

**TIPS and THEORY**

**ACCOUNTING AND FINANCE ATAR YEAR 11**

**Exam Paper Structure:**

**15 Multiple Choice Questions 15 marks 15%**

**4 Practical Questions 108 marks 70%**

**Choice between 2 Extended Answer Questions 25 marks 15%**



**Herewith some points to bear in mind when you work out and answer practical questions**

* **Five Elements of Financial Statements:**

Assets

Liabilities

Equity

Income

Expenses

* **Accounting Equation:** Assets = Liabilities + Equity

also: Equity = Assets - Liabilities

* **General Ledger/General Journal Rules:**

**Assets** Debit Balances

**Expenses** Increase with Debit Entries

**Drawings** Decrease with Credit Entries

**Liabilities** Credit Balances

**Equity**  Increase with Credit Entries

**Income** Decrease with Debit Entries

**General Journals**

* Remember to write the date
* For each transaction, the total debits of the journal must equal the total credits
* Remember to add narrations / journal descriptions
* Sales Journal:

**Dr Accounts Receivable / Cash at Bank (Amount INCL GST)**

**Cr Sales (Amount EXCL GST)**

**Cr GST Payable/Collections**

**Dr Cost of Sales**

**Cr Inventory**

*Credit Sales or Cash Sales*

* Purchase Journal:

**Dr Inventory (Amount EXCL GST)**

**Dr GST Credits/Outlay**

**Cr Accounts Receivable (Amount INCL GST)**

*Purchases on Credit*

**General Ledgers**

* Remember the Dates
* Under “Details”, state the contra account, i.e. where the other leg of the transaction is.
* Balance the account on 30 June.
* Income and Expense Accounts: Do the closing entries on 30 June.

**Financial Reporting**

* Income Statement and Balance Sheet 🡪 Examples in document on Connect
* Answer only what the question asks, e.g. If it only asks for the “Asset section” on Balance Sheet, then only to the Current Assets and Non-Current Assets and show the Total Assets amount.

**Balance Day Adjustments**

**Current Assets:**

* **Prepaid Expenses**

e.g. Prepaid Advertising $40,000

Not used: $4,000 🡪 Listed as a Current Asset on Balance Sheet

Reallocate: $36,000 🡪 Dr Advertising Exp & Cr Prepaid Advertising

* **Accrued Income**

e.g. Interest Accrued 🡪 Dr Accrued Income & Cr Interest Income

🡪List the accrued amount a Current Asset on Balance Sheet

**Current Liabilities**

* **Unearned Income**

e.g. Unearned Income: $75,000

To be delivered: $5,000 🡪 Listed as a Current Liability on Balance Sheet

Reallocate: $70,000 🡪 Dr Unearned Income & Cr Fees

* **Accrued Expenses**

e.g. Accrued Wages 🡪 Dr Wages & Cr Accrued Expenses

🡪 List the accrued amount as a Current Liability on Balance Sheet

**Depreciation**

**ACF 11 Study Tips: Depreciation**

**Straight-line Method (SLM):**

(Cost + Additional Costs incurred – residual value) X number of months

Lifetime in Years12

**Reducing Balance Method (RBM):**

(Cost + Additional Costs incurred – Accumulated Depreciation) X % X number of months

12

* *at school level the percentage for RBM will always be provided!*

**Additional Costs:**

Delivery Costs

Insurance during delivery

Installation Costs

Alterations prior to use

Repairs prior to use

**Journal Entries:**

**Purchase:** Dr the Asset account with the cost of the asset itself

Dr the Asset with each of the modifications, extras or add-ons prior to use 🡪 *Show each of these separately in the Asset account*

Dr GST Credits

Cr Cash at Bank or Loan

**Depreciation:** Dr Depreciation (expense account)

Cr Accumulated Depreciation (negative asset account)

**Sale of Asset Steps:**

1. Transfer Asset to Sale of Asset Account
2. Transfer Accumulated Depreciation to Sale of Asset Account
3. Allocate Money Received for the Asset
4. Transfer the Gain or Loss to the Gain or Loss on Sale of Asset account… always end with a cleared account (no balance)
5. Close off Gain or Loss on Sale of Asset to Profit and Loss Summary account on 30 June

**Sale of Asset Journals:**

1. Transfer Asset out of Asset acc to Sale of Asset account

Dr Sale of Asset

Cr Asset

1. Transfer Accumulated Depreciation to Sale of Asset account

Dr Accumulated Depreciation

Cr Sale of Asset

1. Record the Sale of the Asset

Dr Cash at Bank

Cr Sale of Asset

Cr GST Payable (if applicable)

1. Transfer the Gain or Loss to out of Sale of Asset acc to Gain or Loss on Sale of Asset

**Total Credit entries greater: GAIN 🡪 Dr Sale of Asset**

**Cr Gain on Sale of Asset**

**Total Debit entries greater: LOSS 🡪 Dr Loss on Sale of Asset**

**Cr Sale of Asset**

**Sale of Asset**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Date** | **Cross Reference** | **Amount** | **Date** | **Cross Reference** | **Amount** |
|  | Asset | 1,300 |  | Accum Depreciation | 500 |
|  | **Gain on Sale of Asset** | **100** |  | Cash at Bank | 900 |
|  |  | **1,400** |  |  | **1,400** |
|  |  |  |  |  |  |

**🡪 the Asset was over depreciated causing a GAIN when the asset was sold**

**Sale of Asset**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Date** | **Cross Reference** | **Amount** | **Date** | **Cross Reference** | **Amount** |
|  | Asset | 1,300 |  | Accum Depreciation | 500 |
|  |  |  |  | Cash at Bank | 600 |
|  |  |  |  | **Loss on Sale of Asset** | **200** |
|  |  | **1,300** |  |  | **1,300** |
|  |  |  |  |  |  |

**🡪 the Asset was under depreciated and therefor a LOSS was made during the sale of the asset**

1. On 30 June **close off** **Gain on Sale of Asset** or **Loss on Sale of Asset** account to Profit and Loss Summary account.

