POLITEKNIK MALAYSIA

KEMENTERIAN PENGAJIAN TINGGI

KOLEJ KOMUNITI MALAYSIA

BUSINESS ACCOUNTING

Penulis:

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Perdagangan

BUSINESS ACCOUNTING

e ISBN: 987-967-25866-2-3

https://www.pmbs.edu.my/v3/index.php/muat-turun/penerbitan/category/21-e-book?download=74:business-mathematics-2

PUBLISHED BY:

POLITEKNIK METrO BETONG SARAWAK

95700 BETONG SARAWAK

PREFACE

Business Accounting is revised from Fundamental of Accounting which cater for student's semester two in Politeknik METrO Betong Sarawak. This e-book also suitable for students of other polytechnics and other institutions of higher learning who are pursuing professional courses in finance, business studies, accounting, business administration and commerce may also find this e-book useful.

This comprehensive e-book consists of seven chapters: Introduction to Accounting, Accounting Classification and Accounting Equation, Accounting Process and Books of Accounts, Double Entries Principles and Balancing Off, Trial Balance, Year End Adjustments and Financial Statements with Year End Adjustments.

Each chapter begins with learning outcomes focus on the important concepts and theories related to business accounting. The topic coverage in this edition adheres closely to the latest requirement of Malaysian polytechnic syllabus. In each chapter, the accounting concepts are discussed using suitable worked examples with solution. It is enabling the students to fully understand the concepts taught. In addition, review questions are also provided for application.

We would like to acknowledge the assistance and encouragement of our friends and colleagues as well our family who have contributed and support us to the successful publication of this e-book.

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CHAPTER 1

Introduction to Accounting

LEARNING OUTCOMES >>

At the end of this chapter, students should be able to:

1. Define accounting and bookkeeping
2. Describe the users of accounting information
3. Describe the roles of an accountant
4. Discuss each type of accounting field
5. Describe the approved accounting standards in Malaysia
6. Describe the functions of regulatory bodies in Malaysia
7. Explain the following basic of accounting concepts

1.1 ACCOUNTING AND BOOKKEEPING

1.1.1. Definition of Accounting and Bookkeeping

1. **BOOKKEEPING** refers to **the recording of financial transactions.** It is usually performed by bookkeeper or clerk, not by an accountant. Bookkeeping involves only a part of accounting process which are **classifying, recording and summarizing business transactions**.
2. **ACCOUNTING** is the process of **classifying, recording, summarizing** business transaction in monetary unit and **analyzing and interpreting** the financial data of business in order to assist stakeholder in making decisions.

1.1.2. DISTINGUISH BETWEEN ACCOUNTING AND BOOKKEEPING

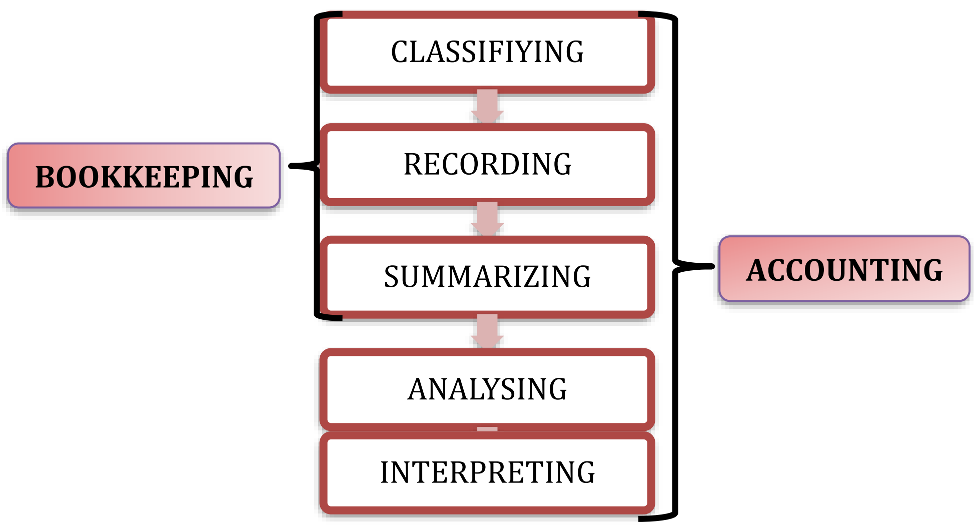


Figure 1.1: Distinguishing between Accounting and Bookkeeping

Detail four (4) Phases in Accounting as describe in Figure 1.2:

PHASE 1
- **Classifying**
- Data from business documents (e.g.: receipts, invoices, cash bills, credit notes) are arranges & categorize into its' books.

PHASE 2
- **Recording**
  - Transactions are recorded in a day book (journal) and ledgers.

PHASE 3
- **Summarizing**
  - Accounting data for particular period is summarized and shown in form of financial statements. Part of financial statement are Statement of Comprehensive Income & statement of Financial Position.

PHASE 4
- **Analyzing & Interpreting**
  - Financial Statement will be analyzed and the result of the analysis will be used as a guide to make decisions by stakeholder

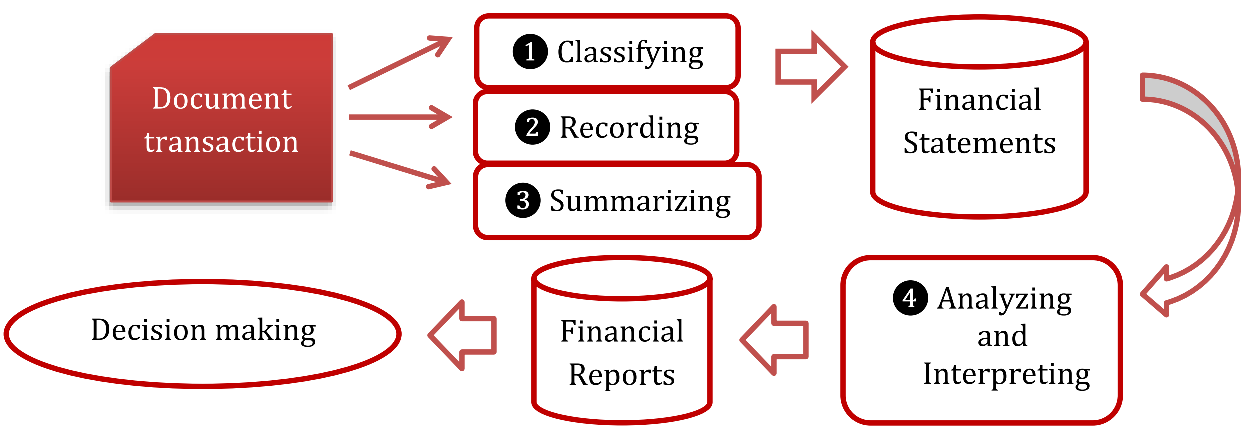


Figure 1.3: The accounting cycle

1.2 USERS OF ACCOUNTING INFORMATION

There is **TWO (2)** types of users of accounting information which are Internal Users and External Users as describe below:

INTERNAL USERS Individuals or organizations inside a business and use the information for daily business decisions				
Management Financial information use as a guildline to plan, organize and control the organization as well as analyse the performance of business.	**Finance Department** Financial information is used to evaluate the ability of organization to pays its business debts.	**Marketing Department** Financial information is used as a guildline to determine the policies and the price of the products to be marketed.	**Shareholder** Shareholders need to know the expected rate of return obtained from investments, financial position and the growth rate of the business.	**Employee** Financial information use to ensure the business is able keep on operating, maintaining their job position at acceptable wages.

Table 1.1: 5 types of Internal Users of Accounting Information

EXTERNAL USERS Individuals or organizations outside a business who have no involvement in the daily business operations and decisions.				
Bank and financial Institutions These institutions need to know the ability of a company or business to repay loans or debts.	**Suppliers** Financial information enable suppliers to evaluate the company's ability to pay their debts.	**Investor** Financial information use to determine the business liquidity position, business's prospect and ability of the management to handle the business.	**Goverment** Goverment bodies refers to financial information in order to determine the amount of tax to be paid to Inland Revenue Board (IRB)	**Employee Union** Financial information use to ensure their demands to the employer such as salary and other benefits are reasonable.

Table 1.2: 5 types of External Users of Accounting Information

1.3 ROLES OF ACCOUNTANT

1. An accountant is a person with requisite knowledge, skills and experiences in accounting and financial background**, used to prepare, establish and maintain accurate financial reports** for individuals or businesses for decision making.
2. The accountant is also liable to abide by a certain code ethics and be alert to any updates or changes to do their professions. Hence, this reason why financial reports must be prepared according to accounting principles & assumptions.
3. In Malaysia, those who wish to become professional accountants must be register as members of Malaysian Institute of Accountant (MIA).
4. Generally, an accountant position is under the finance department & carries out all tasks of an accounting cycle including collecting, recording, analyzing and presenting the financial operations and performance of the business to users.
5. The tasks or roles of an accountants such as:
   a. Designing and controlling systems of financial records.
   b. Preparing accounts and tax returns.
   c. Preparing financial reports.
   d. Auditing financial information.
   e. Compiling, analyzing and presenting information to users and management.
   f. Applying his expertise to provide financial advice to management.
   g. Dealing with third parties such as suppliers and banks.

1.4 TYPES OF ACCOUNTING FIELD

Accounting has several fields interrelated to each other, among them are **Financial Accounting, Cost Accounting, Management Accounting, Auditing, Taxation and Forensic Accounting.**

Financial Accounting	Cost Accounting	Management Accounting
•This field related to the preparation of financial statements for the use of external users. •Financial Accounting objective is to determine the profit or loss made by a business during the year and the company financial position.	•This type of accounting is to provide information to the management of the company to determine the total cost or cost per unit of the product or service. •The objective is to help the management in cost control.	•It is a type of accounting prepared specifically for the management team by management accountants to provide necessary information to the top management. •It uses to assist the management in making policies, taking decisions and controlling various business activities and departments of the company.

Auditing	Taxation	Forensic Accounting
• Auditing involves the examination and verification of the company accounts. The are two types of auditing, external and internal auditing. •External auditors are inependent audit firm hired by the company to examine the company's account and give and opinion. On the other hand, internal auditing is perform by the company's own accountant to evaluate the company's performance and operation and then make suggestion.	•Tax accountants are responsible to preparing and filing various tax forms and documentations as well as determining the amount of taxes payable by the company each year. •Tax accountants also assist companies to minimize the taxes payable by applying various tax planning.	•Forensic Accounting is a new branch of accounting •It applies accounting, auditing and investigative skills to detect financial wrongdoing and fraud.

Table 1.3: 6 types of Accounting Field

1.5 APPROVED ACCOUNTING STANDARD IN MALAYSIA.

1. The accounting profession has specified guidelines for the preparation of financial statements. These guidelines which are known as the Generally Accepted Accounting Principles (GAAP) can be defined as follows:
   "The Generally Accepted Accounting Principles cover conventions, rules & procedures, which are necessary to determine the accounting practice which is acceptable at any time"
2. It is important for firms to use similar reporting guidelines when preparing their financial statements. So that, all external users will know how to read and analyze the information.
3. The guideline for financial reporting used by the company in Malaysia was based on IFRS (International Financial Reporting Standard). IFRS are developed by IASB (International Accounting Standards Board).

1.6 THE FUNCTIONS OF REGULATORY BODIES IN MALAYSIA

1. **Malaysian Institute of Accountants (MIA)**
   A regulatory body formed in 1969 under Section 23 Accountant Act 1967.
   Functions:
   a. To oversee development and growth of the accounting bodies.
   b. A sole body where the accountants must register.
   c. To conduct training and courses for members to ensure they remain with developments in the profession.

2. **Malaysian Accounting Standard Board (MASB)**
   A statutory body established under the Financial Reporting Act 1997.
   Functions:
   a. To issue accounting standard and statements of principles for financial reporting.
   b. To review or to adopt existing accounting standards.
   c. To issue technical pronouncements.
   d. To develop conceptual framework.
   e. To change the structure or contents of proposed accounting standards.

3. **The Companies Commission of Malaysia (SSM)**

   It is a statutory body formed as a result of a merger between the Registrar of Companies (ROC) and the Registrar of Businesses (ROB) in Malaysia which regulates companies and businesses. SSM came into operation on 16 April 2002.

   Functions:

   a. To serve as an agency to incorporate companies and register businesses as well as to provide company and business information to the public.
   b. To act as leading authority for the improvement of corporate governance.
   c. To ensure compliance with business registration and corporate legislation through comprehensive enforcement and monitoring activities.

4. **Inland Revenue Board (IRB/LHDN)**

   IRB Malaysia is one of the main revenue collecting agencies of the Ministry of Finance. It was established in accordance with the Inland Revenue Board of Malaysia Act 1995 to give it more autonomy especially in financial and personnel management as well as to improve the quality and effectiveness of tax administration.

