Year 12

Accounting

ACCOUNTING

Year 12

GOVERNMENT OF SĀMOA
MINISTRY OF EDUCATION, SPORTS AND CULTURE

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Table Of Contents

Introduction

This book provides a course of study for students of accounting at Year 12 in Sāmoa. It has been developed around the accounting strands of the curriculum. The content will cover the basic requirements for achievement objectives relevant to Year 12 but teachers may need to supplement this with other activities to ensure that students have a wider range of learning experiences necessary at this level.

By the time students have completed this course, they will have learned how to prepare financial statements for different types of organisations. They will also develop an understanding of how financial information in these statements can be reported in meaningful ways to help people who use this information to make good decisions.

The book is divided into seven major topic areas that are organised broadly around the three accounting strands of the curriculum statement. Each chapter will commence with a reference to the achievement objectives and learning outcomes relevant to each of the topic areas.

What Is Accounting?

Accounting is a system that provides information on the economic activities of a business. It is about the communication of financial information. The accountant is responsible for presenting this financial information so that those who use this information can make business decisions. The accountant has a responsibility to prepare this information so that it is understandable. It must conform with *generally accepted accounting practice*, which means that it is prepared according to the standards prescribed by the Society of Chartered Accountants of Sāmoa. Of course, the users of the information must have some basic understanding of what financial statements are about before the accountant can communicate successfully.

Accountants communicate financial information. In order to produce this financial information, an accountant must answer the following questions:

What information do I need?	**Identify**
Where does this information belong?	**Process**
How can I present this information?	**Summarise and Report**
What does this information show?	**Analyse**
What do these trends mean?	**Interpret**

When these questions have been answered, the accountant can finally communicate the information to the user. People who use the information must combine it with other kinds of information (non-financial information) to make their business decisions.

Unit 1

Accounting For Decision Making

Aims

On completion of this unit you should be able to:

- ❑ Identify and recall the purposes of different financial documents consumers use in everyday life;
- ❑ Identify ways to organise and store personal accounting documents;
- ❑ Recognise different areas of specialisation of accounting;
- ❑ Identify different users of accounting information;
- ❑ Recognise the importance of non-financial information.

Overview

This unit relates to the nature, purpose and functions of accounting. Accounting is a process of identifying, measuring and communicating financial information. Accounting or financial information is necessary to assist people and organisations make financial decisions based on what has happened in the past. There are different specialised areas of accounting:

- ❑ Management Accounting – concerned with everyday running of the business. A Management Accountant makes sure that the resources of the company are used efficiently.
- ❑ Cost Accounting – concerned with the production of goods. A Cost Accountant is responsible for calculating the costs associated with manufacturing goods.
- ❑ Financial Accounting – concerned with the reporting and analysis of results of the operations of the business. Financial Accountants are responsible for the production of end-of-year financial reports.
- ❑ Taxation Accounting – concerned with tax legislation. Taxation Accountants help businesses organise their affairs so that they pay the least amount of tax and still remain within the law.

- ❑ Auditing – concerned with checking accounting records and systems of businesses. All companies that issue shares to the public are required by law to be audited. Some businesses have their own internal auditors who ensure that accounting records and business systems are functioning at the required level so that the work of the external auditor is minimised when they do their checks.
- ❑ Accounting Technicians – concerned with the practical aspects of recording financial information. An Accounting Technician is usually not a registered chartered accountant, but has the knowledge and skills to ensure that the process of recording accounting information is carried out efficiently.

Who Uses Financial Information?

Individuals use financial information
Every time an individual spends money, they are making a decision. When you decide to buy something, you are making a choice to use your money in a particular way, rather than saving it or buying something else. This is making a financial decision.

Households or families use financial information
Members of a family or household use financial information to make financial decisions too. The decision to buy a car, rent a house or contribute to a family event are some examples of financial decisions that families make. Adult members of your family who work for employers, receive pay advice slips. These documents are forms of financial information created by the employer.

Families and households will also receive bills that they must pay. Some of these bills are regular, such as electricity or telephone bills, while others such as repairs to the car occur as required. These bills or invoices sent by the producers or service providers to the household are created to record financial information useful to both the customer (to pay the bill) and the producer (as a record of what is due from each household). The producer, organisation or business that sends the invoice to be paid must have an adequate accounting system which can create these documents and keep track of amounts due from each customer.

Different organisations use financial information
Schools and hospitals also use financial information. The School Principal or School Committee collect school fees and fundraise each year from which they must decide the amounts to set aside for operational costs such as electricity, water, repairs and other items, and capital costs such as furniture, equipment, classroom materials and buildings. The managers at the hospitals must decide how the allocation made to them by the government will be spent to pay for operational costs and capital costs such as new equipment, furniture and so on. Financial information (together with other types of information) is used to decide how this money is spent.

Clubs and other non-profit organisations also use financial information to make decisions. Clubs use financial information to set the subscriptions for members to pay each year. This decision is made by all members at the Annual General Meeting, when the officers of the club have explained the reasons why the subscription is set at a particular level.

Business owners and investors use financial information

People who run a business or who invest in a business need to know how well the business is doing. Business owners use this information to make decisions about whether the business needs more capital to expand or to finance new assets and whether the profits made are improving or not. Businesses often use financial plans or budgets to guide revenue and expenditure for the year. Actual financial results are compared against the budgets and reports are written to explain the variances or differences between the planned profits (budgets) and the actual results. Business managers use these reports to respond to questions such as:

- How well did the business do?
- What areas need to be improved?

Financial accounting is the area of accounting that prepares reports for external users of accounting information. This information is used by people wanting to invest in businesses which are run by others. People who buy shares in other businesses are called investors. They look at the financial information (and other information also) of the business to decide which company would be the most profitable investment for them. Investors look for companies which will give them a good rate of return (dividends) on their investment. This rate of return should be higher than what can be gained if the funds were invested in a bank.

The Government uses financial information

The government agency that is responsible for collecting revenue from individuals, businesses and other government agencies for the government to use, is called the Inland Revenue Department. This agency collects taxes that have been calculated from financial information such as total earnings of an individual, company and organisation profits.

Towards the end of each financial year, the government will prepare its Annual Budget, for the following year. This budget shows how the government intends to collect its income for the year (from taxes, duties and levies) and how much it proposes to spend. If government spending exceeds income then a budget deficit will occur. However, if income exceeds spending, then the budget is in surplus. At the end of the year, the government will compare its actual results against its budget. This requires financial information.

Non-financial information

Financial information is not the only type of information used by individuals, businesses and organisations to make important decisions. When businesses are required to make a decision about whether they should expand their operations, non-financial information is also required. Apart from getting financial information such as – is there enough capital? and what increase in sales is required to finance the expansion? – they also need to look at things such as competition in the market, availability of equipment or other resources, and so on. Non-financial information is just as necessary as financial information before decisions can be made in regards to business ventures.

Financial Documents

Consumers use financial information all the time and they come across financial documents in different ways. Some of these documents are sent to consumers as a request for payment of a bill, e.g. an **invoice** to pay for the telephone bill to SamoaTel. Another document such as a **credit note**, is issued to a consumer if he or she is returning goods because it is faulty or broken. A credit note allows the customer to choose another item to replace the one that is faulty or they can use the amount in credit another time when they want to buy goods from the same store.

INVOICE

Tropical Footwear
PO Box 1261
Suva, Fiji

Invoice to:		
Fiji Traders	Date:	13 April 2008
31 Beach Rd	GST	Tax Invoice 8976
Suva	GST No.	123-456-789

Quantity	Description of goods	Unit	Total
10	Sandals	$32.00	$320.00
20	Slaps	$15.00	$300.00
	Total payable		**$620.00**

CREDIT NOTE

Tropical Footwear
PO Box 1261
Suva, Fiji

Credit note to:		
Fiji Traders	Date:	15 April 2008
31 Beach Rd	GST	Credit Note 23
Suva	GST No.	123-456-789

Quantity	Description of goods	Unit	Total
2	Slaps	15.00	$30.00

Other important documents that consumers have to become familiar with are:

- pay advice slips or payslips
- bank statements.

Pay Advice Slips are a record of a person's wages or salary. Wages are worked out on an hourly rate of pay. The hours are totalled at the end of the week (or fortnight) and then multiplied by the hourly pay rate to find the gross pay for the period. So if Fia works 40 hours in the week and gets paid $4.00 per hour, her gross pay for that week will be $160.00.

A salary is calculated over a year, and then divided into weekly or fortnightly payments. For example, if Samu's annual salary is $33 800, she will receive $650.00 gross pay each week. This amount is calculated in this way:

$33 800 ÷ 52 weeks = $650.00 per week

Deductions such as income tax and National Provident Fund contributions need to made from the gross pay to calculate the net pay for the period.

Government of Sāmoa
Department of Health – Pay Advice Slip

Ferani Roscoe			Employment No: 05-75-33	
Week ending:		10 July 2005		
Annual salary:		A 4 $15 600.00		
Gross Pay	Ordinary time	1.5 time	2x time	TOTAL
Hours worked	40	4	nil	44
Rate per hour	$7.50	$11.25	$15.00	
Gross amount	$300.00	$45.00	nil	$345.00
Less deductions:				
PAYE Tax			$69.00	
SNPF			$34.50	$103.50
Net Pay				**$241.50**

A bank statement is a record of an account held at the bank by an individual, business or organisation. It is a record of the transactions against that account as recorded by the bank. The most common bank statement received by individuals, businesses or organisations is for current or cheque accounts. Bank statements and cheque accounts were covered in detail in *Business Studies* Year 10, Book 2 and can be revised at this time.

When a bank statement is received from the bank, it's a good idea to complete a reconciliation because the balance shown in the statement may be different from what the individual has in his or her personal record. An example of a bank reconciliation for Ioana Soti is shown over the page. Ioana receives her bank statement which shows that the balance for her cheque account is $359.00. However, her personal records show that her balance is $361.00. She uses the information in the bank statement and her personal records to complete a reconciliation.

EASTPAK BANK (SĀMOA)
Apia Branch

Ioana Soti	**CHEQUE ACCOUNT**		
PO Box 433	**Customer No 04 0067 3894531 00**		
APIA			
SĀMOA	**Opening date**	**01 February 2006.**	
	Statement number 9	**Page No. 1**	

Date	Transactions	Debit / Withdrawal	Deposit	Balance
01 Feb	Opening balance			$651.00
04 Feb	1248	$45.00		$606.00
09 Feb	1250	$63.00		$543.00
10 Feb			$120.00	$663.00
15 Feb	1253	$220.00		$443.00
20 Feb	Bank fee and charges	$4.00		$439.00
24 Feb	EFTPOS Sāmoa Water Authority	$55.00		$384.00
28 Feb	1252	$25.00		$359.00
28 Feb	Closing balance			**$359.00**

Ioana notes that two cheques, #1249 for $72.00 and #1251 for $50.00 have not been presented. She had also deposited $120.00 late on 28 February but this has not been included in the bank statement. Ioana uses all this information to complete a reconciliation for her account as seen below:

TO ASSIST YOU IN RECONCILING YOUR ACCOUNT PLEASE FOLLOW THE NUMBERED INSTRUCTIONS

Step 1

Enter in <u>your chequebook</u> any withdrawals or deposits shown on this statement but not already recorded by you:

Cheque book balance (28 Feb)	$361.00	
Less bank charges	<u>$4.00</u>	
Reconciled cheque book balance	$357.00	

NOTE: **a** If account is overdrawn, SUBTRACT deposits and ADD withdrawals.
b Watch for regular payments for insurance, etc. These should be deducted.

Step 2

Unpaid cheques / withdrawals made after final date of this statement:

Chq no. 1249	$72.00	
Chq no. 1251	<u>$50.00</u>	$122.00

Step 3

Deposits made after final date		$120.00

Step 4

Final Balance of this statement:	$359.00	
Add total deposits	<u>$120.00</u>	
TOTAL	$479.00	
Subtract total unpaid cheques / withdrawals	<u>–$122.00</u>	
This should be your cheque book balance	**$357.00**	

Ioana notes that there is a difference of $4.00 between her chequebook balance of $361.00 and the final reconciliation balance (shown on the previous page) of $357.00. This is because she needs to deduct the bank charges of $4.00 from her chequebook balance and then the two balances will match.

Preparing Personal Financial Statements

Other personal financial statements that may also be useful are the Statement of Affairs or the Statement of Net Worth. This is a statement of assets and liabilities for an individual. A Statement of Affairs is usually required when a person is applying for a loan either from a bank or another financial organisation. The other statement which is also required is a statement of income and expenditure, or a budget. A budget is the list of income, and expenditure against this income for the individual over a period of time, usually one week or over one month. These two personal statements have been discussed thoroughly in *Business Studies* Year 10, Book 2 and is therefore only reviewed briefly here.

Ioana Soti prepares her Statement of Affairs and Weekly Budget to take to her meeting with the bank manager:

Statement of Affairs for Ioana Soti as at 30 June 2005

ASSETS		
Computer	$3 000	
Car	$9 000	
CD Player	$800	
Savings	$500	
Total Assets		$13 300
LIABILITIES		
Vaiala Computers Ltd	$1 500	
PSA Credit Union	$3 000	
Total Liabilities		$4 500
NET WORTH		**$8 800**

Weekly Budget for Ioana Soti

Net take home pay			$300
Fixed Expenses			
Board to parents	$100		
Lunches	$15		
Repayments on loans	$40	$155	
Variable Expenses			
Clothes & entertainment	$50		
Petrol and oil	$30	$80	
Savings		$65	$300
Amount left over			Nil

Keeping Financial Documents

It is important to keep financial documents as evidence or proof of payment as well as for income tax purposes. Personal accounting files are usually not that large and so they can be stored in a ring binder, plastic bag, filing cabinet or cardboard box. Whichever method is used, the file should be readily accessible (easy to get at), simple and kept up-to-date.

Activities

Copy and complete the following in your book:

1 Sione is in business with his wife. They own and manage a café situated along Beach Road in Apia. At the end of the year, the accountant prepares a set of Financial Statements. Identify THREE users of the information and explain why they need this information.

2 Each of the following use financial information. Write down a decision that each could make using this information:

User	**Decision**
National Provident Fund	How much of the fund can be borrowed by the public
Plantation owner	
Bank Manager	
Shop owner	
Household	
Golf club	
Company director	

3 Ken Chan is employed as a mechanic by Toyo Motors at a rate of $8.50 an hour. During the week he worked the basic 40 hours. The tax due is 10 cents in the dollar and his NPF contribution is 10% of gross pay. Calculate his net wages for the week.

4 Vera Amio works as an office manager and earns a salary of $20 800 per annum. Vera pays taxes at the rate of 15% and her NPF contribution is 10% of gross pay. How much would Vera take home each week?

Questions 5 and 6 relate to the following extract from Paulo's bank statement.

STATEMENT OF ACCOUNT WITH
SAMOANA COMMERCIAL BANK
PO Box 2544 Apia Tel: 258390

Paulo Reed
PO Box 433
APIA
SĀMOA **Opening date: 01 March 2006**
Account No: 05 3421 9834217 00 **Statement number 12 Page No. 1**

Date: 31 March 2006 Last statement dated: 28 Feb 2006 Opening balance: $4 295.70

Date	Transactions	Debit / Withdrawal	Deposit	Balance
01 Mar	Opening balance			$4 295.70
03 Mar	EFTPOS –Sails Rest.	$215.00		$4 080.70
06 Mar	28679	$348.50		$3 732.20
10 Mar	DC – Salary Min Health		$620.00	$4 352.20

5 **a** What type of account does Paulo have with the Samoana Commercial Bank?
b What is the Paulo's account number with the bank?
c What was the date for the last statement sent to Paulo for this account?

6 Describe the transactions recorded on 3rd–10th March 2006 as shown in the bank statement given above.

7 Prepare a Statement of Affairs for Helena Peace as at 30 September 2005. On this date Helena has the following assets and liabilities:

Television $800, CD Player $500, Motor Vehicle $35 000, Bank loan $24 000, Term investment $1000, Personal loan from parents $5000.

8 Define the terms "asset" and "liabilities".

9 Prepare a Bank Reconciliation Statement for Rasela Hunt using the following information:

Rasela received a bank statement dated 20 October 2005 showing a balance of $365. At this date her personal cashbook showed a balance of $445. On checking one record against the other, Rasela found the following:

Items in the bank statement and not in the cashbook:
- **i** Cheque book charge $3.00
- **ii** A direct debit to SamoaTel $55.00

Items in Rasela's cashbook and not in the bank statement:
- **i** Deposit of $60.00
- **ii** Cheque 3345 $38.00

You are required to complete the bank reconciliation statement for Rasela Hunt using the format given in the earlier example.

10 Identify the specialised area of accounting referred to for each of the following descriptions:

Area of Specialisation	Description
	Reports and interprets financial statements for interested parties.
	Organises business affairs so that the business pays the lowest amount of tax possible under the tax law.
	Checks for the accuracy and reliability of the accounting records.
	Enters information into the accounting system.
	Calculates the unit cost for each good produced.
	Provides financial information that allows for good decisions to be made about the effective use of business resources.

Unit 2

Business Ownership Characteristics

Aims

On completion of this unit you should be able to:

- ❑ Compare and contrast the different ownership characteristics – sole proprietorships, partnerships, limited liability companies and clubs and societies;
- ❑ Compare the alternative accounting methods and presentation for different types of business organisations;
- ❑ Recognise different components included in the Owner's Equity section of the Statement of Financial Position for different entities;
- ❑ Identify and apply accounting concepts to determine financial statements for different entities.

Overview

In previous accounting textbooks the only forms of business ownership which have been described were sole proprietorships and clubs and societies. The financial statements for these two different forms of business ownership were described and shown in *Business Studies* Year 11, Book 2. This unit will describe another two common forms of multiple ownership – partnership and the company. In these cases, unlike the sole trader, the business is owned by more than one person. There are advantages and disadvantages to the different forms of business ownership that will be discussed more thoroughly in this unit.

Sole Trader Or Sole Proprietorship

The sole trader is the simplest form of business ownership. The one owner of the business takes all the risks of business ownership but also receives all the benefits or rewards. In the previous textbook (Year 11, Book 2), you were introduced to accounting concepts which determine the rules and principles. These will be revised later in this unit. One concept that is important to note at this point in time, is the *accounting entity concept*. This concept states that the owner of the business is a separate accounting entity from that of the business that they own. However, in the case of a sole trader, because the owner is responsible for any debts or profits that the business may have, he or she is the same *legal entity*.

For example:

Tavita owns a car motor repair shop, which he operates from the back of his home. He calls his business Vital Motor Repairs. Tavita and Vital Motor Repairs are two separate *accounting entities*. You will not see any of Tavita's personal assets (his houses, his cars, his boat) or his liabilities (the amount owing on his credit card or his mortgage for his houses) in the Statement of Financial Position for Vital Motor Repairs. However, because his business is a sole trader one, Tavita is totally responsible for any debts that Vital Motor Repairs may incur and if the business is not able to repay theses debts, then Tavita is personally responsible for them. In other words, he is the same *legal entity* as Vital Motor Repairs or the sole trader has *unlimited liability*.

The **sole trader** is the most common business organisation and is the easiest to set up. A sole trader has the following characteristics:

Advantages:

- ❑ there is just one owner
- ❑ the owner owns all the assets of the business
- ❑ the owner keeps all the profits
- ❑ the owner makes all the decisions about the day-to-day running of the business.

Disadvantages:

- ❑ the owner is responsible for all the debts of the business
- ❑ the owner's personal assets may be sold to repay any business debts
- ❑ financing for the business is limited to the owner's contribution of capital or through loans the owner can raise or through reinvestment of profits.

The owner of a Sole Trader business has **unlimited liability**. The owner's personal assets may be sold to repay any business debts if the business gets into any financial difficulties.

Partnerships

A partnership consists of people who have joined together to run a business with a view to making a profit. Each partner contributes cash or skills (or both) to the partnership and usually shares in the running of the partnership. The partnership is the simplest form of multiple ownership.

A partnership has the following characteristics:

- A partnership can have 2–25 partners.
- The partners jointly own the assets of the business.
- The partners share all the profits according to the ratio agreed to by all the partners.
- The partners are jointly responsible for all the debts of the business.
- Partners' personal assets may be sold to repay the debts of the business.
- Financing for the business is available through the contributions of capital by the partners, loans that can be raised by them or by reinvestment of profits.
- The partners make all the decisions about the day-to-day running of the business.
- The lifetime of a partnership is limited. If a partner dies or retires, the partnership is at an end.

