

FINANCIAL STATEMENTS OF COMPANIES

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All companies are required to maintain accurate and complete accounting records. Their Financial Statements must be prepared six months after financial year-end.

All public companies must be audited. Public companies must appoint an audit committee.

The Financial Statements of a company should include:

- Statement of Comprehensive Income (Income Statement)
- Statement of Financial Position (Balance Sheet)
- Cash Flow Statement
- Director's Report
- Auditors Report

The purpose of Financial Statements is to provide information about the financial position, financial performance and cash flow of a business to a wide variety of users. The Financial Statements also show if the resources of the business were managed effectively.

Characteristics of Financial Statements

In the first place the statements must adhere to the principles of **GAAP** (Generally Accepted Accounting Practice).

Financial Statements must always answer to the following criteria:

- Comparable
- On time
- Understandable
- Reliable
- Fair

The independent auditor

The independent auditor's main purpose is not to detect fraud. His main purpose is to confirm to the shareholders that the Financial Statements is a fair reflection of the financial position of the company. The external auditor is bound to very strict ethical standards and might lose his job if it is not performed properly

DEFINITIONS AND CONCEPTS

Director's Report

The Director's report is a written, verbal explanation of a company's operations during a financial year.

The Director's report is prepared by the Board of Directors and is a declaration of the directors' responsibilities.

Audit Report

An external audit gives an independent review on a company's financial information and provides assurance on the accuracy and reliability of financial disclosures. The audit report provides shareholders with an objective opinion of the company's financial position and whether they followed accounting rules and principles.

The audit report can often be divided into three paragraphs:

- Paragraph 1 will state the responsibilities of the auditor and those of the directors.
- Paragraph 2 states that reporting standards such as GAAP and IFRS were used.
- Paragraph 3 gives the opinion of the independent auditor.

Certificate of Incorporation

A document used by the Registrar of Companies that indicates the formation of a new legal entity; allows a company to start trading.

MOI – Memorandum of Incorporation

This is the document that is required to form/start a company. This document sets out rights, duties and responsibilities of shareholders, directors and others within and relation to a company.

Prospectus

A document describing the main features of a company. It is used to advertise a company and to give information to potential shareholders.

Companies Act

Regulates all matters pertaining to companies.

King III Report

A report on corporate governance in South Africa.

Good corporate governance: A plan to address certain aspects of King III was approved for implementation during 2011 and progress was monitored by the audit and risk committee and reported to the Board.

Shareholders

The owners of a company are the shareholders who provide capital.

Share register

A record is kept of every shareholder and the number or shares he/she owns.

Directors

The directors are required to run a company to the best of their ability. They are appointed by the shareholders on an Annual General Meeting.

Notice of AGM

An invitation to shareholders to a formal meeting that is held once a year.

Limited liability

Because a company has a separate legal personality distinct from its owners, the shareholders cannot be held liable for its debts. In the event of insolvency, the shareholders will only lose the amount invested by them in terms of shares sold to them.

Continuity

A company has the capacity to have its own rights and duties and an indefinite existence apart from its owners. A company's life continues even after the withdrawal or death of one of the owners.

Applicability

Users should be able to use the information in the Financial Statements for decision-making purposes.

Reliability

Information in the statements must be reliable – free from mistakes and unbiased, prudent and complete.

Comparability

The business should be able to compare statements from the one year to the next, and similar entities should also be able to compare statements in order to evaluate their performance.

The **tax return form** has to be completed in order to file income taxes with SARS every year.

The **tax assessment form** is a form that SARS sends to the company to state the amount of income tax that is due.

Conflict of interest

When there is a clash between professional obligations and personal interest where an employee tries to perform a duty, but at the same time tries to achieve personal gain.

Insider trading

An illegal practice where an employee uses confidential information to do trading on the stock exchange to his/her own advantage.

Price-fixing

An illegal agreement between businesses or persons to manipulate the selling price of certain products – not to sell goods or services below a certain price.

Theft

The action or crime of stealing.

Fraud

Wrongful or criminal deception intended to result in financial or personal gain.

Corruption

When someone is guilty of dishonest practices, like bribery.

Bribery

When a person gives or receives something of value, like cash or gifts, for the purpose of influencing someone's actions or views.

