POA THEORY

Trading Business
A trading business is a business which buys goods from suppliers and sells it to its customers.
A trading business has a gross profit,sales return and cost of sales

Service Business
A service business is a business which sells its services to the business.
A service business only has service fee revenue

Types of business and ownerships
Sole Proprietorship

Capital Structure	It is owned by one person who solely contributes to the capital to set up the business Banks and other lenders are less likely to lend money to an sp due to the lack of personal assets that serve as collaterals.Hence the access to funds is normally limited to the personal funds of the owner
Risks	When an sp incurs debts and losses,the owner is obliged to pay them using her or her personal assets
Management of the business	1. The sole owner runs the business by himself or herself and has absolute control over the business and he or she can hire professionals to help him or her out 2. It exists until the owner is alive and willing to continue operations 3. The sole owner can transfer his of her ownership to another person by updating the particulars of the new owner to notify the corporate regulatory authority of the transfer of ownership 4. An SP has minimal Administrative duties to adhere to

Limited Liability Partnership(LLP)

Capital Structure	It is owned by two or more partners where each partner contributes capital to set up the business Banks and other lenders are more likely to lend money to an LLP due to more sources of personal and assets from owners and business assets.Alternatively they can also join more people as partners and contribute to the capital.
Risks	When an LLP incurs debts and losses, the owners are not personally liable for them,However when an LLP incurs debts and losses dut to the wrongful actions that partner is personally liable for those debts and losses and the other partners are not affected
Management of the business	Usually the control over the business is shared among the partners with at least one partner heavily involved in managing the business. It exists until wound up or struck off. All owners need to agree to the addition or withdrawal of owners before the corporate regulatory authority acknowledges the transfer of ownership. An LLP has few regulatory duties to adhere to. However one of the owners have to submit an annual declaration stating whether the business is able to pay the debts and losses during the normal course of the business.

Private limited company(PLC)

Capital Structure	It is owned by 50 or less shareholders where each shareholder buys shares and contributes capital Banks and other lenders are more likely to lend money to a company due to more sources of business of high value that serve as collaterals. Alternatively, the company can issue more shares and raise funds
Risks	When a company incurs debts and losses, The shareholders are not obliged to pay them using their personal assets and may lose their dividends. In the worst case scenario,they would have to forfeit their investment.
Management of the business	The shareholders have no control over the business unless they are part of the management team. The company hires professionals to manage the business on behalf of shareholders. It exists forever until wound up or struck off. Shareholders can pay stamp duty to the tax authority to give their shares to another person or organisation They have statutory requirements to comply with and file annual financial reports.

Different stakeholders and their decisions

Owners and Shareholders	Contribute capital and expect profit distribution in return Whether to continue to invest on the business depending on the risks and returns related to the business
Managers	Work for the business and devise strategic plans to run the business efficiently Whether to consider ways to improve the performance of the business
Employees	Work for the business and perform executive duties Whether to continue to work for the business
Banks and other lenders	Make money available to the business and expect it to be fully repaid with interest Whether to grant loans to the business depending on the business ability to repay the loan principal and pay interest
Suppliers	Supply goods and/or services to the business Whether to supply goods and/or services to the business on credit depending on the business ability to pay
Customers	Buy goods and/or service from the business Whether to buy goods and/or services from the business,depending on the business ability to provide what they need and good after sales service
Governments	Enforce tax regulations Whether the business complies with the tax regulations and decide the amount of tax to be collected from the business
Competitors	Sell similar goods and/or services as the business Whether they are comparable with the business and how to improve their own performance.

Role Of Accounting

Accounting is an information system which provides accounting information for stakeholders to make informed decisions regarding the management of resources and the performance of the businesses.

Role Of An Accountant

Accountants prepare and provide accounting information for stakeholders to make informed decisions. By doing so, they set up the accounting information system and become stewards of the business.

Professional ethics

Integrity

An accountant who is straightforward is honest in all professional relationships

Objective

A accountant who is objective will not let bias,conflict of interests or undue influence of others affect their professional judgement

Accounting theories

- **Accounting Entity Theory:** The activities of the business are recorded separately from the actions of the owners, All transactions are recorded from business point of view
- **Accounting period:** The life of a business is divided into regular time intervals(usually 12 years = 1 financial year)
- **Accrual of Basis of Accounting theory:** Business activities that have occurred regardless of whether cash is paid or received must be recorded in the relevant financial periods.
  Expenses: Expenses incurred regardless of whether cash is paid or not must be recorded in relevant accounting period

	Beginning of the financial period	Ending of the financial period
Prepaid Expenses	+	-
Expense payable	-	+

Income: Income earned regardless of whether cash is received or not must be recorded in relevant accounting period

	Beginning of the financial period	Ending of the financial period
Income Received in advance	+	-
Income receivables	-	+

