ATSWA

ACCOUNTING TECHNICIANS SCHEME WEST AFRICA

STUDY TEXT

BASIC ACCOUNTING PROCESSESS AND SYSTEMS

PUBLICATION OF ASSOCIATION OF ACCOUNTANCY BODIES IN WEST AFRICA (ABWA)

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ACCOUNTING TECHNICIANS SCHEME

WEST AFRICA (ATSWA)

STUDY TEXT FOR

BASIC ACCOUNTING PROCESSESS AND SYSTEMS

THIRD EDITION

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DISCLAIMER

This book is published by ABWA; however, the views are entirely those of the writers.

PREFACE

INTRODUCTION

The Council of the Association of Accountancy Bodies in West Africa (ABWA) recognised the difficulty of students when preparing for the Accounting Technicians Scheme West Africa examinations. One of the major difficulties has been the non-availability of study materials purposely written for the scheme. Consequently, students relied on text books written in economic and socio-cultural environments quite different from the West African environment.

AIM OF THE STUDY TEXT

In view of the above, the quest for good study materials for the subjects of the examinations and the commitment of the ABWA Council to bridge the gap in technical accounting training in West Africa led to the production of this Study Text.

The Study Text assumes a minimum prior knowledge and every chapter reappraises basic methods and ideas in line with the syllabus.

READERSHIP

The Study Text is primarily intended to provide comprehensive study materials for students preparing to write the ATSWA examinations.

Other beneficiaries of the Study Text include candidates of other Professional Institutes, students of Universities and Polytechnics pursuing undergraduate and post graduate studies in Accounting, advanced degrees in Accounting as well as Professional Accountants who may use the Study Text as reference material.

APPROACH

The Study Text has been designed for independent study by students and as such concepts have been developed methodically or as a text to be used in conjunction with tuition at schools and colleges. The Study Text can be effectively used as a course text and for revision. It is recommended that readers have their own copies.

FORWARD

The ABWA Council, in order to actualize its desire and ensure the success of students at the examinations of the Accounting Technicians Scheme West Africa (ATSWA), put in place a Harmonisation Committee, to among other things, facilitate the production of Study Texts for students. Hitherto, the major obstacle faced by students was the dearth of study texts which they needed to prepare for the examinations.

The Committee took up the challenge and commenced the task in earnest. To start off the process, the existing syllabus in use by some member Institutes were harmonized and reviewed. Renowned professionals in private and public sectors, the academia, as well as eminent scholars who had previously written books on the relevant subjects and distinguished themselves in the profession, were commissioned to produce Study Texts for the twelve subjects of the examination.

A minimum of two Writers and a Reviewer were tasked with the preparation of Study Text for each subject. Their output was subjected to a comprehensive review by experienced imprimaturs. The Study Texts cover the following subjects:

PART I

1 Basic Accounting Processes and Systems
2 Economics
3 Business Law
4 Communication Skills

PART II

1 Principles and Practice of Financial Accounting
2 Public Sector Accounting
3 Quantitative Analysis
4 Information Technology

PART III

1 Principles of Auditing
2 Cost Accounting
3 Preparation of Tax Computation and Returns

4 Management

Although, these Study Texts have been specially designed to assist candidates preparing for the technicians examinations of ABWA, they should be used in conjunction with other materials listed in the bibliography and recommended text.

PRESIDENT, ABWA

STRUCTURE OF THE STUDY TEXT

The layout of the chapters has been standardized so as to present information in a simple form that is easy to assimilate.

The Study Text is organised into chapters. Each chapter deals with a particular area of the subject, starting with learning objective and a summary of sections contained therein.

The introduction also gives specific guidance to the reader based on the contents of the current syllabus and the current trends in examinations. The main body of the chapter is subdivided into sections to make for easy and coherent reading. However, in some chapters, the emphasis is on the principles or applications while others emphasise method and procedures.

At the end of each chapter is found the following:

- Summary
- Points to note (these are used for purposes of emphasis or clarification);
- Examination type questions; and
- Suggested answers.

HOW TO USE THE STUDY TEXT

Students are advised to read the Study Text, attempt the questions before checking the suggested answers.

ACKNOWLEDGMENTS

The ATSWA Harmonisation and Implementation Committee, on the occasion of the publication of the first edition of the ATSWA Study Texts acknowledges the contributions of the following groups of people. The ABWA Council, for their inspiration which gave birth to the whole idea of having a West African Technicians Programme. Their support and encouragement as well as financial support cannot be overemphasized. We are eternally grateful.

To The Councils of the Institute of Chartered Accountants of Nigeria (ICAN), and the Institute of Chartered Accountants, Ghana (ICAG), and the Liberia Institute of Certified Public Accountants (LICPA) for their financial commitment and the release of staff at various points to work on the programme and for hosting the several meetings of the Committee, we say kudos.

We are grateful to the following copyright holders for permission to use their intellectual properties:

- The Institute of Chartered Accountants of Nigeria (ICAN) for the use of the Institute's examination materials;
- International Federation of Accountants (IFAC) for the use of her various publications;
- International Accounting Standards Board (IASB) for the use of International Accounting Standards and International Financial Reporting Standards;
- Owners of Trademarks and Trade names referred to or mentioned in this Study Text.

We have made every effort to obtain permission for use of intellectual materials in this Study Texts from the appropriate sources.

We wish to acknowledge the immense contributions of the writers and reviewers of this manual;

Our sincere appreciation also goes to various imprimaturs and workshop facilitators. Without their input, we would not have had these Study Texts. We salute them.

Chairman
ATSWA Harmonization & Implementation Committee

A new syllabus for the ATSWA Examinations has been approved by ABWA Council and the various PAOs. Following the approval of the new syllabus which becomes effective from the September 2017 diet a team was constitutes to undertake a comprehensive review of the Study Texts in line with the syllabus under the supervision of an editorial board.

The Reviewers and Editorial board members are:

REVIEWERS

This Study text was reviewed by:

- Prof. Jeremiah Idialu,	Samuel Adegboyega University, Ogwa, Edo State
- Mr. Moses Akinlabi Odedoyin	Osun State College of Education, Ila-Orangun
- Mr. Mukail Akinde	Federal Polytechnic Ilaro

EDITORIAL BOARD

The editorial Board Members are:

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- Mr. Ikhiegbia Braimoh Momoh, FCA	ICAN, Deputy Director, Examination
- Mr. John Adeniyi Adeyemo	ICAN, Principal Manager & HOD, ATSWA Examinations Department

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PAPER 1: BASIC ACCOUNTING PROCESSES AND SYSTEMS

COURSE TITLE: BASIC ACCOUNTING PROCESSES AND SYSTEMS

AIMS:

* To develop an appreciation of the role of accounting information.
* To examine the candidates' knowledge and understanding of the basic concepts, methods and procedures followed in keeping financial records.
* To examine candidates' ability to prepare final accounts for sole traders.

OBJECTIVES:

On completion of this paper, candidates should be able to:

a. Understand the nature, principles and scope of accounting and its role in the management of an organization;
b. Use the principles of double entry to post transactions into the relevant ledger accounts;
c. Identify the source documents as evidence of transactions and relate them to right books of original entry;
d. Balance off ledger accounts and extract the trial balance, identify errors and effect their corrections;
e. Maintain simple cash and petty cash records;
f. Prepare and explain the importance of bank reconciliation statements;
g. Prepare and explain the uses of control accounts;
h. Differentiate between capital and revenue items and explain why the distinction is necessary;
i. Collect and collate information for preparation of final accounts of sole traders;
j. Effect the necessary adjustments in the profit and loss account and balance sheet;
k. Record payroll transactions;
l. Record income and expenditures transactions;
m. Prepare the financial statements of not-for-profit organizations with necessary adjustments; and
n. Code and extract income and expenditure items correctly using computer accounting package to develop the candidates' ability in carrying out simple accounting process tasks.

STRUCTURE OF PAPER:

The paper will be a three-hour paper divided into two sections:

Section A (50 Marks): This shall consist of 50 compulsory questions made up of 30 multiple-choice questions and 20 short answer questions covering the entire syllabus.

Section B (50 Marks): Six questions, out of which, candidates are expected to attempt any four, at 12½ marks each.

CONTENTS:

1. <u>General Framework</u> **5%**

The roles of the International Accounting Standards Board (IASB) and the International Financial Reporting Interpretations Committee (IFRIC).

2. <u>Nature and Significance of Accounting</u> **5%**

(a) Brief historical development of accounting

(b) Purpose of accounting

(c) Users of financial statements and their information needs

(d) The range of accounting services provided to an organisation

3. <u>Forms and Structures of Business Organisations</u> **10%**

(a) Sole Proprietorship; Characteristics, advantages and disadvantages

(b) Partnership; Characteristics, forms, advantages and disadvantages

(c) Limited Liability Companies; Characteristics and types (including provisions and reserves)

(d) Public Enterprises; Characteristics, advantages and disadvantages

4. <u>Accounting Concepts and Conventions</u> **10%**

(a) The distinction between the entity and its owner (Entity Concept)

(b) Historical cost convention

(c) Other concepts:

(i) Going concern

(ii) Money measurement

(iii) Consistency

(iv) Conservatism/prudence

(v) Materiality

(vi) Accrual/matching

(vii) Objectivity/fairness

(viii) Realisation

(ix) Periodicity/Time Interval

5. **Accounting Processes** **20%**

(a) Main accounting source documents and their uses e.g. quotation, sales and purchase orders, delivery note, invoice and pro-forma invoice, credit note, debit note, remittance advice, receipt, payslip, payment voucher, etc.

(b) Books of original (prime) entries or Day Books:

(i) Purchases Day Book

(ii) Sales Day Book

(iii) Purchases Returns or Returns Outward Book

(iv) Sales Returns or Returns Inwards Book

(v) Cash Book (single, two-column and three –column)

(vi) Petty Cash Book

(vii) General Journal

(c) Uses of the Journal Proper

(d) Principles and practice of double entry bookkeeping:

(i) Ledgers and their classifications

(ii) Postings by means of double entry

(iii) Balancing-off ledger accounts

(e) The Trial Balance:

(i) Purpose of extracting a trial balance

(ii) Errors not affecting the agreement of the trial balance

(iii) Errors that affect the agreement of the trial balance

(iv) Use of suspense Accounts

(f) Receivables and Payables Statements

(g) Accounting for fixed assets

(i) Types and characteristics of fixed assets

(ii) Classification of expenditure into capital and Revenue and the importance of their distinction.

(iii) Accounting for depreciation and disposal of non-current assets; straight-line and reducing balance methods only.

h) Simple adjustments affecting final accounts:

(i) Allowances for irrecoverable and doubtful debts

(ii) Allowance for discounts

(iii) Accruals and prepayments

(iv) Drawings account

(v) Discounts allowed and received

(vi) Distinction between current and non-current liabilities

(vii) Distinction between current and non-current assets

6. **Control Accounts** **10%**

(i) Sales (Receivables) and Purchases (payables) Control Accounts

(ii) Different types of errors

(iii) Correction of errors (including journals)

(iv) Reconciliation of control account with ledger, Sales ledger; Purchases ledger.

7. Banking Transactions **5%**

(a) Types of bank accounts

(b) Banking monies received

(i) banking documentation, e.g. paying-in slip, credit and debit card documentation

(ii) methods of handling and storing money, including security aspects.

(iii) Inter bank transfer and settlements, e.g. clearing rules, etc.

(c) Correction of cash book errors,

(d) Preparation of bank reconciliation statement

8. Payroll Accounting **10%**

(a) Simple payroll procedures:

(i) documentation

(ii) authorisation and approval

(iii) payment methods, e.g. cash, cheques and automated payments

(b) Calculation of gross earnings, deductions and net payments

(c) Basic Employee Records

(d) Recording of payroll transactions; journal preparation and postings to nominal ledger

9. Accounting for Cash Transactions **5%**

(a) Cash handling

(b) Petty cash operations; imprest and non-imprest system

(c) Cash security

(d) Keeping of a Petty cash book

10. Preparation of Simple Financial Statements **10%**

(a) Trading profit and loss account and balance sheet of sole traders with simple adjustments

(b) Simple manufacturing accounts

(c) Accounts of not-for-profit organisations

(d) Ethical rules in financial reporting

11. Use of Computer Application Packages in: **10%**

(a) Sales and purchase ledger

(b) Control accounts

(c) Payroll administration and accounting

(d) Stock Control

(e) Bank Reconciliation

RECOMMENDED TEXTS

1. ATSWA Study Pack on Basic Accounting Processes & Systems
2. Ajileye J. O. and O. Adetifa Get Your Financial Accounting Right, Books 1 and 2, Hadlley Lagos.

3. A. O. Akinduko Basic Accounting, Spetin Akure, Nigeria

3. Appiah-Mensah, K.B Principles of Accounting

4. Anao A. R An introduction to Financial Accounting, Longman

OTHER REFERENCE BOOK

Gavor,S.D.K.N Basic and Intermediate Accounting Vols 1 & 2

CHAPTER ONE

NATURE AND GENERAL FRAMEWORK OF ACCOUNTING

1.0 Learning Objectives

After studying this chapter, readers should be able to:

- Explain the historical development of accounting
- State the meaning of Accounting and Book-Keeping
- Explain the purpose and scope of accounting
- Identify users of accounting information and their information needs
- Explain the qualities of accounting information
- Describe the range of services provided by accountants
- List the roles of the International Accounting Standards Board (IASB)
- Identify the roles of the Financial Reporting Interpretations Committee (FRIC)
- Describe the functions of Financial Reporting Council of Nigeria (FRCN)

1.1 Introduction

Accounting is concerned basically with "accountability". The underlying purpose of accounting is to provide financial information about an economic entity. The information is provided periodically, to shareholders and others connected with the organization to enable them decide the extent to which they want to continue to deal with the organization. The need for accounting is more pronounced in a business where a lot of finance, risk and effort have been involved. Financial information is needed to plan and control the finance and operation of a business.

Every other person such as the owner, creditor, government, employee and other parties need financial information of a business for one purpose or the other; details of which would be discussed later in this chapter.

1.2 The Historical Development of Accounting

Rudimentary form of accounting started with book-keeping by *Lucia Pacioli*, an Italian monk. In his book titled "*Summa de Arithmetical, Geometrica, proportioni et* *proportionalita*," published in 1494 on Arithmetic, Geometry and Proportion, he devoted a chapter to expound the principles of the double entry system. It became necessary for managers to report to the owners of businesses during the period under review. Such report would include mainly the following:

- How the financial resources of the business have been obtained and how they have been invested during the 'period'
- The profit earned or loss incurred during the 'period' and
- The assets, liabilities and the owners' equity at the end of the period under review.

After this initial development, a lot of changes have been witnessed in accounting. These changes were informed by the sophistication and complexity of businesses, industrial and political environments which placed more responsibilities on management of business to disclose more information to owners and other interested parties.

For instance, a lot of Generally Accepted Accounting Principles (GAAPs) have been developed to be followed in the preparation of financial statements. Also, accounts have to be "audited" and reported on as presenting a "true and fair" position. Accounting has also gone beyond mere reporting for managerial decisions, to include tax management, government accounting and social responsibility accounting.

The GAAPs are developed from time to time to keep pace with changes in the economic and political environments. The GAAPs are also codified into what is known as *Accounting Standards*. Therefore, accounting is not a fixed set of rules but a constantly evolving body of knowledge.

1.3 The Meaning and Purpose of Accounting and Book-Keeping

Accounting is the art of recording, classifying, summarizing and analyzing financial transactions of a business. It follows, therefore, that accounting is a process, the product of which is the provision of financial information that is useful to a wide range of users.

Bookkeeping is the recording phase of accounting. It is the classification and recording of business transactions in the books of account. The recording of the transactions is a routine task, therefore it tends to be repetitive.

The processes involved in bookkeeping are as follows:

(a) Classification of business transactions using source documents;

(b) Recording of transactions in appropriate subsidiary books or books of prime entry;

(c) Posting of entries from subsidiary books to the ledger and

(d) Extraction of the Trial Balance.

Accounting, however, includes not only the keeping of accounting records, but also the design of efficient accounting, systems, preparation and presentation of Financial Statements, analysis and interpretation of the Financial Statements as well as the development of forecast for decision-making.

The accounts of companies contained in their Annual Reports and Accounts are examples of the product of accounting and they are called *financial statements.*

1.4 Scope of Accounting

Accounting generally covers Financial Accounting; Cost Accounting, Performance Management, Auditing, Government Accounting, Taxation, Financial Management, Forensic Accounting, Social and environmental Accounting etc.

1.4.1 Financial Accounting

Financial accounting involves an accounting process that starts with bookkeeping and ends with the preparation and interpretation of financial statements. Financial Accounting is majorly concerned with providing accounting information to both internal and external users.

The components of Financial Statements “in accordance with IAS 1” are:

a. Statement of financial position
b. Statement of profit or loss and other comprehensive income (in this syllabus as statement of profit or loss)
c. Statement of cash flows
d. Statement of changes in equity (not in this syllabus)
e. Notes to the financial statements (not in this syllabus)

1.4.2 Cost Accounting

Cost accounting is the procedure for accumulating data to provide information for managerial action. Cost accumulation is the collection of cost data in some organised way by means of accounting systems. The cost accumulated will be related to specific products and departments for planning, control and decision making by management.

1.4.3 Performance Management

Performance Management is a continuous process where managers and employees combine efforts in planning, monitoring and reviewing the effectiveness of the workforce towards the achievement of the overall objectives of the entity.

1.4.4 Auditing

Only complete and reliable financial statements can be of any use to interested parties. To guarantee this, the Financial Statements must be examined by an independent person called *an Auditor*. Auditing is the independent examination of the books of accounts and records of an entity by a professional accountant who will gather various forms of audit evidence before he forms an opinion on the financial statements. At the end of the audit exercise, he will write a report on the fairness of the financial statements and the scope of work he carried out before arriving at his opinion.

1.4.5 Government Accounting

Government accounting is the process of recognising and reflecting in the appropriate books of accounts and records of the generated revenue and disbursed expenditure of Government in such a way as to easily provide relevant financial information vital for appropriate decision making from time to time, and in compliance with the laws regulating government finances.

It is a class of Accounting in the Public Sector where government has some executive responsibility. Public sector consists of the ministries and Departments and their agencies (MDAs).

Government accounting is concerned with planning, control and appraisal of government activities and in effect, accountability.

1.4.6 Taxation

The accounting profits generated in the financial statements provide the basis for determining the taxable profits of an entity. The taxable profits are different from the accounting profits because certain expenses and income are allowable for accounting purpose but disallowed for tax purpose. A good understanding of the knowledge of these taxable and non-taxable incomes and expenses would help an entity in its tax management.

1.4.7 Financial Management

Finance is meant to be the cash and cash equivalents and other financial resources of an entity. Financial Management is the process employed by management of an entity to ensure the resources are efficiently and effectively procured, utilized and accounted for by the owners of the business in such a way to maximise the wealth of the owners.

The primary task of financial management is best divided into three, namely

a. Financing decisions'
b. Investment decisions, and
c. Dividend decisions

The financial manager ensures he obtains adequate and cost effective funds for the entity's use at the right time. The various investments on which the funds are employed are carefully and professionally selected. Finally, he also ensures the efficient distribution of profits earned to Owners and other stakeholders

Other secondary roles of the financial manager include:

- Treasury and liquidity management
- Replacement of non-current assets
- Taking appropriate insurance policies on the entity's assets generally
- Tax management and
- Management of the entity's working capital

1.4.8 Forensic accounting

Forensic accounting refers to the application of accounting skills to investigate and probe frauds, deliberate misrepresentations (Falsifications, misappropriations) or embezzlements of an entity's resources with a view to recovering such funds, usually through legal proceedings.

1.4.9 Social and environmental Accounting

Social and environmental Accounting is the branch of accounts that deal with the accounting for and reporting of the social and environmental impact of an entity's activities upon the stakeholders (investors, management, employees, customers, suppliers, local community where the entity operates, etc).

1.5 Qualitative Characteristics of Useful Financial Information

The International Accounting Standards Board's conceptual framework states that accounting information is useful if it possesses both the fundamental and enhancing qualitative characteristics.

Fundamental Qualitative Characteristics

The fundamental Qualitative Characteristics are relevance and faithful representation

a. Relevance

A financial information is relevant if it can make a difference in the decision made by users. A financial information makes difference in users' decision when the users are aware of such information and take full advantage of it or not. A reliable financial information is capable of making difference in decisions when it has:

i. Predictive value Confirmative value or both information has predictive value if it helps the users to predict what happen in the future. Where the information helps users confirm their earlier assessments and predictions made in the past, it is said to possess confirmatory value

b. Faithful Representation

Financial reports a depiction of economic phenomena in words and numbers. To be useful, financial information must not only represent relevant phenomena, but it must also faithfully represent the phenomena that it purports to represent. To be a perfectly faithful representation, a decision would have three characteristics. It will be complete, neutral and free from error.

A complete depiction includes all information necessary for a user to understand the phenomenon being depicted.

A neutral depiction is without bias in the selection or presentation of financial information.

Free from error means there are no errors or omissions in the description of the phenomenon, and the process used to produce the reported information has been selected and applied with no errors in the process.

Enhancing Qualitative Characteristics

These are qualitative characteristics that enhance the usefulness of information that is relevant and faithfully presented. They include:

i. Comparability

ii. Verifiability

iii. Timeliness

iv. Understandability

Comparability

Comparability is that qualitative characteristic of financial information that allows a choice between alternatives. Where an entity is privileged to have information about the financial performance of other entities of similar sizes in the same industry, a comparison of the entity's performance with those of others enables sound economic decisions to be made. For example, decisions as to whether to dispose or hold a particular investment, whether to invest in one industry in preference to another are made by this process.

Verifiability

Verifiability is the quality that enables users to have the assurance that the information depicts exactly what it purports to state. As such different knowledgeable people considering the information will be able to arrive at similar decisions on the same issue.

Timeliness

Timeliness implies that users are given the relevant information needed to take economic decisions in time. Generally, the longer the information had been obtained the less useful it becomes for making today's decisions. However, where a user is required to make some trend analysis, seemingly old information may have some continuing usefulness

Understandability

Information should be presented in a way that the user can comprehend it. This can be achieved if the information is appropriately classified so that the user easily grasps the information. Financial reports should therefore be presented in a form that any average knowledgeable reader can understand for it to be useful to him.

1.6 Users of Accounting Information

Accounting information is of interest to various groups of people. The following people are likely to be interested in accounting information.

(a) **Owners of the business/investors**: These are sole traders, partners and shareholders. They need accounting information to assess how efficiently the management is performing – they want to know how profitable the business is and how much of this profit they can withdraw for their own use. It will also allow shareholders to make appropriate investment decisions such as buying and selling of shares, deciding on whether to dispose some or all the shares, or to acquire more of the entity'shares.

(b) **Management**: These are the people who manage the affairs of the business for the owners. In a limited liability company, they are the members of the board of directors and other management staff. They need accounting information to ascertain the efficiency of the policy they formulate and to plan and control the resources of the business.

(c) **Trade Payables**: These are the people who supply goods to the business on credit. The trade payables want to know the ability of the business to pay for the goods supplied to the business promptly. They will be interested in the liquidity of the business.

(d) **Customers:** These are the people who purchase the goods or services provided by the business. The customers want to know whether the business will continue to be a reliable source of supply; though they will also be interested in the quality of the products of the business.

(e) **Tax authority**: Accounting Profits determine the basis of computing tax. The tax authority wants to determine the tax payable by the entity and its employees.

(f) **Employees of the entity:** Existing employees need accounting information to enable them decide how secure their job is and the ability of the business to pay good salaries and provide good welfare facilities.

(g) **Lenders**: These include the banks and other loan payables. Financial statements enable them to decide whether more credit facility can be granted and whether the company will be able to pay interest and principal when they fall due. They are interested in the liquidity and of the entity's profitability as well as reliability of its underlying assets.

(h) **Government:** Government needs accounting information to enable it formulate fiscal policies.

(i) **Financial Analysts:** They analyze financial statements for their clients in order to help them make informed decisions. Financial analysts include stock brokers, credit agencies and financial reporters.

(j) **The Public**: Members of the general public (individuals, trade unions and associations, political parties, African unions, International Monetary Funds (IMF) etc need accounting information for various purposes. They use the available financial information to take decisions on whether or not to deal with an entity determine their level of involvement in its activities.

1.7 The Work of an Accountant

A professional accountant performs various types of work for an entity either as an employee or as a consultant. For instance, members of the Institute of Chartered Accountants of Nigeria (ICAN) are classified into two broad categories; members in public practice and members not in public practice.

1.7.1 Members in Public Practice

These are accountants working in accounting firms which offer a variety of accounting services to their clients. Their principal functions are:

(i) **Auditing**: They examine the books and records of the entities, obtain reliable, relevant and sufficient audit evidence and then issue a report on the true and fair view of the financial statements. The report issued by the auditor enables users to rely on the financial statements.

(ii) **Tax Services**: They engage in tax planning for entities or individuals with a view to minimizing their tax payable. Their services are also engaged by government in the investigation of the adequacy of tax paid by entities and individuals.

(iii) **Management advisory services**: Firms rely on the extensive knowledge of accountants to provide a range of management consulting services. They could render advice in the area of mergers and acquisition as well as give advice on whether an entity should enter a new line of business or divest. They could also offer advice on asset replacement policy, the best Computer based accounting system to adopt, setting up and operating the accounting system, etc.

(iv) **Insolvency Services**: They could act as receiver manager in the process of winding up of entities.

(v) **Investigation Services:** They investigate fraud or any other matter for which investigation services are required, including the use of forensic accounting.

1.7.2 Members not in Public Practice

These are accountants in the employment of government ministries and parastatals or in private entities. Their main functions include the following:

(i) They prepare the financial statements and the annual reports of the entity on behalf of management.

(ii) They provide relevant management accounting information for decision making.

(iii) They set up and run efficient systems of accounting and internal control.

(iv) They act as treasury managers.

(v) They function as treasury and financial managers

1.8 International Accounting Standards Board (IASB)

The constitution of the IFRS Foundation states that the IASB:

(a) has complete responsibility for all technical matters of the Board including the preparation and issuing of International Financial Reporting Standards (IFRSs) (other than Interpretations) and exposure drafts, each of which shall include any dissenting opinions, and the approval and issuing of Interpretations developed by the Interpretations Committee.

(b) Publishes exposure drafts on all projects and normally publishes a discussion document for public comments on major projects in accordance with procedures approved by the Trustees.

(c) in exceptional circumstances, and only after formally requesting and receiving prior approval from 75 per cent of the Trustees, reduce, but not dispense with, the period for public comment on an exposure draft below that described as the minimum in the Due Process Handbook.

(d) has full discretion in developing and pursuing its technical agenda, subject to the following:

(i) Consulting the Trustees and the Advisory Council; and

(ii) Carrying out a public consultation every three years.

(e) has full discretion over project assignments on technical matters: In organising the conduct of its work, the IASB may outsource detailed research or other work to national standard-setters or other organisations.

(f) establishes procedures for reviewing comments made within a reasonable period on documents published for comment.

(g) normally forms working groups or other types of specialist advisory groups to give advice on major projects;

(h) consults the Advisory Council on major projects, agenda decisions and work priorities;

(i) normally publishes a basis for conclusions with an IFRS or an exposure draft;

(j) considers holding public hearings to discuss proposed standards, although there is no requirement to hold public hearings for every project;

(k) considers undertaking field tests (both in developed countries and in emerging markets) to ensure that proposed standards are practical and workable in all environments, although there is no requirement to undertake field tests for every project; and

(l) gives reasons if it does not follow any of the non-mandatory procedures set out in (b), (g), (i), (j) and (k).

1.9 The IFRS Interpretations Committee (IFRIC)

The constitution of the IFRS foundation states that the IFRIC Interpretation Committee's duties are:

a) Interpreting the application of IFRSs and providing timely guidance on financial reporting issues not specifically addressed in IFRSs, in the context of the IASB's Framework and undertaking other tasks at the request of the IASB.

b) In carrying out its work under (a) above, have regard to the IASB's objective of working actively with national standard-setters to bring about convergence of national accounting standards and IFRSs to high quality solution.

c) Publishing after clearance by the IASB draft Interpretations for public comment and consider comments made within a reasonable period before finalising an Interpretation

d) Reporting to the IASB and obtaining the approval of nine of its members for final Interpretations if there are fewer than sixteen members, or by ten of its members if there are sixteen members.

1.10 The Financial Reporting Council of Nigeria (FRCN)

The Financial Reporting Council of Nigeria Act gives the FRCN responsibility to:

(*a*) develop and publish accounting and financial reporting standards to be observed in the preparation of financial statements of public interest entities.

(*b*) review, promote and enforce compliance with the accounting and financial reporting standards adopted by the Council.

(*c*) receive notices of non-compliance with approved standards from preparers, users, other third parties or auditors of financial statements.

(*d*) receive copies of annual reports and financial statements of public interest entities from preparers within 60 days of the approval of the Board.

(*e*) advise the Federal Government on matters relating to accounting and financial reporting standards.

(*f*) maintain a register of professional accountants and other professionals engaged in the financial reporting process.

(*g*) monitor compliance with the reporting requirements specified in the adopted code of corporate governance.

(*h*) promote compliance with the adopted standards issued by the International Federation of Accountants and International Accounting Standards Board.

(*i*) monitor and promote education, research and training in the fields of accounting, auditing, financial reporting and corporate governance.

(*j*) conduct practice reviews of registered professionals.

(*k*) review financial statements and reports of public interest entities.

(*l*) enforce compliance with the Act and the rules of the Council on registered professionals and the affected public interest entities.

(*m*) establish such systems, schemes or engage in any relevant activity, either alone or in conjunction with any other organization or agency, whether local or international, for the discharge of its functions.

(*n*) receive copies of all qualified reports together with detailed explanations for such qualifications from auditors of the financial statements within a period of 30 days from the date of such qualification and such reports shall not be announced to the public until all accounting issues relating to the reports are resolved by the Council.

(*o*) adopt and keep up-to-date accounting and financial reporting standards, and ensure consistency between standards issued and the International Financial Reporting Standards.

(*p*) specify, in the accounting and financial reporting standards, the minimum requirements for recognition, measurement, presentation and disclosure in annual financial statements, group annual financial statements or other financial reports which every public interest entity shall comply with, in the preparation of financial statements and reports.

(*q*) develop or adopt and keep up-to-date auditing standards issued by relevant professional bodies and ensure consistency between the standards issued and the auditing standards and pronouncements of the International Auditing and Assurance Standards Board

(*r*) perform such other functions which in the opinion of the Board are necessary or expedient to ensure the efficient performance of the functions of the Council.

1.11 Chapter Summary

In this chapter we have discussed:

- Meaning, purpose and scope of accounting and book-keeping.
- Historical development of accounting from the rudimentary form to its modern form.
- Importance of accounting information to the various user groups.
- The nature of services normally rendered by accountants.
- Qualitative characteristics of useful financial information.
- The roles of International Accounting Standards Board (IASB), the Interpretation Committee and Financial Reporting Council of Nigeria (FRCN).

1.12 Revision Questions

Multiple Choice and Short-Answer Questions

(1) The last phase of book keeping is

(a) extraction of the Trial Balance

(b) preparation of financial statements

(c) issuing annual reports

(d) preparation of source document

(2) Who reports on the "true and fair view" of the financial statements?

(a) Government agencies

(b) Owners of the entity

(c) The entity's accountant

(d) The Auditor

(3) What is the usefulness of the Annual Reports and Accounts?

(a) To boost entity's profit

(b) For periodic review of entity's performance

(c) For daily operations of the entity by management

(d) To be able to minimize tax payable by the entity

(4) One of the following is **NOT** an example of business entity

(a) Sole trader

(b) Partnership

(c) Limited liability Company

(d) Club or Association

(5) One of the following is **NOT** an importance of accounting and book keeping.

(a) Book keeping provides permanent records for all financial transactions

(b) The records are used by the Inland Revenue for tax assessment.

(c) The records can be used to determine the promoters of the organization

(d) The assets and liabilities of a business are shown

(6) The two main financial statements drawn up by a sole trader are................. and.......................

(7) Which form of accounting provide information needed for the day to day running of a business?

(8) The body responsible for developing International Financial Reporting Standards is the...........................

1.13 Practice Questions

1. Define the following
   - A. Accounting
   - B. Book-keeping
   - C. Social and environmental accounting
   - D. Forensic accounting
   - E. Performance Management

2. Briefly trace the historical development of accounting to the present day.

3. A professional accountant performs many roles for an entity.

   State and explain the roles of professional accountants to an entity.

4. Explain the qualitative characteristics of Useful Financial Information.

5. Explain the functions of each of:
   A. The IASB
   B. The IFRIC
   C. The FRCN

1.14 Solution to Revision Questions

(1) A

(2) D

(3) B

(4) D

(5) C

(6) The statement of profit or loss and statement of financial position

(7) Performance Management

(8) International Accounting Standards Board (IASB)

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CHAPTER TWO

FORMS AND STRUCTURES OF ENTITIES

2.0 Learning Objectives

After studying this chapter, readers should be able to:

- Define business.
- Explain the characteristics of a business.
- Describe the key features of sole proprietorship, partnership and limited company.
- Explain the advantages and the disadvantages of the sole proprietorship, partnership and limited company forms of business entities.

2.1 Forms of Entities

There are two major types of entities, these are:

a) Business entities

b) Not-for-profit entities

2.2 Business

Business as defined in ICAN Financial Accounting Study text is used in different contexts It is used to describe:

- An economic system where goods and services are exchanged for one another or for money.
- A commercial entity that aims to make a profit from its operations.
- An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return to investors or other owners.

2.3 Characteristics of Business

The following are some of the characteristics of business:

a) It exists to make profits

b) It makes profit by supplying goods or services to others (customers)

c) It supplies goods that it either makes or buys from other parties

d) Its reward for accepting risk is profit

e) The profit earned by it belongs to its owners (sole proprietor, partners or shareholders).

2.4 Types of Business entities

There are three sub-types of Business Entities. They are:

a) Sole Proprietorship

b) Partnership

c) Limited Liability Companies

2.4.1 Sole-proprietorship

It is a business owned by an individual. He bears the responsibility for running the business and he alone takes the profits or loss. The sole-proprietorship is not regulated by special rules of law.

Advantages

(a) The individual provides the capital and employs a handful of people, if and when necessary.

(b) He takes decisions quickly without consulting anybody.

(c) He is highly committed because the profit is entirely his own in case of success and he depends on the business for his livelihood.

(d) There is privacy

(e) It is not regulated by special rules of law.

Disadvantages

(a) The finance available for expansion is limited to that which the sole trader can raise.

(b) The owner has unlimited liability because all his assets might be seized if the business goes bankrupt.

(c) It lacks continuity because the death of the owner automatically leads to the collapse of the business.

Sole-proprietorship is common in retailing, farming, personal services such as hairdressing, fashion designing etc.

2.4.2 Partnership

(a) Partnership Formation

Partnership is the relationship which exists between two or more persons, commonly referred to as partners, carrying on a business in common with a view to making profit. The business may also result in a loss although the purpose is that of profit. Their coming together is voluntary and the exit of a partner may also be voluntary.

The Partnership Act 1890 and the Limited Partnership Act 1907 contain the provisions which govern the relationship between persons carrying on a business with the intention of making profit.

The maximum number of partners in a firm is twenty. There is no maximum limit for professional firms such as accountants and solicitors who have received the approval of the law for this purpose. A firm with more than twenty members would normally be incorporated as a Limited Liability Company.

Most partnerships are formed under a formal agreement. In the absence of an agreement, the Partnership Act 1890 provides among other things, that:

(a) All profits and losses are to be shared equally between the partners

(b) No interest is allowed on capital and current accounts.

(c) No remuneration will be paid to a partner.

(d) Any advance or loan made by a partner in excess of his agreed share of capital will attract interest at 5% per annum.

An agreement is most important, if it is intended that partners should be rewarded according to their differing contributions made to the firm in form of capital, expertise, experience or effort. Resulting from this, an agreement would necessarily contain provisions regarding the following, to ensure as far as possible, that there is an equitable distribution of profits or losses.

(a) The amount of capital to be provided and maintained by each Partner.

(b) The rate of interest (if any) to be paid on capital.

(c) The extent to which drawings are allowed and the rate of interest (if any) to be charged on drawings.

(d) The remuneration (if any) to be paid to partners for their services.

(e) The interest to be paid on any advance or loan made to the firm by a partner over and above his agreed capital.

(f) The proportions in which profits or losses are to be shared after taking account of any adjustments as a result of the above.

Decisions regarding the distribution of profits can be quite interesting in practice due to the search for an equitable relationship among partners. If all partners provide equally in all respects, an equal distribution of profits might adequately represent each partner's interest. But in case of differing amounts of capital, while all other contributions to the firm are equal, the varied amounts of capital would usually be compensated for by allowing interest on capital at an agreed partners 'rate'. In this way, each partner would be given a return on his capital before distribution of the remaining profit. Differences in partners' contributions in the form of expertise, experience or effort could be compensated with salaries and/or differential distribution of profits.

The problems inherent in determining a just and equitable distribution of profits are not usually a concern of examination candidates. A question will normally indicate:

(a) Whether salaries are to be paid.
(b) Whether interest is to be allowed on capital
(c) Whether interest is to be charged on Drawings, and
(d) How the remaining profit should be distributed.

Candidates problems are usually technical, arithmetical and presentational.

Fixed or flexible capital accounts

A partnership will often maintain a **fixed amount of capital**. Under these circumstances, it is preferable that only an agreed capital ratio should be credited to a separate capital account for each partner. All other transactions involving partners such as share of profits, interest, salary, drawings, should be dealt with in their current accounts rather than through the capital accounts. It is simple in this way to keep a constant check on the current accounts; provided a partner's Current Account is not overdrawn, the agreed capital at least must remain with the firm. Of course, profits (or losses) are accruing over the whole of the year, and not just when the final accounts are prepared. It follows therefore that an overdrawn current account is not necessarily an indication that a partner is not maintaining his agreed capital. It is up to the partners to agree on the extent to which drawings are allowed and whether the drawings may exceed the current account balance at the beginning of the year.

(b) Partnership Agreements

Since the essence of partnership is mutual agreement, it is desirable for the partners to come to some understanding before entering into partnership as to the conditions upon which the business is to be carried on and their respective rights and powers.

The Partnership Act 1890 provides certain rules to be observed in the absence of any agreement. However, the circumstances must determine whether these rules are applicable in the particular case and since many matters should be decided which are not included in these rules, it is important that a formal agreement be entered into with a view to preventing disputes in the future. The advantages of written agreements need no emphasis and it is preferable that it should be under seal, since the character of a deed precludes contradiction by any party of the terms which have been agreed.

Even where a formal agreement is made, it does not preclude subsequent variation where changing circumstances demand it; such variation can always be effected with the consent of all the partners, which may be evidenced by an amended agreement.

Contents of Partnership Agreements

The provisions affecting partnership accounts are as follow:

(a) **Capital Contribution:** The agreement states whether each partner should contribute a fixed or a flexible amount.

(b) **Division of Profits or Losses:** The basis as to how profits and losses shall be shared among the partners.

(c) **Fixed or Flexible Capital:** Whether the Capital Accounts are to be Fixed Account, or rawings and profits are to be adjusted in the current accounts, or in the capital accounts.

(d) **Interest on Capital and/or Drawings:** Whether interest on capital and/or drawings is to be allowed or charged before arriving at the profits divisible in the agreed proportions, and if so, at what rate.

(e) **Current Accounts:** Whether current accounts (if any) are to bear interest, and if so, at what rate.

(f) **Partners' Drawings:** Whether partners' drawings are to be limited in amount in order to prevent a negative balance against the capital account, and/or whether interests are to be charged on drawings and at what rate.

(g) **Partners' Remuneration:** Whether partners are to be allowed remuneration for their services before arriving at divisible profits, and if so, the amount of the remuneration.

(h) **Accounting Records:** Proper accounts shall be prepared at least once a year and that these shall be audited by a professional accountant and signed by all the partners.

(i) **Signed Accounts:** The accounts, when prepared and duly signed, shall be binding on the partners, but shall be capable of being reopened within a specified period on an error being discovered.

(j) **Valuation of Goodwill:** The method by which the value of Goodwill shall be determined in the event of admission, retirement or death of any of the partners.

(k) **Compensation to the Estate of Deceased Partner:** The method of determining the amount due to the estate of a deceased partner and the manner in which the liability is to be paid within a specified period, by instalments of certain proportions and the rate of interest to be allowed on outstanding balances.

(l) **Insurance Premiums:** Where there are partnership insurance policies, the division of the policy among partners and the method of treating the premiums thereon must be stated.

The main advantages of partnership over sole-proprietorship are:

(a) Greater finance is to partnership than to sole proprietorship

(b) Higher performance may be achieved by the partnerships than the sole proprietorships' since two heads are better than one.

(c) Decision-making is also swift since partners are friends and they are not many, though may not be as fast as in sole proprietorships'

(d) Decision made in partnerships are more efficient and effective than decisions made in sole proprietorships

The disadvantages are:

(a) The major disadvantage is that the liability of members of the partnership is unlimited.

(b) The amount of capital the partners can raise may still not be enough to enable them carry out large investments.

(c) The death and bankruptcy of a partner may lead to the dissolution of the entity. There is no perpetual succession.

(d) Disagreement may occur between the partners. They may find out that they are not compatible which may lead to the dissolution of the partnership.

2.4.3 Limited Liability Company

Nature, Formation and Statutory Books Of Limited Liability Companies

A limited liability company is a form of business entity that has a personality distinct from those of its owners. The attraction of this form of business enterprise is its access to capital larger than what its promoters can provide. Because of its distinct legal personality, it can sue and be sued in its name and enter into contracts for which it is solely liable.

Classification of Companies

Generally, a company may be either a **private** company or a **public** company. it may be:

- A company limited by shares
- A company limited by guarantee
- An unlimited company

Private Company

A private company is one that is stated to be so by its Memorandum of Association and has the following features:

(a) Its Articles of Association must restrict the transfer of its shares

(b) The total number of members must not be more than 50, excluding persons who are employees of the company, existing or retired. However, where two or more persons hold one or more shares jointly, they shall be treated as a single member.

(c) It cannot invite the public to deposit money for fixed periods or payable at call whether or not they bear interest.

Public Company

Any Company other than a private company is a public company and its Memorandum of Association must so state that it is a public company.

Companies derive their existence under the provisions of the Companies and Allied Matters Act, Cap. C 20 LFN 2004. The rules and procedures guiding the incorporation or formation of limited liability or unlimited liability companies are contained in Sections 18 – 49 of the Companies and Allied Matters Act, Cap. C 20 LFN 2004.

Advantages and disadvantages of Limited Liability Company

Advantages

(a) The liability of the shareholders is limited to the amount they have subscribed to the company's capital if it goes bankrupt.

(b) It can raise substantial amount of capital from the numerous shareholders or from financial institutions.

(c) The chance of survival is high because the company is controlled and managed by highly skilled professional management team appointed by the Board of Directors who are elected by and answerable to the shareholders.

(d) The limited company is a separate legal entity distinct from its members. It can sue and be sued in its name.

(e) Unless it is wound up, a limited company has perpetual succession so that it is not affected by the death, bankruptcy, mental disorder or retirement of its members.

(f) Floating charges can be created by a limited company.

(g) Shares in a public company can be transferred without the consent of other members.

Disadvantages

(a) Formation of limited liability company requires costly legal expenses

(b) Decision making may be delayed due to bureaucratic bottlenecks.

(c) The members of the company have no power to manage its affairs.

(d) Much legal and publicity formalities are observed e.g. Filing of annual returns, annual general meeting, etc.

(e) much of its activities are open to public scrutiny.'

2.5 Formation Procedure

(a) The name proposed by the promoter of a company has to be 'searched for' and approved by the Corporate Affairs Commission, which must be utilized within 60 days, otherwise the name has to be revalidated.

This is to ensure that the entity's proposed name does not bear resemblance of already existing names and does not cause confusion.'

(b) A limited liability company, private or public, may be brought into existence when the documents enumerated below and appropriate fees are paid to the Registrar, Corporate Affairs Commission:

(i) A Memorandum of Association signed by at least two subscribers, dated and witnessed by a Chartered Accountant, Chartered Secretary 'or' a Lawyer facilitating the registration of the Company. Each subscriber must agree to subscribe for at least one share.

(ii) A minimum of 25% of the authorized share capital must be taken up at incorporation.

(iii) Articles of Association will be similarly signed, dated and witnessed by the Professionals involved in the registration of the Company as mentioned above.

(iv) A statement of nominal capital (unless the company is to have no share capital) must be stated. Stamp duty varying with the amount of authorized share capital is payable.

(v) There is no upper limit to the amount of the authorized share capital, although the minimum is currently ₦10,000 for a private company while that of a public limited liability company is N500,000 (except in cases of special companies such as, banks and insurance companies).

(vi) A statutory declaration by a solicitor engaged in the formation of the company or by one of the persons named as directors or secretary that the requirements of the Companies and Allied Matters Act 2004 in respect of registration have been complied with.

(vii) A statement (in the prescribed form) of the particulars of the first directors and secretary and the first address of the company's registered office. The persons named as directors and secretary must sign the form to record their consent to act in the relevant capacity and when the company is incorporated; these persons are automatically appointed.

(c) When the Registrar General, Corporate Affairs Commission is satisfied that all the documents are in order and that the objects specified in the memorandum are lawful, he issues a certificate of incorporation.

(d) The purpose of the memorandum and articles of association is to define the constitution of the company. The memorandum sets out basic elements of the constitution while the articles are mainly internal rules, but of interest to outsiders since they define the powers of the directors to enter into contracts on behalf of the company. The memorandum prevails if there is any inconsistency between it and the articles.

(e) A private company may do business and exercise its borrowing powers from the date of its incorporation but a public company (incorporated as such) may not do business or borrow until it has obtained a trading certificate (not a statutory expression) from the Registrar General.

(f) The memorandum of every company limited by shares must include:

(i) The company's name, which if the company is limited by shares or by guarantee, should end with the word 'limited'. A limited company may in some circumstances omit the word "limited" from its name. An unlimited company does not end its name with the word "Limited".

(ii) The country (not the address) in which the company's registered office is to be situated. This determines the nationality and the place of domicile of the company which cannot be changed.

(iii) The objects of the company contained in an "objects clause" which, because of the developments of company law over time, specifying both alternative business activities and express powers to engage in every kind of business which the company might wish to undertake. The objects stated in the opening paragraphs are treated as "main objects'' while the others are ancillary to them, unless the contrary is stated.

(iv) The liability of members: If the company is one limited by guarantee, this is followed by a second clause, which states the maximum amount that each member undertakes to contribute in winding-up to enable the company pays its debts. The authorized share capital (of a company limited by shares) must disclose the amount of the share capital with which the company proposes to be registered and specify shares of stated value into which that amount is divided. For example, the share capital of the company of ₦100,000 may be divided into 200,000 shares of 50k each. The amount of the authorized share capital may be increased (or reduced) in the manner provided by the articles, usually by passing an ordinary resolution. The authorized share capital is the maximum amount in shares which the company may issue.

(g) The articles of association deal mainly with the internal conduct of the company's affairs, e.g. the issue and transfer of its shares, alterations of its capital structure, conduct of general meetings, members voting rights, powers of directors and board meetings, dividends, accounts and notices.

(h) The articles of association usually delegate the power to allot and issue shares to the directors as one of their management functions. The formal procedure is that the subscriber applies for shares (often in response to an invitation by the company) and the directors accept his offer by deciding at a board meeting to allot shares to him. His name is entered in the register of members, a share certificate is issued and within one month of allotment, a return is submitted to the Registrar General.

2.6 Statutory Books

Statutory books are the official records kept by the company relating to all legal and statutory matters. The statutory books of the company must be maintained and kept at the company's registered office (or alternative location notified to the Corporate Affairs Commission) where they can be inspected. The list of the registers and documents which every company is required under the CAMA to keep include:

a) The register of the company's members,
b) The Index of members where they are more than 50,
c) The register of charges registered against the company;
d) Minutes Book (of all General meetings, Directors' meetings and Manager's meetings (if any) including copies of shareholders' resolutions passed,
e) Register of Directors' shares' and Debentures
f) The register of directors and secretaries,
g) The register of interest in shares
h) The Accounting Records
i) Director's service contracts

The essence of maintaining these statutory books is to offer members of the company or any other person an opportunity to inspect the records of the company and be aware of its state of affairs.

(a) <u>Redeemable Preference Shares</u>

Under section 122 and 158 of the Companies and Allied Matters Act Cap C20 LFN 2004, a company so authorized by its articles may issue redeemable preference shares, provided that:

(i) There are in issue other shares which are not redeemable.

(ii) The redeemable shares may not be redeemed unless they are fully paid.

(iii) The terms of redemption provide for the company to make payment at the time shares are redeemed. The redemption may be effected on such terms and in such manner as may be provided by the articles as long as the provisions of the Act are complied with.

(iv) Redemption is made out of the:

- Distributable profits of the company
- Proceeds of a fresh issue of shares made for the purposes of the redemption.

(v) Any premium payable on redemption is payable out of the company's distributable profits, except: the premium payable on the redemption of redeemable preference shares which were issued before the appointed day may be paid out of the share premium account or partly out of the distributable profits (section 158(4) of the Companies and Allied Matters Act, Cap. C20, LFN 2004).

(vi) Where the redemption is made out of the proceeds of a fresh issue of shares made for the purpose of the redemption and the shares to be redeemed were originally issued at a premium, any premium payable on their redemption shall be paid out of the share premium account up to an amount equal to the lower of:

- the aggregate of the premium received by the company on the issue of the shares redeemed, or
- the current amount of the company's share premium account (including any sum transferred to that account in respect of premium on the new shares).

Participating Preference Shares

Where specific provision is made in the articles, preference shares may be participating preference shares. This type of shares entitles the holders to share in any remaining profits after the preference shares and ordinary shares have received specified dividends.

(c) Ordinary shares

The ordinary share capital of a company is often termed the ''equity capital''. Ordinary shares may be divided into preferred and deferred ordinary shares, in which case the balance of the profit is shared between the two types of ordinary shares in some prescribed proportions.

2.7 Not for Profit Entities

Not-for- profit entities are entities that do not have profit maximisation as their main objectives. Decision making in Not-for-profit entities is not based on cost-benefit analysis. A goal can still be pursued even where the cost out-weighed the benefits provided such goal will add value to the intended beneficiaries. Their performance are usually not measured in terms of return on investment. Not-for-profit entities can be sub-divided into two groups as follows:

Governmental entities

a) Non-governmental entities

2.7.1 **Governmental Entities**

Governmental entities are also called Public Sector Entities. They are the Local, State and Federal Governments as well as their Ministries, Departments and Agencies generally called (MDAs).

Among the agencies of government are Public Corporations. These are special government entities that are run on similar basis as Private Sector Businesses. The government provides the capital for the entity. The Minister/Commissioner acting on behalf of the Federal/State government appoints the members of the Board who in turn formulate policies within the enabling Act establishing the Corporation and the framework. Examples of public corporations are Ghana Airways, the Nigerian Railway Corporation, the Nigerian Ports Authority and the Nigerian National Petroleum Corporation (NNPC).

Characteristics of Public Sector Entities

The following are the key characteristics of Public Sector entities:

i) The requirement for public accountability by the operators

ii) They have multiple objectives

iii) The rights, powers and responsibilities of the entities are derived from the constitution or the law setting them up

iv) There is no equity ownership

v) Their operating and financial frameworks are set by legislation

vi) Budget is very important

vii) By their nature, profit maximisation is not a major objective

Non-Governmental Entities (NGOs)

These are usually described as (NGOs). They include religious, charitable, social entities, etc. Since the source of their funding is mainly from the public, the characteristics of NGOs are akin to that of public sector entities.

Advantages of Governmental Entities

(a) Some activities such as the generation of electricity, provision of port facilities and rail transport services involve huge financial outlays which the private entrepreneurs cannot provide. These facilities must be provided to quicken the pace of economic development and industrial growth.

(b) It enables some natural resources, especially minerals to be efficiently exploited and effectively managed.

(c) Some essential goods or services if left in the hands of private businesses may not be provided insufficient quantities or may be provided at exorbitant prices. Thus, the common people will not be able to afford them and this may worsen their standard of living.

(d) The public company can borrow money externally by issuing bonds or Loan Notes. This is not possible for the private sector entities.

Disadvantages of Governmental Entities

The major disadvantage of public sector enterprises is that members of the Board are political appointees who control and manage the corporation. Often times, they do not possess the relevant skills to manage such organisations efficiently. Some members of staff are appointed on political grounds and quota basis, resulting in low productivity.

The performance of public sector entities is poor when compared with the private sector entities. Most of the public sector entities are being run at a loss as the motive for establishing them is not for profit. They receive subventions from the government without commensurate service to the people.

2.8 Chapter Summary

In this Chapter, we have discussed:

- The forms of entities and their conceptual definitions.
- The characteristics of the entities.
- Formation, advantages and disadvantages of the entities.

2.9 Multiple Choice Questions and Short Answer Questions

1. The maximum number of partners in a professional firm such as solicitors and accountants is
   (a) Five
   (b) Unlimited
   (c) Between Ten and Twenty
   (d) Between Twenty and Thirty
   (e) Fifty
2. In the absence of a partnership deed
   (a) Partners' remuneration is 5% of profit
   (b) No remuneration will be paid to a partner
   (c) Remuneration will be paid equally to all the partners
   (d) Remuneration will be paid net of tax
   (e) Partners' remuneration is 10% of profit.

3. The minimum authorized capital of a public limited liability company is
   (a) ₦10,000
   (b) ₦25,000
   (c) ₦500,000
   (d) ₦1,000,000

(e) ₦50,000

4. The body charged with the responsibility of incorporation of limited liability companies in Nigeria is
   (a) The Central Bank of Nigeria
   (b) The Federal Ministry of Finance
   (c) The Ministry of Foreign Affairs
   (d) Corporate Affairs Commission
   (e) Security and Exchange Commission

5. The under listed are forms of Loan Notes **EXCEPT**
   (a) Secured
   (b) Bearer
   (c) Preference
   (d) Redeemable
   (e) Naked

6. Identify two sources of capital available to a public limited company.

7. A company that has no share capital is described as…………….

8. Undistributed profits accumulated over the years by a limited liability company are referred to as……………

9. The major advantage of limited liability company over partnership is……….

10. The major disadvantage of public enterprise is……………

2.8 Solution to Multiple Choice Questions and Short Answer Questions

1. B
2. B
3. C
4. D

5. C
6. Issue of shares and loan notes
7. Limited by guarantee
8. Reserves
9. The liability of members of the company is limited to the amount unpaid on their shares.
10. Political influence.

CHAPTER THREE

ACCOUNTING CONCEPTS AND CONVENTIONS

3.0 Learning Objectives

At the end of this chapter candidates should be able to:

- Identify and explain the relevance of accounting concepts.
- Explain the relationship between a business entity and its owner.
- Explain the relationship between accounting equation and statement of financial position.
- Differentiate between assets, liabilities and Owner's equity
- Identify elements of financial statements

3.1 General Purpose Financial Statements

The IASB's conceptual framework prescribes that the financial statements required of entities are General Purpose Financial Statements. It also described the objective of general purpose financial statement as providing financial information about a reporting entity. The information is useful to existing and potential investors, lenders and other payables in making decisions about providing resources to the entity.

General purpose financial statements are prepared under certain assumptions generally regarded as concepts and conventions

3.2 Concepts and Conventions

Concepts, principles, conventions, laws, rules and regulations combined are known as Generally Accepted Accounting Principles (GAAP). GAAP varies from country to country but with the adoption of International Financial Reporting Standards (IFRSs) by many countries, the variations are greatly reduced. Nigeria is one of the countries that have adopted (IFRSs)

The concepts and conventions as described in conceptual framework and international Accounting Standard number (I) (IAS 1) are discussed below:

3.2.1 Entity Concept

In the strict legal sense, only limited liability companies are regarded as legal entities separate from their owners. They can acquire assets and incur liabilities. They can enter into contracts on their own and can owe debts. They can sue and be sued.

In accounting, however, all forms of entities are regarded as being separate from their owners. The resources contributed by the owner to the business is regarded as the liability of the business to the owner, which is called capital or owners' equity.

The essence of the entity concept is to distinguish the income and costs of the business from the private income and costs of the proprietor or his drawings from the business. For instance, if the owner of a business draws cash from the business bank account to repair delivery vans for business use, it would be regarded as business expenses. But if he pays his child's school fees with the business cash, the amount will be treated as drawings of the owner rather than expenses. The entity concept is key to the proper understanding of the double entry principle and so must be properly grasped at this stage. We shall next consider the other concepts and conventions.

3.2.2 Money Measurement Concept

Money serves as the common denominator for measuring the various assets and liabilities of an entity, therefore, accounting transactions are expressed in monetary values. The Naira and the Cedi represents a unit of value which has the ability to command goods and services in Nigeria and Ghana respectively.

Apart from the fact that money serves as a common unit, accountants also believe that it is stable in value.

There are some limitations in the use of money as measure of value in accounting.

(a) The value of money does not always remain stable particularly in an inflationary economy.

(b) Apart from inflation, the time value of money today is greater than the time value of money in any future time. This affects the cost of funds.

(c) There are some activities of an entity that are not recorded because monetary value cannot be attached to them. Examples are good management, employees' morale, an entity's comparative advantages, etc.

However, accounting does not provide all the information about a firm, it provides only economic information that can be expressed in monetary terms.

We may then understand why limited liability companies are now being required to disclose a lot of non-accounting information in their annual reports and accounts.

3.2.3 The going concern concept

Unless otherwise stated, it is always assumed that a business entity will continue in operation for the foreseeable future. It is assumed that the entity has neither the intention nor the necessity of liquidation or curtailing significantly the scale of its operation.

The going concern concept will help investors, payables, employees, customers and other stakeholders to determine the extent to which they want to continue to patronize the business. The going concern concept may be more justified in a limited liability company where the death or withdrawal of any member (shareholder) may not affect its scale of operation.

Assets and liabilities of a going concern entity are generally valued on historical cost basis, or fair value basis.

3.2.4 Periodicity concept

The assumed life span of a business is usually subdivided into smaller periods of twelve months (one year). This enables an entity's operations to be subjected to periodic review to determine the financial performance and position of the entity. It also empowers the management to make periodic distributions to the owners.

The periodic review would also help to assess management efficiency and the planning and control of future operations.

3.2.5 Prudence concept

The prudence concept requires that an accountant should not recognize income until the income has been earned and adequate allowances made for all known losses. The essence of the principle is that profits are not overstated in any accounting period.

The prudence concept is most useful when matters of judgement or estimates are involved. For instance, if the credit policy of a business requires a customer to pay for the goods sold to him within 60 days and he has not paid after 120 days, it may be reasonable to make allowance for the entire amount as irrecoverable and doubtful debt. Another example is when inventories become obsolete and its net realizable value falls below cost, the difference between the cost and the net realizable value should be written off to the statement of profit or loss.

Failure to write foreseeable losses off or the recognition of unrealized income will produce a misleading result which may lead to payment of taxes or distributions that should not have been made.

3.2.6 Substance Over Form

Although business transactions are usually governed by legal principles; nevertheless they are accounted for and presented in accordance with their financial substance and reality and not merely by their legal form. In order to be useful information contained in financial statements must be relevant and reliable. This can only be achieved if the substances of transactions is recorded. If this did not happen the financial statements would not represent faithfully the transactions and other events that had occurred.

Examples are found in sales and re-purchase agreements, lease contracts and consignment of goods.

3.2.7 The Consistency concept

Usually there is more than one way of treating an item in the accounts without going against any accounting principle

Consistency concept requires that when a method has been adopted in treating an item in the financial statements, the method should not be changed but used consistently from period to period. For instance, there are many methods of depreciating non-current asset such as straight line, reducing balance, sum of the digits methods. If straight line method is chosen to depreciate buildings in year one, the company should continue to depreciate buildings on straight line basis from year to year. This method should not be changed unless there are compelling reasons.

