

FINANCIAL MANAGEMENT

Financial Management means planning, organizing, directing and controlling the financial activities such as procurement and utilization of funds of the enterprise. It means applying general management principles to financial resources of the enterprise.

FINAL ACCOUNTS

While the Trial Balance checks the accuracy of ledger balances, the final account reveals two facts:

1. Whether the business is in profit or loss during the period covered by the Trial Balance. A Trading and Profit & Loss account also known as income statement is prepared for this purpose.
2. What is the financial position (financial position means picture of assets and liabilities) of the business? This is judged by preparing a balance sheet for the business.

Thus, income statement represents the summary of all the expenses and incomes occurred during the financial year whereas balance sheet represents the financial position of the concerned organization at a particular point of time, usually at the end of financial year i.e., 31st December. Final accounts are statutory requirements for all type of registered organizations. They are popularly known as Financial Statements.

The following are the three financial statements prepared for the preparation of final accounts:

- Trading account, it shows Gross Profit/Loss of the business.
- Profit & loss account, it shows the Net Profit/ Loss of the business.
- Balance sheet, it shows the financial position of the business.

Trading Account

The trading account shows the result of buying and selling goods. In preparing, this account, the general established charges are ignored and only the transactions in the goods are included. It's a normal account and is prepared for calculating the Gross Profit/Loss arising as a result of trading activities of the business.

Items Appearing In the Trading Account

- **Opening stock:** stock on the hand of commencement of the year or period is termed as Opening Stock.
- **Purchases:** it indicates total purchases both cash and credit made during the year.
- **Purchases Returns or Return outwards:** Purchases returns must be subtracted from the total purchases to get the net purchases. Net purchases will be shown in the trading account.
- **Goods available for sale:** This is the total of opening stock plus the Net purchases

- **Direct Expenses on purchases:** some of the direct expenses include;
 - *Wages:* it is also known as productive wages or manufacturing wages.
 - *Carriage on purchases or carriage in wards*

Net Purchases = (Purchases + Carriage on purchases + wages) - Purchases Returns

- **Cost of sales:** Closing stock must be subtracted from the Goods available for sale.
- **Sales:** Total sales (including both cash and credit) made during the year.
- **Sales Returns or Returns Inwards:** sales returns must be subtracted from the Total sales to get Net Sales.

Net Sales = Sales - Sales Returns / Returns Inwards

Gross profit/loss: Net Sales - Cost of sales

- **Closing stock:** Generally, Closing stock does not appear in the Trial Balance. It appears outside the Trial Balance. It represents the value of goods at the end of the trading period.

Format of a trading account

Kamuntu
Trading account
For the period ended 31/12/2015

Particulars	Amount (Shs)	Amount (Shs)	Amount (Shs)
Sales		XXX	
Less: Sales Returns		<u>XXX</u>	
Net Sales			XXXX
Less: Cost Of Sales			
Opening Stock		XXX	
Add Purchases	XXX		
Carriage In Wards	XXX		
Wages	<u>XXX</u>		
	XXXX		
Less: Purchase Returns	<u>XXX</u>		
Net Purchases		XXXX	
Goods Available For Sale		<u>XXXX</u>	
Less: Closing Stock		<u>XXX</u>	
Cost Of Sales			<u>XXXX</u>
Gross Profit/Loss			<u>XXXXX</u>

Example

On 31st December 2016, the books of Maslow show the following balances:

Items	Shs
Opening stock	1000
Purchases	2600
Sales	9000
Returns outwards	200
Returns inwards	450
Carriage inwards	40
Wages	200

Closing stock was valued at Shs400

Solution

Maslow

Trading account

For the period ended 31/12/2016

Particulars	Amount (Shs)	Amount (Shs)	Amount (Shs)
Sales		9000	
Less: Sales Returns		<u>450</u>	
Net Sales			8550
Less: Cost Of Sales			
Opening Stock		1000	
Add Purchases	2600		
Carriage In Wards	40		
Wages	<u>200</u>		
	2840		
Less: Purchase Returns	<u>200</u>		
Net Purchases		<u>2640</u>	
Goods Available For Sale		3640	
Less: Closing Stock		<u>400</u>	
Cost Of Sales			<u>3240</u>
Gross Profit/Loss			<u>5310</u>

Profit And Loss Account

A profit and loss account is an account into which all gains and losses are collected, in order to ascertain the excess of gains over the losses or vice-versa.

