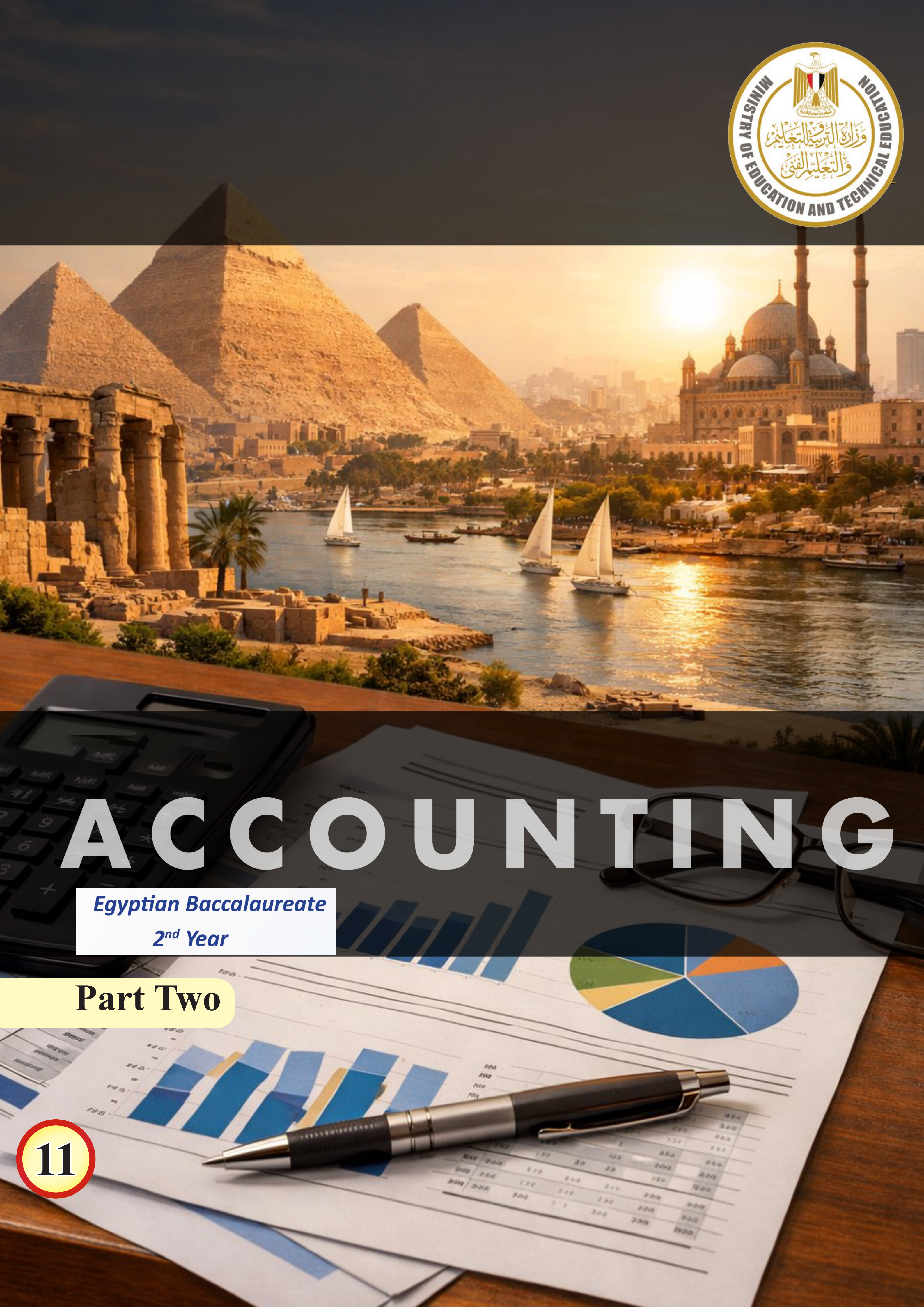

MINISTRY OF EDUCATION AND TECHNICAL EDUCATION

وزارة التربية والتعليم والتعليم الفني

ACCOUNTING

Egyptian Baccalaureate
2nd Year

Part Two

11

Accounting

Egyptian Baccalaureate

2^{nd} Year

The International Baccalaureate™

has reviewed the pedagogical and assessment approaches underpinning this textbook.

Ministry of Education and Technical Education

New Administrative Capital

Cairo, Egypt

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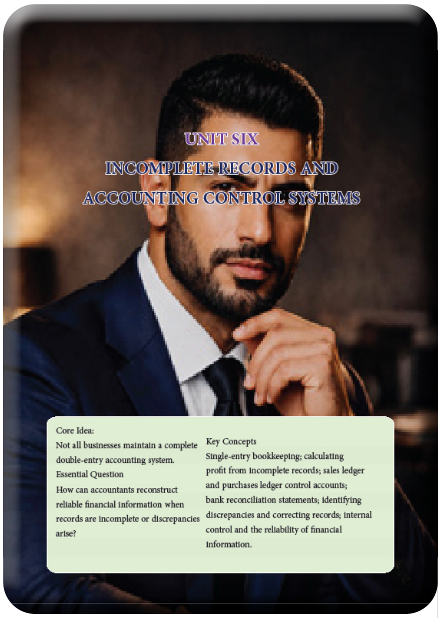
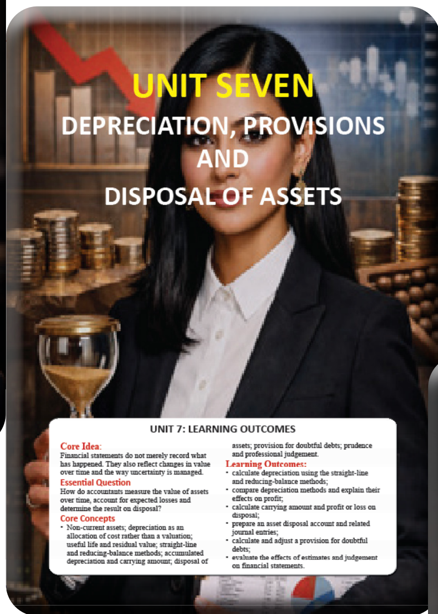
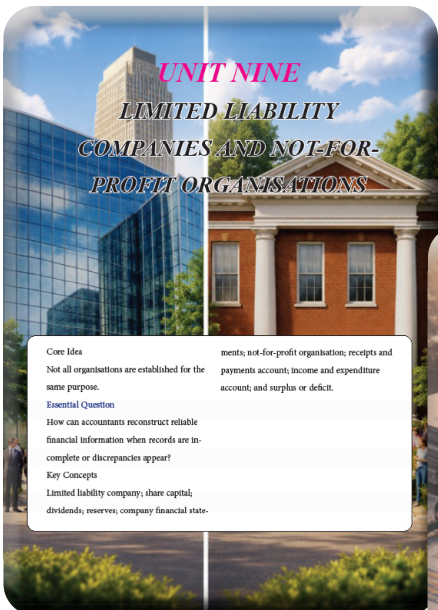
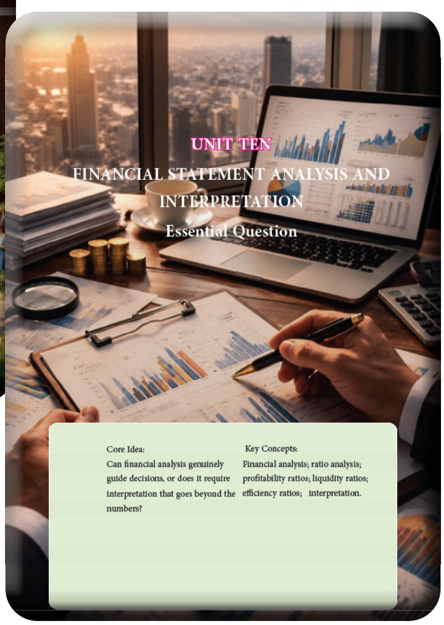








UNIT SIX

INCOMPLETE RECORDS AND ACCOUNTING CONTROL SYSTEMS

Core Idea:

Not all businesses maintain a complete double-entry accounting system.

Essential Question

How can accountants reconstruct reliable financial information when records are incomplete or discrepancies arise?

Key Concepts

Single-entry bookkeeping; calculating profit from incomplete records; sales ledger and purchases ledger control accounts; bank reconciliation statements; identifying discrepancies and correcting records; internal control and the reliability of financial information.

The Unit's Core Idea

Not every business keeps a complete double-entry accounting system. When records are incomplete, accountants must reconstruct financial information from the available evidence and control procedures. Control accounts for customers and suppliers, together with bank reconciliation statements, help ensure accuracy, accountability and internal control. They also help businesses detect misstatements caused by error or fraud

What are incomplete accounting records?

Case Study: Missing Records at Samir's Workshop

Samir owns a small workshop that repairs agricultural equipment. For years, he managed the business using simple notes in a notebook. He recorded cash received from customers and cash paid to suppliers, but did not maintain a complete double-entry system.

At the end of the year, Samir wanted to know whether his business had made a profit or a loss. Several problems emerged: some customer receipts had been recorded and others lost; purchases from suppliers appeared in different notebooks; the bank statement showed charges that Samir had not recorded; and several cheques issued to suppliers had not yet been presented to the bank.

The accountant explained that the missing information could still be reconstructed. By comparing opening and closing capital, preparing control accounts and completing a bank reconciliation, he could rebuild the business's financial position

Case Study: Conclusion

Samir realised that accounting is not limited to recording transactions. It also involves detecting misstatements, verifying records and maintaining financial control. Available evidence may not replace a complete accounting system, but it can help an accountant develop a reasonable and supportable financial picture.

CHECK YOUR UNDERSTANDING

Why are bank reconciliations important to the accuracy of financial information?

Understanding Incomplete Records

Not every business maintains an integrated accounting system. Many small businesses record only selected transactions. They may record cash received and paid without keeping detailed records of credit transactions, inventory, suppliers or expenses. This is often called a single-entry system. Such records normally focus on cash receipts and payments, while other accounts are missing or incomplete. As a result, there may not be enough information to prepare financial statements directly.

Records are incomplete when a business does not apply the double-entry system in full. A cash book, sales records and purchase invoices may exist, while sales and purchases ledgers, inventory records or complete expense accounts may be absent. The accountant must then use the available information to reconstruct the financial position

Basis of Comparison	Single-entry System	Double-entry System
Records maintained	Limited or partial	Complete and systematic
Recording transactions	Usually focuses on cash	Two entries for each transaction
Checking accuracy	More difficult	Supported by a trial balance
Financial statements	Require reconstruction	Prepared regularly
Reliability	Low to moderate	Relatively high

Why is the double-entry system more reliable than the single-entry system?

CHECK YOUR UNDERSTANDING

Name two accounting records that may be missing from an incomplete accounting system

Why Businesses Use Single-entry Records

A small business may keep incomplete records because the owner has limited accounting knowledge, the business is small and informal, or the owner wants a simple way to monitor cash. A professional accounting system may also appear costly. However, incomplete records create difficulties when the true financial performance of the business must be measured.

Example

Ali operates a small repair workshop. He records cash received from customers and cash paid for supplies, but does not keep records of credit sales or detailed expense accounts. At the end of the year, the accountant must reconstruct the available information to determine profit or loss.

CORE POINT

When accounting records are incomplete, the accountant uses the available information to rebuild the business's financial picture.

Why might a small business use single-entry records instead of a complete double-entry system?

Reconstructing Profit

Why are drawings added back when profit is calculated?

Profit can be calculated even when a business has not maintained complete records because profit is linked to the change in the owner's capital over time. If the owner's wealth invested in the business increases, the business may have made a profit; if it decreases, the business may have incurred a loss. Drawings and additional capital must also be considered.

- Opening capital: the owner's investment at the beginning of the period.
- Closing capital: the owner's investment at the end of the period.
- Drawings: money or assets withdrawn by the owner for personal use.
- Additional capital: further investment introduced by the owner during the period.

Closing Capital Equation

Closing capital = Opening capital + Additional capital + Profit – Loss – Drawings

remember

Any variable from the previous equation can be calculated if the other variables are known.

CHECK YOUR UNDERSTANDING

Which items increase or decrease closing capital?

What does an increase in capital usually indicate?

Calculating Capital and Profit

Capital = Assets – Liabilities

On 1 January: cash 5,000 EGP; inventory 10,000 EGP; equipment 15,000 EGP; suppliers 6,000 EGP.

Opening capital = (5,000 + 10,000 + 15,000) – 6,000 = 24,000.

On 31 December: cash 8,000 EGP; inventory 9,000 EGP; equipment 15,000 EGP; suppliers 7,000 EGP.

Closing capital = (8,000 + 9,000 + 15,000) – 7,000 = 25,000.

Drawings were 4,000 and additional capital was 2,000.

Profit = 25,000 – 24,000 + 4,000 – 2,000 = 3,000.

Core Idea

Profit or loss can be calculated from the change in the owner's capital even when complete records are unavailable.

Remember

remember

1. Opening capital = Opening assets – Opening liabilities.
2. Closing capital = Closing assets – Closing liabilities.
3. The difference between closing capital and opening capital is adjusted for additional capital and drawings in order to calculate net profit or loss.

CHECK YOUR UNDERSTANDING

What equation is used to calculate profit from incomplete records?

Practice: Reconstructing Profit

Exercise 1

Opening balances: cash 6,000 EGP; inventory 8,000 EGP; equipment 12,000 EGP; suppliers 5,000 EGP. Closing balances: cash 9,000 EGP; inventory 7,000 EGP; equipment 12,000 EGP; suppliers 6,000 EGP. Drawings were 3,000 EGP and additional capital was 2,000 EGP. Calculate opening capital, closing capital and profit for the year.

Exercise 2

Opening capital was 30,000 EGP, closing capital 42,000 EGP, drawings 5,000 EGP and additional capital 4,000 EGP. Calculate profit for the year.

Control Accounts

A double-entry system records many credit transactions in the individual accounts of customers and suppliers. Errors may occur through omission, recording an incorrect amount or posting to the wrong account. Businesses therefore use control accounts.