The essence of this principle is to make it easy for users of financial statements to compare the results of one period to another. Constant change in method will distort profits and make comparison difficult.

Occasionally there may be justification to change from one method to another. If the change is made, adequate disclosure must be made about the nature of the change and the effect of the change on profits.

3.2.8 Accrual / Matching Concept

This can be called either accrual or matching concept. The accrual concept states that income should be recognized when they are earned and not when they are received in cash. Expenses should also be recorded when they are incurred and not when paid. The application of this concept gives rise to prepayments and accrued expenses (accrual). An accrued expense occurs when it has been incurred but has not been paid. Prepaid expenses occur when payment has been made for services but benefits have not been derived from them. They give rise to liabilities and assets respectively. Prepaid expenses and outstanding receivables are assets while income received in advance and outstanding payables are liabilities of the business.

All expenses due but not yet paid should be added to the expenses paid in order to determine the total expenses for the period. All expenses prepaid should be excluded from the amount to be deducted in the statement of profit or loss. All income due and receivable should form part of the income for the period. While all income received in advance should be excluded. The concept also holds that for any accounting period, the earned revenue should be matched with the cost that earned them. If revenue is deferred from one period to another, all elements of cost relating to them should also be carried forward accordingly.

The concept is important in measuring the cost of goods sold or services rendered in a period. It is also useful in determining when the cost of an item becomes expenses (that is expired cost). This concept is applied to products where the costs can be related directly to them. It is applied in relation to time period where the cost incurred cannot be related to the product.

For instance, if a trader bought 50 pairs of shoes for ₦50,000 and sold 35 pairs for ₦70,000 at the end of a period. The cost of goods sold would be measured on the 35 pairs sold. That is 35/50 x ₦50,000 = ₦35,000. ₦15,000 would be deferred to the next period.

Some costs that cannot be related to specific transactions are depreciation, electricity bill, insurance cost etc. When this concept is not properly applied profits are either overstated or understated.

3.2.9 Materiality Concept

Any accounting information that affects users' decision about a reporting entity's performance when such information is omitted or misstated is regarded as material

The principle of materiality holds that financial statements should separately disclose items which are significant enough to affect evaluation or decisions. It refers to the relative importance of an item; therefore some level of judgement may be required in determining what is material to an entity; as what is material to a sole trader may be immaterial to a large company.

The nature, amount (value) and size of a business (in terms if capital employed) will generally be considered in determining the materiality of an item of cost. For instance, stapler, perforator, waste basket are expected to be used for more than one period, so that their costs should be measured over the period of use. However, because of the insignificant amounts involved, the concept of materiality permits the immediate write off of these costs as expenses.

3.2.10 Historical Cost Concept

Historical cost is the amount of cash or cash equivalent paid or the fair value of the considerations given to acquire assets. In this vein, liabilities are recorded at the amount of proceeds received in exchange for the obligation. The justification for the historical cost principle is its objectivity; that is, the cost can be traced to the source documents whereas other measures of value would be based on the subjective judgement of management. The main criticism against the historical cost concept is that, with the passage of time, cost would no more represent the fair value of an asset. For instance, the value of a building constructed ten years ago might have appreciated considerably over the period. In periods of inflation, the use of historical cost instead of fair values, normally leads to the recognition of "holding gain" because cost would significantly understate the value of the resources being consumed. Recognizing holding gain may lead to the distribution of the profits that would have been retained in the business for further expansion. Hence, the IASB has prescribed the use of fair value as an alternative.

3.2.11 Objectivity / Fairness Concept

Objectivity concept holds that financial statements should not be influenced by personal bias of management. The use of historical cost for asset valuation is an attempt to be objective, because it can be backed up by vouchers, invoices, cheques, bills etc.

A change in the value of an asset should therefore be recognized when it can be measured in objective terms.

Objectivity is useful in accounting in the following ways:

(a) Auditing is made possible

(b) Accounting data are standardized.

(c) Fraud and falsification of accounts are minimized.

(d) Data is available for an independent party to cross-check.

In spite of the goals of objectivity concept some personal opinions and judgement are brought into accounting information in a few instances. For instance, estimates are required to determine the useful life of a non-current asset and the net realizable value of inventories or the allowance to be made for irrecoverable and doubtful debts.

However, figures used in financial statements should rely as little as possible on estimates or subjectivity.

3.2.12 Fair Value basis

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The basis for determining fair value is arm's length transaction, that is, transaction that involves dealing with unrelated or unknown parties.

3.2.13 Realisation Concept

Under accrual concept, revenue should be recorded when it is earned. The realisation concept is concerned with determining when revenue is earned.

The realisation concept holds that revenue should be recognised at the time goods are sold and services are rendered; that is the point at which the customer has incurred liability.

Before revenue can be realised and recorded, it must have met the following two conditions

(a) The revenue is capable of objective measurement

(b) The value of asset received or receivable is reasonably certain.

The realisation concept may however be difficult to apply in hire purchase transactions, lease transactions, contract jobs, advertisement agencies etc.

You will learn the rules that are applied in recognising revenue as you progress in your studies.

3.3 The Elements of Financial Statements.

The IASB's conceptual framework identified five elements of Financial Statements. Three of these that relate to the statement of financial position are as follows:

i) assets;

ii) Liabilities; and

iii) Equity

The remaining two relate to the statement of profit or loss and they are:

i) Income; and

ii) Expenses

3.3.1 Assets

An asset is defined by the IASB's "Framework" as:

i) A resource controlled by an entity;

ii) As a result of past events; and

iii) From which future economic benefits are expected to flow to the entity

For an asset to be recognised in the statement of financial position, the asset must possess the above three characteristics.

3.3.1.1 Non-current Assets

These are the economic resources that aid income generation for more than one accounting period. They include land and buildings, motor vehicles, equipment, machinery, furniture etc.

3.3.1.2 Current Assets

These are the economic resources of the business which are easily converted to cash or can be consumed within an accounting period or operation cycle, whichever is longer. Examples are cash in hand and at bank, receivables and other receivables, prepaid expenses and inventories of goods meant for resale.

3.3.2 Liabilities

A liability is defined by the IASB as:

i) A present obligation of an entity

ii) Arising from past events

iii) The settlement of which is expected to result in an outflow of resources that embody economic benefits

3.3.2.1 Non-current liabilities: These are current obligations that will take more than one year before repayment is due. They are long-term loans.

3.3.2.2 Current Liabilities

These are the amounts owed currently by business that are meant to be paid within twelve months. Examples of current liabilities are trade payables (supplier of goods on credit), and other payables such as outstanding bills on electricity, salary and wages, taxation etc. and bank overdraft.

3.3.3 Equity

Equity is the residual interest in an entity after the value of all its liabilities have been deducted from the value of all its assets.

Examples are ordinary shares, preferred shares, share premium and retained earnings.

3.3.4 Income

Income includes both revenue and gains.

i) **Revenue** is income arising in the course of the ordinary activities of an entity. Examples are sales revenue, fee income, royalties' income, and rental income

ii) Include gains on the disposal of non-current assets.

3.3.5 Expenses

Expenses are expenses and losses

- Expenses arising in the normal course of activities. Examples are cost of sales and other operating costs.
- Losses include loss on the disposal of non-current assets or diminution in value of assets.

3.4 Accounting equation

This signifies the relationships existing between the elements of the basic financial statements (statement of financial position and statement of profit or loss)

3.4.1 Basic Accounting Equation

The basic accounting equation expresses the equality of Assets to Equity. In practice, the owner of a business outfit starts by bringing in equity and this is recorded by the business as incoming asset that is equivalent to the equity supplied.

Mathematically, this is expressed as:

$$\text{Asset} = \text{Equity}$$

Symbolically, this can be stated as:

A = E

Where A is asset

E is equity

Example 1

Oduduwa, started his business by paying ₦250,000 into the Business Bank Account.

Solution

Payment by Oduduwa is equity (E)

Money received into the Business Account is asset (A)

Therefore A = E

Substituting values for the equation above

₦250,000 = ₦250,000

Example 2

If Oduduwa decides to buy inventory of ₦50,000 on credit, the structure of the equation will change.

We now have a liability, the giver of the inventory and also an asset, the inventory received. The equation has now expanded to include, Assets, Liability and equity. Symbolically, Liability is represented by L. The new accounting equation will now be:

	A	=	L	+	E
	₦		₦		₦
Cash at Bank	250,000				250,000
Inventory	50,000	(owing to suppliers)	50,000		
	300,000	=	50,000		250,000

Assets and Liabilities have both increased.

The expanded equation is now

A = L + E

3.4.2 Changing the subject to the formula

The subject of the formula can be changed to derive any of the two other items as follows:

To make L the subject of the formula

A = L + E

A - E = L

This can be rearranged to read:

L = A - E

If on the other hand E is to be made the subject of the formula, the formula will be derived as follows:

A = L + E

A - L = L

Rearranged, it will be

E = A - L

Example 3

Use the accounting equation to fill the gaps in the table below

	Assets	Liabilities	Equity
	₦	₦	₦
(i)	-	34,561	22,416
(ii)	246,122	-	134,769
(iii)	144,903	65,711	-

Start by stating the accounting equation to derive the solution to (i) to (iii) above

Answer

Accounting equations

(i) A = L + E

(ii) L = A - E

(iii) E = A - L

(i) A = ₦34,561 +₦22,416

= ₦56,977 Ans

(ii) L = ₦ 246,122 - ₦ 134,769

₦ 111,353 Ans

(iii) E = ₦ 144,903 - ₦ 65,711

= ₦ 79,192 Ans

3.4.3 Revenue Based Accounting Equation

The goal of the statement of profit or loss is to derive the profit or loss made during the period. An accounting equation can also be derived from the statement of profit or loss thus:

Profit = Revenue - Expenses

Symbolically, this can be stated as:

$$P = R - E$$

Where P = Profit

R = Revenue

E = Expenses

3.4.4 Change of the subject of the formula

Like in the case of the accounting equation derived from the statement of financial position, the subject of the formula in the accounting equation can be changed thus:

(i) Where Revenue is not known

$$P = R - E$$

$$P + E = R$$

$$R = P + E$$

(ii) Where Expenses figure is not known

$$P = R - E$$

$$P - R = -E$$

Multiply the above equation with minus all through

$$-P - (-R) = -(-E)$$

$$-P + R = +E$$

By Re-arrangement

$$R - P = E$$

$$E = R - P$$

Example 4

(i) Inventory bought for ₦25,000; sold for ₦40,000

(ii) Inventory bought for ₦15,000; Loss on sale ₦3,000

(iii) Goods sold for ₦23,500 and profit on sale is ₦4,500

Required: using the accounting equations:

(i) Determine the profit

(ii) Determine the revenue

(iii) Determine the Expenses

Solution

(i) Accounting equation

$P = R - E$

Where p = profit

R = Revenue

E = Expenses

$\therefore$ P = ₦40,500 - ₦25,000

P = ₦15,000 Ans

(ii) Accounting equation

$R = P + E$

R = ₦(3,000) + ₦15,000(Loss is negative profit)

R = ₦12,000

(iii) Accounting equation

$E = R - P$

E = ₦23,500 - ₦4,500

= ₦19,000 Ans

Example 5

The following information are given:

		₦
Equity	1/4/2014 – 31/3/2015	124,600
Equity	1/4/2015 – 31/3/2016	214,250
Drawings	1/4/2015 – 31/3/2016	22,390

Required:

(a) Determine the profit for the year ended 31/3/2016

(b) Assuming Equity as at year ended 31/3/2016 was ₦82,620, compute the profit or loss for the year.

Solution

₦

Equity	1/4/2014 – 31/3/2015	(E)	124,600	(Opening equity)
Add Profit	1/4/2015 – 31/3/2016	(P)	?	
			?	
Less: Drawings		(D)	(22,390)	
		(E_2)	214,250	

Symbolically:

Represent Equity 1/4/2014 – 31/3/20145 by E_1

Represent profit by P

Represent Drawings at 1/4/2015 – 31/3/2016 D

Represent Equity 1/4/2015 – 31/3/2016 by E_2

(a) Therefore the accounting Equation =

$E_1 + P – D = E_2$

$P = E_2 – E_1 + D$

P = ₦214,250 – ₦124,600 + ₦22,390

P = ₦112,040

Profit = ₦112,040 Ans

Proof:			₦
Equity	(E_1)	1/4/2014 – 31/3/2015	124,600
Add: Profit	(P)		112,040
			236,640
Less: Drawings	(D)		22,390
Closing Equity	(E_2)		214,250

(b). $P = E_2 – E_1 + D$

P = ₦82,620 - ₦124,600 + ₦22,390

P = - ₦19,590 Loss

Loss = - ₦19,590 Ans

Proof:	₦
Equity at beginning	124,600
Less Loss	19,590

	105,010
Less Drawings	22,390
Equity at the end	82,620

Comprehensive Example

The following are extracted from the records of Oduduwa, a proprietor.

i) The proprietor deposited ₦250,000 cash in the business Account as a start-up fund

ii) He acquired inventory of ₦50,000 on credit

iii) He paid the supplier of the inventory the sum of ₦27,000 from the business account

iv) He allowed his building worth ₦250.000 to be used for the business

v) Half of the inventory acquired in (ii) above was sold for cash ₦40,000

vi) He paid ₦10,000 to the supplier of the inventory from his personal resources

Required:

a) State with the aid of a table, the effects of each transaction on Assets, Liabilities and Equity (that is, by stating 'Increase, 'Decrease' and 'No Effect')

b) Provide figures to support your submission in (a) above.

Solution

a.

	Assets	**Liabilities**	**Equity**
(i)	Increase	No effect	Increase
(ii)	Increase	Increase	No effect
(iii)	Decrease	Decrease	No effect
(iv)	Increase	No effect	Increase
(v)	Increase	No effect	Increase
(vi)	No effect	Decrease	Increase

Solution

b.

(i)

	A	=		E
	₦			₦
Cash at Bank	250,000	=	Equity	250,000
Thus:	Assets	=	Equity	

(ii)

	A		L	E
	₦		₦	₦
Cash at Bank	250,000	Equity		250,000
Inventory	50,000	Suppliers	50,000	
	300,000		50,000	250,000

Thus:

Assets = Liability + Equity

(iii)

	A		L	E
	₦		₦	₦
Cash at Bank	223,000	Equity		250,000
Inventory	50,000	Suppliers	23,000	
	273,000		23,000	250,000

Thus:

Assets = Liability + Equity, i.e ₦273,000 = ₦(23,000 + 250,000)

(iv)

	A		L	E
	₦		₦	₦
Building	250,000	Equity		250,000
Inventory	50,000	Equity		250,000
Cash at Bank	223,000	Suppliers	23,000	_______
	523,000		23,000	500,000

Thus:

Assets = Liabilities + Equities i.e. ₦523,000 = ₦(23,000 + 500,000)

(v)

	A	=	L	+ E
	₦		₦	₦
Building	250,000	Equity		250,000
Inventory (₦50,000 – ₦25,000)	25,000	Equity		250,000
Cash at Bank		Equity(Profit)		15,000
(₦223,000 – ₦40,000)	263,000	Suppliers	23,000	_______
	538,000		23,000	515,000

Thus: Assets = Liabilities + Equities

Note: Profit = Sales - Cost

Profit = ₦40,000 - ₦25,000

Profit = ₦15,000

(vi)

	A	=	L	+ E
	₦		₦	₦
Building	250,000	Equity		250,000
Inventory	25,000	Equity		250,000
Cash at Bank	263,000	Equity		10,000
		Equity (Profit)		15,000
		Suppliers	13,000	———
	538,000		13,000	525,000

Thus: Assets = Liabilities + Equities, i.e ₦538,000 = ₦(13,000 + 525,000)

3.5 Chapter Summary

In this chapter we have discussed the fundamental accounting concepts including entity, going-concern, historical cost, periodicity, monetary measurement, realisation, matching, consistency, prudence, materiality, accrual, substance over form and fairness concepts.

We discussed the usefulness of these concepts in accounting information and their limitations.

The chapter also treated the importance of accounting equation in the preparation of the statement of financial position.

3.6 Revision Questions

Multiple Choice and Short-Answer Questions

(1) What effect would purchase of goods for credit have on the assets, liability and Equity (capital) of a business?

	Assets	Liability	Capital
(a)	Increase	decrease	no effect
(b)	Increase	no effect	decrease

(c)	Increase	increase	no effect
(d)	Increase	no effect	no effect
(e)	No effect	increase	increase

(2) Which of the following are the effects of matching concept?

i. Determination of periodic profits

ii. Unexpired costs are deferred

iii. Cost of goods sold may be different from purchases

(a) I, II, and III

(b) I and III

(c) II and III (d) I
and II

(d) None of the above

(3) The accrual concept requires a business to treat as income those which are due and receivable and to treat as expenses those which are in arrears respectively.

(a) Yes Yes

(b) Yes No

(c) No Yes

(d) No No

(e) None of the above

(4) The implication of the entity concept to a sole trader is that the

(a) Business can sue and be sued separately

(b) Liability of the owner is limited

(c) Owner cannot own private assets

(d) Private use of business assets reduces owner's capital.

(e) Owner can issue shares to the public

(5) Which of the following transactions would reduce asset and reduce liability?

(a) Sale of goods on credit

(b) Cash paid to trade payables

(c) Purchases of goods on credit

(d) Cash purchases

(e) Cash received from trade receivable

(6) Which of the following Accounting Equations is **NOT** correct?

(a) A = E
(b) A = L + E
(c) E = A - L
(d) L = A - E
(e) A = E - L

(7) An example of Asset is ....

(a) Equity

(b) Bank loan

(c) Freehold land

(d) Payable

(e) Accrual

(8) Given that:

		₦
Equity	1/1/2016	105,500
Equity	31/12/2016	180,200
Drawings	31/12/2016	14,150

What is profit for the year?

(a) ₦74,700

(b) ₦88,850

(c) ₦105,500

(d) ₦180,200

(e) ₦299,850

(9) Given that:

		₦
Equity	1/1/2016	62,400
Equity	31/12/2016	42,900
Drawings	31/12/2016	5,850

Determine the profit or loss for the year

(a) ₦111, 150 Profit

(b) ₦99,450 Profit

(c) ₦62,400 Loss

(d) ₦42,900 Loss

(e) ₦13,650 Loss

(10) Given the following transaction:

Payment of ₦101,250 to suppliers

What is the effect on accounting equation?

(a) Asset and liability reduced by ₦101,250

(b) Asset reduces by ₦101,250 and liability increases by ₦101,250

(c) Assets and liability increase by ₦101,250

(d) No effect on both assets and liability

(e) Asset reduces by ₦101,250 and no effect on liability

(11) The main advantage of the going-concern concept is......................

(12) State the effect of the historical cost concept on profit in a period of rising prices.

(13) The relevant concept that justifies the charging to expense the cost of small waste basket even though the basket has useful life of several years is................

(14) State which accounting concept justifies the depreciation of non-current assets.

(15) Mensa and Co., a sole trader, discovered that the business liability is in excess of the assets, he thus included his private assets in the Statement of financial position. Which concept is violated?

Solution to Revision Questions

(1) C

(2) A

(3) A

(4) D

(5) B

(6) E

(7) C

(8) B

(9) E

(10) A

(11) The main advantage of the going-concern concept is that it enables stakeholders in a business organisation to assess the extent to which they want to continue to patronize the business.

(12) Use of historical cost would understate cost of assets consumed thereby causing the business to report holding gain or to overstate profits.

(13) Materiality.

(14) Matching concept.

(15) Entity concept.

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CHAPTER FOUR

SOURCE DOCUMENTS AND BOOKS OF ORIGINAL ENTRY

4.0 Learning Objectives

At the end of this chapter candidates should be able to:

- identify the main source documents
- Know the role of source documents
- Know the nature and functions of books of original entry
- Prepare day books and Journals
- Transfer from the books of original entry to the relevant ledgers
- Know the effect of trade discount and value added tax (VAT) on sales and purchases.

4.1 Introduction

Source documents are documents from which accounting information are assembled and classified before being recorded in the subsidiary books or books of original entry. The book of original entry is the accounting record in which transactions are first recorded from source documents. The source documents are usually attached to vouchers or kept in some secured files as supporting documents evidencing the financial transactions of the business.

4.2 The Need for Source Documents

Source documents constitute the source of all original information on the financial transactions of a business.

They perform the following functions:

- they serve as evidence of financial transactions thereby guarding against fraud and making audit possible
- They are usually signed by the parties to the transaction therefore they are difficult to deny and also it is almost impossible to alter them in order to defraud the entity.

- In some cases, there could be more than one source document for a transaction but they would complement one another.

4.3 Main Source Documents

The main source documents that are used for recording in the books of original entry are:

- Quotations
- Sales invoices and Bills
- Pro-forma invoices
- Credit notes
- Debit notes
- Payment vouchers
- Petty cash vouchers
- Bank Pay-in-slips
- Cheque counterfoils
- Receipts
- Payslips
- Monthly bank statements
- Remittance advices

Others which may not contain full information to make recording possible in the books of original entry are

- Purchase orders
- Delivery notes
- Goods Received Notes
- Bin Cards

4.3.1 Quotation

A quotation is a formal statement of intention made by a potential supplier to supply the goods or services required by a purchaser at specified prices and within a specified period. It sometimes also contains terms of sale, payment and warranties. Acceptance of quotation by the buyer leads to issue of sales invoice by the supplier to the buyer which binds both parties.

4.3.2 Pro-Forma Invoice

Pro-forma invoice is an estimated invoice sent by a vendor to a purchaser. It is usually sent ahead of shipment or delivery of goods. The pro-forma invoice states the kind, quantity of goods, their prices and other essential information such as weight and transport fares. It is used as a preliminary invoice to support a quotation for custom purpose in importation. However, the pro-forma invoice can be distinguished from the normal invoice in that while an invoice is a formal request for payment by a supplier, the pro-forma invoice serves as advance information only.

4.3.3 Sales Invoices and Bills

A sales invoice serves as the source document to record in the sales day book. This is a document sent by the seller to the buyer (usually for credit sales) requesting the buyer to pay for the amount stated on the invoice for goods or services rendered to him. Usually bills are sent for service rendered while invoices are sent for goods sold.

A Sales invoice would contain the following particulars

- Name and address of the seller and purchaser
- Date of the sales
- Description and quantity of goods sold
- Unit price and total amount of invoice
- Amount charged for value added tax (VAT)
- Conditions and terms of sales such as trade discount, cash discount and the date payment falls due.
- Signature of the parties to the transaction.

Sales Invoices are pre-numbered and prepared in duplicate. The original is sent to the buyer while the duplicate is used to update the sales day book.

SPECIMEN SALES INVOICE

Grace Enterprises
Iludun Street
Ado-Odo

Invoice No.: 7491

Date: 2 June, 2006
Your Order No S/K/158

To: Ajala Ventures
11 Ajala Street
Idimu

The goods underlisted have been delivered in line with your request

	₦
500 pairs of shoes at ₦200 per pair	100,000
128 silk shirts at ₦250 each	32,000
Less 10% discount	132,000
Sales amount due	13,200
	118,800

Please arrange for the payment immediately. A cheque drawn on the firm's name is acceptable.

-- ------------------------------------

Customer Sales Manager

NOTE: Trade Discount does not form part of the double entry. It is deducted from the gross sales to arrive at the net amount of sales that would be recorded in the ledger.

4.3.4 Purchase Invoices

A purchase invoice serves as the source document to record in the purchases day book. As explained in the last paragraph, the purchases invoice is the original of the sales invoice sent by the supplier to the customer. Therefore, the sales invoice and the purchases invoice contain the same details. The only difference is that purchases invoices are in the books of buyer and are received from various customers and therefore will not be pre-numbered because goods are purchased from different sources. The invoice numbers are usually not sequential for the same reason.

4.3.5 Credit note

A credit note is a document relating to goods returned by the buyer or refunds to him when the buyer has been overcharged.

Goods may be returned by a customer for any of the following reasons:

- Damage to the goods before delivery
- Wrong specification from the one ordered by the customer.

The purpose of credit note is to inform the buyer that his indebtedness has been reduced by the amount stated on the credit note.

Credit note issued represents returns on sales while credit note received represents returns on purchases. A credit note is made out in red to distinguish it from an invoice.

4.3.6 Debit note

The buyer normally issues a debit note to a supplier to request for a credit note. The buyer may not debit the account of the supplier until his request is approved by him as evidenced by the issue of the credit note to the buyer.

A debit note is also prepared whenever it becomes necessary, for one reason or the other, to increase the amount due from a debtor. An example is where the seller has under- charged a customer on an invoice.

Generally, any expenses that should have been charged to the customer but were erroneously omitted when the invoice was made out would be charged subsequently by means of a debit note prepared by the supplier.

4.3.7 Payment Vouchers

Payment voucher is an authorising document for payment for a particular expense or service. In an entity every payment must be supported by a payment voucher. Examples are payment vouchers for salary and wages, and petty cash vouchers etc.
The voucher must be checked and authorised by a responsible or authorising officer before cash can be paid. Payment vouchers for little expenses recorded in the petty cash book is referred to as petty cash vouchers

4.3.8 Bank Pay-in-slips

A bank pay-in-slip serves as evidence of cheque and cash paid into the bank by an entity and individuals. It is the major source document for recording in the bank column of a cash book (debit side). The bank pay-in-slips are usually supplied by the banks to their customers and have the name of the particular bank on them.

Pay-in-slip contains the following information:

- Name of branch where the account number is operated
- Name of the business and the account number
- Phone number of the depositor.
- Name of the person paying in the cheques or cash
- If it is cash, the total amount of each cash denomination is specified.
- If it is cheque, cheque number, name of bank, amount on each cheque and branch for each of the cheques being lodged
- Column for signature of the person paying in (depositor)

- Column for signature of the bank official receiving the cheques with the bank's official stamp
- Date of lodgement

4.3.9 Cheque Counterfoils

Most cheque books have a small portion of the cheque where the details on the original cheque are summarised. This is called a counterfoil or cheque stub. This part is left after the main cheque has been detached along the perforated line.

Cheque counterfoils serve as evidence of payment to payables through the bank and withdrawals made for office or personal use.

In most entities all cash received must be paid to the bank and all cash payments must be made through the bank, (except petty cash that is operated through the imprest system). Therefore for many businesses, cheque counterfoils have become major source documents for recording in the bank column of the cash book (Credit side).

4.3.10 Receipts

Receipts are issued to acknowledge cash and cheques received from a customer for goods sold or service rendered to him. The original is issued to the buyer, it represents the document for recording cash paid in his cash book. The seller retains the duplicate, which is the document for recording cash received in the cash book of the seller. Receipts are usually pre-numbered.

Receipts contain the following information:

-Name of customer making the payment

-Date of receiving cash/cheque

-Amount of cash/cheque received (in words and figures)

-Signature of the Receiver

4.3.11 Purchase Order

A purchase order is issued by a customer requesting the seller to supply certain quantities of goods of specified description. The purchase order will also state the agreed price and the delivery point and date.

Invoices are compared with the purchase order when invoices are received. A goods received note is issued after it has been ascertained that the goods supplied meet the specifications in the purchase order. An example of a purchase order is the Local Purchase Order (LPO).

4.3.12 Delivery Note

Delivery note is a document that accompanies the goods dispatched to the customer. Delivery note protects the dispatch driver from harassment on how he comes about the goods and serves as evidence of goods received by the purchaser when it is signed by him.

4.3.13 Remittance Advice

When a customer is making payment on invoices to the supplier, he will usually accompany his remittance with a letter stating details of invoices that ate settled by the attached instrument. This letter or document is referred to as Remittance Advice. The letter may also be sent after the remittance had been made, if it was through bank transfer.

4.3.14 Pay Slip

This is a source document issued by employer to the employees showing details of his gross emoluments and payroll deductions. The payroll deductions consist of statutory deductions such as (personal Income Tax, employees' pension contributions, National Housing funds, National Health Insurance and non statutory deductions such as contribution to cooperative societies, union dues, and association fees, etc

The gross emolument consists of basic salary, housing allowance, transport allowance, responsibility allowance and utility allowance etc. The difference between gross emoluments and statutory and non statutory deductions is described as net pay. The document serves as a legal evidence of employees pay records and evidence of tax payment for obtaining tax clearance certificate at the relevant tax authority.

4.3.15 Goods Received Note (GRN)

The good received note shows the evidence that the goods dispatched to an organization are received in good condition and meet the specifications. The accounts department will request for the relevant GRN before paying a supplier's invoice. The GRN is also used to update the Bin Card.

4.3.16 Bin Card

Bin card records movements of inventories. When inventories are received into the store the warehouse bin card is debited and when inventories are issued to production, the bin card is credited.

4.4 Books of Original Entry

These books are also referred to as books of prime entry or subsidiary books or day books or journals. They are the books in which transactions are first recorded before being posted to the ledger. Transactions can be recorded directly to the ledger but the books of original entry are in use because they have the following advantages which the ledger does not have.

(i) They record the total of transactions rather than the individual amounts.

(ii) They provide an explanation of the transactions recorded. For instance the journal shows the complete story of a transaction. You will not need to look at the debit and credit for a transaction in different accounts/folios.

(iii) They provide records of transactions in chronological order.

(iv) They help to prevent error. The total in the book of original entry can be reconciled with the total in the individual accounts.

Main Books of Original Entry

(i) Sales day book

(ii) Purchases day book

(iii) Sales returns book/Returns inward book

(iv) Purchases returns book/Returns outward book

(v) Journal proper

(vi) Cash book (described in chapter 7)

(vii) Petty cash book (described in chapter 7)

In a computerized accounting system the books may not be in printed form but stored in a computer memory.

4.4.1 Sales Day Book

Sales day book is the book of original entry that records credit sales. The relevant source document is the duplicate of the invoice issued to the customer. The volume of daily sales transactions normally demands that they are firstly collated for the period before being transferred to sales ledger accounts.

The sales day book shows the following information:

(i) A list of the sales invoices in the order in which they are issued

(ii) The date of issue

(iii) The name of the customer

(iv) The number of the invoice

(v) The sales ledger number to which the individual accounts are posted

(vi) The net amount of the invoice after deducting trade discount and VAT

The sales day book does not show the description of the goods. These are contained in the invoice.

Illustration 4.1

Baba Olu Enterprises made the following credit sales with invoice numbers 072 – 079 respectively. Baba Olu trades in textile materials

			₦
2016, March	1:	Addo Enterprises	1,500,000
,,	2:	Moslad & Sons	800,000
,,	3:	Kanfo Ltd.	2,500,000
,,	4:	Aburi & Sons	900,000
,,	5:	Akapo Enterprises	1,500,000
,,	6:	Nwosu Ventures	400,000
,,	7:	Bamiro Enterprises	600,000
,,	7:	Adeolu Ventures	700,000

Record the above sales in the sales day book.

Solution to Illustration 4.1

Baba Olu Enterprises

SALES DAY BOOK

Date	Customer	Invoice No	Folio	Amount
2006				₦
March 1	Addo Enterprises	072	SL 18	1,500,000
,, 2	Moslad & Sons	073	SL 11	800,000
,, 3	Kanfo Ltd.	074	SL 15	2,500,000
,, 4	Aburi & Sons	075	SL 7	900,000
,, 5	Akapo Enterprises	076	SL 16	1,500,000
,, 6	Nwosu Ventures	077	SL 10	400,000
,, 7	Bamiro Enterprises	078	SL 8	600,000
,, 7	Adeolu Ventures	079	SL 5	700,000
" 7	Transfer to sales A/c	CR	GL 5	8,900,000

The Folio states the sales ledger reference to which the sales to each customer are posted. At the end of the period the total of ₦8,900,000 is posted to the credit of the sales account. While transactions relating to each customers are also posted to the debit side of the their respective ledger accounts.

A business entity may trade in more than one type of products. The periodic sales are usually analyzed according to each product in the sales day book.

Illustration 4.2

In the first week of September 2016 Victor Enterprises issued the following invoices to its customers. The invoice numbers were 1182 to 1187. The entity trades in wooden chairs and wall clocks.

Date	Description of goods	₦
02/09/16	Jacobs & Sons(invoice no 1182)	
	12 wooden chairs at ₦500 each	6,000
	4 wall clocks at ₦650 each	2,600
		8,600
03/09/16	Moruf Enterprises(invoice no 1183)	
	25 wooden chairs at ₦500 each	12,500
04/09/16	Sago Ventures (invoice no 1184)	
	40 wooden chairs at ₦500 each	20,000
	50 wall clocks at ₦650 each	32,500
		52,500
	Trade discount at 5%	2,625
		49,875
04/09/16	Koku Emmanuel (invoice no 1185)	
	2 wall clocks at ₦650 each	1,300
05/09/16	Solola and Co. (invoice no 1186)	
	10 wall clocks at ₦650 each	6,500
07/09/16	Annan Enterprises (invoice no 1187)	
	100 wooden chairs at ₦500 each	50,000
	80 wall clocks at ₦650 each	52,000
		102,000
	Trade discount at 8%	8,160
		93,840

Prepare the analytical sales day book of Victor Enterprises for the week ending 7 September, 2016.

Solution to Illustration 4.2

VICTOR ENTERPRISES

SALES DAY BOOK

					Analysis	
Date	Particulars	Invoice Number	Folio	Amount	Wooden Chairs	Wall Clock
				₦	₦	₦
2/9/16	Jacobs & Sons	1182	SL 114	8,600	6,000	2,600
3/9/16	Moruf Enterprise	1183	SL 83	12,500	12,500	-
4/9/16	Sago Ventures	1184	SL 68	49,875	19,000	30,875
4/9/16	Koku Emmanuel	1185	SL 101	1,300	-	1,300
5/9/16	Solola & Co	1186	SL 94	6,500	-	6,500
7/9/16	Annan Enterprises	1187	SL 71	93,840	46,000	47840
Transfer to Sales A/c			GL 12	172,615	83,500	89,115

Notes: SL reference is the reference to the Sales Ledger
GL " " General Ledger

(i) The analysis would help managers to assess the rate at which each class of inventories is sold for decision making and efficient management of the business.

(ii) Where trade discounts were given, the effects were distributed on a pro-rata basis between the two classes of goods sold. For instance in the sales to Sago Venture the amount on wooden chairs and wall clocks were calculated as follows

Wooden chairs ₦20,000 – (20,000 x 5%) = ₦19,000

Wall clocks ₦32,500 – (32,500 x 5%) = ₦30,875

4.4.2 Trade Discount

a. Trade discount is an allowance given to a trader buying in large quantity. The invoice price would be the same for all customers but the net selling price may be different for customers depending on the quantity purchased by them.

b. Trade discount is not recorded in the books of accounts. It is only a means of calculating the net selling price of goods. Only the net amount of goods sold is transferred to the books.

We shall discuss cash discount in the next chapter.

4.4.3 Purchases Day Book

The purchases day book is the book of original entry used to record all credit purchases. The total therein is transferred to the debit of the purchases ledger at regular intervals. Amounts relating to each supplier is credited in their respective subsidiary ledgers. The period covered may be daily, weekly or monthly depending on the volume of purchases transactions. The details on purchases day book are extracted from incoming invoices. Each supplier 's account is correspondingly credited in the subsidiary ledger.

Illustration 4.3

Maomao Enterprises made the following purchases on credit

1/8/2016	Mrs B. Kent	¢ 150,000 with invoice N0.1062
	I. Akolade Ltd.	¢ 108,000 with invoice No. 083
4/8/2016	Saidi Ojo	¢ 60,000 with invoice No. 003
	Wasiu Stars	¢ 82,800 with invoice No 288
	Akala & Co	¢ 98,250 with invoice No. 1124
7/8/2016	Onuo Paul & Sons	¢120,000 with invoice No. 002
	J. Mfon Ltd.	¢ 67,500 with invoice No. 116
	Festac Enterprises	¢ 337,500 with invoice No. 644

Enter the transactions in the purchases day book of Maomao Enterprises.

Solution to Illustration 4.3

Maomao Enterprises

Purchases day book

Date	Particulars (Suppliers)	Invoice No	Folio	Detail ¢	Amount ¢
1/8/2016	Mrs. B. Kent	1062	PL 22	150,000	
	I. Akolade Ltd	083	PL 132	108,000	
					258,000
4/8/2016	Saidi Ojo	003	PL 08	60,000	
	Wasiu Stars	288	PL 042	82,800	
	Akala & Co	1124	PL 015	98,250	
					241,050

7/8/2016	Onuo Paul & sons	002	PL 06	120,000	
	J. Mfon Ltd	116	PL 04	67,500	
	Festac Enterprises	644	PL 105	337,500	525,000
7/8/2016 Transfer to purchases ledger				DR	1,024,050

Note

(i) PL reference is the reference to the Purchases Ledger

(ii) The purchases day book records invoices coming from different suppliers with the pre-printed numbers

4.4.4 Analyzed Purchases Day Book

Like the sales day book, the purchases day book can be analyzed, but unlike the case of sales day book, it may contain columns for goods meant for resale, goods not meant for resale and bills received for services.

Illustration 4.4

Benard Carena, a sole trader, made the following transactions which relate to the month of July, 2016.

2016			¢
July	1	Bought goods in credit from J. Leye Ltd.	1,500,000
,,	2	Bought goods on credit from Bala & Sons	850,000
,,	6	Bought stationery on credit from Suzie Ltd.	750,000
,,	9	Bought goods on credit from Sasa & Sons	640,000
,,	12	Received invoices for carriage on goods from Samcol	940,000
,,	14	Bought goods on credit from Bala & Sons	1,050,000
,,	15	Received invoice for electricity from EDCN	750,000
,,	18	Bought goods on credit from Mike Essien & Co	645,000
,,	25	Bought stationery on credit from Suzie Ltd.	874,000
,,	26	Received invoice from Babs Motors for vehicle repair	682,000
,,	28	Bought goods on credit from Bala & Sons	1,200,000
,,	30	Bought goods on credit from Nana & Co	450,000
,,	31	Received invoices for gas consumed from Owusu Ltd.	894,500

Prepare the Analyzed purchases day book for the month of July, 2016 in the books of Benard Carena.

Solution to Illustration 4.4

Analyzed Purchases Day Book

Date	Particulars Names of Supplier	Folio	Total	Purchases	Stationery	Carriage Inwards	Motor Expenses	Electricity & Gas
2006			¢	¢	¢	¢	¢	¢
July 1	J. Leye	PL 40	1,500,000	1,500,000				
,, 2	Bala & Sons	PL 36	850,000	850,000				
,, 6	Suzie Ltd.	PL 48	750,000		750,000			
,, 9	Sasa & Sons	PL 16	640,000	640,000				
,, 12	Samcol	PL 12	940,000			940,000		
,, 14	Bala & Sons	PL 36	1,050,000	1,050,000				
,, 15	EDNC	PL 18	750,000					750,000
,, 18	Mike Essien & Co	PL 06	645,000	645,000				
,, 25	Suzie Ltd.	PL 48	874,000		874,000			
,, 26	Babs Motors	PL 64	682,000				682,000	
,, 28	Bala & Sons	PL 36	1,200,000	1,200,000				
,, 30	Nana & Co	PL 72	450,000	450,000				
,, 31	Owusu Ltd.	PL 04	894,500					894,500
	Total		11,225,500	6,335,000	1,624,000	940,000	682,000	1,644,500
	Transfer		(DR)	GL 28	GL 30	GL 43	GL 68	GL 46

Notes

(i) The goods bought for resale are called “purchases”

(ii) The analysis shows all invoices for transactions that will not be paid for immediately.

(iii) The sum of the row totals should be equal to the sum of the column totals. This is useful for control purposes.

(iv) The total in each column will be debited to the purchases account, stationery account, carriage inwards account, motor expenses account and electricity and Gas account respectively in the general ledger. The individual amounts are also to be credited to the accounts of the respective suppliers accordingly.

4.4.5 Sales Returns Book

The sales returns book or returns inward book is the book of original entry that records returns on goods sold to customers.

The sales returns book analyses what goods were returned.

Illustration 4.5

Refer to Illustration 4.2

Victor Enterprises

Sept. 10, 2016 Jacobs and Sons returned 3 wooden chairs

Sept. 12 2016 Annan Enterprises returned 2 wall clocks

Sept. 14 2016 Moruf Enterprises returned 1 wooden chair

Prepare the Sales returns book for Victor Enterprises.

Solution to Illustration 4.5

Victor Enterprises

Sales Returns Day Book

Date	Particulars	Sales ledger ref	Amount
2006 Sept. 10	Jacobs & Sons		₦
	3 wooden chairs	SL 114	1,500
Sept. 12	Annan Enterprises		
	2 wall clocks	SL 71	1,196

Sept 14	Moruf Enterprises		
	1 wooden chair	SL 83	500
	Transfer to sales return DR	GL12	3,196

Refer to illustration 4.4

Benard Carena

Returns Outwards Book

Date	Supplier	Folio	
		Purchases ledger ref	Amount
2016			₵
Aug 3	J. Leye Ltd.	PL40	200,000
Aug 5	Bala & Sons	PL36	150,000
Aug 10	Mike Essien & Co	PL06	40,000
Aug 10	Nana & Co	PL72	45,000
Transfer to returns outward account GL 180			435,000

The relevant purchases ledger references would be the same as those in the purchases day book.

4.5 The Journal (General Journal)

The journal is used as the book to record transactions that do not fit into other subsidiary books. The information recorded in the journal about each transaction includes:

- The date of the transaction
- The debit and credit charges in specific ledger accounts
- A brief explanation of the transaction, referred to as "narration"

The narration is required to indicate the purpose and authority of the transaction. For efficient use of the journal, candidates must be able to analyse the effect of a transaction on assets, liabilities, and owner's equity. The subsidiary books already considered are also referred to as journals. For example, the Sales Day Book or sales Journal, Purchases Day Book or purchases Journal, etc. To distinguish this book from other day books, this journal is sometimes referred to as "General Journal" or "Journal Proper"

4.5.1 Uses of the Journal

The journal is used for the following:-

- Opening and closing entries
- Transfer from one account to the other
- Purchases and sales of non-current assets on credit.
- End of period adjustments
- Correction of errors.
- To record purchase of business transaction

4.5.2 The layout of the Journal

The Journal has similar rulings to the purchases Day Book and other day books already considered but with slight modifications to show the accounts to be debited and credited in the ledger. A typical Journal is ruled thus:

Date	Particulars	Folio	Dr	Cr
	The name of account to debit		XX	
	The name of account to credit			XX
	The Narration			

The name of the account to be debited is always shown first. The name of the account to credit is inset to the right hand side.

The narration is not indented. After each set of journal entries, there should be a gap before the next set of entries are made. This is to make each set of journal entries stand out clearly.

4.5.3 Opening Entries

When the journal is used for opening entries the aim is to determine the value of the opening capital.

Illustration 4.6

N. Gyan business affairs on 1 January, 2016 stood as follows:

	¢
Cash in hand	66,000
Cash at bank	366,000
Inventories	375,000
Furniture and fittings	180,000
Trade Payables	150,000

Prepare the opening Journal of the business.

Record these transactions in a Journal.

Solution to Illustration 4.6

N. Gyan
Journal

Date	Particulars		Dr ¢	Cr ¢
2006				
1 Jan	Cash in hand	CB1	66,000	
	Cash at bank	CB1	366,000	
	Inventories	GL1	375,000	
	Furniture and fittings	GL2	180,000	
	Trade Payables	PL3		150,000
	Capital (difference)	PL1		837,000
Being assets and liabilities of N. Gyan at 1 January, 2016			987,000	987,000

4.5.4 Transfer from one account to the other through the journal

Only the journal can readily explain the transfer from one account to the other. The reason for the transfer will be explained as narration, thus removing any doubt about the authenticity of the adjustment,

Illustration 4.7

Record through the journal entry the transfer of ₦600,000 from Wazobia & Co's account in the bought ledger to their account in the sales Ledger, to set off purchase against sales. The transaction took place on 31 January, 2017.

Wazobia & Co
Journal

Date	Particulars	**Fol.**	Dr	Cr
31/01/17	Bought ledger control account Sales ledger control account Being balance on bought ledger transferred to sales ledger on contra basis.	PL. 20 SL.12	600,000 600,000	

4.5.5 Other uses of the Journal

The use of journal for other purposes is shown in the following illustration:

Illustration 4.8

The following transactions took place in the books of Orire Ltd. in June, 2016

(i) A machine is bought on credit from Jerry Enterprises for N186,000 on June 1

(ii) A motor vehicle is sold to Jebeleje on credit for N360,000 on June 8

(iii) Bobo T, a debtor owed N160,000. He offers a motor car in full settlement of the debt on June 16 and the offer was accepted.

(iv) Ilemobayo is a creditor. On June 25, his business is taken over by Prospect Ventures to which the debt of N45,000 is now to be paid.

Show the journal entries to record the transactions

Solution to Illustration 4.8

Orire Ltd.

Journal

Date 2016	Particulars	Fol	Dr ₦	Cr ₦
June 1	Machinery DR		186,000	
	Jerry Enterprises			
	Purchase of machinery on credit			186,000
June 8	Jebeleje DR		360,000	
	Motor vehicle			360,000
June 16	Motor vehicle DR		160,000	
	Bobo T.			160,000
	Recording acceptance of motor car in full settlement of debt.			
June 25	Ilemobayo DR		45,000	
	Prospect Ventures			45,000
	Debt owed to Ilemobayo to be paid to prospect ventures			

4.6 Chapter Summary

In this chapter we have discussed source documents, their uses and their relationship to the books of original entry. We also examined the importance of the books of original entry and illustrated how they are to be transferred to the ledger accounts. The Journal, as a means of recording unusual transactions, was also examined.

4.7 Review Questions

Multiple choice questions and short-answer questions

(1) Which of the following statements about a journal are correct?

- I. The double entry for a transaction is completed in a journal.
- II. Journal is used to record withdrawal of cash to the office.
- III. A set-off between customers and suppliers is resolved through journal entries
- IV. Journal records adjusting events.

A. I, III and IV

B. I, II and III

C. II and IV

D. III and IV

E. II, III and IV

(2) Which of the following journal entries may be accepted as being correct according to their narration?

		Dr	Cr
		₦	₦
(A)	Plant and machinery	250,000	
	Ernest Opare & Co		250,000
	Purchases of inventories on credit		
(B)	Baoku Ltd.	160,000	
	Cash account		160,000
	Cash received from Baoku Ltd.		
(C)	Sangisha & Sons	840,000	
	Motor Vehicles		840,000
	Sales of motor vehicle on credit		
(D)	Capital account	1,500,000	
	Power generation		1,500,000
	Introduction of generator into the business.		
(E)	Cash Account	20,000	
	Motor Vehicles		20,000
	Sales of motor vehicles on credit		

(3) The invoiced price of a commodity is ₦50,000 with a trade discount of 10%. C. Eghan issued the invoice to Wii Dromo. How much is recorded in the books of original entry of Wii Dromo and in what book is it recorded?

(A) ₦50,000 and purchases day book

(B) ₦45,000 and purchases day book

(C) ₦50,000 and sales day book

(D) ₦45,000 and sales day book

(E) ₦50,000 and sales journal

(4) Which of the following roles does a debit note serve?

(A) A document issued by the seller informing the buyer that his account has been credited for overcharge on the invoice.

(B) A document issued by the seller informing the buyer that his invoice was undercharged.

(C) A document that generates a credit note from the seller to the buyer

(D) A document by which goods are issued from store to production.

(E) A document by which goods already issued are returned to store

(5) What is the relationship between a Purchase Order and Goods Received Note (GRN)?

(I) The GRN confirms that goods are supplied according to the specification in the purchase order.

(II) The purchase order is issued after goods have been received stating that the goods are in order.

(III) The amount on the purchase order is compared with the amount on the GRN before payment is made to the buyer.

(IV) There is no relationship between GRN and Purchase order.

(V) Goods Received Note is issued before arrival of the goods

A. I and III

B. I,II and III

C. II and IV

D. IV and V

E. I,II and IV

(6) What is the main source document for recording cash paid into the bank?

(7) The total in a sales day book is transferred to.................. account.

(8) The duplicate copy of credit note will serve as the source document to record in the ....book.

(9) State the importance of narration in a journal.

(10) What is the source document for cash sales?

4.8 Theory and Calculation Questions

1. A source document provides basic information that is used in posting entries into the books of original entries. You are required to:

(a) Explain the following form of source documents

(i) Receipt

(ii) Sales Invoice

(iii) Debit Note

(iv) Credit Note

(v) Pay Slip

(vi) Cheque Counterfoils

(b) Describe **FOUR (4)** usefulness of source documents in recording in books of accounts.

2. Explain the following source documents:
   (a) Quotations
   (b) Pro Forma Invoice
   (c) Delivery Note
   (d) Purchase Order
   (e) Payment Vouchers

3. On 2 January, 2017, Accra Enterprises issued the following invoices to its customers. The invoice numbers were serially numbered as: 2119 – 2124. The entity trades in gift items, designer's birthday cards and bags.

Date	Description of Goods	
3/1/17	Joseph Ventures	
	24 Cards	@ N600
	8 Cards	@ N900
	Trade discount @ 2%	
4/1/17	Michael Enterprises	
	40 Birthday Cards @	₦600 each
	Trade discount @ 2%	
10/1/17	Sunday Ventures	
	80 Birthday Cards @	₦600 each
	90 Bags @	₦900 each
	Trade Discount @ $7^{1}/_{2}$%	

12/1/17	Kate Paulina	
	5 Bags @	₦900 each
	12 Birthday cards @	₦600 each
15/1/17	Jude Deku	
	15 Birthday cards @	₦600 each
	18 Bags @	₦900 each
	Trade discount @ $2^1/_2$%	
31/1/17	Adam Enterprises	
	150 Birthday Cards @	₦600 each
	105 Bags @	₦900 each
	Trade Discount @ 9%	

Prepare the analytical sales day book of Accra Ventures for the month of January, 2017.

Solution to Review Questions

(1) A

(2) C

(3) B

(4) B

(5) A

(6) Bank Pay-in-Slips.

(7) Sales ledger.

(8) Returns inwards/Returns on sales.

(9) To indicate the purpose and authority of the transaction.

(10) Duplicate of the cash receipt issued by the seller.

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CHAPTER FIVE

DOUBLE ENTRY BOOK KEEPING AND THE TRIAL BALANCE

5.0 Learning Objectives

At the end of this chapter candidates should be able to:

- Understand the double entry principle
- Use the principle of double entry to post transactions to the relevant ledger accounts
- Differentiate between various classes of accounts
- Balance the ledger accounts
- Extract the Trial Balance.

5.1 Introduction

From our discussion of the accounting equation in chapter two, you will discover that every transaction has a *dual* effect. That is when there is a transaction it is recorded twice in form of a balanced equation. This principle of dual effect called the double entry principle is applied in recording every transaction in the ledger accounts.

5.2 Principle of Double Entry

Double entry principle states that for every debit entry, there must be a corresponding credit entry and vice versa. If the principle is properly followed, the total of the debit entries in the accounts must be equal to the total of the credit entries.

There are three pairs of concepts that aid the understanding of the double entity principles and they are:

	Debit	Credit
1	Incoming	Outgoings
2	Receiving (Receiver)	Giving (giver)
3	Losses/Expenses	Profit/gains

Anything considered to be an incoming, or being received by an entity is debited e.g. cash is an incoming to an entity hence cash received is debited. On the other hand, anything that is outgoing, or given out is credited e.g. goods sold are outgoing hence sales is credited.

In general, the above principles are the underlying basis for debiting assets and expenses as well as crediting liabilities and revenue

Before we go into the application of the double entry principle, let us discuss the nature, types and functions of ledger accounts.

5.3 Ledger Accounts

A ledger is the book containing a group of accounts. It contains the permanent records of the assets, liabilities, income, expenses and equity of a business entity. The accounts in a ledger are those to which entries are posted from the subsidiary books.

5.3.1 Importance of the ledger accounts

(i) They serve as the means of keeping permanent records of assets, liabilities, income,expenses and Owner's equity.

(ii) They provide relevant information that is required to prepare the statement of profit or loss and the statement of financial position.

(iii) They give the origin of every transaction and the parties involved.

(iv) They show the details of the movement in each account. For instance, a bank account will show what amount had been deposited or how much had been withdrawn and for what purpose.

(v) The Trial Balance is extracted from the ledger accounts at the end of the accounting period.

5.3.2 Types of Accounts:

Accounts can be grouped under three main headings

- Real Accounts
- Personal Accounts
- Nominal Accounts

Real Accounts: These are accounts relating to tangible things that can be seen, felt, touched and moved in most cases e.g. cash, cars, goods etc. The rule of double entry to these types of accounts is *Debit,* when there are additions, that is, when more of these items are acquired. *Credit*, when these items are disposed off, either by selling them off, when damaged beyond use or when given out as gift.

Personal Accounts: These are accounts dealing with persons, corporate bodies or even partnerships. Before these accounts can exist, there must be credit transactions unlike the real accounts where both cash and credit transactions are involved.

In personal accounts, the accounts are opened only if the persons concerned purchase goods or services on credit or if they sell goods or services on credit. There is no need of writing or recording the names of persons who have purchased on cash basis. This amounts to a waste of time and efforts since the company has nothing to do with the persons again. However, cash paid or received for debt owed or receivable can be recorded in the personal accounts.

The case will be different if payment is deferred till a future date, it will be necessary to know those who owe and those who are owed as the case may be.

Nominal Accounts: These are the accounts opened for income and expenses'. They are not real or personal but are for gains and losses items. We only talk of benefits arising from these accounts as a result of the services rendered. Examples are rent, salaries, electricity, discounts, drawings, net profits or losses on trading or disposal of non-current assets etc.

5.3.3 Types of Ledgers

Ledgers can also be classified into the following four groups:-

(a) **Sales Ledger or Trade Receivables Ledger**

This contains all the personal accounts of customers otherwise referred to as trade receivables.

(b) **Purchases Ledger or Payables Ledger**

This contains the personal accounts of suppliers of goods and services, otherwise referred to as trade payables.

(c) **Private Ledger**

The Private ledger contains details of capital accounts, drawings account, loan account and investment account. Usually only the senior managers have access to these accounts in order to prevent details of the items contained therein from being publicized.

(d) **General Ledger**

The general ledger, also referred to as the nominal ledger, contains the remaining accounts such as:-

- **Nominal accounts;** relating to expenses, wages, rent, sales, purchases, bad debts accounts; and
- **Real accounts;** relating to assets such as land and buildings, motor vehicles, inventories, plant and machinery.

5.4 Application of the double entry principle

To record a transaction using the double entry principle the following steps must be taken.

(i) Ensure that a transaction has actually taken place. That is at least two parties are involved and the transaction can be measured in monetary terms.

(ii) Identify the two main accounts involved. That is, under which two main subject matters the transaction can be divided.

For example: Adeolu Enterprises purchased a motor car for ₦750,000 cash.

- The transaction can be measured monetarily and it involves at least two parties (Adeolu Enterprises and the motor dealer)
- Two main subject matters can be identified
  - (a) Motor car was purchased
  - (b) Cash was paid

(iii) Identify the one that receives value. In the above example motor car has increased, therefore it has received value.

(iv) Identify the one that has given value – cash has been reduced, in this case it has given value

(v) Debit the account that has received value with ₦750,000 (i.e. debit motor car)

and credit the account that has given value (i.e. credit cash)

5.4.1 Debit and Credit Entries

(a) An account consists of two sides; the debit side to the left hand side and the credit side to the right hand side. By the time it is ruled a T – account is formed.

Debit side		Title of the account					Credit side
Date	Particulars	folio	Amount	Date	Particulars	folio	Amount

(b) On both sides of the accounts we have columns for date, particulars (details of the transaction), the folio and the amount.

(c) An amount recorded on the debit side is called debit entry while an amount recorded on the credit side is called a credit entry.

(d) The corresponding entry of the debit entry is found on the credit side of another account and the corresponding entry for the credit entry is found on the debit side of another account.

(e) The folio is the ledger page on which the corresponding debit or credit entry could be found.

What is explained above can be summarized as follows

Asset Account

(Debit)	₦	(Credit)	₦
Increase (through acquisition or introduction by owner)		(Decrease through disposal for cash or other considerations)	

Liability Account

(Debit)	₦	(Credit)	₦
Decrease (through settlement in cash or other consideration		Increase (obtaining goods or services on credit	

Capital Account

(Debit) ₦	(Credit) ₦
Decrease (as a result of losses incurred)	Increase (through cash/asset introduced and profit made)

Revenue Account

(Debit)	(Credit)
Decrease	Increase (Sales)

Expenses Account

Debit	Credit
(Increase)	Decrease

5.4.2 The general rules for recording in the ledger are as follows:

A. An account that receives is debited

(i) An increase in an asset or in an expense is debited. That is there is addition to assets and expenses.

E.g. Office rent is paid. The rent is an expense and has increased by the transaction; therefore the rent account should be debited.

(ii) A decrease in revenue or a decrease in liability is debited.

Examples

(a) Returns on sales is a decrease of sales revenue, therefore the return on sales/returns inwards account should be debited.

(b) When payables are paid, the liability due to the suppliers will reduce, therefore the payables account is debited with the amount paid.

B. An account that gives is credited:

(i) Any decrease in an asset or in an expense account is credited. E.g. when a machine is sold, the amount in the account will decrease, therefore machine account is credited.

(ii) Any increase in liabilities or income is a credit. E.g. when goods are sold the revenue of the company increases, therefore sales account is credited.

5.4.3 Cash Transactions

The simplest way to look at the application of the double entry is through cash transactions.

a. When cash is received, debit cash and credit the corresponding accounts

b. When cash is paid, credit cash account and debit the corresponding account.

Illustration 5.1

The following transactions took place in the books of Olu Aina Enterprises in 2016

(i) January 4, 2016 Cash sales of ₦900,000

(ii) January 10, 2016 Payment of office rent ₦250,000 in cash

(iii) January 18, 2016 Purchased ₦200,000 goods for cash

(iv) January 25, 2016 Purchased stationery for N40,000 cash.

Prepare the necessary ledger Accounts for each of the transactions.

Solution to Illustration 5.1

i. Cash is received for goods sold

Debit cash with ₦900,000

Credit sales with ₦900.000

Cash Account

DR			CR
	₦		₦
2016			
January 4 Sales a/c	900,000		

DR		**Sales Account**	**CR**
	₦	2016	₦
		Jan. 4 Cash	
			900,000

Note the narration/particulars: In the cash account the particulars is “Sales

Account" because the corresponding credit entry is found in the Sales Account. Following the same logic, the particulars in the Sales Account is stated as "Cash" because the corresponding debit entry is in the Cash Account.

ii Cash is paid for office rent

Credit cash account and debit rent

DR	Cash Account		**CR**
	₦	2016	₦
		Jan 10 Office rent	250,000

DR	Office Rent Account		**CR**
2016	₦		
Jan 10 Cash account	250,000		

iii Purchased goods for cash ₦200,000

Cash is given, therefore credit cash account and debit purchases account.

DR	Cash Account		**CR**
		2016	₦
		Jan 18 Purchases	200,000

DR	Purchases Account		**CR**
2016	₦		
Jan 18 Cash	200,000		

iv. Purchased stationery for cash – cash is given, therefore credit cash and debit Stationery account

DR	Cash Account		CR
	₦	2016	₦
		Jan. 25 Stationery	40,000

DR	Stationery Account		CR
2016	₦	₦	
Jan. 25 Cash	40,000		

Note

You will notice that for each of the four transactions of Olu Aina Enterprises cash account is affected. The four cash Accounts can be combined as shown below

Olu Aina Enterprises

Cash Account

DR | CR

2016		₦	2016		₦
Jan 4	Sales	900,000	Jan 10	Office rent	250,000
			Jan 18	Purchases	200,000
			Jan 25	Stationery	40,000

This is not different from how a firm's purchases and sales of different dates will be Combined in one purchases account and sales account respectively.

