The implication for users of financial statements accounting essay

Financial statements should be well understood by those who read it especially those individuals who have considerable knowledge of business and economic world and those ones willing to learn the information carefully. There are various users of financial statements. These users are classified into two broad categories. These users have different purposes for using these statements. The first category of these users is the internal users. The internal users refer to those individuals who have direct interest to the activities of the organization. They include: 1) Managers and owners need financial statements so as to make business decisions. They analyze the information provided by financial statements so as to obtain a clear position of the organization. Variable elements of financial reports such as the ratio of current debt to equity ratio is vital in making a decision on the amount of long run capital that needs to be available; 2)employees form the second group of internal users of financial statements. Employees require this information especially when making joint collective bargains (Dyson, 1996). Such statements are of significant importance when discussing issues concerning promotion, salary increase and rankings. External users include: 1) institutional investors who use the financial reports to evaluate the financial capability of the business so as to make reasonable investment decisions; 2) Various financial institutions like banks and other loan bodies need to evaluate financial reports of businesses before lending them money; 3) the government also analyzes financial statement of different companies so as to prove if they paying taxes accurately ; 4) the general public as well as the mass media may be interested in analyzing the statements of certain businesses.

1. 2-What are the different aspects of legal and regulatory framework that relates to financial statements?

There are different methods which can be followed when presenting financial statements. Rules-based accounting is made up of precise rules that must be observed during preparation of financial statements. Many accountants prefer the use of this method so that they reduce their liability in the event misjudgments. In situation whereby the management decides not to use rule-base accounting, it can choose to employ other accounting policies in preparing their financial statement (Guilding, 2002). However, this can be challenging because there are some policies which do conflict. Companies which need to included in stock exchange in more than a single country need to prepare their statements in accordance with GAAP. There are several reasons why it is necessary to have regulatory framework guiding financial reporting within countries and on international level. One of the reasons regard to irregular information (Moncarz and Portocarrero, 1986). Assume a scenario whereby the manager of the company is the one responsible for preparation of financial reports. This responsibility gives the manager the opportunity to access financial information which other members of the organization do not. Managers can take advantage of this privilege to exploit the statements so as to favor their own personal interest. Therefore, there must be regulation on reporting to stop insiders from exploiting financial statements. Another important factor to be considered is reliability and relevance of financial statements.

Access the implication for users of financial statements?

The different aspects of legal and regulatory framework have significant implication for users of financial statements. Some of the users of financial statements have complained that some of the regulations add unimportant complexities. The basis behind their argument is that there are some rules which are extremely detailed, with standards extending to more than hundred pages. Others have argued that these rules provide loopholes for financial engineering and fail to provide a ‘ true and fair’ image of the business. It has also been noted that sometimes these rules fail to capture the details of targeted cases. Another negative phase of these rules is that they fail to provide solutions in the event of ‘ gaps’ (Kotas, 1999). Management can also choose to observe all those accounting treatments that favor their interests and avoid those that will define real position of the business. However, it is worth to acknowledge the fact that these rules play a major role in ensuring a fair competition of international businesses which operate in more than one national market. However, it is fairer to say that observance of these legal and regulatory frameworks significantly contribute to preparation of statements which portray a company’s real performance. The different legal and regulatory frameworks should be flexible enough to accommodate new situations in the business. A relevant and reliable makes it easier for users of financial information to analyze those statements.

Describe how different laws and regulations relate with accounting and reporting standards? (Pass P4) Provide the regulatory framework of any country other than UK and compare it with UK regulatory framework (Distinction 1)

There are several accounting bodies which guide the accounting environment and significantly determine the success of a business. Security and exchange commission aimed at eliminating abusive stock market collision that had accumulated and resulted to instability in stock markets. Security and exchange commission ensures that publicly reporting business adhere with the generally agreed accounting principles. Financial accounting standards board (FASB) provides a plane set of standards to be observed when presenting financial statements to the public (Atkinson et al, 1995). It aims at shielding the investors from fraud of business owners. Internal accounting standards board was founded to come up with comprehensible financial accounting reports (Messenger and Shaw, 1993). There is also the government accounting standards board (GASB) which aimed at establishing standards of helpful information that will aid users of reports to understand the reports in a much better way. On the second part of this question, the country of my choice is Kenya. In 1998, the council of Institute of Certified Public Accountants of Kenya set IFRS (International financial reporting standards) as the accounting standard in Kenya. From then henceforth, all the companies were requested to prepare their financial statements in accordance with IFRS. However, in Kenya there is a significant gap that has been observed between applicable accounting standards and the real practice by companies. In 1969, the UK ICAEW issued the statement of intent on accounting standard. This statement made it clear that standards will be generated in future with four main goals. The first goal was to reduce the dissimilarities and diversity in accounting principles. Second, was to disclose the accounting foundations. Third, disclose the diversion from established standards and eventually explain the broad exposure for main new accounting proposals. There have been a number of committees which have been formed since then all with the aim of improving accounting disclosure.

