

chapter 6 - revenue and other income

revenue recognition theory

- ✓ the business shall only recognise revenue when they have sold the goods or provided the services to a customer.
- ✓ only happens when the customer obtains the control of the item or when the customer has received the service

accrual basis of accounting theory

- ✓ income is recognised when it is earned regardless of whether cash has been received
- ✓ expense is recognised when it is incurred regardless of whether cash has been received

sales of goods:

- ✓ you purchase from supplier at cost price and sell to your customer at selling price
- ✓ the difference between cost price and selling price is the gross profit
- ✓ selling price is the sales revenue earned from selling the goods

journal entry to record sale of goods at selling price

Dr trade receivable / cash at bank / cash in hand

Cr sales revenue

- ✓ cost price is cost spent to buy sold inventory

journal entry to record cost of sales at cost price from sale of goods

Dr cost of sales

Cr inventory

sales returns

- ✓ occurs when customers return the goods purchased previously to the business

reasons for returns:

- damaged / expired goods
- goods aren't according to specific specifications

journal entry to record sales returns

Dr sales returns @ selling price

Cr trade receivable / cash at bank / cash in hand @ selling price

Dr inventory @ cost price

Cr cost of sales

- ✓ gross profit = (sales revenue - sales returns) - cost of sales

provision of services

credit

- ✓ once money has been received for performing / providing services on

Dr trade receivable / cash at bank / cash in hand

Cr service fee revenue

When there is service fee revenue in advance of year

Dr service fee revenue

Cr service fee revenue received in advance

at beginning of next year

Dr service fee revenue received in advance

Cr service fee revenue

other income

Besides main source of revenue (sales revenue), business can also earn other income such as commission/rental/interest

income

Amounts received are recorded as income at the point of receipt and any unearned/unreceived portions are adjusted at the end of financial period

Income should be recognised when it is earned regardless of whether cash has been received

Example:

Income earned but yet to receive cash

- you're a tutor and earn \$1000 a month

- 1st month ended 31 Jan 2021, received \$900

- therefore received \$900 < earned (\$1000) → \$100 is receivable

→ earned income but didn't receive money → income receivable is an asset

Cash received for income but has yet to be earned

- you receive \$1500 instead

- received (\$1500) > earned (\$1000) → \$500 received in advance

→ owe customer service in the future → income received is a current liability

to adjust for income receivable and received in advance at yr end:

income receivable	income received in advance
Dr income receivable acc	Dr income account
Cr income account	Cr income received in advance

All income accounts will be closed off and transferred to income summary

Dr income account

Cr income summary

4 steps approach:

- 1) reverse beginning income receivable or income received in advance
- 2) record amount received for income
- 3) record ending income receivable or income received in advance
- 4) record income earned from the year

summary:

start of year	during the year	end of year	
+ income received in advance	+ income received	- income received in advance	= amt earned for yr
- income receivable		+ income receivable	= amt earned for yr

chapter 7 - cost of sales other expenses

matching theory

states that all expenses incurred for a given period must be matched against income earned in the same period to determine the profit or loss for the period

accrual basis of accounting theory

expenses are recognised when they are incurred and income is recognised when earned regardless of whether money is paid or received

expenses

amount spent to run day-to-day operations of the business in order to generate income

costs that arise in the course of ordinary activities of the biz

cost of sales

cost of inventory that is sold to the customer

in order to sell inventory, we need to buy it first

when inventory is sold, it becomes cost of sales

journal inventory to record purchase of inventory

Dr inventory	\$250	
cr trade payable		\$250

to record sale of inventory

Dr cash at bank	\$80	
cr sales revenue		\$80

Dr cost of sales	\$50	
cr inventory		\$50

other expenses

besides cost of sales, the biz incurs operating & administrative expenses such as interest/repairs/ utilities expense etc

prepaid expense

money paid for expenses but has yet to be incurred for the year
is a current asset because you can enjoy benefits without paying since you have paid already

expense payable

expense incurred for the year but has yet to pay the money

is a current liability because you owe money to a third party

to adjust for prepaid expense & expense payable at year end:

prepaid expense	expense payable
Dr prepaid expense account	Dr expense account
cr expense account	cr expense payable account

All expense accounts will be closed off and transferred to income summary

	when incurred/paid	closing entry
cost of sales	Dr cost of sales Cr inventory	Dr income summary Cr cost of sales
other expenses	Dr expenses Cr cash in hand/bank	Dr income summary Cr expenses

4 step approach

step 1: reverse beginning prepaid expense / payable

@ start of year	prepaid expense Dr expense account Cr prepaid expense acc	expense payable Dr expense payable acc Cr expense acc
-----------------	---	---

step 2: record amount paid for expenses

@ date of payment	→ Dr expense acc Cr cash at bank
-------------------	-------------------------------------

step 3: record ending prepaid expense / payable

@ end of year	prepaid expense Dr prepaid expense acc Cr expense acc	expense payable Dr expense acc Cr expense payable acc
---------------	---	---

