

Name: _____ ()

Class: _____

POA GO

(Pink Booklet)

Revision Notes

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Formula list



Revision Practices

Adjusted Financial Statements

Schools' Prelim Papers

2015 to 2020 O-Level questions modified from previous
syllabus 7175 (Orange Booklet)

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Profitability Ratios

Gross profit margin (%)	$\frac{\text{Gross profit}}{\text{Net sales revenue}} \times 100\%$
Mark-up on cost (%)	$\frac{\text{Gross profit}}{\text{Cost of sales}} \times 100\%$
Profit margin (%)	$\frac{\text{Profit}}{\text{Net sales revenue}} \times 100\%$
Return on equity (%)	$\frac{\text{Profit}}{\text{Average equity}} \times 100\%$ $\text{Average equity} = \frac{\text{Equity (start)} + \text{Equity (end)}}{2}$ <ul style="list-style-type: none"> • Sole proprietorship: owner's equity • Private limited company: shareholders' equity

Liquidity Ratios

Working capital (\$)	Current assets – Current liabilities
Current ratio (no units)	$\frac{\text{Current assets}}{\text{Current liabilities}}$
Quick ratio (no units)	$\frac{\text{Current assets} - \text{Inventory} - \text{Prepaid expense}}{\text{Current liabilities}}$ <p style="text-align: center;">OR</p> $\frac{\text{Cash} + \text{Receivables}}{\text{Current liabilities}}$

Efficiency Ratios

Rate of inventory turnover (times)	$\frac{\text{Cost of sales}}{\text{Average inventory}}$ $\text{Average inventory} = \frac{\text{Inventory (start)} + \text{Inventory (end)}}{2}$
Days sales in inventory (days)	$\frac{\text{Average inventory}}{\text{Cost of sales}} \times 365 \text{ days}$ <p style="text-align: center;">OR</p> $\frac{1}{\text{rate of inventory turnover}} \times 365 \text{ days}$
Rate of trade receivables turnover (times)	$\frac{\text{Net credit sales or service fee revenue}}{\text{Average net TR}}$ $\text{Average net TR} = \frac{\text{Net TR (start)} + \text{Net TR (end)}}{2}$ $\text{Net TR} = \text{TR} - \text{Allowance for impairment of TR}$
Trade receivables collection period (days)	$\frac{\text{Average net TR}}{\text{Net credit sales or service fee revenue}} \times 365 \text{ days}$ <p style="text-align: center;">OR</p> $\frac{1}{\text{rate of TR turnover}} \times 365 \text{ days}$

Basic accounting equation	$\text{Assets} = \text{Liabilities} + \text{Equity}$
Expanded accounting equation (sole proprietorship)	$\text{Assets} = \text{Liabilities} + \text{Owner's equity}$ $\text{Assets} = \text{Liabilities} + \text{Capital} + \text{Profit (or – Loss)} – \text{Drawings}$ $\text{Assets} = \text{Liabilities} + \text{Capital} + (\text{Income} – \text{Expenses}) – \text{Drawings}$
Capital	$\text{Beginning capital} + \text{Additional capital} + \text{Profit (or – Loss)} – \text{Drawings}$
Expanded accounting equation (private limited company)	$\text{Assets} = \text{Liabilities} + \text{Shareholders' equity}$ $\text{Assets} = \text{Liabilities} + \text{Share capital} + \text{Retained earnings}$ $\text{Assets} = \text{Liabilities} + \text{Share capital} + \text{Profit (or – Loss)} – \text{Dividends}$ $\text{Assets} = \text{Liabilities} + \text{Share capital} + (\text{Income} – \text{Expenses}) – \text{Dividends}$
Share capital	$\text{Total number of shares issued} \times \text{Issued price per share (\$)}$
Dividends	$\text{Total number of shares issued} \times \text{Declared dividends per share (\$)}$
Discount	$\text{Invoice price} = \text{List price} – \text{Trade discount}$ $\text{Amount paid} = \text{Invoiced price} – \text{Cash discount (allowed / received)}$
Allowance for impairment of trade receivables	Ending allowance = Estimated % × Ending TR balance (after written off)
Impairment loss on trade receivables (Reversal of)	$ \begin{array}{rclcl} \text{Beginning allowance (given)} & - & \text{Debts written off} & + / - \text{ changes in allowance} & = \text{Ending allowance} \\ & & & (+) \text{ Impairment loss on TR} & \\ & & & (-) \text{ Reversal of impairment loss on TR} & \end{array} $

Depreciation expense (Straight line method)	$\frac{\text{Cost} - \text{Scrap value}}{\text{Estimated useful life}}$ OR $\text{Rate of depreciation (\%)} \times (\text{Cost} - \text{Scrap value})$ Scrap value: amount that the business can receive at the end of the estimated useful life of the non-current asset		
Depreciation expense (Reducing balance method)	$\text{Rate of depreciation (\%)} \times \text{Net book value}$ $\text{Net book value} = \text{Cost} - \text{Accumulated depreciation}$		
Gain (or loss) on sale of non-current asset	Sales proceeds – Net book value		
Cost of inventory purchased	Purchase price + Other costs incurred to bring in goods Transport, custom duties, insurance on goods, packing materials, wages for employees to repack goods		
Impairment loss on inventory	Cost – Net realisable value – Insurance claim receivable		
Interest expense incurred	$\text{Interest rate per annum (\%)} \times \text{Principal sum borrowed}$		
Expense incurred	+ Prepaid expense (reverse)	+ Expense paid	– Prepaid expense (adjust)
	– Expense payable (reverse)	+ Expense paid	+ Expense payable (adjust)
Income earned	– Income receivable (reverse)	+ Income received	+ Income receivable (adjust)
	+ Income received in advance (reverse)	+ Income received	– Income received in advance (adjust)

Chapter 1 Introduction to Accounting

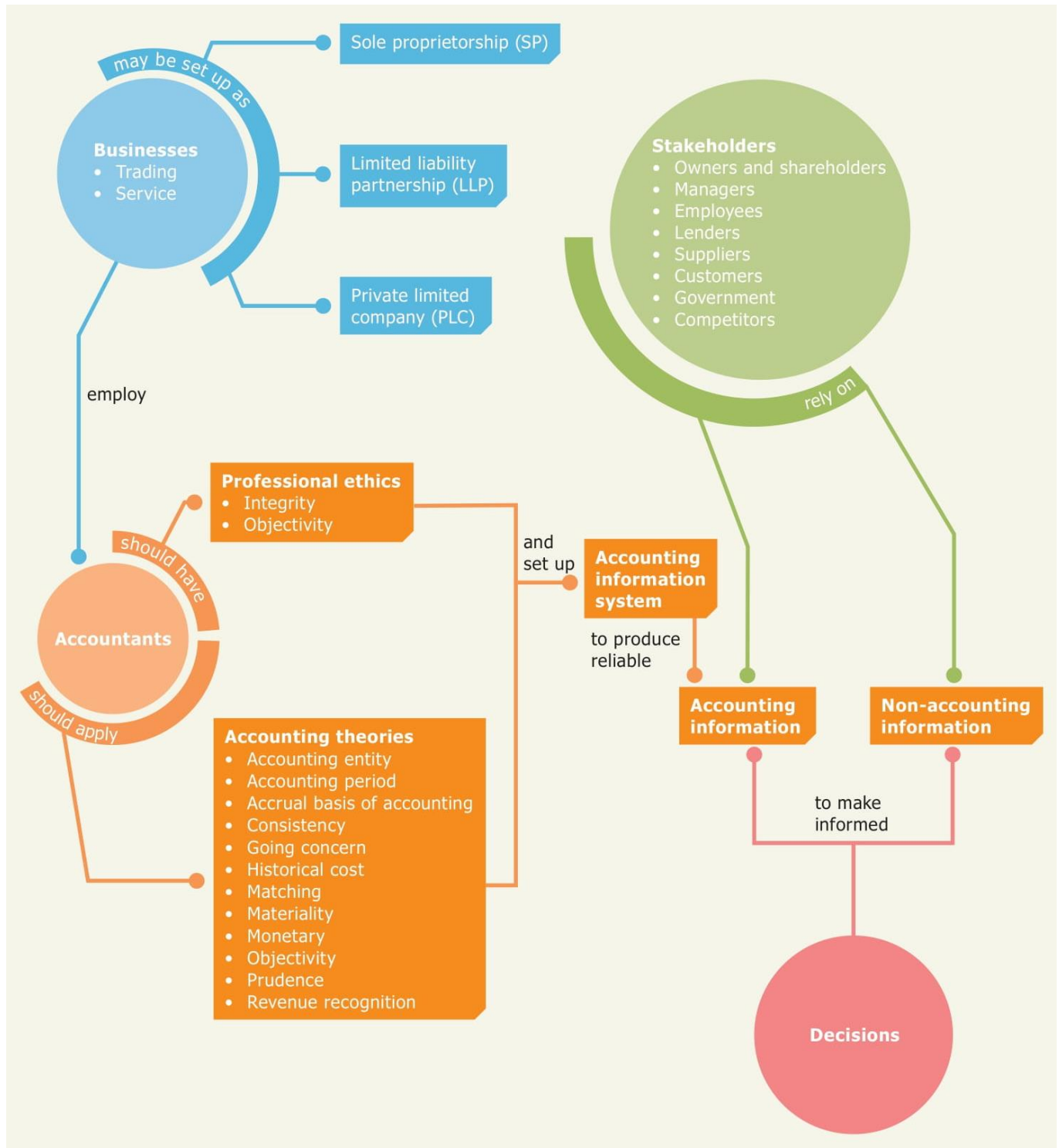
1.1 Introduction to Business

1.2 Stakeholders and Their Decision Needs

1.3 Role of Accounting and Accountants

1.4 Accounting Theories

[TB Pg 14] Summary



Types of businesses	<p>1. Explain the difference between a trading business and a service business.</p> <p>TB Pg 3</p> <p>Trading business buys from suppliers and sells goods to customers while service business provides services to its customers.</p>
Forms of business ownerships	<p>2. State two features (advantages) of being a sole proprietor.</p> <ul style="list-style-type: none"> • A sole proprietor is the only owner of the business and has absolute control over it. • The sole owner can easily update the particulars of the new owner to notify the corporate regulatory authority of the transfer of ownership. • The sole proprietorship has minimal administrative duties to adhere to. • The sole owner is entitled and has access to all business profits. <p>3. State two features (advantages) of being a limited liability partnership.</p> <ul style="list-style-type: none"> • It is 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. • When the LLP incurs debts and losses, the partners are not personally liable for them. They are not affected unless it is caused by their wrongful actions. • The LLP has few regulatory duties to comply with. <p>4. State two features (advantages) of being a private limited company.</p> <ul style="list-style-type: none"> • It is 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. • When the company incurs debts and losses, shareholders are not obliged to pay them using their personal assets. • Shareholders can pay a stamp duty to the tax authority to give their shares to another person or organisation. <p>5. State three differences between a shareholder in a private limited company and a sole proprietor in a business.</p> <p>TB Pg 4 to 5 Table 1.1</p> <ul style="list-style-type: none"> • The shareholders have no control over the running of the business, unless they are part of the management team while the only owner usually runs the business by himself or herself and has absolute control over it. • The company exists forever until wound up or struck off while the SP exists as long as the owner is alive and desires to continue operation. • The PLC must comply with statutory requirements and file its annual financial reports while the SP has minimal administrative duties to adhere to.

	<ul style="list-style-type: none"> The shareholders receive a portion of the profits when the PLC declare dividends while the only owner is entitled and has access to all profits made by the SP. When the business incurs debts and losses, shareholders suffers limited liabilities while the only owner is obliged to pay them using his or her personal assets.
Stakeholders and their decision needs	<p>6. Name two stakeholders and the decision that they might make by using a business' accounting information.</p> <p>TB Pg 8 Table 1.2</p> <ul style="list-style-type: none"> Owners and shareholders will decide whether to continue to invest in the business or sell the business, depending on the risks and returns related to the business Managers will consider ways to improve the performance of the business Employees will decide whether continue working at the business Lenders will decide whether to grant loans to the business, depending on the business' ability to repay the loan principal and pay interest Suppliers will decide whether to sell to the business on credit, depending on its ability to pay Customers will decide whether to buy from the business, depending on the business' ability to provide the goods and/or services that they need and good after-sales service Government will decide the amount of tax to collect from the business Competitors will decide whether they are comparable to the business and consider how to improve their own performance
Role of accounting and accountants	<p>7. State two roles of accounting.</p> <p>TB Pg 11 Accounting is an information system that:</p> <ul style="list-style-type: none"> provides accounting information for stakeholders to make informed decisions regarding the management of resources and performance of businesses. <p>8. Explain the role of accountants.</p> <p>TB Pg 11 Accountants have to:</p> <ul style="list-style-type: none"> adapt, solve problems, think critically and provide accounting and non-accounting information for decision-making provide timely, relevant and credible information, based on accounting theories, which are easily and appropriately understood by stakeholders.

Professional ethics	<p>9. Name and explain the two professional ethics which must be applied by accountants in the preparation and presentation of accounting information.</p> <p>TB Pg 11</p> <ul style="list-style-type: none"> • Integrity: An accountant with integrity is straightforward and honest in all professional relationships. • Objectivity: An accountant who is objective will not let bias, conflict of interest or the undue influence of others override his or her professional judgement. <p>10. Explain the importance of an accountant's professional ethics.</p> <p>Since stakeholders place trust in the information provided by accountants, it is important that accountants have integrity and are objective so that they will not mislead users into making poor decisions.</p> <p>11. Eve applied for a bank loan to purchase a new delivery vehicle. She has asked her accountant to change her profit figures for the previous year to improve her chances of getting the loan. Eve has threatened to move her business to another accountant if he does not agree. If the accountant follows Eve's instruction, explain the impact of his action on the bank's decision.</p> <p>TB Pg 12 Example 1.2</p> <ul style="list-style-type: none"> • If Eve succumbed to the threat of dismissal and provide a false profit figure, it would mislead the bank into thinking that the business is profitable and able to repay its loans. • The bank might then make the decision to approve its application for a bank loan and risk being unable to collect the loan principal and interest. 												
Accounting theories	<p>12. Explain the importance of accounting theories.</p> <p>TB Pg 12</p> <p>When accountants rely on sound accounting theories, the accounting information produced will present a true and fair view of business activities and allow stakeholders to make reliable and informed decisions.</p> <p>13. Explain the _____ theory.</p> <p>TB Pg 13 Table 1.5</p> <table border="0"> <tr> <td>• Accounting entity</td><td>• Matching</td></tr> <tr> <td>• Accounting period</td><td>• Materiality</td></tr> <tr> <td>• Accrual basis of accounting</td><td>• Monetary</td></tr> <tr> <td>• Consistency</td><td>• Objectivity</td></tr> <tr> <td>• Going concern</td><td>• Prudence</td></tr> <tr> <td>• Historical cost</td><td>• Revenue recognition</td></tr> </table>	• Accounting entity	• Matching	• Accounting period	• Materiality	• Accrual basis of accounting	• Monetary	• Consistency	• Objectivity	• Going concern	• Prudence	• Historical cost	• Revenue recognition
• Accounting entity	• Matching												
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• Consistency	• Objectivity												
• Going concern	• Prudence												
• Historical cost	• Revenue recognition												

When **no** context is given, use the **general explanation**.

- Explain/define _____ theory.

When a context is given, use the **specific application**.

- Explain, using a suitable accounting theory, what the business can record in its books.
- Explain, using relevant accounting theory, what she should have done.

Accounting theory	General explanation (no context)	Specific application (context is given)
Accounting entity	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.	<p><i>(context related to owner)</i> <i>explain how the accounting entity theory is applied to account for capital and drawings.</i></p> <p>According to the accounting entity theory, only transactions that affect the business are recorded while transactions relating to the owner that do not affect the business are not recorded.</p> <p>TB Pg 31 Example 3.1</p>
Accounting period	The life of a business is divided into regular time intervals.	<p><i>(context related to financial statements)</i></p> <p>As businesses are assumed to operate forever (going concern theory), financial statements should be prepared at regular time intervals (accounting period theory) to provide timely information for stakeholders to make decisions.</p> <p>TB Pg 72 Example 5.2</p>
Going concern	A business is assumed to have an indefinite economic life unless there is credible evidence that it may close down.	

Accounting theory	General explanation (no context)	Specific application (context is given)
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.	<p><i>(context related to adjustment of income and expense)</i> <i>explain the accrual basis of accounting behind the accounting of revenue and other income.</i></p> <p>Based on the accrual basis of accounting,</p> <ul style="list-style-type: none"> • service fee revenue received before services are provided should not be recognised until the services are provided to the customer regardless of whether payment has been received or not. • other income that relate to services that have been provided but not received must be recorded as other income in the current financial period. <p><i>explain the accrual basis of accounting behind the accounting of other expenses.</i></p> <p>According to the accrual basis of accounting, other expenses must be recognised in the period the services have been used, regardless of whether they have been paid for or not.</p>
Consistency	Once an accounting method is chosen, this method should be applied to all future accounting periods to enable meaningful comparison.	<p><i>(context related to method of depreciation)</i> <i>explain the accounting of depreciation expense in relation to the consistency theory.</i></p> <p>Unless there is a change of usage pattern, a business should use the same method of depreciation (consistency theory) and rate of depreciation every financial period to enable meaningful comparison of the net book value of non-current assets over time.</p>

Accounting theory	General explanation (no context)	Specific application (context is given)
Objectivity	Accounting information recorded must be supported by reliable and verifiable evidence so that financial statements will be free from opinions and biases.	<p><i>(context related to source documents) explain the importance of source documents in relation to the objectivity theory.</i></p> <p>A source document provides evidence (objectivity theory) to capture occurrence of a transaction. The transaction is recorded at the original cost that it occurred (historical cost theory).</p> <p>TB Pg 23 Example 2.1</p>
Historical cost	Transactions should be recorded at their original cost.	
Monetary	Only business transactions that can be measured in monetary terms are recorded.	
Materiality	Relevant information should be reported in the financial statements if it is likely to make a difference to the decision-making process.	<p><i>(context related to expenditure on NCA) explain the treatment of capital expenditure and revenue expenditure in relation to the materiality theory.</i></p> <p>If the amount spent on a non-current asset is insignificant to decision-making when compared to the size of the income, profit, assets or equity of the business, it does not need to be classified as a capital expenditure and be reported as a non-current asset. Instead, it can be classified as revenue expenditure and be reported as an expense. This is in accordance with the materiality theory.</p> <p>TB Pg 203 Example 11.5</p>

Accounting theory	General explanation (no context)	Specific application (context is given)
Matching	Expenses incurred must be matched against income earned in the same period to determine the profit for that period.	<p><i>(context related to income and expense)</i> <i>explain the matching theory behind the accounting of cost of sales and other expenses.</i></p> <p>According to the matching theory</p> <ul style="list-style-type: none"> the cost incurred to buy inventory must be matched against the sales revenue earned from selling the inventory in the same accounting period to determine the gross profit for that period. other costs incurred during the operation of a business to generate revenue and other income must be matched against revenue and other income earned in the same accounting period to determine the profit for that period. <p><i>explain the accounting of depreciation expense in relation to the matching theory.</i></p> <p>When a business uses non-current assets to generate income, a portion of the original cost of the non-current assets has to be recorded as depreciation expense. It will be matched against the income earned in the same financial period (matching theory) to arrive at the profit for the period.</p> <p><i>explain the accounting of impairment loss on trade receivables using the matching theory.</i></p> <p>The change in estimated amount of debts likely to be uncollectible will be reported as impairment loss on trade receivables (expense) in the same financial period as credit sales (income) was earned. The matching of expenses incurred to the income earned is in accordance to the matching theory.</p>

Accounting theory	General explanation (no context)	Specific application (context is given)
Prudence	The accounting treatment chosen should be the one that least overstates assets and profits and least understates liabilities and losses.	<p><i>(context related to assets)</i> <i>explain the valuation of inventory in relation to prudence theory.</i></p> <p>According to the prudence theory, inventory is valued at the lower of cost and net realisable value to ensure that inventory is not overstated.</p> <p><i>explain the accounting of allowance for impairment of trade receivables using the prudence theory.</i></p> <p>The estimated amount of debts likely to be uncollectible will be reported as allowance for impairment of trade receivables and shown as a deduction against the book value of trade receivables. This is to ensure that trade receivables balance is not overstated (prudence theory) and reflects the net amount that is collectible.</p>
Revenue Recognition	Revenue is earned when goods have been delivered or services have been provided.	<p><i>(context related to revenue)</i> <i>explain the revenue recognition theory behind the accounting of revenue and other income.</i></p> <p>According to the revenue recognition theory,</p> <ul style="list-style-type: none"> • revenue is recognised when goods are sold and delivered. • service fee revenue is recognised when services have been provided.

More examples of questions on accounting theories

Accounting theory	Specific application (context is given)	More examples
Accounting entity	Context related to owner <ul style="list-style-type: none"> • Capital • Drawings 	2, 13a, 14a
Accounting period	Context related to financial statements (time)	3, 4, 13b
Accrual basis of accounting	Context related to adjustment of income and expenses <ul style="list-style-type: none"> • Income receivable • Income received in advance • Expense payable • Prepaid expense 	
Consistency	Context related to depreciation expense (method)	5
Going concern	---	4, 6
Historical cost	Context related to source documents	7
Matching	Context related to income and expenses <ul style="list-style-type: none"> • Sales revenue / cost of sales • Income / depreciation expense • Credit sales / impairment loss on trade receivables 	
Materiality	Context related to expenditure on NCA	8, 9
Monetary	---	10, 13c, 14b
Objectivity	Context related to source documents	11, 13d
Prudence	Context related to assets <ul style="list-style-type: none"> • Inventory • Allowance for impairment of trade receivables 	12
Revenue recognition	Context related to revenue <ul style="list-style-type: none"> • Sales revenue • Service fee revenue 	

1. **State** the accounting theory that applies to each scenario.

(a) The owner's personal car is not recorded in books of the business.	Accounting entity theory
(b) Business transactions are recorded based on supporting documents.	Objectivity theory
(c) Business activities are recorded in the accounting period that they occur regardless of whether cash is paid or received.	Accrual basis of accounting theory
(d) The accounting treatment for valuing assets and liabilities should not overstate assets and profits nor understate liabilities and losses.	Prudence theory
(e) Five years ago, a business purchased a piece of land which cost \$1 million. Now, it is valued at \$2 million. The business recorded the cost of the land in its books as \$1 million.	Historical cost theory
(f) Louis Contractor Private Limited decided to buy a new office space as it expects to hire more staff to support its expanding business. The office space is valued at cost.	Historical cost theory
(g) Goh Provisions prepares its financial statements once a year on every 31 December.	Accounting period theory

2. Ross owns Razor Mobile Trading and has carried out the following transactions. Should the following be recorded in the business' books?

(a) Ross took \$200 from the daily sales of the business to pay for his son's piano lessons.	Since Ross took the money from the business, this transaction affects the business and should be recorded. This is known as drawings, as the owner has used the resources (cash) of the business for his personal purpose.
(b) Ross withdrew \$150 from his personal bank account to buy his wife a gift.	Since Ross took the money from his own bank account for personal use, this transaction does not affect the business, and is not recorded.
(c) Ross withdrew \$150 from his personal bank account to pay the business' suppliers.	Since the money was used for the purpose of the business, it is recorded. This is known as capital, as the owner has introduced his personal resources for use in the business.

3. Identify which of the following businesses are complying with the accounting period theory.

(a) Maris café starts operation on 1 January 20X8 and prepares its financial statements on 5 July 20X8, 6 April 20X9 and 10 October 20X9.	Not complying
(b) Bookclub Pte Ltd prepares its financial statements at the end of each calendar month and has its financial year from 1 May to 30 April.	In compliance

4. Sock Kian started a textile trading firm, SS Textile, on 1 January 20X4. Using one or more accounting theories, explain why SS Textile should prepare its statement of financial performance at regular time intervals.

SS Textile is assumed to have an indefinite economic life (going concern theory).

As such, the life of SS Textile is to be divided into regular time intervals (accounting period theory) and Statement of Financial Performance needs to be prepared at these regular intervals to provide timely information for stakeholders to make decisions.

5. Which of the following cases violate the consistency theory?

(a) A business depreciates its machines using the straight-line method in one year and the reducing-balance method in the next. It continues to switch methods from one year to the next.	This violates the consistency theory as a business cannot keep switching its depreciation method.
(b) A business depreciates its motor vehicles using the reducing-balance method. However, five years later, it switches to using the straight-line method after deciding to limit the use of the motor vehicles to its senior managers only.	This does not violate the consistency theory as the change in depreciation method was to reflect more accurately the change in usage of the motor vehicles.
(c) A business depreciates its motor vehicles using the straight-line method while its plant and equipment are depreciated using the reducing-balance method.	This does not violate the consistency theory. Different classes of assets can have different depreciation methods that best reflect how the benefits from the assets are being derived.

6. Which of the following activities show that the business mentioned is a going concern?

(a) A coffee shop buys a computerised ordering and payment system in anticipation of increased sales.	Going concern
(b) A dance school has not paid rent and salaries for six months. It has also not conducted a single dance class for four months.	Not a going concern
(c) A business holds a closing-down sale of used furniture.	Not a going concern

7. In each cash below, what should be the value of the items recorded if the business follows the historical cost theory?

(a) A delivery van used in a business was bought for \$20,000 in 20X1. An offer is made to buy it for \$25,000 now.	\$20,000
(b) A piece of land owned by a business is now valued at \$20 million, 10 times its original cost of \$2 million.	\$2 million
(c) The goods bought by the business cost \$1,000 but could be sold for \$1,500.	\$1,000

8. Mega Home and Eng Lighting are in the home furnishing industry. In the year 20X8, Mega Home made a profit of \$900,000 and Eng Lighting made a profit of \$9,000. During the same financial year, both companies paid \$2,000 for a printer. How would each company classify this expenditure?

The printer is a capital expenditure as the benefits from this expenditure will last for a few years. Thus, this amount should be recorded in the equipment account, which is a non-current asset. However, Mega Home may record the expenditure as revenue expenditure as \$2,000 is immaterial when compared to the size of the profit of the business. This is in accordance with the materiality theory.

9. For each of the transaction or item below, determine whether the transaction or item is material to a business that reports a profit of \$1 million.

(a) Purchase a piece of land for \$500,000	Material
(b) Incur repair cost for a delivery truck for \$1,000	Immaterial
(c) Incur painting of building for \$300,000	Material
(d) Purchase a tablet for \$400	Immaterial

10. Zita owns Zita Bakery. Determine whether each item below should be recorded in the business' books?

(a) Zita had a brilliant idea to market the cakes. She feels that the business would now be able to increase its sales revenue to more than \$1 million.	No, the idea cannot be measured in monetary terms.
(b) Zita sent her staff for training to improve their work-related skills. She paid for their training programme.	Yes, the cost of the training can be measured in monetary terms.
(c) Zita Bakery is known to have the best customer service in the city. Other companies are prepared to pay her staff double their salary to work for them.	No, the value of the customer service cannot be measured in monetary terms.

11. The owner of a new business has contributed his used delivery truck to the business. He feels that the delivery truck has a value of \$60,000. A second-hand car dealer is selling a similar used delivery truck for \$50,000. At which value should the new business record this second-hand delivery truck and why?

The new business should record the second-hand delivery truck at a value of \$50,000. This is the market value of a used delivery truck. The estimate of \$60,000 made by the business owner is not based on objective evidence.

12. Which of the following should be recorded or adjusted?

(a) Several textbooks in a bookstore, which cost \$500, were damaged due to a leaking roof. The textbooks can now be sold for only \$350.	The cost of the textbooks is to be written down from \$500 to \$350. The potential loss of \$150 is recorded even though the books have not been sold.
(b) Antique furniture bought for resale cost \$5,000 at the time of purchase but is worth \$15,000 now.	The increase in value of \$10,000 (i.e. potential profit) is not recorded as the antique furniture has not been sold.
(c) Due to great demand, the inventory of rice in a provision store can now be sold for \$1,300. Its cost price was \$600.	The increase in the value of rice is not recorded as it has not been sold. The profit of \$700 will be recorded when the rice is actually sold and the profit is earned.

13. The following actions were taken by Sophia, a trader.

Explain, using relevant accounting theory, what she should have done.

(a) Sophia took \$500 from her personal bank account and paid for a new desk that was used in her house. She did not record the amount in the books.	According to the accounting entity theory, assets of the business and the owner are considered to be separate. When Sophia took \$500 from the personal account for her own use, it does not affect the business in any way. Thus, Sophia did the right thing by not recording it into the business books.
(b) Sophia started her business on 1 July 20X8. She prepared financial statements for her business on 28 November 20X8, 16 March 20X9 and 28 June 20X9.	According to the accounting period theory, Sophia should prepare the financial statements on the same day each year (at regular time intervals). For example, every 31 December.
(c) Sophia included her loyal and hard-working employees as assets and recorded \$15,000 in the books.	According to the monetary theory, employees cannot be measured in numerical currency/monetary terms and thus should not be recorded into the business books.
(d) Sophia bought some tables and chairs for the business. When they were delivered, she accidentally threw the receipt away. Since it was not a huge amount, she told her clerk to record \$400 in the books.	According to the objectivity theory, Sophia should only record using reliable and verifiable information. She should verify the price of the tables and chairs with the supplier and ask them for a copy of the receipt as proof of purchase, as a reliable source of information.