Requirement 2. 1

The following is a trial balance from auto electrical ltd as at 31 March 2005

£

£

Ordinary shares of 50 p each

400, 000

10% Redeemable Preference shares of £1 each

200, 000

Retained profits as at 1 April 2004

42, 475

Office block (Land £40, 000)

170, 000

Plant and machinery

730, 000

Office equipment

110, 000

Motor vehicles

200, 000

Provision for depreciation – Plant and Machinery

224, 500

– Office equipment

24, 500

– Motor vehicles

80, 000

Accounts receivables/Payables

500, 000

356, 226

Provision for doubtful debts

1, 000

Manufacturing wages

501, 400

Inventory as at 1 April 2004 – raw materials

70, 000

– Work in progress

126, 000

– Finished goods

250, 000

Transport expenses

85, 013

Returns inwards

15, 106

Purchases of raw materials

518, 600

Sales

2, 600, 147

Bank balance

60, 020

Directors salaries

60, 114

Maintenance of plan t

30, 102

Rent

40, 063

Advertising

190, 048

Rates

50, 171

Insurance

20, 116

Office salaries

166, 013

Light and heat

46, 027

Factory power

30, 014

Bank interest

7, 070

Interim dividends on preference shares

10, 000

General administration expenses

63, 011

3, 988, 868

3, 988, 868

Further information is as follows:

Depreciation is to be provided as follows:

Plant and machinery 15% on cost. (Production expense)

Office equipment 10% on cost (administration expense)

Motor vehicles 25% on WDV (distribution cost)

New office blocks 2% on cost (Administration expense).

As at 31 March 2005 rates were prepaid by £3, 140 .

Outstanding light and heat as at 31 march 05 is £1, 214 and rent is £2, 321

Rent, rates, light and heat and insurance are to be apportioned in the ratio of 5: 1 in relation to factory and office expenses.

The company makes a provision of 1% for doubtful debts on all accounts receivables.

The production director is paid £20, 000. £64, 237 is included Office salaries

£100, 000 is to be provided for corporation tax

During the year 1, 500 electrical equipments were transferred from the factory to the warehouse. Only 100 equipments were in hand at the end of the year.

At 31 March 2005 Inventory was:

Raw materials

£56, 200.

Work in progress

£47, 190.

Finished goods

?

Classifying expenses by function

Auto transmission

Income Statement for the year ended 31/03/2005

£

£

Revenue

2, 585, 041

Cost of sales

(1, 586, 692)

Gross profit

998, 349

Expenses

Distribution expenses

373, 298

Administration expenses

244, 489

Finance costs

27, 070

(644, 857)

Profit before tax

353, 492

Income tax expense

(100, 000)

Profit for the period

253, 492

Classifying expenses by nature

Auto Transmission

£

£

Revenue

2, 585, 041

Expenses

Raw materials consumed

532, 40

Changes in finished goods and work in progress

233, 332

Depreciation

153, 100

Employee benefits

727, 527

Other expenses

558, 120

Finance costs

27, 070

2, 231, 549

Profit before tax

353, 492

Income tax expense

(100, 000)

Profit for the period

253, 492

Auto Transmission

Balance sheet as at 31/03/2005

£

£

NON-CURRENT ASSETS

Property, Plant and Equipment

727, 900

CURRENT ASSETS

Inventory

198, 868

Accounts receivables

495, 000

Prepayments

3, 980

697, 848

TOTAL ASSETS

1, 425, 748

EQUITY AND LIABILITIES

Ordinary share capital

400, 000

RESERVES

Retained profits

295, 967

Shareholders' funds

695, 967

NON-CURRENT LIABILITIES

10% Redeemable preference shares

200, 000

CURRENT LIABILITIES

Bank overdraft

60, 020

Trade payables

356, 226

Accruals

13, 535

Current tax

100, 000

529, 781

Total Equity and Liabilities

1, 425, 748

Workings

£

Revenue

2, 600, 147

Less return inwards

(15, 106)