A control account is a summary account in the general ledger. It shows the total of a group of individual ledger balances and is used to check the accuracy of those records. If the control-account balance does not agree with the total of the individual accounts, an error probably exists

Sales Ledger Control Account

This account summarises customer accounts arising from credit sales. It includes opening receivables, credit sales, cash received, discounts allowed, sales returns, bad debts and the closing balance

Purchases Ledger Control Account

This account summarises supplier accounts arising from credit purchases. It includes opening payables, credit purchases, cash paid, discounts received, purchase returns and the closing balance..

CHECK YOUR UNDERSTANDING

What is the purpose of a control account?

Structure of a Control Account

Control accounts follow the same double-entry format as other ledger accounts.

Example data for the sales ledger control account: opening customer balance 5,000 EGP; **credit sales 12,000** EGP; **cash received 8,000** EGP; **discount allowed 1,000** EGP; **sales returns 2,000** EGP.

Debit	Amount	Credit	Amount
Balance brought down	5,000	Cash received	8,000
Credit sales	12,000	Discount allowed	1,000
		Sales returns	2,000
		Balance carried down	6,000
Total	17,000	Total	17,000

The closing balance of 6,000 represents the total amount owed by customers at the end of the period.

Why might a control-account balance differ from the total of the individual accounts?

What does the closing balance of the sales ledger control account represent?

Practice: Control Accounts

Exercise 1

Opening customer balance 4,000 EGP; credit sales 10,000 EGP; cash received 7,000 EGP; discount allowed 500 EGP; sales returns 1,500 EGP. Prepare the sales ledger control account and determine the closing balance.

Exercise 2

Opening supplier balance 6,000 EGP; credit purchases 14,000 EGP; cash paid 9,000 EGP; discount received 1,000 EGP; purchase returns 2,000. Prepare the purchases ledger control account.

Exercise 3

A business had opening capital of 50,000 EGP, drawings of 4,000 EGP and net profit of 20,000 EGP.

1.What was closing capital?

A. 60,000 B. 56,000 C. 65,000 D. 66,000

2. The amount of increase in closing capital:

A. 1,200 B. 1,400 C. 1,600 D. 1,800

3. The increase percentage in closing capital:

A. 23% B. 32% C. 33% D. 22%

Bank Reconciliation and Financial Control

A business records its cash transactions in the cash book, while the bank records transactions relating to the business in the bank statement. The two records should agree, but differences may arise because a transaction has been recorded in one record but not the other, has been recorded at a different time, or has been recorded incorrectly.

A bank reconciliation statement compares the adjusted cash-book balance with the bank-statement balance and explains the differences.

- Unpresented cheques: cheques issued by the business but not yet processed by the bank.
- Deposits in transit: amounts recorded in the cash book but not yet credited by the bank.
- Bank charges: fees deducted by the bank but not yet recorded by the business.
- Direct debits or standing orders: payments made automatically by the bank.

What is an unpresented cheque?

FORMATIVE ASSESSMENT

Why must the cash book be updated before a bank reconciliation statement is prepared?

Preparing a Bank Reconciliation Statement

The business records its cash transactions in the cash book, while the bank records the transactions in the bank statement.

Step 1: Update the Cash Book

Before reconciliation, update the cash book for bank charges, direct debits, interest, dishonoured cheques and errors affecting the business's records. If the balance before adjustment is 5,000 EGP, bank charges are 200 EGP and a direct debit is 800, the adjusted balance is 4,000 EGP.

Step 2: Prepare the Reconciliation

Assume deposits in transit are 2,000 EGP and unpresented cheques are 1,500 EGP.

Item	Amount
Adjusted cash-book balance	4,000
Less: deposits in transit	2,000
Add: unpresented cheques	(1,500)
Balance per bank statement	3,500

Basic Idea:

A bank reconciliation statement does not correct errors; rather, it explains the difference between two correct balances.

Question:

How do you explain the difference in the cash balance after updating according to the company's books compared to the cash balance according to the bank statement?

Answer:

This could be due to:

1) Reasons related to the company, such as forgetting to record a certain transaction or not recording a cash sales invoice.

2) Reasons related to the bank, such as recording bank interest that the company was unaware of.

Unsolved practical exercise

Case Study: Reconstructing Karim's Records

Karim owns a small trading business with incomplete records. The cash-book balance before adjustment is 6,000 EGP. The bank statement shows bank charges of 300 EGP and a direct debit of 700 EGP. There are also unpresented cheques of 1,200 EGP and deposits in transit of 1,800 EGP.

Financial Position	Assets	Liabilities
Opening	30,000	10,000
Closing	38,000	12,000

Drawings were 5,000 and additional capital was 3,000

1. Update the cash book balance.

2. Prepare the bank reconciliation memo.

3. Calculate the opening and closing capital.

4. Calculate the period's profit.

5. Explain the importance of bank reconciliation for financial control.

When may closing capital equal opening capital, and when will the two amounts differ?

CHECK YOUR UNDERSTANDING

Practical Solved Example:

Ashraf owns a retail shop that maintains incomplete records.

The following data is available regarding the shop:

Unadjusted cash balance: 18,000 EGP

Bank statement includes:

Bank charges: 900 EGP

Direct debit / Direct deduction: 2,100 EGP

Additional data:

Unpresented cheques: 3,600 EGP

Deposits in transit: 5,400 EGP

The financial center was as follows:

Financial Position	Assets	Liabilities
Opening	90,000	30,000
Closing	114,000	36,000

Drawings were 25,000 and additional capital was 16,000

Solution

Required:

Adjust the cash book Adjusted cash book balance

1. Adjusting the Cash Book

Item	Amount
Balance	18,000
Less: bank charges	(900)
Less: direct debit	(2,100)
Adjusted balance	15,000

2. Bank Reconciliation Statement

Item	Amount
Adjusted cash-book balance	15,000
Less: deposits in transit	5,400
Add: unpresented cheques	(3,600)
Balance per bank statement	13,200

3. Capital:

Opening capital = 90,000 – 30,000 = 60,000 EGP.

Closing capital = 114,000 – 36,000 = 78,000 EGP.

4. Profit for the Period

Profit = 78,000 – 60,000 + 25,000 – 16,000 = 27,000 EGP.

Justify and Reasoning with Evidence

Financial records may be incomplete, missing or inconsistent. Nevertheless, accountants produce reconstructed profit figures, capital values, control accounts and reconciled balances. These results may appear orderly and balanced, but they depend on limited evidence, reconstructed figures, assumptions and professional judgment.

Question:

When financial records are incomplete, to what extent should reconstructed accounting information be regarded as reliable?

Answer Guidelines:

What's required is not just stating its usefulness, but evaluating how reliable it is as a faithful representation of financial performance. It relies on partial records, estimates, assumptions, and accounting methods. Profit is not observed directly, but reconstructed from changes in capital. Monitoring accounts depend on totals that may be incomplete, and the bank reconciliation explains differences but does not eliminate all uncertainty. Two accountants may reach slightly different results using the same incomplete data. Additionally, don't forget that referring back to the previous comparison between the single-entry and double-entry systems allows relying on: the method of comparing capital; opening and closing capital; withdrawals and additional capital; monitoring accounts; bank reconciliation; internal control; the difference between accuracy and reliability; error detection; and financial verification. It can be said that accounting methods provide a sufficient degree of reliability, or that the lack of data limits the accuracy of the results. Both positions are acceptable if based on disciplined, logical, and justified reasoning.

Justify and Reasoning with Evidence Writing Framework:

A strong response should explain the recalculation of profit, evaluate the reliability of the methods used, discuss the limitations of missing data and the role of control accounts and reconciliations, present a counter-argument, and reach a balanced, justified conclusion. The essay must analyze rather than merely describe, and evaluate rather than merely summarize.

Section	Purpose	Guiding Question
Introduction	Define the issue and reliability	What is the problem?
Argument 1	Explain why the information may be reliable	Which methods support confidence?
Argument 2	Explain limitations and risks	What follows from missing records?
Evaluation	Compare both sides	Which argument is stronger, and why?
Conclusion	Give a balanced judgment	To what extent can the information be trusted?

Article rating scale

the total mark: 20

Essay Marking Rubric

Criterion	Excellent (4)	Good (3)	Developing (2)	Limited (1)
Conceptual framework	Strong understanding	Clear understanding	Basic understanding	Limited under-standing
Analysis	Precise evaluation	Clear evaluation	Mostly descriptive	Little analysis
Use of unit evi-dence	Integrates methods effectively	Relevant references	Limited application	Weak reference to concepts
Organisation	Logical, cohesive argument	Mostly well organised	Weak flow	Disorganised
Judgment	Balanced and justified	Clear but limited	Underdeveloped	Unsupported conclusion

Indicative bands: 18–20 exceptional analysis; 14–17 strong reasoning; 10–13 adequate understanding with limited depth; 6–9 basic understanding with gaps; 0–5 limited reasoning and inadequate structure.

Model Response

Reconstructed accounting information is used when a business does not possess complete records. Accountants use the available evidence to calculate profit and rebuild the financial position. Some argue that the resulting information can be reliable, while others believe that it may remain incomplete or inaccurate.

On the one hand, accountants apply clear and logical procedures. Profit is calculated from changes in capital, control accounts help test accuracy, and bank reconciliation compares the cash book with the bank statement. These procedures reduce errors and may provide the only practical means of understanding the performance of a small business.

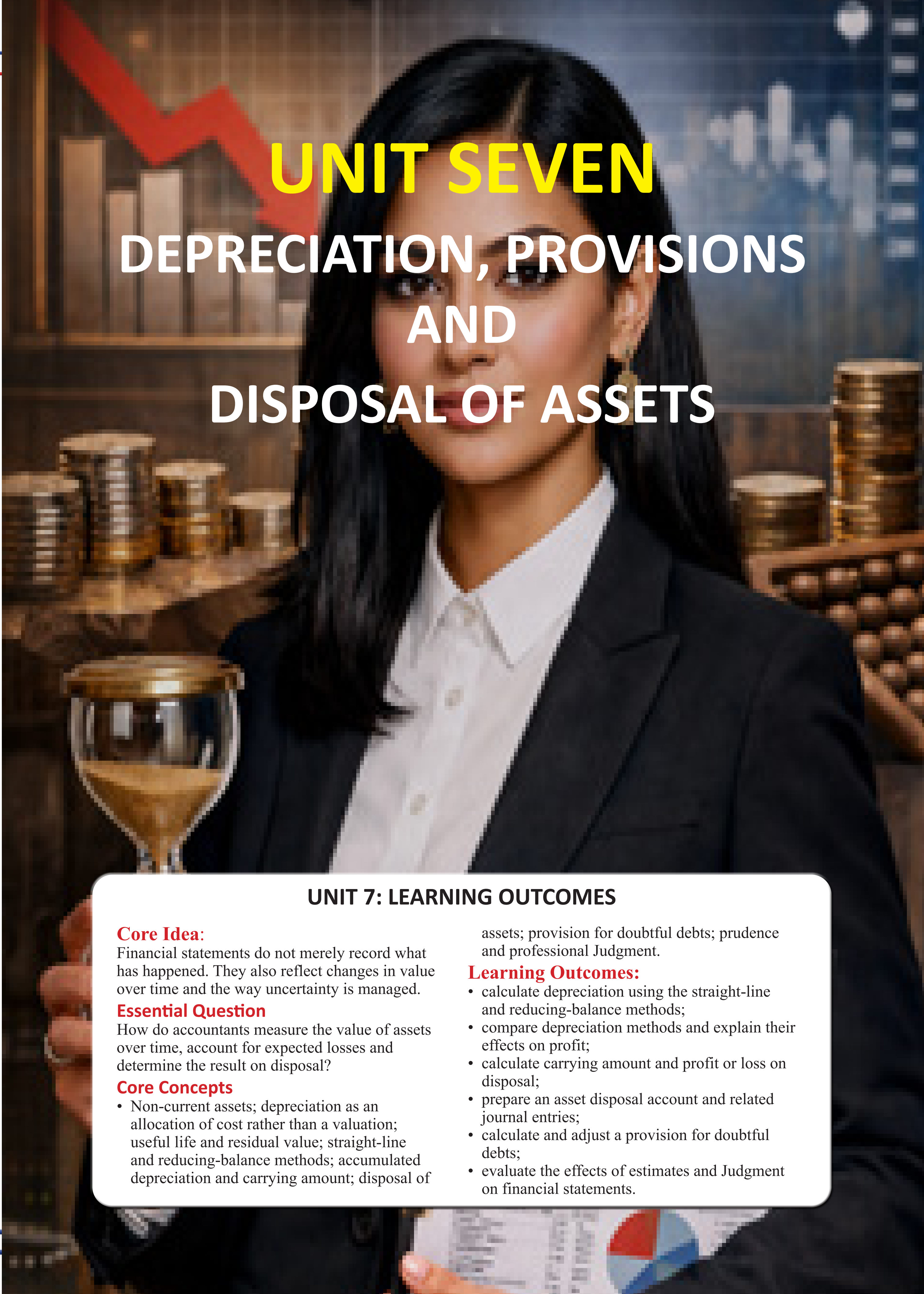
On the other hand, reconstructed information may not be fully reliable because some records are missing and assumptions are required. Control accounts and reconciliations also depend on the quality of the available data. If those data contain errors, the final figures may not faithfully represent the true financial position.

In conclusion, reconstructed information can be useful and reasonably reliable when sound accounting methods and appropriate controls are applied. However, it is not perfectly precise and should be used with care. Businesses should maintain complete records to improve reliability, accountability and decision-making.

To improve reliability, the response is characterized by a clear understanding of the question, balanced reasoning, and the application of capital concepts, control accounts, and reconciliation, with a logical structure and a justified conclusion. It demonstrates skills in analysis, evaluation, and reaching a judgment based on reasons and supported by evidence.

WHY THIS IS A STRONG RESPONSE

It addresses both sides, applies the unit's concepts, reaches a balanced judgment and supports that judgment with relevant reasons.