   Functions:

   a. To act as agent of the Government and to provide services in administering, assessing, collecting and enforcing payment of income tax, petroleum income tax, real property gains tax, estate duty, stamp duties and such other taxes as may be agreed between the Government and the Board.
   b. To advise the Government on matters relating to taxation and to liaise with the appropriate Ministries and statutory bodies on such matters.
   c. To participate in or outside Malaysia in respect of matters relating to taxation.
   d. To perform such other functions as are conferred on the Board by any other written law.

1.7 BASIC OF ACCOUNTING CONCEPTS

1. **Historical cost concept**
    a. All accounting records are prepared based on the cost value or the actual price stated in the source document.
    b. Cost value is the current value at the time of the transaction.

2. **Prudence / conservatism concept**
    a. Businesses must avoid overstating values of assets and revenue, and understating liabilities and expenses when recording transactions.
    b. All expected loss must be disclosed in Financial Statements for example Depreciation and Provision for Doubtful Debts.
    c. For investment and inventories, it must be recorded in lowest value.

3. **Consistency concept**
    a. Businesses must practice and adhere to rules, assumptions or principles consistently. They cannot change their practices without concreate reasons.
    b. For example, same method consistently used to calculate closing inventory.

4. **Matching concept**
    a. The revenues earned in an accounting period must be matched against the expenses incurred in order to generate revenues in the same period.
    b. Recognizing revenues that have been earned during the period, whether received in cash or not.
    c. Subtracting expenses incurred in the earning of these revenues, regardless of whether these expenses have been paid or not.

5. **Accrual concept**
    a. Revenues are recognized and recorded when goods and services are sold or provided regardless of whether cash has been received or not
    b. Expenses will be recorded when the goods and services were used in accounting period regardless of whether it has been paid for or not.

6. **Materiality concept**
    a. Materiality refers to the relative importance or significance of an item or event.
    b. Only the data from transactions which affect and influence decision making is considered making and should be accounted for.

7. **Business entity concept**
    a. Business and its owner are two separate entities
    b. The business's transactions must be accounted separately from the owner's transactions
    c. The transactions recorded into business book should not be mixed with the owner's personal affairs

8. **Going concern concept**
    a. Accounts are prepared with the assumption that the business or organization will continue to operate for a foreseeable future.

9. **Objectivity / reliability concept**
    a. Accounting records and statements are based on the most reliable data available so that they will be as accurate and as useful possible.
    b. Each transaction must be recorded based on objective evidence or verified and unbiased information, in short, written documents.

10. **Money measurement concept**
    a. Financial data must be recorded and presented in a financial configuration that is in monetary value, such as Ringgit in Malaysia and Yen in Japan.
    b. The monetary value is assumed to be stable.

11. **Periodicity (time period) concept**
    a. Business activities can be divided into specific periods, for example, a month, a quarter, six month or a year depends on the business
    b. The accounting period in financial reporting must be consistent in order to make comparison of business performance between accounting periods.

REVIEW QUESTIONS

1. Identify the different between bookkeeping and accounting.
2. List down three external and internal users of the financial statements.

Users	Examples
Internal user	a) b) c)
External user	a) b) c)

3. Explain three types of accounting fields.
4. Describe the function of Inland Revenue Board (IRB) and Malaysian Institute of Accountants (MIA).
5. Elaborate the following basic accounting concepts:

Accounting concepts	Elaboration
Going concern concept	
Prudence concept	
Matching concept	
Consistency concept	
Full disclosure concept	

CHAPTER 2

Accounting Classification and Accounting Equation

LEARNING OUTCOMES >>

At the end of this chapter, students should be able to:

1. Discuss the accounting classification and accounting equation
2. Elaborate the definition of assets, owner's equity and liabilities
3. Elaborate the definition of revenues and expenses
4. Elaborate the definition of inventory (finished goods)

2.1 ACCOUNTING CLASSIFICATION AND ACCOUNTING EQUATION

1. Accounting classification can be divided into 3 components which are Assets, Liabilities and Owner's Equity
2. The relationship between these 3 elements is known as the accounting equation as illustrate in figure 2.1 below:

Assets = Liabilities + Owner's Equity

Figure 2.1: Basic accounting equation

3. Accounting equation explained the dual aspect concept. This concept states that there are two aspects of accounting (one represented by the assets of the business and the other represented by the claims against the assets which are liabilities or owner's equity). These two aspects are always equal to each other.

2.2 THE DEFINITION OF ASSETS, OWNER'S EQUITY AND LIABILITIES

1. **ASSETS**
   a. Assets are resources controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.
   b. Assets can divide into two main categories which are Non-current Assets (Fixed Assets) and Current Assets
   c. Asset accounts have **DEBIT** balance.
   d. These are the characteristics of Non-Current Assets and Current Assets:

ASSETS	CHARACTERISTICS	EXAMPLE
Non-current Assets	i. Asset life is longer than one accounting period ii. Can be used repeatedly iii. Fixed value	• Premise • Land • Plant & machineries • Office equipment • Motor vehicle • Fixtures and fittings • Furniture

Current Assets	i. Assets that are easily converted into cash. ii. Value is not fixed.	• Cash • Bank • Debtors • Inventories • Prepaid expenses • Accrued revenue

Table 2.1: Characteristics of Non-Current Assets and Current Assets

2. **LIABILITIES**

   a. A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying academic benefits.

   b. In short, liabilities are debts owed by a business entity to external parties.

   c. Liabilities also can be divided into two main categories which are Non-current Liabilities (Long-term liabilities) and Current liabilities.

   d. Liability accounts have **CREDIT** balance.

   e. These are the characteristic of Non-current Liabilities and Current Liabilities:

LIABILITIES	CHARACTERISTICS	EXAMPLE
Non-current Liabilities	Debt that must be paid off after one accounting period	• Bank Loan • Debentures • Mortgage
Current Liabilities	Debt that must be paid off within one accounting period	• Creditors • Bank Overdraft • Accrued expenses • Unearned/Prepaid revenues

Table 2.2: Characteristic of Non-current Liabilities and Current Liabilities

3. **OWNER'S EQUITY**

   a. Equity is the residual interest in the assets of the entity after deducting all its liabilities.

   b. The owner equity is the business debt to the business owner based on the amount invested by the business owner. Thus, the total amount of owner equity will be determined by the capital, drawings and business performance.

   c. Equity accounts have a **CREDIT** balance except **drawings account has DEBIT** balance.

d. The characteristic of Owner's Equity:

EQUITY	CHARACTERISTICS	ACCOUNT BALANCE
Capital	i. Cash or assets brought into the business by the owner	Credit balance
Drawings	i. Cash/goods/assets taken by the owner for personal use ii. Reduction of owner's equity	Debit balance
Business Performance (Profit or Loss)	i. Calculated through the Closing Account ii. Owner's equity is increased if business generates a profit. If loss is obtained, the owner's equity will be decreased	Debit or Credit balance

Table 2.3: Characteristic of Owner's Equity

4. **The effect of transactions on the accounting equation as highlighted in red color below:**

Assets = Liabilities + Owner's Equity (+ Profit or - Loss) - Drawings

Figure 2.2: The effect of transaction on the accounting equation

2.3 THE DEFINITION OF REVENUES AND EXPENSES

1. **REVENUE**

   a. Revenues or income are the gross increase in owner's equity resulting from business activities through the selling of goods and providing business.

   b. Generally, revenues result from the sales of goods or services provided, commission received, interest received or rent received.

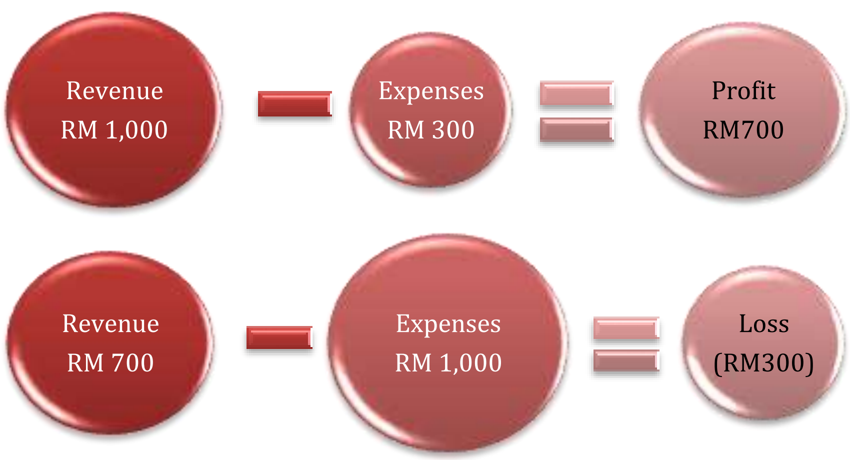
   c. However, revenue may be received from extraordinary business such as profit sale of used assets and dividend from investment

   d. The receipt of revenue will increase the profit and capital of a business entity

   e. A revenue account has a **CREDIT** balance

2. **EXPENSES**
   a. Expenses are the cost of assets consumed or services used in the process of earning revenue. Operating expenses refers to expenditure for formal business activities
   b. Generally, expenses result from the purchase of goods, employer salaries and wages, freight charges and other expenses.
   c. If expenses are not incurred as a result of business operation, then the expenses are for non-ordinary business activities such as Loss of Sale used Assets, donation and others
   d. An expense account has a **DEBIT** balance.
   e. Expenses will reduce the profit and capital of a business entity.

In short, the effects of revenues and expenses will cause either profit or loss as illustrated below:



3. **The effect of transactions on the expanded accounting equation:**

Assets = Liabilities + Owner's Equity - Drawings + Revenue - Expenses

OR

Expenses + Drawings + Assets = Liabilities + Owner's Equity + Revenues

Figure 2.3: The effect of transaction on the accounting equation

2.4 THE DEFINITION OF INVENTORY (FINISHED GOODS)

1. **The purpose of accounting for inventory**
   a. FRS 102 defines inventory as assets owned by a business for the purpose of selling to the customer.
   b. Inventories are managed in order to determine inventories on hand, inventories available for sale and cost of goods sold (COGS).

2. **The movement of the inventory**

   Movement of inventory can be divided into two types which are increase in inventory and decrease in inventory.

Increase in Inventory
- Purchase of goods by cash/bank or on credit
- Returns inwards/ Sales returns

Decrease in Inventory
- Sale of goods by cash/bank or on credit
- Returns outwards/ Purchase returns

Figure 2.4: The movement of inventory

a. Increase in inventory is caused either by purchase of goods from supplier or returns inwards by customers into a business of goods that have been previously sold.

b. While decrease in inventory is caused by sales of goods to customers or return of goods that have been previously purchase by the business back to the supplier.

REVIEW QUESTIONS

1. List down **THREE (3)** basic items in accounting classification.

2. Elaborate the definition of assets, owner's equity, liabilities, revenues and expenses.

Accounting items	Definition
Assets	
Owner's Equity	
Liabilities	
Revenues	
Expenses	

3. Discuss the characteristics of **THREE (3)** components in Owner's Equity.

4. Complete the following transaction:
   a. Assets = ________ + Owner's Equity
   b. Profit = Revenues - ________
   c. Assets = Liabilities + ________ + ________ - ________ - Drawings
   d. Expenses + ________ + ________ = ________ + Owner's Equity + Revenues

5. Elaborate **TWO (2)** transaction that caused increase in inventory of a business.

CHAPTER 3

Accounting Process and Books of Accounts

LEARNING OUTCOMES >>

At the end of this chapter, students should be able to:

1. Describe the accounting process
2. Highlight the importance of the source documents used in the business
3. Discuss the function of each the journals by sorting the documents into the prime books
4. Discuss the function of the ledgers

3.1 ACCOUNTING PROCESS

1. An accounting process is the cycle of recording business transactions. This cycle involves several stages over a particular period of time.
2. An accounting cycle shows the steps to collect and record business information systematically so that the financial reports or statements can be presented to the management and analyzed.
3. Steps in Accounting Cycle are as follows:

