Stage 2 Accounting 2020
FAQ

1 How should discount allowed and discount received be recorded in the new course?

The expectation is that students will subtract Discount Allowed from Sales (at the same point as Sales Returns) and Discount Received will be subtracted from Cost of Goods sold (at the same point as Purchase Returns). While this isn't a requirement in the accounting standards it is suggested that as discount allowed is generally provided to customers to whom goods are sold to on credit, subtracting this from the Net Sales Revenue figure gives a more accurate picture of the income earned from those sales. Similarly, discount received can be linked to the early payment to suppliers of goods purchased on credit and so subtracting this from the Cost of Sales more accurately represents the expense incurred in the acquiring and selling of those goods.

See example below:

	$	$	$
Sales			*10,000*
Less sales return and allowances			*100*
Less discount allowed			*30*
			9,870
Less Cost of goods sold			
Opening stock		*300*	
Add purchases	*200*		
Less purchases return	*80*		
Less discount received	*15*		
	105		
Custom duty	*70*		
Carriage inwards	*40*		
		215	
		515	
Less closing stock		*130*	
			385
Gross profit			*9,485*

2 What figures should be used in calculating inventory turnover?

The reporting of discount received as a part of COGS in the income statement is justified in linking that information to the transactions that gives rise to the discount. However, the purpose of calculating inventory turnover is to determine an entity's efficiency in selling stock. As a result, the COGS figure used in the inventory turnover ratio should exclude the discount received. This discount, while related to the purchasing of stock, is a function of the ability of an entity to repay their liabilities early or to negotiate a discount rather than their efficiency in selling goods.

3 How should inventory be recorded?

A sales return under the First In, First Out method should be costed at the most recently sold cost price. When dealing with Sales Returns on an Inventory Card the return should be taken from the bottom item (and then work upwards) from the last lot of sales. Some texts have previously suggested it should be from the top line of the last lot of sales as this follows the idea that the first items to come back in, should be the first ones that went out. However, as sales return reverses a previous sale, logically the reverse of First in, First out would be Last Out, First In.

To extend the logic further (and this can also apply in a periodic system) if we are talking FIFO, and the first (purchases) in are the first (sales) out, it must mean whatever we have on hand is made up of the "last (purchases) in". So ending inventory must be made up of the most recent purchases. If we track that back to any sales return, then the last item that went out must be the one being returned (as it will be from the most recent batch purchased). Remembering this is based on a costing/valuation assumption and may not be what happens physically it is how it will be recorded in the system.

4 Is it necessary to complete the particulars column on the stock card?

In the stock card, the particulars column isn't of critical importance but should logically make sense. The stock card is a subsidiary type document, while the Inventory ledger account which will be updated from the stock card does require precise naming conventions. For the stock card, movements of stock in to the business I would expect to see Purchases and Sales Returns commonly listed (the corresponding entries in the ledger that would also be acceptable would be cash/creditors and COGS), a stock gain would also show up as an "in". For movements out I would expect to see Sales and Purchase Returns (in the ledger COGS and cash/creditor), also stock losses.

Additionally, Sales and Purchase Returns could be recorded as "negative" ins and outs and this is acceptable (and actually my preference).

5 How should we treat cash receipts in advance?

Where cash is received prior to providing a service or good I would expect to see it recorded as Unearned Revenue or Revenue Received in Advance (both liabilities). I have seen the terms Prepaid Revenue used but would advise against this as it suggests a payment made by the business rather than cash received.

6 Can AT2 be completed as a Test?

This is discouraged. There is very little advantage to students in completing a major task such as this (30%) under test conditions. This task is more suited to an assignment - there can be a collaborative component as well where students do some research together. The teacher can validate student work by looking at work-in-progress along the way. Students are more advantaged if they have the opportunity to submit a draft for this assessment type also.

7 How should bad and doubtful debts be treated?

Bad and doubtful debts are an expense that arise due to the granting of credit to customers who then are unable to fulfil their payment obligations.

When taken literally, bad debts refer to an amount that has been written off because the debtor is definitely not going to pay, while doubtful debts indicate a portion of accounts receivable that are predicted to be uncollectible in the future. While a distinction can be made between the two expenses, the only reporting requirement for identifying bad debts separately is for taxation purposes where deductions are only allowed for debts **actually** written off.

In practice, when an allowance is in use, the expense is usually reported as "Bad and doubtful debts expense" or the terms are used interchangeably. This approach also simplifies the process of accounting for these events by requiring the expense only to be recorded as part of the end of period adjustments and that any accounts written off will be debited directly to the allowance account.

The two entries would be shown as:

An end of period adjustment

Bad and Doubtful Debts Expense	$$$$	
Allowance for Doubtful Debts		$$$$
(Bad debts provided for a % of net credit sales or through an alternative method of prediction)		

The write off of an uncollectible account:

Allowance for Doubtful Debts	$$$	
Accounts Receivable – xxx		$$$
(Debtor account written off using allowance method)		

It should be noted that while it is possible to "directly write-off" bad debts as an expense against accounts receivable, where an allowance is in use, this creates an unnecessary extra layer of complexity, requiring the Bad Debt Expense to be closed to the allowance account before the end of year adjustment is made. Where an allowance account is not used, bad debts can also be directly written off against accounts receivable, however, this approach is not considered consistent with accrual based accounting or with accounting standard requirements.

A simple example to show the ledger entries in context is shown below.

Accounts Receivable (opening balance) - $10,000
Allowance for Doubtful Debts (opening balance) - $2,500
Bad Debt written off during the period (Oct 1) - $3,100
Allowance for Doubtful Debts (closing balance) - $2,300

- *Note this closing balance would normally be calculated by student using additional information but had been provided for simplicity)*

Accounts Receivable

July 1	**Op Balance**	**10,000**	**October 1**	**Allow for DD**	**3100**
			This is to write off bad debt		

Allowance for Doubtful Debts

			July 1	**Op Balance**	**2,500**
October 1	**Accounts Rec.**	**3100**			
This is to write off bad debt					
			June 30	**Bad & DD Exp**	**2900**
			This is the end of period adjustment calculated to achieve the closing balance		
			June 30	**Clos Balance**	**2,300**
			This is the figure provided (normally calculated by the student)		

Bad and Doubtful Debts Expense

June 30	**Allow for DD**	**2900**			
This is the end of period adjustment calculated to achieve the closing balance					