

Ordinary Level Notes

ACCOUNTS

BOOKS OF ORIGINAL ENTRIES

These are the books of first entry. The transactions are first recorded in these books before being entered in the ledger books. These books are also called as books of Prime entry or Subsidiary books. They are six in number.

1. **Purchases Journal (or Purchases Book)** used to record all credit purchases of goods. It is written up from invoice.
2. **Sales Journal (or Sales Book)** is used to record all the credit sales of goods. It is written up from the invoice.
3. **Sales Returns Journal (or Return Inwards Book):** It is used to record all returns inwards. It is written up from the copies of the credit notes send to customers.
4. **Purchases Return Journal (or Returns Outwards Book):** It is used to record all purchases returns. It is written up from the credit notes received from the suppliers.
5. **Cash Book:** It is used to record all receipts and payments of cash and cheques. It is been given the ruling in such a way that it acts both as a book of original entry and ledger account.
6. **General Journal (or Journal):** This book is used to record all those items or transactions that cannot be recorded in any other book of original entry like
 - i. Correction of errors
 - ii. Opening entries
 - iii. Purchase or Sale of Assets on Credit etc.

BOOKS OF FINAL ENTRY

LEDGER BOOKS

Ledger books are the books of final entry which contains the various accounts to which the entries made in the Books of Original entry are transferred.

DIVISION OF LEDGER BOOK

1. **Purchases Ledger Book:** This book contains all the accounts of Suppliers.
2. **Sales Ledger Book:** This book contains all the accounts of Customers.
3. **General Ledger Book:** This book contains all the rest of the accounts like, Assets Accounts, expenses account, losses account, etc., and also the Total purchases account, Total sales account, Total Sales returns account, Purchases Returns account. It is also called as Nominal ledger.

Advantages Of Dividing The Ledger:

1. It facilitates division of labour in the maintenance of ledger.

2. It becomes easy to locate errors in ledger accounts.
3. It helps the ledger clerks to complete their respective work in time with perfection.
4. It becomes easy to refer to any particular account.

BUSINESS DOCUMENTS

1. Invoice: Whenever there is a credit sale, the selling business will send a document to buyer showing full details of the goods sold. This document is called as Invoice. It is known to the buyer as a "Purchases invoice". And to the seller as a "Sales invoice".

Note: Entries in the sales book and the purchases Book are made with the help of an invoice.

2. Debit Note: This document is prepared by the purchaser and it is sent to the supplier to report him if any faulty goods are been sent or shortages or overcharges are been made.

3. Credit Note: When goods are returned, or there has been an over-charge, a supplier may issue a credit note to the buyer. This reduces the amount owed by the customer.

Note: This document is used to make the entries in both the purchases returns Book and the sales returns Book.

4. Statement of Account: This document is prepared and sent to the customer by the supplier. It is issued to remind the customer about his due amount. It is basically a summary of the transaction of a customer during the month like sales made, Returns received and Cash received

CASH BOOK

Cash book is the only book of original entry which is given ruling in such a way that it could act at the same time as a book of original entry and as a ledger account.

1. Trade Discount: It is an allowance or deduction given by the supplier to the retailer on the catalogue price or list price.

- i. It is given to encourage him to buy in bulk.
- ii. It is given so that retailer could make some profit.

Note: It is not recorded in the books either by the seller or the buyer.

2. Cash Discount: It is an allowance or deduction given by the receiver of cash to the payer of cash for prompt payment.

It is of two types discount allowed and discount received.

- i. It is given to encourage the payer to pay on or before the due date.
- ii. **Note:** This discount is recorded in the Cash Book. Discount allowed is recorded at the debit side and discount received on the credit side.
- iii. **Note:** Discount columns are never balanced. It is just totalled.

iv. Note: Every month the Total's of discount allowed column is transferred to debit side of Discount allowed account in General ledger and the total of discount-received column is transferred

to the credit side of Discount received account in the General ledger.