5.4.4 Transactions made on credit

(i) When cash is not received immediately for goods sold then it is sold on credit. Therefore the receivables/customers' account receives instead of cash, therefore the receivables account is debited and sales account is still credited.

(ii) When cash is not paid immediately for goods, then it is purchased on credit, therefore, the creditor gives. Payables account will be credited and purchases account debited.

Illustration 5.2

R. Okonkwo is a sole trader. The following transactions took place in his books.

		₦
(i)	Bought goods on credit from Jaja Ltd.	85,000
(ii)	Sold goods on credit to Sule I & Co	176,000
(iii)	Purchased some office machines on credit from Apala Engineering Ltd.	150,000

Show the double entries for each of the transactions.

Solution to Illustration 5.2

(i)

R. Okonkwo

Purchases Account

	₦		₦
Jaja Ltd.	85,000		

Payabless Account (Jaja Ltd.)

	₦		₦
		Purchases	85,000

(ii)

Receivables Account (Sule I & Co)

	₦		₦
Sales	176,000		

Sales Account

	₦		₦
		Receivables (Sule I & Co)	176,000

(iii)

Office Machine

	₦		₦
Apala Engineering Ltd.	150,000		

Apala Engineering Account

	₦		₦
		Office machine	150,000

Note the following

We just decided to post the transactions to the ledger accounts for demonstration only. In real life situation, the amount recorded in the sales ledger, purchases ledger and office machines would have been accumulated in the relevant books of original entry, only the totals would be transferred to the different Ledger accounts.

5.4.5 Balancing a ledger Account

At the end of every period, all ledger accounts must be balanced off. Balancing means to find the difference between the debit side and credit side of one account.

(i) Balance carried down (bal c/d): This is the figure that is used to force the lesser side to agree with the higher side, because the total of the two sides of an account must be equal.

(ii) Balance brought down (bal b/d): This is the closing balance (bal c/d) of the period that becomes the opening balance at the beginning of the next period.

5.4.6 Interpretation of the balances

(i) In a trade receivables account, the debit side is expected to be greater than the credit side, therefore the balance c/d would be on the credit side of the trade receivables account but when it is brought down (bal b/d) in the next period, it is debit balance. Therefore a debit balance in trade receivables account and other assets account represents an asset.

(ii) In a trade payables account, the credit side is usually greater than the debit side. Balance c/d is on the debit side and balance b/d on the credit side. This is a liability.

(iii) The cash account will always be a debit balance, except where it is a bank account when it can either be a credit balance (bank overdraft) or debit balance(an asset).

(iv) The capital account will always be a credit balance.

5.4.7 Comprehensive Illustration

We shall now take a comprehensive question to demonstrate all the principles we have explained in this chapter.

Illustration 5.3

Mensa Joe Enterprises started a retail business, selling cement on retail basis. On March 1 2016, he introduced the following into the business:

(i) Motor van valued at ₦480,000

(ii) Cash from his salary account ₦330,000

(iii) Money borrowed from a friend ₦66,000

The following transactions also took place in March

			₦
March	3	Purchased cement on credit from Fola Ltd.	189,000
,,	3	Paid carriage on cement to warehouse	16,456
,,	6	Sold goods on credit to Aburi & Co	190,000
,,	8	Sold cement for cash	26,280
,,	11	Paid sundry expenses	16,278
,,	15	Purchased cement on credit from Fola Ltd.	60,000
,,	17	Bought some Dunlop tyres from Okechukwu Enterprises on credit	10,852
,,	20	Paid cash to Fola Ltd. on account	167,500
,,	22	Aburi & Co paid cash on account	125,000
,,	25	Paid Salaries and wages	77,958
,,	25	Paid electricity bill	6,000
,,	27	Sold cement on credit to K. Opobo	68,000

Required

(i) An opening Journal.

(ii) Open the ledger accounts and post the opening journal and transactions during the month.

(iii) Balance the ledger accounts.

(iv) Draw up a trial balance as at 31 March 2016

Solution to illustration 5.3

Mensah Joe Enterprises

(i) Opening Journal

Date	Particulars		DR ₦	CR ₦
2016	Motor Van		480,000	
March 1	Cash		396,000	
	Loan (friend)			66,000
	Capital			810,000
			876,000	876,000

(ii)

Capital account

2016	₦	2016	₦
March 31 Bal c/d	810,000	March 1 Cash	330,000
		March 1 Motor vehicle	480,000
	810,000		810,000
		April 1 Bal b/d	810,000

Loan account

2016	₦	2016	₦
March 31 Bal c/d	66,000	March 1 Cash Account	66,000
		April 1 Bal b/d	66,000

Cash account

2016	₦	2016		₦
Bal. b/d	Opening balance			
March 1 Capital	330,000	March 3	Carriage inward	16,456
,, 1 Loan	66,000	,," 11	Sundry expenses	16,278
,, 8 Sales	26,280	,, 20	Fola Ltd.	167,500
		" 25	Salaries & Wages	77,958
,, 22 Aburi & Co	125,000	,, 25	Electricity bill	6,000
		" 31	Bal c/d	263,088
	547,280			547,280
April Bal b/d	263,088			

Motor vehicle Account

2016		₦	2016		₦
March 1	Capital(Opening bal)	480,000	March 31	Bal c/d	480,000
April 1	Bal b/d	480,000			

Carriage Inwards

2016		₦	2016		₦
March 3	Cash	16,456	March 31	Bal c/d	16,456
April 1	Bal b/d	16,456			

Aburi & Co-Receivables

2016		₦	2016		₦
March 6	Sales	190,000	March 22	Cash	125,000
			March 31	Bal c/d	65,000
		190,000			190,000
April 1	Bal b/d	65,000			

Fola Ltd- Payable

2016		₦	2016		₦
March 20	Cash	167,500	March 3	Purchases	189,000
March 31	Bal c/d	81,500	March 15	Purchase	60,000
		249,000			249,000
			April 1	Bal b/d	81,500

Sundry Expenses Account

2016		₦	2016		₦
March 11	Cash	16,278	March 31	Bal c/d	16,278
March 31	c/d	16,278			

Motor Van expenses

2016	₦	2016	₦
March 17 Okechukwu-Tyres	10,852	March 31 Bal c/d	10,852
April 1 Bal c/d	10,852		

Salaries & Wages account

2016	₦	2016	₦
March 25 Cash	77,958	March 31 Bal c/d	77,958
April 1 Bal b/d	77,958		

Electricity Bill Account

2016	₦	2016	₦
March 25 Cash	6,000	March 31 Bal c/d	6,000
April1 Bal b/d	6,000		

Purchases Account

2016	₦	2016	₦
March 3 Fola Ltd.	189,000		
March 15 Fola Ltd.	60,000	March 31 Bal c/d	249,000
	249,000		249,000
April 1 Bal b/d	249,000		

Sales Account

2016	₦	2016	₦
March 31 Bal c/d	284,280	March 6 Aburi & Co	190,000
		" 8 Cash	26,280
		,, 27 K. Opobo	68,000
	284,280		284,280
		April 1 Bal b/d	284,280

Okechukwu Enterprises –Accounts payable

2016	₦	2016	₦
March 31 Bal c/d	10,852	March 17 M/V expenses-Tyres	10,852
		April1 Bal b/d	10,852

K. Opobo Account –Receivables

2016	₦	2016	₦
March 27 Sales	68,000	March 31 Bal c/d	68,000
	68,000		68,000
April1 Bal b/d	68,000		

Notes

(a) Balances carried down on 31 March 2016, the end of March, became the balances brought down on 1 April, the beginning of the next period.

(b)(i) All assets accounts, i.e. cash account, motor vehicle account and trade receivables account, have debit balances.

(ii) All liabilities accounts, i.e. loan account and Trade payables account have credit balances.

(iii) Capital accounts have credit balances

(iv) Sales account has credit balance

(v) In our illustrations in this chapter, the transactions are posted directly to the ledger accounts. In real practice the transactions would first pass through the books of original entry or Day Books.

(iv) Trial Balance

	DR	CR
	₦	₦
Capital		810,000
Loan		66,000
Cash	263,088	
Motor Vehicle	480,000	
Carriage Inwards	16,456	
Trade Receivables – Aburi & Co	65,000	
- K. Opobo	68,000	

Trade Payables – Fola Ltd		81,500
- Okechukwu Enterprises		10,852
Sundry Expenses	16,278	
Motor Van Expenses	10,852	
Salaries and Wages	77,958	
Electricity bill	6,000	
Purchases	249,000	
Sales		284,280
	1,252,632	1,252,632

5.5 Trial Balance

A Trial Balance is a list of balances extracted from the ledger accounts at a given date, arranged according to whether they are debit balances or credit balances. The total of the debit and credit balances should agree if the double entry rules have been properly followed. Though a Trial Balance can be drawn at any time, it is usual practice to prepare it at the end of an accounting period before preparing the entity's final accounts.

Illustration 5.4

The Trial Balance to our illustration 5.3 can be drawn up thus:

Mensah Joe Enterprises
Trial Balance at 31 March 2016

	Dr	Cr
	₦	₦
Capital		810,000
Loan		66,000
Cash	263,088	
Motor vehicle	480,000	
Carriage inwards	16,456	
Trade Receivables – Aburi &	65,000	
Trade payables		81,500
Sundry expenses	16.278	
Motor van expenses	10,852	
Salaries and wages	77,958	
Electricity bill	6,000	
Purchases	249,000	
Sales		284,280
Account payable		10,852
Receivables – Opobo	68,000	
	1,252,632	1,252,632

NOTE

(i) The two receivables (i.e. Aburi & Co and Opobo) accounts could have been summed up in the General Ledger but they are shown separately here for convenience.

(ii) The balances brought down represent the position of the items in the Trial Balance . For instance, the balances brought down for capital, loan, payables, sales and accounts payable are on the credit side, this is also their position in the Trial Balance.

5.5.1 Uses of the Trial Balance

The main uses of the Trial Balance are:

(i) To check the arithmetical accuracy of entries in the ledger

(ii) To detect such errors of posting that can easily be identified by the Trial Balance

(iii) To facilitate preparation of the final accounts.

5.5.2 Errors not affecting Trial Balance Agreement

The preparation of a Trial Balance does not prove that transactions have been completely and correctly recorded in the proper accounts. There are errors that do not affect the agreement of the Trial Balance and they include the following:

(i) **Error of omission**: This is a complete omission of a transaction from the ledger. Both the debit entry and the credit entry were not recorded.

(ii) **Error of principle:** When a transaction is posted to the wrong class of account an error of principle has been committed. An example is where a trader purchases an additional motor vehicle for ₦950,000 in cash and treated the transaction as a motor running expense by crediting his cash/bank account and debiting Motor Running Expenses Account (Nominal class of account). The motor vehicles Account (asset-Real Account) ought to have been debited and cash/bank credited.

(iii) **Error of commission:** This is an error within the same class of account but affecting different persons. It is the posting of entry to the account of a person other than the one intended. For example, a payment received from B. Abbey that is credited to B. Abu’s account.

(iv) **Compensating errors:** An error made in the ledger which, is exactly by sheer coincidence, balanced by another error elsewhere in the ledger is referred to as a compensating error, More than one error may at times be made and yet the sum totals exactly equal another single error somewhere else in the ledger. The effect is usually that there is overstatement of an item in one account and an equivalent amount understated in another account

(v) **Complete reversal of entries:** This involves error in which, for a transaction, the account that ought to be debited is credited and the one to be credited is debited. For instance, cash paid to trade receivables is debited in cash account and credited in trade payable account instead of vice versa.

(vi) **Errors of original entry**: This error is committed where a transaction is incorrectly recorded in a source document or book of original entry and the incorrect amount is eventually posted to the relevant account in the ledger. This type of error will not have any effect on the agreement of the trial balance. For example if goods invoiced at ₦52,500 to J. K. Salmon is record as ₦55,200 in the sales day book, the trial balance will in no way show the error if the incorrect amount of ₦55,200 is also debited to J. K. Salmon's account with other sales.

5.5.3 Errors that affect the Trial Balance

The total of the debit side and credit side of the Trial Balance may not agree which means that one or more errors have been committed. Some of these errors are:

(i) Arithmetic errors in balancing ledger accounts

(ii) Using one figure for the debit entry and another figure for the credit entry in respect of one transaction.

(iv) Errors of extracting the wrong figure from the ledger to the Trial Balance

(v) Listing a debit balance to the credit side of the Trial Balance

(vi) Listing a credit balance to the debit side of the Trial Balance.

(vii) The posting of debit as credit or vice versa while the other entry is correctly made.

(viii) Making an entry on only one side of the accounts, omitting the second entry.

5.6 Correction of Errors

There are two approaches to the correction of errors. This is dependent on the effect of the error on the Trial Balance. For errors which do not affect the agreement of Trial Balance totals, there will always be two affected accounts in between which the error will be corrected, while errors which affect the agreement of the Trial Balance will affect only one ledger account, thereby requiring one other account, which is the Suspense Account for correction to be effected.

5.6.1 Suspense Account

The suspense account is an account in which the net difference in Trial Balance totals is recorded pending the location and correction of the errors causing the difference.

5.6.2 Location of Errors

Errors which affect the agreement of the Trial Balance totals are more easily discovered than those which do not affect Trial Balance totals. In most cases errors not affecting the Trial Balance will only come to light through complaints from affected third parties such as customers or suppliers.

An error of either type can be located by taking the following steps:

(i) Re-cast the addition of ledger balances on the Trial Balance

(ii) Check for any omission on the Trial Balance

(iii) Make sure that the ledger balances appear on the correct side of the Trial Balance i.e. Income, Liabilities, capital and sales to be on the credit side while Expenses, Assets, Drawings and Purchases should be on the debit side.

(iv) Check for correct transfer of ledger balances to the Trial Balance.

(v) Take a general look at the entries in the ledger to see if a figure close to the difference sought is in them.

(vi) Check the double entries in the ledger.

(vii) Check the arithmetic in the ledger. Recast each side of ledger accounts and reconfirm the balances c/d and b/d

(viii) If the trial balance difference is exactly divisible by two, check for one half of the difference on the trial balance, the figure might be on the wrong side of the trial balance.

(ix) If the trial balance difference is exactly divisible by 9, there could be error of transposition of figures, for example, ₦98 written as ₦89. The difference is 9.

5.6.3 Steps involved in correcting Errors

In correcting errors which are not revealed by the Trial Balance the following steps should be taken:

(i) Read the question well and try to understand the transaction involved.

(ii) When the transaction is understood, determine the accounts involved and the entry which ought to be passed.

(iii) Compare the entries which ought to be passed with what has been done, as reported in the question.

(iv) On the basis of the observed difference, effect the correction of error.

Illustration 5.5

After extracting the Trial Balance of Giringori Enterprises on 31 March, 2016, It was discovered that the debit side was higher than the credit side by ₦6,180. A review of the ledger revealed the following errors:

1. A sum of ₦720 on a Receivables' account was omitted from the balance of Trade Receivables.
2. An item of furniture purchased for ₦5,760 had been debited to repairs.
3. The payments side of the cash account had been undercast by ₦3,900
4. The total of one page of the sales day book had been carried forward as ₦12,924, whereas the correct amount was ₦15,084.
5. A debit note of ₦1,260 received from a customer had been posted to the wrong side of his account.
6. Mr. Laku whose debts of ₦3,120 to the business had been written off, paid during the year. His personal account was credited but no corresponding entry was made.

You are required to:

(i) Prepare Journal entries to correct the errors.

(ii) Write up the Suspense account.

Solution to Illustration 5.5

GIRINGORI ENTERPRISES

(i) Journal Entries on 31 March, 2016

			DR	CR
			₦	₦
(a)	Suspense Account	Dr	720	
	To Payables Account			720
	(Being entry in respect of omitted receivable balance)			
(b)	Furniture Account	Dr	5,760	
	To Repairs Account			5,760
	(Being correction of the purchase of Furniture earlier debited to Repairs account)			
(c)	Suspense Account	Dr	3,900	
	To Cash Account			3,900
	(Being correction of the undercast of cash book payment)			
(d)	Suspense Account	Dr	2,160	
	To Sales Account			2,160
	(Being correction of wrong amount c/f on one page of the sales daybook)			
(e)	Suspense Account	Dr	2,520	
	To Receivables Account			2,520
	(Being correction of posting a debit note to the page of the Sales day book)			
(f)	Cash Account	Dr	3,120	
	To Suspense Account			3,120
	(Being entry of recovered debt omitted from cash account)			

(ii) Suspense Account

	₦		₦
Payables	720	Cash	3,120
Cash	3,900	Trial Bal diff	6,180
Sales	2,160		
Receivables	2,520		
	9,300		9,300

5.7 Manual and Computer based accounting systems compared

Computers are programmed to perform mechanical tasks with great speed and accuracy. The computer can re-arrange accounting data in a required format and can add and balance accounting data programmed into it automatically. Therefore they eliminate the need for copying and re-arranging what has already been entered into the computer system. They also eliminate most of the paper work required in a manual accounting system.

However, the procedure and principles involved in the operation of manual and computer based accounting systems are usually the same.

The human aspects in the processing of transactions through the computer are as follows:

(i) Determining which transactions to be recorded in the accounting records.

(ii) Determining which accounts to debit or credit

5.7.1 Recording in computer-based systems

The manner in which accounting data is recorded in a manual based accounting system is different from how it is recorded in the computer based system.

(i) Accounting data are not handwritten but entered through the keyboard, optical scanner and other input devices.

(ii) Accounting data are entered in a data base instead of the books of original entry.

(iii) Therefore data posted to the ledger accounts in a computer-based system come directly from the data base and not from the books of original entry.

(iv) The information required for the preparation of the Trial Balance is already contained in the data base; they are automatically extracted by the computer.

5.8 Chapter Summary

In this chapter we have discussed the double entry system. We also described the ledger accounts and the rules of debits and credits in these accounts.

We prepared the Trial Balance from ledger balances. We discussed the uses of the Trial Balance and also trial balance errors. We also compared briefly the use the manual systems and the computerised systems to record accounting transactions.

5.9 Review Questions

Multiple choice and short-answer questions

(1) Which of the following will increase the value of the account?

I. Debit an asset account

II. Debit a liability account

III. Debit an expense account

IV. Debit an income account

(A) I and II

(B) I and III

(C) II and III

(D) II and IV

(E) I and II &IV

(2) When a photocopy machine is purchased on credit for N500,000, state the account to be debited and credited

	Debit	Credit
(A)	Office equipment	Purchases
(B)	Purchases	Office equipment
(C)	Seller	Office equipment
(D)	Office equipment	Seller
(E)	Office Equipment	Sales

(3) An entry on the right-hand side of a ledger account is

(A) Credit entry

(B) Debit entry

(C) Contra entry

(D) Balance c/d

(E) Balance b/d

Use the following information to answer questions 4 and 5

The following two accounts show the application of the double entry for a transaction on a particular date.

Motor Vehicle

	₦		-
Olu Ventures	75,000	Cash	15,000
	________	Bal c/d	60,000
	75,000		75,000

Olu Ventures

	₦		₦
bal c/d	75,000	Motor Car	75,000
	75,000		75,000

(4) What does the entry on the debit side of Motor vehicle account represent?

(A) Olu Ventures purchased ₦75,000 motor vehicle in cash

(B) A motor vehicle of ₦75,000 is purchased from Olu Ventures

(C) Motor vehicle is sold to Olu Ventures for ₦75,000

(D) Olu Ventures sold a motor vehicle for ₦75,000

(E) Olu Venture brought down ₦ 75,000 in motor vehicle account

(5) What does the balance c/d in Olu Ventures account stand for?

(A) Trade Payables

(B) Trade Receivable

(C) Accounts payable for motor car

(D) Accounts receivable for motor car amount transferred to statement of profit or loss'

(6) Information stored in a computer-based accounting system which can be arranged into any desired format is called.......................

(7) The relationship between the ledger and the Trial Balance is that a debit balance in the ledger will be on the................side of the Trial Balance and a credit balance on the................side.

(8) How does the Trial Balance complement the usefulness of the double entry principle?

(9) State any four types of errors that do not affect the Trial Balance

(10) While the Trial Balance proves the equality of the debit and credit entries in the ledger it does not guarantee absence of......................

(11) It is common to divide the ledger for a large organisation into four separate ledgers known as the private,.........................and...................................

5.10 Theory and calculation Questions

Review Questions

(1) (a) Identify and explain Three (3) Types of accounts

(b) Outline Four (4) uses of a ledger account

(2) An entity started a trading business in Mokola on 1 December 2016 with ₦200,000deposited in a bank at Mokola Other transactions for the month of December 2016 were:

2/12/2016:	The proprietor gave his old car to the business for ₦180,000
3/12/2016	Bought office Furniture ₦40,000 from John Venture on credit
3/12/2016	Bought goods worth ₦92,000 with cheque from Paul
4/12/2016	Cash sales worth ₦65,000 and money deposited into the business account by the customer direct.
10/12/2016	Paid John Venture ₦22,500 with cheque in respect of the purchase of furniture
12/12/2016	Purchase goods worth ₦72,500 on credit from Julius Ventures
15/12/2016	Goods sold on credit totalling ₦48,900 to Azikwe Enterprise
20/12/2016	Paid Julius Venture total outstanding amount as at 12 December 2016
24/12/2016	Paid stationery expenses ₦12,500 with cheque
31/12/2016	Paid Telephone expenses for business calls ₦4,500 cheque
31/12/2016	Settled staff salaries with ₦20,000 cheque

You are required to:

(a) Prepare and balance all relevant ledger accounts as at 31 December, 2016

(b) Prepare the entity's trial balance on 31 December, 2016

(3) (a) Give and explain Five (5) types of errors that do not affect balancing of a trial balance

(b) Itemise any SIX (6) errors that will affect balancing of a trial balance

Solution to Review Questions

(1) B

(2) D

(3) A

(4) B

(5) C

(6) Database

(7) Debit, credit

(8) The Trial Balance tests whether the principle of double entry is properly followed in recording in ledger accounts.

(9) Error of principle

- Error of commission
- Error of complete omission
- Errors of compensation

(10) Errors

(11) Private, Sales ledger and Purchases ledger and General Ledger.

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CHAPTER SIX

CONTROL OR TOTAL ACCOUNTS

6.0 Learning Objectives

At the end of this chapter candidates should be able to:

- Explain control accounts and know their usefulness
- Know the main types of control accounts
- Prepare control accounts from given information
- Describe trade receivables statements of account
- Prepare trade receivables statements of account.

6.1 Introduction

In a small entity it may be possible for one person to maintain all the ledger accounts. Where a business maintains a large number of accounts, it will become necessary to divide the ledger into sections and assign the recording of each section to different persons for internal control purposes. The main areas to which such ledgers can be divided are the Subsidiary Ledger, Trade Receivables Ledger, Trade Payables Ledger and General Ledger.

In very large entities, the sub-division may further be divided among employees. Where this type of divisions takes place, it will be necessary to institute controls on the accuracy of the postings made to each ledger. This is achieved by maintaining total accounts for trade receivables and payables in the general ledger. These total accounts are referred to as control accounts.

6.2 The Nature and Functions of Control Accounts

A control account is an account, the balance of which reflects the aggregate balances of many related subsidiary accounts which are part of the double entry system.

The control account is a memorandum record only, and so does not form part of the double entry system. However, it is kept using double entry principle. Control accounts can be kept in respect of Customers accounts (Sales Ledger), Suppliers' accounts (Bought Ledger) and expenses. Control accounts are maintained to facilitate easy detection of errors. Consequently, they act as a check on the entries in the various subsidiary ledgers. Where the Trial Balance totals are not equal, balances in each ledger can be added together and compared with the balance in the respective control accounts. Ordinarily, the two should be equal, Where there is a difference, such ledger that fails to reconcile with the control account will be investigated rather than all the ledger accounts.

Control accounts are also called self-balancing ledgers because the total trade receivables and total trade payables in the general ledger should be equal to the aggregate of the balances in the respective individual accounts in the subsidiary ledger.

6.2.1 Merits of Control Accounts

The merits of using control accounts can be summarized as follows:

- They can be used to locate errors more easily as they are localised to specific Ledger(s).
- They make it difficult to commit fraud because they are normally under the control of responsible officers and their preparation is separate from the clerks who maintain the individual ledger accounts.
- They provide information about the total trade receivables and total trade payables thereby making management of the receivables and payables accounts easy.
- They allow for account set-off
- Reduce risk of errors by posting totals rather than individual items.
- Reduce delay in producing final accounts.

6.2.2 Sources of Information for Control Accounts

Information recorded in control accounts are obtained from:

- Receivables and Payables accounts
- Returns inwards and outwards accounts
- Bills payable and receivable accounts
- Dishonoured cheques
- Cash paid to payables and cash received from receivables (obtained from the cash book).

- Discount received and discount allowed accounts
- Sales day book and purchases day book.

6.2.3 Trade Receivables or Sales Ledger Control Account

Sales ledger control account is the account containing the summary of all trade receivables or customers' accounts. What is posted to the debit side of this account are the aggregate of all the items recorded on the debit side of the receivables accounts. The same thing applies to the credit side of the account.

Summary of Entries

(i) Debit – (a) Opening debit balances
(b) Credit Sales from sales day book
(c) Dishonoured bills and cheques from customers
(d) Debit notes issued
(e) Cash paid to Customers from the cash book
(f) Transfers and other items (Contra)

Credits :(a) Opening Credit Balances
(b) Cash received from customers as recorded in the cash book.
(c) Discounts allowed as recorded in the cashbook
(d) Returns inwards as recorded in the sales return day book.
(e) Irrecoverable debts written off
(f) Bills receivable
(g) Set off between sales ledger control and purchases ledger Control accounts(Contra)

The above listed items are presented in a T- account below:

Sales (or Trade Receivables) Ledger Control Account

	₦		₦
Bal b/d	X	Bal. b/d (if any)	X
Credit sales	X	Cash received	X
Dishonoured bills and cheques	X	Discounts allowed	X
Debit Notes	X	Returns inwards/sales Return	X
Cash refunds	X	Irrecoverable debts	X
Contra	X	Bill receivable	X
Balances c/d	X	Contra	X
		Bal. c/d	X
	XX		XX
Bal. b/d	X	Balances b/d	X

6.2.4 Purchases (or Bought or Payables) Ledger Control Account

This is the account containing the summary of all the accounts of the trade payables or suppliers in the purchases ledger. What is posted to the debit side of this account are the aggregate of all the items recorded on the debit side of the payables accounts. The same thing applies to the credit side of the account.'

Summary of entries in the Purchases Ledger Control Accounts

Debit entries

(a) Opening debit balance

(b) Payment to suppliers obtained from the cash book

(c) Returns outwards

(d) Bills payable

(e) Discounts received from the memorandum column on the credit side of the

(f) Credit notes

(g) Transfers between sales ledger control and purchases ledger control accounts.

Credit entries

(a) Opening Credit balances

(b) Credit purchases obtained from the purchases day book

(c) Cash refund from suppliers

(d) Dishonoured bills payable

(e) Transfers and other items

The above listed items are presented in a T – account below:

PURCHASES (TRADE PAYABLES) LEDGER CONTROL ACCOUNT

	₦		₦
Bal b/d if any	X	Bal. b/d (if any)	X
Cash Payment to Suppliers	X	Credit Purchase	X
Returns Outwards/Purchases returns	X	Dishonoured Cheques	X
Bills Payable	X	Dishonoured bills payable	X
Discount received	X	Cash refund Contra	X
Credit notes receivables	X	Balance c/d	X
Contra/setoff	X		

Bal. c/d	X		
	XX		XX
		Bal. b/d	X

NOTE

Cash sales should not be debited to the sales ledger control account rather, cash sales should be debited to the cash book. Cash purchases should also not be credited to purchases ledger control account but should be credited to the cash book. Allowance for doubtful debts, discount allowed and received as well as interest paid on bill discounted should be ignored.'

*Illustration 6.*1

Extracts from the books of JK Ltd. shows the following balances for the month of June 2016

	₦'000
Sales ledger balances – 1 June 2016	4,702
Purchases ledger balances – 1 June 2016	2,757
Sales journal balances – 30 June 2016	37,437
Purchases journal balances – 30 June 2016	40,800
Returns Inwards	910
Returns Outwards	749
Receipts from Customers – Cash	38,529
Discount allowed	1,345
Payments to Suppliers	35,415
Discounts received	746
Irrecoverable debts written off	115
Sales ledger set off	209
Purchases ledger set off	110

On 30 June 2016, it was discovered that a supplier was paid twice in error for ₦157. The amount was refunded on that date.

You are required to Prepare the sales and purchases ledger balances at 1 July 2016.

(Adapted from ATS ICAN)

Solution to Illustration 6.1

JK Ltd.
Sales Ledger Control Account

2016 June		₦'000	2016 June		₦'000
1	Bal b/f	4,702	30	Cash	38,529
30	Sales	37,437	30	Returns inwards	910
30	Set off	110	30	Discounts allowed	1,345
			30	Irrecoverable debts	115
			30	Set-off	209
			30	Bal c/d	1,141
		42,249			42,249
1 July	Bal b/d	1,141			

Purchases Ledger Control Account

2016 June		₦'000	2016 June		₦'000
30	Returns outwards	749	1	Bal b/f	2,757
30	Cash	35,415	30	Purchases	40,800
30	Discounts received	746	30	Cash refund	157
30	Set-off	209	30	Set off	110
30	Bal c/d	6,705			
		43,824			43,824
			July 1	Balance b/d	6,705

Illustration 6.2

Aje Father Enterprises controls his Trade payables accounts by drawing up monthly Trade Payables Ledger Control Account in two parts A and B.
The following figures are available at January 31 2016 when there is a difference on the Trial Balance of ₦2,000.

	A	B
	₦	₦
Jan 1 Balances on Trade Payables (credit side)	18,400	13,600
Jan 1 Balances on Trade Payables Ledger (debit side)	150	184
Jan 1 – 31 Purchases	114,512	17,372
Jan 1 – 31 Returns outwards	11,000	1,652
Jan 1 – 31 Sundry charges by suppliers	1,200	144
Jan 1 – 31 Cheques paid to suppliers	17,980	13,420
Jan 1 – 31 Discount received from suppliers	1,420	1,180
Jan 31 Balances carried down to debit side	150	132

The book-keeper in charge of the A Ledger makes his Ledger accounts balance ₦103,712 while the clerk in charge of the B Ledger makes his Ledger balances total ₦16,812.

Draw up the two Control Account and draw any conclusion you can from them.

Solution to Illustration 6.2

AJE Father Enterprises
Trade Payables Ledger Control Account (A)

2016		₦	2016		₦
Jan	Balance b/d	150	Jan 1	Balance b/d	18,400
1 – 31	Returns outwards	11,000	1 – 31	Purchases	114,512
1 – 31	Bank	17,980	1 – 31	Sundry charges	1,200
1 – 31	Disc. Received	1,420	31	Balance c/d	150
31	Balance c/d	103,712			
		134,262			134,262
Feb 1	Balance b/d	150	Feb 1	Balance b/d	103,712

Trade Payables Ledger Control Account (B)

2016		₦	2016		₦
Jan	Balance b/d	184	Jan 1	Balance b/d	13,600
1 – 31	Bank	13,420	1 – 31	Purchases	17,372
1 – 31	Disc Received	1,180	1 – 31	Sundry charges	144
1 – 31	Returns outwards	1,652	31	Balance c/d	132
1 – 31	Balance c/d	14,812			
		31,248			31,248

Feb 1	Balance b/d	132	Feb 1	Balance b/d	14,812

The Control Accounts reveal that there is a difference of ₦2,000 between the Control Account for the B Ledger (₦16,812 – ₦14,812) which is the total discovered by the book keeper in charge of that Ledger. The A Ledger seems to be correct. The error has been localised to the B Ledger, the entries in which can be re-checked carefully to detect the error. This is an advantage of the Total or Control account.

6.2.5 Trade Receivables Statements of Account

Trade receivables statements are documents sent periodically, usually once a month, by a seller to his customers showing the position of their accounts up to a certain date. Each statement gives the particulars of the invoices, debit notes and credit notes that the seller has sent to the customer during a month, payments made by the customer and how much the customer owes the seller and when the amount will be due for payment. The statement is often a copy of the customer's account in the seller's books.

The statement may be kept for reference purposes or returned to the seller with the Customer's cheque. In either case neither the customer nor the sellers records the statement in his books.

Illustration 6.3

The following transactions took place between Sisi Eko Enterprises of 2, Balinga Street, Lagos and her customer Ambrose & Co of 10 Dennis Avenue, Ikeja in January 2016.

2 Jan 2016 invoice number 426, Value ₦23,120

9 Jan 2016 invoice number 489, value ₦16,240

16 Jan. 2016 Ambrose & Co paid a sum of ₦25,140 with cheque No 04934

22 Jan. 2016 invoice number 563 for ₦52,910

25 Jan. 20X1 Credit note number 1326 for ₦6,000 was sent

Required:

Prepare a Trade Receivables Statement to show these transactions

(ATS ICAN)Solution to Illustration 6.3

SISI EKO Enterprises

2, Balinga Street, Lagos

Ambrose & Co — January 2016

10, Dennis Avenue, Ikeja

		Ref	Debits	Credits	Balances
January			₦	₦	₦
2	Goods	426	23,120		23,120
9	Goods	489	16,240		39,360
16	Payment	CHQ04934		25,140	14,220
22	Goods	563	52,910		67,130
25	Credit note	1326		6,000	61,130

Amount due on January 31 2016

Cash discount terms: 5% for payment within 15 days

6.3 Chapter Summary

In this chapter we have explained the importance of control account in the detection of error and in the management of the subsidiary accounts. We also showed, through illustrations, how errors in a Trial Balance that does not "balance" can be detected easily through the control account. We also described the receivables statement and how they are prepared.

6.4 Review Questions

Multiple- choice questions and short-answer questions.

(1) When there is a set off between trade receivables and trade payables, the amount is:

A. debited in sales ledger control account and credited in purchases ledger control Account

B. debited in purchase ledger control account and credited in sales ledger control account

C. Debited to the Customer's account and credited to purchases Ledger Control account

D. Debited in the cash book and credited in sales ledger control Account

E. Credited in the cash book and debited in the purchases ledger Control Account

(2) Which of the following will **NOT** be recorded in the sales ledger control account?

I. Amount received from receivables

II. Bills payable discounted

III. Cash sales

IV Discounts allowed

A. I and II B.

I and III C.

II and III D.

II and IV

E. II,III and IV

(3) Control accounts are also called

I. Total accounts

II. Self balancing ledger

III. Three column cash book

IV General Journal

A. I and II .

B II and III

C. I and III

D. III and IV

E. I, III, and IV

(4) What is the effect of purchases set-off on control account?

A. It will reduce amount receivable from trade receivables

B. It will increase the amount receivable from trade receivables

C. It will require issue of credit note to the trade payables.

D. It will require the supply of goods to the tune of the set-off in full settlement.

E. It will require issue of debit note to trade receivable.

(5) What is the source of information for dishonoured cheques recorded in total account?

A. Bank statement credit side

B. Cash book credit side

C. Cash book debit side

D. Debit note

E. Credit note

(6) The account in the general ledger that shows the total amount owed to the business and agrees with the totals of the relevant subsidiary ledger account is termed the........................ account.

(7) How often are postings made to the general ledger?

(8) A supplementary record used to provide detailed breakdown of control account balances in the general ledger is known as.....................

(9) List four items that are normally posted to the credit side of the purchases ledger control account.

6.5 Self-test Questions

1. (a) Give Six (6) sources of Information for Control accounts

   (b) Highlight four (4) Advantages of Control Accounts

2. The following information were extracted from the records of Agbowo shopping complex for the month January, 2017

	₦
Sales ledger balance – 1/1/17	5,805
Bought ledger balances – 1/1/17	3,405
Sales Journal Totals – 31/1/17	40,455
Purchases Journal Totals - 31/1/17	48,400
Sales Return	950
Purchases Return	845
Receipt from Customers – Cash	38,200
Allowances to Customers	1,450
Allowances from Suppliers	1,240
Allowances to Customer disallowed	230
Irrecoverable debts	145
Allowance from suppliers withdrew	125
Purchases ledger set off	190

On 31 January, 2017, it was discovered that a supplier was paid thrice for ₦185 on each occasion. The amount paid in excess was refunded on that date to:

You are required to prepare the sales and purchased ledger balances on 1 February, 2017.

3. (a) Give five (5) items each on the credit side of sales control account and debit side of purchases control account

(b) Why is control accounts are described as a self-balancing ledger?

6.6 Solution to Revision Questions

(1) B

(2) C

(3) A

(4) A

(5) B

(6) Sales Ledger Control account or Receivables ledger Control Account

(7) Every month end

(8) Subsidiary ledger

(9) (i) Opening Credit balances

(ii) Credit purchases

(iii) Cash refund from suppliers

(iv) Dishonoured bill payable

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CHAPTER SEVEN

ACCOUNTING FOR CASH TRANSACTIONS

7.0 Learning Objectives

At the end of this chapter candidates should be able to

- Know the need for control over cash
- Know basic requirements for internal control over cash
- Distinguish between trade discount and cash discount
- Know the need for the use of petty cash book and how it is prepared.
- Explain the importance of using the imprest system to control cash.
- Prepare two column or three column cash book.
- Prepare an analysis cash book

7.1 Introduction

Cash is defined to include cheques, money order, coins and paper money that a bank will accept for immediate deposit from a customer.

Cash is the asset most susceptible to loss through theft and other means; therefore there is a need for proper internal control over cash to minimize the loss of cash.

7.2 The need for Control over Cash

A good internal control over cash will help management to achieve the following objectives:

(i) There will be accurate accounting for cash transactions.

(ii) Management will maintain adequate amount of cash at all times

(iii) Management will not only maintain adequate amount of cash at all times they will also be able to invest idle cash revealed in profitable ventures.

(iv) It will prevent losses of cash from fraud or theft.

(v) Temptation to embezzle idle cash by staff is avoided.

7.2.1 How to Handle Cash

In order to have good internal control over cash, the following steps should be taken in handling cash:

(i) Cash should be deposited daily in the bank

(ii) All payments (except for petty cash transactions) should be made by cheques.

(iii) The function of receiving cash should be separated from that of maintaining records of cash. Each function should be performed by different persons.

(iv) All cash receipts should be recorded in a cash register. At the end of each day the amount in the register should be compared with the physical cash.

(v) All payments should be checked and approved in writing by responsible officers before payments are made.

(vi) The function of approving payment should be separated from the function of signing cheques.

(vii) Carbonized receipts should be issued for all cash sales and cash received.

(viii) When payment is made for a transaction the invoice and other supporting documents relating to that transaction should be stamped paid with date so that payment will not be made for a transaction twice.

7.3 Definition of Some Terms Relating to Control Over Cash

(i) **Voucher System** A voucher system involves a written authorization called a voucher that is prepared for every cash payment transaction. It requires that every transaction be verified, approved and recorded before payment is made.

(ii) **Voucher**: A voucher is a written authorization used in approving a transaction for payment.

(iii) **Voucher register**: This is a special permanent record of all payment vouchers for future reference. It shows the date of payment, payee, purpose of payment, voucher number and the amount.

(iv) **Cash over or short**: This is the account in which errors in making change to a cash customer would be recorded.

7.4 Discounts

In chapter four we described the *trade discount* as a reduction in the invoiced price for goods and that it is usually given for bulk purchase. We also explained that only the net amount of purchases or sales would be recorded in the books. This means that trade discount is not recorded as part of the double entry. Trade discount and other types of discounts commonly available are now discussed.

7.4.1 Trade Discount

Trade discount is an allowance in form of a percentage reduction in the full invoice price made to a customer. This practice is often used for several reasons such as:

(a.) To alter prices of articles, especially in periods of clearance sales to dispose of surplus inventory without reprinting the existing catalogue, thus saving on printing costs.
(b.) To allow a retailer a margin of profit.

7.4.2 Quantity Discount

Quantity discount is a similar reduction in price given to a customer who buys in large quantities

The deduction of both trade and quantity discounts is made on the invoice and only the net figure is entered in the Purchases Day Book and Inventory Records.

7.4.3 Cash Discount

This is an amount allowed to a customer so that he can pay promptly. It is often calculated as a percentage of the invoice value of the goods and the customer is required to settle his account within a specified period of time, otherwise, he will not be entitled to claim the allowance. If he pays in time, he takes off the discount from the invoice value and remits the net amount. If he pays after the specified period of time, he has to pay, the full value of the invoice.

Illustration 7.1

Appiah Enterprises sold goods to Sule Ventures for ₦250,000. A trade discount of 10% was granted and cash discount of 5% (if payment is made within 60 days) was allowed.

Required:

Calculate (i) The net sales value (ii) the cash discount and the amount received by Appiah Enterprises if it paid within 60 days.

Solution to Illustration 7.1

Immediately the goods were sold a trade discount of 10% is deducted i.e.

	₦
Invoiced price	250,000
Less: 10% trade discount	25,000
Net sales value	225,000

Assuming the customer paid within 60 days the amount due, the settlement discount of 5% would be deducted from ₦225,000. i.e.

	₦
Net sales value	225,000
Less: Cash discount of 5%	11,250
Amount received by Appiah Enterprises	213,750

7.4.2 Accounting Treatment of Cash Discounts

(a) Cash discounts (allowed and received) are recorded in a memorandum column in the cash book.

Discount allowed is recorded in a column on the debit side of the cash book, the same side in which receipts from cash sales are recorded. Discount received is recorded on the credit side, the same side in which payments for cash purchases are recorded in the cash book.

(b) The sales and purchases would be recorded in the books at their invoice value less trade discount.

(c) Discount allowed is debited in discounts account and discount received is credited in the discounts account. When the income statement is being prepared the amount will be transferred from the discount allowed account to Income statement as expenses.

(d) Discount received is debited to trade payable account and credited to discount received account. When the income statement is being prepared, it is transferred from discount received account to statements of profit or loss as addition to income.

We shall illustrate the treatment for cash discounts later in this chapter.

7.5 The Main Cash Book

We have seen in chapter five that cash book records only cash receipts and payments. Another thing is to note that cash book is a book of original entry as well as a ledger account for cash transactions. The cash book is kept separately from the main ledger because cash transactions are always very many.

In this chapter we shall consider the double column and three column cash book.

7.5.1 Two Column Cash Book

The two column cash book has two columns on both sides of the accounts namely; cash and bank columns.

The cash column records the cash transactions that involve cash in hand. The bank column records cash transactions that involve cash in bank. Supporting documents for these bank transactions are mainly cheques and pay-in-slips.

Contra entries

In relation to the cash book, contra entry refers to either the lodgement of cash into the bank account or the withdrawal of cash from the bank for office use. The complete double entry posting is done simultaneously in the cash book. The letter 'C' is used to indicate this in the folio column of the cash book on the date of transaction.

Illustration 7.2

Mallam Ture has been in business for many years as a sole trader. His cash at hand on 1 June 2016 was ₦75,000 but there was no bank account.

The following transactions took place during the month of June 2016.

			₦
June	1	Opened bank account and paid in cash	75,000
,,	4	Rented premises and paid for 2 months by cheque	3,000
,,	7	Bought furniture and fitting by cheque	9,000
,,	11	Purchased goods for sale by cheque	12,000
,,	14	Cash sales to date	22,500
,,	16	Received cheque from Kojo on account of May Sales	12,300
,,	19	Paid Cash into bank	19,000
,,	20	Purchased goods for resale from Shuaib and Sons on credit	15,000
,,	25	Cash Sales	11,250
,,	26	Paid cash into bank	11,250
,,	28	Sold goods on credit to Stephens & Co	2,700

,,	29	Withdrew Cash for office use	10,000
,,	29	Paid Shuaib and Sons on account by cheque	7,500
,,	30	Paid Salaries by cash	8,155
,,	30	Paid electricity bill by cheque	1,350
,,	30	Paid sundry expenses by cash	600

Required: Prepare the two column cash book of Malam Ture Enterprises for the month of June 2016

Solution to illustration 7.2

MALLAM TURE

DR. **CASH BOOK** Cr

Date	Particulars	fo	Cash	Bank		Date	Particulars	fo	Cash
			₦	₦					₦
June1	Balance b/d		75,000			June 1	Bank	c	75,000
1	Cash	c		75,000		4	Rent-Premises		
14	Sales		22,500			7	Furniture/fittings		
16	Kojo			12,300		11	Purchases		
19	Cash	c		19,000		19	Bank	c	19,000
25	Sales		11,250			26	Bank	c	11,250
26	Cash	c		11,250					
						29	Cash	c	
29	Bank	c	10,000			29	Shuaib & Sons		
						30	Salaries		8,155
						30	Electricity bill		
						30	Sundry Expenses		600
						30	Balance	c/d	4,745
			118,750	117,550					118,750
July 1	Balance	b/d	4, 745	74,700					

<u>NOTES</u>

(i) When cash was paid into the bank we debited bank account and credited cash account and indicated by 'C' in the ledger folio column that it is a contra entry.

(ii) When cash was withdrawn from the bank for office use, it was also a contra entry. We debited cash account and credited bank account.

(iii) The transactions of June 20 and June 28 did not pass through the cash book because they were not cash transactions.

(iv) The cash book will normally show a debit balance but the bank column may show a credit balance when the business enjoys overdraft facility from the bank, otherwise a person cannot spend more cash than what he has.

7.5.2 Three Column Cash Book

The three column cash book now has three main columns by adding a discount column to cash and bank columns. Discount allowed is shown as a memorandum column on the debit side of the cash book while discount received is shown as a memorandum column on the credit side of the cash book.

As explained earlier, memorandum records do not form part of the double entry.

Illustration 7.3

Solo Enterprises started a business with N96,000 on 1 July 2016 and paid the money into the bank on 4 July, 2016. His transactions for the rest of the month were as follows:

2016		₦
July 4	Purchases by cheque	32,760
" 7	Credit purchases	30,240
" 7	Electricity paid with cheque	600
" 7	Rent paid with cheque	840
" 10	Sales - credit	51,024
	- cheque	60,000
	- cash	576
" 10	Drew cash for office use	2,400
" 11	Paid trade payables by cheques after deducting cash discount of N384	18,120

" 12	Cash Sales	20,538
" 12	Wages paid by cash	600
" 14	Cheques received from customers (discount deducted N960)	47,040
" 17	Drew cash for Office use	300
" 18	Paid cash for repairs	144
" 18	Purchases – credit	54,000
	- cheques	6,000
	- cash	23,000
" 22	Sales – cash	45,000
	- cheques	20,400
" 24	Paid trade payables by cheques after Deducting discount of N120	32,400
" 24	Cash Sales immediately paid into bank	2,400
" 26	Paid rent by cheque	1,800
" 26	Paid Wages & Salaries by cheques	6,720
" 31	Cash paid into bank	12,000
" 31	Drew cheque for petty cash	240

Required:

(a) Enter the above transactions in the analysis cash book of Solo Enterprises. (Receipts side: Receivables, cash sales and others; payments side: payables, petty cash, salaries and others)

(b) Show the discount allowed and discount received accounts

(c) Show the trade receivables account and the trade payables account.

SOLUTION TO ILLUSTRATION 7.3

(a) **SOLO ENTERPRISES**

ANALYSIS CASH BOOK (RECEIPTS)

						ANALYSIS		
Date 2016	**Particulars**	**Fol**	**Discount Allowed ₦**	**Cash ₦**	**Bank ₦**	**Receivables ₦**	**Cash Sales ₦**	**Others ₦**
July 1	Cash - Capital			96,000				
" 4	Cash	⊄			96,000			
" 10	Sales			576	60,000		576 60,000	
" 10	Bank	⊄		2,400				
" 12	Sales			20,538			20,538	
" 14	Receivables		960		47,040	47,040		
" 17	Bank	⊄		300				
" 22	Sales			45,000	20,400		45,000 20,400	
" 24	Sales				2,400		2,400	
" 31	Cash	⊄			12,000			
" 31	Bank	⊄		240				
			960	165,054	237,840	47,040	148,914	

ANALYSIS CASH BOOK (PAYMENTS)

						ANALYSIS			
Date 2016	**Particulars**	**Fol**	**Discounts Received ₦**	**Cash ₦**	**Bank ₦**	**Payables ₦**	**Petty Cash ₦**	**Salaries and others ₦**	**Cash Purchases ₦**
July 4	Bank	⊄		96,000					
" 4	Purchases				32,760				32,760
" 7	Electricity				600			600	
" 7	Rent				840			840	
" 10	Cash	⊄			2,400				
" 11	Payables		384		18,120	18,120			
" 12	Wages			600				600	
" 17	Cash	⊄			300				
" 18	Repairs			144			144		
" 18	Purchases			23,000	6,000				23,000
" 24	Payables		120		32,400	32,400			6,000
" 26	Rent				1,800			1800	
" 26	Wages & Salaries				6,720			6,720	
" 31	Bank	⊄		12,000					
	cash	⊄			240				
" 31	Balance	c/d		33,310	135,660				

			504	165,054	237,840	50,520	144	10,560	61,760

(b)(i) Discount Allowed Account

Date	Particulars	Fol	₦	Date	Particulars	Fol	₦
2016				2016			
July 14	Cash book		960	July 31	Balance	c/d	960
			960				960
Aug 1	Balance	b/o	960				

(iii) Discount Received Account

Date	Particulars	Fol	₦	Date	Particulars	Fol	₦
2016				2016			
July 31	Balance	c/d	504	July 11	Cash Book		384
				" 24	Cash Book		120
Aug 1	Balance	b/o	504				504
				Aug 1	Balance	b/d	504

(i) Trade Receivables Account

Date		₦	Date	Particulars	₦
2016			2016		
July 10	Sales	51,024	July 14	Bank	47,040
				Discount allowed	960
		51,024	July 31	Balance c/d	3,024
Aug 1	Balance b/d	3,024			51,024

(ii) Trade Payables Account

Date		₦	Date	Particulars	₦
2016			2016		
July 11	Bank	18,120	July 7	Purchases	30,240
	Discount Received	384	July 18	Purchases	
July 24	Bank	32,400			54,000
	Discount received	120			
July 31	Balance c/d	33,216			
		84,240			84,240
			Aug 1	Balance b/d	33,216

Note

The total of receipts is ₦67,860 while the total of payments is ₦62,100. Therefore the balance carried down is N5,760 (i.e. ₦67,860 – ₦62,100).

7.6 The Petty Cash Book

The petty cash book is used for recording expenses of a smaller size than those recorded in the main cash book.

The petty cash book is usually operated on the imprest system in which *cash float* is maintained. The cash float is reimbursed by the amount spent at the end of a specific period.

The only source of cash inflows to the petty cash is the imprest. The expenses are spread on various items which are separately analyzed. At the end of specific periods the columns are added and posted to the debit side of the ledger accounts to which they relate.

7.6.1 Control over Petty Cash Imprest

A petty cash voucher must be filled and approved before the disbursement of any expenditure. The petty cash voucher shows the date, the amount paid, the purpose of the expenditure, the signature of the person who approved the payment and the signature of the person receiving the money.

A surprise count of the imprest should be done occasionally so that the fund can always be kept intact.

7.6.2 Advantages of the *Imprest System*

(a) It trains young staff (the petty cashier) to be responsible about money and accurate in accounting for it.

(b) It saves the time of the main cashier, who has great responsibilities.

(c) The main cash book will not be overloaded with payments of items with low amounts.

(d) It makes expense analysis and monitoring easy.

(e) It reduces the number of accounts to be opened in the ledger accounts thereby facilitating balancing of periodic accounts.

Illustration 7.4

Rasak Ventures maintains an imprest of ₦10,000 per month. The transactions for the month of February, 2017 are as follows:

Feb. 1	Petty cash in hand	₦2,500
" 1	Received cash to make up the imprest	
Feb. 3	Bought postage stamps	₦650
"	Transport fare	₦400
Feb 6	Telephone bills	₦1,500
"	Paid carriage	₦650
"	Taxi fares	₦850
Feb 7	Paid for repairs to computer keyboard	₦1,600
"	Paid carriage	₦2,500
"	Office entertainment (beverages)	₦1,000
"	Purchase of envelopes ₦550	
Feb 8	The imprest was restored	

Prepare the petty cashbook for the period to show separate totals for amounts spent on postage and stationery, transport and travelling, carriage and sundry office expenses.

Solution to Illustration 7.4

Rasak Ventures
Petty Cash book

Date 2017	Particu-lars	Fol	Amount ₦	Date 2017	Particulars	PV No	Total ₦	**ANALYSIS** Post-age & Station-ery ₦	Transport & Travelling ₦	Carri-age ₦	Sundry Office Expenses ₦
Feb 1	Balance	b/d	2,500	Feb 3	Postage stamps	01	650	650			
" 1	Bank	CB7	7,500	" 3	Transport fare	02	400		400		
				" 6	Telephone bills	03	1,500				1,500
				" 6	Carriage	04	650			650	
				" 6	Taxi fares	05	850		850		
				" 7	Repairs-Comp. Keyboard	06	1,600				1,600
				" 7	Carriage	07	2,500			2,500	
				" 7	Office entert. (Bar)	08	1,000				1,000
				" 7	Envelopes	09	550	550			
					Total		**9,700**	**1,200**	**1,250**	**3,150**	**4,100**
				" 7	Balance	c/d	300	GL1	GL2	GL3	GL4
			10,000				**10,000**				
Feb 8	Balance	b/d	300								
" "	Bank	CB 10	9,700								

7.7 Chapter Summary

In this chapter we have explained the need for control over cash, the internal control required for the security of cash transactions and the operation of the petty cash system.

The chapter also discussed the nature of discounts and the accounting entries for cash discounts. We also explained how to prepare two column cash book and three column cash book.

7.8 Review Questions

Multiple-choice and short answer questions

(1) Which of the following represents discount on goods sold?

(A) Amount on the discount column in the credit side of the cash book. (B) Amount on the discount column in the debit side of the cash book. (C) Credit balance in a discount account

(D) Discount found in the payables account

(E) Discount found in the payables account

Use the following information to answer questions 2 and 3

Petty cash book (Extracts)

Debit			Credit
₦	Date	Particulars	Total (₦)
	2016		
400 8,600	April 1	Balance b/d Cash	
	April 30	Sundries Payment	7,200
	April 30	Bal c/d	1,800 (2)

What is the cash float every month?

(A) ₦8,600 (B) ₦7,200 (C) ₦9,000 (D) ₦7,600 (E) ₦400

(3) On 1 May, the petty cashier will be reimbursed with

(A) ₦1,800 (B) ₦7,200 (C) ₦400 (D) ₦8,200 (E) ₦8,600

(4) The following are the aims of good internal control over cash except to

(A) Prevent theft of cash

(B) Maintain the same level of cash always

(C) Maintain proper banking system for cash transactions

(D) Keep optimal level of cash

(E) Ensuring that receipts are issued for cash/cheques received

(5) Which of the following is both a book of original entry and a ledger? (A) Journal

(B) Cash discount

(C) Trade discount (D) Cash book

(E) Sales Day Book

(6) State how a voucher system helps to establish a proper check over cash.

(7) Some steps are involved in the disbursement of cash; the first step is to raise a voucher. List the other two steps.

(8) What specific measure should a business entity take to ensure that it does not pay for the same transaction twice?

(9) An overdraft would be represented by a _______balance in a business entity's cash book

(10) State the two types of transactions that give rise to contra entry in the double column cash book.

7.9 Theory and Calculations

(1)

(a) Highlight four (4) reasons why internal control over cash is important in an entity

(b) Identify six (6) procedures to be employed to have solid internal checks over cash

(2).

(a) Describe the following types of discounts

(i) Trade discount

(ii) Quantity discount

(iii) Discount allowed

(iv) Discount received

(b) Define the following terms in relation to control over cash:

(i) Voucher

(ii) Cash over
(iii) Voucher system
(iv) Voucher register
(ii) Contra entries

(3) Shubomi enterprise began a business with ₦182,000 and the sum was paid into bank on 3 January, 2017.

2017		₦
Jan 4		
	Shubomi introduced the following assets and brought the following liabilities forward into the business:	
	Building	205,000
	Office Furniture	42,500
	Trade Payables	10,500
	Electricity accrued	4,250
Jan 8	Bought goods by cheque	29,214
" 8	Electricity paid with cheque	925
" 8	Good sold on credit to Kunle	34,219
" 8	Received cheque from Kunle	
" 8	after deducting ₦1,711	32,508
" 12	Bought goods on credit	21,105
" 14	Cash sales	41,112
" 16	Cash paid into bank account	29,312
" 21	Paid trade payables after deducting ₦1,818	15,108
" 22	Bought goods on credit	108,420
" 22	Cash Sales	44,450
" 24	Cash withdrew for personal use	12,309
" 26	Paid cash for repairs	1,134
" 26	Goods sold to Jide	84,115
" 26	Purchases – Credit	52,000
	Purchases – Cheque	15,250
	Purchases – Cash	18,450
" 31	Jide paid cheque after deducting ₦1,950	68,905
" 31	Cash sales paid immediately into bank	35,608
" 31	Paid stationery	2,515
" 31	Drew cheque for petty cash	1,500

You are required to:

(a) Three column cash book and other relevant ledgers for the month of January, 2017.

(b) Prepare discount allowed and discount received account.

(c) Prepare the trial balance for the month of January, 2017.

Note: Prepare individual customers account and combine suppliers' account in trade payable account.

Solution to Revision Questions

(1) B

(2) C

(3) B

(4) B

(5) D

(6) A voucher system requires that every transaction for which cash would be paid should be verified, approved and recorded before the cash is paid.

(7) i. Authorisation of payment

ii. Issue of cheque or payment of cash

(8) All invoices relating to the transaction should be stamped paid with the date of payment.

(9) Credit balance.

(10) (i) Paid cash into bank

(ii) Withdrew cash for office use.

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CHAPTER EIGHT

BANKING SYSTEMS AND SERVICES

8.0 Learning objectives

At the end of this chapter candidates should be able to

- Know the types of accounts a business can open with the bank
- Understand interbank transfers
- Understand the role and operations of the electronic fund transfer (EFT)
- Recognize the causes of discrepancy between bank statement and cash book balances.
- Determine the cash available to a business for inclusion in the end of period statement of financial position.
- Prepare a bank reconciliation statement.

8.1 Introduction

In the last chapter we pointed out that one of the ways to guard against loss of cash through theft and fraud is to open and maintain a bank account. Apart from the prevention of theft, a business entity or customer can also enjoy some credit facilities and professional advice from its bank. There are two main types of account a customer may keep with the bank. These are **current account** and **savings account.**

8.2 Current Account

A current account is operated by the use of cheques. Money can be withdrawn from the account anytime without giving prior notice to the banker. For this reason it is called "Demand Deposit." The customer usually does not enjoy any interest on current account balances. In a few cases, little interest may be given by the bank. A current account customer may be granted an overdraft.

A Cheque book containing cheque leaves is issued to the account holder when a current account is opened. The cheque leaves are serially numbered. The holder of the account can issue cheques to pay for goods and services rendered to the business with. However, the cheques must be duly signed by the drawer and the signature must be regular or identical to that on the mandate card.

Money is deposited into the bank account through pay-in-slips. The cheque and pay-in-slip numbers are printed in magnetic ink to facilitate the processing of transactions by the computer.

At intervals, usually every month, the banker sends bank statements to its customers, detailing all cash lodgements, cheques paid, dishonoured cheques, bank charges, direct payments, dividend warrants received on behalf of the customer, etc.

8.2.1 Opening a Bank Current Account

Every business entity is required to open a current account to transact its business. To open a current account, most banks usually request for such items/information as:

(a) A written application to open an account, stating the type and purpose of the account.

(b) Two or more reference letters from people who maintain current accounts with any branch of the bank or other banks.

(c) Two or more passport photographs.

(d) Copy of the Article and Memorandum of Association if it is a corporate organization or deed of partnership for partnership firms and constitution in respect of an un-incorporated body.

(e) An extract of the minutes of the meeting in which the decision to open the account was taken.

(f) An initial deposit as may be stipulated by the bank from time to time.

