

**MOJZA**

**O Level**

**ACCOUNTING  
NOTES**

7707



**BY TEAM MOJZA**

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# Topic 1: Accounting Basics

## - What is accounting?

- The process of accounting starts once the book-keeper finishes recording the financial transactions.
- It deals with **measuring, identifying, and communicating** financial information recorded by the book-keeper which facilitates the preparation of financial statements.
- **Bookkeeping** involves recording financial transactions from source documents of a business whereas accounting deals with maintaining financial statements from the bookkeeping records.

## Accounting Terms

### - Assets:

- The resources **owned** and **controlled** by a company.
- An increase in an asset is a debit and a decrease is a credit.
- **Formula:**

$$\text{Assets} = \text{Capital} + \text{Liabilities}$$

- Every asset can be categorised between two, **Tangible** and **Intangible**.
- A tangible asset is something you can touch, like a building, equipment, or furniture in an office. Tangible assets can be divided into two categories: inventory (things a company sells) and fixed assets (things a company uses to make its products or provide services). Tangible assets provide value to a company and can be sold or used as collateral for loans.
- Intangible assets are things a company owns that can't be touched or seen. They include things like patents, trademarks, brand recognition and goodwill. These assets are important because they help a company maintain a competitive edge in the market. It's harder to put a price on intangible assets compared to tangible assets, but they are still a valuable part of a company's overall assets.
- There are two types of assets:
  - ↳ **Current Assets:** An asset which has a monetary value or can be converted into cash within 12 months. Examples include account receivables and cash.
  - ↳ **Non-Current Assets:** Also known as Fixed Assets, these assets are acquired to earn revenue for the company and used for more than 12 months without being intended for resale. Examples include buildings and machinery, tools, and vehicles.

### -Goodwill:

- Goodwill refers to the intangible asset that represents the reputation, customer loyalty, brand value, and other non-physical attributes of a business. It arises when one company acquires another company for a price higher than the fair value of its net assets. The excess amount paid is recorded as goodwill on the acquiring company's balance sheet. Goodwill enhances the overall value of a business and reflects its intangible strengths and

advantages in the market. However, it is important to note that goodwill may be subject to impairment if its value declines over time.

- Factors affecting goodwill are:
  - ◆ Brand loyalty
  - ◆ Business reputation
  - ◆ Quality of staff
  - ◆ Business's location

### - Capital:

- The number of resources and funds provided **by the owner** injected into the business.
- An increase in capital is a credit while a decrease or drawings is a debit

## Basic Accounting Equation:

$$\text{Capital} = \text{Assets} - \text{Liabilities}$$

### - Liability:

- The money **owed** to another firm or an entity.
- Examples include bank loans and credit card debts.

#### Formula:

$$\text{Liabilities} = \text{Assets} - \text{Capital}$$

- The two types of liability are:
  - ↳ **Current Liability:** The amount of money owed to be paid within a year, for example, account payable.
  - ↳ **Non-Current Liability:** The amount of money owed that can be paid after a year, for example, a mortgage loan.

### - Drawings:

- The money **withdrawn** by the business owner for their personal use.
- Opposite of capital.
- An increase in drawings has a debit nature whilst a decrease is a credit nature.

### - Account Receivable:

- The money owed to the company by **debtors**. It is recorded as an asset.

### - Account Payable:

- The opposite of Account Receivable, since it is recorded as a liability.
- The money owed by the company to the **creditors**.

### - Bank overdraft

- Withdrawing money more than that is available in the account which means that the business owes the bank a liability.

### - Credit:

→ The accounting entries which indicate a decrease in an asset or an increase in a liability.

**- Debit:**

→ The accounting entries which indicate a decrease in a liability or an increase in an asset.

**- Balance b/d:**

→ It stands for **balance brought down**.

→ It refers to the balance of an account at the end of one account period [12 months], which is carried forward to the next period as the opening balance.

**- Balance c/d:**

→ It stands for **balance carried down/forward**.

→ It refers to the balance of an account at the end of an accounting period [12 months], which is then carried to the next period as the opening balance.

**- Debit Balance:**

→ When the debit side is greater than the credit side in a T-Account.

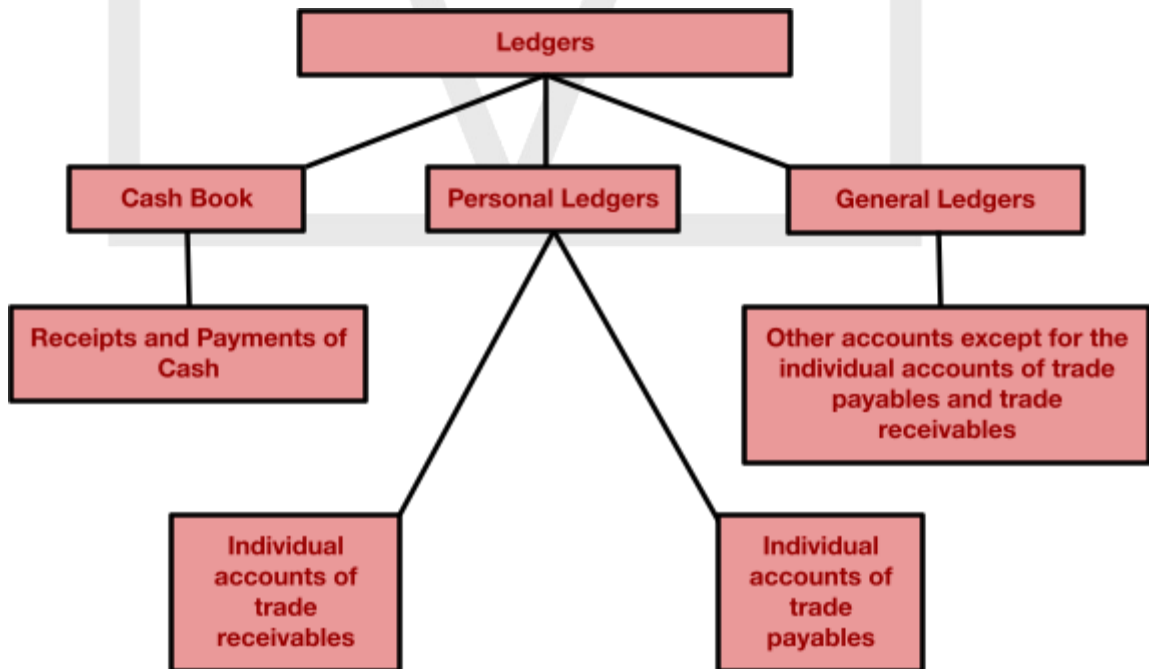
**- Credit Balance:**

→ When the credit side is greater than the debit side in a T-Account.

**- Ledger:**

→ The ledger tracks all the financial transactions of a specific person or an item which is called an **account**.

→ Types of Ledgers -> Sales ledger, Purchase Ledger, General Ledger.



**- T-Accounts:**

→ Made to visualise the representation of accounts in the letter ->T.

dr			Account Title	cr		
Date	Details	\$	Date	Details	\$	

**- Journal Entries:**

→ Made to visualise the recording of journal entries with this format:

**[Format]**

Date	Account Title	Debit	Credit
1st-Feb	Account with a debit	\$XX	
	Account with a credit		\$XX

**- Preparation of Accounts:**

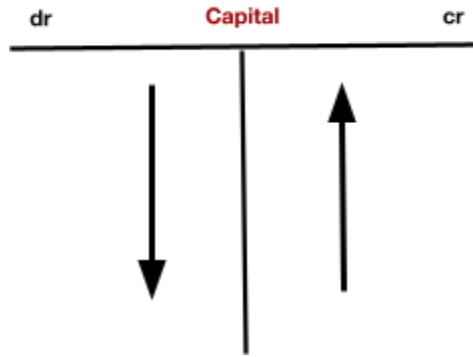
A business prepares its accounts in the following order

- Business Documents
- General Journal
- Ledgers
- Trial Balance

**Classification of Accounts “CLEAR”**

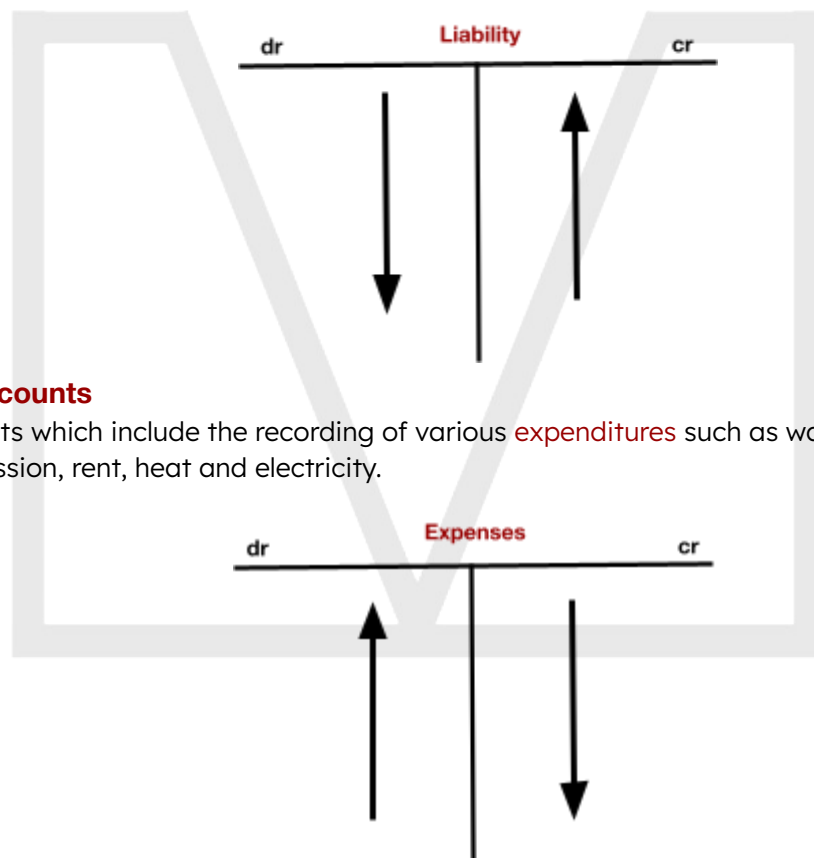
**- Capital Accounts**

→ Known as the owner’s equity account, it keeps track of a business owner’s individual transactions. Examples: Mrs Y Account.



### -Liability Accounts

→ Accounts which include loan account, wages and salaries payable, account payable and others.

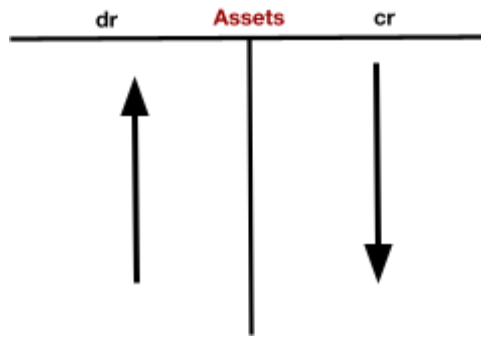


### - Expense Accounts

→ Accounts which include the recording of various **expenditures** such as wages, salaries, commission, rent, heat and electricity.

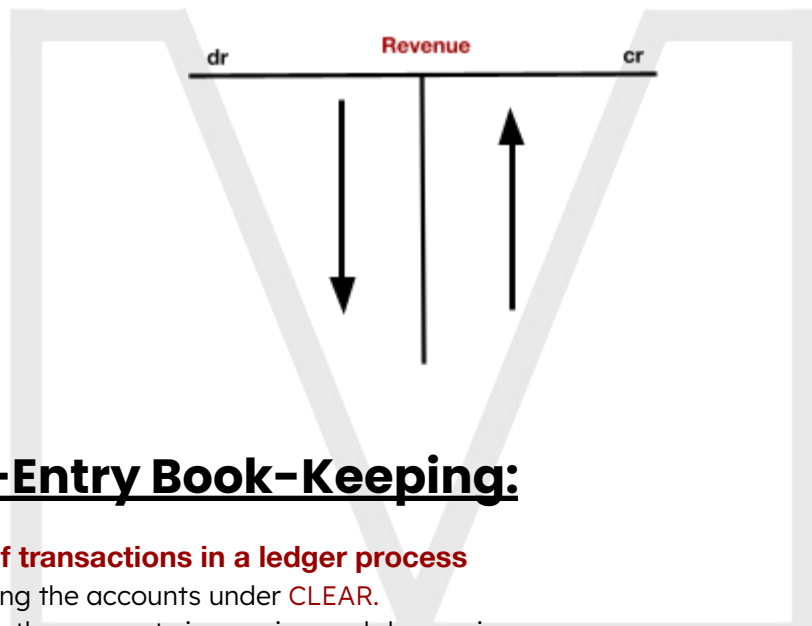
### - Asset Accounts

→ These accounts include both current assets - cash - and non-current assets - land and machinery.



**- Revenue Accounts**

- These accounts acquire the business by generating the **income** as, sales, commission received, wages received and interest received.



**Double-Entry Book-Keeping:**

**- Recording of transactions in a ledger process**

- Allocating the accounts under **CLEAR**.
- Mention the accounts increasing and decreasing.
- Mention the increase or decrease with the accounting terms, debit or credit.

**Documents of a Business**

Documents used to **communicate information** with a firm or business organisation are called business documents.

<b>Business Documents</b>	<b>Purpose and uses</b>
<b>Quotation</b>	<b>Sent by the supplier to the buyer including the details of the product with their prices.</b>
<b>Purchase Order</b>	<b>Upon accepting the quotation, the buyer will send a purchase order</b>

	<b>with the quantity and address of the goods to order.</b>
<b>Dispatch Note</b>	<b>A package of goods is dispatched and the details are included in this document.</b>
<b>Credit Note</b>	<b>A document sent to the buyer showing a deduction in the value of an invoice due to sales return.</b>
<b>Debit Note</b>	<b>A document sent to the supplier asking for a deduction in the value of an invoice due to purchases returned.</b>
<b>Invoice</b>	<b>Also known as the bill as it is sent to the buyer from the supplier.</b>
<b>Cheque</b>	<b>The withdrawal from the buyer's bank account to the supplier's account as a form of payment.</b>
<b>Receipt</b>	<b>A document of proof that the supplier has received the payment from the buyer.</b>
<b>Statement of Account</b>	<b>A summary of the month's transactions sent to notify the buyer from the supplier.</b>

## **Books of Prime Entry**

- The books of prime entry are also known as the **daybooks** or **journals**. Transactions are entered chronologically in these books before they are transferred to the ledger.
- It allows the preparation of **control accounts**.
- Allocate the same types of transactions.
- Enable the work to be divided amongst people.
- Errors in the ledger accounts can be easily found.

