

**FINANCIAL ACCOUNTING
WEEK 8 (LECTURE EIGHT)**

**WEEK 7: PREPARATION OF THE STATEMENT OF FINANCIAL POSITION
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Learning Objectives:

Upon completion of this chapter you will be able to:

- ❖ Explain the relationship between the trading account and profit and loss accounts
- ❖ Explain the importance of a Statement of Financial Position
- ❖ Prepare an income statement from information given in trial balances
- ❖ Prepare a Statement of Financial Position (Balance Sheet) from information given in trial balances
- ❖ Recommended Format of Statement of Financial Position

A **balance sheet** (Statement of Financial Position) is a financial statement that provides a snapshot of a company's assets, liabilities, and equity at a given point in time. A statement of financial position shows the well-being or lack of in terms of assets, capital and liabilities. It is commonly referred to as a balance sheet (BS) or an ACCOUNTING EQUATION (ASSETS= LIABILITIES + EQUITY). Preparation of financial statements is one of the last steps in the accounting cycle, using information from the previous statements to develop the current financial statement.

Using a statement of financial position, decision makers can be able make various decisions after conducting various analysis. For example appreciating the Liquidity position of the company, Leverage level of a company or asset utilization efficiency.

Business owners may not need all the details, but they definitely need to understand the true view of their current financial and cash positions. These insights are crucial when making business operation decisions. IAS 1 specifies the minimum information which must be shown on the face of the balance sheet. It does not specify the order in which information is to be presented.

In a summary a Statement of Financial Position has three main sections:

- **Assets:** This section includes all of the resources that a company owns. These resources may be tangible, such as cash, inventory, and property, or intangible, such as patents and copyrights.
- **Liabilities:** This section includes all of the debts and obligations that a company owes. These debts may be short-term liabilities (current liabilities), such as accounts payable, or long-term liabilities (non-current liabilities), such as bonds.
- **Equity:** This section includes the ownership interests that shareholders have in a company. Equity can be classified as common stock, preferred stock, or retained earnings.

The statement requires entities to separate out:

- Non-current assets, the usual sort of fixed assets such as property, plant, equipment, plant and machinery, motor vehicles, intangible assets, goodwill, etc.
- Current assets; inventories, trade receivables, cash and cash equivalents.
- Current liabilities; trade payables, bank overdrafts and taxation.
- Non-current liabilities; bank loans and long-term provisions.
- Equity; Share capital, share premium reserves and retained earnings.

NB: IAS 1 does not prescribe the format of the balance sheet. Assets can be presented current then non-current, or vice versa, and liabilities and equity can be presented current then non-current then equity, or vice versa. A net asset presentation (assets minus liabilities) is allowed.

The Purpose of a Statement of Financial Position (SoFP)

1. A SoFP gives a comprehensive overview of the health of a business

Your **SoFP** should display in a manner that is easy to read and follow the business' assets, liabilities, earnings, and equity. Assets include cash, land, infrastructure, and equipment. Assets may be tangible or intangible, movable, or immovable. Liabilities include the payroll, utilities, interest, employee medical insurance, building rent as well as any contributions you're making to pension plans. Equity refers to what's left after liabilities have been subtracted from the assets. And finally, retained earnings is the profit that the business gets to keep, these are earnings that are not shared with the shareholders.

2. A Statement of Financial Position may be used to meet financial obligations

Interested parties looking to buy your business may want to understand how they will be able to meet their financial obligations. Perhaps they will want to sell shares of the company. They can only do this if they have an idea of the company's financial position. From the balance sheet, they'll be able to analyze potential rates of return and also have a snapshot of the capital structure. As a buyer what are you hoping to achieve with the business in the next few years? Do you want to grow the business beyond its current setup? Given the liabilities and assets in possession do they give you leeway to expand or debts may restrict your ambitious goals? The statement of financial position can be a powerful tool to unlock such uncertainties.

3. A Statement of Financial Position may be used to secure lines of credit

According to a survey carried out by the Small Business Administration, more than \$600 billion is loaned to small businesses every year. And just what is the average loan amount? In 2017, the average amount loaned to SMEs was \$663,000. It's not hard to see that investors are very happy to seed money into ventures that look lucrative and promise to deliver credible returns.