(g) In some countries evidence of payment of tax by the sole trader, partner or the limited liability company.

(h) Completed specimen signature card

(i) The specimen signatures of the authorized person(s) must be on the mandate card. The signature(s) on cheques are compared with the specimen signature(s) each time the customer wants to make a withdrawal.

8.2.2 Cheques

A cheque is a written order upon a particular banker to pay a certain sum of money to a specified person or entity. There are three parties to a cheque namely

i. The drawer- issues the cheque (Account holder)

ii. The drawee- The bank on which the cheque is written and

iii. The payee- the person to whom the cheque is payable.

One of the means by which a bank customer can have an idea of the balance in his/her account is to record on the cheque counterfoils the amount of money drawn and the amount of money deposited. Another means of knowing the balance is through the amount recorded in the bank columns of the cash book.

8.2.3 Pay-In-Slip

A bank customer fills out pay-in-slip for each deposit usually in duplicate or triplicate. Some pay-in-slips are carbonized, thus providing automatic office copies of the pay-in-slip for posting into the cash book. Pay-in-slips are sometimes referred to as cash lodgement tellers.

Items to be found on a pay –in-slip or cash lodgements teller are:-

i. Date
ii. Name of bank and the branch
iii. Account number
iv. Account name
v. Note and coin denomination
vi. Amount in figures
vii. Amount in words
viii. Total amount
ix. Payer’s name and signature
x. Payer’s telephone number
xi. Mother’s maiden name

Where the pay-in-slip is not the carbonized type, details of cheques are analyzed on the reverse side.

The bank teller or collecting cashier will sign the duplicate copy of the pay-in-slip and puts the bank’s official date stamp on it. This will serve as documentary evidence of the amount deposited. The pay-in-slip can be compared with the amount debited in the cash book. Some banks now also confirm lodgement with machine generated slips.

8.2.4 Dishonoured Cheques

A business may deposit a cheque received from a customer into its bank account but the bank may refuse to honour the cheque for various reasons. A cheque that the banker has refused to pay (for whatever reason) is referred to as a dishonoured cheque.

A cheque may be dishonoured for any of the following reasons:-

i. The cheque is not dated
ii. The amount in words does not correspond to the figure written on the cheque
iii. The balance in the drawer's account is not sufficient to accommodate the amount to be drawn with the cheque.
iv. The cheque has been mutilated
v. The cheque has become stale
vi. Signature on the cheque is irregular
vii. The cheque is post-dated
viii. The cheque is not signed.
ix. Where it is suspected that the cheque has been stolen from the drawer and the bank wishes to seek further confirmation from the drawer as a safeguard.

8.2.5 Stale Cheque

The legal tenure of a properly endorsed cheque is 6 months from the date of issue. A cheque presented after 6 months is said to be stale. A stale cheque when presented to the bank will not be honoured. However, a stale cheque may be re-validated by altering the date but the authorised signatures have to endorse the altered date before the bank will accept to honour it.

8.2.6 Order Cheque

A cheque is described as an order cheque when it is only made payable to the person named on the cheque. The bank can only make payments to the person whose name is written on the cheque. It is not negotiated, that is it cannot be endorsed to another person.

8.2.7 Bearer's Cheque

This refers to cheque paid over-the-counter to a specific name or to the presenter(bearer) of the cheque. A bearer cheque can be a cheque endorsed to another person. That is, it can be passed to another party by mere delivery.

8.2.8 Crossed Cheque

It denotes a cheque that has two transverse lines drawn across the face of the cheque.

This means the cheque can only be paid into the recipient bank's account. It cannot be cashed over the counter in a bank.

8.2.9 Bank's Clearing System

This refers to an established system of settling payments among banks. Clearing of cheques are usually done within 3 working days in Nigeria by a 'clearing house'.

8.2.10 Stop Payment Order

As soon as a bank customer becomes aware that a cheque is lost or stolen, he should issue a stop payment order on the bank immediately. The order should state the serial number of the cheque, the amount and the payee (if already issued and signed).

8.3 Interest Bearing Accounts

Some business organisations transact a large volume of business through their current accounts every month, and they may not be able to earn any interest on their current account balances. Therefore some businesses usually open some other accounts on which they can earn interests; these could be referred to as interest-bearing accounts. These consist of savings accounts and fixed deposit accounts. They will transfer surplus cash from the current account to these accounts to earn interests

8.3.1 Savings Account

This type of account is meant for the small savers to keep their surplus funds. This account is usually opened by individuals such as clubs, associations, salary earners, petty traders etc. A prospective customer who is a salary earner should bring a letter of introduction from his/her employer, upon which he/she will be given the bank's application forms to complete and supply the following information:

His full names and address (Not Postal Office Box)

(i) Business or Occupation

(ii) Specimen signature or thumb print

(iv) Three (3) recent passport photographs, and

(v) Customer's identity card or international passport or driver's license.

(vi) An initial deposit. This varies from bank to bank. The bank then issues the paying-in-booklet to the customer to enter the initial deposit and other subsequent deposits.

Some other distinguishing features of savings accounts are:

(i) No cheques are required for withdrawal

(ii) Customers may not be granted overdraft facilities on this type of account

(iii) Interest is payable on the sum standing to the customer's credit

(iv) The balance standing to a customer's credit on savings account is repayable on demand. However, the bank reserves the right to demand 7 days notice for withdrawals of part or the whole deposit on the account.

(v) Customers must be present physically when withdrawal is made.

(vi) In the past, passbooks were issued to the customer to show both the credit and debit entries of the account. But nowadays, paying-in-slips and withdrawal slips are issued to customers to make deposits to and withdrawals.

(vii) No reference is required for this type of account except where cheques will be paid into the account in the future, but a letter of introduction is required where the account will be used to receive the customer's salary.

8.3.2 Fixed Deposit Account

A fixed deposit account is an account kept with the bank in form of investment for a specific period of time usually 30 days, 60 days, 90 days or 180 days. A fixed rate of interest is payable by the bank on such deposits.

Adequate notice of withdrawal from or termination of the investment must be given to the bank or else the customer forfeits his right to the next interest payable on the investment or suffers penal charge for premature termination.

The features of this type of account are as follows:

(i) The balance standing to a customer's credit on deposit account is repayable at date of maturity but banks usually reserve the right to roll-over the investment and the accrued interest at the prevailing market rate if they do not receive any counter instruction from the accounts holder on or before maturity.

(ii) The customer is not issued with cheque book but with a receipt or certificate indicating the terms and conditions of the deposit e.g. amount fixed, interest rate, date of maturity, etc.

(iii) Both the bank and the customer agree on the terms and conditions of the relationship, such as interest rate, amount and duration of the account.

(iv) No bank statement is issued to the customer.

(v) No reference is taken since the account requires cash transaction. But where lodgement of cheque is anticipated in the future, bank must ensure that references are taken and all the necessary account opening procedures are followed.

(vi) Although, commission is charged by the bank, accrued interest on the investment is subject to withholding tax at the prevailing rate (currently 10%).

8.4 Inter-Bank Transfers

Through the use of computer and the internet, a lot of electronic equipment is now available which enables banks to transfer funds from the account of one customer to another without the need for exchange of paper documents. This electronic equipment is turning the monetary system to a cashless society.

At present in Nigeria, some of the available Electronic banking products are Auto- Teller Machine (ATM), Electronic Fund Transfer (EFT) and Electronic devices such as the Magnetic Ink Character Recognition (MICR).

Apart from the foregoing, there are some other forms of electronic banking including Electronic Fund Transfer At Point of Sales (EFTPOS), Debit Cards and Smart Cards.

We shall now discuss the mode of operation of some of these products.

8.4.1 Mode of Operation of Electronic Banking Products

i) Auto-Teller Machines (ATM)

ATM is a cash dispenser which is designed to enable customers enjoy banking services without coming in contact with the Bank Teller (Cashier). The machine, therefore, performs the functions traditionally reserved for cashiers. It is electronically operated and as such response to request by customers is done instantaneously.

(a) ATM is user-friendly and it guides users through the instructions that have been pre-programmed into it for easy operation.

(b) Access to the ATM is through the use of a Personal Identification Number (PIN) and a plastic card that contains magnetic strips with which the customer is identified. Banks usually handover the PIN personally to the customer who is usually instructed not to disclose the number to a third party.

(c) It is essential for users to ensure that the ATM card is safe and that it is not defaced. Otherwise, it may be rejected by the machine, even where the PIN has been correctly entered.

(d) The first step to take while using the ATM is to insert the Card and thereafter the PIN. Then the customer selects the service required e.g. withdrawal, in which case, he will depress the "Withdrawal Key" and then press the number keys to indicate the amount of money required and the preferred denominations. It is not enough to punch the amount required, it is also necessary to press "ENTER" for the ATM to dispense cash.

Other functions that the machine is capable of performing are:

- Printing of statements
- Provision of account balances
- Transfer of funds
- Payment of bills
- Cash Advances and

- Display of Promotional messages

The objective of introducing the ATM in Nigeria is mainly to decongest the counter.

ii) Electronic Fund Transfer (EFT)

EFT system allows customers account to be (instantly) credited electronically anywhere in the country especially in banks where there is on-line service. It provides a more suitable and cost-effective way of transferring funds when compared with the traditional modes such as Mail/Telegraphic transfers. It is more secure and time saving when money is transferred through EFT. Such money is transferred electronically by the bank through their branches or accredited agents.

iii) Electronic Fund Transfer At Point of Sale (EFTPOS)

This is a system which enables a customer's account to be debited instantly with the cost of purchase in an outlet. The system requires the customer to be an ATM Card holder.

iv) Electronic Card Products (DEBIT CARD)

At present, most banks in Nigeria issue electronic debit cards. Debit Cards are like the EFTPOS that are supposed to be passed to a customer's account immediately.

There are two popular debit cards; the Pass Card and the Smart Card.

(a) Pass Card

This product is processed in an IBM machine by debiting a customer's bank account.

(b) Smart Card

This is a debit card whose micro-chips contain additional information on the bio-data and financial position of the holder.

8.5 Credit Cards

A credit card is a convenient method of payment which embodies two essential aspects of basic banking functions; the transmission of payment and the granting of credits. This type of card is not yet in operation in Nigeria.

Another variant of a credit card is that which provides a bank customer with a revolving credit line via POS, Web and ATMs. The features of this type of card include:

a. Cash withdrawals (through ATM)
b. Purchases (through POS and internet)
c. Convenient access to a revolving line of credit, renewable and available throughout card life span
d. Flexible repayment options – repayment could be in full or in part (subject to interest on outstanding indebtedness).

8.6 Bank Statement

The bank usually sends a bank statement to its customer at the end of every month. The statement contains details of the receipts and payments by and on behalf of the customer for that period. Receipts will include cash paid into the customer's account and those paid by third parties direct into the bank. Until the customer receives the bank statement or a credit advice transaction alert in respect of the direct credit to his bank account, the business may not be aware of it or the amount involved.

Payment or withdrawal will also include details of cheques issued by the customer, bank charges and payments made automatically at given dates on behalf of the customer to third parties by the bank (on the customer's instruction). This is called a standing order.

The balance at the end of the period represents the balance as per bank statement. This balance can be a credit balance (favourable) or a debit balance (overdraft). Remember that in the cash book of the customer, a favourable balance is a debit balance and a credit balance is an overdraft.

8.6.1 Example of a Bank Statement

Illustration 8.2 below is used as an example of a bank statement.

Illustration 8.2

Mr. K. A. Afolabi maintains a current account No. 0023456789 with XYZ Bank Ltd.. The balance on the account as at 31/12/2015 was ₦15,500 credit.

Mr. Afolabi's transactions with the bank in the month of January 2016 were as follows:

(i) ₦10,000 cash deposited on 2/1/2016.

(ii) A cheque of ₦2,500 issued to Mr. Afolabi by one of his receivables was lodged into his bank account on 6/1/2016.

(iii) He drew a 'cash' cheque number 000062 for ₦4,000 on 7/1/2016. The cheque was presented to the bank and payment received on that date.

(iv) He issued a cheque No.000063 for ₦5,000 to one of his payables, Mr. S. O. Babalola on 10/1/2016. Mr. Babalola presented the cheque to XYZ Bank Ltd. on 13/1/2016 and received payment.

(v) Received cheques totalling ₦22,000 from various customers and lodged them into the account on 14/1/2016. All cheques matured for credit to the account on 19/1/2016.

(vi) There was a standing agreement between the bank and Mr. Afolabi that his monthly life assurance premium of ₦2,150 should be paid direct to the insurance company by the bank. The bank remitted this on 25/1/2016.

(vii) A customer living upcountry deposited a cash sum of ₦9,500 into Mr. Afolabi's account No 0023456789 with the local branch of XYZ Bank Ltd. on 27/1/2016. The bank credited Mr. Afolabi's Account the same day.

(viii) On 31/1/2016 XYZ Bank Ltd. debited Mr. Afolabi's account with a service charge of ₦420.50.

You are required to prepare a statement as it would have been prepared by XYZ Bank Ltd reflecting the above transactions

Solution to Illustration 8.2

XYZ Bank Limited

202 Marina, Lagos

Statement In respect of:

Account No:	0023456789
Customer:	Mr. K. A. Afolabi
Period covered:	01/01/2016 – 31/01/2016
Date issued:	05/02/2016

Date	Transaction	Debit	Credit	Balance
		₦	₦	₦
01/01/2016	Balance b/f			
02/01/2016	Cash deposit		10,000	25,500
06/01/2016	Cheque deposit		2,500	28,000
07/01/2016	Cheque No 000062 –cash	4,000		24,000
13/01/2016	Cheques No 000063-	5,000		19,000
19/01/2016	Cheque deposit		22,000	41,000
25/01/2016	Standing Order	2,150		38,850
27/01/2016	Cash deposit		9,500	48,350
31/01/2016	Service charge	420.50		47,929.50

Opening Balance	15,500.00
Total Debit	11,570.50
Total credits	44,000.00
Closing balance	47,929.50

8.7 Bank Reconciliation Statement

The bank and its customer (e.g. a business entity) maintain independent records in respect of the transactions taking place between them. Therefore it is necessary to reconcile the bank statement balance with the bank balance in the cash book to be assured that the two are in agreement on the amount of money deposited and cheques drawn.

Usually the bank column balance in the cash book and bank statement balance are not always in agreement and they need to be reconciled.

The disagreement between the two may be traced to the following factors:-

(a) Unpresented cheques: - These are the cheques drawn on the bank to the payees but have not been presented to the bank for payment. The cash book of the business would have been credited (that is, it has been treated as payment through the bank by the business). This transaction would appear on the credit side of the cash book but missing from the debit side of the bank statement.

(b) Uncredited cheques: - These are cheques deposited in the business bank account and not yet recorded in the bank statement until three or four days thereafter, whereas it would have been recorded on the debit side of the cash book.

The transaction will appear on the debit side of the cash book but missing from the credit side of the bank statement.

(c) Bank charges: These are charges made by the bank to cover the expenses in handling bank account. The major charges are based on the volume (i.e. turnover) of the transactions on the account. It is sometimes called commission on turnover (COT). Other charges are charges for cheque book, interest charges on bank overdraft facilities from the bank, administration expenses etc.

These charges would have been recorded in the bank statement but will be missing on the credit side of the cash book.

(d) Standing Order: This is where the business entity has instructed its bank to make regular amounts of money at given dates to some other third parties. On due dates, the bank would have made the payments but the fact will not be known to the business. An example is where a business instructs its bank to make regular payments of insurance premiums on its policies to its insurance company. The bank would show the debit entries on the bank statement but the credit entries will be missing on the cash book of the business.

(e) Direct Debits: These are direct payments of expenses on behalf of the business by the bank, e.g electricity bills and telephone bills. These have the same effect as the bank charges.

(f) Direct Credits: These are amounts received on behalf of the business directly by the bank. The bank account would have been credited and shown on the bank statement but the entry will be missing from the debit side of the cash book e.g dividends on investments.

(g) Error of the customer or of the bank

8.7.1 Steps Involved In Reconciling the Discrepancies

(a) Tick items on the debit side of the cash book against items on the credit side of the bank statement. Outstanding items on the debit side of the cash book that are missing on the credit side of the bank statement are uncredited lodgements. List them out.

(b) Tick items on the credit side of cash book against items on the debit side of the bank statement. Items outstanding on the credit side of the cash book but missing on the debit side of the bank statement are unpresented cheques. List them out.

(c) The remaining items on the debit side of the bank statement are bank charges and standing orders. List them out.

(d) The remaining items on the credit side of the bank statement are amounts paid into the bank directly for the benefit of the business entity by its customers (i.e. direct credits).

(e) After all these have been adjusted, it should be possible to reconcile the cash book balance with the balance on the bank statement. If it is not, then there are some errors which further investigation would reveal and be traced to their sources.

8.7.2 Preparation of the Bank Reconciliation Statement

Two main steps are involved in the preparation of a bank reconciliation statement.

(1) Determine the adjusted cash book balance. This adjustment will not be affected by items (a) and (b) above. The adjustment will be affected mainly by items (c) and (d).

(2) Reconciling the adjusted cash book balance with the bank statement balance.

Step 1 - Determining the adjusted Cash Book Balance

Format

Cash Book (with Adjustment)

	₦		₦
Direct credit	x	Direct debits	x
Balance b/d	x	Standing order	x
		Cheque earlier lodged now dishonoured	x
Add: - Direct Credit	x	Bank charges	x
Understatement	x	Overstatement of cash	x
	_	Adjusted cash balance	x
	xx		Xx

The adjusted cash book balance is the amount that will be shown in the statement of financial position as balance at bank (current asset).

Step 2 - Reconciling the adjusted cash book balance with the bank statement balance.

	₦
Adjusted Balance as per cash book	xx
Add: Unpresented cheques	xx
Error of overstatement by bank	xx
	xx
Uncredited cheques	(xx)
Error reducing the business balance committed by bank	(xx)
Balance as per bank statement	xx

Using an Alternative Method

	₦
Balance as per bank statement	xx
Add: Uncredited cheques	xx
Bank error reducing cash balance	xx
	xx
Unpresented cheques	(xx)
Bank error overstating cash balance	(xx)
Adjusted Balance as per cash book	xx

Illustration 8.3

The following bank account and bank statement relate to the firm of Mohammed and Sons for the period of 1 to 12 September, 2016.

Bank Account

2016		₦	2016		₦
Sept 1	Bal b/f	6000	Sept 2	Cheque Owen	400
3	Cash	500	2	Cheque Peter	150
5	Cheque Kuku	85	6	Cheque Ringo	105
7	Cheque Labe	220	8	Cheque Smith	365
9	Cheque Michael	155	10	Cheque Thomas	1,120
11	Cheque Ndidi	36	12	Balance c/d	5,180
		7,320			7,320
	Balance b/d	5,180			

Bank statement as at 12 September, 2016

2016		Debit ₦	Credit ₦	Balance ₦
Sept 1	Balance			6,000
2	Cheque no. 98876	400		5,600
3	Cash		500	6,100
4	Charges	20		6,080
5	Cheque deposits		85	6,165
6	Cheque no.98877	150		6,015
7	Cheque deposit		220	6,235

8	Cheque deposit (by Umoru)		600	6,835
9	Cheque dishonoured	85		6,750
10	Standing order (Insurance Premium)	560		6,190
11	Cheque 98878	105		6,085

You are required to:

(a) Effect the necessary adjustments to the bank account and prepare the adjusted balance.

(b) Prepare a Bank Reconciliation Statement

Solution to Illustration 8.3

(A) Adjusted Cash Book

Date	Sept 2016	₦	Sept 2016	₦
	Balance b/d	5,180	Bank charges	20
	Direct credit (Umoru)	600	Standing Order	560
			Dishonoured cheques	85
			Bal c/d	5,115
		5,780		5,780
	Balance b/d	5,115		

(B) Bank Reconciliation Statement at 12 September, 2016

			₦
Adjusted balance as per cash book			5,115
Add:- unpresented cheques:-			
	Smith	365	
	Thomas	1,120	1,485
			6,600
less:- Uncredited cheques:			
	Micheal	155	
	Ndidi	360	515
Balance as per Bank statement			6,085

Illustration 8.4

The following is the summary of the cash book of Akintola Enterprises for the month ended

31/12/2016

Cash Book

	₦		₦
Balance b/d	2,110	sundry payments	23,280
Sundry receipt	22,610	Bal. c/d	1,440
	24,720		24,720
Balance b/d	1,440		

On investigation the following errors were discovered.

i. Bank charges of ₦53 on the bank statement had not been entered in the cash book.

ii. A cheque drawn for ₦27 by the enterprise had been returned by the bank marked "Returned to drawer" but this had not been recorded in the cash book.

iii. The opening balance in the cash book was wrongly brought down as ₦2,110 instead of ₦2,205.

iv. The cash book showed a deposit of ₦2,178 which had not yet been credited to the account by the bank.

v. The bank had debited a cheque for ₦108 in error to the entity's account. vi. The bank statement showed an overdrawn balance of ₦50

vii. A payment of ₦70 cheque was treated as a receipt in the cash book.

viii. Three cheques issued to suppliers for ₦321, ₦555 and ₦45 had not been presented for payment.

You are required to

(a) Write up the cash book.

(b) Prepare a bank reconciliation statement.

Solution to Illustration 8.5

(a) Akintola Enterprises
Adjusted Cash Book

	₦		₦
Balance b/d	1,440	Bank Charges	53
Difference in opening bal.	95	Error in cheques drawn	140
		Dishonoured cheque	27
		Balance c/d	1,315
	1,535		1,535
Balance b/d	1,315		

(b) Bank Reconciliation Statement at 31 December 2016

	₦	₦
Adjusted balance as per cash book		1,315
Add: unpresented cheques	321	
	555	
	45	921
		2,236
Less: Uncredited cheque	2,178	
Debit in error by the bank	108	2,286
Balance as per Bank Statement (Overdraft)		(50)

Note: Payment of ₦70 cheque recorded in error as receipt gave a correction of ₦140 in the cash book because the error will be cancelled first before the ₦70 is reinstated on the credit side.

Illustration 8.5

The following information was extracted from the records of a petty trader as at 30 June 2016.

Balance as per Bank Statement was ₦1,000 credit. Cash Book balance showed ₦37,000 credit in the Bank Account column.

The following had been reflected in the Bank Statement but not in the Cash book.

Bank charges	₦5,000
Bank loan interest	₦1,000
Interest from investments	₦2,000
Dividends from shares	₦12,000

In addition, a cheque for ₦20,000 issued to Kete was dishonoured because of insufficient fund. Another cheque for ₦30,000 issued to Jimoh remained unpresented. A cheque for ₦20,000 from Kudiratu was yet to be credited

You are required to produce an adjusted Cash Book and then a Bank Reconciliation Statement as at 30 June 2016.

Solution to Illustration 8.5

Adjusted Cash Book Account

	₦		₦
Interest on Investments	2,000	Balance b/f	37,000
Dividends	12,000	Bank charges	5,000
Kete (dishonoured Cheque)	20,000	Interest on loan	1,000
Balance c/d	9,000		
	43,000		43,000
		Balance b/d	9,000

Bank Reconciliation Statement as at 30 June 2016

	₦
Adjusted Cash Book Balance	(9,000)
Add: unpresented cheques	30,000
	21,000
Less: Uncredited cheque	20,000
Balance per Bank statement	1,000

Illustration 8.6

The following Cash Book and Bank Statement were extracted from the records of Dugbe Alawo Enterprise as at 31 January 2017.

Cash Book on 31 January 2017

Date	**Details**	**Cheque No.**	**Amount ₦**	**Date**	**Details**	**Cheque No.**	**Amount ₦**
3/1/17	Bal b/d		18,500	6/1/17	Owen	000666	4,595
4/1/17	Elijah	007605	1,980	9/1/17	Mikel	000667	1,450
6/1/17	Roland	101005	3,700	16/1/17	George	000669	1,430
16/1/17	Bright	202808	3,600	27/1/17	Obama	000670	2,105
31/1/17	Bush	404003	2,880	31/1/17	Bal c/d		21,080
			30,660				**30,660**
31/1/17	Bal b/d		21,080				

Dugbe Alawo Enterprise
Bank Statements on 31 January 2017

Date	**Details**	**Cheque No.**	**Debit** ₦	**Credit** ₦	**Balance** ₦
4/1/17	-		-	-	18,500
5/1/17	Elijah	007605	-	1,980	20,480
9/1/17	Roland	101005	-	7,300	27,780
17/1/17	Mikel	000667	1,450	-	26,330
30/1/17	Obama	000670	2,105	-	24,225
30/1/17	Credit Transfer		-	1,680	25,905
30/1/17	Dishonoured cheque	007605	1,980	-	23,925
31/1/17	Cheque	909808	1,560	-	22,365
31/1/17	Bank charges		548	-	21,817
31/1/17	Standing Order		5,560	-	16,257
31/1/17	Bank charges		28	-	16,229
31/1/17	VAT on charges		29	-	16,200

Note: Cheque number 101005 had been transposed in error in the Cash Book as ₦7,300. Also, cheque number 909808 was debited in error in the Bank Statements.

You are required to prepare Dugbe Alawo Adjusted Cash Book and Bank Reconciliation on 31 January, 2017

Steps to be followed:

a. Prepare Adjusted Cash Book:

(i) Check debit entries in the Bank Statement not credited in the original cash book; credit these in the Adjusted Cash Book. These are:

	₦
Dishonoured cheque	1,980
Bank charges	548
Standing order	5,560
Bank charges	28
VAT on charges	29

(ii) Check credit entries in the Bank statements not debited in the original cash book; debit this in the Adjusted Cash Book. This is:

	₦
Credit Transfer	1,680

(iii) Correct transposition errors made in the Cash Book – Roland (₦7,300 – ₦3,700 = ₦3,600)

Since the amount is understated in the cash book, debit ₦3,600 into Adjusted Cash Book.

b. Prepare the Bank Reconciliation Statement:

(i) Use either closing balance in the original cash book (₦21,080) or closing balance in the Bank Statements (₦16,200).

(ii) If the closing balance in the original cash book is used, add unpresented cheques and deduct uncredited cheques.

(iii) If the closing balance in the Bank Statement is used, adjust bank errors (₦1,550), add this back to the closing balance, add uncredited cheques and deduct unpresented cheques.

(iv) Identify uncredited cheques by checking cheques received (debited) in the original cash book but not credited in the bank statement; where these cheques were not on the credit column of the bank statements, the cheque will be described as uncredited cheques. They are:

	₦
Bright – Cheque number 202808	3,600
Bush – Cheque number 404003	2,880
	6,480

(v) Identify the unpresented cheques by checking cheques that had been issued to customers, credited in the original cash book but not on the debit side of the bank statements. These cheques are described as unpresented cheques. They are:

	₦
Owen - Cheque number 000660	4,595
George - Cheque number 000669	1,430
	6,025

(vi) Reconcile all bank statements and cash book errors.

(vii) Prepare the Adjusted Cash Book to determine debit items credited in the bank statements but not debited in the original cash book because the cash book keepers did not have information about the transactions.

It also includes correction of errors in the original cash book: These are:

	₦
Bank charges	548
Standing Order	5,560
Bank charges	28
VAT on charges	29
	6,165

The items are all direct debit in the bank statements not credited in the cash book. These items are credited in the Adjusted Cash Book. This also includes dishonoured cheque 007605, earlier credited in the Bank Statements but now reversed as a result of unavailability of funds in Elijah's account in the bank, instructions not to pay the cheque and non-conformity with other banking procedures.

(viii) Correct errors in cash book (₦7,300 – ₦3,700) debiting Adjusted Cash Book.

(ix) Determine direct credit in the bank statements not debited in the original cash book, this is:

	₦
Credit Transfer	1,680

This is debited in Adjusted Cash Book.

(x) Prepare the Bank Reconciliation Statements.

Solution

Adjusted Cash Book

	₦		₦
Bal b/d	21,080	Bank charges	548
Errors in cash book		Standing Order	5,560
		Bank Charges	28
(₦7,300 – ₦3,700)	3,600	VAT on charges	29
Credit Transfer	1,680	Dishonoured cheque	1,980
		Bal c/d	18,215
	26,360		26,360
Bal b/d	18,215		

Dugbe Alawo Enterprise
Bank Reconciliation Statements on 31 January 2017

	₦	₦
Balance as per Bank Statements		16,200
Add:		
Cheque No: 909,808		1,560
		17,760
Add: Uncredited cheques:		
Bright	3,600	
Bush	2,880	6,480
		24,240
Less: Unpresented cheques:		
Owen	4,595	
George	1,430	
		6,025
Balance as per Cash Book		**18,215**

Dugbe Alawo Enterprise
Alternative Presentation: Bank Reconciliation 31/1/2017

	₦	₦
Balance as per Adjusted Cash Book		18,215
Add: Unpresented cheques:		
Owen	4,595	
George	1,430	6,025
		24,240
Less: Uncredited cheques:		
Bright	3,600	
Bush	2,880	6,480
		17,760
Less: Amount deducted in error		
Cheque number 909808		1,560
Balance as per Bank Statements		16,200

In February, 2017, Dugbe Alawo Enterprise should ensure ₦1,560 debited in error should be credited back to the Bank Statements.

8.8 Review Questions
Multiple choice and short-answer questions

(1) Which of the following reconciliation items will affect the cash book balance?
I. Bank error overstating the bank balance
II. Cash book error, overstating the bank balance
III. Income received through the bank
IV. Imprest cheques
(A) I and II
(B) II and III
(C) II and IV
(D) I and III
(E) III and IV

(2) The cash book of a trader shows an overdrawn account. Which of the following will reduce the balance when the necessary recordings are completed?
(A) Bank charges
(B) Unpresented cheques
(C) Uncredited cheques
(D) Dividend received by bank on behalf of customer.
(E) Bank debit note

(3) Name the two main steps involved in preparing the bank reconciliation statement.

(4) When a customer's cheque that is lodged is dishonoured by the bank, what is the effect on cash balance?

(5) Name the account that a business normally maintains with a bank when it has fund for investment for a relatively long period.

Use the following information to answer questions 6 & 7

Given:

		₦	
i.	Balance as per cash book	223,760	DR
ii.	Dividend received by bank on behalf of customers	1,170	
iii.	Bank charges	360	
iv.	Unpresented cheques	21,600	
v.	Uncredited cheques	33,300	
vi.	Total lodgements credited by the bank	750,000	

(6) Determine the Adjusted Cash Book Balance

(7) Determine the balance as per bank statement.

Solution to Revision Questions

(1) B

(2) D

(3) i. Determining the correct cash book balance

ii. Reconciling the adjusted cash book balance with the bank statement balance

(4) It will reduce the cash balance

(5) Fixed deposit account

(6) ₦242,570 (i.e. ₦223,760 + ₦21,170 – ₦2,360)

(7) ₦212,870 (i.e. ₦24,570 + ₦21,600 – ₦33,300)

Practice Questions

Multiple Choice and Short Answers Questions

(8) Which of the following kind of cheques describe customer's cheque not honoured in the bank?

(A) Stale cheque
(B) Crossed cheque
(C) Order cheque

(D) Dishonoured cheque
(E) Bearer cheque

(9) Which of the following cheques cannot be endorsed from one person to another?

(A) Bearer cheque
(B) Order cheque
(C) Crossed cheque
(D) Stale cheque
(E) Dishonoured cheque

(10) A cheque that has been recorded as a credit entry in the original cash book but not yet recorded as a credit entry in the bank statement is known as:

(A) Crossed cheque
(B) Dishonoured cheque
(C) Uncredited cheque
(D) Unpresented cheque
(E) Crossed cheque

(11) Write short notes on the following:

(a) Credit card
(b) Electronic Fund Transfer (EFT)
(c) Automatic Teller Machine (ATM)
(d) Stale Cheque
(e) Bank's Clearing System

(12) Cash Book of Favour Ventures on 31/1/2016

		₦			₦
4/1/2017	Bal b/d	29,000	4/1/2017	Oliver	12,500
	Revenue	15,000	9/1/2017	David	7,500
12/1/2017	Abraham	5,000	16/1/2017	Jacob	2,500
30/1/2017	Sales – cheque 501	30,000	30/1/2017	PAYE	2,500
31/1/2017	Sales – cheque 101	15,000	30/1/2017	Pension	2,500
			30/1/2017	Emmanuel	1,000
			Bal c/d		65,500
		94,000			94,000
Bal b/d		65,500			

Favour Bank Statements on 31/1/207

Date	Details	Cheque No.	Debit ₦	Credit ₦	Balance ₦
4/1/17	Balance b/f	-	-	-	29,000
16/1/17	Abraham	-	-	5,000	34,000
17/1/17	Owen	-	12,500	-	21,500
18/1/17	Deposit	501		30,000	51,500
19/1/17	David		7,500	-	44,000
19/1/17	Standing Order		1,000	-	43,000

30/1/17	PAYE	2,050	-	40,950
30/1/17	Commission on transactions	115	-	40,835
31/1/17	VAT	6	-	40,829
31/1/17	sms alert	105	-	40,724

Note: The cashier made transposition errors in recording PAYE in the Cash Book.

You are required to prepare Favour Ventures Adjusted Cash Book and Bank Reconciliation Statements on 31 January, 2017.

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CHAPTER NINE

PAYROLL ACCOUNTING

9.0 Learning Objectives

After you have studied this chapter, you should be able to:

- Define and explain payroll.
- Explain the difference between gross salary, net salary and take-home pay.
- Explain and calculate the difference between employee's and employer's social security contributions.
- Calculate the net salary or net pay of an employee where his or her gross pay, statutory and other deductions and personal income tax schedule are given.
- State the control procedures required in the management of payroll.
- Demonstrate ability to record payroll activities in the accounting records of a business organisation.

9.1 Introduction

In this chapter you will learn how to calculate the wages and salaries of employees and the various deductions that are made from the gross pay before calculating the income tax. You will also learn how to use the Progressive Personal Income Tax Schedule to calculate the income tax of an employee. You will learn why statutory deductions like social security contributions are made and how they are calculated. Finally you will learn what types of reliefs are available to employees and how they are adjusted before the employees' net pay is calculated.

9.2 Payroll

Payroll may be defined as a record showing the names of employees, rates of pay, hours worked, bonuses, allowances, gross earning (salaries), statutory deductions and other deductions during a given pay period. In simple terms, payroll may be understood as a document showing for each worker his gross earning, any deductions (statutory and otherwise) made from his gross earnings and the net amount payable to him in a particular pay period.

The objectives of payroll accounting are to process information such as; Hours Worked, Pay Rate, Gross Earning, Deduction and Net Pay (salary). Business organisations record information relating to employees' pay due to the following:

1) Payroll usually constitutes the most significant or material obligation or expense in most business entities.

2) Business entities are required by law to send returns on their payroll including the amount of income tax deducted at source to the tax authorities.

3) It is used for cost control purposes, usually in the form of variance analysis.

4) It is also the basis upon which most tax clearance certificates are prepared.

Employees are usually paid either a wage or a salary. Wages refer to the type of employee remuneration package that is time based. In this situation the rate of pay is given as a fixed amount per hour for the number of hours actually worked or of those who reported for duty. Salary, though time based, is quoted on an annual basis.

In Ghana and Nigeria all employees are taxed under the PAYE (Pay-as-You Earn) system. This is a form of withholding tax system where the employer is legally required to deduct at source the income tax and social security contributions from the wages or salaries of employees and pay the same to the appropriate authorities. This therefore means that the employee will not have to wait till the end of the year for him to personally pay his tax liabilities to the state. The PAYE tax is a monthly phenomenon which is seen as an estimate and as such may result in overpayment or underpayment of an employee's income tax liability at the end of the year.

9.3 Gross pay or earning is the total emolument or, pay/salary or total weekly wage that employees earn in a particular period before statutory and other deductions are made. In Nigeria and Ghana, gross pay is the consolidated income of an individual earned from employment. The consolidated salary of an employee may consist of the following components:

- Basic Salary
- Leave allowance
- Responsibility allowance
- Transport allowance
- Overtime allowance
- Risk allowance

The two main remuneration methods often used are: Time based system and Piecework system. Others include: Straight salary, bonuses, commission and allowances.

9.4. Methods of calculating Gross pay

Methods of remuneration refer to the basis used in calculating wages of workers. In the preparation of payroll, the organisation must initially determine the employee's Gross Salary or wages using the most appropriate remuneration plan adopted by the entity.

9.4.1 Time Based System

In this system of remuneration, employees are paid according to number of hours actually worked multiplied by a fixed amount or rate. This simply means that the longer the period for which an employee works, the larger his or her gross pay will be. This method of remuneration is usually employed in the manufacturing industries. The payment to the employees is based on this formula:

Earnings = Clock hours x Rate per hour

Advantages

- It is simple to understand and administer
- Wage negotiations (changes) can be easily effected
- It has stood the test of time
- It provides incentive for longer period of work
- It facilitates cost control

Disadvantages

- There is no incentive to improve productivity and efficiency
- It is not a sound accounting practice to pay all employees in the grade the same rate irrespective of performance.
- Cost of supervision under this method is very high
- It is not a very good basis for cost control.
- It does not encourage innovation.

9.4.2 Performance related Systems

Under this system, the remuneration in terms of wages or salaries that is paid to each employee is dependent on his or her level of output, performance or services rendered. Workers are normally given a fixed sum per unit of output so that the higher one's output the larger one's gross pay or salary. Casual labourers, cooks, painters, contractors, etc. are often paid by this method. The payment to the employee is based on the formula below:

Earnings = Number of units produced x rate per unit

Advantages

- It attracts higher grade workers
- It provides direct incentive for innovations, efficiency and high productivity without the difficulties associated with individual piecework rates, schemes.
- It is simple to understand and administer.
- It facilitates cost control.
- It has stood the test of time.

Disadvantages

- Cost of output may exceed budget if proper supervision is not carried out.

  It results in competition for higher grade workers thereby increasing the cost per output.
- Shoddy work or inferior goods may be made, if there is no proper supervision.
- It does not take into account individual disabilities, or abilities.

9.4.3 Straight Salary

Under this method of remuneration, employees are paid a fixed amount annually with a constant increase per annum. This is usually stated as follows:

Gross Pay = ¢10,000,000 x¢ 2,000,000 – ¢18,000,000.

The above statement means that this employee will receive ¢10,000,000 for the first year of his engagement. Thereafter his gross pay will increase by ¢2,000,000 every subsequent year following the date of his employment. This increment will continue until when it gets to ¢18,000,000. Thereafter, only if he is promoted will he earn further increments.

It must however be noted that the gross pay under this method does not depend on the number of hours worked or output produced.

9.4.4 Bonus Schemes

These are schemes which are used by employers to reward exceptional performance of employees. Bonuses are paid in addition to the normal earnings mentioned above. Such incentives vary from one company to the other. The main purpose of providing these incentives is to encourage workers to produce their best for the company.

9.4.5 Types of Bonus Schemes

9.4.5.1 Halsey Premium Plan

This plan was introduced by F. A. Halsey in 1891. The plan simply combines the time and piece rate systems. The main features of this plan are as follows:

a. Workers are paid at a rate per hour for the actual time taken to perform a task.

b. A standard time is set for each piece of work, job or operation.

c. If a worker takes standard time or more than the standard time to complete his work, he is paid wages for the actual time taken by him at the time rate.

d. If a worker takes less than the standard time, he is paid a bonus equal to 50 % of the time saved at the time rate fixed.

Under this system, total earnings of a worker are equal to wages for the actual time taken by him plus a bonus. The formula for calculating bonus and total earnings under this incentive plan is:

Bonus = 50% of [Time saved x Time rate]

Total earnings = Time rate x Time taken + 50% of [Time saved x Time rate]

Illustration 9.1

Standard time (or Allowed time) = 250 hours.

Wages rate per hour = ¢15

Actual time taken = 220 hours

Thus time saved = 250hrs – 220hrs = 30hrs.

Bonus = 50% [30hrs x ¢15] = ¢225

Total earnings = ¢15 x 220hrs + 50% [30hrs x ¢15] = ¢3,525

Advantages of Halsey Plan.

1. It is easy to understand.
2. It guarantees a minimum time wages to all the workers. This means that slow or lazy and relatively inefficient workers have nothing to fear on the plan.
3. The benefits resulting from saving in time is equally divided between workers and the employer.

4. Bonus is separately calculated for each job. As a result any time saved by a worker on a particular job is not adjusted against excess time taken by him on another job.

Disadvantages of Halsey Plan

1. Workers do not like the employer to share the benefits of time saved by them.
2. It does not provide the employer with full protection against high rate setting.
3. Extra efficiency of a worker is not fully recognised and rewarded.

9.4.5.2 Rowan Plan

This plan is similar to the Halsey incentive plan mentioned above. The difference lies in the calculation of bonus. The main features of Rowan Plan are as follows:

a. Wages are paid on time basis for the actual time worked by the worker
b. A standard time is determined for each piece of work or job.
c. If a worker completes his work in standard time or in more than the standard time, he is paid wages for the time actually taken by him.
d. If a worker completes his work in less than the standard time, he is entitled to a bonus.
e. The Bonus is calculated as the proportion of wages of actual time taken which the time saved bears to the standard time.

The formula for calculating bonus and total earnings under this incentive plan is:

$$\text{Bonus} = \frac{\text{Time saved}}{\text{Time allowed}} \times \text{Time taken} \times \text{Time rate}$$

$$\text{Total earnings} = (\text{Time taken} \times \text{Time rate}) + \text{Bonus}$$

Illustration 9.2

Standard time (or Allowed time) = 250 hours.

Wages rate per hour = ¢15

Actual time taken = 220 hours

$$\text{Bonus} = \frac{30 \text{ hrs}}{250 \text{ hrs}} \times 220 \text{ hrs} \times ¢15 = \underline{¢396}$$

$$\text{Earnings} = (220 \text{ hrs} \times ¢15) + ¢396$$
$$= ¢3{,}300 + ¢396 = \underline{¢3{,}696}$$

Advantages of Rowan Plan

1. Just like Halsey plan, it provides guaranteed minimum wages to workers.
2. It protects the employers against loose rate setting.
3. It pays a higher bonus than that under the Halsey plan up to 50% of the standard time saved.
4. The worker is not induced to rush through the work if time saved is more than 50% of the standard time, the bonus increases at a decreasing rate.
5. It provides good incentives for comparatively slow workers and beginners.

Disadvantage of Rowan Plan

1. The calculation of bonus is complicated and may not be easily understood by workers who may suspect the employers' motives.
2. In case of extra efficient workers, bonus is less than under Halsey Plan. This is true when the time saved is more than the time taken.

9.4.5.3 Comparison of Halsey Plan and Rowan Plan

1. **Bonus:** When time saved increases, bonus under Halsey Plan also keeps increasing. But under the Rowan Plan, when time saved increases, bonus increases only when time saved is up to 50% of the standard time allowed. Thereafter the amount of bonus begins to decline. Bonus under the two plans is the same when time saved is exactly 50%. Before 50% of standard time saved, bonus under Rowan Plan is higher than that of Halsey Plan and after 50% of the time saved, bonus under Rowan plan is lower than that of Halsey Plan. For example under Rowan plan, a person who has saved 60% of time allowed earns the same amount of bonus if he saves 40% of the time allowed.

2. **Earnings per hour:** Under both plans earnings per hour of workers keep on increasing,but the rates of earnings under the two plans differ. When time saved is less than 50% of time allowed , the rate of increase in per hour earnings is higher in Rowan Plan whereas when time saved is more than 50% of time allowed , the rate increase in per hour earnings is higher in Halsey Plan. At 50% time saved, earnings per hour under both schemes are the same.

3. **Effect on labour cost**: Labour cost per unit decreases as production increases up to the standard time allowed; thereafter, it continues to decrease but not at a faster rate.

Rowan plan cost per unit is higher than under Halsey Plan until time saved is 50% of time allowed. Thereafter it is lower and soon becomes significantly lower. At 50% time saved, labour cost per unit is the same under both plans.

9.5 Allowable deductions and reliefs

These are statutory deductions and others that are expected to be deducted from the gross salary of an employee at the end of a given period. In Ghana, these deductions include the following:

a. Income Tax
b. 5% of employee's pay for Social Security Contributions
c. employees' provident fund
d. Any percentage contribution towards a Special retirement fund by an employee
e. Medical Insurance
f. Union/Senior Staff Dues or Welfare Fund Contributions
g. Repayment of Employees Advances or Loan from Employers
h. Hire Purchase Deductions
i. Others

The first two deductions (income tax and social security contribution) are compulsory in Ghana. However, the other deductions will depend on the regulations of the company in question and the employee's own preferences.

In Nigeria, the deductions are similar to what you have in Ghana in many respects. Some of the deductions include:

Income tax

a. 8% of employee's gross pay for contributory pension
b. Medical insurance
c. Union dues/welfare contributions
d. Cooperative contributions/loan repayments
e. Others

9.6 Net Pay

This is the excess of the gross pay or salary over deductions. It is often called disposable income or "take home pay". It is the pay the worker actually takes home for a given period.

At the beginning of each Government fiscal year (1^{st} January in the case of Ghana), the Minister of Finance presents the Budget to Parliament. In Nigeria, the President presents the Appropriation bill to the National assembly a few months before the commencement of a fiscal year (1^{st} January). After due processes the bill is passed into law and becomes the Appropriation Act.

The budget statements contain the rates of income tax and any deductible reliefs for the following year. Due to the annual changes in rates and reliefs, the rates of income tax used in the computations in this book are for illustration purposes only. The calculation of income tax and net pay is as follows:

Income tax:

	¢
Basic Salary	xxxxx
Add Other Cash allowances	xxxxx
Total Consolidated Salary	xxxxx
Less Statutory deductions and reliefs	xxxxx
Taxable Pay or Salary	xxxxx
Income Tax = (Taxable pay x rate of tax)	xxxxx

Net Pay:

Total Consolidated Salary	xxxxx
Less Statutory deductions	xxxxx
Taxable pay or salary	xxxxx
Less:Income Tax	xxxxx
Net Pay or Salary	xxxxx

Illustration 9.3

Mr Victor Kakapo has been in the employment of Pacheco Limited since 1 January, 2016 on a salary scale of ¢50,000,000 per annum. For the year 2016 his entitlements were as follows:

	¢
Inconvenience allowance	5,000,000
Leave allowance	3,000,000
Risk allowance	4,000,000

He is married with two children attending secondary schools in Ghana. He contributes to the social security scheme. He qualifies for the following reliefs:

	¢
Marriage	300,000
Child education	480,000
Aged dependent relatives - two	400,000

You are required to calculate Mr. Victor Kakapo's Income tax and Net pay in 2016 using the income tax rates below:

	Income	Tax rate
	¢	
First	1,800,000	0%
Next	1,800,000	5%
Next	4,800,000	10%
Next	27,600,000	15%
Next	33,000,000	20%
Exceeding	69,000,000	28%

Computation of Mr. Victor Kakapo's Taxable Pay

	¢	¢
Basic Salary (2016)		50,000,000
Inconvenience allowance		5,000,000
Leave allowance		3,000,000
Risk allowance		4,000,000
Consolidated Salary		62,000,000
Less Statutory deductions & reliefs:		
5% Social security	2,500,000	
Marriage allowance	300,000	
Child education	480,000	
Aged dependent	400,000	3,680,000
Taxable Pay		58,320,000

Computation of Mr. Victor Kakapo's Income Tax

	Income	Tax rate	Tax amount
	¢		¢
First	1,800,000	0%	-
Next	1,800,000	5%	90,000
Next	4,800,000	10%	480,000
Next	27,600,000	15%	4,140,000
Next	22,320,000	20%	4,464,000
Total	58,320,000		9,174,000

Therefore Victor Kakapo's Net Pay for 2016 is:

Basic Salary		50,000,000
Add Cash allowances		12,000,000
Total Consolidated Salary		62,000,000
Less:		
5% Social security	2,500,000	
Income tax	9,174,000	11,674,000
Net Pay or Salary		50,326,000

9.7 Accounting Entries

For the purpose of Accounting, the entries in the pay slips are passed in through the general journal to record the payments made at the end of the given pay period.

1. When Liabilities/Expenses are due
   - Debit Wages/Salaries Account with the Gross Salary.
   - Credit Provident Fund Account.
   - Credit Income Tax Account.
   - Credit Medical Insurance Account
   - Credit Union Dues Account
   - Credit any Other Deduction Account
   - Credit Payroll Payable Account with Net Salary or Wages.
   - Credit 12.5% Employer's Social Security Fund Account
   - Debit Employer's Social Security expenses Account (i.e. contribution)

2. When Expenses or Liabilities are Paid

   - Debit provident fund account and credit Cash/Bank account with the amount paid
   - Debit Income tax account and credit cash/bank with the sum paid.
   - Debit any other deduction account and credit cash/bank account with the amount paid.
   - Debit payroll payable account and credit cash/bank account with the amount paid.
   - Debit 12.5% Employer's Social Security Fund Account and credit cash or bank account with the amount paid.

SALARY JOURNAL
MONTH OF JANUARY 2016

Date	**Particulars**	**Fol**	**Dr**	**Cr**
2016 January 31			₦	₦
	Wages and Salaries A/c		xx	
	Provident Fund			xx
	Union Dues			xx
	Other deductions			xx
	Income Tax			xx
	Net pay			xx
	Payroll summary for the month of		xx	xx
	Provident Fund		xx	
	Medical Insurance		xx	
	Union Dues		xx	
	Other deductions		xx	
	Income Tax		xx	
	Net pay		xx	
	Bank			xx
	Payment of staff salaries and allowances for the month of		xx	xx

9.8 Multiple Choice Questions

1. Which document contains details of gross earnings made and the amount of net earnings payable to a specific employee in a particular pay period?.

   a. Payroll
   b. Wages sheet
   c. Pay slip
   d. Payment voucher
   e. Salary control register

2. Which of the following payroll deductions is influenced by statutory legislation?
   a. Union dues
   b. Income tax
   c. Co-operative contribution
   d. Salary advance
   e. Loan refund

3. Which of the following is not a function of a payroll voucher?

   a. It gives evidence that an employee has collected his salary
   b. It shows the date of payment of wages and salaries
   c. It is used to collect salary on behalf of an employee
   d. It shows the total deductions from the gross salary.
   e. It shows net salary payable

Use the information below to answer Questions 4 and 5.

Victor Akakpo works with a company which operates Rowan Bonus scheme to reward its workers. His rate per hour is fixed at ¢250 with a standard time of 12 hours to perform a job.Actual time spent by him to complete the job is 9hours.

4. What is the bonus paid to Victor Akakpo?
   a. ¢ 364
   b. ¢ 452
   c. ¢ 545
   d. ¢ 563
   e. ¢ 216

5. What is Victor Akakpo's gross pay?
   a. ¢ 2,052
   b. ¢ 2,161
   c. ¢ 2,700
   d. ¢ 2,813
   e. ¢ 41,260

Use the information below to answer Questions 6 to 8

The pay slip of Musah Busanga for the month of August 2016 revealed the following: Basic Salary ¢100,000
Income Tax 15% of basic salary

Social Security Contribution:

Employer:	12½% of basic salary
Employee:	5% of basic salary
Professional allowance:	¢25,000 per month

6. What was the amount of total deductions from Musah Busanga's basic pay?
   a. ¢5,000
   b. ¢14,250
   c. ¢20,000
   d. ¢23,000
   e. ¢23,750

7. The total amount of social security contributions to the credit of Musah Busanga for August 2016 was

   a. ¢5,000
   b. ¢12,500
   c. ¢17,500
   d. ¢19,250
   e. ¢20,000

8. What was the net salary paid to Musah Busanga for August 2016?
   a. ¢82,000
   b. ¢89,500
   c. ¢102,000
   d. ¢105,000
   e. ¢477,000

9. Business entities are required by law to send returns on their payroll including the amount of income tax deducted at source to ....

10. .... system is used by employers to reward exceptional performance of employees

9.9 Examination type questions

Question 1

The table below shows the data relating to three employees of Victorosky Ltd for the month ending July 31, 2016.

Name	Regular hours worked	Hours worked as overtime	Rate per hour(¢)

Busanga	250	50	45,000
Akakpo	200	45	38,000
Abinga	175	80	30,000

The overtime rate per hour is 2.5 times the regular rate.

It is the policy of Victorosky Ltd to grant the following allowances to all staff:

1. Risk allowance of 15% of basic salary
2. Leave allowance equal to 45% of the basic salary of each staff
3. Social security contribution and
4. Senior staff association dues of ¢500,000 per month in respect of each staff.

You are required to prepare:

a. Payroll work sheet, showing the basic pay, deductions and net salary of each staff
b. Journal entries to record the above information

Question 2

Victor, Simon and Alata are in the employment of Sikaman Enterprise. Their conditions of service for the year 2016 are as follows:

Name	Basic salary (¢)	Rent allowance(¢)	Bonus(¢)	Meal Allowance(¢)
Victor	27,500,000	2,000,000	40% of basic	500,000
Simon	26,200,000	1,800,000	35% of basic	450,000
Alata	24,800,000	1,500,000	30% of basic	400,000

Statutory deductions are:

a. Social security contribution of 5%
b. Income tax liability of 15%

The company also operates a special retirement fund to which all employees are expected to contribute 8%. It is the policy of the employer to top up each employee's contribution by 10%.

During the year 2016 the following loans were granted to each staff:

Name	Car loan(¢)	Distress Loan(¢)	Year loan was taken

Victor	50,000,000	10,000,000	2014
Simon	40,000,000	8,000,000	2015
Alata	20,000,000	8,000,000	2015

All loans taken in the Enterprise with the exception of distressed loans attract a concessionary interest at a rate of 5% simple interest on the reduced balance at the beginning of the period. It is expected that the principal amount will be repaid or amortised on an equal basis over a period of five years.

You are required to prepare the payroll worksheet of Victor, Simon and Alata for the year 2016.

Question 3

Explain briefly what is meant by:

a. Time rate method of remuneration

b. Piece rate method of remuneration

c. State any three (3) advantages and two (2) disadvantages of each of the methods of remuneration mentioned above.

Question 4

State briefly the main features of:

a. Halsey Premium incentive plan of remuneration

b. Rowan incentive plan of remuneration

c. Compare the main features of the incentive plans discussed above.

Question 5

The table below shows the data relating to three employees of Watonga Ltd for the month ending 31 December 2016.

Name	Standard hours expected	Actual hours worked	Rate per hour(¢)

Amartey	255	215	40,000
Osibio	200	222	35,000
Morton	180	160	30,000

Included in the conditions of service of Watonga Ltd for the above named members of staff are the following:

(ii) Rent allowance of 18% of the basic salary
(iii) Risk allowance equal to 20% of the basic salary
(iv) Social security contributions and
(v) Personal income tax liability at the rate of 17.5%.

You are required to prepare Payroll work sheet, showing the basic pay, deductions and net salary of each staff under the following:

(a) Halsey Premium incentive plan of remuneration
(b) Rowan incentive plan of remuneration

Solution to Multiple Choice Questions

1. c
2. b
3. c
4. d
5. d
6. c
7. c
8. d
9. The tax authority
10. Bonus Scheme

Solution to Examination type questions

Question 1

Victorosky Ltd.

Payroll Work sheet for the month of July 2007

	Busanga ¢'000	Akakpo ¢'000	Abinga ¢'000	Total ¢'000
Basic Salary	**11,250**	**7,600**	**5,250**	**24,100**
Overtime	5,625	4,275	6,000	15,900
Leave allowance	5,063	3,420	2,363	10,846
Risk allowance	1,688	1,140	788	3,616
Consolidated Salary	**23,626**	**16,435**	**14,401**	**54,462**
Less Statutory deductions:				-
5% Social security i.e of basic salary	563	380	263	1,206
Taxable Pay	23,063	16,055	14,138	53,256
Less Income tax	2,769	1,718	1,431	5,918
	20,294	14,337	12,707	47,338
Less other deductions:				
Senior staff association dues	500	500	500	1,500
Net Salary	**19,794**	**13,837**	**12,207**	**45,838**

Computation of Busanga's Income Tax

	Income ¢'000	Tax rate	Amount ¢'000
First	1,800	0%	-
Next	1,800	5%	90
Next	4,800	10%	480
Next	14,663	15%	2,199
Total	23,063		2,769

Computation of Akakpo's Income Tax

	Income ¢	Tax rate	Amount ¢
First	1,800	0%	-
Next	1,800	5%	90
Next	4,800	10%	480
Next	7,655	15%	1,148
Total	16,055		1,718

Computation of Abinga's Income Tax

	Income ¢'000	Tax rate	Amount ¢'000
First	1,800	0%	-
Next	1,800	5%	90
Next	4,800	10%	480
Next	5,738	15%	861
Total	14,138		1,431

The Journal	Dr. ¢'000	Cr. ¢'000
Consolidated salary	54,462	
12.5% Employer's SSNIT	6,808	
IRS - PAYE		5,918
SSNIT - 5% Social security		1,206
SSNIT - 12.5% Social security		6,808
Senior staff association dues		1,500
Busanga		19,794
Akakpo		13,837
Abinga		12,207
Being the recording of salaries and other deductions due for July 2016	61,270	61,270

IRS - PAYE	5,918	
SSNIT - 5% Social security	1,206	
SSNIT - 12.5% Social security	6,808	
Senior staff association dues	1,500	
Busanga	19,794	
Akakpo	13,837	
Abinga	12,207	
Bank		61,270
Being the payment of deductions and net salary for July 2016	61,270	61,270

Notes: SSNIT = Social Security

IRS = Internal Revenue Service

PAYE = Pay As You Earn

Question 2

Sikaman Enterprise

Payroll Work sheet for the Year ended 31st July 2007

	Victor	Simon	Alata	Total
	¢'000	¢'000	¢'000	¢'000
Basic Salary	**27,500**	**26,200**	**24,800**	**78,500**
Rent allowance	2,000	1,800	1,500	5,300
Meals allowance	500	450	400	1,350
Bonus	11,000	9,170	7,440	27,610
Consolidated Salary	**41,000**	**37,620**	**34,140**	**112,760**
Less Statutory deductions:				-
5% Social security of basic	(1,375)	(1,310)	(1,240)	(3,925)
Taxable Pay	39,625	36,310	32,900	108,835
Less Income tax (15%)	(5,944)	(5,447)	(4,935)	(16,326)
	33,681	30,863	27,965	92,509
Less other deductions:				-
Special retirement fund (8%)	(2,200)	(2,096)	(1,984)	(6,280)
Loan repayment	(10,000)	(8,000)	(4,000)	(22,000)
Interest on loan	(1,500)	(1,600)	(800)	(3,900)
	13,700	11,696	6,784	32,180
Net Salary	**19,981**	**19,167**	**21,181**	**60,329**

Victor Loan Repayment Schedule

	Loan			Repayment			
Year	**Opening Balance**	**Interest Due (5%)**	**Total Prin + Int**	**Principal**	**Interest**	**Total Repayment**	**Closing Balance**
	¢		¢	¢			
2014	50,000,000	2,500,000	52,500,000	10,000,000	2,500,000	12,500,000	40,000,000
2015	40,000,000	2,000,000	42,000,000	10,000,000	2,000,000	12,000,000	30,000,000
2016	30,000,000	1,500,000	31,500,000	10,000,000	1,500,000	11,500,000	20,000,000
2017	20,000,000	1,000,000	21,000,000	10,000,000	1,000,000	11,000,000	10,000,000
2018	10,000,000	500,000	10,500,000	10,000,000	500,000	10,500,000	-

Simon Loan Repayment Schedule

	Loan			Repayment			
Year	**Opening Balance**	**Interest Due (5%)**	**Total Prin + Int**	**Principal**	**Interest**	**Total Repayment**	**Closing Balance**
	¢		¢	¢			
2015	40,000,000	2,000,000	42,000,000	8,000,000	2,000,000	10,000,000	32,000,000
2016	32,000,000	1,600,000	33,600,000	8,000,000	1,600,000	9,600,000	24,000,000
2017	24,000,000	1,200,000	25,200,000	8,000,000	1,200,000	9,200,000	16,000,000
2018	16,000,000	800,000	16,800,000	8,000,000	800,000	8,800,000	8,000,000
2019	8,000,000	400,000	8,400,000	8,000,000	400,000	8,400,000	-

Alata Loan Repayment Schedule

Year	Loan: Opening Balance	Loan: Interest Due (5%)	Loan: Total Prin + Int	Repayment: Principal	Repayment: Interest	Repayment: Total Repayment	Closing Balance
	¢		¢	¢			
2015	20,000,000	1,000,000	21,000,000	4,000,000	1,000,000	5,000,000	16,000,000
2016	16,000,000	800,000	16,800,000	4,000,000	800,000	4,800,000	12,000,000
2017	12,000,000	600,000	12,600,000	4,000,000	600,000	4,600,000	8,000,000
2018	8,000,000	400,000	8,400,000	4,000,000	400,000	4,400,000	4,000,000
2019	4,000,000	200,000	4,200,000	4,000,000	200,000	4,200,000	-

Question 5

Watonga limited

a) Halsey incentive plan

Payroll Work sheet for the month ended 31 December 2016.

