CAT Paper 3 Maintaining Financial Records Flashcards

Run through the **Flashcards** as often as you can during your final revision period. The day before the exam, try to go through the **Flashcards** again. You will be well on your way to passing your exams.

Contents

The Purpose of Financial Reporting

a business has a number of functions the most prominent is to make a profit for the owners.

Profit is the excess of income over expenditure.

Types of Business Entity

- Sole Traders – refers to ownership, sole traders can have employees.
- Partnership – two or more people working together to earn profits.
- Limited Liability Company – owners have liability limited to the amount they pay for their shares. A limited liability company has a separate legal identity from its owners.

Users of Account

- Managers of the company
- Shareholders of the company
- Trade contacts
- Providers of finance to the company
- Taxation authorities
- Employees of the company
- Financial analysts and advisors
- Government and their agencies
- The public

The larger the entity, the greater the interest from various groups of people.

Entity Concept

- The entity is treated as separate from its owners.
- The entity owns the cash invested
- The entity owes this cash to the owner (capital)

Asset

- Something valuable which an entity owns or has use of. Example.
- Factory building, Cash, Inventories

Liability

- Something owed to somebody else
- Bank loan
- Taxation owed to government

Balance Sheet

A list of assets owned by the entity and liabilities owed by the entity on a particular date.

Income Statement

A record of income generated and expenditure incurred over a given period.

The financial Statements are prepared on a accruals basis

Accruals Concept

A sale or purchase is dealt with in the period it is made, even if cash changes hands later than this.

Statement of Financial Position

	$	$	$
Non Current Asset			
Property Plant & Equipment	xxx		
less: Accumulated depreciation	(xxx)	xxx	
Land and Building	xxx		
less: Accumulated depreciation	(xxx)	xxx	
Current Asset			
Closing Inventory	xxx		
A/c Receivable	xxx		
less: Allowance for Rece.	(xxx)		
Cash / Bank	xxx		
Accrued Income	xxx		
Advance Expense	xxx	xxx	xxx
less: Non Current Liabilities			
Bank Loan			(xxx)
less: Current Liabilities			
Bank Overdraft	xxx		
A/c Payable	xxx		
Accrued Expense	xxx		
Advance Income	xxx		(xxx)
**Capital employed / Net Asset / Closing Capital			**xxx**
Capital & Equity			
Opening Capital	xxx		
Add: Net Profit	xxx		
Additional Investment	xxx		xxx
less: Drawings			(xxx)
** Same			**xxx**

Statement of Comprehensive Income

	$	$	$
Sales		xxx	
less: Sales Return		(xxx)	xxx
less: COGS			
Opening Inventory	xx		
Purchases	xx		
Carriage Inwards	xx		
less: Purchase Discount	(xx)	xxx	
less: Closing Inventory		(xxx)	(xxx)
GROSS PROFIT			**xxx**
Add: Discount / Rent Received		xx	
Add: Gain on Sale of NCA		xx	
Decrease in Allowance for Rece.		xx	xxx
			xxx
less: Expense			
Carriage Outwards		xx	
Sales Discount		xx	
Bad Debt		xx	
Increase in Allowance for Rece.		xx	
Provision for Depreciation of NCA		xx	
Loss on Sale of NCA		xx	
Heating and Lighting		xx	
Rent and Insurance		xx	(xxx)
NET PROFIT			**xxx**

