

AS-LEVEL ACCOUNTING (9706)

1. Financial Accounting

1.1 The Accounting Cycle

→ Introduction

- Book-keeping: recording financial information, particularly transactions in a systematic way
 - Records not maintained → something will be overlooked (prone to errors)
 - Basis: double entry book-keeping
- Accounting: a system of collecting, storing & processing financial information & accounting data to permit informed judgements & decisions by user of the information
 - To see if business is making P/L
 - Profit: Total revenue exceeds total costs
 - Loss: Total costs exceeds total revenue
- Purpose of maintaining accounting records
 - Information recorded is used to make IS & SOFP
 - Allows for calculation of P/L
 - Understand the progress/growth of the business
 - Base the business future & make decisions based on P/L

→ Double entry system of book-keeping

- A system of recording accounting transactions that recognises that there are 2 sides/aspects (debit & credit) to every transaction
- Debits = Credits
- Advantages
 - Less risk of errors/fraud
 - Easier to refer to previous transactions
 - Financial position can be ascertained
 - Easier to prepare financial statements & make business decisions
- Income: Money that an individual/business received in exchange for providing a good/service
 - Eg. Sales, rent received, commission
- Expenses: Cost of an asset used by a company in its operations to produce revenues
 - Eg. Advertising, rent, wages, purchases, electricity & water
- Carriage: cost of transporting goods
 - Carriage inwards: cost of bringing the goods to the business
 - Carriage outwards: cost of delivering goods to the customer
- Entries

Sales	Purchases
<ul style="list-style-type: none"> • Dr bank a/c • Cr sales a/c 	<ul style="list-style-type: none"> • Dr purchase a/c • Cr bank a/c

→ Accounting Equation

- SOFP: statement of the assets & liabilities of a business on certain date
- Assets = Liabilities + Capital
 - Assets: something which is owned by/owed to a business
 - Net Assets: total assets - total liabilities
 - Net Current asset (working capital) = current assets - current liabilities

Non-current assets (NCA)	Current assets
<ul style="list-style-type: none"> • Assets obtained for use (not for resale) which helps the business earn revenue • Long term assets • Eg. equipment, premises, motor vehicles, fixtures & fittings etc. 	<ul style="list-style-type: none"> • Short term assets whose amounts are constantly changing • Eg. bank, trade receivables, inventory etc. • Inventory <ul style="list-style-type: none"> ◦ Goods a business has available for resale • Trade Receivables <ul style="list-style-type: none"> ◦ Represents the amount owed to the business by its credit customer

SOFP = Statement of financial position
 PNL = Profit & Loss
 P/L = Profit or Loss
 IS = Income statement
 NCA = Non-current Asset
 CA = Current Asset
 CL = Current Liabilities
 NCL = Non-current Liabilities
 COS = Cost of Sales
 Dr = Debit
 Cr = Credit
 A/C = Account
 TP = Trade Payable
 TR = Trade Receivable
 PFDD = Provision for doubtful debt
 CPU = Contribution per unit
 BEP = Break even point
 OAR = Overhead absorption rate

Dr	Cr
Assets	Liabilities
Drawing	Income
Expenses	Capital

Increases on respective side

1. Purchases 2. Purchases returns 3. Payments to credit suppliers 4. Discount received from credit supplier 5. Refunds from credit suppliers 6. Interest charged on overdue a/c	1. Purchases journal 2. Purchases returns journal 3. CB 4. CB 5. CB 6. Journal
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→ Reconcile control a/c & ledgers

- Balances on both sides of control a/cs

Causes of debit balance in credit supplier a/c	Causes of credit balance in credit customers a/c
<ul style="list-style-type: none"> Overpayment to the supplier Returning goods to the supplier after paying what is owed Prepayment to the supplier Cash discount not being deducted before payment was made 	<ul style="list-style-type: none"> Overpayment by customer Customer returning goods after paying what was owed Customer paying in advance for goods Cash discount not being deducted before payment was made

- Contra entries
 - Interledger transfers that happen when a transfer is made from an a/c of the same business/person in the purchase ledger
 - Dr purchase ledger control a/c with the contra amount
 - Cr Sales ledger control a/c with the contra amount
- Effect of not updating:

