



# FUNDAMENTALS OF ACCOUNTANCY, BUSINESS, AND MANAGEMENT




# CHAPTER 1 Statement of Financial Position



## Learning Objectives

- To understand the purpose of the Statement of Financial Position or SFP
- To enumerate the basic elements of the SFP
- To describe the nature of the accounts reported on the SFP
- To prepare SFP using report format and account format
- To prepare a classified SFP
- To determine the normal balances of the SFP accounts




## A Snapshot of the Financial Position

- The **Statement of Financial Position** or **SFP** is divided into two parts:
  - ✓ The **assets** are on one side and the **claims** are on the other side.
  - ✓ Claims are made up of *liabilities* and *equity*.
  - ✓ The total of the assets should be equal to the total of the claims.

Assets	Liabilities
	Equity

The Accounting Equation



## A Snapshot of the Financial Position

**ABC Company**  
Statement of Comprehensive Income  
For the year-ended December 31, 20X1

- At the topmost part of the SFP is the title. The title of the title shows the name of the company. It allows easy identification of the reporting entity.
- The second line identifies the Financial Statement (FS) which is the SFP.
- The third line is the date of the SFP. It states "as of the year-ended".

<b>ABC Company</b>	
Statement of Comprehensive Income	
For the year-ended December 31, 20X1	
Revenues	P1,290,000
Less: Expenses	890,000
Net Income	P400,000

<b>ABC Company</b>	
Statement of Changes in Equity	
For the year-ended December 31, 20X1	
Balance, January 1, 20X1	P876,000
Add: Contributions during the year	200,000
Add: Net Income	400,000
Less: Drawings of owners	250,000
Balance, December 31, 20X1	P1,226,000

<b>ABC Company</b>	
Statement of Financial Position	
As of December 31, 20X1	
Cash	P120,000
Other current assets	570,000
Property, plant and equipment	1,200,000
Total Assets	P1,890,000

## A Snapshot of the Financial Position

Financial statements are interconnected reports. To appreciate the relationship of the Financial Statements to each other, refer to the arrows in the figure here.

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<b>ABC Company</b>	
Statement of Financial Position	
As of December 31, 20X1	
Cash	P120,000
Other current assets	570,000
Property, plant and equipment	1,200,000
Total Assets	P1,890,000
Current liabilities	P412,000
Long term notes payable	252,000
Total liabilities	664,000
Owner, Capital	1,226,000
Total liabilities and equity	P1,890,000

<b>ABC Company</b>	
Statement of Cash Flows	
For the year-ended December 31, 20X1	
Cash inflow from operating activities	P1,120,000
Cash outflow from investing activities	(1,090,000)
Cash inflow from operating activities	8,400
Net change in cash	8,400
Cash, January 1, 20X1	84,000
Cash, December 31, 20X1	P120,000

## Elements of the SFP

Assets

□ **Assets** are resources with future benefits that are within the "control" of the company.

□ "Control" means that the company can prevent others from using the benefits from the asset.


Liabilities

Equity

□ **Liabilities and equity** are sources of financing.



□ **Liabilities are claims of creditors** while equity represents **claims of owners**.

## Assets





**Below are the kinds of assets that we will be focusing on.**

1. Cash
2. Receivables
3. Inventories
4. Prepaid Expenses / Prepayments
5. Property, Plant, and Equipment
6. Intangible Assets




## Cash as an Asset

- Cash is money owned by the company.
- Cash kept in the company's premises is called *cash on hand*.
- *Cash in bank* refers to money in the bank which can be kept in a savings or checking account.
- Cash refers only to funds readily available to be spent for the company's operations like buying assets, paying suppliers, utilities, employee salaries, as well as settling obligations.
- Cash are sourced from contribution of owners, proceeds from borrowings, sale of assets, or collections from customers.
- Cash on hand includes bills, coins, and bank checks kept in the premises of the company.





