Module 3 - Accounting Books and Financial Statements

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3.1 Introduction

In this chapter your will learn the followings:

- Recognise the importance of accounting cycle
- State and apply Accounting Equation
- Explain the purpose of preparing Financial Statement
- Prepare a complete set of Financial Statement

3.2 Accounting Cycle

Accounting cycle is a collective process of identifying, analyzing, and recording the accounting events of a company.

It is a standard 8-step process that begins when a transaction occurs and ends with its inclusion in the financial statements.

3.2.1 Step in Accounting Cycle

The key steps in the eight-step accounting cycle include.

Step 1 Collecting transactions

All business activities must be supported with documents as evidence.

Step 2 Identifying Data

Identified transactions according to nature

Step 3 Recording data

Information for each transaction will be recorded into primary book of entry.

Step 4 Posting Data

All primary entries will be posted into relevant account/ledger according to double entry principle.

Step 5 Adjustment

Additional transaction other than primary book transactions to be adjusted to ensure faithful representation.

Step 6 Generating Ledger

Report recorded all business transactions according to transaction nature.

Step 7 Prepare Trial Balance

Summary of all account/ledger. The purpose of preparing the trial balance is to determine the equality of debits and credits. It is a way to check the mathematical accuracy of the entries in the ledger.

Step 8 Prepare Financial Statements

Formal records of all business activities of a business in one accounting period. This report is to summary the business performance in an accounting period.

The accounting cycle generally comprises a year or other accounting period.

Accounting software today mostly automates the accounting cycle.

3.3 Financial Statements

Financial statements are written records that convey the business activities and the financial performance of a company.

Financial statements of a company (Private or Public) is required to be audited by license auditor to ensure accuracy and for tax, financing, or investing purposes.

Private Exempt Company, Sole proprietor, Partnership and Limited Liability Partnership are exempted to be audited.

Financial statements include:

- Balance sheet
- Income statement
- Cash flow statement
- Note to Accounts

3.3.1 Balance Sheet

Currently known as Statement of Financial Position is prepared to determine financial position of the business at the end of its accounting period.

Financial Position is prepared by a listing showing the net total amount of money / asset that the company have after minus off total amount that the company owing to third party. Third Party including amount invested by member and accumulated profit earn from day one.

It is showing how much your company worth when everything realized.

The balance figure in this report is carry forward forever until the company being wound up.

A balance sheet is a financial statement that reports a company's assets, liabilities and shareholders' equity.

The balance sheet is one of the three (income statement and statement of cash flows being the other two) core financial statements used to evaluate a business.

The balance sheet is a snapshot, representing the state of a company's finances (what it owns and owes) as of the date of publication.
Summary balances for all real and personal account.

Balance sheet always represent by Accounting Equation.

3.3.1.1 Balance Sheet Items

Accounting terminologies refer to special language that always used in accounting.

It is important to know the accounting terminology before delving into the subject.

Terminologies according to following equation.

3.3.1.2 Asset

all resources owned by company to help generate income.

3.3.1.2.1. Non-Current Assets

Assets obtained from a business to be used for several periods of time. They are expected to last for at least one year or more. Use in business to help generate income for the company and not bought specifically for resale.

Example: Motor Vehicles, furniture Fitting, Land Building

Normal term used was Property Plant and Equipment (PPE), also known as Fixed Assets

3.3.1.2.2. Current Assets

Assets that will be used in one period of time. They have short period of life span usually less than one year. The value change frequently and are readily to convert into cash.

Example: Inventory, Receivables, Cash and Bank Balances Receivable represents customers owing to the company. It can be either Trade Receivables or Non-Trade Receivables

3.3.1.3 Liabilities

all resources borrowed by company to ensure company sufficient fund to run the business.

3.3.1.3.1. Non-Current Liabilities

Money owed by the company to someone. The repayment is more than one year.

