SUVA SANGAM COLLEGE
YEAR 12C/D
Accounting

Week 1 Date: 05th July 2021 – 09th July 2021

Strand: **Final accounts** **Sub-strand:** **Closing/Reversal journal entries**

Achievement Indicators

1. Close of temporary ledger accounts at the end of the accounting period.
2. Incorporate reversal entries in final accounts.

Closing Journal Entries

- After the preparations of financial statements, business entities close **temporary** accounts by transferring its balance to the Statement of Financial Performance or Income Statement.
- Revenue, expenses, gains, losses and drawings are closed off at the end of the reporting period.
- Accounts which are not closed off are the items from Statement of Financial Position (Balance Sheet), which are assets, liabilities and owners' equity because they are permanent accounts and their balances are transferred to the next accounting period.

	Particulars	Debit $	Credit $
1	Income Statement	XX	
	Opening Inventory		XX
	(For closing off opening inventory)		
2	Purchases Returns/ Income Statement	XX	
	Purchases		XX
	(For closing off purchases returns)		
3	Sales	XX	
	Sales Returns		XX
	(For closing off sales returns)		
4	Income Statement	XX	
	Purchases (net)		XX
	(For closing off purchases account)		
5	Income Statement	XX	
	Customs Duty		XX
	(For closing off customs duty)		
6	Sales	XX	
	Income Statement		XX
	(For closing off sales)		
7	Closing Inventory	XX	
	Income Statement		XX
	(For closing off Closing inventory)		
8	Income Statement	XX	
	Advertising		XX
	Sales Returns		XX
	Depreciation on Plant		XX
	Cost of Goods sold		XX
	Wages		XX
	(For closing off expenses to Income Statement)		

9	Rent Income	XX	
	Discount Received	XX	
	Commission Received	XX	
	Income Statement		XX
	(For closing off revenues to Income Statement)		
10	Income Statement	XX	
	Capital		XX
	(For closing off net profit to capital account)		
11	Capital	XX	
	Drawing		XX
	(For closing off drawings to capital account)		

Reversing Entries

- Take place on the first day of the new accounting period.
- This is to reverse the temporary book entry balance day adjustments that were prepared on the balance date to adhere to the accrual basis of accounting.
- There are four types of adjustments that need to be reversed: Accrued expenses, Prepayments, Accrued Income, Revenue in Advance.
- These items are reversed because the expenses and income accounts need to reflect the accurate amount for the next financial period.
- To prepare the reversal journal entry, the original journal entry is reversed.

	Particulars	Debit $	Credit $
1	Related Expense account	XX	
	Prepaid expense		XX
2	Expenses Due	XX	
	Related Expense account		XX
3	Related Income account	XX	
	Income Accrued		XX
4	Income received in advance	XX	
	Related Income account		XX

Activities

1. Show the closing journal entries for the following accounts.

(i)	Wages	$10 000	**(1 mark)**
(ii)	Drawings	$1 000	**(1 mark)**
(iii)	Cartage Inwards	$200	**(1 mark)**

2. Prepare the closing journal entries for the following accounts: (Narrations are not required.)

(i)	Sales	$90 000
(ii)	Purchase	$42 800
(iii)	Insurance	$8 900
(iv)	Commission Received	$5 200

Week 2 Date: 12th July 2021 – 16th July 2021

Strand: **ANALYSIS AND INTERPRETATION OF FINANCIAL STATEMENTS**

Strand Outcome: Apply knowledge of financial reporting to analyse vertically, horizontally and conduct trend analysis before interpreting the ratios calculated in the books of a sole trader.

Sub-strand: Analysing Accounting Reports

Achievement Indicators

1. Define financial statement analysis.
2. Explain the ways of analysing financial statements.
3. Outline the meaning and purpose of ratios.
4. Identify limitations of ratio analysis.

Read through the notes

Financial Statement Analysis

It is the process of identifying the financial strengths and weaknesses of a business by properly establishing the relationships between the items of Statement of Financial Performance and Statement of Financial Position.