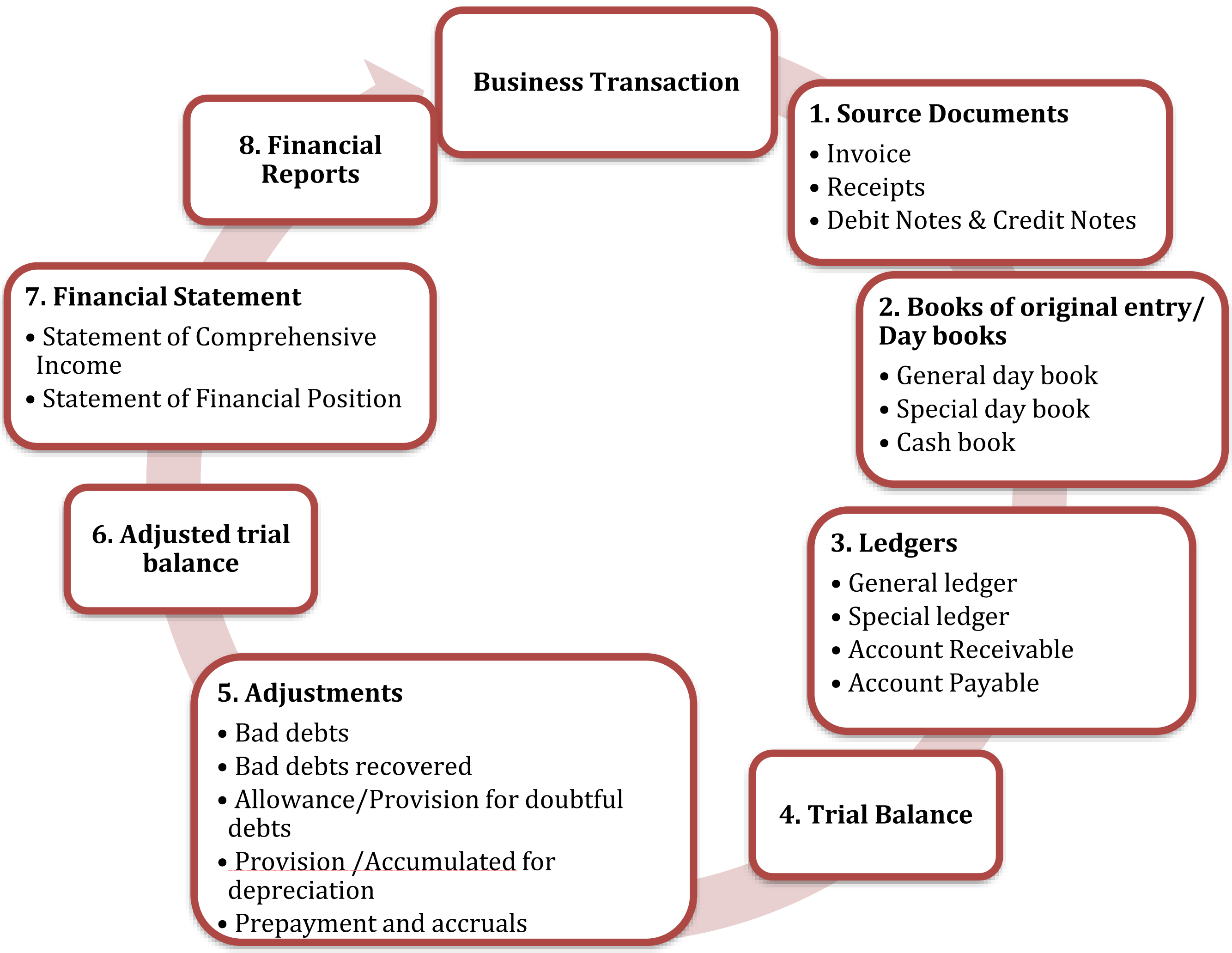


Figure 3.1: Steps in Accounting Cycle

3.2 THE IMPORTANCE OF THE FOLLOWING SOURCES DOCUMENTS USED IN THE BUSINESS

Source Documents	Usage
Sales order	• Document generated by the seller upon receiving a purchase order from a buyer. • Its specifying the details about the product or service along with price, quantity, buyer details like the shipping address, billing address, mode of payment and terms and conditions.
Purchase order	• Document a buyer sends to a supplier or vendor to authorize a purchase. • Purchase orders outline what the buyer would like to purchase and how much of it they would like to receive.
Delivery order	• Document to record the descriptions and quantity of the goods concern. • Issued by seller to record goods being delivered to a customer.
Invoices	• Used in credit transactions only • Issued by seller • Created by a business to request a payment that's due from someone who purchased goods or services from them.
Cash bills	❖ Used in cash transactions only ❖ Issued by sellers
Credit notes	❖ Used to inform the buyers that his or her account has been credited with the stated amount ❖ Usually issued when there is a sales return or when the price is overstated
Debit notes	❖ Used to inform the buyer that his or her account has been debited with the stated amount ❖ Usually issued when a sales price is understated
Official Receipts	❖ Issued by a receiver of payment to the payer for payment made by cash or cheque.

Vouchers ➢ **Cash voucher** ➢ **Payment voucher**	❖ Used when a payment has been made but a receipt is not given by a receiver of payment (seller) ➢ when payment made by cash ➢ when payment made by cheque
Memo	❖ Used as a notice when there is an increase in capital, drawings, or other extraordinary event.
Cheque	❖ The bank is instructed to pay the payee (the person named in the cheque), as ordered by the account holder or payer (the one who issue the cheque).

Table 3.1: The usage of source documents

3.3 THE FUNCTION OF EACH JOURNALS

1. Journal is a sheet in which all business transaction entries are recorded in chronological order.
2. Journal can be categorized as:
   - General journal – basic journal used to record all business transactions that cannot be recorded in cash book or special journal.
   - Special journals – used to record a specific type of transaction only. Examples:
     - Purchase journal
     - Sales journal
     - Purchase returns journal (returns outwards journal)
     - Sales returns journal (returns inwards journal)
3. Journal entries must be posted to the ledger of related account based on the double-entry system.
4. Journal is a sheet in which all business transaction entries are recorded in chronological order.

Special journal:

a. **Purchase journal**

- The purchased journal is a list of record of all credit purchases for each period.
- Is used for posting credit purchases to the purchase ledger.

PURCHASE JOURNAL

Date	Particulars	Amount (RM)
20XX		
Nov 8	Yunos	8,000
15	Ahmad	25,000
30	Total Purchases	33,000

b. **Sales journal**

- The sales journal is a list of record of all credit sales for each period.
- Is used for posting credit sales to the sales ledger.

SALES JOURNAL

Date	Particulars	Amount (RM)
20XX		
Nov 5	Latiff	2,000
15	Sharifah	15,000
30	Total Sales	17,000

c. **Sales return @ Return inwards journal**

- The return inwards journal is used to record goods returned to us from customers.
- The reasons customers returning goods to us such as:
  - Goods were of the wrong type
  - Goods were the wrong color
  - Goods were faulty

RETURN INWARDS JOURNAL

Date	Particulars	Amount (RM)
20XX **Nov 8**	Sharifah	5,000
30	Total Return Inwards	5,000

d. **Purchase return @ Return outwards journal**

- The return outwards journal is used to record goods returned by us to our suppliers.

RETURN OUTWARDS JOURNAL

Date	Particulars	Amount (RM)
20XX **Nov 18**	Ahmad	10,000
30	Total Return Outwards	10,000

e. **General journal**

- Basic journal used to record all business transactions that cannot be recorded in cash book or special journal. The transactions recorded in general journal are:

  i. The purchased and sales of fixed assets on credit
  ii. The correction of errors
  iii. Writing off bad debts
  iv. Opening balance entries
  v. Drawings of goods
  vi. Increase in capitals

GENERAL JOURNAL

Date	Particulars	Debit (RM)	Credit (RM)
20XX **Nov 7**	Dr. Drawings Cr. Purchases	2,000	 2,000
14	Dr. Motor Vehicles Cr. Tan Ching Motors	50,000	 50,000

f. **Cash Receipts Journal**

- It is used to record all cash and/or bank received by the business.
- Examples of the items recorded in the cash receipts journal are sales, income and cash received from debtors.
- As in Figure 3.2, the 'Discount Allowed' column records the amount of cash discount given by the business to the debtors for early settlement of their accounts.

g. **Cash Payment Journal**

- It is used to record all transactions where cash and/or bank has been paid out.
- Example of the items recorded in the cash payment journals are purchases, payments made to creditors, expenses paid and also discount received.
- As shown in Figure 3.2, Discount Received is the cash discounts received by the business from its creditors for early settlement of accounts payable.

Debit (IN)					**CASH BOOK**				**Credit (OUT)**
Date	**Particulars**	**Discount Allowed**	**Cash**	**Bank**	**Date**	**Particulars**	**Discount Received**	**Cash**	**Bank**

Figure 3.2: Cash receipts and payment journals

CASH BOOK

An alternative to the cash receipts and cash payments journals is the cash book. All money received (cash and/or bank receipt) is recorded in debit side of the cash book. On the other hand, all money paid (cash and/or bank payment) is recorded in credit side of the cash book.

Table 3.2 shows the relationship between Source Documents, Transactions and Book of Prime Entry:

Source Document	Transaction	Book of Original Entry
Invoice received	Credit purchases	Purchase Journal
Invoice issued	Credit sales	Sales Journal
Cash bill received	Cash purchases	Cash book (CR)
Cash bill issued	Cash sales	Cash book (DR)
Receipt received	Cash payment	Cash book (CR)
Receipt issued	Cash received	Cash book (DR)
Credit note received	Return Outwards Overstated purchase price	Return outwards Journal General Journal
Credit note issued	Return Inwards Understated purchase price	Return inwards Journal General Journal
Debit note received	Understated purchase price	General Journal
Debit note issued	Understated sales price	General Journal
Vouchers	Payments made but no receipt issued	Cash book (CR)
Cheque butts	Payment by cheques	Cash book (CR-bank)
Memos	Additional capital Drawings of assets/goods	General Journal

Table 3.2: Relationship between Source Documents, Transactions and Book of Prime Entry

3.3.1 Narration of general journal

i. The sentences that appear below the line containing the account heads that are debited and credited.

ii. The narration is a brief explanation for the entry. It includes certain details in relation to the transactions.

iii. The purpose of the narration is to enable anyone who reads it to get a preliminary idea of why the entry is being recorded.

GENERAL JOURNAL (WITH NARRATION)

Date	Particulars	Debit (RM)	Credit (RM)
20XX **Nov 7**	Dr. Drawings Cr. Purchases **(Owner took goods for own use)**	2,000	2,000
14	Dr. Motor Vehicles Cr. Tan Ching Motors **(Purchase Motor Vehicle on credit)**	50,000	50,000

3.4 DISCUSS THE FUNCTION OF LEDGERS

LEDGER

1. A ledger is the principal book for recording and totaling economic transactions measured in terms of a monetary unit of account-by-account type, with debits and credits in separate columns and a beginning monetary balance and ending monetary balance for each account.
2. All ledger's account must be balanced before a trial balance is prepared.
3. All ledger's account is balanced by comparing the total debit amount with the total credit amount, and determining which amount is larger.

Example 3.1

The following transactions relate to the sole proprietorship business of Liyana Enterprise Sdn Bhd in May 20X1:

Date	Transactions
May 1	Balance brought forward of this month is cash in hand worth RM 6,000 and cash at bank worth RM14,000.
3	Sold goods on credit to Desmond (RM560) and Razak (RM1,480).
5	Purchased goods on credit from: Cheng Ho RM 1,440 and Salim RM760.
7	Desmond returned goods worth RM200
8	Liyana Enterprise returned goods worth RM220 to Salim.
10	Sold goods for RM1,020 by cash.
11	Bought motor van on credit from Vanida Motor Sdn. Bhd. for RM6,500.
15	Paid rental expense of RM1,000 by cash.
20	Sold goods on credit to Krishnan (RM570) and Mary (RM1,120).
21	Purchased goods worth RM1,500 by bank from Gopal using cheque.
25	Liyana withdrew cash of RM1,000 for her personal usage.

You are required to record the above transaction in the journals (general and special journals) and cash book.

Solutions

General Journal			
Date	Particulars	Debit (RM)	Credit (RM)
20X1 May 10	Dr. Cash in hand Dr. Bank Cr. Capital (Balance brought forward with cash in hand and bank)	6,000 14,000	 20,000
11	Dr. Motor Vehicles Cr. Vanida Motor Sdn Bhd (Purchased motor vehicle from Vanida Motor)	6,500	 6,500

Purchase Journal		
Date	Particulars	Total (RM)
20X1 May 5	Cheng Ho	1,440
5	Salim	760
31	Purchase Account (Dr.)	2,200

Sales Journal		
Date	Particulars	Total (RM)
20X1 May 3	Desmond	560
3	Razak	1,480
20	Krishnan	570
20	Mary	1,120
31	Sales Account (Cr.)	3,730

Purchase Return Journal		
Date	Particulars	Total (RM)
20X1 May 8	Salim	220
31	Purchase Return Account (Cr.)	220

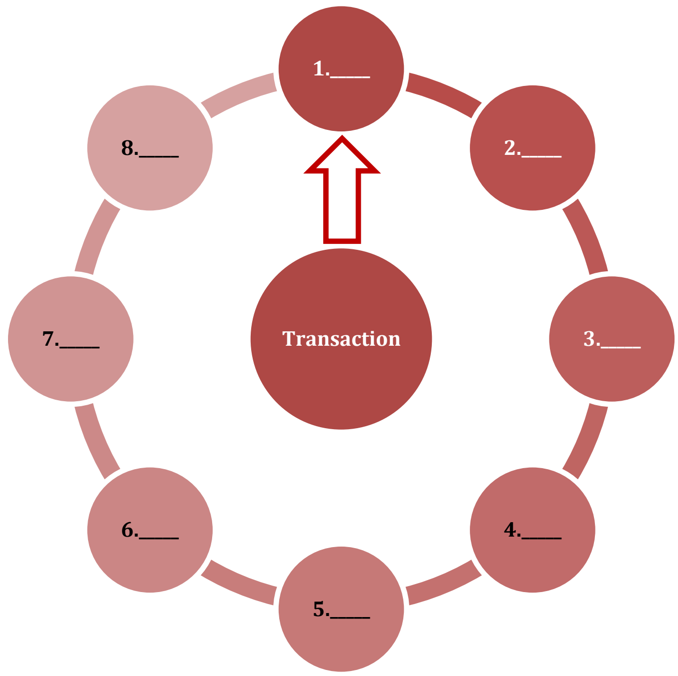
Sales Return Journal		
Date	Particulars	Total (RM)
20X1 May 7	Desmond	200
31	Sales Return Account (Dr.)	200

Cash Book							
Date	Particular	Cash (RM)	Bank (RM)	Date	Particular	Cash (RM)	Bank (RM)
20X1 May 1	Capital	6,000	14,000	20X1 May 15	Rental	1,000	
10	Sales	1,020		21	Purchases		1,500
				25	Drawing	1,000	
				31	Balance c/d	5,020/	12,500/
		7,020	14,000			7,020	14,000
20X1							
June 1	Balance b/d	5,020	12,500				

REVIEW QUESTIONS

1. Discuss the meaning of accounting cycle.

2. Complete the accounting cycle below:



3. State the functions of following documents:

Documents	Functions
Memo	
Debit Notes	
Purchase Invoice	
Cheque	
Receipts	
Purchase Order	
Credit Notes	

4. State types of special journals

5. The following transactions relate to the business of Apapunada Sdn Bhd in January 20X2. Balance brought forward for this month is cash in hand worth RM 1,000 and cash at bank worth RM7,200.