Influences upon Financial Accounting

Accounting Standards – IAS/IFRS

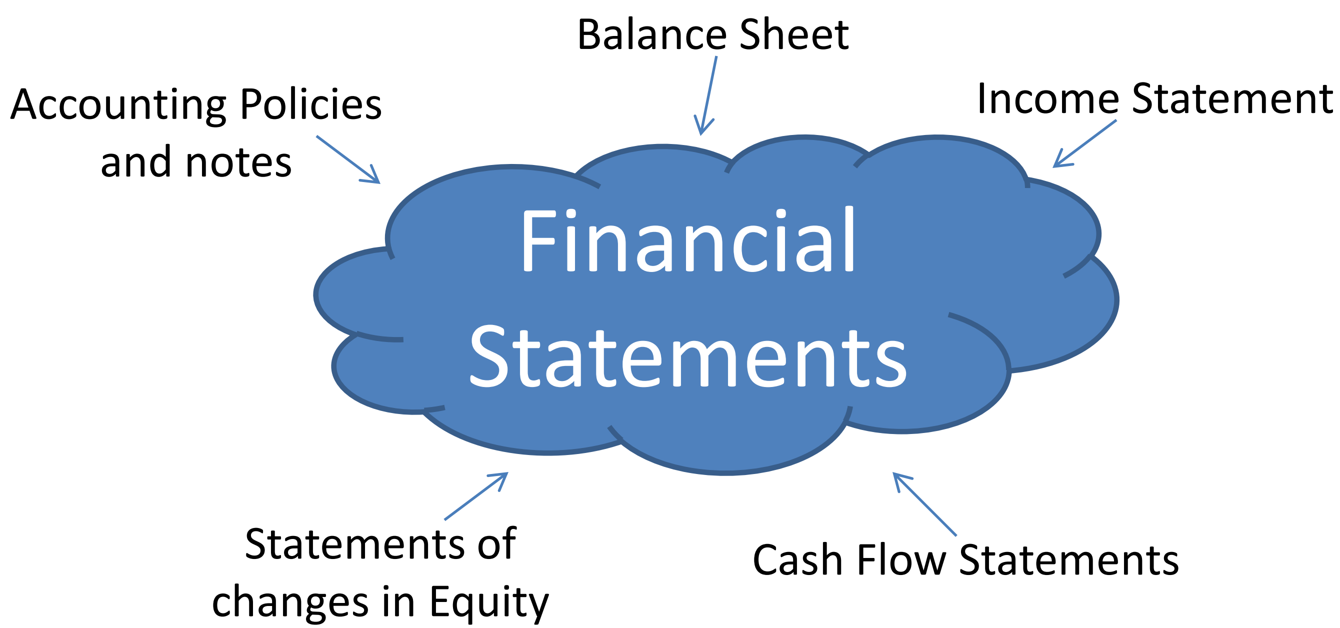
National law

Accounting concepts

Accounting Concepts

- Fair Presentation
- Going Concern
- Accruals or Matching
- Consistency
- Prudence
- Materiality
- Relevance
- Reliability
- Comparability

IAS 1 *Presentation of Financial Statements* considers accounting policies, fundamental assumptions and the format and content of financial statements.



Going Concern	• The entity will continue in operation for the foreseeable future. There is no intention to put the entity into liquidation or to make drastic cutbacks to the scale of the operations.
Accruals	• Revenue and cost be recognized as they are earned or incurred, not as money received or paid. They must be matched with one another so far as the relationship can be established or justifiably assumed and dealt with in i/s in which they were incurred.
Prudence	• The inclusion of a degree of caution in the exercise of judgement, such that assets or income are not overstated and liabilities or expenses are not understated.
Consistency	• The presentation and classification of items should stay the same from one period to the next
Materiality	• Information is material if its omission or misstatements could influence the economic decisions of users.

Good Accounting Information has the following qualities

- Relevance
- Understandability
- Reliability
- Comparability
- Objectivity
- Timeliness
- Completeness

The four principal qualitative characteristics defined by the IASB *Framework* are:

- Relevance
- Reliability
- Understandability
- Comparability

Bases of Valuation

Historical Cost means that transactions are recorded at the cost when they occurred

Net Realizable Value means the estimated selling price less the estimated cost of completion and the estimated cost to make the sales

Replacement Cost means the amount needed to replace the asset with an identical asset.

Economic Value means the amount of the profits an asset is expected to generate during its remaining life.

Source Documents

- Quotation
- Sales order
- Purchase order
- Invoice
- Credit note
- Debit note
- Goods received note

Books of Prime Entry

- The source document are recorded in books of prime entry.

Journal

- Source information that is not contained within books of prime entry.
- Period adjustments
- Correction of errors

Purchase Daybook

Date	Supplier Name	Reference	Amount	Electricity	Widgets
10 July 2006	Electricity Company	PI1	1000	1000	
12 July 2006	Widget Company	PI2	1600		1600
			-------	-------	-------
		Total	2600	1000	1600
			====	====	====
			Credit	**Debit**	**Debit**
			Trade	*Electricity*	*Widgets*
			Creditors	*G/L*	*G/L*
			control a/c	*a/c*	*a/c*

Sales Daybook

Date	Customer Name	Reference	Amount	Parts	Service
2 July 2006	JJ Manufacturing	SI1	2500	2500	
29 July 2006	JJ Manufacturing	SI2	3200		3200
			-------	-------	-------
		Total	5700	2500	3200
			====	====	====
			Debit	**Credit**	**Credit**
			Trade	*Sales*	*Sales*
			debtors	*Parts*	*Service*
			control a/c	alabiebi *a/c*	*a/c*

