INTRODUCTION TO APPLIED ACCOUNTING SKILLS – IAAS 101



1. Foundations of Accounting are the basic principles, concepts, and rules used to record, classify, summarize, and report financial transactions. They provide the framework for preparing accurate financial statements.

Importance of Accounting

- Helps in decision-making.
- Tracks business performance.
- Ensures legal and tax compliance.
- Assists in budgeting and planning.
- Provides information to investors, creditors, and management.

Purpose of Accounting

The main purpose of accounting is to provide accurate and reliable financial information to people who need it for decision-making.

1. Records Financial Transactions

- Keeps a complete and accurate record of all business transactions.
- Ensures financial information is organized and available when needed.

2. Measures Business Performance

- Determines whether a business has made a **profit or loss** during a specific period.
- Helps evaluate the success of the business.

3. Shows Financial Position

- Provides information about what the business owns (**assets**) and owes (**liabilities**).
- Indicates the owner's investment (**equity**).

4. Supports Decision-Making

- Helps managers make informed decisions about budgeting, investing, pricing, and expansion.
- Assists owners in planning future business activities.

5. Facilitates Planning and Budgeting

- Provides historical financial information for forecasting future income and expenses.
- Helps prepare budgets and financial plans.

6. Ensures Legal Compliance

- Assists businesses in complying with tax laws and government regulations.

- Provides evidence during audits.

7. Promotes Accountability

- Ensures that managers are responsible for how they use business resources.
- Reduces the risk of fraud and financial mismanagement.

8. Provides Information to Stakeholders

Accounting information is useful to:

- Owners
- Managers
- Investors
- Creditors and lenders
- Government agencies
- Employees
- Customers and suppliers

Objectives of Accounting

The objectives of accounting are to:

- Maintain accurate financial records.
- Determine profit or loss.
- Determine the financial position of the business.
- Provide useful information for decision-making.
- Protect business assets.
- Ensure compliance with laws and regulations.
- Assist in planning and controlling business activities.

Example: A grocery store records all sales and expenses for the month.

- Total Sales: **P120,000**
- Total Expenses: **P85,000**

Profit = Sales − Expenses

Profit = P120,000 − P85,000 = P35,000

This accounting information helps the owner determine whether the business is profitable and make decisions about future operations.

Users of Accounting Information

Users of accounting information are individuals or organizations that use financial information produced by accounting systems to make economic and business decisions. These users rely on financial statements such as the income statement, statement of financial position (balance sheet), and cash flow statement to assess the financial performance and position of a business.

Types of Users of Accounting Information

Users are divided into **internal users** and **external users**.

A. Internal Users

Internal users are people within the organization who use accounting information for planning, controlling, and decision-making.

1. Owners

- Determine whether the business is making a profit.
- Assess the value of their investment.
- Decide whether to expand, continue, or sell the business.

2. Managers

- Plan and control business operations.
- Prepare budgets and forecasts.
- Make decisions on pricing, production, and staffing.
- Monitor business performance.

3. Employees

- Assess the financial stability of the business.
- Determine job security.
- Negotiate salaries, wages, and other benefits.

B. External Users

External users are individuals or organizations outside the business who use accounting information for various purposes.

1. Investors

- Evaluate the profitability and financial health of the business.
- Decide whether to invest, hold, or sell shares.

2. Creditors and Lenders

- Assess the business's ability to repay loans.
- Decide whether to grant credit or loans.

3. Suppliers

- Determine whether the business can pay for goods and services on time.
- Decide whether to offer goods on credit.

4. Customers

- Assess whether the business is financially stable and likely to continue operating.
- Particularly important when they depend on long-term supply agreements.

5. Government and Tax Authorities

- Calculate taxes owed by the business.
- Ensure compliance with tax laws and financial regulations.
- Collect statistical information for economic planning.

6. Regulatory Authorities

- Ensure businesses comply with accounting standards and legal requirements.
- Monitor corporate governance and financial reporting.

7. The General Public

- Assess the company's contribution to the economy.
- Evaluate employment opportunities and environmental or social responsibility.

Types of Businesses

A **business** is an organization that produces or sells goods and services to earn a profit. The most common forms of business ownership are **sole trader, partnership, and company**.

1. Sole Trader - A **sole trader** (also called a sole proprietorship) is a business that is **owned and operated by one person**. The owner is responsible for all business decisions, profits, and losses.

Characteristics

- Owned by one person.
- Easy and inexpensive to start.
- The owner has full control of the business.
- The owner receives all profits.
- The owner has **unlimited liability**, meaning personal assets can be used to pay business debts.

Advantages

- Easy to establish and operate.
- Full control over decision-making.
- Keeps all the profits.
- Simple record-keeping.
- Business can be kept confidential.

Disadvantages

- Unlimited liability.
- Limited capital.
- Business depends on one person.
- Limited skills and expertise.
- Difficult to expand.

Examples

- Small grocery shop
- Hair salon
- Tailoring business
- Local bakery

2. Partnership - A **partnership** is a business owned and managed by **two or more people** who agree to share profits, losses, and responsibilities.

Characteristics

- Owned by two or more partners.
- Formed through a partnership agreement.
- Partners contribute capital and skills.
- Profits and losses are shared according to the agreement.
- Most partnerships have **unlimited liability**, unless they are limited liability partnerships.

Advantages

- More capital than a sole trader.
- Shared responsibilities.
- Greater range of skills and experience.
- Easier decision-making through teamwork.
- Business risks are shared.

Disadvantages

- Unlimited liability (in general partnerships).
- Profits must be shared.

- Disagreements may occur.
- Decisions may take longer.
- One partner's actions may legally bind the others.

Examples

- Law firms
- Medical practices
- Accounting firms
- Consulting businesses

3. Company - A **company** is a **separate legal entity** owned by shareholders and managed by directors. It is formed by registering under company law.

Characteristics

- Owned by shareholders.
- Managed by directors.
- Has a separate legal identity from its owners.
- Can own property and enter contracts.
- Shareholders have **limited liability**.
- Can continue to exist even if owners change (perpetual succession).

Advantages

- Limited liability protects shareholders' personal assets.
- Easier to raise large amounts of capital.
- Continuous existence.
- Greater credibility with banks and customers.
- Easier to expand.

Disadvantages

- Expensive and complex to establish.
- Subject to government regulations.
- Financial information may need to be publicly disclosed.
- Decision-making can be slower.
- Higher administrative costs.

Examples

- Manufacturing companies
- Banks
- Supermarket chains
- Telecommunications companies

Comparison of Business Types

Feature	Sole Trader	Partnership	Company
Owners	One person	Two or more people	Shareholders
Legal Status	Not separate from owner	Not separate (general partnership)	Separate legal entity
Liability	Unlimited	Usually unlimited	Limited
Capital	Limited	More than sole trader	Large
Decision-Making	Owner alone	Shared by partners	Directors and management
Profit Sharing	Owner keeps all profits	Shared among partners	Distributed as dividends or retained
Continuity	Ends if owner leaves or dies	May end if a partner leaves (unless agreed otherwise)	Continues regardless of ownership changes

Introduction to Financial Accounting vs. Management Accounting

Accounting is divided into different branches to meet the information needs of various users. Two of the most important branches are **Financial Accounting** and **Management Accounting**.

- **Financial Accounting** focuses on preparing financial reports for people **outside the business**, such as investors, creditors, and government agencies.
- **Management Accounting** focuses on providing information to **managers within the business** to help them plan, control, and make decisions.

Although both branches use accounting information, they differ in their purpose, users, and reporting methods.

Financial Accounting

Financial accounting is the process of recording, classifying, summarizing, and reporting a business's financial transactions to produce financial statements for external users.

Purpose

The main purpose of financial accounting is to:

- Provide accurate financial information to external users.
- Show the financial performance and financial position of the business.
- Meet legal and regulatory reporting requirements.

Users of Financial Accounting

- Investors
- Shareholders
- Creditors and lenders
- Suppliers
- Government and tax authorities
- Customers
- Regulatory bodies

Main Financial Statements

- Income Statement (Statement of Profit or Loss)
- Statement of Financial Position (Balance Sheet)
- Cash Flow Statement
- Statement of Changes in Equity

Characteristics

- Based on historical financial information.
- Follows accounting standards (e.g., IFRS or GAAP).
- Reports are prepared at regular intervals (monthly, quarterly, or annually).
- Information is objective, reliable, and verifiable.

Management Accounting

Management accounting is the process of preparing financial and non-financial information to help managers plan, control, and make business decisions.

Purpose

The main purpose of management accounting is to:

- Assist managers in decision-making.
- Support planning and budgeting.
- Improve business efficiency.
- Monitor and control business performance.

Users of Management Accounting

- Business owners
- Managers
- Department heads
- Supervisors

Common Management Accounting Reports

- Budgets
- Cost reports
- Sales reports
- Performance reports
- Forecasts
- Variance analysis

Characteristics

- Focuses on future planning as well as current performance.
- Information may include both financial and non-financial data.
- Reports are prepared whenever needed.
- Does not have to follow formal accounting standards.
- Reports are confidential and intended for internal use only.

Differences Between Financial Accounting and Management Accounting

Aspect	Financial Accounting	Management Accounting
Purpose	Provide information to external users	Help managers make decisions
Users	Investors, creditors, government, shareholders	Managers, owners, supervisors
Time Focus	Historical (past performance)	Present and future planning
Reporting Frequency	Periodically (monthly, quarterly, annually)	As needed
Regulations	Must follow accounting standards (IFRS/GAAP)	No mandatory accounting standards
Information	Mainly financial information	Financial and non-financial information
Confidentiality	Usually published for external use	Confidential and for internal use
Main Reports	Financial statements	Budgets, forecasts, cost reports, performance reports

Similarities Between Financial Accounting and Management Accounting

- Both use accounting information to support decision-making.
- Both help improve the management of business resources.
- Both rely on accurate and reliable financial records.
- Both contribute to evaluating business performance.

Importance of Financial and Management Accounting

Financial Accounting

- Helps investors and creditors make informed decisions.
- Ensures legal and tax compliance.
- Builds confidence among stakeholders.
- Provides a clear picture of business performance and financial position.

Management Accounting

- Supports planning and budgeting.
- Helps managers control costs.
- Assists in pricing and investment decisions.
- Improves operational efficiency and profitability.

Overview of Financial Reporting Frameworks

(e.g., Principles Influenced by the International Accounting Standards Board)

A **financial reporting framework** is a set of **principles, rules, and guidelines** used to prepare and present financial statements. These frameworks ensure that financial reports are **consistent, reliable, transparent, and comparable** across different businesses and countries.

Many countries use accounting standards developed by the **International Accounting Standards Board (IASB)**, which issues the **International Financial Reporting Standards (IFRS)**.

What is the International Accounting Standards Board (IASB)?

The **International Accounting Standards Board (IASB)** is an independent international organization responsible for developing and issuing **International Financial Reporting Standards (IFRS)**.

Objectives of the IASB

- Develop high-quality global accounting standards.
- Improve transparency and accountability in financial reporting.
- Promote consistency and comparability of financial statements worldwide.
- Support investors and other users in making informed economic decisions.

International Financial Reporting Standards (IFRS)

IFRS are accounting standards that guide how businesses prepare and present their financial statements.

Purpose of IFRS

- Ensure financial statements are prepared consistently.
- Improve comparability between businesses and countries.
- Increase investor confidence.
- Facilitate international trade and investment.

Components of a Financial Reporting Framework

A financial reporting framework provides guidance on:

1. Recognition - Determines **when** assets, liabilities, income, and expenses should be included in the financial statements. **Example:**

- Revenue is recognized when it is earned, not necessarily when cash is received.

2. Measurement - Determines **how much** an item should be recorded at.

Examples include:

- Historical cost
- Fair value
- Current value

3. Presentation - Specifies how financial information should be displayed in financial statements.

Examples:

- Statement of Financial Position (Balance Sheet)
- Income Statement (Statement of Profit or Loss)
- Cash Flow Statement
- Statement of Changes in Equity

4. Disclosure - Requires businesses to provide additional information in the notes to the financial statements.

Examples:

- Accounting policies
- Risks and uncertainties

- Significant assumptions
- Contingent liabilities

Qualitative Characteristics of Useful Financial Information

According to the IASB Conceptual Framework, useful financial information should have the following qualities:

Fundamental Characteristics

1. Relevance - Information should be capable of influencing users' decisions.

2. Faithful Representation

Information should be:

- Complete
- Neutral
- Free from material error

Enhancing Characteristics

1. Comparability: Users should be able to compare financial statements across different businesses and accounting periods.

