POA Cheat Sheet
GCE N LEVEL

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With love by West Spring Sec POA Unit ☺
(Updated June 2023)

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It is meant as supplementary reading material. Kindly alert Mrs Juliet if you spot typo error.

CHAPTER 1: INTRODUCTION TO ACCOUNTING

- Trading business buys from suppliers and sells goods to customers.
  Service business provides services to customers.

- Stakeholders are groups of people who will make use of information about the business to make decisions.

Stakeholder	Interaction with the Business	Example of Decision that Each Group Will Need to Make
Owners and shareholders	Contribute capital to the business and expect profit distribution in return	Whether to continue to invest in the business or sell the business, depending on the risks and returns related to the business
Managers	Work for the business and devise strategic plans to run the business efficiently	Whether to consider ways to improve the performance of the business
Employees	Work for the business and perform executive duties	Whether to continue working at the business
Lenders	Make money available to the business and expect it to be fully repaid with interest	Whether to grant loans to the business, depending on the business' ability to repay the loan principal and pay interest
Suppliers	Supply goods and/or services to the business	Whether to sell to the business on credit, depending on its ability to pay
Customers	Buy goods and/or services from the business	Whether to buy from the business, depending on the business' ability to provide the goods and/or services that they need and good after-sales service
Government	Enforce tax regulations	Whether the business complies with the tax regulations and decides the amount of tax to collect from the business
Competitors	Sell similar goods and/or services as the business	Whether they are comparable to the business and how to improve their own performance

- Role of accounting: businesses require accounting information for decision-making. Accounting is an information system that provides accounting information for stakeholders to make informed decisions regarding the management of resources and performance of businesses.

- Role of accountant: accountants prepare and provide accounting information for decision making. Accountants set up an accounting information system and become stewards of businesses.

- Stewards are responsible for managing the resources of the business on behalf of the owner(s).

- Two professional ethics in accounting: **integrity** (straightforward and honest in all professional relationships) and **objective** (not let bias, conflict of interest or undue influence of others override his or her professional judgement).

- It is important for accountants to uphold professional ethics as stakeholders rely on them to prepare and provide accurate accounting information for informed decision-making. They will not misled users into making poor decisions.

- Stakeholders rely on both accounting and non-accounting information that are not shown on financial statements for decision-making. Non-accounting information refers to qualitative factors that may reflect current or future trends and fundamentals of a business but are not captured by the accounting information.

- Forms of business ownership will determine how the owner(s) of business set up the business. There are 3 common forms of business ownerships. These are (1) sole proprietorship, (2) limited liability partnership and (3) private limited company. In N Level syllabus, we focus on sole proprietorship.

- Features of sole proprietorship

1 owner, known as sole proprietor (ownership)
Sole proprietor has full control over running of business (level of control)
Sole proprietor gets all profits. On the other hand, sole proprietor is also obliged to pay debts and losses using personal assets (risk)
Easier and less expensive to set up and maintain (formalities and procedure)
Banks may be less willing to lend to a sole proprietorship (access to funds)

- Accounting theories: when accountants rely on sound accounting theories, the accounting information produced will
  (1) present a true and fair view of business activities; and
  (2) allow stakeholders to make reliable and informed decisions.

-

Accounting theory	Definition
1. Accounting entity	The business is a separate entity from its owner, and all transactions are recorded from point of view of the business.
2. Monetary	Only business activities that can be measured in monetary terms are recorded.
3. Historical cost	Transactions should be recorded at their original cost.
4. Objectivity	Accounting information recorded must be supported by reliable and verifiable evidence so that financial statements will be free from opinions and biases.
5. Going concern	Assumes the business will operate forever, unless there is credible evidence that it may close down.
6. Accounting period	Business has to prepare financial statements at regular intervals, such as the end of each half year or each year.
7. Accrual basis of accounting	Business transactions should be recorded in the relevant accounting period, regardless of whether cash is paid or received. OR Income earned and expenses incurred should be recorded in the relevant accounting period, regardless of whether it is received or paid.
8. Matching	Expenses incurred must be matched against income earned in the same period to determine the profit for that period.
9. Consistency	Once an accounting method is chosen (e.g. straight-line method or reducing balance method), this method should be applied to all future accounting periods to enable meaningful comparison.
10. Materiality	A capital expenditure may be recorded as a revenue expenditure if its value is considered insignificant, as compared to the size of the business in terms of income, profit, assets or equity, and does not make a difference in decision-making.
11. Prudence	The business should not overstate assets and profits.
12. Revenue recognition	Revenue is earned when goods have been delivered or services have been provided.

CHAPTER 2: ACCOUNTING INFORMATION SYSTEM

2 types of transactions

- Cash transaction → immediate payment is made at point of purchase/sale
- Credit transaction → payment is made at a later date after purchase/sale

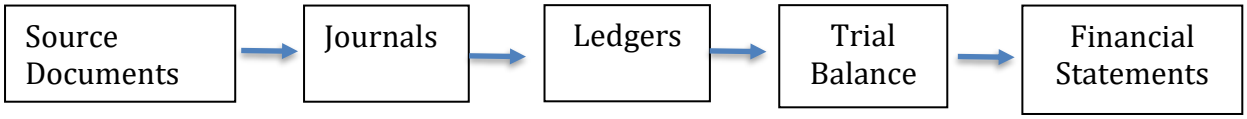
Accounting cycle: the accounting cycle is the processing of accounting transactions through the accounting information system.

- The stages of accounting cycle are: (details given below)
  (i) identifying and recording - daily
  (ii) adjusting – end of year
  (iii) reporting – end of year
  (iv) closing of accounts – end of year

The accounting cycle comprises of 4 stages:

- Stage 1 – **Identify and record** → source documents are used to record transactions in the journal and the journal entries are posted to the ledger. Transactions are recorded daily.
- Stage 2 – **Adjust** → the ending balances of ledger accounts are listed in a trial balance. Any adjusting entries are recorded in the journal and posted to the ledger. Accounts are adjusted at least once in a financial year.
- Stage 3 – **Report** → based on the adjusted trial balance, the financial statements are prepared. Reports are prepared at least once in a financial year.
- Stage 4 – **Close** → after the financial statement are finalised, income, expenses, income summary, drawings and dividends accounts are closed by first passing journal entries before posted to the ledger. Accounts are closed once at the end of the financial year.

Order in which each type of transaction is processed through the **accounting information system**



Accounting information system comprises of

Step 1 - **Source documents**

Provide proof that the transactions have taken placed; contains details of transaction.
Follow <u>objectivity theory</u>

Purpose of each type of source documents

No	Source Document	Purpose of source document
1	Invoice	Informs credit customers of the amount owed after the business sold goods or provided services on credit.
2	Credit note	<u>Reduces</u> the amount owed by credit customers: • Who were previously overcharged; or • After goods were returned
3	Debit note	<u>Increases</u> the amount owed by credit customers who were previously undercharged.
4	Remittance advice	Informs credit supplier that payment by cheque has been made for a specific invoice.
5	Receipt	Acknowledges payment received from customers immediately after the business has sold goods or provided services. -pay/receive cash/cheque
6	Payment voucher	Processes <u>payment</u> to credit suppliers: • Must be approved by authorised personnel; and • Must be supported by original supplier's invoice
7	Bank statement	Checks and tallies against the business records of its cash at bank account. - Bank charges, interest income, interest expense

Step 2 – **Journals**

Daily record of transactions organised by transaction dates

Step 3 – **Ledgers**

A ledger account consolidates all transactions relating to a specific asset, liability, equity, income and expense item

Step 4 – **Trial Balance**

Summary of the balances of each ledger account on last day of accounting year

Check for arithmetic error that may have occurred in the ledger accounts

Step 5 – **Statement of financial performance**

Report income and expenses, **c**alculate profit or loss for the year

Step 6 – **Statement of financial position**

List assets, equity and liabilities of the business at a specific date

CHAPTER 3: ELEMENTS OF THE FINANCIAL STATEMENTS AND THE ACCOUNTING EQUATION

- Accounting equation
  Assets = Liabilities + Equity (also known as Net Assets)

  The above accounting equation can also be represented by:
  Equity (also known as Net Assets) **= Assets - Liabilities**

- The expanded accounting equation
  Sole proprietorship:
  Assets = Liabilities + Owner's equity
  Assets = Liabilities + Capital + (Income – Expenses) - Drawings

  Private limited company (for O-level only):
  Assets = Liabilities + Shareholders' equity
  Assets = Liabilities + Share Capital + (Income – Expenses) - Dividends

- **Assets** are resources (or items) the business owns that are expected to provide future benefits
- **Equity represents claim by the owner(s) on the net assets of the business. Equity** comprises of beginning capital (assets contributed by owner), add additional capital (if any), add profit for the year, less drawings (assets taken by the owner for personal use)
- **Liabilities** are amounts the business owed to others that are expected to be settled in the future.
- Profit for the year = **Total income – Total expenses**
- **Income** consists of amounts earned from business activities.
  It comprises of
  (i) Revenue (*amounts earned through main business activity, i.e. sales revenue or service fee revenue)*
  (ii) Other income
- **Expenses** are costs incurred in the operation of a business to earn income in the same accounting year. For a trading business, main expense is cost of sales (*total cost price of goods that have been sold)*. A business will incur other expenses too, example salaries expense.
  Unlike assets, benefits generated from expenses normally last less than a year
  Any reduction in value of asset becomes an expense too, e.g., depreciation of non-current assets, impairment loss on inventory, impairment loss on trade receivables.

- Every business transaction has the following effects on the accounting equation:
  1. Will have at least two effects
  2. Accounting equation must maintain its balance. Otherwise, there will be errors
  (Important!) Always record based on business's perspective

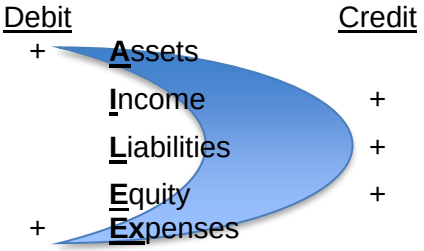
	Transaction	Effects on		
		Assets	Liabilities	Equity
1	Owner contributed a personal cheque $5000 to the business.	Cash at bank +$5000	No effect	Capital +$5000
2	Owner withdrew $500 from business bank account for personal use.	Cash at bank -$500	No effect	Drawings -$500
3	Owner took goods $50 for own use.	Inventory -$50	No effect	Drawings -$50
4	Withdrew $1000 from business bank account for office use.	Cash at bank -$1000 Cash in hand +$1000	No effect	No effect
5	Bought goods $200 paying by cheque.	Inventory +$200 Cash at bank -$200	No effect	No effect
6	Bought goods $900 on credit from Noob.	Inventory +$900	Trade payable - Noob +$900	No effect

7	Returned faulty goods worth $100 to supplier Noob.	Inventory -$100	Trade payable – Noob -$100	No effect
8	Paid Noob cheque for amount owing $800.	Cash at bank -$800	Trade payable – Noob -$800	No effect
9	Bought $1800 computer on credit from Appler.	Office equipment +$1800	Trade payable – Appler +$1800	No effect
10	Bought $100 fixtures and fittings by cash.	Fixtures and fittings +$100 Cash in hand -$100	No effect	No effect
11	Borrowed $10000 bank loan.	Cash at bank +$10000	Bank loan +$10000	No effect
12	Repaid part of bank loan $2000 by cash.	Cash in hand -$2000	Bank loan -$2000	No effect
13	Purchased a motor vehicle costing $20000, paying $5000 deposit by cheque and the balance on credit from Ferravi	Motor vehicle +$20000 Cash at bank -$5000	Trade payable - Ferravi +$15000	No effect
14	Deposited $100 cash into business bank account	Cash at bank +$100 Cash in hand -$100	No effect	No effect
15	Sold inventory costing $400 at a price of $700 receiving cash.	Cash in hand +$700 Inventory -$400	No effect	Sales revenue +$700 Cost of sales -$400
16	Sold goods costing $400 at a price of $700 on credit to customer Bala.	Trade receivable - Bala +$700 Inventory -$400	No effect	Sales revenue +$700 Cost of sales -$400
17	Bala returned goods with wrong specification costing $200 which business previously sold to him at $350.	Trade receivable - Bala -$350 Inventory +$200	No effect	Sales returns -$350 Cost of sales +$200
18	Received $350 cheque from Bala.	Cash at bank +$350 Trade receivable - Bala -$350	No effect	No effect
19	Paid $100 advertising expense by cash	Cash in hand -$100		Advertising expense -$100
20	Received $800 rental income by cheque	Cash at bank +$800		Rental income +$800
21	Received $1000 cheque from trade receivable Lee in full settlement of $1200 owing.	Trade receivable - Lee -$1200 Cash at bank +$1000		Discount allowed -$200
22	Business received 5% cash discount for early payment by cash for $1000 outstanding amount owing to credit supplier Boo.	Cash in hand -$950	Trade payable - Boo -$1000	Discount received +$50
23	Cash purchases list price $100 with 10% trade discount	Inventory +$90 Cash in hand -$90		

CHAPTER 4: DOUBLE-ENTRY RECORDING

Double-entry recording rules

1. Every transaction affects at least two accounts.
2. There must be at least one debit (left side) and one credit (right side) entry.
3. The total debit amount must be equal to the total credit amount.



