ACCA - Financial Accounting

Last reviewed: July 30th, 2025

1 ACCOUTNING FOR BUSINESS TRANSACTIONS

80/100 pts

The Financial Accounting syllabus introduces five business activities:

- Selling Goods or Services: This can involve immediate payment from customers (Cash Sales) or a promise of payment at a later date (Credit Sales).
- Customer Returning Goods: When customers bring back items they bought (Sales Returns).
- Buying Goods or Services: This can involve paying immediately with cash (Cash Purchases) or promising to pay later (Credit Purchases).
- Returning Goods to Suppliers: When our business sends back items we bought (Purchase Returns).
- Small Cash Payments: Handling minor, everyday expenses using a special small cash fund (Petty Cash transactions).

The business activities can be also be furter split into three groups: activites that affect cash, activites that affect credit and activites that affect petty cash. Cash sales and purchases, credit sales and purchases, petty expenses.

Each of these business transactions goes through a consistent three-step process.

Firstly , when a business transaction takes place, it creates a source document. This document acts as an original piece of evidence for the transaction.

Secondly , this source document is used to write down the transaction in a journal entry. The journal entry is a chronological diary where every business transaction is initially recorded. In this entry we figure out what specific accounts (like 'Cash', 'Sales Revenue', or 'Accounts Payable') are affected and whether they need to increase or decrease. This is important because for each transaction, *at least* two accounts will be affected. One will be debited and at least one will be credited for the exact amount.

Lastly , after a journal entry is made, its details are posted to the affected inidividual legder accounts. Each individual ledger account resides within a document called the general ledger. A simple way to think of this is as a binder, where each page is an individual ledger account and the binder is the general ledger account. When an entry is *posted*, we simply take the debit and credit amounts from the journal entry and apply them to the correct sides of their respective individual accounts in the general ledger. This updates the balance of each account, so we always know how much money we have, how much customers owe us, what our expenses arc, and so on.

1.1 IAS37 Provisions, Contingent liabilities and Contingent Assets

1.1.1 Provisions

A provision is a liability of uncertain timing or amount. For it to be recognizied, the outflow of economic resources must be probable (a 50% likliehood of occuring), the cost must be able to estimated and it is obligation that arises from past events. Provisions must be recognizied in the financial statements if the previous conditions have been satisfied.

1.1.2 Contingent Assets

1.1.3 Contingent Liabilities

1.2 IAS2 Inventory

1.3 IAS16 Property, Plant and Equipment

1.4 IAS38 Intangible Assets

Journal Entry: Cash Sales

	Account Title	Category	Explanation	Amount ($)
Dr	Cash	Asset	Cash increased	1,000
Cr	Sales Revenue	Income	Sales increased	(1,000)

Journal Entry: Cash Sales

	Account Title	Category	Explanation	Amount ($)
Dr	Trade Receivables	Asset	Trade Receivables increased	1,000
Cr	Sales Revenue	Income	Sales increased	(1,000)

Journal Entry: Trade Receivables

	Account Title	Category	Explanation	Amount ($)
Dr	Sales as Sales returns	Income	Sales decreased	1,000
Cr	Trade Receivables	Asset	Receivables decreased	(1,000)

Journal Entry: Sales Return

	Account Title	Category	Explanation	Amount ($)
Dr	Bank/Cash	Asset	Bank/Cash increased	1,000
Cr	Trade Receivables	Asset	Receivables decreased	(1,000)

Journal Entry: Receipts from customers

	Account Title	Category	Explanation	Amount ($)
Dr	Purchases	Expense	Purchases increased	1,000
Cr	Cash/Bank	Asset	Cash decreased	(1,000)

Journal Entry: Cash purchases

	Account Title	Category	Explanation	Amount ($)
Dr	Purchases	Expense	Purchases increased	1,000
Cr	Trade Payables	Liability	Payables increased	(1,000)

Journal Entry: Credit purchases

	Account Title	Category	Explanation	Amount ($)
Dr	Trade Payables	Liability	Payables decreased	1,000
Cr	Purchases	Expense	Purchase decreased	(1,000)

Journal Entry: Purchase Returns

	Account Title	Category	Explanation	Amount ($)
Dr	Trade Payables	Liability	Payables decreased	1,000
Cr	Bank/Cash	Asset	Cash decreased	(1,000)

Journal Entry: Payment to Suppliers

1.5 Irrecoverable Debts

	Account Title	Category	Explanation	Amount ($)
Dr	Irrecoverable debt expenses account	expenses	Irrecoverable debt expenses increased	1,000
Cr	Trade Receivables	Asset	Receivables decreased	(1,000)

Journal Entry: Payment to Suppliers

1.5.1 Subsequent Recovery of Irrecoverable Debt

Step 1: Reverse the irrecoverable debt write-off

	Account Title	Category	Explanation	Amount ($)
Dr	Receivables	Asset	Receivables increased	1,000
Cr	Irrecoverable debts expense account	Expense	Irrecoverable debts expensed decreased	(1,000)

Journal Entry: Payment to Suppliers

Since the balance owed has been paid, the amount is not irrecoverable. Therefore, an adjustment to reverse te earlier write-off is made.

