

Unit 2: Financial Accounting

Syllabus Section	Learning Outcomes	Suggested Teaching Activities	Resources	Online Resources
Trading and Profit and Loss Account of sole traders	Students will be able to prepare Trading and Profit and Loss Accounts in vertical form, and with items grouped in a logical order.	<p>Explain how Trading and Profit and Loss Accounts are part of the double entry model and illustrate this by journal entries and/or ledger accounts. Move by stages from horizontal to vertical accounts.</p> <p>Invite students to say what information they can discover from Trading and Profit and Loss Accounts. How could such accounts help them run their own businesses?</p> <p>Give particular attention to:</p> <ul style="list-style-type: none"> • Trading and Profit and Loss Accounts are part of the double entry system • all Trading and Profit and Loss Accounts should be prepared in vertical format. The horizontal format is not used now • Trading and Profit and Loss Accounts must be given proper headings. They cover a stated period of time • the words 'Cost of sales', 'Gross profit', 'Net profit' must be shown against the appropriate items • carriage inwards must be included in cost of sales • goods taken by the owner for personal use must be deducted from purchases at cost and treated as drawings 	<p>(Randall, 2005, chapter 7)</p> <p>(Wood & Sangster, 1999a, chapter 7 Review questions)</p>	<p>http://www.askltd.com/askjava/</p>

<p>Balance Sheets for sole traders.</p>	<p>Students will be able to prepare Balance Sheets in vertical form with items grouped in a logical order.</p>	<p>Explain that Balance Sheets are not part of the double entry model. Move by stages from horizontal to vertical Balance Sheets.</p> <p>Invite students to say what information they can discover from Balance Sheets. How could Balance Sheets help them run their own businesses?</p> <p>Give particular attention to:</p> <ul style="list-style-type: none"> • Balance Sheets are not part of the double entry system; they are lists of balances remaining in the ledger after a Trading and Profit and Loss Accounts have been prepared • Balance Sheets must be given proper headings. They show the position of a business at a particular time • Balance Sheets should be prepared in vertical format. The horizontal format is not in common use now • fixed assets must be shown separately from current assets. Current assets should be shown in the order: stock, debtors, bank and cash • current liabilities must be deducted from current assets before the resulting balance (working capital or net current assets) is added to the total of the fixed assets • long term liabilities must be shown as a deduction from total assets less the current liabilities. 	<p>(Randall, 2005, chapter 8)</p> <p>(Wood & Sangster, 1999a, Chapters 8 & 9 Review questions)</p>	<p>http://www.askltd.com/askjava/</p> <p>Before teaching the adjustments an excellent revision resource may be found by logging on to: http://www.bized.ac.uk/learn/business/accounting/busaccounts/pizza/stuindex.htm</p> <p>Then work on the trial balance, the trading and profit and loss account and the balance sheet packages.</p>
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<p>Accounting principles: <i>These principles comprise section B of the syllabus but students will appreciate the relevance and importance of the principles if they are taught at this stage.</i></p>	<p>Students will learn the concepts which ensure accounts are prepared on realistic and reliable bases to ensure their reliability and usefulness.</p>	<p>Ensure that students recognise the purpose of each concept and are able to apply it on all relevant occasions.</p> <p>Use a team game to test recognition of concepts; multiple choice questions from past 8706 papers 1 and 2 are useful for this purpose.</p> <p>Give particular attention to:</p> <ul style="list-style-type: none"> • the concepts should be learnt and understood. Explain the reasons which underlie the principles • require students to prepare written answers based on this topic. They must distinguish between 'define', 'explain', 'discuss' etc. Repetition of points must be avoided and the language should be clear. 	<p>(Randall, 2005, chapter 9)</p> <p>Wood & Sangster, 1999a, chapter 10 review questions)</p> <p>(Wood & Sangster, 1998, chapter 8 review questions)</p>	
<p>Accruals and prepayments</p>	<p>Students will be able to distinguish between revenue received and revenue earned in a period, and between expenditure incurred and payments made in the period.</p>	<p>Make sure that students recognise the effect on profit if revenue and expenses are entered in the Profit and Loss Account on a cash basis instead of as incurred; and the consequent effect on current assets and current liabilities in the Balance Sheet.</p> <p>Get students to explain how some expense accounts (e.g. stationery, fuel, etc.) can have both debit and credit balances at a period end, and what the balances would represent.</p>	<p>(Randall, 2005, chapter 10)</p> <p>(Wood & Sangster, 1999a, chapter 27 review questions)</p>	

