## (a)

| | | | | |
|---|---|---|---|---|
| **COLLIER BUTCHER SHOP** | | | | |
| **Balance Sheet** | | | | |
| **July 1, 2015** | | | | |
| Assets | | | Liabilities & Owners' Equity | |
| Cash | $ 4,100 | | Liabilities: | |
| Accounts receivable | 8,200 | | Notes payable | $ 40,000 |
| Supplies | 7,000 | | Accounts payable | 7,000 |
| Equipment & fixtures | 25,000 | | Salaries payable | 3,700 |
| Building | 90,000 | | Total liabilities | $ 50,700 |
| Land | 50,000 | | Owners' equity: | |
| | | | Capital stock | 100,000 |
| | | | Retained earnings * | 33,600 |
| Total | $ 184,300 | | Total | $ 184,300 |
| | | | | |
| | | | | |

*Retained earnings ($33,600) = Total assets ($184,300), less total liabilities ($50,700) + capital stock ($100,000).

**(b)**

| | | | |
|---|---|---|---|
| **COLLIER BUTCHER SHOP** | | | |
| **Balance Sheet** | | | |
| **July 5, 2015** | | | |
| Assets | | Liabilities & Owners' Equity | |
| Cash | $ 26,100 | Liabilities: | |
| Accounts receivable | 8,200 | Notes payable | $ 40,000 |
| Supplies | 8,000 | Accounts payable | 6,000 |
| Equipment & fixtures | 31,000 | Salaries payable | 3,700 |
| Building | 90,000 | Total liabilities | $ 49,700 |
| Land | 50,000 | Owners' equity: | |
| | | Capital stock | 130,000 |
| | | Retained earnings | 33,600 |
| Total | $ 213,300 | Total | $ 213,300 |

| | | |
|---|---|---|
| **COLLIER BUTCHER SHOP** | | |
| **Statement of Cash Flows** | | |
| **For the Period July 1-5, 2015** | | |
| Cash flows from operating activities: | | |
| Cash payment of accounts payable | $ (7,000) | |
| Cash purchase of supplies | (1,000) | |
| Cash used in operating activities | | $ (8,000) |
| | | |
| Cash flows from investing activities: | | |
| None | | |
| | | |
| Cash flows from financing activities: | | |
| Sale of capital stock | | $ 30,000 |
| | | |
| Increase in cash | | $ 22,000 |
| Cash balance, July 1, 2015 | | 4,100 |
| Cash balance, July 5, 2015 | | $ 26,100 |

**(c)**

Collier Butcher Shop is in a stronger financial position on July 5 than it was on July 1.

On July 1, the highly liquid assets (cash and accounts receivable) total only $12,300, but the company has $10,700 in debts due in the near future (accounts payable plus salaries payable).

On July 5, after additional infusion of cash from the sale of stock, the liquid assets total $34,300, and debts due in the near future amount to $9,700.

# Question No. 3

Six transactions of Brigal Company, a corporation, are summarized below in equation form, with each of the six transactions identified by a letter. For each of the transactions **(a)** through **(f)** write a separate statement explaining the nature of the transaction. For example, the explanation of transaction **(a)** could be as follows: Purchased furniture for cash at a cost of $800.

| | Assets | | | | | | | | | = | Liabilities | + | Owners' Equity |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Cash | + | Accounts Receivable | + | Land | + | Building | + | Furniture | = | Accounts Payable | + | Capital Stock |
| Balances | $ 9,000 | | $30,000 | | $40,000 | | $90,000 | | $10,000 | | $30,000 | | $149,000 |
| (a) | −800 | | | | | | | | +800 | | | | |
| Balances | $ 8,200 | | $30,000 | | $40,000 | | $90,000 | | $10,800 | | $30,000 | | $149,000 |
| (b) | +500 | | −500 | | | | | | | | | | |
| Balances | $ 8,700 | | $29,500 | | $40,000 | | $90,000 | | $10,800 | | $30,000 | | $149,000 |
| (c) | −3,000 | | | | | | | | +5,000 | | +2,000 | | |
| Balances | $ 5,700 | | $29,500 | | $40,000 | | $90,000 | | $15,800 | | $32,000 | | $149,000 |
| (d) | −2,000 | | | | | | | | | | −2,000 | | |
| Balances | $ 3,700 | | $29,500 | | $40,000 | | $90,000 | | $15,800 | | $30,000 | | $149,000 |
| (e) | +10,000 | | | | | | | | | | | | +10,000 |
| Balances | $13,700 | | $29,500 | | $40,000 | | $90,000 | | $15,800 | | $30,000 | | $159,000 |
| (f) | | | | | | | | | +3,000 | | +3,000 | | |
| Balances | $13,700 | | $29,500 | | $40,000 | | $90,000 | | $18,800 | | $33,000 | | $159,000 |

# **Answer**

Description of transactions:

a. Purchased furniture for cash at a cost of $800.

b. Received $500 cash from collection of accounts receivable.

c. Purchased furniture at a cost of $5,000; paid $3,000 cash as down payment and incurred liability (account payable) for the remaining $2,000.

d. Paid $2,000 of accounts payable.

e. $10,000 cash was received from the sale of capital stock.

f. Purchased furniture on account for $3,000.