JUNYUAN SECONDARY SCHOOL

Principles of Accounts

Logical Learning. Life-Long Skill.

We Nurture People of Accountability

FORMAT & MEMORY ESSENCE (SEC 4E5N)

FOR O LEVEL SYLLABUS 7087

Name	
Class	

2024 EDITION

Required to interpret the accounts but need not prepare the accounts.

CONTENTS PAGE

CHAPTER 1 INTRODUCTION TO ACCOUNTING

TYPES OF BUSINESSES

- **Trading business** buys from suppliers and sells goods to customers. E.g. bookshop
- **Service business** provides services to its customers. E.g. cleaning service.

ROLE OF ACCOUNTING & ACCOUNTANTS

Role of Accounting

- Accounting provides accounting information for **decision making** by owners and other stakeholders.

Role of Accountants

- Through providing accounting information for stakeholders' decision-making, accountants act as **stewards** of businesses. Accountants do not own the business but are given the responsibility to manage the business.
- Accountants set up the **accounting information system** to collate, record, organise and report accounting information so that owners and other stakeholders can make decisions regarding the management of resources and the performance of businesses.
- They think critically, **solve problems**, adapt and meet the need for sophisticated accounting and business information.
- In the face of an evolving business environment and rapid technological advancement, accountants have to provide relevant information in a timely manner for decision-making and insights that are easily and appropriately understood by owners and other stakeholders based on **accounting theories**.

PROFESSIONAL ETHICS

- **Integrity**: Being straightforward and honest in all professional and business relationships
- **Objectivity**: Not letting bias, conflict of interest or undue influence of others override professional judgement.
- **Importance of Professional Ethics**: Stakeholders rely on financial reports provided by accountants to make business decisions. If they are given false or inaccurate information about the business, they are likely to make poor decisions.

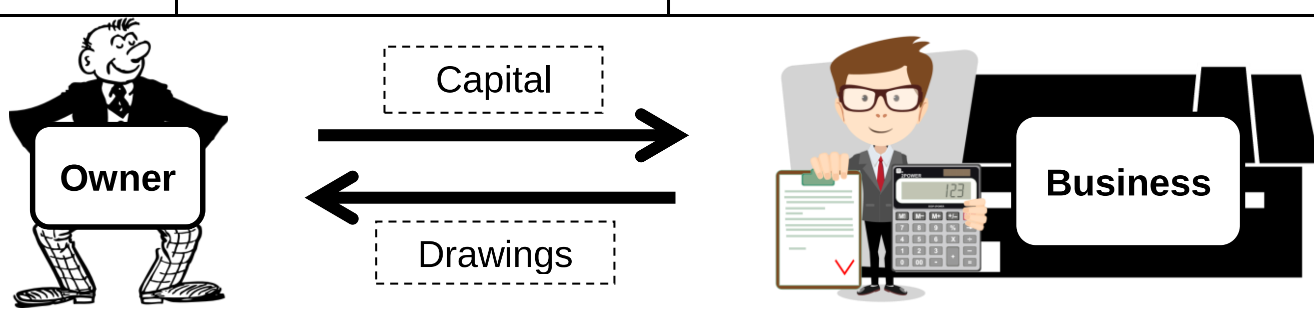
STAKEHOLDERS

Stakeholders are people with an interest or concern in a business. Stakeholders use accounting and non-accounting information of a business to make decisions.

Stakeholder	Role	Decision needs
Owners	Contribute capital & expect profit distribution in return	Whether to continue investing in business, depending on the risks and returns
Managers	Work for the business and devise strategic plans to run the business efficiently	Whether to consider ways to improve the performance of the business
Employees	Work for the business and perform executive duties	Whether to continue working at the business
Lenders	Lend money to the business and expect it to be fully repaid with interest	Whether to grant loans to the business, depending on the business' ability to repay the principal amount and interest
Suppliers	Supply goods and/or provide services to the business	Whether to sell to the business on credit, depending on its ability to pay
Customers	Buy goods and/or engage services from the business	Whether to buy from the business, depending on its ability to provide goods and/or services that they need and good after-sales service
Government	Enforce tax regulations	Whether the business complies with the tax regulations and decides the amount of tax to collect
Competitors	Sell similar goods and/or provide similar services	Whether they are comparable to the business and how to improve their own performance

ACCOUNTING THEORIES

	Accounting theory	Definition	Application
1	Monetary theory	Only business transactions that can be measured in monetary terms are recorded.	<u>Chapter 2 Accounting Information System</u> Factors such as staff morale and loyalty are not recorded as it is not possible to determine a monetary value.
2	Historical cost theory	Transactions should be recorded at their original cost.	<u>Chapter 2 Accounting Information System</u> Transactions should be recorded at their original cost.
3	Objectivity theory	Accounting information recorded must be supported by reliable and verifiable evidence so that financial statements will be free from opinions and biases.	<u>Chapter 2 Accounting Information System</u> Source documents are kept as evidence to show details of the transactions that have taken place.
4	Accounting entity theory	The activities of a business are separate from the actions of the owner. All transactions are recorded from the point of view of the business.	<u>Chapter 14 Owner's Equity</u> Resources contributed by the owner for business use are recorded as capital and withdrawal of business assets for personal use are recorded as drawings. <u>Chapter 14 Shareholders' Equity</u> [O Level only] Shareholders can contribute cash to the business through the buying of more shares. Profits may be distributed to the shareholders through dividends declared.



NOTE: You are not the business owner. You assume the role of the <u>accountant</u> in the business. Hence, you take the perspective of the business when recording a transaction.

<u>Consider:</u>
Do we record the following transactions in the business' books?

1. Owner withdrew money from <u>business</u> bank account to pay for <u>personal</u> expenses.
2. Owner withdrew money from <u>business</u> bank account to pay for <u>business</u> expenses.
3. Owner withdrew money from <u>personal</u> bank account to pay for <u>business</u> expenses.

4. Owner withdrew money from personal bank account to pay for personal expenses.

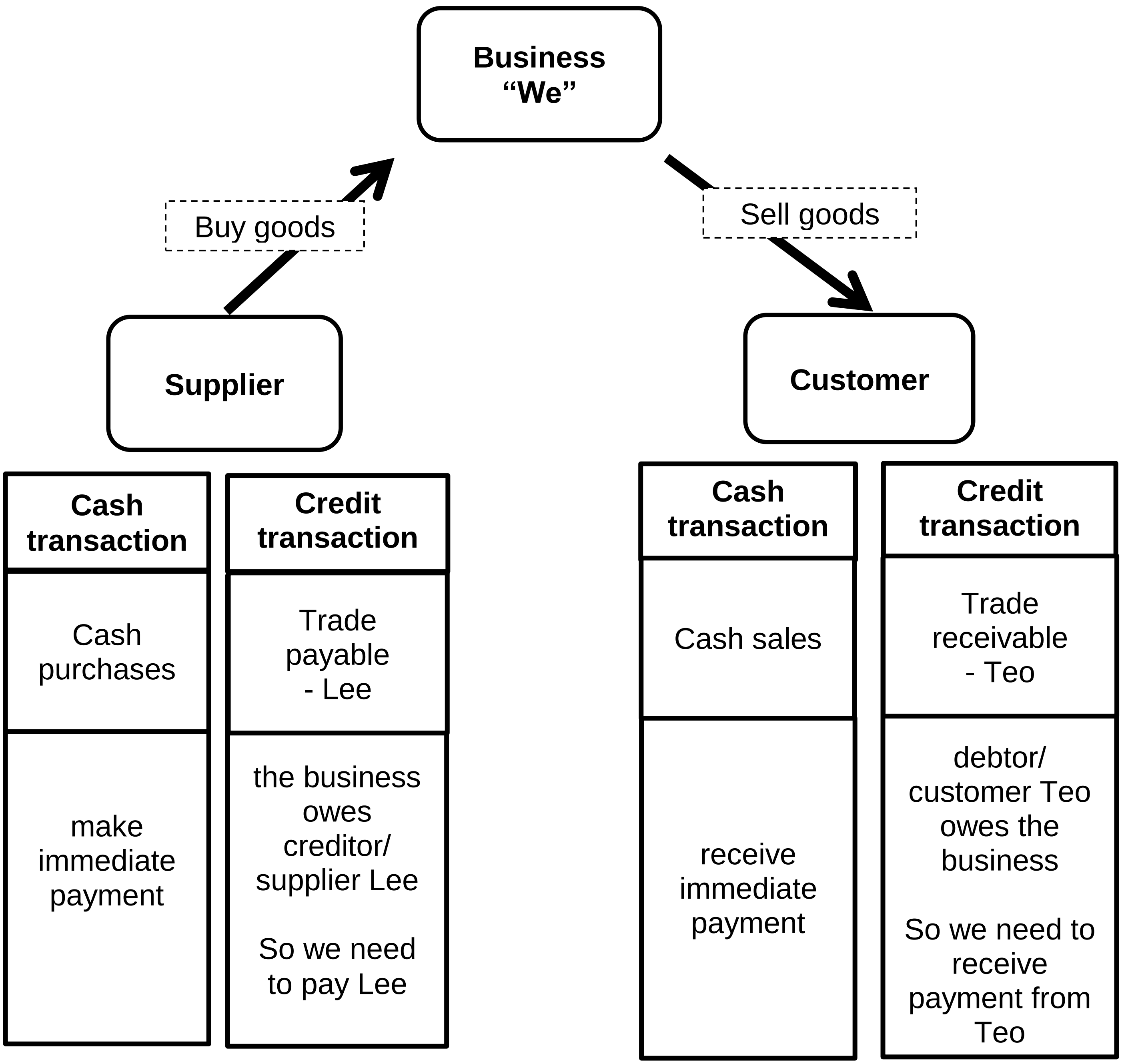
	Accounting Theory	Definition	Application
5	Going concern theory	A business is assumed to have an indefinite economic life unless there is credible evidence that it may close down.	Chapter 5 Financial Statements Financial statements are prepared to assess the performance and position of the business for continuity.
6	Accounting period theory	The life of a business is divided into regular time intervals.	Chapter 5 Financial Statements Financial statements are prepared yearly, half-yearly or quarterly.
7	Revenue recognition theory	Income is earned when goods have been delivered or services have been provided.	Chapter 6 Revenue and Income Income is earned when goods have been delivered or services have been provided.
8	Accrual basis of accounting	Business activities that have occurred, regardless of whether cash is paid or received, should be recorded in the relevant accounting period.	Chapter 6 Revenue and Income Income is recognised when goods are delivered or services are provided regardless whether payment is received. Chapter 7 Cost of Sales and Expenses Expenses are recognised when incurred regardless whether payment is made.
9	Matching theory	Expenses incurred must be matched against income earned in the same period to determine the profit for the period.	Chapter 7 Cost of Sales and Expenses Expenses incurred must be matched against income earned in the same accounting year to determine the profit for the year. Chapter 10 Trade receivables As the increase in allowance for impairment of trade receivables is a likely expense, it should be recorded in the same accounting year as the sales revenue earned to obtain a true and far profit for the year. Chapter 11 Non-current assets (NCA) Depreciation expense, which is a portion of the cost of the NCA, should be matched against the income earned from using the NCA in the same year to obtain a true and fair profit for the year.

	Accounting Theory	Definition	Application
10	Prudence theory	The accounting treatment chosen should be the one that least overstates assets and profit and least understates liabilities and losses.	Chapter 9 Inventories Inventory is valued at the lower of cost and net realisable value so as not to overstate inventory and understate impairment losses. Chapter 10 Trade receivables The allowance for impairment of trade receivables is reported in the statement of financial position as a deduction against the trade receivables (TR) book value to ensure that the current asset is not overstated. Chapter 11 Non-current assets Non-current assets should be valued at their net book value, which is at cost less accumulated depreciation to ensure that the non-current asset is not overstated.
11	Consistency theory	Once an accounting method is chosen, this method should be applied to future accounting periods to enable meaningful comparison.	Chapter 11 Non-current assets The depreciation method used by the business must be consistent from period to period so that its financial performance can be meaningfully compared across financial periods.
12	Materiality theory	Financial information is material to the financial statements if it would change the opinion or view of a reasonable person.	Chapter 11 Non-current assets (NCA) If the amount spent on a NCA is insignificant/ immaterial to decision making, it does not have to be reported as an NCA even though its benefits last for more than one accounting year. It can be classified as a revenue expenditure and reported as an expense in the statement of financial performance.

CHAPTER 2 ACCOUNTING INFORMATION SYSTEM

TYPES OF BUSINESS TRANSACTIONS

- **Cash transactions:** Payment is made immediately during a cash sale or purchase
- **Credit transactions:** Payment is delayed during a credit sale or purchase



ACCOUNTING CYCLE

- Stage 1: Identify and record
  Source documents are used to record transactions in the **journal** daily. Journal entries are posted to the **ledger**.

- Stage 2: Adjust
  The ending balances of ledger accounts are listed in a **trial balance**. Any adjusting entries are recorded in the journal and posted to the ledger. Accounts are adjusted at least once in a financial year.

- Stage 3: Report
  Based on adjusted trial balance, **financial statements** are prepared at least once in a financial year.

- Stage 4: Closing
  After the financial statements are finalised, *income, expenses, income summary, drawings and dividends* accounts are closed. Accounts are closed once at end of financial year.

ACCOUNTING INFORMATION SYSTEM

It is a system that a business uses to collect, store and process accounting data.

	Components	Purpose
1	Source documents	A source document provides proof that transactions have occurred.
2	Journal	A journal is a daily record of transactions containing details from source documents.
3	Ledgers	Journal entries are posted to ledger accounts. A ledger account is a consolidation of transactions relating to a specific asset, liability, equity, income or expense item.
4	Trial balance	A trial balance provides a summary of ending balances of each ledger account at a specified date to check for errors.
5	Financial statements	A statement of financial performance provides a report on income earned and expenses incurred to determine the profit or loss for the period. A statement of financial position provides a report on assets, liabilities and equity at a specified date to show how resources are obtained and funded.

SOURCE DOCUMENTS

Purpose

A source document is a written document that provides details of a transaction and proves that the transaction has taken place.

The seller issues source documents to the buyer. The buyer receives the original copy while the seller keeps a duplicate so that both parties would be clear about the details of the transactions.

Application of Accounting Theory

1. **Objectivity theory** – a source document provides evidence so that transactions are recorded based on reliable and verifiable information.

2. **Historical cost theory** – The transaction is recorded at the original cost that it occurred as stated on the source document.

Source document	Purpose	Transaction / Keywords
Receipt	Acknowledges payment received from customers	Received cash or cheque
Payment voucher	To seek approval before making payment	Paid cash or cheque
Remittance advice	Informs credit supplier that payment by cheque has been made for specific invoice(s)	Only for payment to credit supplier
Bank statement	Prepared by the bank to check and tally against the business records of its cash at bank account	Bank amounts paid or received through: • standing order • credit transfer • direct debit • dishonoured cheque • bank charges
Invoice	Informs credit customers of the amount owed for goods or services provided.	• Sold goods/NCA on credit • Purchased goods/NCA on credit
Debit note	Increases the amount owed by credit customers.	• Undercharged customer • Undercharged by supplier
Credit note	Reduces the amount owed by credit customers.	• Goods returned by customer • Goods returned to supplier • Overcharged customer • Overcharged by supplier

CHAPTER 3 ELEMENTS OF FINANCIAL STATEMENTS & ACCOUNTING EQUATION

ELEMENTS OF FINANCIAL STATEMENTS

- **Assets** are resources a business owns or controls that are expected to generate future benefits.

- **Liabilities** are obligations owed by a business to others that are expected to be settled in the future.

- **Equity** is the claim by the owner on the net assets of a business, where net assets is total assets less total liabilities. Equity consists of capital contributed by the owner and the profit generated by the business.

- **Income** are earnings from the activities of a business, which consist of sales revenue, service fee revenue and other income.

- **Expenses** are costs incurred to earn income in the same accounting period, which consist of cost of sales and other expenses.

ACCOUNTING EQUATION

Basic: **Assets = Liabilities + *Equity***

Expanded: **Assets = Liabilities + *[Capital + Profit for the year – Drawings]***

Assets = Liabilities + *[Capital + (Income – Expenses) – Drawings]*

Note: Rearranging the equation
Assets + Expenses + Drawings = Liabilities + Income + Capital

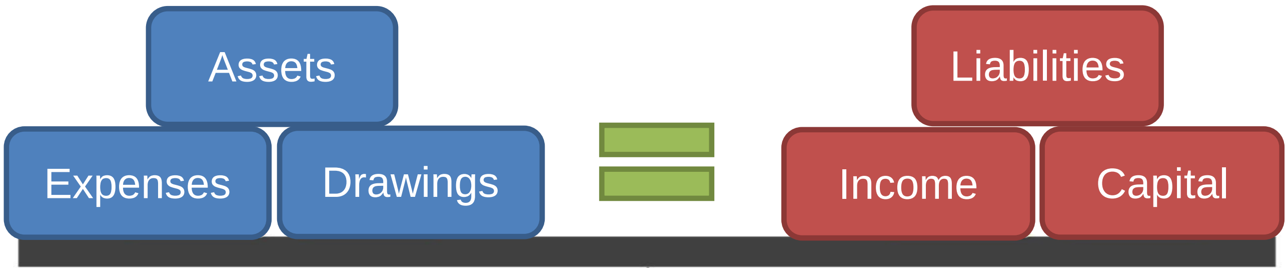
KEYWORDS TO IDENTIFY ACCOUNT NAMES

Keywords	Account Name
▪ Cheque ▪ Dishonoured cheque ▪ Bank ▪ Receipt	Cash at bank
▪ Took for own / personal / private use *(Not for office / business use)*	Drawings
▪ For resale ▪ Goods / stock	Inventory
▪ Cash	Cash in hand
▪ Credit customer ▪ Sold goods on credit ▪ Debtor	Trade receivable
▪ Credit supplier ▪ Bought goods on credit ▪ Creditor	Trade payable
▪ Computer ▪ Machinery	Equipment
▪ Tables and chairs ▪ Shelves ▪ Cupboard	Furniture / Fixtures and fittings
▪ Received ▪ Earned	__________ income
▪ Paid ▪ Incurred	__________ expense

CHAPTER 4 DOUBLE-ENTRY RECORDING

DOUBLE ENTRY SYSTEM

The double entry system states that there must be **<u>at least two</u>** accounts recorded for every business transaction. The total **<u>debit</u>** and total **<u>credit</u>** values are always **<u>equal</u>.**



<u>A</u>ssets, **<u>E</u>**xpenses & **<u>D</u>**rawings accounts:
natural balance is **<u>Debit (Dr)</u>**
LHS of the accounting equation

<u>L</u>iabilities, **<u>I</u>**ncome & **<u>C</u>**apital accounts:
natural balance is **<u>Credit (Cr)</u>**
RHS of the accounting equation

<u>Examples of Assets:</u>

1. Premises / Land & Property
2. Equipment / Machinery
3. Fixtures and fittings / Furniture
4. Motor vehicle
5. Inventory *(goods)*
6. Cash at bank *(cheque)*
7. Cash in hand *(cash)*
8. Trade receivables
   (debts which customers owe)

<u>Examples of Liabilities:</u>

1. Loan from bank
2. Mortgage loan
3. Bank overdraft
   (overspent bank account)
4. Trade payables
   (debts which are owed to suppliers)

<u>Examples of Expenses:</u>

1. Cost of sales
2. Utilities expense
3. Repairs and maintenance
4. Insurance expense
5. Advertising expense
6. Salaries expense
7. Rent expense
8. Commission expense
9. Stationery
10. Discount allowed
11. Bank charges
12. Interest on loan

<u>Examples of Income:</u>
1. Sales revenue
   (income earned from selling goods)
2. Service fee revenue
3. Commission income
4. Rent income
5. Discount received
6. Interest on fixed deposit

CONCEPT OF DEBIT & CREDIT

“ **A**fter **E**very **D**inner, **L**et’s **I**nnovate **C**reatively”

Dr	**A**ssets	Cr
+		-

1. Premises / Land & Property
2. Equipment
3. Fixtures and fittings
4. Motor vehicle
5. Inventory *(goods/stock/for resale)*
6. Cash at bank *(cheque)*
7. Cash in hand *(cash)*
8. Trade receivables

Dr	**L**iabilities	Cr
-		+

1. Loan from bank
2. Mortgage
3. Bank overdraft
4. Trade payables

Dr	**E**xpenses	Cr
+		

1. Cost of sales
2. Utilities expense
3. Repairs and maintenance
4. Insurance expense
5. Advertising expense
6. Salaries expense
7. Rent expense
8. Commission expense
9. Stationery
10. Discount allowed
11. Bank charges
12. Interest on loan

Dr	**I**ncome	Cr
		+

1. Sales revenue
   (income earned from selling goods)
2. Service fee revenue
3. Commission income
4. Rent income
5. Discount received
6. Interest on fixed deposit

Dr	**D**rawings	Cr
+		

Owner’s takings of business assets for his personal use

Dr	**C**apital	Cr
		+

Owner’s contribution of personal assets for business use

JOURNAL ENTRIES

Journal

Date	Particulars	Dr $	Cr $
2021			
Jan 14	Trade payable John	2 000	
	Cash at bank		2 000
	The business paid trade payable John		
	$2000 cheque.		
Jan 26	Cash at bank	3 000	
	Capital		3 000
	Owner contributed $3000 into the		
	business bank account.		

Dr entry
Cr entry
Narration

Purpose of narration: Helps in recalling the background of each transaction without having to refer to the source documents.

Note: The Dr entry is always presented first in the Journal.

LEDGER ACCOUNTS

this means Cr CAB 2000

Dr/Cr must be indicated in the Bal column

Cash at Bank Account

2021	Particulars	Dr $	Cr $	Bal $	
Jan 1	Balance b/d			10 000	Dr*
14	Trade payable John		2 000	8 000	Dr
26	Capital	3 000		11 000	Dr
2021					
Feb 1	Balance b/d			11 000	Dr*

Heading and Particulars are NEVER the same!

* Only the first and last running balance are required

Closing of ledger accounts
At the end of each <u>month</u>, running balances of **all** ledger accounts are bought down (balance b/d) to the next month.

At the end of each <u>year</u>, <u>income and expenses accounts</u> are closed and transferred to <u>income summary account</u>.