2. Verifiability: Independent people should be able to reach similar conclusions using the same information.

3. Timeliness: Information should be available in time to influence decisions.

4. Understandability: Financial information should be presented clearly and simply so that users can understand it.

Basic Accounting Principles Influenced by IASB Standards

1. Going Concern Principle: Financial statements are prepared on the assumption that the business will continue operating for the foreseeable future.

2. Accrual Basis Principle - Transactions are recorded when they occur, not when cash is received or paid.

3. Consistency Principle - The same accounting methods should be used from one period to another unless a justified change is required.

4. Materiality Principle - Only information that could influence users' decisions should be reported separately.

5. Prudence (Conservatism) - Exercise caution when making estimates under conditions of uncertainty, ensuring assets and income are not overstated and liabilities and expenses are not understated.

6. Substance Over Form - Transactions should be accounted for according to their economic reality, not merely their legal form.

Importance of Financial Reporting Frameworks

Financial reporting frameworks:

- Promote consistency in financial reporting.
- Improve the reliability of financial statements.
- Increase transparency and accountability.
- Help investors, lenders, and other stakeholders make informed decisions.
- Facilitate comparison between businesses.
- Support compliance with legal and regulatory requirements.
- Enhance confidence in financial information.

Benefits of Using IFRS

- Common global accounting language.
- Easier comparison of companies across countries.
- Improved access to international investment.
- Greater transparency and credibility.
- Reduced reporting differences between countries.

2. Basic Accounting Principles

Accounting principles are the fundamental rules and guidelines used to prepare financial statements. The main principles include:

1.Business Entity Concept

The **Business Entity Concept** is one of the fundamental accounting principles. It states that a business is treated as a **separate and distinct entity** from its owner(s). This means that the financial transactions of the business must be recorded separately from the personal transactions of the owner.

Key Features

- The business has its own accounting records.
- The owner's personal income, expenses, assets, and liabilities are not mixed with those of the business.
- Financial statements report only the activities of the business.

- This concept applies to all forms of business, including sole traders, partnerships, and companies.

Example 1 - Mary owns a clothing shop. She withdraws **P5,000** from the business bank account to pay her child's school fees.

- This is **not** recorded as a business expense.
- It is recorded as **Drawings**, which reduces the owner's equity.

Example 2 - John uses his personal money to purchase a computer for his business worth **P8,000**.

- The business records the computer as a business asset.
- The amount is treated as additional capital introduced by the owner.

Importance of the Business Entity Concept

- Ensures accurate financial records.
- Makes it easier to determine the true profit or loss of the business.
- Helps prepare reliable financial statements.
- Prevents confusion between business and personal finances.
- Improves accountability and transparency.

Advantages

- Provides clear and accurate accounting records.
- Helps in measuring business performance.
- Simplifies tax calculations.
- Increases the confidence of investors, lenders, and other stakeholders.

Limitations

- Small business owners, especially sole traders, may find it difficult to keep personal and business transactions completely separate.
- It does not recognise that the owner and the business may be legally the same person in a sole proprietorship, although they are treated separately for accounting purposes.

The **Business Entity Concept** requires accountants to treat the business as a separate accounting entity from its owner(s). Only business transactions are recorded in the accounting records, ensuring that financial statements accurately reflect the business's financial performance and position.

2.Accruals vs. Cash Basis Accounting

Accrual Basis Accounting and **Cash Basis Accounting** are two different methods used to record financial transactions. The main difference is **when income and expenses are recognised**.

Accrual Basis Accounting	Cash Basis Accounting
Records income when it is **earned**, whether or not cash has been received.	Records income only when **cash is received**.
Records expenses when they are **incurred**, whether or not they have been paid.	Records expenses only when **cash is paid**.
Provides a more accurate picture of the financial performance and position of the business.	Provides a simpler record of cash inflows and outflows.
Used by most medium and large businesses and companies.	Commonly used by small businesses and sole traders.
Follows the **matching principle**, matching revenue with the expenses incurred to earn it.	Does not follow the matching principle.

Example of Accrual Basis Accounting - A business provides consulting services worth **P10,000** in June but receives payment in July.

- **Accrual basis:** Records **P10,000 revenue in June**, because the income was earned in June.
- **Cash basis:** Records **P10,000 revenue in July**, because that is when the cash was received.

Example of Expenses - A business receives an electricity bill of **P2,000** in December but pays it in January.

- **Accrual basis:** Records the **P2,000 expense in December**, when the expense was incurred.
- **Cash basis:** Records the **P2,000 expense in January**, when the payment is made.

Advantages of Accrual Basis Accounting

- Provides a more accurate measure of profit.
- Matches income with related expenses.
- Produces more reliable financial statements.
- Helps managers make better business decisions.
- Required under most financial reporting standards for many organizations.

Disadvantages of Accrual Basis Accounting

- More complex to maintain.
- Requires accounting knowledge.
- Income may be recorded before cash is received, which can create cash flow challenges.

Advantages of Cash Basis Accounting

- Simple and easy to understand.
- Easy to prepare and maintain.
- Clearly shows the business's cash position.
- Suitable for many small businesses with straightforward transactions.

Disadvantages of Cash Basis Accounting

- Does not show the true profitability of the business over a period.
- Income and expenses may be recorded in different accounting periods.
- Financial statements may be less useful for decision-making.
- Not appropriate for many larger businesses.

Key Differences

Feature	Accrual Basis	Cash Basis
Revenue recognised	When earned	When cash is received
Expenses recognised	When incurred	When cash is paid
Accuracy	High	Lower
Complexity	More complex	Simpler
Best suited for	Medium and large businesses	Small businesses

3.Going Concern Concept

The **Going Concern Concept** is a fundamental accounting principle that assumes a business will continue operating for the **foreseeable future** and does not intend, nor is it expected, to close down or significantly reduce its operations.

Because the business is expected to continue operating, its assets and liabilities are recorded based on their ongoing use in the business rather than their immediate sale value.

Key Features

- Assumes the business will continue its operations into the foreseeable future.
- Assets are valued based on their continued use, not their liquidation (selling) value.
- Liabilities are expected to be settled in the normal course of business.
- Financial statements are prepared on the assumption that the business will remain in operation.

Example 1 - A business purchases machinery for **P120,000** with an expected useful life of **10 years**.

- Under the **Going Concern Concept**, the machinery is recorded as a non-current asset.
- Its cost is allocated over its useful life through **depreciation**, rather than being treated as an expense immediately.

Example 2 - A company owns a building worth **P2,000,000**.

- If the company is expected to continue operating, the building is recorded as an asset used in the business.
- If the company plans to close, the building may instead be valued at the amount it could be sold for (its liquidation value).

Importance of the Going Concern Concept

- Allows businesses to prepare financial statements on a consistent basis.
- Supports the use of depreciation and amortisation.
- Helps investors, lenders, and other users assess the long-term financial position of the business.
- Prevents unnecessary undervaluation of business assets.

Advantages

- Provides a realistic basis for preparing financial statements.
- Supports long-term planning and investment decisions.
- Allows assets to be used over their expected useful lives.
- Improves consistency and comparability of financial reports.

Limitations

- The assumption may not always be valid if a business is experiencing serious financial difficulties.
- Unexpected events, such as economic crises or natural disasters, may affect the business's ability to continue operating.
- If the business is no longer a going concern, financial statements must be prepared using a different basis of accounting.

Indicators That a Business May Not Be a Going Concern

- Continuous operating losses.
- Inability to pay debts when they are due.
- Loss of major customers or suppliers.
- Legal action that threatens the business's survival.
- Plans to liquidate or cease operations.

The **Going Concern Concept** assumes that a business will continue operating for the foreseeable future. This assumption allows accountants to record assets and liabilities on the basis that the business will continue using them in its normal operations rather than selling them immediately. It is one of the key assumptions underlying the preparation of financial statements.

4.Consistency Principle (Accounting)

The **consistency principle** is an accounting principle that requires a business to use the **same accounting methods and procedures from one accounting period to the next**. This makes it easier to compare financial statements over time.

The **consistency principle** states that once a business adopts an accounting method (such as inventory valuation or depreciation), it should continue using that method unless there is a valid reason to change it.

Purpose - The consistency principle helps to:

- Improve the **comparability** of financial statements.
- Ensure financial information is **reliable** and **understandable**.
- Help investors, managers, and other users identify trends in the business's performance.
- Prevent businesses from changing accounting methods simply to make profits appear higher or lower.

Examples

Example 1: Depreciation

A company chooses the **straight-line method** to depreciate its machinery. It should continue using the straight-line method each year unless there is a justified reason to switch to another method, such as the reducing balance method.

Example 2: Inventory Valuation

A business uses the **First-In, First-Out (FIFO)** method to value inventory. It should continue using FIFO in future accounting periods so that inventory values and cost of goods sold remain comparable.

When Can a Business Change an Accounting Method?

A business may change its accounting method if:

- The new method provides **more reliable and relevant** financial information.
- A new accounting standard or law requires the change.

When a change is made, the business should:

- Explain the reason for the change.
- Disclose the effect of the change on the financial statements.

Advantages of the Consistency Principle

- Makes financial statements easier to compare over different years.
- Increases confidence in financial reports.
- Helps users make better economic decisions.
- Reduces the risk of manipulating financial results.

Limitations

- A business may continue using a method that is no longer the most appropriate.
- Changes in business operations may require a different accounting method, making comparisons more difficult.

5.Prudence Principle (Conservatism) in Accounting

The **prudence principle**, also known as the **conservatism principle**, requires accountants to **exercise caution when making judgments under conditions of uncertainty**. It means that expenses and liabilities should not be understated, while income and assets should not be overstated.

The **prudence principle** states that when there is uncertainty, accountants should choose the accounting treatment that avoids overstating the business's financial position or performance.

Purpose

The prudence principle helps to:

- Ensure financial statements are **reliable and realistic**.
- Prevent the overstatement of profits and assets.
- Protect investors, creditors, and other users from misleading financial information.
- Encourage careful and responsible financial reporting.

Key Rule

- **Recognize expected losses or expenses as soon as they are probable.**
- **Recognize income or gains only when they are earned or reasonably certain.**

Examples

Example 1: Bad Debts

A business has customers who owe **P20,000**, but it expects that **P3,000** may not be collected. Under the prudence principle, the business records an **allowance for doubtful debts** of **P3,000**, reducing profit and accounts receivable.

Example 2: Inventory Valuation

A business bought inventory for **P50,000**, but its market value has fallen to **P45,000**. The inventory should be reported at **P45,000** (the lower value), recognizing the expected loss.

Example 3: Lawsuit

A company is likely to lose a lawsuit and estimates compensation of **P100,000**. Even before the case is settled, the company records a **provision (liability)** because the loss is probable.

Advantages of the Prudence Principle

- Prevents overstatement of profits and assets.
- Produces more reliable and credible financial statements.
- Helps users make informed financial decisions.
- Reduces the risk of misleading investors and creditors.

Limitations

- Excessive prudence can **understate profits or assets**.
- It may reduce the comparability of financial statements if applied inconsistently.
- Too much conservatism may give an overly pessimistic view of a business.

Difference Between Prudence and Consistency

Prudence	Consistency
Focuses on caution when uncertainty exists.	Focuses on using the same accounting methods over time.
Avoids overstating assets and income.	Improves comparability between accounting periods.
Recognizes expected losses early.	Requires accounting policies to remain the same unless there is a valid reason to change them.

6.Materiality Principle in Accounting

The **materiality principle** states that **all important (material) information that could influence the decisions of users of financial statements must be disclosed**, while insignificant (immaterial) items may be treated in a simpler way.

The **materiality principle** means that an item is **material** if its omission, misstatement, or incorrect reporting could affect the decisions of investors, creditors, managers, or other users of the financial statements.

Purpose

The materiality principle helps to:

- Ensure financial statements include all significant information.
- Improve the relevance and usefulness of accounting information.
- Avoid unnecessary detail for items that are too small to influence decisions.
- Help users make informed financial decisions.

What Is a Material Item?

A material item is one that is significant because of:

- **Its size (amount)** – for example, a large expense or liability.
- **Its nature** – for example, fraud or an illegal transaction, even if the amount is small.

Examples

Example 1: Small Office Supplies

A company buys pens and paper worth **P500**. Instead of recording them as assets, the company records them as an expense immediately because the amount is not material.

