POA THEORY QUESTIONS (EXPRESS)

CHAPTER 1: INTRODUCTION TO ACCOUNTING

State the role of accounting.

Accounting provides accounting information for decision-making by business owners and other stakeholders to make informed decisions regarding the management of resources and performance of businesses.

State the role of accountants.

Accountants act as **stewards of businesses** through preparing and providing accounting information for stakeholders' decision-making.

Stewards are responsible for managing the resources of the business on behalf of the owner(s).

Define integrity and objectivity.

Integrity - being straightforward and honest in all professional and business relationships

Objective - not letting bias, conflict of interest or undue influence of others override professional judgement

Explain the importance of having integrity and objectivity in preparing and presenting accounting information.

Accountants must adhere to professional ethics, uphold integrity and be objective so that stakeholders can place trust in the information provided.

State the stakeholders who are interested in the affairs of the business and make use of the accounting information for decision-making. Explain why stakeholders of a business are interested in accounting information.

Stakeholder	**Why the stakeholder is interested**
Owners	Whether *to continue to invest in the business* or sell the business, depending on the risks and returns related to the business.
Managers	Whether to consider ways *to improve the performance of the business.*
Employees	Whether *to continue working for the business*.
Lenders	Whether *to grant loans to the business*, depending on the business' ability to repay the loan principal and pay interest.
Suppliers	Whether *to sell to the business on credit*, depending on its ability to pay.
Customers	Whether *to buy from the business*, depending on the business' ability to provide the goods and services that they need and good after-sales service.
Government	Whether the *business complies with the tax regulations* and decides the amount of tax to collect from the business.
Competitors	Whether *they are comparable to the business and how to improve their own performance*.

Define each accounting theory.

1) Accounting Entity
Accounting Entity theory requires that 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.

2) Accounting Period
Accounting period theory divides the life of a business into regular time intervals.

3) Accrual basis of accounting
Accrual basis of accounting theory requires the recording of all business activities which have occurred, regardless of whether cash is paid or received in that accounting period.

4) Matching
Matching theory states that expenses incurred in a given period must be matched against income earned to determine the profit and loss for that period.

5) Consistency
Consistency theory requires an entity to use the same accounting methods and procedures across periods to enable meaningful comparison over time.

6) Going Concern
Going concern theory states that a business entity is assumed to operate indefinitely unless there are signs that it has to stop operating.

7) Historical Cost
Historical cost theory requires that transactions be recorded at their original cost.

8) Monetary
Monetary theory states that only transactions which can be measured in monetary terms are to be recorded.

9) Materiality
Materiality theory requires that relevant information should be reported in the financial statements if it is likely to make a difference to the decision-making process.

10) Objectivity
Objectivity theory requires that accounting information recorded must be supported by reliable and verifiable evidence so that financial statements will be free from opinions and biases.

11) Prudence
Prudence theory requires that the accounting treatment chosen should be one that least overstates profits and least understates liabilities and losses.

12) Revenue recognition
Revenue recognition theory states that revenue is earned when goods have been delivered or services have been provided.

Explain the differences between trading and service businesses.

A trading business buys goods from suppliers and sells the goods to customers, while a service business provides services to its customers.

Distinguish between financial statements of businesses in trading and services.

In a trading business, the statement of financial performance has a trading portion and the presence of inventory which a service business does not have. The inventory is also present in its statement of financial position.

Distinguish between the financial statements of a sole proprietorship and private limited company

In the statement of financial position, the private limited company shows shareholders' equity in the equity section while the sole proprietorship shows owner's equity.

Explain the features of a sole proprietorship, limited liability partnership and private limited company

Feature	Sole Proprietorship (SP)	Limited Liability Partnership (LLP)	Private Limited Company (PLC)
Capital structure	Owned by **1 person** who contributes the capital to set up the SP.	Owned by **2 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	Banks and other lenders are **less likely to lend money** to the SP due to the lack of personal assets that can serve as collaterals. Access to funds usually limited to **owner's contributions**.	Banks and other lenders are **more likely to lend money** to the LLP as there are more sources of personal assets from partners and business assets to serve as collaterals. May get more persons to **join as partners and contribute capital**.	Banks and other lenders are **more likely to lend money** to the PLC as there are more business assets of high value to serve as collaterals. May **issue more shares to raise funds**.
Extent of liability (risk)	Owner is **obliged to pay all debts and losses** using personal assets.	Partners are **not obliged to pay all debts and losses** using their personal assets. Only the partner who is responsible for the debts or losses due to wrongful actions need to be personally liable.	Shareholders are **not obliged to pay all debts and losses** using the personal assets. They will only need to forfeit the investments in the business.