DOUBLE ENTRY RECORDING

Capital contribution from Owner

	Dr $	Cr $
Cash in hand/ Cash at bank/ Inventory/ Equipment	xxx	
Capital		xxx

Drawings taken by Owner

	Dr $	Cr $
Drawings	xxx	
Cash in hand/ Cash at bank/ Inventory/ Equipment		xxx

Borrowing of Loan

	Dr $	Cr $
Cash in hand/ Cash at bank	xxx	
Loan from XXX Bank		xxx

Repayment of Loan

	Dr $	Cr $
Loan from XXX Bank	xxx	
Cash in hand/ Cash at bank		xxx

Payment for Expenses

	Dr $	Cr $
Rent expense/ Stationery/ Salaries and wages/ Utilities	xxx	
Cash in hand/ Cash at bank		xxx

Receipt from Income

	Dr $	Cr $
Cash in hand/ Cash at bank	xxx	
Interest income/ Commission income/ Rent income		xxx

Purchase of Non-Current Assets

	Dr $	Cr $
Furniture/ Equipment/ Motor vehicle	xxx	
Cash in hand/ Cash at bank/ Trade payable-XXX		xxx

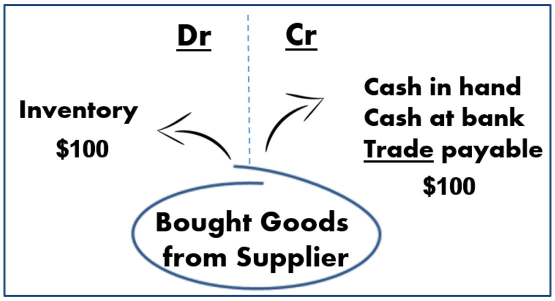
Transfer of funds: Withdrawal for office use

	Dr $	Cr $
Cash in hand	xxx	
Cash at bank		xxx

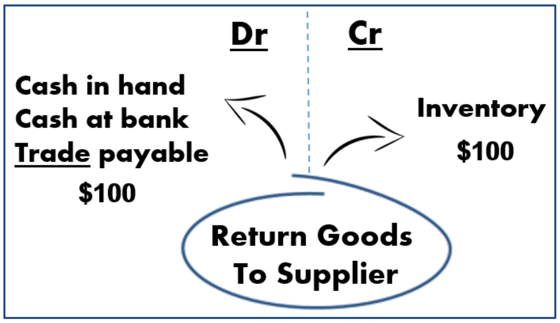
Transfer of funds: Deposit business funds

	Dr $	Cr $
Cash at bank	xxx	
Cash in hand		xxx

Between Business and Supplier Jack

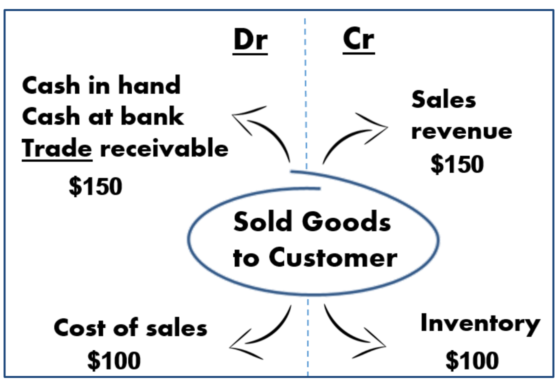


	Dr $	Cr $
Inventory (A+)	100	
Cash in hand (A-)/ Cash at bank(A-)/ Trade payable-Jack(L+)		100

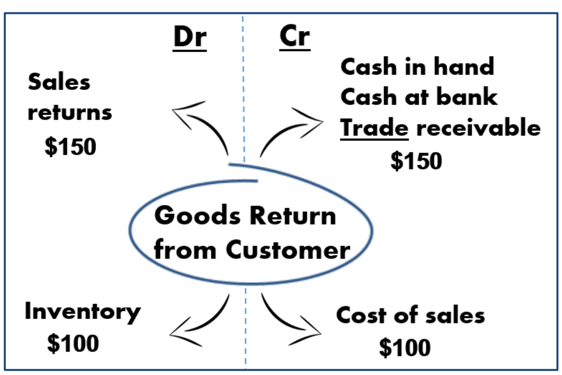


	Dr $	Cr $
Cash in hand (A+)/ Cash at bank (A+)/ Trade payable-Jack (L-)	100	
Inventory (A-)		100

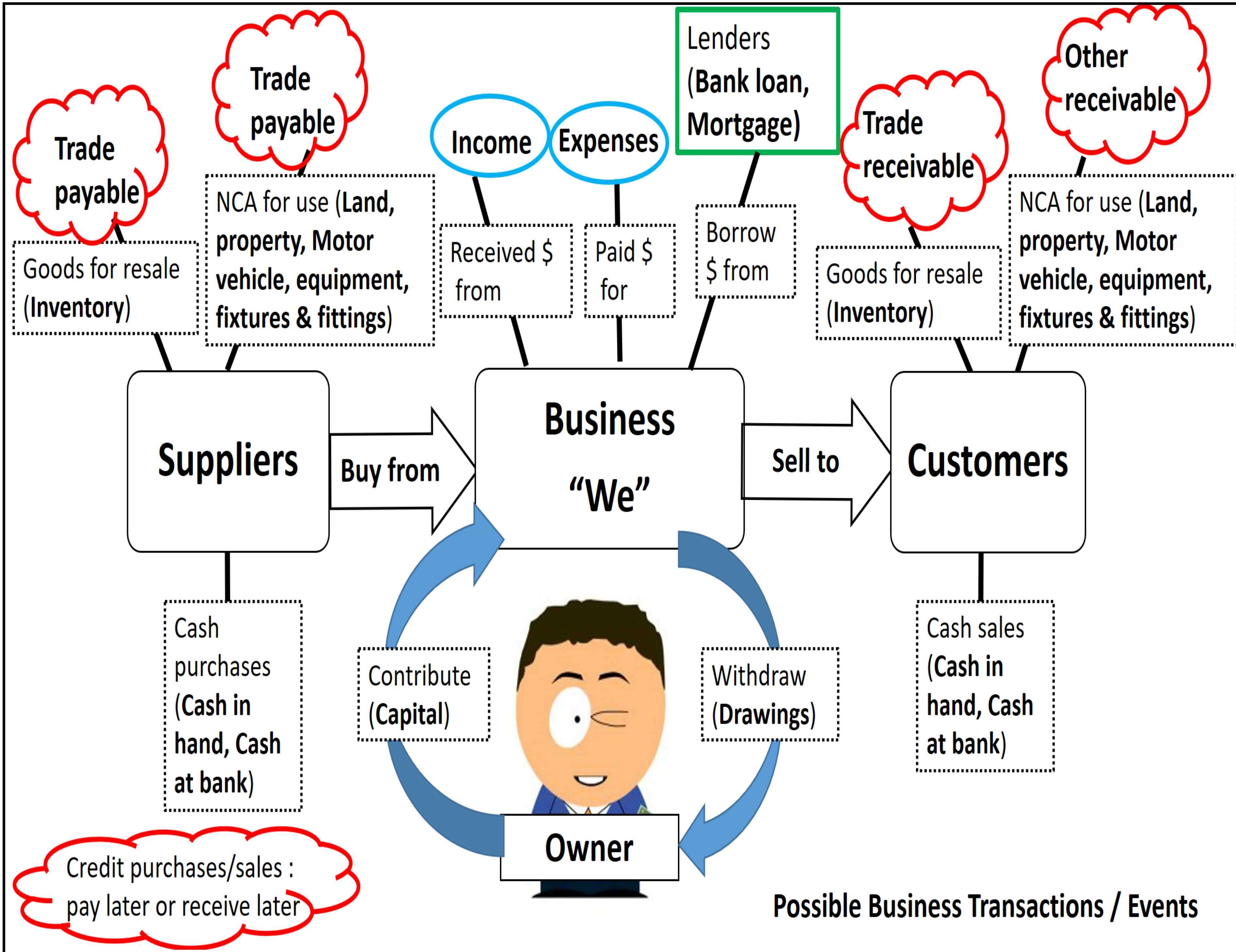
Between Business and Customer Tom



	Dr $	Cr $
Cash in hand (A+)/ Cash at bank (A+)/ Trade receivable-Tom (A+)	150	
Sales revenue (I+)		150
Cost of sales (E+)	100	
Inventory (A-)		100



	Dr $	Cr $
Sales returns (I-)	150	
Cash in hand (A-)/ Cash at bank (A-)/ Trade receivable-Tom (A-)		150
Inventory (A+)	100	
Cost of sales (E-)		100



Possible Business Transactions / Events

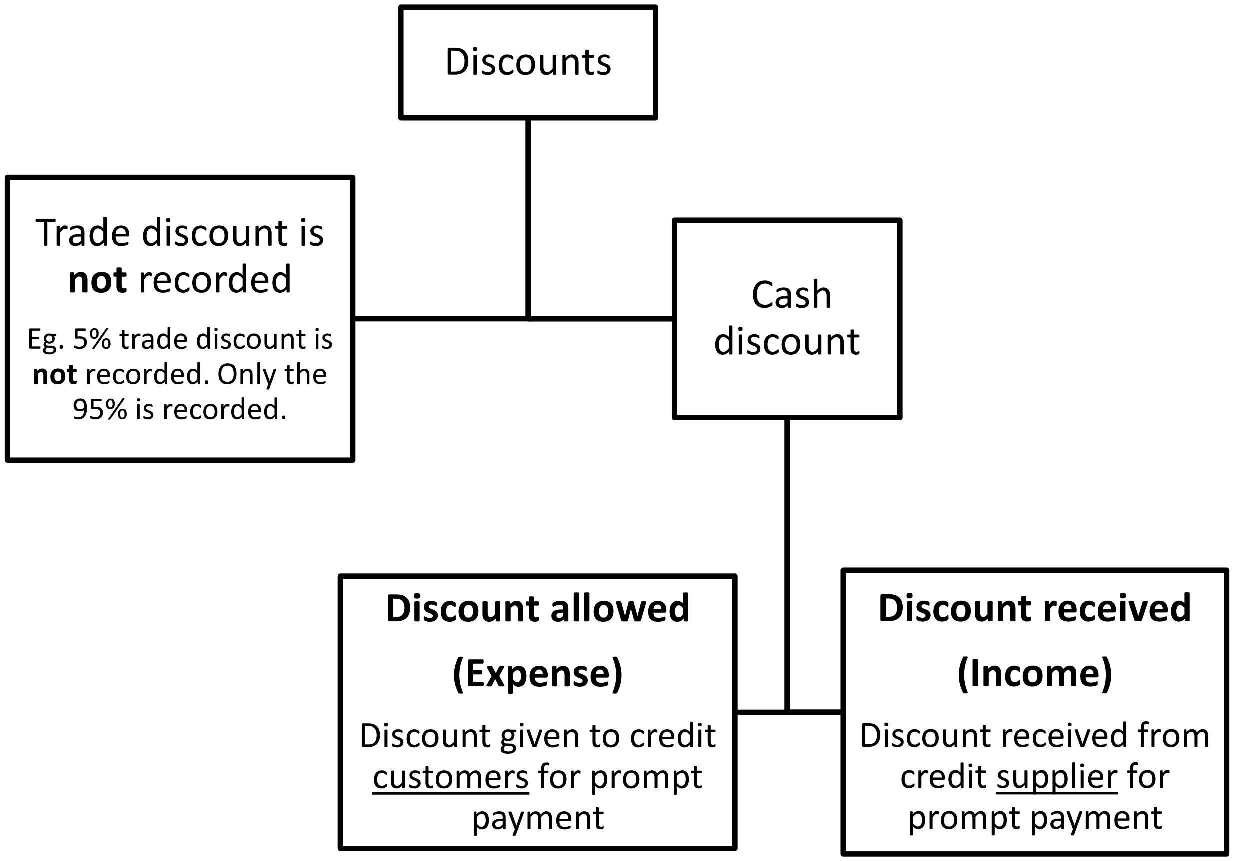
TRADE DISCOUNT AND CASH DISCOUNT

		Trade Discount	Cash Discount
1	*Definition (what is…?)*	Reduction to the **list price**	Reduction to the **invoiced price**
2	*Purpose (why give?)*	**To encourage:** • **customers to buy in bulk** • **customer patronage** • **customer loyalty**	**To encourage credit customers to pay promptly, by a specified date**
3	*When given?*	Given at the **point of sale** …means given when the order is placed and sale is confirmed	Given at the **point of payment** …means given when cash/cheque is received
4	*How to record?*	Trade discount is **not recorded** Eg. 5% trade discount is not recorded. Only the 95% is recorded.	**Recorded as discount allowed or discount received** Dr Discount allowed (E+) Cr Trade receivable Name (A-) Dr Trade payable Name (L-) Cr Discount received (I+)
5	*Example*	Buy 10 get 10% discount Buy 20 get 20% discount	If payment is made within 10 days, 5% discount will be given.

Note:
List price = Original price (before discount)
Net price = After discount
Invoiced amount = Amount owing as stated in the invoice

Refer to Chapter 10 for trade receivable account
Refer to Chapter 12 for trade payable account

DISCOUNTS



Discounts
Trade discount is **not** recorded
Eg. 5% trade discount is **not** recorded. Only the 95% is recorded.
Cash discount
Discount allowed
(Expense)
Discount given to credit customers for prompt payment
Discount received
(Income)
Discount received from credit supplier for prompt payment

CHAPTER 5 TRIAL BALANCE & FINANCIAL STATEMENTS

TRIAL BALANCE

Definition
A trial balance is a listing of ledger account balances at a specific date.

Purpose
- Facilitate the preparation of the financial statements
- Ensure arithmetic accuracy in recording

Assets
Expenses
Drawings

Liabilities
Income
Capital

JYSS Ltd
Trial Balance as at 31 March 2022

	Dr $	Cr $
Trade receivables	xx	
Allowance for impairment of trade receivables *(contra-asset)*		xx
Cash at bank	xx	
Inventory	xx	
Trade payables		xx
Long term borrowing		xx
Capital		xx
Sales revenue		xx
Sales returns *(contra-income)*	xx	
Drawings	xx	
Cost of sales	xx	
Rent expense	xx	
Equipment	xx	
Accumulated depreciation *(contra-asset)*		xx
Interest income		xx
	Xxx	Xxx

Ensure that total debit equal to total credit

STATEMENT OF FINANCIAL PERFORMANCE

Definition
A financial statement that shows the income earned and expenses incurred for a period of time to determine the profit or loss of a business.

Income are earnings from the activities of a business. It consists of:
(i) Revenue could be sales revenue or service fee revenue. Sales revenue earned from selling goods. Service fee revenue is earned from providing services.
(ii) Other income is earnings which are not from normal sale of goods and services e.g. interest income.
(iii) Other gains arise when the business sells its non-current assets.

Expenses are costs incurred to earn income in the same accounting period, which consist of cost of sales and other expenses.

Application of Accounting Theory

1. **Going concern theory**
   A business is assumed to have indefinite economic life unless there is credible evidence that it may close down.

2. **Accounting period theory**
   The statement of financial performance is prepared periodically (usually yearly) to assess the profitability of the business.

3. **Revenue recognition theory**
   Revenue is recognised / earned when goods have been delivered or services have been provided.

4. **Matching theory**
   Profit or loss for the year is determined by matching the expenses incurred to the income earned in the same accounting year.

Trading portion	**Profit and loss portion**
Shows gross profit or loss	Shows (overall) profit or loss for the year
Reflects how well the business is able to sell its goods to generate profit	Reflects the overall profitability of a business
Gross Profit = Sales revenue – Sales returns – Cost of sales	Profit for the year = Gross profit + Other income – Other expenses

TRADING BUSINESS

JYSS Ltd

Statement of Financial Performance for the year ended 31 October 2022

Items in the trading portion are <u>fixed</u>!

If there's <u>no sales returns</u>, <u>skip net sales revenue</u> too.

		$	$
Trading portion	**Sales revenue**	X	
	Less: **Sales returns**	X	
	Net sales revenue		X
	Less: **Cost of sales**		X
	Gross profit / Gross loss		XX / (XX)
Profit & Loss portion	<u>Other income</u>		
	Discount received	X	
	Rent income	X	
	Gain on sale of non-current assets	X	XX
	<u>Less: Other expenses</u>		
	Impairment loss on trade receivables	X	
	OR Reversal of impairment loss on trade receivables	(X)	
	Depreciation of fixtures and fittings	X	
	Depreciation of motor vehicles	X	
	Loss on sale of non-current assets	X	
	Insurance expense	X	
	Commission expense	X	
	Discount allowed	X	
	⋮	⋮	
	Bank charges	X	XX
	Profit for the year / Loss for the year		XX / (XX)

Note: Single solid line means "sum up the above figures".
"Less" means subtract.
Bracket means "negative".
Double line means "the end"

For income and expenses in the P&L portion, include only the items reflected in the question. The income and expenses provided above are only examples.

SERVICE BUSINESS

JYSS Ltd
Statement of Financial Performance for the year ended 31 October 2022

Profit & Loss portion

	$	$
Service fee revenue		XX
Other income		
Discount received	X	
Rent income	X	
Gain on sale of non-current assets	X	XX
Less: Other expenses		
Impairment loss on trade receivables	X	
OR Reversal of impairment loss on trade receivables	(X)	
Depreciation of fixtures and fittings	X	
Depreciation of motor vehicles	X	
Loss on sale of non-current assets	X	
Insurance expense	X	
Commission expense	X	
Discount allowed	X	
⋮	⋮	
Bank charges	X	XX
Profit for the year / Loss for the year		XX / (XX)

Note: Single solid line means "sum up the above figures".
"Less" means subtract.
Bracket means "negative".
Double line means "the end"

There is NO trading portion as the service business does not trade i.e. buy and sell goods. It is replaced by service fee revenue (the main income earned from providing services), and is set apart from other income.

For income and expenses in the P&L portion, include only the items reflected in the question. The income and expenses provided above are only examples.

STATEMENT OF FINANCIAL POSITION

Definition
A list of the assets, liabilities and equity of a business at a specified date.

Non-current Assets are resources that have benefits that **last** beyond one financial year, and are not easily converted to cash.

Current Assets are resources that have benefits that are **used** within one financial year, and are easily converted to cash.

Owner's Equity is the claim by the owner on the net assets of a business.

Non-current Liabilities are long-term debts due to be repaid after one financial year.

Current Liabilities are short-term debts due to be repaid within one financial year.

Application of Accounting Theory

1. **Accounting period theory**
   The statement of financial position is prepared periodically (usually yearly) to assess how the resources are obtained and used in a business and the claim by the owner on the net assets of the business on a certain date.

2. **Prudence theory**
   Non-current assets, trade receivables and inventory are written down so that assets are not overstated.

BANK OVERDRAFT VS CASH AT BANK

SOLE PROPRIETORSHIP – STATEMENT OF FINANCIAL POSITION

JYSS Ltd

Statement of Financial Position as at 31 October 2022

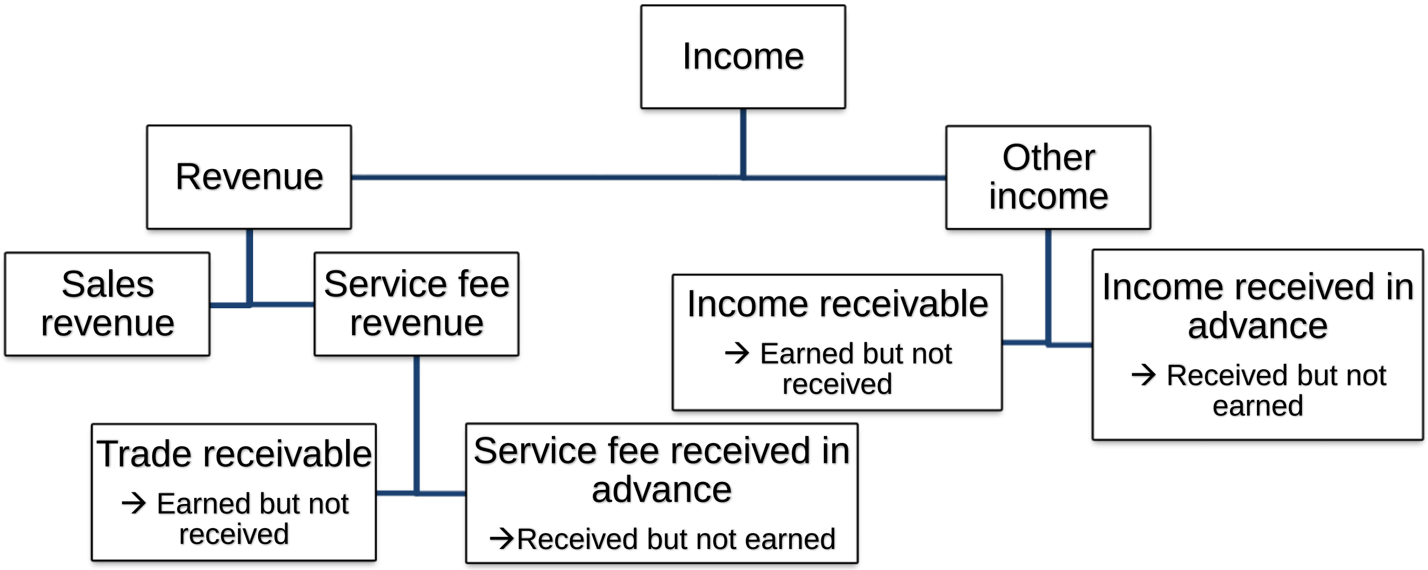
		$	$
ASSETS			
Non-current assets	Cost	Accumulated depreciation	Net book value
Motor vehicle	X	X	X
Equipment	X	X	X
Fixtures and fittings	X	X	X
			XX
Current assets			
Trade receivables	X		
Less: Allowance for impairment of trade receivables	X	X	
Inventory		X	
Other receivables		X	
Cash in hand		X	
Cash at bank		X	
Prepaid ________ expense		X	
________ income receivable		X	XX
Total assets			XXX
EQUITY AND LIABILITIES			
Owner's Equity			
Capital *(Beginning capital + Additional capital + Profit for the year / – Loss for the year – Drawings)*			XX
Non-current liabilities			
Long-term borrowings *(Loan / Mortgage)*			XX
Current liabilities			
Current-portion of long-term borrowings		X	
Bank overdraft		X	
Trade payables		X	
________ expense payable		X	
________ income received in advance		X	XX
Total equity and liabilities			XXX

PRIVATE LIMITED COMPANY: STATEMENT OF FINANCIAL POSITION (O LEVEL ONLY)

JYSS Ltd
Statement of Financial Position as at 31 October 2022

		$	$
ASSETS			
Non-current assets	Cost	Accumulated depreciation	Net book value
Motor vehicle	X	X	X
Equipment	X	X	X
Fixtures and fittings	X	X	X
			XX
Current assets			
Trade receivables	X		
Less: Allowance for impairment of trade receivables	X	X	
Inventory		X	
Other receivables		X	
Cash in hand		X	
Cash at bank		X	
Prepaid ________ expense		X	
________ income receivable		X	XX
Total assets			XXX
EQUITY AND LIABILITIES			
Shareholders' Equity			
Share capital, xxx ordinary shares		X	
Retained earnings / Less: Accumulated losses		X	XX
Non-current liabilities			
Long-term borrowings			XX
Current liabilities			
Dividend payable		X	
Current-portion of long-term borrowings		X	
Bank overdraft		X	
Trade payables		X	
________ expense payable		X	
________ income received in advance		X	XX
Total equity and liabilities			XXX

CHAPTER 6 INCOME



- Received = cash / cheque is received
- Earned = goods / services have been provided

Income Receivable	Income Received in Advance
▪ Owing/Outstanding/Due/Accrued ▪ Earned but not yet received ▪ Received < Earned ▪ Receivable = Earned – Received ▪ Recorded as **Current Assets**	▪ Unearned/owed services or goods ▪ Received but not yet earned ▪ Received > Earned ▪ Received in Advance = Received – Earned ▪ Recorded as **Current Liabilities**

Application of Accounting Theory

1. **Revenue recognition theory**
   Revenue is recognised / earned when goods have been delivered or services have been provided.

2. **Accrual basis of accounting**
   Income earned but not received must be recorded in the current financial year even though cash has not been received.

   Income received before goods or services are provided should not be recorded until goods or services are provided to customer, regardless of whether cash is received.

SALES REVENUE

Sales revenue is the income earned from the sale of goods, and is credit in nature.

Journal Entry

Journal

Date	Particulars	Dr $	Cr $
2021			
Jun 12	Trade receivable Jeff (A+)	3 000	
	Sales revenue (I+)		3 000
	Cost of sales (E+)	1 200	
	Inventory (A-)		1 200
	Sold goods on credit to Jeff for $3000. The cost of goods sold was $1200.		
Jun 26	Cash in hand (A+) *(received cheque → Cash at bank)*	4 000	
	Sales revenue (I+)		4 000
	Cost of sales (E+)	2 700	
	Inventory (A-)		2 700
	Sold goods to Tom for $4000 and received cash. The cost of goods sold was $2700.		
Jun 30	**Sales revenue**	7 000	
(year-end)	Income summary		7 000
(Closing entry)	*Total sales revenue* ***earned*** *for the year transferred to income summary account.*		

Sales revenue account

2021		Dr - $	Cr + $	Bal $
Jun 1	Balance b/d			1 000 Cr
12	Trade receivable Jeff		3 000	4 000 Cr
26	Cash in hand		4 000	8 000 Cr
30	Income summary	8 000		0

Interpretation of Ledger Account

- 1 Jun: Sales revenue of $1000 was brought down from May to Jun.
- 12 Jun: the business sold goods **for** $3000 on credit to Jeff.
- 26 Jun: the business sold goods and received $4000 in cash.
- 30 Jun: $8000 of sales revenue was earned during the year and transferred to the income summary account.

SALES RETURNS

Sales returns are the return of goods from customers, and is debit in nature.