The partners of a partnership business have **unlimited liability**. The partners' personal assets may be sold to repay any business debts if the business gets into any financial difficulties. Some partnerships may have a *sleeping partner*, a person who invests capital in the business but does not participate in any decision making or work of the business. They usually do not receive a share in the profits. A legal agreement between the partners is usually drawn up to set out the rules of the partnership. A **partnership agreement** is a formal document that sets out details for the partnership stating:

1. How much capital is to be contributed by each partner
2. What wages each partner should receive
3. The share of the profits that each partner will get.

If the partnership does not have an agreement, then the rules set out in the **Partnership Act (1908)** will apply. In such a situation, the partners get equal share of the profits. Sāmoa still adheres to New Zealand's Partnership Act (1908).

Advantages of a Partnership:

- there is more cash available for the partnership to use
- the partners can share skills and expertise to improve or expand the partnership
- the partners share the risks and responsibilities.

Disadvantages of a Partnership:

- disagreements between partners could occur
- each partner is personally liable for debts of the partnership
- expansion is limited to the capital that the partners can raise themselves
- if a partner dies or retires, the partnership must end. The existing partners can buy the retiring partner's share or bring in a new partner. Either way, a new partnership is formed
- profits are shared amongst the partners.

Companies

A business that is a company has a major advantage in that it has limited liability. The company is a separate legal entity from its owners.

Private limited liability company

A **private company** is a business organisation that is established by a family or a group of friends. This is the most common form of company that exists in Sāmoa. This type of business is also known as an **unlisted company**. It has the following characteristics:

- It normally has between 2–25 shareholders.
- The company has an unlimited life. If shareholders die or sell their shares, the company keeps going.
- The assets of the company are owned by the business as it is a separate **legal entity** to the shareholders.
- The profits of the business are distributed to shareholders as **dividends**.
- The shareholders' liability for the company's debts is limited to the money they pay for shares.
- The shareholders' personal assets are protected because the company has **limited liability**.
- Finance for the business is raised by selling shares to shareholders or from loans and profits not distributed to shareholders.
- An elected director, who is usually a shareholder, normally manages the business.

The shareholders of a company are not personally liable for the debts of the company. Shareholders liability is limited to the sum of money they invest through the purchase of shares. This is because a company is a **limited liability**. The company is a separate **legal identity** to the shareholders. It is a separate body and recognised by law and therefore it has legal responsibilities – it can be sued, it can sue and it must pay taxes. Sāmoa has yet to finalise its Companies Act, as this book goes to print. It therefore adheres to the New Zealand Companies Act (1993). This Act sets out the rules which companies must abide by in terms of their financial statements and operations. The Act states that "companies must have at least one share, one shareholder, one director and an address for service".

In many ways, a private, unlisted company is like a sole trader partnership except that it enjoys the advantage of limited liability. Another advantage is that the company can continue to exist beyond the life of the shareholders as the shares can be transferred. However, it takes time to set up a company and legal formalities can be costly.

Public limited liability company

Public limited liability companies are also known as **listed companies** as the shares for such companies can be bought by and sold to members of the public. These companies are large business units that are run by a Board of Directors who are elected by the shareholders at an Annual General Meeting. When a public company is formed, a **prospectus**, which invites people to invest in the company, is issued. The prospectus also outlines the company's intentions for using the investments made by shareholders. A public company has the following characteristics:

- Shares are available for the public to invest in the company. There must be at least seven shareholders.
- The assets of the company are owned by the business as it is a separate **legal entity** to the shareholders.
- The profits of the business are distributed to shareholders as **dividends** or kept in the business for expansion.
- The shareholders' liability for the company's debts is limited to the money they pay for shares.
- The shareholders' personal assets are protected because the company has **limited liability**.
- Finance for the business is raised by selling shares to shareholders or from loans (debentures) and profits not distributed to shareholders.
- The company continues to exist even if shareholders die or sell their shares.
- Accounts must be audited annually and published ready for the Annual General Meeting.
- Rules for public companies are set out in the Companies Act 1955 (NZ).
- Management are usually paid workers of the company, not shareholders.

Public companies are very large businesses that can raise large sums of capital from the many shareholders. There are very few such companies in Sāmoa as its economy is too small. An example of a public company is Sāmoa Breweries. While some of its shares are owned by the government of Sāmoa and some members of the public, most of them are owned by an Australian company called Fosters. The advantages of a public company, apart from having limited liability are that it can access large amounts of capital (as it can issue more shares) and skilled managers can be employed to run the business. However, the disadvantages are that it is costly to establish and legal formalities must be completed before it can start to operate. The annual accounts of a public company must be audited or checked for accuracy and correctness.

Incorporated Societies

The members of a club or society are able to register their organisation as an *incorporated society*. This will protect members from the risk of being held personally responsible for any debts that the club or society has. Therefore, the members of the club or society will have limited liability in the same way as the shareholders of a company. A club must have at least 15 members and a majority must agree before the club can be incorporated. Every incorporated society must:

- keep a register of members which it sends to the Register of Incorporated Societies on demand;
- have a set of rules which describe what the club is for, who may be members, how officers are appointed, how funds are invested, and so on;
- send a set of financial statements to the Registrar each year. These statements must have been audited. They must also have been signed by an officer of the society to say that they have been approved by the members at a general meeting.

Clubs and societies become registered so that they are able to own assets such as land or buildings and they can be distinguished by having the letters "Inc" after their name. However the major advantage for the members of a club or society that is registered is that it is a limited liability organisation.

Table 2.1 Comparison of different types of business ownerships

	Sole Trader	**Partnership**	**Company**	**Incorporated Society**
Number of owners	1	2–25	1–unlimited	More than 15
Entity is a separate legal entity (limited liability)	No	No	Yes	Yes
Source of Finance (Capital)	Owner's funds	Partner's funds	Shareholders Capital	Members' Subscription
Do the accounts have to be audited?	No	No	Yes	Yes
Who runs the organisation?	Owner	Partners (usually)	Depends on the size	An elected committee
What is the title given to the owner?	Proprietor/Owner	Partner	Shareholder	Member
How do the owners receive business profits?	Drawings	Drawings	Dividends	Members may not withdraw club funds
How are profits shared?	The owner takes all profits	Profits are shared according to Partnership Agreement or Partnership Act	Dividends are distributed as per resolution of Directors	No distribution of funds to members
What documents are required to establish this type of entity?	None	Partnership Agreement (usually)	Constitution (usually)	Constitution

Statement Of Financial Position For Different Business Ownership Entities

Sole Trader

Vital Motor Repairs owner Tavita Keyes has the following Statement of Financial Position for his business as at 31 December 2006:

VITAL MOTOR REPAIRS
Statement of Financial Position as at 31 December 2006

	$	$	$
Owner's Equity			
Capital – Tavita Keyes			**67 700**
Represented by:			
Current Assets			
Cash at Bank		3 000	
Accounts Receivable		8 000	
Spare Parts		12 500	23 500
Less: Current Liabilities			
Accounts Payable		4 600	
Term Loan (due 01/07/07)		5 000	9 600
Working Capital			13 900
Plus: Non-current Assets			
Investments			
Shares in AST		10 000	
Fixed Assets			
Premises	42 000		
Equipment	15 000		
Tools	6 800		
Truck	25 000	88 800	98 800
			112 700
Less: Non-Current Liabilities			
Mortgage (due 31/03/15)			45 000
Total Net Assets			**67 700**

Partnership

Tavita decides to ask his cousin Tanielu if he is interested in becoming a partner in his business as he is getting too busy and wants to spend more time with his young family. Tanielu is also a qualified motor mechanic who presently works for another business. After their discussions, it is decided that Tanielu will contribute $34 000 cash to the business and in return for his investment will receive one-third of the business profits.

The Statement of Financial Position for the new business – T & T Motor Repairs has been drawn up and appears below:

T & T MOTOR REPAIRS

Statement of Financial Position as at 1st January 2007

	$	$	$
Owner's Equity			
Capital – Tavita Keyes			67 700
Capital – Tanielu Keyes			34 000
			101 700
Represented by:			
Current Assets			
Cash at Bank		37 000	
Accounts Receivable		8 000	
Spare Parts		12 500	57 500
Less: Current Liabilities			
Accounts Payable		4 600	
Term Loan (due 01/07/07)		5 000	9 600
Working Capital			47 900
Plus: Non-current Assets			
Investments			
Shares in AST		10 000	
Fixed Assets			
Premises	42 000		
Equipment	15 000		
Tools	6 800		
Truck	25 000	88 800	98 800
			146 700
Less: Non-Current Liabilities			
Mortgage (due 31/03/15)			45 000
Total Net Assets			**101 700**

Note:

- ❑ Cash at Bank has increased by the amount of the cash contribution made by Tanielu to become a partner.
- ❑ The Owner's Equity now shows two capital accounts, one for each of the partners. Each partner's share of the business, or equity, is shown separately.

After the first year of trading as a partnership, T & T Motors has made a profit of $90 000. The partners have been advised by their accountants to keep their original investment in the business (capital) intact and they each operate a Current Account to show profits distributed and drawings made. The profits are divided according to the agreement made at the start of the partnership, with Tavita getting two-thirds of the profits and Tanielu getting one-third:

Profit Share Calculation:

Tavita's share of the profits	=	$90 000 x $^{2}/_{3}$	=	$60 000
Tanielu's share of the profits	=	$90 000 x $^{1}/_{3}$	=	$30 000

Current Account Balances Calculation:

Current account:	Tavita	Tanielu
Opening balance	–	–
Plus Profit Share	$60 000	$30 000
	$60 000	$30 000
Less Drawings	$40 000	$15 000
Closing balance	**$20 000**	**$15 000**

T & T MOTOR REPAIRS

Statement of Financial Position as at 31 December 2007

	$	$	$
Owner's Equity			
Tavita Keyes:			
Capital		67 700	
Current		20 000	87 700
Tanielu Keyes:			
Capital		34 000	
Current		15 000	49 000
			136 700
Represented by:			
Current Assets			
Cash at Bank		51 700	
Accounts Receivable		6 000	
Spare Parts		9 800	67 500
Less: Current Liabilities			
Accounts Payable			10 400
Working Capital			57 100
Plus: Non-current Assets			
Investments			
Shares in AST		10 000	
Fixed Assets			
Premises	42 000		
Equipment	15 000		
Tools	11 500		
Truck	40 000	108 500	118 500
			175 600
Less: Non-Current Liabilities			
Mortgage (due 31/03/15)			38 900
Total Net Assets			**136 700**

Company

After operating in the partnership for three years, Tavita and Tanielu decide to form a company. As at 31 December 2009, Tavita's equity in the business was $100 000 and Tanileu's equity was $60 000. They sought advice from their solicitor who drew up the necessary documents and in time they received a Certificate of Incorporation which meant that their business was now a company! They decided to issue themselves shares at $1 each. Tavita had 100 000 shares and Tanielu had 60 000 shares. Their shares were fully paid for, because their investment was the contribution of all the partnership's assets to the company. Tavita's sister, Katie and Tanielu's brother Tomasi also decided to invest in the business. Katie decided to invest $10 000 and Tomasi wanted to buy 20 000 shares but he only had $12 000. It was agreed to issue Katie 10 000 shares fully paid and Tomasi would get 20 000 shares with $8000 still owing or *uncalled capital*. The shareholders of the new company were recorded in the company's Share Register:

Name	**Number of Shares**	**Amount Paid Up**
Tavita Keyes	100 000	$100 000
Tanielu Keyes	60 000	$60 000
Katie Keyes	10 000	$10 000
Tomasi Keyes	20 000	$12 000
Total	**190 000**	**$182 000**

The new company is to be called T & T Motor Repairs Ltd and the accountant drew up the Statement of Financial Position as follows:

T & T MOTOR REPAIRS LTD
Statement of Financial Position as at 1 January 2010

	$	$	$
Shareholders' Equity			
Issued and Paid Up Capital			
190 000 $1 shares		190 000	
Less: Uncalled capital of 40 cents per share on 20 000 shares		8 000	
Total Shareholders' Equity			**182 000**
Represented by:			
Current Assets			
Cash at Bank		35 000	
Accounts Receivable		7 600	
Spare Parts		9 500	52 100
Less: Current Liabilities			
Accounts Payable			6 100
Working Capital			46 000
Plus: Non-Current Assets			
Investments			
Shares in AST		20 000	
Fixed Assets			
Premises	85 000		
Equipment	20 000		
Tools	14 000		
Truck	40 000		
Office Furniture and Equipment	7 000	166 000	186 000
			232 000
Less: Non-Current Liabilities			
Mortgage (due 31/12/20)			50 000
Total Net Assets			**182 000**

Note:

- ❑ The name of the business now has "Ltd" at the end of it, indicating that it is a limited liability company.
- ❑ The Owners' Equity section of the statement is now called the "Shareholders' Equity". The owners of the company are called shareholders.
- ❑ The number and value of shares that have been issued and paid up, must be shown in the Statement of Financial Position in the Shareholders' Equity section.
- ❑ The names of the shareholders are not shown in the statement.

During the next two years, Tavita and Tanielu expand the company by building a store at the front with petrol pumps. Apart from selling petrol and oil, their company has also become a very busy supermarket. The profit for the year ended 31 December 2011 is $60 000. The company directors (Tavita and Tanielu) decide to pay a dividend of 15 cents per share. This means that each shareholder will receive 15 cents for every share that is fully paid. Tavita, Tanielu and Katie will receive the full 15 cents per share as they have paid for their shares in full, but Tomasi will only receive 9 cents per share in dividends, as he has only paid 60% of his shares (12 000÷20 000 = 60%).

The dividend to be received by each shareholder is calculated as follows:

Name	No. of Shares	Dividend calculation	Dividend amount
Tavita Keyes	100 000	$100 000 x 0.15	$15 000
Tanielu Keyes	60 000	$60 000 x 0.15	$9 000
Katie Keyes	10 000	$10 000 x 0.15	$1 500
Tomasi Keyes	20 000	$20 000 x 0.09	$1 800
Total	**190 000**		**$27 300**

Payment of Dividends

The payment of dividends is the distribution of company profits to its owners, the shareholders. However, there are other interested parties also involved in the business whose interests must be protected – the creditors or accounts payable. To safeguard their interest, the Companies Act (1993) states that a solvency test must be met before a company is allowed to pay dividends to shareholders. The solvency test involves two conditions that must be met **after** the dividend has been paid:

1. The assets of the business must be greater than the liabilities. The Shareholders' Equity must be a positive quantity;
2. The company must be able to meet its debts in the ordinary course of business. This means that it must have a positive working capital or that the current ratio (CA/CL:1) must be positive.

The accountant drew up the Statement of Financial Position as at 1 January 2012 after the payment of dividends to the shareholders:

T & T MOTOR REPAIRS LTD
Statement of Financial Position as at 1 January 2012

	$	$	$
Shareholders' Equity			
Issued and Paid Up Capital			
190 000 $1 shares		190 000	
Less: Uncalled capital of 40 cents per share on 20 000 shares		8 000	182 000
Retained earnings			32 700
Total Shareholders' Equity			**214 700**
Represented by			
Current Assets			
Cash at Bank		21 000	
Accounts Receivable		9 100	
Store Inventory		8 400	
Petrol and Oil Inventory		18 200	
Spare Parts		7 000	63 700
Less: Current Liabilities			
Accounts Payable			15 000
Working Capital			48 700
Plus: Non-Current Assets			
Investments			
Shares in AST		20 000	
Fixed Assets			
Premises	85 000		
Plant and Equipment	47 000		
Tools	20 000		
Truck	30 000		
Shop Equipment and Fittings	9 000		
Office Furniture and Equipment	5 000	196 000	216 000
			264 700
Less: Non-Current Liabilities			
Mortgage (due 31/12/20)			50 000
Total Net Assets			**214 700**

Note:

- ❑ That portion of the net profit that is not paid out in dividends is called *retained earnings*. This is included in the Shareholders' Equity section of the statement. In the example given on page 30, the net profit for the year was $60 000, of which $27 300 was paid to shareholders. The amount remaining ($60 000 – $27 300 = $32 700), retained earnings forms part of the Shareholders' Equity.

Incorporated Society

The Statement of Financial Position for clubs and societies is very similar to that for sole trader businesses. The main difference is that the Owners' Equity section is called the *Accumulated Fund*. The owners of these types of organisations are known as members and unlike the owner of sole trader or partnership business entities, club or society members are not allowed to withdraw cash. The Statement of Financial Position for the Bay Golf Club is shown below:

BAY GOLF CLUB

Statement of Financial Position as at 30 June 2008

		$	$
Accumulated Fund			
	Balance as at 1 July 2007		24 500
	Plus: Excess Income over Expenditure		7 500
	Balance as at 30 June 2008		**32 000**
Represented by			
Current Assets			
	Bank		6 800
Less:	**Current Liabilities**		
	Accounts Payable		800
			6 000
Plus:	**Non-current Assets**		
	Fixed Assets		
	Golf Carts	5 000	
	Club house	31 000	36 000
			42 000
Less:	**Non-current Liabilities**		
	Mortgage		10 000
Total Net Assets			**32 000**

Note:

- ❑ The assets and liabilities are classified in the same way that they are classified for business organisations.
- ❑ The Accumulated Fund section is the equivalent to the Owners' Equity section for sole trader and partnership business organisations.
- ❑ The term "excess income over expenditure" describes the profit made by the club during this financial period. This amount is added to the Accumulated Fund balance at the start of the period. If a loss is made, the term used is "excess expenditure over income" and this amount would reduce the Accumulated Fund.

Accounting Concepts

This unit has focused on the presentation of the Statement of Financial Position for different ownership entities so that you are able to recognise the different ownership details for each. Later in this book, the other financial statements that are prepared at the end of the financial year will be covered for sole proprietorship entities and community organisation entities. In the preparation of end of year financial statements for any accounting entity, accountants are guided by accounting concepts and principles that have been developed so financial information can be recorded in a similar and consistent manner. Remember accounting is a system of recording and processing financial information so that it can be used to make good decisions.

Accounting concepts have already been introduced to you in *Business Studies* Year 11, Book 2 and it would be useful for you to revise them again at this stage. In this particular unit, we will look at those accounting concepts relevant to the preparation of the end of year financial statements for business organisations and the other concepts will be covered later in the book as required.

Accounting Entity Concept

The first concept referred to in this unit was that of the **Accounting Entity Concept**. The **Accounting Entity Concept** states that the business affairs of the organisation are kept separate from the affairs of the owners and other business organisations. In the example that has been used in this unit, you would have noticed that the Statement of Financial Position for Vital Motor Repairs did not include any information about the personal affairs of Tavita. The Statement of Financial Position for T & T Motor Repairs as a partnership and as a company did not include any information on the partners or shareholders. When the owners or partners used money from the business, this was recorded as drawings and shown separately for each owner in the end of year financial statement. In the case of a company, when profits were distributed to the shareholders in the form of dividends, this was shown in end of year financial statement. Members for clubs and societies are not allowed to have drawings against the organisation.

A business will always be a separate **accounting entity** from its owner, however, it is not necessarily a separate **legal entity**. A business is only a **legal entity** if it can exist in the eyes of law, in its own right. Because the owners of sole traders or partnerships are liable for any debts that their business may have, these types of business ownership organisations are **not** legal entities. Sole traders, partnerships and unincorporated clubs and societies have **unlimited liability**. However, companies and incorporated societies are recognised in the eyes of the law as having the right to exist, own property and enter into other contracts. Therefore they are **legal entities**. This means their shareholders and members respectively, have **limited liability**.

Going Concern Concept

The **Going Concern Concept** assumes that the business will continue to operate in the future. Decisions are usually made about the future using the information given in accounting financial reports. Therefore, unless otherwise stated, users of this information will assume that the business has a future and if it was not going to continue, that this fact would be disclosed in the financial reports.

Accounting Period Concept

The **Accounting Period Concept** is also important in the preparation of end of year financial statements for business organisations. The operations of the business are continuous but owners and other users of financial information need to be able to measure the performance and determine the financial position of the business. Therefore, to measure past performance as a result of decisions made at that time and to make decisions for the future, it is necessary to divide the business lifetime into periods of equal length. Dividing the periods into equal length means that the results can be compared between periods and with other businesses.

Most businesses prepare their financial reports every six months or annually. However, a business can prepare its financial statements more frequently so that its performance can be monitored more closely and the necessary action taken more quickly if planned targets are not being met. Once the accounting period has been established, it is possible to measure the value of assets and liabilities at the end of the financial year and to also measure the change in the owner's equity since the start of the year. You will note that the surplus or profit (deficit or loss) is always described as "profit for the year".

Monetary Measurement Concept

The **Monetary Measurement Concept** in accounting means that money values are used in an accounting system to record all financial events affecting the entity. Therefore only those things which can be stated in monetary terms are stated in the financial statements. The value of assets and liabilities are stated in dollar terms and can be easily stated. Assigning money values to different transactions means that it is possible to compare different items. However, there are problems associated with the monetary concept. **Inflation** or rising prices and incomes could change money values so they do not always reflect the original price at which the assets were purchased. During times of high inflation, the purchasing power of the dollar decreases. This means that the same goods and services will cost more than they did in the past.