Items appearing in a profit and loss account

- **Gross profit or loss.** It is transferred to the P&L account from the trading account. Gross profit is transferred to the debit side whereas gross loss is transferred to the credit side.
- **Any incomes or gains.** Any income or gains of the business from sources other than sales are recorded on the credit side of profit and loss account.
- **Office and administrative expenses.** Examples include salaries, office rent, lighting, stationery
- **Selling and distribution expenses.** Include advertising expense, commission, carriage outwards, and bad debts
- **Miscellaneous expenses.** Such as, interest on loan, interest on capital, depreciation etc.

Format of a Profit And Loss Account

Tim Enterprises
Profit And Loss Account
For The Period Ended 31/12/2017

	Shs	Shs	Shs
Gross Profit/Loss			xxx
Add: Miscellaneous Income			
Rent Income			xxx
Interest Income			xxx
Decrease in provision for bad debts			xxx
Commission Received			xxx
Discount Received			xxx
Gross Income			xxxx
Less: Operating Expenses			
Salaries And Wages		xxx	
Interest Expenses		xxx	
Rent And Rates		xxx	
Carriage Outwards		xxx	
Depreciation		xxx	
Discount Allowed		xxx	
Motor Expenses		xxx	
Total Expenses			<u>xxxx</u>
Net Profit/Loss			<u>xxxxx</u>

Example

Prepare the profit and loss account, from the following balance of Mr. Nene for the year ending 31.12.2017.

Office rent	3000
Printing expenses	2,200
Insurance	1,400
Discount received	400
Advertisement	3,600
Salaries	8000
Stationaries	2,400
Discount allowed	600
Travelling expenses	2,600

Gross profit transferred from the trading account is shs25,000

Solution

Mr. Nene

Profit and loss account

For the year ended 31.12.2017.

	Shs	Shs	Shs
Gross Profit/Loss			25,000
Add: Miscellaneous Income			
Discount Received			600
Gross Income			25600
Less: Operating Expenses			
Office rent			
Printing expenses			
Insurance		400	
Advertisement		3,600	
Salaries		2,400	
Discount Allowed		600	
Travelling Expenses		2,600	
Total Expenses			9,600
Net Profit/Loss			<u>1,600</u>

COMBINING THE TRADING ACCOUNT WITH THE PROFIT AND LOSS ACCOUNT

Out of the above three statements, trading, profit and loss accounts are prepared together, and balance sheet is prepared, independently. Here, it is very necessary to remember that these accounts are not prepared in the ledger rather than on the plain sheets or papers. These papers are filled for future reference.

Format Of The Trading, Profit And Loss Account/ Income Statement/Statement Of Comprehensive Income

MR. NENE

INCOME STATEMENT/STATEMENT OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED 31.12.2017.

PARTICULARS	AMOUNT (SHS)	AMOUNT (SHS)	AMOUNT (SHS)
Sales		xxx	
Less: sales returns		xxx	
Net sales			xxxx
Less: cost of sales			
Opening stock		xxx	
Add: purchases	xxx		
Carriage inwards	xxx		
Wages	xxx		
	xxxx		
Less: purchase returns	xxx		
Net purchases		<u>xxx</u>	
Cost Goods available for sale		xxxx	
Less: closing stock		<u>xxx</u>	
Cost of sales			<u>xxx</u>
Gross Profit/Loss			xxxx
Add: Miscellaneous Income			
Rent Income			xxx
Decrease in provision for bad debts			xxx
Commission Received			xxx
Discount Received			xxx
Gross Income			xxxx
Less: Operating Expenses			
Salaries And Wages		xxx	
Rent And Rates		xxx	
Carriage Outwards		xxx	
Depreciation		xxx	
Motor Expenses		xxx	
Total Expenses			<u>xxxx</u>
Net Profit/Loss			<u>xxxxx</u>

Example

The following trial balance was extracted from the books of Mr. Nene a trader in Kasese district.