3. Contra Entry: When a transaction effects both cash and bank accounts at the same time, such entries are called as Contra Entries.

PETTY CASH BOOK

Imprest System: It is a system where a reimbursement is made of the total amount paid in a period or it can also be called as a system where petty cashier begin each new accounting period with the same amount of petty cash.

Advantages Of Petty Cash Book:

1. The number of entries in the main cashbook is reduced.
2. The main cashier's burden is reduced.
3. The chances of mistakes in recording is minimised.
4. Posting become more easy with the Total's Analysis Columns.

Advantages of using Analysis columns:

It let us know the money spent on each different nature of small expense. The double entry for each analysis column by transferring the totals of the analysis columns to their respective accounts which are available in the General ledger.

TRIAL BALANCE

Trial balance may be defined as a statement or a list of all ledger account balances taken from various ledger books on a particular date to check the arithmetical accuracy.

Objectives Or Advantages Of Trial Balance

1. It checks the arithmetical accuracy of ledger accounts.
2. It gives material for preparing Final accounts.
3. To have a proof that the double entry of each transaction is made.

Important Points To Prepare Trial Balance:

1. It should be remembered that all the Assets and expenses accounts are always debited.
2. All liabilities and incomes are always credited.
3. All provisions are always credited.
4. Closing stock is never taken in trial balance. (it is to be shown out of the trial balance).

CAPITAL AND REVENUE EXPENDITURE

I. Capital Expenses:

1. All expenses for acquiring the fixed Assets like, Machinery, Building, Furniture etc;
2. All expenses incidental to the acquisition of Fixed Assets.
Examples: Transporting of Machinery and Fixing and Registration of Land and Building or Business.
3. All expenses to improve the existing Assets to increase Profit earning capacity.
4. Major repairs and renewals to increase the efficiency of the business.

II. Revenue Expenses:

1. All regular expenses which are incurred in the daily course of business.
Example: Wages, Salaries, Repairs, Administration expenses.
2. Purchase of Raw Material and goods.
3. Losses through bad debts and depreciation.
4. Interest paid on borrowed funds. Etc.

III. Capital Income/ Capital Receipt:

The receipt of money, which arise not from regular source of income

Examples: i. Capital bought in to the business.

- ii. Income through bank loan.
- iii. Income through sale of fixed Assets.

IV. Revenue Incomes/Revenue Receipts:

The receipt of money, which arises in regular course of business.

1. Sales proceeds of business
2. Commission or Interest received
3. Discount received. etc.

FINAL ACCOUNTS

I. Trading Account:

As the name itself implies this account deals with trading i.e. buying and selling of goods. This account shows the Gross Profit earned or loss incurred on the goods sold.

II. Profit and Loss Account:

As the name implies this account deals with profits and losses, gains and expenses. This shows the calculation of Final Profit or loss of a business.

III. Balance Sheet:

“This is not an account” but it is a statement of financial position of a business on a certain date.

ADJUSTMENTS

Accruals:

It is the due, which has to be paid for the benefit or service enjoyed during an accounting period. It can also be called as due, an outstanding or an arrears.

Prepayments:

It is a payment for the benefit which has not yet been enjoyed.

Bad Debts:

It is a debt which is deemed to be irrecoverable.

Bad Debts Recovered:

It is a debt which was previously written off and is now paid to us.

Provision For Bad Debts: It is a saving from profit for a possible future loss that may or may not occur.

DEPARTMENTAL ACCOUNTS

Departmental Accounts are the accounts that through light not only on the trading result of the business as a whole but also on the trading result of each department individually.

Reasons Or Advantages Of Making Departmental Accounts:

OR

Reasons To Know The Result Of Each Department:

1. It lets us know the expenses and incomes of each department clearly at one place.
2. It helps us to compare the results i.e. G.P or N.P of one department with the other.
3. It helps us to formulate policies in order to develop the business on proper lines.
4. To decide whether to drop or start a new department.
5. It helps us to reward the departmental managers.