	Amartey	Morton	Osibio	Total
	¢'000	¢'000	¢'000	¢'000
Basic Salary	**8,600**	**7,770**	**4,800**	**21,170**
Rent allowance	1,548	1,399	864	3,811
Risk allowance	1,720	1,554	960	4,234
Bonus (see workings)	800	-	300	1,100
Consolidated Salary	**12,668**	**10,723**	**6,924**	**30,315**
Less Statutory deductions:				-
5% Social security	430	389	240	1,059
Taxable Pay	12,238	10,334	6,684	29,256
Less Income tax (17.5%)	2,142	1,808	1,170	5,120
Net Salary	10,096	8,526	5,514	24,136

b) Rowan incentive plan

Payroll Work sheet for the month ended 31st December 2016

	Amartey	Morton	Osibio	Total
	¢'000	¢'000	¢'000	¢'000
Basic Salary	**8,600**	**7,770**	**4,800**	**21,170**
Rent allowance	1,548	1,399	864	3,811
Risk allowance	1,720	1,554	960	4,234
Bonus (see workings)	1,349	-	533	1,882
Consolidated Salary	**13,217**	**10,723**	**7,157**	**31,097**
Less Statutory deductions:				-
5% Social security	430	389	240	1,059
Taxable Pay	12,787	10,334	6,917	30,038
Less Income tax (17.5%)	2,238	1,808	1,210	5,256
Net Salary	10,549	8,526	5,707	24,782

Workings on bonus

Halsey incentive plan

Bonus = 50% of [Time saved x Time rate]

Thus time saved

Name	Standard hours expected (A)	Actual hours worked (B)	Time saved (A-B)
Amartey	255	215	40 hrs
Osibio	200	222	Nil
Morton	180	160	20 hrs

Bonus for Amartey = 50% [40hrs x ¢40,000] = ¢800,000

Bonus for Osibio = 50% [0hrs x ¢35,000] = ¢Nil

Bonus for Morton = 50% [20hrs x ¢30,000] = ¢300,000

Rowan incentive plan =

$$\text{Bonus} = \frac{\text{Time saved}}{\text{Time allowed}} \times \text{Time taken} \times \text{Time rate}$$

$$\text{Bonus for Amartey} = \frac{40\text{hrs}}{255\text{ hrs}} \times 215\text{ hrs} \times ¢40{,}000 = ¢1{,}349{,}020$$

$$\text{Bonus for Osibio} = \frac{0\text{hrs}}{200\text{ hrs}} \times 222\text{ hrs} \times ¢35{,}000 = ¢\text{Nil}$$

$$\text{Bonus for Morton} = \frac{20\text{hrs}}{180\text{ hrs}} \times 160\text{ hrs} \times ¢30{,}000 = ¢533{,}333$$

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CHAPTER TEN

ACCOUNTING FOR NON-CURRENT ASSETS

10.0 Learning objectives

After you have studied this chapter, you should be able to:

- State the types and characteristics of non-current assets
- Differentiate between capital and revenue expenditure
- Define depreciation and explain why accountants provide for depreciation in final accounts
- Calculate depreciation using the straight line and the reducing balance methods
- Calculate any profit or loss made on the sale of non-current assets
- Explain the significance of maintaining non-current assets register

10.1 Introduction

The recommendation of the International Accounting Standard (IAS) number 16 is followed with accounting for non-current assets (Property, Plant and Equipment).

10.1.1 <u>Assets:</u>

An asset has been defined as 'a resource controlled by an entity as result of past events, and from which future economic benefits are expected to flow to the entity'.

A careful examination of the above definition will bring out the following salient characteristics of anything that will qualify to be referred to as asset.

i. It must be a resource. In other words for anything to be called an asset, it must be valuable.

ii. It must be owned or controlled by the entity. By control, we mean that the entity can prevent others from obtaining the same economic benefits that it is entitled to derive from the resource.

iii. It must have resulted from past events. That is to say that an asset will ordinarily not be from a future transaction that is yet to happen. If we propose to buy a motor vehicle next financial year, such intention to buy the vehicle does not in any way create an asset.

iv. Economic benefits are expected to be derived by the entity from the asset in future. Anything that has no future economic benefit cannot be referred to as an asset.

10.2 Classification of Assets

There are two forms of assets held by business organizations. These are:

Non-current assets and current assets.

a. Current Assets

According to IAS I (Presentation of financial statements), current assets include cash, receivables, prepaid expenses and inventory. They are assets that are likely to be realised, sold or consumed in an entity's normal opening cycle; or within twelve months after the reporting date. They are held for the purpose of trading. All other assets are classified as non- current.

b. Non-Current Assets

Non-current assets are those assets that were not bought purposely to be sold but to be used in the business for a long time. Non-current assets are categorised into two:

i. Tangible non-current assets

Tangible non-current assets are assets that have material and physical existence such as property (Land and buildings, plant and equipment (motor vehicles, furniture and fittings, machinery, etc). Such assets are usually held for use in the production or supply of goods and services. For rental to others or for administrative purposes

ii. **Intangible non-current assets**

Intangible non-current assets have no physical or material existence and cannot be touched but they provide expected future benefits. Such intangible assets are goodwill, patents and trademarks. No further reference is made to intangible assets because the detail treatment is outside this syllabus.

Sometimes, it is not possible to state whether an asset is current or non-current until we know its function. The classification of an asset as current or non-current requires a little caution. This is because an asset may indeed change with changing circumstances. For instance, an entity that manufactures and sells cars will classify cars as inventory, a current asset. If however, the entity were to use one of its manufactured cars for its operations, then the classification changes from 'current' to 'non-current'. We must therefore understand that the classification of assets as property, plant and equipment is usually guided by their functions, physical attributes or expected useful lives.

10.3 The determination of the cost of non-current assets

Almost every business entity of any size or activity uses assets of a durable nature in its operations. Such assets are not acquired for resale but rather they are used in the business to increase the earning capacity or productivity of the organization.

10.3.1 Initial Measurement

At the date of acquisition, items of property, plant and equipment are recorded at their initial historical cost. Cost in this case refers to the amount of cash or cash equivalent that was paid or the fair value of other consideration that have been given instead of cash, to acquire an asset at the time of its acquisition or construction. Business entities sometimes construct by themselves using their available materials and manpower, assets such as buildings, plant and equipment, furniture, fixtures and fittings. This may be done in order to save costs, meet their own preferred specification or simply because they wish to make use of their idle capacity. Fair value is the price to be received or orderly transaction between market participants at the measurement date (IFRS 13). Transactions between two people any one of paid to sell an asset or transfer a liability in an whom does not have influence on, or control over, the other, is referred to as arm's length transaction. In other words, the price at which the item was exchanged between them is free and fair and market-determined.

10.3.2 Components of Acquisition Costs

Generally, the cost of an item of property, plant and equipment comprises:

a. Its purchase price plus import and other non-recurring levies (e.g development levies, consent fee, etc) less any trade discounts and rebates.
b. The directly attributable costs of bringing the asset to its location and working condition for the purpose the management intended to use the asset (IAS 16).

These directly attributable costs may include the cost of labour engaged in its installation or construction, cost of preparing the site for construction, carriage inwards, installation and assembly expenses, cost of testing the asset on completion and relevant professional charges (e.g architects fee, surveyor's fee,) etc.

Illustration 10.1

Slopworks (Ghana) Ltd, orders a machine from a Nigerian tools manufacturer at an invoice price of ¢100,000,000. Payment will be made in 48 monthly instalments of ¢2,500,000 (including ¢20,000,000 interest charges). Other relevant costs include:

	¢
Value Added Tax	12,500,000
Freight Charges	10,250,000
Installation and other start-up costs	4,000,000
Trade discount given	1,000,000

What is the cost of the machine to be capitalized in Slopworks (Ghana) Ltd?

Solution to Illustration 10.1

	¢
Invoice price	100,000,000
Trade discount	(1,000,000)
	99,000,000
VAT	12,500,000
Transportation charges	10,250,000
Cost of installation	4,000,000
Total Cost	125,750,000

* The interest charges of ¢20,000,000 on the instalment purchase will be recognised as interest expense over the next 48 months and written-off in the statement of profit or loss.

We now consider the elements of cost of different types of property, plant and equipment.

Capitalization: means to recognize an amount of cost or part of the cost of an item as an asset. So when an item of cost is 'capitalized', it is treated as an asset and not an expense.

10.3.3 Land

When land is purchased, certain incidental costs are generally incurred, in addition to the purchase price. These incidental costs may include commissions to real estate brokers, legal fees for examining and insuring the title and fees for surveying, draining, clearing and grading the property. All these expenditures are part of the cost of the land since they are intended to get the assets ready for use. Any proceeds obtained in the process of getting the land ready for its intended use, such as the sale of cleared timber, are treated as reduction in the price of the land.

Local improvements, such as pavements, streetlights, sewers, drainage system and land-scaping require special treatment. These are usually charged to the land account because they are relatively permanent in nature. However, expenditures on land such as private driveways, fences, and car parks are recorded separately. These expenditures should be recorded as land improvements and depreciated over their estimated useful lives because they have limited useful lives.

10.3.4 Cost of building

The cost of building should include all expenditures related directly to their acquisition or construction. These costs include materials, labour, overheads costs incurred during construction, professional fees and building permit. An entity may engage the services of contractors to have its building constructed. All costs incurred by the contractors from excavation to completion, are considered part of the building cost.

There are occasions where land purchased as a building site has on it an old building which is not suitable for the buyer's use. In this case, the only useful "asset" being acquired, is the land. Where this happens, any cost incurred in demolishing the old building should be charged to land together with the purchase price of the land itself. This is because the cost of demolition less its salvage value is a cost of getting the land ready for its intended use.

10.3.5 Cost of equipment

The term "equipment" in accounting includes delivery equipment, office equipment, machinery, furniture and fittings, factory equipment and similar assets. The costs of these assets include the purchase price, freight and handling charges incurred, insurance on the equipment while in transit and costs of conducting trial runs. Costs therefore include all expenditures incurred in acquiring the equipment and preparing it for use.

10.4 Capital expenditure and Revenue Expenditure

10.4.1 <u>Capital Expenditure</u>

Capital expenditure may be defined as the cost of acquiring a non-current asset for use in an entity. Capital expenditure includes such costs as are incurred in adding value to existing non-current assets in order to improve their earning capacity and to prolong their lives for more than one accounting period.

Examples of capital expenditure are:

a) Purchase price of non-current assets such as motor vehicles, buildings, furniture and fittings, plant and machinery

b) Extension or any improvement of a permanent nature made to any structure

c) Legal fees of acquiring land or buildings

d) The cost incurred in bringing any non-current asset to its present location

e) Any other cost that must be incurred in getting the non-current assets ready for its intended use.

10.4.2 Revenue Expenditure

Revenue expenditure on the other hand is any cost in which its earning potential is exhausted within one accounting period. Such expenditures are not made to increase or improve the value of non-current assets but rather, are made for the maintenance and day-to- day running of the business.

Examples of revenue expenditure are:

1) The cost incurred in acquiring trading inventories for sale
2) Cost of repairing any non-current assets
3) Discount allowed on credit sales
4) Expenses in connection with rent, insurance, telephone and electricity.
5) Staff salaries and emoluments.

10.4.3 Differences between capital and revenue expenditure

Differences due to time:

Where the benefit that is derived from an item of expenditure is used up or exhausted within one accounting period, then such expenditure is revenue expenditure. However if the benefit derived from an item of expenditure extends to more than one period of account, it should be referred to as capital expenditure.

Differences due to type of account:

An increase in capital expenditure is added or debited to a non-current asset account, which is finally disclosed in the statement of financial position. All revenue expenditures are charged to the Statement of profit or loss.

You should be careful not to incorrectly classify capital and revenue expenditure. As you can see from the above, the classification of capital and revenue expenditure has a direct impact on the resulting profit figure in the statement of profit or loss and also the assets values in the statement of financial position. This is true because if you wrongly classify revenue expenditure as a capital expenditure, the total expenses figure in the statement of profit or loss will be understated. This will result in overstating the net profit of the business. Should the owner appropriate the profit for his personal use, it might lead to the collapse of the business since the owner is spending his capital instead of the profits or gains from the business.

10.5 Depreciation

Capital expenditure like building, plant, fixtures and fittings do normally last for more than one year. It is obviously possible that these assets may deteriorate with the passage of time due to its usage. There is therefore the need to recognise the loss in the value of non-current assets in the books of accounts. If this is not done, the value of non-current assets in the statement of financial position will be incorrectly stated.

The process of recognising the loss in the value of non-current assets as a result of using such assets is called depreciation. IAS 16 defined depreciation and some concepts relevant to depreciation accounting. They include:

1. **Depreciation**

   This is the systematic allocation of the depreciable amount of an asset over its useful life.

2. **Depreciable amount**

   This is the cost of an asset (or its revalued amount, in cases where a non-current asset is revalued during its life) less its residual value.

3. **Residual value**

   This is the expected disposal value of the asset (after deducting disposal costs) at the end of its expected useful life

4. **Useful life**

   This is the period over which the asset is expected to be available for use by the business entity.

Non-current assets produce revenue through use rather than through resale. They can be viewed as quantities of economic service potential to be consumed over time in the earning of revenues. Depreciation recognition transfers a portion of acquisition cost and capitalised post-acquisition cost of non-current asset to an expense account called depreciation expense. The corresponding credit is the accumulated depreciation account, a contra non-current assets account that reduces gross assets to net book value now called carrying amount. This expense is recorded as an adjusting entry at the end of each accounting period. Depreciation expense could be classified as a selling or administrative expense, depending on the use to which the asset is put. Manufacturing firms include depreciation of plant and machinery or factory building in the cost of goods produced. When the goods are sold, depreciation becomes part of cost of goods sold.

Certain types of non-current assets have unlimited useful economic lives, and so do not require depreciation. This is usually true of land unless the land is an agricultural land or land acquired for extractive purposes. By contrast, buildings will normally have limited useful economic life, and therefore, will normally be subjected to depreciation.

It is important to point out/emphasize that the accumulated depreciation account does not represent cash set aside for replacement of non-current assets; nor does its recognition imply the creation of reserves for asset replacement.

10.5.1 Causes of depreciation

There are several factors that contribute to depreciation of non-current assets. These factors or causes can be classified as follows:

1) Physical deterioration

This is where the fall in value of a non-current asset is due to wear and tear as a result of its constant use. Natural occurrences such as erosion, rust and decay also reduce the value of any non-current asset.

2) Obsolescence

This is where an asset is put out of use even though it is in good working condition. This occurs where an asset becomes out of date as a result of new inventions or technological advancement. For example bakers used clay-moulded oven in baking bread. The invention of gas-molded ovens has certainly rendered the use of the lay mould out of date. This factor of depreciation is known as obsolescence.

3) Inadequacy

Another situation closely linked with obsolescence is where a non-current asset is rendered useless as a result of the growth and changes in the size of a business. A fisherman who uses canoe may have to acquire a large fishing boat when the demand for fish increases beyond the capacity that the canoe can cope with. In this situation you can clearly deduce that it would be more efficient and economical to operate a large fishing boat than the canoe, and as a result the canoe will be put out of use, though it is in good working condition. This factor of depreciation is known as inadequacy.

4) **Depletion**

Natural resources such as mines, quarries, oil, coal and gas deposits become worthless when the deposits or resources are depleted. These assets are called wasting assets. The process of providing for the consumption of such assets is called depletion.

5) **Time factor**

There are certain assets that have specific period of legally determined life span. Assets such as patent, copyrights, finance leases have a legal life fixed in terms of years. As and when the years elapse, the value of these assets reduces. The cost of these assets must be spread over their legal lives. The term used in recognising the fall in value of these assets is termed amortisation.

10.5.2 Methods of calculating depreciation

There are several methods of calculating depreciation. These include:

1) Straight Line Method or Fixed Instalment Method
2) Reducing Balance Method or Diminishing Balance Method
3) Sum-of- the-Years'-Digits Method
4) Units-of-Output Method
5) Revaluation Method
6) Machine Hour Method
7) Depletion of Unit Method

The syllabus for which this manual is prepared covers only two of the methods listed above: Straight Line or fixed instalment method and the reducing balance or diminishing balance method. The remaining methods will be treated in the next stage of the course.

Before the two methods are discussed, it is important to note the elements of depreciation that will be put into use while illustrating the depreciation methods; the elements include:

- The cost (or revalued amount) of the non-current asset.
- The estimated residual value of the non-current asset.
- The estimated useful economic life of the non-current asset.
- The method of depreciation considered appropriate for the business by management.

  This method becomes the accounting policy of the business entity.

All the elements mentioned above involve a certain amount of subjectivity. As a result of the subjective nature of the depreciation computation.

10.5.3 Straight Line Method

The straight line method is the most widely used method of computing depreciation charge for financial statements purposes. Under this method, an equal amount of depreciation is charged in each accounting period over the useful life of the non-current asset. The depreciation amount is computed by dividing the original cost of the non-current asset less estimated residual (salvage) by the useful life of the asset. A mathematical formula can be deduced as follows:

$$\text{Annual Depreciation} = \frac{\text{Original cost of Asset} - \text{Salvage Value}}{\text{Useful Life of Asset}}$$

Illustration 10.2

On January 1, 2016 Hyde Limited purchased a motor vehicle for ¢250,000,000. The motor vehicle has an estimated useful life of five years with a salvage value of ¢5,000,000.

You are required to calculate the depreciation charge and accumulated depreciation for each of the years and show the net book value as at the end of 2020 accounting period using the straight-line method.

Solution to Illustration 10.2

$$\text{Annual Depreciation} = \frac{¢250{,}000{,}000 - ¢5{,}000{,}000}{5}$$

$$= \underline{¢49{,}000{,}000}$$

Year	Carrying amount at start of year	Depreciation for the year	Accumulated Depreciation	Carrying amount at end of year
	¢	¢	¢	¢
2016	250,000,000	49,000,000	49,000,000	201,000,000
2017	201,000,000	49,000,000	98,000,000	152,000,000
2018	152,000,000	49,000,000	147,000,000	103,000,000
2019	103,000,000	49,000,000	196,000,000	54,000,000
2020	54,000,000	49,000,000	245,000,000	5,000,000

In the example above, the cost of the non-current asset is **¢250,000,000; the depreciable amount is ¢245,000,000; the residual value is ¢5,000,000; the useful life is 5years and the depreciation per year is ¢49,000,000. The carrying amount at the end of 2020 equals the residual value (¢5,000,000).**

10.5.2 Reducing Balance Method

Under this method of depreciation, the book value of a non-current asset at the beginning of the year is multiplied by a fixed percentage to determine the depreciation for the accounting year. This procedure is repeated in subsequent accounting periods so as to reduce the depreciable amount of the non-current asset to its residual value or to zero if it has no residual value.

Illustration 10.3

On January 1, 2016 John Kay Limited purchased plant for ¢250,000,000. It is the policy of John Kay to depreciate Plant at 20% per annum. You are required to calculate carrying amount as at the end of 2020 accounting period using the reducing balance method.

Solution to Illustration 10.3

Year	Carrying amount at start of year	Depreciation Rate	Depreciation for the year	Accumulated Depreciation	Carrying amount at end of year
	¢		¢	¢	¢
2016	250,000,000	20%	50,000,000	50,000,000	200,000,000
2017	200,000,000	20%	40,000,000	90,000,000	160,000,000
2018	160,000,000	20%	32,000,000	122,000,000	128,000,000
2019	128,000,000	20%	25,600,000	147,600,000	102,400,000
2020	102,400,000	20%	20,480,000	168,080,000	81,920,000

When a non-current asset is purchased during the year, depreciation is calculated to the nearest month. In some organisations, a full year's depreciation charge is provided on non-current assets acquired during the year irrespective of the date in the year in which they were purchased. Where this is the case any asset sold in the year will also not attract depreciation in the year of sale irrespective of the time of sale within the accounting period.

Computing Reducing Balance Depreciation Rate

Where the percentage rate is not given, this can be calculated by using a formula, provided the residual value, the cost and the estimated useful life of the non-current asset is known.

The formula that can be used to derive the percentage depreciation rate per annum to write down the asset to the residual value or zero (where the asset has no residual value) is:

$$\text{Depreciation Rate} = 1 - n\sqrt{\frac{Residual\ Value}{Cost\ of\ Asset}}$$

Where

n = estimated useful life of the asset.

Illustration 10.4

A non-current asset cost **¢1,000,000 and its estimated value is ¢200,000 at the end of 5years. The reducing balance depreciation rate is**

$$\text{Depreciation rate} = 1 - n\sqrt{\frac{R}{C}} = 1 - 5\sqrt{\frac{¢200{,}000}{1{,}000{,}000}}$$

$= 1 – 5 \sqrt{0.2}$

$= 1 – 0.7248$

$= 0.2752$ or 27.52%

Using this rate to depreciate the non-current asset using the diminishing balance method, we have

Year	Cost/Carrying amount at beginning	Rate	Depreciation for the year	Accumulated Depreciation	Carrying amount of at end year
	¢	%	¢	¢	¢
1	1,000,000	27.52	275,200	275,200	724,800
2	724,800	27.52	199,465	474,665	525,335
3	525,335	27.52	144,572	619,237	380,763
4	380,763	27.52	104,786	724,023	275,977
5	275,977	27.52	75,949	799,972	200,028

Note: The excess of **¢28 over the residual value of ¢200,000 is due to rounding error.**

10.6 Accounting for depreciation

After calculating the depreciation charge for the accounting year, you must record the amount in the books of account. It is important for you to remember that the process of making allowance for depreciation is charging to revenue the cost of the non-current asset consumed during the accounting period. This, therefore, means that depreciation is revenue expenditure and as such must be recorded in the same manner that accountants record normal business expenses.

There are two main ways of recording depreciation in the books of account of a business entity. The old method and the modern method of recording depreciation. Under the old method, depreciation charges are recorded in the non- current asset account. It is important to note that this method is no longer in use. The double entry of depreciation is as follows under the two methods:

Old Method	New Method
Dr. Depreciation Expense Account	Dr. Depreciation Expense Account
Cr. The non-current asset Account in question	Cr. Allowance for depreciation on non-current asset in question
Dr. Statement of Profit or Loss	Dr. Statement of Profit or Loss
Cr. Depreciation Expense Account	Cr. Depreciation Expense Account

Illustration 10.5

On 1 January, 2012 Brown Kay Limited purchased Equipment for ¢450,000. It is the policy of John Kay to depreciate Plant at 20%. You are required to show the Equipment account in the books of Brown Kay Limited as at the end of 2016 accounting period using the reducing balance method, under the old method of accounting for depreciation.

Solution to Illustration 10.5

Equipment account

		¢			¢
01/01/2012	Bank	450,000	31/12/2012	Depreciation expense	90,000
			31/12/2012	Balance c/f	360,000
		450,000			450,000
01/01/2013	Balance b/d	360,000	31/12/2013	Depreciation expense	72,000
			31/12/2013	Balance c/f	288,000
		360,000			360,000
01/01/2014	Balance b/d	288,000	31/12/2014	Depreciation expense	57,600
			31/12/2014	Balance c/f	230,400
		288,000			288,000
01/01/2015	Balance b/d	230,400	31/12/2015	Depreciation expense	46,080
			31/12/2015	Balance c/f	184,320
		230,400			230,400
01/01/2016	Balance b/d	184,320	31/12/2016	Depreciation expense	36,864
			31/12/2016	Balance c/f	147,456
		184,320			184,320
	Balance b/d	147,456			

Note: Under the new method, the non-current asset account remains at cost or revalued amount while the annual depreciation is accumulated in the allowance for depreciation account from year to year. In the statement of financial position the non-current asset account is stated at cost less accumulated depreciation to give the carrying amount at the date of the statement of financial position.

Depreciation Expense Account

		¢			¢
31/12/2012	Equipment account	90,000	31/12/2012	Profit or loss	90,000
31/12/2013	Equipment account	72,000	31/12/2013	Profit or loss	72,000
31/12/2014	Equipment account	57,600	31/12/2014	Profit or loss	57,600
31/12/2015	Equipment account	46,080	31/12/2015	Profit or loss	46,080
31/12/2016	Equipment account	36,864	31/12/2016	Profit or loss	36,864

Statement of Profit or Loss (extract) for year ended 31 December ....

		Debit side
		¢
2012	Depreciation Expense	90,000
2013	Depreciation Expense	72,000
2014	Depreciation Expense	57,600
2015	Depreciation Expense	46,080
2016	Depreciation Expense	36,864

The modern practice of recording depreciation treats depreciation as a contra to the non-current asset account. The non-current asset account is maintained at its original cost. A ledger account called “Accumulated Depreciation account” is opened and all depreciation calculations are credited to that account, the corresponding entry being passed into the Depreciation charge Account as a debit. The double entry is as follows:

Dr. Depreciation charge Account

Cr. Accumulated Depreciation Account

Illustration 10.6

On 1 January, 2012 Amoroso Limited purchased Equipment for ¢800,000. It is the policy of the Company to depreciate all equipment at 20% per annum. On redundancy balance method.

Required: Using the modern method of accounting for depreciation. Show for the years ending 31 December 2012, 2013,2014, 2015 and 2016:

a. The Equipment account
b. The Accumulated Depreciation on Equipment Account
c. The Depreciation Expense Account
d. The Statement of Profit or Loss (Extracts) for the respective years.
e. The Statement of Financial Position (Extracts) as at 31 December 2012 – 2016.

(a) **SOLUTION TO ILLUSTRATION 10.5**

Equipment Account

			¢				¢
2012 Jan	Bank		800,000	2012 Dec 31	Balance	c/d	800,000
2013 Jan	Balance	b/d	800,000	2013 Dec 31	Balance	c/d	800,000
2014 Jan	Balance	b/d	800,000	2014 Dec 31	Balance	c/d	800,000
2015 Jan	Balance	b/d	800,000	2015 Dec 31	Balance	c/d	800,000
2016 Jan	Balance	b/d	800,000	2016 Dec 31	Balance	c/d	800,000

(b) **Accumulated Depreciation on Equipment Account**

31/12/2012	Balance c/d	160,000	31/12/2012	Depreciation expense	160,000
31/12/2013	Balance c/d	288,000	01/01/2013	Balance b/d	160,000
			31/12/2013	Depreciation expense	128,000
		288,000			288,000
31/12/2014	Balance c/d	390,400	01/01/2014	Balance b/d	288,000
			31/12/2014	Depreciation expense	102,400
		390,400			390,400
31/12/2015	Balance c/d	472,320	01/01/2015	Balance b/d	390,400
			31/12/2015	Depreciation expense	81,920
		472,320			472,320
31/12/2016	Balance c/d	537,856	01/01/2016	Balance b/d	472,320
			31/12/2016	Depreciation expense	65,536
		537,856			537,856
			01/01/2017	Balance b/d	537,856

(c) **Depreciation Expense Account**

		¢			¢
31/12/2012	Accum. Depr. Equipt	160,000	31/12/2012	Profit or loss	160,000
31/12/2013	Accum. Depr. Equipt	128,000	31/12/2013	Profit or loss	128,000
31/12/2014	Accum. Depr. Equipt	102,400	31/12/2014	Profit or loss	102,400
31/12/2015	Accum. Depr. Equipt	81,920	31/12/2015	Profit or loss	81,920

31/12/2016	Accum. Depr. Equipt	65,536	31/12/2016	Profit or loss	65,536

Statement of Profit or Loss (extract) for year ended 31 December

		Debit side ¢
2012	Depreciation Expense	160,000
2013	Depreciation Expense	128,000
2014	Depreciation Expense	102,400
2015	Depreciation Expense	81,920
2016	Depreciation Expense	65,536

The balance on the equipment account will be shown on the statement of financial position at the end of the accounting year less the balance on the Accumulated Depreciation Account as follows:

Statement of Financial Position (Extract) at 31 December

	Assets	Cost ¢	Accumulated Depreciation ¢	Carrying amount at end year ¢
2012	Non-current Assets Equipment	800,000	160,000	640,000
2013	Equipment	800,000	288,000	512,000
2014	Equipment	800,000	390,400	409,600
2015	Equipment	800,000	472,320	327,680
2016	Equipment	800,000	537,856	262,144

10.7 Disposal of non-current assets

An entity can dispose of its non-current assets by either selling it for cash, exchanging it for a similar asset or a different one, or merely by discarding the asset. In all these three situations you must remember to take out the asset disposed from the main non-current asset account. This is done by opening an account for the purpose of the disposal. Into this account is debited the cost of the non-current asset and its associated accumulated depreciation is credited into the same account. A profit or loss may arise from the disposal of the non-current asset when compared with the carrying cost (cost less accumulated depreciation).

Accounting Entries

On the disposal of non-current asset, the following entries must be passed:

Open a Non-current Asset Disposal Account and;

1) Transfer the cost of the non-current asset sold to the non-current asset disposal account thus:

    Dr. Non-current asset disposal Account

Cr. Non-current asset Account

2) Transfer the accumulated depreciation on the asset sold to the non-current asset disposal account as follows:

   Dr. Accumulated depreciation Account

   Cr. Non-current asset disposal Account

3) The amount realized from the sale of the non-current asset must be recorded thus:

   Dr. Cash, Bank or Sundry receivables Account
   Cr. Non-current asset disposal Account

Where the non-current assets disposal account ends in a credit balance, it means that the amount received from the sale is more than the carrying amount of the non-current asset, hence a profit is the resulting figure.

Dr. Non-current asset disposal Account

Statement of Profit or Loss

Where the non-current asset disposal account ends in a debit balance, it means that the amount received from the sale is less than the carrying amount of the non-current asset sold, hence, the loss must be recorded.

Dr. Statement of Profit or Loss

Cr. Non-current asset disposal Account

The entries above can be illustrated by assuming that the equipment purchased by Amoroso in Illustration 10.5 was sold for cash amounting to ¢295,000 at 2 January 2017. The cost of the equipment as at 2 January, 2017 was ¢800,000, its associated accumulated depreciation amounted to ¢537,856 leaving a net book value of ¢262,144 (¢800,000-¢537,856). Since the equipment was sold for ¢295,000 it means that a profit amounting to ¢32,856 will be calculated as thus:

Calculation of profit on sale of equipment	¢
Cost of equipment	800,000
Less Accumulated depreciation	537,856
Carrying Amount	262,144
Proceeds from sale of equipment	295,000
Less Carrying amount	262,144
Profit on disposal of equipment	32,856

If one again assumes that the equipment purchased by Amoroso in Illustration 10.5 was sold for cash amounting to ¢200,000 on 2 January 2017. The balance on the equipment account as at 2 January, 2017 will show cost of ¢800,000, with its associated accumulated depreciation of ¢537,856 leaving a carrying amount of ¢262,144 (¢800,000-¢537,856). Since the equipment was sold for ¢200,000, a loss amounting to ¢62,144 will be calculated as thus:

Calculation of loss on sale of equipment	¢
cost of equipment	800,000
Less Accumulated depreciation	537,856
Carrying amount	**262,144**
Proceeds from sale of equipment	200,000
Less carrying amount	262,144
Loss on disposal of equipment	**(62,144)**

The transaction involving the sale of assets at a profit as per Illustration 10.5 will be recorded as:

Equipment Account

		¢			¢
01/01/2017	Balance b/d	800,000	02/01/2017	Equipment disposals	800,000

Accumulated Provision for Depreciation Account - Equipment

		¢			¢
02/01/2017	Equipment disposals		01/01/2017	Balance b/d	537,856

Equipment Disposals Account

02/01/2017	Equipment account	800,000	02/01/2017	Accumulated provision for depreciation	537,856
31/12/2017	Statement of Profit or Loss	32,856	02/01/2017	Cash	295,000
		832,856			832,856

Statement of Profit or Loss (extract) for the year ended 31 December 2017

Gross Profit	xxxxx
Add profit on sale of equipment	32,856

10.8 Summary

In this chapter the distinction between capital expenditure and revenue expenditure has been clearly explained. The item of cost or expenditure to be capitalised should include all the activities that are intended to put the asset in a condition ready for use. We have also defined depreciation to mean the process of spreading the cost of a non- current asset over its useful life and that where an asset is fully depreciated and it is still in use one must not continue depreciating the asset. We again learnt that where an asset is disposed off during the year the carrying amount at the time of sale should be deducted from the sale proceeds and either a profit or loss on disposal posted to the Statement of Profit or Loss.

10.9 MULTIPLE CHOICE QUESTIONS

Use the data below to answer Questions 1 and 2.

Cost of Machine
Estimated useful life
Estimated residual value

1. What is the depreciable amount of the machine?
   - a. ¢48,000
   - b. ¢200,000
   - c. ¢240,000
   - d. ¢250,000
   - e. ¢270,000

2. Using straight line method, what would be the annual depreciation charge for the second year of usage?
   - a. ¢40,000
   - b. ¢40,250
   - c. ¢48,000
   - d. ¢48,250
   - e. ¢52,000

3. Dominic bought a non-current asset on credit from Mepai Company Limited. In

which subsidiary book will Mepai Company Limited record this transaction?

a. Purchases journal
b. Sales journal
c. Cash book
d. Journal proper
e. Non-current asset register

4. The fall in value of non-current intangible assets as a result of passage of time is referred to as?

a. Depletion
b. Deterioration
c. Wasting
d. Amortization
e. Obsolescence

5. Depreciation of an asset with fixed period of legal life is often referred to as?

a. Obsolescence
b. Amortization
c. Diminishing balance method
d. Depletion
e. Deterioration

6. An increase in the value of a non-current asset over and above its original cost is termed?

a. Depreciation
b. Appreciation
c. Inflation
d. Residual value
e. Deflation

7. The basic formula for the straight-line method of depreciation is given as?

i. Annual depreciation = <u>a –b</u>

c

ii. where

a. a = cost of the asset, b = expected asset life in years, c = residual value

b. a = cost of the asset, b = residual value, c = expected asset life in years

c. a = residual value, b = cost of asset, c = expected asset life in years

d. a = expected asset life in years, b = residual value, c = cost of the asset

8. Which of the following assets will not be shown on the statement of financial position of a business entity?

   a. Intangible asset such as management services
   b. Intangible asset such as goodwill
   c. Tangible asset such as machinery
   d. Tangible asset such as buildings
   e. Intangible asset such as research and development

9. Which of the following is an example of revenue expenditure?

   a. Expenditure on non-current assets bought by the firm
   b. Expenditure on the repairs of buildings
   c. Formation expenses before a company commenced business
   d. Tax paid to the Internal Revenue Service
   e. Repairs to vehicle with hooked engine

10. Every asset should have at least

    a. Tangible and intangible qualities
    b. Monetary cost and future benefit
    c. An adequate monetary value
    d. An inadequate monetary value
    e. Durable qualities

Use the information below to answer Questions 11 and 12.

A motor van was purchased by a bookshop on 1 July 2014 for ¢10,000,000 and sold on 30 June 2016 for ¢8,200,000. The firm's accounting year ends on 31 December each year. Motor vans are depreciated at 10% per annum on cost. Full year depreciation is charged in the year of purchase but none in the year of sale. The asset is not expected to have any residual value on date of sale.

11. What is the profit or loss on disposal of the motor van?

    a. ¢100,000 (loss)
    b. ¢200,000 (loss)
    c. ¢200,000 (profit)
    d. ¢1,200,000 (loss)
    e. ¢1,200,000 (profit)

12. What is the accumulated depreciation on the motor van as at 30 June, 2015?

    a. ¢500,000
    b. ¢1,000,000
    c. ¢1,500,000
    d. ¢2,000,000
    e. ¢3,000,000

13. A company has business premises worth ¢80,000,000. An additional amount of ¢20,000 was used to provide metal gate for the building. The cost of the gate should be treated as

    a. Revenue expenditure
    b. Capital expenditure
    c. Revenue receipt
    d. Capital receipt
    e. Income statement item

The following information relates to Questions 14 and 15

- Motor vehicles at cost (1/1/2016) ¢50,000,000
- Accumulated depreciation (1/1/2016) ¢18,000,000

- Depreciation is at the rate of 20% per annum using reducing balance method

14. What would be the depreciation charge for 2016?

    a. ¢6,400,000
    b. ¢6,800,000
    c. ¢7,200,000
    d. ¢10,000,000
    e. ¢29,400,000

15. What would be the carrying amount of the motor vehicles as at December, 31 2016?

    a. ¢25,600,000
    b. ¢28,800,000
    c. ¢29,200,000
    d. ¢32,000,000
    e. ¢43,200,000

16. The value of a non-current asset is recorded in a

    a. Nominal account
    b. Real account
    c. Personal account
    d. Control account
    e. Dominant account

17. Which of the following best describes the provision made for the loss in value of non-current assets that is of a wasting nature?

    a. Depletion
    b. Depreciation
    c. Amortization
    d. Capitalization
    e. Revaluation

18. An expense is said to be capital in nature if it

a. Reduces the capital of the business
b. Adds to or improves the value of a non-current asset
c. Necessitates the introduction of additional capital by the owner
d. Adds to or increases the operating expenses of the business
e. Increases the capital of the business.

10.10 EXAMINATION TYPE QUESTIONS

I. Kumbaya Ltd. made the following non-current asset purchases in 2016 accounting year.

Type of Asset	Cost (¢)	Date
Motor vehicle	70,000,000	January, 1
Furniture and fittings	120,000,000	March, 1
Furniture and fittings	40,000,000	July, 1
Motor vehicle	208,000,000	October, 1

The company's policy is to depreciate motor vehicle and furniture and fittings at the rates of 25% and 20%, using the fixed instalment and reducing balance methods respectively.

Depreciation is calculated on monthly basis.

Required:

1) The Motor Vehicle Account
2) Furniture and Fittings account
3) The respective Accumulated depreciation accounts
4) A statement of financial position (extract) for each of the years 2016 and 2017

2. Attakora is a trader dealing in the sale of second hand clothes and prepares account to 31 December of each year. The following transactions in assets have taken place:

2016	January, 1	Purchased Office Equipment for ¢150.000,000
2016	July, 1	Purchased Plant and Machinery costing ¢500.000,000
2017	October,1	Bought Plant for ¢300.000,000
2017	December,1	Purchased Office Equipment for ¢200.000,000

Attakora maintains its non-current assets at cost and depreciates its asset at a constant rate of 20% using the straight line method of providing for depreciation. Assets purchased attract full year depreciation charge in the year of acquisition, whilst any asset disposed off attracts no depreciation charge in the year of sale.

You are required to prepare the following accounts for year 2016 to 2017:

I. The Office equipment account
II. The Plant and Machinery account
III. The respective accumulated Provision for depreciation accounts
IV. A statement of financial position (extract) as at 31 December 2016 and 2017

3. A company depreciates its fleets of motor vehicles at the rate of 25%, using the reducing balance method. From the information given below, you are required to draw up the following accounts for year ended 31 December, 2015 and 2016:

a) The Motor vehicles Account
b) The accumulated depreciation account – Motor Vehicle
c) The Motor vehicle disposal account
d) A statement of financial position (extract) as at 31 December 2015 and 2016

2015	January, 1	Purchased 6 cars for ¢50.000,000 each
2015	September, 1	Purchased 2 trucks costing ¢500.000,000
2016	November,1	Sold 2 of the cars bought on 1 January 2015 for ¢90,000,000
2016	December,1	Purchased one truck for ¢200.000,000

4. Watonga commenced business on 1 March 2010 selling mobile phones and prepares accounts to 31 December of each year. The following transactions in assets have taken place:

Date	Asset	Details	Cost	Scrap value	Dep. rate
Jan, 1 2014	Land & Buildings	Purchase	¢980,000,000	¢80,000,000	4 %
Jan, 1 2014	Plant & Machinery	Purchase	¢550,000,000	¢20,000,000	10%
June, 30 2016	Building	Sale	¢480,000,000	¢20,000,000	
Aug, 1 2016	Plant & Machinery	Purchase	¢475,000,000	¢65,000,000	10%
Oct, 1 2016	Building	Purchase	¢550,000,000	Nil	4 %

Included in the land and buildings account is ¢100,000,000 representing the cost of land with a scrap value of ¢40,000,000. The scrap values of the various assets above were determined by a firm of professional valuers. The depreciation method used is the straight line method and it is the policy of the company to provide depreciation on the basis of one month ownership one month depreciation charge. The building with a scrap value of ¢20,000,000 was sold for ¢400,000,000 on June, 30 2016.

Required:

i. The respective non-current assets accounts
ii. The disposal of asset account
iii. The respective accumulated depreciation accounts

Solution to Multiple Choice Questions

1. c.
2. c.
3. d.
4. d.
5. b.
6. b.
7. b.
8. a.
9. b.
10. b.
11. c.
12. b.
13. b.
14. a.
15. a.
16. b.
17. a.
18. b.

Solution to Examination type questions

1. **Motor Vehicle Account**

		¢'000			¢'000
1/1/2016	Bank	70,000	.	.	.
1/10/2016	Bank	208,000	31/12/2016	Balance c/f	278,000
		278,000			278,000
1/1/2017	Balance b/d	278,000	31/12/2017	Balance c/d	278,050
1/1/2018	Balance b/d	278,000			

Furniture & Fittings Account

		¢'000			¢'000
1/3/2016	Bank	120,000	.	.	.
1/7/2016	Bank	40,000	31/12/2016	Balance c/d	160,000
		160,000		31/12/2017 bal c/d	160,000
1/1/2017	Balance b/d	160,000			160,000
1/01/2018	Bal b/d	160,000			

Depreciation account – Motor vehicles

		¢'000			¢'000
31/12/2016	Bal c/d	30,500	31/12/2017	Depreciation Expense	. 30,500
		30,500			30,500
				Balance b/d	30,500
31/12/2017	Bal c/f	100,000	01/01/2017	Depreciation Expense	69,500
		100,000			100,000
			01/01/2018	Balance b/d	100,000

Accumulated Depreciation Account – Furniture & Fittings

		¢'000			¢'000
31/12/2016	Balance c/f	24,000	31/12/2016	Depreciation expense	24,000
		24,000			24,000
31/12/2017	Balance c/f	51,200	1/1/2017	Balance b/d	24,000
			31/12/2017	Depreciation expense	27,200
		51,200			51,200
			1/1/2003	Balance b/d	51,200

Statement of Financial Position (Extract) as at 31 Dec.

2016	Cost ¢'000	Accumulated Depreciation ¢'000	Carrying amount ¢'000
Non-current Assets			
Motor vehicles	278,000	30,500	247,500
Furniture & Fittings	160,000	24,000	136,000
	438,000	54,500	383,500
2017			
Non-current Assets			
Motor vehicles	278,000	100,000	178,000
Furniture & Fittings	160,000	51,200	108,800
	438,000	151,200	286,800

ATTAKORA

Office Equipment Account

2.

		¢'000			¢'000
01/01/2016	Bank	150,000	31/12/2016	Balance c/f	150,000
		150,000			150,000
01/01/2017	Balance b/d	150,000	31/12/2017	Balance c/f	350,000
01/12/2017		200,000			
		350,000			350,000
01/01/2018	Balance b/d	350,000			

Plant & Machinery Account

		¢'000			¢'000
01/07/2016	Bank	500,000	31/12/2016	Balance c/f	500,000
		500,000			500,000
01/01/2017	Balance b/d	500,000	31/12/2017	Balance c/f	800,000
01/10/2017	Bank	300,000			
		800,000			800,000
01/01/2018	Balance b/d	800,000			

Accumulated Depreciation Account-Office equipment

		¢'000			¢'000
31/12/2016	Balance c/f	30,000	31/12/2016	Depreciation expense	30,000
		30,000			30,000
31/12/2017	Balance c/f	100,000	01/01/2017	Balance b/d	30,000
			31/12/2017	Depreciation expense	70,000
		100,000			100,000
			01/01/2018	Balance b/d	100,000

Accumulated for Depreciation Account-Plant & machinery

		¢'000			¢'000
31/12/2016	Balance c/f	100,000	31/12/2016	Depreciation expense	100,000
		100,000			100,000
31/12/2017	Balance c/f	260,000	01/01/2017	Balance b/d	100,000
			31/12/2017	Depreciation expense	160,000
		260,000			260,000
			01/01/2018	Balance b/d	260,000

Depreciation Expense Account-Office equipment

		¢'000			¢'000
31/12/2016	Accumulated depreciation Account	30,000	31/12/2016	Statement of Profit or Loss	30,000
		30,000			30,000
2017					
31/12/2017	Accumulated depreciation Account	100,000	31/12/2017	Statement of Profit or Loss	100,000
		100,000			100,000

Depreciation Expense Account-Plant & Machinery

		¢'000			¢'000
31/12/2016	Accumulated depreciation Account	100,000	31/12/2016	Statement of Profit or Loss	100,000
		100,000			100,000
2017					
31/12/2017	Accumulated depreciation Account	160,000	31/12/2017	Statement of Profit or Loss	160,000
		70,000			160,000

Statement of Financial Position (Extract) as at 31 December

2016	Cost **¢'000**	Accumulated Depreciation **¢'000**	Carrying amount **¢'000**
Non-current Assets			
Office Equipment	150,000	30,000	120,000
Plant & Machinery	500,000	100,000	400,000
	650,000	130,000	520,000
2017			
Non-current Assets			
Office Equipment	350,000	100,000	250,000
Plant & Machinery	800,000	260,000	540,000
	1,150,000	360,000	790,000

3.

Motor vehicles Account

		¢'000			¢'000
01/01/2015	Bank	300,000	31/12/2015	Balance c/f	800,000
01/09/2015	Bank	500,000			
		800,000			800,000
01/01/2016	Balance b/d	800,000	01/11/2016	Disposal a/c	100,000

01/12/2016	Bank	200,000	31/12/2016	Balance c/f	900,000
		1,000,000			1,000,000
01/01/2017	Balance b/d	900,000			

Accumulated Depreciation Account-Motor vehicles

		¢'000			¢'000
31/12/2015	Balance c/f	116,667	31/12/2015	Depreciation expense	116,667
		116,667			116,667
11/01/2016	Disposal a/c	40,625	01/01/2016	Balance b/d	116,667
31/12/2016	Balance c/f	247,917	31/12/2016	Depreciation expense	171,875
		288,542			288,542
			01/01/2017	Balance b/d	247,917

Disposal Account - Motor vehicles

		¢'000			¢'000
1/11/2016	Motor vehicles	100,000	1/11/2016	Bank	90,000
1/11/2016	Profit/loss	30,625	1/11/2016	Accumu. Dep	40,625
		115,000			130,625

Depreciation Expense Account-Motor vehicles

		¢'000			¢'000
31/12/2015	Accumulated depreciation Account	116,667	31/12/2015	Statement of Profit or Loss	116,667
		116,667			116,667
2016			2016		
31/12/2016	Accumulated depreciation Account	171,875	31/12/2016	Statement of Profit or Loss	171,875
		179,167			179,167

Statement of Financial Position (Extract) as at 31 December

2015	Cost **¢'000**	Accumulated Depreciation **¢'000**	Carrying amount **¢'000**
Non-current Assets			
Motor vehicles	800,000	116,667	683,333
2016			
Motor vehicles	900,000	247,917	652,083

4. Watanga

Land & Building Account

		¢'000			¢'000
Jan 1 2014	Bank	980,000	31/12/2014	Balance c/f	980,000
		980,000			980,000
Jan 1 2016	Balance b/d	980,000	11/01/2015	Balance c/f	980,000
		980,000			980,000
	Balance b/d	980,000	07/01/2016	Disposal a/c	480,000
	Bank	550,000	31/12/2016	Balance c/f	1,050,000
		1,530,000			1,530,000
	Balance b/d	1,050,000			

Plant & Machinery Account

		¢'000			¢'000
1/1/2014	Bank	550,000	31/12/2014	Balance c/f	550,000
		550,000			550,000
1/1/2015	Balance b/d	550,000	31/12/2015	Balance c/f	550,000
		550,000			550,000
1/1/2016	Balance b/d	550,000	31/12/2016	Balance c/f	1,025,000
1/8/2016	Bank	475,000			
		1,025,000			1,025,000
1/1/2017	Balance b/d	1,025,000			

Accumulated Depreciation Account- Land & Buildings

		¢'000			¢'000
31/12/2014	Balance c/f	36,000	31/12/2014	Depreciation expense	36,000
		36,000			36,000
31/12/2015	Balance c/f	72,000	01/01/2015	Balance b/d	36,000
			31/12/2015	Depreciation expense	36,600
		72,000			72,000
11/01/2016	Disposal a/c	46,000	01/01/2016	Balance b/d	72,000
31/12/2016	Balance c/f	58,300	31/12/2016	Depreciation expense	32,300
		104,300			104,300
			01/01/2017	Balance b/d	58,300

Accumulated Depreciation Account- Plant & machinery

		¢'000			¢'000
31/12/2014	Balance c/f	53,000	31/12/2014	Depreciation expense	53,000
		53,000			53,000
31/12/2015	Balance c/f	106,000	1/1/2015	Balance b/d	53,000
			31/12/2015	Depreciation expense	53,000
		106,000			106,000
31/12/2016	Balance c/f	176,083	1/1/2016	Balance b/d	106,000
			31/12/2016	Depreciation expense	70,083
		176,083			176,083
			1/1/2017	Balance b/d	176,083

Disposal Account - Buildings

		¢'000				¢'000
30/6/2016	Buildings	480,000	30/6/2016	Bank		400,000
			30/6/2016	Prov. For dep.		46,000
			30/6/2016	Profit & loss		34,000
		480,000				480,000

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Year	Carrying amount at start of year	Depr' n Rate	Depreciation for the year	Accum. Depreciation	Carrying amount at end of year
CARS	¢'0000	¢'0000	¢'0000	¢'0000	¢'0000
2015	**300,000(6)**	**25%**	**75,000**	**75,000**	**225,000**
2016	**150,000(4)**	**25%**	**37,500**	**87,500**	**112,500**
	75,000(2)	**25%**	**15,625**	**40,625**	**-(sold)**
	225,000		**53,125**	**128,125**	**112,500**
TRUCKS					
2015	**500,000(2)**	**25%**	**41,667 (4 months)**	**41,667**	**458,333**
2016	**458,333 (2)**	**25%**	**114,583**	**156,250**	**343,750**
	200,000(1)	**25%**	**4,167 (1 month)**	**4,167**	**195,833**
	658,333		**118,750**	**160,417**	**539,583**

Accumulated Depreciation

	2015	2016	Total
	¢'000	¢'000	¢'000
Cars	**75,000**	**53,125**	**128,125**
Trucks	**41,667**	**118,750**	**160,417**
	116,667	**171,875**	**288,542**
Less: Accum. Depre on sold cars			**40,625**
			247,917

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Depreciation Allowance

Land and Buildings

2014	Cost	Scrap Value	Depreciable Amount	Depreciation
	¢'000	¢'000	¢'000	¢'000
Land	100,000	40,000	60,000 x 4%	2,400
Building	880,000	40,000	840,000 x 4%	33,600
	980,000	80,000	900,000	36,000
2015	-	-	-	36,000
2016				
Land	100,000	40,000	60,000 x 4%	2,400
Building disposed	480,000	20,000	460,000 x 4% x $^{6}/12$	9,200
Remainder	400,000	20,000 (balance)	380,000 x 4%	15,200
	980,000	80,000	900,000	
Addition				
Building (Oct 1)	550,000	NIL	550,000 x 4% x $^{3}/12$	5,500
				32,300

Accumulated Depreciation – Building Disposed				
2014 Building	480,000	20,000	460,000 x 4%	18,400
2015 Building	-	-	-	18,400
2016 Building	480,000	20,000	460,000 x 4% x $^{6}/12$	9,200
Total				46,000

Land and Buildings

		¢'000			¢'000
1/1/2014	Bank	980,000	31/12/2014	Balance b/d	980,000
		980,000			980,000
1/1/2015	Balance b/d	980,000	1/12/2015	Balance c/d	980,000
		980,000			980,000
1/1/2016	Balance b/d	980,000	30/6/2016	L & B Disp A/c	480,000
1/10/2016	Bank	550,000		Balance c/d	1,050,000
		1,530,000	31/12/2016		1,530,000
1/1/2017	Balance b/d	1,050,000			

Accumulated Depreciation Account (Land & Buildings)

		¢'000			¢'000
31/12/2014	Balance c/d	36,000	31/12/2014	Depreciation Expense	36,000
		36,000			36,000
31/12/2015	Balance c/d	72,000	1/1/2015	Balance b/d	36,000
		72,000	31/12/2015	Depreciation Expense	36,000
					72,000
30/6/2016	L&B disposal A/c	46,000	1/1/2016	Balance b/d	72,000
31/12/2016	Balance c/d	58,300	31/12/2018	Depreciation Expense	32,300
		104,300			104,300
			1/1/2017	Balance b/d	58,300

Depreciation Expense Account (Land & Buildings)

		¢'000			¢'000
31/12/2014	Accumulated depreciation	36,000	31/12/2014	Statement of Profit or Loss	36,000
		35,000			35,200
31/12/2015	Accumulated depreciation	36,000	31/12/2015	Statement of Profit or Loss	36,000
		36,000			36,000
31/12/2016	Accumulated depreciation	32,300	31/12/2015	Statement of Profit or Loss	32,300
		32,300			32,300

Disposal Account - Buildings

		¢'000			¢'000
30/6/2016	Land & Buildings	480,000	30/6/2016	Bank	400,000
			30/6/2016	Accumulated depreciation	46,000
			30/6/2016	Profit or Loss Account	34,000
		480,000			480,000

Depreciation – Plant & Machinery

2014	Cost	Scrap Value	Depreciable Amount	Depreciation
	¢'000	¢'000	¢'000	¢'000
Plant & Machinery	550,000	20,000	530,000 x 10%	53,000
2015	550,000	20,000	530,000 x 10%	53,000
2016				
Plant & Machinery (old)	550,000	20,000	530,000 x 10%	53,000
Addition Aug 1	475,000	65,000	410,000 x 10% x $^{5}/12$	17,083
				70,083

Depreciation Expense Account – Plant & Machinery

		¢'000			¢'000
31/12/2014	Accumulated depreciation	53,000	31/12/2014	Statement of Profit or Loss	53,000
		53,000			53,000
31/12/2015	Accumulated depreciation	53,000	1/12/2015	Statement of Profit or Loss	53,000
		53,000			53,000
31/12/2016	Accumulated depreciation	70,083	31/12/2016	Statement of Profit or Loss	70,083
		70,083			70,083

Accumulated Depreciation – Plant & Machinery

		¢'000			¢'000
31/12/2014	Balance c/d	53,000	31/12/2014	Depr. expense	53,000
		53,000			53,000
31/12/2015	Balance c/d	106,000	1/1/2015	Balance b/d	53,000
		106,000	31/12/2015	Depr. expenses	53,000
			1/1/2016	Balance b/d	106,000
			1/1/2016	Balanceb/d	106,000
31/12/2016	Balance c/d	176,083	31/12/2016	Depr. expense	70,083
					176,083
		176,083	1/1/2017	Balance b/d	176,083

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7. Ghana National Accounting Standards 9 – (Property, Plant and Equipment)
8. Ghana National Accounting Standards 10 – (Accounting for Depreciation)
9. Nigeria Accounting Standard Board (1984), statement of Accounting Standard No. 3 – Accounting for Property, Plant and Equipment
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CHAPTER ELEVEN

END OF PERIOD ADJUSTMENTS

11.0 Learning Objectives

After you have studied this chapter, you should be able to:

- Differentiate between capital expenditure and revenue expenditure
- Explain the effect on profit if a revenue expenditure has been wrongly classified as a capital expenditure, and vice versa
- Explain prepayments and accruals
- Pass adjusting entries in respect of prepayment and accruals
- Explain and pass entries in respect of irrecoverable debts and allowance for doubtful debts
- Record increases and decreases in the allowance for doubtful debts
- Calculate and make entries with respect to allowance for discount on receivables and payables.

11.1 Introduction

There are many change that occur in the management of an entity's economic resources and financial obligations. For example, interest accrues daily on debts, as rent expense on an office building. Other resources and obligations such as employee salaries originate as service is rendered, with payment to follow at specified dates. The end of the accounting period generally does not coincide with the receipts or payment of cash associated with all types of resource changes. Adjusting entries are, therefore, used to record such resource changes to ensure the accuracy of the financial statements. This chapter will consider some of the adjustments most commonly made in the preparation of the final accounts and also discuss why such adjustments are required, their treatment in both the Statement of Profit or Loss and Statement of Financial Position will be treated in detail.

Accountants rely on two principles in the adjusting process – **revenue recognition** and **matching principles**. The revenue recognition concept requires that revenue be reported when earned, not before and not after. Revenue is earned for most entities when services and products are delivered to customers. If an entity sells goods in 2016 to a customer, the revenue was earned in 2016 and as such should be reported in the 2016 Statement of Profit or Loss for year 2016, even if the customer paid for the goods in a day later than 2016.

The matching principle aims to report expenses in the same accounting period as the revenues that are earned as a result of incurring these expenses. The matching of expenses with revenue is a major part of the adjusting process. As an example if a business earns monthly revenue while operating out of rented store space, the matching concept stipulates that rent must be reported on the statement of profit or loss for a particular period, December, even if rent is paid in a period earlier than or after December. This ensures that the rent expense for December is matched with the revenue of the particular month.

At the end of an accounting period, it is likely that an entity will find that some expenses have been paid which relate to the next accounting period, whilst other amounts, which relate to the current period remain outstanding. In order that the account shows a true and fair view of the entity's Financial Performance, adjustments for such items are necessary. Adjustments are classified into three categories:

(1) Deferrals and prepayments

(2) Accruals

(3) Other adjustments

11.2 Deferred Revenue and Prepayments

Deferrals or prepayments refer to transactions where cash is paid or received before a related expense or revenue is recognized. These transactions are recorded when cash is paid for expenses that apply to more than one accounting period or when cash is received for revenue that relates to more than one accounting period. The portion of the expense or revenue that applies to the future period is deferred as a prepaid expense (asset) or unearned revenue (liability). If we do not make adjustments for prepayments and unearned revenues, profit for the current period will be understated or overstated respectively. Items, which normally need to be prepaid, include rent and rates, insurance and road licensing fee.

The accounting entry requires the prepayment to reduce the relevant expense in the Statement of Profit or Loss thereby increasing profit. The same applies to the unearned revenue, where the adjusting entry reduces the relevant revenue in the Statement of Profit or Loss thereby decreasing profit. Since conceptually the prepayment represents an amount owned by an entity from a third party and unearned revenue represents amounts owed by the business to third party, they are included under current assets and current liabilities respectively in the statement of financial position. The accounting entries are as follows:

Debit: Prepayments (Statement of financial position)

Credit: Expenses (Statement of profit or loss)

Debit: Revenue (Statement of profit or loss)

Credit: Unearned revenue (Statement of financial position)

Illustration 11.1

Assume that Santo Ltd. paid ¢240,000 for two years insurance protection beginning on December 1, 2016.