LUCKY SYMBOL: INVERTED C

BOSS ***AILEEx***

IMPORTANT: Always record transactions from the viewpoint of the business, not owner**.**

	Transaction	Account debited	Account credited
1	Owner contributed a personal cheque $5000 to the business.	Cash at bank $5000	Capital $5000
2	Owner withdrew $500 from business bank account for personal use.	Drawings $500	Cash at bank $500
3	Owner took goods $50 for own use.	Drawings $50	Inventory $50
4	Withdrew $1000 from business bank account for office use.	Cash in hand $1000	Cash at bank $1000
5	Bought goods $200 paying by cheque.	Inventory $200	Cash at bank $200
6	Bought goods $900 on credit from Noob.	Inventory $900	Trade payable - Noob $900
7	Returned faulty goods worth $100 to supplier Noob.	Trade payable - Noob $100	Inventory $100
8	Paid Noob cheque for amount owing $800.	Trade payable - Noob $800	Cash at bank $800
9	Bought $1800 computer on credit from Appler.	Office equipment $1800	Trade payable - Appler $1800
10	Bought $100 fixtures and fittings by cash.	Fixtures and fittings $100	Cash in hand $100
11	Borrowed $10000 bank loan.	Cash at bank $10000	Bank loan $10000
12	Repaid part of bank loan $2000 by cash.	Bank loan $2000	Cash in hand $2000

	Transaction	Account debited	Account credited
13	Purchased a motor vehicle costing $20000, paying $5000 deposit by cheque and the balance on credit from Ferravi	Motor vehicle $20000	Cash at bank $5000 Trade payable - Ferravi $15000
14	Deposited $100 cash into business bank account	Cash at bank $100	Cash in hand $100
15	Sold inventory costing $400 at a price of $700 receiving cash.	Cash in hand $700 Cost of sales $400	Sales revenue $700 Inventory $400
16	Sold goods costing $400 at a price of $700 on credit to customer Bala.	Trade receivable - Bala $700 Cost of sales $400	Sales revenue $700 Inventory $400
17	Bala returned goods with wrong specification costing $200 which business previously sold to him at $350.	Sales returns $350 Inventory $200	Trade receivable - Bala $350 Cost of sales $200
18	Received $350 cheque from Bala.	Cash at bank $350	Trade receivable - Bala $350
19	Paid $100 advertising expense by cash	Advertising expense $100	Cash in hand $100
20	Received $800 rental income by cheque	Cash at bank $800	Rental income $800
21	Received $1000 cheque from trade receivable Lee in full settlement of $1200 owing.	Cash at bank $1000 Discount allowed $200	Trade receivable - Lee $1200
22	Business received 5% cash discount for early payment by cash for $1000 outstanding amount owing to credit supplier Boo.	Trade payable - Boo $1000	Cash in hand $950 Discount received $50
23	Cash purchases list price $100 with 10% trade discount	Inventory $900	Cash in hand $900

<u>Illustration</u>
On 15 April 2019, Boon the owner contributed $100 goods to the business.

Recording in Journal**, i.e. journal entries**

Journal

Date	Particulars	Debit $	Credit $
2019 Apr 15	Inventory Capital Being owner contributed $100 goods to the business	100	 100

Posting this transaction to **ledger accounts**

Inventory account

+ A -

Date	Particulars	Debit $	Credit $	Balance $
2019 Apr 15	Capital	100		100 Dr

Capital account

- E +

Date	Particulars	Debit $	Credit $	Balance $
2019 Apr 15	Inventory		100	100 Cr

It is important to read journal **and** ledger accounts correctly

Take note:

- *Cash at bank account is the only ledger account that can have either debit or credit ending balance Debit balance indicates positive balance, i.e. cash at bank, while credit balance indicates negative balance, i.e. bank overdraft*

Differences between Trade Discount and Cash Discount

	Trade Discount	Cash Discount
Define	A reduction to the **list price**	A reduction to the invoiced price
Purpose	Encourage: • customers to **buy in bulk**; • their **patronage**; and • their **loyalty**.	Encourage credit customers to **pay early**, within a specified time.
Calculation	Reduces list price. Invoice price = List price – Trade discount	Reduces invoiced price. Amount paid = Invoiced price – Cash discount
Recording	**Not** recorded in the ledger account as only the invoiced price is recorded	Recorded in the ledger account as **discount allowed** or **discount received**

Differences between Cash Discounts: Discount Allowed and Discount Received

	Discount Allowed	Discount Received
Condition	When credit customers pay early, the business **gives** cash discount to the credit customers.	When the business pays early, the business **receives** cash discount from its credit suppliers.
Impact on Profit	Since the business receives a lower amount from credit customers, discount allowed will **decrease** profit.	Since the business pays a lower amount to buy goods, discount received will **increase** profit.
Accounting Element	Expense	Income

CHAPTER 5: TRIAL BALANCE AND FINANCIAL STATEMENTS

Trial balance is a list of all the ledger accounts and their ending balances at a point in time.

Purpose of trial balance
It is prepared to:

- To check for arithmetic accuracy in recording
- To help in preparation of the financial statements

Limitation of trial balance
A balanced trial balance is **not** an absolute proof of accuracy. There may be errors not revealed by a trial balance.

To determine if an account has debit or credit balance

→ Follow the + side based on its classification
E.g. Motor vehicle is an asset
Asset + is debit
Hence motor vehicle amount should be on the debit side of Trial Balance.

Debit		Credit
+	**A**ssets	
	Income	+
	Liabilities	+
	Equity	+
+	**Ex**penses	

Always remember our big boss

What is her lucky sign that will help you to ace POA?
(Hint: Inverted letter)

To note
Drawings account is contra-equity (i.e. decrease equity), so it has a debit balance.
Sales returns account is contra-income, so it has a debit balance.

Hint:
If total debits and total credits do not tally, capital may be a missing figure.
To find missing capital = Total debits – Total credits

Format of Trial Balance

Figures are just for illustrative purpose

For trading business

Business name

Last day of financial period. For title, you must spell the month in full

CJ Trading

Trial Balance as at 31 December 2020

		Debit $	Credit $
Property	Assets, debit balance	XX	
Motor vehicles		XX	
Office equipment		XX	
Fixtures and fittings		XX	
Inventory		XX	
Cash at bank		XX	
Cash in hand		XX	
Trade receivables		XX	
Other receivables		XX	
Prepaid expense		XX	
Income receivable		XX	
Capital	Equity, credit balance		XX
Drawings →	Contra-equity, debit balance	XX	
Bank loan	Liabilities, credit balance		XX
Mortgage loan			XX
Bank overdraft			XX
Trade payables			XX
Expense payables			XX
Income received in advance			XX
Sales returns →	Contra-income, debit balance	XX	
Sales revenue	Income, credit balance		XX
Interest earned			XX
Discount received			XX
Rental income			XX
Cost of sales	Expenses, debit balance	XX	
Salaries and wages		XX	
Discount allowed		XX	
Utilities		XX	
Advertising expense		XX	
Insurance expense		XX	
Interest expense		XX	
Repair expense		XX	
Depreciation of non-current assets		XX	
Impairment loss on inventory		XX	
Impairment loss on trade receivables		XX	
		XXX	XXX

End with a double underline

Statement of Financial Performance

- Statement of financial performance shows the income, expenses, and profit or loss of a business over a period of time, normally one year. It measures profitability of the business.

S/N	Additional information	Year-end adjustments	Helpful tips
1	Advertising expense payable $80	Advertising expense +$80 *Insert:* Advertising expense payable $80	Payable means not yet paid but incurred (+) Prepaid means paid but not yet incurred (-) Receivable means not yet received but earned (+) Received in advance means received but not yet earned (-)
2	Prepaid utilities expense $50	Utilities expense -$50 *Insert:* Prepaid utilities expense $50	
3	Commission income receivable $100	Commission income +$100 *Insert:* Commission income receivable $100	
4	Rental income received in advance $90	Rental income -$90 *Insert:* Rental income received in advance $90	
5	Owner withdrew cash $30 for own use	Cash in hand - $30 Drawings +$30	
6	Ending inventory costing $200 were partially damaged with net realisable value $130	Inventory -$70 *Insert:* Impairment loss on inventory $70	
7	Depreciation on equipment is 10% per annum on cost (based on straight line method) Equipment, at cost $5000 Accumulated depreciation of equipment $1000	Accumulated depreciation of equipment +$500 *Insert:* Depreciation of equipment $500	Depreciation = % X cost *must pro-rate if necessary
8	Depreciation on motor vehicles is 10% per annum on net book value (based on reducing balance method) Motor vehicles, at cost $20000 Accumulated depreciation of motor vehicles $3800	Accumulated depreciation of motor vehicles +$1620 *Insert:* Depreciation of motor vehicles $1620	Depreciation = % X NBV Where NBV = Cost - AD *must pro-rate if necessary
9	Trade receivable Bala went bankrupt and its debt $100 written off	Trade receivables - $100 Allowance for impairment of trade receivables -$100	Key word: written off bankrupt
10	Beginning AFI $200 TR written off $100 Ending AFI $500	Allowance for impairment of trade receivables +$400 *Insert:* Impairment loss on trade receivables $400	Ending AFI – (Beginning AFI – TR written off) = ILO as the missing figure

Format

Figures are just for illustrative purpose

For trading business

Business name

Last day of financial period
* For title, need to spell month in full

CJ Trading

Statement of financial performance for the year ended 31 December 2020

	$	$
Sales revenue		150
Less: Sales returns		(5)
Net sales revenue		145
Less: Cost of sales		(20)
Gross Profit		125
Other income		
Discount **received**	8	
Interest **earned**	12	
Commission **income**	15	
#Gain on sale of non-current asset	10	
		45
		170
Less: Other expenses		
Discount allowed	10	
Wages and salaries	10	
Rental expense	10	
Utilities	10	
Interest expense	10	
Repair expense	10	
Advertising expense	10	
Stationery expense	10	
Depreciation of non-current assets	10	
#Loss on sale of non-current asset	10	
Impairment loss on inventory	10	
Impairment loss on trade receivables	10	
		(120)
Profit for the year		* 50

Trading portion (buying and selling of goods)

Underline means equal to

Income not earned from selling goods

Key words: Received, earned, income, revenue

Operating expenses

Profit and loss portion

End with a double underline

* If it's a loss for the year, denote amount with ( ) to show that it is a negative figure and describe it as loss for the year.

for O-level only

Format

Figures are just for illustrative purpose

For service business

Business name

Last day of financial period *Remember to spell month in full

CJ Services

Statement of financial performance for the year ended 31 December 2020

	$	$
Income		
Service fee revenue		80
Consultancy fee		40
#Gain on sale of non-current sale		10
Commission income		20
		150
Less: Other expenses		
Discount allowed	10	
Wages and salaries	10	
Rental expense	10	
Utilities	10	
Interest expense	10	
Repair expense	10	
Advertising expense	10	
Stationery expense	10	
Depreciation of non-current assets	10	
#Loss on sale of non-current asset	10	
Impairment loss on trade receivables	10	
Impairment loss on inventory	10	
		(120)
Profit for the year		* 30

Underline means equal to

Profit and loss

End with a double underline

* If it's a loss for the year, denote amount with ( ) to show that it is a negative figure and describe it as loss for the year.

for O-level only

Which accounting concept is being applied in preparation of statement of financial performance?