**Gain on Sale of Asset**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Date** | **Cross Reference** | **Amount** | **Date** | **Cross Reference** | **Amount** |
|  | Profit and Loss Summary | 100 |  | Sale of Asset | **100** |
|  |  |  |  |  |  |

**Loss on Sale of Asset**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Date** | **Cross Reference** | **Amount** | **Date** | **Cross Reference** | **Amount** |
|  | Sale of Asset | **200** |  | Profit and Loss Summary | 200 |
|  |  |  |  |  |  |

**Note:**

* **Use the correct DATES in the General Jounral and General Ledger**
* **Remember the Journal DESCRIPTIONS when you do Journals!!**

**Allowance for Doubtful Debts**

Trial Balance Extract: Dr Cr

Accounts Receivable $30,000

Allowance for Doubtful Debts $500

Bad Debts $300

Extra Info:

* An additional $100 was written off as Bad Debts on 30 June 2020.
* Allowance for Doubtful Debts needs to be set at 2% of Accounts Receivable

***Steps:***

1. **Write off Bad Debts against Accounts Receivable**
2. **Clear new Bad Debts balance against Allowance for Doubtful Debts**
3. **Adjust Allowance for Doubtful Debts to 2% of new Accounts Receivable balance**

**Journals:**

1. Dr Bad Debts **100**

Cr Accounts Receivable **100**

*Bad Debts written off*

1. Dr Allowance for Doubtful Debts **400**

Cr Bad Debts **400**

*Transfer Bad Debts to Allowance for Doubtful Debts*

1. Dr Doubtful Debts **498**

Cr Allowance for Doubtful Debts **498**

*Adjust Allowance for Doubtful Debts*

***($29,900 x 2% => $598Cr Balance needed)***

**General Ledger:**

**Accounts Receivable**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Date | Contra Account | Dr | Date | Contra Account | Cr |
| 2020  Jun 30 | Balance b/f | 30,000 | 2020  Jun 30 | **Bad Debts** | **100** |
|  |  |  |  | Balance c/f | 29,900 |
|  |  | 30,000 |  |  | 30,000 |
|  | Balance b/f | **29,900** |  |  |  |

**Bad Debts**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Date | Contra Account | Dr | Date | Contra Account | Cr |
| 2020  Jun 30 | Balance b/f | 300 | 2020  Jun 30 | **Allowance for Doubtful Debts** | **400** |
|  | **Accounts Receivable** | **100** |  |  |  |
|  |  | 400 |  |  | 400 |

**Allowance for Doubtful Debts**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Date | Contra Account | Dr | Date | Contra Account | Cr |
| 2020  Jun 30 | **Bad Debts** | **400** | 2020  Jun 30 | **Balance b/f** | **500** |
|  | **Balance c/f** | **598** |  | **Doubtful Debts** | **498** |
|  |  | 998 |  |  | 998 |
|  |  |  | 30 | **Balance b/f** | **598** |

**Doubtful Debts**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Date | Contra Account | Dr | Date | Contra Account | Cr |
| 2020  Jun 30 | **Allowance for Doubtful Debts** | **498** | 2020  Jun 30 | Profit and Loss Summary | 498 |
|  |  | 498 |  |  | 498 |