The cash payment of ¢240,000 will be debited to the insurance account. With the passage of time, the benefit of the insurance protection gradually expires and a portion of the unexpired insurance is transferred to the next accounting period as a prepaid expense. For instance, one month's insurance coverage expires by December 31, 2016. This expense is ¢10,000 , 240,000 x $^{1}/_{24}$ The insurance account will be as follows:

Insurance Account

		¢			¢
1/12/2016	Cash	240,000	31/12/2016	Profit or loss	10,000
				Prepaid c/f	230,000
		240,000			240,000
1/1/2017	Prepaid b/f	230,000	31/12/2017	Profit or loss (240,000 x $^{12}/24$)	120,000
			31/12/2017	Prepaid c/f	110,000
		230,000			230,000
1/1/2018	Prepaid b/f	110,000			

The balances carried forward of ¢230,000, and ¢110,000 represents insurance prepaid to be shown under current assets in the Statement of Financial Position for the years 2016 and 2017 respectively.

The adjusting entries will be journalized as follows:

2016	Dr ¢	Cr ¢
Insurance Prepaid	230,000	
Insurance expense		230,000
2017		
Insurance Prepaid	110,000	
Insurance expense		110,000

Let us now illustrate the treatment of deferred revenue as follows:

Illustration 11.2

Assume that Santo Ltd rented a small office in its building to a customer on January 1, 2016. The rental agreement required the payment of ¢180,000 cash in advance for 18 month's rent. This transaction is recorded as

Dr: Cash. Cr: Rent Received.

On December 31, 2016, the unadjusted Trial Balance will report ¢180,000 as rent received, which is overstated by ¢60,000 (6/18 x ¢180,000) relating to 2017. The rent received account will be as follows:

Rent receivable account

		¢'000			¢'000
31/12/2016	Profit or loss	120,000	1/1/2016	Cash	180,000
31/12/2016	Balance c/f	60,000			180,000
		180,000	1/1/2017	Balance b/f	60,000

The balance carried forward of ¢60,000 in 2016 represents unearned revenue which will be recorded under current liabilities in the Statement of Financial Position for the year 2016. The adjusting entry will be journalised as follows:

	Dr. ¢	Cr. ¢
Rent receivable A/c	60,000	
Deferred Rent Revenue		60,000

11.3 Accrued Expenses

Accrued expenses and accrued revenues reflect transactions where cash is paid or received after a related expense or revenue is recognized. It represents an item, the use of which the firm has already benefited from during the current accounting period, but which will not be paid for until the next accounting period. If we do not make an adjustment the profit for the current period will be overstated. Examples of items that need to be accrued for include electricity, since it is not likely that these bills will exactly coincide with the entity's accounting year-end. The accounting entry for accrued expense is:

	Dr.	Cr.
Expense (Statement of Profit or loss)	x	
To: Accrued expense (Statement of financial position)		x

In this case, the relevant expense in the Statement of Profit or Loss is increased by the accrued amount whilst in the Statement of Financial Position, accruals appear under current liabilities, reflecting an amount owing by the business entity.

Illustration 11.3

Assume Santo Ltd's Trial Balance recorded electricity expenses of ¢600,000 which cover the period Jan 1 to 31 October 2016. A careful examination of the previous electricity bills of Santo Ltd shows that the company's consumption of energy is even throughout the period.

The above example tells us that the electricity charge in the Trial Balance does not cover the entire year. This means that an accrual is required for the period of November 1 to 31 2016. Since electricity is used evenly throughout the year, we can estimate the outstanding amount based on the bills received to date. The ¢600,000 recorded in the Trial Balance represents 10 months of electricity charge, therefore, the accrual is estimated as follows:

Accrual = ¢600,000 x 2/10 = ¢120,000

The electricity expense recorded as follows:

Electricity Expenses Account

		¢'000			¢'000
1/1/2016	Cash	600,000	31/1/2016	Profit or Loss	720,000
31/12/2016	Balance c/f	120,000			
		720,000			720,000
			1/1/2017	Balance b/f	120,000

The balance carried forward of ¢120,000 in 2017 represents accrued expense and will be recognized as current liabilities in the Statement of Financial Position. The adjusting entry will be as follows:

		¢	¢
Electricity expense A/c	Dr.	120,000	
To: Accrued Expense A/c			120,000

11.4 Accrued Revenue

Accrued revenue refers to transactions where cash is received after related revenue is recognized. It represents an item, the use of which the entity has already dispensed with during the current accounting period, but which will not be received until the next accounting period. If we do not make an adjustment the profit for the current period will be understated. Examples of items that need to be accrued for include interest earned on treasury bills of which payment has not been received, since it is not likely that the maturity of these bills will exactly coincide with the entity's accounting year- end. The accounting entry for accrued revenue is:

		₦	₦
Accrued income (Statement of Financial Position)	Dr.	x	
To: Interest Receivable (Statement of Profit or Loss)			x

In this case the relevant income in the Income statement is increased by the accrued amount. In the statement of financial position the accrued income will appear under current assets, reflecting an amount owned by the business entity.

Illustration 11.4

Assume that the Trial Balance of Sky Ltd. shows interest receivable of ¢855,000. Excluded from the Trial Balance is a 182 days Bank of Ghana Bond purchased on August, 1 2015 at an interest rate of 15% per annum at a cost of ¢12,000,000. Sky Ltd prepares account to December, 31 each year.

From the illustration above, Sky Ltd. will receive a total of ¢900,000 (15% x ¢12,000,000 x 6/12) representing interest that will be earned on the bond for the period August, 1 2015 to

January, 31 2016. Since five months interest amounting to ¢750,000 (5/6 x ¢900,000) relates

to 2015 financial year, it must be accrued in the Statement of Profit or Loss for 2015 though the amount will be received after 2015. The interest receivable account will be recorded as follows:

Interest Receivable Account

2015			2015		¢'000
Dec 31	Statement of profit or Loss	1,605,000	Dec 31	Cash	855,000
			Dec 31	Int. Receivables (Unearned income) c/d	750,000
		1,605,000			1,605,000
2016			2016		
Jan 1	Balance b/d	750.000	Jan 31	Cash	900,000
Dec 31	Statement of profit or Loss	150,000			
		900,000			900,000

The adjusting entry will be as follows:

	Dr. ¢	Cr. ¢
Interest accrued A/c	750,000	
To: Interest receivable A/c		¢750,000

11.5 Other adjustments

11.5.1 Depreciation Expense

As stated earlier, the non-current assets (both tangible and intangible) reduce in value of their expected useful life due to factors identified in an earlier chapter of this book. The reduction in value is accounted for using depreciation. The depreciable value of the non-current assets are spread over its useful life. The accounting treatment is as follows:

	Dr. ¢	Cr. ¢
Depreciation expense (Statement of Profit or Loss)	X	
To: Accumulated Depreciation (Statement of financial position)		X

The effect of the entry is to show depreciation as a business expense in the Statement of Profit or Loss, thereby reflecting the proportion of cost or valuation attributable to the current period. The fact must not be forgotten that depreciation is a non-cash item. This means it is a book adjustment only, which does not involve the physical movement of cash.

Illustration 11.5

Given below is the record of depreciation extracted from the books of Santos Ltd. at the end of 2015 under the straight-line method.

Assets (Cost) ¢		Residual Estimated Value ¢	Useful life	Proportional use by function	
				Selling & Distribution	**Administrative**
Building	1,600,000	100,000	15 yrs	46%	54%
Equipment	910,000	10,000	10 yrs	40%	60%

Computation:

		Selling ¢	Administration ¢
Building [(¢1,600,000-¢100,000)÷15yrs]	100,000	46,000	54,000
Equipment[(910,000-10,000)÷10yrs]	90,000	36,000	54,000
Totals	190,000	82,000	108,000

The adjusting entry for these two assets is:

		Dr. ¢	Cr. ¢
Depreciation Expense	Selling expense	82,000	
	Administration expense	108,000	
Accumulated Depreciation:	Building		100,000
	Equipment		90,000

The adjusting entry reduces the carrying amount of the building and equipment accounts. The Accumulated Depreciation account is a contra account that has a stated balance against that of the assets account to which it relates. Thus, the accumulated depreciation account is deducted from the gross building and equipment accounts, leaving the carrying amounts of ¢1,500,000 (¢1,600,000-¢100,000) and ¢820,000 (¢910,000-¢90,000) for building and equipment respectively in the Statement of Financial Position.

11.5.2 Bad Debts or Irrecoverable Debts.

An entity that sells its goods on purely cash basis, does not have to worry about customers not paying for such goods. This is, however, not always the case. Goods and services are usually sold or rendered on credit, giving rise to trade receivables. The business entity is therefore taking the risk of some customers defaulting in the payment of their debts. Trade receivables that cannot be collected are called bad debts or irrecoverable debts, which is the risk of doing business on credit terms.

Where a customer's debt is found to be irrecoverable, steps must be taken to remove such debts from the list of customers owing the business entity. This is done by completely writing off the debt from the receivables account. Writing off of a particular debt from the list of receivables accounts means that the value of the assets (receivables) of the business has reduced or diminished. This has the effect that the business entity has incurred losses that must be accounted for by increasing the expense account of irrecoverable debt, which will eventually reduce profit and also reduce assets of receivables. This also translates to a reduction of the net assets of the business.

Where an account containing a debt is declared 'irrecoverable' a journal entry must be passed as follows:

	Dr. ₦	Cr. ₦
Bad /Irrecoverable debts expense account (Statement of Profit or Loss)	x	
To: Trade receivables account (Statement of financial position)		x

It is important for entities to review their receivables periodically and identify those debts that are unlikely to be collected in full. These irrecoverable debts may then be written-off in the statement of profit or loss. This practice prevents overstatement of both profit and assets and is always required if irrecoverable debts are probable and can be estimated. At the end of the accounting period the total debt written off is transferred from the irrecoverable debts account to the Statement of Profit or Loss as follows:

	Dr.	Cr.
Statement of Profit or Loss	x	
Irrecoverable debts account		x

Illustration 11.6

Jack Terror has been in business for several years dealing in the sale of second hand clothes. During the three years ended October, 31 2016, he presented the following information relating to receivables:

	Credit sales	Irrecoverable Debts
	¢	¢
October, 31 2014	4,500,000	1,200,000
October, 31 2015	8,750,000	3,850,000
October, 31 2016	12,200,000	6,300,000

You are required to show the above information for the year ended October, 31 2014, 2015 and 2016 in the following accounts:

(a) Trade receivables account

(b) Irrecoverable debts account

(c) Statement of Profit or Loss

Solution to Illustration 11.6

(a) **Trade Receivable Account**

	¢		¢
31/10/2014 Sales	4,500,000	31/10/2014 Irrecoverable debts	1,200,000
		31/10/2014 Balance c/f	3,300,000
	4,500,000		4,500,000
1/11/2014 Balance b/f	3,300,000		

Trade Receivable Account

	¢		¢
31/10/2015 Sales	8,750,000	31/10/2015 Irrecoverable debts	3,850,000
		31/10/2015 Balance c/f	4,900,000
	8,750,000		8,750,000
1/11/2015 Balance b/f	4,900,000		

Trade Receivables Account

	¢		¢
31/10/2016 Sales	12,200,000	31/10/2016 Irrecoverable debts	6,300,000
		31/10/2016 Balance c/f	5,900,000
	12,200,000		12,200,000
1/11/2016 Balance b/f	5,900,000		

(b) Irrecoverable debt Account

	¢		¢
31/10/2014 Trade Receivables	1,200,000	31/10/2014 Statement of Profit or Loss	1,200,000
31/10/2015 Trade Receivables	3,850,000	31/10/2015 Statement of Profit or Loss	3,850,000
31/10/2016 Trade Receivables	6,300,000	31/10/2016 Statement of Profit or Loss	6,300,000

c. Statement of Profit or Loss (extract) ended October, 31 xxxxxx

		¢	¢
2014	Gross profit	xxxxxx	
	Less Irrecoverable debts	1,200,000	x
2015	Gross profit	xxxxxx	
	Less Irrecoverable debts	3,850,000	x
2016	Gross profit	xxxxxx	
	Less Irrecoverable debts	6,300,000	x

11.5.3 Allowance for doubtful debts

This is the process of making allowance for the possibility of a debt becoming irrecoverable in the future but by what amount cannot be calculated with substantial accuracy. In the case of doubtful debts, the amount or its estimate still remains in the list of receivables and is not cancelled from the receivables account unlike the case of debts that have actually become irrecoverable. Doubtful debt does not relate to any specific debtor, but the business entity recognizes the fact that not all the existing debts will be collected and as such, it is prudent that such uncertainty is reflected in the Statement of Profit or Loss and the statement of financial position. The accounting treatment necessary to make a provision for doubtful debts is:

1. When a provision is made for the first time:

   Debit: Statement of Profit or Loss
   Credit: Allowance for doubtful debts Account } With the initial allowance made.

In this way the current year's profit is reduced, whilst in the statement of financial position the allowance is clearly shown and deducted from trade receivables.

2. In subsequent accounting period's new estimate must be made in respect of debts that may be considered doubtful. The new allowance should be compared with the existing one and

where the current allowance is greater than the previous one, the difference representing an increase in allowance for doubtful debts should be accounted for as follows:

Debit: Statement of Profit or Loss	With the increase
Credit: Allowance for doubtful debts	(current allowance less previous allowance)

However, if the current allowance is less than the previous one, the difference representing a decrease in allowance for doubtful debts should be accounted for as follows:

Debit: Allowance for doubtful debts account	With the reduction in allowance made
Credit: Statement of Profit or Loss	(Previous allowance less current allowance)

Illustration 11.7

Viscosity Ltd. has been in business since 2014 dealing in the sale of mobile phones. During the three-years period ended December, 31 2016 the company presented the following information relating to receivables:

	Receivables (excluding Irrecoverable debts)	Irrecoverable Debts
	¢	¢
31 December, 2014	7,000,000	1,000,000
31 December, 2015	18,250,000	2,500,000
31 December, 2016	10,000,000	4,300,000

Viscosity Ltd. makes provision for doubtful debts at the rate of 6% on receivables. There was no balance on the provision for doubtful debt at the beginning of 2014 financial year.

You are required to show the above information for the year ended 31 December, 2014, 2015 and 2016 in the following accounts:

(a) Irrecoverable debt

(b) Allowance for doubtful debts account

(c) Statements of Profit or Loss (extracts)

(d) Statements of financial position (extracts)

Solution to Illustration 11.7

(a) Irrecoverable debts account

		¢			¢
31/12/2014	Trade Receivables	1,000,00	31/12/2014	Statement of Profit or Loss	1,000,000
31/12/2015	Trade Receivables	2,500,000	31/12/2015	Statement of Profit or Loss	2,500,000
31/12/2016	Trade Receivables	4,300,000	31/12/2016	Statement of Profit or Loss	4,300,000

(b) Allowance for doubtful debts account

		¢			¢
31/12/2014	Balance c/f	420,000	31/12/2014	Statement of Profit or Loss	420,000
		420,000			420,000
			1/1/2015	Balance b/f	420,000
31/12/2015	Balance c/f	1,095,000	31/12/2015	Statement of Profit or Loss	675,000
		1,095,000			1,095,000
31/12/2016	Statement of Profit or Loss	495,000	1/1/2016	Balance b/f	
					1,095,000
31/12/2016	Balance c/d	600,000			
		1,095,000	1/1/2017	Balance b/f	600,000

(c) Statement of Profit or Loss (extract) for the year ended 31 December xxxxxxx

		¢	¢	¢
2014	Gross profit		xxxxxx	
	Less Irrecoverable debts	1,000,000		
	Increase in allowance for doubtful debt	420,000	(1,420,000)	x
2015	Gross profit		xxxxxx	x
	Less bad debts	2,500,000		
	Increase in Provision for doubtful debt	675,000	3,175,000	x
2016	Gross profit		xxxxxx	
	Add Decrease in Provision for doubtful debt	495,000		
	Less bad debts	(4,300,000)	(3,805,000)	x

(d) **Statement of Financial Position (extract) at 31 December xxxxxxx**

		¢	¢
2014	Trade Receivables	7,000,000	
	Less allowance for doubtful debts	420,000	6,580,000
	Increase in allowance for doubtful debt		
2015	Trade Receivables	18,250,000	
	Less allowance for doubtful debts	675,000	17,575,000
2016	Trade Receivables		
	Less allowance for doubtful debts	10,000,000	
	Less bad debts	675,000	9,400,000

11.5.4 Irrecoverable Debts Recovered

It is a common occurrence that a debt, which has previously been written off in previous accounting periods, may be paid or recovered. In such a situation, the recovered debt should be reinstated. The debt is reinstated in the sales ledger account to ensure that a detailed and concise history of the customer is available as a guide for granting credit to the same customer in future. It will also assist the entity in its credit rating of all customers that buy goods from them on credit.

The accounting entries when a debt is recovered are:

Debit: Trade Receivables account
Credit: Irrecoverable debts recovered account } With the amount of debt reinstated

Debit: Cash or bank account
Credit: Trade Receivables account } With the amount recovered from the customer in full or part settlement of all of debt owed

At the end of the accounting period the balance in the irrecoverable debts recovered account will either be transferred directly to the Statement of Profit or Loss or to the main irrecoverable debts account. Whichever way the transfer will produce the same result.

11.5.5 Allowance for Discount on Trade Receivables

In certain businesses allowance is made for cash discount that is expected to be offered to customers on the trade receivables balance at the reporting period end. Proponents of this concept argue that since entities allow discounts on credit sale for prompt payment, recording gross realisable value of receivables as the balance on receivables account less allowance for doubtful debts alone will not give the best estimate of the amount expected to be collected from trade receivables. They argue that the best estimate of the value of receivable is that one that gives effect to cash discounts. Hence, making the determination of allowance for discounts on receivables.

The way in which allowance for discount on receivables is calculated is almost the same as when calculating allowance for doubtful debts alone. You must however remember to apply the same rate or percentage to the net amount of trade receivables less allowance for doubtful debts. This is so because discounts are allowed on debts expected to be paid and not irrecoverable debts.

Illustration 11.8

Mahatma Ltd. has been in business since 2014 dealing in the sale of Italian executive shoes. During the three years ended 31 December 2016 the company presented the following
information relating to receivables:

	Trade Receivables	Allowance for doubtful debts	Allowance for cash discount allowed
	¢	¢	%
31 December 2014	17,000,000	1,000,000	4
31 December 2015	28,550,000	4,500,000	4
31 December 2016	22,000,000	2,800,000	4

You are required to show the above information for the years ended 31 December, 2014, 2015, and 2016 in the following accounts:

a. Allowance for discounts on receivables
b. Statements of Profit or Loss (extracts)
c. Statements of financial position (extracts)

Solution to Illustration 11.8

(a) Allowance for discounts on receivables account

		Notes	¢'000			Notes	¢'000
31/12/2014	Balance c/f		640,000	31/12/2014	Statement of Profit or Loss	(1)	640,000
				1/1/2015	Balance b/d		640,000
31/12/2015	Balance c/f	(2)	962,000	31/1/2015	Statement of Profit or Loss	(4)	322,000
			962,000				962,000
31/12/2016	Statement of Profit or Loss	(5)	194,000	11/1/2016	Balance b/f	(2)	962,000
31/12/2016	Balance c/f	(3)	768,000				
			962,000				962,000
				1/1/2017	Balance b/f		768,000

Statement of Profit or Loss (extract) for the year ended 31 December xxxxxxx

		¢	¢	¢
2014	Gross profit		xxxxxx	x
	Less allowance for doubtful debt	1,000,000		
	Allowance for discount on receivables	640,000	(1,640,000)	x
2015	Gross profit		xxxxxx	x
	Less allowance for doubtful debts (Note 4)	4,500,000		
	Allowance for discount on receivables	322,000	4,822,000	x
2016	Gross profit		xxxxxx	
	Less: Allowance for doubtful debts.	2,800,000		
	Decrease in allowance for discounts on receivables (Note 6)	(194,000)	2,606,000	x

(c) Statement of Financial Position (extract) as at 31 December xxxxxxxx

	¢	¢	¢
2014			
Receivables		17,000,000	
Less allowance for doubtful debts	1,000,000		
allowance for discounts on receivables	640,000	1,640,000	
			15,360.000
2015			
Receivables		28,550.000	
Less allowance for doubtful debts	4,500,000		
allowance for discounts on receivables	962,000	(5,462,000)	
			23,088,000
2016			
Receivables		22,000,000	
Less allowance for doubtful debts	2,800,000		
allowance for discounts on receivables	768,000	(3,568,000)	
			18,432,000

Note 1: ¢ (1,7000,000 – 1,000,000) x 4% = ¢ 640,000
Note 2: ¢ (28,550,000 – 4,500,000) x 4% = ¢ 962,000
Note 3: ¢ (22,000,000 – 2,800,000) x 4% = ¢ 768,000
Note 4: ¢ (4,500,000 – 1,000,000) = ¢3,500,000 (Increase in allowance)

Note 5: ¢ (4,500,000 – 1,000,000) = ¢3,500,000 (Increase in allowance)

Note 6: ¢ (768,000 – 962,000) = -194,000(decrease in allowance)

11.7 Summary

In this chapter we have considered some of the adjustments that are often made to improve the quality of the year-end accounts used to prepare the financial statements. We should also understand that these adjustments are needed in order to record the actual expenses incurred and the actual revenue earned for the accounting year. It must also be remembered that each of the adjustments considered will impact upon the Statement of Profit or Loss and the Statement of Financial Position.

We have learnt that depreciation is a business expense that must be charged in the statement of profit or loss of any period that a non-current asset has been in use. In addition we learnt that any business debt that an entity is unable to collect is called a irrecoverable debt and that there is the need to also record allowance for irrecoverable debts so that the receivable figures in the statement of financial position will reflect the amount that the business is likely to collect from receivables. Finally we have also learnt how to record irrecoverable debts, allowance for

doubtful debts, allowance for cash discounts in the ledger, Statement of profit or loss and the statement of financial position. It is hoped that, readers will have better understanding of the purpose and accounting treatment for depreciation, irrecoverable debts allowance and accruals and prepayments.

11.8 Multiple Choice Questions

1. Which of the following would result from an increase in the allowance for doubtful debts?
   a. A decrease in gross profit
   b. An increase in gross profit
   c. A decrease in net profit
   d. An increase in net profit
   e. An increase in asset

Use the following details to answer Question 2.

Trade receivables control account balance	¢500,000.00
Allowance for doubtful debts	¢ 50,000.00
Allowance for discount allowed on receivables	5%

2. The receivables figure to be shown under current assets in the Statement of Financial position is
   a. ¢425,000.00
   b. ¢427,500.00
   c. ¢447,500.00
   d. ¢450,000.00
   e. ¢475,000.00

3. During year 2016, Victor paid rent amounting to ¢500,000. He owed ¢50,000 at the beginning of the year and by 31 December 2016, he had paid rent in advance of ¢100,000. His rent charge for 2016 was?

   a. ¢350,000
   b. ¢450,000
   c. ¢500,000
   d. ¢550,000
   e. ¢650,000

4. At the end of the first year of trading, a trader's receivables amounted to ¢5,000. This excludes ¢180 debts found to be irrecoverable. At the same date, it was estimated that ¢70 of the ¢5,000 would still turn out to be irrecoverable debts. Determine the net realisable value of receivables at the end of the first year of trading.

   a. ¢4,750
   b. ¢4,820

c. ¢4,930
d. ¢5,000
e. ¢45,030

5. A trader had trade receivables of ¢50,000 at the end of his accounting period. Trade receivables at the beginning of the period was ¢60,000. His policy is to make allowance for doubtful debts at the rate of 5%. State the change in value of the allowance for doubtful debts at the end of the current accounting period.

   a. ¢500 decrease in allowance
   b. ¢500 increase in allowance
   c. ¢2,500 decrease in allowance
   d. ¢2,500 increase in allowance
   e. ¢3,000 decrease in allowance

6. When a debt thought to be irrecoverable and written off is subsequently recovered, which additional entry is required to complete the two entries given below?

   I. Debit Personal Account/Credit Irrecoverable Debts Recovered Account
   II. Debit Cash/Bank Account/Credit Personal Account
      a. Debit Income statement/Credit irrecoverable debts recovered account
      b. Debit Statement of Profit or Loss/Credit Cash/Bank account
      c. Debit irrecoverable debts recovered account/Credit Statement of Profit or Loss account
      d. Debit irrecoverable debts recovered account/Credit personal account
      e. Debit cash/credit Statement of Profit or Loss

7. From the following information, calculate the cash paid by trade receivables during the year.

   Receivables at the beginning of the year¢350,000
   Receivables at close of the year ¢500,000
   Credit sales for the year ¢510,000

   a. ¢340,000
   b. ¢360,000
   c. ¢380,000
   d. ¢520,000
   e. ¢660,000

8. The fact that allowances are made against doubtful debts upholds the concept of

   a. Consistency
   b. Prudence
   c. Materiality
   d. Business entity
   e. Realisation

9. Which accounting concept does not agree with making allowance for discount receivable?

   a. Prudence

b. Business entity
c. Accruals
d. Consistency
e. Materiality

10. A customer owing ¢200,000 was allowed to pay ¢180,000 in full settlement of his indebtedness. This results in a

a. Decrease in liability, increase in asset and increase in capital
b. Decrease in asset, decrease in capital and decrease in liability
   Receivables/Cash/Capital
c. Decrease Receivables, increase cash and decrease capital’

d. Decrease in capital, decrease in asset and increase in liability
e. Increase in capital, decrease in asset and decrease in liability

11. Annual rent payable is ¢500,000. Rent prepaid at 1 January, 2016 was ¢80,000 and rent accrued at 31December 2016 was ¢60,000. How much was paid in respect of rent in 2016?

a. ¢360,000
b. ¢420,000
c. ¢480,000
d. ¢500,000
e. ¢520,000

11.9 THEORY AND CALCULATION QUESTIONS

1. On 1 January, 2016 the following balances among others stood in the books of Menntua Enterprise.

Electricity and Water	¢15,000,000 Cr.
Insurance	¢50,000,000 Dr.

During the year ended 31 December 2016, the following information relating to the above accounts have been provided:

a. Motor insurance of ¢870,000,000 was paid on 1June 2016 for a one year period.

b. Marine insurance of ¢190,000,000 covering the year ended 31March 2017 was paid on 1st April 2016. The Entity had not insured one of its buildings in respect of fire after the insurance premium expired on 31 December 2015. The Building was insured for ¢60,000,000 last year and the insurance company does not intend to renew the premium.

c. Electricity bill amounting to ¢750,000,000 was paid on 1 March 2016 and also electricity bill amounting to ¢250,000,000 in respect of November and December 2016 had not been paid by the end of the accounting period. On June 1, 2016

¢15,000,000 was paid in respect of an old building that is being used as warehouse by the entity. This payment was made at a time when there was no meter in the building. The electricity bill for the building was arrived at by charging the entity ¢13,500,000 for total consumption in 2016.

You are required to record the above transactions in the appropriate ledger accounts.

2. The following balances were extracted from the ledgers of Victorosky Ltd..

	01/04/2015	31/03/2016
	¢'000	¢'000
Rent receivable –Prepayments	108,000	215,000
Rates and insurance- Prepayment	450,000	385,000
Accruals	103,000	185,000
Trade receivables	798,000	985,000
Stationery: inventories in hand	235,000	275,000
Owing to suppliers	109,000	97,500

During the year ended 31 March 2016, the following transactions took place:

	¢'000
Rent received by cheque	418,000
Rates paid to AMA by cash	950,000
Payment to suppliers for stationery	205,000
Irrecoverable debts written off on a customer who has been declared bankrupt	50,000
Insurance paid by cheque	550,000
Discount allowed	65,000
Cheque received from customers	8,525,000

You are required to post and balance the above transactions in the appropriate ledger accounts.

3. The Trial Balance of Santo Ltd. At 31 December 2014 reported an amount of ¢750,000 by way of trade receivables. At the time of preparing the Trial Balance, the accounts clerk discovered that a customer owing ¢150,000 would not be able to settle such debts. It is the policy of Santo Ltd. to make allowance for doubtful debts of 5% of all outstanding trade receivables at the end of each accounting period.

During the accounting year ended 31 December 2015 the company made a total credit sale of ¢980,000 out of which an amount of ¢550,000 was collected from trade receivables. A court in Accra declared a customer who owes the company an amount of ¢85,000 bankrupt in August 2015. The company recorded three cheques amounting to ¢175,000 that were dishonoured.

The company recorded ¢1,500,000 and ¢850,000 in connection with cash sales and credit sales respectively in the year 2016. The company received ¢1,250,000 from trade receivables and also showed ¢670,000 as the outstanding balance on the sales ledger account. A cheque was received from the customer whose debt was written off in 2014 in full settlement of his debt.

You are required to post and balance the following accounts:

a. Trade receivables account

b. Irrecoverable debts account

c. Allowance for doubtful debts account

4. The net profit of Kumasa Ltd. for years ended 31 December 2013, 2014, 2015 and 2016 were ¢450,000,000, ¢598,000,000, ¢515,000,000 and ¢798,000,000 respectively. It has now been found that the wrong method of depreciation has been used over the years for motor vehicles and Plant and Machinery.

Details on the assets are as follows:

	Date	Cost ¢'000	Scrap value ¢'000	Depreciation Rate
Plant and Machinery	1/1/2013	980,000	40,000	10%
Motor vehicles	1/1/2013	670,000	20,000	25%

The straight line method of depreciation was used with an estimated useful life of ten (10) years and four (4) years for Plant and Machinery and Motor vehicles respectively. The directors of the company have now decided to adopt the diminishing balance method of providing for depreciation as follows:

Plant and Machinery	15%
Motor vehicles	20%

You are required to re-compute the net profit of Kumasa Ltd. for the years ended 31 December 31 2013, 2014, 2015 and 2016

Solution to Multiple Choice Questions

1. c.
2. b.
3. a.
4. c.
5. a.
6. c.
7. b.
8. b.
9. a.
10. c.
11. a.

Solution to Examination type Questions

Solution to question 1

Menntua Enterprise

Water and Electricity Account

2016		¢'000	2016		¢'000
March 1	Bank	750,000	Jan 1	Balance b/f	15,000
June 1	Bank	15,000	Dec 31	Statement of Profit or Loss	998,500
Dec 31	Balance c/d	250,000	Dec 31	Balance c/d(15000-13,500)	1,500
		1,015,000			**1,015,000**
2017				2017	
Jan 1	Balance b/f	1,500	Jan 1	Balance c/d	250,000

Insurance Account

2016		¢'000	2016		¢'000
Jan 1	Balance b/d	50,000	Dec 31	Statement of Profit or Loss	760,000
April 1	Bank	190,000	Dec 31	Balance c/d	
				- Marine	47,500
				- Motor	362.500
June 1	Bank	870,000			
Dec 31	Balance	60,000			
		1,170,000			**1,170,000**
2017				2017	
Jan 1	Balance b/d:		Jan 1	Balance b/f	60,000
	Marine	47,500			
	Motor	262,500			

Solution to question 2

Victorosky Ltd.
Rent Receivable Account

2015		¢'000	2015		¢'000
31/3/2015	Statement of Profit or loss	311,000	1/4/2015	Prepaid b/f	108,000
31/3/2015	Prepaid c/f	215,000		Bank	418,000
		526,000			**526,050**
2017			1/4/2016	Prepaid b/f	215,000

Rates and Insurance Account

2015		¢'000	2015		¢'000
April 1	Balance b/f	450,000	April 1	Bal b/f	103,000
	Cash	950,000		Profit and Loss	1,647,000
	Bank	550,000		Prepaid c/f	385,000
	Owing c/f	185,000			
		2,135,000			**2,135,000**
				Owing b/f (fire)	185,000

Trade Receivables Account

2015		¢'000	2015		¢'000
April 1	Balance b/f	798,000		Bal b/f	103,000
				Bank	8,525,000
	Credit Sales	8,930,000		Irrecoverable debt	50,000
				Discount allowed	65,000
				Bal c/f	**985,000**
		9,728,000			**9,728,000**
	Bal b/f	985,000			

Stationery Account

2015		¢'000	2015		¢'000
April 1	Balance b/f	235,000	April 1, 2016	Bal b/f	109,000
2016	Bank	205,000	March 31	Statement of Profit or Loss	153,500
March 31	Owing c/f	97,500	March 31	Prepaid c/f	275,000
2016		537,500	2016		537,500
April 1	Prepaid b/f	275,000	April 1	Owing b/f	**97,500**

Solution to question 3

Santo Ltd.
Trade Receivables Account

a.

		¢'			¢
2014	Balance b/f	750,000	2014	Irrecoverable debt	150,000
				Bal c/f	600,000
		750,000			750,000
2015	Bal b/f	600,000	2015	Bank	550,000
2015	Credit sales	980,000	2015	Irrecoverable debt	85,000
2015	Dishonoured cheque	175,000	2015	Bal c/f	1,120,000
		1,755,000			1,755,000
2016	Bal b/f	1,120,000	2016	Bank	1,250,000
2016	Credit sales	850,000	2016	Irrecoverable debt	50,000

2016	Irrecoverable debt recovered account	150,000			Bank (debt recovered)	150,00
				2016	Bal c/f	670,00
		2,120,000				2,120,0
2017	Bal b/f	670,000				

b.

Irrecoverable Debts Account

		¢'			¢
2014	Trade receivables	150,000	2014	Statement of Profit or Loss	150,000
		150,000			150,000
2015	Trade receivables	85,000			
		85,000	2015	Statement of Profit or Loss	85,000
					85,000
2016	Trade receivables	50,000	2016	Trade Receivables (debt recovered)	150,000
	Statement of Profit or Loss	100,000			150,000
		150,000			
					150,000

c. **Allowance for doubtful debts account**

		¢'			¢
2014	Balance c/d	30,000	2014	Statement of Profit or Loss	30,000
		30,000		(750,000 – 150,000) x 5%	30,000
2015	Balance c/d	56,000			
		56,000	2015	Balance b/d	30,000
				Statement of profit or loss (1120,000 x 5% - 30,000)	26,000
					56,000
					56,000
2016	Statement of profit or loss(reduction)	22,500			
	Balance c/d	33,500	2017	Balance b/d	33,500
		56,000			

Solution to question 4

Kumasa Ltd.
Straight line method – Plant and machinery

Year	Beginning Depreciable Amount	Depreciation Rate	Depreciation for the year	Accumulated Depreciation
	¢		¢	¢
2013	940,000,000	10%	94,000,000	94,000,000
2014	940,000,000	10%	94,000,000	188,000,000
2015	940,000,000	10%	94,000,000	282,000,000
2016	940,000,000	10%	94,000,000	376,000,000

Straight line method- Motor Vehicles

Year	Begining Depreciable amount	Depreciation Rate	Depreciation for the year	Accumulated Depreciation
	¢		¢	¢
2003	650,000,000	25%	162,500,000	162,500,000
2004	650,000,000	25%	162,500,000	325,000,000
2005	650,000,000	25%	162,500,000	487,500,000
2006	650,000,000	25%	162,500,000	650,000,000

Reducing balance method – Plant and Machinery

Year	Beginning Depreciable amount	Depreciation Rate	Depreciation for the year	Accumulated Depreciation	Closing Depreciable amount
	¢		¢	¢	
2013	940,000,000	15%	141,000,000	141,000,000	799,000,000
2014	799,000,000	15%	119,850,000	260,850,000	679,150,000
2015	679,150,000	15%	101,872,500	362,722,500	577,277,500
2016	577,277,500	15%	86,591,625	449,314,125	490,685,875

Motor vehicles

Year	Beginning Depreciable amount	Depreciation Rate	Depreciation for the year	Accumulated Depreciation	Closing Depreciable amount
	¢		¢	¢	¢
2013	650,000,000	20%	130,000,000	130,000,000	520,000,000
2014	520,000,000	20%	104,000,000	234,000,000	416,000,000
2015	416,000,000	20%	83,200,000	317,200,000	332,800,000
2016	332,800,000	20%	66,560,000	383,760,000	266,240,000

Computation of Adjusted Net profit for the years ended 31 December 2013, 2014, 2015, and 2016.

	2013	2014	2015	2016
	¢000	¢000	¢000	¢000
Net profit before adjustment	450,000	598,000	515,000	798,000
Add Depreciation (wrong				
method)	162,500	162,500	162,500	162,500
Motor vehicles	94,000	94,000	94,000	94,000
Plant & equipment				
	706,500	854,500	771,500	1,054,500
Less Depreciation (correct	(130,000)	(104,000)	(83,200)	(66,560)
method)	(141,000)	(119,850)	(101,873)	(86,592)
Motor vehicles				
Plant & equipment				
Adjusted Net Profit	**435,500**	**630,650**	**586,427**	**901,348**

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CHAPTER TWELVE

PREPARATION OF SIMPLE FINANCIAL STATEMENTS

12.0 Learning Objectives

After you have studied this chapter, you should be able to:

- define, explain and record returns inwards, returns outwards, carriage inwards and carriage outwards.
- identify items that will appear in the Statement of Profit or Loss and statement of Financial Position of a sole trader
- explain why carriage inwards and carriage outwards are recorded in the Statement of Profit or Loss
- prepare the inventories account and show how the opening and closing inventories are treated in the Statement of Profit or Loss
- prepare a Statement of Profit or Loss and Statement of Financial Position
- pass the necessary adjustments in respect of accruals, prepayments and provisions that affect the Statement of Profit or Loss
- explain and calculate cost of goods sold taking into consideration the appropriate adjustments such as returns inwards and outwards, carriage inwards and outwards, and inventories
- prepare Manufacturing Account

12.1 Introduction

The information recorded in the book-keeping system (ledger records) is analysed and summarised periodically (usually each year) and the summarised information is presented in Financial Statements. The objects of preparing financial statement is to provide information that is useful for decision making.

The components of financial statements as earlier stated in this manual include:

(b) A statement of profit or loss and other comprehensive income;

(c) A statement of financial position;

(d) A statement of changes in equity;

(e) A statement of cash flows; and

(f) Notes to the financial statements

In this syllabus, the focus is on the statement of profit or loss but other comprehensive income is outside the syllabus hence the statement in this study text is going to concentrate on the statement of profit or loss. The other statement treated in this syllabus is the statement of financial position.

12.2 Preparation of Financial Statements

The basic approach to preparing a statement of profit or loss (a performance statement) and a statement of financial position (a position statement) in practice is summarised as follows:

a. The balances on all the accounts in the ledgers are extracted into a trial balance
b. Adjustments are made for year-end items
c. Prepare the statement of profit or loss for the year from the adjusted income and expenses to determine profit for the year
d. After the determination of profit, prepare the statement of financial position. This is done using accounting equation: Asset(Non-current and current) = Equity (Capital) + Liabilities (Non-current and current)

12.3 The Trial Balance

The first step in the preparation of the final accounts is the compilation of a Trial Balance, with a view to:

(a) Confirming the arithmetical accuracy of the Ledger postings, and

(b) Providing in one statement a concise summary of the items, which are to be included in the Statement of profit of loss and the Statement of Financial Position.

Debit balances recorded in the Trial Balance normally represent either assets, losses or expenses. The assets are reported in the Statement of Financial Position, while losses and expenses are debited to the Statement of profit of loss.

Also, credit balances represent liabilities, allowances, reserves, or revenues and gains. The liabilities are reported in the Statement of Financial Position while income and gains are credited to the Statement of profit or loss.

Candidates must remember to carefully distinguish between balances which appear in the Statement of profit or loss, and those that appear in the Statement of Financial

Position. The Statement of profit or loss essentially closes off all the nominal account balances during a particular accounting period. Any account, which remains in the Trial Balance after the Statement of profit of loss has been prepared, represents either assets or liabilities that must be recognized in the Statement of Financial Position. The balance on the Statement of profit of loss will finally be transferred to the capital account in the Statement of Financial Position.

12.4 The Statement of Profit or Loss

The main objective of this Statement is the determination or calculation of the gross and net profits for the period. It is also in this account that the cost of obtaining the goods, usually referred to as cost of goods sold or simply as cost of sales is calculated.

Another important function of this Statement is that it enables the owner of a business entity to compare the gross and net profit of a current period with the results attained in previous periods. It is pertinent that, the component items in the Statement or profit or loss do not vary in any material effect from previous and subsequent accounts, as this will make it impossible for any analyst to make meaningful approximate comparison. This therefore means that the Statement of profit or loss should be standardized so that the same items appear in similar form in the successive final accounts in order that an effective comparison may be made of one financial year and another.

A Statement or Profit or Loss is a Performance Statement

The actual items in the Statement of profit or loss of different classes of entities will necessarily vary depending on the nature of the nominal accounts in the respective business; for example, customs duty, licenses, and freight and insurance on inward shipments of raw materials will be essential items in the books of a cigarette manufacturer, but these particular items would not appear in the Statement of profit or loss of a retail tobacconist.

The following is the usual method of preparing the Statement of profit or loss.

On the debit side are recorded:

(1) Inventories at commencement of the period, which is usually, called opening

inventories.

(2) Purchases during the period (less returns outwards) – net purchases

(3) All purchase expenses, such as wages, carriage inwards, and other items which are incurred in putting the product in a saleable condition or location.

The account is credited with-

1. Sales during the period (less returns inwards) – net sales.
2. Inventories at end of period (it is the usual practice of deducting the closing inventories figure from the sum total of opening inventories and net purchases on the debit side of the Statement of profit or loss so as to show on the face of the account the cost of goods sold).

Where there is a credit balance on the Statement of profit or loss, then the business entity has recorded a gain, which is referred to as gross profit and will be transferred to the net Income section as a credit entry.

Before we attempt to complete the Statement of profit or loss of an entity in detail we need to understand the following accounting terminologies:

12.4.1 The movement of inventories

Entities usually maintain four different accounts for the inventories function. These are:

- Sales account
- Returns Inwards Account or Sales Returns Account
- Purchases account and
- Returns outwards account or Purchases Returns Account

Goods sold are recorded in the Sales account and goods returned by customers (returns inwards) are recorded in the returns inwards account. In the same vein, transactions involving goods bought for sale are recorded in Purchases account while goods bought but returned to the supplier are recorded in the returns outwards account.

Usually, sales are recorded separately on the credit side of the sales account; no further entries are debited into the account. The return inwards account is not recorded in the debit side of sales account. The normal accounting entry for return inward is: Debit returns inward and credit customer's account or receivables account. The returns inwards account serves as a contra to the sales account by recording all sales that have been returned by customers. Return inward, being a contra entry to sales account has a debit balance, which is usually deducted from sales at the end of the financial period in the statement of profit or loss to have net sales. Thus, sales minus return inward is described as net sales.

The accounting entries will be recorded as follows

a. Cash Sales

Dr. Cash Cr. Sales Account	With goods sold for cash

b. Credit Sales:

Dr. Trade Receivables Account Cr. Sales Account	with goods sold on credit

c. Returns inwards Account

Dr. Returns inwards Account Cr. Trade Receivables Account	With goods sold but returned by customers

d. Closing Balance on Returns Inwards Account

Dr. Sales Account (by deduction) Cr. Returns inwards Account	With the closing balance on the return inwards account

Similarly the purchases account is maintained separately for recording all goods bought for the sole purpose of resale in the accounting period. The returns outwards account serves as a contra to the purchases account. Into this account is recorded all purchases that were returned to suppliers. Being a contra account to the purchases account means that it is eventually deducted from purchases when preparing the Statement of Profit or Loss. The net effect shows the net purchases of the entity for the period.

The accounting entries will be recorded as follows:

a. Cash Purchases:

Dr. Purchases Account Cr. Bank Trade Payables Account	With goods bought for cash

b. Credit Purchases

Dr. Purchases Account

CR. Trade Payables Account — With goods bought on credit

12.4.2 Carriage inwards and outwards

Carriage is an accounting terminology that refers to the cost of transport that a trading entity incurs in moving goods meant for resale into or out of the entity. Where the carriage is charged for delivering goods purchased, it is called carriage inwards. Carriage of goods upon sale out of a firm to customers is called carriage outwards.

Carriage inward: is a cost that is incurred in order to bring the goods into the company in a condition that is necessary for its sale and as such should be charged to the Statement of Profit or Loss. This is done by adding the carriage inwards to the purchases figure in the Statement of Profit or Loss. This ensures that the true cost of buying goods for resale is taken into account in calculating the gross profit of an entity.

Carriage outwards however, is not considered as a relevant cost for the purpose of putting the asset into a saleable condition. It is therefore, not added (i.e debited) to purchases in the trading section of the Statement of Profit or Loss. As such, carriage outwards is not included in the calculation of gross profit. This is because carriage outwards is seen as expenses on sales; and as a result is charged against the gross profit along with other expenses in the Statement of Profit or Loss.

12.4.3 Goods (Inventories) taken by the Proprietor

In the last chapter, the reader's attention was drawn to the practice of taking out for their personal uses, goods or other tangible assets of their businesses by sole proprietors and partners. The use of such products or goods (inventories) by the proprietors and partners is termed "drawings" and this constitutes a part withdrawal of the owner's capital.

The accounting effect of proprietor's drawings is a reduction in the cost of goods available for sale by the value of inventories drawn. This transaction should therefore be posted in the books thus:

	Dr	Cr
Inventories drawings	X	
To Purchases Account		X

Goods for sale taken out by the owner.

Alternatively, this can be shown as a deduction from purchases on the Statement of Profit or Loss before arriving at the gross profit from trading activities.

The total of all drawings (goods or other tangible assets) are eventually deducted from the capital plus net profit in the Statement of financial position.

Illustration 12.1

From the following Trial Balance of Jack Terror after his first year's trading, you are required to prepare a Statement of Profit or Loss for the year ended 30 June 2016 and a Statement of Financial Position as on the same date..

	¢000	¢000
Sales		28,000
Purchases	20,000	
Carriage outwards	800	
Electricity	400	
Salaries & Wages	3,100	
Insurance	150	
Buildings	50,000	
Fixtures	2,000	
Receivables	3,500	
Returns inwards	450	
Payables		2,050
Bank	3,250	
Drawings	2,400	
Carriage inwards	650	
Motor Vehicles	8,000	
Capital		64,405
Returns outwards		745
Rent of computers	500	
	95,200	**95,200**

Solution to Illustration 12.1

Statement of Profit or Loss for the year ended 30 June, 2016

	¢000	¢000
Sales		28,000
(Return inwards)		450
Net sales		27,550

Less: Cost of sales		
Purchases	20,000	
Carriage inwards	650	
	20,650	
Returns outwards	745	19,905
Gross Profit		7,645
Expenses		
Carriage outwards	800	
Electricity	400	
Salaries & Wages	3,100	
Insurance	150	
Rent of Computers	500	
		(4,950)
Profit for year		2,695

Statement of Financial Position as at 30 June, 2016

Assets	**¢000**	**¢000**
Non-current assets		
Buildings	50,000	
Fixtures	2,000	
Motor vehicles	8,000	
		60,000
Current Assets		
Receivables	3,500	
Bank	3,250	6,750
Total Assets		66,750
Equity and Liabilities		
Capital (Equity)		64,405
Net Profit		2,695
Drawings		(2,400)
		64,700
Current Liabilities		
Payables		2,050
Total Assets and Liabilities		66,750

12.4.4 The accounting treatment of inventories

From the above Statement of Profit or Loss, one can deduce that the entity is a new one as there were no inventories at the start of period and so only the goods that were purchased during the year were sold during the accounting period ended 30 June 2016. The usual practice is for entities in trading activities to hold certain minimum level of inventories to meet future demand.

In practice, it is expected that an entity would have as closing inventories, goods that were bought in the current accounting period but have not been sold. Goods that were bought for the purpose of resale in an accounting period but have not been sold in that particular period and carried forward to the next accounting period constitute what is referred to as closing inventories.

It must be noted that the closing inventories of an accounting period is brought forward as the opening inventories of the next accounting period. This is treated in the Statement of Profit or Loss by adding the opening inventories to the purchases figure which gives rise to cost of goods available for sale and deducting the closing inventories figure resulting in cost of goods sold.

Illustration 12.2

The following is the Trial Balance of Victorosky Trading Enterprise who has been in business for several years. You are required to draw up the Statement of Profit or Loss for the year ended 31 December 2016 and a Statement of Financial Position as at that date..

	Dr.	Cr.
	₦000	₦000
Sales		45,000
Purchases	38,000	
Carriage inwards	1,800	
Inventories at 1/1/2016	4,000	
Returns inwards	2,550	
Payables		2,050
Bank	3,250	
Receivables	6,450	
Motor vehicles	11,500	
Capital		18,750
Returns outwards		1,750
	67,550	**67,550**

The following additional information is available:

1. Inventories at the end of the period ₦6,500,000
2. The proprietor withdrew goods valued at 8,500,000 for his household.

Solution to Illustration 12.2

Victorosky Trading Enterprise Statement of Profit or Loss for the year ended 31 December 2016

	₦'000	**₦'000**
Sales		45,000
Returns inwards		(2,550)
Revenue		42,450
Cost of Sales		
Opening inventories	4,000	
Purchases	38,000	
Carriage inwards	1,800	
	43,800	
Returns outwards	(1,750)	
Drawings – inventories	(8,500)	
	33,550	
Closing Inventory	(6,500)	(27,050)
Gross Profit		15,400
Expenses		(-)
Net Profit		15,400

Statement of Financial Position as at 31 December 2016

Assets	**₦'000**	**₦'000**
Non-current assets		
Motor vehicles		11,500
Current Assets		
Inventories	6,500	
Receivables	6,450	
Bank	3,250	16,200
Total Assets		27,700
Equity and Liabilities		
Equity		18,750
Net Profit		15,400
Drawings		8,500
		25,650
Current Liabilities		
Payables		2,050
Total Assets and Liabilities		27,700

12.5 Statement of Profit or Loss

The main function of the Statement of Profit or Loss is to ascertain the net profit resulting from the trading activities of the accounting period.

It is debited with the gross loss and with the general, Selling, Distribution and Administration expenses for the period, and is credited with the gross profit and any miscellaneous gains made, such as interests discounts received and allowances for irrecoverable and doubtful debts no longer required.

The following format of IAS 1 is recommended for use.

IAS 1: Presentation of Financial Statements:

Statement of Profit or Loss account for the year ended............

		₦
Revenue		XX
Return inwards		XX
Net Revenue (A)		(XX)
Cost of goods sold:		
Opening inventories		XX
Purchases		XX
Carriage inwards		XX
Inventories drawings		(XX)
Return outwards		(XX)
Cost of goods available for sale		XX
Less closing inventories		(XX)
Cost of goods sold (B)		XX
Gross profit (A – B) = C		XX
Decrease in provision for irrecoverable debts		XX
Commission received/receivable		XX
Discount received/receivable		XX
Other income		XX
Total profit from operation (D)		XX
Expenses:		
Administrative expenses:		
Salaries and wages		XX
Accrued salaries		XX
Stationery		XX
Prepaid stationery		(XX)
Depreciation of office building		XX
		XX
Distribution expenses:		XX
Advertising	(E)	XX

Bad debt		XX
Allowance for irrecoverable debt		XX
Discount allowed		XX
Sales commission		XX
Depreciation of delivery van		XX
		XX
Finance costs:	(F)	XX
Interest on loan		XX
Interest on overdraft		XX
		XX
Total expense (E + F + G) = H		XX
Net profit from operation(D-H)		XX
Personal Income Tax		(X)
Net Profit After Tax		XX

Examiners may require candidates to prepare the Statement of Profit or Loss and Statement of Financial Position, from a Trial Balance, which already contains the gross profit figure. The inventories that appear in the Trial Balance in this situation are the closing inventories, which must be recorded in the Statement of Financial Position as a current asset and should not be treated as an adjustment in the Statement of Profit or Loss. The opening inventories will not be recorded because it has already been accounted for in the inventories prior to the extraction of the Trial Balance.

The balance on the Statement of Profit or Loss represents net profit or loss of the business of the entity. The resulting balance in the statement whether debit or credit will be transferred to the debit or credit of the capital account of the proprietor. The effect of this entry is to close off the Statement of Profit or Loss to the capital account.

12.5.1 Adjustments in the Final Accounts

The ultimate objective of preparing the Statement of Profit or Loss and the Statement of Financial Position, is to enable the management of an entity determine:

(a) The result of operations during a given period; and

(b) The financial position at the end of that period.

It must also be noted that, in order to obtain these results accurately, it is necessary to make adjustments for:

(1) Expenses incurred but not yet paid.

(2) Expenses paid in advance, that is a proportion of it relate to subsequent

accounting period(s).

(3) Income earned in respect of the current accounting period but has not yet been received.

(4) Income received during the current accounting part of which relate to the next accounting period.

(5) Allowance for possible losses, e.g., Irrecoverable debts, and discounts on receivables.

(6) Necessary adjustments for depreciation in the values of the non- current assets at the end of the trading period.

12.6 The Statement of Financial Position

It is a position statement that shows the net worth of an entity. This Statement shows the Financial Position of an entity as at the end of an accounting period. It is therefore a concise summary of assets and liabilities of an entity so arranged that the financial position of the entity on the date of the statement may be clearly ascertained.

The arrangement of the Statement of Financial Position is nothing but the expression of the accounting equation (i.e Assets = Capital (Equity) + Liabilities) and as such must always agree or balance. This means the total carrying amount of assets must be equal to the sum of the values of Capital/Equity and Liabilities. The assets of a business are usually arranged in order of their permanence and for this reason' they may conveniently be classified into non-current and current assets.

12.6.1 Non-current assets

These are assets which by their nature or the type of business in which they are employed, are held with the aim of earning revenue and not for the purpose of sale in the normal course of business. Non-current assets are generally valued at cost, less allowances for accumulated depreciation that is sufficient to reduce the carrying amount of the asset to its salvage or scrap value by the end of its useful working life. Examples of non-current assets are land, buildings, motor vehicles and office equipment.

It must be emphasised that the amount at which non-current assets are shown in the Statement does not reflect the amount that will be realised if sold or the cost that will be incurred when they are replaced, but rather it is a historical record of their cost less allowances made for accumulated depreciation. Depreciation represents that part of the cost of a non- current asset to its owner, which is not recoverable when the asset is finally scrapped or sold. Allowance against this loss of capital must be made before calculating the amount of profit or loss made by a business entity.

12.6.2 Current assets

These are assets that are acquired and held for resale, and not as agents of production, but for the purpose of eventual conversion into cash. They are therefore not permanent in nature, but are continually changing in the ordinary course of business. Examples of current assets are cash, receivables, closing inventories and bills receivable. The professionally accepted basis of valuing inventories is “cost price or net realizable value, whichever is the lower.” The fundamental reason for this basis of valuation is that anticipated losses should always be provided for as far as possible, while anticipated profits should be ignored until actually realised.

Although, examples of current and non-current assets have been mentioned above, it must be remembered that the dividing line between current and non- current assets is a thin one. This is due to the fact that what is considered a non-current asset in one business may be a current asset in another, and any classification must depend upon the nature of the particular business carried on by the entity. For example a business that manufactures and sells furniture will certainly record a motor vehicle purchased as a non-current asset and furniture as a current asset but if he uses any of the furniture in the office such furniture will be classified as a non-current asset.

12.6.3 Liabilities

A liability is defined as:

- a present obligation of an entity
- arising from past events
- the settlement of which is expected to result in an outflow of resources that embody economic benefits

A liability is an obligation that already exists. An obligation may arise also from normal business dealings usually from past transactions or events. Trade payables for example, arise out of past purchase transactions so also an obligation to pay a bank loan must have arisen out of past borrowings.

In the Statement of Financial Position, liabilities are usually presented under two main categories.

a. **Current Liabilities**

Current liabilities represent amounts payable by the entity within twelve months (i.e) within the entity's normal operating cycle), for example trade payables, accruals, bank overdrafts and outstanding tax obligation.

b. **Non-current Liabilities**

Non-current liabilities refer to those obligations that will mature for settlement more than one year after the period end. Examples are long term borrowings, bank loans and loan notes.

12.6.4 Capital Account

This represents the contribution of the proprietor of an entity to the assets that the entity has acquired. It is made up of the following:

(1) The initial amount that the owner used in starting the business

(2) Any additional amount that he invested in the business during any accounting period

(3) The net profit from the Statement of Profit or Loss, which has the effect of increasing the capital of the owner at the end of the accounting period

(4) The net loss from the Statement of Profit or Loss that has the effect of reducing the capital account balance at the end of the period, and

(5) Drawings, which eventually results in the reduction of the capital balance.

12.7 Manufacturing Account

In the performance reporting (Statement of Profit or Loss) of trading entities, we ascertain operating profit or loss in the financial year. This statement does not provide any information that explain cost of goods manufactured. We shall then proceed to determine profit or loss in a manufacturing entity.

Manufacturing entities usually prepare a supplementary statement called Manufacturing Account. This account shows the cost of goods produced or manufactured. The cost of goods manufactured, normally called the production costs is transferred from the Manufacturing Account into the Statement of Profit or Loss by crediting the Manufacturing Account and debiting the Statement of Profit or Loss. The production cost effectively replaces purchases found in the Statement of Profit or Loss of a retail entity. It must however be noted that where a manufacturing entity produces more than one product, a separate Manufacturing Account should be prepared for each product, usually in form of a departmental account.

The sequence and grouping of items in a Manufacturing Account depends on the costing system of the entity. It is usually designed to yield the maximum amount of information on the composition of the total cost of production. The classification, sequencing and grouping of the Manufacturing Account is as follows:

- Prime cost
- Factory overhead
- Production cost
- Work-in-progress

12.7.1 Prime cost

(1) This is the cost of raw materials consumed. These consist of the cost of direct materials that the entity purchased and used in the manufacturing process. It is calculated as follows:

	¢
Opening inventories of raw materials	500,000
Add Purchases of raw materials	2,500,000
	3,000,000
Less returns outwards of raw materials	200,000
Cost of raw materials available	2,800,000
Less closing inventories of raw materials	600,000
Cost of raw materials consumed	2,200,000

(2) **Direct labour costs**: These consist of the cost of labour such as wages of operatives and workers (both casual and regular) whose efforts are traceable directly to the manufactured product.

(3) **Direct Expenses**: These consist of all direct costs other than direct materials and direct labour. Examples include royalties and cost of hiring machine.

All the above costs sum up to “Prime Cost”.

12.7.2 Factory Overheads:

This sub-heading is shown immediately below the prime cost figure and consists of all indirect costs in respect of materials, labour and expenses. They may include rent, rates, electricity, depreciation of plant and equipment, insurance, the wages of foremen in the factory and research and development costs.

Expenses that are common to the manufacturing process as well as to the general administration of the entity are to be apportioned between the Factory, Administration, Selling and Distribution costs. The method or basis commonly used in apportioning these common expenses will usually be provided in an examination question.

12.7.3 Production Cost:

This is the summation of the prime costs and factory overhead figures. The factory overheads consist of indirect materials, indirect labour and indirect expenses. This represents the total cost that a manufacturing entity incurs in the production process and is transferred to the Statement of Profit or Loss for that accounting period.

Illustration 12.3

Kefir Enterprises, a manufacturing entity has presented the following balances for the year ended 30 June 2016.

	¢
Inventories of raw materials at 1/7/2015	30,000
Purchases of raw materials	40,000
Return outwards	2,000
Manufacturing wages	40,000
Carriage outwards	28,000
Depreciation of Plant	5,600
Rent and rates	16,000
Inventories of raw materials of 30/06/2016	26,000
Factory expenses	16,800
80% of rent and rates relates to the factory	

You are required to prepare the Manufacturing Account for the year ended 30 June 2016.

Solution to Illustration 12.3

The Manufacturing Account will be prepared as follows:

Kefir Enterprises

Manufacturing Account for the year ended 30 June 2016.

	₦	₦
Opening inventories		30,000
Add purchases	40,000	
Returns outwards	(2,000)	38,000
		68,000
Less closing inventories		26,000
Cost of raw material consumed		42,000
Manufacturing wages		40,000
Prime cost		82,000
Factory Overheads:		
Depreciation of Plant	5,600	
Factory expenses	16,800	
Rent and rates (Factory) 80%	12,800	35,200
Manufacturing cost c/f		117,200

12.7.4 Work-in-progress

The time spent by manufacturing entities to complete a unit or batch of production is not the same; it varies from one entity to another. It is therefore possible that at the time that the accounting period of a manufacturing entity ends there might be some products that are not fully complete. Those products that have not been completed at the date of the statement of financial position are called inventories of work-in-progress.