Prepare (i) Trading And Profit& Loss Account/Income Statement

Trial balanceAs at 31.12.2014

Details	Dr.(Shs)	Cr.(Shs)
Cash in hand	2,000	
Capital		200,000
Machinery	60,000	
Sales		254,800
Stock 1.1.2014	50,000	
Creditors		40,000
Bills receivable	1,600	
Bank overdraft		22,000
Sundry debtors	50,000	
Return outwards		3,000
Wages	70,000	
Discount received		1,800
Land	40,000	
Bills payable		1,800
Carriage inwards	2,400	
Purchases	180,000	
Salaries	24,000	
Rent and rates	4,000	
Postage	1,000	
Returns inwards	3,200	
Drawings	10,000	
Furniture	18,000	
Interest expenses	600	
Cash at bank	6,600	
Total	523,400	523,400

Stock as on 31.12.2014 to shs100,000

Solution**MR. NENE****INCOME STATEMENT/STATEMENT OF COMPREHENSIVE INCOME****FOR THE YEAR ENDED 31.12.2017.**

PARTICULARS	AMOUNT (SHS)	AMOUNT (SHS)	AMOUNT (SHS)
Sales		254,800	
Less: sales returns		3,200	
Net sales			251,600
Less: cost of sales			
Opening stock		50,000	
Add: purchases	180,000		
Carriage inwards	2,400		
Wages	<u>70,000</u>		
	252,400		
Less: purchase returns	3,000		
Net purchases		<u>249,400</u>	
Cost Goods available for sale		299,400	
Less: closing stock		<u>100,000</u>	
Cost of sales			<u>199,400</u>
Gross Profit/Loss			52,200
Add: Miscellaneous Income			
Discount Received			<u>1,800</u>
Gross Income			54,000
Less: Operating Expenses			
Salaries		24,000	
Rent And Rates		4,000	
Postage		1,000	
Interest expenses		600	
Total Expenses			<u>29,600</u>
Net Profit			<u>24,400</u>

BALANCE SHEET

Balance sheet is a statement, which shows the financial position of the business on a particular day. “The balance sheet is a statement at a particular date showing on one side the company’s property and possessions (Assets) and on the other hand the liabilities and capital.

Thus, we can say that

- Balance sheet is a statement not an account.
- It is prepared to show the financial position of the business.
- It records all the assets and liabilities of the business.
- It shows the financial position on a particular day not for a period of time.

ITEMS APPEARING ON A BALANCE SHEET

Assets

Assets of a business are what it owns. They can be classified as:

Fixed assets/Non-current assets: All those assets which are owned by the business and last for more than an accounting year. Examples include Land, building, machinery, vehicles, furniture and fixtures and the like.

Current assets: it includes all those assets which either in the form of cash or can be easily converted into cash within one accounting period. Current assets include cash, debtors/accounts receivables and stock/inventory.

Liabilities.

Liabilities represent what the business owes to outside persons other than owners. These liabilities are classified on basis of time period of repayment.

Long term liabilities/non-current liabilities: these are liabilities which the business owes for more than one accounting period e.g. long term bank loans, debentures, mortgage etc.

Current liabilities: these are short term debts of the business that are to be repaid within one accounting period e.g. creditors and bank overdraft, bills payable

Owner’s Equity/Capital/Shareholders equity

Owner’s equity represents what the business owes its owner. It is equal to total assets minus total liabilities.

