

<b>Topic Overview</b>	
<b>Topic</b>	BAFS Elective Part - Accounting Module – Financial Accounting A02: Financial Reporting for Different Forms of Business Ownership
<b>Level</b>	S5 / S6
<b>Duration</b>	2 lessons (40 minutes per lesson)

**Learning Objectives:**

1. To reinforce students’ understanding of the differences in establishing business entities using sole proprietorship, partnership and limited company;
2. To understand how financial statements are formatted to serve the different types of business entities; and
3. To describe the Hong Kong accounting regulatory framework.

**Overview of Contents:**

- Lesson 1    Profit Distribution and Appropriation Account  
 Lesson 2    Capital or Owner’s Equity and Regulatory Framework of Accounting

**Prior Knowledge:**

Students should have basic understanding of the “Forms of business ownership” and “The preparation of financial statements” studied in other parts modules.

**Resources:**

- Topic Overview, Teaching Plan and Answers to Student Worksheet
- PowerPoint Presentation
- Student Worksheet

**Suggested Activities:**

- Group Discussion
- Practical Exercise
- Presentation

<b>Lesson 1</b>	
<b>Theme</b>	Profit Distribution and Appropriation Account
<b>Duration</b>	40 minutes

**Expected Learning Outcomes:**

Upon completion of this lesson, students will be able to:

1. Understand how net profit is distributed to company owners under different types of business structures: sole trader, partnership and limited company; and
2. Understand the function of the Appropriation Account in distributing net profits.

**Teaching Sequence and Time Allocation:**

Activities	Reference	Time Allocation
<b>Part I: Introduction</b>		
◇ Teacher begins lesson by asking students to think about setting up a business to sell mobile phones and accessories.		2 minutes
<b>Part II: Contents</b>		
◇ Differences in business structures of: sole proprietorship, partnership, and limited company. This part has been covered in other modules, teachers remain flexible to adapt to students' prior knowledge levels.	PPT#1-4	3 minutes
◇ Teacher asks students to explain the three different business ownership forms and discuss the three unique aspects.	PPT#5-7	5 minutes
◇ <b>Activity 1 - Group discussion</b> <ul style="list-style-type: none"> <li>■ Students are required to discuss and give answers to Activity 1. Teacher invites a volunteer to show the answer to the class.</li> <li>■ Teacher shows solutions to the class.</li> </ul>	Student Worksheet p.1	
◇ Teacher asks students to determine the key factors to be considered when selecting a business ownership structure.	PPT#8	3 minutes
◇ <b>Activity 2 - Matching</b> <ul style="list-style-type: none"> <li>■ Students are required to provide answers to Activity #2. Teacher invites a volunteer to explain the answer to the class.</li> <li>■ Teacher presents solutions to the class.</li> </ul>	PPT#9-10 Student Worksheet p.2	7 minutes
◇ <b>Activity 3 - Case Study</b> <ul style="list-style-type: none"> <li>■ Students are provided with three sets of financial statements for sole proprietorship, partnership and</li> </ul>	PPT#11-15	18 minutes

<p>a limited company for a mobile phone and accessories company in student worksheet p.3-7.</p> <ul style="list-style-type: none"> <li>■ Teacher tells students to determine the differences in profit distribution under the three forms of business ownership.</li> <li>■ Students can refer to the three income statements (Trading and Profit and Loss and Appropriation accounts) to complete the table in student worksheet p.7.</li> <li>■ Teacher invites a volunteer to present answers to class.</li> <li>■ Teacher presents solutions to the class.</li> <li>■ Teacher asks students to vote for the form of business ownership that suits Ming to expand his business.</li> </ul>	<p>Student Worksheet pp.3-7</p>	
<b>Part III: Conclusion</b>		
<p>◇ Teacher concludes the lesson by reviewing the key points learned in this lesson.</p>	<p>PPT#16</p>	<p>2 minutes</p>

**Preparation for the next lesson:**

<p>1.</p>	<p>Students are asked to finish studying the three Balance Sheets (student worksheet p.8-10) to discuss during the next lesson.</p>
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<b>Lesson 2</b>	
<b>Theme</b>	Capital or Owner's Equity and Regulatory Framework of Accounting
<b>Duration</b>	40 minutes

**Expected Learning Outcomes:**

Upon completion of this lesson, students will be able to:

1. Determine how capital balances of the company are treated in different types of business ownerships: Sole Proprietorship, Partnership, Limited Company.
2. Explain the differences of the capital or owner's equity in the Balance Sheet of each business ownership.
3. Describe the regulatory Hong Kong regulatory framework.