UNIT SEVEN

DEPRECIATION, PROVISIONS AND DISPOSAL OF ASSETS

UNIT 7: LEARNING OUTCOMES

Core Idea:
Financial statements do not merely record what has happened. They also reflect changes in value over time and the way uncertainty is managed.

Essential Question
How do accountants measure the value of assets over time, account for expected losses and determine the result on disposal?

Core Concepts
- Non-current assets; depreciation as an allocation of cost rather than a valuation; useful life and residual value; straight-line and reducing-balance methods; accumulated depreciation and carrying amount; disposal of assets; provision for doubtful debts; prudence and professional Judgment.

Learning Outcomes:
- calculate depreciation using the straight-line and reducing-balance methods;
- compare depreciation methods and explain their effects on profit;
- calculate carrying amount and profit or loss on disposal;
- prepare an asset disposal account and related journal entries;
- calculate and adjust a provision for doubtful debts;
- evaluate the effects of estimates and Judgment on financial statements.

Core Idea and Opening Case

Financial statements do not simply record past events. They also reflect changes in value over time and the management of uncertainty. Assets lose part of their service potential through use, some customers may not pay their debts, and businesses must decide how to account for such changes. Accounting therefore involves Judgment, estimation and timing.

Case Study: The Delivery Company's Decision

Maha owns a delivery company that uses motorcycles to transport goods. At the beginning of the year, she bought new motorcycles to expand the business. After one year, the accountant told her that their value in the accounts had to be reduced even though they were still working well.

At the same time, some customers had not paid their invoices. Although Maha expected most of them to pay, the accountant proposed recognising an expected loss. Later, Maha sold one motorcycle and the accounts showed a profit on disposal, even though she believed that it had been sold at a fair price.

Maha began to ask why asset values change in the accounts, why possible losses are recognised before they become certain, and how an accounting profit or loss arises when an asset is sold.

Test your knowledge Do accounting instructions make things more accurate or more subject to judgment?

Exercise
How do you explain

Why may an asset's carrying amount decline while the asset remains in use? How can a profit or loss arise when an asset is sold?

Depreciation

Allocating the Cost of an Asset

Businesses use machinery, vehicles and equipment for several years to generate revenue. These assets may lose efficiency or become obsolete over time. Their cost is therefore not charged entirely to one year; instead, the depreciable amount is allocated over the years in which the asset is used. This process is called depreciation.

CORE POINT Depreciation is the systematic allocation of an asset's depreciable amount over its useful life. It is not a direct measurement of the asset's market value.

• Cost: the purchase price and other directly attributable costs required to bring the asset into use.

• Useful life: the period over which the business expects to use the asset.

• Residual value: the estimated amount expected from disposing of the asset at the end of its useful life.

General idea: The cost, minus the salvage value of the asset (if any), is spread over time (the years of using the asset) over time.

What are incomplete accounting records?

CHECK YOUR UNDERSTANDING

Why is depreciation not the same as a fall in market value?

Methods of Depreciation

1) Fixed Installment Method: The principal is charged with the same amount of depreciation each year, provided it is purchased.

Annual depreciation = (Cost − Residual value) ÷ Useful life

Example 1: cost 10,000 EGP; residual value 2,000 EGP; useful life four years. Annual depreciation = (10,000 − 2,000) ÷ 4 = 2,000.
Example 2: cost 20,000 EGP; useful life four years; no residual value. Annual depreciation = 20,000 ÷ 4 = 5,000.

2. Reducing-balance Method

A fixed percentage is applied to the carrying amount at the beginning of each year. Depreciation is therefore higher in the earlier years and lower in later years.

Depreciation = Rate × Opening carrying amount

1: Its original cost is 10,000 with a depreciation rate of 20%. First year: 20% × 10,000 = 2,000, so the new value is 8,000. Second year: 20% × 8,000 = 1,600.

Exercise
Formative Check

1. What is the difference between the straight-line method and the reducing-balance method?

How does depreciation affect reported profit?

CHECK YOUR UNDERSTANDING

IMPORTANT

1. A reducing-balance rate is normally specified by the accounting policy or the question. It should not automatically be calculated as 100% divided by useful life unless this is explicitly required.

Example 2: Its original cost is 50,000 EGP and its useful life is 5 years. Calculate depreciation for the first and second years. Depreciation for the first year =

$$20\% \times 50,000 = 10,000.$$

Depreciation for the second year =

$$(10,000 - 20\% \times (50,000) = 8,000.$$

Note: The depreciation rate is determined by dividing 100% by the useful life.

Comparing depreciation methods.

Basis	Fixed Installment Method	Reducing Balance
Annual charge	Constant	Decreases over time
Complexity	Simple	More complex
Suitable	Assets providing benefits evenly	Assets losing benefits faster at first

Depreciation is an expense. A higher depreciation charge reduces profit, while a lower charge increases profit. Total depreciation over the asset's useful life is not changed merely by choosing a different pattern of allocation.

remember: Depreciation of depreciable non-current assets occurs for three reasons:

1- Use of the asset (usage)

2- Passage of time (without using the asset)

3- Emergence of more modern assets (obsolescence)

Remember.

CHECK YOUR UNDERSTANDING

Why does the choice of depreciation method affect the reported profit?

Depreciation Practice

Exercise 1: Fixed Installment Method.

A machine costs 12,000 EGP, has a residual value of 2,000 EGP and a useful life of five years. Calculate the depreciable amount, annual depreciation, and carrying amount at the end of Years 1 and 3.

Exercise 2: Fixed Installment Method.

A delivery vehicle costs 20,000 EGP, has a residual value of 4,000 EGP and a useful life of four years. Calculate annual depreciation, accumulated depreciation after two years and carrying amount after two years. Explain whether annual depreciation changes under this method.

Exercise 3 — Reducing Balance

An asset costs 15,000 EGP and is depreciated at 10% per year. Calculate depreciation for Years 1 and 2 and the carrying amount at the end of Year 2.

Exercise 4 — Reducing Balance

A machine costs 25,000 EGP and is depreciated at 20% per year. Calculate depreciation for Years 1, 2 and 3, and the carrying amount at the end of Year 3. Explain why the annual charge decreases.

Exercise 5 — Comparison

Equipment costs 10,000 EGP, has no residual value and a useful life of five years. Compare Year 1 depreciation under straight-line and reducing balance at 20%. State which method gives the higher Year 1 profit and explain why.

Exercise
How do you explain

1. Which method normally produces the higher profit in the early years: Fixed Installment Method line or reducing balance? Explain.

Exercise 6 — Understanding the Concept

Why is depreciation treated as an expense? Why is it not simply described as a loss in market value? Which method may be more suitable for vehicles and which for buildings? Justify your answers.

Optional Challenge

A machine costs 18,000 EGP, has a residual value of 3,000 EGP and a useful life of five years. Calculate annual straight-line depreciation and the carrying amount at the end of Year 2. If the reducing-balance method is used at 15%, would Year 1 profit be higher or lower? Explain.

Disposal of Non-current Assets

Businesses do not keep assets indefinitely. An asset may be sold, scrapped or exchanged. When this happens, it must be removed from the accounts. Because the disposal proceeds often differ from the asset's carrying amount, a profit or loss on disposal arises.

When an asset is sold, compare the proceeds with its carrying amount.

• Cost includes the purchase price and other costs necessary to bring the asset into use.

• Accumulated depreciation is the total depreciation charged on the asset up to the date of disposal.

• Carrying amount = Cost − Accumulated depreciation.

• If proceeds exceed carrying amount, a profit arises. If proceeds are lower, a loss arises.

Exercise - How do you explain

1. What is the carrying amount of an asset?

CHECK YOUR UNDERSTANDING

When does a business make a profit on disposal of an asset?

Asset Disposal Account.

An asset disposal account removes the asset's cost and accumulated depreciation from the ledgers, records the disposal proceeds and identifies the resulting profit or loss.

Example: asset cost 20,000 EGP; accumulated depreciation 12,000 EGP; proceeds 10,000 EGP. Carrying amount = 20,000 − 12,000 = 8,000. As proceeds are 10,000, the profit on disposal is 2,000.

Debit	Amount	Credit	Amount
Asset at cost	20,000	Accumulated depreciation	12,000
Profit on disposal	2,000	Cash / disposal proceeds	10,000
Total	22,000	Total	22,000

The disposal account removes the asset, closes its accumulated depreciation and determines the result of disposal.

Exercise - How do you explain

1. Which depreciation method usually produces the higher reported profit in the early years, and why?

What›s the purpose of the exclusion account?

Practice: Disposal of Assets

Exercise 1

Cost 15,000 EGP;

accumulated depreciation 9,000 EGP;

proceeds 5,000 EGP.

Calculate carrying amount and profit or loss, then prepare the asset disposal account.

Exercise 2

Cost 25,000 EGP;

accumulated depreciation 15,000 EGP;

proceeds 12,000 EGP.

Calculate carrying amount and profit or loss, then prepare the asset disposal account.

KEY SUMMARY:

Selling an asset does not automatically create a profit. The result depends on the difference between disposal proceeds and carrying amount.

Exercise
Formative Check

1. How do you explain
2. what is " provision"?

CHECK YOUR UNDERSTANDING

Why is a provision for doubtful debts created?

Provision for Doubtful Debts

The provision is an estimate of the part of trade receivables that may be uncollectible. Creating or increasing the provision reduces profit and the net amount of trade receivables reported in the statement of financial position.

Example: trade receivables 10,000 EGP and provision rate 5%. Required provision = 10,000 × 5% = 500. Net trade receivables = 10,000 − 500 = 9,500.

The provision is reviewed annually. If it rises from 400 to 600, the increase of 200 is recognised as an expense. If it falls from 600 to 400, the decrease of 200 is recognised as income because part of the previous provision is no longer required.

Exercise
Formative Check

1. How do you explain
2. what happens to profit when the provision increases?

Key Insight

1. Profit is affected not just by actual losses, but also by expected losses.

REMEMBE:

The provision is an accounting estimate charged against revenue. It is not a cash payment, but it reflects an expected reduction in the amount that will be collected from customers.

Why is prudence important when receivables are reported?

Provision Practice

Exercise 1

Trade receivables are 8,000 EGP and the provision rate is 5%. Calculate the provision and net trade receivables.

Exercise 2

The existing provision is 300 EGP and the new required provision is 500 EGP. Calculate the change, identify whether it is an expense or income and explain its effect on profit.

Exercise 3

Trade receivables are 20,000 EGP and the provision rate is 10%. Calculate the provision and net receivables, and explain the importance of the adjustment.

FORMATIVE ASSESSMENT

1. Why must depreciation be recognised before profit is calculated?

Integrated Application:

Year-end adjustments do not occur in isolation. At the same time, an accountant may need to calculate depreciation, account for disposal of an asset and adjust the provision for doubtful debts. Together, these adjustments affect profit, asset values and the financial statements, producing a more realistic financial picture.

Case Study: Hassan Trading

At the end of the year, Hassan asks the accountant to complete the required adjustments before finalising the financial statements.

test your knowledge

How does exclusion affect asset calculations?

Case Data and Student Tasks

Equipment cost 40,000 EGP and is depreciated by the straight-line method over five years with no residual value. A piece of equipment costing 10,000 EGP, with accumulated depreciation of 6,000, was sold for 5,000 EGP.

Trade receivables total 12,000 EGP; the new provision is 5%; and the existing provision is 400 EGP.

1. Calculate the annual depreciation for the equipment and the total depreciation for the year.
2. Calculate the book value of the sold asset and the profit or loss, then prepare the asset after accounting for the disposal.
3. Calculate the new provision and its change, and determine its effect on profit.
4. Identify which adjustment has the most impact on profit, and explain how adjustments improve the accuracy of financial statements, and whether they make them more reliable or more subject to judgment.

How do these adjustments improve the usefulness of financial statements while also increasing reliance on Judgment?

Exercise
Formative Check

1. Why does an increase in the provision reduce profit?

Student Answer Templates:

Depreciation Calculation	Amount
Cost	________
Less: residual value	________
Depreciable amount	________
Divide by useful life	________
Annual depreciation	________

Calculating the principal after exclusion	amount	Exclusion account - Creditor	amount
		Depreciation Complex	
		cach	
		loss	
total		total	

CARRYING AMOUNT

1. At 31 December 2026: 50,000 − 10,000 = 40,000.

Provision Calculation	Amount
Trade receivables	________
Provision rate	________
New provision	________
Existing provision	________
Increase / decrease	________

Justify and Reasoning with Evidence

Adjustments include depreciation, provisions and disposal of assets. They affect profit, asset values and financial position. Although the calculations appear objective, they depend on estimates, assumptions, Judgment and the timing of recognition.

Question: Do adjustments for depreciation and provisions improve the accuracy of financial statements, or do they introduce an excessive degree of subjectivity?

Evaluate their effect on accuracy and professional Judgment. Consider estimated useful life, the choice of depreciation method, assumptions about doubtful debts, the timing of recognition, prudence, matching and the possibility that similar businesses report different profits because of different accounting choices.

Central Issue

Do adjustments improve the accuracy of financial reports, or do they introduce personal judgment into the financial statements?

One can rely on: straight-line and declining balance; book value; asset write-offs; allowance for doubtful debts; the prudence principle; the matching principle; profit adjustment; and the financial position.

It can be said that adjustments either improve accuracy and reliability, or they introduce judgment.

Guidance for the Justify and Reasoning with Evidence

The response should evaluate the effect of accounting adjustments on accuracy and professional Judgment, rather than merely explain why adjustments are necessary. Depreciation depends on estimated useful life, residual value and method. A provision for doubtful debts depends on expectations about future collection. These estimates may cause similar businesses to report different profits. Evidence may include: straight-line and reducing-balance depreciation; carrying amount; disposal of assets; provision for doubtful debts; prudence; matching; profit adjustment; and the statement of financial position.

Section	Purpose	Guiding Question
Introduction	Define the issue	Where does Judgment enter the accounts?
Argument 1	Explain how adjustments improve information	Why are depreciation and provisions necessary?
Argument 2	Explain subjectivity	How may estimates affect results?
Evaluation	Compare both arguments	Which is stronger, and why?
Conclusion	Give a balanced Judgment	Do adjustments improve reliability overall?