REVISION ON ASSET DISPOSAL

Asset disposal is a very important part of the adjustments. In grade 11 the Asset disposal was more tricky and difficult, When they asked it as an adjustment, most of the information will be given.

Just follow the steps:

Step 1	Cost price	Dr Asset disposal Cr Vehicles/Equipment
Step 2	Additional depreciation	Dr Depreciation Cr Accumulated depreciation on vehicles/equipment
Step 3	Total Accumulated depreciation	Cr Accumulated depreciation on vehicles/equipment Cr Asset disposal
Step 4	Selling price	Dr Bank / Debtors control / Creditors control / Drawings Cr Asset disposal
Step 5	Profit / Loss	Profit: Dr Asset disposal Cr Profit on sale of asset Loss: Dr Loss on sale of asset Cr Asset disposal
Step 6	Depreciation on the remaining assets (old and new) at the end of the year	Dr Depreciation Cr Accumulated depreciation on vehicles/equipment

Example on Asset disposal

Balances on 28 February 2018:

Equipment	R72 000
Accumulated depreciation on equipment	R25 920

Adjustment: A computer, cost price R8 740, was sold for R4 800 cash on 1 March 2018. The accumulated depreciation amounted to R4 520 on the date of sale. No entry was made.

Depreciation on equipment has to be brought into account on 28 February 2019 at 20% per annum on the carrying value.

Step 1	Cost price = R8 740	Dr Asset disposal Cr Vehicles/Equipment
Step 2	No additional depreciation	The computer was sold on the first day of the financial year.
Step 3	Total Accumulated depreciation = R4 520	Cr Accumulated depreciation on vehicles/equipment Cr Asset disposal
Step 4	Selling price = R4 800 cash	Dr Bank / Debtors control / Creditors control / Drawings Cr Asset disposal
Step 5	Profit / Loss = R580 profit	Dr Asset disposal Cr Profit on sale of asset
Step 6	Depreciation on the remaining assets (old and new) at the end of the year	Dr Depreciation Cr Accumulated depreciation on vehicles/equipment

Asset disposal

Equipment (2)	8 740	Accumulated depreciation on equipment (3)	4 520
Profit on sale of asset (5)	580	Bank (4)	4 800
	9 320		9 320

Disposal at carrying value = Step 1 minus Step 3

$$= R8\ 740 - R4\ 520$$

$$= R4\ 220$$

The business made a profit because they sell the computer for R580 more than what it is worth (carrying value) on that day.

Step 6:

Depreciation on the remaining equipment.

$$\text{Cost price of the remaining old equipment} = R72\ 000 - R8\ 740 \\ = R63\ 260$$

Accumulated depreciation on remaining equipment

$$= R25\ 920 - R4\ 520 \\ = R21\ 400$$

$$\text{Thus, depreciation} = 20/100 \times (63\ 260 - 21\ 400) = R8\ 372$$

Note 3: Fixed assets

Carrying value beginning of the year	46 080
Cost price	72 000
Accumulated depreciation	(25 920)
Movements	
Disposal at carrying value (8 740 – 4 520)	(4 220)
Depreciation for the year	(8 372)
Carrying value end of the year	33 488
Cost (72 000 – 8 740)	63 260
Accumulated depreciation (25 920 – 4 520 + 8 372)	(29 772)

FINANCIAL STATEMENTS

INCOME STATEMENT

The Income Statement measures a company's financial performance over a specific accounting period.

It is a summary of its revenues and expenses and show the **net profit / loss** incurred for the specific accounting period.

- The Income Statement is known as the **Statement of Comprehensive Income**.
- **Directors fees** is never part of Salaries and Wages, but must be shown separately.
- **Income tax** is shown in the Income Statement, at the bottom where it is subtracted from Net profit before tax.
- **Dividends on ordinary shares** will never be shown in the Income Statement, only in the note for **Retained income**.

The face of the Income Statement;

Income Statement of ... for the year ended ...