**Special requirement:**

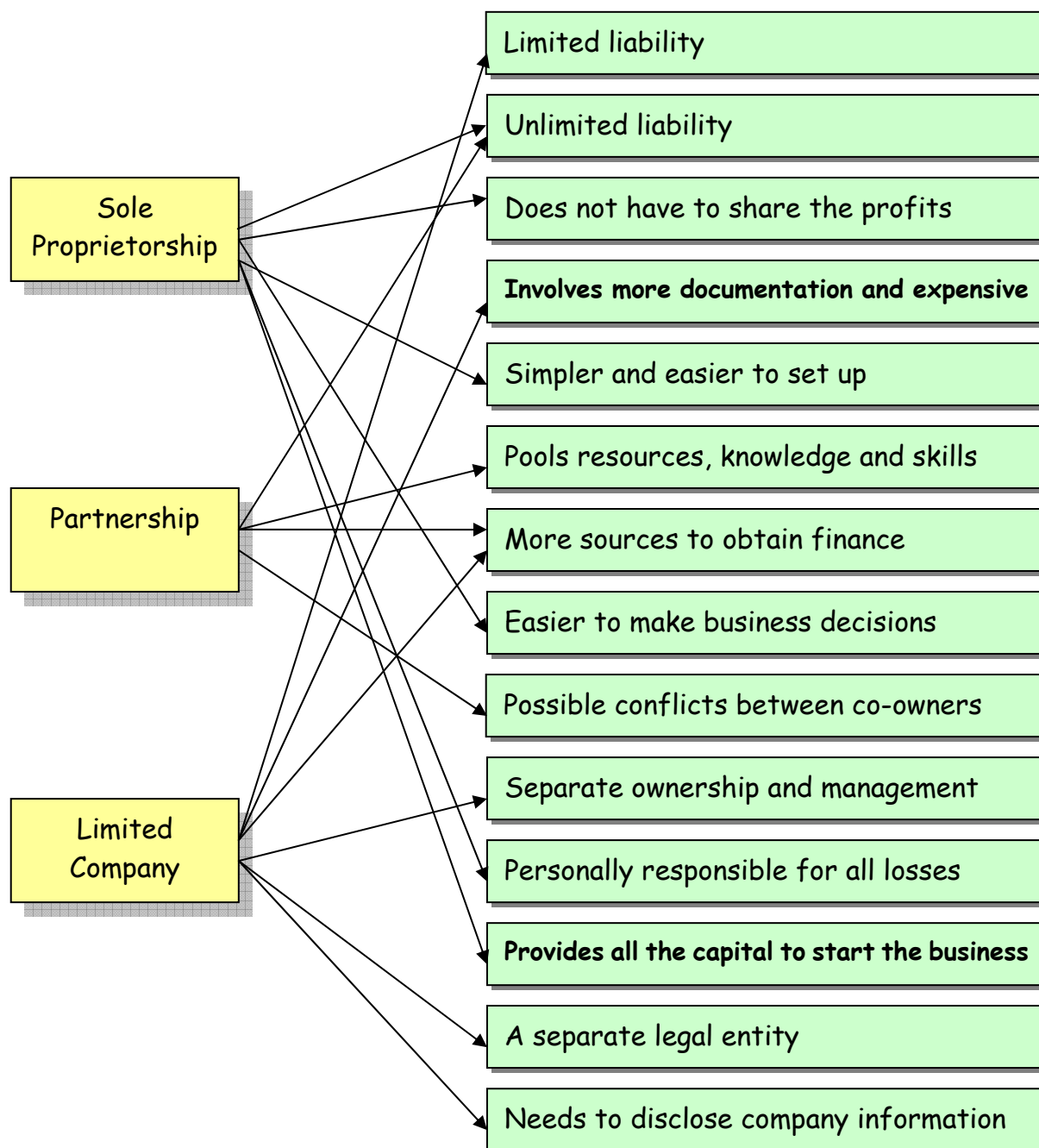
As students are required to surf the Internet for information in Activity 5, teachers are suggested to conduct lessons in a room with appropriate equipment or in the computer room.

**Teaching Sequence and Time Allocation:**

Activities	Reference	Time Allocation
<b>Part I: Introduction</b>		
✧ Teacher begins lesson by reviewing the points covered during the last lesson.	PPT#17	2 minutes
<b>Part II: Contents</b>		
✧ <b>Activity 4 - Case Study</b> <ul style="list-style-type: none"> <li>■ Following the previous case study, Ming now asked about the differences shown in the Balance Sheet (student worksheet p.8-10) for sole proprietorship, partnership and limited company.</li> <li>■ Students are asked to compare the capital / owner's equity in the balance sheets of sole proprietorship, partnership and a limited company by completing the table in student worksheet p11.</li> <li>■ Students are asked to explain different presentations shown in each type of business ownership.</li> <li>■ Teacher invites volunteers to present the answer to class.</li> <li>■ Teacher then presents the solution to class.</li> </ul>	PPT#18-22  Student Worksheet pp.8-11	25 minutes

<p>◇ <b>Activity 5 - Quiz</b></p> <ul style="list-style-type: none"> <li>■ Ming is interested in accounting and wanted to know more. Students are now requested to help Ming answer the questions in student worksheet p.12.</li> <li>■ Teacher should note that all questions are related to the accounting regulatory framework</li> <li>■ Students are required works in groups and complete the quiz within 5 minutes.</li> <li>■ Students are allowed to surf the Internet for information.</li> <li>■ Teacher checks the answers with students.</li> </ul>	<p>PPT#23-28</p> <p>Student Worksheet p.12</p>	<p>10 minutes</p>
<p><b>Part III: Conclusion</b></p>		
<p>◇ Teacher concludes the lesson by reviewing the key points learned.</p>	<p>PPT#29</p>	<p>3 minutes</p>

## Answer to Activity 2: Matching



## Answer for Activity 3: Case Study

	<b>Sole Proprietorship</b>	<b>Partnership</b>	<b>Limited Companies</b>
<b>Number of owners entitled for profit sharing</b>	1	2-20	Private: 2-50 Public: more than 2
<b>Financial Statement showing profit distribution</b>	Profit and Loss account	Appropriation account	Appropriation account
<b>Item(s) for profit distribution to owners</b>	Net Profit	<ul style="list-style-type: none"> <li>• Interest on Capital</li> <li>• Salary to Partners</li> <li>• Share of Profit</li> </ul>	Dividend paid according to number of share held
<b>Accounting entries made for profit distribution</b>	Non-cash items credited to capital	Non-cash items credited to capital	<ul style="list-style-type: none"> <li>• Cash Dividend</li> <li>• Retained Profit carried forward</li> </ul>
<b>Way to withdraw profit earned</b>	Cash Drawings	Cash Drawings	Cash dividend