14. Explain, using a suitable accounting theory, what the business can record in its books.

<p>(a) Jonathan, a business owner, bought a cash register for the shop using his personal funds.</p>	<p>According to the accounting entity theory, the activities of a business are separate from that of the owner and all transactions are recorded from the point of view of the business. Only transactions that affect the business are recorded while transactions relating to the owner that do not affect the business are not recorded. Thus, the transaction is recorded because it affects the business (increases assets) with the additional cash register contributed along with the increase in capital.</p>
<p>(b) Every year, a business sends its new staff to the service training academy for courses. As a result, many customers commended its quality of service and left positive online reviews.</p>	<p>Monetary theory states that only business transactions that can be measured in monetary terms are recorded. As such, the cost of the staff service training can be recorded in its books. However, the business should not record the positive customers' comments on its quality of service and positive online reviews as these cannot be quantified in monetary terms.</p>

Chapter 2 Accounting Information System

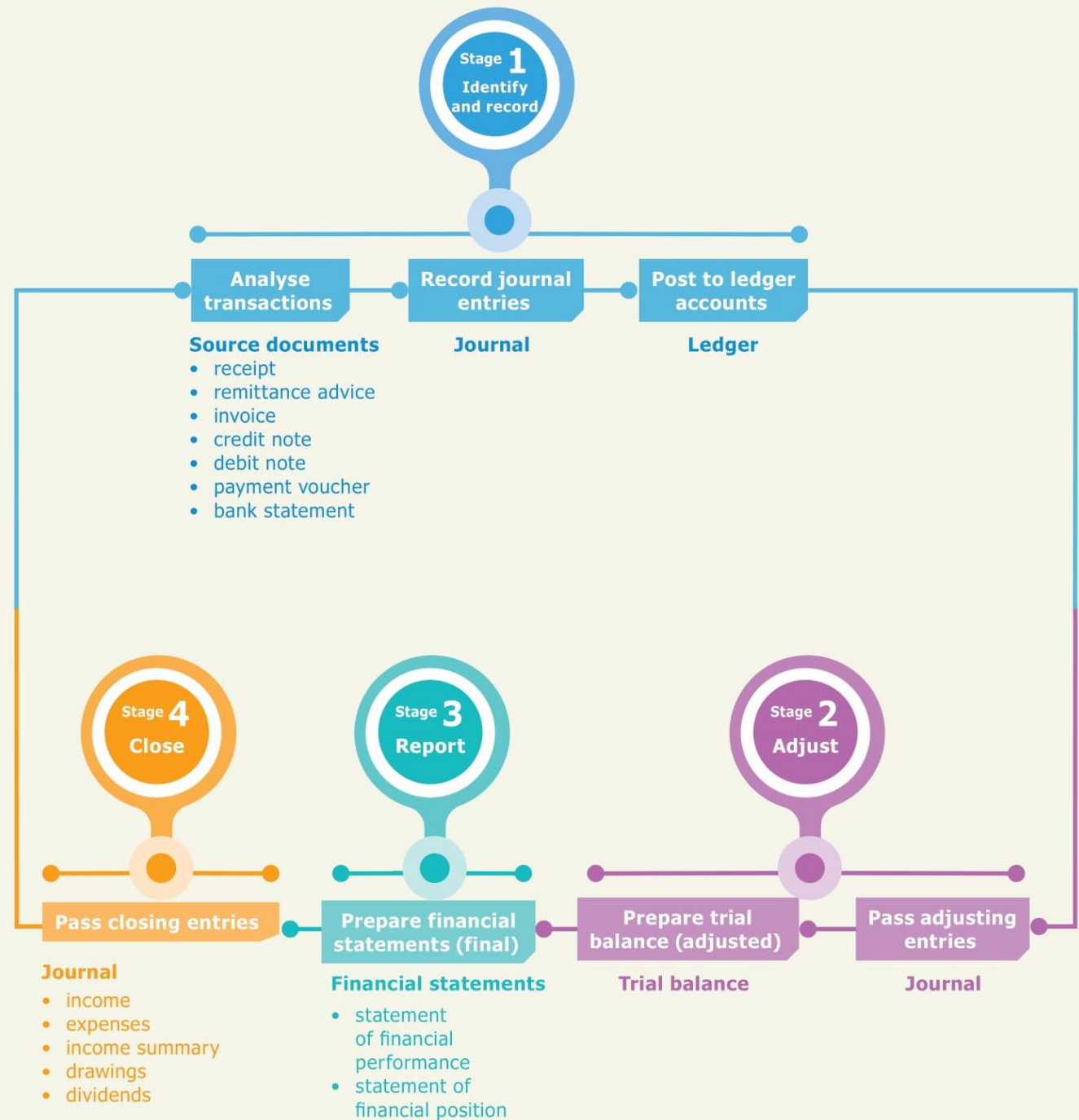
2.1 Types of Business Transactions

2.2 Accounting Cycle

2.3 Accounting Information System

[TB Pg 24] Summary

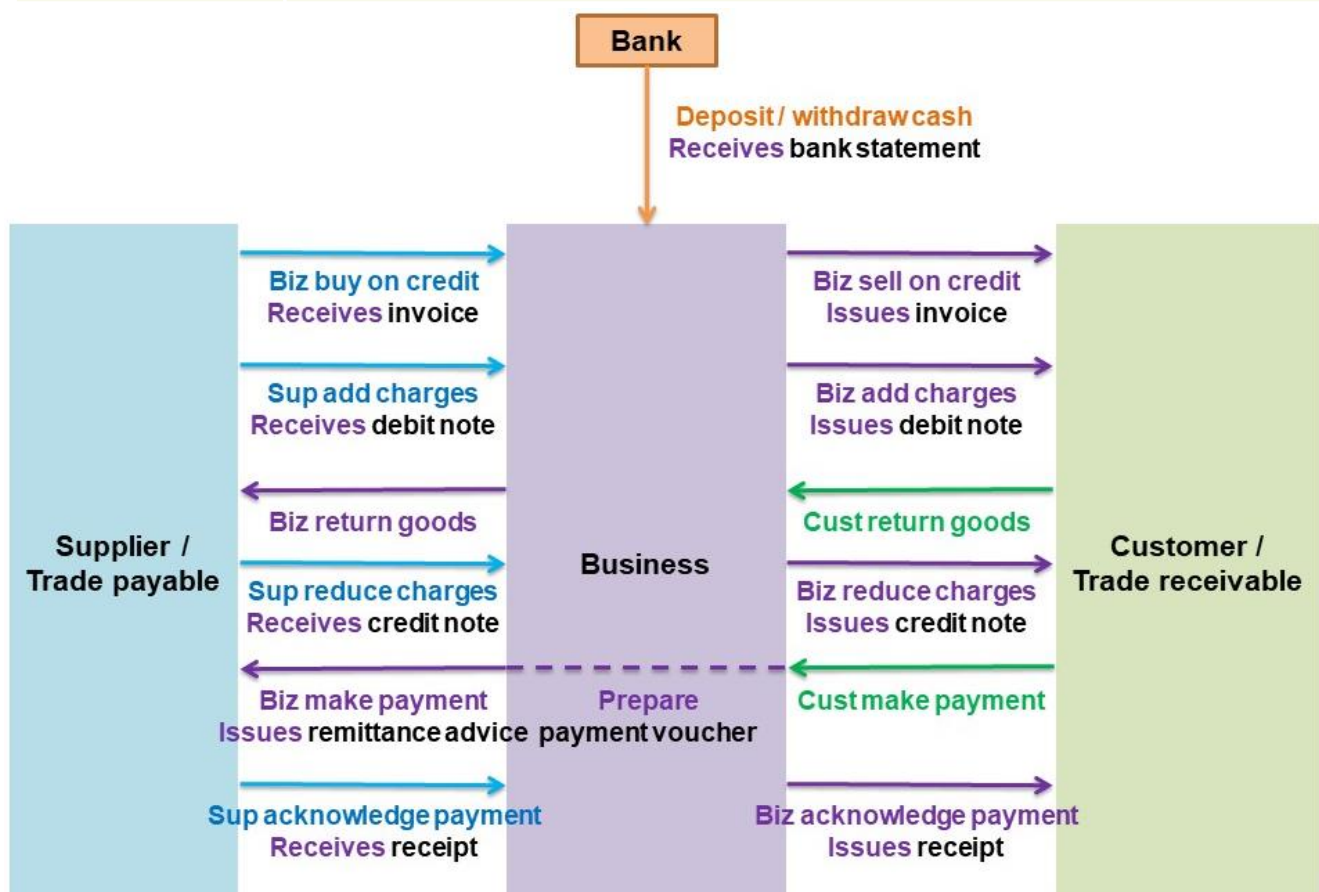
The figure below shows the relationship between the accounting information system and the accounting cycle.



Type of transactions	<p>1. State the difference between a cash transaction and a credit transaction.</p> <p>TB Pg 18 Payment is made at the same time or immediately during a cash transaction while payment is delayed or postponed during a credit transaction.</p> <p>2. Suggest a reason why a business buys services on credit instead of paying cash for them.</p> <p>When the business buys services on credit, it is able to delay payment and use the cash to meet its immediate needs.</p>
Accounting cycle	<p>3. List the stages of the accounting cycle.</p> <p>TB Pg 19 The accounting cycle comprises four stages.</p> <ul style="list-style-type: none"> • Identify and record: Source documents are used to identify and record transactions daily. • Adjust: The ending balances of ledger accounts are listed in a trial balance and adjusted at least once in a financial year. • Report: The adjusted balances are reported in the financial statements at least once in a financial year. • Close: After the financial statements are finalised, income, expenses, income summary, drawings and dividends accounts are closed at the end of the financial year.
Accounting information system	<p>4. What is an accounting information system?</p> <p>TB Pg 20 Accounting information system is a system that a business uses to collect, store and process accounting data.</p> <p>5. State the order in which financial transactions are processed through the accounting system.</p> <p>TB Pg 20 Source documents, journal, ledger, trial balance, financial statements</p>

Source documents	<p>6. What are source documents?</p> <p>Source documents provide evidence / proof that transactions have occurred and details that can be recorded in a journal.</p> <p>7. State one reason why the business would issue a credit note to a customer.</p> <p>TB Pg 21 Table 2.2</p> <p>Business issues credit note to reduce the amount owed by credit customers:</p> <ul style="list-style-type: none"> • who were previously overcharged • after goods were returned
------------------	---

Source Document	Purpose of Source Document
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.
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: <ul style="list-style-type: none"> • who were previously overcharged; or • after goods were returned.
Debit note	Increases the amount owed by credit customers who were previously undercharged.
Payment voucher	Processes payment to credit suppliers: <ul style="list-style-type: none"> • must be approved by authorised personnel; and • must be supported by original supplier's invoice.
Bank statement	Checks and tallies against the business records of its cash at bank account.



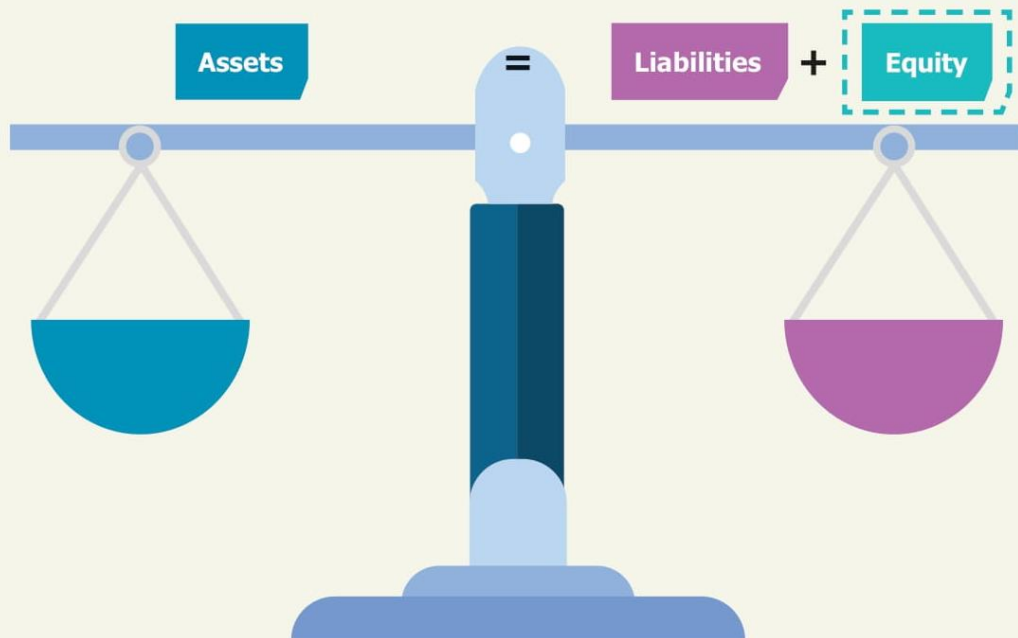
Chapter 3 Elements of Financial Statements and the Accounting Equation

3.1 Elements of Financial Statements

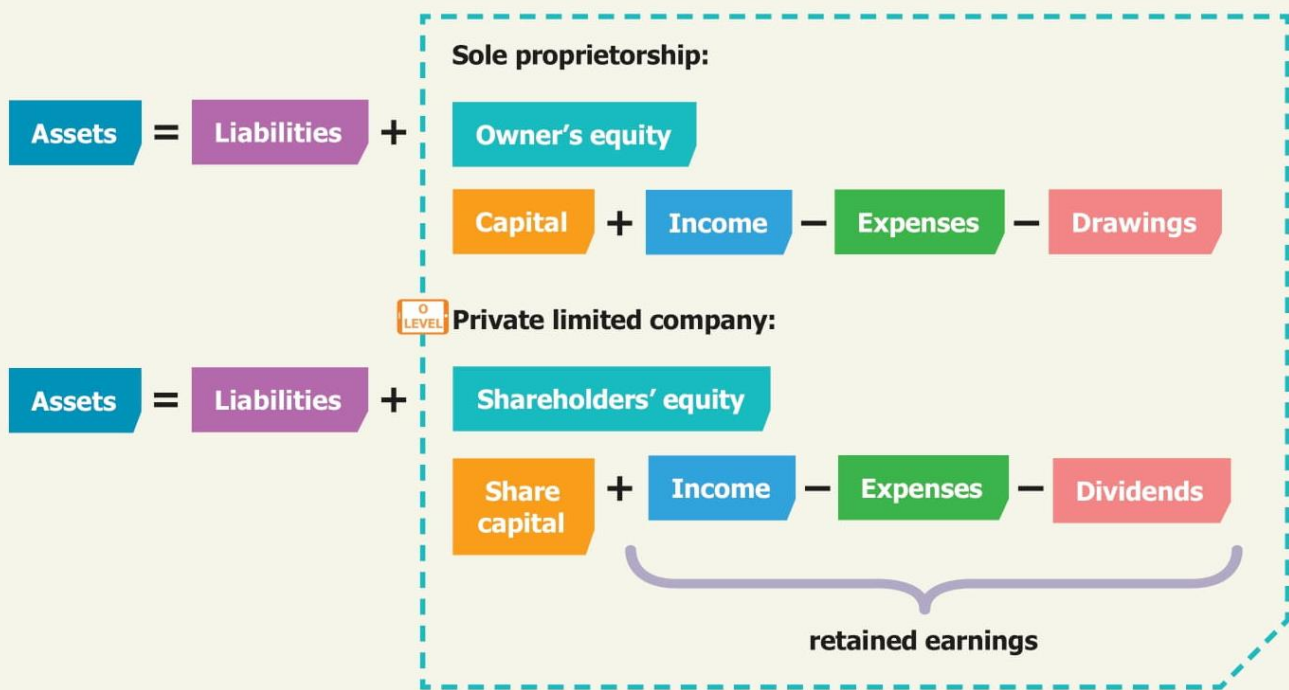
3.2 Accounting Equation

[TB Pg 42] Summary

Basic accounting equation



Expanded accounting equation



Basic accounting equation	Assets = Liabilities + Equity
Expanded accounting equation (sole proprietorship)	<u>A</u> ssets = <u>L</u> iabilities + <u>O</u> wner's <u>E</u> quity (ALOE vera) Assets = Liabilities + Capital + Profit (or – Loss) – Drawings Assets = Liabilities + Capital + Income – Expenses – Drawings <u>A</u> ssets + <u>E</u> xpenses + <u>D</u> rawings = <u>L</u> iabilities + <u>C</u> apital + <u>I</u> ncome (AED LCI) <u>A</u> fter <u>E</u> very <u>D</u> inner <u>L</u> et's <u>C</u> atch <u>I</u> gglybuff (pokemon)
Expanded accounting equation (private limited company)	Assets = Liabilities + Shareholders' Equity Assets = Liabilities + Share capital + Retained earnings Assets = Liabilities + Share capital + Profit (or – Loss) – Dividends Assets = Liabilities + Share capital + Income – Expenses – Dividends

[TB Pg 27 to 30] Table 3.1 to 3.9

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

Non-current assets		Current assets	
<ul style="list-style-type: none"> Benefits last beyond one financial year Not easily converted to cash 		<ul style="list-style-type: none"> Benefits are used within one financial year Are easily converted to cash 	
Office equipment	electronic appliances used in office (e.g. computers, printers)	Cash at bank	cash deposited with the bank
Motor vehicles	vehicles for business use (e.g. vans, trucks)	Cash in hand	physical cash kept by the business
Fixtures and fittings	furniture and items that are attached to a building by nail or screw for business use (e.g. tables, shelves)	Inventory	goods bought by the business to sell to its customers
Machinery	heavy-duty electronic appliances used to perform complex tasks (e.g. drills)	Trade receivables	revenue earned but not yet collected from credit customers
Premises / Property	buildings and land owned and used by the business	Income receivable	income earned but not yet collected from credit customers
Accumulated depreciation of NCA (contra asset)	total cost of the non-current asset incurred to generate profits since it started operation	Prepaid expense	expenses not incurred but paid in advance
		Allowance for impairment of trade receivables (contra asset)	estimated amount of debts likely to be uncollectible from credit customers
		Supplies	items used by employees to provide service to its customers
		Note: Supplies may be classified as supplies expense if the amount spent is insignificant (materiality theory)	

Liabilities: Obligations owed by a business to others that are expected to be settled in the future

Non-current liabilities		Current liabilities	
<ul style="list-style-type: none"> Due to be paid beyond one financial year 		<ul style="list-style-type: none"> Due to be paid within one financial year 	
Loan	money borrowed from banks and other lenders	Trade payables	amounts owed to credit suppliers after buying goods and other assets
Mortgage loan	money borrowed using collaterals	Bank overdraft	money borrowed, when the bank account is overdrawn and the available balance goes below zero
		Income received in advance	income not earned but collected in advance
		Expense payable	expense incurred but not yet paid to credit suppliers
		Dividends payable	a portion of retained earnings that has been declared but not yet paid to shareholders

Equity: Claim by the owner(s) on the net assets of a business

Owner's equity		Shareholders' equity	
Capital	resources contributed by the owner for business use	Share capital	cash raised by issuing shares to investors
Profit or loss for the period	the difference between the income earned and the expenses incurred within one accounting period	Retained earnings (or accumulated losses)	accumulation of profits and losses that has not been distributed to shareholders yet since operation
Drawings (contra equity)	assets taken from a business for the owner's personal use	Dividends (contra equity)	a portion of retained earnings that is distributed to shareholders

Income: Amounts earned from the activities of a business

Revenue: Amounts earned from the main activities of a business

Service fee revenue	money earned from providing services (e.g. legal fee revenue)
Sales revenue	<ul style="list-style-type: none"> money earned from selling goods selling price of goods that have been sold
Sales returns (contra income)	selling price of goods that have been returned by customers

Other income: Amounts earned from business activities other than the main business activity

Discount received	cash discount received from credit suppliers for making early payment
Interest on deposit	amount earned on the cash held in the business bank account
Rent income	money earned from letting out part of the shop/ office space
Commission income	amount earned for making sales or closing deals for third parties

Expenses: Costs incurred to earn income in the same accounting period

Cost of sales	cost price of goods that have been sold
Discount allowed	cash discount given to credit customers for making early payment
Interest on loan	charges for borrowing money from banks or other lenders
Rent expense	cost to utilise a property or location for an office, shop or storage space
Utilities expense	cost to use electricity, water, waste disposal, heating, and sewage
Insurance expense	cost to protect property, inventory and workers of the business
Wages and salaries expense	cost to compensate employees for their time and services
Advertising expense	cost to promote its products, brands, and image via various media channels
Depreciation on NCA	a portion of the original cost of the non-current asset allocated over its useful life
Impairment loss on trade receivables	change (increase/decrease) in estimated amount of debts likely to be uncollectible from credit customers
Impairment loss on inventory	amount of potential loss (decrease) when cost of goods falls below its net realisable value

[TB Pg 33] Example 3.3**(1)** Classify accounts into AED LCI**(2)** Apply the basic / expanded accounting equation

The following balances are extracted from the books of Groome Trading.

		\$
A	Cash at bank	8,000
L	Trade payables	2,700
A	Trade receivables	5,000
A	Inventory	7,000
D	Drawings	100
I	Sales revenue	15,000
Ex	Cost of sales	9,500
L	Mortgage loan	20,000
A	Motor vehicles	30,000
Ex	Utilities expenses	800

Calculate the capital of the business.

$$\begin{aligned}
 &\text{Assets} + \text{Expenses} + \text{Drawings} = \text{Liabilities} + \text{Capital} + \text{Income} \\
 8,000 + 5,000 + 7,000 + 30,000 + 9,500 + 800 + 100 &= 2,700 + 20,000 + \text{Capital} + 15,000 \\
 60,400 &= 37,700 + \text{Capital} \\
 \text{Capital} &= 60,400 - 37,700 \\
 &= \underline{\underline{\$22,700}}
 \end{aligned}$$

Ch 3 Notes

Elements of FS and the Accounting Equation

[TB Pg 34 to 41] Example 3.5 to 3.7

(1) Identify two accounts for each value

Note Specify customer / supplier / lender's name

(2) Classify the accounts as AED LCI

(3) State the effect of the transaction on these accounts + / -

(4) State the effect on owner's equity + / -

Note: Owner's Equity = Capital + Income – Expenses – Drawings

(5) Check that the accounting equation is balanced $A = L + OE$

20X1	Description of transaction
Jan 1	Jessica deposited \$1,000 of her own cash into the business bank account.
Jan 11	The business installed clothes racks and shelves costing \$5,000 from Blinkz in its shop. \$3,000 of the cost was paid by cheque. The remaining \$2,000 was bought on credit.
Jan 14	The business sold dresses and received \$200 cash. The cost of the dresses was \$80.
Feb 5	Jessica took \$120 cash from the business to pay for her son's swimming lessons.
Mar 31	The business issued a cheque to pay rental of \$2,000.

Identify the effects of the above transactions on the accounting equation.

Amount to be recorded for Jan 1: \$1,000

Keywords	Jessica deposited	business bank account
(1)	Capital	Cash at bank
(2, 3)	+C	+A
(4)	+OE	Does not affect OE

20X1	Assets	Liabilities	Owner's Equity
Jan 1	Cash at bank +1,000	No effect	Capital +1,000
(5)	+1,000	=	+1,000

Ch 3 Notes**Elements of FS and the Accounting Equation**

Amount to be recorded for Jan 11: \$3,000

Keywords	<u>clothes racks and shelves</u>	<u>cheque</u>
(1)	Fixtures and fittings	Cash at bank
(2, 3)	+A	-A
(4)	Does not affect OE	Does not affect OE

Amount to be recorded for Jan 11: \$3,000

Keywords	<u>clothes racks and shelves</u>	bought <u>on credit</u>
(1)	Fixtures and fittings	Trade payables
(2, 3)	+A	+L
(4)	Does not affect OE	Does not affect OE

20X1	Assets	Liabilities	Owner's Equity
Jan 1	Fixtures and fittings +3,000 Cash at bank -3,000 Fixtures and fittings +2,000	Trade payables +2,000	No effect
(5)	+2,000	=	+2,000

Ch 3 Notes**Elements of FS and the Accounting Equation**

Selling price of goods sold on Jan 14: \$200

Keywords	<u>sold</u>	<u>cash</u>
(1)	Sales revenue	Cash in hand
(2, 3)	+I	+A
(4)	+OE	Does not affect OE

Cost price of goods sold on Jan 14: \$80

Keywords	<u>cost</u>	<u>dresses</u>
(1)	Cost of sales	Inventory
(2, 3)	+Ex (effect of Ex follow the effect of I)	-A
(4)	-OE	Does not affect OE

Note: Cost of sales is always tagged to inventory (these two accounts are “attached”).

20X1	Assets	Liabilities	Owner's Equity
Jan 1	Cash in hand +200 Inventory -80	No effect	Sales revenue +200 Cost of sales -80
(5)	+120 =		+120

Amount to be recorded for Feb 5: \$120

Keywords	<u>cash</u>	<u>pay for her son's</u>
(1)	Cash in hand	Drawings
(2, 3)	-A	+D
(4)	Does not affect OE	-OE

20X1	Assets	Liabilities	Owner's Equity
Jan 1	Cash in hand -120	No effect	Drawings -120
(5)	-120 =		-120

Ch 3 Notes**Elements of FS and the Accounting Equation**

Amount to be recorded for Mar 31: \$2,000

Keywords	<u>cheque</u>	<u>rental</u>
(1)	Cash at bank	Rental expense
(2, 3)	-A	+Ex
(4)	Does not affect OE	-OE

20X1	Assets	Liabilities	Owner's Equity
Jan 1	Cash at bank -2,000	No effect	Rental expense -2,000
(5)	-2,000	=	-2,000

Chapter 4 Double-entry Recording

- 4.1 Understanding Double-entry Recording System
- 4.2 Journal Entries
- 4.3 Ledger Accounts
- 4.4 Discounts

[TB Pg 65] Summary

Manner of recording changes in the accounting elements

Accounting Element	Increase +	Decrease -
Assets	Dr	Cr
Liabilities	Cr	Dr
Equity	Cr	Dr
Income	Cr	Dr
Expenses	Dr	Cr

Example: On 1 January 20X1, Jessica deposited \$1,000 cash into the business bank account.

Journal			
Date	Particulars	Debit	Credit
20X1		\$	\$
Jan 1	Cash at bank	1,000	
	(gap) Capital		1,000
	Contribution of \$1,000 from owner to the business bank account (Narration)		

Cash at bank account				
Date	Particulars	Debit	Credit	Balance
20X1		\$	\$	\$
Jan 1	Capital	1,000		1,000 Dr

Capital account				
Date	Particulars	Debit	Credit	Balance
20X1		\$	\$	\$
Jan 1	Cash at bank		1,000	1,000 Cr

Rule	<p>1. State the double-entry recording rules.</p> <p>TB Pg 45</p> <p>There are three rules of the double-entry system.</p> <ul style="list-style-type: none"> • Each business transaction will affect at least two accounts. • At least one account will be debited, where the amount will be recorded on the debit column of that account. • At least one account will be credited, where the amount will be recorded on the credit column of that account.
Goods returns	<p>2. State two reasons why customers might make returns.</p> <ul style="list-style-type: none"> • Goods are defective/faulty/spoilt/expired. • Goods delivered are different from what were ordered e.g. wrong specifications.
Trade discount	<p>3. State two reasons why a supplier would offer a trade discount.</p> <p>TB Pg 58 Table 4.2</p> <p>To encourage:</p> <ul style="list-style-type: none"> • customers to buy in bulk • their patronage • their loyalty
Cash discount	<p>4. State why a business might receive cash discounts from a supplier.</p> <p>TB Pg 59 Table 4.3</p> <p>When the business pays early, the business receives cash discount from its credit suppliers.</p> <p>5. State why a business may allow a cash discount to a customer.</p> <p>When credit customers pay early, the business gives cash discount to the credit customers.</p> <p>6. State the benefits to a business of offering cash discounts to customers.</p> <p>When customers are encouraged to pay early, the business will be able to receive cash earlier and use it to meet its daily operational needs.</p>
Discount	<p>Invoice price = List price (original) – Trade discount</p> <p>Amount paid / received = Invoice price – Cash discount (allowed / received)</p>

[TB Pg 58] Table 4.2

Define	Trade Discount	Cash Discount
Purpose	Encourage: <ul style="list-style-type: none"> customers to buy in bulk; their patronage; and their loyalty. 	Encourage credit customers to pay early , within a specified time.
Calculation	Reduces list price. <div> Invoice price = List price - Trade discount </div>	Reduces invoiced price. <div> Amount paid = Invoiced price - Cash discount </div>
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

5-step procedure to analyse each transaction:

(1) Identify two accounts for each value

Note Specify customer / supplier / lender's **name**

(2) Classify the accounts as AED LCI

(3) State the effect of the transaction on these accounts + / -

(4) Convert effect to debit or credit Dr / Cr

(5) Check that there is one Dr and one Cr for each value i.e. Dr = Cr

Dr (diet)

+

Cr (coke)

+

Assets (After) + Expense Every + Drawings Dinner, = Liabilities Let's + Capital Catch + Income Igglybuff)

Cr

-

Dr

-

[TB Pg 46 to 54] Example 4.1 to 4.3

20X1	Description of transaction
Jan 1	<u>Jessica deposited</u> \$1,000 of her own cash into the <u>business bank account</u> .

Amount to be recorded for Jan 1: \$1,000

Keywords	<u>Jessica deposited</u>	<u>business bank account</u>
(1)	Capital	Cash at bank
(2, 3)	+C	+A
(4, 5)	Cr	Dr

Journal			
Date	Particulars	Debit	Credit
20X1		\$	\$
Jan 1	Cash at bank	1,000	
	gap Capital		1,000
	Contribution of \$1,000 from owner to the business bank account		

Dr entry is always on **top** of Cr entry.

Cr entry is 'shifted' to the **right**, leaving a **gap**.

Narration is a **brief** description of the transaction.

Record transactions	Account to be debited	Account to be credited
Obtain loan	Cash at bank +A	Loan +L
Repayment of loan	Loan -L	Cash at bank -A
Purchase of non-current asset (capital expenditure) <ul style="list-style-type: none"> on credit using cheque 	Non-current asset +A	Trade payable +L
		Cash at bank -A
Purchase of goods from supplier <ul style="list-style-type: none"> on credit using cheque 	Inventory +A	Trade payable +L
		Cash at bank -A
Return of goods to suppliers <ul style="list-style-type: none"> previously purchased on credit refund cheque 	Trade payable -L	Inventory -A
	Cash at bank +A	
Payment to credit suppliers using cheque	Trade payable -L	Cash at bank -A
Received cash discount from credit suppliers	Trade payable -L	Discount received +I
Sale of goods to customers (selling price) <ul style="list-style-type: none"> on credit received cheque 	Trade receivables +A	Sales revenue +I
	Cash at bank +A	
Cost price of goods sold	Cost of sales +Ex	Inventory -A
Return of goods by customers (selling price) <ul style="list-style-type: none"> previously sold on credit refund cheque 	Sales returns -I	Trade receivables -A
		Cash at bank -A
Cost price of goods returned	Inventory +A	Cost of sales -Ex

Record transactions	Account to be debited	Account to be credited
Collected cheque from credit customers	Cash at bank +A	Trade receivables -A
Gave cash discount to credit customers	Discount allowed +Ex	Trade receivables -A
Dishonoured cheque	Trade receivables +A	Cash at bank -A
Withdrew cash discount given	Trade receivables +A	Discount allowed -Ex
Withdrew from bank as office cash	Cash in hand +A	Cash at bank -A
Deposit excess cash into bank	Cash at bank +A	Cash in hand -A
Contribution from owner	Any assets +A	Capital +C
Withdrawal by owner for personal use	Drawings +D	Any assets -A
Contribution from shareholders	Cash at bank +A	Share capital +C
Declared dividends <ul style="list-style-type: none"> But not paid yet Paid immediately 	Dividends +D	Dividends payables +L
	Dividends +D	Cash at bank -A

Note: Refer to double entries related to income and expenses in Ch 6 and 7 Notes respectively

Transfer 5-step procedure to the format of a **5-column ledger**:

- (1) Classify the account you are preparing as AED LCI
- (2) Indicate +/- for the respective Dr / Cr column
- (3) Write balance b/d for the first of the month if a starting balance is given in the question
- (4) Write the value in the correct Dr / Cr column according to your 5-step procedure
- (5) Write the other account name with the same value in the Particulars column
- (6) Calculate the ending balance and write the amount following by a suffix Dr / Cr (first, last)
- (7) Write balance b/d for the first of next month, if the ending balance is not zero (next)

Note: It is optional to fill in the balance in between the first and last row.