Cash Book

INCOME

Date	Details	Amount
01.02.06	Balance b/f	11256.00
05.02.06	Deposit	5000.00
	Deposit	100.00
TOTAL		16356.00
	Balance c/f	7986.00

EXPENSES

Date	#	Details	Amount
01.02.06	125	Telephone	50.00
	126	Credit card	1000.00
	127	Chemist	200.00
	128	Salary	300.00
	129	Rent	6000.00
18.02.06		Butcher	300.00
		Bank charge	20.00
		Stop order	500.00
TOTAL			8370.00

Petty Cashbook

Organization's name:								
Petty Cash Book for month:							Reporting	
Date	Reference	Recipie nt	Description	Income	Expenditure	Cash Balance	Documentation attached?	Funder
			Opening Balance					
							Yes/No	
							Yes/No	
							Yes/No	
							Yes/No	
							Yes/No	
							Yes/No	
							Yes/No	
							Yes/No	
							Yes/No	
							Yes/No	
							Yes/No	

Under the Imprest system:

	$
cash still in petty cash	X
plus vouchers payments	X
must equal the agreed sum or float	X

Reimbursement is made equal to the voucher payments to bring the float back up to the imprest amount.

Ledger Accounting is the process by which a business keeps a record of its transactions:

- In chronological order
- Built up in cumulative totals

The Nominal Ledger is an accounting record which summarizes the financial affairs of a business. Accounts within the nominal ledger include the following:

- Plant machinery (non current assets)
- Inventories (current assets)
- Sales (income)
- Rent (expense
- Total payables (current liability

A ledger account or T account looks like this.

Name of Account

DEBIT	$	CREDIT	**$**

The Accounting Equation

CAPITAL + LIABILITIES = ASSETS

Capital:
investments of funds with the intention of earning a return

Drawings:
amounts withdraw from the business by the owner.

The accounting equation is based on the principle that an entity is separate from the owner.

The Business Equation

$$P = I + D + C_i$$

P = profits
I = increase in the entity's net assets over a period
D = drawings
C_i = increase in capital thanks to an injection of funds by the owner

Basic Principles

Double entry bookkeeping is based on the same idea as the accounting equation.

- Every accounting transaction has two equal but opposite effects.
- Equality of assets and liabilities is preserved.

In a system of double entry bookkeeping every accounting event must be entered in ledger accounts both as a debit and as an equal but opposite credit.

Debit

- An increase in an expense
- An increase in an asset
- A decrease in a liability

Credit

- An increase in income
- An increase in an liability
- A decrease in an asset

Double Entry Bookkeeping

The rules of double entry bookkeeping are best learnt by considering the cashbook.

- A *credit entry* indicates a payment made by the business; the matching debit entry is made in an account denoting an expense paid, an asset purchased or a liability settled
- A *debit entry* in the cash book indicates cash received by the business; the matching credit entry is then made in an account denoting revenue received, a liability created or an asset realized

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Trade Accounts Receivable & Payable

