

Chapter 8 Financial statements for sole proprietorships (II)

8.2 Difference between the income statement and the balance sheet (損益表和資產負債表的分別)

A **balance sheet** (資產負債表) is a simply a list of **balances** (一份餘額清單) of the **assets** (資產), **liabilities** (負債) and **capital** (資本) of a business at a point in time (在某日的狀況). It shows the **financial position** (財務狀況) of a business at a **certain date** (在某日). The balance sheet is **not part of the double-entry system** (不是複式記帳系統的一部分) and we **would not close off** (不會結清) the **account** (帳戶) of **assets** (資產), **liabilities** (負債) and **capital** (資本) at the end of an **accounting period** (在會計期末). Instead, these **account balances** (這些帳戶的餘額) will be **carried forward to the next period** (會被轉到下期).

The income statement uses the **flow concept** (流量概念) to **measure** (匯報) the **financial results** (財務表現) of a business during an **accounting period** (企業在某段會計期間) while the balance sheet uses the **stock concept** (存量概念).

8.3 Classifications of assets and liabilities (資產和負債的分類)

8.3.1 Assets (資產)

Current assets (流動資產)

Current assets (short-term assets) refer to cash and other assets that are **likely** (能在) to be **converted into cash** (變現), **sold or consumed** (出售或消耗) in the **short term** (短期內), which is usually **within a year** (通常在一年內). Examples are **inventory** (存貨), **accounts receivable** (應收帳款), **bank balance** (銀行帳戶結餘) and **cash** (現金).

Non-current assets (非流動資產)

Non-current assets (fixed assets or long-term assets) are assets that are **long-term in nature** (可長期使用) and can **benefit** (得益) the business for **more than one year** (通常超過一年). They are **material in amount** (金錢價值) and **physical substance** (物理物質). They are **acquired for use** (購買時用於) in the **operations of the business** (企業營運) and **not for resale** (不打算轉售). Examples are **land and buildings** (房地產), **fixtures and fittings** (裝修與裝置), **furniture** (家具), **machinery** (機器), **equipment** (設備) and **motor vehicles** (汽車).

8.3.2 Liabilities (負債)

Current liabilities (流動負債)

Current liabilities (short-term liabilities) refer to **liabilities** (債務) that **have to be repaid within a year** (必須在一年內償還). Examples include **accounts payable** (應付帳款) and **bank overdrafts** (銀行透支).

Non-current liabilities (非流動負債)

Non-current liabilities (long-term liabilities) refer to **liabilities** (債務) that **do not have to be repaid within a year** (不須在一年內償還). Examples include **loans** (貸款) from banks or **other financial institutions** (其他金融機構).

Class work 1

1. Given the following figures: Equipment \$67,900; Motor vehicle \$15,670; Bank overdraft \$4,920; Cash \$56,790; Inventory \$23,840; Accounts payable \$43,800; Accounts receivable \$78,200; Long-term bank loan \$45,000. Find the Capital.

$$\text{Current assets} = 56,790 + 23,840 + 78,200 = 158,830$$

$$\text{Fixed assets} = 67,900 + 15,670 = 83,570$$

$$\text{Total assets} = 158,830 + 83,570 = 242,400$$

$$\text{Current liabilities} = 4,920 + 43,800 = 48,720$$

$$\text{Long-term liabilities} = 45,000$$

$$\text{Total liabilities} = 48,720 + 45,000 = 93,720$$

$$\text{Capital} = \text{Assets} - \text{Liabilities} = 242,400 - 93,720 = 148,680$$

2. On 31 December 2009, a business had the following balances:

Non-current assets \$93,456; Current assets \$32,222; Current liabilities \$12,439; Non-current liabilities \$5,000.

Find the capital as at 31 December 2009

$$\text{Capital} = \text{Assets} - \text{Liabilities}$$

$$= (93,456 + 32,222) - (12,439 + 5,000)$$

$$= \$108,239$$

8.4 Preparation of a balance sheet (編製資產負債表)

Example

M Chan
Trial Balance as at 31 December 2008

	Dr	Cr
	\$	\$
Sales		207,000
Purchases	142,600	
Returns inwards	3,450	
Returns outwards		2,100
Carriage inwards	1,950	
Carriage outwards	1,330	
Rent and rates	15,650	
Salaries	26,000	
Discounts allowed	2,200	
Sundry expenses	1,700	
Discounts received		3,500
Shop premises	250,000	
Fixtures and fittings	53,600	
Accounts receivable	42,300	
Accounts payable		41,880
Bank	56,000	
Cash	8,200	
Loan from C Ho (repayable in 2011)		90,000
Drawings	23,000	
Capital		290,000
Inventory	6,500	
	634,480	634,480

Additional information:

The **net profit** for the year is **16,620**.