<b>Books of Prime Entry</b>	<b>Transactions recorded</b>
<b>Cash Book</b>	<b>The receipts and payments made by cash and bank. It contains ledger accounts for both cash and bank.</b>
<b>Petty Cash Book</b>	<b>Records small expenses, like postage, stationary and motor expenses.</b>
<b>Sales Day Book</b>	<b>Records credit sales of goods.</b>
<b>Sales Return Day Book</b>	<b>Records sales returns of goods</b>
<b>Purchase Day Book</b>	<b>Records credit purchases of goods.</b>
<b>Purchase Return Day Book</b>	<b>Records purchase returns of goods</b>

<b>General Journal</b>	<b>Records all the other transactions, such as, the purchase and sales of non-current assets, the year end transfers to the income statement, depreciation, correction of errors, and bad debts.</b>
------------------------	--

Books of Prime Entry:	Business Documents:
<b>Cash Book</b>	<b>Paying in Slip</b>
<b>Petty Cash Book</b>	<b>Receipt/Voucher</b>
<b>Sales Day Book</b>	<b>Sales Invoice</b>
<b>Sales Return Day Book</b>	<b>Credit Note issued, Debit Note received</b>
<b>Purchase Day Book</b>	<b>Purchase Invoice</b>
<b>Purchase Return Day Book</b>	<b>Debit Note issued, Credit Note received</b>
<b>General Journal</b>	<b>Invoice for non-current assets, purchased on credit or other suitable document</b>

## Cash Book Format:

- There are primarily two types of Cash Books, 2 column cash books and 3 column cash books.
- 2 Column cash books consist of Cash and Bank columns only on debit and credit sides. Whereas in 3 column cash books we have another column added of **Discounts**. On the debit side we have a **Discount Allowed** column, and on the credit side we have **Discount Received** column.
- Discount allowed is the amount of concession the business allows to their debtors
- Discount received is the amount of concession the business received from its creditors.
- The debit side of the cash book consists of all the **receipts** or the **inflows** of money into the business.
- The credit side of the cash book consists of all the **payments** or the **outflows** of money from the business
- A balance b/d is produced on the side which is the greatest and is the opening balance of the next year.
- A balance c/d is produced on the smaller side and is the closing balance.

### **[Format]**

Three Column Cash Book

Date	Details	Discount Allowed	Cash	Bank	Date	Details	Discount Received	Cash	Bank
	Balance b/d	xx	xx	xx		Balance b/d	xx	xx	xx



	<b>[All cash and bank inflows]</b>	xx	xx	xx		<b>[All cash and bank outflows]</b>	xx	xx	xx
	<b>Balance c/d</b>		xx	xx		<b>Balance c/d</b>		xx	xx

### [Format]

Two Column Cash Book

Date	Details	Cash	Bank	Date	Details	Cash	Bank
	<b>Balance b/d</b>	xx	xx		<b>Balance b/d</b>	xx	xx
	<b>[All cash and bank inflows]</b>	xx	xx		<b>[All cash and bank outflows]</b>	xx	xx
	<b>TOTAL</b>	<u>xx</u>	<u>xx</u>		<b>TOTAL</b>	<u>xx</u>	<u>xx</u>
	<b>Balance c/d</b>	xx	xx		<b>Balance c/d</b>	xx	xx

## Petty Cash Format:

- Imprest system is a system to set up petty cash funds.
- An imprest amount or a fixed sum is set up given to the cashier for a specific period of time.

The petty cash is reimbursed after the appropriate amount, thus making up the balance to the original amount.

- **Imprest Amount**

**Formula:**

<b>Balance b/d + Amount Reimbursed = Imprest Amount</b>
---

- **Amount Reimbursed**

**Formula:**

<b>Amount paid = Amount Reimbursed</b>
--

### [Format]

Date	Amount Received	Details	Amount Paid	Postages	Stationery	Motor Expenses	Cartage
	xx						

			xx	x	x	x	x
	xx	Balance c/d	xx				
	-	Total	-	-	-	-	-

### Sales Day Book Format:

Date	Customer Details	\$\$\$
1-Jan	Mr. A	900
4-Jan	Mr.B	100
31-Jan	TOTAL CREDIT SALES	1000

### Sales Return Day Book Format:

Date	Customer Details	\$\$\$
1-Jan	Mr. C	200
4-Jan	Mr.B	50
31-Jan	TOTAL SALES RETURN	250

### Purchase Day Book Format:

Date	Customer Details	\$\$\$
2-Jan	Mr. X	100
8-Jan	Mr.Z	500
31-Jan	TOTAL CREDIT PURCHASES	600

## Purchase Return Day Book Format:

Date	Customer Details	\$\$\$
2-Jan	Mr. K	40
8-Jan	Mr.Z	400
31-Jan	<b>TOTAL CREDIT PURCHASES</b>	<b>440</b>

## General Journal Format:

Date	Account Title	Debit	Credit
1st-Feb	Account with a debit	\$XX	
	Account with a credit		\$XX
	Narration [a short detail about the transaction]		

## Trade Discounts and Cash Discounts

### - Trade Discounts

- Also known as **Bargained discount**, it is given by the seller at the time of purchase.
- Allows customers to buy goods in bulk quantity
- Trade discount transactions are **not recorded**
- Reduction in the list price of goods bought and sold
- Journal Entry:

	\$
<b>Debit Trade Receivables</b>	<b>XX</b>
<b>Credit Sales</b>	<b>XX</b>

**- Cash Discounts**

- Reduction in the amount of debt owing to the supplier by the buyer
  - Encourages prompt payment to increase sales within a specific period
  - A transaction is **recorded**
- ↳ **Discount Allowed:** this discount is given to trade receivables and has a debit nature.

	\$
<b>Debit Discount Allowed</b>	<b>XX</b>
<b>Credit Trade Receivables</b>	<b>XX</b>

- ↳ **Discount Received:** this discount is given to trade payables and has a credit nature.

	\$
<b>Debit Trade Payables</b>	<b>XX</b>
<b>Credit Discount Receivables</b>	<b>XX</b>

# Topic 2: Accounting Principles & Policies

## Principles & Concepts:

### - Duality Concept

→ This concept states that for a certain value of debit, there is an equal value of credit with each transaction being recorded in two different accounts.

**Example 1.** Furniture bought for \$50 from cash.

Double Entry

	\$
<b>Furniture</b>	<b>\$50 Dr</b>
<b>Cash</b>	<b>\$50 Cr</b>

This transaction requires an entry to be made on both sides

**Example 2.** Sold goods on credit to Robert for \$250

	\$
<b>Robert</b>	<b>\$250 Dr</b>
<b>Sales</b>	<b>\$250 Cr</b>

### - Prudence Concept

This concept states that assets and profits should not be **understated** or **overstated**.

The expense to be recorded once it is known, however revenue shouldn't be recorded until earned

**For example,** this concept is applied in Provision for Doubtful Debts which is a provision created to record expenses, however it is yet not confirmed but recorded as a provision as per the prudence concept.

### - Consistency Concept

This concept states that a business will **continue its operations** with the same accounting principles and methods in every accounting period as well as the financial statements.

**For example**, if a business uses reducing balance method in one accounting period and switches to Straight-Line method does not comply with the Consistency Concept. However, if a business feels that a certain policy is not reflecting the true and fair view of the business, it is allowed to change the policy once only and disclose the changes to its readers of financial statements.

### - Historic Cost Concept

This concept states that business transactions and record of all assets should be done at its **cost price**

**For example**, If a business purchases a building (asset) in 2000 with a purchase price of \$100000. However, if the market value is \$150000, it will still be recorded at its cost price as per this concept

### - Business Entity Concept

This concept states that the transactions and records of the business is separate from its owners having a **separate legal identity**

**For example**, A owner using money from the business to pay for its personal expense will be identified as drawings and not a part of business expense

### - Going Concern concept

This concept states that a business or entity will **continue** its operations in the foreseeable future

**For example**: A retail business is dealing with immense financial problems and lack of funds for necessary machinery. If the government provides incentives and clear all its credit payments, the company may still be complying to going concern

### - Matching

This concept states that expenses should be recorded in the **same accounting period** as its revenues and to recognize them in the same period.

**For example**: If a building has a useful life of 5 years and costs \$50000, it will be depreciated and the expense of depreciation will spread over 5 years to match with the revenue it creates.

### - Materiality Concept

This concept states that all material items meaning those who bring a significant impact on investors decision making to be recorded in financial statements

**For example**: An item of stationary costing \$50, of a large business may be immaterial as it does not affect the decisions of the business

### **- Realisation Concept**

This concept states that revenue to only be recognised once it is earned while expense be recorded as soon as it is incurred.

**For example:** A tailor will only earn its income to sew clothes for \$150 once the tailor completes the task and complies with realisation concept

### **- Money Measurement Concept**

This concept states that items with a monetary value will only be recorded in the financial statements.

**For example:** Employee and Stakeholder satisfaction level does not comply with this concept as it cannot be measured in monetary terms.

### **- Accounting Period Concept**

This concept states that the span of time in which financial reporting is done could be a calendar or fiscal year. It usually lasts up to 12 months.

## **Accounting Policies:**

### **- Comparability**

It is the usability of accounting information and standardisation of accounting information to be compared with other organisations

### **- Relevance**

This policy states that accounting information should be helpful to be useful to the end-users while making decisions regarding the direction of the business.

### **- Reliability**

This policy states that accounting information should be accurate to be used and could be backed up and verified with objective evidence, so that stakeholders and internal managers don't have inaccurate information.

### **- Understandability**

This policy states that accounting information should be displayed or presented in a way that is easily understandable and can be comprehended to those who are reading and using this information.

# Topic 3: Trial Balance and Suspense Account

## Trial Balance

### - Definition:

- A trial balance is a list of all accounts and their balances in a business's general ledger.
- It ensures that the total of all debit equals to all credits.
- It is usually prepared at the end of an accounting period [12 months].
- It identifies any errors in the accounting records.

### - Uses of a trial balance:

- One of the main purposes is to identify the errors, such as incorrect postings or calculation mistakes.
- The balances from the trial balance facilitate the preparation of a firm's financial statements, for example, the balance sheet and the income statement.
- It identifies trends and patterns in the firm's financial activity.
- It ensures the **arithmetical accuracy** of a double entry system.
- The balances of each account can be checked at a single glance.

### - Particulars of trial balance:

The particulars included in a trial balance include all accounts that are used in the business's accounting records. These could include various types of assets, liabilities, expenses, and revenues.

Examples of **debit accounts** in trial balance could be cash, accounts receivable, prepaid expenses, and depreciation expenses.

Examples of **credit accounts** in trial balance could be accounts payable, unearned revenue, interest income, and sales revenue.

**Opening inventory** is not included in a trial balance as it is already accounted for in the calculation of the closing inventory balance.

### - Format of a trial balance:

#### [Format]

Trial Balance as at 20XX		
Particulars	Debit	Credit
Assets	XX	

<b>Liabilities</b>		<b>XX</b>
<b>Expenses</b>	<b>XX</b>	
<b>Income</b>		<b>XX</b>
<b>Drawings</b>	<b>XX</b>	
<b>Capital</b>		<b>XX</b>
<b>Purchases</b>	<b>XX</b>	
<b>Purchase Returns</b>		<b>XX</b>
<b>Sales</b>		<b>XX</b>
<b>Sales Returns</b>	<b>XX</b>	
<b>Provision for depreciation</b>		<b>XX</b>
<b>Provision for doubtful debts</b>		<b>XX</b>
<b>Irrecoverable debts</b>	<b>XX</b>	
<b>Irrecoverable debts recovered</b>		<b>XX</b>
<b>Total</b>	<b>XX</b>	<b>XX</b>

## Errors not affecting the trial Balance

- Limitations of a trial balance are errors. They are two types of errors that occur:
  - ↳ **Errors Affecting the Trial Balance**
  - ↳ **Errors not affecting the Trial Balance:** the debit and credit side of the trial balance will remain the same.
- Some of these errors have a debit entry and a credit entry of an equal value, so they do not affect the agreement of the trial balance.
- These are fixed with simple journal entries.

### - Error of Complete Omission

- The transaction is entirely omitted from the records or not recorded from the books.
- **Correction:** record the transaction.
- **Example:** The purchase of a motor bike on 1st Feb for \$10000 by cheque was omitted from the books.
- General Entries:
  - ↳ **Correct Entry**

Date	Account Title	Debit	Credit
1st-Feb	Motor Bike	\$10000	
	Bank		\$10000
	Narration [To correct an error of omission]		

### - Error of Commission

- The transaction was recorded in the wrong person's account.
- **Correction:** Remove the transaction from the incorrect account and put it in the correct account.
- **Example:** A credit sale for \$200 made to Mr. XYZ on 1st Feb was entered in Mr.JKL's account.
- General Entries:

#### ↳ Original Entry

Date	Account Title	Debit	Credit
1st-Feb	Mr.XYZ	\$200	
	Sales		\$200
	Narration []		

#### ↳ Incorrect Entry

Date	Account Title	Debit	Credit
1st-Feb	Mr.JKL	\$200	
	Sales		\$200
	Narration []		

#### ↳ Correct Entry

Date	Account Title	Debit	Credit
1st-Feb	Mr.XYZ	\$200	
	Mr.JKL		\$200
	Narration [To correct an error of commission]		

### - Error of Principle

- The transaction was recorded in the wrong account of different nature.
- **Correction:** Remove the transaction from the incorrect account and put it in the correct account.
- **Example:** The payment of motor expenses, \$100, by cheque on 1st Feb was entered in the motor vehicle's account.

#### → General Entries:

##### ↳ Original Entry

Date	Account Title	Debit	Credit
1st-Feb	Motor Expenses	\$100	
	Bank		\$100
	Narration []		

##### ↳ Incorrect Entry:

Date	Account Title	Debit	Credit
1st-Feb	Motor Vehicles	\$100	
	Bank		\$100
	Narration []		

##### ↳ Correct Entry

Date	Account Title	Debit	Credit
1st-Feb	Motor Expenses	\$100	
	Motor Vehicles		\$100
	Narration [To correct an error of principle]		

### - Error of Original Entry

- It occurs when the wrong amount or figure was recorded in double entry.
- **Correction:** Find the difference between the correct amount and incorrect amount and place it in the double entry.