## Cash as an Asset




**Why can't some types of bank deposits be classified as cash?**

- Some accounts are not readily available for use such as a time *deposit account*. A time deposit account is a deposit in the bank that earns higher interest because the depositor commits not to withdraw the funds over the agreed upon time. Otherwise, he/she will incur penalties. Given these withdrawal restrictions, time deposits are not classified as cash.
- *Cash equivalents*, which are time deposits with a maturity term of up to 90 days or less, are technically not cash because it is not immediately available for use even though is almost cash in the sense that it will become cash within the next 90 days.





## Cash as an Asset




**What CONCEPTS do we need to know about RECEIVABLES as assets?**

- **Receivables** is a general term that refers to the company's right to collect or claim payment.
- The right to collect comes from unpaid sales or lending activities.
- Generally, the company collects cash from its receivables, but there are also receivables that may be settled in other assets or services. For example, receivable from suppliers may be settled in merchandise.





## Receivables as Assets




**What are the TYPES of receivables?**

- **Accounts Receivable (AR)**
  - ❑ This account means receivable from customers and is evidenced by sales invoices and delivery receipts.
  - ❑ It normally has a term of 30 days which means a customer should pay 30 days from date of delivery (although some sellers are more lenient and give terms of 60, 90, or even 180 days).
- **Notes Receivable (NR)**
  - ❑ This kind of receivable is evidenced by *promissory notes* (PN), a legal document that says the borrower promises to pay, on scheduled payment dates, a specific sum called the *principal* and *interest* based on principal and stated interest rate.
  - ❑ Customers who are unable to pay their accounts on due dates are sometimes required to sign a PN.






## Inventories as Assets




**What CONCEPTS do we need to know about INVENTORIES as assets?**

- The inventory account reports the cost of unsold merchandise.
- The inventory account of a trading business contains merchandise held for resale.
- A manufacturing company will have more complex inventories composed of raw materials, unfinished inventories in the middle of the manufacturing process (may also be called work in process), and unsold finished goods.
- Only merchandise held for sale are reported as inventories, which means that items that are to be used in the day-to-day activities of the company are supplies and not inventories.






## Inventories as Assets




**Why is CONSIGNMENT an important issue in inventory accounting?**

In a consignment arrangement, the producer/owner of goods places them "on-consignment" in the store (usually in display shelves) of a store owner, who is not obligated to purchase the goods. In such arrangement, the goods are now classified as consigned items. The store owner, in turn, will remit to the producer/owner of the goods the proceeds from the sale of the consigned items. The store owner's income from this transaction may be in the form of commissions from the sale and/or rent from the store space used to display the consigned items. The store owner should not report the consigned items as inventory even if they are held in the store premises. Rather, the consigned merchandise will be reported as inventories by the producer/owner of the goods.






## Prepaid Expenses/Prepayments as Assets



**What are the PREPAYMENTS?**

- They refer to future expenses that the company had paid for in advance.
- They are placed in this account until the services or items are used and have become expenses.
- Popular examples are mobile phone services (both prepaid and post-paid accounts) and insurance.

## Prepaid Expenses/Prepayments as Assets

### Friendly Convenience Store: Prepayments

(continuation). Juana paid premium of ₱2,500 for one-year fire insurance in the name of the store on October 1, 20X1. How much should prepaid insurance be on December 31, 20X1?

### Answer

Insurance premium is paid in advance. In the case of the Friendly Convenience Store, the ₱2,500 premium payment was for insurance from October 1, 20X1 to September 30, 20X2. As of December 31, 20X1, 3 months had already passed and considered expense. Therefore, only 9 months is prepaid.

We compute the prepaid insurance expense as  $₱2,500 \times 9/12 = ₱1,875$



## Property, Plant, and Equipment (PPE) as Assets



How do we qualify PPE as assets?

- PPE are long-term assets that are used in the operations of the company.
- These are classified as long term assets (or non-current assets) because they will be used in the business for more than one year.
- Examples of PPE are land, building, warehouse, automobiles, delivery vehicle, computer equipment and manufacturing equipment.
- Only those assets owned and controlled by the company will be reported as PPE, which means rented facilities and equipment are excluded.