20X1	Description of transaction
Mar 6	The <u>owner deposited</u> \$3,900 personal cash into the <u>business bank account</u> .

Amount to be recorded for Mar 6: \$3,900

Keywords	<u>owner deposited</u>	<u>business bank account</u>
(1)	Capital	Cash at bank
(2, 3)	+C	+A
(4, 5)	Cr	<u>Dr</u> ←

Ch 4 Notes

Double-entry recording

Working for ending balance: $-300 + 3,900 + 1,400 - 500 + 2,200 - 2,200 - 1,600 = 2,900$

(1) Classify the account you are preparing
(2) Indicate +/-
(3) Starting balance (if given)

Cash at bank account (A)					
Date	Particulars	Debit	Credit	Balance	
		\$ (+)	\$ (-)	\$	
20X2					
Mar 1	Balance b/d			300 Cr	First ✓
6	Capital	3,900		3,600 Dr	Optional
13	Service fee revenue	1,400		5,000 Dr	
17	Office equipment		500	4,500 Dr	
20	Trade receivable — Blissful Services	2,200		6,700 Dr	
22	Trade receivable — Blissful Services		2,200	4,500 Dr	
28	Salaries expense		1,600	2,900 Dr	Last ✓
Apr 1	Balance b/d			2,900 Dr	Next ✓

(4) Write the value in the correct Dr/Cr column
(5) Write the other account name with the same value
(6) Calculate the ending balance
Amount + Dr/Cr (suffix)
(7) Bring down (b/d) ending balance to next month

Working for ending balance: $800 - 770 - 30 = 0$

Trade payable — Eco Detergent account (L)					
Date	Particulars	Debit	Credit	Balance	
		\$ (-)	\$ (+)	\$	
20X1					
Jan 7	Cleaning supplies		800	800 Cr	First ✓
12	Cash at bank	770		30 Cr	Optional
12	Discount received	30		—	

Last ✓

Zero balance is shown as **0** or a long dash '—'

There is no need to bring down zero balance to the next month.

Chapter 5 Trial Balance and Financial Statements

5.1 Trial Balance

5.2 Financial Statements

The amounts from ledger accounts with debit balances are recorded in the **debit column**.

The amounts from ledger accounts with credit balances are recorded in the **credit column**.

Classify into
AED LCI

Name of business		Trial Balance as at 31 January 20X1	
		Debit \$	Credit \$
A	Equipment	13,000	
A	Fixtures and fittings	100,000	
A	Motor vehicle	90,000	
A	Inventory	50,000	
A	Trade receivables	43,000	
A / L	Cash at bank / Bank overdraft	52,000 (A)	520 (L)
A	Cash in hand	3,000	
L	Trade payables		39,000
L	Bank loan		100,000
C	Capital, 1 Jul 20X2		180,000
D	Drawings	5,600	
I	Discount received		14,200
I	Sales revenue		350,000
-I	Sales returns	4,500	
Ex	Cost of sales	120,000	
Ex	Discount allowed	13,800	
Ex	General expenses	3,300	
Ex	Utilities expense	6,000	
Ex	Insurance expense	11,000	
Ex	Rent expense	60,000	
Ex	Salaries expense	108,000	
		683,200	683,200

When the total amount in the debit column is the **same** as the total amount in the credit column, the trial balance is **balanced**.

[TB Pg 309 to 312]

Statement of Financial Performance

- Informs stakeholders of the profitability of the business
- Prepared for a period of time
- Gross profit/loss
= Net sales revenue (Sales revenue – Sales returns) – Cost of sales
- Profit/Loss for the period
= Gross profit/loss + Other income – Other expenses

(A) Trading Business

Name of Business Statement of Financial Performance for the year/period ended [_____]		
	\$	\$
Sales revenue	XXXX	XXXX
Less: Sales returns	XXXX	
Net sales revenue		XXXX
Less: Cost of sales		XXXX
Gross profit		XXXX
Other income		
Commission income	XXXX	
Discount received	XXXX	
Gain on sale of non-current assets ¹	XXXX	
Rent income	XXXX	XXXX
Less: Other expenses		
Impairment loss on trade receivables <u>or</u> Reversal of impairment loss on trade receivables	XXXX <u>or</u> (XXXX)	
Impairment loss on inventory	XXXX	
Depreciation of office equipment	XXXX	
Depreciation of motor vehicles	XXXX	
Interest	XXXX	
Insurance	XXXX	
Loss on sale of non-current assets ¹	XXXX	
Motor vehicle expenses	XXXX	
Office expenses	XXXX	
Rent and rates	XXXX	
Wages and salaries	XXXX	XXXX
Profit for the year/period		XXXX

¹ Either one of these items will appear if only one asset was sold during the year.

Note 1

If customers did not return goods (**zero** sales returns), there is no need to calculate net sales revenue.

Note 2

Loss for the year / period is shown as a **negative** number, with the use of brackets.e.g. (1,000)

Hence, sales revenue can be recorded in the **outer** column.

(B) Service Business

Name of Business		
Statement of Financial Performance for the year/period ended [_____]		
	\$	\$
Service fee revenue		XXXX
Other income		
Commission income	XXXX	
Discount received	XXXX	
Gain on sale of non-current assets ¹	XXXX	
Rent income	XXXX	XXXX
Less: Other expenses		
Impairment loss on trade receivables <u>or</u> Reversal of impairment loss on trade receivables	XXXX <u>or</u> (XXXX)	
Impairment loss on inventory	XXXX	
Depreciation of office equipment	XXXX	
Depreciation of motor vehicles	XXXX	
Interest	XXXX	
Insurance	XXXX	
Loss on sale of non-current assets ¹	XXXX	
Motor vehicle expenses	XXXX	
Office expenses	XXXX	
Rent and rates	XXXX	
Wages and salaries	XXXX	XXXX
Profit for the year/period		XXXX

¹ Either one of these items will appear if only one asset was sold during the year.

Statement of Financial Position

- Informs stakeholders of how resources are obtained and used
- Prepared at a point in time
- Assets = Liabilities + Equity

(A) Sole Proprietorship

Name of Business Statement of Financial Position as at [_____]			
	\$	\$	\$
Assets			
<u>Non-current assets</u>	Cost	Accumulated depreciation	Net book value
Property	XXXX	XXXX	XXXX
Fixtures and fittings	XXXX	XXXX	XXXX
Office equipment	XXXX	XXXX	XXXX
Motor vehicles	XXXX	XXXX	XXXX
			XXXX
<u>Current assets</u>			
Inventory		XXXX	
Trade receivables	XXXX		
Less: Allowance for impairment of trade receivables	XXXX	XXXX	
Other receivables/prepaid expenses/income receivables		XXXX	
Cash at bank		XXXX	
Cash in hand		XXXX	XXXX
Total assets			XXXX
Equity and Liabilities			
<u>Owner's equity</u>			
Capital (beginning capital + additional capital + profit or the year/period – drawings) or - loss			XXXX
<u>Non-current liabilities</u>			
Long-term borrowings			XXXX
<u>Current liabilities</u>			
Trade payables		XXXX	
Expenses payable/income received in advance		XXXX	
Current portion of long-term borrowings		XXXX	XXXX
Total equity and liabilities			XXXX

(B) Private Limited Company

Name of Business
Statement of Financial Position as at [_____]

	\$	\$	\$
Assets			
<u>Non-current assets</u>	Cost	Accumulated depreciation	Net book value
Property	xxxx	xxxx	xxxx
Fixtures and fittings	xxxx	xxxx	xxxx
Office equipment	xxxx	xxxx	xxxx
Motor vehicles	xxxx	xxxx	xxxx
	<hr/>	<hr/>	<hr/>
			xxxx
<u>Current assets</u>			
Inventory		xxxx	
Trade receivables	xxxx		
Less: Allowance for impairment of trade receivables	xxxx	xxxx	
Other receivables/prepaid expenses/income receivables	<hr/>	xxxx	
Cash at bank		xxxx	
Cash in hand		xxxx	xxxx
Total assets		<hr/>	<hr/>
			xxxx
Equity and Liabilities			
<u>Shareholders' equity</u>			
Share capital, xxx ordinary shares		xxxx	
Retained earnings <u>or</u> Accumulated losses		xxxx	xxxx
		<hr/>	
<u>Non-current liabilities</u>			
Long-term borrowings			xxxx
<u>Current liabilities</u>			
Trade payables		xxxx	
Expenses payable/income received in advance		xxxx	
Current portion of long-term borrowings		xxxx	xxxx
Total equity and liabilities		<hr/>	<hr/>
			xxxx

 Bank overdraft

Trial balance	<p>1. Explain why a business prepares a trial balance at the end of the financial year.</p> <p>TB Pg 69 A trial balance is prepared to:</p> <ul style="list-style-type: none"> • facilitate the preparation of the financial statements • ensure arithmetic accuracy in recording <p>2. Explain the limitation of a trial balance (refer to Ch 15 Correction of errors).</p> <p>A balanced trial balance is not an absolute proof of accuracy. There may be errors not revealed by a trial balance.</p>
Statement of financial performance	<p>3. State the purpose of a statement of financial performance.</p> <p>TB Pg 72 A statement of financial performance shows the income earned and expenses incurred for a period of time and informs stakeholders of the profitability of a business.</p> <p>4. Explain the difference between the statements of financial performance of a trading and of a service business.</p> <p>TB Pg 73 There are two portions of a statement of financial performance for a trading business, trading portion and profit and loss portion. However, for a service business, there is no trading portion in its statement of financial performance.</p>
Statement of financial position	<p>5. State the purpose of a statement of financial performance.</p> <p>TB Pg 76 The statement of financial position lists the assets, liabilities and equity of a business as at a specified date and provides information on how resources are obtained / funded and used in a business at a point in time.</p> <p>6. Explain the meaning of the term 'current assets'.</p> <p>Current assets refer to resources a business owns or controls that are expected to provide future benefits which are used within one financial year.</p> <p>7. Explain the meaning of the term 'current liabilities'.</p> <p>Current liabilities refer to obligations owed by a business to others that are expected to be settled/paid within one financial year.</p>

8. State the difference between a current asset and a non-current asset.

TB Pg 77

- The benefits of current asset are used within one financial year while the benefits of non-current assets last beyond one financial year.
- Non-current assets are not easily converted to cash while current assets are easily converted to cash.

9. State the difference between a current liability and a non-current liability.

TB Pg 78

Current liability is due to be paid within one financial year while non-current liability is due to be paid beyond one financial year.

10. Explain why trade receivable is a current asset.

Payment is expected to be collected from credit customers within one financial year.

11. Explain why machinery is a non-current asset.

Machine used by the business to produce/process goods can be used for more than one financial year.

12. Explain why trade payable is a current liability.

Amounts owed to credit suppliers is expected to be paid within one financial year.

13. Explain why bank loan is a non-current liability.

Money borrowed from bank is expected to be paid beyond one financial year.

Sole Proprietorship (Trading) – 2018 West Spring 4E MYE P2 Q1

The following balances were extracted from the books of Agro Enterprise on 31 December 2017.

Step 1: Classify into AED LCI

I	Sales revenue
CA	Inventory
Ex	Cost of sales
Ex	Discount allowed
I	Discount received
-I	Sales returns
C	Capital, 1 January 2017
NCL	Bank loan, repayable on 31 December 2023 (to be presented as long-term borrowings)
I	Rent income
CA	Trade receivables
Ex	Salaries expenses
Ex	Advertising expenses
CL	Trade payables
NCA	Office equipment
NCA	Land
	Accumulated depreciation – office equipment
	Allowance for impairment of trade receivables
CA	Cash at bank (check whether ending CAB has +/- value)
D	Drawings

Step 3: Adjust value of given accounts

\$



110 000	
12 700	- 2,400
63 500	
1 800	
1 700	
3 300	
45 000	
25 000	- 5,000
7 800	+ 270
16 400	- 3,700
6 400	+ 1,500
4 200	- 600
11 900	
8 500	
77 000	
4 400	+ 1,275
4 300	- 3,700 + 162
13 300	
3 000	+ 2,400

Step 2: Apply 5-step procedure to analyse additional information

Additional information

- During the year, the owner Christopher withdrew goods worth \$2 400 for personal use.
- Salaries expenses of \$1 500 were outstanding.
- \$800 advertising expense was paid for four months till 31 March 2018.
- Rental income of \$270 was earned but not collected yet.
- Interest on long term loan is at 10% per annum. No interest has been paid.
- Annual depreciation is charged on office equipment at 15% per annum using the straight-line method.
- A credit customer who owes \$3 700 was declared bankrupt. The business decided to write off the debt.
- The allowance for impairment of trade receivables is to be maintained at 6% of trade receivables.
- \$5 000 of the long-term loan is to be repaid on 30 June 2018.

REQUIRED

- (a) Prepare the statement of financial performance for the year ended 31 December 2017.
 (b) Prepare the statement of financial position as at 31 December 2017.

Amount to be adjusted for info 1: **\$2,400**

(1)	Inventory	Drawings
(2, 3)	-A	+D
(4, 5)	Cr	Dr

Amount to be adjusted for info 2: **\$1,500**

(1)	Salaries expense	Salaries expense payable <i>(new!)</i>
(2, 3)	+Ex (incurred)	+L
(4, 5)	Dr	Cr

Amount to be adjusted for info 3: **$800 \div 4 \times 3 = 600$**

(prepaid for 3 months from 1 Jan to 31 Mar 2018)

(1)	Advertising expense	Prepaid advertising expense <i>(new!)</i>
(2,3)	-Ex (not incurred)	+A
(4, 5)	Cr	Dr

Amount to be adjusted for info 4: **\$270**

(1)	Rent income	Rent income receivable <i>(new!)</i>
(2,3)	+I (earned)	+A
(4, 5)	Cr	Dr

Amount to be adjusted for info 5: **$10\% \times 25,000 = 2,500$**

(1)	Interest expense <i>(new!)</i>	Interest expense payable <i>(new!)</i>
(2,3)	+Ex (incurred)	+L
(4, 5)	Dr	Cr

Amount to be adjusted for info 6: **$15\% \times 8,500 = 1,275$** (straight-line method)

(1)	Depreciation on office equipment <i>(new!)</i>	Accumulated depreciation of office equipment
(2, 3)	+Ex	+contra-A (-A)
(4, 5)	Dr	Cr

Amount to be adjusted for info 7: **\$3,700**

(1)	Trade receivables	Allowance for impairment of trade receivables
(2, 3)	-A	-contra-A (+A)
(4, 5)	Cr	Dr

After a customer went bankrupt and \$3,700 debts was written off from the estimated amount of debts likely to be uncollectible, the business can still tolerate \$600 debts to be uncollectible (which is within its expectations).

Start	Write-off	Adjust	End
4,300	- 3,700	762 - 600	6% X (16,400 - 3,700)
4,300 - 3,700 = 600		= 162 (increase)	= 762

However, it estimated more \$ may not be collectible next year (bad sign) → increased from \$600 (allowance after write-off) to \$762 (end).

Amount to be adjusted for info 8: **\$162**

(1)	allowance for impairment of trade receivables	Impairment loss on trade receivables <i>(new!)</i>
(2, 3)	+contra-A (-A)	+Ex
(4, 5)	Cr	Dr

Amount to be adjusted for info 9: **\$5,000**

(1)	Long-term borrowings	Current portion of long-term borrowings <i>(new!)</i>
(2, 3)	-NCL	+CL
(4, 5)	Dr	Cr

Step 4: Take note of new accounts arising from the additional information.

↓ Use your own abbreviations to save space.

(new!)

CL	Sal exP	1,500	CL	Int exP	2,500
CA	PP adv ex	600	Ex	Dep on OEq	1,275
CA	Rent IR	270	Ex	Imp loss on TR	162
Ex	Int ex	2,500	CL	CP of LTB	5,000

Step 5: Transfer relevant working (step 2-3) into both statements

Agro Enterprise
Statement of Financial Performance for the year ended 31 December 2017

	\$	\$
Sales revenue	110 000	
Less: Sales returns	3 300	
Net sales revenue		106 700
Less: Cost of sales		63 500
Gross profit		43 200
Other income		
Discount received	1 700	
Rent income (7 800 + 270)	8 070	9 770
Less: Other expenses		
Discount allowed	1 800	
Salaries expenses (6 400 + 1 500)	7 900	
Advertising expenses (4 200 – 600)	3 600	
Interest expense (10 % X 25 000)	2 500	
Depreciation on office equipment (15% X 8 500)	1 275	
Impairment loss on trade receivables (6% X 12,700) – (4 300 – 3 700)	162	17 237
Profit for the year		35 733

Step 6: Transfer profit/loss for the year to calculate ending capital

Ensure total assets = total equity and liabilities

Agro Enterprise
Statement of Financial Position as at 31 December 2017

Assets	\$	\$	\$
<u>Non-current assets</u>	Cost	Accumulated depreciation	Net book value
Office equipment	8 500	5 675 (4 400 + 1 275)	2 825
Land	77 000	-	77 000
			79 825
<u>Current assets</u>			
Inventory (12 700 – 2 400)		10 300	
Trade receivables (16 400 – 3 700)	12 700		
Less: Allowance for impairment of trade receivables (6% X 12 700)	762	11 938	
Cash at bank		13 300	
Prepaid advertising expenses (800 / 4 X 3)		600	
Rent income receivable		270	36 408
Total assets			116 233
Equity and Liabilities			
<u>Owner's equity</u>			
Capital 45 000 + 35 733 – (3 000 + 2 400)			75 333
<u>Non-current liabilities</u>			
Long-term borrowings (25 000 – 5 000)			20 000
<u>Current liabilities</u>			
Trade payables		11 900	
Salaries expense payable		1 500	
Interest expense payable		2 500	
Current portion of long-term borrowings		5 000	20 900
Total equity and liabilities			116 233

Private Limited Company (Trading) – 2018 Yishun Town 5N MYE P2 Q1 (modified)

The following balances were extracted from the books of Kang Wei Company at 31 March 2017.

Step 1: Classify into AED LCI**Step 3: Adjust value of given accounts**

		\$	
↓			↓
	Share capital, 100 000 ordinary shares	200 000	
	Retained earnings, 1 April 2016	56 000	
I	Sales revenue	712 300	
-I	Sales returns	10 400	
Ex	Cost of sales	291 300	
CA	Inventory	62 400 + 3,500	
Ex	General expenses	60 000	
Ex	Salaries expense	79 860	
Ex	Insurance expense	5 000 - 300	
I	Discount received	900	
I	Rent income	1 200	
NCA	Land and property	250 000	
NCA	Fixtures and fittings, at cost	80 000	
NCA	Motor vehicles ,at cost	56 000	
	Accumulated depreciation:		
	Fixtures and fittings	24 000 + 8,000	
	Motor vehicles	20 160 + 7,168	
CA	Trade receivables	142 300 - 1,500	
CL	Trade payables	25 000 + 3,500	
	Allowance for impairment of trade receivables	4 400 - 1,500 - 84	
CA	Cash at bank (check whether ending CAB has +/- value)	54 100	
Ex	Interest on loan	2 600 + 1,400	
NCL	8% bank loan repayable 30 September 2023 (to be presented as long-term borrowings)	50 000	

Step 2: Apply 5-step procedure to analyse additional information

↓
Additional information

- 1 An invoice was received for the purchase of inventory for \$3 500.
- 2 Included in the insurance expense of \$5 000 was a payment of \$1 200 for a one year fire insurance policy that ended on 30 June 2017.
- 3 Interest on the 8% bank loan was not fully paid up.
- 4 Annual depreciation is charged on the non-current assets as follows:
 Fixtures and fittings at 10% per annum on cost
 Motor vehicles at 20% per annum on net book value
- 5 A credit customer who owed \$1 500 declared bankrupt. His debt is to be written off as irrecoverable.
- 6 The allowance for impairment of trade receivables is to be maintained at 2% of trade receivables.
- 7 A dividends of 20 cents per ordinary share was declared on 28 March 2017. The dividends would be paid on 15 April 2017.

REQUIRED

- (a) Prepare the statement of financial performance for the year ended 31 March 2017.
 (b) Prepare the statement of financial position at 31 March 2017.

Amount to be adjusted for info 1: **\$3,500**

(1)	Trade payables	Inventory
(2, 3)	+L	+A
(4, 5)	Cr	Dr

Amount to be adjusted for info 2: **$1,200 \div 12 \times 3 = 300$**

(prepaid for 3 months from 1 Apr to 30 Jun 2017)

(1)	Insurance expense	Prepaid insurance expense (<i>new!</i>)
(2, 3)	-Ex (not incurred)	+A
(4, 5)	Cr	Dr

Amount to be adjusted for info 3: **$8\% \times 50,000 = 4,000$ (incurred)**

$4,000 - 2,600$ (paid) = 1,400 (owing)

(1)	Interest expense	Interest expense payable (<i>new!</i>)
(2, 3)	+Ex (incurred)	+L
(4, 5)	Dr	Cr

Amount to be adjusted for info 4: **$10\% \times 80,000 = 8,000$** (straight line method)

(1)	Depreciation on fixtures and fittings (<i>new!</i>)	Accumulated depreciation of fixtures and fittings
(2, 3)	+Ex	+contra-A (-A)
(4, 5)	Dr	Cr

Amount to be adjusted for info 4: **$20\% \times (56,000 - 20,160) = 7,168$** (reducing balance method)

(1)	Depreciation expense on motor vehicles (<i>new!</i>)	Accumulated depreciation of motor vehicles
(2, 3)	+Ex	+contra-A (-A)
(4, 5)	Dr	Cr

Amount to be adjusted for info 5: **\$1,500**

(1)	Trade receivables	Allowance for impairment of trade receivables
(2, 3)	-A	-contra-A (+A)
(4, 5)	Cr	Dr

After a customer went bankrupt and \$1,500 debts was written off from the estimated amount of debts likely to be uncollectible, the business can still tolerate \$2,900 debts to be uncollectible (which is within its expectations).

Start	Write-off	Adjust	End
4,400	- 1,500	2,816 – 2,900	2% X (142,300 – 1,500)
4,400 – 1,500 = 2,900		= –84 (decrease)	= 2,816

However, it estimated less \$ may not be collectible next year (good sign) → decreased from \$2,900 (allowance after write-off) to \$2,816 (end).

Amount to be adjusted for info 6: **\$84**

(1)	Allowance for impairment of trade receivables	Impairment loss on trade receivables (new!)
(2, 3)	-contra-A (+A)	-Ex (shown as a reversal)
(4, 5)	Dr	Cr

Amount to be adjusted for info 7: **0.20 X 100,000 = 20,000**

(1)	Dividends (new!)	Dividends payable (new!)
(2, 3)	+D	+L
(4, 5)	Dr	Cr

Step 4: Take note of new accounts arising from the additional information.

↓ Use your own abbreviations to save space.

(new!)

CA	PP ins ex	300	-Ex	Rev of imp loss on TR	84
CL	Int exP	1,400	Ex	Dep on OEq	1,275
Ex	Dep on F&F	8,000	D	Div	20,000
Ex	Dep on MV	7,168	CL	Div P	20,000

Step 5: Transfer relevant working (step 2-3) into both statements

Kang Wei Company
Statement of Financial Performance for the year ended 31 March 2017

	\$	\$
Sales revenue	712 300	
Less: Sales returns	10 400	
Net sales revenue		701 900
Less: Cost of sales		291 300
Gross profit		410 600
Other income		
Discount received	900	
Rent income	1 200	2 100
Less: Other expenses		
General expenses	60 000	
Salaries expense	79 860	
Insurance expense (5 000 – 300)	4 700	
Interest on loan (8% X 50 000)	4 000	
Depreciation on fixtures and fittings (10% X 80 000)	8 000	
Depreciation on motor vehicles 20% X (56 000 – 20 160)	7 168	
Reversal of impairment loss on trade receivables (2% X 140 800) – (4 400 – 1 500)	(84)	163 644
Profit for the year		249 056

Step 6: Transfer profit/loss for the year to calculate ending retained earnings
 Ensure total assets = total equity and liabilities

Kang Wei Company
 Statement of Financial Position as at 31 March 2017

Assets	\$	\$	\$
<u>Non-current assets</u>	Cost	Accumulated depreciation	Net book value
Land and property	250 000	-	250 000
Fixtures and fittings	80 000	32 000 (24 000 + 8 000)	48 000
Motor vehicles	56 000	27 328 (20 160 + 7 168)	28 675
			326 672
<u>Current assets</u>			
Inventory (62 400 + 3 500)		65 900	
Trade receivables (142 300 – 1 500)	140 800		
Less: Allowance for impairment of trade receivables (2% X 140 800)	2 816	137 984	
Cash at bank		54 100	
Prepaid insurance expense (1 200 / 12 X 3)		300	258 284
Total assets			584 956
Equity and Liabilities			
<u>Shareholders' equity</u>			
Share capital, 100 000 ordinary shares		200 000	
Retained earnings (56 000 + 249 056 – 20 000)		285 056	485 056
<u>Non-current liabilities</u>			
Long-term borrowings			50 000
<u>Current liabilities</u>			
Trade payables (25 000 + 3 500)		28 500	
Interest payable (4 000 – 2 600)		1 400	
Dividends payable (0.2 X 100 000)		20 000	49 900
Total equity and liabilities			584 956

Chapter 6 Revenue and Other Income

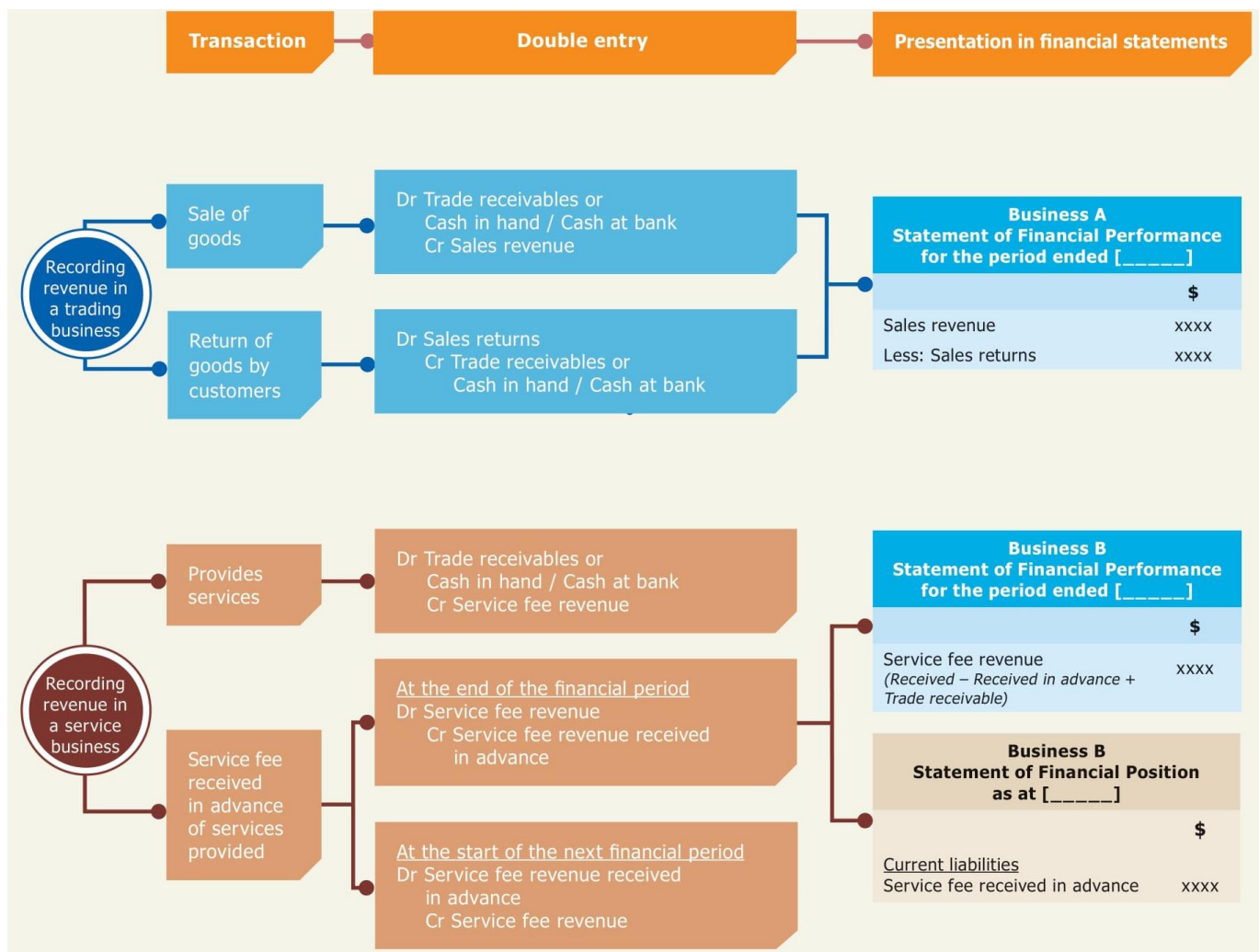
6.1 Income

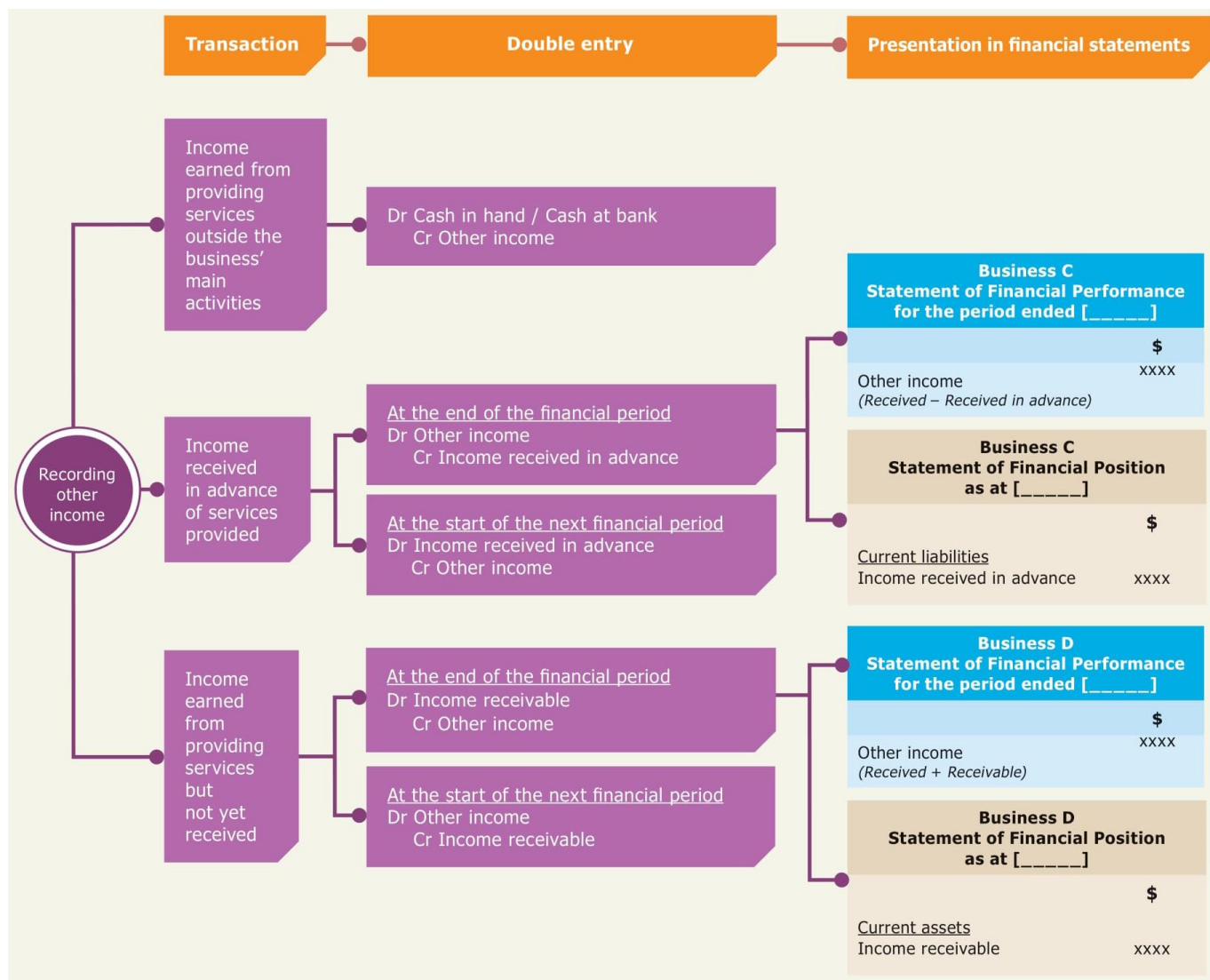
6.2 Accounting for Revenue

6.3 Accounting for Other Income

6.4 Presentation of Income

[TB Pg 105 to 106] Summary





Income	<p>1. Explain the difference between revenue and other income.</p> <p>Revenue refers to amounts earned through the main activities of the business while other income refers to amounts earned from business activities other than the main business activity.</p>
--------	--