Things to be considered before closing a department:

1. Consider all possible means to improve the department.
2. The methods used to apportion the expenses should be studied to see if they are in fact the fairest methods.
3. The effect of the closure of one department on the other department should be investigated.
4. The attractive uses of the space becoming available need to be considered.
5. Non-Monetary factors such as staff morale and the effect on supplies and customers faith is also to be considered.

MANUFACTURING ACCOUNT

Manufacturing businesses prepare manufacturing account in addition to the usual final Accounts. Manufacturing account shows how much does it cost the business to manufacture the goods in a financial year.

Cost Of Raw Material Consumed:

It is the value of Raw material used in production. It consist of net purchases of Raw Material, carriage on raw material opening stock of raw material closing stock of Raw material.

Prime Cost:

It is the basic cost of manufacturing the goods. It consists of direct raw material direct labour and direct expenses.

Production Cost: It is the total cost of manufacturing the goods. It consist of prime cost plus factory expenses, and it is after any adjustment for work-in-progress.

Work-in-progress:

These are the goods which are partly made, but which are not yet completed are known as work-in-progress.

PARTNERSHIP BUSINESS

A partnership business is an Association of two or more persons formed with the object of sharing profits arising out of business.

Advantages

1. Huge Capital: More capital can be secured than in the case of a sole trading business.
2. Wise decision: It enjoys the benefit of combined ability.
3. Introduction of Division of labour: Partnership enjoys all advantages of Division of labour. Duties can be assigned to different partners according to their qualifications and specialization.
4. Greater borrowing capacity:
5. Diffusion of risk.
6. More contact with the customers.

Disadvantages

1. Unlimited liability
2. Delay in decision.
3. Difference in opinions.
4. No perpetual existence.
5. Secrets cannot be maintained.

Accounts of Partnership Firm

Partnership firms prepare the following final accounts:

1. Trading A/c
2. Profit & Loss A/c
3. Profit & Loss Appropriation A/c
4. Current Accounts
5. Partners Capital Accounts
6. Balance sheet.

1) Trading and 2) Profit & Loss A/c is prepared in the usual form.

Profit and Loss Appropriation Account

This account is a continuation of the profit and loss account and it is prepared to show the appropriation of profits and losses among the partners.

Current Accounts

In a partnership business amount withdrawn by a partner is generally accounted for separately by debiting the current accounts of the partner who withdraws the amount from the business.

Capital Accounts

In a partnership business there are as many capital accounts as are partners. A partner's contribution to the business is called his capital. It always shows a credit balance which is always fixed. It has changes only when extra capital is bought in to the business or a new partner enters into the business.

Goodwill

Goodwill means the good reputation of the business which enables it to enjoy regular flow of customer. It is an intangible fixed Asset.

INCOMPLETE RECORDS/SINGLE ENTRY SYSTEM

It is a system which is defined as any system which is not exactly the double entry system. It is developed by certain small business people.

Computation of Profit:

Net Profit:

(Closing Capital + Drawings) - (Opening Capital + Additional Capital)

Mark-up: gross profit calculation as a percentage of cost price

$$\text{Mark-up} = \frac{\text{Profit}}{\text{Cost price}} \times 100$$

Margin: The calculation of Gross Profit as a percentage of Selling price.

$$\text{Margin} = \frac{\text{Profit}}{\text{Selling price}} \times 100$$

CONTROL ACCOUNT

Control accounts are sometimes known as total accounts. A control account act as a summary of the ledger which it controls. There are two control accounts.

1. Sales ledger control account / Total debtors account
2. Purchases ledger control account / Total creditors account.

1. Sales Ledger Control Account: It resembles the account of an individual debtor. It is an account recording in total the transactions affecting all the debtors.