		<p>Give particular attention to:</p> <ul style="list-style-type: none"> • adjustments must be calculated accurately and the workings submitted with the answers • a balance carried down on a ledger account must be shown as a balance brought down on the account on the next day • care must be taken to complete the double entry for each adjustment • debit balances represent assets, and credit balances represent liabilities. These must be included in the Balance Sheet in the correct positions. 		
Depreciation of fixed assets	Students will understand the purpose of depreciation, and be able to calculate annual charges accurately.	<p>Explain that capital expenditure on fixed assets is a kind of “deferred” revenue expenditure and should be spread over the life of the assets on an equitable basis.</p> <p>Students should discuss the relevant merits of straight line and reducing balance methods of depreciation, and which method is appropriate for particular occasions. What do they understand by net book values shown in Balance Sheets?</p> <p>Give particular attention to:</p> <ul style="list-style-type: none"> • the purpose of depreciation – to spread expenditure on fixed assets over the periods of their useful lives (it is <u>not</u> to provide funds for the replacement of assets) 	<p>(Randall, 2005, chapter 11)</p> <p>(Wood & Sangster, 1999a, chapters 23 and 24 review questions)</p>	Use depreciation section of Pepe’s Pizza Parlour (see above).

		<ul style="list-style-type: none"> • the difference between straight line and reducing balance depreciation • the purpose of the Provision for Depreciation accounts • the treatment of the disposals of fixed assets • Balance Sheets must show fixed assets <ul style="list-style-type: none"> - at cost - depreciation provided to date - at net book value. 		
Bad and doubtful debts	Students will be able to recognise the fair value of debtors shown in Balance Sheets.	<p>Teach students how to create a Doubtful Debts Provision and how to adjust it in later years. Ensure that the students can calculate general provisions accurately.</p> <p>Give particular attention to:</p> <ul style="list-style-type: none"> • the difference between bad debts and doubtful debts • how to provide for doubtful debt • only the increase or decrease in the provision is debited (or credited) in the Profit and Loss Account • the treatment of bad debts recovered • trade debtors are shown in the Balance Sheet less the Provision for Doubtful Debts. <p>Divide the class into 3 groups. Introduce a simple set of accounts without a provision. Then in year 1 a provision of 5% of debtors is introduced.</p>	<p>(Randall, 2005, chapter 12)</p> <p>(Wood & Sangster, 1999a, chapter 26)</p> <p>CIE papers 0452/03 May 2003 Qs 2(a), 4(b) and (c), 7110/02 May 2002 Qs 2 and 3, 7110/02 Nov 2002 Q4 & 8706/02 Nov 2001 Q1(a)(b) and (c).</p>	

		<p>Group 1 – Provision still 5% for year 2. Group 2 – Provision rises to 6% for year 2. Group 3 – Provision falls to 4% for year 2. Ask groups to prepare relevant parts of accounts on the board and then discuss.</p>		
Control accounts	<p>Students will be able to prepare control accounts correctly. They will be able to correct Control and other ledger accounts and adjust profit and working capital.</p>	<p>Make sure that students thoroughly understand the posting of the books of prime entry to the ledgers. They should understand the effects of posting errors from the books of prime entry on the accounts.</p> <p>Team games based on the correction of errors.</p> <p>Give particular attention to: The purpose of control accounts</p> <ul style="list-style-type: none"> • preparation of control accounts from books of prime entry • the entries for bad debts recovered in the Sales Ledger Control account • offsetting balances in the Sales Ledger Control account against balances in the Purchase Ledger Control account • revision of gross and net profits and working capital shown in draft accounts. 	<p>(Randall, 2005, chapter 14)</p> <p>(Randall, 1996, chapter 2 questions)</p> <p>(Wood & Sangster, 1999a, chapter 30 review questions)</p> <p>CIE paper 0452/03 May 2003</p>	
Suspense accounts	<p>Students will be able to recognise the types of error which do not affect the trial balance and therefore are not corrected through a Suspense account.</p>	<p>Revise the correction of errors through the journal; illustrate the six types of error which do not affect trial balances with examples.</p>	<p>(Randall, 2005, chapter 15)</p> <p>(Randall, 1996, chapter 3 questions)</p> <p>(Wood & Sangster, 1999a, chapter 32 questions)</p>	