Journal Entry

Journal

Date	Particulars	Dr $	Cr $
2021			
Jun 19	**Sales returns** (I-)	500	
	Trade receivable Jeff (A-)		500
	Inventory (A+)	100	
	Cost of sales (E-)		100
	Customer Jeff returned goods that was previously sold to him on credit for $500. The cost of goods sold was $100.		
Jun 28	**Sales returns** (I-)	900	
	Cash in hand (A-) *(received cheque → Cash at bank)*		900
	Inventory (A+)	300	
	Cost of sales (E-)		300
	Customer Tom returned goods and $900 cash refund was made to him. The cost of goods sold was $300.		
Jun 30	Income summary	1 400	
(year-end)	**Sales returns**		1 400
(Closing entry)	*Total sales returns for the year transferred to income summary account.*		

Sales returns account

2021		Dr + $	Cr - $	Bal $
Jun 1	Balance b/d			2 000 Dr
19	Trade receivable Jeff	500		
28	Cash in hand	900		3 400 Dr
30	Income summary		3 400	0

Interpretation of Ledger Account

- 1 Jun: Sales returns $2 000 was brought down from May to Jun.
- 19 Jun: Customer Jeff returned goods previously sold to him on credit **for** $500.
- 28 Jun: Customer returned goods and $900 cash refund was made to him.
- 30 Jun: Sales returns totalled $3400 for the year was transferred to the income summary account.

INCOME RECEIVABLE

It is income earned in the financial year but payment have not been received. It is recorded as a **current asset** in the statement of financial position.

Journal Entry

Journal

Date	Particulars	Dr $	Cr $
2021			
Jan 1	Income (I-)	2 000	
	Income receivable (A-)		2 000
	Reversal entry for the income receivable recorded last year.		
Dec 31	Cash at bank / cash in hand (A+)	5 000	
(use date if given)	Income (I+)		5 000
	*The business **received** cheque / cash for income.*		
Dec 31	Income (I-)	3 400	
(year-end)	Income summary		3 400
(Closing entry)	*Income **earned** for the year transferred to income summary.*		
Dec 31	Income receivable (A+)	400	
(year-end)	Income (I+)		400
	Income earned this year but have not been received.		

☞ Income account (I)

2021	Particulars	Dr $ -	Cr $ +	Bal $
Jan 1	Income receivable (**0**)	2 000		2 000 Dr
Dec 31	Cash in hand / Cash at bank (**1**)		5 000	
Dec 31	Income summary (**2**)	3 400		
Dec 31	Income receivable (**3**)		400	0

Interpretation of Ledger Account

(0) 1 Jan 2021: $2000 <u>income earned but not received last year</u> was reversed.
(1) 31 Dec 2021: <u>Cash/cheque</u> of $5000 was <u>received</u> for income.
(2) 31 Dec 2021: $3400 income was <u>earned</u> during the year and transferred to the income summary account.
(3) 31 Dec 2021: $400 of <u>income was earned this year</u> but <u>payment have not been received</u>.

INCOME RECEIVED IN ADVANCE

Income received in advance is income received but not earned. The owing of the service is recognised as a **current liability** in the statement of financial position.

Journal Entry

Journal

Date	Particulars	Dr $	Cr $
2020			
Apr 1	Income received in advance (L-)	600	
	Income (I+)		600
	Reversal entry for the income received in advance recorded last year.		
2021			
Mar 31	Cash at bank / cash in hand (A+)	1 000	
(use date if given)	Income (I+)		1 000
	*The business **received** cheque / cash for* ___ income.		
Mar 31	Income	900	
(year-end)	Income summary		900
(Closing entry)	*Income **earned** for the year transferred to income summary.*		
Mar 31	Income (I-)	700	
(year-end)	Income received in advance (L+)		700
	Income received this year but not earned.		

Income account (I)

2020	Particulars	Dr $ -	Cr $ +	Bal $
Apr 1	Income received in advance (**0**)		600	600 Cr
2021 Mar 31	Cash in hand/ Cash at bank (**1**)		1 000	
Mar 31	Income summary (**2**)	900		
Mar 31	Income received in advance (**3**)	700		0

Interpretation of Ledger Account

(0) 1 Apr 2020: $600 income received but not earned last year was reversed.
(1) 31 Mar 2021: Cash/cheque of $1000 was received for income.
(2) 31 Mar 2021: $900 income was earned during the year and transferred to the income summary account.
(3) 31 Mar 2021: $700 of income received this year, have not been earned.

Summary

0	**Reversal** at the start of the financial year	Reversal of last year's income received in advance	Dr Income received in advance **(L-)** Cr *Income* (I+)
		Reversal of last year's income receivable	Dr *Income* (I-) Cr Income receivable **(A-)**
1	Record income **received**		Dr **Cash in hand / Cash at bank** (A+) Cr *Income* (I+)
2	Record income **earned** (**closing entry** / transfer to income summary at end of financial year)		Dr *Income* (I-) Cr **Income Summary**
3	**Adjustment** at the end of the financial year	Adjust for income received in advance	Dr *Income* (I-) Cr Income received in advance **(L+)**
		Adjust for income receivable	Dr Income receivable **(A+)** Cr *Income* (I+)

Income account (I)

2021	Particulars	Dr $ -	Cr $ +	Bal $
Jan 1	Income receivable / Income received in advance (**0**)	**R**eceivable	Received in **A**dvance	
Dec 31	Cash in hand / Cash at bank (**1**)		√	
Dec 31	Income summary (**2**)	√		
Dec 31	Income received in advance / Income receivable (**3**)	Received in **A**dvance	**R**eceivable	0

JYSS Ltd
Statement of Financial Performance for year ended 31 December 2021 (extract)

	$
Other Income	
___________ income **(2)** — Amount transferred to the **income summary** account →	XX

JYSS Ltd
Statement of Financial Position as at 31 December 2021 (extract)

	$
Current assets	
___________ income **receivable (3)**	XX
Current liabilities	
___________ income **received in advance (3)**	XX

Calculation of Income Earned

Income **earned*** this year	=	Cash / cheque **received**	–	***Not*** *earned this year*	+	***Earned*** *this year*
				Last year's **receivable** OR This year's **received in advance**		Last year's **received in advance** OR This year's **receivable**

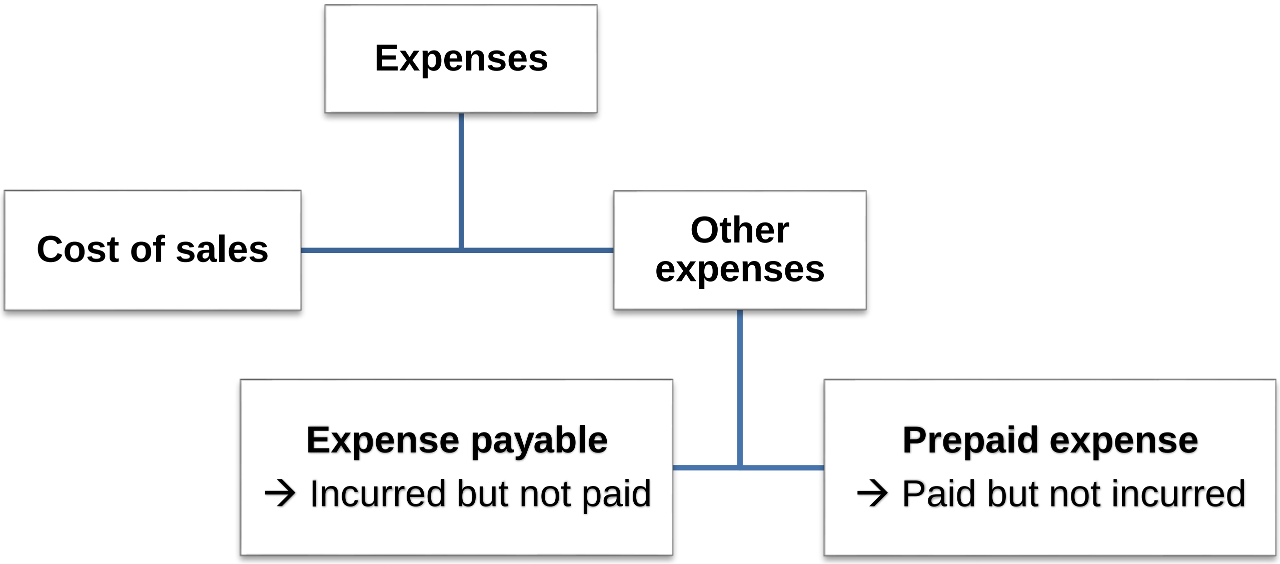
*Income earned is the closing entry transferred to **income summary**
Also reflected in the **statement of financial performance**

Effects of Year-End Adjustment

Income receivable	Effect on		
	Income	**Profit**	**Current Asset**
If not adjusted	Understated	Understated	Understated
After adjustment	Increased	Increased	Increased

Income received in advance	Effect on		
	Income	**Profit**	**Current Liability**
If not adjusted	Overstated	Overstated	Understated
After adjustment	Decreased	Decreased	Increased

CHAPTER 7 EXPENSES



Expense Payable	Prepaid Expense
▪ Owing/Outstanding/Due/Payable/Accrued ▪ Incurred but not yet paid ▪ Paid < Incurred (used) ▪ Payable = Incurred – Paid ▪ Recorded as **Current Liabilities**	▪ Paid in advance ▪ Paid but not yet incurred ▪ Paid > Incurred (used) ▪ Prepaid = Paid – Incurred ▪ Recorded as **Current Assets**

Application of Accounting Theory

1. **Matching theory**

   The cost of sales must be matched against the sales revenue earned from selling the inventory in the same accounting year to determine the gross profit.

   Other costs incurred to generate revenue and other income must be matched against revenue and other income earned in the same accounting year to determine the profit for the year.

2. **Accrual basis of accounting**

   Expenses should be recognised in the year the services have been used, regardless of whether they have been paid or not.

COST OF SALES

It is the cost of goods sold, recorded when goods are sold and when sold goods are returned. It is an expense, and is debit in nature.

Journal Entry

Journal

Date	Particulars	Dr $	Cr $
2021			
Dec 15	Trade receivable Akif (A+)	1 000	
	Sales revenue (I+)		1 000
	Cost of sales (E+)	600	
	Inventory (A-)		600
	Sold goods to Akif on credit for $1 000. The cost of goods sold was $600.		
Dec 24	Cash at bank (A+) *(received cash → Cash in hand)*	750	
	Sales revenue (I+)		750
	Cost of sales (E+)	330	
	Inventory (A-)		330
	Sold goods and received $750 cheque. The cost of goods sold was $330.		
Dec 28	Sales returns (I-)	50	
	Trade receivable Akif (A-)		50
	Inventory (A+)	10	
	Cost of sales (E-)		10
	Akif returned goods worth $50. The cost of goods sold was $10.		
Dec 31	Income summary	920	
(year-end)	**Cost of sales**		920
(Closing entry)	*Total sales returns for the year transferred to income summary account.*		

Cost of sales account

2021	Particulars	Dr $ +	Cr $ -	Bal $
Dec 1	Balance b/d			4 000 Dr
15	Inventory	600		
24	Inventory	330		
28	Inventory		10	4 920 Dr
31	Income summary		4 920	0

Cost of sales **increases** when goods are **sold**

Interpretation of Ledger Account

- 1 Dec 2021: Cost of sales of $4000 was brought down from Nov to Dec.
- 15 Dec 2021: the business sold goods **costing** $600.
- 24 Dec 2021: the business sold goods **costing** $330.
- 28 Dec 2021: Customers returned goods **costing** $10.
- 31 Dec 2021: A total of $4920 cost of sales was **incurred** during the year and transferred to the income summary account.

PREPAID EXPENSE

It is an expense paid in advance before services are incurred or used. It is recognised as a **current asset** in the statement of financial position.

Journal Entry

Journal

Date	Particulars	Dr $	Cr $
2020			
July 1	Expense (E+)	500	
	Prepaid expense (A-)		500
	Reversal entry for the prepaid expense recorded last year.		
2021			
Jun 30	Expense (E+)	2 000	
(use date if given)	Cash at bank / cash in hand (A-)		2 000
	*The business **paid** cheque / cash for* expense.		
Jun 30	Income summary	1 100	
(year-end)	Expense		1 100
(Closing entry)	*Expense **incurred** for the year transferred to income summary.*		
Jun 30	Prepaid expense (A+)	1 400	
(year-end)	Expense (E-)		1 400
	Expense paid in advance this year but not incurred.		

Expense account

2020	Particulars	Dr $ +	Cr $ -	Bal $
Jul 1	Prepaid expense (**0**)	500		500 Dr
2021 Jun 30	Cash in hand/ Cash at bank (**1**)	2 000		
Jun 30	Income summary (**2**)		1 100	
Jun 30	Prepaid expense (**3**)		1 400	0

Interpretation of Ledger Account

(0) 1 Jul 2020: $500 <u>expense paid but not incurred last year</u> was reversed.
(1) 30 Jun 2021: <u>Cash/cheque</u> of $2000 was <u>paid</u> for expense.
(2) 30 Jun 2021: $1100 expense was <u>incurred</u> during the year and transferred to the income summary account.
(3) 30 Jun 2021: $1400 of expense <u>paid this year</u>, have <u>not been incurred</u>.

EXPENSE PAYABLE

It is expense incurred but not yet paid. The owing of the expense is recognised as a **current liability** in the statement of financial position.

Journal Entry

Journal

Date	Particulars	Dr $	Cr $
2020			
Oct 1	Expense payable (L-)	800	
	Expense (E-)		800
	Reversal entry for the expense payable recorded last year.		
2021			
Sep 30	Expense (E+)	1 000	
(use date if given)	Cash at bank / cash in hand (A-)		1 000
	The business ***paid*** *cheque / cash for* expense.		
Sep 30	Income summary	400	
(year-end)	Expense		400
(Closing entry)	*Expense* ***incurred*** *for the year transferred to income summary.*		
Sep 30	Expense (E+)	200	
(year-end)	Expense payable (L+)		200
	Expense incurred but not paid this year.		

Expense account

2020	Particulars	Dr $ +	Cr $ -	Bal $
Oct 1	Expense payable (**0**)		800	800 Cr
2021 Sep 30	Cash in hand/ Cash at bank (**1**)	1 000		
Sep 30	Income summary (**2**)		400	
Sep 30	Expense payable (**3**)	200		0

Interpretation of Ledger Account

(0) 1 Oct 2020: $800 expense incurred but not paid last year was reversed.
(1) 30 Sep 2021: Cash/cheque of $1000 was paid for expense.
(2) 30 Sep 2021: $400 expense was incurred during the year and transferred to the income summary account.
(3) 30 Sep 2021: $200 of expense was incurred this year, have not been paid.

Summary

0	**Reversal** at the start of the financial year	Reversal of last year's expenses payable	Dr Expense payable (L-) *Cr Expense (E-)*
		Reversal of last year's prepaid expenses	*Dr Expense (E+)* Cr Prepaid expense (A-)
1	Record expenses **paid**		*Dr Expense (E+)* Cr Cash in hand / Cash at bank (A-)
2	Record expenses **incurred (closing entry** / transfer to income summary at end of financial year)		Dr Income Summary *Cr Expense (E-)*
3	**Adjustment** at the end of the financial year	Adjust for expenses payable	*Dr Expense (E+)* Cr Expense payable (L+)
		Adjust for prepaid expenses	Dr Prepaid expense (A+) *Cr Expense (E-)*

Expense account (E)

2021	Particulars	Dr $ +	Cr $ -	Bal $
Jan 1	Prepaid expense / Expense payable **(0)**	Prepaid	Payable	
Dec 31	Cash in hand/ Cash at bank **(1)**	√		
Dec 31	Income summary **(2)**		√	
Dec 31	Expense payable / Prepaid expense **(3)**	Payable	Prepaid	0

JYSS Ltd
Statement of Financial Performance for year ended 31 December 2021 (extract)

	$
Less: Other expenses	
_____ expense **(2)**	XX

Same as the amount transferred to the **income summary** account

JYSS Ltd
Statement of Financial Position as at 31 December 2021 (extract)

	$
Current assets	
Prepaid _____ expense **(3)**	XX
Current liabilities	
_______ expense **payable (3)**	XX

Calculation of Expense Incurred

Expense **incurred*** this year	=	Cash / cheque **paid**	–	***Not** incurred this year* Last year's expense **payable** OR This year's **prepaid** expense	+	***Incurred** this year* Last year's **prepaid** expense OR This year's expense **payable**

*Expense incurred is the closing entry transferred to **income summary**
Also reflected in the **statement of financial performance**

Effects of Year-End Adjustment

Prepaid expense	Effect on		
	Expense	**Profit**	**Current Asset**
If not adjusted	Overstated	Understated	Understated
After adjustment	Decreased	Increased	Increased

Expense payable	Effect on		
	Expense	**Profit**	**Current Liability**
If not adjusted	Understated	Overstated	Understated
After adjustment	Increased	Decreased	Increased

CHAPTER 8 CASH

DISHONOURED CHEQUE

Cheques can become dishonoured/ rejected/ labelled "refer to drawer" for the following reasons:

- Cheque has expired.
- Cheque is post-dated.
- Inconsistent information on cheque e.g. signature on the cheque does not tally with the authorised signature recorded with the bank.
- Information on cheque is not complete e.g. no date.
- Payers' bank account does not have enough money.

Journal Entry

Journal

2021	Particulars	Dr $	Cr $
Jun 5	Cash at bank (A+)	800	
	Discount allowed (E+)	10	
	Trade receivable Leonard (A-)		810
	The business received $800 cheque from trade receivable Leonard and gave Leonard a $10 cash discount for paying by the agreed date.		

On 12 June, when the bank informed the business that the $800 cheque received from Leonard on 5 June was *<u>dishonoured</u>*, the business prepares the following journal entries to **reverse** the entries made on 5 June, as if the transaction on 5 June never did happen:

Journal

2021		Dr $	Cr $
Jun 12	Trade receivable Leonard (A+)	810	
	Discount allowed (E-)		10
	Cash at bank (A-)		800
	The bank informed the business that the $800 cheque received from Leonard on 5 June was <u>dishonoured.</u>		

Note:
If cash discount was not given on 5 Jun, the reversal entry on 12 Jun due to the dishonoured cheque would also not adjust 'discount allowed'.

INTERNAL CONTROL

Purpose

Internal controls are policies and procedures established to:

1. Safeguard assets of business
2. Ensure business transactions are recorded accurately
3. Comply with laws and regulations

Types of internal control over cash	**Explanation**
1) Segregation of duties	Separate cash handling and cash recording duties among different employees so that no one single person has control over the entire cash process.
2) Custody of cash	Secure cash and cheques in a locked storage and limit access of cash only to authorised employees.
3) Authorisation	Obtain proper approvals for all payments from authorised personnel**.**
4) Bank reconciliation	Compare and identify items that caused the differences between the ending balances in the cash at bank account and bank statement.

CASH IN HAND & CASH AT BANK ACCOUNT

Interpretation of Ledger Account

Cash in hand account

2021		Dr + $	Cr - $	Bal $
Jan 1	Bal b/d			1000 Dr
1	Rent expense		402	598 Dr
3	Sales revenue	250		848 Dr
5	Advertising		100	748 Dr
6	Inventory		325	423 Dr
12	Cash at bank		200	223 Dr
29	Cash at bank	800		1023 Dr
Feb 1	Bal b/d			1023 Dr

- 1 Jan 2021: the business has $1000 **cash** balance from previous month.
- 1 Jan 2021: the business paid $402 **cash** for rent expense.
- 3 Jan 2021: the business received $250 **cash** for the sale of goods.
- 5 Jan 2021: the business paid $100 **cash** for advertising.
- 12 Jan 2021: the business deposited $200 office **cash** into the business bank.
- 29 Jan 2021: the business withdrew $800 **cash** from business bank account for office use.
- 1 Feb 2021: the business has $1023 **cash** balance brought down from Jan to Feb.

Cash at bank account

2016		Dr + $	Cr - $	Bal $
Jan 1	Bal b/d			300 Dr
12	Cash in hand	200		500 Dr
15	Thomas	400		900 Dr
22	Joey		600	300 Dr
28	Drawings		900	600 Cr
29	Cash in hand		800	1400 Cr
Feb 1	Bal b/d			1400 Cr

- 1 Jan 2016: the business has $300 in the business **bank** account.
- 12 Jan 2016: the business deposited $200 office cash into the business **bank**.
- 15 Jan 2016: the business received $400 **cheque** from Thomas after $50 discount.
- 22 Jan 2016: the business paid Joey $600 **cheque** after receiving $25 discount.
- 28 Jan 2016: the owner took $900 **cash at bank** for personal use.
- 29 Jan 2016: the business withdrew $800 cash from business **bank** account for office use.
- 1 Feb 2021: the business owed the bank $1400 **overdraft**.

BANK RECONCILIATION

Business deposits money into the bank account

Bank Statement

Cash at bank account

	Dr($)	Cr($)	Bal($)
Sales revenue	600		

Recorded by the Business as Asset

Debit is +

Recorded by the Bank as Liability

Credit is +

The bank has responsibility to safeguard the money and owes it to the business.

Both records ought to be identical but are different due to timing differences and errors. Hence, the accountant needs to reconcile the differences.

BANK RECONCILIATION

<u>Steps:</u>

1. Put in +/- in cash at bank a/c and -/+ in bank statement.
2. Check opening balance and <u>cancel</u> the items that caused any differences.
3. Tick the common items and circle the differences.
4. Use the circled items in the bank statement to update the cash at bank a/c.
5. Use the circled items in the cash at bank a/c to prepare the bank reconciliation statement.

Cash at Bank account

2022		Dr ($) +	Cr ($) -	Balance ($)
Sep 30	Balance b/d			**A** Dr or **A** Cr
	Nicholas	X		
	Dividends	X		
	Bank charges		X	
	Interest expense		X	
	Insurance		X	
Oct 1	Balance b/d			**C** Dr or **C** Cr

DO NOT write "dishonoured cheque" in the particulars! Write the ***<u>name of the TR</u>*** who gave the cheque.

JYSS Ltd
Bank Reconciliation Statement as at 30 September 2022

	$
Credit/(Debit) balance as per bank statement	**B** or **(B)**
<u>Add: Deposits in transit</u>	
Cash	X
Jeremy	X
<u>Less: Cheques not yet presented</u>	
Kelly	X
Yao Hui	X
Debit/(Credit) balance as per adjusted cash at bank a/c	**C** or **(C)**

Obtain this from the last balance in bank statement

These are the circled items in CAB Dr+ side

These are the circled items in CAB Cr- side

Must be the same if done correctly

- ❖ Credit balance in the cash at bank a/c means bank overdraft.
- ❖ Debit balance in the bank statement means bank overdraft.

Recall: Money deposited in the bank is the business' asset (debit in the cash at bank account prepared by the business) is a **LIABILITY** (credit in the bank statement prepared by the bank) to the bank.

BANK RECONCILIATION

Purpose

- It is prepared by the business to <u>explain the differences</u>, between the <u>cash at bank account balance</u> and the <u>bank statement balance</u> due to <u>timing differences.</u>
- To identify any errors in the cash at bank or the bank statement.
- To deter fraud

<u> Items recorded in the cash at bank a/c but not in bank statement</u>:**

(i) Deposits in transit

Business has deposited the cheque with the bank but the bank has not recorded the transaction.

(ii) Cheques not yet presented

Business has issued a cheque to its supplier but the supplier has not presented the cheque to the bank for payment yet.

<u> Items not recorded in cash at bank a/c but recorded in bank statement:</u>**

(i) Direct deposits

Money received by the bank on behalf of the company. E.g. credit transfer, bank interest income.

(ii) Direct payments

Instructions to the bank to make payments at a given date. E.g. standing order
Fees deducted directly by bank. E.g. bank charges, interest on bank loan.

(iii) Dishonoured cheque

Cheque refused by the bank due to reasons such as insufficient funds or error on the cheque.

(iv) Bank charges

Money deducted by the bank for services rendered. Bank charges is an expense, and is presented in the statement of financial performance.