Example 2: Expensive Equipment

A business purchases machinery worth **P500,000**. This is a material item, so it should be recorded as a **non-current asset** and depreciated over its useful life.

Example 3: Legal Case

A company is involved in a lawsuit that could result in a large financial loss. Even if the case has not been settled, the information is material and should be disclosed in the financial statements if it could influence users' decisions.

Advantages of the Materiality Principle

- Ensures important information is reported.
- Makes financial statements more relevant and understandable.
- Saves time and cost by avoiding unnecessary accounting for insignificant items.
- Supports better decision-making by users of financial statements.

Limitations

- Materiality depends on professional judgment, so different accountants may reach different conclusions.
- There is no single monetary amount that defines what is material for every business.

- An item that is immaterial for a large company may be material for a small business.

Difference Between Materiality and Prudence

Materiality	Prudence
Focuses on whether information is significant enough to affect decisions.	Focuses on being cautious when dealing with uncertainty.
Significant items must be disclosed.	Expected losses are recognized promptly, while gains are recognized only when they are reasonably certain.
Depends on the size or nature of an item.	Depends on uncertainty and the risk of overstating profits or assets.

3. Double-Entry Bookkeeping System

The **double-entry bookkeeping system** is an accounting method in which **every financial transaction affects at least two accounts**. One account is **debited**, and another account is **credited**, with the total debits always equal to the total credits.

This system helps maintain the accuracy of financial records and ensures that the accounting equation remains balanced.

Accounting Equation:

Assets = Liabilities + Owner's Equity

Principles of Double-Entry Bookkeeping

1. Every transaction has two effects.
2. Every debit has a corresponding credit of the same amount.
3. Total debits must always equal total credits.
4. The accounting equation must always remain balanced.

Rules of Debit and Credit

Account Type	Increase	Decrease
Assets	Debit	Credit
Liabilities	Credit	Debit
Owner's Equity	Credit	Debit
Revenue (Income)	Credit	Debit
Expenses	Debit	Credit

Examples

Example 1: Owner invests cash into the business

The owner invests **P20,000** in cash.

Account	Debit (P)	Credit (P)
Cash	20,000	
Capital		20,000

Explanation:

- Cash (asset) increases → Debit
- Capital (owner's equity) increases → Credit

Example 2: Purchase equipment for cash

Equipment costing **P5,000** is purchased for cash.

Account	Debit (P)	Credit (P)
Equipment	5,000	
Cash		5,000

Explanation:

- Equipment (asset) increases → Debit
- Cash (asset) decreases → Credit

Example 3: Receive cash from customers

Cash received from customers for services rendered: **P3,000**.

Account	Debit (P)	Credit (P)
Cash	3,000	
Service Revenue		3,000

Explanation:

- Cash increases → Debit
- Revenue increases → Credit

Example 4: Pay electricity expense

Electricity bill paid: **P800**.

Account	Debit (P)	Credit (P)
Electricity Expense	800	
Cash		800

Explanation:

- Expense increases → Debit
- Cash decreases → Credit

Advantages of Double-Entry Bookkeeping

- Produces more accurate financial records.
- Helps detect and prevent accounting errors.
- Maintains balanced accounts through the accounting equation.
- Makes it easier to prepare financial statements.
- Provides complete information about each transaction.
- Assists in decision-making by providing reliable financial information.

Disadvantages of Double-Entry Bookkeeping

- More complex than single-entry bookkeeping.
- Requires trained accounting personnel.
- Can be time-consuming for small businesses.
- Errors may still occur if both the debit and credit entries are incorrect but equal.

Importance of Double-Entry Bookkeeping

- Ensures accuracy in financial records.
- Helps prepare the **trial balance**, **income statement**, **statement of financial position (balance sheet)**, and **cash flow statement**.
- Supports auditing and compliance with accounting standards.
- Enables businesses to monitor assets, liabilities, income, and expenses effectively.

The **double-entry bookkeeping system** is the foundation of modern accounting. Every transaction is recorded with **equal debit and credit entries**, ensuring that the accounting equation remains balanced:

Assets = Liabilities + Owner's Equity

By following this system, businesses can produce accurate financial records, detect errors more easily, and prepare reliable financial statements.

CHART OF ACCOUNTS

A **Chart of Accounts (COA)** is a structured list of all the accounts a business uses to record financial transactions. It organizes accounts into categories that appear in the financial statements.

Here's a standard chart of accounts template:

Account No.	Account Name	Category
1000–1999	**Assets**	
1010	Cash	Current Asset
1020	Bank Account	Current Asset
1030	Accounts Receivable	Current Asset
1040	Inventory	Current Asset
1050	Prepaid Expenses	Current Asset
1100	Equipment	Fixed Asset
1110	Accumulated Depreciation	Contra Asset
2000–2999	**Liabilities**	
2010	Accounts Payable	Current Liability
2020	Accrued Expenses	Current Liability
2030	Salaries Payable	Current Liability
2040	Taxes Payable	Current Liability
2100	Bank Loan	Long-term Liability
3000–3999	**Equity**	
3010	Owner's Capital	Equity
3020	Retained Earnings	Equity
3030	Owner's Drawings	Contra Equity
4000–4999	**Revenue**	
4010	Sales Revenue	Income
4020	Service Revenue	Income
4030	Other Income	Income
5000–5999	**Cost of Goods Sold (COGS)**	
5010	Cost of Goods Sold	Expense
5020	Freight In	Expense
6000–6999	**Operating Expenses**	
6010	Salaries & Wages	Expense
6020	Rent Expense	Expense
6030	Utilities Expense	Expense
6040	Office Supplies	Expense
6050	Advertising & Marketing	Expense
6060	Insurance Expense	Expense
6070	Repairs & Maintenance	Expense
6080	Depreciation Expense	Expense
6090	Travel Expense	Expense
6100	Telephone & Internet	Expense

6110	Bank Charges	Expense
6120	Professional Fees	Expense
6130	Miscellaneous Expenses	Expense

Main Categories

- **Assets (1000–1999):** What the business owns.
- **Liabilities (2000–2999):** What the business owes.
- **Equity (3000–3999):** Owner's investment and retained earnings.
- **Revenue (4000–4999):** Income earned from operations.
- **Cost of Goods Sold (5000–5999):** Direct costs of products sold.
- **Expenses (6000–6999):** Operating costs incurred to run the business.

Source Documents in Accounting

Source documents are the original records that provide evidence that a business transaction has occurred. They are the first documents used to record transactions before they are entered into the accounting system.

Source documents are important because they:

- Provide proof that a transaction took place.
- Support entries made in the accounting records.
- Help prevent errors and fraud.
- Serve as evidence during audits.
- Assist in resolving disputes.

Common Types of Source Documents

Source Document	Purpose	Example
Invoice	Records the sale or purchase of goods or services on credit	A supplier invoices a business for office furniture
Receipt	Confirms that payment has been received	A customer pays cash and receives a receipt
Cash Register Tape	Records cash sales made during the day	Daily sales summary from a supermarket
Credit Note	Reduces the amount owed by a customer due to returned goods or overcharging	Customer returns damaged goods
Debit Note	Informs a supplier that their account has been debited, often due to returned goods	Business returns defective goods to supplier
Purchase Order	Authorizes the purchase of goods or services	Business orders 100 chairs from a supplier

Delivery Note	Confirms that goods have been delivered	Supplier delivers office equipment
Goods Received Note (GRN)	Confirms that goods ordered have been received	Warehouse receives inventory
Bank Statement	Shows transactions in the business bank account	Monthly bank statement
Cheque Stub/Counterfoil	Records details of cheques issued	Payment made to a supplier by cheque
Deposit Slip	Confirms money deposited into a bank account	Daily cash deposited into the bank
Payroll Record	Shows employee wages and deductions	Monthly salary register

Information Found on Source Documents

Most source documents contain:

- Date of the transaction
- Name and address of the buyer and seller
- Description of goods or services
- Quantity of goods
- Unit price and total amount
- Taxes (if applicable)
- Payment terms
- Signature or authorization
- Invoice or receipt number

Importance of Source Documents

- They provide reliable evidence of business transactions.
- They ensure accounting records are accurate and complete.
- They support the preparation of financial statements.
- They make auditing easier.
- They help detect and prevent fraud.
- They assist in tax reporting and compliance.

Example

Transaction: ABC Traders buys office supplies worth P2,500 on credit from XYZ Stationers.

Source Document: Supplier Invoice

Accounting Entry:

- Debit: Office Supplies Expense P2,500
- Credit: Accounts Payable P2,500

The invoice serves as the evidence for recording this transaction.

Source documents are the foundation of the accounting process. Every transaction should be supported by an appropriate source document before it is recorded in the books of account. Proper management of source documents helps ensure that financial records are accurate, complete, and verifiable.

Journals in Accounting

A **journal** is a book of original entry where business transactions are recorded in chronological (date) order before they are posted to the ledger. Each journal entry is supported by a source document, such as an invoice, receipt, or bank statement.

Purpose of Journals

Journals are used to:

- Record transactions as they occur.
- Provide a chronological record of business activities.
- Ensure the double-entry principle is followed (every transaction has a debit and a credit).
- Reduce errors before posting to the ledger.
- Create an audit trail for verification.

Types of Journals

1. General Journal: The **general journal** is used to record transactions that do not fit into any of the special journals. **Examples:**

- Correcting errors
- Depreciation
- Adjusting entries
- Opening entries
- Closing entries

Example

Date	Details	Debit (P)	Credit (P)
10 Jan	Equipment	8,000	
	Cash		8,000
	Purchased equipment for cash.		

2. Sales Journal: The **sales journal** records **credit sales of goods** only.

Example

Date	Customer	Invoice No.	Amount (P)
5 Jan	John Traders	INV001	3,500
8 Jan	ABC Stores	INV002	5,200

3. Purchases Journal

The **purchases journal** records **credit purchases of goods** for resale only.

Example

Date	Supplier	Invoice No.	Amount (P)
6 Jan	XYZ Suppliers	INV210	4,800
9 Jan	Delta Wholesalers	INV211	2,700

4. Cash Receipts Journal: The **cash receipts journal** records **all cash received**. **Examples:**

- Cash sales
- Money received from customers
- Bank interest received
- Capital introduced by the owner

Example

Date	Source	Cash Received (P)
4 Jan	Cash Sales	2,500
7 Jan	Customer Payment	1,800

5. Cash Payments Journal

The **cash payments journal** records **all cash payments**.

Examples:

- Paying suppliers
- Rent
- Salaries
- Utilities

Example

Date	Details	Cash Paid (P)
5 Jan	Rent	2,000

8 Jan	Supplier Payment	3,500

6. Returns Inwards Journal (Sales Returns Journal)

This journal records **goods returned by customers**.

Example

Date	Customer	Credit Note No.	Amount (P)
12 Jan	John Traders	CN001	600

7. Returns Outwards Journal (Purchases Returns Journal)

This journal records **goods returned to suppliers**.

Example

Date	Supplier	Debit Note No.	Amount (P)
13 Jan	XYZ Suppliers	DN001	450

Advantages of Using Journals

- Records transactions in date order.
- Makes it easier to locate transactions.
- Helps ensure accurate double-entry bookkeeping.
- Simplifies posting to the ledger.
- Provides evidence for audits and financial reporting.

The Journal Entry Format

Every journal entry follows the double-entry principle:

Date	Account Title	Debit (P)	Credit (P)
xx/xx/20xx	Cash	5,000	
	Sales Revenue		5,000
	Being cash received from sales.		

Relationship Between Source Documents, Journals, and Ledgers

Source Document → Journal → Ledger → Trial Balance → Financial Statements

1. A transaction occurs.
2. A **source document** (e.g., invoice or receipt) provides evidence of the transaction.
3. The transaction is recorded in the appropriate **journal**.
4. The journal entry is posted to the **ledger**.
5. Ledger balances are used to prepare the **trial balance**.

6. The trial balance forms the basis for the **financial statements**.

A journal is the **book of original entry** in accounting. It records transactions in chronological order and ensures that each transaction follows the **double-entry system**. Businesses use different journals—such as the **general journal, sales journal, purchases journal, cash receipts journal, cash payments journal, returns inwards journal, and returns outwards journal**—to organize transactions efficiently before posting them to the ledger.

Ledger in Accounting

A **ledger** is the **book of final entry** in accounting. It contains all the individual accounts of a business, where transactions recorded in the journals are classified and summarized. Information from the journals is **posted** to the ledger.