	<p>They will be able to prepare journal entries for the corrections if required. They will also be able to amend profit and working capital as required.</p>	<p>Allow students to work Suspense account questions on the board in front of the class and to explain their corrections as they go.</p> <p>Give particular attention to:</p> <ul style="list-style-type: none"> • how to open a Suspense account • six types of error that do not affect trial balances • Journal entries to correct errors • posting of Journal entries to the Suspense account • a Suspense account should balance after all postings to it have been made correctly. • correction of gross and net profits and working capital • students should be told to distinguish between a requirement to correct profit and a requirement to state the effect of errors on net profit. Students often get confused between the two requirements. 		
Incomplete records	<p>Students will recognise that profit increases capital while losses reduce it. They will learn to calculate profit and losses from changes in owner's capital and to prepare Profit and Loss Accounts and pro-forma Balance Sheets from limited information.</p>	<p>Teach students to prepare opening and closing statements of affairs. Ensure that they master a reliable method of preparing Trading and Profit and Loss Accounts and Balance Sheets. Encourage students to show clear workings ("T" accounts). Ensure that they can calculate margin and mark-up and are able to use their knowledge of Control accounts to find missing figures.</p>	<p>(Randall, 2005, chapter 16)</p> <p>(Randall, 1996, chapter 4 questions)</p> <p>(Wood & Sangster, 1999a, chapter 34 questions)</p> <p>CIE paper 7110/02 May 2002</p>	

		<p>Invite students to suggest types of businesses which might not have complete records. Name the assets and liabilities which might be found in those businesses.</p> <p>Give particular attention to</p> <ul style="list-style-type: none"> • explaining that capital is increased by profit but is reduced by a loss • calculation of profit (or loss) using statements of affairs • the preparation of Receipts and Payments accounts • margin and mark-up and the relationship between them • the preparation of Trading and Profit and Loss accounts and Balance Sheets • calculation of stock lost by fire or theft is an important topic and students should be given adequate practice. 		
Non-profit-making organisations	Students will be able to prepare club accounts in user-friendly forms using techniques learned from incomplete records.	<p>Teach students to use incomplete records techniques to prepare club accounts and to use club account terminology.</p> <p>Let them talk about and discuss the accounts produced by the clubs etc. to which they belong. If the school has a canteen, social or drama club, they could prepare the accounts for those.</p>	<p>(Randall, 2005, chapter 17)</p> <p>(Randall, 1996, chapter 5 questions)</p> <p>(Wood & Sangster, 1999a, chapter 35 questions)</p> <p>CIE papers 0452/03 May 2003 Q5, 9366/02 May 2001 Q3(b) & 7110/02 May 2002 Q4</p>	

		<p>Give particular attention to:</p> <ul style="list-style-type: none"> • special features of these organisations (new terminology) • pay particular attention to the treatment of subscriptions. This often confuses students • good presentation of Income and Expenditure Accounts • the Income and Expenditure Account does not include the purchases or sales of fixed assets, but only profits or losses on sales of these • the Accumulated Fund (Balance Sheet). 		
Departmental accounts.	Students will be able to prepare departmental accounts in columnar form with revenue and expenses allocated or apportioned correctly.	<p>Explain allocation and apportionment clearly and ensure that all calculations are made accurately. Students should name local departmental stores and name the different departments for which the store would produce separate accounts. Which expense would be allocated and which apportioned? On what basis would the expenses be apportioned?</p> <p>Give particular attention to:</p> <ul style="list-style-type: none"> • allocation and apportionments being made in accordance with the terms in the question • preparation of the accounts in columnar form • decisions regarding retention or closure of a loss making department based on its contribution to overall profit. 	<p>(Randall, 2005, chapter 18)</p> <p>(Randall, 1996, chapter 15 exercises)</p> <p>Wood & Sangster, 1999a, chapter 37 questions)</p>	