Closing inventory as at 31 December 2008 was valued at **\$5,400**.

Horizontal style (橫式)

M Chan
Balance sheet as at 31 December 2008

	\$	\$		\$
Non-current assets Note2			Capital	
Shop premises		250,000	Balance as at 1 January 2008	290,000
Fixtures and fittings		53,600	Add Net profit for the year Note4	16,620
		303,600		306,620
Current assets Note3			Less Drawings Note5	(23,000)
Inventory	5,400			283,620
Accounts receivable	42,300		Non-current liabilities	
Bank	56,000		Loan from C Ho	90,000
Cash	8,200	111,900	Current liabilities	
		415,500	Accounts payable	41,880
				415,500

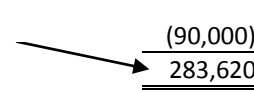
- The balance sheet is **prepared (編制)** as the **basis (基礎)** on an **accounting equation (會計等式)**. (Assets = Capital + Liabilities)
- Non-current assets are listed in **descending order (降序)** of **durability (耐用性)**, from the **most durable asset to the least durable one (由最耐用的項目開始到最不耐用)**.
- Current assets are listed in **ascending order (升序)** of **liquidity (變現能力)**, from the asset that is the **most difficult to be turned into cash to the one that is the easiest to be turned into cash, which is usually cash itself (由最難變現的項目開始到最易變現，通常是現金自己)**.
- Net profit (純利)** come from the **income statement (從損益帳戶而來)** and is **added to capital (並要加到資本中)**. On the contrary (相反), if there is a **net loss (一個淨虧損)**, it will be **deducted from capital (將會從資本中扣除)**. The amount of capital shown (顯示的資本) in the **trial balance (在試算表)** represents the **opening capital (為期初資本)** and the **closing capital** is calculated as (期末資本的計算公式為): Closing capital = Opening capital + Contribution of capital + net profit/loss – Drawings.
- Drawings (提用)** are **deducted from capital (是從資本中扣除)**.

Vertical Style (直式)

M Chan
Balance sheet as at 31 December 2008

	\$	\$
Non-current assets		
Shop premises	250,000	
Fixtures and fittings	<u>53,600</u>	303,600
Current assets		
Inventory	5,400	
Accounts receivable	42,300	
Bank	56,000	
Cash	<u>8,200</u>	
	111,900	
Less Current liabilities		
Accounts payable	<u>(41,880)</u>	
Net current assets Note 1		<u>70,020</u>
		373,620
Less Non-current liabilities		
Loan from C Ho		<u>(90,000)</u>
		<u><u>283,620</u></u>
Financed by:		
Capital		
Balance as at 1 January 2008		290,000
Add Net profit for the year		<u>16,620</u>
		306,620
Less Drawings		<u>(23,000)</u>
		<u><u>283,620</u></u>

Closing capital
Net Assets



- In a vertical-style balance sheet, **current liabilities (流動負債)** are subtracted from **current assets (流動資產)** in order to compute the amount of **net current assets (working capital) (淨流動資產)**.

$$\text{Net current assets} = \text{Current assets} - \text{Current liabilities}$$

This figure measures whether the firm has **sufficient current assets (足夠的流動資產)** to **meet its current liabilities (償還流動負債)**. In other words, it **indicates (表明)** the **firm's ability (公司的能力)** to **meet its short-term debts (償還短期債務)**. If **current liabilities (流動負債) exceed (超過) current assets (流動資產)**, the **difference (相差)** is called **net current liabilities (淨流動負債)**.

- The vertical style is more commonly used by modern businesses.

Class work 2

- Suppose a firm has the following assets and liabilities as at the end of year:

Assets: Plan and machinery \$2.5 million; Office equipment \$620,000; Inventory \$75,000; Accounts receivable \$48,000;
Cash at bank \$29,000

Liabilities: Loan from bank \$120,000 (repayable after five years); Accounts payable \$88,000

Calculate the amount of net current assets (or net current liabilities) of this firm. Does it have sufficient current assets to meet its current liabilities?

$$\text{Current assets} = \$75,000 + \$48,000 + \$29,000 = \$152,000$$

$$\text{Current liabilities} = \$88,000$$

$$\text{Net current assets} = \$152,000 - \$88,000 = \$64,000$$

Yes, the firm has sufficient current assets to meet its current liabilities.

