

O Level Principles of Accounts (7110)

Unit 5: Financial Statements – Sole Trader

Recommended Prior Knowledge

Students should have a thorough understanding of Units 1 to 4 before embarking on a study of this unit.

Context

Financial statements combine the knowledge gained in Units 1 and 4 and a test of this topic conventionally acts as a summary assessment of knowledge acquired earlier. Financial statements are used in examinations and in practice to highlight organisational performance and position.

Outline

This unit concentrates on financial statements which measure performance in terms of gross and net profit and position (what an organisation owns, owes and what is owed to it).

AO	Learning outcomes	Suggested Teaching activities	Learning resources
3.1	<p>Candidates should be able to:</p> <ul style="list-style-type: none"> calculate the gross and net profits or losses, based on accounting principles, for a specified period 	<p>Recapitulate on the matching concept and how it affects the:</p> <ul style="list-style-type: none"> Trading account section of the income statement Profit and loss account section of the income statement <p>Explain the differences between the two and what each cover. When looking at the role of closing inventory, consider introducing the concept of cost or net realisable value.</p> <p>It is helpful to students to show them how the information from the ledgers is transferred by 'closing', for example, the sales and purchases accounts and taking the balances to the income statement.</p> <p>A progressive approach assists students in their understanding, for example:</p> <ol style="list-style-type: none"> gross profit = sales less cost of sales (opening stock + purchases – closing stock) including sales returns and purchase returns 	<p>http://www.staffs.ac.uk/schools/business/bsadmin/staff/s5/accsys/wtwo.htm#l1</p> <p>Past question papers available from CIE, e.g.</p> <p>Nov 2003 Paper 1 Q27 Specimen Paper 1 Q16,22</p>

AO	Learning outcomes	Suggested Teaching activities	Learning resources				
		3) including carriage inwards (emphasising carriage outwards is not included in the trading account section) and make adjustments for goods taken by owner for own use					
3.1	<p>Candidates should be able to:</p> <ul style="list-style-type: none">recognise that profit (or loss) for the year is the increase (or decrease) in the net value of assets during that periodprepare simple columnar trading account sections of an income statement when dealing with a business which has two departments	<p>Columnar trading account sections of an income statement will not be complex in the examination. Practice will help students gain familiarity with them</p>	<p>Past question papers available from CIE, e.g.</p> <p>Nov 2003 Paper 2 Q1</p>				
3.2	<p>Candidates should be able to:</p> <ul style="list-style-type: none">recognise that a balance sheet is a statement of balances of assets and liabilities on a specified date set out in any valid layoutdemonstrate knowledge of the meaning, importance and designation of non-current assets, goodwill, current assets, current liabilities, non-current liabilities and working capitalcomment upon the significance of the inter-relationship of the Balance	<p>Remind students about the accounting equation and use it to illustrate the effect of changes in assets and liabilities. Translate this into an expanded accounting equation using a balance sheet format.</p> <p>This can be shown simply using the Quadrant:</p> <table border="1"><tr><td>Non-current Assets</td><td>Capital</td></tr><tr><td>Current Assets</td><td>Current Liabilities</td></tr></table> <p>Take students through the implications of a change in one quarter on the other quarters.</p>	Non-current Assets	Capital	Current Assets	Current Liabilities	<p>http://www.bized.ac.uk/stafsup/options/accounting/work02.htm</p> <p>http://www.staffs.ac.uk/schools/business/bsadmin/staff/s5/accsys/wone.htm#1</p>
Non-current Assets	Capital						
Current Assets	Current Liabilities						

AO	Learning outcomes	Suggested Teaching activities	Learning resources
	Sheet items		
	<ul style="list-style-type: none"> relate working capital to the liquidity of a business 	<p>Working capital is important to a business and a question and answer session with students allowing them to think through what would happen to a business which is short of:</p> <ul style="list-style-type: none"> Cash Inventory Ability to obtain credit <p>will help students understand the content and importance of working capital.</p> <p>Students often have difficulty seeing how changes outside current assets and current liabilities can affect working capital. The quadrant may help understanding.</p>	<p>Past question papers available from CIE, e.g.</p> <p>Jun 2005 Paper 1 Q27, 28</p>
	<p>Candidates should be able to:</p> <ul style="list-style-type: none"> explain the basis of valuation of assets as follows: <ul style="list-style-type: none"> non-current assets at cost less accumulated depreciation inventory at cost or net realisable value, whichever is lower trade receivables at expected collectible amount i.e. after deduction of provision for doubtful debts distinguish between, and show understanding of, capital and capital employed 	<p>Rules, such as those about asset valuation, are often easier to learn by considering examples. Students should be able to explain terms e.g. the meaning of 'cost' or 'net realisable value'.</p> <p>Students can easily become confused by the term capital when used in a different context:</p> <ul style="list-style-type: none"> Capital Capital employed Capital expenditure Working capital 	<p>Past question papers available from CIE, e.g.</p> <p>Nov 2003 Paper 1 Q25</p> <p>Nov 2005 Paper 2 Q3(e)</p> <p>Jun 2003 Paper 2 Q4</p>

AO	Learning outcomes	Suggested Teaching activities	Learning resources
		Time is well spent testing students on the differences so that they are clear about the different terms and what they mean.	
4.1	<p>Candidates should be able to:</p> <ul style="list-style-type: none"> explain the difference between a trading and a service business prepare Income Statements and Balance Sheets for trading businesses prepare Income Statements and Balance Sheets for service businesses make adjustments for provision for depreciation using the straight line, diminishing (reducing) balance and revaluation methods make adjustments for provisions for doubtful debts make adjustments for other payables and other receivables to take account of accrued and prepaid expenses and outstanding and prepaid income make adjustments for goods taken by owner for own use 	<p>Examples of local business can be used to illustrate/check understanding. Students could be asked to prepare a list of organisations providing business and consumer services</p> <p>At this stage, students have looked at the individual aspects of the financial statements. Illustrate and provide practice for students to help them see how the individual elements fit together. Although much teaching will involve sole trader businesses, students should be aware, as they progress through their studies, that similar accounts and statements are used, as appropriate, for all organisations.</p> <p>There should be examples of all of these various adjustments from earlier units which can be brought in here to again illustrate to students the interconnected nature of the ledger and financial statements and how double entry principles are applied throughout.</p>	<p>Past question papers available from CIE, e.g.</p> <p>Jun 2003 Paper 2 Q4</p> <p>http://www.staffs.ac.uk/schools/business/bsadmin/staff/s5/mscproj/defn.htm</p> <p>http://accounting10.tripod.com/content.htm</p> <p>Past question papers available from CIE, e.g.</p> <p>Nov 2003 Paper 2 Q6 Jun 2003 Paper 2 Q5 Nov 2005 Paper 2 Q5</p>