	Note	R
Sales		xxx
- Cost of sales		(xx)
= Gross profit		xxx
+ Other operating income		xxx
Rent income		xx
Discount received		xx
Profit on sale of asset		xx
Bad debts recovered		xx
Provision for bad debts adjustment (income)		xx
= Gross operating income		xxx
- Operating expenses		(xxx)
Salaries and wages		xx
Water and electricity		xx
Directors fees		xx
Audit fees		xx
Loss on sale of asset		xx
Provision for bad debts adjustment (expense)		xx
...		xx
= Operating profit		xxx
+ Interest income	1	xx
= Profit before interest expense		xxx
- Interest expense	2	(xx)
= Net profit before tax		xxx
- Income tax (tax assessment)		(xx)
= Net profit after tax	8	xxx

BALANCE SHEET

The Balance Sheet shows the **financial position** of the company on a specific date, the last day of the accounting period. The Balance Sheet gives the status of the company's Assets, Liabilities and Shareholder's Equity.

- The Balance Sheet is known as the **Statement of Financial Position**.
- Remember to distinguish clearly between long-term and short-term when showing **Loans** and **Fixed Deposits**.
- **Authorised share capital** will never have an amount, only a number of shares.
- **SARS (Income tax)** can have a debit balance (note 5) or a credit balance (note 9) – depending on whether the business paid too much or too little tax during the year.
- The most important **notes** regarding the allocation of marks are:
 - Note 3** for Fixed assets
 - Note 5** for Trade and other receivables
 - Note 7** for Ordinary share capital
 - Note 8** for Retained income
 - Note 9** for Trade and other payables
- Remember the treatment of a **post-dated EFT** (scheduled) at the end of the year – Note 6 or Bank overdraft and Note 9.
 - **Add** the amount to the **Bank** because the money is not paid yet.
 - **Add** the amount to the **Creditors** because they are not paid yet.

The Balance Sheet is based on the accounting equation:

Assets =	Equity +	Liabilities
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Balance Sheet of ... at ...

	Note	R
ASSETS		
Non-current assets		xxx
Fixed assets	3	xxx
Financial assets		
Fixed deposit: AB Bank		xx
Current assets		xxx
Inventories	4	xxx
Trade and other receivables (Debtors)	5	xxx
Cash and cash equivalents	6	xx
TOTAL ASSETS		xxx
EQUITY AND LIABILITIES		
Shareholder's equity		xxx
Ordinary share capital	7	xxx
Retained income	8	xx
Non-current liabilities		xxx
Loan / Mortgage loan: BA Bank		xxx
Current liabilities		xxx
Trade and other payables (Creditors)	9	xx
Short term loan		xx
Shareholders for dividends		xx
SARS (Income tax)		xx
Bank overdraft		xx
TOTAL EQUITY AND LIABILITIES		xxx

NOTES TO THE FINANCIAL STATEMENTS

1. INTEREST INCOME		
	Interest income (on overdue debtors)	xx
	Interest on current account (bank)	xx
	Interest on fixed deposit	xx
	Interest on savings account	xx
		xxx

2. INTEREST EXPENSE		
	Interest expense (on overdue creditors)	xx
	Interest on overdraft (negative bank)	xx
	Interest on loan	xx
		xxx

3. FIXED / TANGIBLE ASSETS					
		Land and buildings	Vehicles	Equip-ment	Total
	Carrying value beginning of the year	xxx	xxx	xxx	xxx
	Cost	xxx	xxx	xxx	xxx
	Accumulated dep	–	(xx)	(xx)	(xx)
	Movements				
	Addition at cost	xx	xx	xx	xx
*	Disposal at carrying value	–	(xx)	(xx)	(xx)
#	Depreciation for the year	–	(xx)	(xx)	(xx)
	Carrying value end of the year	xxx	xxx	xxx	xxx
\$	Cost	xxx	xxx	xxx	xxx
@	Accumulated dep	–	(xx)	(xx)	(xx)

* **Disposal at carrying value = Step 1 – step 3**

= Cost price of the asset sold – Total Accumulated depreciation on the date of sale

Depreciation for the year = Step 2 + step 6

= Depreciation for this year on the asset sold + Depreciation end of the year on the remaining assets

\$ **Cost end of the year = Balance + new – step 1**

= Balance beginning (cost) + new asset – cost price of the asset sold

@ Accumulated depreciation end of the year

= **Balance + step 2 + step 6 – step 3**

= Balance beginning (accumulated depreciation) + Depreciation for the year – total Accumulated depreciation on the date of sale