*** Definitions not tested*

Items that cause cash at bank balance <u>greater than</u> bank statement balance

i. Deposits in transit
ii. Direct payments
iii. Dishonoured cheques
iv. Bank charges

Items that cause cash at bank balance <u>less than</u> bank statement balance

i. Cheques not yet presented
ii. Direct deposits

Effects of Adjusting the Differences on Cash at Bank and Profit for the year

Reconciling Item	Double Entry	Effects on	
		Cash at Bank	Profit for the year
Direct payments	Dr Expenses Cr Cash at bank	Decrease	Decrease
Dishonoured cheque	Dr Trade receivable Cr Cash at bank	Decrease	No effect
Direct deposits (income)	Dr Cash at bank Cr Income	Increase	Increase
Direct deposits from trade receivable	Dr Cash at bank Cr Trade receivable	Increase	No effect

CHAPTER 9 INVENTORY

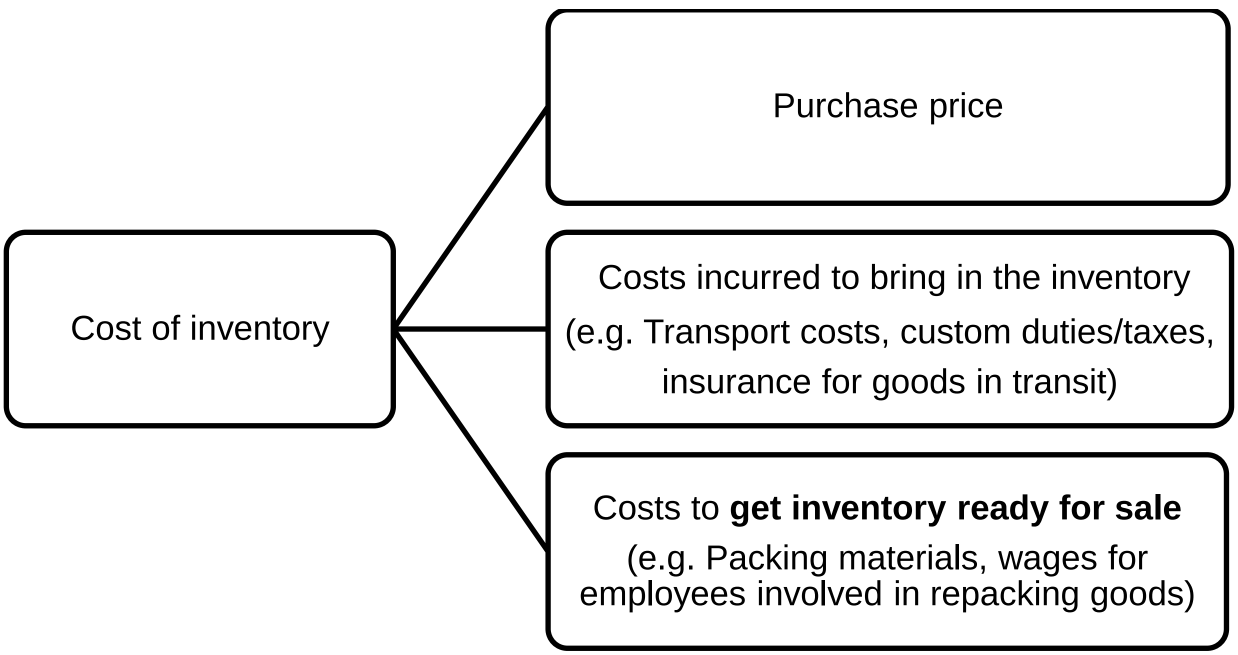
Why businesses keep inventories

- A business buys sufficient goods to keep on hand to prevent a stock-out situation, which often results in loss of sales.
- However, if the business buys too much goods, it will incur higher storage costs and increase the risk of the goods becoming obsolete.

How businesses manage inventories

- Keep proper computerised records to track changes in inventory balances using the perpetual inventory system so that the quantity of inventories are updated on a continuous basis to avoid buying too little or too many goods.
- Keep inventories in the shops and warehouse to avoid stock-out situation.
- Buy insurance to insure the inventory against risks of potential loss caused by damaged goods. Insurance claims are then made to seek compensation.

COST OF PURCHASES



FIRST-IN-FIRST-OUT (FIFO)

- FIFO method is used to calculate the cost of sales assuming that the goods purchased earliest are sold first. As such, the ending inventory is made up of goods purchased last.
- FIFO is only applicable to determining the cost of sales and returns from customers.
- FIFO does not apply to purchases returns.

Journal Entry

Journal

Date	Particulars	Dr $	Cr $
2021			
Feb 2	**Inventory** (A+)	500	
	Cash in hand/ Cash at bank (A-)		500
	Bought goods worth $500 and paid cash/ cheque.		
Feb 3	**Inventory** (A+)	4 000	
	Trade payable – Alvin (L+)		4 000
	Bought goods worth $4000 on credit from supplier Alvin.		
Feb 9	Trade payable – Alvin (L-)	1 000	
	Inventory (A-)		1 000
	Returned goods worth $1000 to credit supplier Alvin.		
Feb 10	Trade receivable/ Cash in hand/ Cash at bank (A+)	7 000	
	Sales revenue (I+)		7 000
	Cost of sales (E+)	3 000	
	Inventory (A-)		3 000
	Sold goods for $7000 on credit / received cash / cheque. The cost of goods sold was $3000.		
Feb 15	Trade receivable/ Cash in hand/ Cash at bank (A+)	900	
	Sales revenue (I+)		900
	Cost of sales (E+)	500	
	Inventory (A-)		500
	Sold goods for $900 on credit / received cash / cheque. The cost of goods sold was $500.		
Feb 21	Sales returns (I-)	120	
	Trade receivable/ Cash in hand/ Cash at bank (A-)		120
	Inventory (A+)	70	
	Cost of sales (E-)		70
	Customer returned goods previously sold at $120. The cost of sales was $70.		
Feb 22	Drawings	2 000	
	Inventory (A-)		2 000
	The owner took goods costing $2 000 for his own use.		

Inventory account (asset)

2021	Particulars	Dr $ +	Cr $ -	Bal $
Feb 1	Balance b/d			3 000 Dr
2	Cash in hand/ Cash at bank	500		
3	Trade payable – Alvin	4 000		
9	Trade payable – Alvin		1 000	
10	**Cost of sales**		3 000	FIFO
15	**Cost of sales**		500	
21	**Cost of sales**	70		
22	Drawings		2 000	1 070 Dr
Mar 1	Bal b/d			1 070 Dr

Interpretation of Ledger Account

- 1 Feb 2021: the business had goods costing $3000 brought over from the previous month.
- 2 Feb 2021: the business purchased goods and paid $500 by cash/ cheque.
- 3 Feb 2021: the business purchased goods worth $4000 on credit from Alvin.
- 9 Feb 2021: the business returned goods costing $1000 previously bought on credit from Alvin.
- 10 Feb 2021: the business sold goods **costing** $3000.
- 15 Feb 2021: the business sold goods **costing** $500.
- 21 Feb 2021: Customers returned goods **costing** $70.
- 22 Feb 2021: Owner withdrew goods worth $2000 for his personal use.
- 1 Mar 2021: the business had goods costing $1070 brought down from Feb to Mar.

Extracts of Financial Statements

JYSS Ltd
Statement of Financial Position as at 28 February 2021 (extract)

	$	
Current assets		
Inventory	1 070	

Cost of sales account (expense)

2021	Particulars	Dr $ +	Cr $ -	Bal $
Feb10	**Inventory** *(sold goods)*	3 000		3 000 Dr
15	**Inventory** *(sold goods)*	500		
21	**Inventory** *(goods returned by customers)*		70	3 430 Dr
28	Income summary		3 430	0

Interpretation of Ledger Account

- 10 Feb 2021: the business sold goods **costing** $3000.
- 15 Feb 2021: the business sold goods **costing** $500.
- 21 Feb 2021: Customers returned goods **costing** $70.
- 28 Feb 2021: $3430 cost of sales was **incurred** during the year and transferred to the income summary account.

Extracts of Financial Statements

JYSS Ltd

Statement of Financial Performance for the month ended 28 February 2021 (extract)

	$	$
Sales revenue (7 000 + 900)	7 900	
Less: Sales returns	120	
Net sales revenue		7 780
Less: Cost of sales		3 430
Gross profit		4 350

IMPAIRMENT LOSS ON INVENTORY

Inventory Valuation Method / Rule
Inventory is valued at cost or net realisable value, whichever is lower.

Net Realisable Value
The net realisable value (NRV) is the potential amount receivable from selling goods. Businesses aim to sell its goods at a NRV higher than its cost.
NRV = Estimated selling price – additional cost to sell the inventory

Impairment Loss on Inventory
Usually, inventory is recorded at cost. However, when the NRV is lower than its cost, the value of inventory is to be written down (reduced) to its NRV.

Impairment loss on inventory is the difference between the higher cost of inventory and the lower NRV. It is recorded as an expense, and is debit in nature.

Causes of Impairment Loss on Inventory

- Goods damaged by fire or flood
- Goods stolen
- Goods outdated

Application of Accounting Theory

1. **Prudence theory**
   Inventory is valued at cost or net realisable value, whichever is lower. When the NRV falls below the cost of inventory, the business should record the potential loss as impairment loss on inventory so as not to overstate its assets and profits.

IMPAIRMENT LOSS ON INVENTORY

Journal Entry

Journal

Date	Particulars	Dr $	Cr $
2021			
Nov 10	Impairment loss on inventory (E+)	2 000	
	Inventory (A-)		2 000
	Due to goods damaged in a flood, the cost of inventory $3 500 was written down to its net realisable value $1 500.		
Nov 30	Insurance claim receivable (A+)	800	
	Impairment loss on inventory (E-)		800
	Insurance company confirmed that the business is able to claim $800 of compensation which will be paid out after the financial year.		

Inventory account (asset)

2021	Particulars	Dr $ +	Cr $ -	Bal $
Nov 1	Balance b/d			3 500 Dr
10	Impairment loss on inventory		2 000	1 500 Dr
Dec 1	Balance b/d			1 500 Dr

Interpretation of Ledger Account

- 1 Nov 2021: the business had $3 500 worth of inventory carried down from previous month.
- 10 Nov 2021: the cost of the inventory was written down by $2 000, from $3500 to $1500.

☟ Impairment loss on inventory account (expense)

2021	Particulars	Dr $ +	Cr $ -	Bal $
Nov 10	Inventory	2 000		2 000 Dr
30	Insurance claim receivable		800	1 200 Dr
30	Income summary		1 200	0

Interpretation of Ledger Account

- 10 Nov 2021: The cost of the inventory was written down by $2 000 to its net realisable value.
- 30 Nov 2021: $800 of the impairment loss on inventory would be compensated by insurance.
- 30 Nov 2021: $1 200 of impairment loss on inventory was incurred during the year and transferred to the income summary account.

Extracts of Financial Statements

JYSS Ltd
Statement of Financial Performance for year ended 30 November 2021 (extract)

	$
Less: Other expenses	
Impairment loss on inventory	1 200

JYSS Ltd
Statement of Financial Position as at 30 November 2021 (extract)

	$
Current assets	
Inventory	1 500
Insurance claim receivable	800

CHAPTER 10 TRADE RECEIVABLES (TR)

A trade receivable is a customer who bought goods on credit. It is an asset, and is debit in nature.

Journal Entry

Journal

Date	Particulars	Dr $	Cr $
2021			
Jan 2	**Trade receivable Hazim** (A+)	950	
	Sales revenue (I+)		950
	Cost of sales (E+)	200	
	Inventory (A-)		200
	Sold goods on credit to Hazim for $950. The cost of goods sold was $200.		
Jan 9	Sales returns (I-)	76	
	Trade receivable Hazim (A-)		76
	Inventory (A+)	30	
	Cost of sales (E-)		30
	Credit customer Hazim returned goods previously sold at $76. The cost of goods sold was $30.		
Jan 11	**Trade receivable Hazim** (A+)	100	
	Sales revenue (I+)		100
	Cost of sales (E+)	40	
	Inventory (A-)		40
	Sold goods on credit to Hazim for $950. The cost of goods sold was $200.		
Jan 15	Cash in hand / cash at bank (A+)	882	
	Discount allowed (E+)	18	
	Trade receivable Hazim (A-)		900
	Cash/cheque payment from credit customer Hazim to settle $900 owing, after 2% cash discount was given.		
Jan 18	**Trade receivable Hazim** (A+)	900	
	Cash in hand / cash at bank (A-)		882
	Discount allowed (E-)		18
	The bank informed that the cheque received on 15 Jan was dishonoured.		

Trade Receivable Ledger account

For TR acc, particulars should not be inventory when the biz is selling goods

Customer Hazim **owes** business **more**

Customer Hazim **owes** business **less**

(Asset)
Trade receivable Hazim account

2021	Particulars	Dr $ +	Cr $ -	Bal $	Source document
Jan 1	Balance b/d			900 Dr	
2	**Sales revenue** (95%x1000)	950			Invoice
9	**Sales returns** (95%x80)		76		Credit note
11	**Sales revenue**	100			Debit note
15	Cash in hand / cash at bank (98%x900)		882		Receipt
15	Discount allowed (2%x900)		18		Receipt
18	Cash at bank	882			Bank statement
18	Discount **allowed**	18		1 874 Dr	
Feb 1	Balance b/d			1 874 Dr	

Date	**Interpretation of Ledger Account**	Remarks
Jan 1	$900 owed by credit customer Hazim from the previous month.	
Jan 2	Sold goods on credit to Hazim for $950.	*If Qn states list price $1000 less 5% trade discount, only the 95% owed by Hazim is recorded. 5% trade discount is not recorded.*
Jan 9	Credit customer Hazim returned goods previously sold at $76.	*If Qn states list price $80, the trade discount given earlier when the goods was purchased should also apply to the returns of the same batch of goods. If Qn states net price $76, no working is needed.*
Jan 11	Credit purchases made on 2 Jan was undercharged.	*The double entry for invoice and debit note is the same.*
Jan 15	Cash/cheque payment from credit customer Hazim to settle $900 owing, after 2% cash discount was given.	*'Settle' means the business no longer owes supplier $900, for 2 reasons: The 98% paid and the 2% discount. Cash discount must be recorded.*
Jan 18	The bank informed that the cheque received on 15 Jan was dishonoured.	*The entries recorded on 15 Jan must be reversed on 18 Jan. Refer to Chapter 8 (dishonoured cheque) for more details.*
Feb 1	$1 874 owed by credit customer Hazim was brought down from Jan to Feb.	

Cash sales is **NOT** recorded in TR account because the double entry is:

Dr Cash at bank / Cash in hand (A+)
Cr Sales revenue (I+)

Refer to Chapter 2 for source documents and Chapter 4 for discounts.

ALLOWANCE FOR IMPAIRMENT OF TRADE RECEIVABLES

Trade Receivables (TR)
Refers to the amounts owed by customers who buy goods or enjoy services from the business on credit. It is a current asset, and is debit in nature.

Trade Receivable Valuation Method
Trade receivables is valued at net trade receivables, which is total trade receivables less allowance for impairment of trade receivables, in the statement of financial position.

Allowance for Impairment of Trade Receivables
Refers to the amount of debt owed by trade receivables that is estimated likely to be uncollectible. It is a contra-asset, and is credit in nature.

Allowance = Estimated % x Ending TR balance

Application of Accounting Theory

1. **Prudence theory**
   The allowance for impairment of trade receivables is reported in the statement of financial position as a deduction against the trade receivables book value to ensure that the trade receivables balance is not overstated.

2. **Matching theory**
   As the increase in allowance for impairment of trade receivables is a likely expense, it should be recorded in the same accounting year as the sales revenue earned to obtain a true and fair profit for the year.

IMPAIRMENT LOSS ON TRADE RECEIVABLES

Impairment Loss on Trade Receivables is the difference between the allowance at the beginning and end of the year. It is the change (increase or decrease) in allowance. It is an expense account, and is debit in nature.

Given info	31 Dec 2019 ($)	31 Dec 2020 ($)	31 Dec 2021 ($)
TR	4000	3200	5800
Allowance at 5% of TR	200	160	290
Net TR	3800	3040	5510

Impairment Loss - 40

Impairment Loss + 130

Journal Entry

Journal

Date	Particulars	Dr $	Cr $
2019			
Dec 31	Impairment loss on trade receivables (E+)	200	
	Allowance for impairment of trade recievables (A-)		200
	The estimated uncollectible debt increased from $0 to $200.		
2020			
Dec 31	Allowance for impairment of trade recievables (A+)	40	
	Impairment loss on trade receivables (E-)		40
	The estimated uncollectible debt decreased by $40.		
2021			
Dec 31	Impairment loss on trade receivables (E+)	130	
	Allowance for impairment of trade recievables (A-)		130
	The estimated uncollectible debt increased by $130.		

✋ AFIOTR account (contra-asset)

2019	Particulars	Dr $ -	Cr $ +	Bal $
Dec 31	Impairment loss on trade receivables		200	200 Cr
2020				
Jan 1	Bal b/d			200 Cr
Dec 31	Impairment loss on trade receivables	40		160 Cr
2021				
Jan 1	Bal b/d			160 Cr
Dec 31	Impairment loss on trade receivables		130	290 Cr
2022				
Jan 1	Bal b/d			290 Cr

Interpretation of Ledger Account

- 2019 Dec 31: The business reviewed its trade receivables and increased its estimated uncollectible debts by and to $200.
- 2020 Jan 1: The estimated uncollectible debts owed by credit customers totalled $200.
- 2020 Dec 31: The estimated uncollectible debts decreased by $40, from $200 to $160.
- 2021 Jan 1: The estimated uncollectible debts of trade receivables amounted to $160.
- 2021 Dec 31: The estimated uncollectible debts increased by $130, from $160 to $290.
- 2022 Jan 1: The estimated uncollectible debts owed by customers was $290.

☟ Impairment loss on trade receivables account (expense)

2019	Particulars	Dr $ +	Cr $ -	Bal $
Dec 31	AFIOTR	200		200 Dr
Dec 31	Income summary		200	0
2020				
Dec 31	AFIOTR		40	40 Cr
Dec 31	Income summary	40		0
2021				
Dec 31	AFIOTR	130		130 Dr
Dec 31	Income summary		130	0

Interpretation of Ledger Account

- 2019 Dec 31: The business reviewed its trade receivables and increased the estimated uncollectible debts by $200. The $200 impairment loss on trade receivables was transferred to income summary account as an expense.

- 2020 Dec 31: The business reviewed its trade receivables and decreased the estimated uncollectible debts by $40. The $40 impairment loss on trade receivables was transferred to income summary account as a reversal of expense.

- 2021 Dec 31: The business reviewed its trade receivables and increased the estimated uncollectible debts by $130. The $130 impairment loss on trade receivables was transferred to income summary account as an expense.

Extracts of Financial Statements

JYSS Ltd
Statement of Financial **Performance** for year ended 31 December **2019** (extract)

	$
Less: Other expenses	
Impairment loss on trade receivables	200

JYSS Ltd
Statement of Financial **Performance** for year ended 31 December **2020** (extract)

	$
Less: Other expenses	
Reversal of impairment loss on trade receivables *Decrease in AFIOTR*	(40)

JYSS Ltd
Statement of Financial **Performance** for year ended 31 December **2021** (extract)

	$
Less: Other expenses	
Impairment loss on trade receivables	130

Extracts of Financial Statements

JYSS Ltd
Statement of Financial **Position** as at 31 December **2019** (extract)

	$	$
Current assets		
Trade receivables	4 000	
Less: **Allowance** for impairment of trade receivables	200	3 800

JYSS Ltd
Statement of Financial **Position** as at 31 December **2020** (extract)

	$	$
Current assets		
Trade receivables	3 200	
Less: **Allowance** for impairment of trade receivables	160	3 040

JYSS Ltd
Statement of Financial **Position** as at 31 December **2021** (extract)

	$	$
Current assets		
Trade receivables	5 800	
Less: **Allowance** for impairment of trade receivables	290	5 510

Likely to be uncollectible

Amount that the business is confident of collecting

WRITING OFF DEBT

When it is certain/confirmed that the debts are uncollectible, the business should write-off the debt owed by the specific customer.

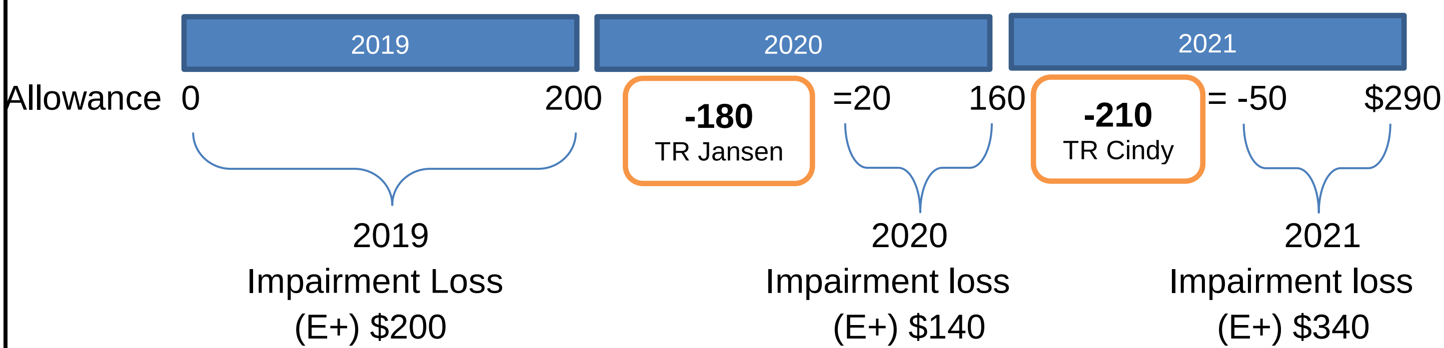
Journal Entry

Journal

Date	Particulars	Dr $	Cr $
2020			
Mar 20	Allowance for impairment of trade recievables	180	
	Trade receivable Jansen (A-)		180
	Trade receivable Jansen declared bankrupt and the $180 debt		
	he owed was written off.		
2021			
Sep 15	Cash in hand (A+) [30% x 300]	90	
	Allowance for impairment of trade recievables [70% x 300]	210	
	Trade receivable Cindy (A-)		300
	Credit customer Cindy paid 30% of her $300 debt by cash and		
	the remaining was written off as irrecoverable.		

Writing Off of Irrecoverable Debt

Using the same given info	31 Dec 2019 ($)	31 Dec 2020 ($)	31 Dec 2021 ($)
TR	4000	3200	5800
Allowance at 5% of TR	200	160	290
Net TR	3800	3040	5510



AFIOTR account (contra-asset)

2019	Particulars	Dr $ -	Cr $ +	Bal $
Dec 31	Impairment loss on trade receivables		200	200 Cr
2020				
Jan 1	Bal b/d			200 Cr
Mar 20	**Trade receivable Jansen**	**180**		20 Cr
Dec 31	Impairment loss on trade receivables		**140**	160 Cr
2021				
Jan 1	Bal b/d			160 Cr
Sep 15	**Trade receivable Cindy**	**210**		50 Dr
Dec 31	Impairment loss on trade receivables		**340**	290 Cr
2022				
Jan 1	Bal b/d			290 Cr

Interpretation of Ledger Account

- 2020 Mar 20: The business wrote off $180 worth of debts owed by Jansen.
- 2020 Dec 31: The estimated uncollectible debts increased by $140 to $160 after a review of its trade receivables.
- 2021 Sep 15: Trade receivable Cindy's debt of $210 was written off.
- 2021 Dec 31: The estimated uncollectible debts increased by $340 to $290 after a review of its trade receivables.

CHAPTER 11 NON-CURRENT ASSETS (NCA)

CAPITAL & REVENUE EXPENDITURE

	Capital Expenditure	Revenue Expenditure
Definition	• Are **costs of purchasing** the NCA, • costs to **bring** the NCA **to its intended use**, and * costs to **enhance** the NCA	* Are costs to **operate** the NCA, and * to **repair and maintain** the NCA in **working condition**
Impact on financial statements	* All related capital expenditures are added and presented as a **non-current asset** in the statement of financial **position** * As the **benefits** of capital expenditures usually **last for more than 1 year**	* Revenue expenditures are presented as individual **expenses** in the statement of financial **performance** * As the **benefits** of revenue expenditures are usually **used within 1 year**
Examples	Purchase cost of the NCA, Extension to premises, Installation fees of air conditioner, Freight / delivery / shipping charges, Import duties, legal fees etc.	Petrol for vehicle, Machine oil for equipment, Utility bills for air conditioner, Repairs of machinery, Servicing of engine parts etc.

Journal Entry

Journal

Date	Particulars	Dr $	Cr $
2022			
Dec 5	NCA (A+)	10 500	
	Trade payable (L+) / Cash at bank (A-) / Cash in hand (A-)		10 500
	Recording capital expenditures for the purchase of NCA on credit / paid by cheque / by cash.		
Dec 5	Expense (E+)	750	
	Expense payable (L+) / Cash at bank (A-) / Cash in hand (A-)		750
	Recording revenue expenditures as expensed incurred but not yet paid / paid by cheque / by cash.		