Example: Term Loan, Debenture

3.3.1.3.2. Current Liabilities

Money owed by the company which repayable within 1 year
Example: Bank Overdraft, Payables

Payables represents amount owing by company to others. It can be either Trade Payables or Non-Trade Payables.

3.3.1.4 Shareholders' Equities

fund or capital injected by owner to start the business. It is also including profit that the company generated.

3.3.1.4.1. Share Capital

A company's share capital is the money invested from shareholders in return with a share certificate.

A company may raise funds from investor by increase share capital on its balance sheet.

3.3.1.4.2. Retained Earnings

Retained earnings (RE) is the amount of net profit left over for the business after it has paid out dividends to its shareholders.

The decision to retain the earnings or to distribute it among the shareholders is usually left to the company management.

Retained earnings = Retained earning b/f + **Current Year Net Profit**

3.3.1.5 Format Of Balance Sheet

STATEMENT OF FINANCIAL POSITION
AS AT 31ST DECEMBER 2019

	Note	2019 RM	2018 RM
ASSETS			
NON-CURRENT ASSET			
Property, plant and equipment	4	382,422	515,418
CURRENT ASSETS			
Inventories	5	182,379	183,628
Other receivables, deposits and prepayments	6	19,194	94,064
Tax recoverable		1,132	4,000
Cash and bank balances		15,155	28,201
		217,860	309,893
TOTAL ASSETS		600,282	825,311
EQUITY AND LIABILITIES			
CAPITAL AND RESERVES			
Share capital	7	400,000	400,000
Accumulated losses		(1,046,440)	(712,619)
CAPITAL DEFICIENCY		(646,440)	(312,619)
CURRENT LIABILITIES			
Trade payables	8	33,986	30,231
Other payables, deposits received and accruals	9	1,212,736	24,124
Amount due to directors	10	-	1,083,575
		1,246,722	1,137,930
TOTAL LIABILITIES		1,246,722	1,137,930
TOTAL EQUITY AND LIABILITIES		600,282	825,311

STATEMENT OF CHANGES IN EQUITY
FOR THE FINANCIAL YEAR ENDED 31ST DECEMBER 2019

	Share capital RM	Accumulated losses RM	Total RM
As at 1st January 2018	400,000	(479,026)	(79,026)
Total comprehensive loss for the financial year	-	(233,593)	(233,593)
As at 31st December 2018	400,000	(712,619)	(312,619)
Total comprehensive loss for the financial year	-	(333,821)	(333,821)
As at 31st December 2019	400,000	(1,046,440)	(646,440)

3.3.2 Income Statement

Currently known as Statement of Comprehensive income

It is prepared for calculating the company profit. After Sales minus off cost and expenses.

This report is only for current year and the total profit earn will be closed and transferred to balance sheet for shareholders distribution in term of dividend.

3.3.2.1. Items Included in a Statement of Comprehensive Income

Accounts	Details
Sales / Income / Revenue	Sales of Goods or Services to customer by cash term or credit term
Sales Return / Return Inward	Goods being return by customers
Discount Allowed / Discount Given	Discount given to customers
Net Sales	Sales – Sales Return – Sales Discount
Purchases	Purchases of goods for resale. Either by Cash Term or Credit Term
Purchase Return / Return Outwards	Goods being return to supplier / Trade Creditors
Discount Received	Discount received from supplier / Trade Creditors
Other Purchases Expenses	Expenses added to the purchase of goods for resales
Freight / Carriage Inwards / Transportation Purchase Tax / Import Duty	The cost of transportation in order to carry goods purchased into business premises Tax charged on imported goods
Insurance on purchase	Insurance expenses paid on goods carried on the way to the business premises.
Packaging	Repackaging expenses for goods purchased to be sold.
Net Purchase	Purchases – Purchase Return – Discount Received + Other Purchase Cost
Opening Stock / Inventory	Goods from previous year or month remain unsold and still store at warehouse