Sales ledger	Purchase ledger
<ul style="list-style-type: none"> Business not collecting right amount from credit customers Risk of bad debt Non-collection of debts = negatively impact cash balances Incorrect financial statements 	<ul style="list-style-type: none"> Possible disputes with suppliers (affects deliveries) May lead to credit facilities withdrawn Overpaying suppliers Loss of opportunities of settlement discount

- Outline the uses & limitations of control a/cs

Uses	Limitations
<ul style="list-style-type: none"> Proof of arithmetical accuracy of the ledger Locate errors if trial balance doesn't balance Reduces fraud <ul style="list-style-type: none"> A/cs prepared by someone not involved in maintaining ledgers Total balances assists preparation of financial statements Important if business doesn't maintain double-entry system Identify account where errors have been made Summary of the transactions affecting the TR & TP for TB 	<ul style="list-style-type: none"> Control a/c may contain errors No guarantee of accuracy of individual a/c <ul style="list-style-type: none"> Compensation errors Additional costs to business <ul style="list-style-type: none"> Specialist required to verify accuracy

1.4 Preparations of financial statements

→ Understand the need for & purpose of financial statements

- Management purposes
 - To highlight areas of good practise & find areas within business that could benefit from improvement
- Stewardship
 - Show providers of finance how funds that they provided are being used (wisely/misused)
- Benefits
 - Helps future planning/targets/goals
 - Decision making
 - Able to assess performance/comparisons
 - Valuations of assets, liabilities & capital

- Markup
 - Gross profit expressed as a percentage of the cost price
- Margin
 - Gross profit expressed as a percentage of the selling price

Mark-up: COS is always 100%

Sales (125%)
- COS (100%)
Gross Profit (25%)

Margin: Sales is always 100%

Sales (100%)
- COS (80%)
Gross Profit (20%)

1.4.3 Partnership (*working tutorial 20*)

- A business in which 2 or more people work together as owners with a view to making profits

Advantages	Disadvantages
<ul style="list-style-type: none"> ● Additional capital available ● Responsibilities shared ● Additional knowledge, experience & skills available ● Variety of ideas & solution to problems ● Cover for holidays or sickness ● Share risks 	<ul style="list-style-type: none"> ● Unlimited liability ● Potential disagreements ● Share profits ● Decisions take longer to put into place ● Hard to reach an agreement (differing opinions) ● All partners are responsible for the debts of the business ● One partner's actions on behalf of the business are binding on all the partners

→ Partnership Agreement

- Document setting out the rules under which the partners will operate the business including profit sharing arrangements
- Contents
 - Capital invested
 - Partners don't need to invest equal amounts
 - Profit/loss sharing ratios
 - Interest on capital
 - Reward for investing in the business (more invested = more interest received)
 - Interest paid according to amount of capital invested
 - Reduces amount of profit in partnership but improves the individual partner's current a/c
 - Partnership salaries
 - To ensure a partner receives a minimum income
 - Reward for partner who may have more responsibilities/tasks
 - Drawings & interest on drawings
 - To deter partners from taking out cash unnecessarily
 - Partners withdraw significant amounts of cash = cash shortage
 - Interest on loans
 - Partners lend the partnership finance
 - Incurs less interest than borrowing from financial institutions
 - Partner loans not part of the capital of the business
 - Business expense
 - Loan obtained from a partner
 - Dr Bank a/c
 - Cr loan from partner X a/c
 - Loan repaid to a partner
 - Dr loan from partner X a/c
 - Cr Bank a/c
 - Interest on loan paid
 - Dr interest on loan a/c
 - Cr bank a/c
 - Interest on loan due not paid
 - Dr interest on loan a/c
 - Cr partner X current a/c
- No partnership agreement = follow Partnership Act 1890
 - Profit & losses shared equally
 - No interest allowed on capital
 - No interest on drawings