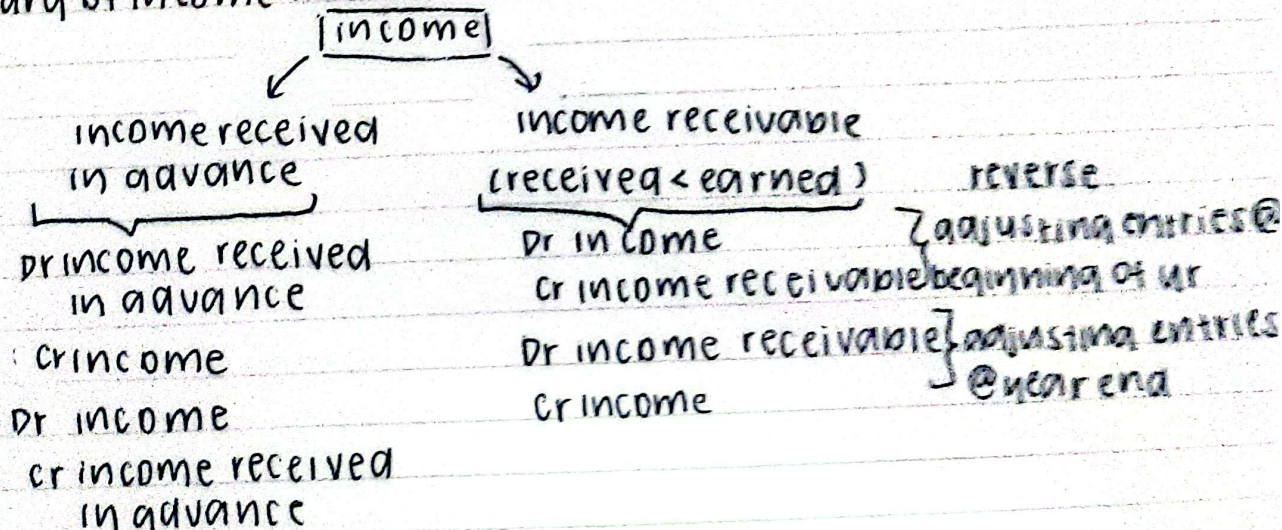
step 4: record expense incurred for the year

@ end of year	→ Dr income summary Cr expense acc
---------------	---------------------------------------

summary

start of year	during year	end of yr	
+ prepaid expense	+ expense paid	- prepaid exp	+ amt incurred for yr
- expense payable		+ exp payable	+ amt incurred for yr

summary of income and expense



expense

expense payable
(paid < incurred)

Dr expense payable
Cr expense

Dr expense

Cr expense payable

prepaid expense

(paid > incurred) (reverse)

Dr expense

Cr prepaid expense

Dr prepaid expense

Cr expense

} Adjusting entries @
beginning of yr

} Adjusting entries
@ year end

Chapter 3

statement of financial position

assets = liabilities + expense

statement of financial performance

income & expenses

Assets

↳ resources owned and controlled by the business which will be used to generate income
current assets

↳ Assets that are more liquid can be converted to cash and provide benefits within one accounting period

e.g. cash in hand, cash at bank, inventory, trade receivable, prepaid expense

non current assets

↳ assets that are less liquid (difficult to be converted to cash) and provide benefits for more than a year

e.g. fixtures and fittings, machinery, motor vehicles

liabilities

↳ amounts or debts owed to a third party by the business as a result of past transaction

current liabilities

↳ debts that need to be settled or repaid within one accounting period

e.g. trade payables, exp payable, bank overdraft, short term loan

non current liability

↳ debts that need to be settled or repaid in more than one accounting period

e.g. long term borrowing, mortgage loan

equity

↳ the amount that represents the interests of the owners in the biz (the net assets of the biz)

↳ sole proprietorship: capital, drawings, profit/loss for the year

↳ private limited company: share capital, dividends, retained earnings

income

↳ the amount earned from conducting business activities or other activities

- main activities derive main income

- other activities derive other incomes

main income

trading business: sales revenue (income from buying and selling of goods)

service business: consultancy (service) income (income from providing service)

other income

↳ for both trading and service business: rental income, commission income, interest income, gain on sale of NCA, discount received

expense

↳ the amount incurred to operate the biz and provide support for the biz to generate income

eg: cost of sales, advertising/interest/salaries and wages/depreciation expense, loss on sale of NCA

accounting equation

$\text{assets} = \text{liabilities} + \text{equity (owner's equity / shareholder's equity)}$

How accounting eqn is affected by biz transaction:

↳ every business transaction should have at least 2 effects on elements of accounting eqn eg: when biz purchase asset using cash

- cash decreases and asset increases

↳ the accounting eqn must be balanced at all times

expanded accounting eqn

sole proprietorship

$\text{assets} = \text{liabilities} + \text{capital} - \text{drawings} + \text{income} - \text{expenses}$

private limited company

$\text{assets} = \text{liabilities} + \text{beginning retained earnings} - \text{dividends} + \text{income} - \text{expense}$

other equations:

