### Syllabus overview

6.1 The purpose of accounting
- Understand and explain the difference between book-keeping and accounting.
- State the purposes of measuring business profit and loss.
- Explain the role of accounting in providing information for monitoring progress and decision-making.

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6.2 Sources and recording of data

6.2.1 The double entry system of book-keeping
- Explain the meaning of assets, liabilities and owner’s equity.
- Explain and apply the accounting equation.
- Outline the double entry system of book-keeping.
- Process accounting data using the double entry system.
- Recognise the division of the ledger into the sales ledger, the purchases ledger and the nominal (general ledger).

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6.2.2 Business documents
- Recognise and understand the following business documents: invoice, credit note, debit note, statement of account.
- Complete proforma business documents.
- Understand the use of business documents as sources of information.

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6.2.3 Business documents
- Explain the advantage of using various books of prime entry.
- Post the ledger entries from the books of prime (original) entry.
- Distinguish between and account for trade discount and cash discounts.
- Explain the dual function of the cash book as a book of prime (original) entry and as a ledger account for bank and cash.
- Explain and apply the imprest system of petty cash.

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6.2.4 The ledger
- Prepare ledger accounts.
- Post transactions to the ledger accounts.
- Balance ledger accounts as required and make transfers to final accounts.
- Interpret ledger accounts and their balances.

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### 6.3 Verification of accounting records

#### 6.3.1 The trial balance
- Understand that a trial balance is a statement of ledger balances on a particular date.
- Outline the uses and limitations of a trial balance.
- Prepare a trial balance from a given list of balances and amend a trial balance which contains errors.
- Identify and explain those errors which do not affect the trial balance – commission, compensating, complete reversal, omission, original entry, principle.

#### 6.3.2 Correction of errors
- Correct errors by means of journal entries.
- Correct errors by means of suspense accounts.
- Adjust the profit or loss for an accounting period after the correction of errors.
- Understand the effect of correction of errors on a statement of financial position.

#### 6.3.3 Control accounts
- Understand the use and purpose of a bank statement.
- Update the cash book for bank charges, bank interest paid and received, correction of errors, credit transfers, direct debits, dividends, and standing orders.
- Understand the purpose of, and prepare, a bank reconciliation statement to include bank errors, uncredited deposits and unpresented cheques.

### 6.4 Accounting procedures

#### 6.4.1 Capital and revenue expenditure and receipts
- Distinguish between and account for capital expenditure and revenue expenditure.
- Distinguish between and account for capital receipts and revenue receipts.
- Calculate and comment on the effect on profit of incorrect treatment.
- Calculate and comment on the effect on asset valuations of incorrect treatment.

#### 6.4.2 Accounting for depreciation and disposal of non-current assets
- Define depreciation.
- Explain the reasons for accounting for depreciation.
- Name and describe the straight line (equal instalment), reducing (diminishing) balance and revaluation methods of depreciation.
- Prepare ledger accounts and journal entries for the provision of depreciation.
- Prepare ledger accounts and journal entries to record the sale of non-current assets, including the use of disposal accounts.
### 6.4.3 Other payables and other receivables

- Recognise the importance of matching costs and revenues.
- Prepare ledger accounts and journal entries to record accrued and prepaid expenses.
- Prepare ledger accounts and journal entries to record accrued and prepaid incomes.

### 6.4.4 Bad debts and provision for doubtful debts

- Understand the meaning of bad debts and bad debts recovered.
- Prepare ledger accounts and journal entries to record bad debts written off.
- Prepare ledger accounts and journal entries to record bad debts recovered.
- Explain the reasons for maintaining a provision for doubtful debts.
- Prepare ledger accounts and journal entries to record the creation of, and adjustments to, a provision for doubtful debts.

### 6.4.5 Valuation of inventory

- Understand the basis of the valuation of inventory at the lower of cost and net realisable value.
- Prepare simple inventory valuation statements.

### 6.5 Principles of financial statements

#### 6.6.1 Sole traders

- Explain the difference between a trading business and a service business.
- Prepare income statements and statements of financial position for trading businesses.
- Prepare income statements and statements of financial position for service businesses.
- Make adjustments for provision for depreciation using the straight line (equal instalment), diminishing (reducing) balance and revaluation methods.
- Make adjustments for accrued and prepaid expenses and accrued and prepaid income.
- Make adjustments for bad debts and provisions for doubtful debts.
- Make adjustments for goods taken by the owner for own use.

#### 6.6.2 Partnerships

- Explain the advantages and disadvantages of forming a partnership.
- Outline the importance and contents of a partnership agreement.
- Explain the purpose of an appropriation account.
- Prepare income statements, appropriation accounts and statements of financial position.
- Show the treatment of interest on partners’ loans, interest on capital, interest on drawings, partners’ salaries and the division of the balance of profit or loss.
- Make adjustments to financial statements as detailed in 6.6.1.
- Explain the uses of, and differences between, capital and current accounts.
- Draw up partners’ capital and current accounts in ledger account form and as part of a statement of financial position presentation.

#### 6.6.3 Limited liability companies

- Understand the meaning of the term limited liability.
- Prepare simple appropriation accounts.
- Understand and distinguish between called-up and paid-up share capital.
- Understand and distinguish between share capital (preference shares and ordinary shares) and loan capital (debentures).
- Understand the capital structure of a limited company comprising preference share capital, ordinary share capital, general reserve and retained earnings.
- Prepare statements of changes in equity.
- Prepare statements of financial position.