Essay Marking Rubric

Criterion	Excellent (4)	Good (3)	Developing (2)	Limited (1)
Conceptual understanding	Strong and accurate	Clear	Basic	Limited
Analysis	Evaluates estimates precisely	Clear evaluation	Mostly descriptive	Little analysis
Use of evidence	Integrates Unit 7 concepts	Relevant refer-ences	Limited application	Weak evidence
Organisation	Logical and cohesive	Mostly organised	Weak flow	Disorganised
Judgment	Balanced and justified	Clear but limited	Underdeveloped	Unsupported

Indicative bands: 18–20 exceptional analysis; 14–17 strong reasoning; 10–13 adequate understanding with limited depth; 6–9 basic understanding with gaps; 0–5 limited reasoning and inadequate structure.

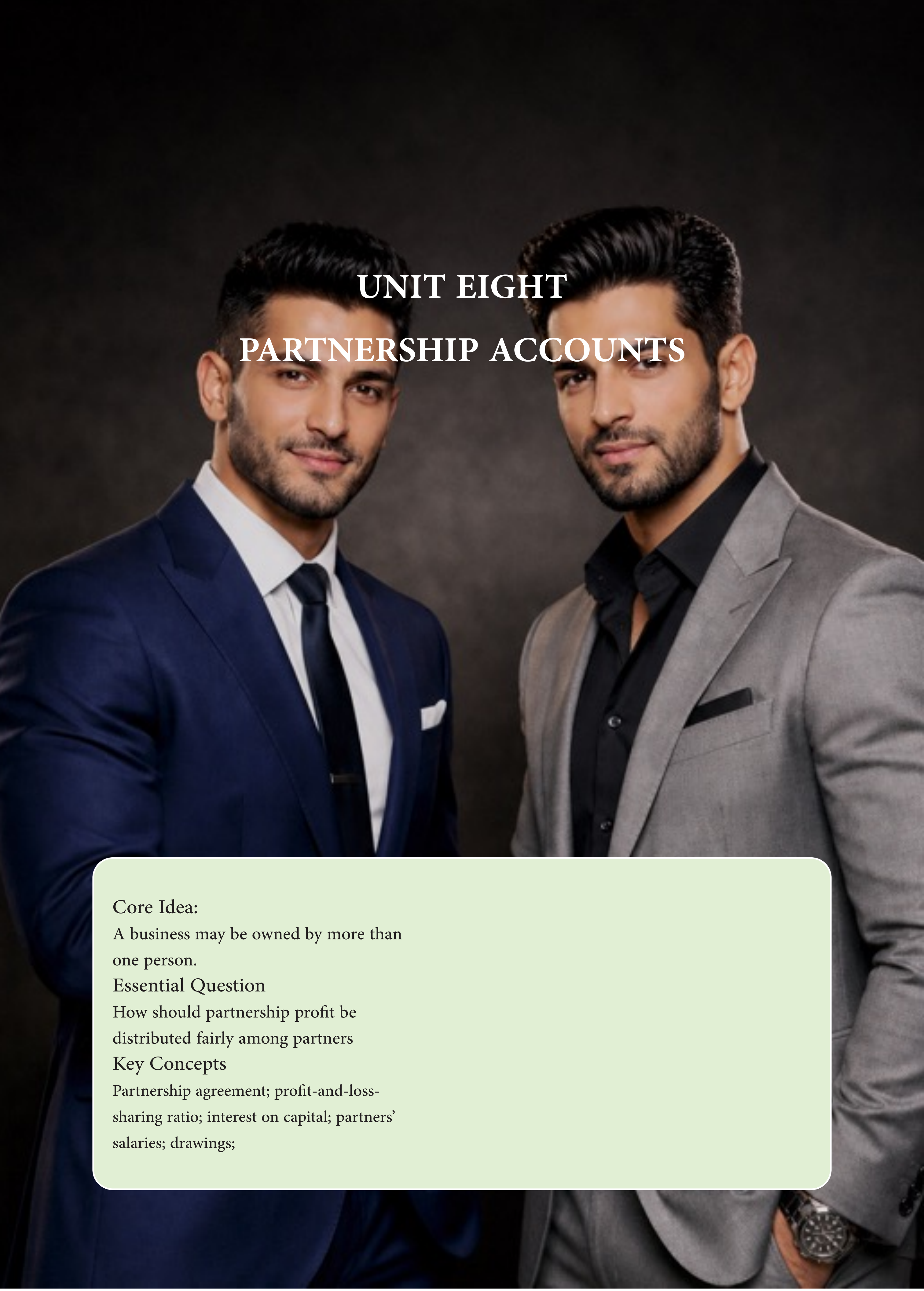
Model Response

Adjustments such as depreciation and provisions are used to improve financial statements. Some argue that they make the statements more accurate, while others argue that they introduce subjectivity because they depend on professional Judgment.

On the one hand, the adjustments improve reporting by matching the expenses of a period with its revenue. Depreciation allocates the cost of an asset over its useful life, producing a more realistic annual profit. Provisions recognise expected losses early and prevent assets and profit from being overstated.

On the other hand, adjustments involve uncertainty. Useful life and residual value are estimates, different depreciation methods create different profit patterns, and a provision for doubtful debts is based on expectations rather than a certain amount. Similar businesses may

therefore report different profits because of their accounting choices.
In conclusion, adjustments generally improve the relevance and faithful representation of financial statements by applying matching and prudence. However, they also introduce a degree of subjectivity. Financial statements are not perfectly objective, but carefully supported estimates can provide a reasonable and useful representation of performance and financial position.



UNIT EIGHT

PARTNERSHIP ACCOUNTS

Core Idea:

A business may be owned by more than one person.

Essential Question

How should partnership profit be distributed fairly among partners

Key Concepts

Partnership agreement; profit-and-loss-sharing ratio; interest on capital; partners' salaries; drawings;

Core Idea and Opening Case

A partnership is owned by two or more people. Profit must not only be calculated; it must also be distributed fairly. Partners may contribute different amounts of capital, perform different roles and agree to different terms. Partnership accounting should therefore reflect the agreement, fairness and mutual understanding between the partners.

Case Study: The Café Partnership

Omar and Lina decided to open a small café. Omar invested 100,000 and Lina invested 50,000. Omar works full time in management, while Lina works part time. At the end of the year, the café made a profit of 60,000.

Omar believed that he deserved a larger share because of his greater investment and work. Lina believed that the profit should be divided equally because they were partners. They then discovered that they had not clearly agreed how profit would be distributed.

The accountant suggested interest on capital, a salary allowance for Omar and an agreed profit-sharing ratio. A year later, a third partner wished to join after the café's value had increased. The partners now had to determine a fair distribution and account for the change in ownership.

Must partnership profit always be shared equally? How should differences in capital and effort affect distribution?

Partnership Agreements and Profit Distribution

A partnership agreement is a set of rules agreed by the partners. It may specify the profit-and-loss-sharing ratio, interest on capital, partners' salaries, rules for drawings and other rights and responsibilities.

What is a profit-sharing ratio?

Profit-and-loss-sharing Ratio

The profit-and-loss-sharing ratio determines how profit or loss .is divided among the partners

Example: Omar and Younis agree to share profit in the ratio 2:1. If profit is 30,000 EGP, Omar receives 20,000 EGP and Younis receives 10,000 EGP.

If no partnership agreement exists, profit and loss are normally shared equally, subject to the law governing the partnership. Thus, if profit is 30,000 EGP and two partners share equally, each receives 15,000 EGP.

Losses are shared using the same agreed ratio.

If the ratio is 3:2 and the loss is 10,000 EGP, the first partner bears 6,000 EGP and the second bears 4,000 EGP.

Steps in Distributing Profit

1. State total profit.

2. Add the parts of the agreed ratio.

3. Divide profit according to those parts.

Example: profit is 40,000 and the ratio is 3:1. Total parts = 4. The first partner receives 40,000 × 3/4 = 30,000; the second receives 40,000 × 1/4 = 10,000.

Practice: Sharing Profit and Loss

- Ali and Omar share profit 2:1. Profit is 45,000 EGP. Calculate each share.

- Sara and Sama share profit equally. Profit is 36,000 EGP. Calculate each share.

- Three partners share profit 3:2:1. Profit is 60,000 EGP. Calculate each share.

- Two partners share a loss of 25,000 EGP in the ratio 4:1. Calculate each share.

- Profit is 50,000 EGP and the ratio is 5:3. Calculate both shares and explain why one is larger.

How are partnership losses shared?

CHECK YOUR UNDERSTANDING

Why are partners' salary allowances not treated as ordinary operating expenses?

Interest on Capital and Partners' Salaries

Partners may invest different amounts of capital or contribute different

levels of effort. If the remaining profit is shared only by ratio, the result

may appear unfair. The agreement may therefore provide appropriations

before the residual profit is shared.

Why may partners receive interest on capital?

The core idea

The profit is adjusted first, and then the remaining profit is distributed.

Interest on Capital

A partner receives interest based on the capital invested as a reward for the investment. This interest is treated as an appropriation of profit.

For example, if the partner's capital is 100,000 and the interest rate is 10%, the interest on capital will be 10,000.

Partner's Salary

A partner may be allocated a salary in return for the work performed. However, this salary is not treated as an operating expense of the business; rather, it is treated as an appropriation of profit.

Example: Partner's salary = 20,000

Why are partners' salaries not considered expenses?

test your knowledge

Adjustments Between Partners:

1. Start with the total profit.
2. Deduct interest on capital andpartners' salaries.
3. Calculate the remaining profit.
4. Distribute the remaining profit according to the profit-sharing ratio.

Example (1)

Profit = 60,000; Partner A's capital =100,000; Partner B's capital = 50,000; interest on capital = 10%; Partner A's salary = 10,000; and the profit-sharing ratio = 2:1.

Interest on Partner A's capital =10,000.

Interest on Partner B's capital = 5,000.

Total adjustments =10,000 + 5,000 + 10,000 = 25,000.

Remaining profit = 60,000 – 25,000 = 35,000.

Partner A receives:

35,000 × 2/3 = 23,333

Partner B receives:

35,000 × 1/3 = 11,667

Are appropriations made before or after the residual profit is distributed?

Final Distribution of Profits and Current Accounts:

1. Final Distribution of Profits.

Partner	Interest	Salary	Share of Remaining Profit	Total
A	10,000	10,000	23,333	43,333
B	5,000	----	11,667	16,667
Total	15,000	10,000	35,000	60,000

Example (2)

Profit = 90,000; Partner Omar's capital =150,000;

Partner Younis's capital = 75,000;

interest on capital =10%; Partner Younis's salary =15,000; and the profit-sharing ratio = 1:1.

Interest on Omar's capital = 10% × 150,000 = 15,000.

Interest on Younis's capital = 10% × 75,000 = 7,500.

Remaining profit:

90,000 – (15,000 + 7,500 + 15,000) = 52,500

Exercise – Explain Why

1. Are the adjustments made before or after the distribution of profit?

2. Why must the partners agree on a profit-sharing ratio ?

What is the purpose of a partner's current account?

Partners' Current Accounts

Instead of making adjustments to the partners' capital accounts, these adjustments are recorded in the partners' current accounts.

The partners' current accounts record the share of profit, interest on capital, partners' salaries, and drawings, and show each partner's current balance in the partnership

Exercise: Interest on Capital

Profit =40,000; Partner A's capital = 80,000; Partner B's capital = 40,000; interest rate = 10%; and the profit-sharing ratio = 1:1

Calculate the interest on capital for each partner, the total interest, and the remaining profit, then distribute the remaining profit.

Partner	Interest	Share of Remaining Profit	Total
A			
B			

CHECK YOUR UNDERSTANDING

Which transactions are recorded in a partner's current account?

Exercise – Explain Why

What is the purpose of a partner's current account?

What transactions are recorded in a partner's current account?

test your knowledge

Exercises on Profit Appropriations – Effect of Partners’ Salaries

ANSWER CHECK

Interest: A 15,000 and B 5,000. Residual profit 65,000. A receives 52,000 of the residual profit and a total of 67,000. B receives 13,000 plus salary 15,000 and interest 5,000, giving a total of 33,000.

Profit =50,000 EGP; Partner A’s salary =8,000 EGP; and the profit-sharing ratio = 3:2

Deduct the salary, calculate the remaining profit and distribute it, then calculate the total amount received by each partner

Particulars	Amount
Profit	
Less: Partner A’s Salary	
Remaining Profit	

Partner	Interest	Share of Remaining Profit	Total
A			
B			

Profit Appropriations – Effect of Partners' Salaries and Interest on Capital

Profit =70,000 EGP; Partner A's capital =100,000 EGP; Partner B's capital = 500,000 EGP; interest rate = 10%; Partner B's salary = 10,000 EGP; and the profit-sharing ratio =2:1

Calculate the interest on capital, the total appropriations, the remaining profit, then distribute it and calculate the total amount received by each partner.

Particulars	Amount
Profit	
Less: Interest on Capital – Partner A	
Less: Interest on Capital – Partner B	
Less: Partner B's Salary	
Remaining Profit	

Partner	Interest	Share of Remaining Profit	Total
A			
B			

What does goodwill represent?

CORE POINT

When a partnership changes, the value of the business and each partner's rights must be reconsidered.

Who benefits from goodwill, and why are accounts adjusted when the partnership changes?

Comprehensive Application

Profit = 90,000 EGP; Partner A's capital =120,000 EGP; Partner B's capital =60,000 EGP; interest rate = 10%; Partner A's salary = 12,000 EGP; and the profit-sharing ratio = 3:1

Particulars	Amount
Profit	
Less: Interest on Capital – Partner A	
Less: Interest on Capital – Partner B	
Less: Partner A's Salary	
Remaining Profit	

Explanation and Exam Challenge

Explain why interest on capital is granted before the remaining profit is distributed, why partners' salaries are not treated as ordinary business expenses , how these appropriations make the distribution of profit fairer, and what would happen if profit were distributed before making these appropriations

CHECK YOUR UNDERSTANDING

When is goodwill considered in partnership accounts?