$\text{working capital} = \text{current assets} - \text{current liabilities}$

$\text{net assets (equity)} = \text{total assets} - \text{total liabilities}$

retained earnings:

portions of company's net income that is kept by company, rather than distributed to shareholders as dividends to reinvest in the biz (funding expansion/debt)

→ accumulation of profit over time
- ability to generate and sustain earnings
- contribute to long term growth and financial sustainability

chapter 5

what is a trial balance?

listing all the ledger accounts in the biz as at a certain date sorted according to their account nature

purpose of a trial balance:

✓ facilitate preparation of financial statements of company

✓ serves as a check on the arithmetic accuracy on transactions recorded

limitation of trial balance

✓ not an absolute proof of accuracy

format of a trial balance:

company name
trial balance as at (date)

trade receivables
motor vehicle
machinery } assets

trade payable L

discount received I

cost of sales I

loan from euro bank L

inventory A

sales revenue I

salaries and wages expense

depreciation expense

accumulated depreciation-motor vehicle

accumulated depreciation-machinery

prepaid utilities expense

utilities expense

advertising expense

capital C

drawings

insurance expense exp

sales returns

cash at bank

cash in hand

property

allowance for impairment on trade receivable

name of biz
trial balance as at xxxx
dr (L) Cr

asset		
expense		
drawings		
liability		
capital		
income		
sales returns (contra income)		
	xxxx	xxx

78000

25000

20000

30000

1220

10630

14000

314383

900

12400

5400

78020

5000

190000

876738

1005

876738

What is a financial statement?

Financial statements are detailed summary reports used to communicate with the stakeholders about the biz activities and financial performance of company

Why do we need financial statements?

Stakeholders retrieve information from financial statements to evaluate and analyse the financial health as well as the earning potential of company

To report to the authority to ensure compliance of company to accounting standards

Statement of financial performance

Accounting adjustments that can be made:

- depreciation of NCA
- impairment loss on trade receivable
- prepaid expenses and expenses payable
- income received in advance and income receivable
- reclassification of current portion of NCL
- correction of errors not revealed by trial balance
- impairment loss on inventory

Statement of financial position

Snap shot of the company's financial position at a point in time where it shows the amount of assets, liabilities and equities of a biz

Valuation methods for assets:

- NCA valued at NBV (cost - accumulated depreciation)
- TR at net trade receivable (TR - allowance for impairment of TR)
- inventory valued at the lower of cost or net realisable value

Accounting adjustments that can be made:

- declaration of dividends
- depreciation of NCA
- impairment loss on inventory
- impairment loss on TR
- prepaid expenses and accrued expense
- income receivable/received in advance
- reclassification of current portion of NCL
- correction of errors not revealed by trial balance

statement of financial performance - trading business

name of business

statement of financial performance for the year ended DD MM YYYY

	\$	\$
Sales revenue	xx	
less: sales returns	(xx)	xx
net sales revenue		(xx)
less: cost of sales		xxx
gross profit		
Other income	xx	
commission income	xx	
discount received	xx	
rental income	xx	xxx
gain on sale of non-current asset		
less: other expenses	xx	
impairment loss on TR	xx	
depreciation of NCA	xx	
interest expense	xx	
insurance expense	xx	
motor vehicle expense	xx	
office expense	xx	
rent and rates	xx	
wages and salaries	xx	
impairment loss on inventory	xx	(xxx)
loss on sale of NCA		xxxx
profit (or loss) for the year		

statement of financial performance - service biz

name of business

statement of financial performance for the year ended DD MM YYYY

	\$	\$
service fee revenue		xxx
Other income:	xx	
commission income	xx	
discount received	xx	
rental income	xx	xxx
gain on sale of NCA		

	\$	\$
less: other expenses	xx	
impairment loss on TR	xx	
depreciation of NCA	xx	
interest expense	xx	
insurance expense	xx	
motor vehicle expense	xx	
office expense	xx	
rent and rates	xx	
wages and salaries	xx	
impairment loss on inventory	xx	
loss on sale of NCA	xx	(xxx)
profit (or loss) for the year		xxxx

statement of financial position - service biz

name of business

statement of financial position as at DD MM YYYY

assets	\$ cost	\$ accumulated depreciation	\$ net book value
<u>non-current assets</u>			
property	xx	xx	xx
fixtures and fittings	xx	xx	xx
office equipment	xx	xx	xx
motor vehicles	xx	xx	xx
<u>current assets</u>			
inventory		xx	
trade receivables	xx		
less: allowance for impairment of TR	xx	xx	
other receivable / prepaid exp / inc. receivable		xx	
cash at bank		xx	
cash in hand		xx	xx
total assets			xx
<u>equity and liabilities</u>			
<u>owner's equity</u>			
capital			xx
<u>non current liabilities</u>			
long term borrowings			xx

current liabilities
trade payables
exp payable/inc received in advance
current portion of long term borrowings
total equity and liabilities