Accounts	Details
Closing Stock / Inventory	Goods for this year or this month remain unsold and keep at warehouse
Cost Of Goods Sold	Opening Stock + Net Purchase – Closing Stock
Gross Profit	Net Sales – Cost of Goods Sold
Other Income / Revenue	Income received not directly related to the business. For example Interest Income, Rental Income
Expenses / Expenditure	Other operating expenses use to run business. For example rental , salary & Wages
Net Profit	Gross Profit + Other Income - Expenses
Taxation	Income Tax if it is a Sdn Bhd / Bhd / LLP
Net Profit After Tax	Net Profit - Taxation

3.3.2.2. Format of Income Statement

STATEMENT OF COMPREHENSIVE INCOME
FOR THE FINANCIAL YEAR ENDED 31ST DECEMBER 2019

	Note	2019 RM	2018 RM
Revenue	12	685,528	1,215,864
Cost of sales		(472,337)	(732,457)
Gross profit		213,191	483,407
Administration expenses		(340,559)	(381,874)
Staff costs	13	(206,453)	(335,126)
Loss before tax	14	(333,821)	(233,593)
Income tax expense	15	-	-
Loss after tax for the financial year		(333,821)	(233,593)
Other comprehensive income, net of tax		-	-
Total comprehensive loss for the financial year		(333,821)	(233,593)

DETAILED INCOME STATEMENT
FOR THE FINANCIAK YEAR ENDED 31ST DECEMBER 2019

	2019 RM	2018 RM
REVENUE	685,528	1,215,864
LESS: COST OF SALES		
Opening inventories	183,628	252,047
Purchases	267,387	488,424
Freight, duty and port charges	203,701	175,614
	654,716	916,085
Less: Closing inventories	(182,379)	(183,628)
	472,337	732,457
GROSS PROFIT	213,191	483,407
LESS: OPERATING EXPENSES	(547,012)	(717,000)
LOSS BEFORE TAX	(333,821)	(233,593)

OPERATING EXPENSES
FOR THE FINANCIAL YEAR ENDED 31ST DECEMBER 2019

	2019 RM	2018 RM
ADMINISTRATION EXPENSES		
Advertisement expenses	-	4,684
Ang pow	2,000	200
Auditors' remuneration	3,000	3,000
Bank charges	912	140
Bad debts written off	123	-
Consultancy charges	1,400	-
Courier charges	21	-
Credit card charges	4,981	5,885
Depreciation of property, plant and equipment	129,286	136,457
Electricity and water charges	63,179	84,485
Filing fee	350	200
GST expenses	-	2,384
Insurance and road tax	2,209	2,487
License fee	5,780	5,135
Loss on disposal of property, plant and equipment	3,210	-
Medical charges	-	60
Penalty	468	1,409
Petrol, toll and parking	1,399	1,317
Printing and stationery	1,562	3,106
Professional fees	11,700	10,644
Quit rent and asssessment	-	617
Rental of premises	35,600	38,400
Rental of storeroom	6,000	7,000
Repair and maintenance	-	42,448
Secretarial fee	960	979
Service tax	367	-
Staff welfare	1,102	1,404
Stamp duty	210	10
Subscription fees	1,037	4,467
Telephone charges	4,970	4,306
Training expenses	200	880
Travelling, transportation and accommodation	218	277
Upkeep of computers	4,200	3,250
Upkeep of office equipment	-	992
Upkeep of shop	45,736	2,910
Work permit and levy charges	8,378	12,341
	340,559	381,874

3.3.3 Cash Flow Statements

A cash flow statement is a financial statement that summarizes the amount of cash and cash equivalents entering and leaving a company.

The cash flow statement measures how well a company manages its cash position, meaning how well the company generates cash to pay its debt obligations and fund its operating expenses.

It is a reconciliation between Income Statement and Balance Sheet after adjusting non-cash item.

3.3.4 Note to Account

Supporting information that is usually provided along with a company's final accounts or financial statements. Many such notes are required to be provided by law.

