**ACCOUNTING AND FINANCE ATAR YEAR 11**

**Revision Notes – Semester 1, 2023**

**Exam Paper Structure:**

**15 Multiple Choice Questions 15%**

**3 Practical Questions 70%**

**Choose between 2 Extended Answer Questions (do 1 ONLY) 15%**

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**Tips for 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 debts of the journal must equal the total debits
* 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 to put in the Dates
* Under “Details”, state the contra account, i.e. where the other leg of the transaction is.
* If there is more than one entry and/or an opening balance in a ledger account, remember to balance the ledger account on the last day of the month if it is an Asset, Liability or Capital account.
* Do the closing entry if the ledger account it is an Income, Expense or Drawings account, and also show the totals for both the debit and credit sides.

**Financial Reporting**

* Income Statement and Balance Sheet 🡪 Examples on PowerPoint on Connect
* Answer only what the question asks

**Theory:**

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| --- |
| **Financial institutions and systems: Financial systems and fundamental principles**   * 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. * **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 company** * A company is an entity that has a separate legal existence from its owners. * The owners of the company are known as members or shareholders. * Its legal status gives a company the same rights as a natural person which means that a company can incur debt, sue and be sued. * Shareholders are paid dividends out of any company profit, if there is decreasing profits, it will mean that shareholders may not get dividends. * Shareholders of a proprietary limited company can only sell their shares privately and according to the company’s constitution. This can make it difficult for existing shareholders of the company to sell their shares when the company is not performing well. * The value of the shares can increase when the company performs well and decrease when the company does not perform well. * Pty Ltd company, shares cannot be bought by the public. Shareholders can sell to existing shareholders, another company or to professionals in the same industry.   **Company - Advantages**   * Advantages can include: * The liability of shareholders is limited meaning that if their shareholding is fully paid up, then any debts the company incurs is payable by the company and not shareholders. * The separate legal entity concept is the characteristic applied to companies as being a separate entity from its owners. This means the company is an artificial person created in law, in its own right that can sue, be sued, acquire assets and finance in its own name. This also means that the company is responsible for all debts it accumulates provided all of its shareholding is fully paid up * 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. * 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.   Government and the community: The role and influence of governments and other bodies 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. 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.  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. An ABN is a unique business identifier, and it is required to be able to administer the GST and to deal with government authorities such as the ATO. The ABN also helps customers and suppliers know that they are dealing with a legally registered business that can be researched and held to account if necessary. Businesses without an ABN means the receiver of goods and services from them will need to withhold tax at the highest rate which can affect their cash flow.  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.   **Financial institutions and systems: Financial systems and fundamental principles**  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 and bank fees  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.  **GST Accounting Responsibilities**  The business needs to keep separate accounts to deal with GST paid and GST received in transactions, These accounts are called GST Credits when the business pays GST on goods and services purchased and GST Payable when the business sells goods or services and charges GST. The business needs to apply 10% to all goods and services that are taxable supplies and provide a Tax Invoice that clearly indicates the GST added or included in the total of the bill. Any receipts must also indicate where the GST was applicable on the items sold and indicate the total GST applicable on the sale either included or added separately. This is only required if the business turns over $75,000 or more and must operate on an accrual basis using an appropriate accounting software system.  **GST Reporting Responsibilities**  The business is required to prepare a BAS statement that outlines all income and taxes applicable including the GST. The form will indicate if the business expects a refund or have to pay GST to the ATO. This is why the ledger accounts are important so that the figures as the end of a period can be extracted to prepare the BAS Statement. The BAS Statement can be completed monthly or quarterly. At the end of the year, a reconciliation is made between the BAS statements and income statement to determine any final refund or GST Owed to the ATO. |
| **Financial institutions and systems: Financial systems and fundamental principles**  Fundamental concepts and conventions of financial accounting, including:   * + the accounting equation: Assets = Liabilities + Equity (A=L+E)   + double entry accounting: For each debit entry, there must be corresponding credit entries to the same value   + the accounting cycle: documents, journals, ledger, adjusting entries, closing entries and financial statements   Definition of the elements of financial statements:  **ASSET:**  A present economic resource controlled by the entity as a result of past events.  **LIABILITY:**  A present obligation of the entity to transfer an economic resource as a result of past events.  **EQUITY:** (E= A – L)  The residual interest in the assets of the entity after deducting all its liabilities.  **INCOME:**  Increases in assets or decrease in liabilities that result in increase in equity, other than those relating to contributions from holders of equity claims.  **EXPENSES:**  Decreases in assets or increases in liabilities that result in decreases in equity, other than those relating to distributions to holders of equity claims.  Fundamental concepts and conventions of financial accounting, including:  Principles of the perpetual inventory system   1. In the perpetual inventory method, the inventory account is continually updated by a computerised system. 2. Sales are recorded in a sales account. 3. The cost of goods sold is transferred to the cost of sales account at the same time the sale is recorded. 4. Purchases of inventory are recorded in an inventory account.   Perpetual versus periodic inventory methods   1. In the perpetual inventory system financial statements can be prepared anytime as cost of sales is always known. In the periodic system, a physical stocktake is required to determine opening and closing inventory and therefore cost of sales. 2. In the perpetual inventory system fast and slow moving inventory items are easily identified and re ordering can be set up automatically if required. In the periodic method inventory movements need to be identified with a physical count. 3. The possibility of running out of stock is reduced as inventory on hand is always known. 4. Can detect stock losses if the perpetual system is combined with a physical stocktake. |