Record transactions	Account to be debited	Account to be credited
Sale of goods / services <ul style="list-style-type: none"> • on credit • received cheque 	Trade receivables / Cash at bank +A	Sales revenue / Service fee revenue +I
Return of goods by credit customers <ul style="list-style-type: none"> • previously sold on credit • refund cheque 	Sales returns -I	Trade receivables / Cash at bank -A

Time of the year		Account to be debited	Account to be credited
Start	Reverse income received in advance adjusted in the <u>previous FY</u>	Service fee revenue / Income received in advance (-L) (provide the service owed last FY)	Income (+I) (earned i.e. provide the service this FY)
During / End	Receive cheques for other income	Cash at bank (+A)	Income (+I)
End	Adjust income received in advance and report in statement of financial <u>position</u>	Income (-I) (NOT earned i.e. did not provide service this FY)	Service fee revenue / Income received in advance (+L) (owe a service to be provided in the next FY)
End	Close / Transfer other income <u>earned</u> for the year to statement of financial <u>performance</u>	Income (-I)	Income summary (abbreviation for statement of financial performance)

[TB Pg 95] Table 6.4

Service fee revenue / Income Received in Advance	Effect on Service Fee Revenue	Effect on Profit	Effect on Current Liability
Not adjusted	Overstates	Overstates	Understates
Correctly adjusted	Decreases	Decreases	Increases

Time of the year		Account to be debited	Account to be credited
Start	Reverse income receivable adjusted in the <u>previous FY</u>	Income (-I) (NOT earned i.e. provided service last FY)	Income receivable (-A) (collect payment this FY)
During / End	Receive cheques for other income	Cash at bank (+A)	Income (+I)
End	Adjust income receivable and report in statement of financial <u>position</u>	Income receivable (+A) (payment to be collected in the next FY)	Income (+I) (earned i.e. provided service this FY)
End	Close / Transfer other income <u>earned</u> for the year to statement of financial <u>performance</u>	Income (-I)	Income summary (abbreviation for statement of financial performance)

[TB Pg 100] Table 6.9

Other Income Receivable	Effect on Other Income	Effect on Profit	Effect on Current Asset
Not adjusted	Understates	Understates	Understates
Correctly adjusted	Increases	Increases	Increases

[WB Pg 70] Q7

Wholesome Wholesaler's financial year ends on 30 June. For the financial year ended 30 June 20X2, the following information for the rental income account was extracted.

On 1 July 20X1, the rental income received in advance account had a balance of \$1,800. During the year, the business received a cheque of \$72,900 for rental income. Annual rental income for the year ended 30 June 20X2 amounted to \$75,000. (alternate phrasing: Rental income earned for the year was \$75,000.)

Prepare the journal entries to account for the rental income for the financial year ended 30 June 20X2, including the closing entry. Narrations are **not** required.

Reverse IRIA	Receive cheques for income	Adjust IR / IRIA * (position)	Close / Transfer income <u>earned</u> (performance)
(1 Jul 20X1) +1,800	+72,900	x	(30 Jun 20X2) 75,000

Note:

- Let the amount to be adjusted be $\$x$ and **solve** the linear equation.
- If the amount to be adjusted is positive, it means that the income has been earned
→ adjust for income receivable.
- If the amount to be adjusted is negative, it means that the income has **not** been earned
→ adjust for income received in advance.

$$1,800 + 72,900 + x = 75,000$$

$$x = 75,000 - 1,800 - 72,900$$

$$= \underline{\underline{300 \text{ (earned } \rightarrow \text{ IR)}}}$$

Journal

	Date	Particulars	Debit	Credit
	20X1		\$	\$
Reverse	Jul 1	Rental income received in advance	1,800	
(start)		Rental income		1,800
	20X2			
Receive	Jun 30	Cash at bank	72,900	
(end)		Rental income		72,900
Adjust	30	Rental income receivable	300	
(end)		Rental income		300
Close	30	Rental income	75,000	
(end)		Income summary		75,000

Explain the effects on profit for the year and current assets if the rental income was **not adjusted at the end of the year**.

If rental income receivable of \$300 was not adjusted,

- rental income will be understated by \$300, causing profit for the year to be understated by \$300
- current assets will be understated by \$300

Explain the effects of **adjusting** rental income **at the end of the year** on profit for the year and current assets.

After rental income receivable of \$300 was adjusted,

- rental income will increase by \$300, causing profit for the year to increase by \$300
- current assets will increase by \$300

[WB Pg 72] Q10

Monica Bloom sells flower bouquets. Occasionally, it hosts events in its premises.

	1 Jan 20X3	31 Dec 20X3
	\$	\$
Hosting fee income receivable	700	
Hosting fee income received in advance		150

During the year, the business received electronic transfers amounting to \$1,600 for hosting fee.

Prepare the journal entries to account for the hosting fee income for the year ended 31 December 20X3, including the closing entry. Narrations are **not** required.

Reverse IR	Receive cheques for income	Adjust IRIA (position)	Close / Transfer income <u>earned</u> (performance)
(1 Jan 20X3) -700	+1,600	-150	(31 Dec 20X3) - 700 + 1,600 - 150 = <u>750</u>

Journal

	Date	Particulars	Debit	Credit
	20X3		\$	\$
Reverse	Jan 1	Hosting fee income	700	
(start)		Hosting fee income receivable		700
Receive	Dec 31	Cash at bank	1,600	
(end)		Hosting fee income		1,600
Adjust	31	Hosting fee income	150	
(end)		Hosting fee income received in advance		150
Close	31	Hosting fee income	750	
(end)		Income summary		750

Explain the effects on profit for the year and current assets if the hosting fee income receivable was **not reversed at the beginning of the year**.

After hosting fee income receivable of \$700 was not reversed,

- hosting fee income will be overstated by \$700, causing profit for the year to overstated by \$700
- current assets will be overstated by \$700

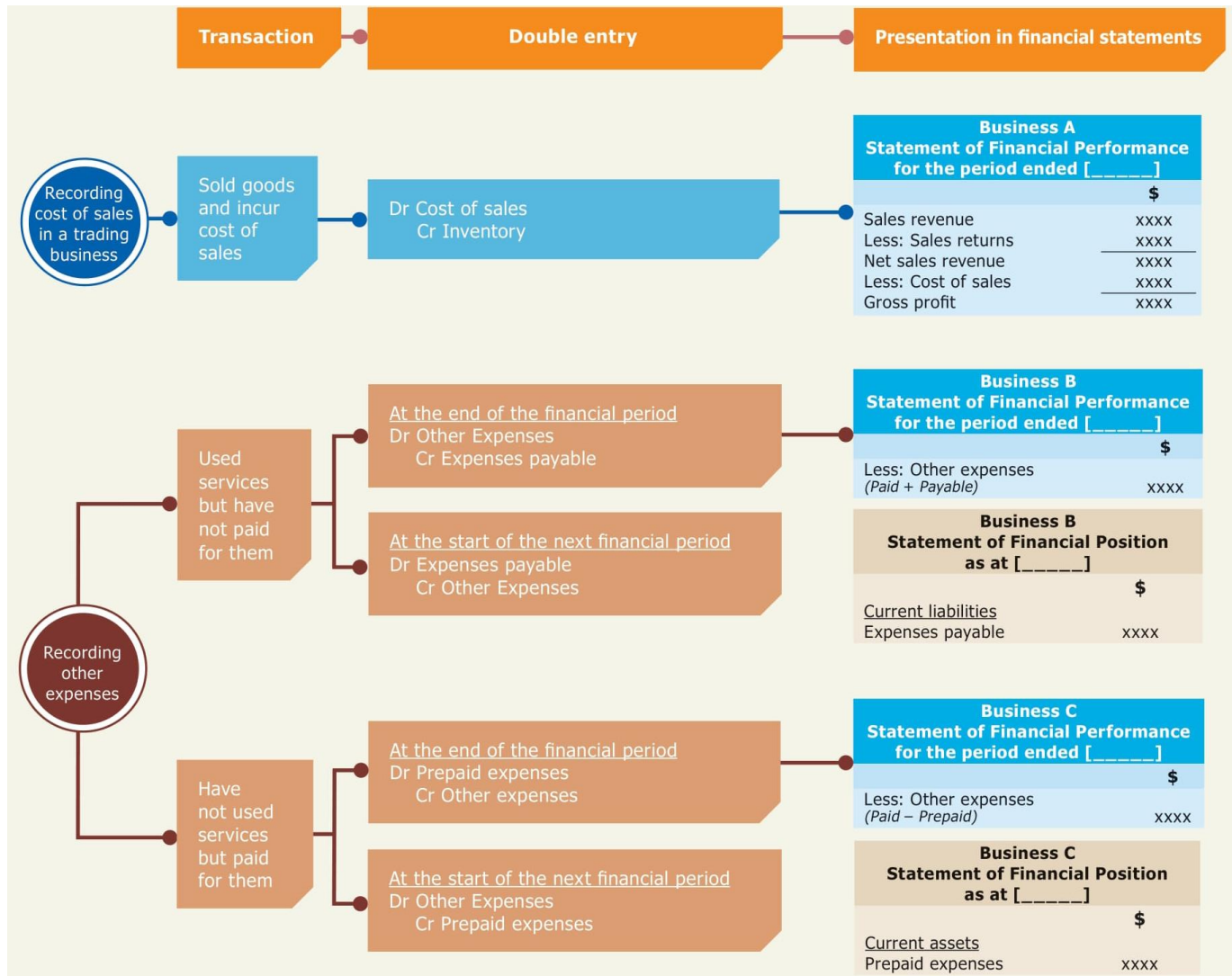
Chapter 7 Cost of Sales and Other Expenses

7.1 Expenses

7.2 Accounting for Expenses

7.3 Presentation of Expenses

[TB Pg 120] Summary



Expenses	<p>1. Explain the difference between cost of sales and other expenses.</p> <p>Cost of sales refer to the total cost price of goods that have been sold while other expenses refer to costs incurred in the operation of a business.</p>
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Ch 7 Notes

Cost of sales and other expenses

Record transactions	Account to be debited	Account to be credited
Cost price of goods sold (to customers)	Cost of sales +Ex	Inventory -A
Cost price of goods returned (by customers)	Inventory +A	Cost of sales -Ex

Time of the year		Account to be debited	Account to be credited
Start	Reverse expense payables adjusted in the <u>previous FY</u>	Expense payable (-L) (paid amount owed this FY)	Expense (-Ex) (NOT incurred i.e. used the service last FY)
During / End	Paid cheques for other expenses	Expense (+Ex)	Cash at bank (-A)
End	Adjust expense payables and report in statement of financial <u>position</u>	Expense (+Ex) (incurred i.e. used the service this FY)	Expense payable (+L) (owe payment to be settled in the next FY)
End	Close / Transfer other expenses <u>incurred</u> for the year to statement of financial <u>performance</u>	Income summary (abbreviation for statement of financial performance)	Expense (-Ex)

[TB Pg 113] Table 7.4

Expenses Payable	Effect on Expenses	Effect on Profit	Effect on Current Liability
Not adjusted	Understates	Overstates	Understates
Correctly adjusted	Increases	Decreases	Increases

Time of the year		Account to be debited	Account to be credited
Start	Reverse prepaid expense adjusted in the <u>previous FY</u>	Expense (+Ex) (NOT incurred i.e. has not used the service this FY)	Prepaid expense (-A) (service to be used in the next FY)
During / End	Paid cheques for other expenses	Expense (+Ex)	Cash at bank (-A)
End	Adjust prepaid expense and report in statement of financial <u>position</u>	Prepaid expense (+A) (service to be used in the next FY)	Expense (-Ex) (NOT incurred i.e. has not used the service this FY)
End	Close / Transfer other expenses <u>incurred</u> for the year to statement of financial <u>performance</u>	Income summary (abbreviation for statement of financial performance)	Expense (-Ex)

[TB Pg 116] Table 7.6

Prepaid Expenses	Effect on Expenses	Effect on Profit	Effect on Current Asset
Not adjusted	Overstates	Understates	Understates
Correctly adjusted	Decreases	Increases	Increases

[WB Pg 83] Q1a, d (modified)

Restful Spa's financial year ends on 31 May. The following information was extracted from the books of the business in relation to the insurance account for the year ended 31 May 20X2.

On 1 June 20X1, Restful Spa's prepaid insurance account had a balance of \$2,000.

Restful Spa's insurance per month is \$2,000.

As at 31 May 20X2, \$26,000 has been paid for insurance.

Prepare the journal entries to account for insurance expense for the year ended 31 May 20X2, including the closing entry. Narrations are **not** required.

Reverse PPex	Paid cheques for expenses	Adjust PPex / exp* (position)	Close / Transfer expense <u>incurred</u> (performance)
(1 Jul 20X3) +2,000	+26,000	x	(30 Jun 20X4) 2,000 X 12 = 24,000

Note:

- Let the amount to be adjusted be \$ x and **solve** the linear equation.
- If the amount to be adjusted is positive, it means that the expense has been incurred
→ adjust for expense payable.
- If the amount to be adjusted is negative, it means that the expense has **not** been incurred
→ adjust for prepaid expense.

$$2,000 + 26,000 + x = 2,000 \times 12$$

$$x = 24,000 - 2,000 - 26,000$$

$$= \underline{\underline{-4,000 \text{ (not incurred} \rightarrow \text{PPex)}}}$$

Journal

	Date	Particulars	Debit	Credit
	20X7		\$	\$
Reverse	Jul 1	Insurance expense	2,000	
(start)		Prepaid insurance expense		2,000
	20X8			
Paid	Jun 30	Insurance expense	26,000	
(end)		Cash at bank		26,000
Adjust	30	Prepaid insurance expense	4,000	
(end)		Insurance expense		4,000
Close	30	Income summary	24,000	
(end)		Insurance expense		24,000

Ch 7 Notes

Cost of sales and other expenses

Explain the effects on profit for the year and current assets if prepaid insurance expense was **not reversed at the beginning of the year**.

If prepaid insurance expense of \$2,000 was not reversed,

- insurance expense will be understated by \$2,000, causing profit for the year to be overstated by \$2,000
- current assets will be overstated by \$4,000

Explain the effects of **adjusting** insurance expense **at the end of the year** on profit for the year and current assets.

After prepaid insurance expense of \$4,000 was adjusted,

- insurance expense will decrease by \$4,000, causing profit for the year to increase by \$4,000
- current assets will increase by \$4,000

[WB Pg 85] Q5a, d

Low Heel Trading's financial year ends on 30 June.

The owner of the business, Nancy, provided the following balances:

	1 Jul 20X7
	\$
Salaries expense payable	3,600

During the year ended 30 June 20X8, a \$59,600 cheque for salaries was issued.

The annual salaries expense amounted to \$60,000 for the year ended 30 June 20X8.

(alternate phrasing: Total salaries expense incurred for the year was \$60,000.)

Prepare the journal entries to account for salaries expense for the year ended 30 June 20X8. including the closing entry. Narrations are **not** required.

Reverse exP	Paid cheques for expenses	Adjust PPex / exP* (position)	Close / Transfer expense <u>incurred</u> (performance)
(1 Jul 20X3) -3,600	+59,600	x	(30 Jun 20X4) 60,000

$$- 3,600 + 59,600 + x = 60,000$$

$$x = 60,000 + 3,600 - 59,600$$

$$= \underline{\underline{4,000 \text{ (incurred} \rightarrow \text{expense payable)}}}$$

Journal

	Date	Particulars	Debit	Credit
	20X7		\$	\$
Reverse	Jul 1	Salaries expense payable	3,600	
(start)		Salaries expense		3,600
	20X8			
Paid	Jun 30	Salaries expense	59,600	
(end)		Cash at bank		59,600
Adjust	30	Salaries expense	4,000	
(end)		Salaries expense payable		4,000
Close	30	Income summary	60,000	
(end)		Salaries expense		60,000

Explain the effects on profit for the year and current liabilities if the salaries expense was **not adjusted at the end of the year**.

If salaries expense payable of \$4,000 was not adjusted,

- salaries expense will be understated by \$4,000, causing profit for the year to be overstated by \$4,000
- current liabilities will be understated by \$4,000

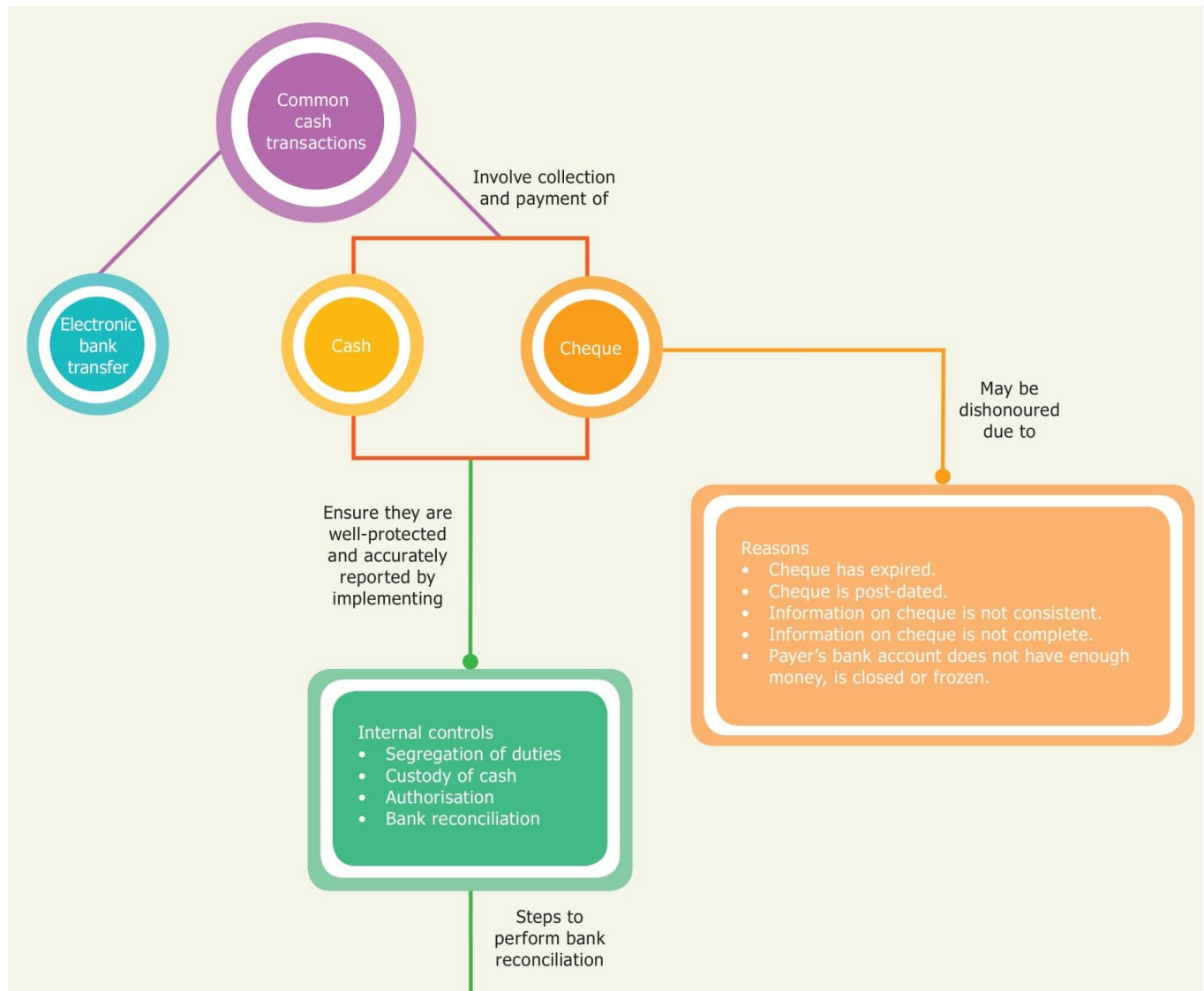
Chapter 8 Cash

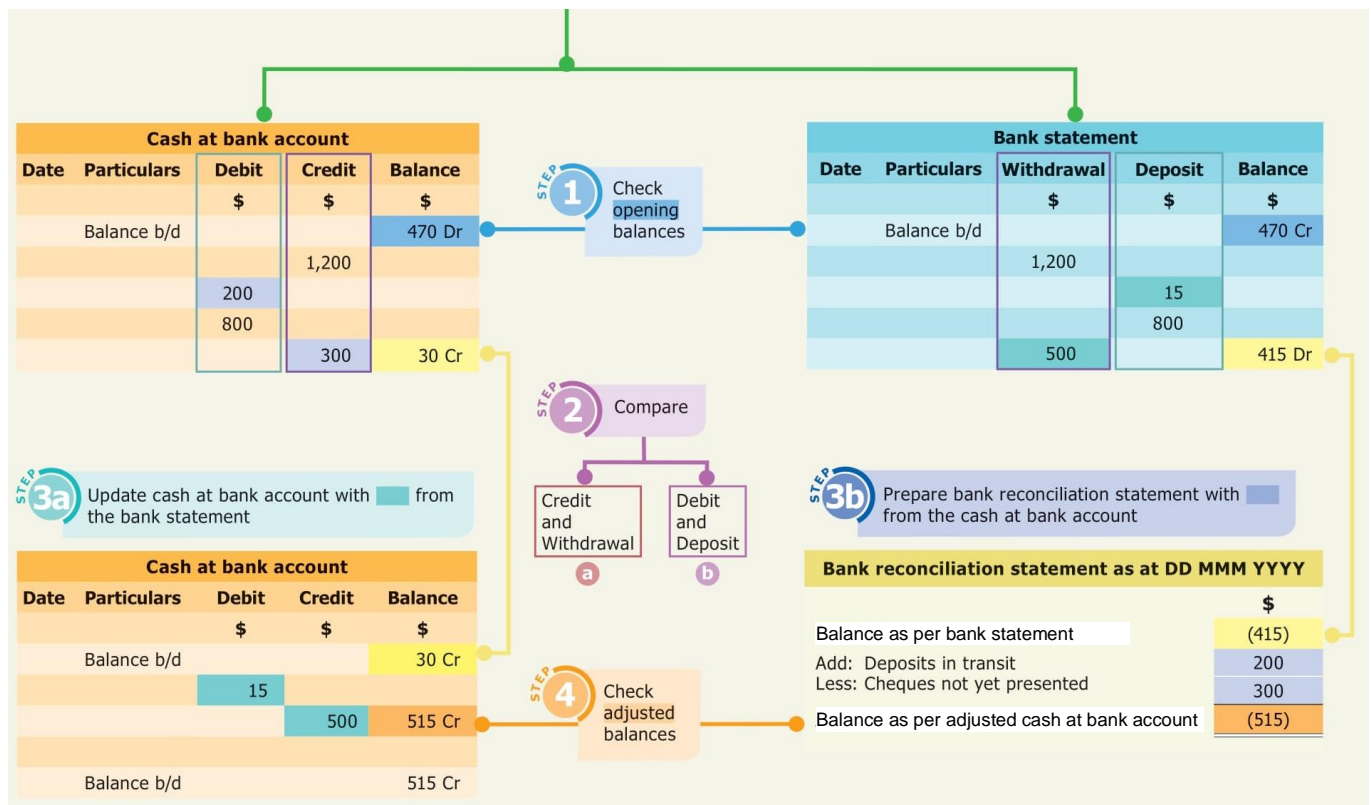
8.1 Cash

8.3 Purposes of Internal Controls

8.4 Bank Reconciliation

[TB Pg 142 to 143] Summary





Dishonoured cheque	<p>1. State two reasons why a cheque would be returned by the bank as dishonoured.</p> <p>TB Pg 125</p> <p>Reasons for dishonoured cheque:</p> <ul style="list-style-type: none"> Cheque has expired - It was dated six months ago and is now no longer valid Cheque is post-dated - It was written for a future date and the bank will only pay on or after that date Information on cheque is not consistent - Amount written in numbers does not match amount written in words Information on cheque is not complete - There is no date, amount to be paid or signature. Payer's bank account does not have enough money
Internal controls	<p>2. Explain why internal controls are needed to protect cash.</p> <p>TB Pg 130</p> <p>As cash is highly portable, it has a high chance of getting stolen. Internal controls are needed to reduce the possibility of theft or the likelihood of error in order to ensure that cash is well-protected and accurately reported.</p>

	<p>3. Name and explain two types of internal controls over cash.</p> <p>TB Pg 131 Table 8.5</p> <ul style="list-style-type: none"> • Segregation of duties - Separate cash handling and cash recording duties among different employees so that no single person has control over the entire cash process • Custody of cash - Secure cash and cheques in a locked storage: • Authorisation - Obtain proper approvals for all payments from authorised personnel • Bank reconciliation - Compare the business' records with the bank's records to identify items that caused the differences between the ending balances in the business cash at bank account and the bank statement
Bank reconciliation	<p>4. State two reasons for preparing a bank reconciliation statements.</p> <ul style="list-style-type: none"> • To identify items that caused the differences between the ending balances in the business cash at bank account and the bank statement • To detect errors, discrepancies, or irregularities on time and reduce the possibility of cash being misappropriated <p>5. State two types of item paid or received directly through the bank for which a bank statement may be used as proof.</p> <p>TB Pg 134 Table 8.6</p> <ul style="list-style-type: none"> • Direct deposits – credit transfer, interest on deposit • Direct payment – standing order, bank charges, interest on loan • Dishonoured cheque <p>6. Name three items which cause the difference between the ending balances of a bank statement and business' cash at bank account.</p> <p>TB Pg 134 Table 8.6</p> <ul style="list-style-type: none"> • Direct deposits – credit transfer, interest on deposit • Direct payment – standing order, bank charges, interest on loan • Cheques not yet presented • Deposits in transit • Dishonoured cheque • Errors made by the business and/or bank

[TB Pg 134] Table 8.6

Timing Differences	Examples	Has the Business Recorded?	Has the Bank Recorded?
Direct deposits	The customer deposits cash or cheques with the bank directly or transfers funds directly into the business bank account through a credit transfer .	X	✓
	The bank pays interest on deposits directly into the business bank account.	X	✓
Direct payments	The bank has been authorised by the business via a standing order to pay and transfer funds directly to its suppliers' bank account.	X	✓
	The bank deducts bank charges , interest on overdraft and interest on loans directly from the business bank account.	X	✓
Cheques not yet presented	The business has issued a cheque to its supplier but the supplier has not presented the cheque to the bank for payment yet.	✓	X
Deposits in transit	The business has deposited the cheque with the bank but the bank has not processed the cheque yet.	✓	X
Dishonoured cheques	The bank rejects a cheque that the business has previously deposited.	X	✓

Record transactions	Account to be debited	Account to be credited
Obtain loan	Cash at bank +A	Loan +L
Repayment of loan	Loan -L	Cash at bank -A

Record transactions	Account to be debited	Account to be credited
Purchase of goods using cheque	Inventory +A	Cash at bank -A
Return of goods to suppliers and was refunded cheque	Cash at bank +A	Inventory -A
Payment to credit suppliers	Trade payable -L	Cash in hand / Cash at bank -A
Sale of goods and received cheque	Cash at bank +A	Sales revenue +I
Return of goods by customers and refund cheque	Sales returns -I	Cash in hand / Cash at bank -A
Collections from credit customers	Cash at bank +A	Trade receivables -A
Dishonoured cheque	Trade receivables +A	Cash at bank -A
Withdrew from bank as office cash	Cash in hand +A	Cash at bank -A
Deposit excess cash into bank	Cash at bank +A	Cash in hand -A
Contribution of personal cheque from owner	Cash at bank +A	Capital +C
Withdrawal of business cheque by owner for own use	Drawings +D	Cash at bank -A
Contribution from shareholders [O]	Cash at bank +A	Share capital +C
Declared dividends and paid immediately [O]	Dividends +D	Cash at bank -A

6 steps to perform bank reconciliation

- 1 Label and compare the **corresponding** columns in cash at bank account (Debit / Credit) and bank statement (Withdrawal / Deposit) and **circle** the differences
 - (+) Debit / Deposit
 - (-) Credit / Withdrawal
- 2 **BE CAREFUL!** If the opening balances are **different** Δ , calculate the amount of difference and **ignore** **X** this amount from subsequent adjustments.
- 3 **CORRECT ERROR!** If the accountant made a mistake in the cash at bank account on a specific date, compare the wrong amount in the cash at bank account against correct amount in the bank statement.