xx

xx

xx

xx

xx

statement of financial position - PLC

name of business

statement of financial position as at DD MM YYYY

	£ cost	£ accumulated depreciation	£ net book value
non current assets			
property	xx	xx	xx
fixtures and fittings	xx	xx	xx
office equipment	xx	xx	xx
motor vehicles	xx	xx	xx
current assets			
inventory		xx	
trade receivables	xx	xx	
less: allowance for impairment of TR	xx	xx	
other receivables/prepaid exp/inc receivables		xx	
cash at bank		xx	xx
cash in hand			xx
total assets			
equity and liabilities			
owner's equity			
share capital, xxx ordinary shares		xx	
retained earnings		xx	xx
non current liabilities			
long term borrowings			xx
current liabilities			
trade payables		xx	
exp payable/inc received in advance		xx	
current portion of long term borrowings		xx	
total equity and liabilities			xx

chapter 9 - inventories

- ↳ goods purchased by the company with the purpose of resale.
- ↳ recorded as current asset in the statement of financial position
- ↳ system used to account for inventory
- ↳ perpetual inventory recording method
 - records the purchase or sale of inventory immediately when the transactions occur
- ↳ goods are recorded as inventory at the point of purchase and recorded as an expense, cost of sales, at the point of sale

which inventory to buy

accounting information

- ↳ info usually generated by a business' accounting info system, such as info that can be extracted from the journal, ledger accounts & financial statements
- ↳ accounting info such as cost of inventory and storage cost affects total cost of inventory

rate of inventory turnover informs biz if its been efficient managing inventory

non accounting information

- ↳ info about a biz that can't be found in journal, ledger accounts & financial statement
- ↳ nature of product
- ↳ feature, attribute or quality of product
- ↳ types of storage
- ↳ different goods may require special types of storage
- ↳ customer's preference

- ↳ customers' preferences are the motivations and behaviours which influence the customers' purchasing decisions

accounting of inventories

double entries

Account	credit purchase of inventory	return of inventory to credit supplier
inventory	Dr inventory (+asset)	Dr trade payable (-liability)
	Cr trade payable (+liability)	Cr inventory (-asset)

cost of inventories

- ↳ include all cost of purchases and any other costs incurred in order to bring the inventories to their present location and conditions

purchase price

- ↳ other costs to bring in inventory

example of other costs:

- custom duty
- import tax
- shipping fee
- insurance on transportation
- wages to repack the goods for sale

cost of sales

- trading biz sells inventory to its customers and the customers can also return to the biz

double entries

Account	credit sale of inventory	return of inventory by credit customer
Inventory	Dr cost of sales (+exp) Cr inventory (-asset)	Dr inventory (+asset) Cr cost of sales (-exp)
trade receivables	Dr trade receivables (+asset) Cr sales revenue (+income)	Dr sales returns (-income) Cr trade receivables (-asset)

FIFO method

- goods that are purchased first are assumed to be sold first

prudence theory

- Inventory is valued at the lower of cost and NRV to ensure that inventory is not overstated

- When NRV falls below the cost of inventory, the biz must reduce the value of inventory and record the potential loss as impairment loss on inventory even though inventory hasn't been sold

NRV < cost of inventory

- Account for impairment loss on inventory when $NRV < \text{book value / cost of inventory}$ at the end of FY

- Adjust the inventory amount downwards to reach the NRV
Dr impairment loss on inventory (cost - NRV)

Cr inventory

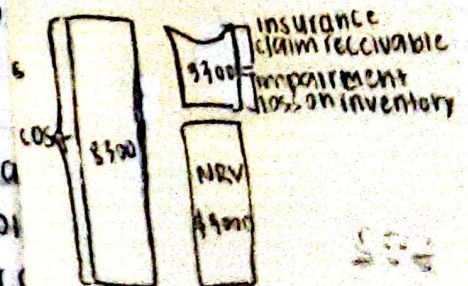
- Since impairment loss on inventory is an expense account, it needs to be closed to income summary at the end of the accounting period

Dr income summary

Cr impairment loss on inventory

double entries for recording insurance claim receivable

Account	insurance claim on damaged goods	cost
insurance claim receivable	Dr insurance claim receivable (+A) Cr impairment loss on inventory (-exp)	Dr Cr insurance claim receivable



effects of non-adjustment of impairment loss on inventory

impairment loss on inventory	effect on other exp	effect on profit	effect on current asset
not adjusted	understates	overstates	overstates
adjusted	increases	decreases	decreases

business A

statement of financial position as at

\$

current assets

inventory 5000

insurance claim receivable 1100

business A

statement of financial performance for the year

less: cost of sales

less: other expenses

impairment loss on inventory

credit trade receivables

credit customers who owe money to the biz as they had purchased goods/inventory on credit purchasing on credit means that the payment for goods will be made on a future date rather than the date of sale. So, the customer will receive goods or service first and pay at a later date

