

The Financial Position

Study Unit 2

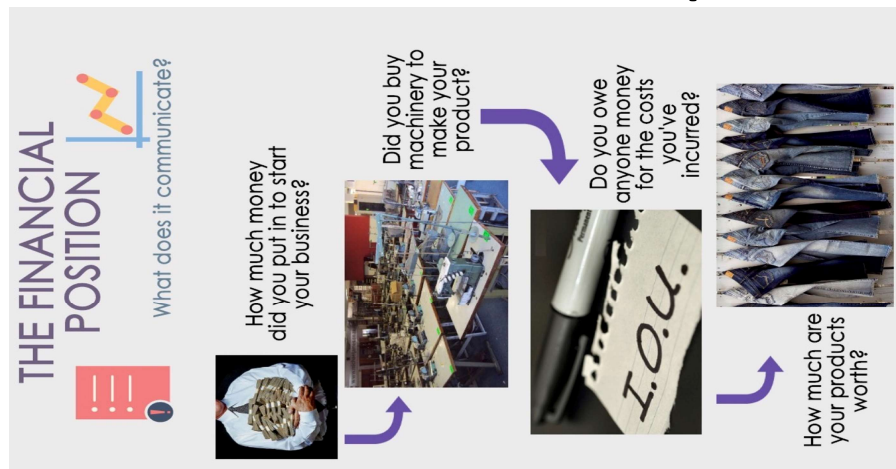
Study Unit 2: The Financial Position

**What do the users want to know
about your Financial Position?**

A basic business example

- The infographic helps visualise the business itself and the financial information that is created in the process
- Of this information, what would users want to know about the business's financial position?

A basic business example



A basic business example

- Would users of your financial information want to know the following:
 - How much did you put in to start your business?
 - Did you buy machinery to manufacture your product?
 - Do you owe anyone money for the costs you've incurred?
 - How much are your products worth?

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The Types of Financial Information that must be included

Financial Position information

- Where did the money come from to fund your business?
 - Did you get loans / finance / credit from banks or suppliers?
(Liabilities)
 - Did the owners contribute / invest money (Equity)
- What did you do with the money that came in?
 - Purchase machines to make your product? (Assets)
 - Keep it in the bank? (Assets)

Financial Position information

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The Basic Accounting Equation

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Working out how much belongs to the Owners of the Business

Accounting Equation

- Money doesn't come from nowhere... and doesn't just disappear
- You need to keep track of where the money comes from, and where it goes!
- Just because you spend it, doesn't mean there's nothing to record!

Accounting Equation

- What belongs to you as the owner? Your financial position?
 - Anything the business owns
 - Less: anything the business owes
- Example:
 - Just because you have a R300 000 car, doesn't mean it's completely yours! If you were financed by the bank... it's not entirely yours!
 - So... what would be yours then?

Accounting Equation

- Example 1:
 - Your R300 000 car was financed by the bank and you still owe the full amount
 - If you sell the car for it's R300 000 value... then what belongs to you?
 - You have to pay the bank first, before you can think about what's yours! You get what's left!!

Accounting Equation

- Example 2:
 - Your R300 000 car was financed by the bank and you owe R200 000 on it
 - If you sell the car for R250 000... then what belongs to you?
 - After you've paid the bank, you get what's left, so your portion would be R50 000

Accounting Equation

- We use the Statement of Financial Position elements to express this
 - Assets; Liabilities; Equity
- Your financial position looks like this:

What you own - What you owe = Your share

Assets - Liabilities = Equity

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The Elements of the Financial Statements

Elements of the Financial Statements

- Assets and Liabilities are elements of Financial Statements.
 - You need to be able to identify and recognise these elements
 - We'll start with infographics defining these elements to help you get comfortable with them

Assets

- The infographic defines assets, and expands on how to assess whether something can be identified as an asset

Use this infographic as a tool to learn the asset definition!

Assets

ELEMENTS OF THE STATEMENT OF FINANCIAL POSITION

ASSETS

DEFINITION:
A resource controlled by the entity as a result of past events, from which future economic benefits are expected to flow to the entity

- ...resource...**
 - Doesn't always have a physical form
 - Anything that will create a future benefit
- ...controlled...**
 - Doesn't necessarily mean 'owned'
 - Are there restrict access to the future benefit (ie can you prevent others from obtaining the future benefit?)
- ...result of a past event...**
 - Must arise from an event in the past (ie: can't raise 'future' assets)
- ...future economic benefit inflows...**
 - Can be in the form of future cash
 - Can be in the form of future reduction of costs / expenses
- ...expected...**
 - Not guaranteed!
 - Must be done by estimates

Is it or isn't it?