Wrong amount in the CAB (Credit) Example 1	Amount to adjust in the CAB (Credit) to correct the error	Correct amount in the bank statement (Withdrawal)
- 706	- 54	- 760

Wrong amount in the CAB (Debit) Example 2	Amount to adjust in the CAB (Debit) to correct the error	Correct amount in the bank statement (Deposit)
+ 706	+ 54	+ 760

Wrong amount in the CAB (Credit) Example 3	Amount to adjust in the CAB (Debit) to correct the error	Correct amount in the bank statement (Deposit)
- 706	+ 1,412	+ 706

- 4 Starting with the **ending** balance in the cash at bank account (Balance b/d), adjust using the circles inside the bank statement at the **end** of the month.
 - (+) Deposit → Debit (**Trade receivable, income**)
 - (-) Withdrawal → Credit (**Trade payable, expense**) **Exception: Trade receivable**
(dishonoured / rejected cheque)
- 5 Starting with the **ending** balance in the bank statement (Balance as per bank statement), prepare a bank reconciliation statement using the circles inside the cash at bank account.
 - (+) Debit → Add: Deposits in transit
 - (-) Credit → Less: Cheques not yet presented
 - If there is more than one item, write the value in the **inner** column and calculate the sub-total in the **outer** column.
- 6 Ensure that the ending balances in the adjusted cash at bank account and bank reconciliation statement is the **same**.
 - Balance b/d (next month)
 - Balance as per adjusted cash at bank account

WB Pg 104 Q4

The following cash at bank account was extracted from Rosella Supplies' accounts for October 20X6.

Cash at bank account (A)					
Date	Particulars	Cheque	Debit	Credit	Balance
20X6			\$ (+)	\$ (-)	\$
Oct 1	Balance b/d				1,300 Dr
5	Danny Store	20513		X 706	594 Dr
8	Sales revenue		500		1,094 Dr
10	Sebastian	20514		400	694 Dr
19	Insurance expense	20515		1,100	406 Cr
21	Wei Ling Holdings		600		194 Dr
24	Benji	20516		826	632 Cr
28	Sales revenue		340		292 Cr
30	Allen Provisions		900		608 Dr
31	Jaslyn Retail	20517		640	32 Cr
Nov 1	Balance b/d				32 Cr

△ Amount to adjust to correct error:
 -54
 $-706 \rightarrow -760$
 (X) (✓)

(Oct 31) Balance b/d

Use the circles in bank statement to adjust CAB

The bank statement received for October 20X6 was as follows.

Bank statement				
Date	Particulars	Withdrawal	Deposit	Balance
20X6		(Dr) \$ (-)	(Cr) \$ (+)	\$
Oct 1	Balance b/d			1,500 Cr
4	Credit transfer: Louis Retail		700	2,200 Cr
8	Cash		500	2,700 Cr
8	Cheque: 20511	△ Ignore 280		2,500 Cr
10	Cheque: 20513	✓ 760		1,740 Cr
17	Cheque: 20514	400		1,340 Cr
19	Direct payments: Utilities	800		540 Cr
25	Cheque: 20515	1,100		560 Dr
27	Cheque deposit		600	40 Dr
28	Cheque deposit		340	380 Cr
30	Rejected cheque (27 October)	600		220 Dr
31	Interest charges	20		240 Dr

△ Amount of difference (opening balances):
 $1,500 - 1,300 = 200$

Use the circles in CAB to prepare bank reconciliation statement

Additional information:

It was discovered that the **accountant** of Rosella Supplies had incorrectly recorded the transaction on **5 October**.

Balance as per bank statement

Cr → Positive

Dr → Negative (add bracket)
 e.g. (2,613)

Wrong amount in the CAB	Amount to adjust in the CAB to correct the error	Correct amount in the bank statement
5 Oct Cheque 20513 (Credit) -706	x $-706 + x = -760$ $x = -760 + 706$ $= -54 \text{ (credit)}$	10 Oct Cheque 20513 (Withdrawal) -760

(a) Prepare the adjusted the cash at bank account for October 20X6.

Cash at bank (A)				
Date	Particulars	Debit	Credit	Balance
20X6		\$ (+)	\$ (-)	\$
Oct 31	Balance b/d			32 Cr
31	Trade receivable – Louis Retail	700		
31	Utilities expense		800	
31	Trade receivable – Wei Ling Holdings		600	
31	Interest expense		20	
31	Trade payable – Danny Store		54	806 Cr
Nov 1	Balance b/d			806 Cr

(b) Prepare the bank reconciliation statement as at 31 October 20X6.

Rosella Supplies Bank reconciliation statement as at 31 October 20X6		
	\$ (inner)	\$ (outer)
Balance as per bank statement		(240)
Add: Deposits in transit		
Allen Provisions		900
Less: Cheques not yet presented		
Benji	826	
Jaslyn Retail	640	1,466
Balance as per adjusted cash at bank account		<u>(806)</u>

(c) State the cash at bank balance presented in the statement of financial position as at 31 October 20X6.

\$806 bank overdraft

(d) State the effects of bank reconciliation adjustments on profit for the period ended 31 October 20X6. (refer to adjusted cash at bank account)

After the bank reconciliation adjustments, expenses increase by \$820 (800 + 20).

Hence, profit for the period decreases by \$820.

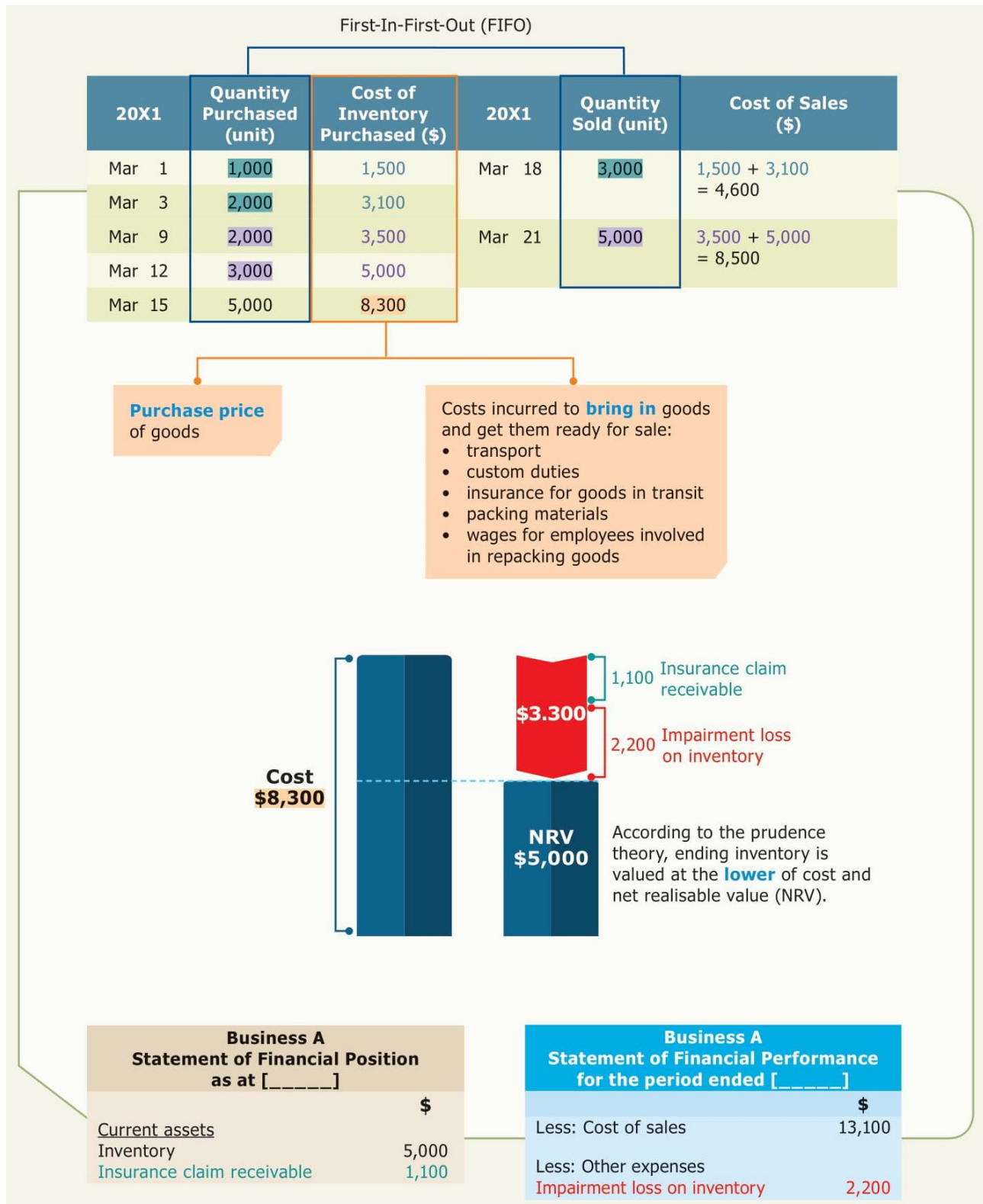
Chapter 9 Inventories

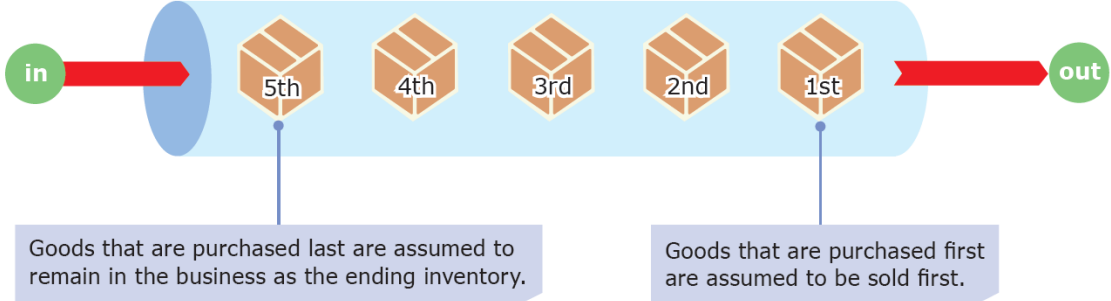
9.1 Inventories

9.3 Accounting for Inventories

9.4 Accounting for Impairment Loss on Inventory

[TB Pg 164] Summary



Valuation	<p>1 State how ending inventory must be valued in the financial statements.</p> <p>Inventory is valued at the lower of cost and net realisable value.</p>
FIFO	<p>2 Explain what is meant by the FIFO method of inventory valuation.</p> <p>TB Pg 155 First-In-First-Out (FIFO) method assumed that goods which are purchased first are sold first. Hence, goods that are purchased last are assumed to remain in the business as the ending inventory.</p> 
Impairment loss on inventory	<p>3 Explain what is meant by net realisable value.</p> <p>TB Pg 159 Net realisable value refers to the selling price of the inventory less the additional cost to sell the inventory.</p>
Cost of inventory purchased	<p>Purchase price + Other costs incurred to bring in goods</p> <p>Transport (e.g. shipping, air freight), custom duties / import tax, insurance on goods in transit, packing materials, wages for employees to repack goods</p>
Impairment loss on inventory	<p>Cost – Net realisable value – Insurance claim receivable</p>

Record transactions	Account to be debited	Account to be credited
Purchase of goods <ul style="list-style-type: none"> on credit using cash / cheque 	Inventory +A	Trade payable +L
		Cash in hand / Cash at bank -A
Return of goods to credit suppliers <ul style="list-style-type: none"> previously purchased on credit refund cash / cheque 	Trade payable -L	Inventory -A
	Cash in hand / Cash at bank +A	
Cost price of goods sold (to customers)	Cost of sales +Ex	Inventory -A
Cost price of goods returned (by customers)	Inventory +A	Cost of sales -Ex

Adjust accounts	Account to be debited	Account to be credited
Net realisable value of goods falls below cost	Impairment loss on inventory +Ex	Inventory -A
Insurance claim on damaged goods	Insurance claim receivable +A	Impairment loss on inventory -Ex
Collection of insurance claim	Cash in hand / Cash at bank +A	Insurance claim receivable -A

[TB Pg 162] Table 9.5

Impairment Loss on Inventory	Effect on Other Expenses	Effect on Profit	Effect on Current Asset
Not adjusted	Understates	Overstates	Overstates
Adjusted	Increases	Decreases	Decreases

ATT buys and sells handphones and uses the FIFO method of inventory valuation.

	Quantity	\$
Sales revenue for the year ended 31 July 2015 (alternate phrasing: During the year ended 31 July 2015, ATT sold 550 handphones at \$500 each.)	550	275 000
Inventory on 1 August 2014 (alternate phrasing: On 1 August 2014, the inventory has a balance of 400 handphones valued at \$2 000.)	400	2 000

The business bought additional goods during the year:

Date	Quantity	Cost of inventory purchased	Mode of payment
2014		\$	
Oct 11	20	9 000	Cheque
Dec 14	30	11 000	On credit
2015			
Jan 30	10	2 000	Cash
May 21	90	28 000	On credit
Jul 10	30	13 500	On credit
Jul 20	10	4 500	Owner's personal cheque

(a) Calculate the cost of sales for the year ended 31 July 2015.

$$(\text{Quantity}) 550 = 400 (\text{beginning}) + 20 + 30 + 10 + 90$$

$$\begin{aligned} \text{Cost of sales} &= 2,000 + 9,000 + 11,000 + 2,000 + 28,000 \\ &= \underline{51,000} \end{aligned}$$

(b) Calculate the value of inventory at 31 July 2015.

$$(\text{unsold / remaining}) 13,500 + 4,500 = \underline{18,000}$$

(c) Calculate the gross profit for the year ended 31 July 2015.

$$\begin{aligned} \text{Gross profit} &= \text{Net sales revenue} - \text{Cost of sales} \\ &= 275,000 - 51,000 \\ &= \underline{224,000} \end{aligned}$$

- (d) Prepare the inventory account to record the above transactions. Bring down the balance to the next year.

Inventory (A)

Date	Particulars	Debit	Credit	Balance
2014		\$ (+)	\$ (-)	\$
Aug 1	Balance b/d			2,000 Dr
Oct 11	Cash at bank	9,000		
Dec 14	Trade payables	11,000		
2015				
Jan 30	Cash in hand	2,000		
May 21	Trade payables	28,000		
Jul 10	Trade payables	13,500		
Jul 20	Capital	4,500		
Jul 31	Cost of sales (from a)		51,000	18,000 Dr
Aug 1	Balance b/d			18,000 Dr

The net realisable value of ATT's inventory at 31 July 2015 was \$16,800.

- (e) State the ending inventory at 31 July 2015.

Cost (from b)	NRV
18 000	<u>16 800</u> (lower)

- (f) Prepare the journal entries to **adjust** the inventory on 31 July 2015. Narrations are required.

$$\begin{aligned}\text{Drop in value} &= 18,000 - 16,800 \\ &= 1,200\end{aligned}$$

Journal

Date	Particulars	Debit	Credit
2015		\$	\$
Jul 31	Impairment loss on inventory	1,200	
	Inventory		1,200
	Net realisable value has fallen below the cost by \$1,200.		

(g) State the effect on profit for the year and current assets if the inventory was not adjusted.

If inventory was not adjusted,

- Impairment loss on inventory will be **understated** by \$1,200, causing profit for the year to be **overstated** by \$1,200
- current assets will be **overstated** by \$1,200

(h) State the effect on profit for the year and current assets after the inventory has been adjusted.

After inventory has been adjusted,

- Impairment loss on inventory will **increase** by \$1,200 causing profit for the year to be **decrease** by \$1,200
- current assets will be **decrease** by \$1,200

On 31 July 2015, after the shop was closed, a fire broke out and inventory costing \$8,800 was destroyed. A partial insurance claim of \$1,800 would be collectible on 13 August 2015.

(i) Prepare the journal entries to adjust the inventory and record the partial insurance claim. Narrations are required.

Journal

Date	Particulars	Debit	Credit
2015		\$	\$
Jul 31	Impairment loss on inventory	8,800	
	Inventory		8,800
	Goods costing \$16,800 was destroyed / damaged.		
31	Insurance claim receivable	1,800	
	Impairment loss on inventory		1,800
	Insurance claim of \$1,800 was agreed.		

- (j) Prepare an extract of the statement of financial performance for the year ended 31 July 2015.

ATT

Statement of Financial Performance for the year ended 31 July 2015 (extract)

	\$
Net sales revenue	275,000
Less: Cost of sales	51,000
Gross profit	224,000
Less: Other expenses	
Impairment loss on inventory (1,200 + 8,800 – 1,800)	8,200

- (k) Prepare an extract of the statement of financial position as at 31 July 2015, showing only the current assets section.

ATT

Statement of Financial Position as at 31 July 2015 (extract)

<u>Current assets</u>	\$
Inventory (16,800 – 8,800)	8,000
Insurance claim receivable	1,800

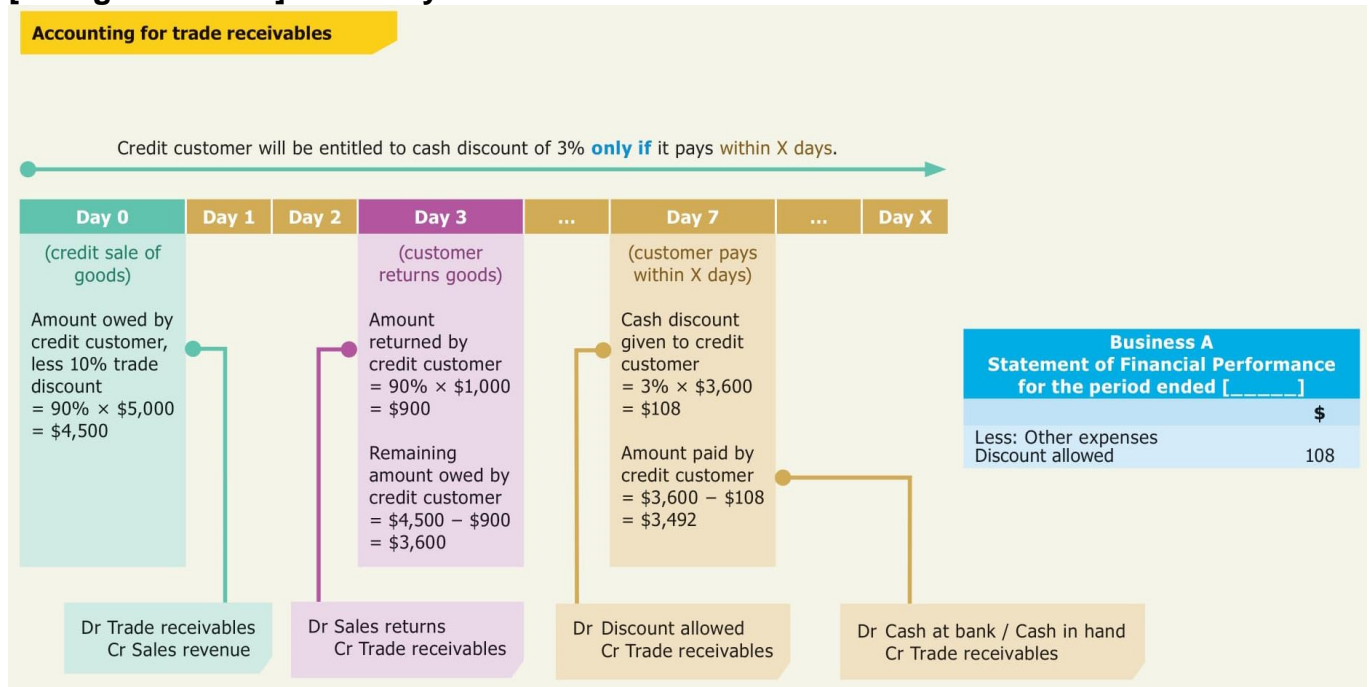
Chapter 10 Trade Receivables

10.1 Trade Receivables

10.3 Accounting for Trade Receivables

10.4 Accounting for Impairment Loss on Trade Receivables

[TB Pg 185 to 186] Summary



Record transactions	Account to be debited	Account to be credited
Sale of goods / services <ul style="list-style-type: none"> on credit 	Trade receivables +A	Sales revenue / Service fee revenue +I
Return of goods by credit customers <ul style="list-style-type: none"> previously sold on credit 	Sales returns -I	Trade receivables -A
Received cheque from credit customers	Cash at bank +A	Trade receivables -A
Gave cash discount to credit customers	Discount allowed +Ex	Trade receivables -A
Dishonoured cheque	Trade receivables +A	Cash at bank -A
Withdrew cash discount given previously	Trade receivables +A	Discount allowed -Ex

[TB Pg 173 to 175] Example 10.3c (modified)

Ch 10 Notes

Trade receivables

United Rice sold rice to CheapPrice Supermarket in August 20X8.

The balance of the trade receivable – CheapPrice Supermarket account as at 1 August 20X8 was \$1,000, which was invoiced on 30 July 20X8 (Day 0).

If CheapPrice Supermarket paid **within 10 days**, a 2% cash discount would be given.

20X1	Description of transaction
Aug 2	<u>Sold</u> rice to <u>CheapPrice Supermarket</u> at a list price of \$8,000 and provided 10% trade discount. The <u>cost</u> of the <u>rice</u> sold was \$4,000.
Aug 5	<u>CheapPrice Supermarket</u> <u>returned</u> rice, bought on 2 August, amounting to a list price of \$500. The <u>cost</u> of the <u>rice</u> returned was \$250.
Aug 9	<u>CheapPrice Supermarket</u> paid <u>cheque</u> to settle the outstanding balance on 1 August.
Aug 12	Informed by the bank that the <u>cheque</u> received from <u>CheapPrice Supermarket</u> was <u>dishonoured</u>

Prepare the trade receivable – CheapPrice Supermarket account for the month of August 20X8.

Selling price of goods sold on Aug 2: **90% X 8,000 = 7,200**

Keywords	<u>Sold</u>	<u>CheapPrice Supermarket</u>
(1)	<u>Sales revenue</u>	Trade receivable – CheapPrice Supermarket
(2, 3)	+I	+A
(4, 5)	Cr	<u>Dr</u>

Cost price of goods sold on Aug 2: **\$4,000**

Keywords	<u>cost</u>	<u>rice</u>
(1)	Cost of sales	Inventory
(2, 3)	+Ex (effect of Ex follow the effect of I)	-A
(4, 5)	Dr	Cr

Note: Cost of sales is always tagged to inventory (these two accounts are “attached”).

Ch 10 Notes

Trade receivables

Selling price of goods returned by **customer** on Aug 5: **90% X 500 = 450**

Keywords	<u>CheapPrice Supermarket</u>	<u>returned</u>
(1)	Trade receivable – CheapPrice Supermarket	<u>Sales returns</u>
(2, 3)	-A	I
(4, 5)	<u>Cr</u>	Dr

Cost price of goods returned on Aug 2: **\$250**

Keywords	<u>cost</u>	<u>rice</u>
(1)	Cost of sales	Inventory
(2, 3)	-Ex (effect of Ex follow the effect of I)	+A
(4, 5)	Cr	Dr

Note: Cost of sales is always tagged to inventory (these two accounts are “attached”).

Cash discount **given** to customer for Aug 9 (Day 9): **2% X 1,000 = 20**

met the criteria for cash discount (≤ 10 days)

Keywords	<u>CheapPrice Supermarket</u>	<u>cash discount</u>
(1)	Trade receivable – CheapPrice Supermarket	<u>Discount allowed</u>
(2, 3)	-A	+Ex
(4, 5)	<u>Cr</u>	Dr

Cheque amount received on Mar 11: **1,000 – 20 = 980**

Keywords	<u>CheapPrice Supermarket</u>	<u>cheque</u>
(1)	Trade receivable – CheapPrice Supermarket	<u>Cash at bank</u>
(2, 3)	-A	+A
(4, 5)	<u>Cr</u>	Dr

Ch 10 Notes

Trade receivables

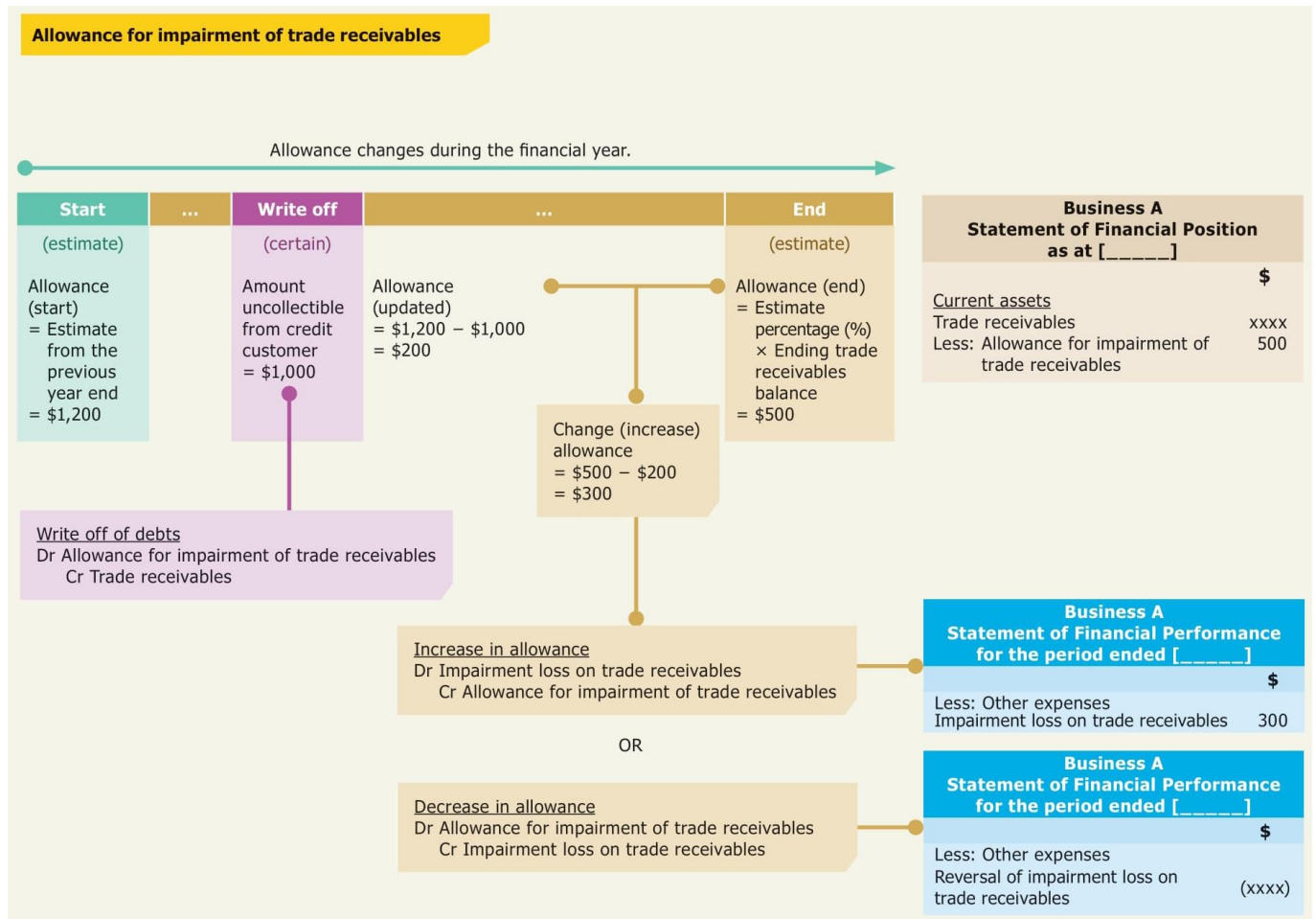
Cash discount withdrawn on Aug 12: **\$20 (reverse/ undo previous entry)**

Keywords	<u>CheapPrice Supermarket</u>	<u>cash discount</u>
(1)	Trade receivable – CheapPrice Supermarket	Discount allowed
(2, 3)	+A	-Ex
(4, 5)	<u>Dr</u>	Cr

Dishonoured cheque on Aug 12: **\$980 (reverse / undo previous entry)**

Keywords	<u>CheapPrice Supermarket</u>	<u>dishonoured cheque</u>
(1)	Trade receivable – CheapPrice Supermarket	Cash at bank
(2, 3)	+A	-A
(4, 5)	<u>Dr</u>	Cr

Trade receivable — CheapPrice Supermarket account (A)					
Date	Particulars	Debit	Credit	Balance	
20X8		\$ (+)	\$ (-)	\$	
Aug 1	Balance b/d			1,000 Dr	First ✓
2	Sales revenue	7,200		8,200 Dr	Optional
5	Sales returns		450	7,750 Dr	
9	Cash at bank		980	6,770 Dr	
9	Discount allowed		20	6,750 Dr	
12	Cash at bank	980			Last ✓
12	Discount allowed	20		7,750 Dr	
				↓	
Sep 1	Balance b/d			7,750 Dr	Next ✓



Allowance for impairment of trade receivables	Estimated amount of debts that are likely to be uncollectible from credit customers Ending allowance = Estimated % × Ending TR balance (after written off)							
Impairment loss on trade receivables (Reversal of)	Change (increase/decrease) in estimated amount of debts likely to be uncollectible from credit customers <table><tr><td>Beginning allowance (given)</td><td>– Debts written off</td><td>+ / - changes in allowance (+) Impairment loss on TR (-) Reversal of impairment loss on TR</td><td>= Ending allowance</td></tr></table>				Beginning allowance (given)	– Debts written off	+ / - changes in allowance (+) Impairment loss on TR (-) Reversal of impairment loss on TR	= Ending allowance
Beginning allowance (given)	– Debts written off	+ / - changes in allowance (+) Impairment loss on TR (-) Reversal of impairment loss on TR	= Ending allowance					

Timing of the year		Account to be debited	Account to be credited
End	Increase in estimated uncollectible debts	Impairment loss on trade receivables +Ex Disadvantage to the business	Allowance for impairment of trade receivables + contra A (-A) More credit customers may not be able to pay, causing net trade receivables to decrease
End	Decrease in estimated uncollectible debts	Allowance for impairment of trade receivables - contra A (+A) More credit customers may be able to pay, causing net trade receivables to increase	Impairment loss on trade receivables -Ex Advantage to the business
On date of bankruptcy / business close down	Write-off debts	Allowance for impairment of trade receivables - contra A (+A) It has become certain that credit customers are unable to pay. No longer an estimate	Trade receivables - A No need to remember these customers anymore

[TB Pg 183] Table 10.4

After Adjustment	Effect on Other Expenses	Effect on Profit	Effect on Current Assets
Increase in allowance	Increases	Decreases	Decreases
Decrease in allowance	Decreases	Increases	Increases

Non-adjustment	Effect on Other Expenses	Effect on Profit	Effect on Current Assets
Increase in allowance	Understated	Overstated	Overstated
Decrease in allowance	Overstated	Understated	Understated

[WB Pg 128] Q2a (modified)

On 1 May 20X4, Singa Clothing provided the following balance.