- **Example:** The payment of wages \$3000 by cheque was recorded in both accounts as \$5000.on 1st Feb.
- **General Entries:**

↳ **Original Entry**

Date	Account Title	Debit	Credit
1st-Feb	Wages	\$3000	
	Bank		\$3000
	Narration []		

↳ **Incorrect Entry**

Date	Account Title	Debit	Credit
1st-Feb	Wages	\$5000	
	Bank		\$5000
	Narration []		

↳ **Correct Entry**

Date	Account Title	Debit	Credit
1st-Feb	Bank	\$2000	
	Wages		\$2000
	Narration [To correct an error of original entry]		

**- Compensating Error**

- When two errors cancel each other out, it is a compensating error.
- **Correction:** Place the amount on the opposite sides of the accounts by cancelling them.
- **Example:**Sales and Purchases were overcasted by \$50on 1st Feb.
- **General Entries:**

↳ **Correct Entry**

Date	Account Title	Debit	Credit
------	---------------	-------	--------

<b>1st-Feb</b>	<b>Sales</b>	<b>\$50</b>	
	<b>Purchases</b>		<b>\$50</b>
	<b>Narration [To correct an error of compensation]</b>		

### - Error of Complete Reversal

- When the entries are made on the opposite side of the double entries.
- **Correction:** Make the entries on the opposite side of the accounts and double the amount.
- **Example:** Cash sales of \$400 were recorded on the opposite of both accounts on 1st Feb.
- **General Entries:**

#### ↳ Correct Entry

<b>Date</b>	<b>Account Title</b>	<b>Debit</b>	<b>Credit</b>
<b>1st-Feb</b>	<b>Cash</b>	<b>\$800</b>	
	<b>Sales</b>		<b>\$800</b>
	<b>Narration [To correct an error of complete reversal]</b>		

### - Error of Transposition

- The error is caused when two or more sequential digits are reversed in the double entries.
- **Correction:** Find the difference between the debit and credit side of the entries and place them in the appropriate accounts.
- **Example:** A payment of \$79 was journalized as a debit to the motor expenses account and a credit to the cash account as \$97.
- **General Entries:**

#### ↳ Correct Entry

<b>Date</b>	<b>Account Title</b>	<b>Debit</b>	<b>Credit</b>
<b>1st-Feb</b>	<b>Motor Expenses</b>	<b>\$18</b>	
	<b>Cash</b>		<b>\$18</b>
	<b>Narration [To correct an error of transposition]</b>		

# Suspense Account

## - What is a Suspense Account?

- A Suspense Account is a temporary fix for the errors that caused the initial disagreement of the trial balance which should be found and corrected.
- A suspense Account with a debit balance = Current Asset.
- A suspense Account with a credit balance = Current Liability.

## - Uses of a Suspense Account?

- Acts as a temporary fix when the trial balance fails to agree.
- Complete the double-entry and aid in balancing the trial balance.
- Facilitate the preparation of financial statements.
- Used in the correction of errors and help identify them.

## - Example of a Suspense Account:

Trial Balance as at "the date"		
Particulars	Debit	Credit
Capital		100000
Bank	90000	
Loan		40000
Sales		80000
Expenses	60000	
Suspense	70000	
<b>Total</b>	<b>220000</b>	<b>220000</b>

## - Casting Error

- These occur when the day books are added incorrectly along with mistakes in balancing off the accounts.
- **Example:** The total of sales journals was overcasted by \$200 on 1st Feb.

### → **General Entries:**

#### ↳ **Correct Entry**

Date	Account Title	Debit	Credit
1st-Feb	Sales	\$200	

	<b>Suspense</b>		<b>\$200</b>
	<b>Narration []</b>		

### - Single Omission

- There is only one entry recorded and the other is omitted.
- **Example:** Receipt of \$100 from MR. JKL was correctly entered in the cashbook, but it was not recorded in JKL's account on 1st Feb
- **General Entries:**
  - ↳ **Original Entry**

Date	Account Title	Debit	Credit
<b>1st-Feb</b>	<b>Bank</b>	<b>\$100</b>	
	<b>JKL</b>		<b>\$100</b>
	<b>Narration []</b>		

#### ↳ **Correct Entry:**

Date	Account Title	Debit	Credit
<b>1st-Feb</b>	<b>Suspense</b>	<b>\$100</b>	
	<b>JKL</b>		<b>\$100</b>
	<b>Narration [To correct an error of single omission]</b>		

### - Wrong posting on the opposite side

- When entries are recorded on the opposite sides of the account.
- **Example :** Discount allowed of \$300 was recorded on the credit side of the discount received account on 1st Feb.
- **General Entries:**
  - ↳ **Error Entry:**

Date	Account Title	Debit	Credit
<b>1st-Feb</b>	<b>Discount Allowed</b>	<b>\$300</b>	
	<b>Discount Received</b>		<b>\$300</b>
	<b>Narration []</b>		

↳ **Correct Entry**

<b>Date</b>	<b>Account Title</b>	<b>Debit</b>	<b>Credit</b>
<b>1st-Feb</b>	<b>Discount Allowed</b>	<b>\$300</b>	
	<b>Discount Received</b>	<b>\$300</b>	
	<b>Suspense</b>		<b>\$600</b>
	<b>Narration [To correct an error of wrong posting]</b>		

## **Correcting Profit for the Year**

<b>Statement of corrected profit or loss for the year ended 20XX</b>	
	<b>\$\$\$</b>
<b>Profit/Loss for the year before correction</b>	<b>XX</b>
<b>Add: Errors that understate profits</b>	<b>XX</b>
<b>[These include revenue understating and expenses overstating]</b>	
<b>Less: Errors that overstate profits</b>	<b>(XX)</b>
<b>[These include revenue overstating and expenses understating]</b>	
<b>Corrected Profit/Loss for the year</b>	<b>XX/(XX)</b>

# TOPIC 4: BANK RECONCILIATION

## - Definition

Bank reconciliation is the process of comparing the **cashbook bank balance** and the **business's bank statement balance** to identify discrepancies. The cashbook is from the business's perspective, so all payments received in the bank are **debited** in the cashbook. But the business's bank statement is prepared from the bank's perspective, hence the entries made on the debit side of the cash book would appear as **credit** entries in the bank statement.

Bank reconciliation ensures that all transactions are accurately recorded and any errors are corrected. By reconciling the two balances, businesses can identify any **outstanding checks, deposits in transit, or bank errors** that need to be addressed. Bank reconciliation is an essential practice in maintaining accurate financial records.

## Reasons for the difference:

Difference between the balances of cashbook and bank statement may occur due to,

- **Automated transactions:** Payments made into and out of the bank automatically are known as automated transactions. These include bank charges , Interest paid and received , Credit transfer , Standing order , direct debits and dividends . Not entering these transactions in the business's cash book causes a difference
- **Timing difference:** Payments and receipts that are received by the business and entered into the cash book but have not yet been deposited into or paid out of the bank
- **Errors:** Errors may have been made by either the bank or the business such as incorrect amounts entered or a credit balance debited
- **Fraudulent activity/embezzlement:** a business may suffer from fraud or bad debts which can lead to a difference in the bank accounts.
- **Dishonoured cheques:** cheques, which are returned unpaid, also known as bounced cheques.

## Updating cash book

In order to **find errors** in existing cash book , **updating** the cash book is required. Updating cashbooks denotes adding transactions that appear in the bank statement but do not appear in the cash book.

For instance,  
An update of the cash book would be required, with the entries listed below.

<b>CASH BOOK ( BANK COLUMN ONLY )</b>					
<b>Date</b>	<b>Particulars</b>	<b>\$</b>	<b>Date</b>	<b>Particulars</b>	<b>\$</b>
<b>1 Aug</b>	<b>Balance b/d</b>	<b>26</b>	<b>10 Aug</b>	<b>Amber</b>	<b>217</b>
<b>6 Aug</b>	<b>Michele</b>	<b>350</b>	<b>16 Aug</b>	<b>Malcom</b>	<b>370</b>
<b>21 Aug</b>	<b>Bob</b>	<b>323</b>	<b>31 Aug</b>	<b>Balance c/d</b>	<b>112</b>
		<b>699</b>			<b>699</b>
<b>1 Sep</b>	<b>Balance b/d</b>	<b>112</b>			

<b>Particulars</b>	<b>\$</b>
<b>Interest paid</b>	<b>21</b>
<b>Standing order : Olivia</b>	<b>45</b>
<b>Direct Debit : Marcus</b>	<b>110</b>
<b>Dividends received</b>	<b>34</b>

For which, the updated Cashbook would look like this,

<b>CASH BOOK ( BANK COLUMN ONLY )</b>					
<b>Date</b>	<b>Particulars</b>	<b>\$</b>	<b>Date</b>	<b>Particulars</b>	<b>\$</b>
<b>1 Sep</b>	<b>Balance b/d</b>	<b>112</b>	<b>1 Sep</b>	<b>Interest paid</b>	<b>21</b>
<b>1 Sep</b>	<b>Dividends received</b>	<b>34</b>	<b>1 Sep</b>	<b>Standing order : Olivia</b>	<b>45</b>
<b>1 Sep</b>	<b>Balance c/d</b>	<b>30</b>	<b>1 Sep</b>	<b>Direct debit : Marcus</b>	<b>110</b>
		<b>176</b>			<b>176</b>
			<b>1 Sep</b>	<b>Balance b/d</b>	<b>30</b>

OR

CASH BOOK ( BANK COLUMN ONLY )					
Date	Particulars	\$	Date	Particulars	\$
1 Aug	Balance b/d	26	10 Aug	Amber	217
6 Aug	Michele	350	16 Aug	Malcom	370
21 Aug	Bob	323	31 Aug	Interest paid	21
31 Aug	Dividends received	34	31 Aug	Standing order: Olivia	45
31 Aug	Balance c/d	30	31 Aug	Direct debit: Marcus	110
		763			763
			1 Aug	Balance b/d	30

**To explain what happened:**

- Dividends received increases the bank and , therefore , increases on the debit side
- Interest is paid out of the bank and , hence , increases on the credit side
- Standing order is paid out of the bank and increases on the credit side
- Direct debit is also paid out of the business and , therefore , increases on the credit side
- If there was a credit transfer it increases the bank and therefore would have increased on the debit side

## Preparing a bank reconciliation statement

Once the cash book has been updated , the business can now make a bank reconciliation statement . This statement will show any difference between the cash book and bank statement due to any timing difference. The most common type of delays are

- **Unpresented cheque** : An unpresented cheque is a cheque which has been issued but the payment has not yet appeared on the bank statement. The payment would have been credited in the business cash book and would result in the bank statement balance being higher than the cash book balance
- **Uncredited deposit** : An uncredited deposit is an amount which has been received by the business but the receipt has not yet appeared on the bank statement. The payment or receipt would have been debited in the business cash book and would result in the cash book balance being higher than the bank statement balance.

There are two ways to preparing a bank reconciliation statement :

### **-USING UPDATED CASH BOOK BALANCE**

[Format]

- Updated cash book balance
- **Add** unpresented cheques
- **Less** uncredited deposit
- Results in bank statement balance

Hence : **updated cash book balance + unpresented cheque - uncredit deposit = bank statement balance**

### **-USING BANK STATEMENT BALANCE**

[Format]

- Bank statement balance
- **Less** unpresented cheques
- **Add** uncredited deposit
- Results in updated cash book balance

Hence : **Bank statement balance - unpresented cheque + uncredit deposit = Updated cash book balance**

### **- QUESTION WITH SOLUTION**

Mathew received a bank statement for Aug 2019 showing a credit balance of \$134 while the bank column of his cash book has a debit balance of \$114 on 1 Sep. When compared following differences were revealed

Only listed in the bank statement,

- Direct debit to Ron \$91
- Cheque received from Elfin , a credit customer , for \$214 was dishonoured
- Gas bill paid by standing order \$65
- Dividends received \$50

Only listed in the cash book,

- Cheque paid to Olivia , a credit supplier \$335
- Cash sales paid directly into the bank on 27 Aug \$95

The total of the credit side of the cash book has been overcasted by \$100

Q. UPDATE THE CASH BOOK AND THEN PREPARE A BANK RECONCILIATION STATEMENT

**MATHEW's**

<b>UPDATED CASH BOOK ( BANK COLUMN ONLY ) AS AT 1 SEP 2019</b>					
<b>Date</b>	<b>Particulars</b>	<b>\$</b>	<b>Date</b>	<b>Particulars</b>	<b>\$</b>
1 Sep	Balance b/d	114	1 Sep	Ron ( direct debit)	91
1 Sep	Dividends received	50	1 Sep	Dishonoured cheque: Elfin	214
1 Sep	Error correction	100	1 Sep	Gas ( S.O )	65
1 Sep	Balance c/d	106			
		<u>370</u>			<u>370</u>
			1 Sep	Balance b/d	106

**MATHEW's**

<b>BANK RECONCILIATION STATEMENT AS AT 1 SEP 2019</b>	
<b>Particulars</b>	<b>\$</b>
Balance as per Updated cash book	106 O/D
ADD : unpresented cheque (Olivia)	335
	229
LESS : uncredited deposit (cash sales)	( 95 )
Balance on bank statement	134

# Topic 5: Control Accounts

**Control Account:** A control account, often called a controlling account, is a summary account that equals the sum of the subsidiary account and is used to simplify and organise the general ledger.

## Why are Control Account kept :

When all the accounts are kept in one ledger a trial balance could be drawn up as a test of the arithmetical accuracy of the accounts. If the trial balance totals disagrees with the books of a small business, it could easily and quickly be checked so as to find the errors. Of course, as you know, even when the totals do agree, certain types of errors may still have occurred. The nature of which makes it impossible for them to be detected in this way. Nevertheless, using a trial balance at least ensures that all the double entries appear and have been recorded correctly.

### Advantages & Purpose of keeping Control Accounts

- Helps to locate errors.
- Detection of fraud.
- Sales and Purchases figures are known.
- Debtors and Creditors figures are known.
- Provide a summary of the transactions relating to trade receivables and trade payables.

### Types of Control Accounts.

- Sales Ledger Control Account
- Purchase Ledger Control Account

## Sales Ledger Control Account:

Sales Ledger Control Account typically looks like a T-account or a replica of an individual Trade Receivable account, but instead of containing transactions related to one trade receivable, it contains transactions related to **all the trade receivables** in the business.

### [Format]

Sales Ledger Control A/C			
Particulars	\$	Particulars	\$
Balance b/d (Debit Balance)	xxx	Balance b/d (Credit Balance)	xxx
Sales (Only Credit)	xxx	Sales Return	xxx
Dishonoured Cheques	xxx	Discount allowed	xxx

<b>Interest on Cash Overdue</b>	<b>xxx</b>	<b>Bad Debts</b>	<b>xxx</b>
<b>Cash Refund to Debtors</b>	<b>xxx</b>	<b>Set Off/Contra</b>	<b>xxx</b>
<b>TOTAL</b>	<b>xxx</b>	<b>TOTAL</b>	<b>xxx</b>
<b>Balance c/d (Credit Balance)</b>	<b>xxx</b>	<b>Balance c/d (Debit Balance)</b>	<b>xxx</b>

## **Purchase Ledger Control Account :**

Purchase Ledger Control account typically looks like a T-account or a replica of an individual Trade Payable Account, but instead of containing transactions related to one trade payable, it contains transactions related to **all trade payables** in the business.