Exam Challenge

Profit =100,000 EGP; Partner A's capital = 150,000 EGP; Partner B's capital = 50,000 EGP; interest rate =10%; Partner B's salary =15,000 EGP; and the profit-sharing ratio =4:1.

Training Tip

Start with the profit, then deduct the appropriations, distribute the remaining profit, and calculate the final totals

Goodwill and Changes in Partnership

A new partner may be admitted, an existing partner may retire, or the profit-sharing ratio may change. The financial interests of the partners must then be adjusted fairly.

Goodwill represents the value of reputation, customer relationships and other advantages that enable a business to earn more than the normal return on its identifiable net assets.

If net assets are 100,000 and the agreed value of the business is 130,000, implied goodwill is 30,000. A new partner benefits from the existing reputation, so the old partners may need to be compensated. The new partner contributes capital, the profit-sharing ratio changes and goodwill may be adjusted.

Why must the accounts be adjusted when the partnership changes?

test your knowledge

FORMATIVE ASSESSMENT

Why are appropriations made before ? residual profit is distributed

Goodwill Adjustments when Partners Change

On admission, a new partner normally compensates the existing partners for the share of goodwill acquired. The old partners' entitlement is based on the sacrifice they make in the profit-sharing ratio. In a simplified case where they sacrifice in their old ratio, goodwill may be credited using that old ratio.

When a partner retires, the amount due includes capital and the retiring partner's entitlement to goodwill. The remaining partners then agree a new profit-sharing ratio. A change in ratio without admission or retirement may also require a goodwill adjustment between partners.

Example: A and B share profit equally and goodwill is valued at 20,000 before a new partner is admitted. If A and B sacrifice equally, each is credited with 10,000 of goodwill.

CHECK YOUR UNDERSTANDING

Why does goodwill initially belong to the existing partners?

Goodwill Exercises

How do changes in partnership affect fairness, and what role can accounting play in resolving disagreements?

1. Goodwill = 30,000 EGP, and Partners A and B share profits in the ratio 2:1. Allocate the goodwill between them.

2. Goodwill = 24,000 EGP, and three partners share profits in the ratio 3:2:1. Allocate the goodwill among them.

3. Partners A and B share profits equally,

and goodwill = 40,000 EGP. Partner C then joins the partnership. Allocate the goodwill between A and B, and explain why Partner C does not receive a share of it.

4. Partners A, B, and C share profits in the ratio 3:2:1, and goodwill = 60,000 EGP. Partner C then retires from the partnership. Calculate C's share of goodwill and explain the accounting treatment.

5. Define goodwill, explain its importance when a new partner is admitted, explain why a retiring partner is entitled to their share of goodwill, and explain the effect of a change in the partnership on the profit-sharing arrangement.

CHECK YOUR UNDERSTANDING

What role does accounting play in resolving disagreements between partners?

Integrated Application: Changes in Partnership

In real partnerships, profit-sharing ratios, interest on capital, salary allowances, changes in partners and goodwill may all arise together. Partnership accounting therefore combines calculation, agreement and fairness.

Case Study

Hassan and Maryam operate a small trading business and share residual profit in the ratio 2:1. After a successful year, they decide to expand and Youssef wishes to join. The business has also developed a strong reputation. Hassan believes that his greater work should be rewarded, while Maryam believes that her capital contribution is more important. The accountant explains that all these factors must be reflected in the partnership agreement and accounts.

Case Data

Profit for the year is 120,000. Hassan's capital is 150,000 and Maryam's capital is 90,000. Interest on capital is 10%. Hassan receives a salary allowance of 15,000. Hassan and Maryam share residual profit in the ratio 2:1. Youssef is admitted and goodwill is valued at 60,000.

CORE SUMMARY

Partnership accounting ensures that financial results reflect agreements, contributions and changes in ownership—not merely the total profit .earned

Student Tasks and Reflection

• 1. Calculate interest on capital for Hassan and Maryam, deduct Hassan's salary allowance, calculate residual profit and distribute it.

• 2. Prepare a final distribution table showing interest, salary, residual-profit share and total appropriation.

• 3. Allocate goodwill between Hassan and Maryam and explain why Youssef does not receive a share of value created before his admission.

• 4. Identify which partner benefits most from the appropriations, evaluate whether the result is fair and explain how goodwill reflects business value.

Hassan is satisfied because his larger capital contribution and salary allowance give him a greater total share. Maryam may still believe that her contribution is undervalued. Both partners recognise that distribution depends on the agreement rather than on perception alone. The accountant explains that goodwill belongs initially to the old partners because they created the reputation from which the new partner will benefit.

Student Templates and Summary

At the end of the process, the partners agree that accounting has helped them understand fairness, avoid disputes, and make clear decisions. It manages relationships through a structured framework and is not limited to numbers.

Profit Appropriation	Amount
Profit	
Less: Interest on Capital – Hassan	
Less: Interest on Capital – Mariam	
Less: Hassan's Salary	
Remaining Profit	

Partner	Share of Goodwill
Hassan	
Mariam	

Key Summary

Partnership accounting ensures that financial results reflect agreements, contributions, and changes, rather than merely calculating profit.

Justify and Reasoning with Evidence

A partnership brings together individuals who may contribute different amounts of capital, time, or effort and who rely on contractual agreements and trust. Profit is distributed according to rules that may include profit-sharing ratios, interest on capital, partners' salaries, and goodwill adjustments.

The process appears structured; however, partners may differ in their assessment of whether the outcome reflects each partner's contribution. Effort, risk, and participation are not always fully measurable.

Question

Do partnership agreements ensure fairness in the distribution of profit, or can they produce outcomes that partners may still perceive as unequal?

What Is Required

Evaluate whether partnership agreements ensure fairness, rather than merely explaining why such agreements are necessary.

Fairness depends on the agreed profit-sharing ratios, capital contributions and interest on capital, partners' salaries, and goodwill. However, these arrangements may not fully measure differences in effort, risk, and time contributed.

Two partners may therefore apply the same agreement correctly, yet one of them may still perceive the outcome as unfair.

Guidance for the Justify and Reasoning with Evidence

The response should evaluate whether partnership agreements ensure fairness, not merely explain why agreements are necessary. Agreements may use profit-sharing ratios, interest on capital, salary allowances, current accounts and goodwill adjustments. However, they may not capture every difference in effort, risk, time and expertise.

Evidence may include: profit-sharing ratios; interest on capital; partners' salaries; current accounts; goodwill; admission and retirement; capital versus effort; and fairness versus equality.

Section	Purpose	Guiding Question
Introduction	Define fairness in partnership	What does fairness mean here?
Argument 1	Explain how agreements create fairness	How do rules organise distribution?
Argument 2	Explain the limits of agreements	Why may partners still feel unfairly treated?
Evaluation	Compare both views	Can complete fairness be achieved?
Conclusion	Give a balanced Judgment	Are agreements sufficient?

Essay Marking Rubric

Criterion	Excellent (4)	Good (3)	Developing (2)	Limited (1)
Conceptual understanding	Strong and accurate	Clear	Basic	Limited
Analysis	Evaluates fairness precisely	Clear evaluation	Mostly descriptive	Little analysis
Use of Unit 4 evidence	Integrates ratios and appropriations	Relevant references	Limited application	Weak evidence
Organisation	Logical and cohesive	Mostly organised	Weak flow	Disorganised
Judgment	Balanced and justified	Clear but limited	Underdeveloped	Unsupported

Indicative bands: 18–20 exceptional analysis; 14–17 strong reasoning; 10–13 adequate understanding with limited depth; 6–9 basic understanding with gaps; 0–5 limited reasoning and inadequate structure.

Model Response

Partnership agreements determine how profit is distributed through ratios, interest on capital and partners' salary allowances. Some argue that these rules ensure fairness, while others believe that outcomes may still appear unequal to the partners.

On the one hand, agreements create fairness by providing clear rules. Profit-sharing ratios organise distribution, interest on capital rewards those who invest more, and salary allowances reward partners who contribute more work. The rules reflect different contributions and reduce disputes.

On the other hand, agreements cannot guarantee perfect fairness. Partners may contribute expertise, decision-making and risk that are difficult to measure. Even when the agreement is followed, a partner may believe that the result does not reflect the true contribution. Agreements may also remain fixed while circumstances change.

In conclusion, partnership agreements provide an organised framework that improves fairness, but they cannot guarantee it completely because human contributions are complex and cannot always be measured precisely. Fairness therefore depends not only on accounting rules, but also on communication, regular review and mutual trust.

UNIT NINE

LIMITED LIABILITY COMPANIES AND NOT-FOR-PROFIT ORGANISATIONS

Core Idea

Not all organisations are established for the same purpose.

Essential Question

How can accountants reconstruct reliable financial information when records are incomplete or discrepancies appear?

Key Concepts

Limited liability company; share capital; dividends; reserves; company financial statements; not-for-profit organisation; receipts and payments account; income and expenditure account; and surplus or deficit.

The Unit's Core Idea

Not all organisations are established for the same purpose. Some aim to earn profit for their owners, while others serve a social, cultural or community purpose. Ownership of a limited liability company is divided into shares, and profits are distributed to shareholders, while a not-for-profit organisation uses its income to support its activities rather than distribute it to owners. Accounting must therefore reflect the different purpose and the way resources are managed and distributed.

Case Study: Two Organisations with Different Purposes

Nour notices the difference between two organisations in her community. A technology company raises money by selling shares to investors, reports profit, pays dividends to shareholders and retains part of the profit for growth. The local sports club, however, collects members' subscriptions and donations and organises community activities. It does not report profit, but calculates a surplus or deficit. Nour wonders: Why do they use different accounts? Who benefits from the results of each? How is success measured when profit is not the objective?

Key Concepts for Profit-Making Businesses

Cash dividends are mainly determined in the light of several considerations, such as:

1. The amount of profit.
2. The company's need for cash.
3. Future growth and expansion plans.
4. Plans for replacing and renewing assets.
5. Dividends in previous years.

Management takes these considerations into account and, accordingly, submits a proposed distribution to the company's owners for approval, rejection or amendment.

Limited Liability Companies

Some businesses need large amounts of money in order to grow. Instead of relying on one owner or a few partners, they raise funds from many investors and are called limited liability companies.

Core Idea

Shareholders own a limited liability company, and ownership is divided into shares.

A limited liability company has a legal personality separate from its owners. Its owners are called shareholders and enjoy limited liability: a shareholder is liable only up to the amount invested and does not lose personal assets if the company fails. The company raises funds by selling shares, and the resulting money is called share capital. Example: issuing 10,000 shares with a value of 10 each produces share capital of 100,000.

Shareholders, Dividends and Reserves

A shareholder owns part of a company and receives a share of its profit, but may not participate in day-to-day management. When a company earns a profit, it may distribute part of it to shareholders; this is called dividends. If profit is 50,000 and dividends are 20,000, shareholders receive 20,000.

Not all profit is distributed. A company may retain part of it, called a reserve, for expansion, managing future risks and

Strengthening its financial position.

Basis of comparison	Partnership	Limited company
Ownership	Partners	Shareholders
Profit distribution	According to agreement	Dividends
Liability	Often unlimited	Limited
Management	Managed by the owners or one of them	Managers may be separate from owners

Key Insight

Ownership may be separated from management, and profit is distributed according to shares rather than effort

Share Capital and Dividend Practice

Exercise One

A company issued 5,000 shares with a value of 20 each.

Income statement	Amount
number of shares	-------
value of shares	-------
Share capital	-------

Exercise Two

A company earned a profit of 80,000 EGP and paid dividends of 30,000 EGP. Calculate the amount distributed and the amount retained as reserves.

Item	Amount
Profit	-----------
Less: Dividends	-----------
Reserves	-----------

Dividend per Share and a Multi-Step Application

Exercise Three

The company has 10,000 EGP shares, and dividend per share is 2. Calculate total dividends.

Exercise Four

The company raised share capital of 200,000 EGP, earned a profit of 60,000 EGP and paid dividends of 25,000 EGP. Identify share capital, and calculate reserves and the proportion of profit distributed.

Item	Amount
Profit	-------
Less: Dividends	-------
Reserves	-------

Ratios and Comparison

Dividend payout ratio = (Dividends ÷ Profit) × 100

Exercise Five

Companies A and B each earned a profit of 100,000. Company A paid dividends of 40,000 and Company B paid 70,000. Calculate the reserves of both companies and determine which retains more profit and which pays more to shareholders.

Company	Profit	Dividends	Reserves
A	-------	-------	-------
B	-------	-------	-------

Understanding Incomplete Records

Not every business maintains an integrated accounting system. Many small businesses record only selected transactions. They may record cash received and paid without keeping detailed records of credit transactions, inventory, suppliers or expenses. This is often called a single-entry system. Such records normally focus on cash receipts and payments, while other accounts are missing or incomplete. As a result, there may not be enough information to prepare financial statements directly.

Records are incomplete when a business does not apply the double-entry system in full. A cash book, sales records and purchase invoices may exist, while sales and purchases ledgers, inventory records or complete expense accounts may be absent. The accountant must then use the available information to reconstruct the financial position

Applied Case

A company issued 8,000 shares at a price of 15 per share. At the end of the year, profit was 96,000 and dividend per share was 3. Calculate share capital, total dividends, reserves and the proportion of profit distributed.

Step	Item	Amount
1	Share capital	-------
2	Total dividends	-------
3	Reserves	-------
4	Payout ratio	-------

Company Financial Statements

mance and financial position in terms of assets and liabilities, and to inform shareholders and investors. These statements resemble those studied previously, but they must also explain how profit is distributed.

Core Idea

A company's financial statements show not only profit, but also how it is used.

A company prepares an income statement and a statement of financial position. The income statement presents revenue, expenses and profit for the year. Once profit has been calculated, the way it is used is determined: whether it is distributed or retained.

