Contents

Unit 1 - Fundamentals of Accounting

1.1 - Purpose of Accounting

Bookkeeping - The process of recording the financial transactions of a business. These are recorded in the books of prime, and ledger accounts.

Accounting - providing information for monitoring progress and decision making, by making financial statements, like income statements and statements of financial position.

1.2 - Accounting Equation

Assets = Equity + Liabilities

Assets - things which are owned by the business or organisation.

Non-Current	Current
To be used in the business for more than 1 year.	To be used in the operation of the business within 1 year.
Examples: Premise, furniture, fixtures, fittings, vehicles, machinery, goodwill, etc.	Examples: Cash in bank, cash in hand, closing Inventory, trade receivables, prepaid expenses, accrued income, etc.

Liabilities - things which are owed to a third party outside of the organisation.

Non-Current	Current
To be paid within more than 1 year.	To be fully paid within 1 year.
Examples: Bank loan, mortgage loan, debentures, redeemable preference shares, etc.	Examples: Trade payables, bank overdraft, prepaid income, accrued expenses, etc.

Owner's equity - The owner's personal assets brought into the business to be used for business operations.

Owner's Equity / capital
Examples: Owner's vehicles, equipment, cash, etc.

Unit 2 - Sources and Recording of Data

2.1 Double Entry system

Double entry system - for every transaction, an entry will be recorded in two accounts as debit or credit.

Debits are recorded on the **left** side of a journal entry.

Credits are recorded on the **right** side of a journal entry.

Increase in debit shows the **gain in expenses & assets**, and the **loss of revenue & liabilities**.

Increase in credit shows the **gain in revenue & liabilities**, and the **loss of expenses & assets**.

Sales ledger - contains the accounts of trade receivables.
Purchases ledger - contains the account of trade payables.
General (nominal ledger) - Contains the accounts of everything else.

2.2 Business Documents

Business documents:

- Invoice - A business document issued to the customer when the business sells goods on credit.
- Debit note - A document sent to a supplier asking for allowance for something unsatisfactory.
- Credit note - A document sent to the customer to show allowance.
- Statement of account - A document that shows all transactions that took place between the business and a particular customer over a period of time.
- Cheque - A bill of exchange where one party orders the bank to transfer the money to the bank account of another party.
- Receipt - Evidence that a payment is received.

Business documents that are sources of information

- Invoice
- Credit note
- Cheque counterfoil - Contains information related to cheques issued by the business.
- Paying-in slip - A document used when depositing cash or cheques into a bank account.
- Receipt
- Bank statement - A document that summarises transactions of money going in and out of your bank account.

2.3. Books of prime entry

Cashbook - records transactions of large amounts of cash and bank.
Petty cash book - records translations of small quantities of cash and bank.
Sales journal - records credit sales.
Purchases journal - records credit purchases.
Sales returns journal - records return inwards.
Purchases returns journal - records return outwards.
General journal - records everything else.

Trade discounts

- Discounts given when they **purchase in bulk**.
- Encourages people to buy in large quantities.
- Not recorded in any books of account, but is shown on invoices.
- The amount recorded on the books is after deducting trade discounts.

Cash discounts

- Discounts given when **payments are made before a given time**.
- Encourages quick payment of trade receivables.
- Recorded in the cashbook.

Imprest system of petty cash - a fixed maximum amount for small transactions monthly. Every month, money is added to reset it back to the fixed amount.

Unit 3 - Verification of Accounting Records

3.1 Trial Balance

Trial balance - a statement of ledger balances on a particular date.

Uses of trial balance
- Summarises the accounts of a business.
- Checks accuracy of double keeping bookkeeping.
- Easier to prepare financial statements.

Limitations of a trial balance
- Too much time to prepare.
- Errors might still exist. Errors which do not affect the trial balance: commission, compensating, complete reversal, omission, original entry, principle.

3.2 Correction of Errors

Error of commission. Entry made in the wrong account, but same class of account.
Error of principle. Entry made in the wrong account.
Error of omission. Transaction overlooked & not recorded.
Entry of original entry. Mistake in the amounts of both transactions.
Entry of complete reversal. Debit and credit are reversed.
Compensating error. One error has been compensated by another entry that's also in error.