- **Matching Theory**

Definition: Expenses incurred are matched against income earned during the **same** accounting period to determine accurate profit figure.

Net sales revenue = Sales revenue – Sales returns

Gross profit/loss = Net sales revenue – Cost of sales

Profit/Loss for the period = Gross profit/loss + Other income – Other expenses

Statement of Financial Position

- Statement of financial position lists assets, equity and liabilities of a business at a given point of time, normally end of the year
- Statement of financial position for trading business and service business looks the same, except that service business does not have inventory

FORMAT for sole-proprietorship

Ryan Trading
Statement of financial position as at 31 December 2020

	Cost	Accumulated depreciation	Net book value
Assets	$	$	$
Non-current assets			
Land and building / Property / Premise	XX	(XX)	XX
Motor vehicles	XX	(XX)	XX
Plant and machinery	XX	(XX)	XX
Office equipment	XX	(XX)	XX
Fixtures and fittings	XX	(XX)	XX
	XXX	(XXX)	XXX
Current assets			
Trade receivables	XX		
Less: Allowance for impairment of trade receivables	XX	XX	
Inventory		XX	
Other receivables		XX	
(specify) income receivables		XX	
Prepaid (specify) expense		XX	
Cash at bank **only if bank overdraft doesn't exist*		XX	
Cash in hand		XX	XXX
Total assets			XXX
Equity and liabilities			
Owner's equity			
Capital *			XXX
Non-current liability			
Long-term borrowing			XXX
Current liabilities			
Trade payables		XX	
(specify) expense payable		XX	
(specify) income received in advance		XX	
Current portion of long-term borrowing		XX	
Bank overdraft **only if cash at bank doesn't exist*		XX	XXX
Total equity and liabilities			XXX

*Capital is derived from beginning capital + additional capital + profit for the year – drawings

Assets Resources a business owns or controls that are expected to provide future benefits	Non-current assets - Benefits last beyond one financial year - Not easily converted to cash	Current assets - Benefits are used within one financial year - Are easily converted to cash
Liabilities Obligations owed by a business to others that are expected to be settled in the future	Non-current liabilities - Due to be paid beyond one financial year - Eg: bank loan, mortgage loan - Classified as long-term borrowing in SOFP	Current liabilities - Due to be paid within one financial year. - Eg: Trade payables, expenses payable

CHAPTER 6: REVENUE AND ~~OTHER~~ INCOME

Revenue is the amount of money earned when a business **sells goods or provide services** to customers.
~~**Other**~~ **income** is the amount of money earned from other business activities.

Recording of transactions involving revenue and other income

Trading business	Service business
Credit sales of goods Dr Trade receivable - name Cr Sales revenue	**Credit sales of services** Dr Trade receivable – name Cr Service fee revenue
Sales returns of goods Dr Sales returns Cr Trade receivable - name	Refunds are **less common** for service business. Not in syllabus
Receipt of cash / cheque for other income earned Dr Cash in hand / Cash at bank Cr Other income (commission income/rental income etc)	
At the end of financial year, the revenue and other income account will be **closed** and the amount is transferred to the **income summary**. Dr Sales revenue / Service fee revenue / Other income Cr Income summary	

Revenue and Income Recognition

Accrual basis of accounting states that income earned is recognised regardless of whether payment has been received.

Revenue recognition theory states that revenue is recorded only when business has delivered the goods or provided the services.

Revenue is recognised:

- when a trading business sells and delivers goods to customers; or
- when a service business provided services to customers.

Other income is recognised:

- when earned and not when received in cash.

Service fee revenue received in advance

- Service businesses may **receive service fees** before services are provided.
- Based on the **accrual basis of accounting**, service fee revenue received before services are provided should **not** be recognised until the services are provided to the customer regardless of whether payment has been received or not. The service fee revenue should be reduced, and service fee revenue received in advance will be recorded as a **current liability**.

Worked Example 1

On first day of the accounting year, the business had balance of service fee revenue received in advance $200. During the year, the business received $10 000 service fee revenue by cheque, out of which $400 was service fee revenue received in advance at financial year-end.

Total service fee revenue earned = + $200 + $10 000 – $400 = $9800

Transactions	Name of Account	Dr $	Cr $
Reversal of previous year-end adjustment	Service fee revenue received in advance	200	
	Service fee revenue		200

Record receipt of service fee revenue	Cash at bank	10000	
	Service fee revenue		10000
Adjust service fee revenue received in advance at year-end	Service fee revenue	400	
	Service fee revenue received in advance		400
Transfer to income summary	Service fee revenue	9800	
	Income summary		9800

Statement of financial position as at ---------- (extract)

	$
Service fee revenue	9800

Statement of financial performance for the year ended ---------- (extract)

	$
Current liabilities	
Service fee revenue received in advance	400

Effects of adjusting service fee revenue received in advance on revenue, profit for the year and current liabilities.

	Service fee revenue	Profit for the year	Current liabilities
If service fee revenue received in advance is not adjusted	overstated	overstated	understated
If service fee revenue received in advance is adjusted	decrease	decrease	increase

Income Receivable

- Business has provided the service but has not received payment for it.
- Based on the accrual basis of accounting, other income is recognised when earned and not when it is received. Since service has been provided, this other income should be added even though payment has not been received yet. The amount to be received (soon) is recognised as a **current asset.**

Worked Example 2

On first day of the accounting year, the business had a balance of $500 commission income receivables. During the year, the business received $4000 commission income by cheque. There was $800 commission income yet to be received at financial year-end.

Total commission income earned = - $500 + $4000 + 800 = $4300

Transactions	**Name of Account**	**Dr $**	**Cr $**
Reversal of previous year-end adjustment	Commission income	500	
	Commission income receivables		500
Record receipt of commission income	Cash at bank	4000	
	Commission income		4000
Adjust commission income outstanding at financial year-end	Commission income receivable	800	
	Commission income		800
Transfer to income summary	Commission income	4300	
	Income summary		4300

Statement of financial position as at ---------- (extract)

	$
Current Assets	
Commission income receivable	800

Statement of financial performance for the year ended ---------- (extract)

	$
Other income	
Commission income	4300

Effects of adjusting other income on other income, profit for the year and current assets

	Other income	Profit for the year	Current assets
If other income is not adjusted	Understated	Understated	Understated
If other income is adjusted	Increase	Increase	Increase

Other income received in advance

- Businesses may **receive other income** before they are earned.
- Accounting is the same as service fee revenue received in advance (refer to first page of this chapter).

Ledger accounts w/o adjustments

The following dates, particular and amounts are for illustration purposes only.
The business's financial year ends 31 December.

Sales revenue / Service fee revenue account

Date	Particulars	Debit $	Credit $	Balance $
2023				
Jan 8	Cash in hand		500	500 Cr
May 19	Cash at bank		1000	
Aug 12	Trade receivable Sam		1200	2700 Cr
Dec 31	Income summary	2700		0

Sales returns account

Date	Particulars	Debit $	Credit $	Balance $
2023				
Aug 13	Trade receivable Sam	100		100 Dr
Dec 31	Income summary		100	0

Rental income account

Date	Particulars	Debit $	Credit $	Balance $
2023				
Jan 1	Cash in hand		600	600 Cr
June 1	Cash at bank		600	1200 Cr
Dec 31	Income summary	1200		0

Interpreting ledger account

Worked Example 3

Siti buys and sells computer, and also rents out part of its retail space to another business. The sales revenue and rental income accounts for the year ended 31 December 2019.

Rental income account

Date	Particulars	Debit $	Credit $	Balance $
2019				
Jan 1	Rental income receivable	1 000		1 000 Dr
Feb 10	Cash in hand		3 000	2 000 Cr
June 15	Cash at bank		10 000	12 000Cr
Nov 1	Cash at bank		15 000	27 000 Cr
Dec 31	Rental income received in advance	1 500		25 500 Cr
Dec 31	Income summary	25 500		-

REQUIRED

(a) Interpret the entries on the following date:

1 Jan	On 1 January, the business reversed the previous year's rental income receivable to rental income account. $1 000 rental income was earned last year but not yet received in December 2018.
10 Feb	On 10 February, the business received $3 000 rental income in cash
15 Jun	On 15 June, the business received $10 000 rental income by cheque
31 Dec	On 31 December, the business made an adjustment of $1500 of rental income collected in advance this year for rental income meant for next year.
31 Dec	A total of $25 500 rental income was earned for the year and amount was transferred to the income summary account.

(b) What are the effects on profits and current liabilities if the business did not record the 31 December entry?

Profit will be overstated by $1500

Current liabilities will be understated by $1500

CHAPTER 7: COST OF SALES AND O[redacted]R EXPENSES

EXPENSES are costs incurred in the operation of a business to earn income in the same accounting period.
Cost of sales refers to the cost of goods sold by a trading business.
[redacted]**r Expenses** are other costs that a business would incur in their operation.

Recording of cost of sales and other expenses transactions

Cost of Sales	Other expenses
E.g. Business sold goods $1,000 by cheque, costing $700. Dr Cash at bank $1,000 Cr Sales revenue $1,000 Dr Cost of sales $700 Cr Inventory $700	E.g. Business paid $900 salaries expense by cheque. Dr Salaries expense $900 Cr Cash at bank $900
At the end of financial year, the cost of sales and other expenses account will be **closed** and the amount is transferred to the **income summary**. Dr Income summary Cr Cost of sales / Salaries expense	

Accounting Theories

- **Accrual basis of accounting** states that expenses incurred are recorded and recognised regardless if it is paid.
- **Matching theory** states that expenses incurred should be matched with the income earned during the same financial period in order to determine the profit for the period.

Cost of sales is recorded at the same time when sales revenue from selling goods is recorded.

Other expenses are recognised when incurred and not when paid in cash.

EXPENSE PAYABLE

- Businesses may have enjoyed the use of services but not paid for such services at year-end.
- Based on the **accrual basis of accounting**, expenses incurred should be recognised regardless of whether payment has been made or not. These expenses should be added and expense payable will be recorded as a **current liability**.

Worked Example 1

On the first day of the current financial year, the business had a balance of $350 for salaries expense payable. During the year, the business paid $4 000 salaries expense by cheque. There was still $500 salaries expense incurred but not yet paid at financial year-end.