- Long term loan which has a fixed interest rate, payable irrespective of the profit of the company
- Loan taken from many organisations
- Holders make a non-current loan of capital to the business
- Interest recorded as a finance cost in IS (- from operating profit)
- Entries for issue of debentures at premium
 - Dr Bank
 - Cr Debenture
 - Cr Debenture Premium
- Entries for issue of debentures at a discount
 - Dr Bank
 - Dr Debenture Premium/Share Premium
 - Only Dr Share premium if there is no existing debenture premium a/c
 - Cr Debenture
- Dividends: Shareholders rewarded for investing in a company by being paid dividends on their shares
 - Dividends paid during the year:
 - Interim dividends
 - Last year's proposed dividends which company approves to pay this year
 - Dividends to ordinary shareholders recorded in SOCE
 - Dividend proposed during the year not recorded at all
 - Recorded in SOCE next year when dividends agreed to be paid
 - Preference dividend
 - Fixed dividend rate
 - Calculated as percentage of nominal value of shares
 - Ordinary dividend
 - No fixed rate
 - May receive interim dividend during the year & propose to pay final ordinary dividend at the end of the year
- Intangible assets: assets that can't be seen, felt or touched
 - Eg. goodwill, patents, trademarks etc.
- Tangible NCA: assets with a physical existence & can be seen, felt or touched
 - Eg. Motor vehicles, premises
- Investments
 - Any investments (usually shares in other companies)
 - Long term investments under NCA; short term under CA
- Provision for taxation
 - Estimate of tax liability owed to the govt

SOFP Format	
Equity	Total \$
Issued Ordinary Share Capital	X
Issued Non-Redeemable Preference Share Capital	X
Revaluation Reserves	X
Share Premium	X
General Reserves	X
Retained Earnings	X
Non Current Liabilities	
Loans	X
Debentures	X
Redeemable Preference Shares	X
Current Liabilities	
Trade Payables	X
Provision for taxation	X
Other payables	X
Cash & cash equivalents	X
Total Equity & Liabilities	XX

- Share Premium: when shares are issued at a price above their nominal value

■ Finding OAR for each cost centre

Positive	Negative
<ul style="list-style-type: none"> • Relates to departments • More accurate/ competitive selling price computed 	<ul style="list-style-type: none"> • Use or arbitrary basis to apportion OH • More complex data required • May not be relevant for small business

- Overhead recovered = $OAR \times Budgeted\ hours$
- Under-absorption = $budgeted\ expenditure < overhead\ recovered$
 - Bad; treat as an expense
 - Occurs when:
 - Actual overheads is more than absorbed (expected) overheads
 - Actual volume produced is less than expected volume to be produced
- Over-absorption = $budgeted\ expenditure > overhead\ recovered$
 - Good; treat as income
 - Occurs when:
 - Actual overheads is less than absorbed (expected) overheads
 - Actual volume produced is more than expected volume to be produced
 - Results:
- Absorbed overhead: $Budget\ OAR \times actual\ base$
 - $Actual\ overhead = Absorbed\ overhead + under\ absorption$
 - $Actual\ overhead = Absorbed\ overhead - over\ absorption$
- Drawbacks of using budgeted OAR
 - Estimated figures may be inaccurate (cause under/over absorption)
 - Over-absorption of overheads led to high prices = lose customers
 - Under-absorption of overheads lead to low prices = lower profits

→ Job & batch costing

- Job Costing: a method of costing in which costs are attributed to individual jobs
 - Primary objectives
 - Charge direct material, direct labour & overheads individually to each job order
 - Calculate profit/loss on each job
 - Characteristics
 - Production made for specific orders
 - A job is clearly identifiable throughout the production process
 - Different from each other & non-repetitive in nature
 - Each job become a separate cost centre
 - Costs charged directly to individual job orders
 - Job order may extend to several accounting periods
 - Manufacturing cost of a job can only be calculated after the job order is complete
 - Used when:
 - Production is non-repetitive & not continuous
 - Each job maintains its separate identity throughout the production process
 - Each job is independent from each other
 - Examples where job costing is applied:
 - Aircraft manufacturing industry
 - Shipbuilding industry
 - Tailor made garment manufacturing
 - Job cost sheet
 - Basic document to accumulate costs: job cost sheet/job cost card
 - Basis of entries in job cost sheet: stores requisition & work tickets
 - Separate job cost card prepared for each job
 - Nature of each job is different
 - Format of a job cost card is different for each organisation
 - Contains all the details relating to the cost incurred on a job
 - Separately lists the material, labour and overhead costs.