Date	Transactions
Jan 3	Paid general expenses RM820 by cheque
5	Purchase goods from Musleh on credit RM790
8	Paid RM210 cash for carriage inwards
12	Credit sales to George RM500
13	Received a credit note from Musleh amounting RM90
17	Purchased furniture RM5,000 from ABC Group by credit
21	Cash sales RM320 from Lina
25	Received commission RM170 from Mama Trading

You are required to record the above transaction in the journals (general and special journals) and cash book.

CHAPTER 4

Double Entries Principles and Balancing Off

LEARNING OUTCOMES >>

At the end of this chapter, students should be able to:

1. Explain the double-entry rules
2. Prepare the posting of journal entries into the respective ledger accounts
3. Show the balancing off the account

4.1 DOUBLE ENTRIES RULES

1. Double entries rules are a record keeping system which every transaction is recorded at least two accounts.
2. There is no limit on the number of accounts that may be used in a transaction, but the minimum is two accounts.
3. The sum of all debits of the transaction must be equaled to the sum of credit of transactions
4. Debit entries will not necessarily mean an increase in the value of an account, and the credit will not necessarily mean a decrease value of account.

4.1.1 Double entries principles for assets, liabilities, capital, expenses and revenues.

EFFECT ON VALUE OF BALANCE	ACCOUNTS TYPE					
	Assets	Expenses	OE (Drawing) =	Liabilities	OE (Capital)	Revenues
DEBIT (Dr)	↑ Increase	↑ Increase	↑ Increase	↓ Decrease	↓ Decrease	↓ Decrease
CREDIT (Cr)	↓ Decrease	↓ Decrease	↓ Decrease	↑ Increase	↑ Increase	↑ Increase

Table 4.1: Accounting equation and the double entries principle

4.1.2 Double entries principles for inventories

Transaction	Effects on inventory	Double Entries Principles
Purchase of Goods	Increase in Inventory	Dr Purchases Cr Creditor / Cash/ Bank
Return Inwards	Increase in Inventory	Dr Return Inwards Cr Debtors
Sales of Goods	Decrease in Inventory	Dr Creditor / Cash/ Bank Cr Sales
Return Inwards	Decrease in Inventory	Dr Creditor / Supplier Cr Return Inwards

Table 4.2: Double entries principles for Inventory

4.1.3 Double entries principles for trade discount and cash discount

1. **Trade discount**

   A trade discount is a term used to address a reduction in the prices of inventories purchased or sold. It is usually given by businesses to their customers to encourage bulk purchases of inventories.

   The double entry for trade discount:

   Dr Cash/Bank
   Dr Discount allowed
   Cr Debtors

2. **Cash discount**

   i. Discount allowed (expenses)

   A discount given by the business to its customers. This will mean that the business receives less than the amount owed by its customers.

   The double entry for discount allowed:

   Dr Cash/Bank
   Dr Discount allowed
   Cr Debtors

ii. Discount received (revenue)

A discount received by the business from its suppliers. This will mean that the business pays less than the amount it owes to its suppliers.

The double entry for discount received:

Dr Creditors
Dr Discount received
Cr Cash/Bank

4.1.4 The differences between trade discount and cash discount

1. **Trade Discounts** are discount given as a reduction from the selling price. The amount of discount **does not appear** anywhere in the accounting books, and thus, may also not appear anywhere in the financial statement.

2. **Cash Discounts** are given or received to encourage early payment. Discount allowed may include in the terms of a credit sale of a cash discount to the customer for prompt payment of the balance due. The amount of the discount **will be recorded in every accounting entry**, thus will also be recorded in the financial statement.

Example 4.1:

ENAKNYA SDN BHD
Jalan Pisang Kembar,
06700 Kedah

INVOICE

Invoice No: 2100

BESTARI WALK ENT
No.10, Jalan Melewar
48500 Ipoh
Perak

Date: 21/1/20X0

No.	Particulars	Quantity	Price (RM)	Total (RM)
1.	Crème Biscuits	6 tins	5.00	30.00
2.	Chocolate Biscuits	10 tins	4.00	40.00
3.	Tiger Biscuits	5 tins	6.00	30.00
	TOTAL			100.00
Less: Trade Discount 10%				(10.00)
	NET AMOUNT			**90.00**

Ringgit Malaysia: Ninety only
Discount terms: 5% 7 days, 3% 21 days

Amylia

Sales Manager

If settlement of debt is made within 7 days of the invoice date, a discount of RM4.50 (5% X RM90) will be given. If settlement of debt is made after the 7th day of the invoice date until the 21st day, a discount of RM2.70 (3% X RM90) will be given.

A trade discount is the discount given in order to encourage customers to buy in bulk.
* Note: Only the net amount of the invoice (after deduction of trade discount) will be recorded. Therefore, the amount of trade discount will not be recorded in the book.

4.2 THE POSTING OF JOURNAL ENTRIES INTO THE RESPECTIVE LEDGER ACCOUNTS

1. The process of posting from journal entries into the respective ledger is usually done at the end of each month.
2. In order to be systematic, accounts created during the ledger entries process should be opened on a date-to-date basis.

Example 4.2

The following are the transactions of Betong Berhad in the month of January 20X1

Jan 3	Purchase new furniture worth RM2,000 by cheque
5	Paid RM300 for electricity bills by cash
10	Sold goods worth RM4,500 to Indah Bhd by credit
12	Received a commission worth RM1,000 from Azhar by cash
18	Indah Bhd return goods worth RM200 to the business
20	Indah Bhd paid his debt in full by cheque
21	Transfer RM1,600 from company's bank account into cash till

Using the information given, we can now prepare the entries to record them in a general ledger. Remember that we are going to do this on a date-to-date basis.

Solutions:

Journal entries:

Date	Particulars	Debit (RM)	Credit (RM)
20X1	Furniture	2,000	
Jan 3	Cash at bank		2,000
5	Water and Electricity	300	
	Cash in hand		300

10	Indah Bhd	4,500	
	Sales		4,500
12	Cash in hand	1,000	
	Commission received		1,000
18	Return Inwards	200	
	Indah Bhd		200
20	Cash at bank	4,300	
	Indah Bhd		4,300
21	Cash in hand	1,600	
	Cash at bank		1,600

Ledger Entries:

Furniture Account					
20X1		RM			
Jan 3	Cash at bank	2,000			
Cash at Bank Account					
20X1		RM	20X1		RM
Jan 20	Indah Bhd	4,300	Jan 3	Furniture	2,000
			21	Cash in hand	1,600
Water and Electricity Account					
20X1		RM			
Jan 3	Cash in hand	300			
Cash in Hand Account					
20X1		RM	20X1		RM
Jan 12	Commission received	1,000	Jan 3	Water and electricity	300
21	Cash at bank	1,600			

Indah Bhd Account					
20X1		RM	20X1		RM
Jan 10	Sales	4,500	Jan 18	Return inwards	200
			20	Cash at bank	4,300

Sales Account					
			20X1		RM
			Jan 10	Indah Bhd	4,500

Commission Received Account					
			20X1		RM
			Jan 12	Cash in hand	1,000

Return Inwards Account					
20X1		RM			
Jan 18	Indah Bhd	200			

4.3 SHOW THE BALANCING OFF THE ACCOUNT

4.3.1 The balancing off the accounts for assets, liabilities, capital, revenues and expenses

1. The balancing off the accounts is according to normal balance of particular account. The details shown below:

ACCOUNT TYPES	NORMAL BALANCE	
	DEBIT	CREDIT
Assets	√	
Expenses	√	
Drawings	√	
Liabilities		√
Owner's equity		√
Revenue		√

Table 4.3: Normal balance for different types of account

2. Steps of balancing off an account are as follows:
   i. Add up both sides.
   ii. Find the difference by subtracting the smaller amount from the greater amount.
   iii. Write down the difference on the lighter side, write as "balance c/d". This is to make the two sides equal.
   iv. Lastly, bring down the balance to the opposite side, write as "balance b/d".

Example 4.3:

Cash in Hand Account					
20X1		RM	20X1		RM
Jan 1	Balance b/d	2,000	Jan 3	Water and electricity	600
12	Commission received	1,000	15	Stationery	280
21	Cash at bank	1,600	30	Wages	2,000
			31	Balance c/d	1,720
		4,600			4,600
Feb 1	Balance b/d	1,720			

In this example, the debits exceed the credits by RM1,720. Therefore, the account has a debit balance of RM 1,720. The abbreviations 'c/d' and 'b/d' stand for carried down and brought down respectively. The balance that is brought down forms the first entry for the next month or year.

4.3.2 The difference between the debit balance, credit balance and zero balance

1. If the total debit side is greater than the total credit side, then we have a **debit balance.**
2. If the total credit side is greater than the total debit side, then we have a **credit balance.**
3. If the total debit side is equal to the total credit side, then we have a **zero balance.**

Transaction and double entry principles

Transaction	Account Debited	Account Credited
Cash inflows	Cash/Bank Cash/Bank	Sales/Debtor/ Revenue/Capital
Cash outflows	Purchase Creditor Expenses Drawing Assets	Cash/Bank Cash/Bank Cash/Bank Cash/Bank Cash/Bank
Purchase of Goods:		
• Cash Purchase	Purchase	Cash/Bank
• Credit Purchase	Purchase	Creditors
Sales:		
• Cash Sales	Cash/Bank	Sales
• Credit Sales	Debtor	Sales
Returns Inwards/ Sales Returns	Returns Inwards	Debtor
Returns Outwards/ Purchase Returns	Creditors	Returns Outwards
Assets: Business Resources:		
• Purchase of new assets		
- by cash	Asset	Cash/Bank
- by credit	Asset	Creditor
• Selling of used asset		
- by cash	Cash/Bank	Asset
- by credit	Debtors	Asset
Capital: Resources brought into business by owner		
• Cash	Cash	Capital
• Bank	Bank	Capital
• Assets	Asset	Capital

Drawings:		
• Cash	Drawings	Cash
• Bank	Drawings	Bank
• Goods	Drawings	Purchase
• Assets withdrawn by the owner for personal use	Drawings	Asset
Payment of expenses	Expenses	Cash/Bank
Receipt of revenue	Cash/Bank	Revenue
Debtors: Customer who purchased goods on credit		
• Sale of Goods on credit to customer	Debtor	Sales
• Debtor returned goods	Sales return	Debtor
• Giving discount to debtors	Discount Allowed	Debtor
• Received Cash or cheque	Cash\Bank	Debtor
Creditors: Supplier who supplied goods on credit		
• Purchase of goods on credit	Purchase	Creditor
• Return of goods to creditor	Creditor	Purchase return
• Discount received	Creditor	Discount Received
• Payment to creditors by cash or cheque	Creditor	Cash\Bank
Liabilities:		
• Bank Loan	Bank	Loan
• Approved bank Overdraft	Bank	Bank Overdraft

Table 4.4: Transaction and double entry principles

REVIEW QUESTIONS

1. Explain the double entries principle for revenues and expenses.

2. Outline the double entries principles for inventories.

3. Discuss the differences between trade discount and cash discount.

Accounts	Details
Trade discount	
Cash discount	

4. Kedai Ceria has the following business transactions:
   a. The owner invested RM5,000 cash into the business
   b. Bought a computer costing RM3,500 by cheque
   c. Paid wages of RM1,000 by cash
   d. The owner borrowed RM500 from company's bank account Maybank Berhad
   e. Received invoices of RM5,000 from Lydia & Co.
   f. Sold goods on credit to Fazidah for RM1,500

   Required:

   Show the effect of each transaction (increase or decrease) on the accounts affected.