<b>Purchase Ledger Control A/C</b>			
<b>Particulars</b>	<b>\$</b>	<b>Particulars</b>	<b>\$</b>
<b>Balance b/d (Debit Balance)</b>	<b>xxx</b>	<b>Balance b/d (Credit Balance)</b>	<b>xxx</b>
<b>Purchase Returns</b>	<b>xxx</b>	<b>Purchases (only credit)</b>	<b>xxx</b>
<b>Discount Received</b>	<b>xxx</b>	<b>Dishonoured Cheques</b>	<b>xxx</b>
<b>Cash and Bank</b>	<b>xxx</b>	<b>Interest on Overdue Creditors</b>	<b>xxx</b>
<b>Set off/ Contra</b>	<b>xxx</b>	<b>Cash Refund from Creditors</b>	<b>xxx</b>
<b>TOTAL</b>	<b>xxx</b>	<b>TOTAL</b>	<b>xxx</b>
<b>Balance c/d (Credit Balance)</b>	<b>xxx</b>	<b>Balance c/d (Debit Balance)</b>	<b>xxx</b>

## **Contra Entry :**

A Contra Entry is when an account in the **Sales Ledger** is set against an account in the purchases ledger. Such an entry is made when a supplier is also a customer of the business and has an account in both ledgers.

# TOPIC 6: CAPITAL & REVENUE RECEIPTS & EXPENDITURE

## Capital expenditure

Business expenditure used to purchase or improve assets that are expected to be used in the business for more than a year are known as **capital expenditure**. It includes the **cost** of getting those assets ready for use .

Capital expenditure may include

- Cost of buying assets
- Delivery cost
- Import cost
- Cost of installation
- Initial testing and safety certificates
- Initial training of workers
- Legal cost of buying asset

When calculating profit , capital expenditure is not classified as expense in income statement but instead is shown on the statement of financial position. It is important to distinguish if an expense is capital or not because capital expenditure if entered as an expense, understate profit.

## Revenue expenditure

**Revenue expenditure** is expenditure incurred in the running of the business on an everyday basis. It is linked to the expenses of a particular time period .

Revenue expenditure may include

- Maintenance and repairs
- Replacement parts
- Heat and lighting
- Wages
- Operating cost
- Insurance
- Rent
- Increase in the provision for doubtful debt

When calculating profit , revenue expenditure is treated as an expense in the income statement . It is important to identify revenue expenditure as not including one in the expense will overstate profit .

**- Example**

	<b>\$</b>
<b>Cost of purchasing van</b>	<b>15000</b>
<b>Painting business logo on the van</b>	<b>500</b>
<b>Replacing worn seats</b>	<b>250</b>
<b>Petrol costs for year</b>	<b>1500</b>
<b>Insurance</b>	<b>1000</b>
<b>Purchase of new engine for van</b>	<b>3000</b>

From this table, calculate the capital expenditure

In the question table :

- Cost of purchasing van is the cost of buying new asset therefore it is capital expenditure
- The cost of painting business logo on the van is the cost of getting the van ready to use for the business and therefore is the capital expenditure
- Replacing worn seats is a maintenance cost and therefore will be treated as a revenue expenditure
- The petrol cost for an year and Insurance is the cost of using the asset for day to day needs and over a period of time and is therefore a revenue expenditure
- The purchasing of new engine for the van is the cost of improving the asset and hence is a capital expenditure

Therefore the answer would be :

	<b>\$</b>
<b>Cost of purchasing van</b>	<b>15000</b>
<b>Painting business logo on the van</b>	<b>500</b>
<b>Purchase of new engine for van</b>	<b>3000</b>
<b>Total capital expenditure</b>	<b>18500</b>

## **Capital receipts**

**Capital receipt** is the business income that is not part of the day to day operations of the business and hence is unlikely to be repeated regularly .

**Examples** of capital receipt may include:

- Addition of money to the business from the owner
- Sales of non current assets
- Loans and other long term borrowing taken out by the business
- Issue of shares

Capital receipts are **not** classified as **income** in the income statement of a business. Therefore it is important to identify capital receipts because if one is treated as an income in the income statement then profit may be overstated

## **Revenue receipts**

**Revenue receipts** are the business income that comes from the day to day business operations and is normally linked to a particular time period .

**Examples** of revenue receipts may include:

- Sales of inventory / revenue from inventory
- Commission received
- Rent received
- Profit on disposal of non current asset
- Decrease in the provision for doubtful debt

Revenue receipts are classified as **income** in the income statement of a business. Therefore it is important to identify revenue receipts because if one is not treated as an income in the income statement then profit may be understated.

# Topic 7: Depreciation

## What is Depreciation?

### - Definition

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

There are 3 policies which could be used when charging depreciation:

- Full year depreciation charged in the **year of purchase** but none in the year of sale
- Full year depreciation charged in **year of sale** and none in year of purchase
- Questions may also ask about charging depreciation on a monthly basis.

### Formula:

$$\frac{\text{Depreciation} \times 100}{\text{Cost}}$$

### - Why are non-current assets depreciated?

Non-current assets are depreciated due to:

- Time factor
- Technological changes
- Obsolescence
- Wear and tear
- Depletion
- Inadequacy
- Damage
- Usage

### - Methods of Depreciation

There are 3 methods of depreciation:

- Straight Line method
- Reducing (Diminishing) Balance method
- Revaluation method

## Straight line method

In straight line method, non current assets are depreciated at a uniform value on cost until it reaches its residual value

Formula of straight line method:

$$\frac{\text{Cost} - \text{Residual/Scrap Value}}{\text{Useful Life}}$$

For example:

<b>Straight - Line Method</b>	
<b>Cost of Machine:</b>	<b>\$200000</b>
<b>Residual Value:</b>	<b>25000</b>
<b>Useful life:</b>	<b>5 years</b>
<b>Every year the machine would be depreciated by \$35000.</b>	
<b><math>200000 - 25000 / 5 = 35000</math></b>	
<b>Depreciation for the year ended = \$35000</b>	

## **Diminishing/Reducing Balancing method**

Diminishing balancing method also known as **Reducing balance method** is charging a **fixed or uniform rate on the net book value** of non-current assets. Assets are depreciated at a higher rate in the initial years than in the later years.

<b>Reducing Balance Method</b>	
<b>Cost of Machine:</b>	<b>\$150000</b>
<b>Depreciation rate:</b>	<b>25%</b>
<b>1st year depreciation:</b>	<b>25% of 150000 = 37,500</b>
<b>2nd year depreciation:</b>	<b><math>150000 - 37500 = 112,500</math> ( net book value)</b>
<b>25% of 112500 =</b>	<b>28,125 ( depreciation of second year)</b>

## **Revaluation Method**

This method of depreciation is mostly applied to loose tools that don't have a substantial value alone but only collectively.

### **- Formula**

<b>Revaluation Method</b>	<b>\$</b>
<b>Opening value of loose tools</b>	<b>xxx</b>

<b>Add: Purchase of loose tools</b>	<b>xxx</b>
<b>Less: Sale of loose tools</b>	<b>( xxx )</b>
<b>Less: Ending value of loose tools</b>	<b>( xxx )</b>
	<b>-----</b>
<b>Depreciation of loose tools</b>	<b>xxx</b>

## Disposal of Assets:

Disposal of non-current assets is the process of **selling or otherwise getting rid of long-term assets** that are no longer needed or useful to a business. This includes assets such as property, plant, and equipment, as well as intangible assets such as patents and trademarks. The disposal process involves determining the fair value of the asset, finding a buyer or other means of disposal, and removing the asset from the company's balance sheet. Proper disposal of non-current assets is important to maintain **accurate financial records** and **maximise the value of the company's assets**.

<b>Cost A/C</b>			
<b>Particulars</b>	<b>\$</b>	<b>Particulars</b>	<b>\$</b>
<b>Balance b/d</b>	<b>xxx</b>	<b>Disposal of NCA</b>	<b>xxx</b>
<b>Purchase of NCA</b>	<b>xxx</b>	<b>Balance c/d</b>	<b>xxx</b>

<b>Provision for Depreciation A/C</b>			
<b>Particulars</b>	<b>\$</b>	<b>Particulars</b>	<b>\$</b>
<b>Disposal</b>	<b>xxx</b>	<b>Balance b/d</b>	<b>xxx</b>
<b>Balance c/d</b>	<b>xxx</b>	<b>Income Statement</b>	<b>xxx</b>

Disposal A/C			
Particulars	\$	Particulars	\$
Cost of asset	xxx	Provision for Depreciation	xxx
Income statement (profit)	xxx	Sale Proceeds	xxx
		Income Statement (loss)	xxx

### - Disposal Entries

	\$
Disposal	xxx Dr
Cost of Asset	xxx Cr
Provision for Depreciation	xxx Dr
Disposal	xxx Cr
Sale proceeds	xxx Dr
Disposal	xxx Cr
Income statement (loss)	xxx Dr
Disposal	xxx Cr
Disposal	xxx Dr
Income statement (gain)	xxx Cr

# Topic 8: Accruals and Prepayments

## Accruals

### - What is Accrued?

Accruals are an **outstanding balance** in expense and income. **Accrued Expense** occurs when expense is incurred but not yet paid for in the same accounting period which will be treated as a current liability in the statement of financial position as the expense has not been paid for.

Accrued **Income** occurs when it has already been earned by finishing the task but the income hasn't been received hence will be treated as a current asset in the statement of financial position as the task has been completed.

## Prepayments

### - What is Prepaid?

Prepaid are when **payments are made in advance** in income and in expense. **Prepaid Expense** occurs when expense has been paid for but not incurred, hence are treated as current assets in the statement of financial position as it has already been paid.

While **Prepaid Income** occurs when income has been received but not yet earned hence will be treated as a non current liability in the statement of financial position as the task has not been completed yet and still has to be done.

## Income & Expense Ledger

### Ledger Account for Expense

Expense A/C			
Particulars	\$	Particulars	\$
Balance b/d (opening prepaid)	xxx	Balance b/d (opening accrued)	xxx
Bank	xxx	Income Statement	xxx
Balance c/d (Ending Accrued)	xxx	Balance c/d (Ending Prepaid)	xxx

### Ledger Account for Income

Income A/C			
Particulars	\$	Particulars	\$
Balance b/d (opening accrual)	xxx	Balance b/d (opening prepaid)	xxx
Income Statement	xxx	Bank	xxx
Balance c/d (Ending prepaid)	xxx	Balance c/d (Ending accrual)	xxx

Acronyms are good for memorising as they turn long phrases into one easy-to-remember words. The following acronyms help with remembering the format for Income and Expense Accounts.

P= prepaid

A= accrued

**Expense = PAAP**

**Income = APPA**

# Topic 9: Inventory Valuation

## Methods of Valuation

**Inventory Valuation :** Inventory is stock of goods which is to be valued at lower of **Cost** or **Net Realisable Value** [NRV] according to the prudence concept.

**Cost :** The Cost of inventory is the actual **purchase price** of the goods plus any additional cost incurred in bringing the goods to their present position and condition.

**Net Realisable Value :** Net Realisable Value means the resale value less any cost incurred in putting inventory in a saleable condition.

### Net Realisable Value Formula:

<b>Expected selling Price - Total Selling Cost</b>
--

- At the time of Inventory Valuation nothing is to be recorded at selling price, it should be either at **Net Realisable Value** or **Lower Cost**
- As per the **Prudence Concept**, lower value is to be recorded

### The Difference Between Cost and Net Realisable

Cost	Net Realisable Value
<b>Cost is the actual purchase price plus any additional costs incurred in bringing the inventory to its present condition and position.</b>	<b>Net Realisable Value is the estimated receipts from sale of the inventory, less any costs of completing or selling the goods.</b>

## Effects of Incorrect Inventory Valuation

→ **Effect of Overstating The Value of Inventory :**

<b>Result On /Accounting year</b>	<b>Gross Profit</b>	<b>Net Profit</b>	<b>Non-Current Assets</b>	<b>Owner's Equity</b>
<b>Accounting Period I</b>	<b>Overstated</b>	<b>Overstated</b>	<b>Overstated</b>	<b>Overstated</b>
<b>Accounting period II</b>	<b>Understated</b>	<b>Understated</b>	<b>No Effect</b>	<b>No Effect</b>

→ **Effect of Understating The Value of Inventory :**

<b>Result On /Accounting year</b>	<b>Gross Profit</b>	<b>Net Profit</b>	<b>Non-Current Assets</b>	<b>Owner's Equity</b>
<b>Accounting Period I</b>	<b>Understated</b>	<b>Understated</b>	<b>Understated</b>	<b>Understated</b>
<b>Accounting period II</b>	<b>Overstated</b>	<b>Overstated</b>	<b>No Effect</b>	<b>No Effect</b>

# Topic 10: Ratio Analysis

## **What Is Ratio Analysis:**

Ratio analysis is a method of **analysing financial records** to evaluate a company's performance. It involves a **comparison of financial ratios** with benchmarks such as industry averages, competitor ratios, or historical ratios.

This helps businesses to **make informed decisions** such as whether to invest new capital, expand operations, or make changes to their financial strategies. Ratio analysis also helps businesses to understand their financial position and make better decisions for their future.

## **EFFECTS OF RATIOS:**

**There are different advantages and disadvantages of Ratios.**

### **The Advantages of Ratios are as follows:**

- They are calculated to monitor the progress of a business.
- They are very useful for decision making.
- Ratios help businesses to compare their performance with other competitors.
- They also help managers to set different targets for the business.

### **The Disadvantages of Ratios are as follows:**

- Ratios are based on past records only, which may not be true in future.
- Inflation rate might disturb the accuracy of ratios.
- Ratios only shows whether performance of the business has improved or deteriorated – it does not tell the reasons for such performance.
- Ratios are just indicators and should not be taken as the final conclusion; other qualitative factors should also be taken into account for overall analysis.

## **Types of Ratios:**

- Profitability Ratios.
- Liquidity Ratios.
- Efficiency Ratios

## Profitability Ratios:

A profitability ratio is a measure of profitability — these ratios are used to measure the financial performance of the company, i.e whether the company is profitable or not. It helps the business to operate more efficiently in order to increase its return for shareholders.

Businesses use these ratios to compare their current performance with their previous ones, their industry's average performance, or their competitors.

Most common examples of Profitability Ratios include,

### → Gross Profit Margin :

It shows the gross profit earned from the **number of sales** made by a business.

