It is important to diferentiate between capital expenditure and revenue expenditu...

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Fixed Asset is last longer and not for resale. For example is premises, motor vehicles, machinery, and fixtures and fittings. Current Asset is liquid and bought for resale. For example is cash in hand, cash at bank, stock and debtor.

i) Business entity concept is the affairs of a business are to be treated as

being quite separate from the non-business activities of its owners.

Example is “ the figure for fixed assets includes a camera that the

owner of the business has bought for his own use”.

Accrual concept is concerned with the different between cash receipts and cash expenditure (actual payments and receipts of money for items) and revenue and expenditure. It states that items should be recorded when used and not when paid for.

Example is “ a bill for electricity was received in the lost financial year but has been recorded in the current year as payment was only made recently”.

Going Concern Concept is it implies that the business will continue to operate for the foreseeable future.

Example: the assumption should not be made are:

If the business is going to close down in the near future

Where shortage of cash makes it almost certain that the business will have to cease trading

Business have to close down because of shortage of cash

The term is about to close down as the owner is retiring the accounts

have not been altered.

Consistency concept is each firm should try to choose the methods which give the most reliable picture of the business.

Example is the method used for calculating stock has been changed from LIFO to FIFO to overage cost.

i) Capital expenditure is made when a firm spends money either to:

Buy fixed assets, or

Add to the value of an existing fixed asset.

Included in such amounts should be those spent on:

Acquiring fixed assets.

Bringing them into the firm.

Legal costs of buying buildings.

Carriage inwards on machinery bought.

Any other cost needed to get the fixed asset ready for use.

Revenue expenditure is expenditure which is not for increasing the value

fixed assets, but for running the business on a day-to-day basis, is known as revenue expenditure.

The difference between revenue and capital expenditure can be seen clearly with the total cost of using a motor van for a firm. To buy a motor van is capital expenditure. The motor van will be in use for several years and is, therefore, a fixed asset.

To pay for petrol to use in the motor van for the next few days is revenue expenditure. This is because the expenditure is used up in a few days and does not add to the value of fixed assets.

Revenue expenditure is treated to expenses and they will posted to Income statement.

Capital expenditure is treated to fixed assets and transact to Balance sheet.

Difference between capital and revenue expenditure

Expenditure

Type of Expenditure

1. Buying motor van

Capital

2. Petrol costs for motor van

Revenue

3. Repairs to motor van

Revenue

4. Putting extra headlights on motor van

Capital

5. Buying machinery

Capital

6. Electricity cost of using machinery

Revenue

7. We spent RM 1, 500 on machinery. RM 1, 000 was for an item added to the machine: RM500 for repairs

Capital RM1, 000

Revenue RM 500

8. Painting outside of new building

Capital

9. Three years later- repainting outside of building in (8)

Revenue

d) Reducing balance method

Cost price 1 year

Cost = RM 100, 000

% = 10%

2005 Cost = 100, 000 X 10% = 10000 X 7/12= 5833 100, 000 – 5833 = 94167

2006 Cost = 94167 X 10% = 94167 X 7/12 = 5493 94167 – 5493 = 88674

e) i) Relevance is one more factors that must be present in the information for it to be

useful. Information that is not relevant is considered as a waste of valuable time in

decision making.

ii) Reliability is the right decision based on a set of financial information would also

depend on the reliability of the information. In the context, self generated

information is considered to be the most reliable as compared to information gather

by third parties. The user must be able to depend on the truthfulness of the

information.

iii) Comparability is procedures and practices should remain the same across time and

reports, if difference is occurs they should be due to substantive differences in the

events and conditions reported rather than arbitrarily implemented practices or

procedures for data collection.

iv) Understandability is information should be simple but not over simplified.

Explanations and interpretations should be included where necessary.

Understandability of information is governed by user characteristics and

characteristics of information provided. Understandability may be relating to

a particular decision makes.

i) Share holder

ii) Manager

iii) Bank

iv) Government

v) Creditor

QUESTION 2

You have been supplied with the following balances for Betsy Li, a sole trader, for the year ended 31 December 2009:

RM

Property at cost 140, 000

Equipment at cost 70, 000

Provision for depreciation at 01/01/09:

– Property 4, 200

– Equipment 17, 500

Purchases 385, 000

Sales 592, 000

Stock at 01/01/09 17, 400

Discount allowed 14, 000

Discount received 1, 900

Returns outward 17, 600

Wages and salaries 43, 400

Creditors 28, 500

Debtors 15, 800

Bank overdraft 2, 900

Cash in hand 520

Drawings 17, 950

Provision for bad debts at 01/01/09 200

General expenses 11, 400

Long term loan 20, 000

Capital at 01/01/09 30, 670

The following adjustments need to be taken into account:

Stock at 31/12/09 is $21, 600

Wages and salaries outstanding at 31/12/09 are $4,, 100

General expenses includes a prepayment for rates of $1, 000

The provision for bad debts needs increasing to $280

Depreciation for the year has still to be provided as follow:

Property 1. 5% per year using the straight line method

Equipment 25% per year using the reducing balance method

Loan interest of $2, 000 is outstanding

Required:

a) Prepare a trial balance for Betsy Li as at 31 December 2009. (10 marks)

b) Prepare the Income Statement and Balance Sheet for Betsy Li for the period ending 31

December 2009. (15 marks)

ANSWER QUESTION 2

Trial Balance at 31 December 2009

Property

140, 000

Equipment at cost

70, 000

Property

4, 200

Equipment

17, 500

Purchases

385, 000

Sales

592, 000

Stock

174, 00

Discount allowed

14, 000

Discount received

1, 900

Return outward

17, 600

Wages and salaries

43, 400

Creditors

28, 500

Debtors

15, 800

Bank overdraft

2, 900

Cash in hand

520

Drawings

17, 950

Provision for bad debts

200

General expenses

11, 400

Long term loan

20, 000

Capital

30, 670

715470

715470

Income statement for Betsy Li for the year ending 31 December 2009

Sales

592, 000

592, 000

less) Cost of good sales

Opening stock

17, 400

Purchase

385, 000

less) Return outwards

(17, 600)

367, 400

Net purchase

384, 800

less) Closing stock

(21, 600)

(363, 200)

Gross profit

228, 800

add) Revenue

Discount received

1, 900

230, 700

less) Expenses

Discount allowed

14, 000

Wages and salaries (43, 400+4, 100)

47, 500

General expenses (11, 400-1000)

10400

i) Provision for depreciation = Property at cost

2, 100

ii) = Equipment at cost

13, 125

iii) Provision for doubtful dept

80

Loan interest

2, 000

(89205)

Net profit

141, 495

140, 000 X 1. 5% = 2100

70, 000 – 17, 500 = 52, 500 X 25% = 13, 125

iii) Provision for bad debts

Balance b/d 280 Balance b/d 280

Income statement 80

280 280

Cost

Accumulated

Depreciation

Fixed assets

Property

140, 000

6, 300

133, 700

Equipment

70, 000

30, 625

39, 375

173075

Current assets

Stock

21, 600

Debtor

15, 800

Provision for bad debt

(280)

15, 520

General expenses prepayment

1000

38, 640

Current liability

Creditor

28, 500

Bank overdraft

2900

Wages and salaries outstanding

4, 100

Loan interest outstanding

2000

(37, 500)

1, 140

174, 215

Financed by

Capital

30, 670

add) Net Profit

141, 495

172, 165

less) Drawing

(17, 950)

154, 215

Non-current liabilities

Long term loan

20, 000

174, 215