One of the biggest reasons sole proprietorships and partnerships find it difficult to secure lines of credit is a failure to show a balance sheet. The ability to show creditors good accounting records gives them the confidence to release funds. A business' balance sheet will be able to demonstrate that the business is in a good place and has the potential to become bigger with the right financial muscle backing it up.

4. A Statement of Financial Position can show areas that need improvement

A Statement of Financial Position is like a doctor's report. It shows the areas that need improvement, the areas that are in good shape, and those that could do with a little more attention. To add on, the Statement of Financial Position can also highlight specific places that are causing the business to lose money. Perhaps its overhead costs which need to be lowered – moving into a smaller space, downsizing the company, or finding contractors with cheaper equipment to hire. Maximizing value can only happen when you can clearly see what's working and what's not.

5. A Statement of Financial Position shows a good financial practice

If the corporation is already listed on the stock exchange or you're still in the initial stages of preparing to go public, your financial statements will be appraised to ensure that everything checks out. Government agencies, stock, and banking regulators use a company's balance sheet to screen for possible financial malpractice. Fraudulent activities can often be tracked on balanced sheets. By regularly going through a public company's balance sheet, stock market regulators are able to detect any financial malpractice and call to order any entity in practice of such malpractices.

6. Win the trust of your suppliers with audited balance sheets

Most businesses rely on suppliers and creditors to stay afloat. If you're running an operation that needs you to purchase raw materials from another company, having good credit (which can be shown by your balance sheet) is a surefire way to win their trust. Suppliers want to do business with companies they know are reliable and trustworthy. Hence the importance of a balance sheet can never be overestimated if you're building a business.

7. A Statement of Financial Position allows for efficient business management

In order to manage the company efficiently, it is key to know the numbers – debt funding status, current cash flow, asset investments, status of trade receivables, and company liquidity situation. Planning for future expansion is only possible if you know how the company is doing. Looking at the balance sheet as a buyer you might also be able to see whether or not there is a future in the entity or otherwise.

Many standards make various stipulations relating to the information to be presented in the Balance Sheet (Statement of financial position) as highlighted below:

Statement of financial position

Information to be presented in the statement of financial position

The statement of financial position should include line items that present the following amounts (IAS 1:54):

- property, plant and equipment;
- investment property;
- intangible assets;

- financial assets (excluding amounts shown under investments, trade and other receivables and cash and cash equivalents);
- groups of contracts within the scope of IFRS 17 that are asset, disaggregated as required by IFRS 17:78;
- investments accounted for using the equity method;
- biological assets within the scope of IAS 41 Agriculture (IAS 41);
- inventories;
- trade and other receivables;
- cash and cash equivalents;
- the total of assets classified as held for sale and assets included in disposal groups classified as held for sale in accordance with IFRS 5 Non current assets held for sale and discontinued operations (IFRS 5);
- trade and other payables;
- provisions;
- financial liabilities (excluding amounts shown under trade and other payables and provisions);
- groups of contracts within the scope of IFRS 17 that are liabilities, disaggregated as required by IFRS 17:78;
- liabilities and assets for current tax, as defined in IAS 12 Income Taxes (IAS 12);
- deferred tax liabilities and deferred tax assets, as defined in IAS 12;
- liabilities included in disposal groups classified as held for sale in accordance with IFRS 5;
- non-controlling interests, presented within equity; and
- issued capital and reserves attributable to equity holders of the parent.

As per IAS 1:57 the order or format of these items does not have to follow as above, it is purely a list of items for inclusion.

Current assets

An asset should be classified as current when it satisfies any of the following criteria:

- it is expected to be realised in, or is intended for sale or consumption in, the entity's normal operating cycle;
- it is held primarily for the purpose of being traded;
- it is expected to be realised within 12 months after the balance sheet date; or

- it is cash or a cash equivalent (as defined in IAS 7) unless it is restricted from being exchanged or used to settle a liability for at least 12 months after the balance sheet date.

All other assets should be classified as non-current (IAS 1:66).

Current assets include assets (such as inventories and trade receivables) that are sold, consumed or realised as part of the normal operating cycle even when they are not expected to be realised within 12 months after the balance sheet date. Current assets also include assets held primarily for the purpose of being traded (financial assets within this category are classified as held for trading in accordance with IFRS 9) and the current portion of non-current financial assets (IAS 1:68).