A high gross margin indicates a high selling price and a low cost price.

An increase in gross margin depicts an improvement in the business which can result in attaining a competitive edge.

To correct gross profit margin, a company needs to increase its **revenue** or decrease its **expenses**.

#### Formula:

$$\frac{\text{Gross Profit}}{\text{Net Sales}} \times 100$$

### → Net Profit Margin:

It shows the net profit earned from the **number of sales** made by a business.

A high net profit margin indicates an increase in the gross profit and a decrease in expenses.

After expenses and taxes are taken into account, this ratio reflects an organisation's ability to generate earnings.

It can indicate whether a company is generating sufficient profits from its sales and keeping its costs under control.

To correct net profit margin, a company needs to increase its **revenue** or decrease its **expenses**.

#### Formula:

$$\frac{\text{Net Profit}}{\text{Net Sales}} \times 100$$

#### Formula for Net Sales:

$$\text{Revenue/Sales} - \text{Return Inwards/Sales Return}$$

### → Gross Profit Markup :

Gross Profit Markup (**GPM**) is a helpful tool that tells how much extra money a business should add to the cost of making a product to cover their profit and expenses.

The ideal markup is the percentage that ensures the selling price covers both the **cost of goods sold** and desired **gross profit**. It represents the profit margin a business aims to achieve on each sale.

For example, if a product costs a business \$10 to make, and it wants to add \$5 extra to make a profit, its Gross Profit Markup would be 50%. So, it would sell the product for \$15 (which is \$10 cost + \$5 profit).

If the markup is below the benchmark, a business can take the following steps:

**Increase selling price:** Raise the price of products to improve the gross profit margin.

**Decrease costs:** Find ways to reduce the cost of goods sold to increase gross profit.

**Analyse competitors:** Research competitors' prices to remain competitive.

**Formula:**

$$\frac{\text{Gross Profit}}{\text{Cost of goods sold}} \times 100$$

**→ Return on Capital Employed :**

It shows the total profit earned as a result of total investment made.

A high return on capital indicates that a business is profitable and has high return on investment.

A high return can also attract investors to invest in the business.

Using **loans** to fund more operations and to buy back **shares** can improve the return, thereby minimising equity use.

**Formula:**

$$\frac{\text{Net Profit before Interest and Tax}}{\text{Capital Employed}} \times 100$$

**Formula for Capital Employed:**

$$\text{Total Assets} - \text{Current Liabilities}$$

$$\text{Owner's Equity/Capital/Net Assets} + \text{Long Term Loans}$$

**Owner's Equity/Capital/Net Assets:**

$$\text{Total Assets} - \text{Total Liabilities} + \text{Long-Term Loans}$$

**Liquidity Ratios :**

Liquidity refers to the ability of a business to repay its current liabilities and operate the day-to-day expenses with its current assets such as cash. Having good liquidity ensures the

financial strength of the business in repaying its loans and obligations. Having negative liquidity can cause a business to go bankrupt and unable to survive.  
Most common examples of Liquidity Ratios include

**→ Current Ratio :**

A Current Ratio is a measure of the liquidity of a business by dividing Current Assets by Current Liabilities. Ratio of 1.5:1 OR 2:1 is generally regarded as satisfactory. If the current ratio is 1:1, it shows that the business is liquid. The business has current assets of \$1 to cover current liabilities of \$1.

If the current ratio is 0.5:1, it shows that the business is not liquid. The business can only repay 50% of its current liabilities with its current assets.

Current ratio can be corrected by the following:

- Increasing current assets, such as accounts receivable and inventory,
- Decreasing current liabilities, such as account payable, and short term debt,
- Allowing cash discounts on early payments by customers,
- Extending accounts payables period.

**Formula:**

$$\frac{\text{Current Assets}}{\text{Current Liabilities}}$$

**→ Working Capital :**

It is the difference between current liabilities and current assets.

The working capital of a business should always be positive to be shown as net current assets and in order to meet all the short-term obligations and retain existing customers.

Insufficient working capital is shown as net current liabilities which leads to difficulty in retaining the staff and the bankruptcy of the business.

The owner may inject more capital into the business by taking up a long-term loan or can sell spare non-current assets.

Paying accounts payables on time,

Speeding up accounts receivables payments, by increasing interest, only payments or allowing cash discounts,

Decreasing current liabilities such a short term debt,

Increase in current assets, such as inventory and bank.

**Formula:**

$$\text{Current Assets} - \text{Current Liabilities}$$

**→ Acid Test / Quick Ratio :**

It shows the ability of a business to pay its short-term liabilities with quick or immediate assets such as cash and account receivables.

If the quick ratio is 1:1, it shows that the business is liquid. The business has quick assets of \$1 to cover current liabilities of \$1.

If the quick ratio is 0.5:1, it shows that the business is not liquid. The business can only repay 50% of its current liabilities with its quick assets.

Quick ratio can be corrected by the following ways:

Increasing quick assets such as cash,

Decreasing current liabilities, such as short-term debt,

Allowing cash discounts on early payments to customers,

Reducing **prepaid expenses**.

**Formula :**

$$\frac{\text{Current Assets Excluding Inventory}}{\text{Current Liabilities}}$$

### → Rate of Inventory Turnover :

The rate of inventory is sometimes referred to as “**Rate of Stock Turnover**”. This ratio calculates the number of times a business sells and replaces its inventory in a given period of time. The higher the rate of inventory, the quicker the business is selling its inventory. The lower the rate of inventory, the less likely the business is able to sell its inventory.

A business can increase the rate of selling the inventory quickly:

↳ by reducing the **selling price** to attract customers.

↳ by allowing **trade discounts** and promotional advertising.

**Formula:**

$$\frac{\text{Cost of Sales}}{\text{Average Inventory}}$$

**Formula for Average Inventory:**

$$\frac{\text{Opening Inventory} + \text{Closing Inventory}}{2}$$

### Efficiency Ratios :

Efficiency Ratios allows a business to analyse the profit it makes with current assets and liabilities available. They are used to analyse the company’s ability to efficiently employ its resources to generate an income.

Managing and operating a company efficiently increases its long-term profitability for owners and shareholders.

### → Trade Payables Turnover:

It measures the average time taken by a business to its credit suppliers.

A low trade payables turnover indicates how efficiently a business manages its cash outflows.

A high trade payables turnover will lead to the suppliers not offering the cash or trade discounts to the business.

Trade payables turnover can be corrected:  
Reducing accounts payable days,  
Improving inventory management,  
Extending payment terms with accounts payables.

**Formula:**

$$\frac{\text{Trade Payables}}{\text{Credit Purchases}} \times 365$$

**→ Trade Receivables Turnover:**

It is the number of days in which the trade receivables will pay their due amount it owes a business.

A low trade receivables turnover indicates that a business is efficient in managing its trade receivables.

A high trade receivables turnover shows the inefficiency of a business in collecting its debts which can lead to cash inflow problems.

Trade Receivables turnover can be corrected by:

Speeding up and accounts receivables, but either allowing cash discounts on early payments,  
Changing payment policies, such as increasing interest on overdue debts,

**Formula:**

$$\frac{\text{Account Receivable}}{\text{Credit Sales}} \times 365$$

# Topic 11: Sole Trader

## Sole Trader :

A Sole Trader is a simple business arrangement, in which **one individual** runs and owns the entire business.

## Advantages & Disadvantages of Sole Trading

### The Advantages of Sole Trader are :-

- You keep all the profits.
- Start-up costs are low.
- Establishing and operating your business is simple.
- It's easy to change legal structure later if circumstances change.
- Needs to comply with fewer government regulations.
- Less Legal Documentation is required.

### The Disadvantages of Sole Trader are :-

- Sole Traders have **“Unlimited Liability”**, which means when business owners who are legally liable for any debt their business might accrue, there's no legal distinction between private and business assets.
- Capacity to raise capital is limited.
- Lack of scope for growth.
- Limited Managerial Expertise.
- Retaining high-calibre employees can be difficult

## Final Accounts

### Final Account :

Final accounts gives an idea about the **profitability** and **financial position** of a business to its management, owners, and other interested parties. All business transactions are first recorded in a journal. They are then transferred to a ledger and balanced.

### There are certain benefits of preparing Final Accounts :

- The preparation of Final Accounts helps to maintain business records.
- The preparation of Final Accounts increases the accuracy and effectiveness of the accounts.
- During the preparation, any innocent mistakes or fraud can be discovered and could be rectified quickly.

**Income Statement :** An Income statement is a financial statement that shows you the company's income and expenditures. It also shows whether a company is making profit or loss for a given period. The income statement, along with the balance sheet and cash flow statement, helps you understand the financial health of your business. **An income statement is always made during the end of the year.**

**An Income Statement has two parts:**

- **Trading Account** - includes only the trading activities such as buying and selling. In trading account part of the income statement, business calculates gross profit
- **Profit and Loss Account** - includes the other incomes and expenses. In profit and loss account part of the incomes statement, business calculates Profit for the year

**- Income Statement of Trading Business:** When in a sole trader business income statement, adjustments are made to account for the owner's drawings. Drawings are subtracted from purchases when calculating the cost of goods sold (COGS) to accurately reflect the business's expenses. This is because drawings represent an owner's personal withdrawals, which do not contribute to the business's revenues or profits. Subtracting drawings from purchases results in a more accurate COGS figure, which is used to calculate the business's gross profit.

[Format]  
[Business's Name]

<b>Income Statement as at 20XX</b>		
	\$	\$
<b>Revenue</b>		<b>xxx</b>
<b>Less: sales return / return inwards</b>		<b>(xxx)</b>
<b>Less : Cost of Sales</b>		
<b>(+) Opening inventory</b>	<b>xxx</b>	
<b>(+) Purchases</b>	<b>xxx</b>	
<b>(-) Drawings (only when adjusted)</b>	<b>(xxx)</b>	
<b>(+) Carriage Inwards</b>	<b>xxx</b>	
<b>(-) Purchase Returns/Return Outwards</b>	<b>xxx</b>	
<b>(-) Closing Inventory</b>	<b>xxx</b>	<b><u>(xxx)</u></b>

<b>Income Statement as at 20XX</b>		
	<b>\$</b>	<b>\$</b>
Revenue		xxx
Less: sales return / return inwards		(xxx)
<b>Less : Cost of Sales</b>		
(+) Opening inventory	xxx	
<b>Gross Profit</b>		xxx
<b>Add : Other income</b>		
Discount received	xxx	
Decrease in PFDD	xxx	
Commision received	xxx	
Rent received	xxx	<u>xxx</u>
		xxx
<b>Less : Expenses</b>		
Carriage Outwards	xxx	
Rent payable	xxx	
Depreciation	xxx	
Irrecoverable debts	xxx	
Increase in PFDD	xxx	
Interest expense	xxx	
Discount allowed	xxx	<u>(xxx)</u>
<b>Profit for the year</b>		xxx

**Statement of Financial Position** : The financial position helps the management understand the company's performance in comparison to the other businesses and the sector. Providing

management with accurate information enables them to form proper policies for the companies and make correct decisions. These statements rank the performance of management. The format of Statement of Financial Position summarises a company's assets (what it owns), Liabilities (what it owes) and Equity (assets less liabilities) usually at the end of a financial month or financial year.

### Statement of Financial Position is made with the help of Trial Balance

- In Trial Balance, all the assets and expenses will be debited and all the incomes and liabilities will be credited.
- Capital amount given in Trial Balance is called Opening Capital, which may change by new investment, earning profit for the year or sustaining losses and withdrawing money for personal use ( i.e drawings ). The new capital after adjustment is called Closing Capital.

#### → Closing Capital Formula:

$$\text{Opening Capital} + \text{Profit for the Year} - \text{Drawings}$$

- The Total Asset Amount and the Total Equities and Liabilities amount should be matched in the Statement of Financial Position.

### - Statement of Financial Position of Trading Business

[Business's Name]

[Format] Statement of Financial Position as at 20XX			
	\$	\$	\$
<b>Non-Current Assets</b>	[ cost ]	[accumulated depreciation ]	[ net book value ]
Property	xxx	(xxx)	xxx
Motor Vehicle	xxx	(xxx)	xxx
Equipment	xxx	(xxx)	xxx
<b>Total NCA</b>			xxx
<b>Current Assets</b>			
Inventory [ closing ]		xxx	
Trade Receivable		xxx	

[Format] Statement of Financial Position as at 20XX			
	\$	\$	\$
Non-Current Assets	[ cost ]	[accumulated depreciation ]	[ net book value ]
Decrease in PFDD		(xxx)	
Cash and Bank		xxx	
Other Receivables		xxx	<u>xxx</u>
<b>Total Assets</b>			xxx
Equities And Liabilities			
Capital		xxx	
Profit for the year		(xxx)	xxx
Drawings			
<b>Non Current Liabilities</b>			
Bank Loan		xxx	
Other long term loan		xxx	xxx
<b>Current Liabilities</b>			
Trade Payables		xxx	
Bank overdraft		xxx	
Other payables		xxx	<u>xxx</u>
<b>Total Equities And Liabilities</b>			xxx

# Topic 12: Partnership

## - What is a partnership?

→ Partnership occurs when a business is owned and controlled by **more than one** owner and have a maximum of 20 owners.

## Advantages & Disadvantages of Partnership

### - Advantages of a Partnership

- Large amount of capital
- New ideas enter the business
- Losses and responsibilities are shared

### - Disadvantages of a Partnership

- Profits are to be shared
- Unlimited liability, meaning if debts are not paid, personal belongings of partners can be taken
- There may be disputes between partners

## Partnership Agreement

Partners make a **partnership agreement** to clear the functions of the business and the partners to avoid any disputes in the future

It consists of

- Interest on Drawings
- Interest on Capital
- Partner salary
- Loan from partner
- Appropriation of profit/loss

If this agreement is not present, thus the **Partnership Act of 1980** will be followed in which interest on capital, interest on drawings, salary and commission is absent. In case if a partner loans the business they will receive 5% interest and residual profit/loss to be shared equally.

**Interest on Capital** is given to partners by the business when capital is invested by them and credited to the current account which reduces the residual profit

**Formula:**

**Capital x Rate of interest per annum x time period**

	\$
<b>Interest on Capital</b>	<b>Dr</b>
<b>Capital</b>	<b>Cr</b>

**Interest on Drawings** has to be paid by the partners to the business when drawings are taken out and is debited to the current account hence increasing the profit/loss

**Formula:**

**Drawings x Rate of interest on drawings x time period**

	\$
<b>Interest on Drawings</b>	<b>Dr</b>
<b>Drawings</b>	<b>Cr</b>

**Salary** to Partner is credited to the current account hence decreasing the residual profit/loss to be distributed to partners while if it paid to the partner it comes to the debit side with journal entry

**Loan** from partner only consists in the current account on the credit side reducing the amount of profit/loss to be distributed

**Interest on loan** paid to a partner will not be included in the current account, while unpaid interest will be part of the partner's current account but not included in the statement of financial position's accruals or current liabilities. However, it will always be part of the Income Statement as an expense.