What are the future economic benefits expected to flow from the machine, sell them, earn income!

Does the entity control the machine? How is used, who has access, what they do with it?

Company buys a machine for cash

Was the purchase in the past? (ie: before the year-end)

Are the identified benefits (those that make it a 'resource') expected to flow INTO the entity?

Do you think you will be able to sell the products the machine makes?

Liabilities

- The infographic defines liabilities, and expands on how to assess whether something can be identified as a liability

Use this infographic as a tool to learn the liability definition!

ACCOUNTING BASICS

LIABILITIES

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 (future outflows)



- There must be a CURRENT obligation
- Must arise from an event in the past (ie: the event causing the obligation must have taken place)
- Not guaranteed!
- Whether in cash or otherwise, the settlement of the obligation will require an outflow from the entity

- ↑ ...present obligation...
- ↑ ...arising from past events...
- ↑ ...settlement... expected...
- ↑ ...future outflows...



Is it or isn't it?!

Is there a present obligation?
At this point, you are indebted to the bank

Was the obligating event in the past? (ie: the contract signed and money received before the yearend)

Company takes a loan from the bank

Are the outflows expected?
Is there any uncertainty about whether the bank will expect payment?

What are the future outflows?
You'll need cash in the future to settle the loan with the bank

Liabilities

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Assets: Current & Non-Current

Current vs non-Current

- Assets
 - Machinery
 - Inventory
 - Debtors
 - Cash
- When / how are the Assets realised?

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Liabilities: Current & Non-Current

Current vs non-Current

- Liabilities
 - Mortgages / Bonds
 - Long-term loans
 - Creditors
- When / how are the liabilities settled?

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The Double-entry System

Double-entry System

- The double-entry system is a vital part of your Accounting basics. To start off with, take a look at the infographic to get comfortable with the concept

Double-entry System

- The infographic introduces you to the double-entry system and the effect of transactions on the Basic Accounting Equation

Use this infographic as a tool to remember that transactions always affect the Basic Accounting Equation in more than one way!

Double-entry System

ACCOUNTING BASICS

DOUBLE ENTRY SYSTEM

Every transaction affects more than one item in the Basic Accounting Equation (BAE). You must identify all the effects and keep the BAE in balance

Remember the Accounting Equation?

ASSETS = **EQUITY** + **LIABILITIES**

Company purchases a machine for cash

Machinery \uparrow No effect No effect
Cash in Bank \downarrow

Company purchases a machine with a loan from the bank

Machinery \uparrow No effect Loan from Bank \uparrow

Owner invests money to buy machine

Machinery \uparrow Owners Equity \uparrow No effect

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The Entity and its Reporting Period

Separate legal entities

- A short read on the concept of a separate legal entity
- Make sure you understand the separation between owner and business

Separate legal entities

- A company is a separate legal entity. This means that the rights and obligations of the company are seen as SEPARATE from that of the owners. All the reporting and financial information is done from the viewpoint of the Company, NOT the owners.
- Eg: An asset will be valued at what it's worth to the company, not the owners of the company
- This also means that liabilities incurred by the company are not seen as liabilities of the owners.

Accounting Periods

- A short read on yearends. Every business has one!
- The yearend must be used when preparing financial statements

Make sure you always identify the yearend in questions!

Accounting Periods

- The Annual Financial Statements are prepared according to the reporting period of the company. When the company is started, a yearend is selected, and this yearend is used EVERY year as the financial yearend for the Annual Financial Statements. (Most companies use the Tax yearend, 28 February)
- The reporting period is the period from one yearend to the next. (Thus, most companies have a reporting period of 1 March 2013 to 28 February 2014)

Accounting Periods

- The Statement of Financial Position will be reported as follows:

Statement of Financial Position of xxx (Pty) Ltd as at 28 February 2014

- The Statement of Profit or Loss and other Comprehensive Income is reported as follows:

Statement of Profit or Loss and other Comprehensive Income of xxx (Pty) Ltd for the year ended 28 February 2014

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Class Example: Storms for Africa

Class Example

- Download the handouts for Storms for Africa
- Attempt to compile the Statement of Financial Position for the case study
- Watch the feedback video (Lecture 10) for the solution

Pay attention to the details, headings, names of accounts and structure