

Module 3 - Accounting Books and Financial Statements

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3.1 Introduction

In this chapter you will learn the followings:

- Recognize 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	<u>382,422</u>	<u>515,418</u>
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		<u>15,155</u>	<u>28,201</u>
		<u>217,860</u>	<u>309,893</u>
TOTAL ASSETS		<u><u>600,282</u></u>	<u><u>825,311</u></u>
EQUITY AND LIABILITIES			
CAPITAL AND RESERVES			
Share capital	7	400,000	400,000
Accumulated losses		<u>(1,046,440)</u>	<u>(712,619)</u>
CAPITAL DEFICIENCY		<u>(646,440)</u>	<u>(312,619)</u>
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	-	<u>1,083,575</u>
		<u>1,246,722</u>	<u>1,137,930</u>
TOTAL LIABILITIES		<u>1,246,722</u>	<u>1,137,930</u>
TOTAL EQUITY AND LIABILITIES		<u><u>600,282</u></u>	<u><u>825,311</u></u>

**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	<u>-</u>	<u>(233,593)</u>	<u>(233,593)</u>
As at 31st December 2018	400,000	(712,619)	(312,619)
Total comprehensive loss for the financial year	<u>-</u>	<u>(333,821)</u>	<u>(333,821)</u>
As at 31st December 2019	<u>400,000</u>	<u>(1,046,440)</u>	<u>(646,440)</u>

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	The cost of transportation in order to carry goods purchased into business premises
Purchase Tax / Import Duty	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		<u>(472,337)</u>	<u>(732,457)</u>
Gross profit		213,191	483,407
Administration expenses		(340,559)	(381,874)
Staff costs	13	<u>(206,453)</u>	<u>(335,126)</u>
Loss before tax	14	(333,821)	(233,593)
Income tax expense	15	<u>-</u>	<u>-</u>
Loss after tax for the financial year		(333,821)	(233,593)
Other comprehensive income, net of tax		<u>-</u>	<u>-</u>
Total comprehensive loss for the financial year		<u><u>(333,821)</u></u>	<u><u>(233,593)</u></u>

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

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

**OPERATING EXPENSES
FOR THE FINANCIAL YEAR ENDED 31ST DECEMBER 2019**

	2019	2018
	RM	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 assessment	-	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
	<u>340,559</u>	<u>381,874</u>

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

Assets = Liabilities + Owner's Equity

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.

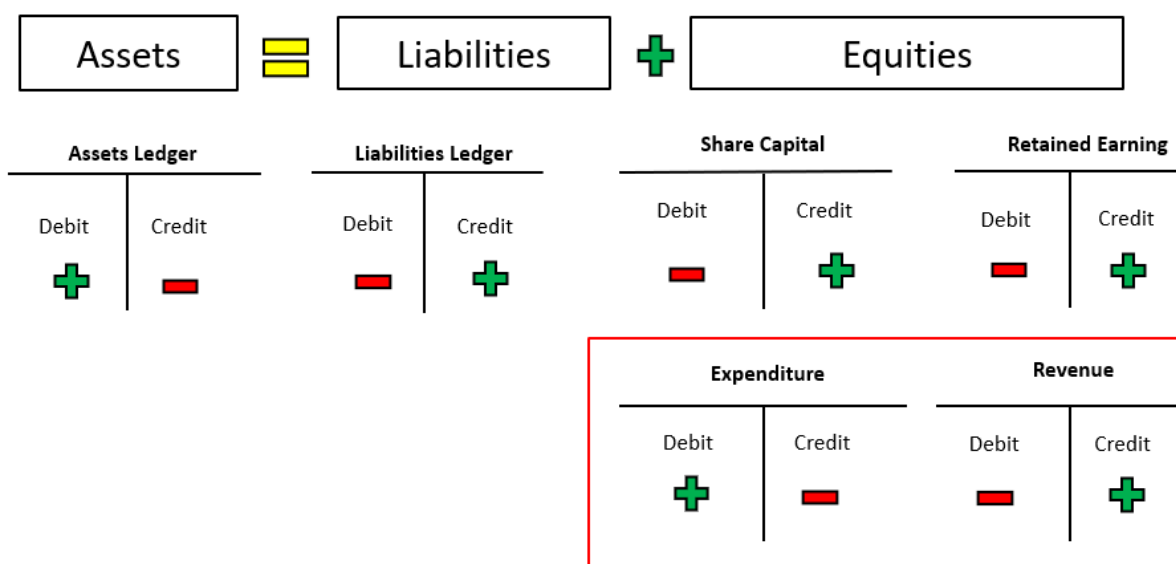
Asset	(Bank)	+100,000
Liabilities	(Bank Loan)	-100,000

Assets = Liabilities + Shareholders' Equities

3.5 Double Entry System

- Double-entry refers to an accounting concept whereby $\text{assets} = \text{liabilities} + \text{owners' equity}$.
- 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.