2, 585, 041

Cost of sales

Opening inventory : Finished goods

Cost of finished goods

250, 000

1, 682, 170

Less: closing inventory of finished goods

(95, 478)

1, 586, 692

Factory cost of finished goods

Manufacturing account

£

£

Opening inventory : raw materials

70, 000

Purchases of raw materials

518, 600

588, 600

Less: Closing stock inventory raw materials

(56, 200)

Raw materials consumed

532, 400

Direct labour: Manufacturing wages

501, 400

PRIME COSTS

1, 033, 800

Factory overheads

Directors' salaries : Factory manager

20, 000

Maintenance of plant

30, 102

Rent

35, 320

Rates

39, 192. 50

Insurance

16, 063

Light and hear

39, 376. 50

Factory power

30, 014

Depreciation on plant

109, 500

319, 560

Total cost of production

1, 353, 369

Add: Opening WIP

126, 000

1, 479, 360

Less: Closing W. I. P

47, 190

Factory cost of finished goods

1, 42, 170

Value of closing stock/finished goods: 1, 432, 170 x 100 = 95, 478 = 95, 478

1500

Expenses

Distribution

Administration

Finance costs

Transport

85, 013

Directors' salaries

40, 114

Rent

7, 064

Advertising

190, 048

Rates

7, 838

Insurance

3, 213

Office salaries

101, 776

Light and heat

7, 873

Bank interest

7, 070

Preference dividends (redeemable)

20, 000

Salesmen salaries

64, 237

Increase in provision for bad debts

4, 000

Depreciation on – new office block

2, 600

– office equipment

11, 00

– motor vehicles

30, 000

General administration expense

63, 011

373, 298

244, 489

27, 070

Workings for classification by nature

Changes in finished goods and W . I. P

Finished goods

Work in progress

TOTAL

£

£

£

Closing inventory

95, 478

47, 190

142, 668

Opening inventory

(250, 000)

(126, 000)

(376, 000)

Increase (decrease)

(154, 522)

(78, 810)

(233, 332)

An increase is treated as a saving while a decrease is an expense .

Depreciation

Plant and machinery

109, 500

New office block

2, 600

Office equipment

11, 000

Motor vehicles

30, 000

153, 100

Employee benefits

Manufacturing wages

501, 400

Factory manger salary

20, 000

Director salaries

40, 114

Office salaries

101, 776

Salesman salaries

64, 237

727, 527

Other expenses

Transport

85, 013

Rent

42, 384

Advertising

190, 048

Rates

47, 031

Insurance

19, 276

Ling and heat

47, 241

Plant maintenance

30, 102

Factor power

30, 014

Provision for bad debts

4, 000

Bank interest

7, 070

General administration

63, 011

558, 120

Property, Plant and Equipment

Cost

Depreciation to date

Net Book value

Office block

170, 000

2, 600

167, 400

Plant and machinery

730, 000

334, 000

396, 000

Office equipment

110, 000

35, 500

74, 500

Motor vehicles

200, 000

110, 000

90, 000

727, 900

Prepayments and Accruals

Prepayments

Accruals

Rates

3, 140

Light and heat

1, 214

Insurance

840

Rent

2, 321

Dividend on redeemable preference shares

10, 000

3, 980

13, 535

Retained profits

Balance c/d 42, 475

42, 475

Profit for the period 253, 492

Retained earnings 295, 967

Gross profit margin profit/sales= 998, 349/2585041= 38. 62%

Net profit margin profit/sales= 295, 967/2, 585, 041= 11%

Differential 38. 62-11= 27. 62

Requirement 2. 2

Utah textile

Incomes statement for the year ending 31 December 2009

Sh. Sh.

revenue 476000

Expenses

Advertising expense 14500

Supplies Expenses 31500

Rent expense 12000

Miscellaneous expense 5100

Salaries expense 78000

Utilities expense 2500 (143600)

Profit before tax 332400

Net income 109450

Total income 441850

Income tax expense (132555)

Profit for the period 309295

Distribution to owners (48100)

retained earnings 261195

Balance sheet as at 31 december 2009

Non Current Assets Sh. Sh.