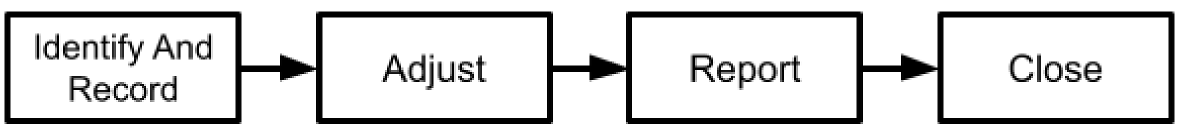
- **Going-Concern Theory** : A business is assumed to have an indefinite economic life unless there is credible evidence that the business is going to close down.
- **Historical Cost Theory** : All transactions are recorded at their original costs
- **Monetary Theory :** Only transactions that can be measured in monetary terms are recorded
- **Objectivity Theory :** All transactions recorded must be supported with reliable and verifiable evidence to free financial statements from opinions and biases.
- **Prudence Theory :**
    1. Inventory should be valued at its cost or net realisable value whichever is lower.
    2. The allowance for impairment loss of trade receivable is shown as a deduction against the book value of trade receivables to prevent overstating the book value of trade receivables and reflect the net amount which is collectible.
    3. Non current assets should be valued at its net book value which is cost - accumulated depreciation(depreciation is the allocation of cost of a non current asset over the estimated useful life)
- **Matching Theory :**
    1. It states that the expenses incurred is matched against the income earned to determine the profit for the period
    2. The change in the allowance for impairment of trade receivables is recorded as impairment loss of trade receivables in the statement of financial performance which is added to the other expenses and is matched against the income earned to determine the profit for the period.
    3. It states that a portion of the non current asset is recorded as a depreciation expense in the statement of financial performance as an expense which is matched against the income earned to determine the profit for the period
- **Consistency Theory**
    1. The Accounting method used must be the same for all financial periods to enable meaningful comparison
    2. The same method of depreciation and rate of depreciation must be used to calculate the depreciation expense of non current assets to enable meaning comparison over time

- **Materiality theory**
    1. Relevant accounting information is recorded if it is likely to make a change to the decision making process
    2. When the cost spent on a NCA is insignificant when compared to the size of income and profit it does not need to be recorded as a non current asset in the statement of financial position it must be recorded as an revenue expenditure in the expense column in the statement of financial performance.

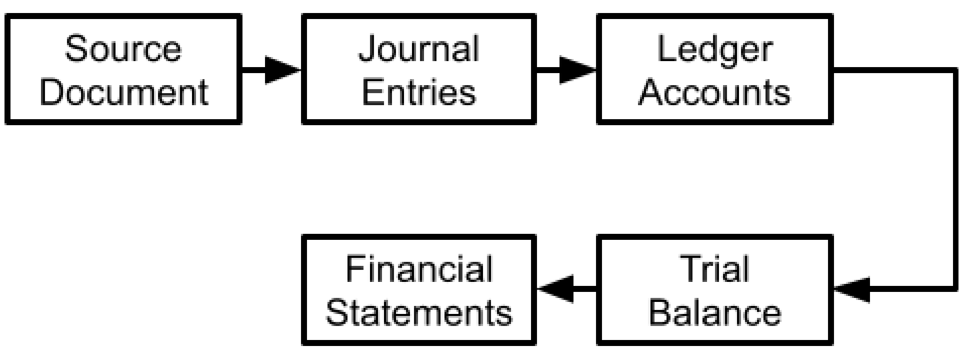
Capital Expenditure	Revenue Expenditure
It is the cost spent to buy and bring the non current asset to intended use It is the cost spent to enhance the non current asset	It is the cost spent to operate,maintain and repair the non current asset in working condition
It provides benefits beyond one year	It provides benefits within one year
Recorded as a Non Current asset	Recorded as an expense

- **Revenue Recognition Theory :** Revenue is earned when the goods have been delivered or the services have been provided

ACCOUNTING CYCLE



Accounting Information System



Double entries for insurance claim on damaged goods Recording the insurance claim received

Dr Insurance Claim receivable

Cr Impairment Loss of inventory

Recording the insurance claim received

Dr Cash At Bank

Cr Insurance Claim Receivables

SOURCE DOCUMENTS

Receipt	Acknowledges the the payment made by customers immediately after the goods have been sold or services have been provided
Remittance Advice	Informs the Credit supplier about the payment made by cheque for a specific invoice
Invoice	Informs the credit customer about the amount of money owed after the business have sold goods or provided services
Credit Note	Reduces the amount of money owned by the credit customers as they might be previously overcharged or goods might have been returned
Debit Note	Increases the amount of money owed by the business as they might be previously overcharged
Payment Voucher	Processes payment made to credit supplier which must be approved by authorised personnel and supported by original suppliers invoice
Bank Statement	Check and tallies against the business records of the business bank account

Purpose of internal control

Safeguard assets of the business

Ensure all business transactions are recorded accurately

Ensure business complies with laws and regulations

Types of internal control

- Segregation of duties
  Separate cash handling and cash recording duties among different employees and not one person managing the entire cash process
- Custody of Cash
  Secure cash in a locked storage and only allow authorised personnel to access it
- Authorisation
  Transactions must be at least authorised by 2 people
- Bank Reconciliation
  Identify the accounts which resulted in the difference between the balances of the bank statement and the business bank account.