5. Lubuk Emas Sdn Bhd started business on April 20X1. Below are the business transactions during the month of February 20X1.

Date	Transactions
February 3	Owner brought in RM20,000 cash and motor vehicle valued RM35,000 into the business.
4	Transfer cash of RM16,000 into bank account.
7	Purchase of stock is made by cheque RM3,000 before receiving trade discount of 2%.
8	Sold goods on credit RM5,000 to Mr. Yap.
9	Bought goods on credit RM4,300 from Emilyn.
11	Make cash sales of RM3,800.
14	Business purchased machinery on credit from Machine Suppliers of RM6,700.
17	Mr. Yap paid the amount due in full by cheque and was allowed a discount of RM200.
18	Paid Emilyn the amount owed RM4,300 by cheque.
22	Owner withdrawn goods of RM100 for his personal use.
24	Issued a cheque of RM1,000 for rental paid to the landlord.
25	Paid salary to workers RM2,300 by cheque.
28	Received commission RM1,200 by cheque.

Required:

Prepare journal and ledger entries to record of the transactions above. (Do not forget to show the balancing off for each accounts)

CHAPTER 5

Trial Balance

LEARNING OUTCOMES >>

At the end of this chapter, students should be able to:

1. Describe the purpose of preparing Trial Balance
2. Prepare the Trial Balance
3. Recognise types of errors that are revealed by Trial Balance

5.1 PURPOSE OF PREPARING TRIAL BALANCE

1. The trial balance is a statement prepared based on account balances in the ledgers at the end of an accounting period.
2. It is a device used to ensure that the total debits and credits in the account are equal and balance.

Purpose of a Trial Balance

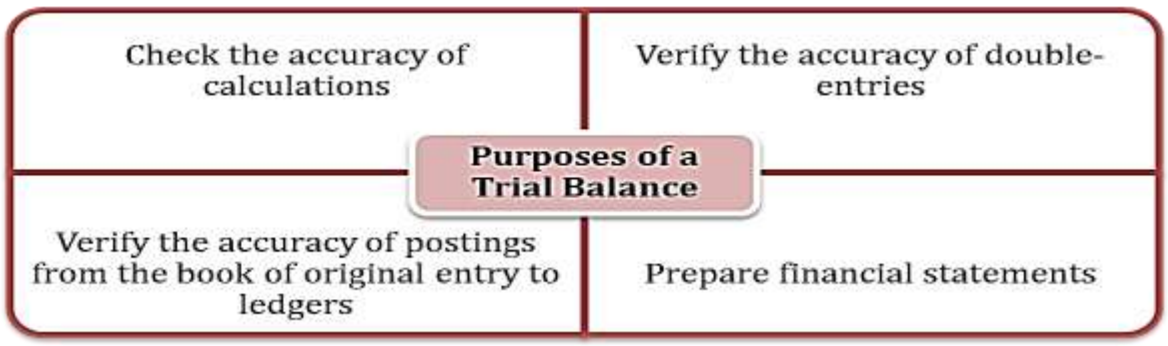


Figure 5.1: Purpose of a Trial Balance

Limitation of a Trial Balance

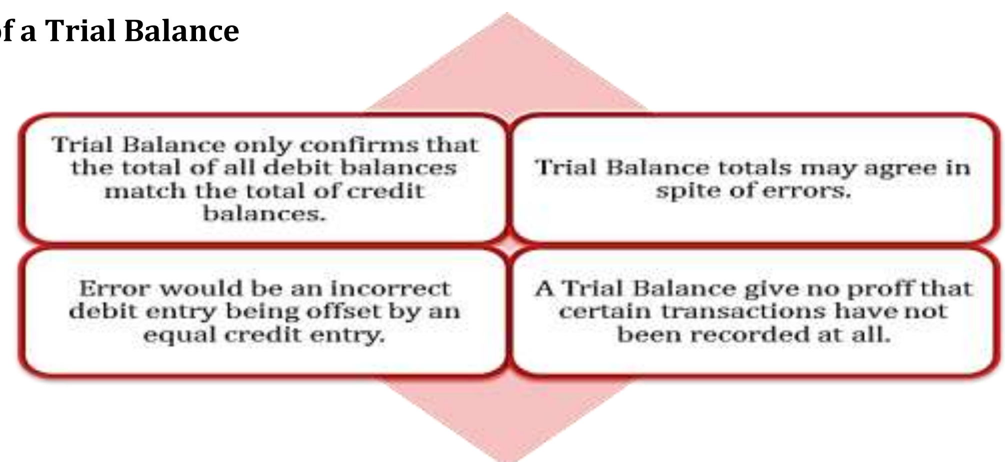


Figure 5.2: Limitation of a Trial Balance

5.2 PREPARE THE TRIAL BALANCE

Step 1: List each account that has a balance

Step 2: All accounts with debit balances will be listed in the debit side, while accounts with credit balances will be listed in the credit side.

Step 3: Compare the totals of the columns. The total debit amount must be equal to the total credit amount.

If the amounts are not balanced or not equal, this means that errors or mistakes occurred when entries were made into the accounts, and further checking must be done.

Assets & Expenses			
	RM		**RM**
Balance b/d	20,000	XXXXXX	1,000
XXXXXX	300	XXXXXX	7,000
XXXXXX	700	XXXXXX	2,000
XXXXXX	4,000	Balance c/d	15,000
	25,000		25,000
Balance b/d	**15,000**		

Liabilities, Owner's equity & Revenue			
	RM		**RM**
XXXXXX	3,000	Balance b/d	150,000
XXXXXX	2,000	XXXXXX	600
XXXXXX	2,000	XXXXXX	400
Balance c/d	8,200	XXXXXX	1,000
	152,000		152,000
		Balance b/d	**8,200**

XYZ Company
Trial Balance as at 31 December 20XX

Account	**Debit RM**	**Credit RM**
Assets and Expenses	15,000	
Liabilities, Owner's equity and Revenue		8,200

Figure 5.3: Steps in preparing the Trial Balance

XYZ Company
Trial Balance as at 31 December 20XX

Account	Debit RM	Credit RM
Land and Building	XXXX	
Plant and Machinery	XXXX	
Fixtures and Fittings	XXXX	
Vehicles	XXXX	
Furniture	XXXX	
Investment	XXXX	
Premises	XXXX	
Cash/Bank	XXXX	
Account Receivables/Debtors	XXXX	
Inventory	XXXX	
Drawings	XXXX	
Purchases	XXXX	
Sales Return/Return Inwards	XXXX	
Carriage Inwards	XXXX	
Carriage Outwards	XXXX	
Salary	XXXX	
Utility Bills	XXXX	
Advertising	XXXX	
Stationeries	XXXX	
Discount Allowed	XXXX	
Rental Expenses	XXXX	
Insurance	XXXX	
Vehicle Maintenance	XXXX	
Capital		XXXX
Account Payables/Creditors		XXXX
Bank Overdraft		XXXX
Loan		XXXX
Debentures		XXXX
Mortgage		XXXX
Sales		XXXX
Purchase Return/Return Outwards		XXXX
Commission Received		XXXX
Rent Received		XXXX
Discount Received		XXXX
	XXXXX	**XXXXX**

5.3 RECOGNISE TYPES OF ERROR THAT ARE RELEVENT BY TRIAL BALANCE

a. Errors affecting the Trial Balance agreement

Errors affecting the Trial Balance agreement	
Errors of posting to the same side of double entry	**Example:** Posting both accounts to debit side for RM500 expense transaction. Dr. Cash 500 Dr. Expense 500
Errors of omission of one side of double entry	**Example:** Posting RM2,500 rental transaction to expense account only. Dr. Rental expense 2,500 Cr. [blank]
Errors of posting where digits of number are reversed on side of double entry	**Example:** Posting RM450 stationary expense as RM540 in expense account. Dr. Stationary expense 540 Cr. Cash 450
Errors of original entry	**Example:** Making a mistake when entering a sales invoice into the sales day book (journal).
Errors of adding up	**Example:** Making a mistake of totaling on debit side or credit side.

Table 5.1: Errors affecting the Trial Balance agreement

a. Errors not affecting the Trial Balance agreement

Errors not revealed by Trial Balance	
Errors of omission on both sides of double entry	**Example:** The company forgot to post the RM3,000 of utility expense Dr. [blank] Cr. [blank]
Errors of posting on both sides of double entry with the same amount	**Example:** Posting RM3,200 transportation expense as RM3,500 in the accounting entry. Dr. Transportation exp. 3,500 Cr. Cash 3,500
Errors of reverse posting in double entry	**Example:** Posting RM310 maintenance expense in reverse sides as below. Dr. Cash 310 Cr. Maintenance exp. 310
Errors of accounting principle	**Example:** Posting of RM550 of maintenance expense to machinery fixed asset. Dr. Machinery 550 Cr. Cash 550

Table 5.2: Errors not affecting the Trial Balance agreement

Example 5.1

The following account balance are taken from the accounting book of Aren Legasi Berhad as at 30 November 20X1.

Particular	RM
Motor Vehicles	40,000
Furniture Fittings	30,000
Cash in hand	10,000
Cash at bank	50,000
Debtor –Ah Seng	20,000
Creditor-Ah Meng	15,000

During December 20X1, the following transaction occurred.

Date	Particular
20X1 Dec 1	Purchase new vehicles costing RM25,000 90% of the price is paid by cheque and the balance is paid by cash
3	Paid telephone bill of RM150, water bill RM100 and electricity bill RM200 with cash
9	Sold good s on credit Ah Seng of RM7,000
10	Paid goods by cash of RM3,000 and received discount 10%
15	Debtor Ah Seng returned low quality goods worth RM700
17	Cash sales of RM300
23	Paid house rent of owner's children of RM700 with cheque
29	Paid debtor Ah Seng half of the debt by cheque
31	Paid creditor Ah Meng debt of RM5,000 by cheque. Purchase goods Ah Meng on credit of RM6,000

Solutions:

Bank Account

		RM			RM
20X1		**RM**	**20X1**		**RM**
Dec 1	Balance b/d	50,000	Dec 1	Motor Vehicles	22,500
29	Debtor	13,150	23	Drawings	700
			31	Creditors	5,000
			31	Balance c/d	34,950
		63,150			63,150
20X2					
Jan 1	Balance b/d	34,950			

Cash Account

20X1		**RM**	**20X1**		**RM**
Dec 1	Balance b/d	10,000	Dec 1	Motor Vehicles	2,500
17	Sales	300	3	Telephone	150
			3	Water	100
			3	Electricity	200
			10	Purchase	2,700
			31	Balance c/d	4,650
		10,300			10,300
20x2					
Jan 1	Balance b/d	4,650			

Motor Vehicles Account

20X1		**RM**	**20X1**		**RM**
Dec 1	Balance b/d	40,000	Dec 31	Balance c/d	65,000
1	Bank	22,500			
1	Cash	2,500			
		65,000			63,150
20X2					
Jan 1	Balance b/d	65,000			

Furniture Fittings Account

20X1		**RM**	**20X1**		**RM**
Dec 1	Balance b/d	30,000	Dec 31	Balance c/d	30,000
		30,000			30,000
20X2					
Jan 1	Balance b/d	30,000			

Telephone Expenses Account

20X1		**RM**	**20X1**		**RM**
Dec 3	Cash	150	Dec 31	Balance c/d	150
		150			150
20X2					
Jan 1	Balance b/d	150			

Water Expenses Account

20X1		**RM**	**20X1**		**RM**
Dec 3	Cash	100	Dec 31	Balance c/d	100
		100			100
20X2					
Jan 1	Balance b/d	100			

Electricity Expenses Account

20X1		**RM**	**20X1**		**RM**
Dec 3	Cash	200	Dec 31	Balance c/d	200
		200			200
20X2					
Jan 1	Balance b/d	200			

Debtor Account-Ah Seng

20X1		**RM**	**20X1**		**RM**
Dec 1	Balance b/d	20,000	Dec 15	Returns inwards	700
9	Sales	7,000	29	Bank	13,150
			31	Balance c/d	13,150
		27,000			27,000
20X2					
Jan 1	Balance b/d	13,150			

Creditors Account -Ah Meng

20X1		**RM**	**20X1**		**RM**
Dec 31	Bank	5,000	Dec 31	Balance b/d	15,000
31	Balance c/d	16,000	10	Purchase	6,000
		21,000			21,000
			20X2		
			Jan 1	Balance b/d	16,000

Capital Account

20X1		**RM**	**20X1**		**RM**
Dec 31	Balance c/d	135,000	Dec 1	Balance b/d	135,000
		21,000			135,000
			20X2		
			Jan 1	Balance b/d	135,000