Feature	Sole Proprietorship (SP)	Limited Liability Partnership (LLP)	Private Limited Company (PLC)
Level of control	Owner has **absolute control** over the business.	Partners **share the control** of the business, with at least one partner heavily involved in the running of the business.	Shareholders have **no control over the running of the business unless they are part of the management team.** The company hires professionals to run the business on behalf of the shareholders.
Lifespan	**Exists as long as the owner is alive** and desires to continue operation.	**Exists forever** until it is wound up.	**Exists forever** until it is wound up.
Transferability of ownership	**Update the particulars of the new owner** in the Accounting and Corporate Regulatory Authority (ACRA) of the transfer of ownership.	All partners to **agree to the addition or withdrawal of partner(s)** before ACRA acknowledges the transfer of ownership.	Shareholders **pay a stamp duty** (tax related to the transfer of shares) **to the tax authority** to transfer their shares to another person or organisation.

CHAPTER 2: ACCOUNTING INFORMATION SYSTEM

State the order in which each type of transaction is processed through the accounting information system.

Source documents → **Journal** → **Ledgers** → **Trial Balance** → **Statement of financial performance** → **Statement of financial position**

State the stages of the accounting cycle.

Identify and record → Adjust → Report → Close

State the purposes of source documents

Source documents provide evidence to capture occurrence of a transaction.

State the purpose of each type of source document.

Source document	**Purpose**
Receipt	Acknowledges payment received from customers immediately after the business has sold goods or provided services.
Remittance advice	Informs credit supplier that payment by cheque has been made for a specific invoice.
Payment voucher	Processes payment to credit suppliers.
Bank statement	Checks and tallies against the business records of its cash at bank account.
Invoice	Informs credit customers of the amount owed after the business sold goods or provided services on credit.
Credit note	Reduces the amount owed by credit customers who were previously overcharged or after goods were returned.
Debit note	Increases the amount owed by credit customers who were previously undercharged.

State the difference between a cash transaction and a credit transaction.

A cash transaction is where payment is made at the same time or immediately at the point of sale or purchase, while a credit transaction is where payment is delayed or postponed at a later date at the point of sale or purchase.

CHAPTER 3: ELEMENTS OF FINANCIAL STATEMENTS AND THE ACCOUNTING EQUATION

Define assets, liabilities, equity, income and expenses.

Assets are resources a business owns or controls that are expected to provide 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.

Income is the amounts earned from the activities of a business.

Expenses are costs incurred to earn income in the same accounting period.

State the accounting equation and its expansion.

Basic: Assets = Liabilities + Owner's equity

Expanded: Assets = Liabilities + Capital + Income – Expenses - Drawings

CHAPTER 4: DOUBLE-ENTRY RECORDING

Define trade discount *(Definition)*

Explain why a trade discount is given *(Purpose)*

Define cash discount *(Definition)*

Explain why a cash discount is given *(Purpose)*

Distinguish between trade and cash discounts *(Definition, Recording or Purpose)*

	Trade Discount	**Cash Discount**
Definition	A reduction to the list price.	A reduction to the invoiced price.
Purpose	To encourage customers to buy in bulk.	To encourage credit customers to pay early, within a specified time.
Recording	Not recorded in the ledger account as only the invoiced price is recorded.	Recorded in the ledger account as discount allowed or discount received.

CHAPTER 5: TRIAL BALANCE AND FINANCIAL STATEMENTS

Define the trial balance

- It is a listing of the ending balances of all accounts at the end of a given period, and these balances are classified under debits and credits.

Explain the purpose of the Trial Balance

- To ensure arithmetic accuracy in recording
- To facilitate the preparation of the the financial statements

Explain the limitations of Trial Balance

- A balanced trial balance is not a absolute proof of accuracy as there may be errors not revealed by a trial balance. (explain 1 or 2 of the 5 errors that cannot be revealed by the Trial Balance)

Explain the purpose of the trading portion of the Statement of Financial Performance

- It shows the gross profit or loss from the buying and selling of goods.

Explain the meaning of gross profit/loss

- It is the amount earned/lost after deducting Cost of sales from Sales revenue.

Explain the purpose of the profit and loss portion of the Statement of Financial Performance

- Reports the overall profit earned form operating the business.

Explain the meaning of profit/loss for the period.

- It is the amount earned/lost after deducting total expenses incurred from total income earned.

Define and distinguish between non-current and current assets

Non-current assets *(resources a business owns or controls)*	**Current assets** *(resources a business owns or controls)*
Benefits last beyond one financial year	Benefits are used within one financial year
Not easily converted to cash	Are easily converted to cash

Define and distinguish between non-current and current liabilities

Non-current liabilities *(obligations owed by a business to others)*	**Current liabilities** *(resources a business owns or controls)*
Due to be paid beyond one financial year	Due to be paid within one financial year

Define net assets and equity

Net assets is the balance after deducting total liabilities from total assets. It is equal to the equity of the business.