2. On 31 December 2009, a sole proprietorship had the following balances:
 Non-current assets \$93,456; Current assets \$32,222; Current liabilities \$12,439; Non-current liabilities \$5,000
 Find the the firm's net current assets I as at 31 December 2009

$$\text{Net current assets} = \text{Current assets} - \text{Current liabilities}$$

$$= 32,222 - 12,439$$

$$= \$19,783$$

3. Given the following information about a sole proprietorship:

	Total Assets = Closing Capital + Closing Liabilities	
Total assets as at 1	Net Assets = Total Assets – Closing Liabilities	
Total liabilities as at	= Closing Capital + Closing Liabilities – Closing Liabilities	
Capital introduced	= Closing Capital	
Drawings made in A		
Net profit for April 2010		9,500

- (a) Find the capital as at 30 April 2010

$$\text{closing capital} = \text{opening capital} + \text{contribution of capital} + \text{net profit/loss} - \text{drawings}$$

$$= (80,680 - 52,000) + 3,500 + 9,500 - 12,300$$

$$= \$29,380$$

- (b) Find the net assets as at 30 April 2010

$$\text{Net assets} = \text{Closing Capital}$$

$$= \$29,380$$

4. The opening and closing capital balances for Thomas Li's business for the year ended 31 March 2010 were \$34,567 and \$44,521, respectively. The net profit for the year was \$7,222. Find the Li's capital contribution during the year.

$$\text{closing capital} = \text{opening capital} + \text{contribution of capital} + \text{net profit/loss} - \text{drawings}$$

$$44,521 = 34,567 + \text{contribution of capital} + 7,222$$

$$\text{contribution of capital} = \$2,732$$

5. Joe Choi commenced business on 1 January 2009. He brought in non-current assets and inventory totalling \$87,000. He also opened a business bank account and deposited \$2,000 of his own money into the account. On 31 December 2009, the business had net assets of \$44,230. The net profit for the year was \$11,000. Find Joe's drawings for the year.

$$\text{closing capital} = \text{opening capital} + \text{contribution of capital} + \text{net profit/loss} - \text{drawings}$$

$$44,230 = 87,000 + 2,000 + 11,000 - \text{drawings}$$

$$\text{drawings} = \$55,770$$

6. The following are balance of T Chan as at 31 December 2007. Draw up a balance sheet as at that date.

	\$
Capital as at 1 January 2007	100,000
Fixtures and fittings	47,000
Accounts receivable	12,900
Accounts payable	8,100
Bank	31,300
Drawings	31,700
Inventory as at 31 December 2007	42,100
Net profit for the year	56,900

Vertical Style

**T Chan
Balance sheet as at 31 December 2007**

	\$	\$
Non-current assets		
Fixtures and fittings		47,000
Current assets		
Inventory	42,100	
Accounts receivable	12,900	
Bank	31,300	
	86,300	
Less Current liabilities		
Accounts payable	8,100	
Net current assets		78,200
		125,200
Financed by:		
Capital		
Capital as at 1 January 2007		100,000
Add Net profit for the year		56,900
		156,900
Less Drawings		(31,700)
		125,200

7. Draw up a balance sheet for T Lo as at 31 December 2008 from the following balances:

	\$
Accounts receivable	41,900
Bank	30,600
Accounts payable	12,900
Inventory as at 31 December 2008	124,100
Drawings	45,000
Cash	400
Net profit for the year	59,100
Capital as at 1 January 2008	250,000
Office equipment	80,000

Horizontal style

**Martin Lee
Balance sheet as at 31 December 2008**

	\$	\$		\$
Non-current assets			Capital	
Office equipment		80,000	Balance as at 1 January 2008	250,000
			Add Net profit for the year	59,100
Current assets				309,100
Inventory	124,100		Less Drawings	(45,000)
Accounts receivable	41,900			264,100
Bank	30,600		Current liabilities	
Cash	400	197,000	Accounts payable	12,900
		277,000		277,000

Trial Balance as at 31 March 2009

	Dr	Cr
	\$	\$
Office equipment	220,000	
Furniture and fixtures	90,600	
Accounts receivable	53,920	
Accounts payable		59,310
Bank overdraft		38,260
Cash	9,390	
Drawings	14,000	
Loan from bank (long-term)		200,000
Capital		130,000
Income statement	22,810	
Closing Inventory	16,850	
	<u>427,570</u>	<u>427,570</u>