Income statement	Amount
Revenue	-------
Less: Expenses	-------
Profit for the year	-------

Profit Appropriation and Financial Position

Profit is divided between dividends and reserves. If profit is 80,000 EGP and dividends are 30,000 EGP, retained profit is 50,000 EGP.

The statement of financial position presents assets, liabilities and equity according to the equation:

Assets = Liabilities + Equity.

Company equity includes share capital and retained earnings or reserves.

Assets	Amount	Equity and liabilities	Amount
Non-current assets	-------	Share capital	-------
Current assets	-------	Reserves	-------
		Liabilities	-------

From a Sole Trader to a Limited Liability Company

In a sole trader business, profit belongs to one owner. In a limited liability company, part of the profit is distributed and the remainder is retained.

Revenue is 180,000 EGP, expenses are 120,000 EGP and dividends are 20,000 EGP. Calculate profit and retained earnings, and identify what is new compared with the sole trader business.

Income statement	Amount
Revenue	-------
Less: Expenses	-------
Profit	-------

Profit distribution	Amount
Profit	-------
Less: Dividends	-------
Retained earnings	-------

Understanding the Use of Profit

In a sole trader business, profit was the final result. In a limited liability company, it is the starting point for distribution. If profit is 90,000 and dividends are 30,000, calculate retained earnings and explain why the entire profit is not distributed.

Item	Amount
Profit	-------
Less: Dividends	-------
Retained earnings	-------

The Company's Financial Position

A sole trader business presents the capital of one owner, whereas a limited liability company presents share capital and reserves. If non-current assets are 150,000, current assets are 50,000, liabilities are 60,000 and share capital is 100,000, calculate total assets and reserves and identify the difference from a sole trader business.

Assets calculation	Amount	Equity calculation	Amount
Non-current assets	-------	Total assets	-------
Current assets	-------	Less: Liabilities	-------
Total assets	-------	Equity	-------
		Less: Share capital	-------
		Reserves	-------

Complete Limited Liability Company Structure

Revenue is 220,000, expenses are 150,000, dividends are 25,000, share capital is 140,000, and liabilities are 55,000. Prepare the income statement, calculate retained earnings, then prepare the statement of financial position.

Stage	Item	Amount
Income statement	Profit	-------
Distribution	Retained earnings	-------
Financial position	Share capital	-------
Financial position	Reserves	-------
Financial position	Liabilities	-------
Financial position	Total assets	-------

Comparison and Interpretation

Compare a sole trader business with a limited liability company in terms of ownership, use of profit, the name given to equity and the method of distributing profit.
If a company reports profit of 100,000, dividends of 40,000 and retained earnings of 60,000, calculate the proportion of profit distributed and the proportion retained, and explain the importance of this decision for the company's future.

Item	Amount
Dividends	-------
Profit	-------
Payout ratio	-------
Retained-profit ratio	-------

Not-for-Profit Organisations

Not all organisations aim to make a profit. An organisation may be established to serve the community, provide services, or support social, cultural or sporting activities. Examples include sports clubs, charities, schools and community centres.

Core Idea

A not-for-profit organisation focuses on providing a service. It does not seek to earn profit and does not use the same system as companies. Instead, it begins with a simple account: the receipts and payments account.

Receipts and Payments Account

This is a summary of all cash received and paid during a period. It includes all cash transactions, does not distinguish between revenue and capital items, does not match income to the time period, and resembles a summary of the cash book. It therefore shows cash movement, not financial performance.
Example: At a sports club, members' subscriptions received were 20,000, donations received were 10,000, rent paid was 8,000 and equipment purchased was 12,000. Prepare the receipts and payments account.

Receipts	Amount	Payments	Amount
Members› subscriptions	20,000	Rent	8,000
Donations	10,000	Equipment	12,000

Key Concepts

Revenue expenditure: expenditure relating to one financial period or part of it that maintains productive capacity. It is called operating expenditure, such as salaries and rent.

Capital expenditure:

expenditure relating to more than one financial period that increases productive capacity. Depreciation is calculated on depreciable assets. It is described as expenditure on assets such as machinery, equipment, buildings, furniture and vehicles

Preparing the Basic Account: Receipts and Payments Acount

The focus is no longer on profit, but on cash movement. Receipts: subscriptions 15,000 and donations 5,000. Payments: rent 6,000 and equipment 4,000. Prepare the receipts and payments account.

Receipts	Amount	Payments	Amount
-------	-------	-------	-------
-------	-------	-------	-------

Classifying Receipts and Payments

The receipts and payments account does not distinguish between revenue and capital items. Classify the following as receipts or payments: donation received; purchase of equipment; members' subscriptions; and payment of rent.

Item	Receipt or payment
Donation received	-------
Purchase of equipment	-------
Members› subscriptions	-------
Payment of rent	-------

Complete Summary of a Receipts and Payments Account

Receipts: subscriptions 25,000, donations 8,000 and event income 12,000. Payments: rent 10,000, salaries 15,000 and equipment 5,000. Prepare the receipts and payments account and calculate the total on each side.

Receipts	Amount	Payments	Amount
Subscriptions	-------	Rent	-------
Donations	-------	Salaries	-------
Event income	-------	Equipment	-------
Total	-------	Total	-------

Comprehensive Question

Does the receipts and payments account show profit? Why? What is its main purpose?

Conclusion

The receipts and payments account shows cash movement; it does not show financial performance.

Income and Expenditure Account

The receipts and payments account shows cash received and paid, but it does not show the quality of the organisation's performance or whether income relates to the current year. A not-for-profit organisation therefore prepares an income and expenditure account to measure performance.
The account shows income and expenses during the period and ends with a surplus or deficit.

Basis of comparison	Receipts and payments	Income and expenditure
Basis of accounting	Cash	Accrual
Scope	All transactions	Current-period transactions only
Result	Does not measure performance	Measures performance as a surplus or deficit

Example and Case Study

If income is 30,000 and expenses are 22,000, the surplus is 8,000.

Case Study: Community Sports Club

A local sports club wants to measure its performance for the year. The treasurer prepared a receipts and payments account, but the committee wants to know the true performance.
Receipts: subscriptions 40,000 and donations 10,000.
Payments: rent 15,000, salaries 20,000 and equipment 5,000.
Of the subscriptions, 5,000 relates to the following year, and there are unpaid expenses of 3,000.

Student Tasks

- ١. Adjust income by excluding subscriptions relating to the following year.
- 2. Adjust expenses by adding unpaid expenses.
- 3. Prepare the income and expenditure account and determine the surplus or deficit

Income adjustment	Amount	Expense adjustment	Amount
Subscriptions	______	Expenses paid	______
Less: Following year	______	Add: Unpaid	______
Adjusted income	______	Adjusted expenses	______

Adjusted Income Practice

Exercise One

Income is 50,000 and expenses are 35,000. Calculate the surplus.

Exercise Two

Total subscriptions are 30,000, of which 5,000 relates to the following year Calculate adjusted income.

Income adjustment	Amount	Expense adjustment	Amount
Subscriptions	______	Expenses paid	______
Less: Following year	______	Add: Unpaid	______
Adjusted income	______	Adjusted expenses	______

Expense Adjustment and Comprehensive Application

Exercise Three

Expenses paid are 20,000 and unpaid accrued expenses are 4,000. Calculate total expenses for the period.

Exercise Four

Subscriptions are 60,000, of which 10,000 relates to the following year; expenses paid are 40,000 and unpaid expenses are 5,000. Adjust income and expenses and calculate the surplus.

Final calculation	Amount
Adjusted income	______
Adjusted expenses	______
Surplus	______

Conceptual Comparison

Basis of comparison	Receipts and payments	Income and expenditure
Basis	______	______
Does it show performance?	______	______
Does it include adjustments?	______	______

Conclusion

The receipts and payments account shows cash movement, while the income and expenditure account shows .true financial performance

Evidence-Supported Interpretation

Organisations have different objectives: some earn profit, while others provide services and support the community. Companies calculate profit and distribute it to shareholders or retain it for growth, whereas a not-for-profit organisation uses its income to support its activities. Although organised accounting rules are followed, questions arise about purpose, performance, value and impact.

Question

Is financial success best measured by profit, or by how effectively an organisation achieves its purpose?
You are required to determine how objectives define success, not to decide which type of organisation is better.
In companies, success is often measured through profit and growth, while a not-for-profit organisation measures success through service and impact. However, profit does not always reflect long-term value, and the impact of service is difficult to measure.

The Central Issue

Is profit the best measure of success, or should success be measured by the extent to which an organisation achieves its purpose?
You may draw on: profit and dividends; reserves; shareholders; not-for-profit organisations; receipts and payments; income and expenditure; surplus and deficit; purpose versus profit; and financial performance versus social impact.
You may argue that profit is a clear and measurable indicator, or that purpose and impact are more meaningful measures. Both positions are acceptable if supported by clear reasoning and logical justification.

Essay Writing Framework

A strong response should explain how companies measure success through profit; how not-for-profit organisations measure success differently; evaluate the advantages and limitations of both measures; discuss the role of purpose; present a counterargument; and end with a balanced Judgment.

Section	Requirement	Guiding Question
Introduction	Define financial success	What does success mean for each organisation?
Argument One	Profit as a measure of success	Why is profit useful?
Argument Two	Purpose as a measure of success	Why might impact be more important?
Evaluation	Compare the two views	Can success be measured in one way?
Conclusion	Make a balanced Judgment	What is the most appropriate measure overall?

Essay Rubric

Total mark: 20.

Criterion	4 (Excellent)	3 (Good)	2 (Developing)	1 (Limited)
Conceptual understanding	Strong understanding of adjustments and report structure	Clear understanding	Basic understanding	Limited understanding
Depth of analysis	Precise evaluation of reality and interpretation	Clear evaluation	Mostly descriptive	Little analysis
Use of evidence from Unit Nine	Integrates adjustments, statements and ratios effectively	Relevant references	Limited application	Weak reference
Organisation and coherence	Logical sequence and strong counterargument	Mostly organised	Weak flow	Unorganised
Conclusion and Judgment	Balanced, justified and mature	Clear but limited	Undeveloped	Conclusion without reason or evidence

Mark interpretation: 18-20 exceptional analytical maturity; 14-17 strong reasoning; 10-13 adequate understanding with limited depth; 6-9 basic understanding with gaps; 0-5 limited reasoning and inadequate structure.

Model Response

Financial success is often measured by profit, especially in companies, while not-for-profit organisations measure success differently. Some believe that profit is the best indicator, while others believe that achieving the organisation's purpose is more important.

On the one hand, profit is a clear and measurable indicator. Companies use it to reward shareholders through dividends and to invest in growth. Financial statements provide organised information for investors and managers, and profit can easily be compared across organisations and over time.

On the other hand, profit does not always reflect true value. Not-for-profit organisations serve the community, and their success is measured by their impact on education, health or social development. Such impact is not easily measured financially. An organisation may earn only a small surplus while achieving its purpose to a very high degree.

In conclusion, profit is an important measure of financial performance, but it is not the only measure. For not-for-profit organisations, achievement of objectives is a more appropriate measure of success. The measure therefore depends on the organisation's purpose, and both profit and impact should be considered.

This response demonstrates an understanding of profit and purpose, balance between the two views, application of dividends, surplus and accounts, a logical structure, and a justified conclusion.

UNIT TEN

FINANCIAL STATEMENT ANALYSIS AND INTERPRETATION

Essential Question

Core Idea:
Can financial analysis genuinely guide decisions, or does it require interpretation that goes beyond the numbers?

Key Concepts:
Financial analysis; ratio analysis; profitability ratios; liquidity ratios; efficiency ratios; interpretation.

Financial Analysis and Decision-Making

Core Idea and Opening Case

Financial statements do not make decisions; managers do. Numbers can provide information and indicators, but they must be interpreted, questioned and understood in context. Financial analysis is not limited to calculations; it concerns Judgment, comparison and decision-making under uncertainty

Essential Question

Can financial analysis genuinely guide decisions, or does it require interpretation that goes beyond the numbers?

Unit Opening Case: The Investment Decision

Amir has recently started work at an investment company. On his first day, his manager assigns him a task: “Two companies are seeking investment. Both appear profitable. I want you to decide which company we should invest in.”

Amir receives the financial statements of the two companies. At first sight, both appear successful: revenue is high and profits are positive. However, his manager adds one further instruction: “Do not merely tell me the numbers; tell me what they mean.” Amir begins his analysis.

Looking at Profit, Liquidity and Efficiency

Part A: Looking at Profit

Amir begins by examining profitability. Company A shows a high gross profit margin, while Company B's margin is lower, but Company B controls its expenses more effectively. Amir calculates the gross profit margin and net profit margin, and the results are surprising: one company appears strong at first, but weaker after expenses are taken into account.

CORE IDEA

Profit alone does not tell thewhole story.

Part B: Looking at Liquidity

Amir asks a different question: "Can the company pay its short-term obligations?" He calculates the current ratio. One company earns high profits but has weak liquidity, while the other earns moderate profits and has a stable cash position.

CORE IDEA

A profitable business may stillface financial risk.

Part C: Looking at Efficiency

Amir then examines how efficiently the two companies operate and studies inventory turnover. One company sells its inventory quickly, while the other holds it for long periods. He begins to identify important patterns.

CORE IDEA

Performance concerns not only profit, but also how resources are used.

Part E: Questioning the Numbers

Amir begins to think more deeply:

- Have these figures been affected by the accounting methods used?
- Do the figures reflect present reality or past performance?
- Is there information that does not appear in the financial statements?

He remembers everything he has learned: adjustments in Unit Five; incomplete records in Unit Six; personal Judgment, depreciation, provisions and disposal of assets in Unit Seven; fairness between partners in Unit Eight; and purpose in Unit Nine. Suddenly, the task becomes clearer.

The question is not only, “Which company is better?” but also, “What do these numbers actually tell us, and what do they not tell us?”