Need for preparing Comparative Statements

- It enables us to compare budgeted results with the actual results of the business.
- Able to see the progress of the business in comparison to the past results.
- Identify the areas of weakness.

Techniques of Financial Statement Analysis

1. **Vertical Analysis -** analysis of relationship between items or group of items within the financial statement for one accounting period.
2. **Horizontal Analysis -** analysis of relationship between items or group of items within the financial statement for consecutive accounting period.
3. **Trend Analysis -** analysis of relationship between items or group of items within the financial statement for a period of three or more years.
4. **Ratio Analysis -** is an arithmetic term which describes a simple relationship between two numbers. Accountants use ratio analysis to make financial decisions.

Ratios can be analysed in percentages, time and dollar amounts under the following categories:

- Profitability Ratios or Earning Capacity
- Liquidity Ratios or Measures of Financial Stability
- Measures of Management Effectiveness

Overtrading

- Occurs when business is selling large amount of stock with a lower mark-up, or on credit, resulting in an increase in profit but does not have adequate funds to meet the current obligations.
- It may increase debtors and profits but the business will be unable to pay for its expenses which may cause liquidity problems in the business.

Over Capitalisation

- Means too much capital is invested in fixed assets that provide no income.
- Over-investment in fixed assets not only ties up cash but it also becomes unproductive and there is a risk of obsolescence.

Under Capitalisation

- Owners' investment is insufficient for the size of the business.
- It could be due to payment of excessive interests on borrowed funds, use of out dated equipment and machines because of the inability to purchase a new one and increased cost of production.

Limitations of Ratio Analysis

1. Items that cannot be quantified in monetary terms are not included in the ratio analysis.
2. Single year's figures are meaningless unless compared to the previous year of the business trend.
3. Calculations are based on historical cost ignoring the changes in the price level.
4. Different businesses may have different accounting policies which make comparison rather difficult in the same industry. For example, one firm may charge depreciation on straight line basis and the other on diminishing value method.
5. Ratio analysis explains the relationships between past information while users are more concerned about current and future information.

Short Answer Questions

a. Identify two ways to analyse financial statements.

b. Explain why the following users of accounting information need the financial reports:

   i. Trade Creditors.
   ii. Commercial Banks.
   iii. Potential investors.

c. List two purposes of analysing and interpreting final reports.

d. Suggest one reason why studying two years financial reports is more useful than studying one year's financial reports.

e. Differentiate between trend analysis and vertical analysis.

f. State two limitations of the analysis and interpretation of financial statements.

Week 3 Date: 19th July 2021 – 23rd July 2021

Strand: **ANALYSIS AND INTERPRETATION OF FINANCIAL STATEMENTS**
Sub-strand: **Analysing Accounting Reports**

Achievement Indicators

1. Calculate key ratios, percentages and dollar amounts to assist the analysis and interpretation of periodic accounting reports.

Measures of Earning Capacity or Profitability Ratios

FORMULAE, PURPOSE AND REASONS FOR CHANGE IN RATIOS

MEASURES OF EARNING CAPACITY OR PROFITABILITY RATIOS

Ratios under this category are associated with business profitability.