Vertical style

Balance sheet as at 31 March 2009

	\$	\$	\$
Non-current assets			
Office equipment		220,000	
Furniture and fixtures		90,600	310,600
Current assets			
Inventory		16,850	
Accounts receivable		53,920	
Cash		9,390	
		80,160	
Less Current liabilities			
Accounts payable	59,310		
Bank overdraft	38,260	(97,570)	
Net current assets			(17,410)
			293,190
Less Non-current liabilities			
Loan from bank			(200,000)
			93,190
Financed by:			
Capital			
Balance as at 1 April 2008			130,000
Less Net loss for the year			(22,810)
			107,190
Less Drawings			(14,000)
			93,190

Horizontal style

Balance sheet as at 31 March 2009

	\$	\$	\$	\$
Non-current assets			Capital	
Office equipment		220,000	Balance as at 1 April 2008	130,000
Furniture and fixtures		90,600	Less Net loss for the year	(22,810)
		310,600		107,190
Current assets			Less Drawings	(14,000)
Inventory	16,850			93,190
Accounts receivable	53,920		Non-current liabilities	
Cash	9,390	80,160	Loan from bank	200,000
			Current liabilities	
			Accounts payable	59,310
			Bank overdraft	38,260
		390,760		97,570
				390,760

9. Following is the trial balance of K Sung as at 31 March 2006. Draw up a set of final accounts for the year ended 31 March 2006.

K Sung
Trial Balance as at 31 March 2006

	Dr	Cr
	\$	\$
Inventory as at 1 April 2005	181,000	
Purchases and sales	791,800	923,000
Carriage inwards	4,200	
Carriage outwards	15,700	
Returns outwards		6,200
Wages and salaries	182,400	
Rent and rates	30,150	
Telephone charges	16,240	
Packing charges for goods	12,160	
Insurance	5,250	
Sundry expenses	3,150	
Buildings	220,000	
Accounts receivable and accounts payable	143,200	181,600
Bank	29,700	
Cash	9,650	
Loan from K Kwan (repayable in 2009)		200,000
Drawings	75,000	
Capital		408,800
	<u>1,719,600</u>	<u>1,719,600</u>

Inventory as at 31 March 2006 was valued at \$33,900. The packing charges for goods should add to cost of goods sold.

K Sung
Income Statement for the year ended 31 March 2006

	\$	\$		\$
Opening inventory		181,000	Sales	923,000
Add Purchases	791,800		Gross loss c/d	26,060
Carriage inwards	4,200			
Packing charges	12,160			
	808,160			
Less Returns outwards	(6,200)	801,960		
		982,960		
Less Closing inventory		(33,900)		
Cost of goods sold		949,060		949,060
Gross loss b/d		26,060	Net loss	278,950
Carriage outwards		15,700		
Wages and salaries		182,400		
Rent and rates		30,150		
Telephone charges		16,240		
Insurance		5,250		
Sundry expenses		3,150		
		278,950		278,950

K Sung
Balance sheet as at 31 March 2006

	\$	\$		\$	\$
Non-current assets			Capital		
Buildings		220,000	Balance as at 1 April 2005		408,800
			Less Net loss for the year	278,950	
Current assets			Drawings	75,000	(353,950)
Inventory	33,900				54,850
Accounts receivable	143,200		Non-current liabilities		
Bank	29,700		Loan from K Kwan		200,000
Cash	9,650	216,450	Current liabilities		
			Accounts payable		181,600
		436,450			436,450

8.5 Balancing off the capital account (結平資本帳戶)

We would transfer (轉到) the balances (餘額) of the profit and loss account (income statement) (損益帳戶) and the drawings account (提用帳戶) to the capital account (資本帳戶內). The double entries required are (所需的複式記帳如下):

To transfer the balance of the profit and loss account (把損益帳戶的餘額轉出)

If there is a net profit,

Dr Profit and loss account
Cr Capital account

If there is a net loss,

Dr Capital account
Cr Profit and loss account

To transfer the balance of the drawings account (把提用帳戶的餘額轉出)

Dr Capital account
Cr Drawings account

The capital account of M Chan's business is balanced off at the end of the year as follows:

Capital							
2008		\$	2008		\$		
Dec	31	Drawings	23,000	Jan	1	Balance b/f	290,000
"	31	Balance c/f	283,620	Dec	31	Profit and loss (net profit)	16,620
			<u>306,620</u>				<u>306,620</u>

Class work 3

- Given the following figures as at 31 December 2010: Opening capital \$67,900; Net profit for the year \$15,670 and Drawings \$4,920. Write up and balance off the capital account at the end of the accounting year.