Comprehensive Formula Sheet

1. Income StatementCalculations

Item	Formula	Purpose
Gross profit	Sales revenue - Cost of sales	Calculate profit before expenses
Net profit	Gross profit - Expenses	Complete missing figures
Net profit - alternative	Sales revenue - Cost of sales - Expenses	Direct calculation
Cost of sales	Sales revenue - Gross profit	Reverse calculation
Expenses	Gross profit - Netprofit	Reverse calculation

2. Profitability Ratios

Ratio	Formula	Purpose
Gross profit margin (%)	(Gross profit ÷ Sales revenue) × 100	Measure trading profitability before expenses
Net profit margin (%)	(Net profit ÷ Sales revenue) × 100	Measure overall profitability

3. Liquidity Measures

Item	Formula	Purpose
Current ratio	Current assets ÷ Current liabilities	Measure ability to pay short-term debts
Working capital	Working capital Current assets - Current liabilities Measure liquidity strength	Measure liquidity strength

4. Efficiency Ratio

Item	Formula	Purpose
Inventory turnover	Cost of sales ÷ Inventory	Measure how quickly inventory is sold
Inventory holding period - optional	Inventory ÷ Cost of sales) × 365	Measure how long inventory is held

5. Supporting Interpretation in Steps Three and Four

Situation	Rule	Meaning
Higher gross profit margin	The higher ratio is usually better	Better cost control or pricing
Higher net profit margin	The higher ratio is usually better	Better expense management
Higher current ratio	The higher ratio is usually better	Stronger liquidity
Higher inventory turnover	The higher rate is usually better	More efficient use of inventory

EXPLAIN

Are adjustments made beforeprofit is distributed or after it?

6. Decision-Making and Critical Thinking in Steps Five and Six

Requirement	What should be used	Support the final answer
Investment decision	At least two ratios	Show reasoning
Comparison	Comparison between A and	Show reasoning
One limitation	Ratios do not present the complete picture	Add critical thinking

7. Core Idea Box

Concept	Meaning
Accounting treatments	Methods such as depreciation affect profit
Incomplete data	Ratios overlook external risks
Profit does not equal safety	High profit does not mean low risk

Student Task: Complete the Missing Figures

Amir receives the following summarised financial information for the two companies:

Income Statement Data

Item	Company A	Company B
Sales revenue	200,000	180,000
Cost of sales	120,000	90,000
Expenses	50,000	60,000
Net profit		

Statement of Financial Position Data

Item	Company A	Company B
Inventory	40,000	20,000
Current assets	80,000	60,000
Current liabilities	70,000	30,000

You Are the Analyst

Step One: Complete the missing income statement figures.

Item	Company A	Company B
Sales revenue		
Cost of sales		
Gross profit		
Expenses		

Calculate and Interpret the Ratios

Step Two: Calculate the ratios.

(a) Gross profit margin

Item	Company A	Company B
Sales revenue		
Cost of sales		
Gross profit		
Expenses		

b) Net Profit Margin

Item	Company A	Company B
Net profit		
Sales revenue		
Net profit margin (%)		

c) Current Ratio

Item	Company A	Company B
Current assets		
Current liabilities		
Current ratio		

d) Inventory Turnover

Item	Company A	Company B
Cost of sales		
Inventory		
Inventory turnover		

Step Three: Interpretation

• Which company has the higher gross profit margin? What does this indicate?

• Which company has the higher net profit margin? What does this reveal about expenses?

• Which company is more liquid? How did you determine this?

• Which company uses inventory more efficiently?

Comparison, Critical Thinking and the Final Decision

Step Four: Comparison

• Which company appears stronger in terms of profitability?

• Which company appears stronger in terms of financial stability?

• Which company shows better overall efficiency?

Step Five: Critical Thinking - Going Beyond the Numbers

- Do these ratios present a complete picture of each company? Why?
- How could accounting choices, such as depreciation methods and inventory valuation, affect these results?
- What important information is not included in this analysis?
- Could a company appear strong according to the ratios and still be risky? Explain your answer.

Step Six: Final Decision

You are advising the investment company. Which company would you choose for investment?

Justify your answer by using:

- At least two ratios.
- One comparison.
- One limitation of using financial analysis.

Narrative Reflection

Amir presents his recommendation. The manager listens carefully and then asks one final question: “Are you certain about your decision?”

Amir pauses for a moment. He realises that financial analysis does not provide certainty; it provides evidence, not final answers. At that moment, he understands that the analyst's role is not to guarantee being right, but to make the best possible Judgment in the light of limited information.

KEY CONCLUSION

Calculation is the beginning. Interpretation is the skill. Judgment is the goal.

The Central Issue and Supporting Concepts

Central Issue

Can financial analysis provide reliable guidance for decisions, or should it always be used with caution and critical thinking?

Key Concepts You May Use

When preparing your response, you may refer to:

1. Ratio analysis: profitability, liquidity and efficiency.
2. Comparison.
3. Interpretation.
4. Limitations of financial information.
5. Estimates and personal judgements.
6. Historical performance versus current performance.
7. Decision-making under uncertainty.

You may argue either that financial analysis provides useful and reliable guidance, or that it has limitations and must be interpreted carefully. Either position can be defended if it is supported by clear reasoning.

Expectations of a Strong Response and Writing Framework

Expectations of a Strong Response

A high-quality response should:

1. Explain how financial analysis supports decision-making.
2. Evaluate the reliability of ratios and financial data.
3. Discuss the limitations of using accounting information.
4. Recognise the role of interpretation and Judgment.
5. Present a counterargument.
6. End with a balanced, justified Judgment.

Your essay must analyse the issue rather than merely describe it, and evaluate it rather than merely summarise it.

Justify and Reasoning with Evidence Framework

Section	Requirement	Guiding Questions
Introduction	Define financial analysis and reliability	What does the reliability of financial analysis mean?
Argument One Explain the benefit of financial analysis	Explain the benefit of financial analysis	How do financial ratios support users› decisions?
Argument Two	Explain limitations and risks	Why might the analysis be misleading?
Evaluation	Compare the alternatives	Can the analysis be trusted completely?
Conclusion	Make a balanced Judgment	Should decisions rely on financial analysis alone?

Justify and Reasoning with Evidence Rubric

Total mark: 20 marks

Criterion	4 (Excellent)	3 (Good)	2(Developing)	1 (Limited)
Conceptual understanding	Strong understanding of adjustments and report structure	Clear understanding	Basic understanding	Limited understanding
Depth of analysis	Precise evaluation of reality versus interpretation	Clear evaluation	Mostly descriptive	Little analysis
Use of evidence from Unit Six	Integrates adjustments, statements and ratios effectively	Relevant references	Limited application	Weak reference to concepts
Organisation and coherence	Logical sequence and strong counterargument	Mostly organised	Weak flow	Unorganised
Opinion and conclusion	Balanced, justified and intellectually mature Judgment	Clear but limited	Undeveloped	Unsupported

Mark Interpretation

• 18-20: Exceptional analytical maturity and professional-level insight.

• 14-17: Strong reasoning with minor weaknesses.

• 10-13: Adequate understanding, but limited depth.

• 6-9: Basic understanding with analytical gaps.

• 0-5: Limited reasoning and inadequate structure.

Model Response

“Can financial analysis provide a reliable basis for decision-making, or should it always be interpreted with caution?”

Financial analysis is widely used to support investment decisions in business entities, as it employs ratios and financial data to evaluate performance. Some believe that it provides reliable guidance, while others believe that it should always be used with caution.

On the one hand, financial analysis is useful because it simplifies complex financial information. Ratios such as profitability and liquidity help identify strengths and weaknesses in a business. Investors and managers can use this information to compare companies and make informed decisions. Financial analysis also provides an organised method for evaluating performance and reduces uncertainty.

On the other hand, financial analysis has important limitations. It relies on financial statements that contain estimates and personal judgements. Different accounting methods may produce different results that affect ratios. Financial data are also based on past performance and may not reflect current conditions. In addition, ratios exclude non-financial factors such as management quality or market conditions. Financial analysis may therefore sometimes be misleading if used without caution.

In conclusion, financial analysis is a valuable decision-making tool because it provides useful insights into business performance, but it is not completely reliable when used on its own. It should always be interpreted carefully and used together with personal Judgment and additional information. Financial analysis therefore supports decision-making, but should not replace critical thinking.

Why Is This a Strong Response?

• Clear understanding of the question: it addresses reliability and the need for caution.

• Balanced reasoning: it evaluates both viewpoints.

• Use of concepts: it applies ratios, financial limitations and interpretation.

• Logical structure: introduction, arguments and conclusion.

• Reasoned conclusion: it stresses the importance of Judgment and caution.

This demonstrates the essential skills of a Justify and Reasoning with Evidence: analysis, evaluation and making a justified Judgment.

Justify and Reasoning with Evidence

Financial statements present information such as revenue, profit, assets and liabilities, while ratios summarise key aspects of performance, including profitability, liquidity and efficiency. These figures are calculated and compared, and they often appear objective. However, they depend on accounting methods, estimates and historical data, and may sometimes depend on incomplete information. Financial analysis can therefore guide decisions, but it cannot guarantee their outcomes. This leads to a deeper question:

Can financial analysis provide a reliable basis for decision-making, or should it always be interpreted with caution?

Understanding the Question

You are not being asked to state whether financial analysis is useful. You are being asked to evaluate whether it is sufficiently reliable for decisions to be based upon it. Financial analysis depends on:

- Ratios derived from financial statements.
- Historical financial data.
- Accounting methods and assumptions.
- Comparisons between business entities.

Financial analysis helps identify patterns and trends. Nevertheless, financial statements may contain estimates and judgements; different accounting methods may produce different results; ratios condense complex financial information; important non-financial factors are excluded; and two analysts may interpret the same data differently.

Preparing for the Examination

Comprehensive Review and Examination Preparation

Units 1-10

Original Page 229 - Quick Knowledge Check

This review is intended to consolidate learning from the units, build examination confidence, strengthen calculation, interpretation and Judgment, and prepare students for actual examination conditions.

Answer briefly:

- 1. What is the purpose of an income statement?
- 2. What is the difference between capital expenditure and **revenue expenditure?**
- 3. Why is depreciation charged?
- 4. What is the purpose of control accounts?
- 5. What is a provision for doubtful debts?
- 6. What is goodwill in a partnership?
- 7. What are dividends?

Original Page 230 - Essential Calculations

- 8. What is the difference between a receipts and payments account and an income and expenditure account?
- 9. What is the current ratio used for?
- 10. Why must financial information be interpreted carefully?

Question One - Income Statement

Revenue is 250,000, cost of sales is 150,000, and expenses are 60,000. Calculate gross profit and net profit.

Item	Amount
Revenue	______
Cost of sales	______
Gross profit	______
Expenses	______
Net profit	______

Original Page 231 - Depreciation

Cost is 30,000, residual value is 6,000, and useful life is 6 years. Calculate annual depreciation and the carrying amount after two years..

Item	Amount
Depreciable amount	______
Annual depreciation	______
Carrying amount after two years	______

Original Page 232 - Partnership

Profit is 90,000, A's capital is 120,000, B's capital is 60,000, interest rate is 10%, A's salary is 10,000, and the profit-sharing ratio is 2:1. Calculate interest and residual profit, then distribute the profit

Item	Amount
Profit	______
Interest - A	______
Interest - B	______
Salary - A	______
Residual profit	______

Original Page 233 - Company

Profit is 120,000 and dividends are 50,000. Calculate retained earnings and the dividend payout ratio.

Item	Amount
Profit	______
Dividends	______
Retained earnings	______
Payout ratio	______

Original Page 234 - Ratio Analysis

Revenue is 200,000, gross profit is 80,000, net profit is 40,000, current assets are 100,000, and current liabilities are 50,000. Calculate gross profit margin, net profit margin and current ratio.

Ratio	Calculation	Answer
Gross profit margin	____	______
Net profit margin	____	______
Current ratio	____	______
Payout ratio	____	______

Original Page 235 - Case Study: Retail Business

Original Page 235 - Case Study: Retail Business

A retail business has achieved growth, but management is unsure whether performance has improved. Revenue is 300,000, cost of sales is 180,000, expenses are 80,000, depreciation is 10,000, inventory is 60,000, current assets are 120,000, and current liabilities are 90,000.

Calculate net profit, gross profit margin, net profit margin, current ratio and inventory turnover. Then evaluate profitability, liquidity and inventory-management efficiency, and determine whether management should be concerned.

Original Page 236 - Case Study: Partnership Expansion

A partnership reviews its performance before admitting a new partner. Profit is 100,000, A's capital is 150,000, B's capital is 50,000, interest rate is 10%, A's salary is 20,000, and the profit-sharing ratio is 3:1.

Calculate interest, residual profit, profit distribution and the total received by each partner. Then identify who benefits most and evaluate, with justification, whether the distribution is fair.

Original Page 237 - Case Study: Community Club

A not-for-profit organisation wants to evaluate its performance. Subscriptions are 50,000, of which 10,000 relate to the following year; expenses paid are 30,000 and unpaid expenses are 5,000. Adjust income and expenses, calculate the surplus, then evaluate performance and explain why surplus differs from profit.

Original Page 238 - Advanced Case Study: Investment Decision

Item	Company A	Company B
Revenue	250,000	220,000
Cost of sales	150,000	100,000
Expenses	70,000	80,000
Current assets	100,000	80,000
Current liabilities	90,000	40,000
Inventory	70,000	30,000

Calculate the key ratios, compare the two companies, identify strengths and weaknesses, then make a justified investment decision

Original Page 239 - Final Extended Response

Discuss the statement: “Financial analysis is useful, but it does not provide complete certainty.” Write a balanced response that includes an argument, a counterargument, accounting examples and a justified Judgment. Then reflect: Which unit was the most challenging? Which skills improved most? What is your examination strategy?

Original Page 240 - Advanced Mixed Calculations

Question One - Adjusted Profit

Revenue is 180,000, cost of sales is 100,000, expenses are 50,000, depreciation is 8,000, and the provision increases by 2,000. Calculate adjusted net profit

.

Item	Amount
Revenue	______
Cost of sales	______
Gross profit	______
Expenses	______
Depreciation	______
Increase in provision	______
Net profit	______

Original Page 241 - Disposal of an Asset

The asset cost is 25,000, accumulated depreciation is 15,000, and the selling price is 12,000. Calculate the carrying amount and the profit or loss on disposal.