Manufacturing accounts	Students will be able to calculate the cost of manufacturing goods and to calculate the unrealised profit in closing stocks.	<p>Help students to distinguish between direct and indirect costs and to calculate prime cost. Teach students how to account for manufacturing profit and the value of closing stocks.</p> <p>Students should consider various industries and suggest the nature of their direct and indirect expenses. They should discuss a situation where the cost of manufacture exceeds the cost of goods bought from another supplier. What might they suggest should be done, and the matters to be taken into account before discontinuing production.</p> <p>Give particular attention to:</p> <ul style="list-style-type: none"> • making it clear that Manufacturing Accounts are prepared before the Trading and Profit and Loss Accounts • calculation of prime cost • treatment of stocks of work in progress • the treatment of factory profit • accounting for unrealised profit in stock of finished goods • stocks of raw materials, work in progress and finished goods in the Balance Sheet. 	<p>(Randall, 2005, chapter 19)</p> <p>(Randall, 1996, chapter 16 exercises)</p> <p>Wood & Sangster, 1999a, chapter 36 §§1–13)</p> <p>CIE paper 7110/02 Nov 2001 Q1(a)</p>	
Valuation of stock	Students will be able to value stock in accordance with accepted accounting standards.	Ensure that students are able to calculate FIFO, LIFO and AVCO accurately by the most direct methods. Explain the accounting standards involved.	<p>(Randall, 2005, chapter 20)</p> <p>(Randall, 1996, chapter 17 exercises)</p>	

		<p>Students should discuss the importance of valuing stock consistently on a realistic basis. Does it matter which basis is adopted?</p> <p>Give particular attention to:</p> <ul style="list-style-type: none"> • FIFO, LIFO and AVCO • merits and defects of each method • continuous and periodic inventories • net realisable value • valuation of individual items of groups of items on lower of cost or net realisable values. 	<p>(Wood & Sangster, 1999a, chapter 28 questions)</p> <p>CIE paper 8427/02 May 2001 Q2</p>	
Partnership accounts	Students will be able to prepare simple partnership accounts, including the partners' Capital, Current and Drawings accounts.	<p>Explain the circumstances in which the Partnership Act 1890 applies. Ensure that the students can calculate the partners' shares of profits accurately. Students should imagine that they are in business and discuss whether they would prefer to remain as sole traders or to form a partnership. They should discuss what they see as advantages and disadvantages of their chosen form of trading.</p> <p>Give particular attention to:</p> <ul style="list-style-type: none"> • interest on a partner's loan to the firm. It is an expense debited in the Profit and Loss Account. Net profit is <u>always</u> the profit <u>after</u> charging the interest • partners' interest on capital and drawings, and their salaries are methods of dividing the net profit and are shown in the Appropriation Account 	<p>(Randall, 2005, chapter 21)</p> <p>(Randall, 1996, chapter 7 questions)</p> <p>(Wood & Sangster, 1999a chapter 38 questions)</p> <p>CIE paper 7110/02 May 2002 Q5</p>	