Notes to accounts help users of accounting information to understand the current financial position of a company and act as a support for its estimated future performance.

The information supplied depends on the accounting standards used.

3.4 Accounting Equation

<u>Assets = Liabilities + Owner’s Equity</u>

The accounting equation is the foundation of the double-entry accounting system.

The accounting equation shows on a company's balance that a company's total assets are equal to the sum of the company's liabilities and shareholders' equity.

Assets represent the valuable resources controlled by the company. The liabilities represent their obligations.

Both liabilities and shareholders' equity represent how the assets of a company are financed.

Financing through debt shows as a liability, while financing through issuing equity shares appears in shareholders' equity.

For example, loan RM100,000 from bank to start business. Bank A bank in the loan to company bank account and the company owing to the Bank A.

Asset (Bank)	**+100,000**
Liabilities (Bank Loan)	**-100,000**

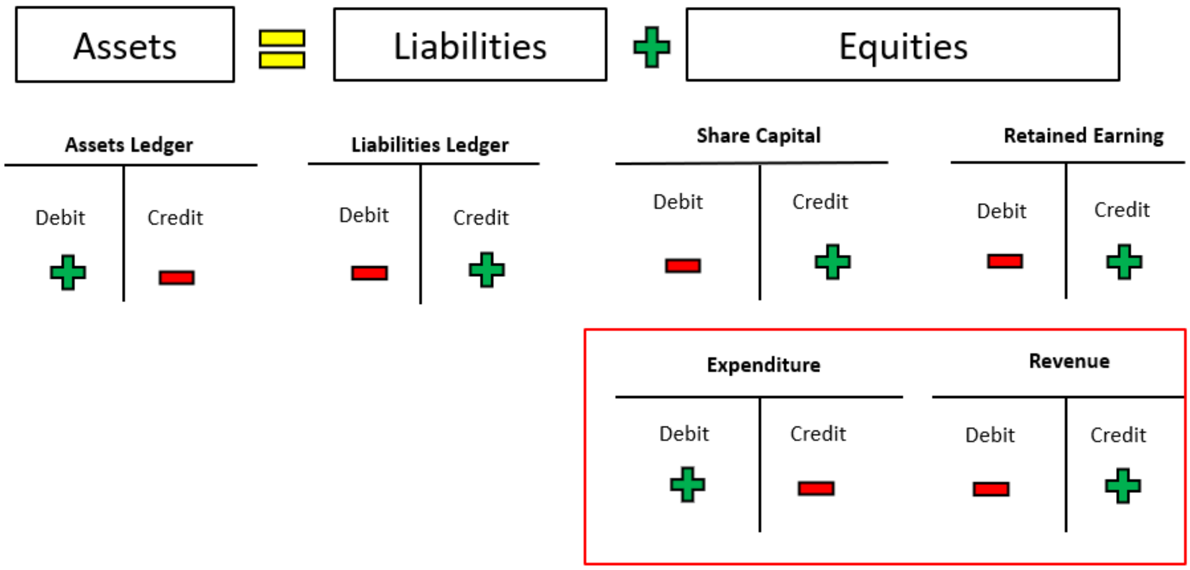
Assets = Liabilities + Shareholders’ Equities

3.5 Double Entry System

- Double-entry refers to an accounting concept whereby assets = liabilities + owners' equity.

- In the double-entry system, transactions are recorded in terms of **debits and credits**.

3.5.1. Debit & Credit Effects



3.6 Trial Balance

A trial balance is a worksheet with two columns, one for debits and one for credits, that ensures a company's bookkeeping is mathematically correct.

The debits and credits include all business transactions for a company over a certain period, including the sum of such accounts as assets, expenses, liabilities, and revenues.

Debits and credits of a trial balance being equal ensure there are no mathematical errors, but there could still be mistakes or errors in the accounting systems.

Companies initially record their business transactions in bookkeeping accounts within the general ledger.