Item	Amount
Carrying amount	______
Selling price	______
Profit or loss	______

Original Page 242 - Complete Partnership Adjustments

Profit is 120,000, A's capital is 200,000, B's capital is 100,000, interest is 10%, B's salary is 15,000, and the profit-sharing ratio is 3:2. Calculate interest, deduct the adjustments, distribute residual profit and calculate the totals.

Item	Amount
Profit	______
Interest - A	______
Interest - B	______
Salary - B	______
Residual profit	______

Original Page 243 - Company Equity

Share capital is 300,000, profit is 150,000, and dividends are 60,000. Calculate reserves and total equity.

Item	Amount
Profit	______
Dividends	______
Reserves	______
Total equity	______

Original Page 244 - Detecting and Correcting A

business did not record depreciation, understated the provision, and recorded revenue twice. Identify the effect of each error on profit..

Error	Effect on profit
Failure to record depreciation	______
Understating the provision	______
Recording revenue twice	______

A partnership forgot to recognise a partner's salary and interest on capital. Identify who benefits from the error and explain its effect on fairness of distribution.

Original Page 245 - Written Interpretation and Analysis

• 1. A company earned a high profit and had a low current ratio. Explain what this means in terms of profitability, liquidity and risk.

• 2. A business showed low profit and high inventory turnover. What do the two results together suggest?

Original Page 246 - Not-for-Profit Performance and Investment Risk

• 3. A not-for-profit organisation reported high receipts and a low surplus. Explain the situation and distinguish between cash and performance.

Investment Risk Scenario

A company has strong profit margins and very low liquidity. Would you invest in it? Justify your decision using advantages, risks and the additional information required.

Original Page 247 - Scenario-Based Decisions

Partnership Dispute

Two partners disagree over profit distribution: one contributed more capital while the other worked more hours. Propose accounting adjustments that help achieve fairness balance..

Evaluating a Not-for-Profit Organisation

A charity reported a small surplus and a large community impact. Is it successful? Explain, taking the organisation's purpose into account.

Original Page 248 - Extended Case Study: The Growing Business

A business began as a sole trader, then became a partnership and then a company, and is now seeking investment. Revenue is 400,000, cost of sales is 240,000, expenses are 120,000, depreciation is 15,000, provision is 5,000, current assets are 150,000, current liabilities are 100,000, and inventory is 80,000.

Calculate net profit and the key ratios, evaluate performance and identify risks, then present an investment recommendation and a justified final Judgment.

Original Page 249 - Reflection and Examination Strategy

Identify the type of question you find most difficult, your greatest strengths, and what you will focus on during revision. Then write an examination plan, explaining the order in which you will answer, time management, calculation steps and methods for checking results

Original Page 250 - Complete Adjustment Chain

Revenue is 320,000, cost of sales is 200,000, expenses are 70,000, depreciation is 12,000, and the provision increased from 4,000 to 7,000. Calculate gross profit, net profit before adjustments and adjusted net profit

Item	Amount
Revenue	______
Cost of sales	______
Gross profit	______
Expenses	______
Net profit before adjustments	______
Depreciation	______
Increase in provision	______
Final net profit	______

Original Page 251 - Disposal and Depreciation

The asset cost is 40,000, accumulated depreciation is 24,000, and it was sold for 20,000. Calculate the carrying amount and the profit or loss, and explain the reason for the result.

Item	Amount
Carrying amount	______
Selling price	______
Profit or loss	______

Original Page 252 - Complex Partnership Problem

Profit is 180,000, A's capital is 200,000, B's capital is 100,000, C's capital is 50,000, the interest rate is 10%, A's salary is 20,000, B's salary is 10,000, and the profit-sharing ratio is 3:2:1.

Calculate interest on capital, deduct the adjustments, distribute residual profit, then calculate the total received by each partner

Original Page 253 - Ratio Analysis Under Pressure

Ratio	Company X	Company Y
Gross profit margin	60%	40%
Net profit margin	20%	25%
Current ratio	0.8	2.0

Identify the company with better cost control, the company with greater liquidity and the company with higher risk; then choose one and justify your choice.

If a company has high inventory turnover and a low profit margin, explain what the two results suggest about efficiency, pricing and costs.

Original Page 254 - Accounting Judgment Scenarios

- 1. A company changed its depreciation method. How does this affect profit? Does it affect the reliability of comparison?
- 2. A business increased its provision substantially. What happens to profit, and why might management make this decision?
- 3. Two companies use different inventory valuation methods. Explain the effect on comparing their results.

Original Page 255 - Integrative Case Across Units

A large industrial group operates in several sectors and is seeking investment. Revenue is 500,000, cost of sales is 300,000, expenses are 120,000, depreciation is 20,000, provision is 10,000, current assets are 200,000, current liabilities are 150,000, and inventory is 100,000.

Calculate adjusted net profit and the key ratios, evaluate performance, identify weaknesses and propose improvements, then present a justified final evaluation

Original Page 256 - Advanced Thinking Questions

- 1. Can a company influence profit without violating accounting rules? Explain.
- 2. Is higher profit always better?
- 3. Can a business appear financially strong and then fail?

Original Page 257 - Quick Practice and Mastery Challenge

Calculate quickly:

- 1. Profit = 100,000 - 60,000 - 20,000 = ______.
- 2. Depreciation = (50,000 - 10,000) ÷ 5 = ______.
- 3. Current ratio = 80,000 ÷ 40,000 = ______.
- 4. Provision = 5% of 20,000 = ______.
- 5. Dividend payout ratio = 30,000 ÷ 100,000 = ______.

Mastery Challenge

Choose between Company A, which has high profit, low liquidity and slow-moving inventory, and Company B, which has moderate profit, strong liquidity and fast-moving inventory. Write a complete evaluation of strengths, weaknesses, risks and the final decision.

Original Page 258 - Mastery Challenge Answer Space

Write your answer in organised paragraphs: a short introduction, comparison using ratios, risk analysis, one limitation of the analysis, and then a justified final Judgment.

Original Page 259 - Judgment and Reasoning

Question Bank

Foundations of Truth, Measurement and Reality

Do numbers always reflect reality, or an organised interpretation of it? Can measurement be precise when it depends on estimates? Is financial truth objective, or is it constructed by rules? Do statements present the truth, or what standards accept? Can two correct methods produce two different pictures of reality?

Judgment, Uncertainty and Decision

Can a decision be completely rational when information is incomplete? Is it better to act using incomplete data or wait for certainty that may never come? Does analysis reduce uncertainty or organise it? Is a decision justified if it is based on reasonable assumptions but produces a bad result? Does caution always outweigh optimism?

Fairness and Distribution

Is fairness achieved through fixed rules or flexible Judgment? Do rewards reflect effort, investment or results? Is equality always fair? Do systems guarantee fairness, or merely standardise inequality? Who deserves profit: the investor, the worker, or both?

Value, Profit and Purpose

Is profit the best measure of success? Can an organisation succeed without profit? Does financial performance outweigh social impact? Is value always measured in money? Do statements capture what truly matters?

Original Page 260 - Continuation of the Question BankRisk, Reliability and Confidence

Can financial information be trusted completely? Does verification guarantee accuracy or consistency? Is risk measured or estimated? Can a business appear stable while carrying high risk? Does the decision-maker trust the data or challenge it?

Time, Change and Performance

Does the past predict the future? Do the results of one period represent long-term performance? Is timing more important than accuracy? Can short-term success conceal long-term weakness? How does a business balance the present and sustainability?

Systems, Rules and Limitations

Do rules create clarity or limit understanding? Does a consistent system fully reflect complexity? Do standards improve the truth or standardise its interpretation? Is simplification necessary even if it reduces accuracy? Do organised systems capture the complexity of reality?

Ethics, Responsibility and Influence

Does an accountant's responsibility extend beyond following rules? Do reports influence behaviour? Is a technically correct but potentially misleading presentation ethical? Do decisions treat stakeholders equally? Is complete neutrality possible?

Comparison, Perspective and Interpretation

Can two analysts interpret the same data differently and both be correct? Is comparison useful when methods differ? Do ratios reveal the truth or simplify it? Can performance be evaluated without context? Is interpretation more important than calculation?

Original Page 261 - Final Synthesis Questions

• 46. Is accounting a science of measurement or an art of interpretation?

• 47. Does financial analysis provide certainty in decision-making?

• 48. Do numbers guide decisions, or do people shape their meaning?

• 49. Is financial success the result of performance, perception, or both?

• 50. To what extent can accounting truly represent reality?

Glossary of Accounting Words and Phrases

Glossary

Term	Definition
Accruals	Expenses incurred but not yet paid, recognised to match income with the correct accounting period.
Accounting equation	The relationship showing that Assets = Liabilities + Capital; the foundation of accounting.
Accounting period	The period for which financial statements are prepared, such as a month or a year.
Accounting principles	Rules and concepts that guide the preparation and presentation of financial statements.
Accumulated depreciation	Total depreciation charged on an asset since it was acquired.
Admission of a partner	The process of a new partner entering a business and the resulting adjustments to ownership and profit distribution.
Analysis	Examining financial information to understand performance and trends.
Assets	Economic resources owned by a business that provide future benefits.

Glossary - Continued

Term	Definition
Bank reconciliation	Comparing cash-book records with the bank statement to identify differences.
Bookkeeping	Recording and organising financial transactions.
Books of prime entry	The first place in which transactions are recorded before posting to the ledger.
Capital	The owner's investment in a business used to support its operations.
Capital expenditure	Expenditure on long-term assets that benefit the business over several periods.
Case study	A detailed situation used to apply accounting knowledge to real or simulated cases.
Cash book	A record of all cash and bank transactions of a business.
Client	A person or organisation that receives accounting services or deals with a business.
Company	A legal business entity owned by shareholders and separate from its owners.
Comparison	Evaluating financial data across periods or between entities to identify differences.
Control account	A total account used to check the accuracy of detailed ledger accounts.
Cost of sales	The direct cost associated with goods sold during a period.
Credit entry	An entry on the right-hand side of an account representing an increase in liabilities or income.
Creditors	Individuals or businesses to whom the business owes money.
Current assets	Assets expected to be converted into cash within one year.
Current liabilities	Obligations that must be settled within one year.
Current ratio	A liquidity measure showing the business's ability to meet short-term obligations.
Data	Financial information used for recording, analysis and decision-making.

Glossary - Continued

Term	Definition
Glossary - Continued	Comparing cash-book records with the bank statement to identify differences.
Term	Definition
Debit entry	An entry on the left-hand side of an account representing an increase in assets or expenses.
Debtors	Customers who owe money to the business.
Decision-making	Using financial information to choose between alternatives.
Depreciation	The systematic allocation of an asset's cost over its useful life.
Disposal of an asset	Removing an asset from the accounts when it is sold or no longer used.
Discount allowed	A reduction granted to customers to encourage early payment or sales.
Discount received	A reduction received by the business from suppliers for early payment.
Dividends	A portion of profit distributed to shareholders.
Double entry	A system in which every transaction is recorded in two accounts to maintain accounting balance.
Drawings	Money or assets withdrawn by the owner for personal use.
Efficiency ratios	Measures of how efficiently a business uses its resources.
Errors of commission	Errors arising when incorrect amounts are recorded.
Errors of omission	Errors in which transactions are left completely unrecorded.
Expenses	Costs incurred by a business in carrying out its activities.
Financial analysis	Evaluating financial data to assess performance and support decisions.
Financial information	Data relating to a business's financial activities and financial position.
Financial position	The state of a business's assets, liabilities and equity at a particular date.
Financial statements	Formal reports presenting financial performance and financial position.
Goodwill	The intangible value of reputation, brand and customer relationships.

Glossary - Continued

Term	Definition
Gross profit	Revenue less cost of sales; it shows basic trading performance.
Income	Money earned from the activities of a business.
Income and expenditure account	An account used by not-for-profit organisations to determine surplus or deficit.
Interpretation	Explaining the meaning of financial data in context.
Inventory	Goods held for resale in the ordinary course of business.
Inventory turnover	A ratio measuring how quickly inventory is sold.
Ledger	The collection of all accounts in which transactions are recorded.
Liabilities	Amounts owed by a business to external parties.
Limited company	A business owned by shareholders whose liability is limited.
Liquidity	The ability of a business to meet its short-term obligations.
Margin of error	The possible range of inaccuracy in estimates or calculations.
Matching principle	The principle that expenses are matched with the revenue they helped generate.
Net profit	Profit remaining after all expenses have been deducted.
Not-for-profit organisation	An entity that uses its income to support its activities rather than distribute profits.
Partnership	A business owned by two or more persons who share profits and responsibility.
Prepaid expenses	Payments made in advance for expenses relating to future periods.
Professional Judgment	Using professional reasoning in making accounting decisions.
Partnership	A business owned by two or more persons who share profits and responsibility.
Prepaid expenses	Payments made in advance for expenses relating to future periods.
Professional Judgment	Using professional reasoning in making accounting decisions.

Glossary - Continued

Term	Definition
Profit	The financial gain remaining after expenses are deducted from revenue.
Profit margin	A ratio showing profit as a percentage of revenue.
Profit-sharing ratio	The agreed ratio in which partners distribute profit.
Provision	An estimated amount set aside for future losses or obligations.
Receipts and payments account	A summary of all cash inflows and outflows of a not-for-profit organisation.
Reliability	The degree to which financial information can be depended upon.
Reserves	Profits retained within the business for future use.
Revenue	Income earned from the ordinary activities of a business.
Revenue expenditure	Expenditure on day-to-day expenses benefiting the current period.
Risk	The possibility of financial loss or uncertainty of outcomes.
Share capital	Funds raised by issuing shares to investors.
Shareholders	Owners of a company who hold its shares.
Statement of financial position	A report presenting assets, liabilities and equity at a specified date.
Trial balance	A statement used to check the accuracy of ledger balances.
Uncertainty	The absence of complete certainty regarding financial outcomes or estimates.
Working capital	The difference between current assets and current liabilities.

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