Financial Accounting 14 –

Financial Statement Preparation

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Bala Sir welcomed the ladies for the next session. He said, we are now ready to re-construct our financial statements, from the journal entries and the T-accounts we have prepared so far. First of all, he urged them to look at the Cash Flow Statement. As you would see soon, we have all the necessary details in the T-account for Cash for developing our cash flow statement. He reproduced the Cash account below. He also gave them the basic structure for preparing the Cash Flow Statement.

	Cash Flow Statement			
#	**Transaction**	**Operating**	**Investing**	**Financing**
1	Promoter's contribution - Issue of 60,000 shares			60,000
2	Bank loan			340,000
3	Advance rent paid	(12,000)		
4	Purchase of Furniture and Fixtures		(120,000)	
5	Purchase of merchandise inventory	(100,000)		
6	Sale of merchandise inventory	200,000		
7	Electricity bill paid	(1,000)		
8	Salary paid	(7,500)		
9	Self-service remunerations paid	(25,000)		
	Total	54,500	(120,000)	400,000
	Net surplus in bank – Rs. 334,500			

Cash	
Debit	**Credit**
60,000 (1) F	
340,000 (2) F	
	12,000 (3) O
	120,000 (4) I
	100,000 (5) O
200,000 (6) O	
	1,000 (8) O
	7,500 (9) O
	25,000 (10) O
Closing balance	
334,500	

All we need to do is to classify each item of the transaction into the respective categories – Operating, Investing and Financing. So, here we go. The first entry is Dr. 60,000 (1). Please recall, the number in bracket refers to the transaction number. Therefore, we know that this was the amount the ladies had contributed individually for *starting the business*. Therefore, this comes under financing, and this is cash coming in for APS. Therefore, we make the first entry as above. We now take up the next entry. It is again a cash inflow, as a result of the bank loan. In terms of categorisation, this is again an activity required for *starting the business*. So, this also becomes a Financing activity. Accordingly, we make the second entry above. The next item is a credit entry of 12,000 for transaction # 3. This is an outflow. It was for taking a shop on rent, and an advance payment of Rs. 12,000 was made. Therefore, it should go as an operating cash flow. The third entry goes up. Please note that we enter the amount within brackets, to indicate that it is an outflow. The next entry (Trn # 4) refers to the purchase of furniture and fixture for APS. It is an outflow, being a credit entry. Which category does this belong? Not financing for sure. Is this operating or investing? Well, these are definitely required for operations of APS, *but* these are going to last for several years of APS operations. Therefore, this belongs to the category – investing. Accordingly, we make the fourth entry. We take up the next item. We paid Rs. 100,000 for purchase of merchandise inventory. It is an outflow. Which category? Well these are required for carrying out our business of selling groceries. Therefore, it definitely belongs to the operating category. We make the 5th entry. APS received 200,000 in cash for sale of merchandise inventory during the month. This is an inflow, and belongs to operating category. Therefore, we make the sixth entry above. The next 3 items refer to payment of electricity bill, salary for the month, and remunerations for self-service. All are cash outflows, and belong to the operating category. We have no difficulty in making these 3 entries. This completes all entries from the cash book. We now compute the column totals, and the net total in the last row.

We arrive at the same Cash Flow Statement, with a slight change in the order of the entries only.

Now we shall try to re-construct the APS Income and Expenditure Statement for October 2021 from the journal entries and the T-accounts. Before that, let us try to understand our objective. Our aim is to make a complete list of all the income and expenses *arising out of the operations of APS.* We have all the necessary details in our journal entries and T-accounts. All we need to do is to pick-up and properly organise the details under income and expenditure incurred for this period. The key to this exercise is 'to make a complete list of all the income and expenses *arising out of the operations of APS.'*.

Fortunately, the accountants have devised a simple solution for this exercise. Please recall that a balance sheet has two sides: Assets and Liabilities. Similarly, the Income and Expenditure statement also has two sides: Income and Expenditure. These are all the four types of accounts that exist in all accounting systems, no more and no less. Therefore, we need to identify every single T-account we have into these four categories. Once this is done, preparation of the balance sheet and income and expenditure statements becomes a simple task of accumulating the closing balances of the respective accounts at the end of the period. This may seem to be rather abstract, but we shall explain this with the help of our own little example of setting up and running APS for just one month.

So, let us look at each account and classify it under one of these 4 categories. We have also noted the closing balance against each account from the earlier exercises. Please note that we used the Excel sheets for arranging them neatly into these categories.

Account name	**Type**	**Closing balance**
Accounts Receivable	Asset	**40,000**
Cash	Asset	**3,34,500**
Furniture and Fixture	Asset	**1,18,000**
Merchandise inventory	Asset	**20,000**
Pre-paid rent	Asset	**11,000**
COGS	Expense	**1,80,000**
Depreciation expenses (F&F)	Expense	**2,000**
Electricity Bill	Expense	**1,000**

Interest expenses	Expense	**3,400**
Salary expenses	Expense	**7,500**
Self-service expenses	Expense	**25,000**
Shop Rent expenses	Expense	**1,000**
Sales revenue	Income	**2,40,000**
Accounts Payable	Liability	**1,00,000**
Bank Loan	Liability	**3,40,000**
Shareholders' Equity	Liability	**60,000**
Interest Payable	Liability	**3,400**

Now the next step is to put them into a columnar structure. Income on the left and expenditure on the right for the Income and Expenditure Statement. Assets on the left and liabilities on the right for the Balance Sheet.

Income and Expenditure Statement				
Income	**Amount**		**Expenditure**	**Amount**
Sales revenue	**2,40,000**		**COGS**	**1,80,000**
			Depreciation expenses (F&F)	**2,000**
			Electricity Bill	**1,000**
			Interest expenses	**3,400**
			Salary expenses	**7,500**
			Self-service expenses	**25,000**
			Shop Rent expenses	**1,000**
			Excess of Income over expenses	**20,100**
Total	**2,40,000**		**Total**	**2,40,000**

Balance Sheet				
Assets	**Amount**		**Liabilities**	**Amount**
Accounts Receivable	**40,000**		**Accounts Payable**	**1,00,000**
Cash	**3,34,500**		**Bank Loan**	**3,40,000**
Furniture and Fixture	**1,18,000**		**Shareholders' Equity**	**60,000**
Merchandise inventory	**20,000**		**Interest Payable**	**3,400**
Pre-paid rent	**11,000**		**Retained Earnings**	**20,100**
Total	**5,23,500**		**Total**	**5,23,500**

Thus, we can see how systematic recording of all transactions help us to prepare all the three financial statements.