IAS 1 uses the term ‘non-current’ to include tangible, intangible and financial assets of a long-term nature. It does not prohibit the use of alternative descriptions as long as the meaning is clear (IAS 1:67).

Current liabilities

A liability should be classified as current when it satisfies any of the following criteria:

- it is expected to be settled in the entity’s normal operating cycle;
- it is held primarily for the purpose of being traded;
- it is due to be settled within 12 months after the balance sheet date; or
- the entity does not have an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date. Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification.

All other liabilities should be classified as non-current (IAS 1:69).

Non-current liabilities are long-term liabilities, which are financial obligations of a company that will come due in a year or longer. A company will classify a liability as non-current if it has a right to defer settlement for at least 12 months after the reporting date. This right may be subject to a company complying with conditions (covenants) specified in a loan arrangement.

FORMAT OF STATEMENT OF FINANCIAL POSITION

Company Accounts

Company is an organization that has a separate legal entity and has limited liability. Companies are majorly classified into two public and private. By separate legal entity it means that the company can enter into binding obligations on its own account and can be sued or be sued to that regard. Limited liability on the other hand implies that shareholders liability will only be limited to the extent of their shareholding

Types of companies

Companies can be classified as either Private or public

The differences between the two can be summarized as follows

Public company

1. They have no maximum limit for membership
2. Their membership is open to the public
3. Can raise capital through the issue of shares to the public
4. There is free transfer of shares amongst shareholders

Private company

1. Has a maximum limit of 50 members
2. Membership is only open for relatives or close associate of the existing members
3. Cannot raise capital from the members of the public
4. Transfer of shares is restricted and must be authorized

Company's capital

The major types of capitals that a company has are:

1) Loan capital (debentures)

This is capital borrowed from creditors which will be repaid later at an interest. It's actually a liability to the company.

2) Share capital

To become an owner of any company a person must have contributed to its capital. To facilitate this there total capital required by the company is divided into small units or **shares**. One becomes a member of a company (shareholder) by purchasing one or more of the shares. Share capital is thus the capital raised from members of the company. As expected shareholders expect return on their investment. Thus the profits made by the company are distributed to the shareholders in proportion to the number of shares held. The profit distributed to the shareholders is referred to as a **divided**. This amount is determined and proposed to the shareholders for approval by the directors. The shareholders; however, are only allowed to review the proposal downwards. The accounting for and distribution of profits shall be covered comprehensively later on.

Types of Share Capital

- i) Preference shares
- ii) Ordinary shares

Preference shares

Holders of these shares receive their dividend at an agreed rate before the ordinary shareholders receive anything.

Ordinary shares

The ordinary shareholders receive their dividends after the preference shareholders, if there is any profit it left.

The preference shares are further divided into:

Cumulative preference shares

These are preference shares who have agreed percentage of **dividend** accumulates over the period they are fully paid.

Non-cumulative preference shares

These are preference shares which if not paid the **percentage** of dividend agreed upon in a given period lose the right to claim such dividends ever again in future periods.

Participating preference shares

These are shares that receive an agreed percentage of **dividends** before the ordinary shareholders and still receive a portion of the remaining profits being distributed to the ordinary shareholders.

Non-participating preference shares

These are the preference shares that receive only the agreed percentage of dividend, no more.

Redeemable and Irredeemable preference shares

Redeemable preference shares refer to preference shares that will be paid back at some point in future or after agreed period of time. While irredeemable preference shares are those that are held to perpetuity.

Share capital

Authorized share capital

This is the amount of capital that the company is allowed to issue as indicated in its Articles of Association. A company may issue only a portion of the authorized share capital to shareholders. The remaining capital not issued remains as security to the company in case more capital is needed in future, and only then shall it be issued. However, no company is allowed to

issue more shares than the amount authorized. The authorized share capital is normally shown in the statement of financial position under the equities section but its value is not summed up together with the rest of the equity items.

Issued share capital

This is the part of the share capital that has already been issued to the shareholders.