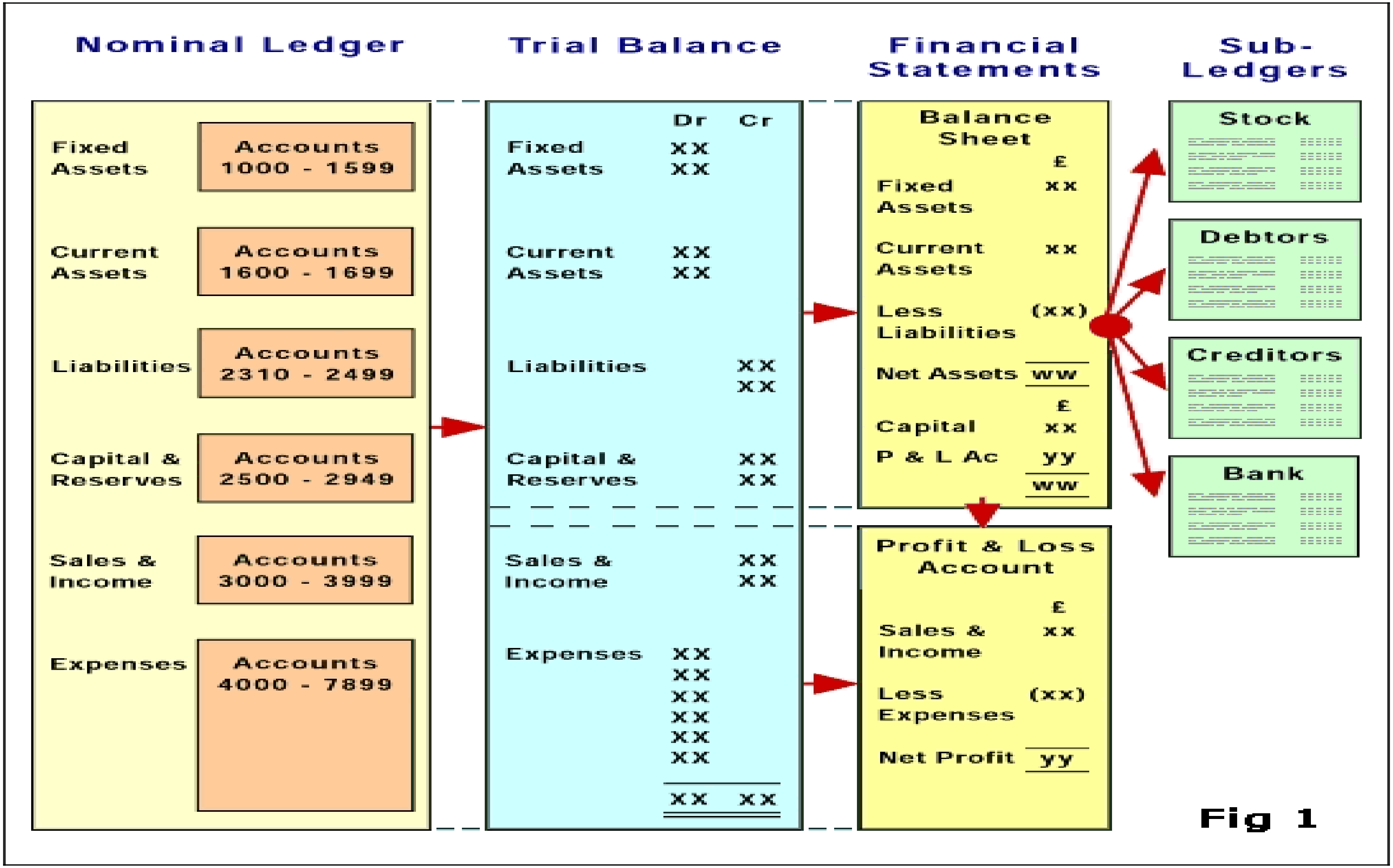
TRADE ACCOUNT RECEIVABLE (debtor)

Customer who buys goods without paying for them straight away(an asset).

TRADE ACCOUNT PAYABLE (creditor)

A person to whom business owes money (a liability).

Accounting Process Overview



Administer by tax authorities

Sales Tax

Is an indirect tax levied on the sale of goods and services.

Can have number of rates.

Output Sales Tax

- Sales tax charged by the business on goods/ services
- Greater than input?, pay difference to tax authorities.

Input Sales Tax

- Sales tax on purchases made by the business
- Greater than output?, refund due to business.

Formula for the cost of goods sold

	$
Opening inventory	XX
add: puchases	XX
	XX
less: closing inventory	(XX)
COGS	XXX

Carriage Inward

- Cost paid by the purchaser of having goods transported to his business
- Added to cost of purchase

Carriage Outward

- Cost to the seller, paid by the seller. Of having goods transported to customer
- Is a selling and distribution expense

Closing Inventories

In order to make the entry for the closing inventory, we need to know what is held at the year end. We find this out not from the accounting records, but by going into the warehouse and actually counting the boxes on the shelves.

Some business keep detailed records of inventory coming in and going out, so as not to have to count everything on the last day of the year. These records are not the part of the double entry system.

Valuing Inventory

Prices

The price used to value an item of inventory might be any of a number of possibilities, e.g. selling price, replacement cost. However we use the lower of the following.

- Cost
- The Net Realizable Value(NRV)

Inventory can be valued in financial accounting on two methods

- FIFO (first in first out)
- AVCO (weighted average cost)
  - Periodic
  - Continuous

IAS 2

- Inventories should be measured at the lower of cost and net realizable value – the comparison between the two should ideally be made separately for each of item.
- Cost is the cost incurred in the normal course of business in bringing the product to its present location and condition, including production overheads and cost of conversion.
- Inventory can include raw materials, work in progress, finished goods, goods purchases for resale.
- FIFO and AVCO are allowed
- LIFO is not allowed

- **Inventories are assets**:
  - Held for sale in the ordinary course of business
  - In the process of production for such sale;
  - In the form of materials or suppliers to be consumed in the production process or the rendering of services.