Sources Of Information For Sales Ledger Control Account:

Sales	Sales Book
Cash and Cheques received	Cash Book
Dishonoured Cheques	Cash Book
Discount allowed	Cash Book
Bad debts	Journal

2. Purchases Ledger Control Account:

It resembles the account of an individual creditor. It records the transactions effecting all the creditors.

Sources Of Information For This Account

Purchases	Purchase Book
Purchases Returns	Purchase Returns Book
Cash and cheque paid	Cash Book
Discount received	Cash Book
Cash refund's from creditors	Cash Book

Note: Sometimes it can happen that there is a small opening Debit balance on a purchases ledger control account in addition to the usual credit balance. It happens when the business has overpaid a creditor, or has returned the goods after paying the due amount.

Note: Sometimes sales ledger control account too also has small opening credit balance b/d on a sales ledger control account, in addition to the usual opening debit balance. It happens when a debtor has over paid his account or has returned goods after paying his account or due amount.

Advantages Of Control Account:

1. It helps in locating errors.

2. It helps in checking the arithmetical accuracy of the ledger it controls.
3. It gives us readymade figures for Total debtors and Total creditors on a certain date.
4. Fraud is made more difficult by the use of control account.

BANK RECONCILIATION STATEMENT

The purpose of bank reconciliation statement is to explain any difference between the bank balance appearing on the bank statement provided by the bank..

Reasons For Difference:

Sometimes it so happen that some entries are made in cash book but they are not recorded in the bank. Like.

1. Cheques deposited but not credited in the Bank.
2. Cheques issued but are not presented in the bank.

Sometimes it so happens that some entries are made in bank statement but they are not recorded in cashbook. Like.

1. Direct deposits in the bank by our customers
2. Direct collections made by the bank on our behalf
3. Direct payments made by bank
4. Interest allowed by the bank and charged by the bank
5. Dishonoured cheques.

Therefore a statement is prepared to reconcile this difference. This statement is called as "Bank Reconciliation statement".

Methods Of Preparing Bank Reconciliation Statement:

Step I: Compare the bank column of the cashbook with the bank statement. Tick all those receipts and payments which can be found in both the cash book and the bank statement, when this has been done, there remains some unticked items in cash book and the bank statement.

Step II: Make Adjusted cash book by taking into account all the existing cash book entries plus the unticked bank statement items into the cash book and calculate the new balance. This balance is considered as the true bank balance of the business and this figure will be shown in the balance sheet as bank balance.

Step III: Prepare Bank Reconciliation Statement.

Note: When we prepare B.R.S. we do not look at the entries of bank statement. We just take into account the entries which are in Cash Book but not in Bank Statement.

1. Start with the balance shown in the Adjusted cash book..

2. Add the entries that are credited in the cash book but not debited on the bank statement. (unpresented cheques)

3. Deduct any items that are debited in the cash book but are not credited in the bank statement.

The resulting figure should be equal to Bank Statement balance.

Reasons For Preparing bank Reconciliation Statement:

1. To ensure that the cash book entries are complete.
2. To discover bank errors.
3. To discover errors in cash book.
4. To check Fraud and embezzlement.
5. To discover dishonoured cheques.

DEPRECIATION

“Depreciation is the gradual and permanent decrease in the value of an asset from any cause.”

Causes Of Depreciation:

1. Some Assets get worn or torn out due to its constant use in production.
2. Some Assets get decreased in their value with the passage of time.
3. Some Assets may meet an accident and therefore it may get depreciated in its value.

Reasons For Providing Depreciation:

1. To reveal the correct profit or loss of a business.
2. To show correct financial position of a business.
3. To make provision for replacement of an asset.