Effects of wrong classification of Capital Expenditure (NCA) and Revenue Expenditure (Expense)

Classification of Expenditure	Effect on Other Expenses	Effect on Profit	Effect on Non-current Assets
Capital expenditure (NCA) wrongly classified as revenue expenditure (Expense)	Overstated	Understated	Understated
Revenue expenditure (Expense) wrongly classified as capital expenditure (NCA)	Understated	Overstated	Overstated

Application of Accounting Theory

1. **Materiality theory**

   If the amount spent on a NCA is insignificant to decision making, it does not need to be reported as an NCA even though the benefits last for more than one accounting year. It could be classified as revenue expenditure and reported as an expense in the statement of financial performance.

Motor vehicles account (at **cost**)

2020	Particulars	Dr $ +	Cr $ -	Bal $
Jan 1	Bal b/d			6 000 Dr
Apr 16	Cash at bank	1 500		
May 20	Trade payable Thom	4 000		11 500 Dr
2021				
Jan 1	Bal b/d			11 500 Dr

Interpretation of Ledger Account

- 2020 Jan 1: The business had existing motor vehicles <u>costing</u> $6 000.
- 2020 Apr 16: The business bought motor vehicles <u>costing</u> $1 500 by cheque.
- 2020 May 20: The business bought motor vehicles <u>costing</u> $4 000 from Thom on credit.
- 2021 Jan 1: The business had motor vehicles <u>costing</u> $11 500.

DEPRECIATION

Depreciation

Depreciation is the allocation of cost of NCA over its estimated useful life.
It is an expense, and is debit in nature.

Depreciation is not provided for land because land is a limited resource and it is not subjected to wear and tear.

Depreciation is not provided for inventory because inventory is bought for resale purpose and not meant for long term use.

Accumulated Depreciation

Accumulated depreciation refers to the total depreciation to-date.
It is a contra-asset account, and is credit in nature.

Non-current Assets Valuation Method

Non-current assets are presented at net book value, which is cost less accumulated depreciation in the statement of financial position.
Net book value = Cost – Accumulated depreciation

Causes of Depreciation

- Wear and tear (e.g. motor vehicle)
- Obsolescence/Out-dated (e.g. computers)
- Usage (e.g. coal from coal mines)
- Legal limits (e.g. 60 year leasehold shop)

Depreciation is not provided for land because land is a limited resource and it is not subjected to wear and tear.

Depreciation is not provided for inventory because inventory is bought for resale purpose and not meant for long term use.

DEPRECIATION METHODS

	Straight Line Method	Reducing-balance Method
Also known as	% on **Cost**	% on **Net Book Value** NBV = Cost – Acc Dep
Formula	*Depreciation expense* *= % Rate x (Cost – **Scrap value**)* *OR* $\frac{Cost - Scrap\ value*}{Useful\ life\ (in\ years)}$ * Scrap / Residual value refers to the remaining amount that the business is able to receive at the end of its useful life	*Depreciation expense* *= % Rate x (Cost – **Acc Dep**)*
Effect on Expenses	**Equal** amount of **depreciation** is recorded every financial period, hence its name “straight line”	**Higher depreciation** expense is recorded in the **earlier years** and **reduces** as time goes by, hence its name “reducing-balance”.
Effect on Profit	Profit decreases by the same amount every year	Profit decreases by a higher amount in earlier years
Effect on Net Book Value	NBV decreases by an equal amount ever year	NBV decreases by a higher amount in earlier years
Suitability	Suited for NCA that is expected to earn income evenly over its useful life	Suited for NCA that is expected to earn more income in its earlier years than in its later years.

Application of Accounting Theory

Why should a business depreciate its NCA?

1. **Matching theory**
   Depreciation expense, which is a portion of the cost of the NCA, should be matched against the income earned from using the NCA in the same year to obtain a true and fair profit for the year.
2. **Prudence theory**
   Non-current assets should be valued at their net book value, which is cost less accumulated depreciation, so that profits and assets are not overstated.

Why should the same accounting methods be used?

1. **Consistency theory**
   The same method of depreciation and rate of depreciation should be used every financial period so that its financial performance can be meaningfully compared across financial periods.

ACCOUNTING FOR DEPRECIATION

Method	Straight line
Cost of equipment	$1 000
% Rate	10%
Depreciation Exp	$100 every year

Journal Entry

Journal

Date	Particulars	Dr $	Cr $
2020			
Jun 30	Depreciation (E+)	100	
(year-end)	Accumulated depreciation (A-)		100
	Depreciation charged for the year was $100.		
Jun 30	Income summary	100	
(year-end)	Depreciation (E-)		100
Closing entry	*Depreciation expense for the year was transferred to*		
	the income summary account.		

Depreciation of equipment account (expense)

2020	Particulars	Dr $ +	Cr $ -	Bal $
Jun 30	Accumulated depreciation	100		100 Dr
30	Income summary		100	0
2021				
Jun 30	Accumulated depreciation	100		100 Dr
30	Income summary		100	0

Interpretation of ledger account

30 Jun 2020 and 30 Jun 2021:
Depreciation charged on equipment for the year was $100 and the depreciation expense incurred was transferred to the income summary account.

☟ Accumulated depreciation of equipment account (contra-asset)

2020	Particulars	Dr $ -	Cr $ +	Bal $
Jun 30	Depreciation		100	100 Cr
Jul 1	Bal b/d			100 Cr
2021				
Jun 30	Depreciation		100	200 Cr
Jul 1	Bal b/d			200 Cr

Interpretation of ledger account

- 30 Jun 2020: Accumulated depreciation of equipment increased by and to $100.
- 1 Jul 2020: The accumulated depreciation was $100.
- 30 June 2021: Accumulated depreciation of equipment increased by $100 to $200.
- 1 Jul 2021: The accumulated depreciation was $200.

Extracts of Financial Statements

JYSS Ltd

Statement of Financial Performance for year ended 30 June 2021 (extract)

	$
Less: Other expenses	
Depreciation of equipment	100

JYSS Ltd

Statement of Financial Position as at 30 June 2021 (extract)

	$	$	$
Non-current assets	**Cost**	**Accumulated depreciation**	**Net book value**
Equipment	1 000	200	800

SALE OF NON-CURRENT ASSET *(O LEVEL ONLY)*

When an NCA is sold, it is no longer worth the cost it was originally bought at.
As it has been used to generate income, its estimated worth is the net book value.
Proceeds refers to the money received from the sale of NCA.
The gain or loss on sale of NCA is calculated by comparing the proceeds with NBV.

Gain on sale of NCA (Income) → Proceeds is higher than NBV
Loss on sale of NCA (Expense) → Proceeds is lower than NBV

Journal entry

Journal

Date	Particulars	Dr $	Cr $
2020			
Mar 16	**Sale of NCA**	2 000	
(day of sale)	Motor vehicles (A-)		2 000
	Original cost of the motor vehicle sold is transferred to the		
	Sale of NCA account		
2020			
Mar 16	Accumulated depreciation	200	
(day of sale)	**Sale of NCA**		200
	Total depreciation charged for all the years of usage is		
	transferred to the Sale of NCA account		
2020			
Mar 16	Cash at bank/ Cash in hand (A+)	1 100	
(day of sale)	**Sale of NCA**		1 100
	Cheque/ cash was received for the motor vehicle sold		
2020			
Dec 31	Income summary (E+)	700	
(year-end)	**Sale of NCA**		700
Closing entry	*Loss on sale of NCA transferred to the income summary*		
	account		

Motor vehicles account (asset)

2020	Particulars	Dr $ +	Cr $ -	Bal $
Jan 1	Bal b/d *Original cost of the NCA sold*			6 000 Dr
Mar 16	Sale of non-current asset (**1**)		**2 000**	4 000 Dr
Oct 1	Cash at bank/ Cash in hand/ Trade payable	1 500		5 500 Dr
2015				
Jan 1	Bal b/d			5 500 Dr

Interpretation of ledger account

- 16 Mar 2020: The business sold its motor vehicles, and the original cost $2 000 was transferred to the sale of non-current asset account.

Accumulated depreciation account (contra-asset)

2020	Particulars	Dr $ -	Cr $ +	Bal $
	Accumulated *depreciation for the NCA* ***sold***			
Jan 1	Bal b/d			600 Cr
Mar 16	Sale of non-current asset (**2**)	**200**		400 Cr
Dec 31	**Depreciation** ***1 year*** *depreciation for* ***remaining*** *NCA*		400	800 Cr
2015				
Jan 1	Bal b/d			800 Cr

Interpretation of ledger account

- 16 Mar 2020: The accumulated depreciation $200 of the motor vehicles sold was transferred to the sale of non-current asset account.

☟ Sale of non-current asset account

2020	Particulars	Dr $	Cr $	Bal $
Mar 16	Motor vehicles (**1**)	2 000		2 000 Dr
Mar 16	Accumulated depreciation (**2**)		200	1 800 Dr
Mar 16	Cash at bank/ Cash in hand/ Other receivable (**3**)		1 100	700 Dr
Dec 31	Income summary (**4**)		700	0

Interpretation of ledger account

- 16 Mar 2020: The business sold its motor vehicles costing $2 000 and received a cheque of $1 100 / cash of $1 100 / on credit for $1 100. It has been depreciated by $200 since the business bought it.
- 31 Dec 2020: A loss of $700 on the sale of the motor vehicles transferred to the income summary account.

Extracts of Financial Statements

JYSS Ltd

Statement of Financial Performance for year ended 31 December 2020 (extract)

	$
Less: Other expenses	
Loss on sale of non-current asset **(4)**	700
Depreciation of non-current asset	400

JYSS Ltd

Statement of Financial Position as at 31 December 2020 (extract)

	$	$	$
Non-current assets	Cost	Accumulated depreciation	Net book value
Motor Vehicles	5 500	800	4 700

CHAPTER 12 TRADE PAYABLES

A trade payable is a supplier whom the business bought on credit from. It is a liability, and is credit in nature.

Journal entry

Journal

Date	Particulars	Dr $	Cr $
2021			
Jan 6	Inventory (A+)	4 500	
	Trade payable Eugene (L+)		4 500
	Bought goods on credit from supplier Eugene.		
Jan 12	**Trade payable Eugene** (L-)	270	
	Inventory (A-)		270
	The business returned goods to credit supplier Eugene.		
Jan 29	**Trade payable Eugene** (L-)	6 000	
	Cash in hand / cash at bank		5 880
	Discount received		120
	Paid credit supplier Eugene cash/cheque to settle $6000 owing after $120 cash discount received.		
Jan 31	Inventory (A+)	100	
	Trade payable Eugene (L+)		100
	Credit purchases made on 6 Jan was undercharged.		

Trade Payable Ledger account (with discounts & source documents)

For TP acc, particulars cannot be:
Sales revenue, sales returns or cost of sales
Because the biz is not selling but buying goods

Business **owes** supplier Eugene **less**

Business **owes** supplier Eugene **more**

(Liability)
Trade payable Eugene account

2021	Particulars	Dr $ –	Cr $ +	Bal $	Source document
Jan 1	Balance b/d			7 500 Cr	
6	**Inventory** (90%x5000)		4 500		Invoice
12	**Inventory** (90%x300)	270			Credit note
29	Cash in hand / cash at bank (98%x6000)	5 880			Payment voucher
29	Discount **received** (2%x6000)	120			-
31	**Inventory**		100	5 830 Cr	Debit note
Feb 1	Balance b/d			5 830 Cr	

Date	**Interpretation of Ledger Account**	Remarks
Jan 1	$7 500 was owed to credit supplier Eugene from the previous month.	
Jan 6	Bought goods worth $4 500 on credit from supplier Eugene.	*If Qn states list price $5000 less 10% trade discount, only the 90% owed to Eugene is recorded. 10% trade discount is not recorded.*
Jan 12	The business returned goods worth $270 to credit supplier Eugene.	*If Qn states list price $300, the trade discount given earlier when the goods was purchased should also apply to the returns of the same batch of goods.* *If Qn states net price $270, no further working will be needed.*
Jan 29	Paid credit supplier Eugene cash/cheque to settle $6000 owing after 2% cash discount was received.	*'Settle' means the business no longer owes supplier $6000, for 2 reasons:* *The 98% paid and the 2% discount.* *Cash discount must be recorded.*
Jan 31	Credit purchases made on 6 Jan was undercharged.	*The double entry for invoice and debit note is the same.*
Feb 1	$5 830 owed to credit supplier Eugene was brought down from Jan to Feb.	

Cash purchases is **NOT** recorded in TP account because the double entry is:
Dr Inventory (A+)
Cr Cash at bank / Cash in hand (A-)

Refer to Chapter 2 for source documents and Chapter 4 for discounts.

CHAPTER 13 LONG-TERM BORROWINGS

BANK LOAN VS BANK OVERDRAFT

	Bank loan	Bank overdraft
Amount of borrowing	Amount borrowed is fixed.	Amount borrowed is not fixed but it must not exceed the limit agreed with the bank.
Transference of cash	Cash is transferred to the business.	No cash is transferred to the business. Business withdrew more than what is deposited in its bank account.
Repayment	Usually regular fixed cash repayments to reduce the amount borrowed. Sometimes the business is allowed to pay off entire amount only at the end of loan period.	No cash repayment. Any deposit into the bank account reduces the amount borrowed.
Double entry recording	Loan from bank account is credited	Reflected as a credit balance of the cash at bank account
Classification in statement of financial position	Shown as long term borrowing under non-current liabilities.	Shown as bank overdraft under current liabilities.

ACCOUNTING FOR LOAN

The business took a 5 year loan of $10 000 from the bank on 1 Jan 2020.
The partial principal sum repayment is to be made on 31 December every year.

Journal entry

Journal

Date	Particulars	Dr $	Cr $
2020			
Jan 1	Cash at bank (A+)	10 000	
	Loan from bank (L+)		10 000
	The business obtained loan from bank.		
Dec 31	**Loan from bank** (L-)	2 000	
	Cash at bank (A-)		2 000
	The business repaid bank loan.		

Bank loan account

2020	Particulars	Dr $ –	Cr $ +	Bal $
Jan 1	Cash at bank		10 000	10 000 Cr
Dec 31	Cash at bank	2 000		8 000 Cr
2021				
Jan 1	Bal b/d			8 000 Cr

Interpretation of ledger account

- 1 Jan 2020: The business borrowed bank loan of $10 000.
- 31 Dec 2020: The business repaid $2 000 of the bank loan by cheque.
- 1 Jan 2021: The amount of loan owing to the bank was $8 000.

Extracts of Financial Statements

JYSS Ltd
Statement of Financial Position as at 31 December 2020 (extract)

	$
<u>Non-current liabilities</u>	
Long-term borrowings	6 000
<u>Current liabilities</u>	
Current portion of long-term borrowings	2 000

Note:
On 31 Dec 2020, a total of $8 000 loan was outstanding. However, $2 000 will be due for repayment next year, hence it is the current portion of the LTB, a CL. The remaining $6 000 loan owed will be due for repayment years later, hence NCL.

ACCOUNTING FOR INTEREST EXPENSE *(O LEVEL ONLY)*

Interest expense incurred = Interest rate (%) x Principal sum borrowed ** To be pro-rated by the number of months when necessary*

Application of Accounting Theory

1. **Matching theory**
   Interest expense <u>incurred</u> must be <u>matched</u> against the <u>income earned</u> from using the loan to operate business in the <u>same accounting year</u> to determine the profit for the year.

2. **Accrual basis of accounting**
   Interest expense must be recognised in the financial period once incurred <u>whether or not it has been paid</u>.

Journal entry (*Similar to expenses journal entries in Chapter 7)

1	Adjust for interest expenses payable (Reversal)	Dr Interest expense payable (L-) Cr Interest expense (E-)
2	Record interest expense paid	Dr Interest expense (E+) Cr Cash at bank (A-)
3	Record interest expenses incurred (transfer to income summary at end of financial year)	Dr Income Summary Cr Interest expense (E-)
4	Adjust for interest expenses payable (current year)	Dr Interest expense (E+) Cr Interest expense payable (L+)

✋ Interest expense account

2020	Particulars	Dr $ +	Cr $ –	Bal $
Jan 1	Interest expense payable		4 500	4 500 Cr
Mar 31	Cash at bank	6 000		1 500 Dr
Dec 31	Interest expense payable	4 200		5 700 Dr
31	Income summary		5 700	0

Interpretation of ledger account

- 1 Jan 2020: The business reversed the adjustment made for $4 500 interest expense owed in the previous financial year.
- 31 Mar 2020: The business paid $6 000 interest expense by cheque.
- 31 Dec 2020: The business owed $4 200 of interest expense as at year end.
- 31 Dec 2020: The business <u>incurred</u> $5 700 of interest expense for the year.

Extracts of Financial Statements

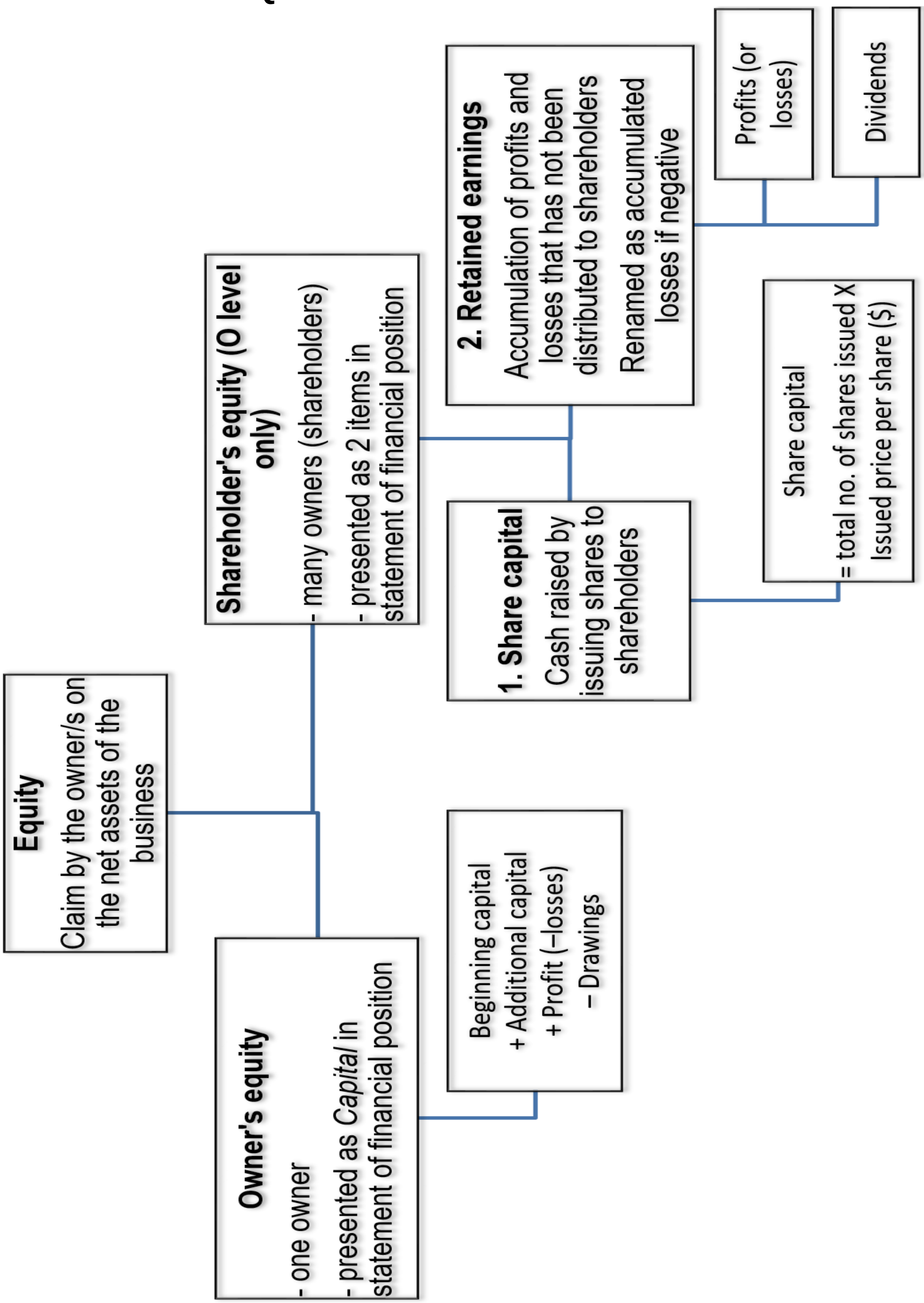
JYSS Ltd
Statement of Financial Performance for year ended 31 December 2020 (extract)

	$
<u>Less: Other expenses</u>	
Interest expense	5 700

JYSS Ltd
Statement of Financial Position as at 31 December 2020 (extract)

	$
<u>Current liabilities</u>	
Interest expense **payable**	4 200

CHAPTER 14 EQUITIES



OWNER'S EQUITY

Application of Accounting Theory

1. **Accounting entity theory**
   Transactions of the business are separate from the actions of the owner. All transactions are recorded from the point of view of the business. Resources contributed by the owner for business use are recorded as <u>capital</u>. Withdrawal of business assets for personal use are recorded as <u>drawings</u>.

DRAWINGS

Drawings is the amount of resources withdrawn by the business owner for his personal use. It is a contra-equity account, and is debit in nature. At the end of the financial year, the total drawings are transferred to the capital account to reduce it.

Journal entry

Journal

Date	Particulars	Dr $	Cr $
2021			
Feb 3	Drawings	3 000	
	Cash at bank (A-)		3 000
	The owner took $3000 from the business bank for		
	personal use.		
Jun 20	Drawings	250	
	Inventory (A-)		250
	The owner took $250 worth of goods for his own use.		
Oct 24	Drawings	700	
	Cash in hand (A-)		700
	The owner took $700 from the office cash for his		
	private use.		
Dec 31	Capital	3 950	
(year-end)	Drawings		3 950
Closing entry	*Total drawings for the year are transferred to the*		
	capital account.		

Drawings account

2021	Particulars	Dr $ +	Cr $ -	Bal $
Feb 3	Cash at bank	3 000		3 000 Dr
Jun 20	Inventory	250		
Oct 24	Cash in hand	700		3 950 Dr
Dec 31	Capital		3 950	0

Interpretation of ledger account

- 3 Feb: Owner took cash from business bank account $3 000 for his own use.
- 20 Jun: Owner took inventory costing $250 for personal use.
- 24 Oct: Owner took business/office cash $700 for his own use.
- 31 Dec: The total drawings of $3 950 for the year was transferred to the capital account.

CAPITAL
Capital is the amount of resources/ net assets contributed by the business owner.
Capital or net assets = Total Assets – Total Liabilities
It is an equity account, and is credit in nature.

Journal entry

Journal

Date	Particulars	Dr $	Cr $
2021			
Mar 15	Equipment (A+)	5 000	
	Capital (+)		5 000
	Owner contributed a personal equipment worth $3000.		
Dec 31	Capital (-)	3 950	
(year-end)	Drawings (-)		3 950
	Total drawings for the year are transferred to the		
	capital account.		
Dec 31	Income summary	1 050	
(year-end)	Capital (+)		1 050
	The business made a profit of $1 050 transferred		
	from income summary account.		

Capital Account

2021	Particulars	Dr $ -	Cr $ +	Bal $
Jan 1	Balance b/d			10 000 Cr
Mar 15	Equipment		5 000	
Dec 31	Drawings	3 950		
Dec 31	Income Summary **(2)**	[Loss]	1 050 [Profit]	12 100 Cr
2022				
Jan 1	Balance b/d			12 100 Cr

Interpretation of ledger account

- 1 Jan 2021: The capital brought down from previous year was $10 000.
- 15 Mar: Owner brought his own equipment costing $5 000 into the business.
- 31 Dec: Owner took a total of $3 950 drawings for the year for his own use.
- 31 Dec: $1 050 profit for the year was transferred from income summary account.
- 1 Jan 2022: The capital brought down to the following year was $12 100.