	Ratio	Formula	Purpose/ Significance	Reasons for change in ratios: Increase	Reasons for change in ratios: Decrease
1	Gross profit ratio OR Gross Profit %	Gross profit: Net Sales OR $\frac{\text{Gross Profit}}{\text{Net Sales}} \times \frac{100}{1}$	-Measures the gross profit per dollar of sales. - It indicates the margin of profit available to cover expenses.	- An increase in the selling price without the corresponding increase in costs. - Incorrect stock valuation e.g. closing stock may be overvalued. - Increase in demand for a particular good. - Decrease in COGS E.g. finds the cheaper supplier.	- A decrease in the selling price without the corresponding increase in costs. - Incorrect stock valuation e.g. closing stock may be undervalued. - An increase in costs without a corresponding increase in the selling price of the goods. - Due to low sales margin and expensive buying.
2	Net profit ratio OR Net Profit %	Net profit : Net Sales OR $\frac{\text{Net Profit}}{\text{Net Sales}} \times \frac{100}{1}$	- Measures net profit per dollar of sales. - Indicates net margin per dollar after all expenses.	- A lower figure for cost of goods sold. - A higher gross profit ratio. - Reduced expense rate. - Increase mark up by increasing selling price.	- A higher figure for cost of goods sold. - A lower gross profit ratio. - Higher expense rate.
3	Mark – up %	$\frac{\text{Gross profit}}{\text{Cost of goods sold}} \times \frac{100}{1}$	- Measures the gross profit based on the cost price.	- When the goods are on demand. - There is a new type of good in the market with a single distributor. - Buying from cheaper suppliers.	- When the goods are old or have become outdated. - There are many suppliers of the same goods and competition.
4	Expense to sales ratio OR Expenses to Sales %	$\frac{\text{Total Expenses}}{\text{Net sales}}$ $\frac{\text{Total Expense}}{\text{Net sales}} \times \frac{100}{1}$ **Individual Expenses** a) $\frac{\text{Selling\&Distribution Exp}}{\text{Net sales}} \times \frac{100}{1}$ b) $\frac{\text{Administrative Expense}}{\text{Net sales}} \times \frac{100}{1}$ c) $\frac{\text{Financial Expense}}{\text{Net sales}} \times \frac{100}{1}$	- Measures the ratio of expenses in relation to the sales dollar.	- Due to additional expenses being incurred. - Expenses in relation to the sale of the item have Increased.	- Due to decrease in the expenses.

5	Return on total assets ratio OR Rate of return on total assets %	Net profit +interest expense / Average total assets $\frac{\text{Net profit + int exp}}{\text{Average total assets}} \times \frac{100}{1}$	- Measures the net profit derived from every dollar of asset employed by the business.	- Means more efficient use of assets. - Could be as a result of disposing unused or unproductive assets. -Due to a higher profit (reduction in expenses). - Increase mark up.	- Means assets are not fully utilised. - Use of unproductive old assets. -Due to a decline in the profit.
6	Return on owners equity ratio OR Return on owners' equity %	Net profit / Average capital OR $\frac{\text{Net profit}}{\text{Average capital}} \times \frac{100}{1}$ Average capital = (opening capital + closing capital) ÷ 2	- Measures return on investments or assets provided by the owner. - Measures how effectively invested funds are used.	- Due to increased profits. - Decrease in expenses. - Increase in mark up.	- Result of overcapitalisation. - Decreased profits.

Refer to pages 138 to 141 of the text book for the examples on profitability ratios.

Activity 5.1.3
Question 1 Pg 154

Required:
Calculate the following ratios and percentages for the above business for the years 2015 and 2016.

a) Mark Up percentage
b) Gross profit ratio.
c) Administrative expense percentage.
d) Rate of return on total assets.

Activity 5.1.6

1. Kathy has a supermarket and sells food and other groceries. Sandy has a smaller store which sells vegetables and fruits.

   The following information is available for the year ended 30th June 2015.

	Kathy's Store ($)	Sandy's Store ($)
Revenue (Sales)	120000	48000
Gross Profit	42000	26400
Net profit for the Year	14400	17600
Capital at 1 July 2014	96000	50000

Required:
i) For each business, calculate the following
a) The percentage of gross profit.
b) Net profit percentage.
c) Rate of Return on Owners Equity.

ii) State **one** reason for the difference in the Net profit percentage between the two businesses.

iii) Kathy believes that she will increase her profit by increasing her sales. Explain why this may not be the case.

Week 4 Date: 26th July 2021 – 30th July 2021

Strand: **ANALYSIS AND INTERPRETATION OF FINANCIAL STATEMENTS**
Sub-strand: **Analysing Accounting Reports**

Achievement Indicators

1. Calculate key ratios, percentages and dollar amounts to assist the analysis and interpretation of periodic accounting reports.