buildings 512000

land 90000

Current assets

supplies 4250

account Receivables 95000

Cash 63000 162250

TOTAL ASSETS 764250

Ordinary Share Capital 310300

Retained Profits 261195

Shareholders’ funds 571495

Non-Current Liabilities

mortgage payable 423400

Current Liabilities

Trade payables 74300

Current tax 132555

Proposed dividends 48100 265400

TOTAL EQUITY & LIABILITIES 764250

Requirement 2. 3

Below is the group financial statement for Albar machinery distributors’ ltd. On October 1997 Albar purchased stake in Nguo. Later this group bought stake in kipi. BELOW UU

Income statements for the year ended 31 March 2000 for:

Albar Ltd Nguo Ltd Kipi Ltd

Sh. m Sh. m Sh. m

Revenue 1, 368 774 685

Cost of sales (810) (407) (355)

Gross profit 558 367 330

Distribution costs (196) (64) (78)

Administration expenses (112) (73) (72)

Finance cost (50) (20) 0

Profit before tax 200 210 180

Income tax expense (60) (60) (50)

Profit after tax 140 150 130

Proposed dividends (150) (100) (100)

Retained profits for the year (10) 50 30

Retained profits brought forward 713 610 420

Retained profit carried forward 703 660 450

Balance sheet as at 31 March 2000 Albar Ltd Nguo Ltd Kipi Ltd

Noncurrent assets sh. m sh. m sh. m

Property, plant and equipment 853 415 495

Investment in Nguo 702

Investment in kipi 405

1555 820 495

Current assets

Inventory 368 200 190

Trade receivables 380 230 240

Cash at bank 120 115 91

Total assets 2, 423 1, 365 1, 016

Ordinary share capital 900 200 100

Retained profits 703 660 450

Shareholders' funds 1, 603 860 550

Noncurrent liabilities

10% loan stock 500 200 0

Current liabilities

Trade and other payables 140 175 346

Current tax 30 30 20

Proposed Dividends 150 100 100

Total equity and liabilities 2, 423 1, 365 1, 016

Albar and Its subsidiaries

Consolidated Income statement for the year ended 31 March 2000

Sh. Sh.

Revenue 2, 507. 00

Cost of Sales (1, 322. 00)

Gross Profit 1, 185. 00

Expenses

Distribution Costs 338. 00

Administration Expenses 261. 00

Goodwill impaired 55. 00

Finance costs 60. 00 (714. 00)

Profit before tax 471. 00

Income tax expense (170. 00)

Profit for the period 301. 00

Profit attributable to: Holding Company 228. 60

Minority interest 72. 40

301. 00

Consolidated Balance sheet as at 31 March 2000

Non Current Assets Sh. Sh.

Property, plant and equipment 1, 755. 00

Goodwill 55. 00

1, 810. 00

Current assets

Inventory 728. 00

Trade Receivables 808. 00

Cash at bank 326. 00 1, 862. 00

TOTAL ASSETS 3, 672. 00

Ordinary Share Capital 900. 00

Retained Profits 957. 20

1, 857. 20

Minority Interest 330. 80

Shareholders’ funds 2, 188. 00

Non-Current Liabilities

10% Loanstock 600. 00

Current Liabilities

Trade & Other payables 609. 00

Current tax 80. 00

Proposed dividends 195. 00 884. 00

TOTAL EQUITY & LIABILITIES 3, 672. 00

Statement of retained profits b/f Yr C/f

Albar 713. 00 (25. 00) 688. 00

Share in Nguo 96. 00 100. 00 196. 00

Share in kipi 69. 60 3. 60 73. 20

878. 60 78. 60 957. 20

Workings

Albar

As per the accounts 713. 00 (10. 00) 703. 00

Add Divs receivable 80. 00 80. 00

Interest receivable 10. 00 10. 00

Less UPPPE (50. 00) (50. 00)

Less Goodwill Impaired (55. 00) (55. 00)

713. 00 (25. 00) 688. 00

Share in Nguo

As per the accounts 610. 00 50. 00 660. 00

Less preacquisition (490. 00) ____- (490. 00)

120. 00 50. 00 170. 00

Less UPCS – (10. 00) (10. 00)

Add excess depreciation 10. 00 10. 00

Add Divs Receivable _____- – 75. 00 75. 00