Historical Cost Concept

In accounting, all transactions are recorded at the value at the time of the transaction. Assets are therefore recorded at their original price. The present market value of fixed assets is not shown in the Statement of Financial Position. For example, land and buildings is recorded at the original cost to the business of say, $30 000. Five years later, this property is now valued at $45 000 because of the high demand for business space in that particular part of the city. However, land and buildings continue to be recorded at the original cost of $30 000.

Activities

Copy and complete the following in your book.

1 Complete the table for different types of Accounting Entities:

Table 2.2 Different types of accounting entities

	Sole proprietor	**Partnership**	**Company**	**Incorporated Club or Society**
How many owners?				
What are the owners called?				
What are the sources of finance?				
Who runs the day-to-day business?				
Is the organisation a separate legal entity?				
How do owners receive profits?				
Do the accounts have to be audited?				
How are the profits shared?				

2 Using a newspaper or telephone book, identify an example for each of the following organisations:

a sole trader

b partnership

c club/society

d company.

3 When Tavita decided to form a partnership with Tanielu, he made a list of all the advantages to doing this. List three of these advantages.

4 Discuss the following case study in a small group and respond to the questions that follow.

> Grace has received $20 000 from her share of the family home that was sold after her mother died. Her sister, Heather, operates a very successful restaurant which she would like to expand and asks Grace to invest in her business as a silent partner. This would mean that for a capital contribution of $20 000, Grace would get one third of all the profits made by the restaurant. Heather would continue to manage the restaurant. Over the last three years, the restaurant has made an average annual profit of $15 000. Heather suggests that the expansion of the business would increase profits by another $5000 each year.

a Identify the advantages of this proposal for Grace.

b Identify the disadvantages of this proposal for Grace.

c What other information would Grace require so that she is able to make a final decision?

5 Using the information below, show the Owners' Equity section of the Statement of Financial Position as at 31 March 2008.

> Anne and Sally are partners who commenced business on 1 April 2007. At this time, Anne contributed capital to the value of $15 000 and Sally invested $10 000. They decided to share profits in the same ratio as their contribution of capital. At the end of the financial year, 31 March 2008, their financial results were as follows:
>
> | | |
> |---|---|
> | Net Profit | $40 000 |
> | Sally's drawings | $5 000 |
> | Anne's drawings | $12 000 |

6 Using the information below, answer questions **a** to **c**.

> Savai'i Air Ltd commenced business on 1 January 2010 when it had sold 1 000 000 shares at $2 each, fully paid up. After only three months the business was performing very well and a further 500 000 shares were made available and all sold at $1 with the uncalled capital due in two years. At the end of the year, 31 December 2010, the company recorded a profit of $200 000 and a dividend of 6 cents per share was declared.

a Calculate the total amount contributed by shareholders to the company.

b Calculate the total amount paid for dividends for this year.

c Prepare the Shareholders' Equity section of the Statement of Financial Position as at 31 December 2010.

7 Using the information below, answer questions **a** and **b**.

> T & T Motor Repairs Ltd recorded a profit of $80 000 for the financial year ending 31 December 2013. The directors recommend a dividend of 25 cents per share.

a Calculate the amount paid in dividends to each of the shareholders.

b Calculate the retained earnings not distributed as dividends.

8 Using the information below, answer questions **a** and **b**.

> Tana Lemala owns a sports shop. He prepares his own financial statements for the year ended 30 June 2010 and has brought them to you to look over. You find the following:
>
> - Tana withdrew $200 each week for personal expenses and recorded this in the business financial records as wages.
> - The Statement of Financial Position for Tana's sports shop, shows his house at a value of $75 000.
> - The financial records for the sports shop for the last four years, have been prepared over different time periods. In the first one, the financial records were for 9 months. The second set of records covered a 15 month period. The third and fourth set were for one year each.

a Identify the accounting concept which has been breached or not followed in each of the situations given above.

b Write a letter to Tana that explains the changes that you would recommend to him and the reasons why the changes are necessary.

Unit

3 Profit And Financial Performance

Aims

On completion of this unit you should be able to:

- ❑ Draw up fully classified financial statements for sole proprietor service industries and trading firms and community organisations;
- ❑ Identify entries and relevant sources required on balance date to record revenue and expenditure relating to different accounting periods;
- ❑ Identify and describe the straight line and diminishing value methods of accounting for depreciation.

Overview

The previous unit dealt with how the financial position of different business organisations is reported on at the start or end of each financial period. The Statement of Financial Position is only one of the financial statements prepared at the end of the financial period. In this unit, you will learn more about the Statement of Financial Performance that is prepared to calculate the net profit for a business. The preparation of the Statement of Financial Performance for a business will require you to understand the adjustments necessary at balance date to ensure that the net profit for the year is calculated as accurately as possible. You will also be introduced to the Statement of Change in Cash Position or the Statement of Cash Flows. This statement is prepared to show the change in the bank balance between the start of the financial period and the end of this period and how this occurred.

Statement Of Change In Cash Position

The Statement of Change in Cash Position or Statement of Cash Flows has two purposes:

1 to show the cash balance at the start of the accounting period plus net receipts of cash, to reach the final cash balance at the end of the accounting period;

2 to show the sources of cash and the uses of cash during the accounting period.

Credit transactions are not included, only movements in cash. The statement can be prepared in three ways from a summary list of transactions, from source documents or from a bank statement. However, preparing the statement using bank statements can be difficult unless full particulars of each transaction are shown. Otherwise, unidentified deposits and withdrawals are summarised together and listed as other receipts and other payments.

The statement helps users of accounting information by showing how the business used its cash. The Statement of Change in Cash Position also helps the owner to interpret changes in cash position and how it impacts on their business. Has the business got enough cash to operate? Does the business have too much cash tied up in fixed assets?

Tana Sports Shop, gives you a list of the transactions for the month of July 2008 and asks you to complete a Statement of Change in Cash Position for this month.

Tana invested another $2000 in the business; received $800 from customers paying accounts; cash sales for the month were $5800; paid wages of $640; received the bill for electricity for $150; sold old computer for $1000; paid the telephone account of $300; sent invoices to customers for goods sold on credit equalling $1300; bought more stock for cash of $960 and bought a new computer for $4200 paying only half immediately with the balance to be paid in 6 months The balance at the bank as at 1 July 2008 was $3700.

TANA SPORTS SHOP

Statement of Change in Cash Position for month ended 31 July 2008

Cash receipts	**$**	**$**
Cash was provided from:		
Additional capital invested by owner		2 000
Cash Sales		5 800
Accounts Receivable		800
Sale of old computer		1 000
Total Cash received		9 600
Cash payments		
Cash was applied to:		
Wages	640	
Telephone	300	
Stock	960	
Computer (half)	2 100	
Total Cash payments		4 000
Net increase in cash held		**5 600**
Cash at the start of the month (1 July 2008)		3 700
Balance at end of month (31 July 2008)		**9 300**

Note:

- ❑ Credit transactions are all ignored for this statement, e.g. the invoice received for electricity.
- ❑ Sometimes all operational expenses paid during the month are added together and shown as a single amount.

Determining Profit For The Accounting Period

The profit of a business is calculated by deducting the expenses of the business from the revenue earned for a specific period of time. This period of time could be a month, six months or a year. You have learned how to prepare a Statement of Financial Performance for sole proprietors in past books and so this unit will only briefly review this.

Revenue and expenses

Revenue is the inflow of cash or other assets or the reduction in liabilities. This does not include contributions by the owners that result in an increase in the owners' equity. Revenues result from business activities such as selling goods or provision of services. Revenues include things such as sales of goods, fees received, interest earned from investment, gain in the sale of a fixed asset, interest charged for overdue accounts, commission received or rent received. Revenues earned will increase owners' equity.

Expenses are reductions in assets or increases in liabilities. These do not include distributions or withdrawals by the owners, that result in a decrease in owners' equity.

There are two different types of expenditure that have been discussed with you in earlier textbooks, **capital expenditure** and **revenue expenditure**. Capital expenditure is the money spent to purchase and/or create an asset which will stay in the business and be used to generate future revenue. Capital Expenditure will be recorded in the Statement of Financial Position. Capital Expenditure does not directly affect the calculation of the net profit for the accounting period. Examples of capital expenditure include:

- ❑ the purchase of a fixed asset
- ❑ costs to install and prepare the fixed asset ready for use in the operations of the business
- ❑ improvements to fixed assets to extend its useful life.

Revenue expenditure is the money spent on the everyday activities of the business. These are the items that are usually called expenses. Revenue expenditure will directly affect the current year's net profit calculation and so will be recorded in the Statement of Financial Performance (or Revenue Statement). Expenses are costs incurred for earning the revenue. Examples of expenses include wages paid, rent, electricity, writing off bad debts, loss on sale of fixed asset, interest paid or buying goods for resale. Expenses incurred will decrease owners' equity.

Accrual And Cash-Based Accounting

Accrual accounting is when transactions are recorded in the records of the business when revenues are earned and expenses are incurred, whether or not the cash has been received or paid. **Cash-based accounting** is when transactions are recorded only when cash is received or paid.

Most businesses record transactions on the accrual basis as it gives a clearer picture of business activities over a period of time. The results of the business operations are entered in the accounting records when they take place rather than when they are paid or received. Therefore, if a customer is sent an invoice for goods sold on credit, the revenue has been earned and the transaction is recorded. This recognises that the business has done the work, even though the customer has not paid for these services (or goods). This is referred to as a *credit* transaction. Accrual accounting is also applicable to expenses. When an invoice for expenses such as electricity or rent is received, the transaction is recorded immediately in the accounting records of the business. This recognises that the expense has been incurred and the business now has an obligation to make payment for that invoice.

Some businesses use cash-based accounting whereby transactions are only recorded when the cash is received or when it is paid. While this may be appropriate for small businesses, the recording of transactions on a cash basis does not accurately represent a business' operating activities. For example, if all customers paid their accounts at the end of every six months, then the revenue would not be recognised until they have actually been paid. Expenses would not be recognised by the business until they have been paid, no matter how long they have been due to be paid. If revenue is not recognised until it is actually received in cash, then it would also be very difficult for the business to have an accurate and up-to-date view of the business' operations. The following table shows the major differences between accrual and cash-based accounting:

Table 3.1 Accrual accounting and cash-based accounting comparison

Transaction	**Accrual Accounting**	**Cash-based Accounting**
Cash sales received and banked	Increase Bank Increase Owners' Equity	Increase Bank Increase Owners' Equity
Invoice sent to customer	Increase Accounts Receivable Increase Owners' Equity	No entry made in accounting records
Accounts receivable paid account	Increase Bank Decrease Accounts Receivable	Increase Bank Increase Owners' Equity
Paid telephone and electricity accounts	Decrease Bank Decrease Owners' Equity	Decrease Bank Decrease Owners' Equity
Received invoice for computer purchased on credit	Increase Fixed Assets Increase Accounts Payable	No entry made in accounting records
Paid for computer purchased on credit	Decrease Bank Decrease Accounts Payable	Increase Fixed Assets Decrease Bank
Received invoice for internet connection	Increase Accounts Payable Decrease Owners' Equity	No entry made in accounting records

Statement Of Financial Performance

The purpose of the Statement of Financial Performance is the calculation of profit for a business over a specific time period. When preparing a Statement of Financial Performance for an entity, the following concepts are significant:

- The Going Concern Concept – which assumes that the business will continue to operate into the foreseeable future.
- The Accounting Period Concept – which divides the life of the business into equal lengths of time.
- The Matching Concept – that transactions are recorded in the accounting records and reported in the financial statements of the period to which they relate.

You would have learned in Year 11, how the Statement of Financial Performance is prepared and classified according to whether it is a service type business or trading type business. You are able to refer back to the textbook for Year 11 to review how the financial performance statements are prepared for these two different types of entities.

Problems With Estimating Profit

The profit for any organisation is always calculated for a specific time period. This could be for one month, six months, one year or over a longer period of time. The accounting period is defined in the heading of the statement of financial performance, e.g. Statement of Financial Performance for year ended 31 December 2005. The final day of the accounting period is called **balance day** and the cut-off point is midnight.

Business operations do not come to a halt on balance day. There are some transactions which are not yet complete, for example, the business could have money owing for expenses or income may be owed to the business. A decision will need to be made as to which accounting period these types of transactions will belong to.

Balance Day Adjustments

It is important to have a cut-off date for calculating profit accurately. Therefore, adjustments must be made for any transactions that are not complete on balance day. The accountant matches all relevant revenue and expenses to the particular accounting period under review, whether or not the cash has changed hands at that point in time. Any transactions that do not belong to the current accounting period are taken out and matched to the next or the previous accounting period.

Balance day adjustments include:

- any amounts the business owes to other organisations or individuals on balance day
- any amounts paid in advance by the business, e.g. insurance
- any amounts owed to the business by outsiders
- any amounts received in advance, e.g. commission
- the value of the inventory on hand at the end of the accounting period must be recorded and this becomes the inventory on hand at the start of the next period
- the depreciation amounts applied to the cost of fixed assets.

Amounts the business owes

On balance day, the business will have expenses which it has incurred, such as wages or electricity or advertising but are not due to be paid until after the balance date.

Example:

Tana Sports Shop has two staff that it pays on a weekly basis. The wages expense each week is $450. As at balance date, two days of wages have yet to be incurred. Therefore three days of wages are due for the accounting period up to balance day.

Calculation for wages due on balance date:

- ❑ Weekly wages expense (5 days) is $450 or $90 per day.
- ❑ Balance day fell two days before the cheque is drawn to pay for wages for the week. Therefore, three days of wages belong to the accounting period up to balance day – $90 × 3 days = $270

Three days' wages ($270) is **added to the expenses** for the current accounting period because they were incurred before balance day, even though the cash has not been paid out for this transaction. The other account to be affected is called **accrued expenses**. This amount is a current liability and will appear in the Statement of Financial Position. Accrued expenses is a current liability, because it is an amount that has been incurred and has not been paid by the business. This balance day transaction will require an entry to be made in the General Journal:

TANA SPORTS SHOP
General Journal

Date (2008)	Particulars	Debit $	Credit $
Dec 31	Wages Accrued expenses for wages owing on balance day	270	 270

Amounts paid in advance by the business

A business can have expenses that it has paid in advance on balance day. It could be that a business pays for expenses in advance and on balance day, some part of this prepaid expense has not been used and will only be incurred in the next accounting period. That part of the amount prepaid, needs to be matched to the next accounting period and therefore deducted on the expense account to which it was charged when the transaction occurred.

Example:

When Tana's accountant went through his records, he found that Tana had paid insurance for the shop on 1 September 2008 for one year. The total expense for insurance that had been paid on 1 September, was $600 or $50 per month. On balance day, therefore, nine months of this expense needs to be recorded as prepaid or matched to next accounting period's revenue. This would decrease the insurance expense account and increase a new account called **Prepayments**, a current asset item. This account is classified as a current asset because the amount prepaid, represents an asset which belongs to the business, as the service it refers to has not yet been delivered (in this case by the insurance company). Therefore, if Tana decides to cancel this insurance policy on balance day, the amount of prepaid insurance would be returned back to him. The balance day transaction required to be recorded is shown below:

TANA SPORTS SHOP
General Journal

Date (2008)	Particulars	Debit $	Credit $
Dec 31	Prepayments Insurance for insurance paid in advance at balance day	450	 450

Amounts owed to the Business

At balance day, a business could have amounts owing to it by outside individuals or organisations. The amounts owing to the business would be called **accrued revenue** (or **accrued income**). Accrued revenue is income owing to the business but not yet received by it on balance day. This amount will therefore appear as a current asset item in the Statement of Financial Position as it represents an amount due to the business but at balance day was still not received.

Example:

Tana Sports Shop has investments (10 000 shares) in another large company. A dividend for the year is due to be paid on 30 April 2009. The dividend declared was 12 cents per share. Therefore on balance day, Tana Sports Shop is owed dividends of eight months (from 1 May to 31 December 2008).

Calculation for the amount of dividend per month:

- ❑ 10 000 shares × 0.12 per share = $1200 dividend for the year.
- ❑ Dividend per month = $1200 ÷ 12 = $100 per month.

The amount owing to Tana Sports Shop for dividends on 31 December 2008 is $800 ($100 × 8 months). The balance day transaction will require an entry in the General Journal:

(cont.)

TANA SPORTS SHOP General Journal			
Date (2008)	**Particulars**	**Debit $**	**Credit $**
Dec 31	Accrued Revenue Dividends received for dividends due but not received on balance day	800	 800

Amounts received in advance

On balance day, the business may have received **revenue in advance** for goods or services. In this case, the amount received which does not belong in the current accounting period needs to be deducted from the total amount already received so that only the amount relevant to this period is included to find the profit. The amount received in advance belongs to the next accounting period. Revenue in advance is a **current liability** item because it represents that amount received for services not yet performed by the business.

Example:

Tana owns the building that houses Tana Sports Shop. He rents out part of this building to other retail stores. The rent received from this is revenue that goes directly to his business. The rent received each year is $6000 ($500 per month) and is paid every six months on 1 March and 1 September. Therefore, on 1 September 2008, Tana Sports Shop received $3000 for six months rent. On balance day, 31 December, there is two months rent (for January and February) that have been received but relate to the next accounting period. The balance day transaction will require an entry in the General Journal:

TANA SPORTS SHOP General Journal			
Date (2008)	**Particulars**	**Debit $**	**Credit $**
Dec 31	Rent Received Revenue in Advance for rent received in advance on balance day	1 000	 1 000

Other Adjustments

There are other adjustments that are required on balance day, to ensure that all the relevant expenses related to the current accounting period are included in the calculation of profit. These adjustments relate to the value of fixed assets and inventory on hand on balance day.

Depreciation

Over a period of time, non-current or fixed assets wear out or become out-of-date or obsolete. Fixed assets are purchased to help earn revenue over a number of years. To determine a more accurate calculation of profit for the accounting period, the cost of the fixed asset is spread over the asset's period of usefulness. **Depreciation** is a measure of the loss of future service potential of a fixed asset over an accounting period. It is calculated by spreading the cost of an asset (less its estimated residual value or value that it can be sold for at the end of its useful life) over its useful economic lifetime. Depreciation is an expense and is based on the historical cost of the fixed asset. The expense of depreciation would appear in the Statement of Financial Performance.

One method of calculating the depreciation for each accounting period is called **straight-line depreciation**. This method depreciates the fixed asset evenly over its useful life. The calculation for this method of depreciation is as follows:

$$\text{Straight line depreciation} = \frac{\text{Original Cost} - \text{Residual Value}}{\text{Estimated Useful Life}}$$

Example:

Tana Sports Store owns a delivery van that cost $50 000 when it was purchased on 1 January 2008. It is estimated that it will be useful for five years when it could then be sold for $15 000 (residual value). The amount to be expensed as depreciation each year under the straight line method would be calculated as follows:

$$\text{Depreciation cost} = \frac{\$50\,000 - \$15\,000}{5 \text{ years}}$$

$$= \frac{\$35\,000}{5}$$

$$= \$7\,000 \text{ per year}$$

Tana will show $7000 depreciation on the delivery van per year as an expense in his Statement of Financial Performance.

Depreciation for all fixed assets are calculated on balance day and entered in the accounting records by a General Journal entry. The General Journal entry for the above example is given below:

TANA SPORTS SHOP
General Journal

Date (2008)	Particulars	Debit $	Credit $
Dec 31	Depreciation – Delivery Van Accumulated Depreciation depreciation on delivery van	7 000	 7 000

(cont.)

Depreciation would appear in the Statement of Financial Performance for year ended 31 December 2008 as follows:

TANA SPORTS SHOP
Statement of Financial Performance for year ended 31 December 2008 (extract)

Selling Expenses	**$**
Depreciation – Delivery Van	7 000

TANA SPORTS SHOP
Statement of Financial Position as at 31 December 2008 (extract)

Non-Current Assets	**$**	**$**
Fixed Assets		
Delivery Van (cost)	50 000	
Less Accumulated Depreciation	7 000	43 000

Note:

- The depreciation on the delivery van is a selling expense as it is associated with the selling and distribution of goods sold by Tana Sports Shop;
- The *accumulated depreciation* is a **contra asset account** and is shown in the Statement of Financial Position as a deduction against the historical cost of the asset;
- The difference between the historical cost and accumulated depreciation, $43 000 is the *book value* of the asset as at 31 December 2008.