**6.6.4 Clubs and societies**

- Distinguish between receipts and payments accounts and income and expenditure accounts.
- Prepare receipts and payments accounts.
- Prepare accounts for revenue-generating activities, e.g. refreshments, subscriptions.
- Prepare income and expenditure accounts and statements of financial position.
- Make adjustments as detailed in 6.6.1 as appropriate.
- Calculate the accumulated fund.

**6.6.5 Manufacturing accounts**

- Distinguish between direct and indirect costs.
- Distinguish between direct material, direct labour, prime cost and factory overheads.
- Understand and make adjustments for work in progress.
- Calculate factory cost of production.
- Prepare manufacturing financial statements: income statements and statements of financial position.
- Make adjustments to financial statements as detailed in 6.6.1.

**6.6.6 Incomplete records**

- Prepare opening and closing statements of affairs.
- Calculate profit for the year from changes in capital over time.
- Calculate sales, purchases, gross profit, trade receivables and trade payables and other figures from incomplete information.
- Prepare income statements and statements of financial position.
- Make adjustments to financial statements as detailed in 6.6.1.
- Apply the techniques of mark-up, margin and inventory turnover to arrive at missing figures.

**6.7 Analysis and interpretation**

**6.7.1 Summary of commonly used ratios**

1. **Profitability ratios**
   
   (i) Percentage of gross profit to revenue (gross profit margin) = \[
   \frac{\text{Gross Profit}}{\text{Revenue}} \times 100
   \]
   
   (ii) Percentage of gross profit to revenue (net profit margin) = \[
   \frac{\text{Profit for the Year}}{\text{Revenue}} \times 100
   \]
   
   (iii) Return on Capital Employed (ROCE) = \[
   \frac{\text{Profit for the Year}}{\text{Capital Employed}} \times 100
   \]
   
   \((\text{Capital Employed} = \text{Owner’s capital + long term liabilities})\)
2. **Liquidity**

   (i) Current ratio = \[
   \frac{\text{Current Assets}}{\text{Liabilities}}
   \] (also known as working capital ratio)

   (ii) Quick ratio = \[
   \frac{\text{Current Assets} - \text{Inventory}}{\text{Current Liabilities}}
   \] (also known as ‘Acid Test’ or ‘Liquid ratio’)

   (iii) Quick ratio = \[
   \frac{\text{Current Assets} - \text{Inventory}}{\text{Current Liabilities}}
   \] (also known as ‘Acid Test’ or ‘Liquid ratio’)

   (iv) Trade Payables Payment Period = \[
   \frac{\text{Trade Payables}}{\text{Credit Sales}} \times 365 \text{ days}
   \]

   (v) Rate of Inventory Turnover = \[
   \frac{\text{Cost of Goods Sold}}{\text{Average Inventory}}
   \] (answer given in times)

   Or Inventory Turnover = \[
   \frac{\text{Average Inventory}}{\text{Cost of Goods Sold}} \times 365 \text{ days}
   \]

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<tr>
<th>6.7.2 Interpretation of accounting ratios</th>
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<tbody>
<tr>
<td>• Prepare and comment on simple statements showing comparison of results for different years.</td>
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<td>• Make recommendations and suggestions for improving profitability and working capital.</td>
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<td>• Understand the significance of the difference between the gross profit percentage and the percentage of profit to revenue as an indicator of a business’s efficiency.</td>
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<th>6.7.3 Inter-firm comparison</th>
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<tr>
<td>• Understand the problems of inter-firm comparison due to factors such as differing accounting policies.</td>
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<tr>
<td>• Apply accounting ratios to inter-firm comparison.</td>
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<th>6.7.4 Interested parties</th>
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<td>• Discuss the uses of accounting by the following interested parties for decision making:</td>
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| - owners
| - managers
| - trade payables
| - banks
| - investors
| - club members
| - other interested parties such as governments, tax authorities, etc. |

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<th>6.7.5 Limitations of accounting statements</th>
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<td>• Recognise the limitations of accounting statements due to such factors as:</td>
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| - historic cost
| - difficulties of definition
| - non-financial aspects. |

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<th>6.8 Accounting principles and policies</th>
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<td>6.8.1 Accounting principles</td>
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<tr>
<td>• Accruals (matching): understand that costs must be matched against related income.</td>
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<td>• Business entity and ownership: know that a distinction is made between the financial transactions of a business and those of its owner(s).</td>
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<td>• Consistency: understand that the same accounting treatment should be applied to similar items at all times.</td>
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<td>• Duality: understand the two-fold aspect of every transaction.</td>
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- Going concern: understand that accounting assumes that a business will continue to operate indefinitely.
- Money measurement: know that transactions must be expressed in monetary terms
- Prudence: know that profit should not be overstated by ignoring foreseeable losses or that revenue should not be recorded before it is earned.
- Realisation: know that revenue is recognised as being earned when legal liability to pay is incurred by the customer (i.e. when ownership of goods passes to the customer).

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<td>Recognise the influence of international accounting standards and understand the following objectives in selecting accounting policies:</td>
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<tr>
<td>- comparability: recognise that a financial report can only be compared with reports for other periods if similarities and differences can be identified</td>
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<td>- relevance: understand that financial information is relevant only if it affects the business decisions</td>
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<tr>
<td>- reliability: understand that financial information is reliable only if it can be depended upon to represent actual events and is free from error and bias</td>
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<tr>
<td>- understandability: recognise that a financial report must be capable of being understood by the users of that report.</td>
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