## Answer for Activity 4: Case Study

<i>Balance Sheet</i>	<b>Sole Proprietorship</b>	<b>Partnership</b>	<b>Limited Companies</b>
<b>Form of Capital</b>	In terms of money	In terms of money	In terms of shares <ul style="list-style-type: none"> <li>• Ordinary Shares</li> <li>• Preference Shares</li> </ul>
<b>Change of Capital</b>			
<b>Capital (Opening)</b>	Opening Capital	Opening Capital	Opening Capital
<b>Capital increased by</b>	Net Profit	<ul style="list-style-type: none"> <li>• Interest on Capital</li> <li>• Salary</li> <li>• Share of Profit</li> </ul>	<ul style="list-style-type: none"> <li>• Retained profit after dividend</li> <li>• Reserves</li> </ul>
<b>Capital decreased by</b>	Drawings	Drawings Interest on Drawings	None (Dividend has been deducted in retained profit balance)
<b>Capital (Closing)</b>	Closing Capital	Closing Capital	Closing Capital Equity



# BAFS Elective Part Accounting Module – Financial Accounting

Topic A02:  
Financial Reporting for Different  
Forms of Business Ownership

Technology Education Section  
Curriculum Development Institute  
Education Bureau, HKSARG  
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## Lesson One

### Profit Distribution and Appropriation Account

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BAFS Elective Part  
Learning and Teaching Example

#### Introduction

This session aims at pointing out the know-how and know-why in preparing the financial statements so as to serve the various nature of sole proprietorship, partnership, and limited company.

Students will be required to explain the relationship between the business types and practices in preparing financial statements. Focus will be put on the comparison of (i) how profit is distributed and (ii) how capital or owners' equity is presented in: sole proprietorships, partnerships and limited companies. The regulatory framework of accounting will also be covered.

#### Duration

Two 40-minute lessons

#### Contents

Lesson 1 - Profit Distribution and Appropriation Account

Lesson 2 - Capital or Owner's Equity and Regulatory Framework of Accounting

#### Lesson 1

Students are able to determine how net profit is distributed in different business ownership types and understand the function of an appropriation account in the distribution of net profits.

## Tell us ...

Do you know the different business ownership structures available to set up your business?



Teacher leads students to think and explain to the class the three different business ownership structures. Please refer to Slide #4 for answers.

Teacher may ask the following questions:

- (1) Do you want to start the business by yourself? If so, which business ownership structure will you choose?
- (2) If you want to find a partner, which business ownership structure will you use?
- (3) If you are concerned about the business liabilities, what is the preferred business ownership structure?

## Forms of Business Ownership

- Sole proprietorship
- Partnership
- Limited Company

For limited companies, explain to students that they only meet the requirements for setting up a **private limited company** as they just start the business. They do not meet the requirements for setting up a **publicly-limited company or a listed company**.

For publicly-listed companies, you must meet certain requirements set by the HKEX, for example:

- Financial requirements: at least HK\$50 million in the last three financial years (with profits of at least HK\$20 million recorded in the most recent year, and aggregate profits of at least HK\$30 million recorded in the two years before that).
- Market capitalisation: at least HK\$200 million at the time of listing.

For more information, teacher may ask students to visit the website: <http://www.hkex.com.hk>

Definitions:

**Sole proprietorship:** A business conducted by one person. Owner receives all profit but also assumes all business risks and fully liable for all the debts incurred by the business. No separate legal identity.

**Partnership:** Two or more people join together to form a business. A partnership can have up to a maximum of 20 partners. Every partner is jointly liable for the firm's debts. A partnership does not have a separate legal identity.

**Limited Company:** Share capital is divided into a number of shares. Shares are held by the investors who are the company shareholders. If the company makes profits, dividends will be distributed to the shareholders in accordance with their respective shareholdings. If the company suffers a loss, the shareholders will, at the most, lose all their investment in the shares of the company. In other words, their liabilities are limited to the value of the shares. A company has a separate legal identity.

Do you know the differences among sole proprietorship, partnership and limited company in terms of:

- Owner liabilities,
- Management of the business, and
- Profit distribution?



Teacher explains the differences and uniqueness among the three forms of business ownership.

## Activity 1: Group discussion

Discuss and present answers to Activity 1 in student worksheet p. 1.



Teacher asks students to form small groups of 4 or 5 to discuss the differences between the three business ownership forms in terms of owner liabilities, management of business, and profit distribution. Students are asked to record answers on Student Worksheet p. 1. Invite group leaders to present the answers to the class.

Students have 5 minutes to complete this activity.

## Answer to Activity 1

	<b>Sole Proprietorship</b>	<b>Partnership</b>	<b>Limited Company</b>
<b>Liabilities of the owner</b>	Unlimited	Unlimited	Limited
<b>Management of business</b>	By owner	By partners	By directors
<b>Distribution of profits</b>	All to the sole owner	Shared by partners according to profit and loss sharing ratio	Distribute to shareholders by way of dividends

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Learning and Teaching Example

Teacher summarises the main points offered by group leaders and shows the answers to the class.

Remarks:

1. Liabilities of the owner: For partnerships, liabilities are unlimited except for limited partner(s). For limited company, liabilities are limited to the amount invested.
2. Management of business: For limited companies, shareholders vote for directors to manage the business on their behalf.
3. Distribution of profits: For partnerships, profits are shared by the partners after charging interest on drawings, allowing interest on capital and salaries, if any. For limited company, some of the profits can be transferred to a reserve account for general or specific purpose, some may be distributed as dividends, and the remaining profit can be retained for future business use.