		<ul style="list-style-type: none"> • good presentation of the partners' capital and Current accounts in the Balance Sheet. 		
Partnership changes	Students will be able to prepare accounts to reflect partnership changes which occur before the end of a firm's financial year. An outgoing partner's share in the firm will be recorded strictly in the agreed terms.	<p>Explain that a partnership change involves the termination of one partnership and the commencement of another. Explain the procedure for adjusting partners' Capital accounts for Goodwill when no Goodwill is to be shown in the books. Teach students how to prepare Profit and Loss Accounts split between the periods before and after the change. Students should discuss what they understand by the term "Goodwill". How do they think Goodwill is created? Do they think that Goodwill should be recorded in a firm's books? If not, why not? If it is recorded in the books, should Goodwill be amortised (depreciated) over a period of time, and why (or why not)?</p> <p>Give particular attention to:</p> <ul style="list-style-type: none"> • a partnership change resulting in the termination of one partnership and the commencement of a new one • revaluation of assets and goodwill on a partnership change. 	<p>(Randall, 2005, chapter 22)</p> <p>(Randall, 1996, chapter 7 exercises)</p> <p>(Wood & Sangster, 1999a, chapters 38 – 40 questions)</p> <p>CIE papers 7110/02 Nov 2002 Q3 & 9366/02 May 2001 Q2</p>	

<p>Accounts of limited companies</p>	<p>Students will be able to prepare simple account for limited companies as far as possible in a format which conforms to Schedule 4 of the Companies Act 1985.</p>	<p>Make sure that students fully understand the difference between shares and debentures; provisions and reserves. Students should learn the basic outlines of company Profit and Loss Accounts and Balance Sheets.</p> <p>1) Students should discuss the advantages and disadvantages of trading as an incorporated company. 2) Students should study the Profit and Loss Account format for 20 minutes before attempting to reproduce it from memory. They should then check their work, awarding themselves a mark for each item they placed in the correct position. A further 10 minutes should be allowed to concentrate on the items they missed on the first attempt (ignoring those they got right), followed by a second attempt to copy it from memory. They should find that their score has improved dramatically. This is an object lesson to be applied in all revision; always concentrate revision on what has not been mastered; do not waste time revising what is already known. Students should then learn the Balance Sheet format in the same way.</p>	<p>(Randall, 2005, chapter 23)</p> <p>(Randall, 1996, chapter 9 exercises)</p> <p>(Wood & Sangster, 1999a, chapter 41 §§1-11 questions)</p> <p>CIE papers 9706/02 May 2002 Q1(a) and (b), 7110/02mMay 2003 Q3 & 8427/02 May 2001 Q1.</p>	<p>http://www.askltd.com/askjava/intro.htm</p>
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		<p>Give particular attention to:</p> <ul style="list-style-type: none"> • Profit and Loss Accounts and Balance Sheets should be prepared, as closely as possible, to the formats prescribed by the Companies Act 1985 • debentures must be shown as liabilities (long term, unless redeemable within one year), and never as part of share capital and reserves • students must distinguish between: liabilities, provisions and reserves; and between capital reserves and revenue reserves • the premium on the issue of shares must be credited to Share Premium account (never to Share Capital account – frequent error made by students) • proposed dividends are shown as current liabilities in the Balance Sheet • the accounting entries for the revaluation of fixed assets are important and should be given adequate teaching time. <p>Compare and contrast the accounts of sole traders, partnerships and limited companies.</p>		
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Cash flow statements	Students will be able to prepare cash flow statements from the Balance Sheets of two consecutive sets of a company's annual accounts. They will also be able to prepare a company's annual accounts from its cash flow statement and additional information.	<p>Explain that cash flows are determined by the increase and decreases in the assets and liabilities and capital of a company over a period of time. Teach how some details are found by re-constructing "T" accounts as workings. Insist that all workings are clearly shown with answers.</p> <p>Students should discuss the usefulness of cash flow statements and how they may be used by investors.</p> <p>Give particular attention to</p> <ul style="list-style-type: none"> • explaining how cash inflows and outflows are found by the comparison of one Balance Sheet with an earlier one • the form of cash flow statements and the contents of the headings • the correct treatment of non-cash items in the Profit and Loss Account • the distinction between profitability and liquidity • the preparation of cash flow statements for sole traders and partnerships which though not required may be useful. • the preparation of Balance Sheets from cash flow statements • statements of total recognised gains and losses. 	<p>(Randall, 2005, chapter 24)</p> <p>(Randall, 1996, chapter 14 questions)</p> <p>(Wood & Sangster, 1999a, chapter 43 questions)</p> <p>(Wood & Sangster, 1999b, chapter 18 questions)</p> <p>CIE papers 9706/04 June 2003 Q2 & 9706/04 Nov 2004 Q2</p>	
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<p>Share capital, debentures capital reductions and reconstructions</p>	<p>Students will have a good grasp of the types of share capital and bonus and rights issues. They will be able to answer questions based on the reduction of a company's share capital and reconstruction.</p>	<p>Ensure that students have a clear understanding of the difference between bonus shares and a rights issue (source of confusion to many students). Give particular attention to the redemption or purchase by a company of its own shares, <i>especially</i> to the treatment of premiums paid on redemption.</p> <p>Pose various capital redemption scenarios to the students to test their ability to treat premiums paid on redemption correctly. They should explain the basis of their treatment.</p> <p>Give particular attention to</p> <ul style="list-style-type: none"> • retention of reserves in the most flexible form • when and how a Capital Redemption Reserve should be created • working of capital redemption and capital reconstruction. 	<p>(Randall, 2005, chapter 25)</p> <p>(Randall, 1996, chapters 9 & 12 questions)</p> <p>(Wood & Sangster, 1999b, chapter questions)</p> <p>(Wood & Sangster, 1998, chapter 5 questions)</p> <p>CIE papers 9706/04 June 2003 Q1(a) & 9706/04 Nov 2004 Q1 (a)</p>	
<p>Business purchase</p>	<p>Students will be able to prepare the balance sheet of a company following the purchase of the business of a sole trader or partnership.</p>	<p>Define Goodwill and show how it may arise in the purchase of a business. Explain how Goodwill is treated in the books of the company. Show how the assets and liabilities of the business acquired are incorporated in the company's Balance Sheet at the values taken over.</p>	<p>(Randall, 2005, chapter 26)</p> <p>(Randall, 1996, chapter 8 §4 Questions 3 – 7)</p> <p>(Wood & Sangster, 1999a, chapter 42 questions)</p> <p>(Wood & Sangster, 1999b, chapter 10 §§1-3 Qs. 1, 3, 5 and 6)</p>	