**UNIT 1 – Theory**

|  |
| --- |
| * **Characteristics of the main types of small business ownership**     **Advantages and disadvantages of the main types of small business ownership**  **Sole trader**  A sole trader is the simplest form of business structure and is relatively easy and inexpensive to set up. As a sole trader you will be legally responsible for all aspects of the business. You’ll generally make all the decisions about starting and running your business and you can employ people.   * **Sole trader - Advantages** * Simple to set up and operate. * You retain complete control of your assets and business decisions. * Fewer reporting requirements. * Any losses incurred by your business activities may be offset against other income, such as your investment income or wages (subject to certain conditions). * Allows you to use your individual tax file number (TFN) to lodge tax returns. * You are not considered an employee of your own business and therefore don’t pay payroll tax, superannuation or workers’ compensation on income you draw from the business. * Relatively easy to change business structure if your business grows or if you wish to wind things up * **Sole trader - Disadvantages** * A partnership is not a separate legal entity. Each partner is fully responsible for debts and liabilities incurred on behalf of the business by other partners – with or without their knowledge. * Potential for disputes over profit sharing, administrative control and business direction. * Changes of ownership can be difficult and generally requires a new partnership to be established.   **Partnerships**  A partnership involves two or more people (up to 20, with some exceptions) going into business together with a view to making a profit. In Western Australia, partnerships are governed by the [*Partnership Act 1895*.](http://www.slp.wa.gov.au/legislation/statutes.nsf/main_mrtitle_680_homepage.html)  A limited partnership is one formed by up to 20 people. It has at least one general partner who controls the company’s day-to-day operations and is personally liable for business debts, and passive partners called limited partners.  Mutual agency applies in partnerships (but not other forms of business).  The partners get a share of total profits according to the Partnership Agreement or Act.   * **Partnership - Advantages** * Simple and inexpensive to set up. * Minimal reporting requirements. * Shared control and management with other partners. * A partner’s share of the [business’s tax losses](https://www.ato.gov.au/business/non-commercial-losses/partnerships/) may be offset against other personal income, subject to certain conditions. * More opportunities for tax planning (such as income splitting between family members) than that of a sole trader. * Relatively easy to dissolve the partnership or to resign and recover your share. * Partners are not employees. Superannuation contributions and workers’ compensation insurance are not payable for partners. * **Partnership - Disadvantages** * A partnership is not a separate legal entity. Each partner is fully responsible for debts and liabilities incurred on behalf of the business by other partners – with or without their knowledge. * Potential for disputes over profit sharing, administrative control and business direction. * Changes of ownership can be difficult and generally requires a new partnership to be established.   **A small proprietary company**   * The total gross assets of the company must be less than 25 million dollars and/or it must have less than 100 employees and/or the total revenue of the company must be less than 50 million dollars. * The company is a separate legal entity in that the company itself is recognized as an artificial person with rights and obligations like an individual in business. Therefore, the company can sue, be sued, own property and enter contracts in its own name. * Companies have separate ownership to their management. The shareholders who are the part owners of the company do not manage the day-to-day operations of the company, directors do. * Shareholders can only get a share of the profits in the form of dividends if declared by directors. The amount of dividends is also subject to the shareholder’s investment in the company ie the number of shares they hold. * **Company - Advantages** * Advantages can include: * The liability of shareholders is limited to the share capital they have subscribed and any debts which they may have personally guaranteed. * Shareholders and directors can be employed by the company under normal salary and wage conditions and their income taxed at personal rates * Shareholder's personal assets are not under threat if the company incurs financial loss and debts, it is separate and distinct from the company’s name. This is because a company is an artificial person created in law that enables it to carry out business transactions in its own name, purchase or sell assets, invest assets and create debts in its own name too. This is due to the separate legal entity concept which protects shareholders from any company liability provided the shareholder has paid up all of its shares before the debt was incurred by the company. * Company taxation is at a fixed rate. A company's income tax is calculated as a percentage of the taxable income earned by the company during the financial year. The current rate is 30 percent. * Compared with other business structures, the transfer of company ownership can be relatively simple. The company does not have to be wound up in the event of the death, disability or retirement of any on the persons involved. * **Company - Disadvantages** * Forming a proprietary company can be a complicated task and with the level of legal paperwork required, can take up to six weeks. * There are greater regulations to adhere to under the Corporations Act and through the Australian Securities and Investment Commission. * Increased record-keeping is required.   **Different types and characteristics of business undertakings**  Three main types of small businesses are:  **1. Manufacturing** (making products) eg. Making toys.  **2. Trading** (selling already made products) This includes  + **retail**, a business that sells to the public. eg. Newsagent or supermarket.  + **wholesale**, a business that purchases products from the manufacturer and sells this to the retailer.  **3. Service** (selling a service) eg. Hairdresser, bricklayer.    **Legislation relating to the formation of sole traders and partnership, including:**   * The Partnership Act 1895 (WA)regulates the conduct of a partnership if there is no partnership agreement or if the agreement does not cover one or more of the items set out in the Act. **(1)**  The Act does not provide for partnership salaries, interest on drawings or interest on capital. Other legal requirements include number of owners, registration of business name, GST registration, licenses and permits relevant to the business. * The GST Act 1999 (WA) sets out when and how the GST arises, and who is liable to pay it; when and how input tax credits arise, and who is entitled to them; how to work out payments and refunds of GST; GST exemptions and special circumstances. The goods and services tax adds 10% to the cost goods and services in Australia, except those that are specifically exempt. Suppliers collect the 10% tax on the sales price of goods and services on behalf of the government. In turn they receive a credit, or refund, for GST paid on goods and services used in their business. * The Business Names Registration Act 2011 (CTH)sets out how and when a business needs to register for a business name   The impact of GST legal requirements on small businesses, including:  Registering for GST  You must register for GST with the ATO generally when your business or enterprise has a GST turnover (gross income minus GST) of $75,000 or more. GST is reported on the BAS and is a federal tax. Businesses that carry on an enterprise and sell a taxable supply that attracts GST with a turnover of over $75,000, must register for GST.  