On balance day in 2009, the financial statements of Tana Sports Shop would show depreciation as follows:

TANA SPORTS SHOP
Statement of Financial Performance for year ended 31 December 2009 (extract)

Selling Expenses	**$**
Depreciation – Delivery Van	7 000

TANA SPORTS SHOP
Statement of Financial Position as at 31 December 2009 (extract)

Non-Current Assets	**$**	**$**
Fixed Assets		
Delivery Van (cost)	50 000	
Less Accumulated Depreciation	14 000	36 000

Note:

- The amount expensed as depreciation each year is the same – $7000, because the straight line method of depreciation allocates the net cost of the asset over its useful life in equal portions. This represents the expense of using the delivery van for the second year.
- The accumulated depreciation is now $14 000. This represents two years of depreciation that has been charged to the Statement of Financial Performance since the delivery van was first purchased on 1 January 2008.
- The book value of the delivery van is now $36 000.
- On balance day in 2010, a further $7000 of depreciation will be charged to expenses and appear in the Statement of Financial Performance. The accumulated depreciation will increase to $21 000 and the book value of the asset will be $29 000.

Depreciation schedule

It is useful to use a schedule to summarise the depreciation expense, accumulated depreciation and book value of an asset over its lifetime. The depreciation schedule for Tana's delivery van, using the straight line method of depreciation is prepared below as an example:

Table 3.2 Straight line depreciation schedule

Year	Cost $	Book value (beginning) $	Depreciation Expense $	Accumulated Depreciation $	Book value (end) $
1	50 000	50 000	7 000	7 000	43 000
2		43 000	7 000	14 000	36 000
3		36 000	7 000	21 000	29 000
4		29 000	7 000	28 000	22 000
5		22 000	7 000	35 000	15 000

The book value at the end of year 5 represents the residual value of the asset, or the amount that the asset is expected to be sold for at the end of its useful life in the business.

Diminishing value method for depreciation

This method of calculating depreciation assumes that the loss of future service potential is highest in the earliest years of the asset's lifetime. This method of depreciation calculation is most appropriate for fixed assets such as computers which tend to become out-of-date very quickly.

To calculate the depreciation expense for the year, the following formula is used:

Depreciation expense = Rate x Book value

Example:

Tana Sports Shop purchased a computer on 1 January 2006 for $6000 that depreciates at 20% on diminishing value. The computer will have no residual value after it is used by the business. The calculation for the depreciation over its useful life can be shown more clearly using a depreciation schedule:

Table 3.3 Diminishing value depreciation schedule

Year	Cost	Book value (beginning)	Depreciation Expense	Accumulated Depreciation	Book value (end)
Computer	**$**	**$**	**$**	**$**	**$**
1/1/06–31/12/06	6 000	6 000	1 200 (6 000 x 20%)	1 200	4 800
1/1/07–31/12/07		4 800	960 (4 800 x 20%)	2 160	3 840
1/1/08–31/12/08		3 840	768 (3 840 x 20%)	2 928	3 072

Value of Inventory on hand

At the end of the accounting period stock on hand must be physically counted and valued in money terms. This is called **stocktaking**. The closing stock value appears in the trading section of the Statement of Financial Performance and is deducted from the value of Goods Available for Sale to find the Cost of Goods Sold. Closing inventory is shown in the current asset section of the Statement of Financial Position. Inventory is valued at cost price or net realisable value, whichever is the lower.

Example:

TANA SPORTS SHOP
Statement of Financial Performance for year ended 31 December 2008 (extract)

	$	$	$
Cost of Goods Sold:			
Inventory (1 Jan 08)			12 000
Plus Purchases		52 000	
Less Purchase Returns		4 000	48 000
Goods available for sale			60 000
Less Inventory (31 Dec 08)			10 000
Cost of Goods Sold			50 000

TANA SPORTS SHOP
Statement of Financial Position as at 31 December 2008 (extract)

	$
Current Assets	
Inventory	10 000

Worked Example:

Tana Sports Shop has the following Trial Balance as at 31 December 2008. He asks you to prepare a Statement of Financial Performance and a Statement of Financial Position using the information given in the Trial Balance as well as the additional information. You decide to use a worksheet to help include the balance day adjustments required before completing the financial statements.

TANA SPORTS SHOP
Trial Balance as at 31 December 2008

	$		$
Accounts Receivable	2 300	Capital	65 650
Advertising	1 200	Sales	66 000
Buildings(1/1/06)	40 000	Accumulated Depreciation – Buildings	4 000
Cash at Bank	12 960	Dividends received	1 200
Drawings	8 500	Accounts Payable	3 000
Delivery van (1/1/08)	50 000	Accumulated Depreciation – Computer	2 160
Computer 1/1/06	6 000	Rent received	7 000
General office expenses	500	Loan (due 31/12/2011)	10 000
Insurance	1 050	Mortgage (due 31/12/2015)	20 000
Inventory 1 /1 /08	11 000		
Purchases	21 000		
Wages	14 500		
Shares in EPC	10 000		
	179 010		**179 010**

Additional information:

- inventory on hand 31 December 2008, $9500
- dividends due to be paid to Tana on 30/4/09 for the year, $1200
- depreciation on delivery van (residual value $15 000, useful life five years), straight line value
- depreciation on computer, 20% per annum diminishing value
- wages expense owing but unpaid at balance day, $270
- insurance prepaid as at balance day, $450
- rent received for six months on 1 September 2008, $3000
- depreciation on buildings is 5% per annum, straight line value.

TANA SPORTS SHOP **Worksheet for Trial Balance as at 31 December 2008**						
	Trial Balance		**Adjustments**		**Adj Trial Balance**	
	Debit $	**Credit $**	**Debit $**	**Credit $**	**Debit $**	**Credit $**
Accounts Receivable	2 300				2 300	
Advertising	1 200				1 200	
Buildings (cost)	40 000				40 000	
Cash at Bank	12 960				12 960	
Drawings	8 500				8 500	
Computer (cost)	6 000				6 000	
Delivery Van (cost)	50 000				50 000	
General office expenses	500				500	
Insurance	1 050			450	600	
Inventory (1/1/08)	11 000				11 000	
Purchases	21 000				21 000	
Shares in EPC	10 000				10 000	
Wages	14 500		270		14 770	
Accounts Payable		3 000				3 000
Accumulated Depreciation:						
Buildings		4 000		2000		6 000
Computer		2 160		768		2 928
Delivery Van				7000		7 000
Capital		65 650				65 650
Dividends received		1 200		800		2 000
Loan (31/12/11)		10 000				10 000
Mortgage (31/12/15)		20 000				20 000
Rent received		7 000	1 000			6 000
Sales		66 000				66 000
Accrued revenue			800		800	
Accrued expenses				270		270
Prepayments			450		450	
Revenue in advance				1000		1 000
Depreciation Expense:						
Buildings			2 000		2 000	
Computer			768		768	
Delivery Van			7 000		7 000	
	179 010	179 010	12 288	12 288	189 848	189 848

TANA SPORTS SHOP
Statement of Financial Performance for year ended 31 December 2008

	$	$	$
Sales			66 000
Less Cost of Goods Sold			
Inventory 1/1/08		11 000	
Plus Purchases		21 000	
Goods available for sale		32 000	
Less Inventory 31/12/08		9 500	
Cost of Goods Sold			22 500
Gross Profit			43 500
Plus Other Income			
Rent Received		6 000	
Dividends Received		2 000	8 000
			51 500
Less Operating Expenses			
Selling and distribution Expenses			
Advertising	1 200		
Depreciation – Delivery Van	7 000		
Wages – shop assistants	14 770	22 970	
Administrative Expenses			
Depreciation – Buildings	2 000		
Depreciation – Computer	768		
General Office Expenses	500		
Insurance	600	3 868	
Total Operating Expenses			26 838
Net Profit transferred to Owners' Equity			**24 662**

Note:

- Wages are included in the selling and distribution category of expenses as they are for the sales assistants who work in the shop.
- The balance day adjusted amounts for the revenue and expense items are included in the Statement of Financial Performance so that a more accurate calculation of profit can be made.
- Depreciation for the delivery van is included as a selling and distribution expense as the van is used to deliver goods sold to customers.
- Net profit is transferred to the Owner's Equity section of the Statement of Financial Position. It increases the owner's capital in the business.

TANA SPORTS SHOP
Statement of Financial Position as at 31 December 2008

		$	$	$
Owners' Equity				
	Capital 1/1/08		65 650	
	Plus Net Profit		24 662	90 312
	Less Drawings			8 500
				81 812
This is represented by:				
Current Assets				
	Cash at Bank		12 960	
	Accounts Receivable		2 300	
	Prepayments		450	
	Accrued Revenue		800	
	Inventory on hand		9 500	26 010
Less	**Current Liabilities**			
	Accounts Payable		3 000	
	Accrued Expenses		270	
	Revenue in Advance		1 000	4 270
	Working Capital			21 740
Plus	**Non-Current Assets**			
	Investments			
	Shares in EPC			10 000
	Fixed Assets			
	Buildings (cost)	40 000		
	Accumulated Depreciation	6 000	34 000	
	Computer (cost)	6 000		
	Less Accumulated Depreciation	2 928	3 072	
	Delivery Van (cost)	50 000		
	Less Accumulated Depreciation	7 000	43 000	80 072
				111 812
Less	**Non-Current Liabilities**			
	Loan (31/12/11)		10 000	
	Mortgage (31/12/15)		20 000	30 000
				81 812

Note:

- Balance day adjustment accounts, created to record those amounts for this accounting period and to exclude amounts from the next accounting period, are shown in the Statement of Financial Position in the current assets and current liabilities sections.
- Accumulated depreciation for the different fixed assets are deducted from the historical cost of the asset to find the book value of the fixed assets on balance day.

Activities

Copy and complete these activities in your book.

Questions 1 to 7 refer the following Trial Balance for Liana's Chemist, before the balance day adjustments have been completed.

LIANA'S CHEMIST
Trial Balance as at 31 March 2006

	$		$
Accounts Receivable	1 500	Capital	44 750
Advertising	1 500	Sales	57 000
Cash at Bank	15 000	Dividends received	300
Drawings	6 000	Accounts Payable	4 000
Equipment (1 April 2003)	28 000	Accumulated Depreciation – Equipment	6 000
Furniture and Fittings (1 April 2003)	5 000	Accumulated Depreciation – Furn. & Fitt.	950
General office expenses	900	Loan – due 31 December 2010	8 000
Insurance	1 100		
Inventory 1 /4 /05	8 000		
Petty Cash Imprest	100		
Purchases	28 000		
Rent	6 500		
Sales assistants' wages	14 400		
Shares in SāmoaTel	5 000		
	121 000		**121 000**

Additional information:

- inventory on hand as at 31 March 2006, $6000
- dividends owing to Liana as at 31 March 2006, $300
- depreciation on equipment (residual value $4000, useful life eight years) straight line value
- depreciation on furniture and fittings 10% per annum diminishing value
- advertising expense owing $200
- insurance prepaid as at balance day, $100.

1 Complete the calculation for depreciation using a schedule to find the amount of depreciation and the accumulated depreciation amount.

Table 3.3 Depreciation and the accumulated depreciation amount

Year	Cost $	Book value (beginning) $	Depreciation Expense $	Accumulated Depreciation $	Book value (end) $
Equipment					
1/4/03–31/3/04	28 000	28 000	3 000	3 000	25 000
1/4/04–31/3/05					
1/4/05–31/3/06					
Furniture and Fittings					
1/4/03–31/3/04	5 000	5 000	500	500	4 500
1/4/04–31/3/05		4 500	450	950	4 050
1/4/05–31/3/06					

2 Liana uses spreadsheets to help her prepare final accounts. The following table is an extract of the spreadsheet she has prepared using the information given above.

You are required to:

Complete the spreadsheet using the information given above:

Table 3.4 Spreadsheet extract

Unadjusted Trial Balance amount	Adjustment required	Adjusted Trial Balance amount	Balance Day Adjustment Account
Dividends received $300	Dividends owing on balance day $300	Dividends received $600	Accrued Revenue $300
Advertising $1 500	Advertising owing on balance day $200		
Insurance $1 100	Insurance paid in advance $100		
Accumulated Depreciation on Equipment $6 000	Depreciation expense on balance day $ ____	Accumulated Depreciation $ ____	Depreciation on Equipment $3 000
Accumulated Depreciation on Furniture & Fittings			

3 How is the inventory on at hand on 31 March 2006 determined?

4 Give the annual amount charged for depreciation on equipment and for furniture and fittings.

5 Why does the business need to charge for depreciation on equipment?

6 Using the information given in the Trial Balance for Lianas Chemist as at 31 March 2006, prepare the Statement of Financial Performance for this period and Statement of Financial Position as at balance day. Prepare these in the T or account form.

7 What is the adjusted value for dividends received for the year ended 31 March 2006?

8 Show in the General Journal, the entries required for Lena Cakes Store on balance date 30 June 2007, to incorporate into the accounting records the following:

a interest due but not received on investment in the bank, $360

b owner takes goods for her own use, $80

c credit sales made on balance day, to Kitano Restaurant, $260

d rent due but not paid at balance day, $600.

9 Pacific Loan Services had a bank balance of $5000 on 1 August 2010. The following transactions occurred during the month of August. You are required to use this information to prepare a Statement of Change in Cash Position for the month ended 31 August 2010.

Aug 1	Received cash fees $300;
2	Paid rent for the month, $500;
4	Received $800 from clients paying for their accounts;
8	Paid wages for the month, $600;
10	Sent accounts to clients, $450;
13	Purchase new computer, paying $1000 now and $4000 on credit;
14	Paid telephone and electricity, $330;
17	Owner takes $500 for own use;
23	Purchased stationery $55 cash;
24	Owner invests $5000 into business;
28	Paid accounts payable, $750;
30	Received cash from accounts receivable, $820.

10 Mose purchased a tractor which cost $60 000 to use on his plantation. He estimates that he can resell the tractor for $15 000 after 10 years of use.

a How much would Mose depreciate the tractor for each year (assuming the straight-line method of depreciation).

b What book value would the tractor have after two years of use?

c Draw up a depreciation schedule to show the amount charged for depreciation each year, the accumulated depreciation and the book value over the first five years.

11 This question deals with final accounts for service firms.

BLUE SKY TOURS

Trial Balance as at 30 June 2009

	$		$
Cash on hand	200	Capital	24 200
Accounts Receivable	3 800	Accounts Payable	2 300
Tour Vans (cost)	58 000	Bank overdraft	2 900
Tents and Equipment (cost)	15 000	Tour income	98 000
Van Expenses	9 500	Accumulated Depreciation: Vans	5 800
Equipment Repairs	700	Accumulated Depreciation: Tents	3 000
Bad Debts	300	Loan (due 2014)	10 000
Office Expenses	8 600		
Telephone Expenses	4 800		
Tour Food Expenses	26 000		
Tour Food on hand	1 800		
Ferry Expenses	2 500		
Drawings	15 000		
	146 200		**146 200**

Additional information:

- tour income of $3000 has been received in advance
- interest on loan is owing $500
- depreciation is charged on the tour vans at 10% p.a. (diminishing value)
- depreciation on tents and equipment is based on the expectation of use of five years and a residual value of $5000.

You are required to:

a Prepare fully classified Statement of Financial Performance (with suitable presentation for external users) and classify the expenses into *Tour Expenses, Administrative Expenses* and *Financial Expenses.*

b From the Trial Balance and additional information, complete the Current Liabilities section of the Blue Sky Tours' Statement of Financial Position as at 30 June 2009.

12 Explain the Monetary Measurement Concept used in accounting and the problems associated with this concept. Use some examples in your answer to this question.

Unit 4 Analysing The Financial Statements

Aims

On completion of this unit you should be able to:

- ❑ Analyse and interpret accounting data from different financial statements for Sole Proprietorships and other entities;
- ❑ Identify and explain the accounting concepts relevant to the interpretation of the accounting data shown in the financial statements;
- ❑ Compare figures and ratios derived from the financial statements of a business with results for different accounting periods, with other businesses in the same or similar industry or against industry norms.

Overview

When financial statements and reports are completed at the end of each financial year, the owners or shareholders will not necessarily be satisfied with information contained in these. The managers within a business will also have questions that cannot be answered just by looking at the accounting information contained in the financial statements. A very important part of the accountant's work therefore, is to *analyse* and *interpret* the figures. Part of this analysis and interpretation will require the accountant to compare current figures with those of past years and comment on the trends. Another part of this will also involve the comparison of figures with those of the industry or industry norms, i.e. expected results for that particular industry. The accountant will not just rely on the figures in the financial statements but she will also calculate ratios and percentages which will make comparisons across accounting periods and with industry norms easier.

Analysing financial statements was introduced in Year 11. All the main ratios and percentages used were explained in full at that time so these will only be briefly reviewed here. This unit will assist you to become more familiar with the use of ratios and percentages calculated from financial statements. It will also look at how this information can be interpreted and reported on so that users of accounting data are able to make informed decisions for the future benefit of the business.

Profitability Analysis

The Statement of Financial Performance provides information on the operating performance of a business during an accounting period. This information is stated in money terms (monetary measurement concept) and while it is useful in that it shows the amounts spent on different expenses and how much has received in income, it does not give the full picture. Calculating ratios and percentages allows for comparisons between accounting periods and between firms in the same industry.

The ratios and percentages that are calculated from to measure profitability are:

- mark-up and mark-up percentage
- gross profit percentage
- expenses percentages
- net profit percentage.

Mark-up

When the owners of a business sell goods, they will make sure that they add enough onto the cost of the goods sold to cover expenses, drawings or dividends, taxes and to make a reasonable profit for the expansion of the business. The amount added onto the cost of goods sold, is known as the **profit margin** or **mark-up** and is usually expressed as a percentage of the cost price. The mark-up will vary from business to business and will vary according to the types of goods. Goods that have a high turnover, such as bread, will have a lower mark-up than other goods that are not as popular. The owner predetermines the mark-up percentage. Factors that influence this decision include things such as competition for the sale of the same goods by other firms and demand for the goods. Once the decision has been made about the mark-up percentage, the selling price can be calculated:

$$\text{Selling Price} = \text{Cost price} + \text{Mark-up}$$

$$\text{Mark-up percentage} = \frac{\text{Gross profit}}{\text{Cost of goods sold}} \times \frac{100}{1}$$

It is possible to check the mark-up applied to all sales and then compare this to the **predetermined mark-up** to see if this mark-up level has been maintained. If the check shows that the mark-up percentage for all sales is less than the predetermined mark-up, it could mean any of the following:

- The business has been applying the wrong selling price on goods.
- Unpopular goods may have been marked down in price to get rid of them.
- An error has occurred in stocktaking.
- Shoplifting has occurred.
- Employees have been helping themselves to the goods.

All these explanations will need to be checked out so that appropriate measures or safeguards can be put into place to ensure that the business assets are secured.

Gross profit percentage

The gross profit for a business should always be large enough to cover operating expenses and other expenditure such as:

- the owner's drawings, shareholders' dividends
- expansion
- the replacement of fixed assets or the purchase of new assets.

$$\text{Gross profit percentage} = \frac{\text{Gross profit}}{\text{Net sales}} \times \frac{100}{1}$$

It is useful to compare the gross profit percentage with percentages obtained from previous accounting periods. If the gross profit percentage is lower than in previous periods, then the accountant would investigate the same areas as identified above for mark-up. If the cause for the decrease in gross profit percentage is not found, then the best solution would be to maintain or increase the level of sales to ensure the survival of the business.

Expenses percentage

This percentage gives the amount for every $1 of revenue earned, that is spent on the expenses for the earning of that revenue. Operating expenses can be either fixed or variable. Fixed expenses are those costs which do not change with the amount of revenue earned. Examples of this include rent and insurance. However, other expenses such as advertising, selling expenses, cost of running the factory and electricity, are examples of variable expenses.

Common categories of expenses expressed as a percentage of net sales include:

$$\text{Selling expenses percentage} = \frac{\text{Selling expenses}}{\text{Net Sales}} \times \frac{100}{1}$$

$$\text{Administrative expenses percentage} = \frac{\text{Administrative expenses}}{\text{Net Sales}} \times \frac{100}{1}$$

$$\text{Financial expenses percentage} = \frac{\text{Financial expenses}}{\text{Net Sales}} \times \frac{100}{1}$$

$$\text{Total operating expenses percentage} = \frac{\text{Total operating expenses}}{\text{Net Sales}} \times \frac{100}{1}$$

When percentages for different accounting periods are compared, the percentages should stay the same or show decreased expenses compared to net sales.

Activities

Copy and complete the following in your book:

1. A firm has a mark-up percentage of 50%. For this financial year, the opening inventory was $40 000, closing inventory of $37 000 and purchases was $95 000. Calculate the sales for the period.
2. Ama's Takeaways was flooded during a bad storm and all the invoices for the year ended 31 December 2010 were destroyed. Fortunately, Amelia, the owner had taken home the stock records and was able to calculate the stock at the start of the year as $3500 and at the end of the financial year the stock on hand cost $4800. The sales for the year was $104 000. In previous years, the average gross profit percentage for the business was 30% of sales. Use this information to calculate the cost of purchases for the year.