Total salaries expense incurred = - $350 + $4,000 + $500 = $4,150

Transactions	Name of Account	Dr $	Cr $
Reversal of previous year-end adjustment	Salaries expense payable	350	
	Salaries expense		350
Record salaries expense paid.	Salaries expense	4000	
	Cash at bank		4000

Adjust salaries expense payable at year-end	Salaries expense	500	
	Salaries expense		500
Transfer to income summary at year-end	Income summary	4150	
	Salaries expense payable		4150

Statement of financial performance for the year ended ---------- (extract)

	$
Less: other expenses	
Salaries expense	4150

Statement of financial position as at ---------- (extract)

	$
Current liabilities	
Salaries expense payable	500

Effect of not adjusting expenses payable on profit for the year and current liabilities.

	Other expenses	Profit for the year	Current liabilities
If other expenses is not adjusted	Understated	overstated	understated
If other expenses is adjusted	increase	decrease	increase

PREPAID EXPENSES

- Businesses may have **paid cash in advance** for services before using the services.
- The other expenses recorded may have included expenses that are **paid but not incurred (used)**.
- Based on the **accrual basis of accounting**, other expenses should exclude the amount paid in advance but not yet incurred.
- The **prepaid expenses** is recognised as a **current asset.**

Worked Example 2

On the first day of the current financial year, the business had a balance $500 for prepaid insurance expense. During the year, the business paid $2,000 insurance expense by cheque, out of which $800 was paid in advance at financial year-end.

Total insurance expense incurred = + $500 + $2,000 - $800 = $1700

Transactions	Name of Account	Dr $	Cr $
Reversal of previous year end adjustment	Insurance expense	500	
	Prepaid insurance expense		500
Record insurance expense paid	Insurance expense	2000	
	Cash at bank		2000
Adjust insurance expenses paid in advance at year-end	Prepaid insurance expense	800	
	Insurance expense		800
Transfer to income summary	Income summary	1700	
	Insurance expense		1700

Statement of financial performance for the year ended ---------- (extract)

	$
Less: Other expenses	
Insurance expense	1700

Statement of financial position as at ---------- (extract)

	$
Current assets	
Prepaid insurance expense	800

Effect of not adjusting prepaid expenses on profit for the year and current assets

	Other expense	Profit for the year	Current assets
If other expense is not adjusted	overstated	understated	understated
If other expense is adjusted	decrease	increase	increase

Ledger accounts w/o adjustments

The following dates, particular and amounts are for illustration purposes only.
The business's financial year ends 31 December.

Cost of sales account

Date	Particulars	Debit $	Credit $	Balance $
2023				
Feb 15	Inventory *(due to sales)*	400		400 Dr
Feb 16	Inventory *(due to sales return)*		50	350 Dr
Dec 31	Income summary		350	0

Advertising expense account

Date	Particulars	Debit $	Credit $	Balance $
2023				
Mar 15	Cash in hand	250		250 Dr
Aug 2	Cash at bank	300		550 Dr
Dec 31	Income summary		550	0

Interpreting ledger account

Worked Example 3
Gabriel Trading buys and sells face masks and shields, and also pays rent for its office space. Cost of sales account and rent expense account for the year ended 31 December 2019 are shown below.

Cost of Sales account

Date	Particulars	Debit $	Credit $	Balance $
2019				
Jan 10	Inventory	10 000		10 000 Dr
Jan 13	Inventory		2,000	8,000 Dr
July 6	Inventory	4,500		12,500 Dr
Dec 31	Income summary		12,500	-

Rental expense account

Date	Particulars	Debit $	Credit $	Balance $
2019				
Jan 1	Rent expense payable		1,400	1,400 Cr
July 15	Cash at bank	8,000		6,600 Dr
Sept 20	Cash at bank	10,000		16,600 Dr
Dec 31	Prepaid rent expense		800	15,800Dr
Dec 31	Income summary		15,800	-

(a) Interpret the entries on the following dates for cost of sales on:

10 Jan	On 10 January 2019, the business sold goods to customers that cost $10,000.
13 Jan	On 13 January 2019, customers returned goods that cost $2,000.
31 Dec	On 31 December 2019, the business closed the cost of sales account to income summary account.

(b) Explain the entries on 1 Jan 2019's rent expense payable and 31 December 2019's prepaid rent expense in the rent expense account?

On 1 January 2019, the business reversed the previous financial year's adjusting entry for rent expense payable. $1,400 of rent expense was incurred but not paid as at 31 December 2018.
On 31 December 2019, the business adjusted $800 of rent expense not yet incurred but paid in advance.

(c) What is the amount paid for rent during the year ended 31 December 2019?
Amount paid = $8000 + $10,000 = $18,000

(d) Explain the effects on profit and current assets if the business did not record the 31 December 2019 "Prepaid rent expense" entry.
Profit will be <u>understated by $800</u>

Current assets will be <u>understated by $800</u>.

CHAPTER 8: CASH

Receipts and payments of money can be in cash, cheque or electronic funds transfer (eg. Paynow)

Scenario	Receipts	Payments
Trade discount (TD) - Given at point of sale - Directly deducted from sale/purchase value	DR TR (after TD) $100 CR Sales revenue $100	DR Inventory $50 CR TP $50
Cash discount - Given at point of payment within the period allowed	DR CAB $95 DR Discount allowed $5 CR TR $100	DR TP $50 CR Discount received $5 CR CAB $45
Dishonoured cheques - Reverse cheque amount - Take back cash discount, if it was given previously	DR TR $100 CR discount allowed $95 CR CAB $5	DR CAB $45 DR Discount received $5 CR CAB $50

Cash is highly portable; it is the most easily mishandled and has a high chance of getting stolen.

Internal controls are important in a business as it serves to:

- safeguard assets of the business, to reduce the possibility of theft or misappropriation of funds.
- ensure business transactions are recorded objectively and on a timely basis
- ensure that the business complies with laws and regulation

Ways of internal controls over cash in hand, cash at bank, cash in transit, cash receipts and cash payments

important

(i) Custody and security of cash:

- Limit of cash to authorised personnel
- Safekeeping of cash (security access codes only given to authorised personnel)
- Minimise balance of cash at business premises (daily depositing into bank)

(ii) Segregation of duties

- Cash handling and custody
- Approval of cash transactions
- Cash recording

(iii) Authorisation

- Require at least two persons to review and approve all payments
- Require valid support documents for all payments

(iv) Bank reconciliation

- A tool to detect errors and fraud involving cash transactions

<u>Purpose of preparing bank reconciliation</u>

To reconcile transactions recorded by the business but not by the bank and vice-versa.

Reason for the differences between the business cash at bank balance and the balance in the bank statement

1. Timing differences in recording by the bank and the business
   - Direct deposits *(by customers or bank hence not yet recorded in business CAB account)*
   - Direct payments *(eg. business authorized bank to make payment via standing order)*
   - Cheques not yet presented *(eg. business issued cheques but suppliers have not deposited)*
   - Deposits in transit *(eg. business has deposited the cheques but bank hasn't processed)*
   - Dishonoured cheques *(bank rejects cheque that the business has previously deposited)*
2. Errors made by the business or the bank

Reasons for dishonoured cheques

1. Cheque has expired.
   It is dated six months ago and it is no longer valid.
2. Cheque is post-dated.
   It was written for a future date.
3. Information on cheque is not consistent
   - Amount written in numbers does not match amount written in words.
   - Signature is different from the bank's records
4. Information on cheque is not complete.
   There is no date, amount, signature etc
5. Payer's bank account does not have enough money, closed or frozen

Bank reconciliation illustration

The following cash at bank account was extracted from Sunshine Florist's books for the month of July 2020:

Cash at Bank Account

Date	Particulars	Cheque Number	Debit $	Credit $	Balance $
2020					
Jul 1	Balance b/d				2 500 Dr
3	Linda	21300		545	1,955 Dr
8	Pei Qi	21301		210	1 745 Dr
15	Sales revenue		600		2 345 Dr
21	Koh & Tan		3 890		6 235 Dr
26	Flora Supplies	21302		4 555	1 680 Dr
27	Rachel & Co		888		2 568 Dr
28	Inventory	21303		336	2 232 Dr
28	Advertising expense	21304		2 235	3 Cr
Aug 1	Balance b/d				3 Cr

The bank statement received for July 2020 was as follows:

Bank Statement

Date	Particulars	Withdrawal $	Deposit $	Balance $
2020				
Jul 1	Balance b/d			4 000 Cr
5	Cheque no: 21299	1 500		2 500 Cr
6	Cheque no: 21300	545		1 955 Cr
10	Cheque no: 21301	210		1 745 Cr
16	Cash deposit		600	2 345 Cr
22	Cheque deposit		3 890	6 235 Cr
25	Interest on deposit		120	6 355 Cr
27	Returned cheque	3 890		2 465 Cr
28	Standing order – Insurance expense	525		1 940 Cr
30	Credit Transfer – Corrine		5 000	6 940 Cr
30	Cheque no: 21303	336		6 604 Cr
30	Cheque no: 21304	2 235		4 369 Cr
31	Bank charges	80		4 289 Cr

Steps	Comments
Step 1: Compare the opening balances of the cash book and bank statement and **cross out the item (usually in the bank statement) that accounts for the difference** in the opening balance. If the opening balances are different, it is likely that there is a cheque not yet presented or deposits in transit from the previous period.	If cash at bank a/c has an opening balance of $2500 Dr, bank statement should also begin with the same amount. But in this illustration, bank statement begins with $4000 Cr. How to identify the item that accounts for the difference? - Note that cheque number in the cash at bank start with 21300 - It means 5 July 2020 cheque number 21299 of $1500 in the bank statement belongs to the previous period. - Hence, cross out $1500 as it is the item that accounts for the difference.
Step 2: Using the ending balance of cash at bank a/c, prepare cash at bank a/c starting with balance b/d on the last day of the month. Using the ending balance of bank statement, prepare bank reconciliation statement as at the last day of the month.	Cash at bank account Date / Particulars / Dr / Cr / Bal 2015 / / $ / $ / $ Jul 31 / Bal b/d / / / 3 Cr Bank reconciliation statement as at 31 July 2020 $ Balance as per bank statement 4289 ---------- *If it had been a debit balance, it would be Bank reconciliation statement as at 31 July 2020 $ Balance as per bank statement (4289)
Step 3: Tick the common items that appear in BOTH the cash at bank account and the bank statement and circle the difference.	Tick the common items that appear on debit side of the cash at bank account with credit side of bank statement, and vice versa. Ticked items do not require any reconciliation of differences.

<table>
<tr><th>Steps</th><th>Comments</th></tr>
<tr><td>Step 4:
Use the circled items in the bank statement to update the cash at bank account.</td><td>Cash at bank account
<table>
<tr><th>Date
2020</th><th>Particulars</th><th>Dr
$</th><th>Cr
$</th><th>Bal
$</th></tr>
<tr><td>Jul 31</td><td>Bal b/d</td><td></td><td></td><td>3 Cr</td></tr>
<tr><td></td><td>Interest on deposit</td><td>120</td><td></td><td>117 Dr</td></tr>
<tr><td></td><td>Koh & Tan (dishonoured cheque)</td><td></td><td>3890</td><td>3773 Cr</td></tr>
<tr><td></td><td>Insurance expense</td><td></td><td>525</td><td>4298 Cr</td></tr>
<tr><td></td><td>Corrine</td><td>5000</td><td></td><td>702 Dr</td></tr>
<tr><td></td><td>Bank charges</td><td></td><td>80</td><td>622 Dr</td></tr>
<tr><td>Aug 1</td><td>Bal b/d</td><td></td><td></td><td>622 Dr</td></tr>
</table></td></tr>
<tr><td>Step 5:
Use the circled items in the cash at bank a/c to prepare the bank reconciliation statement.</td><td><u>Bank reconciliation statement as at 31 July 2020</u>
<table>
<tr><td></td><td>$</td></tr>
<tr><td>Balance as per bank statement</td><td>4289</td></tr>
<tr><td>Add: Deposits in transit</td><td></td></tr>
<tr><td>Rachel & Co</td><td>888</td></tr>
<tr><td>Less: Cheques not yet presented</td><td></td></tr>
<tr><td>Floral Supplies - cheque 21302</td><td>(4555)</td></tr>
<tr><td>Adjusted balance as per cash at bank account</td><td>622</td></tr>
</table></td></tr>
<tr><td>Step 6:
If question were to give a profit figure and ask for adjusted profit or effect of adjustment,</td><td>Example,
If the profit for the month of Sunshine Florist was $5500, calculate the adjusted profit for the month.