## **Partnership Accounts**

### **- Appropriation Account**

An appropriation account is a significant part of partnership as it shows the business how profits/losses are distributed among the partners.

Appropriation account would be as follows

**[Format]**  
**[Business's Name]**

<b>Statement of Financial Position as at 20XX</b>		
	<b>\$</b>	<b>\$</b>
<b>Profit for Appropriation</b>		<b>xxx</b>
<b>Add: Interest on drawings</b>		
<b>Partner A</b>	<b>xxx</b>	
<b>Partner B</b>	<b>xxx</b>	<b>xxx</b>
<b>Less: Interest on Capital</b>		
<b>Partner A</b>	<b>xxx</b>	
<b>Partner B</b>	<b>xxx</b>	<b>(xxx)</b>
<b>Less : Bonus/Salary/Comission to Partner</b>		
<b>Partner A</b>	<b>xxx</b>	
<b>Partner B</b>	<b>xxx</b>	<b>(xxx)</b>
<b>Residual Profit</b>		
<b>Less: Share of Profit</b>		
<b>Partner A</b>	<b>xxx</b>	
<b>Partner B</b>	<b>xxx</b>	<b>(xxx)</b>

### - Current Account

Current account is made to record all the transactions of the partnership and the share of residual profit/loss

Particulars	Partner A	Partner B	Particulars	Partner A	Partner B
Balance b/d	xxx	xxx	Balance b/d	xxx	xxx
Drawings	xxx	xxx	Interest on Capital	xxx	xxx
Interest on Drawings	xxx	xxx	Salary to partner	xxx	xxx
Share of loss	xxx	xxx	Share of profit	xxx	xxx
			Interest on Loan	xxx	xxx
Balance c/d			Balance c/d	xxx	xxx
<b>TOTAL</b>	<b><u>xxx</u></b>	<b><u>xxx</u></b>	<b>TOTAL</b>	<b><u>xxx</u></b>	<b><u>xxx</u></b>
Balance b/f	xxx	xxx	Balance b/f	xxx	xxx

### - Capital Account

Capital A/C					
Particulars	\$	\$	Particulars	\$	\$
Withdrawal Capital/ Drawings	xxx	xxx	Balance b/d	xxx	xxx
			Addition of Capital/ Profit	xxx	xxx
Balance c/d	xxx	xxx			

- Statement of Financial Position ( extract )

[Business's Name]

	\$	\$
<b>Capital Account</b>		
Partner A	xxx	
Partner B	xxx	
		xxx
<b>Current Account</b>		
Partner A	xxx	
Partner B	xxx	
		<u>xxx</u>

# Topic 13: Manufacturing Accounts

## What are Manufacturing Accounts?

### - Definition:

- Manufacturing accounts are created for businesses that produce or manufacture their products in a factory before selling them.
- In addition to tracking inventory levels and production costs, it can also help a business keep track of the materials it consumes while manufacturing products.

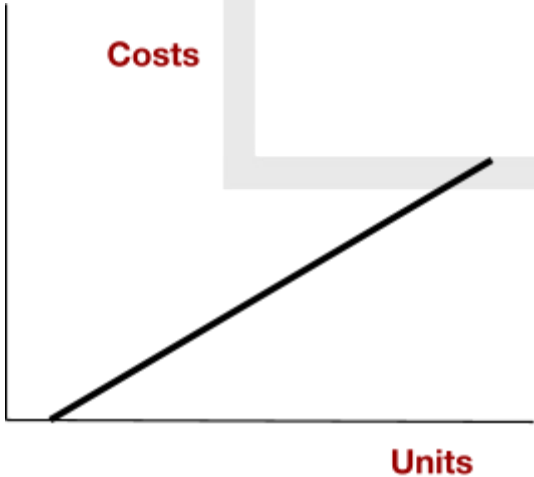
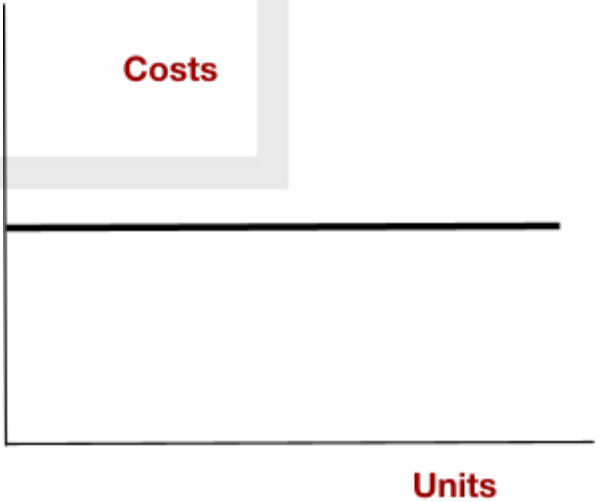
### - Purpose or uses of a manufacturing account:

- A manufacturing account shows the total cost, both indirect and direct, of manufacturing a product from raw materials to finished products.
- The cost of running and maintaining the factory in which the products are made is displayed.
- It helps track the profits or losses made during manufacturing a product which aids the business in decision making on how to allocate their resources efficiently.

### - Accounts Required:

- A Manufacturing Account (*Factory Account*).
- Income Statement (*Office Account*).
- Statement of Financial Statement.

**- Types of Costs:**

Types of Costs in a Manufacturing Account	
Direct Costs [Variable Costs]	Indirect Costs [Fixed Costs]
These are the costs which are directly incurred on each product manufactured.	These are the costs which are not directly incurred on each product manufactured.
→ Direct Materials: paper, plastic, wood, rubber	→ Indirect Materials: paint, ink, glue, polish
→ Direct Labour: factory workers wages, production workers wages, workforce such as painters.	→ Indirect Labour: supervisors, factory managers, and workers not directly linked with the production like accountants.
→ Direct Expenses: royalties, licence fee, specific hire of a machine, carriage on material.	→ Indirect Expenses: depreciation on factory machinery, heat and light, rent.
<b>Direct Costs= Total Costs-Indirect Costs</b>	<b>Indirect Costs= Total Costs-Direct Costs</b>
<b>Direct Costs= Direct Materials+Direct Labour Direct Expenses</b>	<b>Direct Costs= Indirect Materials le Indirect Labour &amp; Indirect Expenses</b>
Direct Costs will increase as output increases.	Indirect Costs do not vary as the output increases or decreases.
	

## Types of Inventories in Manufacturing

### - Raw Materials:

- The raw materials are those items that are initially purchased to be used in the production of finished products.
- Examples include wood, plastic, or paper.

### - Work in Progress:

- Goods that are partially finished and are still under the production process.

### - Finished Goods:

- Products that are completely manufactured after undergoing all aspects of production and are ready to be sold.
- Examples include merchandise.

## Final Accounts of Manufacturing Business

### - Calculating Total Costs of Materials Consumed:

[Format]

Total Costs of Materials Consumed	
	\$
Inventory at opening	XX
Purchases	XX
Carriage Outwards	XX
[Return Outwards]	(XX)
[Inventory at Closing]	(XX)
	<u>XX</u>

**- Manufacturing Account:**

[Business's Name]

<b>Manufacturing Account Statement for the year ended:</b>		
	<b>\$</b>	<b>\$</b>
<b>Opening Inventory of Raw Material</b>	<b>XX</b>	
<b>Purchase of Raw Material</b>	<b>XX</b>	
<b>[Purchase Returns of Raw Material]</b>	<b>(XX)</b>	
<b>[Closing Inventory of Raw Material]</b>	<b>(XX)</b>	
<b>Cost of Raw Materials Used</b>		<b><u>XX</u></b>
<b>Direct Wages</b>	<b>XX</b>	
<b>Direct Expenses</b>	<b>XX</b>	
<b>Royalties</b>	<b>XX</b>	
<b>Factory Wages</b>		
<b>Prime Cost</b>		<b><u>XX</u></b>
<b>Indirect Wages</b>	<b>XX</b>	
<b>Rent and Rates</b>	<b>XX</b>	
<b>Depreciation on Machinery</b>	<b>XX</b>	
<b>Machinery Repairs</b>	<b>XX</b>	
<b>Factory Overheads</b>		<b><u>XX</u></b>
<b>[+] Opening Inventory: Work in Progress</b>	<b>XX</b>	
<b>[-] Closing Inventory: Work in Progress</b>	<b>(XX)</b>	
<b>Production Costs of Finished Goods</b>		<b><u>XX</u></b>

**- Income Statement for Manufacturing Business**

[Business's Name]

<b>Income Statement [ Year ended ]</b>		
	<b>\$\$\$</b>	<b>\$\$\$</b>
<b>Sales Revenue</b>	<b>XX</b>	
<b>[Sales Returns]</b>	<b>XX</b>	
<b>Net Sales</b>		<b><u>XX</u></b>
<b>Opening Inventory of Finished Goods</b>	<b>XX</b>	
<b>Manufacturing Costs</b>	<b>XX</b>	
<b>Purchase of Finished Goods</b>	<b>XX</b>	
<b>[Closing Inventory of Finished Goods]</b>	<b>(XX)</b>	<b>(XX)</b>
<b>Gross Profit</b>		<b><u>XX</u></b>
<b>Operating Expenses</b>		
<b>Rent</b>	<b>XX</b>	
<b>Office Salaries</b>	<b>XX</b>	
<b>Depreciation on machinery</b>	<b>XX</b>	<b>(XX)</b>
<b>Operating Profit</b>		<b><u>XX</u></b>
<b>[Finance Cost]</b>	<b>(XX)</b>	
<b>Net Profit</b>		<b><u>XX</u></b>

**- Statement of Financial Position:**

[Business's Name]

<b>Statement of Financial Position [As of]</b>	
	<b>\$\$\$</b>
<b>Non-Current Assets:</b>	
Land and Building	XX
Plant and Machinery	XX
Office Equipment	XX
<b>Total Non-Current Assets</b>	<b>XX</b>
<b>Current Assets:</b>	
Closing Inventory of Raw Materials	XX
Closing Inventory of Work in Progress	XX
Closing Inventory of Finished Goods	XX
Trade Receivables	XX
[Provision for doubtful debts]	(XX)
<b>Total Current Assets</b>	<b>XX</b>
<b>Total Assets</b>	<b>XX</b>
<b>Total Equity and Liability</b>	
Opening Capital	XX
Net Profit	XX
[Drawings]	(XX)
<b>Closing Capital</b>	<b>XX</b>
<b>Non-Current Liabilities</b>	
Bank Loan	XX



<b>Capital Employed</b>	<b>XX</b>
<b>Current Liabilities</b>	
<b>Trade Payables</b>	<b>XX</b>
<b>Bank Overdraft</b>	<b>XX</b>
<b>Total Equity and Liabilities</b>	<b>XX</b>



# TOPIC 14: NON-PROFIT ORGANISATION (CLUBS)

## What are Non-Profit Organisations

### - Definition

A non-profit organisation is organised and operated by a group of individuals with the main aim to provide services to its members, or to provide social benefits, and generate enough income to pay for day to day expenses. **Examples** may include :

- Clubs
- Societies
- Charities

The financial statements for a non profit organisation may include :

- Subscriptions account
- Receipts and Payments account
- Income and Expenditure account
- Statement of Financial position

### - Incomes and Expenses

The **incomes** of a non-profit making organisation may include :

- Subscriptions (also known as membership fees)
- Donations
- Life memberships
- Grants
- Revenue received from activities and money received from events (other receipts)

The **expenses** of a non-profit making organisation may include :

- Rent
- Wages
- Advertising
- Purchases of new equipment
- Rates and insurance
- other payments

## Accumulated Funds

Accumulated fund is similar to the Capital or retained earnings of a profit making organisation. Accumulated Funds hold **excess money received** by non-profit making organisations. Any surplus on the income and expenditure account is added to the accumulated funds and deficit deducted from accumulated funds .It can be used for various purposes when the NPO is short of finance in order to run the operations .

**Formula:**

$$\text{Assets (current and noncurrent)} - \text{liabilities (current and noncurrent)} = \text{Net assets}$$

**Formula:**

$$\text{Net assets} = \text{Accumulated funds}$$

## Subscriptions

Subscription (membership fees) is the amount of money paid (usually monthly) by the members to keep their membership alive. To find the correct subscription to be included as **income** in the income and expenditure account, a subscription account is to be made at the end of each financial year.

<b>SUBSCRIPTION A/C</b>			
<b>Particulars</b>	<b>\$</b>	<b>Particulars</b>	<b>\$</b>
<b>Balance b/d arrears (accrued)</b>	<b>x</b>	<b>Balance b/d paid in advance (prepaid)</b>	<b>x</b>
<b>Income and expenditure account</b>	<b>x</b>	<b>Bank/Cash</b>	<b>x</b>
<b>Cash Refund</b>	<b>x</b>	<b>Irrecoverable debts</b>	<b>x</b>
<b>Balance c/d paid in advance (prepaid)</b>	<b>x</b>	<b>Balance c/d arrears (accrued)</b>	<b>x</b>
<b>TOTAL</b>	<b>xx</b>	<b>TOTAL</b>	<b>xx</b>
<b>Balance b/d</b>	<b>x</b>	<b>Balance b/d</b>	<b>x</b>

( XX DENOTES TOTAL )

- Since it is an income account, therefore an increase in the income would be credited whereas a decrease would be debited.
- Prepaid subscriptions are the upfront payment by the customer for the services they would receive in the future. Since they increase income therefore the balance brought down or the balance at the start of the year is recorded on the credit side.
- Accrued subscriptions occur when the customers have already availed the services but have not yet paid. Since they decrease the income therefore the balance brought down is recorded on the debit side.

- The bank or cash in the subscription account are the subscriptions received during the year and are recorded on the credit side.
- Irrecoverable debts are also recorded on the credit side.
- The balance carried down or the balance at the end of the year for prepaid subscription is recorded on the opposite of the balance brought down i.e the debit side.
- The balance carried down for accrued subscription is recorded on the credit side.
- Both of the sides are balanced and the difference between the balance is TRANSFERRED to the income and expenditure account as the correct income received from subscriptions.
- Lastly the amounts of the balance c/d are at the end written on the opposite sides as balance b/d.

## **Final Accounts of NPOs**

### **- Receipts & Payments Account**

A receipts and payments account is similar to a cash book . The money received by the business or the receipts are recorded on the debit side whereas the money paid out of the business or payments are recorded on the credit side.