Inventory management

- A business manages its inventory by maintaining it at an optimum level to ensure sufficient goods to meet customer demands.

Efficient inventory management involve two aspects

- Maintaining at an optimum level
- Managing the rate of inventory turnover

Rate of inventory turnover

(cost of sales/average inventory)
Average inventory= (beginning + ending inventory)/2

Measure the number of times the business sells and replaces its inventory
The higher the rate of inventory turnover,the more efficient the business is managing its inventory(the reasoning)

Day sales in inventory turnover

(Average inventory/Cost of sales)
Average Inventory= (beginning inventory + ending inventory)/2

Measures the number of days the business takes to sell its inventory
The shorter the number of days,the more efficient the business is managing its inventory.

Benefits of good inventory management

- Ensure sufficient goods to meet sales demands
- Optimise cost of purchase and ensure business qualifies for trade discount and cash discounts
- Reduces the possibility of inventory being obsolete or damaged
- Minimise storage costs

Consequences of poor inventory management

- A business should ensure that it has sufficient goods in hand to prevent a stock out situation.This is because when a business is not able to provide the goods the customer need it might result in the loss of credibility and loss of sales from customers
- When a business buys too much inventory and is unable to sell them,it might lead to higher cost of purchases,missing out on cash discounts
- Increases the possibility of inventory being obsolete or damaged
- Higher storage costs

Ways to improve the inventory management

- Sell goods faster!!!
    1. Lower the selling price of slower moving goods
    2. Provide trade discounts to encourage customers to buy in bulk
    3. Attract more customers through marketing and advertising campaigns
- Ensure sufficient goods in hand
    1. Use technology to increase the accuracy of predictions of customer demands in order to know how much goods to buy

Trade receivables management

- A business manages its trade receivable by granting appropriate credit terms to promote sales and collect money from credit customers on a timely basis
- Rate of trade receivable turnover
  (Net credit sales or Net credit service fee revenue)/(Average net trade receivables)
  Net trade receivable means trade receivables - allowance
  Average net trade receivable=(beginning + ending)/2
  Measures the number of times the business collects payments from its credit customers
  The higher the rate of trade receivable turnover the more efficient the business is in managing its trade receivables(the reasoning)
- Trade receivable collection period
  Average net trade receivables/Net credit sales or Net service fee
  Net trade receivable means trade receivables - allowance
  Average net trade receivable=(beginning + ending)/2
  Measures the number of days the business takes to collect money from its credit customers
  The shorter the number of days the more efficient the business is managing its trade receivables(the reasoning)
- Good trade receivable management
  Increases sales revenue
  Attracts more customers and maintains customer loyalty
  Maintains good cash in flow from credit customers
- Consequences of poor trade receivable management
  Lack of sales and lack of customers
  Liquidity will be affected due to slower or lower cash inflow from credit customers
- Ways to improve trade receivable management
  Improve credit granting process
    - Monitor the collection period closely
    - Only grant credit terms to customers who are financially able

  Provide monetary incentives
    - Provide cash discounts to encourage credit customers to pay early

  Increase debt recovery efforts
    - Send regular reminders to credit customers who delay payment or refuse to pay
    - Hire professional debt recovery agencies to collect money from financially distressed credit customers

Profitability

- Profitability refers to the ability of the business to generate excess income to cover the expenses
- Gross profit(Net sales revenue - Cost of sales)
  It is important for a business to have a gross profit as a gross loss means that the business is selling its goods below its cost price
- Profit(Gross profit + Other income - Other expenses)
  It is important for the business to have a profit as it can be reinvested back into the business
- Generally,the profitability ratio help determine the business performance
- Gross Profit Margin
  (Gross profit/ Net Sales revenue) x 100%
  Whether the business is able to sell the goods at a higher selling price
  Measure how much gross profit the business earns for every dollar of net sales revenue
  The Higher the gross profit margin the more profitable the business
- Mark-up on cost
  (Gross profit/Cost of sales) x 100%
  Whether the business is able to find a supplier who sells the **same goods** at a lower cost price
  Measures how much gross profit the business earns for every dollar of cost of sales
  The higher the mark-up on cost the more profitable the business is.
- Profit margin
  (Profit/Net sales revenue) x 100%
  Whether the business is able to manage its expenses well
  Measures how much profit the business earns from every dollar of net sales revenue
  The higher the profit margin the more profitable the business is
- Return on equity
  Profit for the year/Average inventory
  Measure on how much profit the business makes from every dollar of equity invested in to the business my owners and shareholders
  The higher the return on equity,the more profitable the business,meaning it generates more profits for owners and shareholders