3 Tana Sports Shop paid $50 per unit for volleyball kits which are sold for $80 each. During the year ended 31 December 2009, 1000 kits were sold.
You are required to:

a calculate the gross profit per kit

b calculate the total cost of units sold during the year

c calculate the total sales of volleyball kits for the year

d calculate the mark-up percentage for volleyball kits

e calculate the gross profit percentage for volleyball kits.

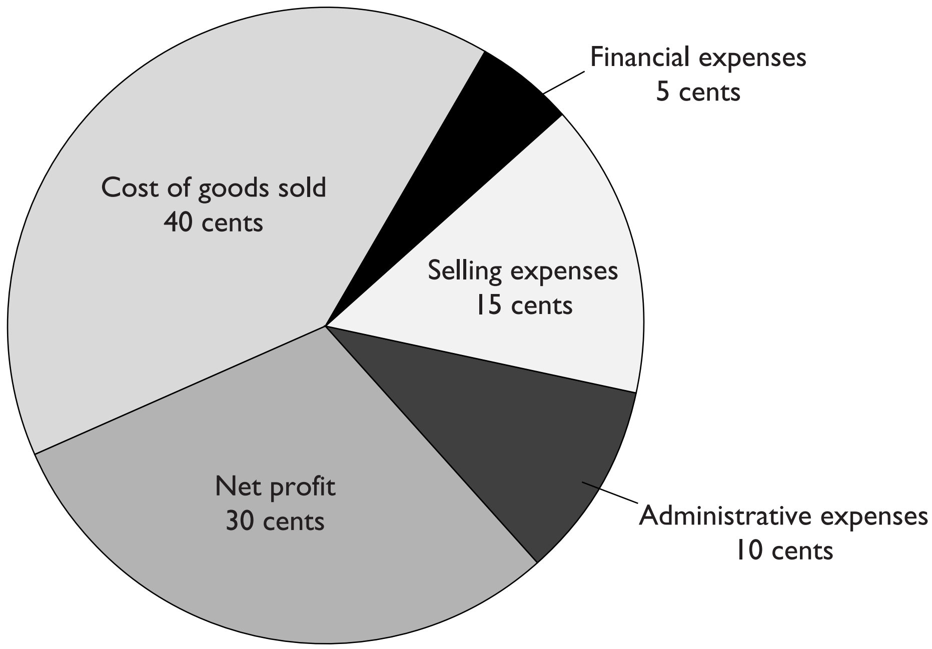
4 Relay Industries has a gross profit percentage of 20%. If the gross profit is $80 000, calculate the:

a sales

b cost of goods sold

c mark-up percentage.

5 The diagram below represents each sales dollar of Citi Wear Clothing Retailers for the year ended 31 March 2012. The total sales for the year were $400 000.



You are required to:

a prepare the Statement of Financial Performance for the year ended 31 March 2012

b calculate the mark-up percentage

c In the year ended 31 March 2013 the mark-up percentage was 100% and the profit was 30% of sales. Sales were $300 000.

i Give two reasons (apart from stocktaking errors) why the mark-up percentage may have changed this year.

ii Give one reason why the net profit percentage may have changed this year.

iii How much was the gross profit?
(HINT: calculate the gross profit percentage first.)

iv How much was the net profit?

v Comment on these results.

6 The table below shows the operating results for Sāmoa Komputas for the past three years:

	2008	2009	2010
Sales	$150 000	$180 000	$200 000
Gross Profit	$90 000	$120 000	$100 000
Net Profit	$30 000	$40 000	$20 000

a Draw a line graph showing the results given in the table above.
b Shade your graph to show:
  i Cost of goods sold
  ii Total expenses.
c Comment on the trends shown by the graph you have drawn.

Analysing And Interpreting Results For The Statement Of Financial Position

Percentages and ratios based on the Statement of Financial Position include:

- net profit as a return on capital invested or Return on Owner's Equity percentage
- owner's equity ratio
- working capital ratio or current ratio
- liquid ratio.

Owners' Equity

Owners' equity ratio is a very important measure as it indicates the extent of the owner's equity or share of the business. For a sole proprietor or partnership, the calculation is:

$$\text{Equity Ratio} = \frac{\text{Owner's Equity}}{\text{Total Assets}}$$

For a company this ratio is known as **Shareholders Equity Ratio**

$$\text{Shareholders Equity Ratio} = \frac{\text{Shareholders' Equity}}{\text{Total Assets}}$$

If the ratio is less than 0.5:1, it means that the creditors have more equity in the business than the owners. This is not a desirable position to be in. The business is at risk and creditors may put pressure for payment which would force the owner to sell some of the business assets to meet their demands.

Example for Sole Proprietor:

Tana Sports Shop has the following equity ratios for 2010 and 2011:

2010	2011
$= \frac{\$80\ 000}{\$140\ 000}$	$= \frac{\$75\ 000}{\$150\ 000}$
= 0.57:1	= 0.50:1

The equity ratio for Tana Sports Shop has decreased. The owner now only has 50 cents in each $1 of asset owned by the business. This is not a good trend and Tana should be aware of the risks to his business if he does not do anything to turn this trend around. It would not be a good idea for Tana to try to borrow much more because he would be increasing the exposure of his business to creditors.

Tana's options:

- ❑ Tana could invest more capital in the business. By injecting more cash into the business, Tana would be increasing the owners' equity. This option would depend on whether Tana had the personal sources of cash to put into the business.
- ❑ The business could have a large sale to get rid of the out-of-date inventory at cheaper prices. Although this would decrease his profit margin, Tana could use the cash to repay some of his creditors.
- ❑ The business could sell some of the non-current assets that it did not require, e.g. shop fittings which are not being used, shelves or furniture.
- ❑ Tana will also need to reduce his drawings so that he does not decrease the owner's equity.

Tana would be best advised to try a combination of the options suggested above.

Example for a Company:

The Statement of Financial Position for Pacific Water Bottlers is shown below:

PACIFIC WATER BOTTLERS LTD
Statement of Financial Position as at 31 December 2011

2010 $	Shareholders' Equity	$
500 000	Paid up capital	600 000
100 000	Retained earnings	150 000
600 000	*Total Shareholders' Equity*	750 000
	Represented by:	
150 000	Current Assets	160 000
30 000	*Less:* Current Liabilities	40 000
120 000	Working Capital	120 000
700 000	*Plus:* Non-current assets	840 000
820 000		960 000
220 000	*Less:* Non-current Liabilities	210 000
600 000	*Total Net Assets*	**750 000**

The Shareholders' Equity Ratio can be calculated:

$$\text{Shareholders' Equity Ratio} = \frac{\text{Shareholders' Equity}}{\text{Total Assets}}$$

	2010		2011
=	$\frac{\$600\,000}{\$150\,000 + \$700\,000}$	=	$\frac{\$750\,000}{\$160\,000 + \$840\,000}$
=	0.71:1	=	0.75:1

Note:

- The shareholders' equity includes both the paid up capital (the amount paid by shareholders for shares in the company) and retained earnings (profit that is not distributed to shareholders as dividends).
- The equity ratio for companies is the same as it is for other different ownership entities, with the only difference being the title given to the owners' equity section.

Working capital and working capital ratio

Working capital is the difference between current assets and current liabilities. It is usually shown in the Statement of Financial Position. Working capital represents the amount of current assets available to pay liabilities. These liabilities are due to be paid in the next two to three months. Current assets should always exceed current liabilities. Working capital can also be calculated as a ratio.

$$\text{Working Capital Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

For Pacific Water Bottles Ltd:

		2010	2011
Working Capital Ratio	=	$\frac{\$150\,000}{\$30\,000}$	$\frac{\$160\,000}{\$40\,000}$
	=	5:1	4:1

The working capital ratio is a measurement used to give an indication of the **financial stability** of the business. This refers to the ability of the business to pay its debts. The working capital ratio provides a measure of the *short term liquidity* of the business, over the next accounting period. The other measure used to assess the financial stability of a business is to look at its **liquid assets** or **liquid ratio**. This measures the *immediate liquidity* of the business.

Liquid capital and the liquid ratio

Liquid capital and liquid ratio provides a measure of immediate liquidity or the ability of the business to meet its immediate debts or debts due in the next month. Assets that can be turned into cash within one month are sometimes referred to as *quick assets*. Current assets included in this are cash, accounts receivable and accrued revenue (if it can be collected in the next month). Prepayments are not included as these are expenses which the business has paid in advance and the services for these will be used by the business. Inventory on hand is also not included as a liquid asset because it is very unlikely that these can be sold for cash in the next month. The one current liability item that is usually excluded from this calculation is a bank overdraft that is secured. If the bank overdraft is secured, it usually means that the bank will not require this to be repaid within the month as it is secured against the assets of the business.

$$\text{Liquid Capital} = \text{Quick Assets} - \text{Quick Liabilities}$$

$$\text{Liquid Asset Ratio} = \frac{\text{Quick Assets}}{\text{Quick Liabilities}} = \frac{\text{Current Assets} - (\text{Prepayments} + \text{Stock})}{\text{Current Liabilities} - \text{Secured Bank O/D}}$$

For Tana Sports Shop:

	2010	2011
Liquid Asset Ratio =	$\frac{\$20\ 000}{\$15\ 000}$	$\frac{\$10\ 000}{\$12\ 000}$
=	1.3:1	0.83:1

These calculations show that in 2010, Tana Sports Shop had $1.33 in cash to pay for each dollar of immediate debt but in 2011, it only had 83 cents in cash to pay for each dollar of immediate debt. This situation should be considered very seriously by Tana as the owner, because the business could find it hard to meet debts if its current liabilities were to increase or if current assets were to decrease.

Return on owner's investment

Owners or shareholders invest in a business because they want to get some return for the money they put in. In the case of a sole trader or partnership, there are other returns also, such as being your own boss, making decisions for the business and working your own hours. This investment is made knowing that there are risks involved and for sole trader and partnership type ownerships, one major risk is the fact that the owners are personally liable for all the debts of the business. Shareholders have limited liability, because the company is a legal entity and the personal assets of the shareholders cannot be used to settle any debts of the business.

The owners and shareholders are very interested in the return they make from the investment in the business. They would expect the return to exceed the rate of return they would get if they had invested in other investments such as in banks. For sole traders and partners, they would expect their return on investment to be similar to that of being in regular employment working in another organisation.

$$\text{Return on owner's investment} = \frac{\text{Net Profit}}{\text{Average Owner's Equity}} \times \frac{100}{1}$$

$$\text{Average Owner's Equity} = \frac{\text{Opening Capital} + \text{Closing Capital}}{2}$$

Tana Sports Shop:

	2010	2011
Return on owner's investment =	$\frac{\$30\ 000}{\frac{1}{2}(\$84\ 000 + \$80\ 000)} \times \frac{100}{1}$	$\frac{\$25\ 000}{\frac{1}{2}(\$80\ 000 + \$75\ 000)} \times \frac{100}{1}$
=	37%	32%

The return on owner's equity for Tana, is very good as it shows that he is getting 37 cents back on every dollar he has invested in the business in 2010 and in 2011, he is getting back 32 cents in every dollar. This is a much higher return than he would get if he put this capital into the bank. However, there is cause for concern that the return on investment has decreased during this time. Tana should look at this trend together with other ratios and percentages such as those of profitability. If the net profit percentage is also showing a downward trend, then Tana should monitor operating costs and inventory controls to ensure that mark-up is maintained at the determined level. If net profit is not showing a downward trend, then Tana should look at his drawings and ensure that he controls this to an appropriate level.

Example:

Pacific Water Bottlers Ltd:

Return on Shareholders Equity:

	2010	2011
=	$\frac{\$150\,000}{\frac{1}{2}(\$650\,000 + \$600\,000)} \times \frac{100}{1}$	$\frac{\$180\,000}{\frac{1}{2}(\$600\,000 + \$750\,000)} \times \frac{100}{1}$
=	24%	27%

This rate of return should be compared with rates of return for other similar types of business and industry norms. The trend over these two years looks as if it is increasing which is a positive sign. This percentage should be viewed together with other profitability measures.

Summary Of Percentages And Ratios

The percentages and ratios discussed in this unit have been summarised for you in the tables given below. These are the same tables that appear in the textbook for *Business Studies* Year 11, Book 2. They have been repeated here to assist you in recalling and using the percentages and ratios for the analysis and interpretation of financial information.

Table 4.1 Measures of profitability

Sales Trend Shows the percentage change in sales.	$\frac{\text{Current year's sales} - \text{Previous year's sales}}{\text{Previous year's sales}}$ **Source:** Statement of Financial Performance	**Satisfactory:** The percentage change is positive if sales have increased over the last two years. **Reasons for unsatisfactory result:** ❑ downturn in sales due to poor demand or poor marketing strategy ❑ theft of goods ❑ sales not recorded.

(cont.)

Mark-up Percentage Shows the gross profit earned as a percentage of cost of goods sold.	$\frac{\text{Gross Profit x 100}}{\text{Cost of Goods Sold}}$ **Source:** Statement of Financial Performance	**Satisfactory:** The figure is close to the budgeted mark-up. **Reasons for unsatisfactory result:** ❑ theft of stock ❑ sales at reduced price ❑ If the business sells a variety of goods with different mark-ups, there may have been a change in the sales mix, with more goods that have a lower mark-up being sold ❑ inaccurate stock figures.
Gross Profit Percentage Shows the proportion left out of every dollar of net sales to cover other expenses.	$\frac{\text{Gross Profit x 100}}{\text{Net sales}}$ **Source:** Statement of Financial Performance	**Satisfactory:** That it is similar to those of previous years. **Reasons for unsatisfactory result:** ❑ decreased sales ❑ cost of goods sold have increased.
Expenses Percentage Shows the proportion of each dollar of net sales that is spent on each particular group of expenses	$\frac{\text{Expenses x 100}}{\text{Net Sales}}$ **Source:** Statement of Financial Performance	**Satisfactory:** That it is similar to those of previous years. **Reasons for unsatisfactory result:** ❑ decreased sales ❑ increased expenses ❑ Some expenses, e.g. rent, may remain fixed even though net sales increases.
Net Profit Percentage Shows the proportion of each dollar of sales which is net profit.	$\frac{\text{Net Profit x 100}}{\text{Net Sales}}$ **Source:** Statement of Financial Performance	**Satisfactory:** The owner is able to draw a reasonable level of income from the business. As net profit is the amount left over after all expenses have been paid, it should increase if expenses are reduced.
Return on Owners Equity Percentage Shows the reward to the owner for every dollar invested in the business.	$\frac{\text{Net Profit x 100}}{\text{Average owner's equity}}$ [Note: if average owner's equity cannot be calculated, the owners equity at the start of the period should be used] **Source:** Statement of Financial Position	**Satisfactory:** This figure should be compared with the return on other investments including term deposits with banks. The return should be higher than the current percentage earned in a bank account.

Table 4.2 Measures of financial stability

Working Capital figure This is expressed in dollar terms and shows the amount of current assets remaining after current liabilities were to be paid.	Working capital = Current Assets – Current Liabilities **Source:** Statement of Financial Position	**Satisfactory:** Businesses should aim for a positive figure in order to be able to pay their liabilities due during the current accounting period. **Note**: The working capital does not take the size of the business into consideration.
Current ratio / Working capital ratio This shows the ability of the business to repay its debts in the short term (3–6 months).	$\frac{\text{Current Assets}}{\text{Current Liabilities}}$: 1	**Satisfactory:** 2:1 For every $1 of current liabilities, the business has $2 of current assets to cover them.
Liquid ratio / Quick asset ratio Shows the business' ability to repay immediate debts in the short term (1 –2 months)	$\frac{\text{Current Assets – (Inventory + Prepayments)}}{\text{Current Liabilities – Secured bank o/d}}$: 1	**Satisfactory:** It should be at least 1:1 Quick assets are cash and assets that can be converted into cash within the next one or two months. Inventory is excluded as it is very unlikely that all stock can be sold within two months. Prepayments are excluded as getting a refund for prepaid expenses can be difficult. Quick liabilities are debts due within the next two months. A secured bank overdraft is unlikely to called in unless the limit has been exceeded.
Return on Owners Equity Shows the return on owners' investment in the business	$\frac{\text{Net Profit x 100}}{\text{Average Owners' Equity}}$	**Satisfactory:** Above the percentage rate offered by banks and allows for a return risk and a return on the time invested by the owner.
Equity Ratio Shows the proportion of the business' assets funded by the owner and therefore the control that the business has over its assets.	$\frac{\text{Closing Owners' Equity}}{\text{Total Assets}}$: 1	**Satisfactory:** The ratio shows that internal ownership is greater than external ownership 0.6:1. The benchmark is 0.5:1. If it gets below this, there is a real danger that the business cannot pay its debts and the owner may lose control of the business.

Activities

Copy and complete the following in your books.

1 The following extracts have been taken from the Statements of Financial Performance of Tropical Fruits Ltd for the past three years:

	2008	**2009**	**2010**
Sales	$250 000	$280 000	$300 000
Cost of Goods Sold	$175 000	$180 000	$190 000
Selling Expense	$30 000	$35 000	$40 000
Administrative Expenses	$12 000	$14 000	$15 000
Financial Expenses	$8 000	$8 000	$10 000
Shareholders' Equity	$85 000	$100 000	$130 000

The Shareholders' Equity for 2007 was $50 000.

You are required to:

a Calculate the following percentages for 2008, 2009 and 2010:

- **i** gross profit percentage
- **ii** selling expense as a percentage of sales
- **iii** administrative expenses as a percentage of sales
- **iv** financial expenses as a percentage of sales
- **v** net profit percentage
- **vi** percentage return on shareholders' equity.

b For each of the percentages you have calculated in **a** above, write one sentence giving a possible reason for the trend which has occurred.

c The company paid no dividends in the year ended 31 December 2008 but it did sell some shares. How much did the company receive from the share sales?

d In the year to 31 December 2009 the company did not sell any shares but it paid a dividend.

- **i** What is a dividend?
- **ii** Calculate the amount of the dividend.

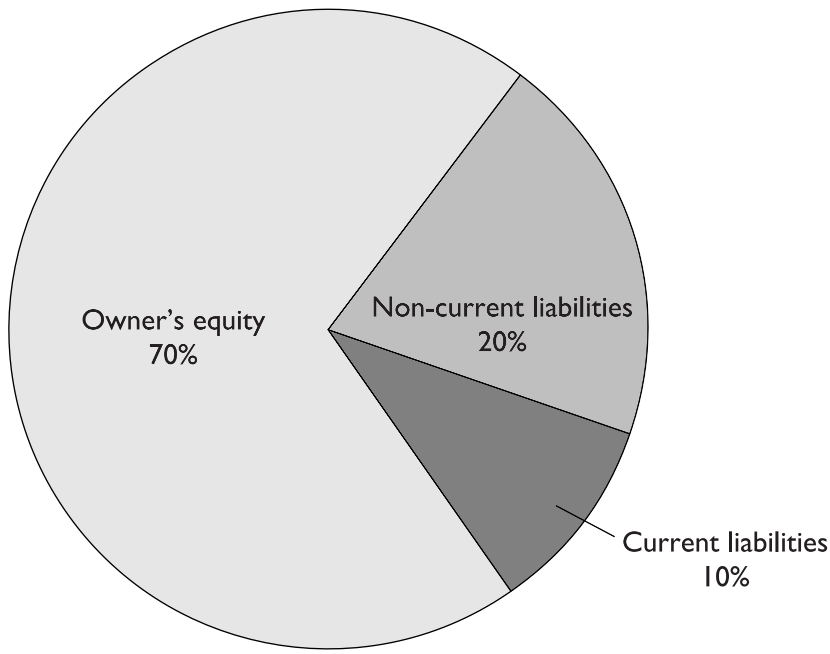
e In the following year, 2010, your sharebroker suggests to you that you buy some shares in this company. You have $10 000 in the bank on a term deposit at 8.5% per annum.

- **i** Give one reason why it would be a good idea to buy the shares.
- **ii** Give one reason why it would not be a good idea to buy the shares.

2 Trendy Fashions has the following assets as at 31 March 2012:

Cash at Bank	$18 000	Inventory	$27 000
Accounts Receivable	$10 000	Furniture and Fittings (cost)	$45 000

The total liabilities and owner's equity of the business are shown in the pie graph below:



The only current liabilities of the business are accounts payable. The non-current liability is a loan from the bank which is due for repayment as at 31 March 2017.