Methods Of Providing Depreciation:

There are three methods of providing depreciation

1. Straight Line Method: This is also termed as Fixed instalment method. Under this method Fixed Percentage on original cost is written off the asset every year. The amount of depreciation is calculated as follows.

$$\text{Annual Depreciation} = \frac{\text{Cost of the Asset} - \text{Scrape Value}}{\text{No. of years in use}}$$
$$\text{Rate of Depreciation} = \frac{\text{Annual Depreciation}}{\text{Cost of Asset} - \text{Scrape Value}} \times 100$$

2. Reducing Balance Method: This method is also known as Diminishing balance method or written down value method. Under this method depreciation is charged at a fixed rate on the reduced balance every year.

3. Revaluation Method: Sometimes it is not possible to maintain detailed records of certain types of fixed Assets, such as very small items of equipment packing cases and hand tools. In such case the revaluation method is used. Under this method the assets are revalued at the end of each year and this value is compared with the value at the beginning of the period. The difference is treated as depreciation.

Formula = Value of Assets beginning + Purchases of Assets during the period - value of Asset at the end.

Provision For Depreciation: It means saving a part of profit for the replacement of the Asset.

Prudence Concept: According to this concept all the losses incurred or expected to be incurred are to be taken into account but not all anticipated profits to be taken into consideration while finding the profit. To apply this concept that we take depreciation in the profit and loss account.

CONCEPTS OF ACCOUNTING

These are the basic assumptions or rules to be followed while recording and presenting accounting information.

1. Business Entity Concept: This concept explains that the business is distinct from the proprietor. Thus, the transactions of business only are to be recorded in the books of business.

2. Duality Concept: According to this concept every transaction has two aspects i.e. the benefit receiving aspect and benefit giving aspect. These two aspects are to be recorded in the books of accounts.

3. Money Measurement Concept: According to this concept only those transactions which are expressed in money terms are to be recorded in accounting books.

4. Going Concern Concept: This concept assumes that the business has a perpetual succession or continued existence.

5. Realisation Concept: This concept speaks about recording of only those transactions which are actually realised. For example Sale or Profit on sales will be taken into account only when money is realised i.e. either cash is received or legal ownership is transferred.

6. Matching Concept: It is referred to as matching of expenses against incomes. It means that all incomes and expenses relating to the financial period to which the accounts relate should be taken into account without regard to the date of receipts or payment.

7. Consistency Concept: This Concept says that the Accounting practices should not change or must remain unchanged over a period of several years.

8. Prudence Concept: According to this concept all the losses incurred or expected to be incurred are to be taken into account but not all anticipated profits to be taken into consideration while finding the profit. Similarly while finding the value of closing stock, least of the two values i.e. Market price or Cost price is to be taken into account.
“Lower of the cost or net realisable value”.

ACCOUNTS OF CLUBS AND SOCIETIES

Receipts and Payments Accounts: It is a summary of cashbook, i.e. all cash and bank transactions during a given period of time. It starts with an opening balance and debited with all items of receipts irrespective of whether they are of capital nature or revenue nature and whether they are pertaining to the current period or not. It is credited with all payments made during the year. Those payments may be of Capital or Revenue nature whether pertaining to the current year or not

Note: This account does not take into account outstandings and prepayments.

Income and Expenditure Account: Income and expenditure account is a nominal account. It is debited with all expenses and losses and credited with all incomes and gains. This account serves exactly the same purpose as the profit and loss account in a trading concern.

Accumulated Fund: It is the surplus accumulated with in the organisation.

Difference Between The Terms Used In

Trading Business

1. Cash Book
2. Profit and Loss Account
3. Net Profit
4. Net Loss
5. Capital

Non-Trading Business

- Receipts and payments account
- Income and expenditure account
- Surplus
- Deficit
- Accumulated fund

Sources Of Income To Club:

1. Donations
2. Subscriptions
3. Entrance fees
4. Sales of Old Assets

CORRECTION OF ERRORS

Type of error Nature of error Examples

1. Error of Omission
 2. Error of Commission
 3. Error of Principle
 4. Error or Original Entry
- A transaction is completely omitted from the books.
- A purchase or sale is entered in the wrong creditor or debtor account
- An item is entered in a completely wrong class of account.
- A wrong amount is entered in a book
- A purchase of goods is not recorded because the purchase invoice has been mislaid

A sale of goods to J Tyler is posted to J Taylor's account
A purchase of a fixed asset is posted to the purchases account.
A sales clerk in a hurry reads an www.studyguide.pk
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5. Compensating Errors I

6. Compensating Errors II

7. Reversal of Entries

8. Entries Done twice

of original entry and this figure is then used for posting to the ledger.