Purpose of a Ledger

A ledger is used to:

- Classify transactions into individual accounts.
- Show the balance of each account.
- Help prepare the trial balance.
- Provide information for preparing financial statements.
- Monitor changes in assets, liabilities, equity, income, and expenses.

Features of a Ledger

- Contains separate accounts for each item (e.g., Cash, Sales, Rent Expense).
- Transactions are posted from the journals.
- Records both debit and credit entries.
- Shows the running balance of each account.
- Forms the basis for preparing the trial balance.

Types of Ledgers

1. General Ledger

The **general ledger** contains all the accounts used by a business.

Examples of accounts include:

- Cash
- Bank
- Accounts Receivable
- Inventory
- Equipment
- Accounts Payable

- Sales Revenue
- Rent Expense

2. Sales Ledger (Debtors Ledger)

The **sales ledger** contains individual accounts for customers who purchase goods or services on credit.

Example

Customer	Balance (P)
John Traders	3,500
ABC Stores	5,200

3. Purchases Ledger (Creditors Ledger)

The **purchases ledger** contains individual accounts for suppliers from whom goods or services are bought on credit.

Example

Supplier	Balance (P)
XYZ Suppliers	4,800
Delta Wholesalers	2,700

Format of a Ledger Account (T-Account)

A ledger account is commonly presented as a **T-account**.

Cash Account

Debit (Dr)		Credit (Cr)	
Date	Amount (P)	Date	Amount (P)
Capital	10,000	Rent	2,000
Sales	5,000	Purchases	3,000

Balance = P10,000 + P5,000 − P2,000 − P3,000 = P10,000 (Debit Balance)

Example of Posting from the Journal to the Ledger

Step 1: Journal Entry

Date	Account	Debit (P)	Credit (P)
5 Jan	Cash	2,000	
	Sales Revenue		2,000

Step 2: Ledger Posting

Cash Account

Debit	Amount (P)	Credit	Amount (P)
Sales	2,000		

Sales Revenue Account

Debit	Amount (P)	Credit	Amount (P)
		Cash	2,000

Steps in Posting to the Ledger

1. Record the transaction in the appropriate journal.
2. Identify the accounts affected.
3. Post the debit entry to the debit side of the appropriate ledger account.
4. Post the credit entry to the credit side of the appropriate ledger account.
5. Enter the date and reference.
6. Calculate the account balance.

Advantages of a Ledger

- Organizes accounting information by account.
- Makes it easy to determine account balances.
- Helps detect errors.
- Provides information needed to prepare the trial balance.
- Supports the preparation of financial statements.

Difference Between Journal and Ledger

Journal	Ledger
Book of original entry	Book of final entry
Transactions recorded in chronological order	Transactions classified by account
Entries made first	Entries made after journal entries
Used to record transactions	Used to summarize and classify transactions
Basis for posting	Basis for preparing the trial balance

Accounting Cycle

The ledger is an important part of the accounting cycle:

Source Documents → Journals → Ledgers → Trial Balance → Financial Statements

- **Source documents** provide evidence of transactions.

- **Journals** record transactions in chronological order.
- **Ledgers** classify transactions into individual accounts.
- **Trial Balance** checks the accuracy of ledger balances.
- **Financial Statements** report the financial performance and position of the business.

A **ledger** is the **book of final entry** that organizes transactions into individual accounts. Transactions are posted from journals to the ledger, where account balances are maintained. The ledger is essential for preparing the **trial balance** and **financial statements**, making it a key component of the accounting system.

Trial Balance Preparation

A **trial balance** is a statement that lists all the ledger account balances at a particular date to check whether the total debits equal the total credits. It is prepared after transactions have been recorded in the journals and posted to the ledger.

The trial balance helps to verify the mathematical accuracy of the double-entry bookkeeping system.

Objectives of a Trial Balance

A trial balance is prepared to:

- Check the accuracy of ledger postings.
- Ensure that total debits equal total credits.
- Detect certain accounting errors.
- Provide the basis for preparing financial statements.
- Summarize the balances of all ledger accounts.

Steps in Preparing a Trial Balance

1. **Balance each ledger account.**
2. **List all account names** from the ledger.
3. **Record debit balances** in the debit column.
4. **Record credit balances** in the credit column.
5. **Add the debit and credit columns.**
6. **Compare the totals.** If they are equal, the trial balance is said to balance.

Format of a Trial Balance

ABC Traders
Trial Balance as at 31 January 20XX

Account Name	Debit (P)	Credit (P)
Cash	12,000	
Bank	8,000	

Accounts Receivable	5,000	
Inventory	10,000	
Equipment	15,000	
Accounts Payable		6,000
Bank Loan		10,000
Owner's Capital		25,000
Sales Revenue		20,000
Purchases	9,000	
Rent Expense	2,000	
Salaries Expense	3,000	
Utilities Expense	1,000	
Totals	**65,000**	**61,000**

Note: This example **does not balance**, indicating that an error has occurred.

Correct Example

Account Name	Debit (P)	Credit (P)
Cash	12,000	
Bank	8,000	
Accounts Receivable	5,000	
Inventory	10,000	
Equipment	15,000	
Purchases	9,000	
Rent Expense	2,000	
Salaries Expense	3,000	
Utilities Expense	1,000	
Accounts Payable		10,000
Bank Loan		10,000
Owner's Capital		25,000
Sales Revenue		20,000
Totals	**65,000**	**65,000**

The trial balance now **balances**, meaning the total debits equal the total credits.

Accounts Included in a Trial Balance

Debit Balances

- Assets (e.g., Cash, Bank, Inventory, Equipment)
- Expenses (e.g., Rent, Salaries, Utilities)
- Drawings
- Purchases

Credit Balances

- Liabilities (e.g., Accounts Payable, Loans)
- Owner's Capital
- Revenue (e.g., Sales, Service Revenue)

Advantages of a Trial Balance

- Confirms that total debits equal total credits.
- Helps identify posting and arithmetic errors.
- Summarizes ledger account balances.
- Forms the basis for preparing financial statements.
- Assists accountants in locating errors before final accounts are prepared.

Limitations of a Trial Balance

A balanced trial balance **does not guarantee** that the accounting records are free from errors. It cannot detect:

- Errors of omission (a transaction is not recorded at all).
- Errors of principle (recording a transaction in the wrong type of account).
- Errors of commission (recording the correct amount in the wrong account of the same class).
- Compensating errors (two or more errors that cancel each other out).
- Complete reversal of entries (debit and credit accounts are swapped).

Common Errors Revealed by a Trial Balance

- One side of a journal entry was not posted.
- Debit or credit postings were made for the wrong amount.
- Errors in addition or balancing of ledger accounts.
- Figures entered in the wrong trial balance column.

Example

Ledger Balances

- Cash – Debit P8,000
- Inventory – Debit P5,000
- Equipment – Debit P12,000
- Accounts Payable – Credit P4,000
- Capital – Credit P18,000
- Sales Revenue – Credit P9,000
- Rent Expense – Debit P3,000
- Salaries Expense – Debit P3,000

Trial Balance

Account Name	Debit (P)	Credit (P)
Cash	8,000	
Inventory	5,000	
Equipment	12,000	
Rent Expense	3,000	
Salaries Expense	3,000	
Accounts Payable		4,000
Capital		18,000
Sales Revenue		9,000
Totals	**31,000**	**31,000**

Since the total debits equal the total credits, the trial balance is **balanced**.

Relationship in the Accounting Cycle

The trial balance is prepared after posting transactions to the ledger and before preparing the financial statements.

Source Documents → Journals → Ledgers → Trial Balance → Financial Statements

A **trial balance** is a statement prepared from the balances of all ledger accounts to verify the accuracy of the double-entry bookkeeping system. If the total debits equal the total credits, the trial balance is balanced. Although it helps detect many accounting errors, it does not identify every type of error. It is an essential step in preparing accurate financial statements.

4. Preparation of Financial Statements

What are Financial Statements?

Financial statements are formal reports that summarize? the financial performance and financial position of a business over a specific accounting period. They help owners, managers, investors, lenders, and government authorities make informed decisions.

Objectives of Financial Statements

- Show the profitability of the business.
- Show the financial position of the business.
- Assist in decision-making.
- Provide information to investors and lenders.
- Meet legal and tax reporting requirements.

Statement of Profit or Loss

A **Statement of Profit or Loss** (also called an **Income Statement**) is a financial statement that summarises a business's **income, expenses, and profit or loss** over a specific accounting period. It shows whether the business made a **profit** (income exceeds expenses) or a **loss** (expenses exceed income).

Purpose of the Statement of Profit or Loss

The statement is prepared to:

- Determine the profit or loss made during the accounting period.
- Measure the financial performance of the business.
- Help management make business decisions.
- Provide useful information to investors, lenders, and other stakeholders.
- Assist in tax calculations and financial reporting.

Main Components

1. Revenue (Sales): The total income earned from selling goods or providing services.

2. Cost of Sales: The direct costs incurred in producing or purchasing goods sold.

Formula:

Cost of Sales = Opening Inventory + Purchases + Carriage Inwards − Closing Inventory

3. Gross Profit: Gross profit is the profit made after deducting the cost of sales from revenue.

Formula:

Gross Profit = Sales Revenue − Cost of Sales

4. Other Income: Income earned from activities other than the main business operations, such as:

- Rent received
- Interest received
- Commission received

5. Operating Expenses

These are expenses incurred in running the business, for example:

- Salaries and wages

- Rent
- Electricity and water
- Insurance
- Advertising
- Depreciation
- Office expenses
- Motor vehicle expenses

6. Operating Profit

Formula:

Operating Profit = Gross Profit + Other Income − Operating Expenses

7. Finance Costs

Expenses related to borrowing money, such as interest on loans.

8. Profit Before Tax

Formula:

Profit Before Tax = Operating Profit − Finance Costs

9. Income Tax Expense

The amount of tax payable on profit.

10. Net Profit (Profit for the Year)

Formula:

Net Profit = Profit Before Tax − Income Tax

Format of a Statement of Profit or Loss

Statement of Profit or Loss for the Year Ended 31 December 20XX	**£**
Sales Revenue	120,000
Less: Cost of Sales	(70,000)
Gross Profit	**50,000**
Add: Other Income	5,000
Total Income	**55,000**
Less: Operating Expenses	
Salaries	20,000
Rent	8,000

Electricity	2,000
Insurance	1,000
Depreciation	3,000
Total Operating Expenses	**34,000**
Operating Profit	**21,000**
Less: Finance Costs	(1,000)
Profit Before Tax	**20,000**
Less: Income Tax	(5,000)
Net Profit for the Year	**15,000**

Worked Example

Given:

- Sales = £80,000
- Opening Inventory = £8,000
- Purchases = £42,000
- Carriage Inwards = £1,000
- Closing Inventory = £6,000
- Salaries = £10,000
- Rent = £4,000
- Insurance = £2,000
- Interest Received = £1,500

Step 1: Calculate Cost of Sales

Cost of Sales = £8,000 + £42,000 + £1,000 − £6,000

= **£45,000**

Step 2: Calculate Gross Profit

Gross Profit = £80,000 − £45,000

= **£35,000**

Step 3: Calculate Operating Profit

Operating Expenses = £10,000 + £4,000 + £2,000 = **£16,000**

Operating Profit = £35,000 + £1,500 − £16,000

= **£20,500**

If there are no finance costs or tax, the **Net Profit = £20,500**.

Importance of the Statement of Profit or Loss

- Measures the profitability of the business.
- Assists management in planning and decision-making.
- Helps investors assess business performance.
- Enables comparison of performance over different periods.
- Supports budgeting and cost control.
- Provides information for tax reporting.

Limitations

- It is based on historical information.
- It may be affected by accounting estimates, such as depreciation.
- It does not show the business's cash position.
- It can be influenced by changes in accounting policies.

4. Preparation of Financial Statements

Meaning of Financial Statements

Financial statements are formal accounting reports prepared from the accounting records of a business to show its **financial performance and financial position** over a particular period.

The main financial statements are:

- **Income Statement / Statement of Profit or Loss** – shows income, expenses, and profit or loss.
- **Statement of Financial Position / Balance Sheet** – shows assets, liabilities, and owner's equity at a specific date.
- **Statement of Cash Flows** – shows cash inflows and outflows during a period.
- **Statement of Changes in Equity** – shows changes in owner's/shareholders' equity.
- **Notes to the Financial Statements** – provide additional explanations and accounting information.