You are required to:

a Prepare a Statement of Financial Position for the firm as at 31 March 2012.

b Calculate the following ratios:

i current ratio

ii liquid ratio

iii equity ratio.

c State whether or not you consider each of the ratios you have calculated in **b** above to be satisfactory or not and why.

The premises that Trendy Fashion leases have become available for purchase. They will cost $100 000. Mei, the owner of the business decides to purchase the building and uses $45 000 of personal savings as a deposit and the bank has agreed to lend the rest on mortgage for 20 years. Mei purchases the building on 1 April 2013.

d Prepare the Statement of Financial Position for Trendy Fashions after the purchase of the building.

e Calculate the equity ratio after the purchase of the premises. Is this satisfactory? Why?

3 The following financial statements are for two businesses in competition with each other in Salelologa.

Statement of Financial Performance for year ended 30 June 2015		
	Alpha **$**	**Betta** **$**
Sales	100 000	160 000
Less Cost of Goods Sold	67 500	118 000
Gross Profit	32 500	42 000
Less Expenses	17 500	12 000
Net Profit	**15 000**	**30 000**

Statement of Financial Position as at 30 June 2015		
	Alpha **$**	**Betta** **$**
Capital as at 1 July 2014	160 000	240 000
Plus Net Profit	15 000	30 000
	175 000	270 000
Less Drawings	25 000	20 000
Capital as at 30 June 2015	150 000	250 000
Current Assets	60 000	70 000
Less Current Liabilities	35 000	35 000
	25 000	35 000
Plus Non-current Assets	125 000	215 000
	150 000	**250 000**

a Which business has performed more profitably? Show the percentages and ratios you would look at to support your answer.

b Comment on the liquidity of each business.

c Give at least three limitations of using percentage /ratios in assessing the performance of a business.

Unit 5

Journals

Aims

On completion of this unit you should be able to:

- ❑ Classify information from various source documents and record them accurately into the appropriate journals;
- ❑ Describe the different methods of accounting for and recording of VAGST;
- ❑ Record VAGST for Cash Journal entries only;
- ❑ Identify and explain general procedures for internal control as a means for managing financial resources of organisations;
- ❑ Describe the features of internal control systems for cash receipts and cash payments.

Overview

Journals have been introduced in earlier texts. In this unit we will review the recording of cash and credit transactions in the different journals as well as introduce the recording of VAGST. We will also cover the importance of internal controls on cash.

Journals are used to categorise transactions into cash receipts and cash payments, credit transactions relevant to the sale and purchase of inventory and special events transactions.

Input		**Process**		**Output**
Source documents	→	Journals, ledgers	→	Financial statement

Goods And Services Tax

VAGST or value added goods and services tax, is a tax imposed by the government and administered by the Inland Revenue Department. VAGST is an indirect tax, which means that it is not deducted from wages or salaries, but is added to goods and services that a consumer or other producers pay for. All businesses are registered for VAGST, unless they are very small or have an exemption to do so. The registered businesses charge VAGST on all goods and services they sell and pay VAGST on most of their expenses. At regular intervals, these same businesses will calculate the difference between the amount of VAGST they have paid and the amount they have received, to see if they have to pay money or will receive a refund from the Inland Revenue Department. A VAGST return has to be lodged by all registered firms. If a payment for VAGST is due it must be made at the same time the return is lodged.

Calculating VAGST

VAGST is added to the selling price of goods or services at the rate of 12.5% of the price. This represents one-eighth of the pre-VAGST (now abbreviated to GST) price. For example, an item with a price of $100 (GST excl) will be sold at $112.50 (GST incl).

$$\frac{12.5}{100} = \frac{1}{8}$$

When we add the GST amount onto the price of an item the GST inclusive price will now be nine eighths of the GST exclusive price. This is represented in the diagram below.

This means that the GST component is one-ninth of the total price. For the sake of simplicity, the recording of GST is only dealt with in the Cash Receipts and Cash Payments Journals at this stage. Accounting for GST on credit transactions will not be dealt with until later in Year 13.

Example:

An item which is priced at $200 plus GST is sold at $225 (GST incl):

$200 x 12.5% = $25 (GST component)

$200 + $25 = $225 (GST incl)

Therefore as a fraction of the selling price, the GST is:

$$\frac{25}{225} = \frac{1}{9}$$

This means you can calculate the GST component of a selling price (which is GST inclusive) by dividing it by 9.

Cash Receipts Journal

The preparation of cash journals have been covered thoroughly in previous texts and so this unit will look at requirements for the accounting and recording of GST through the cash journals. When cash is received by the business, for some transactions, a portion of the amount received is GST and therefore must be shown in the journals as GST collected.

The Cash Receipts Journal records details of cash received by the business. Cash received should be receipted and banked regularly, preferably daily. The amount on the deposit slip butt is then entered into the Cash Receipts Journal. Other amounts which are recorded in the Cash Receipts Journal are not receipted but will have another source document from which the information is recorded from. For example, total cash sales for the day will be summarised on the cash register tape (CRT) or interest received is entered from the bank statement (BS). The source documents used to record transactions that are then entered in the Cash Receipts Journal include:

- ❑ receipts
- ❑ cash register tape
- ❑ bank statement.

The example given below shows how transactions are recorded in the Cash Receipts Journal for Tana Sports Shop during the month of January 2008. You will note that there is a separate analysis column for GST and also that not all cash received will have a GST component, e.g. capital invested by the owner or a loan received from the bank, or interest received.

Example:

Tana Sports Shop was established on 1 January 2008, when Tana invested $20 000 cash in it. The following is a summary of all the cash received during the month of January, 2008. All the amounts below include GST if applicable.

Jan 1	Tana commenced business with $20 000 cash, rec.001
3	Banked sales for the day, $1 200
5	Banked a loan from the bank, $10 000 cash, rec.002
10	Banked sales for the week, $5 600
13	Received rent for that portion of the building leased to another business, $135, rec.003
17	Banked sales for the week, $7 200
20	Received $800 for a computer Tana had invested in the business but was sold because it was inadequate for the office, rec.004
	Received rent, $135 rec.005
24	Banked sales for the week, $6 500
27	Received rent, $135 rec.006
31	Banked sales for the week, $8 500

The bank statement for the month showed that the business received $10 interest which was paid by the bank into the account on 20 January. The cash receipts journal prepared from the summary above is shown over the page:

TANA SPORTS SHOP
Cash Receipts Journal

Page 1

Date(08)	Particulars	Rec	Ref	Receipts $	Bank $	GST $	Sales $	Rent $	Sundry $
Jan 1	Capital – Tana	001		20 000	20 000				20 000
3	Sales	CRT		1 200	1 200	133	1 067		
5	Bank loan	002		10 000	10 000				10 000
10	Sales	CRT		5 400	5 400	600	4 800		
13	Rent	003		135	135	15		120	
17	Sales	CRT		7 200	7 200	800	6 400		
20	Computer sold	004		900		100			800
	Rent	005		135	1 035	15		120	
24	Sales	CRT		6 500	6 500	722	5 778		
27	Rent	006		135	135	15		120	
31	Sales	CRT		8 500	8 500	944	7 556		
20	Interest	BS			10				10
					60 115	3 344	25 601	360	30 810

Note:

- The GST amount is one ninth of the amount received (GST incl) by the business.
- Some transactions do not have GST added to them, e.g. capital, interest and bank loans.
- The receipts column is used to show what cash went through the business before it was banked. Interest was paid directly by the bank into the account and therefore is not entered into this column.
- BS is the abbreviation for Bank Statement, which is the source document which records the interest received from the bank. CRT is the abbreviation for cash register tape.
- The sundry column is used to analyse those items that are not regular receipts by the business, e.g. capital, bank loan and van sold.
- The entries in the Cash Receipts Journal are normally posted to the ledger accounts at the end of each month.

The summary of ledger postings are:

Debit entries:	**$**	**Credit entries:**	**$**
Bank	60 115	GST	3 344
		Sales	25 601
		Rent received	360
		Capital	20 000
		Bank Loan	10 000
		Computer	800
		Interest received	10
	60 115		**60 115**

Cash Payments Journal

The Cash Payments Journal records all the payments made by the business. All payments made by the business should be made by cheque or automatic payment from the bank account. Cheques should be signed by the people authorised to do so. When the payment is made, the cheque butt should be filled in clearly and the invoice that is being paid should have a note with the cheque number of the cheque used for payment. If a petty cash imprest system is used, then only small payments should be made from this and a separate voucher should be filled in for each payment (evidence of use of cash). The source documents that are used to record the entries in the Cash Payments Journal include:

- ❑ cheque butts
- ❑ entries of payments made directly by the bank.

Example:

Tana Sports Shop was established on 1 January 2008, when Tana invested $20 000 cash in it. He also contributed a computer valued at $1000. The following is a summary of all the cash payments during the month of January, 2008. All the amounts below include GST if applicable.

Jan 1	Purchased goods for $8 100, chq 130
2	Tana Sports Shop purchased a shop for $15 000 cash, chq 131
4	Paid wages of $450, chq 132
7	Paid for electricity chq 133, $360
10	Paid for telephone connection, chq 134, $270
11	Paid wages of $450, chq 135
11	Cash drawings of $500, chq 136
14	Paid computer repairs, $300, chq.137
18	Paid wages of $450, chq 138
23	Paid for telephone, $180 and stamps $27, with the same cheque, 139
25	Paid wages of $450 chq 140
31	Cash drawings of $200, chq 141

The bank statement showed an automatic payment for insurance on the buildings of $90 was made on 20 January and bank fees of $9 were charged on 30 January.

TANA SPORTS SHOP

Cash Payments Journal

Date (08)	Particulars	Chq#	Ref	Details	Bank $	GST $	Wages $	Drawings $	Phone $	Sundry $
Jan 1	Purchases	130			8 100	900				7 200
2	Building	131			16 875	1 875				15 000
4	Wages	132			450		450			
7	Electricity	133			360	40				320
10	Telephone	134			270	30			240	
11	Wages	135			450		450			
	Drawings	136			500			500		
14	Computer repairs	137			300	33				267
18	Wages	138			450		450			
23	Telephone	139		180		20			160	
	Stamps			27	207	3				24
25	Wages	140			450		450			
31	Drawings	141			200			200		
20	Insurance	BS			90	10				80
30	Bank fees	BS			9					9
					28 711	2 911	1 800	700	400	22 900

Note:

- There are separate analysis columns for transactions which occur frequently. All other transactions are analysed in the Sundry column.
- The details column is only used when one cheque is used to pay for two separate items.
- All transactions have a corresponding cheque number or another source document recorded as evidence of the transaction.
- Insurance which was paid as an automatic payment directly from the bank account, has BS or bank statement as the source document. Bank fees are charged directly by the bank on the business bank account. These last two entries can only be entered when the bank statement is received by the business.
- GST is paid on most expenses, except wages and drawings.

The ledger postings summary is as follows:

Debit entries	$	Credit entries	$
GST	2 911	Bank	28 711
Wages	1 800		
Drawings	700		
Telephone	400		
Purchases	7 200		
Buildings	15 000		
Electricity	320		
Computer repairs	267		
Stamps	24		
Insurance	80		
Bank fees	9		
	28 711		**28 711**

Internal Controls Over Cash

For any business, cash is the asset which is most at risk since it can be used easily for any transaction and is difficult to trace if stolen. The main purposes of internal control over cash are to ensure that all:

- cash assets are protected
- cash received is banked
- cash received is recorded
- payments are authorised
- payments are recorded.

Controls For Cash Receipts

The internal controls over cash receipts must be designed carefully. The separation of duties is very important to ensure adequate internal control. The controls established by firms will depend on how the cash is received. For small organisations, where cash is all received over the counter, owners will have cameras which record the cash-handling area. These ensure that the employees are safe from theft by others, as well as keeping them honest! For large firms where customers make payments by post, procedures for opening mail will be needed to ensure that the payment made by the customers is accounted for accurately and banked intact. The following procedures should be put in place for security of cash assets:

- All cash should be banked intact, daily.
- All mail should be opened by two people.
- All incoming cheques should be crossed and stamped “Not Transferable”.
- All receipts should be pre-numbered. Any cancelled receipts should remain in the receipt book.

- Spare receipt books and cheque books should be securely locked away.
- Cash sales should be recorded on a cash register with a locked in tape. The cash in the till should be reconciled against the tape at the end of the day, or when cashiers change.
- Goods are priced in odd amounts to force sales assistants to give change. This prevents them from pocketing the cash without recording a sale.
- Duties and tasks should be separated and no two tasks done by one person. The cashier should not update the cash receipts journal or update the customer records.
- The bank reconciliation statement should be prepared by an employee who is independent of the cash receipts subsystem (separation of duties).

Controls For Cash Payments

If a manual accounting system of cash payments is used, then the most important aspect for the business will be to ensure that all payments are properly authorised. The main features for internal control will ensure that:

- All payments should be made by cheque unless they are small payments which should be made through a petty cash imprest system. All cheques should be crossed and marked "Not Transferable".
- All payments should be properly authorised.
- The petty cash imprest system should be managed by one independent person and checked regularly by a senior staff member.
- Spare cheque books should be securely locked away.
- The cashier should not be a signatory for cheques or be responsible for updating accounting records.
- Cheque signatories should not have sole responsibility for approving payment of invoices.
- The bank reconciliation should be completed by a staff member who is independent of the cash payments subsystem.

Activities

Copy and complete the following in your book.

1 The cheque butts given on the following page were written by Samu, the owner of Super Appliances. All amounts include GST where applicable.

You are required to:

Prepare a cash payments journal to record these transactions and a posting summary.

1 September 20 09

To Always Ready

For Purchases

Bal B/Fwd	7 000	–
Deposits	–	
	7 000	–
This cheque	810	–
Bal C/Fwd	6 190	–

231905

3 September 20 09

To Cash

For Drawings

Bal B/Fwd	6 190	–
Deposits	–	
	6 190	–
This cheque	500	–
Bal C/Fwd	5 690	–

231906

6 September 20 09

To Power Sāmoa

For Electricity

Bal B/Fwd	5 690	–
Deposits	800	–
	6 490	–
This cheque	225	–
Bal C/Fwd	6 265	–

231907

14 September 20 09

To Hana

For Wages

Bal B/Fwd	6 265	–
Deposits	–	
	6 265	–
This cheque	720	–
Bal C/Fwd	5 545	–

231908

16 September 20 09

To Electrix Supplies

For Purchases

Bal B/Fwd	5 545	–
Deposits	–	
	5 545	–
This cheque	1 350	–
Bal C/Fwd	4 195	–

231909

20 September 20 09

To Cash

For Drawings

Bal B/Fwd	4 195	–
Deposits	–	
	4 195	–
This cheque	500	–
Bal C/Fwd	3 695	–

231910

28 September 20 09

To Steve

For Wages

Bal B/Fwd	3 695	–
Deposits	–	
	3 695	–
This cheque	720	–
Bal C/Fwd	2 975	–

231911

30 September 20 09

To Towns Properties

For Rent

Bal B/Fwd	2 975	–
Deposits	–	
	2 975	–
This cheque	1 800	–
Bal C/Fwd	1 175	–

231912

2 The source documents below were issued by Liki's Hardware.

You are required to:

Enter the transactions shown by these documents in a Cash Receipts Journal and prepare a ledger posting summary at the end of the week.

TAX INVOICE No: 631
1 June 2009
Liki's Hardware
RECEIPT
GST No: 435-874-921
RECEIVED FROM: Andy's Autos
FOR: Ladders
$450.00

TAX INVOICE No: 632
2 June 2009
Liki's Hardware
RECEIPT
GST No: 435-874-921
RECEIVED FROM: Pete's Painters
FOR: Paint
$360.00

TAX INVOICE No: 633
4 June 2009
Liki's Hardware
RECEIPT
GST No: 435-874-921
RECEIVED FROM: Harry
FOR: Capital
$9 000.00

TAX INVOICE No: 634
5 June 2009
Liki's Hardware
RECEIPT
GST No: 435-874-921
RECEIVED FROM: Apia Artists
FOR: Commission
$45.00

TAX INVOICE No: 635
6 June 2009
Liki's Hardware
RECEIPT
GST No: 435-874-921
RECEIVED FROM: Sparky's
FOR: Electric drill
$90.00

TAX INVOICE No: 636
7 June 2009
Liki's Hardware
RECEIPT
GST No: 435-874-921
RECEIVED FROM: Pete's Painters
FOR: Paint
$315.00

Liki's Hardware
GST No: 435-874-921
2 June 2009
3.40 +
5.90 +
25.95 +
9.75 +
45.00 T
THANK YOU
CALL AGAIN

Liki's Hardware
GST No: 435-874-921
4 June 2009
6.70 +
15.95 +
19.25 +
39.10 +
81.00 T
THANK YOU
CALL AGAIN

Liki's Hardware
GST No: 435-874-921
7 June 2009
49.95 +
19.95 +
14.95 +
14.15 +
99.00 T
THANK YOU
CALL AGAIN

Other Journals

You have already learned about the journals which record credit transactions, such as the buying and selling of goods on credit. These will not be covered again in this unit other than in the activities where you will be required to complete them. The table that follows summarises the journals used so far.

Review of Journals:

Name of Journal	Function and purpose	Source documents which provide information for this journal
Cash Receipts Journal	Records cash received by the business or organisation. We are able to summarise all of the transactions of a particular type and make a single entry into the ledger account.	❑ cash register tape ❑ receipts issued ❑ bank statements.
Cash Payments Journal	Records cash paid by the business or organisation. It analyses payments into different categories, like the Cash Receipts Journal.	❑ cheque butts ❑ bank statements.
Sales Journal	Records credit sale of goods by the business.	❑ copy of invoices issued to debtors.
Sales Returns Journal	Records the return of goods sold by the business.	❑ copy of credit note issued by the business to the debtor.
Purchases Journal	Records the purchase of goods on credit from suppliers.	❑ original of invoice issued by supplier (creditor).
Purchase Returns Journal	Records the return of goods back to the supplier because they were faulty or incorrectly supplied.	❑ original of credit note issued by the supplier (creditor).
General Journal	Records miscellaneous transactions that are not cash or related to the sale or purchase of goods on credit.	A variety of source documents including: ❑ memorandum from management or owner ❑ invoice for purchase of fixed asset on credit ❑ internal memorandum from accounting dept ❑ other documents.

In Unit 2, you were introduced to adjustments that are completed on balance day to ensure that a more accurate calculation of profit is made. Balance day adjustments are first recorded in the accounting records through the General Journal. This will include entries for the expense of depreciation on fixed assets.

Activities

Copy and complete the following in your book.

1 The credit transactions for Pacific Timber Products appear below for the month of April 2008. The firm is not registered for GST.

Mar 1	Bought goods from Savai'i Lumber, invoice 322, $7 000
3	Island Crafts bought goods $600, invoice 483
5	Returned goods to Savai'i Lumber, credit note 065, $350
9	Sold goods to Tivoli Markets, invoice 484, $580
11	Tivoli Markets returns faulty goods, credit note 021, $80
14	Bought goods from Hawkes Wood Products, invoice 638, $5 200
16	Sold goods to Planters Ltd, invoice 485, $1 340
18	Sold goods to Apia Hardware, invoice 486, $2 300
22	Bought goods from Savai'i Lumber, invoice 389, $4 000
23	Returned goods to Savai'i Lumber, credit note 077, $250
27	Sold goods to Planters Ltd invoice 487, $2 050
30	Bought goods from Hawkes Wood Products, invoice 699, $3 700
	Sold goods to Island Crafts $840, invoice 488.

You are required to:

Record the above transactions in the sales, sales returns and allowances, purchases or purchase returns and allowances journals of Pacific Timber Products.

2 Pacific Timber Products also have the following transactions which need to be recorded but they do not seem to fit into any of the credit or cash journals:

Mar 13 The owner takes goods for his own use. The goods cost $870. Memorandum.

Mar 24 It is decided that the debt owed by Smith Ltd will be written off as a bad debt. Smith Ltd owes the business $250.

Mar 27 The owner contributes equipment worth $5 000 to the business.

Mar 31 On balance day the following adjustments are required:

- **i** prepaid insurance is $200
- **ii** rent received in advance is $300
- **iii** wages due but not paid on balance day, $750
- **iv** depreciation to be allocated for Plant and Equipment at 10% p.a. on cost of fixed asset, $250 000.

3 Identify the journals where each of the following source documents would be recorded:

a the original of a receipt

b the copy of a credit note

c the copy of an invoice

d a cheque butt

e the copy of a cash register tape

f the original of an invoice

g a memorandum from the owner that she has taken goods for personal use

h the original of a credit note

i a copy of a receipt.