Once registered for GST, the 10% GST must be stated on every invoice issued by the business. At the end of each period, the business will need to complete a Business Activity Statement (BAS) that details the company’s income, GST collection and credits as well as other information for the Australian Taxation Office (ATO). At the end of the year a reconciliation of GST needs to be made when the company’s income statement is prepared to ensure any additional GST outstanding is paid or refund expected.  Failure to administer the GST will result in hefty penalties depending upon the size of the business and frequency of the penalties. Deliberate evasion of GST can incur imprisonment. It is an obligation of all businesses to pay correct taxes to avoid penalties and potential damaged reputation and business sales.  Australian Business Number (ABN)  If you want to carry on a business under a business name (other than your individual name), you will generally need to register the business name. To register a business name, you must complete an online application and lodge it with ASIC.  The concept of bankruptcy as defined by the *Bankruptcy Act 1966* (WA)  *Bankruptcy* is a legal process where an individual is declared unable to pay their debts   * Can petition for voluntary bankruptcy or involuntary bankruptcy where a creditor applies to the courts to have a person made bankrupt * Once bankrupt a trustee is appointed to manage the bankruptcy * Once a person becomes bankrupt their business and personal assets will be sold to repay their debts * Bankrupts can enter into a debt arrangement to pay off less than the amounts owing to creditors or enter into an agreement to pay off amounts owing in instalments * Bankruptcy lasts for 3 years and 1 day.   Principles and features of the GST, including:  taxable supplies, GST-free supplies and input taxed supplies  A taxable supply is defined very widely to include the selling price of goods and services to further an enterprise. It is connected to Australia and is for consideration. There are two types of products exempt from GST: GST free supplies and input taxed supplies.  GST free supplies include: fresh food, education, child care services, water  Input taxed supples include: residential rent, bank fees and loan interest.  Accounting and reporting for the GST, including the business activity statement BAS  The BAS is a form that must be lodged monthly, quarterly or annually with the ATO to report a business’s GST credits/payable and other tax obligations and to calculate the amount of GST owed or the GST refund due. |
| **Stock Taking -** physical counting of inventory at the end of a period  **Principles of the Perpetual Inventory system**   * In the perpetual inventory method, the inventory account is continually updated by a computerised system. * Sales are recorded in a sales account. * The cost of goods sold is transferred to the cost of sales account at the same time the sale is recorded. * Purchases of inventory are recorded in an inventory account.   **Benefits of the Perpetual Inventory system**   * Gross profit can be calculated easily at any time by the computer software, because the cost of sales is readily available as an account in the general ledger which is continuously updated. * Inventory balances are readily available because they are updated with every sale and purchase made, allowing the business to determine its fast- and slow-moving lines. * A physical stock take is only required to check computer data with what is on the floor and fast- or slow-moving lines are available at any time without a stock take because inventory is continuously updated after each transaction sale or purchase.   **Principles of the Periodic Inventory System**   * A manual system, a physical stocktake is required to determine opening and closing inventory and therefore cost of sales and the calculation of gross profit. * In the periodic method inventory movements need to be identified with a physical count. Physical stock takes in a periodic system are essential to determine closing stock, fast- or slow-moving lines * The possibility of running out of stock exists as inventory on hand is not always known. * The cost of sales is calculated by using the formula Opening Inventory + Purchases – closing inventory. |
| **The Accounting Cycle**   1. Documenting events – eg. transactions as seen on a tax invoice (a source document) 2. Recording events – eg. recorded as a general journal 3. Processing events – eg. recorded as a general ledger, then trial balance, then adjusting entries 4. Report to people – eg. as income statement and balance sheet   **Purpose of the trial balance**  The purpose of a trial balance is to confirm that the total of all debit ledger accounts equals the total of all credit ledger accounts, that is, double entry. It also ensures that the reports from which the final account balances are used provide accurate financial information for the assessment of the business’s financial performance, stability and liquidity. Users who rely on accurate financial information are dependent upon recording systems be accurate and preparing a Trial Balance provides an internal control tool for accurate reporting.  **Errors detected through the Trial Balance:**   1. Omitting a debit or credit entry, e.g. only recording the figure in one account and forgetting to enter it in the other account. 2. A transposing error, e.g. if you enter $964 as the debit amount in one account and $946 as the credit amount in another account. 3. Incorrectly record an amount in both accounts as a debit or in both accounts as a credit. 4. Incorrectly adding up the totals of the debit and credit sides of the Trial Balance.   **Errors not detected through the Trial Balance:**   1. The incorrect amount was entered in both accounts, i.e. the debit and credit entries were both incorrect. 2. The transaction was recorded more than once. 3. A transaction was left out. 4. The transaction was recorded in the wrong account, e.g. Electricity expenses was incorrectly allocated to Telephone expenses. |
| **Closing entries**   * + Close off Income and Expense accounts to determine whether the company has made a profit or a loss   + Close off Income and Expense accounts to zero balances at the end of the year to start with zero at the beginning of the new financial year for comparison purposes   + Transfer profit or loss to Capital account to bring Equity up to date   + Close off Drawings account to Capital account to bring Equity up to date   **Sources of finance, other than equity, available to small businesses**   * term loan – loans available from a financial institutions (e.g. a bank) for either a short-term or long-term  advantages: interest rates may be fixed (making it possible to forecast repayments), interest paid on loan is a tax deduction   disadvantages: interest paid on the loan, security over assets may be required for larger amounts, lack of flexibility over some loans, higher rate of interest may be charged if loan is not secured over assets, may require a personal guarantee for a business start-up   * mortgage – A long term source of finance where amounts are borrowed from a financial institution with a set rate of interest and a set