Extracts of Financial Statements

JYSS Ltd
Statement of Financial Position as at 31 December 2020 (extract)

	$
Owner's equity	
Capital (10 000 + 5 000 + 1 050 – 3 950)	12 100

Note:
Capital = Beginning capital + additional capital + Profit for the year – Drawings

Effect on Owner's Equity

Business activities	Effect on Owner's Equity
Owner contributes assets to the business i.e. additional capital.	Increase
Owner withdraws business assets for personal use i.e. drawings.	Decrease
Profit for the year	Increase
Loss for the year	Decrease

FORMS OF BUSINESS OWNERSHIPS *(O LEVEL ONLY)*

Features	Sole Proprietorship (SP)	Limited Liability Partnership (LLP)	Private Limited Company (PLC)
Ownership	**Owned by one person** who contributes capital to set up the SP.	Owned by **two or more partners** where each partner contributes capital to set up the LLP.	Owned by **50 or less shareholders** where each shareholder buys shares and contributes capital.
Access to funds	Less likely for banks and other lenders to lend money to the SP due to the **lack of personal assets that can serve as collaterals.** Hence, access to funds is usually limited to the personal funds of the owner.	More likely for banks and other lenders to lend money to the LLP as there are **more sources of personal assets** from partners and business assets to serve as collaterals. Alternatively, the LLP may get more persons to join as partners and contribute capital.	More likely for banks and other lenders to lend money to the PLC as there are **more business assets of high value to serve as collaterals.** Alternatively, the company may issue more shares to raise funds.
Extent of liability	When the SP incurs debts and losses, the sole owner is **obliged to pay them using his personal assets.**	When the LLP incurs debts and losses, the partners are **not personally liable** for them. However, when the LLP incurs debts and losses due to the wrongful actions of one of the partners, only that partner is personally liable for them while other partners are not affected.	When the company incurs debts and losses, shareholders are **not obliged to pay them using their personal assets** and may not receive dividends. In the worst-case scenario, they will **only need to forfeit their investments.**

Features	Sole Proprietorship (SP)	Limited Liability Partnership (LLP)	Private Limited Company (PLC)
Level of control	The only owner usually runs the business by himself and has **absolute control** over it. The owner may hire professionals to help him.	Control over the business is usually **shared** among the partners with at least one partner heavily involved in running the business. The partners may hire professionals to help them.	The shareholders have **no control** over the running of the business **unless they are part of the management team**. The company hires professionals to manage the business on behalf of shareholders.
Lifespan of business	The SP exists as long as the owner is alive and desires to continue operation.	The LLP exists forever until wound up or struck off.	The PLC exists forever until wound up or struck off.
Transferability of ownership	The sole owner can easily update the particulars of the new owner to notify the corporate regulatory authority of the transfer of ownership.	**All partners need to agree** to the addition or withdrawal of partner(s) before the corporate regulatory authority will acknowledge the transfer of ownership.	Shareholders can pay a stamp duty to the tax authority to give their shares to another person or organisation.
Formalities and procedures	The SP has minimal administrative duties to adhere to.	The LLP has few regulatory duties to comply with. However, one of the partners needs to submit an annual declaration stating whether is is able to pay its debts during the normal course of business.	The PLC must comply with statutory requirements and file its annual financial reports.

SHAREHOLDERS' EQUITY (*O LEVEL ONLY)*

Share capital is the amount of funds raised by issuing shares to shareholders.
It is an equity account, thus credit in nature, likened as the capital account.

Retained earnings is the accumulation of profits that has not been distributed to shareholders. It is an equity account, thus credit in nature.

When losses are accumulated, retained earnings would be renamed as accumulated losses.

Dividends are profits distributed to the shareholders based on the amount declared.
It is a contra-equity account, thus debit in nature, likened as the drawings account.

Shareholders' Equity = Share capital + Retained earnings

Retained earnings = Beginning retained earnings + Profit for the year – Dividends declared

Application of Accounting Theory

1. **Accounting entity theory**
   Transactions of a private limited company are separate from the actions of the shareholders. Business transactions are recorded from the point of view of the business. Shareholders contribute cash to the business through the buying of more shares. Profits may be distributed to the shareholders through dividends declared.

Journal entry

Journal

Date	Particulars	Dr $	Cr $
2021			
May 20	Cash at bank (A+)	150 000	
(date of issue)	Share capital (C+)		150 000
	100,000 ordinary shares issued at $1.50 per share.		
Jun 1	Dividends (D+)	8 000	
(date of	Cash at bank (A-)		8 000
declaration)	*$0.04 dividends declared for 200,000 ordinary shares and are fully paid on the same day.*		
Nov 30	Dividends (D+)	2 000	
(date of	Dividends payable (L+)		2 000
declaration)	*$0.01 dividends declared for 200,000 ordinary shares*		
	which will be paid in the next financial year.		
Dec 31	Retained earnings (I-)	10 000	
(year-end)	Dividends (D-)		10 000
	Total dividends declared are transferred to the		
	Retained earnings account.		
Dec 31	Income summary	6 700	
(year-end)	Retained earnings (I+)		6 700
	Transfer of profit for the year to the retained earnings		
	account.		
2022			
Feb 1	Dividends payable (L-)	2 000	
(date of	Cash at bank (A-)		2 000
payment)	*Dividends declared on 30 Nov 2021 was paid.*		

Interpretation of ledger account

Share Capital Account (equity)

2021	Particulars	Dr $ -	Cr $ +	Bal $
Jan 1	Balance b/d			500 000 Cr
May 20	Cash at bank		150 000	650 000 Cr
2022				
Jan 1	Balance b/d			650 000 Cr

- ❖ 20 May 2021: The business issued additional shares and received $150 000 cash in its bank account.

Retained Earnings Account (equity)

2021	Particulars	Dr $ -	Cr $ +	Bal $
Jan 1	Balance b/d			12 400 Cr
Dec 31	Dividends	10 000		
Dec 31	Income Summary	[Loss]	6 700 [Profit]	9 100 Cr
2022				
Jan 1	Balance b/d			9 100 Cr

- ❖ 31 Dec 2021: A total of $10 000 dividends is transferred to retained earnings account at the end of the financial year.
- ❖ 31 Dec 2021: A profit of $6 700 was transferred into the retained earnings account for the year ended 31 Dec 2021.

Dividends Account (contra-equity)

2021	Particulars	Dr $ +	Cr $ -	Bal $
Jun 1	Cash at bank	8 000		8 000 Dr
Nov	Dividends Payable	2 000		
Dec	Retained earnings		10 000	0

- ❖ 1 June: The business declared and paid dividends of $8 000.
- ❖ 30 Nov: The business declared dividends of $2 000 but it will be paid at a later date.
- ❖ 31 Dec: $10 000 of total dividends declared is transferred to the retained earnings account at the end of the financial year.

Dividends Payable Account (liability)

2021	Particulars	Dr $ -	Cr $ +	Bal $
Nov 30	Dividends		2 000	2 000 Cr
2022				
Jan 1	Balance b/d			2 000 Cr
Feb 1	Cash at bank	2 000		0

- ❖ 30 Nov 2021: The business declared dividend of $2 000 to be paid in the next financial year.
- ❖ 1 Jan 2022: The business owes $2 000 of dividends to its shareholders.
- ❖ 1 Feb 2022: The business paid $2 000 from its cash at bank account for dividends previously declared.

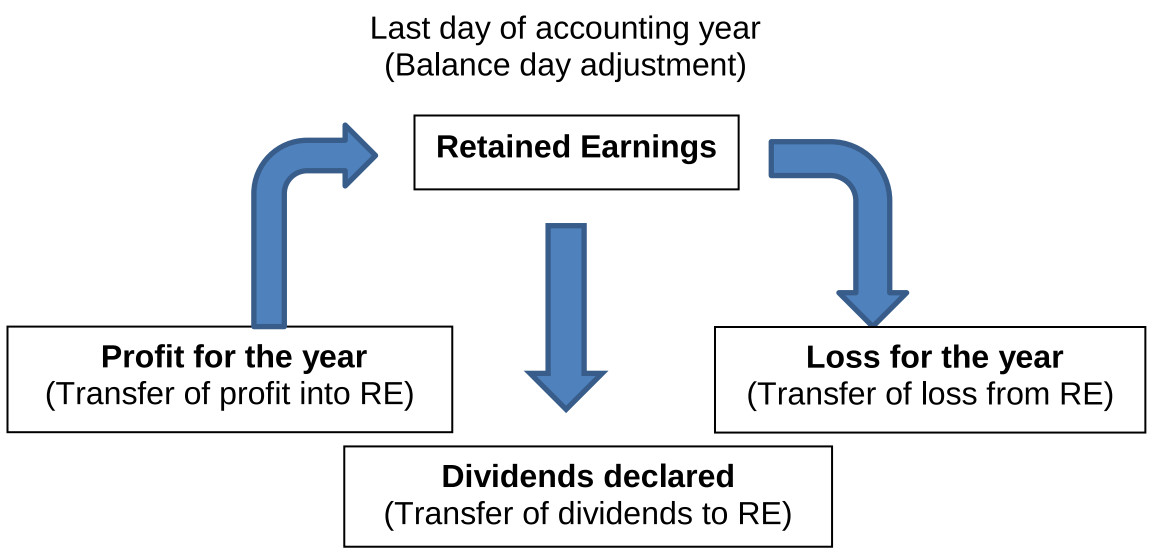
Extracts of Financial Statements

JYSS Ltd
Statement of Financial Position as at 31 December 2021 (extract)

	$	$
Shareholder's Equity		
Share capital, **300 000 ordinary shares**	650 000	
Retained earnings* (12 400 + 6 700 – 10 000)	9 100	659 100
Current Liability		
Dividends payable		2 000

* Ending retained earnings
= Beginning retained earnings + Profit for the year – Dividends **declared**

Note: If retained earnings is negative, it would be renamed as **accumulated losses.**



Activities	Effect on Shareholders' Equity
* Private limited company issues new shares. * Business makes a profit for the year.	Increase
* Private limited company declares dividends. * Business makes a loss for the year.	Decrease

CHAPTER 15 CORRECTIONS OF ERRORS

Limitation of Trial Balance

There are errors in the accounts if the trial balance is not balanced.
However, there are some errors which will not affect the agreement of the trial balance totals. Such errors are not revealed by the trial balance.

Errors Not Revealed by Trial Balance

1) The transaction is not recorded at all.
2) The wrong amount is recorded on both the debit and credit entries.
3) The transaction is recorded in the wrong account of a <u>different</u> accounting element.
4) The transaction is recorded in the wrong account of the <u>same</u> accounting element.
5) The debit and credit entries are reversed.

Error in Amount

When the recorded amount is understated:
A $2000✓ cheque received from a trade receivable has been recorded as $200✗.

✗ Wrong entry *(as described in question)*	Dr Cash at bank 200 Cr Trade receivable 200	
Correction of Error *[This is the Answer!]*		**Dr Cash at bank 1800** **Cr Trade receivable 1800**
✓ Correct entry *(by right should have been like that)*	Dr Cash at bank 2000 Cr Trade receivable 2000	

*Amount for **Dr** Cash at bank was **too low**, to **increase** it by $1800 → **Dr** Cash at bank $1800*
*Amount for **Cr** Trade receivable was **too low**, to **increase** it by $1800 → **Cr** Trade receivable $1800*

*∴ **Top up** the Dr & Cr entries by the difference when the wrong amount is **too low**.*

When the recorded amount is overstated:
Credit purchase of goods worth $340✓ has been recorded as $430✗.

✗ Wrong entry *(as described in question)*	Dr Inventory 430 Cr Trade payable 430	
Correction of Error *[This is the Answer!]*		**Dr Trade payable 90** **Cr Inventory 90**
✓ Correct entry *(by right should have been like that)*	Dr Inventory 340 Cr Trade payable 340	

*Amount for **Dr** Inventory was **too high**, to **reduce** it by $90 → **Cr** Inventory $90*
*Amount for **Cr** Trade payable was **too high**, to **reduce** it by $90 → **Dr** Trade payable $90*

*∴ **Reverse** the Dr & Cr entries by the difference when the wrong amount is **too high**.*

Wrong Account of a <u>Different</u> Accounting Element

Purchase of equipment ✓ worth $400 has been recorded as repairs✗ of equipment.

✗ Wrong entry *(as described in question)*	Dr Repairs expense 400 ✗ *Cr CAB / CIH / TP 400 ✓	
Correction of Error *[This is the Answer!]*		**Dr Equipment 400** **Cr Repairs expense 400**
✓ Correct entry *(by right should have been like that)*	Dr Equipment 400 *Cr CAB / CIH / TP 400 ✓	

** The credit entry is not described in the question as there is no error and does not require correction.*
***Remove** the wrong **Dr** Repairs by correcting it with **Cr** Repairs.*
*Then, **create** the correct entry **Dr** Equipment.*

Wrong Account of the <u>Same</u> Accounting Element

Credit sale of goods worth $500 to Lucy ✓ has been posted to Luca's✗ account.

✗ Wrong entry *(as described in question)*	Dr TR Luca 500 ✗ *Cr Sales revenue 500 ✓	
Correction of Error *[This is the Answer!]*		**Dr TR Lucy 500** **Cr TR Luca 500**
✓ Correct entry *(by right should have been like that)*	Dr TR Lucy 500 *Cr Sales revenue 500 ✓	

** The credit entry is not wrong and does not require correction.*
***Remove** the wrong **Dr** TR Luca by correcting it with **Cr** TR Luca.*
*Then, **create** the correct entry **Dr** TR Lucy.*

Reversal of entries

Cheques of $600 received from Betty ✓ has been debited to Betty's ✗ account and credited to cash at bank.

✗ Wrong entry *(as described in question)*	Dr TR Betty 600 Cr Cash at bank 600	
Correction of Error *[This is the Answer!]*		**Dr Cash at bank 1200** **Cr TR Betty 1200**
✓ Correct entry *(by right should have been like that)*	Dr Cash at bank 600 Cr TR Betty 600	

Dr *TR Betty $600 was wrong. To* ***remove*** *it →* ***Cr*** *TR Betty $600*
To create the correct entry → ***Cr*** *TR Betty $600 again.*

Cr *Cash at bank $600 was wrong. To* ***remove*** *it →* ***Dr*** *Cash at bank $600*
To create the correct entry → ***Dr*** *Cash at bank $600 again.*

∴ *To correct the error of complete reversal, do the correct entry with the amount* ***doubled****.*

EFFECTS ON PROFIT

Correction Item	Effect of **Error** on		Effect of **Correction** on	
	Gross Profit	Profit for the year	Gross Profit	Profit for the year
Debit: • Sales revenue • Sales returns • Cost of sales	Overstated		**Decrease**	
Credit: • Sales revenue • Sales returns • Cost of sales	Understated		**Increase**	
Debit: • Other income • Other expense	No effect	Overstated	No effect	**Decrease**
Credit: • Other income • Other expense	No effect	Understated	No effect	**Increase**

*Profit is **Cr** in nature.*
*∴ When any income / expenses is **credited** to correct an error, the profit **increases**, and vice versa.*

STATEMENT TO SHOW ADJUSTED PROFIT (O LEVEL ONLY)

JYSS Ltd

Statement to show adjusted profit for the year ended 30 June 2022

	$
Profit for the year **before** correction	6 270
(i) Less: Cost of repairs wrongly debited to machinery account	(500)
(ii) Add: Credit sale of goods $300 was recorded as $200	100
(iii) Add: Discount received treated as discount allowed	80
(iv) Goods sold to Joan on credit was debited to Jane account.	No effect
Profit for the year **after** correction	5 950

CHAPTER 16 FINANCIAL STATEMENTS ANALYSIS *(O LEVEL ONLY)*

FORMULA

For answers not exact, round off to **2 decimal places**.

	Profitability Ratio	Formula
1	**Mark-up on Cost** (%) Measures how much GP a business earns for every dollar of its COS. An indication on the pricing of goods. 25% mark-up means that for every dollar of COS, GP is $0.25.	$\frac{\text{Gross profit}}{\text{Cost of sales}}$ X 100 = ____%
2	**Gross Profit Margin** (%) Measures how much GP a business earns for every dollar of NSR. An indication of the trading profitability of the business. 30% GPM means that for every dollar of NSR, GP is $0.30.	$\frac{\text{Gross profit}}{\text{Net sales revenue}}$ X 100 = ____%
3	**Profit Margin** (%) Measures how much profit a business earns for every dollar of NSR. An indication of the overall profitability of the business.	$\frac{\text{Profit for the year}}{\text{Net sales revenue}}$ X 100 = ____%

	Investment Ratio	Formula
4	**Return on Equity** (%) measures profit a business earns for every dollar of equity invested. Equity refers to either owner's equity or shareholders' equity.	$\frac{\text{Profit for the year}}{\text{Average equity}}$ X 100 = ____% Average equity = $\frac{\text{Beginning equity + Ending equity}}{2}$

	Liquidity Ratio	Formula
5	**Working Capital** is the amount of capital that is used to pay the day-to-day expenses of running the business.	Current Assets – Current Liabilities = $ ______ • Positive WC means the business has sufficient current assets to pay its short-term debts. • Negative WC means the business has insufficient current assets to pay its short-term debts.
6	**Current Ratio** A current ratio of 2.52 means that the business has $2.52 of **current** assets to pay every $1 of its short-term debts.	$\frac{\text{Current Assets}}{\text{Current Liabilities}} =$ _____ • CR ≥ 1 means the business has sufficient current assets to pay its short-term debts. • CR < 1 means the business has insufficient current assets to pay its short-term debts. • The general benchmark to use is 2 although the acceptable norm varies from industry to industry.
7	**Quick Ratio** A quick ratio of 0.78 means that the business has $0.78 of **quick** assets to pay every $1 of its short-term debts.	Quick assets $\frac{\boxed{\text{Current Assets – Inventory – Prepayments}}}{\text{Current Liabilities}} =$ _____ • QR ≥ 1 means the business has sufficient quick assets to pay its short-term debts. • QR < 1 means the business has insufficient quick assets to pay its short-term debts. • The general benchmark to use is 1 although the acceptable norm varies from industry to industry. OR Quick assets = Cash in hand + Cash at bank + Net TR

	Inventory management	Formula
8	**Rate of Inventory Turnover** measures how fast goods are sold and replenished. 12 times means the business replenished its goods 12 times in the year.	$\frac{\text{Cost of sales}}{\text{Average inventory*}}$ = ______ **times**
9	**Days Sales in Inventory** measures the number of days a business takes to sell its inventory. The **fewer** the days sales in inventory, the **more efficient** the business is at managing its inventory.	$\frac{\text{Average inventory*}}{\text{Cost of sales}}$ X 365 days = ______ **days** *Average inventory= $\frac{\text{Beginning inventory + Ending inventory}}{2}$
	Trade receivables management	**Formula**
10	**Rate of Trade Receivables Turnover** measures the number of times a business collects payment from its credit customers.	$\frac{\text{Net Credit Sales Revenue}}{\text{Average Net Trade Receivables (NTR)*}}$ = ______ **times**
11	**Trade Receivables Collection Period** measures the number of days a business takes to collect payment from its credit customers. The **fewer** the number of days for the TR collection period, the **more efficient** the business is at managing TR.	$\frac{\text{Average NTR*}}{\text{Net Credit Sales Revenue}}$ X 365 days = ______ **days** *Average NTR = $\frac{\text{Beginning NTR + Ending NTR}}{2}$

RATIO ANALYSIS: PROFITABILITY

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Profitability
Measures the ability of a business to generate excess income to cover its expenses.

profit

Importance of profitability in its trading activities

- Important to make gross profit from the buying and selling of goods as a gross loss means that the business is selling its goods at a price that is below its cost price.
- A business that generates a gross loss may be unable to compete with its competitors

Not being profitable in its trading activities would lead to insufficient funds to cover the operating expenses and result in overall losses for the business.

Importance of profitability as a whole business

Every business aims to maximise its profits so that it can:

- distribute profits to its owners to reward them for their contributions and attract investors
- expand its operation to a bigger store or to add more stores
- reward its employees and have them continue working for it

Not being profitable as a whole business may force a business into bankruptcy and close down.

Poorer profitability could mean:

- Lower selling price
- Higher cost price
- Lower other income
- Higher other expenses

$\boxed{\text{Mark-up, GPM}}$

$\boxed{\text{PM}}$

STEP-BY-STEP GUIDE TO COMMENTING PROFITABILITY

Comparison across 3 Years

	2020	2021	2022
Gross profit margin (GPM)	15%	20%	14%
Profit Margin (PM)	8%	15%	6%
% Expenses (GPM-PM)	*7%*	*5%*	*8%*

Step 1: Compare GPM

- The GPM has <u>improved</u> from 15% in 2020 to 20% in 2021,
  - but the GPM has <u>worsened</u> from 20% in 2021 to 14% in 2022.

Step 2: Probable reason → Selling price and cost price of goods
→ Mark-up on Cost [if available]

- The improvement of GPM from 2020 to 2021 is probably due to the goods having <u>higher selling price or lower cost price</u> in 2021 as compared to 2020.
  - However, the worsening of GPM from 2021 to 2022 is probably due to the goods having <u>lower selling price or higher cost price</u> in 2022 compared to 2021.

Step 3: Compare PM

- Similarly, the PM has <u>improved</u> from 8% in 2020 to 15% in 2021,
  - but the PM has <u>worsened</u> from 15% in 2021 to 6% in 2022.

Step 4: Probable reason(s) → GPM
→ Other expenses

- It is partly due to the <u>improved</u> GPM in 2021 from 2020,
  - and the <u>deteriorated</u> GPM in 2022 from 2021.
- It is also partly due to the business being <u>more efficient</u> in controlling its expenses to generate NSR in 2021 than in 2020.
  - and the business being <u>less efficient</u> in controlling its expenses to generate NSR in 2021 than in 2022.

Step 5: Conclusion based on PM → more profitable / less profitable

- Overall, the profitability of the business has <u>improved</u> from 2020 to 2021,
  - but has <u>worsened</u> from 2021 to 2022.

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Comparison between 2 Businesses

(Between A & B / Between B & C)

	A	B	C
Gross profit margin	20%	~~18%~~ 17%	19%
Mark-up on cost	80%	50%	60%
Profit Margin	12%	10%	7%
% Expenses (GPM-PM)	~~*7%*~~ 8%	~~*5%*~~ 7%	~~*8%*~~ 12%

Step 1: Compare GPM

- The GPM of A 20% is better than B's 18%.
- ○ The GPM of B 18% is worse than C's 19%.

Step 2: Probable reason → Selling price and cost price of goods
→ Mark-up on Cost [if available]

- This is probably due to A's goods having higher selling price or lower cost price compared to B.
- This is supported by the better mark-up on cost of A's 80% compared to B's 50%.

- ○ This is probably due to B's goods having lower selling price or higher cost price compared to C.
- ○ This is supported by the worse mark-up on cost of B's 50% compared to C's 60%.

Step 3: Compare PM

- Similarly, the PM of A 12% is better than B's 10%.
- ○ However, the PM of B 10% is better than C's 7%.

Step 4: Probable reason(s) → GPM
→ Other expenses

- Both the GPM and PM of A are better than B by 2%. This indicates that the better PM of A is entirely due to its better GPM, and both A and B have comparable efficiency in contolling its expenses.

- ○ The 10% PM of B is better than C's 7% PM. However, the ~~18%~~ 17% GPM of B is worse than the 19% GPM of C. This shows that B is worse at trading goods for profit but more efficient in controlling its expenses compared to C.

Step 5: Conclusion → more profitable / less profitable (Based on PM)

- Overall, business A is more profitable than business B.
- ○ Overall, business B is more profitable than business C.

RATIO ANALYSIS: LIQUIDITY

Liquidity

Measures the ability of a business to repay its current liabilities when they are due.

Importance of being liquid

- Cash is required to operate the business such as buying inventory, paying for rent, salaries and utilities etc.

- If the business does not have sufficient cash, it would face the following **consequences of not being liquid:**
  - Unable to pay immediate debts and day-to-day operating expenses
  - Unable to enjoy cash discounts because of insufficient cash to pay to suppliers promptly
  - Unable to buy on credit from supplier because of the risk of inability to pay up
  - Loss of customer goodwill which will lead to loss of sales

- In the long run, it may be forced to close down.

Why quick ratio is a better indicator of liquidity than current ratio

- Current ratio measures the ability of the business to pay its short-term debts using its current assets while quick ratio measures the ability of the business to pay its short-term debts using quick assets.

- Quick assets are cash and other current assets that can be converted into cash quickly. Quick assets are more liquid than current assets.