Suspense account - A temporary measure to balance the trial balance.

3.3 Bank Reconciliation

Bank statement - A document that summarises transactions of money going in and out of your bank account.

Bank reconciliation statement:
- To detect any errors in recording transactions caused by timing differences.
- Includes bank errors, uncredited deposit and unpresented cheques.

Updated Cashbook

Balance b/d (from the cashbook)	Xxxx	Bank charges	Xxxx
Credit transfer	Xxxx	Direct debit	Xxxx
(Anything in the **credit** side of the bank statement that's not included in the cashbook)	Xxxx	Standing order	Xxxx
		(Anything in the **debit** side of the bank statement that's not included in the cashbook)	Xxxx
	Xxxx		Xxxx

Bank Reconciliation Statement

Balance as per bank statement		Xxxx
Less: unpresented cheque		
Cheque 1	Xxxx	
Cheque 2	Xxxx	Xxxx
Add: uncredited deposit		
Trade receivable 1	Xxxx	
Trade receivable 2	Xxxx	Xxxx
Balance as per updated cashbook		Xxxx

3.4 Control Accounts

Sales ledger control account

- A book that contains accounts of all credit customers.
- Used to monitor the amount that customers owe.

Purchases ledger control account

- A book that contains accounts of all credit suppliers.
- Used to monitor the amount owed by your business to suppliers.

The books of prime entry are sources of information for the control account entries.

Sales ledger control account

Balance b/d	Xxxx	Bank	Xxxxx
Credit sales	Xxxxx	Sales return	Xxxx
Dishounoured cheque	Xxxx	Discount allowed	Xxxx
Refund	Xxxx	Irrecoverable debts	Xxxx
Interest	Xxxx	Contra	Xxxx
		Balance c/d	Xxxx
	Xxxxx		Xxxxx
Balance b/d	Xxxx		

Purchases ledger control account

Bank	Xxxxx	Balance b/d	Xxxx
Purchases return	Xxxx	Credit purchases	Xxxxx
Discount received	Xxxx	Interest	Xxxx
Contra	Xxxx		
Balance c/d	Xxxx		
	Xxxxx		Xxxxx
		Balance b/d	Xxxxx

Unit 4 - Accounting Procedures

4.1 Capital and Revenue Expenditure and Receipt

Capital expenditure - money spent on buying, improving, or extending the life of non current assets.
Revenue expenditure - money spent on the day-to-day running costs of a business.
Capital receipt - money received from selling non current assets.
Revenue receipt - money received from the regular operations of a business, such as sales.

4.2 Provision for Depreciation and Disposal of Non-Current Assets

Depreciation - the amount of value an asset loses each year, due to the 'wear and tear' (obsolete, outdated, no longer efficient).

Reasons we account for depreciation:

- Helps to figure out how much value your assets lost during the year.
- Prudence principle.

Methods of depreciation:

- Straight-line = (Cost – Residual Value) / Estimated years
- Reducing balance = (Cost – All Previous Depreciation) x %
- Revaluation = Opening Value + Purchases For The Year – Closing Value

Ledger accounts & journal entries for provision of depreciation

General Journal

Dr. Depreciation	Xxxxx	
Cr. Income statement		Xxxxx

Provision for depreciation account

Balance c/d	Xxxxx	Income statement	Xxxxx

Extract of income statement for the year ended dd/mm/yy

Less: all expenses		
Depreciation of asset	Xxxxx	Xxxxx

Statement of financial position for the year ended dd/mm/yy

Non current assets	Cost	Prov of dep	NBV
Asset	Xxxxx	Xxxxx (this year + previous years)	Xxxxx

Ledger accounts & journal entries of sales of non current assets

General journal

Dr. Disposal Cr. Asset *(Disposal of asset)*	Xxxxx	 Xxxxx
Dr. Provision for depreciation Cr. Disposal *(Removal of provision of depreciation of disposed asset)*	Xxxxx	 Xxxxx
Dr. Cash/bank/trade receivable Cr. Disposal *(asset sold by cash/bank)*	Xxxxx	 Xxxxx

Asset account

Balance b/d	Xxxxx	Disposal	Xxxxx
		Income statement	Xxxxx

Provision for depreciation account

Disposal	Xxxxx	Balance b/d	Xxxxx
Balance c/d	Xxxxx		

Disposal account

Asset	Xxxxx	Provision for depreciation	Xxxxx
Gain on disposal	Xxxxx	Cash/bank/t.receivable	Xxxxx
		Loss on disposal	Xxxxx

4.3 Other Payables and Receivables

In accounting, you must match costs and revenues. This follows the matching principle.