maturity date and are secured against property. It is used to purchase land and buildings advantages: interest paid on the mortgage is a tax deduction, interest rates may be lower than term loans as a mortgage is usually longer disadvantages: mortgage is secured over the property * lease – the business is able to hire and use a non-current asset over a period of time and then possibly purchase at the expiration of the lease advantages: less cash required upfront to obtain assets, lease repayments are known and fixed, can keep upgrading as new assets are available, easy to obtain disadvantages: need to continue to make repayments over the term of the lease, often cannot be terminated before the term of lease is over, total cost of lease may exceed original cost of asset, equipment purchased at end may be old, do not have ownership of the asset (only control) * overdraft – facility for businesses to keep withdrawing funds to an authorised limit from the cash account of the business when the balance reaches zero  advantages: flexible (only used when needed), interest charges when in overdraft, application process may be easier than a loan or mortgage, may not require security over non-current assets disadvantages: interest rates may be higher, not recommended for long-term finance * loans from family and friends   advantages: may be able to negotiate terms to pay little or no interest, can be arranged quickly disadvantages: may risk personal relationships if not able to pay back   * crowdfunding – usually involves using social media or crowdfunding websites to obtain funding from a large number of people by the idea or reason for the required funding   advantages: depending on setup of funding may not need to be paid back, can seek funding from large groups of people disadvantages: may need to supply those providing funding with a sample product/service, not guaranteed to raise the amount required and/or in time required   * Trade credit- A short term source of finance used to buy goods on credit, allowing payment at an agreed later date. It is used to purchase inventory/goods/stock from suppliers on credit. * Bank overdraft -A short term source of finance where the bank allows the business to overdraw their bank account to an agreed limit. Used to purchase inventory or provide working capital or overcome seasonal fluctuations.   **RISK - banks and other financial institutions will need to determine the risk of a lender being able to repay the debt commitments as and when they fall due. To do this they will examine the following:**   * + What assets the business can provide to a financial institution as **security or collateral** in case the business cannot repay a debt.   + How **liquid** the business assets are (how easily they can be converted into cash) and how much cash they have available after all costs of running the business have been taken into account.   + What is the credit **history** of the lender, how long has the business been in operation, have debts been paid in time?   + Are there **guarantors** willing to repay the debt if the owner is unable to make the debt commitments personally   **RETURN - Banks will also factor into their decision the potential return on the investment**   * + The **interest** rate charged on the investment will reflect the level of risk involved   + The bank may be willing to consider a higher risk investment if they perceive a beneficial relationship and growth with **future business** potential |
| **Purpose of financial statements, including:**  **Financial Performance (Income Statement is the Statement of Financial Performance)**   * The ability of the entity to utilise its assets effectively and efficiently. * What are the business goals (i.e. profit/not for profit)? * The statement is heavily relied upon by business owners, investors and creditors to see if profit is being made. * The statement also provides information to carry out financial analysis using ratios to assess profitability of the business over a period of time to determine trends and predictable outcomes for the business.   **Financial Position (Balance Sheet is the Statement of Financial Position)**   * The financial resources controlled by the entity * illustrates the assets, liabilities and equity of a business and the financial stability of the business by comparing the total assets with total liabilities at a particular point in time. * The statement is heavily relied upon by business owners, investors and creditors of the claims that can be made upon the assets of the business should the business face financial instability. * The statement also provides information to carry out financial analysis using ratios to assess liquidity and leverage of the business over a period of time to determine trends and predictable outcomes for the business. * This is important for deciding continued investment in the business and the business as a going concern.   **Liquidity**   * Measure of liquidity and solvency * Adequate cash flow to pay the interest and other fees at regular due dates * Scrutiny of the entity’s other short-term obligations and expected cash flows   **Financial statements**   * Financial statements provide information that will be useful to users such as owners, investors, creditors, analysts, employees, regulators and others in making and evaluating decisions about the allocation of scarce economic resources. * The Balance Sheet presents the financial position and allows assessments about liquidity. * The Income Statement allows assessment of its financial performance or profitability.   **Accepted accounting principles and conventions:**   * **Accounting entity** – business transactions are recorded separately from the owner as the business is considered as a separate entity from its owner(s) and all other firms * **Monetary assumption** – all transactions in accounting are recorded in the currency of the country in which the records and reports are kept * **Historical cost** – assets recorded in an accounting system at the purchase cost at the time of acquisition, not altered for current market value * **Going concern** – reports are prepared on the assumption that an entity is continuing to operate in the foreseeable future * **Accounting period** – the life of a business is divided into arbitrary time periods so financial statements can be prepared to determine the profit or loss * **Materiality** – information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial report   **Accounting entity v Legal entity:**  Accounting Entity – the accounting entity is a recording principle of recording business transactions separately from the owner’s private transactions The business must record transactions from the point of view of the business and not the owner so that the financial reports reflect the financial state of the business whereas  Legal Entity – the legal entity principle relates to the structure of the business in determining who is responsible for the debts of the business. All entities except for companies do not have separate legal entity which means the owner is not separate from the business and there is responsible for all debts accumulated in the business. This is not the case with a company because it has separate legal entity created in law. The owners and management are totally separate. |