The ending balance of each ledger account as shown in the trial balance worksheet is the sum of all debits and credits that have been entered to that account based on all related business transactions.

3.7 General Ledger

In accounting, a General Ledger (GL) is a record of all past transactions of a company, organized by accounts.

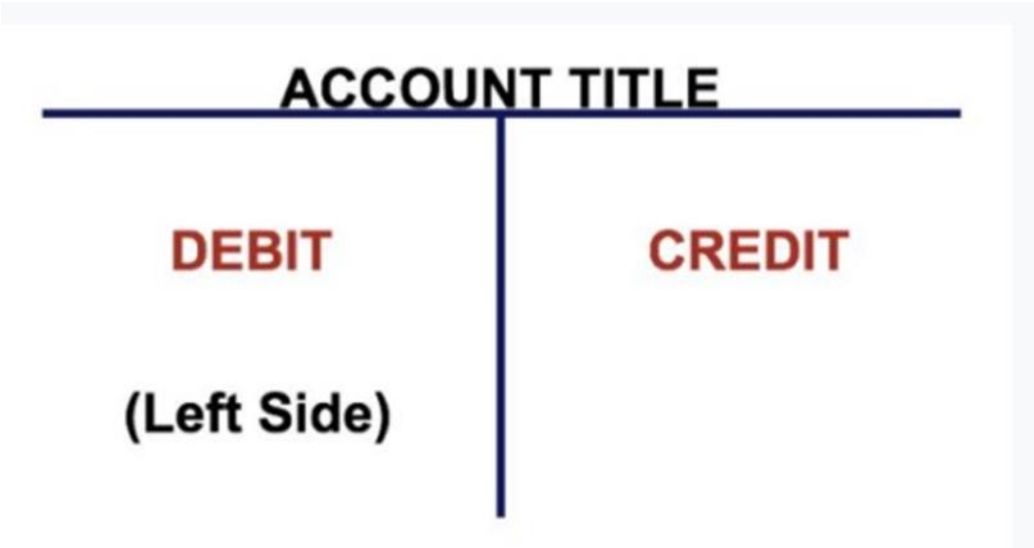
General Ledger (GL) accounts contain all debit and credit transactions affecting them.

In addition, they include detailed information about each transaction, such as the date, description, amount, and may also include some descriptive information on what the transaction was.

3.7.1. T Ledger

T Accounts may be your new best friend. The T Account is a visual representation of individual accounts in the form of a "T," making it so that all additions and subtractions (debits and credits) to the account can be easily tracked and represented visually.

Each account will have its own individual T Account, which looks like the following:



3.7.2. Statement Form Ledger

Account Code: 901-0000		ADVERTISEMENT				
Date	Journal	REF. 1/ REF. 2	Description	Debit	Credit	Balance
		BALANCE B/F				0.00
20/01/2021	PURCHASE	PI 20-000017 SKW9DX2DA2	FACEBOOK AD JAN INTAKE 18/12/20 - 19/12/20	109.34		109.34
21/02/2021	PURCHASE	PI 21-000001 7138721	FACEBOOK AD APR INTAKE 20/02/21 - 20/02/21	0.06		109.40
21/02/2021	PURCHASE	PI 21-000001 7138721	FACEBOOK AD CREDIT CARD EXTRA	0.75		110.15
21/02/2021	PURCHASE	PI 21-000018 7138720	FACEBOOK AD APR INTAKE 20/02/21 - 20/02/21	0.28		110.43
20/03/2021	PURCHASE	PI 21-000019 7288540	FACEBOOK AD APR INTAKE 20/02/21 - 15/03/21	266.27		376.70
20/03/2021	PURCHASE	PI 21-000019 7288540	FACEBOOK AD CREDIT CARD EXTRA	2.66		379.36
20/04/2021	PURCHASE	PI 21-000020 7462778	FACEBOOK AD APR INTAKE 27/03/21 - 18/04/21	169.45		548.81
20/04/2021	PURCHASE	PI 21-000020 7462778	FACEBOOK AD CREDIT CARD EXTRA CHARGES ON FA AD	3.40		552.21
20/04/2021	PURCHASE	PI 21-000020 7462778	FACEBOOK AD JUNE INTAKE 27/03/21 - 18/04/21	170.70		722.91
				722.91	0.00	722.91

3.8 Type of Account and Double Entry

3 Different types of accounts in accounting are:

3.8.1. Real Account

A real account in a business is a record of the amount of asset, liability, or owners' equity at a precise moment in time.