What are the factors you should consider when choosing the ownership form to establish your business?



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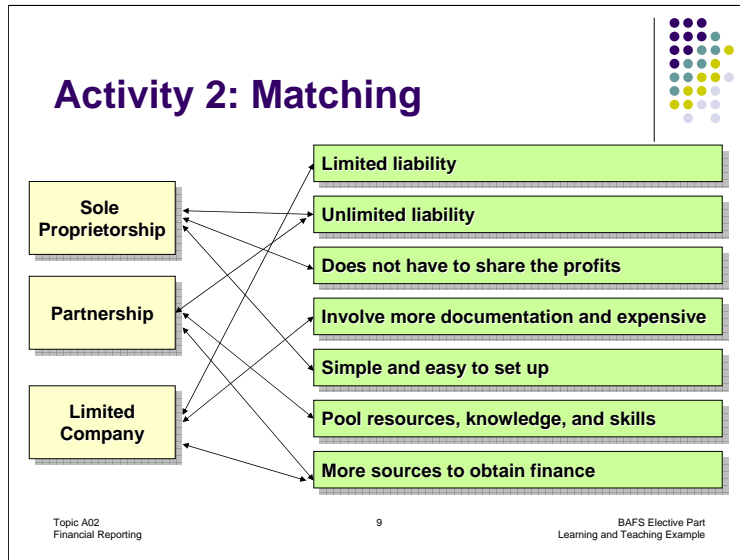
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Learning and Teaching Example

Teacher leads students to think about the factors consider when choosing the ownership form to establish a business. For example:

- Limited or unlimited liability
- Ownership and management of business
- Share of profits
- Sources of fund
- Simple or difficult to set up
- Separate legal entity
- Disclosure of company information

In order to strengthen students' understanding of the different forms of business ownership, students are required to complete Activity 2 - Matching in Students Worksheet p.2.

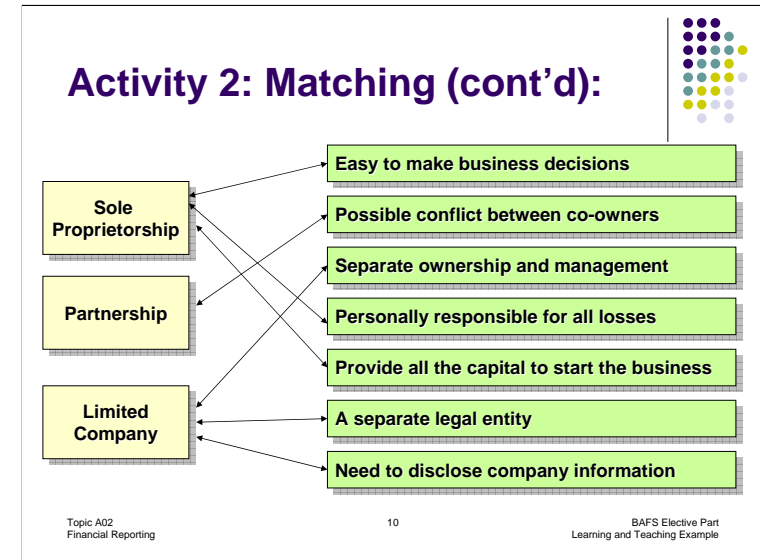
Students have 5 minutes to complete the activity.



Teacher shows the answer of activity 2: matching.

For more details for setting up business in Hong Kong, ask students to visit the website below:

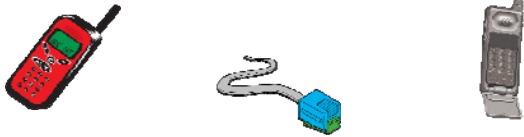
[http://sme.hktdc.com/sme\\_listing.aspx?src=List\\_setup&w\\_sid=194&w\\_pid=896&w\\_nid=11511&w\\_cid=19&w\\_idt=1900-01-01](http://sme.hktdc.com/sme_listing.aspx?src=List_setup&w_sid=194&w_pid=896&w_nid=11511&w_cid=19&w_idt=1900-01-01)



Teacher presents the answers.

## Activity 3: Case Study

Ming has set up a small business, Smart Phone Company selling mobile phones and accessories for a year. Now he wants to expand....



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Learning and Teaching Example

Teacher goes through Ming's case with students. Ming has set up a small business, which is a sole proprietorship, and now he wants to expand the business. Further information is given in the following slides.

## Additional information

Sources of fund	From a friend, Lee: Maximum \$120,000 From parents: Maximum \$100,000
Interest charge	5% per annum
Management	Need somebody who is trustworthy and reliable to help
Liability	Concerned about the obligation in the liabilities of the business

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Learning and Teaching Example

Teacher provides more information about expanding the business.

Ming's parents can help him to expand the business by lending him a maximum of \$100,000. His best friend, Lee, has \$120,000, is interested in the business. Both of them will charge Ming 5% interest per annum on the amount borrowed. Ming wants to find somebody who is trustworthy and reliable to join him in the business. Ming is also concerned about the potential liability in the operation of the business.

Remarks:

1. Ming could simply borrow \$120,000 from Lee and pay him 5% interest per annum. Then, Lee becomes a creditor of the business.
2. Ming could invite Lee to be the co-owner of the business. In that case, Lee brings in \$120,000 to the business and his expertise, e.g. his marketing or purchasing skills, to help Ming expand the business. Lee then becomes one of the owners / partners. He does not work for the salary but shares the profits with Ming.
3. Ming and Lee could consider forming a limited company. They both become the shareholders. If the company makes a profit, they receive dividends according to the percentage of ownership.