| **Costs and benefits for small business of engaging in socially, environmentally and ethically responsible behaviour, including:**   * + sponsorship – corporate **sponsorship** is a form of advertising in which companies pay to be associated with certain events. When the sponsorship of a non-profit or charitable event is involved, the sponsorship activity is often referred to as event marketing or cause marketing.   + resource conservation – **Packaging**: reduce, re-use, recycle & **Waste Disposal**: maintain and update manufacturing equipment   + taxation responsibility: Businesses need to fill out their **tax returns honestly** as their taxes contribute to society and the goodwill of the community.   **Benefits of Corporate Social Responsibility (CSR) include:**   * It may result in increased customer loyalty or new customers, therefore, increased sales. * It may result in lower employee turnover, which will decrease recruitment costs and staff training costs. * It improves all round business credibility because of greater transparency. * It assists the business in complying with some government regulation requirements. * It benefits the business’ reputation through positive media coverage. * It enhances staff morale due to greater motivation and productivity. * It provides a licence to continue operating the entity’s business in the community. * CSR can reduce costs for the company by finding alternatives that are cost effective in the long term. * CSR can raise the profile of the company as a good corporate citizen which can attract investment and increase market share. * CSR can attract loyal employees who have the same values as the company and who will enforce the company’s CSR policies and procedures.   **Costs/Challenges of Corporate Social Responsibility (CSR) include:**   * Lack of finance. * Lack of knowledge in the area to set up systems and processes. * Lack of resources (i.e. staff, time, electricity, paper etc). * Sourcing environmentally friendly products can be difficult and expensive. * Having to train employees in new ways can be a burden. |
| **Definition of Internal Control**  Those **internal business measures** that **ensure efficient management** of business and assist in **achieving their goals or objectives.** Measures would depend on the size and complexity of the business with the aim to:   * Protect the **assets** of the business * Ensure the business is **operating efficiently** * Check accuracy and reliability of **accounting data** * Encourage **employees** to follow rules and procedures.   **Principles of internal control**   * Segregation of duties: the handling of cash should be separated from the recording of cash. * Security of assets and records: the cash registered should be locked, cleared at regular intervals during the day and all cash banked daily. Restrict employee access to cash. * Verification and checking processes: Senior employees should verify and check invoices and purchase orders etc to cash payments to suppliers/ cash receipts from customers. * Authorization: All payments should be approved by a senior employee * Reporting and Documentation: All payments should be made by cheque. * Training and hiring staff: Do Police clearance checks and conduct proper reference checks on staff who handle cash, make sure that they are trained on company policies. * Any other reasonable response   **CASH**   * Segregation of duties where the person handling the cash is not the same person responsible for recording/reporting. * Appropriate security of cash and records such as the cash register being bolted to the counter and cash being banked daily. * Installation of mechanical and electronic devices to monitor the safe movement and storage of cash. * Adequate recording and documentation systems such as petty cash, bank reconciliation, and cash budgeting. * Installation of verification and checking processes such as internal auditing to check for fraud, theft and human error. * Employment of competent and reliable staff who are appropriately checked and trained to reduce the likelihood of fraud theft and error. * Established lines of responsibility so all staff understand who has access to cash and who is able to authorise and verify cash transactions.   **ACCOUNTS RECEIVABLE**   * Each customer has a satisfactory credit rating * Credit approval policy must be in place; credit checks done regularly * Goods cannot be dispatched without a properly authorised sales order * Monthly statements for outstanding balances reviewed by the owner and mailed by the owner or responsible employee other than the bookkeeper * An aging schedule of customers' accounts prepared monthly * Write-offs and other adjustments to customer accounts authorised by the owner   **ACCOUNTS PAYABLE**   * Communicate to supplier/creditor if business might have difficulty in meeting payment deadline * Supplier invoices must be matched with applicable purchasing orders * Ensure all available discounts are taken * Written evidence that invoices have been properly processed before payment, e.g. stamped * Those who work Accounts Payable should not handle cash or inventories (segregation of duties)   **INVENTORY**   * The purchasing of inventory (books) is not done by the person in charge of the inventory store. * A designated officer is given the task of monitoring inventory levels. * All inventory is barcoded and scanned in and out of the store. * Use of the perpetual inventory system to help monitor slow and fast moving items. * The business only purchases from an approved supplier list. * Adequate insurance over stock is maintained. * Stocktakes are completed at least once a year to detect theft and check any damage to stock * Purchase order forms are in use. * Installing cameras and regular stock security patrols can prevent theft, deliberate or accidental damage to inventory.   **NON-CURRENT ASSETS**   * Non-current asset registers are used. * Adequate insurance over non-current assets is maintained. * Approving the purchase of non-current assets is not done by the person who makes the payments for their purchase. * All non-current assets are engraved, tagged or barcoded with the business name and an identification number. * Periodic physical checking of all non-current assets is made and compared to the details on asset registers. * The purchasing of non-current assets is approved by an authorised person.   **Limitations of internal control** (explain in full sentences)   * Collusion. Collusion is a deliberate act between employees to steal from the business. It is difficult to control collusion between employees who conspire to steal valuable inventory. Even the best employed staff with a good track record can succumb to temptation to steal inventory by covering steps to avoid detection. Such practices are difficult to trace and sometimes may go on for long periods of time before anomalies appear that require attention. * Staff shortages. Inability to recruit required employees. Even if an appropriate software system is installed, not having enough staff to handle inventory in and out of the business can make inventory vulnerable to theft. If there isn’t enough staff to do physical stock takes to check computer accuracy then it will result in damage and shrinkage of inventory. Not enough staff on the floor to service customers can result in lost sales which contributes to obsolete stock because they are not being sold. * Liquidity issues. Lack of cash when required. Inability to buy equipment such as cameras, security guards, security equipment can make it difficult to safe-guard inventory. Inventory control processes will be inadequate if cash is limited to install required control systems that will make inventory vulnerable to damage, theft and shrinkage. * Human error exists * Needs to be cost effective * Employees can conspire to commit fraud * Smaller business may not have enough staff to segregate duties * Reviews are required to check control procedures are effective |