The cost of production must be adjusted for work-in-progress at the end at and the beginning of the accounting period. This is due to the fact that the amount to be transferred to the Statement of Profit or Loss must contain the cost of only products that are fully complete. Any item or product that has not been fully processed cannot be sold; hence they must not appear in the Statement.

Illustration 12.4

Koki Enterprise is a manufacturing entity and has presented the following balances for the year ended 30 June 2016.

	¢
Inventories of raw materials at 1/7/2015	80,000
Purchases of raw materials	240,000
Work-in-Progress 1/7/2015	58,000
Return outwards	35,000
Manufacturing wages	160,000
Office salaries	67,000
Carriage inwards	44,000
Depreciation of Plant	56,000
Insurance expenses – factory	28,000
Inventories of raw materials as at 30/06/2016	48,000
Factory expenses	66,000
Work-in-Progress 30/06/2016	50,000
Royalties paid	72,000

Required: Prepare the Manufacturing Account for the year ended 30 June 2016

Solution to Illustration 12.4

The cost of production taking into ‘consideration’’, work-in-progress would be prepared as follows:

Koki Enterprises

Manufacturing Account for the year ended 30 June 2016

	₦	₦
Raw materials		
Opening inventories		80,000
Purchases	240,000	
Carriage inwards	44,000	
	284,000	
Returns outwards	(35,000)	249,000
Cost of raw materials available		329,000
Closing inventories		(48,000)
Cost of raw materials consumed		281,000
Manufacturing wages	160,000	
Royalties paid	72,000	232,000
PRIME COST		513,000
Factory Overheads		
Depreciation of Plant	56,000	
Insurance expenses – factory	28,000	

Factory expenses	66,000	150,000
		663,000
Work-in-Progress		
Opening inventories		58,000
Closing inventories		(50,000)
Cost of manufactured goods c/fwd		671,000

12.7.5 Transfer Pricing

The usual practice in the preparation of Manufacturing Account is to transfer the production cost to the Statement of Profit and Loss at historical cost. This means that the Manufacturing Account will not record any profit or loss and for that matter it becomes difficult to know whether the manufacturing process is profitable.

To ascertain the profit or loss on the manufacturing operation, goods manufactured are transferred to the Statement of Profit and Loss at the market value of the finished products. The market value must have taken care of any relevant margin on the manufactured goods. The rationale for this technique is that the entity would want to assess its efficiency in manufacturing by comparing the cost of manufacture with the price of acquiring the products in the open market instead of going through the process of manufacturing.

In this situation, the Manufacturing Account will show a balance, which will reveal either a profit or loss on production. This will therefore inform management whether the production department is a profitable one. If the answer to this question is negative management may have to decide whether to close the production department or institute cost-cutting measures that will result in lower cost of production by means of strict supervision and economies to cheaper production.

Illustration 12.5

Given the same question in illustration 12.4 above, let us assume that the production department transfers the finished product from the factory to the marketing department at cost plus 25%.

The solution in 12.4 can then be represented thus:

The Manufacturing Account will be prepared in the horizontal format as follows:

Manufacturing Account for the year ended 30 June 2016.

Raw materials:	**¢**	**¢**		**¢**
Opening inventories		80,000	Market value of goods completed c/f	838,750
Purchases	240,000			
Add: Carriage inwards	44,000			
	284,000			
Less Return outwards	35,000	249,000		
Cost of raw materials available		329,000		
Less closing inventories		48,000		
Cost of raw materials consumed		281,000		
Manufacturing wages	160,000			
Royalties paid	72,000	232,000		
Prime cost		513,000		
Factory Overheads:				
Depreciation of Plant	56,000			
Insurance expenses -factory	28,000			
Factory expenses	66,000	150,000		
		663,000		
Work-in-progress:				
Add Opening inventories		58,000		
		721,000		
Less closing inventories		50,000		
Cost of completed goods c/f		671,000		
Gross profit on manufacure c/f		167,750		
		838,750		838,750

12.8 Summary

We have learned that the purpose of the Statement of Profit and Loss of a sole proprietor is to determine his performance for the accounting period. The performance is determined by calculating the net profit or net loss as the case may be. Important terms such as carriage inwards, carriage outwards, returns inward and returns outward have also been explained. The statement of financial position was also mentioned and explained as a statement that shows the financial position of an enterprise as at a particular time or date.

We also saw that entities that manufacture products for sale will need an additional account called Manufacturing Account to record the total cost incurred in producing the products.

12.9 MULTIPLE CHOICE QUESTIONS

1. Which of the following are factory overheads?
   - I. Factory rent
   - II. Carriage on purchases
   - III. Factory workers' basic wages
   - IV. Basic raw materials
   - V. Plant repairs

   - a. I, III and V
   - b. III, IV and V
   - c. I and V only
   - d. IV and V
   - e. I, II and V

2. What is the effect of a decrease in Allowance for Bad Debts on the final account?
   - a. Decrease in assets, increase in expenses
   - b. Increase in expenses, increase in liabilities
   - c. Increase in capital, increase in expenses
   - d. Increase in assets, increase in revenue
   - e. Decrease in assets, decrease in revenue

Use the data below to answer Questions 3 and 4

Caterpillar Ltd has the following information at 31/12/2016

	₵
Cost of raw materials	4,500,000
Manufacturing overheads	2,300,000
Productive wages	2,600,000
Work in progress 1/12/2016	800,000
Work in progress 31/12/2016	300,000
Payment of royalties	800,000
Closing inventories of finished goods	450,000
Manufactured goods transferred to Sales Dept at cost plus 25%	

3. Prime cost is
   - a. ₦2,675,500
   - b. ₦6,650,000
   - c. ₦7,600,000
   - d. ₦7,900,000
   - e. ₦9,750,000

4. The manufacturing profit is
   - a. ₦1,862,500
   - b. ₦2,000,000
   - c. ₦2,050,000
   - d. ₦2,562,500
   - e. ₦2,675,000

5. A statement of financial position is usually prepared with
   - a. Assets and liabilities at the end of the period
   - b. Assets and liabilities at the beginning of the period

c. Liabilities and sales at the end of the period
d. Assets and equities at the beginning of the period
e. Inventories and payables at the end of the period

Use the information below to answer Questions 6 to 9

	₵
Returns inwards	40,000
Sales	820,000
Opening inventories	200,000
Purchases	740,000
Gross profit	200,000

6. The closing inventories figure is

   a. ₦160,000
   b. ₦320,000
   c. ₦360,000
   d. ₦400,000
   e. ₦580,000

7. The cost of goods sold is

   a. ₦580,000
   b. ₦620,000
   c. ₦640,000
   d. ₦660,000
   e. ₦740,000

8. The mark-up of the business is

   a. 24.39%
   b. 25.64%
   c. 32.26%
   d. 34.48%
   e. 36.32%

9. Rent prepaid is

   a. An expense for the year
   b. A current liability
   c. A current asset
   d. A revenue receipt
   e. Non-current liability

10. In preparing a Statement of Profit or Loss, interest on overdue receivables balance is treated as

   a. A prepaid revenue
   b. A current asset
   c. An expense
   d. An income
   e. A current liability

11. Unearned commission received is

a. A current liability
b. An expense for the year
c. A current asset
d. A revenue for the year
e. A non-current liability

12. Which of the following is not a factory overhead?

a. Rent of factory building
b. Cost of direct raw materials
c. Depreciation of plant and machinery
d. Factory supervisor's salary
e. Factory manager's salary

13. After preparing the final accounts of 2016, it was discovered that the opening inventories was undervalued by ¢80,000. What was the effect of this error on the year's Statement of Profit or Loss?

a. Net profit understated by ¢80,000
b. Net profit overstated by ¢80,000
c. Gross profit overstated by ¢160,000
d. No effect on the Statement of Profit or Loss
e. Gross Profit understated by ¢160,000

14. A statement that shows the state of affairs of a business entity at a point in time is referred to as a

a. Statement of Profit or Loss
b. Statement of changes in equity
c. Statement of financial position
d. Statement of Cash flow
e. Statement of changes in non-current assets

Use the following information to answer Questions 15 to 18

		¢
Inventories of raw materials	1 January 2016	24,500
	31 December 2016	38,000
Purchases of raw materials		92,600
Carriage of raw materials		2,400
Royalties		22,000
Direct labour cost		29,000
Total overhead cost		47,000
Work-in-progress	1 January 2016	7,000
	31 December 2016	4,200

15. What is the amount of prime cost?

a. ₦110,500
b. ₦114,000
c. ₦130,100
d. ₦132,500
e. ₦170,500

16. What is the cost of raw materials consumed?

a. ¢70,500
b. ¢79,100
c. ¢81,500
d. ¢95,000
e. ¢157,000

17. How much of the manufactured products are yet to be completed?

a. ¢4,200
b. ¢7,000
c. ¢22,000
d. ¢24,500
e. ¢38,000

18. What is the manufacturing cost of goods completed?
a. ¢164,200
b. ¢176,700
c. ¢179,500
d. ¢182,300
e. ¢185,100

12.10 THEORY AND CALCULATIONS QUESTIONS

Question 1

The following Trial Balance was extracted from the books of Abigyagoro Enterprise as at 31December, 2016.

	DR	CR
	¢000	¢000
Capital		112,000
Motor Van	40,000	
Inventories	32,800	
Balance at bank	24,800	
Purchases	320,000	
Sales		446,000
Trade receivables	58,000	
Trade payables		33,120
Rent and rates	11,216	
Salaries	70,080	

General expenses	8,944	
Motor expenses	5,120	
Discount allowed	8,080	
Discount received		7,920
Insurance	3,920	
Irrecoverable debts	6,080	
Drawings	10,000	
	599,040	599,040

The following matters are to be taken into account:

a) Inventories in trade as at 31 December 2016 was ¢40,320,000

b) Salaries and wages outstanding as at 31/12/2016 amounted to ¢24,000,000.

c) Insurance paid in advance was ¢1,400,000

One fourth of the general expenses was for private purposes.

Required

Prepare a Statement of Profit or Loss for the year ended 31 December, 2016 and a Statement of Financial Position as at that date.

Question 2

The following Trial Balance was extracted from the books of Victorosky a dealer in second hand clothes.

Trial Balance as at 30 June 2016.

	DR ¢000	CR ¢000
Capital		553,500
Purchases	1,255,500	
Sales		1,644,300
Repairs to building	22,896	
Motor Car	25,650	
Car expense	8,586	
Freehold land and buildings	270,000	
Balance at bank	14,580	
Furniture and fittings	39,420	
Wages and salaries	232,362	
Discount allowed	28,647	
Discounted received		21,978
Rate and insurance	6,696	
Irrecoverable debts	9,693	
Allowance for doubtful debts		3,780
Drawings	64,800	
Trade receivables	140,751	
Trade payables		108,945
General expenses	42,822	
Inventories	170,100	
	2,332,503	2,332,503

After adjusting for the following matters, you are required to prepare a Statement of Profit or Loss for the year ended 30th June 2016 and a Statement of Financial Position as at that date:

1. Inventories in trade at 30/06/2016, ¢237,600,000
2. Wages and salaries outstanding at 30/06/2016, ¢9,720,000
3. Rates and insurance paid in advance at 30/06/2016, ¢1,620,000
4. The allowance for doubtful debts is to be increased to ¢4,860,000
5. During the accounting year ended 30/06/2016, Victorosky withdrew goods valued at ¢16,200,000 for his own consumption. He instructed the accounts clerk not to record the transaction in the books.

Question 3

Alaskan Enterprise is a dealer in special traditional medicine. He imports similar medicines from China whenever there is shortage in the local market. The Trial Balance of the entity as at 31 December 2016 is as detailed below:

	Dr.	**Cr.**
	¢'000	**¢'000**
Investment income		550
Purchases	7,970	
Sales		40,250
Receivables and Payables	4,850	2,380
Inventories of finished goods	1,140	
Motor vehicles	3,800	
Electricity expenses	325	
Land and buildings (cost of land ¢2,000)	14,000	
Office Equipment	4,550	
Drawings	1,825	
Returns	930	485
Carriage inwards	300	
Administrative expenses	980	
Salaries and wages	3,650	
Vehicle running expenses	320	
Allowance for irrecoverable debts		450
Investments	8,500	
Bank and cash balances	4,380	
Selling expenses	4,785	
Furniture & fittings	5,000	
Capital		13,455
Allowance for Depreciation:		
- Office Equipment		2,250
- Motor vehicles		2,270
- Land & Buildings		5,500

Discount allowed	285	
	67,590	**67,590**

The following additional information is relevant:

1. The inventories at 31December 2016 were recorded at ¢950,000.
2. The Enterprise depreciates its assets on cost as follows:

Assets:	%
Buildings	4
Motor Vehicles	20
Office Equipment	15
Furniture & fittings	10

3. Administrative expenses include rent of ¢250,000. This represents rent for the period of 1 July 2016 to 31 May 2017.
4. The Enterprise is to make allowance of ¢345,000 in respect of Personal income tax for 2016 accounting year.
5. Amount owing in respect of electricity and vehicle running expenses are ¢55,000 and ¢75,000 respectively.
6. Allowance for irrecoverable debt is ¢500,000.

Required: Prepare statement of profit or loss for year ended 31 December 2016 and a statement of financial position as at that date.

Question 4

XYC Ltd is a Manufacturing Entity. The following is an extract from its books for the year ended 31 December 2016.

	¢
Stock of raw materials as at 1 January, 2016	30,000
Purchases of raw materials	240,000
Manufacturing wages	40,000
Office salaries	28,000
Royalties	10,000
Opening stock of finished goods	13,000
Carriage outwards	2,400
Printing and stationery	5,600
Rent and rates	16,000
General expenses	26,000
Travelling expenses	16,800
Factory expenses	10,000
Sales	480,000

You are also supplied with the following additional information:

a. Depreciation of 10% is to be charged on Plant and machinery worth ¢20,000

b. The following are inventories on hand at 31/12/2016:

Inventories of Raw materials	¢16,000
Inventories of finished goods	¢15,000

c. Half of the rent and rates is chargeable to the Manufacturing Account

You are required to prepare the Statement of Manufacturing and Profit or Loss for the year ended 31 December 2016.

Question 5

Azotize is a well known manufacturer of toys for babies under the age of one year. At 1 January 2016, he had the following in inventories:

Raw materials	¢1,200
Finished goods	¢ 600
Work-in-progress	¢1,500

During the year, the following were recorded:

	¢
Purchases of raw materials	10,000
Manufacturing wages	4,000
Carriage of raw materials	260
Carriage on sales	340
Sales	25,000
Factory expenses	1,200
Insurance	800 (Admin 200)
Rent	2,000 (Admin 500)
Printing and Stationery	90

You are required to prepare the Statement of Manufacturing and Profit or Loss for the year ended 31 December 2016, after due consideration is given to the following:.

a.	Plant and Machinery stood at ¢8,000 on 1st January 2016 and on 31st December 2016, it was revalued to ¢7,500	
b	Discount allowed	¢261
	Sales returns	¢276
	Return outwards (raw materials)	¢392
	Irrecoverable debts written off	¢151
c	Inventories at 31st December, 2016 were: Raw materials ¢800; Work-in-progress ¢600; Completed toys ¢470	

Question 6

The following balances were extracted from the books of Victorosky Manufacturing Entity on 31 December 2016.

	DR. ¢	CR. ¢
Work-in-progress	25,000	
Manufacturing Wages	21,000	
Office Rent & Rates	810	
Inventories of raw materials	11,200	
Sales		105,000
Purchases of finished goods	12,000	
Capital		80,000
General expenses	4,200	
Receivables	3,550	
Payables		2,980
Selling expenses	8,640	
Plant and equipment	10,000	
Inventories of finished goods	9,500	
Factory rent	900	
Purchase - Raw materials	48,000	
Plant repairs	6,575	
Factory expenses	6,800	
Motor vehicles	8,000	
Drawings	6,520	
Office salaries	4,800	
Bank and Cash	485	
	187,980	187,980

Additional information:

1. The manufactured goods were transferred to the warehouse at a mark-up of 25%.
2. The Entity depreciates its assets on cost as follows:

Assets:	%
Plant and Equipment	15
Motor Vehicles	20

3. The following inventories were on hand as at end of the financial year:

Raw materials	¢25,800
Finished goods	¢15,500
Work-in-progress	¢20,000

You are required to prepare the Statement of Manufacturing and Profit or Loss for the year ended 31 December 2016, and a statement of financial position as at that date.

Solution to Multiple Choice Questions

1.	c.	10.	d.
2.	d.	11.	a.
3.	d.	12.	b.
4.	e.	13.	b.
5.	a.	14.	c.
6.	c.	15.	d.
7.	a.	16.	c.
8.	d.	17.	a.
9.	c.	18.	d.

Solution to Examination type questions

Question 1

Abigyagoro Enterprise

Statement of Profit or Loss for the year ended 31 December, 2016

	¢'000	¢'000	¢'000
Sales			446,000
Less cost of sales:			
Opening inventories		32,800	
Add Purchases		320,000	
		352,800	
Less closing inventories		40,320	312,480
Gross profit			133,520
Add Discount received			7,920
			141,440
Less expenses:			
Salaries	70,080		
Add owings	24,000	94,080	
Rent and rates		11,216	
General expenses	8,944		
Less drawings	2,236	6,708	
Motor expenses		5,120	
Discount allowed		8,080	
Irrecoverable debts		6,080	
Insurance	3,920		
Less prepaid	1,400	2,520	
			133,804
Net Profit			7,636

Statement of Financial Position As at 31 December, 2016

Assets	**¢'000**	**¢'000**
Non-current Assets		
Motor van		40,000
Current Assets		
Inventories	40,320	
Trade Receivables	58,000	
Insurance prepaid	1,400	
Balance at bank	24,800	
		124,520
Total Assets		**164,520**
Equity and Liabilities		
Capital/Equity		112,000
Net Profit		7,636
		119,636
Drawings (10,000 + 2,236)		(12,236)
		107,400
Current Liabilities		
Trade Payables	33,120	
Accruals (Salaries)	24,000	57,120
Total Equity and Liabilities		**164,520**

Question 2

(a) Victorosky

Statement of Profit or Loss for the year ended 30 June 2016

	¢'000	¢'000	¢'000
Sales			1,644,300
Less cost of sales:			
Opening		170,100	
Add Purchases	1,255,500		
Less inventories drawings	16,200	1,239,300	
		1,409,400	
Less closing inventories		237,600	1,171,800
Gross profit			472,500
Add Discounts received			21,978
			494,478
Less expenses:			
Salaries	232,362		
Add owings	9,720	242,082	
Rates & Insurance	6,696		
Less prepaid	1,620	5,076	
General expenses		42,822	
Car expenses		8,586	
Discounts allowed		28,647	
Irrecoverable debts		9,693	
Allowance for bad debts		1,080	
Repairs to building		22,896	360,882
Net profit			133,596

Victorosky

(b) Statement of Financial Position as at 30 June 2016

Assets	**¢**	**¢**	**¢**
Non-current Assets			
Freehold land and buildings			270,000
Motor car			25,650
Furniture and Fittings			39,420
			335,070
Current Assets			
Inventories		237,600	
Trade Receivables	140,751		
Allowance	4,860	135,891	
Prepaid expenses		1,620	
Balance at bank		14,580	389,691
Total Assets			**724,761**
Equity and Liabilities			
			¢
Capital /Equity			553,500
Net Profit			133,596
			687,096
			81,000
Less Drawings (64,800 + 16,200)			606,096
Liabilities			
Non-current			-
Current			
Trade Payables		108,945	
Accruals-wages & salaries		9,720	118,665
Total Equities and Liabilities			724,761

Question 3

Alaskan Enterprise

Statement of Profit or Loss for the year ended 31 December 2016

	¢'000	¢'000	¢'000
Sales			40,250
Less returns inward			930
			39,320
Less: Cost of sales			
Opening inventories		1,140	
Purchases	7,970		
Add: Carriage	300		
	8,270		
Less Returns Outwards	485	7,785	
		8,925	
Less: Closing inventories		950	7,975
Gross Profit			31,345
Add investment income			550
			31,895
Less expenses:			
Electricity	325		
Add Owings	55	380	
Administrative expenses(980-250)	730		
Rent (250-prepaid 114)	136	866	
Selling expense		4,785	
Vehicle running expenses	320		
Add owings	75	395	
Discount allowed		285	
Allowance for irrecoverable debts(500-450)		50	
Salaries and wages		3,650	
Provision for depreciation:			
Motor vehicles	760		
Buildings	480		
Office equipment	683		
Furniture & fittings	500	2,423	
			12,834
Net profit before tax			**19,061**
Less allowance for tax			345
Net profit after tax			**18,716**

Statement of Financial Position as at 31 December 2016

	¢'000	¢'000	¢'000
Non-Current Assets:	**Cost**	**Dep**	**Net**
Land & buildings	14,000	5,980	8,020
Office equipment	4,550	2,933	1,617
Motor vehicles	3,800	3,030	770
Furniture & fittings	5,000	500	4,500
	27,350	12,443	14,907
Investment			8,500
			23,407
Current assets:			
Inventories		950	
Trade receivables	4,850		
Less allowance	500	4,350	
Prepaid expenses-rent		114	
Bank and cash		4,380	9,794
Total Asset			33,201
Equity and Liabilities			
Capital/Equity			13,455
Add net profit after tax			18,716
			32,171
Less Drawings			2,855
			30,346

Current liabilities			
Trade Payables Accruals:		2,380	
Electricity	55		
Vehicle Expenses	75	130	
Allowance for tax		345	
			2,855
Total Equity and Liabilities			33,201

Question 4

XYC Ltd.. Manufacturing Company

Statement of Manufacturing and Profit or Loss for the year ended 31 December 2016

Raw materials:	**¢**	**¢**
Opening inventories		30,000
Add Purchases		240,000
Cost of raw materials available		270,000
Less closing inventories		16,000
Cost of raw materials consumed		254,000
Manufacturing wages		40,000
Royalties		10,000
Prime cost		304,000
Factory Overheads:		
Depreciation -plant	2,000	
Rent and rates($^1/_2$ x 16,000)	8,000	
Factory expenses	10,000	20,000
Production cost c/f		324,000
Finished goods:		
Sales		480,000
Less cost of sales:		
Opening inventories	13,000	
Production cost b/f	324,000	
Cost of goods available for sale	337,000	
Less closing inventories	15,000	
		322,000
Gross profit		158,000
Less expenses:		
Office salaries	28,000	
Carriage outwards	2,400	
Printing and stationery	5,600	
Rent and rates($^1/_2$ x 16,000)	8,000	
General Expenses	26,000	
Travelling	16,800	
		86,800
Net Profit		71,200

Question 5

Azotize

Statement of Manufacturing and Profit or Loss for the year ended 31 December 2016

Raw materials:	**¢**	**¢**
Opening inventories		1,200
Purchases	10,000	
Add Carriage inwards	260	
	10,260	
Less purchases returns	(392)	9,868
Cost of raw materials available		11,068
Less closing inventories		800
Cost of raw materials consumed		10,268
Manufacturing wages		4,000
PRIME COST		14,268
Factory Overheads:		
Depreciation -plant	500	
Rent(2000 – 500)	1,500	
Insurance(800 – 200)	600	
Factory expenses	1,200	3,800
		18,068
Add opening inventories of work-in-progress		1,500
		19,568
Less closing inventories of work-in-progress		600
Completed production cost c/f		18,968
Finished goods:		
Sales (Less returns 276)		24,724
Less cost of sales:		
Opening Inventories	600	
Completed production cost b/f	18,968	
Cost of goods available for sale	19,568	
Less closing Stock	470	
		19,098
Gross profit		5,626
Less expenses:		
Irrecoverable debts	151	
Carriage outwards	340	
Printing and stationery	90	
Rent	500	
Insurance	200	
Discount allowed	261	1,542
Net Profit		4,084
Net Profit		4,360

Question 6

Victorosky Manufacturing Enterprise

Statement of Manufacturing, and Profit or Loss for the year ended 31 December 2016

Raw materials:	**¢**	**¢**
Opening inventories		11,200
Purchases		48,000
Cost of raw materials available		59,200
Less closing inventories		25,800
Cost of raw materials consumed		33,400
Manufacturing wages		21,000
Prime cost		54,400
Factory Overheads:		
Depreciation -plant & equipment	1,500	
Rent	900	
Plant repairs	6,575	
Factory expenses	6,800	15,775
		70,175
Add opening inventories of work-in-progress		25,000
		95,175
Less closing inventories of work-in-progress		20,000
Production cost		75,175
Gross profit on manufacturing		18,794
Market value on manufacturing c/f		93,969
Finished goods:		
Sales		105,000
Less cost of sales:		
Opening inventories	9,500	
Market value on manufacturing b/f	93,969	
Purchases	12,000	
Cost of goods available for sale	115,469	
Less closing inventories	15,500	
		99,969
Gross profit on trading		5,031
Gross profit on manufacturing b/f		18,794
		23,825
Less expenses:		
Selling	8,640	
Office rent & rates	810	
General	4,200	
Office salaries	4,800	
Depreciation -motor vehicles	1,600	
		20,050
Net Profit		3,775

Victorosky Manufacturing Enterprise

Statement of financial position as at 31 December 2016

	¢'	**¢'**	**¢**
Non-current	**Cost**	**Dep**	**Net**
Plant & equipment	10,000	1,500	8,500
Motor vehicle	8,000	1,600	6,400
	18,000	3,100	14,900
Current assets:			
Inventories (Note 1)		61,300	
Trade receivables		3,550	
Bank and cash		485	65,335
Total Assets:			80,235
Equity and Liabilities			
CapitalEquity			80,000
Add net profit after tax			3,775
	-		83,775
Less drawings			6,520
			77,255
Current Liabilities			
Trade Payables			2,980
Total Equity and Liabilities			80,235

Note 1:

Inventories		¢'
	Raw Materials	25,800
	W.I.P	15,500
	Finished goods	20,000
		61,300

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CHAPTER THIRTEEN

SINGLE ENTRY AND INCOMPLETE RECORDS

13.0 Learning Objectives

After you have studied this chapter you should be able to:

- Use accounting equation to calculate profit where only opening and closing net assets figures are available
- Convert single entry and incomplete records into double entry records
- Prepare detailed statement of profit or loss from records that were not kept on double entry system
- Derive proprietor's cash drawings or additional capital as a missing figure where all other information relating to cash payments and receipts are known
- Determine the figures for purchases and sales from the purchases ledger control and the sales ledger control accounts
- Derive expenses incurred and revenue earned from incomplete records

13.1 Introduction

The term 'single entry' s applied to any system, which does not provide for the two fold aspects of transactions; while the alternative term 'incomplete records' is often applied to books of account kept on such a single entry or incomplete double entry system. Pure 'single entry' recognises only the personal aspect of transactions, and, consequently, the only essential books are personal ledgers for recording transactions with receivables and trade accounts payables. In practice, however, a cash book is ordinarily kept, but, with this exception, the impersonal aspect of transactions is usually left entirely unrecorded.

In this chapter, readers will learn the procedure involved in preparing the statement of profit or loss and statement of financial position for an entity that has only opening and closing net assets and perhaps capital as the only known figures. Readers will also understand and learn how to ascertain the proprietor's drawings and any additional capital contribution during an accounting period from the scanty information provided by a cash book summary.

Questions on incomplete records and single entry are popular with examiners because they enable them to test important principles and techniques, which are also relevant for other topics such as ledger control accounts. It also provides the basic information necessary to prepare final accounts but without the examiner presenting it in the form of a Trial Balance. Ability to manipulate single or incomplete records to produce final accounts is a true test of knowledge of the primary double entry principle.

13.2 The Ascertainment of Profit from Incomplete Records

Generally speaking, profits (or losses) are ascertained, under the single entry system, by a comparison of the values of the net assets at two specified dates (i.e. closing and opening dates), after taking into account additions to, or withdrawals from, capital during the period. The difference between these two values represents the profit or loss, according to whether there is an increase or decrease in the figures.

Remember the accounting equation, which states that:

Business Assets = Owner's Capital + Business Liabilities

The equation above can be restated as:

Owner's Capital = Business assets – Business Liabilities

If during an accounting period, the business realised an excess of income over expenditure, the additional cash or assets generated belong to the owner(s), thus increasing the capital. The accounting equation will now become:

Opening capital + profit = opening net assets + increase in net assets.

The introduction or withdrawal of resources by the owner will also increase or decrease the owner's capital respectively. As a result, profit can be calculated using the format below:

	¢
Closing capital	XXX
Less opening capital	XXX
Increase in net assets	XXX
Owners' Drawings	XXX
Additional Capital	(XXX)
Net profit for the year	XXX

Illustration to Illustration 13.1:

Calculate the net profit for the year ended 31 December 2016 from the following information:

	31/12/2015	31/12/2016
	¢	¢
Property	200,000	200,000
Equipment	60,000	90,000
Trade Receivables	40,000	80,000
Cash	10,000	15,000
Overdraft	60,000	90,000
Trade Payables	50,000	30,000

Drawings during the year were ¢45,000 and additional capital introduced during the year was ¢50,000.

SOLUTION	31/12/2015	31/12/2016
	¢	¢
Property	200,000	200,000
Equipment	60,000	90,000
Trade receivables	40,000	80,000
Cash	10,000	15,000
Total Assets	310,000	385,000
Overdraft	60,000	90,000
Trade payables	50,000	30,000
Total liabilities	(110,000)	(120,000)
Capital/Net assets	200,000	265,000

	¢
Closing capital	265,000
Opening capital	(200,000)
Increase in net assets	65,000
Additional capital introduced	(50,000)
Owner's drawings	45,000
Net profit for the year	60,000

Alternative Solution:

	31/12/2015	31/12/2016
	¢	¢
Total Assets	310,000	385,000
Total Liabilities	(110,000)	(120,000)
Net Assets	200,000	265,000

	¢
Closing capital	265,000
Less opening capital	200,000
Increase in net assets	65,000
Owners' Drawings	45,000
Additional Capital	(50,000)
Net profit for the year	60,000

13.3 Preparation of detailed final accounts from Incomplete Records

Understandably, calculating the profit of an enterprise using the method as presented above is not satisfactory. It is important for you to note that the accountant does not only prepare the final accounts of an enterprise but also communicates accounting and *financial information to stakeholders. It is therefore much more informative when statement of profit or loss is drawn. It is important for the accountant to convert these scanty and incomplete records into the acceptable double entry form.*

For one to be able to prepare the statement of profit or loss and statement of financial position from single entry and incomplete records, the procedures detailed below are recommended:

Procedures to prepare financial statements under Incomplete Records:

- Prepare a statement of affairs
- Analyze unbanked cash sales
- Post the cash and bank summary to the ledger accounts
- Prepare schedules of trade payables and trade receivables
- Extract a trial balance
- Draw up the final accounts – statement of Profit or Loss and statement of financial position

13.3.1 Preparation of statement of affairs

First step is to construct a statement of financial position at the beginning of the accounting year. This means that the assets and liabilities of the business must be recorded to show the financial position at start of the period ascertained and calculated. The statement prepared to show the financial position of the business at the beginning of the year is technically called 'statement of affairs'

In most practical situations, the owner of the entity will provide lists of values of non-current assets that he uses in the entity together with the dates of acquisition. It should therefore be easy for one to calculate the accumulated allowance for depreciation on the non-current assets from the date of their purchase to the date of reporting. Values of such items as inventories in trade, receivables and liabilities may have to be estimated with the help of the owner.

From the information provided in illustration 13.1, a journal can be opened and accounting entries effected. The aim is to ensure the recording of the accounting entries following the duality principle. This means that appropriate debit entries must be posted into assets account and credit entries entered into capital or liabilities accounts.

The difference between the assets and liabilities, which usually ends up with the assets exceeding the liabilities may be assumed to be the initial amount that the owner used in starting the business. Therefore, it will be recorded as the capital of the entity. It is possible that the owner may be able to mention the initial amount he used in commencing the business. Where this is the case then, any difference between such capital and the net assets estimated may be recorded as the balance on the statement of profit or loss.

13.3.2 Preparation of Cash and Bank Summary

The first task is to ascertain the cash position of the business, in the cash book. This is usually done by carefully examining the available bank statements, pay-in-slips and the cheque counterfoils. The bank statements together with the cheque counterfoils could reveal information concerning purchases, payment of rent, bank charges, wages, insurance, interest earned, the acquisition of non-current assets, and any personal withdrawals. Information extracted from the pay-in-slips will help determine the amount of money paid in by customers to whom goods were sold on credit and also direct sales by cheque instead of cash. The above information may be used to prepare a cash summary or a receipts and payments account for the business.

13.3.3 Analysis of unbanked cash sales

One must at this stage determine the amount of cash sales which have not been banked by the owner, but which might have been used by the owner to pay for business expenses, cash purchases, and perhaps personal drawings. It is possible that the owner might have made use of some of the physical inventories in trade for his or her personal use. In such a situation conducting an informal interview with the owner would confirm the existence of such occurrences. Thus, it will help the bookkeeper make an appropriate estimate for inventories drawings. Physical inventories taken by (i.e. counting) of items of inventories in the store at the close of business will give the actual closing inventories figure and therefore may not need to be estimated.

13.3.4 Posting from the Cash and Bank Summary

After the analysis of the cash book has been made, necessary postings are then made into the ledger. Note that in step one, opening entries were made through the ledger, and therefore some of these new entries will be made into existing ledger accounts.

From the analysis of the debit side or receipts side of the cash and bank summary and information obtained from the pay-in-slips:

a) Opening cash balance in the debit side is added to opening asset at the beginning and opening cash balance in the credit side is added to opening liability to determine capital of the entity in the financial year.

b) All cash sales or takings should be credited to the trade receivables account in the sales ledger;

c) Any proceeds from the sale of non-current assets should be credited to the respective asset accounts;

d) Any interest or income from investment must also be credited to the appropriate revenue account;

e) Any other item should be posted to the credit of the relevant account;

f) Closing balance in the cash book is recognised as a current liability in the statement of financial position

From the analysis of the credit side or payments side of the cash and bank summary and information obtained from the cheque counterfoils:

a) All payments for goods purchased should be debited to the trade payables account in the purchases ledger ;
b) Payment of expenses should be debited to the relevant nominal account;
c) All purchases in connection with non-current assets should be debited to the appropriate asset accounts;
d) Any charges should be posted to debit of the bank charges account;
e) Any other item should be posted to the debit of the relevant account;
f) Closing balance in the cash book is recognised as a current asset in the statement of position

Where any difference exists on the cashbook summary necessary adjusting entries should be posted to balance the difference. If the difference is on the credit side then the cashbook should be credited and the proprietor's drawings account debited. If the difference is on the debit side then one can safely presume that the owner of the business has introduced additional capital. This difference should be debited to cash and credited to the capital account of the business.

13.3.5 Preparation of Trade receivables and Payables Schedule

At this stage we need to determine year-end adjustments and balances.

A schedule should be compiled detailing all customers who are owing the business, as a result of goods sold to them on credit. The total of the schedule of receivables therefore represent debts owed to the entity and as such must be carried forward to the credit of the total sales ledger control account. There is likely to be a difference in the debit side of the total receivables account, which represent total sales on credit for the period and is to be transferred to the credit of the statement profit or loss as sales or turnover (revenue). The cash sales if any in the debit side of the cash book should also be taken to the statement of profit or loss.

Another schedule that should be prepared to have a list of amounts owing by the entity to its suppliers for goods purchased on credit. The total of this schedule represents total liabilities by way of trade payables outstanding at the end of the period and should therefore be carried forward to the debit of the purchases ledger control account. The total of purchases for the period will be derived from the credit side of the purchases ledger control account as a balancing figure and should be transferred to the debit side of the Statement of Profit or Loss. In addition, cash purchases on the credit side of the cash book if any is also taken along to the Statement of Profit or Loss.

Similarly, accruals and prepayments will be carried forward as closing balances in the appropriate expense accounts, the actual expense amount which has been incurred for the accounting period being accounted for as a balancing figure.

13.3.6 Extraction of Trial Balance

This is the final stage since all the transactions would have been recorded and the double entries completed. It is now possible for the business to extract a Trial Balance which will form the basis for the preparation of the Statement of Profit or Loss and the statement of financial position as at the period end.

Illustration 13.2

Boakye, a sole proprietor, trading as KKB Enterprise requested Oko & Associates, a firm of Chartered Accountants to prepare the accounts of his business for the year ended 31 December 2016. The assignment has been given to you by Oko & Associates as their trainee accountant. Your interview with Boakye revealed the following:

i) He did not maintain a double book-keeping system.

ii) All sales were on credit or cash basis. During the year, Boakye received ¢9,025,000 and ¢475,000 in cheques and cash respectively from his customers.

iii) Suppliers of goods during the year were paid ¢6,840,000 by cheque.

iv) Boakye used a prepaid electricity meter in the business. On 1 July2015, he paid ¢480,000 as one year in advance for electricity used in the business. Again, on 1 July, 2016, he paid ¢600,000 in advance to cover one more year for electricity consumption. The payments were made using cheques.

v) The rent for the premises was ¢60,000 per month payments were by cheque.

vi) General business expenses paid by cheques amounted to ¢106,200.

vii) He took cash of ¢38,000 every month for his private use. Boakye provided you with the following additional information:

	31/12/2016	31/12/2015
	¢	¢
Trade receivables	1,254,000	1,045,000
Trade payables	617,500	380,000
Rent owing	60,000	120,000
Bank balance	3,000,000	1,073,500
Cash in hand	60,000	76,000
Inventories	1,700,500	1,510,500
Fixtures & Fittings (at cost)	-	920,000

viii) Depreciation is provided annually at the rate of 20% on Fixtures and Fittings.

ix) Boakye had agreed to pay ¢100,000 as accountancy fees as at 31 December, 2015 having received invoice from Oko & Associates for this amount.

x) Differences in cash and bank balance as at the end of 31 December 2016 represent additional drawings and capital respectively.

You are required to:

(a) Compute the profit of Boakye using the net worth approach.

(b) Cash and bank summary for 2016.

(c) Statement of profit or loss for the year ended 31 December, 2016.

(d) Statement of financial position as at 31 December, 2016.

Solution to Illustration 13.2

You may wish to attempt the question before reading this explanation.

You should proceed along this line to solve the problem.

(a) Calculate opening net assets to arrive at opening capital

It is necessary to determine opening capital to enable us calculate the closing balance in the statement of financial position. All that is required is to **pick up all opening balances not forgetting the opening cash balance.**

Statement of Financial Affairs: Capital = Assets – Liabilities

	31/12/2016	31/12/2015
Assets	**¢**	**¢**
Furniture & fittings (cost)	920,000	920,000
Accumulated depreciation	(184,000)	-
Inventories	1,700,500	1,510,500
Prepaid electricity	300,000	240,000
Trade receivables	1,254,000	1,045,000
Cash in hand	60,000	76,000
Bank Balance	3,000,000	1,073,500
	7,050,500	4,865,000
Liabilities		
Trade payables	617,500	380,000
Rent owing	60,000	120,000
Accountancy fee outstanding	100,000	100,000
	777,500	600,000
Capital (Net worth)	6,273,000	4,265,000

Increase in Net worth:

¢6,273,000 - ¢4,265,000 = ¢2,008,000

Computation of profit using Net worth Approach

	¢
Increase in net worth	2,008,000
Add drawings	491,000
	2,499,000
Less additional capital	1,227,700
Profit for year	1,271,300

Increase in net worth …………………….. ¢5,973,000 - ¢4,125,000 = ¢1,848,000

Computation of profit by the net worth method

	¢
Increase in net worth	2,032,000
Add Drawings (456,000+600,000+35,000)	1,091,000
	3,123,000
Less Additional Capital	1,227,700
Net Profit	**1,895,300**

(b) Construction of cash and bank summary

Even if some of the information in the question is given in the form of a cash or bank summary, it is usually necessary to build up one or both of these summaries to calculate a missing figure such as payment for purchases and owner's drawings

CASH BOOK SUMMARY

	Cash	Bank		Cash	Bank
	¢	¢		¢	¢
Bal b/d	76,000	1,073,500	Suppliers	-	6,740,000
Received from customers	475,000	9,025,000	Drawings	456,000	-
Capital(missing figure)	-	1,227,700	Rent	-	600,000
			Gen. Bus. Exp.	-	106,200
			Drawings (medicals)	-	780,000
			Drawings (missing figure)	35,000	-
			Bal. C/d	60,000	3,000,000
	551,000	11,326,200		551,000	11,326,200
Bal b/d	60,000	3,000,000			

(c) Statement of profit or loss for the year ended 31 December 2016

	¢	¢
Revenue		9,709,000
Cost of Sales		(6,887,500)
Gross profit		2,821,500
Less expenses:		
Electricity	540,000	
Rent	720,000	
Depreciation	184,000	
General expenses	106,200	
		(1,550,200)
Net profit		1,271,300

Cost of Sales	
Opening inventories	1,510,500

Purchases	7,077,500
	8,588,000
Closing inventories	1,700,500
	6,887,500

(d) Statement of Financial Position as at 31 December 2016

	¢
Assets:	
Non-current Assets:	
Furniture & Fittings	
At cost	920,000
Accumulated depreciation	184,000
Carrying amount	736,000
Current Assets:	
Inventories	1,700,500
Prepaid electricity	300,000
Trade Receivables	1,254,000
Cash in hand	60,000
Bank balances	3,000,000
Total current assets	6,314,500
Total Assets	7,050,500
Equity and Liabilities	
Capital 1/1/2016	4,265,000
Additional capital introduced	1,227,700
	5,492,700
Profit for the year	1,271,300
	6,764,000
Less: Drawings	491,000
Total equity	6,273,000
Current liabilities	
Trade payables	617,500
Rent outstanding	60,000
Accountancy fee not paid	100,000
Total liabilities	777,500
Total Equity and Liabilities	7,050,500

WORKINGS

(1) Construct sale and purchases ledger control accounts

In a double entry-system, control accounts are used to confirm the arithmetical accuracy of the sales and purchases ledger system. This technique will be used to calculate sales and purchases as a missing figure.

Purchases Ledger Control Account

	¢		¢
Bank	6,840,000	Bal. B/d	380,000
		Purchases (missing figure)	7,077,500
Bal. C/d	617,500		
	7,457,500		7,457,500
		Bal, b/d	617,500

Sales Ledger Control a/c

	¢		¢
		Customers:	
Bal b/d	1,045,000	Bank	9,025,000
Balancing figure:		Cash	475,000
Sales	9,709,000	Bal c/d	1,254,000
	10,754,000		10,754,00
Balance b/d	1,254,000		

(2) Workings for accruals and prepayments

In addition to these four techniques it will be necessary to construct figures for the Income statement by adjusting cash paid for expenses for opening and closing accruals and prepayment.

Rent Expense Control

Electricity a/c

Balance b/d (6/12x480,000)	240,000	Profit or loss	540,000
Bank	600,000	Balance c/d (6/12*600000)	300,000
	840,000		**840,000**
Balance b/d	300,000		

Rent a/c

Bank	780,000	Balance b/d	120,000
Balance c/d	60,000	Profit or loss	720,000
	840,000		840,000
		Balance b/d	60,000

Accountancy fees a/c

Balance c/d	100,000	Balance b/d	

			100,000
		Balance b/d	100,000

Accumulated depreciation on Fixtures and Fittings a/c

Balance c/d	184,000	Depreciation a/c	184,000
		Balance b/d	184,000

Depreciation account

Accum Depreciation on F & F	184,000	Profit or loss	184,000

Computation of Depreciation	¢
Fixture and fittings at cost (1/1/2016)	920,000
Less Depreciation (20% @ ¢920,000)	184,000
Carrying amount (31/12/2016)	736,000

Illustration 13.3

Damask is a retailer who deals in spare parts at Kokompe. He pays into his bank account amount of his cash takings, after retaining ¢10,000 per week for personal use and after payment of wages and expenses, which for the accounting period of 31 December 2006, were as follows:

	¢
Staff wages	1,200,000
Goods	220,000
Cleaning	75,000
Carriage	35,000
Others	20,000

The transactions in his Bank Account during the period were:

	¢
Balance as at 1st January 2016	2,000,000
Lodgements:	
from takings (cash)	30,130,000
Bulk sales account (cheques)	4,800,000
Interest on treasury bills	30,000
	36,930,000

Withdrawals:	¢
Goods purchased	30,830,000
Rent	400,000
Rates in connection with store	345,000
Rates in connection with own house	55,000
Air conditioner expenses for store	200,000
Air conditioner expenses for house	20,000
Telephone and electricity	150,000
other expenses for store	70,000
Fire insurance	60,000
Life assurance policy	30,000
Repairs	150,000
Fixtures and fittings	600,000
Consultancy fees	70,000
Income tax	900,000
Owner's current account	180,000
Balance as at 31st December 2016	2,900,000
	36,960,000

The following information were also provided:

		31/12/2015	31/12/2016
Receivables – Bulk sales		490,000	430,000
Payables:	Goods purchased	2,900,000	3,195,000
	Rent	80,000	30,000
	Electricity	25,000	65,000
	Telephone	45,000	-
	Consultancy fees	40,000	40,000
Inventories in trade		2,050,000	1,875,000
Fixtures & Fittings			540,000

You are required to prepare statement of Profit or Loss for the year ended 31 December 2016 and a Statement of financial position as at that date.

Hint: There are 52 weeks in a year.

Electricity and telephone are classified as utility expenses.

Solution to Illustration 13.3

a. Calculate opening net assets to arrive at opening capital

You need to calculate the capital of the business by using the information on assets and liabilities at the opening and closing dates. This is done by preparing a statement of affairs of the business by picking up all opening balances and calculating the net asset of the business as at 31 December 2015. The information is presented clearly, and the examiner has even provided information on the bank and cash balances in the presentation of assets and liabilities. The statement of affairs of Damask as at 31 December 2016 is as follows:

STATEMENT OF AFFAIRS

	31/12/2015	31/12/2016
Assets:	¢	¢
Fixtures & Fittings		540,000
Receivables	490,000	430,000
Inventories	2,050,000	1,875,000
Cash in the bank	2,000,000	2,900,000
	4,540,000	5,745,000
Less: Liabilities		
Trade payables	2,900,000	3,195,000
Rent owing	80,000	30,000
Electricity owing	25,000	65,000
Telephone owing	45,000	-
Consultancy fee outstanding	40,000	40,000
	(3,090,000)	(3,330,000)
Capital	**1,450,000**	**2,415,000**

b. Construct sale and purchases ledger control accounts

In a double entry-system, control accounts are used to confirm the arithmetical accuracy of the sales and purchases ledger system. This technique will be used to calculate sales and purchases by way of missing figure. This calculation will explore the horizontal format of determining the sales and purchases figures as missing figures instead of the usual "T" account that you are familiar with.

c. The sales figure will be determined as follows:

	¢	¢
Lodgements:		
Shop takings		30,100,000
Add: Proprietor's drawings (52wks x ¢10,000)		520,000
Expenses paid		1,550,000
Cash sales		32,170,000
Bulk sales account	4,800,000	
Add: Closing balance of receivables	430,000	
Less: Opening balance of receivables	490,000	
Credit sales		4,740,000
Total sales		36,910,000

Expenses paid = 41,200,000 + ¢220,000 + ¢75,000 + ¢35,000 + ¢20,000
= 41,550,000

d. The amount for Purchases is determined as follows:

	¢
Purchases for goods	30,830,000
Add: Closing balance of payables	3,195,000
	34,025,000
Less: Opening balance of trade payables	2,900,000
Credit purchases	31,125,000
Add cash purchases	220,000
Total purchases	**31,345,000**

e. Prepare the final accounts

Statement of comprehensive income for the year ended 31/12/2016

	¢	¢	¢
Revenue			
Less: Cost of sales:			36,910,000
Opening inventories		2,050,000	
Purchases	31,345,000		
Carriage inwards	35,000	31,380,000	
		33,430,000	
Less: Closing inventories		1,875,000	31,555,000
Gross Profit			5,355,000
Interest on treasury bills			30,000
			5,385,000
Less: Administrative Expenses			
Staff wages		1,200,000	
Rates		345,000	
Rent		350,000	
Utility, Electricity + Telephone		45,000	
Consultancy fees		70,000	
Repairs		150,000	

Air condition expenses	200,000	
Fire insurance	60,000	
Cleaning	75,000	
Other expenses (70,000 + 20,000)	90,000	
Depreciation	60,000	2,745,000
Net Profit before tax		2,640,000
Income tax		900,000
		1,740,000

Statement of financial position as at 31/12/2016

	¢	¢	¢
Non-current Assets			
Fixtures and fittings			600,000
Less: Depreciation provision			60,000
			540,000
Current Assets			
Inventories		1,875,000	
Receivables		430,000	
Bank		2,900,000	5,205,000
Total Assets			**5,745,000**
Financed by:			
Equity 1/1/2016			1,450,000
Net profit			1,740,000
			3,190,000
Less Drawings			775,000
			2,415,000
Current Liabilities:			
Trade payables	3,195,000		
Rent owing	30,000		
Electricity	65,000		
Accountancy fee owing	40,000		
			3,330,000
			5,745,000

Workings for accruals and prepayments

In addition to the above techniques it will be necessary to construct figures for the Income statement by adjusting cash paid for expenses for opening and closing accruals and prepayment.

Rent Expense account

	¢		¢
Bank	400,000	Bal b/d	80,000
		Income a/c	350,000
Bal c/d	30,000		
	430,000		**430,000**

		Bal b/d	**30,000**

Telephone & Electricity: Utility Account

	¢		¢
Bank	150,000	Bal b/d (45,000 + 25,000)	70,000
		Income a/c	145,000
Bal c/d	65,000		
	215,000		**215,000**
		Bal b/d	**65,000**

Consultancy Fees

	¢		¢
Bank	70,000	Bal b/d	40,000
		Income a/c	70,000
Bal c/d	40,000		
	110,000		**110,000**
		Bal b/d	**40,000**

Drawings

	¢		¢
Bank	180,000	Bal c/d	775,000
Cash (¢10,000 x 52)	520,000		
Rates	55,000		
Air condition exp	20,000		
	775,000		775,000
Bal. b/d	775,000		

13.4 Summary

In this chapter we have explained the difference between a double entry accounting system and single entry system. We have also learned how to use the closing and opening capital figures to calculate the net profit of a trader that is not keeping his books of accounts on the double entry system.

We have learnt how to convert from a single entry system to a double entry one and also the means by which Statement of Profit or Loss and Statement of Financial Position are prepared from records that are kept on single entry basis. We mentioned that figures such as sales and purchases could be calculated as missing figures from the sales ledger control account and purchases ledger control account respectively.

You should note that as with all accounting topics, frequent practice of incomplete record questions is essential to develop speed and confidence.

13.5 MULTIPLE CHOICE QUESTIONS

1. In which ledgers can data relating to discount be found?

   a) Nominal ledger
   b) Cash book
   c) Sales ledger
   d) Private ledger
   e) Purchases ledger

Use the data below to answer Questions 1 to 4.

	31/12/2015	31/12/2016
	¢	¢
Non-current assets (cost)	320,000	286,000
Current assets	750,000	920,000
Current liabilities	150,000	130,000
Provision for depreciation	70,000	74,000

During 2016, a non-current asset costing ¢54,000 with a book value of ¢20,000 was sold for ¢15,000

2. What was the capital of the business as at 31 December 2015?
   a. ¢850,000
   b. ¢860,000
   c. ¢865,000
   d. ¢920,000
   e. ¢1,002,000

3. What was the capital of the business as at 31 December 2016?
   a. ¢850,000
   b. ¢860,000
   c. ¢865,000
   d. ¢1,002,000
   e. ¢1,076,000

4. What was the value of the net profit or loss for the year ended 31 December, 2016?
   a. ¢140,000 (loss)
   b. ¢152,000 (loss)
   c. ¢152,000 (profit)
   d. ¢240,000 (loss)
   e. ¢260,000 (loss)

5. What was the depreciation charge for 2016?
   a. ¢4,000
   b. ¢14,000
   c. ¢16,000
   d. ¢38,000
   e. ¢74,000

6. A “statement of affairs” is similar to a/an

a. Trading Account
b. Income and Expenditure account
c. Statement of financial position
d. Trial Balance
e. Statement of Income

7. A Statement of Affairs may include only

    a. Accrued expenses, assets, liabilities and outstanding revenues
    b. Expenses, assets, accrued revenues and liabilities
    c. Assets, liabilities and expenses
    d. Expenses, profits, assets and liabilities
    e. Assets, liabilities and income

8. Koki started business on 1 January 2016 with ¢200,000. At the end of the year, his total assets valued ¢500,000. He did not owe anybody. Throughout the year, Koki took ¢70,000 out of the business to maintain his family. In June 2016, he won lotto of ¢150,000 and added the prize to the business capital. Calculate Koki's profit for 2016.

    a. ¢220,000
    b. ¢290,000
    c. ¢300,000
    d. ¢370,000
    e. ¢400,000

9. If cost price is ¢240,000 and selling price is ¢300,000, then

    a. Mark-up is 20%
    b. Margin is 33⅓%
    c. Margin is 20%
    d. Mark-up is 33⅓%
    e. Margin is 25%

10. What is the cost of goods sold, given the sales figure as ¢800,000 with a mark-up of 25%?
    a. ¢126,000
    b. ¢160,000
    c. ¢504,000
    d. ¢600,000
    e. ¢640,000

13.6 EXAMINATION TYPE QUESTIONS

1. Victorosky who does not keep proper books of account has presented the following information for the year ended 31 December 2016:

	2016 (¢)	2015 (¢)
Inventories	376,000	185,000
Cash at Bank	98,500	56,000
Trade receivables	100,000	90,000
Office Equipment	450,000	490,000
Cash in hand	25,000	29,000
Trade payables	250,000	158,500
Motor vehicles	740,000	755,000

You are required to calculate the profit or loss of Victorosky for the year ended 31 December 2016, after taking into consideration the following:

a) Victorosky makes monthly withdrawal of cash and goods valued at ¢50 and ¢15 respectively.
b) Customer with an outstanding bill to the tune of ¢5,400 was declared bankrupt by a court in Accra.
c) Rent prepaid and electricity owing amounted to ¢16,000 and ¢18,500 respectively.

2. Babaginda is a trader who does not keep proper books of account. He has however provided you with the following information:

a. He paid ¢10,000,000 in a bank account as his initial capital on 1 October 2015
b. He banked all sales after withdrawing cash for the following:

Personal use	¢350,000 per week (52 weeks)
Staff salaries and wages	¢500,000 monthly
General expenses	¢11,140,000

Lodgements made into the Bank amounted to ¢450,000,000

Withdrawals from the Bank were:	¢
Rent	13,000,000
Insurance	10,000,000
Transport expenses	6,750,000
Payment to suppliers	245,000,000
Purchase of motor car	63,500,000
Purchase of computers	18,000,000
Telephone expenses	8,698,000

The following balances were also available as at 30 September 2016:

Trade payables	¢134,000,000
Inventories	¢42,000,000
Irrecoverable debts	¢4,420,000
Trade receivables	¢25,000,000
Rent prepaid	¢2,800,000
Payables for insurance	¢2,150,000

Depreciation is to be provided on the cost of all non-current assets at the rate of 20%.

You are required to prepare the statement of profit or loss for the year ended 30 September 2017 and a statement of financial position as at that date. Assume a 52 weeks year.

3. Richardosky has kept the following summary of accounts:

Statement of financial position as at 1 January 2016

	¢		¢
Sundry payables	105,000	Office equipment	250,000
Rent and Rates	6,000	Fixture and Fittings	50,000
		Inventories	120,000
Loan	250,000	Sundry receivables	235,000
Capital - Surplus	404,000	Bank	110,000
	765,000	-	765,000

Analysis of Trade Payables

	¢	¢
Balance 1/1/2016		105,000
Purchases		548,000
Cash paid	415,000	
Discounts - Received	7,000	
Returns	4,000	
Balance 31/12/2016	227,000	
	653,000	653,000

Analysis of Receivables

	¢	¢
Balance 1/1/16	235,000	
Sales	980,000	
Cash received		820,000
Discounts		42,500
Bad debts		35,000
Returns		29,500
Balance 31/12/2016		288,000
	1,215,000	1,215,000

Analysis of Balances as at 31/12/2016

	¢
Inventories	235,000
Rent prepaid	8,000
Rates owing	4,000
General expenses owing	28,000
Office equipment	366,000
Fixture & fittings	45,000

Analysis of Cash book

	Dr.	Cr.
	¢	¢
Balance as at 1/1/2016	110,000	
Trade receivables	820,000	
Trade payables		415,000
Cash sales	95,000	
Office equipment		150,000
Wages and salaries		150,000
General expenses		32,000
Rent and Rates		42,500
Cash Purchases		48,000
Selling expenses		45,000
Drawing		47,500
Balance as at 31/12/2016		95,000
	1,025,000	1,025,000

	Dr.	Cr.
	¢	¢
Balance as at 1/1/2016	110,000	
Trade receivables	820,000	
Trade payables		415,000
Cash sales	95,000	
Office equipment		150,000
Wages and salaries		150,000
General expenses		32,000
Rent and Rates		42,500
Cash Purchases		48,000
Selling expenses		45,000
Balance as at 31/12/2016		95,000
	1,025,000	977,500
	47,500	

You are required to prepare Richardosky's Statement of financial position as at 31 December 2016, together with statement of profit or loss for the year ended 31 December 2016.

Solution to Multiple Choice Questions

1. a.
2. a.
3. d.
4. c.
5. d.
6. c.
7. a.
8. a.

9. c.

10. e.