By coincidence, an error on the debit side cancels out a separate and independent error of the same amount on the credit side.

Two errors compensate for each other on the same side.

The debit entry is written on the credit side and the credit entry is written on the debit side.

The double entry is correctly completed but two debits and two credits are entered

invoice of £10 000 as £1 000 and enters the latter figure in the sales day book

The wages account is overcast by £200 and the creditors are also overstated by £200.

Advertising is understated by £50 and electricity is overstated by £50.

A cash sale is debited to the sales account and credited to the cash account

A purchase of goods by cheque is debited twice to the purchases account and credited twice to the bank account

Effect of Errors on Profit or Loss

Some errors affect the profit while others do not. This distinction does not always coincide with whether or not the trial balance balances.

Errors affecting Profit or Loss

These errors affect those accounts which are included in the Trading and Profit and Loss Account eg purchases, sales, expenses etc. We must ask the following questions:

1) Does the error affect the gross profit, the net profit or both?

(a) Errors which affect items that go into the trading account affect gross profit and net profit to the same extent and in the same direction. Such items are sales, purchases, returns, stock, carriage inwards etc.

(b) Errors which affect items that are entered in the profit and loss section of the account, i.e. operating expenses, affect only net profit. Purchases of fixed assets affect profit only indirectly through provisions for depreciation.

- (a) If sales are overstated or purchases understated, both gross profit and net profit are too high and must be reduced by the relevant amount. The same applies if sales returns are understated or purchases returns overstated.
- (b) If sales are understated or purchases overstated, both gross profit and net profit are too low and must be increased by the relevant amount. The same applies if sales returns are overstated or purchases returns understated.
- (c) If miscellaneous receipts are overstated or if expenses are understated, gross profit is not affected but net profit will be high and must be reduced.
- (d) If miscellaneous receipts are understated or if expenses are overstated, again gross profit is not affected but net profit is too low and must be increased.
- (e) If capital expenditure is wrongly treated as revenue expenditure, eg if the purchase of a fixed asset is treated as an expense, then net profit will be too low and must be increased. The opposite applies if revenue expenditure is treated as capital expenditure.

3) Does the errors that affect items in the balance sheet affect profit as well? The answer is only those that were adjusted after the trial balance was prepared. Errors affecting fixed assets, current assets and liabilities do not normally affect profit but if one of these items has changed as a result of an adjustment, then profit is affected. For example:

- (a) If the closing stock has been overvalued, the stock figure in the balance sheet is too high and so are the gross profit and the net profit. The opposite is true of a closing stock which is undervalued. Remember that closing stock adds on to gross profit and opening stock takes away from it.
- (b) If an accrued or prepaid expense is the wrong amount, both profit and the item in the balance sheet are wrong. If an amount owing is overstated or a prepayment is understated, profit is too low and must be increased, and vice versa.
- (c) The opposite to (b) applies in the case of accrued or prepaid receipts. Estimating the effects of errors can be confusing and you must keep a clear mind. Think how the original figure has affected profit and then try to see in which direction the error is affecting the profit.

ANALYSIS AND INTERPRETATION

1. What is the other name of Gross Profit Ratio?

Gross profit as a percentage of Turnover.

2. What is the formula to find out the GP%?

$$\frac{\text{GP}}{\text{Sales}} \times 100$$

3. What would be the reason for the increase in GP%? Give 2 reasons.

- (a) Selling goods, at higher prices.
- (b) Buying the goods at cheaper prices.

