# Conceptual Framework

**Assets**

**Definition criteria**

- Future inflow of economic benefit
- Control by the entity
- Occurrence of a past event

**Recognition criteria**

- Probable inflow of future economic benefit
- Reliable measurement

**Liability**

**Definition criteria**

- Future outflow of economic benefit
- Present obligation
- Occurrence of a past event

**Recognition criteria**

- Probable future outflow of economic benefit
- Reliable measurement

**Owner's equity**

| A = L + OE |
|---|

**Income**

**Definition criteria**

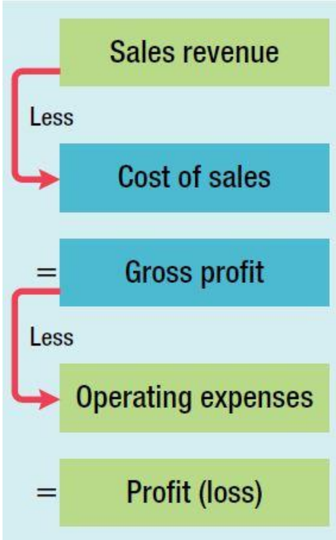
- Inflow of future economic benefit
- Increase in equity
- Other than contributions by equity participants

**Expenses**

**Definition criteria**

- Outflow of future economic benefit
- Decrease in equity
- Other than distributions to equity participants

**Income measurement for a retailer**




# Cash vs Accrual accounting

**Cash Accounting:** Records revenues and expenses when cash is received/paid

**Accrual Accounting:** Records revenues and expenses when transaction occurs | Records income when it has been earned and record expenses when it has been earned (*Record* *regardless whether the cash is received or not*) | Includes non-cash expenses (depreciation; doubtful debts)

- Uses the accrual basis rather than cash basis in accounting

Merchandising and Retail Firms

**Retail firms:** sell products to earn revenue

**Service firms:** provides a service

# Perpetual and Periodic Inventory

**Perpetual Inventory**

- Actual inventory is determined by actual count
- COGS is updated at the time of every sale
- Ledger account call **INVENTORY** (A) records all inflows and outflows of inventory at the time

**Periodic Inventory**

- No record of inventory that should be on hand
- Purchases of inventory is recorded in a temporary ledger called **PURCHASES**

**Entries**

Dr Account Receivable
  Cr Sales Revenue

Dr Cost of goods sold
  Cr Inventory

The amount of COGS and Inventory is always lesser than Account receivable and Sales Revenue

## Illustration Periodic Profit & Loss

| | | |
|---|---|---|
| Sales | | 43,000 |
| Less: Sales Returns | | 2,000 |
| Net Sales | | 41,000 |
| Less: Cost of Goods Sold | | |
| Opening Inventory | 40,000 | |
| Plus: Purchases | 10,000 | |
| Less: Purchase Returns | 500 | |
| Less: Closing Inventory | 20,800 | (28,700) |
| Gross Profit | | $12,300 |

Inventory at the beginning +purchases –purchase returns –inventory at the end =COGS

Net Purchases

| Perpetual | Periodic |
|---|---|
| Facilitates (make an action or process easier) the frequency & timeliness of financial reporting, so that interim reports can be prepared | Requires a physical stock take to measure profit. Stock takes can be costly & disruptive |
| Better control & more efficient management of inventory | Not as efficient as it does not maintain records of inventory movements. |
| Can determine stock loss or gains | No stock loss or gains recorded; assumes all stock is sold |
| Requires considerable record keeping, hence increasing costs | Lower cost & easier recording procedures |
| Development in technology & software has made perpetual inventory more affordable | Lower cost now no longer an advantage |
| Restricted to major value stock items (eg. Motor cars and jewellery) | Most firms (particularly smaller ones) used the periodic system |