Solutions:
Referring to Step 4 updated cash at bank account,
$120 Interest on deposit → Income
$5000 Corrine → Trade/Other receivable, i.e. asset
$3890 Koh & Tan → Trade receivable, i.e. assets
$525 Insurance expense → Expenses
$80 Bank charges → Expenses

Only income and expenses will affect profit.
Hence, for this part, ignore assets, liabilities and equity items.

Adjusted profit = $5500 + $120 - $525 - $80 = $5015
After adjustment, profit decreases by $485.</td></tr>
<tr><td>Step 7:
State amount of bank balance and which section it would appear in statement of financial position</td><td>Amount is $622 debit. If CAB has debit balance, the amount would appear as cash at bank under current assets. If it has credit balance, it would be bank overdraft under current liabilities.</td></tr>
</table>

Interpret cash at bank account

- On 1 July 2020, the business had a bank balance of $2,500.
- On 15 July 2020, the business received $600 for sale of goods by cheque.
- On 26 July 2020, the business paid Flora Supplies $4,555 by cheque.
- On 28 July 2020, the business paid $336 inventory and advertising expense by cheque.

CHAPTER 9: INVENTORIES

Inventory refers to the goods a business buys and sells (meant for resale) to earn profit.

Cost of buying the goods does not only involve cost price of the goods.

The business should also include the following:
+ Freight and delivery charges incurred to transport the goods from supplier to the business
+ Freight insurance to cover any possible loss or damage during transportation
+ Import duties or taxes on goods purchased from overseas
+ Packing materials of goods
+ Salaries paid to workers to process/package the goods

Important to note:
Salaries of salesgirl and warehouse rental costs should not be included because these expenses have to be incurred regardless of whether goods are purchased or not.

FIRST-IN-FIRST-OUT (FIFO) basis

FIFO method is used to calculate cost of sales assuming goods purchased earliest are sold first.

Impairment loss on inventory
Causes → Value of inventory may be impaired/reduced by damaged or stolen goods

Valuation of inventory
Inventory should be valued at cost OR net realizable value, whichever is lower.
(Shortcut: LOCOM – lower of cost or market value)

It is in accordance to <u>prudence theory</u> that states a business must report and adjust for losses that are likely to incur, even though the losses may not be confirmed yet.

However, the business does not record profits that are likely to occur. Profits are recorded only when it is actually earned.

<u>Illustration</u>
During the year ended 31 December 2018, due to flood, inventory costing $1000 had net realisable value $800. Prepare journal entries to adjust inventory. Narration is required.

Journal

Date	Particulars	Debit $	Credit $
2018 Dec 31	Impairment loss on inventory Inventory Being inventory written down from $1000 to $800	200	 200

Statement of financial performance for the year ended 31 December 2018 (extract)

	$
Less: Other expenses	
Impairment loss on inventory	200

Journal entries for inventory-related transactions

Type of transaction	Account debited	Account credited
Buying of goods Bought goods at $200	Inventory $200	Trade payable / Cash at bank / Cash in hand $200
Return of goods bought (Business) returned goods costing $50 (back to supplier) TIP: Journal entries for returns are the opposite of buying of goods	Trade payable / Cash at bank / Cash in hand $50	Inventory $50
Selling of goods Sold goods costing $200 for $1000.	Trade receivable / Cash at bank / Cash in hand $1000	Sales revenue $1000
	Cost of sales $200	Inventory $200
Return of goods sold (Customer) returned goods $300 (back to the business). Cost of goods was $60. TIP: Journal entries for returns are the opposite of selling of goods	Sales return $300	Trade receivable / Cash at bank / Cash in hand $300
	Inventory $60	Cost of sales $60
Writing down of inventory to net realisable value Inventory $1000 Additional information states that net realizable value of inventory was $800	Impairment loss on inventory $200	Inventory $200
Insurance company fully covers inventory loss $200 and makes payment later Instead of debiting impairment loss on inventory, the business will debit insurance claim receivable instead	Insurance claim receivable $200	Inventory $200
Insurance company partially covers inventory loss and makes payment later Inventory $1000 Additional information states that $200 worth of goods were damaged by fires, of which $120 would be compensated by insurance company.	Insurance claim receivable $120 Impairment loss on inventory $80	Inventory $200

Effects of incorrect inventory valuation

If net realizable value was lower than cost but the business still recorded inventory at cost price:

	Cost of sales	Gross profit	Profit for the year	Assets	Equity
Effects of overstated ending inventory in current year	No effect Error just for ending inventory, not inventory sold, hence cost of sales NOT affected	No effect If there is no effect on cost of sales, it will thus have no effect on gross profit too	Overstated If impairment loss on inventory (i.e. an expense) is not recorded, expenses would be too little and thus profit would be too much	Overstated Current assets in the balance sheet would be higher than what it should be	Overstated If profit for the year is overstated, owner's equity would be overstated too OR see the effect from accounting equation… A = L + E If A is overstated & L unchanged, E will be overstated

Illustration

Tom buys and sells electronic goods by cash. At the financial year end on 31 December 2016, he provided the following information:

	Units	$
Sales revenue	9200	285000
Inventory 1 January 2016	2600	15000

Additional information

		Units	$
Goods bought	Feb 23	3600	47000
Goods bought	Apr 12	3000	39500
Goods bought	Jun 18	3400	41000
Goods bought	Sep 10	2200	18500

Tom uses the FIFO (First-In-First-Out) method of inventory valuation.

(a) Calculate the following:

(i) Cost of sales for the year ended 31 December 2016
Cost of sales (for 9200 units) = $15000 (for first 2600 units) + $47000 (for next 3600 units) + $39500 (for next 3000 units) = $101500

(ii) Inventory value at 31 December 2016
Value of inventory = $59500 (the unsold inventory purchased on 18 Jun and 10 Sept)

(b) Prepare the inventory account for the year ended 31 December 2016

(c) Prepare statement of financial performance extract for the year ended 31 December 2016

Inventory account

		+	A	-	
Date	Particulars	Debit		Credit	Balance
		$		$	$
2016					
Jan 1	Bal b/d				15000 Dr
Feb 23	Cash in hand	47000			
Apr 12	Cash in hand	39500			
Jun 18	Cash in hand	41000			
Sep 10	Cash in hand	18500			
Dec 31	Cost of sales			101500	59500 Dr
2017					
Jan 1	Bal b/d				59500 Dr

Tom

Statement of financial performance for the year ended 31 December 2016 (extract)

	$
Sales revenue	285000
Less: Cost of sales	(101500)
Gross profit	183500

CHAPTER 10: TRADE RECEIVABLES

Trade receivables refer to the amount owed by customers who buy goods and services from businesses on credit.

Recording for trade receivables

Worked Example 1 – Sale of goods

On 1 March 2021, the business sold goods to Spring Trading on credit at list price $2,000 with 10 days credit term. On 5 March, Spring Trading returned damaged goods worth $500 which was previously bought on 1 March 2021. On 10 March 2021, Spring Trading paid cheque for amount outstanding.

Transactions	Name of Account	Dr $	Cr $
Record sale of goods on credit	Trade receivable – Spring Trading	2,000	
	Sales revenue		2,000
Record return of goods from credit customer	Sales returns	500	
	Trade receivable–Spring Trading		500
Receipt of cheque from credit customer (without cash discount)	Cash at bank	1500	
	Trade receivable–Spring Trading		1500

Worked Example 2 – Sale of Services or Provision of Services

On 1 April 2021, the business provided maintenance services to West Trading and issued an invoice of $400. On 15 April 2021, West Trading paid and issued a cheque of $340 for full settlement.

Transactions	Name of Account	Dr $	Cr $
Record sale of services on credit	Trade receivable – West Trading	400	
	Maintenance Services fee		400
Receipt of cheque from credit customer (with cash discount)	Cash at bank	340	
	Discount allowed	60	
	Trade receivable – West Trading		400

Worked Example 3a – Sale of goods with trade discount and cash discount

On 10 June, the business sold goods to Tan at $800 with 20% trade discount. On 15 June, Tan returned damaged goods with list price $200 to the business. On 28 June, the business received a cheque from Tan after 5% cash discount.

Transactions	Name of Account	Dr $	Cr $
Record sale of goods on credit	Trade receivable - Tan	640	
	Sales revenue (800 X 80%)		640
Record return of goods from credit customer	Sales returns (200 X 80%)	160	
	Trade receivable – Tan		160
Receipt of cheque from credit customer	Cash at bank	456	
	Discount allowed	24	
	Trade receivable – Tan		480

Worked Example 3b – Dishonoured cheque

On 30 June, the cheque received from Tan on 28 June was dishonoured.

Transactions	Name of Account	Dr $	Cr $
Cheque received from credit customer was dishonoured	Trade receivable – Tan	480	
	Cash at bank		456
	Discount allowed		24

Accounting theories
In accordance to prudence theory, assets and profits should not be overstated. Hence, the ending balance of trade receivables, an asset, should reflect amount that can be collectible.

The estimated amount of uncollectible debts will be reported as allowance for impairment of trade receivables in the statement of financial position and shown as a contra-asset that reduces the trade receivables balance.

In line with the matching theory, the estimated uncollectible debts is recorded as an expense - impairment loss of trade receivables - in the statement of financial performance. The expense incurred to generate the income earned during the same financial period should be matched to the income earned to calculate the profit for the period.

SUSPECT (key word: unlikely to be collectible)

General Journal

Date	Particulars	Debit $	Credit $
Last day	Impairment loss on trade receivables Allowance for impairment of trade receivables	XX	 XX

CONFIRM (key word: written off)

General Journal

Date	Particulars	Debit $	Credit $
Given date	Allowance for impairment of trade receivables Trade receivable – (name)	XX	 XX

CONFIRM (key word: partially written off as trade receivable managed to pay some)

General Journal

Date	Particulars	Debit $	Credit $
Given date	Cash at bank / Cash in hand Allowance for impairment of trade receivables Trade receivable – (name)	XX XX	 XX

At the end of the year, ILO is the missing figure derived from difference between starting and ending AFI:

Summary of recording in allowance for impairment of trade receivables:

No	Transactions	Double entries
1	Increase in AFI	Dr **ILO** Cr **AFI**
2	Decrease in ILO	Dr **AFI** Cr **ILO**
3	Write-off of debts	Dr **AFI** Cr **Trade receivable - XX**

Individual trade receivable account - Illustration

Dates, particulars and amount are for illustration purpose only. This template shown is for the month of January 2023.

Trade receivable James account

Date	Particulars	Debit $	Credit $	Balance $
2023				
Jan 1	Bal b/d			1000 Dr
8	Sales revenue	400		
10	Sales returns		50	
31	Cash at bank		980	
	Discount allowed		20	350 Dr
Feb 1	Bal b/d			350 Dr

Effects of NO adjustment of allowance for impairment of trade receivables

With NO adjustment	Effect on Other expenses	Effect on Profit	Effect on Current Assets
Increase in allowance	Understated	Overstated	Overstated
Decrease in allowance	Overstated	Understated	Understated

Effects of adjustments of allowance for impairment of trade receivables

With adjustment	Effect on Other expenses	Effect on Profit	Effect on Current Assets
Increase in allowance	Increases	Decreases	Decreases
Decrease in allowance	Decreases	Increases	Increases

Interpreting of allowance for impairment of trade receivables account

Worked Example 4

Super Clean Services provides cleaning services to its customers on credit. The following account is the allowance for impairment of trade receivables account of the business for the years ended 30 June 2019 and 30 June 2020.
Super Clean Services has a trade receivables balance of $12000 as of 30 June 2020.