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

CHAPTER 6: REVENUE AND OTHER INCOME

Revenue recognition theory states that revenue is earned when goods have been delivered or services have been provided.

Accrual basis of accounting theory requires the recording of all business activities which have occurred, regardless of whether cash is paid or received in that accounting period.

Income received in advance refers to income received but the service has not been provided yet.

Income Receivable refers to income that relate to services that have been provided but the amounts have not been received.

CHAPTER 7: COST OF SALES AND OTHER EXPENSES

Accrual basis of accounting theory requires the recording of all business activities which have occurred, regardless of whether cash is paid or received in that accounting period.

Matching theory states that expenses incurred in a given period must be matched against income earned to determine the profit and loss for that period.

Expenses Payable refer to expenses incurred in the current accounting period, but have not been paid for.

Prepaid expenses refer to expenses paid in advance before services are used.

CHAPTER 8: CASH

State the causes of dishonoured cheque

1. Cheque has expired.
2. Cheque is post-dated.
3. Information on cheque is not consistent.
   - Amount written in numbers does not match amount written in words.
   - Signature is different from the authorised version in the bank's records
4. Information on cheque is not complete.
5. Payer's bank account has insufficient funds, is closed or is frozen.

Explain the purpose of internal controls

- safeguard assets of the business
- ensure business transactions are recorded accurately
- comply with laws and regulations

Explain the ways of internal controls over cash in hand, cash at bank, cash in transit, cash receipts and cash payments

Internal control	Explanation
Segregation of duties	Separate cash handling and cash recording duties among employees so that no single person controls the entire cash processes.
Custody of cash	Secure cash and cheques in a locked storage.
Authorisation	Obtain proper approvals for all payments from authorized personnel.
Bank reconciliation	Compare the business' records to identify terms that caused the differences between the ending balances in the business cash at bank account and the bank statement.

Explain the purpose of preparing bank reconciliation

- To find out the items that cause the difference between the cash at bank balances and bank statement balances.
- To calculate the accurate bank balance after updating the cash at bank account.
- To act as a deterrence against fraud.

Explain the causes of differences between the business cash at bank balance and the balance in the bank statement

Due to timing differences, the cash at bank account may have cheques that are uncredited or unpresented and thus not recorded in the bank statement while the bank statement may have transactions like standing orders and bank charges not recorded in the cash at bank account.

CHAPTER 9: INVENTORIES

Explain why businesses keep inventories

Businesses keep inventory to avoid a stock-out situation, which often results in the loss of sales.

Describe how businesses manage inventories

- Keeping proper records to track inventory so as to maintain just enough inventories to meet customer demand.

- Buying insurance to insure the inventory against theft or natural disasters.

Explain the valuation of inventory in relation to relevant accounting theories

According to prudence theory, inventory is valued at the lower of cost and net realisable value, so that assets and profits are not overstated.

State the valuation method for inventory in the Statement of Financial Position.

Inventory is valued at the lower of cost or net realisable value.

CHAPTER 10: TRADE RECEIVABLES

Explain the accounting of impairment loss on trade receivables in relation to relevant accounting theories

<u>Allowance for impairment on trade receivables</u>

According to the **prudence** theory, allowance for impairment on trade receivables is recorded to ensure that trade receivables balance is not overstated.

<u>Impairment loss on trade receivables</u>

According to the **matching** theory, the expenses incurred has to be matched against the income earned in the same financial period.

State the valuation method for trade receivables in the Statement of Financial Position

Trade receivables is valued at expected collectible amount i.e. after deduction of allowance for impairment in trade receivables.

CHAPTER 11: NON-CURRENT ASSETS

Explain the application of the materiality theory on the treatment of capital and revenue expenditure

According to the materiality theory, relevant information should be reported in the financial statements if it is likely to make a difference to the decision-making process.

Define capital and revenue expenditure

Capital expenditure is expenditure on non-current assets which provides benefits for more than one year while revenue expenditure is expenditure on non-current assets which provides benefits that will be used within one year.

Distinguish between capital and revenue expenditure

Comparison	**Capital Expenditure**	**Revenue Expenditure**
Definition	Expenditure on non-current assets which provides benefits for **more than one year**.	Expenditure on non-current assets which provides benefits that will be used **within one year**.
1)	Brings the non-current assets to their **intended use**.	The expenditure **repairs and maintains the non-current assets in working condition**.
2)	**Enhances** the non-current asset.	**Does not enhance** the non-current asset.
3)	Recorded as a **non-current asset**.	Recorded as an **expense**.