Accrued expenses: expenses that have been incurred but not paid yet.
Prepaid expenses: expenses that have not been incurred yet but paid in advance.
Accrued income: income that has been earned but not received yet.
Prepaid income: income that has not been earned yet.

In a statement of financial position, accrued expenses and prepaid income are current liabilities. Prepaid expenses and accrued income are current assets.

In an income statement, anything accrued must be added and anything prepaid must be deducted.

4.4 Irrecoverable Debts and Provision for Doubtful Debts

Irrecoverable debts – Money that a business is unable to receive from a credit customer and must be written off as a loss.
Recovery of debts – Payment received for a debt that had previously been written off as irrecoverable.

Ledger accounts & journal entries of irrecoverable debts

General journal

Dr. Irrecoverable debts	Xxxxx	
Cr. Trade receivable		Xxxxx
(Writing off debts from a trade receivable)		
Dr. Income statement	Xxxxx	
Cr. Trade receivable		Xxxxx
(Transfer the total expense to income statement)		

Extract of income statement

Less: all expenses	
Irrecoverable debts	Xxxxx

Trade receivables

Balance b/d	Xxxxx	Irrecoverable debt	Xxxxx

Irrecoverable debt

Trade receivables	Xxxxx	Income statement	Xxxxx

Ledger accounts & journal entries for recovery of debts

General journal

Dr. Bank	Xxxxx	
Cr. Recovered irrecoverable debts		Xxxxx
(Received cheque from a trade receivable that's been written off)		
Dr. Recovered irrecoverable debts	Xxxxx	
Cr. Income statement		Xxxxx
(Transfer the total revenue to income statement)		

Extract of income statement

Add: other income	
Recovered irrecoverable debts	Xxxxx

Bank

Recovered irrecoverable debt	Xxxxx	Balance c/d	Xxxxx

Recovered irrecoverable debt

Income statement	Xxxxx	Bank	Xxxxx

Provision for doubtful debts:

- Ensures profit is not overstated in the year.
- Prudence principle

Ledger accounts & journal entries for provision of doubtful debts

Extract of income statement

Add: other income Recovered irrecoverable debts	Xxxxx

Provision of doubtful debt (example)

2020 balance c/d	1000	2020 income statement	1000
	1000		1000
2021 balance c/d	1500	2021 balance b/d	1000
		2021 income statement	500
	1500		1500
2022 balance c/d	1750	2022 balance b/d	1500
		2022 income statement	250
	1750		1750
2023 income statement	500	2023 balance b/d	1750
2023 balance c/d	1250		
	1750		1750
2024 income statement	250	2024 balance b/d	1250
2024 balance c/d	1000		
	1250		1250

2024 Extract of statement of financial position

Current asset Trade receivable (-) provision for doubtful debt	Xxxxx (1000)

4.5 Valuation of Inventory

Inventory must be calculated with the valuation of inventory at the lower of cost or net realisable value. This follows the prudence principle.

Unit 5 - Introduction to Financial Statements

5.1 Sole trader

Sole trader - a business owned and operated by one person.

Advantages	Disadvantages
Profits are not shared.	Difficult to raise capital.
Easy to establish and manage.	Owner bears all the responsibility.
Decision making is speedy.	Unlimited liability.

Importance of preparing income statements and statements of financial position:
- Helps decision making.
- Used to compare performance of business from previous years.

Trading business	Service business
Sells tangible goods. E.g. grocery store, furniture store.	Sells intangible goods. E.g. cleaning, event planning.