Ming and Lee are considering forming a partnership or a limited company. They want to know the profit distribution criteria for each form.



Income statements of different types of business ownership are provided in Student Worksheet p.4-6. Students are required to group discuss and explain the differences between a partnership and a limited company.

### Activity 3 – Case Study

#### Determine the differences between a partnership and a limited company



	Sole Proprietorship	Partnership	Limited Company
Number of owners entitled to profit sharing	1		
Financial Statement showing distribution of net profit	Profit and Loss Account		
Item(s) for profit distribution	Net Profit		
Accounting entries made for profit distribution	Non-cash item credited to capital		
Methods to withdraw profit earned	Cash Drawings		

Teacher asks students to write answers on Student Worksheet p.7. Answers are given in the next slide.

Students have 15 minutes to complete the activity.

## Differences between a partnership and a limited company



	Sole Proprietorship	Partnership	Limited Company
Number of owners entitled for profit sharing	1	2-20	Private: 2-50 Public: more than 2
Financial Statement showing profit distribution	Profit and Loss account	Appropriation account	Appropriation account
Item(s) for profit distribution to owners	Net Profit	•Interest of Capital •Salary to Partners •Share of Profit	Dividend paid according to number of share held
Accounting entries made for profit distribution	Non-cash item credited to capital	Non-cash items credited to capital	•Cash Dividend •Retained Profit carried forward
Way to withdraw profit earned	Cash Drawings	Cash Drawings	Cash dividend

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Learning and Teaching Example

Teacher covers through the summary with students. Teacher can apply discrepancy to further discuss by using the questions below.

(1) Why is an Appropriation Account is needed?

No appropriation account is required for sole proprietorship as all the profits belong to the sole trader. In partnership, appropriation account shows how profits are distributed to partners. According to the Partnership Agreement, if any, the partnership may charge interest on drawings, deduct interest on capital and salaries before profits are shared by partners. In limited company, the appropriation account shows how the profits are to be used. Limited company is a separate legal entity, therefore it needs to pay tax based on profits made. Directors may decide to transfer some of the profits to reserve account for general or specific purpose.

(2) Why "Salary to Partners" is shown in the Appropriation Account whereas "Directors' Remuneration" is shown in the income statement?

Directors' remuneration is found only in a limited company. Directors are appointed by shareholders to manage the day-to-day business on their behalf.

(3) Why is Retained Profit not carried down in sole proprietorship and partnership?

All profits will be distributed to the sole proprietor and partners, so there will be no retained profit. However, under the limited company structure, any profit that has not been appropriated will be carried forward to next year.

Which form of business ownership do you suggest Ming use if he wants to expand his business?



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BAFS Elective Part  
Learning and Teaching Example

Teacher asks students to vote for the business ownership form that Ming should use to expand his business. If time allows, teacher can ask students' reasons for their choice.

**End of Lesson 1.**





## Lesson Two

### Capital or Owner's Equity and Regulatory Framework of Accounting

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BAFS Elective Part  
Learning and Teaching Example

#### Lesson 2

Students are able to tell how capital balances are treated in different types of business ownership and explain the difference of capital or owner's equity in the Balance Sheet of those types of business ownership. Also, students are capable in describing the Hong Kong regulatory framework of accounting.



## Preparation of Financial Statements

After reviewing the Balance Sheets for different business ownership types, Ming, the owner of Smart Phone Company does not understand why there are differences in the owner's equity.

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BAFS Elective Part  
Learning and Teaching Example

Teacher starts the lesson by asking students to read the case. The balance sheet of different business ownership types are provided in Student Worksheet p.8-10. By studying the balance sheet, students are required to discuss within their groups the reasons for the differences in the owner's equity.

## Activity 4 – Case Study

### Trace the change of capital in Sole Proprietorship and Partnership



	Sole Proprietorship	Partnership	Limited Company
Form of Capital	In terms of money		
Change of Capital			
Capital (Opening)	Opening Capital	Opening Capital	Opening Capital Equity
Capital increased by	Net Profit		
Capital decreased by	Drawings		
Capital (Closing)	Closing Capital	Closing Capital	

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Learning and Teaching Example

Teacher asks students to write down the answer on Student Worksheet p.11. Answer is given in the next few slides.

## Activity 4 – Case Study

### Trace the change of capital in Sole Proprietorship and Partnership



	Sole Proprietorship	Partnership
Form of Capital	In terms of money	In terms of money
Changes in Capital		
Capital (Opening)	Opening Capital	Opening Capital
Capital increased by	Net Profit	<ul style="list-style-type: none"> <li>• Interest on Capital</li> <li>• Salary to Partner</li> <li>• Share of Profit</li> </ul>
Capital decreased by	Drawings	<ul style="list-style-type: none"> <li>• Drawings</li> <li>• Interest on Drawings</li> </ul>
Capital (Closing)	Closing Capital	Closing Capital

Can be recorded in Current Accounts of Partners

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Learning and Teaching Example

1. In sole proprietorship, net profit increases capital and owner drawings decreases capital.
2. In partnership, the same concept applies to partners' capital. However, if there is a partnership agreement, then interest on the drawings may be charged, interest on capital and salaries will be credited to partners' current account before profits is shared between Ming and Lee.
3. A separate current account for Ming and Lee may be opened. Interest on capital, salaries to partners and profits are credited to the current account, drawings and interest on the owner drawings are debited. By doing this, the capital account for each partner remains at the amount they put into the business. A credit balance of the current account represents undrawn profits and a debit balance represents drawings in excess of the profits entitled.