Capital							
2010			\$	2010		\$	
Dec	31	Drawings	4,920	Jan	1	Balance b/f	67,900
"	31	Balance c/f	78,650	Dec	31	Profit and loss (net profit)	15,670
			<u>83,570</u>				<u>83,570</u>

- Following is the part of trial balance and income statement as at 31 March 2006. Write up and balance off the capital account at the end of the accounting year.

Trial Balance as at 31 March 2006

	Dr	Cr
	\$	\$
Drawings	75,000	
Capital		408,800

Income Statement for the year ended 31 March 2006

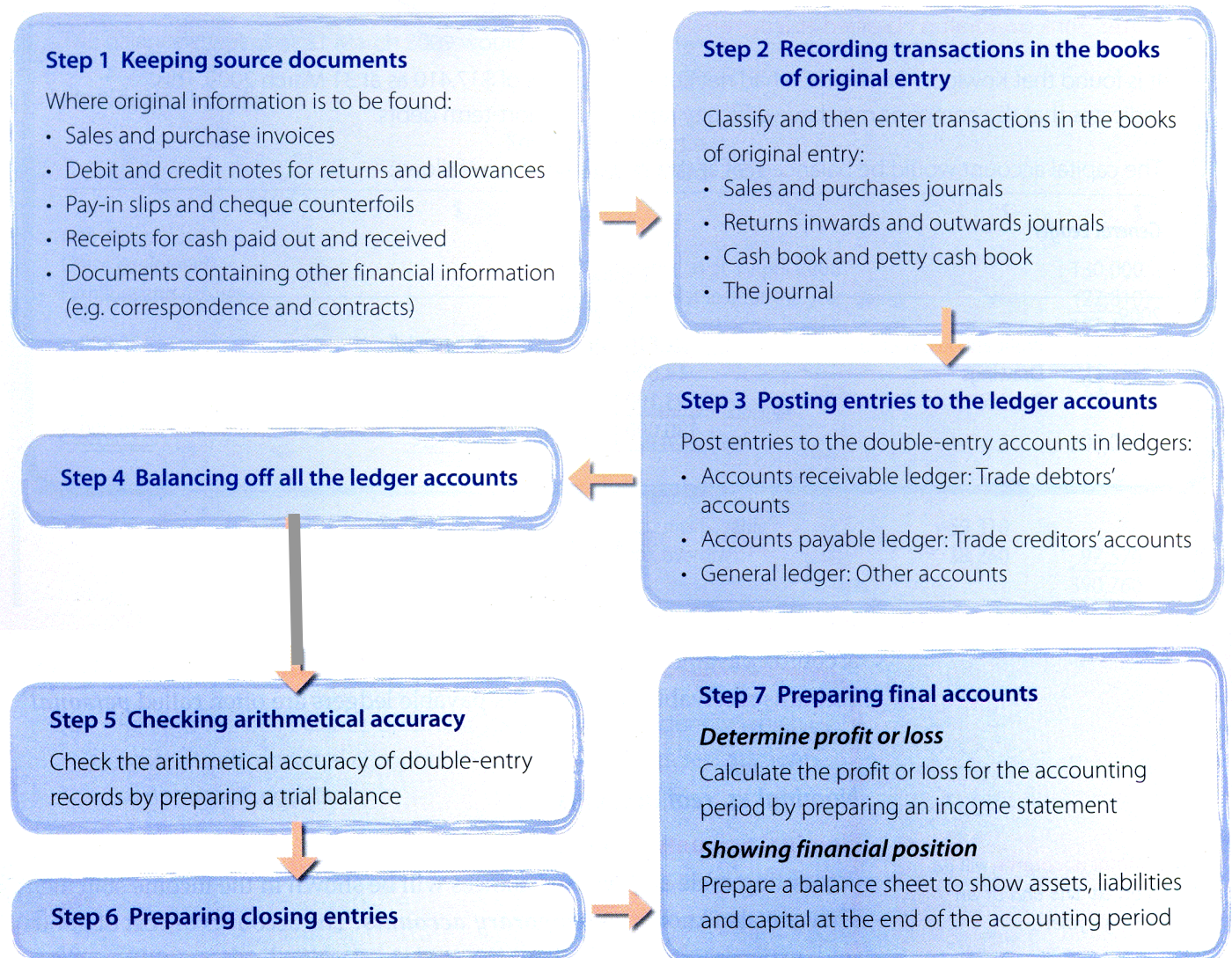
	\$	\$
Net loss		278,950

Capital							
2006			\$	2005		\$	
Mar	31	Drawings	75,000	Apr	1	Balance b/f	408,800
"	31	Profit and loss (net loss)	278,950				
"	31	Balance c/f	54,850				
			<u>408,800</u>				<u>408,800</u>