Objectives of Financial Statements

Financial statements are prepared to:

1. Determine the **profit or loss** of the business.
2. Show the **financial position** of the business.
3. Provide information for **decision-making**.
4. Help management evaluate business performance.
5. Provide information to investors, lenders, government, and other stakeholders.

6. Facilitate comparison of performance between different accounting periods.
7. Demonstrate accountability for the resources of the business.

Basic Accounting Equation

The preparation of financial statements is based on:

Assets = Capital/Equity + Liabilities

Where:

- **Assets** – resources owned or controlled by the business.
- **Liabilities** – amounts owed by the business to outsiders.
- **Capital/Equity** – owner's interest in the business.

For example:

If a business has assets of **P500,000** and liabilities of **P200,000**:

Capital = Assets − Liabilities

P500,000 − P200,000 = P300,000

Therefore, owner's capital is **P300,000**.

Information Needed to Prepare Financial Statements

The accountant normally uses:

- Trial balance
- General ledger
- Cash book
- Sales records
- Purchases records
- Bank statements
- Invoices and receipts
- Inventory records
- Payroll records
- Previous financial statements
- Adjusting information

Profit and Loss Statement

A **Profit and Loss Statement (P&L)**, also called an **Income Statement**, is a financial statement that shows whether a business has made a **profit or a loss** during a specific period.

It records:

- **Income/Revenue** earned
- **Expenses** incurred
- **Profit or loss** made

Purpose of a Profit and Loss Statement

The main purposes are to:

- Determine the **profit or loss** of the business.
- Show the business's **financial performance**.
- Help owners and managers make decisions.
- Help investors and other users assess the business.

Income/Revenue

Income is money earned by the business.

Examples:

- Sales
- Commission received
- Rent received
- Interest received
- Discounts received

For a trading business:

Net Sales = Sales − Returns Inwards

Expenses

Expenses are costs incurred in running the business.

Examples:

- Salaries and wages
- Rent
- Electricity

- Insurance
- Advertising
- Transport
- Repairs
- Depreciation
- Interest

Expenses reduce the profit of the business.

Gross Profit

For a business that buys and sells goods:

Gross Profit = Net Sales − Cost of Sales

For example:

- Net Sales = $50,000
- Cost of Sales = $30,000

Gross Profit = $50,000 − $30,000 = $20,000

Gross Loss

A business makes a **gross loss** when the cost of sales is greater than net sales.

Gross Loss = Cost of Sales − Net Sales

Net Profit

Net profit is the amount left after all relevant expenses have been deducted from income.

Net Profit = Total Income − Total Expenses

For example:

- Income = $50,000
- Expenses = $35,000

Net Profit = $15,000

Net Loss

A business makes a **net loss** when its total expenses are greater than its total income.

Net Loss = Total Expenses − Total Income

Simple Format

Profit and Loss Statement

Particulars	Amount
Sales	$50,000
Less: Cost of Sales	($30,000)
Gross Profit	**$20,000**
Add: Other Income	$2,000
Less: Expenses	($10,000)
Net Profit	**$12,000**

Important Terms

Term	Meaning
Revenue	Income earned from normal business activities
Sales	Money earned from selling goods
Expense	Cost incurred in running the business
Gross Profit	Sales minus cost of sales
Gross Loss	Cost of sales greater than sales
Net Profit	Profit after deducting expenses
Net Loss	Expenses greater than income
Cost of Sales	Cost of goods that have been sold

Easy rule to remember

Income − Expenses = Profit

If income is greater → **Profit** ✓
If expenses are greater → **Loss** ✗

Statement of Financial Position (Balance sheet)

A **Statement of Financial Position (SFP)** is a financial statement that shows the **financial position of a business at a specific date**.

It shows what the business:

- **Owns** → Assets
- **Owes** → Liabilities
- **Belongs to the owner(s)** → Capital/Equity

It is also commonly called a **Balance Sheet**.

The Accounting Equation

The most important formula is:

Assets = Capital (Equity) + Liabilities

Or:

Capital = Assets − Liabilities

This equation must always balance.

Assets

Assets are resources owned or controlled by the business that have economic value.

There are two main types:

A. Non-current assets

These are assets that are expected to be used for more than one accounting period.

Examples:

- Land
- Buildings
- Machinery
- Motor vehicles
- Furniture
- Equipment

B. Current assets

These are assets expected to be converted into cash or used within a short period, usually within one year.

Examples:

- Inventory
- Trade receivables/debtors
- Cash
- Bank balance
- Prepaid expenses

4. Liabilities

Liabilities are amounts that the business owes to other people or organisations.

A. Non-current liabilities

These are debts that are normally payable after more than one year.

Examples:

- Long-term bank loans
- Mortgage loans

B. Current liabilities

These are amounts normally payable within one year.

Examples:

- Trade payables/creditors
- Bank overdraft
- Accrued expenses
- Short-term loans

Capital/Equity

Capital is the owner's investment in the business.

For a sole trader:

Closing Capital = Opening Capital + Net Profit + Additional Capital − Drawings

If the business makes a **loss**, the loss reduces capital.

Drawings are cash or goods taken from the business by the owner for personal use.

Simple Format

Statement of Financial Position as at 31 December 2026

Particulars	Amount
Non-current Assets	
Machinery	$40,000
Motor Vehicles	$20,000
Total Non-current Assets	**$60,000**
Current Assets	
Inventory	$15,000
Trade Receivables	$10,000
Bank	$5,000
Total Current Assets	**$30,000**
Total Assets	**$90,000**
Capital/Equity	$60,000
Non-current Liabilities	
Bank Loan	$20,000
Current Liabilities	
Trade Payables	$10,000
Total Equity and Liabilities	**$90,000**

The statement balances because:

Assets = Equity + Liabilities

$90,000 = $60,000 + $30,000

Difference Between Profit and Loss Statement and Statement of Financial Position

Profit & Loss Statement	Statement of Financial Position
Shows profit or loss	Shows financial position
Covers a period of time	Shows position at a specific date
Includes income and expenses	Includes assets, liabilities and equity
Determines net profit/loss	Shows what the business owns and owes

Key point to remember

Statement of Profit or Loss:
Income − Expenses = Profit/Loss

Statement of Financial Position:
Assets = Capital/Equity + Liabilities

Cash Flow

Cash flow refers to the **movement of cash and cash equivalents into and out of a business** during a particular period.

- **Cash inflow** → money coming **into** the business.
- **Cash outflow** → money going **out of** the business.

A business needs positive cash flow to meet its day-to-day financial obligations.

Cash Inflows

Cash inflows are amounts of money received by the business.

Examples:

- Cash sales
- Money received from customers/debtors
- Capital introduced by the owner
- Bank loans received
- Sale of assets
- Interest received

Cash Outflows

Cash outflows are amounts of money paid by the business.

Examples:

- Payments to suppliers
- Salaries and wages
- Rent
- Electricity
- Purchase of equipment
- Loan repayments
- Interest paid
- Tax paid
- Drawings by the owner

Three Main Types of Cash Flow

Cash flows are normally divided into **three activities**:

A. Operating Activities

These are cash flows from the **normal day-to-day activities** of the business.

Examples of inflows:

- Cash received from customers
- Cash received for services

Examples of outflows:

- Payments to suppliers
- Salaries
- Rent
- Utilities
- Tax

B. Investing Activities

These relate to the **purchase and sale of long-term assets and investments**.

Cash inflows:

- Sale of machinery
- Sale of vehicles
- Sale of property
- Income from certain investments

Cash outflows:

- Purchase of machinery
- Purchase of vehicles
- Purchase of buildings
- Purchase of investments

C. Financing Activities

These relate to **raising and repaying finance**.

Cash inflows:

- Capital introduced by the owner

- Bank loans received
- Shares issued

Cash outflows:

- Repayment of loans
- Drawings by the owner
- Dividends paid

Basic Cash Flow Formula

Net Cash Flow = Total Cash Inflows − Total Cash Outflows

For example:

Cash inflows = $50,000
Cash outflows = $40,000

Net Cash Flow = $50,000 − $40,000 = $10,000

This means the business experienced a **positive cash flow of $10,000**.

Positive and Negative Cash Flow

Positive cash flow:
Cash coming into the business is greater than cash going out.

Negative cash flow:
Cash going out of the business is greater than cash coming in.

A business can make a **profit but still have cash-flow problems**. For example, a business may make many credit sales but not yet receive the cash from customers.

Simple Cash Flow Statement

Particulars	Amount
Cash inflows	
Cash received from customers	$40,000
Loan received	$10,000
Total cash inflows	**$50,000**
Cash outflows	
Payments to suppliers	$20,000
Salaries	$8,000
Rent	$4,000
Equipment purchased	$5,000
Total cash outflows	**$37,000**
Net cash flow	**$13,000**

Why Cash Flow Is Important

Cash flow helps a business to:

- Pay employees and suppliers.
- Pay rent and other expenses.
- Repay loans.
- Purchase assets.
- Plan future spending.
- Avoid cash shortages.
- Determine whether the business has enough cash to operate.

Easy way to remember

Operating = Running the business
Investing = Buying and selling long-term assets
Financing = Getting and repaying money

Cash In − Cash Out = Net Cash Flow

Adjustments in Accounting – Basic Notes

Adjustments are changes made to the accounting records at the end of an accounting period to ensure that **income and expenses are recorded in the correct period**.

Adjustments are important when preparing the **Statement of Profit or Loss** and **Statement of Financial Position**.

Common Accounting Adjustments

A. Accrued Expenses

An **accrued expense** is an expense that has been incurred but **has not yet been paid**.

Example:

Electricity in the trial balance = $5,000
Electricity owing = $1,000

Adjusted electricity expense:

$5,000 + $1,000 = $6,000

- Add the accrual to the expense.
- Show the amount owing as a **current liability**.

Rule: Accrued expense → Add to expense.

B. Prepaid Expenses

A **prepaid expense** is an expense that has been **paid in advance** but relates to a future period.

Example:

Insurance paid = $8,000
Prepaid insurance = $2,000

Adjusted insurance expense:

$8,000 − $2,000 = $6,000

- Deduct the prepaid amount from the expense.
- Show the prepaid amount as a **current asset**.

Rule: Prepaid expense → Deduct from expense.

C. Depreciation

Depreciation is the decrease in the value of a non-current asset due to use, wear and tear, or the passage of time.

Example:

Equipment = $50,000
Depreciation = $5,000

The $5,000 depreciation is:

- An **expense** in the Statement of Profit or Loss.
- Deducted from the asset's carrying amount in the Statement of Financial Position.

Carrying amount = Cost − Accumulated depreciation

D. Closing Inventory

Closing inventory is goods that remain unsold at the end of the accounting period.

It is used when calculating cost of sales:

Cost of Sales = Opening Inventory + Purchases + Direct Expenses − Closing Inventory

Closing inventory is:

- Deducted when calculating **cost of sales**.
- Shown as a **current asset** in the Statement of Financial Position.

E. Bad Debts

A **bad debt** is money owed by a customer that the business does not expect to receive.

Example:

A customer owes $2,000 but is unable to pay.

The $2,000 is treated as a **bad debt expense**.

- Deduct from profit.
- Reduce trade receivables.

F. Accrued Income

Accrued income is income that has been earned but **has not yet been received**.

Example:

Interest received = $3,000
Interest earned but not received = $500

Adjusted interest income:

$3,000 + $500 = $3,500

The $500 is shown as a **current asset**.

Rule: Accrued income → Add to income.

G. Income Received in Advance

This is income that has been **received but has not yet been earned**.

Example:

Rent received = $10,000
Rent received in advance = $2,000

Adjusted rent income:

$10,000 − $2,000 = $8,000

The $2,000 is shown as a **current liability**.

Rule: Income received in advance → Deduct from income.

H. Drawings

Drawings are cash or goods taken from the business by the owner for personal use.

Drawings:

- Reduce the owner's **capital/equity**.
- Are **not a business expense**.