Double Entry Rules:

- Debit what comes into the business.
- Credit what goes out of business.

3.8.2. Personal Account

Second among three types of accounts are personal accounts which are related to individuals, firms, companies, etc.

Few examples are debtors and creditors.

Double Entry Rules:

- Debit the receiver
- Credit the giver

3.8.3. Nominal Account

The nominal account is an income statement account (expenses, income, loss, profit). It is also known as a temporary account, unlike the balance sheet account (Asset, Liability, owner's equity), which are permanent accounts. So nominal accounting starts with a zero balance at the start of every accounting year.

Double Entry Rules:

- Debit the expenses and losses
- Credit the Income and profits

3.9 Close General Ledger to Trial Balance

At the end of an accounting period to transfer balances from a temporary account to a permanent account.

Companies use closing entries to reset the balances of temporary accounts − accounts that show balances over a single accounting period − to zero.

By doing so, the company moves these balances into permanent accounts on the balance sheet. These permanent accounts show a company's long-standing financials.

3.10 Control Accounts

A control account is a summary-level account in the general ledger.

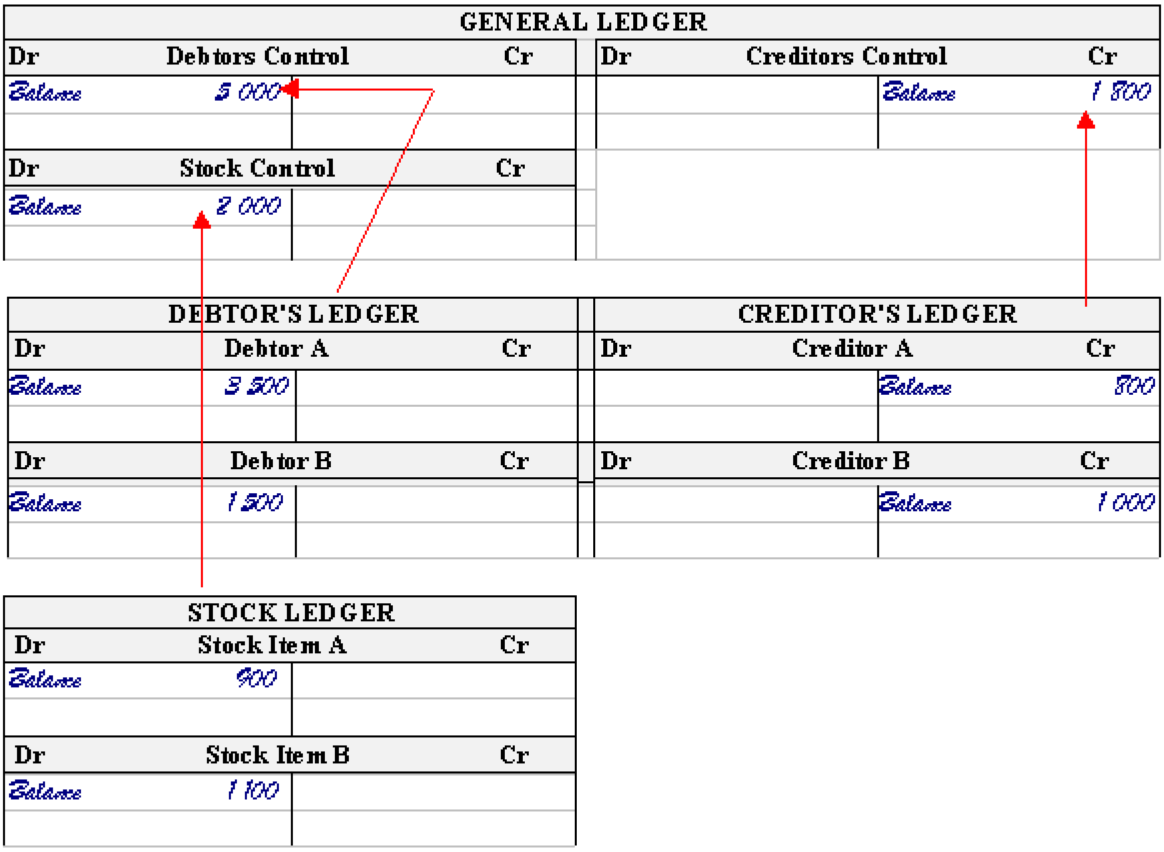
This account contains aggregated totals for transactions that are individually stored in subsidiary-level ledger accounts.