### Activity 4 – Case Study Trace the change of capital in Sole Proprietorship and Limited Company

	Sole Proprietorship	Limited Company
Form of Capital	In terms of money	In terms of shares • Ordinary Shares • Preference Shares
<b>Changes in Capital</b>		
Capital (Opening)	Opening Capital	Opening Capital Equity
Capital increased by	Net Profit	<ul style="list-style-type: none"> <li>• Retained profit after dividend</li> <li>• Reserves (including amount reserved to proposed dividend)</li> </ul>
Capital decreased by	Drawings	None (Dividend for the year has been deducted from retained profit balance)
Capital (Closing)	Closing Capital	Closing Capital Equity

Financial Reporting

Learning and Teaching Example

1. In limited company, capital is stated by number of shares at nominal value. The company can issue ordinary shares and preference shares.
2. Out of the profits made, the company may transfer some of them to a reserve account; and pay cash dividends to shareholders as a return on their investment. The retained profits and reserves will increase the owners' equity.

### Summary of differences in Capital Equity of Sole Proprietorship, Partnership and Limited Company

	Sole Proprietorship	Partnership	Limited Company
Form of Capital	In terms of money	In terms of money	In terms of shares • Ordinary Shares • Preference Shares
<b>Changes in Capital</b>			
Capital (Opening)	Opening Capital	Opening Capital	Opening Capital Equity
Capital increased by	Net Profit	<ul style="list-style-type: none"> <li>• Interest on Capital</li> <li>• Salary</li> <li>• Share of Profit</li> </ul>	<ul style="list-style-type: none"> <li>• Retained profit after dividend</li> <li>• Reserves</li> </ul>
Capital decreased by	Drawings	Drawings Interest on Drawings	None (Dividend has been deducted in retained profit balance)
Capital (Closing)	Closing Capital	Closing Capital	Closing Capital Equity

Financial Reporting

Learning and Teaching Example

Teacher shows the comparison of how profit is distributed and how owners' equity is presented among sole proprietorships, partnerships and a limited company.

Again, draw students' attention to the points stated in slides #20 and #21.

## Regulatory Framework



After reviewing the differences of profit appropriation and owner's equity in different business ownerships, Ming was so interested in accounting that he wanted to know more about the regulatory framework.

Teacher tells students that Ming is now familiar with the different financial statements and business ownership forms. After reviewing the differences, he became interested in accounting and wanted to learn more. Students are required to answer Ming's questions.

## Activity 5: Quiz



- Ming prepared a list of questions about the regulatory framework of accounting.
- Can you answer his questions?



Students are required to help Ming answer his queries about the regulatory framework of accounting in Hong Kong. Teacher distributes Student Worksheet p.12 to the class and asks students to write the answers. Answers can be found in slides #25 to #28.

## Activity 5: Suggested Answer



1. The accounting practices used in Hong Kong are known as **Generally Accepted Accounting Practices (GAAP)**
2. Can you list some ordinances promulgated by the Hong Kong Government to legislate the public section? **The Companies Ordinance, the Inland Revenue Ordinance**

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Learning and Teaching Example

Listed companies must send the current annual report and accounts to their shareholders to enable them to assess the directors' performance and stewardship of the company's assets and management of the company's affairs.

The published accounts of listed companies are prepared in accordance with the Hong Kong Generally Accepted Accounting Principles (HKGAAAP).

### Sources of Regulations on Hong Kong GAAP:

1. Companies Ordinance
2. Inland Revenue Ordinance
3. Hong Kong Financial Reporting Standards
4. The exchange Listing Rules

For up-to-date information, please visit the following websites:

1. Companies Ordinance (Chapter 32)  
<http://www.legislation.gov.hk/eng/home.htm>
2. Inland Revenue Ordinance (Chapter 112)  
<http://www.legislation.gov.hk/eng/home.htm>
3. Hong Kong Financial Reporting Standards  
<http://www.hkicpa.org.hk/>
4. The Exchange Listing Rules  
<http://www.hkex.com.hk/index.htm>

## Activity 5: Suggested Answer



3. The principal private sector regulatory body in Hong Kong is **Hong Kong Institute of Certified Public Accountants (HKICPA)**.
4. Principles include
  - Preface
  - Framework
  - HKFRSs

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Learning and Teaching Example

The Preface explains the scope, authority and timing of application of HKFRSs. It also sets out the relationship between HKFRSs and International Financial Reporting Standards (IFRSs).

The framework serves as the foundation of the HKFRSs. It sets out the general concepts that underlie the preparation and presentation of financial statements for external users.

The HKFRSs apply to the general purpose financial statements and other financial reports of all profit-oriented entities.

## Activity 5: Suggested Answer



5. The HKFRSs comprises of

- Hong Kong Financial Reporting Standards (HKFRS)
- Hong Kong Accounting Standards (HKAS)
- Interpretations

Teacher can refer students to the HKICPA website for details.

## Activity 5: Suggested Answer



6. The requirements of the Companies Ordinance are applicable **only to limited companies incorporated under the Companies Ordinance.**
7. The requirements of the Inland Revenue Ordinance are applicable **to every business organisation with assessable profit.**

Teacher may refer to the websites mentioned in the teacher's notes under PowerPoint #25 for up-to-date information for the Companies Ordinance and Inland Revenue Ordinance.

## Conclusion

- Differences of financial statements under different types of business ownership
- Regulatory framework of activity



Teacher concludes the lesson by reviewing the key points covered.