Step 2: Record the Receipts

	Account Title	Category	Explanation	Amount ($)
Dr	Bank	Asset	Bank increased	1,000
Cr	Receivables	Asset	Receivables decreased	(1,000)

Journal Entry: Payment to Suppliers

Therefore, the net effect of the above two entries is DrḂank, Cr. Irrecoverable debits expense account.

1.6 Allowance for irrecoverable debts

1 Calculate the closing allowance for the allowance for irrecoverable debts at the year-end.

2 Calculate the difference between the closing allowance and the opening allowance (brought forward from the previous accounting period)

3 The difference is posted as a journal entry to the allowance for irrecoverable debits ledger. The corresponding account is the irrecoverable debts expense account.

If the closing allowance is more than the opening allowance, the double entry to record the adjustment is:

	Account Title	Category	Explanation	Amount ($)
Dr	Irrecoverable debts expense	Expense	Bank debt increased	1,000
Cr	Allowance for irrecoverable debts	Asset	Receivables decreased	(1,000)

Journal Entry: Payment to Suppliers

Since it has been identified that the closing allowance is more than the opening allowance, the difference is posted as an irrecoverable debts expense in the statement of profit or loss (in the same way as an irrecoverable debt written off).

If the closing allowance calculated is less than the opening allowance, the double entry to record the adjustment is:

	Account Title	Category	Explanation	Amount ($)
Dr	Allowance for irrecoverable debts	Asset	Receivables increased	1,000
Cr	Irrecoverable debt expense	Expense	Irrecoverable debts expense decreased	(1,000)

Journal Entry: Payment to Suppliers

Since the closing allowance is less than the opening allowance, the difference is posted to decrease the irrecoverable debt expense. The reduced expense will be shown in the statement of profit or loss.

(Note –while the Allowance for irrecoverable debts is described as an asset account, it is a negative asset, as it reduces the value of trade receivables in the statement of financial position.)

1.7 Inventory

The record of inventory and cost of goods sold are made at the end of the year using journals. The objective of the double entries is to:

Ensure the Inventory account reflects the closing inventory valuation Cost of goods sold account is created and reflects the correct amount

To achieve these objectives, there are three double-entry steps to make:

1. Remove the Opening Inventory

Opening inventories are removed and transferred to the Cost of goods sold account. This entry is necessary because the opening inventories are now used to generate sales in the current accounting period.

	Account Title	Category	Explanation	Amount ($)
Dr	Cost of goods sold	Expense	Opening inventory cost now included as expenses	1,000
Cr	Inventory	Asset	Inventory decreased	(1,000)

Journal Entry: Payment to Suppliers

The cost of opening inventories is reflected as a current-year expense in the Statement of Profit or Loss.

2. Close off the Purchases Account

A business makes purchases for inventory for resale. The cost is debited to the Purchases account and credited to cash/payables at the point of purchase. At year-end, the amount in the Purchases account is closed off and transferred to the Cost of Goods Sold.

	Account Title	Category	Explanation	Amount ($)
Dr	Cost of goods sold	Expense	Purchases is transferred to COGS	1,000
Cr	Purchases	Expense	Purchases is closed off	(1,000)

Journal Entry: Payment to Suppliers

3. Post the Closing Inventory

The balance in the inventory account at year-end should reflect the value of closing inventory. The closing balance is presented in the statement of financial position as a current asset.

Since closing inventories are items purchased that are not sold in the accounting period, their cost should not be reflected as an expense in the Cost of goods sold account (SPL). Therefore, the value of closing inventory is transferred out of expenses and reflected as Closing inventory in the Statement of Financial Position.

	Account Title	Category	Explanation	Amount ($)
Dr	Inventory	Asset	Inventory is increased	1,000
Cr	Cost of goods sold	Expense	Costs decreased	(1,000)

Journal Entry: Payment to Suppliers

The value of closing inventory will be next year’s opening inventory value.