Sales Account

20X1		**RM**	**20X1**		**RM**
Dec 31	Balance c/d	7,300	Dec 1	Balance b/d	7,000
			17	Cash	300
		7,300			7,300
			20X2		
			Jan 1	Balance b/d	7,300

Purchases Account

20X1		**RM**	**20X1**		**RM**
Dec 10	Cash	2,700	Dec 31	Balance c/d	8,700
31	Creditor Ah Meng	6,000			
		8,700			8,700
20X2					
Jan 1	Balance b/d	8,700			

Return Inwards Account

20X1		**RM**	**20X1**		**RM**
Dec 9	Debtor Ah-Seng	700	Dec 31	Balance c/d	700
		700			700
20X2					
Jan 1	Balance b/d				

Drawings Account

20X1		**RM**	**20X1**		**RM**
Dec 23	Bank	700	Dec 31	Balance c/d	700
		700			700
20X2					
Jan 1	Balance b/d				

AREN LAGECY BERHAD
Trial Balance as at 31 December 20X1

Accounts	Debit (RM)	Credit (RM)
Cash	4,650	
Bank	34,950	
Motor Vehicles	65,000	
Fixture Fittings	30,000	
Telephone	150	
Water	100	
Electricity	200	
Debtor	13,150	
Returns Inwards	700	
Purchase	8,700	
Drawings	700	
Sales		7,300
Creditors		16,000
Capital		135,000
	158,300	**158,300**

REVIEW QUESTIONS

1. Junny, the owner of Dejaju Trading selling computers and accessories in Penang, commenced business on 1 March 20X1 with the following assets and liabilities:

	RM
Cash at bank	100,000
Furniture	8,000
Van	12,000
Long term loan from MBSB	50,000

Below are the transactions in the month of March 20X1:

Date	Description	Amount (RM)
March 5	Purchased computers from Chan & Gan Trading	18,500
8	Purchased display cabinets RM8,000 from Eco Furniture for the use of business. RM2,000 was paid as down payment and balance will be settled in 60 days.	
9	Purchased notebooks and paid by cheque	7,900
10	Jojo withdrew a wireless mouse for personal use	170
11	Received credit note from Chan & Gan Trading	2,500
12	Cash sales and the amount was banked in on the same day	2,100
15	Sold computer sets to Dynamic Enterprise	9,200
20	Paid loan installment RM5,000 and loan interest RM750 to MBSB by cheque	
21	Paid Chan & Gan Trading by cheque to settle the full amount due	15,000

22	Issued a cheque for paying his personal medical bill	400
23	Sent Dynamic Enterprise a credit notes for faulty accessories returned	1,800
25	Received cheque from Dynamic Enterprise	5,000
26	Bought stationery and paid by cheque	200
27	Paid general expenses by cheque	700
29	Cash sales RM3,000. Out of which 2,000 was used to pay office salaries and the balance was banked into business bank account.	

Requirement:

i. Record the above transaction in the appropriate relevant ledger account (closed)

ii. Prepare Trial Balance as at 31 March 20X1.

CHAPTER 6

Year End Adjustments

LEARNING OUTCOMES >>

At the end of this chapter, students should be able to:

1. Describe the accrual basis and cash basis accounting
2. Provide explanation on the accruals and prepayments
3. Provide explanation on bad debts, provision for doubtful debts (allowance for doubtful debt) and bad debt recovery
4. Provide explanation on the depreciation of plant, property and equipment

6.1 THE ACCRUAL BASIS AND CASH BASIS ACCOUNTING

1. Accounting recording system is based on the principle of revenue and expenses recognition
2. Revenue and expenses that are recognized will be recorded according to cash basis or accrual basis
3. Relates to matching principles, the revenue earned in an accounting period must be matched against the expenses incurred in order to generates revenues in the same period.

6.1.1 Accrual Basis Accounting

1. Revenues are recorded when goods or services were sold regardless of whether cash has been received or not.
2. Expenses were recorded when goods or services are used regardless whether they were paid or not.
3. In other word, in accrual basis accounting, both revenues and expenses are recorded when they occur.

6.1.2 Cash Basis Accounting

1. Revenues was recorded when cash was received.
2. Expenses was recorded when cash was paid.

6.2 THE ACCRUALS AND PREPAYMENTS

6.2.1 Define Accruals and Prepayments

1. After the Trial Balance has been drawn up, there are adjustments that must be made to the balances found in the Trial Balance.
2. The balances of expenditure and revenue which are shown in the Trial Balances are those of expenditure that have been paid and revenue where cash has been received.
3. Adjustments must be made for the following:
    - Accrued expenses
    - Prepaid expenditure
    - Accrued revenue
    - Unearned revenue

	PREPAYMENTS / PREPAID	ACCRUALS
EXPENSES	**EXPENSES** that were paid for in the current accounting period but the goods or services will only be used in the following accounting period. Occurs when the total expenses paid exceeds the amount that should have been paid. Must be deducted from the expenses account. **CURRENT ASSETS** **Dr Prepaid Expenses** **Cr Expenses**	**EXPENSES** that are not yet paid even though the goods were received or services were used. Occur when total expenses paid are less than the amount that should have been paid Must be added to the expenses account. **CURRENT LIABILITIES** **Dr Expenses** **Cr Accrued Expenses**
REVENUE	**REVENUE** is money received in advance for services to be provided to the customers at a later due. Created when the total revenue received exceeds the amount that should have been received. Must be deducted from the revenue account. **CURRENT LIABILITIES** **Dr Revenue** **Prepaid Revenue**	**REVENUE** is money not yet received even though the services have been provided to the customer. Created when the actual revenue received is less than the total that should have been received. Must be added to the revenue account **CURRENT ASSETS** **Dr Accrued Revenue** **Cr Revenue**

Table 6.1: Accruals and Prepayments

6.2.2 Calculation about accruals and prepayments for expenses and revenues.

1. **ACCRUED EXPENSES**

Example 6.1

The following information was taken from Senyum Trading. The accounting period is one year.

Senyum Trading
Trial Balance as at 31 December 20X1

Account	Debit (RM)	Credit (RM)
Salary	6,000	

Additional information:

- Salary is RM 600 per month.

Solution:

Salary: RM600 x 12 months

= RM7 200 (Total salary that should have been paid).

♠ **Therefore**:

Accrued salary = Salary that should have been paid - Salary that has been paid

= RM7,200 – RM6,000

= **RM1,200**

The adjusting entry:

a. General day book

Date	Particulars	Debit (RM)	Credit (RM)
20X1			
Dec 31	Dr. Salary	1,200	
	Cr. Accrued Salary		1,200
	(Salary not yet paid)		

b. General ledger

Salary Account					
20X1		**(RM)**	20X1		**(RM)**
Dec 31	Balance b/d	6,000			
	Accrued salary	1,200	Dec 31	Balance c/d	7,200
		7,200			7,200
20X2					
Jan 1	**Balance b/d**	7,200			

Accrued Salary Account					
20X1		**(RM)**	20X1		**(RM)**
Dec 31	Balance c/d	1,200	Dec 31	Salary	1,200
		1,200			1,200
			20X2		
			Jan 1	**Balance b/d**	**1,200**

Senyum Trading
Statement of Comprehensive Income for the year ended 31 December 20X1

	RM	**RM**
Expenses:		
Salary	7,200	

Senyum Trading
Statement of Financial Position as at 31 December 20X1

	RM	**RM**
Current Liabilities:		
Accrued Salary	2,400	

RM6,000 of the salary was paid, but the total amount transferred to the Statement of Comprehensive Income (SOCI) is the salary that should have been paid, which is RM7,200. This amount includes RM1,200, which was accrued and not yet paid. This accrued expense is recorded as a Current Liability in the Statement of Financial Position (SOFP).

2. PREPAID EXPENSES

Example 6.2

The following information was extracted from the book of Bestari Company.

Bestari Company
Trial Balance as at 31 December 20X1

Account	Debit RM	Credit RM
Insurance	6,000	

Additional information:

- Insurance covered for the period of 1st March 20X1 to 28 February 20X2

Solution:

Insurance for the year = RM6,000 X 10/12 months

= RM5,000

(total insurance covered for the period ended 31 Dec 20X1)

♠ **Therefore**:

Prepaid insurance = Actual expenses paid – Actual expenses incurred

= RM6,000 – RM5,000

= **RM1,000**

The adjusting entry:

a. General day book

Date	Particulars	Debit (RM)	Credit (RM)
20X1			
Dec 31	Dr. Prepaid Insurance	1,000	
	Cr. Insurance		1,000
	(Salary not yet paid)		

b. General ledger

Insurance Account					
20X1			20X1		
Dec 31	Balance b/d	6,000	Dec 31	Prepaid	
		6,000		Insurance	1,000
				Balance c/d	5,000
20X2					6,000
Jan 1	**Balance b/d**	5,000			

Prepaid Insurance Account					
20X1			20X1		
Dec 31	Insurance	1,000	Dec 31	Balance c/d	1,000
		1,000			1,000
20X2					
Jan 1	**Balance b/d**	**1,000**			

Bestari Company
Statement of Comprehensive Income for the year ended 31 December 20X1

	RM	**RM**
Expenses:		
Insurance	5,000	

Bestari Company
Statement of Financial Position as at 31 December 20X1

	RM	**RM**
Current Assets:		
Prepaid Insurance	1,000	

The insurance paid during the accounting period was RM6,000 but total amount transfer to Statement of Comprehensive Income (SOCI) was RM5,000 which is the actual amount should be recognized into SOCI. The prepaid insurance which is RM1,000 is for the next accounting period. The prepaid insurance will be recorded as current asset in Statement of Financial Position (SOFP) and will be recognized as an expense in the next accounting period.

3. ACCRUED REVENUE

Example 6.3

The following information is obtained from XYZ Bhd.

XYZ Bhd

Trial Balance as at 31 December 20X1

Account	Debit RM	Credit RM
Fixed Deposit	100,000	

Additional information:

- Fixed deposit interest rate at 3% per annum.

Solution:

Fixed deposit interest for the year = RM100,000 x 3%

= RM3,000

(total deposit interest income should be recognized).

♠ **Therefore**: **Accrued interest on fixed deposit received**

= Actual income recognized – Actual income received

= RM3,000

The adjusting entry:

a. General day book

Date	Particulars	Debit (RM)	Credit (RM)
20X1			
Dec 31	Dr. Accrued Interest on Fixed Deposit received	3,000	
	Cr. Interest on Fixed Deposit received		3,000
	(Interest on Fixed Deposit received for the year)		

b. General ledger

Interest on Fixed Deposit received					
20X1			20X1		
			Dec 31	Accrued Interest	
Dec 31	Balance c/d	3,000		on Fixed Deposit	3,000
		3,000		received	3,000
			20X2		
			Jan 1	**Balance b/d**	3,000

Accrued Interest on Fixed Deposit received					
20X1			20X1		
Dec 31	Interest on				
	Fixed Deposit	3,000	Dec 31	Balance c/d	3,000
	received	3,000			3,000
20X2					
Jan 1		**3,000**			
	Balance b/d				

XYZ Bhd

Statement of Comprehensive Income for the year ended 31 December 20X1

	RM	**RM**
Revenue:		
Interest on Fixed Deposit received	3,000	

XYZ Bhd

Statement of Financial Position as at 31 December 20X1

	RM	**RM**
Current Assets:		
Accrued Interest on Fixed Deposit received	3,000	

4. UNEARNED/PREPAID REVENUE

Example 6.4

The following information is obtained from Apapunada Bhd.

Apapunada Bhd

Trial Balance as at 31 December 20X1

Account	Debit RM	Credit RM
Rental		19,500

Additional information:

- Rental income per month is RM 1,500

Solution:

Rental income: RM1,500 x 12 months

= RM18,000 (Total rental income for the year).

♠ **Therefore**:

Unearned rental income = Actual income received – actual income recognized

= RM19,500 – RM18,000

= RM1,500

* This means that the amount RM1,500 is the rental revenue that was received in advance, also known as advance revenue.