Liquidity

- Liquidity is the ability of the business to convert assets into cash to pay current liabilities
- Being liquid means that the business has **sufficient** assets and cash to pay current liability
- It is important for a business to be liquid as a business needs cash to meet the needs of daily operations and unforeseen emergencies. When a business has low liquidity,it usually means that the business is short of cash and would be unable to pay its immediate debts. This affects the business operations and also causes the business to be unable to pay the debts on time causing the business to lose its credibility and making it difficult for the business to obtain credit terms from suppliers and loans from banks. If this persists the business might have to eventually close down.
- A profitable business does not necessarily mean it is liquid and a business with high profits does not mean it has more cash
- This is because a profitable business might have more credit sales this might cause the business to have difficulty in collecting money from credit customers or might have used it to enhance non current assets in the aim to generate more income in the future
- Working capital
  Current assets - current liabilities
  Measure the amount of excess current assets over current liabilities that can be used as funds to pay short term debts and operating expenses
  The acceptable norm varies from business to business as it is dependent on the nature and size of the business.
- A business with high liquidity ratios and high working capital means it is more liquid
- Current ratio
  Current assets / Current liabilities
  Measure the ability of the business to pay its current liabilities and short term debts using its current assets.
  The acceptable norm varies but the general benchmark is 2
  If the current ratio is more that 2 it means that the business has **sufficient** current assets to pay its current liabilities(reason)
- **Quick ratio**
  Quick assets/ current liabilities
  Measures the ability of the business to pays its short term obligations using its quick assets which are assets that can easily be converted into cash unlike current assets such as prepayments and inventories.
  The acceptable norm varies from business to business,but the general benchmark is 1
  When the guck ratio is more than 1 it means that the business has **sufficient** quick assets to pays its short term obligations
- Analysis of liquidity
  High liquidity and high current and quick ratio
  It means the business is able to pay its short term debts as it has **sufficient** current assets and quick assets.
  This means the business is stable to continue operations

Low working capital and low quick ratio
It means that the business does not have sufficient quick assets and current assets to pay its short term debts or current liabilities.
The business might have to eventually close down
High current ratio but low quick ratio
It means that the business does not have enough quick assets to pay its current liability or short term debts.
This might possibly be due to more of the cash might be tied up with the unsold inventory

WAYS TO IMPROVE THE LIQUIDITY
Increase sources of cash
- Obtain cash contributions from owners and shareholders
- Obtain a bank loan
- Sell excess non current assets for cash

Manage cash out flow
- Reduce operating expenses such as relocating to a cheaper location that has low rental cost
- Reduce cash withdrawals by owners or dividend payments to shareholders
- Negotiate for better credit terms from credit suppliers

Accounting for sale of Non Current assets

Date	Particulars	Debit	Credit
	Sale of non current assets		
	Non current assets		
	Accumulated depreciation		
	Sale of Non current assets		
	Cash at bank/other receivables		
	Sale of non current assets		

What is the reducing balance method
The reducing balance method is used for nca that that has more benefits in the initial years than the later years
Formula : (Cost - accumulated depreciation) times the rate of depreciation

What is the straight line method
The straight line method is used for nca's that provides that same benefits throughout its useful life
Formula: Cost x rate of depreciation
(Cost - scrap value) divided by the estimated useful life

Assets are resources owned or controlled by the business that is expected to give future benefits
Liabilities are obligations owed by the business that are expected to be repaid in the future
Equity are claims made by owners on the net assets of the business
Income is the amount of money earned from the activities of the business
Expenses is the amount incurred to generate the excess income.

Accounting interpretation

When business records the rental income received in advance from the previous financial year.
On ….., rental income of …. Which was received in advance was reversed back into the rental income account.

When business closes the income or expense account
The total remaining income or expense is transferred to the income summary account and the account is closed off.

The allowance for impairment of trade receivables is the estimated amount of money that is uncollectible from its credit customers

The Impairment loss of trade receivables is the change in the allowance for impairment of trade receivables.

Interpreting the entry on ILOTR decrease in the AILOTR account.
The allowance for impairment of trade receivables decreased by …../ The estimated debt that is uncollectible decrease by ….

Credit transfer is the amount of money that is being transferred to the business bank account from another bank account.

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

THE END