Allowance for impairment of trade receivables account

Date	Particulars	Debit $	Credit $	Balance $
2018				
1 July	Balance b/d			6000 Cr
30 Sept	Trade receivable – Jim Trading	1500		4500 Cr
2019				
30 June	Impairment loss on trade receivables		1300	5800 Cr
1 July	Balance b/d			5800 Cr
29 Nov	Trade receivable – Milo Gao	800		5000 Cr
2020				
30 June	Impairment loss on trade receivables	1300		3700 Cr
1 July	Balance b/d			3700 Cr

REQUIRED
(a) Interpret the entries on the following dates:

2018 1 July	On 1 July 2018, Super Clean Services has estimated trade receivables balance of $6000 likely to be uncollectible.
2018 30 Sept	On 30 September 2019, the business wrote off $1500 debts owed by Jim Trading.
2019 30 June	On 30 June 2019, the business increased its allowance for impairment of trade receivables by $1300 to $5800.
2020 30 June	On 30 June 2020, the business decreased its allowance for impairment of trade receivables by $1300 to $3700.

(b) What are the effects of recording the 30 June 2019 transaction on current assets, other expenses and profit for the year ended 30 June 2019?

Current assets will be decreased by $1300.

Other expenses will be increased by $1300.

Profit will be decreased by $1300

(c) What are the effects of **NOT** recording the 30 June 2020 transaction on current assets, other expenses and profit for the year ended 30 June 2020?

Current assets will be understated by $1300.

Other expenses will be overstated by $1300.

Profit will be understated by $1300

(d) Prepare an extract of the statement of financial performance for the year ended 30 June 2020.

Statement of financial performance for the year ended 30 June 2020 (extract)

	$
Less: Other expenses	
Impairment loss on trade receivables (reversal)	(1300)

(e) Prepare an extract of the statement of financial position as at 30 June 2020.

Statement of financial position as at 30 June 2020 (extract)

	$	$
Current assets		
Trade receivables	12,000	
Less: Allowance for impairment of trade receivables	(3,700)	8,300

CHAPTER 11: NON-CURRENT ASSETS

Non-current assets (NCA) refer to resources that businesses own or control that are expected to provide future benefits beyond one financial year. They are used to generate income.

Difference between capital expenditure and revenue expenditure

Capital expenditure (CE)	Revenue expenditure (RE)
• costs to buy and bring the non-current assets to their **intended use.** Eg import duties, legal fee and installation costs.	• Costs to operate, repair and maintain the non-current assets in **working condition.**
• costs to **enhance** the non-current assets.	
• provides benefits for **more than one year.**	• provide benefits which will be used within one year.
• recorded as non-current assets in the statement of financial position.	• recorded as expenses in the statement of financial performance.
• example: replacement of engine to extend the useful life of a motor vehicle by another 3 years.	• example: servicing of the engine parts in a motor vehicle.

Classify accounting transactions as capital and revenue expenditure

<u>Worked Example 1</u>

On March 2023, Joy Fashion bought a delivery van to transport apparels and incurred the following costs.

Costs incurred	**Amount(S$)**	**Mode of payment**
Price of the delivery van	80,000	Cheque deposit of $30,000 and the remaining to be paid within 30 days
Cooling system inside the delivery van	5,000	Cheque
Motor vehicle insurance	2,000	Bank transfer
Petrol	300	Cash

(a) Classify the above items as capital and revenue expenditure.

Price of the delivery van – capital expenditure

Cooling system inside the delivery van – capital expenditure

Motor vehicle insurance – revenue expenditure

Petrol – revenue expenditure

(b) Calculate the cost of the delivery van.

Cost of the delivery van = $75,000 + $4,000 = $79,000

(c) Prepare journal entries to record the above costs above. Narrations are not required.

Date	Description	Debit ($)	Credit ($)
2023			
March 1	Motor vehicle	10,000	
	Cash at bank		10,000
	Motor vehicle	70,000	
	Trade payable		70,000

March 1	Motor vehicles	5,000	
	Cash at bank		5,000
March 1	Motor vehicles expense	2,000	
	Cash at bank		2,000
March 1	Motor vehicles expense	300	
	Cash in hand		300

Effect of wrong classification of capital expenditure and revenue expenditure

Classification of expenditure	Effect on Other Expenses	Effect on Profit	Effect on Non-Current Assets
Wrongly classified as revenue expenditure	Overstated	Understated	Understated
Wrongly classified as capital expenditure	Understated	Overstated	Overstated

- **Materiality theory**
  According to **materiality theory**, if the amount of capital expenditure (e.g. wastepaper basket, whiteboard duster) is insignificant to decision-making when compared to the size of the income, profit, assets or equity of a business, it can be classified as revenue expenditure.

- **Depreciation** is the allocation of the original cost of a non-current asset over its estimated useful life. It is an expense in the statement of financial performance.

- According to the **matching theory**, expenses incurred must be matched against the income earned in the same period to determine the profit for the period. As the non-current assets are being used to generate income, a portion of the cost of using the non-current asset (depreciation expense) should be matched to the income earned in the same financial period to determine the profit for the period.

- **Accumulated depreciation** (AD) refers to the total depreciation to-date. It is a contra-asset and is presented as a deduction against original cost of the NCA.

- **Net book value** (NBV) is the (original) cost less accumulated depreciation.

- **Causes of depreciation**

	Cause	Example
1	Usage	Coal mines are depleted as coals are being extracted by coal miners.
2	Wear and tear	The exterior structure of a building may deteriorate due to regular exposure to sun and rain.
3	Obsolescence	Electronic gadgets may become obsolete when newer versions that adopt enhanced technology are launched.
4	Legal Limits	Leasehold land can only be occupied for a limited period of time.

- **Methods of calculating depreciation**
  1. **Straight-line method**
     Assumes the NCA provides benefits uniformly throughout its estimated useful life.

     $$\text{Depreciation per year} = \frac{\text{Cost} - \text{Scrap value}}{\text{No. of useful life (years)}}$$

     OR
     Depreciation per year = Rate of depreciation (%) per annum x (Cost – Scrap value)

     Where scrap value refers to the amount that the business can receive at the end of the estimated useful life.

2. **Reducing balance method**
   Assumes the NCA provides more benefits in the earlier years of its useful life than in its later years, hence a higher depreciation amount is recorded in the earlier years and reduces as time goes by.

   Depreciation per year = Rate of depreciation (%) per annum x Net book value

Worked Example 2

On 1 January 2022, the business bought an office equipment for $10,000 on credit. The office equipment has a scrap value of $1,000 and estimated useful life of 10 years. Assumes that the business uses the straight-line method of depreciation and its financial year ends on 31 December.

Journal

Date	Particulars	Debit	Credit
2022		$	$
31 Dec	Depreciation of office equipment [($10,000-1,000)/10 years]	900	
	Accumulated depreciation of office equipment		900

Statement of financial performance for the year ended 31 December 2022 (extract)

	$
Less: other expenses	
Depreciation of office equipment	900

Statement showing financial position as at 31 December 2022

	Cost	Accumulated depreciation	Net book value
Assets	$	$	$
Non-current assets			
Office equipment	10,000	900	9,100

Worked Example 3

On 1 July 2022, the business had the following balances:

Motor vehicles	$50,000
Accumulated depreciation of motor vehicles	$5,000

The business uses the reducing-balance method of depreciation with a rate of depreciation of 10% per annum. The financial year ends is 30 June.

Journal

Date	Particulars	Debit	Credit
2023		$	$
30 June	Depreciation of motor vehicles [10% X ($50000-5000)	4,500	
	Accumulated depreciation of motor vehicles		4,500

Statement of financial performance for the year ended 30 June 2023 (extract)

	$
Less: other expenses	
Depreciation of motor vehicles	4,500

Statement showing financial position as at 30 June 2023

	Cost	Accumulated depreciation	Net book value
Assets	$	$	$
Non-current assets			
Motor vehicles	50,000	9,500	40,500

Effects of Using Different Methods of Depreciation
Different methods of depreciation will result in different amounts of depreciation expense.

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

Consistency theory
Accordance to **consistency theory**, the accounting methods used by the business must be consistent from period to period so that its financial performance can be **meaningfully compared** across financial periods.

Hence, once the method of depreciation is determined, it should be applied consistently to NCA of similar class from year to year.

However, a business may change its accounting methods if new methods provide more accurate information about its transactions.

Suitability of depreciation method for different types of non-current assets
A business should decide on the depreciation method based on the usage pattern of the non-current asset. If the business expects to use the non-current asset uniformly throughout the estimated useful life, straight-line method should be used.

On the other hand, if the business expects to use the non-current asset more in the earlier years and less as the non-current asset gets older and become less efficient, then reducing balance method should be used.

Interpreting Non-Current Assets

Worked Example 4
West Spring United commenced business on 1 January 2020. The following ledger accounts were extracted from the books of West Spring United for the three years ended 31 December 2020, 2021 and 2022.

Equipment account

Date		Debit $	Credit $	Balance $
2020				
Jan 1	Capital	500		500 Dr
2021				
Jan 1	Bal b/d			500 Dr
	Trade payable, High Tech	800		1300 Dr
2022				
Jan 1	Bal b/d			1300 Dr
Jul 1	Cash in hand	300		1600 Dr
2023				
Jan 1	Bal b/d			1600 Dr

Accumulated depreciation of equipment account

Date		Debit $	Credit $	Balance $
2020				
Dec 31	Depreciation of equipment		50	50 Cr
2021				
Jan 1	Bal b/d			50 Cr
Dec 31	Depreciation of equipment		130	180 Cr
2022				
Jan 1	Bal b/d			180 Cr
Dec 31	Depreciation of equipment		145	325 Cr
2023				
Jan 1	Bal b/d			325 Cr

(a) Interpret the entries on 1 January 2020 in the equipment account.

On 1 January 2020, the owner contributed equipment costing $500 to the business.

(b) Interpret the entries on 1 January 2021 in the equipment account.

On 1 January 2021, the business had existing equipment costing $500.
On the same day, the business bought additional equipment costing $800 from High Tech on credit.

(c) Interpret the entries on 1 January 2022 in the equipment account.

On 1 January 2019, the business had existing equipment costing $1300.

(d) Interpret the entries on 1 July 2022 in the equipment account.

On 1 July 2022, the business bought additional equipment costing $300 paying by cash.

(e) Interpret the entries on 31 December 2021 in the accumulated depreciation of equipment account and explain the impact on the net book value of equipment.

For the year ended 31 December 2021, the annual depreciation of equipment was $130.
As a result, the net book value of existing and additional equipment decreased by $130.

(f) Calculate the rate of depreciation per annum.

Rate of depreciation per annum = ($50 / $500) x 100% = 10%

(g) State the method of depreciation used.

Straight line method

(h) Show the workings for calculation of depreciation of equipment on 31 December 2022.

Depreciation of existing equipment + Depreciation of additional equipment
= (10% x $1300) + (10% x 300 x 6/12)
= $130 + $15
= $145

(i) Using information from the given ledger accounts, prepare an extract of statement of financial position as at 31 December 2022.