**UNIT 2 - Theory**

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| **Accrual basis of accounting** as per the *Conceptual Framework for the Preparation and Presentation of Financial Statements (the Conceptual Framework)*  **The distinction between cash and accrual methods of accounting**  **Accrual Accounting**  The accrual basis is explained in The Framework:   * The effects of transactions and other events are recognised when they occur (and not as cash or its equivalent is received or paid) * They are recorded in the accounting records and reported in the financial reports of the periods to which they relate. * This system is more useful to decision makers - it brings to account all assets and liabilities of the entity * The accrual not only records all past transactions involving cash receipts and payments but also future obligations to pay money or those amounts owed to the entity * Income is recognised when it is earned – that is the inflow of economic benefits can be reliably measured * Expenses are recognised when they are incurred – that is the loss or consumption of goods or services can be reliably measured   **Cash Accounting**   * Income is recorded when the cash is received * Expenses are recorded when the cash is paid * It does not record transactions where goods or services are performed on credit * The period in which the income is earned or the expense is incurred is not taken into account * It is most suitable for small businesses which conduct most transactions on cash and which have a sole owner   **Definition, as per the *Conceptual Framework,* of**:   * + assets   + liabilities   + equity   + income   + expenses   **Recognition criteria as per the *Conceptual Framework*, of:**  **Assets**  Definition: An asset is a present economic resource controlled by the entity as a result of past events.  Recognition:An asset is recognised only if it provides users of financial statements with information that is useful. The information needs to be relevant which is capable of making a difference in the decisions made by users. It must be certain that the asset exists and probable that an inflow of economic benefit will flow to the entity. The information must also be faithfully represented where it is complete, neutral and free from bias.  **Liabilities**  Definition: A liability is a present obligation of the entity to transfer an economic resource as a result of past events.  **Owner’s Equity:** the amount of money owed by the business to the owner of the business. Equity is defined as ‘the residual interest in the assets of the entity after deducting all the liabilities.’  Assets - Liabilities = Equity  *Example:* John is the owner of a business. The business has Assets of $20,000 and Liabilities of $5,000; therefore, John’s equity in the business is $15,000.  **Income:**  Definition: ‘Increase in assets, or decreases in liabilities, that result in increases in equity, other than those relating to contributions from holders of equity claims.’, e.g. money received by the business from a sale of goods or for providing a service.  The recognition of income occurs at the same time as:   * the initial recognition of an asset, or an increase in the carrying amount of an asset; or * the derecognition of a liability, or a decrease in the carrying amount of a liability.   **Expenses:**  Definition: ‘Decreases in assets, or increases in liabilities, that result in decreases in equity, other than those relating to distributions to holders of equity claims’,e.g. wages, telephone, electricity, rent.  The recognition of expense occurs at the same time as:   * the initial recognition of an liability, or an increase in the carrying amount of a liability; or * the derecognition of an asset, or a decrease in the carrying amount of an asset. |
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| **Purpose and nature of balance day adjustments**  🡪 To ensure that income and expenses in the income statement get reflected accurately and do not get overstated or understated resulting in the profit being overstated or understated.  🡪 Also to ensure thata assets and liabilities get accurately reflected in the balance sheet and are not overstated or understated resulting in an incorrect equity figure.  **Depreciation**  A depreciable non-current asset is one that suffers wear and tear, technical or commercial obsolescence. These are man-made physical assets that do not last long and consequently have an estimated useful life to the business. At the end of its useful life, the asset may have some residual value left that can be sold which is also estimated. The depreciable asset is purchased to earn the business income when it is put to use either directly or indirectly depending upon the asset.   * Depreciation is the allocation as an expense during each accounting period, of the depreciable amount of an asset, over its useful life. * Depreciation is an expense account that represents the historical cost used up in an accounting period. * Depreciation is a book entry in an accounting system that does not involve a cash inflow or cash outflow. This entry does not set aside cash for the replacement of an asset. * Depreciation is a process of expense allocation not asset valuation. The process is not intended to arrive at the current market value of a depreciable asset. * Depreciation illustrates the portion of the asset that has been used in earning the business income, it adjusts the balance sheet to prevent overstating the total value of assets by representing the carrying value left after depreciation is applied. * Depreciation is a cost allocation process of apportioning the historical cost of a depreciable asset over its useful life. This is then represented in profit calculation to ensure profits are not over estimated. * Depreciation accounts for wear and tear, technical obsolescence and commercial obsolescence. It is calculated at the end of each financial year to represent the year’s use of the asset. * The depreciation expense account is transferred to profit and loss as that portion of the historical cost that has contributed to earning income for the period.   **Causes of Depreciation**   * Wear and tear: the decline of an asset due to use * Technical obsolescence: the asset is redundant due to new technology causing it to no longer be useful * Commercial obsolescence: the asset is redundant due to a declining demand for the goods and services that the asset was used to produce   **Differences between Straight-line Method and Reducing Balance Method:**   * SLM records the same amount of depreciation in each full year, whereas the RBM records more in the earlier years of the assets life. * SLM is more appropriate when the asset earns income evenly over its useful life,whereas the RBM is more appropriate for assets that generate a higher level of income in its earlier years. |
| **Concept of inventory costing methods**  **First-in-first-out Method (FIFO)**   * Under this method it is assumed that the inventory sold at any time will be the inventory that was first purchased. * The amount transferred out of the inventory account to the Cost of Sales account will be the cost of those “oldest” units in stock. * This method is often used with inventory subject to obsolesce or use by dates, agricultural and horticultural products on a seasonal basis and with products such as petrol, which responds to fluctuations in world markets. FIFO might give a higher short term Cost of Sales (and lower profit and income tax). In the long run it does not make a difference as short term differences get cancelled out.   **Weighted Average Method**   * Under this method the total cost of inventory at any time is divided by the number of units in stock at that time to get an average unit cost. * The amount transferred out of the inventory account to the Cost of Sales account will be the number of units sold times the average cost. * This method is beneficial in the short term when inventory prices are rising which is normally the case with most manufactured goods. The weighted average method will result in a higher Cost of Sales amount and hence a lower profit and lower income tax. |