Control accounts are mostly used to summarize accounts receivable and accounts payable, since these areas contain a large volume of transactions, and so need to be separated into subsidiary ledgers, rather than cluttering up the general ledger with too much detailed information.

The ending balance in a control account should match the ending total for the related subsidiary ledger.

If the balance does not match, it is possible that a journal entry was made to the control account that was not also made in the subsidiary ledger.

If anyone wants to see detailed transactional information for accounts payable or accounts receivable, they can review the detail located in the subsidiary ledger, since it is not located in the general ledger.



3.11 Chart of Accounts

The chart of accounts is a tool that lists all the financial accounts included in the financial statements of a company. It provides a way to categorize all the financial transactions that a company conducted during a specific accounting period.

It is used to organize finances and give interested parties, such as investors and shareholders, a clearer insight into a company's financial health.

The chart of accounts provides the name of each account listed, a brief description, and identification codes that are specific to each account.

The balance sheet accounts are listed first, followed by the accounts in the income statement.

Should opened in according to the accounting equation sequential.

The balance sheet accounts comprise assets, liabilities, and shareholders equity, and the accounts are broken down further into various subcategories.

The accounts in the income statement comprise revenues and expenses, and these accounts are also broken down further into sub-categories.

3.11.1. Setting of Chart of Account

When setting up a chart of accounts, typically, the accounts that are listed will depend on the nature of the business.

For example, the taxi business will include a fuel expense account that is not common to all businesses, but it will leave out an inventory account since the taxi business is a service business that does not hold stock.

Typically, when listing accounts in the chart of accounts, you should use a numbering system for easy identification. Numbering also makes it easy to record a transaction. Small businesses commonly use three-digit numbers, while large businesses use four-digit numbers to allow room for additional numbers as the business grows.

Groups of numbers are assigned to each of the five main categories, while blank numbers are left at the end to allow for additional accounts to be added in the future. Also, the numbering should be consistent to make it easier for management to roll up information of the company from one period to the next.

Example: A large business numbering system

- Assets: 1000-1999
- Liabilities: 2000-2999
- Shareholder's equity: 3000-3999
- Revenue: 4000-4999
- Cost : 5000-5999
- Other Income : 6000-6999
- Expenses: 7000-7999
- Taxes : 8000-8999

263000	**LEASE LIABILITIES OFFICE**
263001	Lease Liabilties Office
263002	Provision For Restoration Costs
263009	**TOTAL LEASE LIABILTIES OFFICE**
299995	**DEFERRED TAX**
299996	Deferred Tax Liabilities
299997	**TOTAL DEFERRED TAX**
299998	**TOTAL NON CURRENT LIABILITIES**
299999	**TOTAL LIABILITIES**
299999.1	**NET ASSETS**
300000	**SHAREHOLDER FUND**