Important points regarding the Balance Sheet

- The heading of balance sheet is “as on a particular date” Thus a balance sheet may have different figures on different dates
- Balance sheet is based on the accounting equation

$$\text{Assets} = \text{Liabilities} + \text{Owner's Equity}$$

FORMAT OF THE BALANCE SHEET

Mr. Nene
Balance Sheet
As at 31/12/2014

Particulars	Amount (Shs)	Amount (Shs)	Amount (Shs)
ASSETS			
<u>Non-current/fixed assets</u>	<u>Cost</u>	<u>Acc. Depreciation</u>	<u>NBV</u>
Land	xxx	xxx	xxx
Buildings	xxx	xxx	xxx
Plant and machinery	xxx	xxx	xxx
Fixtures and fittings	xxx	xxx	xxx
Motor vehicle	<u>xxx</u>	<u>xxx</u>	<u>xxx</u>
	<u>xxxx</u>	<u>xxxx</u>	<u>xxxx</u>
<u>Current Assets</u>			
Stock		xxx	
Debtors/ Accounts receivable		xxx	
Bank		xxx	
Cash		<u>xxx</u>	
			<u>xxxx</u>
Total Assets			<u>xxxxxx</u>
<u>EQUITY AND LIABILITIES</u>			
Capital			xxx
Add: Net profit			xxx
			<u>xxxxxx</u>
Less: Drawings			xxx
Owner's equity			<u>xxxxxx</u>
<u>LIABILITIES</u>			
<u>Long term liabilities</u>			
Bank loan		xxx	
Mortgage		xxx	
Debenture		xxx	
<u>Current liabilities</u>			
Creditors/Accounts payable	xxx		
Banks overdraft	xxx		
		<u>xxxx</u>	
Total Capital and liabilities			<u>xxxxxx</u>

Or

**Mr. Nene
Balance Sheet
As at 31/12/2014**

Particulars	Amount (shs)	Amount (shs)	Amount (shs)
<u>Fixed assets</u>	Cost	Acc. Depreciation	Net book value
Shop fittings	xxxx	xxxx	xxxx
Motor van	<u>xxxx</u>	<u>xxxx</u>	<u>xxxx</u>
Total fixed assets	<u>xxxxx</u>	<u>xxxxx</u>	xxxxx
<u>Current assets</u>		xxxx	
Stock	xxxx		
Debtors	<u>xxxx</u>		
Less: provision for bad debts		xxxx	
		xxxx	
Cash at bank		<u>xxxx</u>	
Prepaid rates		xxxxxxx	
Total current assets			
<u>Less: Current liabilities</u>			
Creditors	xxxx		
Outstanding salaries and wages	xxxx		
Outstanding telephone bills	<u>xxxx</u>		
Total current liabilities		<u>xxxxxxx</u>	
Working capital			<u>xxxxx</u>
Capital employed			<u>xxxxxxx</u>
<u>Financed by</u>			
Capital		xxxx	
Add: Net profit		<u>xxxx</u>	
		xxxx	
Less: Drawings		<u>xxxx</u>	
Owners' equity			<u>xxxxxxx</u>

END OF YEAR ADJUSTMENTS

It has already been shown that the ultimate object of book keeping is the preparation and compilation of the trading, profit and loss/income statement account and the balance sheet to enable the trade to ascertain.

- i) The result of the business operation during a given period
- ii) The financial position at the end of a given period.

In order to obtain these results accurately, it is necessary to make adjustments for;

- Accrued expenses
- Prepaid expenses
- Income due
- Income in advance
- Depreciation
- Provision for bad debts

The above adjustments and there accounting treatment is discussed below.

Accrued expenses

These are also termed as expenses owing, outstanding expenses, and expenses due, expenses in arrears or unpaid expenses. They are expenses which relate to the current accounting period, but have not yet been paid.

Thus the amount due/unpaid is added on the related expenses in the income statement that very amount (unpaid amount) is listed as a current liability in the balance sheet.

Prepaid expenses

These are alternatively called expenses paid in advance. They refer to expenses which have already been paid but relate to the following accounting period. The accounting rules state that an entrepreneur should only record/charge the amount which relate to that period.

Thus the amount prepaid (paid in advance)is deducted from the total paid in the income statement and very amount is listed as a current asset in the balance sheet.

Income due

This is also called unpaid income, accrued income, outstanding income, and increase in arrears. This is income that relate to the current accounting period but have period not yet been received. Thus the accrued income is added on to the total incomes received (added to gross profit) in the profit and loss account and the balance sheet they appear as current assets.