- **Net Realizable Value** is the estimated selling price in the ordinary course of business less the estimated cost of completion and the estimated cost necessary to make the sales.

Expenditure

Capital expenditures results in the acquisition of non current asset, or an increase in their earning capacity.

Revenue expenditure is incurred for the purpose of trade or to maintain the existing earning capacity of non current assets.

Depreciation

WHAT: The loss in the value of Non Current Asset.

WHY: To allocate the cost of Non Current Asset over its useful life.

WHEN: Every year end when SOFP are prepared or during the year it asset is disposed

Depreciation of the year → Statement of Comprehensive Statement

Accumulated Depreciation → Statement of Financial Position

Methods of Depreciation

Straight Line Method (SLM)

Reducing Balance Method (RDM)

SLM = Cost – Scrap Value / Useful Life of the Asset

RDM = Net Book Value x Depreciation %

Asset Register

ASSET REGISTER

Current Date/Month	
December 29, 2006	
12	

AT MONTH END		December 31, 2006
CUMULATIVE DEPRECIATION		54,583.33
BOOK VALUE		595,416.67
AT COST	650,000.00	12/31/06
MONTHLY DEPN.	3,750.00	12/31/06
DISPOSALS P/L	842,354.17	12/31/06

All Records Count: 3

Change Month End

0 Months

31 December 2006

Vary the month end by adjusting this cell.

The depreciation lif

Enter the asset class numbers into column D.

The asset class des

Reference Number	Register No:	Description	Asset Class Number	Purchase Date	Purchase Cost	Salvage
	1		0			
	2	Dell computer	2	Jan-05	50,000.00	1,000
	3	Goodwill	25	Apr-06	400,000.00	
	4	Intangibles	22	Jun-05	250,000.00	
	5		0			
	6		0			
	7		0			
	8		0			
	9		0			
	10		0			
	11		0			

Introduction / ToolPak / Asset Classes / Asset Register / Cumulative YTD / LookUp / Disposals / Costs / Photo

Capital expenditure:

- Results of acquisition of non-current assets
- Not charged as an expense in the I/S.
- Depreciation charge will usually be made to write-off the capital expenditure gradually over time.
- Depreciation charges are expenses in the I/S.

Revenue expenditure:

- Incurred for purpose of trade or to maintain non-current assets.
- Example: Administration expenses
- Charged as an expense in the I/S.

Accruals:

- Accrued expenses (accruals) are expenses which relate to an accounting period but have not been paid for.
- Shown in the statement of financial position as a liability.

Prepayments:

- Prepaid expenses (prepayments) are expenses which have already been paid but relate to a future accounting period.
- Shown in the statement of financial position as an asset.

Irrecoverable Debts and Receivable Allowance

Is a specific debt which is not expected to be paid.

Writing off irrecoverable debts:

Dr Irrecoverable debts a/c

Cr Receivables a/c

If irrecoverable debts written off and paid later in the same accounting period, the ledger entry

Dr Receivables a/c

Cr Irrecoverable debts recovered a/c

No other adjustment needed.

If irrecoverable debts written off and paid later in the later accounting period, the ledger entry

Dr Receivables a/c

Cr Irrecoverable debts recovered a/c

The amount paid should be recorded as additional income in the statement of comprehensive income.

Is an estimate of the % of debts which are not expect to be paid (General) or may specific.

An increase in the allowance for receivable shown as an expense in the statement of comprehensive income.

A decrease in the allowance for receivable shown as a reduction of expense in the statement of comprehensive income.

Trade receivables in the statement of financial position are shown net off any allowance for receivable.

Control Accounts

Keeps a total record of a number of individual items.

An impersonal a/c.

Two types of control a/c are:

Receivables control account

Payables control account

Reasons for having control a/c:

Check on the accuracy

Location of errors

Internal check

Simple and quick

Receivable Ledger Control A/C

Bal b/f	xx	Sales Return	xx
Cr. Sales	xx	Discount Allowed	xx
Refund	xx	Cash Received	xx
Interest dues from customers	xx	Bad Debts	xx
		Contra Set off	xx
		Bal c/d	xx
	xx		**xx**
Bal b/d	xx		

Payable Ledger Control A/C

Discount Recevied	xx	Bal B/d	xx
Cash Paid	xx	Cr. Purchases	xx
Purchase Return	xx		
Contra Set off	xx		
Bal c/d	xx		
	xx		**xx**
		Bal b/d	xx