The amt recorded in the TR account represents the cash that can be collected from them in the future

deciding credit worthiness of customer accounting info

such as TR balance, no. of days trade receivables are overdue, history of repayment from existing customers, rate of TR turnover and TR collections period helps the biz to assess its credit customers and their ability to repay debts

non-accounting info

specific industry outlook

the economic performance of the industry that the customer is in affects their ability to repay debts

when the industry is booming, the customer will more likely be able to repay their debts

economic outlook

the economic performance of the country that the customer is in affects their ability to repay debts

when the economy is not doing well, most biz will be adversely affected and the customer would be less likely to be able to repay their debts

reputation of customers

a customer with a good reputation is usually known for providing quality and services

public reviews about the biz can indicate the good reputation of a biz while biz facing a lawsuit may indicate its lack of good reputation

accounting for trade receivables

double entries for recording TR

Account	credit sale of goods or services	collection from credit customers
trade	or trade receivable (+asset)	Pr cash at bank/cash in hand (+asset)
receivables	cr sales/service fee revenue (+inc)	cr trade receivables (-asset)

Accounting for impairment loss on trade receivables

risk of selling on credit: there is a possibility that the debts become uncollectible in the future

Allowance for impairment of TR = estimate a percentage (%) x ending TR balance

valuation of TR

TR account is valued at the amount after deducting the amount of allowance for the yr.

How do we decide on which TR might become uncollectable?

the aging of TR (if the TR hasn't returned debts over 60-90 days)

the financial news of TR

the economic outlook

Write off on trade receivables

- ✓ When TR is confirmed to be uncollectible
- ✓ TR went bankrupt
- ✓ TR passed away
- ✓ TR becomes uncollectible

double entries for recording changes in allowance

Account	increase in allowance	decrease in allowance
allowance for	Dr impairment loss on TR (+exp)	Dr allowance for impairment of TR (+A)
impairment of TR	Cr allowance for impairment of TR (+A)	Cr impairment loss on TR (-exp)

double entry for recording writ-off debts

Account	writ-off
allowance for	Dr allowance for impairment of TR (+asset)
impairment of TR	Cr trade receivables (-asset)

effects of adjustment of allowance

After adjustment	effect on other exp	effect on profit	effect on current assets
increase in allowance	increases	decreases	decreases
decrease in allowance	decreases	increases	increases

✓ Business A
statement of financial position as at [—]

current assets	\$
trade receivables	xxxx
less: allowance for impairment of TR	500

✓ Business A (increase in allowance)
statement of financial performance for the year ended [—]

less: other expenses	200
impairment loss on TR	

Business A (decrease in allowance)
statement of financial performance for the year ended [—]

less: other expenses	
reversal of impairment loss on TR	(xxxx)

chapter 11 non-current asset decision making buy vs rent

accounting info

- ↳ biz need to look at their current financial situation and assess the costs of buying or renting the NCA to determine if it's more viable to buy or rent NCA

non accounting info

- ↳ biz also needs to consider pros and cons of buying or renting NCA
- ↳ when biz rents NCA, it enjoys lower commitment level and greater flexibility in being able to rent a newer NCA over time. However, the terms and conditions are subjected to change when rental agreement is due for renewal
- ↳ when biz buys and owns a NCA, it can exercise greater control over it

deciding which NCA to buy

accounting info

- ↳ price of NCA, installation cost, costs of maintaining NCA and related repair costs affects the total cost of the NCA

non accounting info

- ↳ purpose and features of NCA
- ↳ depending on how the NCA will be used, certain features are necessary while certain features are simply good-to-have
- ↳ customers' reviews
- ↳ evaluation and comments from third parties on the usage of a NCA provide additional info about the experience of using the NCA
- ↳ warranty

- the promise by the manufacturer to replace or repair a NCA within a specified period of time. It safeguards the business from possible cost of repair or breakdowns during stated period

Accounting for NCA

double entry for recording NCA

Account	credit purchase of NCA
NCA	Dr NCA (+ asset) Cr trade payable (+ liability)

capital expenditure (NCA)

- ↳ amt spent to purchase the NCA and to bring it to ready-to-use condition, that will benefit to biz for more than 1 year
- ↳ presented in statement of financial position
- ↳ usually one-time payment
- ↳ material amount → usually large amount

- ↳ amount spent to increase the useful life or improve function of NCA

example: property, motor vehicle (NCA), transportation cost for NCA, installation cost, wages to install NCA, legal fee to purchase property, expansion of office, upgrade of NCA so useful life increases

revenue expenditure

- ↳ amt spent to maintain the NCA in the working condition to run day-to-day biz operations within a year
- ↳ presented in statement of financial performance
- ↳ usually recurring payment
- ↳ immaterial amount $\rightarrow$ relatively small amount

example: purchase of inventory, insurance, repair & maintenance, interest, salaries, stationery, utilities, expense

double entries for recording capital/revenue expenditure

capital expenditure
Dr Non-current asset (asset)
Cr trade payable (liability)
(NB / C/N (-asset))

revenue expenditure
Dr expenses (+exp)
Cr expense payable (liability) /
(NB / C/N (-asset))

effects of wrong classification of capital and revenue expenditure

classification of expenditure	effect on other exp	effect on profit	effect on NCA
wrongly classified as revenue	overstates	understates	understates
wrongly classified as capital	understates	overstates	overstates

materiality theory

- ↳ states that an item is considered material if it affects the decision-making process of the biz and so should be considered as a capital expenditure