Unissued share capital

This is that part of the authorized share capital that has not been issued to the share holders

Note Issued share capital + Unissued share capital = Authorized Share Capital

Called up share capital

Once the company issues the capital to the shareholders it may not require them to pay for the whole amount for the shares purchased. Instead it may prescribe that certain amounts be paid first and the rest to be paid when the company requires. The total amount that a company has already requested to be paid on the shares, up to a specified date is referred to as the called up share capital.

Uncalled up share capital

This is that part of the issued share capital for which the shareholders have not been required to make payments

Note called up capital + uncalled up capital = Issued share capital

Paid up share capital

It's that part of the issued share capital for which calls have been made and payments of the calls actually received by the company.

Calls in arrears

Out of the called up capital, not all of it is paid for. The balance of called up capital that remains unpaid is referred to as calls in arrears.

Note paid up capital + Calls in arrears = Called up Capital

Calls in advance

Some shareholders may pay for the outstanding amount on their shares even before makes the calls for it. Such payments are referred to as the calls in advance.

The following example will help illustrate the above terms.

Intel Solutions Ltd was formed with the legal right to be able to issue 400000 shares of \$. 4

each. However they actually issued 300000 of which none was fully paid. So far Intel Solutions Ltd has made calls of \$ 3 per share. All shares have been paid by the shareholders except for Sh 150000 shares whose shareholders have only paid \$ 1 per share.

Required:

Determine

- a) Authorized share capital
- b) Issued share capital
- c) Unissued share capital
- d) Called up capital
- e) Uncalled up capital
- f) Calls in arrears
- g) Paid up capital.

Solution

Authorized share capital = 400,000 x \$.4 = \$.1, 600,000

Issued share capital = 300,000x \$. 4 = \$. 1,200,000

Unissued share capital = 100,000x \$.4 = \$. 400,000

Remember

Issued capital + Unissued capital = Authorized share Capital

$$1,200,000 + 400,000 = $. 1,600,000$$

Called up Capital= 300,000 x \$. 3 =\$. 900,000

Uncalled up capital= Sh. 300,000 x \$. 1 = \$. 300,000

Remember

Called up capital + Uncalled up capital = Issued share capital

$$$. 900,000 + $. 300,000 = $. 1,200,000$$

Paid up capital = (150,000 x \$. 3 + 150,000 x \$. 1) = \$. 600,000

Call in arrears = 150,000 x \$. 2 = \$. 300,000

Remember

Paid up capital + calls in arrears = called up capital

$$$.600, 000 + $. 300,000 = $. 900,000$$

Reserves

These are funds that the business sets aside for purposes of future financial obligations and appear in the financed-by section of the Statement of financial position.

They are categorized into two:

Capital reserves

Revenue reserves

Revenue reserves: these are the reserves which can be distributed to the shareholders if need be in a form such as bonus shares. They are generally used for the expansion or purchase of non-current assets. They include:

- Retained profits – this is the balance after appropriations
- General reserves

Capital reserves: capital reserves on the other hand cannot be distributed to the shareholders. They include:

• Share premium

This represents the amount paid on the issued shares above their par value. It arises when a company issues shares at a price that is above its par value e.g. if a company issues 200,000 shares of sh 10 par at sh. 12.5, the difference between the issue price sh. 12.5 and sh. 10 the par value is the share premium i.e. the total share premium in this case will be sh. 500,000

• Revaluation reserve

This represents the amounts by which assets appreciate after a revaluation is done. For example if land in the books of a company has book value of sh, 2,000,000 and after a valuation the value increases to sh. 2,500,000 then a revaluation reserve of sh. 500,000 is said to arise.

• Capital redemption reserve fund

This represents the amount transferred from the retained earnings to finance the redemption of preference shares. If the amount is transferred to cater for the redemption of debentures, the reserve created for that purpose is referred to as the Debenture redemption fund.

Statement of Financial Position

The Statement of financial position of a company is also similar to that of a partnership except for the capital section of the Statement of financial position. For company the capital section is also referred to as the ‘financed by’ section. Just as the name suggests, this section shows the funds used to finance the net assets. This stems from the basic accounting equation where:

$$\text{Capital} = \text{assets} - \text{liabilities} = \text{net assets}$$

Therefore the figure obtained for net assets must necessarily tally with that in the financed by section i.e. all other factors e.g. errors held constant, the statement of financial position should balance.