The adjusting entry:

a. General day book

Date	Particulars	Debit (RM)	Credit (RM)
20X1			
Dec 31	Dr. Rental revenue	1,500	
	Cr. Unearned rental revenue		1,500
	(To record unearned rental revenue)		

b. General ledger

Rental Revenue Account					
20X1			20X1		
Dec 31	Unearned		Dec 31		
	Rental Revenue	1,500			
	Balance c/d	18,000		Balance b/d	19,500
		19,500			19,500
			20X2		
			Jan 1	**Balance b/d**	**1,500**
Unearned Rental Revenue Account					
20X1			20X1		
Dec 31	Balance c/d	1,500	Dec 31	Rental Revenue	1,500
		1,500			1,500
			20X2		
			Jan 1	**Balance b/d**	**1,500**

Apapunada Berhad

Statement of Comprehensive Income for the year ended 31 December 20X1

	RM	**RM**
Revenue:		
Rental	18,000	

Apapunada Berhad

Statement of Financial Position as at 31 December 20X1

	RM	**RM**
Current Liabilities:		
Unearned Rental Revenue	1,500	

6.3 BAD DEBTS, PROVISIONS FOR DOUBTFUL DEBTS (ALLOWANCE FOR DOUBTFUL DEBT) AND BAD DEBTS RECOVERY

1. BAD DEBTS

a. Debts that are unable to be collected from the customers, due to:
   - customers' death
   - customers who are mentally incapacitated
   - cannot be traced
   - declared bankrupt by the court

b. Represent loss to a company and will be recorded as an expenses

c. It is listed in debit side in Trial Balance

DOUBLE ENTRY	CLOSING ENTRY
Dr Bad Debts Expenses	Dr SOCI
Cr A/C Receivables	Cr Bad Debts Expenses

Example 6.5

DATE	PARTICULARS	AMOUNT (RM)
20X1	Account Receivable: Amir	500
Jan 1	Account Receivable: Bala	1,500
	Account Receivable: Chong	200

Additional information:

a. On 24 January 20X1, Amir passed away and company decided to write off Amir's debts.

b. Show the related entries for the above transaction in the:
   - General Day Book
   - General Ledger
   - Financial Statements

Solution:

a. General day book

Date	Particulars	Debit (RM)	Credit (RM)
20X1			
Jan 24	Dr. Bad debts expenses	500	
	Cr. Account Receivable: Amir		500
	(To record bad debts expenses)		
31	Dr. SOCI	500	
	Cr. Bad debts expenses		500
	(closing entry)		

b. General ledger

A/C Receivable : Amir					
20X1 Jan 1	Balance b/d	500 500	20X1 Jan 24	Bad debts exp	500 500

Bad debts expenses					
20X1 Jan 24	A/C Receivable : Amir	500 500	20X1 Dec 31	SOCI	500 500

Menang Berhad
Statement of Comprehensive Income for the year ended 31 December 20X1

	RM	RM
Expenses:		
Bad debts	500	

Menang Berhad
Statement of Financial Position as at 31 December 20X1

	RM	RM
Current Assets:		
Account Receivable: Bala	1,500	
Account Receivable: Chong	200	

2. BAD DEBTS RECOVERY

a. Debts repaid by customers after the debts have been written off as bad debts.

b. Represent an **UNEXPECTED GAIN** and are considered as **REVENUE**.

c. Listed in **CREDIT** side in **TRIAL BALANCE.**

DOUBLE ENTRY	CLOSING ENTRY
Dr Cash/Bank	Dr Bad debts recovered
Cr Bad debts recovered	Cr SOCI

Example 6.6

DATE	PARTICULARS	AMOUNT (RM)
20X1	Account Receivable: Kassim	1,500
Jan 1	Account Receivable: Julia	500

Additional information:

a. On 15 March 20X1, the debt of Kassim was written off as bad debts because he could not be traced.

b. Kassim repaid his bad debts by cheque for RM1,000 on 20 October 20X1.

c. Show the related entries for the above transaction in the:

- General Day Book
- General Ledger
- Financial Statement

Solution:

a. General day book

Date	Particulars	Debit (RM)	Credit (RM)
20X1			
Mac 15	Dr. Bad debts expenses	1,500	
	Cr. Account Receivable: Kassim		1,500
	(To record bad debts expenses)		

Oct 20	Dr. Bank Cr. Bad debts recovered (to record bad debts recovered)	1,000	 1,000
Dec 31	Dr. SOCI Cr. Bad debts expenses (closing entry)	1,500	 1,500
Dec 31	Dr. Bad debts recovered Cr. SOCI (closing entry)	1,000	 1,000

b. General ledger

A/C Receivable: Kassim					
20X1 Jan 1	 Balance b/d	 1,500 1,500	20X1 Jan 24	 Bad debts exp	 1,500 1,500

Bad debts expenses					
20X1 Jan 24	 A/C Receivable : Kassim	 1,500 1,500	20X1 Dec 31	 SOCI	 1,500 1,500

Bad debts recovered					
20X1 Dec 31	 SOCI	 1,000 1,000	20X1 Oct 20	 Bank	 1,000 1,000

Menang Berhad
Statement of Comprehensive Income for the year ended 31 December 20X1

	RM	RM
Revenue:		
Bad debts recovered	1,000	
Expenses:		
Bad debts	1,500	

Menang Berhad
Statement of Financial Position as at 31 December 20X1

	RM	RM
Current Assets:		
Bank	1,000	
Account Receivable: Julia	500	

3. PROVISIONS FOR DOUBTFUL DEBTS (PFDD)

a. An estimate of debts that are not expected to be collected in the future accounting periods.

b. Only determined and adjusted after the trial balance is prepared.

c. PFDD/AFDD can be calculated using the following formula:

PFDD/AFDD = % provisions for doubtful debts x Net Debtors

Net Debtors = [Debtors (as per TB) – Unadjusted bad debts (if any)]

d. Normally has a **CREDIT** balance and will be **DEDUCTED** from **DEBTORS A/C** in **SOFP.**

CREATING	INCREASE	DECREASE
Dr. Doubtful debts Cr. PFDD	Dr. Doubtful debts Cr. PFDD	Dr. PFDD Cr. Doubtful debts

Example 6.7

The following information was extracted from Rahmat Trading on 31 December for the year starting 20X1.

Year	Account Receivable A/C (RM)
20X1	10,000
20X2	15,000
20X3	12,000

Additional information:

i. Starting in year 20X1, the company decided to create provisions for doubtful debts account at 4% of the Account Receivable balance at the end of each year.

ii. Prepare the following entries for the year starting 20X1:

   a. Trial Balance
   b. General Day Book
   c. Allowance for Doubtful Debts A/C
   d. SOCI and SOFP

<u>Solution:</u>

Calculations:

Year	Account Receivable	Provision for Doubtful Debts	Adjustment	
			Increase (Debit)	**Decrease (Credit)**
20X1	10,000	4% x 10,000 = 400	400	
20X2	15,000	4% x 15,000 = 600	200	
20X3	12,000	4% x 12,000 = 480		120

a. Trial Balance

Trial Balance as at 31 December 20X1		
Account	**Debit RM**	**Credit RM**
Doubtful debts	400	
Provision for doubtful debts		400
Trial Balance as at 31 December 20X2		
Account	**Debit RM**	**Credit RM**
Doubtful debts	200	
Provision for doubtful debts		600
Trial Balance as at 31 December 20X3		
Account	**Debit RM**	**Credit RM**
Doubtful debts		120
Provision for doubtful debts		480

b. General day book

Date	Particulars	Debit (RM)	Credit (RM)
20X1			
Dec 31	Dr. Doubtful Debts	400	
	Cr. Provisions for Doubtful Debts		400
	(Creating Provision for Doubtful Debts)		
20X2			
Dec 31	Dr. Doubtful Debts	200	
	Cr. Provisions for Doubtful Debts		200
	(Increase Provision for Doubtful Debts)		
20X3			
Dec 31	Dr. Provisions for Doubtful Debts	120	
	Cr. Doubtful Debts		120
	(Decrease Provision for Doubtful Debts)		

c. General ledger

Provisions for Doubtful Debts					
20X1			20X1		
Dec 31	Balance c/d	400	Dec 31	Doubtful Debts	400
		400			400
20X2			20X2		
Dec 31	Balance c/d	600	Jan 1	Balance b/d	400
		600	Dec 31	Doubtful Debts	200
					600
20X3			20X3		
Dec 31	Doubtful Debts	120	Jan 1	Balance b/d	600
	Balance c/d	480			600
		600			
			20X4		
			Jan 1	Balance b/d	480

Statement of Comprehensive Income for the year ended 31 December 20X1, 20X2 and 20X3

	20X1 RM	20X2 RM	20X3 RM
Revenues:			
Doubtful debts (decrease)	-	-	120
Expenses:			
Doubtful debts (increase)	400	200	-

Statement of Financial Position as at 31 December 20X1, 20X2 and 20X3

	20X1 RM	20X2 RM	20X3 RM
Current Assets:			
A/C Receivables	10,000	15,000	12,000
(-) PFDD	(400)	(600)	(480)
Net A/C Receivables	9,600	14,400	11,520

6.4 DEPRECIATION OF PLANT, PROPERTY AND EQUIPMENT

6.4.1 Define depreciation and accumulated depreciation

1. DEPRECIATION

i. Depreciation is reduction of the value of non-current assets after being used in business operations.
ii. Costs of assets that are considered as **EXPENSES.**
iii. Listed in **DEBIT** side in **SOCI.**
iv. It will **REDUCE** the **NET PROFIT.**

2. ACCUMULATED DEPRECIATION

i. Amount of the non-current asset costs allocated to a particular accounting period.
ii. Usually accumulated from year to year.
iii. The book value of assets is the net value of the asset after deduction of cost and accumulated depreciation.

NET BOOK VALUE ASSETS = COST OF ASSETS – ACCUMULATED DEPRECIATION OF ASSETS

iv. Usually has a **CREDIT** balance and listed in **SOFP**

6.4.2 Compute depreciation amount using Straight line method.

1. STRAIGHT LINE METHOD (at cost)

a. The formula to calculate depreciation:

$$\textbf{Annual Depreciation} = \frac{\text{Cost – Scrap Value}}{\text{Estimated Useful Life}}$$

OR

Annual Depreciation = % Provision for depreciation x Cost of Assets

b. Total depreciation is fixed and the amount is same for each accounting period

c. Scrap value is the selling price of an asset as scrap at the end of its estimated useful life.

DOUBLE ENTRY	CLOSING ENTRY
Dr Depreciation of Assets	Dr SOCI
Cr Acc Depreciation of Assets	Cr Depreciation of Assets

6.4.3 Show the transactions for depreciation and accumulated depreciation in the financial statements.

Example 6.8

On 1st December 20X0, Nini Expert Bhd purchased a machine for RM26,000 by cheque. The machine has an estimated useful life of 4 years and expect to sell the machine at the end of its life for RM8,000 in cash.

Show the related entries for the above transaction in the:

a. General Day Book
b. General Ledger
c. Financial Statements

Solution:

Calculation:

$$\text{Depreciation of machine} = \frac{\text{RM26,000} - \text{RM8,000}}{\text{4 years}}$$

$$= \underline{\mathbf{RM4,500}}$$

a. General day book

Date	Particulars	Debit (RM)	Credit (RM)
20X0			
Dec 31	Dr. Depreciation of machine	4,500	
	Cr. Accumulated depreciation of machine		4,500
	(To record depreciation of machine)		
Dec 31	Dr. SOCI	4,500	
	Cr. Depreciation of machine		4,500
	(closing entry)		

b. General ledger

Depreciation of Machine

20X0			20X0		
Dec 31	Acc Dep of machine	4,500	Dec 31	SOCI	4,500
		4,500			4,500

Accumulated Depreciation of Machine

20X0			20X0		
Dec 31	Balance c/d	4,500	Dec 31	Dep of machine	4,500
		4,500			4,500

Nini Expert Bhd

Statement of Comprehensive Income for the year ended 31 December 20X0

	RM	RM
Expenses:		
Depreciation of machine	4,500	

Nini Expert Bhd

Statement of Financial Position as at 31 December 20X0

	RM	RM
Non-Current Assets:		
Machine at Cost	26,000	
(-) Accumulated depreciation of machine	(4,500)	
	21,500	

Example 6.9

Lily Trading purchased a lorry costing RM100,000 on 1 January 20X1. The lorry is depreciated at a rate of 10% per annum on cost.

Show the related entries for the above transaction in the:

a. General Day Book
b. General Ledger
c. Financial Statements

Solution:

Calculation:

Depreciation of Motor Vehicles = 10% x RM100,000

= **RM10,000**

a. General day book

Date	Particulars	Debit (RM)	Credit (RM)
20X1 Dec 31	Dr. Depreciation of motor vehicle Cr. Accumulated depreciation of motor vehicle (To record depreciation of machine)	10,000	10,000
Dec 31	Dr. SOCI Cr. Depreciation of motor vehicle (closing entry)	10,000	10,000

b. General ledger

Depreciation of Motor Vehicle					
20X1			20X1		
Dec 31	Acc Dep of motor vehicle	10,000	Dec 31	SOCI	10,000
		10,000			10,000

Accumulated Depreciation of Motor Vehicle					
20X1			20X1		
Dec 31	Balance c/d	10,000	Dec 31	Dep of machine	10,000
		10,000			10,000

Statement of Comprehensive Income for the year ended 31 December 20X1

	RM	RM
Expenses:		
Depreciation of motor vehicle	10,000	

Statement of Financial Position as at 31 December 20X1

	RM	RM
Non-Current Assets:		
Motor Vehicle at cost	100,000	
(-) Accumulated depreciation of motor vehicle	(10,000)	
	90,000	

REVIEW QUESTIONS

1. Below is the extracted information from the Trial Balance for Rahimi Sdn Bhd for the year ended 31 December 2020.

Particulars	RM
Rent Received	10,000
Salaries	8,000
Utilities	5,000
Insurance	9,600

The following information is required for the adjustments to Rahimi Sdn Bhd's accounts for the year ended 31 December 2020.

i. Salaries for the workers amounting to RM3.000 are still outstanding.
ii. Insurance expenses was for the period from 1/2/2020 until 31/1/2021.
iii. At the end of the accounting period, Rahimi Sdn Bhd had not received rent amounting to RM2,000.
iv. Utility bill still outstanding amounts to RM300.