	\$
Allowance for impairment of trade receivables	3,900

Singa Clothing reviews its list of trade receivables at the end of every financial year and estimates that 6% of its trade receivables is likely to be uncollectible.

The trade receivables balances for the following two years are as follows.

	30 Apr 20X5	30 Apr 20X6
	\$	\$
Trade receivables (after being written off)	66,000	30,000

On 22 September 20X4, one of Singa Clothing's credit customers, Roy Retailer, which owed \$3,400 was declared bankrupt. Roy Retailer was able to pay 55 cents for every dollar owed to Singa Clothing. On the same day, Singa Clothing received a cheque from Roy Retailer and wrote off the remaining amount.

On 29 April 20X6, White Dresses Trading, a credit customer who owed Singa Clothing \$1,600, ceased operations. Singa Clothing wrote off the outstanding amount.

Calculate the change in allowance for impairment of trade receivables for the two years ended 30 April 20X5 and 20X6.

Additional working

Amount paid by Roy Retailer = $0.55 \times 3,400 = 1,870$

Amount to be written off = $3,400 - 1,870$ **OR** $0.45 \times 3,400 = \underline{1,530}$

Start	Write-off	Adjust (performance) increase / decrease *	End (position) (est % x end TR)
(1 May 20X4) Given 3,900	Refer to additional working above – 1,530	$3,960 - \mathbf{2,370}$ $= 1,590$ (increase)	(30 Apr 20X5) $6\% \times 66,000$ $= 3,960$
$3,900 - 1,530 = \mathbf{2,370}$			

Note After Roy Retailer went bankrupt and \$1,530 debts was written off from the estimated amount of debts likely to be uncollectible, the business can still tolerate \$2,370 debts to be uncollectible (which is within its expectations).

However, it estimated more \$ may not be collectible next year (bad sign) → increased from \$2,370 (allowance after write-off) to \$3,960 (end).

Start	Write-off	Adjust (performance) increase / decrease *	End (position) (est % × end TR)
(1 May 20X5) Bal b/d from 30 Apr 20X5 3,960 3,960 – 1,600 = 2,360	– 1,600	1,800 – 2,360 = 560 (decrease)	(30 Apr 20X6) 6% X 30,000 = 1,800

Note After White Dresses ceased operations and \$1,600 debts was written off from the estimated amount of debts likely to be uncollectible, the business can still tolerate \$2,360 debts to be uncollectible (which is within its expectations).
However, it estimated lesser \$ may not be collectible next year (good sign) → decreased from \$2,360 (allowance after write-off) to \$1,800 (end).

(a) Prepare the following journal entries to:

- (i) write off the debt owed by Roy Retailer
 - (ii) write off the debt owed by White Dresses Trading
 - (iii) **adjust** the balance for allowance for impairment of trade receivables for years ended 30 April 20X5 and 20X6
- Narrations are **not** required.

Journal

Date	Particulars	Debit	Credit
20X4		\$	\$
Sep 22	Cash at bank	1,870	
	Trade receivable – Roy Retailer		1,870
22	Allowance for impairment of trade receivables	1,530	
	Trade receivable – Roy Retailer		1,530
20X5			
Apr 30	Impairment loss on trade receivables	1,590	
	Allowance for impairment of trade receivables		1,590
20X6			
Apr 29	Allowance for impairment of trade receivables	1,600	
	Trade receivable – White Dresses Trading		1,600
Apr 30	Allowance for impairment of trade receivables	560	
	Impairment loss on trade receivables		560

- (b) Prepare extracts of the statement of financial performance for the two years ended 30 April 20X5 and 20X6, showing the expenses section.

Singa Clothing

Statement of Financial Performance for the year ended 30 April 20X5 (extract)

Less: Other expenses	\$
Impairment loss on trade receivables	1,590

Statement of Financial Performance for the year ended 30 April 20X6 (extract)

Less: Other expenses	\$
Reversal of impairment loss on trade receivables	(560)

- (c) Prepare an extract of the statement of financial position as at 30 April 20X5 and 20X6, showing the current assets section.

Singa Clothing

Statement of Financial Position as at 30 April 20X5 (extract)

<u>Current assets</u>	\$	\$
Trade receivables	66,000	
Less: Allowance for impairment of trade receivables	3,960	62,040

Statement of Financial Position as at 30 April 20X6 (extract)

<u>Current assets</u>	\$	\$
Trade receivables	30,000	
Less: Allowance for impairment of trade receivables	1,800	28,200

State the effect of **adjusting** allowance for impairment of trade receivables on current assets and profit for the year ended 31 December 20X5.

Due to an **increase** in allowance for impairment of trade receivables,

- expenses will **increase** by \$1,590, causing profit for the year to **decrease** by \$1,590
- current assets will **decrease** by \$1,590

State the effect on trade receivables and profit for the year if impairment loss on trade receivables was **not adjusted** for the year ended 30 April 20X6.

If a **decrease** in allowance for impairment of trade receivables was not adjusted,

- Expenses will be overstated by \$560, causing profit for the year to be understated by \$560
- Allowance for impairment of trade receivables will be overstated by \$560, causing trade receivables to be understated by \$560

Chapter 11 Non-Current Assets

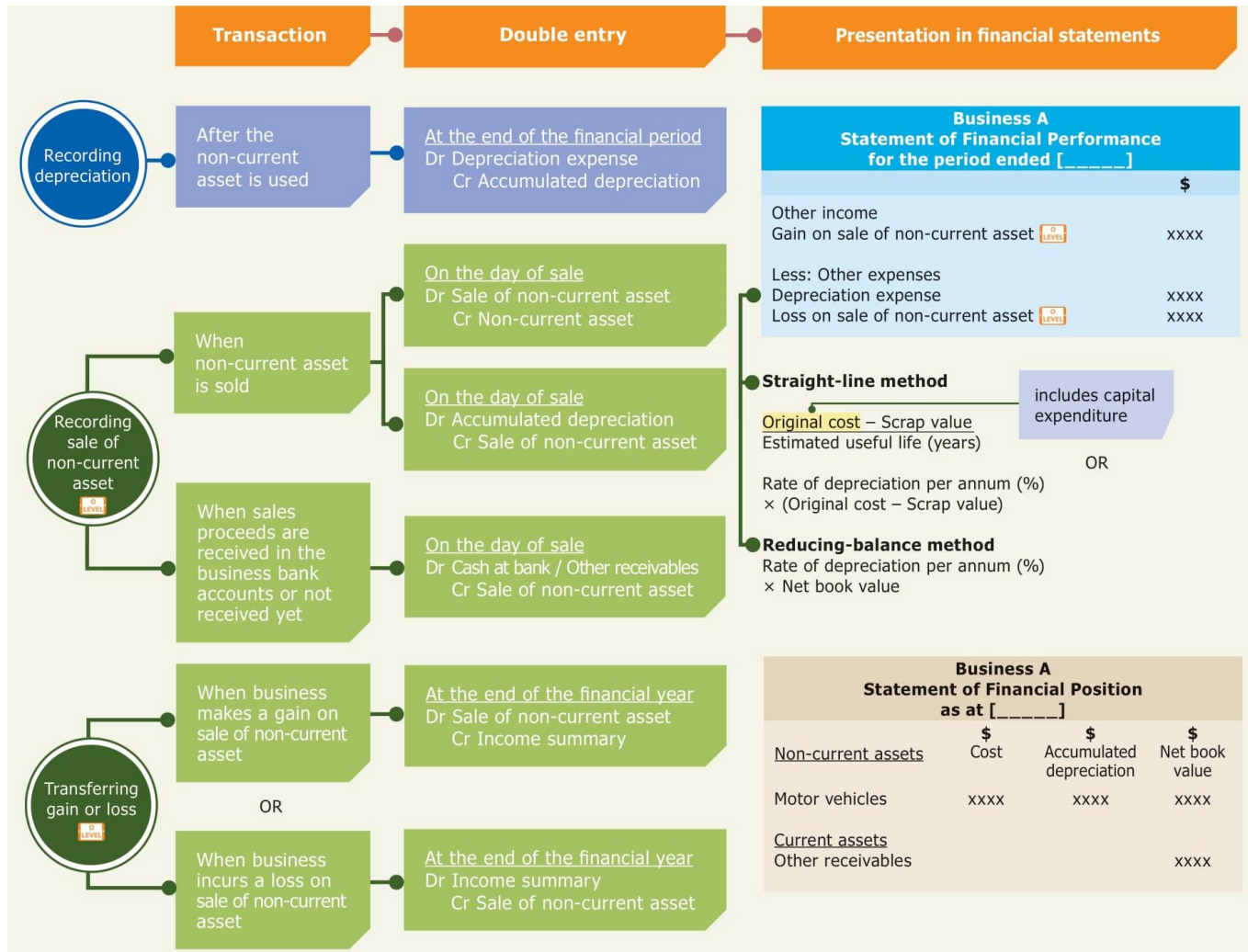
11.1 Non-Current Assets

11.3 Accounting for Non-current Assets

11.4 Accounting for Depreciation

11.6 Accounting for Sale of Non-current Asset

[TB Pg 221] Summary



Expenditure	<p>1. Explain the meaning of the term 'capital expenditure'.</p> <p>TB Pg 199 Capital expenditure refers to:</p> <ul style="list-style-type: none"> costs to buy and bring the non-current assets to their intended use costs to enhance the non-current assets costs incurred on non-current assets that provide benefits for more than one year <p>2. Explain the meaning of the term 'revenue expenditure'.</p> <p>TB Pg 199 Revenue expenditure refers to:</p> <ul style="list-style-type: none"> costs to operate, repair and maintain the non-current assets in working condition costs incurred on non-current assets that provide benefits which will be used within one year
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Record transactions	Account to be debited	Account to be credited
Revenue expenditure	Other expenses +Ex	Cash in hand / Cash at bank -A
Capital expenditure <ul style="list-style-type: none"> on credit using cash / cheque 	Non-current asset +A	Trade payable +L
		Cash in hand / Cash at bank -A

[TB Pg 203] Table 11.3

Classification of Expenditure	Effect on Other Expenses	Effect on Profit	Effect on Non-current Assets
Wrongly classified as revenue expenditure	Overstates	Understates	Understates
Wrongly classified as capital expenditure	Understates	Overstates	Overstates

[TB Pg 201] Example 11.4

On 1 January 20X1, Hossin Trading bought a delivery van to transport chilled items and incurred the following costs.

Decide whether each of the following should be classified as capital expenditure or revenue expenditure. Explain your answer.

Cost incurred	Classification	Explanation
Price of the delivery van	Capital expenditure	The delivery van is used to transport goods and can be used for more than one year. (cost to buy NCA)
Cooling system inside the delivery van	Capital expenditure	The freshness of its chilled items during delivery can only be maintained with the help of the cooling system inside the van. (cost to bring NCA to its intended use)
Motor vehicle insurance	Revenue expenditure	As part of regulation, delivery vans must be covered against possible traffic accidents for them to be operated on the roads. The insurance coverage lasts for one year and must be renewed annually. (cost to operate NCA)
Petrol	Revenue expenditure	The delivery van runs on petrol. Hence, the delivery van is operational until the petrol is depleted. (cost to operate NCA)

Explain how the following will be affected if the cooling system inside the delivery van (capital expenditure) is wrongly recorded as an expense (revenue expenditure).

- Profit for the period / statement of financial performance
- Non-current assets / statement of financial position

If an expense was wrongly recorded,

- expense will be overstated causing profit for the period to be understated.
- non-current assets will be understated

Depreciation	<p>3. State two causes of depreciation.</p> <p>TB Pg 205 Table 11.4 Usage, Wear and tear, Obsolescence, Legal limits</p> <p>4. Explain why the business uses the reducing-balance method of depreciation, rather than the straight-line method, for the motor vehicles.</p> <p>TB Pg 207 and 210</p> <ul style="list-style-type: none"> The business used the reducing-balance method as the business expects to use the motor vehicles more in its earlier years and less as the non-current asset gets older and becomes less efficient. It does not expect to use the motor vehicles uniformly throughout its estimated useful life, hence, straight-line method is not used.
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[TB Pg 214] Table 11.6

Method of Depreciation	Effect on Other Expenses	Effect on Profit	Effect on Non-current Asset
Straight line	Equal depreciation expense every year	Profit decreases by an equal amount every year.	Net book value decreases by an equal amount every year.
Reducing balance	Higher depreciation expense in earlier years and reduces over time	Profit decreases by a higher amount in earlier years.	Net book value decreases by a higher amount in earlier years.

Depreciation expense (Straight line method)	$\frac{\text{Cost} - \text{Scrap value}}{\text{Estimated useful life}} \text{ OR } \text{Rate of depreciation (\%)} \times (\text{Cost} - \text{Scrap value})$ <p>Scrap / Salvage / Residual value: amount that the business can receive at the end of the estimated useful life of the NCA</p>
Depreciation expense (Reducing balance method)	<p>Rate of depreciation (%) × Net book value</p> <p>Net book value = Cost – Accumulated depreciation</p>
Gain (or loss) on sale of non-current asset	Sales proceeds – Net book value

Adjust accounts	Account to be debited	Account to be credited
Depreciation of NCA	Depreciation expense +Ex	Accumulated depreciation + contra-A

Time of the year	Sale of non-current asset	Account to be debited	Account to be credited
On date of sale	Remove cost of NCA sold	Sale of non-current asset	Non-current asset -A
On date of sale	Remove accumulated depreciation of NCA sold	Accumulated depreciation - contra-A	Sale of non-current asset
On date of sale	Collection of sales proceeds	Cash at bank +A	Sale of non-current asset
End	Close / Transfer gain / loss on sale of NCA • Gain • Loss	Sale of non-current asset - I (gain)	Income summary
		Income summary	Sale of non-current asset - Ex (loss)

[WB Pg 142] Q5 (modified)

On 1 October 20X7, KK Cinematics provided the following information.

	\$
Equipment	35,000
Accumulated depreciation of equipment	12,600

On 1 January 20X8, KK Cinematics purchased a piece of equipment for \$24,000 on credit.

On 1 October 20X8, it purchased another piece of equipment for \$12,000 using cheque.

The business depreciates its equipment at 25% per annum using the:

Scenario 1a: SLM

Scenario 1b: SLM. A full year's depreciation is charged in the year of purchase.

Scenario 2a: RBM

Scenario 2b: RBM. A full year's depreciation is charged in the year of purchase.

(a) Calculate the depreciation of the equipment for each of the two years ended 30 September 20X8 and 20X9.

Scenario 1a (SLM): Depreciation is pro-rated based on number of **months** used in the year of purchase.

No scrap value	1 Oct 20X7 – 30 Sep 20X8	1 Oct 20X8 – 30 Sep 20X9
Existing \$35,000	full year $25\% \times (35,000 - 0) = 5,600/\text{year}$	full year 5,600
Additional \$24,000	9 months (1 Jan 20X8 – 30 Sep 20X8) $25\% \times (24,000 - 0) = 6,000/\text{year}$ $6,000 \times 9/12 = 4,500$	full year 6,000
New \$12,000	nil	full year $25\% \times (12,000 - 0) = 3,000/\text{year}$
Total	$5,600 + 4,500 = 10,100$	$5,600 + 6,000 + 3,000 = 14,600$

Scenario 1b (SLM): A **full** year's depreciation is charged in the year of purchase.

No scrap value	1 Oct 20X7 – 30 Sep 20X8	1 Oct 20X8 – 30 Sep 20X9
Existing \$35,000	full year $25\% \times (35,000 - 0) = 5,600/\text{year}$	full year 5,600
Additional \$24,000	9 months but treated as full year $25\% \times (24,000 - 0) = 6,000/\text{year}$	full year 6,000
New \$12,000	nil	full year $25\% \times (12,000 - 0) = 3,000/\text{year}$
Total	$5,600 + 6,000 = 11,600$	$5,600 + 6,000 + 3,000 = 14,600$

Ch 11 Notes**Non-current assets**

Scenario 2a (RBM): Depreciation is pro-rated based on number of **months** used in the year of purchase.

	1 Oct 20X7 – 30 Sep 20X8	1 Oct 20X8 – 30 Sep 20X9
Existing \$35,000	full year $25\% \times (35,000 - 12,600) = 5,600$	full year $25\% \times (35,000 - 12,600 - 5,600) = 4,200$
Additional \$24,000	9 months (1 Jan 20X8 – 30 Sep 20X8) $25\% \times (24,000 - 0) \times 9/12 = 4,500$	full year $25\% \times (24,000 - 4,500) = 4,875$
New \$12,000	nil	full year $25\% \times (12,000 - 0) = 3,000$
Total	$5,600 + 4,500 = 10,100$	$4,200 + 4,875 + 3,000 = 12,075$

Scenario 2b (RBM): A **full** year's depreciation is charged in the year of purchase.

	1 Oct 20X7 – 30 Sep 20X8	1 Oct 20X8 – 30 Sep 20X9
Existing \$35,000	full year $25\% \times (35,000 - 12,600) = 5,600$	full year $25\% \times (35,000 - 12,600 - 5,600) = 4,200$
Additional \$24,000	9 months but treated as full year $25\% \times (24,000 - 0) = 6,000$	full year $25\% \times (24,000 - 6,000) = 4,500$
New \$12,000	nil	full year $25\% \times (12,000 - 0) = 3,000$
Total	$5,600 + 6,000 = 11,600$	$4,200 + 4,500 + 3,000 = 11,700$

(b) Prepare extracts of the statement of financial performance for the years ended 30 September 20X9, showing only the other expenses portion. (Scenario 1a: SLM)

KK Cinematics

Statement of Financial Performance for the year ended 30 September 20X9 (extract)

	\$
Less: Other expenses	
Depreciation on machine	14,600

- (c) Prepare extracts of the statement of financial position as at 30 September 20X8 and 20X9, showing only the non-current assets section. (Scenario 1a: SLM)

KK Cinematics

Statement of Financial Position as at 30 September 20X8 (extract)

	\$	\$	\$
<u>Non-current assets</u>	Cost	Accumulated depreciation	Net book value
Machine	59,000 35,000 + 24,000	22,700 12,600 + 10,100	36,300

Statement of Financial Position as at 30 September 20X9 (extract)

	\$	\$	\$
<u>Non-current assets</u>	Cost	Accumulated depreciation	Net book value
Machine	71,000 35,000 + 24,000 + 12,000	37,300 12,600 + 10,100 + 14,600	33,700

[WB Pg 148] Q5

On 1 January 20X2, Nurul Decoration paid by cheque for **two** identical lorries costing \$105,000 **each**.

On 31 March 20X4, the business **sold one** of the lorries and received a cheque for \$75,000.

On the same day, the business bought a new lorry for \$90,000 by cheque.

The business depreciates its motor vehicles at a rate of 30% per annum on net book value (RBM). A **full** year's depreciation is provided in the year of purchase and **no** depreciation is provided in the year of sale. Nurul Decoration's financial year ends on 31 December.

(a) Calculate the depreciation expense for each of the three years ended 31 December 20X2, 20X3 and 20X4.

	1 Jan – 31 Dec 20X2	1 Jan – 31 Dec 20X3	1 Jan – 31 Dec 20X4
Sold \$105,000	full year $30\% \times (105,000 - 0)$ $= 31,500$	full year $30\% \times (105,000 - 31,500)$ $= 22,050$	3 months (1 Jan – 31 Mar 20X4) but not depreciated in the year of sale
Remaining \$105,000	full year 31,500	full year 22,050	full year $30\% \times (105,000 - 31,500 - 22,050) = 15,435$
New \$90,000	nil	nil	9 months (1 Apr – 31 Dec 20X4) but treated as full year in the year of purchase $30\% \times (90,000 - 0)$ $= 27,000$
Total	$31,500 \times 2$ $= 63,000$	$22,050 \times 2$ $= 44,100$	$15,435 + 27,000$ $= 42,435$

(b) Calculate the gain or loss on the sale of the motor vehicle.

$$\begin{aligned}\text{Accumulated depreciation} &= 31,500 + 22,050 \\ &= 53,550\end{aligned}$$

$$\begin{aligned}\text{Net book value} &= \text{Cost} - \text{Accumulated depreciation} \\ &= 105,000 - 53,550 \\ &= 51,450\end{aligned}$$

$$\begin{aligned}\text{Gain (or loss) on sale of non-current asset} &= \text{Sales proceeds} - \text{Net book value} \\ &= 90,000 - 51,450 \\ &= \underline{\underline{38,550 \text{ (gain)}}}\end{aligned}$$

Ch 11 Notes**Non-current assets**

Provide journal entries to record the sale of the motor vehicle on 31 March 20X4, including the closing entry. Narrations are not required.

Journal

Date	Particulars	Debit	Credit
20X4		\$	\$
Mar 31	Sale of non-current asset	105,000	
	Motor vehicles		105,000
31	Sale of non-current asset	53,550	
	Accumulated depreciation		53,550
31	Cash at bank	90,000	
	Sale of non-current asset		90,000
Dec 31	Sale of non-current asset	38,550	
(Close)	Income summary		38,550

- (d) Prepare extracts of the statement of financial performance for the year ended 31 December 20X4, showing only the relevant sections.

Nurul Decoration**Statement of Financial Performance for the year ended 31 December 20X4 (extract)**

	\$
Other income	
Gain on sale of non-current asset	38,550
Less: Other expenses	
Depreciation on machine	42,435

- (e) Prepare extracts of the statement of financial position as at 31 December 20X3 and 20X4, showing only the non-current assets section.

Nurul Decoration

Statement of Financial Position as at 31 December 20X³ (extract)

	\$	\$	\$
<u>Non-current assets</u>	Cost	Accumulated depreciation	Net book value
Motor vehicles	210,000 105,000 X 2	107,100 63,000 + 44,100	102,900

Statement of Financial Position as at 31 December 20X⁴ (extract)

	\$	\$	\$
<u>Non-current assets</u>	Cost	Accumulated depreciation	Net book value
Motor vehicles	195,000 105,000 + 90,000	37,300 31,500 + 22,050 + 42,435	157,700

[WB Pg 142] Q6

The following balances were taken from the books of Laurel Books at the start of the financial year on 1 January 20X6.

	\$
Fixtures and fittings	58,000
Accumulated depreciation of fixtures and fittings	12,560

On 1 October 20X6, Laurel Books sold one of its bookshelves which cost \$6,000 for \$3,500 by cheque. The bookshelf was bought on 1 January 20X4.

On 15 October 20X6, Laurel Books bought a new bookshelf for \$8,000 by cheque.

Laurel Books provides depreciation at a rate of 20% per annum on net book value. A **full** year's depreciation is provided in the year of purchase and **no** depreciation is provided in the year of sale.

(a) Calculate the gain or loss on the sale of fixtures and fittings for the year ended 31 December 20X6.

(b) Calculate the depreciation expense for the year ended 31 December 20X6.

	1 Jan – 31 Dec 20X4	1 Jan – 31 Dec 20X5	1 Jan – 31 Dec 20X6
Sold \$6,000	full year $20\% \times (6,000 - 0)$ $= 1,200$	full year $20\% \times (6,000 - 1,200)$ $= 960$	9 months (1 Jan – 31 Sep 20X6) but not depreciated in the year of sale
Remaining $58,000 - 6,000$ $= \$52,000$	Let \$x be the accumulated depreciation of the remaining NCA which was unsold. $1,200 + 960 + x = 12,560$ $x = 10,400$		full year $20\% \times (52,000 - 10,400)$ $= 8,320$
New \$8,000	nil	nil	2.5 months (15 Oct – 31 Dec 20X6) but treated as full year in the year of purchase $20\% \times (8,000 - 0)$ $= 1,600$
Total	?	?	$8,320 + 1,600$ $= 9,920$

$$\begin{aligned}\text{Accumulated depreciation} &= 1,200 + 960 \\ &= 2,160\end{aligned}$$

$$\begin{aligned}\text{Net book value} &= \text{Cost} - \text{Accumulated depreciation} \\ &= 6,000 - 2,160 \\ &= 3,840\end{aligned}$$

$$\begin{aligned}\text{Gain (or loss) on sale of non-current asset} &= \text{Sales proceeds} - \text{Net book value} \\ &= 3,500 - 3,840 \\ &= \underline{340 \text{ (loss) }}\end{aligned}$$

Ch 11 Notes**Non-current assets**

Provide journal entries to record the sale of the bookshelves on 1 October 20X6, including the closing entry. Narrations are not required.

Journal

Date	Particulars	Debit	Credit
20X6		\$	\$
Oct 1	Sale of non-current asset	6,000	
	Motor vehicles		6,000
1	Sale of non-current asset	2,160	
	Accumulated depreciation		2,160
1	Cash at bank	3,500	
	Sale of non-current asset		3,500
Dec 31	Income summary	340	
(Close)	Sale of non-current asset		340

- (d) Prepare extracts of the statement of financial performance for the year ended 31 December 20X6, showing only the relevant sections.

Laurel Books**Statement of Financial Performance for the year ended 31 December 20X6 (extract)**

	\$
Less: Other expenses	
Depreciation on fixtures and fittings	9,920
Loss on sale of non-current assets	340

- (e) Prepare extracts of the statement of financial position as at 31 December 20X6, showing only the non-current assets section.

Laurel Books**Statement of Financial Position as at 31 December 20X6 (extract)**

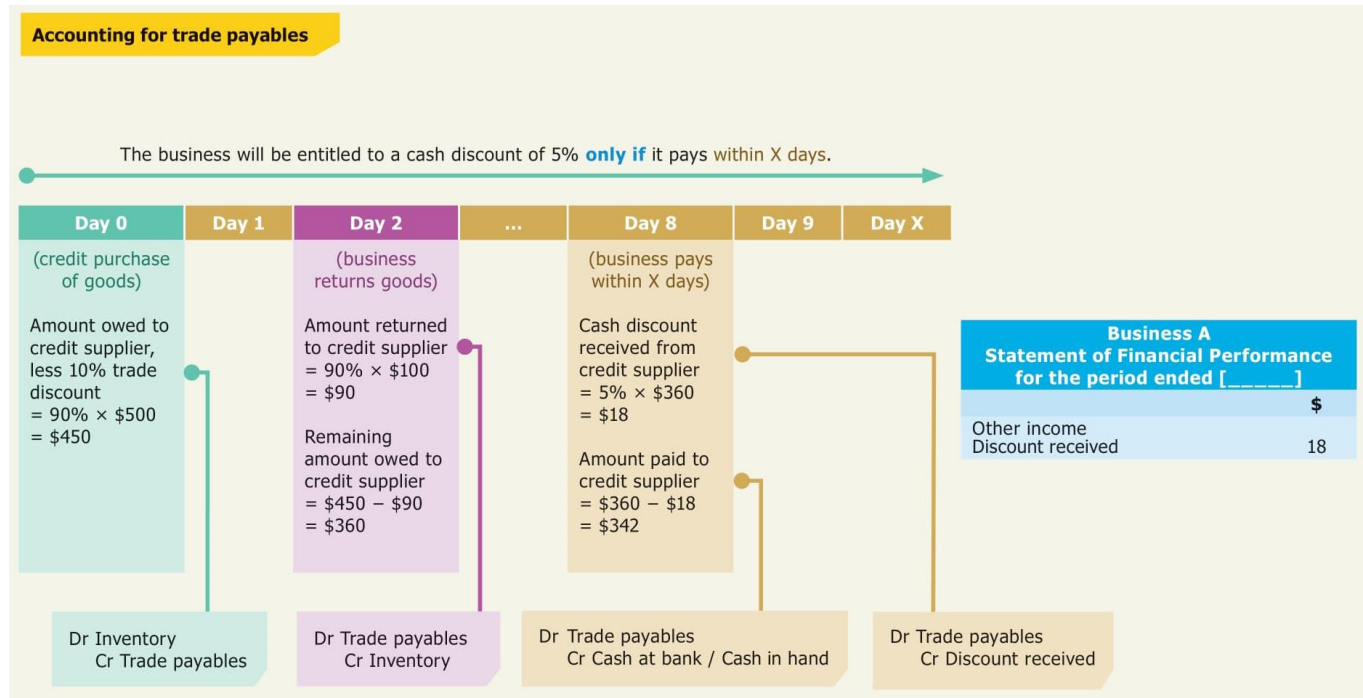
	\$	\$	\$
<u>Non-current assets</u>	Cost	Accumulated depreciation	Net book value
Motor vehicles	60,000 52,000 + 8,000	20,320 10,400 + 9,920	39,680

Chapter 12 Trade Payables

12.1 Trade Payables

12.3 Accounting for Trade Payables

[TB Pg 236] Summary



Record transactions	Account to be debited	Account to be credited
Purchase of goods / NCA (capital expenditure) • on credit	Inventory / Non-current asset +A	Trade payable +L
Return of goods to credit suppliers • previously purchased on credit	Trade payable -L	Inventory -A
Payment to credit suppliers	Trade payable -L	Cash in hand / Cash at bank -A
Received cash discount from credit suppliers	Trade payable -L	Discount received +I

[TB Pg 231 to 233] Example 12.2b

Popz Stationery purchased calculators from its supplier, Comp, on credit.
The following transactions took place during the month of March 20X3.

20X1	Description of transaction
Mar 3	Purchased <u>calculators</u> at a list price of \$500 on a 30-day credit period, less trade discount of 10%. If the business pays within 10 days , it will receive a cash discount of 5%.
Mar 5	<u>Returned</u> faulty <u>calculators</u> , bought on 3 March, with a list price of \$100
Mar 11	Issued <u>cheque</u> to <u>Comp</u> in <u>full settlement</u> of the goods bought on 3 March

If the opening balance of the trade payable – Comp account was \$1,000 as at 1 March 20X3, prepare the trade payable – Comp account for March 20X3.