## Property, Plant, and Equipment (PPE) as Assets



Let us look into a complicated aspect of PPE as assets.

Recall that assets are resources with future benefits for the company. For PPE, such benefits are to be realized for more than one year. The cost of purchasing PPE is not immediately reported as expense; rather, it is recognized as asset. As the asset is used, a portion of the cost is transferred to expense. The process of recognizing the asset is called *capitalization* while *depreciation* refers to transferring of cost of asset to expense. Depreciation is linked to usage.



## Property, Plant, and Equipment (PPE) as Assets



How can we QUANTIFY depreciation?

It seems necessary to estimate the pattern of usage in order to compute for depreciation. To simplify, it is an acceptable assumption in accounting that the asset will be used evenly over its life. This assumption enables accountants to simply divide the cost of the asset over its useful life. This is the *straight-line method* of depreciation. The depreciation will increase the expense account and decrease the asset account. It is normal accounting practice not to directly decrease the PPE account. Rather, a contra-asset account called *accumulated depreciation* is used to catch the depreciation and decrease the asset value to be reported in the SFP. The cost of the PPE, net of the balance of accumulated depreciation as of the SFP date, is called *Net Book Value* of the PPE.



## Property, Plant, and Equipment (PPE) as Assets

**Friendly Convenience Store: Property Plant and Equipment**

(continuation). On January 1, 20X0, Juana purchased an electronic cash register to be used in the Friendly Convenience Store. The cash register was purchased at a cost of ₱15,000. Juana depreciate the cash register over five years. Determine the following:

- (1) Equipment
- (2) Annual depreciation
- (3) Accumulated depreciation as of December 31, 20X1
- (4) Net book value of Equipment

**Answer**

Cost of electronic cash register	₱15,000	(1)
Estimated useful life (in years)	5	
Annual depreciation (₱ 15,000 / 5 years)	₱3,000	(2)
Number of years depreciated (20X0 – 20X1)	2	
Accumulated depreciation (₱ 3,000 X 2)	₱6,000	(3)
<b>Net book value (₱ 15,000 – ₱ 6,000)</b>	<b>₱9,000</b>	(4)



## Intangible Assets



**What CONCEPTS do we need to know about INTANGIBLE ASSETS?**

- They are long term assets similar to PPE. They will be used in the business for more than one year.
- The allocation of the cost of intangible assets to the year it was used is called *amortization*, which is computed similar to depreciation such that the cost of the asset is amortized evenly over its useful life.
- The main difference between the PPE and intangible assets is that intangible assets have no tangible properties, which means you cannot see or touch them. There may be a piece of paper as evidence of the asset but the actual asset is "intangible", thus the name.
- Some examples of Intangible assets are patent, brand-name, and trademark.



## What Have You Learned So Far?

**Instruction:** Identify the assets described below.

- Money in the bank or money in the premises of the company.
- Asset that can be used in the company's business over many years.
- Unsold goods that were purchased to be sold to the company's customers.
- The company's right to claim payments as evidenced by a promissory note signed by the debtor.
- The company's right to collect from the customer because delivery of goods and services have been completed.
- Advance payments for expenses such as cellphone loads.
- A class of PPE that is not subject to depreciation.



## Liabilities



**What are some important CONCEPTS we need to know about LIABILITIES?**

- **Liabilities** are obligations that the company is required to pay.
- Payment for liabilities may be in *cash*, *goods* or *services*.
- Entities to whom the company is indebted are called creditors.



## Liabilities

**Below are the kinds of liabilities that we will be focusing on.**

- Payables
- Accrued expenses
- Unearned income
- Long-term liabilities

## Payables as Liabilities

**What are the TWO KINDS OF PAYABLES?**

➤ Accounts Payable (AP)

- ❑ It refers to obligation to the suppliers of inventories.
- ❑ It is evidenced by the supplier's sales invoices and delivery receipts.