- Inventory and prepayments are not considered quick assets.
  - It can be quite difficult to sell off inventory or return to supplier in the short term to convert inventory into cash
  - Prepayments are not easily converted into cash on an urgent basis

STRUCTURE FOR COMMENTING ON LIQUIDITY

Level 1: Compare ***- improved*** ***- worsened*** ***- better*** ***- worse***	(1) Working Capital	• +ve means business has sufficient funds to repay CL • -ve means insufficient funds to repay CL
	(2) Current Ratio (CR) (3) Quick Ratio (QR)	• General benchmark for CR = 2 • Genera benchmark for QR = 1 • Above benchmark → ideal • Below benchmark → less than ideal
Level 2: Support	(4) Reasons & evidence *for poor / declined liquidity position (QR < 1)*	• **Too much inventory tied up in CA** • **Low cash holding** (bank overdraft) • Prepaid expense
Level 3: Conclude	(5) Conclusion *based on QR*	• Comparison between years: Liquidity position has **improved / worsened** • Comparison between businesses: Liquidity position is **better / worse**

- **Avoid repeating**
  - Quote the evidences / reasons altogether after stating the trends of WC, CR & QR if the trends are the same (all worsened / all improved).

- **Use paragraphing** for clearer organization
  - If the trend differs (e.g. WC improved but CR and QR worsened), one paragraph should be dedicated to WC including the reasons for its improvement, and another paragraph for the worsening of CR and QR including the corresponding reasons.

- **Prioritise** your evidence
  - Pick the <u>most critical</u> reasons to support the trend.
  - The evidences are usually <u>drastic differences</u> in the data provided.
  - *Ignore* the differences in data that seems to *contradict* your stand as they are often insignificant.

STEP-BY-STEP GUIDE TO COMMENTING LIQUIDITY

Comparison across 2 or 3 Years

	2020	2021	2022
Current ratio (CR)	2.52	2.80	2.43
Quick ratio (QR)	1.64	1.37	0.93

Step 1: Compare ratios

- The CR has <u>improved</u> from 2.52 in 2020 to 2.80 in 2021, and <u>worsened</u> from 2.80 in 2021 to 2.43 in 2022. It has remained above the general benchmark of 2 for all three years.

- However, the QR has <u>worsened</u> consistently from 1.64 to 1.37 to 0.93 over the three years. The QR was above the general benchmark of 1 in both 2020 and 2021 but has <u>worsened</u> to less than the general benchmark in 2022.

Step 2: Support with evidence [if data is provided]

- The <u>increase of inventory</u> from $16 000 in 2020 to $24 000 in 2021 has resulted in <u>more / too much current assets are tied up in inventory</u> in 2021 ($24 000 out of $78 000). This has caused the improvement in CR from 2020 to 2021, and the worsening of QR.

- The worsening of both CR and QR from 2021 to 2022 is due to the significant <u>decline in cash holding</u> from $30 000 in 2021 to overdraft of $2 000 in 2022.
- The <u>increase in trade payables</u> from $6 000 in 2021 to $10 000 in 2022 was also a contributing reason.

Step 3: Conclude based on QR

- Overall, liquidity has <u>worsened</u> over the three years from 2020 to 2022. The less than ideal QR in 2022 suggests that the business might not be able to pay short term debts on time.

Comparison between 2 businesses

	A	B
Current ratio (CR)	2.4	2.1
Quick ratio (QR)	0.7	1.2

Step 1: Compare CR

- The 2.4 CR of A is better than B's 2.1 even though both are above the general benchmark of 2.

Step 2: Support with evidence [if data is provided]

- The better CR of A is due to its higher trade receivables $2 500 compared to B's $1 500,
- and A's inventory $17 000 is also higher than B's $5 000.
- Another reason is that A's lower trade payables of $1 200 compared to B's $3 800.

Repeat Step 1: Compare QR

- However, the QR of A (0.7) is worse than B (1.2). A's QR is below the general benchmark of 1 while B's QR is above the general benchmark of 1.

Repeat Step 2: Support with evidence [if data is provided]

- A has a better CR but a worse QR than B because A has more / too much current assets tied up in inventory, $17 000 out of $25 000.
- Moreover, A also has a lower cash holding than B as supported by A's bank overdraft of $500 as compared to B's $4 000 cash at bank.

Step 3: Conclude based on QR

- Overall, the liquidity position of A is worse than B, and A might not be able to pay short term debts on time.

Interpreting for 1 Business / 1 Year
Step 1: State figures * The current ratio is 2.13. o The quick ratio is 0.7.
Step 2: What it means ✓ It means that the business has $2.13 of current assets to repay every dollar of short-term debts. o It means that the business has $0.70 of quick assets to repay every dollar of short-term debts.
Step 3: Below or above general benchmark *(General benchmark of CR = 2 and QR = 1)* ✓ The CR is above the general benchmark of 2, which is ideal. o The QR is below the general benchmark of 1, which is less than ideal.
Step 4: When CR is above the general benchmark (>2) but QR is less than general benchmark (<1) * The ideal CR and less than ideal QR is mainly due to <u>too much current assets tied up in inventory</u> ($5 000 out of $6 700). * Another contributing reason is the <u>low cash holding</u>, evident from the bank overdraft of $200.
Step 5: Conclusion based on QR If QR>1 o Overall, the business is in a <u>healthy liquidity position</u> and is able to pay its short-term debts on time. If QR<1 o Overall, the business is in a <u>poor liquidity position</u> and is unable to pay its short term debts on time.

DIFFERENCE BETWEEN PROFITABILITY AND LIQUIDITY

Profitability measures the ability of a business to earn profit while liquidity measures the ability to repay short term debts.

1) A profitable business may not be liquid.
   - E.g. the business could have spent its cash to buy non-current assets and has little cash or quick assets left.
   - E.g. the business could sell on credit to generate high sales revenue and profit, and yet currently has low amount of cash.

2) Similarly, low profit does not necessary means low cash.
   - E.g. depreciation and impairment loss on trade receivables reduces profit but has no impact on the amount of cash.

3) There is a trade-off between profitability and liquidity.
   - An asset that is liquid, e.g. cash, may not be useful in generating profit. A business with too much cash is not using its resources effectively.
   - However, a non-current asset which is not liquid, e.g. an equipment, can be used to generate profit.

A healthy business is one that strikes a balance between profitability and liquidity.

RATIO ANALYSIS: INVENTORY MANAGEMENT

Rate of inventory turnover

- Measures the number of times a business has sold and replaced its inventory
- The higher the rate of inventory turnover, the more efficient the business is at managing its inventory

Days sales in inventory

- Measures the number of days a business takes to sell its inventory
- The fewer the days sales in inventory, the more efficient the business is at managing its inventory

Importance of inventory management

Excessive inventory
(Buy too much)

Effects

- Increase storage cost and insurance for holding inventory
- Increase risk of outdated inventory
- Poor liquidity (Quick ratio < 1)

Insufficient inventory
(Buy too little)

Effects

- Lost sales as not able to meet customers' demand
- Would not enjoy trade discount when buying in small quantities
- More frequent purchases are required resulting in paying more delivery and handling charges

GUIDE TO COMMENTING RATE OF INVENTORY TURNOVER

Comparison across 2 or 3 Years

	2020	2021	2022
Rate of inventory turnover	12 times	10 times	8 times
Days sales in inventory	30.42 days	36.5 days	45.62 days

The rate of inventory turnover has worsened steadily from 12 times to 10 times to 8 times over the three years. This is in line with the days sales in inventory which has also worsened from 30.42 days to 36.5 days to 45.62 days over the years.

This means the business has become less efficient in managing its inventory and is taking a longer time to sell its inventory.

Comparison between 2 businesses

	A	B
Rate of inventory turnover	9 times	6 times
Days sales in inventory	40.56 days	60.83 days

A’s rate of inventory turnover of 9 times is better than B’s 6 times. This is in line with A’s better days sales in inventory of 40.56 days as compared to B’s 60.83 days.

This means that A is more efficient in managing its inventory and is taking a shorter time to sell its inventory.

RATIO ANALYSIS: TRADE RECEIVABLES (TR) MANAGEMENT

Rate of TR turnover

- Measures the number of times a business collects payment from its credit customers.
- The higher the rate of TR turnover, the more efficient the business is at managing TR.

TR collection period

- Measures the number of days a business takes to collects payment from its credit customers.
- The shorter the TR collection period, the more efficient the business is at managing TR.

Importance of TR Management

Advantages of offering credit to customers

- Gives the business a competitive edge over its competitors who do not offer credit terms.
- Better customer loyalty as credit terms are indication of trust to pay debts before the due dates.
- Entices credit customers to buy in larger quantities, boosting sales revenue for the business.

Disadvantages of offering credit to customers

- Increased risks of credit customers delaying payment or refusing to pay which might result in uncollectible debts and increase in allowance for impairment of trade receivables.
- Less cash available for business operating needs or repayment of debts.

Comparison across 2 or 3 Years			
	2018	2019	2020
Rate of TR turnover	10 times	13 times	11 times
TR collection period	36.5 days	28.08 days	33.18 days

GUIDE TO COMMENTING TR MANAGEMENT

Given: Credit terms to customers - 30 days

The rate of TR turnover has <u>improved</u> from 10 times in 2018 to 13 times in 2019. This is in line with the <u>improvement</u> in TR collection period from 36.5 days in 2018 to 28.08 days in 2019 which is within the 30-day credit period.

This means that in 2019, the business was collecting payment from its credit customers on a <u>more timely basis</u> than the previous year and <u>taking a shorter time</u> to collect payment from its credit customers.

However, from 2019 to 2020, the rate of TR turnover has <u>worsened</u> from 13 times to 11 times. This is in line with the TR collection period which has <u>also worsened</u> from 28.08 days to 33.18 days, which is beyond the 30-day credit period.

This means that in 2020, the business was collecting payment from its credit customers on a <u>less timely basis</u> than the previous year and <u>taking a longer time</u> to collect payment from its credit customers.

Overall, the business has become <u>more efficient</u> at managing its TR from 2018 to 2019 but become <u>less efficient</u> at managing its TR from 2019 to 2020.

Comparison between 2 businesses		
	A	B
Rate of TR turnover	9 times	12 times
TR collection period	40.56 days	30.42 days

The rate of TR turnover of A's 9 times is worse than B's 12 times. This is line with A's worse TR collection period of 40.56 days than B's 30.42 days.

This means that A was collecting payment from its credit customers on a less timely basis than B and taking a longer time to collect payment from its credit customers as compared to B.

Overall, A is less efficient in managing its TR than B.

WAYS TO IMPROVE THE FINANCIAL RATIOS

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	FINANCIAL RATIOS	WAYS TO IMPROVE
1a	**Profitability** ⁎ *How to improve profitability through trading of goods?*	1) Increase selling price of goods 2) Decrease cost price by sourcing for cheaper goods of similar quality 3) Decrease cost price by buying in bulk to enjoy trade discount
1b	**Profitability** ⁎ *How to improve profitability through managing other income & other expenses?*	4) Increase income by renting out part of the premises to earn rent income 5) Increase income by investing in fixed deposit to earn interest income 6) Increase income by paying early to enjoy cash discount 7) Decrease expenses by reviewing the deployment of manpower to reduce salaries expense 8) Decrease expenses by saving water and electricity to reduce utilities expense
2	**Liquidity** ⁎ *How to have more cash to pay CL?*	1) Obtain cash contribution from owner or shareholders 2) Obtain a long-term loan 3) Sell excess non-current assets
3	**Inventory turnover** ⁎ *How to sell more goods?* ⁎ *How to sell goods faster?* ⁎ *How to better manage inventory?*	1) Reduce selling price to increase sales volume 2) Offer trade discounts to encourage customers to buy more 3) Advertising and marketing to attract more customers 4) Use technological tools to improve the accuracy of predictions about customer demand in order to know when and how much inventory to buy
4	**Trade receivables turnover** ⁎ *How to collect debts from credit customers faster?*	1) Ensure credit is granted to customers who are financially able 2) Offer cash discounts to encourage credit customers to pay early 3) Send regular reminders to credit customers who delay payment or refuse to pay 4) Engage professional debt recovery agencies to collect payment from financially distressed credit customers

CHAPTER 17 SCENARIO-BASED

ACCOUNTING AND NON-ACCOUNTING INFORMATION

Accounting information refers to information usually generated by the accounting information system and is largely information that can be extracted from journals, ledger accounts and financial statements (including financial ratios).

Non-accounting information refers to information not found in journals, ledger accounts and financial statements.

Why owners and managers of a business are interested in non-accounting information

Making decisions with only accounting information may cause stakeholders to leave out important business-related factors that are not shown on financial statements but may affect decisions.

SOURCES OF ACCOUNTING AND NON-ACCOUNTING INFORMATION

Decision		Accounting information	Non-accounting information
1	Which **inventory** to buy to sell as goods	1) Cost of goods 2) Storage cost 3) Gross profit margin 4) Rate of inventory turnover 5) Days sales in inventory	1) Nature of product 2) Storage requirements 3) Consumer preference 4) Reputation / review of product
2	Which **supplier** to buy goods or NCA from	1) Cost of inventory / NCA 2) Trade discount 3) Delivery charges 4) Cost of services 5) Credit period 6) Cash discount	1) Online or brick-and-mortar supplier 2) Local or overseas seller 3) After-sales service 4) Return policy 5) Reputation of supplier 6) Warranty
3	Whether to **extend credit** to customer	1) Trade receivables balance 2) Credit terms 3) Days trade receivables are overdue 4) Existing customer's history of repayment 5) Rate of trade receivable turnover 6) Trade receivable collection period	1) Economic outlook of the country 2) Specific industry outlook 3) Reputation of customer 4) Customer's history of repayment
4	Which **business form** to set up		1) Owner's expertise 2) Nature of business 3) Capital commitment for initial set-up 4) Risk appetite 5) Level of control desired 6) Lifespan of business 7) Transferability of ownership
5a	Whether to **buy or rent** the NCA	1) Business' current financial situation 2) Upfront cash required 3) Cost of ownership versus cost of renting	1) Business's needs 2) Efforts required to repair and maintain the NCA 3) Control over the customisation of NCA 4) Flexibility to change NCA
5b	Which **NCA** to buy to use	1) Price of the NCA 2) Installation cost 3) Maintenance cost 4) Repair cost	1) Purpose of the NCA 2) Features of the NCA 3) Efficiency of the NCA 4) Efforts required to repair and maintain the NCA 5) Customer reviews of NCA 6) Warranty

Scenario Based Question (SBQ)

Structure: *7 marks (3 reasons)*

<table>
<tr><td>Para</td><td></td><td>Marks</td><td></td></tr>
<tr><td>1</td><td>Decision</td><td>1m</td><td>State your decision clearly by answering the question.</td></tr>
<tr><td>2</td><td>Reason 1</td><td>2m</td><td>Evidence:
Quote evidence to support.
Make <u>comparison</u> wherever applicable.
✓ Comparison: cheaper, faster, more efficient…
✓ Eg. A costs <u>$40</u> which is <u>cheaper</u> than B which costs <u>$60</u>.

Benefit:
Explain <u>one</u> possible benefit.</td></tr>
<tr><td>3</td><td>Reason 2</td><td>2m</td><td rowspan="2">Avoid repeating the same benefit.</td></tr>
<tr><td>4</td><td>Reason 3</td><td>2m</td></tr>
</table>

- Organise your answer into 4 paragraphs.
- Write in full sentences, not in point form.
- Be succinct. One good sentence scores 1 mark.
- Make a decision. Choose either option A or option B. Do **not** write for both.
- If you choose A, compare and explain why A is good / better. Do **not** explain why you did not choose B or why B is not good / worse.
- No need conclusion as the mark for decision has already been given.

DECISION: WHICH INVENTORY TO BUY TO SELL AS GOODS?

Note: You are the accountant, advising which product the business should buy for its inventory ***to sell*** *to its customers.*

Accounting information

	Source of information	Explanation of benefit
1	**Cost of inventory purchased** *Includes:* *- delivery charges* *- import tax* *- any other cost of inventory* *Consider net cost after trade discount.*	1) **Higher gross profit:** A lower cost of inventory would lead to lower cost of sales and higher gross profit earned, assuming that the selling price is the same. 2) **Maintain competitive pricing:** Lower inventory costs allow the business to be more competitive in the market by offering products at lower prices compared to competitors. This can attract more customers and increase market share. 3) **Improved cash flow:** A lower cost of inventory would lead to cash savings and improved cash flow for other operating needs of the business.
2	**Storage cost**	1) **Higher profit:** A lower storage cost incurred to store goods results in lower expenses and higher profit for the year as more revenue from sales can be retained as profit. 2) **Improved cash flow:** A lower storage cost results in cash savings and improved cash flow as less funds are needed to sustain its day-to-day operations.

DECISION: WHICH INVENTORY TO BUY TO SELL AS GOODS?

Accounting information

	Source of information	Explanation of benefit
3	**Gross profit margin**	1) **Attract investors:** Gross profit margin (GPM) is a key indicator the financial performance of the business core operations. Choosing inventory with higher GPM leads to higher profitability which is important to attract investors. 2) **Investment in growth:** Higher GPM generates more funds that can be reinvested into the business for research and development, plans for expansion and innovation. 3) **Maintain competitive pricing:** Higher GPM allows more flexibility in setting competitive prices while still maintaining healthy profit margin. This provides a strategic advantage for the business over its competitors.
4	**Rate of inventory turnover** *Inventory turnover measures how many times the inventory is sold and replaced in a year.* ➔ *Higher turnover means more efficient* **Days sales in inventory** *Day sales measures the average number of days the business takes to sell its entire inventory in a year.* ➔ *Lower day sales means more efficient*	1) **Improved cash flow:** A higher inventory turnover / lower day sales in inventory means that the products are sold more quickly, leading to a faster conversion of inventory into cash. This improvement in cash flow is critical for meeting short-term obligations, investing in growth, and responding to unexpected expenses. 2) **Reduced expenses:** A faster inventory turnover / lower day sales indicates efficiency in inventory management, reducing the time goods spend in storage, minimizing holding costs associated with warehousing, insurance, and other expenses related to maintaining inventory. 3) **Prevention of obsolescence:** A faster inventory turnover / lower day sales helps prevent products from becoming obsolete. In industries with fast-changing technologies or trends, avoiding obsolescence is crucial to ensuring that the business remains competitive.

DECISION: WHICH INVENTORY TO BUY TO SELL AS GOODS?

Non-accounting information

	Source of information	Explanation of benefit
1	**Nature of product**	1) **Durability:** Goods that are more durable are often associated with good quality, which then enhances the brand image and reputation of the business. 2) **Perishability:** Products with longer shelf life allows more time for the business to sell them before they expire. This lowers the risk of writing off expired goods, and thus minimizing loss of profit. 3) **Eco-friendliness:** Choosing inventory that reflects environmental values not only satisfies customer expectations but also contributes to the business' commitment to sustainability efforts and eco-friendly practices, which may improve brand image.
2	**Storage requirements**	1) **Bulkiness:** Goods that require less storage space allows the business to hold more goods to meet the demands of the customers, which then prevents stock-out situations that might lead to loss of sales. 2) **Specific storage needs:** Goods that are less sensitive to storage conditions inherit lower risk of spoilage, hence incurring less impairment loss on inventory to write off spoilt goods.

DECISION: WHICH INVENTORY TO BUY TO SELL AS GOODS?

Non-accounting information

	Source of information	Explanation of benefit
3	**Consumer preference**	1) **Boost sales volume:** Products that are influenced by trends and fashion require a keen understanding of consumer preferences. Offering products with wider range of colours and designs caters to a broader customer base, potentially expanding the clientele and driving increased sales.
4	**Reputation / Reviews of product**	1) **Brand reputation:** Products associated with a well-known brand enjoy the benefits of its established reputation. Choosing goods from reputable brands attracts and retains loyal customers, fostering a consistent and reliable customer base as compared to goods of a new brand. 2) **Good reviews:** Goods with favorable reviews offers a higher level of quality assurance, minimising the possibility of sales returns due to poor quality, which then also improves the brand image.

DECISION: WHICH SUPPLIER TO BUY GOODS / NCA FROM?

Accounting information

	Source of information	Explanation of benefit
1	**Cost** *Includes:* *- delivery charges* *- import tax* *- any other cost of purchases* *Consider net cost after trade discount.*	1) **Higher gross profit:** A lower cost of inventory would lead to lower cost of sales and higher gross profit earned, assuming that the selling price is the same. 2) **Maintain competitive pricing:** Lower inventory costs allow the business to be more competitive in the market by offering products at lower prices compared to competitors. This can attract more customers and increase market share. 3) **Improved cash flow:** A lower cost of inventory / non-current asset (NCA) would lead to cash savings and improved cash flow for other operating needs of the business.
2	**Credit period** *No. of days supplier allows the business to owe*	1) **Better cash flow** A longer credit period allows the business the flexibility to delay repayment, thereby enhancing its ability to manage cash flow effectively.
3	**Cash discount** *Consider the cash needed after deduction of cash discount.* *→ cash discount is received upon repayment within the credit period.*	1) **Cash savings** Choosing a supplier offering a lower net amount payable after applying cash discounts enables the business to reduce its cash outlay. Timely payments within the stipulated credit period would result in additional cash savings.

DECISION: WHICH SUPPLIER TO BUY GOODS / NCA FROM?

Non-accounting information

	Source of information	**Explanation of benefit**
1	**Online or brick-and-mortar supplier**	1) **Brick-and-mortar supplier:** Suppliers with physical shops enable businesses to physically inspect products, ensuring they meet quality expectations and specifications before purchase. 2) **Online supplier:** Buying from an online seller offers convenience. The business can browse online for product specifications and product reviews before making informed purchase decisions.
2	**Local or overseas supplier**	**Advantages of local seller:** 1) Buying from local seller ensures quicker delivery times compared to overseas counterparts, minimizing the risk of inventory stock-outs and potential loss of sales. 2) In case of repair or return of damaged goods, local suppliers offer convenience and cost-effectiveness as shipping to and from a nearby location is both logistically easier and more economical than an overseas seller.
3	**After-sales service** *Includes free installation, prompt response to enquiries, repair services etc.*	1) **Better customer relations:** Suppliers that provide reliable after-sales services foster better customer relations with the business, encouraging long-term commitment. A committed supplier is likely to prioritize the needs of long-term customers, which can translate into enhanced customer service, quicker response times, and priority support in case of issues or emergencies.

DECISION: WHICH SUPPLIER TO BUY GOODS / NCA FROM?

Non-accounting information

	Source of information	Explanation of benefit
4	**Return policy**	1) **Quality assurance:** A more flexible return policy helps mitigate the business risk of the products not meeting expectations or specifications, which provides greater confidence on the product quality.
5	**Reputation of supplier**	1) **Postive reviews:** Positive customer reviews serve as a testament to a supplier's reputation for delivering quality goods and services. 2) **Established brand:** The supplier who is in the industry for more years is often seen as more established and trustworthy, instilling confidence in their ability to consistently provide high-quality goods.
6	**Warranty** *(For NCA)*	1) **Cost saving:** A longer warranty period not only provides additional assurance of product durability, but also safeguards the business from potential repair or replacement costs over an extended period. 2) **Minimise downtime due to breakdown:** Extended warranty period protects the business from downtime due to equipment breakdowns, contributing to overall operational reliability and continuity.

DECISION: CREDIT WORTHINESS OF CUSTOMER

Which customer to grant credit to?
Whether to extend credit period to customer?

Accounting information

	Source of information	Explanation of benefit
1	**Trade receivables balance**	1) **Higher TR balance:** It implies that the business enjoys more sales revenue from the customer with a higher TR balance. Granting credit extension to that customer would improve customer relation and promote customer loyalty, and contribute to business growth. 2) **Lower TR balance:** The risk of the customer defaulting on payment is lower when credit extension is granted to customer with lower TR balance. Inheriting a lower credit risk can help the business get approval for bank loan more easily.
2	**Credit terms /** **Days trade receivables are overdue /** **Existing customer's history of repayment**	The customer who is able to pay more promptly is a more desirable credit customer. A shorter credit period allows the business to collect payment more promptly. This leads to improved better cash flow and better liquidity for the business.

DECISION: CREDIT WORTHINESS OF CUSTOMER

Accounting information

	Source of information	Explanation of benefit
3	**Rate of trade receivable turnover (times)** *measures how many times business collects its average TR balance in a year.* ➔ *Higher turnover means better TR management* **Trade receivable collection period (days)** *measures how many days business takes to collect its average TR balance.* ➔ *Lower period means better TR management*	1) **Higher TR turnover:** Higher rate of TR turnover means that the business is collecting payment from the credit customer on a more timely basis, which implies better cash position for the business to meet its needs for other operating expenses. 2) **Lower TR collection period:** Taking a shorter time to collect payment from the credit customer implies better cash position for the business to meet its needs for other operating expenses.