Example:

Opening capital = $30,000
Profit = $10,000
Drawings = $5,000

Closing capital:

$30,000 + $10,000 − $5,000 = $35,000

Quick Adjustment Rules

Adjustment	Profit or Loss	Statement of Financial Position
Accrued expense	Add to expense	Current liability
Prepaid expense	Deduct from expense	Current asset
Accrued income	Add to income	Current asset
Income received in advance	Deduct from income	Current liability
Depreciation	Expense	Reduces asset value
Bad debts	Expense	Reduces receivables
Closing inventory	Reduces cost of sales	Current asset
Drawings	Not an expense	Reduces capital

Easy memory trick

Expenses:

- **Accrued → ADD**
- **Prepaid → SUBTRACT**

Income:

- **Accrued → ADD**
- **Received in advance → SUBTRACT**

These adjustments make sure the financial statements show the **correct profit and the correct financial position** for the accounting period.

Budgeting and Cash Management – Basic Notes

1. Budgeting

A **budget** is a financial plan that estimates a business's **income and expenditure for a future period**.

It helps a business plan how money will be received and spent.

2. Importance of Budgeting

Budgeting helps a business to:

- Plan future income and expenses.
- Control spending.
- Avoid unnecessary expenses.
- Set financial targets.
- Identify possible cash shortages.

- Make better financial decisions.
- Measure actual performance against planned performance.

Types of Budgets

A. Sales Budget

Shows the expected **sales revenue** for a future period.

B. Purchases Budget

Shows the expected amount the business will spend on **purchasing goods or materials**.

C. Expense Budget

Estimates expenses such as:

- Rent
- Salaries
- Electricity
- Advertising
- Transport

D. Cash Budget

A **cash budget** estimates the expected **cash inflows and cash outflows** over a future period.

Basic formula:

Opening Cash Balance + Cash Inflows − Cash Outflows = Closing Cash Balance

Example

Particulars	Amount
Opening cash balance	$5,000
Add: Cash received	$15,000
Cash available	**$20,000**
Less: Cash payments	($12,000)
Closing cash balance	**$8,000**

Cash Management

Cash management is the process of **planning, monitoring and controlling the cash of a business** to ensure that enough cash is available when needed.

The aim is to have enough cash to pay expenses while avoiding unnecessary idle cash.

Importance of Cash Management

Good cash management helps a business to:

- Pay suppliers on time.
- Pay employees.
- Meet loan repayments.
- Pay bills and taxes.
- Avoid cash shortages.
- Take advantage of opportunities.
- Reduce the need for unnecessary borrowing.
- Maintain financial stability.

Ways of Improving Cash Management

A. Collect money from customers quickly - Encourage customers to pay on time and follow up overdue accounts.

B. Control expenses - Avoid unnecessary spending and compare prices before purchasing.

C. Manage inventory - Avoid holding too much stock because money can become tied up in inventory.

D. Negotiate payment terms - Where possible, negotiate reasonable payment periods with suppliers.

E. Prepare cash budgets - A cash budget helps identify periods when the business may have insufficient cash.

F. Keep emergency cash - Maintain a reasonable cash reserve for unexpected expenses.

Difference Between Budgeting and Cash Management

Budgeting	Cash Management
Planning future income and expenses	Managing actual cash
Focuses mainly on planning	Focuses on controlling cash
Helps set financial targets	Helps ensure cash is available
Can cover different areas of the business	Specifically focuses on cash and cash equivalents

Key formulas to remember

Budgeted Profit = Budgeted Income − Budgeted Expenses

Closing Cash = Opening Cash + Cash Inflows − Cash Outflows

Simple example

If a business expects:

- Cash sales = $20,000
- Collection from debtors = $10,000
- Expenses paid = $15,000
- Equipment purchased = $5,000

Then:

Cash Inflows = $20,000 + $10,000 = $30,000

Cash Outflows = $15,000 + $5,000 = $20,000

Net Cash Flow = $30,000 − $20,000 = $10,000

So the business has a **positive cash flow of $10,000** before considering the opening cash balance.

Managing Working Capital

Meaning of Working Capital: Working capital is the amount of money available to a business for its **day-to-day operations**.

The basic formula is:

Working Capital = Current Assets − Current Liabilities

Examples

Current Assets:

- Cash and bank
- Inventory
- Trade receivables/debtors
- Short-term investments
- Prepaid expenses

Current Liabilities:

- Trade payables/creditors
- Short-term loans
- Bank overdraft
- Accrued expenses
- Tax payable

Example of Working Capital

Suppose a business has:

- Cash = $10,000
- Inventory = $20,000
- Trade receivables = $15,000

Total current assets = **$45,000**

Current liabilities:

- Trade payables = $18,000
- Short-term loan = $7,000

Total current liabilities = **$25,000**

Therefore:

Working Capital = $45,000 − $25,000 = $20,000

The business has **$20,000 of working capital**.

Importance of Managing Working Capital

Good working capital management helps a business to:

- Pay its short-term debts on time.
- Pay employees and suppliers.
- Maintain sufficient inventory.

- Avoid cash-flow problems.
- Reduce unnecessary borrowing.
- Improve profitability.
- Keep the business operating smoothly.

Main Areas of Working Capital Management

A. Managing Cash

The business should maintain enough cash to meet daily expenses.

Good practices include:

- Preparing cash budgets.
- Monitoring cash inflows and outflows.
- Avoiding unnecessary spending.
- Keeping an emergency cash reserve.

B. Managing Inventory

Inventory should be kept at an appropriate level.

Too much inventory:

- Ties up cash.
- Increases storage costs.
- May become damaged or obsolete.

Too little inventory:

- Can lead to shortages.
- May cause lost sales.
- Can delay production.

The aim is to have **enough inventory without holding excessive amounts**.

C. Managing Trade Receivables

Trade receivables are customers who **owe money to the business**.

A business can improve collection by:

- Setting clear credit terms.
- Checking customers' creditworthiness.
- Sending invoices promptly.
- Following up overdue accounts.

- Offering appropriate discounts for early payment.

The faster customers pay, the faster cash becomes available.

D. Managing Trade Payables

Trade payables are amounts the business **owes to suppliers**.

A business should:

- Pay suppliers on time.
- Take advantage of agreed credit periods.
- Negotiate favourable payment terms.
- Avoid paying too early if it unnecessarily reduces available cash.

Working Capital Cycle

The **working capital cycle** is the time it takes for money invested in the business to return as cash.

A simple cycle is:

Cash → Inventory → Sales → Receivables → Cash

For example:

1. The business uses cash to buy goods.
2. The goods are held as inventory.
3. The goods are sold.
4. If sold on credit, the customer becomes a receivable.
5. The customer pays.
6. Cash returns to the business.

Ways to Improve Working Capital

A business can improve working capital by:

- Collecting debts from customers faster.
- Reducing unnecessary inventory.
- Negotiating longer credit periods with suppliers.
- Controlling operating expenses.
- Preparing cash budgets.
- Improving sales and cash collection.
- Avoiding excessive borrowing.
- Monitoring current assets and liabilities regularly.

Liquidity: **Liquidity** refers to the ability of a business to pay its **short-term obligations** when they become due.

A business with good liquidity can comfortably pay its current liabilities.

Current Ratio

One measure of liquidity is:

Current Ratio = Current Assets ÷ Current Liabilities

Example:

Current assets = $40,000
Current liabilities = $20,000

Current Ratio = $40,000 ÷ $20,000 = 2:1

This means the business has **$2 of current assets for every $1 of current liabilities**.

Key Points to Remember

Area	Main objective
Cash	Maintain enough cash for daily needs
Inventory	Avoid too much or too little stock
Receivables	Collect customer debts quickly
Payables	Manage supplier payments effectively
Liquidity	Ensure short-term debts can be paid

Easy formula

Working Capital = Current Assets − Current Liabilities

Good working capital management = Enough cash + Efficient inventory + Fast collection of debts + Effective management of supplier payments.

Break-Even Analysis

1. Meaning

Break-even analysis is used to determine the level of sales at which a business makes **neither a profit nor a loss**.

At the break-even point:

Total Revenue = Total Costs

2Important Terms

A. Fixed Costs

Costs that **do not change** with the level of production or sales, within a relevant range.

Examples:

- Rent
- Salaries
- Insurance
- Depreciation

B. Variable Costs

Costs that **change according to the level of production or sales**.

Examples:

- Raw materials
- Packaging
- Direct labour
- Sales commissions

C. Selling Price

The amount charged for **one unit of a product**.

D. Contribution

Contribution is the amount remaining from sales after variable costs have been deducted.

Contribution per unit = Selling Price per Unit − Variable Cost per Unit

Break-Even Point

The **break-even point (BEP)** is the number of units that must be sold to cover all costs.

Break-Even Point (units) = Fixed Costs ÷ Contribution per Unit

Example

A business has:

- Fixed costs = $20,000
- Selling price per unit = $50
- Variable cost per unit = $30

First calculate contribution:

Contribution = $50 − $30 = $20

Then:

BEP = $20,000 ÷ $20 = 1,000 units

The business must sell **1,000 units** to break even.

- Below 1,000 units → **Loss**
- At 1,000 units → **Break-even**
- Above 1,000 units → **Profit**

Break-Even Sales Value

Break-even can also be expressed in money.

Break-Even Sales = Break-Even Units × Selling Price per Unit

Using the example:

1,000 × $50 = $50,000

Therefore, break-even sales are **$50,000**.

Margin of Safety

The **margin of safety** shows how much sales can fall before the business reaches its break-even point.

Margin of Safety = Actual Sales − Break-Even Sales

For example:

Actual sales = $70,000
Break-even sales = $50,000

Margin of Safety = $70,000 − $50,000 = $20,000

The business can experience a **$20,000 decrease in sales** before reaching break-even.

Why Break-Even Analysis Is Important

It helps a business to:

- Determine the minimum sales needed to avoid a loss.
- Set sales targets.
- Make pricing decisions.
- Control costs.
- Plan production levels.
- Estimate potential profits.
- Assess the effect of changes in costs or selling prices.

Key Formulas to Remember

Contribution per Unit = Selling Price − Variable Cost

Break-Even Units = Fixed Costs ÷ Contribution per Unit

Break-Even Sales = Break-Even Units × Selling Price

Margin of Safety = Actual Sales − Break-Even Sales

Easy way to remember

Break-even = No Profit + No Loss

Contribution pays for Fixed Costs → anything left after that is Profit.

6.Introduction to Accounting Software and Spreadsheets

Accounting software and **spreadsheets** are important tools used by businesses to record, organize, analyze, and report financial information.

1. Accounting Software

Accounting software is a computer program designed to help businesses manage their financial activities. It can be used to record transactions, prepare invoices, track expenses, manage accounts payable and receivable, and produce financial reports.

Examples of accounting software include **QuickBooks, Sage, Xero, and Zoho Books**.

Common features include:

- Recording sales and purchases
- Managing cash and bank transactions

- Preparing invoices and receipts
- Tracking expenses
- Managing customers and suppliers
- Preparing financial statements
- Calculating taxes
- Generating financial reports

Advantages:

- Saves time and reduces manual work
- Improves accuracy
- Makes financial information easier to access
- Helps produce reports quickly
- Can automate repetitive accounting tasks

2. Spreadsheets

A spreadsheet is a computer application that organizes information into **rows and columns**. Spreadsheets such as **Microsoft Excel** and **Google Sheets** can be used for accounting calculations and financial analysis.

In accounting, spreadsheets can be used to:

- Prepare budgets
- Record transactions
- Calculate totals and balances
- Prepare payroll calculations
- Analyze financial data
- Create charts and graphs
- Prepare simple financial reports

Spreadsheets use **formulas and functions** to perform calculations. For example, a business can use `=SUM(B2:B10)` to calculate the total of several amounts.

3. Accounting Software vs. Spreadsheets

Accounting Software	Spreadsheets
Designed specifically for accounting	General-purpose calculation tool
Automates many accounting processes	Usually requires more manual setup
Provides specialized financial reports	Reports must often be created manually
Better suited to larger or growing businesses	Useful for small businesses and simple tasks
Often includes security and user-access controls	Security depends largely on how the spreadsheet is managed

Accounting software and spreadsheets both help businesses manage financial information. **Accounting software** is more specialized and can automate many accounting activities, while **spreadsheets** provide flexibility for calculations, budgeting, and analysis. Understanding how to use both tools is an important skill for students and people working in accounting and finance.

Spreadsheet Basics for Accounting

Spreadsheets are widely used in accounting to **record, calculate, organize, and analyze financial information**. Programs such as Microsoft Excel and Google Sheets allow accountants to perform calculations and prepare financial reports efficiently.