Income statement for the year ended dd/mm/yy

Revenue	Xxxxx	
(-) sales return	(xxxx)	Xxxxx
Less: cost of sales		
Opening inventory	Xxxxx	
Purchases	Xxxxx	
Carriage inwards	Xxxxx	
(-) purchase returns	(xxxx)	
(-) closing inventory	(xxxx)	(xxxxx)
GROSS PROFIT		Xxxxx
Add: other income		
Discount received	Xxxx	
Commission received	Xxxx	
Rental received	Xxxx	
Interest received	Xxxx	
Decrease in provision for doubtful debt	Xxxx	Xxxx
Less: all expenses		
Discount allowed	Xxxx	
Irrecoverable debt	Xxxx	
Wages	Xxxx	
Insurance	Xxxx	
Administration expenses	Xxxx	
Rent	Xxxx	
Interest	Xxxx	
Depreciation	Xxxx	
Increase in provision for doubtful debt	Xxxx	
Carriage outwards	Xxxx	
(other expenses)	Xxxx	(xxxx)
NET PROFIT		Xxxxxx

Statement of financial position for the year ended dd/mm/yy

Non current assets			
Premises	Xxxxx	Xxxx	Xxxxx
Vehicles	Xxxxx	Xxxx	Xxxxx
Equipment	Xxxxx	Xxxx	Xxxxx
Machinery	Xxxxx	Xxxx	Xxxxx
Fixtures & fittings	Xxxxx	Xxxx	Xxxxx
Goodwill	Xxxxx	Xxxx	Xxxxx
			Xxxxx
Current assets			
Cash		Xxxx	
Bank		Xxxx	
Closing inventory		Xxxx	
Trade receivables	Xxxx		
(-) provision of doubtful debts	(xxxx)	Xxxx	
Prepaid expenses		Xxxx	
Accrued income		Xxxx	Xxxxx
TOTAL ASSETS			Xxxxx
Owner's equity			
Capital		Xxxxx	
(+) Net profit OR (-) Net loss		Xxxx	
(-) Drawings		(xxxx)	Xxxxx
Non current liabilities			
Bank loan		Xxxx	
Debentures		Xxxx	Xxxx
Current liabilities			
Bank overdraft		Xxxx	
Trade payables		Xxxx	
Prepaid income		Xxxx	
Accrued expenses		Xxxx	Xxxx
TOTAL EQUITY & LIABILITIES			Xxxxx

5.2 Partnership

Partnership - a business owned by two or more people to make profits.

Advantages	Disadvantages
More capital and resources available.	Unlimited liability.
Easy to establish and manage.	Must share profits.
More skills, knowledge.	Responsibilities are shared.

Importance of appropriation account:

- Shows how net profit is distributed between partners.

Appropriation account for the year ended dd/mm/yy

Profit for the year		Xxxxx
Add: interest on drawings		
Partner 1	Xxxx	
Partner 2	Xxxx	Xxxx
Less: interest on capital		
Partner 1	Xxxx	
Partner 2	Xxxx	(Xxxx)
Less: partner's salary		
Partner(s)		(Xxxx)
		Xxxxx
Profit shares		
Partner 1 (Xxxxx x percentage)		Xxxx
Partner 2 (Xxxxx x percentage)		Xxxx
		Xxxxx

Current account	Capital account
To show the value of investment they currently have in the business.	To show the main investment they have in the business.

Capital account

	Partner 1	Partner 1		Partner 1	Partner 2
Balance b/d (based on question)	Xxxxx	Xxxxx	Balance b/d (based on question)	Xxxxx	Xxxxx

Current account

	Partner 1	Partner 1		Partner 1	Partner 2
Balance b/d (based on question)	Xxxxx	Xxxxx	Balance b/d (based on question)	Xxxxx	Xxxxx
Drawings	Xxxx	Xxxx	Interest on capital	Xxxx	Xxxx
Interest on drawings	Xxxx	Xxxx	Partner's salary	Xxxx	Xxxx
Balance c/d (based on question)	Xxxx	Xxxx	Profit share	Xxxx	Xxxx
			Balance c/d (based on question)	Xxxx	Xxxx
	Xxxxx	Xxxxx		Xxxxx	Xxxxx

Extract of statement of financial position for the year ended dd/mm/yy

Owner's equity			
Capital account			
Partner 1	Xxxxx		
Partner 2	Xxxxx	Xxxxx	
Current account			
Partner 1	Xxxxx		
Partner 2	Xxxxx	Xxxxx	Xxxxx

5.3 Limited companies

Limited company - a legal entity which has a separate identity from its shareholders, whose liability for the company's debts is limited.