The general format of a statement of financial position is as follows:

XYZ COMPANY LTD

STATEMENT OF FINANCIAL POSITION AS AT 31. 12. 2X22

Non-current assets

Land and buildings		XXX
Plant and equipment	XXX	
Less accumulated depreciation	(XXX)	XXX
Fixtures, furniture and fittings	XXX	
Less accumulated depreciation	(XXX)	XXX
Motor vehicles	XXX	
Less accumulated depreciation	(XXX)	XXX
Total non-current assets		XXX

Current Assets

Stock	XXX	
Debtor's	XXX	
Less provision for doubtful debts	(XXX)	XXX
Prepayments	XXX	
Short term investments	XXX	
Cash at bank	XXX	
Cash in hand	XXX	
Total current assets		XXX

Less Current Liabilities

Bank overdraft	XXX	
Creditor's	XXX	
Accruals	XXX	
Interest payable (debenture interest)	XXX	
Tax payable	XXX	
Dividends payable	XXX	(XXX)

Net current assets

XXX

Total asset

XXX

Financed By

Authorized share capital

E.g. 1,000,000 ordinary shares of \$ 1 each

E.g. 1,000,000 preference shares of \$ 1 each

Issued and fully paid

E.g. 1,000,000 ordinary shares of \$ 1 each XXX

E.g. 1,000,000 10% preference shares of \$ 1 each XXX

Capital reserves

Share premium XXX

Revaluation reserve	XXX
Capital redemption reserve	XXX
Revenue reserves	
General reserve	XXX
Profit and loss account	XXX
Noncurrent liabilities	
10% debentures	<u>XXX</u>
Total Equity and Liabilities	<u>XXX</u>

FORMAT OF STATEMENT OF FINANCIAL POSITION (Sole Proprietor)

**J FRANK
STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2022**

	\$	\$	\$
	Cost	Acc. Dep.	NBV
Non-Current Assets			
Land and buildings	XXX	(XXX)	XXX
Plant and machinery	XXX	(XXX)	XXX
Equipment	XXX	(XXX)	XXX
Motor vehicles	XXX	(XXX)	XXX
Furniture, Fixtures and fittings	XXX	(XXX)	<u>XXX</u>
Current Assets			
Inventory		XXX	
Accounts receivable		XXX	
Prepayments		XXX	
Accrued incomes		XXX	
Bank		XXX	
Cash		<u>XXX</u>	<u>XXX</u>
Total Assets			<u>XXX</u>
Less: Current Liabilities			
Accounts payable	XXX		
Accrued expenses	XXX		
Advance incomes	<u>XXX</u>	XXX	

Less: Long-Term Liabilities			
Long term loans	XXX		
Debentures	XXX		
Bonds	<u>XXX</u>	<u>XXX</u>	<u>(XXX)</u>
			<u>XXX</u>
Financed by:			
Capital			XXX
Add: Net profit			XXX
Less: Drawings			<u>(XXX)</u>
			<u>XXX</u>

The following is a sample of a Statement of Financial Position.

ABC ENTERPRISES
STATEMENT OF FINANCILA POSITION
AS AT 31ST DECEMBER 2022

	\$'000'	\$'000'	\$'000'
NON-CURRENT ASSETS	Cost	Dep/App	NBV
Goodwill	7,700	-	7,700
Land & Buildings	35,000	5,000	40,000
Plant & Machinery	29,000	(4,000)	25,000
Motor Vehicles	24,500	(4,500)	20,000
Fixtures & Fittings	<u>17,000</u>	<u>(2,000)</u>	<u>15,000</u>
	<u>113,200</u>	<u>(5,500)</u>	107,700
CURRENT ASSETS:			
Inventories	1,000		
Trade & Other Receivables	4,000		
Cash and equivalents	500		
Prepaid Expenses	600		
Accrued Revenues	<u>400</u>	<u>6,500</u>	
CURRENT LIABILITIES:			
Trade & other Payables	1,200		