A debit balance on the receipts and payments account is considered as an asset whereas a credit balance denotes liability .

Balance c/d at the end of the financial year is transferred to the next financial year

### **- Key Points**

- The receipts and payments account only includes cash and bank transaction
- It does not include any accrued or prepaid amounts
- It does not differentiate between capital and revenue income and expenditure and therefore all is included

The format is shown below:

**[Business's Name]**

<b>RECEIPTS AND PAYMENTS ACCOUNT</b>			
<b>Particulars</b>	<b>\$</b>	<b>Particulars</b>	<b>\$</b>
<b>Balance b/d ( opening bank balance )</b>	<b>x</b>	<b>Purchases of any equipment</b>	<b>x</b>
<b>Subscriptions received</b>	<b>x</b>	<b>Wages</b>	<b>x</b>
<b>Refreshment sales</b>	<b>x</b>	<b>Rents and rates</b>	<b>x</b>
<b>Fees received</b>	<b>x</b>	<b>General expenses</b>	<b>x</b>
<b>Revenue</b>	<b>x</b>	<b>Travelling expenses</b>	<b>x</b>

		<b>Event expenses</b>	<b>x</b>
		<b>Purchases of refreshment</b>	<b>x</b>
		<b>Balance c/d</b>	<b>x</b>
<b>TOTAL</b>	<b>xx</b>	<b>TOTAL</b>	<b>xx</b>
<b>Balance b/d</b>	<b>x</b>		

( XX DENOTES TOTAL )

### - Income & Expenditure Account

An income and expenditure account is similar to the income statement of other businesses. It includes the summary of all items of income and expense in a financial year . The word profit used by the profit making business is replaced with surplus and loss with deficit. Therefore if income is greater than the expense then a surplus has occurred whereas if the expense is greater then the income then a deficit has resulted.

An income and expenditure account also includes non cash and bank transactions such as depreciation , irrecoverable debts etc.

Below is the standard format for an income and expenditure account:

<b>[Business's Name]</b>		
<b>Income &amp; Expenditure Account</b>		
	<b>\$</b>	<b>\$</b>
<b><u>Incomes:</u></b>		
<b>Subscriptions</b>	<b>x</b>	
<b>Grant received</b>	<b>x</b>	
<b>Life subscriptions</b>	<b>x</b>	
<b>Donations</b>	<b>x</b>	
<b>Profit on events or from income statement</b>	<b>x</b>	
<b>Profit on sale of equipment</b>	<b>x</b>	
		<b>xx</b>
<b><u>Expenses:</u></b>		
<b>Loss on event or from income statement</b>	<b>x</b>	

<b>General expenses</b>	<b>x</b>	
<b>Travelling expenses</b>	<b>x</b>	
<b>Official expenses</b>	<b>x</b>	
<b>Rates and insurance</b>	<b>x</b>	
<b>Loss on sale of equipment</b>	<b>x</b>	
<b>Depreciation</b>	<b>x</b>	
<b>Irrecoverable or bad debt</b>	<b>x</b>	
		<b>(xx)</b>
<b>Surplus/Deficit</b>		<b>xxx/(xxx)</b>

( XXX DENOTES TOTAL )

### - Trading Account

In the case of a non-profit organisation, the trading account is used to track the revenue and expenses related to any trading activities, such as the sale of merchandise or services that generate income. It includes all the direct costs, such as the cost of goods sold or services provided. The format for the trading account of a non-profit organisation typically follows the same principles as that for a business, but with slight variations.

It is important to note that Trading Account will only be made till the Gross Profit if the questions asks you to.

[Business's Name]

<b>Trading Account as at 20XX</b>		
	<b>\$</b>	<b>\$</b>
<b>Revenue</b>		<b>xxx</b>
<b>Less: sales return / return inwards</b>		<b>(xxx)</b>
<b>Less : Cost of Sales</b>		
<b>(+) Opening inventory</b>	<b>xxx</b>	
<b>(+) Purchases</b>	<b>xxx</b>	
<b>(+) Carriage Inwards</b>	<b>xxx</b>	

<b>Trading Account as at 20XX</b>		
	<b>\$</b>	<b>\$</b>
<b>Revenue</b>		<b>xxx</b>
<b>Less: sales return / return inwards</b>		<b>(xxx)</b>
<b>Less : Cost of Sales</b>		
<b>(+) Opening inventory</b>	<b>xxx</b>	
<b>(-) Purchase Returns/Return Outwards</b>	<b>xxx</b>	
<b>(-) Closing Inventory</b>	<b>xxx</b>	<b><u>(xxx)</u></b>
<b>Gross Profit</b>		<b>xxx</b>
<b>Less : Expenses (Related to Trading)</b>		
<b>Carriage Outwards</b>	<b>xxx</b>	
<b>Wages</b>	<b>xxx</b>	
<b>Other Expenses</b>	<b>xxx</b>	<b><u>(xxx)</u></b>
<b>Profit for the year</b>		<b>xxx</b>

### - Statement Of Financial Position

The statement of financial position of a non profit organisation would state the total assets of the organisation along with the total liabilities and the accumulated funds .

The format is similar to the SFP of any other business except capital would be replaced with accumulated funds and profit or loss would be substituted with surplus or deficit .

#### [Business's Name]

<b>Statement of financial position for the year ended 20Xx</b>			
	<b>COST \$</b>	<b>DEPRECIATIONS\$</b>	<b>NET BOOK VALUE \$</b>
<b>Non current assets</b>			
<b>Premises</b>	<b>x</b>	<b>x</b>	<b>x</b>
<b>Fixtures and Fittings</b>	<b>x</b>	<b>x</b>	<b>x</b>



Machinery	x	x	x
Motor vehicles	x	x	x
Office equipments	x	x	x
			XX
<b>Current assets</b>			
Inventory			x
Bank/Cash			x
Any receivables			x
Accrued income			x
Prepaid expenses			x
			XX
<b>TOTAL ASSETS</b>			<b>XXX</b>
<b>Accumulated Funds</b>			<b>XX</b>
Add: surplus for the year OR			x
Less: deficit for the year			(x)
Less: Drawings			(x)
			XXX
<b>Non current liabilities</b>			
Mortgage			x
Loan			x
			XX
<b>Current liabilities</b>			
Bank overdraft			x
Prepaid income			x
Accrued expenses			x
Any trade payables			x



MOJZA

			<b>XX</b>
<b>TOTAL LIABILITIES</b>			<b>XXX</b>

( XX AND XXX DENOTES TOTAL )



# TOPIC 15: LIMITED COMPANIES

## What are Limited Companies

### - Definition

Limited companies are **incorporated businesses** meaning they have a separate legal identity from its owners and hence the owners have limited liability ( only liable to debts up to the investment they made into the business) . Separate legal identity also means that the business can continue even if the shareholders die or become bankrupt

The owners of a limited company are known as **shareholders** and they own the shares of the company . **Share** is the ownership of the business divided into numerous parts.The shareholders of a limited company may not be involved in the day to day running of the operations and instead a board of **directors** runs the day to day activities . The value of the shares issued by a limited company to a shareholder is known as **equity**.

### - **Types of Limited companies**

- **Private** limited companies ( There shares are not traded on stock exchange selling shares to only family and friends)
- **Public** limited companies ( There shares are traded on the stock exchange and hence are larger businesses)

### - **Key documents to setup a limited company**

- **Memorandum of Association** - Contains business name , address and objective. It also states the liability and equity invested by each shareholder
- **Articles of Association** - Contains details of the responsibilities and roles of the directors , how the company directors will be elected , how the profit will be distributed as dividends to the shareholders etc.

## Advantages and Disadvantages of Limited Companies

### - **Private Limited Companies**

#### **ADVANTAGES**

- Limited liability
- Have control over the business as the board of directors are usually the main shareholders
- Decisions can be taken quickly as the business is smaller and less bureaucratic

#### **DISADVANTAGES**

- More legal requirements than sole trader or partnership
- Limited capital as shares cannot be sold on stock exchange
- If compared to public limited, private limited company is smaller and therefore may not benefit from economies of scale

## - Public Limited Companies

### ADVANTAGES

- Can sell shares on stock exchange and therefore gather large sums of capital
- Since they are very large in size, they may benefit from economies of scale
- May obtain benefit from specialisation
- Able to produce goods at lower unit costs

### DISADVANTAGES

- May lose control of operations due to large size
- Conflicts of interests can occur between shareholders and the board of directors
- May have issues with employee relations
- There is a possibility of a takeover or merger as shares are freely available on the stock market

## Share Capital

Capital in a limited company is known as share capital. In a limited company the capital is invested by the shareholders.

### - Types of share capital

- **Authorised share capital**: The maximum amount of share capital that can be issued by a limited company
- **Issued share capital**: The amount of share capital the company currently has by the sales of shares
- **Called-up share capital**: The total amount of money that will be due to a limited company from the issue of shares
- **Paid-up share capital**: The amount of money that has actually been received by a limited company from the issue of shares

## Types of shares

### - Preference shares

Preference shares are the ones where, when the company decides to pay dividends, the holders of the preference shares are the first to be paid. **Redeemable preference shares**- Preference shares repayable by the company at a specified future date when shares are cancelled and shareholders are repaid

**Non-redeemable preference shares**- preference shares that remain in existence indefinitely and are classified as equity in the statement of financial position

- Shareholders receive a fixed percentage rate of dividend
- Shareholders are not entitled to vote at a limited company's annual general meeting
- Shareholders receive their dividends before ordinary shareholders
- Shareholders receive capital before ordinary shareholders if the company goes bankrupt

### - Ordinary shares

- Shareholders receive a **variable** dividend each year or may not receive one at all
- Shareholders are entitled to vote at shareholders meetings
- Shareholders receive their dividend payment after the preference shareholders
- Shareholders are the last to receive share capital in the company goes bankrupt

#### Formula of ordinary share:

**Value per share x number of share issues**

## Dividends

Dividend is a **portion of the profit** made by the company paid out to the shareholders. The dividend to each shareholder is often stated as a percentage of the face value of shares. There are two types of dividends. Interim and Final :

### - Interim dividend

- They are declared by the board of directors
- They are declared before the company has prepared its financial statements
- Interim dividends relate to a part year ( usually 6 months)

### - Final dividend

- The board of directors only proposes the final dividend. The shareholders have the authority to vote on whether to accept them or not at the annual general meetings
- Final dividend are only declared once the financial statements have been prepared and profit has been calculated
- Final dividends relate to a full year

## Debentures

Debenture is a legal document of a **long term loan capital** given to an individual who lent money and is an alternative method of financing a business instead of issuing shares.

- Debenture holders are liability of a company and have no voting rights
- Debenture interest must be paid regardless of whether the company made any profit or losses
- Debenture interest is paid at a fixed rate
- The debentures supposed to be paid within a financial year are recorded as current liabilities
- If a company shuts down or goes bankrupt debenture holders are supposed to receive money before shareholders

## Reserves

Part of the profit kept within the business after dividend has been paid is known as reserves.  
There are two types of reserves:

- **Retained earnings:** This is the profit that is not appropriated (used) to pay shareholders dividends  
To find retained earnings we add net profit or subtract net loss to current retained earnings account balance and subtract any dividends or distribution to shareholders. Therefore

**Formula of retained earnings:**

$$\text{Opening Retained} + \text{net profit ( or - net loss) - dividend paid}$$

The resulted amount is then transferred to general reserve

- **General reserve:** A reserve created for general purposes in the future.( for e.g paying dividends to shareholders incase of an unexpected occurrence). It forms part of the capital of the company.

**Formula of general reserve:**

$$\text{Earned profit} \times \text{rate of profit kept aside}$$

## Statement of Changes in Equity

A limited company prepares a statement of changes in equity to show the movements during a financial year

The format is as follows:

**[Format]**

**[ Name of the company ]**

<b>Statement of changes in equity for the year ended 20XX</b>					
	<b>Ordinary share capital</b>	<b>Preference share capital</b>	<b>General reserve</b>	<b>Retained earnings</b>	<b>Total</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
<b>Opening balance</b>	<b>x</b>	<b>x</b>	<b>x</b>	<b>x</b>	<b>x</b>
<b>Profit for the year</b>				<b>x</b>	<b>x</b>
<b>Dividend paid</b>				<b>(x)</b>	<b>(x)</b>
<b>Transfer to general reserve</b>			<b>x</b>	<b>(x)</b>	
<b>Share issue</b>	<b>x</b>	<b>x</b>			<b>x</b>
<b>Closing balance</b>	<b>x</b>	<b>x</b>	<b>x</b>	<b>x</b>	<b>x</b>

## Final Accounts of Companies

### - Income statement

It is the same as the income statement of a partnership or sole trader. Format is as follows:

#### [Format]

[ Name Of The Company ]

<b>Income Statement For The Year Ended 20XX</b>		
	<b>\$</b>	<b>\$</b>
<b>Sales/ Revenue</b>	<b>x</b>	
<b>Less: sales return</b>	<b>(x)</b>	
		<b>x</b>
<b>Less:Cost of Goods sold</b>		
<b>Opening Inventory</b>	<b>x</b>	
<b>Purchases</b>	<b>x</b>	
<b>Carriage inwards</b>	<b>x</b>	
<b>Purchase return</b>	<b>(x)</b>	
<b>Closing inventory</b>	<b>(x)</b>	
		<b>(x)</b>
<b>Gross profit for the year</b>		<b>XX</b>
<b>Add : other income</b>		
<b>Finance income</b>	<b>x</b>	
<b>Rent received</b>	<b>x</b>	
<b>Commision received</b>	<b>x</b>	
<b>Decrease in the provision for doubtftul debts</b>	<b>x</b>	
		<b>xx</b>
<b>Less: Expenses</b>		
<b>Distribution cost</b>	<b>x</b>	
<b>Administrative expenses</b>	<b>x</b>	

depreciation	x	
Irrecoverable debts	x	
Increase in the provision for doubtful debts	x	
General expenses	x	
Heat and lighting	x	
		(xx)
<b>Net profit for the year</b>		<b>XXX</b>

### - Statement of Financial Position

The statement of financial position for limited companies are somewhat similar to sole traders or partnerships , except there are few additions such as debentures and shares etc.