Types:
- Public limited company - may offer its shares to the public.
- Private limited company - not allowed to offer its shares to the public.

Advantages	Disadvantages
Limited liabilities Easier to raise capital	Expensive to set up, many legal formalities Profit is shared Accounts must be made

Limited liabilities - you can only risk what you've invested into the business.
Equity - the total amount of money invested in the company by shareholders.

The capital structure of a limited company consists of: Preference share capital, Ordinary share capital, General reserve & Retained earnings.

Issued share capital: The amount of capital issued to shareholders.
Called-up share capital: Part of the issued share capital, where the company asks for payment from shareholders.
Paid-up share capital: Part of the called-up share capital, where payment has been received.

Share capital		Loan capital
Preference shares	**Ordinary shares**	**Debentures**
Enable the shareholders of a company to get dividends before the equity shareholders. No voting rights.	Total funds provided by shareholders. Have voting rights.	Long term loan, with fixed rate of interest. No voting rights.

Statement of changes in equity for the year ended dd/mm/yy

	Ordinary share capital	Preference share capital	General reserve	Retained earnings	Total
Opening balance	Xxxx	Xxxx	Xxxx	Xxxx	Xxxxx
Profit for the year				Xxxxx	Xxxxx
Dividend paid (final)				(Xxxx)	(Xxxx)
Dividend paid (interim)				(Xxxx)	(Xxxx)
Transfer to general reserve			Xxxx	(Xxxx)	-
Closing balance	Xxxx	Xxxx	Xxxxx	Xxxxx	Xxxxx

Statement of financial position for the year ended dd/mm/yy (for limited companies)

Non current assets	Xxxxx	
(-) provision for depreciation	(Xxxx)	Xxxxx
Current assets		
Cash	Xxxx	
Bank	Xxxx	
Trade receivables	Xxxx	
Prepaid expenses	Xxxx	
Accrued income	Xxxx	Xxxxx
TOTAL ASSETS		Xxxxx
Equity		
Ordinary shares	Xxxxx	
Preference shares	Xxxxx	
General reserves	Xxxxx	
Retained earnings	Xxxxx	Xxxxx
		Xxxxx
Non current liabilities		
Debentures	Xxxx	
Redeemable preference shares	Xxxx	Xxxx
Current liabilities		
Bank overdraft	Xxxx	
Trade payables	Xxxx	
Prepaid income	Xxxx	
Accrued expenses	Xxxx	Xxxx
TOTAL EQUITY & LIABILITIES		Xxxxx

5.4 Clubs & societies

Receipts and payments accounts	Income and expenditure accounts
Shows money received and paid. Shows the balances of cash/bank. No adjustments.	Shows income and expenses. Shows the surplus/deficit. Includes adjustments (accrual, prepaid)

Receipts & payments account for the year ended dd/mm/yy

Balance b/d	Xxxx	Rental	Xxxx
Subscription	Xxxx	Competition prizes	Xxxx
Entrance fee	Xxxx	Interest on loan	Xxxx
Donation	Xxxx	Salary	Xxxx
Borrowings	Xxxx	(other payments)	Xxxx
(other receipts)	Xxxx		
	Xxxx		Xxxx

Income & expenditure account for the year ended dd/mm/yy

Income		
Subscription	Xxxx	
Entrance fee	Xxxx	
(other income)	Xxxx	Xxxx
Expenditure		
Wages	Xxxx	
Rates & insurance	Xxxx	
Depreciation of equipment	Xxxx	
(other expenses)	Xxxx	(Xxxx)
		Xxxx

Statement of financial position for the year ended dd/mm/yy

Non current assets	Xxxxx	
(-) provision for depreciation	(Xxxx)	Xxxxx
Current assets		
Cash	Xxxx	
Bank	Xxxx	
Trade receivables	Xxxx	
Prepaid expenses	Xxxx	
Accrued income	Xxxx	Xxxxx
TOTAL ASSETS		Xxxxx
Accumulated fund	Xxxxx	
(+) Surplus OR (-) Deficit	Xxxx	Xxxxx
Non current liabilities		
Loan		Xxxx
Current liabilities		
Trade payable	Xxxx	
Other payables	Xxxx	
Prepaid income	Xxxx	
Accrued expenses	Xxxx	Xxxx
TOTAL ACCUMULATED FUND & LIABILITIES		Xxxxx

5.5 Manufacturing account

Direct costs	Indirect costs
Expenses that directly go into producing goods or providing services.	General business expenses that keep you operating.