➤ Notes Payable (NP)

- ❑ It refers to an obligation evidenced by a promissory note.
- ❑ The issuer of the promissory note reports this as NP in his/her accounting books.

## Payables as Liabilities

Friendly Convenience Store: Accounts Payable

(continuation)

On November 15, 20X1, Juana Dela Cruz purchased five sacks of rice at ₱1,800 per sack. The credit term is 2/10, n/30. Determine how much Juana should pay given the following payment dates:

- (1) November 25, 20X1
- (2) December 15, 20X1

Answer

- (1) If Juana will pay anytime from November 15, 20X1 to November 25, 20X1, payment due is:
 

Full cost of one sack of rice	₱1,800
Number of sacks purchased	5
Total cost of purchase	9,000
Discount in %	2%
Discount in Peso	180
Discounted cost to be paid	₱8,820
- (2) If Juana will pay after November 25, 20X1, she is liable for the full cost of ₱9,000. She will forego the savings of ₱180.

## Payables as Liabilities

Friendly Convenience Store: Notes Payable

Read the excerpt of the Promissory Note' below:

Promissory Note  
November 1, 20X1

1. **Promise to Pay.** For value received, Friendly Convenience Store, represented by Juana Dela Cruz, the manager, (Borrower) promises to pay United Bank (Lender) ₱25,000 (Twenty-five thousand pesos) and interest at the yearly rate of 6% on the unpaid balance as specified below.
2. **Installments.** Borrower will pay five payments of ₱5,000 each at monthly intervals on the 30th day of the month. First payment is due on November 30, 20X1.
3. **Application of Payments.** Payments will be applied first to interest and then to principal.
4. **Prepayment.** Borrower may prepay all or any part of the principal without penalty.
5. **Loan Acceleration.** If Borrower is more than five days late in making any payment, Lender may declare that the entire balance of unpaid principal is due immediately, together with the interest that has accrued.

Answer the following questions:

- (1) Who will record the Notes Payable?
- (2) Who will record the Notes Receivable?
- (3) Compute for the payment due on November 30, 20X1 and December 30, 20X1.
- (4) Determine the balance of Notes Payable as of December 31, 20X1.

## Payables as Liabilities

**Answer**

- (1) According to the PN, the borrower is Friendly Convenience Store. A note payable will be reflected on the SFP of the store.
- (2) According to the PN, the lender is United Bank. A note receivable will be reflected on the SFP of the bank.
- (3) Payment due on the following dates:

	November 30, 20X1	December 30, 20X1
Unpaid balance, beginning	P25,000	P20,000
Stated interest	6%	6%
Interest period*	1/12	1/12
Interest to be paid	125	100
Monthly principal payment	5,000	5,000
Payment due	P5,125	P5,100

\*Stated interest of 6% is expressed on a per annum basis. Simply put, it means 6% per 12 months period. To get interest for one month, its 6%/12 months.

- (4) The balance of the Note Payable on December 31, 20X1 is P15,000. Following the payment schedule, Juana should have already made two payments of P5,000 each as of December 31. Hence, the remaining unpaid balance is (P25,000 - P10,000) P15,000.



## Accrued Expenses as Liabilities



**What are ACCRUED EXPENSES and what the COMMON KINDS of accrued expenses?**

- **Accrued Expenses** refer to the unpaid expenses of the company as of the SFP cut-off date.
- Examples of the kinds of accrued expenses are Salaries Payable, Utilities Payable, Rent Payable and Interest Payable.



## Accrued Expenses as Liabilities

**Friendly Convenience Store: Accrued Expense**

(continuation) Juana hired Elena Reyes as storekeeper with salary of P400 per day. Elena is paid every Saturday for work rendered during the week. Sunday is her day-off. December 31, 20X1 falls on a Thursday. Determine the balance of Salaries Payable to be reported on the Store's SFP as of December 31, 20X1.