DECISION: CREDIT WORTHINESS OF CUSTOMER

Non-accounting information

	Source of information	Explanation of benefit
1	**Economic outlook of the country**	When the country is in recession / facing economic downturn, the spending ability of the people weakens, and businesses are adversely affected, which may lead to poor cashflow and its ability to repay debts. When the country is in economic boom, businesses flourish and grow. Credit customers are typically able to provide more sales revenue, and also have better ability to repay debts.
2	**Specific industry outlook**	A business in a new / growing / emerging industry faces challenges of uncertain market demand but is vested with business opportunities while an established / mature industry is stable but faces fierce competition.
3	**Reputation of customer**	A customer with better reputation of providing quality goods and services may have stronger ability to generate sales and profit, and probably better able to repay debts.
4	**Customer's history of repayment**	The customer with better track record of making prompt payments would provide greater assurance of its ability to repay debts on time.

DECISION: WHICH LEGAL FORM OF BUSINESS TO SET UP?

Non-accounting information

	Source of information	Factors to consider
1	**Owner’s expertise**	The individual's own expertise plays a crucial role in deciding whether to seek partners or hire professionals.
2	**Nature of business**	The nature of the business determines how much manpower and/or funds would be required to operate the business.
3	**Capital commitment for initial set-up**	Evaluate the financial capacity to commit to the initial set-up or to secure loans from external sources. This consideration directly impacts the scale and legal form of the business.
4	**Risk appetite**	The extent of personal liability for business debts and losses differs for different business forms so the decision is influenced by the individual's risk tolerance.
5	**Level of control desired**	Determining the desired level of control is pivotal. It involves deciding between SP (absolute control), LLP (shared control), or PLC where control may be more dispersed.
6	**Lifespan of business**	The aspirations of the owner over the lifespan of the business is realised through different legal forms. A SP may align with a person's desire for a business to exist for only as long as he is alive and desires to continue operation, while LLP & PLC exists forever until wound up or struck off.
7	**Transferability of ownership**	The ease of transferring ownership is another considering factor in deciding which legal form of business to set up, depending on the owner’s long-term plans. While SP allows for easy transfer, LLP may require agreement among partners, and transferring shares in a PLC may involve stamp duty payments.

SP – Sole Proprietorship
LLP – Limited Liability Partnership
PLC – Private Limited Company

Refer to Chapter 14 for full details.

DECISION: WHETHER TO BUY OR RENT NON-CURRENT ASSETS (NCA)?

Accounting information

	Source of information	Explanation of benefit
1	**Business's financial situation**	Assess the availability of capital, whether owner is able to contribute more capital or able to take loan. Consider the business budget constraints and how buying or renting aligns with the business financial goals.
2	**Total cost of ownership versus total cost of renting** *Cost of ownership includes:* - *Purchase price* - *Installation cost* - *Repair & maintenance fees* - *Any related costs*	The cost of ownership, including any related expenses, is the total amount of cash needed in the long term commitment. Cash savings from such long term commitments allow businesses to allocate its resources to other critical areas such as expansion, marketing, or research.
3	**Upfront cash required** *Compare the upfront costs associated with purchasing the NCA & the initial expenses involved in renting.*	1) **Benefit of renting:** Purchasing may require a significant upfront investment, potentially limiting available cash for other business needs. Renting, on the other hand, may offer more financial flexibility. Renting usually requires a lower initial investment compared to ownership.

DECISION: WHETHER TO BUY OR RENT NON-CURRENT ASSETS (NCA)?

Non-accounting information

	Source of information	Factors to consider
1	**Business's needs**	Consider the plans of business expansion, oversea ventures, and any other stated needs.
2	**Control over the customisation**	1) **Benefit of buying:** Ownership provides full operational control over the asset. Business can customize, modify, or adapt the asset according to their specific needs without seeking approval from a leaser. When the asset is rented, the business is bound by the terms and conditions in the rental agreement, and is subjected to change upon renewal of contract.
3	**Efforts required to repair and maintain**	2) **Benefit of renting:** Rental agreements often transfer the responsibility of maintenance and repairs to the leaser. This reduces the administrative burden and costs associated with the upkeep of the asset so that the business may focus its efforts on core operations.
4	**Flexibility to change NCA**	1) **Access to lastest technology:** Renting asset provides access to the latest technology and equipment without the long-term commitment, which is particularly beneficial in industries where technology evolves rapidly. Allowing flexibility to try out other models or upgrade to newer models could bring about higher efficiency and productivity. 2) **Adaptability to changing needs:** Renting asset caters to the changing needs of the business as it grows. It offers scalability, enabling the business to access different types and quantities of assets according to growing or fluctuating customer demands.

DECISION: WHICH NCA TO BUY TO USE?

*Note: You are the accountant, advising which **NCA** the business should buy for **long-term use**.*

Accounting information

	Source of information	Explanation of benefit
1	**Upfront cash required**	Lower upfront cash commitments ensures that business have readily available cash to meet immediate financial obligations. It leads to better liquidity and financial flexibility, enabling businesses to respond more effectively to unexpected expenses, market fluctuations, or opportunities that may arise.
2	**Total cost of ownership** *Includes:* - *Purchase price* - *Installation cost* - *Maintenance cost* - *Repair cost*	The cost of ownership, including any related expenses, is the total amount of cash needed in the long term commitment. Lower cost of ownership allows the business to offer products and services at a lower overall cost due to efficient NCA management, gaining a competitive edge.
3	**Costs of repair and maintenance**	Ongoing expenses, such as repair & maintenance costs and depreciation charges, reduces profitability. Incurring less expenses would yield better profitability.

DECISION: WHICH NCA TO BUY TO USE?

Non-accounting information

	Source of information	Explanation of benefit
1	**Purpose and features of NCA**	1) **Technological specifications:** Depending on the purpose of the NCA, certain features are necessary while certain features are simply good-to-have. The business needs to consider the compatibility with existing systems. Higher efficiency machines lead to increased productivity and competitiveness. 2) **Durability:** NCA that is more durable has a longer useful life. This not just means cost savings from getting a replacement NCA, but also lower annual depreciation expense. 3) **Customization:** NCA that are highly customizable tend to have longer production lead times. The business should consider the downtime and the possible loss of sales when equipment breakdown. 4) **Scalability:** The business should consider the potential for accommodating future growth or changes in demand. NCA that is scalable offers flexibility to expand operations without frequent replacements, achieving efficient resource utilization in alignment with business growth. 5) **Environmental impact:** The environmental features of an NCA allows the business to align its commitment to sustainability. This enhances its corporate social responsibility image, and enjoys cost savings through energy efficiency.

DECISION: WHICH NCA TO BUY TO USE?

Non-accounting information

	Source of information	Explanation of benefit
2	**Efforts required to repair and maintain**	Lower level of maintenance efforts required reduces the resources allocated to upkeep the NCA, and thus reduces ongoing operational costs.
3	**Customer reviews on product**	Evaluations and comments from other customers on the usage of a NCA provide information about the experience of using the NCA so that the business can make an informed decision. Positive customer reviews is a testament of the quality of the NCA.
4	**Warranty**	1) **Cost saving:** A longer warranty period not only provides additional assurance of product durability, but also safeguards the business from potential repair or replacement costs over an extended period. 2) **Minimise downtime due to breakdown:** Extended warranty period protects the business from downtime due to equipment breakdowns, contributing to overall operational reliability and continuity.

NOTES ON FINANCIAL STATEMENTS WITH BALANCE DAY ADJUSTMENTS

<table>
<tr><th colspan="2">Type of Adjustments</th><th>Effects on
Statement (Performance)</th><th>Effects on
Statement (Position)</th></tr>
<tr><td>1)</td><td><u>Additional capital</u>

Trial balance as at 31 Dec 2020:
$
Capital 50 000
Cash at bank 8 300
Motor vehicle 40 000

Profit for the year is $1 000.

(i) Owner contributed additional capital of $1 200, which was banked into business bank account.

(ii) Owner brought in a motor vehicle valued at $15 000 for business use.</td><td>No effect</td><td><u>Non-current assets</u>
Motor vehicle
(40 000+15 000) 55 000

<u>Current assets</u>
Cash at bank
(8 300+1 200) 9 500

<u>Owner's equity</u>
Capital 67 200
(50 000+1 200+15 000+1 000)</td></tr>
<tr><td>2)</td><td><u>Drawings</u>

Trial balance as at 31 Dec 2020:
$
Drawings 7 000
Cash at bank (overdrawn) 1 500
Inventory 6 000
Capital 20 000

Profit for the year is $3 000.

(i) Owner withdrew $800 from business bank for personal use.

(ii) Owner withdrew $1 200 goods for personal use.</td><td>No effect</td><td><u>Current assets</u>
Inventory
(6 000 – 1 200) 4 800

<u>Owner's equity</u>
Capital 14 000
[20 000 + 3 000 –
(7 000 + 800 +1 200)]

<u>Current liability</u>
Bank overdraft
(1500 + 800) 2 300</td></tr>
</table>

	Type of Adjustments	Effects on Statement (Performance)	Effects on Statement (Position)
3)	**<u>Prepaid expenses</u>** Trial balance as at 31 Dec 2020: $ Stationery **(Paid)** 400 Advertising **(Paid)** 3 000 Rent **(Paid)** 4 200 (i) Stationery worth $100 was prepaid. (ii) Advertising incurred per month is $200 / The annual advertising expense is $2 400. (iii) Included in the rent was an amount of $600 paid for 6 months contract ending 28 Feb 2021.	*Expenses recorded in Performance is the amount **incurred**.* <u>Less: Other expenses</u> Stationery (400 – 100) 300 Advertising (3 000 – 600*) 2 400 Rent (4 200 – 200**) 4 000 Incurred = Paid – Prepaid	<u>Current **assets**</u> Prepaid stationery 100 Prepaid advertising 600 Prepaid rent 200 *3 months of advertising is prepaid = $3 000 – ($200 X12) = $600 **2 months (Jan & Feb 2021) of rental is prepaid = $600 X 2/6 = $200
4)	**<u>Expenses payable</u>** Trial balance as at 31 Dec 2020: $ Advertising **(Paid)** 3 100 Rent expense **(Paid)** 18 000 Insurance **(Paid)** 5 000 (i) Outstanding advertising of $80. / $80 of advertising was owing. (ii) The annual rent was $19 200. / The monthly rent was $1 600. (iii) Insurance was paid for 10 months to 31 Oct 2020. Insurance for Nov and Dec was owing.	*Expenses recorded in Performance is the amount **incurred**.* <u>Less: Other expenses</u> Advertising (3100 + 80) 3 180 Rent expense (1 600 x 12) 19 200 Insurance (5 000 / 10 x 12) 6 000 Incurred = Paid + Payable	<u>Current **liabilities**</u> Advertising payable 80 Rent payable (19 200 – 18 000) 1 200 Insurance payable 1 000 (5 000 /10 X 2)

Type of Adjustments		Effects on Statement (Performance)	Effects on Statement (Position)
5)	**<u>Income received in advance</u>** Trial balance as at 31 Dec 2020: $ Rent income **(Received)** 750 Service fee revenue **(Received)** 700 Commission income **(Received)** 6 000 (i) Rent received included an advance payment of $250 for the month of January 2021. / Rent income received in advance was $250. (ii) Service fee revenue is earned at $50 per month. / The service fee revenue earned for the year was $600. (iii) Commission income includes payment of $1 200 for the half year to 31 March 2021.	*Income recorded in Performance is the amount **earned**.* Service fee revenue 600 <u>Other income</u> Rent income (750 – 250) 500 Commission income (6 000 – 600*) 5 400 Earned = Received - RIA	<u>Current **liabilities**</u> Rent income received in advance 250 Service fee received in advance 100 Commission income received in advance 600 *3 months (Jan to Mar 2021) of commission was received in advance = $1 200 X 3/6 = $600
6)	**<u>Income receivable</u>** Trial balance as at 31 Dec 2020: $ Interest income **(Received)** 850 Commission income **(Received)** 900 Rent received **(Received)** 1 000 (i) Interest income $120 was yet to be received. (ii) The annual commission income was $1 200. / The monthly commission earned was $100. (iii) Rent income is earned at $200 per month. / The rent income earned for the year was $2 400.	*Income recorded in Performance is the amount **earned**.* <u>Other income</u> Interest income (850+120) 970 Commission income (100 x 12) 1 200 Rent income (200 X 12) 2 400 Earned = Received + Receivable	<u>Current **assets**</u> Interest income receivable 120 Commission income receivable (1 200 – 900) 300 Rent income receivable (2 400 – 1 000) 1 400

	Type of Adjustments	Effects on Statement (Performance)	Effects on Statement (Position)
7)	**<u>Current & Non-current portion of Long Term Borrowing</u>** Trial balance as at 31 Dec 2020: $ Bank loan 4 000 (i) One quarter of the bank loan is to be repaid by 30 June 2021.	No effect	<u>Non-current liabilities</u> Long-term borrowing 3 000 (4 000 x 3/4) <u>Current liabilities</u> Current portion of long-term borrowing 1 000 (4 000 X 1/4)
8)	**<u>Interest on loan (O Level only)</u>** Trial balance as at 31 Dec 2020: $ 5% Long-term loan 20 000 (i) Interest on long term loan has not been paid. (ii) The loan was obtained on 1 Oct 2020.	<u>Less: Other expenses</u> Interest on loan 250 Interest from 1 Oct to 31 Dec 2020 = (5% X 20 000 X 3/12) = $250	<u>Non-current liabilities</u> Long term borrowing 20 000 <u>Current liabilities</u> Interest payable 250
9)	**<u>Interest on loan (O Level only)</u>** Trial balance as at 31 Dec 2020: $ 10% Mortgage loan 8 000 Interest on mortgage loan **(Paid)** 150 (i) Interest on mortgage loan is not fully paid up. The loan was obtained on 1 July 2020.	<u>Less: Other expenses</u> Interest on mortgage loan 400 Interest from 1 Jul to 31 Dec 2020 = (10% x 8 000 x 6/12) = $400	<u>Non-current liabilities</u> Long-term borrowing 8 000 <u>Current liabilities</u> Interest payable 250 (400 – 150)
10)	**<u>Current & Non-current portion of Loan & Interest on loan (O Level only)</u>** Trial balance as at 31 Dec 2020: $ Loan 5 000 Interest on loan **(paid)** 300 (i) Interest on loan is 8% per annum. (ii) One-tenth of the loan is repayable on 31 August 2021.	<u>Less: Other expenses</u> Interest on loan 400 (8% X 5 000)	<u>Non-current liabilities</u> Long-term borrowing (5 000 – 500) 4 500 <u>Current liabilities</u> Interest payable 100 (400 – 300) Current portion of long-term borrowing 500 (5 000 x 1/10)

	Type of Adjustments	Effects on Statement (Performance)	Effects on Statement (Position)
11)	**<u>Interest income (O Level only)</u>** Trial balance as at 31 Dec 2020: $ 5% Bank deposit 20 000 (i) The bank deposits commenced on 30 June 2020.	<u>Other income</u> Interest income 500 Interest income from 30 June 2020 to 31 Dec 2020 = (5% X 20 000 X 6/12) = $500	<u>Current assets</u> 5% Bank deposit 20 000 Interest income receivable 500
12)	**<u>Interest income (O Level only)</u>** Trial balance as at 31 Dec 2020: $ 6% Bank deposits 8 000 Interest income 300 (i) The bank deposits commenced on 31 March 2020.	<u>Other income</u> Interest income 360 Interest income from 31 Mar to 31 Dec 2020 = (6% X 8 000 X 9/12) = $360	<u>Current assets</u> 6% Bank deposits 8 000 Interest income receivable 60 (360 – 300)
13)	**<u>Increase in Allowance for impairment of TR (AFIOTR)</u>** Trial balance as at 31 Dec 2020: $ Trade receivables 6 000 AFIOTR **(last yr's estimate)** 200 (i) It is estimated that 5% of its trade receivables are likely to be uncollectible.	<u>Less: Other expenses</u> Impairment loss on TR 100 (300 – 200) Impairment loss on TR is the change (**increase**) in AFIOTR	<u>Current assets</u> Trade receivables 6 000 Less: AFIOTR (5% X 6 000) <u>300</u> **5700**
14)	**<u>Decrease in Allowance for impairment of TR (AFIOTR)</u>** Trial balance as at 31 Dec 2020: $ Trade receivables 13 000 AFIOTR **(last yr's estimate)** 900 (i) The business maintains its allowance for impairment of trade receivables at 2% of its trade receivables.	<u>Less: Other expenses</u> **Reversal** of impairment loss on TR (640) (900 – 260) Reversal of impairment loss is the change (**decrease**) in AFIOTR	<u>Current assets</u> Trade receivables 13 000 Less: AFIOTR (2% X 13 000) <u>260</u> **12 740**

	Type of Adjustments	Effects on Statement (Performance)	Effects on Statement (Position)
15)	**<u>Write-off of TR (Bankrupt)</u>** **<u>No ending allowance</u>** Trial balance as at 31 Dec 2020: $ Trade receivables 4 800 AFIOTR **(last yr's estimate)** 600 (i) Jen was declared bankrupt and the business decided to write-off the amount $700 owing from her.	<u>Less: Other expenses</u> Impairment loss on TR 100 To write-off: TR – 600; AFIOTR – 600 After write-off, updated AFIOTR = 600 – 700 = – 100 It should **increase by $100** to become $0.	<u>Current assets</u> Trade receivables (4 800 – 600) 4 200 *AFIOTR is 0 as the estimated uncollectible amount is not given in additional info. You may skip it.*
16)	**<u>Partial write-off of TR (Bankrupt)</u>** **<u>No ending allowance</u>** Trial balance as at 31 Dec 2020: $ Trade receivables 9 000 AFIOTR **(last yr's estimate)** 900 Cash at bank 700 (i) A customer who owed $400 paid only 10% of debts owed. The remaining amount was to be written off.	<u>Less: expenses</u> **Reversal** of impairment loss on TR (540) To write-off: TR – 400 AFIOTR – 360; CAB + 40 After write-off, updated AFIOTR = 900 – 360 = 540 It should **decrease by $540** to become $0.	<u>Current assets</u> Trade receivables (9 000 – 400) 8 600 Cash at bank 740 (700 + 40) *AFIOTR is 0 as the estimated uncollectible amount is not given in additional info. You may skip it.*
17)	**<u>Write-off of TR (Bankrupt)</u>** **<u>& Increase in Allowance for impairment of TR (AFIOTR)</u>** Trial balance as at 31 Dec 2020: $ Trade receivables 9 000 AFIOTR **(last yr's estimate)** 200 (i) A customer who owed $1 000 was declared bankrupt and its debt was written off. (ii) It is estimated that 6% of its trade receivables are likely to be uncollectible.	*Write-off of TR must be deducted from TR and allowance before calculating impairment loss* *i.e. do adjustment (i) before (ii)* <u>Less: Other expenses</u> Impairment loss on TR 1 280 To write-off: TR – 1000; AFIOTR – 1000 After write-off, updated AFIOTR = 200 – 1 000 = – 800 It should **increase by $1280** to become $480.	<u>Current assets</u> Trade receivables (9 000 – 1 000) 8 000 Less: AFIOTR (6% X 8 000) <u>480</u> **7 520**

	Type of Adjustments	Effects on Statement (Performance)	Effects on Statement (Position)
18)	**<u>Write-off inventory</u>** Trial balance as at 31 Dec 2020: Inventory 20 000 (i) The net realisable value of inventory is $15 000. / $5 000 worth of inventory was damaged. This has not been adjusted at year end.	*Inventory is recorded at cost of net realisable value, whichever is **lower**. Impairment loss = Cost – NRV* <u>Less: Other expenses</u> Impairment loss on inventory 5 000 [20 000 – 15 000]	<u>Current assets</u> Inventory 15 000
19)	**<u>Write-off inventory & a *total* claim has been agreed with the insurance company.</u>** Trial balance as at 31 Dec 2020: Inventory 20 000 (i) During the year, $5 000 worth of inventory was stolen. The insurance company agreed to compensate fully but this amount has not been received as at year end.	No effect	<u>Current assets</u> Inventory 15 000 (20 000 – 5 000) Insurance claim receivable 5 000
20)	**<u>Write-off inventory & a *partial* claim has been agreed with the insurance company.</u>** Trial balance as at 31 Dec 2020: Inventory 20 000 (i) During the year, $5 000 worth of inventory was stolen. The insurance company agreed to compensate only $1 000. This amount was not paid to the business as at year end.	<u>Less: Other expenses</u> Impairment loss on inventory 4 000 (5 000 – 1 000)	<u>Current assets</u> Inventory 15 000 (20 000 – 5 000) Insurance claim receivable 1 000

	Type of Adjustments	Effects on Statement (Performance)	Effects on Statement (Position)
21)	**Depreciation of NCA** Trial balance as at 31 Dec 2020: $ Equipment 1 800 Accumulated depreciation 360 Motor vehicle 25 900 Accumulated depreciation 5180 Property 120 000 Accumulated depreciation 3 000 (i) Depreciation is charged at 10% using the straight-line method on the equipment. / Depreciation is charged on equipment at 10% **on cost.** (ii) Depreciation is charged at 20% using the reducing balance method on the motor vehicle. Depreciation is charged at 20% **on net book value** of the motor vehicle. (iii) Property have a useful life of 100 years with a residual value of $20 000.	Less: Other expenses Depreciation of equipment (10%x 1 800) 180 Depreciation of motor vehicle 4 144 [20%x (25 900 – 5 180)] Depreciation of property 1 000 [(120 000 – 20 000) /100]	Non-current assets | | Cost | Acc Dep | NBV | Eqmt | 1800 | 540* | 1260 MV | 25900 | 9324** | 16576 Property | 120000 | 4000*** | 116000 *Acc Dep = 360 + 180 **Acc Dep = 5 180 + 4 144 *** Acc Dep = 3 000 +1 000
22)	**Issue of additional share capital (O Levels only)** Trial balance as at 31 Dec 2020: $ Share capital, 4 000 ordinary shares 8 000 Retained earnings 3 000 Cash at bank 1 000 (i) 1 000 ordinary shares at $2.50 were issued and fully paid. **Profit for the year is $700 (from Performance)*	No effect	Current assets Cash at bank 3 500 (1 000 + 2 500^) Shareholders' equity Share capital, **5 000** ordinary shares 10 500 [8 000 + 2 500^] Retained earnings 3 700 (3 000+700* profit) 14 200 ^New shares issued = 2.50 x 1 000 = 2 500

<table>
<tr><th colspan="2">Type of Adjustments</th><th>Effects on
Statement (Performance)</th><th>Effects on
Statement (Position)</th></tr>
<tr><td>23)</td><td><u>Dividends declared but not yet paid (O Levels only)</u>

Trial balance as at 31 Dec 2020:
$
Share capital,
5 000 ordinary shares 10 500
Retained earnings 3 000

(i) During the year, a dividend of $0.15 per share was declared. This amount will only be paid on 31 Jan 2021.

*Profit for the year is $700
(from Performance)</td><td>No effect</td><td>Retained earnings
=RE + Profit – Dividends

<u>Shareholders’ equity</u>
Share capital,
5 000 ordinary shares 10 500
Retained earnings
[3 000+700*-750^] <u>2 950</u> 13 450

<u>Current liabilities</u>
Dividends payable^ 750

^Dividend= $0.15 X 5 000
= $750</td></tr>
<tr><td>24)</td><td><u>Issue of additional share capital (O Levels only)</u>

Trial balance as at 31 Dec 2020:
$
Share capital, 4 000 ordinary shares 8 000
Retained earnings 3 000
Cash at bank 1 000

(i) 1 000 ordinary shares at $2.50 were issued and fully paid.

(ii) During the year, a dividend of $0.15 per share was declared. This amount will only be paid on 31 Jan 2021.

*Loss for the year is $5 000
(from Performance)</td><td>No effect

#New shares issued
= 2.50 x 1 000
= 2 500

^Dividend= $0.15 X 5 000
= $750</td><td><u>Current assets</u>
Cash at bank 3 500
(1 000 + 2 500#)

<u>Shareholders’ equity</u>
Share capital,
5 000 ordinary shares 10 500
[8 000 + 2 500#]
Less: Accumulated losses
[3 000 – 750^ – 5 000*] <u>2 750</u>
7 750

<u>Current liabilities</u>
Dividends payable 1 500

Negative RE is renamed as “Accumulated Losses”</td></tr>
</table>