4 Describe internal controls which could be used to prevent each of the following events from occurring:

a an employee taking petty cash to pay for personal stationery

b an employee writing out a cheque for a false invoice

c paying a supplier twice

d theft of cheques by staff opening the mail

e theft of cheques by a cashier who banks them into her own bank account

f an employee stealing cash from the cash register and recording a cash refund transaction to cover for the theft.

Unit 6

Posting To The Ledger

Aims

On completion of this unit you should be able to:

- ❑ Identify information from the ledgers and use it to accurately draw up financial statements for service industries, trading firms and community organisations;
- ❑ Discuss the function of Subsidiary Ledgers within the Accounting Process;
- ❑ Record information for Accounts Receivable and Accounts Payable in the appropriate Subsidiary Ledgers;
- ❑ Post relevant information from the journals to the General Ledger and Subsidiary Ledgers;
- ❑ Compare manual computer processing methods that can be used for recording, processing and reporting financial information.

Overview

The accounting process was discussed in some detail in Unit 1. We learned that accountants produce accounting information for people interested in using this information to make good decisions. In order to produce quality information, accountants use a system which allows the accountant to analyse and interprete data to give useful information for others to make decisions.

This unit will look at that part of the accounting system which summarises accounting data relevant to an item into one account to make it easier to report on progress and profitability of the business. While a lot of the processing learned and practised through the exercises included in this unit are now done by a computer system, it is useful to understand the process as it will be relatively easy to transfer your knowledge to a mechanical or computerised system. Any accounting system has three specific functions as shown in the diagram below:

Input → **Process** → **Output**

The Subsidiary Ledgers

Ledger accounts discussed in earlier textbooks have been General Ledger accounts where each account has been given a number for easy reference. The numbers are arranged according to a Chart of Accounts. A Chart of Accounts is arranged to suit the particular business. No two businesses will have the same Chart of Accounts or numbering system. For example, Tana Sports Shop's Chart of Accounts could look something like that shown below. The general ledger balances would appear as T accounts or in 3-columnar form. Full examples for both styles of presentation have been given in earlier texts.

TANA SPORTS SHOP **Chart of Accounts**		
100	**Current Assets**	
	110	Bank
	120	Inventory
	130	Accounts Receivable
200	**Non-current Assets**	
	210	Shop Fittings
	220	Delivery Van
	230	Buildings
300	**Current Liabilities**	
	310	Accounts Payable
400	**Non-current Liabilities**	
	410	Loan
	420	Mortgage
500	**Owner's Equity**	
	510	Capital
	520	Drawings

Another type of ledger will be detailed in this unit – subsidiary ledgers. These enable businesses to keep up-to-date records for individual debtors and creditors. Up to this time, you have been recording debtors and creditors in the general ledger. Individual accounts and the total for sales, sales returns, purchases and purchase returns have been recorded as total amounts in respective accounts receivable and accounts payable accounts. The amount owing from accounts receivable and owing to accounts payable have been summarised together. As this does not give us essential information needed to run the business more efficiently, records of individual debtors and creditors are kept in their own separate ledgers known as Accounts Receivable Subsidiary Ledger and Accounts Payable Subsidiary Ledger respectively.

Accounts Receivable Subsidiary Ledger

To help in understanding the process required for the recording we will look at the books of Liki's Hardware. Liki started business on 1 January 2009. He invested $50 000 cash, and took out a bank loan for $10 000 to get the business started. The following transactions occurred during January.

Jan 1	Liki started business with an investment of capital of $50 000 cash, truck valued at $35 000. He took out a bank loan for $10 000.
2	Purchased a building for $40 000 to establish Liki's Hardware, paying $20 000 cash and the rest on a mortgage (due 2020). Purchased goods for $10 000 on credit from Hardware Supplies. Purchased shop fittings for $2 500 cash. Purchased equipment for $7 000 and two computers for $8 000 with cash.
4	Sold goods on credit to H & H Ltd for $5 600. Sold goods for cash $3 200. Returned faulty goods to Hardware Supplies $700. Paid telephone and internet connection $200 cash.
7	Paid wages $600. Sold goods on credit to Fale Builders $5 000. H & H Ltd returned goods $300. Purchased goods on credit from Savai'i Timbers $15 000. Cash sales $4 500.
8	Purchased goods for cash $8 000. Paid Hardware Supplies $5 000. Sold goods on credit $2 500 to Fusi LMS. Cash drawings $500.
12	Cash sales $8 500. Returned goods to Savai'i Timbers $500. Purchased goods from Hardware Supplies on credit $3 000.
14	Paid wages $600. Cash sales $2 500. H & H Ltd pays account in full $5 300. Paid electricity $200 and advertising $500.
17	Cash sales $5 800. Sold goods on credit to Vailoa Catholic Church $6 000. Purchased goods on credit Savai'i Timbers $9 000.
18	Received full payment from Fale Builders $5 000. Sold goods on credit to H & H Ltd for $17 000.
20	Paid Savai'i Timbers $14 500. Received payment from Fusi LMS $2 500. Cash sales $8 600.
21	Paid wages $600 and telephone $240. Paid internet account $400. Purchased goods on credit from Hardware Supplies $7 000.
24	Cash sales $10 400 and received cash from Vailoa Catholic Church $2 000. Cash drawings $1 500. Owner takes goods for own use $3 000.
28	Paid wages $600. Cash sales $3 200. Purchased goods on credit from Savai'i Timbers $6 000.
31	Cash sales $8 200. Cash purchases $2 300. Sold goods to Fale Builders on credit $9 000. Returned goods to Savai'i Timbers $400.

The journals have been completed and are shown on the next page. The relevant amounts are posted from the journals to the General Ledger and the Accounts Receivable Ledger and Accounts Payable Ledger accounts. These have also been completed to help you see how the individual ledger accounts for debtors and creditors appear in the subsidiary ledgers and the Control Accounts for these in the general ledger. GST has been ignored for this exercise.

LIKI'S HARDWARE

Cash Receipts Journal CRJ1

Date	Particulars	Rec	Ref	Receipts $	Bank $	Sales $	A/c Rec $	Sundry $
Jan 1	Capital	001		50 000				50 000
	Bank Loan	002		10 000	60 000			10 000
4	Sales	CRT		3 200	3 200	3 200		
7	Sales	CRT		4 500	4 500	4 500		
12	Sales	CRT		8 500	8 500	8 500		
14	Sales	CRT		2 500		2 500		
	H & H Ltd	003	ARL 1	5 300	7 800		5 300	
17	Sales	CRT		8 500	8 500	8 500		
18	Fale Builders	004	ARL2	5 000	5 000		5 000	
20	Fusi LMS	005	ARL3	2 500			2 500	
	Sales	CRT		8 600	11 100	8 600		
24	Sales	CRT		10 400		10 400		
	Vailoa Cath Ch	006	ARL4	2 000	12 400		2 000	
28	Sales	CRT		3 200	3 200	3 200		
31	Sales	CRT		8 200	8 200	8 200		
					132 400	57 600	14 800	60 000

LIKI'S HARDWARE

Cash Payments Journal CPJ1

Date	Particulars	Chq#	Ref	Details	Bank $	Purchase $	A/cPay $	Wages $	Phone $	Drawing $	Sundry $
Jan 2	Buildings	211			20 000						20 000
	Shop Fittings	212			2 500						2 500
	Equipment	213			7 000						7 000
	Computers	214			8 000						8 000
4	Telephone	215			200				200		
7	Wages	216			600			600			
8	Purchases	217			8 000	8 000					
	Hardware supplies	218	APL1		5 000		5 000				
	Drawings	219			500					500	
14	Wages	220			600			600			
	Electricity	221			200						200
	Advertising	222			500						500
20	Savai'i Timbers	223	APL2		14 500		14 500				
21	Wages	224			600			600			
	Telephone	225			240				240		
	Internet exp	226			400						400
24	Drawings	227			1 500					1 500	
28	Wages	228			600			600			
31	Purchases	229			2 300	2 300					
					73 240	10 300	19 500	2 400	440	2 000	38 600

LIKI'S HARDWARE
General Journal
GJ1

Date	Particulars	Ref	Debit $	Credit $
Jan 1	Truck		35 000	
	Capital			35 000
	Owner invests truck in business			
Jan 2	Buildings		20 000	
	Mortgage			20 000
	Took out mortgage to buy buildings			
Jan 24	Drawings		3 000	
	Purchases			3 000
	Owner takes goods for own use			

LIKI'S HARDWARE
Sales Journal
SJ1

Date	Particulars	Inv No.	Ref	Amount $
Jan 4	H & H Ltd	001	ARL1	5 600
7	Fale Builders	002	ARL2	5 000
8	Fusi LMS	003	ARL3	2 500
17	Vailoa Catholic Church	004	ARL4	6 000
18	H & H Ltd	005	ARL1	17 000
31	Fale Builders	006	ARL2	9 000
				45 100

LIKI'S HARDWARE
Sales Returns Journal
SRJ1

Date	Particulars	CN No.	Ref	Amount $
Jan 7	H & H Ltd	001	ARL1	300

LIKI'S HARDWARE Purchases Journal PJ1				
Date	**Particulars**	**Inv No.**	**Ref**	**Amount $**
Jan 2	Hardware Supplies	204	APL1	10 000
7	Savai'i Timbers	766	APL2	15 000
12	Hardware Supplies	245	APL1	3 000
17	Savai'i Timbers	790	APL2	9 000
21	Hardware Supplies	278	APL1	7 000
28	Savai'i Timbers	812	APL2	6 000
				50 000

LIKI'S HARDWARE Purchases Returns Journal PRJ1				
Date	**Particulars**	**CN No.**	**Ref**	**Amount $**
Jan 4	Hardware Supplies	028	APL1	700
12	Savai'i Timbers	124	APL2	500
31	Savai'i Timbers	129	APL2	400
				1 600

LIKI'S HARDWARE

Accounts Receivable ledger

H & H Ltd **ARL1**

Jan 4	Sales	SJ1	5 600	Jan 7	Sales returns	SRJ1	300
18	Sales	SJ1	17 000	14	Bank	CRJ1	5 300
				31	Balance	c/f	17 000
			22 600				22 600
Feb1	Balance	b/d	**17 000**				

Fale Builders Ltd **ARL2**

Jan 7	Sales	SJ1	5 000	Jan 18	Bank	CRJ1	5 000
31	Sales	SJ1	9 000	31	Balance	c/f	9 000
			14 000				14 000
Feb 1	Balance	c/d	**9 000**				

Fusi LMS **ARL3**

Jan 8	Sales	SJ1	2 500	Jan 20	Bank	CRJ1	2 500

Vailoa Catholic Church **ARL 4**

Jan 17	Sales	SJ1	6 000	Jan 24	Bank	CRJ1	2 000
				31	Balance	c/f	4 000
			6 000				6 000
Feb 1	Balance	c/d	**4 000**				

LIKI'S HARDWARE

Schedule of Accounts Receivable as at 31st January 2009

H & H Ltd	$17 000
Fale Builders	$9 000
Vailoa Catholic Church	$4 000
Balance as per control A/c	$30 000

LIKI'S HARDWARE

General Ledger

Accounts Receivable Control — 120

Jan 31	Sales	SJ1	45 100	Jan 31	Bank	CRJ1	14 800
					Sales returns	SRJ1	300
					Balance	c/f	30 000
			45 100				45 100
Feb 1	Balance	b/d	**30 000**				

Accounts Payable Control — 320

Jan 31	Bank	CPJ1	19 500	Jan 31	Purchases	PJ1	50 000
	Purchase returns	PRJ1	1 600				
	Balance	c/f	28 900				
			50 000				50 000
				Feb 1	Balance	b/d	**28 900**

LIKI'S HARDWARE

Accounts Payable Ledger

Hardware Supplies — APL1

Jan 4	Purchase returns	PRJ1	700	Jan 2	Purchases	PJ1	10 000
8	Bank	CPJ1	5 000	12	Purchases	PJ1	3 000
	Balance	c/f	14 300	21	Purchases	PJ1	7 000
			20 000				20 000
				Feb 1	Balance	b/d	**14 300**

Savai'i Timbers — APL2

Jan 20	Bank	CPJ1	14 500	Jan 7	Purchases	PJ1	15 000
12	Purchase returns	PRJ1	500	17	Purchases	PJ1	9 000
31	Purchase returns	PRJ1	400	28	Purchases	PJ1	6 000
	Balance	c/f	14 600				
			30 000				30 000
				Feb 1	Balance	b/d	**14 600**

LIKI'S HARDWARE **Schedule of Accounts Payable as at 31 Jan 2009**	
Hardware supplies	$14 300
Savai'i Timbers	$14 600
Balance as per control A/c	$28 900

Note:

- The Schedule of Accounts Receivable and Accounts Payable total should be the same as the balance of the respective Control Accounts in the General Account.
- The individual ledger account balances in the Subsidiary Ledgers are NOT shown in the Trial Balance, only the balances to the Control Accounts.
- Small businesses usually do not operate Subsidiary Ledgers but have the individual ledger accounts in the General Ledger.
- The accounts that appear in the General Ledger that have the word Control in it, signal that there is a subsidiary ledger attached to this account.
- GST has been ignored for this example.

Using Computers

Computer technology has advanced at a very fast rate over the last few years and this has had a huge impact on the processing of accounting information. Most businesses try to make use of computers in some way in their accounting process though this depends on the size of the business, availability of technology and the cost. For many businesses in Sāmoa, the system of accounting used is limited by the resources. The cost and maintenance of computer hardware in an environment such as Sāmoa is an important consideration. However, in more recent times, Sāmoa has seen growth in this area of the business sector.

How a computer works

There are two major components:

- hardware
- software.

Hardware

Hardware has a number of different components:

- The **Central Processing Unit (CPU)** is central to the operation of a computer and processes the data. It has a memory component which stores the programme being run and data on which the programme works.
- The input device most commonly used is a keyboard and a mouse, but information can also be entered by voice or touch.

- Storage devices include:
  - **a** floppy disks – a form of storage for external purposes, it holds less data than the hard disk
  - **b** hard disks – this is the large storage device inside the computer.
  - **c** cartridges
  - **d** optical disks
  - **e** compact disks.
- Output devices are used to display and record the information obtained. The two main devices are:
  - **a** Visual Display Unit (VDU) a screen like a TV. This form of output is "soft" as it disappears when the computer is shut off
  - **b** A printed copy which is produced on paper fed through a line computer. This form of output is "hard" as it is a physical record of the information.

Software

Software is another name for programme and refers to the instructions contained in computer programmes or software packages. These instructions are written by the business or purchased from a company which specialises in their manufacture.

- *Systems software* is built into the computer as part of the internal memory;
- *Application software* is another name for programmes which are stored on disks or CDROM and are loaded into the computer's memory as required.

Computer software and hardware are continually becoming more advanced. Devices are now smaller and more powerful, while software is becoming more user-friendly and accessible.

Electronic Data Processing

The following diagram has been used earlier to summarise the accounting process:

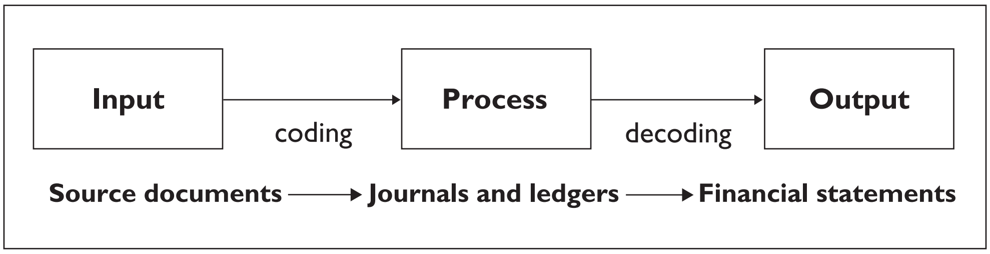


Figure 6.1 Electronic data processing

The inputs for the process were source documents which are coded according to the chart of accounts. This is the same process necessary when using a computer. The output of an accounting package will depend on the programme itself. The business will use the package which produces the output that it requires, e.g. ledger accounts and trial balance, GST returns, bank reconciliation statements and financial statements.

Many businesses use a combination of manual and computerised accounting systems. The main difference between the two systems is the processing of the data. The basic accounting input and output are the same in any system. Accountants will encourage businesses to use an accounting system that can be integrated into the system they use themselves so that it makes processing the data more efficient and reduces the accounting fees.

Activities

Please copy and complete the following in your book:

1 Refer to the worked example of Liki's Hardware for this question:

  a Complete posting all the other journal entries to the General Ledger for Liki's Hardware and complete a Trial Balance as at 31 January 2009.

  b The Subsidiary Ledger Accounts have been completed in T form in the worked example of Liki Hardware shown on pages 86–91. Show the same subsidiary ledger accounts for debtors and creditors using the columnar (3-column) method of presentation.

2 Pippa Hansen has prepared the accounts receivable ledger of her business for the month of April 2008. The ledger accounts are shown below:

W. Jones

Date	Particulars	Debit $	Credit $	Balance
April 1	Balance			1 500 Dr
13	Sales	400		1 900 Dr
21	Bank		1 500	400 Dr
28	Sales	700		1 100 Dr

L. Poynter

Date	Particulars	Debit $	Credit $	Balance
April 1	Balance			900 Dr
5	Sales	800		1 700 Dr
18	Sales	1 300		3 000 Dr
20	Sales Returns		200	2 800 Dr
30	Bank and Discount allowed		1 200	1 600 Dr

S. Barber

Date	Particulars	Debit $	Credit $	Balance
April 1	Balance			320 Dr
30	Bad Debts		320	—

E. Hohaia

Date	Particulars	Debit $	Credit $	Balance
April 1	Balance			2 350 Dr
7	Sales	750		3 100 Dr
14	Sales	540		3 640 Dr
20	Interest	10		3 650 Dr
22	Bank		2 000	1 650 Dr

Pippa has tried to prepare an Accounts Receivable Control Account but is having difficulty in balancing it. She asks for your assistance.

You are required to:

a Prepare the Accounts Receivable Control Account for the month of April 2008, and a Schedule of Accounts Receivable at that date.

b Show the General Journal entries for interest charged to E. Hohaia and bad debts written off for S. Barber.

3 Examine the general ledger accounts below.

Accounts Receivable Control				**210**
Date	**Particulars**	**Debit $**	**Credit $**	**Balance $**
July 1	Balance			7 400 Dr
3	Bad Debts		300	7 100 Dr
9	Interest	15		7 115 Dr
31	Sales	14 700		21 815 Dr
	Bank and Discount Allowed		6 200	15 615 Dr
	Sales Returns		105	15 510 Dr

Accounts Payable Control				**310**
Date	**Particulars**	**Debit $**	**Credit $**	**Balance $**
July 1	Balance			5 900 Cr
8	Freight		200	6 100 Cr
30	Purchases		6 500	12 600 Cr
	Bank and Discount Received	5 900		6 700 Cr
	Purchase Returns		300	6 400 Cr

You are required to:

a Describe the event that occurred on 3 July.

b The discount received from suppliers was $300 for prompt payment of accounts. How much cash was actually paid?

c Cash received from customers was $6050 in total. How much discount was given to customers?

d What was the total of invoices issued during the month?

e What was the total of credit notes received during the month?

f Write a sentence to describe the entry made on 8 July.

4 The following Statement of Financial Position was prepared for *Wood and Style Furnishings* as at 30 June 2011.

WOOD AND STYLE FURNISHINGS
Statement of Financial Position as at 30 June 2011

	$	$	$
Owner's equity			
Capital, 30 June 2011			156 000
Represented by:			
Current Assets			
Accounts receivable		8 000	
Inventory		125 000	
			133 000
Less: Current liabilities			
Bank		1 000	
Accounts payable		12 000	
			13 000
Working capital			120 000
Plus: Non-current assets			
Land and buildings (cost)		80 000	
Shop fittings (cost)	9 000		
Less: Accummulated depreciation	3 000		
		6 000	
			86 000
			206 000
Less: Non-current liability			
Mortgage on premises (due 30 June 2020)			50 000
Total net assets			**156 000**

Schedule of Accounts Receivable as at 30 June 2011

S Nob	$2 500
B Trendy	$4 000
Y Uppie	$1 500
	$8 600

Schedule of Accounts Payable as at 30 June 2011

R Ippoff	$8 400
M Oldy	$2 000
X Pensive	$1 600
	$12 000

You are required to:

a Enter the opening balances in the general ledger, the accounts receivable ledger and the accounts payable ledger.

b Record the transactions listed below for the month of July in appropriate journals, and post to the ledgers (general ledger, accounts receivable ledger and accounts payable ledger).