**Answer**

Daily salary rate	P400
Number of unpaid days (Monday to Thursday)	4
Salaries payable, December 31, 20X1	P1,600



## Unearned Income as Liability



**What are some important CONCEPTS we need to know about UNEARNED INCOME?**

- Customer deposits or down-payments are initially recorded as *unearned income*, a liability payable in goods or services, since they will not count as sales until deliveries are made.
- Although, unearned income is a liability, unlike regular liability, its settlement is not through direct cash payments to the customer but rather by the delivery of goods or rendering of services.





## Unearned Income as Liability

### Friendly Convenience Store: Unearned Income

(continuation). Pedro Benitez, a neighbor of Juana, operates a coffee vending machine business. On October 1, 20X1, he entered in a contract with Juana to rent a small space on the counter-top of the Store where he can put his coffee vending machine. The rent is ₱500 per month. Pedro paid six months advance rent on October 1, 20X1. How much should be reflected as Unearned Rent Income on the Store's SFP as of December 31, 20X1.

### Answer

Monthly rental rate	₱500
Remaining unused months (January to March)	3
Unearned Rent Income, December 31, 20X1	₱1,500



## Long-term Liabilities



**What are LONG-TERM LIABILITIES? What is a COMMON EXAMPLE of a long-term liability?**

- Long-term liabilities refer to obligations with due dates that fall more than one year from the date of the SFP.
- Bank loan is a common example. It is documented by a promissory note. The company pays interest periodically. The repayment of the principal is based on the contractual agreement. It can all be paid at maturity or in installment over the term of the loan. Long term liability is part of the financing activities of the company.



## Long-term Liabilities

### Friendly Convenience Store: Long Term Liability

(continuation)

In order to construct the store, Juana borrowed ₱50,000 from Universal Bank and ₱25,000 from United Bank. Terms of the loans are as follows:

Universal Bank: The bank requires Juana to pay interest of 7% payable monthly. The principal is payable on October 1, 20X3.

United Bank: The bank requires Juana to pay five monthly instalments of ₱5,000 plus interest on the unpaid balance. The loan was taken on November 1, 20X1 and first monthly instalment is due on November 30, 20X1.

Which of the two loans should be reported as Long Term Liability on the Store's calendar year 20X1 SFP?

### Answer

- (1) While interest is payable monthly, the principal on the Universal Bank loan is payable on October 1, 20X3. The due date is one year and 10 months from SFP date of December 31, 20X1. This loan is classified as long term liability because due date is beyond one year of SFP date.
- (2) Given the monthly principal payments, the United Bank loan will be fully paid by the end of March 20X2. This is only three months from the SFP date of December 31, 20X1. Hence, the United Bank loan is a current liability. It may be reported as Note Payable.



## Equity



**What is EQUITY?**

- It is the net assets of the business.
- It is composed of the owners' investments and the accumulated net income of the company, net of any distributions to the owners.
- It reflects the portion of the asset that belongs to the owners of the business.



## Presentation of Statement of Financial Position

**What are two acceptable FORMATS of the SFP?**

➤ Account Form

Assets		Liabilities and Equity	
Cash	xxx	Accounts payable	xxx
Account receivable	xxx	Accrued expenses	xxx
Inventory	xxx	Unearned income	xxx
Prepayments	xxx	Notes payable	xxx
Notes receivable	xxx	Long term payable	xxx
Property, plant and equipment	xxx	Owner, Capital	xxx
Intangible assets	xxx		
<b>Total assets</b>	<b>xxx</b>	<b>Total Liabilities and equity</b>	<b>xxx</b>

## Presentation of Statement of Financial Position

**What are two acceptable FORMATS of the SFP?**

➤ Report Form

- It is a simple
- All the assets finally the eq

Assets	
Cash	xxx
Account receivable	xxx
Inventory	xxx
Prepayments	xxx
Notes receivable	xxx
Property, plant and equipment	xxx
Intangible assets	xxx
<b>Total assets</b>	<b>xxx</b>

Liabilities and Equity	
Accounts payable	xxx
Accrued expenses	xxx
Unearned income	xxx
Notes payable	xxx
Long term payable	xxx
Total liabilities	xxx
Owner, Capital	xxx
<b>Total liabilities and equity</b>	<b>xxx</b>

## Presentation of Statement of Financial Position

**There is a modified form of SFP called CLASSIFIED STATEMENT OF FINANCIAL POSITION.**

➤ This means that assets and liabilities are classified as to current or non-current.