Bank Reconciliation

- Is a comparison between a bank statement and cash book.
- Bank statement is a ***mirror image*** of cash book
- Difference between cash book and bank statement arise for 3 reasons:
  - Errors
  - Omission (i.e. bank charges/interest)
  - Timing differences (i.e. unpresented cheque

Bank Reconciliation Statement

	Cash Book	Bank Statement
Bal b/f	xxx / (xxx)	xxx / (xxx)
Bank Charges	xxx	
Standing Order Paid / Received	(xxx) / xxx	
Interest Received / Paid	xxx / (xxx)	
Direct Debit	xxx	
Dishounred Cheques	(xxx)	
Credit Transfer by Us	(xxx)	
Dividends Paid / Received	(xxx) / xxx	
Direct Deposit	xxx	
Unpresented Cheques / Outstanding Cheques		(xxx)
Uncredited Deposits / Outstanding Lodgements / Uncleared Cheques		xxx
Bank Errors		xxx / (xxx)
Adjusted Balance	**xxx**	**xxx**

Correction Of Errors

- There are five main types of errors. Some can be corrected by journal entry, some require the use of a suspense account.
- If the correction involves a double entry in the ledger a/c, then it is done by using a journal entry in the journal.
- When the error breaks the rule of double entry, then it is corrected by the use of a suspense a/c.

- Errors of omission (completely/partly omit)
- Errors of commission (i.e. Gas instead rent)
- Errors of transposition (i.e. 429 as 492)
- Errors of principle (Repair treated as Capital)
- Compensating errors (coincidentally equal and opposite error)

- Errors Revealed by the Trail Balance
- Error of partial omission (single entry)
- Error of Transposition
- Both entries posted to either Dr. or Cr.
- Wrong amount on one entry

Preparation Of Financial Accounts of A Sole Trader

Final Accounts

- Ledger accounts
- Trial balance
- Format of comprehensive income and financial position statements

Adjustments

- Depreciation
- Inventory
- Accruals and Prepayments
- Irrecoverable Debts
- Allowance for Receivables
- Profit / Loss disposals of non current assets.

Incomplete Records

Incomplete records required:

If a trader does not maintain a ledger

If accounting records are destroyed by accident

Approach:

Opening statement of financial position (Capital)

Income and expense a/c (Sales/COGS)

Cash book (Drawings)

Trade receivables a/c (Sales/Cash received)

Trade payables a/c (Purchased, Cash paid)

Expense a/c (Accruals/Prepayments)

Cost of Goods Sold

	$
Op. Inventory Value	**xx**
Purchases	**xx**
less: Closing Inventory	**xx**
COGS	**xx**

Profit percentage
Mark-up
Gross profit margin

Mark-up: % on cost

Cost	= 100%
Gross profit	= X%
Sales price	= (100+X)%

Gross profit margin: % of Sales price

Cost	= (100-X)%
Gross profit	= X%
Sales price	= 100%

Drawings

In case of personal items of receipts (By business):

Dr Cash a/c

Cr Drawings a/c

In case of personal items of payments (By business):

Dr Drawings a/c

Cr Cash a/c

Step By Step Approach For Incomplete Records

Opening Balances

Net Assets = Proprietor's Interest

Set out the following

Statement of Comprehensive Income	Statement of Financial Position

Open "T" Accounts

Cash account	Bank account	Receivables control account	Payables control account

Partnership

- When two or more individuals engage in an enterprise as co-owners, the organization is known as a partnership.
- Profit / (Loss) sharing → Appropriation A/C
- Partnership agreement

Partner's Current A/C

Bal b/f	**xx**	**Bal b/f**	**xx**
Drawings	**xx**	**Interest on Capital**	**xx**
Interest on Drawings	**xx**	**Salary**	**xx**
		Share of Profit	**xx**
Bal c/d	**xx**		
		Bal c/d	**xx**
	xx		**xx**

Partner's Capital A/C

Withdrawal of Capital	xx	Bal b/f	xx
Drawings	xx	Interest on Capital	xx
Interest on Drawings	xx	Salary	xx
		Share of Profit	xx
Bal c/d	xx	Additional Investment	
		Bal c/d	xx
	xx		**xx**

Profit and Loss Appropriation Account

Net Loss as per P & L a/c		xx	Net Profit as per P & L a/c		xx
Interest on Capital			Interest on Drawings		
	A	xx		A	xx
	B	xx		B	xx
Partner's Salary		xx	Share of Loss		
Share of Profit				A	xx
	A	xx		B	xx
	B	xx			
		xx			**xx**

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