Accounting for depreciation

- ↳ allocation of cost of a NCA over its estimated useful life and can be caused by
 - usage (coal mines are depleted when coal is extracted)
 - wear and tear (exterior of a building may deteriorate due to exposure to sun and rain)
 - obsolescence (electronic gadgets may become obsolete when new technology is developed)
 - legal limits (leasehold land can only be occupied for a limited period of time)
- ↳ net book value = cost - accumulated depreciation

double entry for recording depreciation

account	depreciation of non current asset
depreciation	Dr depreciation (+exp)
expense	Cr accumulated depreciation (-asset)

Methods of depreciation

- ↳ 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 NBV of NCA over time
- ↳ straight line depreciation
 - should be used when the biz uses the NCA uniformly throughout its estimated useful life
 - an equal amount of depreciation is recorded every financial period

- depreciation expense = $\frac{\text{original cost} - \text{scrap value}}{\text{estimated useful life (years)}}$
- depreciation expense = rate of depreciation per annum $\times$ (original cost - scrap value)
- reducing balance method
 - should be used when the biz uses NCA more in its earlier years and less as the NCA gets older and becomes less efficient
 - a higher amount of depreciation expense is recorded in earlier years and reduces as time goes by
- depreciation expense = rate of depreciation per annum (%) $\times$ net book value

effects of using different methods of depreciation

method	effect on other exp	effect on profit	effect on NCA
straight-line	equal depreciation exp every year	profit decreases by equal amt every yr	NBV decreases by an equal amt every yr
reducing balance	higher depreciation exp in early yrs, reduces over time	profit decreases by a higher amt in earlier years	NBV decreases by a higher amount in earlier years

Accounting for sale of NCA

* gain/loss on sale of NCA = sales proceed - net book value

* gain: sales proceeds > NBV (income)

* loss: sales proceeds < NBV (expense)

Account	removal of NCA	removal of accumulated depreciation
sale of NCA	Dr sale of NCA Cr NCA (asset)	Dr accumulated depreciation (+asset) Cr sale of NCA
	collection of sales proceed Dr (C/B) other receivable (+asset) Cr sale of NCA	transfer gain/loss on sale of NCA gain: Dr sale of NCA Cr income summary loss: Dr income summary Cr sale of NCA

Business A	
statement of financial performance for year ended [—]	
	\$
other income	
gain on sale of NCA	xxxx
less: other expenses	
depreciation expense	
loss on sale of NCA	

Business A			
statement of financial position as at [—]			
non-current assets	\$	\$	\$
	cost accumulated net book depreciation value		
motor vehicles	xxxx	xxxx	xxxx
current assets			
other receivables			xxxx

chap 12 - trade payables

deciding which supplier to buy from

accounting info

- cost of inventory, NCA or services, trade discounts, credit terms and cash discounts, delivery charges, installation and maintenance costs affects the total cost of inventory, NCA and services

non accounting info

- local or overseas suppliers
- when buying from overseas suppliers, biz needs to take into consideration that it may take longer to receive its goods as it takes time to ship and clear customs overseas
- online vs brick-and-mortar supplies
- online suppliers operate over the internet while physical suppliers have physical shops where customers can see the products and determine if they meet expectations before they buy
- after-sales service
- such as installation and maintenance for free in first year, is provided to improve customer relations and encourage long term commitment
- return policy
- a process established by suppliers where customers can return defective goods that they have previously bought. A biz can have greater assurance of product quality
- warranty
- the promise by the biz to replace/repair NCA within a specified period of time. It safeguards the customers against possible cost of repair or breakdowns during period
- reputation of suppliers
- customers' reviews, relationship with employees and no. of years a supplier has been doing biz may reflect reputation of a biz
- when a supplier has a good reputation, a biz is more assured of the supplier's ability to provide quality goods and services

double entries for trade payables

Account	credit purchase of NCA and goods	payment to credit suppliers
trade	Dr asset (+asset)	Dr trade payables (-liability)
payables	Cr trade payables (+liability)	Cr CAB/CIH (-asset)

shareholder's equity

- according to accounting entity theory, only transactions that affect the biz are recorded while transactions relating to owner but don't affect biz aren't recorded
- recorded while transactions relating to owner but don't affect biz aren't recorded

in a se, the owner can contribute any personal assets to the biz and withdraw

any biz assets for personal use

owner's equity = contributions + profits (or - losses) - drawings

changes in owner's equity

activities

change in owner's equity

the sole owner contributes additional assets to biz

the biz makes a profit for the year

the sole owner withdraws biz assets for personal use

the biz includes a loss for the period

accounting for owner's equity

at end of financial year, any ending balance will be transferred to capital account:

drawings

income summary

double entries for recording capital

accounts contribution of assets from owner

capital drawings (+asset)

cr capital (+equity)

cr capital (+equity)

loss: dr capital (-equity)

cr income summary

double entries for recording drawings

account withdrawal of assets by owner for personal use

drawings dr drawings (-equity)

cr assets (-asset)

shareholder's equity

in a plc, shareholders contribute cash to biz through buying of more shares

when biz makes profits, the profits will be accumulated as retained earnings

and reinvested in the biz. A portion of the profits may be declared as dividends

and distributed to shareholders. However, when biz incurs losses, it can still

declare dividends out of its retained earnings

equity part of plc consists of: share capital and retained earnings

shareholders equity

share capital + retained earnings

share capital + profits (or - losses) - dividends

share capital

total no. of shares issued x price per share (x)

dividends

total no. of shares issued x declared dividend per share (x)

dividends

total no. of shares issued x declared dividend per share (x)

activities that affect shareholder's equity

activities

- the PLC issued new shares
- the PLC makes a profit for the period
- the PLC declares dividends
- the PLC incurs loss for the period