| **Preparation and interpretation of the following ratios to evaluate the profitability and stability of a business:**   * ***All expressed as percentages***   + **profitability ratios:** (measure against business’s goals, previous years and industry average; 3 years needed for a trend) * **profit** * **gross profit** * **expense** * **rate of return on assets**   + **liquidity ratios:** (measure cash available to meet business commitments) * **current assets** (ideal: 200%)   200% and over: business able to meet short term obligations as they fall due and have access  100% – 200%: business should be able to meet short term obligations as they fall due  Less than 100%: business will struggle to pay off short term debts when they fall due   * **quick asset** (ideal: 100%)   100% – 200%: business should be able to meet short term obligations as they fall due  Less than 100%: business will struggle to pay off short term debts when they fall due   * + **stability/leverage ratio:** * **debt to equity**   ideal: less than 70% for small businesses |
| **The role of the professional accounting and financial associations, including:**  Promotion and enhancement of the role of the accountant.  **CPA Australia**  CPA has a broad focus on general accounting and business management and highly suitable for members who want to work primarily in the ASIA Pacific Region.   * Education and Training * Technical support for members * Advocacy * Represent the profession   **Chartered Accountants Australia and New Zealand**  CAANZ has focus on technical aspects of accounting and complex tax issues and it is highly suited for members who want to work across the global. They focus on specific areas of finance, in-depth analysis and advising and compliance with ASIC.   * Advocacy and leadership * Influence policy * Act in the public interest * Educating candidates and members   **Institute of Public Accountants (IPA)**   * Support member needs * Provide education * Lobby on legislative issues * Products and services for members   **Financial Planning Association of Australia (FPA)**  The association represents the financial interests of the general public. The main focus is on wealth creation and management of financial affairs to meet life goals for the individual.   * Represent the interest of the public * Represent Australia’s professional community of financial planners * Lobby government and regulators * Set and maintain professional standards * Certify members * Provide professional development   **The nature and purpose of the professional codes of conduct for members of professional associations include:**   * Codes of conduct for accountants are written guidelines for ethical behaviour expected from members of professional organisations such as CPA Australia and ICAANZ. * These guidelines cover fundamental principles such as integrity; objectivity; professional competence; confidentiality; and professional behaviour. * Breach of these principles can result in disciplinary action taken by the professional body against the member. * The purpose of the codes of conduct is to: * Build confidence by the public and clients in the services offered by accountants in the community. * Enhances reputation of association. * Provides guidelines for members. * Enhances client confidence and trust. * Ensure high standards of professional behaviour.   **Government and the community: The influence of social, environmental and ethical factors**  the nature and purpose of the professional codes of conduct for members of professional accounting service providers’ associations   * **Integrity -** which means being honest in dealings with clients * **Objectivity -** to provide non bias advice to clients * **Confidentiality -** client information needs to be kept confidential without disclosure to anyone else outside the firm * **Professional behaviour -** conduct must always be of a nature to ensure a high reputation of the business and the individual * **Professional competence and duty of care -** carrying out accounting duties with competence and being highly skilled within areas of responsibility to the client |
| **Financial institutions and systems: Financial institutions**   * nature, benefits and risks to small business of the following types of electronic processing: * **EFTPOS (Electronic Funds Transfer at Point of Sale)** – system where the business arranges with their bank to be linked electronically so the customer can pay by presenting either a debit or credit card. Funds are transferred from the consumer to the business.   **Benefits:**  - More convenience for customers, some customers may not buy if they don’t have the cash  - Less handling of cash by the business. Less opportunity of theft.  **Risks:**  - Service fees – the bank might charge service fees if you want to offer **EFTPOS** payments  - Reliance on electrical and mobile phone infrastructure  - Technical problems   * **Credit card** – a system of payment where funds are transferred to the business via the card company and cardholder pays provider at a future date. A form of short-term finance for both a business and its customers.   **Benefits:**  **-** Gives the business a short-term form of financing  - Gives their customers flexibility of payments without the business having to chase them  - Payments from credit customers easily processed  - Funds received immediately rather than having to handle customer’s cheques which take time to be presented  **Risks:**  **-** Fraud & identity theft can cause extra problems for business to solve   * **Electronic bill payments** – using netbank facilities to make payments online rather than using cheques or cash. Funds are transferred from the consumer to the business.   **Benefits:**  - Can be accessed 24 hours a day  - No cost for customer to use electronic banking payments  - Can be used internationally in any currency  - Funds can be transferred and cleared in real time  - There is electronic proof of the transaction  **Risks:**  - Risk of password and log in details being used fraudulently  - Incorrect transfer details may be used so statements should be reconciled  - Data can be subject to theft and hacking  - Fees to set up own biller code and process transactions   * **Direct debits** – an arrangement made with the bank where regular payments are transferred electronically at the same time every period (eg. rent or insurance payment). A direct debit is made from the businesses account to a supplier’s account.   **Benefits:**  - Gives the business a short-term form of financing  - Gives their customers flexibility of payments without the business having to chase them  - Payments from credit customers easily processed  - Funds received immediately rather than having to handle customer’s cheques which take time to be presented  **Risks:**  - Fraud & identity theft can cause extra problems for business to solve   * **Online Banking** – a system offered by banks where funds can be transferred between entities electronically, without the use of cash   **Benefits:**  - The business can accept payments from credit customers electronically rather than by cheque  - Could lead to increase in business due to convenience offered its customers.  - All payments and receipts recorded automatically allowing for better control  **Risks:**  - Identity Theft: info held on bank server and could easily be stolen by hackers  - Phishing: a criminal sends out emails to people with fake links trying to get those people to click on the links and give away their personal information, e.g. banking details  **Using an established chart of accounts and the perpetual inventory system, apply double entry principles using an accounting information system to electronically record financial data and produce financial reports**   * An accounting information system usually operates on a predetermined chart of accounts * The set of charts of accounts can be tailored to suit the specific requirements or nature of the business * A chart of accounts is flexible, allowing for the addition and the deletion of unwanted accounts * Accounts are categorised into assets, liabilities, equity, income and expenses and given identifying numbers * Double entry principles apply * When a sale gets processed on the accounting information system, then Cost of Sales and Inventory also gets updated in the case of a perpetual inventory system |