Mar 2	Sold goods on credit to S Nob for $1 200, Invoice No. 231
3	Bought goods on credit from X Pensive for $3 100, Invoice No. 556. Paid M Oldy $1 000 on account, Cheque No. 406
4	Paid rates of $3 600, Cheque No. 407
5	Cash Drawings, $500, Cheque No. 408
7	Paid wages, $350, Cheque No. 409
8	Returned broken chair costing $360 to M Oldy, Credit Note No. 540 Paid cash of $4 100 for purchases, Cheque No. 410
9	Received $2 800 on account from B Trendy, Receipt No. 145. Y Uppie paid her account in full less 5% discount, Receipt No. 146
10	Cash sales, $13 200. Received commission of $600, Receipt No. 147
12	Paid electricity, $140, Cheque No. 411. Charged S Nob $20 overdue fees on her account, Invoice No. 232
13	Proprietor took antique desk home, cost price $3 600, selling price $10 300
14	Paid wages, $420, Cheque No. 412. Paid X Pensive $1 000 (Cheque No. 413) and R Ippoff $3 500 (Cheque No. 414) on account
16	Sold goods to B Trendy on credit for $2 900, Invoice No. 232
17	Bought goods costing $2 600 from R Ippoff on credit, Invoice No. 875
18	B Trendy returned goods purchased for $700, Credit Note No. 105. Returned goods costing $850 to R Ippoff, Credit Note No. 642
19	Purchased shop fittings for cash, $1 800, Cheque No. 415
20	Received ten year loan from Bank of Sāmoa, $10 000
21	Paid wages, $350, Cheque No. 416. Cash sales, $26 300
22	Paid $5 900 cash for purchases, Cheque No. 417
23	Received notice that S Nob had been declared bankrupt and wrote off her account
24	Bought goods for $4 600 on credit from M Oldy, Invoice No. 266
25	Cash sales, $21 000. Paid R Ippoff $1 200 on account, discount received $200, Cheque No. 418
26	Cash drawings, $1 000, Cheque No. 419
27	Sold goods to Y Uppie for $1 200 on credit, Invoice No. 233

(cont.)

Mar 28	Paid wages, $400, Cheque No. 420. Charged Y Uppie cartage of $30 on her order, Invoice No. 234
30	Cash sales, $5 800
31	Paid SāmoaTel $150, Cheque No. 421. Issued Credit Note No. 106 for $50 to Y Uppie for damage to goods. Paid $1 500 on the mortgage principal, Cheque No. 422.

c Prepare a Trial Balance as at 31 March 2019.

d Prepare Schedules of Accounts Receivable and Accounts Payable as at 31 March 2019.

e The following balance day adjustments are required as at 31 March:

- ❑ wages due, $140
- ❑ interest of $100 is due on the bank loan and $750 is due on the mortgage
- ❑ rates of $3300 have been paid in advance
- ❑ commission of $100 is due but has not been received
- ❑ inventory on hand at 31 March had cost $148 000
- ❑ depreciation is to be provided at 10% per annum on shop fittings, based on the balance at the beginning of the month.
  (HINT: Remember that you are preparing the financial statements for one month only.)

5 What advantages would using a computer have for a business in Sāmoa. What would be some of the disadvantages? Use your list of advantages and disadvantages to prepare a brief report to Liki on how a computer system could benefit his hardware business.

Unit

7 Accounting For Community Organisations

Aims

On completion of this unit you should be able to:

- ❑ Describe the different stages of the accounting process to identify its application to non-profit entities.
- ❑ Identify the process for recording transactions for clubs and societies.
- ❑ Record simple transactions for clubs and societies in appropriate and relevant style.
- ❑ Record transactions related to the collection of and accounting for subscriptions including subscriptions in advance and subscriptions in arrears.

Overview

Financial statements for community organisations are slightly different from those for businesses. Because of the different nature of activities of a club or society, there are some slight differences in the naming of their financial statements. Most organisations are non-profit in focus and do not use journals or ledgers. They use a cash book system with analysis columns for amounts received and paid. It is from this information that the **Statement of Change in Cash Position** (**Receipts and Payments**) can be drawn up.

The Statement of Financial Performance is often known as the **Statement of Income and Expenditure** when it is prepared for a club or society. The profit is known as the *Excess Income over Expenditure* and a loss is known as *Excess Expenditure over Income*. Clubs and societies do not use the term profit as they are usually non-profit making organisations.

The Statement of Financial Position for a club or society is very similar to that of a business except that the *Owner's Equity* section is called the *Accumulated Fund*. There are certain rules that apply to the accumulated fund of a club or society that makes it very different to the capital account for a business. One major difference is that club members are not permitted to withdraw cash in the same way as the owner of a business can.

Statement Of Change In Cash Position (Receipts And Payments)

The Statement of Receipts and Payments for a club or society has a summary of:

- opening balance at bank
- cash received
- cash paid
- closing balance at bank.

Most clubs or societies are too small to be GST registered but their Statement of Accounting Policies covers the same policies as other financial organisations. They:

- identify the entity by name and nature
- use historical system of accounting
- report as an ongoing concern and use accrual basis of accounting
- must state their policy for depreciation and the method used (usually straight line).

A Statement of Receipts and Payments for a community organisation is very similar to the Bank Account in the General Ledger:

HAPPY GOLFERS CLUB
Statement of Receipts and Payments for year ended 31 December 2010

	$	$
Bank balance as at 1 January 2010		1 800
Add Receipts		
Subscriptions	6 000	
Raffle receipts	11 000	
Food stall sales	2 000	
Donations	500	19 500
		21 300
Less Payments		
Raffle prizes	7 000	
Raffle tickets	900	
Grounds maintenance	2 500	
Food stall purchases	1 000	
Food stall expenses	200	
Secretary's honorarium	2 000	
Rent for store room	500	14 100
Bank balance as at 31 December 2010		**7 200**

Statement Of Income And Expenditure

This statement is the same as the Statement of Financial Performance for a business. Adjustments are made to this account in the same way that balance day adjustments are made to the statement of financial performance. This includes things such as:

- accounts owing
- subscriptions paid in advance
- depreciation.

Community organisations have an additional adjustment for subscriptions. Sometimes members do not pay their subscriptions on the due date and it is still outstanding at balance day while others may pay some amount in advance of the time it relates to. To get a more accurate picture of the income and expenditure, adjustments have to be completed before final accounts are drawn up.

Although community organisations are often called non-trading concerns, many clubs operate different activities which help the club to raise funds for different events. These trading activities include things such as:

- operating a bar
- operating a shop during club nights/days
- raffles
- socials.

A separate account is kept for the trading activity and the net profit is worked out in the same way as a business. The net profit is then transferred to the Statement of Income and Expenditure.

Supplementary Trading And Activities Statement

On 31 December 2010, there were no outstanding bills for raffles. The Raffle Activity Statement appears below:

HAPPY GOLFERS CLUB

Raffle Activity Statement for year ended 31 December 2010

	$	$
Raffle ticket sales		11 000
Less Expenses		
Raffle prizes	7 000	
Raffle tickets	900	7 900
Surplus on Raffle transferred to Income and Expenditure		**3 100**

HAPPY GOLFERS CLUB

Statement of Income and Expenditure for the year ended 31 December 2010

	$	$
Income		
Subscriptions	5 900	
Surplus from Raffle	3 100	
Surplus from Food Stalls	800	
Donations	500	10 300
Less Expenditure		
Grounds maintenance	2 500	
Depreciation on equipment	400	
Secretary's honorarium	2 000	
Rent for store room	400	5 300
Excess of Income over Expenditure		**5 000**

HAPPY GOLFERS CLUB

Statement of Financial Position as at 31 December 2010

	$	$
Accumulated Funds		
Balance 1 January 2010		9 700
Add Excess Income over Expenditure		5 000
Balance as at 31 December 2010		14 700
This is represented by:		
Current Assets		
Bank	7 200	
Rent paid in advance	100	
Subscriptions in Arrears	100	7 400
Less Current Liabilities		
Subscriptions in Advance		200
Working Capital		7 200
Add Non-current Assets		
Equipment	8 000	
Less Accumulated Depreciation	2 000	
	6 000	
Sports uniforms	1 500	7 500
		14 700

Balance Day Adjustments For Clubs

Balance day adjustments for community organisations have already been mentioned earlier. These are exactly the same as they are for other ownership entities. However, because of the different nature of clubs and societies and the treatment of subscriptions, this gives rise to the different names used in the Statement of Financial Position.

Subscriptions are payments made by members to belong to the club. These are usually paid annually and are an important source of income for the club or society. At the end of the financial year, the income and expenditure statement is completed to find out the "surplus" or "deficit" for the year. To get an accurate picture of this, income and expenditure which do not belong in the current accounting period are excluded and so the amounts to appear in the Statement of Income and Expenditure should be for the current accounting period only. Subscriptions are paid by members during the year. At the end of the year, there will be members who have not paid the current subscriptions and others who may have paid for subscriptions in future years. These amounts need to be taken into account in the calculation of subscription income for the year. Subscriptions are a revenue item.

Example 1

If a club has 400 members and the annual subscription is $25 per member, then the club would record $1000 in the Statement of Income and Expenditure as the income from subscriptions for the year. However, it could be that on balance date, the club had received $1200 cash for subscriptions. As all members had paid their subs, then it is calculated that the $200 must be Subscriptions in Advance:

Subscriptions income for the year: 400 members x $25 each =	**$1 000**
Cash received for subscriptions:	**$1 200**
Subscriptions in advance:	**$200**

Subscriptions in Advance will appear in the Statement of Financial Position as a Current Liability because it is money that the club has received and the services have not yet been received by the members. The members who have paid these subscriptions are able to ask for a return of this amount at this time.

Example 2

The Statement of Changes in Cash Position of a club showed that cash received for subscriptions in its first year is $4900. The Statement of Income and Expenditure showed an income from subscriptions of $5000. The annual subscription is $100. You are informed that there is $300 received in advance for subscriptions:

The number of members:

Income from subscriptions	=	$5 000
	=	number of members x annual subscriptions
	=	number of members x $100
Number of members	=	$5 000÷$100
	=	500 members

Calculating subscriptions balance day adjustments:

Subscriptions in Advance	=	$300
Cash Received from subscriptions	=	$4 900

Therefore the amount of subscriptions paid in cash applicable for the current accounting period:

	Cash received	–	amount paid for Subscriptions in Advance
=	$4 900	–	$300
=	$4 600		

Therefore the amount of Subscriptions in Arrears is $400 (as the income for the year should be $5000).

Activities

Copy and complete the following in your book

1 The following items have been taken from Vailele Volleyball Club's accounting records for the year ended 30 June 2007.

VAILELE VOLLEYBALL CLUB
Receipts and Payments extract for year ended 30 June 2007

Receipts	**$**
Subscriptions	9 800
Fair Sales	5 000
Payments	
Coach's wages	7 200
Purchases for the Fair	3 000
Wages for workers at the Fair	2 000

VAILELE VOLLEYBALL CLUB Receipt No. 046

Date: 30/03/07

Received from: Suzi Farani

The sum of: one hundred dollars only

For: Annual subscription

Cash	
Chq	**$100**
Total	**$100**

Signature: R. jackson

Extract from treasurer's report for the year ended 30 June 2007:

The club's excess income over expenditure for the year ended 30 June 2007 was only $400. This was considerably less than expected. The club will need to increase its income by . . . .

VAILELE VOLLEYBALL CLUB

Statement of Financial Position as at 30 June 2007 extract

	2006	**2007**
Stock of good left from Fair	300	500
Subscriptions in Arrears	nil	200
Subscriptions in Advance	nil	500
Accumulated Fund	15 000	?

You are required to:

a State the amount which will be recorded in the Statement of Income and Expenditure for subscriptions for the year ended 30 June 2007. Show your working.

b State the number of members the club had during the year ended 30 June 2007.

c State how each of the following items will be classified in the club's Statement of Position as at 30 June 2007:

i subscriptions in arrears

ii subscriptions in advance.

d State one reason why the receipt has a receipt number.

e Complete the statement in the Treasurer's report suggesting one way the club could increase its income.

f Complete the Accumulated Fund section of the Statement of Financial Position as at 30 June 2007.

2 This question deals with accounting reports. You should ignore GST in this question. Rita is the treasurer of the Bay Rowing Club. The information was taken from the club's records for the year ended 31 August 2010.

Summary of receipts issued:

Subscriptions	$7 000
Kayak and equipment hire	$4 800

Summary of cheques written:

Kayak and equipment repair	$2 400
General club expenses	$1 600
Lifejackets and helmets	$3 000
New paddles	$2 000
New kayaks	$3 000

As at 31 August 2010 the club has the following:

- ❑ Term deposit $500
- ❑ An invoice from Rowing Supplies $800
- ❑ An amount owing for kayak and equipment hire $200
- ❑ Depreciation on kayaks and equipment for the financial year comes to $1 200

You are required to:

a Prepare a Statement of Changes in Cash Position for bay Rowing Club. The balance in the Bank as at 1 September 2006 was $2000.

b Complete the Kayak and Equipment Hire Activity Statement using the outline given below.

BAY ROWING CLUB
Kayak and Equipment Activity Statement for year ended 31 August 2007

Income

Kayak and Equipment hire

Less Expenditure

Kayak and Equipment repairs

Depreciation on Kayak and Equipment

Surplus on Kayak and Equipment Hire

c Explain how the amount owing for kayak and equipment hire illustrates accrual accounting.

3 Apia Jockey Club had the following assets as at 1 June 2007:

Cash at bank, $200, Refreshments on hand, $160, Equipment (cost), $6200, Clubhouse (cost), $25 000. The club had no liabilities.

The club has 100 members and the annual subscription is $20. There were some members who had not paid their subscriptions during the year. None had paid in advance for the following year.

At the end of the year, accounts were owing for repairs to equipment, $50 and competition expenses, $130. $50 of the secretary's honorarium had been paid in advance for the following year. Depreciation of $900 is to be provided on equipment. Refreshments on hand had cost $80.

At the end of the year, the club treasurer prepared the following Statement of Receipts and Payments:

APIA JOCKEY CLUB
Statement of Receipts and Payments for the year ended 31 May 2008

		$	$
Bank balance, 1 June 2007			200
Plus:	**Receipts**		
	Subscriptions	1 840	
	Sale of equipment (cost $1 200)	1 500	
	Competition fees	1 600	
	Refreshment sales	2 250	
	Sale of debentures to members	1 000	
Total receipts			8 190
			8 390
Less:	**Payments**		
	Competition prizes	1 200	
	Competition expenses	560	
	Disposable cups and plates	120	
	General expenses	190	
	Purchase of equipment	2 300	
	Purchase of refreshments	1 880	
	Repairs to equipment	230	
	Secretary's honorarium	250	
Total payments			6 730
			1 660

You are required to:

a Prepare statements which show the year's results for
  i competitions
  ii refreshments.

b Prepare a Statement of Income and Expenditure for the year ended 31 May 2008.

c Prepare a Statement of Financial Position as at 31 May 2008.

Key Vocabulary

Vocabulary	Collocations	Derivations
Accounting	Cost Accounting	
	Management Accounting	
	Financial Accounting	
	Taxation Accounting	
	Auditing Accounting	
	Accounting Technicians	
	an adequate accounting system	
	manual accounting systems	
	computerised accounting systems	
assets	fixed assets	
	current assets	
	quick assets	
	personal assets	
associated with	the costs associated with	
	the problems associated with	
basis	on the accrual basis	
	on a cash basis	
controls	internal controls on cash	
	controls for cash receipts	
	controls for cash payments	
	internal control	control
	internal control systems	
to determine	to determine the financial position	
	to determine a more accurate calculation	
	the owner predetermines the mark-up percentage	to predetermine
	the predetermined mark-up	predetermined
documents	financial documents	
	personal accounting documents	
	source documents	
efficiently	to use efficiently	
	to record efficiently	
to ensure	to ensure that all payments are properly authorised	
	to ensure adequate internal control	
	to ensure the survival of the business	
entity	a separate legal entity	entities
	a separate accounting entity	
	non-profit entities	
	the accounting entity concept	
to exceed	spending exceeds income	
	the limit has been exceeded	
incurred	expenses are incurred	
	costs incurred	
to interpret	to interpret changes in cash position	
	analysis and interpretation	interpretation
	the interpretation of financial information	
to invest	to invest in businesses	
		investors
	the most profitable investment	investment
	a good rate of return on their investment	
	reinvestment of profits	reinvestment
liabilities	current liabilities	liability
	quick liabilities	

(cont.)

Key Vocabulary

Vocabulary	Collocations	Derivations
to be limited	to be limited to the capital limited liability unlimited liability	 limited unlimited
a partner	a sleeping partner	partnership
a procedure	general procedures for internal control to put procedures in place	procedures
reconciliation	a bank reconciliation statement to reconcile your account the cash should be reconciled against . . .	 to reconcile
to be responsible	to be jointly responsible for all the debts to be personally responsible for sole responsibility legal responsibilities	 responsibility responsibilities
revenue	revenue and expenditure accrued revenue the Inland Revenue Department a revenue statement	
the value	the book value the residual value of the asset the value of assets and liabilities the present market value of fixed assets money values value added goods and services tax	

Topic Specific Vocabulary

Related to Unit 1 Accounting For Decision Making	Related to Unit 2 Business Ownership Characteristics
an invoice operational costs capital costs allocation subscriptions an Annual General Meeting (AGM) a credit note pay advice slips or payslips bank statements gross pay, net pay personal financial statements a statement of affairs a statement of assets and liabilities a statement of income and expenditure a statement of net worth	a sole trader a sole proprietor, a sole proprietorship limited liability companies multiple ownership a shareholder dividends a private/public company listed companies a Board of Directors a prospectus loans, debentures an incorporated society audited drawings a constitution a share calculation a solvency test the accumulated fund excess income over expenditure excess expenditure over income the Accounting Entity Concept the Going Concern Concept the Accounting Period Concept the Monetary Measurement Concept the Historical Cost Concept

(cont.)

Topic Specific Vocabulary

Related to Unit 3 Profit And Financial Performance
the statement of financial position
the statement of financial performance
the statement of cash flows
the statement of change in cash position
capital expenditure
a credit transaction
the current year's net profit calculation
accrual accounting
cash-based accounting
the Matching Concept
balance day adjustments
depreciation
straight-line depreciation
the diminishing value method for depreciation
a depreciation schedule
inventory
stocktaking
accumulated depreciation

Related to Unit 4 Analysing The Financial Statements
the creditors
a secured bank overdraft
the industry norms
profitability analysis
the profit margin
variable expenses
operating expenses
the mark-up percentage
the expenses percentage
the net profit percentage
the gross profit percentage
the financial expenses percentage
the administrative expenses percentage
the equity ratio
the owners' equity ratio/percentage
the shareholders' equity ratio/percentage
the working capital ratio, the working capital figure
the liquid capital
the liquid ratio
the quick asset ratio
the paid up capital
sales trend

Related to Unit 5 Journals
goods and services tax (VAGST)
an exemption
the GST inclusive/exclusive price
the GST component
the supplier
goods on credit
cheque butts
properly authorised
petty cash imprest system
a signatory for cheques
the cash register tape
the cash receipts journal
the cash payments journal
the sales journal
the sales returns journal
the purchases journal
the purchase returns journal

Related to Unit 6 Posting To The Ledger
debtors
the subsidiary ledger
the general ledger
a chart of accounts
accounts receivable subsidiary ledger
accounts payable subsidiary ledger
hardware
software
floppy disks
hard disks
cartridges
optical disks
compact disks
systems software
application software
electronic data processing

Related to Unit 7 Accounting For Community Organisations
non-profit making organisations
a statement of change in cash position
a statement of accounting policies
a statement of receipts and payments
a supplementary trading and activities statement

Useful time expressions

- the accounting period
- the financial year
- previous accounting periods
- over a specific time period
- balance day
- a specific time period
- the particular accounting period under review
- the current accounting period
- for the period.

Useful structures

Defining

- Accounting is a system that provides information . . .
- Accounting is a process of identifying, measuring and . . .
- Financial accounting is the area of accounting that prepares reports . . .

Giving examples

- The decision to buy a car, rent a house or contribute to a family event are some examples of financial decisions that families make.
- Examples of expenses include wages paid, rent, electricity, writing off bad debts, loss on the sale of a fixed asset, interest paid or buying goods for resale.
- No two businesses will have the same chart of accounts. For example, . . .

Explaining financial effects or implications

- During times of high inflation, the purchasing power of the dollar decreases. *This means that* the same goods and services will cost more than they did in the past.
- The profit for the year ended 31 December 2011 is $60 000. The company directors decide to pay a dividend of 15 cents per share. *This means that* each shareholder will receive 15 cents . . .
- The company must be able to meet its debts in the ordinary course of business. *This means that* it must have a positive working capital.
- In accounting, all transactions are recorded at the value at the time of the transaction. Assets are *therefore* recorded at their original price.
- The company is a separate legal identity to the shareholders *and therefore* it has legal responsibilities.