# The End

**End of Lesson 2.**

**BAFS Elective Part – Accounting Module – Financial Accounting**

**Topic A02: Financial Reporting for Different Forms of Business Ownership**

**Activity 1: Group discussion**

Form a group of 4 or 5 students to discuss the differences between forms of business ownership in terms of owner liability, management of business, and profit distribution, then write the answer in the table below:

	Sole Proprietorship	Partnership	Limited Company
Owner Liabilities <Limited / Unlimited>			
Management of business <By owner / Partners/ Directors>			
Profit Distribution <To owner / Partners / Shareholders>			



## Activity 2: Matching

Discuss with group members -- then match the factors with the forms of business ownership.

<b>Sole Proprietorship</b>	Limited liability
	Unlimited liability
	Does not have to share the profits
	Involves more documentation and expensive
<b>Partnership</b>	Simple and easy to set up
	Pool resources, knowledge and skills
	More sources to obtain finance
	Easier to make business decisions
<b>Limited Company</b>	Possible conflicts between co-owners
	Separate ownership and management
	Personally responsible for all losses
	Provides all capital to start the business
	A separate legal entity
	Need to disclose company information



## Activity 3: Case Study

Ming has set up a small business, Smart Phone Company, selling mobile phones and accessories for a year. Now he is thinking of expanding...

Additional information:

Funding Sources	From a friend, Lee: Maximum \$120,000 From parents: Maximum \$100,000
Interest charges	5% per annum
Management	Need somebody who is trustworthy and reliable to help
Liability	concerned about the obligation in the liabilities of the business



Ming and Lee are considering whether forming a partnership or a limited company. They like to know what the differences in profit distribution would be.

For consideration, they study the income statements.

Income Statements of different types of business ownership are provided as follows:

Smart Phone Company  
Income Statement for the year ended 31 December Year 1

	\$	\$
Sales	527,100	
Less: Return inwards	<u>2,300</u>	524,800
Less: Cost of Goods Sold		
Purchases	211,200	
Less: Return outwards	<u>8,000</u>	
	203,200	
Add: Carriage inwards	<u>4,200</u>	
	207,400	
Less: Closing inventory	<u>32,800</u>	<u>174,600</u>
Gross Profit		350,200
Add: Discounts received		<u>3,120</u>
		353,320
Less: Expenses		
Loan interest	5,000	
Discount allowed	9,000	
Accumulated depreciation -furniture and fixtures	14,000	
Accumulated depreciation -equipment	12,000	
Allowance for doubtful debts	8,515	
Administrative expenses	22,000	
Insurance	6,400	
Salaries and wages	96,000	
Bad debts	3,500	
Rent and rates	80,000	
Repairs and maintenance	6,000	
Bank interest and charges	<u>4,600</u>	<u>267,015</u>
Net profit		<u>86,305</u>

**Ming and Lee Smart Phone Company**  
**Income Statement for the year ended 31 December Year 1**

	\$	\$
Sales	527,100	
Less: Return inwards	<u>2,300</u>	524,800
Less: Cost of Goods Sold		
Purchases	211,200	
Less: Return outwards	<u>8,000</u>	
	203,200	
Add: Carriage inwards	<u>4,200</u>	
	207,400	
Less: Closing inventory	<u>32,800</u>	<u>174,600</u>
Gross Profit		350,200
Add: Discounts received		<u>3,120</u>
		353,320
Less: Expenses		
Loan interest	5,000	
Discount allowed	9,000	
Accumulated depreciation -furniture and fixtures	14,000	
Accumulated depreciation -equipment	12,000	
Allowance for doubtful debts	8,515	
Administrative expenses	22,000	
Insurance	6,400	
Salaries and wages	96,000	
Bad debts	3,500	
Rent and rates	80,000	
Repairs and maintenance	6,000	
Bank interest and charges	<u>4,600</u>	<u>267,015</u>
Net profit		86,305
Add:		
Interest on drawings		
Ming	150	
Lee	<u>51</u>	<u>201</u>
		86,506
Less:		
Salary - Lee	25,000	
Interest on capital:		
Ming	9,000	
Lee	<u>6,000</u>	<u>(40,000)</u>
Balance of profits		46,506
Shared:		
Ming 2/3	31,004	
Lee 1/3	<u>15,502</u>	<u>46,506</u>

Smart Phone Ltd.  
Income Statement for the year ended 31 December Year 1

	\$	\$
Sales	527,100	
Less: Return inwards	<u>2,300</u>	524,800
Less: Cost of Goods Sold		
Purchases	211,200	
Less: Return outwards	<u>8,000</u>	
	203,200	
Add: Carriage inwards	<u>4,200</u>	
	207,400	
Less: Closing inventory	<u>32,800</u>	<u>174,600</u>
Gross Profit		350,200
Add: Discounts received		<u>3,120</u>
		353,320
Less: Expenses		
Debenture interest	5,000	
Discount allowed	9,000	
Accumulated depreciation -furniture and fixtures	14,000	
Accumulated depreciation -equipment	12,000	
Allowance for doubtful debts	8,515	
Administrative expenses	22,000	
Insurance	6,400	
Salaries and wages	96,000	
Directors' remunerations	4,020	
Bad debts	3,500	
Rent and rates	80,000	
Repairs and maintenance	6,000	
Bank interest and charges	<u>4,600</u>	<u>271,035</u>
Profit before tax		82,285
Less: Taxation		<u>13,166</u>
Profit after tax		69,119
Appropriations:		
Transfer to general reserve	20,000	
Ordinary dividend	<u>18,000</u>	<u>38,000</u>
Retained profits carried forward		<u>31,119</u>

Discuss group members and explain the differences between sole proprietorship, partnership and limited company by completing the following table.