4. What would be the reason for decrease in the GP%? Give 2 reasons.

- (a) Selling goods at higher prices.
- (b) Offering Trade discounts.
- (c) Not passing on increase prices.
- (d) Holding seasonal sales.

5. What is the formula to find out NP Ratio?

$$\frac{\text{NP}}{\text{Sales}} \times 100;$$

6. What is the other name of NP Ratio?

NP as a % of sales

7. What is meant by liquidity?

It is the ability of the business to convert its assets into cash.

8. What is meant by working capital?

It is the money required to meet its every day expenses.

9. What does current Ratio measure?

It measures the ability of the business to meet its current liability as they fall due.

10. What is the standard current Ratio for a business?

Somewhere between 1.5 - 2:1.

11. What are the effects of not having enough working capital?

- (i) Problems in meeting debts as they fall due.
- (ii) Inability to take advantage of cash discount.
- (iii) Difficulty in obtaining further supplies.
- (iv) Inability to take advantage of business opportunity as they arise.

12. Quote 5 ways of improving working capital.

- (i) Introduction of further capital.
- (ii) Obtaining long-term loan.
- (iii) Reducing owners drawings.
- (iv) Selling out useless fixed assets.

13. What is the other name of Quick ratio?

Acid test Ratio

14. What is the formula to find out Quick Ratio?

$$\frac{\text{CA} - \text{stock}}{\text{Current Liabilities}}$$

CL

15. What is the standard quick ratio?

1:1

16. What is the formula to calculate stock turnover ratio?

$$\frac{\text{Cost of goods sold}}{\text{Average stock}}$$

17. In what way knowing the rate of stock turnover will be useful to the businessmen.

- (i) For stock replacement.
- (ii) For comparison.
- (iii) For corrective action.
- (iv) For identifying causes of changes.

18. What are the other names of debtors ratios?

Debtors Ratio/ Sales Ratio.

19. Give 4 ways of improving the collection period from debtors.

- (i) Offer cash discount.
- (ii) Charge interest on over dues.
- (iii) Refuse further supplies.
- (iv) Send regular reminder.

20. Give four ways of reducing the risk of bad debts.

- (i) Obtain reference from new customers.
- (ii) Fix a limit for each credit customer.
- (iii) Follow up over dues promptly.
- (iv) Refuse further supplies until old dues are paid.

21. Give two problem of inter-firm comparison.

- 1. All businesses are not same in all sense.
- 2. Different businesses follow different accounting policies.
- 3. One business may not be of the same size like the other.
- 4. Location of the business may not be at the same place.
- 5. They might have started at different dates.

22. Give four users of accounting information.

- 1. owner.

2. bank manager

3. business manager.

4. creditor

23. What are the limitations of ratio analysis?

Answer:

Accounting statements and ratio analysis provide valuable information about the business's performance but it's important to remember, however that they do have limitations. The comparison with other firms or previous years should be undertaken with caution for the following reasons:

- (i) Difference in the type of stock which affects the rate of stock turnover and the gross profit margin.
- (ii) Difference in the firm's policy because some firms are selling on cash and on credit terms. Others do not use the same policy.
- (iii) Difference in experience because some firms may not operate profitably in their early years of trading but this should not necessarily be the case expected in future years.
- (iv) Difference in management: Because small firms such as a sole trader are not expected to use an efficient managers as well as large
- (v) Difference in location: because income and tastes and perhaps government policies may vary from one area to another, which will affect the performance of the firm.
- (vi) Different accounting periods: because different firms are not expected to start their trading activities at the same date.
- (vii) Difference in capital employed because some firms may have enough capital employed to finance purchases of premises and machinery while others do not and forced to pay more expenses.
- (viii) Difference in accounting policies such as the application of the accounting concepts and methods of depreciation.