Measures of Financial Stability (Liquidity Ratios and Financial Structure)

B	**MEASURES OF FINANCIAL STABILITY (LIQUIDITY RATIOS AND FINANCIAL STRUCTURE)** **Means the ability to meet financial requirements in both short term and long term so that the business could continue to operate as usual.**				
Liquidity ratios: it refers to the ability of the firm to meet its financial obligations as they become due. It relates to the financial strength of the business through working capital and quick asset ratios.					
1	Working capital or current or solvency ratio OR Working Capital % OR Working Capital in Dollars ($)	Current Assets / Current Liabilities OR Current Assets / Current Liabilities × 100/1 Current Assets – Current Liabilities	- Measures the ability to meet current debts with the current assets. - It indicates the ability of the business to meet its debts as it falls due in the short term 3-6 months.	- Increase in accounts receivables and closing stock. - By understating liabilities. - Increase in current asset by owner investing more money in the business.	- Improved stock control and management. - The stocks may be sold quickly. - Debt collection is done at a faster rate. - Increase in current liability.
2	Quick Asset or Acid Test ratio OR Liquid Capital in Dollars ($)	(Current Assets – closing stock - prepayment) / (Current Liabilities – Bank overdraft secured or limit) OR Quick Assets / Quick Liabilities [Current Assets – Closing Stock – Prepayment] – [Current Liabilities – Bank Overdraft (secured)]	- Measures the ability to meet immediate debts using the most liquid assets.	- Reduce credit buying. - An increase in credit sales to the customers. - Increase owners' contribution in form of cash.	- Increased buying of goods on credit. Slow collections from Debtors meaning slow payment to the creditors.

Financial Structure: it describes the business's sources of financing, including shareholders' equity and long- and short-term debts. It can be measured through certain ratios such as equity ratio, debt ratio and debt to equity ratio. These ratios can also be categorised as gearing ratios (or leverage).					
3	Proprietorship ratio or Owners Equity ratio or Equity ratio	$\frac{\text{Owners' Equity}}{\text{Total Assets}}$ OR $\frac{\text{Owners' Equity}}{\text{Total Assets}} \times \frac{100}{1}$	- Measures the percentage of assets or funds provided by the owners. - The ratio should at least be 50%. A very high level shows overcapitalisation by the owners.	- Due to the profits being retained in the business by the owner. - The owner is deliberately increasing investment in the business to avoid tax payments.	- Accumulating losses as a result of unproductive assets. - The owner withdrawing assets from the business.
4	Debt ratio	$\frac{\text{Total External Liabilities}}{\text{Total Assets}}$ OR $\frac{\text{Total External Liabilities}}{\text{Total Assets}} \times \frac{100}{1}$	-Measures the extent of assets or funds provided by the external parties. -The acceptable level is below 50%.	-May be due to buying of goods on credit. -The outsiders' funds in the business is Increasing.	-May be due to goods sold on credit (increase in debtors or assets). -The owner has brought in new productive assets in the business.
5	Debt to Equity ratio	$\frac{\text{Total External Liabilities}}{\text{Owners' Equity}}$ OR $\frac{\text{Total External Liabilities}}{\text{Owners' Equity}} \times \frac{100}{1}$	- Measures the outsiders claim in relation to the owners' equity. - The acceptable level is below 50%. -Shows the long term financial stability of the business.	- Relying more on borrowed funds. - A reduction in owners investment in the business.	- Relying less on borrowed funds. - An increase in investment by the owner.

Refer to pages 142 to 145 of the text book for the examples on financial stability ratios.