		<p>Students should discuss the difference between the purchase of a business and the purchase of the assets of a business. What are the effects (a) on the business purchased, or (b) on the business selling its assets? How is Goodwill measured? What is the opposite of Goodwill and how is it calculated?</p> <p>Give particular attention to:</p> <ul style="list-style-type: none"> • definition and treatment of Goodwill • preparation of journal entries in books of the purchasing company (a weakness for most students) • explain that Goodwill does not arise when only the <u>assets</u> of a business are purchased. 	<p>(Wood & Sangster, 1998, chapter 6 (§§1- 3) Qs.1, 2, 4, 5 and 7)</p> <p>CIE papers 9706/04 Nov 2003 Q3 & 9706/04 June 2004 Q1</p>	
The published accounts of companies	Students will acquire the ability to read the published accounts of companies intelligently and to recognise the underlying accounting standards.	<p>Ensure that students have a basic grasp of the following accounting standards and their application to published accounts: FRS 1, 3, 4, 5, 10, 11, 12, 15 and 18; SSAPs 9 and 25.</p> <p>Obtain copies of the published accounts of companies. (These are usually obtainable without difficulty from companies' registered offices, or online) The students should study the formats and the notes accompanying the Profit and Loss Accounts and Balance Sheets. The students should be encouraged to discuss what useful information they gain from the accounts.</p>	<p>(Randall, 2005, chapter 27)</p> <p>(Randall, 1996, chapter 10 questions)</p> <p>(Wood & Sangster, 1999b, chapters 15 – 1 questions)</p> <p>(Wood & Sangster, 1998, chapters 9 & 10 questions)</p>	http://www.carolworld.com/

		<p>Give particular attention to</p> <ul style="list-style-type: none">• the requirements for the form of accounts and disclosures (Companies Act and relevant standards). Knowledge of these is limited to the coverage in the text• carefully prepared answers to discursive questions on this topic.		
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