Tax Liabilities	1,500		
Prepaid Revenues	1,100		
Accrued Expenses	600		
Bank loan (1 year)	<u>300</u>	<u>(4,700)</u>	
Net Current Assets (Current Assets-Current Liabilities)			<u>1,800</u>
NET ASEETS (NCA +Net Current Assets)			<u>109,500</u>
Capital + Non-Current Liabilities (NCL)			
Capital			48,000
Retained Profits			43,000
Drawings			(8,000)
Share Premium			5,000
General Reserves			10,000
Non-Current Liabilities			
National Bank Loan (5 years)			<u>11,500</u>
Capital Employed (capital +Reserves + NCL)			<u>109,500</u>

ILLUSTRATIONS ON PREPARATION OF STATEMENT OF FINANCIAL POSITION

EXAMPLE ONE:

Daewoo Enterprises is a medium size entity operating in the out skirts of Seoul city. The following trial balance was extracted from their books for the year ending 31 October 2021.

Items	Dr. \$ '000'	Cr. \$ '000'
Land & Buildings	125,000	
Prepaid Transport costs	5,000	
Accrued Commission income	14,000	
Fixtures and fittings	45,000	
Capital and Drawings	4,000	150,000
Share Premium		45,000
Motor vehicles	25,000	
Retained Earnings		40,000
10-year Bank Loan		15,000
Inventory	34,000	
Accounts Receivables	40,000	
Accounts Payables		38,000
Cash at bank	12,000	
Prepaid Rent income		16,000

Total	304,000	304000
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DAEWOO ENTERPRISES
STATEMENT OF FINANCIAL POSITION
AS AT 31ST DECEMBER 2021

	\$'000'	\$'000'	\$ '000'
	Cost	Dep/App	NBV
Non-Current Assets			
Land and buildings	145,000	-	145,000
Motor Vehicles	25,000	-	25,000
Fixtures & Fittings	<u>25,000</u>	=	<u>25,000</u>
	<u>195,000</u>	=	195,000
Current Assets			
Inventory	42,000		
Accounts Receivables	40,000		
Accrued commission income	18,000		
Prepaid transport costs	<u>5,000</u>	105,000	
Current Liabilities			
Accounts Payables	38,000		
Prepaid Income	<u>16,000</u>	<u>54,000</u>	<u>51,000</u>
Net Assets			<u>246,000</u>
Capital + Non-Current Liabilities			
Capital			150,000
Retained Profits			40,000

Drawings			(4,000)
Share Premium			45,000
Non-Current Liabilities			
10 Year Bank loan			<u>15,000</u>
Capital Employed			<u>246,000</u>

ILLUSTRATION TWO:

The following information was obtained from the books of Southern Enterprises for the year ended 30th September 2021 showing the Trial balance for the same period.

Items	Dr. (\$'000')	Cr. (\$'000')
Inventory as on 01/10/2020	23,680	
Carriage inwards	2,000	
Carriage outwards		3,100
Returns	2,050	3,220
Sales & Purchases	118,740	186,000
Salaries & Wages	38,620	
Rent	3,040	
Insurance	780	
Motor Expenses	6,640	
Heating & lighting	2,160	
General Expenses	3,140	
Premises	50,000	
Motor Vehicles	18,000	
Fixtures & Fittings	3,500	

Accounts receivables and Payables	38,960	17,310
Cash at bank	4,820	
Drawings	12,000	
Capital		126,360
TOTAL	332,890	332,890

Required:

Prepare the statement of Financial Position as at 30th September 2021 for the Southern Enterprises.

SUGGESTED SOLUTION:

**The southern Enterprises
Statement of Financial Position
As at 30th September 2021**

	Dr. \$'000'	\$'000'
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NON-CURRENT ASSETS		
Premises		50,000
Motor Vehicles		3,500
Fixtures & Fittings		<u>18,000</u>
		71,500
CURRENT ASSETS		
Inventory	29,460	
Accounts Receivables	38,960	
Cash at Bank	<u>4,820</u>	
Total Current Assets	73,240	
CURRENT LIABILITIES		
Accounts Payables	(17,310)	
Working Capital		55,930
NET ASSETS		<u>127,430</u>
Financed by:		
Capital		126,360
Net Profit for the year		13,070
Drawings for the Year		<u>(12,000)</u>
		<u>127,430</u>

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