Income in advance

This is income (revenue) that has been received but relate the following (next) accounting period. The accounting rules say that an entrepreneur should record those incomes that relate to very accounting period.

Thus the income received in advance is deducted off the total incomes received and in the balance sheet appears as current liability.

Depreciation

Depreciation refers to a constant reduction in the value of the fixed assets. This fall in value may be due to wear and tear, passage of time, obsolescence, price fluctuations, weather conditions etc.

This loss in value is charged against the profit made during the working life of the assets. i.e the amount of depreciation is added on to the operating expenses in the profit and loss account and in the balance sheet the amount of the depreciation is deducted from the value of the fixed asset to determine its net book value.

Provisions

A provision is an amount charged against the profit for known liability. It is that part of capital/profits that is set to cater for possible losses.

Such amount set aside out of the profits to cater for specific risks may take form of;

- i) Provision for bad debts. To cater for any debts the recovery of which is doubtful or impossible.
 - On creation: Debit profit and loss account or it is charged against the profits and in the balance sheet the provision is deducted from the value of debtors.
 - To increase provision. The amount by which provision has increased is added to operating expenses in the income statement and the total provision (ie the original plus the increase)is deducted from the value of debtors in the balance sheet.
 - To decrease provisions. The amount by which provision has reduced is added on the total incomes (added to the gross profit) in the profit and loss account and in the balance sheet the balance provision (original minus the decrease) is deducted from the value of debtors.)

Example

The following information was contained in the trail balance of Henry Trader.

Trail balance as at 31/12/2014

Items	Dr.	Cr.
Capital.		205,000
Drawing	100,000	
Cash in hand	3,000	
Cash at bank	42,000	
Fixtures and fittings	118,000	
Stock 01/01/2014	80,500	
Purchases	420,000	
Sales		650,000
Returns	5000	3000
Debtors	38,000	
Creditors		51,500
Carriage inwards	4,000	
Rent and rates	82,000	
Light and water	9,000	
Discount received		4,500
Miscellaneous expenses	13,000	
Total	909,500	909,500

Additional information

Closing stock was valued at shs 96,000

Out of shs82,000 for rent and rates shs10,000 was rent paid in advance

Depreciate fixtures and fittings at a rate of 10% p.a

A debt of shs8,000 is to be written off as irrecoverable

An amount of shs3,000 was due for light and water.

Required: prepare an income statement and balance sheet.

Solution

**Henry's
Income Statement
For The Year Ended 31/12/2014**

Particulars	Amount (shs)	Amount (shs)	Amount (shs)
Sales		650,000	
Less: return in wards		<u>5,000</u>	
Net sales			645,000
Less: cost of sales			
Opening stock		80,500	
Add: purchases	420,000		
Carriage inwards	<u>4,000</u>		
	424,000		
Less: returns outwards	<u>3,000</u>		
Net purchases		<u>421,000</u>	
Goods available for sale		501,500	
Less: closing stock		<u>96,000</u>	
Cost of sales			<u>405,000</u>
Gross profit			239,500
Add: discount received			<u>4,500</u>
Gross income			244,000
Less: Operating expenses			
Rent and rates	82,000		
Less: prepaid rent	<u>10,000</u>	72,000	
Light and water	9000		
Add: due	<u>3,000</u>	12,000	
Miscellaneous expenses		13,000	
Depreciation on fixtures& fit		11,800	
Bad debts		<u>8,000</u>	
Total expenses			<u>116,000</u>
Net profit			<u>127,000</u>