	Sole Proprietorship	Partnership	Limited Companies
Number of owners entitled for profit sharing	1		
Financial Statement showing profit distribution	Profit and Loss account		
Item(s) for profit distribution to owners	Net Profit		
Accounting entries made for profit distribution	Non-cash items credited to capital		
Way to withdraw profit earned	Cash Drawings		

## Activity 4: Case Study

After reviewing the Balance Sheet of different types of business ownership, Ming, the owner of Smart Phone Company did not understand why there were differences in the owner's equity.

- (a) Balance Sheets of different types of business ownership are provided as follows:

Smart Phone Company			
Balance Sheet as at 31 December Year 1			
	\$	\$	\$
Fixed Assets	Cost	Accumulated depreciation	Net book value
Furniture and fixtures	280,000	14,000	266,000
Equipment	<u>120,000</u>	<u>12,000</u>	<u>108,000</u>
	<u>400,000</u>	<u>26,000</u>	374,000
<b>Current Assets</b>			
Inventory		32,800	
Accounts Receivable	170,300		
Less: Allowance for doubtful debts	<u>8,515</u>	161,785	
Prepayment		600	
Cash		<u>2,000</u>	
		197,185	
<b>Less: Current Liabilities</b>			
Accounts Payable	68,700		
Accruals	7,000		
Bank	<u>13,200</u>	<u>88,900</u>	
Net current assets			<u>108,285</u>
			482,285
<b>Less: Long-term Liabilities</b>			
5% loan			<u>100,000</u>
			<u>382,285</u>
<b>Capital</b>			
Balance at 1 Jan Year 1			300,000
Less: Net profit			<u>86,305</u>
			386,305
<b>Less: Drawings</b>			
			<u>4,020</u>
			<u>382,285</u>

**Ming and Lee Smart Phone Company**  
**Balance Sheet as at 31 December Year 1**

	\$	\$	\$
Fixed Assets	Cost	Accumulated depreciation	Net book value
Furniture and fixtures	280,000	14,000	266,000
Equipment	<u>120,000</u>	<u>12,000</u>	<u>108,000</u>
	<u>400,000</u>	<u>26,000</u>	374,000
Current Assets			
Inventory		32,800	
Accounts Receivable	170,300		
Less: Allowance for doubtful debts	<u>8,515</u>	161,785	
Prepayment		600	
Cash		<u>2,000</u>	
		197,185	
Less: Current Liabilities			
Accounts Payable	68,700		
Accruals	7,000		
Bank	<u>13,200</u>	<u>88,900</u>	
Net current assets			<u>108,285</u>
			482,285
Less: Long-term Liabilities			
5% loan			<u>100,000</u>
			<u>382,285</u>
<i>Financed by:</i>			
Capital: Ming			180,000
Lee			<u>120,000</u>
			300,000
Current accounts	<u>Ming</u>	<u>Lee</u>	
Add: Interest on capital	9,000	6,000	
Salary	-	25,000	
Share of profits	<u>31,004</u>	<u>15,502</u>	
	40,004	46,502	
Less: Interest on drawings	150	51	
Drawings	<u>3,000</u>	<u>1,020</u>	
	<u>36,854</u>	<u>45,431</u>	<u>82,285</u>
			<u>382,285</u>



Smart Phone Ltd.  
Balance Sheet as at 31 December Year 1

	\$	\$	\$
Fixed Assets	Cost	Accumulated depreciation	Net book value
Furniture and fixtures	280,000	14,000	266,000
Equipment	<u>120,000</u>	<u>12,000</u>	<u>108,000</u>
	<u>400,000</u>	<u>26,000</u>	374,000
<b>Current Assets</b>			
Inventory		32,800	
Accounts Receivable	170,300		
Less: Allowance for doubtful debts	<u>8,515</u>	161,785	
Prepayment		600	
Cash		<u>2,000</u>	
		197,185	
<b>Less: Current Liabilities</b>			
Accounts Payable	68,700		
Taxation	13,166		
Accruals	7,000		
Bank	<u>13,200</u>	<u>102,066</u>	
Net current assets			<u>95,119</u>
			469,119
<b>Less: Long-term Liabilities</b>			
5% loan			<u>100,000</u>
			<u>369,119</u>
<i>Financed by:</i>			
<b>Shareholders' equity</b>			
Ordinary shares @ \$1			300,000
General reserve			20,000
Retained profits			31,119
Proposed dividend			<u>18,000</u>
			<u>369,119</u>

Discuss with group members and explain the differences between sole proprietorship, partnership and limited company by completing the following table.

<b><i>Balance Sheet</i></b>	<b>Sole Proprietorship</b>	<b>Partnership</b>	<b>Limited Companies</b>
<b>Form of Capital</b>	In terms of money		
<b>Change of Capital</b>			
<b>Capital (Opening)</b>	Opening Capital	Opening Capital	Opening Capital Equity
<b>Capital increased by</b>	Net Profit		
<b>Capital decreased by</b>	Drawings		
<b>Capital (Closing)</b>	Closing Capital	Closing Capital	

## Activity 5: Quiz

After knowing the differences of profit appropriation and owner's equity in different business ownerships, Ming was so interested in accounting that he wanted to know more about the regulatory framework.

Ming set a list of questions about the regulatory framework of accounting.

Can you answer his questions?

1. The accounting practices used in Hong Kong are known as .....

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2. Can you list some ordinances promulgated by the Hong Kong Government to legislate the public section?

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3. What is the principal private sector regulatory body in Hong Kong?

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4. Which principles have been issued by HKICPA to provide the principal private sources of regulation on accounting practices in Hong Kong?

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5. The HKFRSs comprises of .....

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6. What are the requirements of the Companies Ordinance applicable to?

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7. What are the requirements of the Inland Revenue Ordinance applicable to?

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