| Recording, using and evaluating financial information: Recording, processing and communicating financial information 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. The trial balance also provides a list of general ledger balances from which the financial reports can be prepared  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   **Financial institutions and systems: Financial institutions**  **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 – finance facility for businesses to keep withdrawing funds to an authorised limit from the cash account of the business when the balance reaches zero. A financial institution that allows the account holder to borrow the bank’s money when the account is low. It is replenished by adding funds into the account and interest rates are charged once the account holder uses the bank’s money. There is an arranged limit on an overdraft. advantages: flexible (only used when needed), application process may be easier than a loan or mortgage, may not require security over non-current assets. Everyday expenditure can be paid without the worry of incurring late fees and running out of cash. It is a safety net when cash is low and the account holder can still operate their business having funds available to pay bills. disadvantages: interest rates may be higher, not recommended for long-term finance. The facility attracts high interest rate costs once an overdraft is used. There is an upper limit and cannot go over without arrangement with the financial institution. * 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   * 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 and how long has the business been in operation?   + Are there **guarantors** willing to repay the debt if the owner is unable to make the debt commitments personally   **Interest Rate**  Banks need a return on their investment and will consider charging an appropriate interest rate to earn money. The interest rate will be determined on a borrowing depending upon the level of risk the borrower poses for the bank. The higher the risk, the higher interest rate charged.   * 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   **Future Business**  Banks will consider the business sales and future profit. It will ask for sales forecasts, business plan and income statements to determine the performance the direction of the business and the likelihood of the business continuing profits in the foreseeable future. The higher the likelihood of success, the lower the interest will be charged on the overdraft. |
| Recording, using and evaluating financial information: Recording, processing and communicating financial information |
| Purpose of financial statements, including:  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)?   Financial Position   * The financial resources controlled by the entity * Financial structure   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 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, that is whether the business was able to make a profit or loss for the period.  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. Transactions to be recorded from the point of view of the business and not the owner. Owner’s personal transactions therefore are to be kept separate and distinct from business transactions. * 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 * Going concern – reports are prepared on the assumption that an entity is continuing to operate in the foreseeable future and that accounting records are kept on this basis. It provides a positive view of the business for recording purposes. * 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 |
| **Government and the community: The influence of social, environmental and ethical factors**   * 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 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.   Costs/Challenges of Corporate Social Responsibility include:   * Lack of finance to sponsor ad donate. * 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 more expensive, especially for smaller businesses due to limited buying power and availability of suitable products. * Implementation/ purchase costs to comply with industry legislation and keep up with technology * Training employees on responsible practices can be expensive in terms of time, additional costs and expertise. * Educating consumers on the impacts of their purchasing decisions is costly and the majority of consumers place price above all other criteria. * Expense of hiring a bookkeeper and/or accountant to ensure compliance with ATO * Cost of keeping accurate GST records |
| **Recording, using and evaluating financial information: Evaluating financial information for planning, coordinating, controlling and investing**  **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: processes are separated and given to an employee to become proficient at the part of the process. This allows employees to check processes with one another. 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. * Security equipment such as cameras and sensors to be applied to areas where assets can be vulnerable to theft. * Rotation of Duties – this breaks up processes to allow employees to be proficient in a part for a period of time and then switch to another process to avoid collusion and fraud and to pinpoint errors in the system. * Internal audit – to ensure policies and procedures are applied correctly and any inefficiencies reported for correction. * Any other reasonable response   Application of the principles of internal control over: (max 3 for each – be able to either just outline or explain in more detail)  **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. * Purchase order forms are in use.   **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**   * **Shortage of staff** – not having enough start makes it difficult to put in place sophisticated controls that would improve the security of the business’s assets. Smaller business may not have enough staff to segregate duties * **Collusion** – it is difficult to identify and prevent collusion in the workplace where employees conspire to commit fraud. * **Shortage of Cash** – not having enough cash to purchase equipment or hire more staff to carry out policies and procedures to secure assets can be restricting for the owner of the business. This requires compromises and prioritizing assets that are the most vulnerable to be secured. Needs to be cost effective * **Intimidation** – senior staff that intimidate junior staff into compromising procedures for their own gain can be difficult to expose and trace. |