8.6 Accounting cycle (會計循環)

An accounting cycle (會計循環) is refers (指) to the process (過程) from the recording of daily transactions (由日常交易記錄) in the books and ledgers (在原始分類簿和分類帳) to the preparation of financial statements (直至編製財務報表) at the end of an accounting period (在會計期末). In general, each accounting cycle goes through the following steps:

1. Keeping the source documents for transactions made (保存交易的原始單據)
2. Recording the transactions in the books of original entry according to the information in source documents (根據原始單據上的資料，把交易記錄在原始分錄簿內)
3. Posting the entries from the books of original entry to ledger accounts by means of double entry (運用複式記帳法，把原始分錄簿上的記錄過帳到分類帳帳戶內)
4. Balancing off the ledger accounts at the end of each month (結平所有分類帳帳戶)
5. Preparing a trial balance in order to check the accuracy of double entries made in the ledger accounts (編製試算表，以檢查分類帳帳戶的複式記帳的準確性)
6. Preparing closing entries (編製結帳分錄)
7. Preparing financial statements, usually the income statement and the balance sheet, at the end of the accounting period (在會計期末，編製財務報表)



8.7 Classifications of ledger accounts (帳戶的分類)

Accounts are normally divided into three types (分成三類) and kept (放在) in three separate ledgers (三本獨立的分類帳):

Name	Type of account kept
Accounts payable ledger (also called purchases ledger)	Trade creditors' accounts
Accounts receivable ledger (also called sales ledger)	Trade debtors' accounts
General ledger	All other accounts

Ledger accounts can also be classified in the following ways (帳戶也可按以下的方法分類).

Personal vs. impersonal accounts (人名帳戶與非人名帳戶)

Personal accounts: accounts of individuals and organizations (個人和機構帳戶) having transactions with the firm (與企業進行交易). All the trade debtor's (銷貨債務人) and creditors' accounts (購貨債權人) in the accounts receivable ledgers (應收總帳) and accounts payable (應付總帳) ledgers are classified (分類) as personal accounts (人名帳戶). Therefore, the accounts receivable and accounts payable ledgers are often called personal ledgers (人名分類帳).

Impersonal accounts: accounts other than personal accounts (人名帳戶以外的其他帳戶). The accounts of Wages and salaries (工資和薪金), Furniture and fixtures (家具及裝置), Bank (銀行), Cash (現金) and so on are classified as impersonal accounts (非人名帳戶).

Nominal vs. real accounts (虛帳戶與實帳戶)

Nominal accounts: accounts that will be closed off (帳戶會被結清) at the end of an accounting cycle (會計循環終結時) and whose balances (帳戶餘額) will be shown (會顯示在) in the income statement (損益表上). They are also known as temporary accounts (又稱臨時帳戶). The accounts of cost of goods sold (銷貨成本), expenses (費用), sales and other revenues (銷貨和其他收益等帳戶) are classified as nominal accounts (虛帳戶).

Real accounts: accounts whose balances (帳戶餘額) will be carried forward (會轉到) to the next accounting cycle (下一個會計循環) and will appear (顯示在) in the balance sheet (資產負債表上). They are also known as permanent accounts (又稱永久帳戶). The accounts of assets (資產), liabilities (負債) and capital (資本) are classified as real accounts (實帳戶).

Features of sole proprietorships (獨資經營的特點)

Sole proprietorships are distinct from other forms of business ownership in many ways, as shown below:

Capital can only be raised from one owner (資金由一個東主獨自籌集)

For partnerships, capital can be raised from more than one owner. For public limited companies, capital can be raised from the public by issuing shares.

All profits made belong to one owner (所有利潤屬於一個東主)

For partnerships, any profits made will be shared by all the partners. For limited companies, part of the profits may be distributed as dividends to shareholders, with the rest kept in company as reserves.

The owner is free to make drawings (東主可以自由提用)

For limited companies, shareholders are not allowed to make drawings. For partnerships, interest is usually charged on drawings made by partners. But there is no restriction on drawings made by a sole proprietor.