Direct material - Resources used to make a product.
Direct labour - People whose labour is directly producing the output.
Prime cost - Costs that are directly related to the purchases and handling of goods. It changes as the amount of goods produced changes.
Factory overheads - Expenses to produce the company's product.

Manufacturing account for the year ended dd/mm/yy

Cost of raw material consumed		
Opening inventory of raw material	Xxxx	
Purchases of raw materials	Xxxxx	
Carriage inwards of raw materials	Xxxx	
(-) Purchases returns of raw materials	(xxxx)	
(-) Closing inventory of raw material	(xxxx)	
RAW MATERIALS CONSUMED		Xxxxxx
Direct costs		
Operative wages	Xxxx	
Royalties	Xxxx	Xxxx
PRIME COST		Xxxxx
Factory overheads		
Indirect costs	Xxxx	
Rent & rates	Xxxx	
General expenses	Xxxx	
Depreciation	Xxxx	
(other factory expenses)	Xxxx	Xxxx
Work in progress		
Opening WIP		Xxxx
Closing WIP		(xxxx)
PRODUCTION COSTS		Xxxxxx

Extract of income statement for the year ended dd/mm/yy

Revenue		Xxxxx
Less: cost of sales		
Opening inventory of finished goods	Xxxx	
Purchases of finished goods	Xxxx	
Carriage inwards of finished goods	Xxxx	
Production cost	Xxxx	
(-) closing inventory of finished goods	(Xxxx)	Xxxx
GROSS PROFIT		Xxxx

Extract of statement of financial position for the year ended dd/mm/yy

Current assets		
Closing inventory:		
Raw material	Xxxx	
Work in progress	Xxxx	
Finished goods	Xxxx	Xxxx

5.6 Incomplete records

Statement of affair - summary of the financial position of a business on a certain date.

Disadvantages of not maintaining a full set of accounting records:
- Trial balance cannot be made.
- Difficult to compare with previous years.
- DIfficult for decision making.

Profit = Closing capital – Opening capital + Drawings – Capital Introduced

Measuring gross profit as a percentage:
- Mark-up = Gross profit ÷ cost of sales x 100
- Margin = Gross profit ÷ sales x 100

Statement of affairs for the year ended 1/mm/yy

Non current assets		
Vehicles	Xxxxx	
Equipments	Xxxxx	
(other NCAs)	Xxxxx	Xxxxx
Current assets		
Cash	Xxxx	
Bank	Xxxx	
Inventory	Xxxxx	
Trade receivable	Xxxx	
(other CAs)	Xxxx	Xxxxx
TOTAL ASSETS		Xxxxx
Non current liabilities		
Loan		Xxxxx
Current liabilities		
Trade payable	Xxxx	
Other payables	Xxxx	
Prepaid income	Xxxx	
Accrued expenses	Xxxx	Xxxx
Opening capital		Xxxxx
TOTAL CAPITAL & LIABILITIES		Xxxxx

Statement of affairs for the year ended 31/mm/yy

Non current assets			
Vehicles	Xxxxx	Xxxxx	Xxxxx
Equipments	Xxxxx	Xxxxx	Xxxxx
(other NCAs)	Xxxxx	Xxxxx	Xxxxx
			Xxxxx
Current assets			
Cash		Xxxx	
Inventory		Xxxxx	
Trade receivable		Xxxx	
(-) provision for doubtful debt		(Xxxx)	
(other CAs)		Xxxx	Xxxxx
TOTAL ASSETS			Xxxxx
Non current liabilities			
Loan			Xxxxx
Current liabilities			
Bank overdraft		Xxxx	
Trade payable		Xxxx	
Other payables		Xxxx	
Prepaid income		Xxxx	
Accrued expenses		Xxxx	Xxxx
Closing capital			Xxxxx
TOTAL CAPITAL & LIABILITIES			Xxxxx

Unit 6 - Analysis interpretations

Profitability ratios - measure the performance of the business by comparing the profit to other figures in the same set of financial statements.