Required:

a. Prepare the journal entries for all the adjustments above.
b. Provide an extract of Income Statement and a Balance Sheet for the year ended 31 December 2020

2. The following data of a company shows the adjustment needed for its doubtful debts. The data shows the conditions for three years ended 31 December 2018, 2019 and 2020.

Year	Bad debts written off year to 31 December (RM)	Accounts receivable at 31 December after bad debts written of (RM)	Allowance for doubtful debts (%)
2018	1,125	35,000	2
2019	1,225	54,000	4
2020	2,252	60,000	3

You are required to show:

a. Bad Debts Accounts for each respective year
b. Allowance for Doubtful Debts Accounts for each respective year
c. An extract of the income statement for each respective year
d. An extract of the statement of financial position for each respective year

3. Murni Company purchased two computers valued at RM5,000 each on 1 July 2018. The computer is depreciated at 20% per annum.

Based on the information given above, complete the following table using straight line method.

31 December Each Year	Depreciation	Accumulated Depreciation	Book Value
2018			
2019			
2020			

CHAPTER 7

Financial Statements with Year End Adjustments

LEARNING OUTCOMES >>

At the end of this chapter, students should be able to:

1. Describe types and importance of financial reporting in the business
2. Describe the format of financial statements
3. Prepare the financial statements with adjustments

7.1 TYPES AND IMPORTANCE OF FINANCIAL REPORTING IN THE BUSINESS

Financial Statements represent a formal record of the financial activities of an entity. These are written reports that quantify the financial strength, performance and liquidity of a company. Financial Statements reflect the financial effects of business transactions and events on the entity.

Figure 7.1: 4 types of statement in Financial Statements

The important of financial reporting in the business

Financial report present information about:

a. Financial position as the Statements of Financial Position discloses the financial position of an entity at a point in time (at a specific date).
b. Shows the performance in the Statement of Comprehensive Income. It discloses the performance of an entity during a given time period. It also discloses the revenue or income earned and the expenses incurred to earn that revenue.
c. The company's changes in financial position as shows in the Statement of Cash Flows. It discloses the changes in the financial position of an entity from one period to another. The statement also discloses the cash flow from investing, financing, operating activities of the entity during a given time period.
d. Additional relevant information in notes and supplementary schedule usually accompany financial statements in giving extra information about the items in the financial report of an entity.

e. Financial reporting provides useful information to a wide range of users in making economic decisions:

USERS	
Managers	Managers require Financial Statements to manage the affairs of the company by assessing its financial performance and position and taking important business decisions.
Shareholders	Shareholders use Financial Statements to assess the risk and return of their investment in the company and take investment decisions based on their analysis.
Prospective Investors	Prospective Investors need Financial Statements to assess the viability of investing in a company. Investors may predict future dividends based on the profits disclosed in the Financial Statements. Furthermore, risks associated with the investment may be gauged from the Financial Statements. For instance, fluctuating profits indicate higher risk. Therefore, Financial Statements provide a basis for the investment decisions of potential investors.
Financial Institutions	Financial Institutions (e.g. banks) use Financial Statements to decide whether to grant a loan or credit to a business. Financial institutions assess the financial health of a business to determine the probability of a bad loan. Any decision to lend must be supported by a sufficient asset base and liquidity.
Suppliers	Suppliers need Financial Statements to assess the credit worthiness of a business and ascertain whether to supply goods on credit. Suppliers need to know if they will be repaid. Terms of credit are set according to the assessment of their customers' financial health.
Customers	Customers use Financial Statements to assess whether a supplier has the resources to ensure the steady supply of goods in the future. This is especially

	vital where a customer is dependent on a supplier for a specialized component.
Employees	Employees use Financial Statements for assessing the company's profitability and its consequence on their future remuneration and job security.
Competitors	Competitors compare their performance with rival companies to learn and develop strategies to improve their competitiveness.
General Public	General Public may be interested in the effects of a company on the economy, environment and the local community.
Governments	Governments require Financial Statements to determine the correctness of tax declared in the tax returns. Government also keeps track of economic progress through analysis of Financial Statements of businesses from different sectors of the economy.

Table 7.1: Users of Financial Reporting

7.2 DESCRIBE THE FORMAT OF FINANCIAL STATEMENTS

NAME OF BUSINESS
STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED ……………..

	RM	RM	RM
Sales		X	
- Sales return / return inwards		(X)	
Net sales			X
__Less : Cost of goods sold__			
Opening inventories / opening stock		X	
Purchases	X		
(-) Purchase return / return outwards	(X)		
Net purchases	X		
Add : Purchase expenses			
Carriage inwards / Freight inwards	X		
Wages on purchases	X		
Import duties / custom duties	X		
Insurance on purchases	X		
Purchases costs		X	
Cost of goods available for sale		X	
(-) Closing inventories / closing stock		(X)	
Cost of sales			(X)
GROSS PROFIT / (GROSS LOSS)			XX
Add : Revenue			
Discount received		X	
Interest received		X	
Rental received		X	
Bad debts recovered		X	
Profit on assets disposal		X	
Decrease in provision for doubtful debts		X	
			X
Less : Expenses			
Stationeries		X	
Carriage outwards / freight outwards		X	
Utilities		X	

General / sundry / miscellaneous expenses		**X**	
Administrative expenses		**X**	
Discount allowed		**X**	
Interest on loan / interest on overdraft		**X**	
Salaries		**X**	
Bad debts		**X**	
Advertising		**X**	
Insurance		**X**	
Commission paid		**X**	
Rental		**X**	
Depreciation		**X**	
Increase in provision for doubtful debts / doubtful debt expenses		**X**	
			(X)
NET PROFIT / (NET LOSS)			**XX**

Figure 7.2: Statement of Comprehensive Income format

NAME OF BUSINESS
STATEMENT OF FINANCIAL POSITION AS AT ……………….

	RM	RM	RM
NON-CURRENT ASSETS			
Land		X	
Building / premises		X	
Motor vehicles	X		
- Provision for depreciation	(X)		
		X	
Plant and machinery	X		
- Provision for depreciation	(X)		
		X	
Investment		X	
Goodwill		X	
			XX
CURRENT ASSETS			
Closing inventories		X	
Debtors / Account receivables	X		
- Bad debts (additional)	(X)		
- Provision for doubtful debt	(X)		

		X	
Prepayment expenses		X	
Accrued revenues		X	
Cash at bank		X	
Cash in hand		X	
			XX
Total Assets			**XX**
Financed by:			
OWNER'S EQUITY			
Opening capital		X	
+ net profit / - net loss		X	
Drawings		(X)	
Closing capital			X
NON CURRENT LIABILITIES			
Long term loan		X	
Mortgage		X	
			X
CURRENT LIABILITIES			
Creditors / Account Payable		X	
Accrued expenses		X	
Advanced revenues		X	
Bank overdraft		X	
			X
			XX

Figure 7.2: Statement of Financial Position format

7.3 PREPARE THE FINANCIAL STATEMENTS WITH ADJUSTMENTS

1. **Preparation of Statement of Comprehensive Income**

   a. Shows the financial performance of the company

   b. The Statement of Comprehensive Income should have a heading which includes 3 pieces of information:
      - The name of business
      - The title of the statement
      - The time period covered by the statement

   c. The body of the Statement of Comprehensive Income consists of two main components:
      - Revenue items
      - Expenses items

2. **Preparation of Statement of Financial Positions**

   a. Shows the assets belonging to the company, its liabilities and equity ad at year end.

   b. The Statement of Financial Position should have a heading which includes 3 pieces of information:
      - The name of business
      - The title of the statement
      - The given date / a point in time covered by the statement

   c. The body of the Statement of Comprehensive Income consists of two main components:
      - Assets – any property of anything value belong to the company.
      - Liabilities – a debt or payable
      - Owner's Equity – the value that remains after having deducted the liabilities from the assets.

3. Link Between Statement of Comprehensive Income and Statement Of Financial Position

a. The Statement of Comprehensive Income is the major link between two statements of financial position

b. The profit is added to the owner's equity for successful operation while losses are deducted from the owner's equity for unsuccessful operations.

Example 7.1

Below is a Trial Balance for Malika Jaya Sdn Bhd as at 31 December 2020 for Malika Jaya Sdn Bhd.

Trial Balance as at 31 December 2020

	RM	RM
Opening stock	820	
Purchases	2,400	
Sales return	120	
Drawing	200	
Equipment	3,000	
Debtors	1,300	
Advertising expenses	140	
Cash	3,000	
Carriage inwards	170	
Carriage outwards	150	
Commission expenses	125	
Utilities	110	
Sales		4,100
Capital		3,745
Purchases return		130
Prov for depreciation for equipment		200
Creditors		800
Rental received		180
Loan		2,000
Interest received		120

Provision for doubtful debts		115
Commission received		145
TOTAL	**11,535**	**11,535**

Additional information:

i. Closing stock on 31 December 2020 was valued RM620 at cost price and RM700 at market price.

ii. Depreciation for equipment is 10% per annum with straight line method.

iii. Provision for doubtful debts adjusted at 5% on the debtor.

iv. Prepaid interest received is RM30.

v. Accrued utilities expenses is RM40.

vi. Prepaid commission received is RM25.

You are required to prepare:

a. Statement of Comprehensive Income for The Year Ended 31 December 2020.

b. Statement of Financial Position as at 31 December 2020.

Solution:

Malika Jaya Sdn Bhd **Statement of Comprehensive Income for the year ended 31 December 2020**			
	RM	RM	RM
Sales			4,100
(-) Return Inwards			(120)
Net Sales			3,980
(-) Cost of goods sold			
Beginning stock		820	
Purchase	2,400		
(-) Returns Outward	(130)		
Net purchases	2,270		

(+)Carriage inwards	170		
Purchase cost		2,440	
Cost of goods available for sale		3,260	
(-) Ending stock/ Closing inventory		(620)	
Cost of sales			2,640
Gross Profit			1,340
<u>(+) Revenues</u>			
Rental received		180	
Interest received		90	
Commission received		120	
Decrease in provision for Doubtful Debt		50	440
<u>(-) Expenses</u>			
Carriage outwards		150	
Advertising expenses		140	
Depreciation-equipment		300	
Utilities		150	
Commission expenses		125	865
Net Profit			**915**

Malika Jaya Sdn Bhd

Statement of Financial Position as at 31 December 2020

	RM	RM
<u>Non-Current Assets</u>		
Equipment	3,000	

(-) Depreciation	(500)	2,500
Current Assets		
Closing inventories	620	
Debtor	1,235	
Cash	3,000	4,855
Total asset		**7,355**
Owner's Equity		
Capital	3,745	
(+) Net Profit	915	
(-) Drawings	(200)	
Closing capital		4,460
Non-Current Liabilities		
Loan	2,000	
Current Liabilities		
Creditor	800	
Prepaid interest received	30	
Accrued utilities	40	
Prepaid commission received	25	2,895
		7,355

REVIEW QUESTIONS

Below is a Trial Balance for **Alhakim Holding Berhad** as at 30 June 2021.

ALHAKIM HOLDING BERHAD

TRIAL BALANCE AS AT 30 JUNE 2021

	DEBIT (RM)	CREDIT (RM)
Duty on purchases	1,460	
Motor vehicle (cost)	19,000	
Bank	24,300	
Rates	985	
Sales and Purchases	56,730	109,375
Provision for doubtful debts		980
Debtors and Creditors	12,800	10,660
Stocks as at 1 July 2021	12,500	
Promotion	780	
General expenses	640	
Returns	345	540
Bad debt recovered		1,080
Office equipment (cost)	2,600	
Insurance	1,200	
Carriage outwards	890	
Salary	16,000	
Accumulated depreciation Motor vehicle		950
Discount	240	
Capital as at 1 July 2021		36,665

Cash	1,140	
Rental	8,450	
Carriage inwards	190	
	160,250	**160,250**

Additional information:

i. Closing inventory was RM13,210 at cost price and RM14,200 at market price.

ii. Depreciation using straight line method is to be charged as follows:

Motor Vehicles 10% per annum

Office Equipment 10% per annum

iii. Carriage inwards included in the carriage outwards amounting RM360.

iv. Provision for doubtful debts is to be adjusted to 5% on debtors.

v. Accrued salaries RM2,600 and prepaid rates RM150.

vi. Rental was paid for 13 months.

You are required to prepare:

a) Statement of Comprehensive Income for the year ended 30 June 2021

b) Statement of Financial Position as at 30 June 2021

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Terbitan

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e ISBN 978-967-25866-2-3

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