Henry's
Balance sheet
As at 31/12/2014

Particulars	Amount (shs)	Amount (shs)	Amount (shs)
<u>Fixed assets</u>	Cost	Acc. Depreciation	Net book value
Fixtures and fittings	<u>118,000</u>	<u>11,800</u>	<u>106,200</u>
Total fixed assets	<u>118,000</u>	<u>11,800</u>	106,200
<u>Current assets</u>			
Stock	96,000		
Debtors	30,000		
Cash at bank	42,000		
Cash at hand	3,000		
Prepaid rent	<u>10,000</u>		
Total current assets		181,000	
<u>Less: Current liabilities</u>			
Creditors	51,500		
Light and water due	<u>3,000</u>		
Total current liabilities		<u>54,500</u>	<u>126,500</u>
Working capital			<u>232,700</u>
Capital employed			
<u>Financed by</u>			
Capital		205,500	
Add: Net profit		<u>127,200</u>	
		332,700	
Less: Drawings		<u>100,000</u>	<u>232,700</u>
Owners' equity			

Example

The following balances were extracted from the records of FOSTER's books as at 31/12/2017

Item	Shs
Sales	40,000,000
Purchases	35,000,000
Sales returns	500,000
Stock 1/01/2017	10,000,000
Provision for doubtful debts	80,000
Salaries and wages	3,000,000
Rates	600,000
Telephone	100,000
Shop fittings at cost	4,000,000
Motor van at cost	3,000,000
Debtors	980,000
Creditors	700,000
Bad debts	20,000
Capital	17,900,000
Cash at bank	300,000
Drawings	1,800,000
Purchases returns	620,000

Additional information

Salaries and wages outstanding shs500,000

Stock as at 31/12/2017 shs12,000,000

Prepaid rates shs50,000

The provision for doubtful debts to be increased to 10% of debtors

Telephone bill outstanding shs22,000

Depreciate shop fittings at cost at 10% per annum, and motor van at 20% per annum.

Required:

- i) Prepare the income statement and balance sheet for Foster as at 31/12/2017

Solution

**Foster's
Income statement**

For the period ended 31/12/2018

Particulars	Amount (shs)	Amount (shs)	Amount (shs)
Sales		40,000,000	
Less: return in wards		<u>500,000</u>	
Net sales			39,500,000
Less: cost of sales			
Opening stock		10,000,000	
Add: purchases	35,000,000		
Less: returns outwards	<u>620,000</u>		
Net purchases		<u>34,380,000</u>	
Goods available for sale		44,380,000	
Less: closing stock		<u>12,000,000</u>	
Cost of sales			<u>32,380,000</u>
Gross profit			7,120,000
Less: Operating expenses			
Salaries and wages	3,000,000		
Add : accrued salaries	<u>500,000</u>	3,500,000	
Rates	600,000		
Less : prepaid rates	<u>50,000</u>	550,000	
Telephone	100,000		
Add: outstanding	<u>22,000</u>	122,000	
Bad debts		20,000	
Increase in provision for bad debts		18,000	
Depreciation			
Shop fittings		400,000	
Motor van		<u>600,000</u>	
Total expenses			<u>5,210,000</u>
Net profit			<u>1,910,000</u>

Foster's
Balance sheet
As at 31/12/2018

Particulars	Amount (shs)	Amount (shs)	Amount (shs)
<u>Fixed assets</u>	Cost	Acc. Depreciation	Net book value
Shop fittings	4,000,000	400,000	3,600,000
Motor van	<u>3,000,000</u>	<u>600,000</u>	<u>2,400,000</u>
Total fixed assets	<u>7,000,000</u>	<u>1,000,000</u>	6,000,000
<u>Current assets</u>		12,000,000	
Stock	980,000		
Debtors	<u>98,000</u>		
Less: provision for bad debts		882,000	
		300,000	
Cash at bank		<u>50,000</u>	
Prepaid rates		13,232,000	
Total current assets			
<u>Less: Current liabilities</u>	700,000		
Creditors	500,000		
Outstanding salaries and wages	<u>22,000</u>	<u>1,222,000</u>	
Outstanding telephone bills			
Total current liabilities			<u>12,010,000</u>
Working capital			<u>18,010,000</u>
Capital employed		17,900,000	
<u>Financed by</u>		<u>1,910,000</u>	
Capital		1,981,000	
Add: Net profit		<u>1,800,000</u>	
Less: Drawings			<u>18,010,000</u>
Owners' equity			