Solution to Examination type questions

Question 1

Victorosky

Statement of affairs

	31/12/2015	31/12/2016
Assets:	**¢**	**¢**
Office equipment	400,000	450,000
Motor vehicles	755,000	740,000
Trade Receivables	490,000	376,000
Inventories	185,000	200,000
Prepayments	-	16,000
Cash at bank	56,000	98,500
Cash in hand	29,000	25,000
	1,915,000	1,905,500
Liabilities:		
Trade Payables	158,500	160,000
Accruals	-	18,500
	158,500	178,500
Capital	1,756,500	1,727,000

The calculation of profit or loss could be based on the formula below:

Opening Capital + Net Profit (or – Net loss) + Additional Capital – Drawings = Closing Capital

$$¢1{,}756{,}500 + \text{Net Profit} + ¢75{,}000 - ¢276{,}000 = ¢1{,}727{,}000$$

Solving for Net Profit

$$\text{Net Profit} = ¢1{,}727{,}000 - ¢1{,}756{,}500 - ¢75{,}000 + ¢276{,}000$$

$$\text{Net Profit} = \underline{¢171{,}500}$$

Question 2
BABANGIDA
Statement of Profit or Loss for the year ended 30 September 2016

	¢'000	¢'000
Revenue:		
Cost of sales:		
Purchases	379,000,000	514,760,000
Closing inventory	42,000,000	(337,000,000
Gross Profit		**177,760,000**
Expenses:		
Irrecoverable debts	4,420,000	
Depreciation – Motor car	12,700,000	
- Computers	3,600,000	
Staff wages & salaries	6,000,000	
General expenses	11,140,000	
Rent	10,200,000	
Insurance	12,150,000	
Transport expenses	6,750,000	
Telephone expenses	8,698,000	
		75,658,000
Profit for the year		**102,102,000**

Statement of Financial Position as at 30 September 2016

Assets	**Cost**	**Accumulated Depreciation**	**Carrying Amount**
Non-Current Assets:	**¢'000**	**¢'000**	**¢'000**
Motor vehicles	63,500,000	12,700,000	50,800,000
Computers	18,000,000	3,600,000	14,400,000
	81,500,000	**16,300,000**	**65,200,000**
Current Assets:			
Inventories		42,000,000	
Trade Receivables		25,000,000	
Prepayments		2,800,000	
Bank		95,052,000	
			164,852,000
			230,052,000
Equity and Liabilities:			
Capital			10,000,000
Profit			102,102,000
Capital Net Profit for the year			**112,102,000**
Drawings			18,200,000
			93,902,000
Current Liabilities:			
Trade payables	134,000,000		
Accruals – Insurance	**2,150,000**		136,150,000
			230,052,000

CASH BOOK SUMMARY

	¢		¢
Capital	10,000,000	Rent	13,000,000
Sales	450,000,000	Insurance	10,000,000
		Transport expenses	6,750,000
		Trade Payables – Suppliers	245,000,000
		Motor car	63,500,000
		Computers	18,000,000
		Telephone expenses	8,698,000
			364,948,000
		Bal c/d	95,052,000
	460,000,000		**460,000,000**
Bal b/f	**95,052,000**		

Sales Account

	¢		¢
Trading Account	514,760,000	Bank	450,000,000
		Drawings	18,200,000
		Staff wages & Salaries	6,000,000
		General expenses	11,140,000
		Trade Receivables Credit Sales	29,420,000
	514,760,000		**514,760,000**

Capital Account

	¢		¢
		Bank	10,000,000

Allowance Account Depreciation

	¢		¢
P/L	16,300,000	Depr. Expenses	12,700,000
		Depr. Exp. In Computer	3,600,000
			16,300,000

Purchases

	¢		¢
Trade Payables	379,000,000	P/L	379,000,000

Trade Payables

	¢		¢
Bank	245,000,000	Purchases	379,000
Bal c/d	134,000,000		
	379,000,000		**379,000,000**
		Bal b/f	134,000,000

Trade Receivables

	¢		¢
B/f Sales	29,420,000	Irrecoverable debts	4,420,000
Bal c/d	134,000,000	Bal c/d	25,000,000
	29,420,000		**29,420,000**
Bal b/d	25,000,000		

Irrecoverable debts

	¢		¢
Receivables	4,420,000	P/L	4,420,000

Accruals

	¢		¢
		Insurance	2,150,000

Depreciation Expenses

	¢		¢
Allowance for Depreciation	12,700,000		

Drawings

	¢		¢
Sales	18,200,000		

Staff wages & Salaries

	¢		¢
Sales	6,000,000		

General Expenses

	¢		¢
Sales	11,140,000		

Insurance

	¢		¢
Bank	10,000,000	P/L	12,150,000
Accruals	2,150,000		
	12,150,000		**12,150,000**

Transport Expenses

	¢		¢
Bank	6,750,000		

Motor Car

	¢		¢
Bank	63,500,000		

Computers

	¢		¢
Bank	18,000,000		

Telephone Expense

	¢		¢
Bank	8,698,000		

Inventories

	¢		¢
c/f	42,000,000	P/L	

Prepayment

	¢		¢
Rent	2,800,000	P/L	

Question 3

Richardosky

Statement of profit or loss for the year ended 31 December 2016

	¢	¢	¢
Sales (95+980)			1,075,000
Less returns			29,500
			1,045,500
Less Cost of sales :			
Opening inventories		120,000	
Purchases (548 + 48)	596,000		
Less returns	4,000	592,000	
		712,000	
Less closing inventories		235,000	477,000
Gross profit			568,500
Discount received			7,000
			575,500
Less Expenses:			
Rent (42.5 - 6 - 8 + 4)		32,500	
General expenses (32 + 28)		60,000	
Salaries & wages		150,000	
Bad debts		35,000	
Discount allowed		42,500	
Depreciation - Plant & machinery		34,000	
Depreciation - Fixtures & fittings		5,000	
Selling expenses		45,000	404,000
Net Profit			171,500

Richardosky

Statement of financial position as 31 December 2016

	¢	¢	¢
Non-current Assets:	**Cost**	**Dep.**	**Net**
Offioce equipment	400,000	34,000	366,000
Fixture & fittings	50,000	5,000	45,000
	450,000	39,000	411,000
Current Assets:			
Inventories		235,000	
Trade payables		288,000	
Trade receiables		8,000	
Bank		95,000	
		626,000	
Current Liabilities			
Trade payables	227,000		
Accruals (4 + 28)	32,000		
		259,000	367,000
			778,000
Less loans			250,000
			528,000
Financed by			
Capital			404,000
Add Profit for the year			171,500
			575,500
Less Drawings		-	47,500
			528,000

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CHAPTER FOURTEEN

ACCOUNTING FOR NOT-FOR PROFIT ENTITIES

14.0 Learning Objectives

After you have studied this chapter, you should be able to:

- State the difference between a Receipts and Payments Account and an Income and Expenditure Account
- Explain the difference between the final accounts of not-for profit organizations and those of sole traders and partnerships
- Prepare Receipts and Payments Account
- Prepare Income and Expenditure Account
- Prepare subscription account making the necessary adjustment entries with respect to amounts in arrears and payments in advance.
- Prepare the accumulated fund of a not-for profit organisation

14.1 Introduction

There are many types of not-for profit organisations. They include government owned hospitals and voluntary health and welfare organizations. In West Africa most citizens depend heavily on such entities for religious, educational, social and recreational needs. Examples of other not-for profit organisations include:

- Clubs and Associations
- Private and community foundations
- Professional associations
- Research and scientific organisations
- Social and country societies
- Trade associations
- Labour entities
- Political parties.

It is not only profit making entities that need accounts. Entities set up for purposes other than profit, also need to tell their stakeholders how they have dealt with the funds they have contributed.

The legal status of such entities is usually spelt out in their rules or regulations. Candidates must however remember that external financial information provided by such entities must be in conformity with generally accepted accounting principles.

The accounts of clubs, societies and charitable organisations may consist of the following:

- Receipts and Payment Account
- Income and Expenditure Account and
- Statement of Financial Position

14.2 Receipts and Payments Account

This is a statement of cash actually received and paid during a given period. Receipts being debited and payments credited. It is, in effect, a summary of the cashbook, and therefore shows the opening and closing balances of cash in hand, and receipts and payments of any kind during the period.

Illustration 14.1

An example of a receipts and payments account is shown below:

Receipts	¢'000	**Payments**	¢'000
Bank balance 1/6/2015	118,000	Printing & stationary	228,000
Sponsored walk	23,000	Management expenses	109,000
Subscriptions	580,000	Caterer for president ball	113,250
Sundry income	57,000	Electricity and water	78,500
Sale of club's manual	230,000	Bar payables	278,500
Sale of equipment	254,000	Bank balance 31/5/2016	454,750
	1,262,000		1,262,000

14.3 Income and Expenditure Account

Income and Expenditure Account of the entity is the equivalent of the Statement of profit or loss of trading entity. It contains only revenue items, being debited with all expenditure, and credited with all incomes of a period, whether or not it has actually been paid or received within that period. The final balance of an Income and Expenditure Account represents the excess of income over expenditure or the excess of expenditure over income, as the case may be, for the period. This balance is similar to the net profit or loss of trading entities.

Readers must note that an Income and Expenditure Account differs from the Receipts and Payments Account. The receipts and payments account records only cash movements, whilst Income and Expenditure Account takes into account non-cash adjustments for amounts owing and owed at the period end and for depreciation. It also recognises the accounting distinction between revenue and capital expenditure. The important point that candidates must note is that the Income and Expenditure Account is prepared on an accrual basis.

14.4 Membership subscription:

A club or society receives payments from members for benefits, which members have enjoyed. Annual membership subscriptions of clubs and societies are usually payable one year in advance. Such payment in advance by members is shown as liability in the statement of financial position. This is because the year's membership has still to run as at the date of statement of financial position.

Illustration 14.2

The Mambo Youth Club presented the following Receipts and Payments Account for the period of 1 January 2016 to 31 December 2016.

Receipt and Payments Account for the year ended 31 December 2016

Receipts	**¢'000**	Payments	**¢'000**
Bank balance 1/1/2016	118,000	Printing & stationary	228,000
Sponsored walk	23,000	Management expenses	109,000
Subscription	580,000	Caterer for President's ball	113,250
Sundry income	57,000	Electricity and water	78,500
Sale of club's manual	230,000	Bar payables	278,500
Sale of equipment	254,000	Bank balance 31/12/2016	454,750
	1,262,000		1,262,000
Bank balance1/1/2017	454,750		

Extracts from the membership subscription book revealed that subscriptions owing by members amounted to ¢80,000,000 on 31 December 2015 and ¢120,000,000 on 31 December 2016. The accounts clerk recorded subscription of ¢21,500,000 and ¢109,000,000 in respect of subscriptions that have been paid by members in advance for 2016 and 2017 respectively.

The subscription account will be prepared as follows:

Subscription Account for the year ended 31 December 2016

	¢,000		¢'000
Balance b/f	80,000	Bal b/f	21,500
Income & Expenditure a/c	532,500	Receipts & Payment a/c	580,000
Balance c/f	109,000	Balance c/f	120,000
	721,500		721,500
Balance b/f	120,000	Balance b/f	109,000

By carrying forward subscription in advance, the accountant is applying the matching concept. This is because the payment of ¢109,000,000 in advance for 2017 represents income meant for 2017 accounting year. This must therefore be removed from the current year's Income and Expenditure account, hence the debit carry forward.

From the above solution subscription in arrears have been treated as an asset. This will hold true as a result of the accrual concept since the subscription in arrears are income that have been earned for the accounting year of 2016 but for which cash has not been received.

Subscriptions that are owed by members for a long time may end up not being paid. Therefore, there should be a policy on how subscriptions in arrears for a long-term should be treated in club's account. In examination situation, readers are reminded to follow the policy of the club or society as provided by the examiner.

14.5 Bar Statement of Profit or Loss

It is not uncommon for clubs to engage in other income generating activities to raise additional revenue for the effective running of the club. These other activities are done with the sole aim of making profit. For instance the aim of a local trade union is not to make profit but the union may operate a bar alongside its activities with the object of making profit. The profit will not be distributed among the members but rather used for the purpose of the union.

If a club has a bar, a separate Statement of Profit or Loss will be prepared for its trading activities. The net profit from the bar activities is then included as income in the Income and Expenditure Account. Any loss on the bar activities will be shown in the expenditure side of the Income and Expenditure Account.

14.6 Life Membership

Subscriptions are often received from life members in lump sum. Life members pay a once and for all subscription which entitles them to membership facilities for the rest of their lives. The once- and-for-all payments from life members are not income relating to the year in which they are received by the club, because the payment is for the life of the members, which can of course last a very long time to come. In practice, if life members' subscriptions are small, they are credited to income as received but if they are significant in amount, then they should be credited in equal proportion over the estimated active club membership of such members.

14.7 Accumulated fund

This represents the capital of a not-for profit entity. It has the same meaning ascribed to the capital accounts of a sole trader and partnership and is calculated as the difference between total assets and liabilities. It is common to see most not-for profit entities keeping accounts on single entry basis. For this reason the procedure for preparing the accumulated fund of a not-for profit entity is the same as that of statement of affairs as obtained under incomplete records and single entry.

Illustration 14.2

The following is the Receipts and Payments Account for the Victorosky Fun Club for the year ended 31 October 2016.

RECEIPTS	¢	PAYMENTS	¢"000
Subscription	1,643,560	Printing & stationery	59,160
Sponsored walk	478,802	Bar steward's salary	69,600
President's Ball collections	408,000	Caterer for President's ball	250,000
Sundry income	75,000	Light, cleaning etc.	32,640
Bar takings	510,000	Petty cash	65,000
Sale of equipment	7,923	Bar payables	280,500
Raffle	183,030	Investment in ABC limited	450,000
		Donation	50,000
		Sundry President's ball exp.	5,275
		Prizes for raffle	21,600
		Building project (materials)	839,000
		Rent	360,000
		Secretary's salary	120,000
		Sundry bar expenses	3,360
		Bank charges	36,000
		Hiring of hall for Pres. Ball	20,000
		Building project (wages)	525,000
		Insurance	18,000
		New equipment	67,800
		Bal c/d	33,380
	3,306,315		3,306,315

The following additional information has been given:

1. Current Assets and Liabilities were:

	31 October 2015	2016
	¢'000	¢'000
Bar inventories	27,000	36,000
Bar payables	18,000	33,000
Subscriptions in arrears	240,000	360,000
Subscriptions in advance	150,000	210,000
Light and cleaning owing	4,200	6,800
Insurance prepaid	4,200	5,200
Petty cash float	3,000	1,000
Cash in hand	15,565	14,340
Bank balance	246,500	281,105

2. The petty cash float is used exclusively for telephone and postages.
3. The club started constructing its club House during the year. The project will take four years to complete. Amount owed for building materials supplied at 31 October 2016 was ¢511,500,000. Wages owed for October 2016 was ¢175,000,000. Inventories of materials at the end was ¢220,500,000
4. Tickets for the President's Ball were sold at ¢300,000 each. The Club engaged the services of a caterer who agreed to charge on the number of plates served under the following conditions:
   - Below 1,500 plates, amount to be charged per plate was ¢250,000.
   - From 1,501 to 2,000 plates, amount to be charged per plate was ¢220,000.
   - Above 2,000 plates, amount to be charged per plate was ¢200,000.

   Of the 2,400 tickets sold, 90% attended the function and were served
5. Depreciation of equipment is to be calculated at 10% per annum on written down value. The Club's equipment which was disposed of during the year had a carrying amount of ¢9,905,000 on 1 November 2015.
6. Subscriptions in arrears for more than one year are to be written off.
7. An amount of ¢1,000,000,000 is to be transferred from accumulated fund to building fund.
8. Investment in ABC limited is expected to be held for at least five years.

9. Included in subscription is an amount of ¢192,000,000 in respect of 2015.
10. Rent paid represents one and half years to 30April, 2018.

Required:

(a) Accounts showing the profit or loss on Bar operation and President's Ball
(b) The accumulated fund as at 1 November 2015.
(c) The Income and Expenditure Account of Victorosky Fun Club for the year ended 31 October 2016 and Statement of financial position as at that date.

Solution to illustration 14.2

(a) Victorosky Fun Club

(i)**President ball Income statement for the year ended 31 December 2016**

	¢'000	¢'000
Sale of tickets (2,400@¢300,000)		720,000
Less: Cost of meals served [2,400x90%@¢200,000]		432,000
		288,000
Less Expenses:		
Hiring of Hall	20,000	
Sundry Expenses	5,275	25,275
Profit to I & E a/c		262,725

(ii) **Bar Statement of Profit or loss for the Year Ended 31 October, 2016**

	¢'000	¢'000
Takings		510,000
Less cost of sales:		
Opening inventories	27,000	
Add Purchases(w1)	295,500	
	322,500	
Less Closing Inventories	36,000	286,500
		223,500
Less Expenses:		
Stewards salary	69,600	
Sundry expenses	3,360	72,960
Profit to I & E a/c		150,540

(b) **ACCUMULATED FUND AS AT 1 NOVEMBER, 2015**

Assets	¢'000	¢'000
Equipment		9,905
Cash in hand		15,565
Bank		246,500
Inventories		27,000
Subscriptions		240,000
Prepaid insurance		4,200
Petty cash		3,000
Less Liabilities		546,170
Bar payables	18,000	
Light & Cleaning owing	4,200	
Subscriptions	150,000	172,200
ACCUMULATED FUND		373,970

Victorosky Fun Club
Income and Expenditure Account
for the year ended 31 October 2016

INCOME:	¢'000	¢'000
Subscription W2		1,751,560
Sponsored walk		478,802
Sundry income		75,000
Raffle (¢183,030-¢21,600)		161,430
Profit on Bar Trading		150,540
Profit on President Ball		262,725
		2,880,057
Expenditure:		
Bank charges	36,000	
Insurance (¢4,200+¢18,000-¢5,200)	17,000	
Printing & stationary	59,160	
Light & cleaning (6,800+32,640-4,200)	35,240	
Telephone & Postages W3	67,000	
Depreciation (10% @¢67,800)	6,780	
Donation	50,000	
Secretary's Salary	120,000	
Rent [12/18@¢360,000]	240,000	
Bad debt W1	48,000	
Loss on sale of equipment (¢7,923-¢9,905)	1,982	681,162
Excess of Income over expenditure		2,198,895

Victorosky Fun Club
Statement of Financial Position As At 31 October, 2016

ASSETS	Cost	Accum Depr.	Carrying amount
NON-CURRENT ASSETS	¢'000	¢'000	¢'000
Equipment	67,800	6,780	61,020
Building project (w.5)	1,830,000	-	1,830,000
	1,897,800	6,780	1,891,020
Investment in ABC shares			450,000
CURRENT ASSETS			2,341,020
Inventory (¢220,500 + ¢36,000)		256,500	
Receivables – President's ball (w.4)		312,000	
Subscriptions in arrears		360,000	
Insurance prepaid		5,200	
Rent Prepaid		120,000	
Bank balance		281,105	
Cash (¢14,340 + ¢1,000)		15,340	1,350,145
TOTAL ASSETS			3,691,165
EQUITIES AND LIABILITIES			
Accumulated fund (6)-November 1, 2015			373,970
Excess of income over expenditure			1,198,895
			1,572,865
Building fund			1,000,000
			2,572,865
CURRENT LIABILITIES			
Receivables - Building project		511,500	
- Bar		33,000	
- Cater (¢432,000 – 250,000)		182,000	
Subscriptions in advance		210,000	
Light and cleaning owing		6,800	
Wages outstanding		175,000	1,118,300
TOTAL LIABILITIES AND EQUITY			3,691,165

WORKINGS

(1) **Bar Purchases**:	¢'000
Payables 31 October 2016	33,000
Receipts & Payment a/c	280,500
	313,500
Less payables Nov 1, 2015	18,000
	295,500

(2) Subscription Account

	¢'000		¢'000
Balance b/f	240,000	Balance b/f	150,000
Income & Expenditure a/c	1,751,560	Receipts & Payments a/c	1,643,560
	-	Bad debt (240-192)	48,000
Balance c/f	210,000	Balance c/f	360,000
	2,201,560		2,201,560
Balance b/f	360,000	Balance b/f	210,000

(3) **Telephone & Postages**

	¢'000
Petty cash 2015	3,000
Receipts & Payments	65,000
	68,000
Petty cash 2016	(1,000)
Income & Expenditure a/c	67,000

(4) **Receivables on President's Ball:**

	¢'000
Tickets sold	720,000
Less Amount Paid	408,000
Amount to be collected	312,000

(5) **Work in progress- Club House**

	¢'000	¢'000
Payment for materials		839,000
Add Amount owed (2016)		511,500
		1,350,500
Less Closing inventories		220,500
Materials used on project		1,130,000
Wages paid	525,000	
Add Amount owed (2005)	175,000	
		700,000
Cost to date		1,830,000

(6)	**Accumulated Fund**	¢'000
	Balance as at 1/11/2015	373,970
	Transfer from I & E a/c	2,198,895
		2,572,865
	Amount transferred to building fund	1,000,000
		1,572,865

14.8 Summary

We have learned the difference between a Receipt and Payments account and an Income and Expenditure Account and have also explained that the Receipts and Payments Account does not show the true financial position of the entity.

The Statement of profit or loss of a not-for profit entity is called Income and Expenditure Account from which any surplus (profit) or deficit (loss) is calculated and also the accumulated fund is similar to the capital account of a trader.

We also learned that where the club or society engaged in any activity with the aim of earning income for the attainment of the objectives of the organization, a separate Statement of Profit or Loss should be prepared and the resulting profit or loss transferred to the income and Expenditure Account.

It was also stated that the treatment of subscription owing should be seen as part of the earnings of the entity for the period unless its accounting policy dictates otherwise. Similarly life membership and entrance fees should be accounted for bearing in mind the accounting policy of the entity.

14.9 Multiple Choice Questions

Use the data below to answer Questions 1 to 4

Receipts and Payments Account for the year ended 31 December, 2016.

	¢		¢
Balance b/f	8,000	General expenses	7,800
Subscriptions	50,000	Equipment	9,000
Bar sales	36,000	Club house furniture	27,000
		Bar purchases	30,000
		Bar keeper’s wages	4,000

The treasurer also stated that on 1January 2016, the club had ¢24,000 worth of equipment and owed ¢500 for electricity. Bar inventories on 1 January and 31 December valued ¢10,000 and ¢13,000 respectively. Non-current assets are depreciated at 10% per annum.

1. Bar operation's surplus for the year was
   a. ¢32,000
   b. ¢5,000
   c. ¢6,000
   d. ¢9,000
   e. ¢36,000

2. The accumulated fund at the beginning of the year was?
   a. ¢32,500
   b. ¢41,500
   c. ¢42,000
   d. ¢42,500
   e. ¢335,000

3. The net value of the club's non-current assets as at 31 December, 2016 was?
   a. ¢24,000
   b. ¢33,000
   c. ¢36,000
   d. ¢54,000
   e. ¢60,000

4. The cash balance at the end of the year was?
   a. ¢16,000
   b. ¢16,200
   c. ¢16,700
   d. ¢17,200
   e. ¢18,200

5. In the final accounts of not for profit entity, capital expenditures are recorded in
   a. Income and Expenditure account
   b. Subscription account
   c. Statement of financial position
   d. Statement of Profit or Loss
   e. Receipts and payments account

6. Revenue receipts of a not-for profit making entity are recorded in

   a. Statement of financial position
   b. Income and Expenditure Account
   c. Statement of Affairs
   d. Bar Purchases Account
   e. Profit and loss Account

7. Which of the following statements is **NOT** true about the accounts of clubs and societies?

   a. A deficit on income and expenditure account reduces accumulated fund.
   b. Income and expenditure account does not contain capital receipts and expenditure.

c. The excess of total assets over total liabilities represents accumulated fund
d. The closing balance of receipt and payments account is transferred to income and expenditure account.
e. A surplus on Income and Expenditure Account increases accumulated fund

8. With regard to a not-for-profit entity, a debit balance on the subscription account is reported on

a. Income and Expenditure account
b. Statement of financial position
c. Accumulated fund
d. Receipts and payments account
e. Statement of Profit and Loss

Details of subscriptions account of "Big Men Keep Fit Club" are as follows:

	¢
Subscription owing 1/1/2016	30,000
Subscription received 2016	320,000

Subscription received in 2016 included ¢40,000 in respect of 2017 financial year.

9. What is the subscription to be transferred to Income and Expenditure account for 2016?

a. ¢250,000
b. ¢290,000
c. ¢310,000
d. ¢330,000
e. ¢390,000

10. A club received the following life membership fees in each of its first two years:

Year 1	¢300,000
Year 2	¢160,000

The club's policy is to take credit for life membership fees in equal amounts over 10 years. Determine the amount to be transferred to income and expenditure account in year 2.

a. ¢16,000
b. ¢32,000
c. ¢41,400
d. ¢43,000
e. ¢46,000

11. Which of the following are current liabilities?

I. Bills receivable
II. Bills payable
III. Unearned revenue
IV. Accrued expense

a. I, II and III
b. II, III and IV

c. I, III and IV
d. I, II and IV
e. I, II and IV

14.10 THEORY AND CALCULATION QUESTIONS

Question 1

1. The information below relates to the Madonna Youth Club for the accounting period ending 31 December 2016

		¢'000
Cash in hand 1/1/15		1,800
Subscription received:		
	2015	2,000
	2016	24,000
Receipts for renting of park		1,000
Receipts refreshing guest		6,000
Sundry receipts		12,500
Payments:		
Repairs		1,200
Salaries and wages		10,000
Printing and stationary		3,000
Caretakers wages		6,800
Refreshment materials		8,500
Electricity expenses		4,000
Vehicle running expenses		5,000
Payables for repairs		800
Payables for vehicle running expenses		400
Payables for refreshment materials		2,200
Subscription owing for 2016		3,000

You are required to prepare:

a) Receipts and Payments Accounts

j) Income and Expenditure Account for the year ended 30 June 2016.

Question 2

1) The Financial Treasurer of Ayoyo Fun Club has presented the following records:
Receipts and Payments Account for the year ended 31 December 2016

	¢'000		¢'000
Balance b/f	4,900	Rent and rates	804
Membership subscription	5,760	Social activities expenses	3,000
Membership admission	840	Bar purchases	3,580
Bar receipts	7,500	Bar wages	1,104
Other receipts	3,800	General wages	2,560
		Equipment	5,720
		Electricity expenses	208
		Postage and telephone	352
		Bank charges	116
		Insurance	604
		Balance c/f	4,752
	22,800		22,800

The following additional information is available:

	31/12/15	31/12/16
	¢'000	¢'000
Furniture and fittings	4,400	2,840
Bar inventories	1,040	1,420
Subscription in arrears	80	120
General wages owing	180	
Subscriptions in advance	400	
Insurance prepaid	136	180

Depreciation of 20% is to be written off equipment.

You are required to prepare:

a) Bar Statement of Profit or Loss

b) Income and Expenditure Account for the year ended 31 December 2016.

c) Statement of financial position as at 31 December 2016

Question 3 The Azury Democratic Party prepared accounts for the year to 31 December 2016.

a) They started the year with an amount of ¢11,416,000 in the Koromiko Commercial Bank. The Bank statement as at 31st December 2016 shows an overdraft of ¢1,845,000.

b) The members contributed a total of ¢102,505,000 for the 2016 accounting year as their annual dues. Out of the total contribution ¢9,750,000 represents arrears of members in previous year and ¢12,150,000 in respect of dues for next year.

c) The party received the equivalent of ¢82,600,000 as donation from the members in the London branch of the party. This amount was raised from a fund raising rally organised by the chairman in London incurring ¢33,819,500 as rally expenses.

d) The investment in Ghana Government Treasury bill stood at ¢712,000,000 at the beginning of the year. The party however discounted half of the bills and used all the proceeds as follows:

Campaign van	¢43,250,000
Electricity expenses	¢4,400,000
Congress expenses	¢218,750,000
Insurance on Motor vehicles	¢8,200,000
Renting of constituency offices	¢22,582,000
Stationery	¢15,817,500
	312,999,500

e) Total interest on the bill for the year amounted to ¢389,500 and was received during the year. Half of this amount was spent on buying fuel for campaign activities.

f) The campaign Van is to be depreciated at the rate of 20%, using the straight line method

g) The following additional information is available:

	31/12/15	31/12/16
	¢'000	¢'000
Head office Buildings	75,000	65,000
Furniture and fittings	950,000	888,500
Computer equipment	10,200	4,800
Vehicle running expenses owing	750	320
Stationery prepaid	230	1,050
Rent owing	950	1,125

You are required to prepare:

(a) The receipts and payments accounts

(b) The income and expenditure account for the year ended 31 December 2016

(c) Statement of Financial Position as at that date

Question 4. The following is Receipts and Payment Account of the Hinton Social Club for the year ended 31 December 2016.

Receipts	¢'000	Payments	¢'000
	700	Payment for restaurant and	
Annual subscriptions:		Bar supplies	10,000
For the year 2015	240	Wages	3,400
For the year 2016	3,670	Electricity	460
For the year 2017	30	Secretarial expenses	370
Restaurant and bar sales	12,000	General expenses	2,015
Interest on Bank of Ghana bond	105	Payment on account of new	
Life membership subscriptions	300	Furniture	300
	------	Bal c/d	50
	17,045		17,045

You are given the following information:

a) Inventories of restaurant and bar supplies:

	¢'000
At 31st December 2015	820
At 31st December 2016	2,000

b) Payables for restaurant and bar supplies:

At 31st December 2015	900
At 31st December 2016	1,080

c) The assets of the Club at 31st December 2015 were:

Furniture valued at	2,000
$3^1/_2$% Bank of Ghana Bond	3,100
Leasehold Premises valued at	2,500

(The lease has ten years to run from 2015)

d) During the year new furniture was acquired at a cost of 500

e) The secretary extracted the following information:

	31/12/15	31/12/16
Subscriptions received in advance	40,000	Nil
Secretarial expenses owing	10,000	Nil
Electricity bills outstanding	60,000	Nil
Bank balance	700,000	500,000

f) The secretary to the Club is entitled to free meals valued at ¢50,000 per year.

g) The rules of the Club were amended in 2016 to make provision for life membership at a subscription of ¢30,000 per life member. It was also provided that 10% of each life member's subscription should be transferred annually to the Income and Expenditure account in the year in which such payments are made.

h) It is the policy of the Club not to recognize any subscription in arrears in the Income and Expenditure account until it is actually received.

You are required to prepare all the necessary accounts required to show the financial position and performance of the Hinton Social Club that will be acceptable to its members for the accounting year ended 31 December 2016.

Solution to Multiple Choice Questions

1. B
2. B
3 D
4. B
5. C
6. B
7. D
8. B
9. A
10. E
11. B

Q1.**Solution to the theory and calculation Questions**

Madona Youth Club

Receipts and Payments Account for the year ended 31st December 2016

Receipts:	¢"000	**Payments:**	¢"000
Balance b/f	1,800	Repairs	1,200
Subscription received:		Salaries and wages	10,000
2015	2,000	Printing and stationary	3,000
2016	24,000	Caretakers wages	6,800
Receipts for renting of park	1,000	Refreshment materials	8,500
Receipts refreshing guest	6,000	Electricity expenses	4,000
Sundry receipts	12,500	Vehicle running expenses	5,000
		Balance c/f	8,800
	47,300		47,300
Balance b/f	8,800		

Income and Expenditure Account for the year ended 31st December 2016

	¢'000		¢'000
Repairs (1,200 + 800)	2,000	Subscription	27,000
Salaries and wages	10,000	Receipts for renting of par	1,000
Printing and stationary	3,000	Receipts refreshing guest	6,000
Caretakers wages	6,800	Sundry receipts	12,500
Refreshment materials (8,500 + 2,200	10,700		
Electricity expenses	4,000		
Vehicle running expenses(5000 +400)	5,400		
Surplus	4,600		
	46,500		46,500

Subscription Account

	¢'000		¢'000
Balance b/f	2,000	Receipts & payments:	
Income & expenditure	27,000	2015	2,000
		2016	24,000
		Balance c/f	3,000
	29,000		29,000
Balance b/f	3,000		

Q2

Ayoyo Fun Club

a. Bar Statement of Profit or Loss for the year ended 31 December 2016

	¢'000	¢'000
Sales		7,500
Opening inventories	1,040	
Add purchases	3,580	
	4,620	
Less closing inventories	1,420	
		3,200
Bar wages		4,300
		(1,104)
Profit to income & expenditure a/c		3,196

b. **Income and Expenditure Account for the year ended 31st December 2016**

	¢'000		¢'000
Rent and rates	804	Membership subscription (w3)	6,200
Social activities expenses	3,000	Membership admission	840
Depreciation - furniture & fittings (w.6)	1,560	Bar profit (w.2)	3,196
Depreciation – Equipment	1,144	Other receipts	3,800
General wages (w.5)	2,380		
Postage and telephone	352		
Electricity expenses	208		
Bank charges	116		
Insurance (w.4)	560		
Excess of income over expenditure	3,912		
	14,036		14,036

c. Statement of financial Position as at 31 December 2016

	Cost	Accum depr	Carrying Amount
Non-Current Assets:	₦'000	₦'000	₦'000
Premises	60,000	-	60,000
Furniture and Fittings	4,400	1,560	2,840
Equipment	5,720	1,144	4,576
	70,120	2,704	67,416
Current assets:			
Bar stocks		1,420	
Subscription in area's		120	
Insurance prepared		180	
Bank		4,752	6,472
Total Assets			73,888
Accumulated fund (w1)			69,976
Add excess of income over expenditure			3,912
			73,888

Working 1

Ayoyo Fun Club
Accumulated fund as at 1 January 2016

Assets:	¢'000	¢'000
Premises		60,000
Furniture and fittings		4,400
Bar inventories		1,040
Insurance prepaid		136
Subscription in arrears		80
Bank		4,900
		70,556
Less liabilities		
General wages owing	180	
Subscription in advance	400	(580)
		69,976

Working 2: Subscription Account

	¢000		¢000
Balance b/d	80	Balance b/d	400
Income & expenditure	6,200	Receipts & payments	5,760
	---------	Balance c/d	120
	6,280		6,280
Balance b/d	120		

Working 3: Insurance Account

	¢000		¢000
Balance b/d	136	Income & expenditure	560
Receipts & payments	604	Balance c/d	180
	740		740
Balance b/d	180		

Working 4 General wages Account

	¢000		¢000
Receipts & payments	2,560	Balance b/d	180
	-------	Income & expenditure	2,380
	2,560		2,560
	6,280		6,280

Working 5 Furniture & Fittings

	¢000		¢000
Balance b/d	4,400	Inc. & Exp. - Deprn	1,560
	-------	Balance c/d	2,840
	4,400		4,400
Balance b/d	2,840		

Question (3)
AZURY DEMOCRATIC PARTY

Receipts and Payments Account for the year ended 31 December 2016

Receipts	**¢**	**Payments**	**¢**
Balance b/f (Bank)	11,416,000	Rally expenses	33,819,500
Member's subscriptions	102,505,000	Fuel for campaign	194,750
Donations (London Rally)		Campaign Van	43,250,000
(82,600,000 + 33,819,500)	116,419,500		
Interest on treasury bills	389,500	Electricity expenses	4,400,000
Bank – Bills discounted	312,999,500	Congress expenses	218,750,000
		Insurance on motor vehicle	8,200,000
		Rent of Constituency office	22,582,000
		Stationery	15,817,500
		Vehicle running expenses	430,000
		Bal c/d	196,715,750
	543,729,500		**347,013,750**

Income and Expenditure Account for the year ended 31 December 2016

	¢		**¢**
Rent of constituency office	22,582,500	Members' subscriptions	80,605,000
Fuel for campaign	194,750	Donations from London branch	82,600,000
Discount on bills	43,000,500	Interest on treasury bills	389,500
Electricity expenses	4,400,000	Deficit	234,255,750
Depr. Campaign	8,650,000		
Head office building	10,000,000		
Congress expenses	218,750,000		
Insurance on motor vehicle	8,200,000		
Depreciation on F & F	61,500,000		
- Computer equipment	5,400,000		
Stationery	14,997,500		
Rent of office	175,000		
	397,850,250		**397,850,250**

AZURY DEMOCRATIC PARTY

Statement of Financial Position as at 31 December 2016

Assets	**Cost**	**Accumulated Depreciation**	**Carrying Amount**
Non-Current Assets	**¢'000**	**¢'000**	**¢'000**
Head office building	75,000,000	10,000,000	65,000,000
Campaign van	43,250,000	8,650,000	34,600,000
Furniture & Fittings	950,000,000	61,500,000	888,500,000

Computer equipment	10,200,000	5,400,000	4,800,000
	1,078,450,000	**85,550,000**	**992,900,000**
			356,000,000
			1,348,900,000
Current Assets			
Stationery prepaid		1,050,000	
Bank/Cash		96,715,750	197,765,750
Total Assets			**1,546,665,750**
Equity & Liabilities			
Accumulated fund			1,766,896,000
Deficit of expenses over income			(234,255,750)
			1,532,640,250
Current Liabilities			
Subscription prepaid			12,150,000
Vehicle running expenses owing			320,000
Rent owing			1,125,000
			13,595,000
Total Equity & Liability			1,546,235,250

Statement of Affairs as at 1 Jan 2016

	¢'000
Assets:	
Head office building	75,000,000
Furniture & Fittings	950,000,000
Computer equipment	10,200,000
Treasury bills	712,000,000
Subscriptions owing	9,750,000
Stationery prepaid	230,000
Bank	11,416,000
	1,768,596,000
Liabilities	
Vehicle running expenses owing	750,000
Rent owing	950,000
	(1,700,000)
Accumulated Fund	**1,766,896,000**

Head office buildings

	¢		¢
b/f	75,000,000	I & E Depr.	10,000,000
		Bal c/f	65,000,000
	75,000,000		**75,000,000**
b/f	65,000,000	Bal b/d	

Furniture & Fittings

	¢		¢
b/f	950,000,000	I & E Depr.	61,500,000
		Bal c/d	888,500,000
Bal b/f	888,500,000		

Computer Equipment

	¢		¢
b/f	10,200,000	I & E Depr.	5,400,000
		Bal c/d	4,800,000
	10,200,000		10,200,000
Bal b/f	4,800,000		

Stationery

	¢		¢
b/f	230,000	I & E Depr.	14,997,500
R & P	15,817,500	Bal c/d	1,050,000
	16,047,500		16,047,500
Bal b/f	1,050,000		

Vehicle Running Expenses

	¢		¢
R & P	430,000	B/f	750,000
Bal c/d	320,000	Bal c/d	
	750,000		750,000
Bal b/f	1,050,000	Bal b/d	320,000

Rent (Office)

	¢		¢
Bal c/d	1,125,000	B/f	950,000
		I & E	175,000
	1,125,000		1,125,000
		Bal b/f	1,125,000

Vehicle Running Expenses

	¢		¢
R & P	430,000	I & E	430,000

Subscription

	¢		¢
Bal b/f	9,750,000	Receipts & Payments	102,505,000
Income & Expenditure	80,605,000		
Bal c/d	12,150,000		
	102,505,000		**102,505,000**
		Balance b/f	12,150,000

London Branch Rally

	¢		¢
R & P	33,819,500	R & P	116,419,500
I & E	82,600,000		
	116,419,500		**116,419,500**

Ghana Treasury Bills

	¢		¢
B/f	712,000,000	Build Rec.	356,000,000
		Bal c/d	356,000,000
	712,000,000		**712,000,000**
Bal b/f	356,000,000		

Congress Expenses

	¢		¢
R & P	218,750,000	I & E	218,750,000

Insurance on investment

	¢		¢
R & P	8,200,000	I & E	8,200,000

Bills Receivable

	¢		¢
Treasury Bill	356,000,000	Rec. & Pay	312,999,500
		Disc to	43,000,500
	356,000,000		**356,000,000**

Discounts on Bills

	¢		¢
Bills Rec.	43,000,500	I & E	43,000,500

Discounts on Treasury Bills

	¢		¢
I & E	389,500	R & P	389,500

Campaign Van

	¢		¢
Rec. & Pay	43,250,000	I & E (Dep.)	8,650,000
		Bal c/d	43,600,000
	43,250,000		**43,250,000**

Electricity Expenses

	¢		¢
R & P	4,400,000	I & E	4,400,000

Rent of Constituency Office

	¢		¢
R & P	22,582,000	I & E	22,582,000

Question 4

Hinton Social Club

Statement of Affairs as at 31 December 2016

	¢'000
Assets:	
Furniture	2,000
Leasehold Premises	2,500
Inventories – Bar Restaurant	820
3 $\frac{1}{2}$ Bank of Ghana Bond	3,100
Bank	700
Subscriptions in arrear	240
	9,360
Liabilities	
Payables – Restaurant and Bar supplies	900
Subscriptions in advance	40
Secretarial expenses owing	10
Electricity bills outstanding	60
	(1,010)
Accumulated Fund	8,350

Hinton Social Club
Income and Expenditure for the year ended 31 December 2016

	¢'000	¢'000
Life membership subscription transferred		30
Member's subscriptions		3,710
Profit on Bar trading		3,000
Interest on bond		105
		6,845
Less: Expenses		
Amort-Leasehold Premises	250	
Free meals – Secretary	50	
Wages	3,400	
General Expenses	2,015	
Secretarial Expenses	360	
Electricity bills	400	
		6,475
Surplus of income over expenses		370

Hinton Social Club
Statement of Financial Position as at 31 December 2016

Assets	**Cost**	**Accumulated Depreciation**	**Carrying Amount**
Non-Current Assets	**¢'000**	**¢'000**	**¢'000**
Leasehold Premises	2,5000	250	2,250
Furniture	2,800	-	2,800
	5,300	250	5,050
3 $\frac{1}{2}$ Ghana Bond			3,100
Current Assets			
Inventories – Rest & Bar supplies		2,000	
		500	
			2,500
			10,650
Equity and Liabilities			
Accumulated Fund			8,350
Surplus income over expenditure			370
			8,720
Life membership fund			270
			8,990
Current Liabilities			
Payables – Rest & Bar supplies	1,080		
Furniture	500		
Secretary – free meals	50		
Subscriptions prepaid	30		
			1,660
Total Equity and Liabilities			10,650

Furniture

	¢		¢
Bal b/f	2,000	Bal c/d	2,800
R & P- Add	300		
Payables	500		
	2,800		**2,800**
Bal b/f	**2,800**		

Leasehold Premises

	¢		¢
Bal b/f	2,500	R & E	
		Amortization	250
		Bal c/d	2,250
	2,500		**2,500**
Bal b/f	**2,250**		

$3\frac{1}{2}$% Ghana Bond

	¢		¢
Bal b/f	3,100	Bal c/d	3,100
Bal b/f	**3,100**		

Subscriptions

	¢		¢
Owing b/f	240	B/f	40
I & E	3,710	R&P (240 + 3,670 + 30)	3,980
Bal c/d	30		
	3,980		**3,980**
		Bal b/f	**30**

Bar Trading a/c

	¢	¢
Bar sales	12,000	
Opening inventory	820	
Purchases	10,180	
	11,000	
Closing inventory	(2,000)	9,000
Profit on bar trading to I & E		**3,000**

Bar Surplus

	¢			¢
R & P	10,000	Bar trading	359	10,800

Payables	**180**		
	10,180		**10,180**

Payables-Bar Surplus

	¢		¢
		B/f	900
		Purchases	**180**
Bal c/f	1,080		**1,080**
		Bal b/f	1,080

Secretarial Expenses

	¢		¢
R & P	370	Owing B/f	10
		P & E	**360**
	370		**370**

Payables (Furniture)

	¢		¢
		Furniture	500

Electricity Bills

	¢		¢
R & P	460	Owing B/f	60
		I & E	**400**
	460		**460**

Int on Bond (Bank of Ghana)

	¢		¢
I & E	105	R & P	105

Life Membership Subscription

	¢		¢
I & E	30	R & P	300
Bal c/d	**270**		
	300		**300**
		Bal b/f	270

Wages

	¢		¢
R & P	3,400	I & E	3,400

General Expenses

	¢		¢
R & P	2,015	I & E	2,015

CHAPTER FIFTEEN

USE OF COMPUTER APPLICATION PACKAGES IN ACCOUNTING

15.0 Learning Objectives

At the end of this chapter, readers should be able to understand

- the main information that will be required in developing software packages for common accounting sub-systems such as:
  - Sales and Purchases Ledgers
  - Inventory control
  - Payroll administration
  - Non-Current Assets management
  - Bank Reconciliation
  - Control Accounts

15.1 Introduction

An accounting is the totality of the system put in place to manage income, expenses, assets and liabilities in an entity. The system permits an entity to keep track of various forms of financial transactions emanating from day to day business activities. The system is of two (2) types:

a. Manual Accounting System
b. Computerized Accounting System

a. Manual Accounting System

It is oldest form of accounting system where an entity post and records financial transactions (income, expenses, assets and liabilities) into the source documents, books of original entries, ledgers and general ledgers ,trial balance extraction and production of reports (income statements, statement of financial position, cash flow statements and notes to the accounts) manually.

b. Computerized Accounting System

A computerized accounting system is a system of accounting that is designed to automate the process of postings and recording of financial transactions of an entity electronically and reports trial balance extraction, Statement of Profit or Loss, Statement of Changes in Equity, Statement of Financial Position, Cash Flow Statements and Notes to the Accounts produced at a torch of a button. It is a system of accounting that generates books of original entries electronically from the source documents; process the inputs to generate outputs (reports). A computerized accounting system automates, integrate, rearrange and process high volume of transactions (sales, purchases, inventory, assets and liabilities) speedily to generate information (reports).

The rest of this chapter is devoted to discussion of the various types and aspects of the computerized accounting system.

15.2 Features and Advantages of Computerized Accounting System

The lists below are the features of a computerized accounting system and they can also be regarded as the advantages of a computerized accounting system.

a. Complete Feasibility Plan

A computerized accounting system gives a business entity complete plan on how to process, post, record and control transactions electronically with a view to producing reports speedily and accurately. The system satisfies users of accounting information with a lot of accuracy.

b. Access to Vital Information

It gives access to information only to the authorized users, the system allows for the use of passwords to prevent unauthorized access to an entity's vital information. It is supported with a lot electronic control to distribute access among various users.

c. Data Entry

A computerized accounting system permits the entity to enter data electronically in variety of ways, which make processing of transaction more convenient. There are various forms of electronic source documents that can be used to process data. These include: electronic receipt issued to customers to post into electronic cash book, Electronic invoices issued to customers who bought an entity's goods on credit used to post into the Sales Day Book, electronic invoices and receipts received from suppliers to post into Purchases Day Book and cash book; electronic debit advise (note) from suppliers for posting into return outward and suppliers' account and electronic credit advise (note) use to post into return inward and customers' accounts etcetera.

d. Accuracy and Speed

Accounting software provides a good window and templates to process high volume financial transactions speedily and accurately. The response time is very fast in relation to a manual processing of transaction. Transaction is processed quickly and report generated on a press of a button.

e. Error Detection

The chance of error is almost zero. However, one cannot rule out errors associated with inputted data, remember garbage in garbage out (GIGO). Where there is a system error, it issues a warning message to the user of the system. It has inbuilt capacity to generate Exception Reports.

f. Enhanced Reports

The use of computerized system speed up production of financial reports and can do more than what is possible in manual systems provided the system is well configured to generate the required reports.

g. Adaptability

A computerized accounting system is easily adaptable to the current system and future accounting needs. Future needs can be easily integrated into the existing system

h. Large Volume of Data

It can easily process large volume of data within a shortest possible time. It uses electronic input to process large volume of data.

i. Highly Integrated and Automated

The system is highly inter-connected, integrated and automated to process daily financial transaction at high speed and with accuracy to produce reports.

j. Real Time Processing and Reliability

Transaction processing is real time to facilitate quick decision and reliability

k. Back up Opportunity

The system provides for opportunity to print output in hard copy and back up in devices such as compact disk, external hard disk, flash drive and back up on the entity's web.

i. Cost Effectiveness

It is more cost effective than a manual system

15.3 Application Packages

There are varieties of application packages that can be used in a computerized accounting system. Some application packages are not designed to specifically handle accounting but are very useful in solving accounting and finance problems. Among them is the Microsoft Excel/spread sheet. Some application packages are specifically designed to handle accounting problems. Among accounting application packages are:

a. Peachtree;
b. Sage;
c. Tally; and
d. Oracle

15.4 Microsoft Excel/Spread Sheet

Excel is a powerful tool for manipulating of rows and column to process, record, post and analyze data. They are widely used in the field of accounting and finance to calculate depreciation of various types, project evaluation and mathematics of finance. The excel window of Microsoft includes:

i. Rows

Rows are referenced by numbers starting from 1. There are 65,536 rows

ii. Columns

They are referenced by alphabets starting from A. There are 256 columns

iii. Cell

A cell is the intersection of row and column. The total number of cell is 16,777,216

iv. Worksheet

A worksheet contains cells and consists of 65,536 rows and 256 columns totaling 16,777,216 cells.

v. Workbook

The workbook consists of worksheets. It is also called excel file. A file is a set of worksheets

vi. Title Bar

This refers to the name of current workbook

vii. Menu Bar

This consists of varieties of menu such as file, edit, view, save etcetera.

15.4 Accounting Packages

Accounting packages are application software that record and process accounting transactions within functional modules.

Accounting packages, unlike the spread sheet application packages, process accounting transactions from the beginning to the point of producing reports such as the statement of Profit or Loss, Statements of Changes in Equity, Statement of Financial Positions, Statement of Cash Flow and Notes to the Financial Statements.

Accounting packages are probably the most widely used sort of "off-the-shelf" package in business. A package may consist of a suite of program modules, and the computer user can use a single module for a specific application or "sub-system" or a number of modules in a more integrated system.

There might be separate modules for the general ledger, and subsidiary ledgers such as:

(a) Sales ledger sub-system

(b) Purchases ledger sub-system

(c) Inventory sub-system

(d) Payroll sub-system

(e) Non-current assets sub-system

(f) Trade receivables sub-system

(g) Bank reconciliation sub-system

Each module may be integrated with the others, so that data entered in one module will be accessible across all modules as required.

15.4.1 Sales Ledger Sub-System

The main features of a sales ledger are: (a) Files used.

The main file in a sales ledger sub-system is the sales ledger. The fields in each record will include:

(i) Customer account number

(ii) Customer name

(iii) Address

(iv) Credit limit

(vi) Sales analysis

(vii) Account type

(viii) Transaction date

(viii) Transaction description

(ix) Transaction code

(x) Debits

(xi) Credits

(xii) Balance

(b) Output

(i) Day book listing

(ii) Invoices

(iii) End of month statements for customers

(iv) Age analysis of trade receivables

(v) Sales analysis reports

(vi) Trade receivables reminder letters

(vii) Customer lists

(viii) Responses to enquiries

(ix) Output on to disk file for other modules

(c) File updating (amendments):

- Amendments to customer details e.g. change of address, change of credit limit.
- Insertion of new customers
- Deletion of old “non-active” customers

(d) Transaction data relating to

- Sales transaction (for invoicing)
- Customer payments
- Credit notes
- Adjustments

15.4.2 Purchases Ledger

The simplest purchases system is one where the computer is used to maintain the purchases ledger and produce a purchase analysis. The main features would be:

(a) Inputs, which include data about

- purchases invoices
- credit notes
- cash payments
- adjustments

(b) Outputs, which include:

- lists of transactions posted – produced every time the system is run;
- an analysis of expenditure for nominal ledger purposes.

  This may be produced every time the system is run or at the end of each month;
- lists of trade payables balances together with a reconciliation between the total balance brought forward, the transactions for the month and total balance carried forward;
- copies of payables accounts.

(c) Files used – The fields in each record will include:

(i) account number

(ii) name

(iii) address

(iv) credit details

(v) bank details

(vi) cash discount details

(vii) details of transactions

(viii) balance outstanding.

15.4.3 Inventory Sub-System

Inventory sub-system generates transactions in respect of purchase, holding and issuing of inventories.

The main features of a inventory control system are: (a) Inputs, which would include data about:

(i) goods received note

(ii) issues to production

(iii) production to finished goods store

(iv) dispatch notes

(v) adjustments.

(b) Outputs, which would include:

(i) details of inventory movements

(ii) inventory balances produced as required

(iii) inventory valuation lists

(iv) list of slow moving goods.

(c) Files used

The main file is the inventory ledger. There would be a record on file for each inventory item, and record fields might include:

(i) inventory number

(ii) description

(iii) standard cost

(iv) quantity of inventory in stock

15.4.4 Payroll sub-System

Payroll sub-system is a process of engagement of employees up to the point of determining the total consolidated emoluments and net pay of the employees. It involves the following processes:

a. Engagement of Staff

This is a process of recruitment of staff in an entity. The important information needed to compute salaries of staff are: date of commencement of duty, nature of employment whether contract or pensionable employment, casual workers etcetera.

b. Attendance Register and Time Card

The attendance register is needed to determine actual hours work by the employees or number of days the employees are present and absent from duty to determine basic pay of employees.

c. Personnel Files

Every employee has personal file which has the appointment letter and date of commencement of duty. The engagement letter contains employee's annual salaries, annual housing allowances, annual transport allowances, utility allowances and other forms of allowances that are collectible by employees on a monthly basis.

d. Computation of Gross Pay

The payroll salaries and allowances are divided by 12 respectively and added together to get gross pay per month. The monthly salaries can be prorated where an employee is absent from duty for a number of days. The total monthly salaries and allowances are described as gross pay of employee

e. Computation of Net Pay

This is a process of determining the net pay. It is the total gross pay minus the statutory and non-statutory deductions. The amount payable to employee is net of both statutory non-statutory deductions.

f. Computation of Deductions Schedule

The schedule of each deduction will be made. These include statutory deduction like Personal Income Tax, Pension Fund, National Health Insurance Scheme, Social Security and non-statutory deductions like union dues, car loan, housing loans, cooperative deductions and other personal deductions. A schedule of all deductions is also prepared and this shows at a glance the various deductions made from employees each month and annually in totals.

g. Preparation of Payment Vouchers

After the determination of the total gross pay, statutory and non-statutory deductions, total net pay, the officer in charge of payroll prepares a payment voucher and attaches the various documents like the summary of the pay roll, personal emolument cards, deduction schedules and salary variation analysis, if any. The payment voucher is thereafter signed and forwarded to the internal audit for checking.

h. Internal Audit and Checks

After the preparation of the payrolls, they are forwarded to the internal audit department. It verifies, reviews and reconciles the payrolls to confirm that the figures are correct.

i. Payment of salaries

After the audit, the pay roll officer forward the detail payroll to the chief finance officer or the chief accountant for preparation of cheques or transfer requests with schedules to various salaries and deduction accounts.

j. Authority to Pay

The accounting officer of the entity gives final approval to pay the net salaries and the deductions, thereafter the cheques and transfer requests are sent to the bank for payments.

Technical Issues on payroll sub-system

A simple payroll system would be mainly concerned with the production of a weekly wages payroll. Salary systems are similar to those encountered for wages, the principal difference them being that it is usual for the monthly salary to be calculated from details held on the master file and, therefore with the exception of overtime, bonuses, etc there is no need for any transaction input. The main features of a simple wages system are:

(a) Inputs, which include:
- (i) Clock cards or time sheets. Details of overtime worked will normally be shown on these documents.
- (ii) Amount of bonus or appropriate details if the bonus is calculated by the computer.

(b) Outputs, which include:
- (i) Payslips
- (ii) Payroll
- (iii) Payroll analysis, including analysis of deductions and details for costing purposes
- (iv) Cash analysis, cheques, credit transfer forms, as appropriate
- (v) In some cases, a magnetic tape, cassette or floppy disk with payment details for dispatch to the bank.

(c) Files used.

The master file will hold two types of data in respect of each employee:

(i) **Standing data**. For example, personal details, rates of pay, details of deductions

(ii) **Transaction data.** For example, gross pay to date, tax to date, pension contributions, etc.

15.4.5 Non-Current Assets Sub-System

The main features are:

(a) Inputs, which include data about

(i) Capitalization policy

(ii) Depreciation policy

(iii) Purchase invoices

(iv) Cash payments

(v) Adjustments

(b) Output:

(iv) Non-current assets register which includes the cost of assets, accumulated depreciation, current year depreciation, asset type, depreciation rate and carrying amount of asset.

(v) Non-current asset ledger – records cost of acquisition, additional cost of improvement, disposal value of asset and calculated depreciation based on asset classification.

(c) Files used – The fields in each record will include:

(i) Asset class

(ii) Asset name/description

(iii) Asset identification code

(iv) Cost

(v) Date of acquisition

(vi) Estimated useful life

(vii) Depreciation rate

(viii) Disposal value and date

(ix) Current depreciation

(x) Accumulated depreciation

(xi) Book value of asset

15.4.6 Trade-Receivables Control Sub-System

The trade receivables system deals with transactions that involve sales invoices raised credit notes and debit notes issued to customers and credit notes issued to trade payable control accounts for offset against trade payables and trade receivables payments.

The main features are:

(a) File used

The main file used is sales ledger subsystem.

(b) Inputs, which include data about:

- total credit sales for the period
- total cash received from trade receivables during the period.
- total credit notes issued during the period
- Adjustments.

(c) Outputs, which include:

- End of the period balance
- Comparative analysis of opening and closing balances
- Set-offs against purchases control ledgers
- List of credit notes not yet used by the customers.

15.4.7 Bank Reconciliation

The main features would be

(a) Inputs

- pay-in slips
- cheque stub/counterfoil
- bank debit notes
- bank credit notes

(b) Outputs

- Bank Balance as at the date of reconciliation
- List of stale cheques
- List of uncredited lodgements
- List of unpresented cheques
- List of unmatched items. (Those in the bank statement but not in the cash book).

15.5 Advantages and Disadvantages of Application Packages

Advantages

(a) They make implementation of an application to be quicker and cheaper.

(b) They provide standard approach to common applications

(c) They are efficient in terms of speed, accuracy and storage requirements

(d) They save programming efforts

(e) There is substantial reduction in systems efforts.

Disadvantages

(a) Some packages are not brought up-to-date.

(b) The packages may not be 100% suitable for a particular use, as they may not be fully tailored towards the use

(c) One may not get experts who will be on ground for immediate assistance in case there are problems

(d) Inefficiency may be experienced due to inclusion of features that are not particularly relevant in the packages.

(e) The vendor company that wrote the package may cease to exist. Users will then face the challenge of getting support for and maintaining the software. In some instances the particular packages may have been phased out.

15.6 Factors to consider when deciding on which package to use or buy:

(a) Cost - This includes the cost of software, setting-up and operating the system.

(b) Flexibility – How easy is it to amend or otherwise update or upgrade.

(c) Types of processing – What is the input and output medium associated with the package.

(d) Timing of processing

(e) Hardware required

(f) Degree of reliability

(g) Integration with other systems

(h) Users processing requirements.

15.7 Sources of application packages

The main sources of application packages are:

(a) Computer Bureaux

(b) Computer manufacturers

(c) Specialist software Houses

15.8 Summary and Conclusions

This chapter treats the features, advantages and disadvantage of software packages for common accounting use as it relates to general and subsidiary ledgers, inventory, payroll, non-current assets, control account and bank reconciliation process.

15.9 Multiple Choice Questions and Short Answer Questions

1. The data storage hierarchy is as follows:
   (a) Database, Files, Records, Fields, Bytes, Bits
   (b) Bits, Bytes, Field, Records, Files, Database
   (c) Bytes, Records, Bits, Files, Bits, Database
   (d) Bits, Field, Bytes, Files, Records, Database
   (e) Files, Records, Bits, Bytes, Field, Database

2. The following are optical Disks **EXCEPT**
   (a) CD-ROMs
   (b) WORMS
   (c) DVD – Digital video Disk
   (d) MD – Magnetoptical Disk
   (e) Floppy disk

3. The process of locating and eliminating errors from a program is known as…….
   (a) Tracing
   (b) Debugging
   (c) Dump
   (d) Sorting
   (e) File copying

4. The following are application packages **EXCEPT.**
   (a) Re-writable

(b) Peachtree
(c) Bank master
(d) Oracle
(e) Page maker

5. One of the following is a disadvantage of Application Packages.
   (a) They make implementation of an application to be quicker and cheaper.
   (b) They provide standard approach to common applications.
   (c) They save programming efforts

   (d) There is substantial reduction in systems efforts
   (e) There may be inclusion of features that are not particularly relevant in the packages.

6. What is Internet?
7. Many companies are designing application packages for routine application. Name Five of such packages, giving examples.
8. List Two outputs of inventory sub-system of computer Application Package.
9. List Two types of data being used in a payroll sub-system.
10. List Two transaction data items in sales ledger sub system.
11. A computer that connects incompatible networks is called……

5.10 SOLUTION TO MULTIPLE CHOICE QUESTIONS AND SHORT ANSWER QUESTIONS

1. B
2. E
3. B
4. A
5. E

6. The Internet is a network of networks, linking computers to computers sharing information. It is a transport vehicle for the information stored

in files or documents on another computer. It is the inter-connection of several computers located in different locations around the world.

7. Any five of the following:

(a) Word-processing e.g. Word Perfect, Word Star, Multimate and Microsoft Word 2000.

(b) Spreadsheet e.g. Microsoft Excel, Lotus 1-2-3, Supercalc

(c) Desktop Publishing e.g. Page Maker and Corel Draw

(d) Database management system e.g. Foxpro, Dbase and oracle.

(e) Utilities e.g. Pc tools, Norton and Antivirus

(f) Banking Application e.g. Globus, Finacle, Flexcube and Bank master.

(g) Accounting packages e. g. Dac-Easy, Peach Tree and Sage.

(8)
- details of stock movements
- inventory balances produced as required
- list of inventories below minimum order quantity
- inventory valuation list.

(9)
- standing data e.g. personal details, rates of pay details of deductions
- transaction data e.g. gross pay to date, tax to date, pension contributions.

(10)
- Insertion of new customers
- Deletion of old non-active customers
- amendments to customers‟ details e.g. change of address, change of credit limit

(11)
- Gateway