Accounting for shareholder's equity

change in shareholder's equity
increase
decrease

increases in share capital and retained earnings are credited while decreases are debited

journal entry for recording share capital

Account +	contribution by shareholders
share	Dr cash at bank (+asset)
capital	Cr share capital (+equity)

the PLC may declare dividends and make immediate payment to shareholders or at a later date

increases in dividends account are debited while decreases are credited

Account	declared dividends but not paid	immediate payment of dividends
dividends	Dr dividends (-equity)	Dr dividends (-equity)
	Cr dividends payable (+liability)	Cr cash at bank (+asset)
	when dividends paid subsequently:	
	Dr dividends payable (-liability)	
	Cr cash at bank (-asset)	

at the end of financial year, any ending balances will be transferred to retained earnings

account	closing of income summary	closing of dividends
retained earnings	profits: Dr income summary	Dr retained earnings (-equity)
	Cr retained earnings (+equity)	Cr dividends
earnings	losses: Dr retained earnings (-equity)	
	Cr income summary	

Business A

statement of financial position as at

£

shareholder's equity

share capital / xxx ordinary shares (xxx + xxx)	xxx
less: accumulated losses (xxx - xxx)	xxx

OR

retained earnings (xxx + xxx - xxx)

current liabilities

dividends payable

xxx

xxx

xxx

CONCEPTS OF PARTNERSHIP

CHARACTERISTICS OF PARTNERSHIP

Partnership is a form of business organization in which two or more persons (individuals or firms) agree to pool their resources for the purpose of carrying on a business.

It is a legal entity, created by the agreement of the partners.

It is a voluntary association of persons.

It is a form of business organization.

It is a legal entity, created by the agreement of the partners.

It is a voluntary association of persons.

It is a form of business organization.

It is a legal entity, created by the agreement of the partners.

It is a voluntary association of persons.

It is a form of business organization.

It is a legal entity, created by the agreement of the partners.

It is a voluntary association of persons.

It is a form of business organization.

It is a legal entity, created by the agreement of the partners.

It is a voluntary association of persons.

It is a form of business organization.

It is a legal entity, created by the agreement of the partners.

It is a voluntary association of persons.

It is a form of business organization.

It is a legal entity, created by the agreement of the partners.

It is a voluntary association of persons.

It is a form of business organization.

It is a legal entity, created by the agreement of the partners.

It is a voluntary association of persons.

It is a form of business organization.

It is a legal entity, created by the agreement of the partners.

It is a voluntary association of persons.

It is a form of business organization.

It is a legal entity, created by the agreement of the partners.

It is a voluntary association of persons.

It is a form of business organization.

It is a legal entity, created by the agreement of the partners.

It is a voluntary association of persons.

It is a form of business organization.

It is a legal entity, created by the agreement of the partners.

It is a voluntary association of persons.

- ↳ lifespan
 - biz exists indefinitely until wound up or struck off
 - ↳ transferability of ownership
 - unanimous agreement for a change of partners
 - ↳ legal status
 - biz is a separate legal entity
 - private limited company
 - ↳ ownership
 - owned by max 50 persons (called shareholders)
 - ↳ capital structure
 - issue shares to raise capital, each shareholder can hold different no. of shares
 - ↳ extent of liability
 - shareholders aren't personally liable for debts and losses of company they will only lose up to the amount invested (limited liability)
 - ↳ level of control
 - shareholders have limited control, management of control is in hands of director
 - ↳ lifespan
 - exists indefinitely until wound up or struck off
 - ↳ transferability of ownership
 - shareholders can sell / transfer their shares to transfer ownership
 - ↳ legal status
 - biz is a separate legal entity

| - biz is a separate legal entity | | |
|----------------------------------|---|--|
| stakeholder | interaction with biz | example of decision that they will need to make |
| owners & stakeholders | contribute capital to biz and expect profit in return | to continue to invest in biz or sell it, depending on the risks and returns related to biz |
| manager | work for biz and devise strategic plans for biz efficiently | to consider ways to improve the performance of biz |
| employees | work for biz and perform executive duties | to continue working at the biz |
| lenders | make money available to biz and expect to be repaid with interest | to grant loans to biz, depending on biz's ability to repay loan with interest |
| suppliers | supply goods / services to biz | to sell to biz on credit, depending on its ability to pay |
| customers | buy goods / service from biz | to buy from biz depending on biz's ability to provide goods / services that they need |
| government | enforce tax regulations | on a good after-sales service |
| competitors | sell similar goods / services as biz | the biz complies with tax regulation & decide amt of tax to collect from biz |
| | | they are comparable to biz and how to improve their own performance |