4. INVENTORIES		
	Trading stock (stock taking end of year)	xx
	Consumable stores on hand	xx
		xxx

5. TRADE AND OTHER RECEIVABLES		
	Net trade debtors	xxx
	Trade debtors (Debtors control)	xxx
	Provision for bad debts	(xx)
	Prepaid expenses	xx
	Accrued income	xx
	SARS (Income tax) – if debit balance	xx
	Debtors for insurance	xx
	Deposit on water and electricity	xx
		xxx

6. CASH AND CASH EQUIVALENTS		
	Bank	xx
	Cash float	xx
	Petty cash	xx
	Savings account	xx
	Fixed deposit mature (receivable within 12 months)	xx
		xxx

NOTE!

Note 7 represent the Ordinary share capital account
 Note 8 represent the Retained income and Appropriation accounts

*Transaction: The company bought back 12 000 ordinary shares at **R6,55** each.*

Calculate the **average price of the shares sold** by taking the total value of the shares issued (R390 000 + R67 500) divided by the total amount of shares issued (60 000 + 15000) shares

→ Average price = $R457\,500 / 75\,000 = \mathbf{R6,10}$ per share

7. ORDINARY SHARE CAPITAL			
AUTHORISED			
Number of ordinary authorized shares: xxx shares			
ISSUED			
	60 000	ordinary shares in issue on 1 March 2019 / beginning of the year	390 000
+	15 000	additional ordinary shares issued during the year at R4,50 each	67 500
-	(12 000)	ordinary shares bought back during the year at R6,10 each	(73 200)
=	63 000	Ordinary shares in issued on 28 February 2020 / end of the year	384 300

NOTE!

Because the last action was to buy back 12 000 shares, the balance at the end of the year will also be at the average price.

→ $R384\,300 / 63\,000 = \mathbf{R6,10}$ per share

8. RETAINED INCOME		
	Balance on 1 March 2019 / beginning of year	xxx
+	Net profit after tax → as per Income Statement	xx
-	Buy back shares (12 000 x R0,45)	(5 400)
-	Dividends	(36 000)
	Paid → Interim dividends	16 000
	Recommended → Final dividends #	20 000
=	Balance on 28 February 2020 / end of year	xxx

9.	TRADE AND OTHER PAYABLES	
	Trade creditors (Creditors control)	xx
	Accrued expenses	xx
	Deferred income	xx
	SARS (PAYE)	xx
	Pension Fund	xx
	UIF	xx
	Creditors for salaries	xx
	SARS (Income tax) – if credit balance	xx
#	Shareholders for dividends – Final dividends	20 000
	Short term loan (payable within 12 months)	xx
		xxx

BALANCE SHEET WITHOUT NOTES

In a Balance Sheet without notes, the information of the notes is added in brackets directly in the Balance Sheet.

Balance Sheet of ... at ...

	R
ASSETS	
Non-current assets	xxx
Fixed assets <i>(Land and Buildings + Vehicles + Equipment at cost price minus Accumulated depreciation on vehicles and equipment minus Assets sold at carrying value)</i>	xxx
Financial assets	
Fixed deposit: AB Bank <i>(Fixed deposit minus Fixed deposit amount receivable within 12 months)</i>	xx

Current assets	xxx
Inventories <i>(Trading stock + Consumable stores on hand)</i>	xxx
Trade and other receivables <i>(Trade debtors minus Provision for bad debts + Prepaid expenses + Accrued income + SARS (Income tax) [Dt balance])</i>	xxx
Cash and cash equivalents <i>(Bank + Cash float + Petty cash + Savings account + Fixed deposit amount receivable/maturing within 12 months)</i>	xx
TOTAL ASSETS	xxx
EQUITY AND LIABILITIES	
Shareholder's equity	xxx
Ordinary share capital	xxx
Retained income	xx
Non-current liabilities	xxx
Loan / Mortgage loan: BA Bank <i>(Loan + Interest on loan capitalized minus Loan amount payable within 12 months)</i>	xxx
Current liabilities	xxx
Trade and other payables <i>(Trade creditors + Deferred income + Accrued expenses)</i>	xx
Short term loan	xx
Shareholders for dividends	xx
SARS (Income tax) – if credit balance	xx
Bank overdraft	xx
TOTAL EQUITY AND LIABILITIES	xxx