Understanding a Spreadsheet

A spreadsheet is made up of:

- **Workbook** – the entire spreadsheet file.
- **Worksheet** – an individual page within a workbook.
- **Rows** – horizontal lines identified by numbers (1, 2, 3, etc.).
- **Columns** – vertical lines identified by letters (A, B, C, etc.).
- **Cell** – the intersection of a row and a column, such as **A1**.
- **Cell range** – a group of cells, such as **A1:A10**.

Entering Accounting Data

Accounting information can be entered into columns such as:

Date	Description	Debit	Credit	Balance
01/09/2026	Cash received	1,000		1,000
02/09/2026	Office supplies		200	800
03/09/2026	Sales revenue	500		1,300

It is important to enter data **consistently and accurately**.

Basic Formulas

Formulas allow spreadsheets to perform calculations automatically.

Examples:

- `=B2+C2` — adds two cells
- `=B2-C2` — subtracts one cell from another
- `=B2*C2` — multiplication
- `=B2/C2` — division
- `=SUM(B2:B10)` — adds a range of cells
- `=AVERAGE(B2:B10)` — calculates the average

In accounting, formulas can be used to calculate **totals, balances, expenses, profits, and budgets**.

Formatting Financial Information

Proper formatting makes accounting spreadsheets easier to read. Common formatting includes:

- Currency or accounting format
- Two decimal places
- Dates
- Bold headings
- Borders
- Appropriate column widths
- Negative numbers displayed clearly

Sorting and Filtering

Sorting arranges information, for example from the oldest transaction to the newest.

Filtering displays only information that meets a particular condition. For example, you can filter a transaction list to show only **expenses**.

Basic Accounting Uses

Spreadsheets can be used to prepare:

- Cash books
- Sales and purchases records
- Budgets
- Expense schedules
- Payroll calculations
- Bank reconciliations
- Trial balances
- Simple income statements
- Financial analysis

Important Spreadsheet Practices

When using spreadsheets for accounting:

1. Enter transactions accurately.
2. Use clear headings.
3. Keep dates and numbers in consistent formats.
4. Check formulas regularly.
5. Keep a backup of important files.
6. Protect sensitive financial information.

7. Avoid unnecessary manual calculations.
8. Review totals to make sure **debits and credits balance**.

In summary: Spreadsheet skills are essential for accounting because they help users organize financial data, perform calculations, identify errors, and prepare useful financial information quickly and efficiently.

Absolutely. Here are **simple bookkeeping templates** you can create in Excel or Google Sheets. They are suitable for a small business or for learning basic bookkeeping.

1. Cash Book Template

Date	Description	Receipt (Income)	Payment (Expense)	Balance
01/09/2026	Opening balance	1,000		1,000
02/09/2026	Cash sales	500		1,500
03/09/2026	Stationery		150	1,350
04/09/2026	Transport		100	1,250

Balance formula:

```
=Previous Balance + Receipt - Payment
```

2. Sales Journal

Date	Invoice No.	Customer	Description	Amount
01/09/2026	INV001	Customer A	Goods sold	1,000
03/09/2026	INV002	Customer B	Goods sold	750
			Total Sales	**=SUM(E2:E3)**

3. Purchases/Expenses Journal

Date	Reference	Supplier	Description	Amount
02/09/2026	EXP001	Supplier A	Stationery	200
04/09/2026	EXP002	Supplier B	Transport	150
			Total Expenses	**=SUM(E2:E3)**

4. Accounts Receivable Template

Used to track money **customers owe the business**.

Date	Customer	Invoice	Amount	Amount Paid	Balance Due
01/09/2026	Customer A	INV001	1,000	500	500
03/09/2026	Customer B	INV002	750	0	750

Balance Due formula:

```
=Amount - Amount Paid
```

5. Accounts Payable Template

Used to track money **the business owes suppliers**.

Date	Supplier	Invoice	Amount	Amount Paid	Balance Due
02/09/2026	Supplier A	SUP001	800	300	500
05/09/2026	Supplier B	SUP002	600	0	600

6. Simple Profit & Loss Template

Item	Amount
Sales Revenue	10,000
Less: Cost of Goods Sold	(4,000)
Gross Profit	**6,000**
Rent	(1,000)
Transport	(500)
Salaries	(2,000)
Utilities	(300)
Total Expenses	**(3,800)**
Net Profit	**2,200**

Basic formula:

Net Profit = Revenue − Cost of Goods Sold − Expenses

If you want, I can also create a **complete beginner bookkeeping workbook with 5–6 linked Excel-style sheets**, including a **cash book, sales journal, purchases journal, ledger, trial balance, and income statement**.

Overview of Small Business Accounting Software

Small business accounting software is a computer program designed to help small businesses **record, organize, process, and report financial information**. It reduces the need for manual bookkeeping and helps business owners keep accurate financial records.

Main Functions

Most small business accounting software provides tools for:

- **Recording transactions** – sales, purchases, receipts, and payments.
- **Invoicing** – creating and sending invoices to customers.
- **Expense tracking** – recording and categorizing business expenses.
- **Accounts receivable** – tracking money owed by customers.
- **Accounts payable** – tracking money the business owes to suppliers.
- **Bank reconciliation** – comparing accounting records with bank statements.

- **Payroll** – calculating wages and maintaining employee payment records, where supported.
- **Financial reporting** – producing reports such as the income statement, balance sheet, and cash-flow statement.
- **Tax preparation** – organizing financial information needed for tax reporting.

Examples of Accounting Software

Common examples include:

- QuickBooks — widely used by small businesses for bookkeeping, invoicing, expenses, and reporting.
- Sage — provides accounting and financial management solutions for businesses of different sizes.
- Xero — cloud-based accounting software with invoicing, bank reconciliation, and reporting features.
- Zoho — provides accounting and other business management tools.

Benefits to Small Businesses

Accounting software can:

Save time: Many calculations and repetitive bookkeeping tasks can be automated.

Improve accuracy: Automatic calculations reduce some common mathematical and data-entry errors.

Provide financial information quickly: Business owners can generate reports without manually preparing them.

Improve record keeping: Transactions can be stored and organized electronically.

Support decision-making: Reports help owners understand sales, expenses, profits, cash flow, and outstanding debts.

Improve cash-flow management: Tracking customer payments and supplier bills makes it easier to see when money is coming in and going out.

Choosing Accounting Software

When selecting software, a small business should consider:

Factor	What to Consider
Cost	Is the price affordable for the business?
Ease of use	Can employees learn it quickly?
Features	Does it provide the required accounting functions?

Scalability	Can it support the business as it grows?
Security	How are financial records protected?
Reports	Can it produce the reports the business needs?
Bank integration	Can transactions be imported or synchronized with the bank?
Support	Is customer or technical support available?
Tax requirements	Does it support the business's local tax and reporting requirements?

Accounting Software vs. Manual Bookkeeping

Manual Bookkeeping	Accounting Software
Records are often maintained on paper or basic spreadsheets	Records are stored electronically
Calculations are mostly manual	Many calculations are automated
Reports take more time to prepare	Reports can be generated quickly
Greater risk of calculation errors	Reduces some calculation errors
Suitable for very simple operations	Better suited to businesses with more transactions

Small business accounting software provides an efficient way to manage financial records. It can automate bookkeeping tasks, produce financial reports, track money owed and paid, and help business owners make informed decisions. However, **software does not replace accounting knowledge**—users still need to understand basic accounting principles and check that transactions have been entered correctly.

Digital Record Bookkeeping

Digital record bookkeeping is the process of **recording, storing, organizing, and managing financial transactions electronically** instead of using paper-based accounting records.

It is commonly done using **accounting software, spreadsheets, cloud-based systems, or electronic databases**.

Examples of Digital Records

A business may keep digital records of:

- Sales invoices
- Purchase invoices
- Receipts
- Bank transactions
- Customer payments
- Supplier payments
- Expenses
- Payroll records
- Tax records

- Assets and liabilities
- Financial statements

How Digital Bookkeeping Works

A basic process is:

Transaction occurs → Information is entered → Transaction is classified → Records are updated → Reports are generated → Records are backed up

For example, if a business purchases stationery for P500:

- The transaction is recorded electronically.
- **Stationery expense** is increased by P500.
- **Cash/bank** is reduced by P500.
- The transaction becomes part of the business's financial records.

Advantages of Digital Bookkeeping

Speed: Transactions can be recorded and processed quickly.

Accuracy: Automated calculations reduce the risk of mathematical errors.

Easy access: Records can be searched and retrieved quickly.

Better organization: Large amounts of financial information can be categorized and stored systematically.

Automatic reporting: Software can generate reports such as income statements and balance sheets.

Backups: Digital records can be backed up to prevent loss.

Reduced paperwork: Businesses can store documents electronically instead of maintaining large paper files.

Risks and Challenges

Digital bookkeeping also has some risks:

- Data can be lost if there are no backups.
- Unauthorized people may access financial information.
- Computer viruses or system failures can affect records.
- Incorrect data entry can still produce incorrect reports.
- Users need basic computer and accounting skills.
- Software and cloud services may involve subscription costs.

Good Practices

For effective digital bookkeeping:

1. **Record transactions promptly.**
2. Keep supporting documents such as invoices and receipts.
3. Use consistent account categories.
4. Reconcile bank records regularly.
5. Back up financial data regularly.
6. Use strong passwords and access controls.
7. Keep software updated.
8. Review records for errors.
9. Retain records according to applicable legal and tax requirements.
10. Restrict access to sensitive financial information.

Digital vs. Paper Bookkeeping

Digital Bookkeeping	Paper Bookkeeping
Electronic records	Physical records
Fast to search	Takes longer to locate records
Calculations can be automated	Calculations are mostly manual
Easy to create reports	Reports require more manual work
Requires electronic security	Requires physical security
Can be backed up electronically	Physical copies can be lost or damaged

Digital record bookkeeping makes it easier for businesses to **maintain accurate, organized, and accessible financial records**. It is particularly useful for small businesses because accounting software and spreadsheets can automate many routine bookkeeping activities. However, businesses must protect their digital records through **regular backups, secure access, and careful data management**.

8.Financial Statement Interpretation

Financial statement interpretation is the process of examining a business's financial statements to understand its **financial performance, financial position, profitability, liquidity, and overall financial health**.

The main financial statements used are the **income statement, balance sheet, and cash flow statement**.

Importance of Financial Statement Interpretation

Financial statement interpretation helps:

- **Owners** evaluate business performance.

- **Managers** make better financial decisions.
- **Investors** assess potential returns and risks.
- **Lenders** determine whether a business can repay loans.
- **Government and tax authorities** assess financial information where required.

Interpreting the Financial Performance of a Small Business: Case Study

Case Study: ABC Clothing Store

ABC Clothing Store is a small business that sells clothes. The owner wants to determine whether the business is performing well financially.

The following information is available for two years:

Financial Information	2025	2026
Sales	P200,000	P250,000
Cost of Sales	P120,000	P140,000
Gross Profit	P80,000	P110,000
Operating Expenses	P50,000	P65,000
Net Profit	**P30,000**	**P45,000**

1. Sales Performance

Sales increased from **P200,000 to P250,000**.

Increase:

P250,000 − P200,000 = P50,000

Percentage increase:

P50,000 ÷ P200,000 × 100 = 25%

Interpretation: Sales increased by **25%**, indicating that the business sold more goods or generated more revenue in 2026.

2. Gross Profit Performance

Gross profit increased from **P80,000 to P110,000**.

The gross profit margin in 2025 was:

P80,000 ÷ P200,000 × 100 = 40%

In 2026:

P110,000 ÷ P250,000 × 100 = 44%

Interpretation: The gross profit margin increased from **40% to 44%**. This suggests that the business improved its ability to generate profit from its sales, possibly through better pricing, purchasing at lower costs, or selling more profitable products.

3. Operating Expenses

Operating expenses increased from **P50,000 to P65,000**, an increase of **P15,000**.

Although expenses increased, sales increased by a larger amount.

Interpretation: The increase in expenses should be monitored, but it has not prevented the business from increasing its overall profit.

4. Net Profit

Net profit increased from **P30,000 to P45,000**.

Increase:

P45,000 − P30,000 = P15,000

Percentage increase:

P15,000 ÷ P30,000 × 100 = 50%

Interpretation: Net profit increased by **50%**, which is a strong improvement.

5. Net Profit Margin

2025:

P30,000 ÷ P200,000 × 100 = 15%

2026:

P45,000 ÷ P250,000 × 100 = 18%

Interpretation: The net profit margin improved from **15% to 18%**. This means the business is keeping more profit from each P1 of sales.