Activity 5.1.3
Question 1 Pg 154

Required:
Calculate the following ratios and percentages for the above business for the years 2015 and 2016.

i. Working capital ratio
ii. Quick Asset ratio
iii. Debt to Equity Ratio
iv. Debt Ratio
v. Equity Ratio

Week 5 Date: 2nd August 2021 – 6th August 2021

Strand: **ANALYSIS AND INTERPRETATION OF FINANCIAL STATEMENTS**
Sub-strand: **Analysing Accounting Reports**

Achievement Indicators

1. Calculate key ratios, percentages and dollar amounts to assist the analysis and interpretation of periodic accounting reports.

MANAGEMENT EFFECTIVENESS RATIOS

<table>
<tr><td>C</td><td colspan="5">MEASURES OF THE EFFECTIVENESS OF CERTAIN MANAGEMENT POLICIES
All ratios and percentages indicate the effectiveness of the management in controlling and managing their resources to its best advantage. However, some results are specifically related to certain policies of the management.</td></tr>
<tr><td>1</td><td>Rate of inventory turnover

Stock turnover (days/weeks /months)</td><td>Cost of goods sold / Average Stock = number of times

NB: the higher the rate the more favourable the ratio and vice versa.

Avg. Stock / COGS x days/weeks /months

NB: the higher the time frequency the less favourable the ratio and vice versa.</td><td>- Measures the number of times during the period that average inventory is sold.</td><td>- Improvement in stock control.
- Good selling and promotional techniques.
- Goods are sold in line with the consumers taste and fashion.
- Reduce markup.</td><td>- Stocks are becoming Outdated/ obsolete.
- Poor stock control.
- Poor selling and advertising techniques.</td></tr>
<tr><td>2</td><td>Rate of Accounts Receivable turnover

Accounts Receivables turnover (days/weeks /months)</td><td>Net credit sales / Average debtors = number of times

NB: the higher the rate the more favourable the ratio and vice versa.

Avg. debtors / Net Cr sales x days/weeks /months

NB: the higher the time frequency the less favourable the ratio and vice versa.</td><td>- Measures the time taken by the debtors to pay their debts.
- Indicates how quickly debtors pay their debts.</td><td>- Inefficiency in the collection of debts.
-Financial constraints faced by the customers.
- A change in credit policies to attract more customers.</td><td>- Greater discounts allowed with other attractive offers.
- Staffs in charge of collecting debts are working more effectively.
- A strict credit terms allowed to customers.
- Check credit worthiness of customers before granting credit.
- Charge interest to debtors.
- Take legal action.</td></tr>
</table>

Refer to pages 145 to 146 of the text book for the examples on Management Effectiveness Ratios

Activity 5.1.3
Question 1 Pg 154

Required:
Calculate the following ratios and percentages for the above business for the years 2015 and 2016.

i. Rate of Stock Turnover (times)
ii. Accounts Receivables Turnover (months)

NB: Assume 60% of the sales is on credit.

Multiple Choice

1. The main purpose of analysing ratios is to
   - A. Calculate the correct net profit.
   - B. Attract more investors.
   - C. To make better decisions for the business.
   - D. To decrease expenses.

2. Which of the following is a measure of how quickly a business can turn its assets into cash?
   - A. Profitability ratio.
   - B. Financial Stability ratio.
   - C. Inventory turnover ratio.
   - D. Management effectiveness.

3. Which of the following ratios will measure the effectiveness of the management policies of a firm?
   - A. Debtors turnover ratio.
   - B. Gross profit ratio.
   - C. Quick asset ratio.
   - D. Mark up percentage.

4. Which of the following is the best reason for excluding closing stock from the calculation of Liquid Capital?
   - A. it is not subject to short term demands
   - B. it can be liquidated at a very short notice
   - C. it will take more time for the stock to be sold
   - D. it is a current asset therefore it must be subtracted

5. Owner's contribution has a significant influence over the business assets. Which ratio measures the funds provided by the owner?
   - A. Gross profit ratio
   - B. liquid ratio
   - C. Proprietorship ratio
   - D. current ratio.

6. A firm could be considered to be undercapitalised if the proprietor's equity is
   - A. 95%
   - B. 60%
   - C. 40%
   - D. 86%

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