AME Part 1 Q & A

Part 1

1. What is capital, dude?

It's your money in the business.

You may have saved this 'capital' or borrowed it from somewhere. But it is yours to put in the business.

What Chinese call 资本.

Unlike liability which is what the business has borrowed from others.

Capital is a source of funding of assets. From owners.

Liability is also a source of funding. From non-owners (referred to as creditors).

Just like when you purchase a house through a housing loan:

Capital - your down-payment

Liability – your housing loan

Creditor – your bank

2. What then is a capital asset?

A capital asset is a long term asset, such as property or equipment.

It is referred to as a capital asset because it is usually funded by long term funds, such as capital or term loan.

3. What is the difference between capital and liability?

Capital is what belongs to owners. It is not subject to repayment.

Liability is what is owing to creditors and need to be paid when due.

4. Explain what is credit and what is debit again.

Debit and credit are shorthand representations of a transaction done.

The alternative would be to write down every transaction in a long form which would be tedious. And hard to manage for accounting.

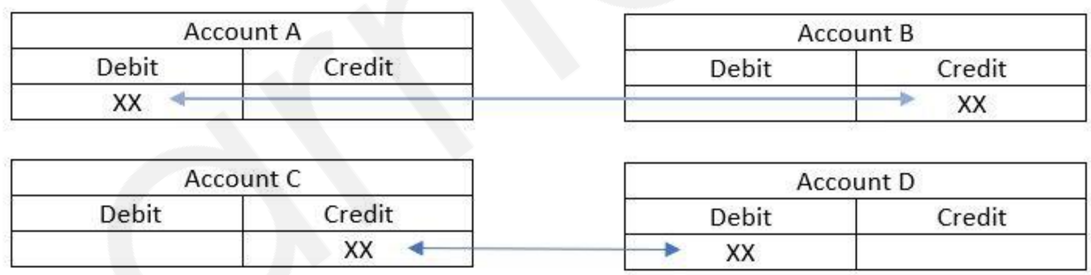
Think of it this way – when you credit someone, it is because he has given something away. If he has given you something of value. He is a creditor.

Credit depicts giving and is always shown on the right side.

Conversely, when you give someone something of value, he is a debtor to you.

Debit depicts receiving and is always shown on the left side.

With the double entry system, every transaction is reflected by a debit or credit entry and, on the opposite side, an equivalent credit or debit entry.



For example:

Let’s say your business has just sold RM100 of products to a customer for cash. The entries would be:

Debit Cash Account (for value *received* in cash) RM100

Credit Sales Account (for value *given* to customer in the form of sale) RM100

Or your business purchased a car for RM100 for cash. The entries would be:

Debit Car Account (for value *received* in the form of a car) RM100

Credit Cash Account (for value *given* to car vendor) RM100

5. Why do some items go to the Profit and Loss Account and some go to the Balance Sheet?

The Profit and Loss Account is to show results of the business for an accounting period. Items that are revenue (such as sales) or expense (such as purchases or rent) and relate to the period would go there.

The Balance Sheet shows assets owned by the business, its liabilities and what is left that belongs to the owners at a particular date. Items that are assets (building, stock, etc.) and liabilities (creditors, bank loan, etc.) would go there.

In the example above, the sale of RM100 would go to the Profit and Loss Account while the purchase of a car for RM100 would go to the Balance Sheet.