Overall Assessment

ABC Clothing Store's financial performance **improved in 2026**.

The main positive indicators are:

- Sales increased by **25%**.
- Gross profit increased by **37.5%**.
- Gross profit margin increased from **40% to 44%**.
- Net profit increased by **50%**.
- Net profit margin increased from **15% to 18%**.

Although operating expenses increased, the business's revenue and profit increased at a stronger rate.

Based on the available information, **ABC Clothing Store is financially improving**. The increase in sales, gross profit, and net profit indicates stronger performance. The business should continue monitoring operating expenses and maintain good control over its cost of sales. It should also investigate what caused the improvement in sales and margins so that successful strategies can be maintained.

Profitability

Profitability refers to a business's ability to **generate profit from the revenue and resources it uses**. When interpreting financial statements, profitability helps determine whether the business is operating efficiently and earning enough profit to remain successful.

1. Gross Profit

Gross Profit = Sales Revenue − Cost of Sales

For example:

Item	Amount
Sales	P100,000
Cost of Sales	P60,000
Gross Profit	**P40,000**

The business made a gross profit of **P40,000**.

2. Gross Profit Margin

The gross profit margin shows how much gross profit the business earns from each P1 of sales.

Gross Profit Margin = (Gross Profit ÷ Sales) × 100

Using the example:

(P40,000 ÷ P100,000) × 100 = 40%

This means the business earns **40% gross profit on its sales**.

3. Net Profit

Net Profit = Gross Profit − Operating Expenses

If operating expenses are P25,000:

P40,000 − P25,000 = P15,000

The business therefore makes a **net profit of P15,000**.

4. Net Profit Margin

The net profit margin shows how much profit remains after all expenses.

Net Profit Margin = (Net Profit ÷ Sales) × 100

(P15,000 ÷ P100,000) × 100 = 15%

This means the business keeps **P15 of profit for every P100 of sales**.

5. Interpreting Profitability

When interpreting profitability, look at:

- **Increasing profit** – may indicate improved sales, pricing, or cost control.
- **Decreasing profit** – may indicate falling sales or increasing expenses.
- **Increasing gross profit margin** – may indicate better pricing or lower cost of sales.
- **Decreasing gross profit margin** – may indicate higher purchase costs or reduced selling prices.
- **Increasing net profit margin** – suggests improved overall profitability.
- **Decreasing net profit margin** – suggests that expenses may be growing faster than revenue.

6. Example of Interpretation

Suppose a business has:

- Sales = **P200,000**
- Gross profit = **P80,000**
- Net profit = **P20,000**

Gross profit margin:

P80,000 ÷ P200,000 × 100 = 40%

Net profit margin:

P20,000 ÷ P200,000 × 100 = 10%

Interpretation: The business generates a 40% gross profit margin, but after operating and other expenses, only 10% of sales remains as net profit. This could suggest that the business should examine its operating expenses and look for ways to improve cost control.

Profitability analysis helps determine **how effectively a business converts sales into profit**. The most common measures are **gross profit, gross profit margin, net profit, and net profit margin**. Comparing these measures over several periods gives a clearer picture of whether the business's financial performance is improving or declining.

Liquidity

Liquidity is the ability of a business to **meet its short-term financial obligations when they become due**. In other words, it shows whether a business has enough short-term assets or cash to pay its short-term debts.

Liquidity is mainly assessed using information from the **balance sheet** and cash-flow information.

Current Ratio

The **current ratio** compares current assets with current liabilities.

Formula:

Current Ratio = Current Assets ÷ Current Liabilities

For example, if a business has:

- Current assets = **P100,000**
- Current liabilities = **P50,000**

Then:

P100,000 ÷ P50,000 = 2:1

Interpretation: The business has P2 of current assets for every P1 of short-term liabilities. This generally indicates a reasonable ability to meet short-term obligations, although the appropriate level varies by industry.

Quick Ratio

The **quick ratio** measures the ability to pay short-term debts using the more liquid current assets. Inventory is normally excluded because it may take time to sell.

Formula:

Quick Ratio = (Current Assets − Inventory) ÷ Current Liabilities

For example:

- Current assets = P100,000
- Inventory = P30,000
- Current liabilities = P50,000

(P100,000 − P30,000) ÷ P50,000 = 1.4:1

Interpretation: The business has P1.40 of relatively liquid assets for every P1 of current liabilities.

Working Capital

Working capital shows the amount left after current liabilities are deducted from current assets.

Formula:

Working Capital = Current Assets − Current Liabilities

Example:

P100,000 − P50,000 = P50,000

Interpretation: The business has **P50,000 of positive working capital**, which can help it finance its day-to-day operations.

Cash Position

Cash is the most liquid asset. When interpreting liquidity, consider:

- Cash available in the bank and on hand
- Cash received from customers
- Cash paid to suppliers
- Loan repayments
- Other regular operating payments

A business can show a profit but still have **poor liquidity** if too much money is tied up in inventory or customers who have not yet paid.

Interpreting Liquidity Changes

Situation	Possible Interpretation
Current ratio increases	Short-term ability to pay debts may be improving
Current ratio decreases	Liquidity may be weakening
Cash balance increases	Business may have greater ability to meet immediate payments
Inventory increases significantly	Cash may be tied up in unsold goods
Receivables increase significantly	Customers may be taking longer to pay
Current liabilities increase	More short-term obligations need to be managed

Example of Interpretation

Suppose a small business has:

- Current assets = **P120,000**
- Inventory = **P40,000**
- Current liabilities = **P60,000**

Current ratio:

P120,000 ÷ P60,000 = **2:1**

Quick ratio:

(P120,000 − P40,000) ÷ P60,000 = **1.33:1**

Interpretation: The business appears to have a reasonable short-term financial position because its current assets are twice its current liabilities. However, after excluding inventory, it has P1.33 of quick assets for every P1 of current liabilities. Management should continue monitoring cash, inventory, and customer payments to ensure that sufficient funds are available when debts become due.

Liquidity analysis helps determine whether a business can **pay its short-term debts and continue normal operations**. The **current ratio, quick ratio, working capital, and cash position** are useful measures. Good liquidity is important, but excessively high liquidity can also mean that resources are not being used efficiently.

Basic Financial Ratios

Financial ratios are calculations used to analyze and interpret a business's financial performance and position. They help business owners, managers, investors, and lenders understand areas such as **profitability, liquidity, efficiency, and solvency**.

Profitability Ratios

These measure the business's ability to generate profit.

Gross Profit Margin

$$\text{Gross profit margin} = \frac{\text{Gross profit}}{\text{Sale}} \times 100$$

It shows how much gross profit is earned from sales.

Example:
Gross profit = P40,000
Sales = P100,000

Gross Profit Margin = 40%

Net Profit Margin

$$\text{Net Profit Margin} = \frac{\text{Net Profit}}{\text{Sales}} \times 100$$

It shows how much profit remains after expenses.

Example:
Net profit = P15,000
Sales = P100,000

Net Profit Margin = 15%

Liquidity Ratios

These measure the ability of a business to meet its **short-term obligations**.

Current Ratio

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

Example:

Current assets = P100,000
Current liabilities = P50,000

Current Ratio = 2:1

This means the business has P2 of current assets for every P1 of current liabilities.

Quick Ratio

$$\text{Quick Ratio} = \frac{\text{Current Assets – Inventory}}{\text{Current Liabilities}}$$

It provides a stricter measure of short-term liquidity because inventory is excluded.

Solvency Ratios

Solvency ratios measure the business's ability to meet its **long-term financial obligations**.

Debt-to-Equity Ratio

$$\text{Debt-to-Equity Ratio} = \frac{\text{Total Liabilities}}{\text{Owner's Equity}}$$

A higher ratio generally indicates greater reliance on borrowed funds and potentially greater financial risk.

Example:

Total liabilities = P80,000
Owner's equity = P100,000

Debt-to-Equity Ratio = 0.8:1

Efficiency Ratios

These measure how effectively a business uses its resources.

Inventory Turnover

$$\text{Inventory Turnover} = \frac{\text{Cost of Sales}}{\text{Average Inventory}}$$

It indicates how many times inventory is sold and replaced during a period.

Receivables Collection Period

$$\text{Collection Period} = \frac{\text{Trade Receivables}}{\text{Credit Sales}} \times 365$$

It estimates the average number of days customers take to pay.

Summary Table

Ratio	Formula	Measures
Gross Profit Margin	Gross Profit ÷ Sales × 100	Gross profitability
Net Profit Margin	Net Profit ÷ Sales × 100	Overall profitability
Current Ratio	Current Assets ÷ Current Liabilities	Short-term liquidity
Quick Ratio	(Current Assets − Inventory) ÷ Current Liabilities	Immediate liquidity
Debt-to-Equity	Total Liabilities ÷ Equity	Financial risk/solvency
Inventory Turnover	Cost of Sales ÷ Average Inventory	Inventory efficiency
Receivables Collection Period	Receivables ÷ Credit Sales × 365	Speed of customer payments

Why Financial Ratios Are Important

Financial ratios help a small business:

- Compare performance from one year to another.
- Identify financial strengths and weaknesses.
- Monitor profitability.
- Assess its ability to pay debts.
- Control inventory and customer debts.
- Support financial decision-making.

Important: A ratio should not normally be interpreted in isolation. It is more useful when compared with **previous years, budgets, industry benchmarks, or similar businesses**.

Decision-Making Using Financial Data

Decision-making using financial data is the process of using accounting records, financial statements, budgets, and financial ratios to make informed business decisions. For a small business, good financial information helps the owner decide **where to spend money, what to sell, whether to borrow, and how to improve profitability**.

1. Sources of Financial Data

A business can obtain useful information from:

- Income statements
- Balance sheets
- Cash-flow statements
- Sales records
- Expense records
- Budgets
- Cash books
- Financial ratios
- Bank statements
- Accounts receivable and payable records

Examples of Business Decisions

A. Pricing Decisions

Financial data can help determine whether the selling price is sufficient to cover costs and generate profit.

Example:
If a product costs P60 to purchase and is sold for P70, the business may have a small profit margin. The owner may consider increasing the selling price or finding a cheaper supplier.

B. Cost Control

By examining expenses, a business can identify areas where costs are too high.

For example, if transport expenses have increased significantly, management could compare suppliers, negotiate better rates, or find alternative delivery methods.

C. Cash-Flow Decisions

Cash-flow information helps a business determine whether it will have enough money to pay its bills.

If cash is low, the owner might:

- Delay non-essential purchases.
- Follow up on outstanding customer accounts.
- Reduce unnecessary expenses.
- Negotiate longer payment terms with suppliers.

D. Investment Decisions

Financial information can help determine whether purchasing equipment or expanding the business is affordable.

The owner should consider:

- Purchase cost
- Expected benefits
- Available cash
- Expected increase in revenue
- Maintenance costs
- Possible financing costs

E. Borrowing Decisions

Financial statements help determine whether the business can afford a loan.

Before borrowing, the owner should consider:

- Amount required
- Interest rate
- Monthly repayments
- Existing debts
- Expected cash flow

Using Financial Ratios

Financial ratios provide useful indicators for decision-making.

Ratio	Decision Supported
Gross Profit Margin	Pricing and cost-of-sales decisions
Net Profit Margin	Expense and profitability decisions
Current Ratio	Short-term borrowing and payment decisions
Quick Ratio	Immediate cash/liquidity decisions
Debt-to-Equity Ratio	Borrowing and financing decisions
Inventory Turnover	Purchasing and inventory decisions
Receivables Collection Period	Customer credit and collection decisions

Example: Using Data to Make a Decision

A small shop has the following results:

Item	2025	2026
Sales	P200,000	P240,000
Gross Profit	P80,000	P84,000
Net Profit	P30,000	P25,000

Sales increased by **20%**, but net profit decreased from **P30,000 to P25,000**.

Interpretation: Although the business is selling more, it is making less net profit. This could indicate that operating expenses have increased or that the cost of goods has risen.

Possible decision: Management should investigate expenses and cost of sales before attempting further expansion.

Steps in Financial Decision-Making

A simple process is:

Collect data → Analyze data → Identify the problem → Consider alternatives → Make a decision → Implement the decision → Review the results

Financial data provides evidence for making better business decisions. Instead of relying only on assumptions, a business owner can use **profits, cash flow, expenses, ratios, and financial trends** to identify problems and opportunities. However, financial information should be combined with other factors such as customer demand, competition, and economic conditions when making important decisions.