Profitability ratios		
Return on capital employed	**Gross margin**	**Profit margin**
To find the ratio/percentage in how much value has been spent in the business to get profit. Profit of the year b4 interest x 100 Capital employed	To calculate the ratio of gross profit. Improvement: Increasing selling prices, obtaining cheaper supplies Effects: Increasing the rate of trade discount, selling goods at cheaper prices. Gross profit x 100 Sales	To calculate the ratio of profit. Improvement: Controlling expenses, increasing other income. Effects: Spent a lot in expenses, less money received. Net profit x 100 Sales

Liquidity ratios - measure the ability of the business to turn assets into cash.

Liquidity ratios		
Current ratio	**Liquid (acid test) ratio**	**Rate of inventory turnover**
The ability of a business to meet its current liabilities when they fall due. Improvement: invest more money into business, obtain long-term loans/non-current liabilities Effects: Cannot meet payment on time, experience difficulties in obtaining further supplies Current ratio : current liabilities	Compares the assets which are in the form of money, or which will convert into money quickly, with the liabilities which are due for repayment. (Current assets - inventory) : Current liabilities	Calculates the number of times a business sells and replaces its inventory in a year. Improvement: Increase sales by offering discounts, change marketing strategies. Effects: Lower sales, inventory over-purchased Cost of sales Average inventory

Trade receivable turnover	Trade payable turnover	
Average time the credit customers take to pay their accounts. Improvement: Improving credit control policy (sending regular statements of account, 'chasing' overdue accounts and so on), offering cash discount. Effects: no credit control policy, no cash discount. $\frac{\text{Trade receivable x 365 (days)}}{\text{Sales}}$	Average time taken to pay the accounts of credit suppliers. Improvements: business in good financial position, pays on time. Effects: suppliers refusing credit, supplier refusing further supplies, business in bad financial position $\frac{\text{Trade payable x 365 (days)}}{\text{Purchases}}$	

6.4 Interested parties

Users of accounting statements

- **Owners** - check performance of business
- **Manager** - to gather information about the company's financials to report to owner and plan for decision making.
- **Employees** - wants to know that the company is able to continue operating, maintain jobs and pay wages.
- **Lenders / trade payables** - interested in the security available, the repayment of the loan when due and the payment of interest when due.
- **Government** - want to know how much tax they can charge to the company
- **Investors**
- **Club members**
- **Banks**

6.5 Limitations of accounting statements

Limitations of accounting statements

- **Historic cost** - the value placed on an asset in the statement of financial position based on the original cost at which the asset was acquired.
- **Difficulties of definition** - accounting policies, principles & concepts used worldwide can differ from country to country. (Tax, currency)

- **Time factor** - A user of financial statements can gain an incorrect view of the financial results or cash flows of a business by only looking at one reporting period.
- **Non-monetary items** - skill of a workforce can't be recorded.

Unit 7 - Accounting Principles and Policies

7.1 - Accounting principles

Business Entity - financial matters of the business must be recorded separately from its owners as they are different legal persons.

Duality - Every transaction must be recorded in two accounts as debit or credit. (Double entry system).

Matching - Expenses and income must be recorded by the amount in the current financial year, whether it has been paid or not. (Prepayment must be deducted. Accruals must be added.)

Materiality - Financial information recorded must only be significant to the decision making of the company and relevant for evaluation.

Money Measurement - Financial information recorded must be in the form of monetary value or must be able to measure the data in money terms.

Prudence - Underestimate the assets and revenues. Overestimate the liabilities and expenses.

Consistency - Calculation techniques/methods shouldn't change without good reason.

Realisation - Revenue should only be recognised when the exchange of goods or services is completed.

Historic Cost - Assets should be recorded at the cost when it was purchased, not its current value.

Going Concern - The business is assumed to continue to trade for the foreseeable future and no intention to close down.

7.2 - Accounting policies

Policies
- International Accounting Standard (IAS)
- Comparability
- Relevance
- Reliability
- Understand-ability

Notes by: Vernice