Explain the need to charge depreciation in relation to relevant accounting theories

In accordance to the matching theory, a portion of the cost of the non-current asset, that is used during that period, is matched against the income earned from using the non-current asset.

Explain the presentation of net book value in relation to relevant accounting theories

In accordance to the Prudence Concept, non-current assets have to be recorded at their net book values as the expenses incurred for using non-current assets have to be recognised so as not to overstate the assets and profits.

Define depreciation and accumulated depreciation

Depreciation is the allocation of the cost of a non-current asset over its estimated useful life.

Accumulated depreciation refers to the total depreciation to-date. It is a contra-asset account.

State the causes of depreciation

- Wear and tear
- Obsolescence
- Legal limits
- Usage

State and distinguish the depreciation methods of (i) straight-line and (ii) reducing-balance methods

	Straight-Line	**Reducing-balance**
Definition	An **equal** amount of depreciation expense is recorded at the end of each financial period.	A **higher** depreciation expense is recorded in the earlier years and reduces as time goes by.
When to use	When the non-current asset is assumed to provide benefits **uniformly** throughout its useful life, eg fixtures and fittings	When the non-current asset is assumed to provide more benefits in the earlier years of its useful life than its later years, eg motor vehicles, machinery
Effect on profit	Profit decreases by an equal amount every year.	Profit decreases by a higher amount in the earlier years.
Effect on non-current asset	Net book value decreases by an equal amount every year.	Net book value decreases by a higher amount in the earlier years.

Explain with an accounting theory why the depreciation methods should not be changed over the years.

In accordance to the consistency theory, an entity should use the same accounting methods and procedures across periods to enable meaningful comparison over time.

State the valuation method for non-current assets in the Statement of Financial Position

Non-current assets are valued at cost less accumulated depreciation.

CHAPTER 13: LONG-TERM BORROWINGS

Explain the accounting of long-term borrowings interest expense in relation to relevant accounting theories

In accordance to the accrual basis of accounting theory, the business has to record all business activities which have occurred, regardless of whether cash is paid or received in that accounting period.

Distinguish between bank loan and bank overdraft

	Bank loan	**Bank overdraft**
How does it arise?	Business borrows a fixed amount and the cash is transferred to its bank account.	Business withdraws more than what it has deposited in the bank account, up to the limit agreed upon between the business and the bank.
How is it repaid?	Business makes regular cash payments in equal instalments over the loan period or a one-time lump-sum payment at the end of the loan period.	Business deposits cash into the bank account within the year to reduce the overdraft.
How is it presented in the statement of financial position?	It is presented under non-current liabilities in the statement of financial position as long-term borrowings.	It is presented under current liabilities in the statement of financial position.

CHAPTER 14: EQUITIES

Explain the accounting of <u>capital and share capital</u> in relation to relevant accounting theories

Explain the accounting of <u>drawings</u> in relation to relevant accounting theories

Accounting entity theory requires that 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.

Define drawings

Drawings is the withdrawal of business assets by the owner for personal use

Define dividends and retained earnings

Dividends are the portion of the retained earnings that is distributed back to the shareholders.

Retained earnings are the profits accumulated and reinvested in the business.

CHAPTER 15: CORRECTION OF ERRORS

Explain how errors not revealed by a Trial Balance happen

- The wrong amount is recorded.
- The transaction is not recorded at all.
- The transaction is recorded in the wrong account of a different accounting element.
- The transaction is recorded in the wrong account of the same accounting element.
- The transaction is recorded on the wrong sides of the accounts involved.

CHAPTER 16: FINANCIAL STATEMENT ANALYSIS

Explain the importance of being profitable

- It means that its products or services are in demand and can thus expand its operations
- Better able to reward business owners for their capital contribution and thus attract more investors
- Better able to reward its employees and have them continue working for it.

A business that continues to suffer losses is likely to close down eventually.

Explain the importance of being liquid

- Cash is required to run its daily business operations, such as buying inventory and paying for rent
- Creditors will be unwilling to sell to the business on credit if the business does not have sufficient cash to pay them on time
- Banks will be unwilling to grant the business short-term loans for fear that the business may default on its payments

State and explain the differences between liquidity and profitability

A profitable business may not be liquid:

- A business which sells mostly on credit may have high sales revenue and profit but a low amount of cash.

A business with high liquidity may not be profitable:

- A business that holds on to too much cash is not using its cash efficiently to explore opportunities to generate more profit

Explain the importance of being able to manage inventory and trade receivables efficiently

Inventory management is important as buying too much will incur higher storage cost and increased risk of the goods becoming obsolete while buying too little may lead to a stock-out situation.

Trade receivables management is important as the longer the time taken to collect payment from trade receivables, the lesser the amount of cash the business has. This will cause its liquidity position to worsen.