- stakeholders rely on both accounting and non accounting info that aren't shown on financial statements for decision making non accounting info refers to qualitative factors that may reflect current/future trends
- role of accounting and accountants

role of accounting
 accounting is an information system that provides accounting info for stakeholders to make informed decisions regarding the management of resources and performance of biz

- role of accountants
- prepare and provide accounting info for doing so and set up accounting information system and become stewards of biz
- they adapt, solve problems, think critically and provide accounting and non accounting info for decision-making, and
- provide timely, relevant and credible info, based on accounting theories which are easily and appropriately understood by stakeholders

professional ethics

- unethical accountant has integrity and is objective. they will not be misled
- users in making poor decisions
- an accountant with integrity is straight forward and honest in all professional relationships an accountant who is objective won't let bias, conflict of interest or undue influence of others override their personal judgement

• actions an ethical accountant won't do

- prepare accounting records that contain false info
- accept a gift or preferential treatment
- get involved in the selection of a vendor when his immediate family member could benefit financially from the transactions
- prepare false info due to threat of dismissal

Accounting theories

• accounting entity

- the activities of a biz are separate from the actions of the owner. All transactions are recorded from pov of the biz

• accounting period

- the life of a biz is divided into regular time intervals

• accrual basis of accounting

- biz activities that have occurred, regardless of whether cash is paid or received, should be recorded in relevant accounting period

• consistency

- once an accounting method is chosen, it should be applied to all future accounting periods to enable meaningful comparison

↳ prudent

- the accounting treatment chosen should be the one that least overstates assets and profits and least understates liabilities and losses.

↳ objectivity

- accounting info recorded must be supported by reliable and verifiable evidence so that financial statements will be free from opinions and biases

↳ going concern

- a biz is assumed to have an indefinite economic life unless there is credible evidence that may close down

↳ matching

- expenses incurred must be matched against income earned in the same period to determine profit

↳ historical cost

- transactions should be recorded at original cost

↳ materiality

process

- a transaction is considered material if it makes a difference to decision-making

↳ monetary

- only biz transactions that can be measured in monetary terms are recorded

↳ revenue recognition

- revenue is earned when goods have been delivered or services have been provided

Chapter 2

Accounting cycle

1. **Identify and record**
Source documents are used to record transactions in the journal and the journal entries are posted in the ledger and transactions are recorded daily

2. **Adjust**
The ending balances of ledger accounts are listed in a trial balance
Any adjusting entries are recorded in the journal and posted to the ledger
Any adjusting entries are prepared

3. **Report**
Based on adjusted trial balance, the financial statements are prepared
Reports are prepared at least one financial year

4. **Close**
After the financial statements are finalised, income, expenses, income summary, drawings and dividends accounts are closed by first passing journal entries before being posted to the ledger
Accounts are closed once at the end of financial year
Accounting information system
Source document

- provides proof that transactions have occurred
Journal

- details in a source document provide info to be recorded in a journal
- daily record of transactions organised by date

Ledger
- journal entries are posted to relevant individual ledger accounts in the ledger
- consolidation of all transactions relating to specific elements

Trial balance
- provides a summary of ending balances of each ledger account at a specified date
Financial statements
- provides a report on income, expenses and profit/loss over a period of time
- provides a report on assets, liabilities and equity at a specified date

Source documents
- provides evidence (objectivity in copy) to capture occurrence of a transaction
The transaction is recorded at the original cost that it occurred
Contains the details of a biz transaction needed for recording
Receipt

- acknowledges payments received from customers immediately after biz
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 amt owed after sold goods or provided services on
- credit note
 - reduces amt owed by credit customers
 - who were previously overcharged
 - after goods were returned
- debit note
 - increases amt owed by credit customers who were previously undercharged
 - payment voucher
 - processes payment to credit suppliers
 - must be approved by authorised personnel, and
 - must be supported by original supplier's invoice
 - bank statement
- checks and tallies against biz records of its cash at bank account

chapter 4 discounts

| | trade discount | cash discount |
|-------------|---|---|
| define | reduction to list price | reduction to invoiced price |
| purpose | encourage customer to buy in bulk, merit patronage & loyalty | encourage credit customers to pay early within a specified time |
| calculation | <ul style="list-style-type: none"> reduces list price invoice price = list price - trade discount | <ul style="list-style-type: none"> reduces invoiced price amt paid = invoiced price - cash discount |
| recording | not recorded in ledger | recorded in ledger |
| | | discount allowed received |

| | discount allowed | discount received |
|--------------------|---|---|
| conditions | when credit customer pays early, biz gives cash discount | when biz pays early, the biz receives cash discount from credit suppliers |
| implication profit | since biz receives a lower amt from credit customers, discount allowed will decrease profit | since biz pays lower amt to buy goods, discount received will increase profit |
| accounting element | income | expense |