➤ On the asset side, assets are classified as current if it can be used or converted to cash within one year.

➤ Examples of current assets are cash, accounts receivable and inventory.

➤ Prepayments maybe classified as current if the advance payment is expected to be used within one year.

## Presentation of Statement of Financial Position

**There is a modified form of SFP called CLASSIFIED STATEMENT OF FINANCIAL POSITION.**


➤ The classification of notes receivable is dependent on the term of payments on the promissory note. The payments collectible within one year are classified as current. Those collectibles after one year are reported as non-current.

➤ Property, Plant and Equipment and Intangible Assets are classified as non-current given their long term nature.

➤ Liabilities may also be classified in similar terms. Current liabilities are payables due to be paid within one year of the SFP date.



➤ Examples of current liabilities are accounts payable and accrued expenses.

## Presentation of Statement of Financial Position



**There is a modified form of SFP called CLASSIFIED STATEMENT OF FINANCIAL POSITION.**

- Unearned income is current if the delivery of goods or services for the settlement of the advance payment is to be made within one year.
- Similar to notes receivable, the classification of notes payable is dependent on the terms of payment on the promissory note. Long term liabilities are generally classified as non-current. If the long term liability is to be settled in installments, then those scheduled to be paid within twelve months are classified as current and referred to as current portion of long term debt. The remaining installments are reported as non-current.



## Presentation of Statement of Financial Position

### Classified SFP

Assets	
Cash	xxx
Account receivable	xxx
Inventory	xxx
Prepayments	xxx
Notes receivable	xxx
Total current assets	xxx
Property, plant and equipment	xxx
Intangible assets	xxx
Total non-current assets	xxx
<b>Total assets</b>	<b>xxx</b>


  

Liabilities and Equity	
Accounts payable	xxx
Accrued expenses	xxx
Unearned income	xxx
Notes payable	xxx
Current portion of long term debt	xxx
Total current liabilities	xxx
Long term payable	xxx
Total liabilities	xxx
Owner, Capital	xxx
<b>Total liabilities and equity</b>	<b>xxx</b>



## Presentation of Statement of Financial Position

### Normal Balances




**The format of a general ledger account that is used in actual business is the GENERAL LEDGER ACCOUNT FORMAT shown below.**

Account Name				
Account Number				
Date	Particulars	Debit	Credit	Balance



## Presentation of Statement of Financial Position

### Normal Balances




**Debit and credit refers to the sides of the t-account.**

Account Name	
Debit	Credit

## Presentation of Statement of Financial Position



### Normal Balances



**The account form and the general ledger t-account forms are reproduced in the format below.**

Assets		Liabilities and Equity	
Cash	xxx	Accounts payable	xxx
Account receivable	xxx	Accrued expenses	xxx
Inventory	xxx	Unearned income	xxx
Prepayments	xxx	Notes payable	xxx
Notes receivable	xxx	Long term payable	xxx
Property, plant and equipment	xxx	Owner, Capital	xxx
Intangible assets	xxx		
<b>Total assets</b>	<b>xxx</b>	<b>Total liabilities and equity</b>	<b>xxx</b>

Account Name
Debit
Credit

## Presentation of Statement of Financial Position

Asset Account	
Beg. Balance	₱ xxx
+	-
<b>Ending Balance = Beg + Debits - Credit</b>	

Asset Account	
Beg. Balance	₱1,000
	900
	990
<b>Ending Balance</b>	<b>₱910</b>