Amount to be recorded for Mar 3 (Day 0): **90% X 500 = 450**

Keywords	<u>calculators</u>	supplier, Comp, <u>on credit</u>
(1)	<u>Inventory</u>	Trade payable – Comp
(2, 3)	+A	+L
(4, 5)	Dr	<u>Cr</u>

Amount to be recorded for Mar 5: **90% X 100 = 90**

Keywords	<u>Returned</u>	<u>calculators</u>
(1)	Trade payable – Comp	<u>Inventory</u>
(2, 3)	-L	-A
(4, 5)	<u>Dr</u>	Cr

Cash discount **received** from supplier on Mar 11 (Day 8): **5% X (450 – 90) = 18**

met the criteria for cash discount (≤ 10 days)

Keywords	<u>full settlement</u>	<u>Comp</u>
(1)	<u>Discount received</u>	Trade payable – Comp
(2, 3)	+I	-L
(4, 5)	Cr	<u>Dr</u>

Cheque amount paid on Mar 11: $450 - 90 - 18 = 342$

Keywords	<u>cheque</u>	<u>Comp</u>
(1)	<u>Cash at bank</u>	Trade payable – Comp
(2, 3)	-A	-L
(4, 5)	Cr	<u>Dr</u>

Trade payable — Comp account (L)					
Date	Particulars	Debit	Credit	Balance	
20X3		\$ (-)	\$ (+)	\$	
Mar 1	Balance b/d			1,000 Cr	First ✓
3	Inventory		450	1,450 Cr	} Optional
5	Inventory	90		1,360 Cr	
11	Cash at bank	342		1,018 Cr	
11	Discount received	18		1,000 Cr	Last ✓
Apr 1	Balance b/d			1,000 Cr	Next ✓

Chapter 13 Long-term Borrowings

13.1 Borrowings

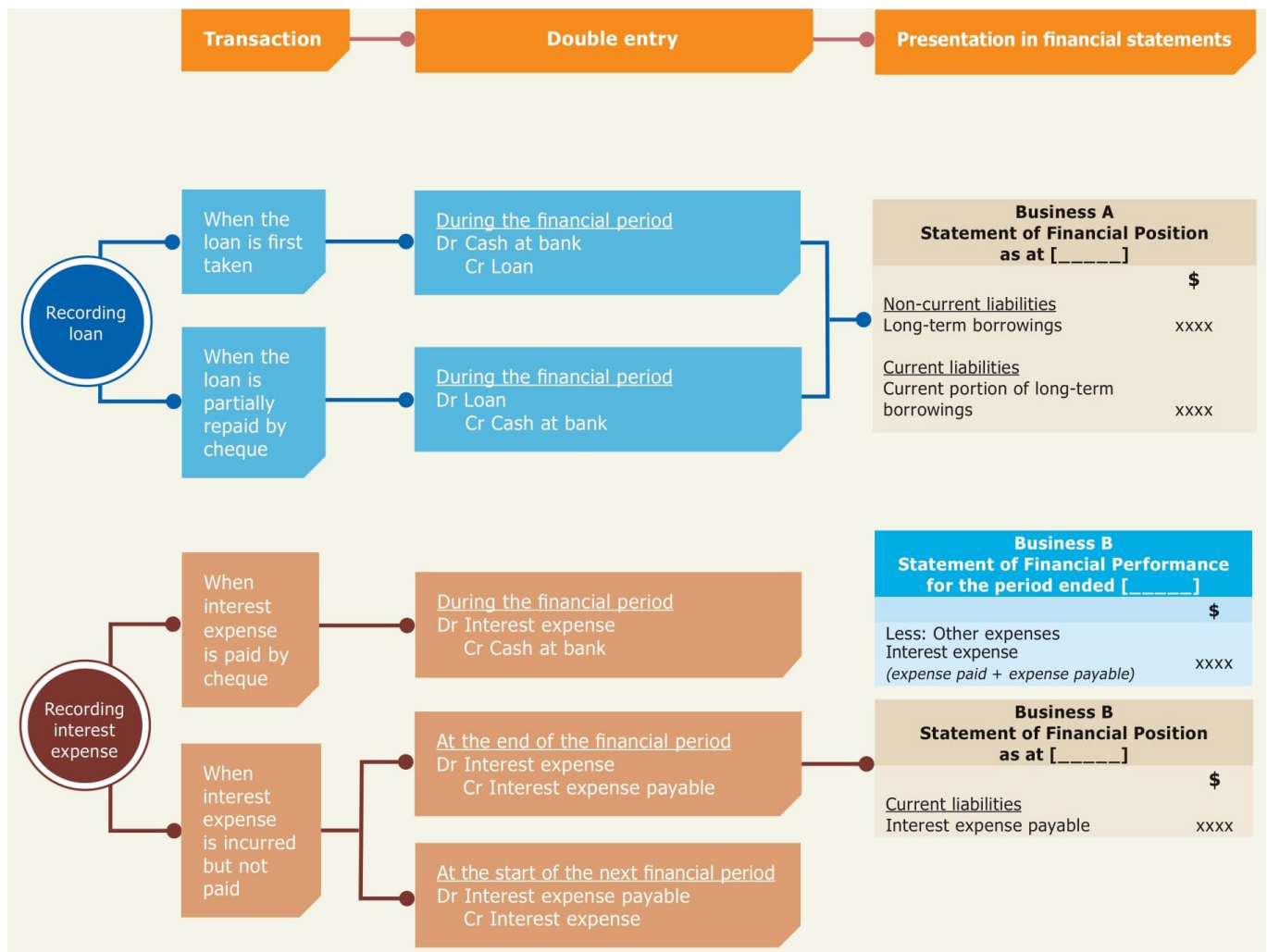
13.2 Accounting for Loan

13.3 Presentation of Long-term Borrowings

13.4 Accounting for Interest Expense

13.5 Presentation of Interest Expense

[TB Pg 252] Summary



Bank loan vs bank overdraft	<p>1. Explain two ways in which a bank loan is different from a bank overdraft.</p> <p>TB Pg 240</p> <ul style="list-style-type: none"> Bank overdraft refers to the amount that the business withdrew beyond what it has deposited in the bank account while bank loan refers to the additional amount borrowed for more than one year. The business deposits cash into the bank account within the year to reduce the overdraft while the 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 to reduce the principal sum.
-----------------------------	---

Record transactions	Account to be debited	Account to be credited
Obtain loan	Cash at bank +A	Loan +L
Repayment of loan	Loan -L	Cash at bank -A
Reclassify loan (position only)	Long-term borrowing -NCL	Current portion of long-term borrowing +CL

Time of the year		Account to be debited	Account to be credited
Start	Reverse interest expense payable adjusted in the <u>previous FY</u>	Interest expense payable (-L) (paid amount owed this FY)	Interest expense (-Ex) (NOT incurred i.e. borrowed \$x loan last FY)
During / End	Paid cheques for interest	Interest expense (+Ex)	Cash at bank (-A)
End	Adjust interest expense payable and report in statement of financial <u>position</u>	Interest expense (+Ex) (incurred i.e. borrow \$y loan this FY)	Interest expense payable (+L) (owe payment to be settled in the next FY)
End	Close / Transfer interest expenses <u>incurred</u> for the year to statement of financial <u>performance</u>	Income summary (abbreviation for statement of financial performance) Interest rate per annum (%) × Principal sum borrowed	Interest expense (-Ex)

[TB Pg 246] Example 13.4 (modified)

The financial year of Ellie Trading ends on 31 December.

On 1 April 20X4, Ellie Trading took a \$300,000 loan at 2% interest per annum.

The loan is to be repaid equally over 15 years.

The partial principal sum repayment and the interest are to be made on 31 March every year.

Calculate the amount of the current portion and non-current portion of long-term borrowings as at 31 December 20X4, 20X5 and 20X6.

	1 Jan – 31 Mar 20X4 (3 months)	1 Apr – 31 Dec 20X4 (9 months)
Outstanding loan	nil	300,000 (no payment made)
Current portion of LTB		$300,000 \div 15$ $= 20,000$ per year
Long-term borrowings		$300,000 - 20,000$ $= 280,000$

	1 Jan – 31 Mar 20X5 (3 months)	1 Apr – 31 Dec 20X5 (9 months)
Outstanding loan	300,000	$300,000 - 20,000$ (after 1 st payment was made on 31 Mar 20X5) = 280,000
Current portion of LTB		20,000
Long-term borrowings		$280,000 - 20,000$ $= 260,000$

	1 Jan – 31 Mar 20X6 (3 months)	1 Apr – 31 Dec 20X6 (9 months)
Outstanding loan	280,000	$280,000 - 20,000$ (after 2 nd payment was made on 31 Mar 20X6) = 260,000
Current portion of LTB		20,000
Long-term borrowings		$260,000 - 20,000$ $= 240,000$

Prepare the loan account for the three years ended 31 December 20X4, 20X5 and 20X6.

Loan (L)

Date	Particulars	Debit	Credit	Balance
20X4		\$ (-)	\$ (+)	\$
Apr 1	Cash at bank		300,000	300,000 Cr
20X5				
Jan 1	Balance b/d			300,000 Cr
Mar 31	Cash at bank	20,000		280,000 Cr
20X6				
Jan 1	Balance b/d			280,000 Cr
Mar 31	Cash at bank	20,000		260,000 Cr
20X7				
Jan 1	Balance b/d			260,000 Cr

Ch 13 Notes**Long-term borrowings**

Calculate the amount of the interest expense incurred for each of the three years ended 31 December 20X4, 20X5 and 20X6.

Reverse exP	Paid cheques for interest	Adjust exP (position)	Close / Transfer expense <u>incurred</u> (performance)
(1 Jan 20X4) nil	(31 Mar 20X4) nil	+ 4,500 $2\% \times 300,000 \times 9/12$	(31 Dec 20X4) <u>4,500</u>
(1 Jan 20X5) – 4,500	(1 st payment made on 31 Mar 20X5) + 6,000 $2\% \times 300,000$	+ 4,200 $2\% \times 280,000 \times 9/12$	(31 Dec 20X5) – 4,500 + 6,000 + 4,200 = <u>5,700</u>
(1 Jan 20X6) – 4,200	(2 nd payment made on 31 Mar 20X6) + 5,600 $2\% \times 280,000$	+ 3,900 $2\% \times 260,000 \times 9/12$	(31 Dec 20X6) – 4,200 + 5,600 + 3,900 = <u>5,300</u>

(a) Prepare journal entries to record the interest expense for the year ended 31 December 20X5, including the closing entry. Narrations are not required.

Journal

	Date	Particulars	Debit	Credit
	20X5		\$	\$
Reverse	Jan 1	Interest expense payable	4,500	
(start)		Interest expense		4,500
Paid	Mar 31	Interest expense	6,000	
(during)		Cash at bank		6,000
	20X5			
Adjust	Dec 31	Interest expense	4,200	
(end)		Interest expense payable		4,200
Close	31	Income summary	5,700	
(end)		Interest expense		5,700

Explain the effects on profit for the year and current liabilities if the interest expense was **not adjusted** for the year ended 31 December 20X5.

If interest expense payable of \$4,200 was not adjusted,

- interest expense will be understated by \$4,200, causing profit for the year to be overstated by \$4,200
- current liabilities will be understated by \$4,200

(b) Prepare an extract of the following for the two years ended 31 December 20X5 and 20X6.

- Statement of financial performance
- Statement of financial position

Ellie Trading

Statement of Financial Performance for the year ended 31 December 20X5 (extract)

Less: Other expenses	\$
Interest expense	5,700

Statement of Financial Performance for the year ended 31 December 20X6 (extract)

Less: Other expenses	\$
Interest expense	5,300

Ellie Trading

Statement of Financial Position as at 31 December 20X5 (extract)

<u>Non-current liabilities</u>	\$
Long-term borrowings	260,000
<u>Current liabilities</u>	
Current portion of long-term borrowings	20,000
Interest expense payable	4,200

Statement of Financial Position as at 31 December 20X6 (extract)

<u>Non-current liabilities</u>	\$
Long-term borrowings	240,000
<u>Current liabilities</u>	
Current portion of long-term borrowings	20,000
Interest expense payable	3,900

Chapter 14 Equities

14.1 Equities

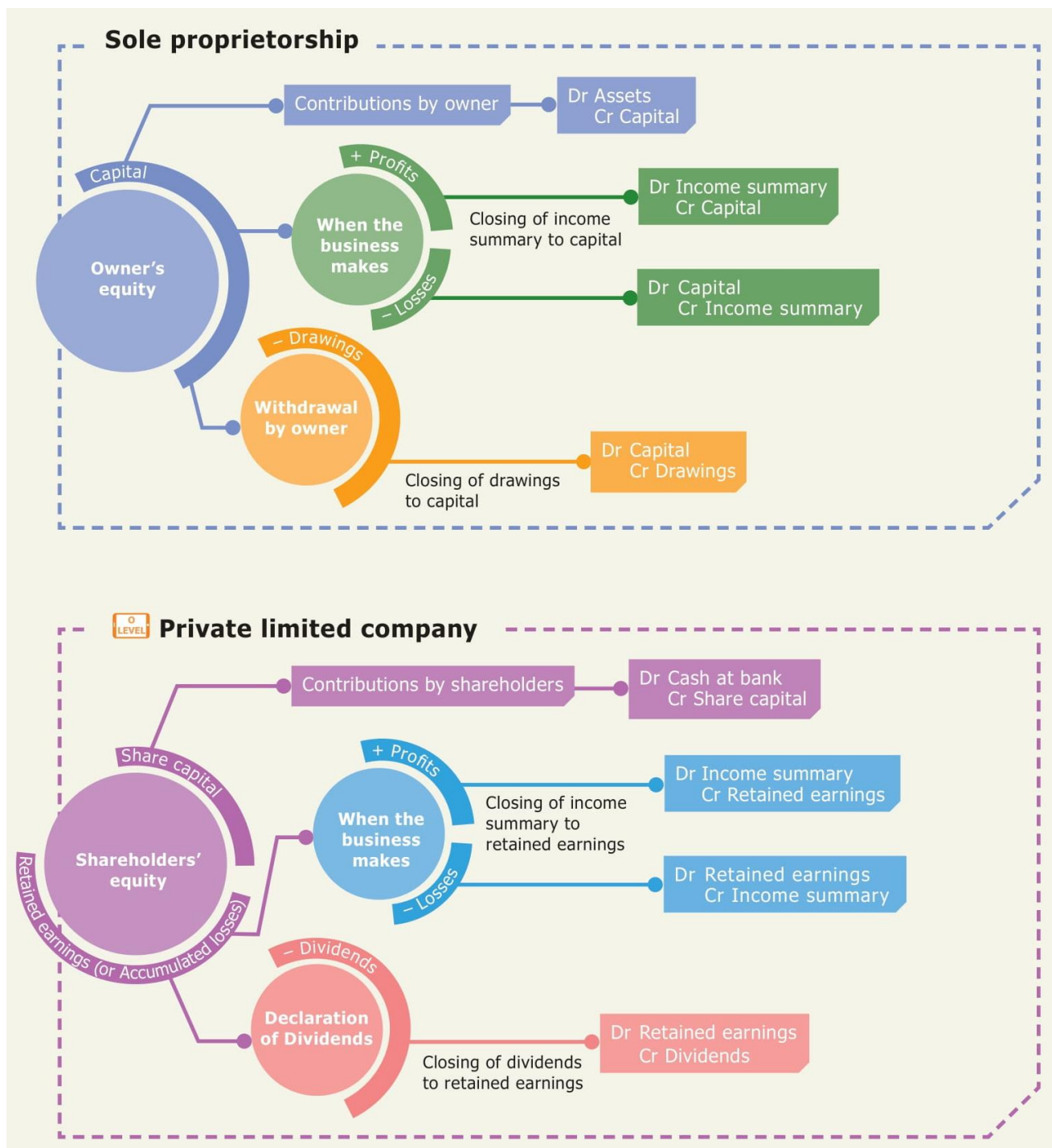
14.2 Owner's Equity

14.3 Accounting for Owner's Equity

14.5 Shareholders' Equity

14.6 Accounting for Shareholders' Equity

[TB Pg 270] Summary



Owner's equity	<p>1. State three reasons why the owner's equity in a sole proprietorship may be different at the end of the accounting year from that at the beginning.</p> <p>TB Pg 257 Table 14.1</p> <table> <tr> <th>Activities</th><th>Change in Owner's Equity</th></tr> <tr> <td> <ul style="list-style-type: none"> The sole owner contributes additional assets to the business. The business makes a profit for the period. </td><td>Increase</td></tr> <tr> <td> <ul style="list-style-type: none"> The sole owner withdraws business assets for personal use. The business incurs a loss for the period. </td><td>Decrease</td></tr> </table>	Activities	Change in Owner's Equity	<ul style="list-style-type: none"> The sole owner contributes additional assets to the business. The business makes a profit for the period. 	Increase	<ul style="list-style-type: none"> The sole owner withdraws business assets for personal use. The business incurs a loss for the period. 	Decrease
Activities	Change in Owner's Equity						
<ul style="list-style-type: none"> The sole owner contributes additional assets to the business. The business makes a profit for the period. 	Increase						
<ul style="list-style-type: none"> The sole owner withdraws business assets for personal use. The business incurs a loss for the period. 	Decrease						
Capital	Beginning capital + Additional capital + Profit (or – Loss) – Drawings						
Shareholders' equity	<p>2. State three reasons why the shareholders' equity in a private limited company may be different at the end of the accounting year from that at the beginning.</p> <p>TB Pg 264 Table 14.4</p> <table> <tr> <th>Activities</th><th>Change in Shareholders' Equity</th></tr> <tr> <td> <ul style="list-style-type: none"> The private limited company issues new shares. The business makes a profit for the period. </td><td>Increase</td></tr> <tr> <td> <ul style="list-style-type: none"> The private limited company declares dividends. The business incurs a loss for the period. </td><td>Decrease</td></tr> </table>	Activities	Change in Shareholders' Equity	<ul style="list-style-type: none"> The private limited company issues new shares. The business makes a profit for the period. 	Increase	<ul style="list-style-type: none"> The private limited company declares dividends. The business incurs a loss for the period. 	Decrease
Activities	Change in Shareholders' Equity						
<ul style="list-style-type: none"> The private limited company issues new shares. The business makes a profit for the period. 	Increase						
<ul style="list-style-type: none"> The private limited company declares dividends. The business incurs a loss for the period. 	Decrease						
Retained earnings	Beginning retained earnings + Profit (or – Loss) – Dividends						
Share capital	Total number of shares issued × Issued price per share (\$)						
Dividends	Total number of shares issued × Declared dividends per share (\$)						

Sole Proprietorship	Account to be debited	Account to be credited
Contribution from owner	Any assets +A	Capital +C
Close income summary • Profit • Loss	Income summary	Capital +C (profit)
	Capital -C (loss)	Income summary
Withdrawal by owner for personal use	Drawings +D	Any assets -A
Close drawings	Capital -C	Drawings -D

Private Limited Company	Account to be debited	Account to be credited
Contribution from shareholders	Cash at bank +A	Share capital +C
Close income summary • Profit • Loss	Income summary	Retained earnings +C (profit)
	Retained earnings -C (loss)	Income summary
Declared dividends • But not paid yet • Paid immediately	Dividends +D	Dividends payables +L
	Dividends +D	Cash at bank -A
Close dividends	Retained earnings -C	Dividends -D

[TB Pg 258] Example 14.1 (modified)

The financial year of Jessica's Fashion Trading ends on 31 December.

On 1 January 20X3, the business had a capital balance of \$22,000.

The following transactions took place between 20X3 and 20X4.

Date	Description of transaction
20X3	
Oct 25	Jessica took <u>goods</u> costing \$200 for her <u>own use</u> .
Dec 31	<u>Loss</u> for the year amounted to \$1,200.
20X4	
Feb 7	Jessica participated in an online contest and won a set of furniture worth \$800. She used the furniture to <u>furnish the shop</u> .
Mar 18	Jessica sold her personal motor vehicle for \$30,000 and used the proceeds to settle an <u>outstanding bank loan</u> of the business.
May 28	Jessica withdrew \$5,000 from the <u>business bank account</u> for <u>personal use</u> .
Dec 31	<u>Profit</u> for the year amounted to \$14,000.

Calculate ending capital as at 31 December 20X3 and 20X4.

Beginning capital + Additional capital	Profit / loss	Drawings	Ending capital
(1 Jan 20X3) 22,000	– 1,200 (loss)	– 200	(31 Dec 20X3) 22,000 – 1,200 – 200 = <u>20,600</u>
(1 Jan 20X4) 20,600 (bal b/d) + 800 + 30,000	+ 14,000 (profit)	– 5,000	(31 Dec 20X4) 20,600 + 800 + 30,000 + 14,000 – 5,000 = <u>60,400</u>

Net increase / decrease

(31 Dec 20X3)

= – 1,200 – 200

= **– 1,400** (decrease)

	+		–	
<input checked="" type="checkbox"/> Additional capital		<	<input checked="" type="checkbox"/> Drawings	} Total
<input checked="" type="checkbox"/> Profit			<input checked="" type="checkbox"/> Loss	

Net increase / decrease

(31 Dec 20X4)

= 30,800 + 14,000 – 5,000

= **39,800** (increase)

	+		–	
Total {	<input checked="" type="checkbox"/> Additional capital	>	<input checked="" type="checkbox"/> Drawings	
	<input checked="" type="checkbox"/> Profit		<input checked="" type="checkbox"/> Loss	

- (d) Explain how the owner's equity changed over the two years.

As there is **no** additional capital contribution, the **total** loss of \$1,200 and drawings of \$200 have caused a **net decrease** of \$1,400 in owner's equity during the year ended 31 December 20X3.

As the **total** additional capital contribution of \$30,800 and profit of \$14,000 are **more than** drawings of \$5,000, there is a **net increase** of \$39,800 in owner's equity during the year ended 31 December 20X4.

- (a) Prepare the journal entries to record the above transactions, including the transfers of drawings and profit or loss to the capital account on 31 December 20X3 and 20X4. Narrations are **not** required.

Journal

Date	Particulars	Debit	Credit
20X3		\$	\$
Oct 25	Drawings	200	
	Inventory		200
Dec 31	Capital	200	
(close total drawings)	Drawings		200
31	Capital	1,200	
(transfer loss)	Income summary		1,200
20X4			
Feb 7	Fixtures and fittings	800	
	Capital		800
Mar 18	Bank loan	30,000	
	Capital		30,000
May 28	Drawings	5,000	
	Cash at bank		5,000
Dec 31	Capital	5,000	
(close total drawings)	Drawings		5,000
31	Income summary	14,000	
(transfer profit)	Capital		14,000

(b) Prepare the following ledger accounts for the two years ended 31 December 20X3 and 20X4.

(i) Drawings

(ii) Capital

Drawings (D)

	Date	Particulars	Debit	Credit	Balance
	20X3		\$ (+)	\$ (-)	\$
	Oct 25	Inventory	200		200 Dr
Close total drawings	Dec 31	Capital		200	- or 0
	20X4				
	May 28	Cash at bank	5,000		5,000 Dr
Close total drawings	Dec 31	Capital		5,000	- or 0



similar to
calculating ending

Capital (C)

Date	Particulars	Debit	Credit	Balance
20X3		\$ (-)	\$ (+)	\$
Jan 1	Balance b/d			22,000 Cr
Dec 31	Income summary	1,200		
31	Drawings	200		20,600 Cr
20X4				
Jan 1	Balance b/d			20,600 Cr
Feb 7	Fixtures and fittings		800	
Mar 18	Bank loan		30,000	
Dec 31	Income summary		14,000	
31	Drawings	5,000		60,400 Cr
20X5				
Jan 1	Balance b/d			60,400 Cr

[WB Pg 172] Q5 (modified)

On 1 August 20X4, Starry Cups Pte Ltd provided the following account balances.

	\$
Share capital, 15,000 ordinary shares	75,000
Retained earnings	21,700

The financial year of Starry Cups Pte Ltd ends on 31 July.

The following transactions took place in 20X5 and 20X6.

Date	Description of transaction
20X5	
Jul 30	Dividends of \$0.05 per share were declared. However, the dividends would only be paid on 2 August 20X7.
Jul 31	The business incurred a loss of \$5,500.
Aug 2	The dividends declared on 30 July were paid.
Nov 15	10,000 shares were issued at \$2 per share. All shares were issued and fully paid (by investors).
20X6	
Jan 12	Dividends at \$0.06 per share were declared and paid in full.
Jul 31	The business made a profit of \$9,000.

Calculate ending share capital and retained earnings as at 31 July 20X5 and 20X6.

Beginning share capital	Additional share capital	Ending share capital
(1 Aug 20X4) 75,000	nil	(31 Jul 20X5) <u>75,000</u>
(1 Aug 20X5) 75,000 (bal b/d)	+ 20,000 = 10,000 X 2	(31 Jul 20X6) 75,000 + 20,000 = <u>95,000</u>

Beginning retained earnings	Profit / loss	Dividends	Ending retained earnings
(1 Aug 20X5) 21,700	– 5,500 (loss)	– 750 = 0.05 X 15,000	(31 Jul 20X5) 21,700 – 5,500 – 750 = <u>15,450</u>
(1 Aug 20X5) 15,450 (bal b/d)	+ 9,000 (profit)	– 1,500 = 0.06 X (15,000 + 10,000)	(31 Jul 20X6) 15,450 + 9,000 – 1,500 = <u>22,950</u>

Ch 14 Notes

Equities

Net **increase / decrease**

(31 Jul 20X5)

= - 5,500 - 750

= **- 6,250** (decrease)

+		-		} Total
X	Additional share capital	√	Dividends	
X	Profit	√	Loss	

Net **increase / decrease**

(31 Jul 20X6)

= 20,000 + 9,000 - 1,500

= **27,500** (increase)

Total {	+		-	
	√	Additional share capital	√	Dividends
	√	Profit	X	Loss

(d) Explain how the shareholders' equity changed over the two years.

As there is **no** additional share capital, the **total** loss of \$5,500 and dividends of \$750 have caused a **net decrease** of \$6,250 in shareholders' equity during the year ended 31 July 20X5.

As the **total** additional share capital of \$20,000 and profit of \$9,000 are **more than** dividends of \$1,500, there is a **net increase** of \$27,500 in shareholders' equity during the year ended 31 July 20X6.

Additional question

Prepare the following journal entries to:

- (i) record the dividends declared on 30 July 20X4
- (ii) transfer dividends and loss to the retained earnings account on 31 July 20X5
- (iii) record the payment of dividends on 2 August 20X5
- (iv) record the issue of additional shares on 15 November 20X5
- (v) record the dividends declared and paid on 12 January 20X6

Narrations are **not** required.

Journal

Date	Particulars	Debit	Credit
20X4		\$	\$
Jul 30	Dividends	750	
(declare dividends)	Dividends payable		750
31	Retained earnings	750	
(close dividends)	Dividends		750
31	Retained earnings	5,500	
(transfer loss)	Income summary		5,500
Aug 2	Dividends payable	750	
	Cash at bank		750
Nov 15	Cash at bank	20,000	
(issues new shares)	Share capital		20,000
20X6			
Jan 12	Dividends	1,500	
	Cash at bank		1,500

Prepare the following ledger accounts for the two years ended 31 July 20X5 and 20X6.

- (a) Share capital
- (b) Retained earnings

Additional question

Dividends

Dividends (D)

	Date	Particulars	Debit	Credit	Balance
	20X5		\$ (+)	\$ (-)	\$
	Jul 30	Dividends payable	750		750 Dr
(close dividends)	31	Retained earnings		750	- or 0
	20X6				
	Jan 12	Cash at bank	1,500		1,500 Dr
(close dividends)	31	Retained earnings		1,500	- or 0



similar to calculating
ending retained earnings

Retained earnings (C)

Date	Particulars	Debit	Credit	Balance
20X4		\$ (-)	\$ (+)	\$
Aug 1	Balance b/d			21,700 Cr
20X5				
Jul 31	Income summary	5,500		
31	Dividends		750	15,450 Cr
Aug 1	Balance b/d			15,450 Cr
Jul 31	Income summary		9,000	
31	Dividends	1,500		22,950 Cr
Aug 1	Balance b/d			22,950 Cr



similar to calculating
ending share capital

Share capital (C)

Date	Particulars	Debit	Credit	Balance
20X4		\$ (-)	\$ (+)	\$
Aug 1	Balance b/d			75,000 Cr
20X5				
Aug 1	Balance b/d			75,000 Cr
Nov 15	Cash at bank		20,000	95,000 Cr
20X6				
Aug 1	Balance b/d			95,000 Cr

Chapter 15 Correction of Errors

15.1 Errors not Revealed by Trial Balance

15.2 Correction of Errors

15.3 Effects of Adjustments

[TB Pg 288] Summary

STEP 1 Identify **wrong** entry

STEP 2 Identify **correct** entry

STEP 3 Adjust

- Prepare journal entry
- Adjusted trial balance
- Statement to show adjusted profit (or loss)
 - Income
 - Expense
- Adjusted statement of financial position
 - Asset
 - Liability
 - Equity

Office equipment

Dr 400 0 Cr

400 Dr

Repairs expense

Dr 400 0 Cr

400 Cr

Journal			
Date	Particulars	Debit	Credit
Year		\$	\$
End date	Office equipment	400	
	Repairs expense		400

Adjusted Trial Balance as at [_____]		
	Debit \$	Credit \$
Office equipment (39,000 + 400)	39,400	
Repairs expense (1,700 – 400)	1,300	
...		
	xx	xx

Statement to show adjusted profit (or loss) for the period ended [_____]	
	\$
Unadjusted profit for the period	22,900
Add: Repairs expense — <i>was overstated</i>	400
Less: ...	
Adjusted profit for the period	yy

Adjusted Statement of Financial Position as at [_____]	
	\$
<u>Non-current assets</u>	
Office equipment (39,000 + 400)	39,400
<u>Owner's equity</u>	
Capital (74,900 – 600 + yy)	96,400

[TB Pg 274] Table 15.1

Description of error not revealed by trial balance	Examples of error
The wrong amount is recorded.	<ul style="list-style-type: none"> • Credit purchase of goods worth \$340 has been recorded as \$430. • Payment of \$2,900 by cheque for advertising has been recorded as \$290 in the books. • Credit sale of goods to Hansel for \$1,600 has been recorded as \$1,900 in the books.
The transaction is not recorded at all.	<ul style="list-style-type: none"> • Payment of \$1,200 for utilities by cheque has been omitted from the books. • Goods costing \$1,650 were purchased using cash but this has not been recorded in the books. • Niel (owner) contributed \$1,340 cash to the business, but this has been omitted from the books.
The transaction is recorded in the wrong account of a different accounting element.	<ul style="list-style-type: none"> • Purchase of office equipment worth \$400 by cheque has been recorded as repairs of equipment. • Premise maintenance expense of \$450 paid by cheque has been posted to the premises account. • Payment of \$860 for general expenses has been debited to the inventory account.
The transaction is recorded in the wrong account of the same accounting element.	<ul style="list-style-type: none"> • Credit sale of goods worth \$300 to Lucy has been posted to Lucas' account. • Cheque of \$680 received from credit customer, Tommy Store, has been recorded in the Timmy Store account. • Purchase of office printer worth \$3,700 has been recorded in the inventory account.
The transaction is recorded on the wrong sides of the accounts involved.	<ul style="list-style-type: none"> • Cheque of \$550 received from Betty has been debited to Betty's account and credited to cash at bank. • Cheque of \$1,230 paid to credit supplier, John Wholesaler, has been debited to the cash at bank account and credited to trade payable – John Wholesaler account. • Discount received of \$1,000 has been debited to the discount received account and credited to Jim Wears account.