West Spring United

Statement showing financial position as at 31 December 2022

	Cost $	Accumulated depreciation $	Net book value $
Assets			
Non-current assets			
Equipment	1600	325	1275

(j) State how the following will be affected when a different method of depreciation is used instead of the method in (g).
- Profit for the year ended 31 December 2022
- Non-current assets as at 31 December 2022

According to straight line method,
Depreciation of equipment for the year ended 31 December was $130, and net book value was $1120.

If it had been reducing balance method,

Depreciation of equipment for the year ended 31 December 2022 would be
10% x (Cost – Accumulated Depreciation) = 10% x ($1300 - $50) = $125
Hence, when reducing balance method is used, depreciation expense will decrease by $5, resulting in profit for the year to increase by $5.

Net book value of equipment as at 31 December 2022 would be
$1300 – ($50+$125) = $1125
Hence, non-current assets will increase by $5.

CHAPTER 12: TRADE PAYABLES

- Trade payables refer to the amount owed to suppliers when businesses buy goods and non-current assets on credit.

- For definition and distinguish between trade discount and cash discount, please refer to Ch 4 Double-entry Recording notes.

Worked Example 1

Peter purchases inventory from Fresh Trading on credit. The following transactions took place in Peter's business for the month of June 2023.

2023	
Jun 1	Peter owed Fresh Trading $1,800.
Jun 6	Peter issued a cheque to settle the amount owing to Fresh Trading on 1 June, less 5% cash discount.
Jun 14	Peter purchased inventory from Fresh Trading at list price $2,000 and received 10% trade discount.
Jun 18	Peter returned inventory worth $300 to Fresh Trading, previously purchased on June 14.

(a) Prepare journal entries to record the transactions on 6 June, 14 June and 18 June 2023. Narrations are not required.

Journal

Date 2023	Particulars	Debit $	Credit $
Jun 6	Trade payable - Fresh Trading	1,800	
	Cash at bank (1800 x 95%)		1,710
	Discount received (1800 x 5%)		90
14	Inventory ($2000 x 90%)	1,800	
	Trade payable- Fresh Trading		1,800
18	Trade payable - Fresh Trading (300 x 90%)	270	
	Inventory		270

(b) Prepare Fresh Trading account in Peter's books for the month of June 2023. Bring the balance down to the next month.

Trade payable Fresh Trading account

Date		Debit $	Credit $	Balance $
2023				
Jun 1	Bal b/d			1,800 Cr
6	Discount received (5% X $1800)	90		1,710 Cr
	Cash at bank (95% X $1800)	1,710		-
14	Inventory (90% X $2000)		1,800	1,800 Cr
18	Inventory (90% X $300)	270		1,530 Cr
Jul 1	Bal b/d			1,530 Cr

(c) Prepare an extract of the statement of financial performance for the month ended 30 June 2023, showing the presentation of discount received.

Peter

Statement of financial performance for the month ended 30 June 2023 (extract)

	$
Other income	
Discount received	90

(d) Prepare an extract of the statement of financial position as at 30 June 2023, showing the presentation of trade payables.

Peter

Statement of financial position as at 30 June 2023 (extract)

Current liabilities	$
Trade payables	1,530

(e) State the effect of receiving the cash discount on 6 June 2023 on Peter's profit for the year, and trade payables.

$90 discount received is an income, hence profit for the year will increase by $90.

Trade payables will be decreased by $90.

Format

Trade payable (name) account

Date	Particulars	Debit	Credit	Balance
Year		$	$	$
1st day	Balance b/d			XX Cr
Given date	Inventory (purchases)		XX	
"	Inventory (purchases return)	XX		
"	Cash at bank	XX		
"	Discount received	XX		XX Cr
year				
1st day	Balance b/d			XX Cr

Interpretation of Trade Payable Account

Worked Example 2

The following trade payable account was extracted from the books of Fitness Gym.

Trade payable Tough account

Date		Debit ($)	Credit ($)	Balance ($)
2022				
Mar 1	Bal b/d			2,500 Cr
5	Inventory		2,000	
7	Inventory	500		
31	Discount received	300		
	Cash at bank	2,700		1,000 Cr
Apr 1	Bal b/d			1,000Cr

(a) Interpret the entries on the following dates.

(i) 1 March
The business owed Tough $2,500.

(ii) 5 March
The business bought inventory costing $2,000 from Tough on credit.

(iii) 7 March
The business returned goods costing $500 previously bought on credit from Tough.

(iv) 31 March
The business paid cheque $2700 to Tough after receiving a cash discount of $300.

On 1 April 2021, trade payable Tough will have a balance of $1000 Cr.

CHAPTER 13: LONG-TERM BORROWINGS

- Differences between a bank loan and a bank overdraft

Bank Loan	Bank overdraft
▪ The business borrows a fixed amount and the cash is transferred to its bank account.	▪ The business withdraws more than what it has deposited in the bank account, up to the limit which the business and the bank have agreed upon.
▪ The business makes regular **cash payments in equal instalments over the loan** period or a **one-time lump-sum payment** at the end of the loan period to reduce the principal sum.	▪ The business **deposits cash** into the bank account **within the year** to reduce the overdraft.
How is it presented in the statement of financial position?	
▪ Non-current liabilities Long-term borrowings	▪ Current liabilities Bank overdraft

Accounting theories

- According to the **matching theory**, the interest expense incurred must be matched against the income earned from using the loan to operate business in the same accounting period to determine the profit for that period.

- Interest expense incurred but not yet paid is known as **interest expense payable**. This amount owing is to be recognised as **current liability.**

- According to the **accrual basis of accounting**, interest expense once incurred must be recognised in the financial period, whether it is paid or not.

Worked Example 1

On 1 October 2021, Donnell Pte Ltd took a $100,000 loan from Amazon Bank to purchase a delivery van.

The loan is repayable in equal instalments over 5 years and the interest rate on the outstanding loan amount is 5% per annum. Both the repayment of the loan and payment of interest are to be made on every 30 September by cheque. The financial year of Donnell Pte Ltd ends on 31 December.

(a) Prepare the journal entries on new loan, interest expenses and interest expense payable including the closing entry for the year ended 31 December 2021.

Journal

Date	Description	Debit ($)	Credit ($)
2021			
1 Oct	Cash at bank	100,000	
	Bank loan – Amazon Bank		100,000
31 Dec	Interest expense (5% X $100 000 X 3/12 months)	1,250	
	Interest expense payable		1,250
	Income summary	1,250	
	Interest expense		1,250

(b) Prepare the journal entries on loan repayment and interest expense payment on 30 September 2022.

Journal

Date	Description	Debit ($)	Credit ($)
2021			
30 Sept	Bank loan – Amazon Bank	20,000	
	Cash at bank		20,000
	Interest expense (5% X $100 000)	5,000	
	Cash at bank		5,000

(c) Prepare bank loan account for the year ended 31 December 2021 and 2022.

Bank loan – Amazon Bank account

Date		Debit ($)	Credit ($)	Balance ($)
2021				
1 Oct	Cash at bank		100,000	100,000 Cr
2022				
1 Jan	Balance b/d			100,000 Cr
30 Sep	Cash at bank	20,000		80,000 Cr
2023				
1 Jan	Balance b/d			80,000 Cr

(d) Prepare an extract of the statement of financial performance for the year ended 31 December 2021.

Statement of financial performance for the month ended 31 December 2021 (extract)

	$
Less: Other expenses	
Interest expense	1,250

(e) Prepare an extract of the statement of financial position as at 31 December 2021.

Statement of financial position as at 31 December 2021 (extract)

	$
Non-current liabilities	
Long term borrowing	80,000
Current liabilities	
Current portion of long-term borrowing	20,000
Interest expense payable	1,250

Interpreting Loan and Interest Expense Accounts

Worked example 2

The following bank loan and interest expense accounts are extracted from the books of Good Watches for the years ended 31 December 20X7 and 20X8.

Bank loan account

Date		Debit ($)	Credit ($)	Balance ($)
20X7				
Sep 1	Cash at bank		600,000	600,000 Cr
20X8				
Jan 1	Balance b/d			600,000 Cr
Aug 31	Cash at bank	60,000		540,000 Cr
20X9				
Jan 1	Balance b/d			540,000 Cr

Interest expense account

Date		Debit ($)	Credit ($)	Balance ($)
20X7				
Dec 31	Interest expense payable	2,000		2,000 Dr
	Income summary		2,000	0
20X8				
Jan 1	Interest expense payable		2,000	2,000 Cr
Aug 31	Cash at bank	6,000		4,000 Cr
Dec 31	Interest expense payable	1,800		5,800 Cr
	Income summary		5,800	0

(f) Interpret the entries in the:

(i) Bank loan account on 1 September 20X7 and 31 August 20X8, and

On 1 September 20X7, the business obtained a bank loan of $600,000.
On 31 August 20X8, the business repaid $60,000 of the bank loan by cheque.

(ii) Interest expense account on 31 December 20X7 and 1 January 20X8.

On 1 January 20X8, the business reversed the adjustment made for $2000 interest expense owed in the previous financial year.

(g) Calculate the length of repayment of the bank loan.

$600,000 / $60,000 = 10 years

(h) Prepare an extract of the statement of financial performance for the year ended 31 December 20X8.

Good Watches
Statement of financial performance for the month ended 31 December 20X8 (extract)

	$
Less: Other expenses	
Interest expense	5,800

(i) Prepare an extract of the statement of financial position as at 31 December 20X8.

Good Watches
Statement of financial position as at 31 December 20X8 (extract)

	$
Non-current liabilities	
Long term borrowing	480,000
Current liabilities	
Current portion of long-term borrowing	60,000
Interest expense payable	1,800

CHAPTER 14: EQUITIES

Owner's Equity

According to the **accounting entity theory**, only transactions that affect the business are recorded while transactions relating to the owner but do not affect the business are not recorded.

Resources (eg cash and office equipment) contributed by the owner for business use are recorded as **Capital**, while withdrawal of business assets for personal use is recorded as **Drawings**.

When the business makes profits, they belong to the sole owner. Similarly, when the business incurs losses, the sole owner has to bear them.

Owner's equity = Capital + Profit (or – Losses) – Drawings

Changes in Owner's Equity

The changes in owner's equity over a financial period can be due to additional capital(s) and drawings by the owner and profit and loss for the period.

Activities that change owner's equity	Changes in Owner's Equity
• The sole owner contributes additional assets to the business. • The business makes a profit for the period.	**Increase**
• The sole owner withdraws business assets for personal use. • The business incurs a loss for the period.	**Decrease**

Worked Example 1 (TB Pg. 258 Example 14.1)

The following information was extracted from Jessica's Fashion Trading.

	$
Capital, 1 Jan 20X3	22,000
Loss for the year ended 31 Dec 20X3	1,200
Profit for the year ended 31 Dec 20X4	14,000

The following transactions took place during the financial years ended 31 December 20X3 and 20X4.

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

a Prepare journal entries on the following dates.
(i) 25 October 20X3
(ii) 18 March 20X4
(iii) To transfer profit for the year ended 31 December 20X4 to the capital account
Narrations are not required.

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

c Prepare an extract of the statement of financial position as at 31 December 20X3 and 20X4, showing only the equity section.