#### [Format]

[ Name Of The Company ]

Statement of Financial Position for the Year Ended 20XX			
	COST \$	DEPRECIATIONS\$	NET BOOK VALUE \$
<b>Non current assets</b>	<b>x</b>	<b>x</b>	<b>x</b>
Premises	x	x	x
Fixtures and Fittings	x	x	x
Machinery	x	x	x
Motor vehicles	x	x	x
Office equipments	x	x	x
			XX
<b>Current assets</b>			
Inventory			x
Bank/Cash			x
Any receivables			x
Accrued income			x
Prepaid expenses			x



			<b>XX</b>
<b>TOTAL ASSETS</b>			<b>XXX</b>
<b>CAPITAL AND RESERVES</b>			
Ordinary share capital			x
%Non-redeemable preference share capital			x
General reserve			x
Retained earnings			x
			<b>XXX</b>
<b>Non current liabilities</b>			
%Debentures (year)			x
% Redeemable preference share capital			x
			<b>XX</b>
<b>Current liabilities</b>			
Bank overdraft			x
Prepaid income			x
Accrued expenses			x
Any trade payables			x
			<b>XX</b>
<b>TOTAL LIABILITIES</b>			<b>XXX</b>

# TOPIC 16: INCOMPLETE RECORDS

## What are Incomplete Records

### - Definition

Incomplete records refers to a condition or situation where a business does **not** have a **complete set of accounting records** including books of prime entry or ledger account. Some reasons may include the records being misplaced, lost, stolen or damaged due to natural calamities. The most common reason for this situation to occur is when a business does not follow the principle of **duality** i.e the double entry bookkeeping where every transaction has a debit and credit entry. This may be due to :

- Cost of employing an accountant to maintain double entry bookkeeping system
- Businesses preferring to prepare single entry accounts
- Few businesses such as sole trader not legally liable to maintain double entry accounting records

Maintaining a **single entry system** would not differentiate entries with similar nature for e.g drawings expenses purchases revenue expenditure etc. In this case since all are being paid for they will be treated as the same.

## Statement of Affairs

Statement of affairs is a statement **listing** the **Assets and Liabilities** of a business at a given date . It is similar to a Statement of Financial Position and is used to find out the capital of a business in the case of incomplete records. Hence all the assets and liabilities of the business must be known for it to complete.

Statement of affairs of a business can be made at the **start of the year** to assess the opening capital and at the **end of the year** to find closing capital.

[ Business name ]

Statement of affairs as at 20XX			
	COST \$	DEPRECIATION\$	NET BOOK VALUE \$
<b>Non current assets</b>	<b>x</b>	<b>x</b>	<b>x</b>
<b>Premises</b>	<b>x</b>	<b>x</b>	<b>x</b>
<b>Fixtures and Fittings</b>	<b>x</b>	<b>x</b>	<b>x</b>



Machinery	x	x	x
Motor vehicles	x	x	x
Office equipments	x	x	x
			XX
<b>Current assets</b>			
Inventory			x
Bank/Cash			x
Any receivables			x
Accrued income			x
Prepaid expenses			x
			XX
<b>TOTAL ASSETS</b>			<b>XXX</b>
<b>Capital</b>			<b>????</b>
<b>Non current liabilities</b>			
Mortgage			x
Loan			x
			XX
<b>Current liabilities</b>			
Bank overdraft			x
Prepaid income			x
Accrued expenses			x
Any trade payables			x
			XX
<b>TOTAL LIABILITIES</b>			<b>XXX</b>

( ???? DENOTES MISSING FIGURE )

## Capital changes

Capital changes refer to the **modification** of a **company's capital** . When a business has incomplete records of transactions or cash books , an accountant may not be able to calculate profit of the business. Therefor changes in capital can be used to calculate the profit of a business

### - Formula

$$\text{Opening capital} - \text{capital introduced} - \text{closing capital} + \text{drawings} = \text{Profit}$$

- **Opening Capital** is the capital at the start of the year
- **Capital introduced** is any capital added during the year
- **Closing capital** is the capital at the end of the year
- **Drawings** are the money taken out by the owner from the business account for personal use

This formula could be rearranged to find figures included in the formula  
E.g to find opening capital it could be rearranged as

$$\text{Capital introduced} + \text{closing capital} + \text{profit} - \text{drawings} = \text{opening capital}$$

## Ratio Method:

Ratios can be used to calculate the missing figures caused by incomplete records

### - Gross Profit Margin

It shows profit the business made after paying the direct or prime costs of the business which includes inventory purchases , carriage inwards and labour. It is calculated as follows :

**Formula:**

$$\text{Gross profit margin} = \frac{\text{GROSS PROFIT}}{\text{REVENUE}} \times 100$$

Formula can be rearranged to find other figures

### - Profit margin

It shows the profit made by the business after paying all the costs and expenses including indirect expenses such as general expenses, heat and lighting, carriage outward etc. It is calculated as follows :

**Formula:**

$$\text{profit margin} = \frac{\text{PROFIT FOR THE YEAR OR NET PROFIT}}{\text{REVENUE}} \times 100$$

Formula can be rearranged to find other figures

**- Mark up**

It is the amount added on the direct cost of the product in order to make money. It is expressed as gross profit as a percentage of cost of sales. It is calculated as follows:

**Formula:**

$$\text{Markup} = \frac{\text{GROSS PROFIT}}{\text{COST OF SALES}} \times 100$$

Formula can be rearranged to find other figures

**- Inventory Turnover**

Inventory turnover is the rate that inventory stock is sold and replaced. It can be calculated as follows:

**Formula:**

$$\text{Inventory Turnover} = \frac{\text{COST OF SALES}}{\text{AVERAGE INVENTORY}} \times 100$$

To find average inventory , the following formula may be used:

**Formula:**

$$\text{Average Inventory} = \frac{\text{OPENING INVENTORY} + \text{CLOSING INVENTORY}}{2} \times 100$$

# Accounting Analysis

In the case of incomplete records of financial transactions , a business still may be able to provide details of assets , liabilities , payments received and paid for .

**- Credit sales**

Credit sales can be calculated in two ways.

**Method 1:**

**Formula:**

**Receipts from trade receivables - opening balance for trade receivables + closing balance for trade receivables = Credit sales**

**Method 2 : Sales ledger control account**

Format is shown below:

SALES LEDGER CONTROL ACCOUNT					
DATE		\$	DATE		\$
	Balance b/d	x		Sales returns	x
	Credit sales	????		Bank	x
	Dishonoured cheque	x		Discounts allowed	x
	Interest on overdue trade receivables	x		Irrecoverable debts	x
	Refunds to customers	x		Balance c/d	x
		xx			xx
	Balance b/d	x			

**- Credit purchases**

Credit purchases can be calculated in two ways

**Method 1 :**

**Formula:**

**Payments to trade payables - opening balance for trade payables + closing balance for trade payables = Credit purchases**

**Method 2 :**

Purchases ledger control account.

PURCHASES LEDGER CONTROL ACCOUNT					
DATE		\$	DATE		\$
	Cash book for credit purchases	x		Balance b/d	x
	Discounts received	????		Credit purchases	????
	Purchase return	x		Interests on overdue trade payables	x
	Contra entries	x			
	Balance c/d	x			
		xx			xx
				Balance b/d	x

- Total sales revenue formula:

**Total sales revenue = credit sales + cash sales**

- Total purchases formula:

**Total purchases = credit purchases + cash purchases**

# Topic 17: Irrecoverable & Doubtful Debts

## What are Irrecoverable debts?

### - Definition:

- A debt that is **not recorded** after all attempts have been made to collect it.
- This is due to the insolvency or bankruptcy of the trade receivable who had been buying goods on credit from a business.
- It is treated as an **expense** in the income statement.
- It reduces the value of trade receivables in the statement of financial position.

## Double Entries of Debts

### - Double Entry:

Date	Account Title	Debit	Credit
xx/xx/xx	Irrecoverable Debts	\$xx	
	Trade Receivable		\$xx
	Narration []		

### - Transfer Entry for Irrecoverable Debts:

Date	Account Title	Debit	Credit
xx/xx/xx	Income Statement	\$xx	
	Irrecoverable Debt		\$xx
	Narration []		

**- Extract of the Income Statement:**

Income Statement [ Year ended ]	
	\$\$\$
<b>Expenses:</b>	
<b>Irrecoverable Debts</b>	<b>XX</b>

**- Example 1:**

- In Year 1, \$2000 worth of irrecoverable debts were found.
- In Year 2, \$3000 worth of irrecoverable debts were found.
- In Year 3, \$1000 worth of irrecoverable debts were found.
- **General Entries for Irrecoverable Debts:**

Date	Account Title	Debit	Credit
<b>Year 1</b>	<b>Irrecoverable Debts</b>	<b>\$2000</b>	
	<b>Trade Receivable</b>		<b>\$2000</b>
<b>Year 2</b>	<b>Irrecoverable Debts</b>	<b>\$3000</b>	
	<b>Trade Receivable</b>		<b>\$3000</b>
<b>Year. 3</b>	<b>Irrecoverable Debts</b>	<b>\$1000</b>	
	<b>Trade Receivable</b>		<b>\$1000</b>

- **General Entries for transferring the bad debts:**

Date	Account Title	Debit	Credit
<b>Year 1</b>	<b>Income Statement</b>	<b>\$2000</b>	
	<b>Irrecoverable Debts</b>		<b>\$2000</b>
<b>Year 2</b>	<b>Income Statement</b>	<b>\$3000</b>	
	<b>Irrecoverable Debts</b>		<b>\$3000</b>
<b>Year. 3</b>	<b>Income Statement</b>	<b>\$1000</b>	
	<b>Irrecoverable Debts</b>		<b>\$1000</b>

**- Irrecoverable Debts Account:**

Irrecoverable Debts					
<b>Year 1</b>	<b>Trade Receivable</b>	<b>2000</b>	<b>Year 1</b>	<b>Income Statement</b>	<b>2000</b>
		<u>2000</u>			<u>2000</u>
<b>Year 2</b>	<b>Trade Receivable</b>	<b>3000</b>	<b>Year 2</b>	<b>Income Statement</b>	<b>3000</b>
		<u>3000</u>			<u>3000</u>
<b>Year 3</b>	<b>Trade Receivable</b>	<b>1000</b>	<b>Year 3</b>	<b>Income Statement</b>	<b>1000</b>
		<u>1000</u>			<u>1000</u>

**- Prudence Concept:**

- In accounting, all anticipated losses are to be recorded to avoid overstatement of profits as an expense.
- However, all unexpected profits are not recorded unless and until they are earned.
- As a result, the business is prepared to meet any bad debts in the future which results in the provision of doubtful debts.

**- Matching Concept:**

- This principle states that all expenses incurred must be matched against the revenue earned for the year.
- Hence, the anticipated bad debts must be matched against the sales earned from the trade receivables.

## **Provision of Debts**

**- Provision for doubtful debts:**

- An estimated amount of debt that a company expects to turn bad or uncollectible is a doubtful debt.
- Hence, the business will create a **provision** where it might be possible that a certain trade receivable will go bad.
- **Formula:**

**Trade Receivable x Percentage of Provision for Doubtful Debt**

- An **increase in provision** is an increase in liability and a decrease in assets which is regarded as an expense.
- A **decrease in provision** is an increase in assets and a decrease in liability which is regarded as an income.

**- Reasons for provision for doubtful debts:**

- Insolvency or bankruptcy of the trade receivable.
- The previous patterns of bad debts incurred in the business.
- The previous patterns of bad debts incurred in the industry.
- How old the debt is.

**- Double Entry for the provision of doubtful debts:**

Date	Account Title	Debit	Credit
xx/xx/xx	<b>Income Statement</b>	<b>\$xx</b>	
	<b>Provision for doubtful debts</b>		<b>\$xx</b>
	<b>Narration []</b>		

**- Double Entry for an increase in the provision for doubtful debts:**

Date	Account Title	Debit	Credit
xx/xx/xx	<b>Income Statement</b>	<b>\$xx</b>	
	<b>Provision for doubtful debts</b>		<b>\$xx</b>
	<b>Narration []</b>		

- Double Entry for a decrease in the provision for doubtful debts:

Date	Account Title	Debit	Credit
xx/xx/xx	Provision for doubtful debts	\$xx	
	Income Statement		\$xx
	Narration []		

- Extract of the Income Statement:

Income Statement [ Year ended ]	
	\$\$\$
Other Incomes [+]:	
Decrease in the provision for doubtful debts	XX
Expenses [-]	
Increase in the provision for doubtful debts	(XX)

- Extract of the Statement of Financial Position:

Statement of Financial Position [As of]	
	\$\$\$
Current Assets:	
Trade Receivables	XX
(Provision for doubtful debts)	(XX)

- Examples:

Date	Trade Receivables		Rate of Provision	Provision for doubtful debts	Increase or decrease of Provision
2010	\$10000	×	10%	\$1000	↑ 1000
2011	\$40000	×	10%	\$4000	↑ 3000
2012	\$60000	×	10%	\$6000	↑ 2000
2013	\$30000	×	10%	\$3000	↓ 3000
2014	\$20000	×	10%	\$2000	↓ 1000
2015	\$100000	×	10%	\$10000	↑ 8000

- Double Entries for the increase or decrease in the provision:

Date	Account Title	Debit	Credit
2010	Income Statement	\$1000	
	Provision for doubtful debts		\$1000
2011	Income Statement	\$3000	
	Provision for doubtful debts		\$3000
2012	Income Statement	\$2000	
	Provision for doubtful debts		\$2000
2013	Provision for doubtful debts	\$3000	
	Income Statement		\$3000
2014	Provision for doubtful debts	\$1000	
	Income Statement		\$1000

**- Provision for doubtful debts Account:**

Provision for doubtful debts					
1 Jan 2010			1 Jan 2010	Balance b/d	0
31 Jan 2010	Balance c/d	1000	31 Jan 2010	Income Statement	1000
		<u>1000</u>			<u>1000</u>
			1 Jan 2011	Balance b/d	1000
31 Jan 2011	Balance c/d	4000	31 Jan 2011	Income Statement	3000
		<u>4000</u>			<u>4000</u>
			1 Jan 2012	Balance b/d	4000
31 Jan 2012	Balance c/d	6000	31 Jan 2012	Income Statement	2000
		<u>6000</u>			<u>6000</u>
			1 Jan 2013	Balance b/d	6000
31 Jan 2013	Income Statement	3000			
31 Jan 2013	Balance c/d	3000			
		<u>6000</u>			<u>6000</u>
			1 Jan 2014	Balance b/d	3000
31 Jan 2014	Income Statement	1000			
31 Jan 2014	Balance c/d	2000			
		<u>3000</u>			<u>3000</u>
			1 Jan 2015	Balance b/d	2000



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## A Note from Mojza

These notes for Accounting (7707) have been prepared by Team Mojza, covering the content for O Level 2022-24 syllabus. The content of these notes has been prepared with utmost care. We apologise for any issues overlooked; factual, grammatical or otherwise. We hope that you benefit from these and find them useful towards achieving your goals for your Cambridge examinations.

If you find any issues within these notes or have any feedback, please contact us at [support@mojza.org](mailto:support@mojza.org).

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