[TB Pg 274, 281, 284] Example 15.1, 15.2, 15.3b (modified)

Rebecca Trading discovered the following errors on 31 December 20X4.

- 1 Credit purchase of goods worth \$340 has been recorded as \$430.
- 2 Payment of \$1,200 for utilities by cheque has been omitted from the books.
- 3 Purchase of office equipment worth \$400 by cheque has been recorded as repairs of equipment.
- 4 Credit sale of goods worth \$300 to Lucy has been posted to Lucas' account.
- 5 Cheque of \$550 received from Betty has been debited to Betty's account and credited to cash at bank.

(a) Prepare journal entries to correct the errors on 31 December 20X4.

Narrations are not required.

(b) State the effect (understated / overstated / no effect), followed by the amount, of each error (**before** correction) on profit for the year and items in the statement of financial position.

(c) State the effect (increase / decrease / no effect), followed by the amount, of correction of each error (**after** correction) on profit for the year and items in the statement of financial position.

Before the errors were corrected, Rebecca Trading's profit for the year ended 31 December 20X4 was \$22,900.

(d) Prepare a statement to show adjusted profit for the year ended 31 December 20X4.

Steps to correct error

- 1 Identify the **correct** double entry (5-step procedure)
- 2 Identify the **wrong** double entry (error described in the question)
- 3 **Adjust** from wrong to correct double entry

Ch 15 Notes

Correction of errors

Error 1: Credit purchase of goods worth \$340 has been recorded as \$430.



Steps to correct error	Amount \$	Ledger account (1)	Ledger account (2)
1 Correct	340	Inventory +A Dr	Trade payables +L Cr
2 Wrong	430	Inventory +A Dr (overstated)	Trade payables +L Cr (overstated)
3 Adjust	430 – 340 = 90	Inventory -A Cr (decrease)	Trade payables -L Dr (decrease)

Error 2: Payment of \$1,200 for utilities by cheque has been omitted from the books.

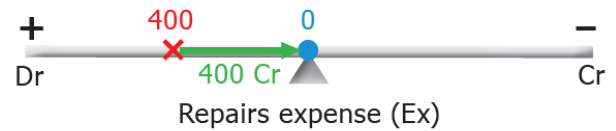
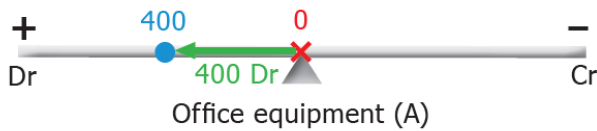


Steps to correct error	Amount \$	Ledger account (1)	Ledger account (2)
1 Correct	1,200	Utilities expense + Ex Dr	Cash at bank - A Cr
2 Wrong	0	Not recorded (Utilities expense understated)	Not recorded (Cash at bank overstated)
3 Adjust	1,200	Utilities expense + Ex Dr (increase) Profit decrease → LESS	Cash at bank - A Cr (decrease)

Ch 15 Notes

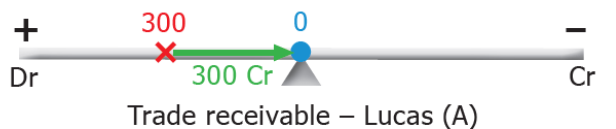
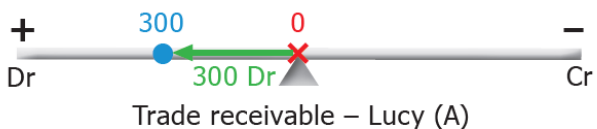
Correction of errors

Error 3: Purchase of office equipment worth \$400 by cheque has been recorded as repairs of equipment.



Steps to correct error	Amount \$	Ledger account (1)	Ledger account (2)
1 Correct	400	Office equipment +A Dr (understated)	Cash at bank -A Cr
2 Wrong	400	Repairs expense +Ex Dr (overstated)	Cash at bank -A Cr (remain unaffected)
3 Adjust	400	Office equipment +A Dr (increase)	Repairs expense -Ex Cr (decrease) Profit increase → ADD

Error 4: Credit sale of goods worth \$300 to Lucy has been posted to Lucas' account.

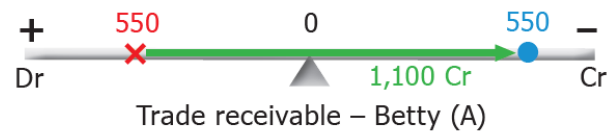
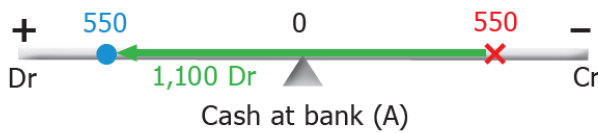


Steps to correct error	Amount \$	Ledger account (1)	Ledger account (2)
1 Correct	300	Trade receivable – Lucy +A Dr (Lucy understated)	Sales revenue +I Cr
2 Wrong	300	Trade receivable – Lucas +A Dr (Lucas overstated)	Sales revenue +I Cr
3 Adjust	300	Trade receivable – Lucy +A Dr (Lucy increase)	Trade receivable – Lucas -A Cr (Lucas decrease)

Ch 15 Notes

Correction of errors

Error 5: Cheque of \$550 received from Betty has been debited to Betty's account and credited to cash at bank.



Steps to correct error	Amount \$	Ledger account (1)	Ledger account (2)
1 Correct	550	Cash at bank +A Dr	Trade receivable – Betty - A Cr
2 Wrong	550	Cash at bank - A Cr (understated)	Trade receivable – Betty +A Dr (overstated)
3 Adjust	550 X 2 = 1,100	Cash at bank +A Dr (increase)	Trade receivable – Betty - A Cr (decrease)

Journal			
Date	Particulars	Debit	Credit
20X4		\$	\$
Dec 31	Trade payables	90	
	Inventory		90
Dec 31	Utilities expense	1,200	
	Cash at bank		1,200
Dec 31	Office equipment	400	
	Repairs expense		400
Dec 31	Trade receivable — Lucy	300	
	Trade receivable — Lucas		300
Dec 31	Cash at bank	1,100	
	Trade receivable — Betty		1,100

Effects of error before correction

Error	Effects of Items on the Statement of Financial Position	Effects on Profit
1	Assets was overstated by \$90 Liabilities was overstated by \$90	No effect
2	Assets was overstated by \$1,200	Profit was overstated by \$1,200
3	Assets was understated by \$400	Profit was understated by \$400
4	No effect	No effect
5	No effect	No effect

Effects of adjustment after correction

Error	Effects of Items on the Statement of Financial Position	Effects on Profit
1	Assets decreased by \$90 Liabilities decreased by \$90	No effect No effect
2	Assets decreased by \$1200	Profit decreased by \$1,200
3	Assets increased by \$400	Profit increased by \$400
4	No effect	No effect
5	No effect	No effect

Rebecca Trading

Statement to show adjusted profit for the year ended 31 December 20X4

	\$
Unadjusted profit for the year	22,900
Add: Repairs expense was overstated	400
Less: Utilities expense was understated	1,200
Adjusted profit for the year	22,100

Add / Less depends on whether profit **increase / decrease** after error was corrected.
Description of error depends on whether expense or income was **overstated / understated** before the error was corrected.



Chapter 16 Financial Statements Analysis

16.1 Financial Statements Analysis

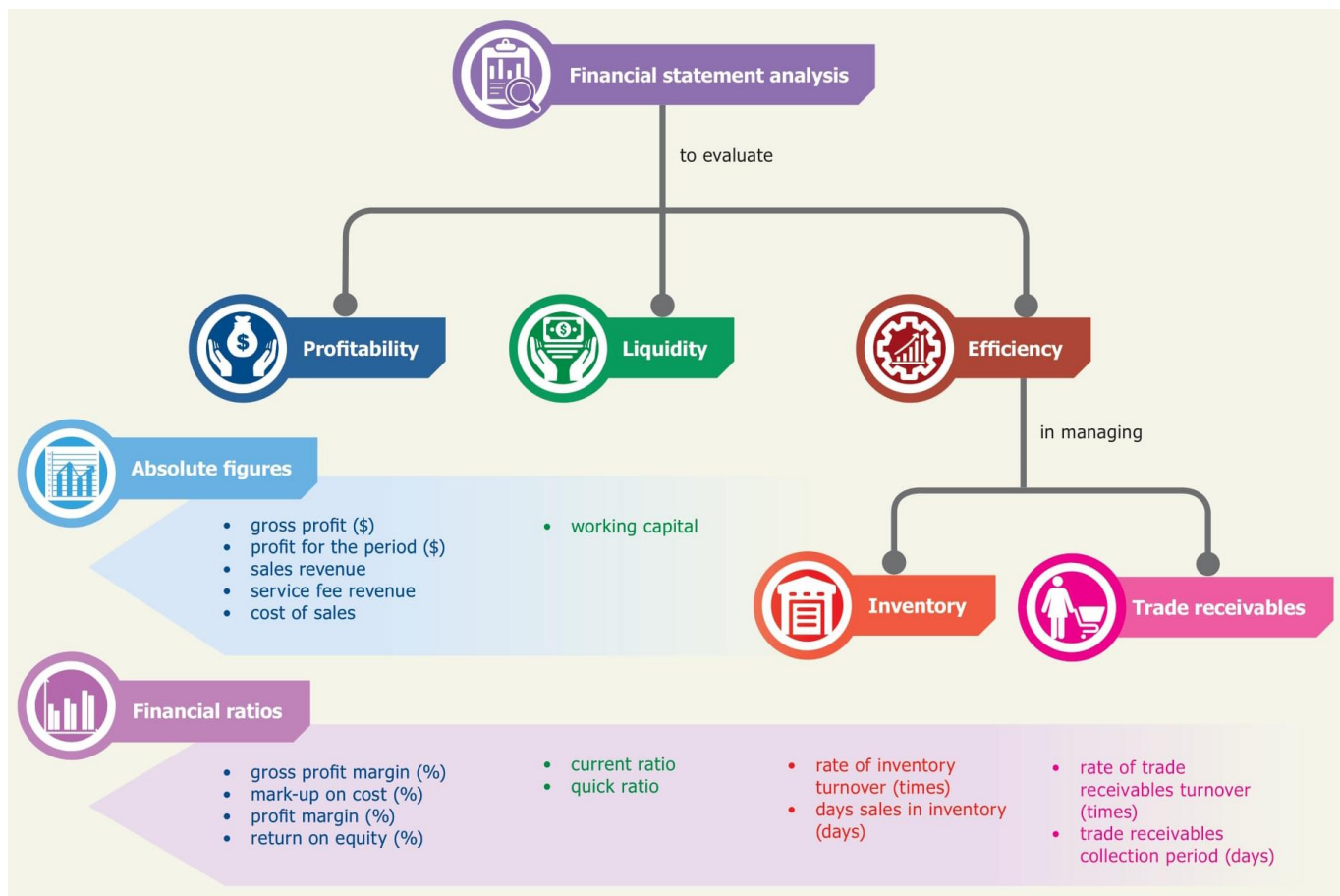
16.2 Profitability

16.3 Liquidity

16.4 Efficiency in Inventory Management

16.5 Efficiency in Trade Receivables Management

[TB Pg 307] Summary



Keywords to use to evaluate financial ratios

Ratio	Over time	Against another business
Example: gross profit margin	<p>The gross profit margin has improved / worsened from 13.04% in 2016 to 16.67% in 2017.</p> <p>In conclusion, the business has become more / less profitable over the years from 2016 to 2017.</p>	<p>A's gross profit margin of 55.00% is better / worse than B's gross profit margin of 52.13%.</p> <p>In conclusion, A is more / less profitable than B.</p>
Word of caution	Avoid increase / decrease in the main comment, use improve / worsen.	Avoid higher / lower in the main comment, use better / worse.

Gross profit margin (%)	$\frac{\text{Gross profit}}{\text{Net sales revenue}} \times 100\%$
Mark-up on cost (%)	$\frac{\text{Gross profit}}{\text{Cost of sales}} \times 100\%$
Profit margin (%)	$\frac{\text{Profit}}{\text{Net sales revenue}} \times 100\%$
Return on equity (%)	$\frac{\text{Profit}}{\text{Average equity}} \times 100\%$ $\text{Average equity} = \frac{\text{Equity (start)} + \text{Equity (end)}}{2}$
Working capital (\$)	Current assets – Current liabilities
Current ratio (no units)	$\frac{\text{Current assets}}{\text{Current liabilities}}$
Quick ratio (no units)	$\frac{\text{Current assets} - \text{Inventory} - \text{Prepaid expense}}{\text{Current liabilities}}$ <p style="text-align: center;">OR</p> $\frac{\text{Cash} + \text{Receivables}}{\text{Current liabilities}}$
Rate of inventory turnover (times)	$\frac{\text{Cost of sales}}{\text{Average inventory}}$ $\text{Average inventory} = \frac{\text{Inventory (start)} + \text{Inventory (end)}}{2}$
Days sales in inventory (days)	$\frac{\text{Average inventory}}{\text{Cost of sales}} \times 365 \text{ days}$ <p style="text-align: center;">OR</p> $\frac{1}{\text{rate of inventory turnover}} \times 365 \text{ days}$
Rate of trade receivables turnover (times)	$\frac{\text{Net credit sales or service fee revenue}}{\text{Average net TR}}$ $\text{Average net TR} = \frac{\text{Net TR (start)} + \text{Net TR (end)}}{2}$ $\text{Net TR} = \text{TR} - \text{Allowance for impairment of TR}$
Trade receivables collection period (days)	$\frac{\text{Average net TR}}{\text{Net credit sales or service fee revenue}} \times 365 \text{ days}$ <p style="text-align: center;">OR</p> $\frac{1}{\text{rate of TR turnover}} \times 365 \text{ days}$

Profitability	<ol style="list-style-type: none"> 1. Explain what is meant by the profitability of a business. Profitability is the ability of a business to generate excess income to cover its expenses. 2. State two reasons why it is important that a business is profitable. TB Pg 293 <ul style="list-style-type: none"> • It is important to make a gross profit from the buying and selling of goods to gain a competitive advantage over its competitors. • It is also important for the business to make a profit so that this can be reinvested in the business. 3. State what is measured by return on equity. Return on equity measures the amount of profit a business earns for every dollar of equity invested by the owner or shareholders in the business. 4. Suggest two ways to improve the profitability of the business. TB Pg 292 Table 16.1 <ul style="list-style-type: none"> • Sell goods at higher selling price • Buy goods at lower cost price - Buy in bulk to obtain trade discount • Increase sources of other income - Sublet excess space to another business to earn rental income • Reduce operating expenses - Reduce the use of electrical appliances to lower utilities expenses
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Profitability Ratio	Formula	Interpretation
gross profit margin (%)	$\frac{\text{Gross profit}}{\text{Net sales revenue}} \times 100\%$	higher GPM, more profitable
mark-up on cost (%)	$\frac{\text{Gross profit}}{\text{Cost of sales}} \times 100\%$	higher MUC, more profitable
profit margin (%)	$\frac{\text{Profit}}{\text{Net sales revenue}} \times 100\%$	higher PM, more profitable
return on equity (%)	$\frac{\text{Profit}}{\text{Average equity}} \times 100\%$ $\text{Average equity} = \frac{\text{Equity (start)} + \text{Equity (end)}}{2}$ <ul style="list-style-type: none"> • Sole proprietorship: owner's equity • Private limited company: shareholders' equity 	higher ROE, more efficient in generating profits for its owners or shareholders

[TB Pg 296] Example 16.2b – Against another business

	HighTech	GreatFun
Gross profit margin	55.00% ★	52.13%
Mark-up on cost	122.22% ★	108.92%
Profit margin	8.36%	15.00% ★
Return on equity	5.03%	11.61% ★

Evaluate the profitability of the two businesses.

Gross profit margin	<ul style="list-style-type: none"> HighTech's gross profit margin of 55.00% is better than GreatFun's gross profit margin of 52.13%.
Mark-up on cost	<ul style="list-style-type: none"> This could be due to HighTech selling its goods at a higher selling price, or buying its goods at a lower cost price, or both as shown by a better mark-up on cost of 122.22% as compared to GreatFun's mark-up on cost of 108.92%.
Profit margin	<ul style="list-style-type: none"> HighTech's profit margin of 8.36% is worse than GreatFun's profit margin of 15.00%. This shows that HighTech is less efficient at controlling its expenses to generate net sales revenue compared to GreatFun.
Return on equity	<ul style="list-style-type: none"> HighTech's return on equity of 5.03% is worse than GreatFun's return on equity of 11.61%. This shows that HighTech is less efficient at generating profits for its shareholders.
Conclusion (profit margin)	<ul style="list-style-type: none"> In conclusion, HighTech is less profitable than GreatFun.

Note

- Be consistent and keep to one perspective, either HighTech or GreatFun.
- Avoid higher / lower in the main comment, use better / worse.

[WB Pg 208] Q4 – Over time

	20X6	20X7	Trend
Gross profit margin	13.04%	16.67%	
Mark-up on cost	15.00%	20.00%	
Profit margin	7.50%	12.65%	

Comment on the profitability of Sparkles Trading for the two years ended 31 December 20X6 and 20X7.

Gross profit margin	<ul style="list-style-type: none"> The gross profit margin has improved from 13.04% in 20X6 to 16.67% in 20X7.
Mark-up on cost	<ul style="list-style-type: none"> This could be due to Sparkles Trading selling its goods at a higher selling price or buying its goods at a lower cost price in 20X7 than in 20X6, or both as shown by the improvement in mark-up on cost from 15.00% in 20X6 to 20.00% in 20X7.
Profit margin	<ul style="list-style-type: none"> Its profit margin improved from 7.50% in 20X6 to 12.65% in 20X7. This shows that the business has become more efficient at controlling its expenses to generate net sales revenue over the years from 20X6 to 20X7.
Conclusion (profit margin)	<ul style="list-style-type: none"> In conclusion, the business has become more profitable over the years from 20X6 to 20X7.

Note Avoid increase / decrease in the main comment, use improve / worsen.

Liquidity	<p>5. Explain what is meant by the liquidity of a business.</p> <p>Liquidity is the ability of a business to convert current assets into cash to pay current liabilities.</p> <p>6. Explain the meaning of the term 'working capital'.</p> <p>Working capital refer to the excess of current assets over current liabilities.</p> <p>7. State two reasons why working capital is important for a business.</p> <ul style="list-style-type: none"> • The business needs to have enough current assets to settle its current liabilities when they fall due. • The business needs to have enough current assets to pay for its daily operating expenses to ensure business run smoothly. • It will be easier for the business to obtain short-term loan from the lenders. <p>8. Distinguish between the quick ratio and the current ratio.</p> <p>TB Pg 299 Table 16.4</p> <p>Current ratio measures the ability of a business to pay its short-term debts using its current assets while quick ratio measures the ability of a business to pay its short-term debts using its quick assets, excluding inventory and prepayments.</p> <p>9. Advise on two measures she may take to improve her liquidity position.</p> <p>TB Pg 297 Table 16.3</p> <ul style="list-style-type: none"> • Increase sources of cash - Obtain cash contribution from owner or shareholders • Manage cash outflow - Reduce operating expenses e.g. utilities <p>10. Identify two problems the business may face as a result of the (poor) liquidity of the business.</p> <p>TB Pg 297</p> <p>A business with low liquidity is usually short of cash and may be unable to settle its immediate debts. If this persists, the business may:</p> <ul style="list-style-type: none"> • eventually close down • be unable to negotiate for better credit terms with supplier • be unable to obtain bank loan
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	<p>11. Suggest why the liquidity of the business has changed even though profit remained the same over the three years.</p> <ul style="list-style-type: none"> Liquidity is determined by its current assets and current liabilities while profit is determined by its income and expenses. The business may buy goods on credit, which will affect liquidity but has no effect on profit. The business may sell to the same group of customers and make the same amount of sales. However, these customers may make payment at different times, which explains the change in liquidity but not profit. <p>12. Explain the impact of having liquidity ratios that are much higher than the acceptable norm.</p> <p>The business may not be fully utilising its cash to generate profits.</p>	
Liquidity Ratio	Formula	Interpretation
Working capital (\$)	Current assets – Current liabilities	Depending on the nature and size of the business, the amount of working capital that is considered sufficient differs
Current ratio	$\frac{\text{Current assets}}{\text{Current liabilities}}$	<p>Higher current ratio, more liquid</p> <p>General benchmark: 2</p>
Quick ratio	$\frac{\text{Current assets} - \text{Inventory} - \text{Prepaid expense}}{\text{Current liabilities}}$ <p style="text-align: center;">OR</p> $\frac{\text{Cash} + \text{Receivables}}{\text{Current liabilities}}$	<p>Higher quick ratio, more liquid</p> <p>General benchmark: 1</p>

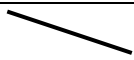
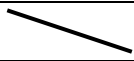
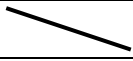
[WB Pg 218] Q10b – Against another business

	Innovative Technology	A Global
Working capital	\$128,400	\$348,450 ★
Current ratio	2.76	4.43 ★
Quick ratio	1.76 ★	0.93

Comment on the liquidity of both businesses.

Working capital	<ul style="list-style-type: none"> Innovative Technology's working capital of \$128,400 is worse than A Global's working capital of \$348,450. This means that Innovative Technology has lesser excess current assets to pay off short term debts than A Global.
Current ratio	<ul style="list-style-type: none"> Innovative Technology's current ratio of 2.76 is worse than A Global's current ratio of 4.43. The current ratios of both businesses are above the general benchmark of 2 which indicates that both businesses have more than sufficient current assets to pay for its short-term debts.
Quick ratio	<ul style="list-style-type: none"> Innovative Technology's quick ratio of 1.76 is better than A Global's quick ratio of 0.93, which is below the general benchmark of 1. This indicates that A Global may not be able to pay its short-term debts using quick assets when they fall due. This may be due to A Global having its funds tied up in inventory as it is holding significantly higher amounts of inventory at \$348,550 as compared to that of Innovative Technology at \$68,000. In addition, A Global's current liabilities have increased due to part of a long-term loan of \$25,000 which would be repaid within a year.
Conclusion (quick ratio)	<ul style="list-style-type: none"> In conclusion, Innovative Technology is more liquid than A Global.

[TB Pg 301] Example 16.3c – Over time

	20X4	20X5	Trend
Working capital	\$33,300	\$31,400	
Current ratio	2.13	1.82	
Quick ratio	1.42	0.92	

Evaluate the liquidity of AverRedi over the two years.

Working capital	<ul style="list-style-type: none"> Working capital has worsened from \$33,300 in 20X4 to \$31,400 in 20X5. This shows that the business has lesser excess of current assets over current liabilities over the two years, hence the business is less able and ready in settling its immediate debts over the years.
Current ratio	<ul style="list-style-type: none"> In addition, current ratio has worsened from 2.13 in 20X4 to 1.82 in 20X5, which was below the general benchmark of 2. This shows that the business has lesser current assets over the years to repay its immediate debts. This could be due to the increase in trade payables from \$19,600 in 20X4 to \$28,100 in 20X5, which might have contributed to the greater extent of increase in current liabilities over current assets over the two years.
Quick ratio	<ul style="list-style-type: none"> Quick ratio has worsened from 1.42 in 20X4 to 0.92 in 20X5, which was below the general benchmark of 1. This indicates that AverRedi has lesser quick assets over the years to pay its short-term debts. In 20X5, the business may not be able to pay its short-term debts using quick assets when they fall due. This could be due to the increase in inventory from \$18,600 in 20X4 to \$31,000 in 20X5, which tied up cash, as shown by the decrease in cash at bank balance from \$18,000 in 20X4 to \$7,000 in 20X5.
Conclusion (quick ratio)	<ul style="list-style-type: none"> Hence, the business has become less liquid over the two years.

Efficiency of inventory management	<p>13. Explain what is meant by the efficiency of inventory management of a business.</p> <p>Efficiency of inventory management is the ability of a business to maintain inventory at an optimal level to meet customer demand.</p> <p>14. Explain why it is important for a business to be efficient in managing its inventory.</p> <ul style="list-style-type: none"> • A business usually buys sufficient goods to keep on hand to prevent a stock-out situation, which often results in a loss of sales. • If the business buys too many goods and is unable to sell them, it will incur higher storage costs and increase the risk of the goods becoming obsolete. <p>15. Suggest two ways in which inventory turnover rates can be improved.</p> <p>TB Pg 302 Table 16.6</p> <ul style="list-style-type: none"> • Sell inventory faster - Provide trade discounts to encourage customers to buy in bulk and regularly • Keep sufficient inventory on hand - Use technological tools to improve the accuracy of predictions about customer demand in order to know when and how much inventory to buy 	
Efficiency Ratios	Formula	Interpretation
Rate of inventory turnover (times)	$\frac{\text{Cost of sales}}{\text{Average inventory}}$ $\text{Average inventory} = \frac{\text{Inventory (start)} + \text{Inventory (end)}}{2}$	Higher number of times a business has sold and replaced its goods, more efficient
Days sales in inventory (days)	$\frac{\text{Average inventory}}{\text{Cost of sales}} \times 365 \text{ days}$ <p style="text-align: center;">OR</p> $\frac{1}{\text{rate of inventory turnover}} \times 365 \text{ days}$	Fewer days a business takes to sell its goods, more efficient

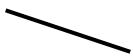

[TB Pg 303] Example 16.4b – Against another business

	AverRedi	Energi
Rate of inventory turnover	14.91 times	20 times ★
Days sales in inventory	24.48 days	18.25 days ★

Evaluate AverRedi's efficiency in inventory management against its competitor, Energi.

Rate of inventory turnover	AverRedi's rate of inventory turnover of 14.91 times is worse than Energi's rate of inventory turnover of 20 times.
Days sales in inventory	AverRedi's days sales in inventory of 24.48 days is worse than Energi's days sales in inventory of 18.25 days.
Conclusion (either ratio)	While there is insufficient information to say why this might be the case, AverRedi and Energi are in the same industry, so it is appropriate to conclude that AverRedi is selling its goods slower and hence, is less efficient at managing its inventory than Energi.

[WB Pg 222] Q5 – Over time



	20X5	20X6	20X7	Trend
Rate of inventory turnover	10 times	9 times	7 times	
Days sales in inventory	36.5 days	40.56 days	52.14 days	

Comment on the trend of rate of inventory turnover and days sales in inventory over the three years from 20X5 to 20X7.

Rate of inventory turnover	<ul style="list-style-type: none"> Rate of inventory turnover has worsened from 10 times in 20X5 to 9 times in 20X6 to 7 times in 20X7.
Days sales in inventory	<ul style="list-style-type: none"> This indicates that the business is taking longer to sell its goods, which can also be seen from the worsening of days sales in inventory from 36.5 days in 20X5 to 40.56 days in 20X6 to 52.14 days in 20X7.
Conclusion (either ratio)	<ul style="list-style-type: none"> Hence, Tiffany Supplies has become less efficient at managing its inventory over the three years.

Efficiency of trade receivables management	<p>16. Explain what is meant by the efficiency of trade receivables management of a business.</p> <p>Efficiency of trade receivables management is the ability of a business to grant appropriate credit terms to promote sales and collect cash from its credit customers on a timely basis.</p> <p>17. Explain why it is important for a business to be efficient in managing its trade receivables.</p> <p>When a business takes longer than usual to collect payment from its credit customers, it would have lesser cash, causing its liquidity position to worsen.</p> <p>18. Suggest one way to improve the efficiency in the management of its trade receivables.</p> <p>TB Pg 305 Table 16.8</p> <ul style="list-style-type: none">• Improve credit granting processes - Ensure credit is granted to customers who are financially able• Provide monetary incentives - Offer cash discounts to encourage credit customers to pay early• Increase debt collection efforts - Send regular reminders to credit customers who delay payment or refuse to pay		
Efficiency Ratio	Formula (Trading)	Formula (Service)	Interpretation
Rate of trade receivables turnover (times)	$\frac{\text{Net credit sales revenue}}{\text{Average net TR}}$	$\frac{\text{Credit service fee revenue}}{\text{Average TR}}$	Higher number of times a business collects payment from its credit customers, more efficient
	$\text{Average net TR} = \frac{\text{Net TR (start)} + \text{Net TR (end)}}{2}$ <p>Net TR = TR – Allowance for impairment of TR</p>		
Trade receivables collection period (days)	$\frac{\text{Average net TR}}{\text{Net credit sales revenue} \times 365 \text{ days}}$	$\frac{\text{Average TR}}{\text{Credit service fee revenue} \times 365 \text{ days}}$	Fewer days a business takes to collect payment from its credit customers, more efficient
	OR $\frac{1}{\text{rate of TR turnover}} \times 365 \text{ days}$		

[TB Pg 306] Example 16.5c – Over time

	20X6	20X7	Trend
Rate of trade receivables turnover	14.14 times	10.80 times	
Trade receivables collection period	25.81 days	33.79 days	

Evaluate the efficiency of Quality Time Trading's trade receivables management over the two years.

Rate of trade receivables turnover	<ul style="list-style-type: none"> Quality Time Trading's rate of trade receivables turnover worsened from 14.14 times in 20X6 to 10.80 times in 20X7. This means that it was collecting payment from its credit customers on a less timely basis than the previous year.
Trade receivables collection period	<ul style="list-style-type: none"> This can also be seen from the worsening of the trade receivables collection period from 25.81 days in 20X6 to 33.79 days in 20X7, <i>which had gone beyond the 30-day credit period.</i> (only if the question provides the credit term) This shows that it was taking longer time to collect payment from its credit customers as compared to the previous year.
Conclusion (either ratio)	<ul style="list-style-type: none"> Hence, Quality Time Trading has become less efficient at managing its trade receivables over the two years.