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

Suggested solution

a

Journal			
Date	**Particulars**	**Debit**	**Credit**
20X3		$	$
Oct 25	Drawings	200	
	Inventory		200
20X4			
Mar 18	Bank loan	30,000	
	Capital		30,000
Dec 31	Income summary	14,000	
	Capital		14,000

Profit increases capital, hence capital account is credited.

b (i)

Drawings account				
Date	**Particulars**	**Debit**	**Credit**	**Balance**
20X3		$	$	$
Oct 25	Inventory	200		200 Dr
Dec 31	Capital		200	0
20X4				
May 28	Cash at bank	5,000		5,000 Dr
Dec 31	Capital		5,000	0

(ii)

Capital account				
Date	**Particulars**	**Debit**	**Credit**	**Balance**
20X3		$	$	$
Jan 1	Balance b/d			22,000 Cr
Dec 31	Income summary	1,200		20,800 Cr
31	Drawings	200		20,600 Cr
20X4				
Jan 1	Balance b/d			20,600 Cr
Feb 7	Fixtures and fittings		800	21,400 Cr
Mar 18	Bank loan		30,000	51,400 Cr
Dec 31	Income summary		14,000	65,400 Cr
31	Drawings	5,000		60,400 Cr
20X5				
Jan 1	Balance b/d			60,400 Cr

Jessica contributed additional capital of $30,800 ($800 + $30,000).

c

Jessica's Fashion Trading Statement of Financial Position as at 31 December 20X3 (extract)	
	$
Owner's equity	
Capital (22,000 – 1,200 – 200)	20,600

Jessica's Fashion Trading Statement of Financial Position as at 31 December 20X4 (extract)	
	$
Owner's equity	
Capital (20,600 + 30,800 + 14,000 – 5,000)	60,400

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

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

Connect

Refer to Table 14.1 for activities that change **owner's equity**.

Interpreting Drawings and Capital

Worked Example 2 (TB Pg. 261 Example 14.2)

Joanna owns Meow Café, which sells drinks and allows customers to interact with cats inside the café. The financial year ends on 31 December.

The following accounts are extracted from the books of Meow Café for the month ended 31 December 20X1.

Drawings account				
Date	**Particulars**	**Debit**	**Credit**	**Balance**
20X1		$	$	$
Dec 1	Balance b/d			600 Dr
15	Cash in hand	120		
18	Inventory **b** (i)	250		
31	Capital **a**			

Capital account				
Date	**Particulars**	**Debit**	**Credit**	**Balance**
20X1		$	$	$
Dec 1	Balance b/d			10,000 Cr
8	Cash at bank		1,000	
26	Equipment **b** (ii)		500	
31	Income summary **b** (ii)		5,000	
31	Drawings **a**			

a Calculate the total drawings for the year ended 31 December 20X1.

b Interpret the entries in the:
(i) drawings account on 18 December 20X1; and
(ii) capital account on 26 and 31 December 20X1.

c Prepare an extract of the statement of financial position as at 31 December 20X1, showing only the equity section.

Suggested solution

a Total drawings
= $600 + $120 + $250
= $970

b

	20X1	Description of Transaction
(i)	Dec 18	Joanna took drinks costing $250 for personal use.
(ii)	Dec 26	Joanna bought equipment worth $500 for the café using her personal funds.
	Dec 31	The business made a profit of $5,000 for the year ended 31 December 20X1.

c

Meow Café
Statement of Financial Position as at 31 December 20X1 (extract)

	$
Owner's equity	
Capital (10,000 + 1,000 + 500 + 5,000 – 970)	15,530

CHAPTER 15: CORRECTION OF ERRORS

When a trial balance is balanced, it does not imply that there are no errors. Such errors may not be easily detected.

Five errors not revealed by trial balance.
Transaction: Purchases a motor vehicle of $35,000 from Jack on credit.

Description of Error	Example of error	Correction of error
Transaction is **not** recorded at all	No journal entries are recorded.	DR MV $35,000 CR TP-Jack $35,000
The wrong **amount** is recorded	Recorded as $53,000.	DR TP-Jack $18,000 CR MV $18,000
The transaction is recorded in the wrong account of a **different** accounting element	Recorded as repairs of MV instead of motor vehicle account.	DR MV $35,000 CR repairs of MV $35,000
The transaction is recorded in the wrong account of a **same** accounting element	Posted to Trade payable –Jill instead of Jack account.	DR TP-Jill $35,000 CR TP-Jack $35,000
The transaction is recorded on the wrong **sides** of the accounts involved.	Debited to Trade payable-Jack and credited to motor vehicle instead.	DR MV (X 2) $70,000 CR TP-Jack $70,000

Worked Example

Li Xin prepared her trial balance on 31 March 2023.

	Debit ($)	Credit ($)
Cash at bank	20,550	
Trade payables		6,500
Trade receivables	6,800	
Drawings	1,300	
Capital		17,130
Sales revenue		44,000
Sales returns	4,400	
Cost of sales	22,000	
Office equipment	7,900	
Commission income		3,450
Inventory	6,180	
General expenses	1,950	

She discovered the following errors:

1. Purchase of office equipment $950 was recorded in the general expenses account.
2. A cheque of $230, received from credit customer Stanley, had been credited to the cash at bank account and debited to his account.
3. Payment of insurance $270 by cheque has been omitted.
4. Both drawings and commission income were understated by $420.
5. A cheque payment of $560 to trade payables had been recorded as $650 in the books.
6. Sales of goods on credit $1,200 to Julie Ltd was wrongly recorded in trade receivable Julia Ltd account.

The unadjusted profit for the year was $19,100.

REQUIRED

(a) Prepare the journal entries to correct the errors.
(b) Prepare the adjusted trial balance as at 31 March 2023. Show your workings.
(c) State the effect of errors on profit and assets.
(d) State the effect of correcting errors on profit and assets.

(a) Journal

		Dr $	Cr $
1	Office equipment	950	
	General expenses		950
	Correction of errors – Purchase of office equipment $950 wrongly recorded in general expenses account		
2	Cash at bank	460	
	Trade receivable, Stanley		460
	Correction of errors – A cheque of $230, received from credit customer Stanley, had been wrongly credited to cash at bank account and debited to his account.		
3	Insurance expense	270	
	Cash at bank		270
	Correction of errors – Payment of insurance $270 by cheque has been omitted		
4	Drawings	420	
	Commission income		420
	Correction of errors – Both drawings and commission income were understated by $420		
5	Cash at bank	90	
	Trade payables		90
	Correction of errors – A cheque payment of $560 to trade payables had been wrongly recorded as $650 in the books		
6	Trade receivable, Julie Ltd	1,200	
	Trade receivable, Julia Ltd		1,200
	Correction of errors – Sales of goods on credit $1200 to Julie Ltd was wrongly recorded in trade receivable Julia Ltd account		

(b) Li Xin

Corrected Trial Balance as at 31 March 2023

	Debit ($)	Credit ($)
Cash at bank (20550+460-270+90)	20,830	
Trade payables (6500+90)		6,590
Trade receivables (6800-460)	6,340	
Drawings (1300+420)	1,720	
Capital		17,130
Sales revenue		44,000
Sales returns	4,400	
Cost of sales	22,000	
Office equipment (7900+950)	8,850	
Commission income (3450+420)		3,870
Inventory	6,180	
General expenses (1950-950)	1,000	
Insurance expenses	270	
	71,590	71,590

(c) Effect of errors (understated, overstated, or no effect)

	Effect of error on	
	Profit	**Assets**
1	Understated by $950	Understated by $950
2	No effect	No effect
3	Overstated by $270	Overstated by $270
4	Understated by $420	No effect
5	No effect	Understated by $90
6	No effect	No effect

(d) Effect of correcting errors (increase, decrease, or no effect)

	Effect of correcting error on	
	Profit	**Assets**
1	Increase by $950	Increase by $950
2	No effect	No effect
3	Decrease by $270	Decrease by $270
4	Increase by $420	No effect
5	No effect	Increase by $90
6	No effect	No effect

CHAPTER 17: SCENARIO-BASED QUESTIONS

Format of your answer should look like this

Decision	*State clearly your recommended decision.*
Evidence 1	*Paraphrase evidence*
Elaboration 1	*Explain how it benefits the business*
Evidence 2	*Paraphrase evidence*
Elaboration 2	*Explain how it benefits the business*
Evidence 3	*Paraphrase evidence*
Elaboration 3	*Explain how it benefits the business*

▼**Table 1.3** How accounting and non-accounting information are used to make decisions

Example of Decision	Accounting Information	Non-accounting Information
Which goods to buy (Chapter 9 Inventories)	• cost of inventory • storage cost • gross profit margin • rate of inventory turnover (times) • days sales in inventory (days)	• types of storage • nature of product • consumer preference
Credit worthiness of customer (Chapter 10 Trade Receivables)	• trade receivables balance • credit terms and cash discount • number of days trade receivables are overdue • existing customer's history of repayment • rate of trade receivable turnover (times) • trade receivable collection period (days)	• economic outlook • specific industry outlook • reputation of customer • customer's history of repayment
Which supplier to buy from (Chapter 12 Trade Payables)	• cost of inventory • credit terms • cash discount • cost of supplies • cost of non-current assets • delivery charges • trade discount • cost of services	• local or overseas supplier • after-sales service • return policy • online vs brick and mortar supplier • reputation of supplier • warranty

<u>INVENTORY – Which goods to buy?</u>

Accounting information

- ✓ Lower cost
  - Lower cost of sales, leading to higher gross profit and profit for the year.
- ✓ Lower storage cost
  - Incur lower expenses and hence higher profit for the year.

Non-accounting information

- ✓ Come with features that cater to customers' preference.
  - *More likely to sell well, leading to higher sales revenue, gross profit and profit for the year.*
- ✓ Does not require special types of storage such as refrigeration.
  - *Will not need to incur additional expense, hence ensuring a higher profit for the year.*
- ✓ Popular with target customers
  - *More likely to sell well, leading to higher sales revenue, gross profit and profit for the year.*

TRADE PAYABLE - Which supplier to buy from?

Accounting information

- ✓ Lower cost of inventory
  - *Cost of sales will therefore be lower, giving a higher gross profit and higher profit for the year.*
- ✓ Lower cost of non-current asset
  - *Cost savings will mean more cash available for business use.*
- ✓ Higher trade discounts
  - *Lower cost of sales, leading to higher gross profit and profit for the year.*
- ✓ Longer credit term
  - *Easier on cash flow; more cash to pay for more urgent expenses first.*
- ✓ Higher cash discount
  - *More other income, and hence higher profit for the year.*
- ✓ Lower or no delivery charges
  - *Lower expenses, and hence higher profit for the year.*
- ✓ Free or lower installation and maintenance
  - *Lower expenses, and hence higher profit for the year.*

Non-accounting information

- ✓ Faster lead time, i.e., receive goods sooner upon placing order.
  - *Will not face stockout situation and loss of potential sales.*
- ✓ Prefer supplier with physical shop.
  - *Can see and touch the products beforehand to ensure quality and expectations are met.*
- ✓ Better after-sales services, such as prompt advice, repair, and service recovery
  - *Better support helps in smooth running of the business.*
- ✓ Better reputation such as many years in business
  - *More stable and less likely to close down, hence lower risk of not being able to honour warranty.*

TRADE RECEIVABLE - Credit worthiness of customers

Accounting information

- ✓ Lower trade receivable balance
  - *Lower risk of impairment loss on trade receivable should the debt have to be written off.*
  - *Easier on the business cashflow since (name of credit customer) owes less amount.*
- ✓ Lower credit term
  - *Can receive payment earlier and use the money to pay for expenses or buy goods.*
- ✓ Lower cash discount
  - *Less discount allowed, hence lower expenses which gives higher profit for the year.*

Non-accounting information

- ✓ Better industry outlook
  - *When the industry is booming, (name of credit customer) will more likely be able to repay debts.*
- ✓ Better economic performance of the country
  - *(Name of credit customer) will more likely do well and be able to repay debts.*
- ✓ More positive reviews
  - *Indicate good reputation usually known for providing quality goods and service.*
- ✓ For new customer, better history of repayment
  - *With good track record of making prompt payments, the business can feel more assured of (name of credit customer)'s ability to repay debts.*